Special Report

European Government Borrowing

Another Record Year

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Sovereign Ratings

Country	FC IDR	LC IDR
Austria	AAA	AAA
Belgium	AA+	AA+
Denmark	AAA	AAA
Finland	AAA	AAA
France	AAA	AAA
Germany	AAA	AAA
Greece	BBB+/Neg	BBB+/Neg
Ireland	AA-	AA-
Italy	AA-	AA-
Luxembourg	AAA	AAA
Netherlands	AAA	AAA
Portugal	AA/Neg	AA/Neg
Spain	AAA	AAA
Sweden	AAA	AAA
Switzerland	AAA	AAA
UK	AAA	AAA

Greece and Portugal on Negative Outlook; all other ratings on Stable Outlook
Source: Fitch

Summary

European governments will need to borrow EUR2,200bn (19% of GDP) from the market in 2010 to finance large deficits and roll over existing debt, Fitch Ratings estimates. This represents a marginal increase on last year's figure, which in turn was the largest borrowing requirement for decades. Gross borrowing in absolute terms is projected to be largest in France (EUR454bn), Italy (EUR393bn), Germany (EUR386bn) and the UK (EUR279bn). As a percentage of GDP, gross borrowing is expected to be largest in Italy, Belgium, France and Ireland (all around 25%).

Last year, financing conditions were favourable for most European governments, with low yields and increased demand from the private sector (whose savings rate rose sharply). At the start of 2009, Fitch estimated a EUR1,990bn borrowing requirement for the year. In the event, the agency expects this figure will have been closer to EUR2,120bn (17% of GDP) despite lower-than-expected fiscal costs of bank support, due to larger-than-expected deficits. A notable development is that France and Germany each covered over half of their net borrowing through increased T-bill issuance. For Spain and Portugal the share was close to a third. The increase in the stock of short-term (ST) debt is a source of concern, as it increases market risk faced by governments, notably exposure to interest rate shocks.

In Fitch's opinion, European government bond markets are likely to be more volatile in 2010 than in 2009 and there is a material risk of a significant rise in governments' cost of funding from historic lows in 2009. As liquidity in other markets and investor risk appetite recovers, the "liquidity premium" enjoyed by sovereign issuers is diminishing. Combined with concerns over the medium-term fiscal and inflation outlook, this will likely cause government bond yields to rise, potentially quite sharply. While this highlights the urgency of credible fiscal consolidation programmes, Fitch considers it unlikely that high-grade sovereigns will face hard constraints in accessing market funding on the scale required, albeit at more expensive rates.

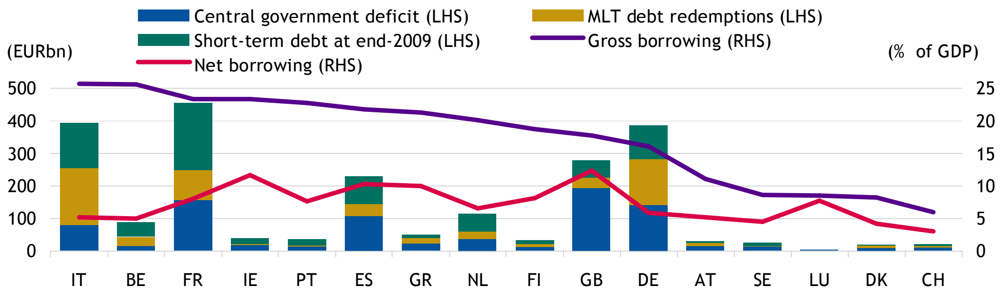
Fitch expects aggregate net borrowing to increase only marginally on last year and medium- and long-term (MLT) redemptions will be lower (see table on right). However, the stock of ST debt to be rolled over has dramatically increased, which has led to a slightly higher overall borrowing requirement in 2010 than in 2009.

Gross European Borrowing

(EURbn)	2009	2010	% yoy
Net borrowing	826.0	852.6	3.2
MLT redemptions	653.5	581.1	-11.1
Stock of ST debt (t-1)	636.6	766.4	20.4
Gross borrowing	2,116.1	2,200.2	4.0

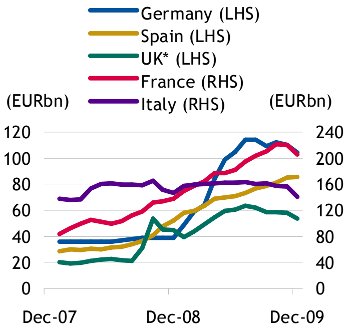
Source: Bloomberg, national debt agencies, Fitch

Central Government Borrowing Requirements in 2010



Source: Bloomberg, national debt agencies, Fitch

Stock of T-Bills Rising



*EUR1 .00/GBP0.891 (fixed rate)
Source: Bloomberg, debt agencies, Fitch

Government Borrowing in Detail

Fitch defines gross borrowing as net borrowing plus redemptions on MLT debt plus the stock of ST debt at the end of the previous year, which will need to be rolled over at least once during the current year. Below are tables showing borrowing requirements for each European country (EU15 plus Switzerland) in 2009 and 2010. Table 1 calculates actual issuance in 2009 by looking at the funding sources (ie gross MLT issuance plus roll-over of ST debt outstanding at end-2008 plus net increase in ST debt). Table 2 estimates 2010 issuance by looking at the funding uses (ie covering MLT redemptions falling in 2010 plus the current budget deficit plus roll-over of ST debt outstanding at end-2008). Note that for 2010, Fitch has assumed no below-the-line operations (eg bank recapitalisation) and no change in governments' cash balances (eg no pre-funding of future expenditure).

Table 1: 2009 Central Government Borrowing

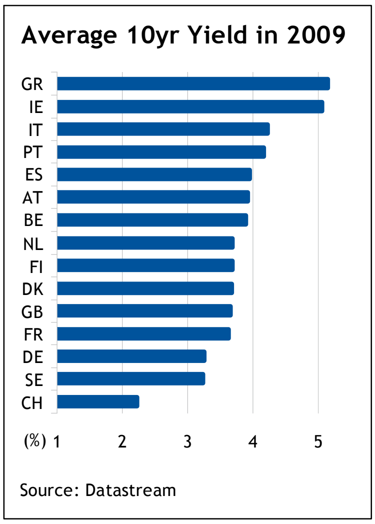
	End-2008 ST debt stock[2]	MLT issuance	Net change in ST debt	MLT redemptions	Gross borrowing	Net borrowing
(EURbn)[1]	(1)	(2)	(3)	(4)	(1) + (2) + (3)	(2) + (3) - (4)
Austria	7.7	28.3	-2.2	19.4	33.9	6.7
Belgium	53.5	38.3	-9.5	17.9	82.3	10.9
Denmark	7.5	33.7	-5.3	9.6	35.8	18.7
Finland	6.4	11.9	5.2	7.3	23.6	9.9
France	138.6	172.5	66.8	110.0	377.8	129.3
Germany	39.0	183.7	65.0	137.8	287.7	111.0
Greece	3.9	71.0	6.0	28.2	80.9	48.8
Ireland	22.6	34.3	-4.5	5.1	52.4	24.8
Italy	145.3	260.8	-5.2	165.8	400.9	89.9
Luxembourg	0.3	0.0	0.0	0.0	0.3	0.0
Netherlands[3]	81.4	48.1	-26.5	34.8	103.0	-13.3
Portugal	14.2	24.9	4.4	15.0	43.5	14.3
Spain	52.1	109.9	33.3	32.0	195.3	111.2
Sweden	12.4	27.3	-3.9	16.8	35.8	6.6
Switzerland	7.1	1.9	-2.5	6.8	6.5	-7.4
UK	44.6	302.8	8.8	47.1	356.2	264.5
UK (GBPbn)	*39.8*	*269.9*	*7.9*	*42.0*	*317.5*	*235.7*
TOTAL	**636.6**	**1,349.4**	**130.1**	**653.5**	**2,116.1**	**826.0**

Source: Bloomberg, national debt agencies, Fitch

Table 2: 2010 Central Government Borrowing

	End-2009 ST debt stock[2]	Budget deficit	MLT redemptions	Gross borrowing	Net borrowing
(EURbn)[1]	(1)	(2)	(3)	(1) + (2) + (3)	(2)
Austria	5.4	14.3	10.6	30.3	14.3
Belgium	44.0	16.9	25.9	86.8	16.9
Denmark	2.2	9.4	6.8	18.3	9.4
Finland	11.6	14.2	7.2	33.0	14.2
France	205.4	155.5	93.1	454.0	155.5
Germany	104.0	141.1	140.7	385.8	141.1
Greece	9.9	24.0	17.2	51.1	24.0
Ireland	18.1	19.0	1.2	38.3	19.0
Italy	140.1	79.8	173.7	393.5	79.8
Luxembourg	0.3	2.9	0.0	3.2	2.9
Netherlands	54.9	37.4	23.3	115.6	37.4
Portugal	18.6	12.3	5.9	36.9	12.3
Spain	85.4	108.1	35.0	228.4	108.1
Sweden	8.5	13.2	3.4	25.1	13.2
Switzerland	4.6	10.8	5.9	21.3	10.8
UK	53.4	193.7	31.4	278.5	193.7
UK (GBPbn)	*47.6*	*172.6*	*28.0*	*248.2*	*172.6*
TOTAL	**766.4**	**852.6**	**581.1**	**2,200.2**	**852.6**

Source: Bloomberg, national debt agencies, Fitch



Net Borrowing Outlook

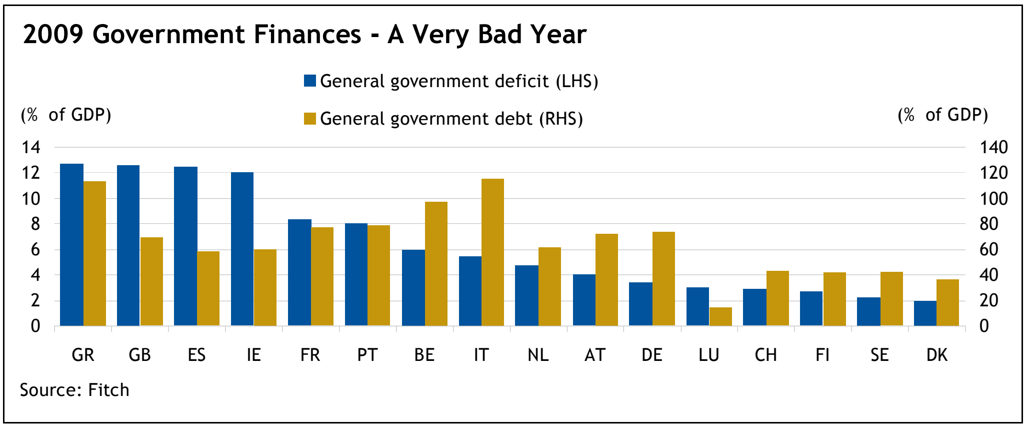
Estimates for fiscal deficits across Europe were subject to constant upward revision over the course of 2009. The scale of the deterioration in budgetary performance is striking, with every European country in deficit and four countries with deficits of over 12% of GDP. This reflects not only the cyclical effect of the recession and the discretionary easing of fiscal policy, but in some cases also a reappraisal of the underlying health of the public finances. Estimates of the structural deficit have been revised up in all countries due to the permanent loss of output after the recovery, but also in some cases due to an over-reliance on above-trend receipts from some sectors. For many countries, increasing ageing costs will add to the structural deficit over the medium to long term.

Although debt markets do not impose binding constraints on European budgets, relative pricing is much more dispersed between countries since the onset of the crisis, and Fitch considers this trend likely to persist. (Greece and Ireland, which have seen the largest upward revisions to their estimated structural deficits, are two notable examples; see chart left.)

Table 3: Outlook for General Government Finances

	Deficit			Gross debt		
(% of GDP)	2009e	2010f	2011f	2009e	2010f	2011f
Austria	4.0	5.0	4.9	72.2	75.2	77.2
Belgium	6.0	6.0	4.5	96.2	101.5	102.0
Denmark	2.0	4.5	3.5	36.7	40.3	42.2
Finland	2.7	4.5	2.0	42.2	49.7	53.3
France	8.3	8.5	7.4	77.0	84.0	89.2
Germany	3.4	5.3	4.5	73.7	77.8	80.2
Greece	12.7	9.4	7.5	113.3	120.8	124.7
Ireland[4]	12.0	12.0	8.7	65.0	116.0	118.0
Italy	5.5	5.2	4.2	115.4	118.1	119.5
Luxembourg	3.0	5.0	4.5	15.0	18.3	21.2
Netherlands	4.8	6.3	5.0	61.9	68.1	71.0
Portugal	8.0	7.0	5.0	78.5	85.4	87.2
Spain[5]	12.4	11.6	8.9	58.1	71.9	81.8
Sweden	2.3	3.4	2.8	42.0	44.2	45.4
Switzerland	2.9	3.6	3.9	43.0	45.2	46.7
UK	12.6	12.2	9.3	69.1	81.0	90.3

Source: Fitch estimates and forecasts



Endnotes:

1. Throughout the report the following fixed exchange rates are used: EUR1.000/GBP0.8913/CHF1.510/SEK10.62/DKK7.446.
2. ST debt is on an original maturity basis and includes T-bills and commercial paper.
3. The Netherlands, which had dramatically increased ST borrowing in 2008, ran this position down in 2009.
4. Table 3 includes National Asset Management Agency (NAMA) debt for Ireland, amounting to about 33% of GDP in 2010 and 2011; Tables 1 and 2 exclude NAMA debt.
5. Table 3 includes Fund for Orderly Bank Restructuring (FROB) debt for Spain, amounting to about 8% of GDP in 2010 and 2011; Tables 1 and 2 exclude FROB debt.