

# The peripheral crisis: challenges and opportunities

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ECMI Annual Conference  
Brussels, October 17, 2013



il Centesimo

Bar Caffetteria

Vineria

Duca della Corogna



il centesimo

BRUSCHETTE



FOCACCE



SPIEDINI

ESPRESSO

0.69 €

al banco



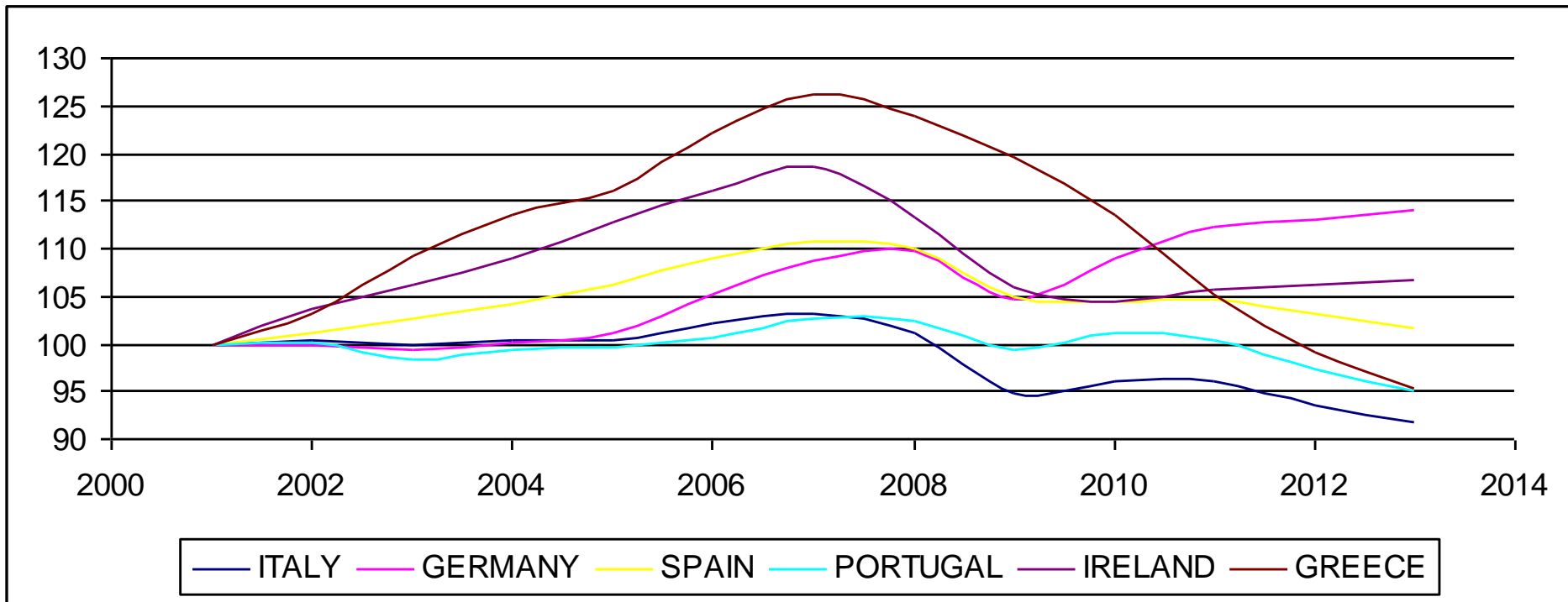


# Summary

- The peripherals' lost decade
- Debt: is this time different?
- How do we try to make it different?
- Is it working? Positive signs from exports but negative signs from unemployment
- What else can we do? Shrinking the public sector? What about European banks?
- Conclusions

# GDP PER CAPITA

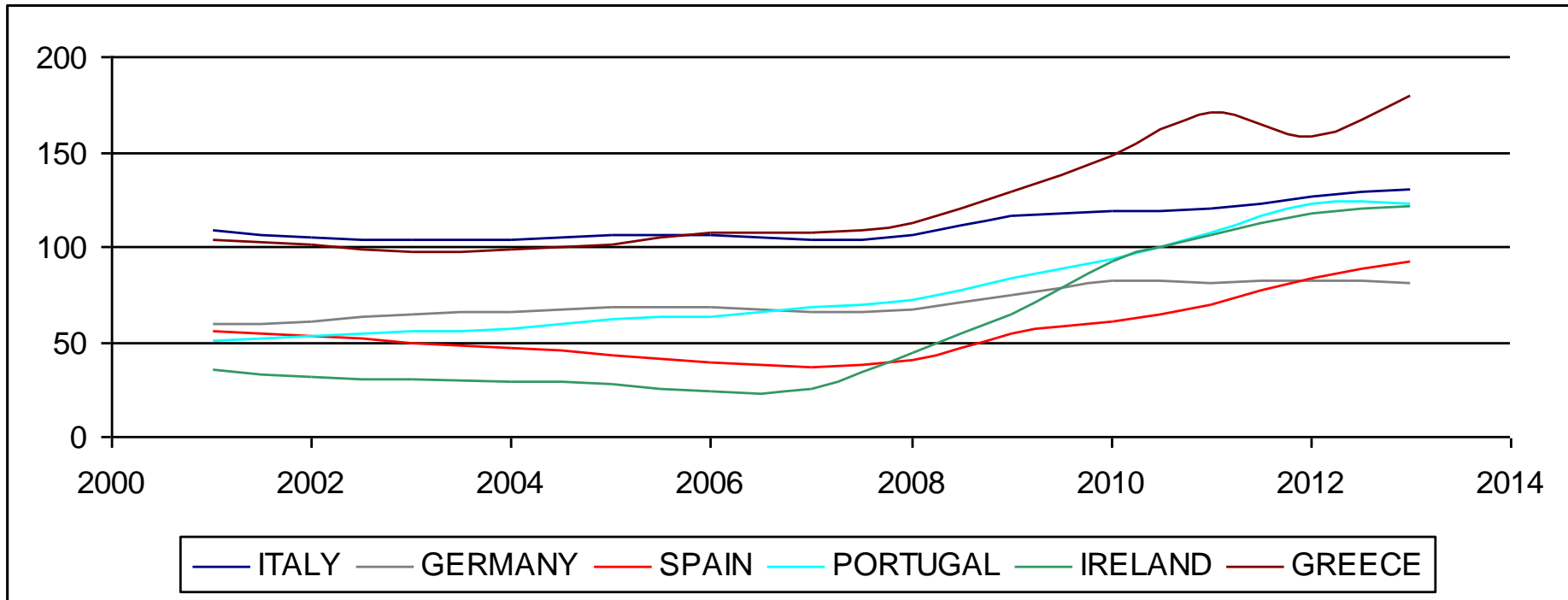
## Peripherals' lost decade



Source: IMF

# DEBT-GDP

Let's hope 'this time is different'



Source: IMF

# How do we try to make it different?

- Institutional framework
- Fiscal policy
- Portfolio decisions

# Institutional framework: public budgets

- Good progress on the sense of European identity
  - In February 2010 the initial discussion was about a series of bilateral operations to help Greece
  - In 2013 for the first time national budgets will have to be presented and discussed at the European level
- It would be useful to coordinate fiscal policies, but that would call for decisions that depend on the state of the economies and common objectives
  - However, all the States are cutting the deficit at the same time

# Institutional framework: banks

- Very ambitious targets on banking regulation, with unclear implications (esp. at a time of unconventional policies) related to the ECB jointly supervising banks and deciding monetary policy
- Still unclear how to deal with systemic financial institutions and how to build a system of European deposit insurance that is large enough
- Bail-in of subordinated and senior bond-holders may have serious implications on banks' cost of funding



# Fiscal policy

- Initial response: austerity, austerity, austerity
- 2013 common wisdom: no growth with too much austerity
- Where did the change come from?
  - Studying Greece and Italy (which has maintained fiscal discipline for ten years with negative growth)
  - The new IMF normal: the income multiplier is around one (maybe more)
- How would a country apply for OMT? Without austerity plans?

# Portfolio decisions: holdings of government bonds, July 2010

- Bonds:
 

|           | Greek   | Irish  | Italian | Portuguese | Spanish |
|-----------|---------|--------|---------|------------|---------|
| Greece    | 261.37% | 0.00%  | 0.00%   | 0.00%      | 0.00%   |
| Ireland   | 0.19%   | 29.60% | 3.43%   | 1.22%      | 1.85%   |
| Italy     | 1.31%   | 0.03%  | 121.51% | 0.09%      | 1.51%   |
| Portugal  | 10.74%  | 2.99%  | 0.75%   | 28.24%     | 0.00%   |
| Spain     | 0.53%   | 0.00%  | 2.54%   | 2.54       | 106.59% |
| Non-GIIPS | 2.58%   | 0.82%  | 4.16%   | 0.70%      | 0.91%   |

- Source: EBA, Bankscope

# Portfolio decisions: holdings of government bonds, October 2012

- Bonds
 

|           | Greek    | Irish  | Italian | Portuguese | Spanish |
|-----------|----------|--------|---------|------------|---------|
| Greece    | 1225.46% | 0.00%  | 12.20%  | 0.00%      | 0.00%   |
| Ireland   | 0.00%    | 48.55% | 0.94%   | 0.07%      | 0.00%   |
| Italy     | 0.00%    | 0.01%  | 218.37% | 0.06%      | 3.31%   |
| Portuga   | 1.21%    | 5.00%  | 1.22%   | 121.9%     | 0.09%   |
| Spain     | 0.00%    | 0.00%  | 2.83%   | 1.89%      | 182.47% |
| Non-GIIPS | 0.00%    | 0.03%  | 0.94%   | 0.00%      | 0.00%   |

- Source: EBA, Bankscope

# Portfolio decisions

- Fragmentation of capital markets is not a result of the crisis, we had a strong domestic bias also before the crisis
- Non-GIIPS banks overall have not contributed to stabilization of financial markets
- Pro-cyclical portfolio choices not due to Basle regulation but to tactical allocation
- Pro-cyclical portfolio choices by professional investors do not help the real economy but may help imposing discipline on borrowers

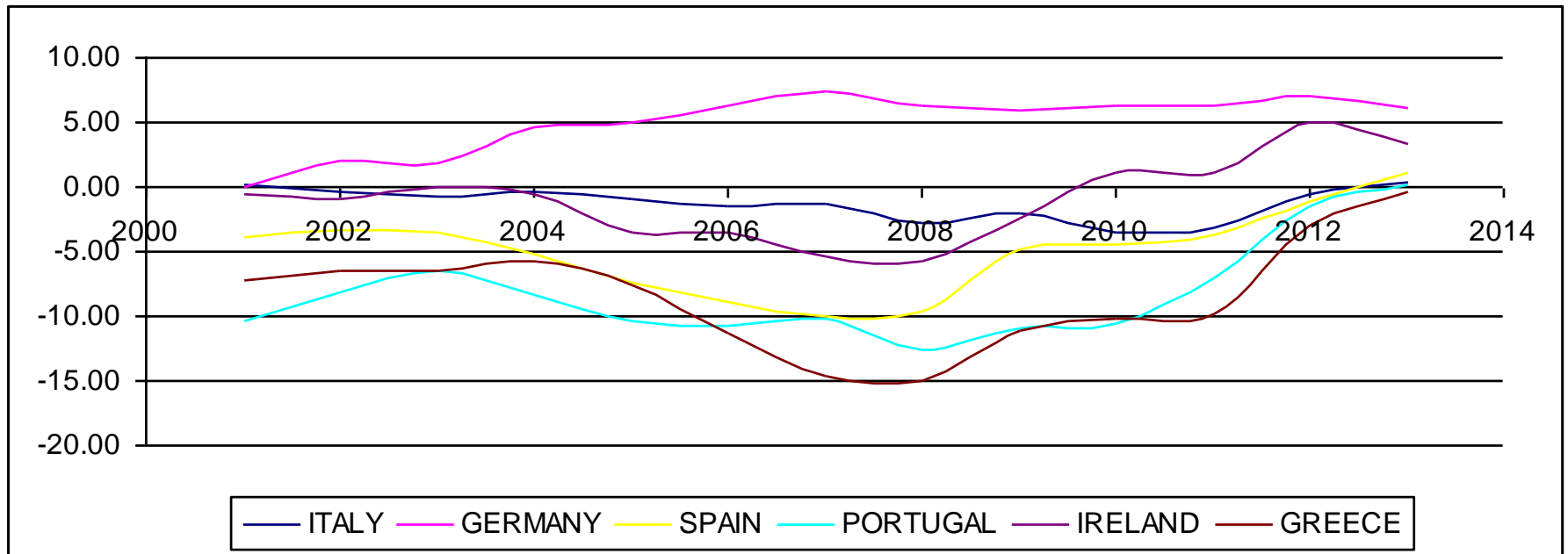
**IS IT WORKING?**

# Is it working? To some, still a second derivative relief...

- Return to growth after 18 months: 0.3% for the eurozone
- Portugal ended recession with growth of 1.1% (-2% yoy) thanks to 6% increase in export and improvement in investment
- Italy and Spain are still in recession
- Eurozone industrial production grew in June at its fastest rate in three years, mainly thanks to Germany; Ireland and Greece also grew ( 8.7% and 2.5%) but Spain and Portugal contracted 0.5% and 2.8%



# CURRENT ACCOUNT SURPLUS: moving in the right direction

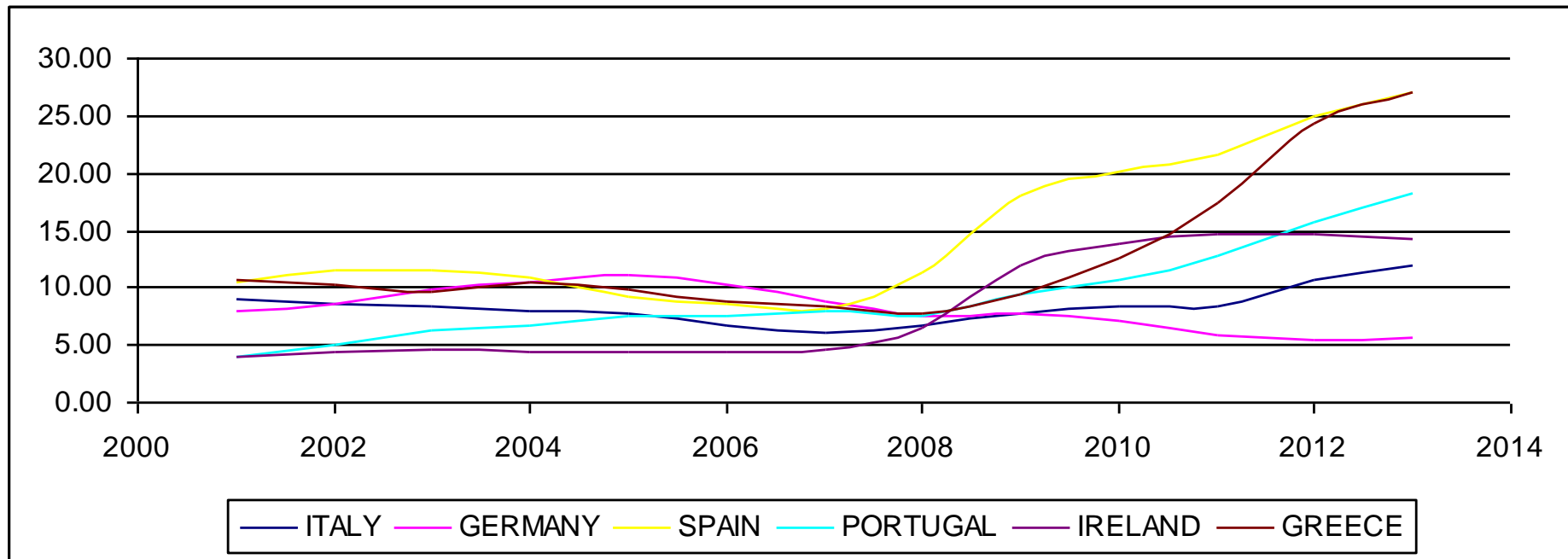


Source: IMF

# Crucial questions

- Is this the result of strict austerity of the 2011-2013 or of the moderation of austerity of the last two quarters? Implications on future actions are completely different
- Can we expect exports to increase fast enough to increase demand even when public demand is shrinking?
  - Okun's law: productivity is cyclical

# UNEMPLOYMENT: long term (maybe irreversible) damage to social capital and productivity



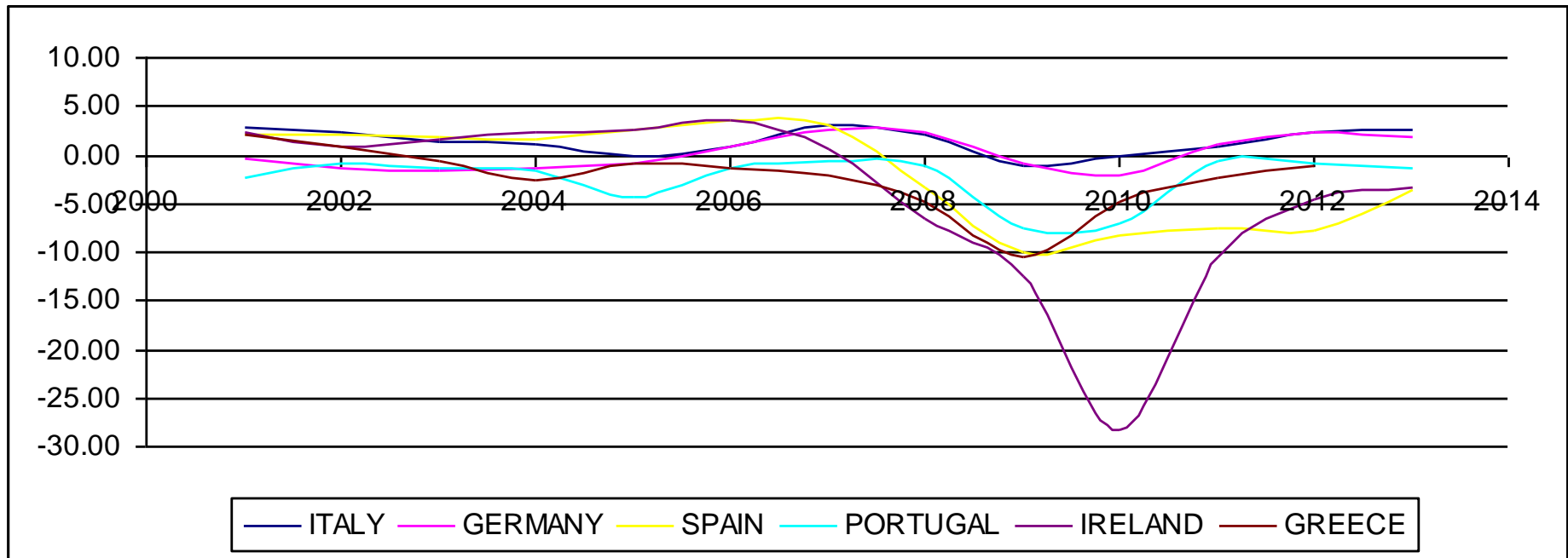
Source: IMF

# Unemployment

- Youth unemployment is very large in Italy and Spain
- This has long lasting negative consequences: some people never learn how to work
- In a very competitive world, there is a risk of irreversible transfer of jobs abroad. If jobs go abroad, then the country is left without the possibility to repay the debt

**WHAT ELSE CAN WE DO?**

# PRIMARY PUBLIC SURPLUS: trying hard to make it different

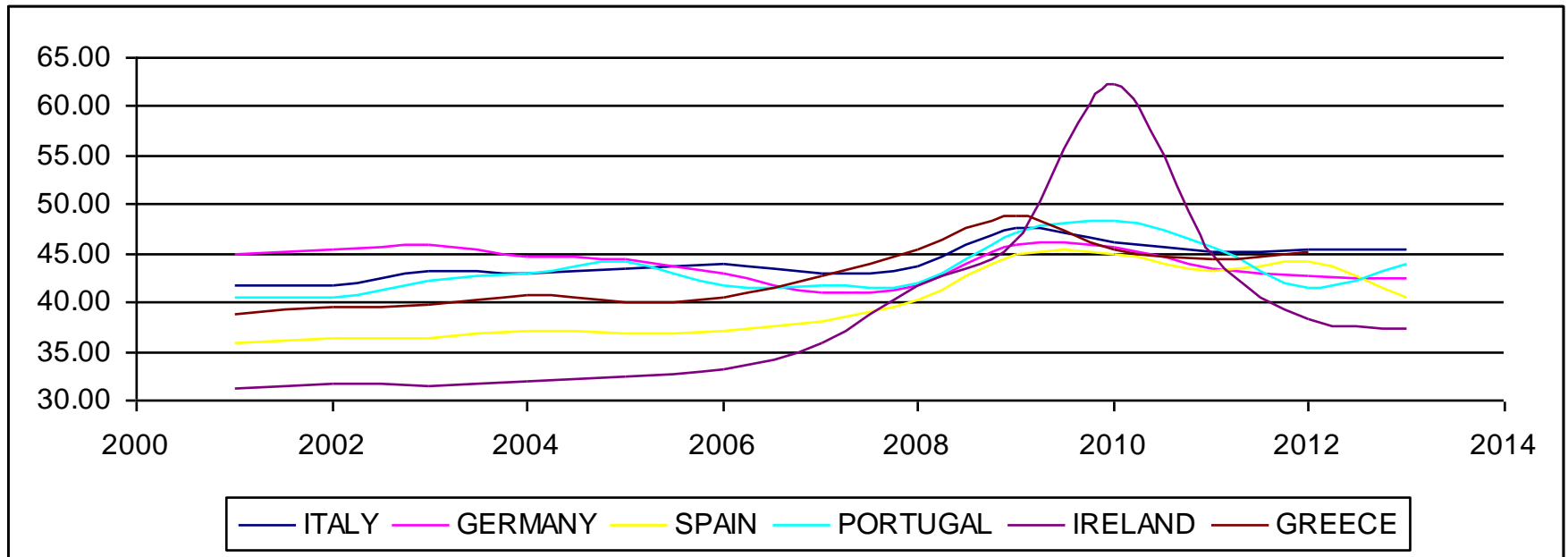


Source: IMF



# NON-INTEREST GOV. EXP.

## Somewhere not moving fast enough



Source: IMF

# Shrinking the public sector

- It must be done, but there is a contractionary impact with a unitary multiplier
- To avoid vicious circles, the only moves can be soft and depend on other sources of growth

# Banks: lending

- Lending is still tight and interest rates very fragmented, with huge differentials between core and periphery
- Eurozone banks have shrunk their assets by almost 3 tn in the last year, and some forecast there will be more downsizing (interesting implications for financial intermediaries)

# Banks: the future

- Redesigning banking:
  - Basel III,
  - Asset Quality Review,
  - Separation between investment banks and commercial banks,
  - Stress tests,
  - Bonds bail-in
  - Leverage rather than Equity/RWA
- Will a more capitalized European banking system be a crucial factor for growth? You can force banks to raise capital, but not to lend (remember UK's funding for lending)
- In order to regulate a banking sector, you need one that is alive, and it can be alive if it is profitable

# CONCLUSIONS





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| CORRANTE    | 0,69 |

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