



# The Euro Area Banking System in Pandemic Times

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# The Journey So Far

- No financial instability (yet)
- No financial fragmentation (yet)
  - ECB initially, then German government leadership
- Vindication of Basel III
  - Even if ECB capital relief is not used for lending
- Vindication of European Banking Supervision
  - Resolved collective action problems, unlike 2007-2012
  - Even though banking union is unfinished
- Massive uncertainty about what comes next

# **\*If\* System-Wide Fragility...**

- **Early action beats late reaction**
  - Direct cost if banks can gamble for resurrection
  - Drag on growth from zombie banking system
- **System-wide beats piecemeal approach**
  - Idiosyncratic problems are highly destabilizing when the system is fragile
- **Public recapitalisation is inescapable**
  - Even if (hopefully) resolution is not
  - Asset relief schemes may help but only at the margin
- **Bank-sovereign vicious circle is deadly**
  - Lessons of 2008 and 2012

# \*If\* System Fragility (cont'd)

- ESM direct precautionary recapitalization
  - Euro Area Summit Statement 28 June 2012: *“When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly.”*
  - ESM treaty (2012), BRRD (2014), state aid stance (2020)
    - 84 euro-headquartered significant institutions
    - Aggregate assets €21.5 trillion; half unlisted (1/3 assets)
    - TARP not a blueprint, but an important benchmark
    - Catalyst for (overdue) sector restructuring
    - Not self-evidently redistributive across MSs
    - Upside potential



# Thank You For Your Attention

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