

Economic Insight

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The message behind the Target balances

In the discussion about the Bundesbank's huge claims under the ECB's Target payment system, all the arguments have actually been exchanged. Nevertheless, the issue has recently been boiled up again because it affects important decisions related to the future of the monetary union.

Consensus: It's the mistrust towards the southern countries

When investors transfer large amounts of bank deposits from the south to the north of the monetary union, which is reflected in the Bundesbank's high Target claims (see graph), this shows mistrust towards the southern countries and their banks. So far the consensus. But there are fierce disputes especially among German economists about how this distrust can be reduced – and by whom.

The Target appeasers: completing the banking union

Economists close to the ECB do not derive any need for action for the ECB from the high Target balances. Instead, politicians are called upon to reduce investors' distrust towards the southern member states and their banks. To this end, they should complete the banking union, including a common deposit guarantee scheme. If the North bears greater liability for the southern countries, investors believe that the risks in the South would decrease; bank customers would hold fewer deposits in the North, with the result that the Bundesbank's Target claims would fall.

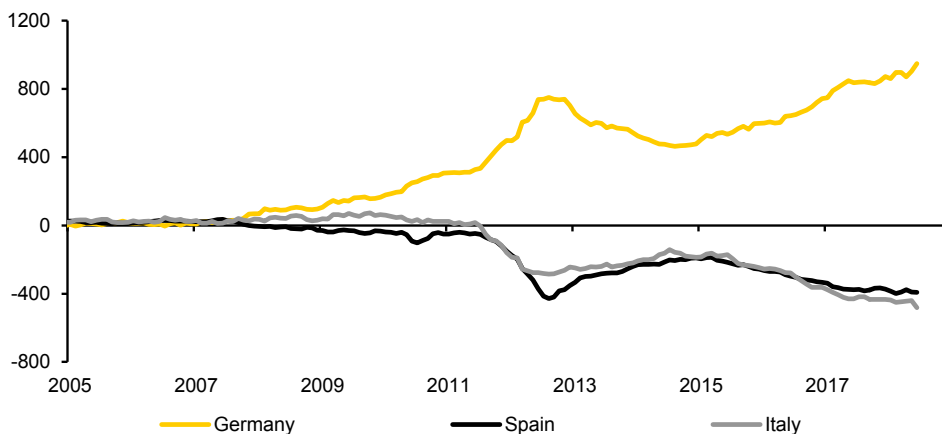
On its own, however, this would not make the banks in the South any more stable. Rather, they would even have an incentive to riskier business models, as the additional risks would be shared by other member states.

The Target critics: Central bank money in short supply again

That is why the critics of the high Target balances do not want to create joint liability, but incentives for the southern countries to make their economies and banks really more stable and thus prevent bank customers from keeping high deposits in the north of the monetary union. This is a comprehensive task to which the ECB can also contribute a lot by making central bank money scarce again. (continued on next page)

Target balances dramatically high

Target2 balances of individual national central banks vis-à-vis the ECB, monthly averages in billion euros



Source: Commerzbank Research

For important disclosure information please see pages 3 and 4.

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Author:

Dr Joerg Kraemer

Chief Economist

+49 69 136 23650

joerg.kraemer@commerzbank.com

At present, banks at the ECB receive virtually unlimited central bank money – even at zero interest. It is of secondary importance for them when investors withdraw credit from them and transfer it to the North. Banks are sealed off from the competition for central bank money. They have not enough incentives to courageously reduce their bad loans or the much too high holdings of government bonds and thus make themselves attractive to investors.

Incentives to solve their problems

By contrast, if the ECB gradually limits the amount of central bank money provided, demands better collateral and a decent interest rate, central bank money becomes scarce again. Banks that lack it must borrow it from other banks as they did before the outbreak of the financial crisis. They are competing for central bank money and must offer interest according to their creditworthiness. This creates strong incentives to solve their problems. Step by step, they are becoming more stable, and customers are no longer drawn to the north of the monetary union with their deposits. Then there are less Bundesbank Target claims at risk.

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Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000	Tel: +852 3988 0988