



BRE BANK SA



Centrum Analiz
Społeczno-Ekonomicznych

◀ Strefa euro – kryzys i drogi wyjścia ▶

Warszawa, 16 czerwca 2011 r.



Why is the debt crisis spreading inside the euro area?

Charles Wyplosz

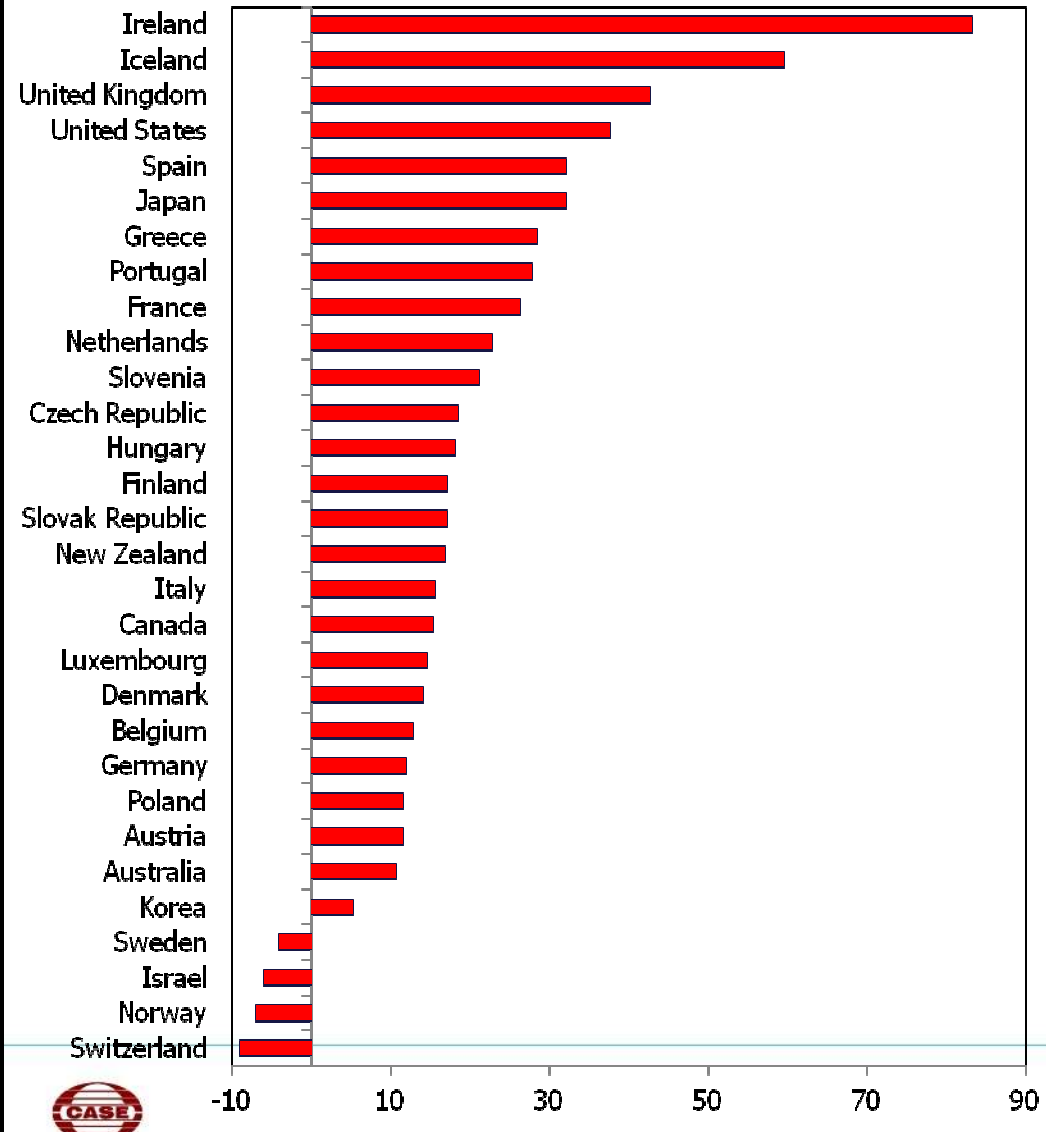
The Graduate Institute, Geneva and CEPR



A striking evolution

- Debt/GDP ratios have risen on average by some 30% among developed countries

Change in debt/GDP ratio



A striking evolution

- Debt/GDP ratios have risen on average by some 30% among developed countries
- Mostly for excellent reasons
 - A sharp change from the past
- So far, only euro area debts under attack

Why?

Why the euro area?

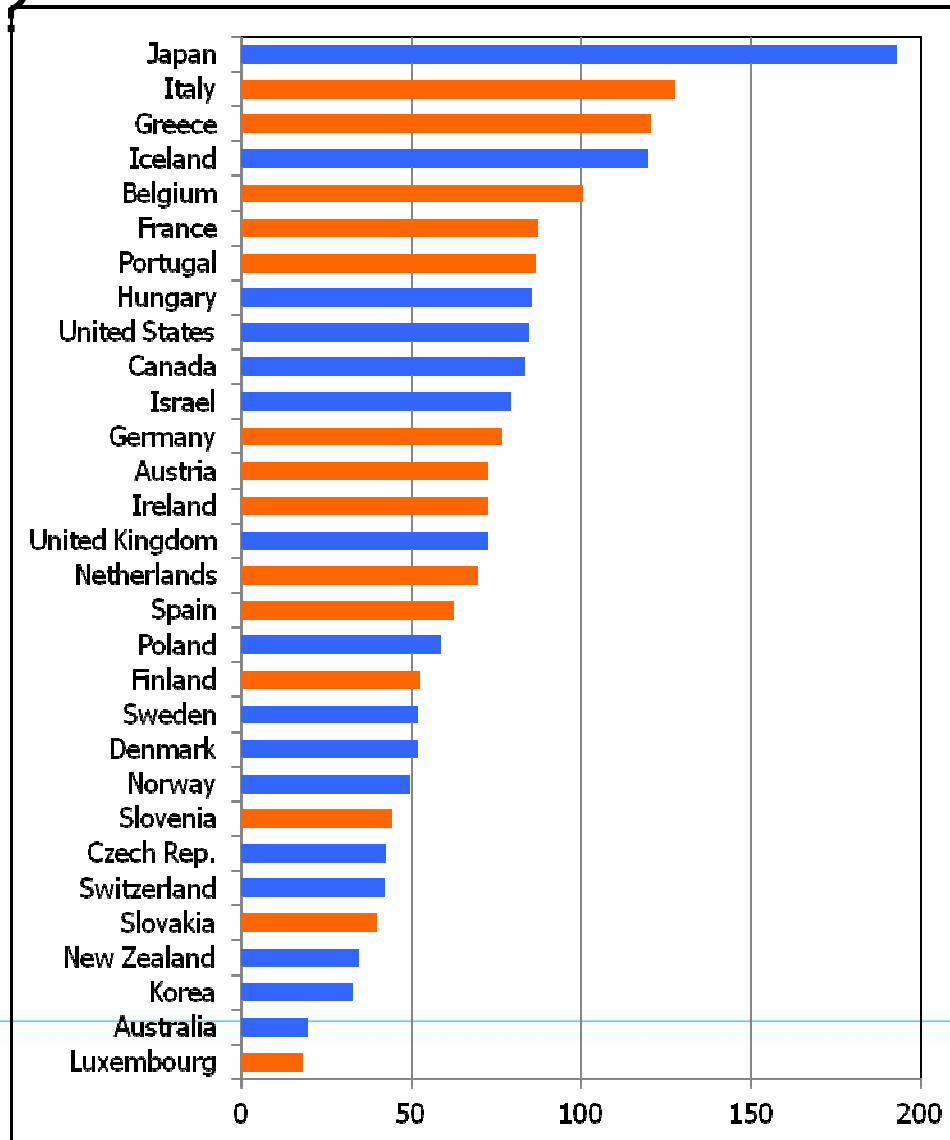
- 1. Largest debts
- 2. Largest deficits
- 3. Loss of exchange rate
- 4. Policy mistakes

Why the euro area?

1. Large debts

Debt/GDP in 2009

Is this a
euro area
effect?



Why do countries have large debts?

Table 1. Public debts

Variable	Coefficient	Std. Error	Prob.
constant	3.70	1.09	0.00
GDP per cap.	-0.20	0.13	0.13
Spending/GDP	0.61	0.23	0.01
Growth	-0.16	0.05	0.01
Corruption index	0.08	0.06	0.20
Euro area	0.23	0.21	0.27

Growth and spending are the story

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Not a richer/poorer country story

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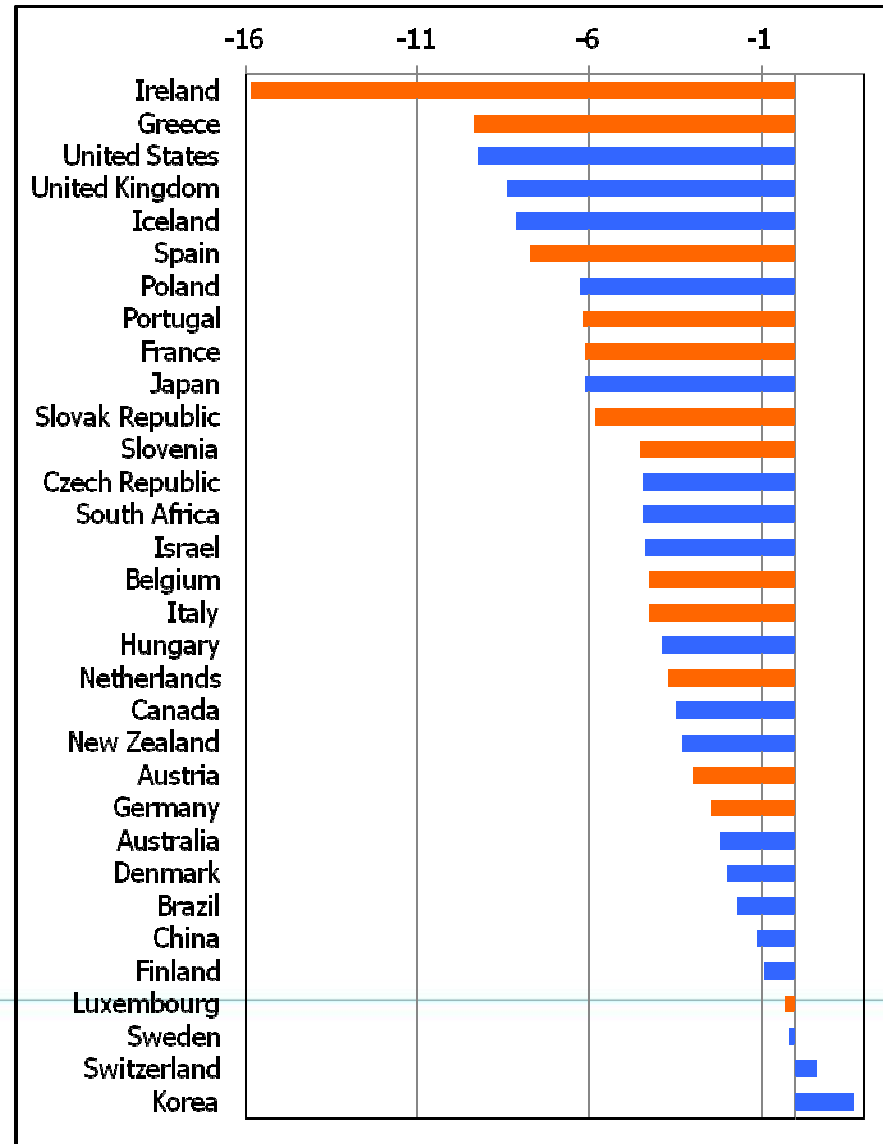
Not a euro area story

Why the euro area?

2. Large deficits

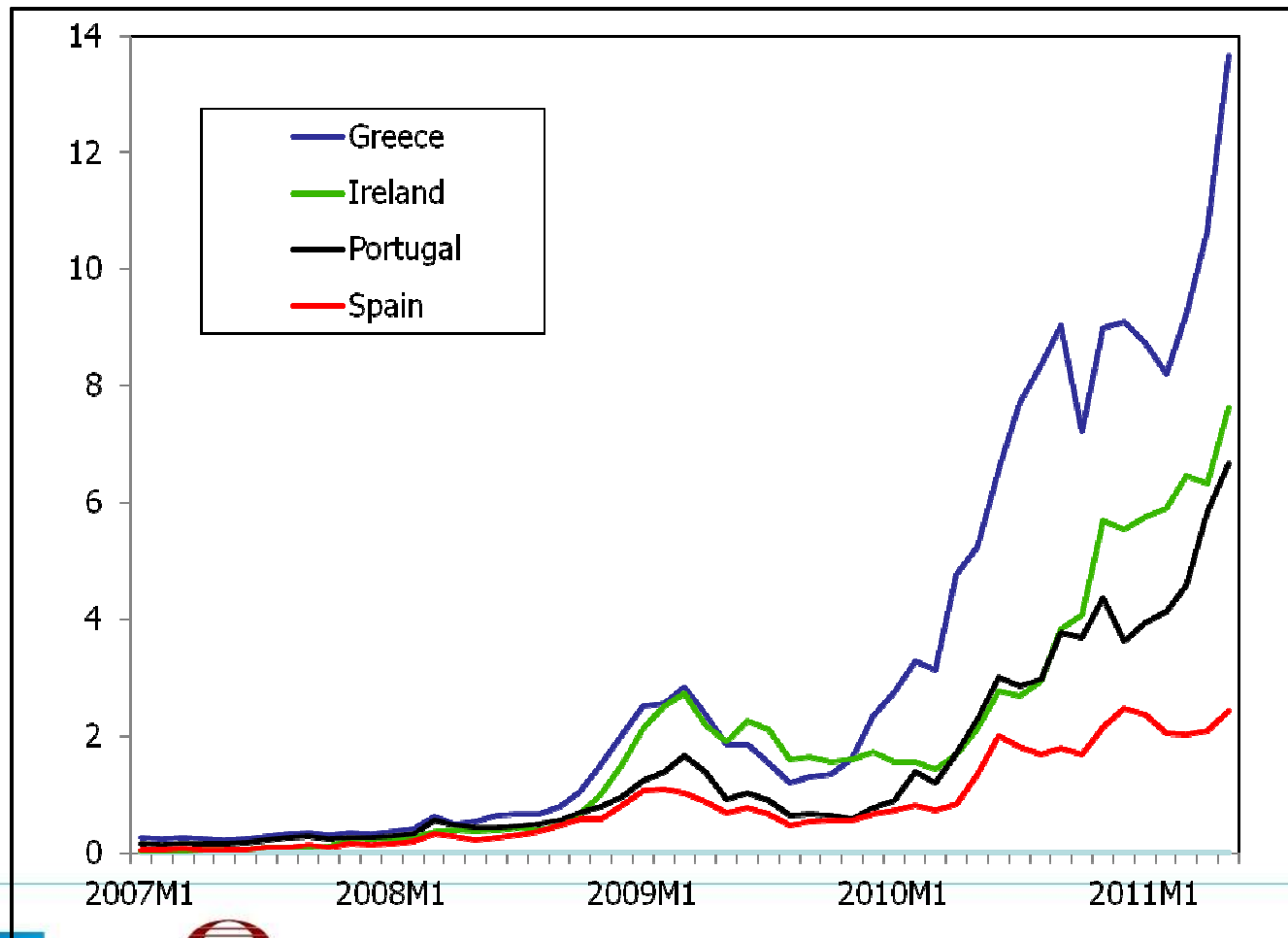
- Expectations
- Self fulfilling

Average 2008-2011



Still, a euro effect

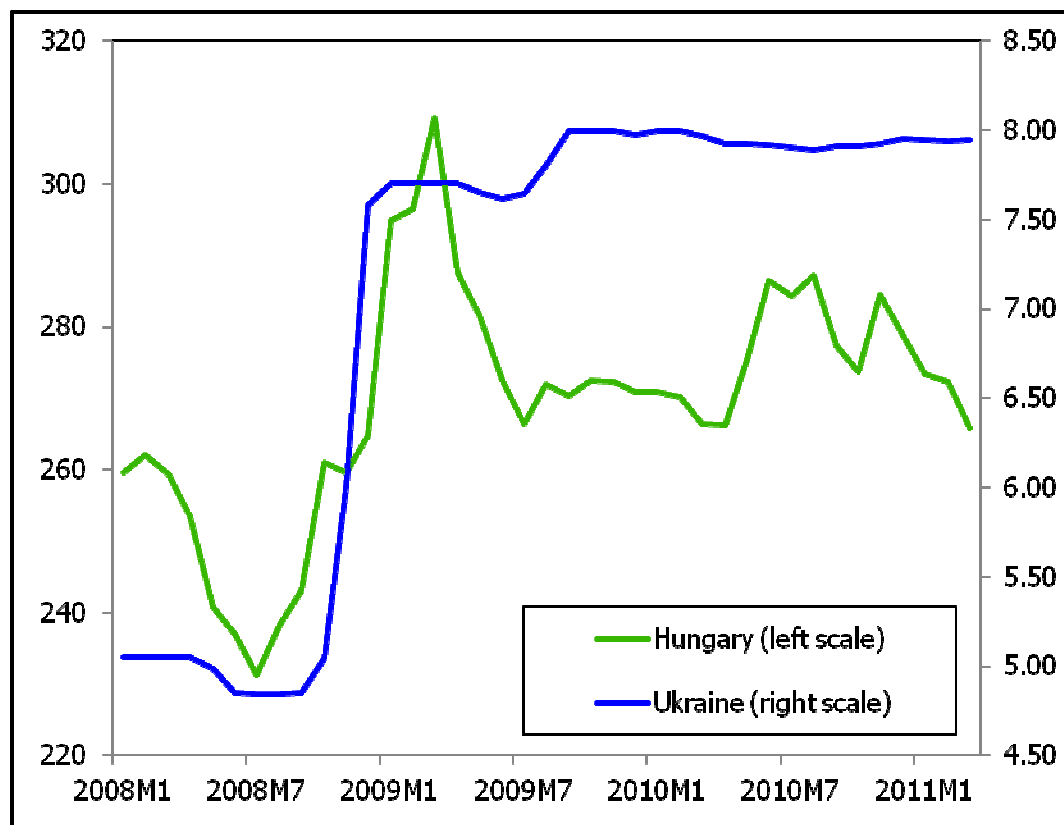
Spreads relative to Germany



3. Loss of monetary/exchange rate policy

- Ambiguous implications
- Good: no currency crisis

Hungary and Ukraine



Loss of monetary/exchange rate policy

- Ambiguous implications
- Good: no currency crisis
- Bad: no offset to contractionary fiscal policy
 - Self-fulfilling
 - If markets impose high rates, no way out of crisis
- A vulnerability, not a fatality
 - Reason for self-imposed fiscal discipline in normal years

Summary so far

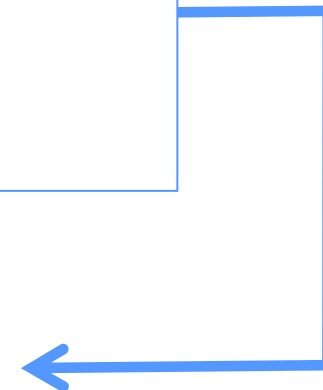
- Yes, large debts but elsewhere too
 - Not a direct effect of euro area membership

-

Note for future reference:
the case for collectively
agreed-upon
fiscal discipline

-

very difficult to cut deficits



4. Policy mistakes

- Self-fulfilling crises may (almost) always happen
 - Only solution: zero vulnerability
- When they happen, policies must be well adapted
 - Sense of failure
 - Not just now, last year as well
- Worse possibility: *the* reason for contagion

Policy mistakes: What were the options?

- The solidarity route
 - Ignore the no-bailout clause
 - Weigh on Greece to “go European”
 - Provide adequate financing
 - Rule out contagion
- The tough love route
 - Enforce the no-bailout clause
 - Let Greece deal with IMF
 - Be prepared to deal with banks

Policy mistake: Pros and cons of the two options

- The solidarity route
 - Open-ended commitment
 - Open way to contagion
 - Need to invent replacement for no-bailout clause
- The tough love route
 - Risk of contagion
 - Potential need to recapitalize banks, again
 - Establish fiscal discipline, once and for all

Why a policy mistake?

- Open-ended commitment
 - Hard to evaluate ex ante
 - The € 750 billion saga
 - EFSF: 440
 - Commission: 60
 - IMF: 250

Really 250

Cancelled

No promise

Why a policy mistake?

- Open-ended commitment
 - Hard to evaluate ex ante
 - The € 750 billion saga

Current debts (€ bn)

	2011		
Greece	352		
Ireland	175		
Portugal	174	↘	526
Spain	737	↘	700
Italy	1911	↘	1436
Euro area	8323	↘	3347

Call in the ECB!

750?

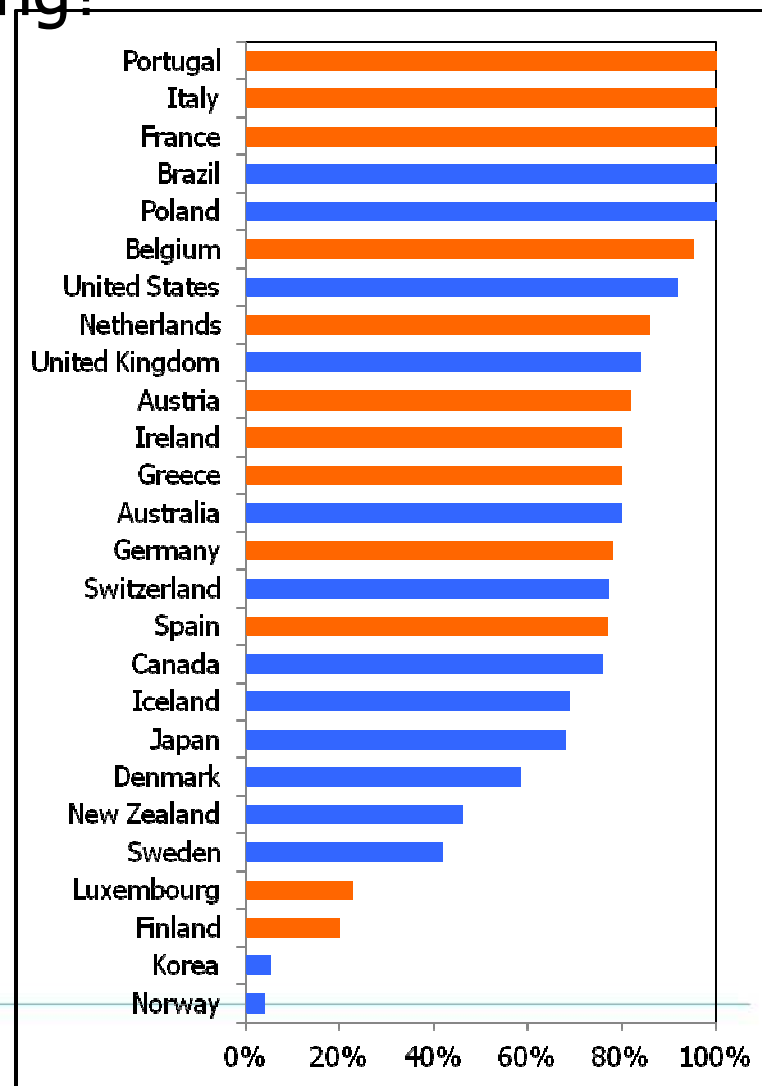
Why a policy mistake?

- Open-ended commitment
- The ECB cannot stay out
 - A further exception to the no-bailout rule
 - A puzzling evolution
 - Never again?
- The need for yet more money
 - Creation of the ESM in 2013
 - Private sector bailing-in
 - And until then?
- And if that does not work?

Does it stand a chance of working?

- Ability to be disciplined

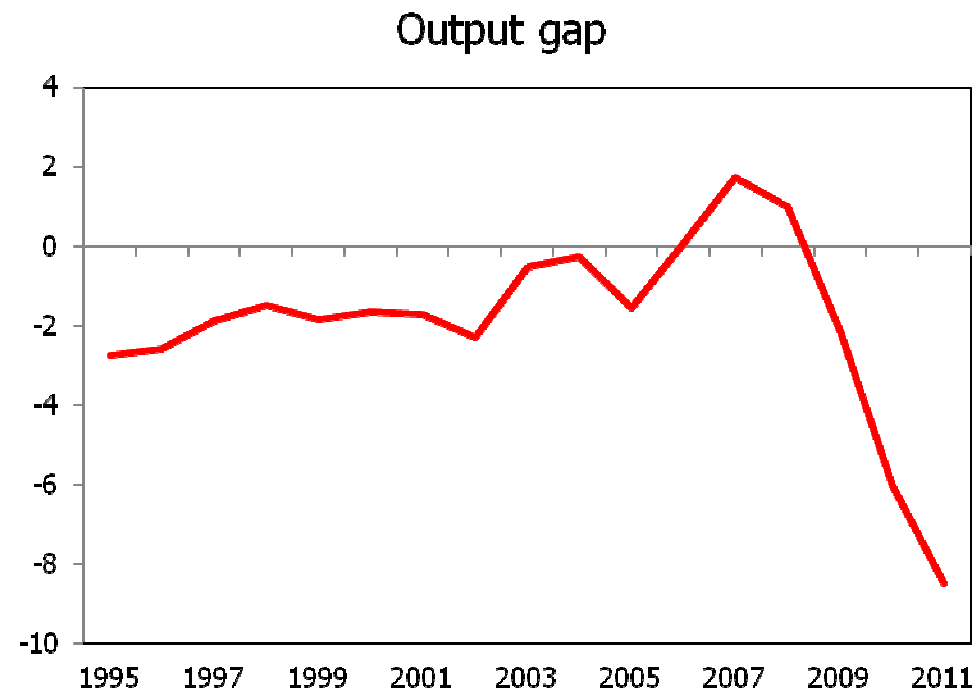
Percent of years
in deficit



Does it stand a chance of working?

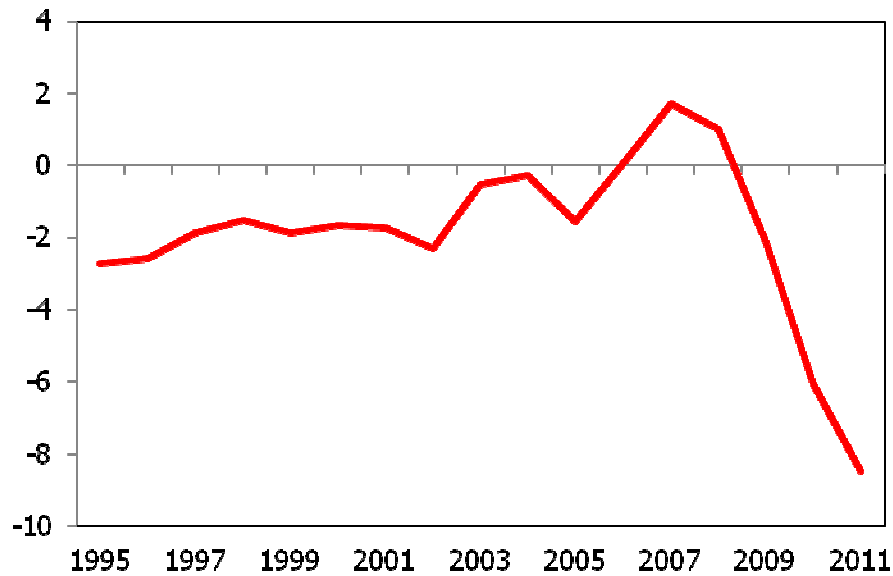
- Ability to be disciplined
- Ability to meet conditions imposed by IMF/European Commission
 - Can you reduce deficit in midst of deep recession?

Greece

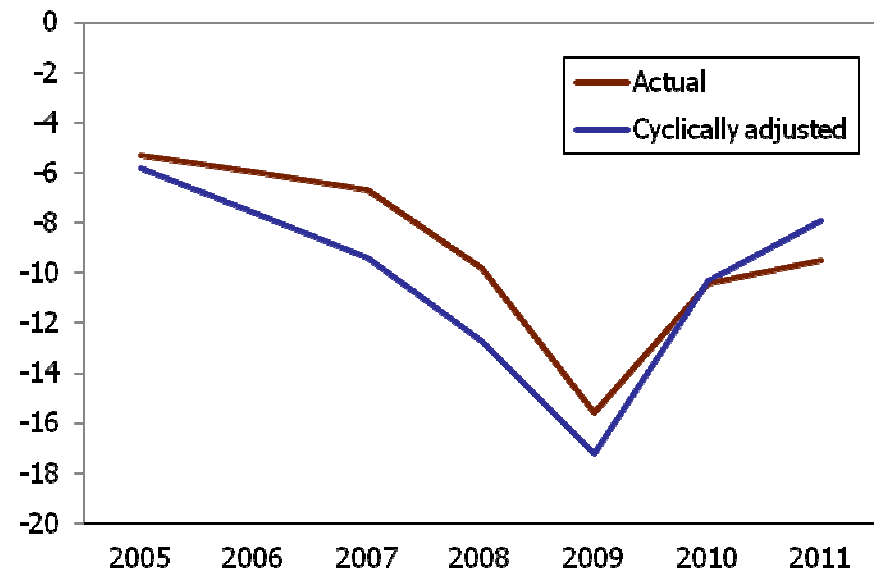


Greece

Output gap



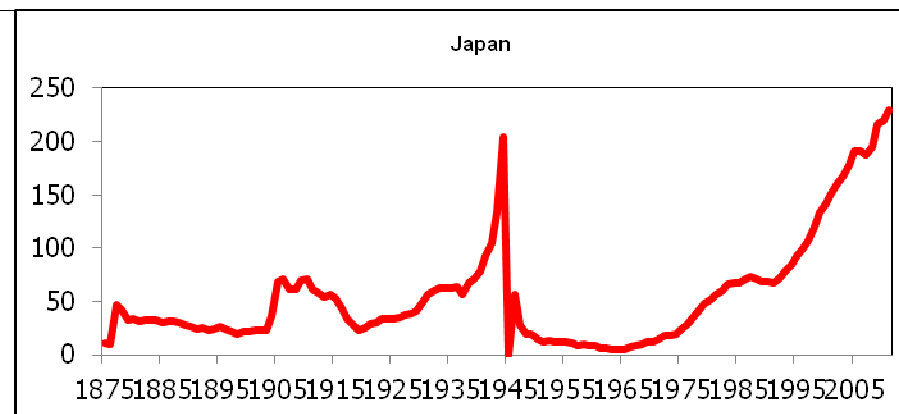
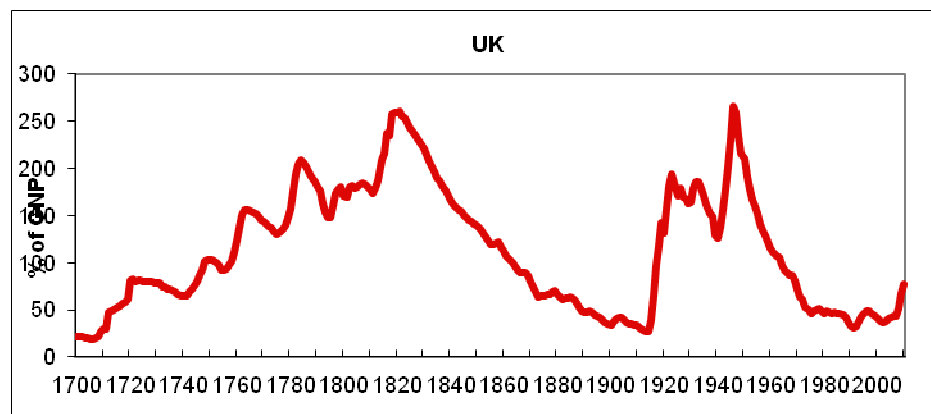
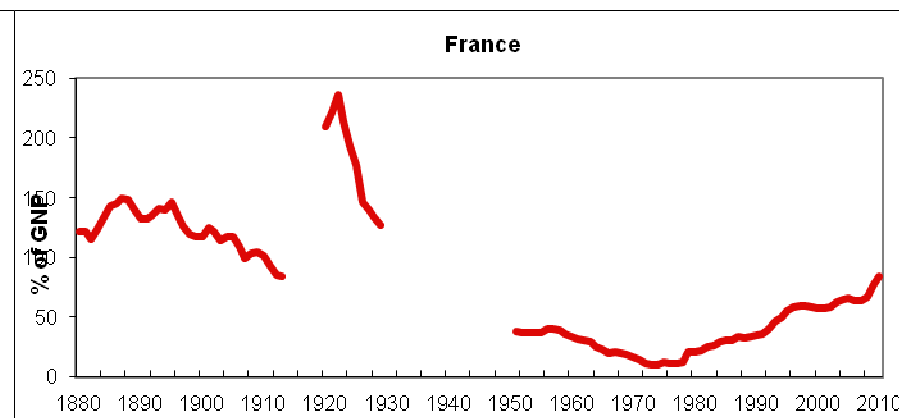
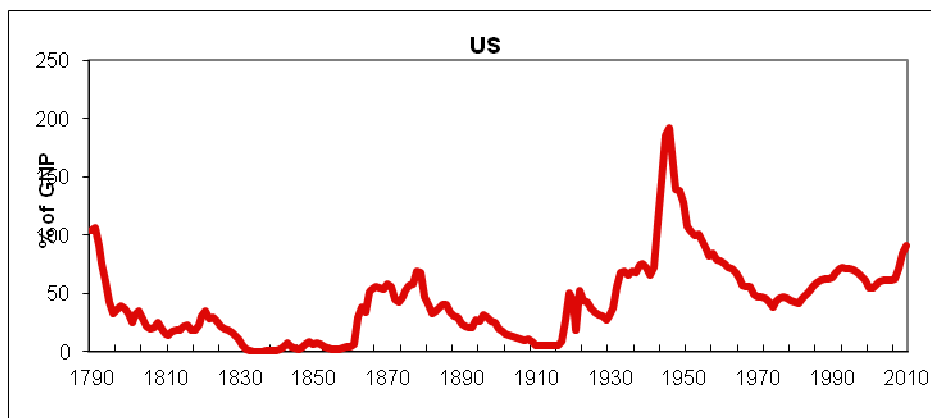
Budget balances



Does it stand a chance of working?

- Ability to be disciplined
- Ability to meet conditions imposed by IMF/European Commission
 - Can you reduce deficit in midst of deep recession?
 - Should you reduce debt quickly?
 - Public debts rose by some 30% of GDP
 - Bringing them down will take decades, not years

Debts: slow climb-downs



And now?

- Urgent issue: stop the rot
- Longer term: has the monetary union changed?

Stop the rot

- Current orientation
 - It hasn't worked, try harder
 - The politics of face-saving
 - Gain time
- The gamble
 - Fast growth erases all problems and mistakes
- If not, what?
 - Defaults
 - Painful consequences
 - Banking systems
 - Politics

Has the monetary union changed?

- Always was unfinished business
 - Economic and monetary union
 - Not a fiscal union
 - Not a political union
 - No federal state
 - No transfers
- Always included internal contradiction
 - Sovereignty in fiscal matters
 - Stability and Growth Pact
 - Lynchpin: no-bailout clause

Foreseen?

No-bailout clause removed: far-reaching consequences

- Needs a new game
- Moral hazard issue
 - Harsh treatment of countries bailed out
 - Conditions not subcontracted to IMF
 - Could make solution self-defeating?
 - No “easy restructuring”
 - How much of sovereignty can be removed?
 - A new Treaty for a new tougher and extended SGP?
- Other side of the coin: obligation to lend
- Third side of the coin: bailing-in of private sector



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Dziękujemy za uwagę

