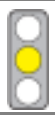
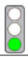
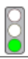
Centrum für
Europäische Politik

cep**Study**

cepDefault-Index 2014

Creditworthiness Trends in Problem Countries in the Eurozone:

Country	cepDefault-Index	Creditworthiness Trends
Belgium	– 0.5	
Finland	– 0.1	
France	1.7	
Greece	– 9.8	
Ireland	6.7	
Italy	– 1.1	
Portugal	– 2.0	
Spain	2.3	

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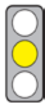
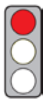
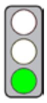
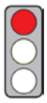
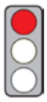
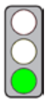
Key Issues

- The successful conclusion of the Irish and Spanish adjustment programmes must not blind us to the fact that the problems which led to the euro crisis still exist and have even spread to other countries.
- Creditworthiness in **Belgium** and **Finland** fell for the first time in the first half of 2013. In net terms, both countries still have foreign assets so their debt sustainability is not yet under direct threat. 
- The outlook for **France's** creditworthiness remains uncertain; there is no sign yet of a clear upward trend. Due to its importance in the eurozone and in view of the continuing creditworthiness problems in Italy, Portugal and Greece, as well as more recently in Belgium and Finland, it is imperative that the French government take consolidation and reform measures to boost the country's competitiveness and with that its creditworthiness. 
- **Greece** is still the eurozone's problem child. The country's creditworthiness is falling further and considerably faster than in any other euro country. There is no sign of Greece regaining its creditworthiness. 
- **Ireland** has overcome the crisis as shown by the continual increase in creditworthiness since 2010. The task now must be to significantly increase investment which has fallen to almost nil. 
- The erosion of creditworthiness, observed in **Italy** since 2009, continues. The decline has accelerated compared with 2012. It is doubtful whether this will change in the foreseeable future because the necessary reforms and consolidation measures have not yet been undertaken by the Italian government. 
- Although Portuguese creditworthiness is still being eroded, the uninterrupted rise of the cepDefault-Index since 2011 shows that **Portugal** has made considerable efforts and handled the adjustments. Despite these positive developments, however, it is doubtful whether Portugal will manage without further financial assistance when the adjustment programme expires in mid-2014. 
- **Spain's** creditworthiness is increasing for the first time since the introduction of the euro. However, this positive trend must not blind us to the fact that the country still has to implement further consolidation and reform measures in order to reduce both government debt, which rose dramatically during the crisis years, and the high level of unemployment. 

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1 Introduction

At first glance, the turmoil in the eurozone seems to have abated in recent months. Government bond yields in the periphery states have fallen, without exception. Spain and Ireland were able to conclude the adjustment programmes and have now successfully returned to the bond market. As the current cepDefault-Index shows, both countries in fact increased their creditworthiness last year. This trend only became apparent in Spain in 2013 but has existed in Ireland since 2010. Portugal is also on the right track and has slowed down the decline in creditworthiness significantly, although not completely, which casts some doubt on the planned return to the bond market in summer 2014.

However, this positive news must not blind us to the fact that, not only do the problems which led to the euro crisis still exist, they have also spread to other countries. Greece's creditworthiness is still in free fall. The erosion of Italy's creditworthiness, apparent since 2009, even gained momentum in the first half of 2013. And the situation in France is still cause for concern. The fact that these three countries are, to a greater or lesser extent, facing major problems was already apparent from the cepDefault-Index 2011. The latest figures show that more countries have been caught up in the downward spiral of eroding creditworthiness, namely Belgium and Finland. Thus northern European countries are now also afflicted.

For this reason, the efforts by the affected countries to bring about reform and consolidation must not be allowed to slacken off. Measures passed at EU level, at the height of the euro crisis - particularly the reform of the Stability and Growth Pact, the ex-ante assessment of national draft budgets by the Commission, the Fiscal Compact and macroeconomic surveillance - may, if consistently applied, have a supportive effect by convincing national populations of the necessity for reform; measures brought in without the backing, or even against the will, of the public will not succeed in solving the structural problems of an economy.

Following a description of the methodology behind the cepDefault-Index in the next chapter, we will look at creditworthiness trends in the problem countries. These include

- euro countries who are currently receiving financial assistance or have received it in the past: Greece, Ireland, Portugal and Spain[1],
- other euro countries showing falling creditworthiness: Belgium, Finland and Italy,
- France.

The cepDefault-Index trends for the remaining euro countries, the eurozone as a whole, the other EU Member States as well as other selected countries – Iceland, Japan, Norway, Switzerland, South Korea and the USA – are set out in an Annex[2].

No reliable figures are available for Croatia, Luxembourg, Malta and Cyprus so the Index for these countries could not be determined.

[1] There is no reliable data available for Cyprus.
[2] Only available on-line; cf. cepDefault-Index 2014 Annex, www.cep.eu.

2 Methodology of the cepDefault-Index[3]

The cepDefault-Index measures the trends in a country’s ability to repay foreign credits, in other words, its creditworthiness.[4] This does not depend solely on the country's indebtedness but rather on the stability of the entire economy. The competitiveness of companies on world markets has particular influence on a country's creditworthiness. The erosion of competitiveness invariably leads to higher imports and lower exports and thus to a current account deficit[5], the flip side of which is an increase in the foreign debt[6] of private economic operators. In addition to government budgets, the cepDefault-Index therefore also takes account of the credit behaviour of banks, companies and consumers and thus measures the creditworthiness trends for the country as a whole.

The Index assesses (1) the net lending or net borrowing of the total economy (NTE), reflecting the demand for foreign credit in an economy, and (2) the resources used to increase the physical capital stock, i.e. capacity enhancing capital formation (CECF), for a given period.

Net borrowing (negative NTE) arises, on the one hand, due to current account deficits - resulting from a lack of competitiveness - financed by foreign capital. On the other hand, it may also occur due to cross-border payments from income and current transfers, namely where more foreign capital is being or has been invested in a country than the inhabitants of that country are investing or have invested abroad. This type of net transfer abroad results in negative NTE unless it is compensated by current account surpluses which also require the country to be sufficiently competitive.

Capacity enhancing capital formation includes the net values for fixed capital formation by companies and the public sector. Housing construction is not included as it does not result in an expansion of production potential. The fact that house construction is left out of the cepDefault-Index has the welcome side-effect that the creditworthiness trends of an economy can be measured without any distortion of the result arising from housing market bubbles.

The Index is formed from the sum of NTE and CECF; both values are indicated as a percentage of the gross domestic product (GDP):

$$\textit{cepDefault-Index} = \textit{NTE} + \textit{CECF}$$

For easier interpretation of the index results, the economies surveyed are divided into four risk categories.

Risk Category 1 (green light): A positive value in the cepDefault-Index combined with overall net lending means that the country does not require any foreign credit during the relevant period because capacity enhancing capital formation and consumption are financed by domestic savings. Its creditworthiness is therefore increasing.

Countries with current account deficits need foreign capital in order to finance such deficits. They therefore register net borrowing. For medium-term creditworthiness, the important thing is whether foreign capital is used to finance capacity enhancing capital formation, with the effect that

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[3] For a detailed explanation see Gerken/Kullas (2011), cepDefault-Index, Chapter 3.
[4] It therefore is a measure of flow rather than of stock.
[5] Where there are flexible exchange rates, an adjustment is made over time which results in the balancing of the current account. However, in a currency union, such adjustment is not possible,
[6] Or the depletion of private assets.

the value created generates the means to repay the foreign credit, or whether [7] it is used to finance consumer goods which are wiped out by consumption.

Risk Category 2 (amber light): A positive value in the cepDefault-Index despite overall net borrowing indicates that capacity enhancing capital formation in a given year exceeds net borrowings. In this case, it is not possible to state generally whether or not the creditworthiness of the economy is being eroded because, although the volume of capacity enhancing capital formation can be calculated from the official statistics, it is not possible to determine what proportion of the investment volume is financed by domestic income and what proportion from borrowing. This is important because foreign credits that are used for capacity enhancing capital formation, create real value with which interest and credits can be repaid, given a reasonable rate of return on investment. This sort of qualified net borrowing may even indicate that a country is highly attractive as a business location because foreign investors see profitable investments and seek to make use of them. On the other hand, foreign credits used for consumption expenditure, do not create any value that might contribute to the repayment of interest and credit. In this case, domestic resources must be used to repay the external credit. This sort of qualified net borrowing arises in particular where the economy is losing, or has already lost, its competitiveness on world markets.

In order to avoid ultimately unreliable estimates, the cepDefault-Index assumes a best-case scenario in favour of the surveyed economy. The calculation is based on the assumption that domestic investment is primarily funded from borrowings, while domestic income is primarily used for consumption expenditure. In other words, the assumption is that foreign credits maximise output which facilitates their repayment.

This leads to a systematic distortion: the Index makes the country look healthier than it actually is because it assumes that, for the maximum possible level of repayment of interest and capital, new production capacities will arise which are attributable to the foreign credit and whose additional output will facilitate the repayment of the foreign credit. In reality, this is obviously not the case.

Risk Category 3 (red-amber light): A negative value in the cepDefault-Index may arise in two ways. Firstly, net borrowings exceed capacity enhancing capital formation. Thus, in mathematical terms, in addition to consuming 100% of its domestic income, the country concerned also consumes part of its net borrowings. Hence, the national economy incurs foreign debt in order to finance consumption. Such a trend threatens creditworthiness. Secondly, and even more problematic, capital flows out of the country to give a positive figure for net lending or borrowing of the total economy (NTE). At the same time, however, capital stock dwindles - expressed by a negative CECF-value - and so much so that it exceeds the value for NTE. In this case, the country is also consuming more than it earns; all else being equal, the lending is a result of falling investment. The country becomes impoverished.

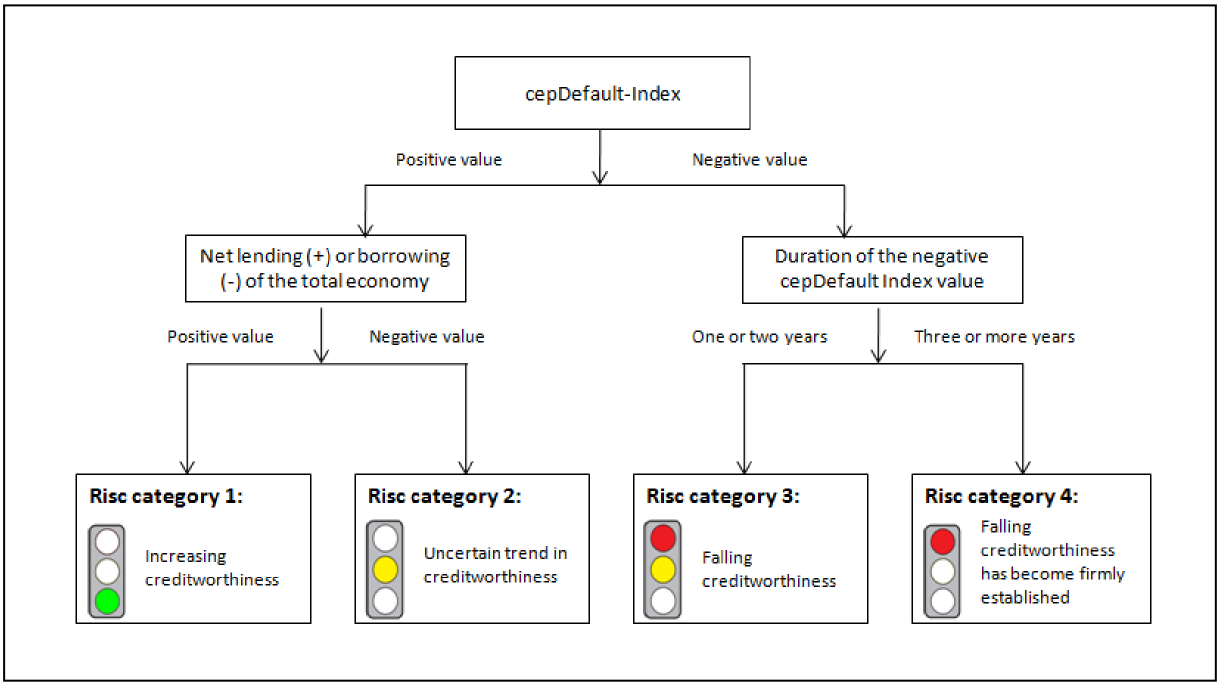
These correlations reveal an important feature of the cepDefault-Index: it distinguishes between whether a problem country reduces its demand for foreign credit by reducing consumption or by reducing capacity enhancing capital formation. Only the former approach to reform is sustainable and therefore reflected in the Index. A drop in net borrowing at the cost of capacity enhancing capital formation, however, does not affect the Index value. In order for the Index value to improve, a drop in net borrowing must be accompanied by the avoidance of consumption rather than of

[7] Here, and in the rest of the report, consumption refers to all expenditure which does not constitute capacity enhancing capital formation. Consumption in this sense therefore also includes, in particular, private housing construction.

investment because the latter results in a decline in the economy's production potential which hinders debt sustainability. Unfortunately, as the cepDefault-Index shows, this trend is can be observed in numerous euro countries.

Risk Category 4 (red light): A negative value on the cepDefault-Index for three years or more means that the erosion of creditworthiness is not a temporary problem but a structural one; the risk of a complete loss of creditworthiness has intensified or, in fact, taken place (Risk Category 4).

The Structure of the cepDefault-Index:



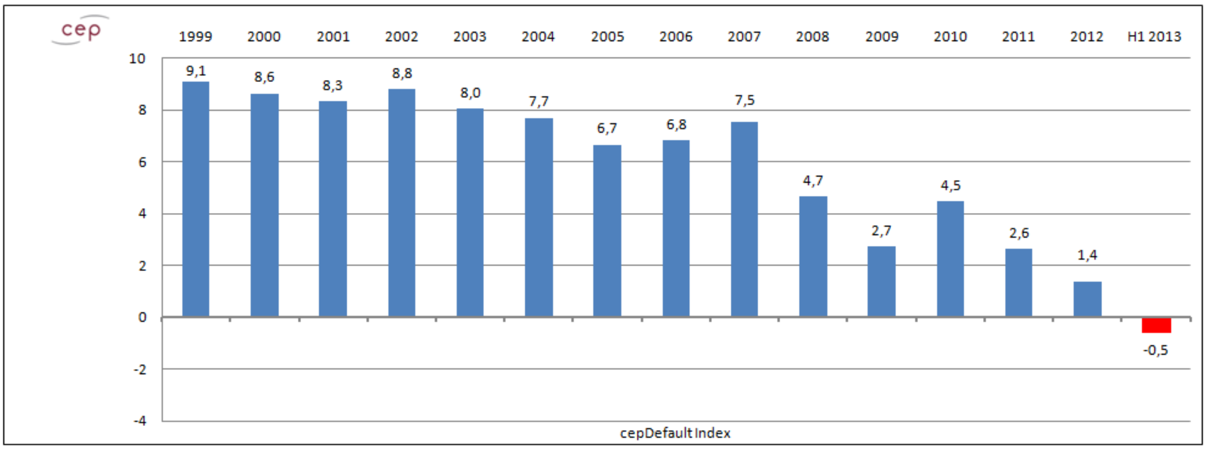
Risks to a country's fiscal policy resulting from property and banking sector bubbles are deliberately only taken into account by the cepDefault-Index insofar as they lead to demand for foreign credit, or to negative net investment, because this sort of bubble can only damage an economy's international creditworthiness in such cases.

The cepDefault-Index also deliberately leaves out the origin of the foreign credit. This is sensible because financial assistance – from the ESM, EFSF, EFSM, IWF and individual Euro countries - in fact simply replaces private foreign creditors with public foreign creditors without directly affecting the foreign credit demand. This approach is the only way to provide an unrestricted picture of the structural situation of the economy.

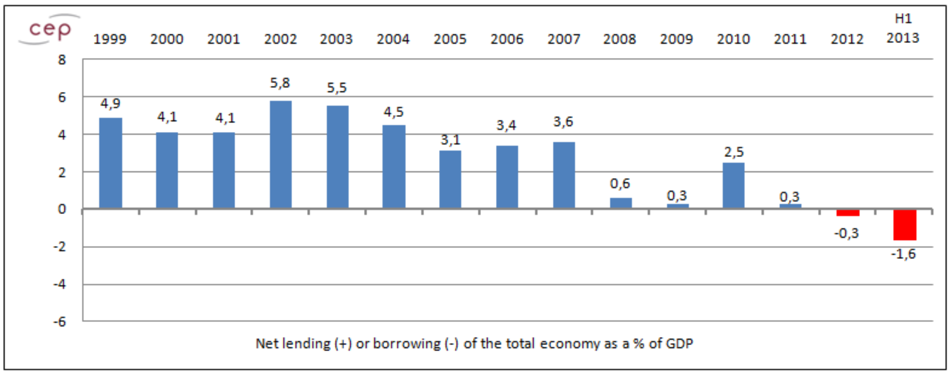
3 Belgium[8]

Trend according to the cepDefault-Index: In the first half of 2013, Belgium's creditworthiness fell for the first time since the introduction of the euro. A trend in that direction has been apparent since as early as 2008 when the index value dropped considerably. It also fell in the ensuing years with one exception. In 2012, the trend was unclear. In the first half of 2013, creditworthiness fell.

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	H1 2013
NTE	4,9	4,1	4,1	5,8	5,5	4,5	3,1	3,4	3,6	0,6	0,3	2,5	0,3	-0,3	-1,6
CECF	4,2	4,5	4,2	3,0	2,5	3,2	3,6	3,4	3,9	4,1	2,4	2,0	2,3	1,7	1,1
cepDefault Index	**9,1**	**8,6**	**8,3**	**8,8**	**8,0**	**7,7**	**6,7**	**6,8**	**7,5**	**4,7**	**2,7**	**4,5**	**2,6**	**1,4**	**-0,5**
Risc category	1	1	1	1	1	1	1	1	1	1	1	1	1	2	3

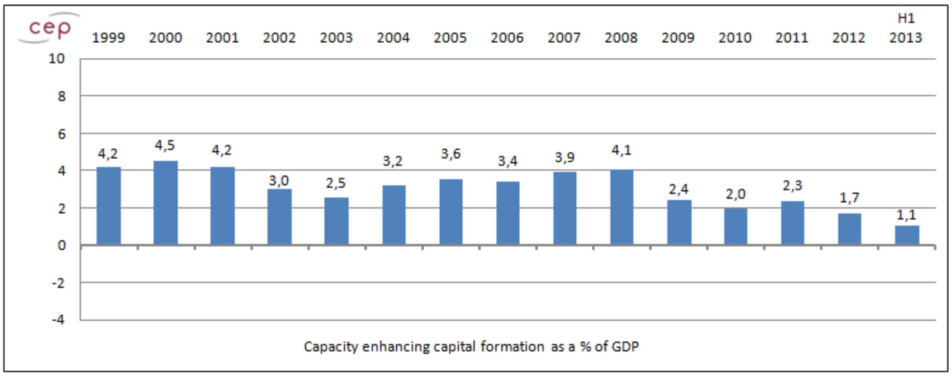


Net lending or net borrowing of the total economy (NTE): In 2012, Belgium became a net borrower for the first time since the introduction of the euro. Borrowing increased again in the first half of 2013. This is all the more remarkable because capacity enhancing capital formation fell in the same period which had a dampening effect on the demand for capital.

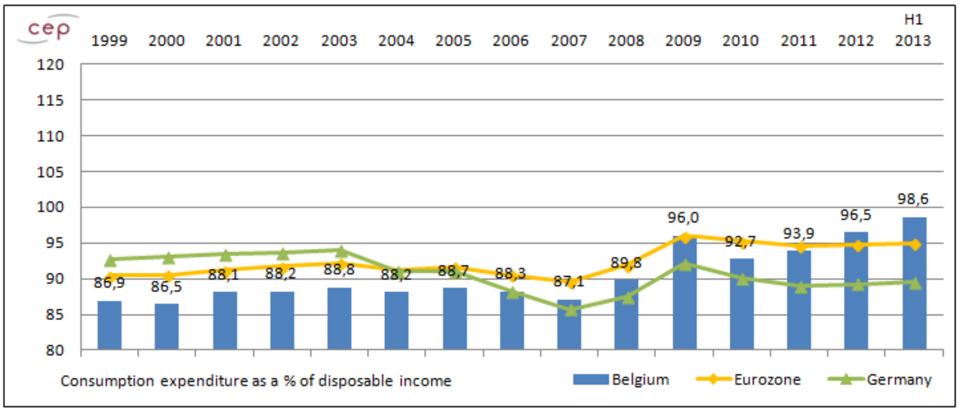


[8] The values for fixed capital formation in housing, which are required in order to calculate capacity enhancing capital formation (C), have been estimated for the first half of 2013 on the basis of an annual prognosis by the Commission.

Capacity enhancing capital formation (CECF): Capacity enhancing capital formation dropped in 2009 by 1.7 percentage points to 2.4% of GDP. Since then it has halved again to 1.1% of GDP. It therefore lies below the eurozone average of 1.3%. Without the drop in capacity enhancing capital formation, borrowings - with the given level of consumption - would have been even greater.



Consumption rate: The negative trend in Belgian creditworthiness is due to an excessive propensity to consume. Since the introduction of the euro, the consumption rate - measured as a percentage of the disposable income - has risen by 11.7 percentage points from 86.9% to 98.6%. Since 2012, it has therefore been considerably above the eurozone average of 94.9%. In order for Belgian creditworthiness to go back up, the propensity to consume must fall. This would result in more domestic funds being available for investment leading to a fall in the demand for foreign credit.

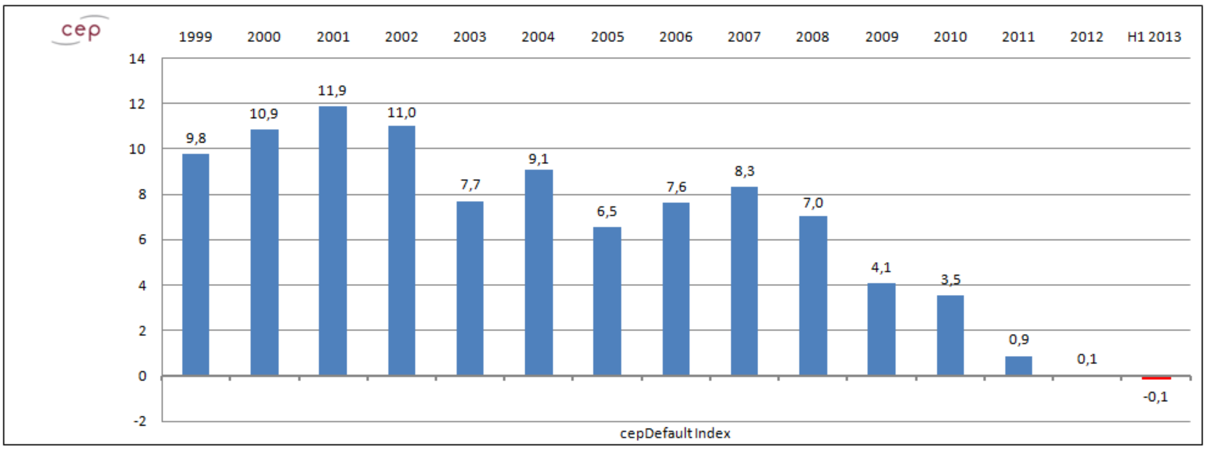


Conclusion: Belgium's creditworthiness fell in the first half of 2013. Since we are seeing this trend for the first time and, in net terms, Belgium still has foreign assets amounting to 46% of GDP, Belgium's debt sustainability is not under immediate threat. The development in other states clearly shows, however, that such a trend becomes problematic if it continues over a longer period.

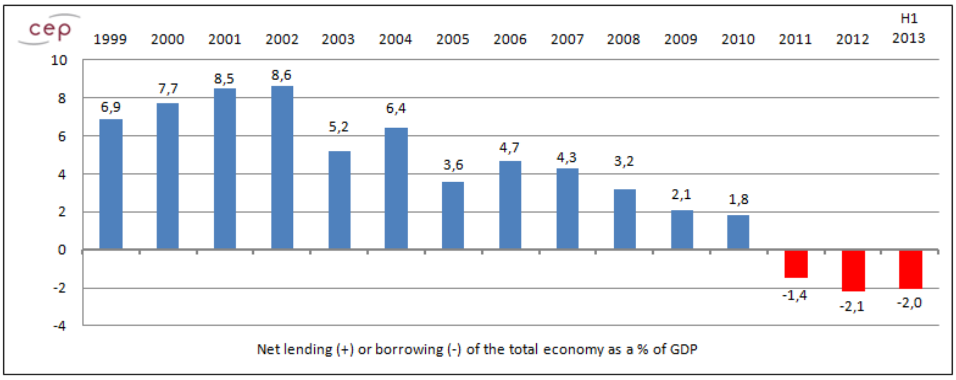
4 Finland

Trend according to the cepDefault-Index: In the first half of 2013, Finland's creditworthiness fell for the first time since the introduction of the euro. This trend is not surprising. The Index value has fallen every year since 2008 with particularly large drops in 2009 and 2011 when the Index value fell by 2.9 and 2.6 points respectively.

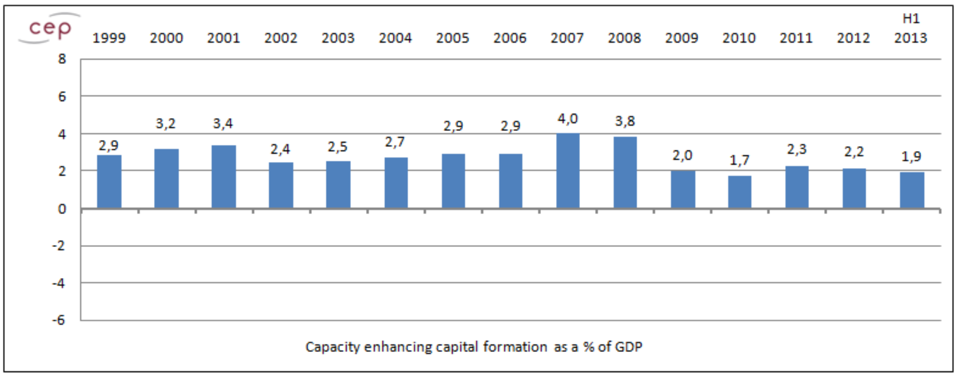
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	H1 2013
NTE	6,9	7,7	8,5	8,6	5,2	6,4	3,6	4,7	4,3	3,2	2,1	1,8	-1,4	-2,1	-2,0
CECF	2,9	3,2	3,4	2,4	2,5	2,7	2,9	2,9	4,0	3,8	2,0	1,7	2,3	2,2	1,9
cepDefault Index	**9,8**	**10,9**	**11,9**	**11,0**	**7,7**	**9,1**	**6,5**	**7,6**	**8,3**	**7,0**	**4,1**	**3,5**	**0,9**	**0,1**	**-0,1**
Risc category	1	1	1	1	1	1	1	1	1	1	1	1	2	2	3



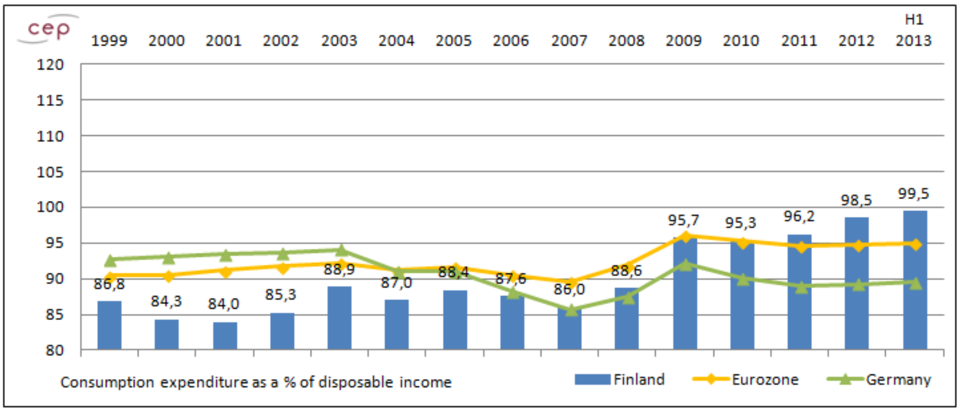
Net lending or borrowing of the total economy (NTE): Finland has been a net borrower since 2011. In 2011 and 2012, borrowings were still accompanied by capacity enhancing capital formation whose return could be used to service the debt. This changed in the first half of 2013 because a proportion of the borrowings was used for consumption.



Capacity enhancing capital formation (CECF): Capacity enhancing capital formation fell slightly in the first half of 2013 by 0.3 percentage points to 1.9% of GDP. However, it is still above the eurozone average of 1.3% of GDP.



Consumption rate: The negative trend in the Finish Default-Index manifests itself in the consumption rate. Since introduction of the euro, it has risen by 12.7 percentage points to 99.5% of the disposable income. It is therefore appreciably higher than the eurozone average of 94.9%. In order for Finish creditworthiness to go back up, the propensity to consume must fall.

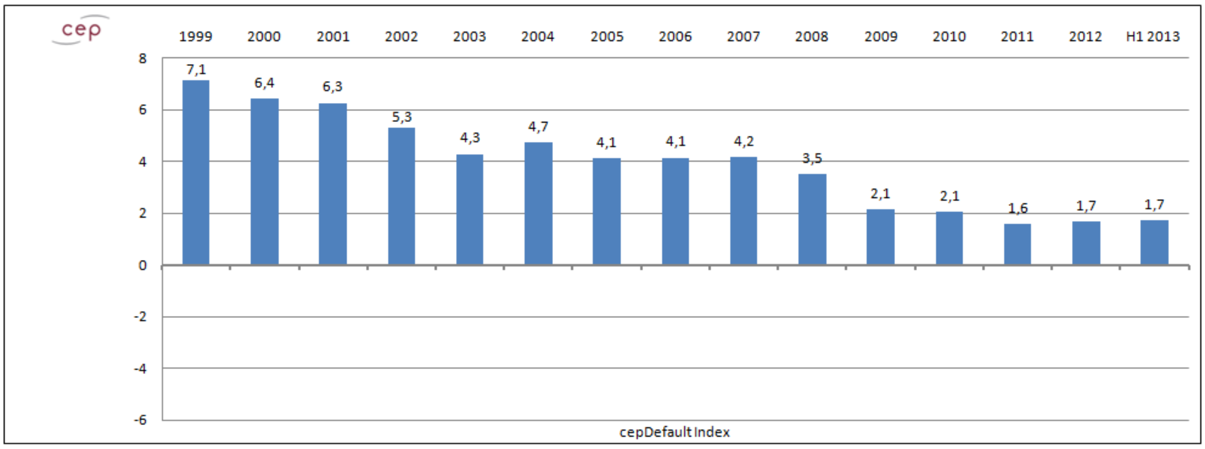


Conclusion: In the first half of 2013, Finish creditworthiness fell for the first time - if only slightly. This fall is not problematic per se because, in net terms, Finland still has foreign assets of 18% of its GDP. Nevertheless, for some time now, the cepDefault-Index for Finland has recorded a downward trend which must be halted and reversed as a matter of urgency.

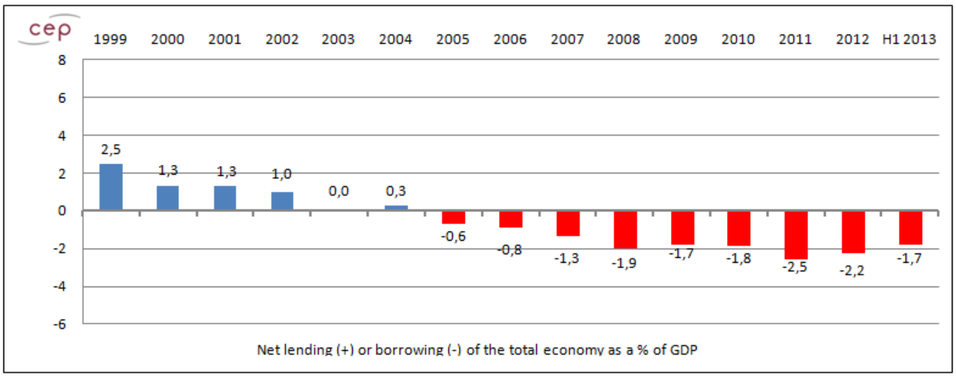
5 France

Trend according to the cepDefault-Index: The trend in France's creditworthiness was unclear in the first half of 2013. The Index value hardly changed compared with 2011 and 2012. The decline in the Index value which began with the introduction of the euro, seems to have been halted for the time being but there is no indication of an upwards trend.

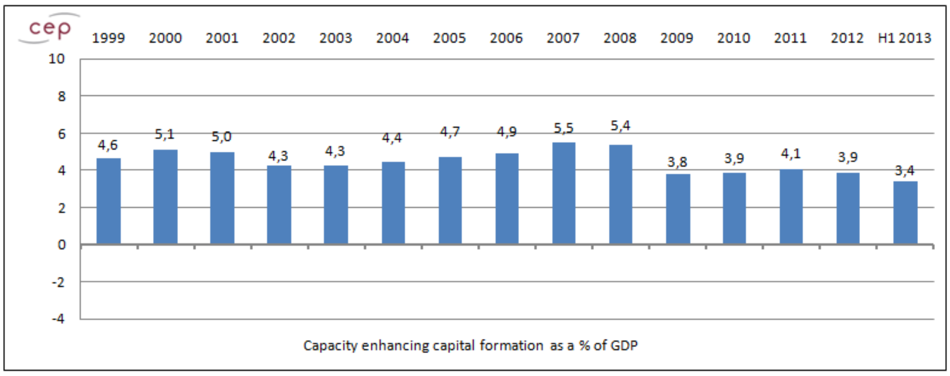
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	H1 2013
NTE	2,5	1,3	1,3	1,0	0,0	0,3	-0,6	-0,8	-1,3	-1,9	-1,7	-1,8	-2,5	-2,2	-1,7
CECF	4,6	5,1	5,0	4,3	4,3	4,4	4,7	4,9	5,5	5,4	3,8	3,9	4,1	3,9	3,4
cepDefault Index	**7,1**	**6,4**	**6,3**	**5,3**	**4,3**	**4,7**	**4,1**	**4,1**	**4,2**	**3,5**	**2,1**	**2,1**	**1,6**	**1,7**	**1,7**
Risc category	1	1	1	1	1	1	2	2	2	2	2	2	2	2	2



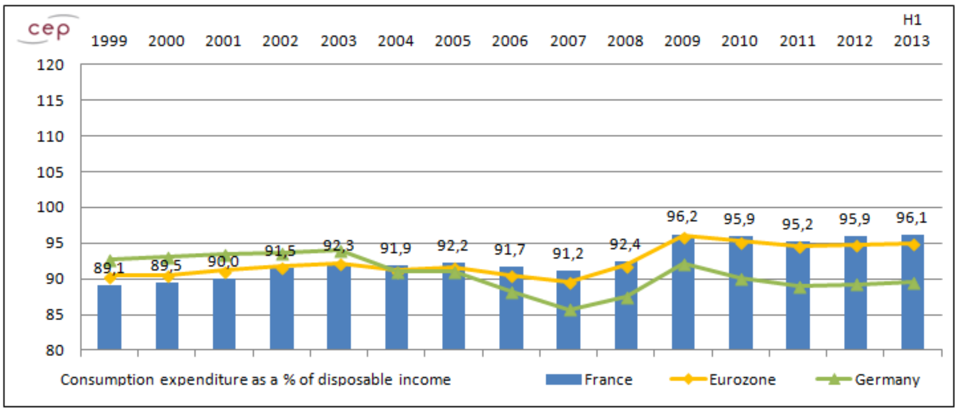
Net lending or borrowing of the total economy (NTE): Since 2005, France has shown net -borrowing. In the first half of 2013, the demand for foreign credit dropped by 0.5 percentage points to 1.7% of GDP. However, this is not the result of a drop in French consumption but is solely due to a fall in capacity enhancing capital formation. Since this does not improve creditworthiness, the value in the cepDefault-Index has not changed.



Capacity enhancing capital formation (CECF): Capacity enhancing capital formation fell further in the first half of 2013. At 3.4% of GDP, however, France is still investing considerably more than the 1.3% average for the euro countries.



Consumption rate: Since the introduction of the euro, the French consumption rate - measured as a percentage of the disposable income - has risen by 7 percentage points. Since 2012, it has therefore been considerably above the eurozone average of 94.9%. After falling slightly in 2010 and 2011, it has been climbing since 2012.



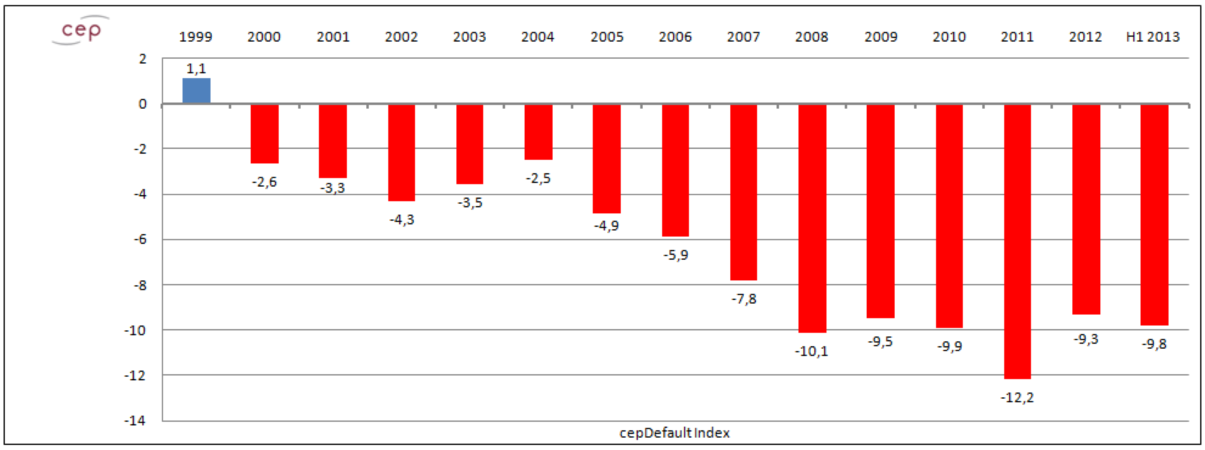
Conclusion: The trend in France's creditworthiness is still unclear. The long-term negative trend in the cepDefault-Index clearly shows that this is the result of falling competitiveness in the French economy. Nevertheless, the Index value has stabilised since 2011 although a clear reversal of the downward trend in creditworthiness is not yet apparent. Due to the economic and political importance of France for the eurozone and in view of the continuing creditworthiness problems in Italy and Greece, as well as more recently in Belgium and Finland, it is imperative that the French government undertake extensive consolidation and reform measures to enable the country's competitiveness and thus its creditworthiness to come back up. The New Year's speech by the French President, François Hollande, in January 2014, shows that France has at least recognised this need.[9]

[9] Börsenzeitung dated 15 January 2014, p. 1.

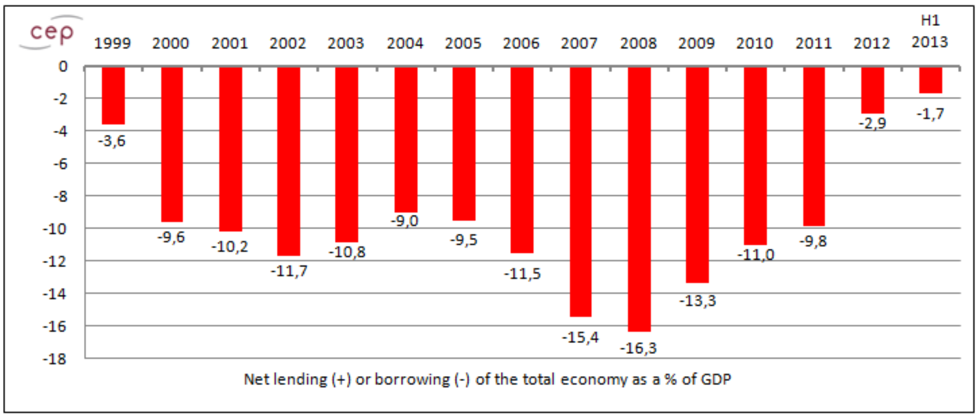
6 Greece[10]

Trend according to the cepDefault-Index: Greece's creditworthiness has been eroding since 2000. This trend continued in the first half of 2013. By comparison with 2012, the Index value worsened by 0.5 points from -9.3 to -9.8, i.e. to a value similar to that existing at the beginning of the crisis. The 2012 consolidation has not therefore continued. While all the other countries that have received or are still receiving financial assistance have been able to improve their Index values considerably, this trend does not apply to Greece. Greece is still a long way from regaining its creditworthiness.

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	H1 2013
NTE	-3,6	-9,6	-10,2	-11,7	-10,8	-9,0	-9,5	-11,5	-15,4	-16,3	-13,3	-11,0	-9,8	-2,9	-1,7
CECF	4,7	7,0	6,9	7,4	7,3	6,5	4,6	5,6	7,6	6,2	3,8	1,1	-2,4	-6,4	-8,1
cepDefault Index	**1,1**	**-2,6**	**-3,3**	**-4,3**	**-3,5**	**-2,5**	**-4,9**	**-5,9**	**-7,8**	**-10,1**	**-9,5**	**-9,9**	**-12,2**	**-9,3**	**-9,8**
Risc category	2	3	3	4	4	4	4	4	4	4	4	4	4	4	4

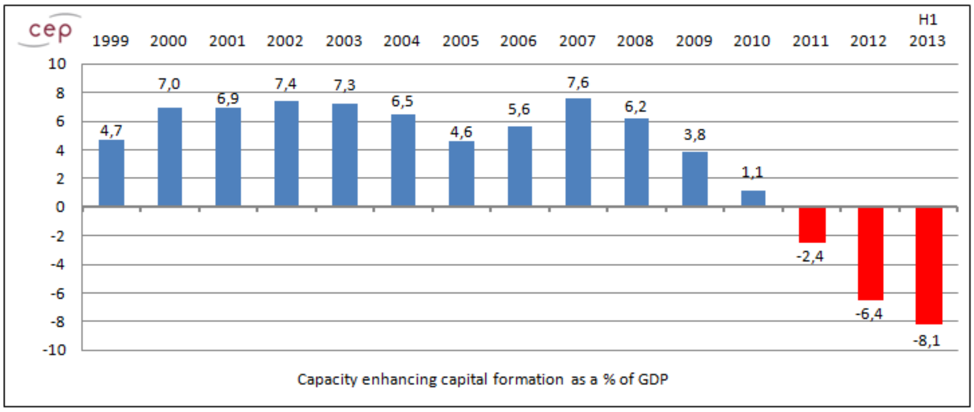


Net lending or borrowing of the total economy (NTE): Although Greece's net borrowings have fallen continuously since 2009, this has had hardly any effect on the cepDefault-Index value because this trend is not the result of a reduction in Greek consumption but is due to a fall in capacity enhancing capital formation.

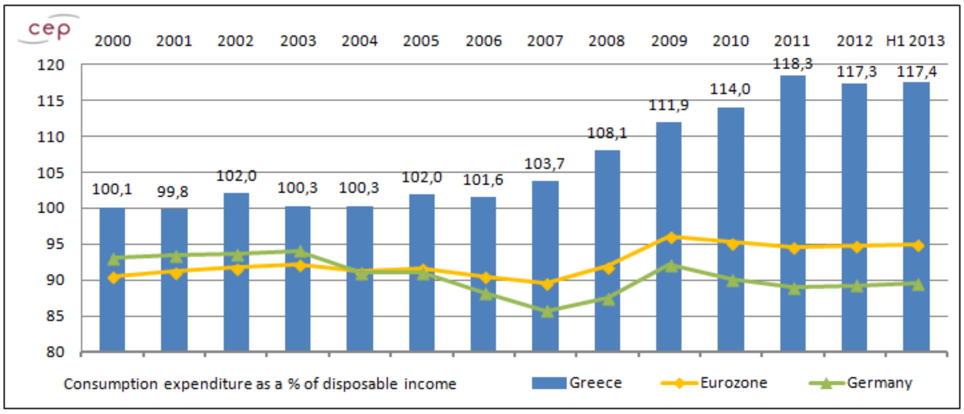


[10] The data for calculating the 1999 Index was taken from the European Commission's database, Ameco. The other data was taken from the Eurostat database. The data for the first half of 2013 is based on the quarterly data for the period Q3/2012 to Q2/2013, which has not been seasonally adjusted.

Capacity enhancing capital formation (CECF): Greece recorded a negative investment quota for the first time in 2011. Since then, this problematic trend has not only continued but has even gained momentum. The result of negative investment is diminishing capital stock. This reduces Greece's ability to extricate itself from the crisis by way of economic growth. In the eurozone, apart from Greece, only Italy and Portugal have recorded diminishing capital stock - but at much lower levels.



Consumption rate: The Greek consumption rate - measured as a percentage of disposable income - is the highest, not only in the eurozone but in the whole European Union. It has been above 100% without exception since 2002 and it even went up slightly in the first half of 2013 as compared with 2012. For Greece to be able to regain its creditworthiness the consumption rate must fall drastically. There is no sign of that happening.

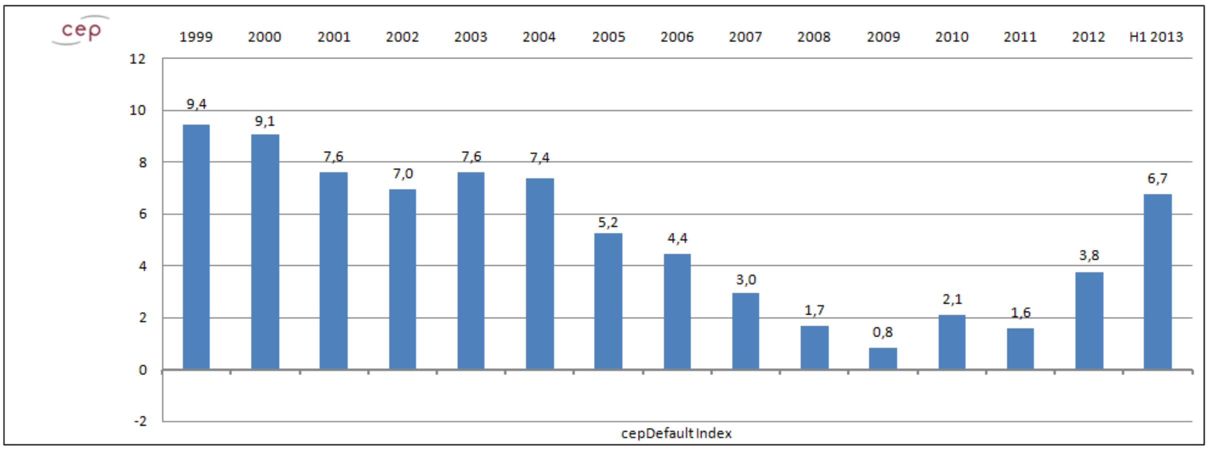


Conclusion: Greece is still the eurozone's problem child. The Index value of -9.8 remains by far the worst value of all the countries surveyed. The country's creditworthiness is thus falling further and considerably faster than in the other countries. The recovery of Greek creditworthiness is not anticipated. Instead, the country is likely to remain dependent on the help of other countries for the foreseeable future.

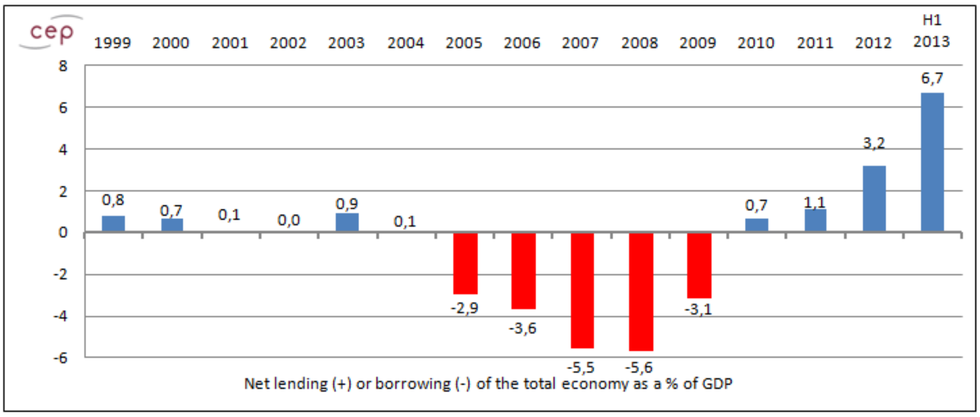
7 Ireland[11]

Trend according to the cepDefault-Index: Irish creditworthiness has now been increasing continuously for three and a half years. This trend clearly gained further momentum in the first half of 2013. The Index value of 6.7 is the highest achieved by the country since the beginning of the Irish crisis in 2007. Against this background, the successful return to the bond market, seen in recent months, comes as no surprise.

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	H1 2013
NTE	0,8	0,7	0,1	0,0	0,9	0,1	-2,9	-3,6	-5,5	-5,6	-3,1	0,7	1,1	3,2	6,7
CECF	8,6	8,4	7,5	7,0	6,7	7,3	8,1	8,0	8,5	7,3	3,9	1,4	0,5	0,6	0,0
cepDefault Index	**9,4**	**9,1**	**7,6**	**7,0**	**7,6**	**7,4**	**5,2**	**4,4**	**3,0**	**1,7**	**0,8**	**2,1**	**1,6**	**3,8**	**6,7**
Risc category	1	1	1	1	1	1	2	2	2	2	2	1	1	1	1

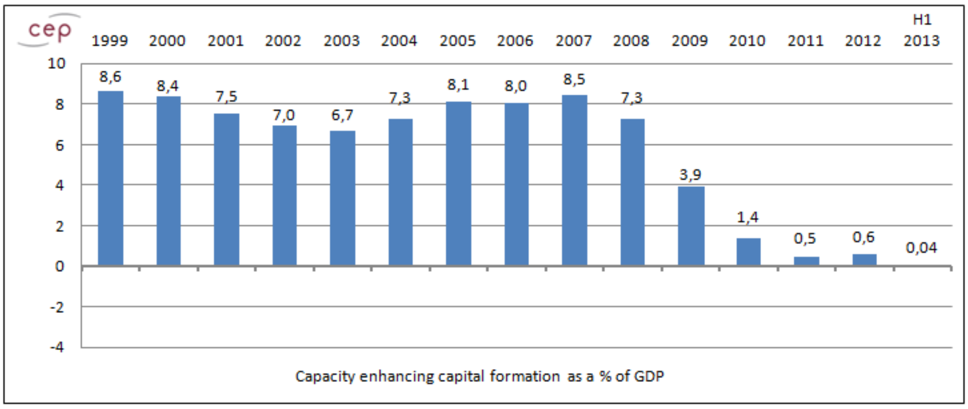


Net lending or borrowing of the total economy (NTE): Ireland has been recording capital export surpluses since as early as 2010. These saw further significant increases in the first half of 2013. On the one hand, this trend is the result of less investment by the Irish economy. On the other, it is due to a lower propensity to consume. The lending will enable the country to reduce its high level of foreign debt, amounting in net terms to 112% of Irish GDP. Apart from Portugal with 155% and Greece with 109%, no other euro country is pressured by such high levels of foreign debt.

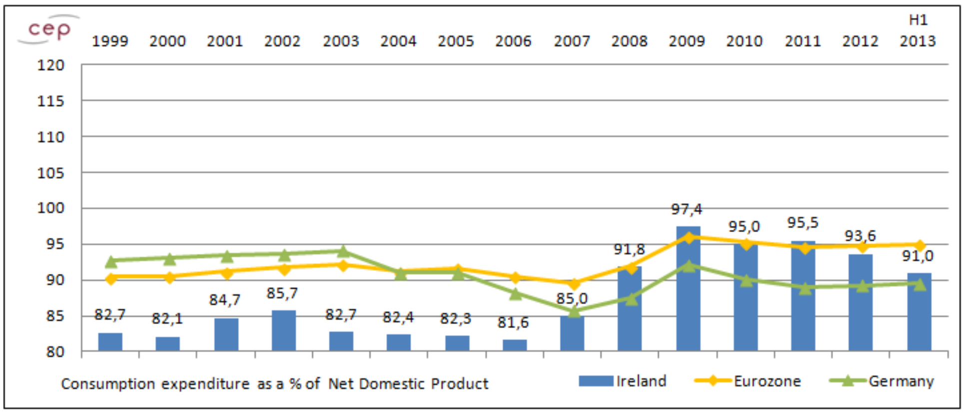


[11] The values for fixed capital formation in housing, which are required in order to calculate capacity enhancing capital formation (CECF), have been estimated for the first half of 2013, on the basis of an annual prognosis by the Commission.

Capacity enhancing capital formation (CECF): Capacity enhancing capital formation dropped significantly when the Irish crisis erupted. The downward trend is still continuing. Capacity enhancing capital formation fell in the first half of 2013 to almost zero percent of GDP (precise figure: 0.04%). If this trend continues, the Irish economy's potential for growth will suffer thereby obstructing improvement in the country's prosperity. This will then have an effect on the country's creditworthiness if the public does not adjust its demand for consumption accordingly.



Consumption rate: The improvement in the Irish Index value results, in particular, from the Irish economy's reduced propensity to consume. Measured as a percentage of the disposable income, it has now fallen by 6.4% to 91% since its peak in 2009. It therefore lies below the eurozone average of 94.9%.

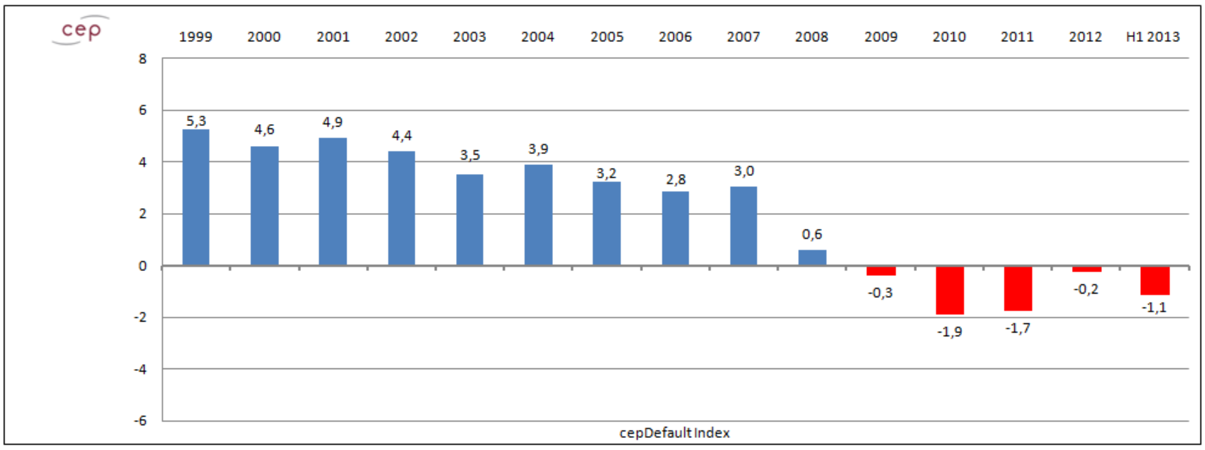


Conclusion: The rise in the cepDefault-Index, which has now endured for three and a half years, indicates that the renewed confidence in Ireland, being shown by capital investors, is justified. The task now must be to significantly increase investment which has fallen to almost nil.

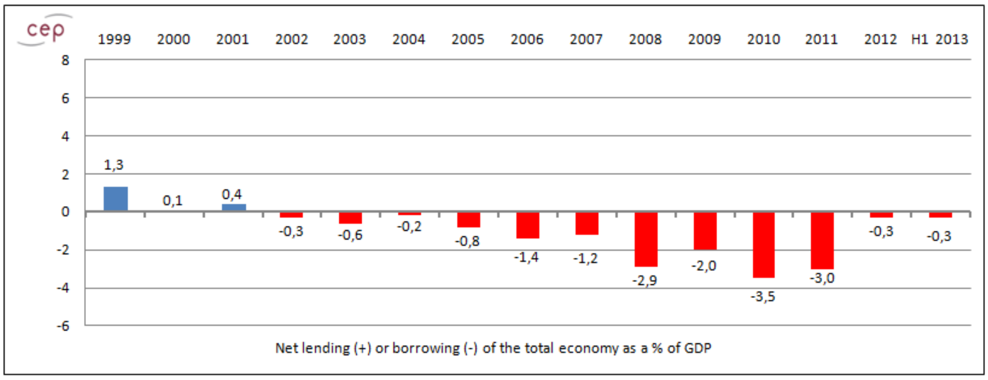
8 Italy

Trend according to the cepDefault-Index: Italy's creditworthiness has already been deteriorating for four years. The fall slowed somewhat in 2012 but gained pace again in the first half of 2013. Although this trend, with an Index value of 1.1, is small, particularly by comparison with Greece, it is the length of time that the deterioration has lasted which poses a problem because the longer it goes on the greater the danger of insolvency. The seriousness of the situation is clear from the fact that, in the eurozone, apart from Italy, it is only in Portugal and Greece that falling creditworthiness has become firmly established. Both countries have little or no access to the bond market.

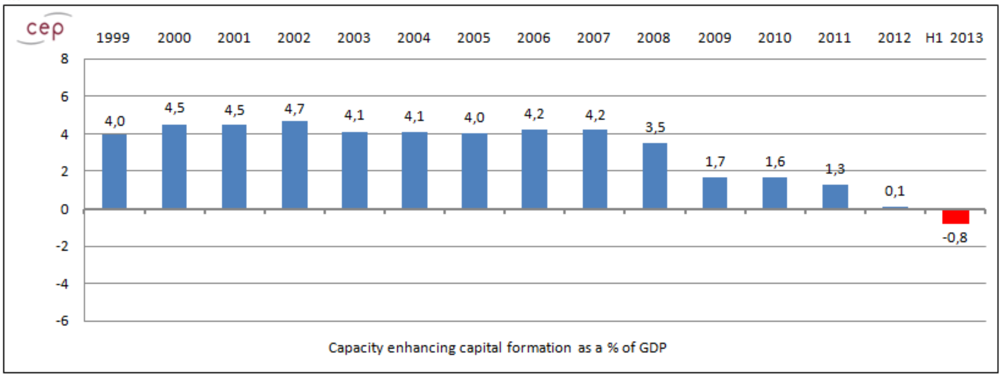
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	H1 2013
NTE	1,3	0,1	0,4	-0,3	-0,6	-0,2	-0,8	-1,4	-1,2	-2,9	-2,0	-3,5	-3,0	-0,3	-0,3
CECF	4,0	4,5	4,5	4,7	4,1	4,1	4,0	4,2	4,2	3,5	1,7	1,6	1,3	0,1	-0,8
cepDefault Index	**5,3**	**4,6**	**4,9**	**4,4**	**3,5**	**3,9**	**3,2**	**2,8**	**3,0**	**0,6**	**-0,3**	**-1,9**	**-1,7**	**-0,2**	**-1,1**
Risc category	1	1	1	2	2	2	2	2	2	2	3	3	4	4	4



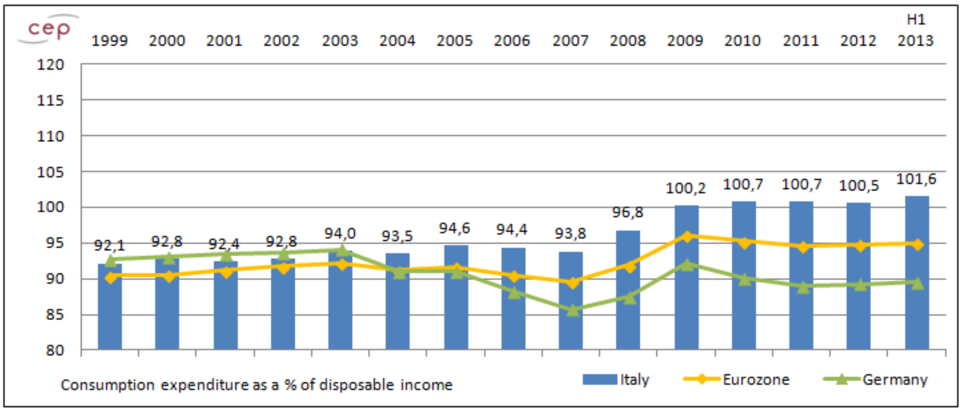
Net lending or borrowing of the total economy (NTE): Italy has been a net borrower since 2002. In 2010, borrowings reached 3.5% of GDP, their highest level so far. In the two subsequent years, they fell to 0.3%. The fact that this value did not rise in the first half of 2013 is due to the fall in capacity enhancing capital formation.



Capacity enhancing capital formation (CECF): Capacity enhancing capital formation was negative in the first half of 2013. The country's capital stock has therefore shrunk. This has an effect in the country's economic strength and makes it more difficult to repay foreign credit. In the eurozone, apart from Italy, only Portugal and Greece show diminishing capital stock.



Consumption rate: Over the previous four and a half years, the Italian population has continuously consumed over 100% of the disposable income. In the first half of 2013, consumption was 101.6%; 1.1 percentage points more than in 2012. Since the introduction of the euro, the consumption rate has risen by 9.5 percentage points. A key requirement for Italy's recovery is for the consumption rate to fall significantly because that is the only way that domestic capital can be made available for capacity enhancing capital formation, without which the erosion of creditworthiness cannot be stopped.

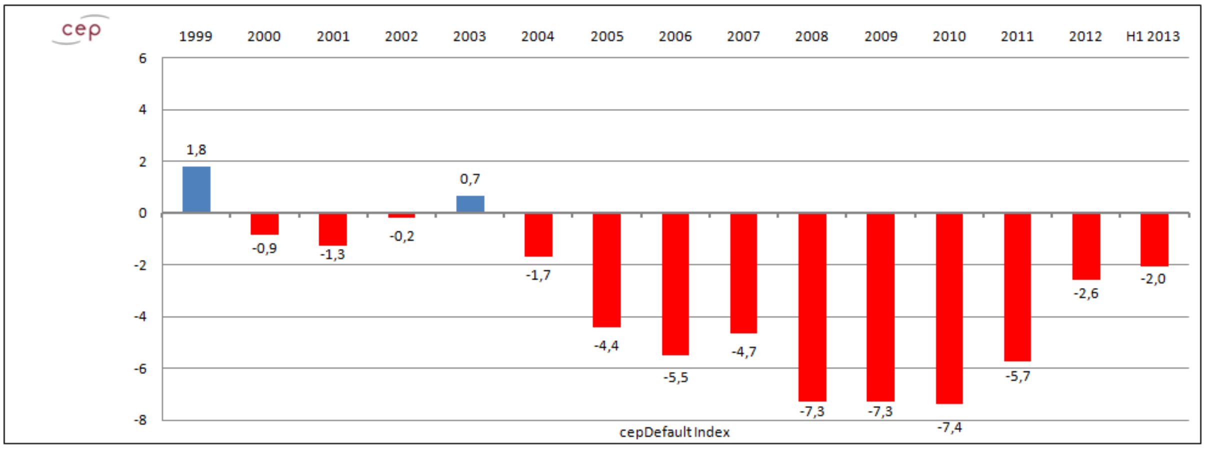


Conclusion: Italy's creditworthiness continues to fall. It is doubtful whether this will change in the foreseeable future because the necessary reforms and consolidation measures have not yet been undertaken by the Italian government.

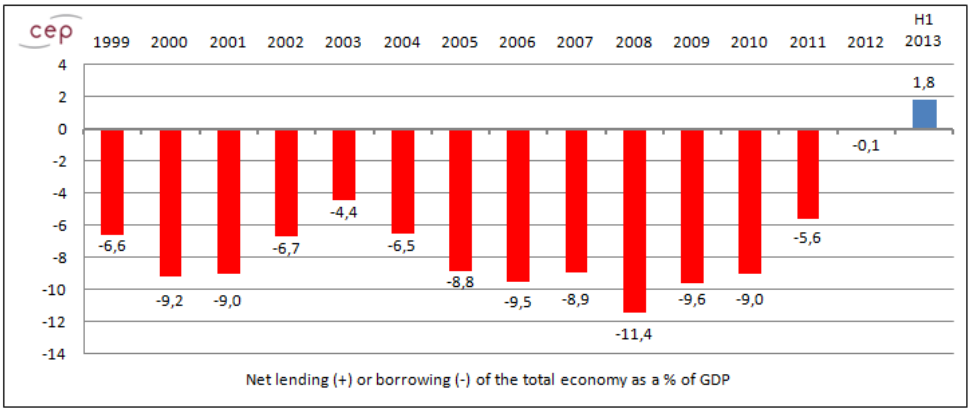
9 Portugal

Trend according to the cepDefault-Index: Portugal's creditworthiness continues to deteriorate but the Index value has climbed considerably as compared with its level at the height of the crisis in 2010. Over the last two and a half years, Portugal has therefore succeeded in bringing about a substantial slow-down in the rate of decline.

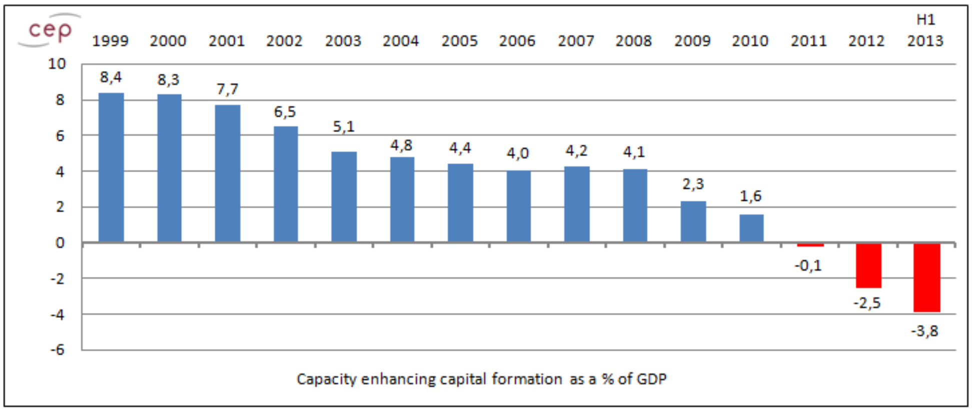
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	H1 2013
NTE	-6,6	-9,2	-9,0	-6,7	-4,4	-6,5	-8,8	-9,5	-8,9	-11,4	-9,6	-9,0	-5,6	-0,1	1,8
CECF	8,4	8,3	7,7	6,5	5,1	4,8	4,4	4,0	4,2	4,1	2,3	1,6	-0,1	-2,5	-3,8
cepDefault Index	**1,8**	**-0,9**	**-1,3**	**-0,2**	**0,7**	**-1,7**	**-4,4**	**-5,5**	**-4,7**	**-7,3**	**-7,3**	**-7,4**	**-5,7**	**-2,6**	**-2,0**
Risc category	2	3	3	4	2	3	3	4	4	4	4	4	4	4	4



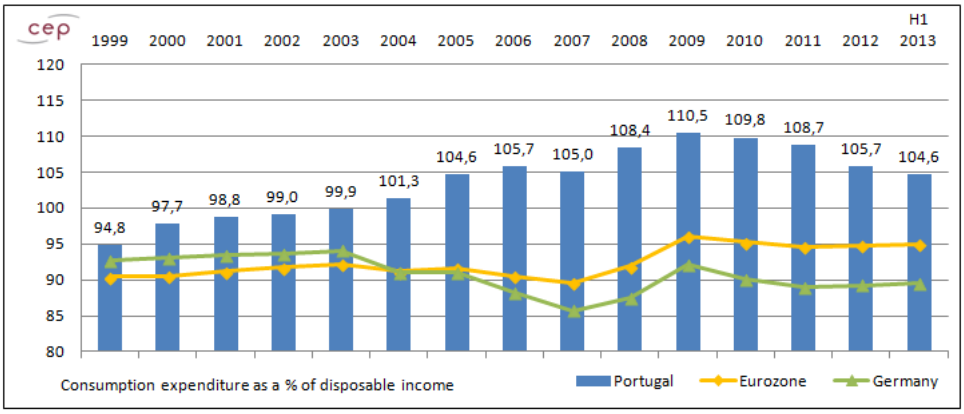
Net lending or net borrowing of the total economy (NTE): For the first time since the introduction of the euro, Portugal recorded capital export surpluses in the first half of 2013. The country has thus turned from a borrower into a lender. However, this trend is primarily due to a drop in capacity enhancing capital formation.



Capacity enhancing capital formation (CECF): Capacity enhancing capital formation was also negative in the first half of 2013. Portugal's capital stock has been shrinking for two and a half years and this trend has gained speed from year to year. Capital stock shrinks when capital consumption exceeds capacity enhancing capital formation. In the eurozone, apart from Portugal, only Italy and Greece show diminishing capital stock. Although, on the one hand, the low level of investment activity reduces the demand for capital in the Portuguese economy so that dependence on foreign capital falls, on the other hand, an economy's production potential shrinks. This will lead - where the propensity to consume remains the same - to a drop in lending.



Consumption rate: The Portuguese population consumed roughly 105% of the disposiable income in the first half of 2013. This is the third highest consumption rate in the eurozone. Nevertheless, it has come down by 5.9 percentage points compared with its highest point in 2009. In order for the country's creditworthiness to climb back up, a further cutback in the consumption rate is unavoidable.

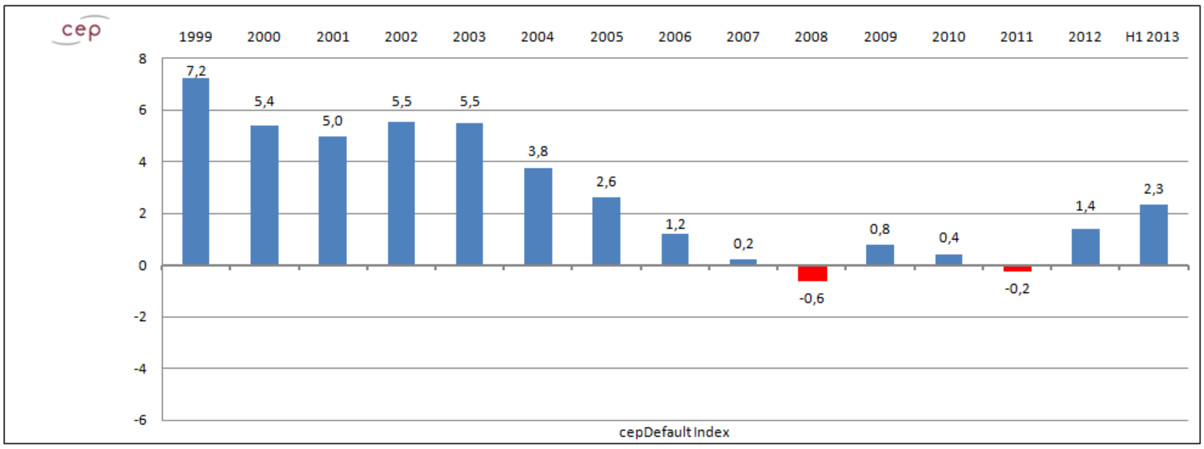


Conclusion: Although Portuguese creditworthiness is still being eroded, the trend in the Index value since 2011 shows that Portugal has made considerable effort and has handled the adjustments. In order for the country's creditworthiness to climb back up, it must continue along the same route. Investments, in particular, must increase once more. At the same time, a reduction in the propensity to consume is advisable. Despite the positive developments, it is doubtful whether Portugal will manage without further financial assistance when the adjustment programme expires in mid-2014. Although Ireland and Spain were able to make a successful return to the bond market on conclusion of their adjustment programmes, unlike Portugal, both countries register increasing creditworthiness.

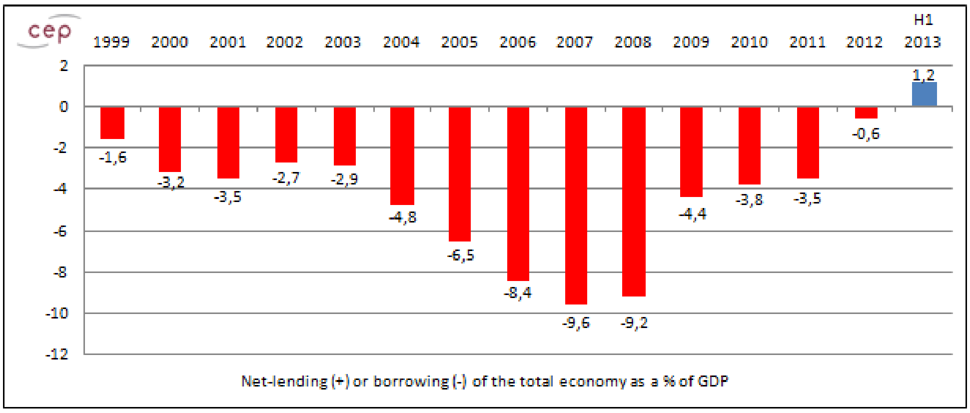
10 Spain[12]

Trend according to the cepDefault-Index: In the first half of 2013, Spain's creditworthiness increased for the first time since the introduction of the euro. The country has thereby taken an important step towards strengthening confidence in its debt sustainability. The Index value went up in the first half of 2013 for the second time in a row reaching 2.3 points.

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	H1 2013
NTE	-1,6	-3,2	-3,5	-2,7	-2,9	-4,8	-6,5	-8,4	-9,6	-9,2	-4,4	-3,8	-3,5	-0,6	1,2
CECF	8,8	8,6	8,5	8,2	8,4	8,6	9,1	9,6	9,8	8,6	5,2	4,2	3,3	2,0	1,1
cepDefault Index	**7,2**	**5,4**	**5,0**	**5,5**	**5,5**	**3,8**	**2,6**	**1,2**	**0,2**	**-0,6**	**0,8**	**0,4**	**-0,2**	**1,4**	**2,3**
Risc category	2	2	2	2	2	2	2	2	2	3	2	2	3	2	1

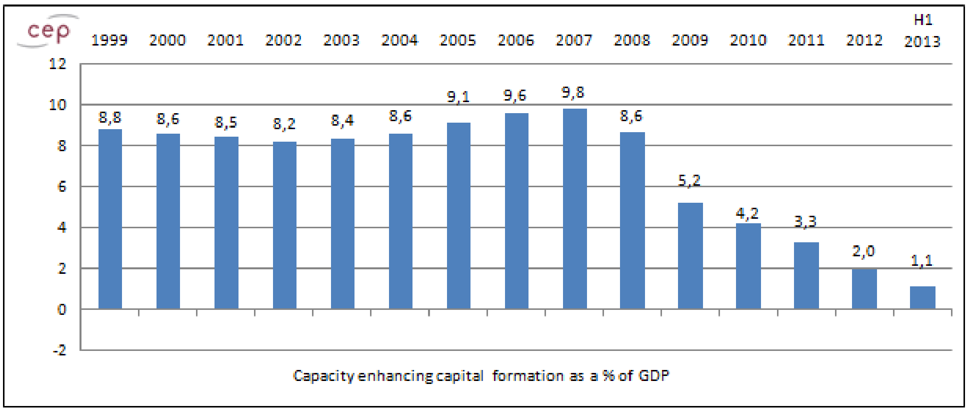


Net lending or net borrowing of the total economy (NTE): In the first half of 2013, in net terms, Spain was lending for the first time since the introduction of the euro. This development was already apparent by the fact that the country's net borrowings have been going down continuously since 2008. In 2012 alone, they sank by 2.9 percentage points of GDP. This trend is due, on the one hand, to a drop in investment, and on the other hand, to a fall in the propensity to consume. A financial surplus over the whole economy is required in order for Spain to bring down its foreign debt, which, in net terms, currently stands at 91.4% of GDP.

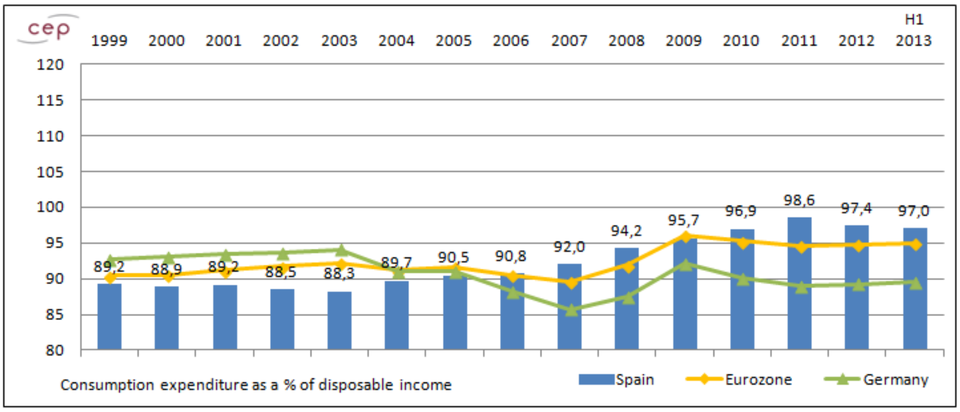


[12] The data for the first half of 2013 is based on the quarterly data for the period Q3/2012 to Q2/2013, which has not been seasonally adjusted.

Capacity enhancing capital formation (CECF): Capacity enhancing capital formation has been falling continuously since 2008. However, with an investment rate of 1.1% of GDP, Spain is just below the eurozone average of 1.3%.



Consumption rate: At 97%, the Spanish consumption rate - measured as a percentage of the disposable income - is still above the eurozone average of 94.9%, nevertheless, it has come down by 1.6 percentage points since reaching its highest point in 2011. In addition, it has never exceeded the 100 percent threshold, as has been, and still is, the case in Greece, Portugal and Italy.



Conclusion: Spain's creditworthiness is growing. However, this must not blind us to the fact that the country still has to implement further consolidation and reform measures in order to reduce both government debt, which rose dramatically during the crisis years, and the high level of unemployment.

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