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Jun. 10, 2012 6:34 PM ET

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Rescue loans for Spain's banks buys Europe time

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WASHINGTON (AP) — A $125 billion plan to rescue Spain's banks won't solve Europe's debt crisis or ease the pain of double-digit unemployment across the continent.

But it is likely to calm financial markets and buy time for European policymakers to work with other weak economies threatening the stability of the 17 countries that use the euro.

Europe still has plenty of troubles to address in the three other countries that have already received financial help â€" Greece, Portugal and Ireland. In Greece, voters could elect a government next week that will refuse to live up to the terms of the country's $170 billion rescue package. Portugal is combating a toxic combination of high debt and 15 percent unemployment. Ireland is cleaning up a banking mess a lot like Spain's. Then there's Italy, the eurozone's third-largest economy, where government debt is piling up as the economy stagnates.

"We still have some pretty fundamental problems to solve," says Nicolas Veron, senior fellow at the Bruegel think tank in Brusssels. "We need more radical solutions than this one."

Spaniards dressed up like Bishops for a stag party play the role of a confessor in downtown Madrid, Saturday June 9 2012. Spain will ask for a bank bailout from the eurozone, becoming the fourth and largest country to seek help since the single currency bloc's debt crisis erupted.(AP Photo/Daniel Ochoa de Olza)

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Spain on Saturday asked finance ministers for the 17 countries that use the euro for money to rescue its banks, which have been crushed under the weight of bad real estate loans. The finance ministers responded by offering up to $125 billion in loans that the Spanish government could funnel to banks.

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The plan eases an immediate crisis in the euro's fourth-largest economy. The deterioration of Spain's banks and the pressing need for a rescue was threatening to bankrupt its government. That would likely cause far more pain for Europe than the financial messes in Greece, Portugal and Ireland.

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"This move brings into sharp relief the enormous amount of money that will be needed to cordon off the rest of the euro zone periphery in the event of a Greek meltdown," says Eswar Prasad, professor of trade policy at Cornell University.

Investors are worried about what will happen when Greek voters go to the polls June 17.

If Greece reneges on the strict austerity measures that come with its rescue package, it could be forced to abandon the euro. Greece's departure from the Eurozone would likely cause financial chaos across Europe: Greek debts would go from being denominated in sturdy euros to being denominated in Greek drachmas of dubious value.

Worse, a Greek exit from the euro would raise fears that another European country such Portugal or Italy might be next.

"A significant part of this (bailout for Spanish banks) has to do with ring-fencing Greece," says Jacob Kirkegaard, a research fellow at the Peterson Institute for International Economics in Washington. "This is enough to prevent added market contagion."

But analysts said even bolder action may be needed from some key European governments and institutions that have been leery of committing too much to the effort.

Germany, worried that it will get stuck with the bill for any ambitious schemes, has rejected several ideas for easing the crisis. It has been reluctant to ease the terms of previous bailouts to reduce the pain of government spending cuts on Greece, Portugal and Ireland. And it has resisted calls for the creation of joint "eurobonds" that would raise money and spread responsibility for repayment across the euro countries.

Likewise, the European Central Bank has been reluctant to intervene to jolt the eurozone economy. Last week, it passed up an opportunity to reduce interest rates. And it has been reluctant to flood the economy with money to push down interest rates the way the U.S. Federal Reserve has.

The rescue money for Spain will come from pools set up by other euro countries. Spain's government will distribute it to the banks. The banks will pay it back with interest, and the money will go back to the rescue pools. Interest rates and other details had not been revealed as of Sunday.

Spain had been resisting pressure to seek outside help for its banks, which have been overwhelmed by bad real estate loans. But leaders became increasingly concerned that any fallout from Greece's upcoming elections would rock markets, further hurting Spain's financial sector. The exact amount Spain needs won't be clear until outside accountants complete an audit of its banks by June 21.

Unlike the three other European countries that have received financial help â€" Ireland, Portugal and Greece â€" Spain did not have to agree to deeper cuts in its government budget to secure the help.

Working in Spain's favor is the fact that its public debts aren't especially high. They amounted to less than 69 percent of its gross domestic product at the end of 2011. Even Germany, an economic powerhouse, has public debt that amounts to 82 percent of annual economic output.

Spain has already agreed to government belt-tightening. More austerity likely would have pushed Spain, already suffering from near-25 percent unemployment, deeper into recession.

"You don't want an economy of that magnitude going down the tubes," says Daniel Drezner, a professor of international politics at Tufts University in Medford, Mass. Spain has the world's 13th-biggest economy, more than four times the size of Greece's. It is the fourth-largest economy in the Eurozone.

In recent weeks, jittery investors had demanded higher interest rates on Spanish bonds. If Spain had tried to borrow money in the bond market to rescue its banks, investors would have demanded a much higher interest rate than the favorable deal the banks are getting from their euro neighbors.

The rising fears come at a time when nearly half the countries that use the euro are in recession. At 11 percent, unemployment in the euro zone is at the highest level since the single currency was introduced in 1999.

Europe's weakest countries aren't all alike.

Spain and Ireland, like the United States, were crushed by a collapse in the housing market, which left their banks with huge losses on housing loans. The Irish government was forced to slash government spending to pay for a bank rescue. The austerity has pinched the economy; Irish unemployment exceeds 14 percent.

Greece ran up vast budget deficits it couldn't sustain and smothered its economy in regulations designed to protect favored industries.

Italy and Portugal are desperately in need of economic growth that will provide the tax revenues they need to pay their bills. But deep spending cuts in both countries are threatening their economies.

The troubles in Europe also are causing economic problems for the United States and developing countries such as China and Brazil, which rely on Europeans to buy their exports. So the plan unveiled Saturday eases pressure on the United States and the rest of the world economy as well.

European economic troubles pinch U.S. businesses. U.S. companies send 22 percent of the goods they export to Europe and have more than $2 trillion invested in factories, offices and businesses there.

A bigger fear is that Europe's financial troubles could cross the Atlantic. When banks lose confidence in each other, they refuse to lend each other money. Credit dries up, depriving economies of the fuel they need to grow. A financial crunch can wreck the economies on both sides of the ocean as it did in 2008.

"Anything that calms European markets is good for the United States," says Tufts' Drezner.

The Spanish deal also gives European policymakers more time to strengthen the euro. They are already planning to create a "banking union" with a centralized regulator, a bailout fund and deposit insurance that covers savers across Europe.

Europe still needs to find a way to stimulate economic growth across the continent so that European countries can begin to grow their way out of their debt problems.

Despite the bank deal, Spain's grinding economic misery will get worse this year, Prime Minister Mariano Rajoy said Sunday. The conservative prime minister said the economy will shrink by 1.7 percent this year and more Spaniards will lose their jobs, even with the help.

"This year is going to be a bad one," Rajoy said.

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Svensson contributed from New York and AP Business Writer Sarah DiLorenzo contributed to this report from Paris.