Spain's Pain
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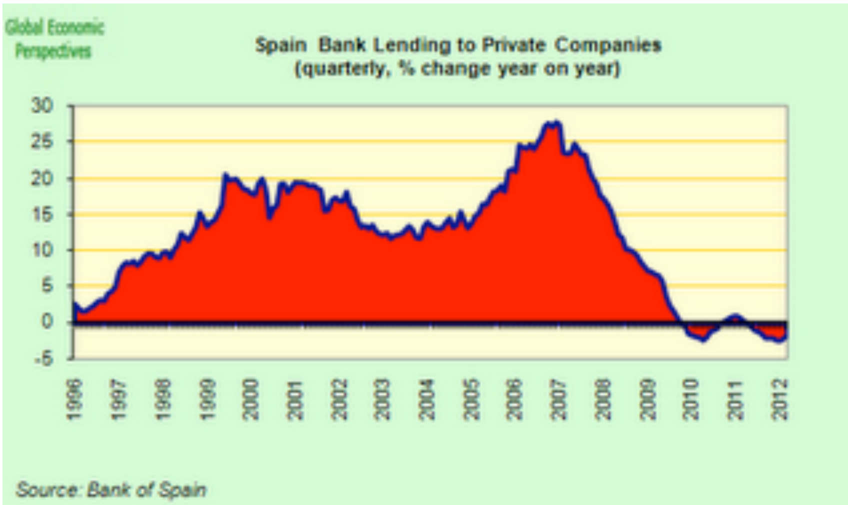
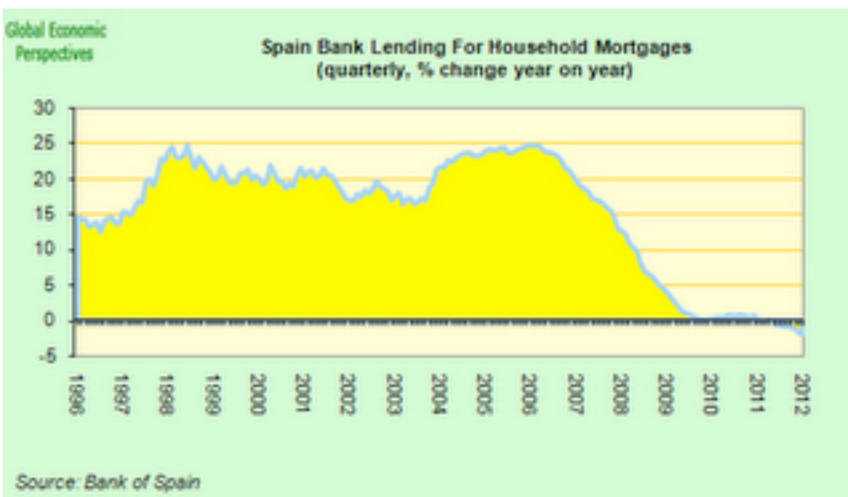
This weekend Spanish leaders asked the European Union's central bank (ECB) for economic assistance, a few days after the Fitch Ratings service has dropped the debt rating on Spanish government bonds to BBB status. The bond markets have responded with some alarm, and next week we may see aftereffects in the U.S. stock market. But to put this downgrade into perspective, Fitch has also assigned a BBB rating to the latest bonds issued by the Time Warner company, which is not, last time anybody checked, facing impending bankruptcy. Fitch also assigns a BBB bond rating to the nations of Brazil, India and South Africa.

But that doesn't mean Spain is out of the woods from an economic perspective. The International Monetary Fund will issue a report on Monday saying that the Spanish banking system needs an infusion of between $50 billion and $112.5 billion (40-90 billion euros) to restore full solvency. Spain's unemployment rate is just over three times the U.S. rate--around 24.3% overall, 51.5% of people under age 25--and the country may already be experiencing a recession that is probably destined to last two years at least.

Most of us remember what happened in the U.S. during the Great Recession; the banking system locked up, shutting off corporate access to credit. The two charts below show that this may be at the root of Spain's problems right now. The red graph shows that bank lending to Spain's corporate sector has fluctuated between 0% and negative territory since late 2009. The yellow graph shows that lending to would-be home buyers has dried up completely. Not surprisingly, Spain's real estate prices have collapsed--housing prices have fallen roughly 25% since 2008. Even if a million young families wanted to scoop up some of the bargains, where would the find the financing?





Seen from this standpoint, the first order of business in Spain, just like the U.S. back in 2008, is to get the banking system back on its feet, credit flowing again, people buying houses and companies investing in the kind of growth that will make a dent in that frightening unemployment rate. As you read the dire headlines in the week ahead, and the need for the European Financial Stability Facility to lend up to 90 billion euros to Spain's lenders, notice somewhere toward the bottom of the story that the European Union has already set aside 440 billion euros in its bailout mechanism. The money is there, and the best news is that none of it is coming out of the pockets of U.S. taxpayers.

Sources:

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