Spain Downgraded to One Level Above Junk by S&P on Risks

By Angeline Benoit and Ian Katz - Oct 10, 2012

Spain’s debt rating was cut to one level above junk by Standard & Poor’s, which cited mounting economic and political risks as the government considers a second bailout.

The country was lowered two levels to BBB- from BBB+, New York-based S&P said in a statement yesterday. S&P assigned a negative outlook to the nation’s long-term rating and lowered the short-term sovereign level to A-3 from A-2.

“The negative outlook on the long-term rating reflects our view of the significant risks to Spain’s economic growth and budgetary performance, and the lack of a clear direction in euro-zone policy,” S&P said. “The deepening economic recession is limiting the Spanish government’s policy options.”

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The downgrade comes after Spain announced a fifth austerity package in less than a year and published details of stress tests of its banks. Creditworthiness concerns have grown since the government requested as much as 100 billion euros ($128 billion) in European Union aid to shore up its lenders and amid signals that the deficit target is in jeopardy.

The rating cut was unexpected and is negative for Spain, said Ignacio Fernandez-Palomero Morales, the deputy head of the nation’s Treasury. The downgrade was based on a lack of clarity in the resolution scheme for the debt crisis, he said today at a conference in Tokyo.

The euro slid against most of its major peers and was fell 0.2 percent to $1.2847 as of 11:43 a.m. in Tokyo.

Second Recession

Investors are shunning Spain’s securities as Prime Minister Mariano Rajoy weighs a second bailout amid a deepening recession. Rajoy has held off on a decision about whether to request European Central Bank and EU bond buying to lower borrowing costs. He’s called for more details on what would be demanded of Spain in return for the support.

Spain’s economy, suffering its second recession since 2009, will probably shrink 1.3 percent next year after a 1.5 percent contraction in 2012, the International Monetary Fund forecasts.

The yield on Spain’s 10-year benchmark bond closed at 5.78 percent yesterday, compared with a record of 7.75 percent on July 25, a day after Spain signed a memorandum of understanding awarding it a credit line for its banks.

The IMF’s managing director, Christine Lagarde, told Bloomberg Television yesterday that the fund doesn’t need to lend money to Spain to help the country tackle its fiscal crisis. The fund is helping monitor a 100 billion-euro bailout of Spanish banks.

Financing Needs

“Some people say unless you have skin in the game, meaning money, you are not really respected, you are not heard,” Lagarde said. “I am not so focused on that as I am on the monitoring. I think we would rather act in our framework, use one of the tools that is frequently used, but as I said we can be flexible.” The IMF’s 188 member nations are convening in Tokyo this week for the fund’s annual meeting.

Spain’s financing needs are increasing along with its costs. It plans to borrow 207.2 billion euros next year, pushing its debt load to 90.5 percent of economic output as the state absorbs the cost of bailing out banks and the power system. The rate was 36 percent in 2007, before a 10-year real-estate boom ended, derailing public finances.

This year’s budget deficit will be 7.4 percent of gross domestic product, Budget Minister Cristobal Montoro said Sept. 29. Even so, Spain’s 6.3 percent target will be met because it can exclude the cost of the bank rescue, he said. Spain’s budget gap was the third-largest in the euro zone last year at 8.96 of GDP.