



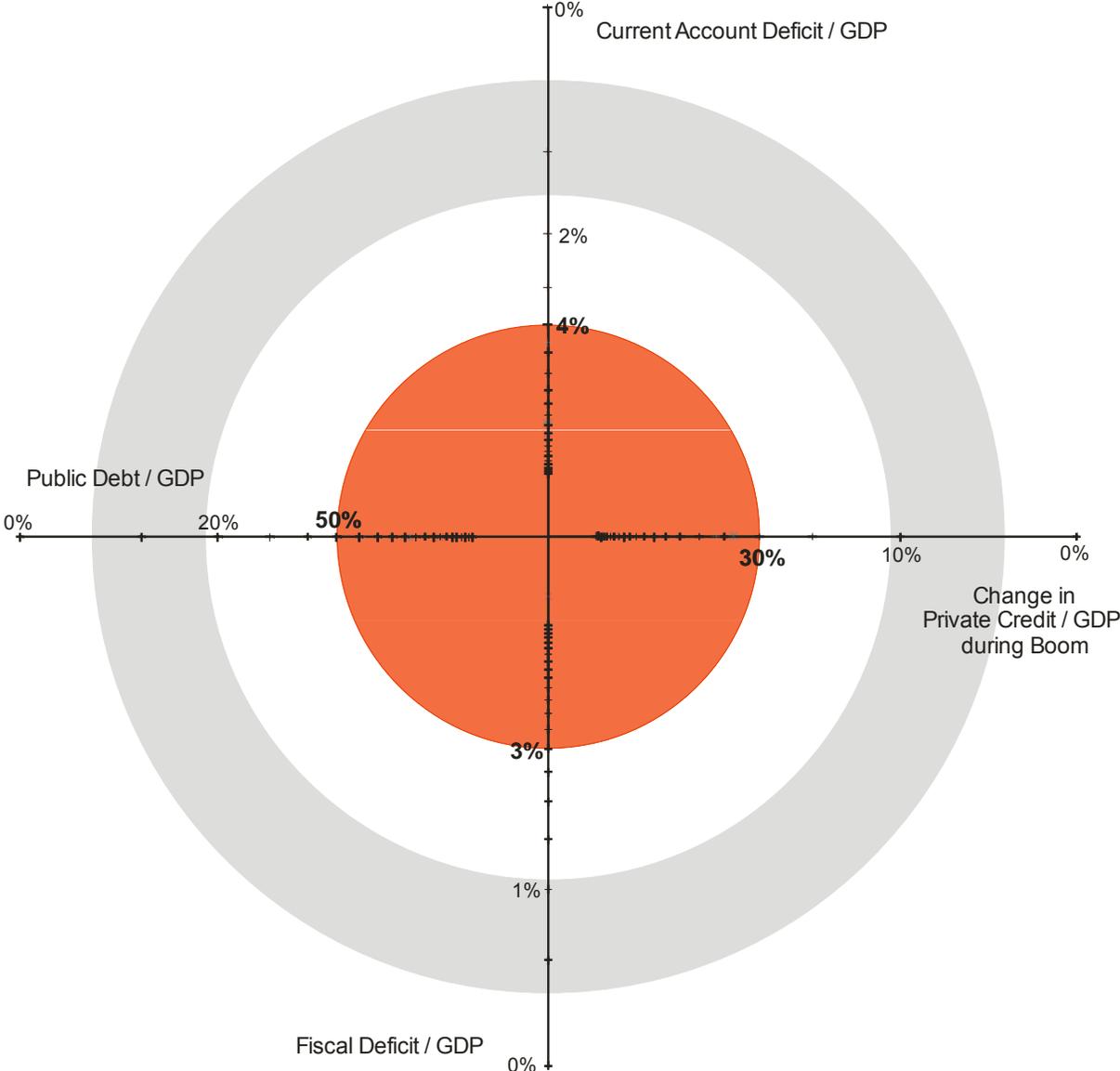
FEDERAL RESERVE BANK
OF PHILADELPHIA

The Realpolitik of Sovereign Debt Restructuring: Monetary and Fiscal Observations from the Front Line

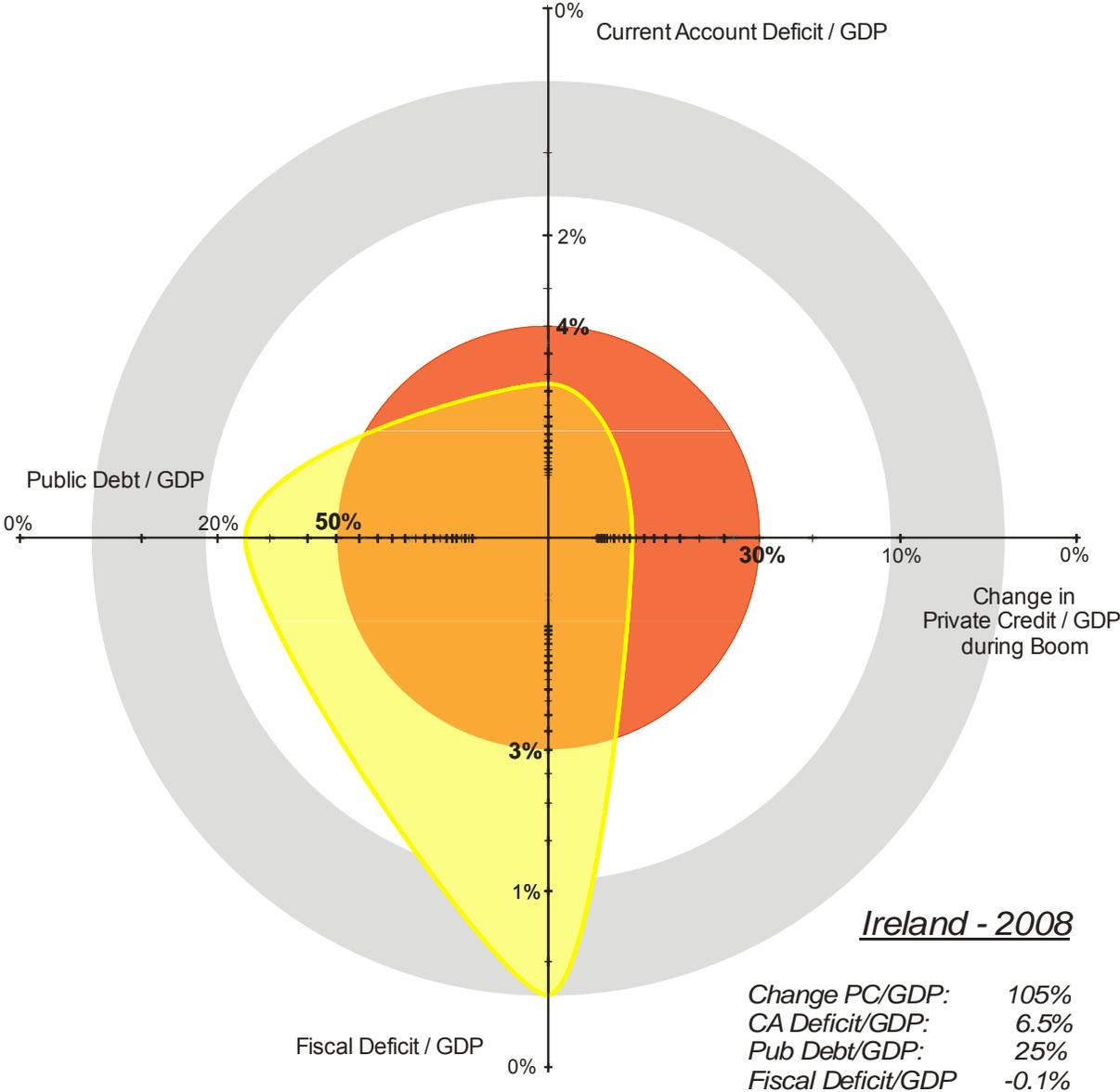
Alfonso Prat-Gay

*The Philadelphia Fed Policy Forum
Budgets on the Brink: Perspectives on
Debt and Monetary Policy
Friday, December 2, 2011*

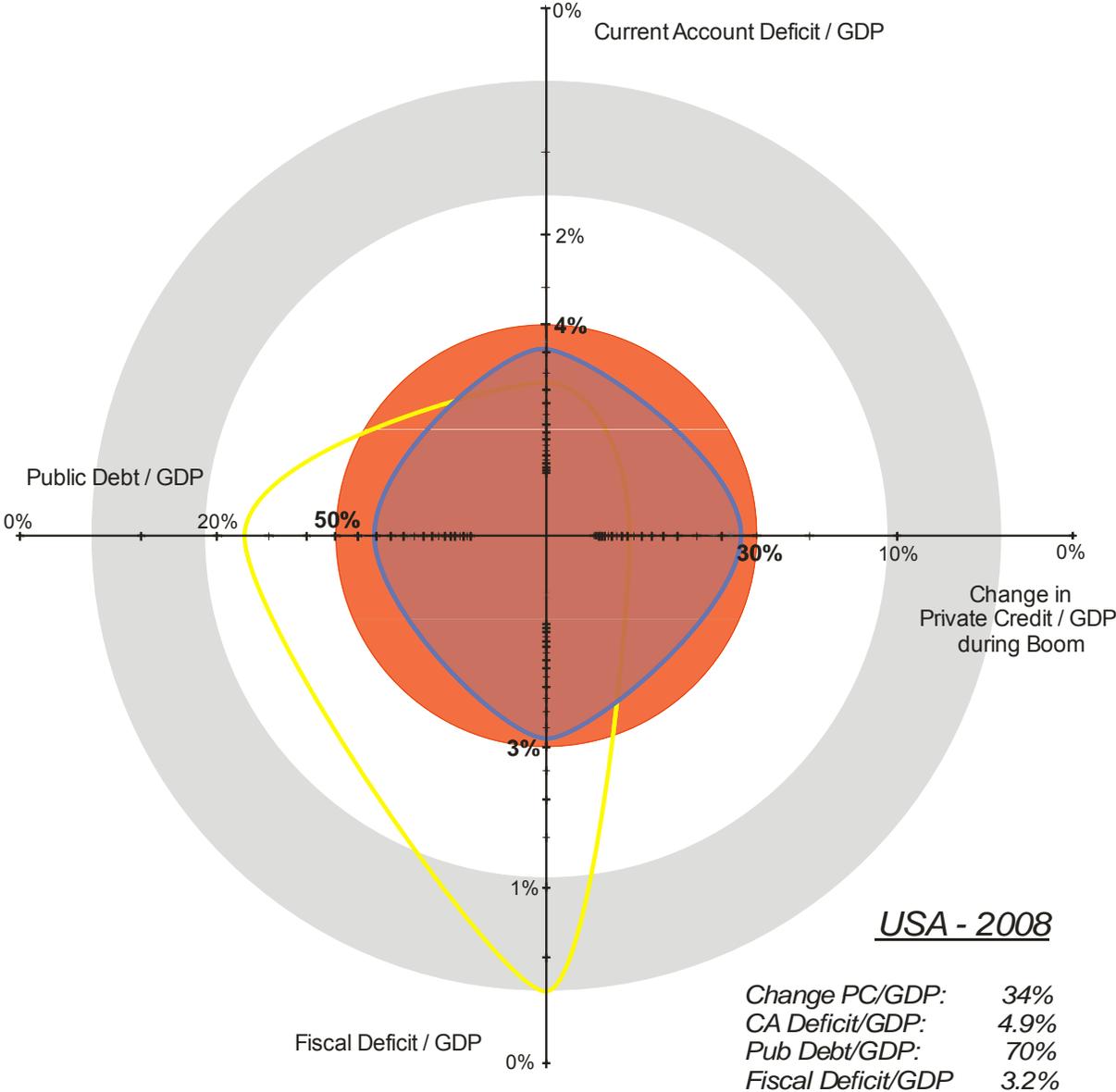
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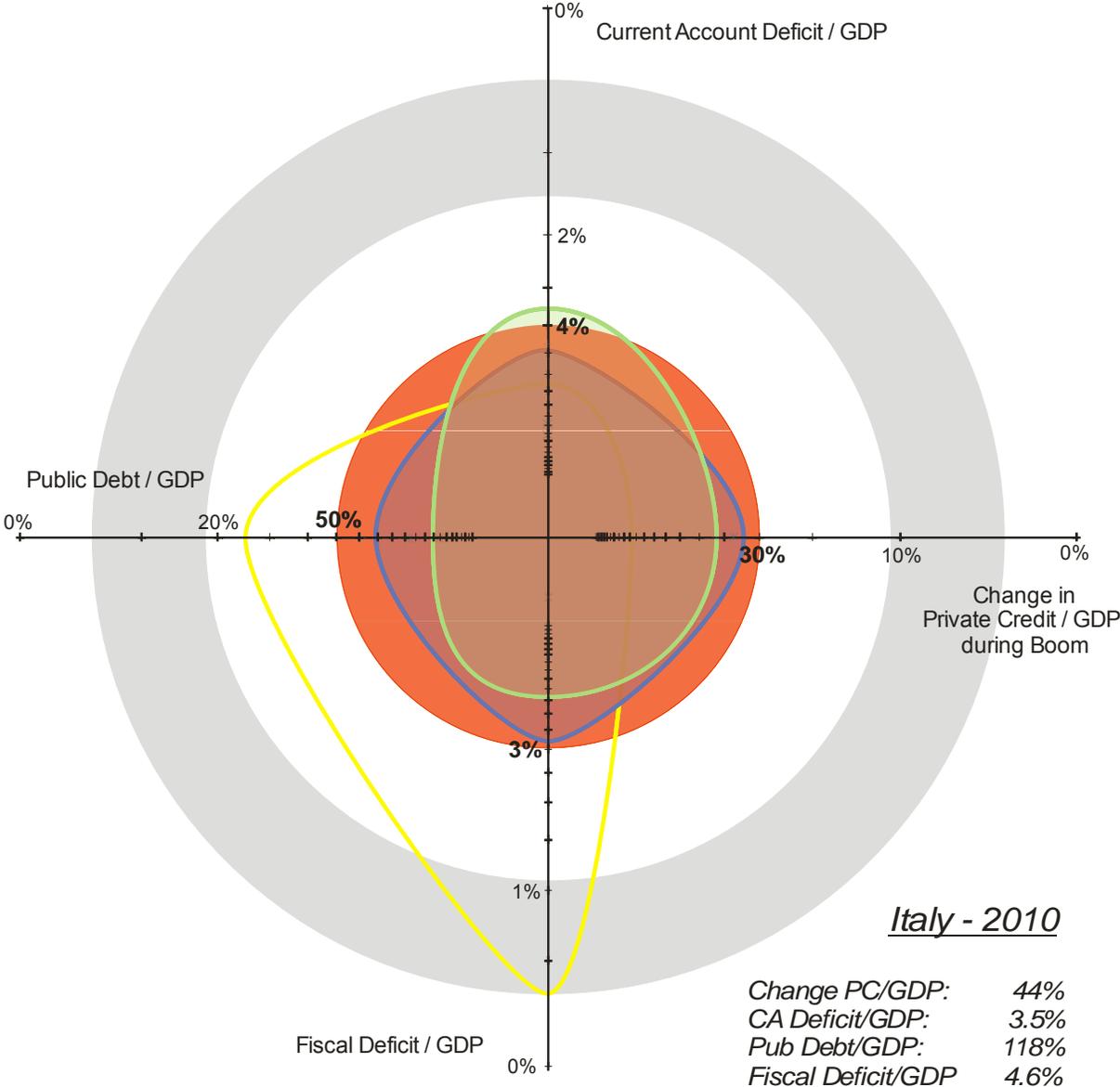
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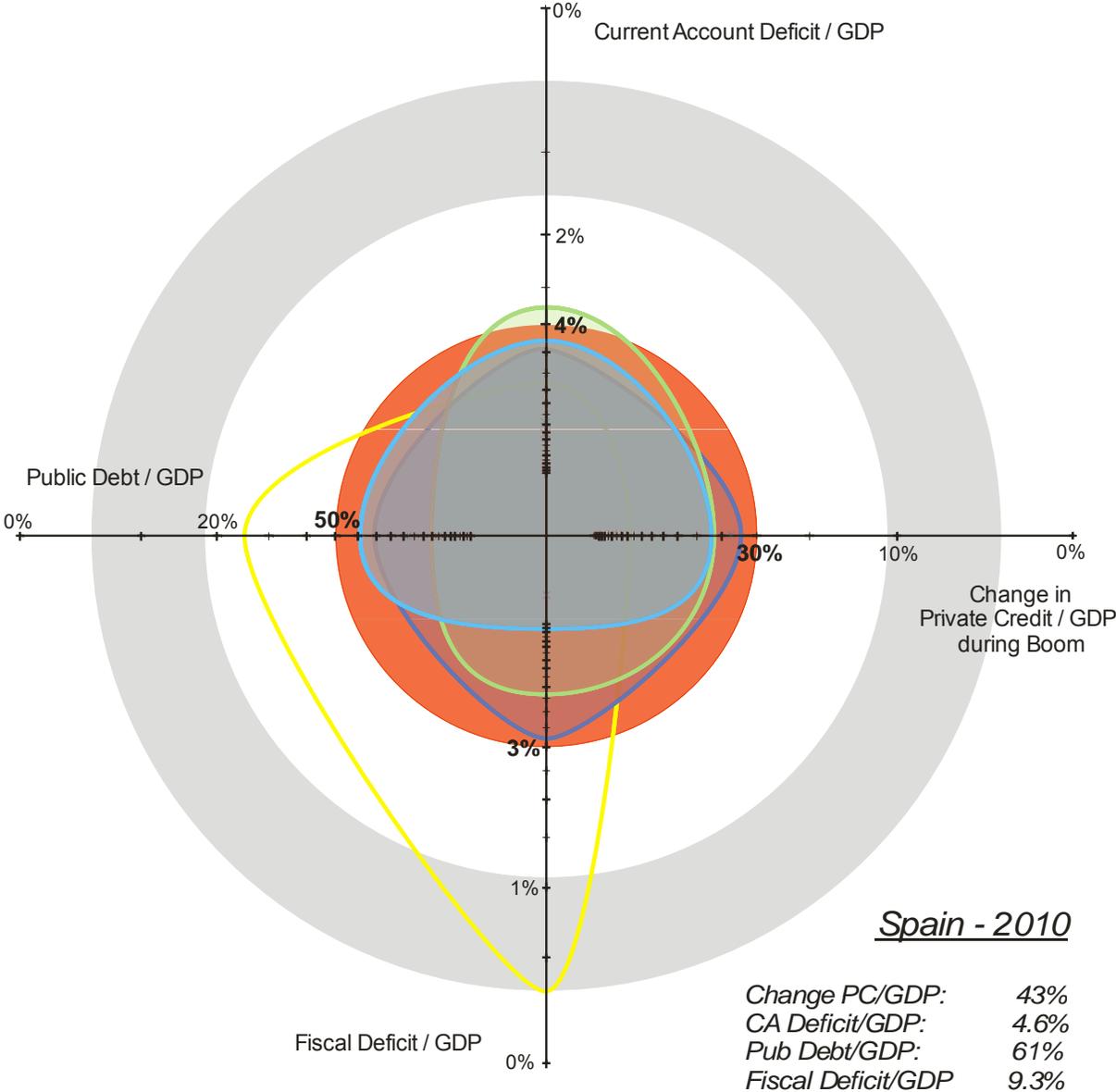
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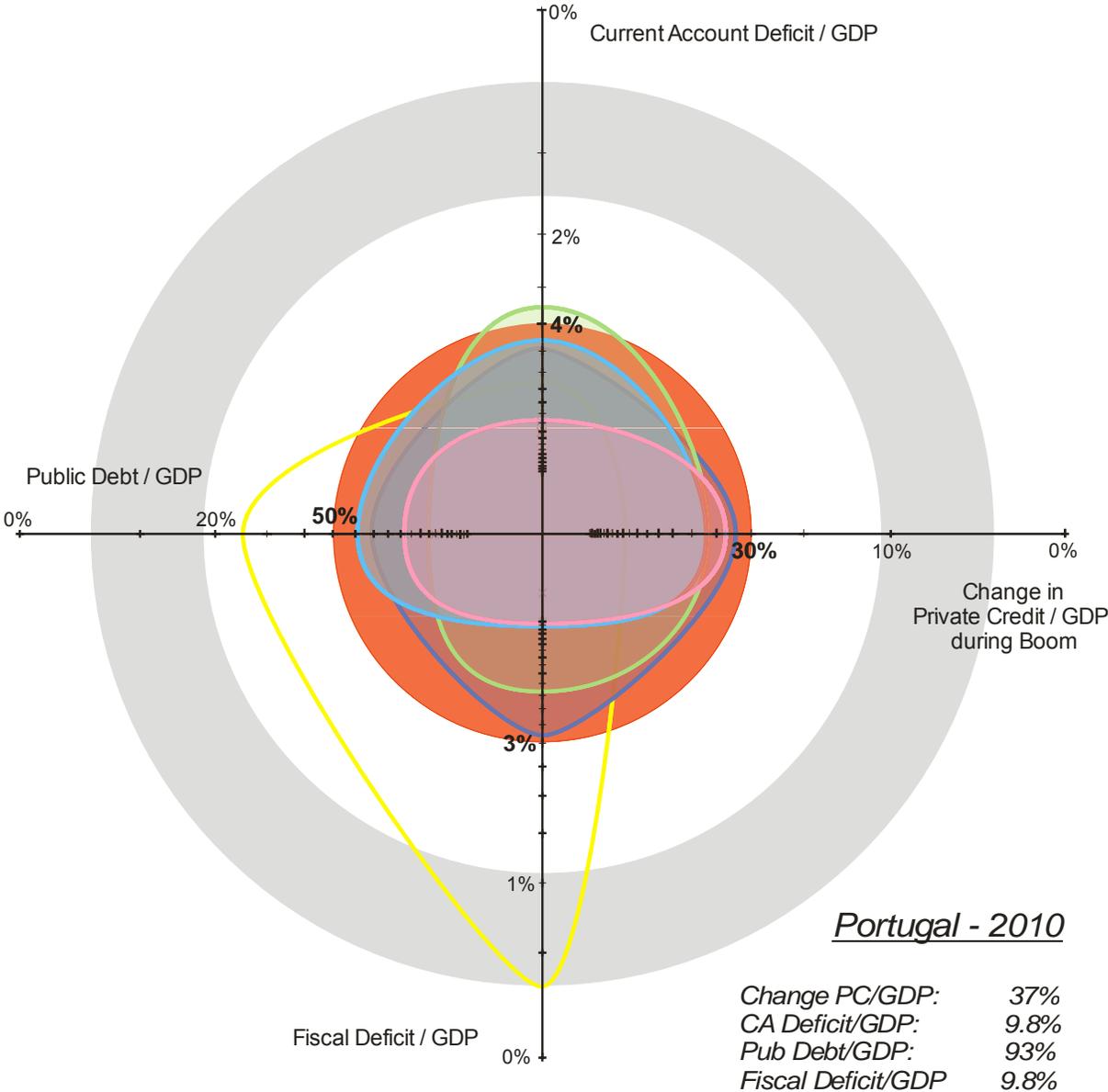
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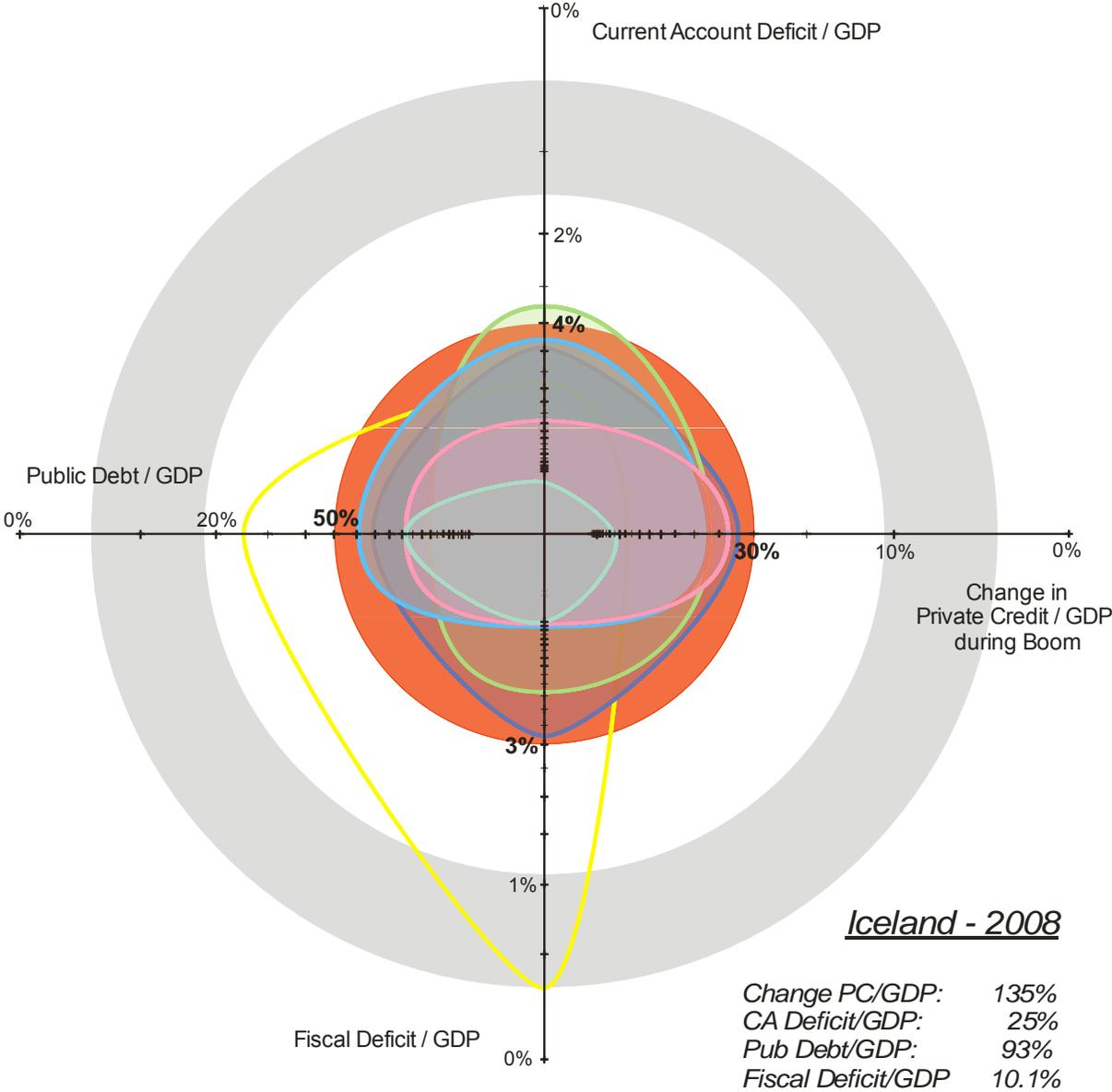
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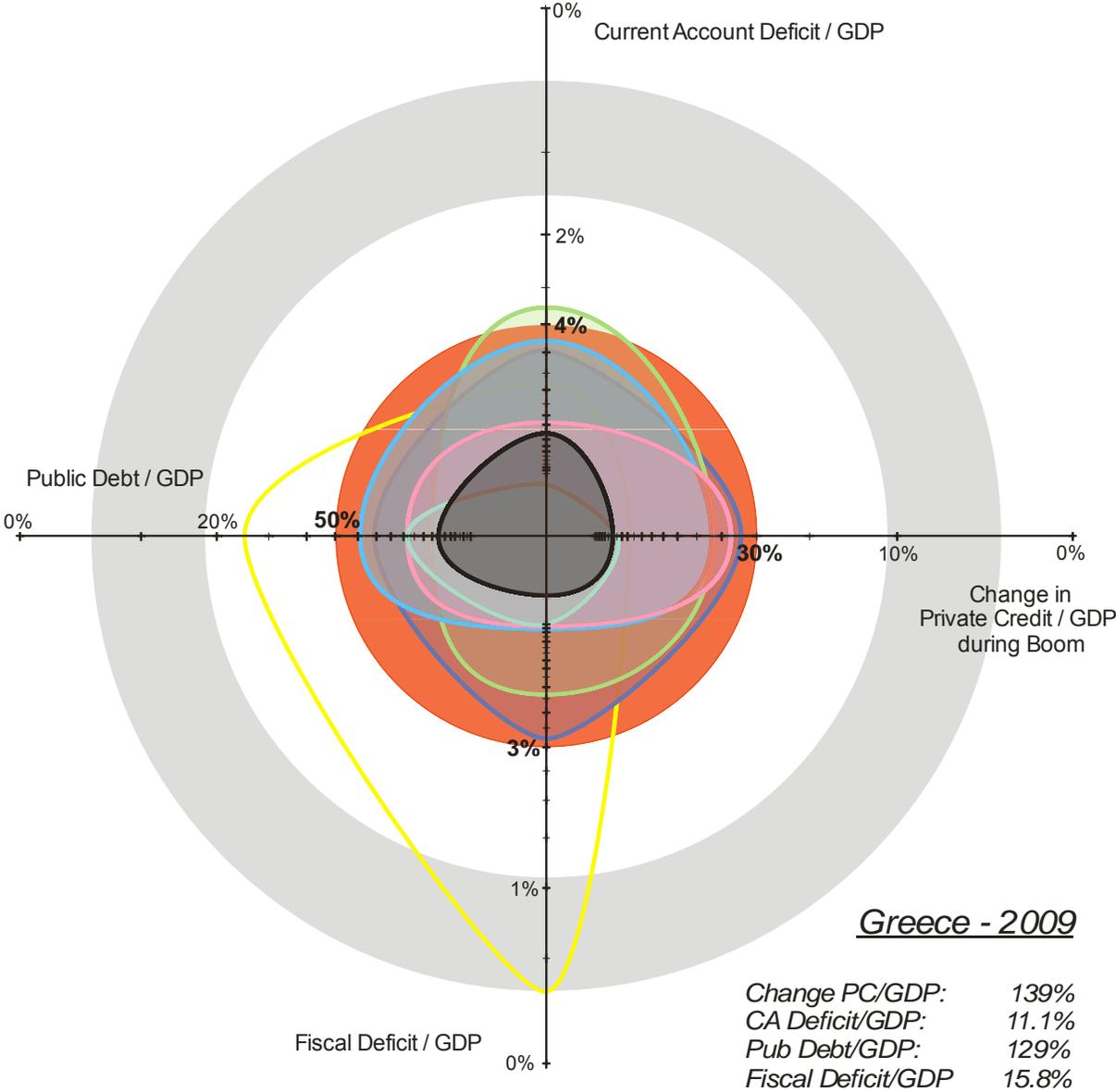
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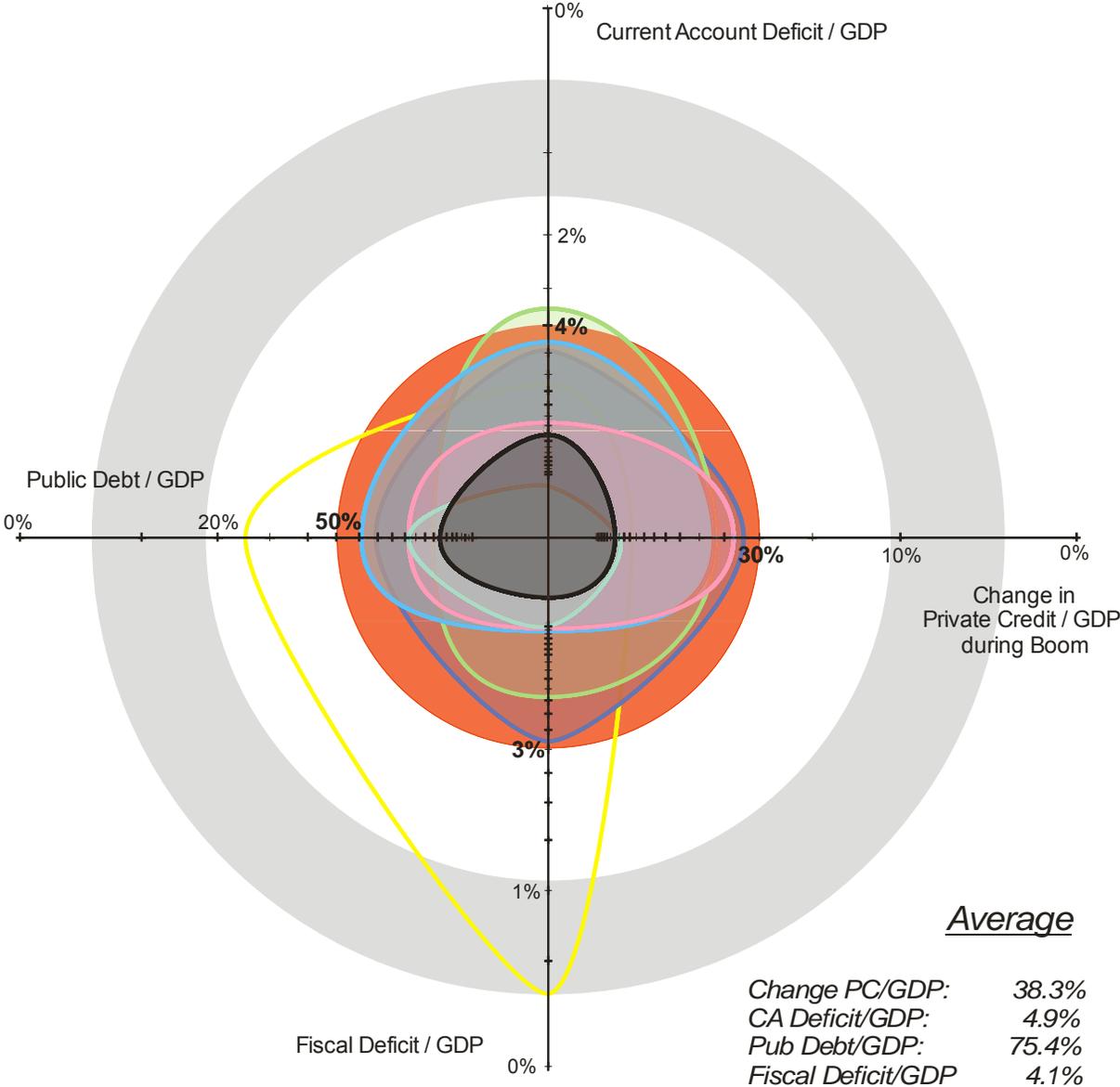
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“GOOD-BYE FINANCIAL REPRESSION, HELLO FINANCIAL CRASH”

THE SEQUENCING OF CRISES

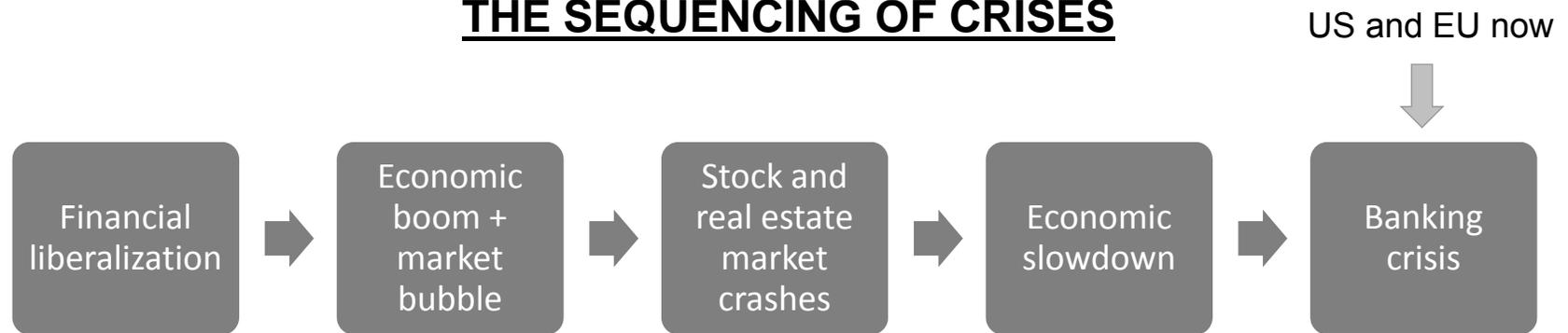
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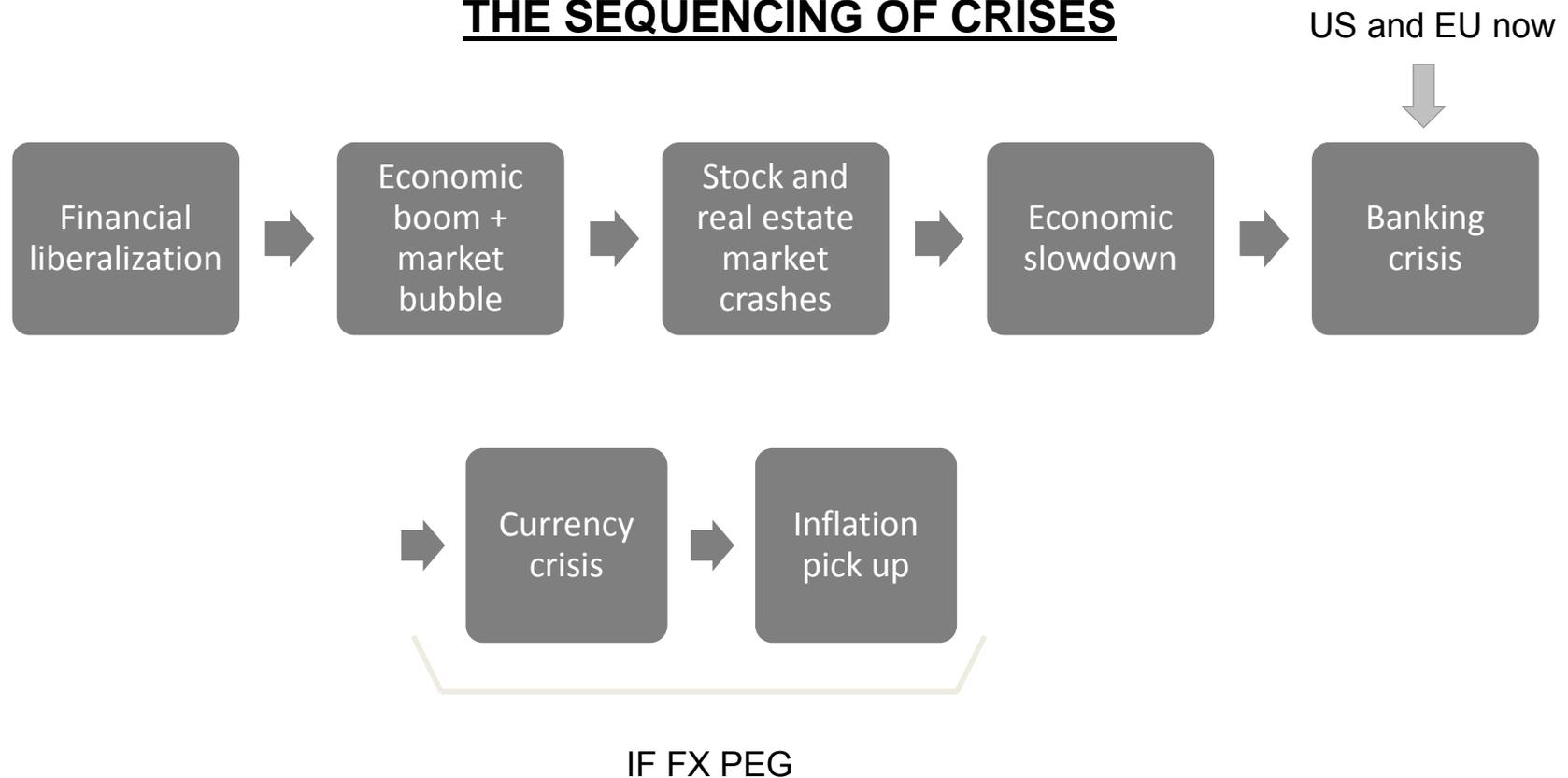
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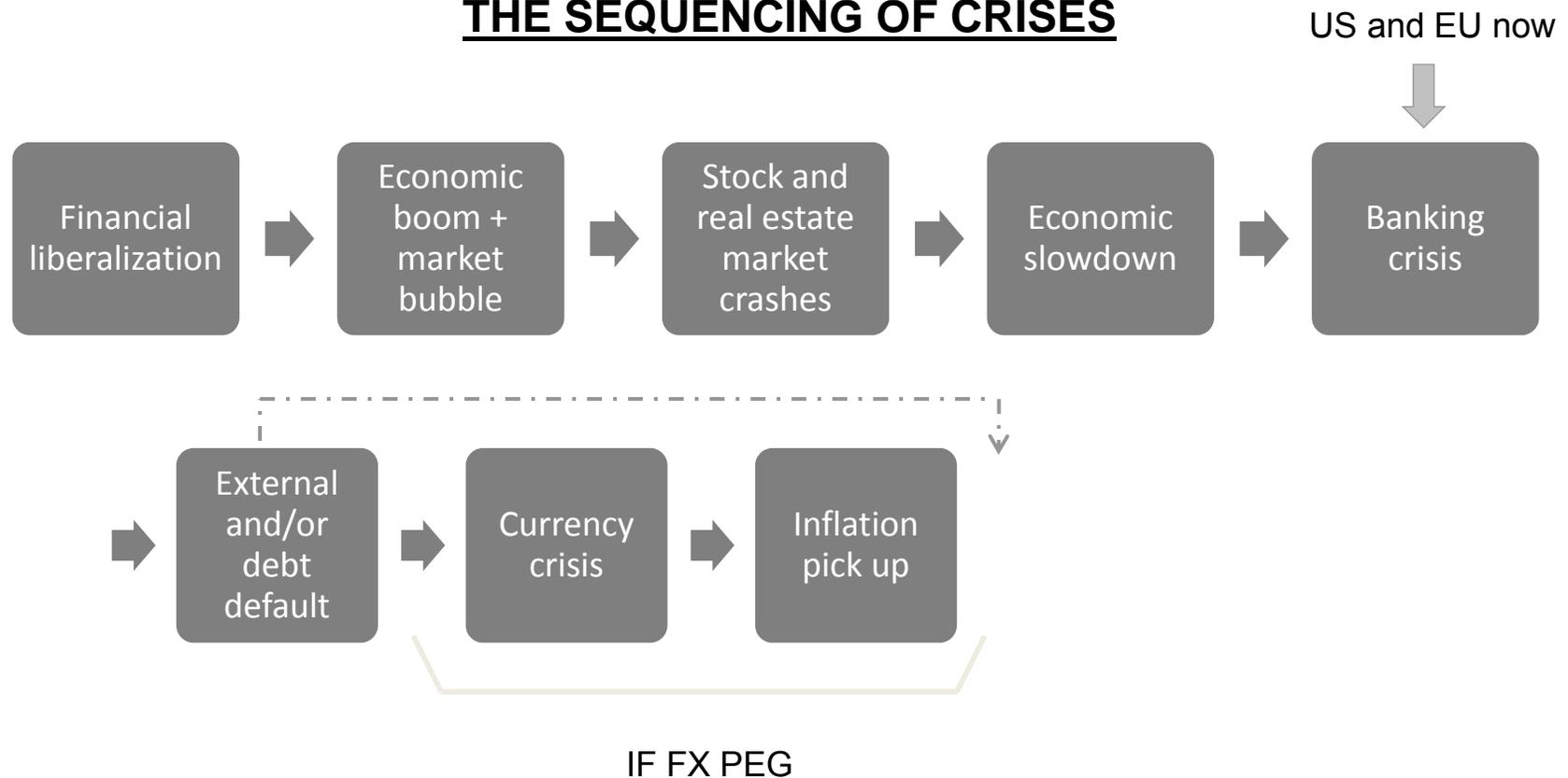
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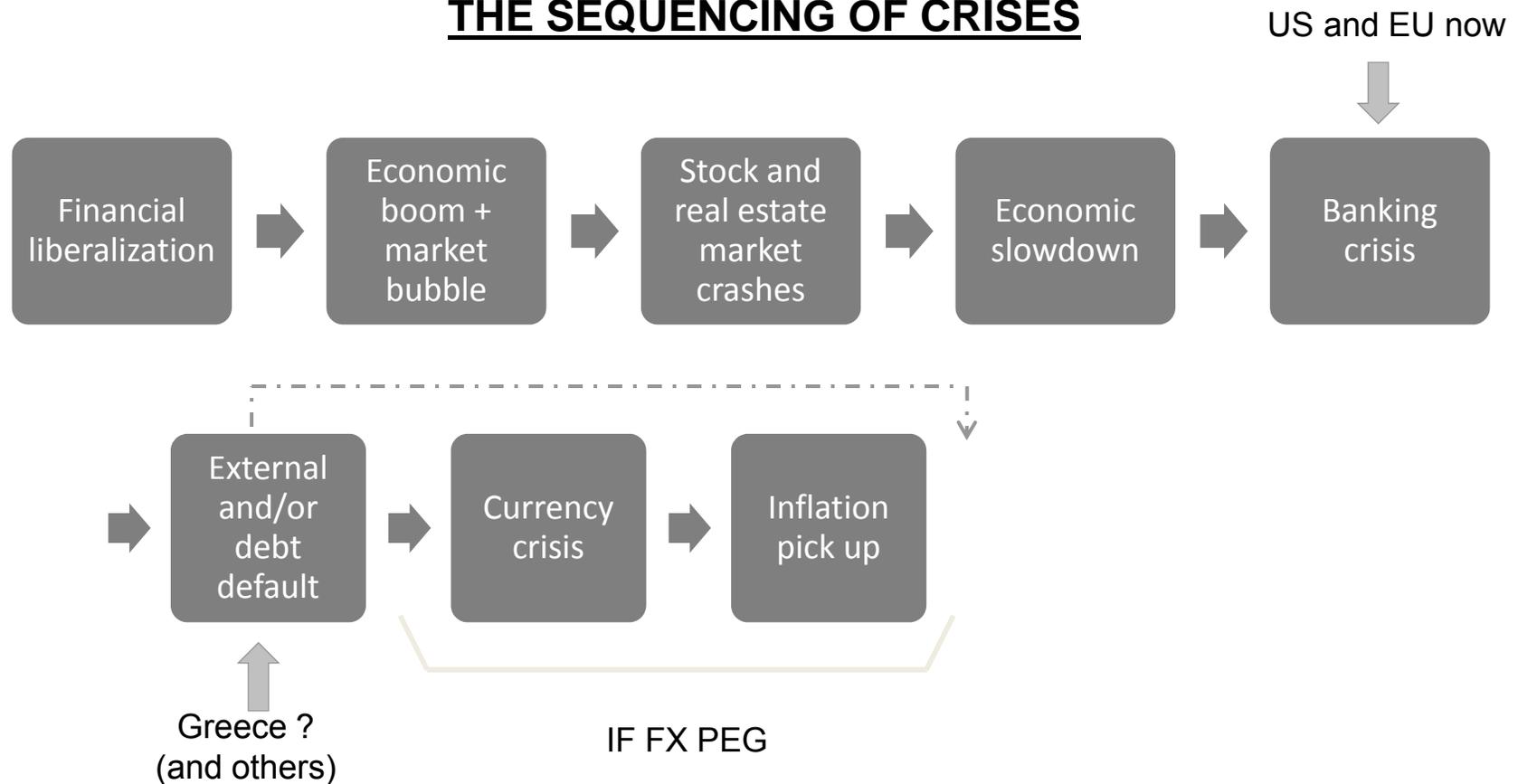
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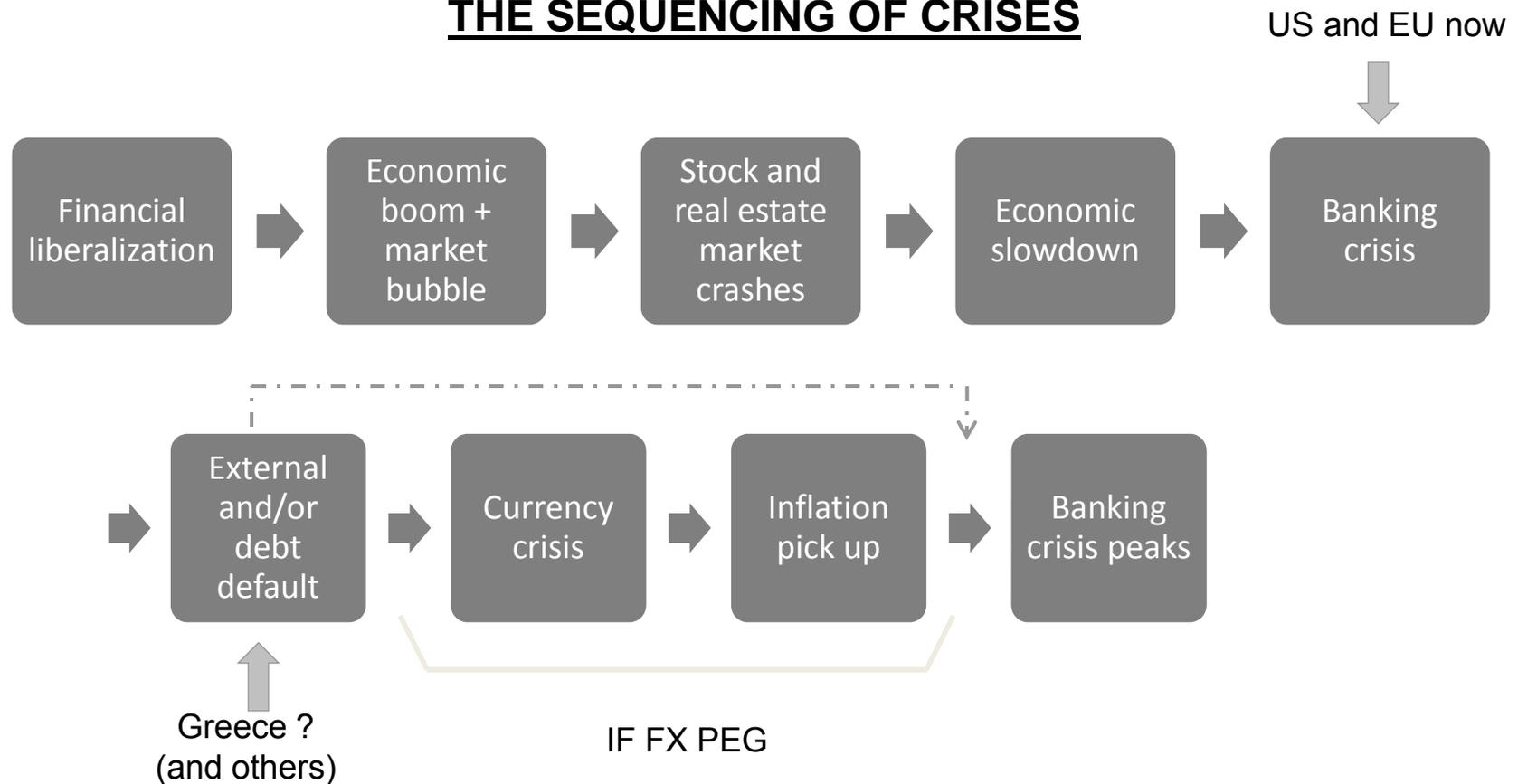
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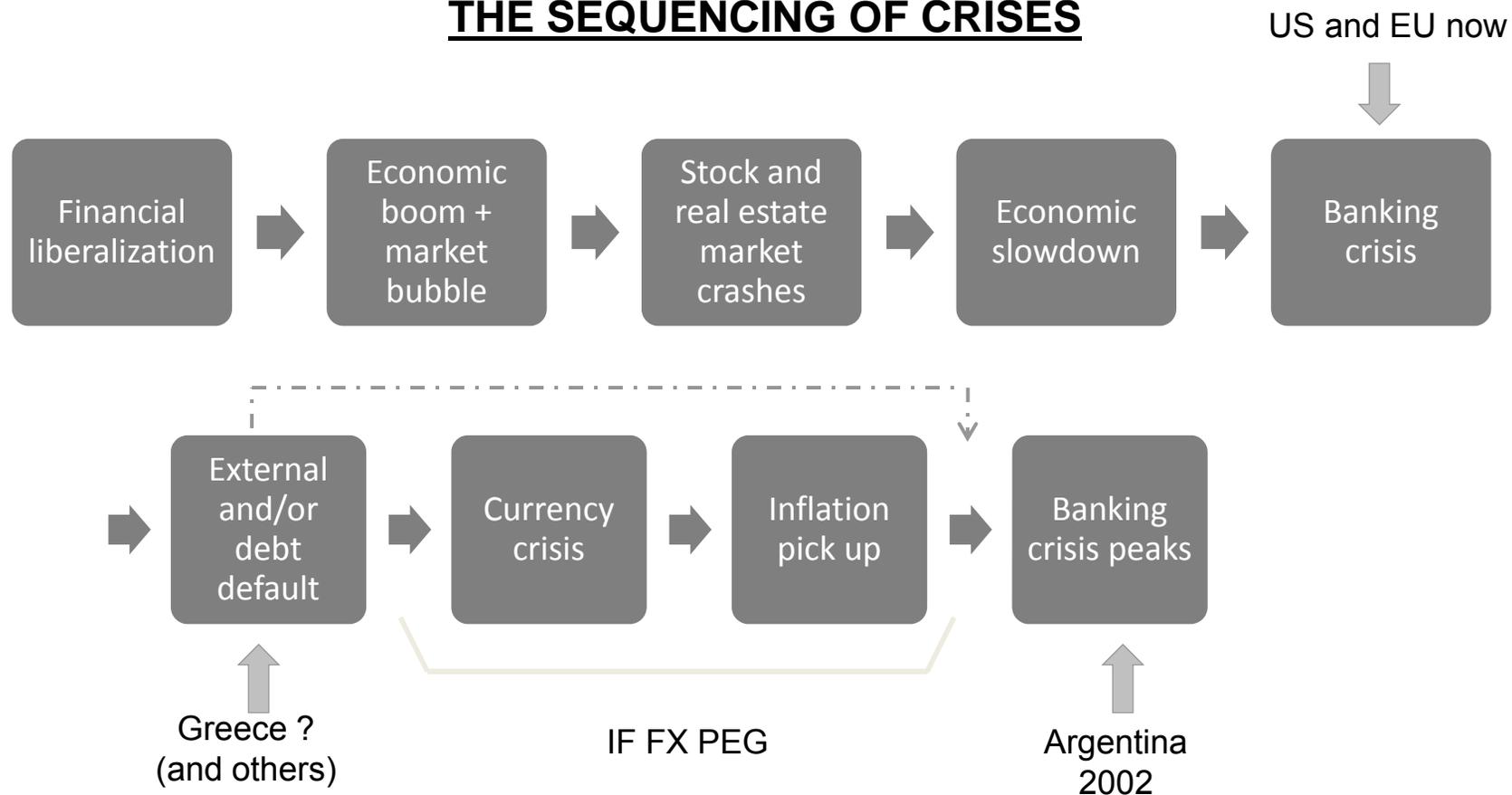
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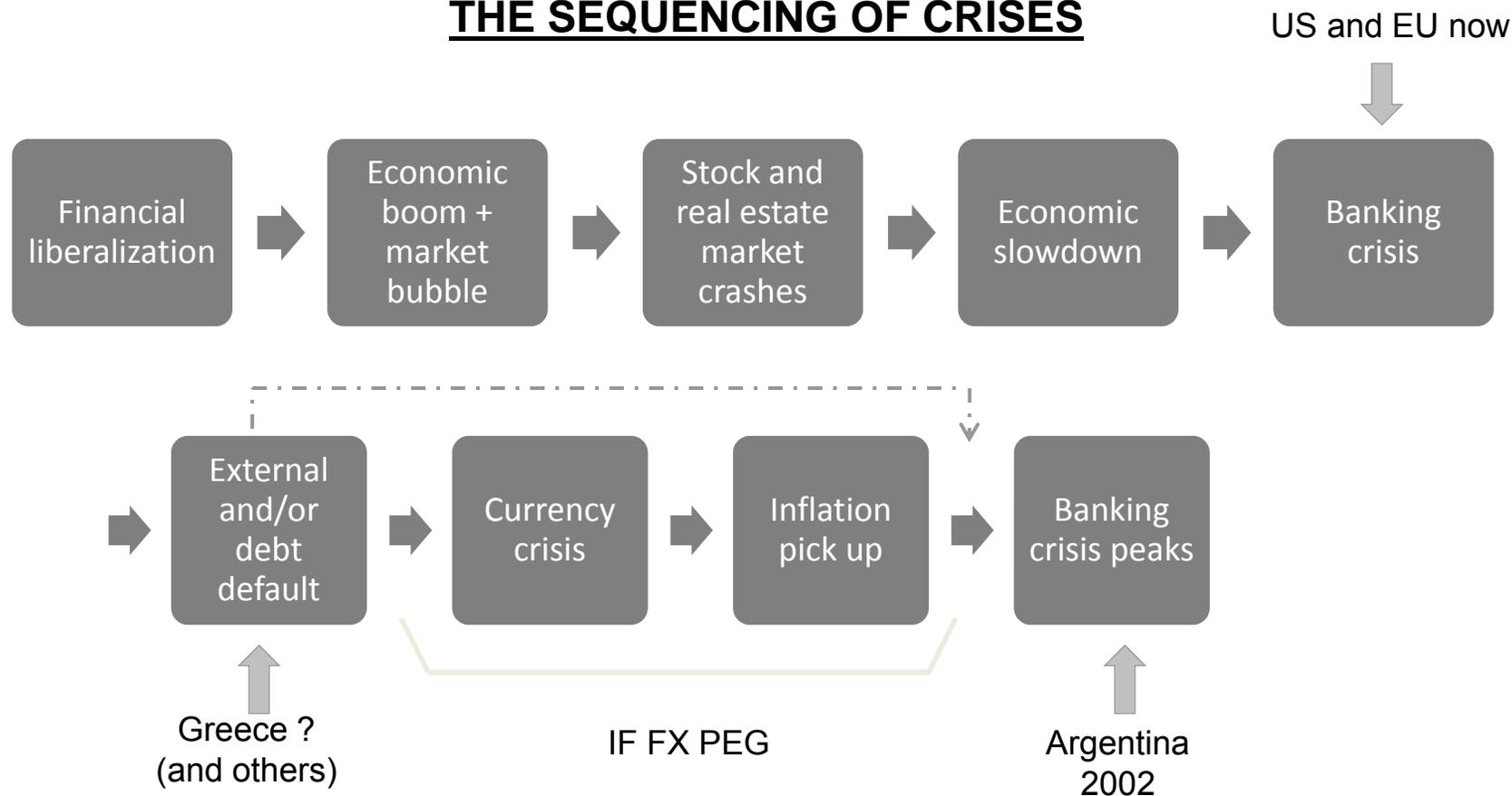
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SOMETHING TO BEAR IN MIND WHEN TRYING TO AVOID THE NEXT CRISIS

STYLIZED LOSSES: US & EU ARE PROBABLY HALF-WAY THROUGH

		The Bill		The Wallet		
Crisis Country	Year	Deposits (1)	NW (2)	Fiscal Bailout (%GDP)	Outside Money (% GDP)	
EM	Mexico	94-95	-15%	-64%	19,3%	11,8%
	Venezuela	94-95	-43%	-6%	15,0%	-1,0%
	Ecuador	98-01	-24%	-59%	21,7%	1,5%
	Korea	97-00	-6%	15%	31,2%	1,3%
	Indonesia	97-00	-13%	-83%	56,8%	6,9%
	Thailand	97-00	-2%	58%	43,8%	5,8%
	Turkey	00-02	-27%	97%	30,5%	2,1%
	Average		-19%	-6%	31,2%	4,1%
Argentina	02-03	-42%	-37%	11,4%	-5,6%	
USA	08- ?	2%		17,2%	-	
EU	08- ?	-25% - 0%		15,9%	6,2% (3)	

(1) Peak to trough

(2) Net Worth Change, two years after the crisis

(3) IMF + Germany (TARGET2 + EFSF)

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CUPBOARDS ARE STILL CROWDED WITH CORPSES

	US (\$ trillion)		EU (€ trillion)	
Government funds allocated to financial system (1)	2,5		1,5	
of which, central banks` rediscounts or swaps	1,2		1,1	
	Est. Loss (\$ trillion)	Est. Loss (%)	Est. Loss (€ trillion)	Est. Loss (%)
Undisclosed Losses (2)	2,08	11%	2,11	8%
European sovereign debt	0,30	50%	0,62	20%
Mortgages	0,87	10%	0,15	4%
MBS	0,17	10%	0,09	9%
Consumer credit	0,11	10%	0,14	10%
Others (derivatives, SIV, CDO, etc.)	0,56	15%	1,13	10%
Final Bill: (1) + (2)	4,6		3,6	
% of GDP	31%		38%	

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DON'T ALWAYS TRUST STRESS TESTS

A REPRESENTATIVE AGENT'S STRESS TEST RESULTS:



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ARGENTINA, CIRCA END 2002

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FISCAL, FINANCIAL, PROVINCIAL AND JUDICIARY DOMINANCE

“ALL YOU NEED IS GROWTH, GROWTH IS ALL YOU NEED”

FOR BOTH SOVEREIGNS AND BANKS ALIKE

Some things we did then				Now useful for
<u>Sovereign Risk</u>	Dic-02	Regulatory target	Reached	
1. Exposure	52%	40% by Jan-06	Sep-04	
2. Valuation	Investment book	Rising benchmark YTM and mark to market by Jun-08	Jun-05	EU Sovereign crisis US Mortgage market?
<u>Solvency</u>	Dic-02	Regulatory target	Reached	
1. Rising CARS	3,50%	8% by 2008	2006	US and EU: Avoid zombie banks
2. Reprogramming rediscounts		70 months @ matching rate	Cancellation before schedule in all cases	EFSF
3. 3-year business plans		Extended from troubled banks to all banks	Monitored quarterly	US and EU: better than stress tests
4. USD loans to non exporters banned				
<u>Liquidity</u>				
1. Deposit unfreeze		Thanks to 2. above	Sep-04: 97% of frozen deposits	
2. Counterparty Risk		Use CB clearing house for settlement of FX operations		TED and OIS-Libor spreads

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THE OLD RULES (AND BALANCE OF POWER) NO LONGER APPLY

A HUNDRED YEARS AGO...

For the immediate future events are taking charge, and the near destiny of Europe is no longer in the hands of any man. The events of the coming year will not be shaped by the deliberate acts of statesmen, but by the hidden currents, flowing continually beneath the surface of political history, of which no one can predict the outcome. In one way only can we influence these hidden currents—by setting in motion those forces of instruction and imagination which change opinion. The assertion of truth, the unveiling of illusion, the dissipation of hate, the enlargement and instruction of men`s hearts and minds, must be the means.

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The Economic Consequences of the Peace (1919)

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