DEVELOPMENT OF FINANCIAL SYSTEMS OF SOUTHERN EUROPE COUNTRIES AFTER THE DEBT CRISIS

РОЗВИТОК ФІНАНСОВИХ СИСТЕМ КРАЇН ПІВДЕННОЇ ЄВРОПИ ПІСЛЯ БОРГОВОЇ КРИЗИ

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This article analyzes the trends in public finances, namely, the state budget deficits and public debts, in Greece, Italy, Spain and Portugal over the period 2010-2020. There was a steady rise in public debt and an improvement in the public budget, which likely influenced the economic development of these countries over the past decade. The indicators of the financial systems of these countries were also analyzed, namely, interest rates, inflation, net international investment position (NIIP), for the period 2015–2020 in order to assess the development of economic activity. Interest rates on short-term loans in Greece and Portugal are at a high level, while interest rates on loans for more than 5 years in Greece and Italy are slightly higher than in Spain and Portugal. Regarding interest rates on deposits, 5 years ago for all four countries were at least 2 times higher than in 2020. CPI increased in all analyzed countries, which indicated an increase in inflation, but deflation was again observed in 2020. Analyzing the net international investment position, it was found that Greece, Italy, Spain and Portugal are indebted countries. Overall, strengths and weaknesses were identified, as well as causes and consequences for the countries of Southern Europe.

Key words: *debt, government, deficit, budget, Greece, Italy, Spain, Portugal, investment, interest rate.*

В статье проводится анализ тенденций государственных финансов, а именно дефицита государственного бюджета и государственного долга, Греции, Италии, Испании и Португалии за период 2010–2020 годов. Было исследовано постоянный рост государственного долга и улучшение государственного бюджета, что, вероятно, повлияло на экономическое развитие этих стран в течение последнего десятилетия. Анализируются также индикаторы финансовых систем данных стран, а именно процентные ставки, инфляция, чистая международная инвестиционная позиция, за период 2015–2020 годов с целью оценки развития экономической деятельности. Процентные ставки по краткосрочным кредитам в Греции и Португалии находятся на высоком уровне, а процентные ставки по кредитам на срок более 5 лет в Греции и Италии немного выше, чем в Испании и Португалии. Что касается процентных ставок по депозитам, то 5 лет назад для всех четырех стран они были как минимум в 2 раза выше, чем в 2020 году. CPI увеличивался во всех анализируемых странах, что свидетельствует о росте инфляции, однако в 2020 году снова наблюдалась дефляция. При анализе чистой международной инвестиционной позиции было обнаружено, что Греция, Италия, Испания и Португалия являются странами-должниками. В целом, были обнаружены слабые и сильные стороны, а также причины и последствия для стран Южной Европы.

Ключевые слова: *долг, правительство, дефицит, бюджет, Греция, Италия, Испания, Португалия, инвестиции, процентные ставки.*

Економіка Південної Європи не така сильна, як інші європейські регіони. Насправді Південна Європа є найбільш повільно зростаючим економічним регіоном на континенті, і найбільші економіки, зокрема Італія, Іспанія, Греція та Португалія, борються. Більшість країн регіону економічно поступаються країнам Центральної та Північної Європи. У цій статті аналізуються тенденції державних фінансів, а саме державного дефіциту та державних боргів, у Греції, Італії, Іспанії та Португалії за період 2010–2020 років. Відбувалося постійне зростання державного боргу та покращення державного бюджету, що, ймовірно, вплинуло на економічний розвиток цих країн за останнє десятиліття. Основною причиною було повільне економічне зростання держав. Однак пандемія в 2020 році знову серйозно погіршила ситуацію. За останні 10 років економічне зростання в Греції, Італії, Португалії та Іспанії було гіршим, ніж в Іраку (незважаючи на 15 років війни), Ірані (незважаючи на роки придушення міжнародних санкцій), Україні (незважаючи на конфлікт з Росією), Судані та багатьох інших країнах. Однак розглянуті в цій роботі країни досягли певного успіху після серйозної кризи суверенного боргу: вони розпочали економічне зростання та здійснили значні продажі облігацій, де інвестори вимагали великих премій за своїми державними облігаціями. Також у статті були проаналізовані показники фінансової системи цих країн, а саме процентні ставки, інфляція, чиста міжнародна інвестиційна позиція (NIIP) за період 2015–2020 рр. з метою оцінки розвитку економічної діяльності. Процентні ставки за короткостроковими позиками в Греції та Португалії знаходяться на високому рівні, тоді як процентні ставки за позиками на термін більше 5 років у Греції та Італії трохи вищі, ніж в Іспанії та Португалії. Що стосується процентних ставок за депозитами, то 5 років тому для всіх чотирьох країн вони були принаймні в 2 рази вищими, ніж у 2020 році. ІСЦ (індекс споживчих цін) зріс у всіх аналізованих країнах, що свідчить про зростання інфляції, але дефляція знову спостерігалася в 2020 році. Аналізуючи позицію чисту міжнародну інвестиційну позицію (NIIP), було встановлено, що Греція, Італія, Іспанія та Португалія є країнами-боржниками. В Іспанії цей показник має найбільше негативне значення серед аналізованих країн. Загалом було виявлено сильні та слабкі сторони, а також причини та наслідки для країн Південної Європи.

Ключові слова: *борг, уряд, дефіцит, бюджет, Греція, Італія, Іспанія, Португалія, інвестиції, процентні ставки.*

Problem statement. Over the past 10 years, economic growth in Greece, Italy, Portugal and Spain has been worse than in Iraq, Iran, Ukraine, Sudan and many other countries. However, these countries did achieve some success after a severe sovereign debt crisis: they started economic growth and made significant bond sales, where investors used to demand large premiums on their sovereign bonds.

The economy of Southern Europe is not as strong as of other European regions. In fact, Southern Europe is the slowest growing economic region on the continent, and the largest economies, in particular Italy, Spain, Greece and Portugal, are struggling. Most of the countries in the region are economically inferior to the countries of Central and Northern Europe.

Analysis of recent research and publications. Allen, Gu, Kowalewski (2017) analyzed financial

structure and economic development. The theory suggests that banks and markets exist to mitigate agency and asymmetric information problems in a variety of ways. Banks play an important role in delegating monitoring, allocating capital and risks in the economy by diversifying and leveling fluctuations over time, while markets are potentially profitable for new technologies [1].

Xu, Lai and Shu (2018) used systems of differential equations of integer and fractional order to model the financial system. The model was based on the interaction of several financial factors. The authors found that the system exhibited a wide variety of dynamic characteristics, including chaos over a wide range of system parameters. Research showed that the interaction of several financial factors under certain circumstances led to chaos [2].

Squartinia, Caldarellia, Ciminia (2018) argued that the study of any systems was limited to partial information. Financial systems were of paramount importance: information about the relationships between financial institutions was protected by confidentiality, which reduced the ability to assess critical systemic properties, such as resilience to the propagation of shocks, correctly. This review aimed to provide a unified framework for presenting all of the studies, mainly focusing on their application to economic and financial networks [3].

Naidoo (2019) argued that without financial systems, the transition to sustainability could be difficult (the role it played went beyond financing the new sustainable economic state). The author examined the possibilities of interconnection of financial systems and transitions to sustainability. First of all, the author argued that the relationship between financial systems and the transition to sustainability began with understanding the nature of the transition process. The paper further reflected on the explicit requirements that the transition period places on the financial system, the process of developing solutions and how they were evaluated. Responding to resilience and climate disruption required accelerating rapid and radical change [4].

Fromentin (2017) analyzed the dynamic impact of remittances on financial development in emerging and developing economies. Using a pooled mean group (PMG) approach, there was strong evidence to support the notion that remittances contributed to financial development in developing countries in the long term, but the effect may be different in the short term [5].

There are also a large number of researches contributed to identifying the influence of different social and economic factors on the development of national financial systems. Among them there are the studies of Kyfak [6], Lomachynska [7], Rogach [8], Rodionova [9], Yakubovskiy [10, 11].

The goal of the research is to investigate the indicators of the financial systems of the countries of Southern Europe in order to determine the strengths and weaknesses of these countries.

Presentation of the main material of the study. The Greek state budget already in 2014 decreased by almost 4 times to 3.6% due to the process of budget consolidation, which continued in 2012–2014. In 2016, a long period of the state budget deficit ended, when the balance turned into a surplus of 0.5% of GDP. This positive development would not have been possible without a fiscal policy aimed at eliminating the very high budget deficit. This policy was pursued through various combinations of fiscal policy. Greece has conducted 2 comprehensive expenditure reviews that cover between 20% and 100% of all government spending and often include an assessment of program effectiveness and sustainability. Thus, the composition of government spending has changed: between 2007 and 2015, government spending in health care, public administration services, including debt service, and others, decreased. The pandemic has hit the Greek economy, but due to hard work in recent years, the country can look forward to well-managed public finances. The state has made significant progress in a number of major reforms over the past few months. But, despite this, it is predicted that there will be a government budget deficit of 7% of GDP again, and the primary deficit will be 6.3% of GDP.

In Portugal, for the period 2010-2018, the state budget was in deficit, but every year, except for 2014 and 2017, the deficit was decreasing, and already in 2019 there was a surplus of 0.2%. Interest expense decreased due to economic growth and rating agencies' upgrades to the government's sovereign debt ratings. Interest rates on bonds in 2019 are below 2%, while at the beginning of 2012 there was a peak of 14%. Debt servicing costs also decreased due to the amortization of bonds issued at very high interest rates during the financial crisis. Portugal is expected to have a budget deficit of 6.3% of GDP in 2020 due to the coronavirus outbreak, a big setback after the country had its first budget surplus in 45 years at the end of 2019. The pandemic left a 5% void in government revenues, mainly due to falling taxes and social security payments, while government spending exceeded forecast, and also included various measures to support the economy in the period of the pandemic.

The deficit of the Spanish state budget increased over the period 2010–2012, but already in 2013 there was a decrease from 10.7% to 7%, and in 2019 it also decreased to 2.8%. The fact is that in 2011, a package of actions was introduced to reduce government spending and increase tax revenues by raising taxes. As a result, unemployment increased, wages and pensions were cut, public services deteriorated, and access to loans for individuals and small businesses was limited. In 2017, Spain reached a deficit below the EU threshold of 3% of GDP for the first time in 10 years. However, in

2019, the deficit increased slightly from 2.5% to 2.8%, which was due to the need to spend more after years of austerity. New measures have been taken regarding costs. Measures included some additional pension increases, a range of social policies, wage increases for public sector workers, restoration of annual inflation-related pension increases, and tax cuts for low-income people. Spain also saw an increase in spending and a decrease in revenue in 2020. The 2020 budget deficit is expected to be 10.34% of GDP.

Overall, Italy has experienced a decline in the government deficit over the period 2010–2019. During the period from 2010–2013, the country made significant financial efforts, increasing its primary surplus to more than 2% of GDP, and in 2013 the state budget deficit was 2.9%, reaching the threshold. Since 2014, the government's fiscal position has deteriorated slightly, while the deficit, as well as the primary deficit, worsened slightly. Immediately in 2014, Italy created an independent Parliamentary Budget Office to assist with economic forecasts and budget proposals. In 2016, Italy launched gender budgeting. After the first experiment in 2017, this method was further developed in 2018. Also, at the end of 2018, a new Italian budget law was introduced. Already in 2019, Italy reached a budget deficit of 1.6%. The country last ran a deficit below 2.2% in 2007. However, these plans were canceled out by the outbreak of the virus, when the state began 2020 with a deficit of 2.2% of GDP, and in April the deficit reached 8% of GDP. The epidemic has brought the economy to its knees and has resulted in a series of government incentives to increase spending to support families and businesses. Italy's budget deficit is projected to be around 10% of GDP in 2020 as the government raises borrowing to try to cushion the impact of the new coronavirus and the economy plunges into a deep recession.

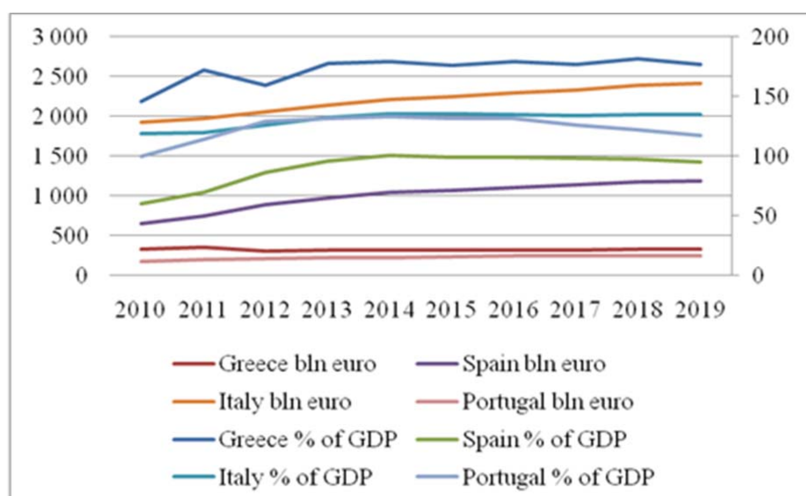

Figure 1. Government debt of Greece, Italy, Spain and Portugal for the period 2010–2019

Source: [12]

Since 2009, Greece has faced a debt crisis. The consequences of this event were felt throughout the Greek economy, which contracted by 25%. The Greek government has received three financial aid packages funded by the European lenders and the IMF. According to Eurostat, Greece's public debt amounted to 146.2% of GDP in 2010, and since 2019 has increased to 176.6% of GDP. This is the highest figure in the EU, far ahead of the second largest country in terms of debt – Italy (134.8% of GDP), as well as the EU average (85.1% of GDP). The restructuring of Greek debt was completed at the end of 2012, when the ECB repurchased Greek bonds, which reduced the debt from 172.1% of GDP (356 billion EUR) to 159.6% of GDP (305 billion EUR). Overall, over the period 2010-2014, debt experienced the largest growth and got out of control, increasing from 146.2% of GDP to 178.9% of GDP in relative terms, although in monetary terms, on the contrary, there was a decrease in debt from 330 billion EUR to 320 billion EUR. Despite the fact that the conditions of financial assistance proposed by the troika were rejected in a referendum in July 2015, a little later the Greek government accepted stricter conditions from creditors than those that were rejected by the referendum, and for the period 2015-2018 the debt increased. Growth in 2018 is due to the latest contribution from eurozone lenders under the third bailout program, which ended in summer 2017. Also, for the period 2015-2018, the share of long-term loans increased, while the share of long-term debt securities, on the contrary, decreased. However, already in 2019, the indicator has steadily decreased. Although public debt remained high, mitigating factors were observed to support debt sustainability. Also in 2019, the state further strengthened its presence in international capital markets, which increased its fiscal financing flexibility. However, if the economy grows at 2% each year, Greece will not return to pre-crisis levels until even 2030.

Italy's public debt is the second largest among the EU countries, and in 2019 amounted to 134.8% of GDP. This level of public debt is the main reason for the vulnerability of the Italian economy. The economic growth of the state is constrained by the level of taxation and high interest expenses, which limit government spending. In general, for the period 2010-2019, Italy's public debt in monetary terms increased (Figure 1). Debt to GDP ratio peaked at 135.4% in 2014 and declined slightly over the period 2015–2017 (although in monetary terms, public debt increased) due to higher primary surplus

and nominal GDP. Italy has implemented significant fiscal consolidation measures that were able to avert risks to sustainability due to a stronger fiscal position achieved. However, in 2018, the debt-to-GDP ratio increased by 0.7% compared to 2017 (Figure 1). This was mainly due to a significant increase in the volume of debt in comparison with real GDP growth. Debt reduction in 2015–2017 due to the higher primary surplus, it practically compensated for the "snowball" effect, which could have increased the debt much more. Debt-to-GDP did not change much in 2019, largely as a result of weakening macroeconomic conditions in the country, together with a strengthening primary government budget surplus and strong privatization receipts.

In Portugal, due to the reduction in the budget deficit, the public debt fell from a peak of 132.9% of GDP in 2014 to 117.7% of GDP in 2019. However, the burden of public debt still severely limits the country's ability to respond to possible economic shocks. Debt servicing currently accounts for about 8% of government spending. Further improvement of public finances will require maintaining budget surplus as well as primary surplus.

Spanish public debt in monetary terms increased over the period 2010–2019 (Figure 1). However, in 2015-2016, Spain's debt-to-GDP ratio was declining due to the recovery in nominal GDP and the debt-decreasing stock-flow adjustment of 1.5% of GDP. In 2019, debt reached a total of 1188,862 billion EUR, a new record in absolute terms. However, in relative terms, the debt fell as the Spanish economy continued to grow. Thus, the government continues to reduce its relative debt, relying on economic growth, despite the fact that the volume of debt continues to grow.

It is also worth noting that the pandemic will entail much higher levels of public debt in all affected countries, in particular, Italy. The ECB stepped in with the PEPP and this policy helped to avoid widening BTP-Bund spreads, tightening financial conditions and deteriorating financial market expectations. Indeed, the PEPP implied (and probably will imply) the transfer of Italian public debt from foreign investors to the central bank.

In Greece and Portugal, interest rates on short-term loans are high (11–14%). Raising interest rates can increase this cost of servicing public debt. However, in a stable interest rate scenario, debt service costs will decline. In Spain, the indicator over the past 5 years has been at the level of 8–10%. In Italy, interest rates on short-term loans for the period 2014-2020 have declined, reaching 3.17% in July 2020 (6.63% in 2014). If we talk about interest rates on loans for more than 5 years, then in Greece and Italy the figure is slightly higher (3–3.5%) than in Spain and Portugal (1–2%).

In 2014, the indicator of interest rates on deposits for each country was at least 2 times higher than in 2020. In Greece, interest rates on deposits are at a higher level, which is not surprising, since interest rates on loans are higher than in the rest countries of Southern Europe. In 2020, out of four countries, only Italy increased the indicator, while in Greece, Spain, Portugal it decreased.

In general, since 2017, CPI for all four countries has increased, which indicates an increase in inflation. For the period 2014–2016, CPI was decreasing in Greece, Italy, Spain, while in Portugal it was increasing for all 5 years. The HCPI of Spain, Italy and Portugal increased over the period 2017–2018, and already sharply decreased in 2019. The opposite situation was observed in Greece and Italy. In 2020, inflation was observed in Italy and Portugal. Regarding Greece, the country's economy came out of deflation only in 2017, when for the first time in 5 years the CPI and PPI showed growth. During the debt crisis, deflation was observed in the state, as the cuts in wages and pensions, and a long-term recession had a strong impact on household income. However, in 2020 deflation was observed again. The lockdown of the Greek government in response to the coronavirus triggered a slowdown in economic activity and consumer spending. The rise in food prices was offset by lower prices for housing and transportation. Overall, inflation in the eurozone fell to 0.4% year-on-year in April 2020 as the coronavirus pandemic virtually halted economic activity across the region.

Based on Figure 2, all four countries are indebted countries. In Spain, this indicator has the largest negative value among the analyzed countries. Despite the current account surplus recorded since 2013, negative valuation effects (partially reflecting increased confidence and higher value of Spanish assets) limited the improvement in the net international investment position (NIIP). Since 2018, the negative NIIP of Spain has been decreasing as a result of the positive amount of net transactions and other flows. Net external liabilities for other investments and portfolio investments decreased, while for direct investments, on the contrary, increased.

In Greece, for the period 2015–2016, there has been an improvement in this indicator due to the reduction of portfolio liabilities (debt securities, equity and investment fund shares) and other investments. In contrast, stocks of direct investment liabilities have increased. In 2017, Greece's NIIP deficit widened to -304 billion dollars and was almost at the level of 2013 when the deficit was at its maximum (Figure 2). This was due to an increase in stocks of liabilities for all types of investments in the country by about 8% and a decrease in stocks of assets for all types of investments. The situation improved in 2018 as the decline in assets was less than the decline in liabilities, although stocks of foreign direct investment liabilities increased slightly. The NIIP increased by about 2% of GDP, the first improvement since 2012.

This improvement was driven by a stronger net position of the Central Bank of Greece (23% of GDP compared to 2017). In 2019, there is an increase in liabilities of all types of investments. It explains the increase in the negative balance of the NIIP indicator. In general, Greece has a very large stock of external liabilities, which is primarily due to external government debt. This stock mainly consists of debt instruments linked to government debt. Such large commitments expose the country to adverse external shocks and mood swings. As can be seen from the analysis, Greece's net international investment position remains negative. Achievements of a more balanced current account, in particular a decrease in a country's import dependence, as well as a decrease in public debt, can help a country to improve its international investment position.

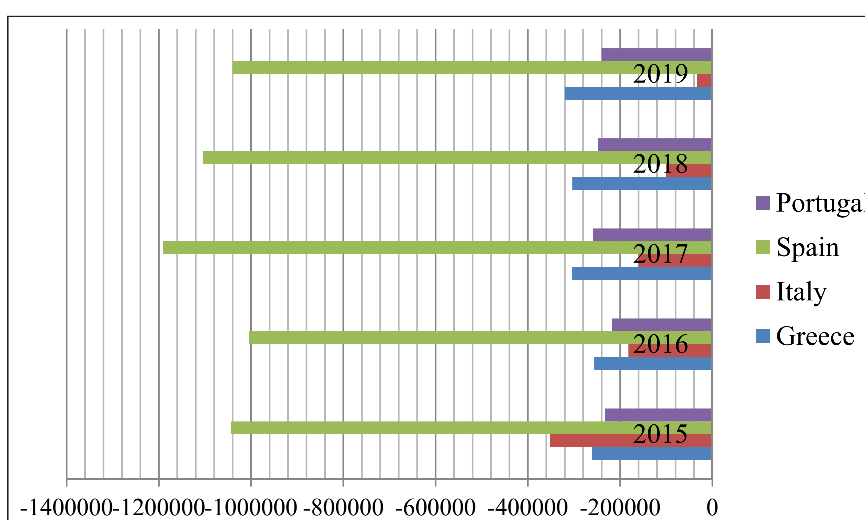

Figure 2. NIIP of Greece, Italy, Spain and Portugal for the period 2015-2019 (mln USD)

Source: [13]

For Portugal, the NIIP deficit has decreased over the period 2015–2016. In 2017, assets increased less than liabilities, which led to an increase in the negative balance from -217 billion USD to -259 billion USD compared to the previous year (Figure 2). Also, this indicator in 2017 was estimated at -60.9% of GDP, having improved from -66.5% a year earlier. However, the structure of Portugal's NIIP has improved due to an increase in net inflows of foreign direct investment. For the period 2018-2019, the country's net international investment position improved to -248 billion USD and -240 billion USD, respectively. In 2018, this was due to a strong reduction in the liabilities of all types of investments, and in 2019 due to an increase in portfolio investment assets and a sharp decrease in liabilities of other types of investments.

Of the analyzed countries, Italy's NIIP has the lowest negative value and is decreasing every year, although in 2015 the negative balance exceeded that of Greece and Portugal (Figure 2). At the end of 2016, Italy's NIIP on external debt decreased by almost 2 times, and amounted to 14.9% of GDP. This contraction was driven by the current account surplus and, to a greater extent, the value adjustment. In terms of assets, the adjustments were largely driven by the rise in market prices for foreign bonds held by Italian residents. Speaking of liabilities, there has been a decline in the market value of Italian portfolio securities held by non-residents. Overall, the negative net international investment position has declined over the past five years, amounting to 33 billion USD (1.7% of GDP) in 2019, largely due to the continuing current account surplus.

Conclusions. In general, the state budgets of the countries of Southern Europe have improved every year since the onset of the debt crisis, even reaching a surplus in some countries. However, the pandemic seriously worsened the situation in 2020 again. Greece's public debt (176.6% of GDP in 2019) is the highest among the EU, followed immediately by Italy (134.8% of GDP in 2019). These figures are well ahead of the EU average (85.1% of GDP). Despite the fact that the state budgets of the countries of Southern Europe were strengthening every year, and the national debt of Portugal and Spain (in relative terms) decreased, the national debt of Greece and Italy, on the contrary, increased. The main reason was the slow economic growth of states. Interest rates on short-term loans in Greece and Portugal are at a high level (11–14%). In Spain, the indicator over the past 5 years has been at the level of 8–10%. In Italy, the indicator declined, reaching 3.17% in July 2020 (6.63% in 2014). If we talk about interest rates on loans for more than 5 years, then in Greece and Italy the figure is slightly higher (3–3.5%) than in Spain and Portugal (1–2%). Regarding interest rates on deposits, back in 2014, the indicator for each country was at least 2 times higher than in 2020. In Greece, interest rates on deposits are at a higher level. Since 2017, CPI has been increasing in all four countries, which indicates a rise in inflation. However, in 2020 deflation was again observed. The lockdown of the Greek government in response to the coronavirus triggered a slowdown in economic activity and consumer spending. Overall, inflation in the eurozone fell to 0.4% year-on-year in April 2020 as the coronavirus pandemic virtually halted economic activity across the region. If we consider the NIIP, we can conclude that all four states are debtor countries. In Spain, this indicator has the largest negative value among the analyzed countries.

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