



Fitch: Spanish Labour Reforms Are a Positive Start

16 Feb 2012 Fitch Ratings-London-16 February 2012: Spanish labour market reforms passed last week could aid Spain's long-term recovery but still leave the country with more inflexible rules than many of its global competitors.

Strict employment legislation has created a dual labour market in which firms have shed employees on temporary contracts at an unprecedented rate but permanent employees have been more shielded from the downturn.

The new rules mean Spanish companies will have greater flexibility over pay, hours and job descriptions of employees on permanent contracts during economic downturns. We believe the inflexibility of the labour market in restricting wage adjustment has hindered the rebalancing of the economy and is likely to have lowered the level of potential GDP due to lost human capital.

The new rules will inject some flexibility into permanent contracts and move long-term employees off temporary contracts onto permanent ones. Despite these changes, the permanent contracts remain inflexible compared with many of Spain's global competitors. For example, one initiative reduces the legal uncertainty and widens the applicable use of an existing contract type that limits severance pay to 33 days per year worked from an effective 45 days, subject to a cap at two years full pay. By contrast, EU15 average severance pay is 21 days per year of service for unfair dismissals, according to the IMF.

Nonetheless, the reforms are a positive step. Fitch maintains its view that, over the long term, Spain could grow at 2%-2.5%, above the euro area average. This is because the currently low levels of labour participation (57.7% in Q111) mean the potential for participation-driven growth is significant, provided labour market reform is effective. This would happen only gradually given the significant skills mismatches in the labour force.

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