

## TARGET: A Printing Press for Loans in Italy and Spain?<sup>1</sup>

Peter Bofinger

(quotes are translated from German)

The increase of German TARGET-balances to almost one trillion euros led to a heated discussion. Hans-Werner Sinn sees this as a public overdraft between the national central banks of the Euro-system, which has enabled other economies in the euro area to pay a net inflow of goods, services and assets from Germany, without borrowing from the private capital market<sup>2</sup>. Germany had become a self-service store, where one can put everything on the slate at will<sup>3</sup>.

On the other hand, Marcel Fratzscher warns of irresponsible and wrong scaremongering<sup>4</sup>. With reference to Ludwig Wittgenstein, Martin Hellwig speaks of a bewitching of the mind by means of language<sup>5</sup>.

To make the debate more objective, it is helpful to take a closer look at developments in Italy and Spain, the largest TARGET debtors. Italy's TARGET balance turned negative in July 2011 and Spain had a comparatively low negative TARGET balance (minus 45 billion euro) contemporaneously, it seems natural to look at the period starting in 2011.

Is there evidence for an asymmetric credit money creation<sup>6</sup> that could explain the expansion of TARGET balances? Loans by Italian banks to households and companies in June 2018 were around 15 billion euros below the January 2011 level. The decline in Spain is even larger with 60 billion. Thus, it is by no means obvious that TARGET had been used by Italian and Spanish commercial banks as a printing press<sup>7</sup> for loans to the private sector, to provide the latter with the opportunity to buy everything not nailed down<sup>8</sup> in Germany via credit financing.

These findings are in line with Germany's bilateral current account balances vis-à-vis Spain and Italy. In the years 2011 to 2017 the German surplus against the euro area amounted to 418 billion euros, of which Italy accounts for 71 billion and Spain only 36 billion.

In total, both countries report a surplus in their total current account balance in the period from 2011 to 2017. Thus, they were able to finance their bilateral deficit against Germany by surpluses against other countries.

This was different in the boom phase from 2001 to 2007, when Germany's surplus against Spain reached 119 billion euros and against Italy 105 billion euros. At that time, Spanish bank loans expanded with extremely risky rates. People in Spain actually financed their consumption in Germany

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<sup>1</sup> English translation of „Sind die Target-Salden eine „Druckerpresse“ für Kredite“ by Peter Bofinger published in Handelsblatt (<https://www.handelsblatt.com/meinung/gastbeitraege/gastkommentar-sind-die-target-salden-eine-druckerpresse-fuer-kredite/22923492.html>)

<sup>2</sup> „einen öffentlichen Überziehungskredit zwischen den nationalen Notenbanken des Euro-Systems, der es anderen Volkswirtschaften des Euro-Raums ermöglicht hat, ohne am privaten Kapitalmarkt Auslandskredite aufzunehmen, einen Nettostrom von Waren, Dienstleistungen und Vermögenstiteln aus Deutschland zu bezahlen" Sinn, 2018, p. 26

<sup>3</sup> "zu einem Selbstbedienungsladen geworden, in dem man nach Belieben anschreiben lassen kann" Sinn, 2018, p.27

<sup>4</sup> "verantwortungslose und falsche Panikmache" Fratzscher, 2018

<sup>5</sup> "Verhexung des Verstands mit Mitteln der Sprache" Hellwig, 2018

<sup>6</sup> "asymmetrische Schöpfung von Kreditgeld" Sinn, 2018, p.27f

<sup>7</sup> "Druckerpresse" Sinn, 2018, p.28

<sup>8</sup> "was nicht niet- und nagelfest war" Sinn, 2018, p. 30

via credit. However, the TARGET balances were close to zero, as German commercial banks were willing to finance this on a large scale.

If TARGET balances are not related to commercial banks' lending to the private sector and the current account balance, their roots must be elsewhere. It might be useful to take a closer look at the two big TARGET-waves from June 2011 to August 2012 and from January 2015 to June 2018.

In the first period, the TARGET-deficit of Spain and Italy increased by 389 billion euros and 286 billion euros respectively. In the second period, the increase in Spain amounted to 206 billion euros and 316 billion euros in Italy.

In both periods, the increase is largely due to purchases of government bonds. The first TARGET-wave was to avoid a breakup of the euro. For this purpose, the ECB provided the commercial banks with extensive credit lines. Since the bonds were purchased on the secondary market, these purchases did not serve to finance the current deficit.

With the successful verbal stabilization of the euro by Mario Draghi on July 26, 2012 ("whatever it takes"), the bond purchases stopped and the TARGET balances declined noticeably. Due to the recession, this was accompanied with a dramatic slump in Spanish and Italian imports from Germany.

In the second TARGET-wave, the ECB itself, together with the national central banks, purchased government bonds. The resulting TARGET balances must also not be interpreted as granting of credit. The sellers of the bonds did not receive anything free nor did they receive a loan.

Their ability to pay goods, services and assets from Germany<sup>9</sup> was not increased. They could have sold their bonds without the purchasing program by the ECB and spent their proceeds in Germany.

Another contribution to the increase of TARGET balances since 2008 was that German banks reduced their external assets against other euro area countries, which they built up massively from 1999 to 2008. Since the end of 2008, they declined by approximately 390 billion euro. Thus, TARGET allowed German banks to dispose of their excessive exposure in the euro-area without friction. It is therefore a transfer of claims of German banks to a TARGET balance of the Bundesbank.

Thus, it is not true when Sinn claims that through the TARGET system a net-worth of goods and assets of 1000 billion euro was transferred to foreigners without Germany getting back anything with real substance<sup>10</sup>.

The logic of the TARGET system can be illustrated with a simple example. An Investor from the UK sells a Spanish bond to the bank of Spain. The equivalent is transferred to her account at a Spanish bank. She then transfers the amount to her account at a German bank. As a result, the central bank reserves of the German bank increase, while those of the Spanish bank decrease.

As a counter position, the TARGET balance of the Bundesbank increases whereas the TARGET balance of the bank of Spain decreases. Thus, no German assets are being transferred but new assets, namely bank deposits, are created in Germany. These assets did not arise from a loan of the Bundesbank but from a deposit of a foreigner at a German bank.

The fact that international investors hold bank deposits especially at German banks reflects Frankfurt's role as the financial centre of the euro area. For example, German banks' liabilities to the

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<sup>9</sup> „Waren, Dienstleistungen und Vermögenstitel aus Deutschland zu bezahlen" Sinn, 2018, p. 26

<sup>10</sup> "gelangte ein Nettobestand an Gütern und Vermögensobjekten [...] im Wert von 1 000 Milliarden Euro in ausländische Hand, ohne dass wirkliche Substanz [nach Deutschland] zurückkam." Sinn, 2018a

UK increased by up to 150 billion euro during the first TARGET-wave and by 170 billion euro during the second.

What risks arise from this balance sheet extension for the Bundesbank? It does not have any redemption claims for its TARGET-liabilities but there exists also no obligation for redemption of the reserves held at the Bundesbank. If the additional assets and liabilities are denominated in the same currency and have the same maturity, no currency or interest rate risk occurs.

If a country leaves the euro zone, it has to provide the euro-system a liability at its central bank that corresponds to its TARGET-balance, but is denominated in the new national currency. In this case, there exists a currency risk for the Bundesbank, similar to the situation after the collapse of the Bretton-Woods system. A settlement of balances, e.g. in gold or US dollar, would contradict the logic of the monetary system since the abandonment of the gold convertibility of the US-Dollar in August 1971, according to which central bank money is generally irredeemable.

This must also apply to central bank money created by bond purchases. Thus, one cannot claim redemption of the TARGET balance by the Banca d'Italia, just because the central bank money it created by buying government bonds was used for transfers of deposits outside Italy.

For some TARGET critics, the underlying intention seems to be the end of the European Monetary Union. This could be achieved quickly by installing the upper limits for TARGET balances that they demand. A stop of cross-border transfers between member states, which would eliminate the convertibility of euro balances held in each member state, would be the end of the euro.

Hans-Werner Sinn is already happily speculating about the time after the euro. If this was followed by an appreciation beyond the desired level, the Bundesbank could follow the model of the Swiss central bank and purchase an international asset portfolio to effectively prevent the appreciation<sup>11</sup>. With this policy, the Swiss National Bank has accumulated around 700 billion euros in foreign currency reserves, which it mainly invests in foreign government bonds.

Relative to the economic strength of Germany, such an intervention policy could result in a Bundesbank portfolio with almost 4,000 billion euros invested in foreign government bonds. Then we would think back to the TARGET balances wistfully.

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<sup>11</sup> "Wenn es dann zu einer Aufwertung zu kommen droht, die über das gewünschte Maß hinausgeht, könnte die Bundesbank nach dem Muster der Schweizer Notenbank verfahren und [...] ein internationales Vermögensportfolio zusammenkaufen, um den Kursanstieg wirksam zu verhindern." Sinn, 2018, p. 37

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