

Example of case study on the impact of european sovereign debt crisis on the cred...

[Business](#), [Marketing](#)



The European sovereign debt crisis dominated international financial markets during 2010-2012. Economies fell into recession and financial market volatility was high. Critically analyze how the government debt problems initially faced by a few relatively

Introduction

The European financial crisis has extended beyond borders and is now affecting other countries in various condiments. China and United States of America are the most affected nations because they depend a lot on European countries for exports. The world is facing a critical problem brought about by the financial crisis, and financial experts are yet to determine the solution to this problem. The global economic meltdown of 2008 found the European Union struggling with the unshakable financial crisis that has been slowing the growth of European currency, the Euro. As the crisis enters its third year, the European and the whole world is worried whether it would end up affecting the world economy leading to world financial crisis (European Commission 2007).

Europe has been struggling to pay the debts built in the recent years. The most affected European countries are Portugal, Greece, Ireland, Spain, and Italy because they have not managed to stabilize their economy. Since the United States financial crisis of 2008-2009, the global economy has been experiencing stagnated growth that is causing the instability in the Europe fiscal policies. Greece was the first country in Europe to feel the effect of financial crisis because it failed in undertaking the necessary fiscal reforms. The debts accumulated by the European countries were so large exceeding the size of the individual country's deficits (Karamessini n. d).

<https://assignbuster.com/example-of-case-study-on-the-impact-of-european-sovereign-debt-crisis-on-the-credit-markets/>

According to Arezki, Candelon and Amadou (2011), the European sovereign debt crisis has been creating a lot of impact on the financial markets. With the ongoing debt crisis, the debate on the role of credit rating agencies during such crisis, and the relationship between differing financial markets has been renewed. The sovereign debt crisis has been spreading the sovereign bond and credit default swap (CDS), and creating a lot of pressure of stock markets. The European debt crisis from 2008 till now has achieved a high degree of financial integration on the financial markets. The World Bank has introduced financial regulatory measures aimed at fostering the European financial integration (Blundell, Wehinger, and Slovik 2009). The most affected financial market areas by the sovereign European debt crisis are: equity markets, bond markets, money markets, derivatives markets and foreign exchange. The following discussion focuses on three financial markets, Equity markets, Bond Markets, and Money markets.

Financial crisis is identified with loss of credit markets confidentiality. The financial crisis evolved to a liquidity crisis which spread to sub marine mortgage markets. Even though the current global financial crisis is natural, the debt crises experienced in Europe have gone to an extreme. The crisis has led into real shocks in the monetary union because of the external competitiveness and market trade unions. The integration of the traditional and capital market banking in Europe is contributing to increase sovereign crisis (Cuthbertson and Nitzsche, 2008). European countries, like Italy and Spain, have large capital market banks making them more exposed to financial debt crisis affecting the currency stability and contributing into

mark-to-market losses. Moreover, any concern by the European market professionals to regulated the following issues results into liquidity crisis. A lot of debates have been introduced as to the main reason why these crises are still occurring despite the high rate of globalization and advancement in technology. The Modern portfolio theory and investment analysis create an analysis of how investors should determine investments that are likely to fall in the coming years. The case of European debt crisis is a clear indication that someone willing to invest in one of the European nations is taking an extremely big risk. In addition, the modern financial world requires an individual who focuses on future outcomes of their investments (Elton, Gruber, Brown and Goetzmann 2007).

On the other hand, this debt crisis could be political oriented. The affected countries are trying to cut the expenses by reducing the gap between revenues and outlays. A lot of public protests are common in Spain and Greece with the aim of removing the current government from power and electing new leaders. In addition, the impact has affected neighboring countries, like the U. S. the crisis has a tremendous effect on the United States Financial budgets. According to Kenny (2012), 40% of the IMF capital comes from United States. When IMF commits a lot of its fund to countering the debt crisis in European Union, the U. S tax payers suffers the impact of increased taxes in order to recover the 40% bill (Tran 2012). The impact of European debt crisis is well analyzed by looking at the individual financial areas of concern as analyzed below.

Impact of European debt crisis on the equity markets

The European sovereign debt crisis has resulted into a lot of impact of much country's equity market. The impact of savages caused by the debt situations in Spain and Italy has created a lot of fear on most countries equity market stability. The increased taxes and growing opposition has created a big recession on the financial market after the Greek bailout was shut down. This resulted into the two countries holding bonds for investors from different parts of the world because Italy and Spain are among biggest economies in the Euro zone. The equity markets share decreased forcing investors to sell their bonds at losses as the interest rates increased up to 6 percent. In addition, the fall of share prices in Italy resulted into the suspension of several banks after their finances decreased suddenly (Blundell-Wignall and Atkinson 2011).

On the other hand, the European debt crisis has threatened the U. S equity markets. United States investors based in Europe are trading at losses due to the low priced Euros. The effect of the crisis is seen as most banks get bankrupt and also fail to pay their debts to the World Bank. The debt crisis has resulted into fall of the European economy as many financial institutions continue to lay off their employees. The unemployment figures continue to increase as the equity markets decrease their returns. With no extra ordinary steps being taken, the financial crisis resulting from Europe debts will face extreme consequences that might cause the diminish of the European Union. The effect on the European Union during the 20th century has created a lot of impact on the continent's economy. Most European countries end up

selling their currency at losses, which is contributing to the increased debt crisis (Greenblatt 2012).

Impact of European debt crisis on the bond markets

The size of Italy bonds market has put investors at risks of losing their finances. Italy has the largest bond market in Europe, and is the largest worldwide. The fall of Italy bond markets has a big impact globally. The present European debt crisis is unfavorable because it is affecting the Italy finances making it borrow more money from the World Bank. The most affected countries are France and Germany since they possess a big percentage of Italian bonds. The European financial default has resulted into major losses on most banks globally who own bonds in the continent. Moreover, the effects are seen in United States who owns Italian bonds valued at billions of dollars (Francesco & Vincenzo 2012). The bond yields have also shown that investors have minimal trust issues in the U. S economy after the European sovereign economy. This led to rise of price of bonds and the yield goes down. It has also affected investments in the country.

When European adopted a single currency they did not consider an infrastructure to protect it. This resulted to problems of harmonization of fiscal policy which was inadequate. Low interest rates and the expansion of investment and financial opportunities arising from securitization of mortgage pushed up values of different commodities, real estates and equities. This later made the consumers budget get pinched because of the rising prices of housing and commodities which made them reduce their

expenditures. The reduced consumer spending led to slowing down of economic activities and also the prices of housing also reduced. This led to risk in interbank money market leading to spread of problems in the money market because they led to fears of undervaluing assets.

It is important to have a developed bond market in order to ensure that there are no potential risks that may occur in future. Financial integration helps to carry stability financially where there is absence of institutional framework. The problem of promoting liquidity in bond markets has been created by the many different currencies creating salient problems in creation of these markets. This has led to creation of currency basket which consists of all currencies which would measure their deviation from the European currency issue.

The expected financial losses are too big that most countries fear to invest in any European country because the debt crisis has not shown any signs of ending. The under pricing of risks has contributed towards the present Europe financial crisis in the capital markets. The European countries are suffering from excessive risks in their banking institutions because of too much leverage. In addition, the deregulations and innovations on the financial sector are happening too rapidly leaving no room for negotiations with other countries possessing bonds in the Euro zone. The recent cases have indicated that Euro zone is suffering from incomplete markets resulting from bank credits and securities. These bank credits are now turning off investors willing to purchase bonds from European countries in fear of losing their investments. In addition, the more debts have contributed in the

decline of Euro zone stock market by 10 percent by the start of year 2012 (Bekaert and Lo Duca 2010).

Impact of European debt crisis on the money markets

Money markets are essential in determining the financial status of individual investor or a nation. Investors have a belief those bank accounts that are lower yielding even though they are not protected. The US dollar has been high in value than the euro from the beginning of this crisis. This strong dollar has led to prices of goods being less competitive hence minimizing the US exports hence slowing the economic growth. This has led it to make it import more than export. The Euro area money has created segmentation between the rich and poor banks, and fragmenting many nations. The recent European debt crisis has created a lot of stresses on the money market. It has introduced increased interest rates that have led into declined market activities in different market segments. The impact of debt crisis on the money market leads banks into borrowing loans from Central Bank funding, which end up becoming the intermediaries of bank-to-bank transactions. The Europe sovereign debt crises have created a significant impact on the money market. As a result, market prices of commodities have increased, investors lack information about their investments. This is taking place because the poor functioning of banks as they strive to repay their loans to the central bank. The presence of financial crises has resulted into the fall of many countries' money market, U. S being the most affected. The effects have cropped into other countries especially the developing ones who depend on U. S. for imports. Most banks in the United States have been

unable to maintain 1\$ per share because they are affected by the increasing European Debt crisis (Chan-Lau 2008).

Conclusion

The fracturing of Euro has the probability of increasing the inflation rates leading into increased market costs of commodities. The increasing continuing European debt crisis could cause pressure among countries that depend on Euro for their business transaction. The European debt crisis has lead into great impact on the financial markets. As discussed above, most countries have been affected, although some are more affected than others. Most countries that have close ties with Europe like China and the United States of America have suffered more. According to the World Bank statistics, the global economic growth is estimated to fall by 1. 1 percent from 2012 to 2013. In addition, if the Europe debt crisis continues, the global GDP could reduce by 0. 6 percent by the year 2013. According to Blundell-Wignall (2012), there is no concrete solution towards the European debt crisis and many economists are holding debates towards the issue. European nations are trying to generate a solution that could solve the current issues and avoid more crises in future.

References list

Arezki, R., Candelon, B., and Amadou, N., 2011, Sovereign Rating News and Financial Markets

Spillovers: Evidence from the European Debt Crisis. IMF Working Papers; p. 3.

Bank for International Settlement. 2012, ' International banking and financial

<https://assignbuster.com/example-of-case-study-on-the-impact-of-european-sovereign-debt-crisis-on-the-credit-markets/>

markets

Development”, BIS Quarterly review; pp. 12-16

Bekaert, H. and Lo Duca. 2010, ‘ Risk, Uncertainty and Monetary Policy’,

NBER

Working Papers 16397

Blundell-Wignall, A. 2012, “ Solving the Financial and Sovereign Debt Crisis in Europe,”

OECD Journal: Financial Market Trends, Vol. 2011, No. 2, pp. 1-23.

Blundell-Wignall, A. and Atkinson, P. E. 2011, Global SIFIs, Derivatives and Financial

Stability, OECD Journal, Financial Market Trends, 2011(1).

Blundell. W., Wehinger. A., G. and Slovik. P. 2009, “ The Elephant in the Room:

The Need to Deal What Banks Do”, OECD Journal: Financial Market Trends, vol. 2

Bodie, Z., Kane, A. and Marcus, A. J. 2008, Investments, (7th ed). McGraw-Hill.

Chan-Lau, J. A., 2008, “ The Globalization of Finance and Its Implications for Financial Stability:

An Overview of the Issues,” International Journal of Banking, Accounting, and Finance, Vol. 1, pp. 3-29.

Cuthbertson, K. and Nitzsche, D. 2008, Investments, (2nd ed). Wiley

Elton, E. J., Gruber, M. J., Brown, S. J. and Goetzmann, W. N. 2007, Modern portfolio

<https://assignbuster.com/example-of-case-study-on-the-impact-of-european-sovereign-debt-crisis-on-the-credit-markets/>

theory and investment analysis, (7th ed). Wiley.

Francesco A. & Vincenzo S. 2012, Uneven Regional Development in Italy: Explaining

Differences in Productivity Levels. Retrieved from:

<http://www.ecostat.unical.it/aiello/GdEAEAiello-Scoppa.PDF>.

Greenblat, J. 2012, European debt crisis threatens U. S equity market.

Retrieved from:

<http://www.futuresmag.com/2012/04/16/european-debt-crisis-threatens-us-equity-markets>

Hartmann, P. 2011, Currency competition and foreign exchange markets – The dollar, the yen and the euro, Cambridge University Press.

Karamessini, M. n. d. Sovereign Debt Crisis: An opportunity for completing the Neo-Liberal

project and dismantling the Greek employment model. Retrieved from:

http://www2.euromemorandum.eu/uploads/ws1_karamessini_debt_crisis.pdf

Kelly, K. 2011, The Euro debt crisis and economic theory. U. S: Ludwig Von Mises Institute

European Commission 2007, European Economy, Belgium: European

Communities

Tran, M. 2012, Eurozone debt crisis poses serious threat to emerging markets. Retrieved from:

<https://assignbuster.com/example-of-case-study-on-the-impact-of-european-sovereign-debt-crisis-on-the-credit-markets/>

<http://www.guardian.co.uk/global-development/2012/jun/19/eurozone-debt-crisis-emerging-markets>

<https://assignbuster.com/example-of-case-study-on-the-impact-of-european-sovereign-debt-crisis-on-the-credit-markets/>