Is the euro safe? The importance of a functioning currency - speech by Klaus Regling

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(Please check against delivery)

Ladies and gentlemen,

Thank you very much, Mr. Tojner, for the interesting introduction.

On 1 January 2019, we celebrated the 20th anniversary of the euro. The euro crisis, which we now have overcome, also occurred during this period. Therefore, asking whether the euro is safe today is a legitimate question.

In my brief introduction, I would like to address the following three points:

- First, what has been done since 2010 to make the euro area and the euro safer?
- Second, what will be further implemented after the recent summit decisions to strengthen the monetary union and the ESM?
- And third, what else should be done to make the euro and the monetary union more resilient?

What has been done since 2010 to make the euro area and the euro safer?

Over a decade ago, the Eurozone slipped into the worst economic crisis in 80 years. This was initially the result of the global financial crisis, which was triggered in the US and reinforced by the Lehman bankruptcy.

Only two years later, our domestic euro crisis followed, for which we ourselves bear the responsibility. During this crisis, it became clear that within the framework of the first decade of monetary union, there had been some considerable failures of the Member States with regard to competitiveness, public debt, as well as real estate bubbles. In addition, the monetary union had institutional weaknesses and gaps.

Thanks to a broad package of measures that produced a positive impact, we are better positioned today. Through important measures, including the profound reforms in the Member States that received EFSF and ESM loans, as well as the unconventional monetary policy of the European Central Bank (ECB), the crisis was overcome. At the same time, coordination of economic policy at EU level has improved significantly. And the institutional architecture of Economic and Monetary Union (EMU) has been significantly strengthened by the creation of the Banking Union and the establishment of the two rescue funds which I manage (the EFSF and ESM).

In the context of the banking union, the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) were created.

In 2010, the temporary European Financial Stability Facility (EFSF) was established. Two years later, the permanent European Stability Mechanism (ESM) was created.

This rescue package closed an institutional gap in the initial concept of EMU. Before the crisis, there was no “lender of last resort” for countries.

Without the creation of the rescue funds, former programme countries such as Greece, Ireland and Portugal would probably have had to leave the monetary union. And Europe would look different today.

The ESM disburses loans only if the beneficiary country implements extensive reforms. This principle of “loans for reforms” has been used effectively for decades at the International Monetary Fund (IMF). And despite what some people claim, ESM programmes are not funded by taxpayer money.

Financing for the loans is raised by the two rescue funds on the market. Programme countries have to fully repay their loans with interest. Of course, our Member States do face risks as shareholders in rescue funds because the national budgets are liable for loans that are not repaid.

The ESM has the highest paid-in capital of all international financial institutions with €80 billion. The capital serves as security for investors. This security is why the ESM has an excellent rating and therefore pays low interest rates in the market.

The ESM passes on its favourable financing conditions to the beneficiary countries while applying strict conditionality. The low interest rates create large savings for the budgets of the beneficiary countries. In the case of Greece, this amounted to around €12 billion in 2017, which is almost 7% of Greek economic output.

Since 2011, the rescue funds have disbursed €295 billion to Ireland, Portugal, Greece, Spain and Cyprus. Today, Ireland, Portugal, Spain and Cyprus are experiencing high growth and rapidly falling unemployment rates. And they can easily refinance themselves on the market again. Greece is on track to making a recovery, provided it continues its reform path.

In short, much has happened since 2010 to strengthen the euro area. But we should not rest on that. Further steps would be useful to make monetary union less crisis-prone.

What is being implemented after the recent summit decisions to strengthen monetary union and the ESM?

That is why Europe is currently working on further deepening the monetary union. It is about the completion of the banking union, the further development of the ESM and fiscal issues.

First, a few words about the further development of the ESM:

In December, the Heads of State and Government adopted a proposal from the euro area finance ministers, which included the strengthening of the ESM. The finance ministers are now putting this into reality. What does this mean exactly?

First, the ESM will take on the role of a backstop in bank resolutions within the Banking Union - also known as the “common backstop”. This backstop, in the form of loan to the Single Resolution Fund (SRF), would only happen if the funds of the SRF were insufficient. Again, there will be no additional financial burden on taxpayers. If the ESM provides money to the SRF, the Fund will claim this money through contributions from European banks and pay back the ESM within three to five years. By 2024 at the latest, the backstop should be fully operational. We are currently working on details such as the voting and decision-making processes.

Second, the ESM will play a stronger role in future assistance programmes. In close cooperation with the European Commission, the ESM will take part in the future design, negotiation and monitoring of the assistance programmes. Both institutions agreed on their future cooperation in November 2018 and the Euro Summit confirmed this.

Third, the Eurogroup has reviewed the “toolkit” of the ESM. Overall, the ESM has various financial instruments. So far, only two have been used: long-term loans under an ESM programme, disbursed to Greece, Ireland, Portugal and Cyprus, and a loan to recapitalise the banking sector, provided to Spain. Part of the December decisions is also to make the ESM precautionary credit lines more efficient.

The Euro Summit decisions also strengthen the role of the ESM in matters of debt sustainability. It is the ESM’s duty to always maintain a creditor’s perspective. According to the ESM Treaty, the ESM can only lend to Member States if their debt is sustainable. In the future, the Commission and the ESM will jointly develop a debt sustainability analysis. In addition, the ESM can facilitate future discussions between creditors and a government on a possible debt restructuring, if this is desirable and useful.

What else should be done to make the euro and the monetary union fully resilient?

The December decisions are another important step towards a more robust monetary union. However, I believe that further steps would be useful to make the euro area permanently resilient.

With regard to the banking union, we should create a European deposit insurance scheme. With a credible joint deposit insurance, savers' fears that their deposits might not be returned in euros, but in a new, national currency would be redundant. This would eliminate the reason for national bank runs.

A credible deposit insurance scheme would improve the protection of savers across the Banking Union, regardless of where their deposits are located. It is the best guarantee that it will never be used. In short, risk-sharing reduces risks in this case.

However, the prerequisite for the introduction of a European deposit insurance is a considerable reduction in the risk exposure of banks. Legacy issues must first be tackled. In the meantime, progress has been made:

The core capital ratio of European banks was almost 15% in September 2018. And the volume of non-performing loans fell by around 12% in the euro area last year, and even more in the problem countries.

However, as there are still some countries with legacy issues in banks, this trend must continue. Similarly, the high proportion of domestic government bonds in bank balance sheets should be reduced.

Together with a Capital Markets Union, a European deposit insurance scheme would make it easier to overcome the fragmentation of financial markets in Europe and to create a single European financial market. The degree of financial market integration in Europe today is far below the level it was 10 years ago. As a result of the crisis, there are 19 national financial markets today in the monetary union, not one integrated market. This prevents risk-sharing across the markets, which works so well in the US and ensures a quasi-automatic macroeconomic stabilisation.

To strengthen the euro area, there are also several proposals for new fiscal instruments for macroeconomic stabilisation and convergence of living conditions. But there is still no agreement on this question among the euro member states.

I think that additional instruments for macroeconomic stabilisation should be considered for the following reasons:

First, in a monetary union, there are two macroeconomic instruments: monetary policy and exchange rate policy. Therefore, only fiscal policy remains for member states to act, if necessary.

Second, monetary policy in a large economic area tends to always be pro-cyclical. Regions or countries with high economic growth and thus higher inflation tend to have low real interest rates. Low growth regions and countries tend to have high real interest rates. We see this in Europe as well as in the USA or China. That may be a reason to make use of fiscal policy.

Third, as already mentioned, economic risk-sharing in the euro area is much less developed than in the US. This applies to both risk-sharing across the markets and risk-sharing through fiscal mechanisms. In the euro area, there are no common tax and social security systems that permanently stabilise business cycles (as in the US states).

Of course, before any fiscal macroeconomic stabilisation instrument is used in the euro area, all euro area countries should first use their national fiscal buffers. This is what the Stability and Growth Pact suggests. These buffers must therefore be built up first. But the national buffers could be strengthened by European instruments to have more fiscal space in a crisis.

There are several proposals for macroeconomic stabilisation in the euro area: investment stabilisation, reinsurance of national unemployment schemes, rainy day funds, short-term ESM loans. All these proposals serve the same purpose, namely additional risk-sharing between the member states in the euro area. This will prevent small crises from escalating into major crises that would force the ESM to step in. Importantly, all these proposals could be designed so that they do not lead to permanent transfers.

Coming back to the introductory question by raised by Dr. Tojner: Is the euro safe?

The decisions of the Euro Summit aim at making the euro safer. However, there are still some additional steps needed to complete the monetary union and to make the euro permanently safer. The ESM will make a decisive contribution to this.

Thank you very much.

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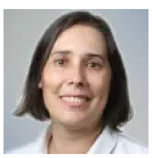

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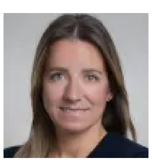

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