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Spanish Region Sells Bonds Locally-But at a High Price

By RAPHAEL MINDER

BARCELONA — In a sale closely monitored across Spain, the government of Catalonia successfully covered its short-term financing shortfall this week with an unusual domestic bond issue that was snapped up by locals.

Economists criticized Catalonia for offering especially generous terms, which could set a worrying precedent for other regions that decide to follow suit.

Catalonia has raised €2.5 billion, or $3.5 billion, in the sale of one-year bonds. The offer opened Oct. 22 and demand was so strong that the government on Wednesday increased the amount from an initial €1.89 billion.

The sale, which closes Nov. 12, comes at a time when all 17 regional governments have been struggling to meet their debt obligations, a task made even more difficult by the “negative” outlooks assigned by the major credit rating agencies.

Catalonia had not sold bonds solely to its citizens since the mid-1980s.

Antoni Castells, Catalonia’s finance minister, described the sale as “a big success,” whose focus on local investors should be welcomed because “it’s good to reduce our dependency on external debt.”

“I’m sure that this is opening a new way that will be used a lot in the future, as well as by others,” he said in an interview.

The bonds were sold at a 4.75 percent rate. In addition to that interest expense, the issuing banks will get about 3 percent in commissions, raising the overall cost for the Catalan government to about 7.75 percent, noted Jordi Galí, director of the Center for Research in International Economics at Pompeu Fabra University in Barcelona.

“One man’s ceiling is another man’s floor, so what makes the Catalan debt very attractive from the point of view of the investor makes it also very costly from a taxpayer’s perspective,” Mr Galí said. “This puts the total cost of Catalonia’s one-year debt well above that of Germany and Spain and close to the cost of longer-term financing for Greece — and that’s certainly a terrible deal for taxpayers."

The bond offering also came ahead of Catalan elections on Nov. 28, in which the Socialist-led coalition government is widely expected to lose power to a Catalan nationalist party, Convergència i Unió.

“The government was forced to act now, both because economically, default cannot be envisaged, and politically to show that it is managing the situation,” said Xavier Vives, an economics professor at the IESE Business School in Barcelona. “The price is high but the timing was difficult and there was probably no other option."

Indeed, Mr. Castells admitted that to sell bonds to his own citizens had not been his initial intention, but “the markets have been closed for all bonds issued from Spain since May, so we had to find other formulas.”

Meanwhile, he predicted that his government’s latest austerity measures would allow Catalonia to cut its deficit to 1.3 percent of gross domestic product next year from 2.4 percent in 2009.

Catalonia's direct and indirect debt rose 20 percent last year to €30.5 billion, Moody's wrote in a report last month. "Unless Catalonia takes drastic measures to reduce its cost base, persistent deficits will further deteriorate the region's already high debt metrics and retain rating pressure for some time," the agency warned.

The Catalan government used 23 financial institutions to sell its bonds. Mr Galí, the economist, said other Spanish regional governments and cities could be expected to follow Catalonia's example to finance transitory budget deficits. But he warned against mirroring Catalonia's marketing approach.

"Governments should seek the most cost-effective way to market their debt," he said. "Bribing banks and saving banks — your very own competitors for retail funding — to do it on your behalf doesn't seem particularly ingenious."

Mr. Castells strongly defended his government's handling of the sale, saying the banks had initially sought even better terms. "It's true that we are paying more for being the first" to issue such domestic debt, he said. "But we have good negotiators and managed to bring the fee down from 4 to 3 percent, which seems reasonable."