EUROPEAN STABILITY MECHANISM

Klaus Regling, ESM Managing Director

“Europe’s growing resilience to crises”

Singapore, 19 May 2022

ESM Public

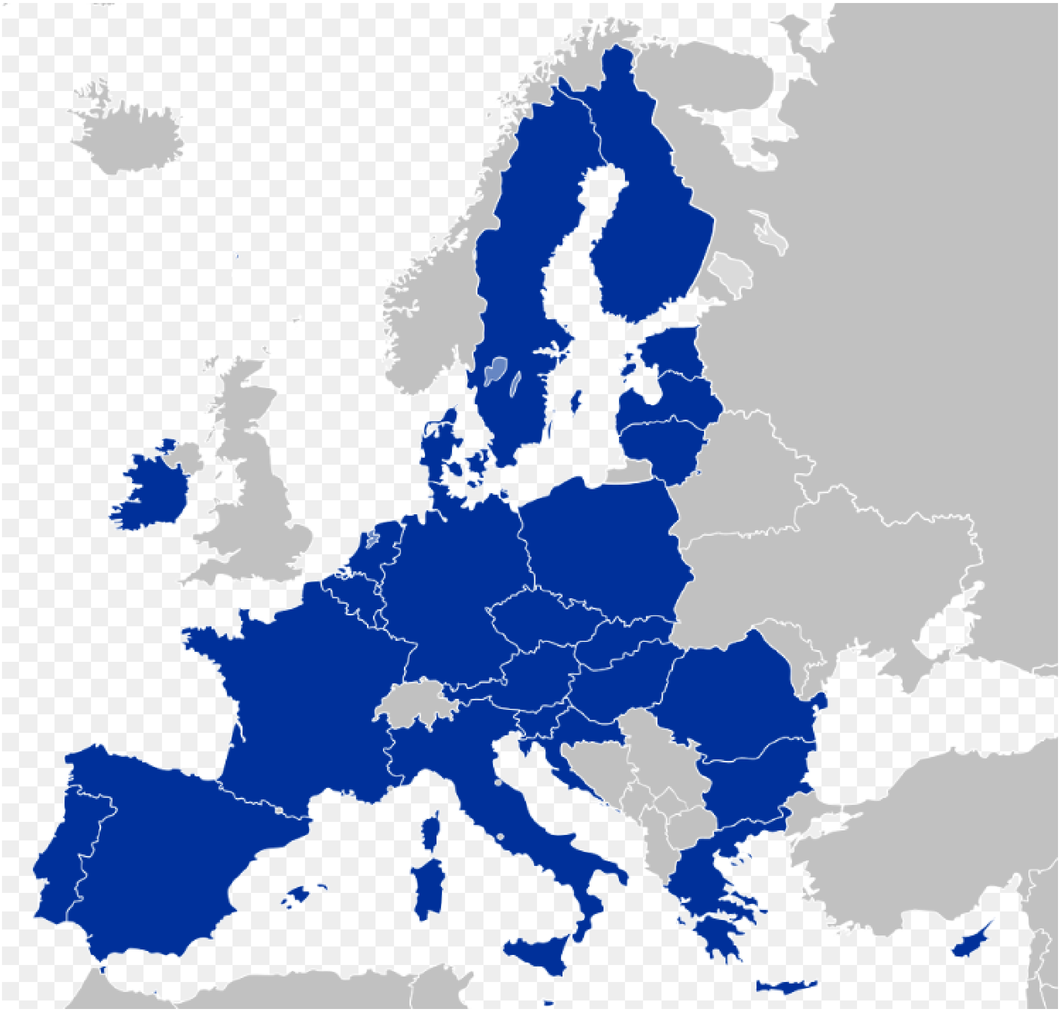
CONTENTS

European Stability Mechanism

THE EUROPEAN UNION; ECONOMIC AND MONETARY UNION

THE EUROPEAN UNION

- 27 Member States
- In 1952, 6 countries created the European Coal and Steel Community
- The EU is a single market where **workers, goods, capital and services** move freely
- **Common policies** in selected areas, e.g. trade, agriculture, regional development
- Key bodies
  - Council of the EU
  - European Commission
  - European Parliament
  - European Court of Justice
- 19 EU countries are integrated further in **Economic and Monetary Union**



ECONOMIC AND MONETARY UNION (EMU): MORE THAN A CURRENCY UNION

- EMU is the result of an **integration process**, dating back to the collapse of Bretton Woods system in 1971
- **European Monetary System** (1979-1999): exchange rate regime set up to prevent large currency fluctuations
- **EMU launched in 1999**; euro banknotes and coins since 2002
- The euro area has grown **from 11 to 19 member countries**
- EMU is not only an economic project, but also a **political project**

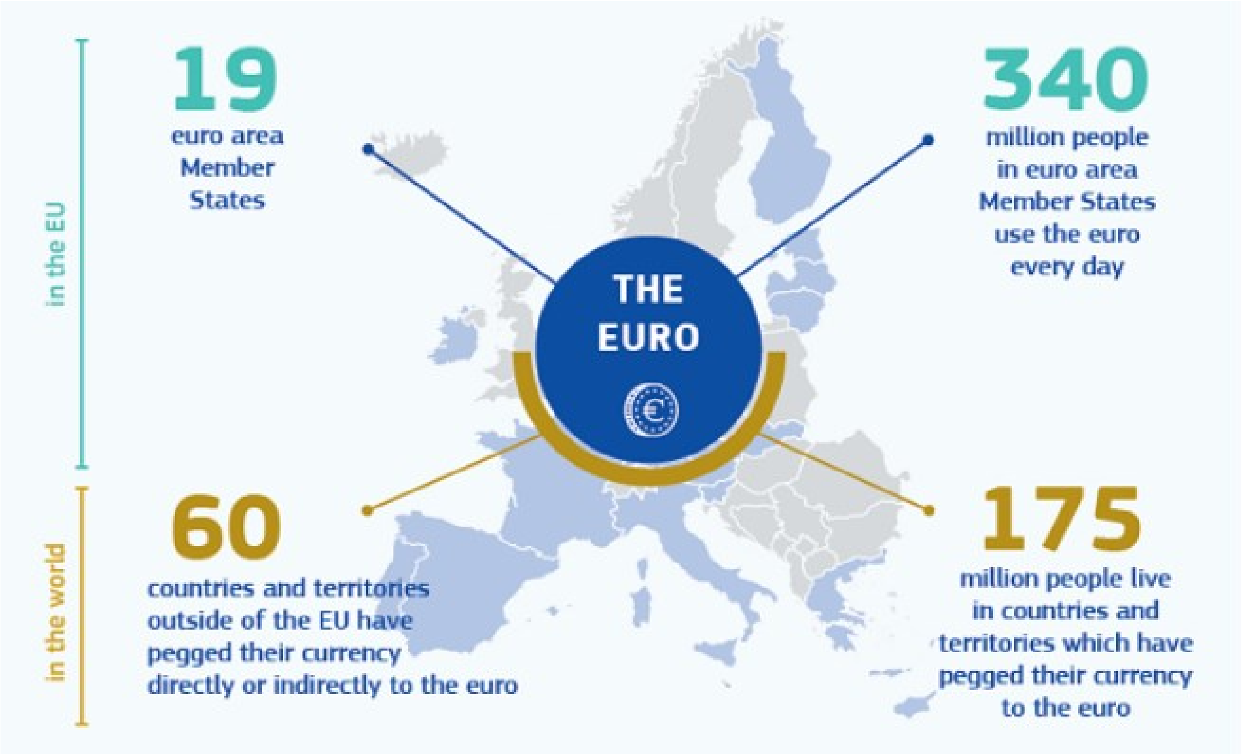


Diagram: European Commission

EMU has a unique institutional set-up

- **European Central Bank** (ECB) in charge of the euro area's monetary policy
- Ultimate responsibility for **fiscal and economic policies** remains at **national level …**
- **… But several coordination mechanisms**: Stability and Growth Pact (SGP), European Semester, Macroeconomic Imbalances Procedure
- **European Commission** monitors the respect and implementation of coordination rules, issues recommendations and may recommend sanctions

HOW EUROPE DEALT WITH FOUR CRISES

II

HOW EUROPE DEALT WITH FOUR CRISES

1. **Global financial crisis, 2008-2009**
2. **Euro crisis, 2009-2013**
3. **Covid-19 pandemic crisis, 2020-2021**
4. **Economic consequences of the war in Ukraine, 2022**

1. GLOBAL FINANCIAL CRISIS (2007-2009)

Overview

- Crisis sparked by downturn in US housing market (sub-prime loans); spread to other parts the world through linkages in the global financial system
- Bankruptcies of major banks and corporations (Lehman Brothers, General Motors, Chrysler)
- Trust in banking sector declined sharply, leading to ‘credit crunch’; banks had to limit their credit supply
- World GDP slowed from 3.1% in 2008 to -0.1% in 2009. Euro area GDP contracted by 4.5% in 2009

Causes

- A long period of low nominal and real interest rates resulted in a search for yield, low risk aversion and high leverage
- Excess consumption in the US and excess savings in Asia fuelled global imbalances
- Supervisors did not pay enough attention to macroprudential developments and to risks arising from new instruments
- Credit rating agencies underestimated the credit risk of structured credit products

1. GLOBAL FINANCIAL CRISIS (2007-2009)

Policy response

- Monetary easing
- Increased government spending to stimulate demand
- Government bailouts of private sector companies and banks
- Policy coordination in key areas by G20 (with EU participation)
- Strengthened oversight of financial sector; new institutions to monitor systemic risk
- Credit rating agencies subject to regulation

2. EURO CRISIS (2009-2013)

Overview

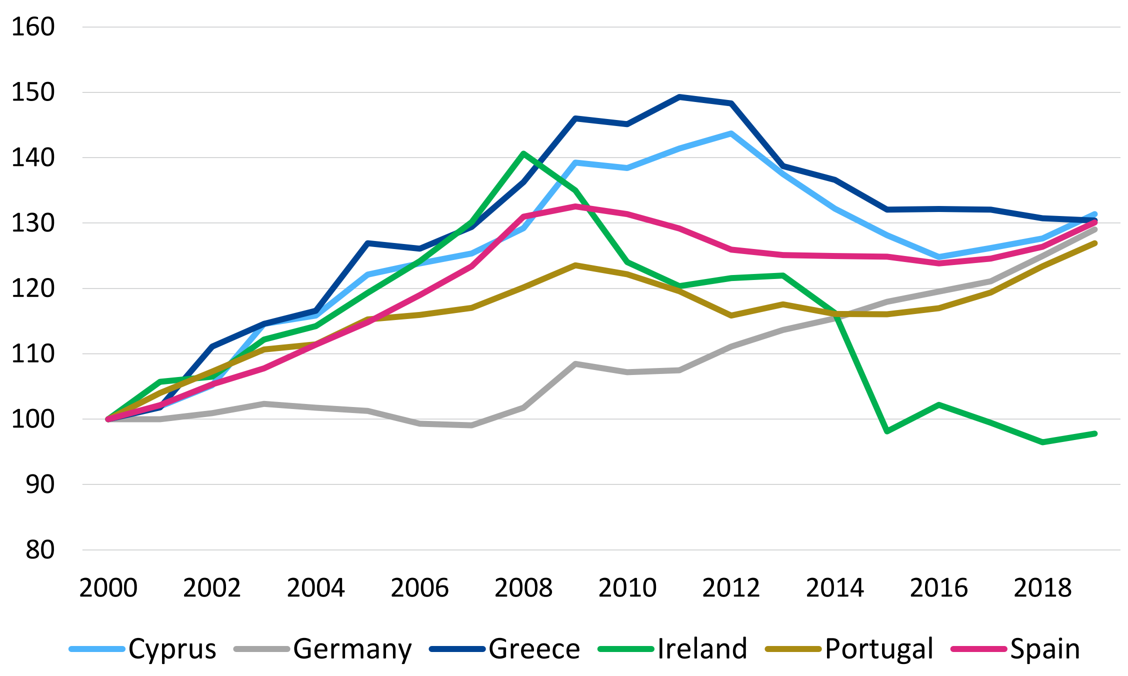
- Several euro area countries lost competitiveness, recorded high levels of public debt and large budget deficits
- As a result, these countries lost market access
- The problems spilled over to the whole euro area, in the form of economic recession, higher unemployment
- Euro area GDP declined by 1.1% (2012-2013) as result of the crisis

Causes

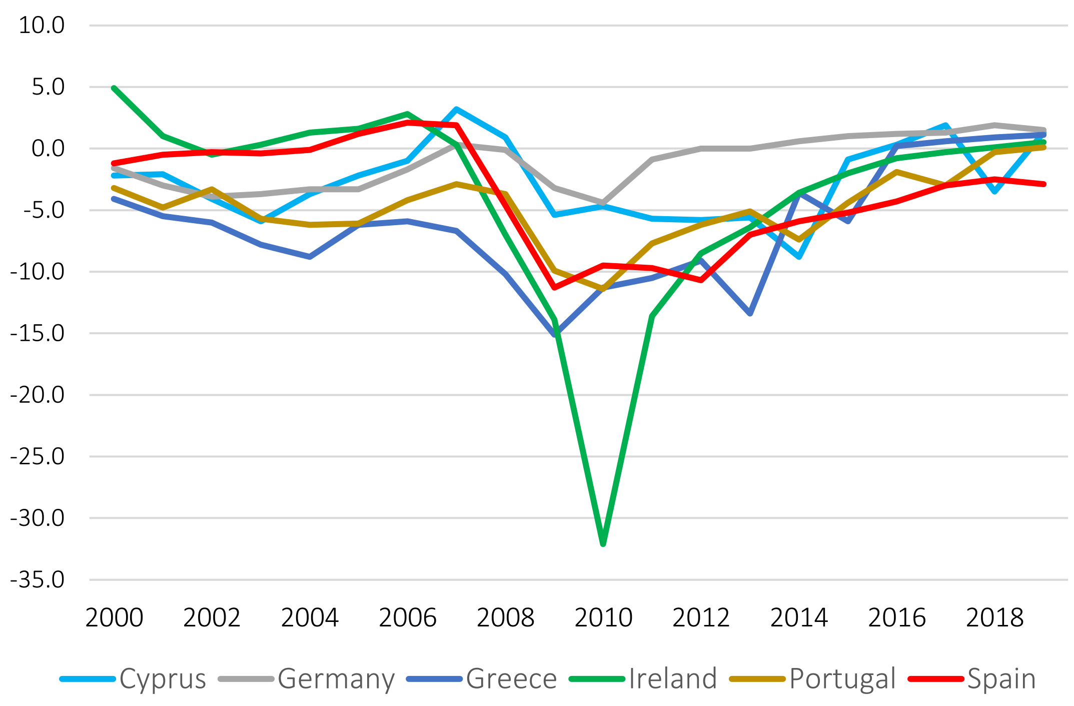
- Lax policies during first decade of EMU in some member states
- Weak coordination of macroeconomic policy at EU level
- Banking supervision and resolution purely national
- No macroprudential supervision at European level
- No lender of last resort for sovereigns

SEVERAL COUNTRIES AFFECTED BY LOSS OF COMPETITIVENESS; HIGH FISCAL DEFICITS

Nominal unit labour costs (2000=100)



Fiscal balances (% of GDP)



Source: AMECO

2. EURO CRISIS (2009-2013)

Policy response

- Adjustment in affected Member States
- Unconventional monetary policy by ECB
- Macroeconomic surveillance broadened and deepened
- Banking union: Creation of institutions responsible for banking supervision and resolution at European level – Single Supervisory Mechanism (SSM), Single Resolution Board (SRB)
- Creation of the two rescue funds - European Financial Stability Facility (EFSF) and European Stability Mechanism (ESM)

EFSF AND ESM PROGRAMMES

EFSF	ESM
Ireland (2010-2013) €17.7 bn	Spain (2012-2013) €41.3 bn
Portugal (2011-2014) €26 bn	Cyprus (2013-2016) €6.3 bn
Greece (2012-2015) €141.8 bn	Greece (2015-2018) €61.9 bn

Total amount disbursed by EFSF and ESM:

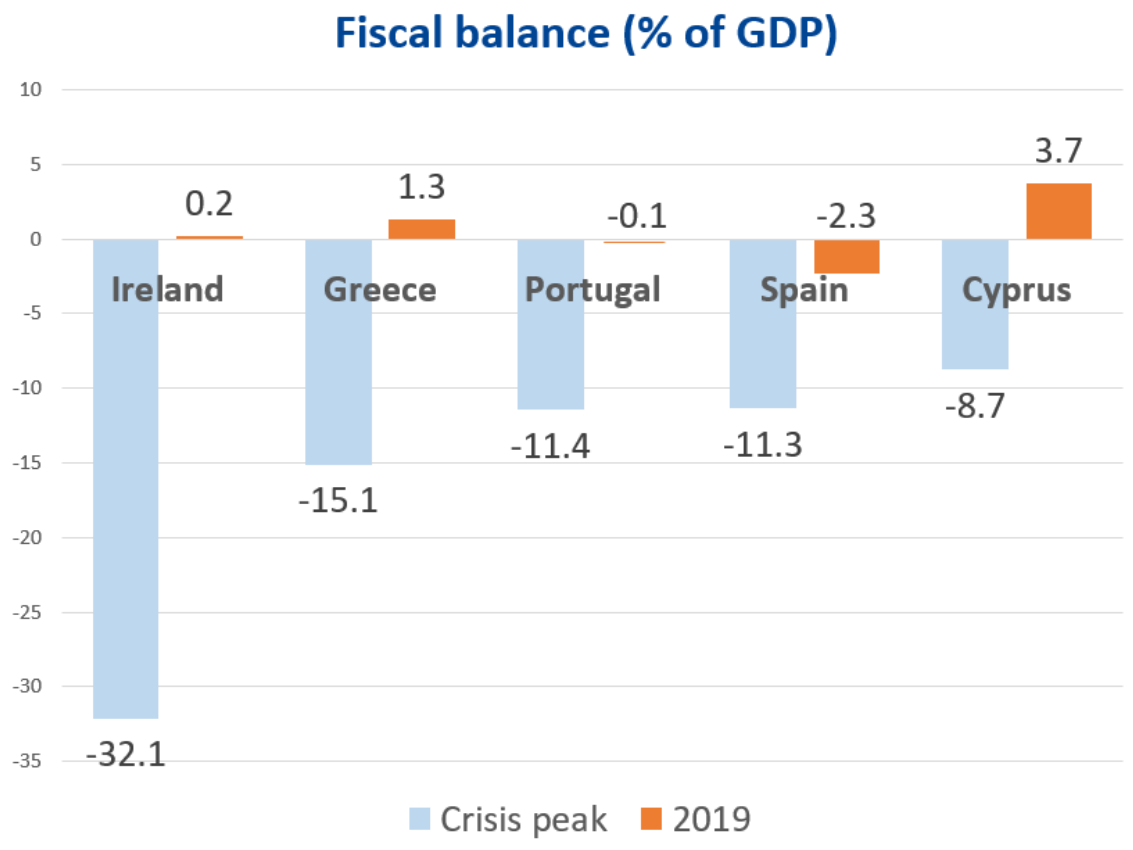
€295 bn

European Stability Mechanism

esm

ALL FIVE EFSF/ESM PROGRAMMES WERE SUCCESSFUL

- EFSF and ESM financial assistance gave programme countries the time to implement **vital reforms**
- As a result, all programme countries were able to **regain market access**
- All five countries **returned to economic growth**, well above the euro area average, which continued until the pandemic crisis broke out



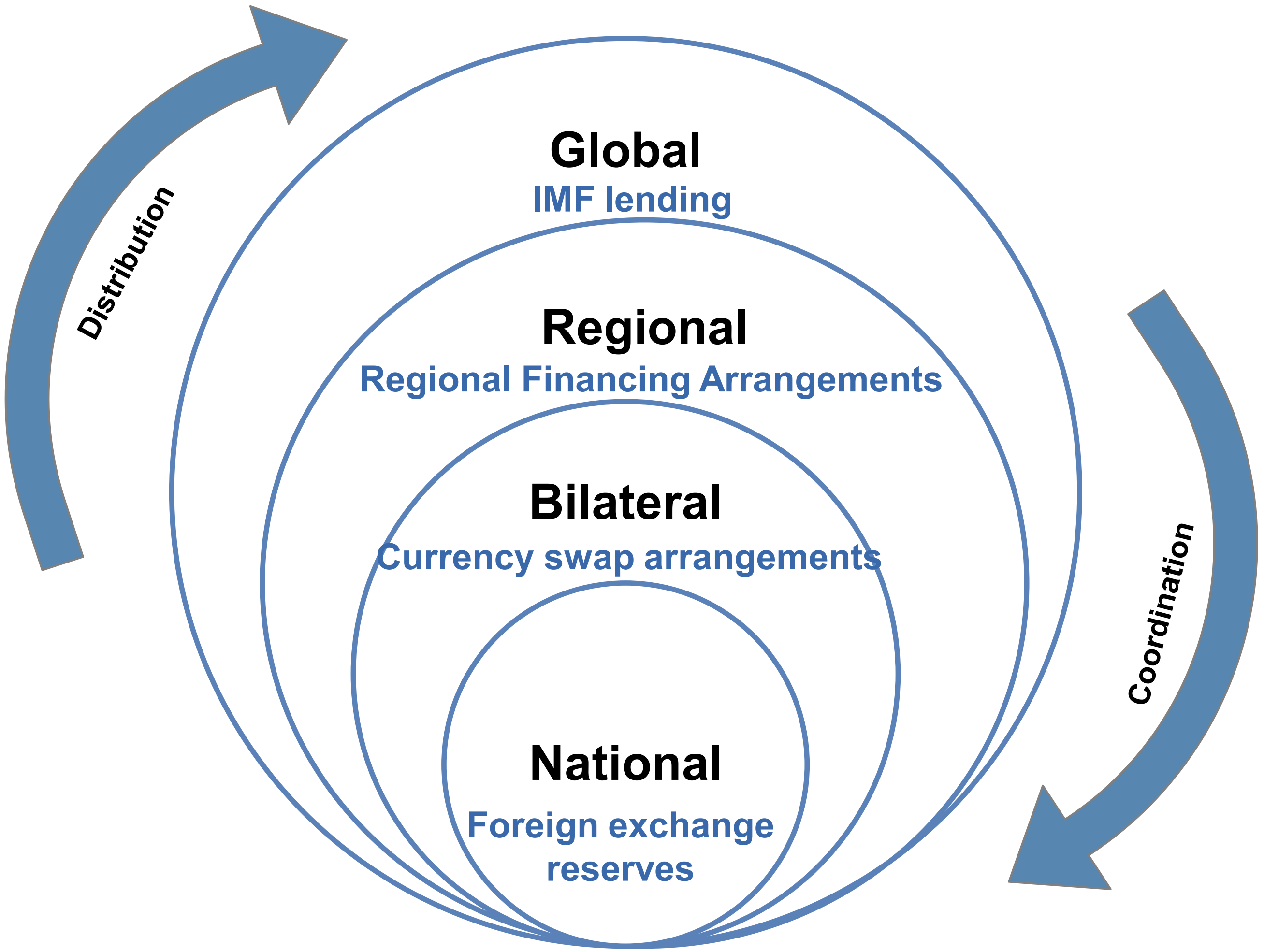
Source: AMECO

RFAs – REGIONAL LINES OF DEFENCE

- **Regional financing arrangements (RFAs)** provide regional lines of defence in the Global Financial Safety Net (GFSN)

- This helps to **prevent** and **mitigate** the effects of **economic and financial crises**

GLOBAL FINANCIAL SAFETY NET



3. COVID-19 PANDEMIC CRISIS (2020-2021)

Overview

- A symmetric shock affecting countries around the world
- Enormous human cost; over 6 million deaths worldwide due to Covid
- Unprecedented health crisis, forcing lockdowns which bought economic activity to a standstill in some sectors
- Significant decline in economic growth in 2020 (globally: -3.1%, euro area: -6.4%) and global trade

3. COVID-19 PANDEMIC CRISIS (2020-2021)

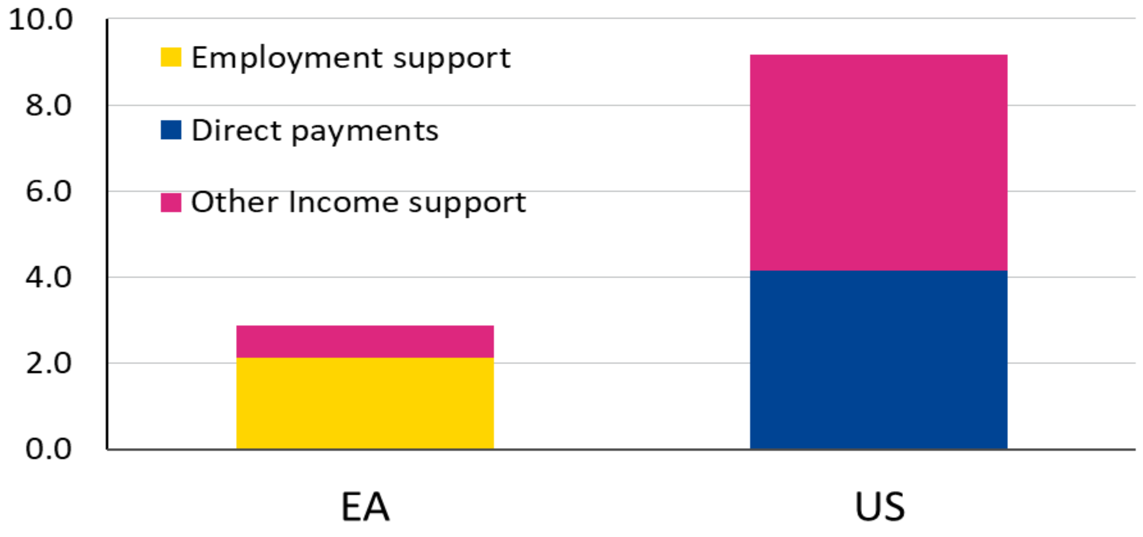
Policy response

- Fiscal measures (government support for businesses and households; employment support) at national level
- EU programmes to support member states, corporates and workers affected by the pandemic
- Monetary policy (significant additional asset purchases)

MAIN ECONOMIC "EMERGENCY" MEASURES: NATIONAL SUPPORT COMPARED

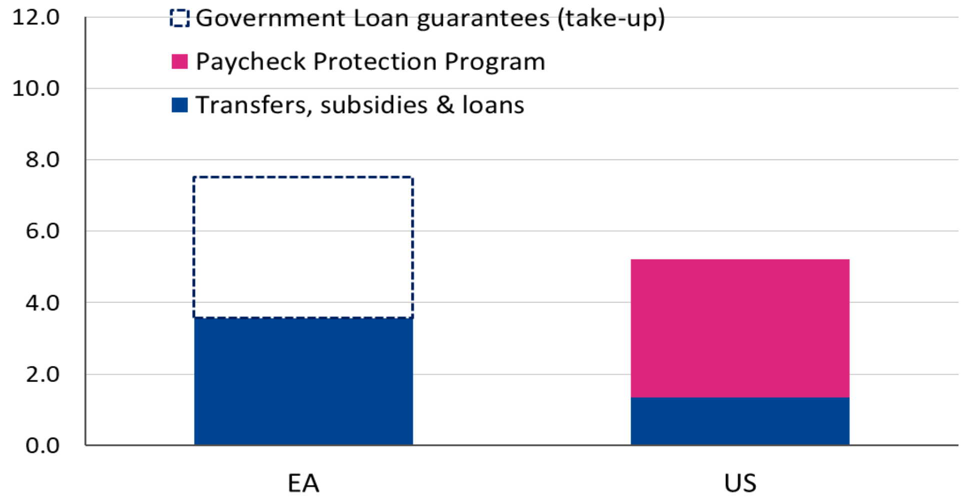
- **US: Direct support across the board** (households, business, state and local governments)
- **EA: support through existing social systems & liquidity to firms**

Covid-19 main discretionary measures: Households (% 2020 GDP)



Source: ESM based on EC, ECB, IMF and CRFB. Total measures approved for 2020-22. Only expenditure measures considered, NGEU financed stimulus included

Covid-19 main discretionary measures: firms (% 2020 GDP)



Source: ESM. Cumulative fiscal impact of measures approved for 2020-22. Only expenditure measures considered

IMMEDIATE RESPONSE AT THE EUROPEAN LEVEL

In May 2020, the EU Heads of State committed € 540 billion to fight the Covid-19 crisis

European Commission

Support for workers

Up to €100bn in loans to EU member states under the **European Commission's SURE** programme in support of national unemployment schemes.

European Investment Bank Group

Support for companies

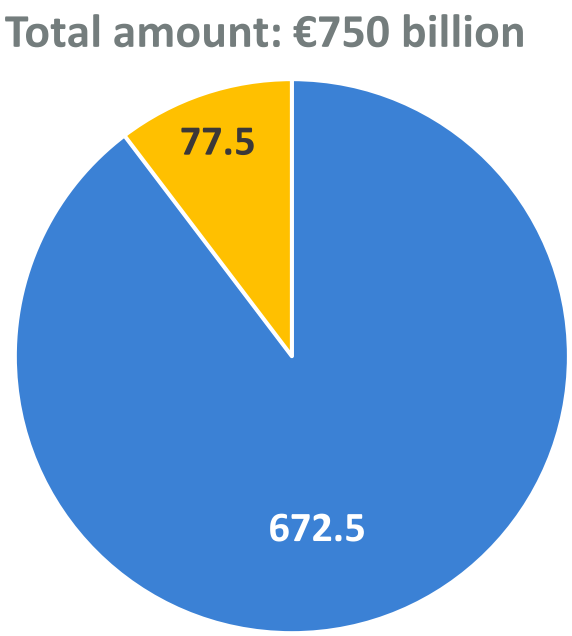
A pan-European **guarantee fund** by the European Investment Bank (**EIB**) of €25bn, which could provide around €200bn of financing for companies, especially SMEs.

Support for countries

The **ESM**'s **Pandemic Crisis Support**, a precautionary credit line with a total volume of up to €240bn, is available to all euro area countries until the end of 2022 to support healthcare-related costs of up to 2% of GDP.

LONG-TERM EU RESPONSE TO THE PANDEMIC: NEXT GENERATION EU

Next Generation EU recovery package (€ bn)



Recovery and Resilience Facility

- Grants (€312.5 bn) and loans (€360 bn) for member states to support reforms, investment and the green and digital transformation
- High degree of solidarity
- Based on country programmes approved by European Commission and Council

Augmentation of programmes under EU budget 2021-2027

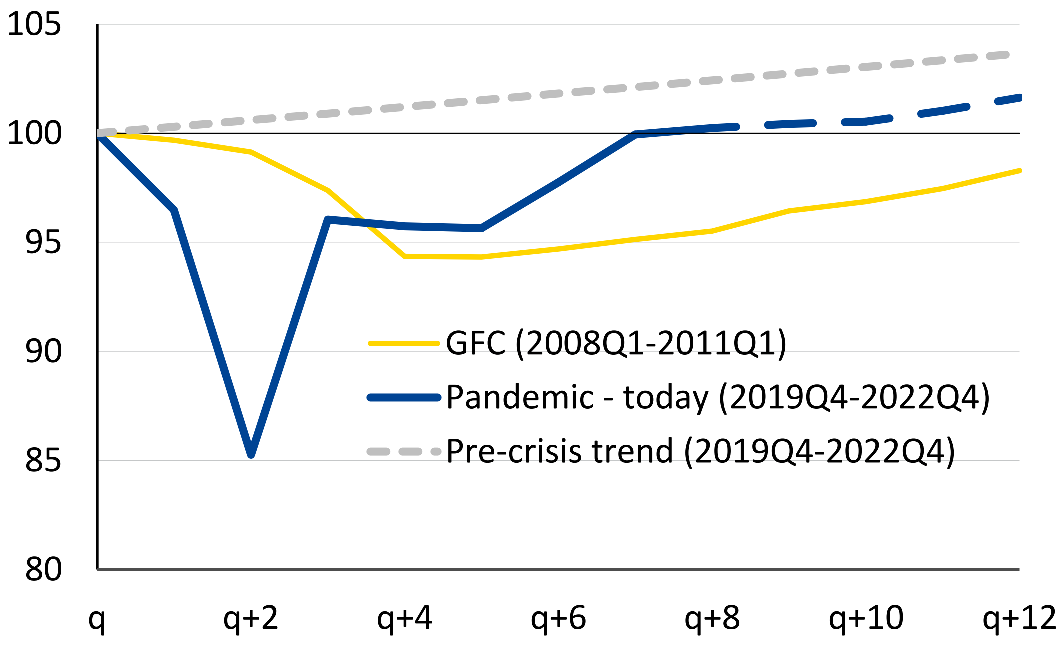
- Regional and rural development; climate neutrality; research and innovation

Figures expressed in 2018 prices

Source: European Commission

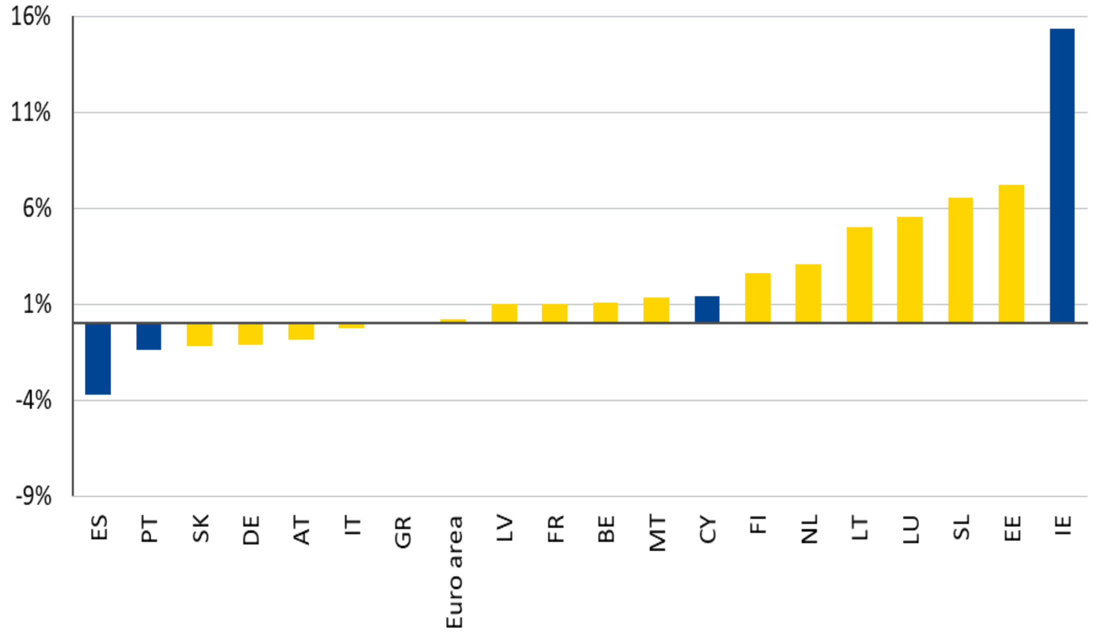
PRE-WAR: FAST RECOVERY FROM THE PANDEMIC, WITH CROSS-COUNTRY DIFFERENCES

EA real GDP level during the pandemic: comparison with the GFC
(Index pre-crisis quarter = 100)



Sources: ESM calculations based on EC 2022 Spring Forecast and Eurostat

Real GDP levels: Q4-2021 vs Q4-2019
(in %)



Source: Eurostat
Note: EFSF/ESM post-programme countries in blue. Multinational corporations' activities might distort GDP figures in Ireland.

4. ECONOMIC CONSEQUENCES OF WAR IN UKRAINE (2022)

Overview:

- Serious economic repercussions globally, but in particular, in Europe
- Rapid rise in inflation due to increasing energy and food prices
- Slower economic growth (1.3% decline in EA and global GDP)
- Increased uncertainty and volatility in financial markets
- Reduced global trade

UKRAINE INVASION: CHANNELS OF TRANSMISSION AND ECONOMIC IMPLICATIONS

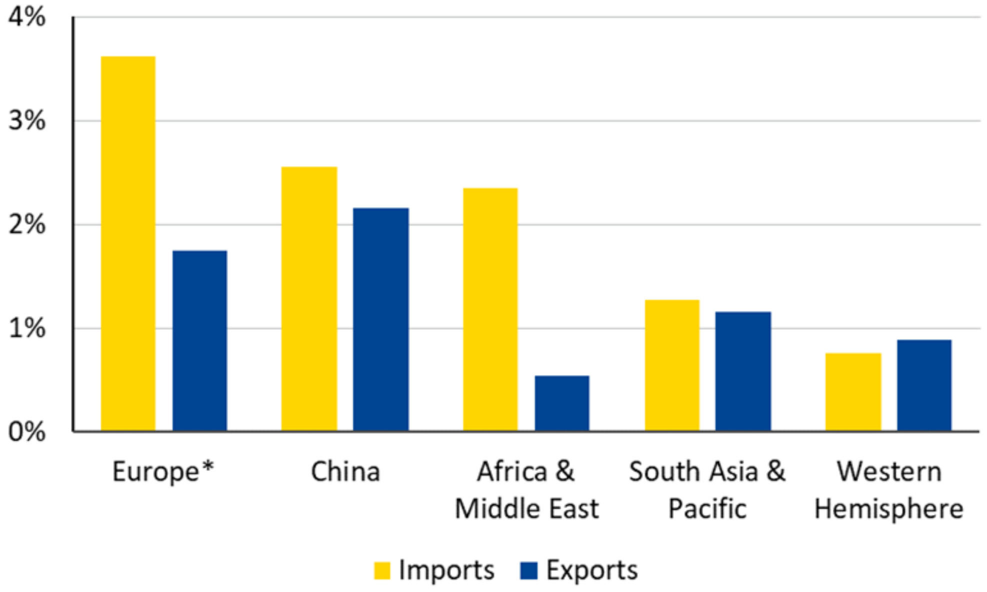
Channels of transmission

- Energy
- Food
- Trade
- Bank exposure
- Confidence

EUROPE MOST EXPOSED TO RUSSIA AND THE WORST HIT BY THE WAR IN UKRAINE

Europe most exposed to Russia…

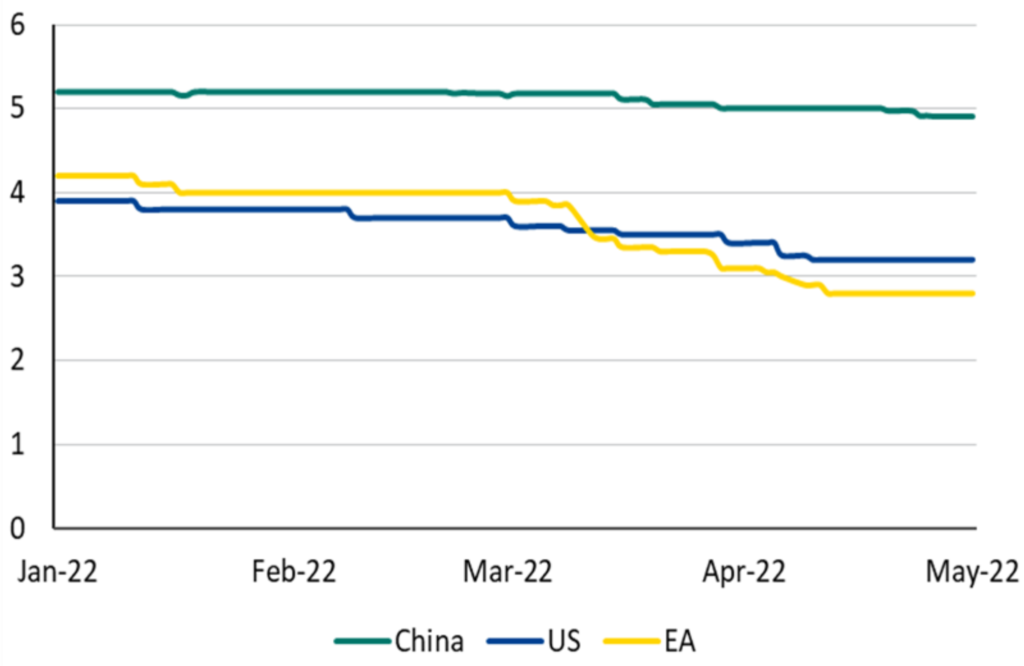
Share of trade in goods with Russia by region, %



Note: Europe includes Georgia, Moldova and Turkey;
Source: GDP weighted averages based on IMF Direction of Trade statistics.

…and the worst hit by the war in Ukraine

Market consensus expectations for growth in 2022

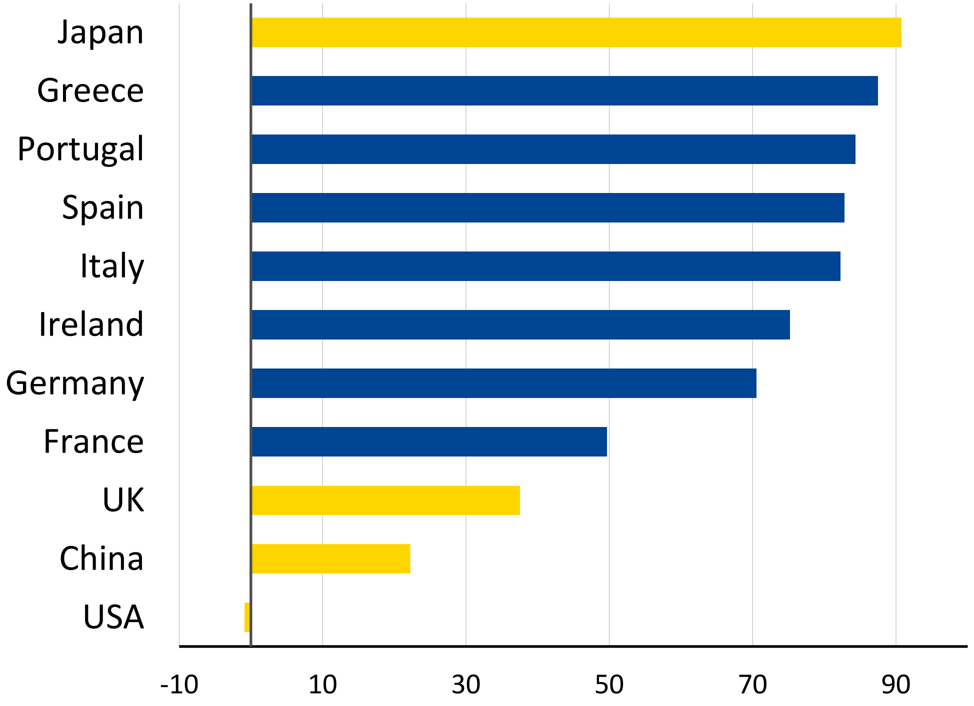


Source: Bloomberg

EUROPEAN ECONOMIES PARTICULARLY EXPOSED TO THE SHOCK IN ENERGY PRICES

Higher energy dependency of European economies…

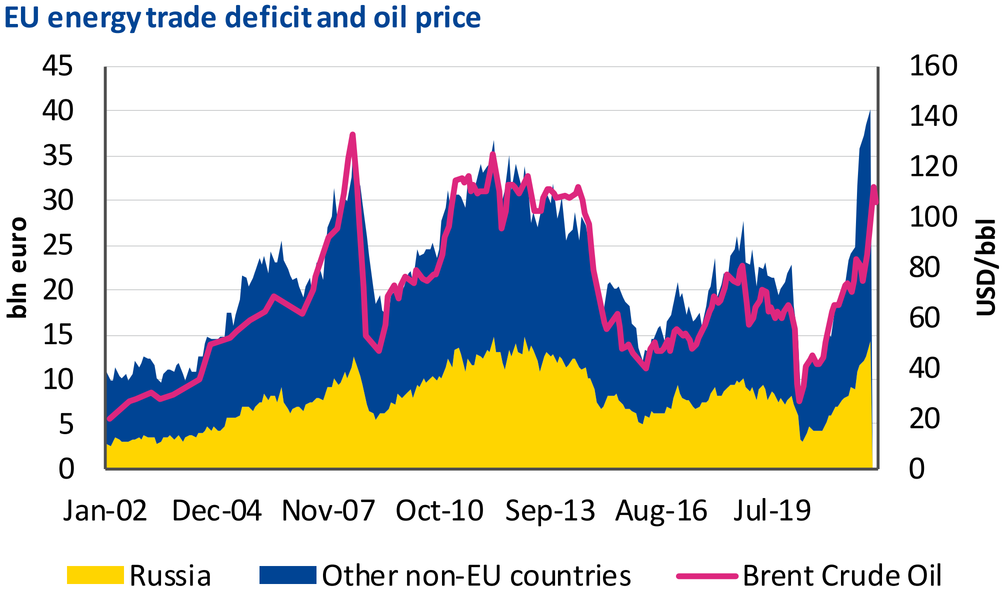
(net imports of energy goods/ total supply,%)



Source: International Energy Agency (IEA).

… results in transfers of income abroad when energy prices increase

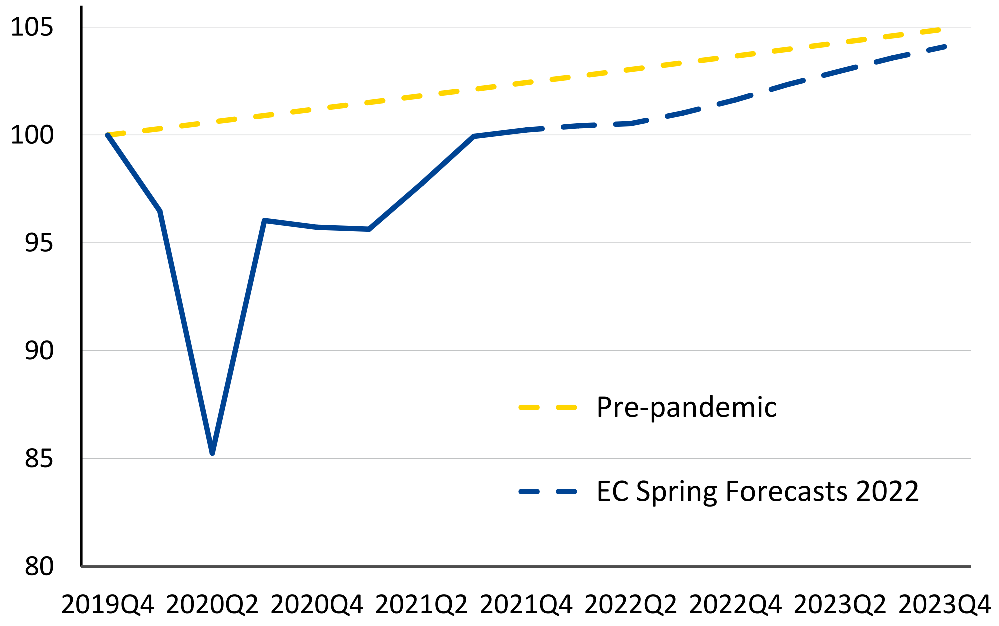
(EU energy trade deficit and oil prices)



Source: Eurostat and Haver Analytics.

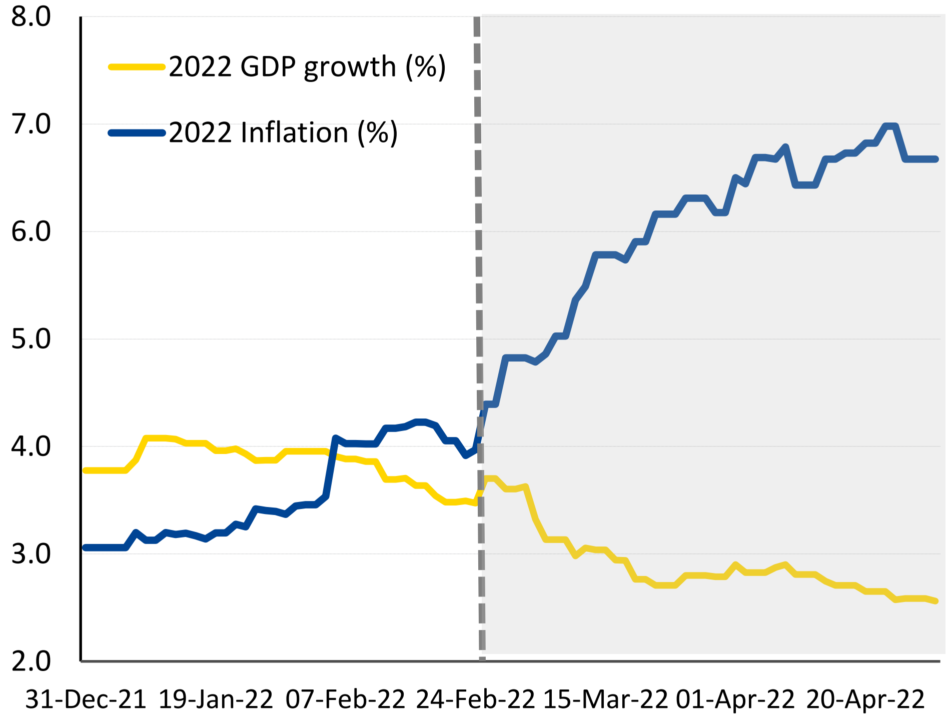
WAR IN UKRAINE TO SLOW DOWN THE RECOVERY AND INCREASE INFLATIONARY PRESSURES

EA real GDP level: pre- and post-war forecasts
(2019Q4 = 100)



Source: Eurostat and EC Spring 2022 forecast indicated by shadowed area.

EA growth and inflation: consensus forecasts for 2022
(daily, moving average)



Source: Consensus Forecasts, April 2022. Note: Continuous Consensus Forecasts calculated each business day as a Moving Average of the latest qualified changed forecasts.

4. ECONOMIC CONSEQUENCES OF WAR IN UKRAINE (2022)

Policy response (ongoing)

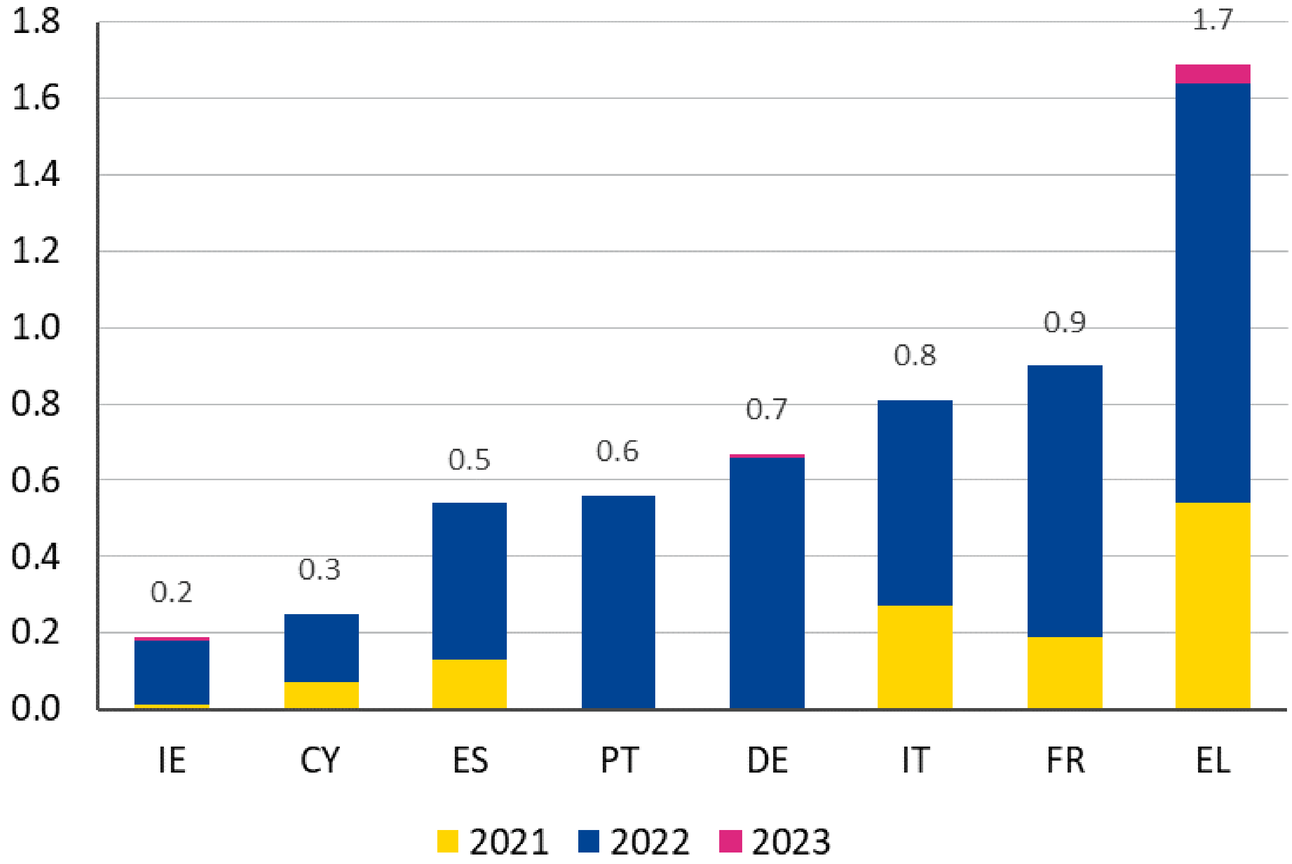
- Tightening monetary policy to curb high inflation
- Reducing dependency on Russian energy sources (oil and gas)
- Sanctions against Russian government and companies
- EU support for Ukraine and Ukrainian refugees
- Increased defence spending by EU member states
- Income support for households affected by higher energy and food prices

European Stability Mechanism

esm

FISCAL RESPONSE AT THE NATIONAL AND EU LEVELS

National fiscal measures adoptedin response to higher energy prices
(in % 2021 GDP)

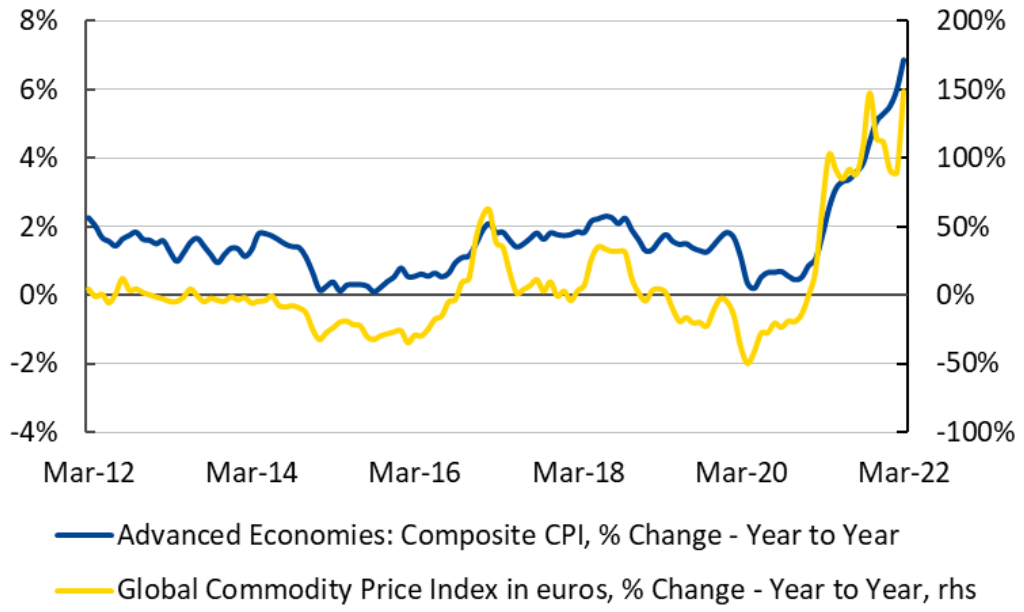


Source: European Commission. Notes: As of May 6, 2022. In the case of EL, in 2022, 0.6% of GDP of budgetary costs are covered by windfall revenues from emission allowances, which is not recorded here as an energy-related measure.

European Stability Mechanism
esm

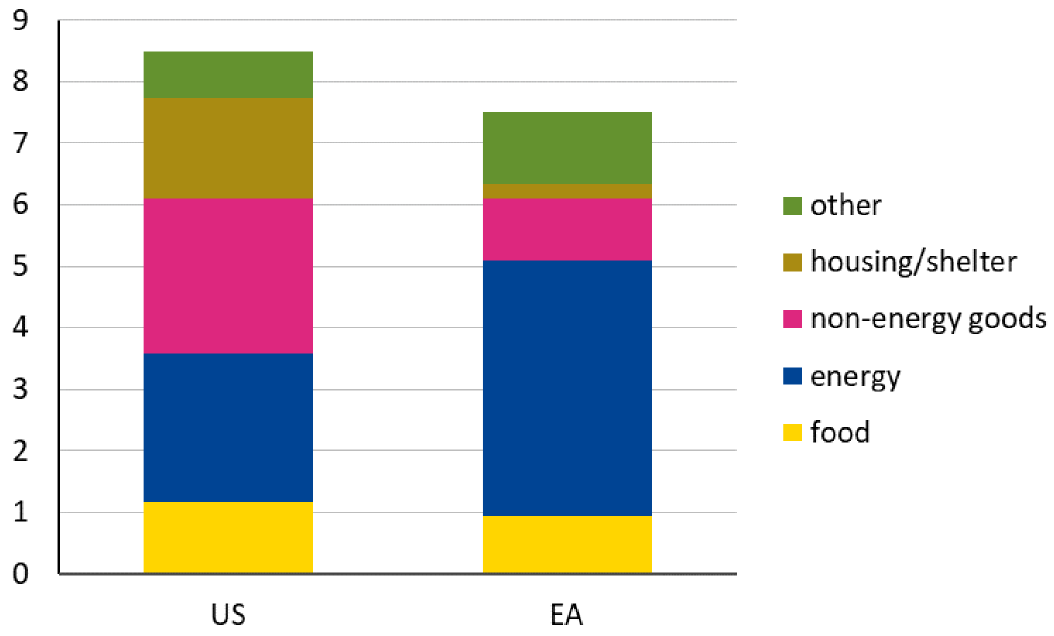
GLOBAL ENVIRONMENT: HIGHER INFLATION

Inflation is picking up
Year-on-year change in headline CPI inflation, %



Source: Haver

Contributions to headline CPI inflation in March in US and euro area, pps



Source: Markit via Haver

FUTURE EUROPEAN INTEGRATION

III

FURTHER DEEPENING OF ECONOMIC AND MONETARY UNION

Capital markets union
- Will reduce reliance on bank funding
- More cross-border capital flows

Completion of banking union
- Missing pillar: European deposit insurance scheme
- Safer banking sector will improve financial stability

Central fiscal capacity
- To help countries affected by significant asymmetric shocks

- **Europe will be more competititve**
- **Higher GDP growth**
- **More risk-sharing = less fragmentation**
- **Stronger international role of the euro**

NEW PROPOSALS FOR EUROPEAN INTEGRATION

French President Emmanuel Macron

- A “European political community” that would also include countries outside the EU
- This would be a new space for cooperation on politics, security, energy, transport, infrastructure, and the movement of people

Italian Prime Minister Mario Draghi

- EU needs “pragmatic federalism”, more integration, majority voting instead of unanimity for EU decision-making
- This would apply to areas undergoing transformation, i.e. economy, energy, security
- Requires revision of EU treaties