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ECB rejects Madrid plan to boost Bankia

By Patrick Jenkins in London, Ralph Atkins in Frankfurt and Miles Johnson in Madrid

A Spanish plan to recapitalise Bankia, the troubled lender, by indirectly tapping the European Central Bank for cash, was bluntly rejected as unacceptable by the ECB, European officials said.

News of the rejection came as Spain faces elevated borrowing costs in the bond markets, tries to persuade investors it can contain problems in a banking sector weighed down by €180bn of bad property loans and, on Tuesday, saw its central bank governor stand down early.

Madrid had floated the unorthodox idea over the weekend of recapitalising Bankia by injecting €19bn of sovereign bonds into its parent company, which could then be swapped for cash at the ECB's three-month refinancing window, avoiding the need to raise the money on bond markets.

The ECB told Madrid that a proper capital injection was needed for Bankia and its plans were in danger of breaching an EU ban on "monetary financing," or central bank funding of governments, according to two European officials.

News of the ECB's hardline response emerged as the Bank of Spain announced that Miguel Angel Fernández Ordóñez, its governor, would step down at the end of next week, a month earlier than planned. Mr Fernández Ordóñez – known by his initials Mafo, who was appointed by Spain's previous socialist government – has been subject to increasing attacks from politicians over his failure to prevent the country's banking crisis.

The ECB's rebuff appeared to toughen Madrid's insistence that the only solution to a crisis that is pushing its borrowing costs close to unsustainable levels is for the ECB to become a government lender of last resort. Spanish 10-year sovereign bond yields topped 6.5 per cent on Monday and only fell back slightly on Tuesday.

Senior government officials in Madrid argue that bailouts in Portugal, Greece and Ireland have been catastrophic and Spain will not compromise on its refusal to accept a similar form of intervention.

They said the country had implemented reforms requested by Brussels and must now be granted relief by the ECB, or the future of the single currency will be threatened. The government would like to see the ECB restart its government bond-buying programme and wants the nascent European Stability Mechanism to be retooled as a bank bailout fund.

"This is like a game of poker now," one government adviser said, "and I don't think Spain is bluffing".

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Brussels has been frustrated with the Rajoy government's handling of the crisis, a concern that dates back to an attempt last month unilaterally to sidestep EU-mandated deficit targets.

The latest bank recapitalisation plan has revived such concerns, with officials saying they had no forewarning about the scheme and that it undermined Spanish claims that they would be able to finance their banking sector on their own, either through the private market or Spanish government money.

But officials are also nervous that the row risks bringing to a head concerns over Spain's creditworthiness, potentially shutting it out from capital markets.

The ECB is determined to avoid a repeat of its bruising experiences handling Ireland's banking crisis and has put pressure on Madrid to consult with it before deciding further steps.

The ECB had no comment on Tuesday.

Additional reporting by Alex Barker and Peter Spiegel in Brussels

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