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## The Eurozone Debt Crisis: A Structural VAR Approach\*

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### Abstract

This paper examines empirically the causes of the 2010 Eurozone debt crisis. We use a battery of econometric models with quarterly data from 2004 to 2014 to identify domestic and external nominal shocks and their transmission mechanisms through impulse response functions and granger causality tests derived from a structural VAR (SVAR) specification. It is shown that shocks to Germany's macroeconomic fundamentals have a significant impact on Greece's inflation rates, industrial production, and interest rates. Our empirical results indicate that the root cause of the Greek debt crisis emanates from imbalances in its balance of payment, mainly in its current account, losses in competitiveness vis-à-vis Germany, and the lack of nominal adjustment measures through monetary policy due to Greece's membership in the Eurozone. We argue, in the absence of nominal adjustment mechanisms, Greece will probably have to go through prolonged deflationary episodes in order to enhance its competitiveness, produce a positive current account, reduce its budget deficits and public debt, and reverse capital outflows. We also argue, in the absence of an effective monetary policy, countries members in a monetary union running large budget and current account deficits maybe more prone to a Greek debt type crisis.

**Key Words:** Greek Debt Crisis; Structural VAR;

**JEL Classification:** E62, E69, F34, C32

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