



European sovereign debt crisis

AIECE General Meeting
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Milan

Bart De Ketelbutter

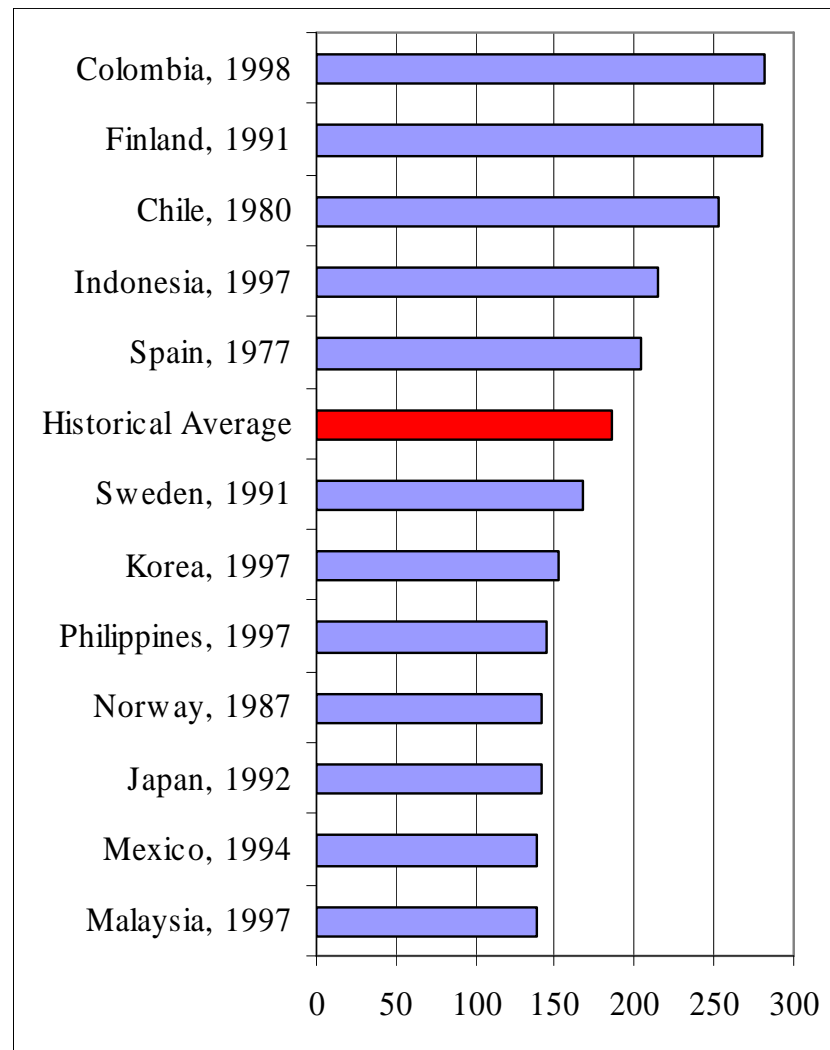
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Next big phase in the financial crisis

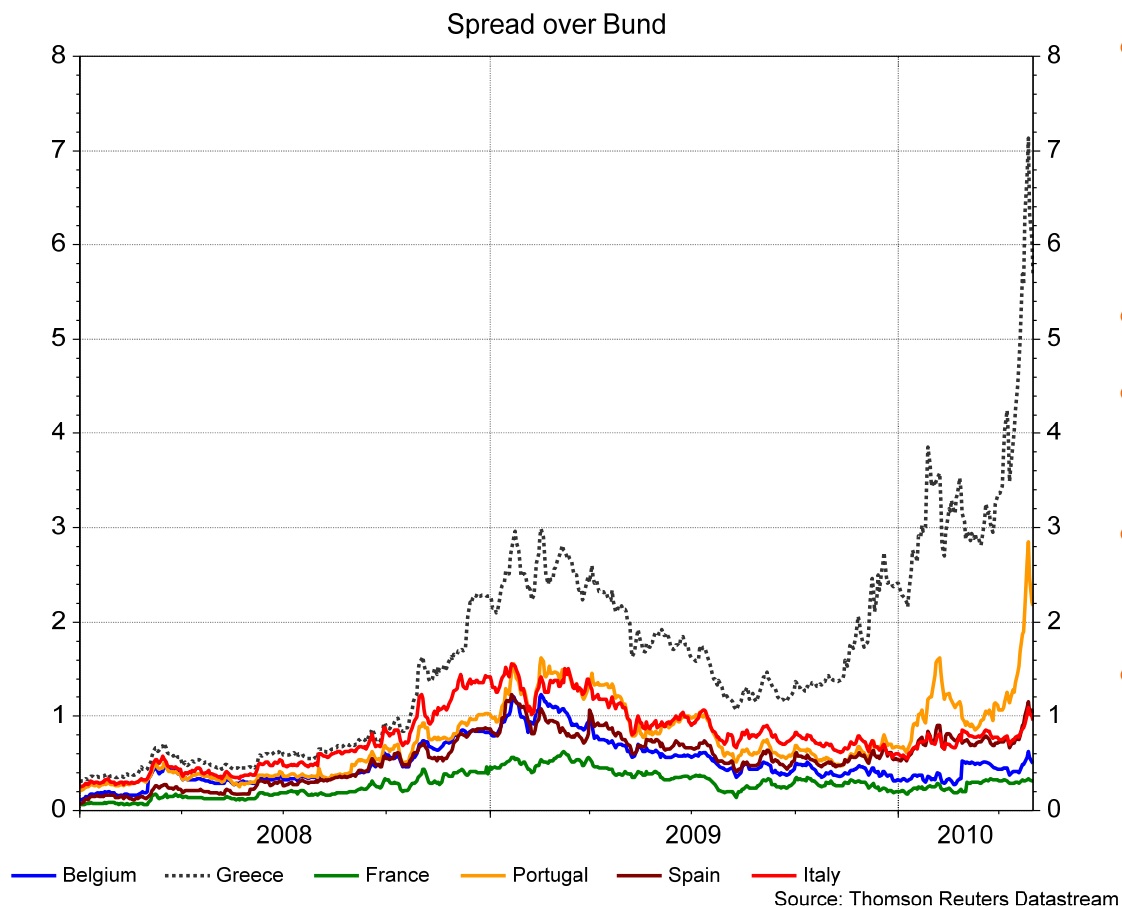
- Let us not be overly optimistic because of buoyant world trade, IP & GDP growth
- Financial crisis still among us (all our risks relate to it)
- Next big phase in the financial crisis (after subprime, banking & economic crisis)
- Reinhart & Rogoff: Public debt soars in wake of fin.crisis & defaults often follow

Cumulative rise in real debt in the 3Y following the banking/financial crisis

Index= 100 in year of crisis



Bond yield spreads against German Bunds



- It started with Greece (statistics falsified) & 2009 deficit estimate suddenly doubled
- Credit downgrades
- Spreads of ES, PT, IR also on the rise
- Last week even small rises in other countries
- Reasons behind crisis?

GR	714	IT	110
PT	286	BE	62
IR	225	FR	33
ES	115	NL	29

Spreads on 28/04:

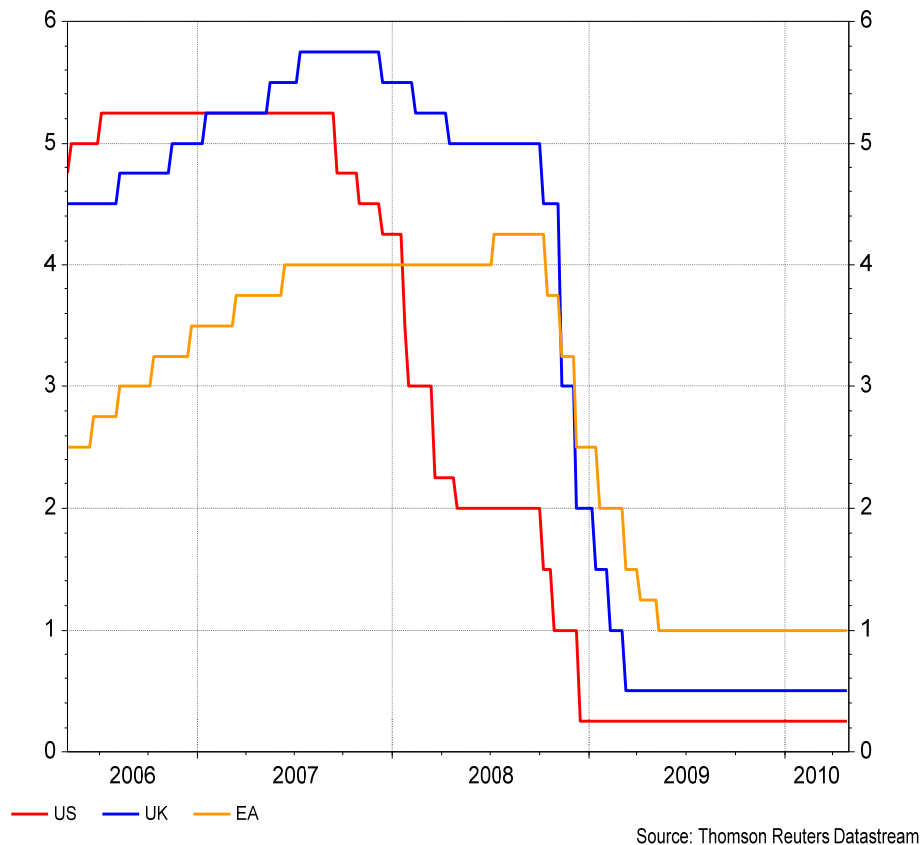
1.State of public finances

	Deficit	Debt
Greece	-12,7	112,6
Spain	-11,2	54,3
Portugal	-8,0	77,4
Ireland	-12,5	65,8
Italy	-5,3	114,6
France	-8,3	76,1
Belgium	-5,9	97,2
Germany	-3,4	73,1
NL	-4,7	59,8
Austria	-4,3	69,1
Finland	-2,8	41,3
EA12	-6,4	78,7
UK	-12,1	68,6
US	-11,3	65,2

- Deteriorated strongly due to recession, stimulus & capital injections in banks
- In some countries : Over-reliance on above-trend receipts from bubbly sectors (e.g. construction in ES, financ.sector in UK)
- LT cost of ageing

Ameco Autumn 09 fc for 2009

2. Phasing out of exceptional monetary stimulus



- Departure from near 0% IRs
- Fade out almost limitless provisioning of liquidity
- End QE
- Has powered financial assets
- Carry-trade on gov.bnds, popular strategy
- Removal of subsidy to public debt
- Mainly hurts most indebted countries (higher ylds ,made them main beneficiaries carry-trade)

3. Competitiveness, CA deficits and foreign debt

Country	ULC Ch 08-99	CA/GDP change 08-99
Greece	40.4	-8.6
Ireland	37.5	-5.3
Portugal	35.5	-3.2
Spain	33.3	-6.8
Italy	16.7	-4.0
Belgium	17.8	-4.7
Austria	8.6	5.1
France	19.7	-5.8
NL	24.9	0.0
Finland	19.8	-5.4
Germany	3.4	7.8
EA12	17.9	-1.2
UK	24.3	0.7
US	17.2	-1.8

- Entrance in euro area lowered interest rates & unleashed credit boom
- Higher wage growth and inflation
- Deterioration of competitiveness
- Strongest rise over last 10Y seen in the four problem countries
- Related: The level of foreign debt and the dependence on foreign capital (PT)

4. The functioning of the euro area: more integration?

- Lack of means to address these imbalances
- Lack to reach consensus rapidly in times of crisis
- Initial plan for Greece was vague and incredible & markets did not buy it
- The EA is no optimal currency area
- US neither, but regional imbalances are attenuated by the federal budget (bulk of taxing & spending) and stronger labour mobility
- Euro area needs to integrate more and go towards a fiscal & political union or else ...

What next? – The new plan for Greece

- More inflation to erode debt overhang, defaults, general loss of confidence in sovereign debt?
- The new plan for Greece:
 - 110bn EUR loan package from EA & IMF
 - Condition of spending cuts & tax hikes
 - Effort needed not entirely unprecedented, but ... (cf. Belgian case)
 - 10 bn EUR to stabilise banking system
 - ECB suspends collateral rule for Greek bonds
 - Plus: No need to turn to bond market next 3Y
 - Enough to restore confidence? No
 - Insolvency remains a problem, some kind of debt restructuring still likely

Questions remain

- Amounts lent to Greece still need to be approved in national parliaments
- Will Greece really be able to achieve these draconian measures
- Contagion risk not addressed (ES, PT): Will they be saved too?
- Markets risk testing this & see if countries are really prepared to restore health in public finances
- Not only in Europe (US, UK, Japan)
- Policymakers need to find way to convince markets they'll do whatever necessary to get ahead of the crisis

Effects of full-blown sovereign debt crisis

- Higher interest rates
 - Premature and severe tightening of fiscal policy
 - Hit to bank assets (writedowns on sovereign debt) and financial panic: The sovereign version of Lehman?
- Would imperil the still fragile economic recovery

Foreign banks' exposure to problem countries

- Bulk with European banks
- Includes debt of public and private sector

	in bn EUR
Greece	163,9
Portugal	198,3
Ireland	601,8
Spain	795,4
Italy	984,2

Source: BIS