

Discussion of Martin Hellwig's :
**“Banks, Governments, and
Monetary Union in the Crisis”**

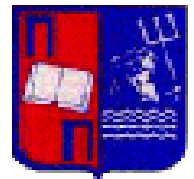
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The special case of Greek Banks

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Sponsored by IOBE at Athens Music Hall

- ❑ Martin Hellwig begins with Weimar Republic and then presents the history of the 4-yr EMU crisis, the different conflicts and the main actors involved: Banks, Governments and the ECB
- ❑ He asks: *“What went wrong?”* In his view, ∃ four fundamental failures in EMU:
 - i. Lack of Market integration
 - ii. Lack of Market discipline
 - iii. Lack of Fiscal discipline
 - iv. Lack of effective Financial Supervision
- ❑ I would add that EMU was a political project, which perhaps came too soon. The use of a common currency was imposed on yet not an Optimum Currency Area (OCA). This was always the American view, which perceived EMU as a competitor to the \$ area
- ❑ There was a belief among politicians that market forces would lead to an endogenous adjustment towards an OCA.

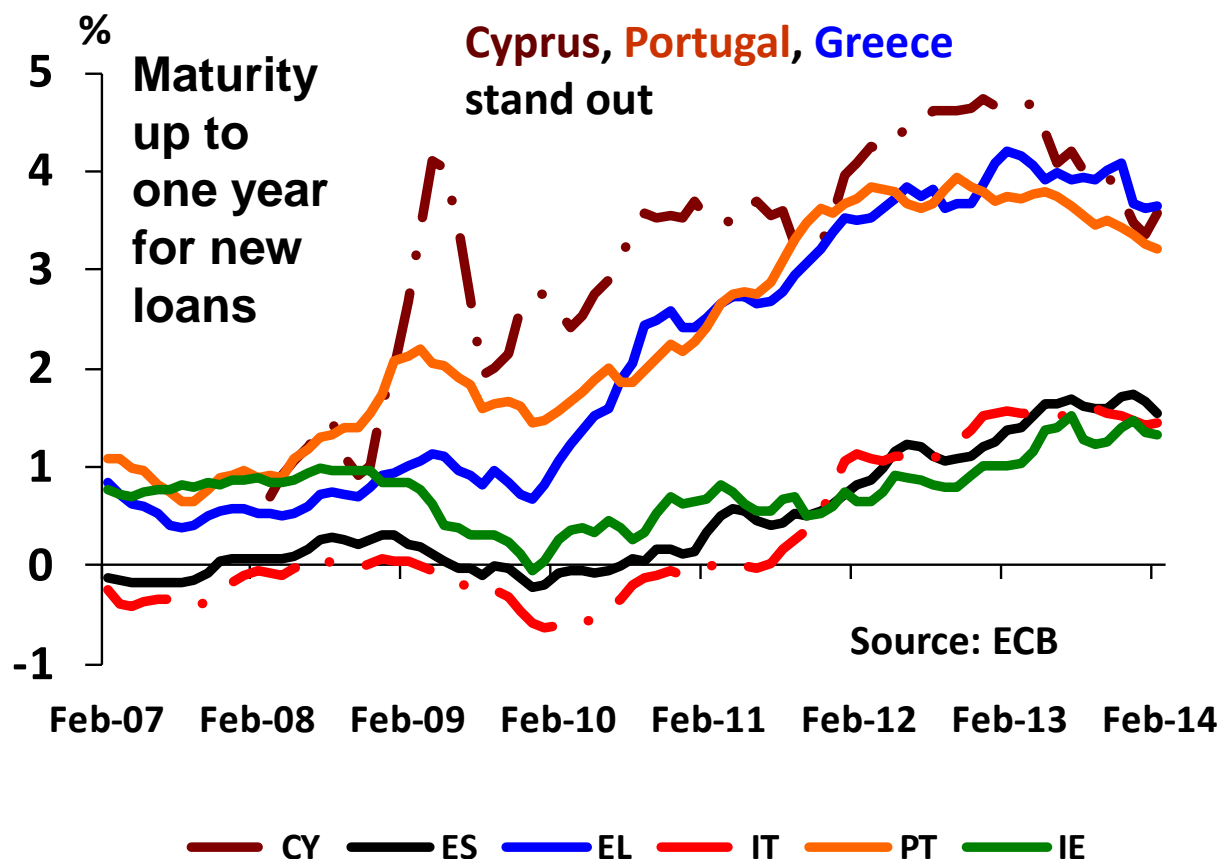
- ❑ Then Martin asks: “*Why there is no progress in addressing the failures?*” He brings political and other reasons:
 - i. Conflicts within countries between political parties, banks, etc.
 - ii. Lack of analysis and populism
 - iii. Lack of workable supranational discourse (e.g. creditors ↔ debtors)
 - iv. Lack of legitimacy (elites ↔ public, legal tricks, etc.)
- ❑ I would add there was a fundamental conflict between two objectives:
 - i. Fixing a new stronger architecture for EMU without further fiscal integration, that is, mimicking an OCA without the need of transfers
 - ii. Resolving the crisis with drastic measures, which would, however, increase moral hazard and undermine objective (i)
- ❑ Creditor nations preferred objective (i) and caused the crisis to prolong. Deauville, or the innocuous bank stress tests of November 2011 are prime examples

- ❑ In Martin's view, the ECB proved to be the only effective backstop to the crisis, e.g. LTROs, OMT
 - Of course, the ECB went through its own learning curve. In the beginning it religiously followed its inflation objective and tried to fortress its independence by espousing aggressive fiscal contraction plans or aggressive deleveraging plans for banks.
 - Gradually it realized there was real danger of instability of the EMU financial system and now it has stretched its mandate in order to accommodate the EMU escape from the crisis
- ❑ Martin argues there is now a moral hazard problem, a Greenspan put in EMU, as politicians have learned to lean on their domestic banks, which in turn would unload their problems on to the ECB
 - Temptation for Greek politicians to ignore the severe liquidity crisis in Greece and the heavy dependence on the ECB, and lean on the recapitalized banks in order to lend fresh money or to even save favorite voters from trouble

❑ More on ECB: Martin discusses the problem of fragmentation of monetary policy today. **This is serious.**

- The spreads discourage lending in the Periphery
- Not only a reflection of different risk premia.
- Some Greek companies abandoned their headquarters in Greece to be able to borrow at cheaper rates
- The ECB is hinting it could intervene in securitization markets for bank loans in the Periphery, yet BASEL III penalizes their formation

Lending rates to NFCs (spreads over German rates)



- ❑ Hellwig: *“Without a REAL banking Union, the monetary union will likely fall apart ... and the event can be very ugly”* I completely agree
- ❑ Yet, he expresses reservations on the feasibility of the project, arguing for each pillar of the Banking Union:
 - i. Supervision: ECB has an incentive to do the AQR and stress tests correctly and start supervision with a clean slate. Yet, He questions the effectiveness of future ECB supervision within 18+ national laws
 - ii. Resolution: He doubts national government would abandon their power to determine which banks to resolve
 - iii. Deposit Insurance: Who will be bailed out and who will pay?
- ❑ And finally he comes to my own earlier comment: The deeper problem is funding for resolution and deposit insurance

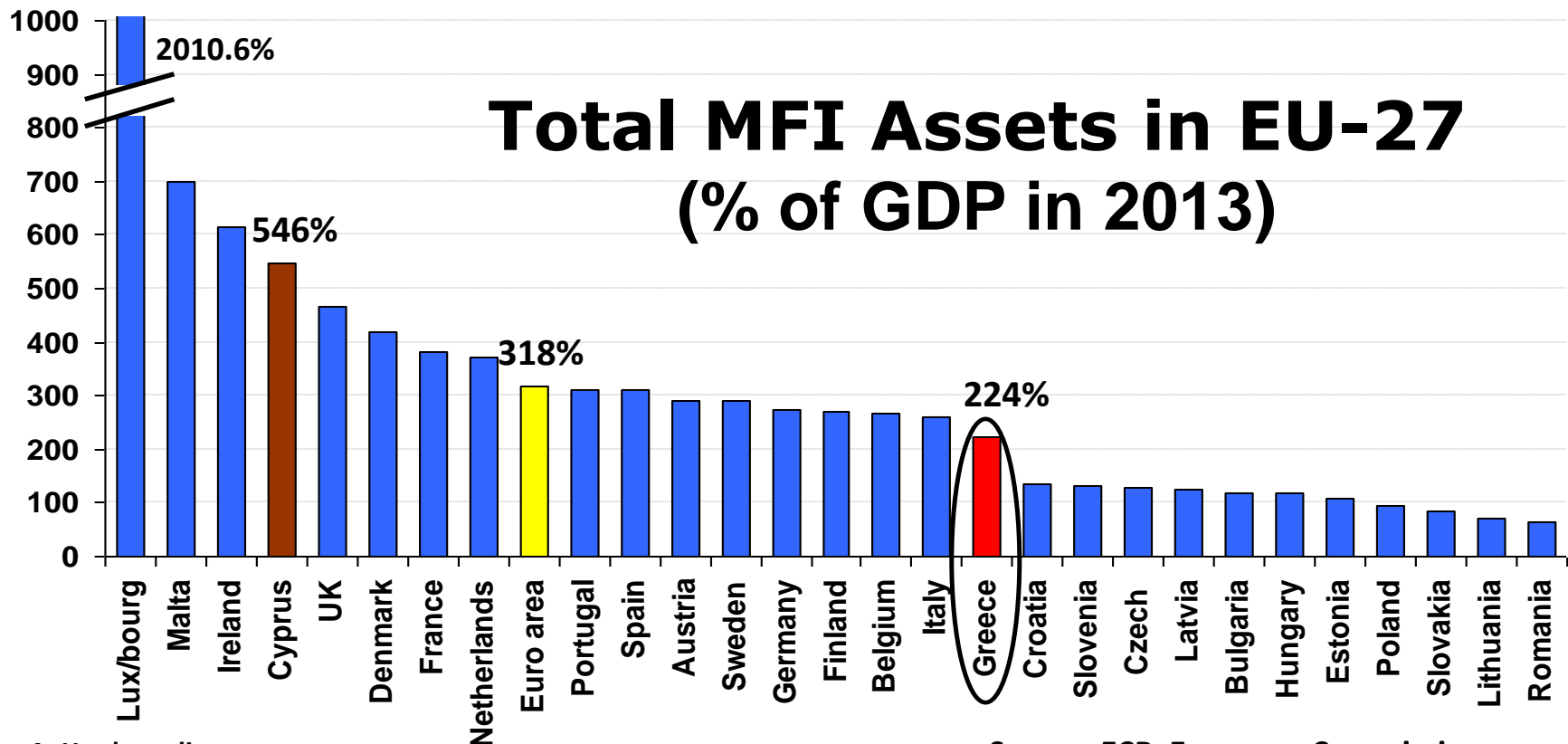
- I. Size of Banking in Greece is small compared to Europe**
- II. The multiple crises affected financial intermediation as the financing of bank balance sheets became difficult**
- III. Major bank restructuring in 2012-13 has led to fewer well-capitalized banks, which now face challenges in the management of Liquidity and NPLs**

Bank size varies across the Globe & across EU countries, remains small in Greece

- ✓ Banks are more important in Europe
- ✓ Greek banking has room to expand

EU, USA & Japan- banking sector (2013)

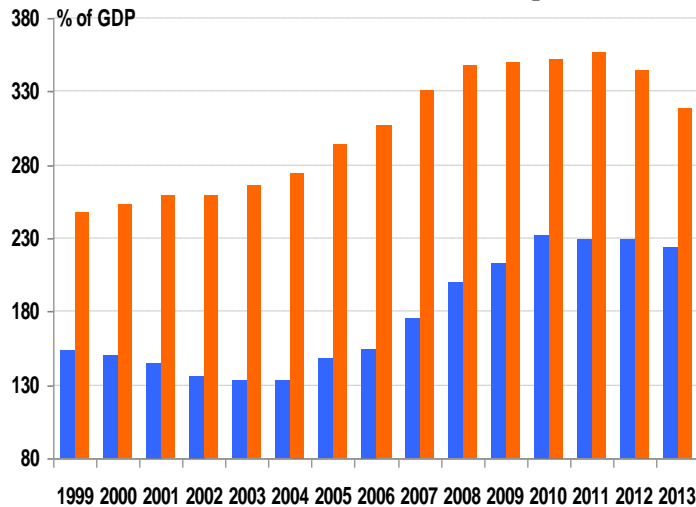
| | EU | USA | Japan |
|----------------------|--------|------|-------|
| Total Assets (€ tr.) | € 42.5 | 10.4 | 7.2 |
| Total Assets (% GDP) | 325% | 85% | 213% |



Source: ECB, European Commission

Growth in Greek banking during the EMU years: nothing extraordinary

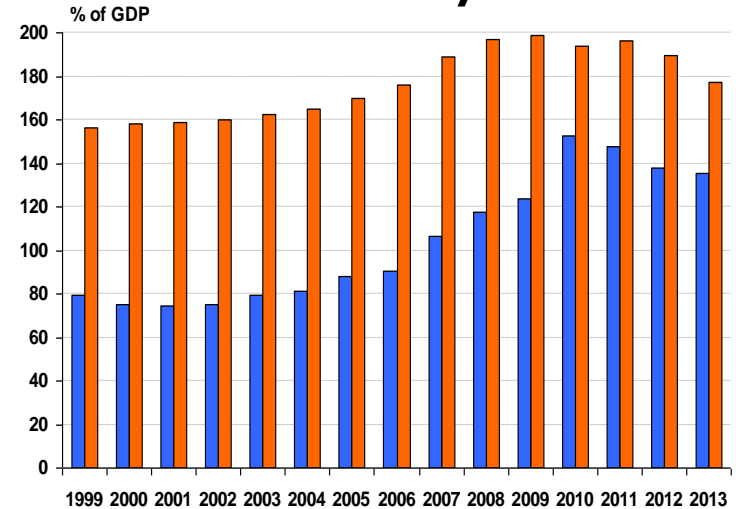
Total assets/GDP



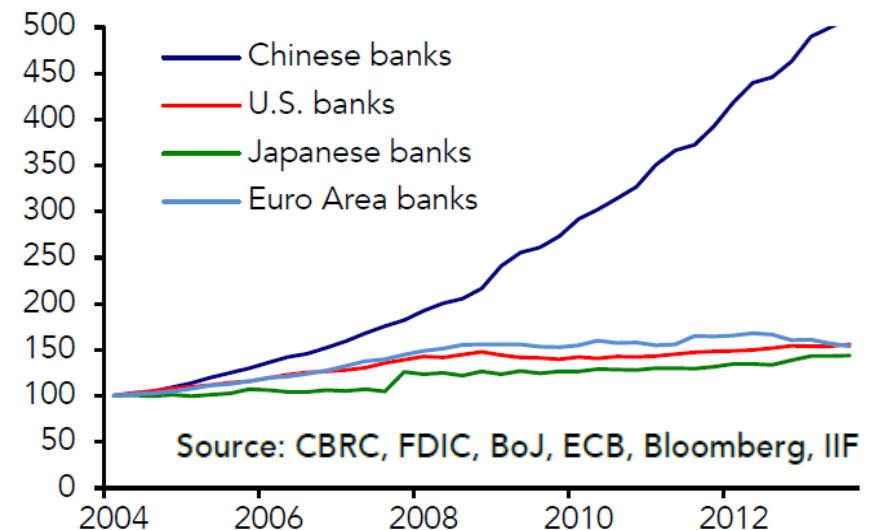
Source: ECB, Eurostat

Euro Area
Greece

Total loans/GDP



Chinese, U.S., European and Japanese Bank Assets index level, 2002=100



Source: CBRC, FDIC, BoJ, ECB, Bloomberg, IIF

- ✓ Bank asset size in Greece smaller than in EA throughout history
- ✓ Asset size grew faster than nominal GDP after 2004, stabilized after 2010
- ✓ Compared to Assets, Greek Lending as % GDP closer to EA avg
- ✓ Chinese huge banking growth !

The four systemic Greek banks today, fully capitalized, face new challenges

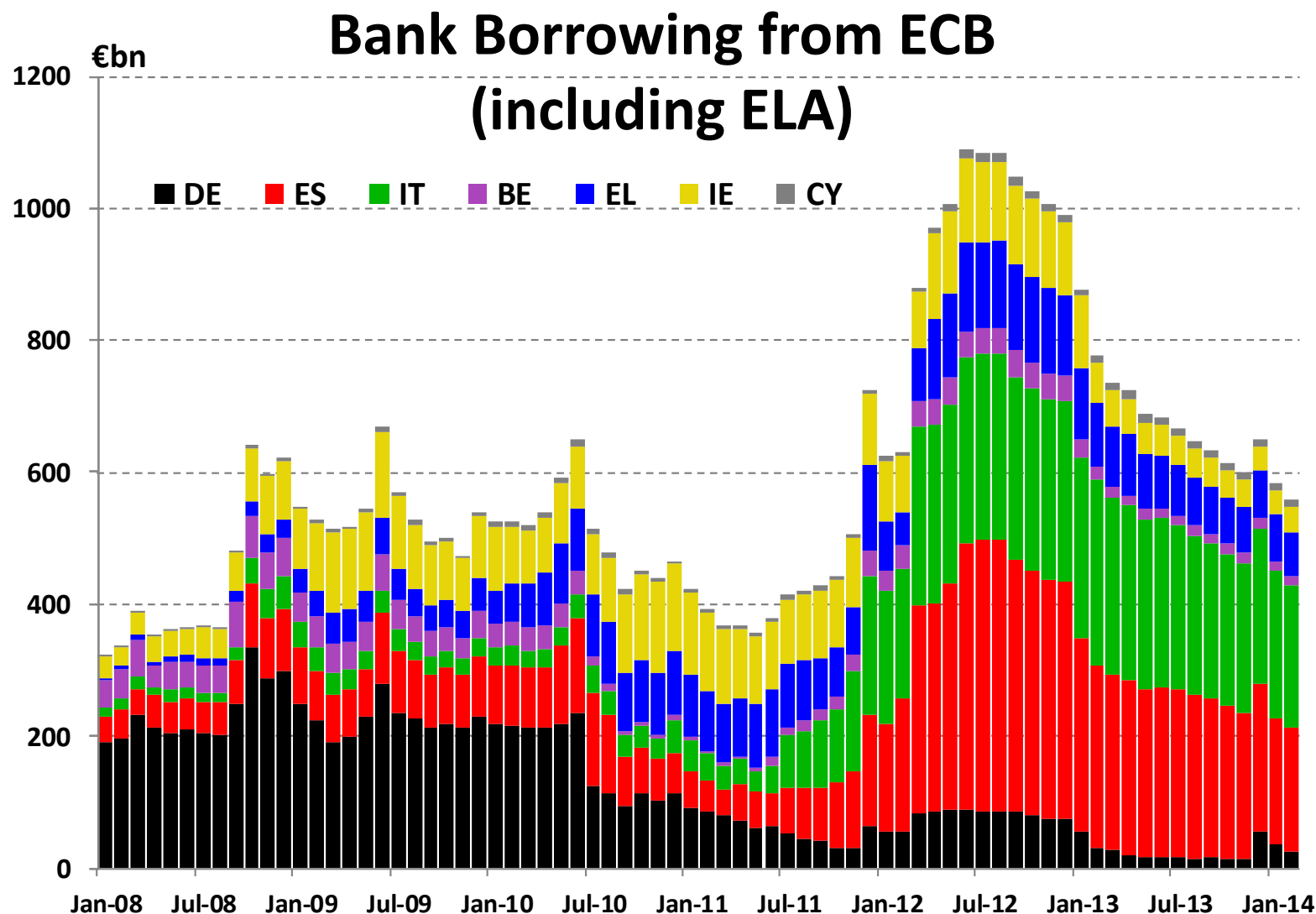
- ✓ Four systemic banks hold 90% of assets and loans
- ✓ Liquidity remains a challenge as long as deposits do not return to the system, the wholesale market remains expensive, forcing banks to the ECB
- ✓ Banks create special divisions to handle NPLs, which continue to rise but at lower rates
- ✓ Loan restructurings can help export-oriented companies and contribute to growth

| 31.12. 2013 | Group Assets €bn. | Group Net Loans €bn. | Group Deposits €bn. | Group Loans / Deposits | Employees World- wide | Capital Adequacy Ratio today |
|------------------------|------------------------------|---------------------------------|--------------------------------|-----------------------------------|--------------------------------------|---|
| NBG | 110.9 | 61.3 | 62.9 | 98% | 36,306 | 15.7% |
| Piraeus | 92.0 | 60.4 | 54.3 | 111% | 22,509 | 15.6% |
| Eurobank | 77.6 | 45.6 | 41.5 | 110% | 20,053 | 19.0% |
| ALPHA | 73.7 | 51.7 | 42.5 | 122% | 16,934 | 16.6% |

Source: Bank announcements in February-March 2014

* Data as of 30.09.2013

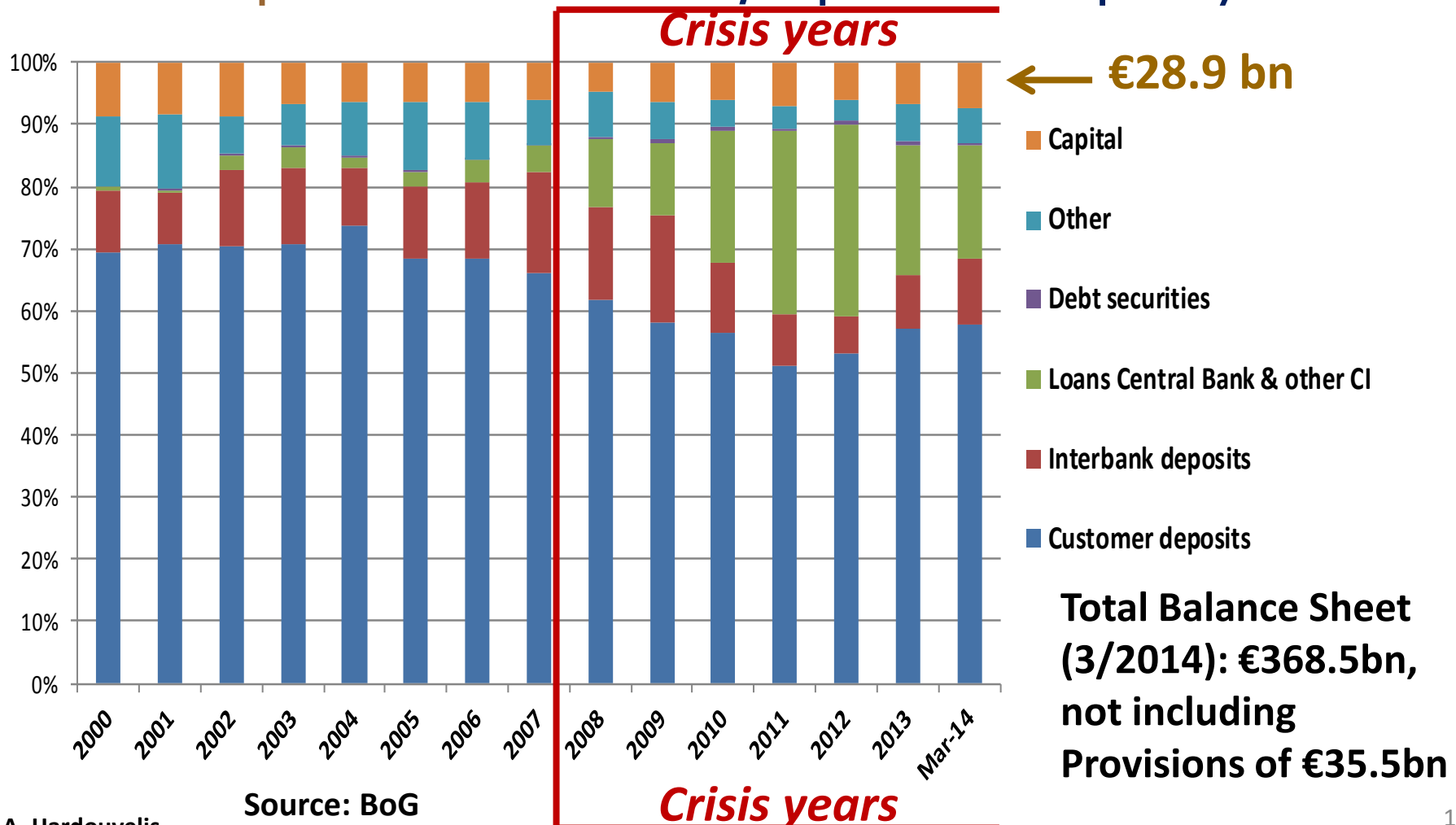
Due to the crisis, ECB dependence has changed nationalities



Source: Bloomberg

Financing of banks' balance sheets over the years in Greece

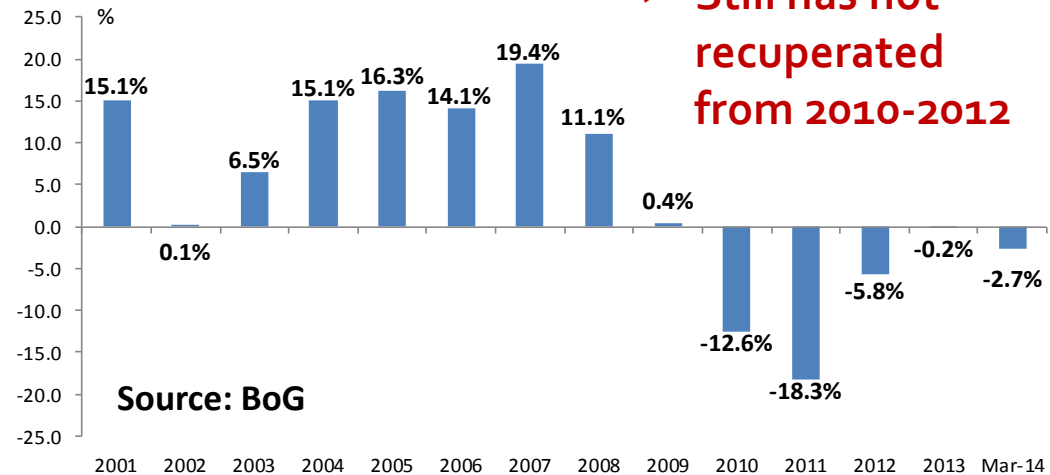
- ✓ Share of deposits falls after 2004, but more so after 2007
- ✓ **Eurosystem funding** increasingly important after 2007
- ✓ Share of **Capital** declines until 2008, improves subsequently



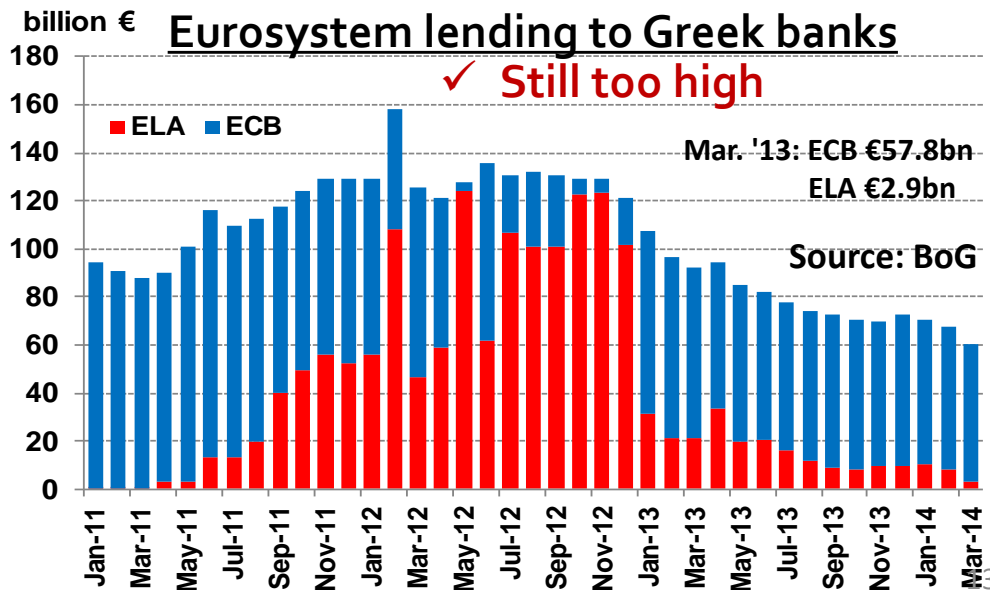
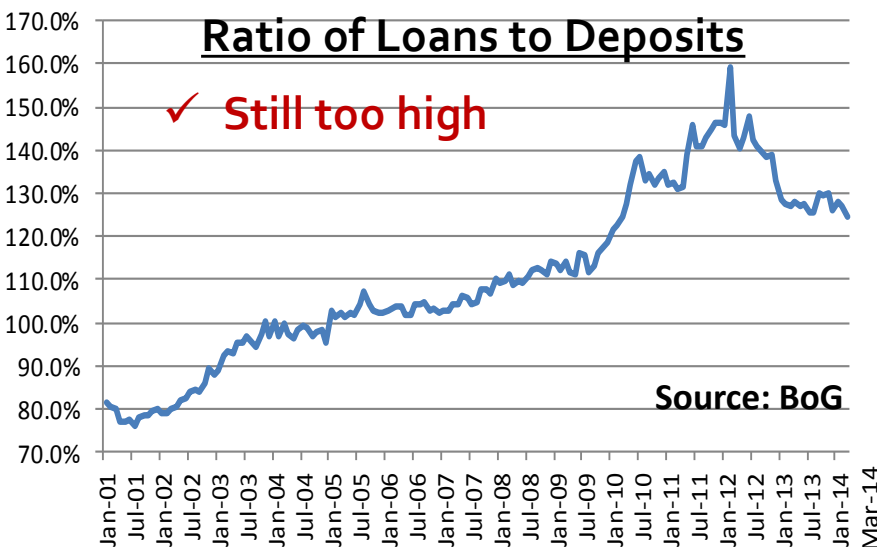
Crisis makes the financing of bank balance sheets increasingly more difficult

- ✓ Deposit ↓ from late 2009 to June 2012 elections ⇒
 - Increase in dependence on the Eurosystem
 - ELA more expensive, has shrunk
 - Increase in ratio of loans to deposits with improvement only after 2012H2

Annual change in Deposits & Repos

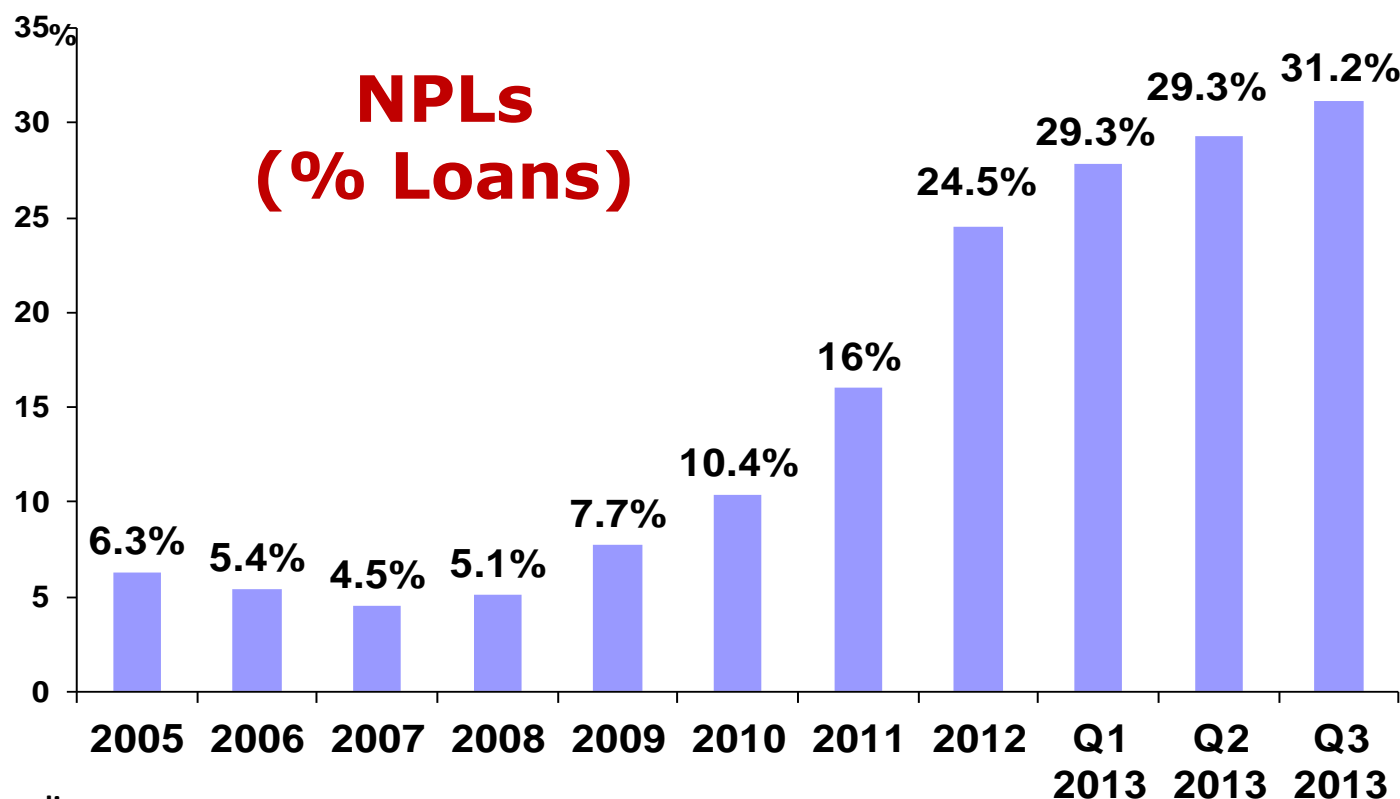


✓ Still has not recuperated from 2010-2012



The second challenge: Non-Performing Loans

- ❖ Continuous loan restructurings contain the rise in NPLs, which are expected to stabilize in 2015
- ❖ New internal units in banks specialize in problematic loans, plus a new export-oriented growth model can be achieved for the Country as emphasis is placed on financing tradable sectors



Despite the Greek crisis, financial intermediation continues

❖ Despite the challenges of

- Capital,
- Liquidity,
- and NPLs,

since the beginning of the EMU crisis, the drop in lending to the private sector is smaller than the drop in deposits

❖ On March 6, 2014 the results of the second BoG stress tests were announced

- Need for additional €6.4bn of new capital to cover needs up to the end of 2016
- Subsequently, Piraeus Bank raised €1.75bn, Alpha €1.2bn, and Eurobank €2.9bn, while NBG is currently raising €2.5bn

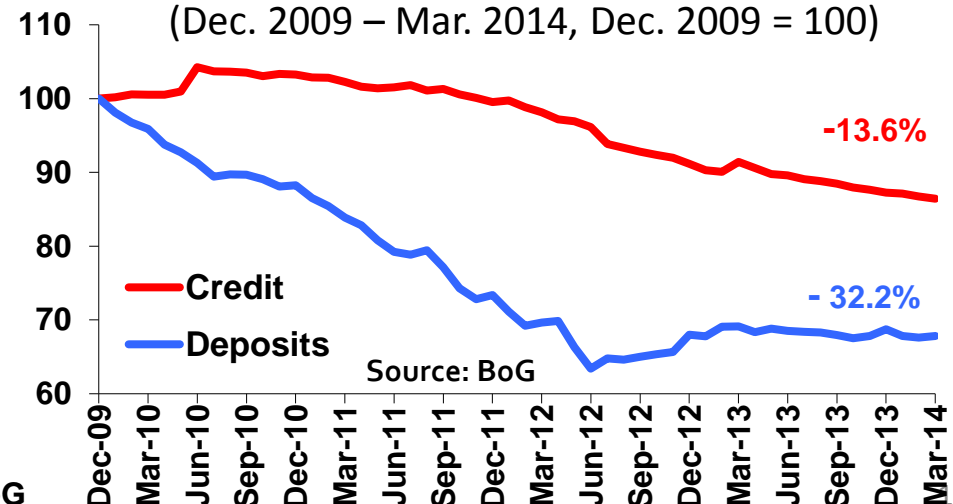
Domestic Private Sector

| (€ bn) | Credit | Deposits | | Credit | Deposits |
|--------|--------|----------|-----------|--------|----------|
| 2008 | 249.3 | 227.6 | Mar. 2013 | 227.0 | 164.1 |
| 2009 | 249.3 | 237.5 | Jun. 2013 | 223.4 | 162.7 |
| 2010 | 257.5 | 209.6 | Sep. 2013 | 220.6 | 161.4 |
| 2011 | 248.2 | 174.2 | Oct. 2013 | 219.3 | 160.4 |
| 2012 | 227.3 | 161.5 | Nov. 2013 | 218.6 | 161.0 |
| | | | Dec. 2013 | 217.5 | 163.3 |
| | | | Feb. 2014 | 216.2 | 160.5 |
| | | | Mar. 2014 | 215.5 | 161.1 |

Source: BoG

Domestic Private Sector Deposits & Loans

(Dec. 2009 – Mar. 2014, Dec. 2009 = 100)



Source: BoG

- ❖ Martin Hellwig provides a fresh look and a sharp analysis of the EMU crisis, which is not completely over yet
- ❖ He is to be applauded for his objective point of view, his concerns and predictions
- ❖ The EMU crisis affected Greek banks originally through the PSI+, now through the challenge of NPLs
- ❖ Despite the recent enthusiastic recapitalizations through the private sector, liquidity remains an open issue as borrowing from the ECB supports close to 1/3 of total lending to the private sector
 - Hence, Greece may escape from a new MoU, but unless citizens regain their trust in the domestic institutions and deposits flow back into the banking system, the country will remain dependent on the ECB for a while

Athens, May 06, 2014,
Discussion on the presentation by Martin Hellwig:
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Thank you for your attention

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