

Management of debt challenges in Europe

Peter Mooslechner

Director, Economic Analysis and Research Department
Oesterreichische Nationalbank

„The challenges for the Southeastern European countries in the enduring economic and financial turbulences in Europe“

*National Bank of the Republic of Macedonia,
Skopje, 27 April 2012*

Motivation

The crisis: *“Anything Different this Time”?*

3 selected examples of obvious/urgent policy relevance:

1. **Interconnectedness, systemic risk and spillovers:
The threat of contagion**
2. **The risks of high leverage and subsequent deleveraging: Financial booms and busts**
3. **Capital adequacy, refinancing, funding and debt restructuring (of banks, the private sector and sovereigns)**

▶ **Focus on asset-liability-structure of an economy, on debt and wealth...**

▶ **Broader macroeconomic focus than fiscal alone...**

Overview

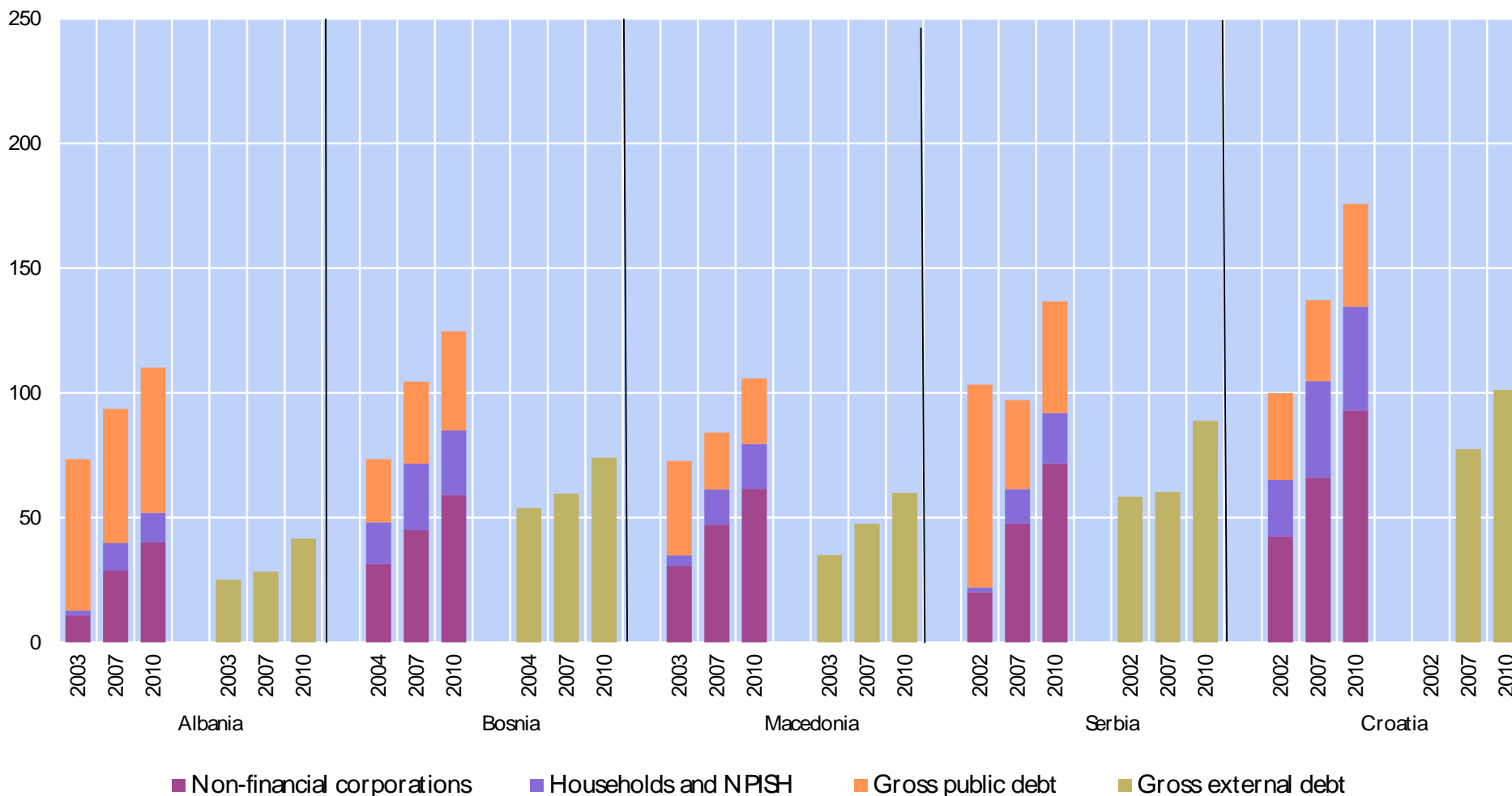
- 1. A perspective on debt dynamics and some characteristics**
- 2. Selected issues of public sector debt**
- 3. How much private sector debt (and financial deepening)?**
- 4. Impact of debt reduction on the real economy**

1. A perspective on debt dynamics and some characteristics

Debt dynamics in selected SEE countries

Total nonbank debt and external debt

percentage of GDP

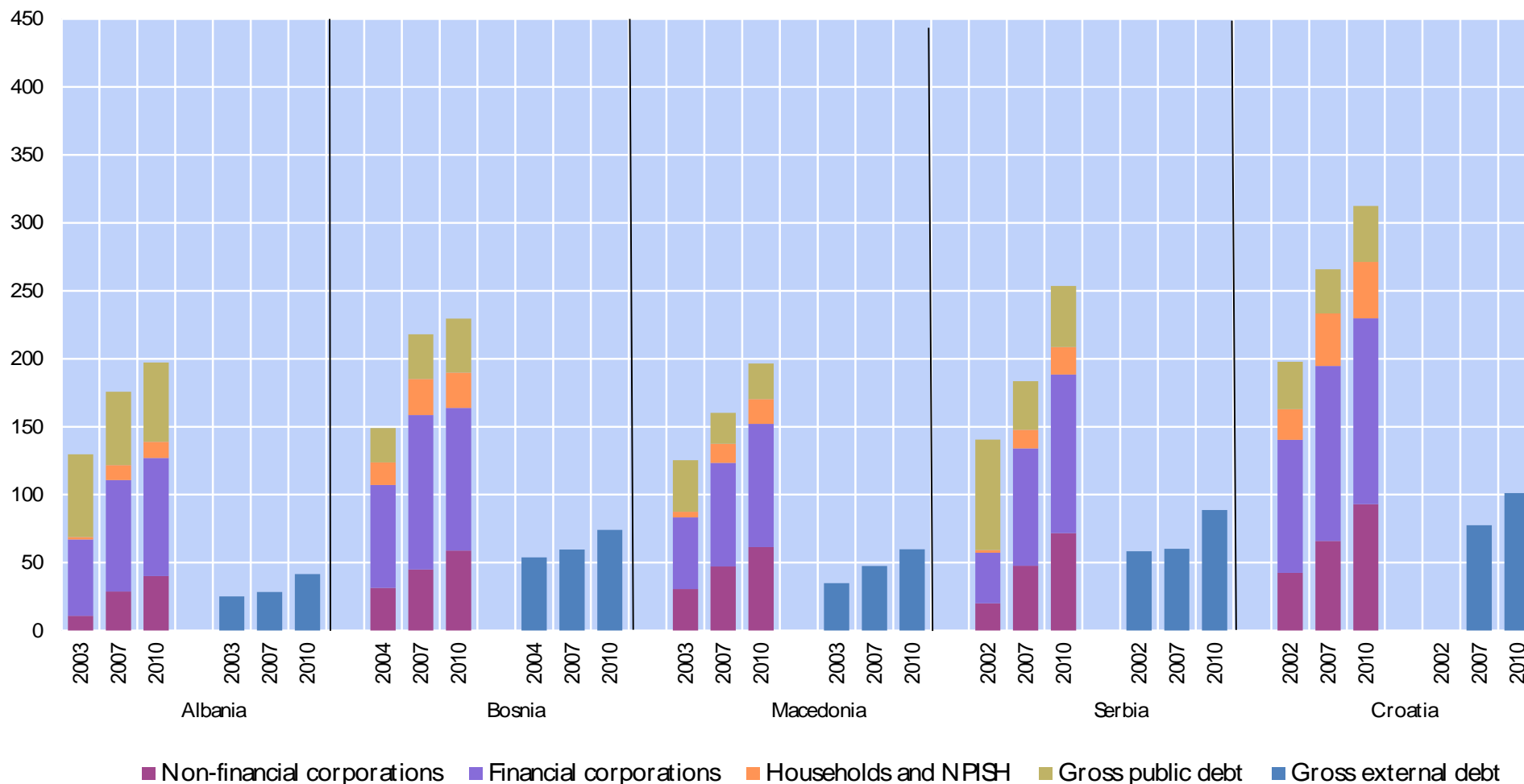


Source: AMECO database, IMF, Thomson Reuters

Total debt developments in selected SEE countries

Total debt of the economy and external debt

percentage of GDP

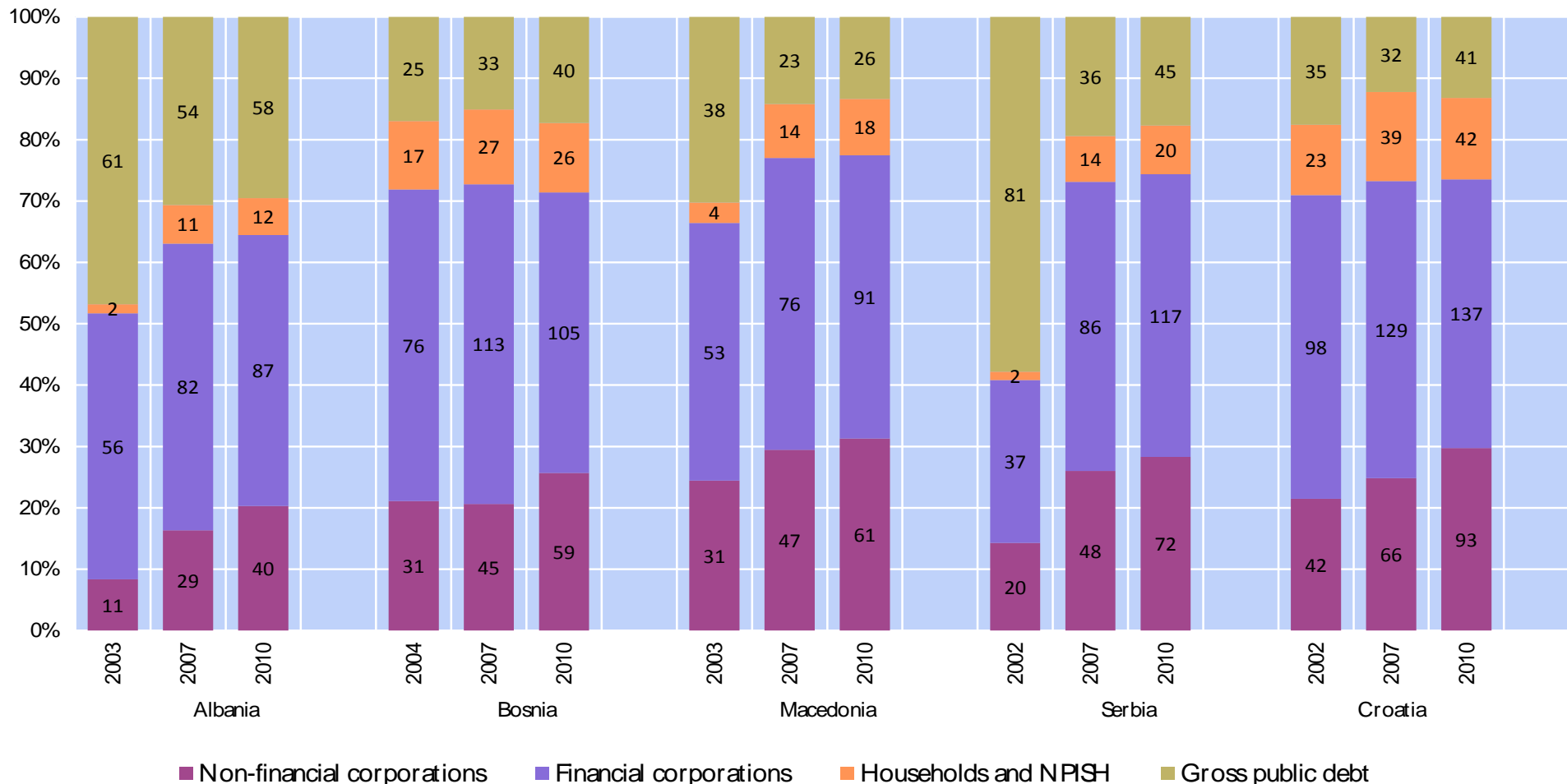


Source: AMECO database, IMF, Thomson Reuters

Total debt composition in selected SEE countries by sector

Total debt of the economy by sectors

percentage of total debt (left axis); figures in the columns show the share of each debt category in GDP (percent)

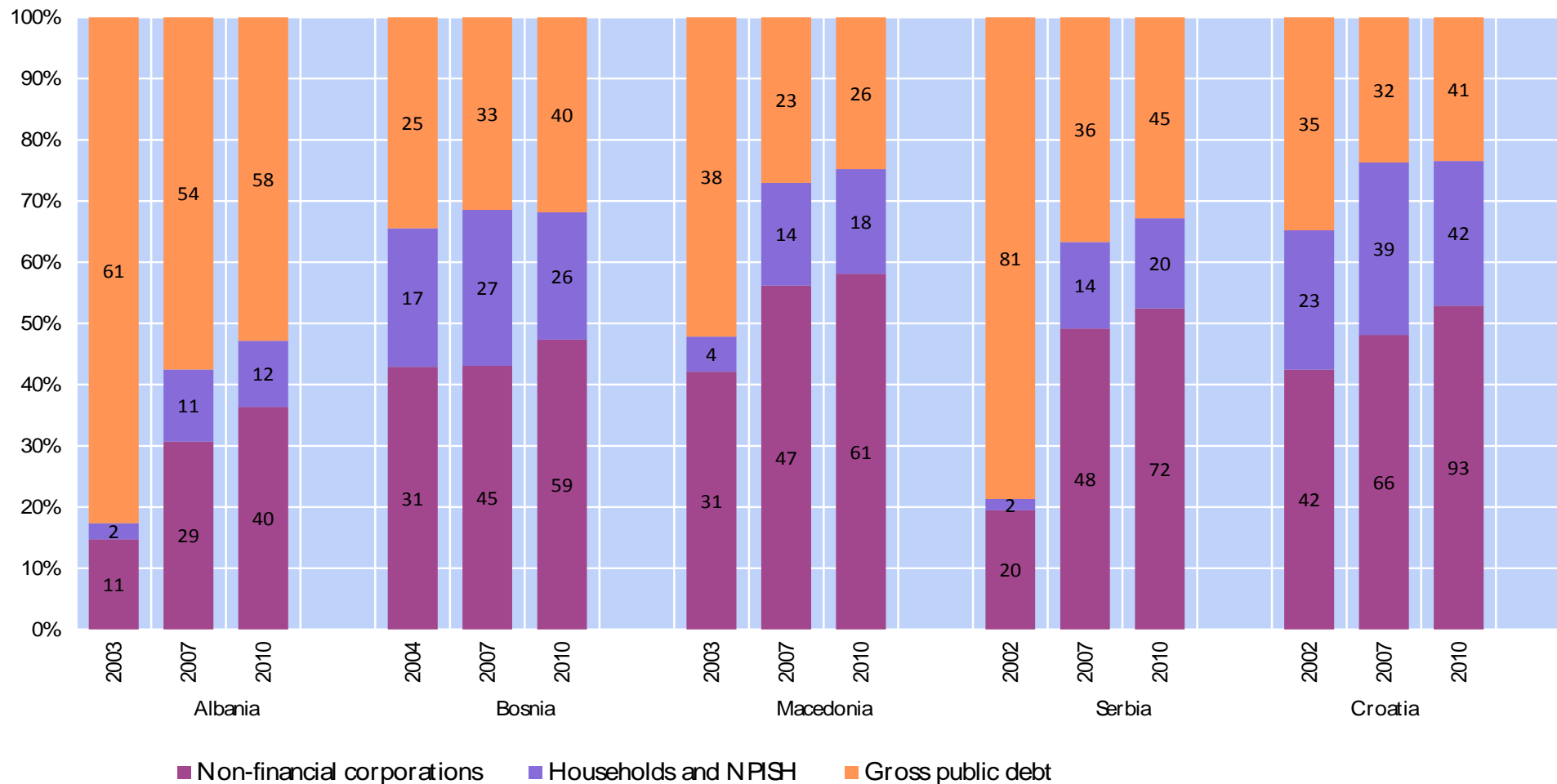


Source: AMECO database, IMF, Thomson Reuters

Nonbank debt structure in selected SEE countries

Total nonbank debt by sectors

percentage of total debt (left axis); figures in the columns show the share of each debt category in GDP (percent)

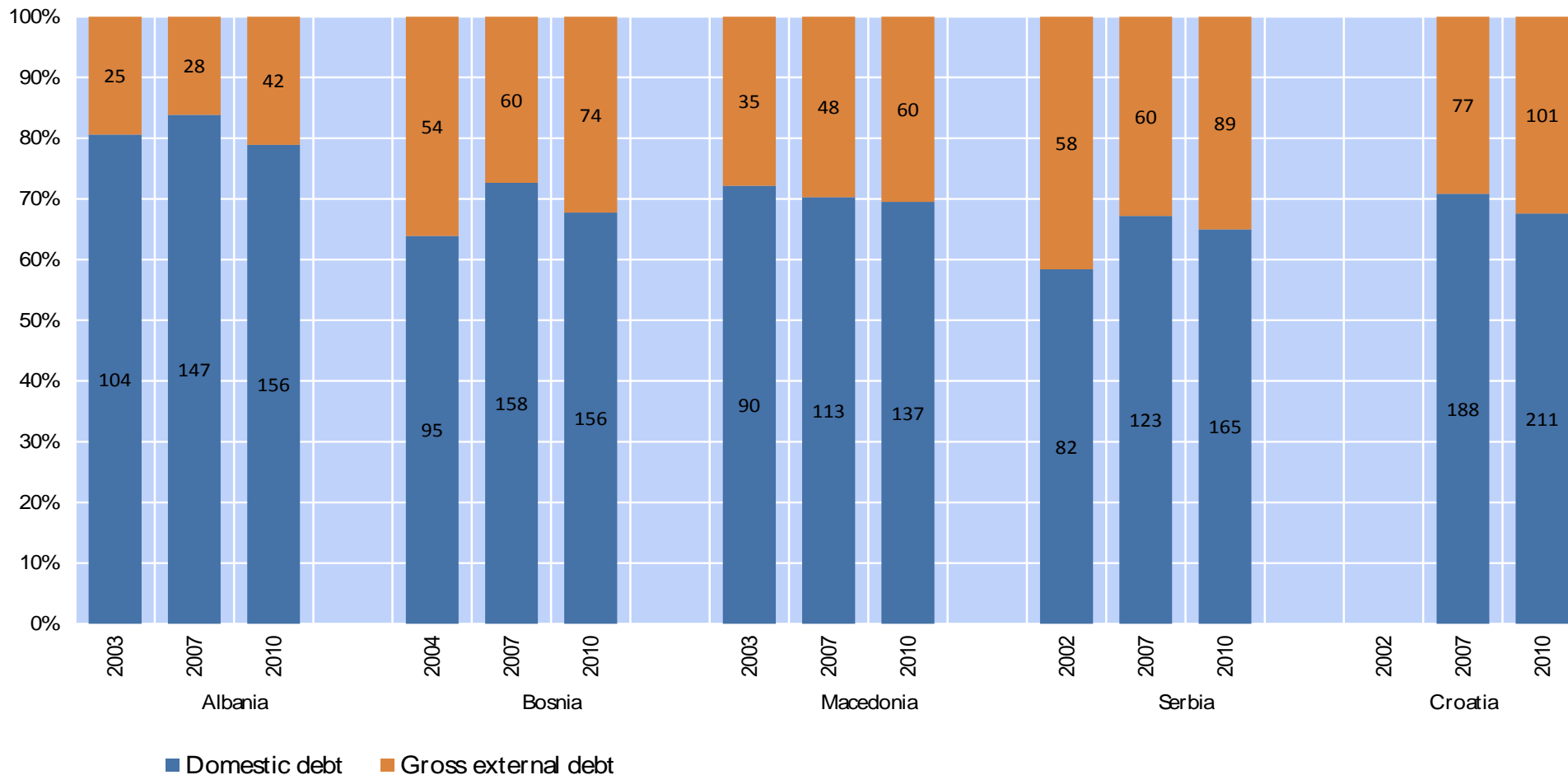


Source: AMECO database, IMF, Thomson Reuters

Share of foreign debt in selected SEE countries

Domestic debt vs. external debt

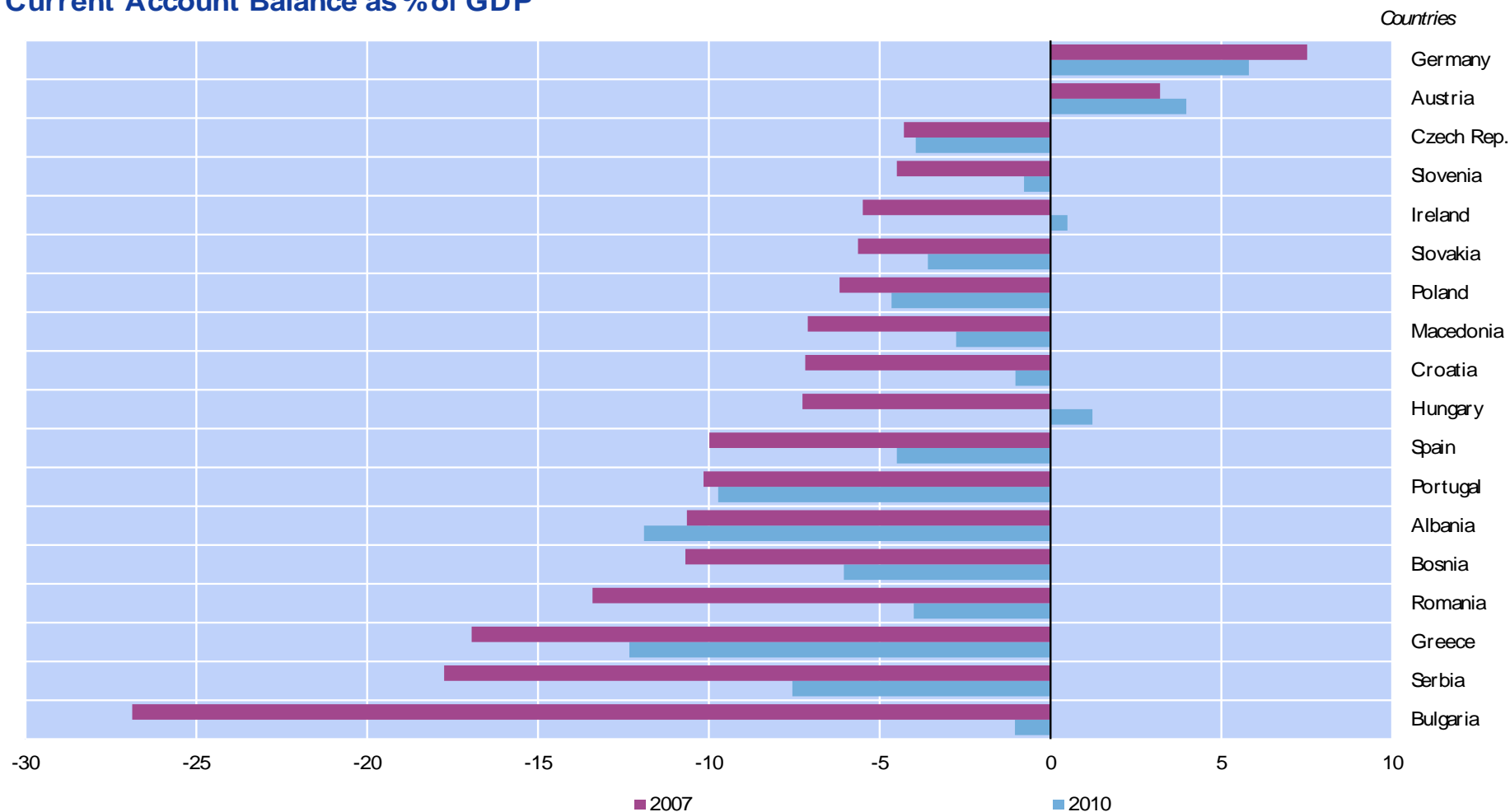
percentage of total debt (left axis); figures in the columns show the share of each debt category in GDP (percent)



Source: AMECO database, IMF, Thomson Reuters

External imbalances have broadly fallen during the crisis

Current Account Balance as % of GDP



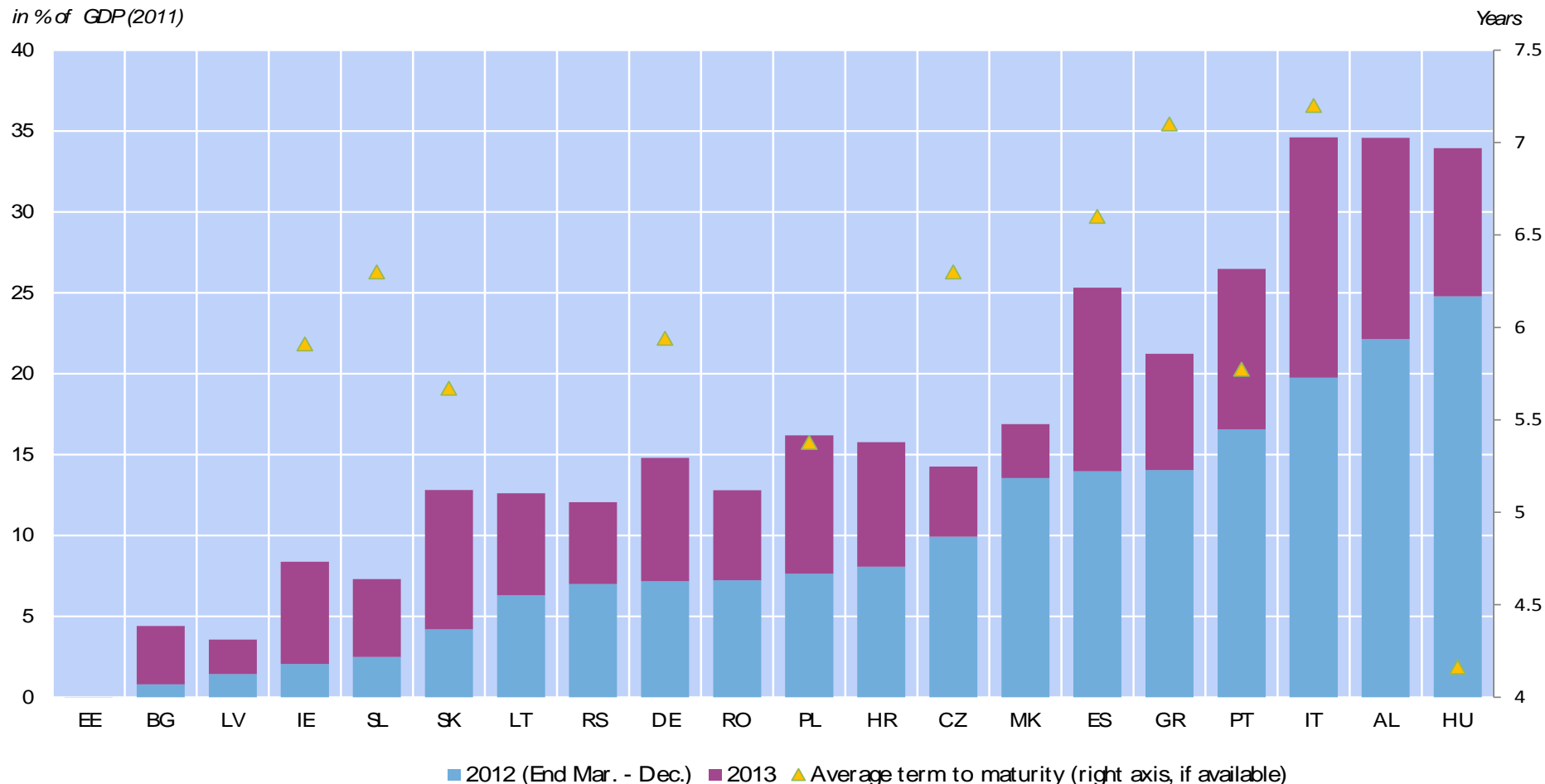
Quelle: European Commission, IMF, NCB

2. Selected issues of public sector debt

Challenge: Large sovereign refinancing needs

Refinancing Needs: Principle and Interest Payments for Bonds and Loans

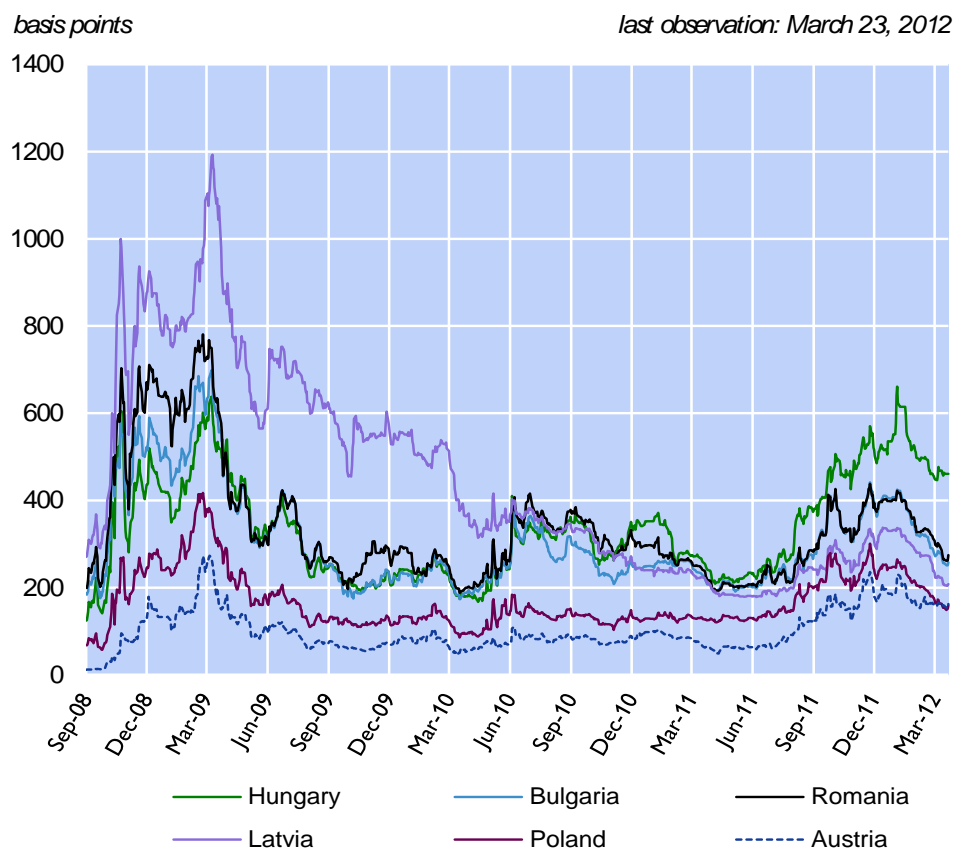
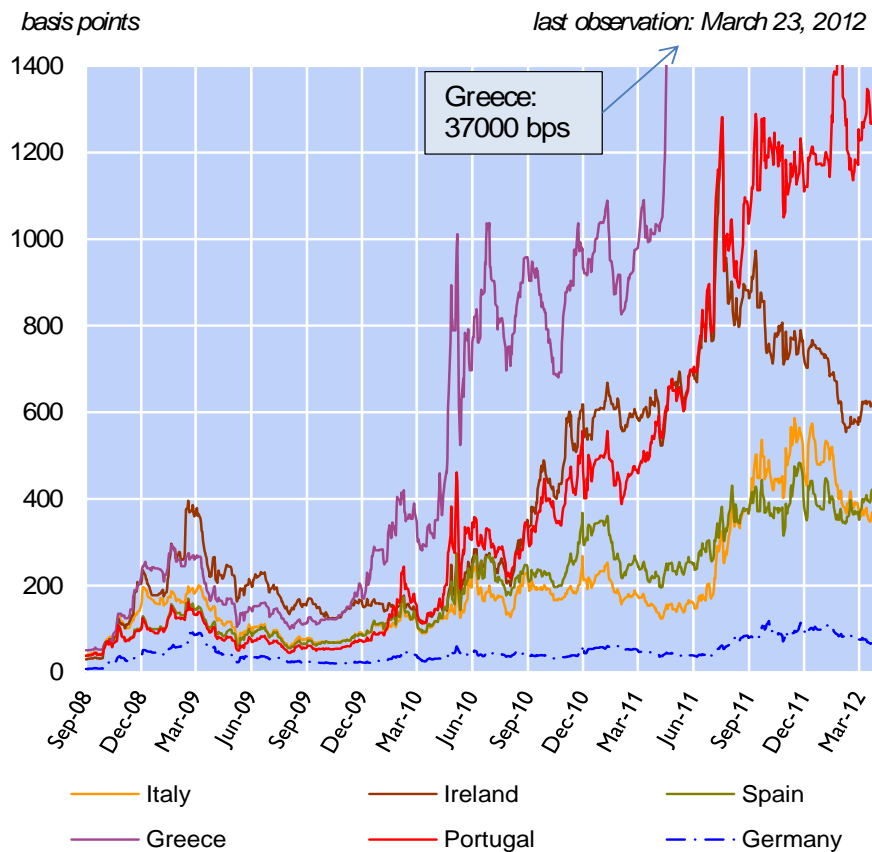
in % of GDP(2011)



Sources: Bloomberg, download March 2012; Eurostat, National sources

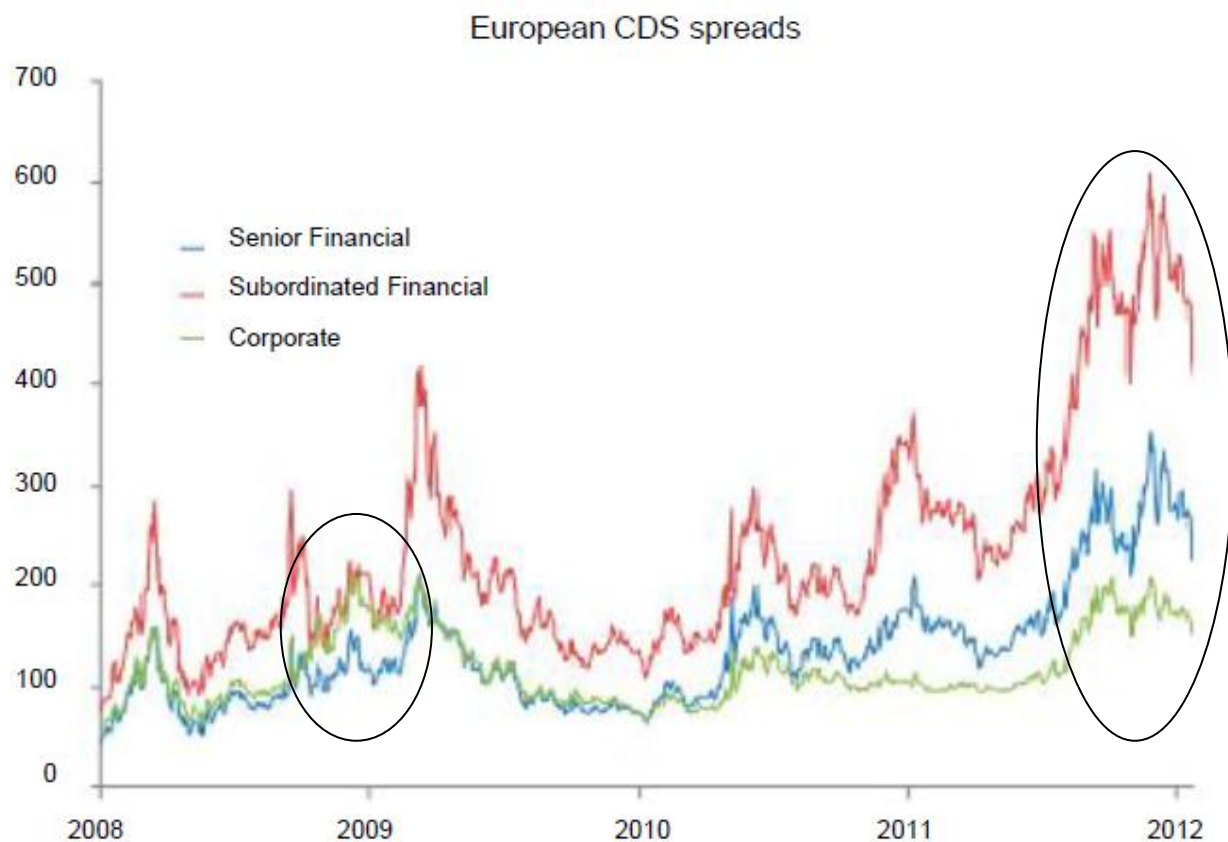
Financing costs: Emerging markets sovereigns hit early in the crisis

Credit Default Swap Premiums for Government Bonds with 5-Year Maturity



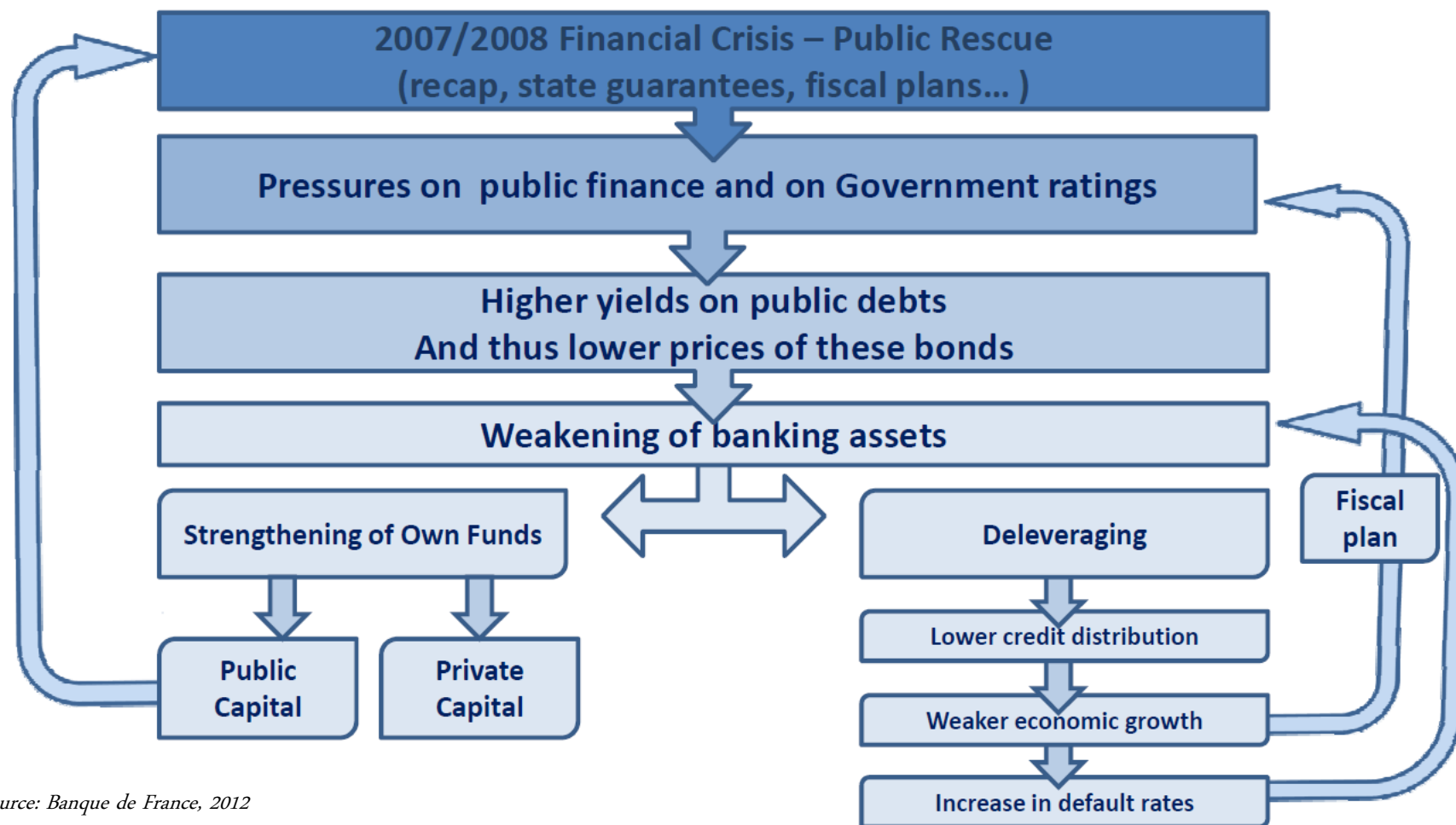
Source: Thomson Reuters, compiled by the OeNB.

Strong correlation of CDS markets



Source: IMF, Global Financial Stability Report, Market Update, January 2012

Fiscal-finance interactions during the crisis: A double feedback loop

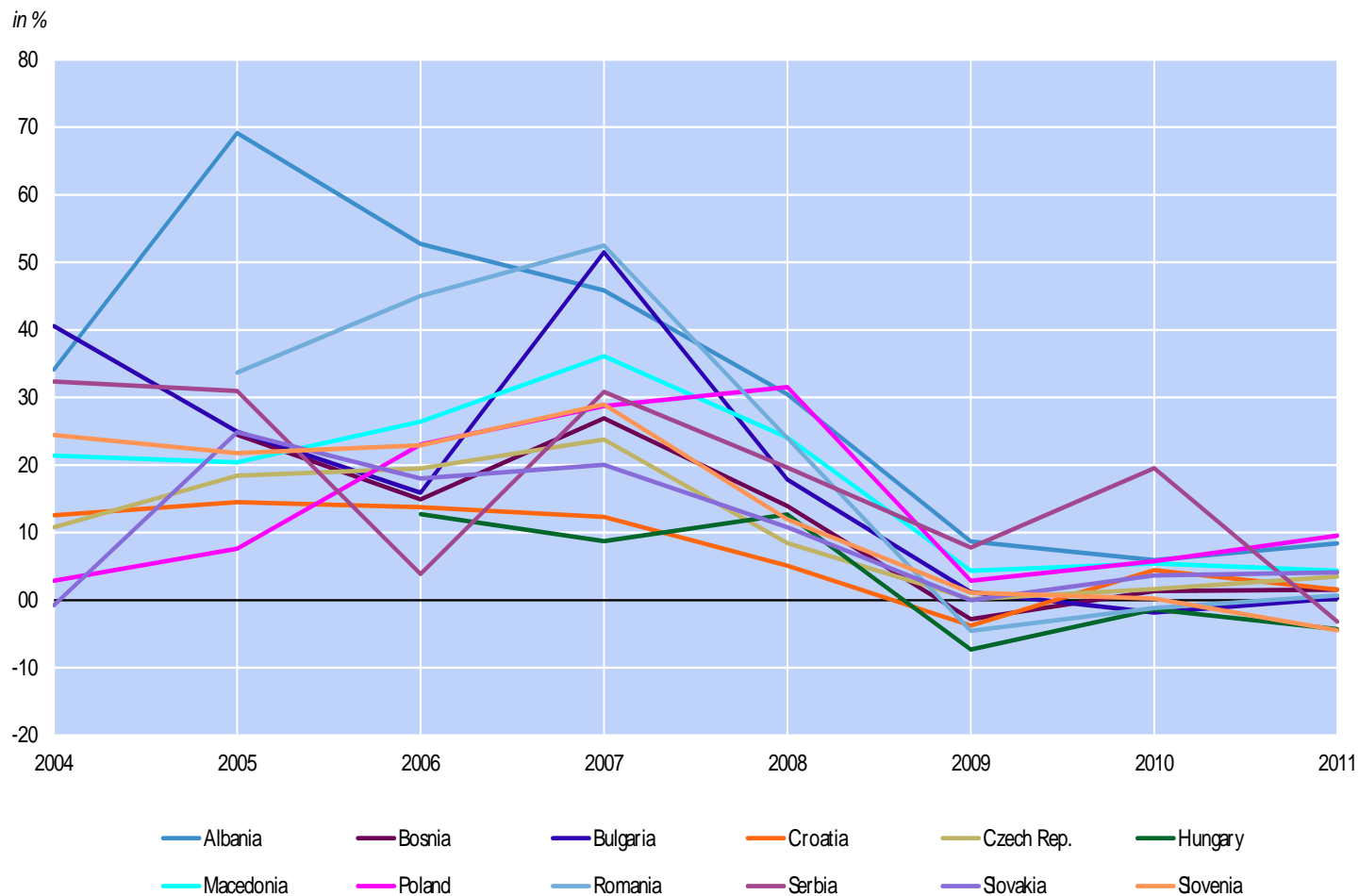


Source: Banque de France, 2012

3. How much private sector debt (and financial deepening)?

Credit growth: very buoyant before the crisis

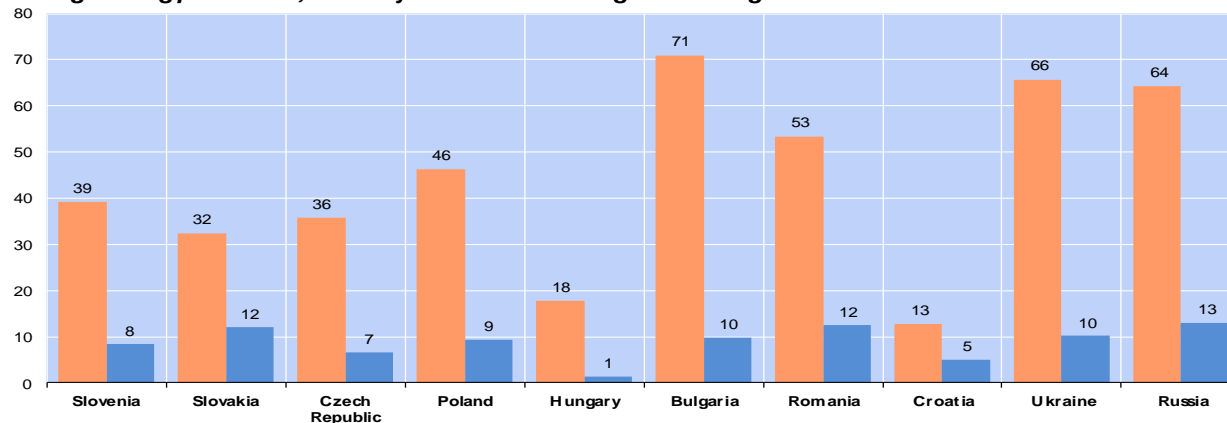
Annual growth of loans to the non-bank domestic private sector (adjusted for inflation)



Pre-crisis real credit growth far above GDP growth in CESEE

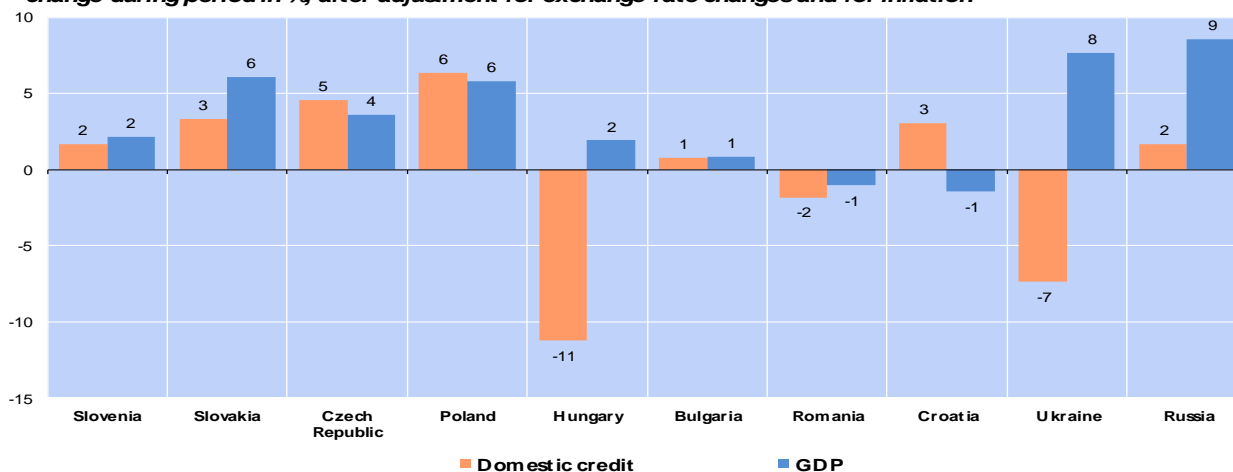
CESEE: Domestic credit to private non-banks and GDP in pre-crisis period (end-06 to mid-08)

change during period in %, after adjustment for exchange-rate changes and for inflation



CESEE: Domestic credit to private non-banks and GDP in post-crisis period (mid-09 to end-10)

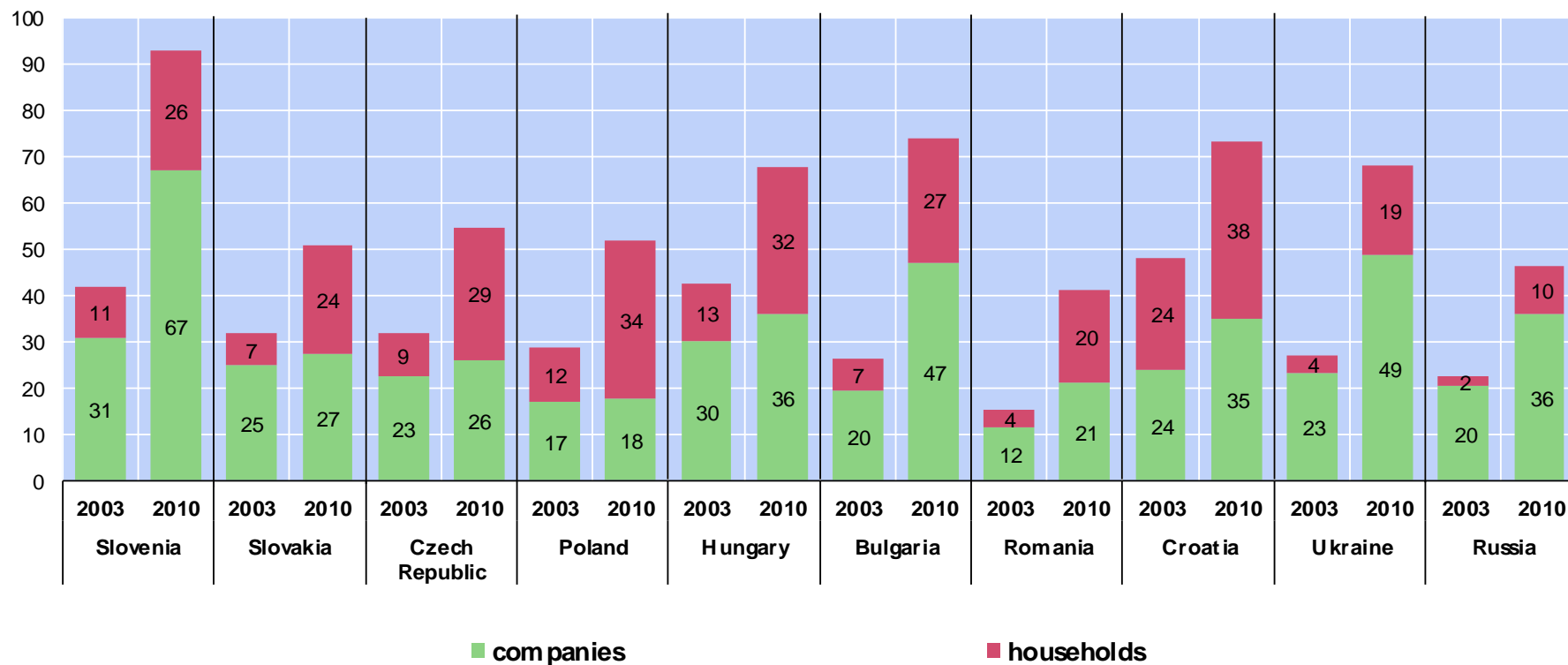
change during period in %, after adjustment for exchange-rate changes and for inflation



Credit to households contributed strongly to the rise of the credit-to-GDP ratio in CESEE

CESEE: Domestic credit to households and companies

credit stock-to-GDP ratio, in percentage points

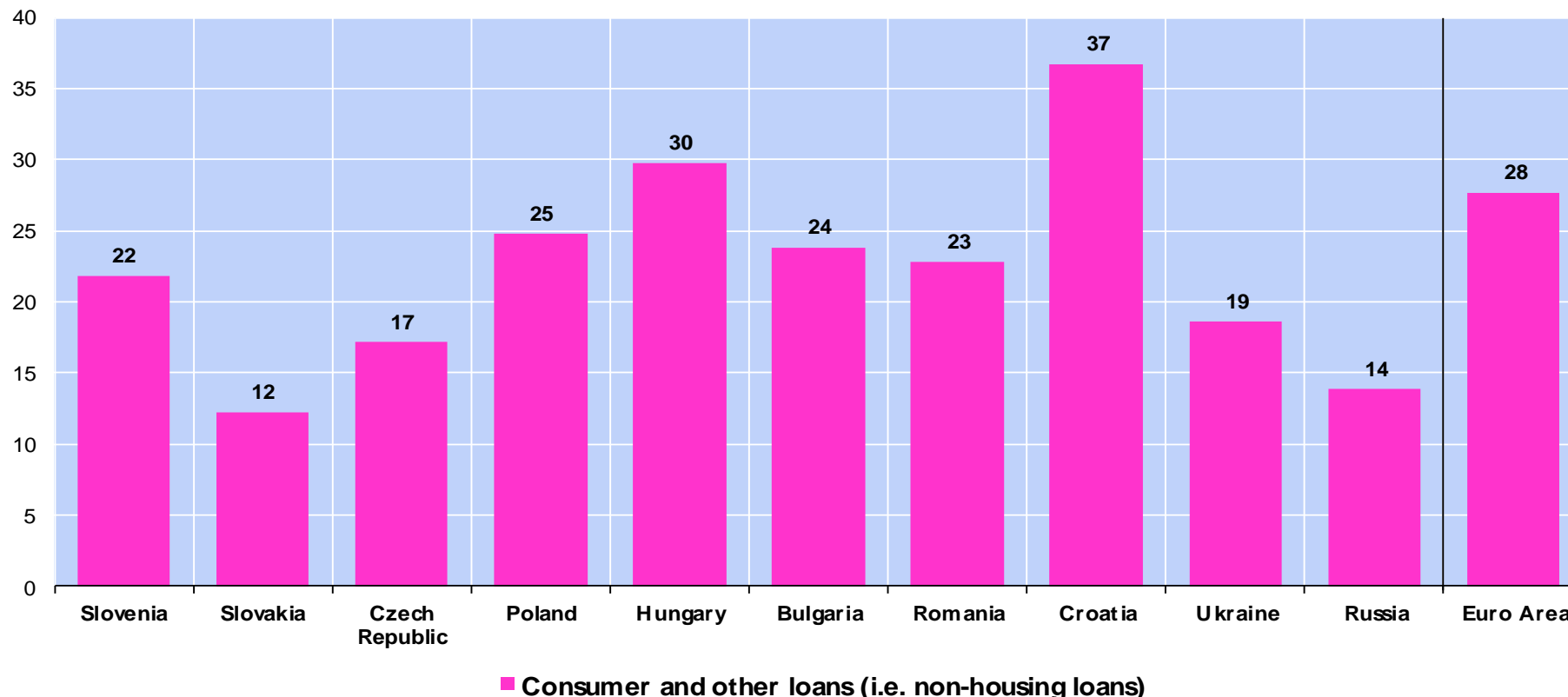


Source: National central banks (NCBs), OeNB

Consumer and other loans to households in CESEE are at a relatively high level (compared to Euro area)

CESEE and Euro Area: Consumer and other loans to households

as percentage of annual private consumption, at end-2010

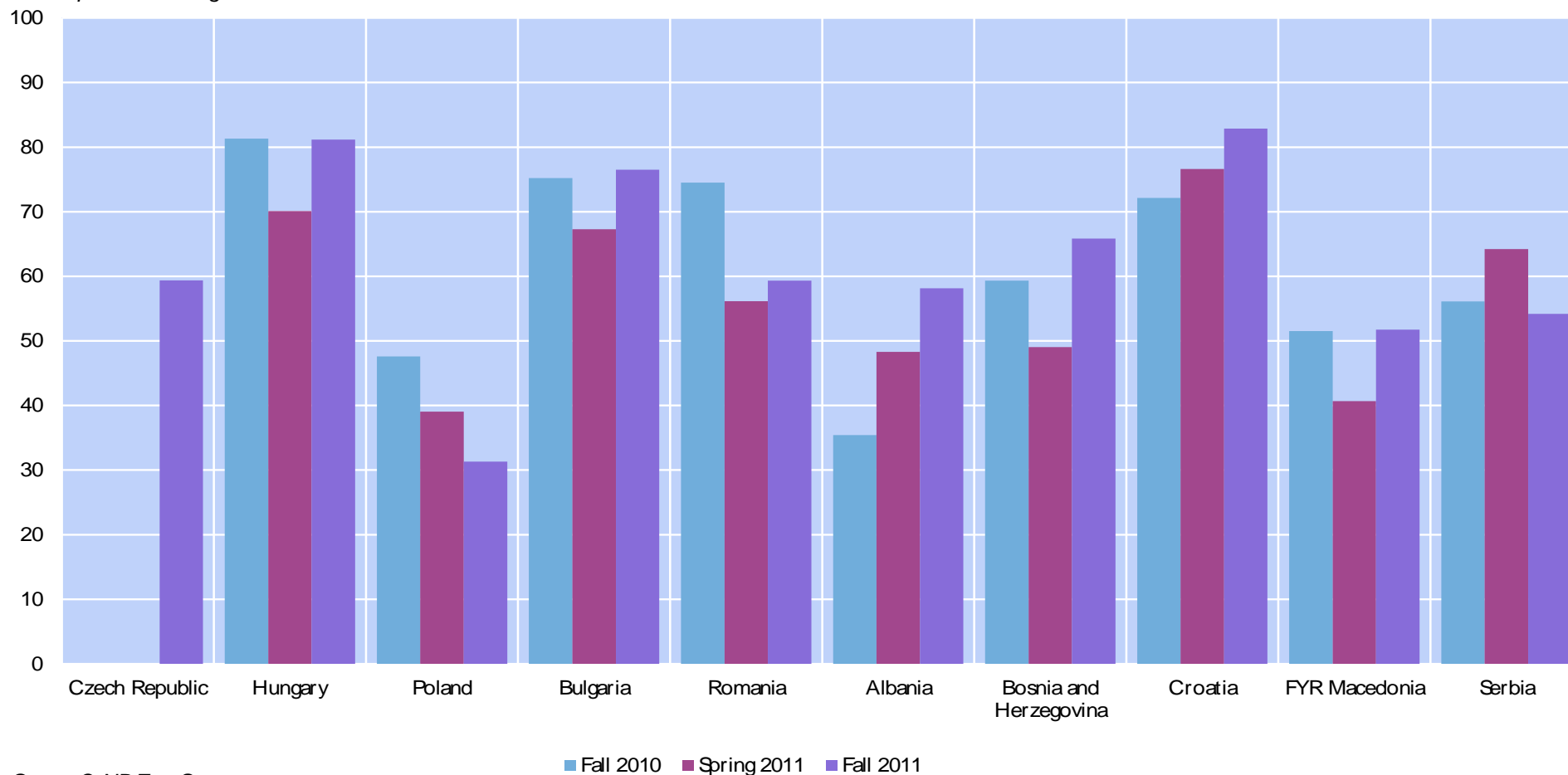


Source: ECB, national central banks (NCBs), OeNB

Households face increased difficulties to meet their debt service commitments

Are you finding it more difficult to pay down your loan as a result of the economic and financial crisis?

% of respondents holding a loan

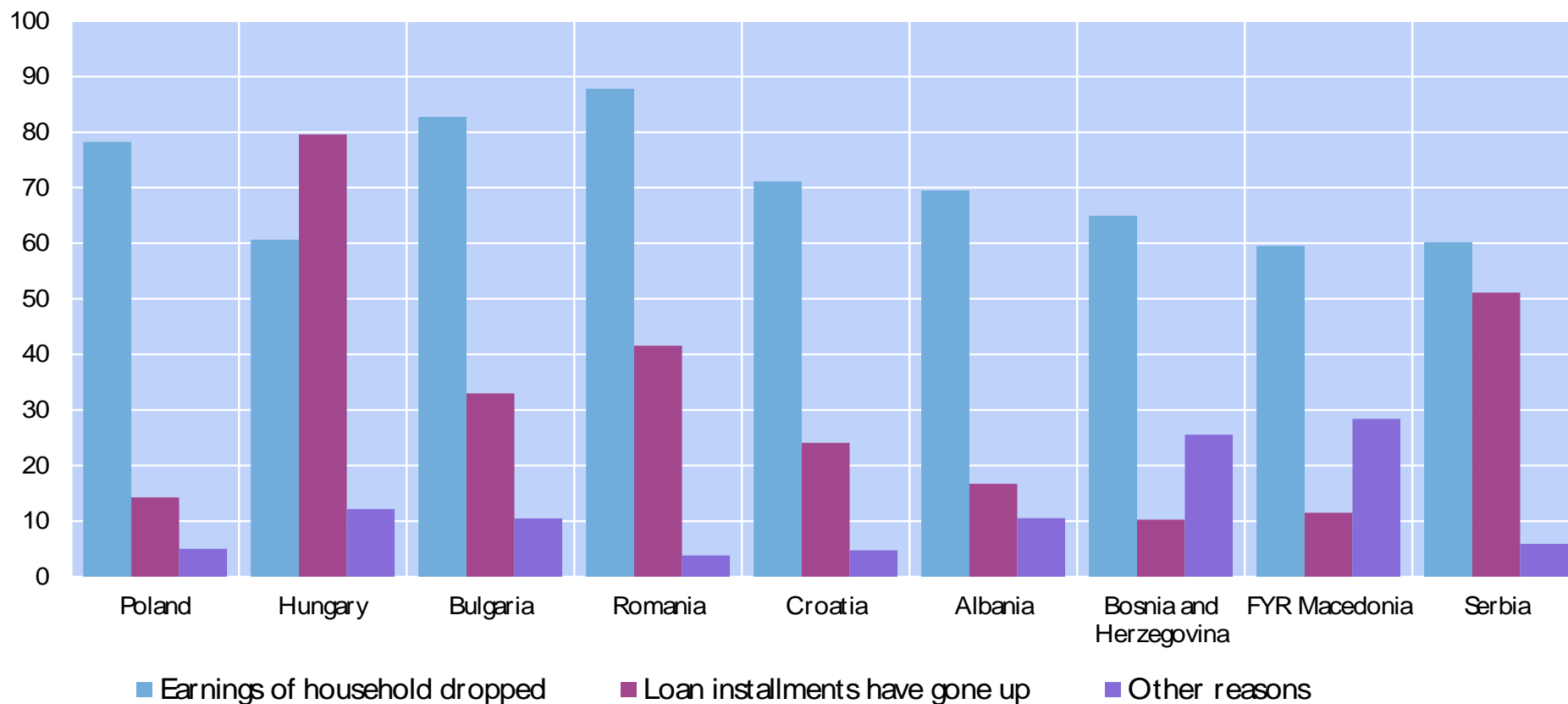


Source: OeNB Euro Survey.

Most important reason: income decline

Reasons for Difficulties to Pay Down Loan

% of respondents who report that it is more difficult to pay down their loan



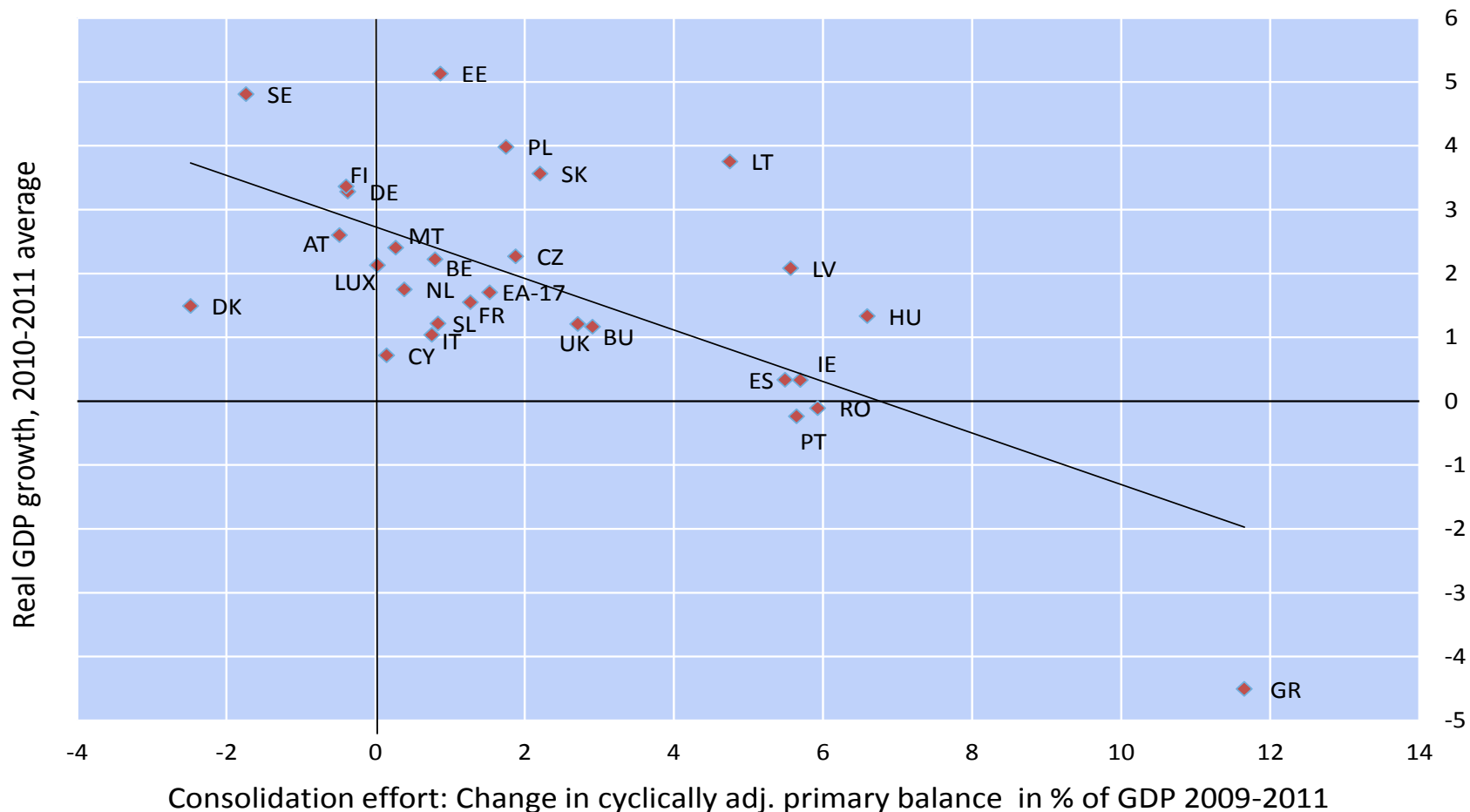
Source: OeNB Euro Survey Fall Wave 2010.

Note: Excluding respondents answering "Don't know / no answer." Respondents were asked the following question: If you do find it more difficult to pay down your loan: Why is this the case? Respondents could choose any number of the following reasons: (i) The earnings of my household have dropped, (ii) the loan installments have gone up, (iii) for other reasons.

4. Impact of debt reduction on the real economy

No surprise: Fiscal consolidation puts a brake on growth

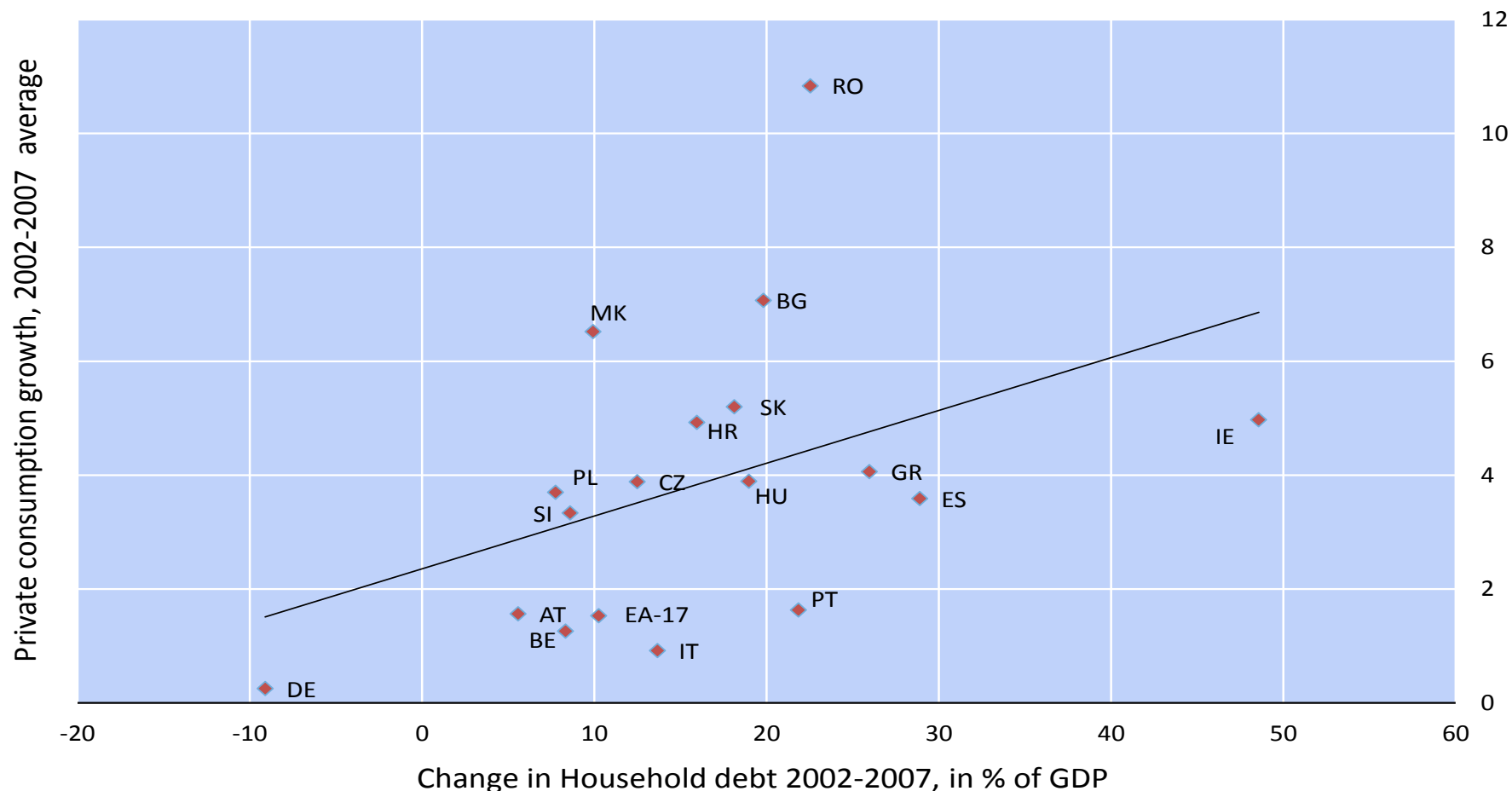
Consolidation effort and GDP growth



Source: European Commission (AMECO database download, March 2012)

Debt makes a difference (I): Debt driven economic boom prior to the crisis?

Private Consumption Growth and Change in Household Debt, 2002-2007



Source: European Commission, IMF, Thomson Reuters.

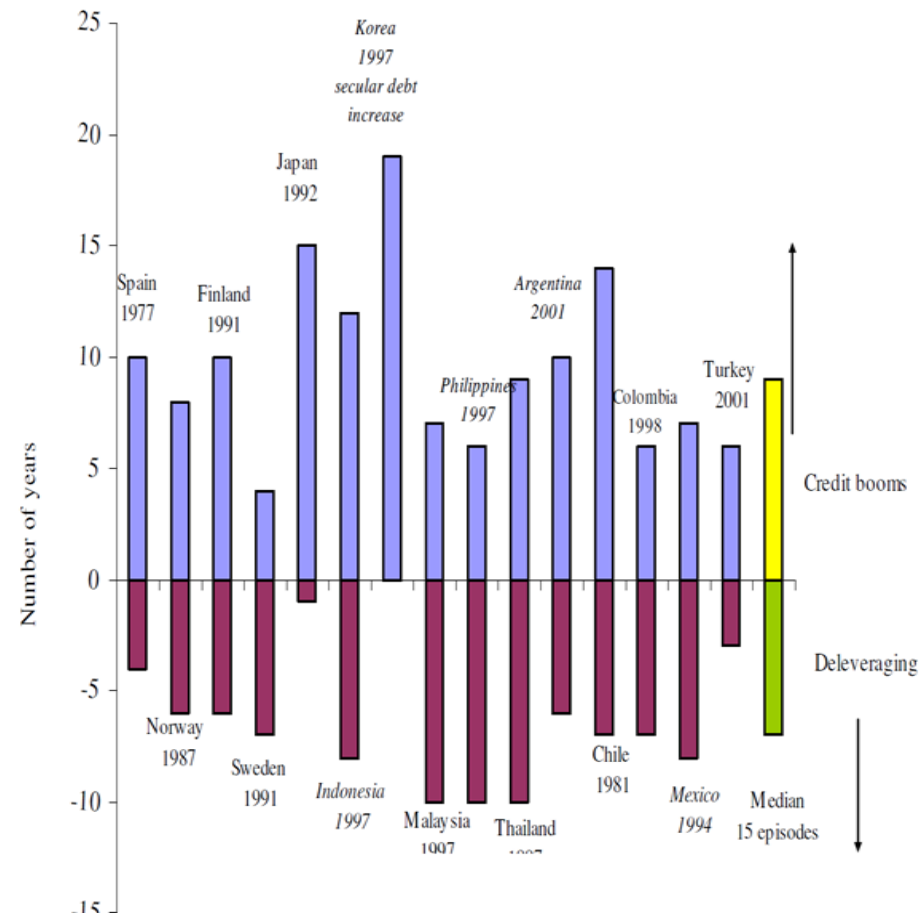
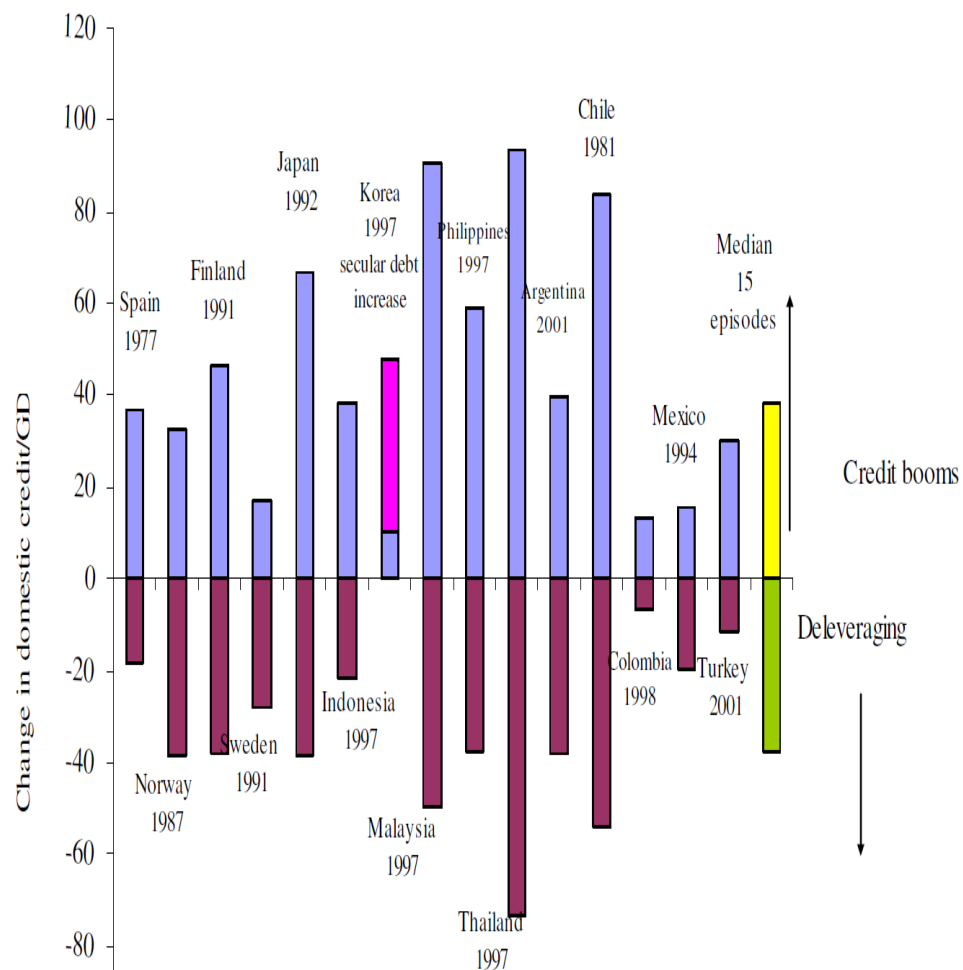
Debt makes a difference (II): Household debt dampens consumption during the crisis!

Private Consumption Growth 2008-2011 and Household Debt in 2008



Source: European Commission, IMF, Thomson Reuters.

Reinhart/Reinhart (2010): Substantial deleveraging to be expected after former financial crises



Source: Reinhart and Reinhart, 2010

Long-lasting impact on growth in crisis-hit economies

Countries	Variable	Pre-crisis (t-10 years) median	Post-crisis (t+10 years) median
Advanced economies - the Big 5	Real GDP growth (per capita)	3.1%	2.1%
	Unemployment rate	2.7%	7.9%
Five Asian crisis, 1997 episodes	Real GDP growth (per capita)	6.6%	3.8%
	Unemployment rate	2.9%	3.7%
All 15 countries	Real GDP growth (per capita)	3.8%	3.2%
	Unemployment rate	3.7%	7.8%

Source: Reinhart and Reinhart, 2010

Conclusions

- 1. Financial deepening and overall rise in sectoral debt have been a significant feature of the way into the crisis worldwide**
- 2. In CESEE, for example, the catching-up model was to a large extent based on the inflow of foreign capital**
- 3. It seems that the SEE region up to now avoided many of the negative effects experienced in many other countries**
- 4. To continue with catching-up successfully, a special focus on macro-financial stability and on implementing the respective policies – from fiscal to financial market supervision - are the important tasks for the future**

Management of debt challenges in Europe

Peter Mooslechner

Director, Economic Analysis and Research Department
Oesterreichische Nationalbank

„The challenges for the Southeastern European countries in the enduring economic and financial turbulences in Europe“

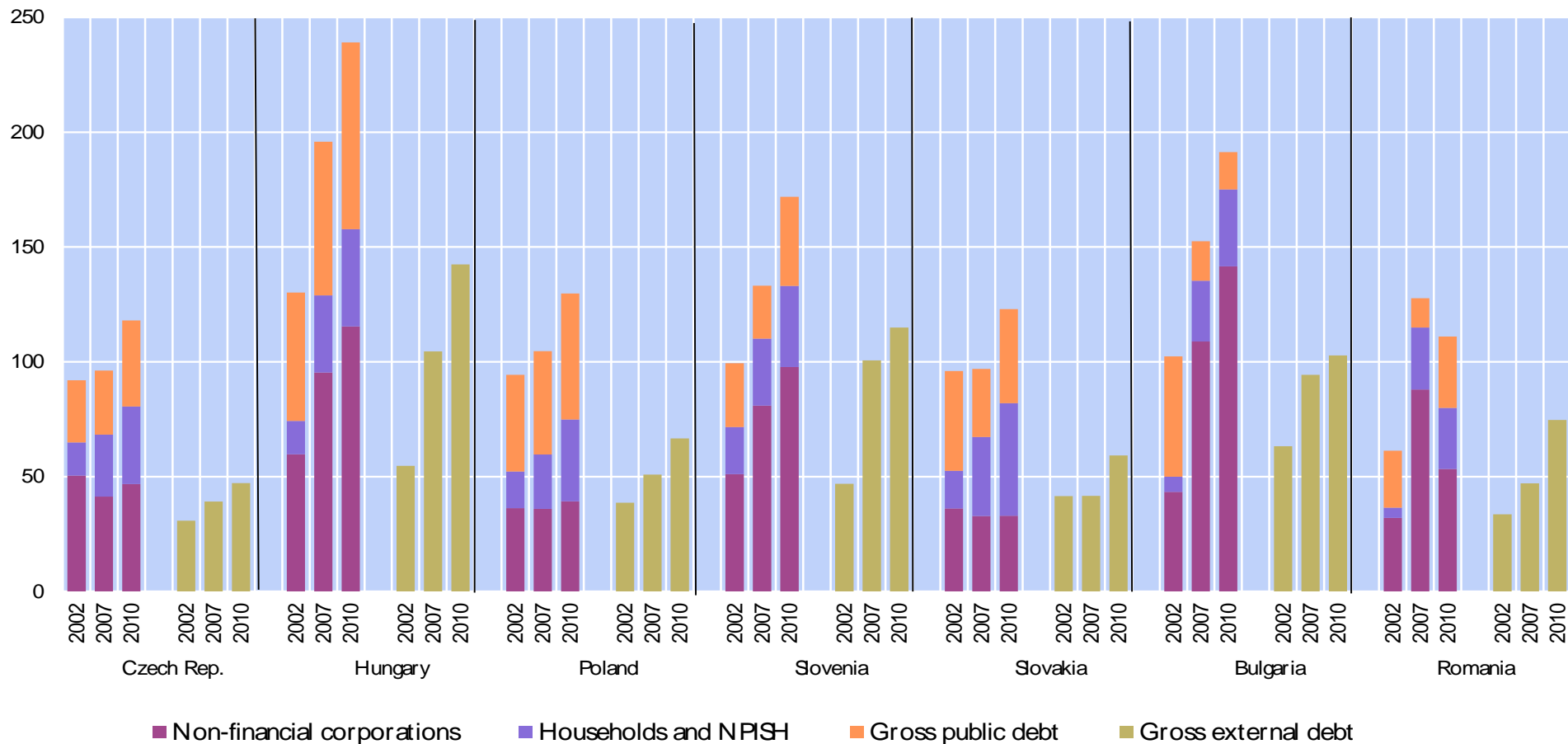
*National Bank of the Republic of Macedonia,
Skopje, 27 April 2012*

Annex:

Debt developments in selected CESEE EU MS

Total nonbank debt and external debt

percentage of GDP

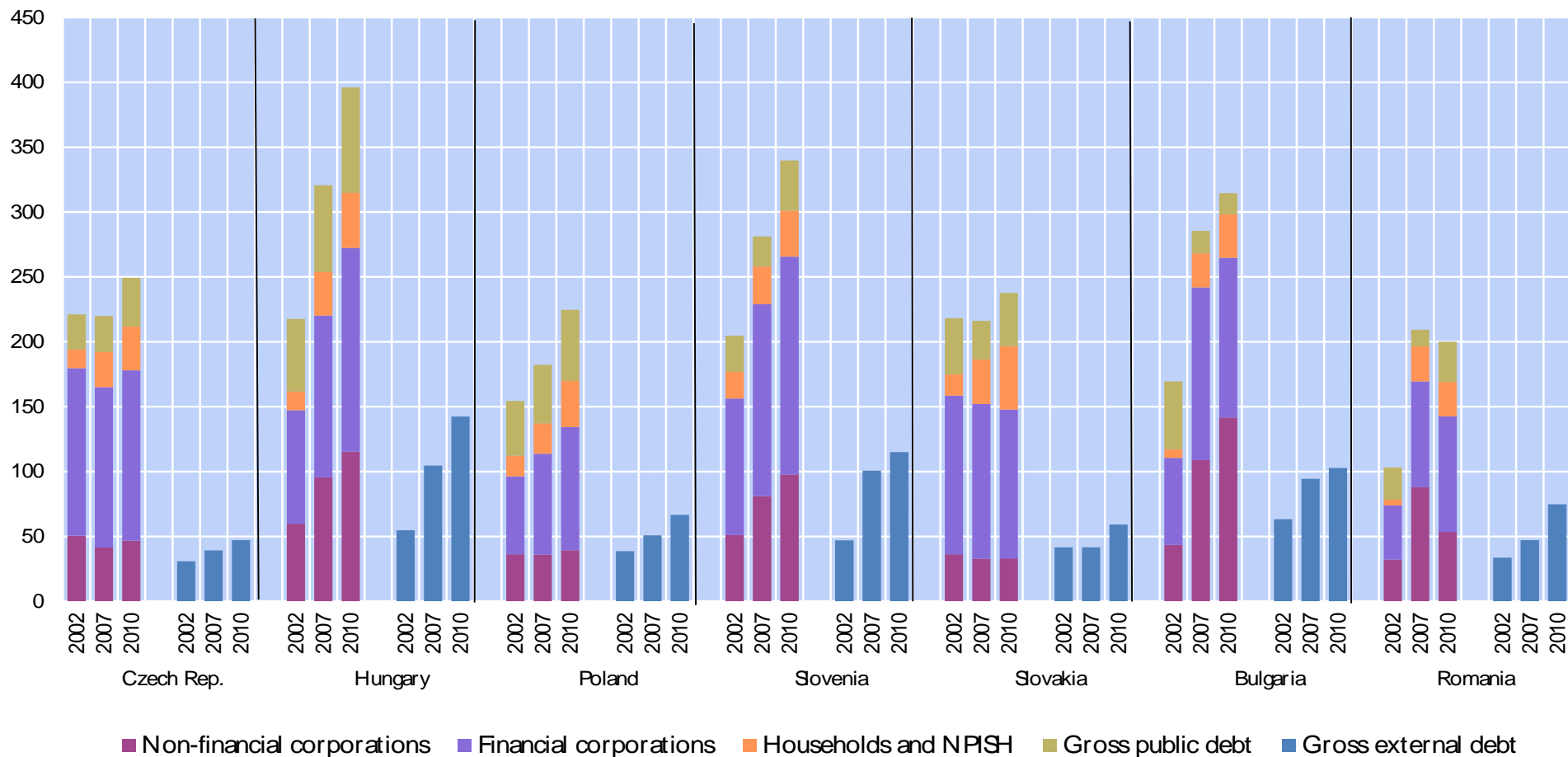


Source: AMECO database, IMF, Thomson Reuters.

Total debt developments in selected CESEE EU MS

Total debt of the economy and external debt

percentage of GDP

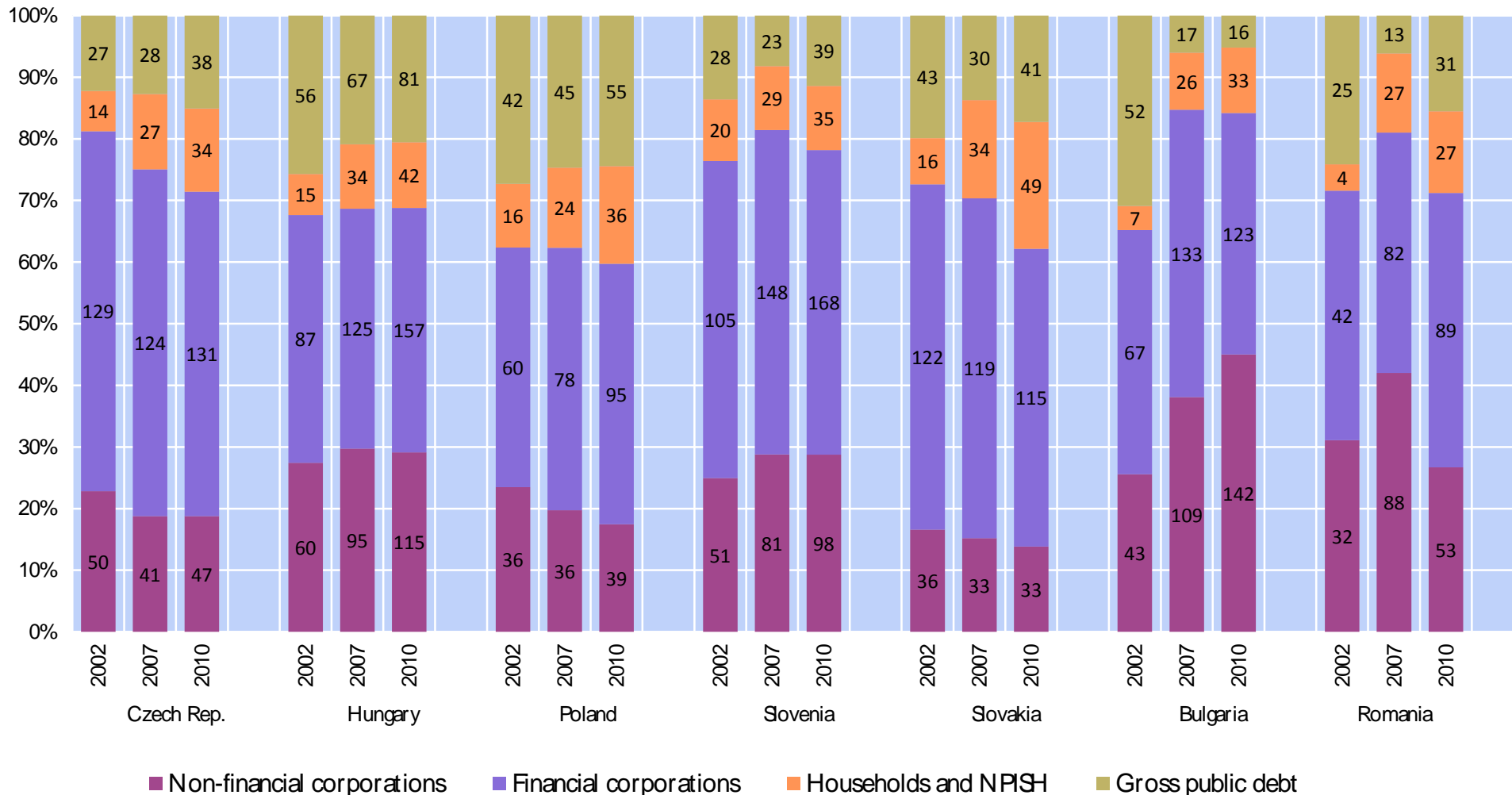


Source: AMECO database, IMF, Thomson Reuters

Debt developments in selected CESEE EU MS

Total debt of the economy by sectors

percentage of total debt (left axis); figures in the columns show the share of each debt category in GDP (percent)

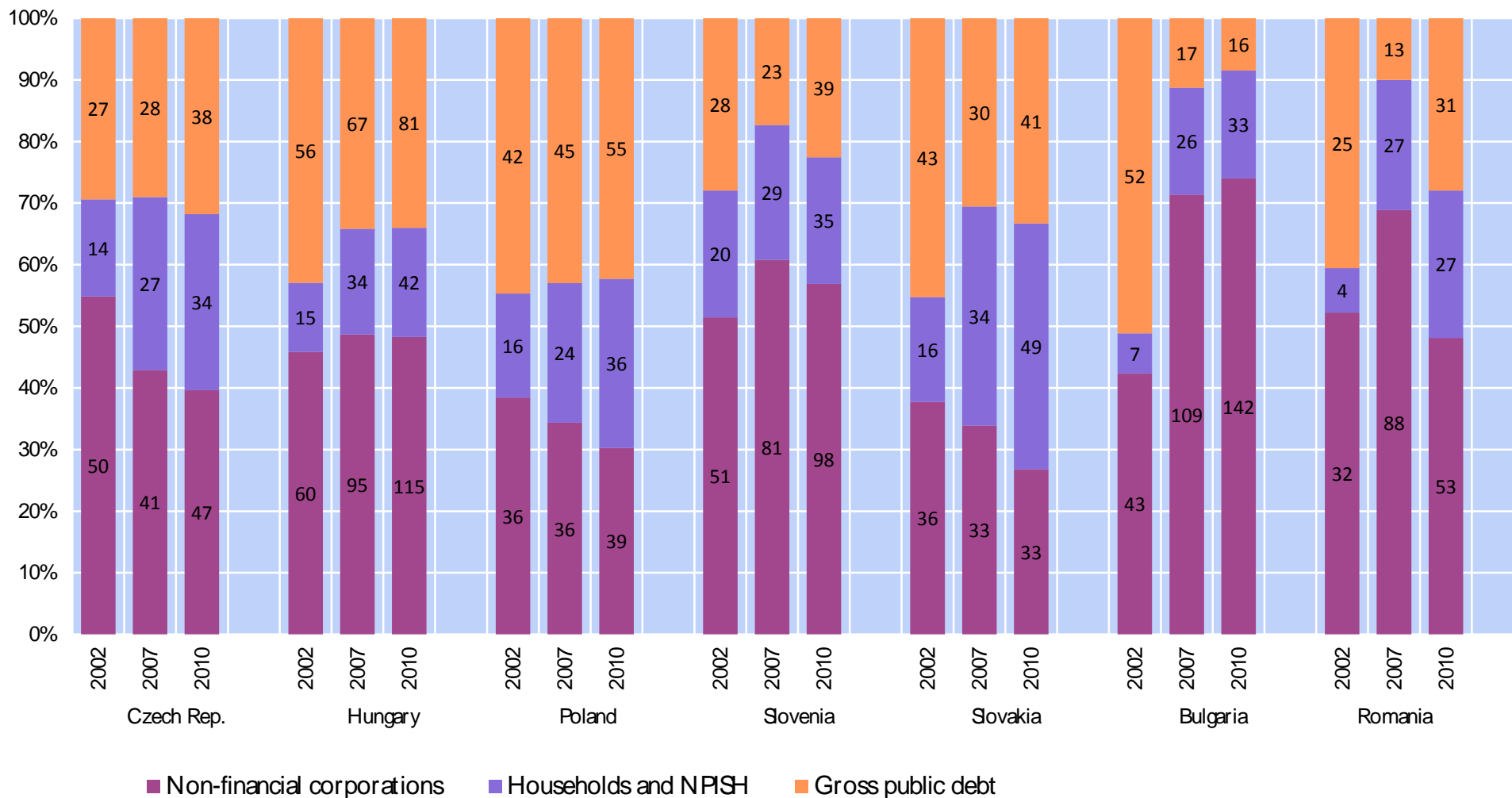


Source: AMECO database, IMF, Thomson Reuters. Note: Figures in the columns show the share of each debt category in GDP (percent).

Debt developments in selected CESEE EU MS

Total nonbank debt by sectors

percentage of total debt (left axis); figures in the columns show the share of each debt category in GDP (percent)



Source: AMECO database, IMF, Thomson Reuters