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The ECB's Target2 Lies - Exposing The Real Capital Flight From Italy & Spain

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The ECB claims that Target2 does not represent capital flight. **Evidence says the ECB is wrong, especially for Italy and Spain.**

I have discussed this previously, but let's recap Target2 before taking a look at new charts.

Project Syndicate writer, **Hans-Werner Sinn, explains why the ECB's asset purchases and Target2 imbalances constitute "Europe's Secret Bailout".**

> Under the ECB's QE program, which started in March 2015, eurozone members' central banks buy private market securities for €1.74 trillion ($1.84 trillion), with more than €1.4 trillion to be used to purchase their own countries' government debt.
>
> **The QE program seems to be symmetrical because each central bank repurchases its own government debt in proportion to the size of the country. But it does not have a symmetrical effect, because government debt from southern European countries, where the debt binges and current-account deficits of the past occurred, are mostly repurchased abroad.**
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> For example, the Banco de España repurchases Spanish government bonds from all over the world, thereby deleveraging the country vis-à-vis private creditors. To this end, it asks other eurozone members' central banks, particularly the German Bundesbank and, in some cases, the Dutch central bank, to credit the payment orders to the German and Dutch bond sellers. *Frequently, if the sellers of Spanish government bonds are outside the eurozone, it will ask the ECB to credit the payment orders*.
>
> In the latter case, this often results in triangular transactions, with the sellers transferring the money to Germany or the Netherlands to invest it in fixed-interest securities, companies, or company shares. Thus, the German Bundesbank and the Dutch central bank must credit not only the direct payment orders from Spain but also the indirect orders resulting from the Banca de España's repurchases in third countries.
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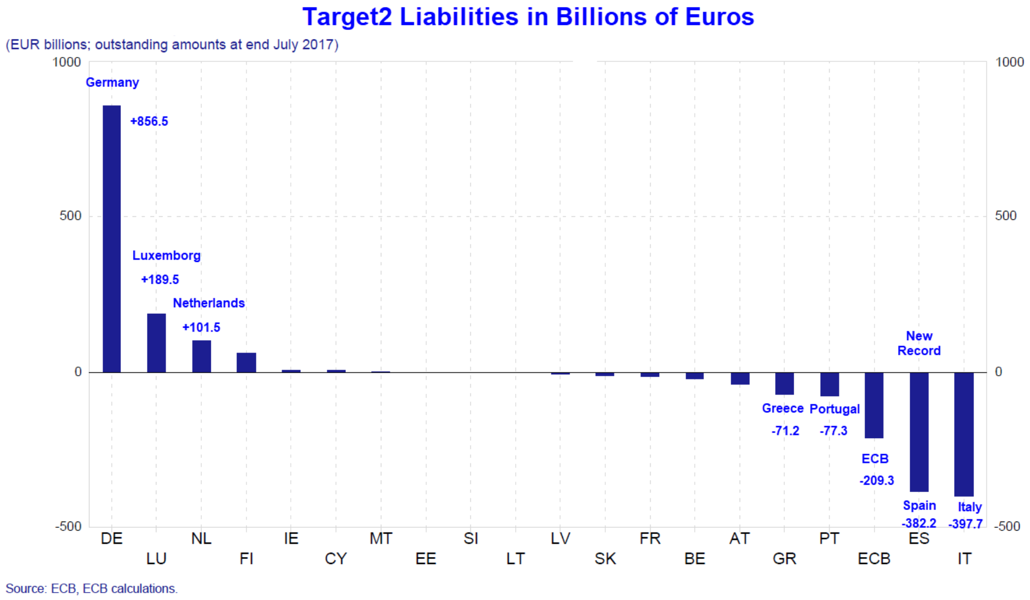
> **The payment order credits granted by the Bundesbank and the Dutch central bank are recorded as Target claims against the euro system.**
>
> For the GIPS countries [Greece, Italy, Portugal, and Spain], these transactions are a splendid deal. They can exchange interest-bearing government debt with fixed maturities held by private investors for the (currently) non-interest-bearing and never-payable Target book debt of their central banks – institutions that the Maastricht Treaty defines as limited liability companies because member states do not have to recapitalize them when they are over-indebted.
>
> **If a crash occurs and those countries leave the euro, their national central banks are likely to go bankrupt because much of their debt is denominated in euro, whereas their claims against the respective states and the banks will be converted to the new depreciating currency.** The Target claims of the remaining euro system will then vanish into thin air, and the Bundesbank and the Dutch central bank will only be able to hope that other surviving central banks participate in their losses. At that time, German and Dutch asset sellers who now hold central bank money will notice that their stocks are claims against their central banks that are no longer covered.

Target2 Liabilities



A quick perusal of Target2 Balances for January shows **capital flight has largely stabilized but the imbalance in Spain hit a new record.**

ECB's Story on Target2 Doesn't Add Up

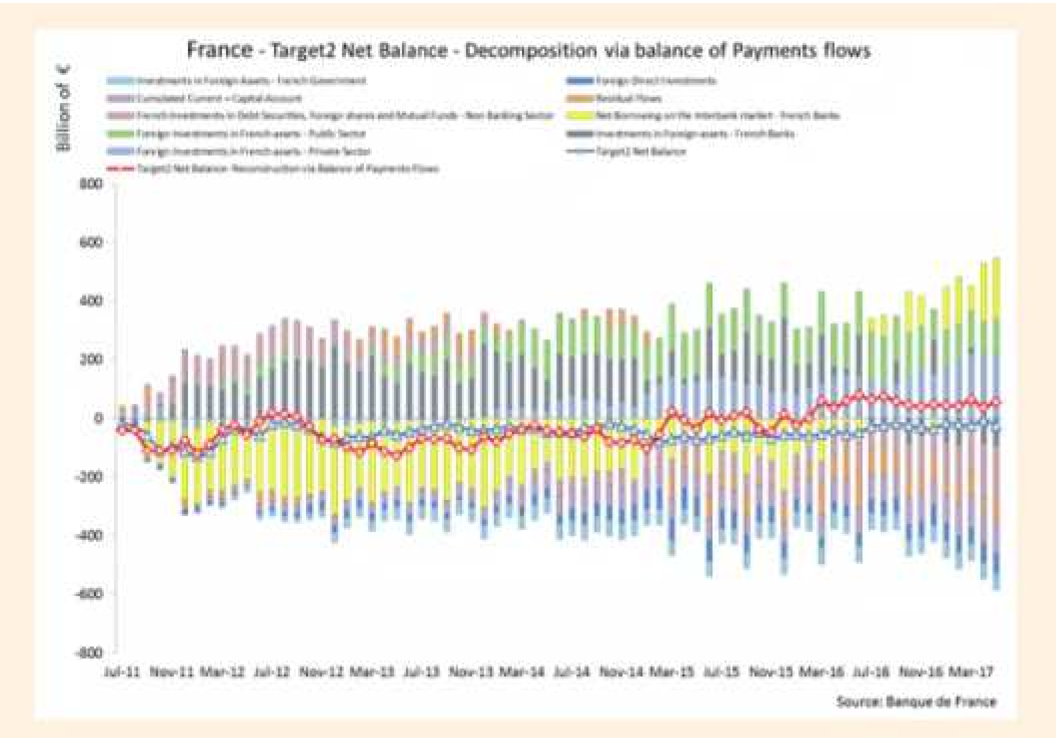
Financial Times Alphaville guest writer Marcello Minenna makes a case in pictures for what I have long stated.

It's interesting to note that Minenna is the head of Quantitative Analysis and Financial Innovation at Consob, the Italian securities regulator.

Minenna says the ECB's Story on Target2 Doesn't Add Up

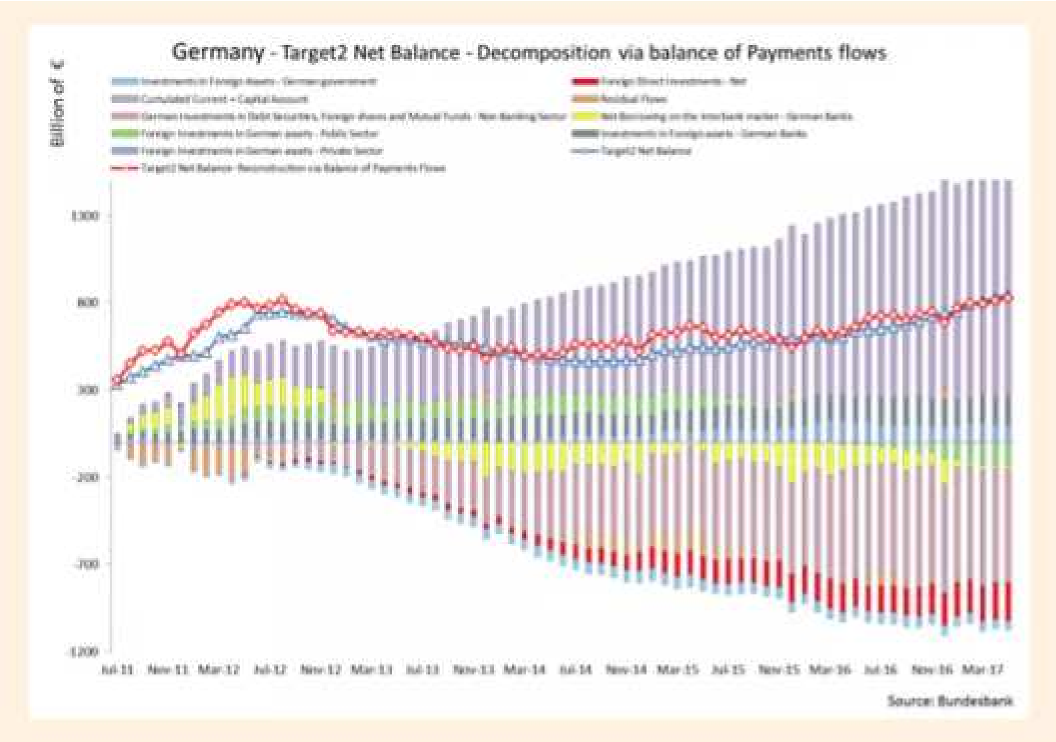
Minenna compares France with its stable Target2 balance to Italy and Spain.

France Target2 Over Time

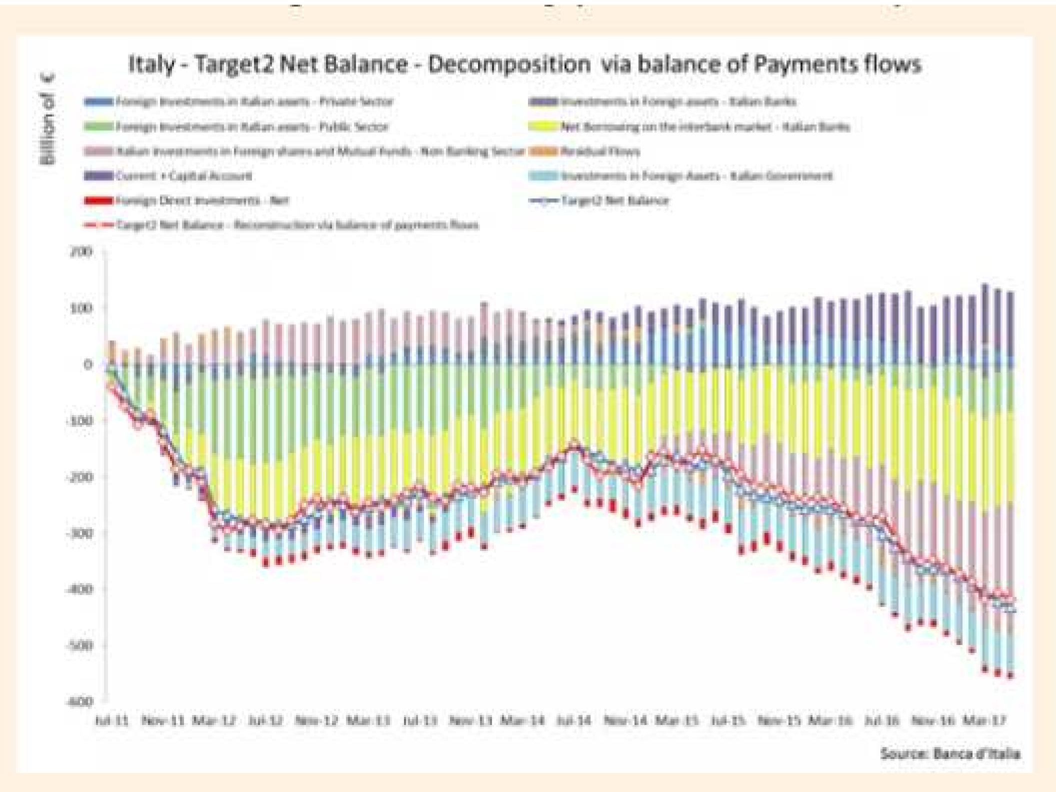


The red line with dots represents the imbalance. As of July France had a Target2 liability of 12.2 billion. **France shows no correlation to ECB asset purchases.**

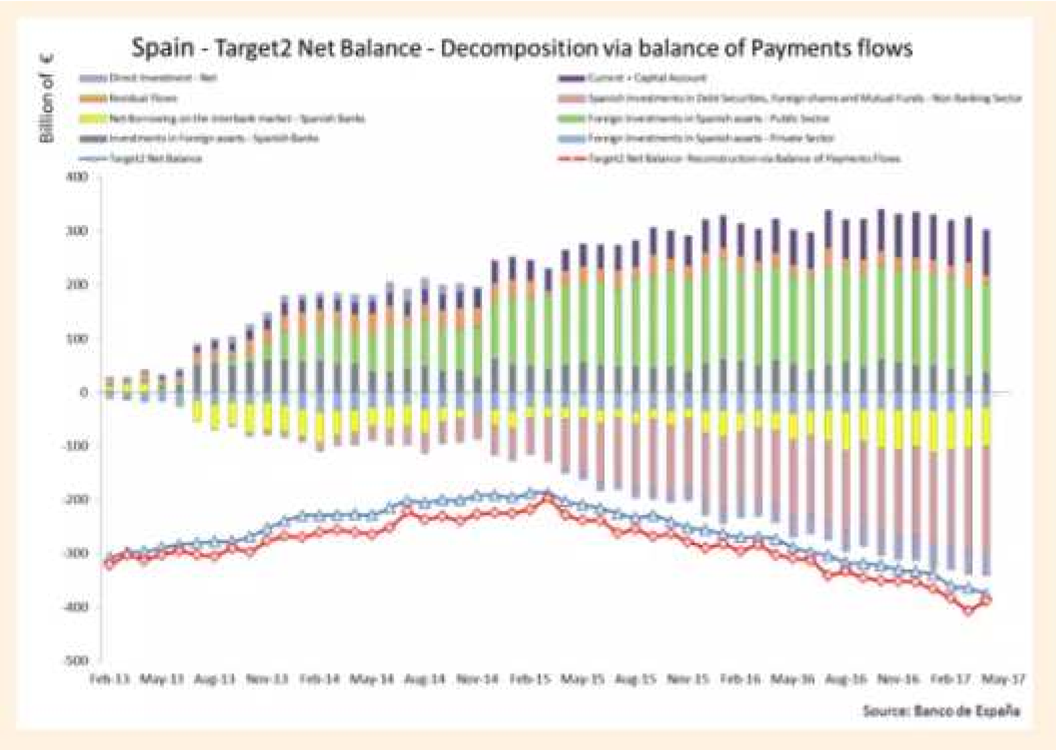
Germany Target2 Surplus



Italy Target2 Liability



Spain Target2 Liability



Minenna goes over what various colored bars represents and concludes ***"For Italy and Spain, the QE programme has facilitated capital outflows by domestic investors. Elsewhere, it has not."***

This is what I concluded long ago. *For discussion, please see Target2 and Secret Bailouts: Will Germany be Forced Into a Fiscal Union with Rest of Eurozone?*