

MACROCOSM

Bundesblock

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Until the German elections, Bundesbank political leverage keeps euro area growth on hold.

We've been highlighting for two months an idea for kick-starting growth and reducing unemployment in the euro area (see ["Not a Big Bang, But It Could Work"](#) May 29, 2013 and ["The EIB, Not the ECB"](#) April 12) -- securitization of loans to small and medium enterprises (SMEs). We're delighted that the idea is going viral among Europe's political elite. Unfortunately, it's also getting tangled up in German politics ahead of the September 22 federal election. Until that stumbling block is passed, progress in the euro area is on hold.

- Loan securitization was endorsed in an op-ed [in yesterday's Wall Street Journal](#) penned by the prime ministers of Finland and Portugal, as the solution to the critical problem of credit unavailability for SMEs in the euro area.
- They point out that if SME loans were bundled into securities and sold directly to investors, these loans would not burden banks capital ratios.
- It is significant that Jyrki Katainen, prime minister of Finland, a notoriously conservative AAA-rated member of the euro "core," is taking this stance. Throughout the crisis Finland has been firmly in the German camp when it comes to implementing reform in -- and reducing exposure to -- the euro periphery.
- After all, it was Finland alone that [demanded collateral](#) for its portion of the bailout loans to Greece as part of the Greek bailout.
- Further, Finland does not have the chronic lending shortage that some in the periphery do (please see chart on next page).
- Last Friday Spanish Prime Minister [Mariano Rajoy endorsed](#) SME loan securitization, too.
- Today, in their [latest review of the Spanish economy](#), the IMF also highlighted the credit availability problem saying "credit is contracting sharply and lending rates remain too high," adding that "Euro-area policies need to be much more supportive."
- This means that the idea is not only becoming mainstream, it is one that can be agreed by both the most conservative and the most needy members of the euro area, and key supra-national organizations.

But this does not mean that SME asset-backed securities are going to be coming to market anytime soon. There still are several challenges to

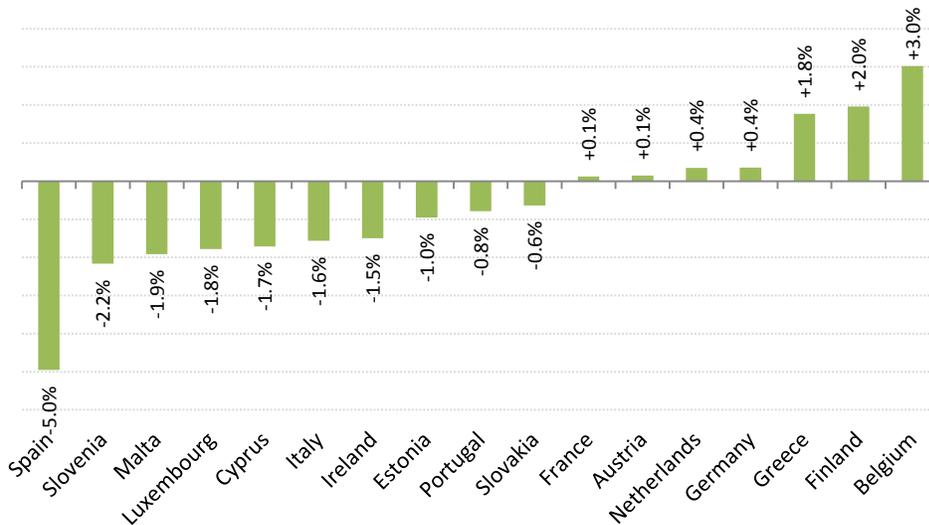
Update to strategic view

EUROPE MACRO, ECB:

The idea of building a securitization market for loans to small and medium enterprises is gaining traction among a broad spectrum of the euro area's political voices. This could be the answer to the critical shortage of credit for this engine of job creation. Unfortunately, ahead of the September German election, the ultra-conservative Bundesbank has the leverage to block the ECB's participation -- which likely puts the idea, and the euro area's growth prospects, on hold for a few months yet.

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Loans to euro area non-financial companies QOQ growth



Source: ECB, TrendMacro calculations

overcome -- not least of these being the Bundesbank's resistance to any and all expansions of the ECB's role, at a moment in German politics that gives the Bundesbank a great deal of leverage.

- In the German Constitutional Court last week we saw German ECB board member -- and Merkel appointee -- [Jörg Asmussen](#) pitched against Bundesbank President [Jens Weidmann](#) in a legal battle over the scope of the ECB's mandate.
- While the subject of SME lending did not come up -- the case was about the European Stability Mechanism and the ECB's Outright Monetary Transactions (OMT) -- Weidmann did use the occasion to highlight how narrowly he views the ECB's inflation-targeting mandate.
- Under such a narrow view, being involved in any way in directing credit to particular parts of the economy would exceed the ECB's mandate.
- So if ECB participation in SME securitization were agreed by the ECB Governing Council, it would be yet another defeat for the Bundesbank and Weidmann.
- This could then lead to Weidmann's resignation as Bundesbank President. That would pose political problems for German Chancellor Angela Merkel, facing an election in September.
- She has already had one Bundesbank president resign since the start of the euro crisis -- Axel Weber. To paraphrase Wilde's [Lady Bracknell](#), to lose one Bundesbank president may be regarded as misfortune. To lose two looks like carelessness.
- For Merkel, accusations of carelessness, especially in monetary affairs, would be best avoided, at least until the electoral dust settles.

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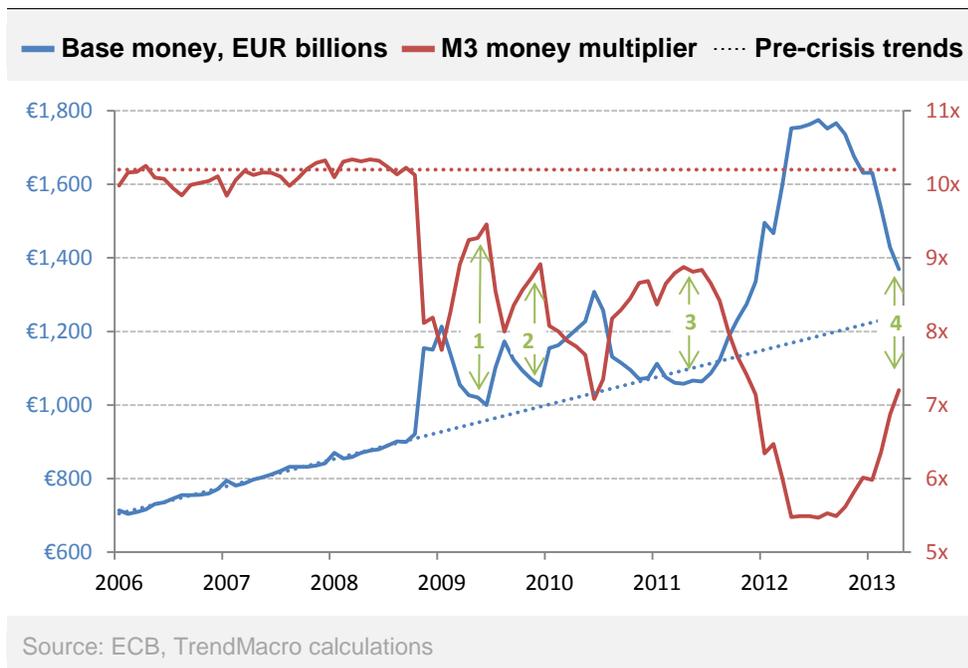
[Europe Needs a Lending Revival](#)

Jyrki Katainen and Pedro Passos Coelho
Wall Street Journal
June 18, 2013

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- Therefore we think that the SME securitization idea will likely be delayed until after the German election, by which point Weidmann's leverage will also have passed.
- Germany's willingness to help address the problem is clear -- only two weeks ago the [German state development bank, the KfW](#), agreed to provide €1 billion to Spain's development bank, the ICO, to fund lending to SMEs.
- But while welcome, bilateral agreements like the one between KfW and ICO are probably too small to move the needle significantly. They do signal an intent to face the problem though, and likely mean that without the Bundesbank acting as blocker -- that is, once the German election is passed -- German political support can be relied on to back the securitization route.

Meanwhile, there is no doubt that credit growth in the euro area is at critically low levels. The proof: for the fourth time since the onset of the euro area debt crisis and the expansion of ECB liquidity, base money is returning to trend. Yet every time it has returned to trend it has done so at a lower M3 money multiplier (please see the chart below).



Pre-crisis, the M3 multiplier was a pretty constant 10.2x. Now, with base money again returning to trend it is languishing at just over 7x. The easiest way to reverse this trend is to increase access to credit, and the most effective place for that credit to go is to the SME sector. As the Finnish and Portuguese prime ministers assert in their op-ed, two out of three private sector jobs in the euro area are in SMEs. So getting SME credit on a sound financial footing would be the first step in a return to growth and the reduction of unemployment in the euro area.

SME securitization seems like a no-brainer solution, and in many ways it is. Unfortunately, politics -- particularly German politics -- will likely force us

to wait for a few months yet before we can see whether this idea will bear fruit.

Bottom line

The idea of building a securitization market for loans to small and medium enterprises is gaining traction among a broad spectrum of the euro area's political voices. This could be the answer to the critical shortage of credit for this engine of job creation. Unfortunately, ahead of the September German election, the ultra-conservative Bundesbank has the leverage to block the ECB's participation -- which likely puts the idea, and the euro area's growth prospects, on hold for a few months yet. ▶