ESM and EFSF lending fosters budget savings

The ESM and the EFSF provide loans to distressed countries at much lower interest rates than those the market would offer. For Ireland, Greece, Spain, Cyprus, and Portugal, these favourable lending terms have generated budgetary savings, facilitating fiscal consolidation and/or tax cuts.

ESM/EFSF's programme countries benefit from the rescue funds' favourable lending terms.

We estimate these savings by comparing the effective interest rate payments on ESM and EFSF loans with the interest payments these countries would have paid had they covered their financing needs in the market. Estimating total budgetary savings requires two steps.

Budgetary savings estimation is a two-step process.

First, we estimate the direct budget savings per disbursement using the spread between the market rates and the actual ESM and EFSF cost. In short, for every disbursement, the ESM and EFSF rate is compared to the 10-year bond yield, used as a proxy long-term market rate, although the actual refinancing would probably be done at a shorter maturity in periods of stress. For our calculations, we apply a cap of 6.4% on market rates, reflecting the experience of the European crisis where an elevated yield approaching 7% has suggested significant sovereign stress and imminent loss of market access.[5] This maximum rate of 6.4%, used in the ESM calculations, also ensures consistency among countries.

The ESM first compares the spread between market rates and ESM/EFSF loan costs.

Second, we calculate the indirect benefits for the programme countries from the favourable ESM/EFSF refinancing costs. In particular, for each disbursement, the ESM calculates the gains from the previous year's reduced financing needs, making the same market rate assumptions as for direct budget savings.

Second, it calculates the indirect benefits based on the lower ESM/EFSF refinancing costs.

As Table 2 shows, budget savings are significant for all programme countries, especially at the peak of the crisis. Greece has benefited the most, with budget savings reaching 6.1% of GDP in 2017 from ESM and EFSF loans, and another 0.6% savings from the deferred interest, which will only come due after 2022. Cyprus is also benefiting as market rates remain relatively high. The other programme countries also benefited, although to a lesser degree, as the countries have secured market access, successfully exited their programmes, and now themselves enjoy favourable market conditions.

Budget savings are significant for all programme countries.

Table 2
Total budget savings for all programme countries
(in % of GDP)

	2011	2012	2013	2014	2015	2016	2017
Ireland	0.1	0.3	0.3	0.3	0.3	0.3	0.3
Greece		1.6	4.1	5.0	5.3	6.3	6.7
EFSF		1.6	3.7	4.3	4.4	4.8	5.0
Deferred interest			0.4	0.7	0.7	0.7	0.6
ESM					0.2	0.9	1.1
Spain			0.2	0.2	0.2	0.2	0.2
Cyprus		0.0	0.7	1.6	1.9	2.0	2.0
Portugal	0.1	0.4	0.6	0.7	0.7	0.7	0.7

Sources: ESM calculations based on European Central Bank and Eurostat data

[5] The development of market yields preceding the requests for official assistance for Greece (April 2010), Ireland (November 2010), and Portugal (April 2011) support these views. In all three cases, yields rapidly increased once they exceeded these levels. Empirically, the maximum yield at which countries in the euro area have been able to issue over the past eight years has been 6.4%. Therefore, we use this as the relevant benchmark.