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Economists ask how long Spain can go without help

LUXEMBOURG

Nation's struggling banks fuel speculation of need to tap euro bailout fund

BY STEPHEN CASTLE

The euro zone's rescue fund has already helped mount full-scale bailouts of three of Europe's smaller economies.

But concern over the health of Spain's financial institutions — laid low by a festering home-mortgage crisis — has fueled speculation that, for the first time, the bailout fund might be needed to help recapitalize the banks of a big country.

"I don't foresee the need for Spain to come, but there is a lot of money available," Klaus P. Regling, chief executive of the euro zone's current bailout fund, said here Tuesday at his staff headquarters. He added that there were "lots of positive elements in Spain that are ignored at the moment but that, no doubt, over time will become clearer to everybody."

Mr. Regling heads the European Financial Stability Facility, the emergency bailout fund that still has about €248 billion, or $325 billion, of its original €440 billion of lending power. In July, that fund is to be superceded by a permanent strongbox, the European Stability Mechanism, which will have a firepower of about €500 billion — beyond the €192 billion already committed to Ireland, Portugal and Greece.

But while Mr. Regling says he does not expect Spain to need help bailing out its banks, other analysts do not necessarily share his optimism.

"They are going to have to do something in Spain's case," said Simon Tilford, chief economist at the Center for European Reform, a research institute. "This is a big economy and the banks are holed below the water line."

Spanish banks initially congratulated themselves for not having invested in the U.S. subprime mortgages that sparked the world financial crisis, but the subsequent Spanish property slump has proved to have a devastating effect on their balance sheets.

Over all, Spanish banks have accumulated €323 billion of property assets, of which €175 billion were labelled as "problematic" by the Bank of Spain last year. That proportion, however, has risen amid soaring unemployment that has left more people unable to meet

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TONY GENTILE/REUTERS

ITALY FACING FISCAL REALITY
Prime Minister Mario Monti, above, has pushed back Italy's balanced budget target by a year. *PAGE 16*

Spain's banks fuel speculation of need for bailout fund

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mortgage payments.

This month , the Spanish central bank governor, Miguel Ángel Fernández Ordóñez, also warned that banks would need more capital if the economy continued to worsen.

Officially, the administration of Mariano Rajoy, which came to power in December, has said it would not seek Europe's help for Spain's economy, in which budget deficits and 23.6 percent unemployment are among the other problems.

Mr. Rajoy and Luis de Guindos, Spain's economy and competitiveness minister, are no doubt aware that the governments of Greece, Ireland and Portugal — the three euro countries that have requested international rescues — were later ejected from power by angry voters.

So Spanish politicians might prefer to ask Europe for aid intended just for their sickly banks. And some creditor countries might see such a step as preferable to letting the European Central Bank intervene again in the Spanish debt market by buying up its government bonds, as it has done in the past.

"I think recapitalization of the banks or injections of funds into the banks is the most likely way of lancing the boil," Mr. Tilford said. But any help for Spanish banks would probably come with conditions. And it would, under current rules, still require that aid go to the government — and not directly to Spanish banks.

Changing those rules would be difficult for the current fund that Mr. Regling runs — requiring parliamentary consent in Germany as well as the approval of euro countries, for example. And it would be even harder, once the new permanent fund comes into operation in July. (The new fund's treaty is still being ratified by various euro zone member countries.) Before requesting help for its banking sector, Spain would have to ask shareholders in Spanish banks to raise new capital first, then demonstrate that the government could not fill the shortfall.

Even if euro zone ministers agreed to help with recapitalization, they would impose conditions. These would focus mostly on the banking sector, but might still be contentious. For example, they could force the opening of Spain's domestic banking industry to foreign ownership.

JULIEN WARNAND/EPA

Klaus Regling, the head of Europe's bailout fund, sees no Spanish emergency.

And Spain's failure to hit existing deficit-reduction targets under the euro zone's rules could also hinder the process. The guidelines for the current bailout fund state that any beneficiary country must "demonstrate that it has a sound fiscal policy record."

Any bank recapitalization plan would also have to be in line with European Union rules guarding against unfair state subsidies. The whole process could take several weeks, officials say. Perhaps the biggest downside of using Europe's bailout funds to prop up Spanish banks is the unsettling message it would send to markets. And some officials caution that such a step may not be enough if Madrid fails to hold the line.

"Spain is doing an adjustment and should continue to do so," said one euro zone finance official who was not authorized to speak publicly. "If there were a general failure, the question is whether they come in for bank recapitalization only or for a market adjustment program. It is not clear."

Raphael Minder contributed reporting from Madrid.