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# Bears will be back for Spanish equities

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## \* Spanish stock performance among weakest in euro zone

- \* Technicals suggest further downside for Spanish stocks
- \* Short sellers target weaker banks

By Alessandra Prentice and Simon Jessop

LONDON, March 22 (Reuters) - The recent recovery in Spanish share prices could well be a false dawn, with unpredictable government fiscal policy and the grim outlook for the debt-stricken banking sector likely to ensure the main index underperforms others in Europe this year.

With one of the largest budget deficits in the euro zone, Spain has been hammered by the region's long-running debt crisis and forced to slash spending as it sinks into recession. As a result, Spanish shares have come very late to a Europe-wide rally.

Despite a 4 percent rise last week, Spain's main index is down 0.9 percent in 2012 so far, underperforming an 11 percent rise for peripheral Europe peer Italy, and a 20 percent rally for Europe's top country index performer, the German DAX.

Spain's IBEX dropped 13 percent in 2011.

"The global picture isn't as bleak as it was four months ago, but in the case of Spain, investors are still very cautious," James Buckley, head of European Equities at Baring Asset Management, said.

"In Spain you still have bad loans from the housing bubble to work through, very high levels of unemployment and an economy which isn't really showing any signs of growth - that's a pretty toxic mixture," he said.

The outlook is no brighter from a technical standpoint, according to Valerie Gastaldy, general manager of Paris-based Technical analysis firm Day by Day, said.

"There was a bit of progress last week, but it's impossible to say it's not bearish still - as long as we are below 8,900 there is no signal that anything is improving," she said.

Market concern over the stability of Spanish finances deepened when Spanish Prime Minister Mariano Rajoy unilaterally set a looser deficit target earlier this month in defiance of the European Commission.

His actions thrust Spain to the forefront of the long-running debt crisis, overtaking Italy as the focus of bond markets. Spanish 10-year bonds were 7.2 basis points higher early Thursday, at 5.49 percent.

"There's a fairly new government and the progress they're making relative to Italy or even Portugal means that if there's slippage in one of these economies it's probably manifesting itself most in Spain," Buckley said.

Further highlighting market doubts of any sustained rally, April stock futures for the IBEX pointed to a fall to 8,412 versus Wednesday's close of 8,490, while options with a May expiry date were at 8,310.

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Banks, which account for 35 percent of the country's benchmark index, are a big drag.

With data showing Spanish banks' exposure to bad loans in January at its highest level since 1994, there promises to be little let-up in the strain on many Spanish lenders' finances and, as a result, their share price.

So short sellers, who bet on falling share prices by borrowing shares and then selling them in the hope of buying them back at a lower price, are out in force on Spanish banks, particularly since a ban on short-selling financial stocks in was lifted in February.

Figures from research firm Data Explorers show second-tier bank Banco Sabadell, which has heavy exposure to bad property loans, has 12.2 percent of its shares out on loan, a 2.5 percentage point rise from February. Sector peer Banco Popular Espanol, has 9.3 percent of its shares out on loan comp a red with 7.9 percent in the previous month.

"Short-sellers have been quite good at identifying individual stocks and even sectors that will underperform, so these positions are a good indicator of market sentiment," David Carruthers, Data Explorers Segment Director, said.

On a price-earnings basis, the country's blue-chip index is at 10.6 times forward 12-month earnings versus 11.4 times for Italy's FTSE MIB. The Euro STOXX 50, meanwhile, is at 11.1 times. That relative cheapness indicates expectations earnings could deteriorate further.

Meanwhile, share prices if share prices of 113 Spanish stocks covered by Thomson Reuters StarMine data imply an expected fall in their collective compounded annual earnings per share growth rate of 6.8 percent a year for five years - by far the worst of all the developed European bourses, with the exception of Greece.

(Editing by Andrew Callus)

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