

CEP Default Index

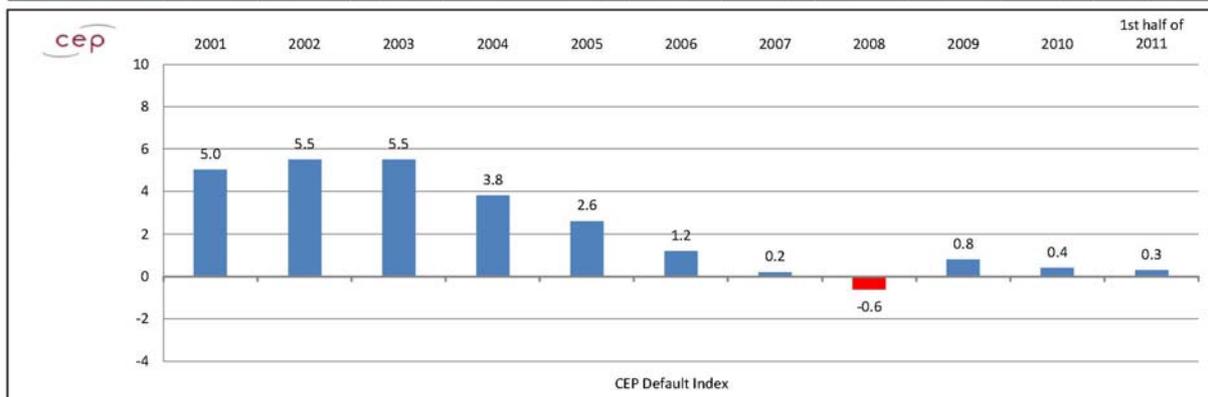
Country Report Spain – 1st half of 2011

Creditworthiness Trends,
Causes and Reform Prospects

– Abstract¹ –

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	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	1st half of 2011
NTE	-3.5	-2.7	-2.9	-4.8	-6.5	-8.4	-9.6	-9.2	-4.7	-4.0	-3.6
i^c	8.5	8.2	8.4	8.6	9.1	9.6	9.8	8.6	5.5	4.4	3.9
CEP Default Index	5.0	5.5	5.5	3.8	2.6	1.2	0.2	-0.6	0.8	0.4	0.3
Risk category	2	2	2	2	2	2	2	3	2	2	2



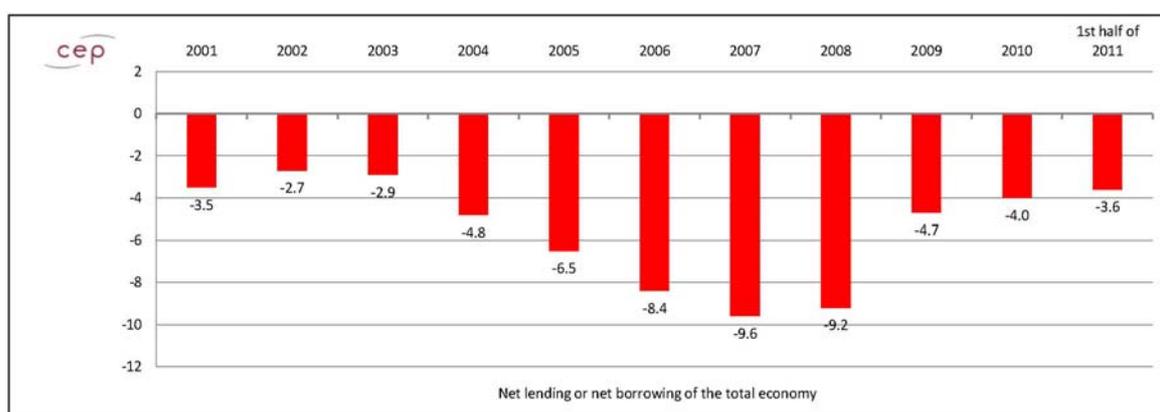
¹ The long version can be found under http://www.cep.eu/fileadmin/user_upload/CEP-Default-Index/Spanien_2011.pdf.

The CEP Default Index²

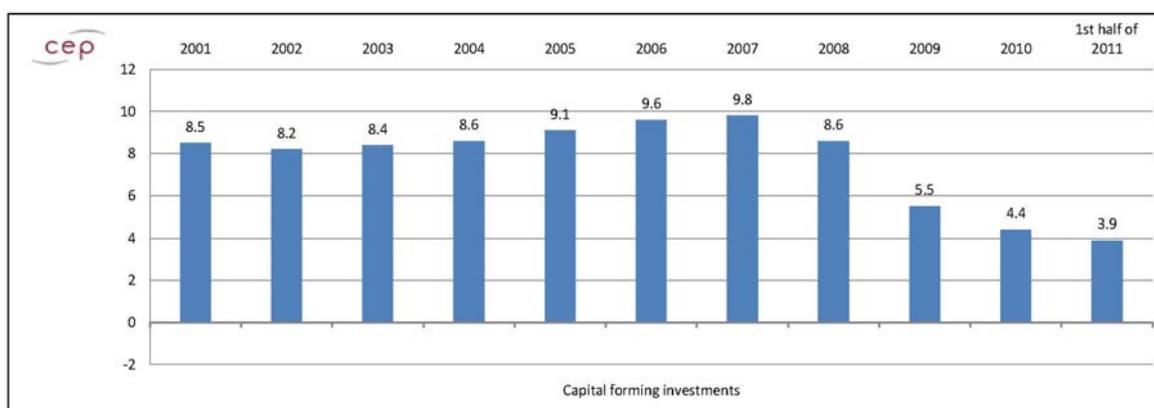
The CEP Default Index measures the development of an individual countries' capability to pay back foreign credits. The Index assesses the net lending or net borrowing of the total economy (NTE) and the resources used to increase physical capital stock, that is capacity forming investments (I^c) for a 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 Spain: Findings

- ▶ The CEP Default Index for Spain was negative only in 2008 (see front page). In 2009 and 2010 it showed low but positive values at 0.8 and 0.4 respectively. In the first half of 2011 there was a further slight decrease to 0.3. The current trend of Spain's solvency is therefore uncertain.
- ▶ The key causes of this trend are:
 - In the first half of 2011, the net credit demand for additional foreign credits dropped by 0.4 percentage points to 3.6% of GDP.



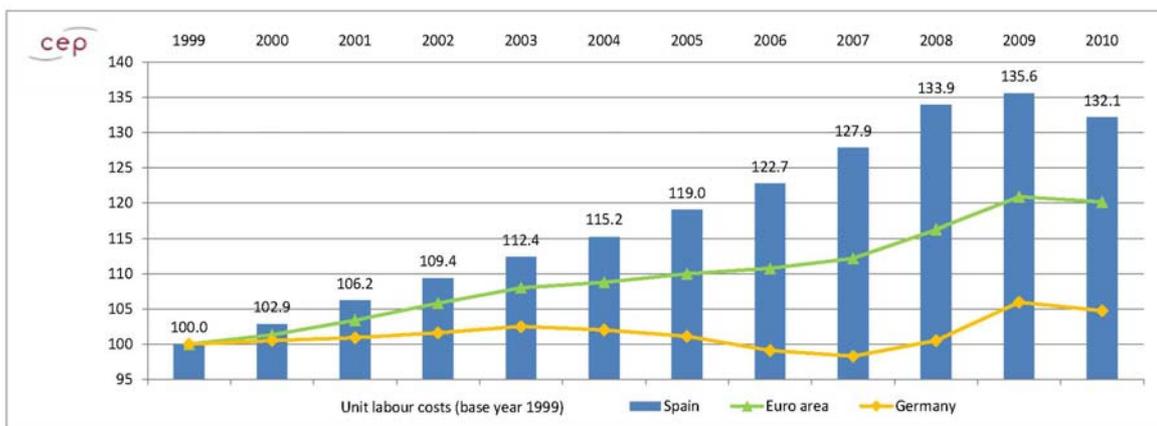
- The Spanish investment rate was very high in the past. In 2009 it collapsed, then it dropped by another 1.1 percentage points in 2010 and again by 0.5 percentage points in the first half of 2011.



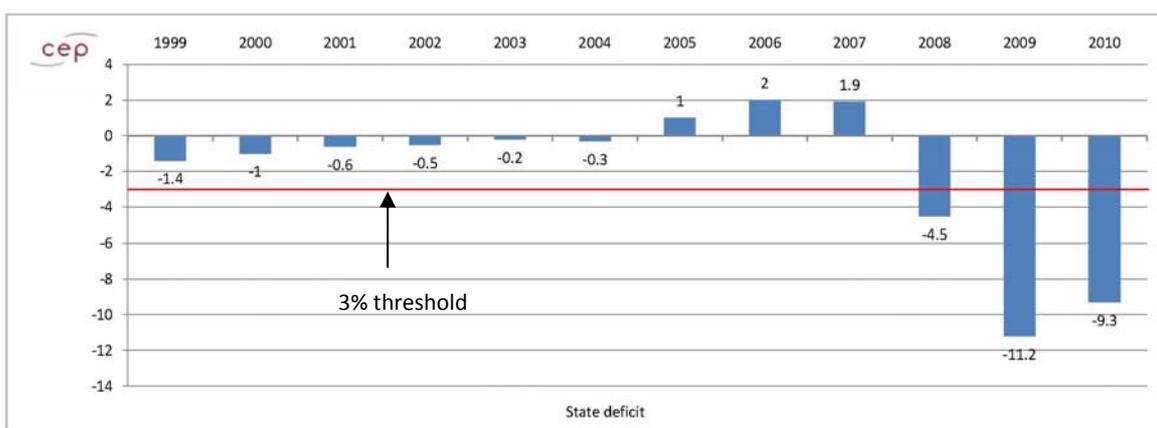
² For a detailed presentation, see CEP Analysis "CEP Default Index" under <http://www.cep.eu/en/analyses-of-eu-policy/economic-stability-policy/cep-default-index>.

Causes for Calling Spain’s Creditworthiness into Question

- ▶ The main cause is that Spain has lost its competitiveness against other Euro countries: Spanish unit labour costs have increased by 32.1% since 1999, German’s by 5%. The difference of 27 percentage points indicates a gap in competition.



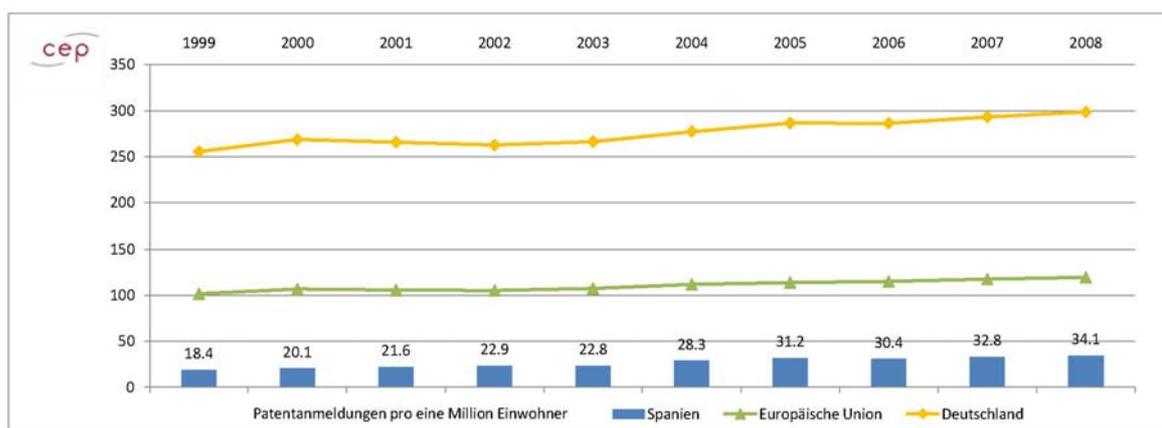
- ▶ High credit-financed investment in the construction sector led to a real estate bubble. The share of housing construction in GDP reached a value of 9% to 12.5%. The bursting of this bubble led to a heavy burdening on Spanish banks. Spanish banks still hold housing credits to a carrying amount of 308 bn euros, half of which are identified as being at risk of default. The Spanish state has been supporting banks since 2010 in order to save them from insolvency.
- ▶ Rigid, inflexible labour markets and, in particular, an excessive level of worker protection has led to Spain having the highest unemployment rate in the Eurozone. In 2010, it was almost twice as high as the Eurozone average. The share of the long-term unemployed in the working population doubled in 2009 to 4.3% and grew to 7.3% in 2010. In the same year, youth unemployment grew to 41.6%, a figure which is way higher than in any other country in the Eurozone and which therefore puts Spain in an isolated position.



- ▶ Even though Spanish state indebtedness of 65% of GDP is relatively low compared to the European average, the annual state deficit of 9 to 11% of GDP gives serious cause for concern.

Reform Prospects

- ▶ Spain will only escape credit unworthiness if it succeeds in removing its foreign credit needs. This is possible only through an elimination of current account deficits, which is a precondition for the restoration of competitiveness.
- ▶ Although Spain has ambitious aims to increase innovation by spending more on research and development, and although Spain's deficit in terms of the number of registered patents compared to the European average has been reduced, the resulting increase in productivity will be at best only in the long term.



- ▶ A cut in workers' salaries and aligning these more closely to productivity is the only way out.
- ▶ Supportive measures must be labour market reforms, relaxing the protection against unlawful dismissal and improving the efficiency of public administration.
- ▶ The described reform measures would not only increase the competitiveness of an economy but also, by reducing labour unit costs, help reduce the high unemployment rate.
- ▶ To what extent a reduction in the high state deficit is successful also depends on the degree to which Spain supports domestic banks in order to save them from insolvency.