

Europe's sovereign debt crisis and implications on the Thai economy

Europe's sovereign debt crisis

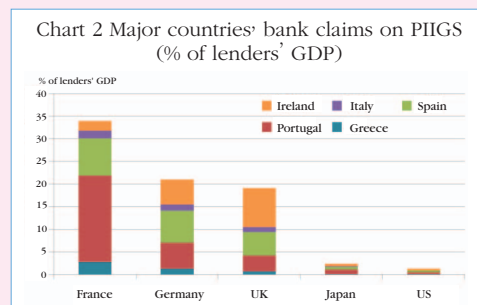
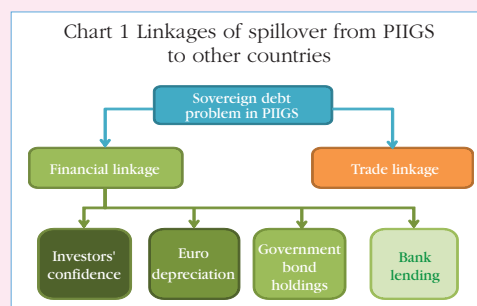
The high and rising levels of public debt in several European countries, especially in PIIGS^{1/}, pose a significant risk to the recovery of Europe as well as to the global economy through two important channels: financial markets and trade.

The key impact that has sent ripples across financial markets so far is a drop in investors' confidence triggered by concerns about debt servicing ability of PIIGS governments. This has led to increasing volatilities in the financial markets, the depreciation of the euro by more than 20 per cent from its peak at end-2009, and a reduction in the value of government bonds in problem countries^{2/}. Nevertheless, losses from bond holdings should be contained within European countries, as 58 per cent^{3/} of total Greek government bonds are held by financial institutions in Europe.

Repercussions through financial markets can also arise from cross-border bank lending, as European firms rely heavily on banks for funding and banks have extensive cross-border lending activities. Major lenders to PIIGS are financial institutions from France and Germany, with outstanding bank loans amounting to 34 and 21 per cent of their respective GDP. Therefore, should financial institutions in PIIGS experience severe problems, the banking sector of these major creditor countries could also be affected, which could create systemic risks to Europe's financial markets going forward.

Through trade, on the other hand, the impact of the sovereign debt crisis is expected to be limited, as PIIGS account for only 7.8 and 13.2 per cent of global and euro-area intra-regional trade, respectively. Nevertheless, the significant depreciation of the euro has the potential to affect other countries' exports to the euro area.

If the problem is contained within PIIGS, the impact of the sovereign debt crisis on Asian economies through financial markets is expected to be limited. Asia has a low financial exposure to PIIGS, and Asia's asset holdings and loans from Europe are concentrated in Germany and France. In addition, Asian countries have significantly



Source: BIS and calculation by Bank of Thailand

^{1/} PIIGS refers to Portugal, Italy, Ireland, Greece and Spain

^{2/} According to the *Financial Stability Report* published in June 2010 by the Bank of England, global mark-to-market losses increased by 3.3 trillion US dollars between March and June 2010.

^{3/} Germany, France, Switzerland, England, Ireland, Austria, Italy, Belgium, the Netherlands, Luxembourg, and Scandinavian countries

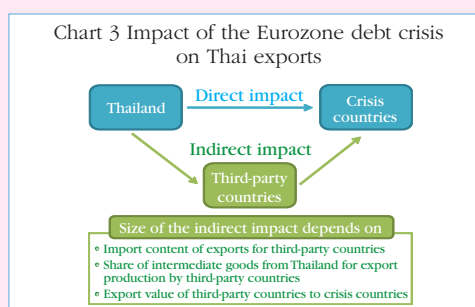
reduced their reliance on external funding from European countries since the 1997 Asian financial crisis. Meanwhile, the impact of the sovereign debt crisis on the real sector is also expected to be limited. Of total exports from the Asian region, exports to PIIGS account for only 2.5 per cent.^{4/} However, should the crisis become widespread and affect Europe's biggest economies, its impact on Asian exports could be substantial, given that the euro area market accounts for 9 per cent of Asia's total exports and in particular 15.6 per cent of China's exports.

The sovereign debt crisis and Thailand

The impact of the euro-area debt crisis on Thailand's financial markets is expected to be limited given that Thai investors, including financial institutions, have low financial exposure to European economies.

The direct impact of the sovereign debt crisis on Thailand through trade depends largely on the extent of the crisis. If the crisis remains contained, its direct impact on Thai exports should be small, since Thailand's exports to PIIGS account for only 1.8 per cent of Thailand's total exports in value terms. In addition, there is an indirect impact through exports of intermediate goods to countries (mostly China, ASEAN-4 and Japan^{5/}) that in turn export to PIIGS. The magnitude of this indirect impact depends on: (1) the import content of those third-party countries' exports; (2) the share in third-party countries' imports of intermediate goods coming from Thailand; and (3) how much the third-party countries export to crisis countries.^{6/} Estimation results show that the indirect impact on Thai exports is just 1.7 per cent, because the share of intermediate goods from Thailand is quite small and because those third-party countries mainly use domestic inputs for production.

However, should the crisis become widespread and affect Europe's major economies^{7/}, the direct impact will significantly increase: 9.3 per cent of total exports will be at risk, especially exports to the United Kingdom, the Netherlands and Germany (which respectively account for 2.1, 2.1 and 1.7 per cent of total Thai exports). The indirect impact is estimated to be 4.7 per cent of total exports, affecting in particular exports to China, ASEAN-4, Japan, the United States, Hong Kong and Vietnam.



Per cent of total exports	Direct impact	Indirect impact	Total impact
PIIGS	1.8	1.7	3.5
EU10	9.3	4.7	14.0

^{4/} Asia refers to Taiwan, Thailand, Korea, Indonesia, the Philippines, Hong Kong and Singapore.

^{5/} ASEAN-4 consists of Malaysia, Indonesia, the Philippines and Singapore.

^{6/} Import content of exports is calculated from input-output databases of the third-party countries. Thailand's shares of imported intermediate goods in third-party countries are calculated based on goods that third-party countries import for use in production of exports. However, limited data availability restricts the calculation of indirect impact to the first-round effect in third-party countries only and does not take into account the income effect of third-party countries, if income falls, in subsequent rounds.

^{7/} This analysis features 10 countries, namely Austria, Belgium, the Czech Republic, Denmark, Finland, France, Germany, the Netherlands, Sweden, and the United Kingdom.