Europe after the crisis

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(*Please check against delivery*)

Dear Willem, ladies and gentlemen, many thanks for inviting me. I'm happy to be back in New York. It's gratifying to see so much interest in Europe. This is good, because it gives me a chance to dispel some of the pessimism that surrounds Europe.

It's easy to get distracted by the negative headlines about Europe. The unfortunate outcome of the referendum in the Netherlands is only the latest example. But today, I'd like to point out some strong points of the European Union. Taken together, they paint a picture that is better than what is often perceived. That is the case when looking at the European economy, our banks, and the fact that the euro area institutional framework has become more robust after the crisis.

The European Monetary Union's response to the crisis was comprehensive – despite the fact that this economic bloc consists of 19 independent democracies. We took a range of measures to reduce or eliminate significant macroeconomic imbalances which existed at the beginning of the crisis. We established a single supervisor for the euro area's largest banks. Last but not least, we now have the ESM, my own institution. This is a firewall to protect countries that lose access to financial markets. These are unprecedented and essential innovations.

STRENGTHS OF THE EUROPEAN ECONOMY

Turning to the European economy, the EU is entering its fourth year of recovery, and is growing at a rate well above potential, driven mainly by consumption. The low oil price, the euro exchange rate, and favourable financing conditions are all helping.

Recent data, such as the Purchasing Managers Index, confidence indicators, and credit growth have all been rising. This suggests that the economy is on a steady course – despite increasing headwinds from the rest of the world. Many analysts are raising their forecasts for first- and second-quarter growth. The European Commission now expects 1.7% growth this year for the euro area, and 1.9% for in 2017.

This may sound modest to you, but it is a solid performance. Growth rates of 1.5-1.8% are well above potential growth. Thus, the output gap is being closed. These forecasts also imply that per capita growth in Europe is moving at the same rate as in the U.S. again. This had always been the case in the previous 25 years, but the two diverged during the euro crisis. Now they are moving back in line. 2

INCOME EQUALITY

At the same time, income is spread across society much more equally in Europe than in the United States. In the U.S., the highest 10% of earners make 5.2 times as much as the lowest 10%, a number that has steadily risen over the years. In Germany, the ratio stands at 3.3, and in France at 3.0 times. In Europe, these ratios are more or less stable. It’s a diverging trend between our two economies which can also be seen from the Gini-coefficient. All this means that 80 to 90% of Europeans have experienced faster income growth than their counterparts in the U.S. for the last 20 years or so.

The European labour market also harbours unexpectedly strong elements. Everybody knows that the European unemployment rate is twice as high as the U.S. rate. Few people recognise that our employment and participation rates are a few percentage points higher than in 2000 while they have dropped by six-to-eight points in the U.S.

I’d like to point out two further elements of euro area strength. First, the fiscal deficit of the euro area has reached sustainable levels of 2% of GDP. Many of you probably believe that European governments should run bigger deficits. That is up for debate. But what is positive is that the euro area has more policy space to react to a future crisis than other large economies. Secondly, we have a surplus on the current account. This makes the euro area less vulnerable to sentiment swings from international investors.

BENEFITS OF THE ESM

Now let me say something about the measures we have taken to strengthen the EMU institutional framework. My own institution, the ESM, is a good example. It’s a firewall to protect countries from losing market access. First the EFSF was set up in 2010, and later the ESM. These are the two institutions that I manage.

The two institutions – which share the same staff – have a lending capacity of €700 billion euro. During the last five years, we have disbursed €254 billion to five countries, which is about three times as much as the IMF has lent out globally. We are one of the biggest issuers of euro-denominated bonds.

We have provided assistance to five countries, four of whom have now successfully exited: Ireland, Spain, Portugal, and Cyprus. Greece started a third programme last year, and is still in the middle of it. Through these programmes, we kept the euro together. Without them, some of these countries would probably have been forced to leave the euro area. Many even expected that the euro would disappear – particularly here in this city.

Through our programmes, countries need to implement comprehensive reform packages. As a result, they have reduced unsustainable fiscal deficits and restored competitiveness. This approach is working: Ireland had 7% growth last year and unemployment has been almost cut in half. Spain had more than 3% growth and made strong employment gains.

Another advantage is that we help countries to return to debt sustainability, by providing our financing very cheaply. Our funding costs are below 1%, and we pass these on directly to the 3 borrowing countries. The IMF charges three- to-four-times more. This is because of the financial guarantees from our strong member states. Our low lending rates lead to substantial budget savings for programme countries. The Greek budget, for example, saves 4% of GDP every year because of it.

BANKING UNION

A second major achievement is the fact that EMU has improved its system of banking supervision in ways that would have been unthinkable only a few years ago.

We now have a single supervisor directly overseeing the 129 largest and systemically relevant banks, the so-called Single Supervisory Mechanism, or SSM, which is housed at the ECB. Since this year, we have the Single Resolution Mechanism and the Single Resolution Fund.

The creation of unified banking supervision means our regulatory system is now more easily comparable to that of the United States. The SSM's role as a bank supervisor is akin to that of the Fed. The SRM has similar capabilities in resolving banks as the FDIC in the U.S. So the first important steps of what we call Banking Union are in place.

BANKS HAVE RECOVERED

More generally, European banks have restructured and adjusted after the crisis even though we have not seen much consolidation. European banks are closing the gap with the U.S., both in terms of capital and profitability. They have raised capital ratios from much lower levels than in the U.S. before the crisis but are now at a similar level.

When it comes to profitability, as measured by return on equity, the subprime crisis had a much stronger negative effect on U.S. banks than on European banks. But U.S. banks also recovered faster. That is because European banks had to cope with a second shock: the euro debt crisis. Since 2012, however, European banks have increased profitability. While they remain somewhat below the U.S., the gap is narrowing.

How about non-performing loans? They are high, around €900 billion in the euro area but are no longer increasing. What is positive, is that provisions are also quite high: the coverage ratio is now stable at an adequate level of 52%. Naturally, these are aggregates, and individual countries – or individual banks – may have bigger problems than others. But there is no reason to sound the alarm bell for the entire sector.

TIGHTER POLICY COORDINATION

Finally, EMU also made crucial progress in improving economic policy coordination. We have tightened the surveillance of fiscal policies with a stricter Stability and Growth Pact, with the Fiscal Compact, and more powers for the European Commission. There is also a new procedure to avoid excessive divergences and imbalances, the so-called Macroeconomic Imbalances Procedure.

With these changes – Banking Union, the crisis firewalls, and better economic policy coordination – Europe has shown a comprehensive reaction to the sovereign debt crisis. We have used the crisis as an opportunity to strengthen our union. 4

This is all the more important because a spate of new challenges have already come up – even if the last crisis is only barely over. New issues such as the refugee crisis, terrorism, the rise of populism, and the risk of a Brexit are now requiring the full attention of policymakers.

FINALISING BANKING UNION, CMU

But it’s also important that we take further steps to make EMU more resilient. A first important step is completing banking union by setting up its third pillar, a European Deposit Insurance Scheme. This is a big step, and so it may take a while. But I’m convinced that we will get there.

Another ambitious project is the Capital Markets Union. This is particularly important to enhance risk sharing between euro area countries. It entails harmonising national company, tax and bankruptcy laws. The aim is to reduce hurdles for cross-border capital flows, and open new ways of funding for small- and mid-sized enterprises, for instance through private equity. It will have the additional benefit of reducing companies’ dependence on bank financing.

OTHER STEPS TO DEEPEN EMU

Other steps towards closer European coordination are mentioned in last year's Five Presidents Report – written by the heads of the European Council, the European Commission, the Eurogroup, the European Central Bank, and the European Parliament.

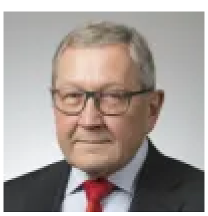
One is a limited fiscal capacity to address asymmetric shocks to individual economies. The report also mentions the possibility of a euro area Finance Minister. A euro area Finance Minister could support policy coordination, external representation, and the visibility of EMU.

Some politicians have also floated ideas for a greater role for the ESM, which could become a euro area Treasury or be transformed into an EMF. For now, these are just ideas for the distant future.

Let me summarise. Europe has come out of the crisis stronger than before. The economy is recovering, and has many strong points when compared to the U.S. Banks are regaining strength. Institutionally, EMU has made impressive strides. Steps have been taken that were unthinkable only a few years ago. It is this progress that should give us the confidence that we can tackle the next challenges that await us.

I now look forward to discussing these issues in greater detail with you.

Author



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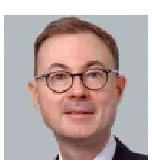

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