



How Europe is overcoming the crisis

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How Europe is overcoming the crisis

I. What went wrong in the euro area?

II. Five lessons from the euro crisis

1. Reduce vulnerabilities, implement reforms
2. Strengthen governance of euro area
3. Create a stronger European banking system
4. An active monetary policy
5. Establish a crisis mechanism

III. Restoring growth in the euro area

I. What went wrong in the euro area?

Eight reasons for the sovereign debt crisis

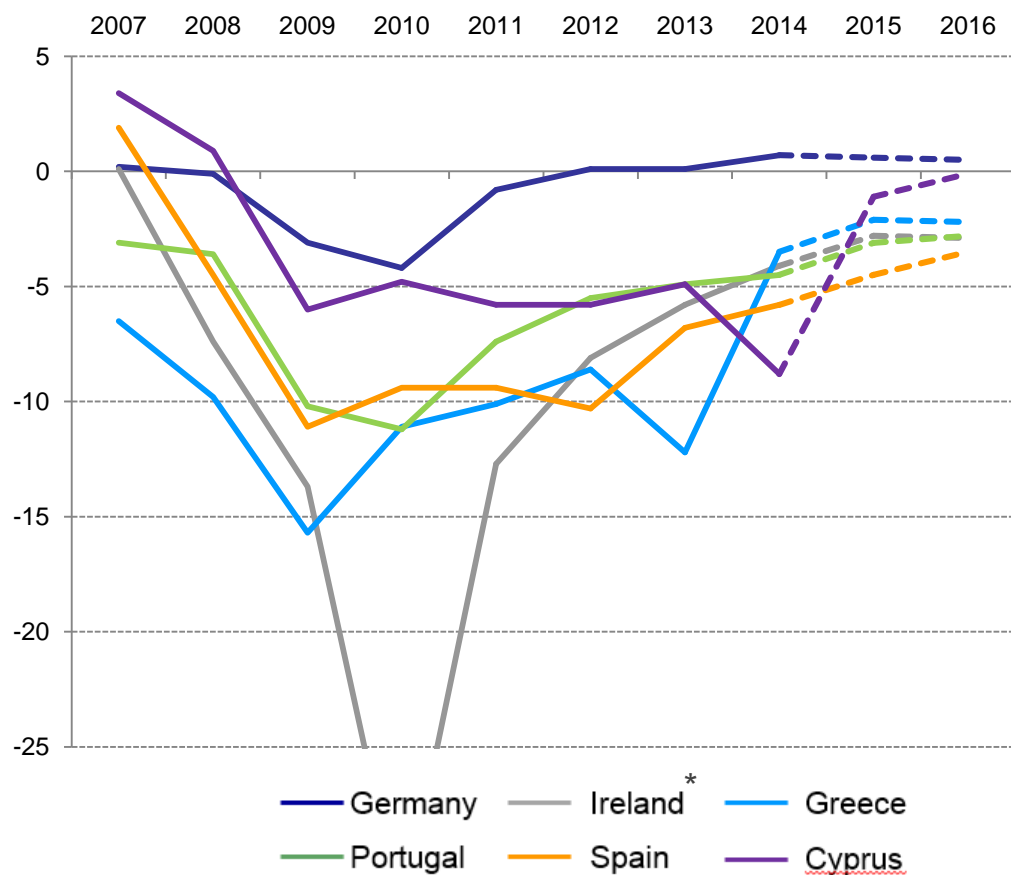
1. Member States did not fully accept the political constraints of being in EMU
2. Transition to permanent lower interest rates
3. Economic surveillance too narrow
4. Methodological problems with calculating structural fiscal balances
5. Insufficient control of data by Eurostat
6. Financial market supervision mainly national
7. No crisis resolution mechanism
8. Biggest financial crisis in 80 years

II. Five lessons from the euro crisis

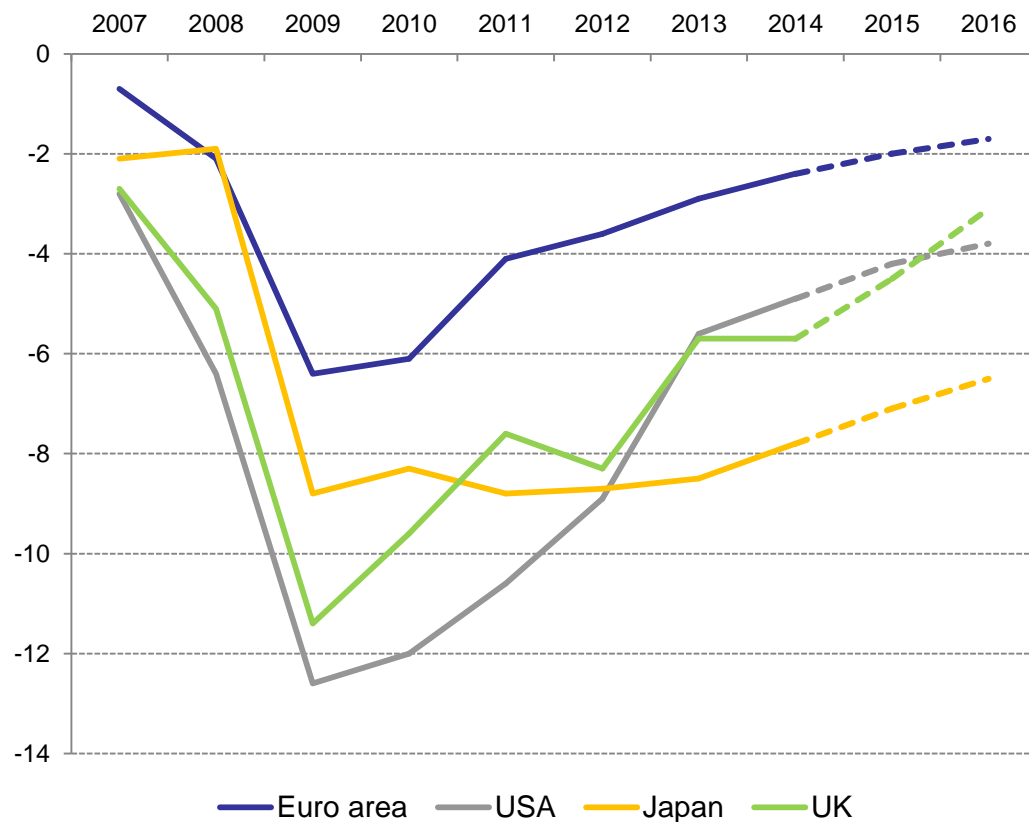
1. Reduce vulnerabilities, implement reforms

Deficit reduction policies are paying off

Fiscal balance in programme countries (% of GDP)



Selected comparative fiscal balances (% of GDP)



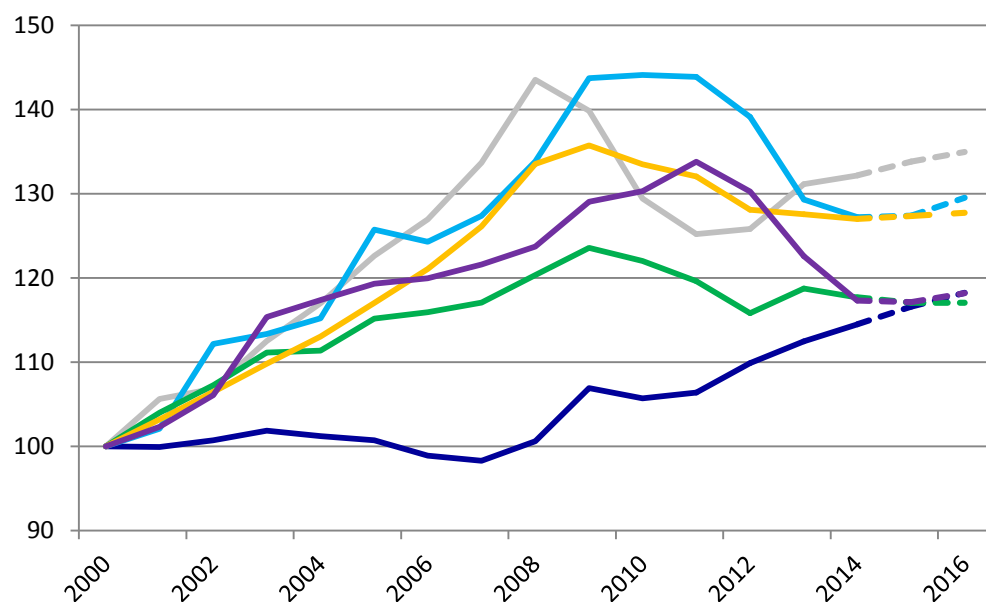
Source: European Commission, Economic Forecast – Spring 2015

* Actual figure for Ireland in 2010: -32.4%

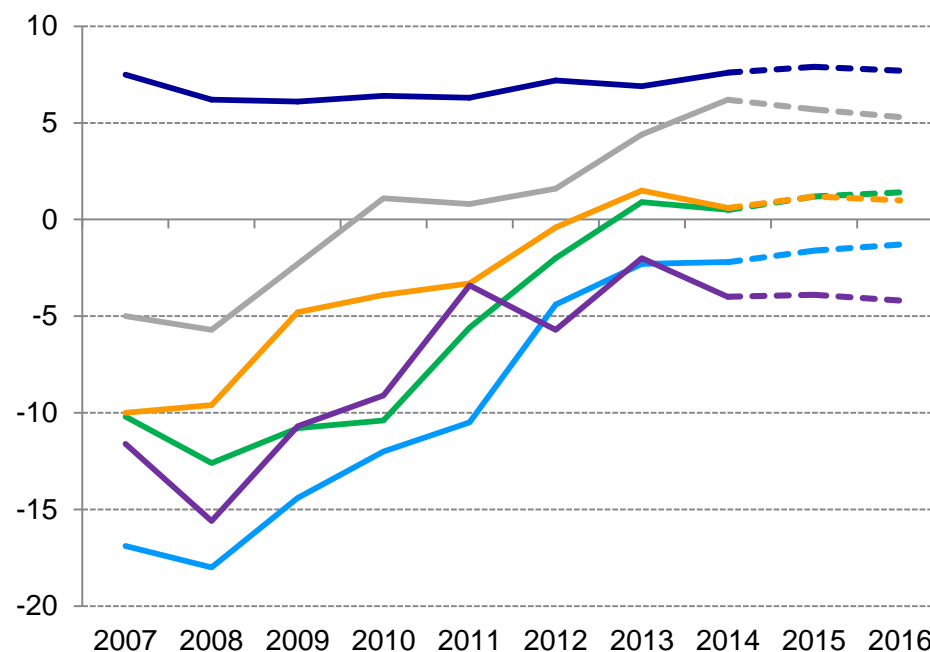
Internal devaluations are restoring competitiveness

- Thanks to the convergence in competitiveness, costly external imbalances in the periphery have disappeared

Nominal unit labour costs (2000=100)



Current account balance (% of GDP)



— Germany — Ireland — Greece
— Portugal — Spain — Cyprus

Source: EC European Economic Forecast – Spring 2015

EFSF/ESM programme countries are the reform champions

- **Greece, Ireland, Portugal and Spain** are in top 5 of 34 **OECD countries** with regard to implementation of **structural reforms**.

Ranking in OECD report
1. Greece
2. Ireland
3. Estonia
4. Portugal
5. Spain

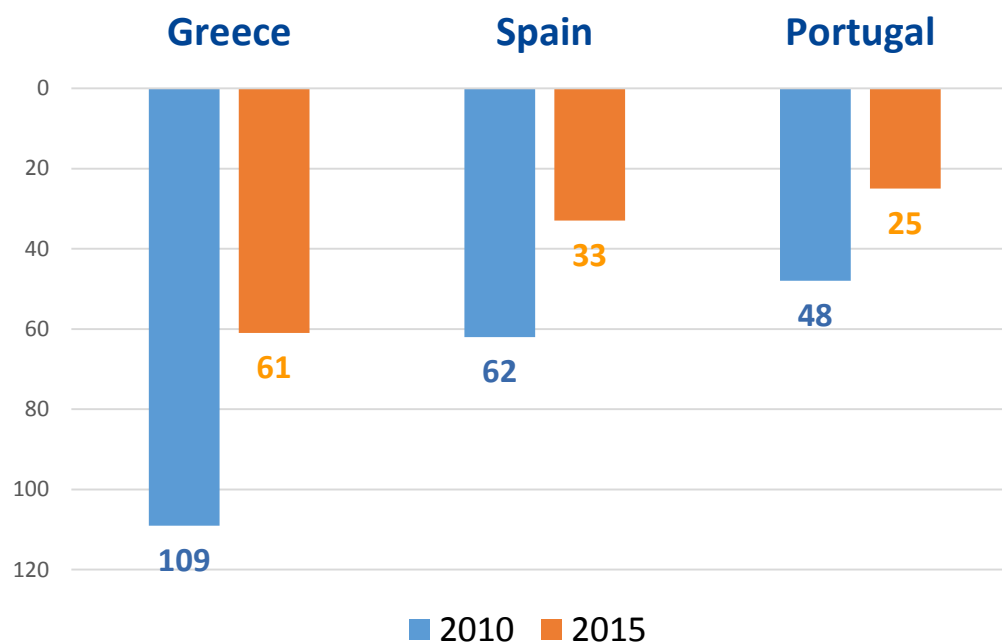
“Euro area countries under financial assistance programmes are among the OECD countries whose responsiveness [to the OECD’s structural reform recommendations] was highest and also where it most increased compared with previous period.”

- *Going for Growth* (OECD Report)

Source: OECD report *Going for Growth* for 2015
Ranking takes into account responsiveness to OECD recommendations on structural reforms in key policy areas

Reforms include improved business regulations

- Greece, Spain and Portugal have recorded significant progress in the **World Bank's *Doing Business*** ranking since 2010
- The ranking measures the ease of starting and operating a local business



Source: the World Bank, *Doing Business* ranking, 2010 and 2015

2. Strengthen governance of euro area

Improved economic policy coordination

- Euro governments adopted **more comprehensive and binding rules** for national economic policies
 - **Stability and Growth Pact** has stricter rules on deficit and debt
 - **Less room for political interference** by national governments
 - **Balanced budget and debt rules** now also in national legal systems
 - **European Semester**: yearly cycle of economic policy coordination
 - Annual **country-specific recommendations**
 - Stronger emphasis on **avoiding macroeconomic imbalances**
 - **Eurostat** authorised to verify national data

How can governance be strengthened further?

- Additional steps in euro area integration likely
- **Proposals under discussion:**
 - a euro area finance minister
 - a “fiscal capacity” for the euro area
 - joint decision-making for structural reforms
 - more democratic accountability and legitimacy
- Implementation legally and politically difficult and time-consuming

3. Create a stronger European banking system

A stronger banking system

- **Three new European supervisory authorities: EBA, EIOPA and ESMA**
- New **ESRB** monitors macro-prudential risks
- **Financial market reforms**
 - “Basel III” (CRDIV/CRR) is being progressively implemented
 - Huge capital increase for banks – Core Tier 1 capital ratios are now 9% or more
 - EU banks added €560 bn to their capital since 2008
- **Banking Union** started in November 2014
 - **Single Supervisory Mechanism (SSM)** operational since 4 November 2014
 - **Bank Recovery and Resolution Directive (BRRD)** will create a uniform framework for bank recovery at national level with **bail-in** as a key instrument
 - **Single Resolution Mechanism (SRM)** with **Single Resolution Fund (SRF)**
 - **ESM Direct Recapitalisation Instrument** available

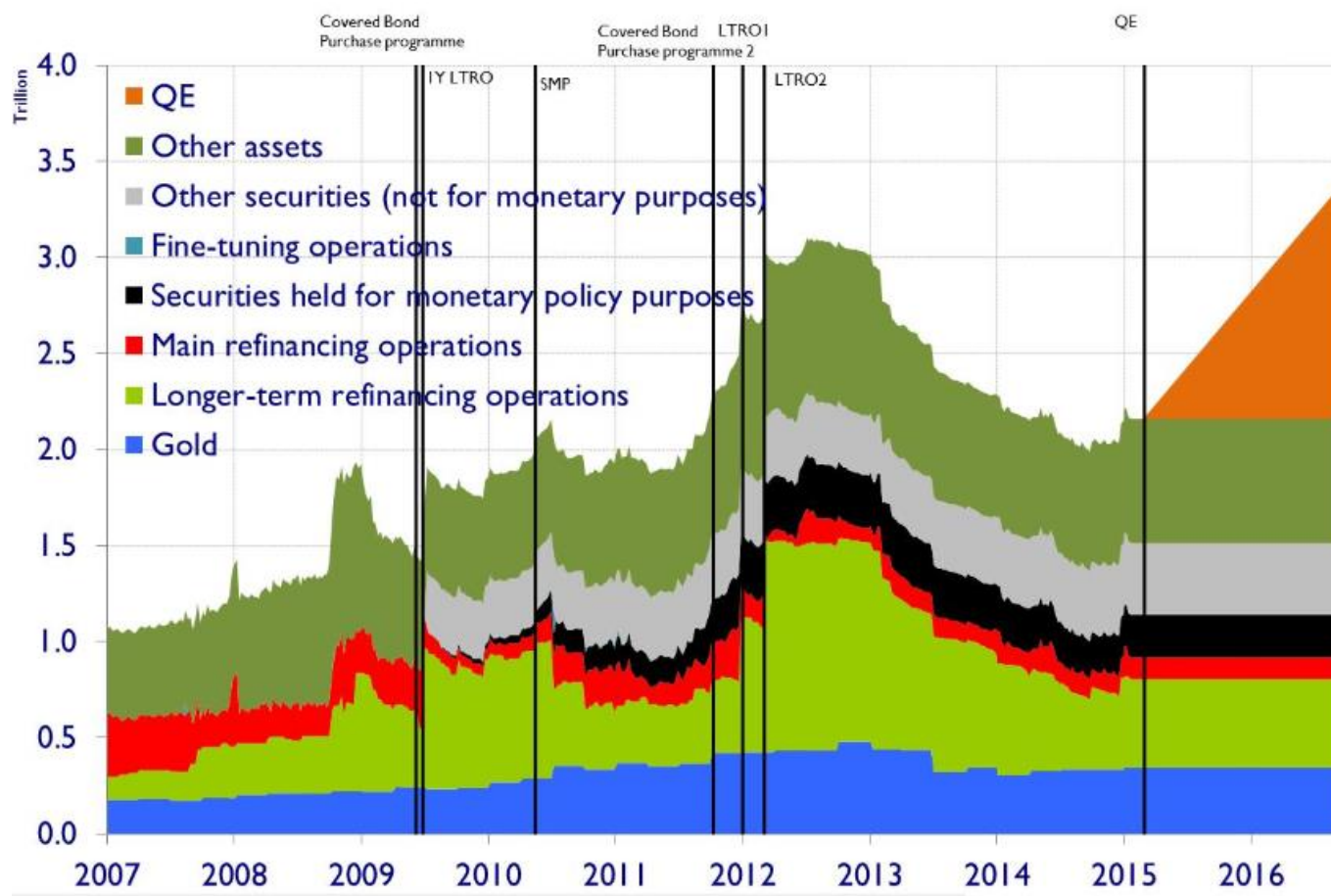
4. An active monetary policy

Monetary policy

- **SMP**: from 2010 to 2012, ECB purchased euro area sovereign bonds (over €200 billion) in secondary markets
- **LTRO** gave banks unlimited liquidity: in December 2011 and March 2012, around **€1 trillion** allotted in 3-year loans
- **OMT** announcement in September 2012 calmed the markets
- **New package** in June 2014
 - Targeted LTRO (at least €400 billion available lending capacity) designed to stimulate lending to small- and medium-sized companies
 - Negative deposit rate
- Programme for buying ABS and covered bonds announced in September 2014
- **Quantitative Easing** programme announced in January 2015
 - Asset purchases expanded to include euro area government bonds
 - Combined monthly purchases of €60 billion from March 2015 to September 2016

QE asset purchases by the ECB started in March 2015

The ECB's balance sheet is to reach €3.4 trillion in Sept. 2016



5. Establish a crisis mechanism

EFSF and ESM: mission and scope of activity

Mission : to safeguard financial stability in Europe by providing financial assistance to euro area Member States

Instruments

Loans

Primary Market Purchases

Secondary Market Purchases

Precautionary Programme

Bank recapitalisations through loans to governments

Direct bank recapitalisation

European Stability Mechanism
ESM only

All assistance is linked to appropriate conditionality

EFSF and ESM finance their activity by issuing bonds or other debt instruments

EFSF and ESM lending

- **Support for five countries (EFSF: Ireland, Portugal, Greece; ESM: Spain and Cyprus)**
 - Combined lending capacity: €700 bn
 - Committed amount to the five countries: €238.6 bn
 - Disbursed so far: €232.5 bn
 - EFSF/ESM disbursed three times as much in Europe as IMF in same period globally
 - Ireland, Spain and Portugal have exited their programmes
 - Macroeconomic adjustment programmes for Greece and Cyprus ongoing

Benefits of EFSF/ESM lending

1. All Member States have **remained in the euro area**
2. EFSF/ESM programmes promote **fiscal adjustment** and **structural reforms**
3. EFSF/ESM lending supports **return to debt sustainability**
4. The euro area has a **lender-of-last-resort** for sovereigns

Benefits of EFSF/ESM lending

Loans are euro area solidarity

Potential savings of EFSF/ESM financing vs theoretical market cost (for 2013)

	In € billion	As percentage of GDP	As percentage of total primary expenditures
Cyprus	0.24	1.5	3.4
Greece	8.58	4.7	8.6
Ireland	0.68	0.4	1.1
Spain	2.43	0.2	0.6
Portugal	1.27	0.8	1.7

Calculated using theoretical market spread of 5- and 7-year bond of each country matching the EFSF/ESM maturity profile on the 3 months before and after each country requested support. This is compared with the equivalent EFSF/ESM funding cost.

A comprehensive response to the euro crisis

1) Reduce vulnerabilities, implement reforms

- Macroeconomic imbalances are disappearing
- Strong growth in programme countries

2) Strengthen governance of euro area

- More comprehensive and stricter rules for policy coordination and surveillance
- Rules need to be credibly implemented

3) Create a stronger European banking system

- European banks have doubled their capital since 2008 and now have a Core Tier 1 capital ratio of 9% or more
- Banking Union is being established

4) An active monetary policy

- The ECB's unconventional measures have ensured sufficient liquidity and removed the threat of deflation

5) Establish a crisis mechanism

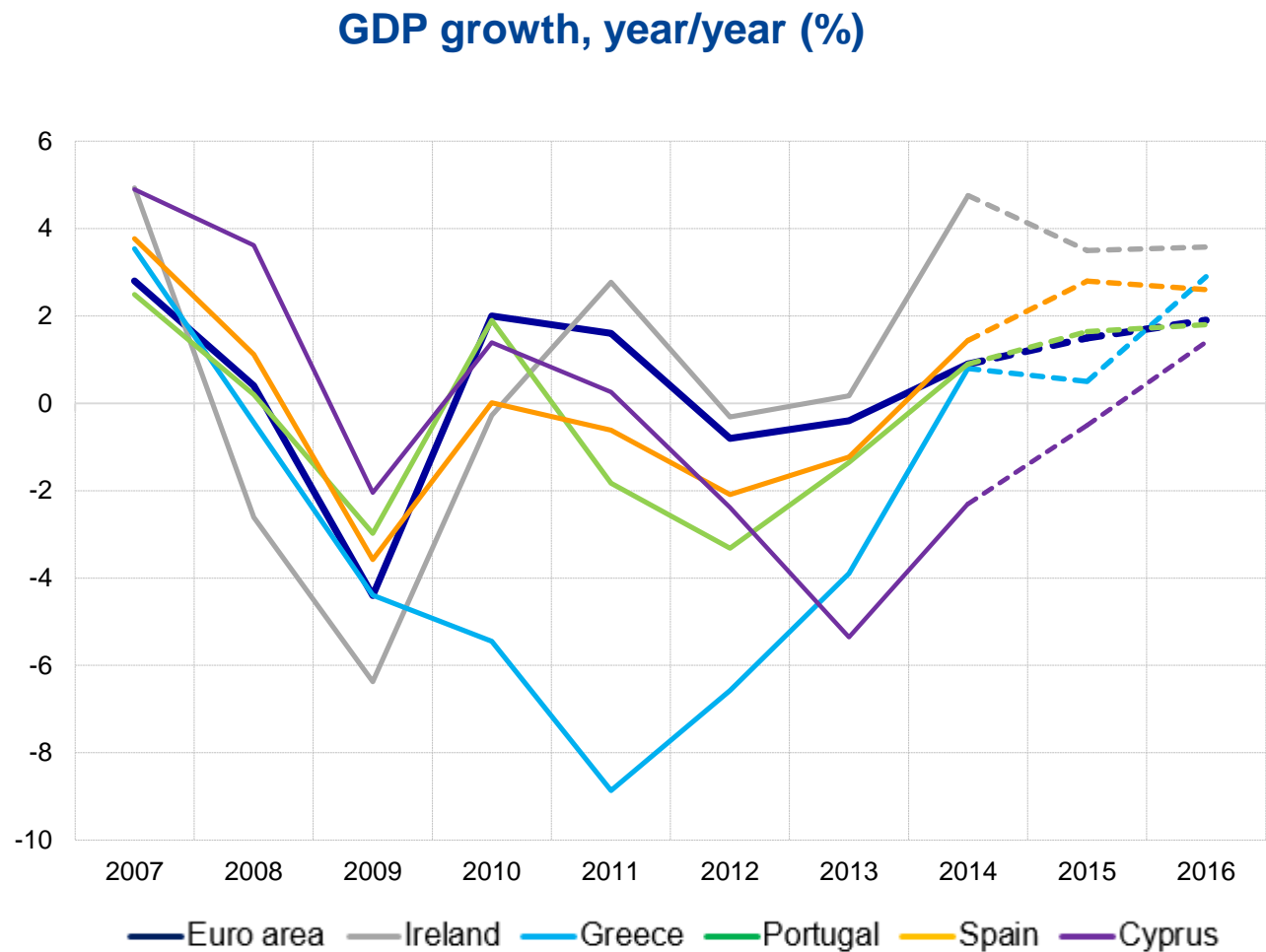
- EFSF and ESM have disbursed €232 bn to Ireland, Portugal, Greece, Spain and Cyprus
- EFSF/ESM loans support adjustment and debt sustainability

III. Restoring growth in the euro area

Focus on growth

- **Economic recovery** in euro area is boosted by **external factors** and **policy measures**
 - fiscal headwinds disappear
 - lower energy prices boost consumption and investment
 - weakening of euro exchange rate supports net exports
- **Structural reforms** are crucial for raising potential growth and they are a precondition for the effectiveness of monetary and fiscal policy
 - Adjustment programmes include long lists of structural reforms
 - European Commission and Council adopt recommendations for each Member State on ways to stimulate growth and create jobs
- Europe has a lot to offer for **education** and **training**

GDP growth is picking up in all programme countries



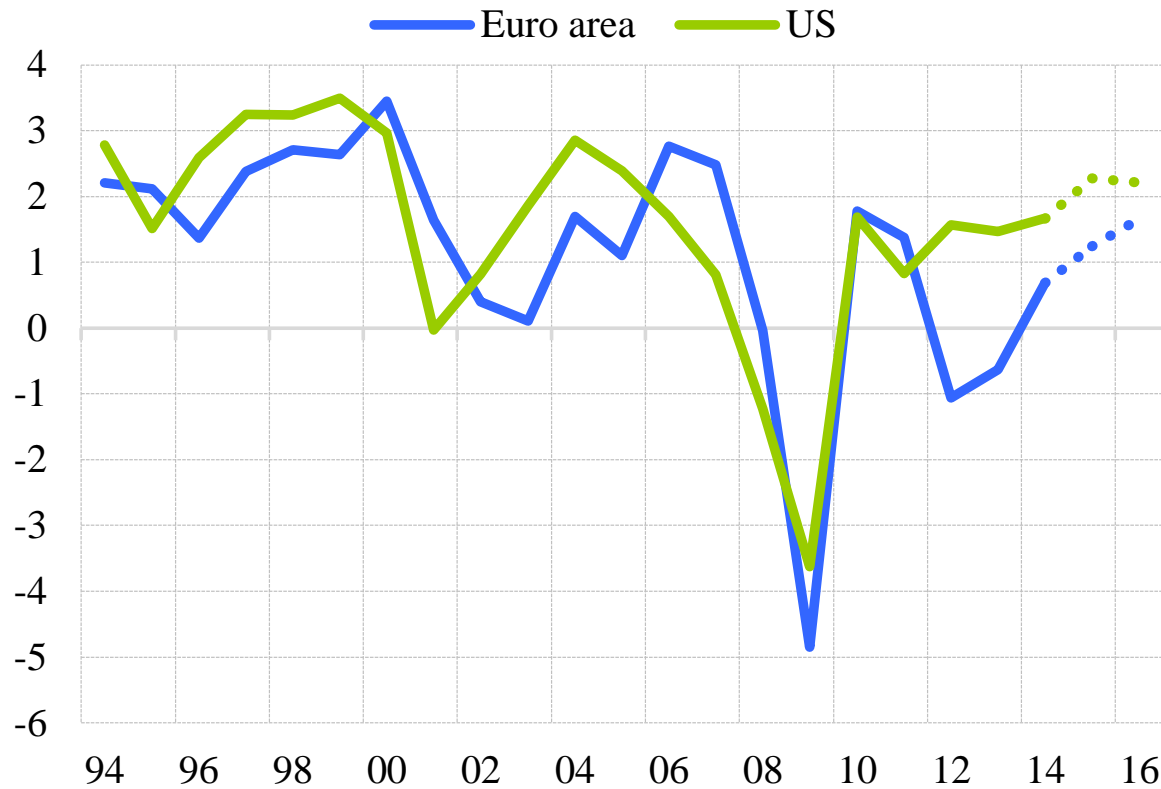
Source: EC European Economic Forecast – Spring 2015

Focus on growth: more can be done

- **Juncker Plan:** creation of European Fund for Strategic Investments (EFSI)
 - A guarantee of **€16 billion** will be created under the EU budget; the EIB will commit €5 billion
 - The Fund has the potential to yield **€315 billion of financing** over three years, thanks to estimated **multiplier effect** of 1:15
 - EFSI will support strategic investments in **infrastructure, education and research**, as well as support risk finance for **SMEs and mid-cap companies**
- **Further measures** are needed
 - Single Market should be completed to boost growth
 - Proposed Capital Markets Union would reduce reliance on bank funding in Europe
 - Private debt deleveraging should be promoted

GDP per capita growth comparison

GDP/capita growth since 1994 has been very similar in US and EU



Average GDP growth per capita, 1999-2008

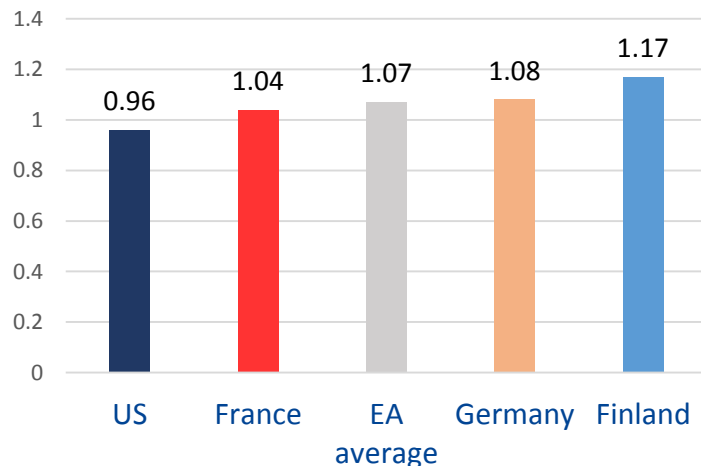
euro area	1.6
US	1.6

Source: Spring 2015 European Commission forecast

Economic well-being shows more than GDP/capita

- A study was recently conducted by Boston Consulting Group on **economic well-being** around the world
- The study defined well-being through three elements that comprise 10 dimensions:
 - **Economics:** income, economic stability, employment
 - **Investments:** health, education, infrastructure
 - **Sustainability:** income equality, civil society, governance and environment
- The study developed two coefficients providing relative indicators of how well a country has converted its (i) wealth and (ii) growth into the well-being of its population

Wealth-to-well-being coefficient in selected countries in 2015



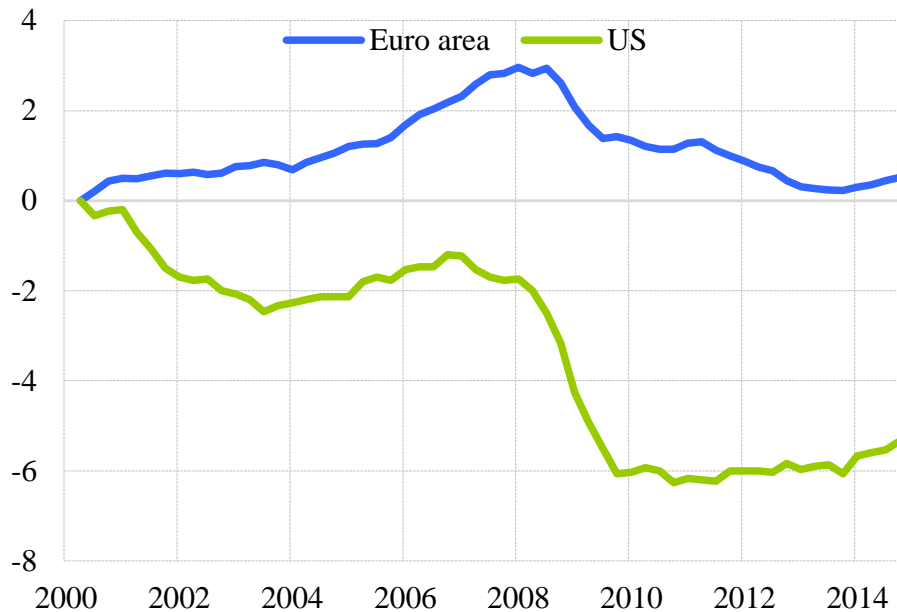
How the US and Germany have translated growth into well-being

- From 2006 - 2013, the US and Germany both recorded an average GDP growth rate of 1.1%
- Germany's ability to convert growth into economic well-being was equivalent to an economy growing at an average rate of 6.2%
- In the case of the US, it was equivalent to an average growth rate of only 0.5%

Labour markets

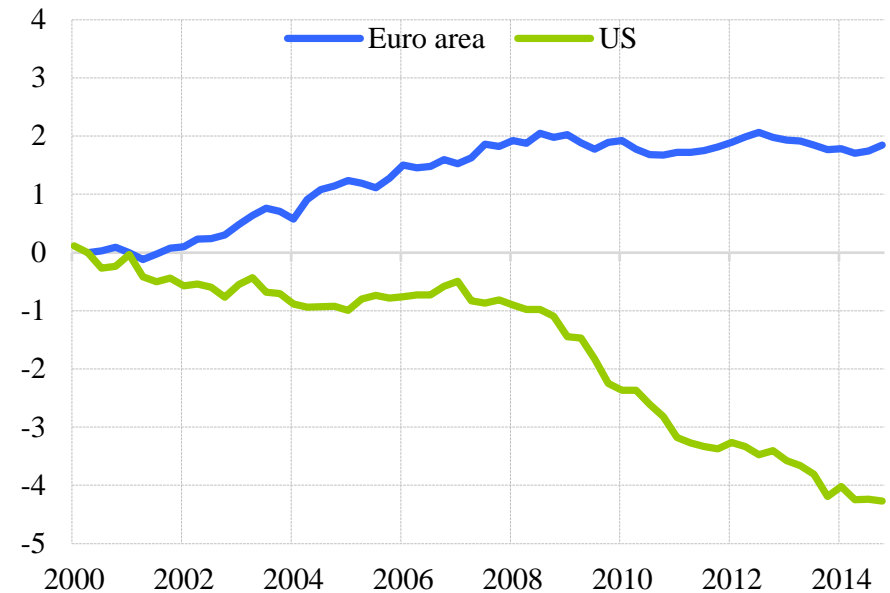
- Since 2000, employment rate has increased in euro area but fallen by around 6 p.p. in the US
- Participation rate in euro area stabilised after rise until 2009; in US continues to decline

Employment rate change since 2000 (%)



Age group: 15+ for euro area, 16+ for US
 Latest observations: Q4 2014
 Source: Eurostat, BLS and ESM calculations

Participation rate change since 2000 (%)



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III. Restoring growth in the euro area

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