Overcoming the Crisis

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Reasons for the crisis

- The crisis was caused by a very **specific mix of circumstances**:
  - Excessive deficit/debt levels in many Member States
  - Loss of competitiveness
  - Excessive macroeconomic imbalances
  - Absence of EU-wide controls over national statistics
  - No banking supervision at EU level
  - Link between sovereigns and banks
  - Institutional gaps in EMU/no backstop

A comprehensive response to the euro crisis

1) Significant **fiscal consolidation** and **structural reforms** at national level

2) **Monetary policy** measures

3) Improved **economic policy coordination** in the euro area

4) Reinforcing the **banking system**

5) Institutional innovations: **financial backstops**

EFSF/ESM programme countries are the reform champions

- **Greece, Ireland, Portugal and Spain** are in top 5 of 34 **OECD countries** with regard to implementation of **structural reforms. Policy areas concerned**:
  - **Labour productivity** (e.g. product market regulation, human capital)
  - **Labour utilisation** (e.g. labour market regulation, social welfare system, active labour market policies)

Ranking in OECD report
1. **Greece**
2. **Ireland**
3. Estonia
4. **Portugal**
5. **Spain**

"Euro area countries under financial assistance programmes are among the OECD countries whose responsiveness [to the OECD's structural reform recommendations] *was highest and also where it most increased compared with previous period."*

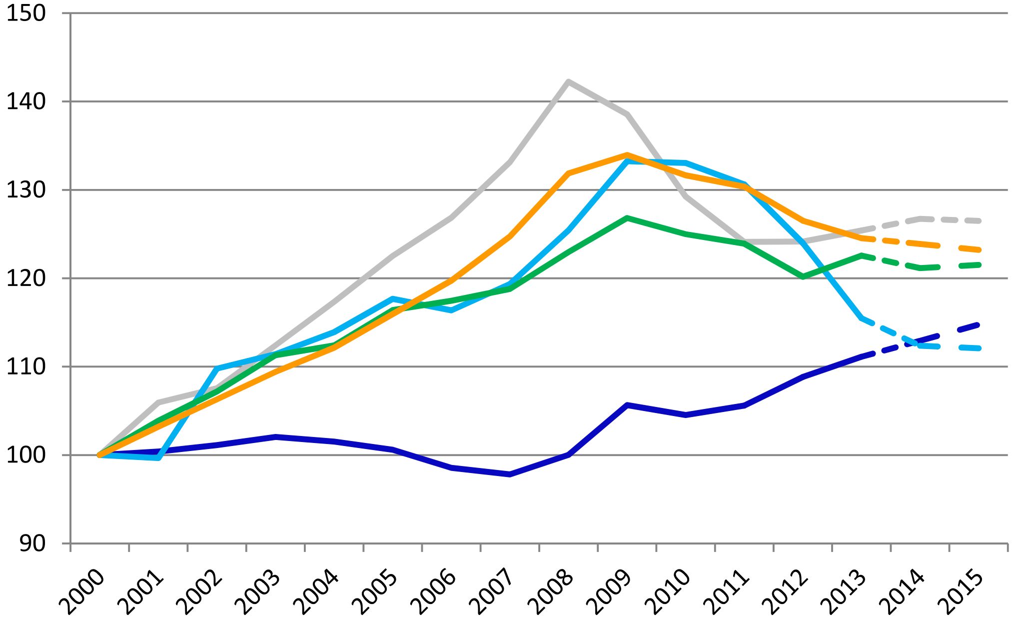
- Going for Growth 2013 (OECD Report)

Source: OECD report *Going for Growth 2013*
Ranking takes into account responsiveness to OECD recommendations on structural reforms in key policy areas

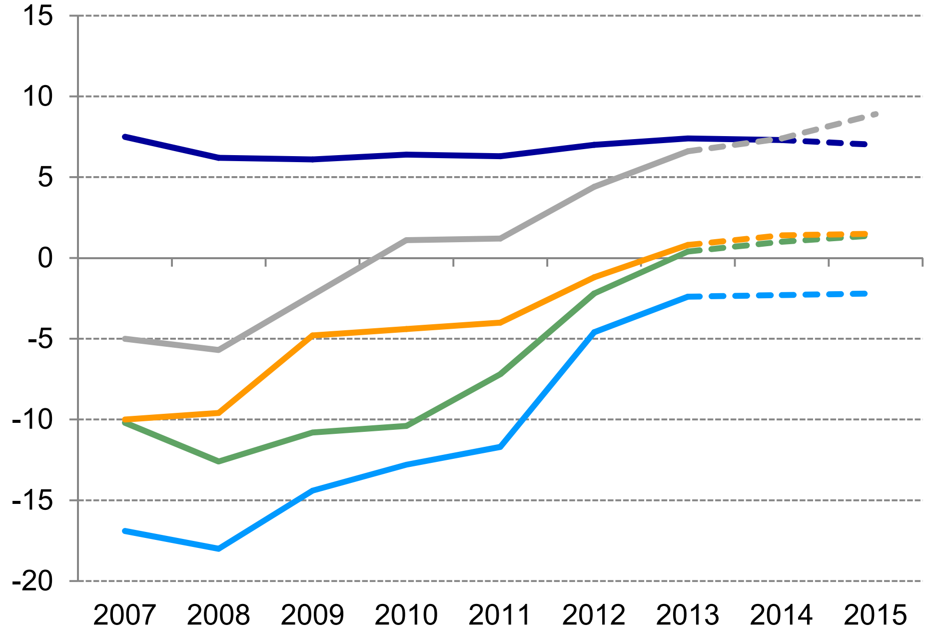
The strategy is delivering results - competitiveness

- Divergences within EMU **are declining**
- **Competitiveness is improving** in all Member countries which received EFSF/ESM financial assistance

Nominal unit labour costs, whole economy (2008=100)



Current Account Balance (as % of GDP)



Source: Eurostat,
EC European Economic Forecast - Spring 2014

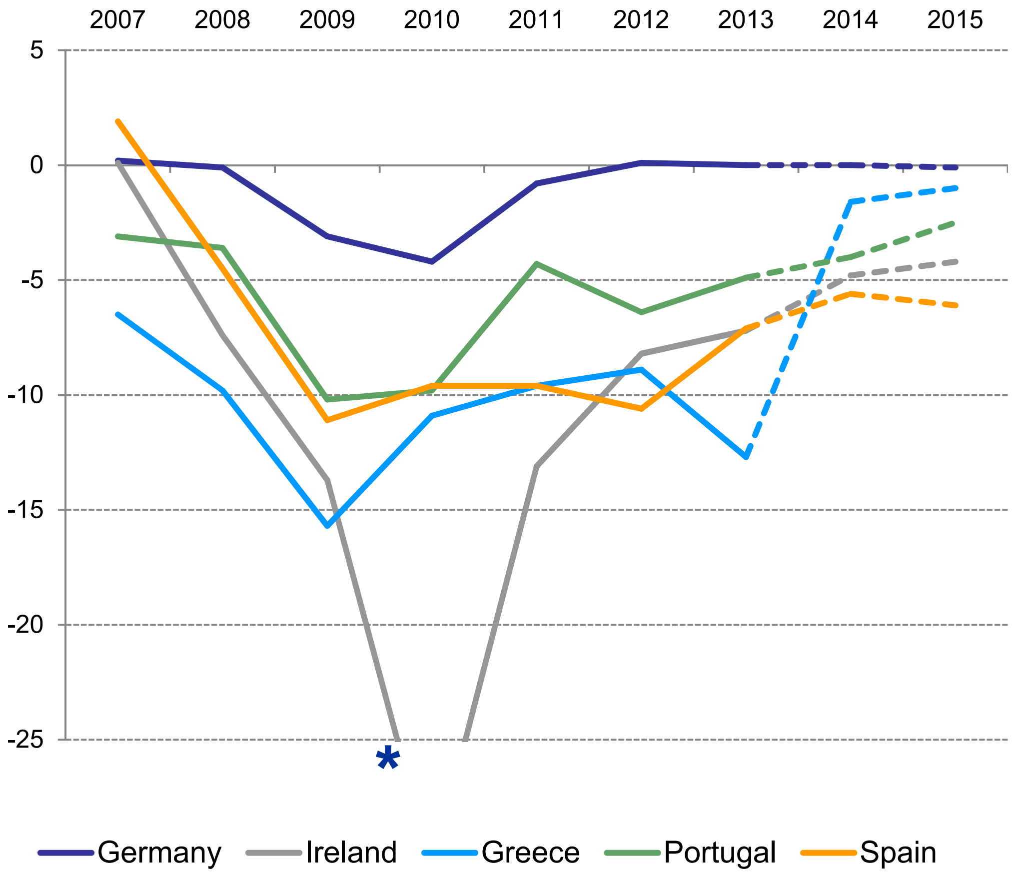
Germany Ireland Greece
Portugal Spain

European Financial Stability Facility

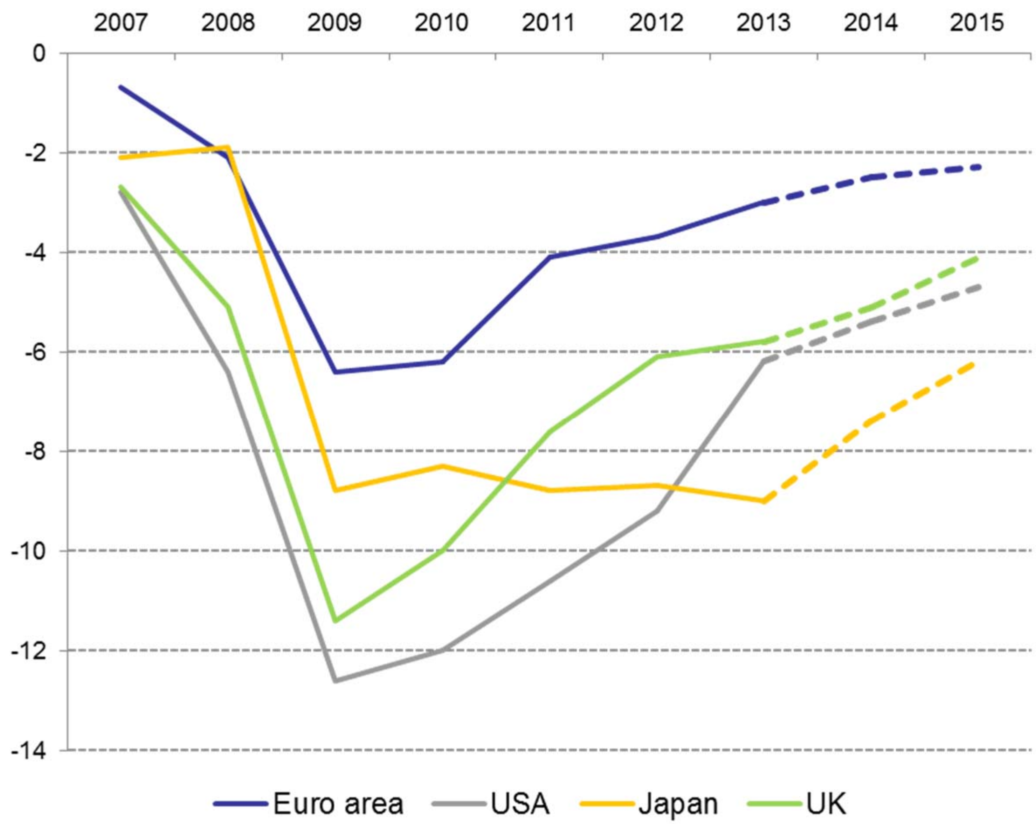
European Stability Mechanism

The strategy is delivering results - fiscal

Fiscal balance, euro area Member States
(as % of GDP)



Fiscal balance, Euro area vs USA and Japan
(as % of GDP)



Source: European Commission, European Economic Forecast – Spring 2014

* Actual figure for Ireland in 2010: -30.6%

Crisis response from the ECB

- In 2007 the ECB was the first central bank to adopt crisis measures
- Securities Markets Programme (**SMP**) – from 2010 to 2012, ECB purchased euro area sovereign bonds (over €200 billion) in secondary markets
- Long-Term Refinancing Operations (**LTRO**) in Dec. 2011 and March 2012: around **€1 trillion** allotted in 3-year loans
- Outright Monetary Transactions (**OMT**) announcement in July 2012 calmed the markets
- **New package of measures** adopted in June 2014
    - targeted LTRO (€400 billion lending programme) designed to stimulate lending to small companies
    - Negative deposit rate

Improved economic policy coordination in the euro area

- Euro governments adopted **more comprehensive and binding rules** for national economic policies
  - **Stability and Growth Pact** has stricter rules on deficit and debt
  - **Less room for political interference** by national governments
  - **Balanced budget and debt rules** now also in national legal systems
  - **European Semester**: yearly cycle of economic policy coordination
  - Stronger emphasis on **avoiding macroeconomic imbalances**
  - **Eurostat** authorised to verify national data

Reinforcing the banking system

- **Three new European supervisory authorities: EBA, EIOPA and ESMA.** New **ESRB** to monitor macro-prudential risks

- Europe is pushing ahead with **financial market reforms**
  - "Basel III" (CRDIV/CRR) to be progressively implemented starting in 2014
  - Huge capital increase for banks – Core Tier 1 capital ratios are now 9% or more
  - Approx. €450 billion raised by EU banks since 2008

- Towards Banking Union
  - **Single Supervisory Mechanism** (SSM) operational in November 2014
  - **Bank Recovery and Resolution Directive** (BRRD) will create a uniform framework for bank recovery at national level with **bail-in** as a key instrument
  - **Single Resolution Mechanism** (SRM) with **Single Resolution Fund** (SRF)
  - **ESM Direct Recapitalisation Instrument** available once SSM enters into force and euro area MS unanimously approve

EFSF and ESM: mission and scope of activity

Mission : to safeguard financial stability in Europe by providing financial assistance to euro area Member States

Instruments

- ***Loans***
- ***Primary Market Purchases***
- ***Secondary Market Purchases***
- ***Precautionary Programme***
- ***Bank recapitalisations through loans to governments***

All assistance is linked to appropriate conditionality

EFSF and ESM finance their activity by issuing bonds and other debt instruments

EFSF/ESM lending and assistance

- **Support for five countries (EFSF: Ireland, Portugal, Greece; ESM: Spain and Cyprus)**
  - Combined lending capacity: €700 bn
  - Committed amount to the five countries: €238.6 bn
  - Disbursed so far: €229.6 bn
  - EFSF no longer engages in new financial assistance programmes since 1 July 2013
  - **Ireland, Spain and Portugal** have exited their financial assistance programmes
  - Macroeconomic adjustment programmes for **Greece** and **Cyprus** ongoing

- **Potential concerted ESM – ECB intervention** (Outright Monetary Transactions/**OMT**)
  - ESM programme provides conditionality
  - The ECB could engage in secondary market purchases

The EFSF and ESM ease beneficiary countries' debt burden

- New framework for providing financial assistance: very **low rates** and very **long maturities**
- The **very low cost of EFSF/ESM funding** is passed on to the beneficiary MS; only very small operational fees
- In the case of Greece interest payments are **deferred for 10 years**
- The **weighted average maturity of loans** ranges from 12.5 years (Spain) to 32 years (Greece)
- As a result, **debt/GDP** ratio is not a meaningful indicator
- More attention should be given to **very low debt service payments**

Budgetary savings as a result of EFSF/ESM lending

Potential savings of EFSF/ESM financing vs theoretical market cost (for 2013)

	In € billion	As percentage of GDP	As percentage of total primary expenditures
Cyprus	0.24	1.5	3.4
Greece	8.58	4.7	8.6
Ireland	0.68	0.4	1.1
Spain	2.43	0.2	0.6
Portugal	1.27	0.8	1.7

Calculated using theoretical market spread of 5- and 7-year bond of each country matching the EFSF/ESM maturity profile on the 3 months before and after each country requested support. This is compared with the equivalent EFSF/ESM funding cost.

EU solidarity to support Greek debt sustainability

- **Since 2010, successive measures to strengthen Greece's debt sustainability and reduce liquidity risks:**
    - Successive reductions of GLF interest rate margin
    - Extension of GLF & EFSF loan maturities and grace period
    - Deferral of EFSF interest payments
    - Cancellation of some EFSF fees
    - Transfer of SMP/ANFA profits of NCBs to Greece

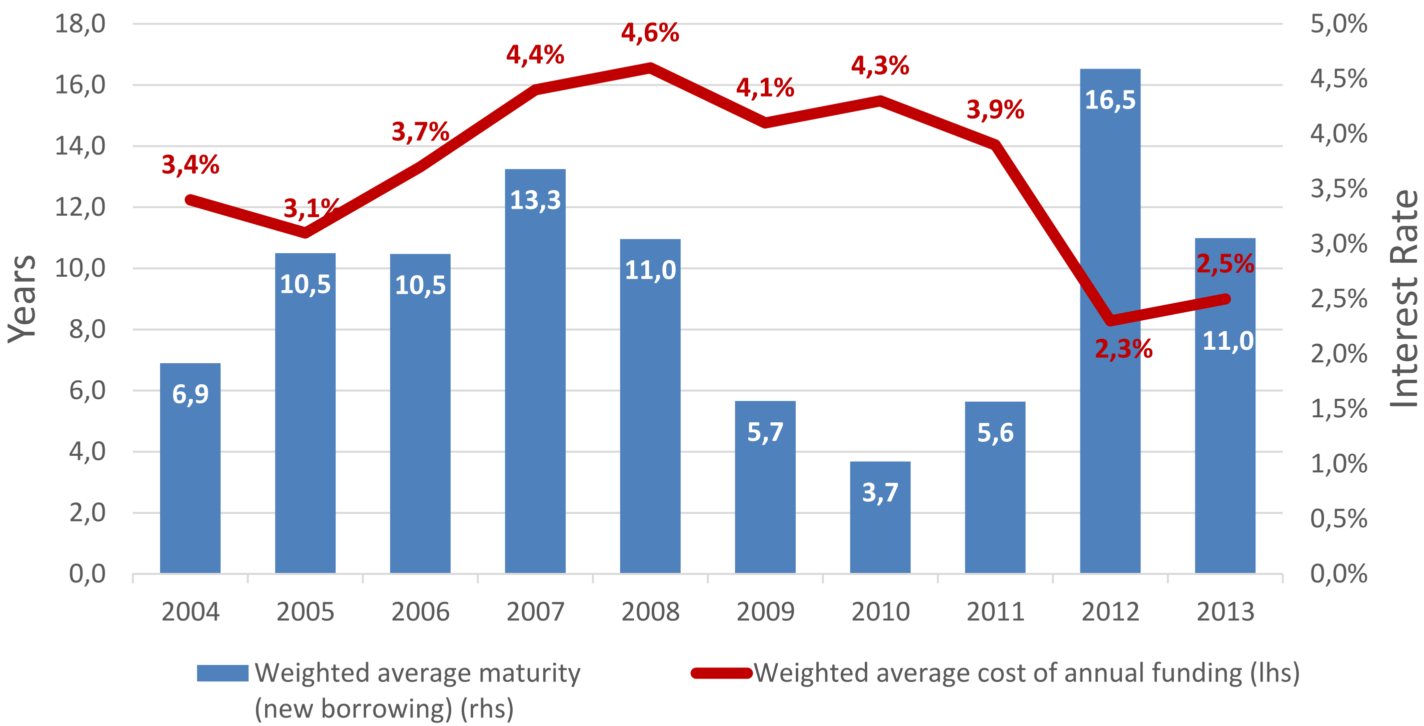
These measures have **reduced annual financing needs** significantly

- **EFSF activity**
    - EFSF has disbursed €139.9 bn to Greece so far (43% of total public debt)
    - Current EFSF lending rate is much lower than IMF lending rate (3.1%) and Greece's market rates for corresponding maturities over the past decade (5%)

Impact of EU solidarity measures for Greece

- Significant reduction of financing needs over the next decades
- Reduction of refinancing risk. Market access has improved but remains costly
- EFSF loans support the economy far beyond the 10-year standard focus of debt sustainability
- No debt overhang for at least a decade
- Lower debt service, compared to market rates, creates fiscal space for implementing growth-enhancing structural reforms

Greece: Evolution of weighted average cost / maturity of annual funding



Source: PDMA, FinMin

European Financial Stability Facility

European Stability Mechanism

Conclusions: The euro crisis is not over yet . . .

. . . **but the end is in sight:**

- The euro area has moved **out of recession**
- Borrowing countries are reducing fiscal deficits and eliminating current account deficits as **competitiveness is restored**
- **Macroeconomic imbalances** within the euro area are **disappearing**
- **Interest rate differences** between Northern and Southern Europe have been **cut by 3/4**
- **Unemployment has started to fall**, industrial production is growing and confidence indicators are up

Conclusions: Certain risks remain

- Borrowing countries need to continue their **difficult adjustment**
- New framework for **economic policy coordination** must be credibly implemented
- **Financial markets** in Europe are still **fragmented**
- Potential growth in Europe will be **limited**
- Yet, monetary union will **function better** after the crisis than before the crisis