Prime Minister Zapatero forced to defend Spain's solvency

Paul Mitchell
5 July 2010

Prime Minister José Luis Zapatero was forced to mount a desperate defence of Spain's economic solvency on July 2, after credit rating agency Moody's announced that it is reviewing the country's sovereign debt rating. Moody's blamed worsening economic growth forecasts and a likelihood the country would not meet its fiscal targets.

Zapatero declared, "I trust in the strength of our financial entities, which are a crucial pillar for the strength of our country's economy."

Moody's announcement followed the downgrading of Spain's credit rating in April by Fitch and by Standard and Poor's in May. With international money markets having virtually cut off lending to Spain and the government having to offer bonds at record yields, the country is teetering on the edge of default. Anxiety is rife in financial circles that Spain will be next to face a Greek-style crisis.

Moody's announcement means that the drastic austerity measures and labour reforms being implemented by the Socialist Party (PSOE) government have failed to satisfy the international financial institutions. Further attacks are on the way. At the end of June, Bank of Spain governor *Miguel Ángel Fernández Ordóñez* called for "greater speed and consensus over pension reform" and regional governments to carry out "radical reductions" to "dispel the uncertainty we've seen in recent weeks".

The government has made great play of its campaign to get the European Union (EU) to publish investigations into the viability of European banks, dubbed "stress tests". Zapatero sees it as some sort of panacea for Spain's problems—a "defining" moment for the return of confidence in the Spanish economy. "Nothing generates more confidence than transparency," Zapatero added.

Stress tests were first introduced last year by the EU, which claimed that the tests would assess plans to restructure banks in need of state aid. Some 22 banks were examined, including Germany's Deutsche Bank and Commerzbank, France's BNP Paribas and Credit Agricole, and the UK's RBS, Barclays and Lloyds. However, only the aggregate results were published—leading to accusations that the poor performance of weaker banks was being covered up.

The exercise did nothing to satisfy the markets and pressure built up to look at the viability of other European banks. Another 60-120 banks have since been stress-tested including Spain's local savings banks (cajas), which were hit hard by the collapse of the country's construction boom in 2008. The cajas were forced to take over unsold or foreclosed homes, hoping that they would be able to sell them when the housing market began to pick up. That has not only failed to materialise, it has got worse. The cajas are holding tens of billions in assets which they are desperately trying to get rid of.

One commentator noted: "As many of the country's banks scramble to unload their real estate assets, they are offering consumers deals that are suspiciously similar to the ones that plunged the global economy into recession two years ago."

The crisis with the cajas came to a head late last year when the government had to step in with a €9 billion bailout of Caja Castilla La Mancha. More recently it had to mount a rescue of the Catholic Church-run CajaSur. As a result, the Bank of Spain has been forced to announce plans to merge 39 out of the country's 45 cajas into a handful of new institutions and hand out billions of euros

© World Socialist Web Site

in the process. The largest new bank will include seven cajas and become the third largest bank in Spain behind Banco Santander and BBVA. Initial reports suggest that the workforce will be cut by about 15 percent and a quarter of all local offices will be closed.

Last month, EU finance ministers agreed to requests from the Spanish government to publish the stress test results of individual banks by mid-July. But according to *euroactiv.com*, a website run by several associations of international bankers, mortgage lenders and accountants, the stress tests will only give banks a pass or fail mark and "will not show exactly how close a bank could be to default in certain scenarios, like a worsening sovereign debt crisis."

One unnamed source said: "Some scenarios that should be included will not be included, at least in what will be publicly revealed, which will be sugar-coated to avoid market panic."

"Under some scenarios European banks would come out bankrupt and of course they are not going to publish that," the source continued.

European financial policy analyst Kevin Newman added: "There is not a whole lot of point doing these tests as the methodology and the transparency is not going to be robust.

"You only have to look at the amount of liquidity the European Central Bank is giving banks to know that large swathes of the European banking sector are in danger of becoming insolvent."

Newman's remarks are directed at Spain in particular.

Spanish banks are borrowing record amounts from the European Central Bank (ECB) in the face of the boycott by global capital markets. This is the highest amount since the eurozone was set up in 1999 and a disproportionate amount of the ECB's emergency funds. Spanish banks accounted for 16.5 percent of direct ECB borrowing in June, about double the normal figure and a 26.5 percent increase over the previous month. This precarious situation has led to the country's 10-year bond yields rising to a record 4.7 percent, which is a huge two percentage points more than in Germany. The inexorable rise in yields is a repeat of what happened in Greece at the onset of the financial crisis.

Spain has also been hit by the decision of the ECB to stop its massive €750 billion emergency one-year one percent loan facility known as the longer-term refinancing operations (LTRO) on July 1. The LTRO formed the central part of the ECB's effort to ease a liquidity crunch across the EU and was supposed to end all doubts about the euro project. From now on the ECB will only issue loans with a maximum payback time of three months.

"The ECB doesn't like governments telling it what to do, I would just say that I hope that on this occasion, as on others, the ECB is conscious of the needs of our financial system," Spanish Finance Minister Elena Salgado said.

According to Simon Samuels, a banks analyst at Barclays Capital, "The system is just not working… We're approaching the third year of liquidity support and still the market cannot survive unaided."

Barclays Capital estimate that banks will have to rollover as much as €300 billion of the LTRO funding into the new three-month loans.

"We're in a dangerous and stressful situation," said Gary Jenkins, a credit expert at Evolution Securities. "Spain is a big enough borrower to wipe out the EU's rescue fund."

The problems for the PSOE grew worse last month when *El Economista* reported that the EU, the International Monetary Fund (IMF), and the US Treasury had been discussing new credit facilities for Spain of up to €250 billion, dwarfing the €110 billion bailout of Greece and the largest in history. IMF managing director Dominique Strauss-Kahn is reported to have called a secret emergency meeting of the board of directors. All involved denied the reports with Zapatero declaring, "Spain is a country that is solvent, solid and strong, with international credibility."

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site