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Spain Can Still Avoid Financial Doom

- By IRWIN STELZER



And so we wait. We wait for the spate of new data on the health of the euroland economies, we wait for the policymakers to come up with some device that satisfies the markets that the eurocracy has come up with a structure that controls national budgets to the satisfaction of German Chancellor Angela Merkel, euroland's paymaster-in-chief.

The waiting for data will end this week, at least for a while; the waiting for a policy decision might not arrive before Godot. Meanwhile, it is all about Spain, Europe's fifth largest economy. Greece is gone, Ireland is gone and Portugal is going—all will have to restructure one way or another. If Spain, larger than all three combined, can survive the tender attentions of the bond market, policymakers will have time for their usual leisurely decision-making pace.



Reuters

Spain's fate will depend on Prime Minister José Luis Zapatero's reforms.

There are some reasons to believe that Spain will escape the fate in store for its smaller colleagues-in-debt. Goldman Sachs Global

Economics, in a new report fetchingly titled, "Spain: Sustainable!", reckons that Spanish public debt "is unlikely to exceed 90% of GDP at the peak: hardly a case of insolvency." There is, concede the Goldman Sachs economists, the possibility of a liquidity crisis that might force Spain to seek "external assistance," aka a bailout, but that can be handled by euro-zone policymakers, who should by now have some competence in this sort of situation.

Start with Spain's financial situation compared with those of the troubled trio. The Economist reports that Spain's gross government debt stands at 64% of GDP, well below the levels of Portugal (83%), Ireland (97%), and Greece (140%). The yield on 10-year government bonds is about half that of Greece, as is the Economist's forecast of gross government debt levels in 2015—85% of GDP compared with 165%. (Ireland and Portugal clock in at 125% and 100%, respectively.) "Spain is probably solvent," concludes the Economist, with a "prospective debt burden...similar to those of 'safe' France and Germany today."

The key word is "probably," not quite as ringing an endorsement as Goldman Sachs' "Sustainable!"

All will depend on four things. The first is the general macroeconomic atmosphere in the euro zone as a whole. Right now the future is finely balanced between a continuation of German-led growth, and a slowdown caused by a European Central Bank decision to tighten monetary policy to nip inflationary pressures, now running at levels the ECB is unprepared to accept if they persist. In the near term the level of the euro should keep Germany's export machine humming, and the new interest of German consumers in spending should give the entire euro zone a bit of a fillip. Also in the near term, Jean-Claude Trichet, head of the ECB, should hold fire on any interest rate increase and any retreat from the bond market until the policymakers agree on a permanent solution to the crisis created by the weakness of periphery countries. All of which is probably a plus for Spain.

A second factor that will determine Spain's ability to avoid a crisis will be the behavior of its highly indebted consumers. Households have significantly reduced their debts (increased their savings), and so have reduced the burden of interest payments, and are actually now

net recipients of interest payments. This augurs well for at least a stabilizing of consumer spending, unless—and this is a very big "unless"—household incomes continue to fall. Economists at Jefferies Fixed Income report that real household disposable incomes fell by almost 6% in the year ending with the third quarter of last year. If a decline at anything like that rate continues, all bets are off, and Spain will not only have to get help from its euro-zone partners (read, Germany), but abandon its position that the banks' creditors are to emerge from the process their curly locks unshorn.

A third addition to the positive side of the ledger is the growth in exports which, combined with a decline in imports, has reduced the current account deficit from 15% in 2008 to 4.3%. Which is one reason economic activity no longer is declining, and seems to be on a modest upswing.

Finally, there is the question of Spain's banks, best described as a mess. The savings banks, or *cajas*, have lent about €189 billion (\$257 billion) to property developers who reportedly are unlikely to be able to repay those loans. The government is forcing the *cajas* to merge—the 45 have become 17—and to raise capital, and has already injected an estimated €11-€15 billion into its Fund For Orderly Bank Restructuring. It says it will inject close to €100 billion into the fund if it has to, if the banks are unable to raise capital from the private sector, which Spanish Prime Minister José Luis Rodríguez Zapatero keeps insisting they can.

Which is what has investors demanding premia for lending money to Spain. After all, it wasn't until Ireland decided to bail out its banks that investors realized the country was bust. Spain has to raise some €93 billion this year, and has already fled to the relative safety of a syndicate of banks, who charge a commission and then break up the bonds into smaller packages for resale, rather than risk peddling some 10- and 15-year bonds on the market.

In the longer term, of course, all will depend on whether Mr. Zapatero can make his labor market and other reforms stick, increasing his economy's competitiveness and growth rate. Polls suggest he will not survive the next election, and so will be watching from the sidelines.

—Irwin Stelzer is a director of economic-policy studies at the Hudson Institute.