
European crisis management: The short term vs the long term

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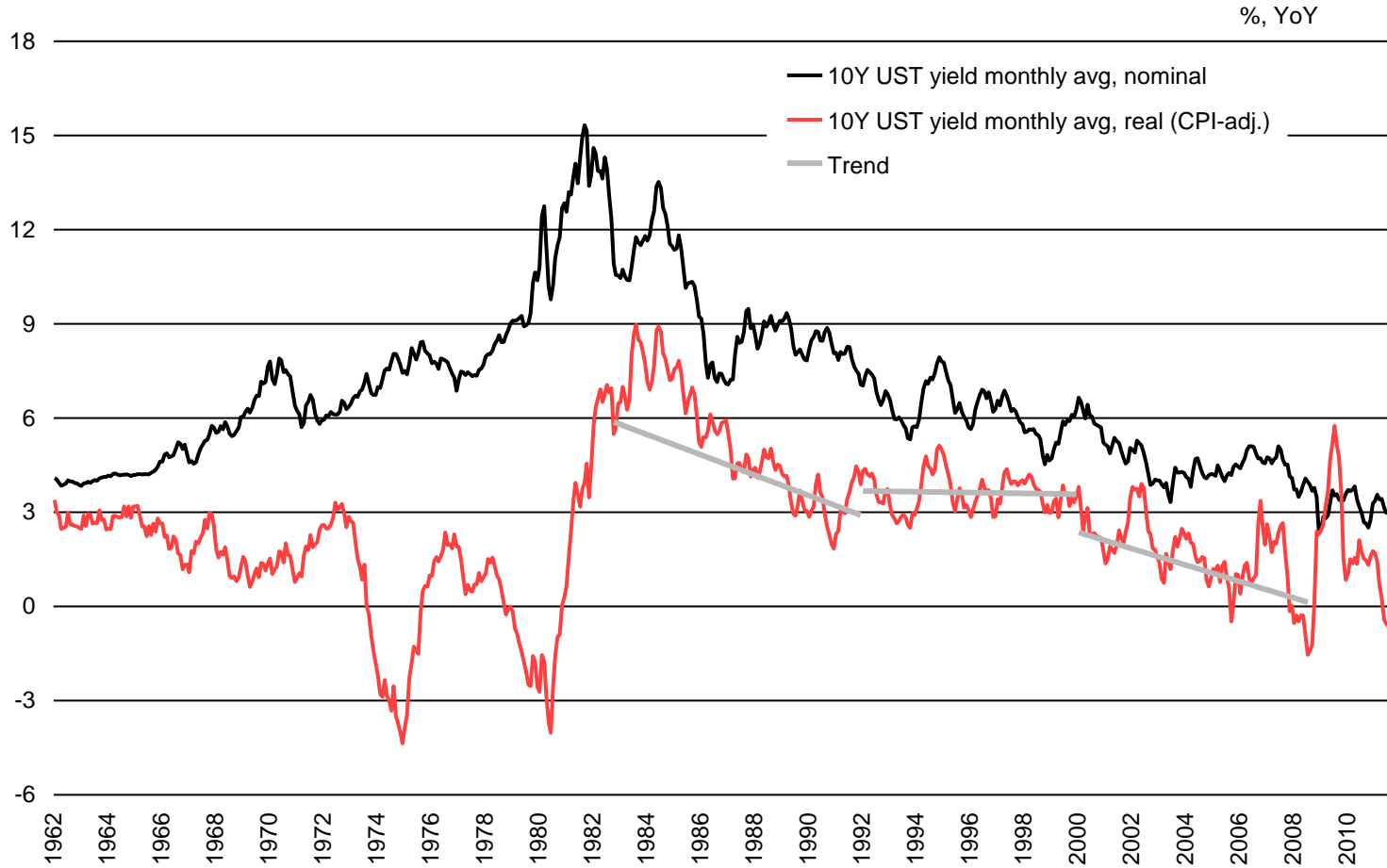
Agenda:

- **The cause of the crisis**
 - Mis-guided response to globalisation in the Western world
 - not a "Eurozone specific" problem

 - **Responses to the crisis so far:**
 - Fiscal tightening
 - Structural reforms
 - Fix your banks (but do you need to protect all creditors?)
 - ECB: Provide liquidity
 - Debt: PSI in Greece

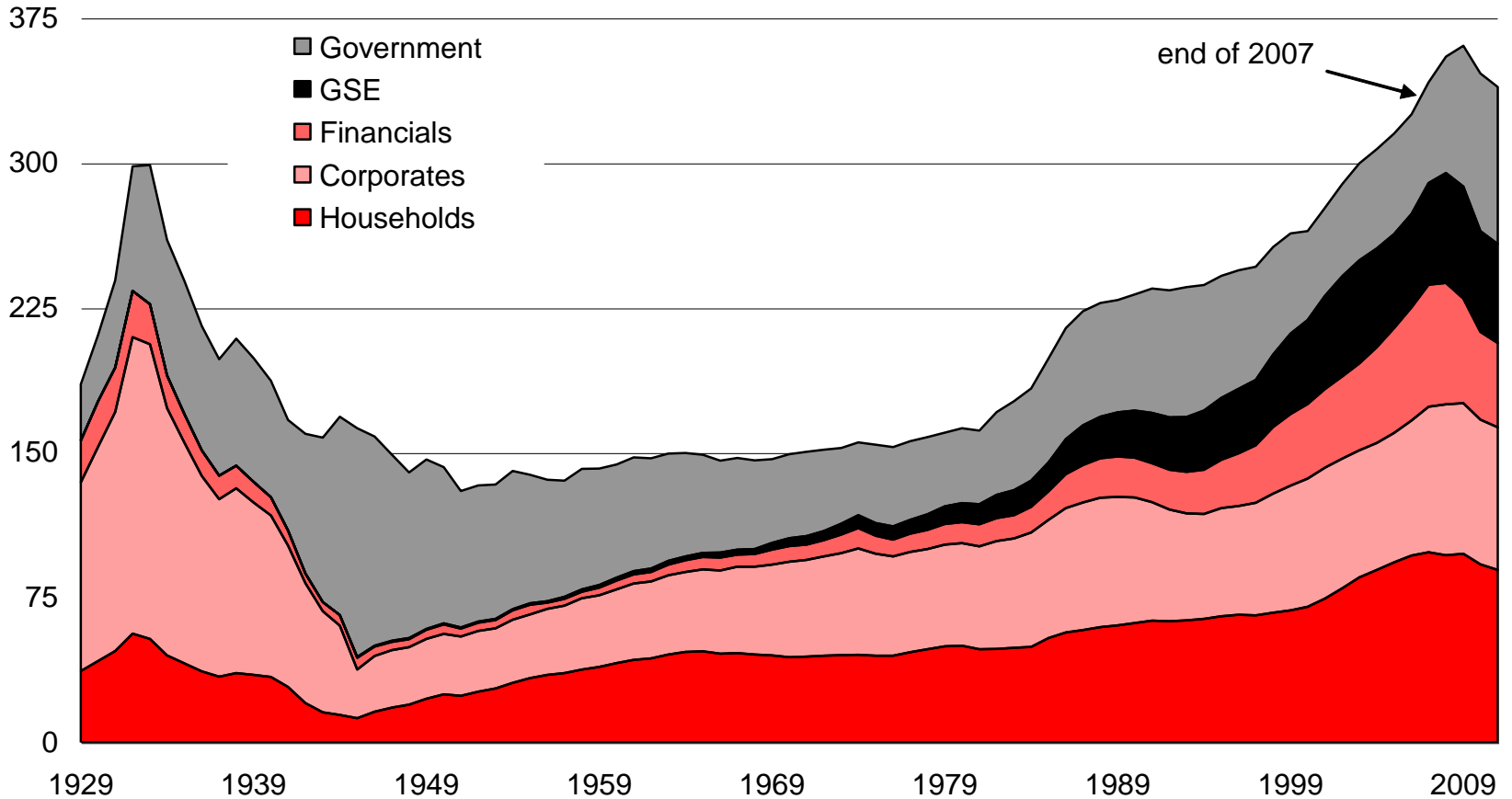
 - **Longer term solutions:**
 - Respond to globalisation
 - A proper firewall
 - Pari Passu for sovereign debt
 - Banking Union – Eurobonds?
-

30 years of declining interest rates – fooled by globalisation



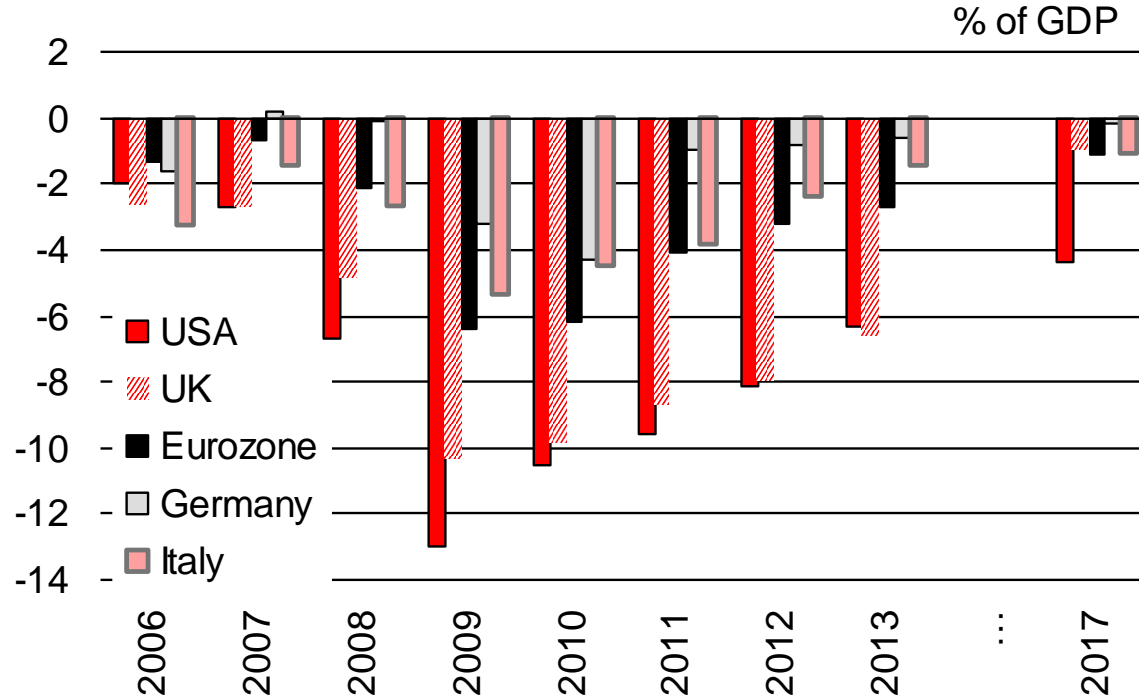
Declining interest rates led to debt build-up (the case of the US)

Credit market debt outstanding, as % of GDP



Source: Federal Reserve, UniCredit Research

Rule #1: If you have too big deficits, bring them down! (General government net borrowing)



Rule #2: Structural reforms to improve your growth prospects

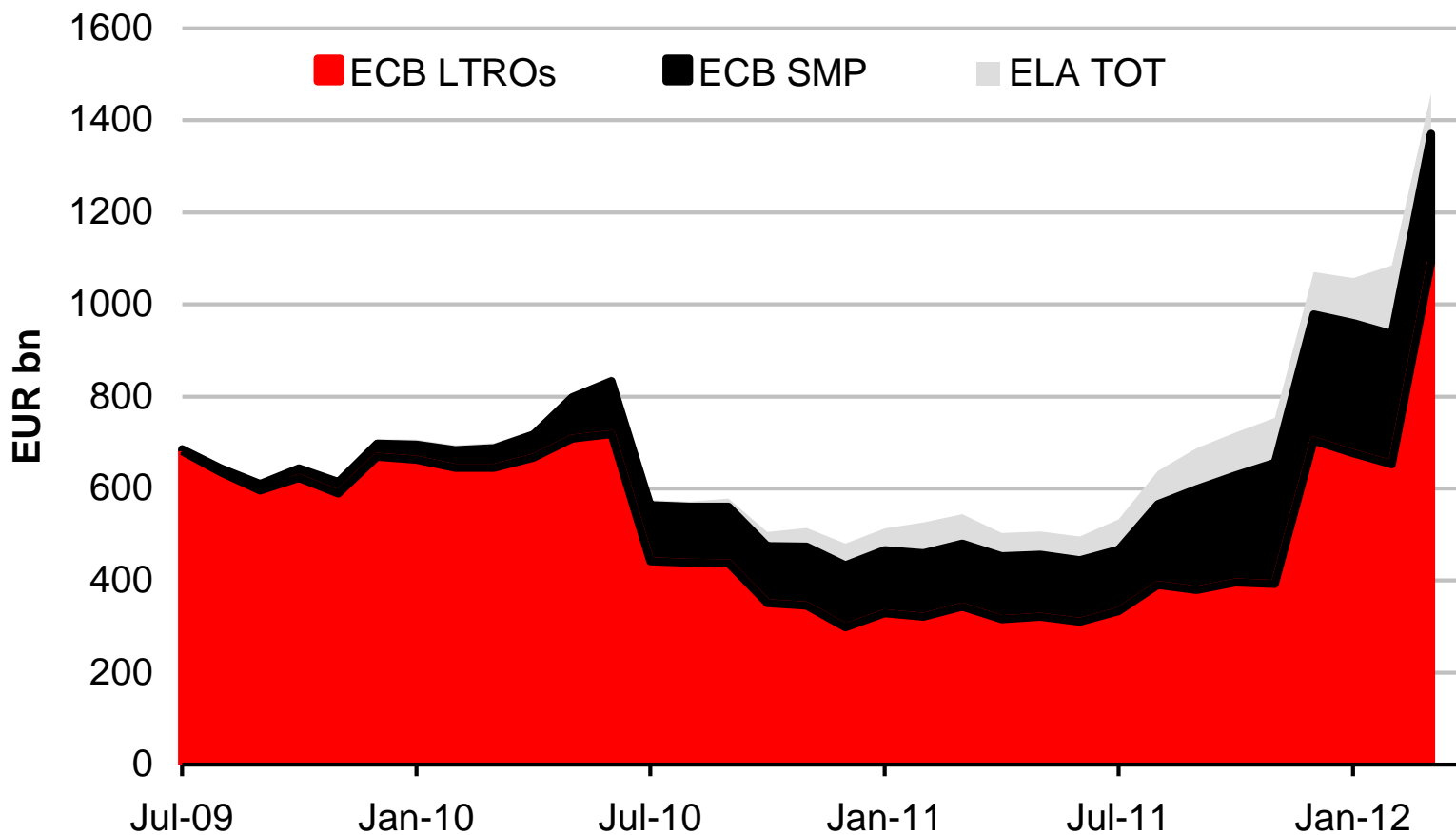
- Liberalise labour and product markets
- Reduce red tape
- Carrots and sticks to get more working hours into the system
 - Pension reforms
 - Women's participation ratio
 - Migration

Rule #3: Fix you banks!

- Greece
- Ireland
- Spain

- National or European?
- Who takes losses?

Rule #4: The central bank steps in with liquidity



Source: Bloomberg, Haver, UniCredit Research

Rule #5: Excessive debt needs to be restructured (or shared)

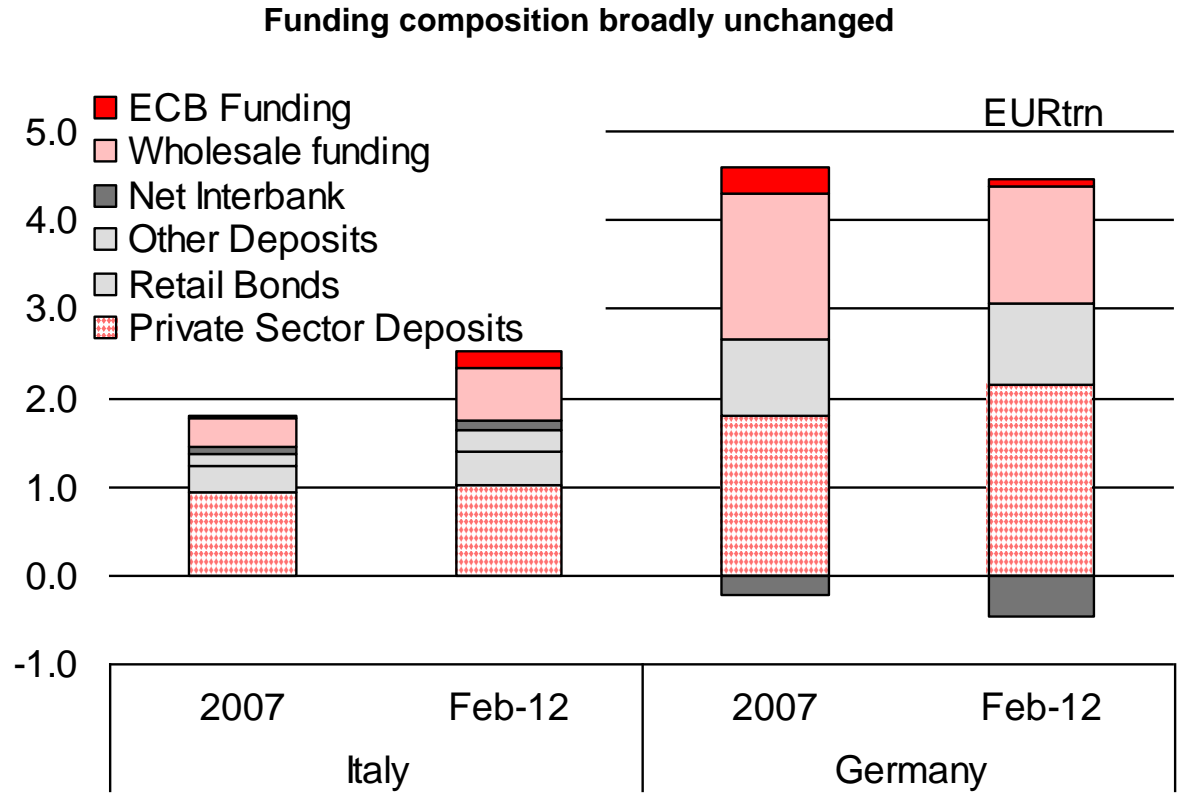
- What does it mean to default in your own currency?
- The Greek PSI

- The tranching of debt

Longer term solutions:

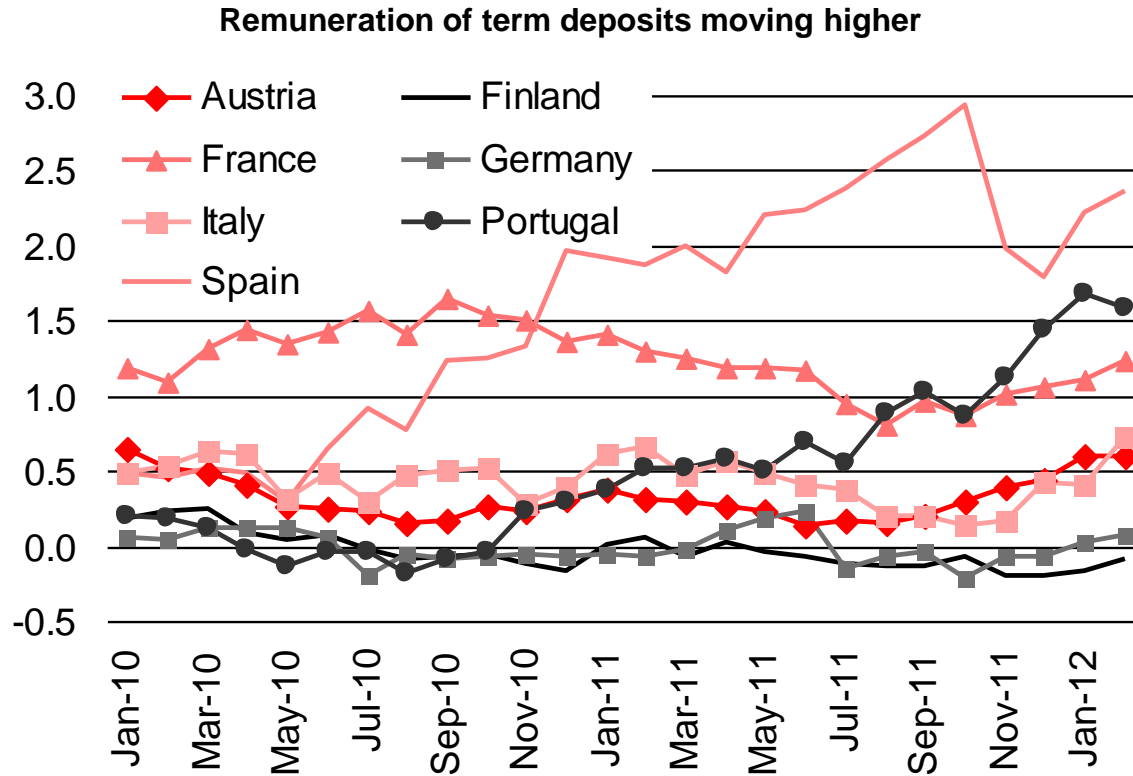
- Respond properly to globalisation: Devalue or move up the value-added curve.
- Make all the sovereign debt pari passu
- Create a proper firewall: Give the ESM a banking license
- Eurobonds???
- Banking Union
 - Shared bank supervision
 - Shared "fiscal underwriting"
 - Shared deposit guarantee

Funding composition broadly unchanged



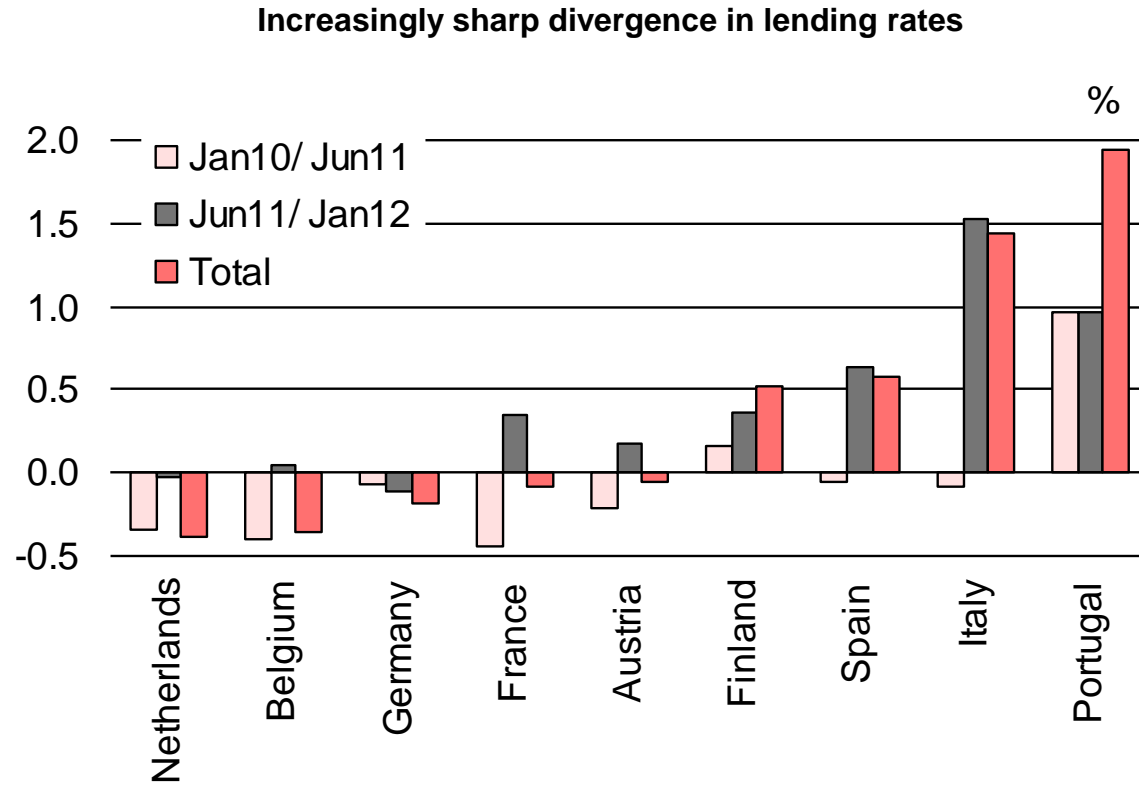
Source: ECB, UniCredit Research

Remuneration of term deposits moving higher



Source: ECB, UniCredit Research

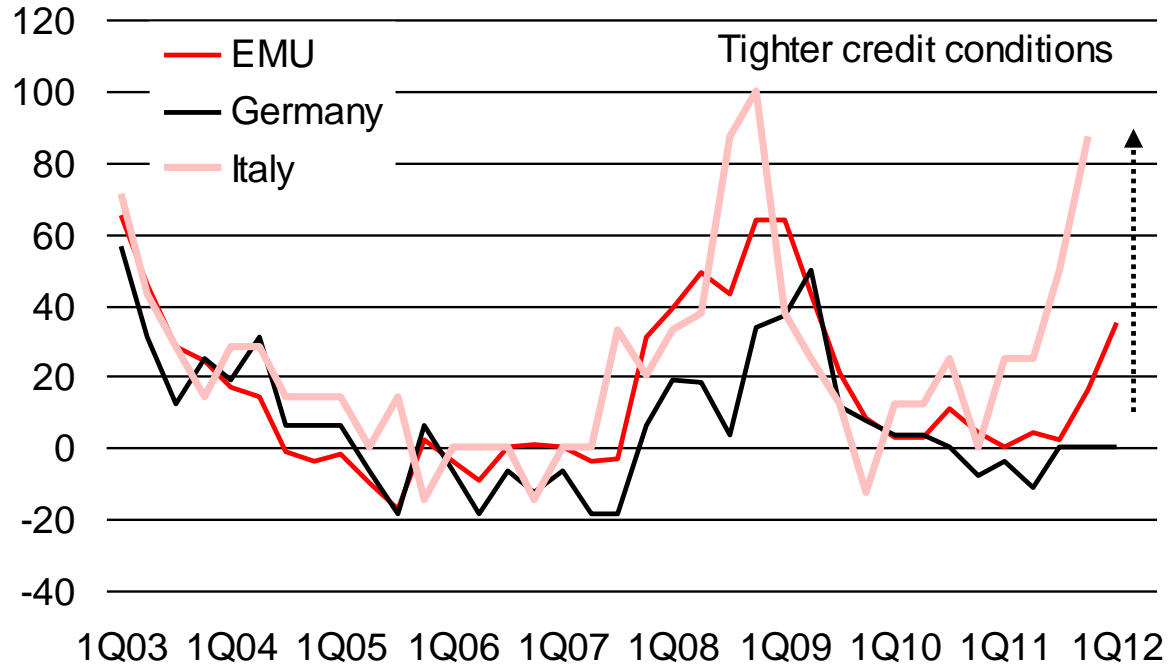
Increasingly sharp divergence in lending rates



Source: Abi/ECB, UniCredit Research

Recent divergence in credit conditions

Recent divergence in credit conditions



Source: ABi/ECB, UniCredit Research

Conclusions:

- Greece's future is up to the Greeks, but Europe will do what they have to do. But while we wait ... increasing risk of accidents.

 - Scenario 1: Greece stays
 - Months of nervous markets, but no substantial spread widening
 - Gradual move towards banking union
 - Gradually lower EUR/USD
 - Stress in CEE and Turkey

 - Scenario 2: Greece leaves (through the backdoor)
 - Substantial turmoil and contagion to other peripheral sovereigns
 - ECB interventions
 - Early introduction of Eurozone deposit guarantee and faster move towards banking union
 - Fast Euro depreciation
 - Potentially severe dislocations in CEE and Turkey
-

Your contacts

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