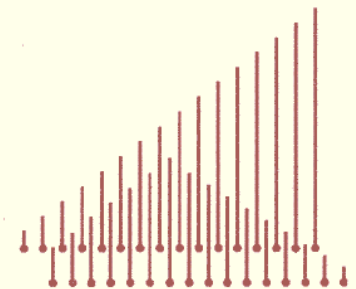


niesr

Banking crisis → sovereign crisis →
banking crisis: can we break the cycle?

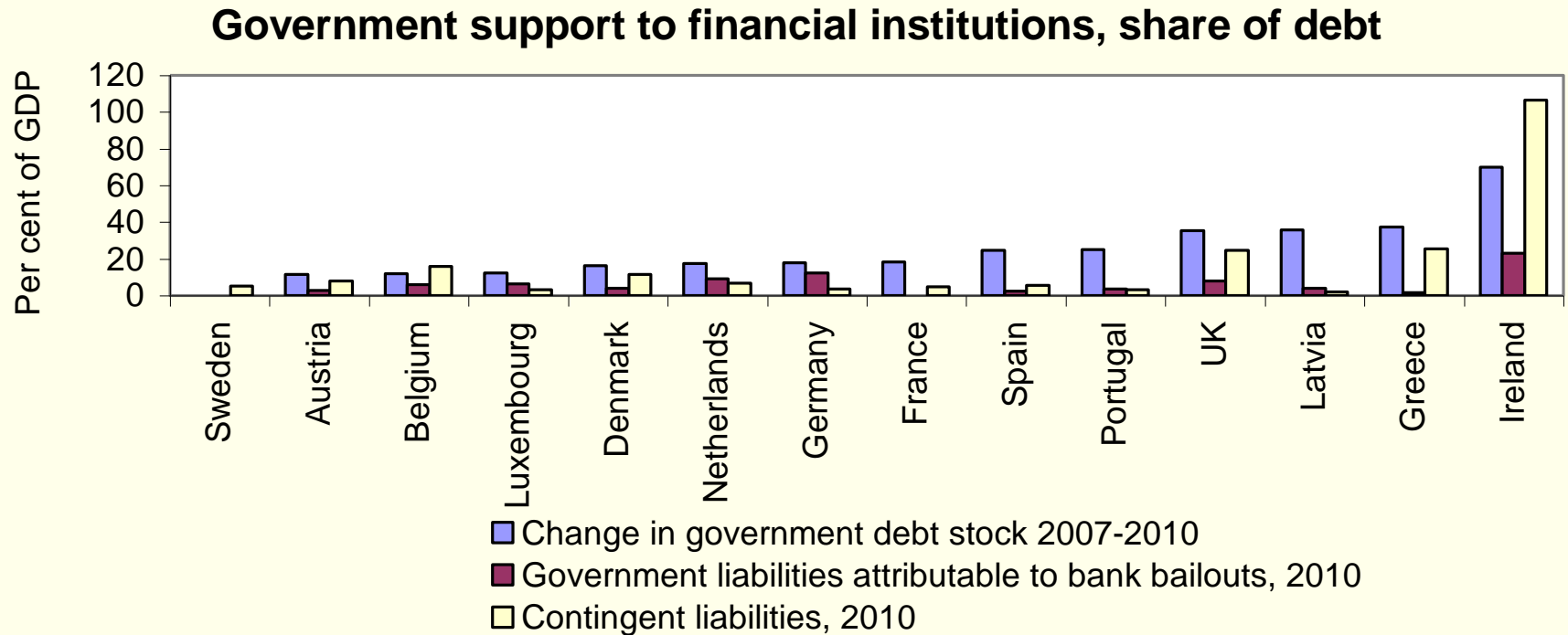
Dawn Holland

AIECE Meeting, Brussels
November 2011



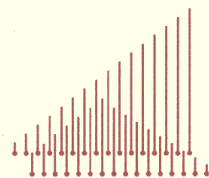
National Institute
of Economic and
Social Research

Bank Bailout costs to sovereigns



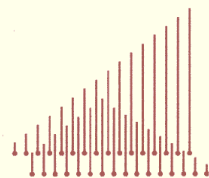
Source: Eurostat

Note: This excludes costs accrued through the deficit – significant in Ireland

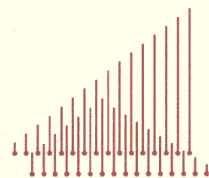
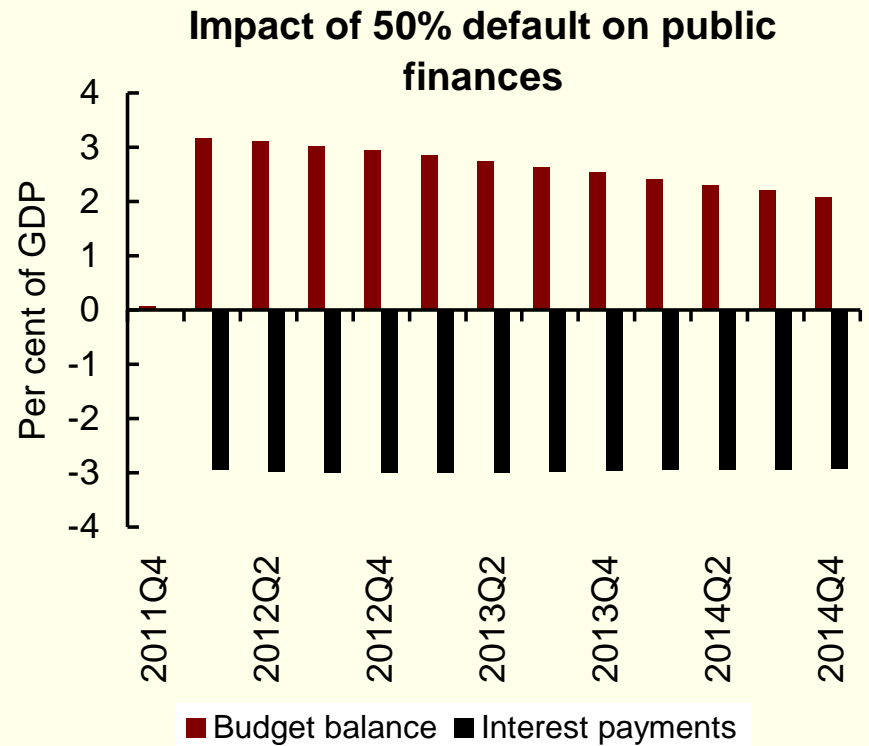
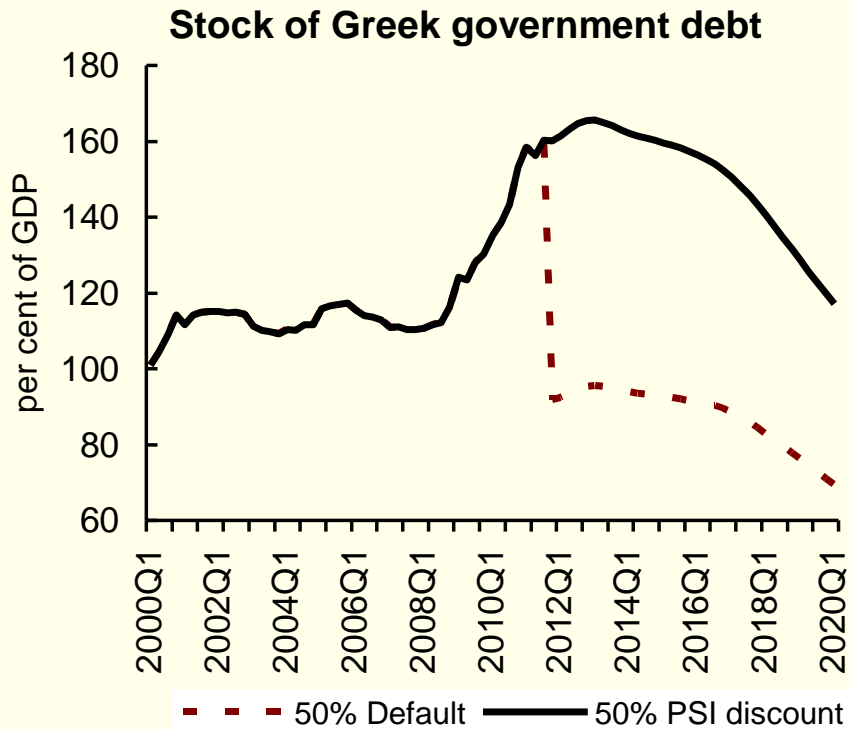


Assessing policy proposals

- *50% “voluntary” discount on Greek government debt (120% GDP by 2020)*
 - Is this Greece sufficient to restore fiscal sustainability?
- *EFSF to be leveraged to €1trn*
 - Not clear how it will be financed – do we need China??
 - Is this enough to ensure liquidity??
- *Bank recapitalisation*
 - Provisions for Greece and other “programme” countries
 - Banks in other countries can access EFSF as a last resort....
- *Longer-term commitment to off-market lending*
- *Monitoring agreed reforms*

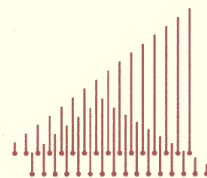


A 50% haircut?



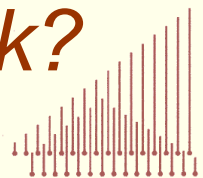
Review of questions for discussion

- *To what extent can we attribute rising risk premia and deteriorating outlook to:*
 - Policy uncertainty/market speculation
 - Sovereign indebtedness
 - Bank bailout costs
 - Banking supervision/banking fragility
 - Household indebtedness/adjustment
 - Policy tightening?
 - Lack of competitiveness/Euro Area imbalances



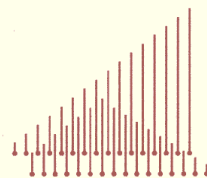
Review of questions for discussion

- *What are our assumptions regarding evolution of the Euro Area crisis?*
 - How long will it take to find a solution?
 - Will risk premia rise further?
 - Are private sector borrowing costs constrained by public sector borrowing costs?
 - What makes a credible consolidation plan?
- *Are any countries immune to sovereign contagion?*
- *Are there any upside risks to the outlook?*



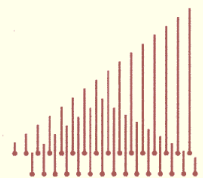
Review of questions for discussion

- *Has labour market response to recession differed from previous recessions?*
 - Will unemployment rise more sharply if Europe falls back into recession?
 - Are our unemployment projections consistent with output projections or overly optimistic?
 - Do they imply additional labour hoarding?



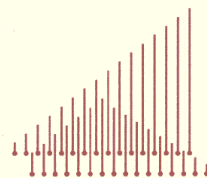
Review of questions for discussion

- *What are the biggest restraints on consumer spending?*
 - Income effects
 - Job losses/Reduced hours/Higher taxes/Wage cuts
 - Uncertainty
 - Access to finance
 - Balance sheet adjustment



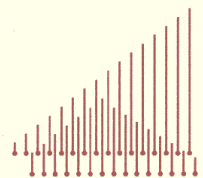
Review of questions for discussion

- *How should we calculate probabilities around a forecast?*
 - Are we too optimistic on Euro Area/EU as a whole in 2012?
- *Is inflation a concern?*
- *Role of the oil price*
 - Is correlation between oil price assumptions and forecast driven by cause or effect?
 - Sequencing of forecast



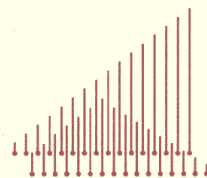
Review of questions for discussion

- *Banking system*
 - Can European banks raise private sector capital in the current climate?
 - Will banks meet the new capital requirements by shrinking their balance sheets rather than raising additional capital?



Review of questions for discussion

- *Prospects for EMU*
 - What is the likelihood of the Euro Area breaking apart?
 - Is an orderly break-up possible?
 - Could a two-tier Euro Area form?
 - Who would join the two clubs?



Review of questions for discussion

- *How can we prevent recession in Europe?*
 - No room for policy stimulus?
 - Can we prevent a collapse in world trade?
- *Should we still be concerned with global imbalances?*
 - US current account deficit just 3% GDP, China's surplus below 4% GDP
 - Perhaps imbalances within Euro Area are more important?

