Spanish banking crisis threatens euro collapse

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European stock markets slumped last week, reflecting fears of an intensification of the euro crisis combined with growing evidence of an economic slowdown in the US and China. The euro has dropped 7.3 percent against the dollar in the past two months, nearing a two-year low.

Following weeks of speculation on the fate of the Greek economy, which is now in its fifth year of recession and has suffered a staggering decline, the European financial press has increasingly focused on the Spanish economy.

As a result of a series of austerity measures introduced by the Spanish government at the behest of the European Union, unemployment rose to the record level of 24.3 percent in April, and manufacturing activity fell to a three-year low. Both figures are even worse than those recorded by Greece. Alongside declining tax revenues and GDP, the government also faces a potential meltdown of the country's banking system, resulting from Spain's real estate bubble.

The Spanish government admitted last week that it needed to find an additional €19 billion (US$23.6 billion) to save Bankia from bankruptcy. It is also seeking money to finance the expenditures of bankrupt regional governments, a number of which were relegated to junk status by ratings agencies, depriving them of the ability to raise their own funds.

While Madrid requires €19 billion to keep Bankia afloat, leading financial institutions put the total sum needed to prevent a collapse of the Spanish banking system at €100 billion. Last month depositors withdrew over €60 billion from the country's banks, transferring the money abroad. This took place even before the Spanish government's panic nationalization of Bankia.

The markets' lack of confidence in the government's ability to repay its debts was reflected in the sale of Spanish 10-year sovereign debt Friday. The bonds traded at 6.5 percent interest—a rate which is considered to be unsustainable to allow Spain to repay its debts.

Commenting on the situation, Spanish Finance Minister Luis de Guindos warned: "I don't know if we are on the edge of a cliff, but we are in a very, very difficult position. The future of the euro is going to play out in the next few weeks in Spain and Italy." His assessment was confirmed by former Spanish Prime Minister Felipe Gonzalez, who said: "We are in a situation of total emergency, the worst crisis we have ever lived through".

Spain is the fourth biggest economy in the euro zone and has close trade and financial links with Italy, the euro zone's third-largest economy. A run on Spanish banks risks spreading to Italy and threatening the very existence of the euro zone.

Addressing the dangers posed by a run on Spanish banks, Olli Rehn, Europe's economics commissioner, warned last week that the euro zone was on the brink of "disintegration".

On Thursday last week, Spanish Deputy Prime Minister Soraya Saenz de Santamaría held emergency talks with US Treasury Secretary Timothy Geithner and IMF head Christine Lagarde. The discussions centered primarily on how to put pressure on Europe's biggest economy, Germany, to free up more money to bail out Spanish banks.

The bailout mechanism preferred by the US treasury and the IMF is to enlarge the existing European bailout fund, the European Stability Mechanism, and permit it to lend directly to banks. In line with existing policy, ESM loans are made to governments, in exchange for the implementation of drastic austerity measures largely laid down by Germany and rubber-stamped by Brussels. This gives the option of forcing private investors to take losses on part of their investments.

The reluctance of the German government to the proposal for new funding powers for the ESM is not due to any fundamental opposition to bailing out banks.

The government led by Angela Merkel has already made huge sums available to bankrupt German financial institutions after the crash of Lehman Brothers in 2008. The chief fear in Berlin—as the chief contributor to both the ESM and the European Central Bank—is that it could be called upon to pay out hundreds of billions in the event of a crash of the banks in southern Europe.

This is why Merkel has always insisted that any increase in powers for the ESM must be accompanied by moves towards a full fiscal union, i.e. the establishment of a structure which allows Germany to dictate economic policy throughout the EU. The basic form of such a policy can already be seen in Greece and Spain: the imposition of austerity measures which have resulted in an unparalleled social and economic collapse.

The German government has also profited financially from the crisis. While the interest rates for Spanish and Italian sovereign bonds are going through the roof, investors were prepared to pay a small dividend last week to buy German bonds as a “safe haven” for their money.

As the chief financial sponsor, Germany also profits from the lucrative lending policy of the ECB. The incestuous manner in which the ECB and the IMF secure their own interests was revealed in an article in the *New York Times* last week entitled: “Most Aid to Athens Circles Back to Europe”.

The article describes how the “troika”—the ECB, European Commission and IMF—have acquired ownership of around three quarters of Greek debt. The article then describes how the billions of funds allocated by the troika to Greece this year have been deposited in a special account set up after Greece’s May 6 elections. These funds are parked in the special account for 2 or 3 days, then returned to the troika in the form of interest payments on the loans taken out.

This arrangement effectively denies the transitional Greek regime of any possibility of making expenditures until the next election later this month. At the same time, the ECB receives an interest rate of 10 percent on the Greek bonds it has purchased.

The article then quotes an analyst at Deutsche Bank, who comments: “Greece will not default on the troika because the troika is paying themselves”.

The ruthlessness of both the central and private banks has massively intensified the crisis. The growing antagonisms between individual states now threaten to blow apart the EU and the euro.

These developments are inevitably impacting on the consciousness of broad layers of of the European population and undermining confidence in the EU. A survey of eight leading European countries by the Pew Research Centre cited in the Spanish daily *El País* reveals that just one-third of Europeans believe that economic integration has been a positive process.