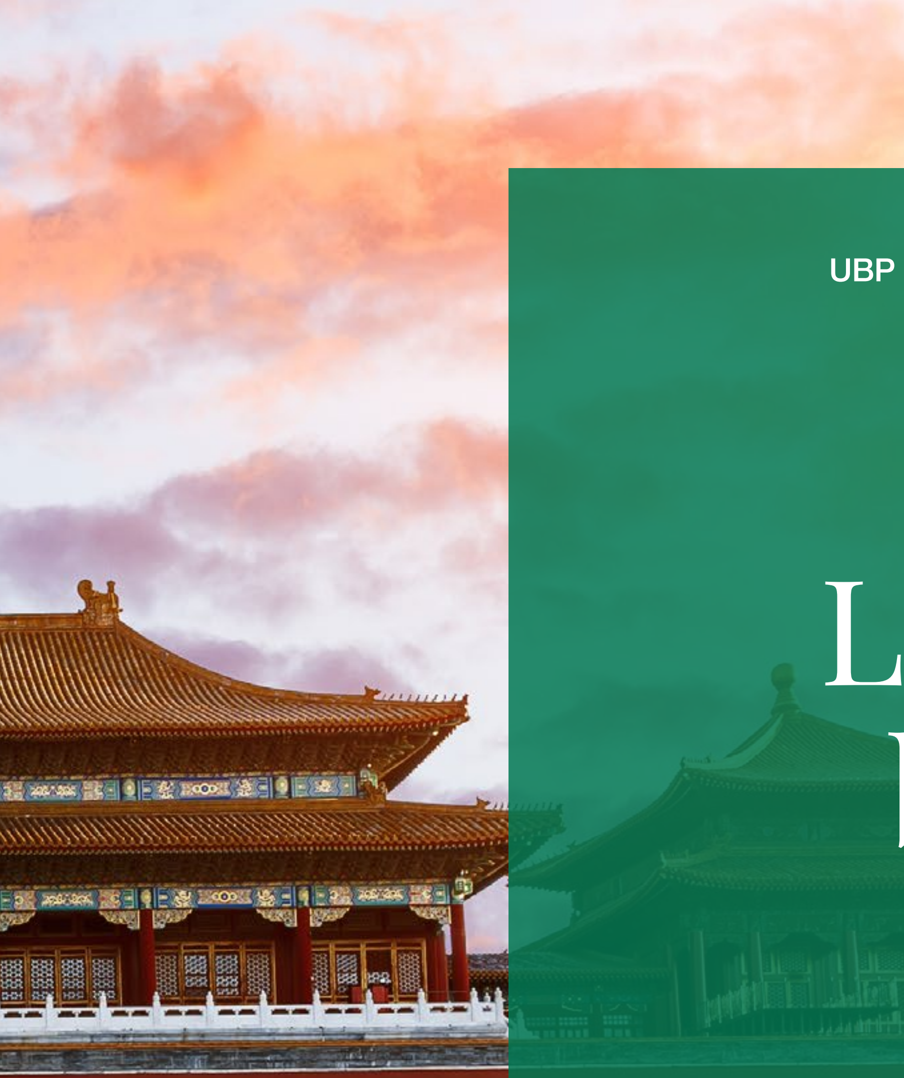

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MARKETING DOCUMENT

Looking beyond China

Union Bancaire Privée

Key Points

- Like post-1989 Japan, post-1998 Asia, the post-2008 US, and post-2011 Europe, China is in a post-bubble economic restructuring phase.
- Though China announced its pivot away from real-estate-led growth in 2011, only with President Xi Jinping's December 2016 exhortation that, "Houses are built to be lived in, not for speculation," did the painful restructuring of its bloated real estate sector begin in earnest.
- Indeed, lessons from post-1989 Japan show the perils of delaying restructuring and reform. Thus, while calls for large-scale stimulus packages have been persistent in the face of growing economic stress, China should seek, and now appears to be seeking, to continue unwinding real estate excesses.
- Unlike post-bubble economic restructurings of the past, China's restructuring phase is being complicated by the shifts in the geopolitical order that began with the Trump trade wars of 2018/19 and accelerated by Russia's 2022 invasion of Ukraine, limiting China's ability to rely on currency weakness and export growth to cushion the impact of reforms on overall economic growth.
- For investors, lessons from other post-bubble economies globally suggest that passive investments in China should be avoided. Instead, tactical investors should focus on the global industrial cycle while China-focused investors should concentrate on longer rather than shorter time horizons in new economic growth segments that will drive the next phase of China's development.
- For emerging markets, investors can look to Indian equities for premium economic and, more importantly, earnings growth to drive returns.

China enters its post-bubble economic restructuring

Many are attributing China's lethargic post-pandemic economic reopening and recovery to poor consumer sentiment and the absence of the kind of government support that characterised the pandemic era in the US and Europe. A better explanation, we believe, is that China is in the midst of a post-bubble economic restructuring not unlike those seen in post-1989 Japan, Asia after 1997, the US following its 2007–08 sub-prime crisis, and Europe in the aftermath of its sovereign crises of 2011.

While China's policymakers signalled a desire to end the real estate surge in its domestic economy as early as the 12th Five-Year Plan in 2011, it was only with President Xi Jinping's 2016 exhortation that "houses are built to be lived in, not for speculation" that the painful restructuring of its bloated real estate sector began in earnest.

We believe the lessons from more than three decades of policies – both successes and failures – can help investors navigate the path ahead for China as it seeks to move into the next phase of the economic transformation it embarked upon in the late 1980s.

LESSON FROM POST-BUBBLE RESTRUCTURINGS SINCE 1989

	Japan (1989)	East Asia (1997)	US (2007-09)	Euro (2011)	China (2017-)
Joint Monetary-Fiscal Policy	NO	NO	YES	NO	YES
Weak Currency	NO	YES	YES	YES	MODERATE
Bank recap	NO	YES	YES	GRADUAL	YES
Writedowns	NO	YES	NO	NO	LIMITED
'New' industries	NO	SELECTED	YES	NO	PARTIAL
Domestic social costs	LIMITED	LARGE	MODERATE	MODERATE	LIMITED
Political Change	NO	YES	NO	NO	NO

Sources: UBP * for details please see appendix

Looking through the lens of post-bubble restructurings since 1989, China has clearly drawn on these experiences as its own policy framework takes shape.

While the International Monetary Fund (IMF) and the US Treasury/Federal Reserve forced capital raising through the Asian and US financial systems following their respective crises, China has maintained high levels of capital within its banking system as a cushion, hopefully for a more decisive write-down and restructuring of debt than the US Treasury and Federal Reserve imposed upon American banks after 2009.

Indeed, though the write-downs began slowly and in a targeted fashion in 2017, 2023 has

seen more proactive developments on this front, providing some hope that China will avoid the drag that these bad debts might pose on the economy looking ahead, similar to those suffered not only by Japan, but also Europe in their respective post-bubble economies.

Moreover, beginning even from the official policy pivot away from a reliance on the real estate sector announced during the 12th Five-Year Plan (2011–15), China has engineered a gradual weakening of its currency against its main trading partner, the United States, reversing almost half of the strengthening of the Chinese yuan against the US dollar since 2005.

Once again, as early as 2012–13, China appeared to have drawn on the mistakes of Japan, which kept too strong a currency in the aftermath of its bubble; China instead looked to South Korea, the United States and the euro area which all relied on weak currencies to ease the domestic social burdens that accompanied their painful restructuring and reform efforts.

Potentially difficult policy trade-offs ahead for China

Although China has made some early choices that are encouraging as it moves through this phase of its economic development, the country is likely to encounter some challenging policy trade-offs in the future.

COMMITMENT TO REFORM/RESTRUCTURING

Perhaps the most important policy choice that lies ahead will be a commitment to restructuring and reform itself. Indeed, although China announced the policy pivot as early as 2011, on two separate occasions since then the threat of destabilising real estate defaults resulted in a return to the traditional fiscal/monetary policy response, effectively providing support to the flagging real estate sector.

Indeed, in 1999, Ben Bernanke highlighted one of Japan's key mistakes, namely pursuing policies that brought about the asset price crash in 1989 (see appendix for more details). However, another important lesson from post-1989 Japan is the perils of delaying restructuring and write-downs, which, combined with other policy errors, resulted in Japan's lost decades.

Thus, while calls for large-scale stimulus packages have been persistent in the face of growing economic stress, China now appears to be seeking, as it should, to unwind real estate excesses in earnest, suggesting an active effort to avoid the mistakes of Japan on this front that prolonged its post-bubble restructuring.

At the same time, the premium that China's leadership places on domestic political stability highlights the delicate balancing act they will need to carry out to avoid the magnitude of instability seen after the 1997 Asian financial crisis.

Instead, showing signs of a commitment to real estate restructuring, China's leadership may pursue a European-style solution which traded off growth in favour of only moderate social instability.

SUBSTANTIAL MONETARY EASING…

Drawing upon the European experience, China will probably need to reverse the positive inflation-adjusted rates in place domestically and ease policy more decisively in a similar way as when the European Central Bank (ECB) President Mario Draghi declared the ECB would do “whatever it takes” to preserve the single-currency area.

Indeed, in retrospect, President Draghi can be seen as taking on board Bernanke’s guidance from 1999 by committing to “easing policy” enough to stabilise demand and inflation following the deflationary shock.

At the time, the ECB’s quantitative easing programme broke new ground in the wake of the global financial crisis by buying corporate debt instead of just the government debt that the US and Japan had focused on.

Moreover, the ECB became the first major central bank to move to negative interest rates, following in the footsteps of its smaller neighbour, the Swiss National Bank, and thus highlighting its commitment to ensuring easy financial conditions.

…AND A WEAKER CURRENCY?

One trade-off which China may need to confront as a bulwark against domestic instability may be a more meaningfully weaker currency. With a closed capital account, China could conceivably seek to maintain its exchange rate.

However, lessons from Japan in the early 1990s caution against such a strategy: in the face of its post-bubble future, Japan saw its currency strengthen by nearly 40% against the US dollar, adding to pressure on the domestic economy and prolonging its first lost decade.

In contrast, South Korea benefited from its near 50% devaluation against the US dollar during the Asian financial crisis, which, alongside the 1999–2000 technology bubble, helped South Korea fund the repair and restructuring of its domestic economy. It cannot be overlooked, however, that the social and political costs of such a rapid devaluation were high.

Europe’s approach may offer a middle ground. As the continent pivoted towards quantitative easing and negative interest rates, the euro weakened by nearly 30% against its main trading partners’ currencies, i.e. the US dollar and Chinese yuan, over five years as it sought to buy time for its domestic efforts to fully bear fruit.

MANAGING A SHIFTING GEOPOLITICAL LANDSCAPE

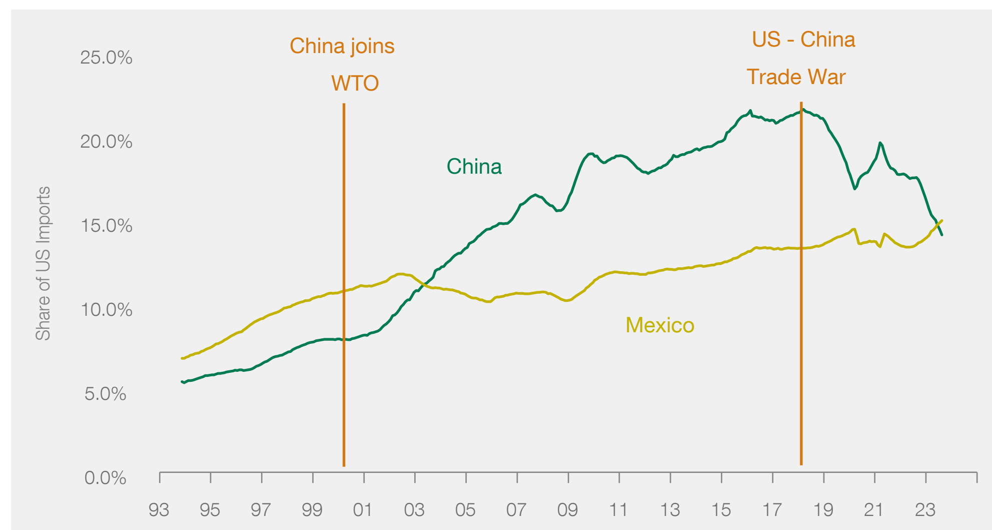
However, China faces a challenge that neither South Korea nor Europe faced: a rapidly shifting global geopolitical landscape.

At headline level, China’s exports to the largest economy in the world have been losing market share to rivals since US–China tensions first erupted with the 2018–19 Trump trade wars, and have escalated further under the Biden administration since 2021.

In particular, China has fallen from being the largest source of US imports at nearly 21% as recently as 2020 to now accounting for less than 14% of total US imports through most of 2023.

China has not seen this level of import share since 2003–04, shortly after China joined to the World Trade Organization in 2001.

CHINA'S SHARE OF US IMPORTS IS FALLING...



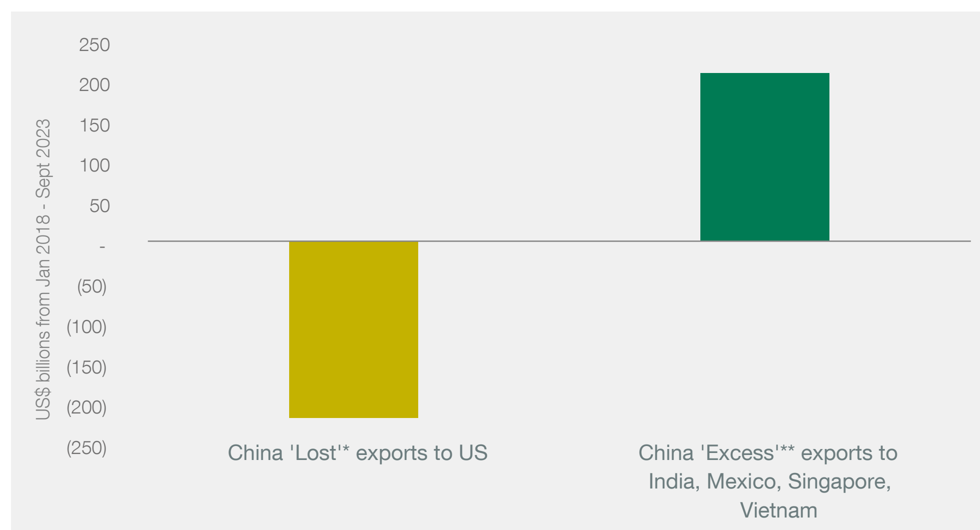
Sources: U.S. Census Bureau, Bloomberg Financial L.P. and UBP

The substantial loss of US import share has been replaced primarily by Mexico, India, Singapore and Vietnam, which is consistent with the "friend-shoring" narrative prevalent in recent years.

However, this headline loss in export share may mask transshipments of China-originated exports. Indeed, work by the Bank of International Settlements and the IMF both highlight the fact that supply chains have become more complex during the deglobalisation of recent years, which may reflect a greater mix between transshipments of goods and the establishment of new, non-China-based production facilities.

Indeed, China exports to Vietnam, Singapore, Mexico and India exceeded their pre-Trump trade war trend by nearly USD 210 billion. Looking at US imports, had China maintained its 20%+ share of US imports, the country would have seen exports nearly USD 220 billion higher than over the past year, suggesting China may have deployed a successful transshipment strategy to circumvent both tariffs and country-of-origin rules that have become a key element of US trade policy.

...BUT IT IS USING TRANSSHIPMENTS TO MITIGATE US TRADE POLICY



Sources: U.S. Census Bureau, China Customs General Administration, Bloomberg Financial L.P. and UBP * Assuming China maintained its 2015-17 average US import share from 2018–2023 ** Cumulative above 2010–16 trend China exports to India, Mexico, Singapore and Vietnam

China has indeed been adept at mitigating the impact of a hawkish US trade policy on its overall exports, but just as transshipment adds another layer of complexity to global value chains, it also has the potential to limit the effectiveness of China's currency policy choices: intermediaries introduced in recent years could instead use China's FX weakness to bolster their own margins and profits, resulting in limited transmission to end customers in the US.

A GROWING ROLE FOR FISCAL POLICY

In the early 1990s and until 2011, China periodically ran cyclical budget deficits of 2% before reverting to balanced budgets/modest surpluses as the economy recovered.

Uncoincidentally, since 2011, when China officially announced its pivot away from real estate as a growth driver, the government deficit expanded to 4% of GDP before hitting 6% of GDP at the height of the pandemic.

In the past, monetary policy was a key contributor to ensuring funding for the real estate and fixed-investment-driven economy. Looking ahead, we expect monetary policy to serve to ensure system stability.

With currency and trade policy potentially more muted as a driver to growth during this phase of economic restructuring and reform, we suspect sustained deficits such as those seen since 2011 to be necessary to mitigate the potential social costs of restructuring, as well as to spur new industries that might help cushion the economic impact of the ongoing restructuring of the real estate sector.

Beyond this, however, and unlike Japan in the 1990s, China has at its disposal investments that can be deployed not only to help spur on growth, but, more importantly, to enhance long-term economic productivity and help mitigate some of the demographic headwinds its economy faces.

The transition of the Chinese auto fleet from internal combustion engines to electric vehicles (EVs) and other renewable vehicles is probably one of the most visible efforts under way. With the US following China's efforts, China continues to have the capability to deploy spending to accelerate this process further.

Moreover, for China to maintain its comparative advantage in battery and solar production, this may require accelerating spending in the face of the aggressive manufacturing subsidies and incentives that are expected to drive nearly USD 1.7 trillion in spending in the US.

Importantly, a large portion of this American spending is not for consumption of finished products, some of which might come from China, but more for establishing a broader US manufacturing base and a green value chain within the United States.

Ongoing investments to maintain or even expand the technological gap will be key for China to confound US efforts to build their own domestic capabilities.

China can also look to enhance its social safety net to help transition its workforce in light of structural demographic, as well as sectoral, shifts within the economy. Broader and more comprehensive unemployment insurance can facilitate worker transitions from sectors undergoing restructuring to new growth sectors. Education and worker-retraining schemes can be used to facilitate this change, as well as to reskill the workforce for the new economic landscape.

With an ageing population, broadening health insurance and pension coverage can help ease concerns among those approaching retirement about the uncertainty surrounding costs and income during their golden years, and potentially free up funds currently held as a cushion against such insecurity.

On balance, as China appears to now be in the middle of its own post-bubble restructuring era, the lessons of similar episodes since the late 1980s highlight the road ahead for the second-largest economy in the world. Leaning heavily on fiscal initiatives to drive the transformation, with monetary and currency policy now in support of the effort, the country can ensure financial and social stability as the reforms take shape.

Lessons from past post-bubble restructurings

Historically, investors in post-bubble economic restructurings have not been rewarded during the process.

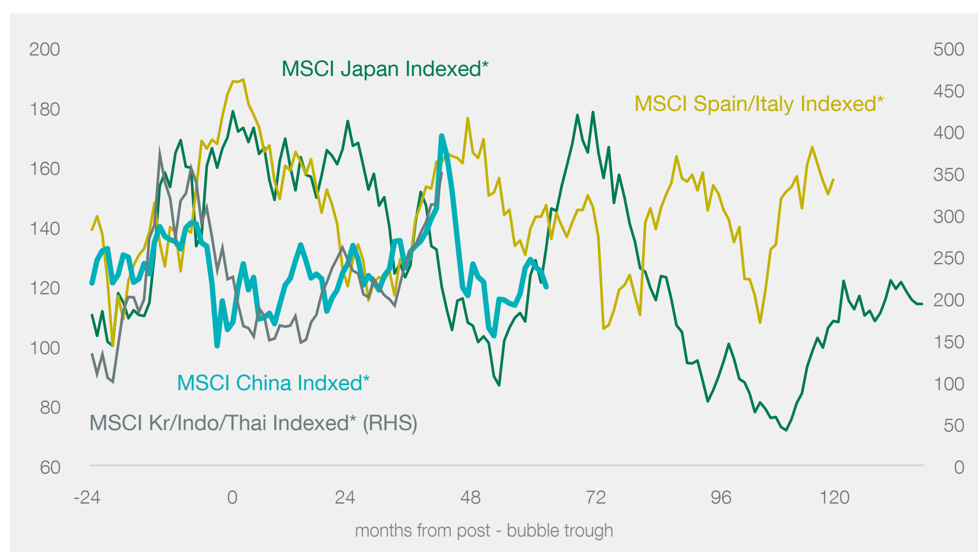
Looking back, Japan, South Korea, Thailand and Indonesia (the countries at the centre of the 1997 Asian financial crisis), and Italy and Spain (the countries at the centre of the European debt crisis), have seen equity markets stagnate for years or, as was the case for Japan, even decades.

Indeed, South Korea was pulled out of its stagnation, not only by IMF-imposed reforms, but also given its positioning at the forefront of the global tech bubble in 1999–2000.

Thailand and Indonesia were not so fortunate despite suffering from a similar malaise following the 1997 Asian financial crisis. Instead, both needed the China bubble that benefited the region and the world following its accession to the World Trade Organization in 2001.

Spain and Italy, which were at the centre of the European debt crisis following Greece's bailout, have continued to see their equity markets languish more than a decade after the continent's crisis.

POST-BUBBLE PERIODS DON'T OFTEN REWARD EQUITY INVESTORS



Sources: MSCI, Bloomberg Financial L.P. and UBP
* USD indices indexed to market post-bubble market trough

Looking at our historical sample, the United States is the only equity market that has been able to shake off its slump in a comparatively short period. The S&P 500 returned to pre-crisis peaks in just three years after the market lows, aided not only by fiscal and monetary support, but also by the rise of new industries driven by the shale revolution that turned the US into the second-largest oil producer in the world, as well as the global social media revolution that gave rise to many of the current tech giants.

If we look at China through the lens of a post-bubble economy beginning with the 12th Five-Year Plan (2011–15), the Chinese equity market is showing similar characteristics to those of other post-bubble economies, having delivered only 3.1% CAGR returns since 2011.

For China, as it moves through this restructuring phase, investors can seek to position within the country in two ways. First, as a global cyclical: benefiting from exports and risk appetite when the global cycle reaccelerates to drive overall economic growth.

Indeed, China equity valuations are at near-crisis lows. These levels have only been seen in 2008–09 during the global financial crisis, the European debt crisis and China's first attempt at restructuring its real estate sector between 2011-14.

With policymakers deploying modest fiscal and monetary policies to avoid the asset price "crash" that Ben Bernanke warned about in his 2001 paper (see appendix), China-focused equity investors are awaiting a cyclical upturn in the global economic cycle in 2024 to allow an uplift in overall growth in the Chinese economy.

As we see the early signs of such a recovery, for China equity investors who have suffered through the year-to-date declines, a cyclical opportunity may unfold in the months ahead to help investors recoup some of the year-to-date losses.

However, investors must be careful to avoid overstaying their welcome, as they did in Japan, Spain, Italy, and even in China in 2015–16, where passive investors substantially gave back all of their gains as the economic cycle turned back down.

Alternatively, China-focused investors can look at the segments of the economy that remain expansionary – focusing on stock selection rather than macro trends – to secure longer-term outperformance and, optimistically, absolute returns.

In Japan from 1992 to 1997, for example, exporters were the focus, with the Japanese auto sector delivering 7.8% CAGR as the overall index contracted by 15%, or 3.6% per annum.

Within China, investors can look at the sectors of the economy that stand to benefit from tailwinds under the current 14th Five-Year Plan (2012–25) which focuses on reducing China's dependency on imported components of foreign technology.

Simultaneously, it is hoped that this will enhance the country's export potential via high-value-added industrial and core technology exports.

EVs are a good example of this approach. China is the world's largest market for EVs, selling 6.8 million of them in 2022 alone. China also overtook Japan as the world's largest exporter of vehicles in the first half of 2023, with 2.34 million cars exported.

Admittedly, potential European restrictions on Chinese EV imports pose a potential headwind for Chinese EV companies attempting to replicate Japan's automotive success of the 1990s.

Additionally, China is investing heavily to reduce its dependency on imported semiconductors in order to fuel growth in sectors related to artificial intelligence (AI) and other data services.

Lastly, in order to ensure that basic welfare services can appropriately cover the needs of China's vast and rapidly ageing population, the government may need to consider promoting the development of domestic insurance services.

ALTERNATIVES TO CHINA FOR EM INVESTORS

For emerging market (EM) investors wary of the capriciousness of single-stock investing in China, Indian equities offer a credible alternative.

Indeed, although China's economy has grown rapidly since the 1980s to become the second-largest in the world, the past three decades have not been rewarding for investors in China equities.

Since 1992, the MSCI China has delivered only 0.5% CAGR to investors through to the end of October, lagging behind the 8.4% CAGR (in USD) returns delivered by Indian equities over

the same period, despite the Indian rupee depreciating by nearly 3.4% per annum against the US dollar over the period.

From the MSCI China lows, prior to China joining the World Trade Organization in December 2001, the MSCI China has delivered 8.4% CAGR, similar to the 8.3% CAGR total returns seen in the S&P 500. However, over this same period, MSCI India delivered 12.2% CAGR returns (in USD), once again outpacing China equities.

Driving this underperformance has been moribund corporate earnings growth. Since 2007, China equities have delivered earnings growth of only 3.6% per annum as returns on equity for shareholders have nearly halved over the period from a peak of 19% to, most recently, below 11%.

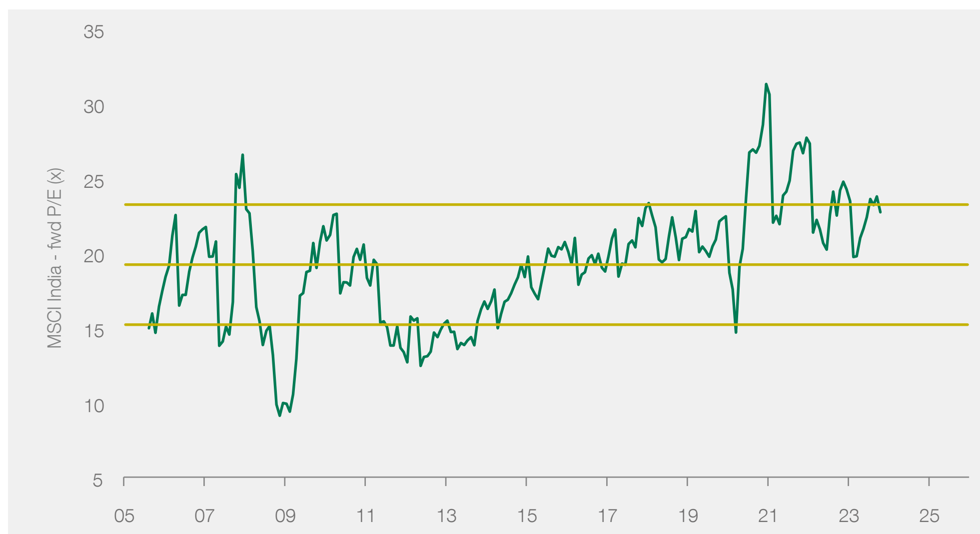
In contrast, Indian equities have delivered earnings growth of 11% annually since 2007, outpacing even the 8.7% the tech-heavy NASDAQ 100 realised over the same period.

Admittedly, the challenge for equity investors in India is that this premium earnings growth typically leaves Indian equities at premium valuations to their China and many global counterparts.

Indeed, the valuation premium that Indian equities command over China corporates is near a historic high. This wide gap is driven by cyclically elevated Indian valuations combined with the near-crisis-low China equity valuations. Similar levels have been seen only in 2008–09 amid the global financial crisis and 2011–14, during the European debt crisis and China's first attempt at restructuring its real estate sector.

Should valuations in India ease from 22x earnings towards their historical average of 20x, an opportunity to build strategic exposure to India would present itself for today's China-focused investors seeking premium economic and earnings growth during China's post-bubble restructuring process.

AWAITING A VALUATION OPPORTUNITY IN INDIAN EQUITIES



Sources: MSCI, Bloomberg Financial L.P. and UBP

On balance, China investors should recognise that this restructuring era of China's economic development offers a different and more challenging investment backdrop.

As a result, investors should likewise adapt their strategies, capitalising on a potential rebound in the global economic cycle to redirect exposure from mature and restructuring sectors towards both longer-cycle economic and earnings growth. This can be done either via a focus on Chinese government policies driving economic transformation and/or complementing China exposure via Indian equities which have historically delivered more sustainable, long-cycle earnings growth for investors.

APPENDIX: Lessons for China from post-bubble restructurings since 1989

JAPAN, 1989

Many fear – understandably – that China is on a similar path to Japan's multiple "lost decades" since the bursting of its bubble in 1989. However, Japan's policy mistakes and successes can be helpful in tracking China's progress towards avoiding a Japan-style outcome.

Japan's policy errors in the 1990s and early 2000s have been well documented by economists around the world, with former US Federal Reserve Chair, Ben Bernanke, penning Japanese Monetary Policy: A Case of Self-Induced Paralysis in 1999 and "…attribut[ing] much of Japan's current dilemma on poor monetary policymaking."

In particular, he cites:

1. A failure to tighten monetary policy going into the peak of the 1989 bubble
2. Policies during 1989–91 which induced an asset price crash
3. Failure to adequately ease policy to stabilise demand and inflation and instead "being distracted" by the exchange rate

Masato Miyazaki at the OECD points to fiscal caution also complicating Japan's attempts at recovery in the aftermath of 1989, with tax increases often impeding public investment spending.

It has only been since the implementation of Japan's former Prime Minister Shinzo Abe's "Three Arrows" in coordination with former Bank of Japan Governor Haruhiko Kuroda's negative interest rate and yield curve control policies that monetary and fiscal policy coordination has started to show signs of lifting Japan out of its multi-decade paralysis.

While fiscal and monetary policy errors stood in the way of domestic recovery, some corporate progress was notable, with, for example, Japanese automakers moving overseas in earnest in order to mitigate the impact of the persistent strengthening of the Japanese yen from the 1989 bubble peak. This move by Japan's advanced manufacturing sector allowed the country to rely on its export sector (and periodic bouts of currency weakness) to cushion the regular external and domestic deflationary shocks that occurred during its post-bubble restructuring battle.

ASIA, 1997

While few look to China's neighbours in East Asia for guidance on their policy trajectory ahead, South Korea, Thailand and Indonesia highlight both the benefits and domestic costs of painful, yet rapid, restructuring and reform following the bursting of asset bubbles.

Whereas Japan's policy struggled over decades, balancing social stability against the need for painful reform, the Asian financial crisis of 1997 brought a different policy approach, as the International Monetary Fund (IMF) dictated draconian terms to East Asian countries seeking assistance following the breaking of their currency pegs in mid-1997.

Currencies devalued sharply, avoiding the more gradual moves sought by Japan. Though creating problems for many countries' external balances, the weakened currencies forced many nations to lean on exports to drive overall growth, a lesson Japan learned only belatedly in its own experience.

Just as importantly, regional banks were not allowed the "extend and pretend" luxury that Japanese banks offered their no-longer-creditworthy borrowers. Instead, large-scale capital raising and write-downs characterised the landscape.

Alongside the forced restructuring of local banking sectors came the effective break-up of many conglomerates in the region, at the centre of which sat some of the largest local banks, similar to Japan's interlocking keiretsu.

Among the high-profile survivors, Samsung's foray into chemicals and autos before 1997 gave way to a focus on technology and Samsung Electronics, while these restructurings laid the groundwork for Hyundai and Kia to take their place among global automakers.

Admittedly, the costs of these rapid and painful restructuring and reform programmes were social as well as political. GDP per capita in US dollar terms fell 40–60% in Indonesia, South Korea and Thailand from peak to trough, while long-serving governments in South Korea and Indonesia lost power as a result.

Whereas Japan's policy vacillations led to multiple lost decades, the forced, aggressive restructuring of East Asian banking systems and economies after 1997 laid the groundwork for a new renaissance by the mid-2000s.

US SUB-PRIME CRISIS, 2007 & GLOBAL FINANCIAL CRISIS, 2008–09

From his role as a member of the US Federal Reserve Board of Governors in 2002 and then, in 2006, assuming the role of Chair of the US Federal Reserve, Ben Bernanke and the policymaking Open Market Committee sought to avoid the mistake he himself pointed out to the Bank of Japan (a failure to tighten policy going into its bubble) by engineering the massive rate increase from 2004–2006 – the largest since the battle with inflation in the early 1980s.

With US residential property prices stabilising in 2006 after a 30% rise over the previous two years, and with headline inflationary pressures easing, the new Fed Chairman Bernanke was comfortable enough being faced with strains in the sub-prime mortgage market to say, "We believe the effect of the troubles in the sub-prime sector on the broader housing market will be limited and we do not expect significant spillovers from the sub-prime market to the rest of the economy or to the financial system."

Thus, while the US central bank was focused on its dual mandates of inflation and employment, in hindsight, it underestimated the threat of financial system instability that even a small sector within the banking industry could pose to the foundation of the global banking system.

In response, Bernanke once again avoided Japan's mistakes by cutting interest rates to the zero bound for the first time in history and, once he recognised this may not be sufficient, began buying government bonds (quantitative easing) to further stimulate activity.

He cajoled fiscal policymakers also to take steps and, following a failed attempt in September 2008, successfully engineered joint monetary and fiscal easing with the near-USD 1 trillion spending programmes in 2008–09.

Drawing from the lessons of the Asian financial crisis, the US similarly forced USD 250 billion in new equity into the US banking system and guaranteed the short-term debt of banks to avoid the bank runs that had been commonplace in Asia a decade earlier.

However, unlike the pain imposed by the IMF on Asian banks and their respective economies, the United States took a decidedly different approach, with low interest rates for longer, allowing otherwise struggling corporates to refinance at historically low interest rates, just as Japan had done previously to avoid the bankruptcies and distress (and restructuring and reform) that were imposed on East Asian economies.

Instead, rising asset prices and incomes driven by new industries, including shale oil and social media, over the subsequent decade helped the US economy to recover enough to allow monetary policy to begin a normalisation process by 2015.

EUROPEAN DEBT CRISIS, 2011

Like Asian economies in 1997, the eurozone suffered from a balance of payments crisis in which foreign capital became unwilling to fund substantial and unsustainable deficits across several members of the single currency area.

Eurozone policymakers pursued a substantially different policy mix, resulting in different economic and social outcomes from those of the 1997 Asia post-bubble restructuring.

Whereas Asian nations were saddled with debts denominated in foreign currency (US dollars), European nations at the centre of the crisis were instead stuck with euro-denominated obligations.

However, like the countries at the heart of the Asian crisis, those involved in the euro crisis could not print new money to meet their obligations (as the United States' central bank did in 2008–09) without the cooperation of the supra-sovereign European Central Bank.

In 2012, the Mario Draghi-led European Central Bank eventually engaged in substantial monetary easing, but not without extracting fiscal concessions from profligate nations in exchange. The policy easing and effective sovereign yield curve control policy – which kept sovereign yields of countries at the centre of the crisis like Italy at a fiscally sustainable level – allowed not only nations to service their debt obligations but also the damaged banking system on the continent to rebuild its capital buffers.

While Greece, which sparked the European debt crisis, suffered both social and political turmoil through 2011–12, the 2012 intervention by the ECB helped limit the social and political instability from spreading more meaningfully across the single-currency area and enabled then ECB President Draghi to keep his commitment to, "do whatever it takes to preserve the euro."

Admittedly, the ECB's 2012 policy choices were not without trade-offs. Artificially low interest rate costs which allowed peripheral nations at the centre of the crisis to repair their economies resulted in economic booms in northern Europe, which did not suffer the same excesses as their southern European neighbours.

This drove leveraging of corporate balance sheets and eventually booming real estate markets in parts of the continent. The low rates also prevented the purging of the economic system in Europe and likewise did not result in innovation or the creation of substantial new industries within Europe as happened in the United States.

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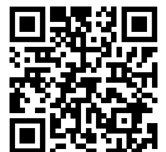

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