

Impact of Sovereign Debt Risk and Corrective Austerity Measures on Private Sector Borrowing Cost in Euro Zone

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Abstract : The current paper evaluates the effect of external public debt risk on the borrowing cost of private non-financial firms in euro zone. Further, the study also treats the impact of austerity measures on syndicated-loan spreads of private firm followed by euro area member states to revive the economic growth in the region. To test these hypotheses, we follow multivariate ordinary least square estimation method to assess the effect of external public debt on the borrowing cost of private firms. By using foreign syndicated-loan issuance data of non-financial private firms from 2005 to 2011, we attempt to gauge how the private financing cost varies with high levels of sovereign external debt prevalent in the euro zone. Our results suggest significant effect of external public debt on the borrowing cost of private firm. In particular, an increase in external public debt by one standard deviation from its sample mean raises syndicated-loan spread by 89 bps. Furthermore, weak creditor rights protection prevalent in member states deepens this effect. However, we do not find any significant effect of domestic public debt on the private sector borrowing cost. In addition, the results show significant effect of austerity measures on private financing cost, both in normal and in crisis period in the euro zone. In particular, one standard deviation change in fiscal consolidation conditional mean reduces the syndicated-loan spread by 22 bps. In turn, it indicates strong presence of credibility channel due to austerity measures in euro area region.

Keywords : corporate debt, fiscal consolidation, sovereign debt, syndicated-loan spread

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