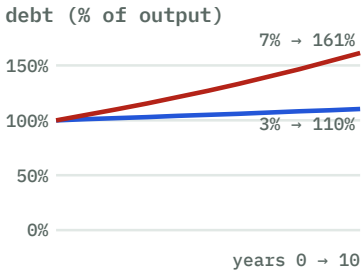
Who saved the euro?

The debt ratio and the rule interest – growth, own money against a shared money, the run on a government, the doom loop, Greece 2009-2013, “whatever it takes”, the debate, checklist sign 8.

1 The debt line

Economic Policy, Lesson 9

- **Debt ratio** = a government’s debt as a share of a year’s output (%) · **interest rate** = the yearly price it pays to borrow by selling **bonds** (promises to repay by a set date)
- Budget before interest balanced (taxes = all other spending) ⇒ yearly change ≈ `debt × (interest − growth)` · at 100% → `interest − growth` points
- Coralia (toy island): debt 100%, growth 2% · `3 − 2 = +1` point a year → ≈110% after 10 years · `7 − 2 = +5` → ≈161%
- interest = growth → **flat** · Practice: growth 3% → flat at 3% · 6% → `+3` points, 133% after 10 years
- Practice: debt **50%**, 6%, 2% → interest bill `3` – growth cut `1` = `+2` points (not 4)



2 Own money or shared

History L4 · International Economics L6

Own money (Coralia’s dollars, Germany’s marks in 1923)	In the euro (Greece, 2012)
its central bank creates the money it owes → can always pay	**European Central Bank** (ECB, Frankfurt) serves many countries → no printing for one
cost of printing to pay: prices can run away (History L4)	fixed exchange rate with partners and **no exit** (leaving = changing every contract)
its money can fall against others → exports cheaper	lenders fear a **missed payment** → higher rate

- **Euro** = the money shared by many European countries · from 1 Jan 1999 (11 countries), notes and coins 2002 · Greece in from 2001

3 A run on a government

History, Lesson 3

- Lenders doubt → ask a **higher rate** → debt grows faster → doubt grows → no loan at a price it can pay
- Nothing changed in the budget · the **fear** raised the rate that made the fear true = a **run**, like the depositors of Lesson 3
- More risk for the lender ⇒ higher price (rate) · the rate itself decides whether a debt is sustainable

4 The doom loop

History, Lesson 7: capital

- **Doom loop** = a government and its banks dragging each other down
- Bonds ↓ → banks’ thin **capital** (own money) ↓ → government rescues banks → its debt ↑ → doubt ↑ → bonds ↓ again
- Practice: bank assets (what it owns) €100, of which €40 government bonds, capital €5 · bonds –10% → `−€4` → capital `€1`

5 2009-2013

the real story

- Oct 2009: new Greek government → **deficit** (spending – taxes, one year) for 2009 ≈**12.7%** of output, not 6-8% · **Eurostat** (European Union statistics office) later **15.4%**, debt ≈127%
- Greek ten-year rate above **30%** in 2012 · Germany ≈**2%**
- May 2010: other euro countries + **IMF** (International Monetary Fund, lender to countries in trouble, 1944) lend **€110 billion**, on condition of spending cuts and tax rises · more rescue loans 2012
- **Mario Draghi** (Italian economist, head of the ECB 2011-19), London, **26 Jul 2012**: “Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.” · no purchases that day → fear ↓ → rates fell in the months after
- Cost: Greek output ≈**–¼** 2008-2013 (100 → 75) · youth unemployment (young job-seekers with no job) >**50%** in Greece and Spain, 2013
- Practice: “the speech fixed it all” → too far: it eased the fear; the cost ran on to 2013

6 Debate, checklist

checklist sign 8

- Who should carry the debt? **Shared money, shared debts**: a member cannot protect itself, so the group stands behind it · **Each one’s discipline**: help without conditions weakens the reason to keep budgets in order · no verdict
- **Bubble checklist** · **Sign 1 · Bought to resell** · **Sign 2 · Money is a promise** · **Sign 3 · A run fills itself** · **Sign 4 · Printing to pay** · **Sign 5 · A supply shock cuts both ways** · **Sign 6 · Debt outlives the bubble** · **Sign 7 · Leverage turns a dip into a wipe-out** · **Sign 8 · A debt in a money you cannot print**

Watch out: `interest − growth` works only at a debt of **100%** · otherwise `debt × (interest − growth)` · own money ≠ free money: printing costs inflation · the promise changed the **fear**, not the budget