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Rajoy presents Spain bailout as 'victory'

By Victor Mallet in Madrid and Peter Spiegel in Brussels


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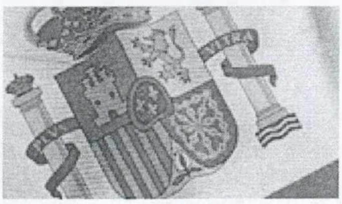
Mariano Rajoy, Spain's embattled prime minister, on Sunday attempted to portray his country's decision to seek as much as €100bn in European Union rescue funds for troubled domestic banks as a victory, saying his government's budget prudence prevented a full-scale bailout that would have forced him to surrender sovereignty to Brussels.

Spain has now became the fourth and largest eurozone economy to seek an international bailout. But Mr Rajoy, who had resisted any outside EU assistance since his centre-right government was voted into office in December, insisted the agreed loan from EU funds was solely to recapitalise banks.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Luis de Guindos, Spain's economy minister, said on Saturday that "the government of Spain declares its intention to request European financing" for its banking system. That announcement followed an emergency 2½-hour conference call between eurozone finance ministers. The 17 euro members agreed to channel the credit through Spain's Fund for Orderly Bank Restructuring (Frob), which would then inject capital into banks struggling with bad property loans.

Greece, Ireland and Portugal have all been obliged to seek bailouts from the EU and the International Monetary Fund over the past two years as a result of the financial crisis.

However, because Spain was able to take advantage of new provisions in the eurozone's €440bn rescue system, it will avoid the kind of intrusive inspection of government books that came along with Irish, Greek and Portuguese bailouts.

But the new loans, expected to be negotiated before the end of the month, will not be condition-free. Olli Rehn, the EU's top economic official, made clear on Sunday that it would be the European Commission and other international experts, and not the Spanish government, that would decide how much Spain's banks need.

In addition, the commission is expected to impose tough new measures on Spain's financial sector overhaul, which some officials believe has gone too slowly and only contributed to market uncertainly. "Spain has been the epicentre of the market turbulence recently," Mr Rehn said yesterday. Other officials said action was needed before potentially disruptive Greek elections next Sunday.

The rescue of Spain, however, is likely to have more impact on financial markets because its economy is nearly twice as large as the other three combined. Nicholas Spiro of Spiro Sovereign Strategy called the request for aid "the most significant and alarming development in the two-year-old eurozone crisis".

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This news does not solve Spain's other structural problem, which is how to stabilise its government debt ratio. If anything, it makes that problem worse.

Despite enthusiastic support for the plan from EU leaders, it remains uncertain whether it will relieve the pressure on the Spanish government. The bailout loans will be funnelled through the government's books, potentially adding as much as 20 per cent to Spain's sovereign debt, which could spook financial markets.

Eurozone leaders did not specify whether the money would come from the current €440bn rescue fund, the European Financial Stability Facility, or the new €500bn fund, the European Stability Mechanism, which is due to go into force next month. Under the terms of the ESM treaty, loans from the ESM take priority over all private sector debt, which could spook potential buyers of Spanish sovereign debt.

The decision to seek aid was reached less than 24 hours after the IMF issued a 77-page report on the Spanish banking sector that found it was suffering through a crisis "unprecedented in its modern history".

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- Mariano Rajoy

Mr Rajoy expressed regret that Spain had not bailed out its struggling domestic banks three years ago along with other European Union members such as the UK, but said the credit line was essential to restore confidence and help banks provide credit to the real economy.

Members of Mr Rajoy's centre-right government have repeatedly denied that the EU aid agreed at the weekend is a "bailout" or a "rescue", arguing that such a programme would have been necessary only if they had not introduced radical fiscal, labour market and financial sector reforms since taking office in December.

"If we hadn't done this in these past five months, what was put forward yesterday would have been a bailout of the Kingdom of Spain," Mr Rajoy said on Sunday. "Because we had been doing our homework for five months, what did happen yesterday, what was agreed, was the opening of a line of credit for our financial system."

Spain's EU partners accept that its existing austerity programmes are rigorous enough, and say the credit line will be directed at banks such as Bankia, the merger of seven regional savings banks that was nationalised by the government last month and said it had a capital shortfall of €19bn.

Economists and analysts say the EU loan nevertheless amounts to a rescue for Spain because the money will go to the Frob, will count as government debt, and was necessary only because Spain itself could not access the sovereign bond markets at a reasonable price.

Mr de Guindos said the loan would "reduce pressure" on Spanish sovereign debt issuance, although some analysts were sceptical that the deal would provide anything other than a temporary breathing space.

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