



BNP PARIBAS
FORTIS

| The bank for a changing world

SAVING THE EURO – at what price?

Austrian Marshall Plan Foundation
Austrian Central bank

Vienna, October 21, 2010.

Freddy Van den Spiegel
Chief Economist

1. Imagine EU without Euro: is/was it worthwhile?



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- The difficult situation before the Euro.



The European Currency Snake

History of the Snake

1972

April 24 The snake arrangement launched.

May 1 United Kingdom and Denmark join.

May 23 Norway joins.

June 23 United Kingdom withdraws.

June 27 Denmark withdraws.

Oct. 10 Denmark rejoins.

1973

Feb. 13 Italy withdraws.

March 19 Mark revalued 3 percent; general float begins, with snake no longer constrained by the tunnel.

April 3 European Monetary Cooperation Fund established to support snake.

June 29 Mark revalued 5.5 percent.

Sept. 17 Guilder revalued 5.5 percent.

Nov. 16 Norwegian krone revalued 5 percent.

1974

Jan. 19 France withdraws.

1975

July 10 France rejoins.

1976

March 15 France withdraws.

Oct. 18 Danish krone devalued 4 percent, Norwegian krone and Swedish krona devalued 1 percent, mark revalued 2 percent.

1977

Apr. 4 Swedish krona devalued 6 percent, Danish and Norwegian kroner devalued 3 percent.

Aug. 28 Sweden withdraws, and Norwegian and Danish kroner devalued by 5 percent.

1978

Feb. 10 Norwegian krone devalued 8 percent.

Oct. 16 German mark revalued 2 percent, Danish and Norwegian kroner devalued 2 percent.

Dec. 12 Norway withdraws.



The European Monetary System 1979-1993

The central parity readjustments

	DEM	FRF	ITL	DKK	BEF	NGL	GBP
24 september 1979	2,0			-2,9			
30 november 1979				-4,8			
23 March 1981			-6,0				
5 October 1981	5,5	-3,0	-3,0			5,5	
22 February 1982				-3,0	-8,5		
14 June 1982	4,25	-5,75	-2,75			4,25	
21 March 1983	5,5	-2,5	-2,5	2,5	1,5	3,5	-3,5
22 July 1985	2,0	2,0	-6,0	2,0	2,0	2,0	2,0
7 april 1986	3,0	-3,0		1,0	1,0	3,0	
4 augustus 1986							-8,0
12 January 1987	3,0				2,0	3,0	
5 January 1990			-3,7				
13 september 1992			-3,5				

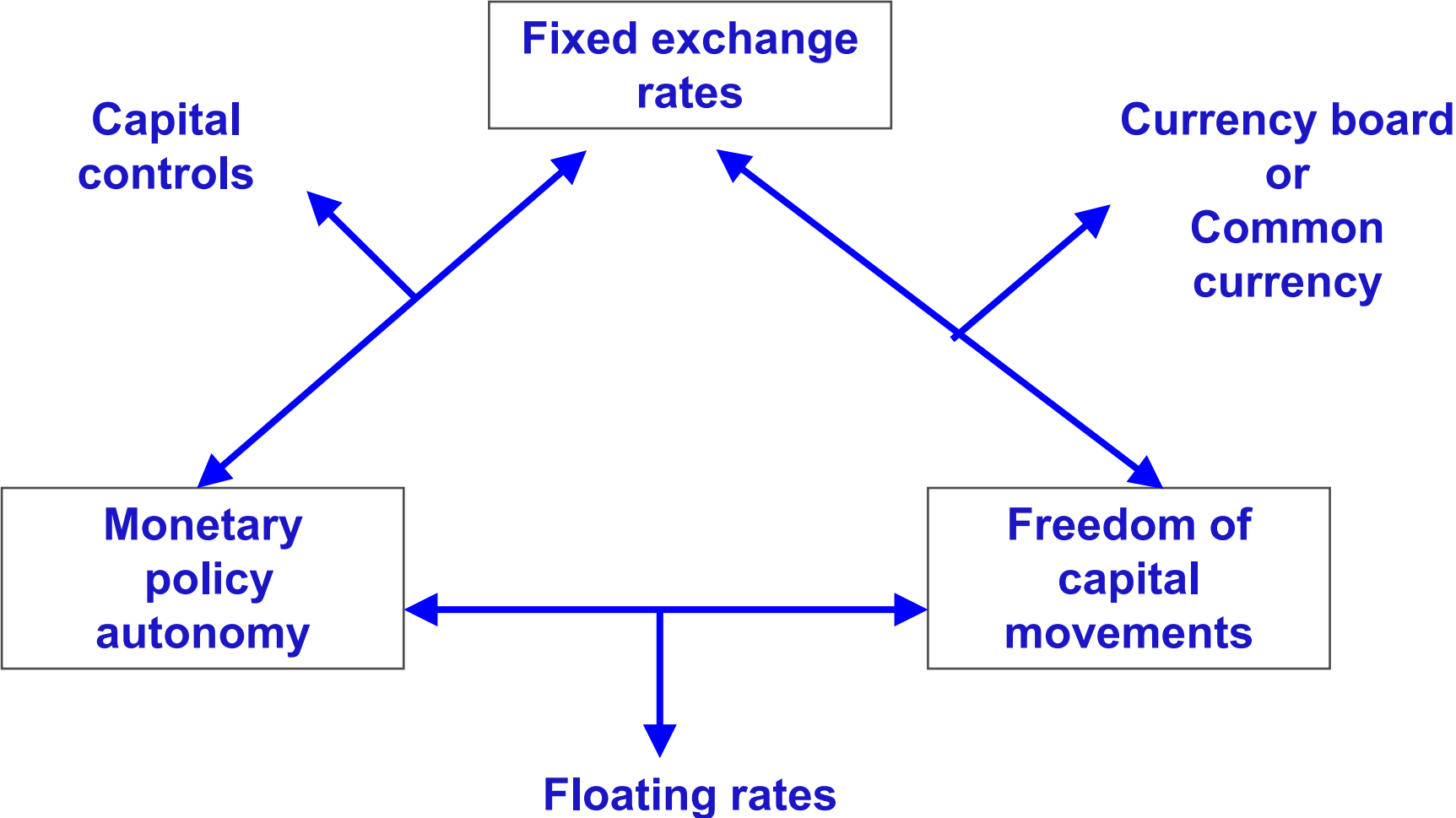
Source: Centre Virtuel de la Connaissance sur l'Europe (CVCE)

Ins & Outs

- 1979: eight original participants: France, Germany, Italy, Belgium, Denmark, Ireland, Luxembourg and the Netherlands.
- 1989: Spain as new member
- 1990: UK as new member
- 1992: Portugal as new member.
- 16 September 1992: UK withdraws
- 17 September 1992: Italy withdraws



ERM : the impossible triangle.

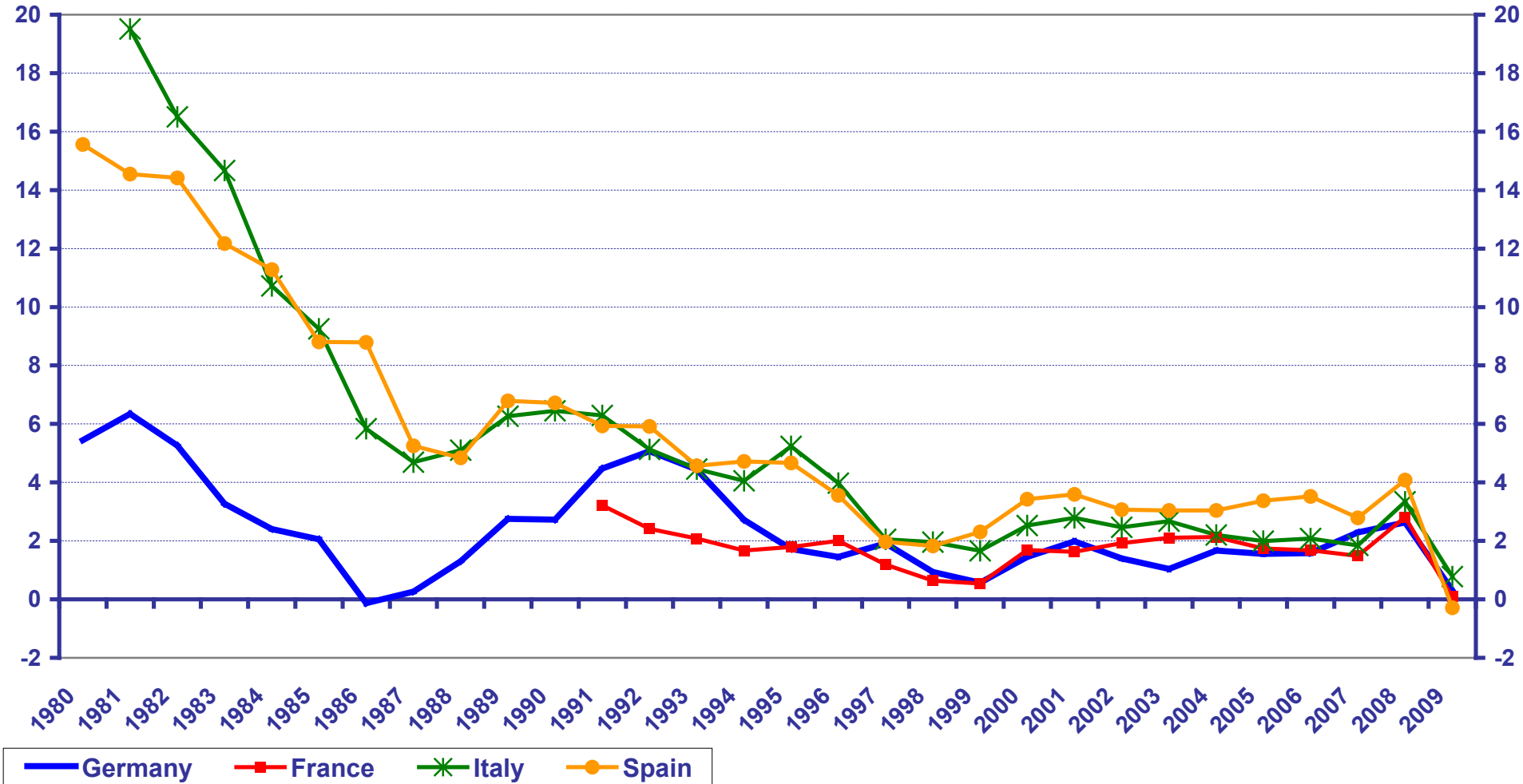


1. Imagine EU without Euro: is/was it worthwhile?

- The difficult situation before the Euro.
- The positive effects.
 - Inflation converging, low and stable.



Inflation CPI 1980 - 2009 (in % yoy)



Source: Thomson Financial Datastream



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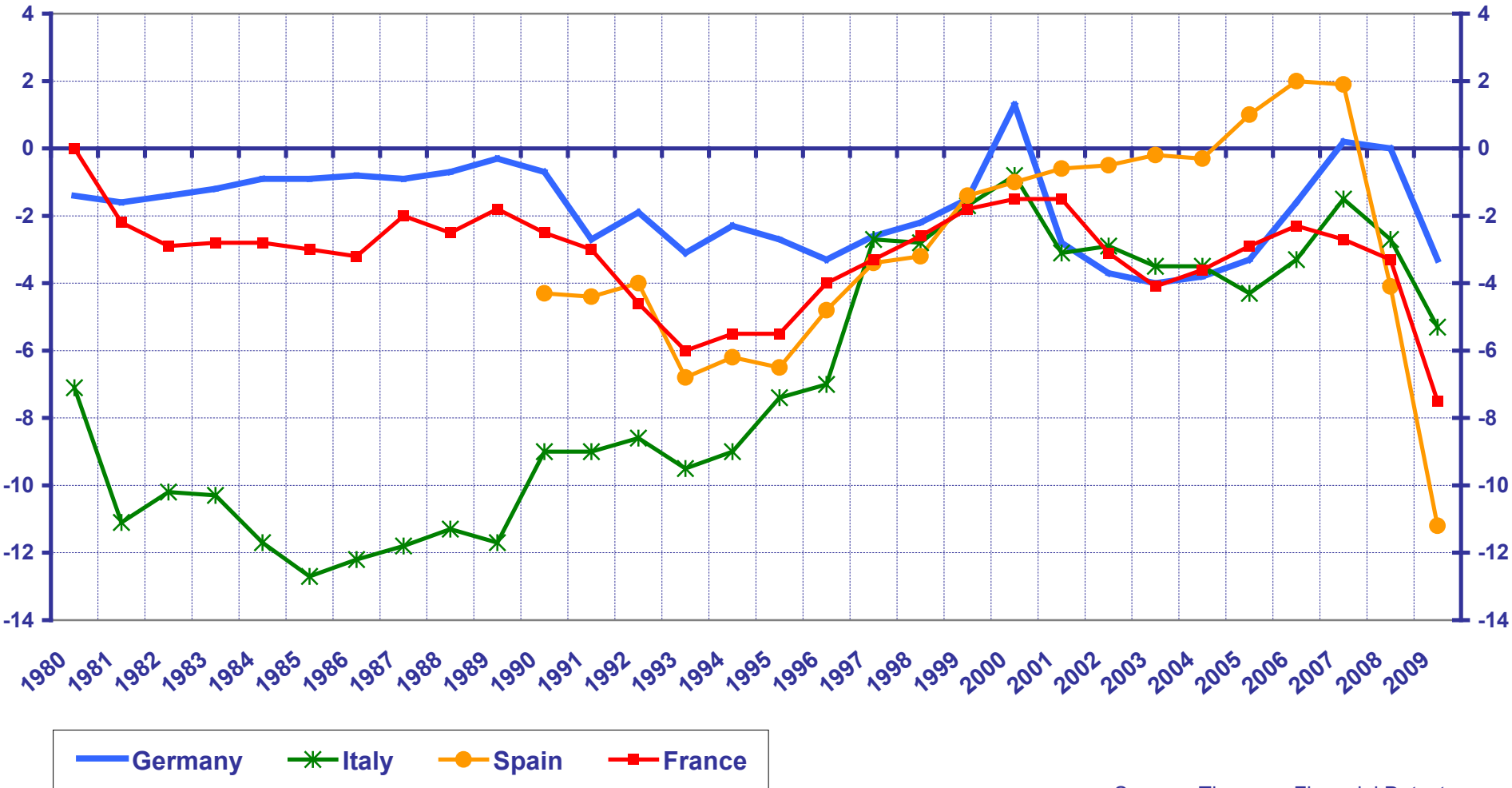
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 - Budget deficits down despite weak discipline of SGP.



Deficit 1980 - 2009 (in % of GDP)



Source: Thomson Financial Datastream

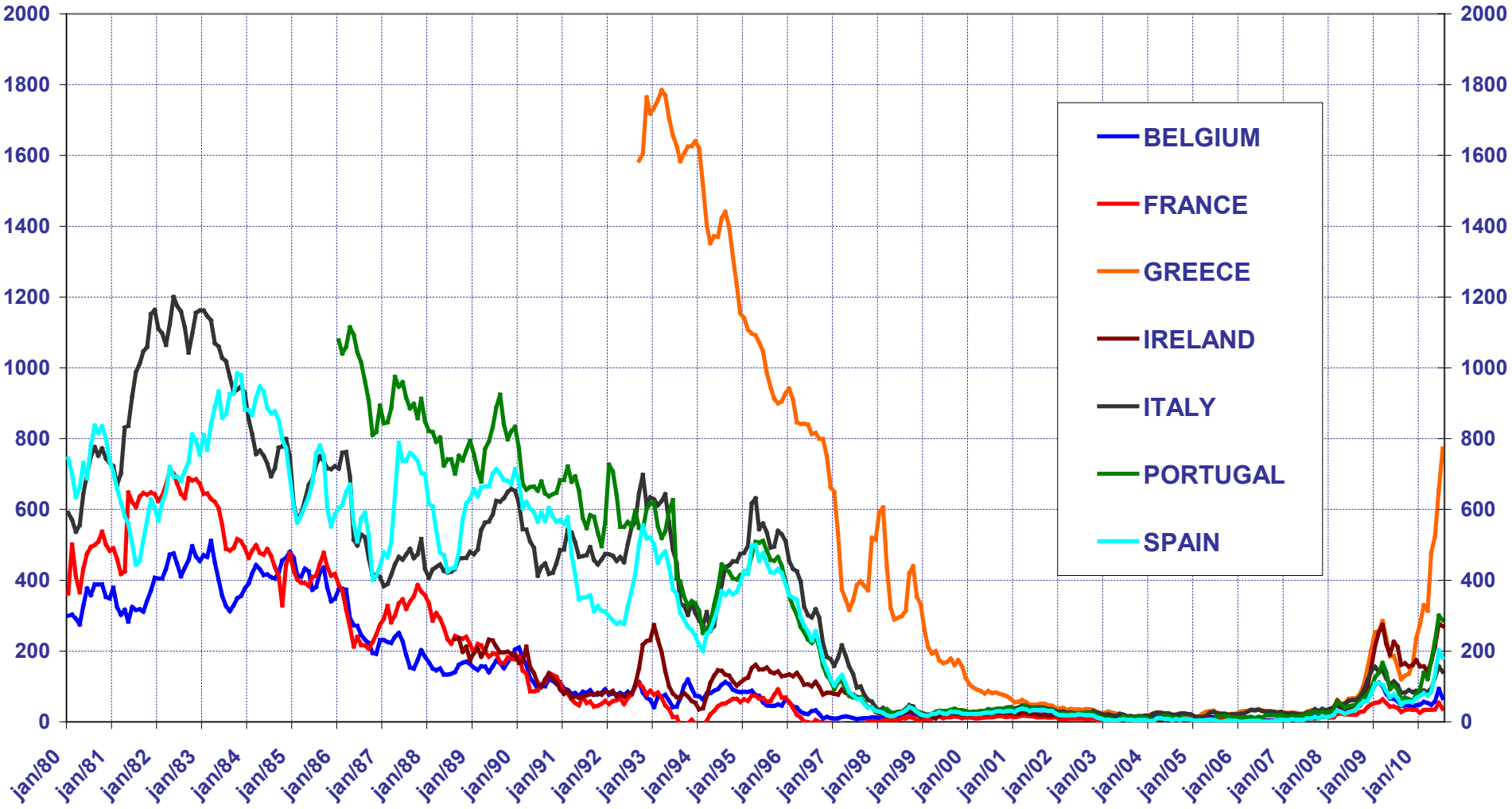


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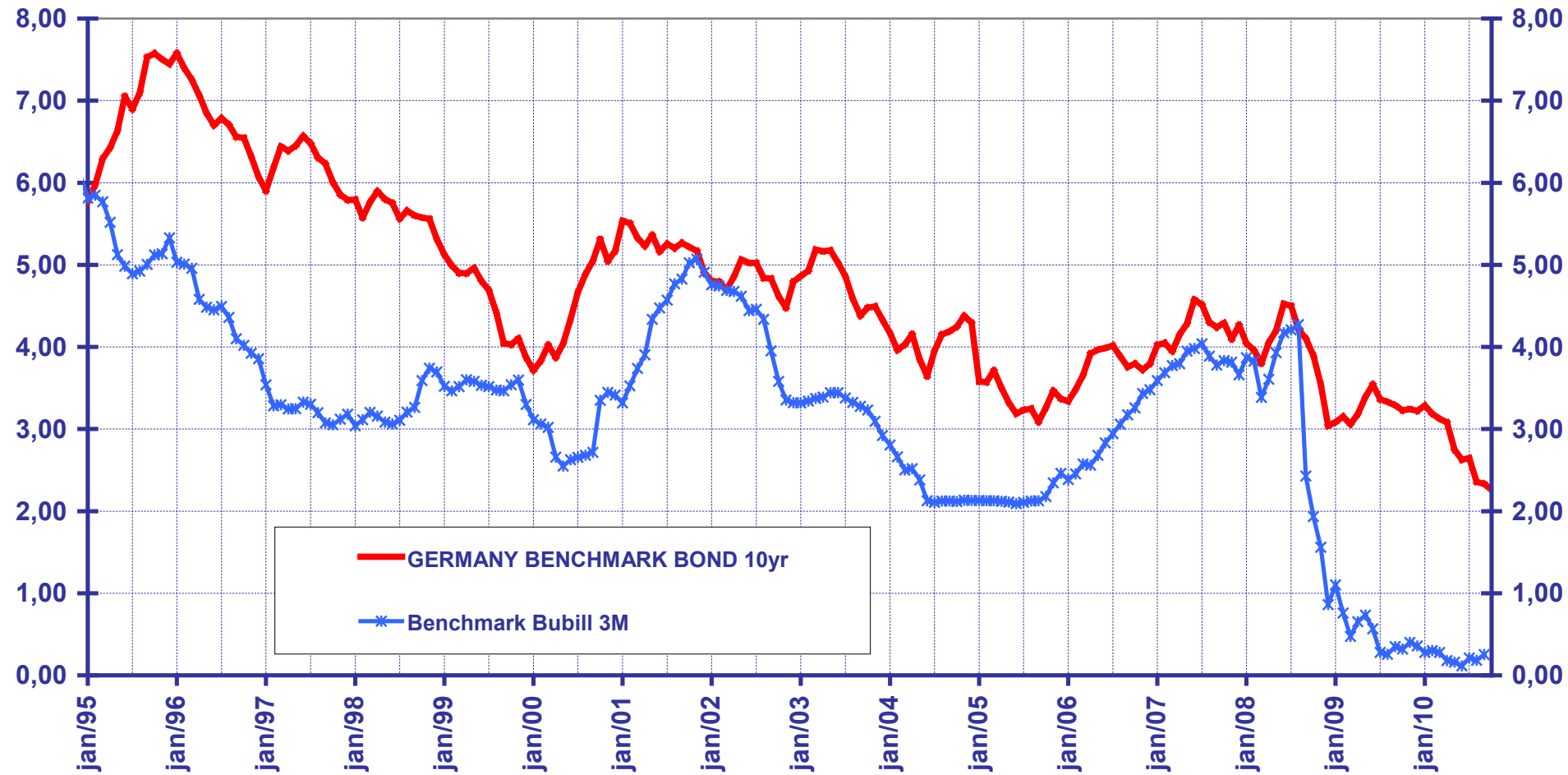
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 - Inflation converging, low and stable.
 - Budget deficits down despite weak discipline of SGP.
 - Cost of capital down.



LONG TERM GOVERNMENT BOND SPREADS WITH GERMAN BUND 10Y (in bp)



EMU BENCHMARK INTEREST RATES



Source: Thomson Financial Datastream



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 - Macro economic stability.



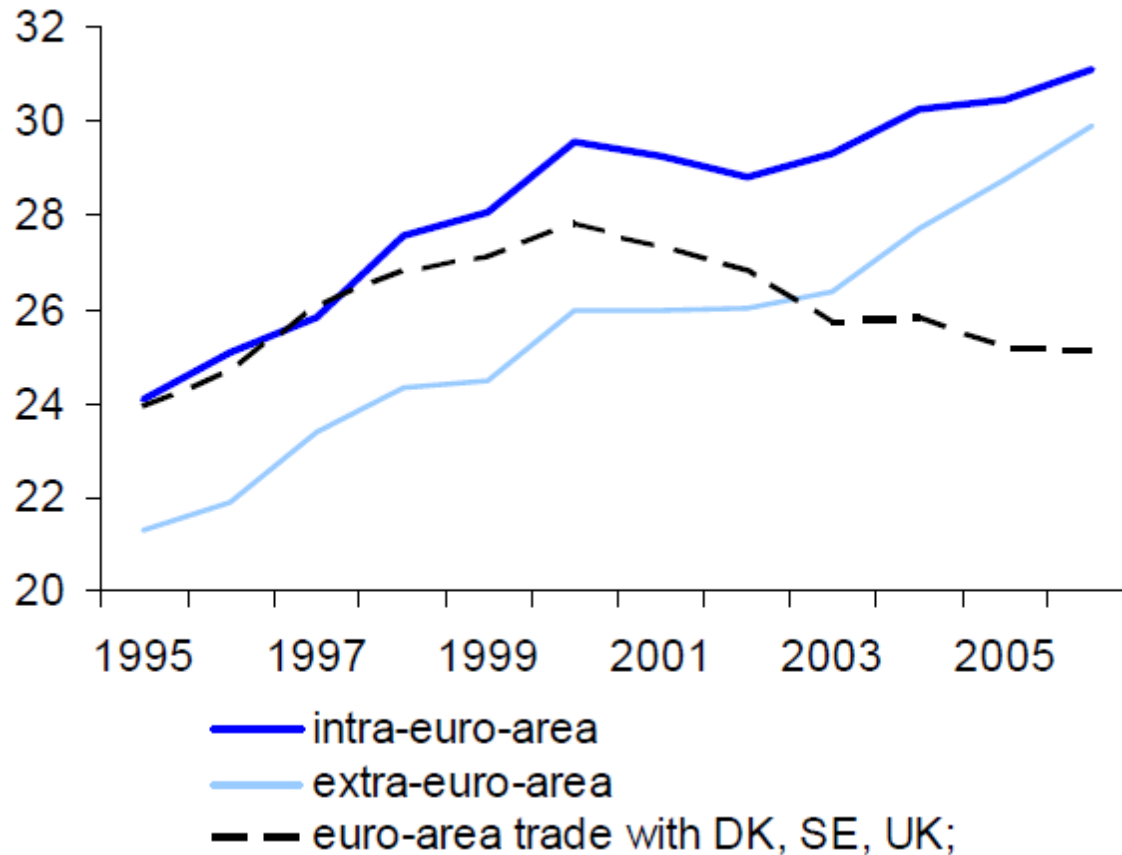
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 - Macro economic stability.
 - Helping the internal market? Statistics are not easy to interpret.



Graph I.2.10: Real trade in goods

Sum of exports and imports as a % of GDP



Source: European Commission.



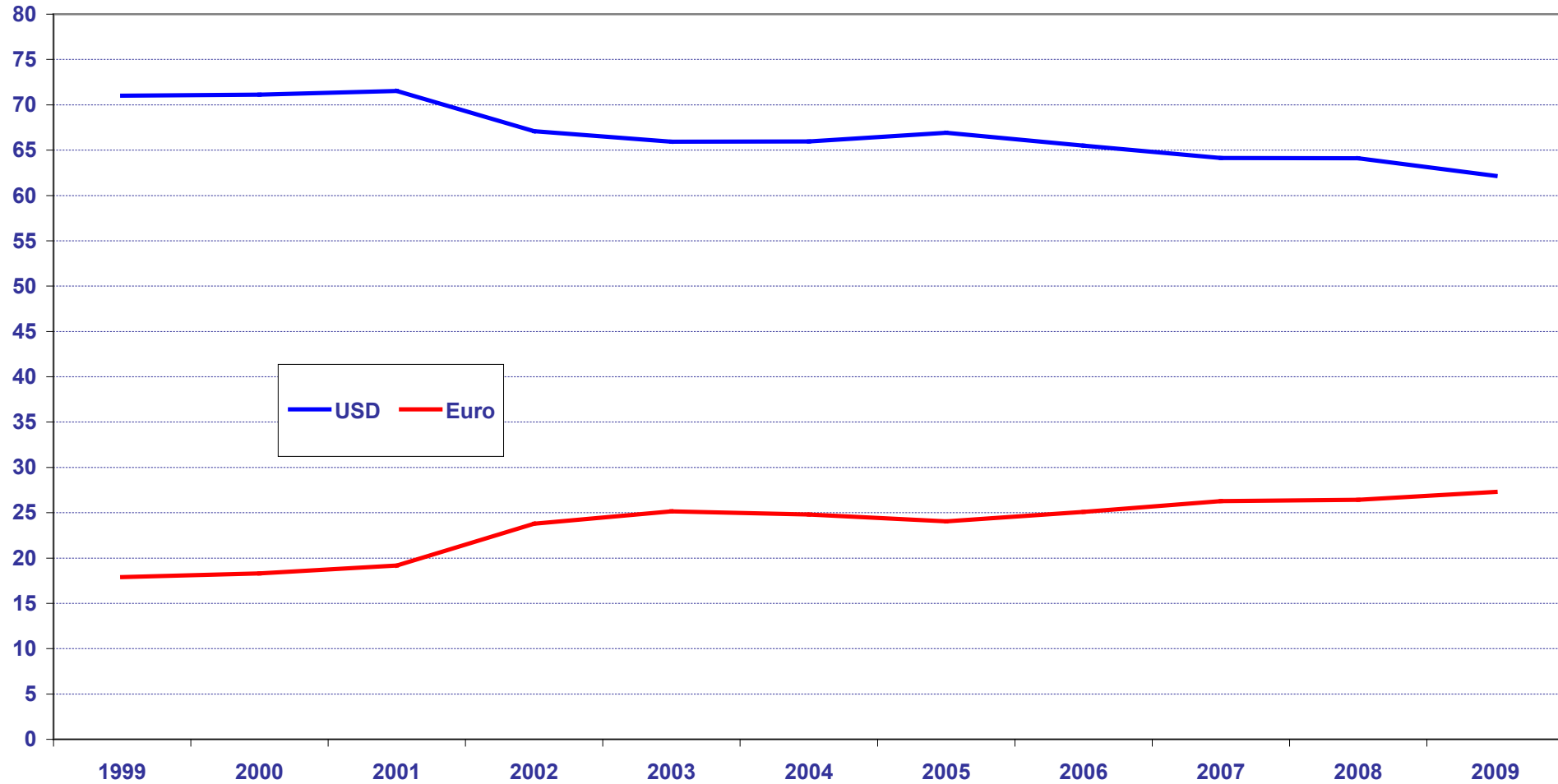
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 - Macro economic stability.
 - Helping the internal market? Statistics are not easy to interpret.
 - Increasing role as reserve currency.



Since the introduction of the euro, the euro's share rose from 18% to 27%, while the share of the USD declined from 71% to 62%

SHARE OF USD AND EURO IN FOREIGN RESERVE HOLDINGS (Percentage of total allocated reserves)



Source: COFER



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 - Macro economic stability.
 - Helping the internal market? Statistics are not easy to interpret.
 - Increasing role as reserve currency.
 - Increasing role in international trade.



The euro share as a settlement/invoicing currency in extra-euro area exports of goods of selected euro area countries
(as a percentage of the total)

	Goods				
	2001	2002	2003	2004	2005
France ¹⁾	50.8	50.5	49.0	49.2	49.9
Germany	...	49.0	63.0	61.1	61.0
Greece	23.5	39.3	47.3	44.3	39.1
Italy	52.7	54.1	58.2	59.0	57.3
Luxembourg	...	44.0	51.5	61.8	61.4
Portugal	40.3	44.1	50.5	55.4	56.6
Spain	52.1	57.6	61.8	62.5	62.0

Sources: National central banks and ECB calculations.

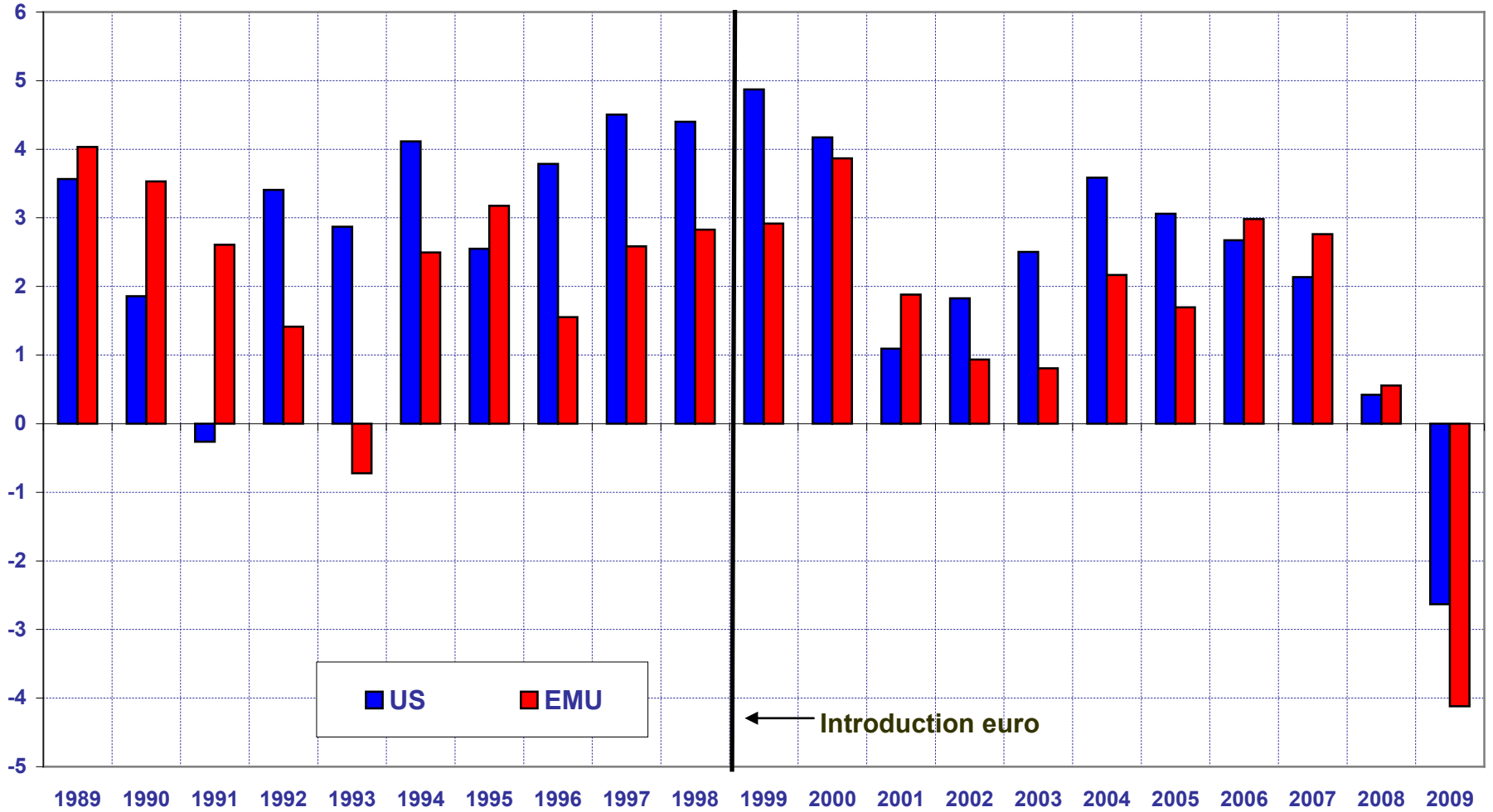


1. Imagine EU without Euro: is/was it worthwhile?

- The difficult situation before the Euro.
- The positive effects.
- The failures and disappointments.
 - Growth below target.



REAL GDP GROWTH (%YoY)



Source: Datastream

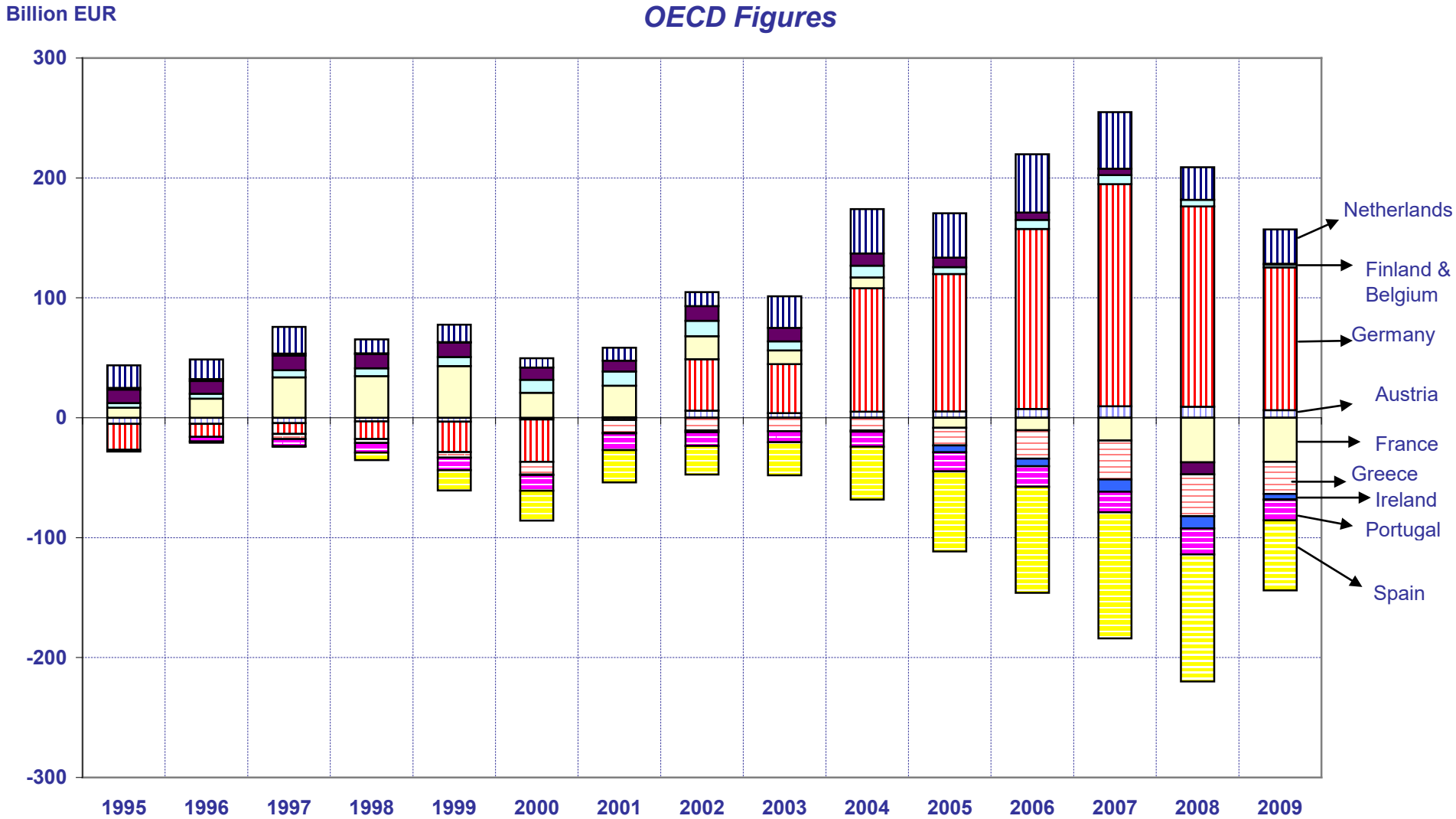


1. Imagine EU without Euro: is/was it worthwhile?

- The difficult situation before the Euro.
- The positive effects.
- The failures and disappointments.
 - Growth below target.
 - Diverging competitiveness.



Current Account Balance (Billion EUR) OECD Figures



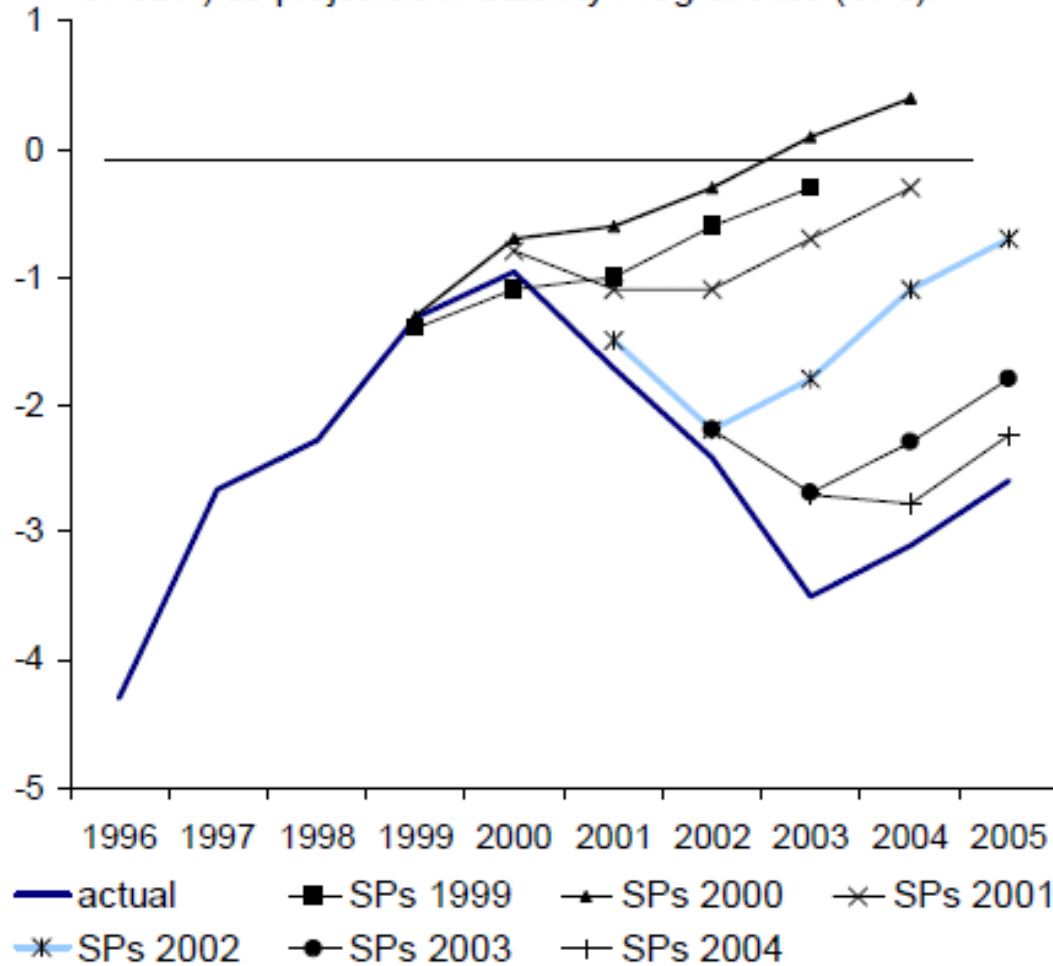
1. Imagine EU without Euro: is/was it worthwhile?

- The difficult situation before the Euro.
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- The failures and disappointments.
 - Growth below target.
 - Diverging competitiveness.
 - Lack of discipline.



Graph I.10.1: Slipping fiscal targets

General government budget balances (excluding UMTS, % of GDP) as projected in Stability Programmes (SPs).



Source: European Commission.



1. Imagine EU without Euro: is/was it worthwhile?

- The difficult situation before the Euro.
- The positive effects.
- The failures and disappointments.
 - Growth below target.
 - Diverging competitiveness.
 - Lack of discipline.

ON BALANCE: A RATHER SATISFACTORY EXPERIENCE
BUT WEAK SPOTS.



1. Imagine EU without Euro: is/was it worthwhile?
2. The crisis as a catalyst for trouble.



2. The crisis as a catalyst for trouble.

- Not a normal crisis: a worldwide regime switch.



2. The crisis as a catalyst for trouble.

- Not a normal crisis: a worldwide regime switch.
- Three consecutive shocks on major pillars of the Western system.
 - The financial system.



How fared the most solid banks in Western Europe?

Bank	Intervention
HSBC Holdings	12,5bn GBP private capital injection
Crédit Agricole Group	3bn EUR capital injection (subordinate debt)
Royal Bank of Scotland	58% nationalised
Santander	2bn EUR capital raised from private investors
BNP Paribas	5,1bn capital injection (preferred shares)
Barclays Bank	£7bn private capital injection, use of credit guarantees
HBOS	taken over by Lloyds TSB, 44% nationalised
UniCredit	seeking 4bn EUR from Italian and Austrian governments
Rabobank Group	no capital injection
ING Bank	10bn EUR capital Injection, 80% government guarantee on 27,7bn Alt-A
UBS	5,3bn USD capital injection, 60bn USD bad assets removed
Deutsche Bank	no capital injection
ABN AMRO Bank	nationalised
Crédit Mutuel	1,2bn EUR capital injection (subordinate debt)
Société Générale	3,4bn EUR capital injection (subordinate debt + preferred shares)
Credit Suisse group	private capital injection of 10bn CHF
BBVA	no capital injection
Lloyds TSB	50% nationalised
Groupe Caisse d'Epargne	1,1bn EUR capital injection (subordinate debt)
Groupe Banques Populaires	0,95bn EUR capital injection (subordinate debt)



How fared the most solid banks in the USA?

Bank	Intervention
Bank of America	expanding (Merrill Lynch, Countrywide), 45bn USD capital injection
Citigroup	50bn USD capital injection + 306bn USD bad asset guarantee, breaking up
JP Morgan Chase	expanding (Bear Stearns, WaMu), 25bn USD capital injection
Wachovia Corporation	failure
Wells Fargo	expanding (Wachovia), 25bn USD capital injection
Washington Mutual	failure
U.S. Bancorp	6,6bn USD capital injection
Countrywide Financial Corp.	sold
SunTrust Banks	4,9bn USD capital injection (preference shares)
Capital One Fin. Corp.	3,6bn USD capital injection
National City Corp.	sold
Regions Financials Group	3,5bn USD capital injection
PNC Financial Services Group	expanding (National City), 7,6bn capital injection (preference shares)
Fifth Third bancorp	3,4bn USD capital injection
KeyCorp	2,5bn USD capital injection
BB & T Corp	3,1bn USD capital injection
State Street Corp	2bn USD capital injection
Bank of New York	3bn USD capital injection
Comerica	2,3bn USD capital injection
Merril Lynch Bank USA	sold

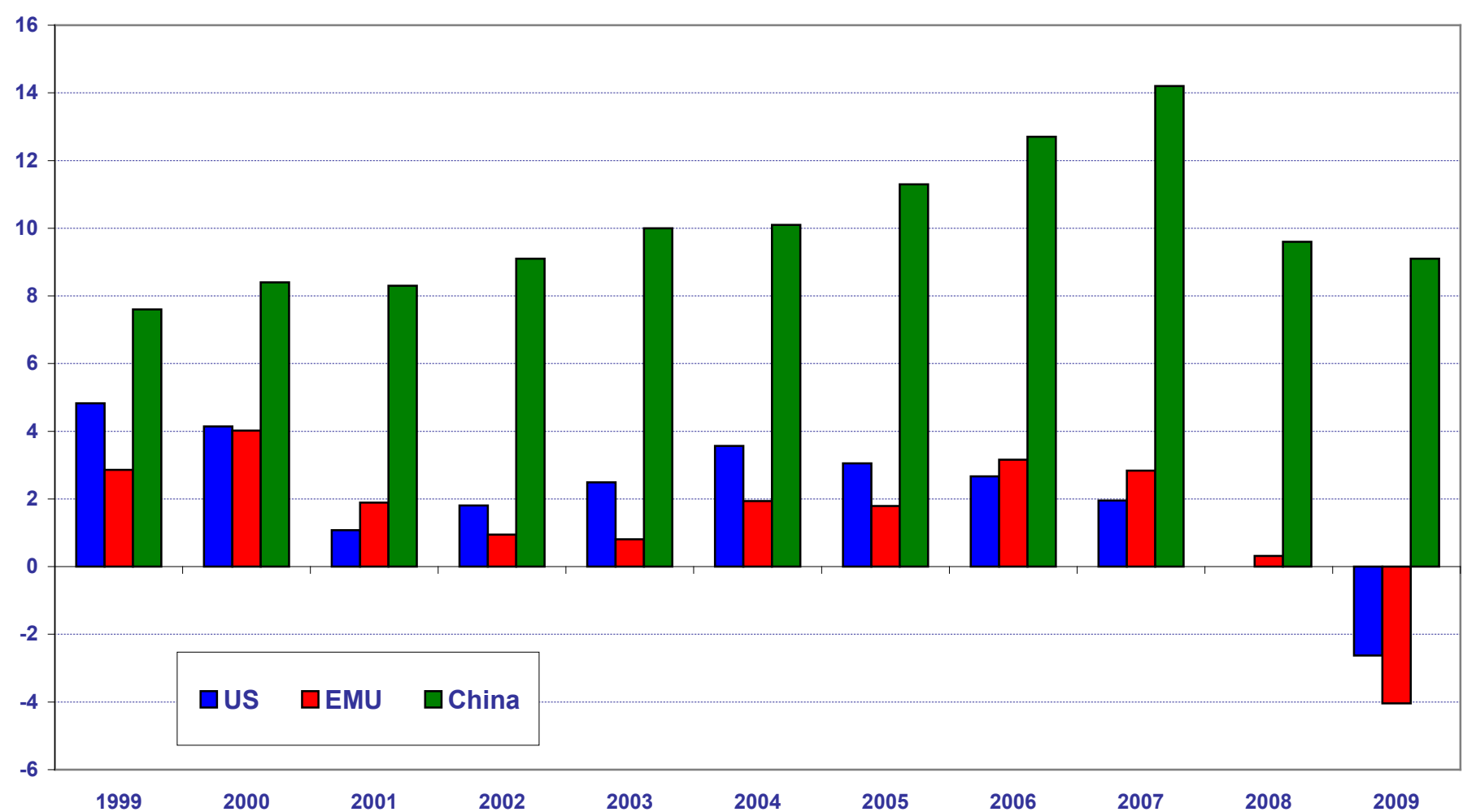


2. The crisis as a catalyst for trouble.

- Not a normal crisis: a worldwide regime switch.
- Three consecutive shocks on major pillars of the Western system.
 - The financial system.
 - The economy.



REAL GDP GROWTH 1999 - 2009 (%YoY)



Source: Datastream



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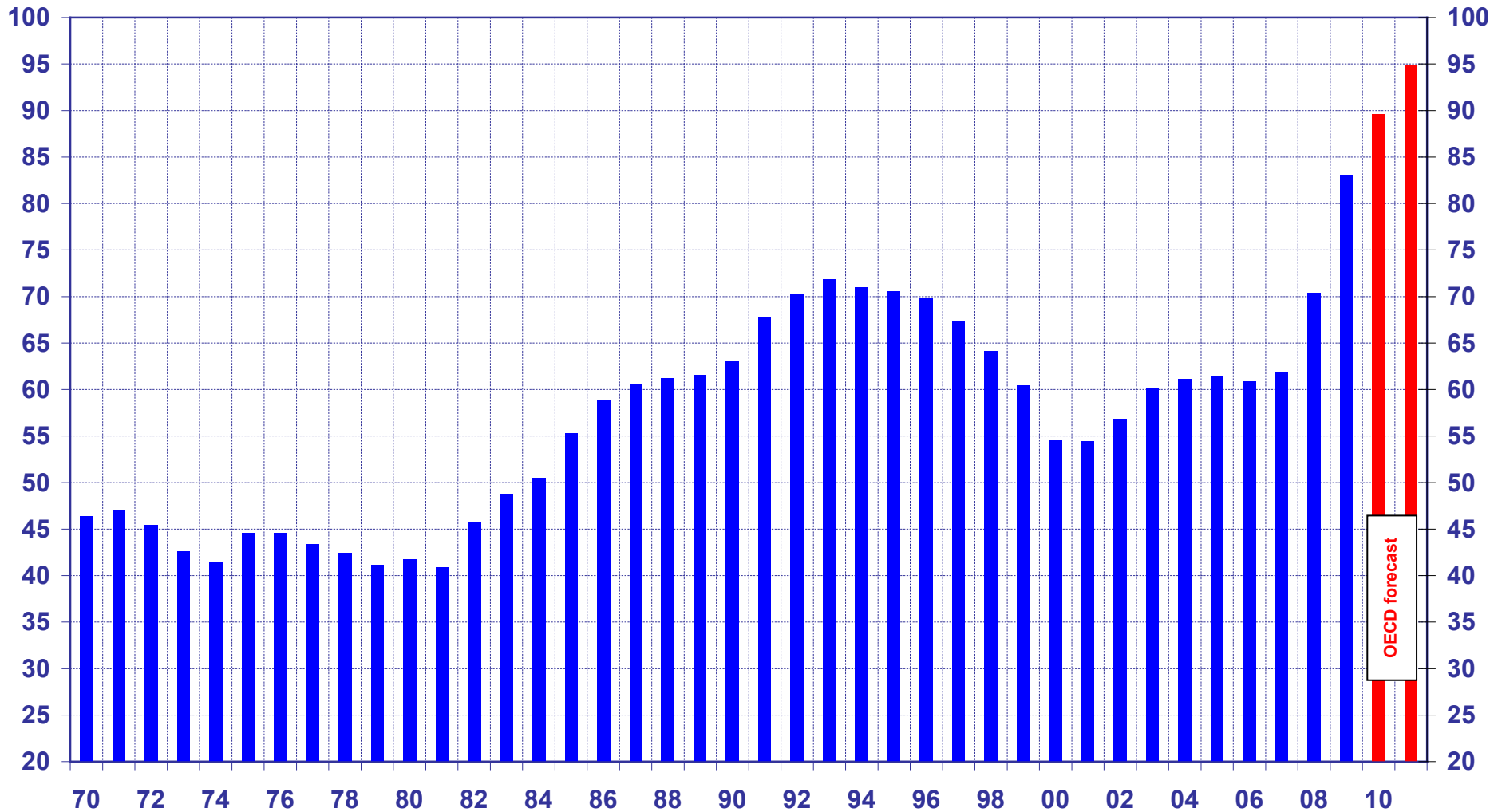
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2. The crisis as a catalyst for trouble.

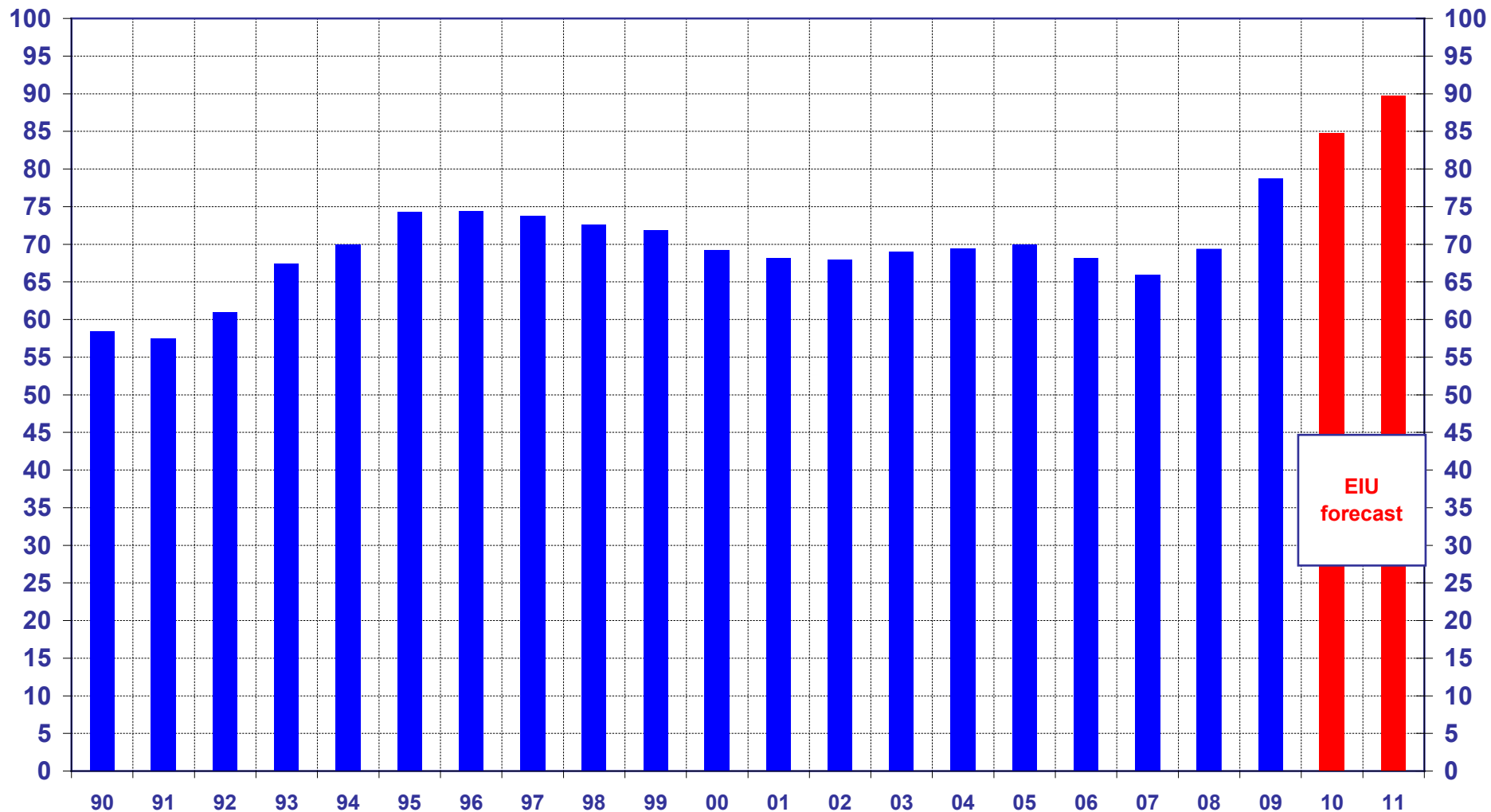
- Not a normal crisis: a worldwide regime switch.
- Three consecutive shocks on major pillars of the Western system.
 - The financial system.
 - The economy.
 - The governments and sovereign risk.



US: PUBLIC DEBT (in % of GDP) OECD figures



EMU: PUBLIC DEBT (in % of GDP) *European Central Bank figures*



2. The crisis as a catalyst for trouble.

- Not a normal crisis: a worldwide regime switch.
- Three consecutive shocks on major pillars of the Western system.
 - The financial system.
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 - The governments and sovereign risk.

EVERY WESTERN ECONOMY SUFFERS IN A DIFFERENT WAY
... DIVERGENCE IS NATURAL.

NOT THE RIGHT BENCHMARK FOR FINAL JUDGEMENT
..... BUT LESSONS HAVE TO BE LEARNED.



1. Imagine EU without Euro: is/was it worthwhile?
2. The crisis as a catalyst for trouble.
3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

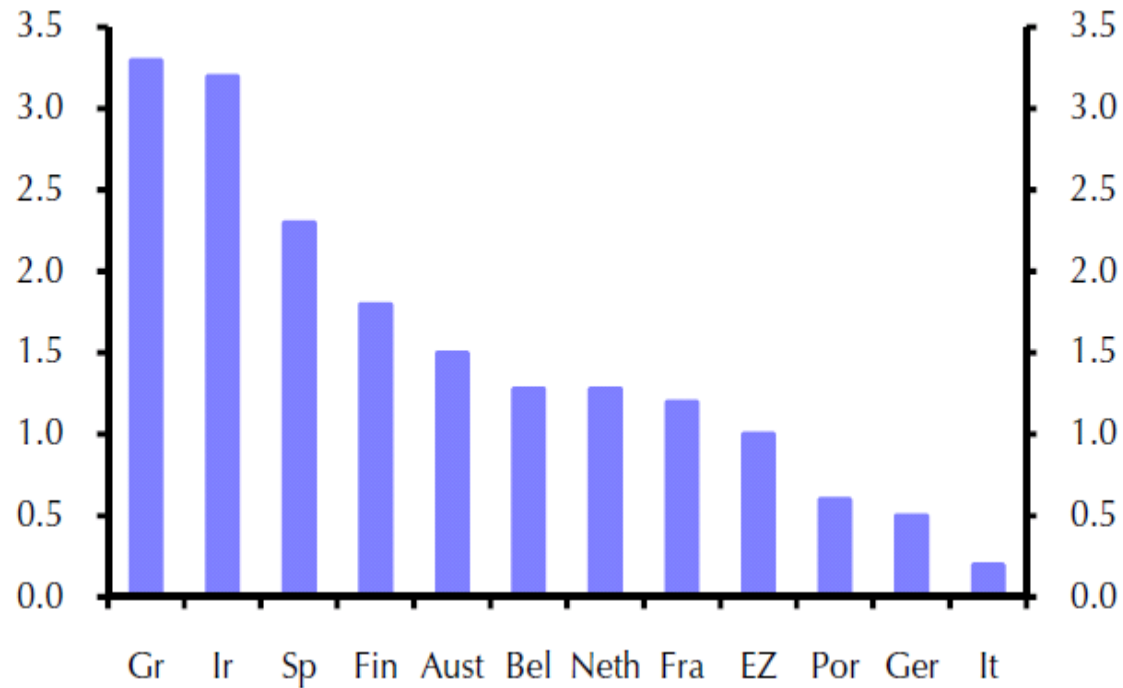


3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

- A question of finding the right balance.
 - It is silly to build a house, so strong, for a storm that will never come.
 - It is irresponsible to build a house, so weak, that it will collapse with the first breeze.
 - The remarkable speed of deterioration of winners into massacre.



Eurozone GDP (%YoY, average 2001-09)



Source: Capital Economics

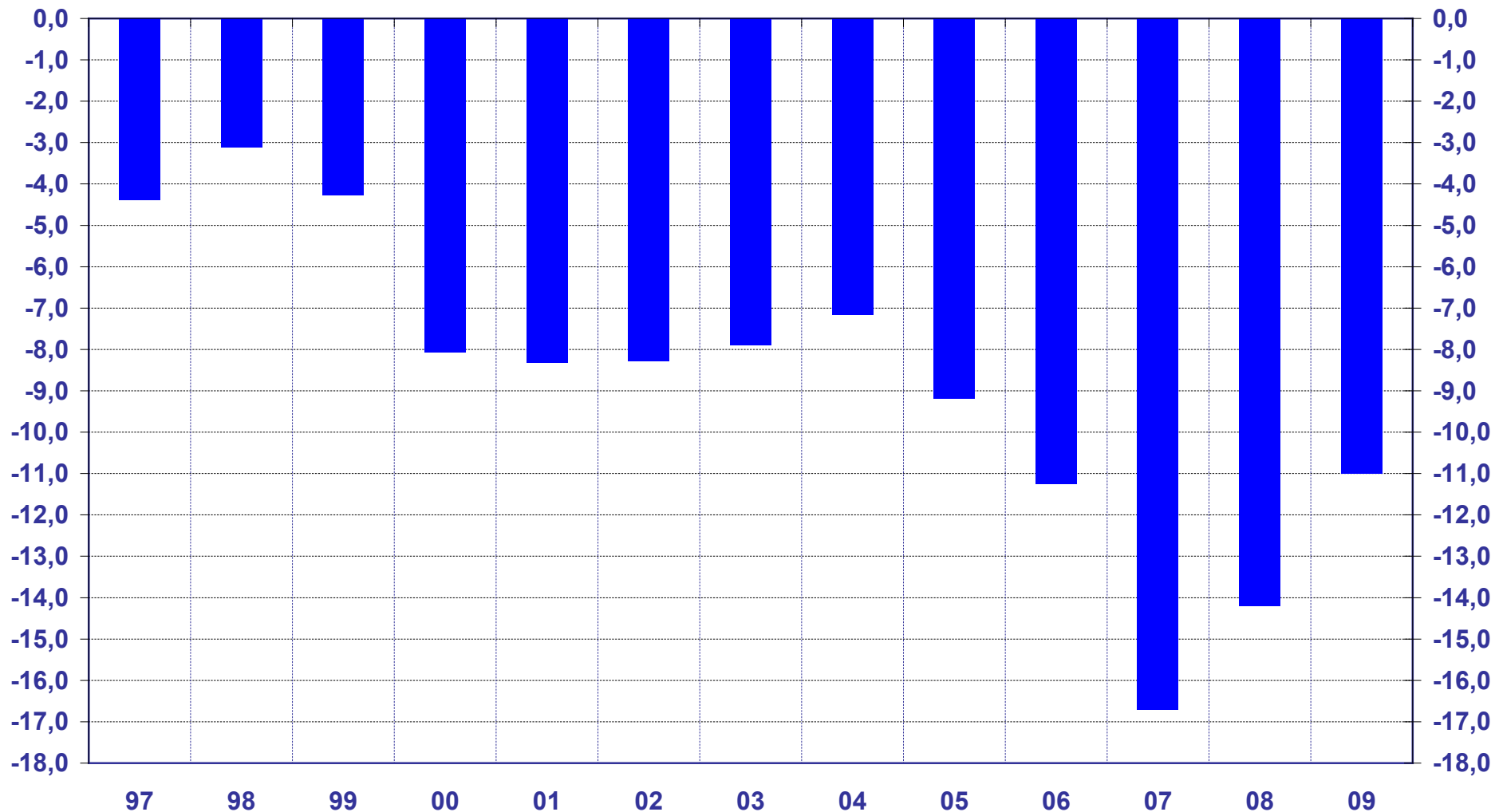


3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

- A question of finding the right balance.
- The fatal combinations for Greece.
 - Current account / ULC.



GREECE: CURRENT ACCOUNT BALANCE (in % of GDP) OECD figures

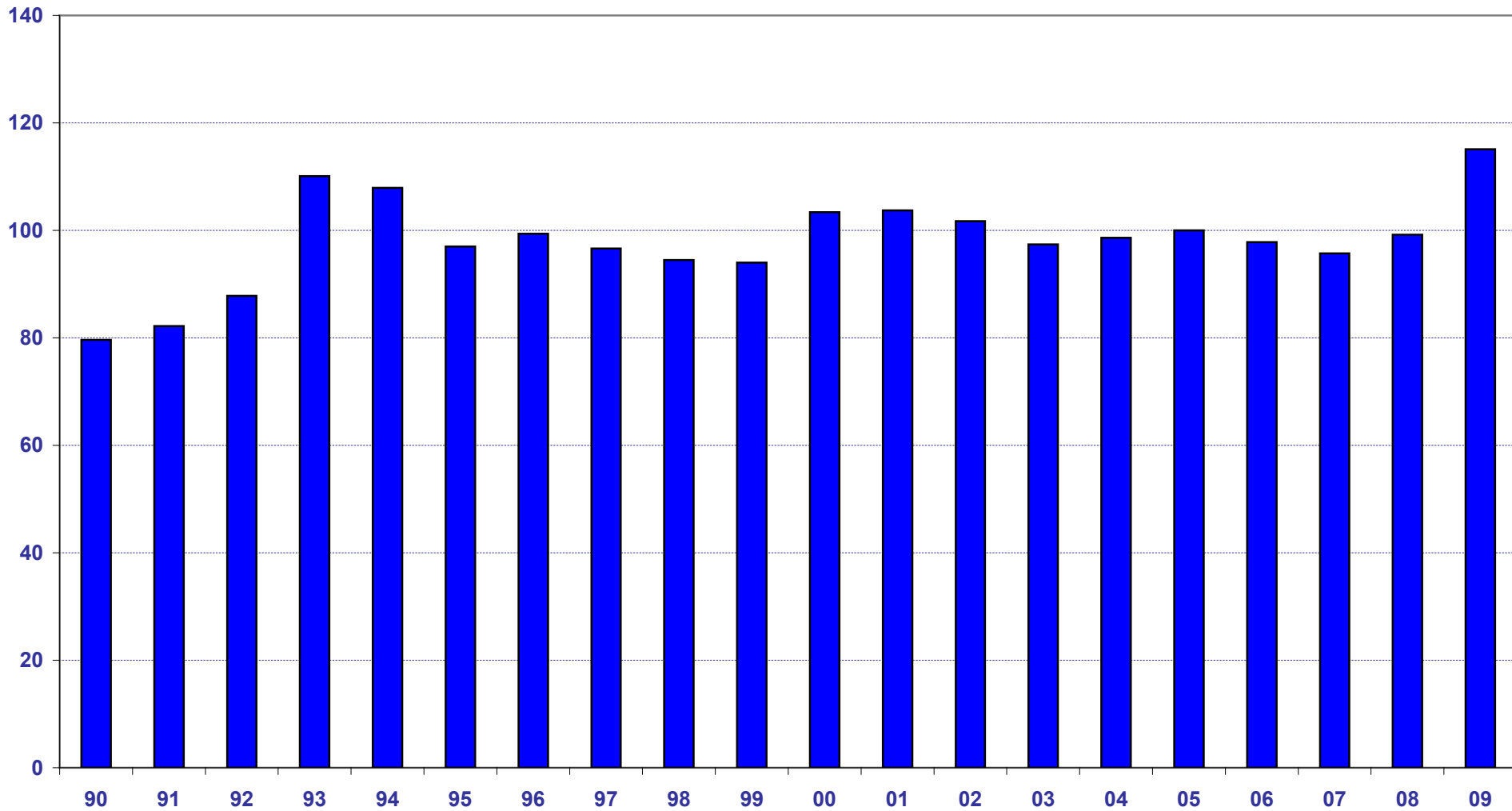


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 - Current account / ULC.
 - Government deficit / debt.



GREECE: GOVERNMENT GROSS NOMINAL CONSOLIDATED DEBT AS % OF GDP

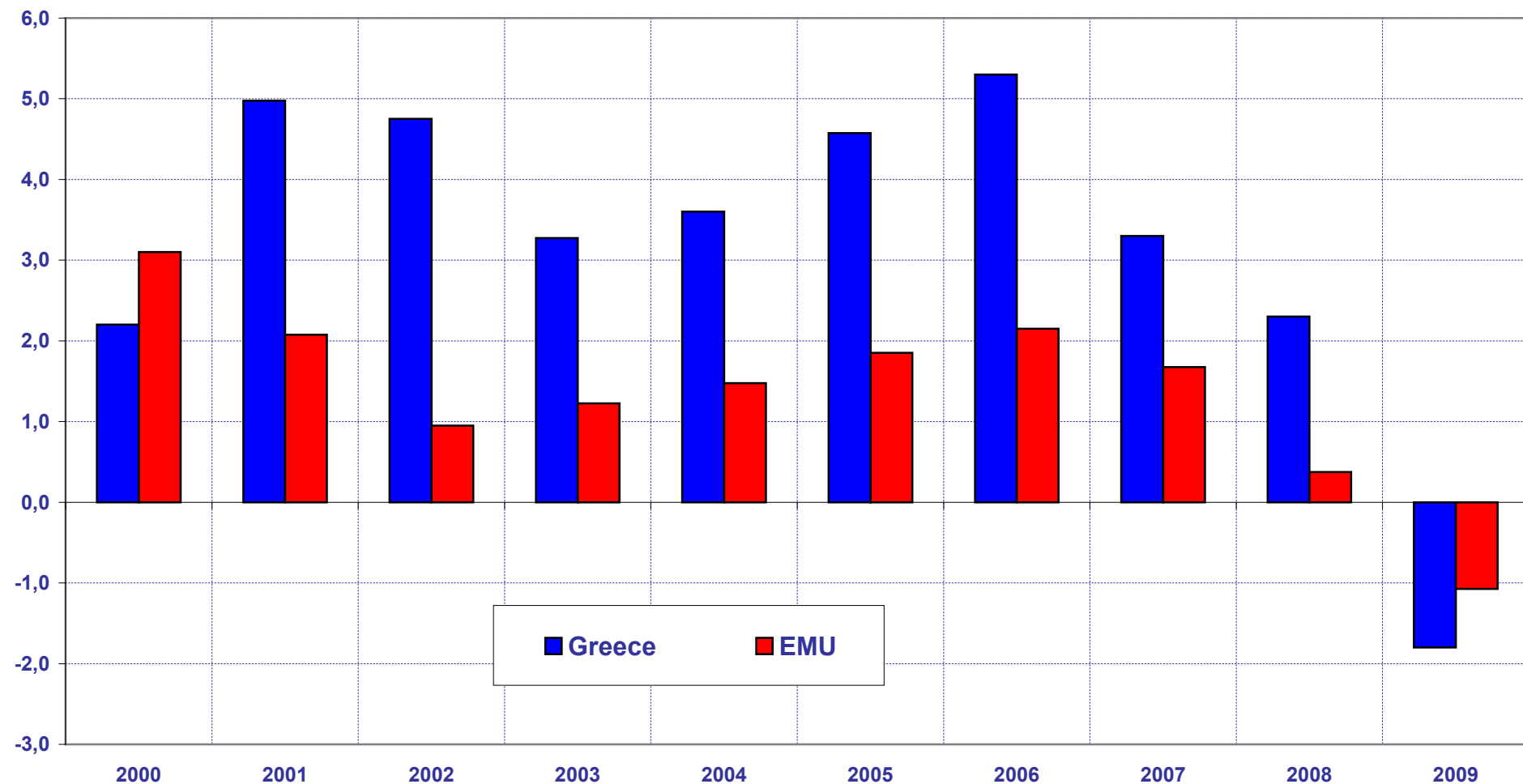


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- A question of finding the right balance.
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 - Current account / ULC.
 - Government deficit / debt.
 - Consumption driven growth.



GROWTH IN PRIVATE CONSUMPTION (%YoY)



Source: Datastream



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3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

- A question of finding the right balance.
- The fatal combinations for Greece.
 - Current account / ULC.
 - Government deficit / debt.
 - Consumption driven growth.
 - “managed” statistics.



Flawed statistics: Greece revised its budget deficit from 3.7% to 12.7% of GDP in the course of 6 months (april 2009 – october 2009)

Table 1. Revision to 2009 deficit estimates

	2009 deficit (% of GDP)
Budget 2009	2
SGP January 2009	3.7
EDP notification April 2009	3.7
EDP notification October 2009	12.7
Budget 2010	12.7
SGP January 2010	12.7
February 2010	12.9
EDP Notification April 2010	13.6

Sources: Greek authorities, Eurostat.

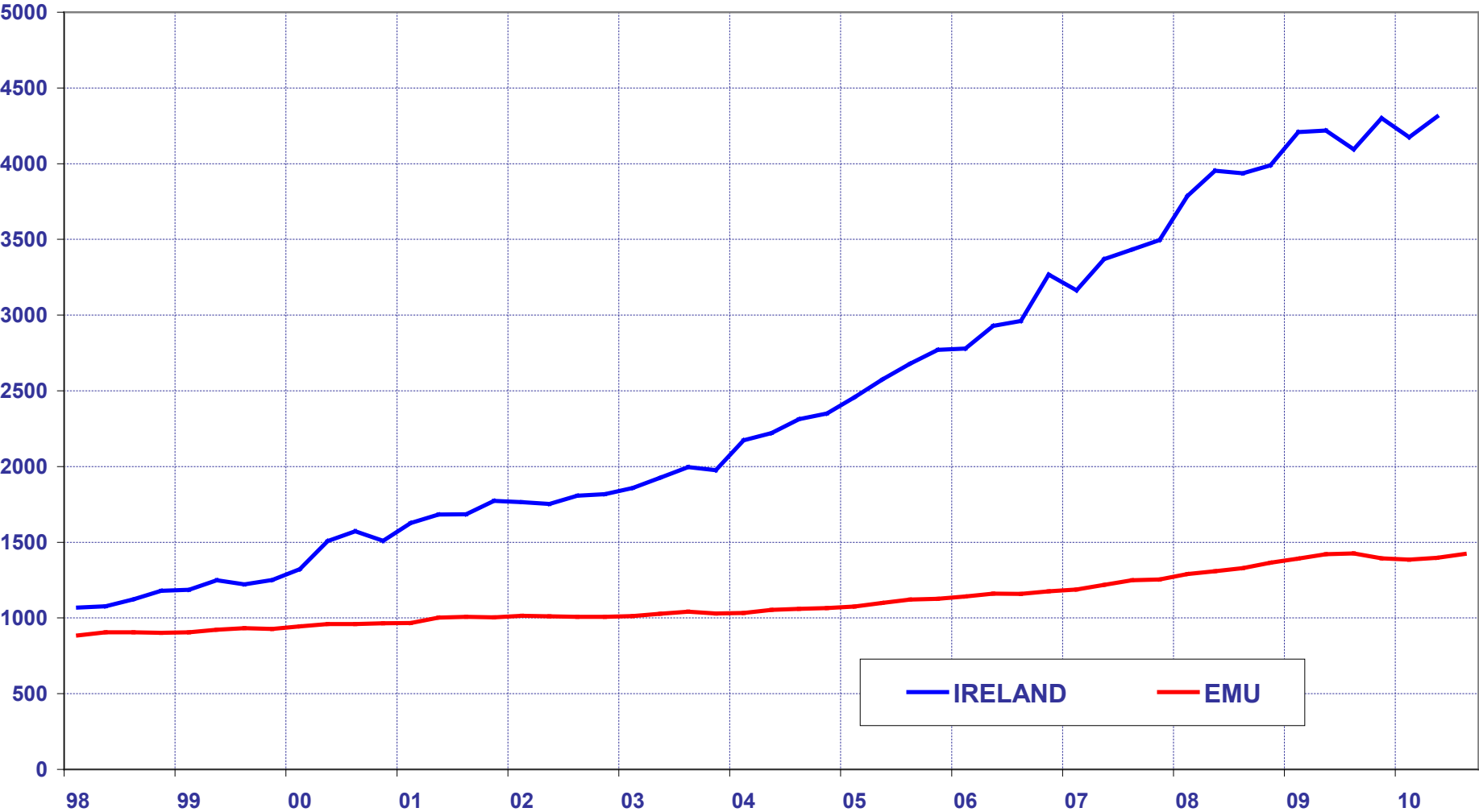


3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

- A question of finding the right balance.
- The fatal combinations for Greece.
- The fatal combinations for Ireland.
 - Importance of financial sector.



SIZE OF FINANCIAL SECTOR: MFI'S TOTAL ASSETS AS % OF GDP

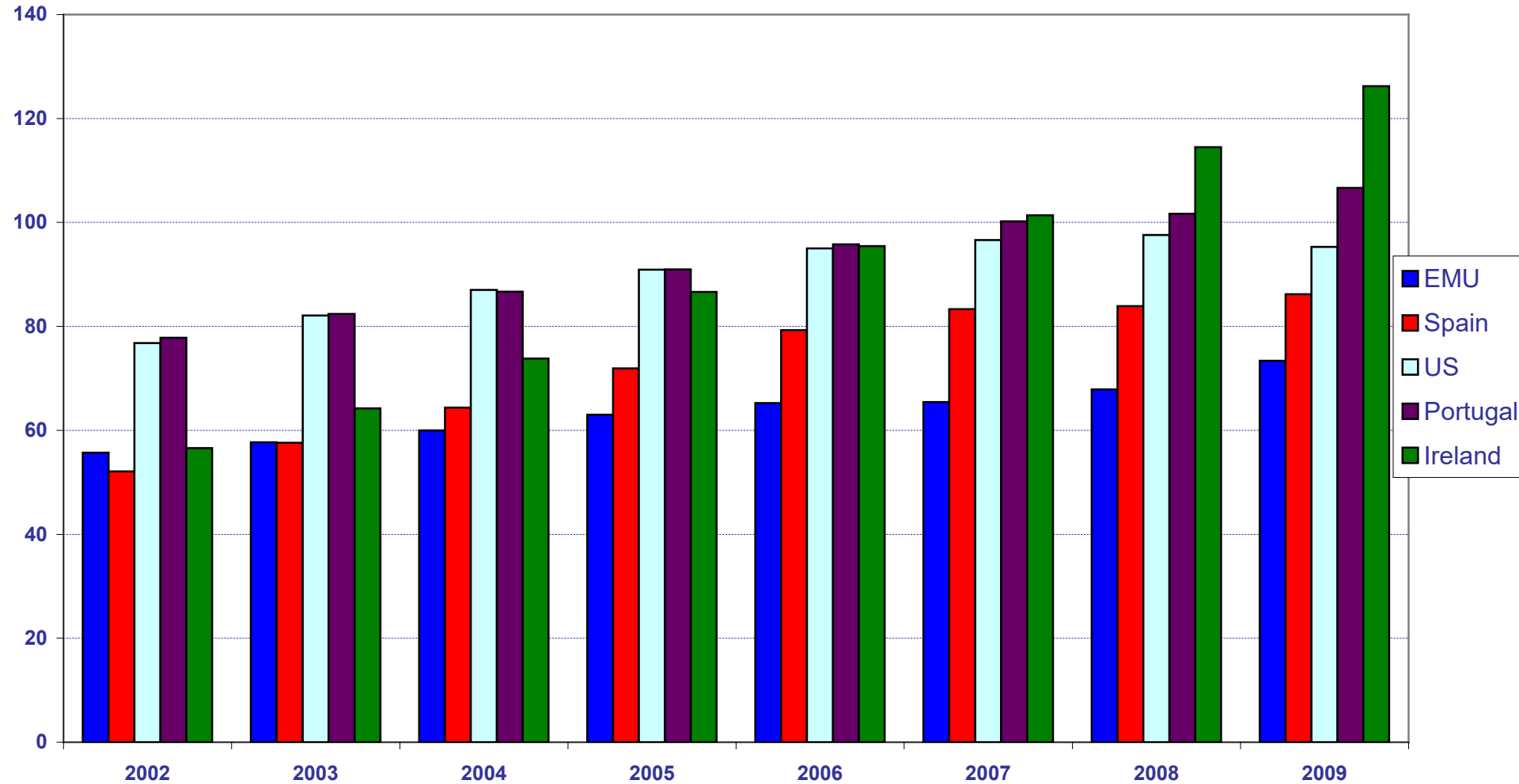


3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

- A question of finding the right balance.
- The fatal combinations for Greece.
- The fatal combinations for Ireland.
 - Importance of financial sector.
 - Household debt.



HOUSEHOLD DEBT AS % OF GDP



Source: ECB, National Central banks



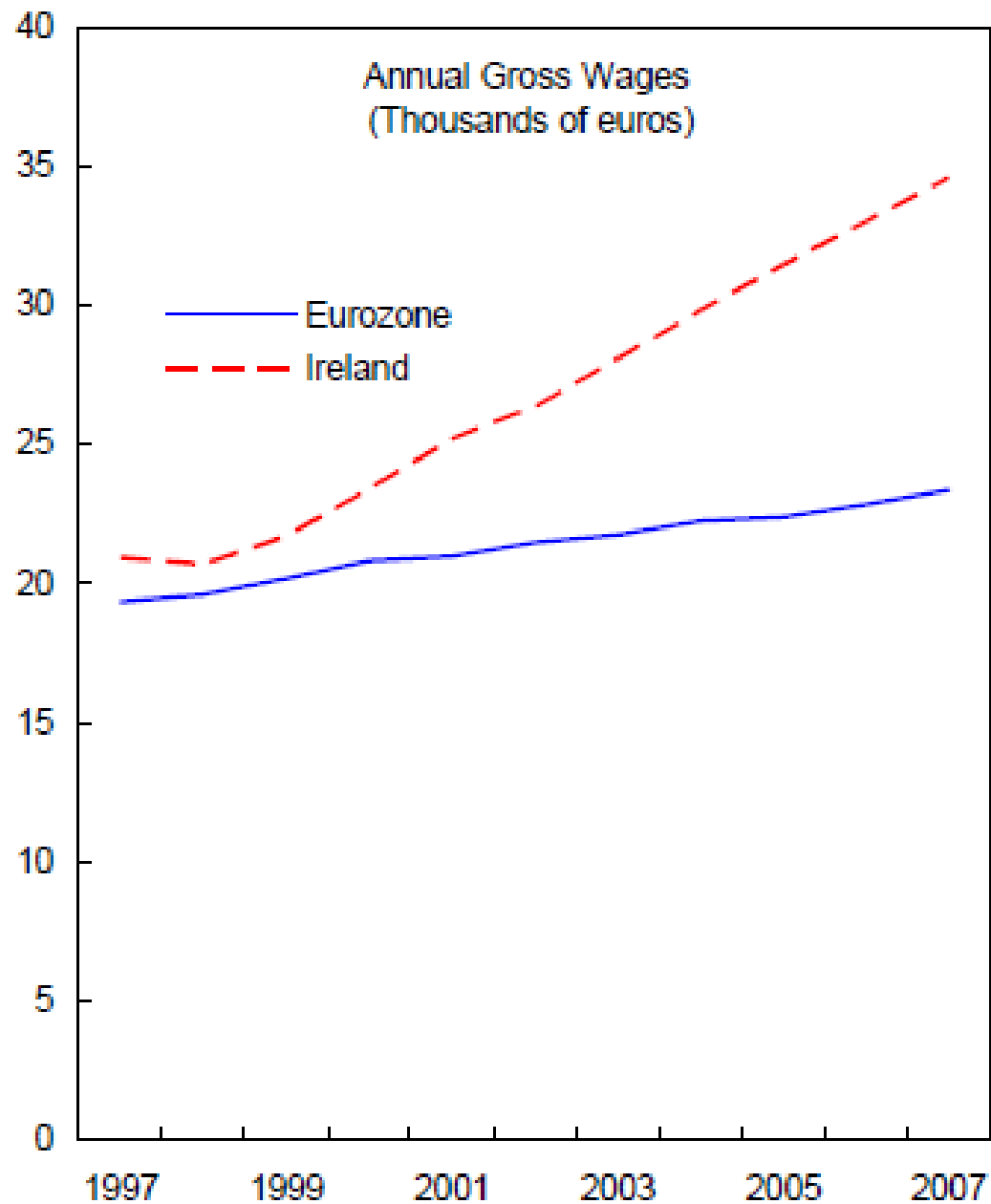
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 - Importance of financial sector.
 - Household debt.
 - Current account / ULC.





Sources: Eurostat; and IMF staff estimates.

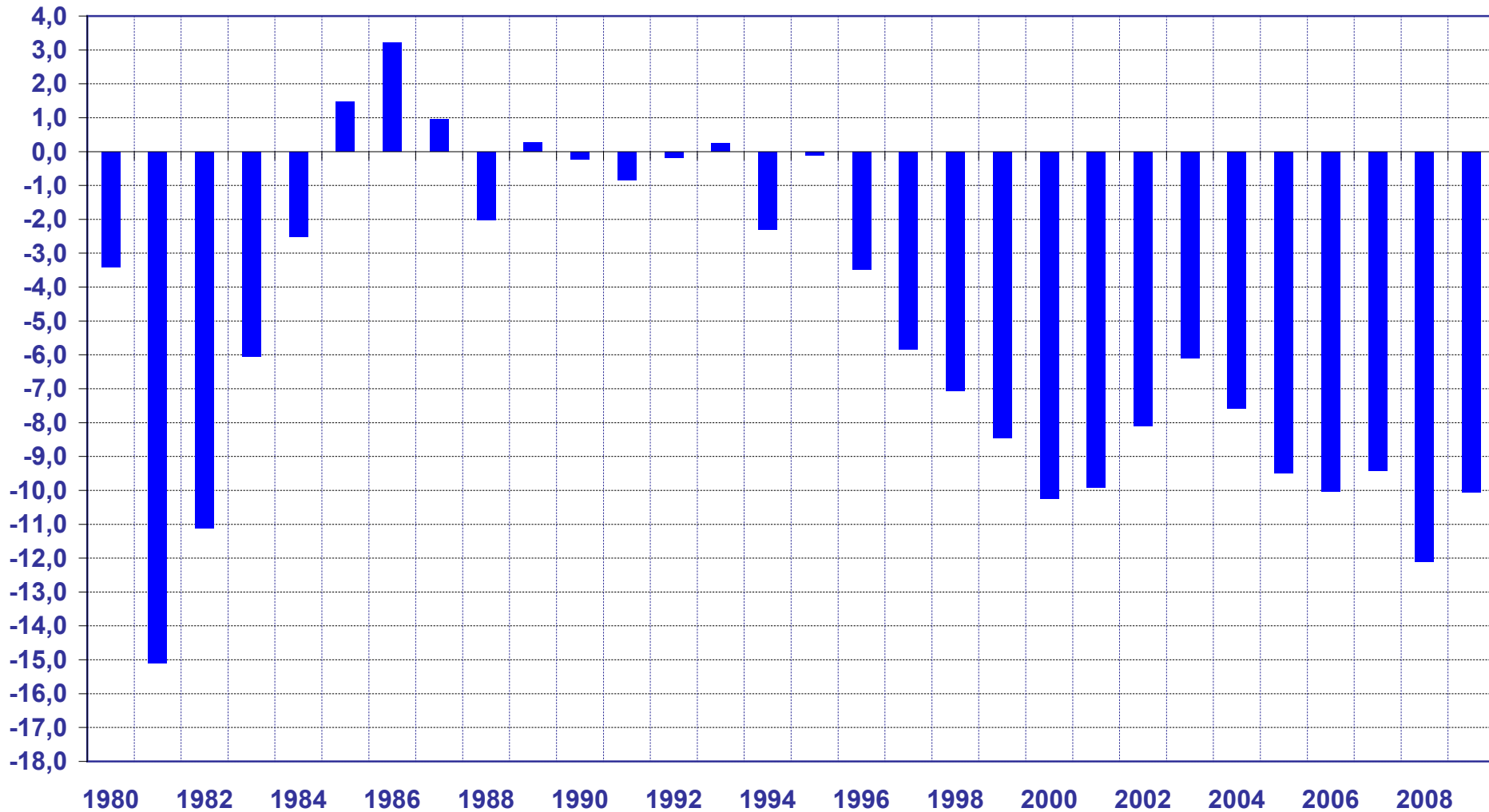


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- A question of finding the right balance.
- The fatal combinations for Greece.
- The fatal combinations for Ireland.
- The fatal combination for Portugal.
 - Current account / ULC



PORTUGAL: CURRENT ACCOUNT BALANCE (in % of GDP) *IMF figures*

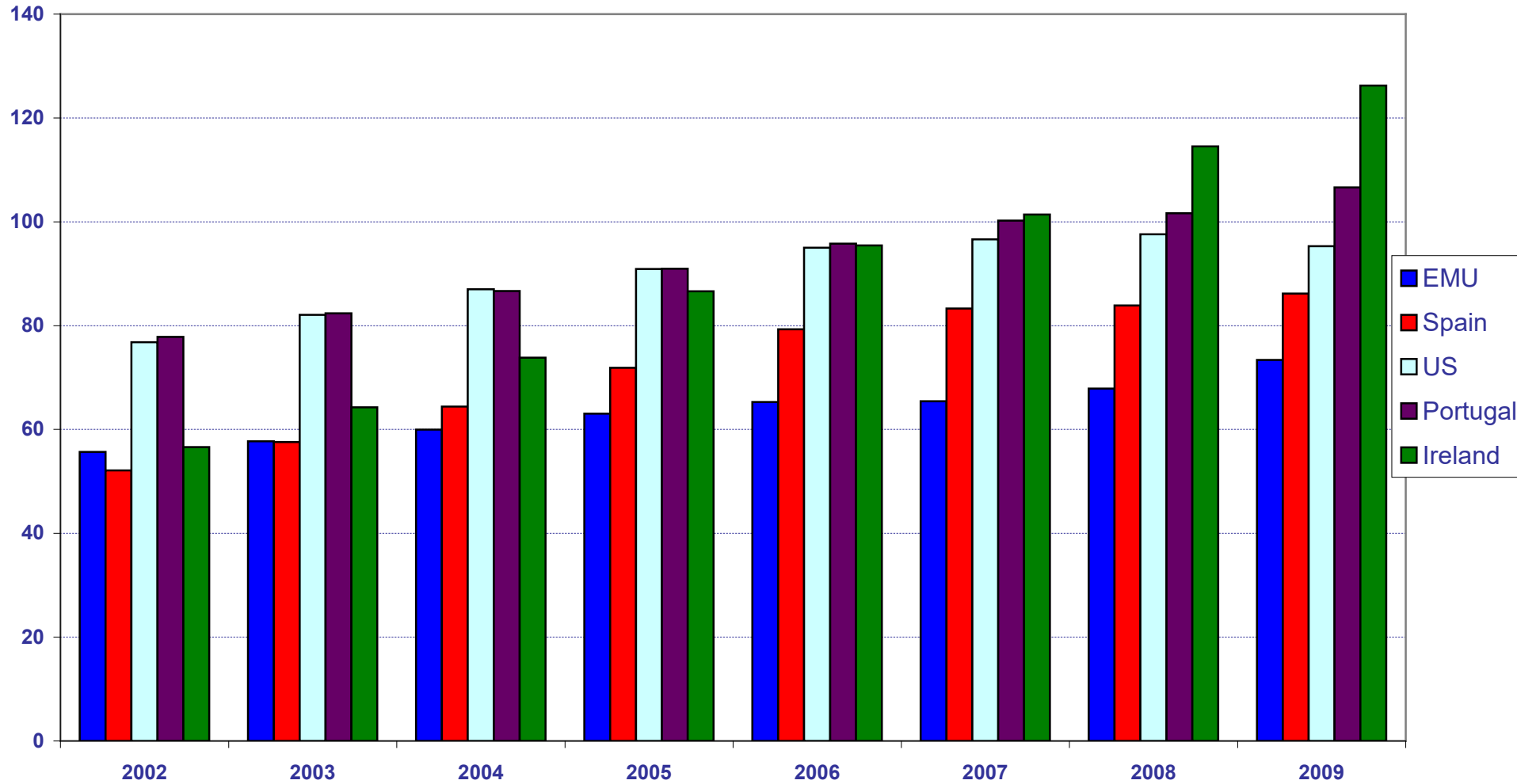


3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

- A question of finding the right balance.
- The fatal combinations for Greece.
- The fatal combinations for Ireland.
- The fatal combination for Portugal.
 - Current account / ULC
 - High household debt



HOUSEHOLD DEBT AS % OF GDP



Source: ECB, National Central banks



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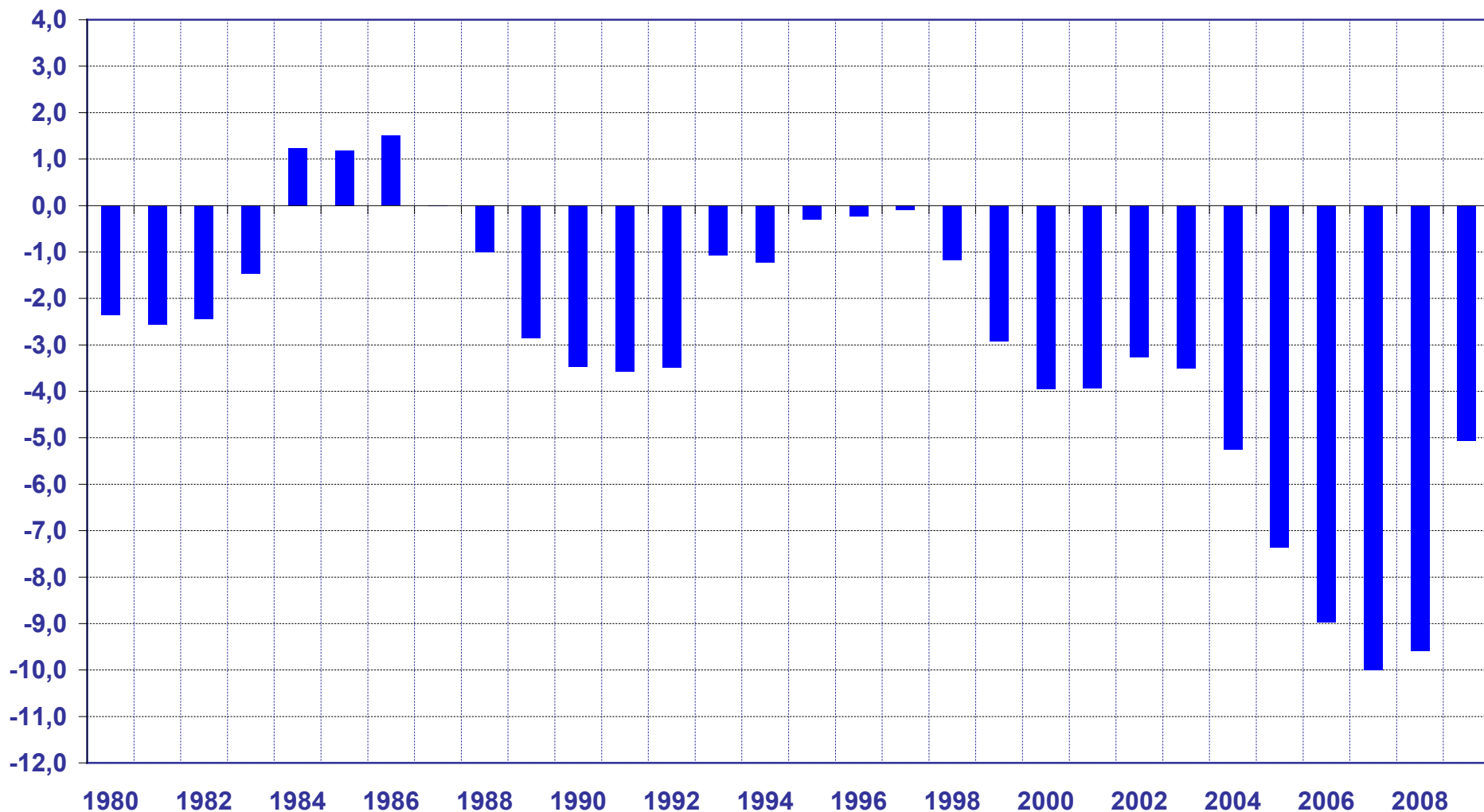
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3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

- A question of finding the right balance.
- The fatal combinations for Greece.
- The fatal combinations for Ireland.
- The fatal combination for Portugal.
- The fatal combination for Spain.
 - Current account / ULC



SPAIN: CURRENT ACCOUNT BALANCE (in % of GDP) *IMF figures*

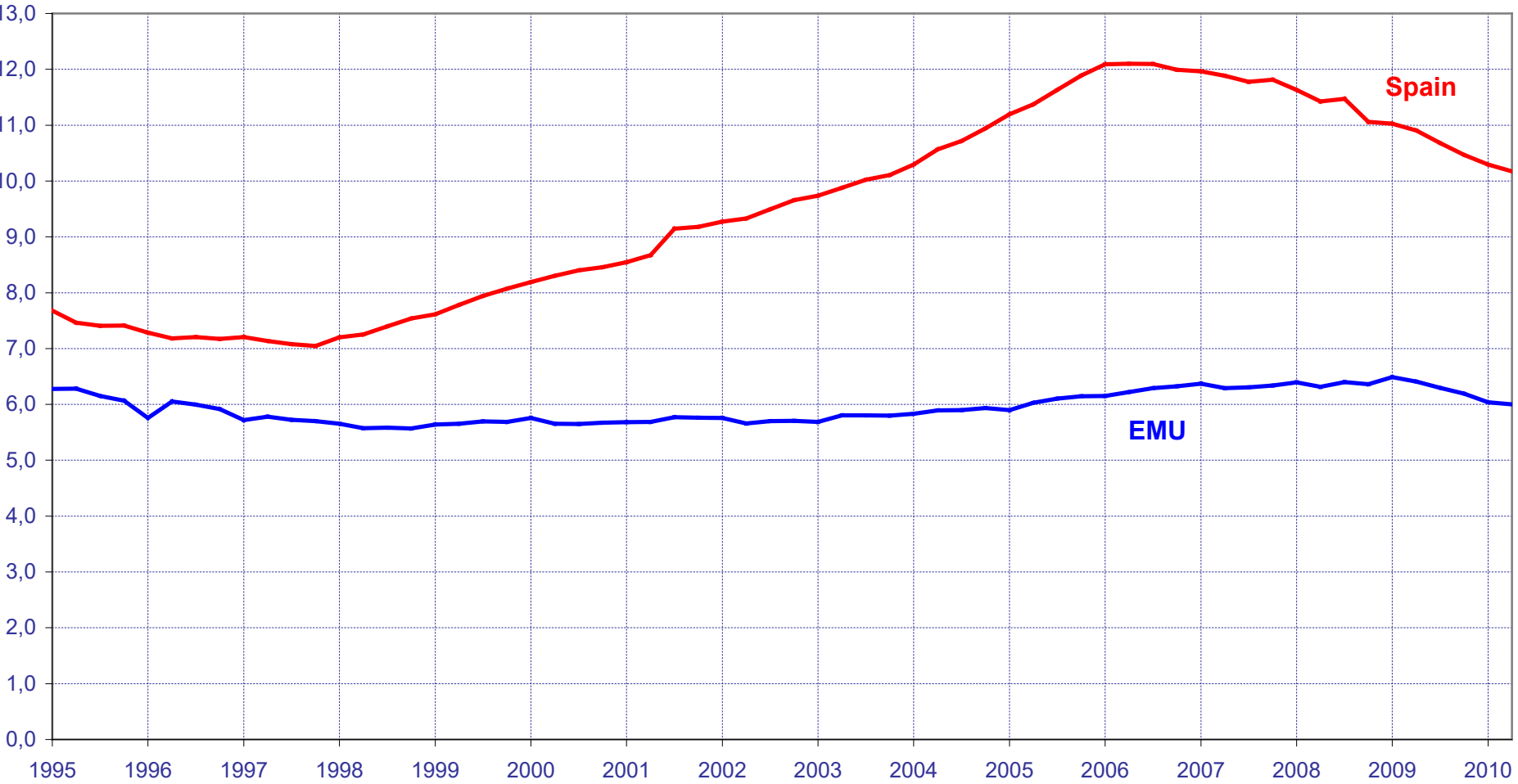


3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

- A question of finding the right balance.
- The fatal combinations for Greece.
- The fatal combinations for Ireland.
- The fatal combination for Portugal.
- The fatal combination for Spain.
 - Current account / ULC
 - Housing / construction bubble



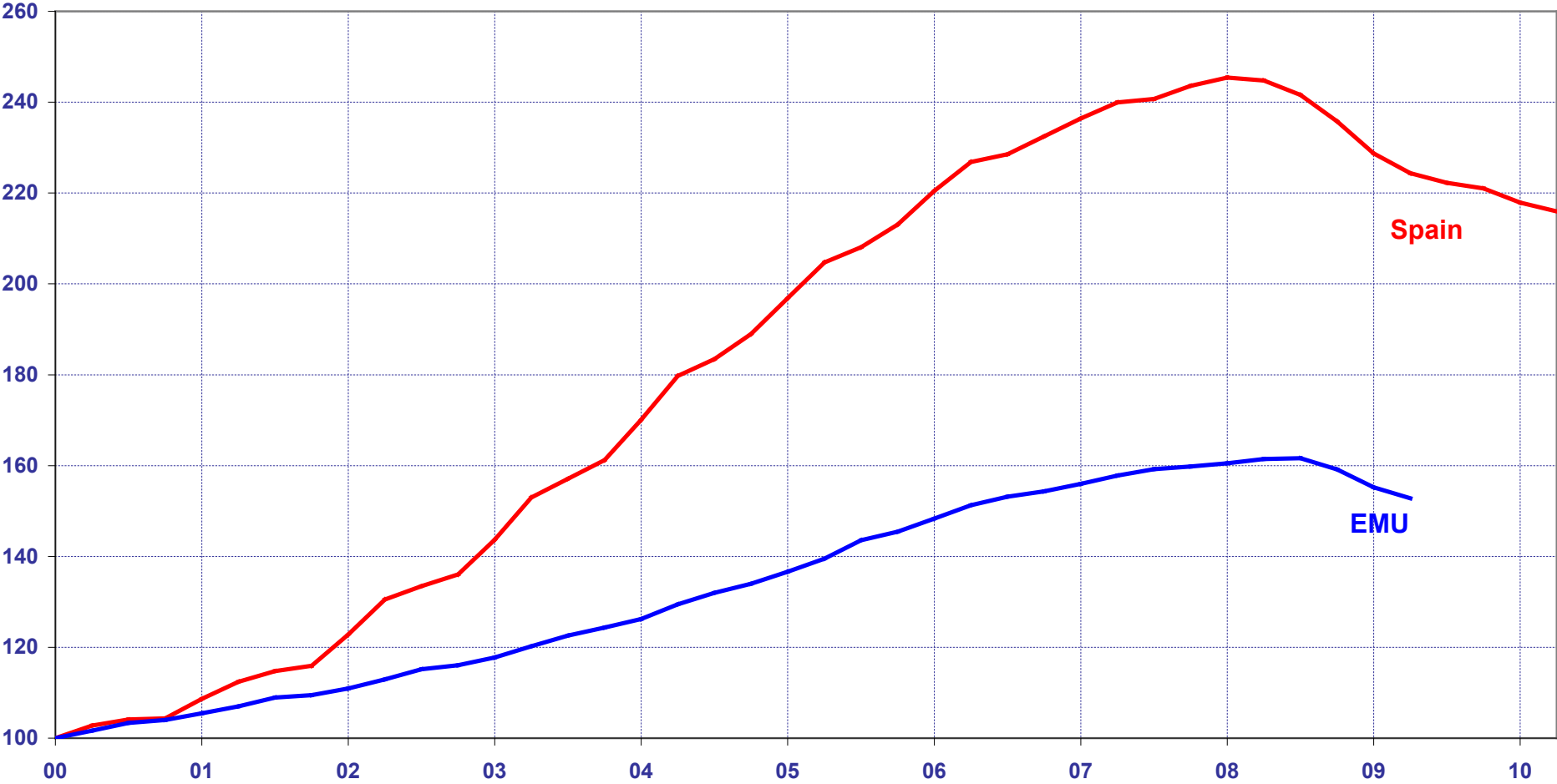
Share of construction sector in GDP (%)



Source: Datastream



HOUSE PRICE EVOLUTION (rebased Q1 = 2000)



Source: Datastream, FT



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- The fatal combinations for Ireland.
- The fatal combination for Portugal.
- The fatal combination for Spain.

FOUR DIFFERENT STORIES BUT SOME COMMON ELEMENTS.



3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.

- The combined score card for the Euro Members.

Performance 2000-2009											
	EMU	Austria	Germany	Netherlands	Belgium	France	Ireland	Spain	Portugal	Italy	Greece
GDP	1,4	1,7	0,9	1,6	1,5	1,4	3,7	2,6	0,9	0,5	3,4
Government debt (end 2009)	78,9	66,5	73,2	60,9	96,7	77,6	64,0	53,2	76,8	115,8	115,1
Unemployment (end 2009)	9,4	4,8	7,5	3,4	7,9	9,4	11,9	18,0	9,6	7,8	9,5
Government deficit	-2,3	-1,6	-2,1	-0,9	-1,0	-3,3	-1,0	-1,3	-4,1	-3,1	-6,1
Inflation	2,1	1,9	1,7	2,3	2,1	1,9	2,9	3,0	2,6	2,3	3,2
Current account	0,2	1,9	3,8	5,5	2,3	0,0	-2,3	-6,1	-9,2	-1,7	-9,3
ULC (2000 = 100)	120,2	114,9	106,9	124,6	123,1	121,1	134,0	131,4	127,0	132,2	137,6



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2. The crisis as a catalyst for trouble.
3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.
4. The Eurosystem reaction (cfr banking crisis).



4. The Eurosystem reaction (cfr banking crisis)

Crisis resolution

- Emergency fund to help MS in trouble (for some time).
- Severe conditionality for MS in trouble.

Crisis prevention

- Work on the design of the Euro system:
 - More discipline.
 - Broader set of stability parameters
 - (Prepare an orderly exit mechanism?)

SEEMS TO BE THE RIGHT AGENDA.

COMPETITIVENESS IS MOST SENSITIVE AND CRITICAL ISSUE.



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4. The Eurosystem reaction (cfr banking crisis).
5. National Austerity programs: will they work?



5. National austerity measures: will they work?

- Focused on government budget.



The efforts to be made:

General Government Budget balance (% of GDP)					
	2009	2010	2011	2012	2013
Greece	-13,6	-8,0	-7,6	-6,5	-4,9
Ireland	-14,3	-32,0	-10,0	-7,2	-4,9
Portugal	-9,4	-8,3	-6,6	-4,6	-2,8
Spain	-11,2	-9,8	-7,5	-5,3	-3,0

Source: National Stability and Growth Programs.

Remark: Irish Government budget deficit will hit 32% of GDP in 2010 because of rescuing its banking sector. This is a one-off measure.



5. National austerity measures: will they work?

- Focused on government budget.
- Expected impact on growth.



Fiscal Austerity: Impact on Growth					
		2010	2011	2012	2013
Greece	SGP	-4,0	-2,6	1,1	2,1
	BNPP	-4,0	-3,2	0,7	
Portugal	SGP	0,7	0,9	1,3	1,7
	BNPP	1,4	-0,5	0,8	
Spain	SGP	-0,3	1,8	2,9	3,1
	BNPP	-0,4	-0,6	1,2	
Ireland	SGP	-1,3	3,3	4,5	4,3
	BNPP	0,5	1,5	3,1	3,6
EMU	SGP	0,9	1,9	2,3	
	BNPP	1,7	1,1	1,4	2,0

Source: Ecofin, BNP Paribas

SGP = forecast as in Stability and Growth Pact

BNPP = forecast by BNP Paribas

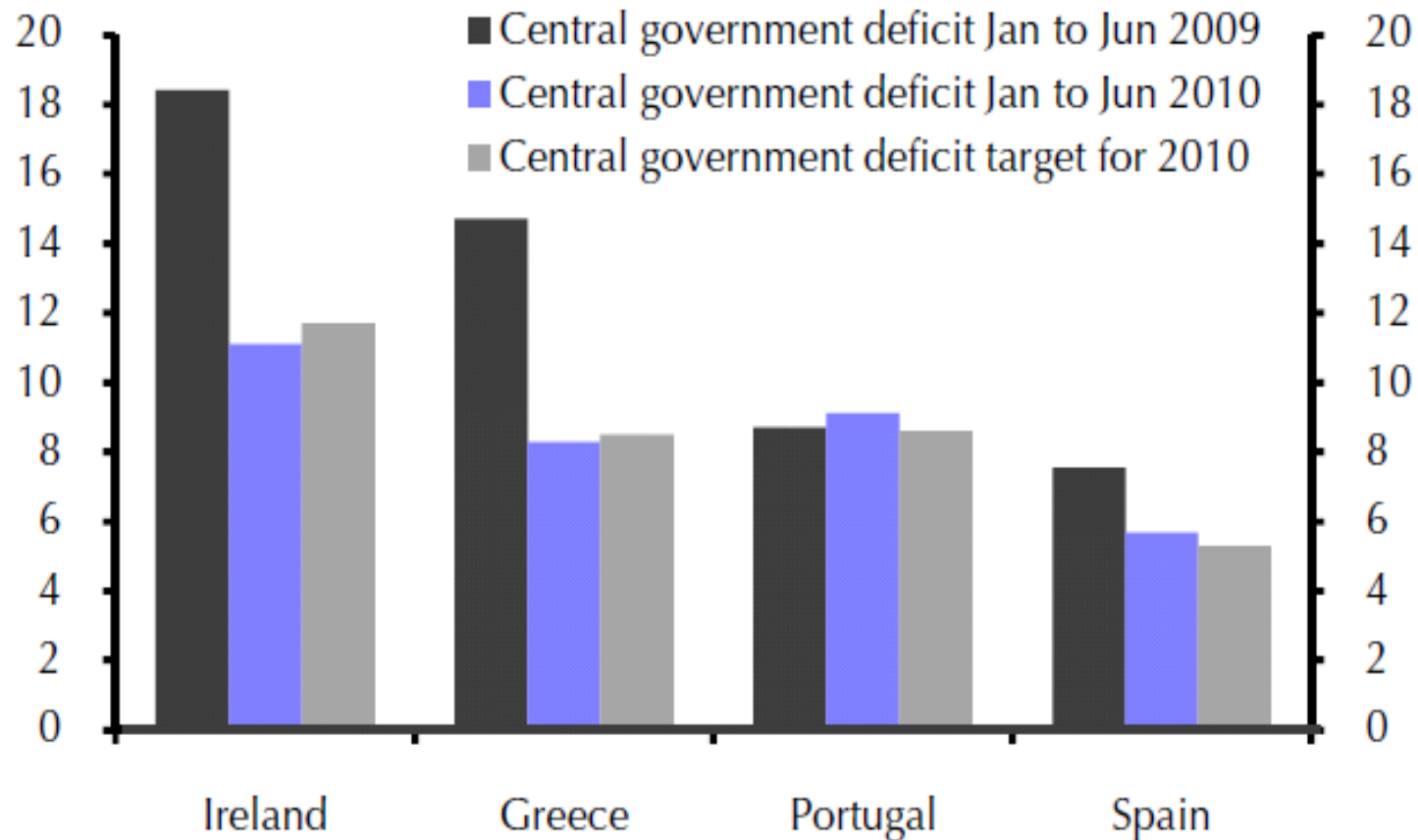


5. National austerity measures: will they work?

- Focused on government budget.
- Expected impact on growth.
- Mixed results until now:
 - Government deficits on target.



Central government budget deficit (% of GDP)



Source: Capital Economics

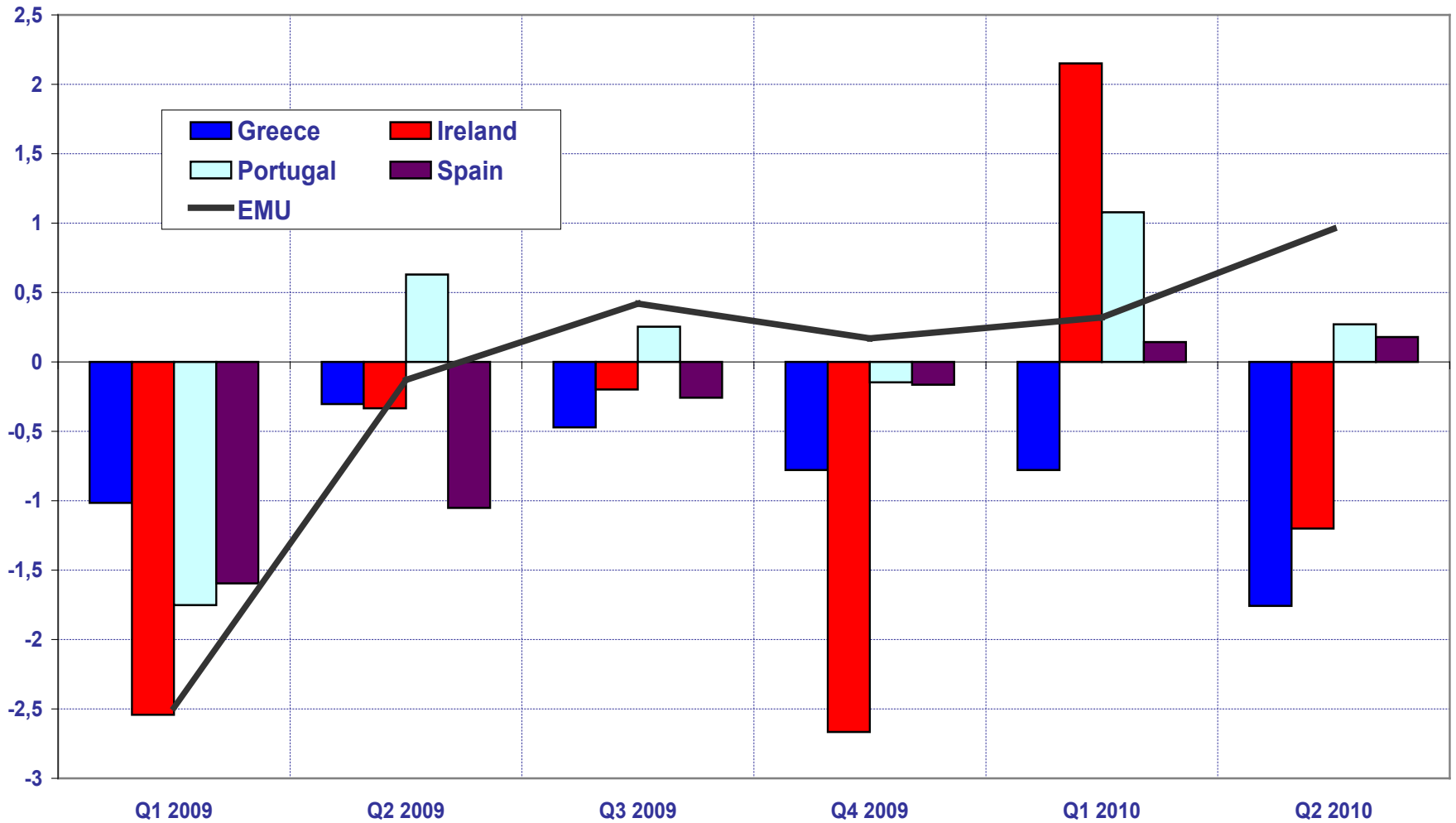


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 - **Growth implosion as expected especially for Greece.**



Evolution of economic growth in PIGS (Real GDP % QoQ)



Source: Datastream

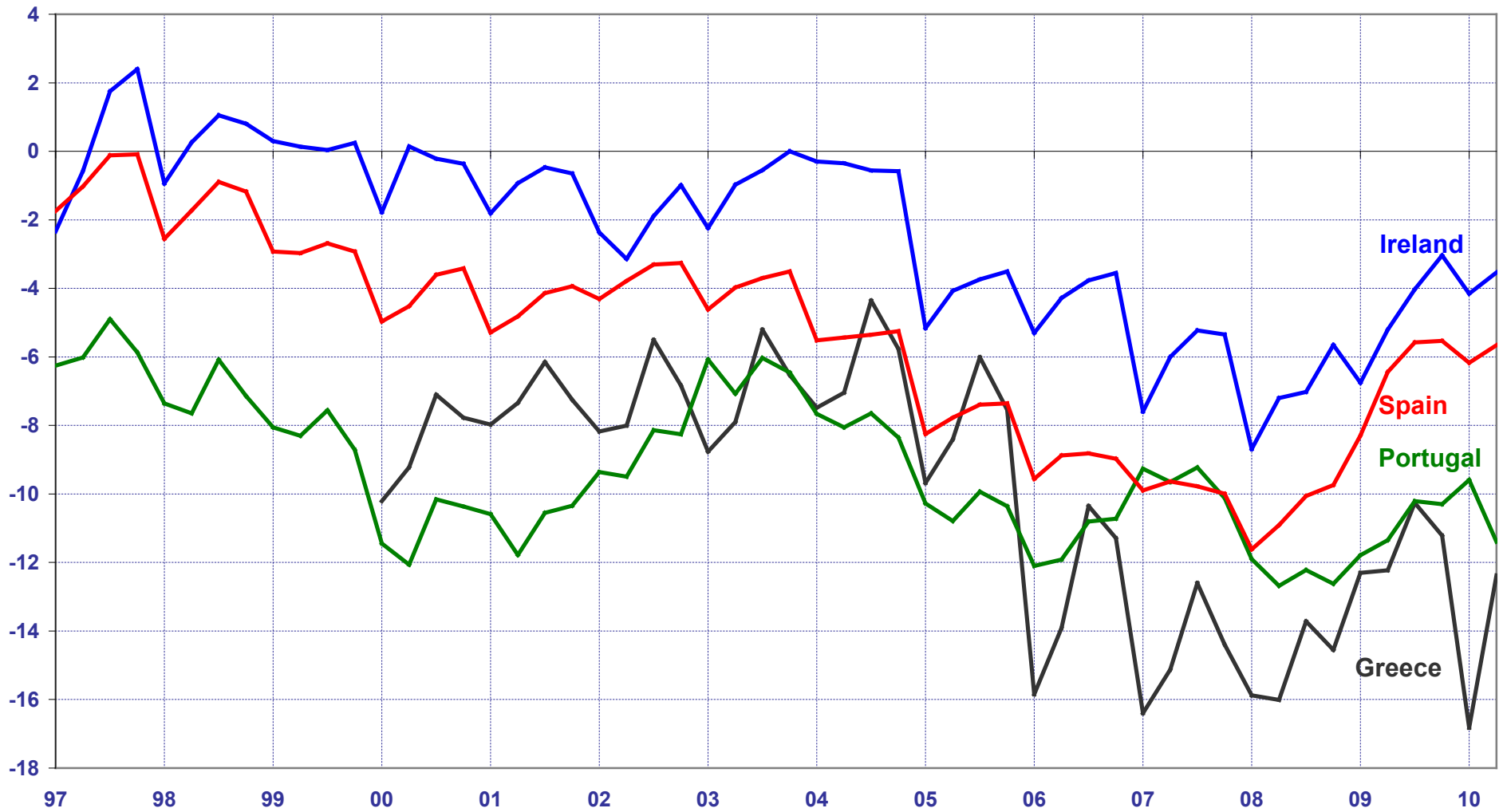


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CURRENT ACCOUNT BALANCES AS % OF GDP



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- Mixed results until now:
 - Government deficits on target.
 - Growth implosion as expected for Greece.
 - Current account problematic for all: the fundamental competitiveness challenge.

CONCLUSION: THE JURY IS STILL OUT BUT HAS TWO MORE YEARS TO CONSIDER.



1. Imagine EU without Euro: is/was it worthwhile?
2. The crisis as a catalyst for trouble.
3. The Eurosystem in stress: a story of 3 (or 4 or 5 ...) little pigs.
4. The Eurosystem reaction (cfr banking crisis).
5. National austerity measures: will they work?
6. Conclusion.



6. CONCLUSION

- Euro was and remains valuable for Europe.
- Chaos and stress are “normal” in this severe crisis: MS suffer in different ways.
- The political reaction to the crisis is fine but unfortunately precious time had been lost.
- Working on the design of the future Eurosystem is essential. Proposals must be convincing: more supra national controls.
- Stability rules and competitiveness unclear and probably most sensitive issues.
- Other challenges ahead for EU in the new world: how to position EU / EURO? (currency wars and other policies)





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Thank you.