Rajoy delay marks bet on turmoil making bailout terms easier

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Demonstrators carry a huge Catalan flag during a protest rally demanding independence for Catalonia in Barcelona

Spanish Prime Minister Mariano Rajoy’s equivocation on seeking a European bailout amounts to a bet that another bout of market turmoil will enable him to broker better terms over German resistance.  
In Rajoy’s thinking, “the worse it gets, the better for Spain,” said Jose Garcia-Montalvo, a former Harvard University economist who teaches at Pompeu Fabra University in Barcelona. “That would make the Germans think more deeply about the cost of letting the southern countries sink. But it’s a very risky strategy.”  
Heading into a European Union summit in a day’s time, Rajoy has brushed off pressure to reach for a lifeline from investors such as Pacific Investment Management Co.’s Bill Gross, who manages the world’s biggest bond fund. EU counterparts are divided. Germany is pushing back against prodding by France and Italy to exploit bond buying by the European Central Bank and counter a financial storm entering its fourth year.  
Defending Spain is crucial because its economy doubles the output of Greece, Ireland, Portugal and Cyprus combined, testing the capacity of aid mechanisms. Its borrowing costs are a reference for Italy and even France, which has so far seen its yields contained even with unemployment at a euro-era record, the economy stagnant and its debt levels climbing.  
Spanish 10-year bond yields rose 2 basis points to 5.84 percent at 11:55 a.m. yesterday even after the Treasury beat its target by selling 4.86 billion euros ($6.32 billion) of debt at an auction. Spain is ready to ask for aid and will wait for European partners to work out the sequencing of a request and its consequences for Italy, the Financial Times reported yesterday, citing a senior economy ministry official.  
Spanish bonds have rallied since the ECB announced its willingness to unleash unlimited firepower to defend struggling sovereigns. The gains have encouraged Rajoy to avoid triggering the aid as demonstrators and regional leaders step up protests against budget cuts. More austerity would probably be required to access the deal with euro governments demanded by the ECB.  
In holding out, the Spanish leader is playing with fire, said Ebrahim Rahbari, an economist at Citigroup Inc. in London.  
“If there’s something inevitable and painful it’s very rare that it pays off in a rational way to defer,” Rahbari said in a telephone interview. “If I was his adviser I’d strongly, strongly suggest changing tack.”

**Rajoy and the PP, who contest regional elections in Galicia and the Basque country next Monday, may again seek to benefit from deferring or even dodging the stigma of a bailout**

Stalling has been a tactic Rajoy has used with limited success. His People’s Party lost the regional election in Andalucia in March even after he delayed announcing unpopular measures until after the vote. Bond yields rose through the spring as he deflected pressure to set up a so-called bad bank to clean up the financial system.  
His government’s first call for outside support for the financial system, contrasting with the routine denials that preceded it, came four days before a 100 billion-euro ($130 billion) bailout request on June 9 to prop up Spain’s banks.  
Rajoy and the PP, who contest regional elections in Galicia and the Basque country next Monday, may again seek to benefit from deferring or even dodging the stigma of a bailout.  
The prospect of a sovereign bailout bid from Spain is receding. Deputy Prime Minister Soraya Saenz de Santamaria said Oct. 5 the government had to be sure aid would “materialize” before asking for it, signaling doubts about German resistance.  
German Finance Minister Wolfgang Schaeuble said Sunday that Rajoy is “delivering” the reforms required and his country can’t subsidize the whole currency union.  
“It’s impossible for Germany to pay everybody’s bills,” Schaeuble said at a forum in Singapore. “Every member state has to fight the problems” it faces.  
Spain’s financial situation is deteriorating amid the bailout debate. Standard & Poor’s last week lowered its rating to BBB-, one step above junk. Moody’s Investors Service may become the first agency to strip the country of its investment grade when it announces the results of a review this month.  
“Spain should swallow its pride and ask for help now,” Pimco’s Gross said in an Oct. 11 post on Twitter. “He who hesitates is lost.”