

Eurozone deepening: some issues and dossiers

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Selecting important dossiers

- European Banking Union (publicize! More important than fiscal union): deposit insurance
 - **NPLs**
 - Sovereign-bank interdependence (“**doom loop**”)
- **ESM-EMF**
 - Governance (no longer intergovernmental?)
 - Tasks (includes sovereign risk sharing, generation of risk free assets, fiscal surveillance, backing of Resolution and Deposit Insurance funds ?)
- Role of **market discipline and orderly resolution** for both sovereigns (automatic procedure?) and banks (bail-in, bail-out)

NPLs

- No sustainable solution without deep restructuring of the banking system
- We can manage stocks and flows but they will come back without intervening on business models and governance. We can deal with the balance sheet but the final solution is in the **income account**. Also: subtract the excess of the resources employed in an obsolete sector like banking
- EU can help but national defensive attitudes (by bankers, politicians and authorities) must stop

Sovereign-bank interdependence and the “doom loop”

- The EU Parliament and Nicolas Véron proposal (gradually **eliminate the concentration risks** with no change of Basel ratios)
 - with positive side effects on capital markets union (& market based risk sharing) and the transmission of monetary policy
- Is the doom-loop issue **overstressed**? As a sovereign default always involves banks. No:
 - From sovereigns to banks: the case of spread-type speculative shocks
 - From banks to sovereigns: liquidity interbank shocks, bail-outs and bail-ins, mark-to-market accounting of banks holdings of sovereigns
 - Implicit support of public debt (with or without moral suasion) and potential crowding out of credit to the private sector

ESM-EMF: governance

- The important point is the independence of management with stability objectives, accountable to the board of directors, with the possibility to intervene *sua sponte*, even with no conditionality
- Resuscitate part of the spirit of the OMTs
- Compatible also with substantial intergovernmental board of directors
- Smoothing markets function as an ex post pillar after ex ante surveillance (Commission for countries, EC for banks) and market discipline.
And ... before default !

Defaults

- Stop the hypocrisy that banks and EU-sovereign defaults are “impossible” or inevitably disastrous
 - market spreads aren’t always market failures
 - Greece, Cyprus have happened: with private (?) solutions
- Once defaults are admitted, orderly publicly regulated procedures are needed
- **No automaticity** as defaults and complex deals also needing tactics and discretion (as well as the implicit consensus of the defaulting government)
- The importance of partial (“small”) sovereign defaults: where the defaulting government compares the cost of adjusting with that of defaulting