Bundesministerium der Finanzen

Overcoming the Euro Area Crisis – Reforms and Results

Holger Fabig

Federal Ministry of Finance, Germany

Introduction

- Europe is in the midst of a sovereign debt crisis and currently in recession

- But comprehensive measures have been taken to live up to this challenge and are bearing fruit already

- This brief presentation will present both reforms, new instruments and some results

Reform of the Stability and Growth Pact

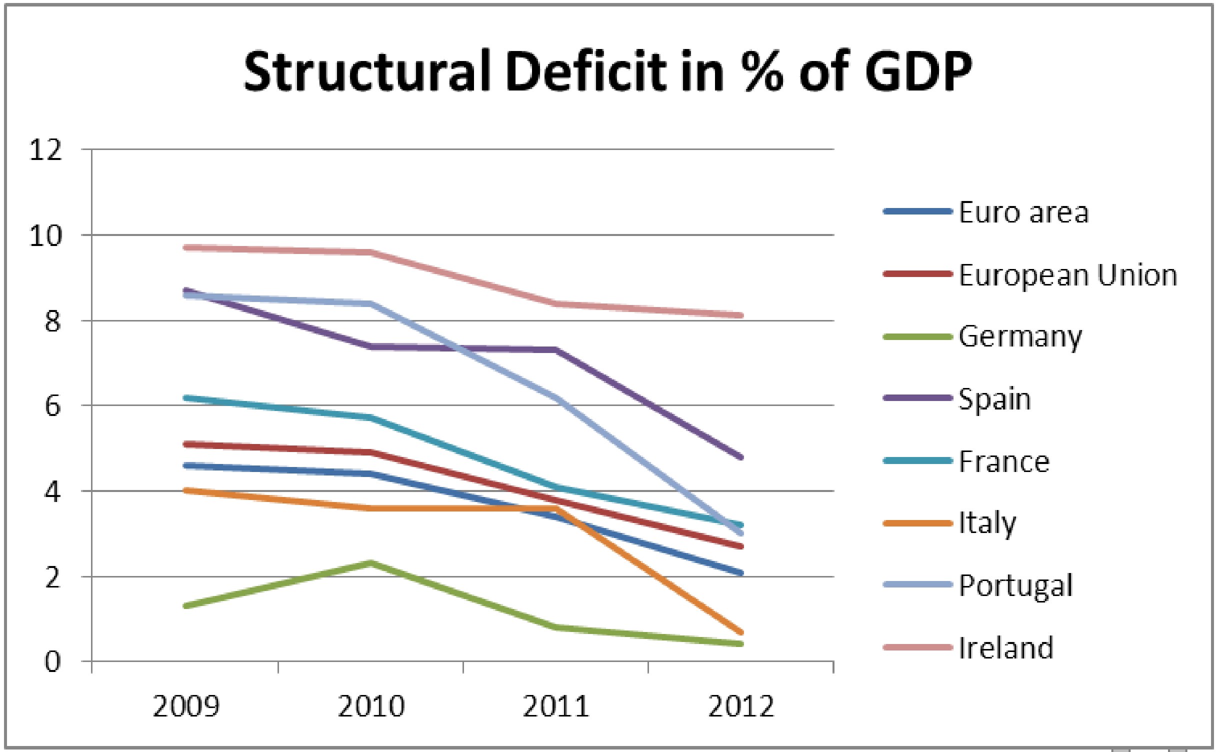
- Preventive Arm:
  - ✓ Stronger focus on balanced fiscal position
  - ✓ Deposit of 0.2% of GDP if MS leaves adjustment path towards country-specific medium-term structural deficit objective (max. 1% of GDP) and does not adjust
- Corrective Arm:
  - ✓ MS whose debt exceeds 60 % of GDP required to reduce debt by 1/20 p.a. of amount above 60%, even if their deficit is below 3 % of GDP
- Sanctions triggered earlier, can only be turned down by qualified majority (quasi-automatic, reverse majority rule)

Fiscal Compact

- Structural deficit must not exceed 0,5% of GDP
- Debt brakes to be integrated into national (constitutional) law
- Confirms 1/20 rule of SGP
- National debt brake pre-condition for ESM use
- MS in excessive deficit procedure need to adopt an economic partnership programme (approved and monitored by the Council and the European Commission)

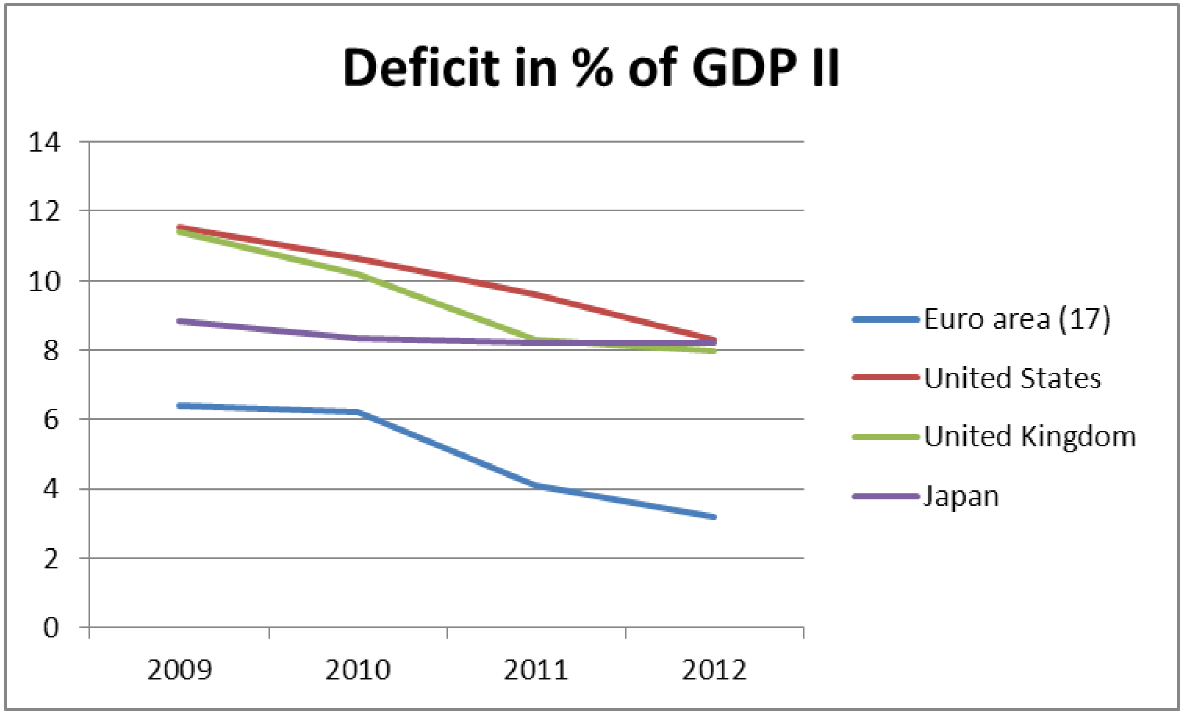
Achievements (I)

- Deficits in the euro area decreased significantly:
  - ✓ Budget deficits: **6,4%** (2009) to **4,1%** (2011), forecast 2012: **3,2%**
  - ✓ Structural deficits: **4,6%** (2009) to **3,4%** (2011), forecast 2012: **2,1%**



Achievements (II)

- Deficits and overall debt is low by international comparison:
- 2011 deficits: US: 9.6%, UK: 8.3%, Japan 8.2%, Eurozone: 4.1%



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Achievements (II)

Debt levels and dynamics

General Government Gross Debt (% of GDP)

Source: IMF Fiscal Monitor October 2012

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Advanced Economies	81,5	95,2	101,4	105,5	110,1	112,8	113,7	113,6	113,1	112,3
G-7	91,8	107,9	114,7	119,9	124,5	127,8	129,2	129,5	129,2	128,6
Eurozone	70,2	80,1	85,6	88,1	92,5	93,6	93,4	92,3	90,8	88,7
USA	76,1	89,7	98,6	102,9	107,1	111,6	113,8	114,3	114,4	114,3
Japan	191,8	210,2	215,3	229,9	234,5	240	244,4	248,6	252,4	255,7

European Semester

- Intensifies coordination through harmonization and synchronized timetables for budget monitoring (SGP) and coordination of economic policies (Europe 2020)
- Integrates conclusions from the MIP and the Euro-Plus-Pact
- Preventive monitoring

Europe 2020 Strategy

- Ten-year growth strategy (2010-20)
- Intention: promotion of smart, sustainable, inclusive growth
- MS translate European headline targets into national targets
- Progress is reported in National Reform Programs
- 5 Core objectives:
    1. 75% of the population aged 20-64 should be employed
    2. 3% of GDP should be spent on R&D/innovation
    3. 20% less greenhouse gas emissions , 20% more renewable energy, 20% more energy efficiency
    4. at least 40% of 30-34-year old should have a university degree
    5. 20 million fewer people who are threatened by social exclusion and poverty

Euro Plus Pact

- Involves euro area countries + DNK, LVA, LTU, POL, BGR, ROM
- Intention: promotion and harmonization of competitiveness for higher levels of growth and convergence
- Annual voluntary commitment of the participating countries and implementation within 12 months

Macroeconomic Imbalance Procedure

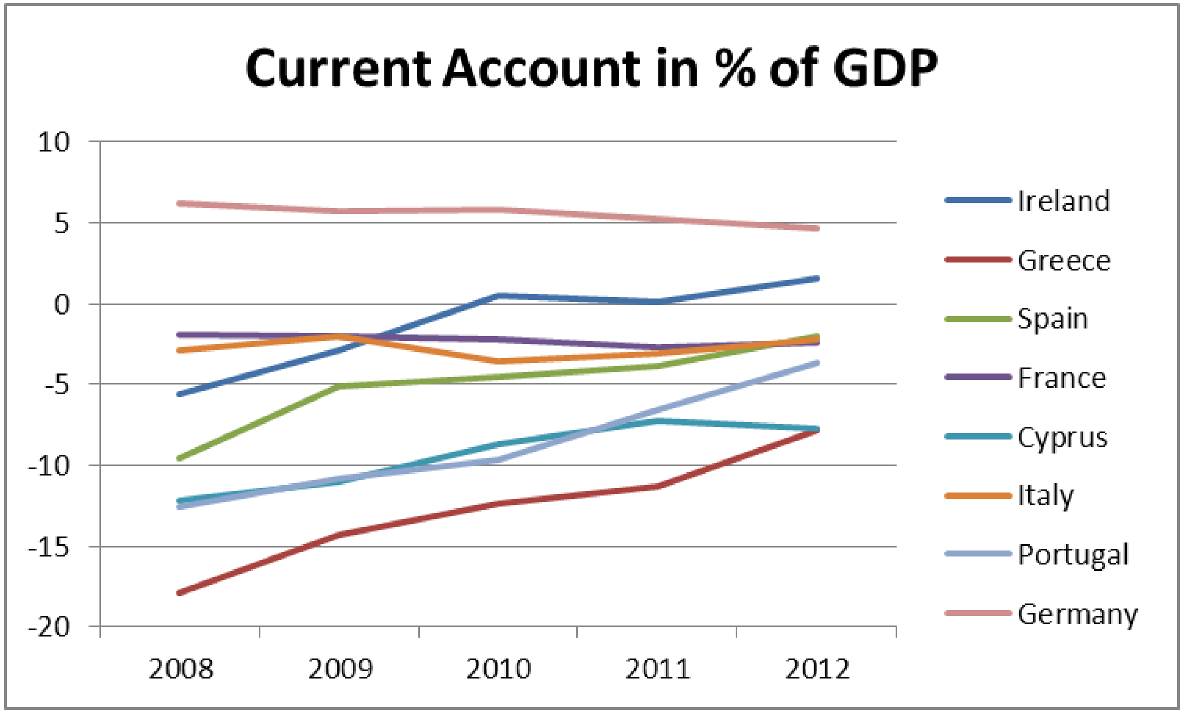
- Intention: identify member states with, or at risk of, macroeconomic imbalances
  - ✓ Early warning system: comprised of an indicator-based scoreboard and country analysis
  - ✓ Prompt corrective measures in case of excessive or potentially harmful macroeconomic imbalances
  - ✓ If no adjustment takes place: sanctions in the form of a deposit or fine of 0.1% of GDP

Compact for Growth and Jobs

- €120 bn package:
  - €60bn additional EIB lending through capital increase
  - €55bn reallocation of Structural Funds
  - € 4.5bn in Project Bonds
- Deepening the Single Market
- Completing the internal energy market
- Reducing the overall regulatory burden
- … and many more measures

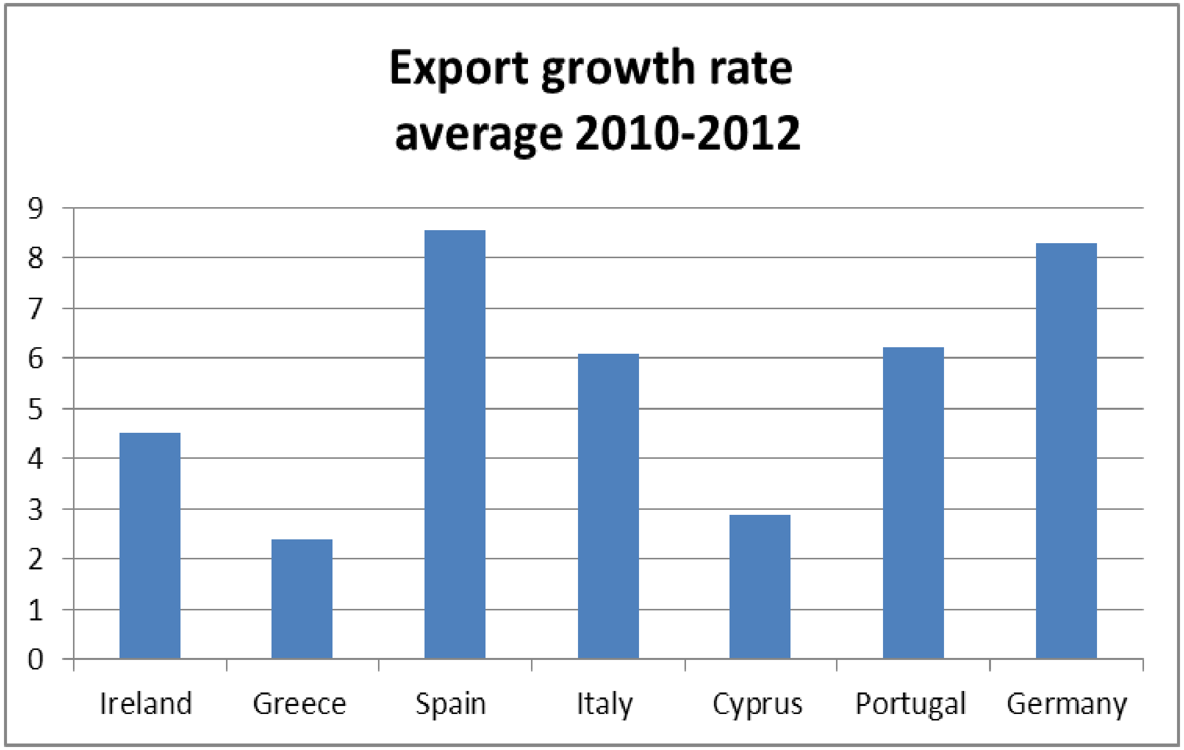
Achievements (III)

- Current account deficits have declined markedly …
  - ✓ 2008-2012: *ESP* **-9,6%** to **-2,0%**, *PRT* **-12,6%** to **-3,6%**, *GRC* **-17,9%** to **-7,8%**



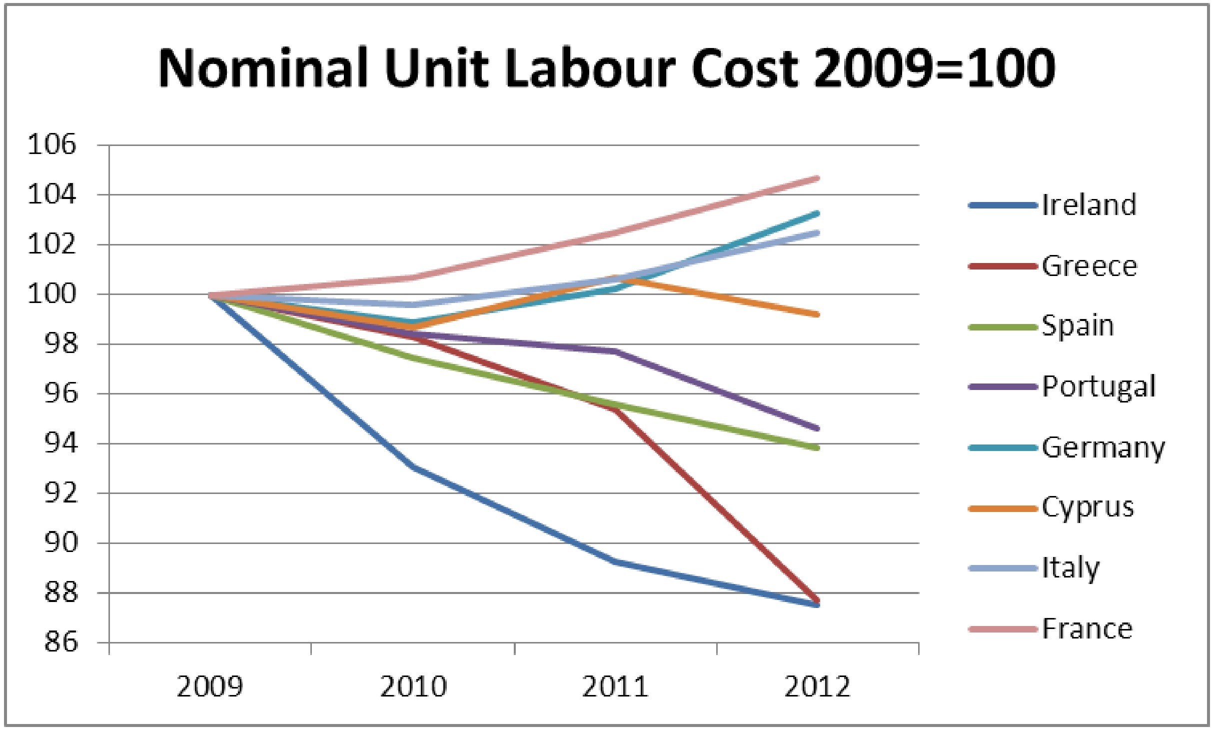
Achievements (IV)

- … not just because of demand compression, but also because exports increased:



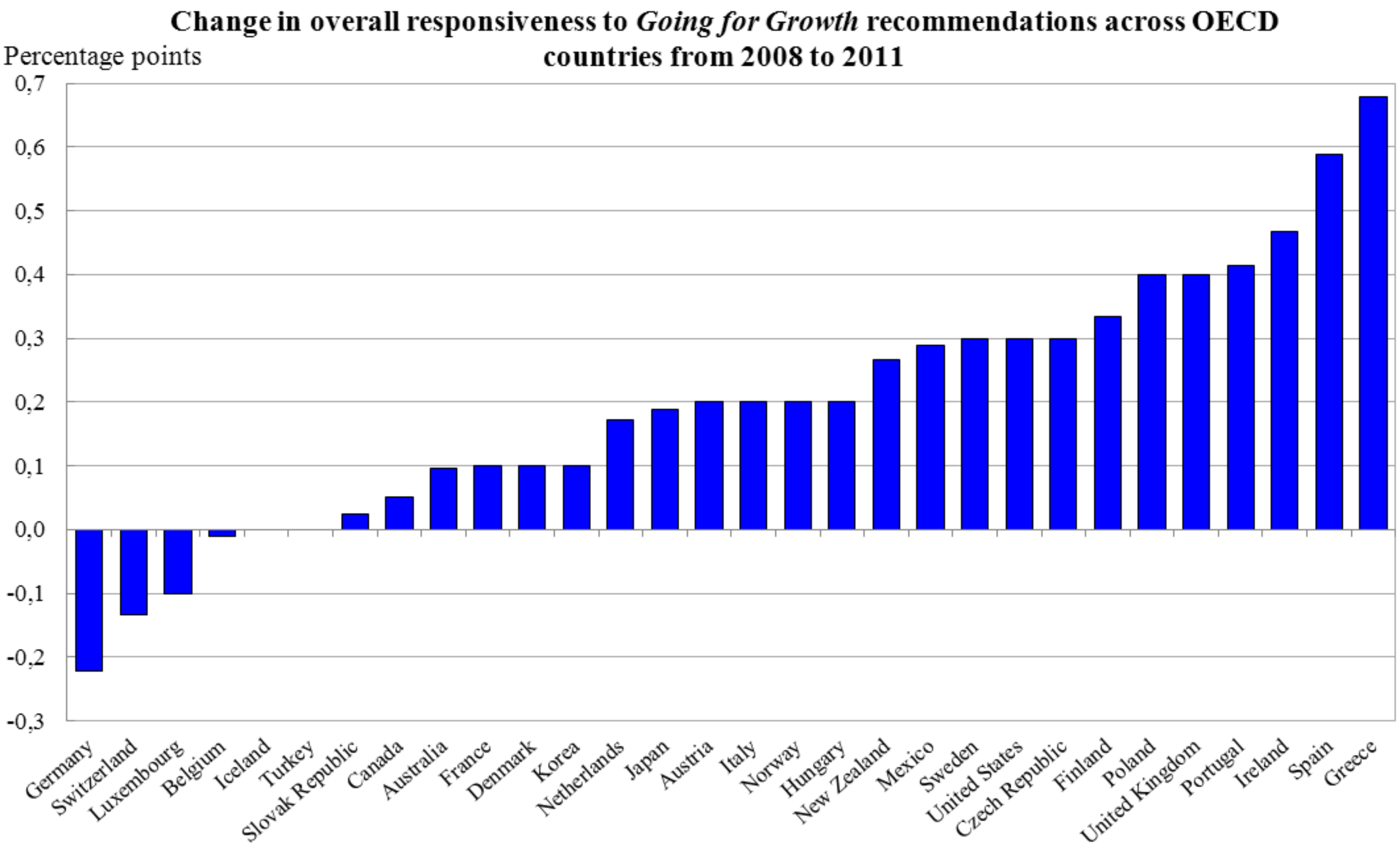
Achievements (V)

- Competitiveness has improved in many crisis countries
  - ✓ The nominal unit labour costs declined in **IRL** and **GRC** by **12%**, in **ESP** by **6%**, in **PRT** by **5%** (2009-2012)



Achievements (VI)

- Reform intensity is particularly high in the crisis countries



EFSM

- “European Financial Stabilization Mechanism”
- Part of the temporary euro rescue package put together in 2010
- Volume: €60 bn
- The EFSM disappears when the ESM comes into force

EFSF (I)

- „European Financial Stabilization Facility“
- Intention: assist member states in financial difficulty by providing funding to preserve the stability of the euro area
- Borrows funds for loans to crisis countries on capital market, with guarantees of the euro countries (max. €780 bn)
- Lending capacity: €440 bn
- Instruments: loans, precautionary credit lines, loans to recapitalize financial institutions, and primary and secondary market purchases of government bonds

EFSF (II)

- Loans subject to strict conditions under a macroeconomic adjustment program (monitored by the Troika)
- As of August 31, 2012, the EFSF has made total disbursements of € 118.3 bn
- Loans of up to EUR 290 billion are pledged to Ireland, Portugal, Greece and Spain
- Will be replaced by the permanent ESM; EFSF loans possible until June 2013

ESM (I)

- “European Stabilization Mechanism”
- Established by international treaty as an international financial institution
- inaugural Governing Board meeting today (October 8, 2012)
- Same instruments as EFSF
- Support only under conditions:
  - ✓ macro-economic adjustment program
  - ✓ ratification of the fiscal pact by March 1, 2013
  - ✓ introduction of national debt brake

ESM (II)


European Stability Mechanism (ESM)
by 2013
ESM loans over-collateralised
to maintain top
credit rating
€620bn
callable
capital / guarantees
€700bn
nominal capital
of crisis fund
€500bn
effective lending
capacity
€80bn
paid-in capital
Germany is to contribute around €22bn. This will be paid in over 5 years.
Source: Federal Ministry of Finance

Banking Union

- Discussion in full swing
- Components of a „banking union“:
  - ✓ single supervisory mechanism (SSM)
    - ✓ Which role for the ECB ?
    - ✓ Which role for national supervisors ?
  - ✓ European system of deposit guarantee schemes
  - ✓ European recovery and resolution framework
  - ✓ European rulebook in the form of capital requirements (Basel III)
- Don’t forget: SSM is a precondition for a possible direct recapitalisation of banks by ESM

Financial Regulation

- Comprehensive reform agenda on the way
- Key elements:
  - ✓ implementing of Basel III (Capital Requirements Directive - CRD IV)
  - ✓ revision of the EU regulation on credit rating agencies
  - ✓ revision of the Markets in Financial Instruments Directive (MiFID) and the current rules on market abuse and investment funds
  - ✓ more stringent regulation of OTC derivatives markets (European Market Infrastructure Regulation - EMIR)
  - ✓ curbing banking pay practices that encourage recklessness
  - ✓ fundamental reform of European insurance supervision law (Solvency II)
  - ✓ regulation of the shadow banking sector (G20)
  - ✓ examine reform of the structure of the banking sector (Liikanen Group)

ECB - Measures (I)

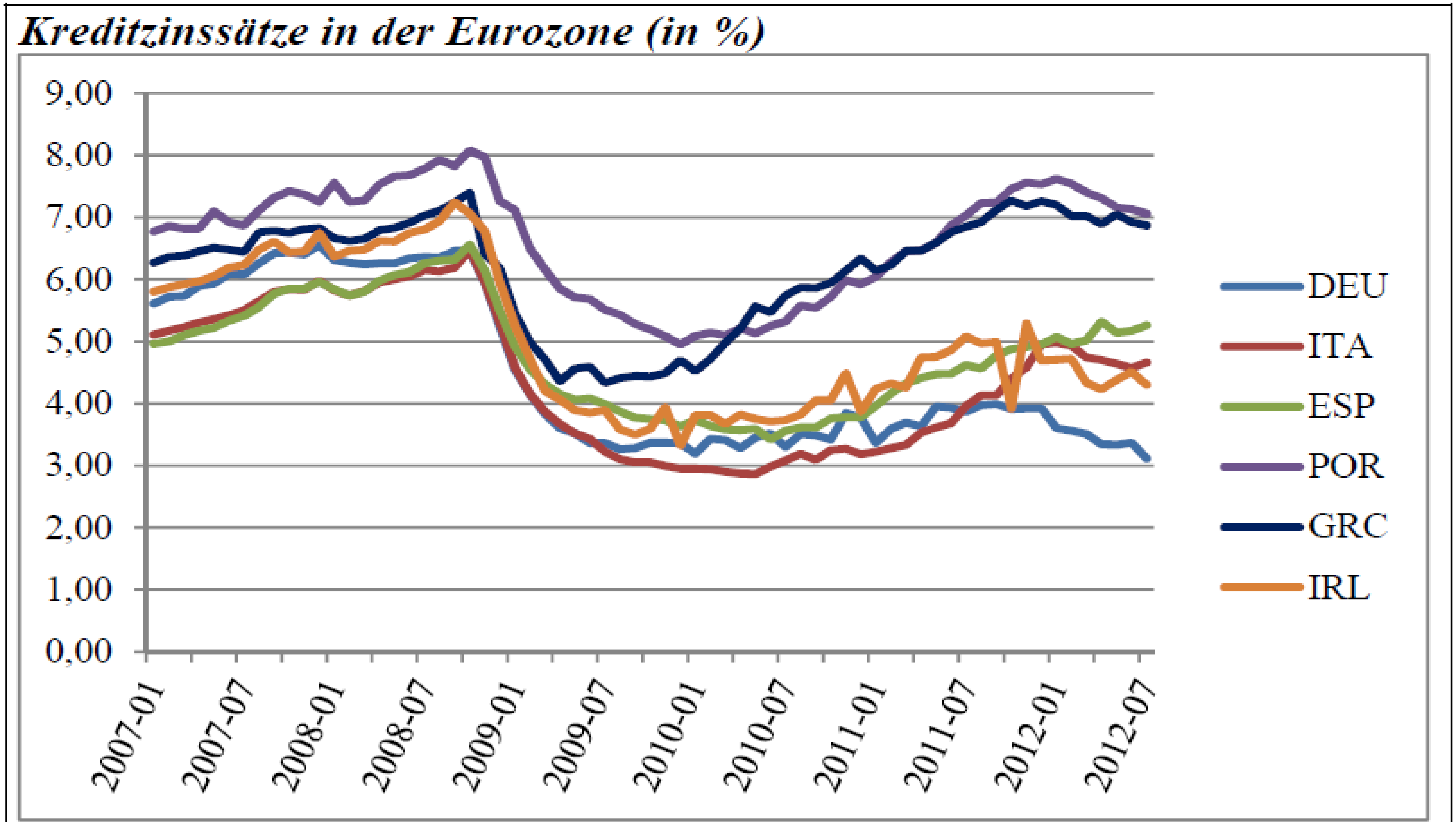
- Securities Market Programme (SMP):
  - ✓ current volume: €209 bn
  - ✓ expired on September 6, 2012
- Outright Monetary Transactions Programme (OMT):
  - ✓ bond purchases only under strict conditionality; no purchases yet
  - ✓ But if: unlimited, without seniority, but with sterilization and transparency
- LTRO I and II:
  - ✓ 36 months
  - ✓ LTRO I (22.12.2011): €489 bn, net allocation €200 bn
  - ✓ LTRO II (29.02.2012): €529,5 bn, net allocation €314 bn

ECB - Measures (II)

- Covered Bond Purchase Programme:
  - ✓ CBPP1 volume: €60 bn
  - ✓ CBPP2 volume: €40bn
- Emergency Liquidity Assistance:
  - ✓ commercial banks can get emergency loans from national central banks under certain conditions
- Significantly lower collateral requirements for ECB lending to commercial banks
- Target 2 imbalances: More a symptom than of problem *sui generis*

ECB - Challenges

- Interest rates for commercial loans diverged



Quelle: Bundesbank.

EU/Euro Area Governance Reforms

- President of the European Council (van Rompuy)
- President of the Euro Summit, elected for 2 ½ years (van Rompuy)
- President of the Euro Group comes from the group of ministers or is full-time president (Juncker)
- Full-time Chairman of the Euro Working Group (Wieser)
- Euro Summit twice a year
- Stronger Euro Group: increased coordination and monitoring of economic and fiscal policies; preparation and follow up of Euro Summits
- “Quadriga” report to further strengthen the EMU due by end-2012; interim report in October; “robust debate”

Conclusion

- Europe has embarked on a journey of comprehensive reform to tackle the euro crisis.
- First results have materialized as regards consolidation and competitiveness. The euro remains a strong reserve currency with low inflation.
- Short-term crisis management must not replace the imperative of fiscal consolidation to achieve sustainable public finances and of structural reforms to restore competitiveness and enhance potential growth.
- Success will not come over night. What is needed is vigorous, steady policy implementation along agreed timetables.
- Europe will prevail because European integration still makes a lot of sense.