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Article

"Settling TARGET balances after the Euro crisis": Seven questions to Claudia Lambert and Philipp König

DIW Economic Bulletin

Provided in Cooperation with:

German Institute for Economic Research (DIW Berlin)

Suggested Citation: Lambert, Claudia; König, Philipp; Wittenberg, Erich (2013): "Settling TARGET balances after the Euro crisis": Seven questions to Claudia Lambert and Philipp König, DIW Economic Bulletin, ISSN 2192-7219, Deutsches Institut für Wirtschaftsforschung (DIW), Berlin, Vol. 3, Iss. 11/12, pp. 12-

This Version is available at: https://hdl.handle.net/10419/88613

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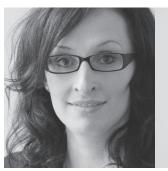
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the Department of Macroeconomics at DIW Berlin

SEVEN OUESTIONS TO CLAUDIA LAMBERT AND PHILIPP KÖNIG

»Settling TARGET Balances after the Euro Crisis«

- 1. TARGET2 is the electronic payment system of the Eurosystem. What's the basic principle of TARGET2? Philipp König: The national central banks and the ECB process payments within the Monetary Union via TARGET2. Here, a national central bank records a TARGET asset if more liquidity flows into the banks in its country via the payment system than they transfer abroad. Conversely, the national central bank records a TARGET2 liability if less central bank liquidity flows into the banks in its country than they transfer abroad.
- 2. How high are the Bundesbank's TARGET2 claims against the European Central Bank? Philipp König: These claims currently amount to around 570 billion euros. Before the crisis, they were very moderate and frequently fluctuated around zero. Since 2008, they have steadily risen in the course of the crisis and reached their highest level of around 750 billion euros in July 2012. They have fallen again since.
- 3. What impact does the level of these TARGET claims have on German commercial banks and their liquidity? Claudia Lambert: We estimate that German commercial banks are currently holding excess reserves of approximately 78 billion euros. New regulations, approved under Basel III, intended to encourage banks to secure their short- and long-term liquidity. These surplus reserves help to achieve this goal.
- 4. What are the risks associated with this? Philipp König: Currently, there are no direct risks resulting from holding excess reserves. But since there is virtually no interest on excess reserves, it is not profitable for banks to hold them. The banks will try to find a better way of

investing them, which may lead to asset price upsurges. This could lead to asset price inflation. But there is no evidence of this at the moment.

- 5. How high are the current TARGET liabilities of the European crisis countries? Philipp König: The current TARGET liabilities of the European crisis countries amount to around 220 billion euros for Italy, around 58 billion for Greece, around 56 billion for Ireland, approximately 60 billion for Portugal, and around 280 billion euros for
- 6. What are the chances that these TARGET balances will be reduced again? Philipp König: The moment the crisis is overcome through structural measures in the crisis countries and the ECB reverts to the mode of liquidity provision it used prior to the crisis, the TARGET balances will also decrease again. But TARGET balances may remain. This is due in particular to a structural change within the demand for liquidity and the liquidity deficit in the euro area.

Claudia Lambert: A decisive factor for repayment of TARGET balances is also that banks begin to trust each other again and the interbank market is active again. That would help to settle these balances.

7. What happens if a crisis country leaves the EMU? Claudia Lambert: The TARGET balances would become foreign currency loans, meaning that a liability would have to be settled in a different currency. At this point in time, however, it is not possible to accurately assess what institutional processes would come into play. It can be assumed that a share of the claims that, for example, Germany now has would also still be recoverable in those circumstances. Therefore, it would not mean that everything would be written off.

Interview by Erich Wittenberg.

12



Volume 3, No 11.12 13 December, 2013 ISSN 2192-7219

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