The Impact of the Eurozone Crisis on Australia and South Korea

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Abstract

The sovereign debt crisis inflicting the Eurozone member states has both international economic and European integration significance. Rarely has a regional economic crisis had such clear and immediate effects on even distant nations such as Australia and South Korea. This crisis is a sovereign debt crisis in which some Eurozone governments are facing unsustainable bond market rates of repayment for having high public debt and low level measures to resolve these debts. Moreover these states are inflicted by low or no economic growth and a no exit solution given they are members of a single currency scenario in which monetary policy is a combined approach and not specific to member states. Countries such as Australia and South Korea will ultimately feel this decline in lower levels of investment, lower levels of exports and potentially decline in the GDP. The aim of this paper is to ascertain in what ways they will feel the effects of the crisis. These are two different economic realities which theoretically should respond differently to this sovereign debt crisis. The paper also seeks to understand the similarities and the differences in the way these two nations will defend themselves from this economic tsunami and what factors will explain this economic defence.

Introduction

For more than 18 months the global economy has witnessed unprecedented economic crisis besides encouraging a dismal economic outlook could be the cause of the break-up of the Eurozone single currency arrangement barely 10 years into its existence. The brunt of this crisis has been felt by the Portugal, Ireland, Italy, Greece and Spain (PIIGS) uncertainty as a result of the Eurozone crisis. Some claim these debt difficulties are limited to the PIIGS countries though other members of the Eurozone are not immune from this contagion. Provoked by sovereign debt worries effecting Portugal, Ireland, and Spain with greater devastation and impact with Greece which has highlighted the viability of the Eurozone has shifted to the emphasis of threatening the integrity and cohesion of the Eurozone as an entity. The trigger to these crises has been the high levels of public debt and the increasing and unsustainable yield on the bonds owned by these governments. These bond markets provide these governments financing and re-financing of government debt and government expenditure. What has most spooked the bond markets and the loans provided to the PIIGS countries has been their forecast future low economic growth and therefore their inability to service these debts and meet debt repayment thus producing sovereign debt. The markets, and especially the bond markets, kept punishing the different Eurozone government efforts to find funding for covering government expenditure.

The rate spread sent clear messages to the Eurozone government that they were seen as a high default risk factor. In the meantime the European Union leadership fumbled through the different options of solutions though what became clear was not an inability to rectify the problem but different national interests which was making finding a common solution impossible to reach. Germany above all remains adamant that the ECB and the Eurozone members must not bear the burden for the bad behaviour of member states that have been undisciplined with their economic management. Theirs is a wait and see, possibly with a Greek exit from the Eurozone, and not resort to ECB or member state bailout.

A crisis waiting to happen – Background to the Eurozone crisis

Much of the difficulties today are based on decisions dating back to the Maastricht Accord in 1991.

What was seen as an epic step for European integration, the Maastricht Accord codified a road map for greater European integration and most especially a common currency under the banner of the Economic and Monetary Union (EMU).

The Maastricht Criteria which would become the agreed upon pre-requisites for the EMU and specifically for the single currency, was influenced by the German Bundesbank anti-inflationary approach which gave less regard to the inequities of the two and three speed economies which existed in the eligible member states. Member states would have targets in relation to budget deficits, public debt, inflation levels, interest rates and currency stability. The criteria however gave no importance to levels of economic growth, unemployment levels and other less inflationary based criteria. There were no allowances for fiscal homogenisation, economic growth, national income and related criteria. In many respects the crisis of the Eurozone in 2010-11 is a by product of this scheme.

Alongside the skewed nature of the Maastricht criteria, which would then become an established economic discipline package once the Euro was introduced in 2000 under the name of the Stability Growth Pact, member states would be embarrassed into submission if they did not abide by the conditions and even the threat of sanctions and fines. The most alarming aspect of the new Eurozone make up was the inability for member states with lower performing economies to have escape valves as many had used in their flexible depreciating or appreciating currency. This had helped economies to recover from momentary speculation, loss of competition and declining trade to mend their ways. This under the new Eurozone arrangements was no longer possible with all countries abiding by a new ECB interest rate discipline and equally a common currency where currency fluctuations were no longer possible. This was for Ireland, Portugal, Spain, Greece and Italy the kiss of death!

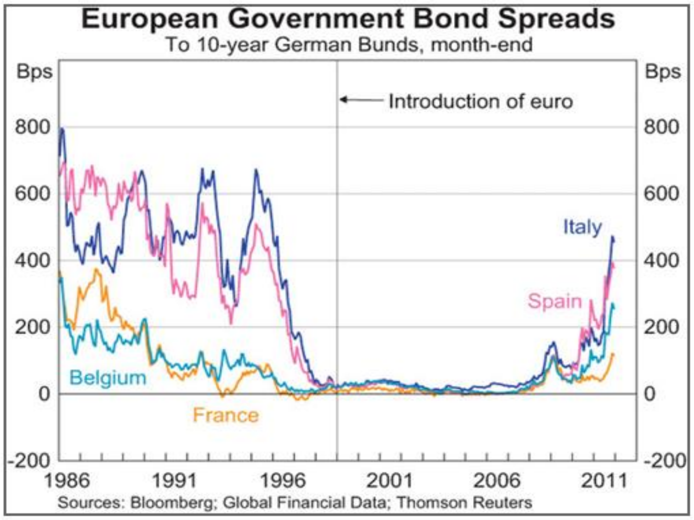
The Eurozone crisis and economic consequences

As the Eurozone celebrated its decade of existence in 2011 few could have predicted the events that would dominate the latter period of 2011 in which the PIIGS countries would be subjected to bond market spikes making government borrowing so expensive that it would force them into default. Throughout the decade and after the loss of value against the US$, the Euro managed to become stabilised and function in all intents and purposes as a serious and credible currency.

While the stronger positioning of the weaker Eurozone states through a stable and reliable currency, improving its loan situation was both welcomed and appreciated, there were equally more serious debilitating effects on these economies. Not only were there perceived inflationary effects, denied by the ECB, the weaker Eurozone member states suffered from a loss of competitive trade positioning. Prior to the arrival of the single currency, these member states, would at times recklessly, devalue their currency to regain their competitive edge, as was practiced frequently during the 1980s and 1990s. Now under the discipline of a single currency, this was no longer possible. The effects were noticed in the 2000s as business was lost to competitors, where nations such as China ate into the commercial fabric of these countries, witnessing industrial decline, unemployment and lower levels of exports. Leaders of the economies such Silvio Berlusconi for Italy began to express concern about the Euro as many directed their anger at the Lira-Euro translation and the inability of the Central Bank to intervene in monetary management of the currency. These economies started haemorrhaging and the once attractiveness of the single currency started to wear thin.

The Euro and its first decade of existence

The consequences of witnessing countries in the Eurozone either struggle to meet their debt or in the worst scenario not meet their debt and default has shown it has gone beyond the viability of these economies or even the viability of the Eurozone. Recession is expected in many Eurozone countries and this will mean high levels of unemployment, lower levels of investment, smaller government budgets and ultimately a decline in consumption. Less consumption means less demand imports and then we see the spread of the recession and economic decline.



Given the nature of this crisis on the finance and credit industry, means that there will be less credit availability as banks will have their capita tied up in debt that cannot be repaid. Banks will apply restrictive policies and reduce their interbank loans as was witnessed during the global financial crisis in 2007-08. Even far off and less impacted markets like South Korea and Australia will not be able to escape from its impact.

It has as has been re-affirmed by numerous world leaders such as Obama "The biggest headwind the American economy is facing right now is uncertainty about Europe" (Middle East 2011) and Chinese leader Bao that the impact is global and it cuts across the developed and developing world simultaneously. IMF's chief managing director, Le Garde has also stated that the global economy is in danger similar to the Great Depression (Wall Street Journal, 2012). The OECD has itself issued these warnings in no uncertain terms:

> "Such turbulence in Europe, with the massive wealth destruction, bankruptcies and a collapse in confidence in European integration and cooperation, would most likely result in a deep depression in both the exiting and remaining euro area countries, as well as in the world economy" (Dawson 2011).

The European difficulties have even cast doubt on Obama's re-election as one media outlet titled: "Euro casts a shadow on Obama's re-election" (Cooper and Lowrey 2011). The US have implored the European leaders to move quickly to aid the defaulting countries as its impact was being felt in the US as it was in other economies. In an equally concerning scenario many China observers have declared that China would also be a victim of a "hard landing" meaning that its high economic growth would suffer (*Wall Street Journal*, p. 11). In trade terms the message coming from the US Department of Commerce could not be any clearer:

> "Trade is the primary channel through which the U.S. economy is hit. The euro zone is the United States' third largest export destination, accounting for 15 percent of total U.S. exports. But the U.S. economy is relatively closed and euro zone exports accounted for only 2.1 percent of total U.S. economic activity in the second quarter" (Dawson 2011).

There are many countries which are not directly tied to the Eurozone and therefore their proximity to this economic concern appears to be tempered. But as the connections become noted it takes little to realise that a decline in Chinese exports to Europe will ultimately have its impact on all segments of the Chinese economy and even economies such as Australia will find that the demand for Iron Ore and Coal will be reduced and in cyclical fashion even the spared Australian economy will ultimately become a victim as have the other global economies. For instance, the South Korean economy will also be heavily affected by the decline of Chinese exports to Europe because South Korea cannot export its capital and intermediate goods to China as a result of the sluggish Eurozone economies. China needs to import these goods from South Korea in order to produce its final products for the EU market. The *Wall Street Journal* noted that manufacturing activity declined in China for the first time in three years (Winning & Brereton-Fukui 2011).

The Eurozone threatened downgrade was the ultimate in pessimism as every member state, including Germany and France were put on watch. This was further bad news on bad news and the spirit of concern spread across all three of the ratings agency. One media outlet explained:

> Six Eurozone countries could have their credit rating downgraded in the next few weeks amid uncertainty over how the financial crisis will be resolved. Belgium, Spain, Slovenia, Italy, Ireland and Cyprus are all facing possible downgrades by ratings agency Fitch. But France's status is not under threat, despite reports that it was on a hit list of countries that would be downgraded (Daily Mail 2011).

Very few positive tidings are in stall for the Euro. The usually Euro positive The Economist warns that "Unless Germany and the ECB move quickly, the single currency's collapse is looming" (The Economist 2011). The effects on the global economy as warned by The Economist are however more credible. They state:

> The panic engulfing Europe's banks is no less alarming. Their access to wholesale funding markets has dried up, and the interbank market is increasingly stressed, as banks refuse to lend to each other. Firms are pulling deposits from peripheral countries' banks. This backdoor run is forcing banks to sell assets and squeeze lending; the credit crunch could be deeper than the one Europe suffered after Lehman brothers collapsed" (The Economist, 2011 p. 11).

It is these effects which are being seen as flow on effects to distant markets in such as Asia, Australia and South Korea specifically.

The Eurozone crisis and Australia

Australia has over the last four years defied all economic doomsday predictions of impending economic decline and recession. After the US sub-prime provoked global financial crisis caused economic recession throughout most of the developed world, against many predictions Australia continued to grow economically. Though it was not able to replicate the more than 3 percent growth of the decade prior to 2007, it maintained growth at more than 2 percent – one of the few western developed economies to register a significant economic growth. Unemployment did not seriously increase and there were mostly positive indicators quite different from other developed nations. Reserve bank deputy Rick Battellino was unashamedly confident that the impact of the Eurozone crisis would be limited. He clearly projected:

> Australia, like other countries, will be affected by the events in Europe, but its strong government finances, healthy banking sector and relatively limited direct trade and financial exposures to Europe make it one of the countries best placed to weather the situation. Australia is also fortunate to be subject, simultaneously, to a resources boom that is resulting in unprecedented investment and therefore helping to sustain economic activity (Battellino 2011).

The reasons for Australia maintaining good growth are many but at the same time tied to factors which might be different with the Eurozone crisis. Australian banks had been structured with a stronger regulatory environment making risky schemes less available. Moreover Australian banks, while partially involved in the sub-prime credit scenario, remained substantially liquidity free and the Australian government at the time ensured that customer savings in banks would be guaranteed by the government through the banks. Most importantly the Australian government to the surprise of many responded audaciously and with speed to provide strong stimulus packages to keep as much of the production process ticking along. In the view of many (example Access Economics) this was the key reason why Australia's economy withstood the global recession and even registered modest economic growth. Other economists have speculated that the banking crisis in Europe will inevitably impact the availability of credit in Australia including mortgages and therefore affect the housing market which is central to Australia's strong performance. Only days after discussing possible effects on Australia, Australia's top four banks received downgrades from S&P. According to one source:

> Australia's big four banks have been hit with a ratings downgrade from AA to AA-. The revisions by Standard and Poor's come as ratings agencies tighten their definition of risk after the collapse of Lehman Brothers more than three years ago. Earlier this week, Standard & Poor's cut the ratings of 15 banks in Europe and the United States due to the revised criteria. These downgrades had been flagged but it is more evidence that banks are operating in a very risky and uncertain world (Ryan 2011).

The Eurozone crisis has also created significant discomfort with interest rates and distortions in the financial community. Recently Australia's ANZ bank, declared it was no longer respecting central directives of the Reserve Bank as the factors affecting Australian banking such as the Eurozone debt crisis were not being reflected in the decisions and philosophy of the Australian Reserve Bank (Gluyas 2011). This is a significant departure by a major bank on the workings of a stable banking system.

Table 1: Australian-located Bank Claims on Euro Area Countries(a)

Ultimate risk basis, as at 30 June 2011

	Banks	Public sector	Private sector	Total	
	$billion	$billion	$billion	$billion	Per cent of assets
Euro area	**66.2**	**4.1**	**16.9**	**87.2**	**2.7**
of which:					
Greece, Ireland, Italy, Portugal and Spain	2.2	0.7	3.3	6.1	0.2
France, Germany and the Netherlands	59.2	3.0	12.4	74.6	2.3

(a) Australian-owned banks and subsidiaries and branches of foreign-owned banks; exposures include those to foreign-owned banks booked in Australia.

Source: APRA

The fallout of the European sovereign debt crisis is both direct and indirect. Recently the French BNP Paribas, one of oldest banks to operate in Australia over 130 years ago, was forced to "wind[ing] back its exposure to syndicated loans in Australia as part of a global retreat by European banks as they shore-up their capital position" (Uren 2011). While concern about Australia's banks and economy being held to ransom by the European debt crisis has set in the upbeat view of the Australian economic fundamentals has been a point of relief. In a recent survey of leading companies in Australia, CEOs offered were more concerned that the government need to play a more leading role than the fear of the Eurozone crisis. Gail Kelly from the Westpac stated:

> "Despite the fallout from global economic volatility, Australia has one of the strongest economies of any developed nation. To take full advantage of our competitive position, we need to move beyond short-term politics to long term policy on issues of national significance" (Durie 2011).

The other key factor in this strong economic performance was that Australia's minerals, iron ore, coal, copper remained in strong demand and especially from China. This maintained a strong export led growth which paralleled the strong stimulus package. Of course Australia's globally envious low to zero government debt became compromised and modest levels of government debt were accrued. Effect on commodity is clearly the great question asked. Is this unique situation liable to be repeated for Australia in the current Eurozone crisis?

As China was in possession of approximately 30 percent of US government bonds, of a US government 100 percent government debt to GDP, it was assumed that China might play a role in the bailout of the Eurozone countries. This futile speculation was quickly put to rest by the Chinese government indicating it had economic problems of its own and the world should not be looking at it to resolve European problems.

Table 2: Share of Merchandise Exports going to Euro Area (2010)

	%
United Kingdom	49
Sweden	39
India	15
China	15
United States	14
East Asia*	11
Japan	8
Canada	5
Australia	4

* Excluding re-exports from Hong Kong and Singapore and oil exports from Singapore
Source: ABS; CEIC; Eurostat; IMF; ONS; RBA; Thomson Reuters

The fear with the Eurozone crisis is that with major bail out projected and government austerity expected to affect the economy in negative terms, the economies in the PIIGS states will decline and consumption will decrease. As such these economies will experience high levels of unemployment and even recession. This means ultimately that demand for Chinese products will decline and as such demand for resources and primary products from countries like Australia may well feel the effects.

However Australia's ability to maintain a positive redress to its economy this time will be harder even if China does not witness a significant economic decline. The reason is that Australia will not be able to engage in the same level of economic stimulus it did in 2009. Moreover the government has politically committed to a surplus budget by 2013 which infer that spending its out of a potential recession will not be possible nor pursued. It is also a reality that in the face of a series of economic global downturns, Australian resistance will eventually be worn down.

The Euro zone crisis and South Korea

The Euro zone crisis has affected South Korea severely in terms of national macro economics if it lasts long term. The reasons for this are rather simple to understand. The EU has become the largest foreign investor along with the USA and Japan in Korea since the liberalization of financial markets after the Asian financial crisis in the late 1990s. Among the EU member nations, Luxemburg, the United Kingdom, Germany, France are the leading investors and play very important roles in the South Korean financial markets. In addition, South Korean private banks have increased their short-term loans from the European financial institutions so that their credit situation could be vulnerable under the Eurozone crisis if European financial institutes do not allow the rollover of their short-term credits. As a result, the Eurozone crisis could affect the South Korean economy heavily, particularly in the financial sector. This is the reason why the Eurozone crisis has affected South Korea severely.

In terms of trade, the Eurozone crisis (2011-12) can influence the South Korean national economy limited in the short term, but seriously in the long term as a whole due to its trade relationship between them. First of all, the EU became the second largest trading partner to South Korea after the People's Republic of China since the year 2009. The trade relationship between South Korea and the EU has intensified continuously due to the government trade policy focusing on the EU as a common single market along with the USA and Japan (Kim, 2011).

In 2011, the trade portion with the EU accounted for 10.4 percent which was the second highest portion after China with 22.4 percent. The trade portion with the USA and Japan accounted for around 10 percent each in the same year. In total, South Korea was dependent on about 30 percent of its whole trade volume with the advanced markets. Logically, it is easy to understand that the structure of South Korean trade has been fairly globalized and diversified with over 150 nations in order to minimize external shocks of the global economy. The policy approach of market diversification has started since the Asian financial crisis that forced the nation adopting liberalization and de-regulation processes.

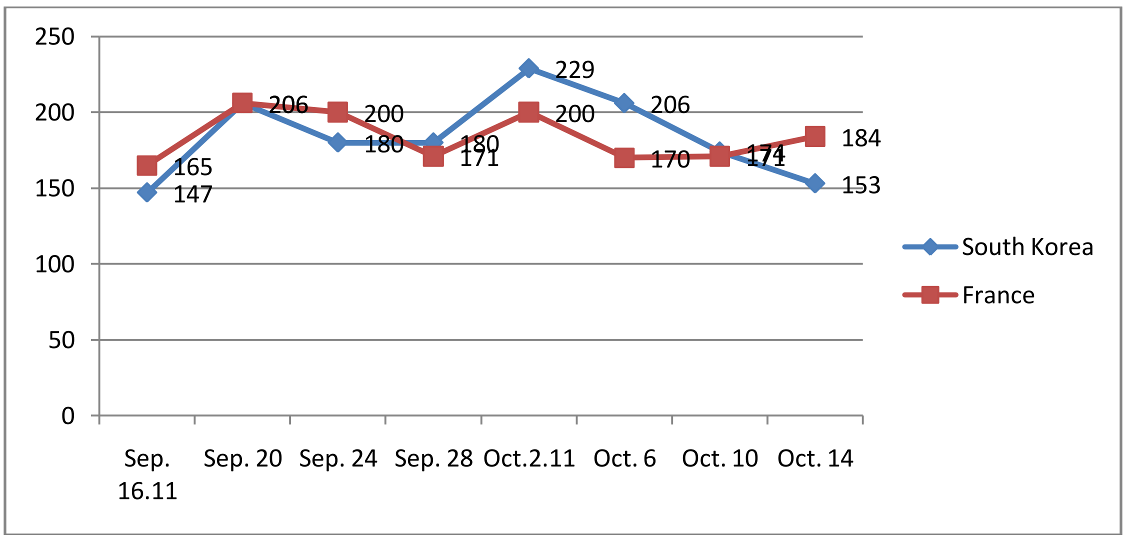
Although the EU has been the second largest trade partner to South Korea, the portion of trade volume is not extremely high that can affect the national economy directly rather limited in the short term. However, the impact of long term EU crisis will be very seriously if the high trade dependency on China and South Korean indirect trade with the EU via China are taken into account. The reason for it is that the crisis may cause a demand decline in the EU market that reduces Chinese export to the EU. As a domino effect, the low Chinese export and the sluggish EU economies lessen the import of South Korean capital and intermediate goods.

In order to understand the effects of Eurozone crisis on South Korea comprehensively, it may be wise to look at the financial and trade sectors separately. Additionally, it may also be useful to analyse how the government has responded to minimize the external effects.

The Eurozone crisis and the financial market in South Korea

As the Eurozone crisis started with the Greek sovereign debt in May, 2010, the South Korean financial market did not react strongly because its macro economic data was very strong with an estimated over 6 percent economic growth forecast. However, the Greek's possible default in August 2011 hit the financial market very negatively. The credit default swap (CDS) rate for South Korean government bond increased from 147 to 229 in the early October and decreased down to 153 in the mid October. 2011. The CDS rate was higher than in France and became lower than in France in the mid October 2011 (KCIF, 2011) (See figure 1). It indicates that global financial institutes regarded that the capability of South Korean financial market could be affected negatively owing to the Eurozone crisis. The global financial institutes expected that South Korean financial institutes need to pay higher interest rates for their loans with the high CDS rate and face difficulties to loan capitals in the global financial markets.

Figure 1: Comparison of the Credit Default Swap Rate between France and South Korea (Unit: bp, 1 bp= 0.01%)



Source: KCIF, 2011, Bloomberg, 2011

The worst possible scenario was that major European investors such as Germany, France, and the UK pulling out their capital from the South Korean financial market in order to subsidize their colossal loss in the South European countries such as Portugal, Italy, Spain, and Greece as well as Ireland. This scenario could impact on the South Korean national economy enormously because the EU has become the largest foreign investor since 1998. Owing to the possible serious impacts on the national economy, the South Korean financial watchdog and the Ministry of Finance have carefully monitored actions of European major investors under the Eurozone crisis period. The impact of the Eurozone crisis on the financial market in South Korea can be explained in the following three aspects. Firstly, the crisis caused a deep decline of capital market due to the repatriation of funds and stocks from foreign investors. They regarded the South Korean financial market as vulnerable and easy to liquidate their investment due to the highly liberalized financial market compared to other nations such as China and Japan.

Since the liberalization of financial market, the South Korean capital market has been regarded as automatic transaction machine (ATM) for foreign investors. Whenever external economic crisis takes place, impacts on the South Korean financial market may hit national economic environment severely. This is one of the most serious weaknesses in the economic structure. In fact, however, the Euro zone crisis affected to the financial market moderately compared to the global financial crisis in 2008.

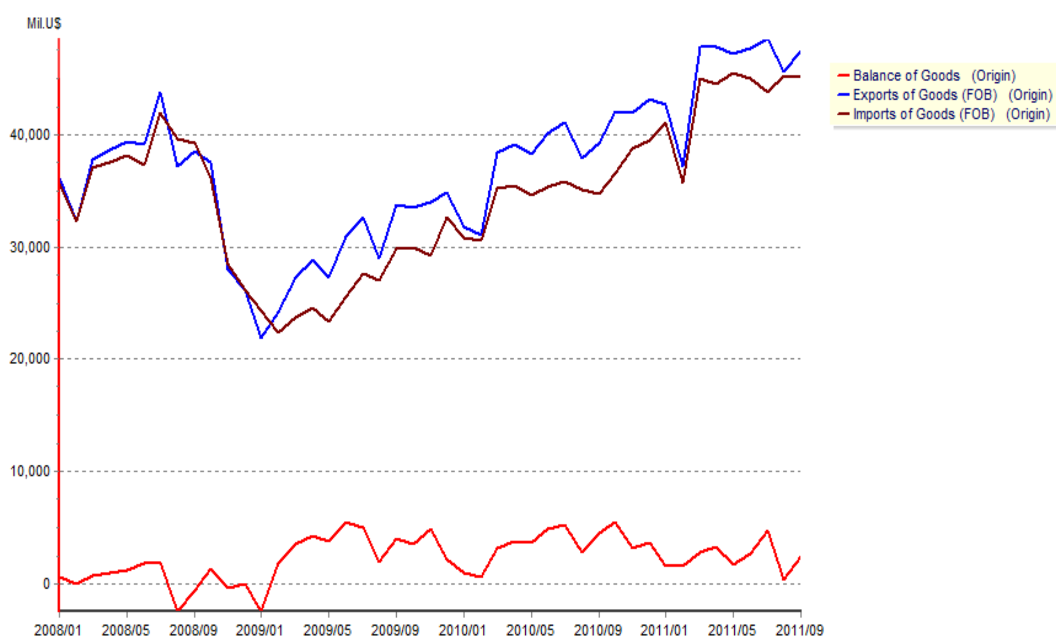
Secondly, the Euro zone crisis weakened the South Korean currency. The crisis resulted in a currency depreciation of c.a. 12.5 percent which was a higher fall than other Asian major countries such as China and Japan, but lower than Brazil and Russia. The currency fluctuation was also rather moderate compared with the global financial crisis that caused a deep fluctuation of 25.4 percent. It was lower than only in Turkey. Among the selected currencies, the South Korean won was the second largest currency depreciation after Iceland.

Lastly, but not least the Euro zone crisis has played crucial roles in the lower economic growth eventually because it has created instable macroeconomic environment. The South Korean government officially announced that its growth target reduced from 5 percent to 4.5 percent due to the Euro zone crisis. The government think tank, Korea Development Institute (KDI) expected an even lower economic growth rate from 4 to 4.5 percent. A private economic research institute, Samsung Economic Research Institute (SERI) downgraded its economic growth rate from 4.2 percent to 3.9 percent in 2011. The weakened expectation of economic growth indicates that the South Korean national economy seriously because it is lower than a potential economic growth rate of 4.3 percent. The latest official statistics indicate that economic growth for South Korea was only 3.6 percent in 2011, which is much lower than expected (Bank of Korea, 2012).

The Euro zone crisis and the trade in South Korea

The trade dependency of South Korea on the EU in 2011 was reported as 10.4 percent. It is more or less a similar portion with other advanced nations such as USA and Japan. As a result, the total dependency of South Korean trade on the advanced markets accounts for 30 percent, while its dependency on the developing markets has expanded up to 70 percent. It may indicate that the impact of the Euro zone crisis on the South Korean trade can be limited in short term owing to the globalization and diversification of trade structure. However, the impacts of long lasting EU zone crisis may cause severe due to its direct and indirect trade impacts. The trend of trade was positive even in the crisis that resulted in a high trade surplus with global trade partners as a whole and EU trade partners in particular. (See figure 2) It is an interesting phenomenon that export increased, while import stabilized under the crisis period, which uses to be described as a downsizing economic boom or an economic boom in a recession.

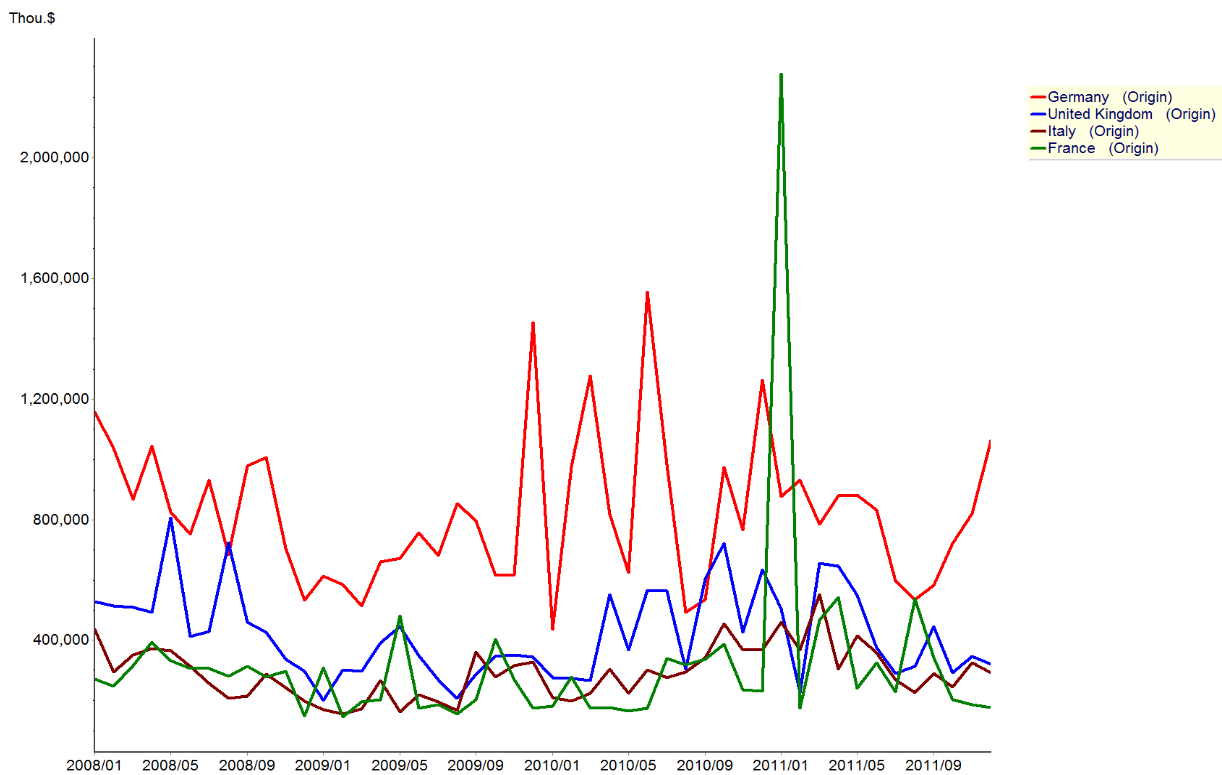
Figure 2: Trend of Trade in South Korea (2008 – 2011)



Source: Bank of Korea, 2011

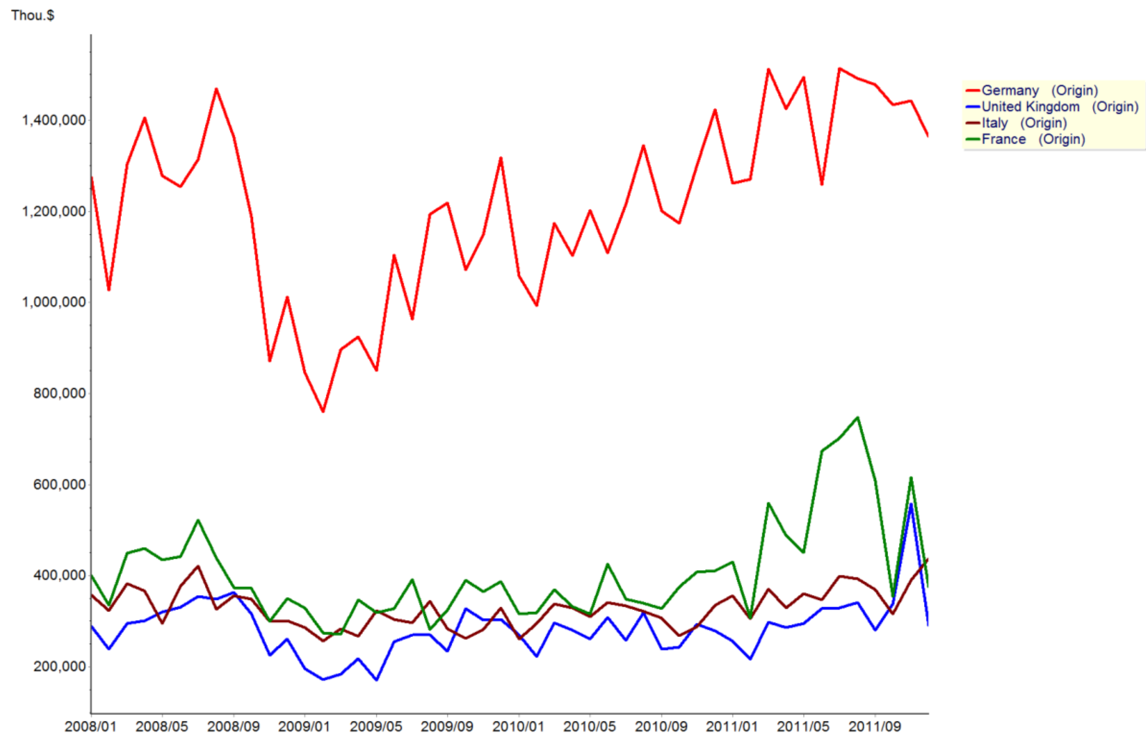
The trade volumes with major EU member nations had increased moderately during the crisis period. In particular, South Korean export to Germany increased while its export to France, the UK and Italy decreased. However, South Korean import only from Italy increased while others decreased in the same period. It may be a result of free trade agreement between South Korea and the EU rectified since July 2011. (See figure 3 and figure 4) Despite the crisis, the total volume of trade in South Korea increased up to 1.08 trillion US dollars in 2011 that is about 17 percent larger than in the previous year and became the 9th nation trading over 1 trillion US dollars in the world (See figure 5). The trade volume between the two trade partners also increased from 92.2 billion US dollars in 2010 to 103 billion US dollars in 2011, which accounts for 10.5 percent increase (Bank of Korea, 2011; Korea Customs Service, 2011).

Figure 3: Export trade with major EU trade partners (2008 – 2011)



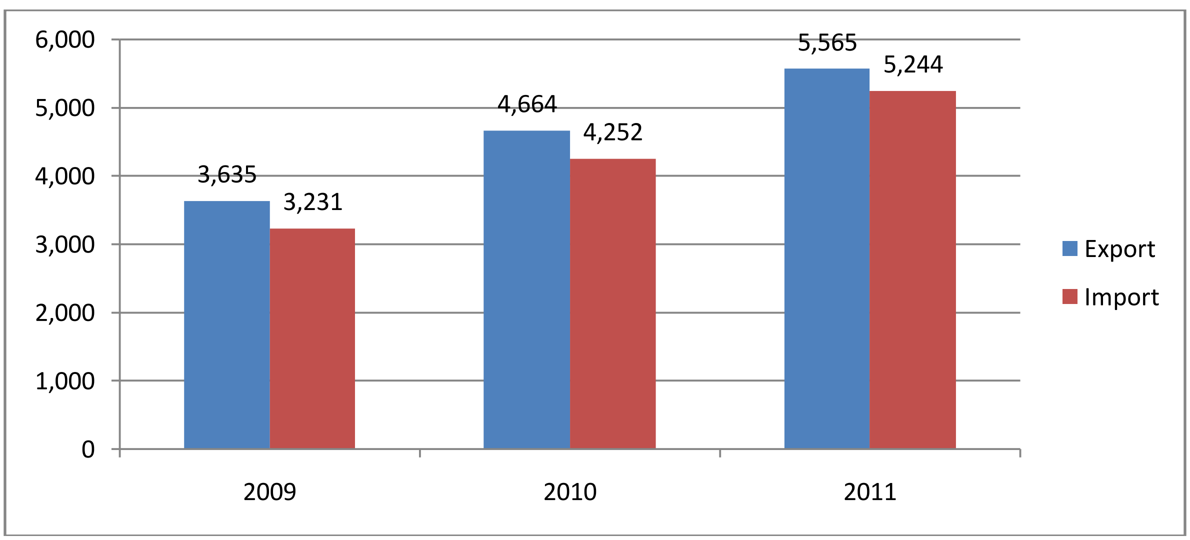
Source: Bank of Korea, 2011

Figure 4: Import trade with major EU trade partners (2008 – 2011)



Source: Bank of Korea, 2011

Figure 5: Total Trade Volume of South Korea (As of 100 million US dollars)



Source: Korea Customs Service, 2012

The negative trend of trade may come in the year 2012 if the crisis continues in the Euro zone that will affect the global market demand seriously. Due to the possible downsizing demand of global economy, the global economic growth in 2012 has been predicted lower than expected from 3.8percent to 2.5 percent in the World Bank as well as from 4.0 percent to 3.3 percent in IMF. (The World Bank, 2012; IMF, 2012) The long lasting crisis can impact not only on the advanced markets such as USA and Japan, but also on emerging markets such as China negatively. Particularly, the trade dependency of China on the EU accounted for c.a. 20 percent in 2011. If the market demand of the EU decreases, Chinese export to the EU will also decline, which will affect Korean export to China directly.

The reason for it is that China must import capital and intermediate goods from Korea in order to export its final products to the EU. As a whole, the EU zone crisis can affect the South Korean trade limited in the short term, but it will seriously impact on the trade in the longer term if it continues in 2012.

The negative impact of the sluggish EU economy on the South Korean trade has already started. A trade deficit of 2 billion US dollars in Jan. 2012 has been recorded that is the first trade deficit month since the global financial crisis in 2008. (Ministry of Knowledge and Economy, 2012) Although the South Korean government does not expect the trade deficit in the year 2012, it is clear that the EU zone crisis affects the global trade environment gloomy in coming years. The trade issue is extremely significant for the South Korean national economy because its trade dependency accounts for approximately 90 percent of GDP. It means that South Korea may face serious economic challenges if it cannot manage the global trade environment properly, which is getting been worse in the EU territory.

Conclusion

What is clear in this current Eurozone crisis is that it has the potential of creating a global downturn which will spare few countries. The current context indicates that the world economy has not sunk to this point as yet. While some continents have been swept into economic crisis it has neither become global or a definitive depression. In this context, both Australia and South Korea, for their own unique and idiosyncratic motives have not been subjected to the same degree to this downturn or flow on effect from the Eurozone sovereign debt crisis.

In both cases however both economies feel the effects of the crisis but in specifically segmented sectors of their economies. In the case of Australia and South Korea the greatest fear is that of the banking and credit sectors and the effects on borrowing and availability of credit. The South Korean economy is also concerned with the decline in trade and exports which have been central to Korean economic growth and a buffer to economic decline during the financial crisis because its domestic market is rather small or medium sized.

In addition both economies have reserves they can call on to cushion the more immediate effects of the financial crisis. Both countries expect some form of downturn, though limited, in the short term because the protection they utilised previously to bolster their economies has been exhausted. The sovereign debt ratio of the two nations is lower than the average of OECD member nations. However, they both carried out a vast capital investment as a rescue package for boosting domestic economies during the global financial crisis 2008. It means that the two governments may be reluctant to exercise the same economic policy tools if they have to deal with other possible global financial crisis caused by the Eurozone crisis.

On the other hand both countries and their respective governments conduct themselves in such a way as to indicate they are not expecting significant economic effects on their respective economies. Indications are that there is some degree of confidence that they will be proven correct. Despite such a positive outlook, the two nations may face relative serious economic challenges if the EU zone crisis continues in the long term and the market demand declines due to their industrial and trade structure as well as domino effects in the global markets.

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Table 1 – European government bond spread from the German bund 10 year base rate

EU member state	1986	1991	1996	2001	2006	2011
Italy	800	480	535	35	43	490
Spain	700	580	525	32	35	400
Belgium	370	85	20	31	26	209
France	210	86	12	29	27	112

Source: RBA, Global Financial Data, ECB, Thomson Reuters, Bloomberg

Table 2 – Australian based bank claims on Eurozone countries (as at 30 June 2011)

	Banks ($B)	Public Sector ($B)	Private Sector ($B)	Total	
				$Billion	% of assets
Eurozone	66.2	4.1	16.9	87.2	2.7
Greece, Ireland, Italy, Portugal and Spain	2.2	0.7	3.3	6.1	0.2
France, Germany and The Netherlands	59.2	3.0	12.4	74.6	2.3

Source: Adapted from APRA

Table 3 – Share of merchandise exports going to the Eurozone (2010)

European country	% of exports
United Kingdom	49
Sweden	39
India	15
China	15
United States	14
East Asia*	11
Japan	8
Canada	5
Australia	4

Source: ABS, ECB, Eurostat, Thomson Reuters, RBA