

A view from Europe - Enhancing Global Economic and Financial Resilience

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Speeches

Online

Keynote Speech Plus Slides Presentation

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Speech

Dear Ladies and Gentlemen,

It is a pleasure to join your great event, the Financial Street Forum, which shares something in common with my own institution, the European Stability Mechanism. Both were founded in 2012.

The ESM was born in October that year. The ESM, together with its temporary predecessor, the European Financial Stability Facility, provided loans of nearly €300 billion to five countries in the euro area that experienced or were threatened with severe financing problems, such as the loss of capital market access. These were Greece, Ireland, Spain, Portugal and Cyprus.

We succeeded to counter the European financial crisis.

In 2020 Europe demonstrated solidarity to counter the pandemic with an initial €540 billion a policy response. ESM created the Pandemic Crisis Support – a sovereign credit worth 2% of GDP for euro area countries.

Post-crisis, Europe turned to matters of how to recover and rebuild, as well as how to prevent future shocks and reinforce financial stability.

In Europe, in the past 13 years, much has changed for the better. Five euro area Member states that required the ESM's help successfully concluded their programmes. The euro crisis was defeated.

Moreover, Greece, one of those countries that needed financial assistance, reformed and has prospered. Greece also regained investment grade in a credit rating upgrade, notably from Standard & Poor's last month. A major achievement!

Financial stability has been restored and this markedly helped us weather other challenges, such as the global pandemic.

It is also important to note that over the last decade 4 countries joined the euro area: Estonia, Latvia, Lithuania, and this year Croatia.

Like other parts of the world, Europe now faces other challenges which include geopolitical and inflation risks. These are immediate challenges.

For my presentation to you today, I would like to include a few visuals.

In an ESM blog published last month, I offered a debrief on the six takeaways from the International Monetary Fund (IMF)/World Bank meetings in Marrakesh last month.

Geopolitics dominated the agenda, especially the recent conflict in the Middle East.

But so too did the growing realisation that we may be facing a longer period of high interest rates. Recent market expectations that interest rates could fall in 2024 are evaporating.

There is also a perception among many in the financial community that monetary and fiscal politics globally are not always aligned.

With more than 2 billion people eligible to vote in 2024, there is also electoral uncertainty in some countries, that can result in spendthrift government policies rather than a disciplined approach to budgets.

But as I suggested already, we are in more resilient Economic and Financial circumstances in Europe than a decade ago.

This is also true globally. The Global Financial Safety Net is stronger than during the 2008 Global Financial Crisis that spurred the European sovereign debt crisis.

At national level, governments protect their economies against external shocks by drawing upon foreign reserves or use fiscal capacity.

At a bi-lateral level, swap lines provide an important source of financial security between major central banks.

At regional level, there are Regional Financial Arrangements, such as the ESM, or in Asia there is AMRO, safeguarding 14 economies including China.

At global level, that safety net involves the IMF providing a financial backstop.

At €500 billion, the ESM and EFSF singularly have the largest financing firepower of the Regional Financing Arrangements. But we can only succeed to overcome future

shocks if we work together.

That is why it is imperative that we foster strong ties between the RFAs.

Last month, the eighth High-level RFAs Dialogue was held in Marrakesh, in the margins of the IMF/WB Annual meetings.

Amidst a precarious global economic recovery, the discussion focused on how crisis fighters can contribute to macroeconomic and financial stability in a more shock-prone world and the role of IMF-RFA collaboration.

We can see the effect of what solidarity and cooperation can do. When the 2010 financial crisis spread globally in Europe we did not yet have the EFSF and ESM institutions.

This chart starkly shows how the financial markets punished the absence of shock absorbers in Europe.

But by 2015 when Greece needed more financial assistance, which the ESM provided, you can see that even 10-year GGB spreads versus German Bunds were less than half of that experienced 5 years earlier.

By 2020 when the pandemic became a symmetrical risk for Europe, GGB spreads widened even less.

Over time, Europe's financial architecture has convinced markets and we see less volatility and lower spreads. Europe was able to calm markets.

In all cases, these market effects became less pronounced as the amount of European solidarity grew. And in the case of the pandemic, markets were impressed at how quickly – within weeks – European institutions came together for a pandemic policy response, involving the European Central Bank, the European Commission, the European Investment Bank and the ESM.

As you can see in this chart, there is an even wider European Financial Architecture, which additionally comprises market regulators.

In less in a decade, we built a robust and convincing market, financial and banking architecture.

In addition to the ESM's roles to provide financial assistance to euro area members as well as uphold monitoring to prevent crises, these roles will be enhanced by a Treaty reform which is presently awaiting ratification.

The ESM will acquire new tools to help the euro area members and provide a common backstop to the Single Resolution Fund, as well as design and monitor any future assistance programmes.

The ESM has an active funding programme, similarly to the World Bank or the Asian Infrastructure Investment Bank.

In 2023, we already completed our funding, which was a combined €28 billion for the EFSF and ESM.

Since inception, Asian investors have been important investors in our bonds. I personally am in China at least once a year to engage with our key partners.

The two issuers need to raise around €30 billion in the absence of crises, because the two institutions manage the rollover of bond issuance for loans, some of which are fully redeemed by 2070. So I will be coming to Asia and China a lot in the future!

As permanent successor to the EFSF, the ESM stands ready to provide financial assistance to euro area members in a well-practised funding operation.

The ESM is not only an issuer of bonds. It is also an investor of €80.5 billion Paid-In Capital which is managed prudently to ensure we retain the ESM's triple-A credit ratings and can secure the lowest-possible cost of borrowing for our members.

But Environmental, Social and Governance factors are in our corporate mission statement. That means the ESM follows a holistic approach to sustainability issues in its investments.

Lending operations' social dimension

- European solidarity
- Making reforms more sustainable
- Countries made impressive turnarounds: all investment grade, since Greek upgrade last month

Funding

- Continued dialogue with ESG rating agencies
- Social aspect of our funding is that ESM bonds contribute to social stability
- Ad-hoc sustainable frameworks for dedicated social programmes, such as the Pandemic Crisis Support credit line

Strategic Priority

- Integrate ESG into the balance sheet
- Integrate ESG into macro analysis and financial stability
- Review existing instruments of our toolkit from ESG perspective
- Embed ESG Framework for Investment, such as UN PRI

The ESM is an investor with a €80.5 billion Paid-In Capital – the highest from all International Financial Institutions. The institution invests in ESG-themed bonds but also takes a full balance sheet approach to its investments.

We seek bonds of issuers who communicate on their ESG strategy, through ESG Ratings, Reporting as well as ESG internal policies.

We published our first-ever ESG Summary Report this summer, a one-stop appraisal of the ESM's own activities and disclosed in that Report, as well as in our Annual Report in June, how we have applied ESG scoring to our investments.

In 2022, the ESM selected Moody's Vigeo Eiris as its ESG rating provider.

When applying the ESG scores to the paid-in capital, the ESM obtained an ESG weighted average score of 73 out of 100 last year, corresponding to Moody's advanced category.

In December, we will further report on our investments as a signatory to the United Nations-backed Principles for Responsible Investments.

In conclusion

While there is global uncertainty, Europe is financially more resilient today than a decade ago.

The IMF World Economic Outlook forecast for 2024 predicts a soft landing for the world economy and is more optimistic than in the previous year.

Savings rates are higher in Europe and the financial architecture is stronger than a decade ago.

There is a positive impact from Next Generation EU, the European Commission's €800 billion temporary recovery instrument to support the economic recovery from the pandemic and build a greener, more digital and more resilient future.

But we realise that Europe is part of the international financial system

So there are even longer-term challenges that we must overcome.

Europe and the world need to keep up momentum in digital change in financial markets, as well as ecological transition to counter climate change.

So what are the difficulties for Europe to overcome?

Perhaps most importantly, we have to continue on our course to deepen European Monetary Union. A lot has been achieved. The euro area is much stronger today than 10 years ago.

We await the ratification of the ESM Treaty, so that the ESM would provide the financial backstop to the banks' resolution mechanism, the Single Resolution Fund, and to sever the link between commercial banks' losses and sovereign debt. The trust in the euro area would increase.

We are in the midst of growing European safe assets. Following the pandemic, the asset class has increased to around €1 trillion. The ESM and EFSF are among issuers who contribute to AAA-rated safe assets.

Europe needs Capital Markets Union to finance infrastructure and innovation but also to add private risk-sharing to public risk sharing.

In Europe, we prize international cooperation, and we look forward to working with global partners. China had been an important partner since inception of ESM and EFSF. We look forward continuing this important relationship for the decades to come.

Thank you.

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