

An Estimation of the Sovereign Risk of a Catalan State

Comissió d'Economia Catalana del
Col·legi d'Economistes de Catalunya

Joan Elias
Joan M. Mateu

January 28th, 2015

AIM OF THIS PAPER

To estimate the potential rating of a Catalan state in international financial markets.

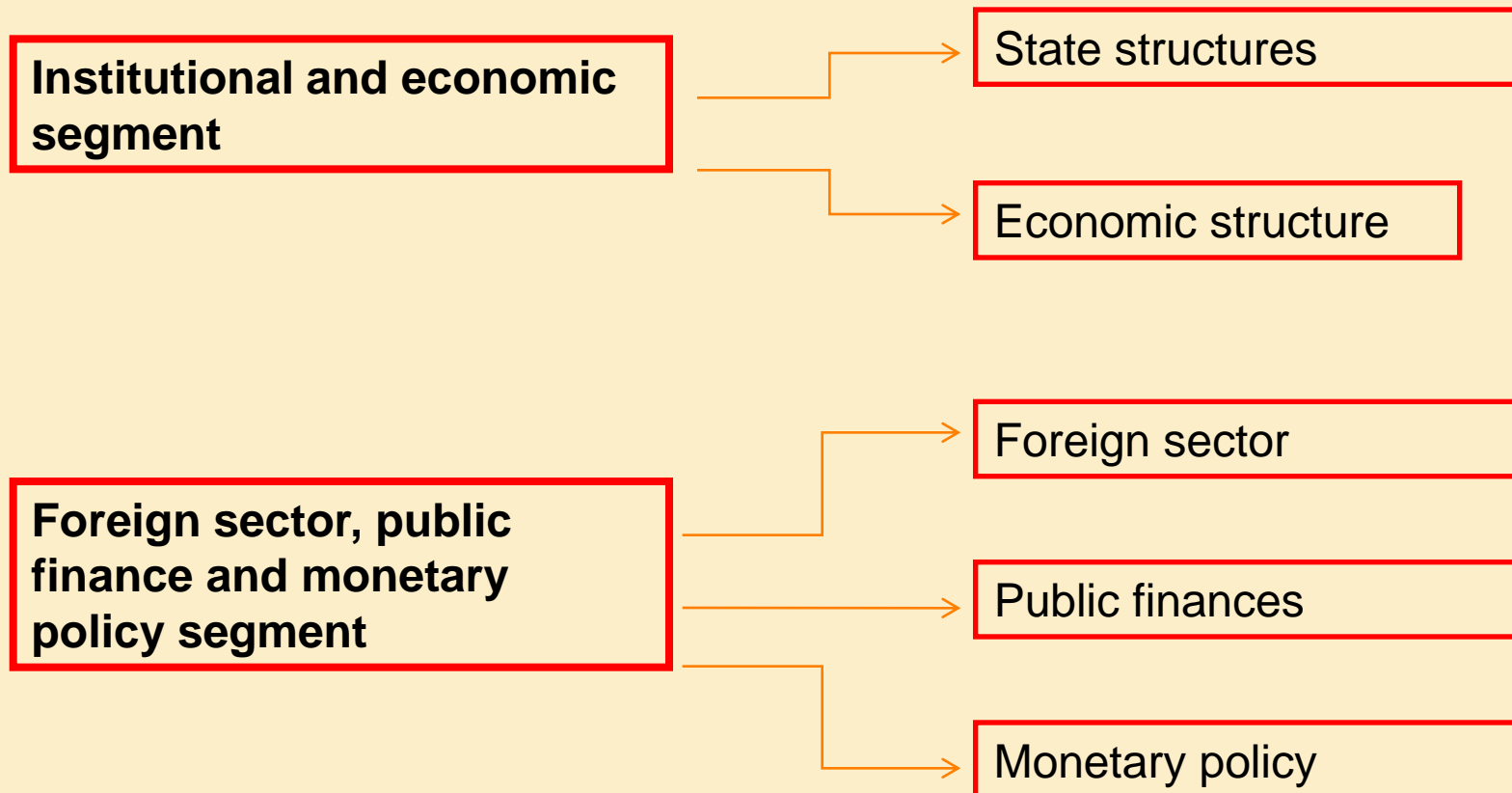
METHODOLOGY AND WORKING ASSUMPTIONS

- S&P methodology of sovereign risk assessment.
- Orderly negotiated settlement with Spain for an independent Catalan state.
- Where data are missing, the relevant estimates are based on the best possible judgment.

CURRENT FINANCIAL SITUATION OF THE CATALAN AUTONOMOUS GOVERNMENT

- Catalonia is not free to manage the resources generated inside its territory.
- Catalonia's annual net fiscal outflow to Spain exceeds €10 billion, whichever the method of calculation is used.
- The cash deficits of the Catalan regional government are funded by the Spanish state through loan mechanisms such as the FLA (*Fondo de Liquidez Autonómico*) or the PPP (*Plan de Pago a Proveedores*).
- Catalonia's current rating, according to S&P criteria, is set at 'BB' (junk bond).
- Catalonia has no access to international financial markets.

AREAS OF CATALAN SOVEREIGN RISK ASSESSMENT



RATING METHODOLOGY

- A score on a scale from '1' to '6' ('1' is best, '6' is worst) will be assigned to each evaluation area.
- The average score of the areas of each analysed segment will be calculated.
- The scores of the two segments will determine the rating. 'AAA' is the top rating, meaning an extremely low default risk, and the bottom rating is 'CC', meaning total insolvency.

STATE STRUCTURES AREA (1)

ASSESSMENT ITEMS

- Consolidated and stable state structures (main element).
- Transparency in institutional management (secondary element).
- Public debt payment culture (potential adjustment element).
- Geopolitical and social stability (potential adjustment element).

SCORING

- Score between '2' and '3' (qualitative evaluation).
- Corresponds to “strong” profile.

ECONOMIC STRUCTURE AREA (2a)

ASSESSMENT ITEMS

- GDP per capita (main element).
- Economic growth (potential adjustment element).
- Diversity and volatility of the economy (potential adjustment element).

SCORING

- Initial score of '2', downgraded to between '2' and '3' because of a weak level of economic growth in recent years, despite a better outlook as from 2015.
- Corresponds to “strong” profile.

ECONOMIC STRUCTURE AREA (2b)

Catalonia's GDP per capita

	2008	2009	2010	2011	2012	2013
GDP (EUR millions)	212,894	203,948	204,285	204,860	203,079	203,615
Population	7,357,506	7,439,311	7,481,935	7,512,893	7,497,218	7,458,842
GDP per capita, euros	28,935	27,414	27,303	27,267	27,087	27,298
GDP per capita, annual growth rates		-5.3 %	-0.4 %	-0.1 %	-0.7 %	+0.8 %

Source: Idescat.

ECONOMIC STRUCTURE AREA (2c)

Breakdown of Catalonia's GDP by activity sectors, % of total

Activity Sectors in %	2008	2009	2010	2011	2012	2013
Agriculture, livestock, etc.	1%	1%	1%	1%	1%	1%
Industry and energy	21%	19%	20%	20%	21%	21%
Construction	12%	12%	9%	8%	7%	7%
Trade, repairs, hotels, restaurants, etc.	29%	29%	30%	31%	32%	32%
Financial activities, real estate, professionals, technology, etc.	20%	21%	20%	21%	21%	21%
Public admin., social security, education, artistic, sanitary and other activities	17%	18%	19%	19%	18%	18%
TOTAL	100%	100%	100%	100%	100%	100%

Source: Idescat.

FOREIGN SECTOR AREA (3a)

ASSESSMENT ITEMS

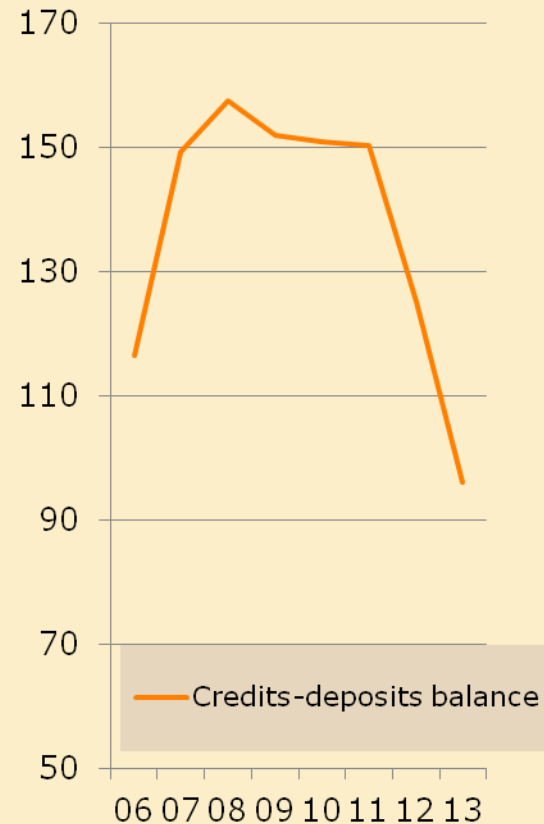
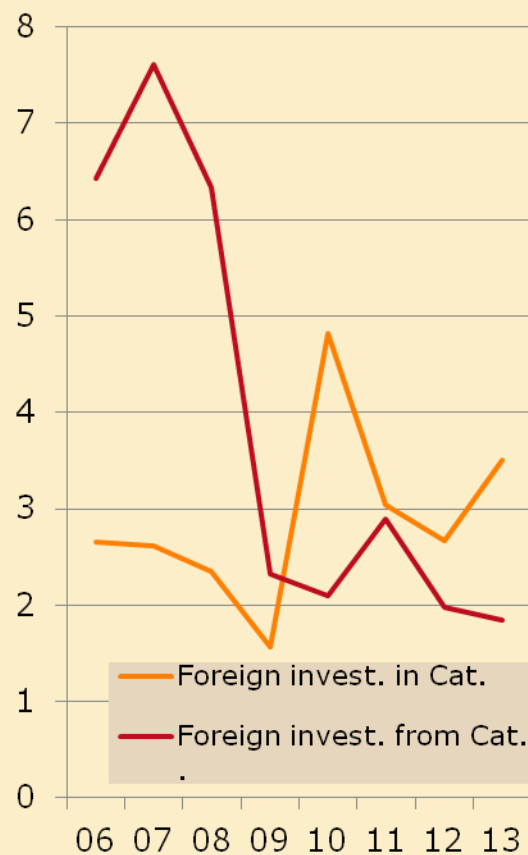
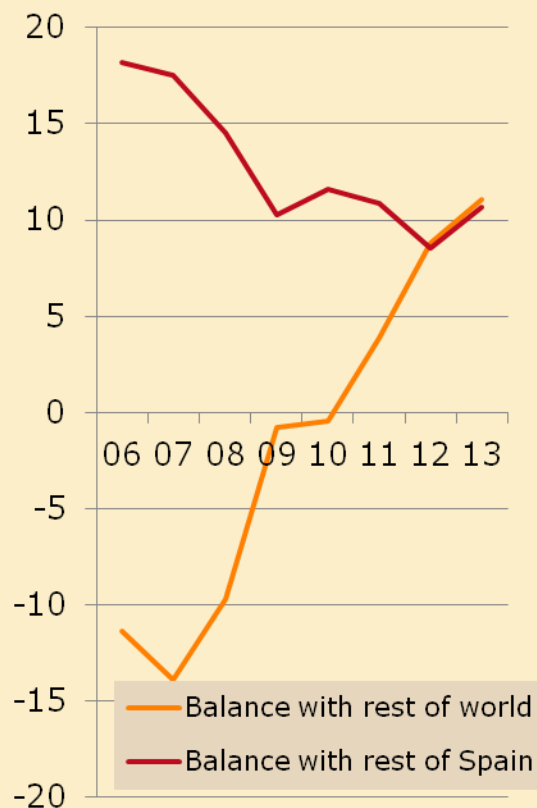
- Liquidity and foreign debt (main elements).
- Catalonia has a favorable balance of payments (adjustment element).
- Maintenance of monetary union (assumption).

SCORING

- Score of '5' (qualitative evaluation).
- Corresponds to “weak” profile.

FOREIGN SECTOR AREA (3b)

EUR billions



PUBLIC FINANCES AREA (4a)

Public finances and fiscal flexibility

ASSESSMENT ITEMS

- Variation of projections of public debt (main element).
- Available liquid assets (potential adjustment element).
- Leeway for fiscal and budgetary policy (potential adjustment element).
- Spending pressures (potential adjustment element).

SCORING

- Initial score of '1', adjusted neither upwards nor downwards.

PUBLIC FINANCES AREA (4b)

Debt burden

ASSESSMENT ITEMS

- Level of public debt in relation to GDP (main element).
- Interest expenditure in relation to public revenues (main element).
- Public debt structure (potential adjustment element).
- Possible risks from negative contingencies (potential adjustment element).

SCORING

- Initial score of '4', adjusted neither upwards nor downwards.

PUBLIC FINANCES AREA (4b)

Public finances of a Catalan state

	2015	2016	2017
GDP at market prices (million EUR)	213,684	220,559	229,902
General government budget balance (% of GDP)	1.3	2.1	2.8
General government debt (% of GDP)	70	66	61
Interest expenditure (% of revenues)	7	6	4
Source: GDP 2015, Dept. Economia i Coneixement de la Generalitat de Catalunya; other, internal figures.			

PUBLIC FINANCES AREA (4d)

ASSESSMENT ITEMS

- Sustainability of government deficits (main element).
- Public debt sustainability (main element).

SCORING

- Overall area score, as the average of scores for fiscal flexibility and public debt burden (i.e., of '1' and '4'), that is '2.5'.

MONETARY POLICY AREA (5)

ASSESSMENT ITEMS

- Exchange rate regime (euro) (main element).
- Credibility of monetary policy (euro) (main element).
- Synchronization with the rest of the monetary union (potential adjustment element).
- Possible problems in the transmission of monetary policy (potential adjustment element).
- Possible significant restrictions on capital movement (potential adjustment element).

SCORING

- Score of '2', one point less than for the monetary union.

FINAL CONCLUSIONS (1)

- The score of an independent Catalan state for the institutional and economic segment would be '2.5' and for the foreign sector, public finances and monetary policy segment it would be '3.2'.
- These scores amount to an 'A+' rating, an investment grade rating.
- An independent Catalan state, with full capacity to manage its own resources, as a member state of the EU and the euro area, would have substantial debt capacity and would easily be able to borrow in international financial markets.

FINAL CONCLUSIONS (2)

- An independent Catalan state would be 2 notches above the rating of the Basque Country and Navarre ('A-') and 4 notches above the rating of Spain ('BBB').

Credit rating	Sovereign risk
...	
A+	Catalonia (independent)
A	
A-	Basque Country, Navarre
BBB+	
BBB	Spain
BBB-	
BB+	
BB	Catalonia (at present)

- The potential rating of an independent Catalan state would move up 7 notches, from the current 'BB' to 'A+'.

www.coleconomistes.cat

Àrees professionals
Comissió Economia Catalana
Documentació conferències