The Eurozone and the Economic Crisis: An Innovative SWOT analysis

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Abstract

The euro area debt crisis, which began in early 2010 in Greece, will become existential in 2012, since unemployment is reaching new highs and business and consumer confidences have worsened as recession fears looms. Whether the area and the common currency survive this crisis will be a matter of how the political class learns to cooperate among themselves, how society deals with economic measures, and if the markets stop being shortsighted and focus on the long-term.

The purpose of this paper is to use a SWOT analysis to present how this crisis has affected the Eurozone by studying the weaknesses and threats that the project is facing, as well as which opportunities and strengths this crisis might bring if politicians, society, and markets work together to overcome the situation.

This paper will highlight that the main strength of the project rests on the attitude of society that is, up to this point, silently coping with a very difficult economic situation and tough restructuring measures that are negatively affecting their purchasing power and living standards. The paper will also elaborate on how the role of the European Central Bank is the Eurozone's main weakness. This crisis has shown that there are plenty of opportunities for the Eurozone to become the political and economic power that the founding fathers envisioned, if the fiscal pact is implemented and governments improve their finances. However, there are a number of threats, the most important being the high price of oil, which may hinder recovery.

Introduction

The euro is facing an economic crisis and its survival depends on a number exogenous and endogenous factors. More importantly, the possibility of an economic recovery is fading and the region is feeling the economic, social, and political pains of recession. However, the Eurozone is not the only area suffering economic sluggishness. The International Monetary Fund (IMF) has announced a lower forecast for global growth in 2012 and it explains that

> "*World Economic Outlook* (WEO) projections indicate that global growth will moderate to about 4 percent through 2012, from over 5 percent in 2010. Real GDP in the advanced economies is projected to expand at an anemic pace of about 1½ percent in 2011 and 2 percent in 2012, helped by a gradual unwinding of the temporary forces that have held back activity during much of the second quarter of 2011."[1] (2011, XV)

Summary of Events	
1992 – Feb 7: Maastricht Treaty is signed	2010—March 18: Papandreu asks EU members to come up with a financial aid plan within a week
1992 – Sept 16: The European Exchange Mechanism faces problems with the UK forced to leave	2010—April 12: Eurozone member states agree to provide up to 30bn euros in loans to Greece for the next year. The IMF agrees to provide additional 15bn euros in funds
1996 – Dec 13: EU leaders agree on the Stability Pact	2010—April 21: Greece begins talks to receive financial help to face 8.5bn euros in bond redemptions due the following month
1999 – Jan 1: The euro is created with 11 countries	2010: April 22: Greece's budget deficit is 13.6% of GDP – more than previously forecasted
2001- Jan 1: Greece enters the euro	2010: April 23: Greek government officially asks for a bailout from the EU and the IMF
2003—Nov 24: Germany and France override EU budget rules for the third year	2010—May 2: Greece is granted a 110bn euro rescue package for a 30 billion euro in austerity measures over the next 3 years
2005—March 20: The Stability and Growth Pact is relaxed	2010—May 9 &10: EU finance ministers agree to set up a 750bn euros rescue mechanism named the European Financial Stability Facility (EFSF)/ The initial capital is of 440bn euros
2008—Sept 15: Lehman Brothers files for bankruptcy	2010--Nov 14: The Irish government says Ireland does not need a bailout
2009—Oct 20: Newly elected Greek government discovers that the deficit	2010—Nov 21: Ireland applies for a bailout

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[1] World Economic Outlook at http://www.imf.org/external/pubs/ft/weo/2011/02/pdf/text.pdf (accessed February 2012).

will be 12.5% of GDP	
2010—Jan 21: The Greek government explains Greece will not need a rescue package	2010—Nov 24: Ireland gets 85bn euro bailout
2010—Feb 2: Greece announces its austerity package to get a deficit in line with the requirements in 2012	2011—March 21: The EU finance ministers agree on a permanent bailout mechanism—the European Stability Mechanism – with a lending capability of 500bn euros starting in 2013
2010—Feb 11: EU leaders have an emergency meeting and agree to take actions to protect the financial stability of the euro	2011—April 6: Portuguese Prime Minister requests EU bailout which is granted on May 18 for 78bn euros

The Strength: Euro Skepticism and Social Unrest

The scale and persistence of the economic crisis that is affecting the European Union for the past three years is taking a toll on European public opinion. Two main questions are at stake. First, how this economic crisis has affected public opinion on the role of the euro must be analyzed. Second, how the need for economic reforms is affecting European public opinion on the project.

This section uses the findings of the Eurobarometer 75[2] (Spring 2011) to conclude that society is blaming the euro. The single currency is not perceived as a tool that has helped overcome the effects of the crisis. However, society agrees that the reforms undertaken by most of the countries and the reforms that are to come are very much needed in order to solve the current and future economic and fiscal problems. Most importantly, society understands that these measures are needed to put the countries on the path to recovery. This attitude shows that society understands the problems and is ready to endure the painful reforms. This is the biggest strength of the European project.

More than half the interviewees—51%--think that the euro has not cushioned the effects of the economic crisis, while 37% defend the role of the single currency. The Eurobarometer shows that the residents of the Eurozone are much more likely to agree that the euro has had a cushioning effect (42%) than those outside of it (30%). It is interesting to point out that countries with economic problems such as Greece and Portugal believe that the euro has not been able to cushion the effects of the economic crisis. Also, the United Kingdom, due to its euro skepticism, disagrees with the view that the euro has cushioned the effects of the economic crisis quite significantly.

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[2] Eurobarometer .2011. *Europeans, the European Union and the Crisis*. 75 (spring) at http://ec.europa.eu/public_opinion/archives/eb/eb75/eb75_cri_en.pdf (accessed February 2012).

QC4 Could you tell me whether you totally agree, tend to agree, tend to disagree or totally disagree with the following statement: Overall the euro has cushioned the effects of the economic crisis.

	Total 'Agree'	Diff. Sp.2011 - Aut.2010		Total 'Disagree'	Diff. Sp.2011 - Aut.2010
EU27	37%	-2	EU27	51%	+3
Euro zone	42%	-1	Euro zone	50%	+2
Non-Euro zone	30%	+1	Non-Euro zone	51%	+1
RO	38%	+7	BG	42%	+10
UK	24%	+5	HU	51%	+10
LV	32%	+4	EL	60%	+8
EE	40%	+3	LU	50%	+8
FR	32%	+3	PT	50%	+8
AT	56%	+3	FI	42%	+8
:	:	:	CY	61%	+7
SI	34%	-6	SI	63%	+7
PT	42%	-7	SE	60%	+7
EL	38%	-8	:	:	:
CY	33%	-8	FR	62%	-2
HU	40%	-8	LV	51%	-3
LU	43%	-9	UK	58%	-4

Source: EUROBAROMETER .2011. *Europeans, the European Union and the Crisis*. No 75 (spring).
http://ec.europa.eu/public_opinion/archives/eb/eb75/eb75_cri_en.pdf

Some of the last Eurobarometers have shown that Europeans are very understanding of the fact that governments must make painful reforms in order to reduce public deficit and debt. In fact, the results show that in autumn 2010 more than three out of four Europeans agreed with and understood that there were certain measures needed to be taken in order reduce the public deficit and debt of their country. More importantly, they understood that these reforms could not be delayed. It is also interesting to note that "respondents in the euro zone are more likely (79%, compared to 73% outside) to think that the measures to reduce the public deficit and debt of their country cannot be delayed."[3]

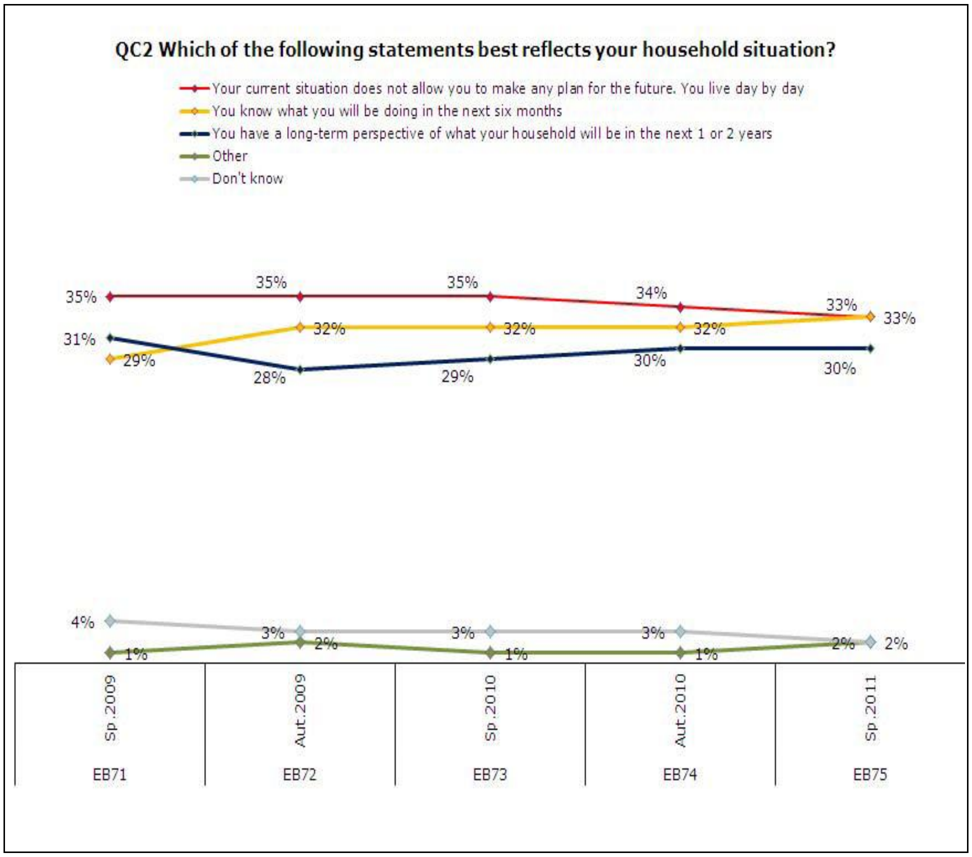
It is important to mention that 63% of Europeans believe that the European Union has sufficient power and tools to face up to international economic competition. The autumn 2010 Standard Eurobarometer aimed at establishing Europeans' opinions on how to improve the performance of the European economy. The result shows that public concern lies with education and training, entrepreneurship, and restoring order to public finances. It is interesting that the results are almost the same in the three groups: EU27, Euro zone, and Non-Euro zone countries.

[3] Eurobarometer .2011. Europeans, the European Union and the Crisis. 75 (spring) at http://ec.europa.eu/public_opinion/archives/eb/eb75/eb75_cri_en.pdf (accessed on February 2012).

QC5 Which three initiatives could most improve the performance of the European economy?	EU27	Euro zone	Non-Euro zone
Improve education and professional training	48%	50%	44%
Make it easier to set up a business	34%	35%	32%
Reduce public deficits and debt	34%	35%	32%
Invest in research and innovation	29%	33%	21%
Use energy more efficiently	25%	24%	26%
Strengthen regulation of financial markets	21%	22%	19%
Make it easier for companies to access credit	20%	22%	17%
Invest in environmentally friendly products and services	15%	15%	13%
Invest in transport (motorways, railways, etc.)	11%	8%	17%
Increase the number of working hours	6%	7%	6%
Increase the retirement age	5%	4%	5%

Source: EUROBAROMETER. 2011. *Europeans, the European Union and the Crisis*. No 75 (Spring). http://ec.europa.eu/public_opinion/archives/eb/eb75/eb75_cri_en.pdf.

Despite the current economic crisis and the uncertainty that it causes, one third of respondents thought that their current economic situation does not enable them to make any plans for the future, while another third answered that they did not know what they will be doing in the next six months. Further, the percentage of people who believe that the current situation did not allow them to make any plans for the future remains almost the same: 35% of the people in the spring 2009 compared to the 33% in the spring 2011 report. However, the percentage of people who knew what they will be doing in the next six months increased from 29% in spring 2009 to 33% in spring 2011. Finally, 31% of Europeans have a long-term perspective on what their household will be in the next year or two, a percentage which has dropped to 30%. I believe that these variations are not significant, given the current economic crisis and financial uproar that has shaken the foundations of the project.



Source: EUROBAROMETER. 2011. *Europeans, the European Union and the Crisis*. No 75 (spring). http://ec.europa.eu/public_opinion/archives/eb/eb75/eb75_cri_en.pdf.

European society is showing its "maturity", as 80% of the respondents understand that making excruciating reforms is a necessary measure that will benefit future generations. However, when the idea of reforms is expected to reduce the current living standards to guarantee the living standards of future generations, these measures are not that welcome and society is equally divided, as 50% support this statement and 45% disagree. However, the urgent reforms needed to help the country face current and future challenges are widely accepted (86%).

The Weakness: The European Central Bank

The Eurozone's debt crisis is sending the area into a second recession and, as a consequence, the European Central Bank is taking action. The sudden collapse of economic indicators, particularly of industrial activity and services, and the financial instability in Europe in the last quarter of 2011 induced the ECB to inject an unprecedented amount of liquidity into the financial system in

December 2011. The result was the expected; the liquidity has revived certain economic indicators which are now suggesting that the Eurozone might be able to avoid the worst case scenario: the collapse of the banking system.

However, this action might have two weak points. On the one hand, it shows that the only help the Eurozone is receiving is directed at the banking system. In other words, the resources of the European economy are selectively concentrated in saving the banking sector hoping this will trickle down into society; so far, this has not been the case. This intervention does not tackle the need to implement a radical reform of the monetary and financial sector. Instead, these are just patches of dubious value that only allow the ECB to gain time, and that is costing a lot of money.

The second weakness lies in the fact that the ECB is funded by member states. In other words, the capital used to intervene in the market "belongs" to member states. In more detailed fashion, "the capital of the ECB comes from the national central banks (NCBs) of all EU Member States. It amounts to €10,760,652,402.58 (as of 29 December 2010) … the net profits and losses of the ECB are allocated among the euro area NCBs in accordance with Article 33 of the Statute of the European System of Central Banks and of the European Central Bank."[4] Since the beginning of the Greek crisis up to August 2011, the European Central Bank has already spent 77,000 million euros to acquire sovereign debt from the Greek, the Portuguese, and the Irish in the secondary market and it is still actively buying securities to alleviate the pressure. If Greece, or any other country for that matter, defaults on its sovereign debt, the ECB will take a direct heavy toll which will be passed on to nation states.

The European Central Bank has proved to be an institution that can easily adjust and cope with the necessities of each moment. Since its creation, the ECB has had three Presidents. Win Duisenberg was in charge for the first four years, but it was Jean Claude Trichet who has done the most to strengthen the institution by endowing the Bank with a more transparent communication policy and making sure it achieved an internal cohesion that has been helpful in the goal of speaking with one voice. His main task up until the break of the Greek sovereign crisis was to maintain inflation under control at an average of 2%. This has not been a big struggle. The "sacrifice ratio" was very high and it has always been debated if the ECB should have allowed for higher inflation in exchange for more growth and employment. The mandate to maintain inflation under control forced Trichet to raise interest rates in 2008 and 2011, two actions that he has confessed regretting, particularly since it has been demonstrated that the need to control inflation did not prevent the creation of a real state bubble in countries such as Spain and Ireland while growth was stalled. In fact, the Taylor Rule has shown that the price of money was totally inappropriate between 2001 and 2007 in the Eurozone: the periphery countries should have interests of around 5%,

[4] European Central Bank Website at
http://www.ecb.int/ecb/orga/capital/html/index.en.html (accessed February 2012)

while hard core countries such as northern European countries should have the interest rate set between 2-4%.

However, the debt crisis made Trichet take steps that have divided the institution, and there have lately been dissidents within the ranks such as Axel Weber, President of the German Bundesbank, in January 2011 and Jurgen Stark, ECB Chief Economist in September 2011, for their disagreements with Trichet's bond purchasing policy. In October 2011, Mario Dragui became the President of the European Central Bank. Dragui's understanding of the economy and the multiple challenges that the Eurozone and the EU project is facing is leading him to change the course of action in the ECB. The EBC had been, up to Dragui's arrival, extremely conservative, mainly because the economic situation up to the current crisis did not require any bold monetary policy. Since mid-2011, the economic situation has gotten more complicated and the new President had no other option but to press forward with more drastic measures.

Since the last regular hearing in October with former President Trichet and now under Dragui, the ECB has taken a number of steps to ensure that it will continue to deliver price stability in the medium term in an environment that remains very challenging. These steps relate both to changes in our interest rates and to non-standard measures. To begin with, the ECB has changed interest rates. The Governing Council decided in early December to lower the key ECB interest rates by 25 basis points, following an additional 25 basis points decrease which took place on November 3rd, 2011. These measures were taken despite the fact that inflation was 3.0% in November 2011 and it is expected to stay above 2% for several months to come. The second measure that has been taken was to change the non-standard monetary measures in order to attempt to prevent a credit crunch and provide banks with access to funding markets. In order to attain these goals, the ECB has taken a number of measures. The most important of all has been the agreement on a three-year refinancing operation to support the supply of credit to the euro area economy. The purpose of this measure was to tackle the risk that financial markets tensions might affect the capacity of the euro area banks to obtain refinancing over longer horizons. That is, the ECB wants to ensure that banks continue to have access to stable funding, also at longer maturities, which gives them the ability to continue lending to firms and households.

Another problem that the ECB has been trying to fix is the fact that some banks have difficulties accessing refinancing operations because they are lacking eligible collateral. In order to solve this situation, the ECB agreed not only on a temporary expansion of the list of collateral, but also intends to enhance the use of bank loans as collateral in Eurosystem operations. These measures should support bank lending by increasing the amount of assets on euro area banks' balance sheets that can be used to obtain central bank refinancing. Finally, the Governing Council decided to temporarily reduce the reserve ration from 2% to 1%, a measure aimed at fostering money market activity. This was expected to increase the incentives for market participants to engage in money market transactions.

As a consequence, on Wednesday December 21, 2011, the ECB loaned €489billion to 523 European banks for three years at an interest rate of 1%, which is an unprecedented measure for the amount and period. This measure is called a Long Term Refinancing Operation (LTRO). The ECB President, Mario Draghi, had been pressing banks to take the money since announcing the plans earlier in December and on Monday, December 19, he warned of a chance of a credit crunch claiming that euro zone bond market pressure could rise to unprecedented levels early next year. French banks have almost quadrupled their intake of ECB money since June to 150 billion euros, while banks in Italy and Spain are each taking more than 100 billion euros. This move eased immediate fears of a credit crunch but left unresolved the question of how much will flow to needy euro zone economies as the funds should bolster banks' finances, ease the threat of a credit crunch and maybe tempt them to buy Italian and Spanish bonds easing the currency area's sovereign debt crisis.

This move has been seen as the Eurozone's version of quantitative easing as it allows European banks to borrow at low rates and in turn buy up sovereign debt. The idea is that European banks buy high yield sovereign debt from troubled countries which banks can use as collateral in the LTRO to receive cheap cash they can use to buy still high yield sovereign debt and pocketing the difference in borrowing cost. This is what might explain the fact that in the last few months, auctions of peripheral European Sovereign debt have been very successful. This is an alternative way of Quantitative Easing as the ECB is not allowed by Art. 123 to directly buy bonds from troubled countries. In fact, Article 123 reads[5]

> Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favor of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments. (101)

Also, the ECB is pressing for countries to put their financing in order. This is also the reason why the ECB is not opening the flood gates to buy sovereign bonds in unlimited amounts. The ECB does not believe that the US response to the Federal Reserve's expansionary monetary policy has been the adequate one. In fact, it has been declared that in the US "once the Federal Reserve made it

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[5] Official Journal of the European Union (2011). *Information and Notices*. 51, 30 March at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:FULL:EN:PDF (accessed February 2012).

known it would use quantitative easing to buy Treasury debt, the Congress abandoned any attempt to deal with U.S. deficit. The ECB has learned this lesson and is not letting European governments slide back into their old habits. It wants some discipline."[6]

It is important to mention that Dragui has been actively pressing member states to implement what he calls the Fiscal Compact to put finances in order. He claims that this compact should be a three pillar structure. First, he has explained that governments should work at the national level by implementing national economic policies geared to obtain fiscal stability, improve economic and competitiveness growth, and create jobs. Second, Dragui has posited that these fiscal rules must be enshrined in primary legislation; hence, national legislation should contain limits to structural deficits and debt. Finally, he has advocated the need for a stabilization mechanism and defended the role of the temporary rescue fund (EFSF) and the permanent European Stabilization Mechanism (EMS).

The Opportunity: New Rules to Reinforce the Fiscal and Monetary System

The current economic crisis brings to mind the words of Albert Einstein who declared "Let's not pretend that things will change if we keep doing the same things. A crisis can be a real blessing to any person, to any nation. For all crises bring progress."[7] As a consequence, the EU is working to improve the two most important pillars on which rest the stability of the project: the stability pact and the banking system.

This crisis has shown that there are plenty of opportunities for the Eurozone to become the political and economic power that the founding fathers envisioned if the fiscal pact is implemented and governments improve their finances. On December 9, 2011 European leaders proposed and agreed to work on a new fiscal pact tightening budget discipline, which will hopefully be signed on March 1, 2012. The idea is to give to the Executive European Commission power to reject national budgets plans that deviate from agreed EU targets. This project has been vetoed by Britain and criticized by some who believe that it will cause more harm than good, as it might send countries into a recession.

As for the euro, the Eurozone member states will respond to downturns in economic activity due to a reduction in the demand of exports in the following way. To keep production and unemployment from falling, the national central banks would have lowered interest to boost national investment and consumption. The increase in the unemployment rate would have decreased tax revenues and increased the need for government transfers—activating the automatic stabilizers. To help the economy, the governments have the option to

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6 Cox, Jeff. 2011. "Europe Using US as a Model to Beat Debt Crisis: Bove. CNBC.com, December 13 at http://www.cnbc.com/id/45655607/Europe_Using_US_as_Model_to_Fix_Debt_Crisis_Bove (accessed February 2012).

7 http://blog.josepruano.com/2009/01/albert-einstein-on-crisis.html (accessed in February 2012).

lower taxes in order to increase the disposable income at the same time that the government deficit is increased. Finally, the value of the currency would have declined due to a lower demand for currency to buy exports.

On December 9, it was agreed to control fiscal deficits. The idea of a well-managed budget deficit is that member states should not be allowed to run fiscal budget deficits in good times, but only in bad times. The problem with the Eurozone is that most members have been growing budget deficits in good times which, in times of economic difficulty, have become unsustainable. Thus, most Eurozone countries are suffering from structural and cyclical budget deficits. The new fiscal rules are designed to prevent countries from running structural budget deficits by seeking constitutional changes that require balanced budgets, although they are agreeing to cap structural deficits at 0.5% of GDP with penalties to those who surpass the 3% of GDP. Those against this measure argue that the needs to maintain the fiscal deficit at 0.5% of GDP will force countries to cancel any automatic fiscal stabilizer, thus reducing even further the demand and sending countries into a depression.

Secondly, there is a need to make sure that the banking system in the EU is "healthy"; that is, it is necessary to measure the resistance of European banks during economic instability. The idea was to have a report on how solvent banks were to avoid a European version of the "US-banking-crisis" scenario particularly since the EU banking system is threaten by the difficult situation of Greece. This study, known as the Stress Test, would hopefully calm the markets and reassure investors that the European banking system is solid. There have been a number of stress tests. The first one took place in September 2009 when the Committee of European Bank Supervisors (CEBS)—the institution in charge of making this analysis—ran a very limited stress test on 22 banks that went almost unnoticed because the results were not made public. The second test took place in July 2010, pressured by the events that unfolded in Greece and the exposure of European banks to a possible Greek default. The results showed that seven out of the 91 banks tested failed.[8] The third time, 90 banks were tested. The results were presented on July 16, 2011. The stress test targeted approximately 65% of the European banking sector and 50% of the banking sector in each country. According to the results, 8 out of the 90 banks tested have failed.[9] Finally, in early December the European Banking Authority published the results of a new round of European stress tests. This time, the results showed that European banks are missing 115bn euros in capital in order to be considered ready to face financial instability.[10]

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[8] BBC News Business. 2010. "Seven EU Banks fails stress test". July, 23 at http://www.bbc.co.uk/news/business-10732597 (accessed February 2012).

[9] Hooper, John, Giles Tremlett and Gil Treanor. 2011. "Europe's banking regulator reveals eight banks failed stress tests". *The Guardian*, July 15 at http://www.guardian.co.uk/business/2011/jul/15/european-banks-stress-test (accessed February 2012).

[10] http://www.ft.com/intl/cms/s/0/8de33032-21b9-11e1-8b93-00144feabdc0.html#axzz1ky895a9o (accessed February 2012).

The stress test showed that banks need to work on their capital requirements to have the proper capital buffer in order to deal with a financial meltdown and avoid the US banking crisis. The Basel Accords are a number of agreements in charge of providing recommendations on banking regulations. The Basel Accord has been defined by the Bank of International Settlements as a comprehensive set of reform and measures which have been developed by the Basel Committee on Banking Supervision to strengthen the regulation, supervision, and risk management of the banking sector. The aim of the Basel Accord is to improve the banking sector's ability to absorb shocks arising from economic and financial stress, improve risk management and governance, and strengthen the transparency and disclosure of banks. There have been three Basel Agreements. The latest one—Basel III—has estimated that the European banking exposure to Greece reached €98.2bn ($138bn). Thus, to calm markets and investors' fears, the EU has been the first area where these rules have become law obliging state to work towards the quick implementation of the so-called Capital Requirement Directive, which forces large banks to have bigger and better levels of capital ready to face a crisis. In an informative way, Basel III is asking banks to achieve some specific capital requirements.

1. The Common Equity Tier One (CET1) requires financial institutions to increase the percentage of risk-weighted assets from 2% to 4%, but the problem is that there are 14 strict criteria to determine what can be counted as CET1.

2. It requires financial institutions to implement a Capital Conservation Buffer, which should account for 2.5% of risk-weighted assets.

This means that the total capital requirement is now 7%. This new reserve requirement poses two intertwined threats to the system. First, banks have to put more money away to comply with this requirement which, in turn, will mean that there might be less money available for the banks to lend; this will reduce the liquidity available. Second, if the EU is the only area, or country, to implement these requirements, the EU would be at a disadvantage with less capital available.

Basel III is aimed at imposing tougher capital requirements and liquidity standards. There are also plans to implement the liquidity standard. The new liquidity requirements are asking lenders to build up liquidity buffers by buying government and corporate bonds. However, buying these in times of distress such as the current times is expensive and could force lenders to slow down lending to the economy. The Liquidity Coverage ratio (LCR) aims at ensuring that banks in "in normal times have a sound funding structure and hold sufficient liquid assets such that central banks are asked to perform only as lenders of last result and not as lenders of first resort."[11] Most of the liquidity buffer has to be in the form of top-rated government bond with the remainder in highly rate corporate bonds. The idea was brought to the front line as some of the banks that run into problems – Northern Rock in Britain—had to be nationalized because of liquidity problems. Implementing the Liquidity Coverage Ratio may represent a significant challenge for some banks but the benefit of implementing the LCR outweighs the cost of implementing it.

The Threat: The Price of Oil

An increase in the price of oil could negatively affect the economic recovery in Europe. The reason is that the barrel of oil is priced in US dollars, which means that Eurozone member states must sell euros and buy US dollars to pay for oil. Since the euro is losing ground against the American currency and the price of oil is increasing, Eurozone nation states are facing a difficult situation. As a consequence, the price of oil is putting an extra burden on the feeble economy of the EU, particularly during the winter time when the demand for energy rises due to heating needs in most countries. By the same token, the Eurozone has enjoyed during the past years a preferred position as the value of the euro has been extremely high, which has helped pay the energy cost.

Since February 2011, the world is watching a number of social revolts in the Middle East that are negatively affecting the price of oil to increase. According to the latest data, the cost of the EU annual need for oil surpasses $400bn. If BP previsions are right, this year will be the first with an average annual oil price above $100 a barrel.[12]

On January 4, 2012[13] European governments agreed, in principle, to ban imports of Iranian oil. This will be a heavy blow to Tehran just months before the Iranian election. EU diplomats have yet to set a date for the embargo which will force Tehran to find other buyers for oil. EU countries buy about 450,000 barrels per day (bpd) of Iran's 2.6 billion bpd in exports, making the bloc collectively the second largest market for Iranian crude after China. To add insult to injury, China has already cut its order of Iranian oil by more than half in the past months. Still, Tehran has declared that this embargo will have no impact on the

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[11] Jones, Huw. 2012. "Global regulators signal leeway on new bank liquidity rules. *Reuters* , January 8, at http://www.reuters.com/article/2012/01/08/us-banks-regulation-idUSTRE8070PD20120108 (accesses February 2012).

[12] BP Statistical Review at http://www.bp.com/sectionbodycopy.do?categoryId=7500&contentId=7068481. (Accessed February 2012).

[13] Reuters. 2012. "Europe Agrees to Ban Imports of Iran Oil; No Date Set". CNBN.com, January 4 at http://www.cnbc.com/id/45871593 (accessed February 2012).

country as "We could very easily replace these customers."[14] However, some Eurozone member states are concerned about the economic impact of an embargo at a time when Europe is struggling with massive debt problems. Still, in retaliation Iranian Vice-President Mohamad Reza Rahimi warned that no oil would be allowed to pass through the Strait of Hormuz if the West applied sanctions on oil exports. Brent oil, a European crude company currently trading at $113 a barrel, could break $200 if Iran closed the Strait of Hormuz.[15]

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