



Talking point

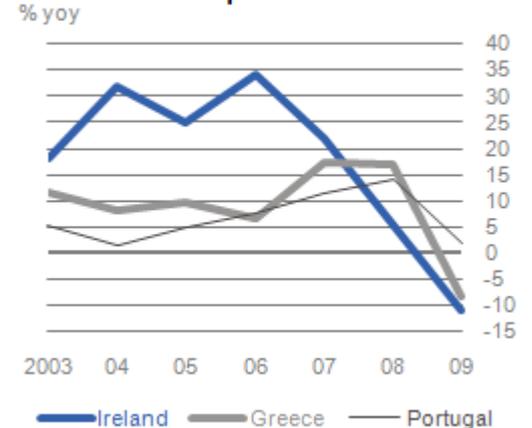
The euro debt crisis – similarities and differences

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The reasons for the current problems of some euro-area sovereigns on the capital markets differ from country to country. In the case of Greece, it was mainly a persistently unsound fiscal policy that led to a loss of confidence among investors, while in Ireland this was primarily due to a credit bubble which had inflated the size of the financial sector.

In times of tight markets, in particular, attention should be paid not only to the common characteristics of the individual economies and banking sectors in focus but also to their differences. The new DB Research Interactive map European banking markets helps with this differentiation. It shows, among other things, the size and growth of the financial sector in each of the 27 EU countries over the past few years. It becomes apparent that the problems faced by Greece and Ireland (or Portugal, for that matter) differ in nature and cannot be traced back to the banking sector in every case. Lending to private companies in Greece, at a mean growth rate of 10.6% p.a., was expansive in the run-up to the crisis, yet not much more than in the euro area as a whole (+8.2%). In Ireland, on the other hand, loan volumes increased by more than 26% on average every year between 2002 and 2007, not least because of the booming construction industry. Nominal corporate debt tripled in less than five years – definitely a clear indicator of unsustainable, excessive credit growth. In Portugal, finally, there was no sign of a lending bubble at all, with loans outstanding advancing by only a moderate 6% per year on average.

Loans to corporations

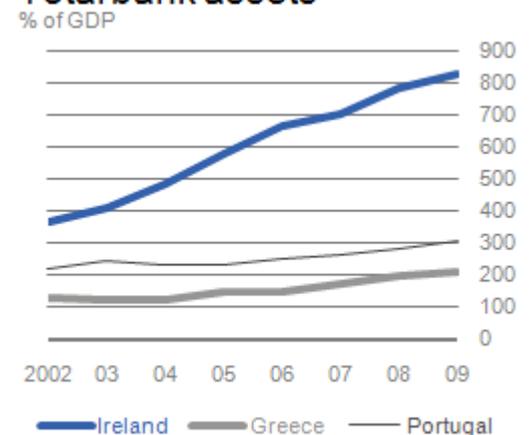


Sources: ECB, DB Research

At second glance, lending to private households confirms the general impression: Irish household credit growth, which averaged 21% p.a. from 2002 to 2007, was clearly unsustainable and mostly used to finance continuously rising housing costs as more homes were built and real estate prices increased. By contrast, the Portuguese figure of 8.9% remained close to that for euroland as a whole. Credit volumes in Greece tripled over the same period of time (+24% p.a.) – also an unhealthy development, though from a significantly lower starting level than in Ireland: household debt in Greece doubled from 27% to 56% of disposable income, while it galloped from 92% to 166% in Ireland. As a result, Irish borrowers were much more vulnerable than Greek debtors to a correction in the housing market and the consequences of the recession that followed the financial crisis.

Two additional factors made the crisis especially painful for the Irish banks and ultimately Irish citizens. First, Ireland's financial institutions were used to only low credit losses until 2007 – with the effect that both operating margins and reserves for irrecoverable claims were lower than in Greece. Second, the Irish banking sector had grown so strongly that its stabilisation was bound to represent a major challenge for an economy of Ireland's size. With a doubling of its banking assets by 2007 from an already high level in 2002 (360% of GDP), Ireland dwarfed most other EU member states – and particularly Greece where the financial sector expanded quite moderately and also stayed considerably smaller than in almost all other EU-15 countries, relative to GDP.

Total bank assets



Sources: ECB, Eurostat, DB Research

Overall, it was mainly country-specific reasons that triggered the deterioration of the situation. In Ireland the oversized post-bubble financial sector got the sovereign into difficulties – aggravated by insufficient banking regulation and supervision and driven by an

interest-rate level that was too low for Ireland as well as by overly optimistic private borrowers. On the other hand, there was no bloated banking industry in Greece and even less so in Portugal. In these two countries it was primarily fiscal policies – which were already unsound before the crisis – that led to a massive loss of confidence on the capital markets in the current recessionary times.

Interactive map European banking markets



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