

EUROZONE BANKS AND CAPITAL FLOW REVERSAL

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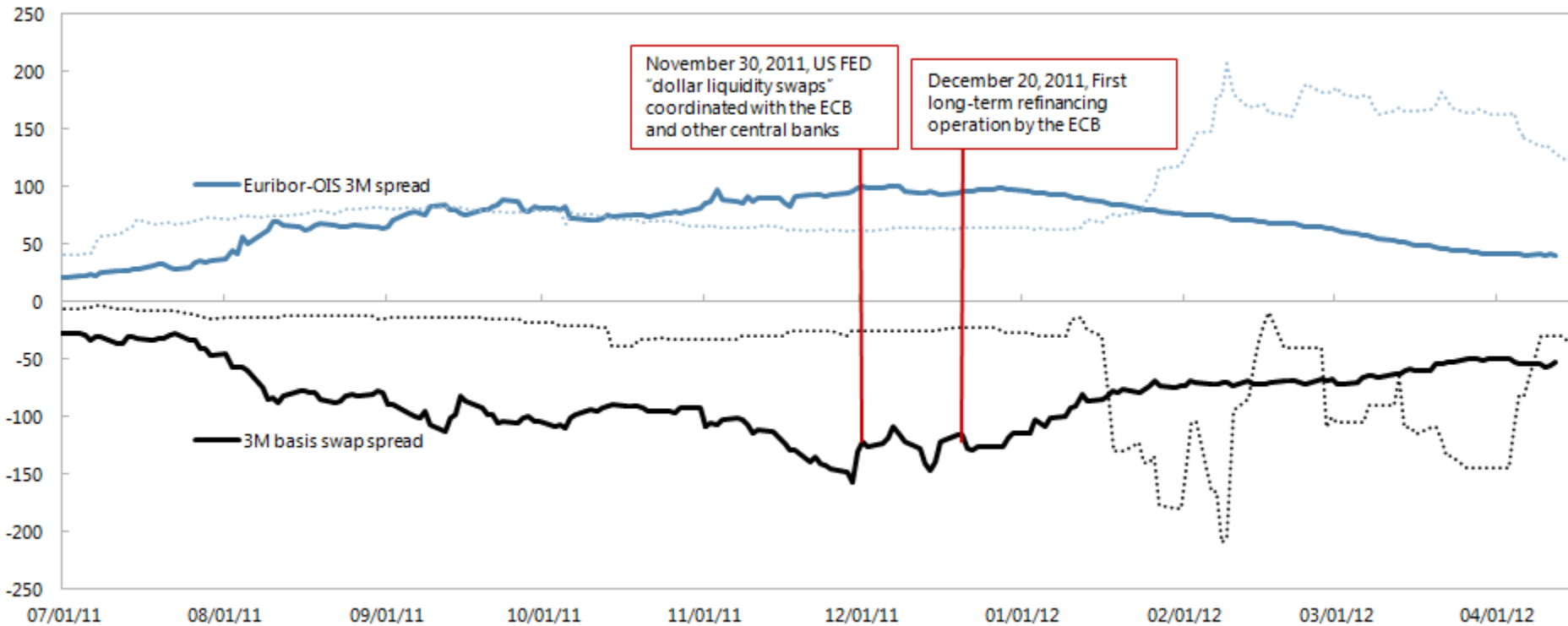
European Crisis: Historical Parallels and Economic Lessons
Julis-Rabinowitz Center for Public Policy and Finance Inaugural Conference

April 18-20, 2012

The views expressed in this presentation are mine and not necessarily those of the IMF.

The Crisis Averted

Interbank and dollar liquidity tensions in the eurozone
(Basis points)



Sources: Bloomberg; and staff calculations.

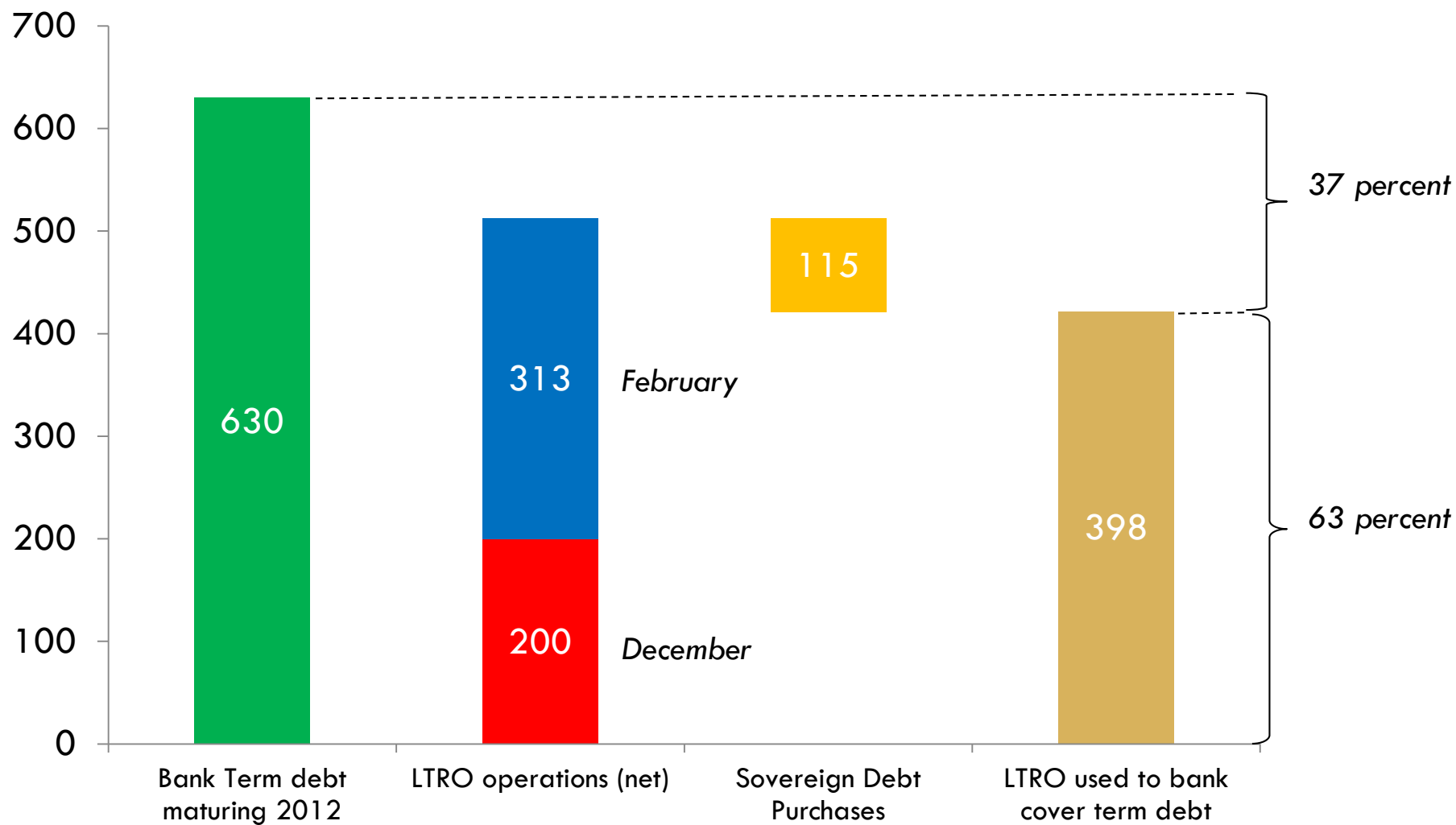
Note: Dotted series start on March 3, 2008, and show post-Bear Stearns developments as a comparison.

Euribor: 3 months Euro interbank offer rate,

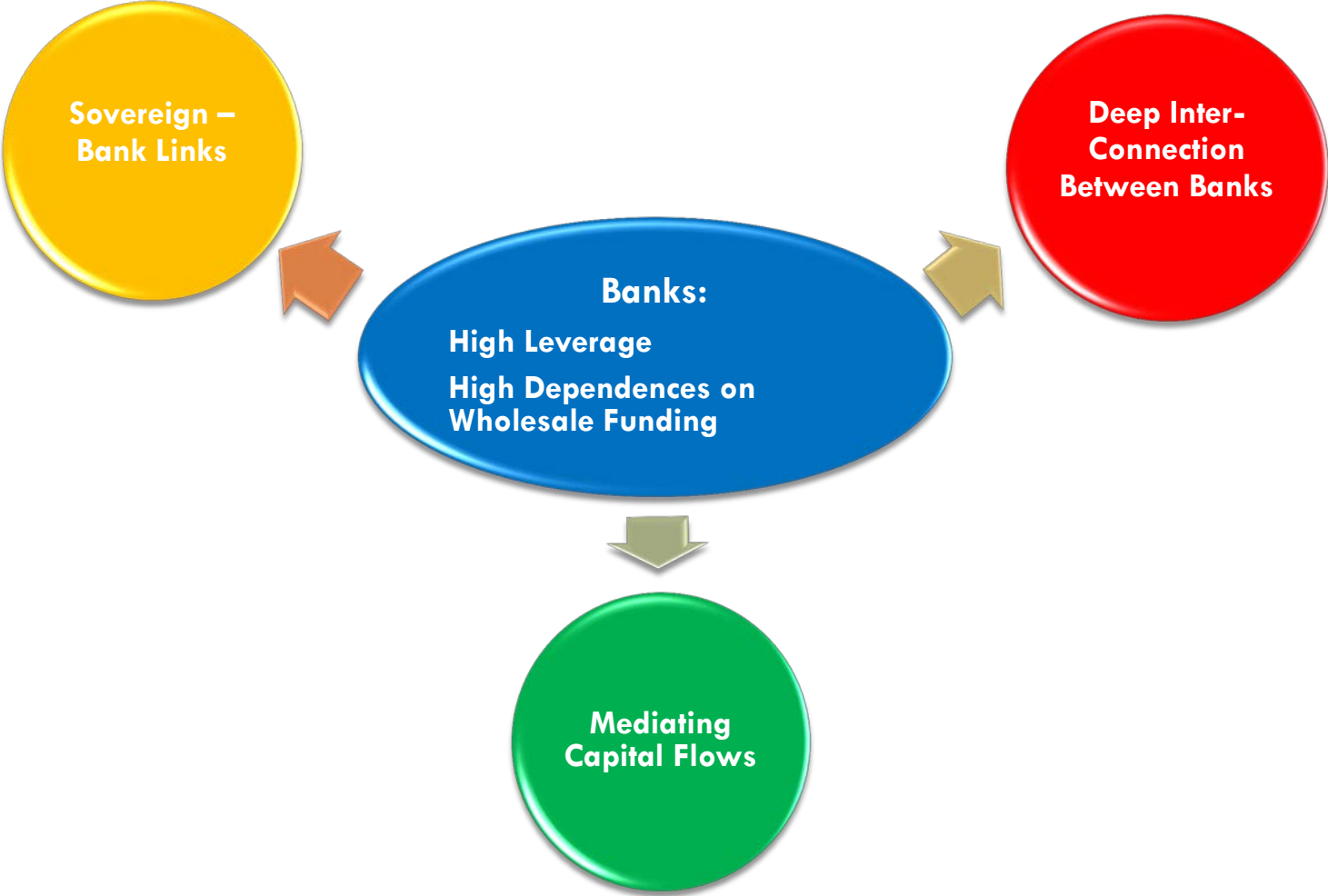
OIS (EUR SWAP/EONIA): Overnight indexed swap between the fixed and flow interest rate swap.

Basis Swap Spread (EUR-USD): Two parties swap variable interest rates between the EUR and USD money markets.

Long-term Refinancing Operations

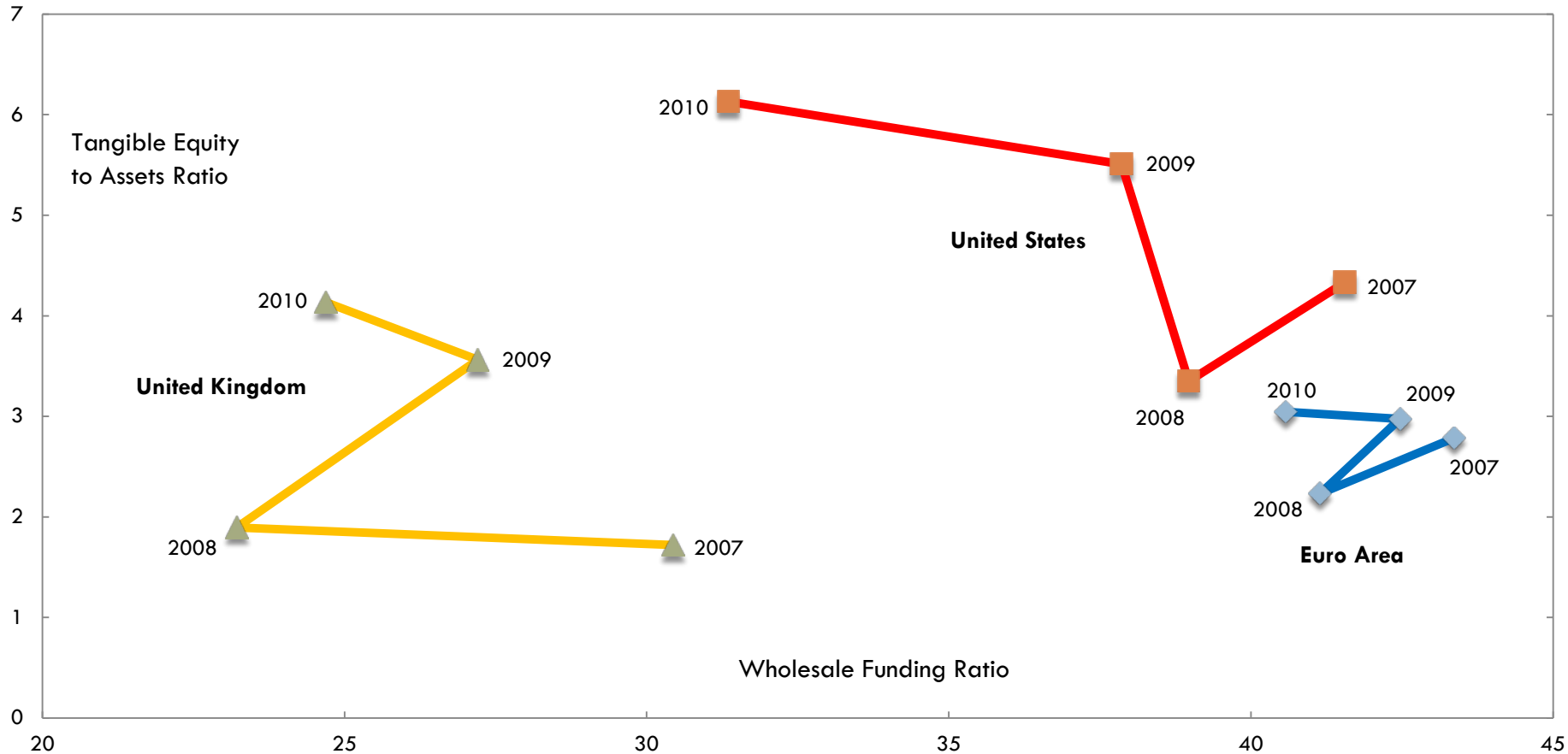


Banks at the Center of the Crisis



Leverage and Wholesale Funding

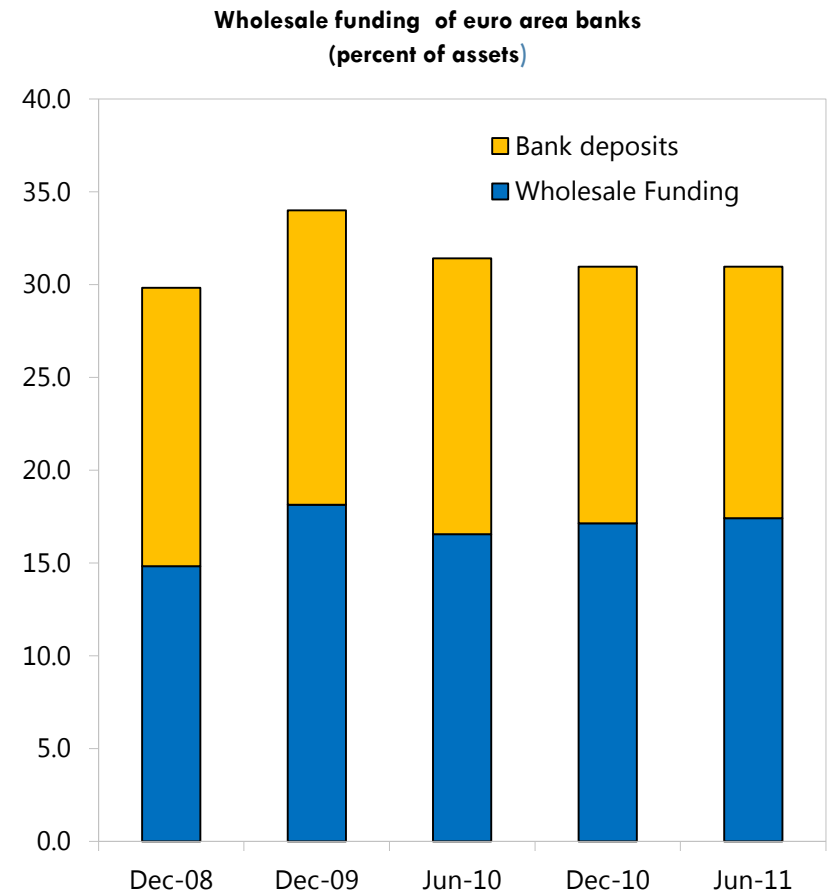
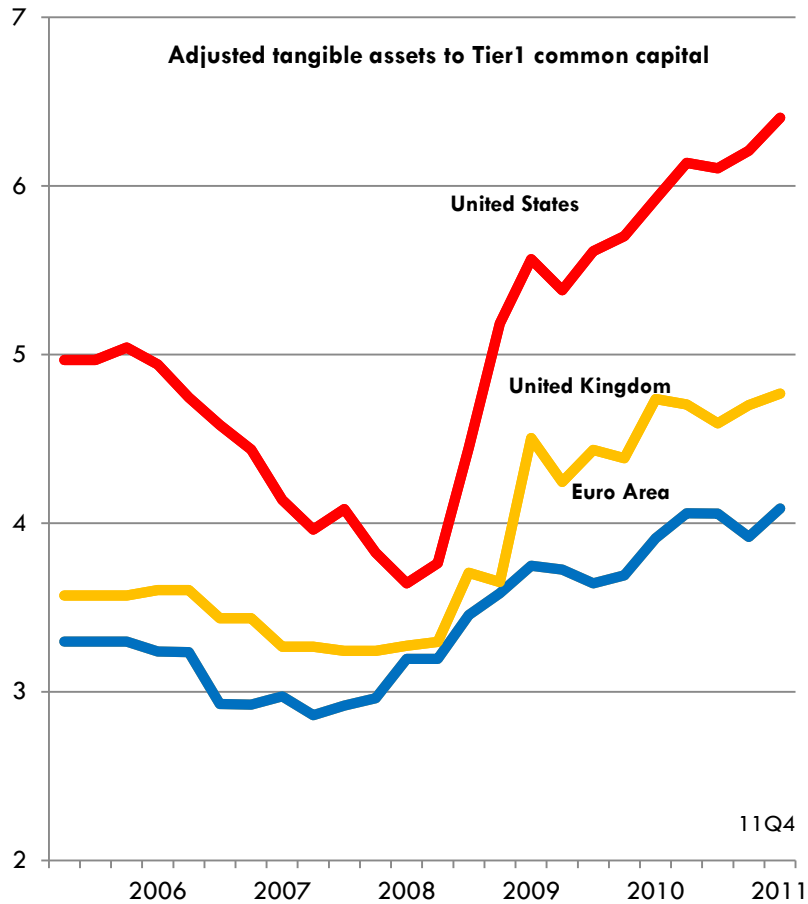
Euro area banks have made least progress in raising capital ratios and reducing reliance on wholesale funding



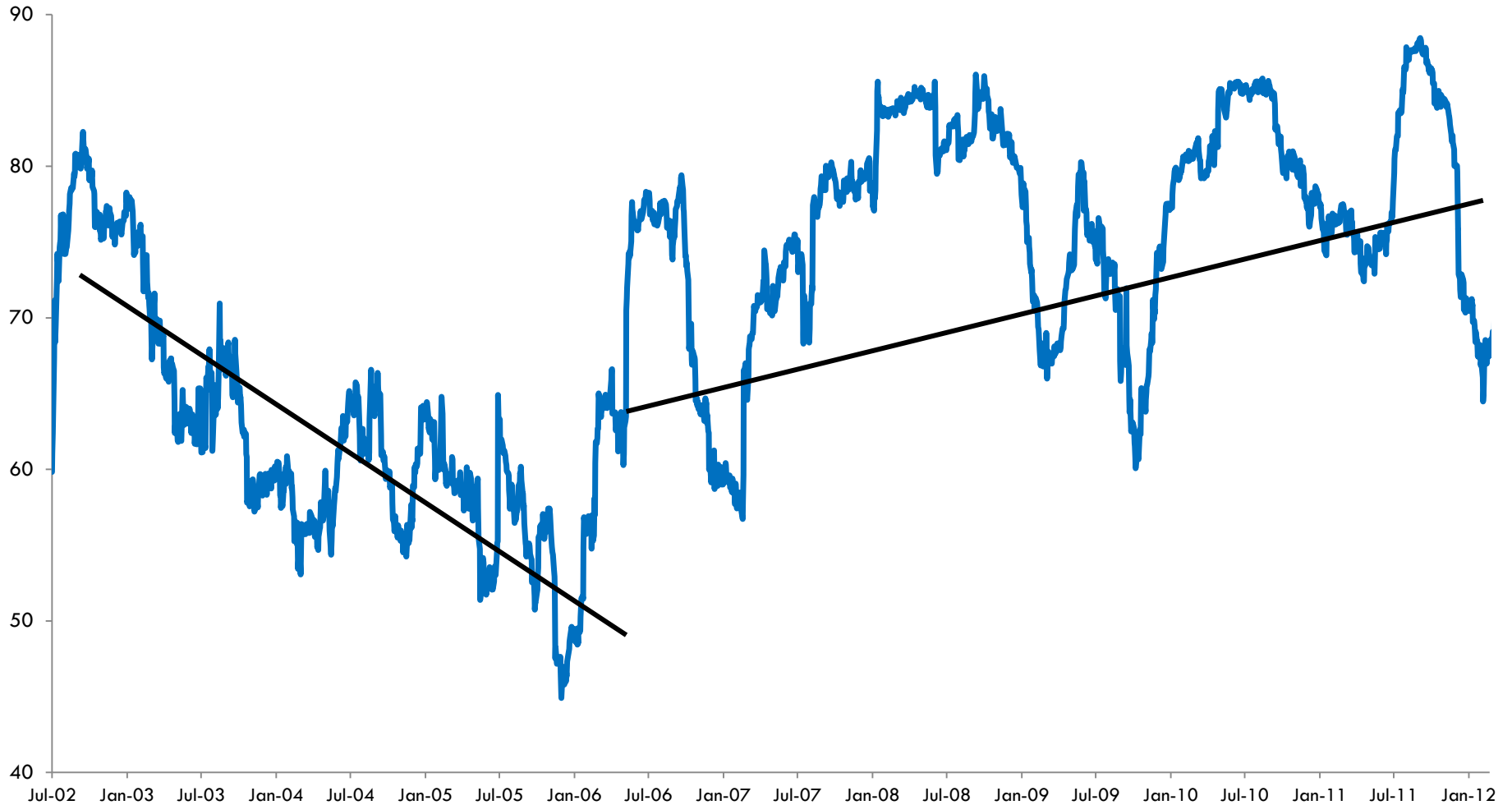
Note:

- 1/ Wholesale funding ratio is short and long-term borrowing and repos to assets.
- 2/ TCE ratio is tangible common equity to tangible assets

Leverage and Wholesale Funding: Update



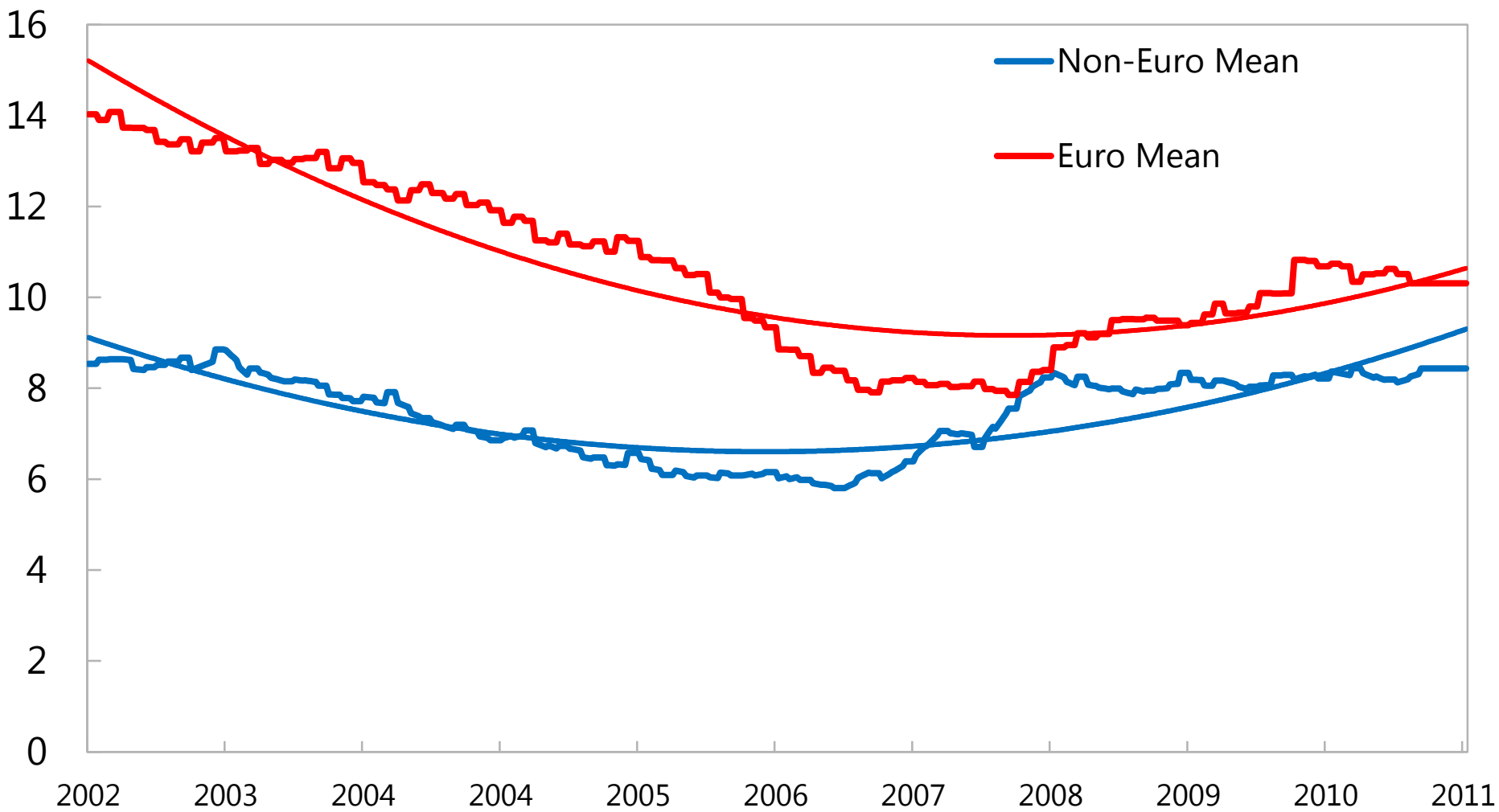
Eurozone Banks' Interconnectedness



Source: Kamil Yilmaz personal communication

Note: Interconnectedness is the fraction of the forecast error variances due to innovations in the stock prices of other banks.

Banking Sector Claims on the Government (percent of total banking sector claims)

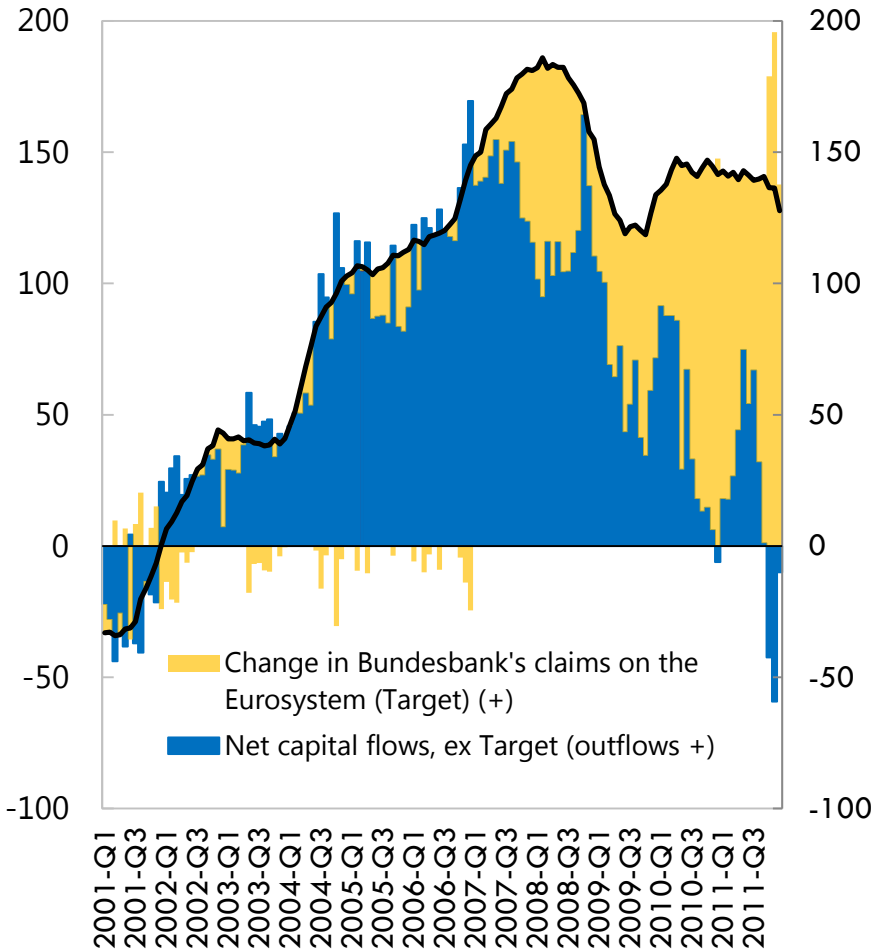


Sources: IMF IFS, WEO, author's calculations

Withdrawal of German Private Capital

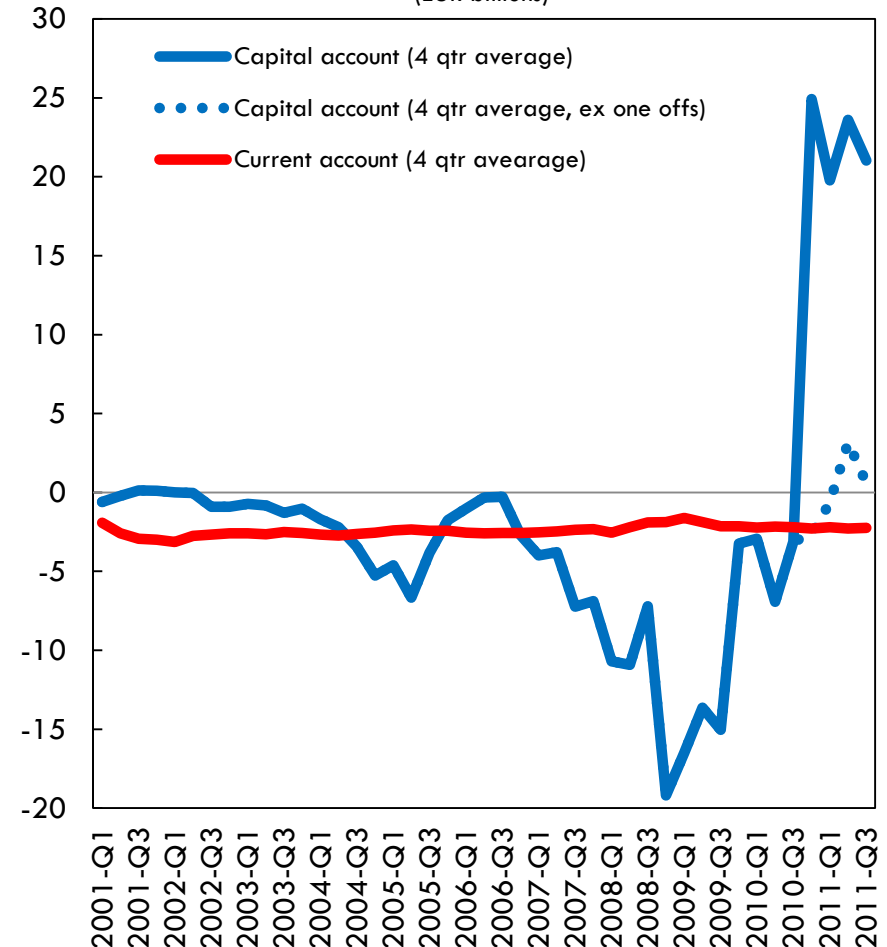
German Balance of Payments

(EUR billion, 12 month rolling sum)



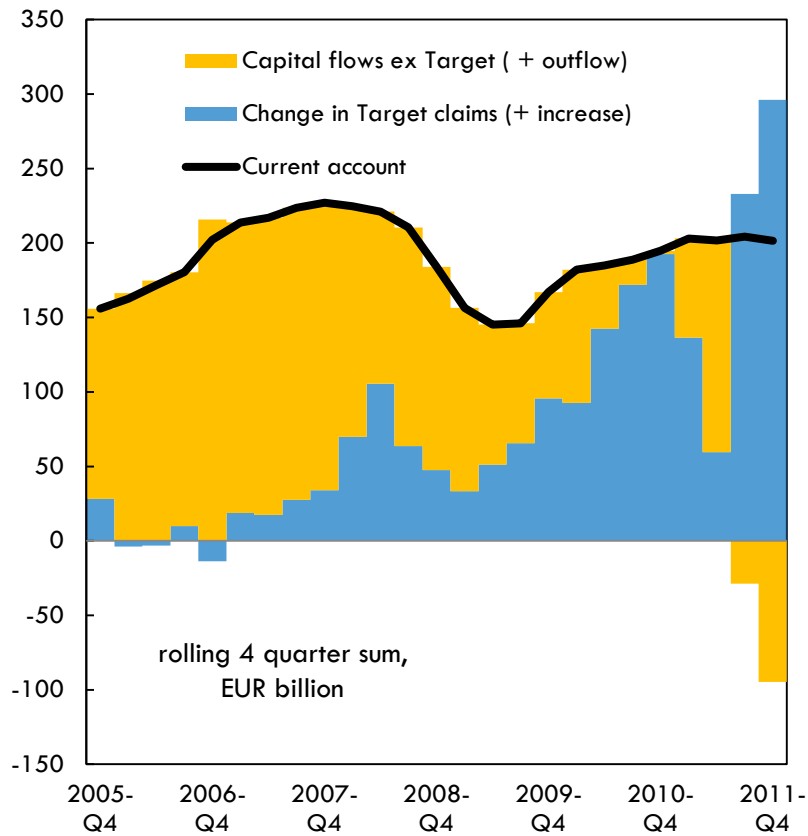
Ireland: Bilateral Flows vis-à-vis Germany

(EUR billions)

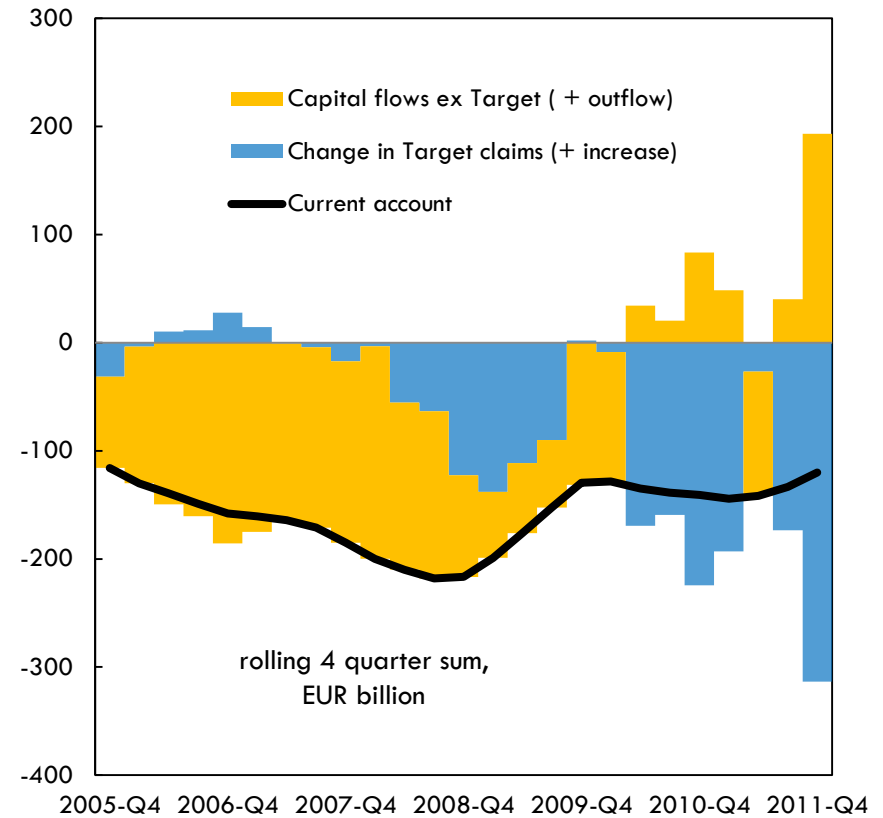


Capital Flow and Target Balances: An Aggregate Perspective

Germany, Finland, Netherlands



Greece, Ireland, Italy, Spain, Portugal



Final Thoughts

- “The treatment of imbalances within TARGET may be the most important piece of unfinished business for the ECB to tackle....” (Kenen, 2000)
- But resolving imbalances is not a technical matter—it is tied to the broader health of eurozone’s banking system
- Concurrent action is needed:
 - ▣ stemming capital flow reversal,
 - ▣ weakening the sovereign-bank links, and
 - ▣ inducing greater transparency in banks’ operations.
 - ▣ Ultimately, more proactive use of resolution powers is likely to be required.