Europe 2013 – Recovery Or Relapse Unfinished Business For Overindebted Economies?

Frank Veneroso

"The Eurozone Crisis, Greece, and the Experience of Austerity"
Athens, Greece

November 8-9, 2013

Megaron Athens International Conference Centre
A conference organized by the Levy Economics Institute of Bard College
with support from the Ford Foundation

Abstract

The following reviews the European crisis and the latest European economic data. It then asks about the immediate future. Basically the crisis was about the fatal flaw in the euro identified by Peter Garber a long time ago – a proneness to bank deposit runs. In early 2012 fiscal austerity led to economic weakness and a focus on sovereign debt. That in turn led to a bank run on the periphery - the fatal flaw of the euro. Then came Super Mario who, with a wave of his magic wand in August, somehow ended the market panic without ever having to use his OMT. It was a triumph of expectations management. In the winter that followed there was a serious recession as the financial crisis worked its way with a lag into aggregate demand and output. But by then all the financial conditions had improved, thanks to Super Mario, and that improvement led to the rather amazing green shoots of this past spring. Now, in the latest months, the data on Europe has become mixed; there is a loss of momentum and a possibility of relapse. The odds may well favor "muddle through" – the consensus expectation. But the coast is not clear.

So what will drive Europe now. These last two years were about bank runs and market panics over sovereign debts and euro exit. Private debt was in the background. But European private debt is extremely high and its ratio to GDP has not gone down over these last years. So there is still a private debt threat. This is Minskian. And inflation is falling, so there is a deflation threat, which is Fisherian. We cannot know if there is another shoe to drop, but if there is it will have to be Minskian and triggered by the disappearance of debt alleviating inflation. And heaven help Europe if the economies on the periphery adjust to the prevailing current account imbalances by deflating their price levels. Because then there could be deflation in Europe, and, with still sky high private debt, it might suffer a Fisherian debt deflation outcome. And remember, there is still no system wide deposit insurance; the fatal flaw in the euro has never been addressed, and it would probably resurface in such a Fisherian outcome.

Crisis Europe: A Saga In Six Parts

- Part I - Bank Runs 2012, The Fatal Flaw In The Euro
- Part II - Super Mario Calms Panicked Financial Markets
- Part III- The Legacy: A Dark Winter Of Recession
- Part IV- Spring 2013: Suddenly Green Shoots Everywhere
- Part V- Late Summer 2013; Relapse?
- Part VI- Looking Forward, Through A Glass Darkly

PART I: THE ARMAGEDDON SCARE

The Fatal Flaw Of The Euro

"In one of the earliest papers on European monetary union, Ingram (1973) notes that in such a union *"payments imbalances among member nations can be financed in the short run through the financial markets, without need for interventions by a monetary authority. Intercommunity payments become analogous to interregional payments within a single country"*3. This view was not challenged in the debate of the 1980s and the 1990s on the economics of Economic and Monetary Union (EMU). It quickly became conventional wisdom. The European Commission's *One Market, One Money* report (1990) similarly posits that *"a major effect of EMU is that balance-of-payments constraints will disappear [..]. Private markets will finance all viable borrowers, and savings and investment balances will no longer be constraints at the national level"*4."

"The benign view prevailed during the first ten years of EMU. It even continues to dominate today."

"Sudden Stops In The Euro Area", Silvia Merler and Jean Pisani-Ferry
Bruegel Policy Contribution
March 2012

For Twenty Years, False Confidence

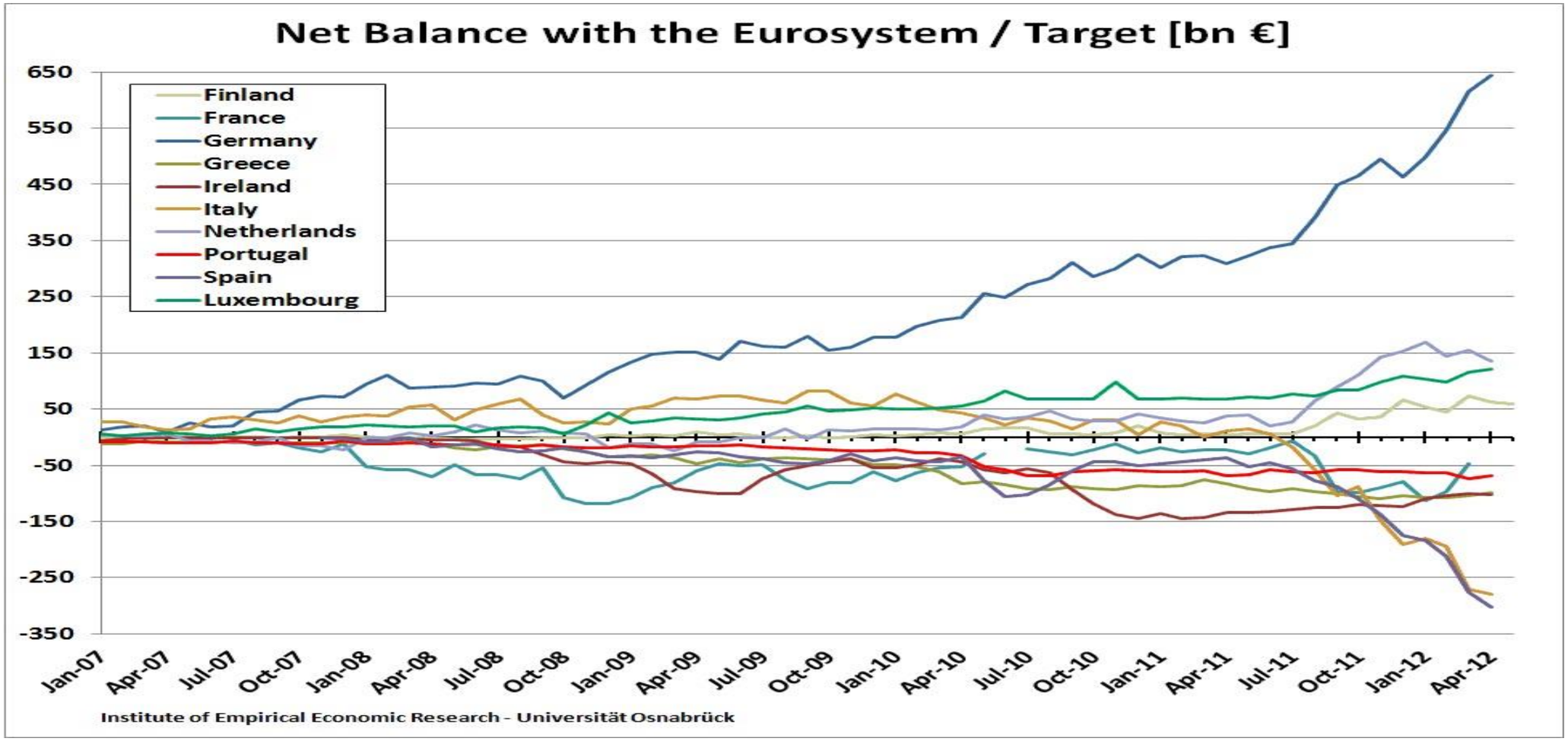
The Fatal Flaw Of The Euro

“To our knowledge, the only one to challenge this benign view was Peter Garber in a 1998 paper on the role of TARGET in a crisis of monetary union (Garber, 1998). The paper insightfully recognized that the federal structure of the Euro system and the corresponding continued existence of national central banks with separate individual balance sheets made it possible to imagine a speculative attack within monetary union. According to Garber, the precondition for an attack “must be skepticism that a strong currency national central bank will provide through TARGET unlimited credit in euros to the weak national central banks”. His conclusion is that “as long as some doubt remains about the permanence of Stage III exchange rates, the existence of the currently proposed structure of the ECB and TARGET does not create additional security against the possibility of an attack. Quite the contrary, it creates a perfect mechanism to make an explosive attack on the system”.

“Sudden Stops In The Euro Area”, Silvia Merler and Jean Pisani-Ferry, Bruegel Policy Contribution, March 2012

Fatal Flaw Exposed In 2012

Target 2 Balances, Q2 - 2012



The Bank Run: From The Weak To The Strong

Deposit Run Potential - Staggering

Spain’s De Guindos Says Euro’s Fate at Stake in Next Weeks, Bloomberg, June 4, 2012

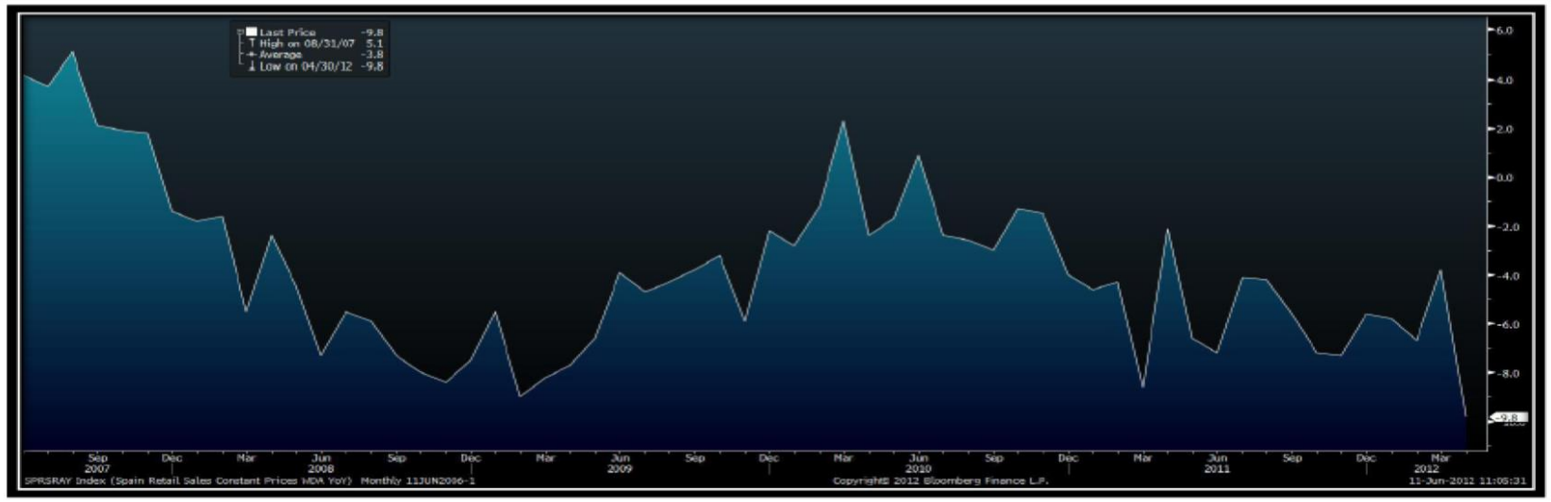
De Guindos said the balance of payments data, which showed an outflow of 97 billion euros in the first quarter, didn't reflect "capital flight," and underlined how Spanish banks were struggling to roll over funding on money markets. The outflow from individuals was about 1 billion euros in the first quarter, he said.

"What this shows is not capital flight, but the financing difficulties of Spanish banks in money markets," he said. "Spanish banks are having growing difficulties accessing money markets mainly in Europe: in the U.S. the money markets are very much closed to all European banks."

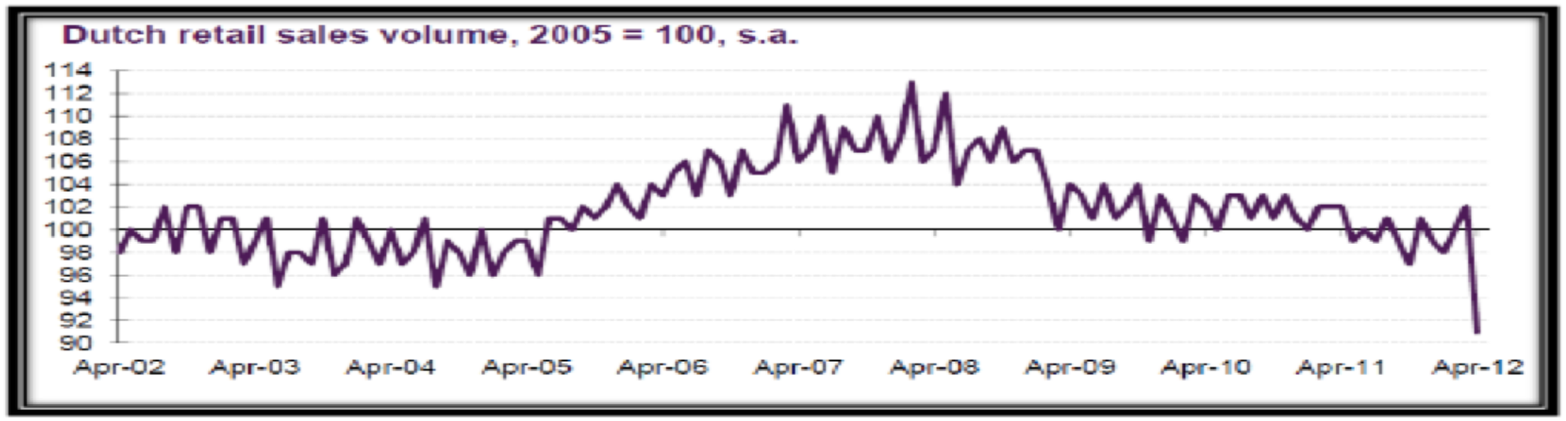
Spain's M3 was € 1138bn in March. At the same date, Spanish banks' total liabilities were € 4231bn, € 2277bn of which domestic. Total deposits were € 2991bn, almost 3 times M3.

Spain: Deposits = 3 X GDP AT Risk

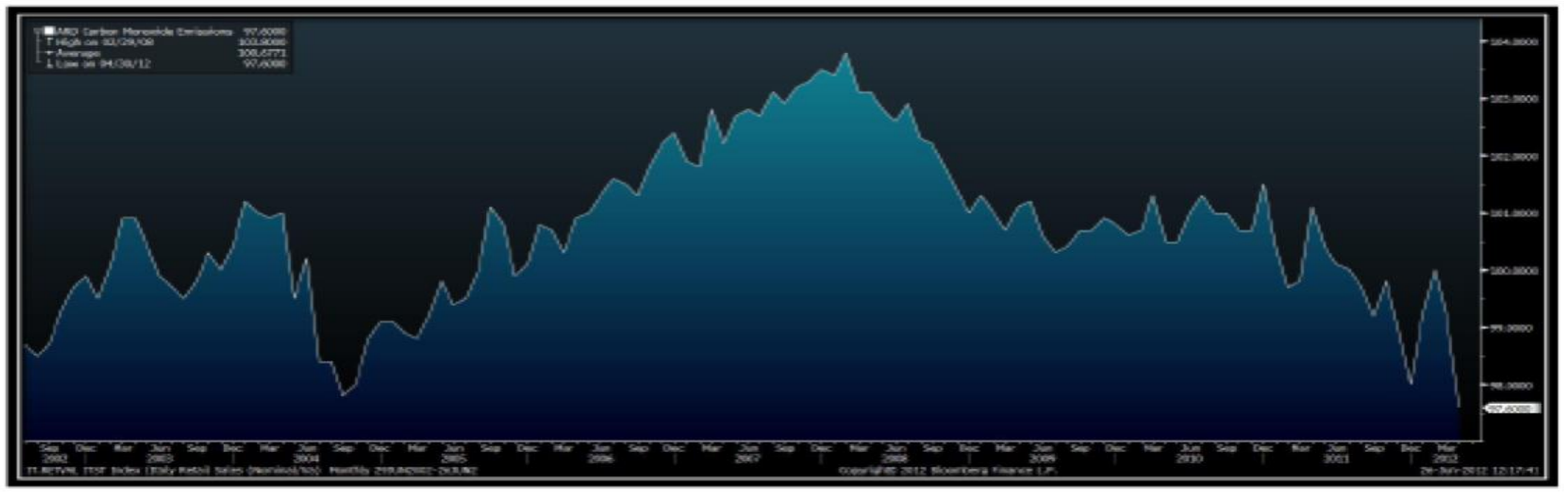
Suddenly The European Economy Starts To Shudder



Bloomberg, November 3,2013



Lombard Street Research, ,2013



Bloomberg, November 3,2013

Alarm! Is It One Minute To Midnight In Europe?

"Joschka Fischer, Germany's former vice-Chancellor: said EU leaders have two weeks left to save the project."

Ambrose Evans-Pritchard, *"The week that Europe stopped pretending"*
June 3, 2012

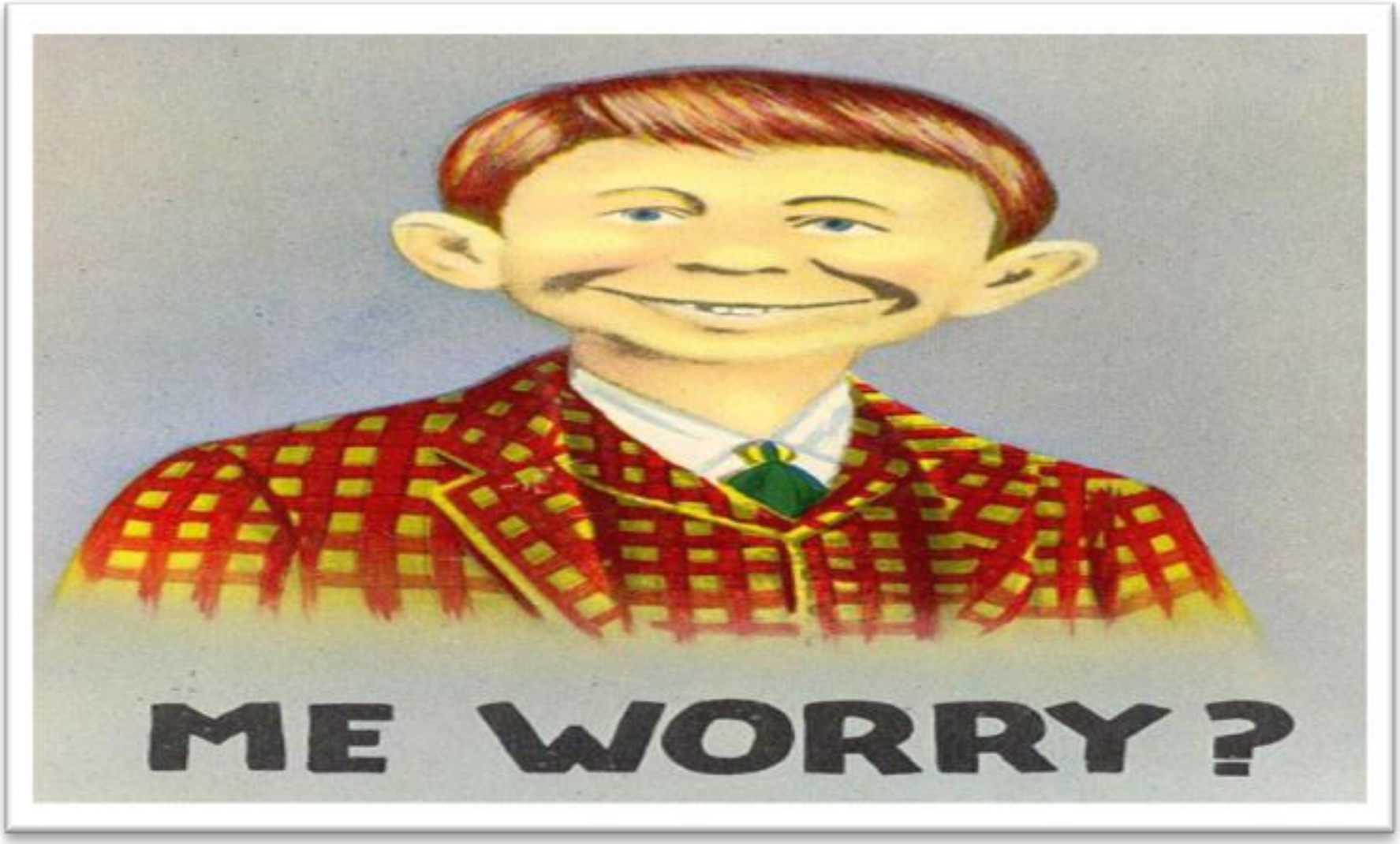
Prime Minister Mario Monti: "we have one week to save the euro zone."

Source: The Guardian

"On a recent visit to Barcelona, one of us was repeatedly asked if it was safe to leave money in a Spanish bank. This kind of process is potentially explosive. What today is a leisurely "bank jog" could easily become a sprint for the exits. In the event of a Greek exit, rational people would ask: who is next?"

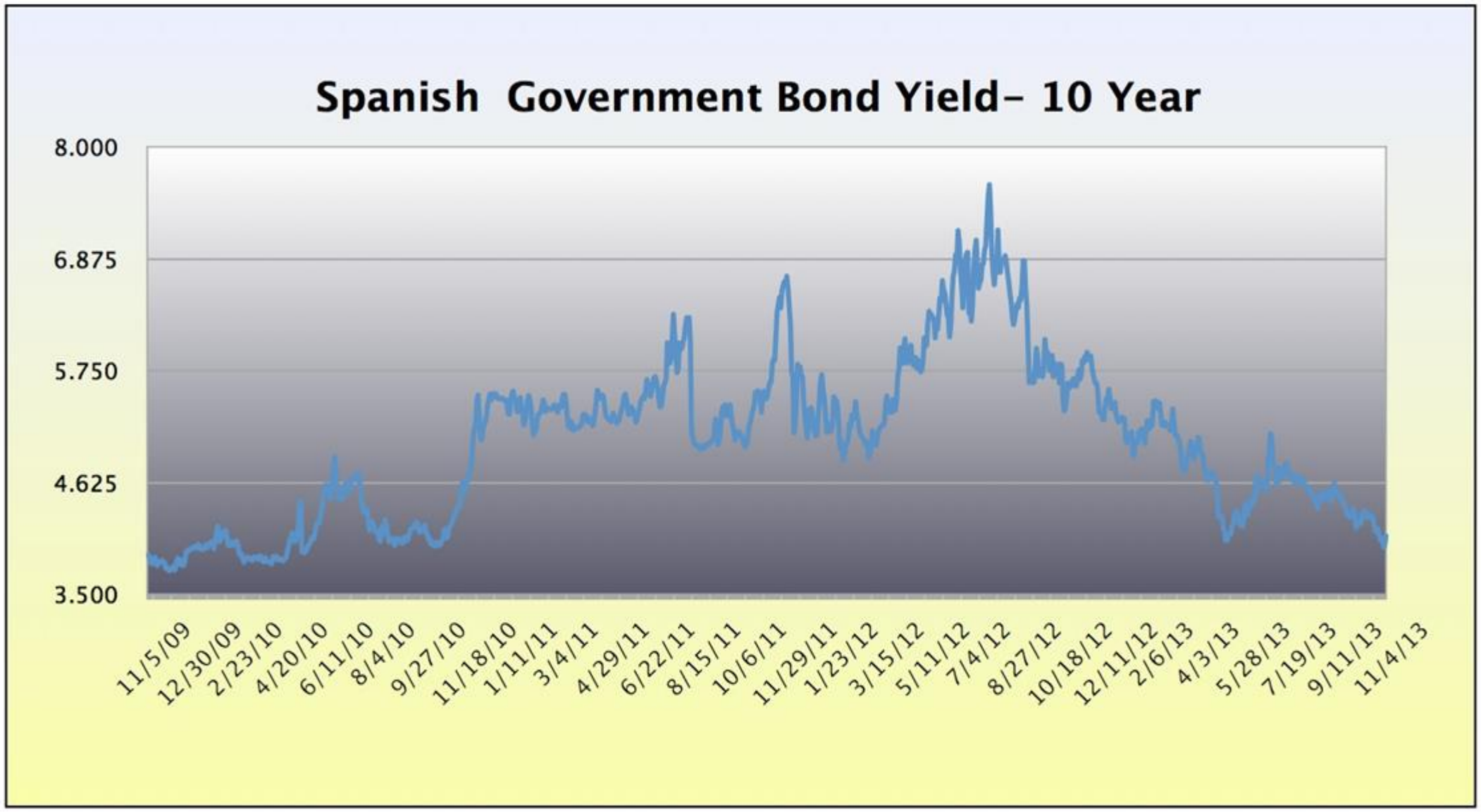
Niall Ferguson and Nouriel Roubini, *"Is it one minute to midnight in Europe?"*
Financial Times, June 11, 2012

PART II: Super Mario



A Triumph Of Expectations Management

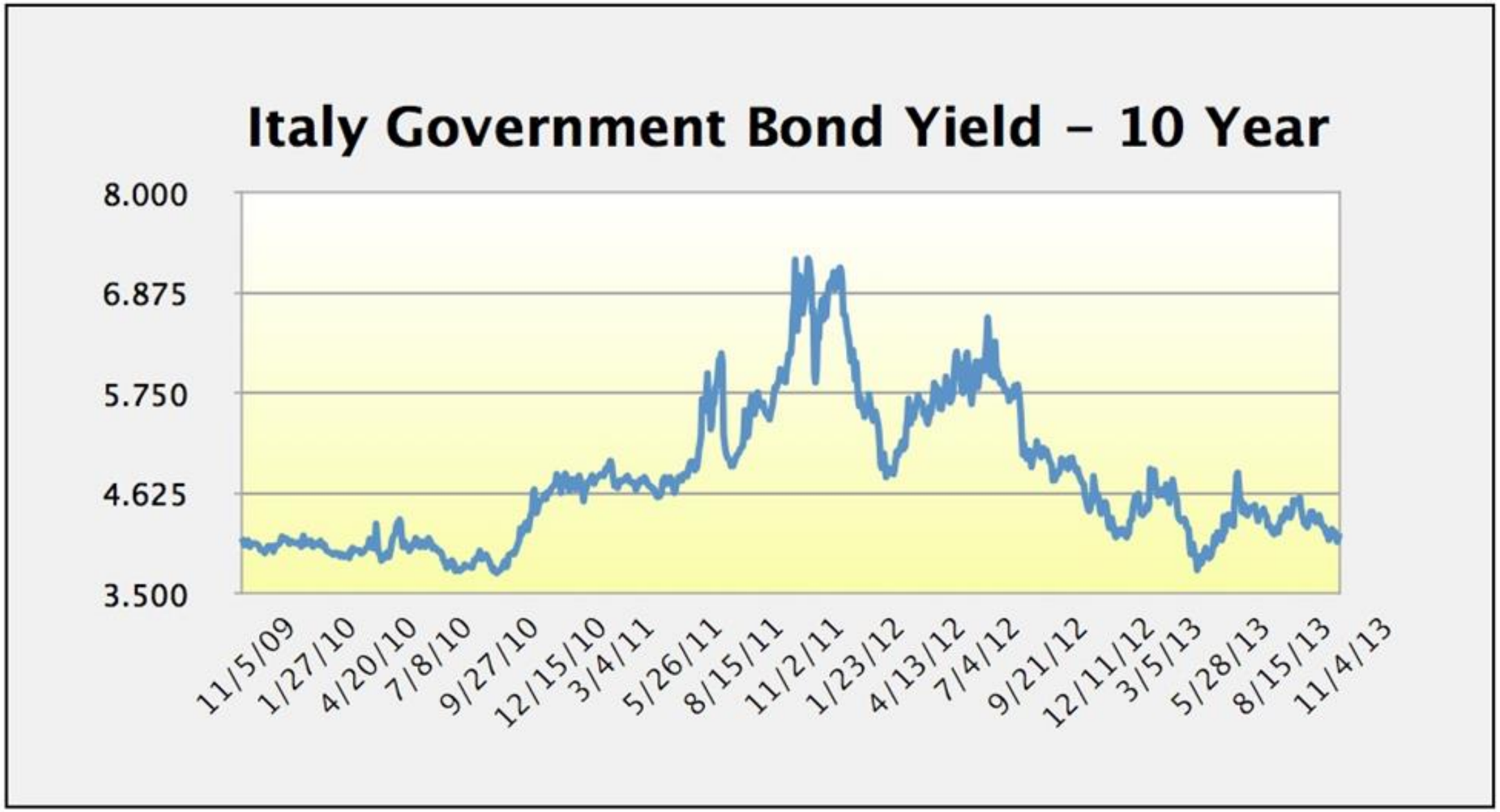
Alarm Leads To Market Panic



Bloomberg, November 3,2013

In Mid Summer 2012 Peripheral Rates Soar

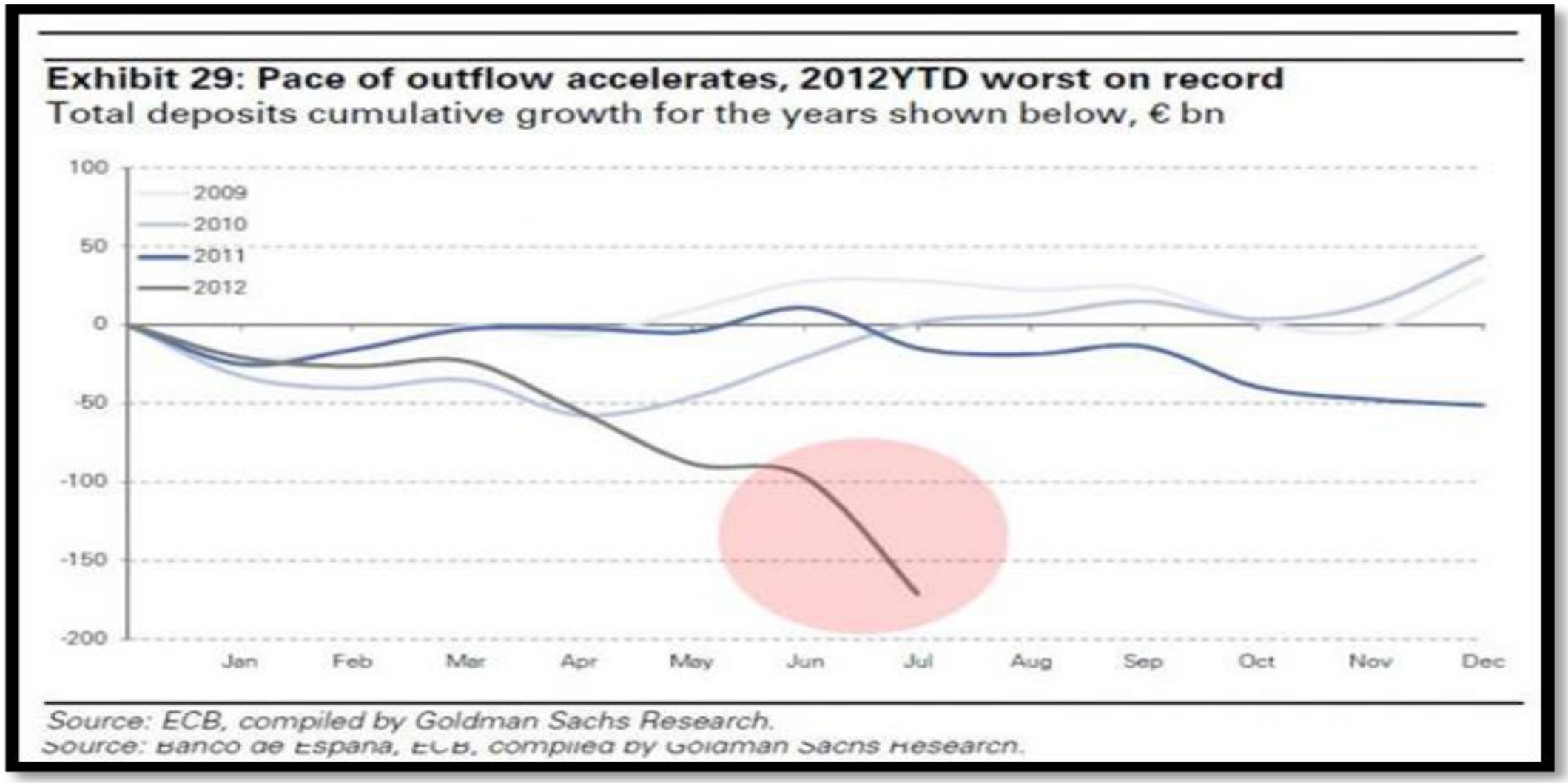
Alarm Leads To Market Panic



Bloomberg, November 3,2013

In Mid Summer 2012 Peripheral Rates Soar

Spain, Summer 2012

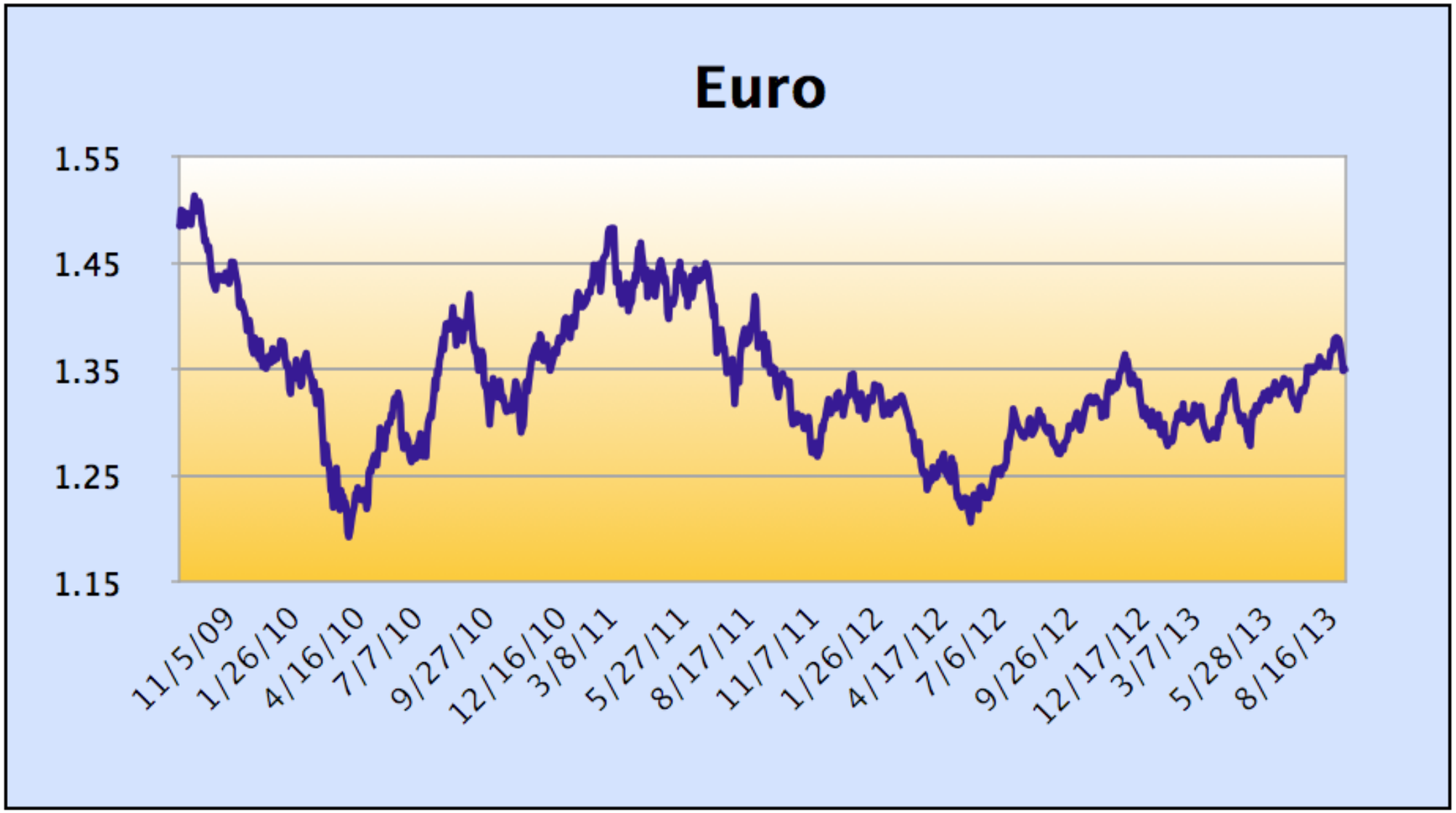


The Deposit Run Intensifies

Super Mario To The Rescue

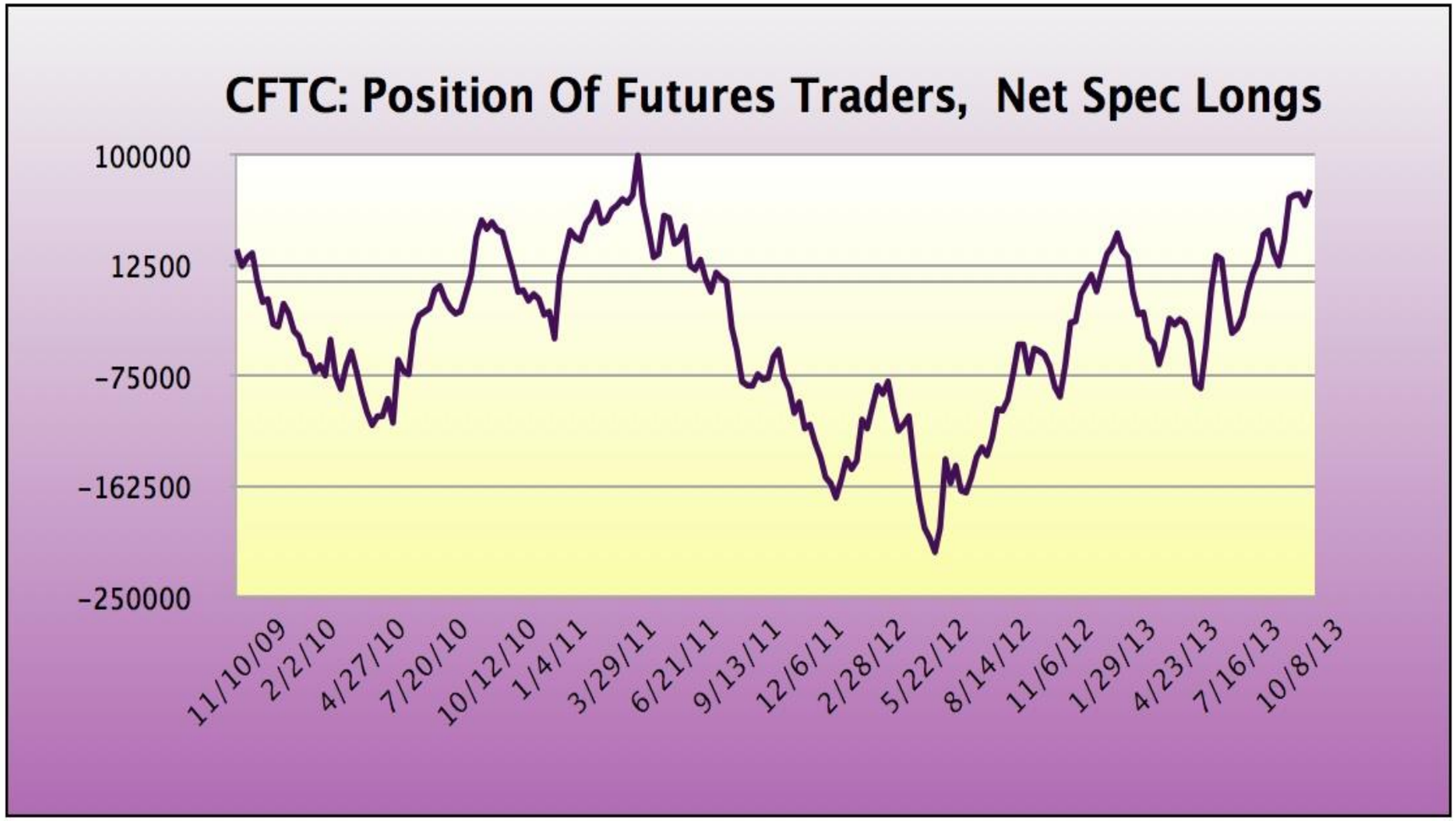
In August the ECB announced its program of outright monetary transactions (OMT) that would purchase European sovereign bonds in the secondary market. This would add to already existing ECB support to beleaguered European banking systems. The policy worked wonders. The “announcement effect” reversed the intense speculation in peripheral bond markets, as the charts just reviewed all showed.

In Summer 2012 The Euro Had Also Weakened



Bloomberg, November 3,2013

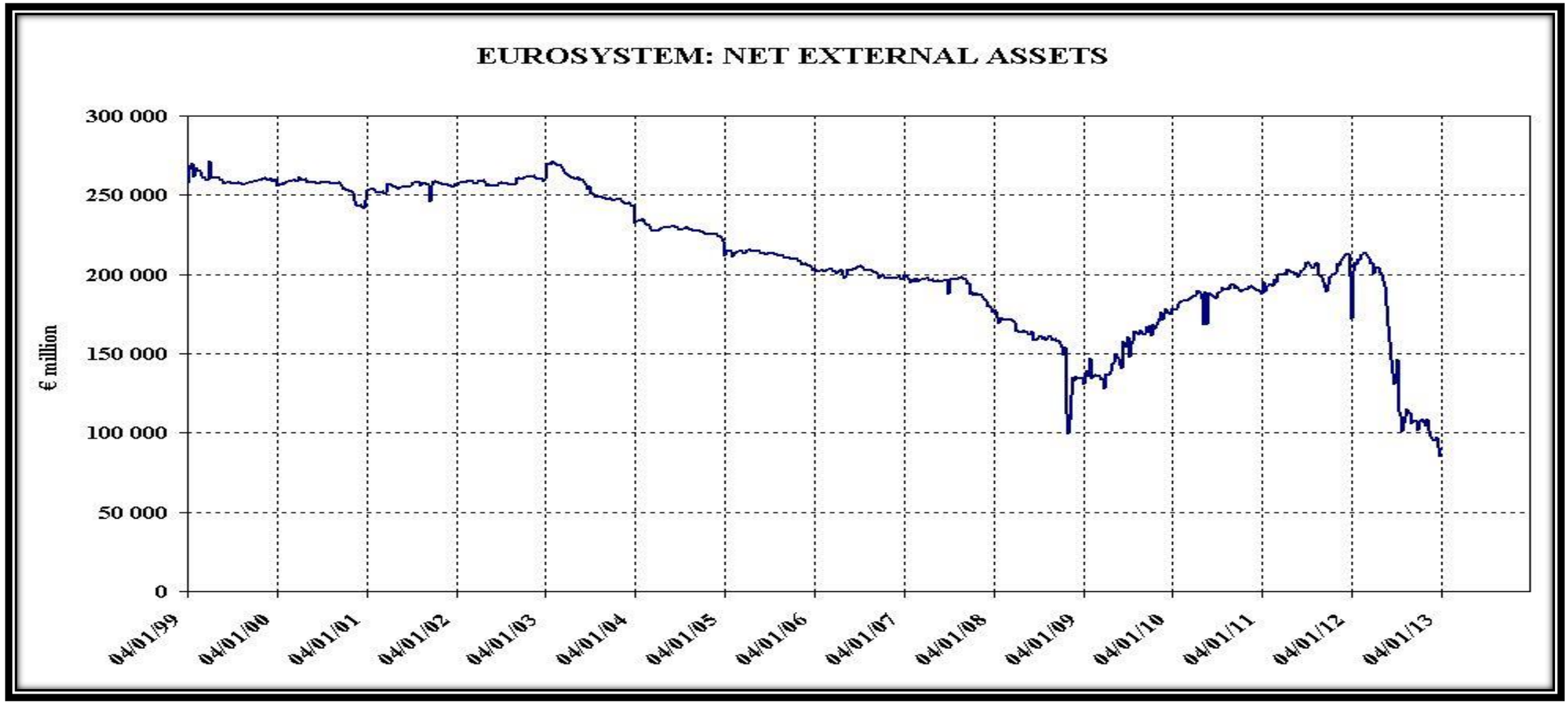
Pounded Down By Unprecedented Speculative Short Selling



Bloomberg, November 3,2013

Which Super Mario's Expectations Management Reversed

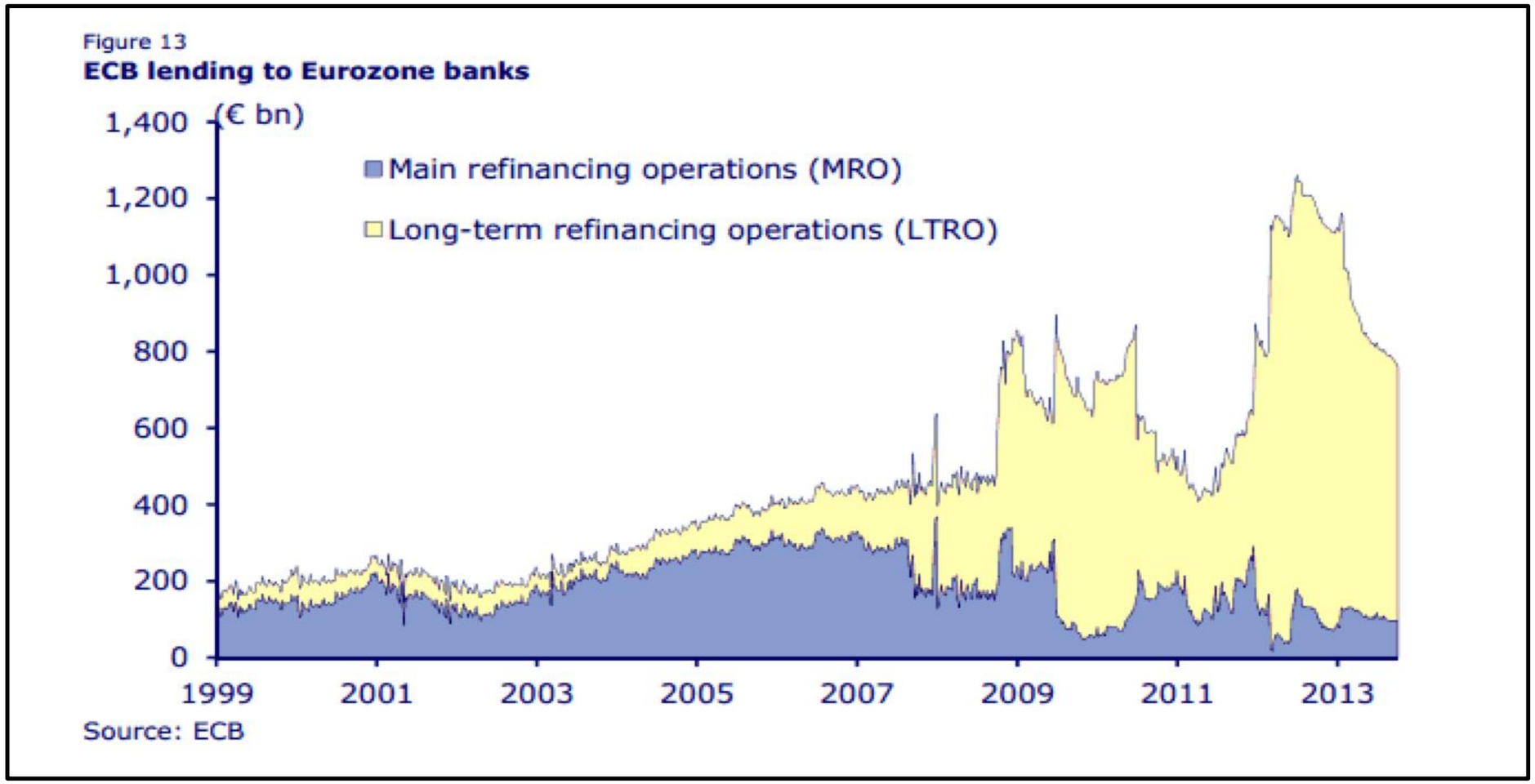
With A Little Help From Friends?



Eric Barthalon, November 6, 2013

The Collapse In ECB Net External Assets Was Due To A Surge In Foreign Exchange Liabilities. Swaps From Official Friends Abroad?

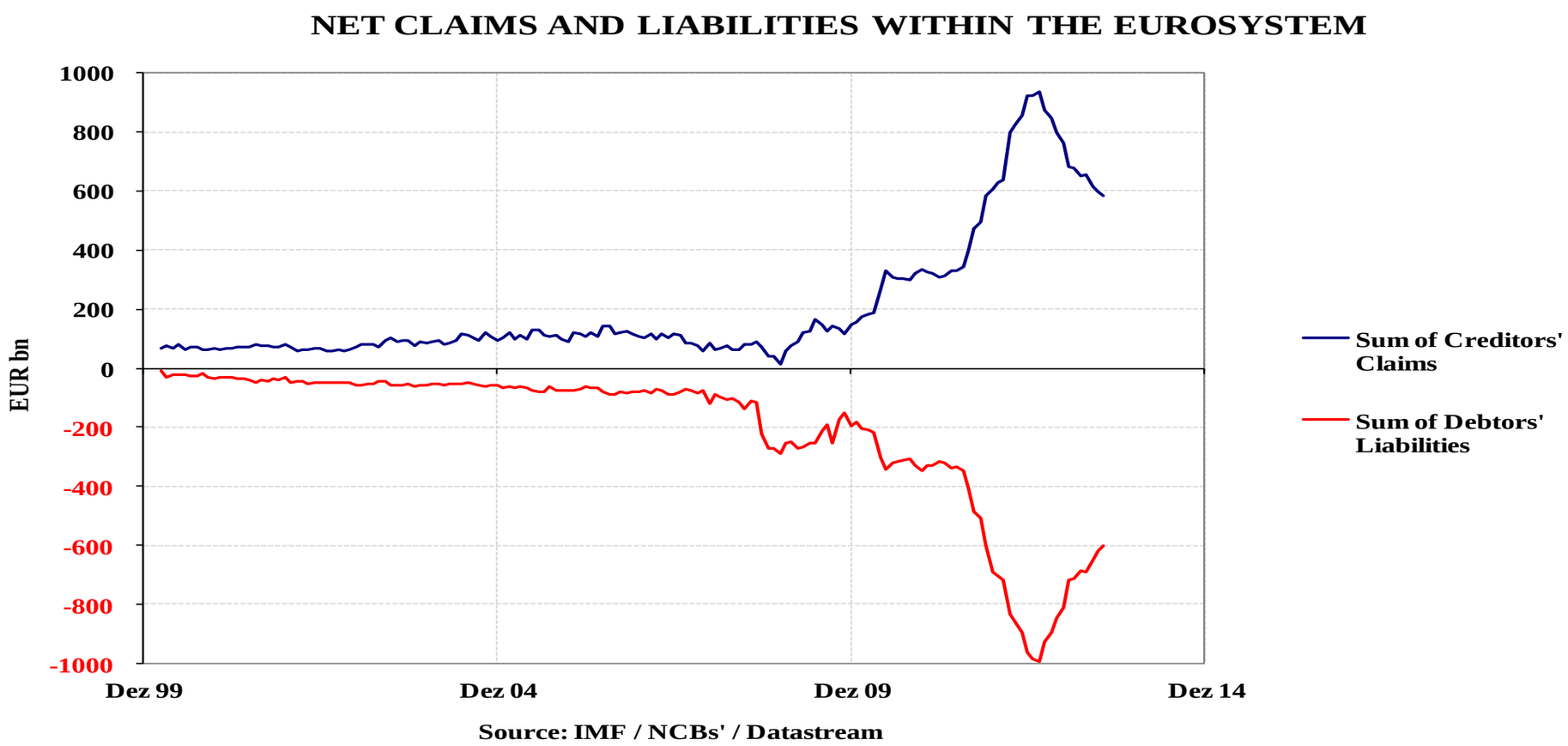
Existing ECB Support Operations Intensified In That Panic Period Until The Markets Dramatically Reversed.



Christopher Wood, CLSA, October 31,2013

In The End The OMT Was Not Needed

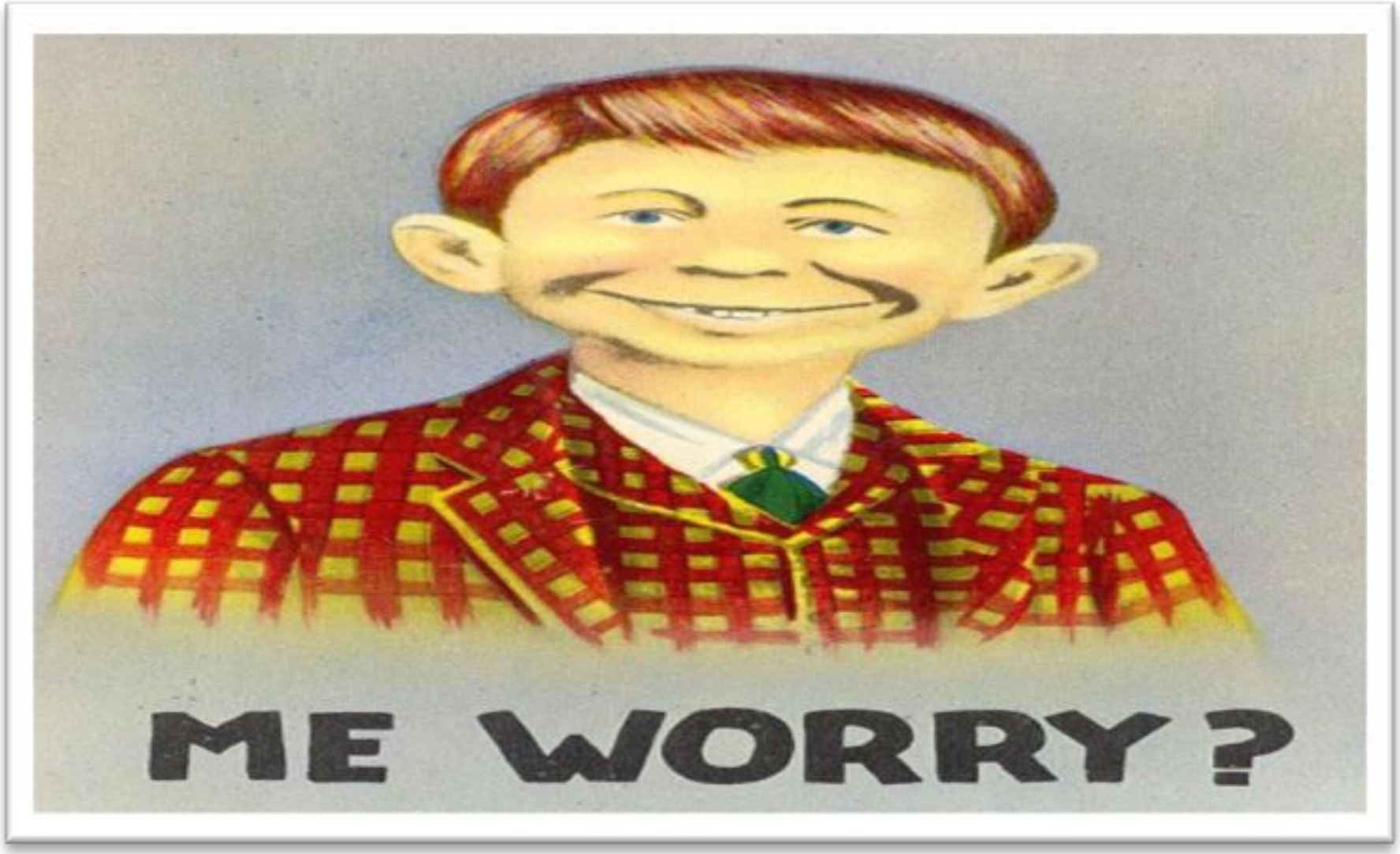
In principle, euro system wide deposit insurance should have been needed to staunch the bank runs in the periphery. In fact, it wasn't. As the decline in Target 2 liabilities shows.



Eric Barthalon, November 6, 2013

Expectations Management And ECB Liquidity Facilities Did The Job

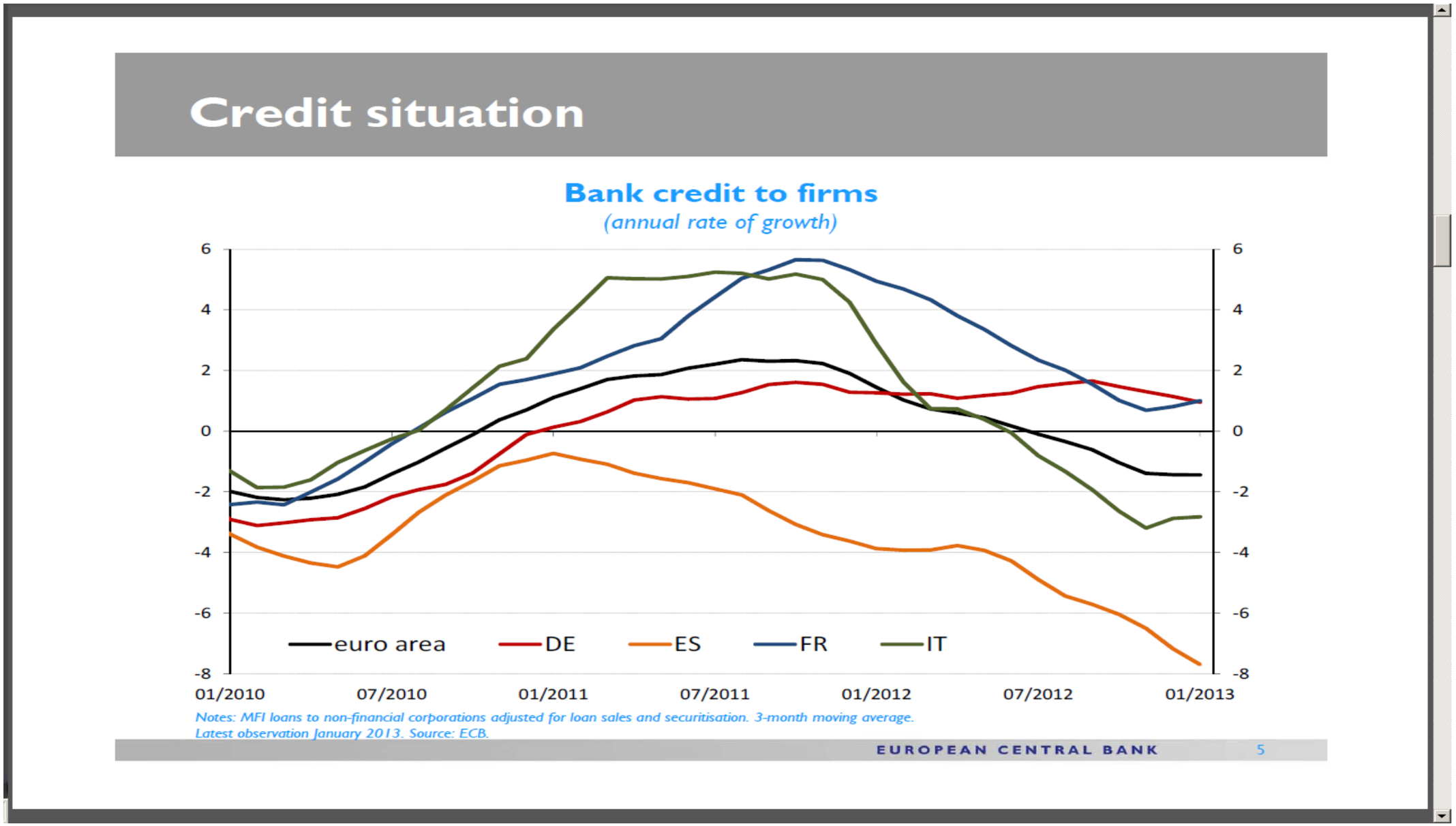
Super Mario. Hurrah!



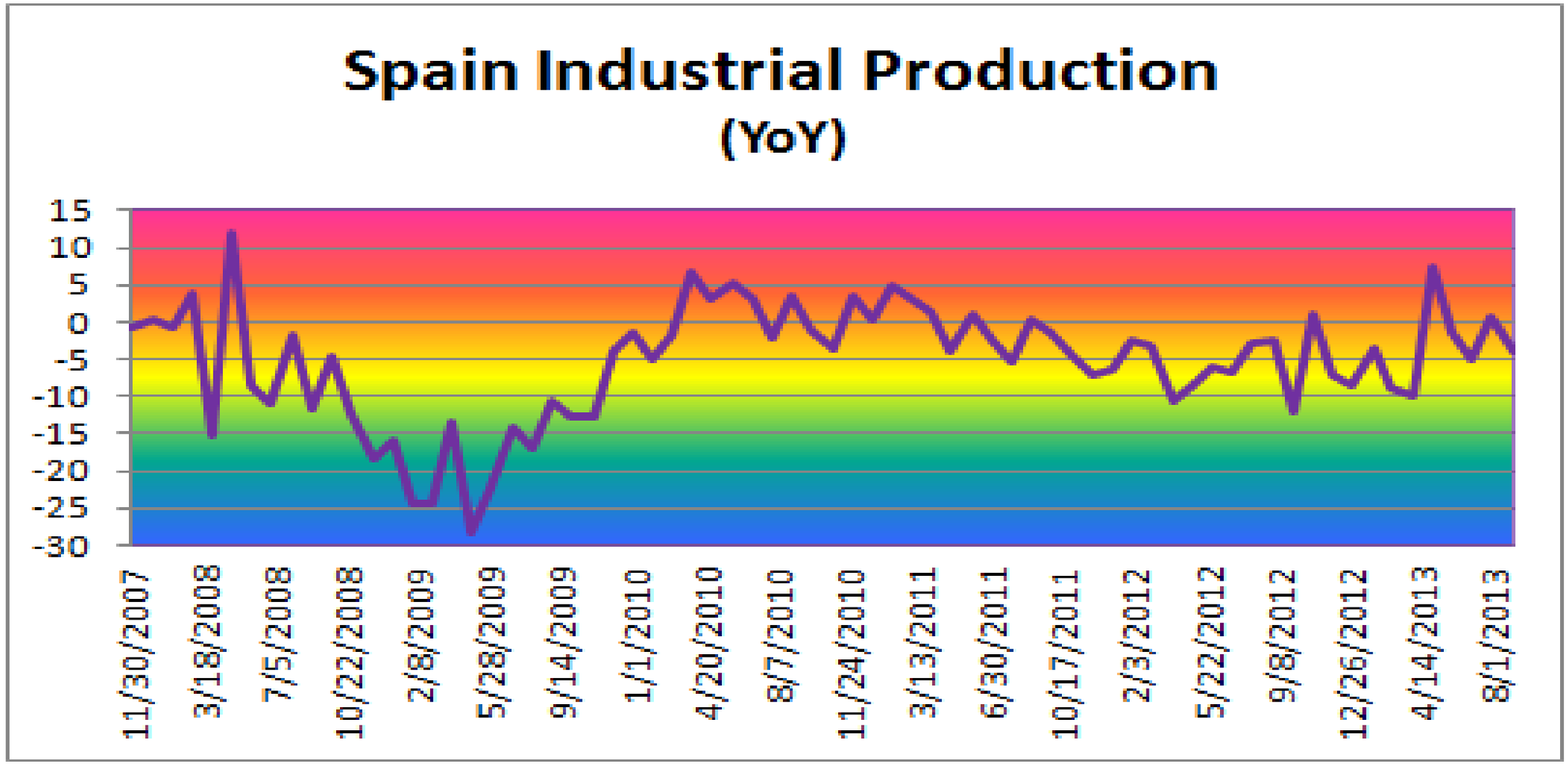
PART III:
The Cold Dark Winter

Financial Panic Subsided But The European Recession Deepened

During The Winter European Bank Credit Contracted



And So Did The Economy



Bloomberg, November 6, 2013

Such Double Digit Declines Were Depression Type Numbers

Spain Real Retail Sales

Bloomberg, November 3, 2013

Such Double Digit Declines Were Depression Type Numbers

Retail Sales Contracted All Across Europe

	Feb. 2013	Jan. 2013	Dec. 2012	Nov. 2012	Oct. 2012	Sept. 2012
	YOY%					
Italy	n/a	-4.1%	-3.0%	-4.1%	-6.3%	-2.4%

	Feb. 2013	Jan. 2013	Dec. 2012	Nov. 2012	Oct. 2012	Sept. 2012
	YOY%					
Netherlands	n/a	-6.6%	-2.8%	-5.4%	-3.6%	0.7%

	Feb. 2013	Jan. 2013	Dec. 2012	Nov. 2012	Oct. 2012	Sept. 2012
	YOY%					
Portugal	-5.3%	-4.4%	-8.2%	-5.8%	-6.1%	-6.3%

Bloomberg, October 2013

Even In Germany Real Retail Sales Fell

	March 2013	Feb. 2013	Jan. 2013	Dec. 2012	Nov. 2012	Oct. 2012	Sept. 2012	Aug. 2012
	----------Seasonally Adjusted----------							
Real MOM%	-0.3%	-0.6%	3.1%	-2.0%	0.9%	-0.6%	0.0%	0.1%
	----------Not Seasonally Adjusted----------							
Real YOY%	-2.8%	-2.6%	2.6%	-3.4%	0.4%	1.6%	-3.5%	-0.4%

Bloomberg, October 2013

A Winter Contraction

Then Came The Cyprus Crisis. A Template For Renewed Bank Runs

"In the bailout of Cyprus, Germany went too far. In order to minimize the cost of the bailout it insisted on bailing in bank depositors. This was premature. If it had happened after a banking union had been established and the banks recapitalised, it might have been a healthy development. But it came at a time when the banking system was retreating into national silos and remained very vulnerable."

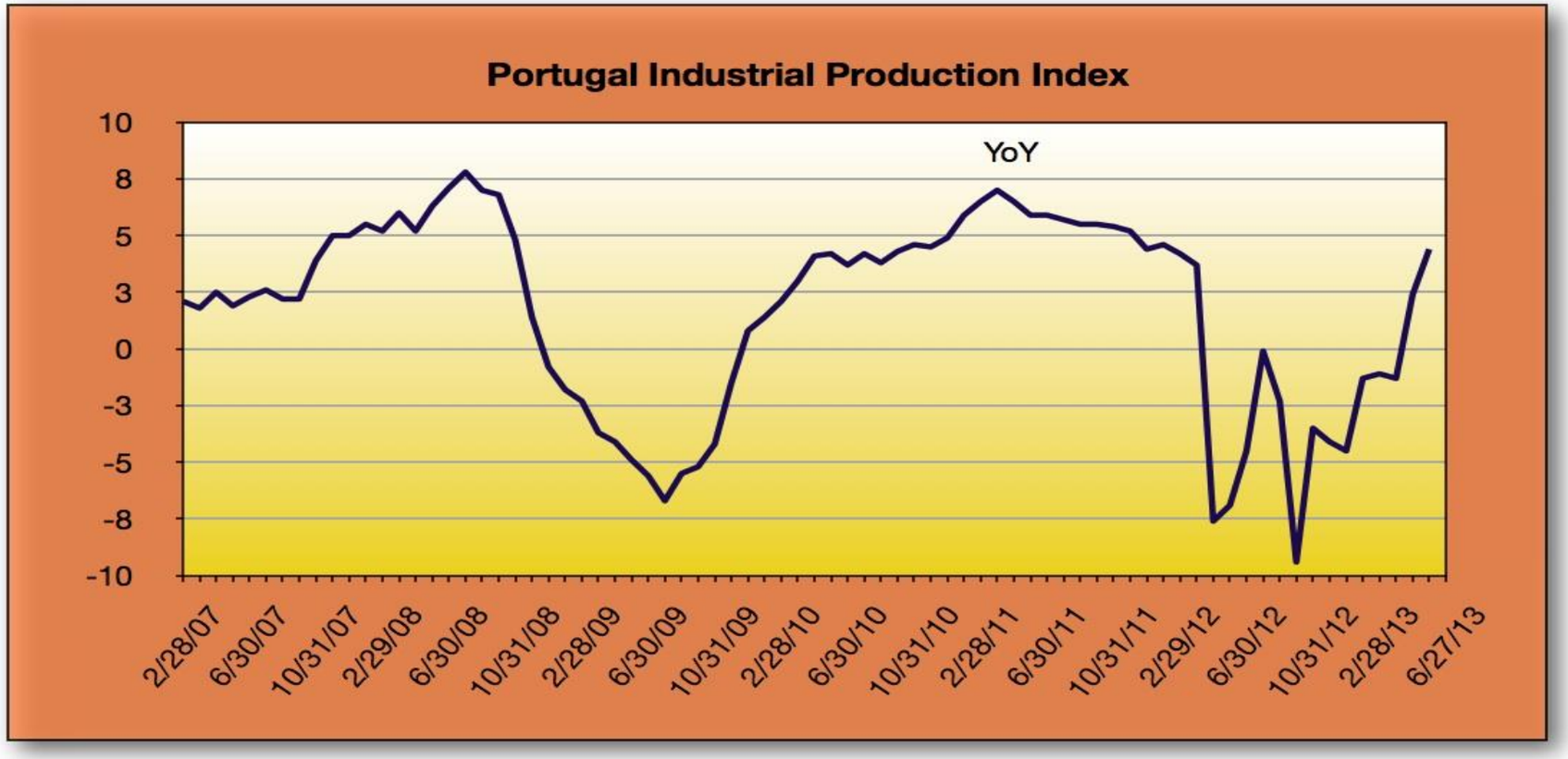
"What happened in Cyprus undermined the business model of European banks, which relies heavily on deposits. Until now the authorities went out of their way to protect depositors. Cyprus has changed that. Attention is focused on the impact of the rescue on Cyprus but the impact on the banking system is far more important. Banks will have to pay risk premiums that will fall more heavily on weaker banks and the banks of weaker countries. The insidious link between the cost of sovereign debt and bank debt will be reinforced. The playing field will become even more uneven than before."

George Soros, April 9, 2013

The Stage Was Set For Another Bank Run On The European Periphery And Yet More Recession

PART IV: MIRACULOUS RESURGENCE?

One Data Point That Just Bowled Me Over



Bloomberg, August 2013

Who would have thunk it? Portuguese house prices were falling, private non-financial debt still more than 200% of GDP, the work force was probably shrinking because of out-migration, and if any country should have had contagion from Cyprus in the form of deposit outflows, it was Portugal.

From Negative To Positive

Germany Real Retail Sales

	May 2013	April 2013	March 2013	Feb. 2013	Jan. 2013	Dec. 2013	Nov. 2013	Oct. 2013
	----------Seasonally Adjusted----------							
Real MOM%	0.8%	-0.1%	- 0.1%	-0.7%	3.3%	-2.0%	1.0%	-0.7%
3-month %	-0.7%	0.7%	1.8%	0.4%	0.3%	-0.6%	-0.4%	-0.7%

German Federal Statistics Office, Wiesbaden
June 28, 2013

From December Through April: Four Months With 3-month Smoothed Gains At A 3.6% Annual Rate

A Sudden Spring Surge

Netherlands Industrial Production

	April 2013	March 2013	Feb. 2013	Jan. 2013	Dec. 2012	Nov. 2012
	YOY%					
Netherlands	0.2%	8.1%	-3.3%	3.0%	2.1%	0.5%

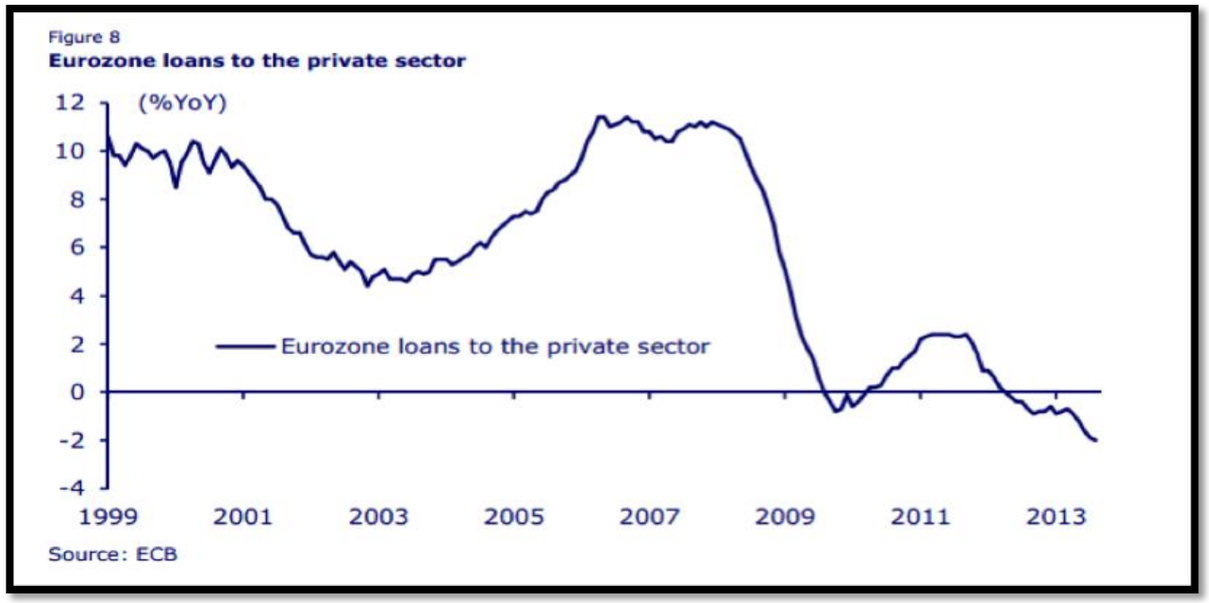
European Commission, Brussels
June 12, 2013

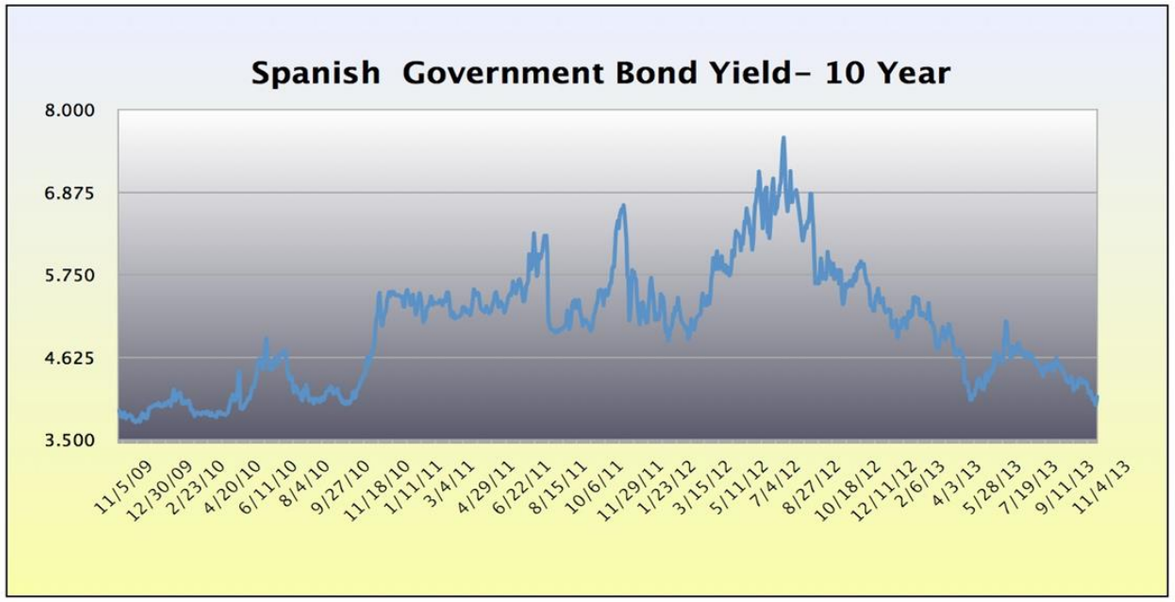
Powerful Sudden Improvement

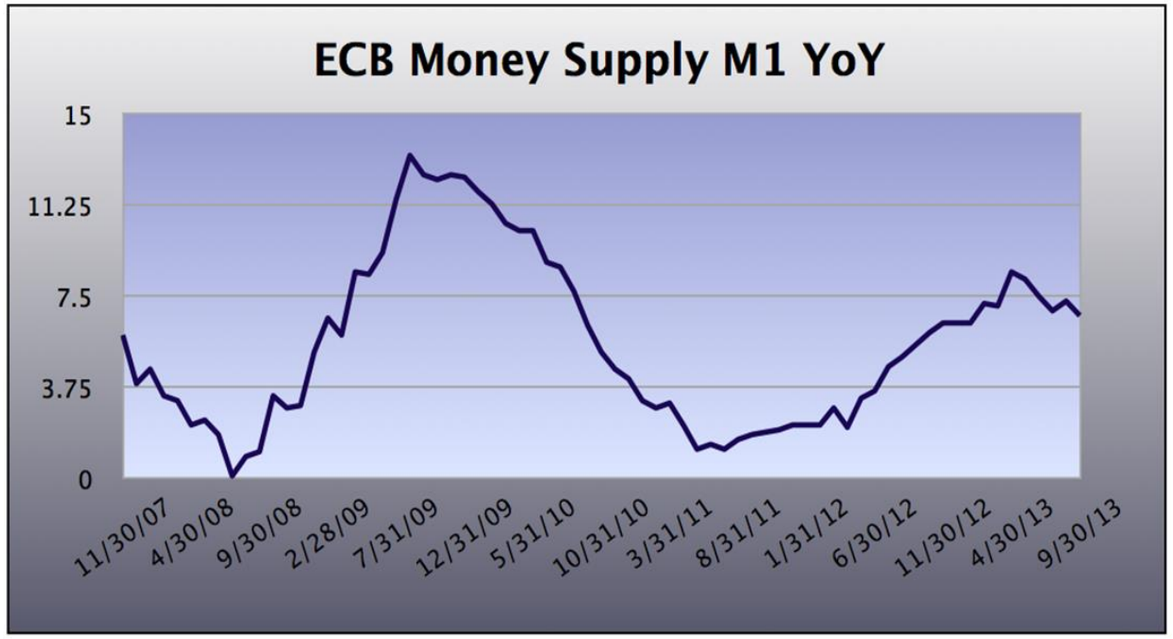
Bloomberg, June 2013

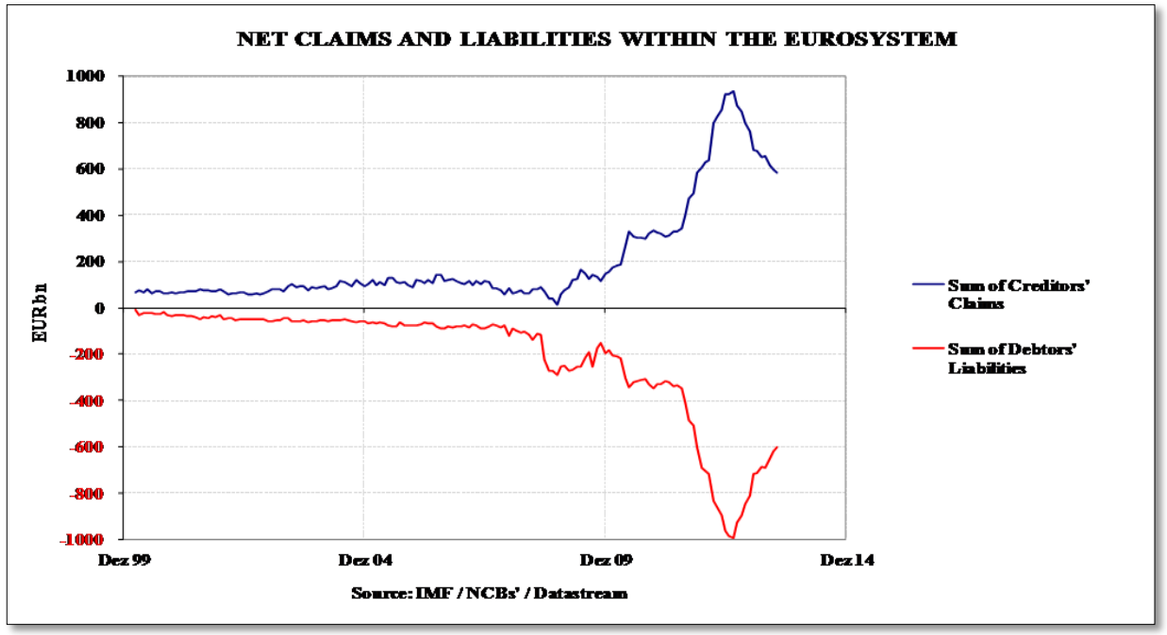
Sentiment On The Mend

Why The Miraculous Recovery?









Several Improvements In Financial Conditions

Why The Miraculous Recovery? Austerity Fatigue.

The Spanish authorities have apparently lied about their fiscal situation for years now: they reported significantly lower fiscal deficits and then they revised the data up to show virtually no such reduction. Therefore, we cannot trust the Spanish fiscal reports. It may be that things have now become so bad in Spain and the social and political opposition to austerity has become so strong that the Spanish have effectively jettisoned all fiscal austerity and there is some measure of incipient stimulus.

Why The Miraculous Recovery? The Revenge Of Say's Law

The history of economic contractions for all economies tells us that, after very severe economic contractions, there can be a "V" shaped economic recovery, and when that happens the data reverses suddenly, surprisingly, and almost miraculously.

Extremely deep contractions never continue indefinitely: despite the highest private debt in the U.S. ever, sky-high double digit real interest rates thanks to severe price deflation, a deepening banking crisis, and no upturn in the money supply, U.S. industrial production bounced explosively in the third quarter of 1932. There was a double bottom in March 1933 followed by a 61% rise in the next twelve months. From the second quarter of 1933 to the beginning of 1937 overall GDP grew faster than at any other time in U.S. economic history .

PART V:
Q3 2013 From Resurgence To Relapse?

Germany,
Strong Man Faltering?

Real Retail Sales

	Sept. 2013	Aug. 2013	July 2013	June 2013	May 2013	April 2013	March 2013	Feb. 2013
	----------Seasonally Adjusted----------							
Real MOM%	-0.4%	-0.2%	0.5%	-1.0%	0.9%	0.3%	-0.5%	-0.9%
3-month %	-0.1%	0.0%	0.4%	-0.1%	0.4%	0.3%	1.5%	0.4%

Statistisches Bundesamt, Wiesbaden
October 31, 2013

On a three-month smoothed basis there was an improvement in late winter and early spring. Since then the data has lost considerable forward momentum. There is a 3% annualized rate of decline in this data over the last four months, a .4% annualized rate of decline over the last three months, and a 3.6% annualized rate of decline over the last two months.

Germany,
Strong Man Faltering?

Germany: Industrial Production Year On Year

Bloomberg, October 30, 2013

Choppy?

Germany
Strong Man Faltering?

Germany Factory Orders

	Sept. 2013	Aug. 2013	July 2013	June 2013	May 2013	April 2013	March 2013
	MOM%						
Manufacturing Orders	3.3%	-0.3%	-2.0%	4.5%	-0.7%	-1.7%	2.2%

Deutsche Bundesbank, Frankfurt
October 8, 2013

Zero improvement in German factory orders from March to August after the prior months showed a big surge. But the September data says the recovery may be still intact.

Germany
Strong Man Faltering?

Bloomberg, October 30, 2013

Over the last two months total employed has barely advanced. This feeble short-term trend is worse than the experience of 2012 when total German employment growth remained decently positive, even though many other economic indicators turned quite negative.

France
Another European Economy That May Now Be Faltering

French Industrial Production Year On Year

Bloomberg, October 30, 2013

French industrial production has fallen for the third month in a row, giving back much of the earlier year improvement. The very recent trend looks quite negative.

France
Another European Economy That Is Now Faltering

France Consumer Spending

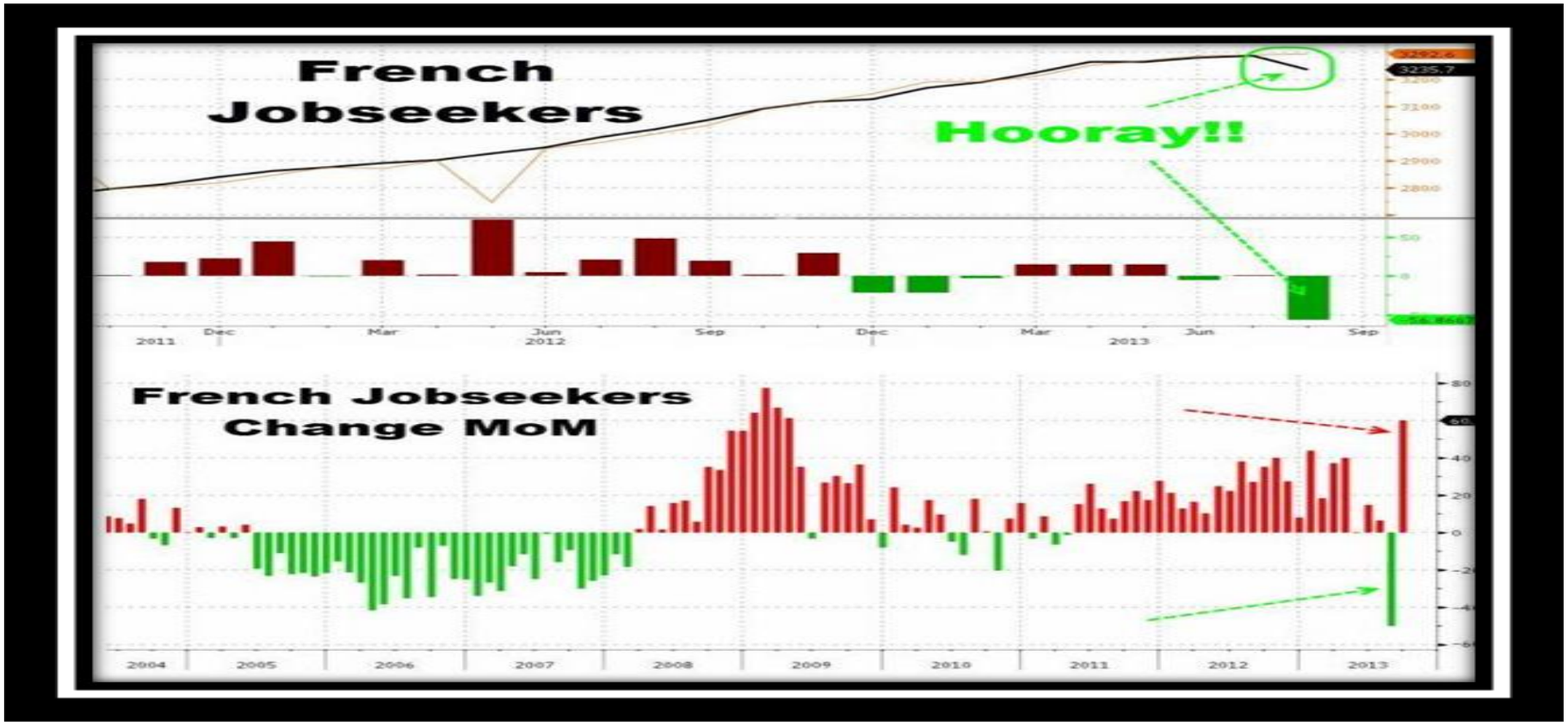
	Sept. 2013	Aug. 2013	July 2013	June 2013	May 2013	April 2013
Monthly percentage change						
Total products	-0.1%	-0.3%	0.4%	-0.8%	0.7%	-0.7%
Manufactured Goods	-0.2%	-0.2%	0.6%	-0.5%	0.9%	-0.5%
Yearly percentage change						
Total products	-0.1%	0.1%	-0.2%	-0.5%	0.8%	0.2%
Manufactured Goods	-0.1%	0.1%	-0.4%	-0.9%	0.1%	0.2%

Real consumer spending over the last two months has been quite negative. The year on year percentage change averages zero over the last two months, down from positive numbers in the spring when Europe overall surged. So the year on year very smoothed data also says the sequential trend has turned negative.

Institut de la Statistique et des Etudes Economiques (INSEE), Paris
October 31, 2013

France
Another European Economy That Is Now Faltering

France: Jobseekers, Monthly Change



As for employment, the data on job seekers showed sudden summer improvement. But that was statistical error. This measure now shows a negative employment trend persists, but at a lesser rate of decline.

Zero Hedge, October 24, 2013

Italy
Still In Trouble

Retail sales continue to be in decline

Italy Retail Sales

	July 2013	June 2013	May 2013	April 2013	March 2013	Feb. 2013
MoM						
Retail Sales sa	-0.3%	-0.2%	0.1%	0.0%	-0.3%	-0.1%
Index level (2005=100)						
Retail Sales sa	95.3	95.6	95.8	95.7	95.7	96.0

Istituto Nazionale di Statistica (ISTAT)
September 26, 2013

Italy
Still In Trouble

Italy Industrial Production

	Aug. 2013	July 2013	June 2013	May 2013	April 2013	March 2013	Feb. 2013	Jan. 2013
MOM% Seasonally Adjusted								
Total	-0.3%	-1.0%	0.2%	0.1%	-0.3%	-0.8%	-0.9%	1.0%
3-mo change (*)	-0.5%	-0.5%	-1.0%	-1.2%	-0.9%	-0.3%	-0.9%	-1.8%
YOY% Change								
Workday adjusted	-4.6%	-4.2%	-2.1%	-4.3%	-4.7%	-5.3%	-4.0%	-3.3%

NOTE: (*) Bloomberg calculations: average seasonally adjusted level in the Past 3 months versus average level in the previous 3 months

Instituto Nazionale de Statistica (STAT), Rome
October 10, 2013

Here is the official industrial production data. It continues to decline. The rate of decline is less than it was at the end of last year. But both the month on month and year on year data would suggest that, even in the most recent months, industrial production has been declining at somewhere between a 2% to 5% annual rate. That is a steep rate of decline.

Italy
Still In Trouble

Italy Employment

	Sept. 2013	Aug. 2013	July 2013	June 2013	May 2013	Sept. 2012
Employed (000's)						
Net change (000's)	-79	-12	-12	4	-31	-15

Instituto Nazionale de Statistica (STAT), Rome
October 31, 2013

September data shows a return to very negative employment, and that has dashed the more positive impression of recent months.

Netherlands
Getting Worse

Dutch Industrial Production

	Aug. 2013	July 2013	June 2013	May 2013	April 2013	March 2013
			MOM%			
Netherlands	2.4%	-1.2%	-3.6%	1.0%	-3.3%	2.2%
			YOY%			
Netherlands	0.1%	-2.0%	-1.8%	1.9%	1.5%	8.1%

Eurostat, Luxembourg, October 30, 2013

Production. Terrible. Down at a 12% annual rate over the last five months. Down at almost a 10% annual rate over the last three months. This is confirmed by the shift in the year on year change from positive to negative.

Netherlands
Getting Worse

Dutch Consumer Spending

	Aug. 2013	July 2013	June 2013	May 2013	April 2013	March 2013	Feb. 2013
	---------- YoY % changes in volume ----------						
Total	-2.0%	-2.0%	-2.5%	-1.9%	-2.0%	-0.7%	-2.3%

Dutch Statistics Office, October 23, 2013

Consumer spending. If anything, it is getting worse.

Spain
Unlike The Rest Of Europe, Still Recovering

Bloomberg, November 3, 2013

Retail sales keep improving year on year. That means they are surging sequentially.

Spain
Unlike The Rest Of Europe, Still Recovering

Spain Employment

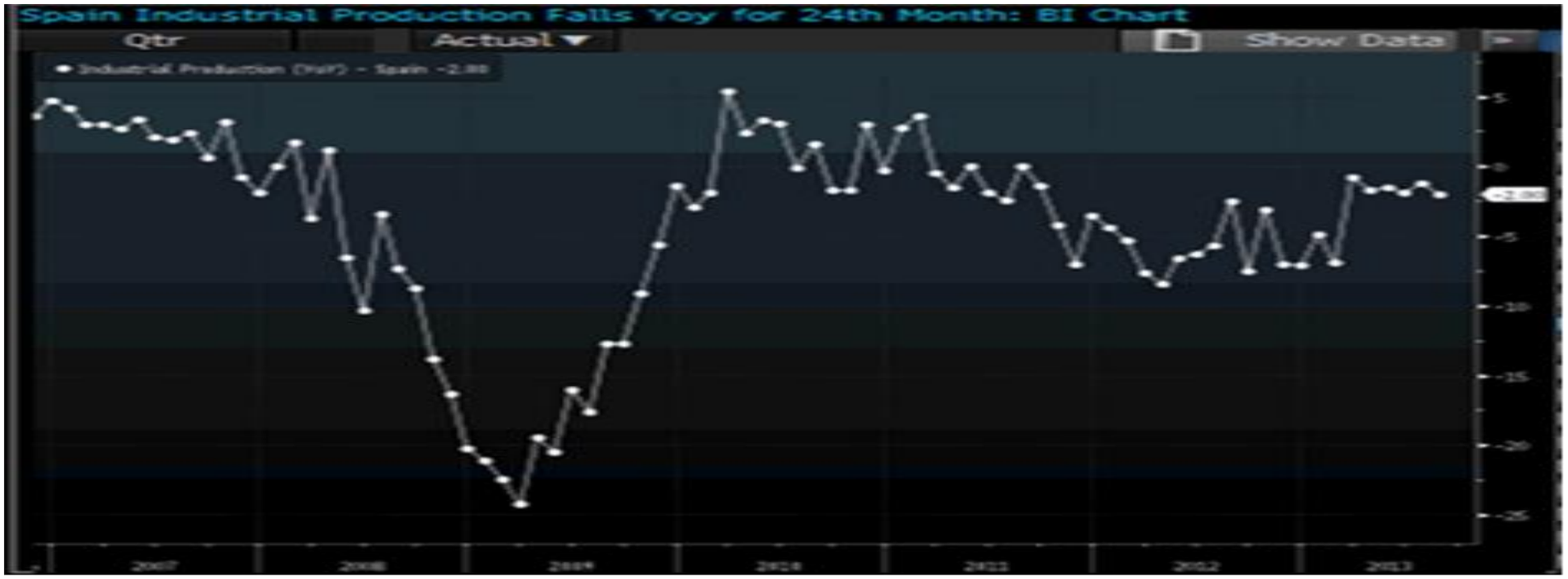
	Oct. 2013	Sept. 2013	Aug. 2013	July 2013	June 2013
---------- Seasonally adjusted ----------					
Net monthly change	71,245	5,636	-14,563	-57,505	-7,324
Net annual change	-375,573	-502,780	-565,735	-600,926	-631,190
MoM%	0.44%	0.03%	-0.09%	-0.35%	-0.04%

Spanish Ministry of Labor, Madrid
November 5, 2013

October's employment data is even more striking with a huge positive gain.

Spain
Unlike The Rest Of Europe, Still Recovering

Spain Industrial Production Year On Year
Work Day Adjusted

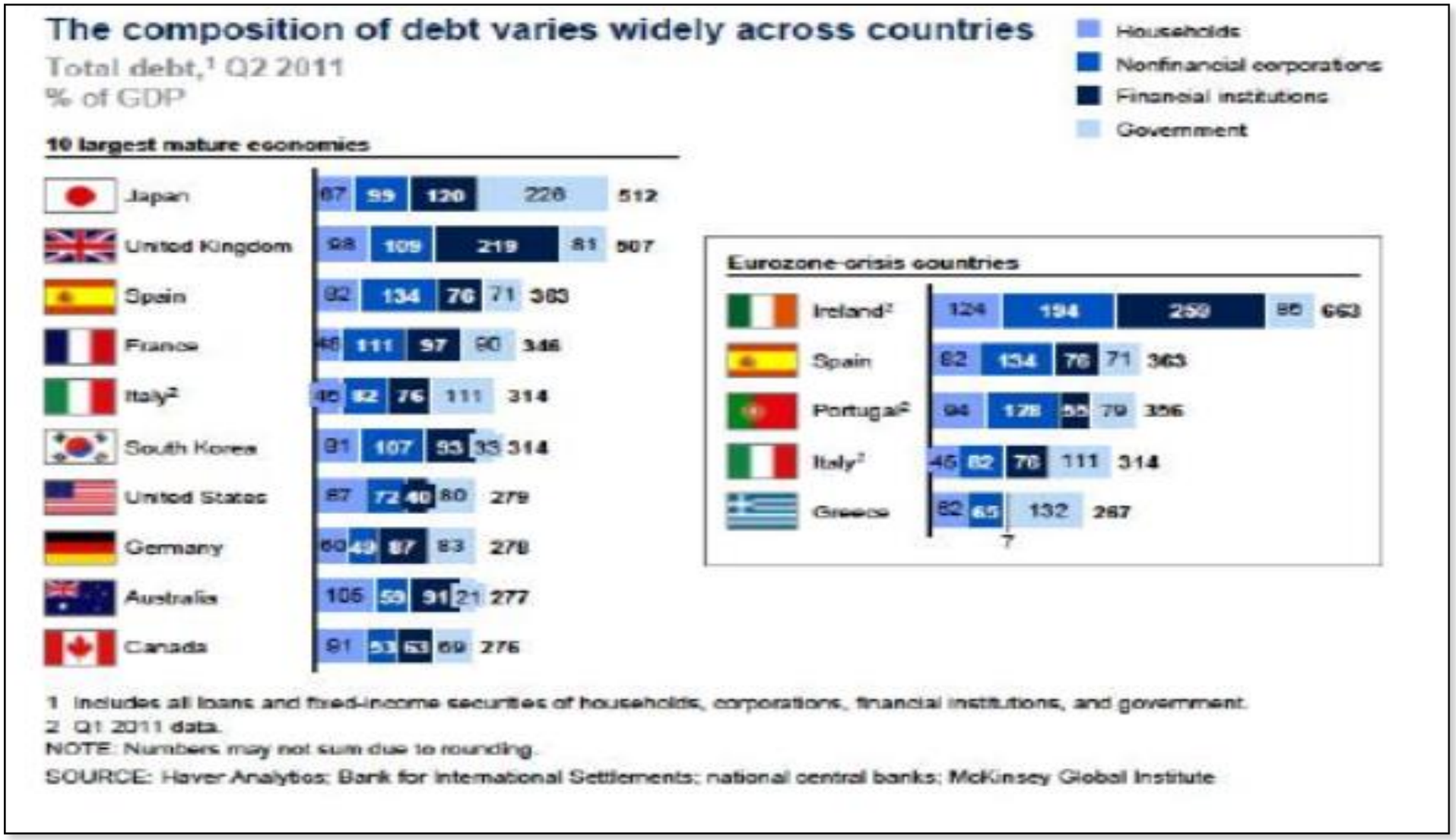


Bloomberg, November 3, 2013

Industrial production miraculously reversed this past spring. To go from 10% negative year on year to 7% positive year on year is nothing short of miraculous. Too miraculous. Surely even such year on year smoothed data is highly distorted. But the more recent smoothed work day adjusted 2%-3% year on year declines after such deep 5% declines from mid-2012 through last winter suggest stabilization sequentially.

PART VI:
Is It Hy's Time Now? Unfinished Business For Overindebted Economies?

Euro Country vs. Other Country Debt



McKinsey & Co. August 2013

Remarkably High European Non Financial Private Debt

Too Much European Private Debt

Eurozone Non Financial Company Debt

	2Q 2013	1Q 2013	4Q 2012	3Q 2012	2Q 2012	1Q 2012	4Q 2011	3Q 2011	2Q 2011
				% of GDP					
Eurozone	99.8%	100.5%	100.5%	101.6%	101.5%	100.6%	101.0%	100.8%	100.6%
Belgium	191.1%	191.9%	191.9%	189.9%	190.1%	190.6%	189.4%	186.6%	185.8%
Portugal	167.3%	166.5%	165.5%	164.2%	164.2%	162.3%	162.3%	162.7%	160.6%
Spain	128.3%	130.1%	133.5%	140.0%	140.4%	140.6%	141.3%	141.8%	142.1%
France	104.0%	105.1%	105.1%	106.1%	105.6%	103.8%	103.1%	103.0%	102.1%
Netherlands	94.4%	94.5%	93.3%	93.6%	95.2%	93.4%	92.9%	91.2%	92.8%
Italy	89.2%	89.6%	89.6%	88.9%	88.6%	89.1%	88.9%	90.2%	91.0%
Germany	67.2%	66.9%	65.8%	66.2%	65.7%	65.8%	66.3%	65.7%	65.2%

European Central Bank, Frankfurt
October 30, 2013

There Is Really No Overall Corporate Deleveraging Yet

Too Much European Private Debt

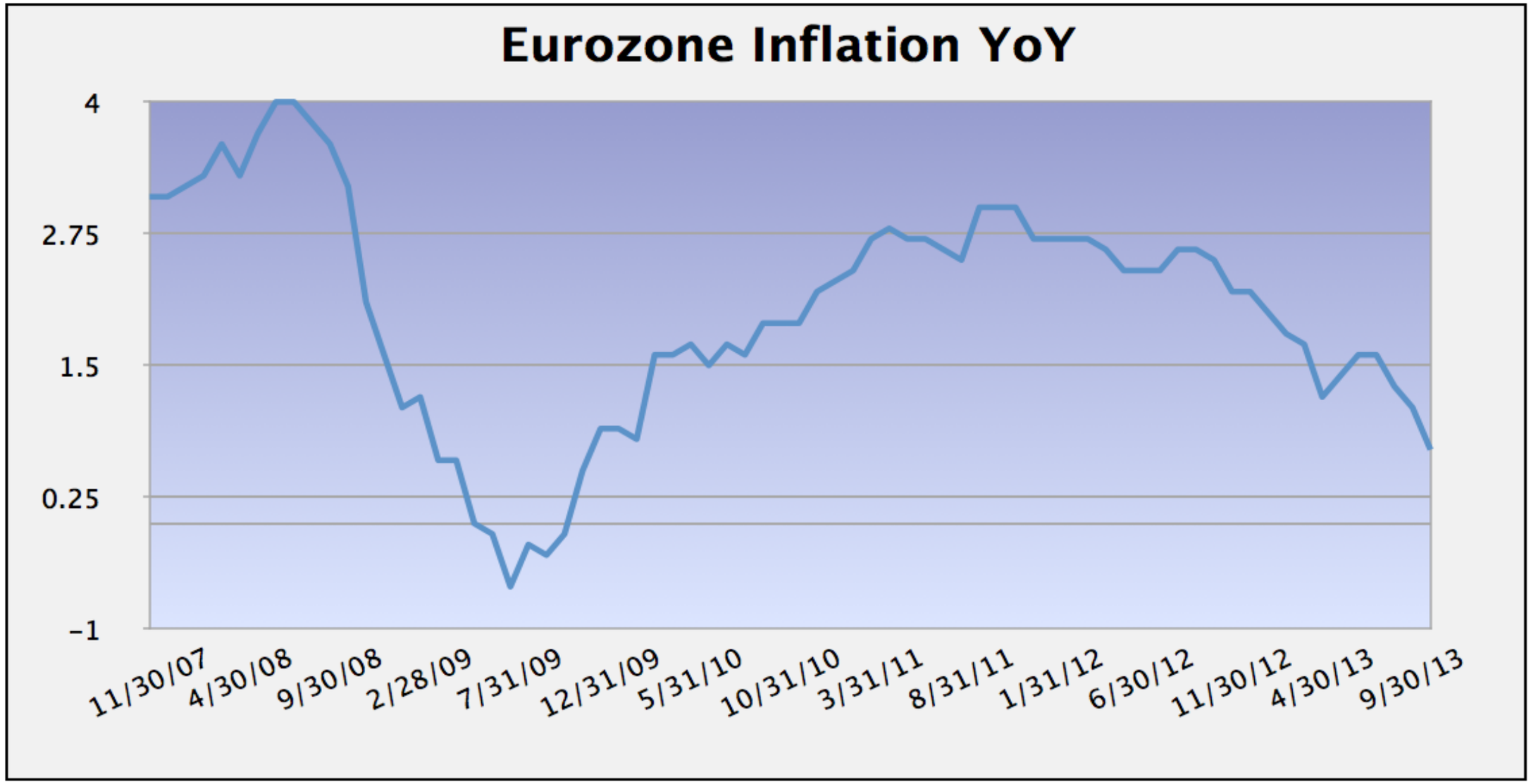
Eurozone Non Financial Company Debt

	2Q	1Q	4Q	3Q	2Q	1Q	4Q	3Q	2Q
	2013	2013	2012	2012	2012	2012	2011	2011	2011
				% of GDP					
Eurozone	63.4%	63.5%	63.8%	63.8%	64.0%	63.9%	64.3%	64.4%	64.6%
Netherlands	127.4%	127.8%	127.9%	128.3%	127.6%	127.3%	127.7%	127.9%	127.5%
Portugal	89.8%	91.0%	91.4%	91.3%	91.8%	91.5%	92.5%	92.5%	92.5%
Spain	79.9%	80.3%	81.3%	81.6%	82.7%	82.6%	83.6%	83.9%	85.1%
Germany	57.8%	58.0%	58.2%	58.4%	58.4%	58.4%	59.0%	59.2%	59.4%
France	56.8%	56.7%	56.7%	56.4%	56.5%	56.4%	56.3%	56.1%	56.0%
Belgium	55.9%	56.0%	55.8%	55.6%	55.4%	54.7%	54.3%	53.7%	53.3%
Italy	45.2%	45.2%	45.3%	45.2%	45.2%	45.1%	45.4%	45.5%	45.5%

European Central Bank, Frankfurt
October 30, 2013

There Is Almost No Real Household Deleveraging Yet

Debt Alleviating Inflation Is Falling



Bloomberg, November 3, 2013

Inflation Expectations Are Falling

Bloomberg, November 6, 2013

The ECB – EU Policy Of Peripheral Adjustment Threatens Deflation

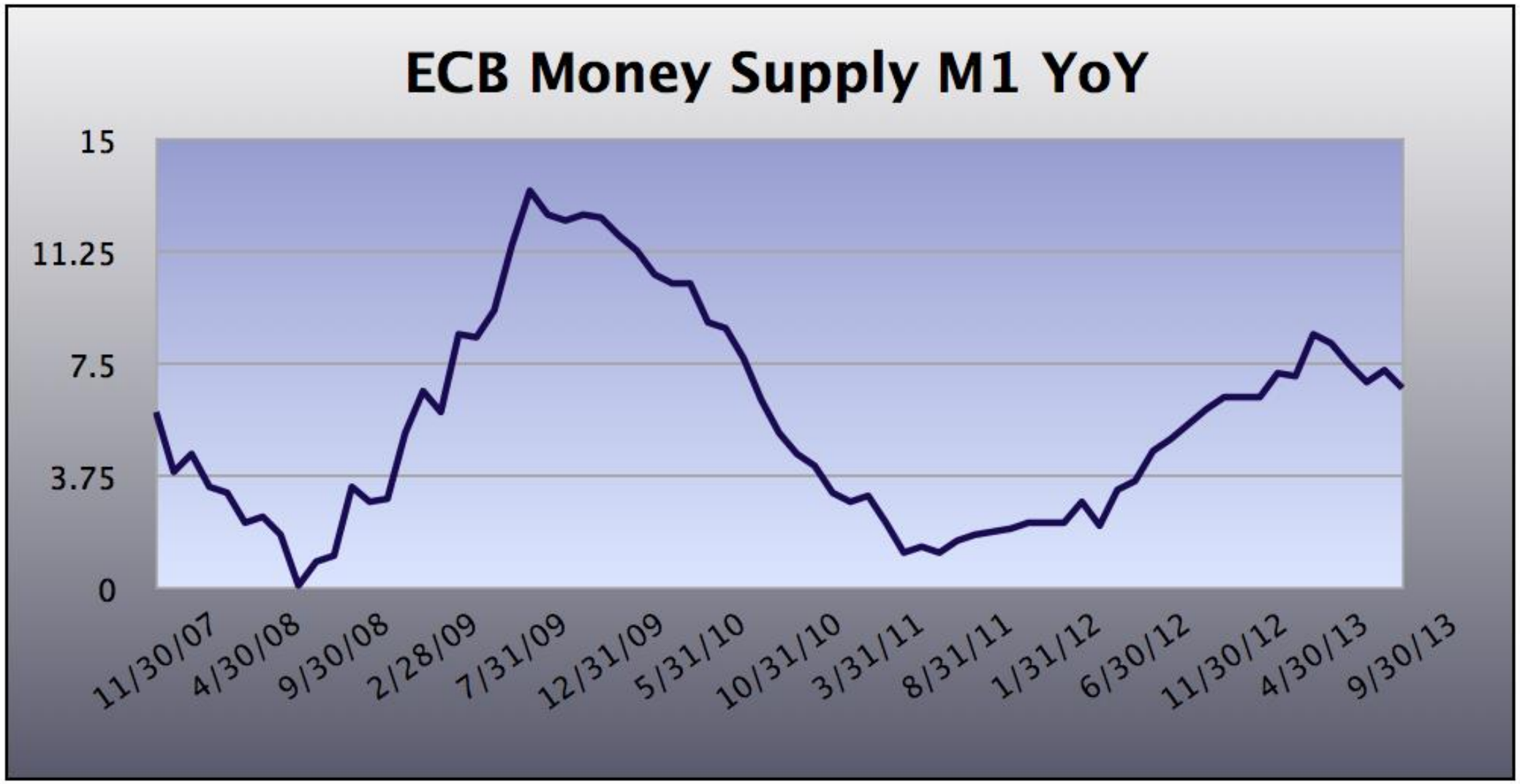
- Last November 1 gave us a glimpse of the biggest danger facing the eurozone in the next decade: a period of sustained deflation. Eurozone core inflation – without energy prices and other volatile items – tumbled in October to an estimated annual rate of 0.8 per cent.

- I doubt even a marginally negative interest rate would avert a slide into deflation. Its deep cause lies in the way the eurozone responds to its debt crisis – through austerity and falling real wages in the periphery and a lack of adjustment in the north.

Worry About The Euro, Not The European Union, Financial Times,
Wolfgang Munchau, November 3, 2013

With High Private Debt An Outright Price Deflation Would Reignite Crisis

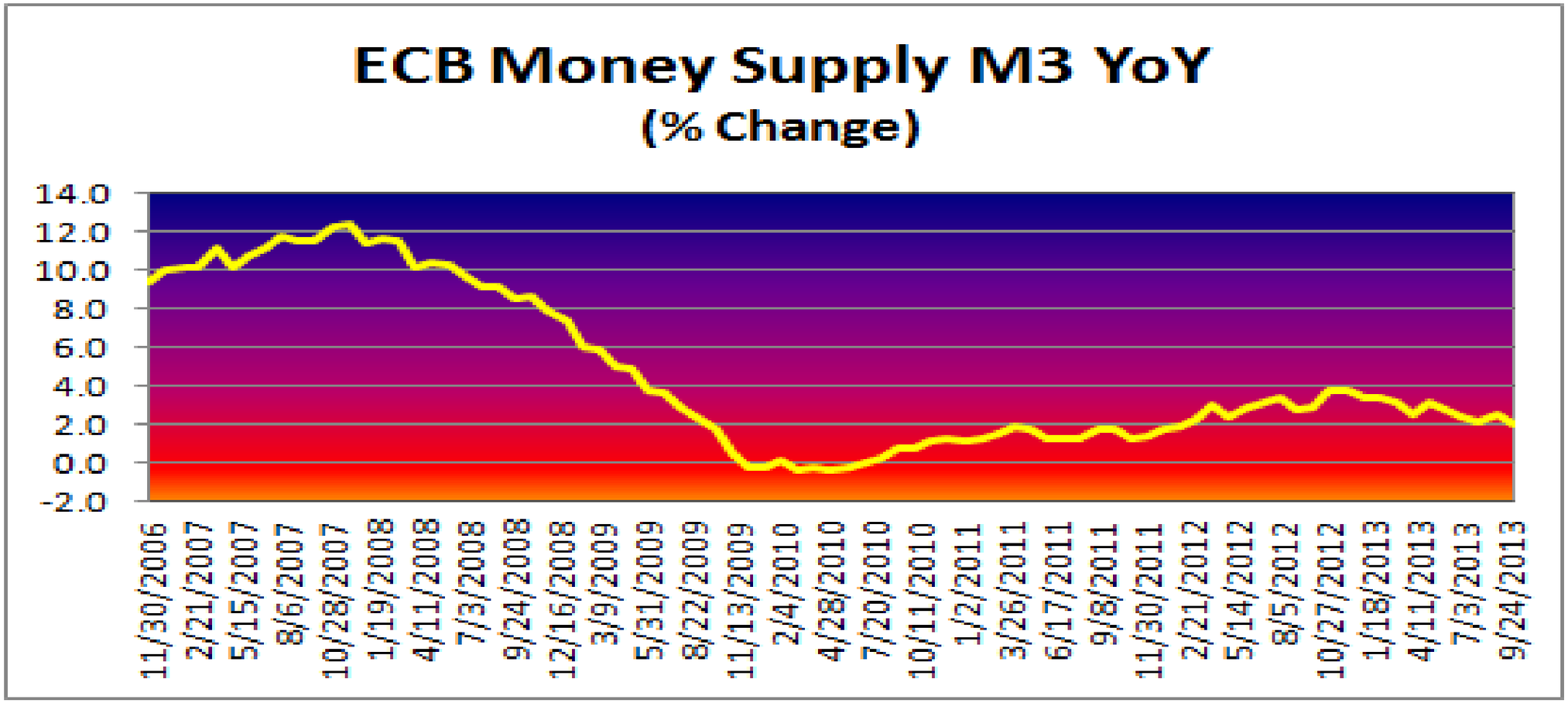
Money Growth Foreshadowed The 2012 Recession And The 2013 Recovery



Bloomberg, November 3, 2013

Is The Recent Fall In Money Growth Ominous?

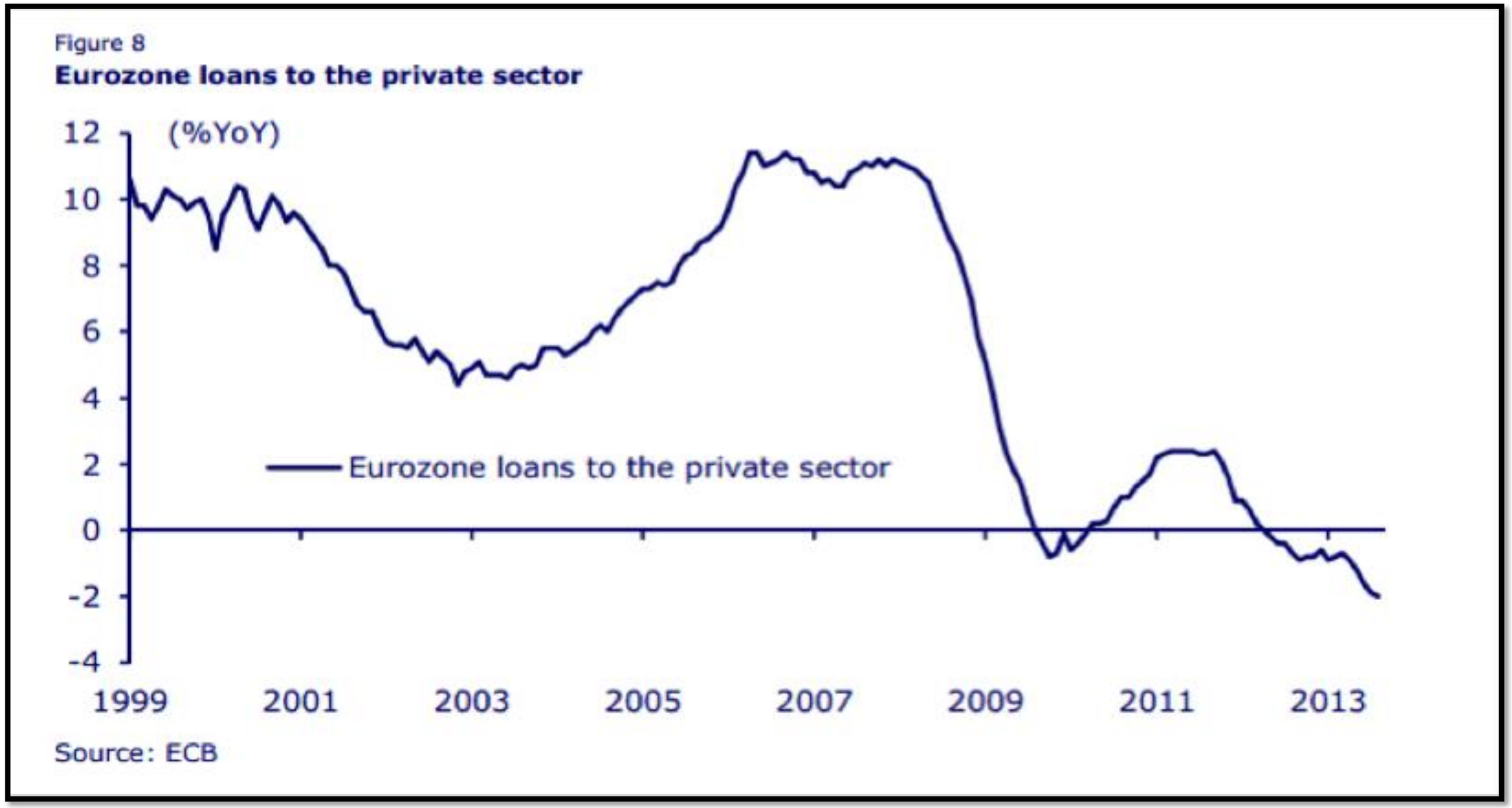
Money Growth Foreshadowed The 2012 Recession And The 2013 Recovery



Bloomberg, November 3, 2013

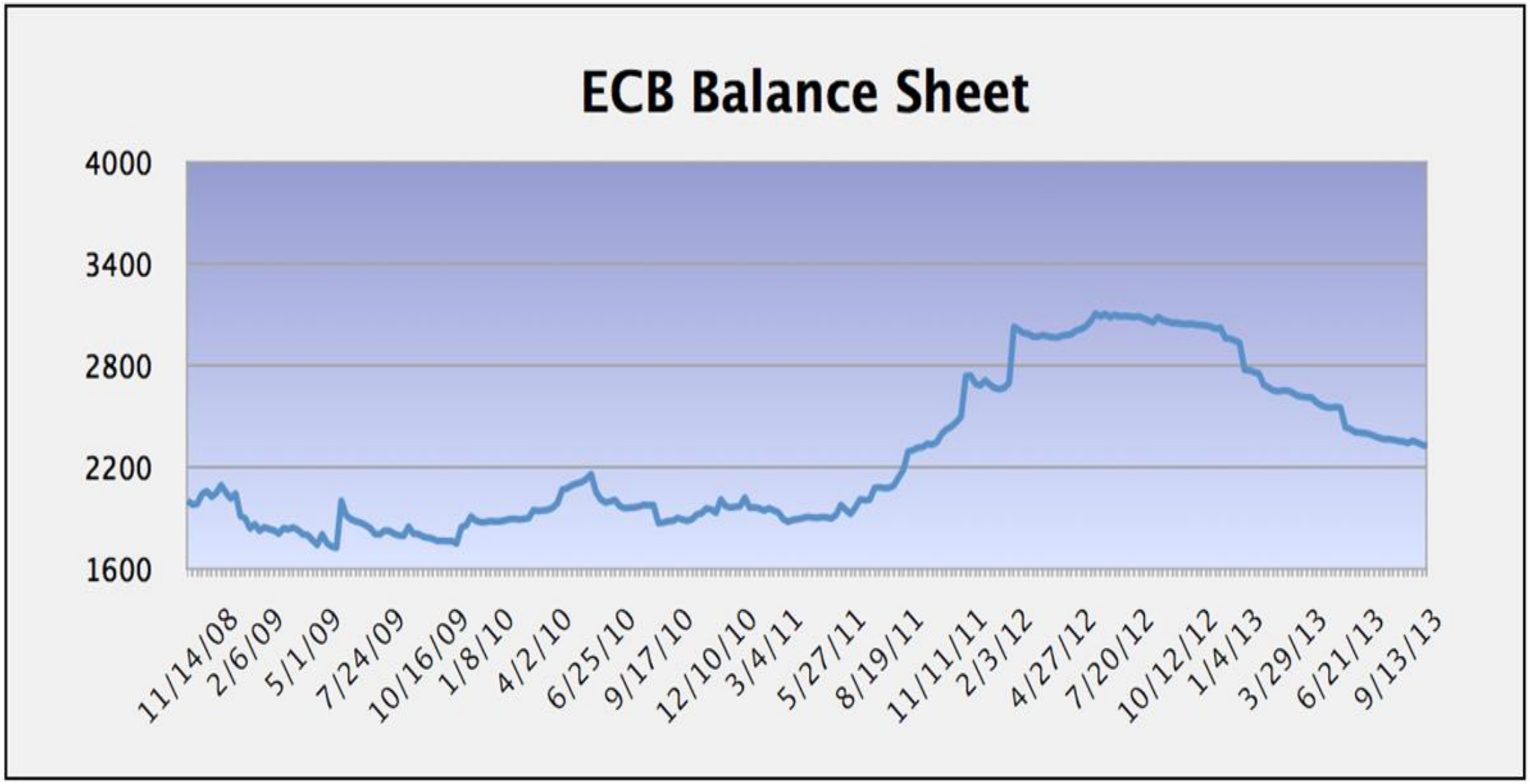
Is The Recent Fall In Money Growth Ominous?

Despite Successful Super Mario Expectations Management, Private Credit Flows Have Gone Negative Again



Christopher Wood, CLSA, October 31,2013

This Is Mostly The Unwind Of Target 2



Bloomberg, November 3, 2013

But Is The ECB Doing what Japan Did 20 Years Ago And Not what Bernanke And Kuroda Are Doing Today?

Is EU Policy Making Matters Worse?

- The findings by Fitch Ratings are set to raise alarm bells among European policy makers seeking ways to push banks to expand corporate lending to boost the continent's slow economic recovery.
- The rating agency's research, to be made public on Monday, shows that Europe's 16 largest banks have increased their risk exposure to sovereign debt by 26 per cent or €550bn in 2011 and 2012.
- At the same time, banks have reduced their risk exposure to corporate credit by 9 per cent or €440bn, according to the research, which looked at those lenders labeled as "systemically important" by global regulators last year.

European Banks Cut Corporate Lending,
Financial Times, November 2, 2013

Corporate Credit Is Contracting

Is Basel III Making Matters Worse?

- Fitch's analysts said incoming global Basel III capital rules were at least partly to blame. "Basel III already appears to be influencing banks' capital management, exposure allocation and credit strategies," said Martin Hansen, macro credit analyst at Fitch.
- The rule-book, which is being phased in until the end of 2018, severely tightens minimum capital requirements, "turbocharging" existing incentives for banks to invest in sovereign bonds while making corporate lending still costlier.

European Banks Cut Corporate Lending,
Financial Times, November 2, 2013

Or Is There Simply Too Much Debt And Bad Demographics?

- Bankers stressed that a lack of economic growth in Europe is pushing lenders into sovereign bonds as there is little demand for loans from companies.
- “There is nothing else to invest in with our excess cash,” said Andreas Treichl, chief executive of Erste Group, one of Austria’s largest banks. “That is the real problem of Europe, there just isn’t another choice. I’d love to lend more to companies instead but there is just not enough growth.”

European Banks Cut Corporate Lending,
Financial Times, November 2, 2013

And Remember

- Expectations management and liquidity provision calmed the markets in 2012
- There is still no system wide deposit insurance
- Therefore the fatal flaw in the euro remains
- And it probably cannot withstand a price deflation

One Last Consideration

- Why is private debt in Europe so high?
- Did the welfare state foster a pervasive moral hazard that distorted downward the perceived risk of loss of lenders and borrowers? And thereby encourage excess debt.
- Is this what Hyman Minsky would say?
- Is euro area “adjustment” chipping away at the supports of the welfare state so that lenders and borrowers no longer find their private indebtedness tenable?
- Is this an unrecognized insidious force for price deflation that overindebted Europe cannot withstand?