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Spanish govt bailout less likely after EU measures

MADRID (AP) — The risk of Spain having to ask for a government bailout that would strain Europe's finances eased Friday after the continent's leaders agreed to give rescue loans directly to the nation's hurting banks, without adding to public debt.

But experts said the country remains a financial hot zone because rescue details haven't been finalized and Spanish officials must still resolve a host of other economic problems.

Under terms still being worked out, the leaders of the 17 nations that use the euro agreed that their bailout for Spain's banks — which could be as large as €100 billion ($126 billion) — can go directly to the banks instead of through the government. That eliminates the risk that the government may find itself repaying loans to the eurozone that its banks were unable to pay back.

The leaders will also allow a eurozone bailout fund to buy government bonds, forcing down the high interest rates investors have been demanding to lend money to Spain. Meanwhile, the European Central Bank will become the banking sector's chief overseer by the end of the year.

While investors appeared relieved, bidding up stocks and bonds, analysts cautioned that the market rally may be a brief flare-up in investor optimism.

The overall impact of the measures is that Spain's chances of having to formally ask for a government bailout like those taken by Greece, Ireland and Portugal is down but not eliminated, said Vincent Forest, an economist with the Economist Intelligence Unit.

That's because Spain still faces huge challenges complying with eurozone goals for reducing its bloated deficit, and its economy is in tatters.

Unemployment is nearly 25 percent after a housing boom went bust, causing mass layoffs and tumbling house prices. Economic prospects are grim, with the economy in a deepening recession, the second in three years. Prime Minister Mariano Rajoy is expected to introduce more austerity measures soon aimed at fixing Spain's finances that will inevitably cause economic pain, including a hike in the VAT, a tax on goods and services.

"There won't be any significant wave of investors coming back to Spain today," Forest said. "What has been announced is something that fixes some parts of the problem in the short-term. There are less chances for Spain needing a full bailout, but it can't be ruled out."

The main reason financial markets jumped higher on Friday was that the bailout for Spain's banks would not add to the government's debt load. Stocks jumped and Spanish government borrowing rates fell sharply, an indication that investors are somewhat less concerned about the country's ability to repay its debts.

The interest rate on Spain's benchmark 10-year bond dropped 0.56 percentage points to 6.34 percent by late Friday, having last week shot past 7 percent, widely considered an unsustainable rate. The yield is the rate a government would pay to raise money from markets and economists expected Spain could have afforded paying 7 percent for only a few more months, after which it would have had to ask for an international bailout.

Spain, however, has the eurozone's fourth largest economy after Germany, France and Italy and is widely seen as too big to bail out.

Despite the drop, Spain's borrowing rate is still high and analysts said it could remain volatile until jittery global investors learn more about how the bank rescue plan will work, possibly following an ECB meeting next week.

"In the end, it is this kind of fine print that the market needs to know," said Alejandro Varela of Madrid brokerage Renta4.

Spain must sell billions in debt auctions in July and get financing for troubled regional governments that work like U.S. states, but it probably won't see durable relief on its borrowing rates unless eurozone leaders quickly finalize details, said Ramon Zarate of Madrid's Emasl financial consulting group.

"We have a political proposal to do more work toward banking and fiscal union but the measures are not going to be put in place today or tomorrow," he said. "The proposal has to be converted into concrete measures very soon, and, if not, the risk premium will stay the same."

Besides reducing concern about the size of public debt, the new EU measures could help stem capital flight from Spanish banks. Bank deposits fell about six percent over the last year, and by 1.8 percent in April — by €3.1 billion to €1.6 trillion — as savers worried that their banks might collapse.

"The more the euro area and Spain are stabilized, and the steps toward the banking union will contribute to it, the less capital flight there will be," said Xavier Vives, an economics professor at the University of Navarra's IESE Business School.

Speaking in Brussels after the European Union summit that resulted in the plan, Rajoy said the meeting "set out the correct path for confronting the crisis and marked out a road map."

He cautioned, however that there's "a long way to go."

He refused comment on suggestions that Spain, Italy and France stood up to austerity-minded Germany to settle volatile debt markets.

"The important thing is that we reached an agreement to strengthen the position of the euro," he said. "The rest are just minor details."