The Shock absorbing function of Banking Union in action: Ireland versus Nevada

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A Banking Union in practice:

States of US enjoy one huge advantage over Eurozone MSs:

A well-functioning ***Banking Union***

- Federally organized securitization (via Freddie Mac, Fannie Mae) and the Federal Deposit Insurance Corporation (FDIC) spread state risks and losses, plus 'private label' securitization and large banks.

- Limited regional impact of bank failures during crisis a prime example:

<u>Nevada versus Ireland</u>

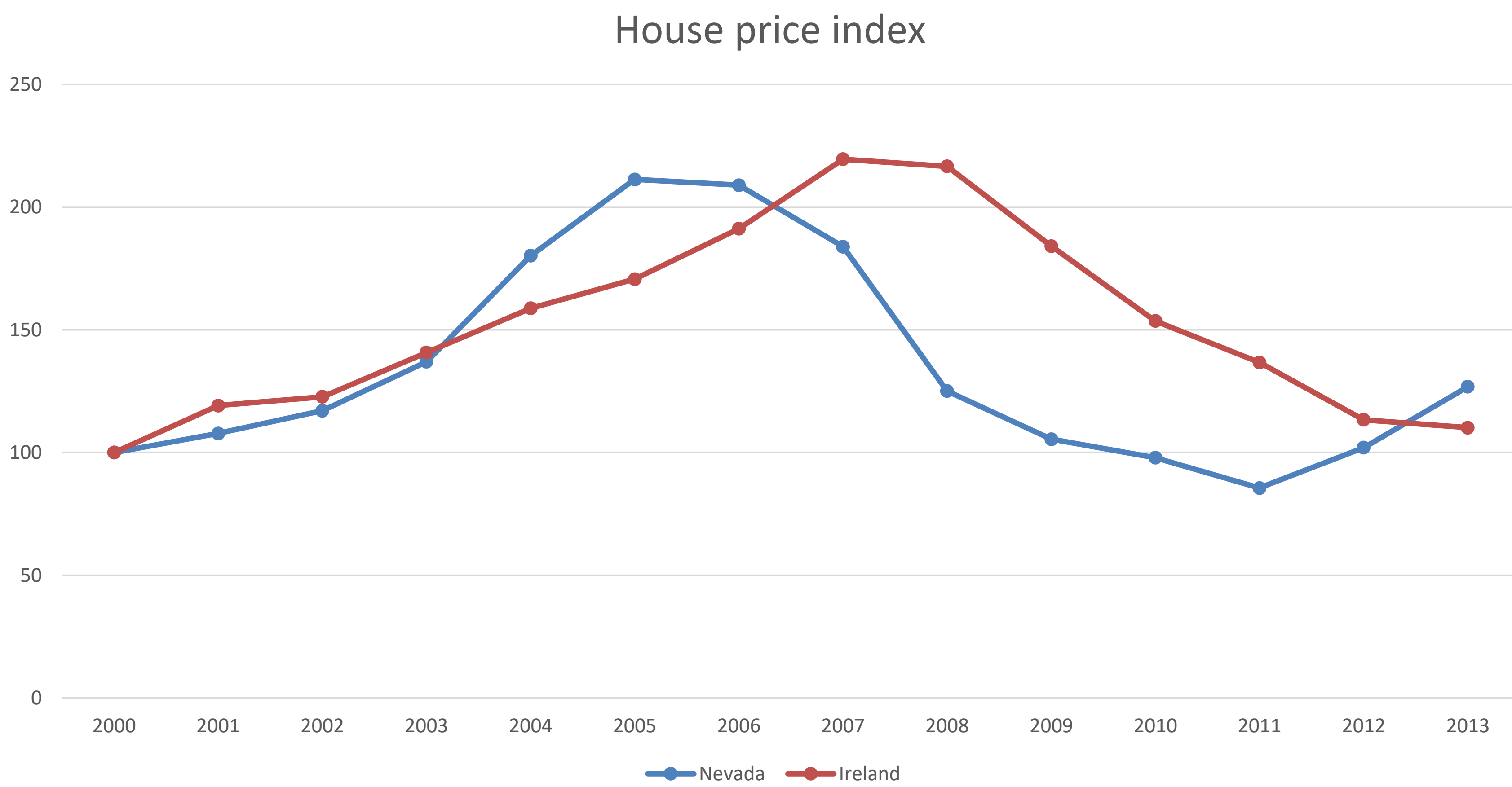
Comparison Ireland & Nevada

Key statistics:

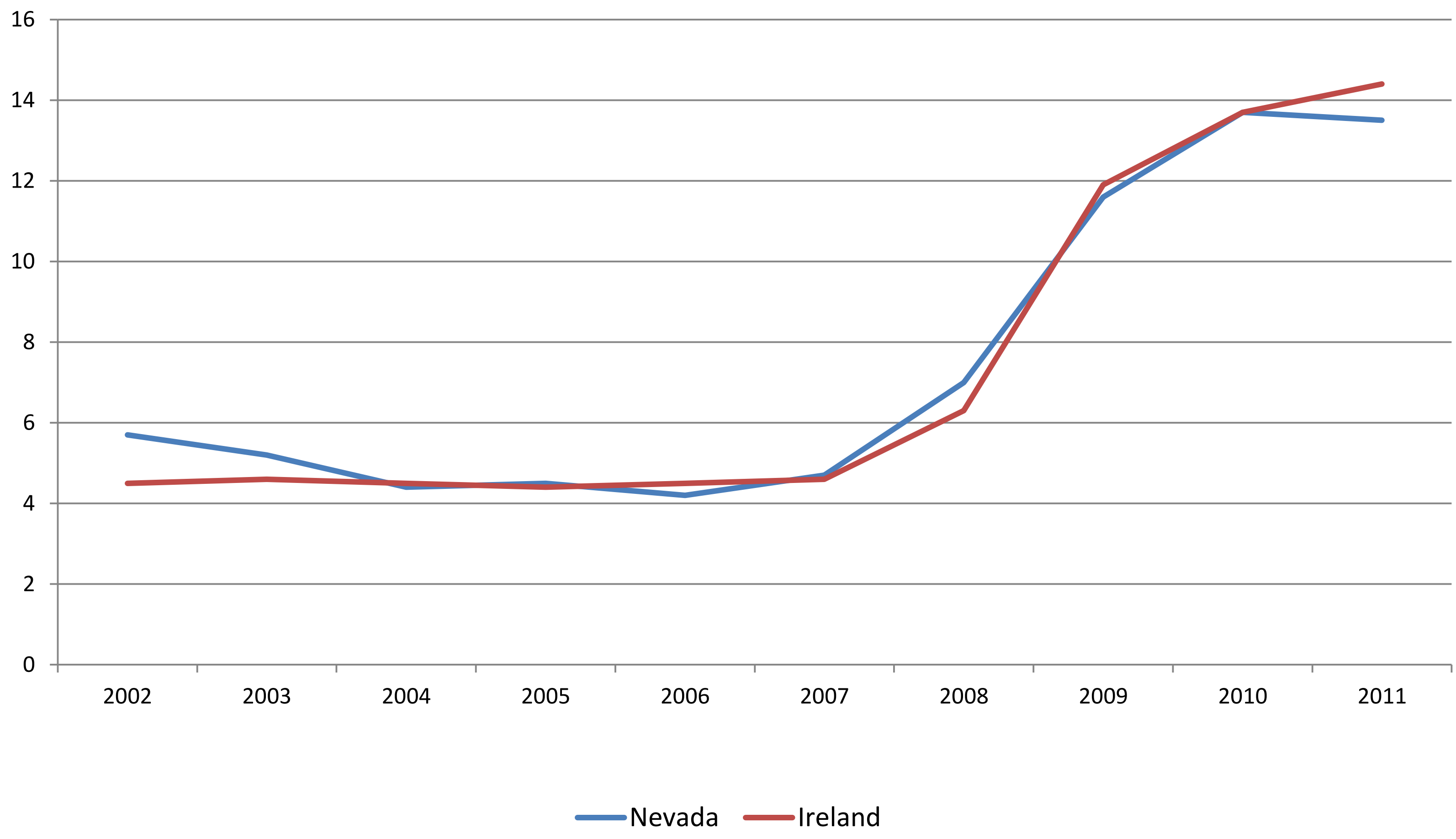
	Ireland	Nevada
Population (in million, 2011)	2.7	4.5
GDP (in $ billion, 2011)	120	200
Average net migration rate since ‘bust’ (2008) as percent of total population	0.32%	0.09%
Unemployment rate (2011)	13.5%	14.4%

Ireland vs. Nevada: Construction, similar cycle

Ireland vs. Nevada: House prices, similar cycle



Unemployment rates in percent, similar deterioration



Nevada’s Advantage

- 2008-09: FDIC closed 11 banks headquartered in NV
  - Assets of over $40 billion =30% NV GSP
  - Losses incurred by FDIC of roughly $4 billion

- Federal loss sharing through Fannie Mae & Freddie Mac of $8 billion since 2008 (losses concentrated in Nevada, borne by federal institutions (but not federal government)).
- Total direct ‘loss absorption’ : about 12 billion, 10 % of GSP.

- Not counted:
- Non conforming (private label) RMBs (sub prime) securitization plus high market share of out-of-state banks in NEV, also, partially in Ireland (HSBC, etc.) = Market banking union.

- => Total loss protection much higher than 10 % of GDP!

Foreign owned banks: a substitute for BU?

- Foreign owned banks must be strong enough to carry losses.
- Magnitudes?
- Estonia about 5 % of GDP in loan write downs by Swedish banks.
- In US large banks have over 50 % market share and absorbed over 440 billion in writ downs (twice as much as FDIC + GSEs) not surprising as GSEs covered only ‘conforming’, i.e. low risk mortgages.
- => More shock-absorbing capacity from foreign owned banks than could ever be provided by any ‘fiscal capacity’ for EA?

But for small countries only?

Loss sharing during Euro Crisis(?)

- The US banking union supported Nevada with a transfer (or rather loss absorption) worth over 10%, possibly up to 20% of its GDP.
- Ireland, Spain: no such loss absorption, government had to save ‘own’ banks.
- Counter example: Estonia, Lithuania: also real estate boom and bust, but no national bank rescues necessary because strong Scandinavian banks absorbed losses (market banking union).

Overall conclusion: More shock-absorbing capacity from a full BU than could ever be provided by any ‘fiscal capacity’.

Conclusions: ‘private banking/capital market integration’ more important than completing ‘official’ BU

- Deposit guarantee likely to become less important under bail-in regime of BRRD.
- (Plus EDIS (European Deposit Insurance System) could not protect against denomination risk.)
- => More important to encourage cross border banking and securitisation than getting EDIS.