# On Peripheral Debt

**By Bob Hancké, LSE**

Those who think the euro crisis is now reaching a relatively benign *dénouement* may feel vindicated. Italy and Spain are borrowing at low interest rates, and yesterday even Greece staged a successful return to the bond markets, with a yield that was significantly lower than could be expected from a country that has not seen a serious private creditor in over four years. Greek sovereign debt, like Spanish and Portuguese debt, are now, again, treated as safe investments.

Let me raise two counterpoints to the euphoria. The first is that it is not quite clear what has actually happened in those countries that were until very recently almost untouchable debtor countries. Growth remains low, austerity may have cut a few percentage points off the current account imbalances, but that has happened at least as much through stifled imports as through regained export competitiveness, and many of them are stuck in with very, very low inflation or even deflation. I'm not sure which of these fundamentals warrant a vote of confidence.

The second is that what you see is what you'd expect if the ECB has repeatedly said that it would do all it takes to save the euro. In effect, what Draghi has done is create a very strong incentive for banks to stock up on sovereign debt – which is exactly what they have done – secure in the knowledge that the ECB will cover their backs. Spanish, Portuguese and Greek sovereign debt not only have high yields relative to German debt, but now also comes with a truly low risk of default (ignore a departure of any of them from the euro-zone for the time being). Any bank that foregoes such an opportunity would probably be delinquent in its duties towards its shareholders.

What we are seeing today is, therefore, froth – very dangerous froth — that gets us back to where we were five years ago. Not a pleasant place to be.

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