- Economic recessions in Southern European countries, etc. In the background, fiscal consolidation weighs heavily, with effects of economic structural vulnerabilities.
  - Vulnerable to withdrawals of foreign funds: One cause of domestic demand led growth until 2007 was an increase in capital inflows (Fig. 22). However, behind this was accumulating foreign debt (Fig. 23).
  - Weaker Competitive Industrial Structure: Internal demand dependent industries have a large share (Fig. 24), not relying on foreign demand. And in an environment of rising wages, labor costs are rising faster than productivity (Fig. 25).
  - Stagnant productivity: TFP is holding productivity down. This is in an environment of competitive barriers due to entry regulations, etc., and an increase in low skill laborers.
  - External imbalance becoming constant: Continuing deficit in trade and service balances.
    - Low value added products such as foods and textiles have large shares, and weak price competitiveness. In Portugal, Spain and Greece, a large percent of exports are to Southern European countries, and Southern Europe's recession drags down exports in a vicious cycle (Fig. 26).
  - After-effects of housing bubble: In Ireland and Spain, households hold high debt levels, and financial institutions face high levels of non-performing loans ratios (Fig. 27).

Fig. 22 Fund Inflows into South Europe, etc.

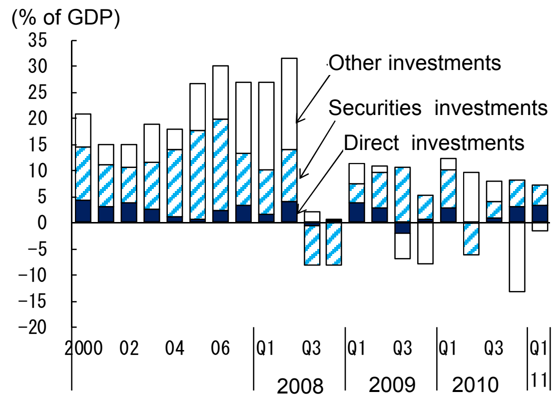


Fig. 23 Europe's Net Foreign Assets

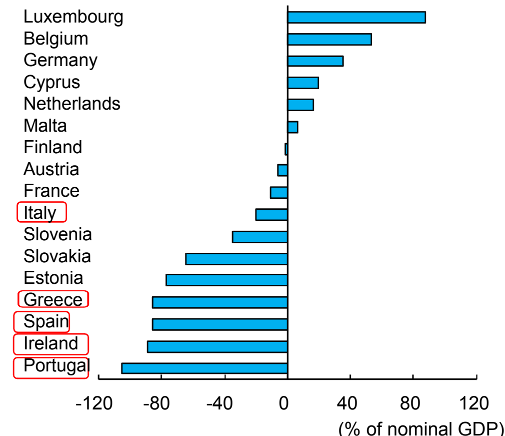


Fig. 24 Production Structure in Southern European Countries etc., by Industry

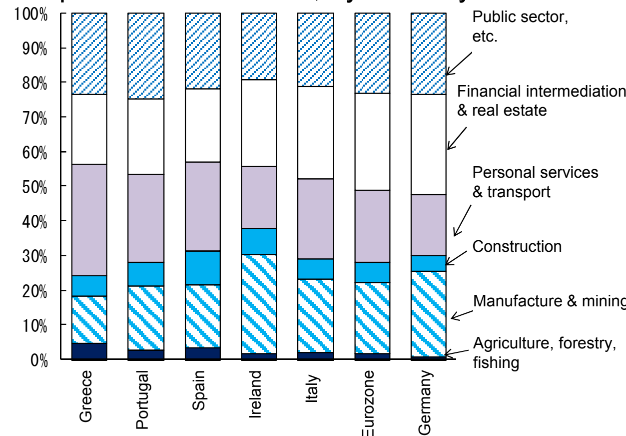


Fig. 25 Productivity & Labor Costs of South Europe Countries, etc. (Manufacturing)

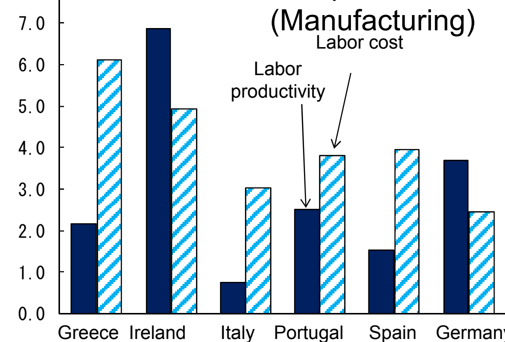


Fig. 26 Export Destinations of Southern

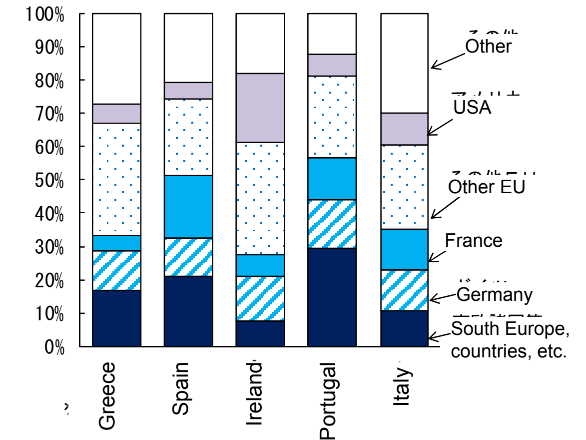
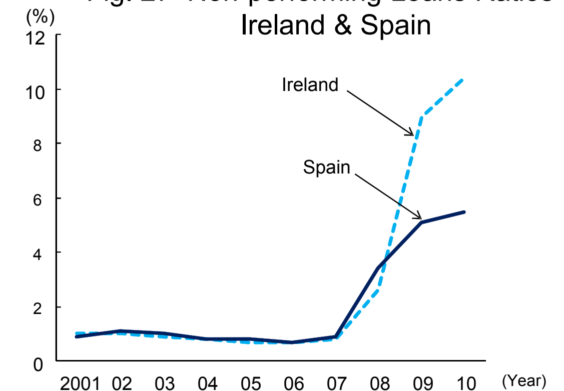


Fig. 27 Non-performing Loans Ratios of Ireland & Spain



- Agreement on Comprehensive Solution Policies: Despite fiscal reconstruction efforts by the government of Greece and support by Eurozone countries, market concerns about Greece debt crisis were not relieved. In response, the EU Summit and Euro Summit meetings on October 26 & 27, 2011 agreed on 1) Greece support (public support by EU & IMF, etc., and proactive burdens taken by private creditors), and 2) Strengthening of European Financial Stability Facility (EFSF, credit guarantees for each country's government bonds, establishment of CIF), 3) Bank capital reinforcement, etc.
- Increase of Market Concerns: The large countries of Italy and France are also affected. these countries' bond yields rose.
  - Italy: Amidst continuing low growth, debt balance grew to almost 120% of GDP (Fig. 28). In November, government bond yields jumped, temporarily exceeding 7% (Fig. 29). Repeated fiscal reconstruction policies were hammered out, but these did not completely eliminate market concerns.
- Financial System Instabilities: European banks hold many credits to Southern European countries, etc. (Fig. 30). Interbank fundraising environment makes it harsher (Figures 31 & 32), and European banks' CDS premiums remain at high levels (Fig. 33).

Fig. 28 Italy's Government Debt & Fiscal Deficit

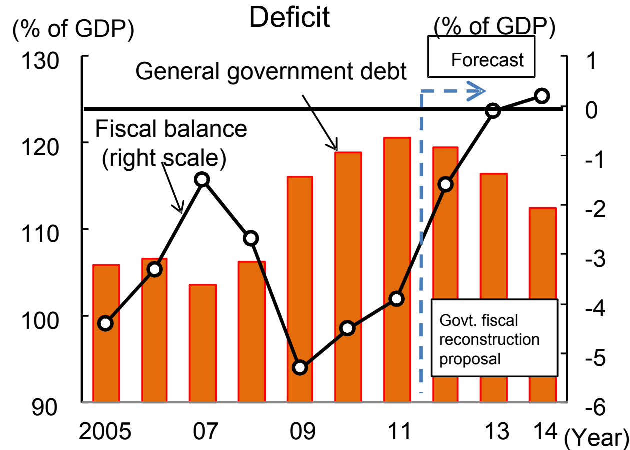


Fig. 29 Italy Government Bonds (10 Year) Yields

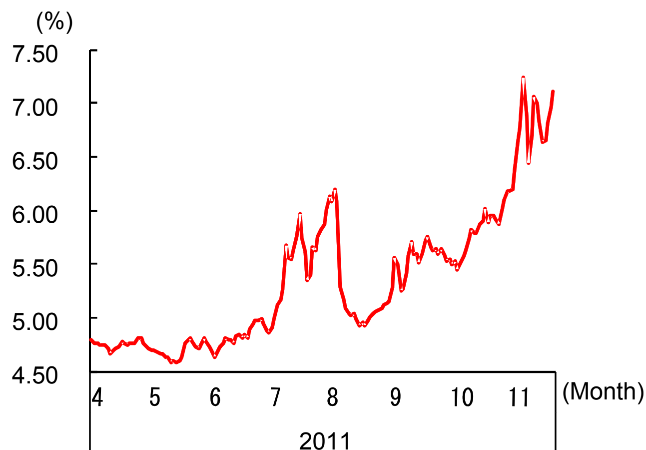


Fig. 30 Major Countries' Banks' Outstanding of Claim to Southern European Countries, etc.

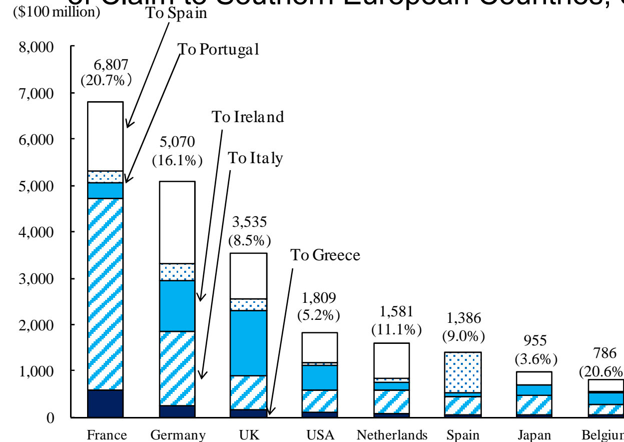


Fig. 31 Market Access Environments of Eurozone Financial Institutions

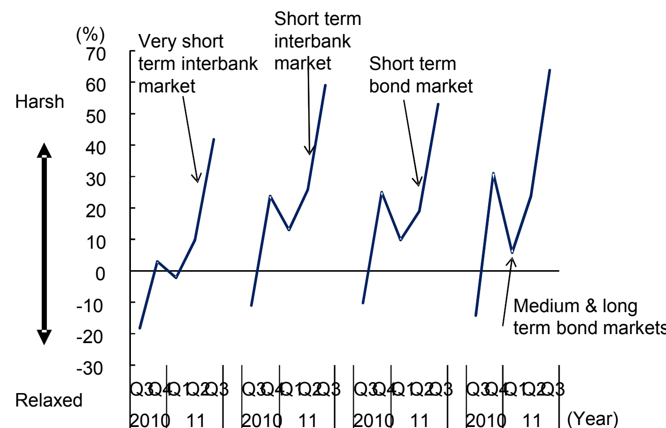


Fig. 32 ECB's Liquidity Provision Outstanding

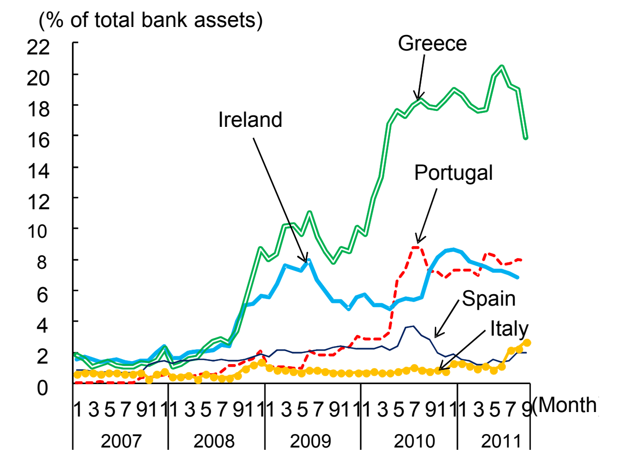
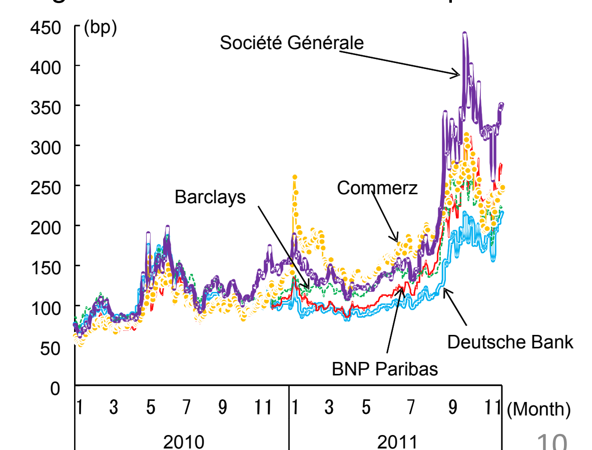


Fig. 33 CDS Premiums for Europe Banks



- European Central Bank (ECB):
  - In November 2011, the policy interest rate was lowered to 1.25% (Fig. 34). This was the first interest rate decrease since May 2009. The reason given was that medium term inflationary pressures could decrease. On the other hand, consumer price index was far above 2%.
  - In August, ECB resumed the government bond purchase program, and provided liquidity for 6 months. In October, liquidity provisions for 12 and 13 months were determined. Thus it was decided to make 40 billion euro of covered bond purchases. Since August, government bond purchase amounts increased quickly (Fig. 35).

- Bank of England (BOE):
  - Consumer price index was far above the BOE's target, but assuming that inflation was due to temporary causes such as VAT, the policy interest rate was left at 0.5% (Fig. 36).
  - In October, it was decided to increase the purchase ceiling for government bonds by 75 billion pounds, to 275 billion pounds (Fig. 37).

Fig. 34 Eurozone's Consumer Price Inflation & Policy Interest Rates

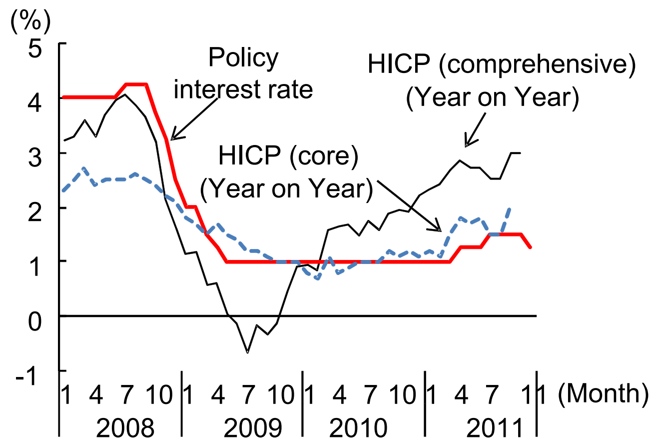


Fig. 36 UK's Consumer Price Inflation & Policy Interest Rates

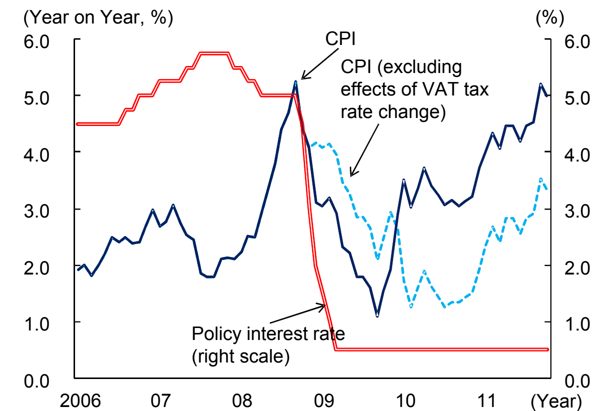


Fig. 37 BOE's Balance Sheet

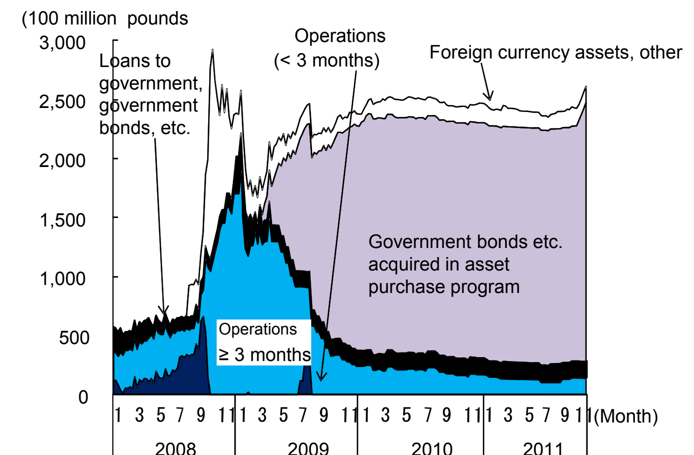


Fig. 35 Outstanding of Government Bonds Purchased by ECB