

Rajoy fights Spanish turmoil

European shares tumble Markets fret as political resolve seems to wane

By Miles Johnson in Madrid and
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Mariano Rajoy will today attempt to stave off a backlash from financial markets by announcing budget plans for next year, as the Spanish prime minister faces the most testing 48 hours of his nine-month-old tenure.

As protesters descended on Spain's parliament for a second night, Mr Rajoy called on Spaniards to ignore "short-term interests". His government is also preparing to unveil a new reform programme and the results of a banking stress test tomorrow.

The political turmoil in Spain triggered a sell-off of European shares, as investor concerns mounted about the eurozone's fourth-largest economy. Spain's Ibex share index, which had rallied over the summer, ended down 3.9 per cent and the FTSE Eurofirst 300 index dropped 1.7 per cent. The euro gave up its gains over the past two weeks, falling to \$1.28.

The financial pressures on Mr Rajoy's government have been intensified by a constitutional crisis brewing over the Catalonia region, which called snap elections this week that could hasten a move toward independence.

"Spain is increasingly slipping from his hands," said Alfredo Pérez Rubalcaba, the leader of the country's opposition socialist party. "There are very clear fractures in Spain, and the one I am most worried about is social fracture."

Catalonia, Spain's largest region by output but also its most indebted, has already been forced to request a €5bn bailout from the central govern-

ment. Artur Mas, the regional president of Catalonia, who this week discarded his Convergència i Unió party's longstanding moderate nationalism in favour of separation from Spain, said he could call a referendum on a split.

While a referendum must be approved by Madrid to be legally binding, Mr Mas said: "Firstly there is the intention to do it in accordance with the law, and if that can't be done we will do it all the same."

This month Mario Draghi, European Central Bank president, unveiled a bond-buying programme that would allow it to intervene massively in Spain's debt market. But Mr Rajoy has yet to give any firm signal that he is prepared to accept the main condition of ECB aid – an economic reform programme drawn up by EU authorities.

Stephane Deo, head of asset allocation at UBS, said the ECB's announcement had initially "triggered a rally which removed the pressure on the Spanish government". But he added that markets were "unlikely to give the benefit of doubt for long".

Investors were also concerned by a statement this week from the finance ministers of Germany, Holland and Finland, who said plans to move bad bank assets off government books would not apply to "legacy assets" – apparently dashingly Spain and Ireland's hopes of being freed of billions of euros of debt incurred in bailing out their banks.

With data this week showing Madrid's budget deficit reduction targets slipping further

away, the government has said it will create an independent fiscal authority and reduce red tape in highly regulated industries.

Tomorrow Luis de Guindos, finance minister, will reveal the outcome of an independent audit of the Spanish banking sector, which he has said is likely to show the country's lenders face a €60bn shortfall.

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Spanish equities

Ibex 35 index



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Spanish MP Sabino Cuadra in an altercation with a Basque police officer in Pamplona yesterday

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