“Opening Address – European Government Bond Conference”

Brussels, 3 November 2014 – Christophe Frankel, Deputy CFO and Deputy Managing Director, ESM

- Good Afternoon. It’s an honour to be here to today and to give the opening address at the 9th annual “European Government Bond Conference” of the Association for Financial Markets in Europe.

- I should start by pointing out that my institution, the ESM, is of course not a European Government. However, if it were a country, the combination of the ESM and EFSF would be the fifth largest issuer of euro denominated debt in the euro area in 2014. Compared with IFIs, we are the largest by volume since 2012. We will also continue to be a major issuer of debt in the long-term – our bonds are on average for around 6 years, while our loans do not have to be paid off for up to three decades. On the markets, our bonds continue to perform very strongly and attract investors who want liquid and highly rated debt.

- Today, I hope to inform you about the activities of our two institutions and, like this figure about the size of our issuances, demonstrate where we fit into a much bigger picture.

- I believe that our story is a compelling one that offers many learning points not just about how the euro successfully navigated the recent crisis, but where based on this experience, the next steps for the euro area will lead.

- Now, I don’t want to proclaim that the crisis is over. Certainly, for the financial markets, it may appear to have passed, but for many people, who have lost their jobs, or seen their standard of living reduced through austerity measures - the crisis is **not** over. And I think that for those of us working in the financial markets it's important to remain very sensitive to this point.

- However, there is a saying that you should "never let a crisis go to waste" and one consequence from this crisis was to oblige the euro area to look hard at the fundamental architecture of the single currency and see where it could be improved, to reassure the global markets and our own citizens that it would be in better shape for the next crisis, whenever that may come.
- And unfortunately, at the height of the crisis, this missing piece of institutional architecture – a financial backstop – became quite critical. Happily, we found a solution, and I'm very proud to work for it today, as deputy managing director.
- We did not have a financial backstop - a critical matter at the height of the crisis. Now, this institutional gap has been closed through the creation of first the EFSF and then, the ESM. I was there from the beginning, when there was literally just a handful of us to put together the first package to support Ireland. Originally, the EFSF worked through guarantees underwriting its funding programme. And I would like to give you a flavour of what we have contributed to restoring confidence in the euro and its member states. Between the two organisations, the EFSF and ESM, we have disbursed loans of €232 billion to Ireland, Greece, Portugal, Spain and Greece - our five programme countries - over the last three and a half years.
- This is three times more than the IMF during the same period and unlike the IMF, it's one of my teams - the funding team - that has raised this debt on the markets. In terms of the impact on the euro area and its 18 member states, I would suggest there are four very different ways that the EFSF and ESM are proving their value:

- **Point number one:** By providing liquidity at a time when market access was lost, the ESM and the EFSF ensured no country left the euro. There were many bankers and analysts who believed a "Grexit" was imminent. Thankfully, those predictions were wrong.

- But, it seems only fair to state it bluntly - several countries would have left the euro area without the financial support from the EFSF and ESM. Today, Europe would be a very different place.

- **Point number two:** As you know, our lending comes with conditionality, which means that all 5 programme countries had to accept a tailored series of reforms. In the short term, these are often painful to introduce, but in the medium to longer term these lay the foundation for sustainable growth, which is why they are now the reform champions of Europe.

- According to the OECD and other research, our five programme countries, Ireland, Portugal, Spain, Greece and Cyprus are amongst the top reformers in the EU and in the OECD area. Therefore, they are best positioned for future growth if they continue their reforms.

- And what are these reform measures? They involve removing barriers to competition, reforming labour markets, cutting public expenditure, raising taxes and other important structural reforms like strengthening public administrations. And the outcome is becoming very clear: Competitiveness is restored, unit labour costs and current account deficits decrease and overall deficits are cut. In Ireland, growth this year may reach 4.5%. Spain and Greece, along with Ireland are also seeing unemployment rates starting to fall.

- We have seen similar examples around the world in countries like Turkey, Indonesia and Brazil through IMF support. They also went through periods of painful adjustment and yet, their own IMF programmes put them on the path towards excellent economic performances in recent years.

- So, when all taken together, this indicates our strategy is working in the programme countries.

- **Point number three:** One of the concerns we often hear is about the long-term debt sustainability in our programme countries. In fact, debt sustainability significantly improves for the EFSF and ESM programme countries. The most striking example is Greece, so let me point to the benefits:

- Our loans deliver budget savings of €8.6 billion per year, or the equivalent of 4.7% of Greek GDP – savings continue year after year. The loans have an average maturity of 32 years, and at the moment pay an interest rate of 1.5%, which is equal to our funding cost. In addition, there is a 10-year moratorium on the payment of interest. So, there is no debt overhang in Greece, at least over the next decade - despite very high debt to GDP ratios. Because of this, debt is sustainable as long as the reforms continue.

- Budget savings in Ireland, Portugal, Cyprus and Spain are smaller than in Greece, nevertheless, they are still significant for these countries too.

- I mentioned the IMF already, however, it is more accurate to state that we have introduced a new system in Europe that goes well beyond the traditional IMF approach. It not only provides emergency financing against conditionality, it also includes substantial solidarity. I know that in many of the less wealthy countries in the euro area there is sometimes a lack of understanding at being requested to support wealthier countries that have gotten into difficulties.

- For people on low incomes this is, no doubt, difficult to accept. In the long-run, I am very confident that solidarity becomes a “win-win” situation for everybody as a stable and sustainable currency union is in the interest of all our member states.

- I would point also to the views of one euro area Finance Minister, who said he considered his country's contribution to the ESM as an "insurance policy" in case of future difficulties in his own country. This lending from EFSF and ESM has not led to any burden for taxpayers anywhere in the euro area – an important point!

- **Point number four:** My final point is that EFSF and ESM lending takes some pressure off the ECB. During the last three and a half years, the ESM has demonstrated quite effectively that it can play this role of a lender of last resort, which – in turn - reduces demands on the ECB to do more.

- Taken together, I believe these four positive results demonstrate why we can be quite proud of what the youngest International Financial Institution has achieved during a relatively short period of time with a very small staff of around 130:

  ✓ Helped to keep the euro area intact

  ✓ Provided massive lending, at low interest rates, without cost for the taxpayer

  ✓ Through conditionality, promoted reforms and debt sustainability Cf: we don't decide neither monitor the conditionalities

  ✓ and made a contribution towards making life for the ECB a little easier

- There is of course a wider context – beyond the EFSF and ESM - that contributed to bringing the euro crisis to an end. Here again, I would point to four important elements:

- The most important are the reforms being conducted at **national level**. As I already mentioned, these efforts to consolidate and structurally reform are most impressive in the five programme countries - Ireland, Portugal, Greece, Spain and Cyprus.

- The second point is the set of **<u>new rules</u>** we have decided collectively in Europe as a result of the crisis: Six Pack, Two Pack, the European Semester, the excessive imbalance procedure new powers for the European Commission and enhanced monitoring possibilities for Eurostat.

- All Member States should **<u>respect the rules</u>** and coordination procedures they decided. The Commission must use the new powers it was given as a result of the crisis. The euro area's weaknesses, which were among the root causes of the past crisis, will be eradicated if Member States and the Commission make the right choices.

- The third element is **<u>Banking Union</u>**. New supervisory agencies have been set up. The Single Supervisory Mechanism, the SSM, will look after the systemic banks in the euro area. A Single Resolution Mechanism SRM and a Single Resolution Fund SRF are currently established. Extensive bail-in rules will significantly weaken the link between banks and sovereigns.

- If, despite the bail-in and national government intervention, European public money is needed, then the ESM may recapitalize a bank directly under certain circumstances.

- And the fourth element of the crisis response is, of course, **<u>monetary policy</u>**. Back in 2007, the ECB was the first central bank to adopt crisis measures. Since then, the ECB has initiated a series of separate measures that were absolutely critical in stabilizing the situation in the summer of 2012, when markets were about to panic and a disintegration of our monetary union was a real threat.

- In my view it is clear that all these elements taken together explain quite well why we are moving out of the crisis:

  ✓ national reforms

  ✓ better and broader economic policy coordination among Member States

  ✓ Banking Union,

✓ monetary policy and

✓ the creation of the crisis resolution funds

- With hindsight, we developed a coherent strategy that gives the euro area a solid ground for the future.

- The crisis triggered an acceptance for further integration that would not have been acceptable to many Member States before. Eight days ago, the ECB released the results of its stress tests on 131 major banks in Europe. Not only was this exercise credible and well designed, but it has provided the financial markets with around 12,000 data points on each institution, which will help analysts better understand the sector. I noted that in its own statement on the exercise, the AFME welcomed the results and described it as a “major milestone” in the implementation of the Banking Union. These are sentiments I fully share.

- Of course, **tomorrow**, marks another milestone, when the SSM will begin to directly regulate 120 of participants in the AQR exercise. This is a major step forward in the creation of a common European playing field across the financial sector and a key step to preventing any renewed crisis for the euro.

- In addition, the ESM can also use its “traditional” tools in the context of the banking union: macro-economic adjustment programmes, where some of the money is used by the government to support banks, which was the case for most of our programme countries, or, as in Spain, it can finance a programme to restructure the entire banking sector.

- As I just mentioned: In future, the ESM stands ready – subject to final political ratification – to recapitalise banks directly as a last resort. This new instrument is yet another building block to mitigate any future crisis. The ESM direct bank recapitalization instrument can only be used once the extensive new bail-in rules have been applied. With these rules in place, the risk of having to use public money to bail-out banks should be significantly reduced.

- Very recently there has also been a debate about whether the ESM could be somehow used to stimulate investment and growth.
- I would like to emphasise that the ESM has contributed to growth all along. The ultimate goal of the economic policy conditionality that is always part of our lending programmes is to support economies in a crisis to become sustainable and competitive again.
- Many of our former programme countries, particularly Spain and Ireland, have impressed with growth figures above the euro area average. In Portugal and Greece, developments are also encouraging.
- On the other side larger euro area economies, especially France and Italy, are facing low growth, even stagnation. Also German growth figures have disappointed lately, creating uncertainties.
- The recovery has been both fragile and uneven. So, after four quarters of positive growth since early 2013 there was stagnation in the second quarter of 2014. And the overall growth figures from the ECB for the euro area also demonstrate the need for further measures: 0.9% in 2014 and 1.6% in 2015
- Currently, there is a lot of discussion about strategies to foster growth in Europe. I fully support this. But I would like to point to the fact that the European Commission and Council each year already adopt detailed and tailor-made recommendations for each Member State on ways to stimulate growth and create jobs.
- There is an implementation gap in many euro area countries with regard to these recommendations.
- Therefore, I would urge **<u>all countries</u>** to take a long hard look at these country specific recommendations that they all signed off at the summer European Council in June and implement them, they're supposed to be binding measures. They are all achievable.

- The new Commission President, Jean-Claude Juncker, has announced a €300 billion investment package and I believe such a package can be important to complement reforms at the national level. He is currently working on the details but he made it clear that he did not want the level of public debt to rise as a result of his plan.

- You may have read in the press discussions about whether the ESM could contribute to such a package. While this could be possible in principle it would require a change of the ESM treaty. Such a change would have to be ratified by all 18 euro area Member States and there is no consensus on this. In any case, it is essential to maintain the “firepower” of the ESM for its real mandate, the stability of the euro area.

- Are there further steps? Certainly, we must concentrate on:

  - ✓ Undertaking crucial structural reforms to unlock investment and raise potential growth across the euro area
  - ✓ Reviving growth and creating jobs, which are the most urgent challenges
  - ✓ Ensure the new framework for economic policy coordination is credibly implemented
  - ✓ Continue to reduce financial market fragmentation

- This path we have chosen was in the best interest of all the euro area countries, not only the beneficiary countries of our programmes. The ESM’s paid-in capital of €80.2 billion is well invested. It allows the ESM to be a credible firewall against all future crisis with a lending capacity of €500 billion of which €450 billion is still available.

- I would also like to stress that there is neither debt mutualisation nor fiscal transfer. We provide loans. We tap the markets to raise this money.

- Any alternative that would have included the risk of a disorderly exit of individual euro area Member States, or a disintegration of the currency union, would have proved much more costly than the path we chose.

- To **<u>conclude</u>**, I would argue that we have made significant progress in putting the euro area on a sound and sustainable basis, more progress than would have seemed possible when the crisis started.

- Our strategy of combining courageous national reforms, better economic policy coordination, Banking Union and the creation of a crisis resolution fund that provides loans against strict conditionality has created a robust framework for the euro area. We would have been able to avoid the worst of the crisis, **<u>if</u>** these elements were in place five years ago.

- In the future, the euro area will function better than before the crisis.

- Thank you very much for your attention.

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