

Solving Spain's other debt problem

Print

Published: June 15 2010 22:05 | Last updated: June 15 2010 22:05

Rumours of Spain's financial demise may be exaggerated. A newspaper story this week that the country would need to tap the European bail-out facility has been firmly denied. But investors remain wary of Spanish debt, and the yields the government needs to pay continue to creep up.

This is not just a problem for the Spanish government, which needs to raise €16.2bn by the end of next month. The market's suspicion is also hurting the country's private sector. Spain is unusual among the southern European countries in that its real financial problem lies on the private side. While the national debt stock stands at about 53 per cent of GDP – among the lowest in the eurozone – private sector debt stands at 178 per cent. Business is struggling to attract capital. As Francisco González, chairman of BBVA, warned this week, the **capital markets are closed to most Spanish companies and financial firms**.

While the government can cut its own borrowing, it can do less to resolve the private sector's woes. Within monetary union, Spain has surrendered its ability to extend liquidity unilaterally. The private sector borrowed excessively during the boom – mainly to fund house building rather than productive investment. Consequently, there are a lot of bad debts, in both the corporate and banking sector. These undermine the ability of healthy companies to attract funding. The government must encourage their crystallisation. One way would be to force Spain's *cajas* to reveal their losses. Were these ailing banks to be obliged to do so, they might seize collateral from tottering companies, forcing them to liquidate and beginning the process of cleansing the system.

This, in turn, should make the government think again about its reticence to impose haircuts on any financial institution – which is the logical inference to be drawn from its **bail-out of tiny CajaSur** last month. Transferring bad private sector debts to an already indigestion-ridden public sector would just reclassify the problem.

Moreover, letting some *cajas* go should not cause a systemic panic. They cannot be too big to fail. Spain's two-tier banking system makes it easy to distinguish between the healthier listed banks and the generally weaker *cajas*.

The more the government can separate private sector sheep from goats the better. It is possible to impose losses on creditors and allow banks to fail without cutting off the supply of credit to sound borrowers. Europe has always touted relationship finance – the reliance of borrowers on a few trusted lenders – as one of its strengths. This is the moment when countries like Spain need to demonstrate these strengths. The government actively holds back this process if it just allows undercapitalised banks to stumble on.

Copyright The Financial Times Limited 2010. Print a single copy of this article for personal use. [Contact us](#) if you wish to print more to distribute to others.