Europe bailout of Spain could cost $125 billion

By DANIEL WOOLLS, Associated Press – Jun 9, 2012 6

MADRID (AP) — Spain became the fourth and largest country to ask Europe to rescue its failing banks, a bailout of up to €100 billion ($125 billion) that leaders hoped would stabilize a financial crisis that threatens to break apart the 17-country eurozone.

The rescue offer follows growing pressure from international investors and the Obama administration and comes a week before elections in Greece, whose voters could decide whether the country leaves the euro.

Europe's widening recession and financial crisis has hurt companies and investors around the world. Providing a financial lifeline to Spanish banks is likely to relieve anxiety on the Spanish economy — which is five times larger than Greece's — and on markets concerned about the country's ability to pay its way.

"What the markets are looking for is essentially the Spanish government's acceptance that its banks are broke," said Jacob Kirkegaard, a research fellow at the Peterson Institute for International Economics in Washington, Saturday.

Economy Minister Luis de Guindos announced the deal after an emergency conference call with eurozone financial leaders. He said the aid will go to the banking sector only and would not come with new austerity conditions attached for the economy in general — conditions that have been an integral part of previous bailouts to Portugal, Ireland and Greece.

The exact figure of the bailout has not yet been decided. De Guindos said the country is waiting until independent audits of the country's banking sector have been carried out before asking for a specific amount. The audits are expected June 21 at the latest.

De Guindos did say, however, that Spain would request enough money for recapitalization, plus a safety margin that will be "significant."

With markets in turmoil, de Guindos said the government's efforts to shore up the financial sector "must be completed with the necessary resources to finance the needs of recapitalization."

Finance ministers of the 17 countries that use the euro said the money would be fed directly into a fund Spain set up to recapitalize its banks, but underscored that the Spanish government is ultimately responsible for the loan.

Still, that plan allows Spain to avoid making the onerous commitments that Greece, Ireland and Portugal were forced to when they sought their rescues. Instead, the eurogroup statement said that it expected Spain's banking sector to implement reforms and that Spain would be held to its previous commitments to reform its labor market and manage its deficit.

The eurogroup statement said that meant the cost could reach €100 billion.

The Spanish acceptance of aid for its banks is a big embarrassment for Prime Minister Mariano Rajoy, who insisted just 10 days ago that the banking sector would not need a bailout. He was elected in November and walked right into a hurricane.

International pressure on Spain to solve its financial problems has grown more urgent in recent weeks. On Thursday ratings agency Fitch hit Spain with a three-notch downgrade of its credit rating. That left it two levels above junk status. Then on Friday, Moody's Investor Services warned it could downgrade Spain and other countries in the eurozone.

The International Monetary Fund early Saturday released a report estimating that Spanish banks need a recapitalization injection of at least €40 billion ($50 billion) following a stress test it performed on the country's financial sector. That report came out three days ahead of schedule, underscoring the urgency of the situation.

And U.S. President Barack Obama, facing re-election, enduring a weak economy and in need of strong trading partners, expressed strong concern late Friday over the European economic crisis.

U.S Treasury Secretary Timothy Geithner welcomed Spain's decision and the offer of European support, describing them as "important for the health of Spain's economy and as concrete steps on the path to financial union, which is vital to the resilience of the euro area."

French Finance Minister Pierre Moscovici said the deal would "contribute to restoring confidence in the eurozone."

"The accord announced tonight speaks to a reinforced solidary among the countries of the eurozone and to their resolute desire to ensure its stability," he said in a statement.

Spain's financial problems are not due to Greek-style government over-spending. The country's banks got caught up in the collapse of a real estate bubble. However, as Spain's leaders have struggled for a solution to their banking crisis, the country's borrowing costs have soared close to the level that forced the governments of Greece, Portugal and Ireland to seek rescues.

Some of Spain's banks are struggling with by toxic real estate loans and assets. The Bank of Spain says they total around €180 billion. Nationalized lender Bankia, SA, which has requested €19 billion in aid, has €32 billion in toxic assets. Around four other banks are considered prime candidates for bailouts. De Guindos said Saturday the sector is largely solid and the euro zone package will be funnel toward only about 30 percent of it.

Analyst Rafael Pampillon if IE Business School in Madrid said the bailout addressed the uncertainty the markets had felt about how Spain's debt-laden banking sector would recapitalize.

"This uncertainty, and hence the panic, will slowly dissipate from the markets," he said. Pampillon added that with polls forecasting a pro-Euro victory in Greek elections, markets would be further relieved because the austerity conditions imposed on Greece would most likely be fulfilled.

Eswar Prasad, a Cornell University trade policy professor and senior fellow at the Brookings Institution, said the decision "buys some temporary breathing room for the eurozone."

Moody's said Spain's banking problem is largely confined to that country and not likely to spill over to other eurozone nations, with the exception of Italy — where the European Central Bank has already stepped in to buy government bonds as a way to help lower the country's borrowing costs.

Spain has been criticized for being too slow to set out a roadmap to resolve its problem. European business leaders and analysts have stressed that Spain must find a solution quickly so that it is not caught up in any market turmoil sparked by the June 17 Greek elections. There are concerns that anti-bailout left-wing party Syriza could become the largest party in the Greek parliament, putting the country's membership in the eurozone at risk.

Working in Spain's favor is the fact that its public debt is actually quite low, at 68.5 percent of its gross domestic product at the end of 2011.

Its debt is predicted to hit 78 percent by the end of the year, but even that figure would be below the debt-to-GDP ratios of Europe's strongest economy, Germany, which is at 82 percent.

But Spain's in its second recession in three years, with unemployment at nearly 25 percent and little hope for improvement this year. Prime Minister Mariano Rajoy's government has imposed a wave of austerity measures since he took office in December that have raised taxes, made it cheaper to hire and fire workers and cut government funding for education and health care.

DiLorenzo reported from Paris. Associated Press writers Juergen Baetz in Berlin, Slobodan Lekic in Brussels, and Alan Clendenning and Harold Heckle in Madrid contributed to this report.

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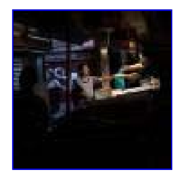
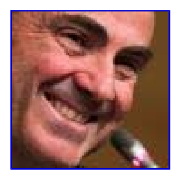
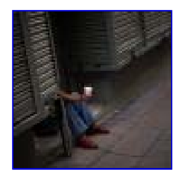
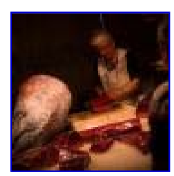
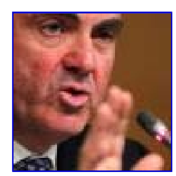
Spain's Economy Minister Luis de Guindos gestures during a news conference at the Ministry of Economy and Competitiveness in Madrid, Spain, Saturday, June 9, 2012. Spain will ask for a bailout for banks felled by bad real estate loans, in an about-face that European officials welcomed Saturday and said could cost up to euro100 billion ($125 billlion). A rescue for Spain will be Europe's fourth since the single currency bloc's debt crisis erupted two years ago. (AP Photo/Andres Kudacki)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