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The emerging 2 speed banking system in Europe

One of the key changes in international financial markets over the last six months has been the improvement in bank to bank lending. This inter-bank lending is the much needed 'oil' that economies need to expand as it helps multiply the impact of low interest rates and ultimately allows credit to be pushed downstream to investors and borrowers. In Europe the main cause of this improvement has been the twin actions of the ECB in lowering their main borrowing rate to 0.75 per cent and directly advancing funds to banks. This approach of providing liquidity into the banking market began modestly post-Lehman in 2008 but was expanded aggressively in late 2010 and early 2011.

The results were slow at first with interbank lending remaining weak up to the start of this year as banks repaired their balance sheets and lending was subdued. But in recent months this approach has yielded results. Measures of interbank lending have improved as the rates at which banks are borrowing have reduced significantly. This improvement has been a key factor in the recent stock market rally as economic data pointed to lower interest rates and increased liquidity being passed through to the real economy.

As many people and businesses reading this article will attest however, this is not the reality facing many investors and borrowers in Ireland. In Ireland as in other peripheral European countries the impact of the ECB actions has not yielded any perceptible improvement in bank lending to borrowers and investors.

Ireland is at a disadvantage to other peripheral countries however on two counts. Firstly the levels of support that was and is still needed for our domestics banks is significantly higher than in the other peripherals and secondly relative to the other peripherals there is an absence of international banks trading within Ireland that could provide the pass through of improved international liquidity. On the first point it is worth noting that there has been a significant improvement in the Irish Government's ability to raise funds on the international markets but Irish banks are still a significant distance away from being able to raise funds at sustainable levels on their own.

The need for Government intervention therefore must be urgent and focused. Given that attracting international banks to Ireland is unlikely, the Government should exercise more direct control of the Irish banking institutions and use improvement in its ability to raise funds at sustainable levels on international markets to provide support. Ensuring that improvements in interbank liquidity is passed along to Irish borrowers and investors should be a key action point for the Irish Government in the coming months to avoid Ireland falling behind in a two tiered banking system.

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