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)
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)
Figure 6: Amount owed by European banks to US prime money market funds by nationality of borrowing bank (end-June 2011) (Source: IMF 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)
Figure 13: International claims of European BIS-reporting banks on counterparties in Spain (Source: BIS consolidated banking statistics, Table 9D)
Figure 14: International claims of European BIS-reporting banks on counterparties in Ireland (Source: BIS consolidated banking statistics, 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)
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?...)

24