THE EUROZONE DEBT CRISIS
PART 2:
ANALYSIS OF EUROZONE DELEVERAGING

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In aggregate, the Eurozone has been able to deleverage modestly from its peak level of debt following the financial crisis. The Eurozone total debt peaked at 250% of GDP in 2014. Since then, it has decreased from 250% to 239% of GDP or by 6.2% Private debt has decreased by 6.6%, while public debt has decreased by 5.3%.

Source: European Central Bank and Eurostat
The Eurozone has had a favorable record of deleveraging in comparison to other industrialized economies since the 2008-09 financial crisis.

Debt levels in the US have increased modestly since 2009, while those in Australia and Canada have increased around 20% since 2009, mostly in the form of private debt. Japanese total debt has increased by 12% since 2009, while private debt decreased, the increase of public debt more than offset private deleveraging.

China has experienced a massive debt increase after 2008, as it turned to debt-financed domestic demand driven economic growth to offset weakness in its main export markets. China’s total debt is estimated to have surpassed 300% of GDP during Q1 of 2019.

Eurozone deleveraging was made possible by a significant improvement in its overall current account balance with the rest of the world, which in turn was due to austerity-oriented macroeconomic policy in the Eurozone and reflations by other major economies.

Source: European Central Bank and Eurostat
Ireland, Portugal and Spain have been able to achieve substantial deleveraging since the crisis. Greece has been much less successful in reducing its overall debt levels.

The decline in the debt levels in Ireland, Portugal and Spain has been driven by a substantial deleveraging of the private sector. In Ireland, private debt fell from 280% of GDP in 2012 to 244% of GDP in 2017. In Spain, private debt has declined from 188% of GDP in 2012 to 133% of GDP in 2018, while in Portugal private debt has decreased from 210% of GDP in 2012 to 156% of GDP in 2018. In both countries, public debt has increased since the crisis but much less than the decline in private debt.

In Greece, private debt has declined modestly while public debt has increased.
Cyprus and Luxembourg experienced a rapid build-up of private debt from 2013-2015, after the main Eurozone crisis hit in the 2010-12 period.

Cyprus and Luxembourg are financial and banking centers with exceptionally high levels of private debt.

Cyprus has been able to deleverage from its 2015 peak by reducing its private sector debt. Its public debt has increased modestly.

Luxembourg has been able to reduce modestly its overall debt level by reducing its private debt and by holding steady its public debt.

Source: European Central Bank and Eurostat
COUNTRIES WITH LITTLE OR NO DELEVERAGING

Since 2012, France, Belgium, Finland, and Slovakia all increased total debt as a percentage of GDP.

France’s total debt levels increased by 28% since 2008 and by 8% since 2012, due to increased public spending and the continued steady increase of private debt.

Belgium’s total debt is slightly higher than it was in 2012 although less than its peak in 2016. The increase is due to higher private debt, while the level of public debt has remained steady.

Finland has deleveraged by 8% since 2014 but is higher than it was in 2012.

Slovakia experienced a massive 18% increase in total debt since 2012. While Slovakia reduced public debt by 11% since 2013 peaks, its private debt has continued to rise.

Source: European Central Bank and Eurostat
The Netherlands has deleveraged by 4% since its 2014 peak. But Dutch total debt is 8% above its 2008 pre-crisis levels.

Austria has deleveraged 5% from its 2010 peak, with modest decreases in both private and public debt.

Sweden’s total debt has decreased 3% from its 2009 peak due to a decline in public debt.

Source: European Central Bank and Eurostat
Greece, Italy, and Luxembourg have undergone modest deleveraging.

From its peak in 2013, Greece has reduced its total debt by approximately 5%. Greece reduced its private sector debt while slightly increasing public spending. The country’s deleveraging efforts were aided by three bail-out packages, including a haircut to Greek sovereign debtholders.

Italy has decreased its total debt by 4% since its 2013 peak. Like Greece it has reduced its private sector debt while increasing modestly its public debt.

Luxembourg’s debt is largely in the private sector. Since its peak in 2016, it has reduced its private sector debt by about 3%. Luxembourg’s public debt has remained constant at around 23% of GDP.

Source: European Central Bank and Eurostat
COUNTRIES WITH SUBSTANTIAL DELEVERAGING: A DEBT REDUCTION OF 10-20%

Portugal and Spain have undergone substantial deleveraging from their 2012-13 peaks. Both countries received bank bailouts, Portugal in 2011 and Spain in 2012, which aided their deleveraging process. Both countries have reduced substantially their private debt levels, while allowing public debt to increase to offset some of the contractionary effect of private sector deleveraging.

Spain has reduced its total debt by 16% since its 2012 peak. This reduction came as a result of private debt deleveraging. Private debt as a percentage of GDP is down 34% from its 2009 peak. Meanwhile, public debt increased from 52% of GDP in 2009 to 97% of GDP in 2018, with the greatest gain coming in the period from 2008 to 2014.

Portugal has reduced total debt by 18% since its peak in 2012. Like in the case of Spain, the majority of its deleveraging is related to a reduction in private sector debt, which is down 26% from its 2012 peak.

Source: European Central Bank and Eurostat
SUBSTANTIAL DELEVERAGING CONTINUED

In terms of total debt as a percentage of GDP, substantial deleveraging also occurred in Slovenia (15%), Lithuania (14%), and Cyprus (11%) from their peaks.

Like the cases of Portugal and Spain, deleveraging in these three economies is the result of a significant reduction in private debt while public debt increased over the same period. From 2015 to 2018, however, public debt as well as private debt decreased in Slovenia and Lithuania after increasing in the period from 2008 to 2015.
Germany has undergone substantial deleveraging from a 2010 peak, decreasing its total debt level by 13%.

This deleveraging came as a result of a decrease in public debt, which in turn can be attributed to the county’s 2009 adoption of its “debt brake” balanced budget amendment, which requires that German deficits not exceed 0.35% of GDP.

Germany deleveraging has complicated the Eurozone adjustment process by reducing Eurozone demand and by forcing greater adjustments onto other economies. Germany has reduced its debt at the same time the highly indebted crisis economies of Portugal, Italy, Ireland, Greece and Spain (PIIGS) have also tried to reduce their own.

Source: European Central Bank and Eurostat
In terms of total debt as a percentage of GDP, exceptional deleveraging (20+%) occurred in Latvia (32%), Malta (28%), Estonia (27%), and Ireland (22%).

This group of exceptional deleveraging cases involve a unique set of states. Latvia, Malta and Estonia are all small states with open economies, which could increase their current account surpluses without disrupting the macroeconomic balance of the Eurozone.

Ireland also is unique in that it is a multinational trans-investment hub, which attracts the inflow of international capital because of its low corporate tax rates. It was able therefore to recover quickly from its 2012 financial crisis with a rapid improvement in its current account balance and strong economic growth.
The Eurozone crisis has its origins in the large imbalances that developed among Eurozone members in the years leading up to the crisis. The adoption of the euro led to lower interest rates and increased borrowing in the peripheral economies. Real estate bubbles soon emerged in the Portugal, Ireland, Greece and Ireland, funded by increased capital flows from Germany and other economies.

Current account deficits ballooned in these economies as they lost competitiveness due to rising wages while surpluses in Germany continued to grow as a result of suppressed wage levels. Normally, a change in currency values would have corrected the imbalances before they reached a dangerous level. But with a single currency, that adjustment process could not happen.

Deleveraging required a reversal of these imbalances. Ideally, to deleverage, debtor economies should run current account surpluses while creditors reduce their surpluses. Portugal, Ireland, Greece and Spain in fact have all moved to current account surpluses. But Germany has stubbornly clung to its surplus, thus limiting the deleveraging process. Deleveraging has only been able to occur because the Eurozone as a whole has moved from a small current account deficit to a large surplus.
With Germany, the Netherlands and other core Eurozone economies continuing to run current account surpluses, Eurozone deleveraging has been made possible only by a significant improvement in the Eurozone’s overall current balance.

In 2011, the Eurozone ran a small current account deficit. By 2018, the deficit had turned into a surplus of 3.6% of GDP.

The Eurozone highly indebted economies could have achieved much more deleveraging with less austerity if the core surplus economies of the Eurozone—in particular, Germany and the Netherlands—had done their part and expanded demand and reduced its surplus. Instead, Germany pursued policies that increased its savings and its surplus, thus shifting the burden to the rest of the world.