Spain Downgraded On Debt Concerns

By DAVID ROMÁN

MADRID—Standard & Poor’s said Thursday it downgraded Spain’s sovereign credit rating by two notches, citing "a challenging fiscal outlook" amid worries on the ability of the country’s regions to curb spending.

The agency said its outlook is negative, reflecting risks to Spain’s economic growth and budgetary performance.

The move is the latest of a series of debt ratings downgrades for Spain, which entered the 2008 crisis with triple-A ratings like Germany, and has seen its credit score slip as the economy contracted.

A government spokeswoman declined to comment on the S&P downgrade. She said senior government officials are expected to comment after the government’s weekly cabinet meeting on Friday.

S&P last downgraded Spain’s credit rating in January, along with a number of downgrades of euro-zone countries.

The latest rating cut comes as Spain’s central government is intensifying efforts to curb spending by the country’s powerful regional governments, which manage key public services such as health-care and education. It also comes as European leaders are voicing concerns about the effect of drastic austerity measures amid a deep economic contraction and a lack of plans to foster growth and employment.

The euro fell against the dollar to $1.3192 from $1.3240 before the S&P release, with currency strategists saying the common currency could fall further on worries that other ratings firms will play catch-up.

Spain’s cabinet is set Friday to approve the fiscal report that European Union countries use to show they are serious about sticking to their debt and deficit rules.

Earlier on Thursday, Spanish Prime Minister Mariano Rajoy said the austerity policies implemented by the Spanish government form part of long-standing EU commitments to have a single currency.

"Austerity isn’t a policy of (German Chancellor) Angela Merkel," Mr. Rajoy said. "This is the policy of the European Union, the euro, a project which we all form part of."

S&P has often been the first rating company to react over the deteriorating credit profiles of countries during the past year. In August, the company stripped the U.S. of its AAA rating, downgrading it one notch to AA-plus. In January, it dropped France’s prized AAA rating by one notch in a swath of sovereign downgrades across the euro-zone.

The downgrade to BBB-plus from A moves Spain into new rating territory, with the credit scores from the other two major rating firms above that from S&P. Moody's Investors Service, which has an A3 rating, one notch above S&P, downgraded the country in February. Fitch Ratings rates Spain at A, two notches above S&P.

In a news release, S&P cited the worse-than-expected deterioration of Spain’s budget trajectory since last year, and a growing likelihood that the government will need to provide aid for the banking sector, hit by mounting real estate losses.
S&P said it expects Spain's economy to contract by 1.5% in 2012 and 0.5% for 2013. It previously forecast GDP growth of 0.3% for 2012 and 1% for 2013.

Because of higher-than-previously-expected deficit projections and other debt-increasing items, S&P sees net general government debt at 76.6% of GDP in 2014, against its prior estimate of 64.6% of GDP.

Robert Lynch, head of currency strategy for the Americas at HSBC Bank, said that while the timing of the downgrade was a surprise, he noted it comes after weeks of deterioration in Spanish bond prices amid worries about the country's fiscal outlook. The gap between the yield on Spanish 10-year debt and comparable German bonds has risen to more than 4 percentage points from around 3 percentage points in early February.

"It's certainly important when you talk about Spain's debt dynamics and the concerns that S&P voiced," says Mr. Lynch. "But it's not saying anything that many people in the market haven't already recognized." He report may include new details on Spain's government forecasts for coming years. The Commission will scrutinize it for any signs of wavering on the government’s commitment to lower its budget deficit to 5.3% of gross domestic product this year. If the commission wants changes, often the case with stability reports, it is expected to propose them in the coming weeks.

The so-called stability report details plans for tens of billions in spending cuts and tax increases the government hopes will enable it to achieve fiscal targets set by the European Commission, the EU executive body that polices fiscal discipline in the 27-nation bloc.

The European Commission the EU executive body that polices fiscal discipline in the 27-nation bloc. has given Spain until April 30 to submit a report on further budget cuts.

—Art Patnaude
and Tom Lauricella contributed to this article.

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