

THE CHALLENGES AND FUTURE OF BANKING IN THE EUROZONE

THORSTEN BECK



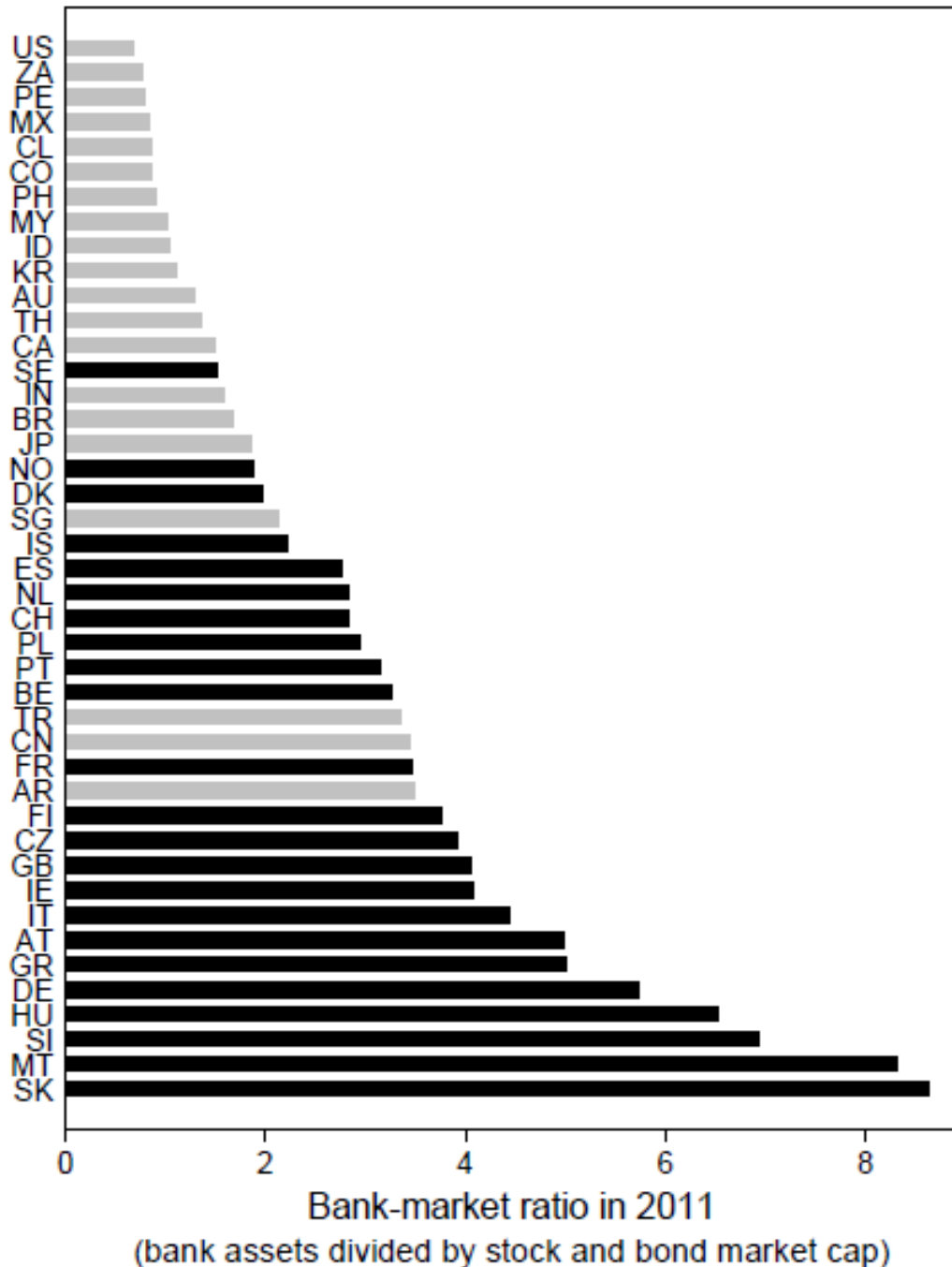
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A SOUND AND COMPETITIVE FINANCIAL SYSTEM – IMPORTANT FOR RECOVERY AND LONG-TERM GROWTH



- Intermediation function critical, especially for SMEs
- Allows for long-term investment, R&D, and thus higher growth
- Banks credit more pro-cyclical than other segments of financial system
- Financial integration important
- Competition and diversity important
- It is about finance, not financiers (or bankers)!
- It is about resource allocation, not volume!

BANKING IN EUROPE – TOO MUCH OF A GOOD THING?



- Rapid expansion of European banks before crisis, driven by 20 largest banks (Langfield and Pagano, 2015)
- European banking market with national safety nets (and national champions) resulted in “banks global in life and domestic in death” in 2008
- Regulatory framework has moved ahead with banking union towards Eurozone regulation
- How successful has it been?

WHAT ABOUT THE NEW REALITY?

What can BES Portugal tell us about the “new reality”?

- National supervisor missing long-standing deterioration
- Bail-in as envisioned, with no contagion and no negative credit supply effects
- But: needed to rely on external funding (IMF) for resolution

What can Greek stand-off in 2015 tell us about the “new reality”?

- Sovereigns and banks still closely connected
- ECB faces clear conflict of interest

What can Banco Popular about the “new reality”?

- Well and swiftly executed resolution; 1:0 for banking union
- But: purely national solution

What can Veneto Banca and Banca Popolare di Vicenza tell us about the “new reality”?

- Bail-in of senior bond holders avoided by going around the spirit/letter of banking union
- Tax-payer support against bail-in mandate
- Problem: Legacy problems not solved before new regime put in place

EURO-PROBLEM 1: LEGACY PROBLEMS



- Core problem: asymmetric approach to Eurozone crisis: creditors to be made whole, debtors to pay up no matter what
- Solution on national level is often beyond national fiscal capacity
- Protracted resolution has made problems worse (Japan syndrome)
- Need for funded AMC, on Eurozone level that undertakes rigorous restructuring
- At minimum: move towards Eurozone-level resolution approaches
- Long-term objective: Eurozone banking system

EURO-PROBLEM 2: A BANKING UNION WITH A PILLAR MISSING?



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- Funding mechanism missing; no public back-stop
- Pretending there will no more bail-outs is naïve (at best) - better to put institutional framework in place than weekend crisis resolution
- Ultimately political question, as linked to question of fiscal union
- Easier to establish after legacy problems have been cleaned up

THANK YOU



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THORSTEN BECK

TBECK@CITY.AC.UK

WWW.THORSTENBECK.COM