EUROZONE BANKS AND CAPITAL FLOW REVERSAL

Ashoka Mody
Research Department
International Monetary Fund

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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

- Bank Term debt maturing 2012: 630
- LTRO operations (net): 313 (February), 200 (December)
- Sovereign Debt Purchases: 115
- LTRO used to bank cover term debt: 398

Banks at the Center of the Crisis

Sovereign – Bank Links

Banks:
- High Leverage
- High Dependences on Wholesale Funding

Deep Inter-Connection Between Banks

Mediating Capital Flows
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

Adjusted tangible assets to Tier1 common capital

Wholesale funding of euro area banks (percent of assets)

- Bank deposits
- Wholesale Funding

United States
- United Kingdom
- Euro Area

2006 2007 2008 2009 2010 2011
Dec-08 Dec-09 Jun-10 Dec-10 Jun-11
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
TARGET Imbalances

- Germany
- Netherlands
- Belgium
- France
- Italy
- GRC, IRL, PRT
- Spain

EUR billion

Mar-07, Jun-07, Sep-07, Dec-07, Mar-08, Jun-08, Sep-08, Dec-08, Mar-09, Jun-09, Sep-09, Dec-09, Mar-10, Jun-10, Sep-10, Dec-10, Mar-11, Jun-11, Sep-11, Dec-11
Withdrawal of German Private Capital

German Balance of Payments
(EUR billion, 12 month rolling sum)

Ireland: Bilateral Flows vis-à-vis Germany
(EUR billions)

- Change in Bundesbank's claims on the Eurosystem (Target) (+)
- Net capital flows, ex Target (outflows +)

- Capital account (4 qtr average)
- Capital account (4 qtr average, ex one offs)
- Current account (4 qtr average)
Capital Flow and Target Balances: An Aggregate Perspective

Graphs showing capital flows, changes in Target claims, and current accounts for Germany, Finland, Netherlands, and Greece, Ireland, Italy, Spain, Portugal, respectively.
“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.