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PHASES OF THE EURO CRISIS UNTIL JUNE 2012

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The euro was the dream of many a politician after creating the European Community. After a long period of planning and negotiating finally, the common currency was established in Maastricht by the European Union (EU) in 1992.

To join the currency, member states had to qualify by meeting the terms of the treaty in terms of budget deficits, inflation, interest rates and other monetary requirements.

On 1 January 1999, the currency officially came into existence. Europe's single currency was soon to be a veritable force on the financial markets, although it was difficult to predict how it would perform. Most analysts expected the euro to be a strong currency, and they were right the euro was strong and if they especially the most instable countries like Greece, Spain, Italy or Portugal will hold out then the euro can be strong again compared to other currencies dollar, yen, Juan or Swiss franc.

In 2001 when Greece joined the Euro Zone, its deficit was more than 3% and its central governmental debt was far more than 60% (%GDP), just like Italy. One year later as the economical inefficiency in the country was nothing; Greece along with the other zone members could introduce the euro notes and coins.

In 2007 the global financial crisis broke out and the Euro Zone countries suffered like any other. For this reason on December 2008, EU leaders agreed on a 200bn-euro stimulus plan to help boost European growth following the global financial crisis. Among others Greece whose central governmental debt increased from 105,7% to 127% over two years (OECD data).

In the beginning of 2009 the euro seemed to be far away from any type of crisis that's why Slovakia joined the Euro Zone, and introduced it promptly, and four other EU member countries decided to join the Exchange Rate Mechanism to bring their currencies and monetary policy into line with the euro in preparation for joining.

Nevertheless the Greek governmental financial situation started to be untenable, so in April, the EU ordered Greece alongside with France, Spain, and the Irish Republic to reduce their budget deficits - the difference between their governmental spending and inland revenue.

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The actual Greek government did not have enough time to carry out the reforms disposed by the EU, because on October 2009 was held the governmental elections. Amid overall anger towards the central right government of Konstantinos A. Karamanlis over corruption and spending, this way gravely indebting the country, George Papandreou's Socialists won general election victory. Their first and foremost duty was to correct a "lack of credibility" in the financial markets and to reduce Greece's substantial budget deficit and government debt.

Greece was burdened with debt amounting to 127% of GDP (OECD data) what is the double the euro zone limit of 60%.

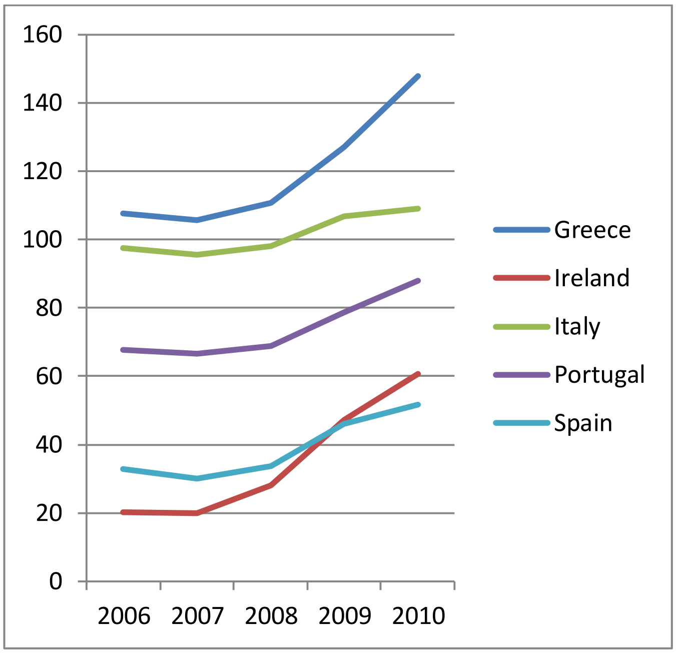

Diagram 1 – Central Government Debt of the PIGS countries from 2006 to2010 (OECD)

Ratings agencies started to downgrade Greek bank and government debt. The Greek Prime Minister Mr Papandreou insisted on that his country is "not about to default on its debts".

For this reason Greek bonds started to decline dramatically in the beginning of 2010, when Investors started to worry that Greece may not be able to pay off its huge debts, and were seeking safer countries for their money.

In January, an EU report condemned a lot of irregularities in Greek accounting procedures. Greece's budget deficit in 2009 was revised upwards to 15.6%, from 3.7%, which is more than five times the maximum allowed by EU rules. Eventually the European Central Bank dismissed a speculation that Greece would have to leave the EU. Facing the situation the government carried into effect a series of austerity measures aimed at whittling the deficit.

Greece was not alone with its financial problems at this time. Spain, Ireland and Portugal were and are heavily indebted countries. This is how the acronym PIGS came into fashion in

Diagram 2 – Euro- Dollar exchange rate from 2006

the financial markets, referring to these troubled countries. As the information was leaked about the situation of these countries the euro started to weaken in comparison to the dollar. The exchange rate was the lowest, 1,2, in June.

On 11 February, the EU promised to act over Greek debts and ordered Greece to make further spending cuts. The austerity plans spark strikes and riots in the streets.

In March, Mr Papandreou was continuing to insist that no support was is needed, his government can manage alone. The euro continued to fall against the dollar and the pound.

The euro zone and IMF agreed on a safety net of 22bn Euros to help out Greece, but no loans yet.

In April, following worsening situation of financial markets and more desperate social protests, euro zone countries agreed to provide up to 30bn Euros as emergency loans for Greece.

Finally, on 2 May 2010, Euro zone members and the IMF have agreed an 110bn-euro three-year bail-out package to rescue Greece's economy. In return for the financial help, Greece would have to make major austerity cuts which required "great sacrifices "from Greek people.

The EU would provide 80bn Euros in funding and the rest will be granted by IMF. Before submitting the money the decision was approved by some parliaments in the 15 other euro zone countries. In return for the financial support, the Greek government has taken strict measures to reduce the deficit, including further tax rises and deeper cuts in pensions and public service pay. The Euro group was trying to speed up its rescue efforts for Greece because they feared that its debt crisis could undermine other dreadfully indebted countries that use the single currency. The first priority for the Greek government was to avoid bankruptcy, and for this reason the citizens would have to make great sacrifices. This time these sacrifices were: abolishing bonus payments for public sector workers; repelling annual holiday bonuses and cutting back them for the ones with higher earnings; banning increases in public sector salaries and pensions for at least three years; increasing VAT from 21% to 23%; raising excise duty on fuel, alcohol and tobacco by 10%; and taxing illegal construction.

The financial support given to Greece was not enough to stabilize the euro zone, and the euro continued to fall and other EU member state debt started to be investigated, firstly the Republic of Ireland. The situation was very serious, and for this reason in November, the EU and IMF agreed to a bailout package to the Irish Republic totalling 85bn Euros. An average interest rate of 5.82% would be payable on the loans, above the 5.2% paid by Greece for its bail-out. Germany had been pushing for a higher interest rate of about 7% so that any rescue loans would not look like cheap money.

The deal would see 35bn Euros to set up the Irish banking system and the remaining 50bn Euros to help the government's day-to-day spending. After the agreement the country passed the toughest budget in its history, to cut down on the deficit and to meet the expectations of the EU and the IMF.

The EU also agreed to create a new European Stability Mechanism (ESM) to wrap the debt crises in the euro zone up. The mechanism would have forced losses on private investors "only on a case by case basis", and would replace an existing rescue fund (European Financial Stability Facility (EFSF)) which have run out in 2013. The announcement on this permanent mechanism was not deliberated enough, but it was established to try to ease spreading concerns about the debt crisis in Europe.

After Estonia joined the Euro zone on 1 January 2011, the 17 finance ministers in February have agreed to set up the mentioned permanent bail-out fund for the region of 500bn Euros. The previous system the EFSF was designed as an extemporaneous facility to last until 2013, had a notional 440bn Euros to loan but in reality could only lend out about 250bn Euros because it had to keep back190 bn Euros to be strong enough to keep its borrowing costs low. In contrary the 500 bn Euros of the new system constituted its effective lending capacity. The ESM project is not only financed by the EU but the IMF as well.

In April, Portugal admitted that it could not manage its finances alone and asked the EU for help. Previously on November 2010 Portugal had ardently denied that the country was in line aid package. In May Euro zone financial leaders unanimously approved a 78bn euro bail-out for Portugal. The loan was to guard the financial stability in the euro area and the EU as a whole. Portugal's loan was split three ways between the European Stability Mechanism (ESM), the European Financial Stability Facility (EFSF), and the IMF. Each contributed 26bn Euros.

In return for the deal private bondholders have been directed to maintain their exposure to Portuguese debt, rather than sell it off. In return for the loan Portugal had also agreed to reform its health care system and pursue an extensive privatisation programme.

In the middle of the crisis IMF was left without a leader because Mr Dominique Strauss-Kahn resigned on 18 May 2011 following allegations that he had sexually assaulted a hotel employee. The leadership vacuum at the IMF came at a highly inopportune time for Europe, which was teetering on the brink of a full-blown debt crisis.

In June Greece was in need of a new loan but euro zone ministers said they had to impose new austerity measures before it could receive the next tranche of its loan, without which the country would probably default on its enormous debts. It must have taken additional steps to consolidate public finances because it was missing its deficit reduction targets. Germany had provided a large chunk of the Greek bail-out cash and wanted to see stringent conditions applied before backing any new aid.

In the next few weeks the talk abounded that Greece was to be forced to become the first country to leave the euro zone, but it was proven to be baseless.

In July, the Greek parliament voted in favour of a fresh round of drastic austerity measures and the EU approved the latest tranche of the Greek loan, worth 12bn Euros. In July the second bailout for Greece was also agreed. The euro zone members agreed on a comprehensive 109bn-euro package designed to resolve the Greek crisis and prevent contagion among other European economies. The Institute of International Finance (IIF) - a global trade body representing big banks and other major lenders - said the planned debt restructuring would target participation by 90% of Greece's private sector lenders.

In August European Commission President Jose Manuel Barroso warned that the sovereign debt crisis was spreading beyond the periphery of the euro zone. The yields on government bonds from Spain and Italy rose sharply - and Germany's fell to record lows - as investors demanded huge returns to borrow. The European Central Bank said it would buy euro zone bonds, following emergency talks on the debt crisis, to try to bring down their borrowing costs, as concern grew that the debt crisis may have spread to the larger economies of Italy and Spain.

The situation was deteriorating in Spain as well. The first step to revive the economy was that during September, Spain passed a constitutional amendment to add in a "golden rule," keeping future budget deficits to a strict limit.

Italy was in the same situation, so after weeks of discussions, Italy's austerity bill had been given final approval by the lower house parliament in Rome on September 2011. But there was fierce public opposition to the measures and police once again clashed with protesters on the streets of the capital. Italy has had the rating of its creditworthiness cut, on 20 September 2011. Standard and Poor's cut its rating by one level to A from A+.

On 19 September, Greece held talks with its international supporters, the European Central Bank, European Commission and IMF. After the negotiations Greek Finance Minister Evangelos Venizelos said his country was been "blackmailed and humiliated" and a "scapegoat" for the EU's incompetence.

The gloomy mood continued in EU all along September, when IMF head Christine Lagarde urged countries to "act now and act together" to keep the path to economic recovery on track. On the same day, UK Prime Minister David Cameron called for swift action on the debt crisis, because they feared that the euro crisis would have spread beyond the euro zone.

After days of intense speculation that Greece would fail to meet its budget cut targets, there were signs of a euro zone rescue plan emerging to write down Greek debt and increase the size of the bloc's bailout fund. The outline of a large and ambitious euro zone rescue plan was taking shape. It was expected to involve a 50% write-down of Greece's massive government debt. The plan also envisaged an increase in the size of the euro zone bailout fund to 2 trillion Euros. Another element of the rescue plan was to strengthen the big euro zone banks, which are perceived to have too little capital to absorb losses.

On 28 September, European Union head Jose Manuel Barroso warned that the EU "faces its greatest challenge". There was a widespread view that the latest efforts to thrash out a deal have failed, but Barroso assured everybody that Greece would stay in the euro zone.

There were new protests in Athens ahead of a visit by international lenders. But the so-called troika, made up of the European Commission, European Central Bank (ECB) and International Monetary Fund (IMF) assessed Greece's eligibility for further bailout money.

To get the next trench of the payment the Greek parliament passed a controversial new property tax bill, which aims to boost revenues. This again triggered a demonstration outside the parliament, on Syntagma Square, riot police fired tear gas, and reportedly used truncheons, to break up the protest by about 1,000 demonstrators.

Despite this new tax bill on 4 October, Euro zone finance ministers delayed a decision on giving Greece its next instalment of bailout cash. It came after Greece said it would not meet this year's deficit cutting plan. The delay sent European shares down sharply, French shares fell 2.6%, German stocks 3% and the UK's FTSE 100 2.6%. US markets also opened sharply lower, but ended the day up thanks to a strong rally in the last hour of trading. The Dow Jones was 1.4% higher at the close.

Banking stocks were again among the biggest fallers, due to concerns about their exposure to Greek government bonds.

Greece was trying to reduce its deficit. They approved a measure to put 30,000 civil service staff on "labour reserve" by the end of the year.

The strong economy of the UK was also in danger so on 6 October 2011 the Bank of England injected a further £75bn into the UK economy through quantitative easing, while the European Central Bank unveiled emergency loans measures to help banks. The European Central Bank was offering unlimited new one-year emergency loans to banks to help steady the euro zone. The ECB said it would also help the banks by spending 40bn Euros buying assets from them known as covered bonds. Earlier, the ECB had left euro zone interest rates unchanged at 1.5%. But the situation of the banking sector was worsening gravely.

Financial markets were bolstered by news on 8 October that the leaders of Germany and France have reached an accord on measures to help resolve the debt crisis. Meanwhile, talks were continuing over the latest bailout tranche, 8bn Euros, for Greece, which could have run out of cash as soon as mid-November. The European Commission, the European Central Bank and the IMF decided about the money to help the Greek government pay its bills.

This is the money from the original 110bn euro bailout agreed in 2010. Another 109bn euro bailout package was also agreed by European leaders in July, but this was to be ratified.

Despite efforts by leaders to contain the crisis, there was little evidence that its end was nearing.

On 14 October, the international ratings agency Fitch downgraded the sovereign credit ratings of Italy and Spain, and another agency, Moody's, downgraded 12 banks in the UK and nine in Portugal. Because of the worsening situation of the bank system France, Belgium and Luxembourg bailed out the troubled bank Dexia, following fears it could go bankrupt.

The bailout plan for Dexia came after German Chancellor Angela Merkel and French President Nicolas Sarkozy agreed Europe's crisis-hit banks needed to be recapitalised. Dexia also secured state guarantees of up to 90bn Euros to secure borrowing over the next 10 years. Belgium would provide 60.5% of these guarantees, France 36.5% and Luxembourg 3%.

Finally on 21 October euro zone finance ministers approved the next, 8bn euro, tranche of Greek bailout loans, potentially saving the country from default. Ministers also said they were working on a second rescue package for Greece. The new plan for the debt-ridden country would have included fresh aid money and contributions from the private sector. However, no further details on the new package were disclosed.

There have been widespread reports of deep divisions between France and Germany. In particular, the two needed to agree on how to increase the firepower of the euro zone’s bailout fund, the European Financial Stability Facility (EFSF), from 440bn Euros.

France proposed turning the EFSF into a bank so that it could borrow from the European Central Bank (ECB), but Germany refused to sanction such a move, arguing it would compromise the ECB's impartiality.

The German government promised its taxpayers that its contribution will not go above 211bn Euros so is looking for a way to increase the size of the fund without increasing the liabilities of German taxpayers.

On 26 October European leaders reached a trilateral agreement described as vital to solve the region's huge debt crisis. They said banks holding Greek debt accepted a 50% loss, the euro zone bailout fund will be boosted and banks will have to raise more capital. Banks also had to raise more capital to protect them against losses resulting from any future government defaults.

The agreement was aimed at preventing the crisis spreading to larger euro zone economies like Italy, but the leaders said work still needed to be done. After marathon talks in Brussels, they agreed a mechanism to boost the euro zone’s main bailout fund to about 1tn Euros. The announcement of the deal helped lift the euro, with investors reacting positively to the outlook for the region's growth and single currency.

On 1 November 2011 Mario Draghi an Italian banker and economist succeeded Jean-Claude Trichet as President of the European Central Bank. He was previously the governor of the Bank of Italy from January 2006 until October 2011.

On 9 December, after another round of talks in Brussels going through much of the night, French President Nicolas Sarkozy announced that euro zone countries and others would press ahead with an inter-governmental treaty enshrining new budgetary rules to tackle the crisis.

Attempts to get all 27 EU countries to agree to treaty changes failed due to the objections of the UK and Hungary. The new accord was to be agreed by March 2012.

On 13 January, credit rating agency Standard & Poor's downgraded France and eight other euro zone countries, blaming the failure of euro zone leaders to deal with the debt crisis. Three days later, the agency also downgraded the EU bailout fund, the European Financial Stability Facility.

On 13 January 2012 talks between Greece and its private sector lenders over a possible 50% write-off of its debts have got stuck. Reaching a deal was a pre-condition for the Greek government to receive the next chunk of bailout cash from the International Monetary Fund and European Union. Without that money, the Greek government could run out of cash and be forced to leave the euro. The deal was necessary if Greece was to receive the bailout funds it needs to repay billions of Euros of debt in March. The talks were to be continued on 18 January.

Twenty-five of the EU's 27 member states agreed to join the fiscal treaty mentioned before, to enforce budget discipline. The Czech Republic and the UK refused to sign up. UK Prime Minister David Cameron said his government would act if the treaty threatened UK interests. Germany - the euro zone’s biggest lender and most powerful economy - was particularly keen to get a binding treaty adopted to enforce budget rules. The treaty empowers the European Court of Justice to monitor compliance and impose fines on rule-breakers.

The treaty also spells out the enhanced role of the European Commission in revising national budgets.

Weeks of negotiations went on between Greece, private lenders and the "troika" of the European Commission, the European Central Bank and the IMF, as Greece tried to get a debt write-off and make even more spending cuts to get its second bailout. But only on 10 February, Greece's coalition government agreed to pass the demands made of it by international lenders. The measures included: 15,000 public-sector job cuts; liberalisation of labour laws; lowering the minimum wage by 20% from 751 Euros per month to 600 Euros; negotiating a debt write-off with banks. This led to a new round of protests. Demonstrators threw rocks and petrol bombs at police, who responded with tear gas. The clashes came after trade unions began a 48-hour strike.

But the euro zone effectively casted doubt on the Greeks' figures, saying Athens must find a further 325m Euros in budget cuts to get the aid, so On 12 February, Greece passed the unpopular austerity bill in parliament - two months before a general election.

On February 22, a Markit survey reported that the euro zone service sector has shrunk unexpectedly, raising fears of a recession. Markit's euro zone Services Purchasing Managers' Index (PMI) initial data fell to 49.4 from January's 50.4. In order to return to reasonable growth demands needed to improve considerably, that did not happen.

March begun with the news that the record. The jobless rate in the 17 countries that use the euro rose to 10.7% in January, while December's figure was revised up from 10.4% to 10.6%. Meanwhile, separate data from Eurostat showed that inflation in the euro area rose to 2.7% in February, rising slightly from 2.6% in January.

However, the economic news took a turn for the better just days later with official figures showing that the euro zone’s retail sales increased unexpectedly in January by 0.3%, and the OECD reported its view that the region was showing tentative signs of recovery.

On 13 March, the euro zone finally supported a second Greek bailout of 130bn Euros. IMF backing was also required and was later given. Finance ministers from the bloc had been meeting in Brussels to approve the package.

The meeting followed Greece swapping most of its privately-held bonds with new ones worth less than half their original value. Greece realised the biggest debt write-down in history, swapping the bulk of its privately held bonds with new ones worth less than half their original value.

Spain's financial status was also on the agenda and finance ministers agreed to allow Spain a bigger 2012 public deficit to 5.3% of GDP, higher than the original target but below the 5.8% Spain originally wanted. Jean-Claude Juncker said the more important figure was the target of a 3% deficit by the end of next year. Earlier this month, Spain said it would miss a deficit target of 4.4% of GDP for 2012 agreed with Brussels. The country was planning 30bn Euros of spending cuts this year. The Spanish government was under political pressure at home, because the demonstrations started to become everyday phenomenon. For example, hundreds of thousands of people protested against government labour reforms.

On 12 April, Italian borrowing costs increased in a sign of fresh concerns among investors about the country's ability to reduce its high levels of debt. In a three-year bond auction, Italy paid an interest rate of 3.89%, up from 2.76% in a similar sale in March. The rate on Italian bonds had fallen these months, but markets were again becoming nervous about Italy and Spain's ability to hit deficit targets.

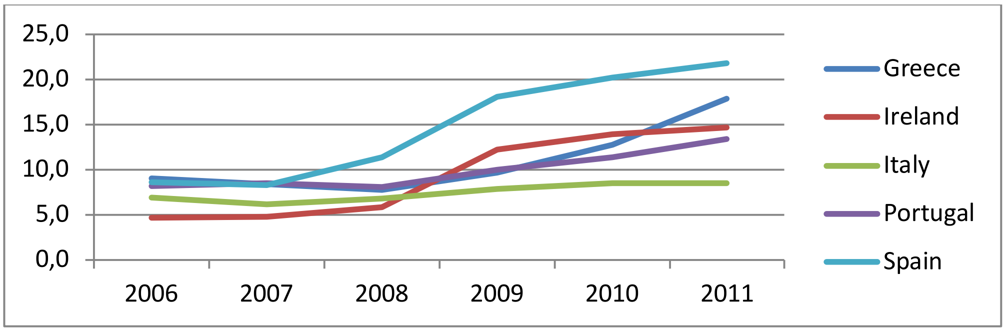

Diagram 3 – Deficit in the PIGS countries (OECD data)

Meanwhile, figures showed a further increase in Greek unemployment. But Greek was not the only economy troubled by the high unemployment rate

Attention shifted to Spain on 13 April, with shares hit by worries over the country's economy and the Spanish government's 10-year cost of borrowing rose back towards 6% - a sign of fear over the country's creditworthiness. The FTSE 100 dropped 1%, while Spain's Ibex fell 3.6% and the Dow Jones in New York closed down 1%.

On 18 April, the Italian government cut its growth forecast for the economy in 2012. It was previously predicting that the economy would shrink by 0.4%, but is now forecasting a 1.2% contraction. The government has also admitted that it will not be able to meet its target of balancing the budget by 2013.

On 19 April, there was some relief for Spain after it saw strong demand at an auction of its debt even though some borrowing costs rose. The 10-year bonds were sold at a yield of 5.743%, up from 5.403% when the bonds were last sold in February.

On 6 May, a majority of Greeks vote in a general election for parties that reject the country's bailout agreement with the EU and International Monetary Fund. This nation, punished by two years of the most drastic austerity measures in modern history, rebelled against the bailout, the political mainstream and the painful cuts that have brought Greece to its knees. "If the European south unites towards our German friends and in particular Chancellor Merkel, she has to realise that these austerity measures are not leading anywhere", said Konstantinos Mihalos, the president of the Greek Chamber of Commerce.

On 16 May, Greece announced new elections for 17 June after attempts to form a coalition government had failed. Greece would hold fresh elections on 17 June and a judge had been chosen to head a temporary government. Final talks to form a coalition failed on Tuesday, raising new concerns over Greece's euro zone future. No party won a majority in the 6 May election.

On May 16 the euro zone crisis pushed Asian stocks lower and knocked oil prices. The uncertainty over the euro has also sparked concern over a run on the banks in Greece. Greek newspapers reported that around 700m Euros has been withdrawn from high street banks over the past few days.

A few days later on 25 May, Spain's fourth largest bank, Bankia, asked the government for a bailout worth 19bn Euros. Bankia also restated its results - saying it made a 2.98bn-euro loss for 2011 rather than the 309m Euros in profit it announced in February. Earlier, trading in Bankia shares was suspended on the Madrid stock exchange while its management put together a restructuring plan. Two weeks earlier, Bankia had a 4.47bn-euro loan by the Spanish bailout fund converted into a 45% stake in the bank. Spain's credit rating was downgraded by S&P in April on the basis that it would probably have to take on more debt to support its banks.

On 9 June, after emergency talks Spain's Economy Minister Luis de Guindos said that the country would shortly make a formal request for up to 100bn Euros in loans from euro zone funds to try to help support its bank system. The move was agreed during emergency talks with euro zone finance ministers. Luis de Guindos said Spain has agreed to officially request assistance, but denied this was a bailout.

The money would bolster the finances of Spain's weakest banks, such as Bankia mentioned before , which have been left with billions of Euros worth of bad loans because of the collapse of the country's property boom and the recession that followed. Some of them borrowed large amounts on the international markets to lend to developers and homebuyers, a riskier strategy than funding it with deposits from savings.

On 12 June, optimism over the bank bailout evaporated as Spain's borrowing costs rose to the highest rate since the launch of the euro in 1999. The benchmark 10-year bond yield hit 6.81%, as optimism about the weekend's Spanish bank bailout continued to evaporate. Ratings agency Fitch downgraded the creditworthiness of 18 Spanish banks, following the decision to cut its ratings on the country's two biggest banks, Santander and BBVA.

The European Commission recommended a European banking union, with a single regulator to oversee banks across all 27 EU states; but disagreements over the proposals highlighted the problems of finding a solution to the crisis

The head of the IMF, Christine Lagarde, urged European leaders to take "decisive steps" to break free of the crisis; she said economic and financial stability was critical to addressing global environmental challenges.

On 17 June, Greeks went to the polls, with the pro-austerity party New Democracy getting most votes., easing fears the country was about to leave the euro zone. New Democracy leader Antonis Samaras said Greeks had chosen to stay in the euro and called for a "national salvation government".

However, correspondents also pointed out that only 40% of voters favoured parties that broadly support the bail-out deal with the EU and the IMF. The elections were watched around the world, amid fears that a Greek exit from the euro could spread contagion to other euro zone members and deepen the turmoil in the global economy.

While the euro zone debt crisis was a cause of concern for some time, it had primarily affected relatively smaller economies such as Greece and Portugal. However, as the crisis spread to bigger economies such as Spain and Italy, there were fears that growth in the region may slow even further.

In June there were four countries which have already received bailout from the EU. First were Greece and Ireland, in 2010, then Portugal in 2011 and this year Spain. The crisis is getting worse and the situation remains unsolved.

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