

# EUROZONE: ‘THE BEGINNING OF THE END OR THE END OF THE BEGINNING’?

February 2013 – PIERRE CAILLETEAU

# ‘Beginning of the End or End of the Beginning?’

## Summary

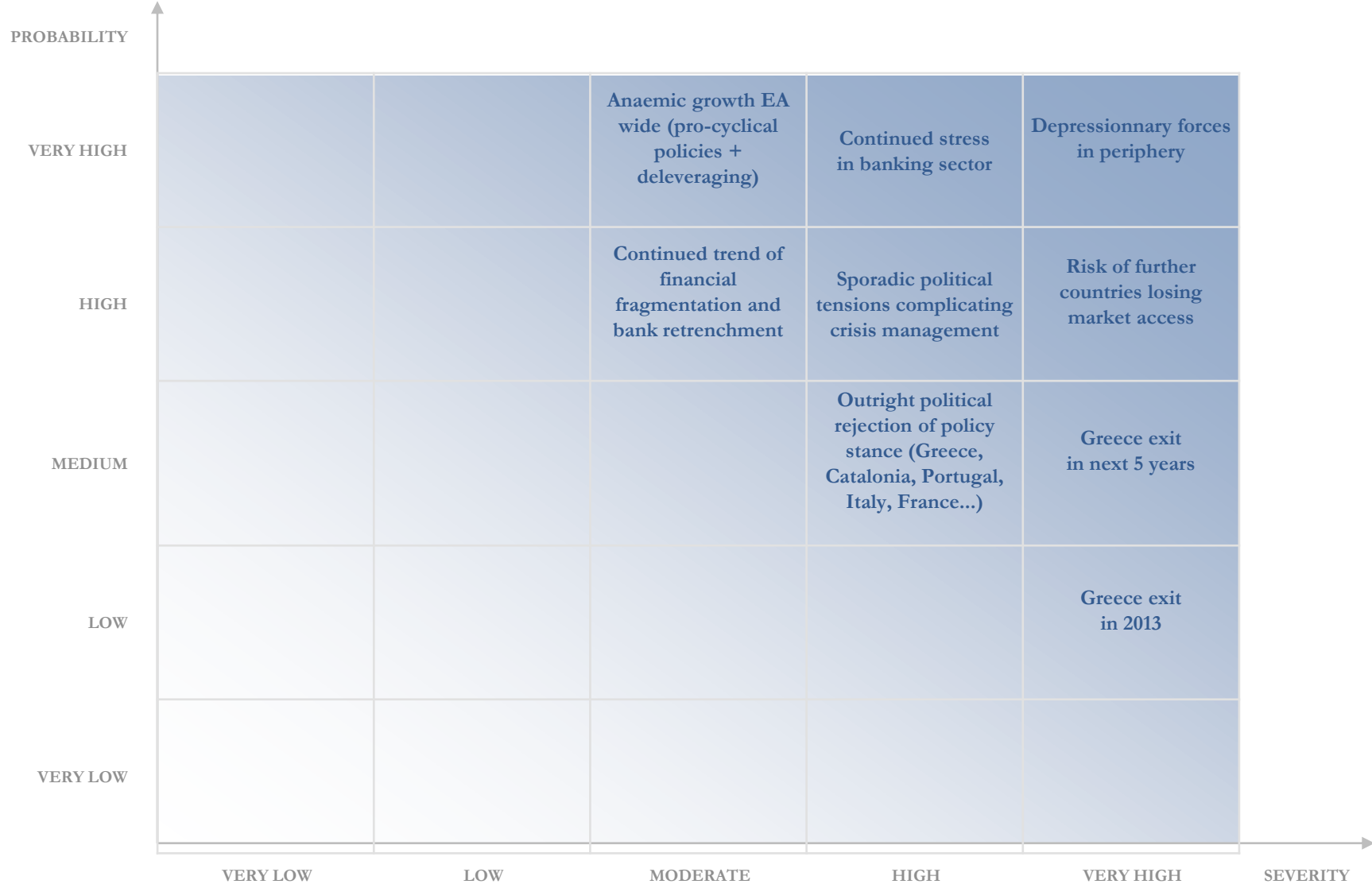
- The risk of an imminent dislocation has receded
- Enough lucidity to avoid the disaster, but not enough political capital to reach a stable equilibrium
- Most of the world economic, financial and monetary challenges get further complicated in the Euro context
- Will M. Draghi be able to say, like Churchill after El Alamein: *‘Before the OMT we never had a victory. After the OMT we never had a defeat?’*

# The Risk of an Imminent Dislocation has Receded

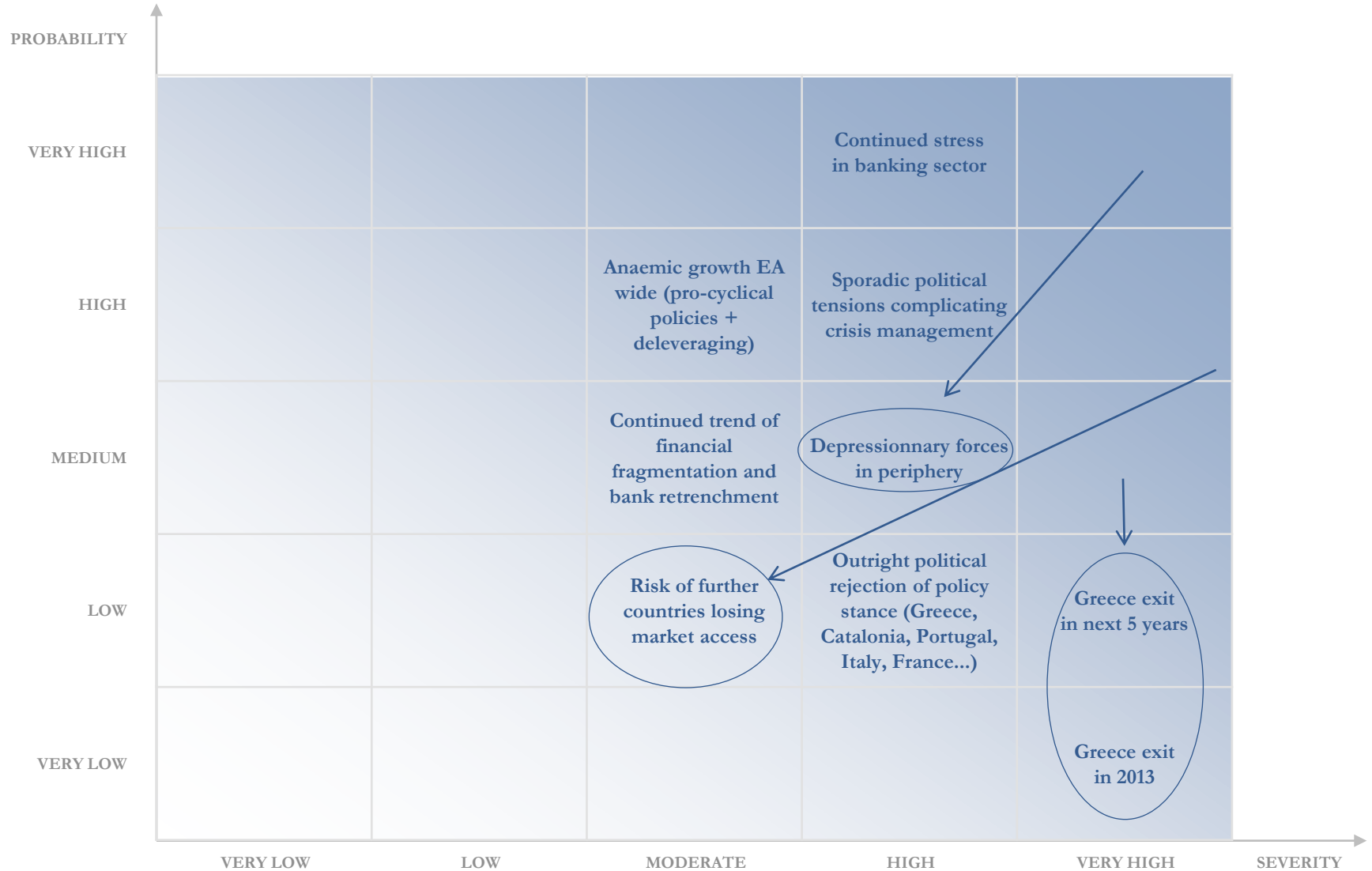
However, enough lucidity to avoid the disaster, but not enough political capital to reach a stable equilibrium

- Four crises in one
- The Euro Area before the OMT (Outright Monetary Transactions)
- The Euro Area after the OMT
- And possibly after the Banking Union
- Conclusion 1: a salutary "South-West" migration
- Conclusion 2: an inherently unstable equilibrium

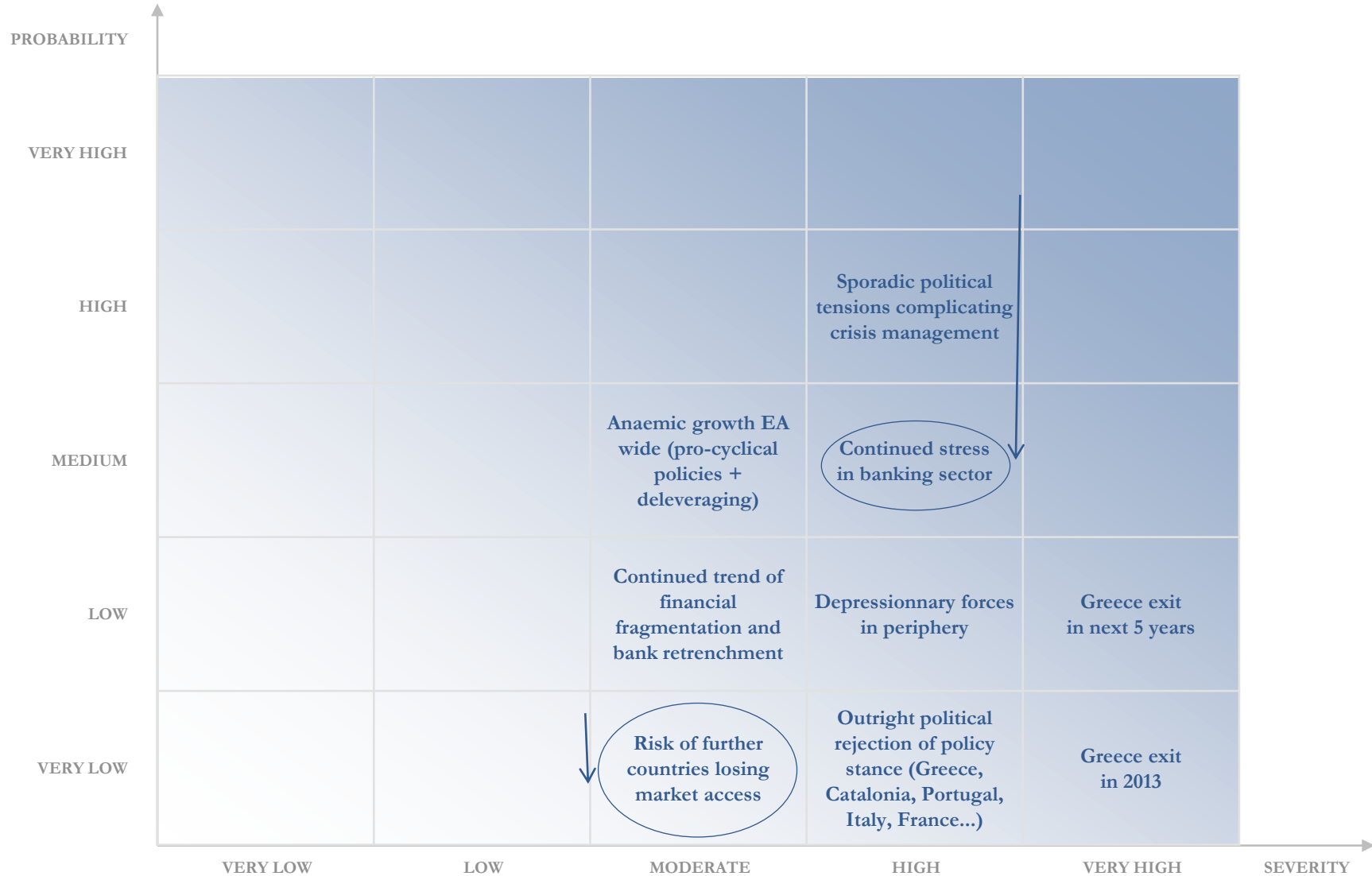
# Eurozone Risk Map Pre ECB Outright Monetary Transactions



# Eurozone Risk Map Post OMT



# Eurozone Risk Map Post Banking Union (Rosy version)



# When Will We Know that the Worst is Behind Us?

Zhou En Lai and the long-term effects of the French Revolution: 'Too soon to tell'...

- **Normalisation: what « normal » means anyway?**
- **What is needed is:**
  - A banking system that can operate profitably: a decent intermediation margin
  - A deleveraging process that does not suffocate the economy
  - The certainty that 1 Euro in Berlin = 1 Euro in Lisbon = 1 Euro in Cyprus
  - Sovereigns that can sustainably borrow at an interest rate lower than nominal growth
  - Progress in the 're-sanctuarisation' of Sovereign debt

# Macro-Financial Challenges Get Magnified

## Multiple Equilibria and the Euro "Original Sin"

- Sovereign or sub-Sovereign debt issuers?
- Deleveraging and balance-sheet recessions in the absence of QE?
- Reliable safe heavens? What does it mean to be AAA?
- Prohibition of public debt monetary financing – inherent limits to monetary experimentations: good or bad?



# Conclusions

- Two interpretations of 'History': (a) the Euro forces a structural adjustment that would have never come about without it, and stops the decline of 'Old Europe'; (b) the Euro as the culmination of a technocratic project that will hit the wall of political legitimacy.
- *'More than any other time in history, mankind faces a crossroads. One path leads to despair and utter hopelessness. The other, to total extinction. Let us pray we have the wisdom to choose correctly'* – Woody Allen