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European Stability Mechanism (ESM)

ESM's new credit line supports low funding costs for euro-area countries, a credit positive

On 23 April 2020, the EU heads of government agreed at the European Council meeting to put in place the coronavirus support package that had been proposed by the Eurogroup on 9 April 2020. The Council's request is to have the package operational by 1 June 2020. The European Stability Mechanism (ESM, Aa1 stable) will take a prominent role with a new credit line of up to €240 billion.[1] In addition, the EU leaders agreed to work towards establishing a recovery fund to support the post-lockdown recovery, and tasked the European Commission to come up with a proposal linked to the next multiannual financial framework (MFF) for the period 2021-27.

The ESM's new €240 billion "Pandemic Crisis Support" credit line – together with the European Central Bank's €750 billion Pandemic Emergency Purchase Programme (PEPP) – will support favourable funding conditions across euro-area countries, a credit positive. The ESM benefits from low funding costs which are currently at around 0% for 10-year bonds, which could – if accessed – help in particular some of the lower-rated sovereigns that have been hard hit by the coronavirus outbreak, including Italy (Baa3 stable) and Spain (Baa1 stable).

The "Pandemic Crisis Support" credit line is based on the existing enhanced conditions credit line (ECCL)[2] which is an existing instrument of the ESM toolkit. This precautionary credit line can be drawn via a loan or a primary market purchase and has an initial availability period of one year; it can be renewed twice for an overall availability period of up to two years. The only condition to access the credit line will be that the requesting country uses the proceeds to "support domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID 19-crisis"; the interpretation of that condition is expected to be rather loose.

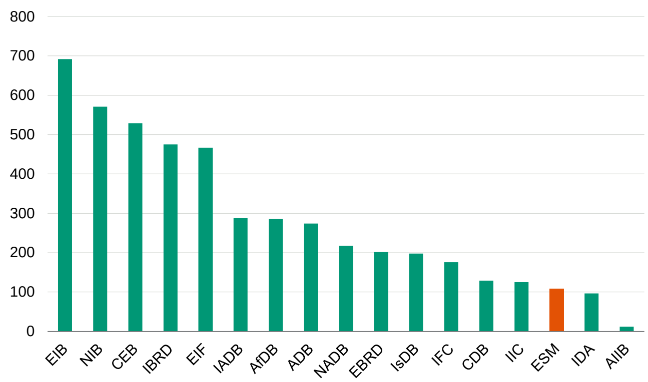
The "Pandemic Crisis Support" credit line will be available to all euro-area countries at a volume of up to 2% of 2019 national GDP. The maximum size of the credit line will be €240 billion or about 60% of the ESM's unused lending capacity of €410 billion. The European Council called for the new credit line to be available by 1 June 2020. The provision of the credit line requires approval by all ESM shareholders which includes parliamentary approval in some cases.[3] We expect that the actual usage of the credit line will be significantly below the €240 billion because we view it as unlikely that highly rated sovereigns such as Germany (Aaa stable) or the Netherlands (Aaa stable) would request the credit line as their funding costs do typically not exceed those of the ESM.

ESM's Aa1 rating with stable outlook is resilient to euro-area countries' use of the “Pandemic Crisis Support” credit line. That said, the usage of the credit line would increase the leverage ratio of the ESM from currently very low levels (see Exhibit 1). In addition, funding the draw-down of the credit line would increase the ESM's total debt, which in turn could affect the coverage of debt with ESM’s callable capital. However, callable capital would remain above 180% of ESM’s debt even if the full maximum amount of the new credit line were to be drawn (see Exhibit 2). Overall, we view the ESM's credit profile as being resilient thanks to its strong credit features – including substantial capital buffers, a low leverage ratio, a prudent capital and liquidity management, a strong liquidity position and a very strong support by its shareholders.

Exhibit 1

ESM's leverage ratio is one of the lowest among Aaa- and Aa1-rated MDBs

Leverage ratio, %

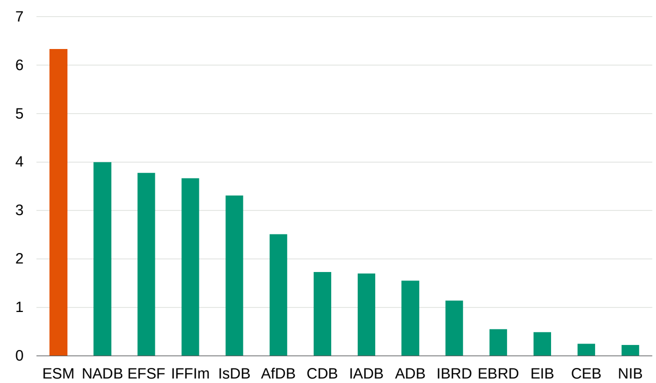


Sources: MDBs, Moody's Investors Service

Exhibit 2

ESM's contractual support is one of the strongest among Aaa- and Aa1-rated MDBs

Callable capital / total debt



Sources: MDBs, Moody's Investors Service

Moody's related publications

» **Sector Comment**: Euro area's coronavirus financial package supports low funding costs for sovereigns, 14 April 2020

» **Rating Action**: Moody's changes outlook to stable from positive on ratings of the European Stability Mechanism (ESM), affirms Aa1 ratings, 28 February 2020

» **Credit Opinion**: European Stability Mechanism – Aa1 stable: Update following outlook change to stable from positive, 28 February 2020

» **Credit Analysis**: European Stability Mechanism – Aa1 stable: Annual credit analysis, 11 March 2020

» **Rating Methodology**: Multilateral Development Banks and Other Supranational Entities, 25 June 2019

Endnotes

1 The maximum size of the overall support package is €540 billion (4.5% of euro-area GDP). Apart from the ESM part, the package includes SURE, a temporary EU unemployment reinsurance fund of up to €100 billion, and a €25 billion guarantee fund of the **Eurpean Investment Bank** (EIB, Aaa stable). The latter could provide bank financing for SMEs of about €200 billion according to EIB estimates (see **Euro area's coronavirus financial package supports low funding costs for sovereigns**, 14 April 2020).

2 Note that the Eurogroup agreed in principle on a package of reforms to the ESM in December 2019. Those reforms of the ESM will be included in a revised ESM treaty, which will come into force after ratification by all 19 ESM members. The reforms will further raise the ESM's profile and relevance through the following key measures: ESM will become "lender of last resort" to the Single Resolution Fund (SRF); access to ESM's precautionary credit lines will be made easier and more predictable; ESM's role in devising financial support programmes will be strengthened; and in the event of a request by a euro area country and if appropriate, the ESM can be involved in debt restructuring on a voluntary and informal basis by facilitating dialogue between the country concerned and investors. See for more details **European Stability Mechanism - Aa1 stable : Annual credit analysis**, 11 March 2020.

3 Parliamentary approval for the new credit line will be required, for example, in **Germany** (Aaa stable), **Austria** (Aa1 stable) and **Finland** (Aa1 Stable). Note that the need for parliamentary approval depends on constitutional requirements and can be different for different ESM decisions.

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