Spain Plays High-Stakes Poker Game with Germany as Borrowing Costs Surge

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Spain has upped the ante in a high-stakes poker game with Germany, pushing for the release of EU stress test results for major banks in a move that risks precipitiating a dramatic escalation of Europe's financial crisis.

"We're not afraid of transparency," said the Spanish Banking Association (AEB), saying the full truth would put an end to rumours battering Spain's instutitions. El Pais reported that the government backs the initiative, putting it on a collision course with Germany which insists on secrecy.

Josef Ackermann, head of Deutsche Bank, warned last week that it would be "very dangerous" to publish the results of each bank, fearing that it would trigger flight from weak lenders and set off a chain reaction.

The Spanish authorities have little to lose by publishing the data given the near paralysis in the country's debt markets. Funding is frozen for much of the private sector.

Spain was pummeled yet again on Tuesday as credit default swaps (CDS) measuring bond risk on Spanish debt jumped to 245 basis points, approaching an all-time high.

Default insurance for Greece rocketed after Moody's downgraded it to junk on Monday, forcing bond indexes to sell up to €20bn of Greek debt. Ireland and Portugal also jumped sharply, with mounting credit stress in Belgium following the electoral triumph of Flemish separatists.

An auction of Spanish debt yesterday underlined how fast the situation is deteriorating. Yields on one-year debt reached 2.45pc compared to 0.9pc as recently as April, suggesting that the markets do not view the EU's €750bn rescue shield as credible.

Francisco Gonzalez, chairman of BBVA, stunned investors earlier this week by admitting that "the majority of the Spanish companies and financial groups are shut out of the international capital markets".

He said the country's external debt had reached €1.5 trillion or 147pc of GDP, much of it on short-term maturities. "This debt has become our most overwhelming problem, since €600bn falls due this year," he said.

Analysts say the call for release of the stress test results is a veiled attack on Germany, retaliation for German media reports – fed by sources in Berlin – claiming that Spain is about to tap the EU's bail-out fund.

Spain's two heavyweights, Santander and BBVA, are well capitalised, though there are concerns that Spain's accounting rules mask the full horror of bad debts in the property sector. The problem lies with savings banks or cajas that are not part of the EU test. These are being kept afloat by the European Central Bank, with loans equal to 20pc of their balance sheets.

By contrast, some German banks may look very ugly. An internal memo last year by the regulator BaFin feared that write-offs might reach €800bn. German banks have accumulated a double set of loses from both US subprime and the Club Med debt crisis. They have the lowest risk-adjusted capital ratios in the world after Japan and have not exploited the global rally to rebuild their base.

Jose Garcia Zarate, credit strategist at 4cast, said Madrid is powerless at this stage. "There is absolutely nothing the Spanish government can do to get their message through. They have lost all market credibility and nobody is listening to them any longer," he said.

Mr Garcia said the country is in a "Catch-22" situation. Madrid has slashed public wages by 5pc this year in a show of discipline, only to find that the markets have now moved the goal posts and fear austerity will choke recovery.

"My view is that it would be suicidal for Madrid to use the rescue fund. The moment they pick up the phone and start talking about this, it is the end of any remaining hope for the single currency. Spain's government just has to put on a brave face, pay the higher yields, and hope for the best," he said.

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