

Spain

Spanish CDS spread widens as economy suffers

Key findings

- Sovereign CDS spread widens.
- PMI data suggest widening is in line with economic fundamentals.

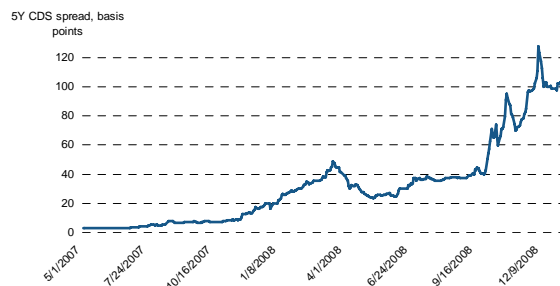
Spanish sovereign CDS spread widens ...

Spanish sovereign debt became more expensive to service in early January, as highlighted by the 5-year sovereign debt CDS spread widening to 127 basis points at the close of 15 January (see Chart 1). In May 2007 – shortly before the credit crunch started in earnest – the CDS spread was below 3 basis points. A widening CDS spread indicates that the market considers the risk of default to have increased and therefore a higher fee is required to protect against it. The latest widening came as credit-rating agency Standard & Poor's threatened to downgrade Spain's AAA sovereign debt rating and Economy Minister Pedro Solbes admitted that "there is a risk" of such a downgrade.

... in line with economic fundamentals according to PMI

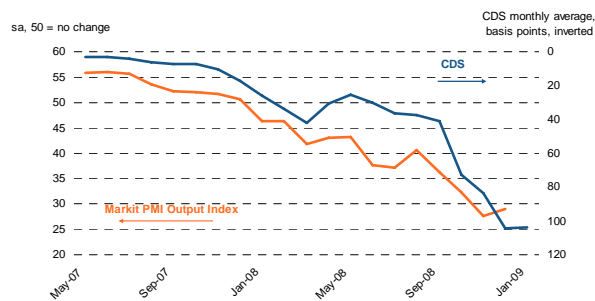
PMI data have signalled a severe deterioration in the Spanish economy. The Markit Composite PMI Output Index rose only slightly from November's record low in December, still representing a substantial contraction in business activity. The trend in the PMI suggests that the government may have to increase borrowing further in order to boost the economy and compensate for falling tax receipts. Therefore, the widening of the CDS spread has been largely in line with economic fundamentals. Spain's budget deficit rose to 1.28% of GDP in November (see Chart 3). The deficit is forecast to be slightly over the EU's limit of 3% for the whole of 2008, and well above that in 2009.

Chart 1: CDS spreads



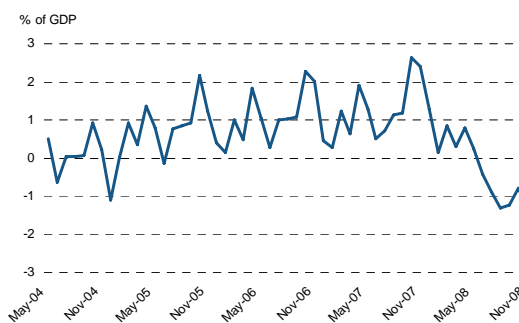
Source: Markit Desktop*

Chart 2: CDS v PMI



Source: Markit

Chart 3: Government budget balance



Source: Ecowin

The January Manufacturing PMI for Spain is released on 2 February 2009, followed by the Services PMI published on 4 February. To find out how to receive data from the surveys, or obtain copies of the reports please contact economics@markit.com

* A trial of Markit Desktop is available at <http://www.markit.com/information/products/desktop.html>

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