Funding health and stability

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We are now part of Europe's EUR540 billion response to fight a crisis caused by the coronavirus. On Thursday, 23 April 2020, the Heads of State and Government[1] endorsed the plan that we can make available Pandemic Crisis Support for all euro member states of around 2% of each country's gross domestic product, representing a total of up to EUR240 billion. This is one element of the European response to the crisis, together with elements from the European Investment Bank (EIB) representing up to EUR200 billion and the European Commission with around EUR100 billion. All three elements should become operational by 1 June 2020.

Our Pandemic Crisis Support is based on our existing precautionary credit line, the Enhanced Conditions Credit Line (ECCL), but tailored for the coronavirus emergency. It is agreed that it can be used by euro area member states to finance direct and indirect health care, cure, and prevention-related costs due to the Covid-19 crisis. Our Pandemic

Crisis Support is cheap, fast, and targeted financing for countries and populations hit hardest by this crisis. It complements national fiscal and liquidity measures and it is particularly useful in countries that only have limited budgetary resources.

Financially, support from the ESM is attractive because the ESM is AAA/Aa1-rated and has low funding costs. That cost is lower for more than ten euro area countries. Even if the maximum EUR240 billion was to be drawn - which is not expected - it would not adversely impact our ratings.

- Several countries could potentially be interested in our support - especially those for which the ESM offers lower cost of funding. We expect the amount to be a fraction of the EUR240 billion, based on current market prices.
- The countries which would benefit most, in current market conditions, include those hit hardest by the coronavirus.

Cheaper funding means annual budgetary savings for member states. For some countries, the savings could be in triple digit millions annually and multiple billions over a period of several years. This represents real financial savings for citizens, meaning fewer taxes that they would need to pay to cover interest costs.

There are further benefits for member states funding via the ESM:

- The ESM's experience in raising funds in times of crisis and reducing funding costs for member states;
- The Pandemic Crisis Support is cash that member states can use to help citizens where they are hardest hit: health, medical, and all other related direct and indirect costs;
- It is very attractive financially, as it is cheaper than some countries can fund themselves in the market;
- No country is singled out, as the money is available to all members of the euro area on equal terms. So no stigma for countries.

The Pandemic Crisis Support is even attractive to countries with strong market access. The current crisis will sharply impact government budgets, which will lead to increased bill and bond funding. Should liquidity tensions arise in the market, this may negatively impact funding costs of otherwise sound and solvent countries, such as countries with less regular issuance and those with smaller investor bases.

If such countries need immediate capital market funding, and cannot afford to wait for better market conditions, they would normally have to pay higher premia. With the ESM credit line, they have another option: they have a new low cost funding source, helping take some of the pressure off issuing bonds and bills. When market conditions improve, these countries can gradually replace ESM funding with market funding.

Why is this Pandemic Crisis Support also interesting for investors?

The set-up of a credit line does not translate into the immediate drawing of the EUR240 billion.

One scenario is that no one draws, but the option remains to receive the credit line at short notice. The Pandemic Crisis Support is a rapid financing line, if markets get difficult. It will be an additional funding option for the member states. What is more, the very existence of the credit line would give member states and their Debt Management Offices more strength in the market for their own domestic issuances. Investors in sovereign debt will know that countries always have an additional financing line, which will increase their confidence in buying national debt, thus suppressing national yield levels. We reinforce this confidence by obligating ourselves to disburse parts of the credit line within five days. These are billions of euros that can be deployed at very short notice.

Another scenario is that some of those countries having a substantial advantage in funding via the ESM will indeed draw. In this case, the activation of a fraction of the EUR240 bn may be one of the shorter-term outcomes.

Once Pandemic Crisis Support credit lines are activated, we will revert to our 1,700-strong global investor community and our bank underwriters. The ESM has a wide range of products with different maturities to spread additional potential supply and raise the money smoothly in the market, as we have done on previous occasions. We would raise the money through the issuance of short-term bills and long-term bonds in the markets.

The ESM is a regular and well-established issuer in all these market sectors. We can also use the US dollar market - which is always swapped backed immediately to euros to avoid currency risk - to garner additional interest from investors, especially from global central banks that keep a majority of their reserves in US dollars. We have recently demonstrated our agility with our brand new 12-month bill line launched two weeks ago. On the bond side, we have shown we can issue bonds with very long maturities to reach all parts of the curve. At the same time, we always have the capability to swap maturities to floating rate or shorter maturities if necessary.

As the money raised through ESM bonds will be allocated exclusively to healthcare expenditures by member states, these bonds could be viewed by investors as the ultimate social stability bonds in response to the Covid-19 crisis. The issuance of social stability bonds to finance the Pandemic Crisis Support would broaden our investor base and thus our funding capacity even further. The ESM issuing social stability bonds for the corona crisis is aligned with our general environmental, social, and governance (ESG) profile. We have done a lot in this space recently.

What are the next steps?

Once our Board of Governors has set up Pandemic Crisis Support - the plan is to have this done by 1 June - member states can decide whether they want to apply. Until then, our funding requirements remain as communicated to the market. We will inform market participants immediately of any changes. For now, the EUR6 billion of ESM issuance left for the rest of 2020 remains.

Our member states have established the ESM as a crisis resolution tool to safeguard financial stability in the euro area. The euro crisis required specific responses and we were able give them, helping affected countries to overcome the crisis and to stay within the currency union. The coronavirus crisis is totally different. That is the reason we are adapting our responses to this specific crisis.

[1] European Council (2020) Conclusions of the President of the European Council following the video conference of the members of the European Council, 23 April 2020