

# The future of the Euro

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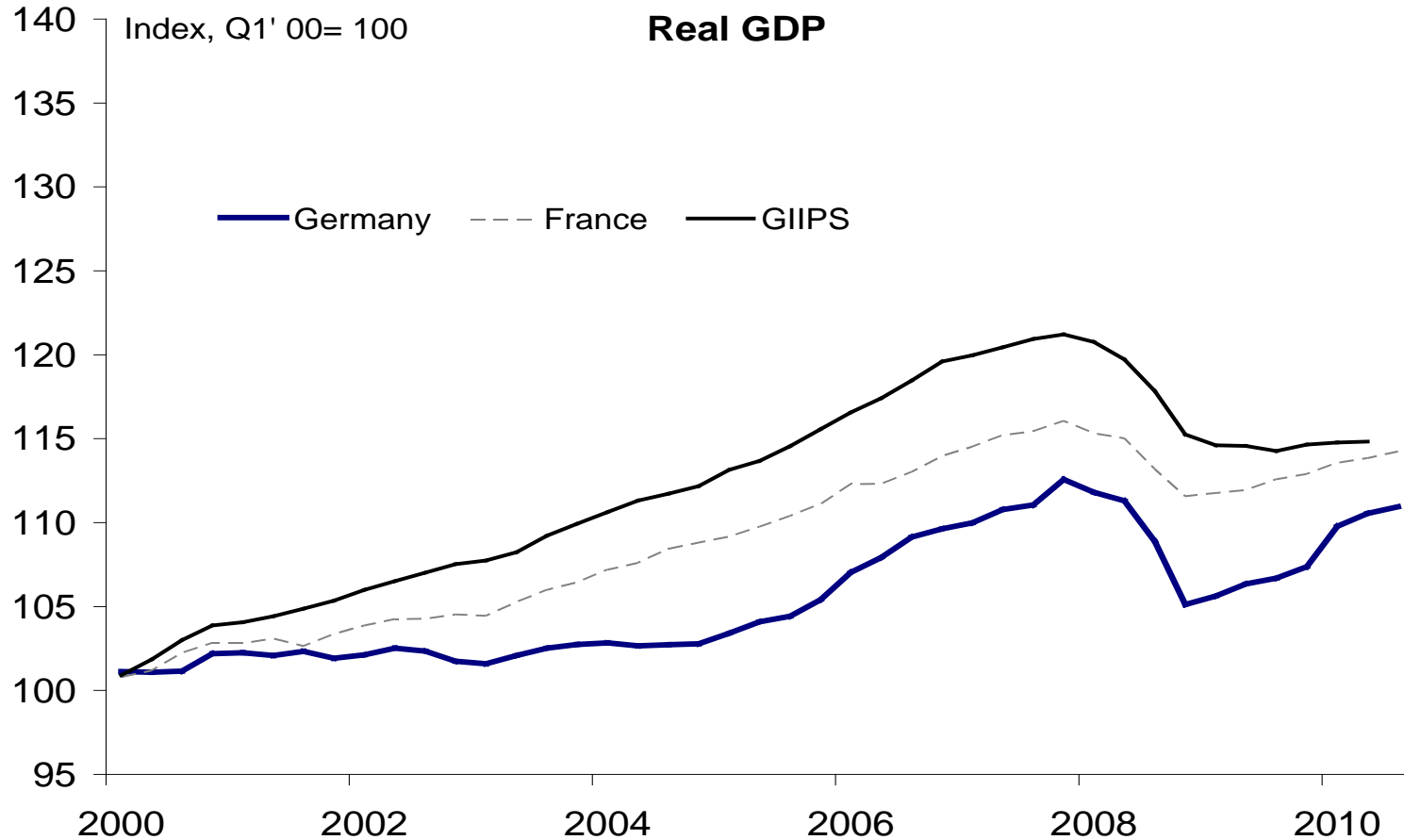
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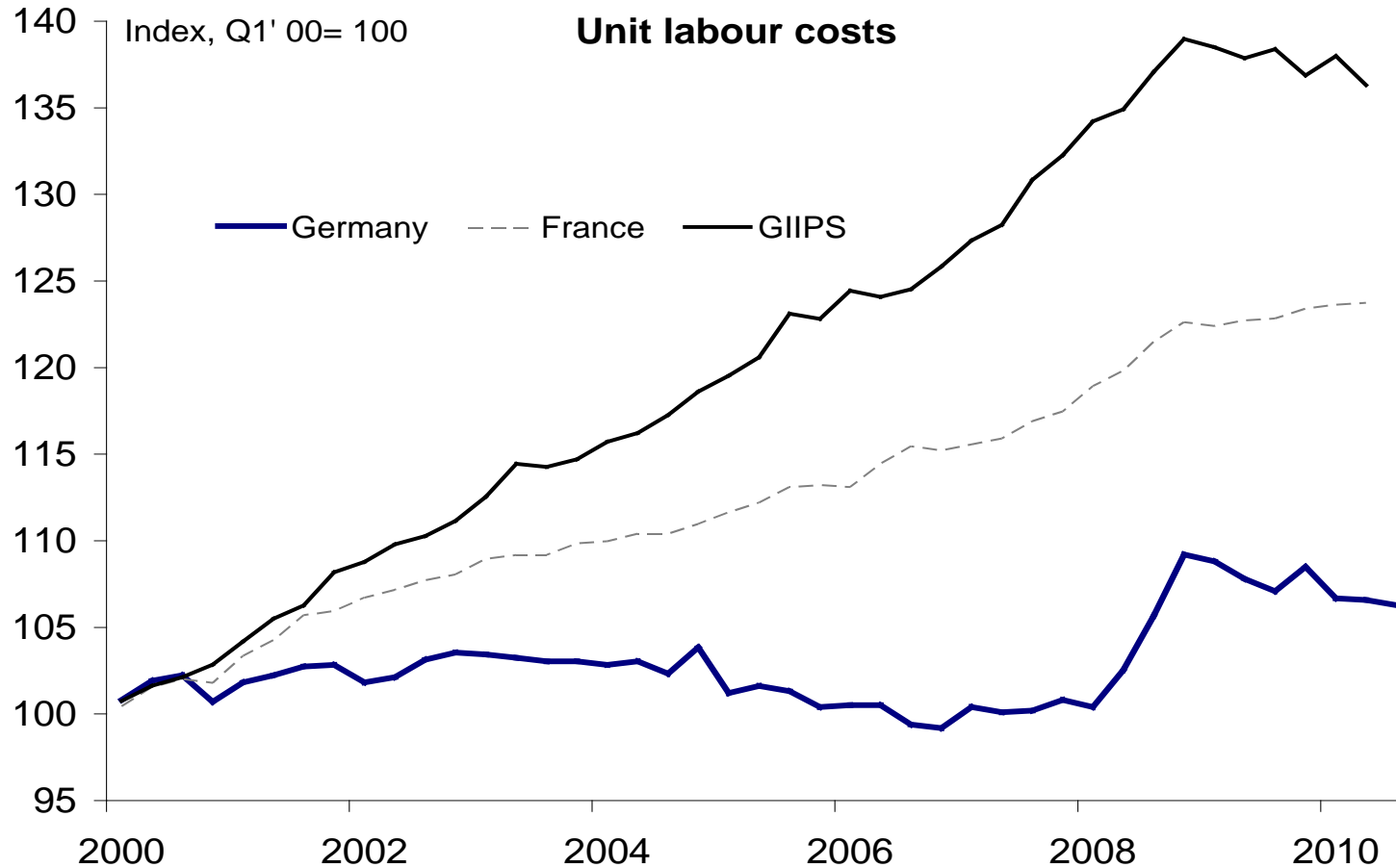
# The first 10 years of EMU were a big party for some...



Source: Haver



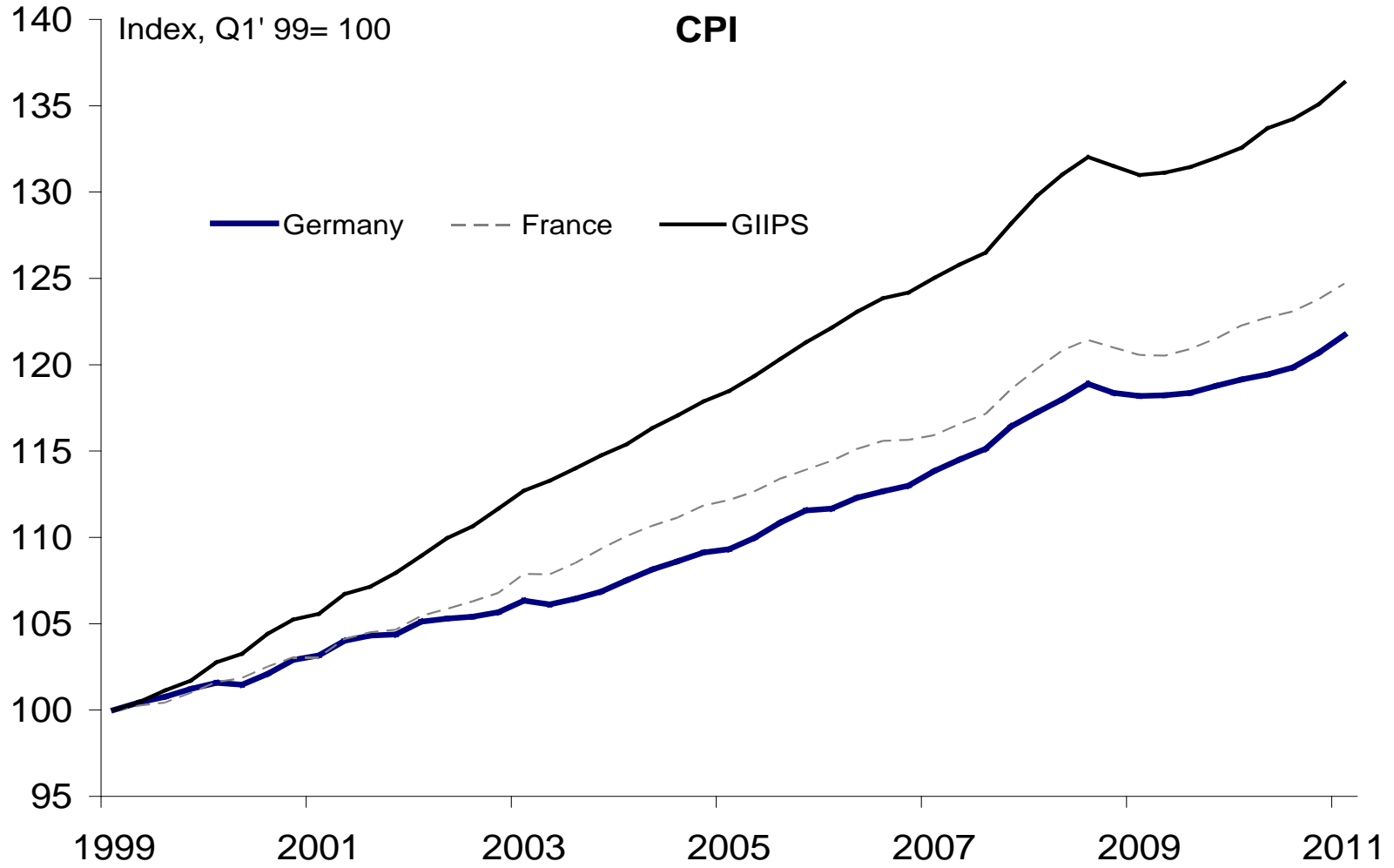
## ...where cost discipline was lost



Source: Haver



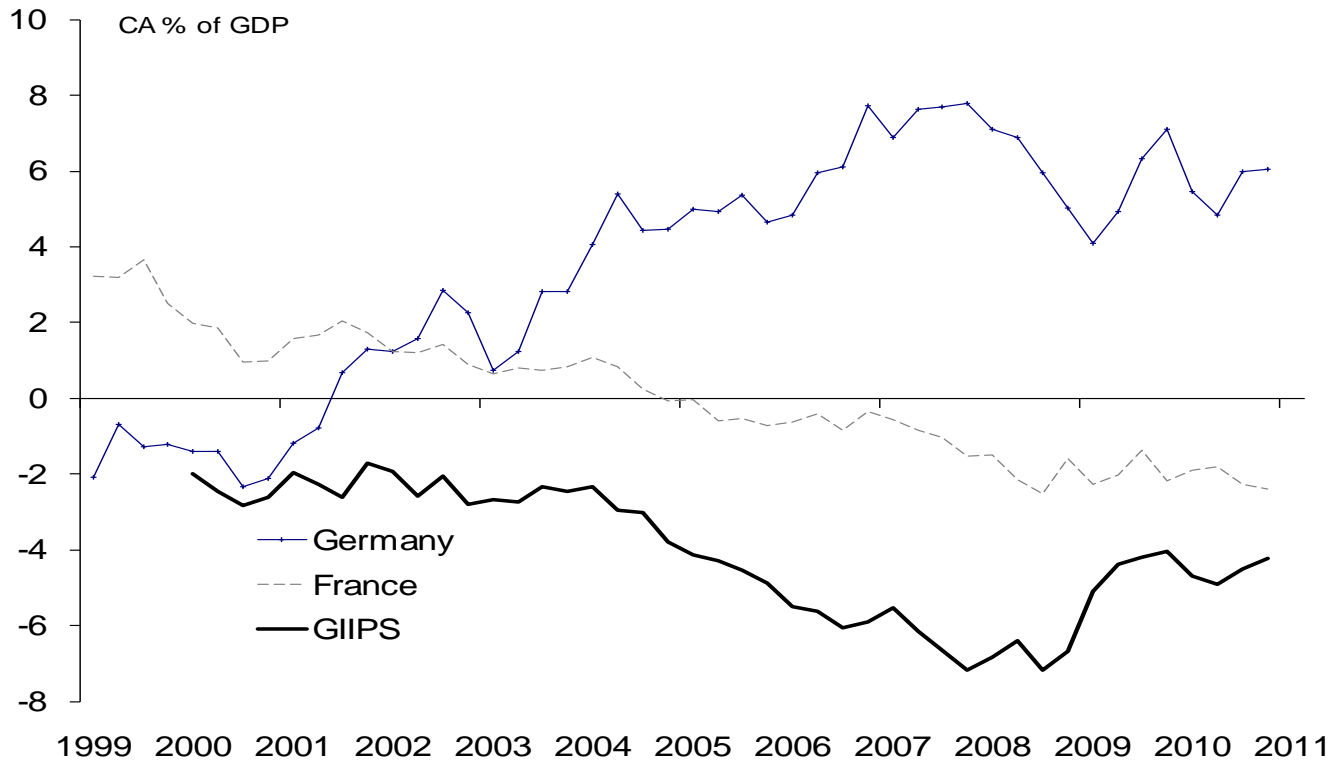
## ...where price discipline was lost



Source: Haver



# ...and where financing of external deficits was not (seen as) a problem



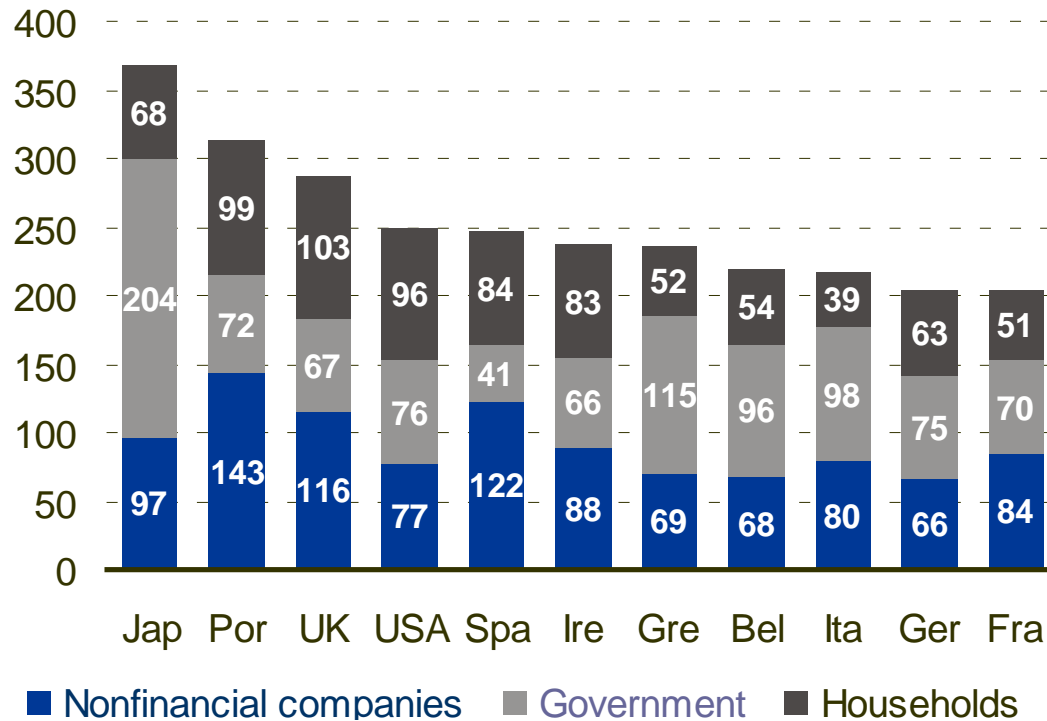
Source: Haver



# The era of debt...

## Debt of the non-financial sector

% GDP



Consolidated data, only UK data is non-consolidated

Most recent data, i.e. 2010: USA, Japan, Ireland 2009: UK, Germany, Portugal, Belgium, Greece, 2008: Spain, France, Italy

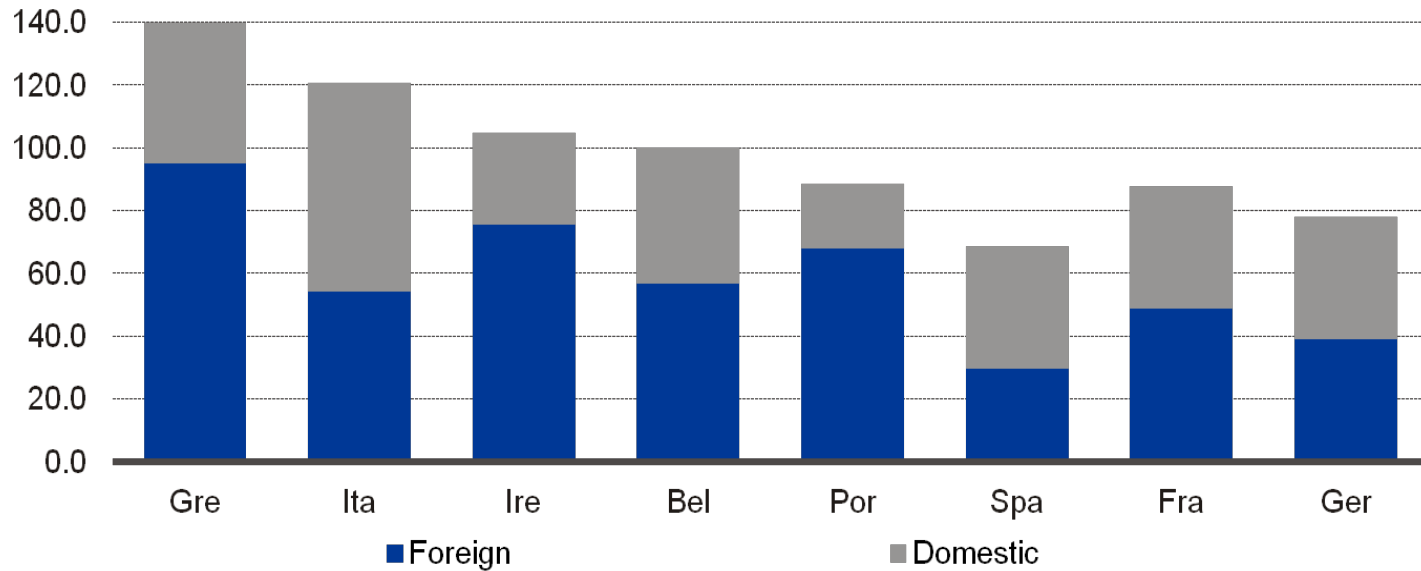
Source: Eurostat, Fed, BoJ, BIS



# ...created dependence on foreign investors

## Government debt 2011

%GDP



Note: Information on foreign vs. domestic based on 2009 data

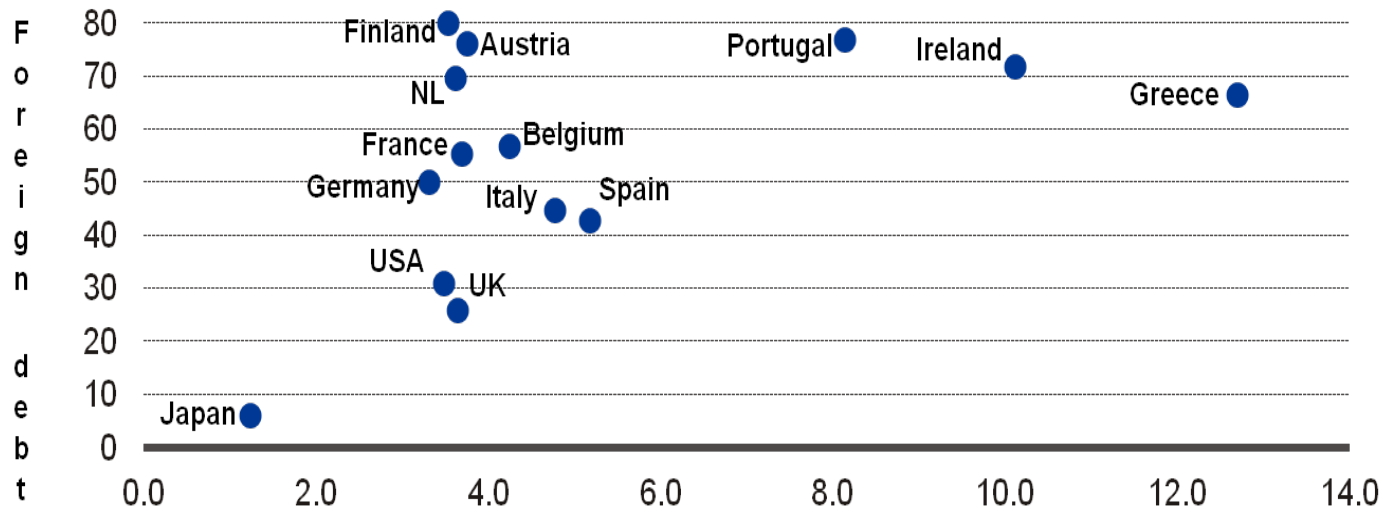
Source: OECD, Eurostat, DB Research



# Costly reliance on foreign borrowing

## Foreign government debt vs bond yields

% of total debt, yields in %



Note: Bond yields are up-to-date, foreign government debt: 2009 data

Bond yields

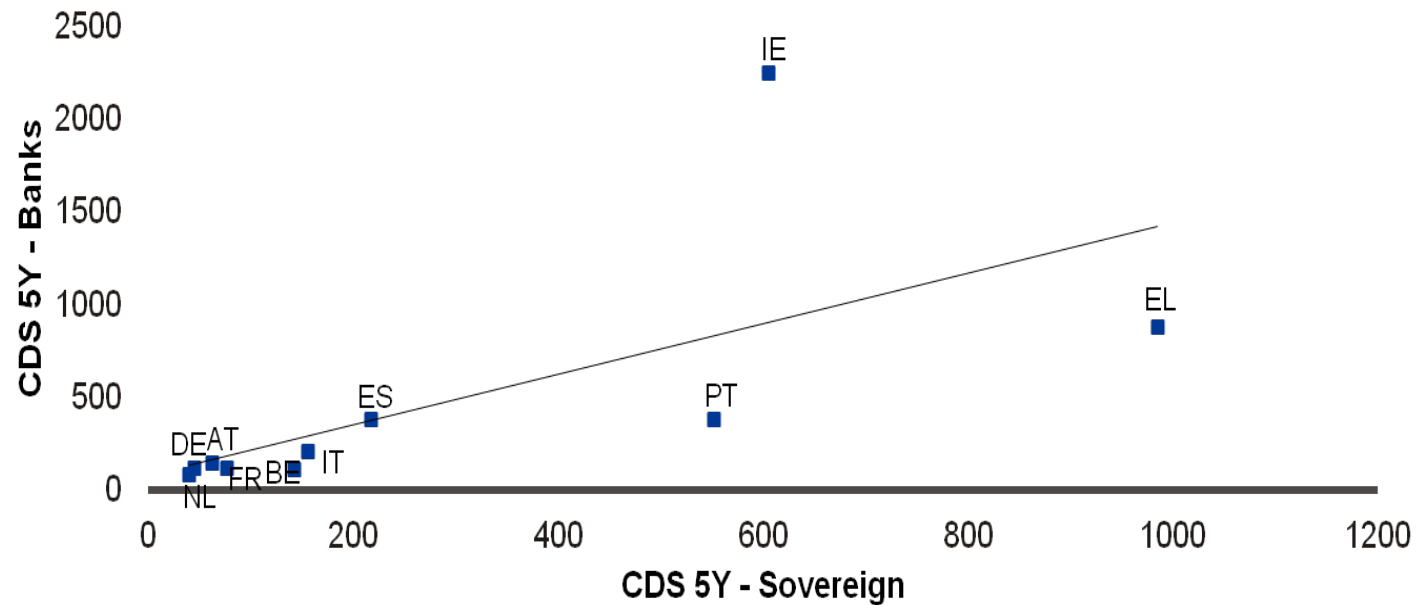
Source: Eurostat, National statistical offices



# Sovereign debt crisis affecting banks

## 2011 sovereign spreads and bank spreads

in bp



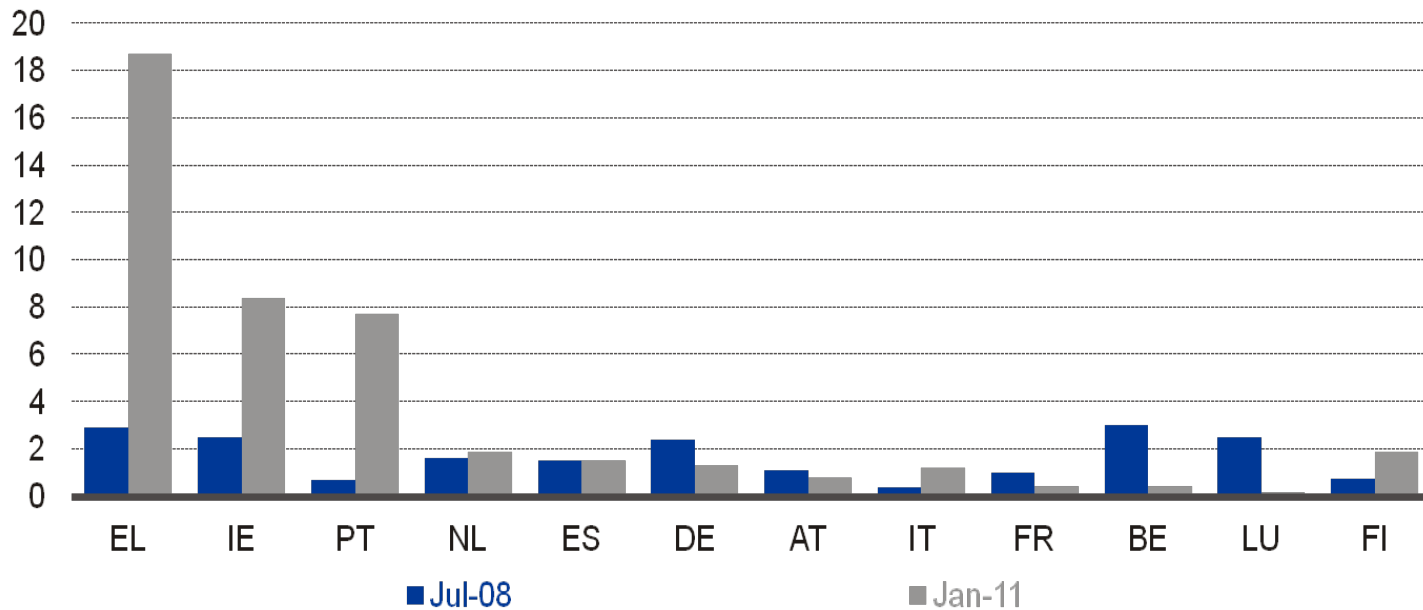
Source: Bloomberg, DB Research



# Banks relying on ECB

## ECB financing

Eurosystem lending to EA credit institutions as a % of MFIs total liabilities



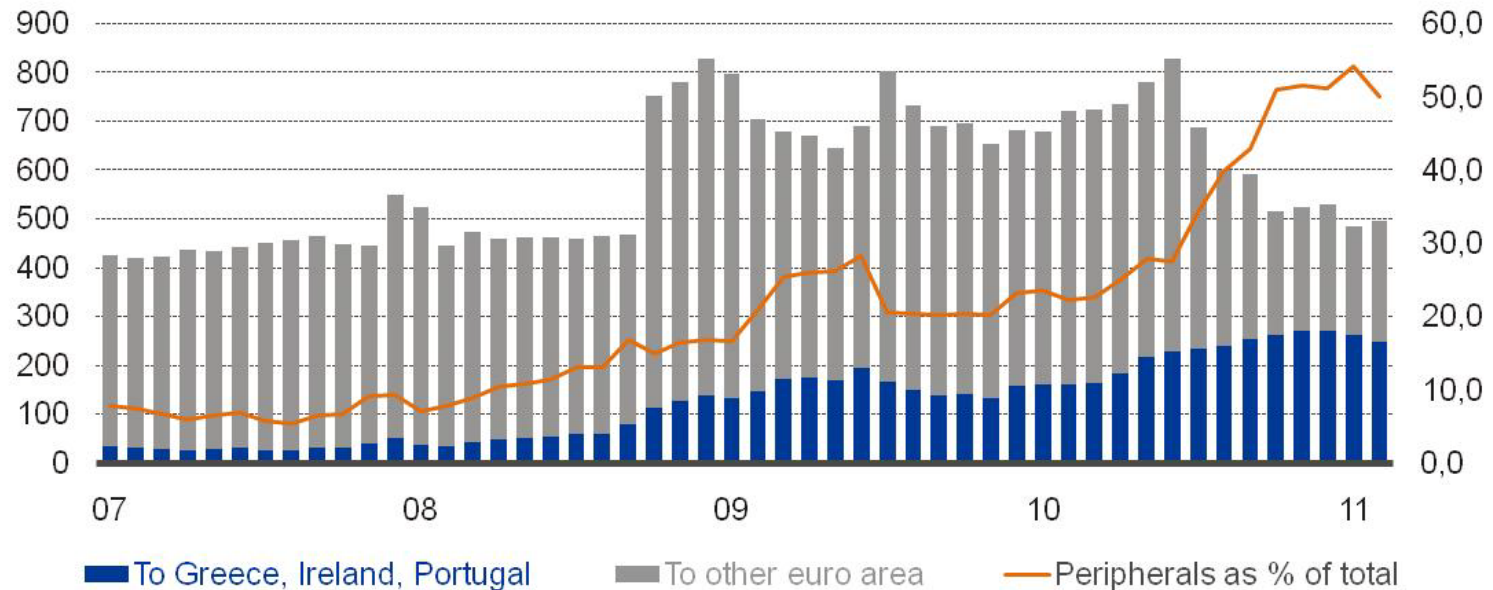
Source: National central banks, DB Research



# ECB lending concentrating on GIP

## Peripherals: ECB refinancing

EUR bn (left), % of total ECB standard refinancing (right)



Source: ECB, National Central Banks, DB Research

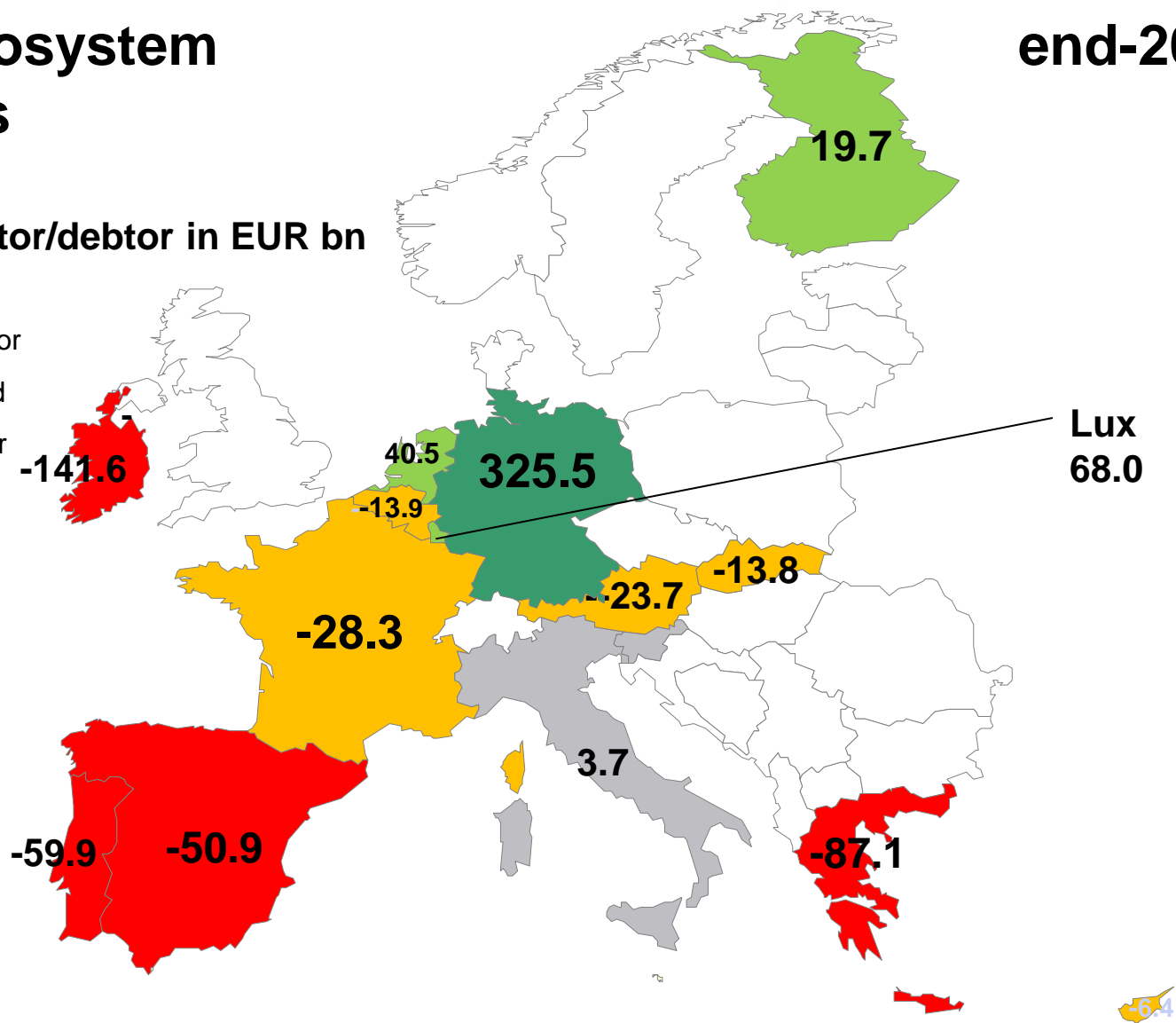


# Intra-eurosystem positions

end-2010

Range of creditor/debtor in EUR bn

- Major creditor
- important creditor
- Nearly balanced
- important debtor
- Major debtor



Recommendation: Read Garber (2010): „The Mechanics of Intra Euro Capital Flight”, DB Global Markets Research.

Source: Whittaker (2011) Intra-eurosystem debts



# Shifting exposures

## GIP: Public Debt by lender (bn EUR)

	2009	2010	2011E
Total public debt	531.1	623.5	678.3
Domestic banks	68.0	133.5	117.0
Foreign banks	137.0	106.5	95.5
National central banks	13.0	18.8	18.8
Other domestic investors	51.4	39.0	33.5
Other foreign investors	261.8	220.6	198.0
EU / IMF assistance	0.0	31.5	148.4
ECB SMP	0.0	73.5	66.8

Source: IFS, BIS, ECB, Bank of Greece, DB Research



# Bank exposures to risky countries

## GIP debt owed to foreign banks (end 2010, bn EUR)

	Greece	Ireland	Portugal	Total
German banks	19.2	2.5	6.0	27.7
French banks	14.5	4.8	11.8	31.0
Spanish banks	0.4	0.2	6.4	7.1
Italian banks	1.9	0.6	0.7	3.1
British banks	2.3	4.8	1.9	9.1
Japanese banks	0.4	1.1	0.9	2.4
US banks	1.3	1.1	1.2	3.6
Other EA banks	11.5	2.7	5.7	19.9
ROW	1.1	0.5	1.1	2.7
<b>Total</b>	<b>52.6</b>	<b>18.3</b>	<b>35.6</b>	<b>106.5</b>

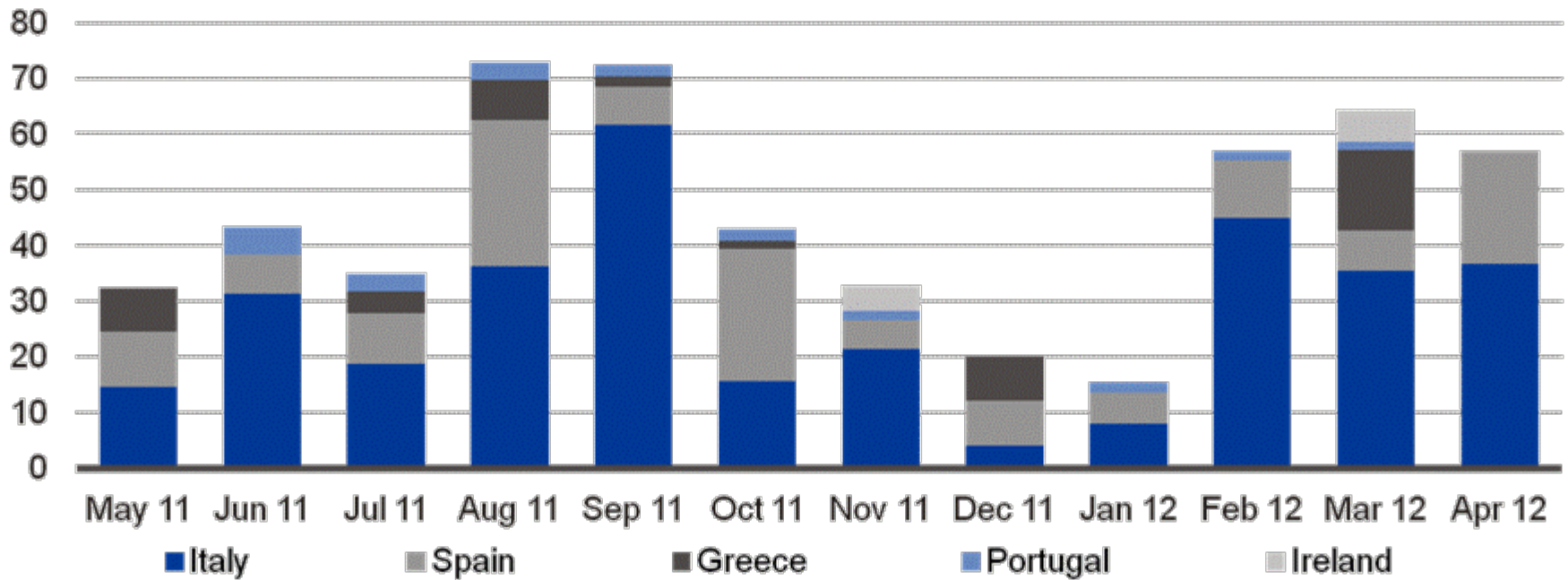
Source: BIS, DB Research



# Who can role and who can't?

## Government bond and bill redemptions

EUR bn

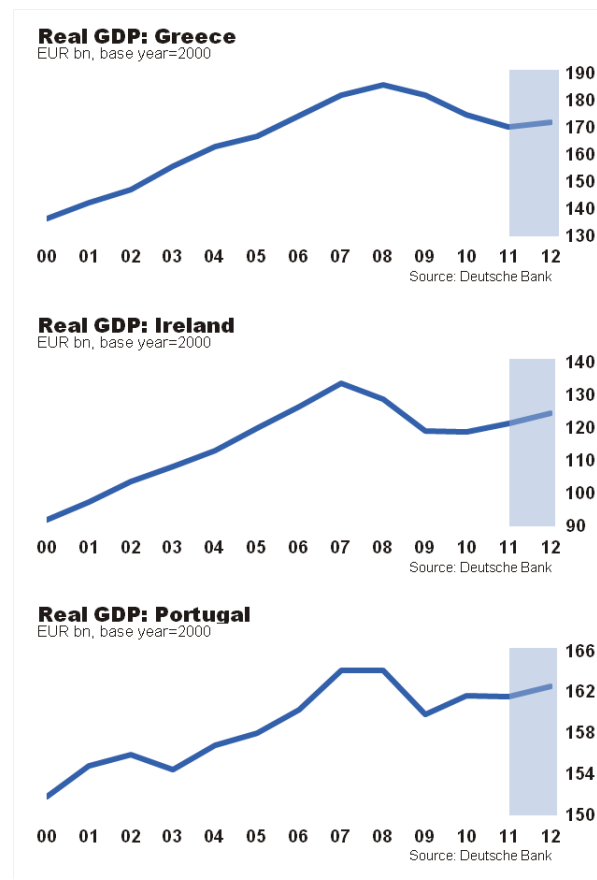
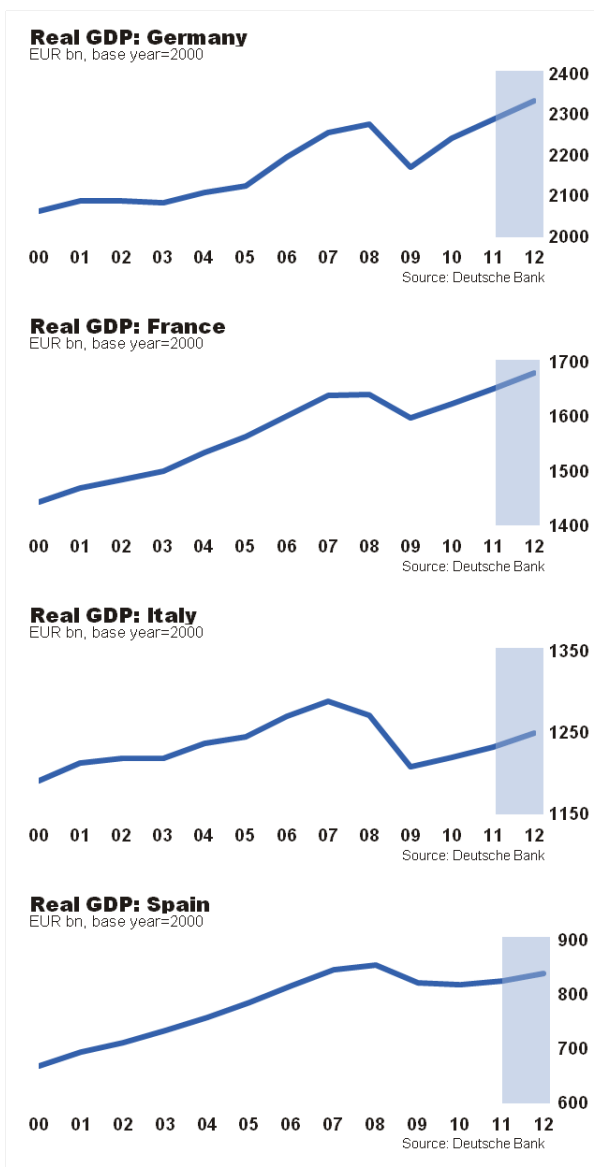


Source: Bloomberg

Source: DB Research



# Real GDP since 2000

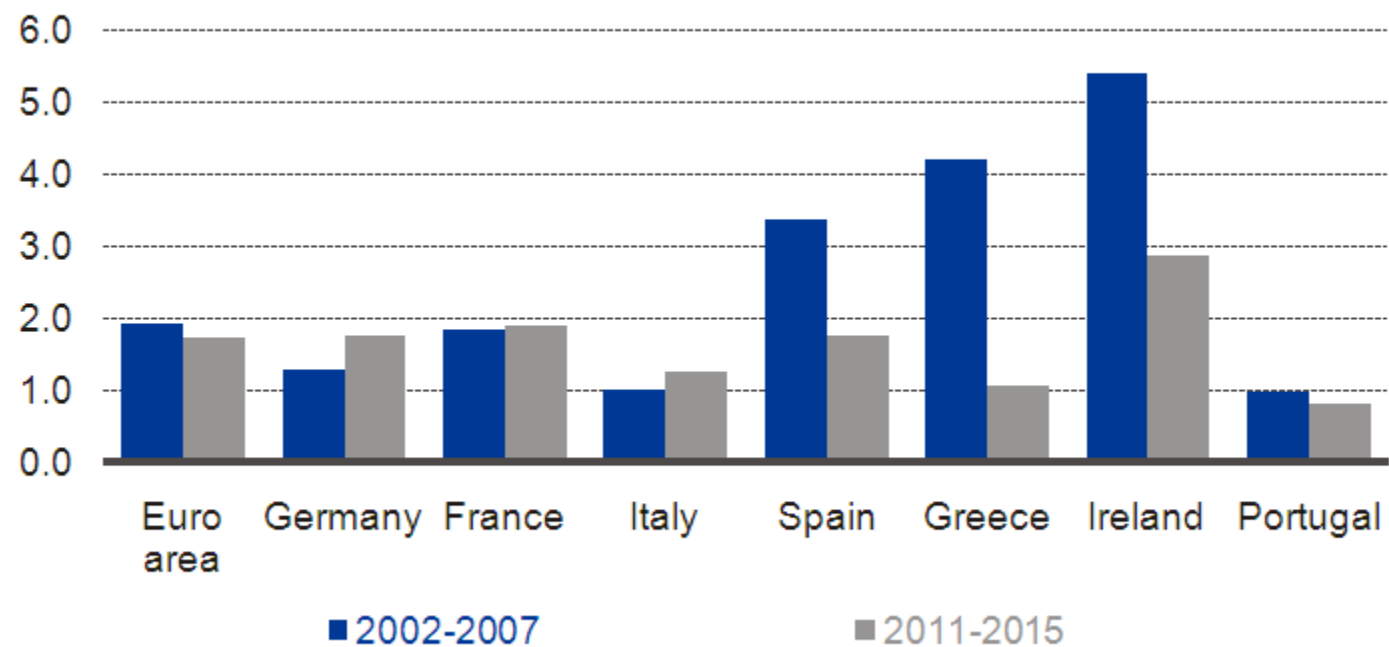




# Euroland forecast: Reversed growth divergence

## Real GDP growth 2011-2015

%yoy



Source: IMF WEO



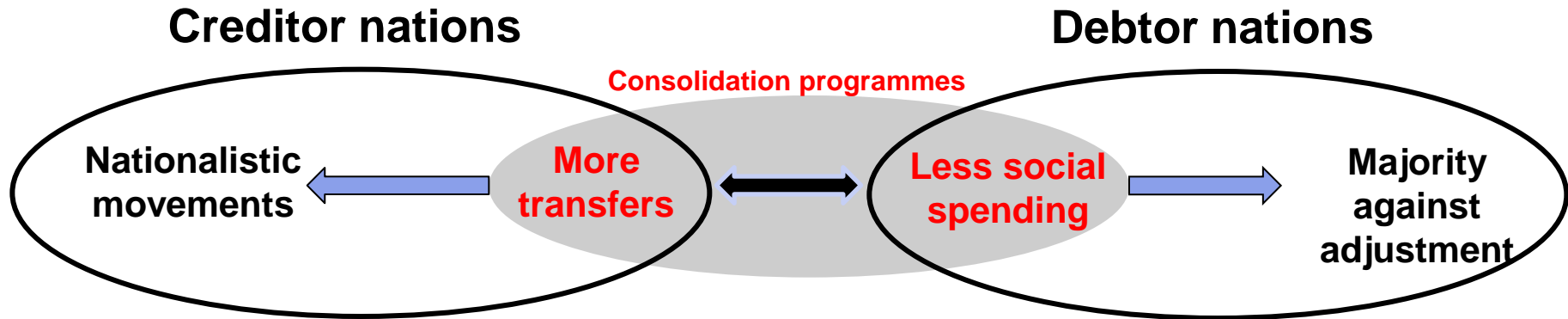
## Agreement on EMU reform: Missing another opportunity

- **Technical shortfalls:** (i) SGP reform omits automatic fines; (ii) Pact for the Euro vague if not firmly anchored in national legislation; (iii) Rise in EFSF lending capacity without clear purpose; (iv) Purchase of government bonds in primary market only a marginal improvement; (v) Operational details of ESM unclear (how is liquidity problem distinguished from solvency problem).
- **Basic flaw:** Present insolvencies continue to be treated as liquidity problems.
- **Consequence:** Continuous pressure for austerity in insolvent countries and continuous payments by solvent countries will create public resistance against EMU in both country groups. Risk of EMU breakup increases.



# Centrifugal forces within the European Monetary Union

Over-borrowing during the decade of easy credit has subjected EMU to a stress test



Without clear assignment of responsibilities of

1. national governments for national debt; and
2. ECB for price stability

a Eurozone break-up cannot be excluded.



# The (optimistic) view of the future EMU: a big Italy

## Italy

- Strong north
- Weak south
- Medium centre
- Weakish government

## EMU

- Strong centre (Germany, et al.)
- Weak periphery (Greece, et al.)
- Medium middle circle (France, et al.)
- Weakish government (in Brussels)



**Both holding together**



## Appendix

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