

# **Panel Discussion: Europe at the Crossroads**

Markus Brunnermeier  
Paul Krugman  
Hyun Song Shin  
Christopher Sims

October 24th, 2011

Department of Economics and  
Griswold Center for Economic Policy Studies

## Schedule

- October 23rd, Summit of EU leaders
- **October 26th, Summit of EU leaders**
- November 3-4th, France to host G20 Summit in Cannes

## Issues on the Table (as based on press leaks/plants)

- How large a haircut (write-down) for Greek debt?
- Size and manner of bank recapitalization
- “Enhancement” of European Financial Stability Facility (EFSF)
  - EFSF as a bank that borrows from ECB
  - EFSF as bond insurer for first  $x\%$  of losses
  - EFSF as co-investor in a securitization vehicle (with China? Brazil?...)

# Why Does It Matter?

- Consequences for **United States**
- Consequences for **emerging/developing economies**

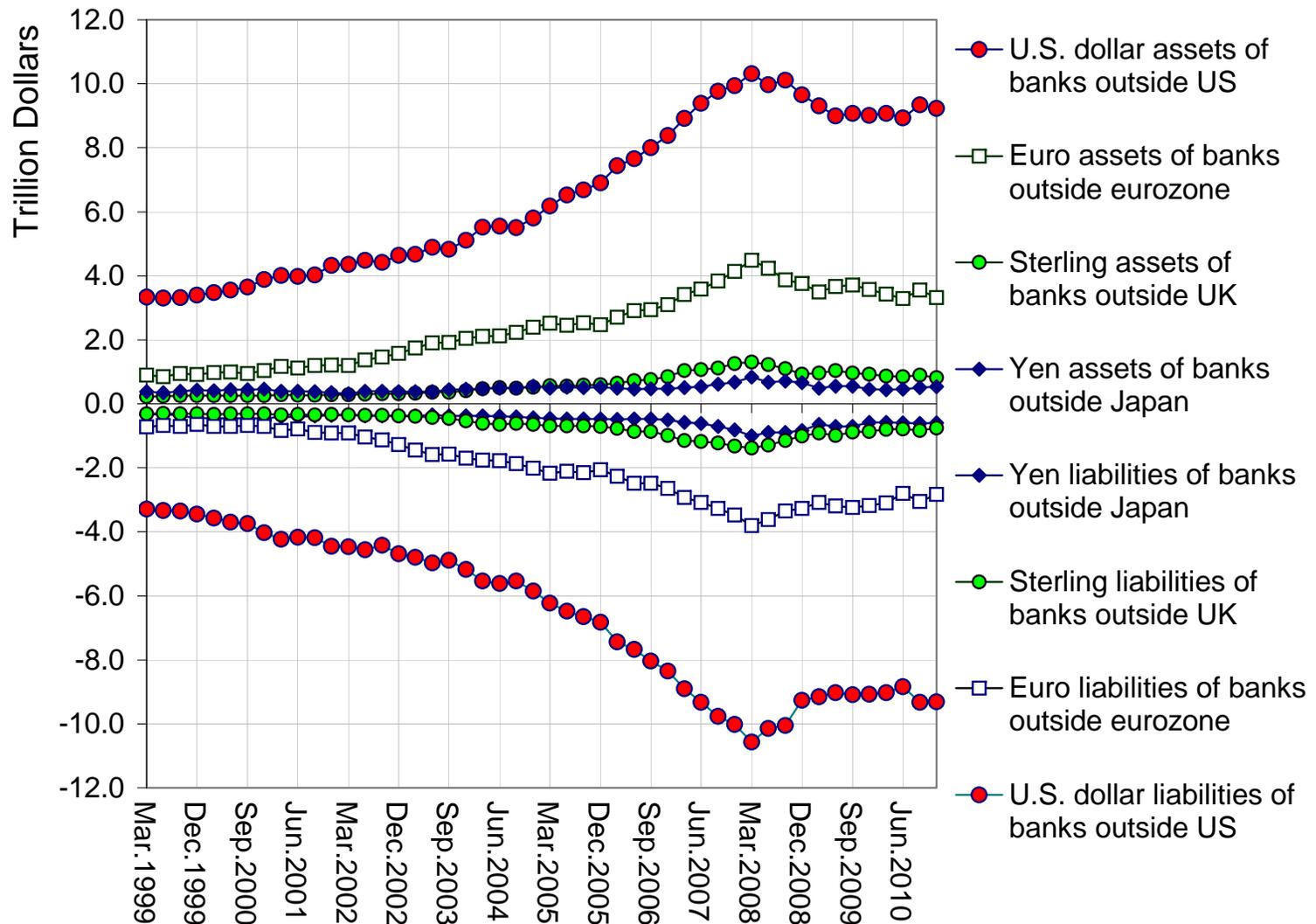


Figure 1: Cross-border foreign currency claims of BIS reporting banks by currency (Source: BIS locational banking statistics, Table 5A)<sup>5</sup>

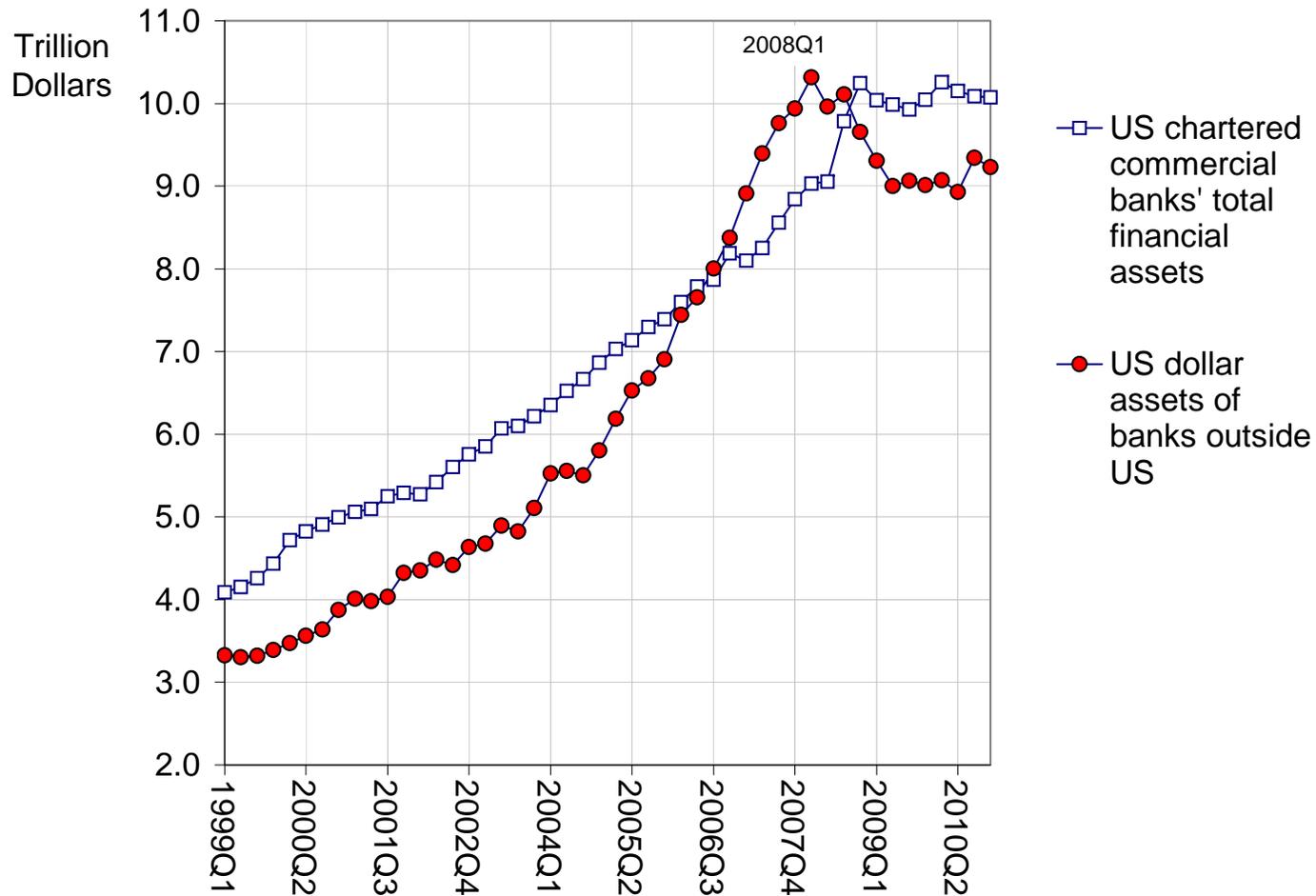


Figure 2: US dollar cross-border foreign currency claims and US commercial bank total assets (Source: Flow of Funds, Federal Reserve and BIS locational banking statistics, Table 5A)

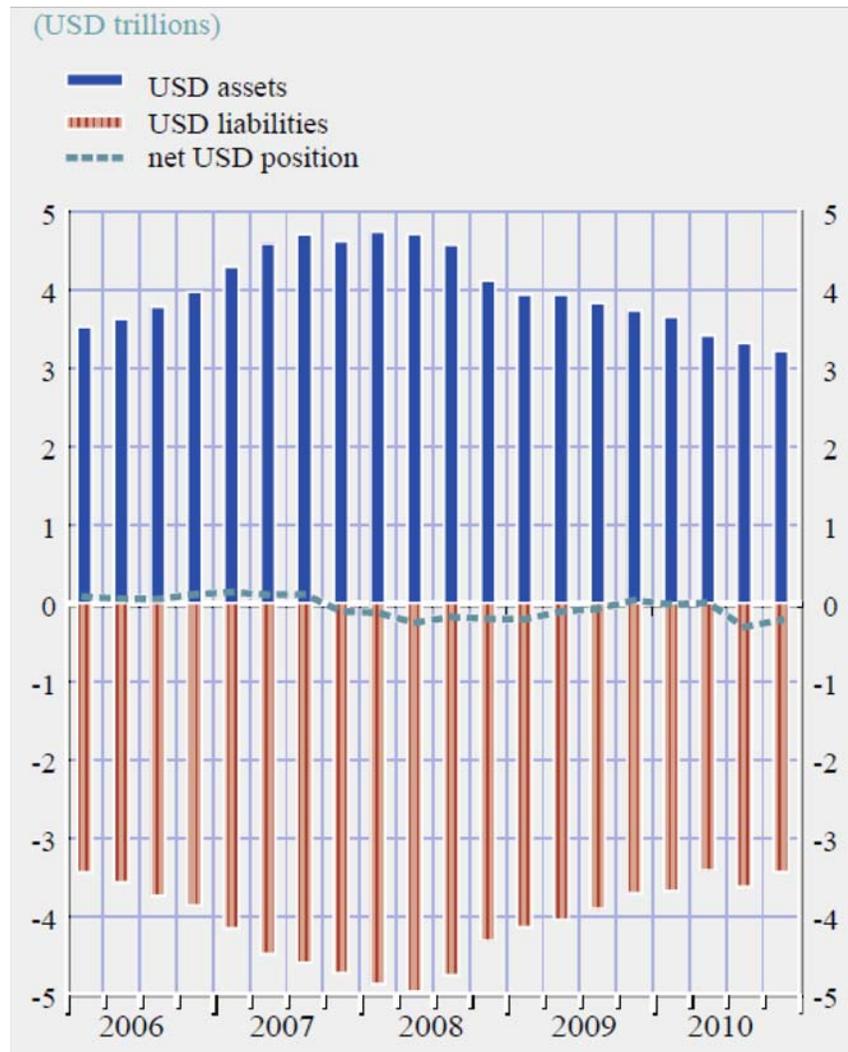


Figure 3: US Dollar-denominated assets and liabilities of euro area banks (Source: ECB Financial Stability Review, June 2011, p. 102)

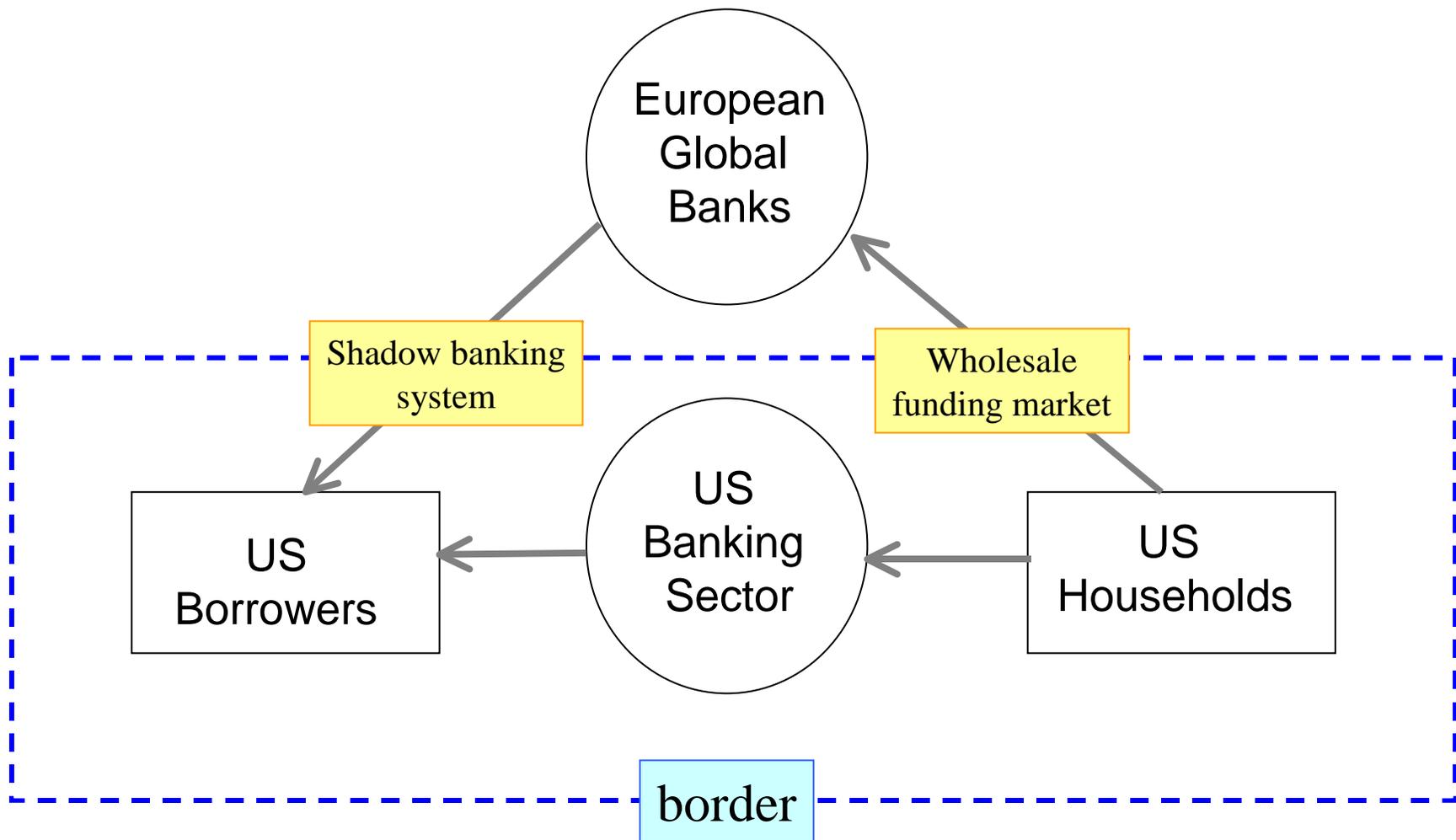


Figure 4: European global banks add intermediation capacity for connecting US savers and borrowers

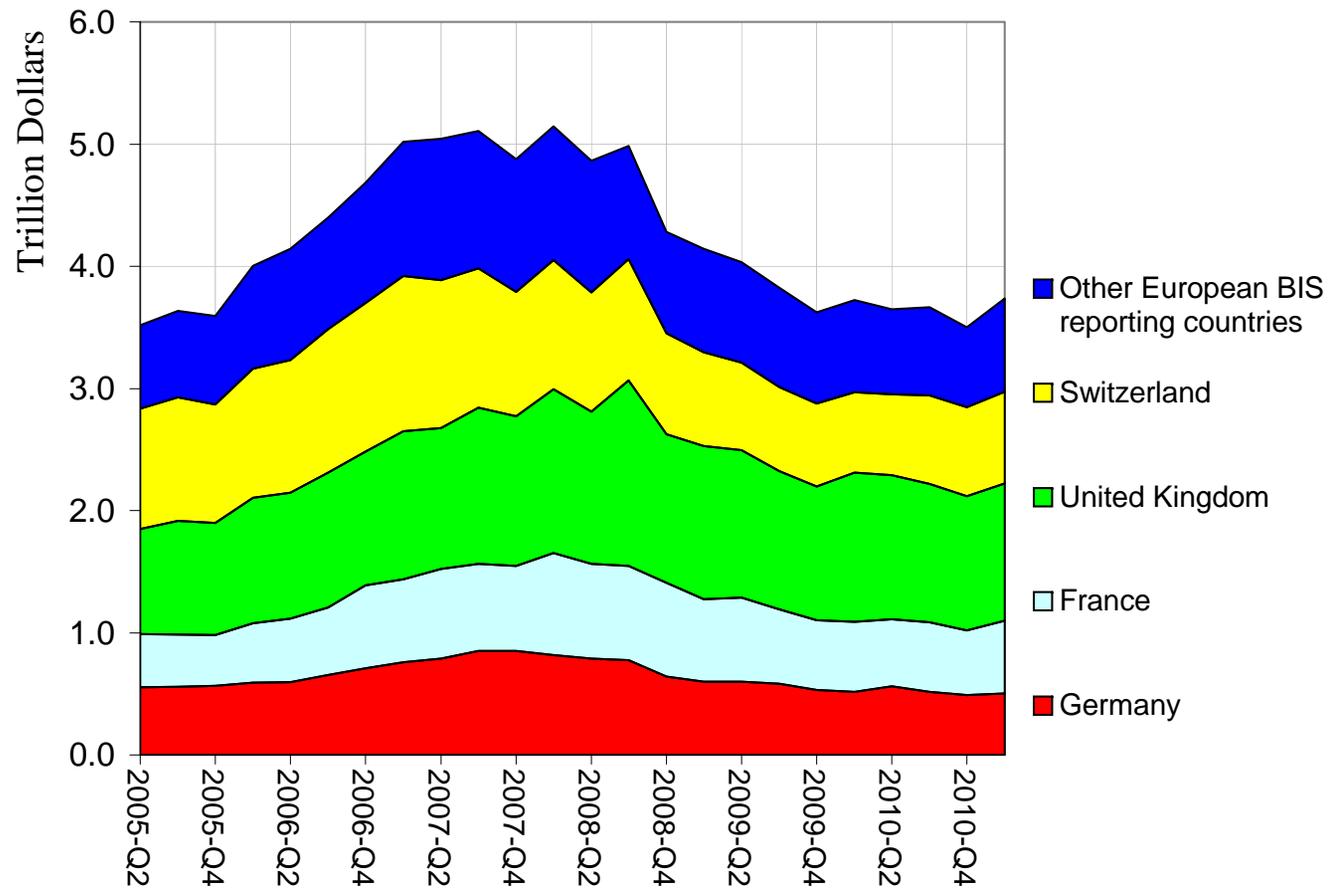


Figure 5: International claims of European BIS reporting banks on US counterparties (Source: BIS consolidated banking statistics, Table 9D) <sup>9</sup>

Amount Owed by European Banks to US Prime Money Market Funds  
end-June, 2011 (by nationality of borrowing bank)

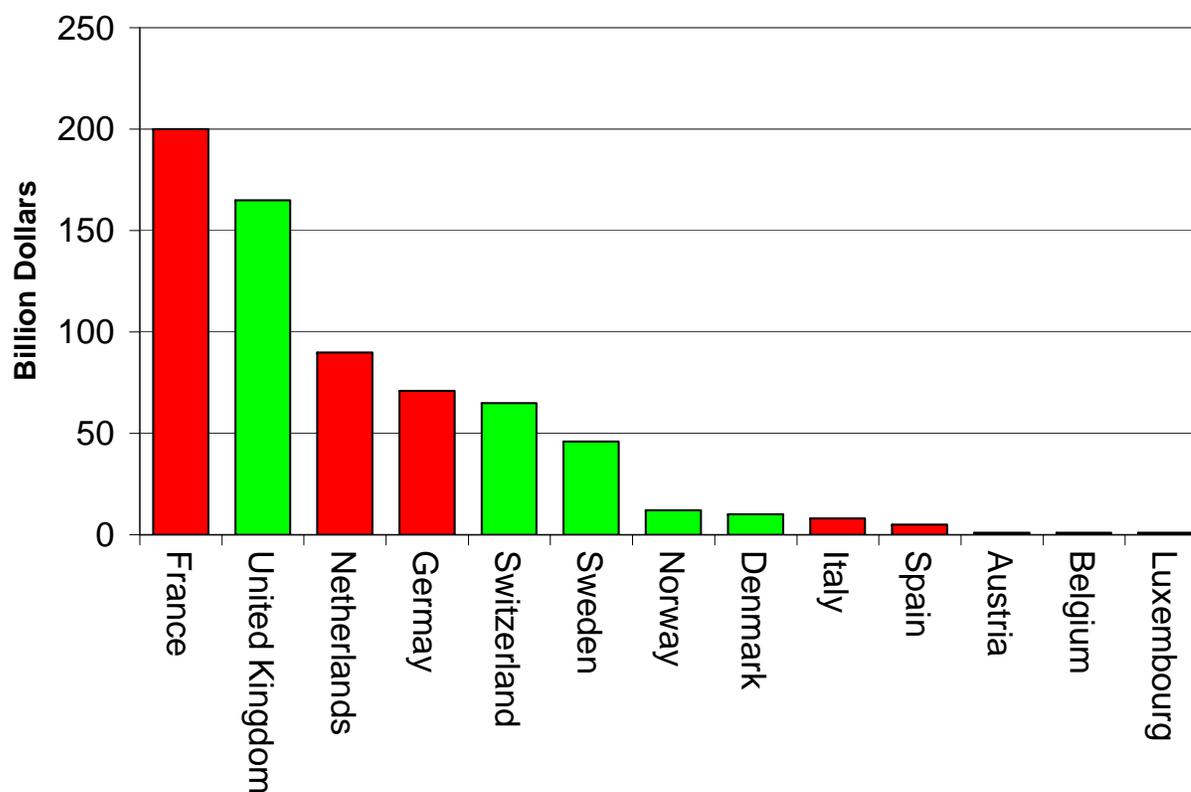


Figure 6: Amount owed by European banks to US prime money market funds by nationality of borrowing bank (end-June 2011) (Source: IMF<sup>®</sup> GFSR September 2011)

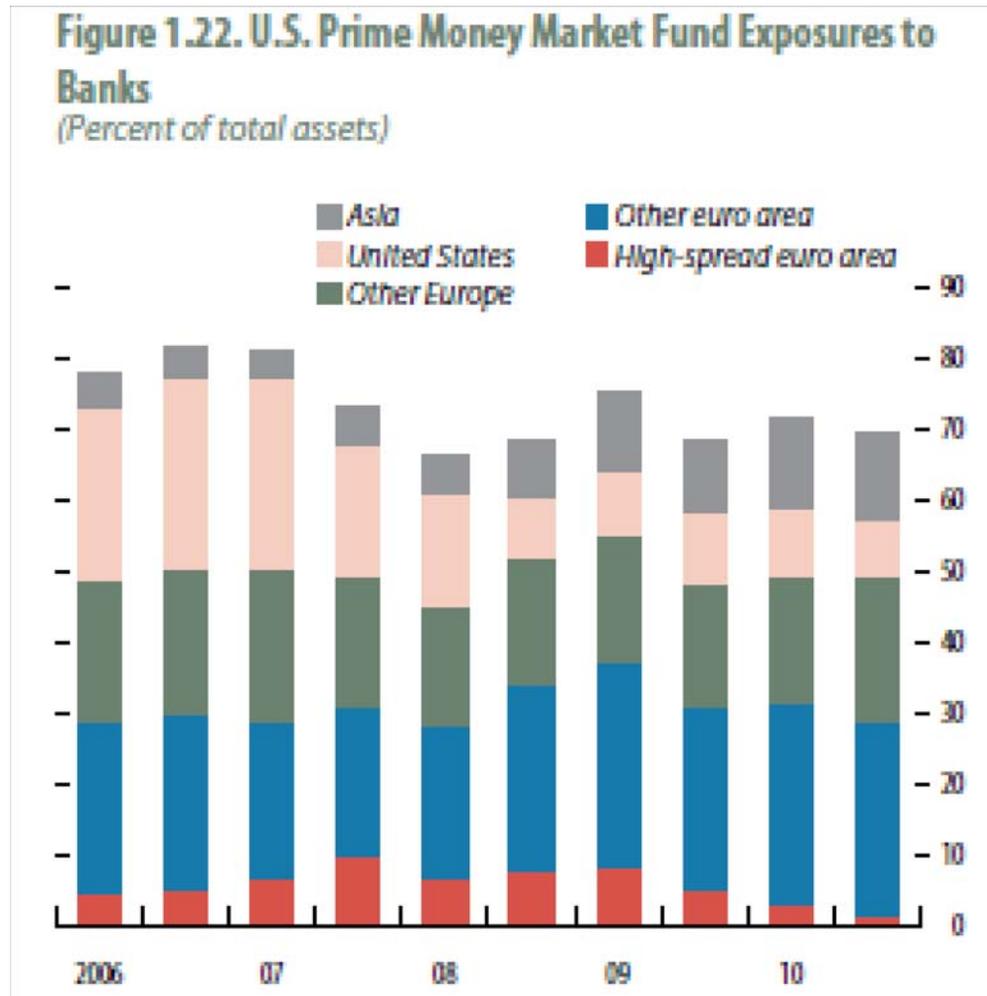


Figure 7: US prime money market fund claims on banks (Source: IMF GFSR September 2011)

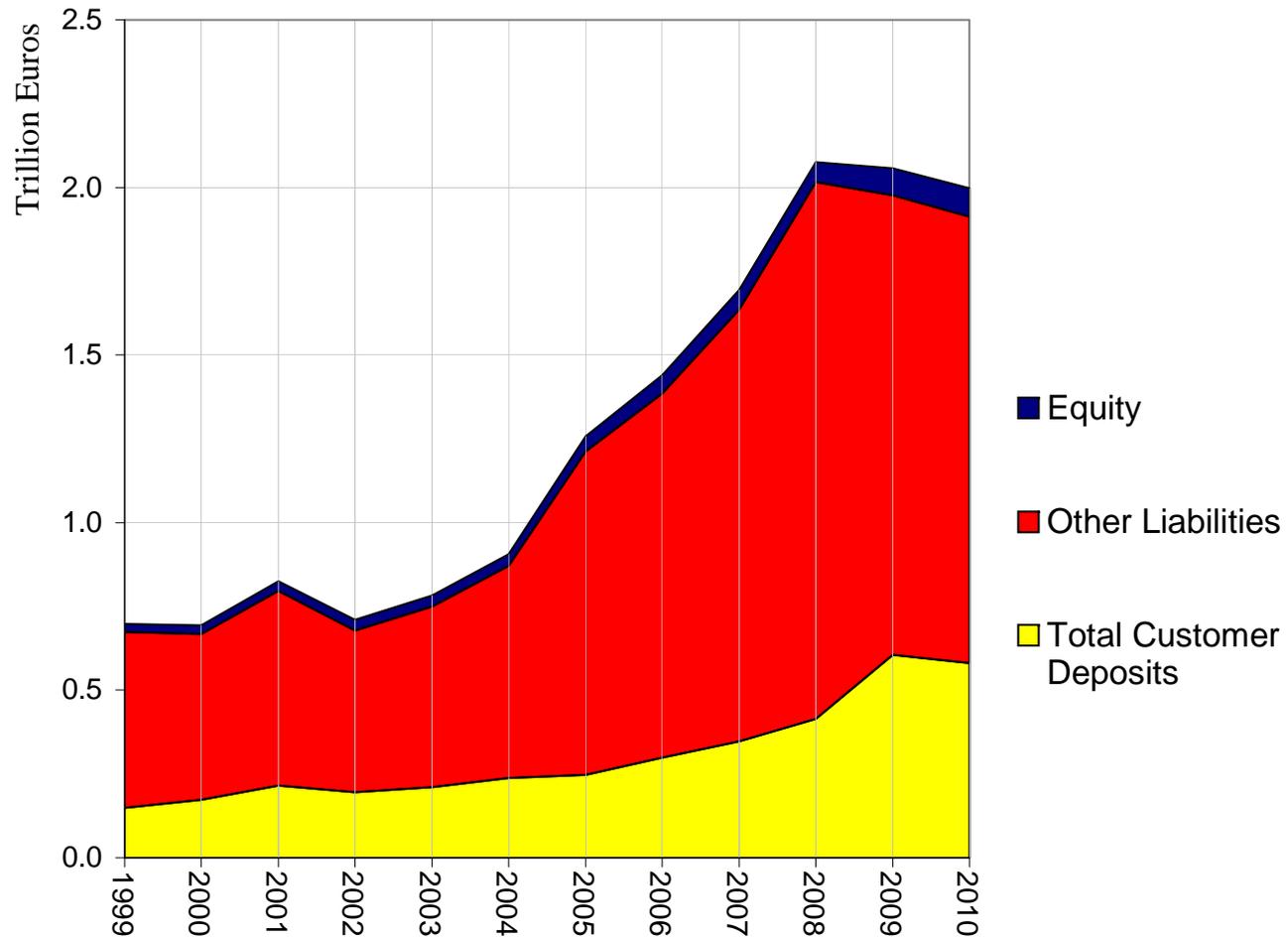


Figure 8: BNP Paribas total liabilities (Source: Bankscope)

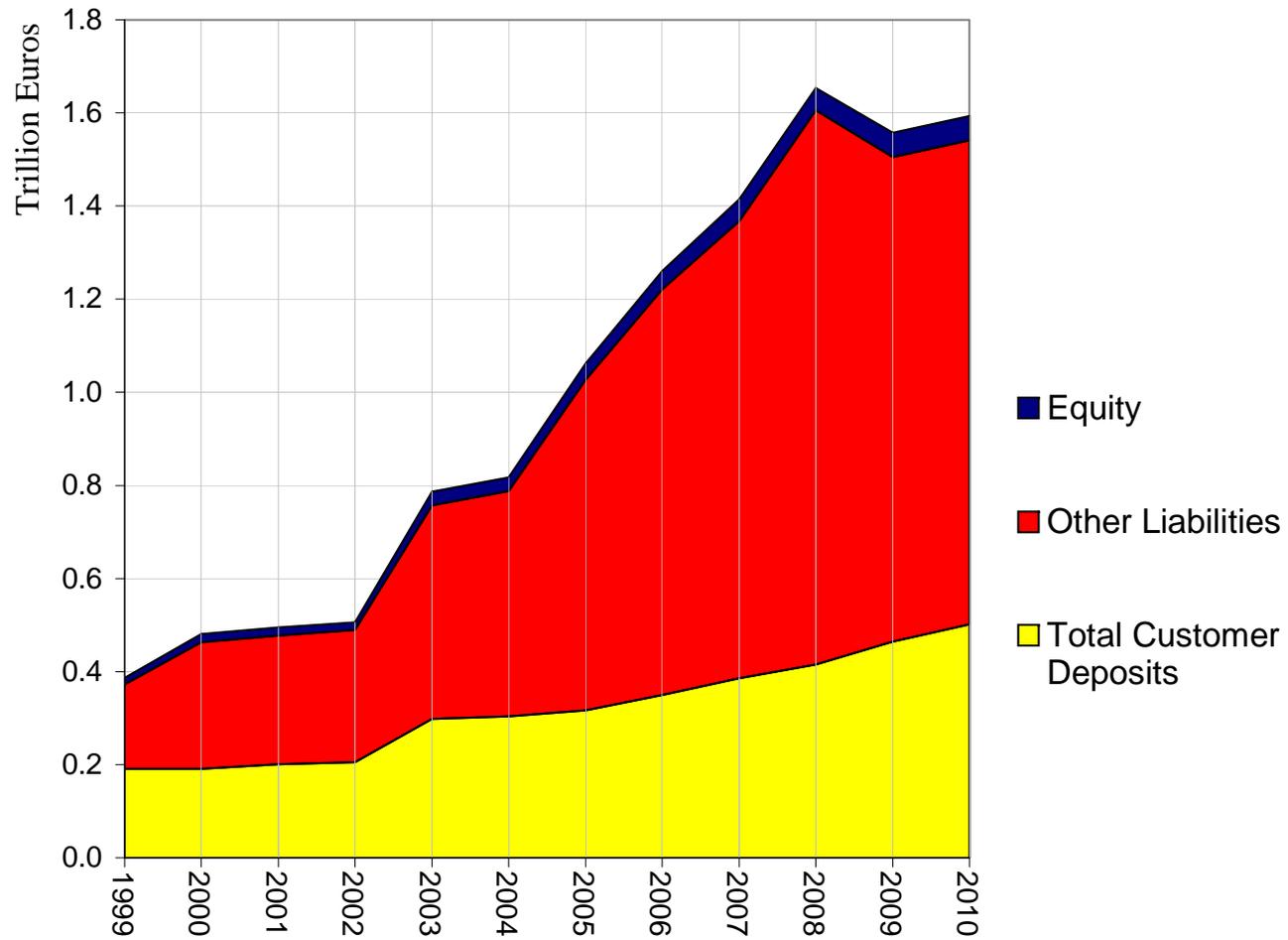


Figure 9: Credit Agricole liabilities 1999 - 2010 (Source: Bankscope)

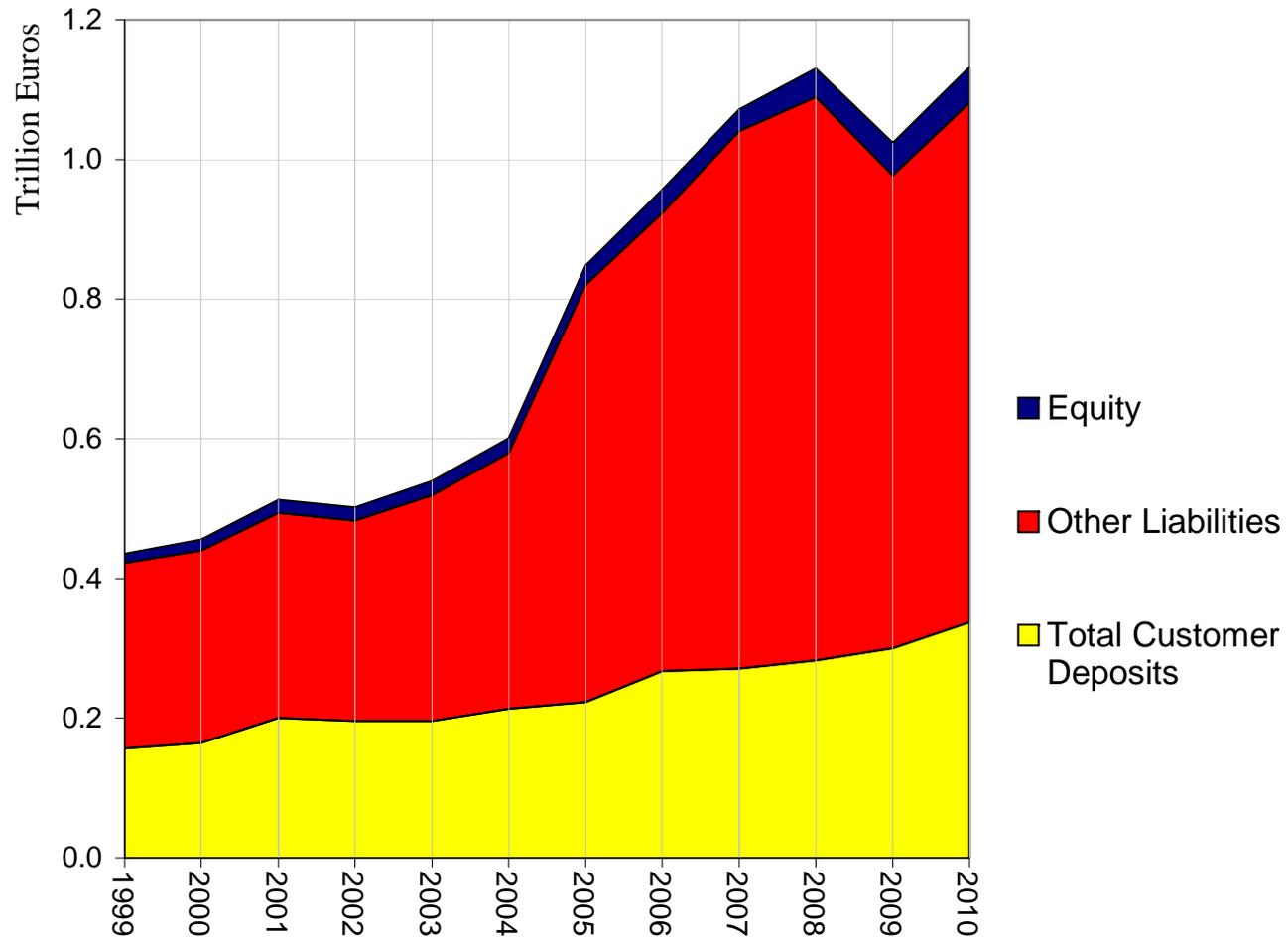


Figure 10: Société Générale liabilities 1999 - 2010 (Source: Bankscope)

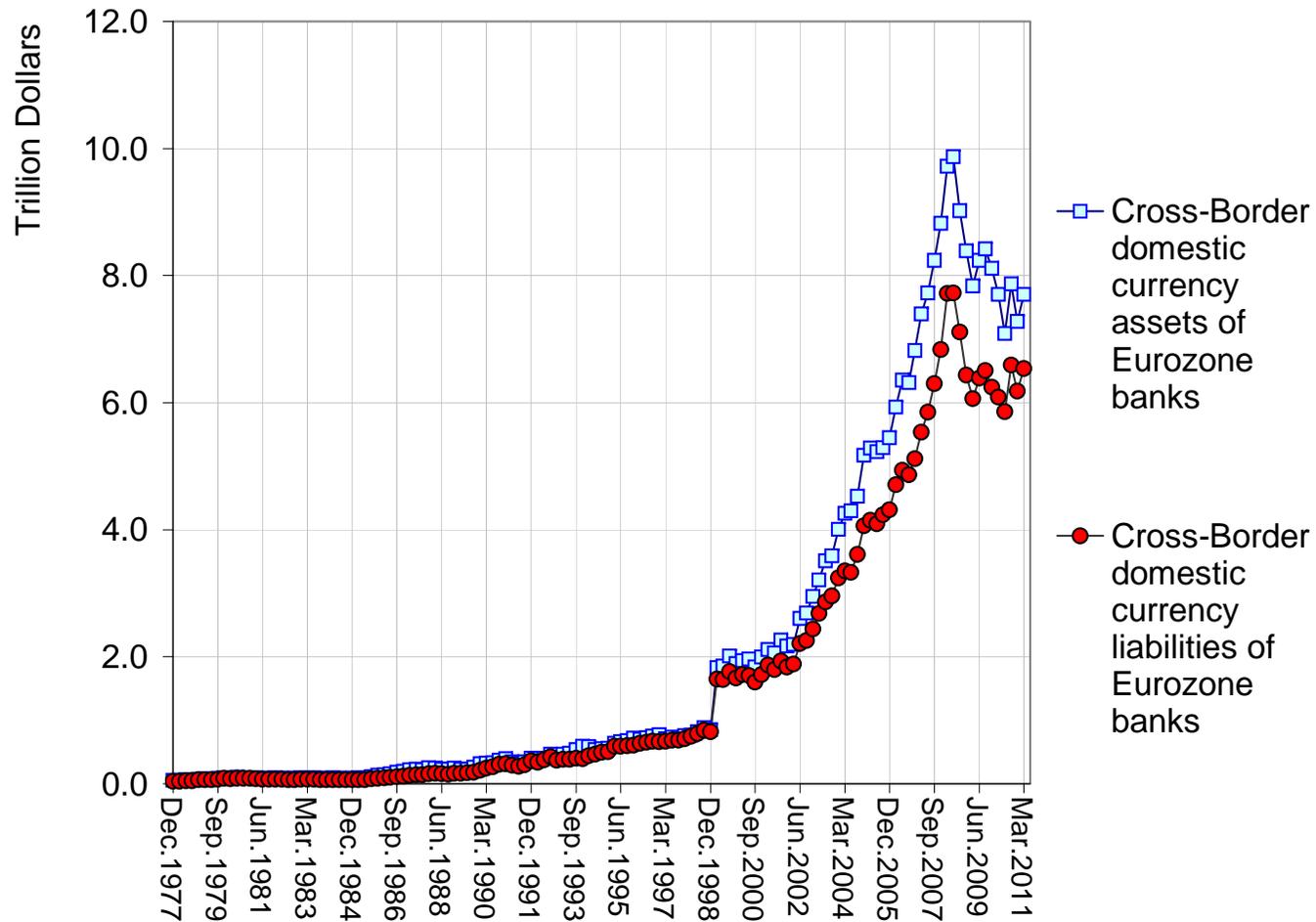


Figure 11: Cross-border domestic currency assets and liabilities of eurozone banks (Source: BIS locational banking statistics, Table 5A)

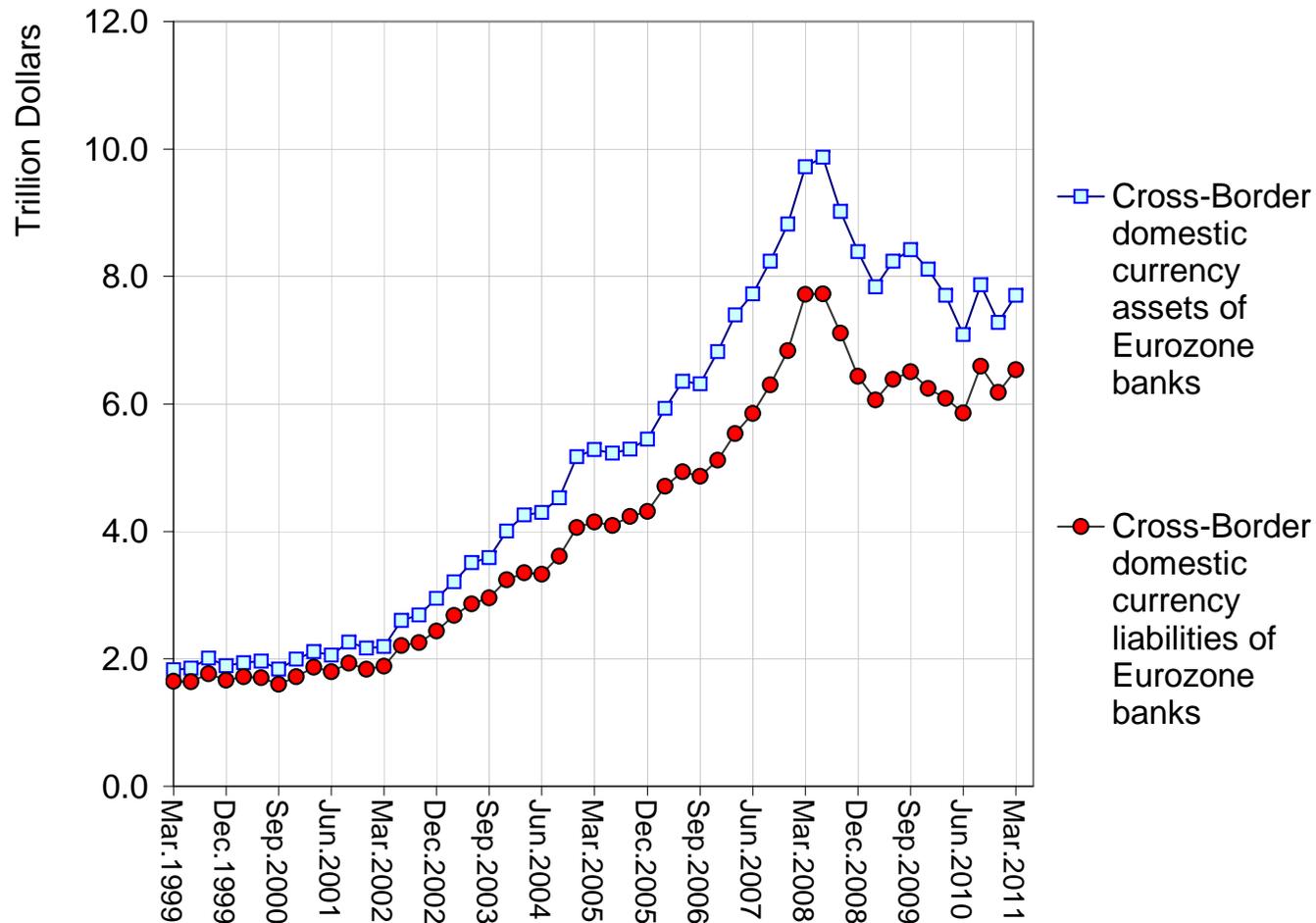


Figure 12: Cross-border domestic currency assets and liabilities of eurozone banks (Source: BIS locational banking statistics, Table 5A)

Claims of European Banks on Counterparties in Spain

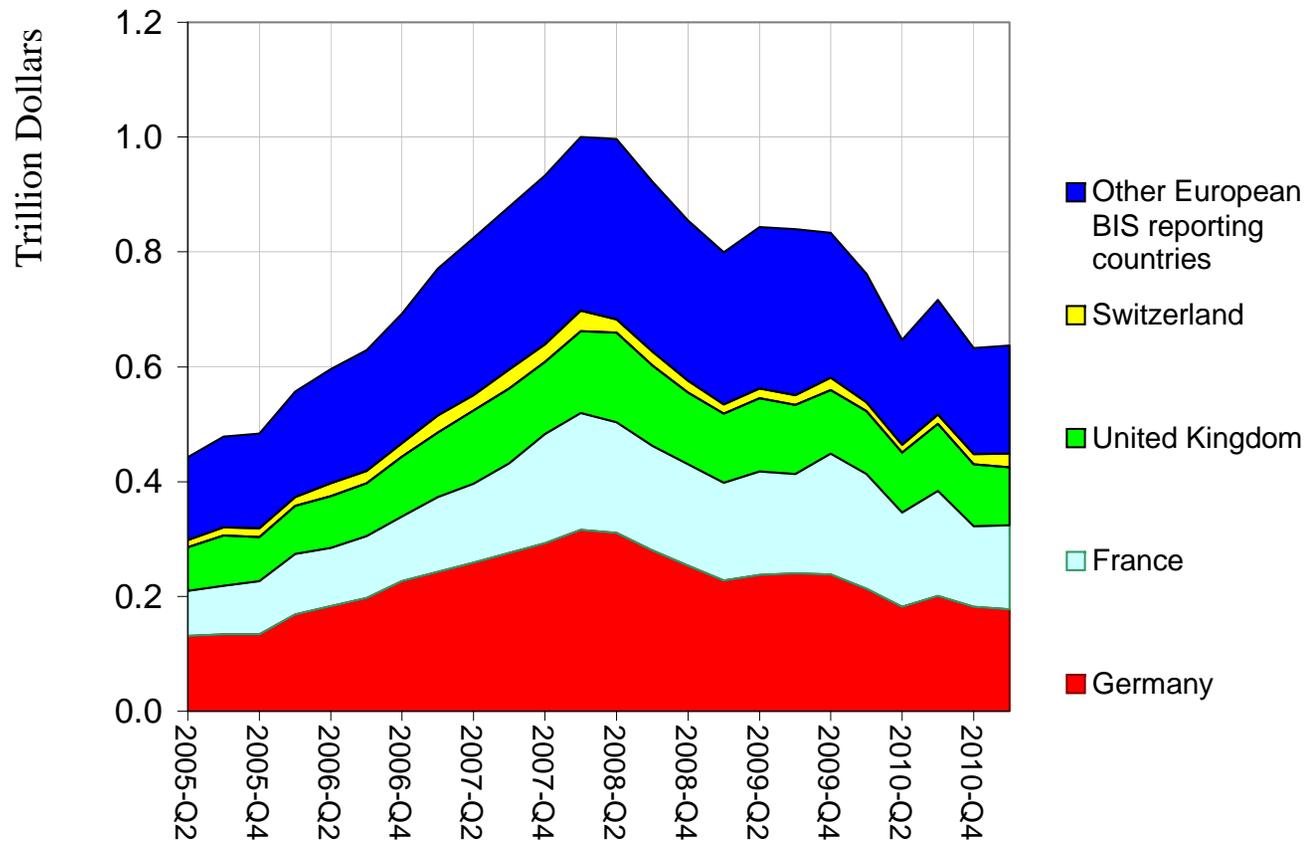


Figure 13: International claims of European BIS-reporting banks on counterparties in Spain (Source: BIS consolidated banking statistics<sup>17</sup>, Table 9D)

Claims of European banks on Counterparties in Ireland

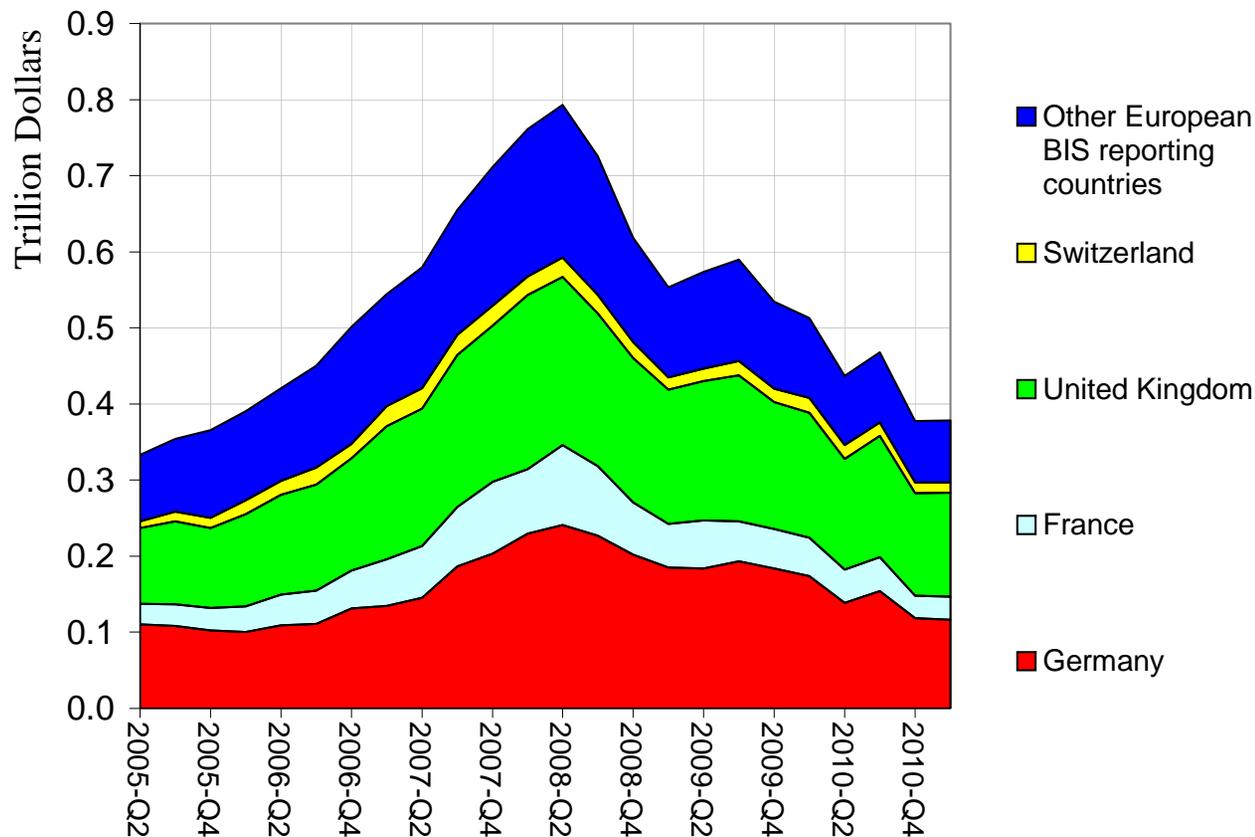


Figure 14: International claims of European BIS-reporting banks on counterparties in Ireland (Source: BIS consolidated banking statistics<sup>8</sup>, Table 9D)

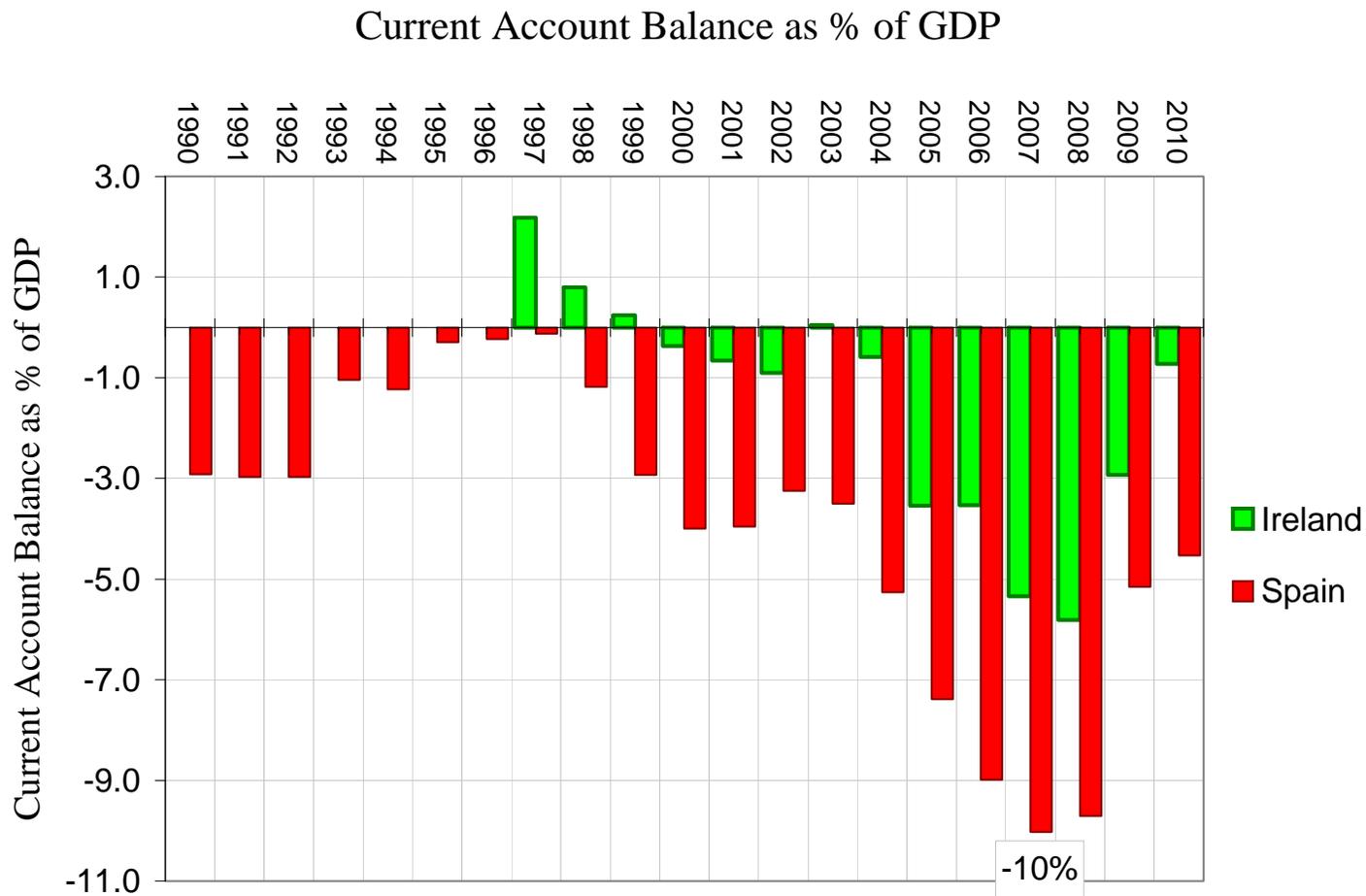


Figure 15: Current account of Ireland and Spain (Source: IMF International Financial Statistics)

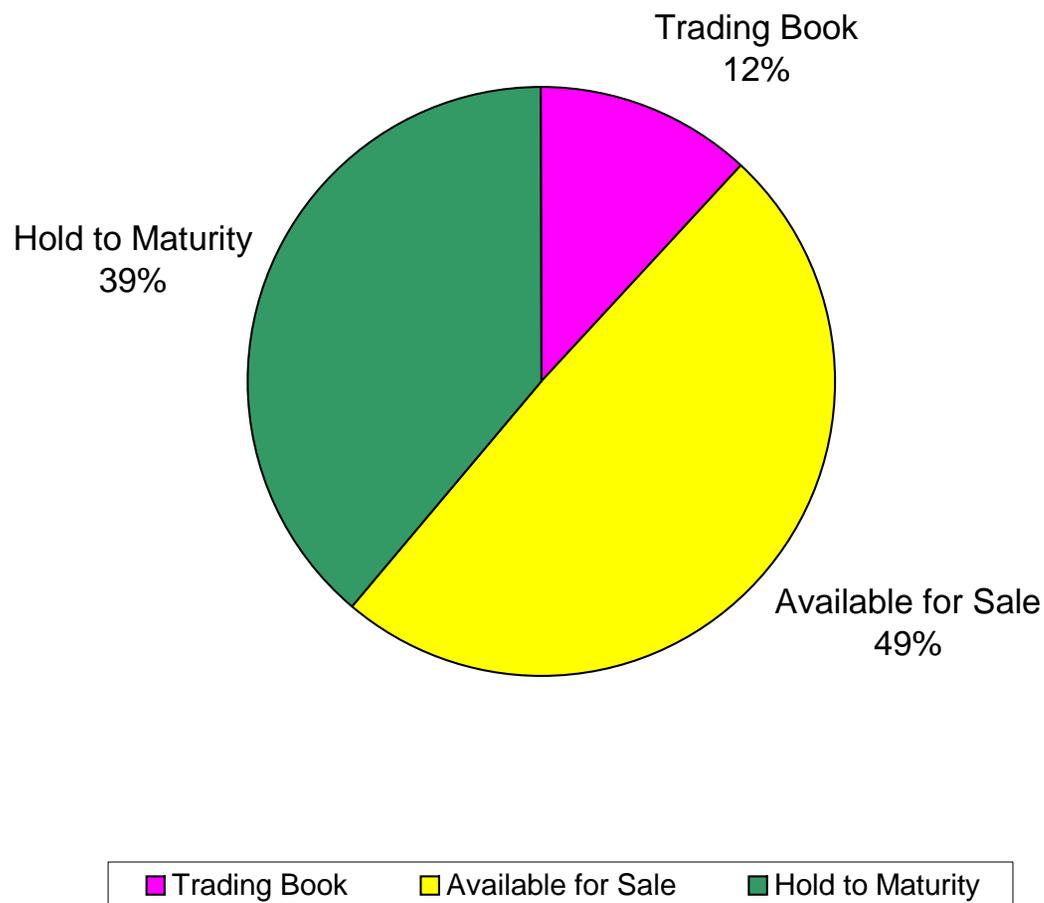


Figure 16: Accounting classifications of European Banks' holding of European sovereign debt (Source: IMF GFSR September 2011)

## Holding of peripheral sovereign debt split by books

	Domestic banks			Non-domestic banks		
	Total (EUR mn)	HTM	AFS, FVO and trading books	Total (EUR mn)	HTM	AFS, FVO and trading books
Greece	49,377	86%	14%	42,585	31%	69%
Ireland	10,913	46%	54%	6,556	20%	80%
Portugal	19,384	35%	65%	20,030	22%	78%
Spain	227,069	47%	53%	43,305	28%	72%
Italy	160,866	34%	66%	132,175	20%	80%

*Source: Deutsche Bank, EBA*

Figure 17: European banks' holding of high spread sovereign debt by accounting classification (Source: FT Alphaville citing Deutsche Bank report)

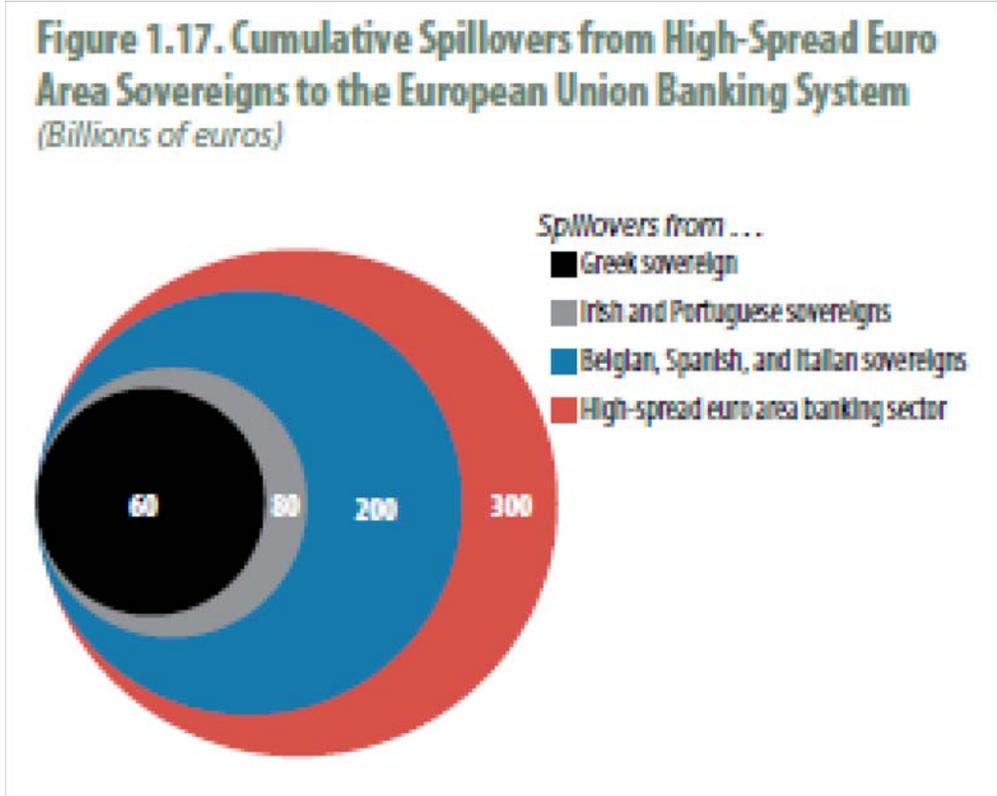


Figure 18: CDS implied impairment of European Bank assets (Source: IMF GFSR September 2011)

## Implications for Current Conjuncture in Europe

- Europe has a **twin crisis**, combining **banking crisis** with **sovereign debt crisis**
  - Emerging economy crises of 1990s were **twin crises**, combining **banking crisis** with **currency crisis**
- Deleveraging by European banks will impact not only eurozone, but also
  - US shadow banking system
  - Capital flows to emerging economies

## Issues on the Table (as based on press leaks/plants)

- How large a haircut (write-down) for Greek debt holders?
- Size and manner of bank recapitalization
- “Enhancement” of European Financial Stability Facility (EFSF)
  - EFSF as a bank that borrows from ECB
  - EFSF as bond insurer for first  $x\%$  of losses
  - EFSF as co-investor in a securitization vehicle (with China? Brazil?...)