



Spain’s Falling Prices Fuel Deflation Fears in Europe



Stefano Buonomici for The New York Times

The company Fermax has reduced prices by a third on the video intercoms it makes for homes and apartment buildings, hoping to increase sales.

By NELSON D. SCHWARTZ
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VALENCIA, Spain — Faced with plunging orders, merchants across this recession-wracked country are starting to do something that many of them have never done: cut retail prices.

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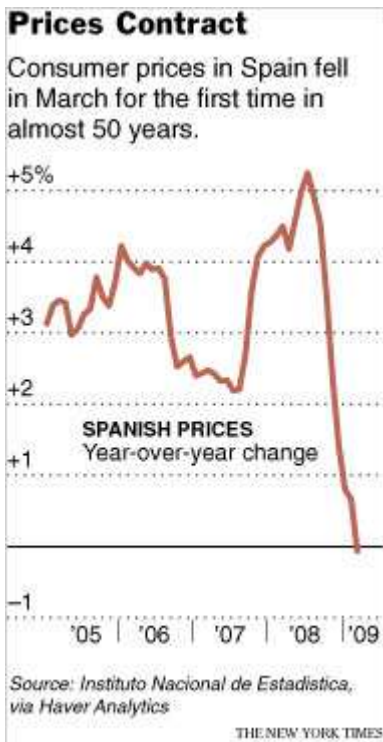
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Some of the decline came as volatile [food prices](#) sank; the cost of fish fell 6.2 percent, and sugar was down 5.7 percent. But even prices in normally stable sectors like drugs and medical treatments fell 0.7 percent in March, and there were slight declines in footwear, clothing and prices for household electronics.

“Alarm bells are going off,” said Lorenzo Amor, president of the Association of Autonomous Workers, which represents small businesses and self-employed people. “Economies can recover from deceleration, but it’s harder to recover from a deflationary situation. This could be a catastrophe for the Spanish economy.”

Deflation is not just a Spanish concern. Luxembourg, Portugal and Ireland have reported price drops, too. While the declines have been slight — and prices rose modestly after factoring out food and energy prices, which can fluctuate widely — other figures released this month suggest the risk of deflation is growing.

In Germany, wholesale prices dropped 8 percent in March from a year ago, the steepest fall since 1987. In Japan, wholesale prices fell 2.2 percent on an annual basis. In the United States, the [Consumer Price Index](#) fell 0.1 percent in March, year over year, the first decline of its kind since 1955, though prices rose 0.2 percent excluding food and energy.

“It doesn’t mean it will spread here to the U.S., but we need to look closely at Spain and other places to understand the dynamic,” says Simon Johnson, a professor at the Sloan School of Management at the [Massachusetts Institute of Technology](#) and a former chief economist for the [International Monetary Fund](#). “It’s like the front line of a new virus outbreak.”

The trends have unnerved even well-established businesses. “There is such a huge lack of confidence in the politicians, in the [European Union](#) and in the banks,” said Arturo Virosque, 79, president of Valencia’s chamber of commerce and the owner of a local logistics company. Ticking off crises going back to the Spanish Civil War in his youth, he said, “this is different. It’s like an illness.”

After price cuts by competitors, Mr. Virosque’s company reduced charges for storage and transportation, and slashed its work force to about 170, from 250. “The worst thing is that we have to cut the young people,” he said, because higher severance makes it too

Prices dipped everywhere, from restaurants and fashion retailers to pharmacies and supermarkets in March. Hoping to increase sales, Fernando Maestre reduced prices by a third on the video intercoms his company makes for homes and apartment buildings. But that has not helped, so, along with many other Spanish employers, he is continuing to fire workers.

The nation’s jobless rate, already a painful 15.5 percent, could soon reach 20 percent, a troubling number for a major industrialized country.

With the combination of rising unemployment and falling prices, economists fear Spain may be in the early grip of [deflation](#), a hallmark of both [the Great Depression](#) and Japan’s lost decade of the 1990s, and a major concern since the [financial crisis](#) went global last year.

Deflation can result in a downward spiral that can be difficult to reverse. As unemployment rises sharply and consumers cut spending, companies cut prices. But if sales do not pick up, then revenue can decline further, forcing more cuts in workers or wages. Mr. Maestre is already contemplating additional job and wage cuts for his 250 employees.

Nowhere is this cycle more evident than in Spain. Last month, it became the first of the 16 nations that use [the euro](#) to record a negative inflation rate. The drop, though just 0.1 percent, had not happened since the government began tracking inflation in 1961, and Spanish officials have said prices could keep dropping through the summer.



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expensive to fire older workers.

While unemployment traditionally is higher in Spain than in much of Europe, the sharp increase has many here nervous. The jobless rate for those under 25 is at a Depression-like level of 31.8 percent, the highest among the 27 nations of the European Union.

Before cutting prices in early 2009, Mr. Maestre ordered several rounds of job cuts at his company, Fermax, as sales of the intercoms collapsed with Spain's housing bubble.

"It's a question of survival for everybody," he said. Still, the lower prices have not translated into higher sales. Fermax's orders fell 25 percent in the first quarter. Prices for some intercom parts that he buys, like video screens, have also come down, but it is not enough to make up for the sales drought. "Prices have to come down more and we will have to spend less," he said.

The effects of this downward spiral are evident at Valencia's principal soup kitchen, in an imposing stone building constructed a century ago as an alms house. Each day, a line forms around the block by noon. The Casa de la Caridad, or House of Charity, is helping three times as many people as it did a year ago. More than 11,000 meals were served in March, and it expects to top 12,000 this month.

As the economic decline has broadened, so has the range of people seeking help. In the past, most were out-of-work immigrants or the homeless, said the center's director, Guadalupe Ferrer. Today, "it's more and more people like us who had a house, a respectable job, but are now unemployed."

The employed worry that falling prices will endanger their jobs as well.

Yolanda Garcia has worked as a butcher under the arches of Valencia's soaring Art Nouveau central market for a decade, but she's troubled that a drop in the price of chicken, to 5.99 euros a kilo, from 6.99, has not attracted more customers to her stall.

"Of course, we're worried the boss will have to reduce staff," said Ms. Garcia, 38, whose husband, a construction worker, was laid off two months ago.

All this has made deflation, once a subject largely reserved for economists who studied the Great Depression, into front-page news here.

The American economy is less vulnerable to deflation, in part because of the [Federal Reserve](#)'s decision to cut interest rates to near zero and increase lending by \$2 trillion. The [European Central Bank](#) has also cut rates, though more slowly, and it has resisted the lending measures adopted by the Fed and the [Bank of England](#) to prop up spending.

When Spain had its own currency, the peseta, the central bank could have simply devalued it, or cut interest rates to zero. But that is not an option in the era of the euro, when monetary policy is controlled from the European Central Bank's headquarters in Frankfurt, said Santiago Carbó, a professor of economics at the University of Granada.

"If we enter into a deflationary period, we won't have the monetary tools to sort it out," Mr. Carbó said.

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