



EUROPE, FINANCIAL MARKETS AND THE BENEFITS OF JOINING THE EURO

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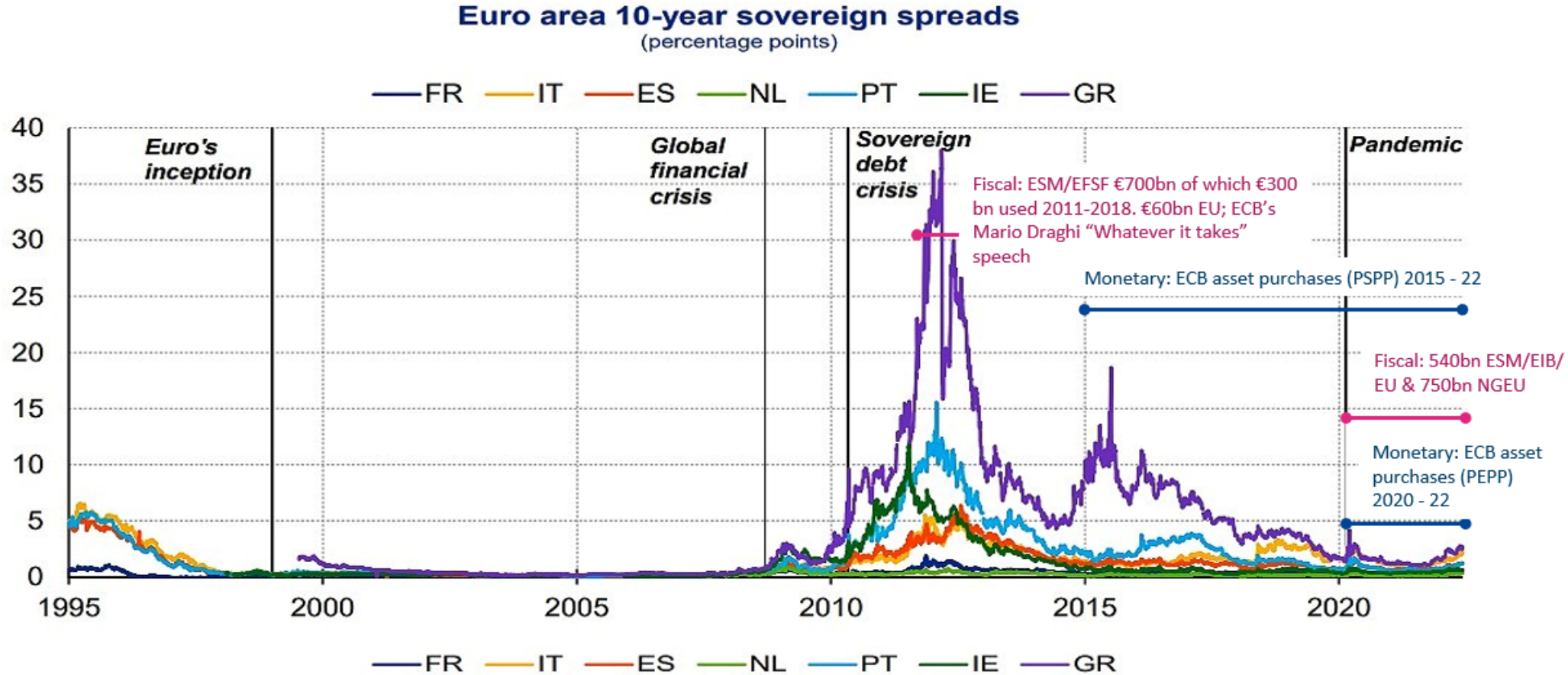
5 December 2023



KEY MESSAGES

- Euro 25 years - a great success
- Euro Area and Euro weathered Euro crisis and pandemic well
- Resulted in a stronger Financial and Banking architecture
- Globally – a stronger safety net as well
- ESM is the world's largest regional financial arrangement
- Since 2010, 4 countries joined the Euro – Croatia in January 2023
- Great benefits of adopting the Euro
- More volatile world – Euro area stronger and more resilient

UNITED FISCAL AND MONETARY RESPONSE MADE EURO AREA STRONGER AND CALMED MARKETS



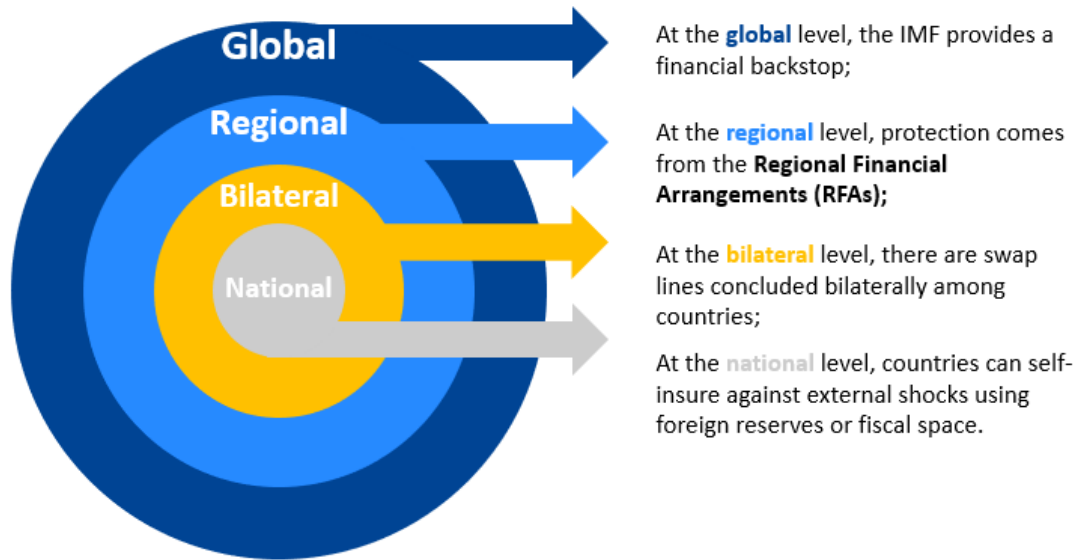
ESM WITHIN THE EUROPEAN FINANCIAL ARCHITECTURE



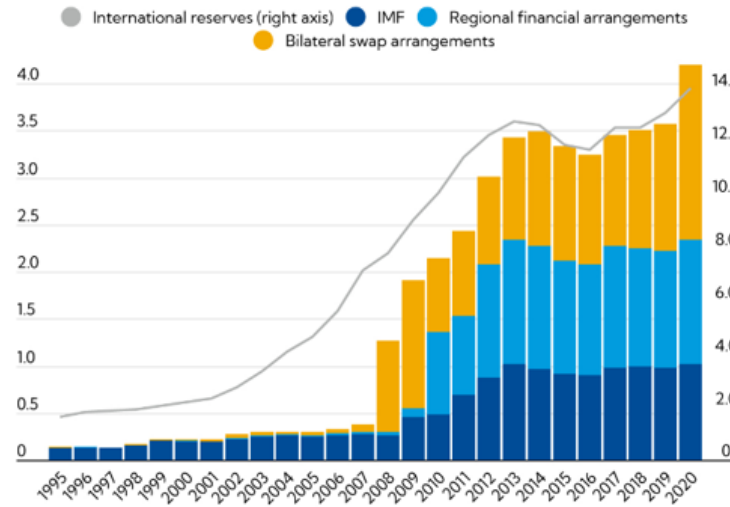
* Ratification of the Amending Agreement to the ESM Treaty ongoing

THE ESM IN THE MULTILATERAL CONTEXT: THE GLOBAL FINANCIAL SAFETY NET (GFSN)

GFSN provides insurance against crises, financing to mitigate their impact, and incentives for sound macro-economic policies to ensure long-term prosperity



GFSN layers and their functions

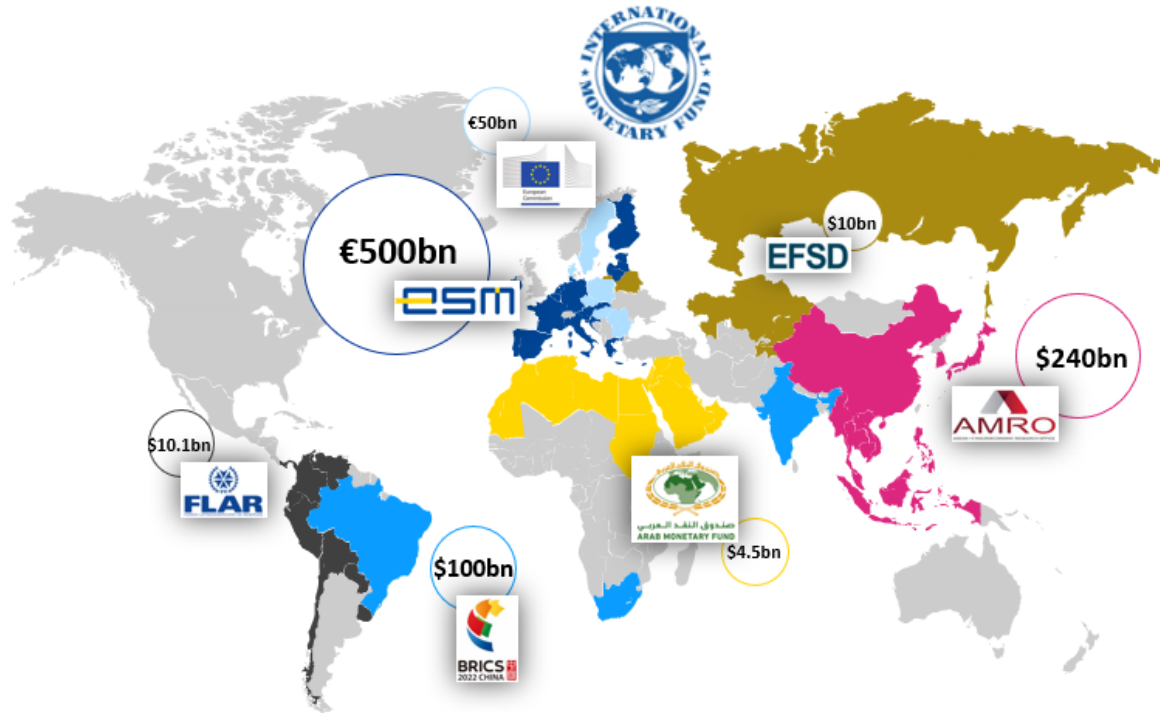


Source: IMF

GFSN firepower expansion (trillions of USD)

ESM IS THE LARGEST REGIONAL PLAYER IN THE GLOBAL FINANCIAL SAFETY NET

Future shocks make a strong case for enhanced cooperation between the regional rescue funds and the IMF



1

Annual **High-level Dialogue between RFA and IMF leaders** initiated by ESM, FLAR and AMRO in 2016 fosters policy exchanges

2

Technical cooperation: joint research projects and regular expert interactions help strengthen institutional capacity

3

Exploring complementarities between IMF' and RFA' toolboxes and lending frameworks

CROATIA BECOMES 20TH MEMBER OF THE ESM

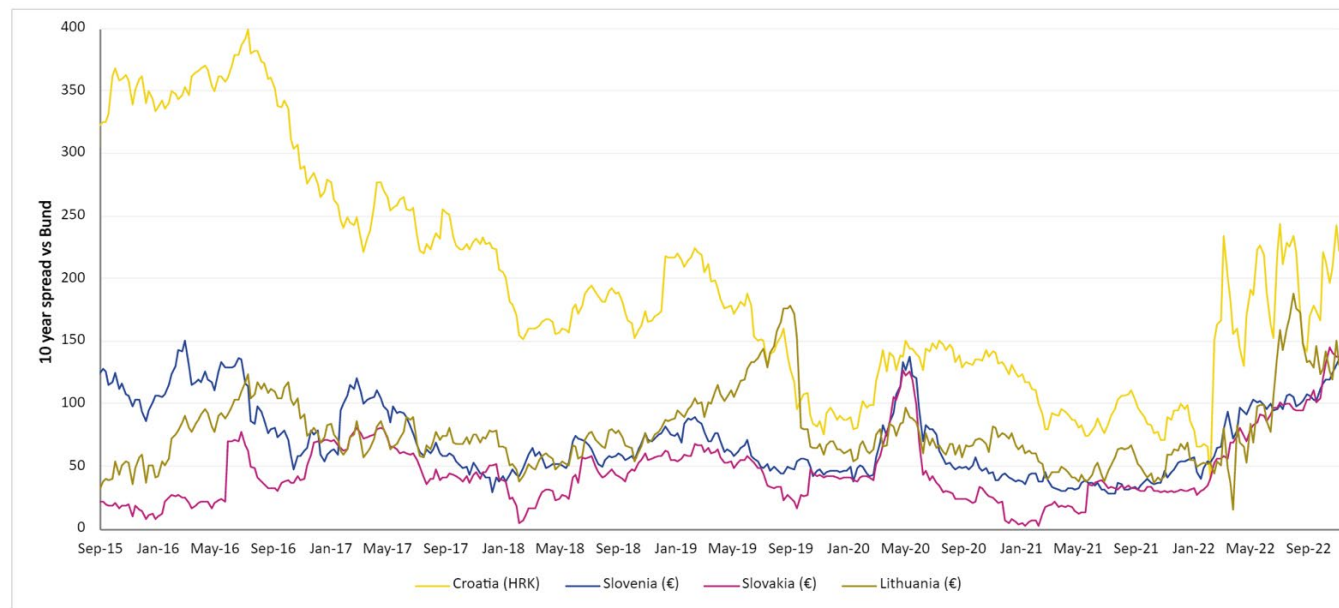
- By joining the euro area on 1 January 2023, Croatia also became eligible for membership in the ESM. Croatia officially joined the ESM on 22 March 2023.
- The minister of Finance of Croatia is now a member of the ESM Board of Governors, which takes all the important decisions regarding the ESM.
- Each Member contributes to the ESM authorised capital based on its respective share of the EU total population and gross domestic product (GDP). Croatia will benefit from a temporary correction period of 12 years, during which its initial capital subscription to the ESM will be lower, thus leading to a temporarily lower paid-in capital contribution.
- Croatia now benefits from the solidarity that comes with ESM membership, with access to financial assistance tools, which is a signal of protection for investors.



ANTICIPATION OF JOINING THE EURO MADE CROATIA CONVERGE TO GERMANY IN BOND MARKETS

Figure 1. Croatia 10-year bond yields converge vs German Bunds as euro adoption loomed

(in basis points)



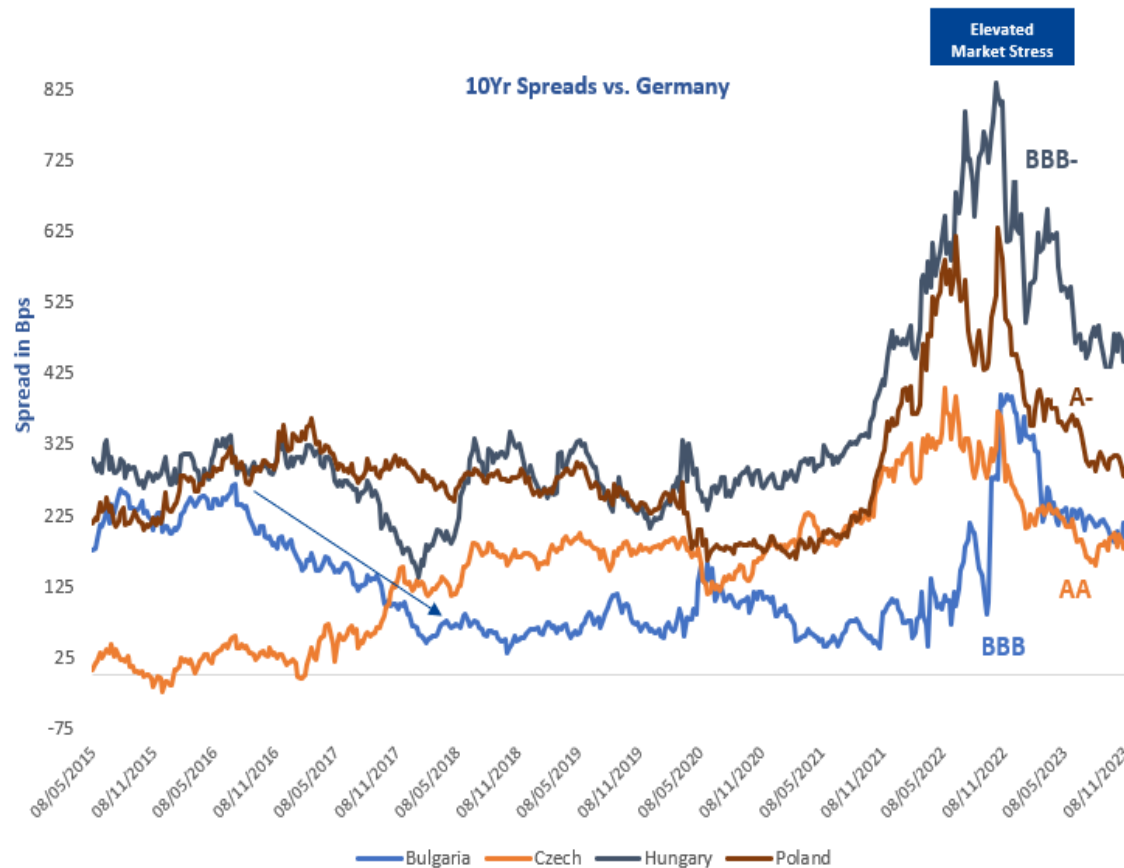
Note: Data for Croatia is only available from mid-2015.

Sources: Bloomberg and ESM

ADVANTAGES TO EURO ADOPTION – CROATIA EXAMPLE

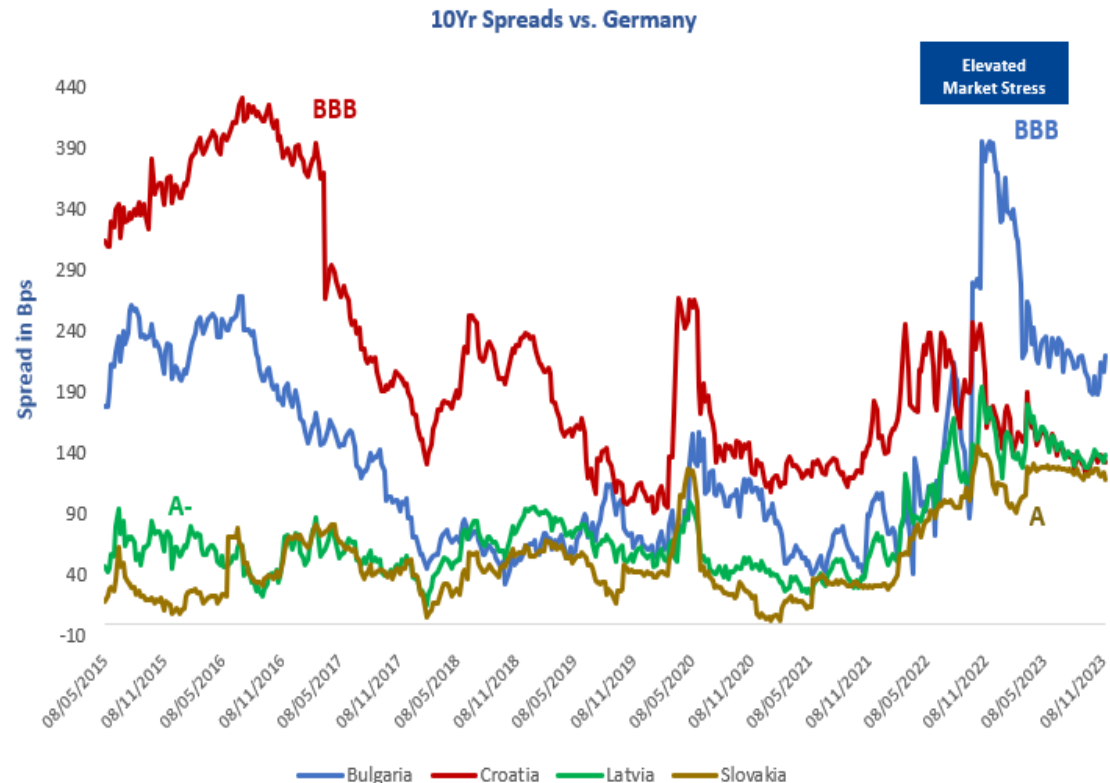
- Country becomes wealthier upon convergence Euro Area
- Meeting convergence criteria – rating upgrades
- Euro-denominated debt no-longer foreign debt
- Join second largest reserve currency globally: enhance investor base, market access and potentially lower funding cost
- Increase investment inflows to local economy
- Payments easier and cheaper, removing transaction fees
- Voting power in ECB, Eurogroup and ESM Board of Governors
- Euro area crisis management framework will gives safety net in the event of future crises, with the ESM as its shield

BULGARIA OUTPERFORMING BOTH HIGHER AND SIMILARLY RATED NON-EURO AREA RATED PEERS



- A composite BBB rating did not prevent Bulgaria perform vs much higher (A- Poland and AA Czech) non-EA rated peers...
- ...having also outperformed similarly rated non-EA peers (BBB- Hungary) over time...
- ...particularly, over elevated market stress episodes, as in mid- end- 2022...
- ...quickly recovering in spread terms.

BULGARIA CONVERGING TO HIGHER RATED EA SOVEREIGNS AS DID RECENT EA JOINER CROATIA



Source: Bloomberg, ESM

- Although still lagging similarly rated sovereigns (Croatia, also BBB) ...
- ...- that recently joined the EA and closed a ~200bps gap vs Bulgaria since 2016-...
- ...especially, during the mid- end-2022 elevated market stress episodes,...
- ...Bulgaria has also largely closed a spread gap vs higher rated EA sovereigns (Latvia A-, Slovakia A).

A MORE VOLATILE WORLD FOR 2024 AND BEYOND

KEY MESSAGES FROM IMF/WB MEETINGS IN MARRAKECH

- Geopolitics top of the agenda
- Higher for longer interest rate risks
- Monetary and fiscal policy mismatch
- Political and electoral uncertainty
- More innovation needed in the market
- Environmental, social, and governance agenda needs refocusing

Upside: A stronger and more resilient Euro Area