

Assessing sovereigns' market access in the euro area

By

18 November 2020

Is it possible to forecast tensions in market access? How does one measure such tensions and how do they evolve over time? Looking back at the experiences of Spain and Greece during the European debt crisis and the ongoing pandemic helps to answer these questions. In the run-up to the European sovereign debt crisis, several financial and macroeconomic indicators already signalled a build-up of stress in the debt markets. Now, the situation looks much better, with vulnerabilities broadly contained, although some indicators have started flashing amid the current pandemic crisis.

In this blog post, we will show that macro-financial indicators can signal risks to market tensions before they materialise, giving policy-makers as much as a year forewarning to tailor a response to the unique origin and impact of each crisis. Economic discipline and reforms stemming from the debt crisis as well as timely and appropriate policy response are helping European countries to better tackle new crises such as the Covid-19 pandemic today.

Were the market access of a country impaired, then the country either could not borrow money to fund itself at sustainable interest rates or could not find the necessary demand at all. During the debt crisis, several countries in the euro area experienced such extremes for the first time. For the purpose of illustration, we use two cases from the sovereign debt crisis: [Spain](#) and [Greece](#). Spain experienced high market tensions, while Greece lost its market access.

The following heat maps (Figures 1 and 2) contain six indicators that provide signals on the evolution of market access conditions from the first quarter of 2008 to the third quarter of 2020. Red denotes periods when the relevant indicator is signalling market tensions. The deeper the colour, the more serious the tension is. Blue indicates periods of calm market access.

Early signals of market stress in the European debt crisis

In the run-up to the European sovereign debt crisis, Spain's access to financial markets grew severely strained and raising money became increasingly expensive. When investors demanded onerously high interest rates to purchase long-term sovereign debt, Spain responded by boosting its issuance of less expensive short-term debt. As a result, in our first indicator of distress, Spain's issuance of Treasury bills (T-bills) as a share of its gross domestic product (GDP) spiked in 2011. Second, the gap between the price that investors were willing to pay for an asset and others to sell it, the bid-ask spread, widened significantly, with transactions drying up as buyers and sellers were too far apart to trade. Third, the share of foreign-held sovereign debt dropped, more than a year before the Spanish programme began in July 2012, as investors perceived those investments as increasingly risky. Fourth, ahead of the Spanish bank recapitalisation programme, credit default swap (CDS) prices, a proxy for credit risk, rose to levels more than three times higher than those at the start of the systemic financial crisis in Spain. Finally, two further indicators, forecasts of government debt and [gross financing needs](#), soared in advance of the Spanish programme.