AcF 304 Financial Markets

Topic 2: Why Do Financial Financial Crises Occur and Why Are They So Damaging to the Economy?

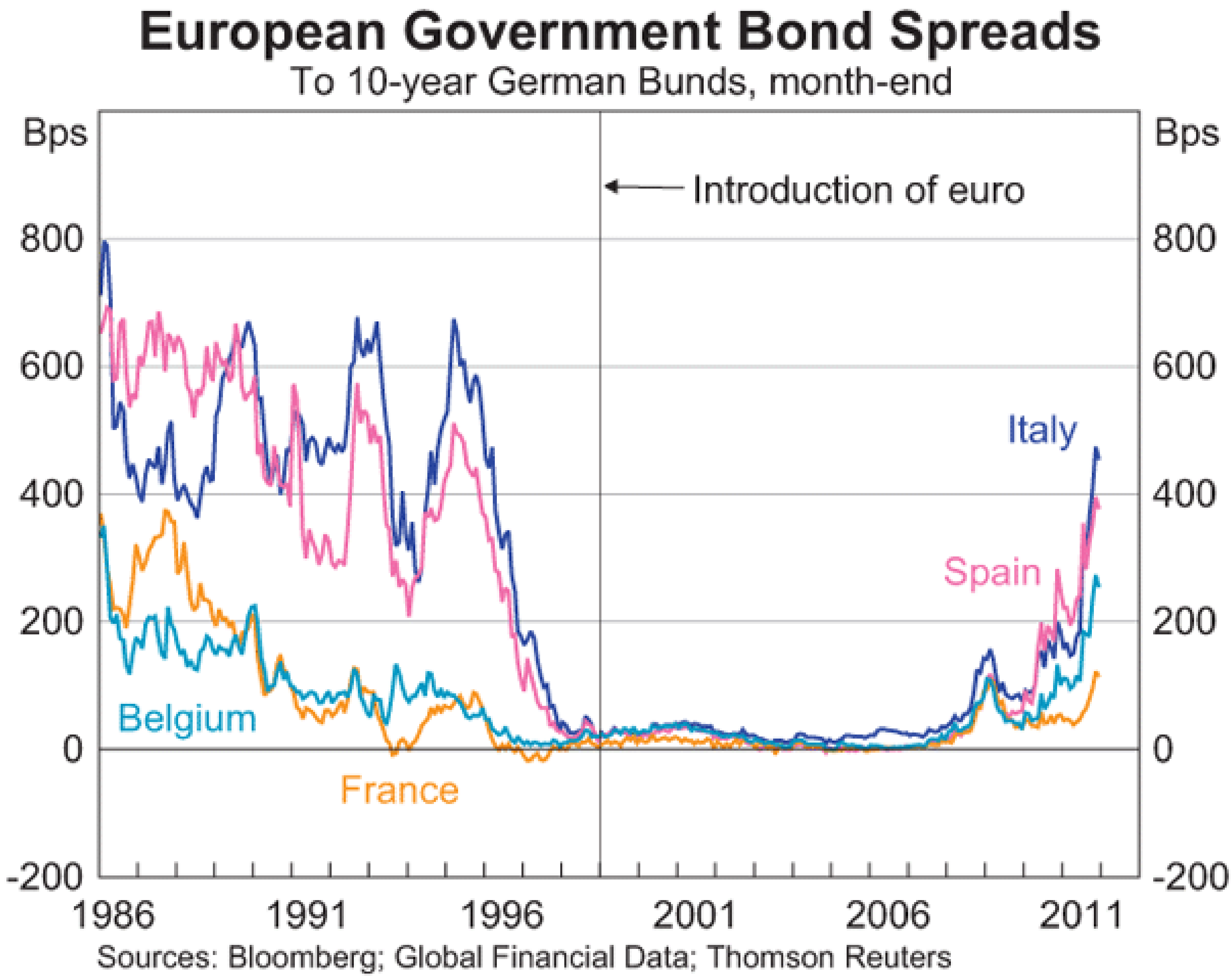
Part 6 – The European Sovereign Debt Crisis

Case: The Global Financial Crisis of 2007-2009 (Chapter 8 – Page 220)

- Global: The European Sovereign Debt Crisis

  - Up until 2007, all the countries that had adopted the euro found their interest rates converging to very low levels.

  - At the same time, several of these countries were hit very hard:
    - Lower tax revenue from economic contraction
    - High outlays for FI bailouts
    - Fear of gov't default cause rates to surge


European Government Bond Spreads
To 10-year German Bunds, month-end
Bps
Bps
Introduction of euro
800
600
400
200
0
-200
Italy
Spain
Belgium
France
1986
1991
1996
2001
2006
2011
Sources: Bloomberg; Global Financial Data; Thomson Reuters

Global: The European Sovereign Debt Crisis (1 of 3)

- Greece was the first domino to fall
  - In September 2008, gov't projected a 6% deficit and debt-to-GDP of 100%
  - In October, with newly elected officials, numbers were shown to be far worse
  - Fear of default caused rates on Greek debt to peak near 40%
  - Debt-to-GDP rose to 160% in 2012

Global: The European Sovereign Debt Crisis (2 of 3)

- Greece was forced to write-down its debt (partial default)
- Civil unrest broke out as unemployment rates climbed
- The prime minister was eventually forced to resign

Global: The European Sovereign Debt Crisis (3 of 3)

- Ireland, Portugal, Spain, and Italy followed
  - Governments forced to embrace austerity measures to shore up their public finances
  - Interest rates climbed to double-digit levels
  - Severe recessions resulted, despite assurances from the ECB to help
  - Unemployment rates rose to double-digits (25% in Spain)
- Will the euro survive?

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Part 6 – Summary & Next Week's Preview