Is the Euro Crisis Over?

Klaus Regling, Managing Director, ESM

Institute of International and European Affairs, Dublin

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Europe reacts to the euro crisis at national and EU level

A comprehensive strategy

- Significant fiscal consolidation and structural reforms at national level
- Improved economic policy coordination in the euro area
- Preparing the system for the future: reinforcing the banking system
- Financial backstops (EFSF and ESM)
- Focus now on growth
The strategy is delivering results - competitiveness

- Divergences within EMU are declining
- Competitiveness is improving in all Member countries having requested EFSF/ESM financial assistance

Nominal unit labour costs, whole economy (2000=100)

Source: Eurostat, EC European Economic Forecast - Autumn 2013
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 – Autumn 2013

* Actual figure for Ireland in 2010: -30.6%
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 rules** are introduced in national legal systems
  - **European Semester**: yearly cycle of economic policy coordination
  - Stronger emphasis on **avoiding macroeconomic imbalances**
  - New focus: **avoid “spillovers”** of bad economic policy from one euro country to another
Reinforcing the banking system

- The EU established **three new European supervisory authorities: EBA, EIOPA and ESMA**. The new **ESRB** early warning system for identifying and monitoring macro-prudential risks is functioning.

- 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

- Regulatory framework at **national level** to be harmonized: **CRDIV/CRR, BRRD, DGSD**. The CRDIV/CRR will be implemented this year. Agreement with the European Parliament on BRRD, DGSD was achieved in December 2013.
Towards Banking Union

- **Single Supervisory Mechanism** (SSM) for euro area banks will be operational in November 2014
- **Bank Recovery and Resolution Directive** (BRRD) will create a uniform framework for bank recovery at national level
- Proposal for **Single Resolution Mechanism** (SRM) with **Single Resolution Fund** (SRF) agreed by European Council in December 2013
- **ESM Direct Recapitalisation Instrument** will be operational once SSM enters into force and euro area MS unanimously approve
- Harmonisation of **national deposit guarantee frameworks** (amended directive to be adopted)
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* * * Including in non-programme countries

All assistance is linked to appropriate conditionality

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

* * * Including in non-programme countries
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: €222 bn
  - Macroeconomic adjustment programmes for Ireland, Portugal, Greece and Cyprus
  - EFSF may no longer engage in new financial assistance programmes (as of 1 July 2013)
  - Ireland and Spain have exited their financial assistance programmes

- **Potential concerted ESM – ECB intervention (Outright Monetary Transactions/OMT)**
  - ESM programme provides conditionality
  - The ECB could engage in secondary market purchases.
“Clean exit” from financial assistance programmes by Ireland and Spain

**Ireland**

- EFSF financial assistance programme **concluded on 8 December 2013**
- Ireland received a total of €67.5 bn in loans from international lenders; **€17.7 bn from the EFSF**
- Thanks to international support and a macroeconomic adjustment programme, Ireland’s **GDP is expanding** and **unemployment has been declining** for 6 consecutive months
- Ireland’s banking sector has undergone **significant correction** (downsizing, recapitalisation and deleveraging)

**Spain**

- ESM financial assistance programme (loan to Spanish government for bank recapitalisation) **concluded on 31 December 2013**
- Spain received **€41.3 bn** in loans (debt securities) from the ESM
- Thanks to ESM assistance, **banks have strengthened their capital, improved access to private funding and regained soundness**
- Successful bank restructuring has paved the way for Spain’s **real economy to rebound**
Measures to boost growth in EU

- Progress in resolving the euro crisis removes important uncertainties for investors, consumers, banks and financial markets
- EFSF/ESM programmes include long list of structural reforms
- Coordinated action at national and EU level for Growth and Jobs
  - Member States take action to achieve specific competitiveness goals
  - Member States coordinate policies to pursue growth-friendly fiscal consolidation and to restore lending to the economy
  - European “Marshall Plan” against youth unemployment
- European Investment Bank (EIB)
  - 90% of its lending supports sustainable growth and job creation
  - €10bn capital increase, which will raise lending capacity by €60 bn
  - EU-EIB Project Bond Initiative
Latest euro area growth figures are encouraging

- **GDP growth positive again** in Q2 and Q3 2013 after 6 quarters of economic contraction
- **Industrial production** in euro area grew 1.8% in October 2013, the fastest pace in over 3 years
- **Spain** moved out of recession in Q3 2013 after 9 negative quarters
- **Ireland’s GDP** expanded by 1% in Q2 and 1.5% in Q3 2013
- **Business activity** and **consumer confidence indicators** in euro area rose significantly in final months of 2013
- European Commission forecast for growth in euro area: **1.1% in 2014 and 1.7% in 2015**

Source: Eurostat, European Commission
The strategy is convincing the market ...

Source: Bloomberg - 10-year government bond yield, 9-year bond yield for Ireland
... allowing countries to once again borrow at sustainable rates ...

**Ireland**
- Successfully regained market access with the issue of a 10-year bond
- Interest rates have fallen (for 10y bond) from 15.15% in July 2011 to 3.2% in mid-January 2014

**Portugal**
- Successfully returned to markets with the issue of a 10-year bond
- Interest rates have fallen (for 10y bond) from 16.6% in Jan. 2012 to 5% in mid-January 2014

**Spain**
- Maintained access to long-term capital markets
- Remained a regular long-term borrower
- Interest rates have fallen (for 10y bond) from 7.56% in July 2012 to 3.7% in mid-January 2014
… as it was shown in the most recent auctions

- Demand was diversified both geographically and by types of investors
- Interest rates in longer term issuance reached historical lows in Ireland and Spain

Average yield at issuance of Irish 10 year bonds (%)  

Average yield at issuance of Spanish 5 year bonds (%)  

Source: Dealogic
Ireland: Fiscal adjustment helped to rebuild confidence

- After reaching more than 10% of GDP in 2011, the budget deficit is expected to fall to less than 5% of GDP in 2014.
- Government debt remains high but it is now expected to start to decline for the first time since 2007.
- Fiscal consolidation must continue.

*Source: Haver, European Commission*
Ireland: Growth was better than in the euro area

- **GDP is expanding again**: GDP expanded now for two quarters in a row and leading indicators point to a continuation of the recovery.

- Thanks to a solid performance of exports, the Irish GDP is now above its pre-programme levels.

Source: Haver, Eurostat
Ireland: Housing market is starting to recover

- **House prices are rebounding again**: House prices are increasing again (in Dublin) on a yearly basis, at a fastest pace than in other markets that have experienced significant corrections.

- Still, this increase is only compensating some of the significant fall since the peak in 2007.

*Source: OECD*
Ireland is on the way to recovery

- Ireland’s successful fiscal consolidation efforts have been **positively assessed by financial markets**
- Since the end of the programme, Ireland has been able to return to funding from **private debt markets**
- The example of Ireland confirms the experience of many other countries under IMF programmes: financial assistance combined with the implementation of necessary policy reforms is effective and allows countries to **return to economic growth**
- **Labour market** is a lagging indicator
The EFSF programme for Ireland is over, but challenges remain

- **Debt/GDP ratio** remains high
- Policies **consistent with fiscal targets** set in Stability and Growth Pact should be maintained
- **Structural reforms** to boost competitiveness should be carried on
- Irish banks need to continue implementing their **restructuring plans**
- With **house prices rising again** in Dublin, caution should be taken not to fuel a new bubble
Post-programme surveillance

- Euro area Member States exiting financial assistance fall under **post-programme monitoring** by the European Commission (based on EU’s Two-Pack Regulation)
- Countries will remain subject to monitoring until they have paid back a **minimum of 75%** of the assistance received
- Post-programme missions foreseen **twice a year** by the European Commission with the ECB
- The EFSF will establish an **“early warning system”** to assess the repayment capacity of beneficiary countries, closely collaborating with the European Commission and ECB
Conclusions: The euro crisis is not over yet . . .

. . . but the end is in sight:

- The euro area moved **out of recession** in Q2 2013
- Borrowing countries are reducing fiscal deficits and eliminating current account deficits as **competitiveness is restored**
- **Interest rate differences** between Northern and Southern Europe have been **cut by more than half**
- **Unemployment has stopped rising**, industrial production is growing and confidence indicators are up
Conclusions: Certain risks to economic recovery are still present

- Borrowing countries need to continue their **difficult adjustment**
- Some of them need continued **financial support**
- **Financial markets** in Europe are **fragmented**
- Potential growth in Europe will be **limited**

Yet we should keep in mind that . . .

- History shows that crises generally trigger **positive changes**
- This is also true in Europe: monetary union **will emerge stronger** when the crisis is over