

Bigger than the GFC

TARGET2 and the Euro crisis

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Payments conference

Do we really need to talk about Europe again?



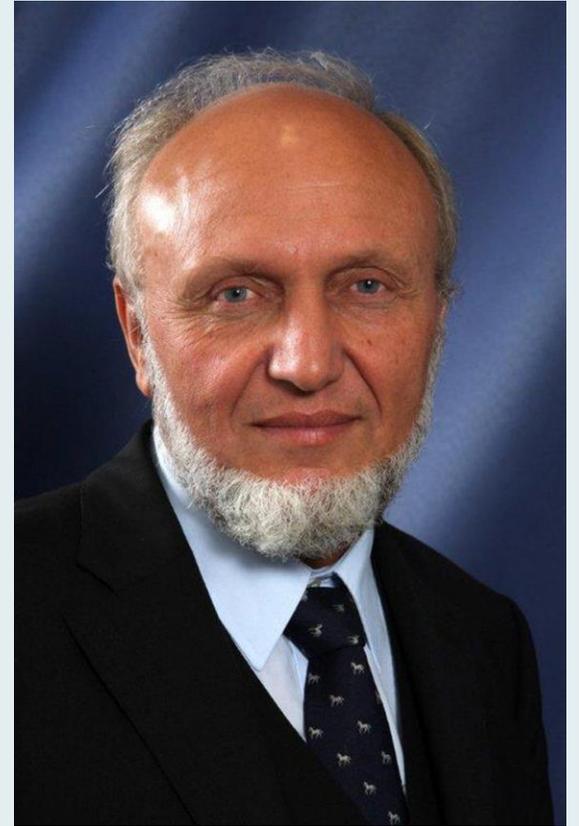
Do we really need to talk about Europe again?

- The Euro crisis has disappeared from the front pages.
- The Greek bailout programme is coming to an end.
- The ECB will stop its bond-buying programme in December.
- Eurozone GDP growth forecast to reach 2.5 percent in 2018.
- Eurozone unemployment at 8.5 percent (down from a peak of 12.1 percent in 2013).

So the Euro crisis is over, or is it?

TARGET2: The hidden side of the Euro crisis

- 2011: Discovery of a hidden ECB bailout mechanism by German top economist Hans-Werner Sinn.
- Trans-European Automated Real-time Gross Settlement Express Transfer System, short: TARGET2.



Hans-Werner Sinn

TARGET2: The hidden side of the Euro crisis

ECB definition:

“TARGET2 settles payments related to monetary policy operations, interbank and customer payments, and payments relating to the operations of all large-value net settlement systems and other financial market infrastructures handling the euro (such as securities settlement systems or central counterparties).”



TARGET2: The hidden side of the Euro crisis

- TARGET2: An ordinary clearing mechanism between the Eurosystem's banks.
- But what should that have to do with the Euro crisis?
- It's highly complicated ... so let's first explain what is going on in Europe with a metaphor.



What Monopoly can teach us about the Eurozone



Some stylised facts about intra-European trade

Before the introduction of the Euro:

- Differences in competitiveness resulting in frequent exchange rate adjustments.
- No significant or persistent trade imbalances.

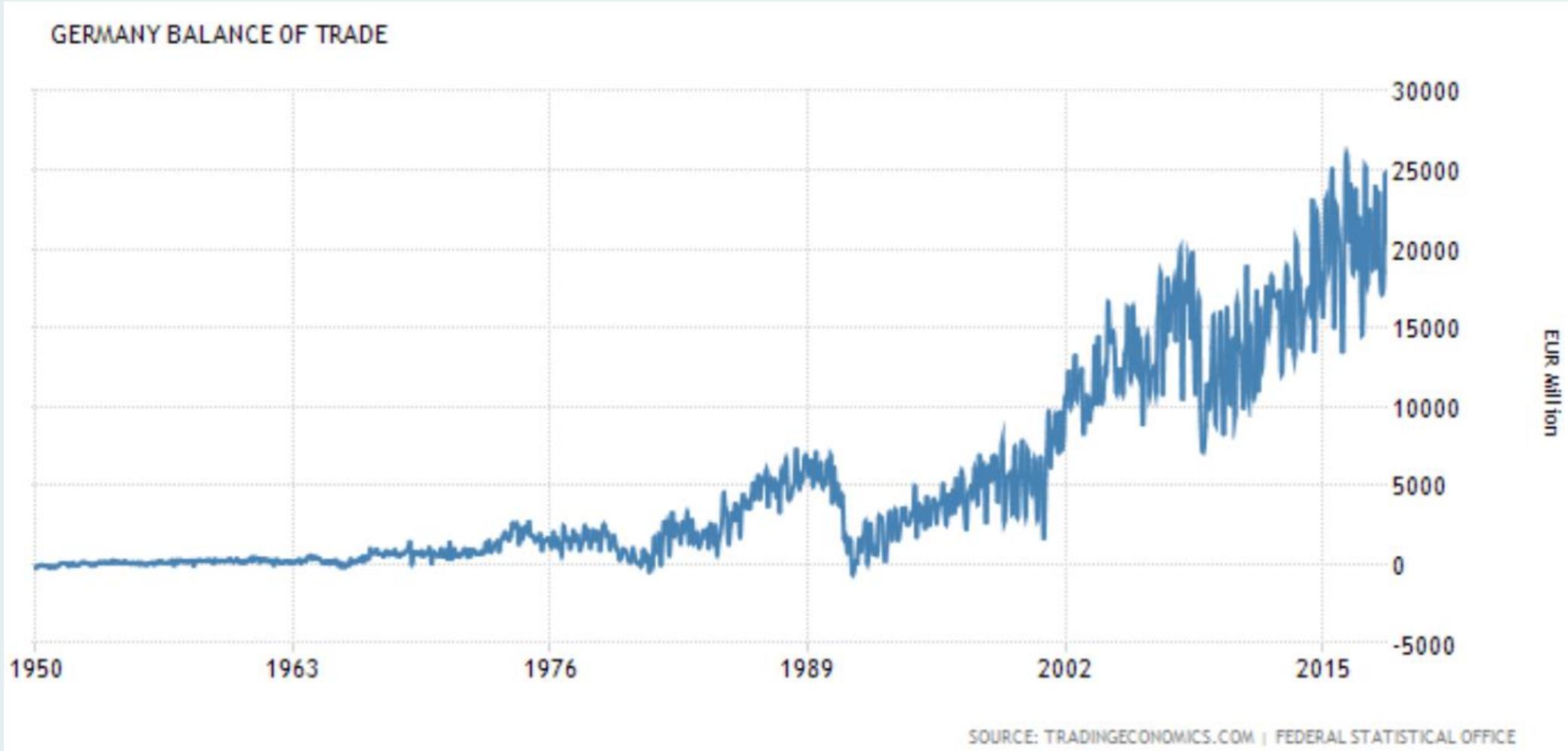
After the introduction of the Euro (1999):

- Fixed exchange rates requiring different adjustments to competitiveness divergences.
- Development of substantial trade imbalances.

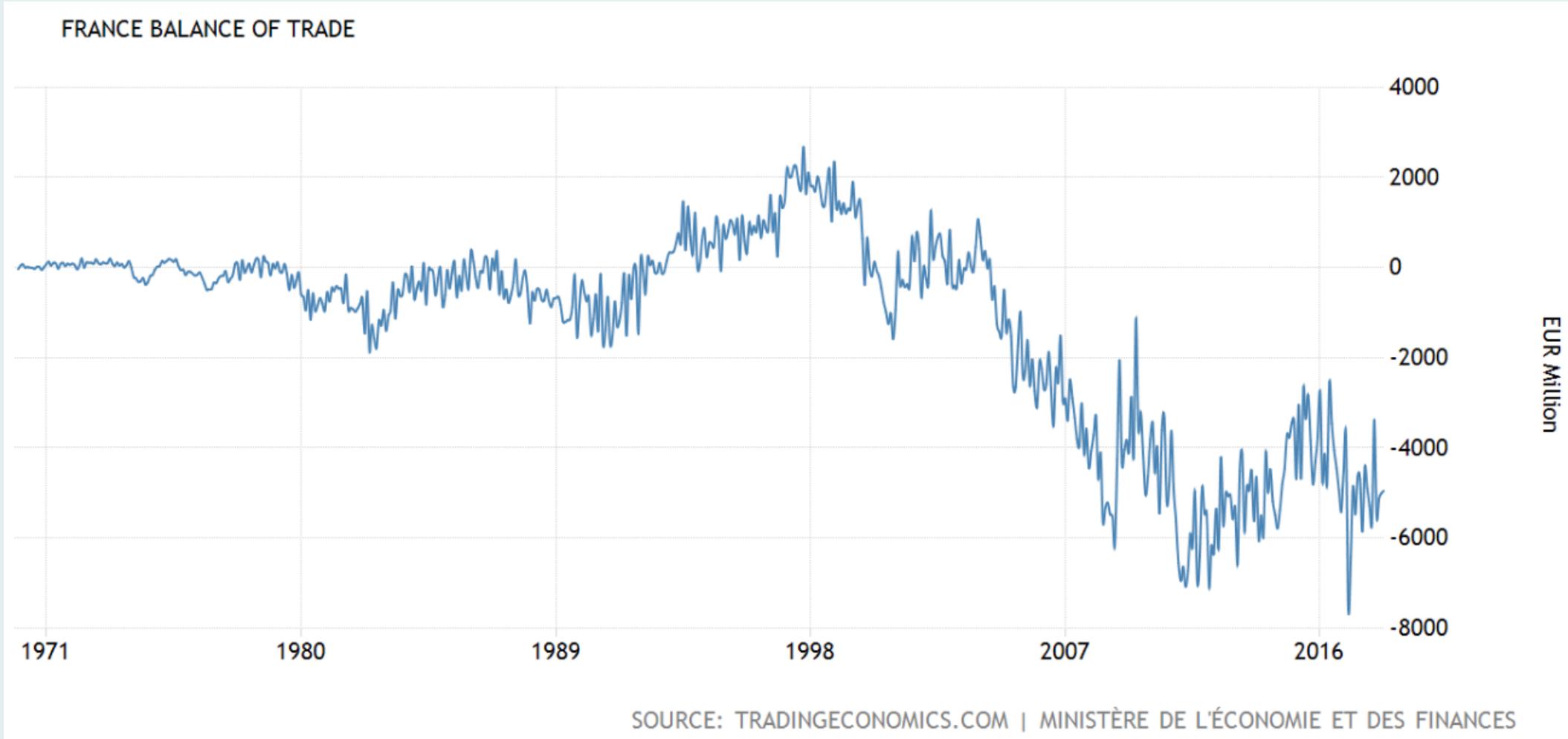
Monetary adjustments before the Euro

	France 100 FRF	Italy 1000 ITL	Spain 100 ESP	UK 1 GBP	US 1 USD
1963	81.36 DM	6.41 DM	6.65 DM	11.16 DM	3.99 DM
1998	29.82 DM	1.01 DM	1.18 DM	2.91 DM	1.76 DM
Devaluation	-63.3%	-84.2%	-82.3%	-73.9%	-55.9%

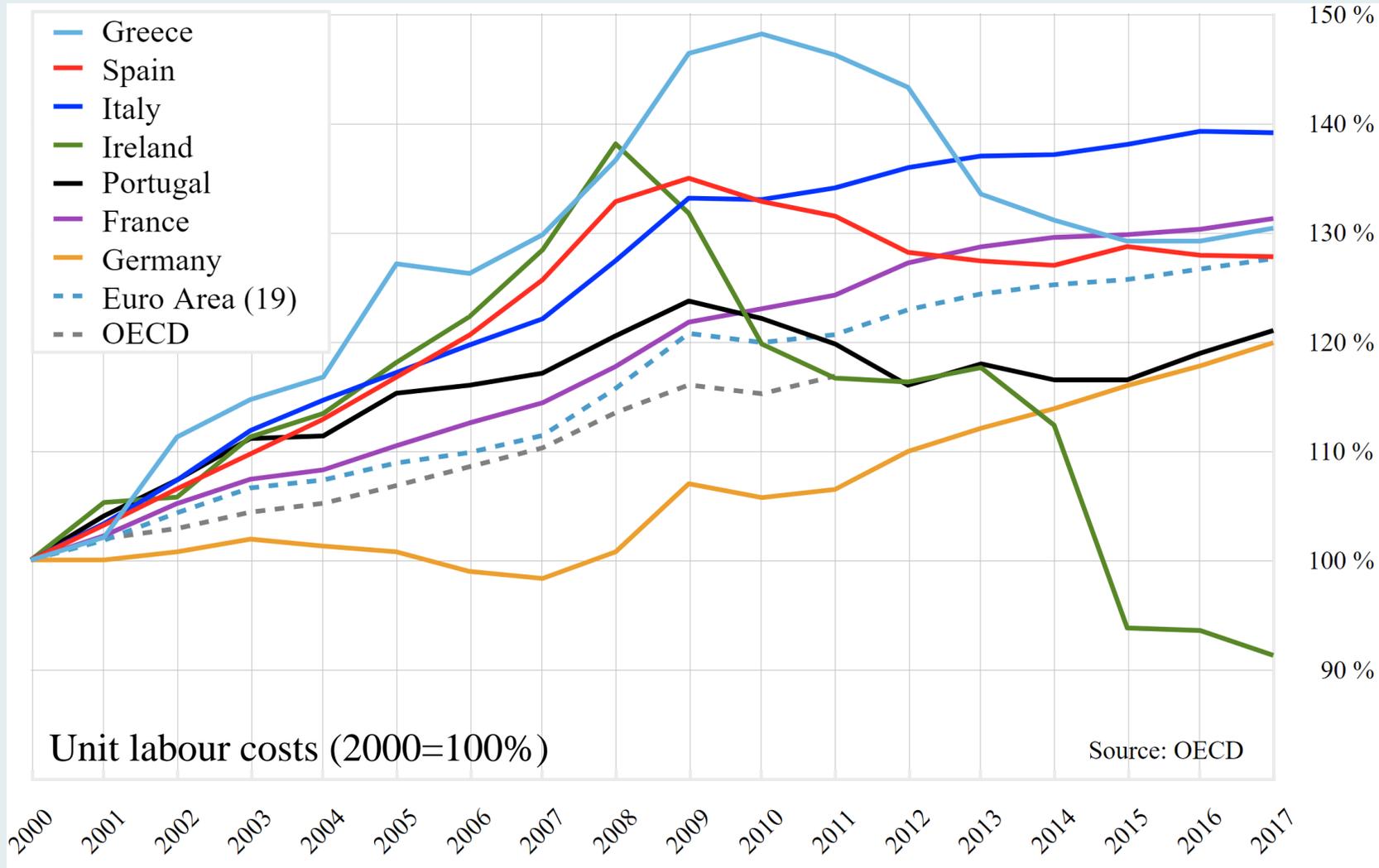
German exports unleashed by the Euro



French exports crippled by the Euro



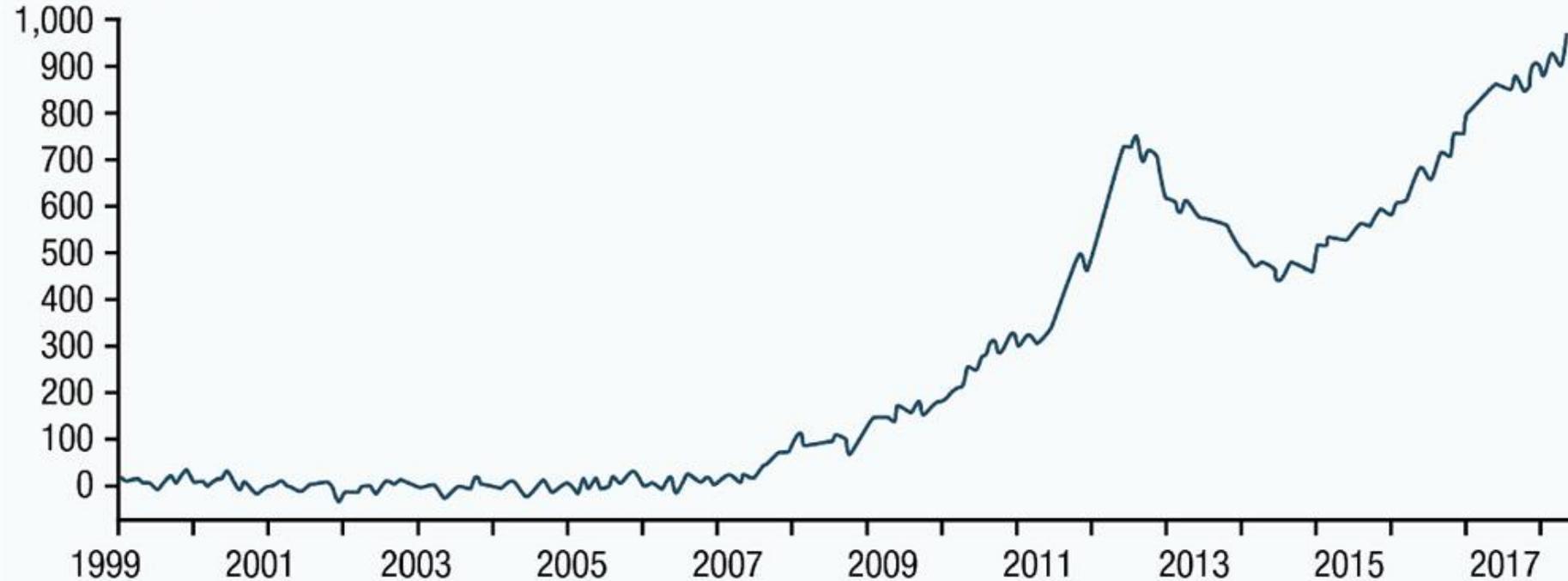
The Euro competitiveness gap



But what did Germany receive in return for its exports?

Germany's Target 2 claims against the rest of Europe

DM/Euro billion



External position of the Bundesbank – assets, other investment, currency and deposits target (net)

Source: Bundesbank

But what did Germany receive in return for its exports?

Bundesbank assets (Euro million)	31-Dec-06	31-Dec-17
Gold and gold receivables	53,114	117,347
Claims on non-euro-area residents denominated in foreign currency	31,651	49,495
Claims on euro-area residents denominated in foreign currency	0	7,168
Claims on non-euro-area residents denominated in euro	300	4,396
Lending to euro-area credit institutions related to monetary policy operations denominated in euro	256,348	94,320
Other claims on euro-area credit institutions denominated in euro	3,049	464
Securities of euro-area residents denominated in euro	0	512,125
Claims on the Federal Government	4,440	4,440
Intra-Eurosystem claims	18,273	919,183
Items in course of settlement	1	2
Other assets	6,360	18,688
Total assets	373,536	1,727,628

Germany's Target 2 claims against the rest of Europe



External position of the Bundesbank – assets, other investment, currency and deposits target (net)
Source: Bundesbank

A TARGET2 example



Greek farmer



Greek commercial bank



Greek central bank



European central bank



German central bank



German commercial bank



German manufacturer

German TARGET2
claim against the ECB

Greek TARGET2
liability towards
the ECB



- Through TARGET2, the ECB maintained existing trade imbalances and new payment imbalances since the Global Financial Crisis.
- TARGET2 creditors, mainly Germany, built up large claims against the rest of the eurozone.
- Germany's export surpluses were largely financed by its own central bank, the Bundesbank.
- None of this is a problem ... as long as the Euro exists.

TARGET2 could destroy the Bundesbank

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🏠 Handelsblatt > Today > Finance > TARGET2: When is a trillion euro not a trillion euro? Suchbegriff, WKN, ISIN 🔍

TARGET2

When is a trillion euro not a trillion euro?

Fear of Italy leaving the euro has driven Germany's surplus with the European Central Bank to a record €956 billion. But economists say this surplus could vanish overnight if a real crisis hit.

TARGET2 could destroy the Bundesbank

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Fresh alarm in Italy as apostles of 'Italexit' take control of parliament



543

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The Italian parliament is now the epicentre of the anti-euro movement, guaranteeing a showdown with Brussels on fiscal plans

TARGET2 could destroy the Bundesbank

Claudio Borghi, Lega's economics spokesperson and chair of the Italian Parliament's budget committee, quoted in *The Daily Telegraph*, 21 June 2018:

Mr Borghi, a former trader at Deutsche Bank, said the best solution for everybody is for Germany to leave the eurozone. If Germany refuses to do so, he argues that Italy can pass a law converting its debt obligations into florins or lira overnight. "The losses would shift to the national central banks through the Target2 system," he said. Bank of Italy would repay €440bn of liabilities to the ECB in devalued coin under the principle of Lex Monetae.

We need to talk about Europe again

- Despite the Eurozone's recovery, severe risks remain.
- A TARGET2 implosion would be triggered by any country leaving the Eurozone.
- It would require an enormous recapitalisation of the Bundesbank and could wreck the (fragile) German banking system.
- And it would make the Germans realise what their past trade surpluses were really worth.
- Germany plays Monopoly just as I did when I was a child.

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