



Leibniz Institute for Financial Research SAFE  
Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

## SAFE Finance Blog

### TARGET Balances Are no Risk Factor by Themselves

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Jan Pieter Krahen: Target imbalances should not be limited, but rather call for an institutional reform of the Eurozone



Organizing payments across borders within a currency area is a complex task. The Target system fulfills this purpose: it is an infrastructure offered by the system of European central banks since 1999 for the quick and smooth processing of international money transfers. The system is in its current form since 2007 (TARGET2).

Repeatedly there has been criticism of Target because of excessive imbalances, especially in Germany. In fact, the German Bundesbank currently has a claim against the euro system of over 900 billion euros. Other countries owe the system hundreds of billions. Critics claim that via Target, these countries can get

into debt as much as they wish, bringing incalculable risk and turning Germany into a kind of “self-service store”. The critics call for political intervention: The Target mechanism should impose a settlement of the balances. The question therefore is whether the Target balances really represent a risk factor by themselves. My answer is no.

### Symptoms of economic shifts in the euro area

In the Target system, payments from one country's account holders to payees in other countries are pooled and routed to the ultimate beneficiary through the central bank of the recipient country. Daily surpluses or deficits arise on the various central bank accounts. The balance accumulates net transfers from the interaction of many underlying transactions over several years; it can thus not be attributed to individual transactions. Therefore, a description of “the cause” of a target balance is so difficult. Since the sum of the Target balances of all participating countries is always zero, one can interpret long-term positive and negative balances as an indicator, or a symptom, of continued shifts in assets and value between countries. These can be investments in capital goods, trading of goods, tourism, capital flight or the byproduct of monetary policy, be it conventional or unconventional - and last but not least the role of individual financial centers of the euro zone. So, in a currency union that operates under normal conditions, Target balances are simply balances on intercountry accounts without any direct political implications. Yet, they may provide useful information on deeper economical shifts in assets and value between countries.

If the Target balances are symptoms of lasting economic shifts across regions, how useful is a limit on their level? An annual settlement by central banks with negative Target balances, using government securities as collateral, would just exchange one form of government debt against another. An economically sensible therapy should therefore rather focus on the underlying economic forces that contributed to these interregional shifts and imbalances.

Nevertheless, the critics may have a point if it comes to the extreme scenario of an exit from the currency union. While such a scenario is difficult to imagine in all its complexity, and unlikely to ever happen for that very reason, the current Target system may actually be offering rewards for mischievous leavers. Such a negative outcome would result if the leaver's central bank engages in money creation and subsequent purchase of foreign assets, thereby producing a Target balance which it may decide not to settle after the leave.

Luckily, a straightforward reform of the euro zone and a strengthening of its modus operandi can avoid such a seemingly free lunch: Running all open market activities through the ECB rather than national central banks will eliminate Target balances altogether. Alternatively, one could constantly rebalance each central bank's claim on a common open market account at the ECB, similar to the way regional balances are handled at the US Fedwire system. Once again, Target balances would disappear.

That way, a strengthening of the euro system's architecture may be the right answer to its major critics – and an improvement of the currency union's inner cohesion.

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