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Spain in Focus

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After Portugal officially asked for a rescue, attention has turned to Spain. Will it be the next? Presently it seems there will be no further domino-effect. But from this point forward, Spain cannot risk making many mistakes….

Even the IMF appreciates that the Spanish government has undertaken serious reforms over the last two years. The transformation of the labor market and the banking and the pension systems has begun.

Concerning the present economic situation in Spain, signs of a very slight recovery began to appear at the end of 2010. These have continued on into the first quarter of 2011. Exports have increased significantly due to increased competitiveness and the recovery of external markets. Investment in equipment has also increased as a component of domestic demand. Unemployment remains very high (20%), but according to current estimates a slight reduction can be expected for the second half of the year[1]. Public debt in Spain increased between 2008 and 2010 from 39.8% to 60.1% of GDP. Compared to some other EU countries, this is not that high. But according to forecasts it will rise further.

Currently the most acute problem in the Spanish economy is the situation of the savings banks (cajas), which are regionally based institutions with more branches and employees than commercial banks. The cajas are in most cases controlled by regional politicians and in the past have financed local real-estate deals. Exposed to varying degrees to the effects of the crisis, their share of non-performing loans has ranged from 1% to 7%.[2] Caja Castilla-La Mancha had the largest liquidity problem and its management was taken over by the Bank of Spain in March 2009. In order to assist in the restructuring of the cajas and banks, the government established the Bank-Restructuring Fund (FROB, Fondo de Reestructuración Ordenada Bancaria), provided with a capital of 9 billion Euros. 2010 was the year of merger agreements between savings banks in the most extensive banking concentration process ever undertaken in Spain. The FROB manages the mergers of the cajas (from 45 cajas, only 17 remained in 2010) and has the capacity to augment the equity of credit institutions.[3]

[1] Informe sobre posición cíclica de la economía Espanola, 6. abril 2011. Ministry of Economy

[2] Cuñat, V, Garicano, L (2010), Did Good Cajas Extend Bad Loans? Governance, Human Capital and Loan Portfolios, *FEDEA Working Paper* no.8., February http://www.fedea.es/pub/Papers/2010/dt2010-08.pdf

[3] Nota sobre el proceso de reestructuración y saneamiento de las cajas de ahorros. Situación en marzo de 2011. Banco de España, 23. Marzo 2011 http://www.bde.es

The Royal Decree 2/2011 raises the core capital requirements of savings banks as of September 2011 and otherwise makes them subject to FROB seizure and control. Core capital should generally be raised to 8% of risk-weighted assets. However this amount has been raised to 10% for those savings banks that depend on wholesale capital markets for more than a fifth of their funding, or if less than a fifth of their shares are in private hands. The IMF claims that the cajas are vulnerable and the events of the past weeks seem to prove this. The fusion of the Caja Mediterráneo (CAM) with three others unraveled at the end of March. CAM asked for the injection of 2.8 billion Euros in public funds and the state took over the savings bank.

Altogether according to the Bank of Spain the Spanish financial system needs 15 billion Euros to raise capital to the levels necessary to meet the strict new requirements aimed at convincing international markets the banks are solvent. Let us hope there are no more “skeletons in the cupboard”….

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