

The significance of the eurozone banking union on the road to stability

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US and Eurozone: Two “areas” with a single currency

	Share in world GDP	Share in world population	Public deficit (% GDP)	Public debt (% GDP)	GDP p.c. (bn \$)
US	23.5%	6.1%	7.3%	105%	48 328
EZ	22.4%	4.6%	3%	89.6%	34764

Before 2008, the euro area was living under the spell of a “feel good” factor

No asymmetries in State's (country's) growth rates

There was a single monetary policy working throughout the euro area

National fiscal policy was (apparently) kept in check

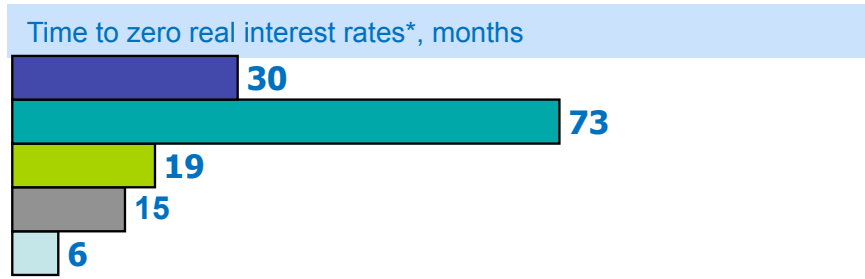
Current account imbalances (apparently) didn't matter

The euro area had a fast and united reaction to the 2008 crisis

POLICY

Monetary policy

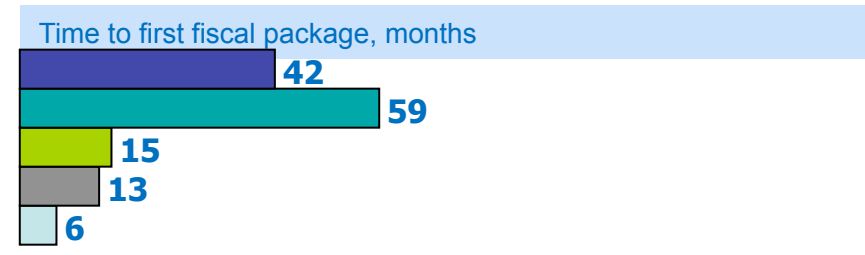
- Great Depression (Oct29)
- Japan (Jun91)
- Europe (Aug07)
- UK (Aug07)
- USA (Aug07)



*Using ex-post inflation for the Great Depression. Inflation expectations for Japan, Europe, UK, USA.

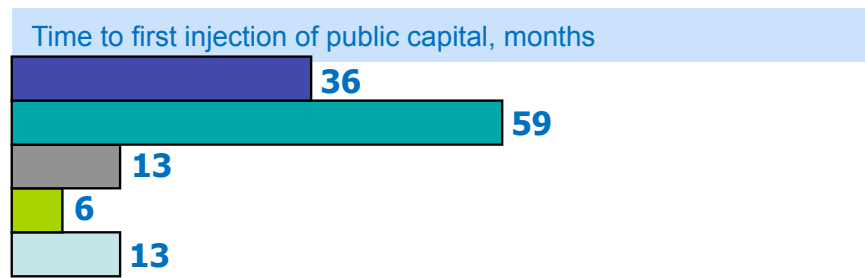
Fiscal policy

- Great Depression (Oct29)
- Japan (Jun91)
- Europe (Aug07)
- UK (Aug07)
- USA (Aug07)



Financial stabilization

- Great Depression (Oct29)
- Japan (Jun91)
- UK (Aug07)
- Europe (Aug07)
- USA (Aug07)



... but in 2010 everything changed

**On the radar
problems that
came back to
haunt the euro
area**

Structural differences (flexibility in product and labor markets)

One-fits-all fiscal policy (and market's misreading of the "no bail out" clause)

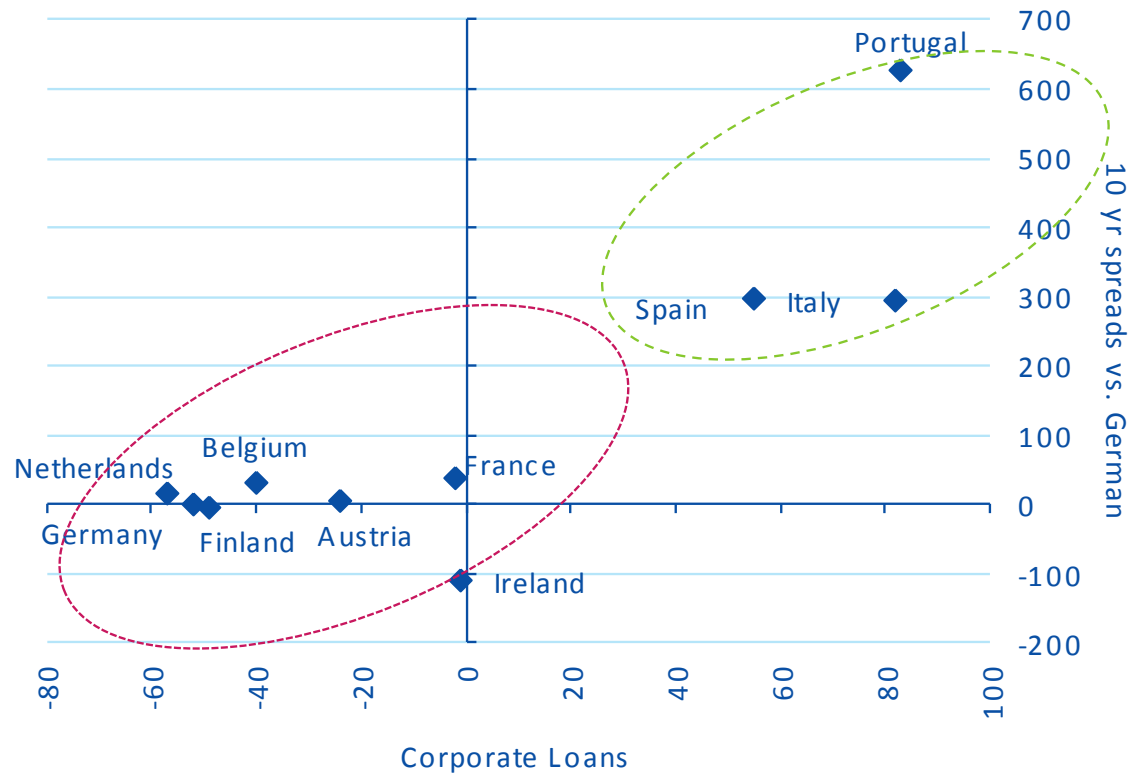
**Off the radar
problems that
compounded
the picture**

The financial integration reversal among euro area countries

The negative feedback loop between bank and sovereign risk
(and the related current account crisis)

Interest rates closely related to the zip code

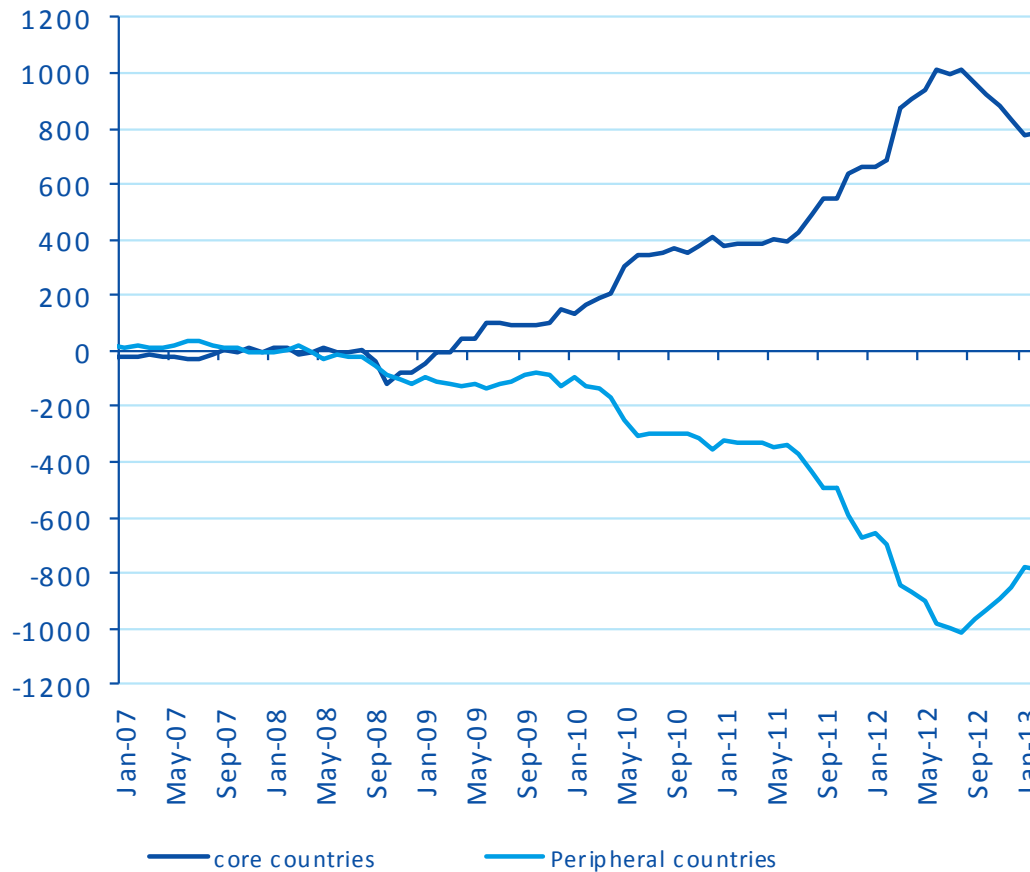
Change in interest rates on new bank loans and Change in 10yr spreads vs. Germany, (Basis points, dec-10 a jul-12)
 Source: IMF, Bloomberg and BBVA Research



National central banks taking the place of the interbank market

TARGET2 position vs the Eurosystem (+) creditor position / (-) debtor position), bn €

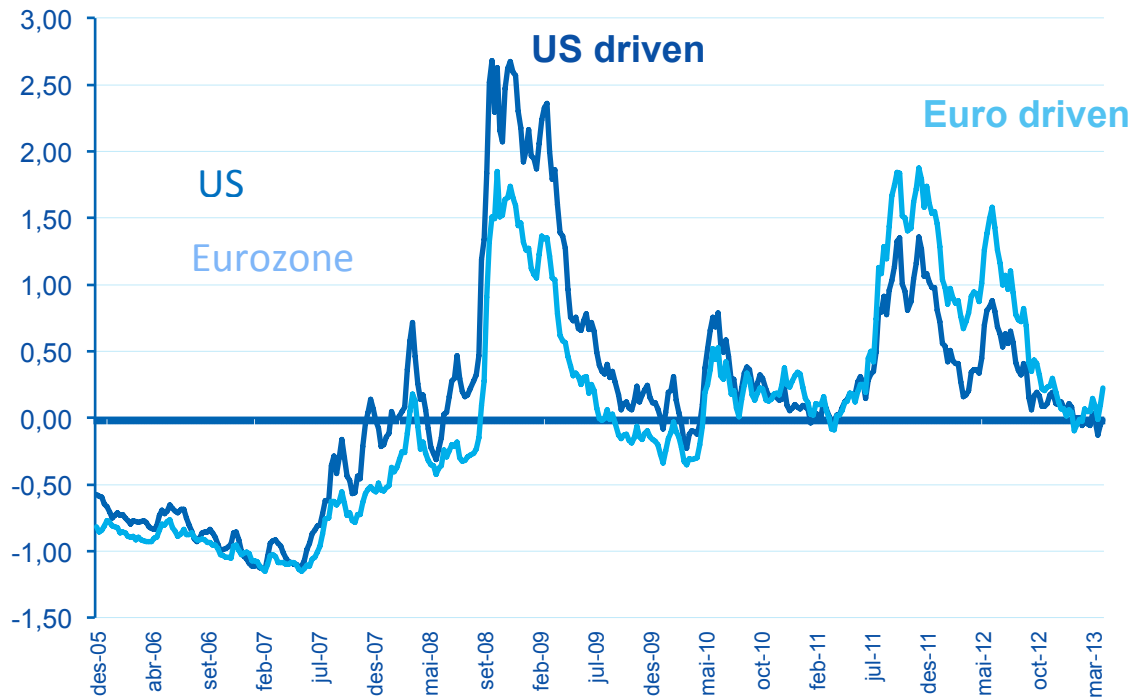
Source: National central Banks and BBVA Research



The euro area crisis has the potential to destabilize the rest of the world economy

Financial stress index

Source: Bloomberg and BBVA Research

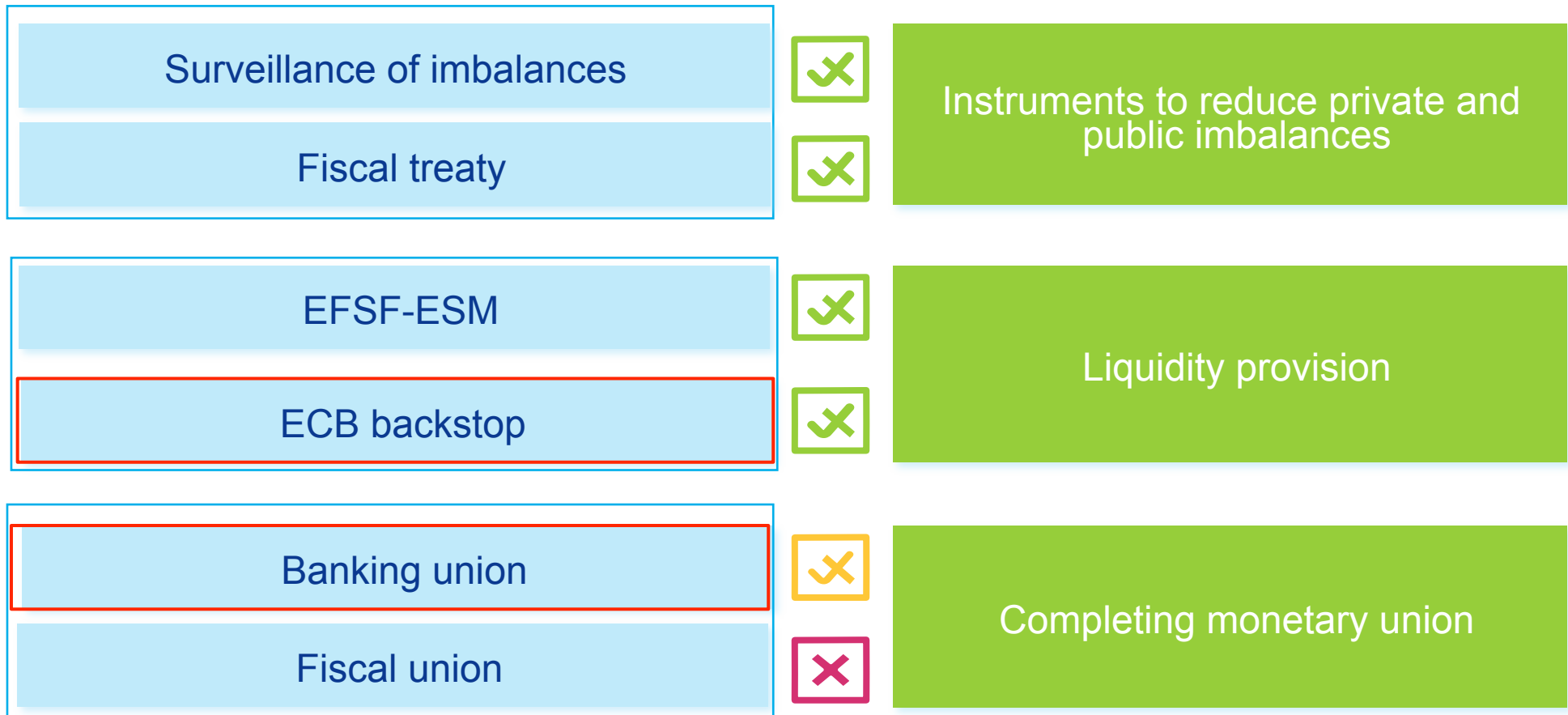


The tale of two small economies: Nevada vs Ireland

	Population	GDP (bn \$)	Unemployment	No. banks bust	Loss absorber	Financial crisis
Nevada	2.7	120	13.5%	11	FDIC	No
Ireland	4.5	200	14.5%	2?	Irish sovg.	Yes

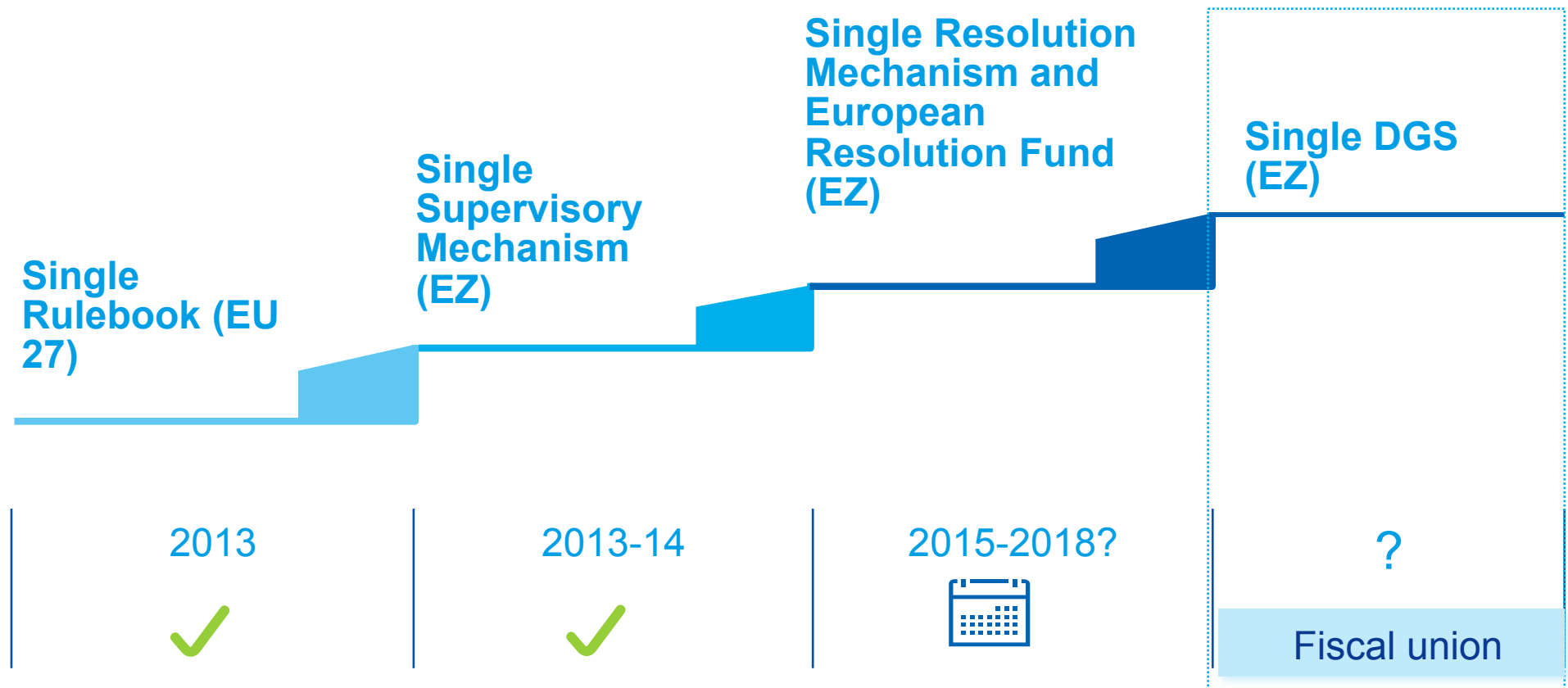
Source: Daniel Gross, CEPS, 2013

The road to a solution: The strategy is focused now on the ECB backstop + Banking union





Banking Union: An ambitious project



The benefits of a banking union

Single supervision reduces banking fragmentation and restores interbank market

A single resolution scheme with participation of the private sector increases incentives for core countries (Germany) to mutualize (part of) the resolution funds

Banking union helps breaking the loop between banking and sovereign risk

Convergence of financing costs and evolution towards trans-european banks and recovery of the financial integration that is key to the survival of the euro area

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