Coverup of Spanish bank debt continues

Paul Mitchell
26 September 2013

Last week, the Basel Committee for Banking Supervision criticised proposals by the Spanish Popular Party (PP) government to reclassify bad debt of the country's banks as "creative accounting."

The Basel Committee was created by the central banks of the Group of Ten countries in 1974.

Madrid wants to allow banks to convert billions of euros worth of "non-performing," i.e., worthless, loans and mortgages, known as deferred tax assets (DTAs), made during the pre-2008 housing boom into tax credits. These can be used to pay taxes on future profits, should they ever materialise. In this way they hope to postpone the day of reckoning once again.

Figures reported last week by the Bank of Spain show that in July non-performing loans reached a record high—some €180 billion ($238 billion), or nearly 12 percent of the €2 trillion total. This is up from 11.6 percent the previous month and just over 10 percent a year ago. Even these disastrous figures are an underestimate according to Exane BNP Paribas analysts, who reckon non-performing loans may be as high as €285 billion, or nearly 19 percent.

An increasing number of companies and individuals are failing to keep up with repayments on their loans or mortgages. The number of companies seeking protection from creditors rose by 26 percent in August compared to a year ago.

The idea behind the government's reclassification proposal is to make the balance sheets of banks appear more healthy than they really are because tax credits, unlike DTAs, are regarded as high-quality capital known as Core Tier 1 (CT1) capital. Under Basel Committee rules, a bank must have a minimum of 9 percent of its assets classified as CT1 capital not to be regarded as risky.

The attempt at reclassifying bad debt comes ahead of moves by the European Central Bank to require all banks to use the same accounting methods to identify bad loans. The European Banking Authority is also planning a new round of more stringent "stress tests," which are supposed to test banks' ability to withstand adverse economic and financial situations. Unsurprisingly, because of these moves, banks are suddenly revealing more losses than they previously admitted to.

DTAs make up a huge proportion of the assets of Spain's top six banks. The latest research suggests they comprise 83 percent of the "tangible book value" of Bankia, 64 percent of Sabadell Bank, 40 percent each of Santander and Popular Bank and up to 25 percent of BBVA and Caixabank.

Following the announcement of the government's reclassification plans, a Basel Committee official told the *International Financial Review*, "This is creative accounting … This has to pass the sniff test—not just for us, but for ratings agencies and investors as well, and it really doesn't."

The plans are a dubious manoeuvre to transfer the banks' bad debts onto the state because the government has to honour tax credits even if a bank becomes bankrupt. As a banking sector analyst explained to the *Review*, "If a DTA is counted as good capital to support payment to depositors in the event of failure and, later, that DTA turns out to be worth nothing, then presumably the government would end up bearing the cost to reimburse the depositors."

The Basel Committee official said that there were also concerns that banks in other parts of the world would try to follow Spain's example and undermine attempts to ensure they have enough high-quality capital. But the committee, he added, was powerless to stop Spain from carrying out its proposals. And in any case, Spain is only doing what the Italian government did in 2011, when it allowed its banks to convert DTAs linked to pension funds into tax credits.

The PP government's tax credit scam is the latest

© World Socialist Web Site

attempt, over many years, to cover up the real indebtedness of Spain's banks.

When the global economic crisis erupted in 2008, Spanish banks and regulators all claimed they had avoided the problems engulfing banks in other countries. This was supposedly due to a special accounting method called "dynamic provisioning," used since 2000, in which profits are supposed to be set aside in boom times to cover losses made in lean times. The usual method is to set aside money only when a specific bad loan has been identified.

The problem with dynamic provisioning is that it encourages banks and companies to understate past profits and transfer them forward in order to hide instability and cover up future losses. It can make them look more healthy than they really are until the day they are forced to use up their last bit of reserves. It is now clear that the more vague dynamic provisioning method allowed Spanish banks to pay less attention to identifying and keeping track of specific bad loans they had on their books. It is also clear they did not set aside the profits either.

Both the Socialist Workers Party (PSOE) government of José Luis Zapatero and its PP successor continued to cover up the seriousness of the situation. It was not until 2012 that the phrase "banking crisis" began appearing in public pronouncements and then only weeks before the PP government was forced to ask the troika (European Union, International Monetary Fund and European Central Bank) to finance a €100 billion bailout of Spain's banks.

The troika, recognising the system was on the point of collapse but complicit in the plot to keep it quiet, ordered Spain to restructure its banks. Some €41 billion of the bailout went to recapitalize Bankia, Novagalicia and Catalunya Banc, which were nationalized. There are now just 14 of the original 45 banks left after mergers. Around €50 billion worth of "toxic" real estate assets—about 100,000 residential and holiday complexes, individual homes and plots of lands—were transferred to a state run "bad bank," Sareb. German, British and French investors helped purchase 55 percent of Sareb's capital, enabling the government to keep its debts off its books and make the budget deficit look better.

Madrid Complutense University's Carlos Sánchez Mato called the Sareb machinations a "fantasy" that would "come to nothing." He added, "Through sleight of hand they have managed to remove the 55 billion euros from the banks' books, while at the same time making sure it doesn't appear as what it is: public debt. But that doesn't mean the debt doesn't exist. We will all end up contributing to paying it off."

In addition, the troika demanded the government take action to make the working class pay for the bailout. Nearly €100 billion worth of budget cuts have seen public services decimated, unemployment rise to 27 percent (55 percent among youth) and wages fall. Labour and pension reforms have been passed and the troika insists on more. A callous, rapid and unprecedented act of mass impoverishment has taken place.

For all the upheaval and suffering that has been caused, Spain's economy shrank for the eighth straight quarter in the second three months of this year and is expected to remain in recession into 2014—falling around 1.5 percent. Its budget deficit was the largest in the European Union last year, standing at 84 percent of GDP and is expected to worsen to 110 percent in 2018.

Last week, the IMF began its fourth audit of Spain's bank restructuring process since the bailout. Before the IMF team arrived, officials said, in the usual understated fashion, that risks to the economy are "elevated" and banks remain "vulnerable." According to news reports, behind the scenes talks are going on about the necessity of using the remaining €60 billion of the rescue package to help sell the nationalised banks and keep Sareb functioning. True to form, the government said it was not necessary and could provide its own funds.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site