Credit rating agencies threaten to downgrade Spain

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20 September 2011

Fitch Ratings warned last week that Spain's credit rating could be downgraded because the country's regions have fallen behind schedule on deficit-reduction targets, economic growth had been poor and public funds to rescue banks had been larger than forecast.

Spain's rating is currently AA+ with a "negative" outlook.

The agency warned that a slowdown in growth elsewhere in Europe—particularly in Germany, the bloc's largest economy—would make it more difficult for Spain to meet its 1.3 percent 2011 growth forecast.

"For Spain, meeting the official GDP [gross domestic product] forecast is becoming more and more challenging, especially because the German economy is weakening," Fitch Ratings Director Douglas Renwick said.

"Risks for the credit rating are clearly on the downside," he added, "The regional deficit performance adds to pressure on the central government to make the needed cuts."

Spain is committed to slashing the total public deficit to 6.0 percent of GDP by the end of 2011, from 9.2 percent in 2010, and to 3.0 percent by 2013.

Fitch downgraded the credit ratings of five Spanish regions—Catalonia, Andalucia, the Canary Islands, Murcia and Valencia—following a "comprehensive review". "The downgrades reflect the sharp fiscal deterioration seen in recent years which has led to sharp increases in debt levels," the agency stated.

The credit agency Moody's also warned this week that Spain's regions will not meet their budget-cutting targets. Last month it downgraded six regions (Catalonia, Andalucia, Murcia, Valencia, Castilla-La-Mancha and Castilla y Leon) and placed on review for a downgrade the ratings of Madrid, the Basque Country, Galicia and Extremadura.

The downgrades are a warning to Spain's 17 semi-autonomous regions, which are responsible for more than a third of public spending, including health care and education, and half of public sector jobs, that there can be no let-up in the drive to cut their budgets. The total debt in the regions is €121 billion ($161 billion). Both Catalonia and Valencia have debts just over 17 percent of GDP. The new right wing Popular Party government in Castilla-La-Mancha has just announced a massive €1.7 billion in spending cuts, mainly from education, public maintenance, pharmaceutical spending, and scrapping commissions and agencies in order to cut its debt of €6.1 billion, or 16.9 percent of regional GDP.

At the same, only one of the 11 regions controlled by the PP has said it will implement a wealth tax decreed on Friday by Socialist Workers Party (PSOE) government Prime Minister José Luis Zapatero. The tax is supposed to be levied on the richest 160,000 Spaniards and raise €1 billion.

Latest figures show most regions have failed to meet their deficit reduction targets. "Such poor results at the year's halfway mark reflect the regional governments' inability to rein in spending aggressively enough to address their structural deficits," Moody's declared in their latest report. "The document underlines our view that this year regional governments will not reach the deficit target they agreed to with the central government."

Moody's said that it believed the regions would take "all possible steps" to cut spending, but "the weak economic recovery" would limit any growth in their revenue. Zapatero warned that economic growth is unlikely to improve during the third quarter of the year from that experienced in the previous three-month period. “At the moment, we have a tense financial situation, economic uncertainty, particularly because of the situation in Greece, which could affect the growth forecasts,” he said.

Latest official data showed growth was only 0.2 percent in the second quarter, undermining prospects that the official government forecast of 1.3 percent growth for the year will be met. The Bank of Spain now estimates it will be just 0.8 percent.

The regions have also been badly hit by the collapse in the housing market, which was a major source of revenue in the years leading up to the global financial crisis in 2008. Recent figures from the national institute of statistics reveal that the annual rate of sales has dropped even more sharply over the last year, with sales of residential real estate falling by 36.3 percent over the period. The government has reduced the tax on property sales from 8 percent to 4 percent for the rest of the year, but analysts say this is unlikely to have much effect.

Last week the government sold €3.95 billion ($5.44 billion) worth of bonds. The yields (interest rates) on 10-year bond, which reached a 6.3 percent euro-era high on July 18, were trading at 5.4 percent after the auction, but this fall has only occurred because the European Central Bank has stepped in to prop up the bond markets since August 8. “Demand was decent, although the pricing wasn’t marvellous,” said UniCredit analyst Chiara Cremonesi, before warning, “The yields are still under pressure after the auction—it’s difficult to absorb supply in this market.”

Spanish banks’ borrowings from the ECB also surged to €70 billion in August, an 11-month high, from €52 billion in July, according to the Bank of Spain.

Some idea of the depth of the crisis haunting the ruling elite was revealed unintentionally earlier this month by secretary general of the Comisiones Obreras trade union, Ignacio Fernández Toxo. Recounting a meeting with Zapatero on August 17 as the sovereign debt crisis threatened to explode and the ECB was forced to intervene, Toxo blurted out that the prime minister had said the country was on the verge of an international bailout. “He told us that things were very bad,” Toxo said in a television interview, and that the economy was “at the edge of the abyss”.

Toxo has been forced to backtrack saying his revelation was “an unfortunate attempt to summarise the contents of an emergency meeting called at a very sensitive time” and that Zapatero did not use those words. Zapatero has repeated that Spain would not be requiring an international bailout, declaring, “Spain, of course, will finance itself... We will survive these tensions.”

It has been revealed that the ECB sent secret letters in August to Spain and Italy, which is also embroiled in the sovereign debt crisis, demanding further austerity measures and economic reforms. Within days Zapatero announced further amendments to labour market laws and rushed through Congress an unprecedented change to the constitution that limits the public deficit and which will be used by the next government to impose harsher austerity measures.

Support for the PSOE has collapsed due to its imposition of austerity measures, wage and social welfare cuts that have resulted in widespread hardship. Unemployment is around 21 percent, with half of all under 25-year-olds without work. Anger at the worsening social conditions has been at the core of the May 15 movement, which saw tens of thousands of indignados (indignant ones) occupy central squares in cities and towns throughout Spain.

In May the PSOE received its worst result in history in regional and local elections. The most recent polls suggest the PSOE will be crushed in the November 20 general election. It is currently polling 30.7 percent of the vote compared to the PP which has 44.8 percent, giving it an outright majority in Congress.

No matter who wins the election, all the main political parties have indicated that they will carry out whatever measures are required by the financial institutions and the money markets.

As for the unions, Toxo recently announced proposals for a “general pact for jobs” with whichever party forms the next government. At the centre of it is an “income pact” with employers, offering companies wage moderation in exchange for a commitment to reinvest profits.