CEP Default Index

Country Report Portugal – 1st half of 2011

Creditworthiness Trends,
Causes and Reform Prospects

– Abstract[1] –

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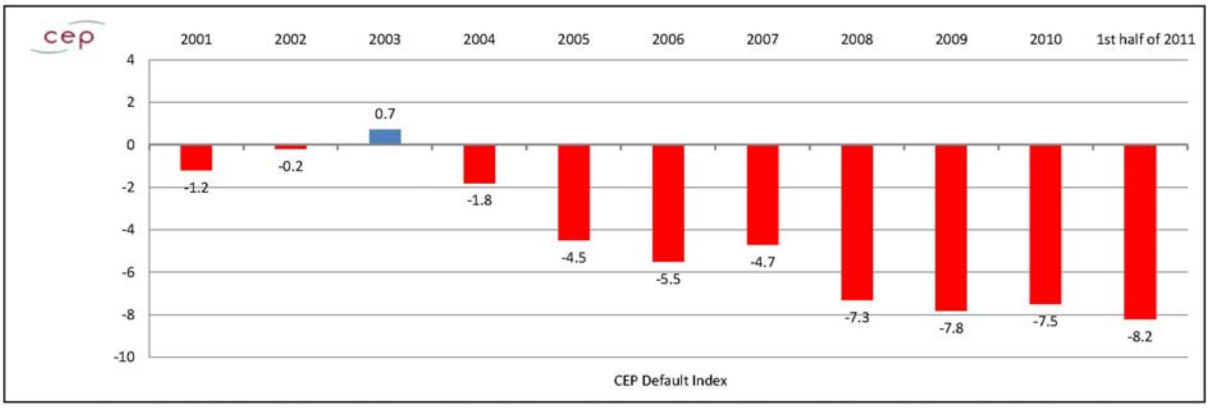
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	1st half of 2011
NTE	-9.0	-6.7	-4.4	-6.6	-8.9	-9.5	-8.9	-11.4	-9.7	-8.4	-8.0
I^C	7.8	6.5	5.1	4.8	4.4	4.0	4.2	4.1	1.9	0.9	-0.2
CEP Default Index	**-1.2**	**-0.2**	**0.7**	**-1.8**	**-4.5**	**-5.5**	**-4.7**	**-7.3**	**-7.8**	**-7.5**	**-8.2**
Risk category	3	3	2	3	3	4	4	4	4	4	4



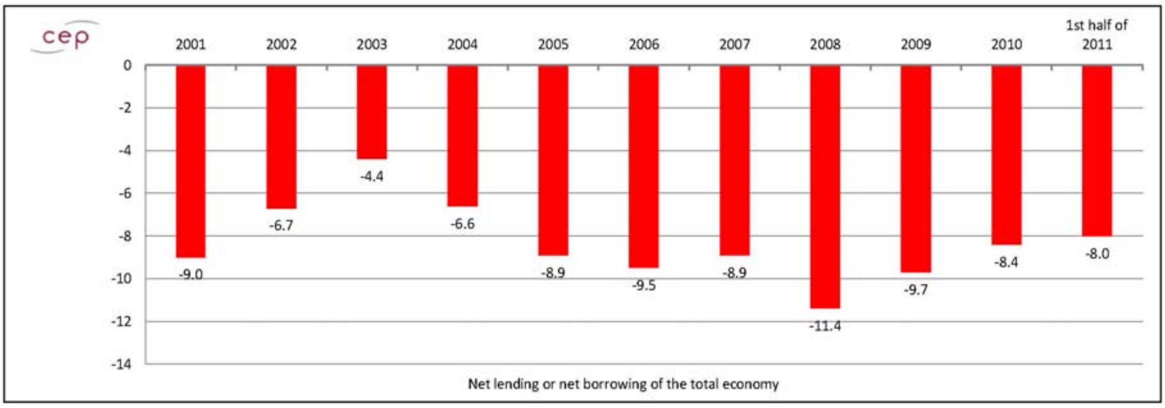
[1] The long version can be found under http://www.cep.eu/fileadmin/user_upload/CEP-Default-Index/Portugal_2011.pdf.

The CEP Default Index[2]

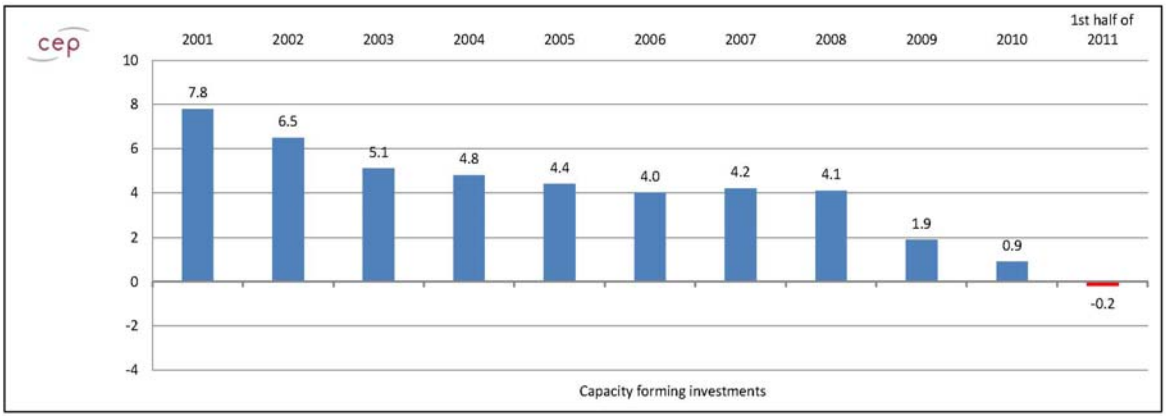
The CEP Default Index measures the development of the individual countries' capability to pay back foreign credits. The Index assesses the net lending or net borrowing of the total economy (NTE) and the resources used to increase physical capital stock, that is capacity forming investments (I^c) for a certain period. Both values are measured as a percentage of gross domestic product (GDP). Negative index values indicate an erosion of creditworthiness.

CEP Default Index for Portugal: Findings

- The erosion of Portugal's creditworthiness began in 2004 and has increased since then from year to year (see front page). In the first half of 2011, the CEP Default Index dropped significantly and reached a new low of - 8.2. Portugal is not creditworthy and no signs of a trend reversal are discernable.
- The key causes of this trend are:
  - In the first half of 2011, the net credit demand for additional foreign credits of 8.0% of GDP was slightly lower than in 2010.



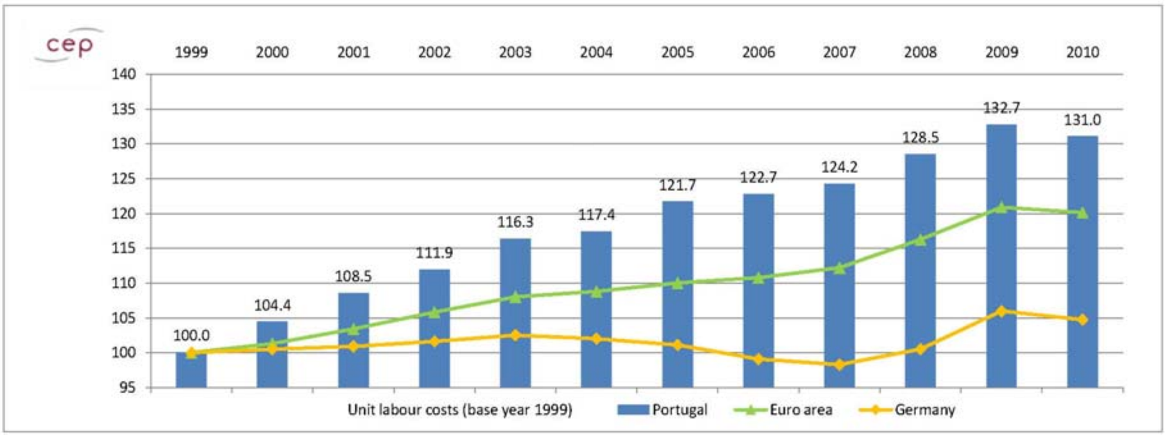
  - At the same time, the capacity forming investments of - 0.2% of GDP assumed a negative value for the first time; capital stock shrunk.



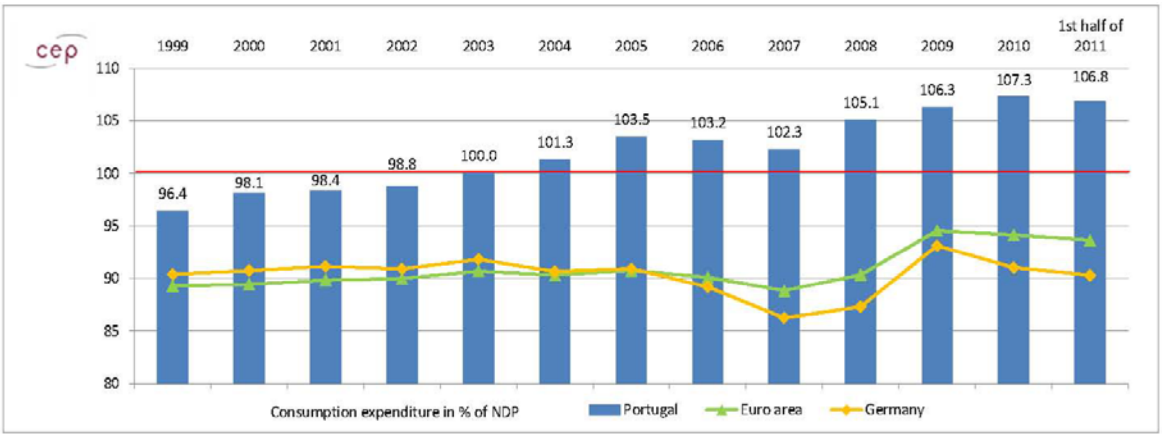
[2] For a detailed presentation, see CEP Analysis "CEP Default Index" under http://www.cep.eu/en/analyses-of-eu-policy/economic-stability-policy/cep-default-index/.

Causes of the Erosion of Portugal's Creditworthiness

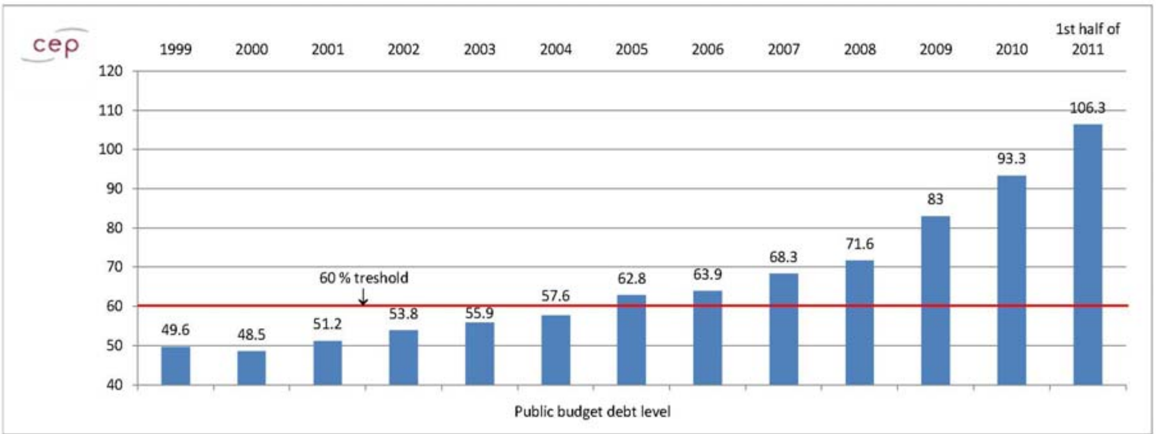
- The key cause is that Portugal has lost its competitiveness against other Euro countries: Portugal's unit labour costs have grown by 31% since 1999, German's by 5%. The difference of 26 percentage points indicates a gap in competition.



- This has been further aggravated by the fact that since 2004 more than 100% of net domestic product (NDP) has gone on consumption expenditure. In 2011 this trend continued. Hence, the country is still living beyond its means. Even a negative investment rate was accepted in order to maintain this high consumption level.

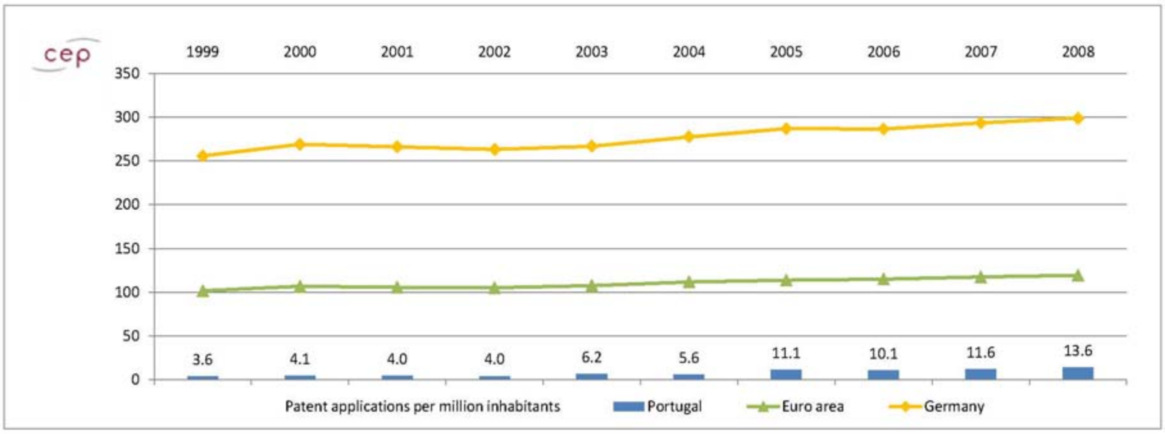


- Moreover, in the first half of 2011 alone, the debt level grew by 13 percentage points from 93.3% to 106.3% of GDP.



Reform Prospects

- The aim to overhaul the country's budget by 2014 cannot be achieved.
- Portugal has a realistic prospect only if it reduces its foreign credit demands. This requires the elimination of current account deficits, which is a precondition for the restoration of competitiveness.
- Portugal's competitiveness can be improved through productivity growth – in the form of investments and innovations – at best only in the long term: net investments have been negative since 2011.
- Moreover, the country does not have a culture of modern research and innovation. The number of patents registered with the European Patent Office is only a twentieth of those registered in Germany.



- Hence, competitiveness can only be increased through a drastic cut in workers' salaries. However, this will be extremely difficult to enforce, if it can be enforced at all, as the state's impact on the wage formation process is limited in a private economy and workers and trade unions have to cooperate.
- Supportive measures must be the liberalisation of labour and goods markets, the overhaul of state finances and a reduction in consumption, for instance by increasing value added tax.
- In view of the willingness of both the politicians and large parts of the Portuguese population, it cannot completely be ruled out that Portugal might one day regain its creditworthiness. It will, however, take many years and be accompanied by a substantial loss of prosperity. To that end, the existing reform efforts must be reinforced considerably.