



INTERNATIONAL FINANCE

The euro-zone debt crisis

How a shared currency turned one country's debts into a crisis for the whole euro area

A case study of events in 2009-2012

For training and education only. Not investment advice.

Share a currency but keep separate budgets, and one country's debt trouble can become everyone's.

Members gave up their own interest rate and exchange rate. A country in trouble could not devalue or print its way out, so lenders feared it might not repay, and then feared its neighbours too.

Why a shared currency made it hard



One currency

Many countries use the euro, but each still runs its own budget and borrows in its own name.



No own printer

Its central bank is part of the Eurosystem and cannot create euros alone, so it cannot print money to repay.



No devaluation

It cannot let its currency fall to regain competitiveness, the way a country with its own money can.

A euro-area country in trouble has fewer escape routes than a country with its own currency.

How the crisis unfolded

1

Late 2009: the gap appears

Greece's reported budget deficit is revised sharply upward, and investors lose trust in its figures.

2

May 2010: the first rescue

Euro-area governments and the IMF lend Greece about €110 billion. A temporary rescue fund, the EFSF, follows in June.

3

2010-11: it spreads

Ireland (late 2010) and Portugal (2011) need rescue programmes too. Borrowing costs jump across the periphery.

4

2012: debt write-down

In March 2012, private investors holding Greek bonds accept a large cut in what they are owed.

5

Mid-late 2012: the turn

The ECB promises to do 'whatever it takes', a permanent fund (the ESM) opens, and markets calm.

Sources: European Stability Mechanism, 'History'; European Central Bank; Eurostat.

The 2012 write-down, in numbers

THE WRITE-DOWN

In March 2012, private investors holding Greek government bonds agreed to a restructuring.

About €197 billion of bonds took part.

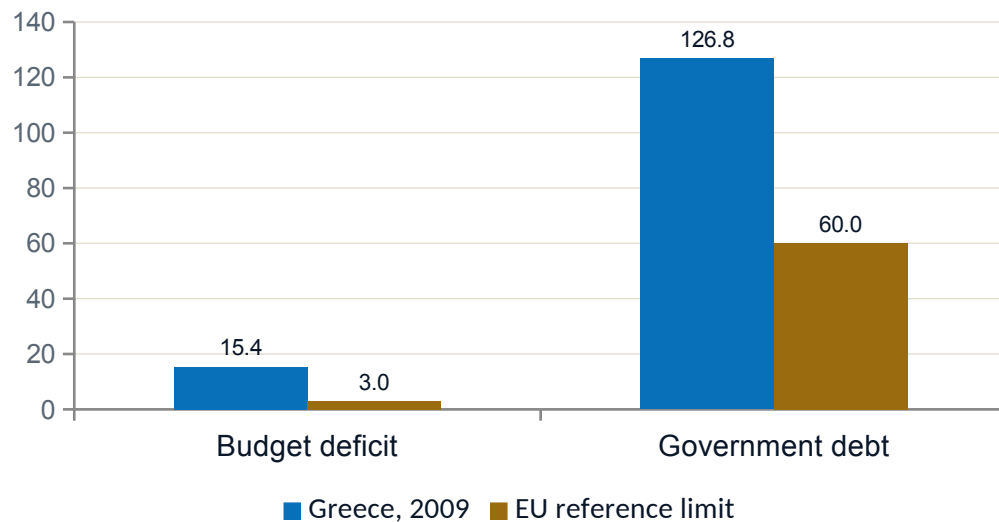
- 1 Each bond's face value was cut by 53.5%.
- 2 $\text{€197 billion} \times 53.5\% \approx \text{€105 billion}$ struck off the face value owed.
- 3 Greece's debt stock fell by roughly €107 billion, the official figure, close to this.
- 4 In present-value terms, investors' losses were larger still; contemporary estimates were around 70-78%.

A write-down cuts what the borrower owes and what lenders get back. Greece stayed in the euro.

Figures from the ESM and contemporary reports (see Sources). Arithmetic rounded.

How far past the limits Greece was

Per cent of GDP: Greece 2009 vs EU limits



Read the chart

- The EU's reference limits are a 3% deficit and 60% debt, both as a share of GDP.
- Greece's 2009 deficit was 15.4%, about five times the limit.
- Its government debt was 126.8%, more than double the limit.
- Numbers this far out made lenders doubt repayment.

Sources: Eurostat (Greek 2009 deficit 15.4%, debt 126.8% of GDP, Nov 2010); EU Stability and Growth Pact reference values.

The central bank's circuit-breaker



'Whatever it takes'

On 26 July 2012 the ECB President said the ECB was 'ready to do whatever it takes to preserve the euro'. Markets steadied in the weeks that followed.



OMT

In Sept 2012 the ECB set out Outright Monetary Transactions: buying a country's 1-3 year bonds, no preset limit, if it is in an EFSF/ESM programme.



Never used

OMT was never activated. Borrowing costs fell anyway, which many credit to the promise. Any buying would be fully sterilised.

A credible promise of unlimited support can work without a single euro being spent.

Sources: ECB (speech of 26 July 2012); ECB press release on OMT technical features, 6 September 2012.

Where things stood at the worst

Figures from the crisis years. These are historical outcomes, not current market data.

GREEK DEFICIT, 2009

15.4%

Of GDP, after Eurostat's revision in Nov 2010; the EU limit is 3%.

BOND WRITE-DOWN

53.5%

Nominal cut on privately held Greek bonds, March 2012.

DEBT REDUCED, €BN

~107

Roughly, from the 2012 private-sector restructuring.

PROGRAMME COUNTRIES

4

Greece, Ireland, Portugal, Cyprus (2013); Spain's was bank-only.

Sources: Eurostat (Nov 2010); European Stability Mechanism, 'History' and 'The private sector debt restructuring, March 2012'.

If you learnt this from older material

Older material said

- Greece might leave the euro and bring back the drachma.
- OMT had just been announced; its effect was unknown.
- The crisis was an open, unfolding question.

What we now know

- Greece stayed in the euro; no member left.
- OMT was never used, yet it calmed markets.
- The acute phase eased after 2012; Greece left its programme in 2018.

This is history now, with an outcome. Teach it as a case study, not as live news.

Sources: European Stability Mechanism, 'History'; European Central Bank.

Four things people get wrong



'It was only Greece's problem.'

Ireland, Portugal, Cyprus and Spain's banks also needed rescues. The doubt spread across the euro area.



'Sharing a currency has no downside.'

Members give up their own interest rate and exchange rate, so a country in trouble cannot devalue or print.



'The ECB bailed the countries out.'

Governments and the IMF funded the rescues. The ECB did buy some bonds from 2010, but OMT, its 2012 backstop, was never drawn.



'A bailout is free money.'

Loans came with strict reform conditions, and private bondholders took a large write-down on Greek debt.

Check yourself

Q1 Why did one country's debt troubles spread to others in the euro area?

Q2 What did the ECB's 2012 'whatever it takes' promise and OMT involve, and was OMT ever used?

Q3 In the March 2012 restructuring, by how much was the face value of privately held Greek bonds cut?

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Greek 2009 deficit revised to 15.4% of GDP (debt 126.8%): Eurostat, 15 Nov 2010. EU reference values (3% deficit, 60% debt): Protocol (No 12) to the EU treaties.
- First Greek programme (€110bn euro-area/IMF package, May 2010): European Commission and IMF. EFSF set up June 2010; ESM set up 8 October 2012: ESM, 'History'.
- Mar 2012 restructuring: 53.5% nominal cut, about €197bn of bonds, ~€107bn debt reduction: ESM, 'Private sector debt restructuring'. 'Largest' per Greece's counsel Cleary Gottlieb, press.
- 'Whatever it takes' speech, 26 July 2012: European Central Bank.
- OMT features (secondary market, 1-3 year maturity, no ex-ante limit, fully sterilised, needs EFSF/ESM programme): ECB press release, 6 Sep 2012. Never activated: Deutsche Bundesbank.
- Greece remained in the euro and exited its rescue programme in 2018: European Stability Mechanism, 'History'.

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