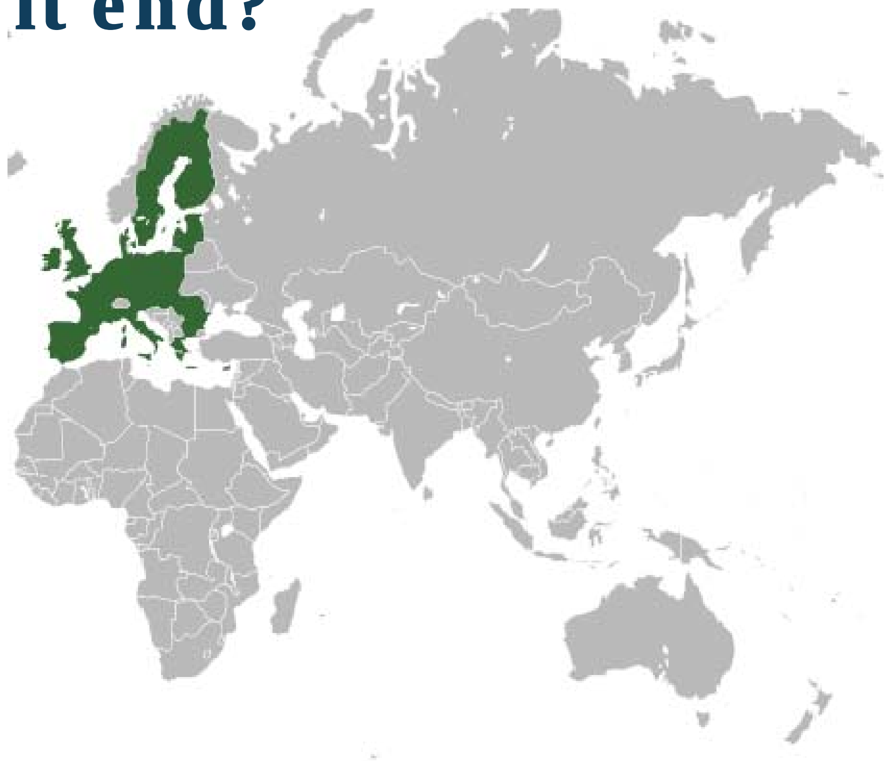
Europe's debt crisis: Where and when will it end?



Charles Jenkins
Editorial Director, Western Europe

Ben Jones
Analyst, Western Europe

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Today's Presenters

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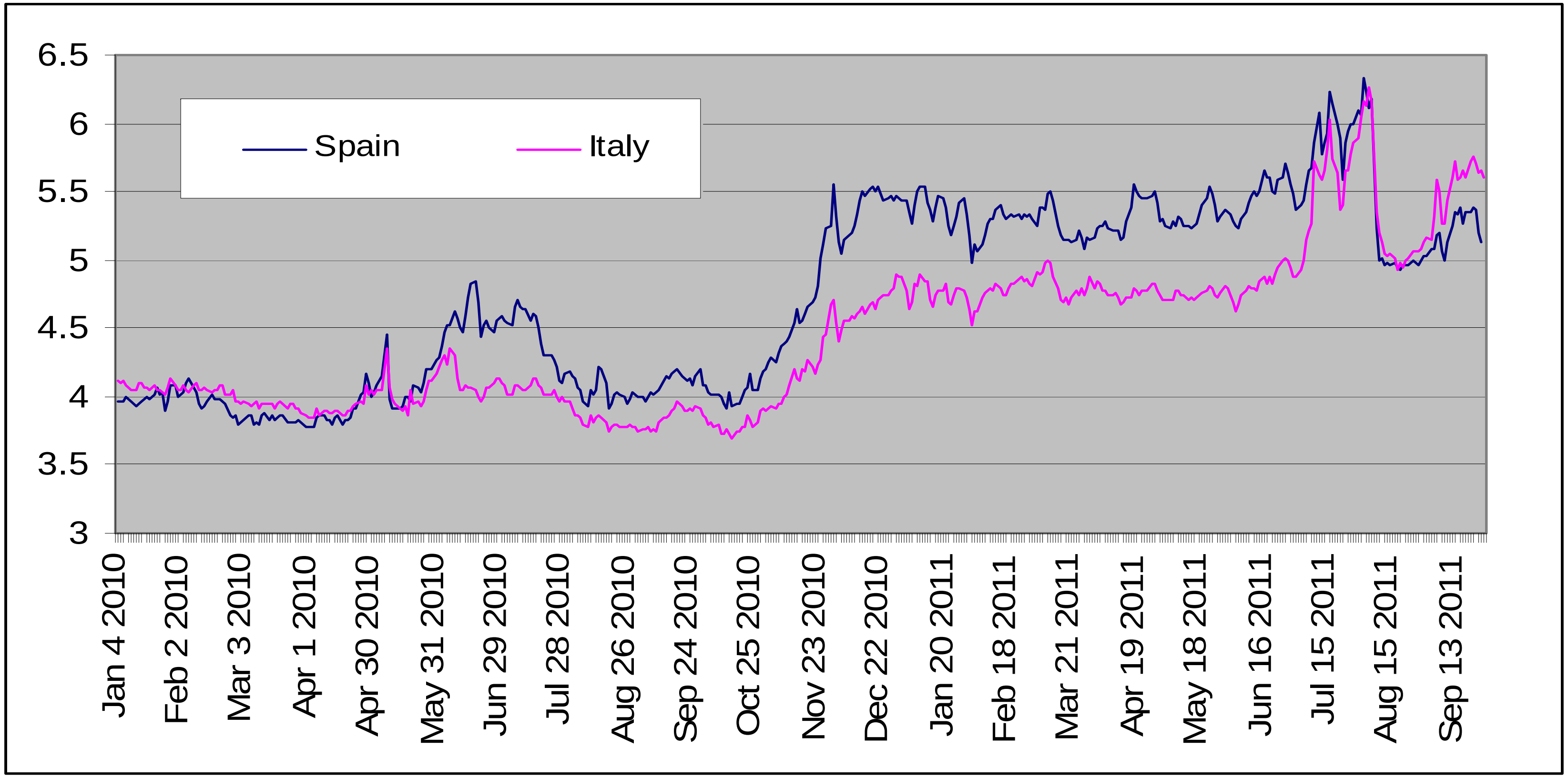
The crisis spreads

10-year government bond yields, %



Source: Haver Analytics.

Crisis management is in limbo

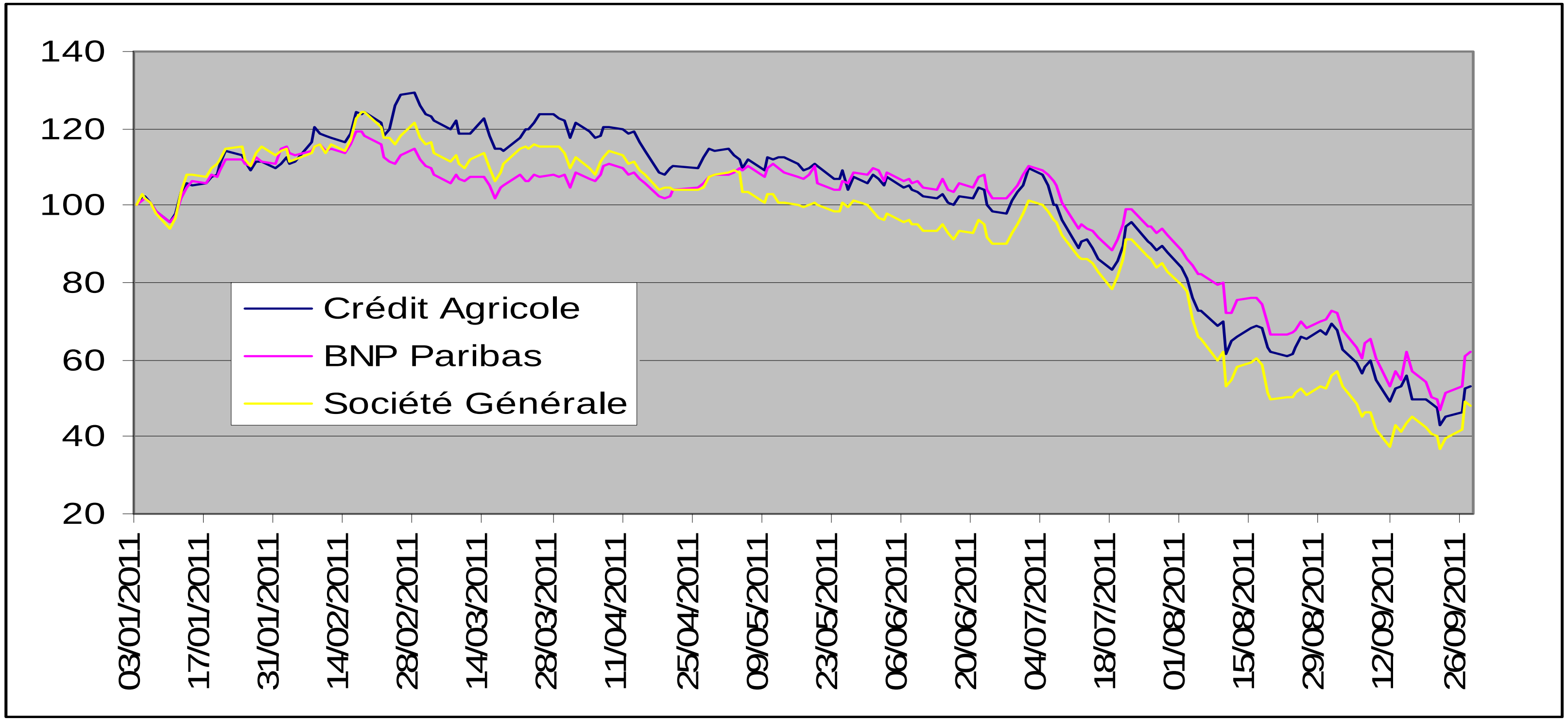
- **Greece is not unique. Investors are finding it hard to judge which countries are "safe" or price for that risk.**

- **The EFSF is too small to buy the debt of larger states on the scale needed to stabilise markets.**

- **The EFSF cannot be scaled up in its current form without threatening the AAA ratings of the creditor countries .**

Crisis hits the core

Share prices (Jan 2011=100)



Source: Bloomberg.

Towards the end-game

What are the options for beefing up the euro zone's defences?

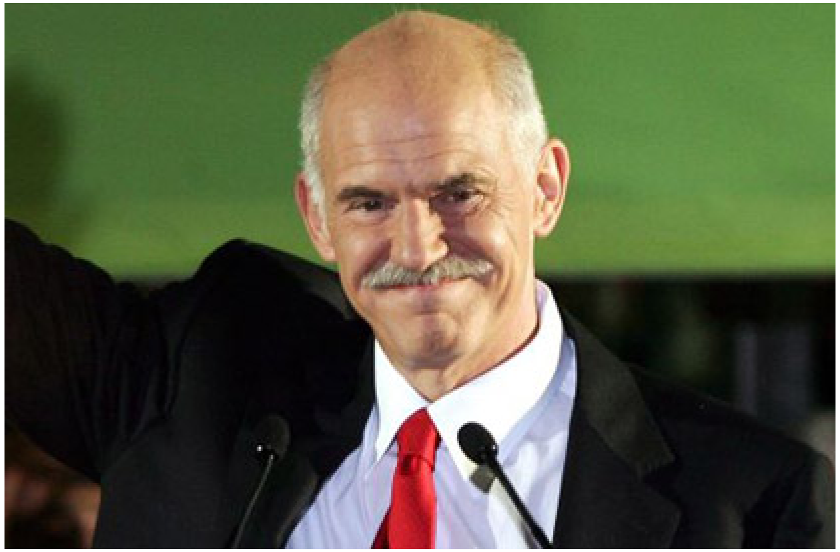
- The ECB extends its securities market programme, providing quasi-fiscal support to struggling governments.
- Full fiscal union and euro bonds.
- The third way: limited euro bonds, limited transfers, ECB bail-outs.

Greece's road to ruin

- Debt ratio rises to 100% of GDP in 1990 but then stabilises
- Further deterioration began in 2004 with the cost of the Olympics
- Still looked just manageable in 2007
- Dramatic deterioration in 2009 with upward revsion of previous deficits

Papandreou takes on disaster

- First indications of 2009 deficit widening in run-up to October election
- Pasok wins decisive but narrow win
- George Papandreou not to blame
- Crisis erupts in winter 2009/10
- Financial rescue negotiations last till May



First austerity round

- Public sector wages effectively cut by 15% plus 3-year freeze
- Severe cuts to pensions
- VAT raised 21% to 23% and many other indirect taxes raised
- Success: deficit: GDP down from 15.6% in 2009 to 10.4% in 2010; primary deficit down from 10.4% to 4.9%

Progress stalls in 2011

- In the first six months no further reduction in deficit.
- Cutting of civil service staff by one in for ten out has failed
- Tax collection has faltered. Tax inspectors take industrial action

June 2011 measures

- Reduction in income tax threshold from €12,000 to €8,000 at 10% rate.
- Higher rates by 1 to 5 percentage points on higher incomes
- VAT on catering up from Sep 1 2011, from 13% to 23%
- Charge of €300 on all self employed

Sep-Oct 2011

- Further reduction in tax threshold to €5,000
- 30,000 public sector to workers to be placed on stand-by at 60% of salary
- 20% fewer public employees in 5 years
- Further 20% cut in public sector salaries and 25% in state enterprises
- Annual property tax from 2011 to raise about €700 for typical home
- 20% cut in pensions over €1,200 a month

Present situation

- Entrenched resistance from all vested interests: public sector and private sector.
- Public transport and taxis on strike
- Troika has to try to negotiate with Greek people in game of brinkmanship
- Next debt rollover December
- 50% or so debt write-down unavoidable

Italy: in the eye of the beholder

- Situation similar to that for last 20 years
- Highest absolute debt in EU
- A year ago it was not one of the PIGS
- Why not? Primary surplus low external deficit, low private debt
- Finance minister Tremonti thought reliable

What went wrong

- Very weak economic recovery
- Lack of reforms to labour market or cartelised professions
- Political bathos with new Berlusconi prosecutions & growing divisions
- Berlusconi's popularity finally falls
- Damage to Tremonti's image

Reaction to loss of confidence

- Berlusconi undermines Tremonti
- Lega Nord vetoes pension reform
- Parliament rejects other expenditure cuts
- Economic prospects worsen
- €48bn package finally passed but mainly as tax rises

Decline and fall may be long

- Emma Marcegaglia: “We are fed up with being an international laughing stock”
- But opposition remains deeply divided
- Electoral system may lead to separate majorities in two houses

Questions and Answers

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Thank you.

Contact for more information:

Holly Donahue
Senior Marketing Manager
Economist Intelligence Unit
hollydonahue@economist.com
+44 (0)20 7576 8379