

## Widening North-South Divide inside the Eurozone

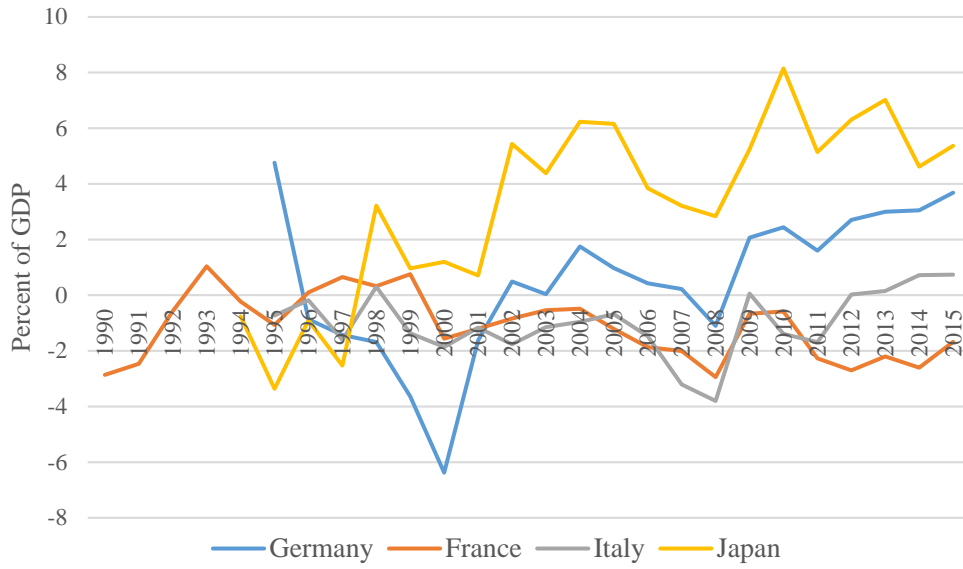
---Can ECB ever taper off QE ?

Shumpei Takemori

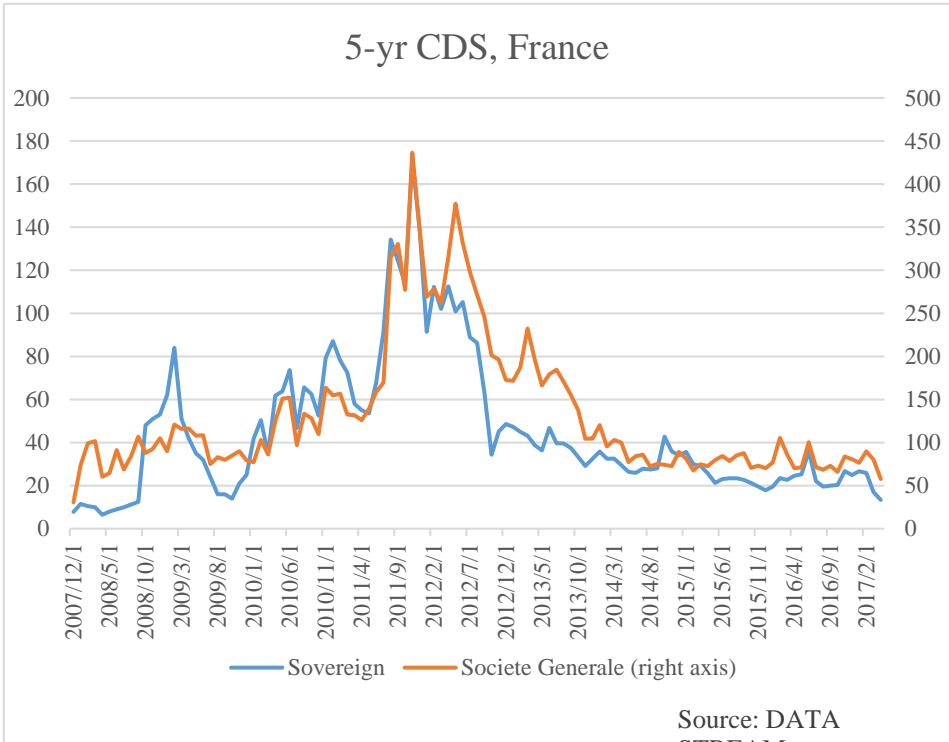
1. Whereas the German Economy can be characterized by Saving Surplus in all sectors, Household, Corporation and Government, in France and Italy the Corporate sectors exhibit the normal tendency of Saving Deficit, i.e. borrowing from market.
2. French and Italian companies are therefore more vulnerable to an interest rate rise. The interest rates that they have to pay, however, are correlated to the spreads of the French and Italian Governments bonds. If the fiscal conditions of France and /or Italy deteriorate the domestic companies must shoulder higher interest rate cost burdens
3. The vicious cycle of deterioration in the banking sector leading to deterioration in the Government fiscal position is already progressing in Italy. Oppressed by Bad Loans Italian bank lending stagnate currently.

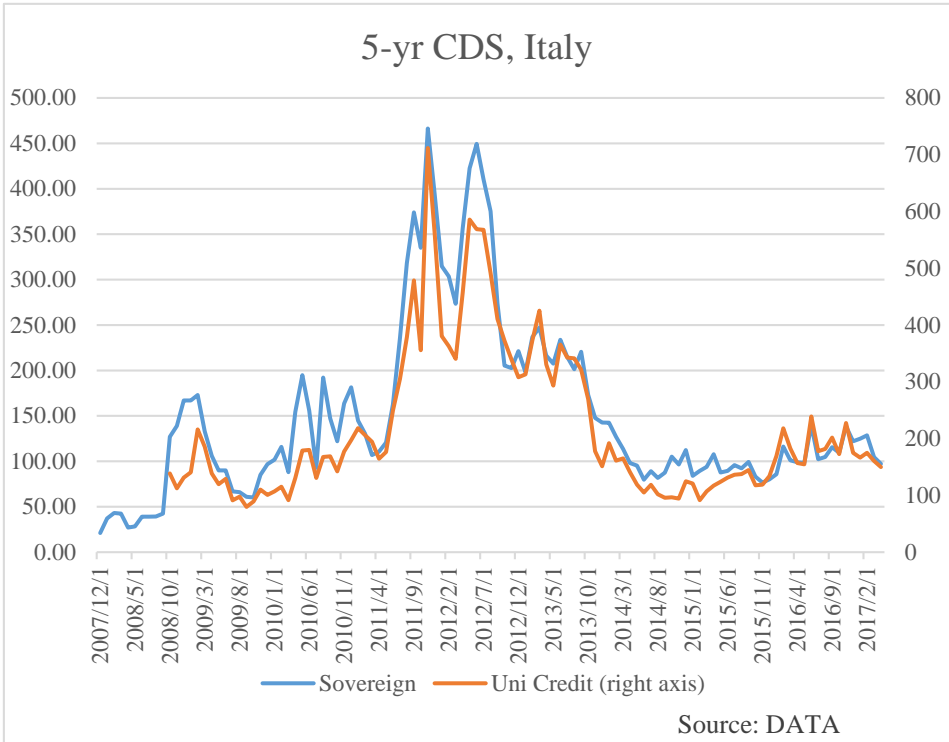
4. But in terms of political leverage “South” has now stronger hand because after Brexit it will become impossible for Germany to block a Supermajority vote on, say, one step toward changing the Eurozone into a transfer union.
  
5. If Inflation rate in Germany rise above 2 % ECB has to choose between imposing pain to South and to North.

### Net Lending (+) and Net Borrowing (-), Non-financial Corporate Sector

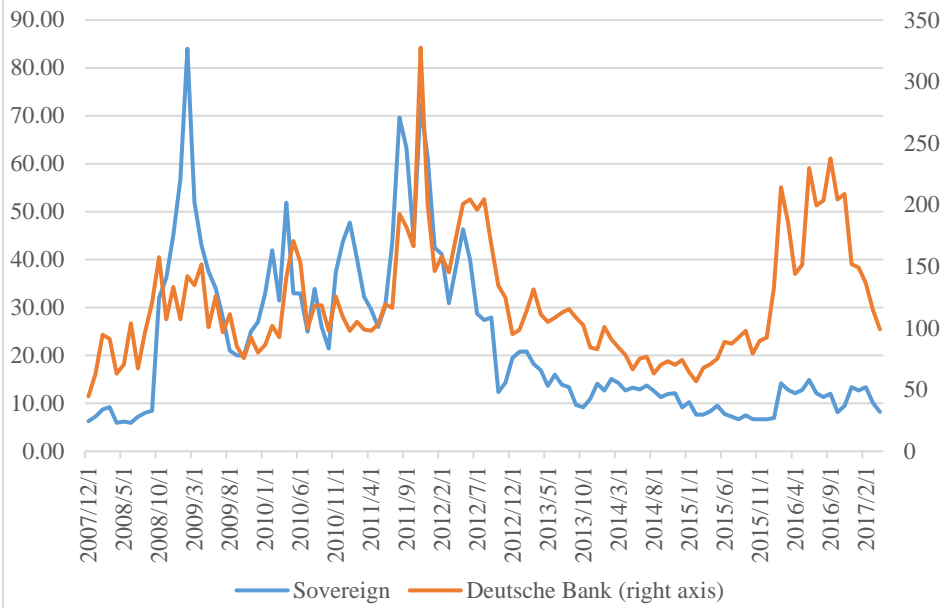


Source: OECD,





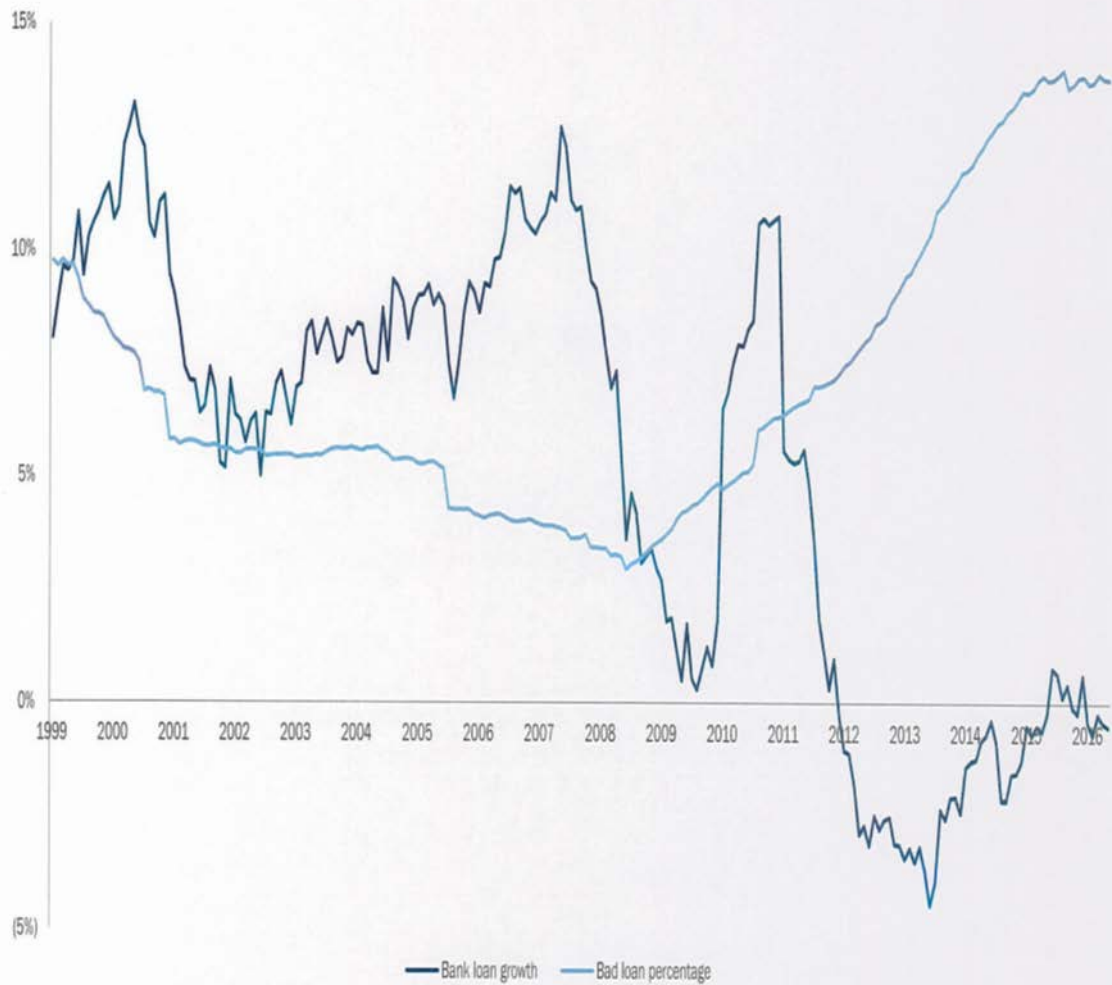
### 5-yr CDS, Germany



Source: DATA  
STREAM

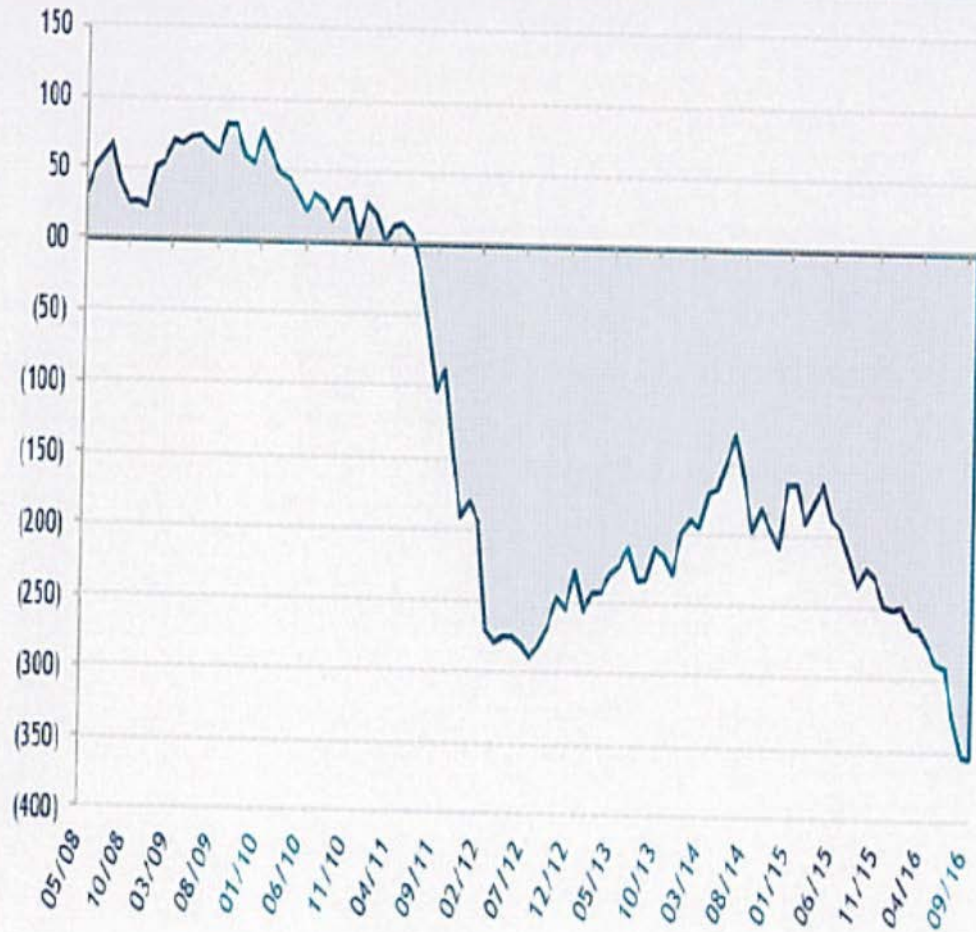
## ...AND THE OBVIOUS CLEAN-UP OF ITS BANKING SYSTEM

Debt deflation feedback loop since 2012 - elevated bad loans reduce bank lending which further reduces aggregate demand



## Italian banking sector's funding practice

### Italy's Target 2 net balance 2008-2016 (€bn)

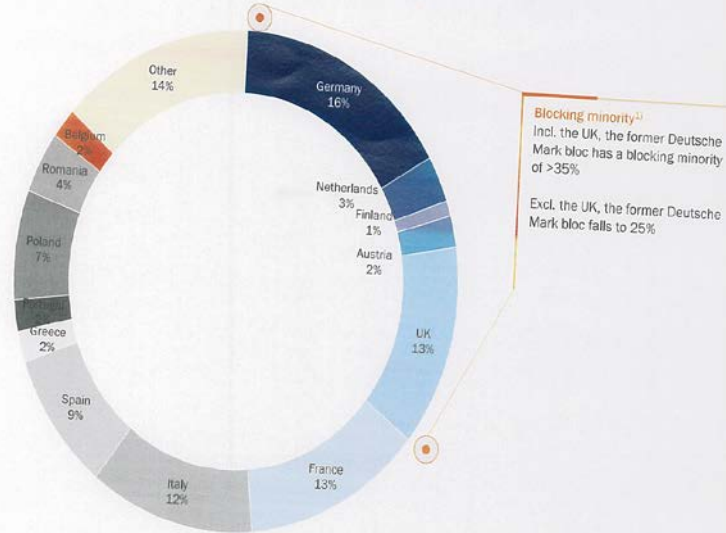


Source: Mediobanca Securities, ECB



# GERMANY IS NOW VULNERABLE: NO BLOCKING MINORITY IN THE EU POST BREXIT

Blocking minorities<sup>1)</sup> in the EU Council: Germany's position will weaken significantly



Source: H.W. Sinn: Der schwarze Juni, September 2016, Astellon calculations

1) Since 2014, decisions are made either unanimously (decisions that impact budgetary decisions of each country), with a simple minority or with a qualified majority (majority of decisions). A qualified majority requires >55% of countries and 65% of the population of such countries. At least 4 countries are required. This implies that 45% of the number of countries and 35% of the population can form a blocking minority