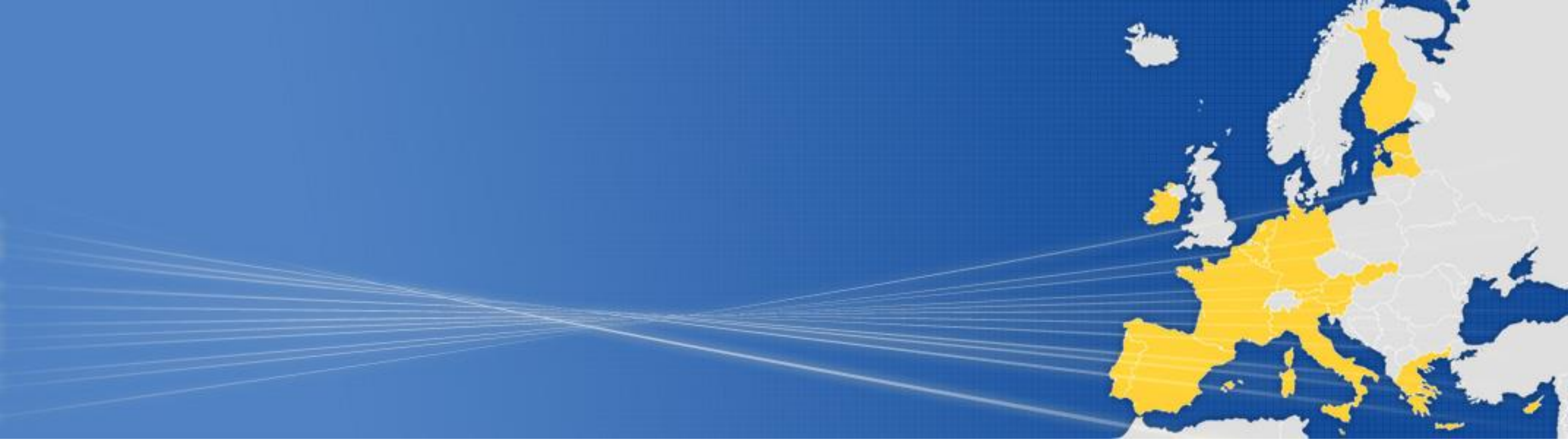


# The European Stability Mechanism

May 2014

# A comprehensive response to the euro crisis

1) **Significant fiscal consolidation and structural reforms at national level**
   - Macroeconomic imbalances are disappearing

2) **Improved economic policy coordination in the euro area**
   - More comprehensive and stricter rules for policy coordination

3) **Institutional innovations: financial backstops and OMT**
   - EFSF and ESM have disbursed €229.6 bn to Ireland, Portugal, Greece, Spain and Cyprus
   - Potential concerted ESM – ECB intervention possible

4) **Reinforcing the banking system**
   - European banks have Core Tier 1 capital ratio of 9% or more
   - Moving towards Banking Union

# 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** |

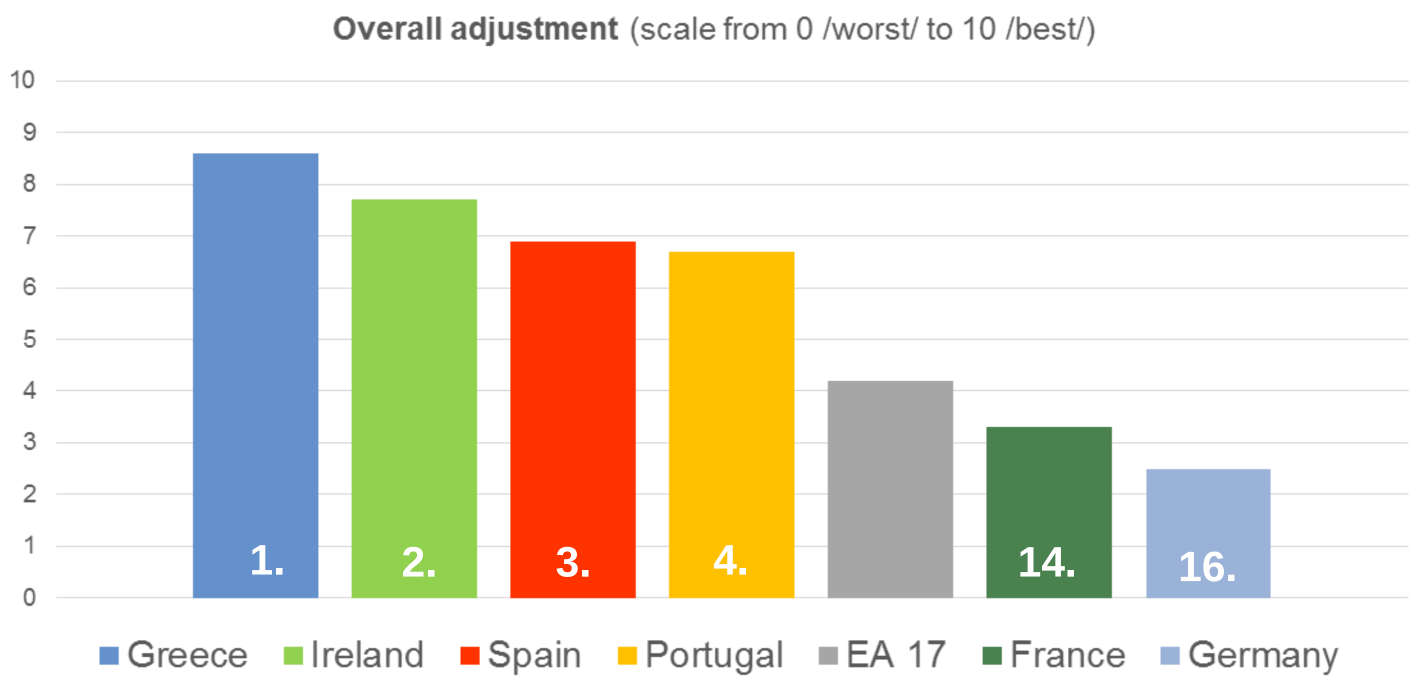
*"Euro area countries under financial assistance programmes are among the OECD countries whose responsiveness* [to the OECD's structural reform recommendations] *was highest and also where it most increased compared with previous period."*

- *Going for Growth 2013* (OECD Report)

Source: OECD report *Going for Growth 2013*
Ranking takes into account responsiveness to OECD recommendations on structural reforms in key policy areas

# EFSF/ESM programme countries are the reform champions (2)

- Lisbon Council: **Greece, Ireland, Spain and Portugal** ranked highest in overall measure of 4 key medium-term adjustment criteria:
  - Rise in exports
  - Reduction of fiscal deficit
  - Changes in unit labour costs
  - Progress in structural reforms



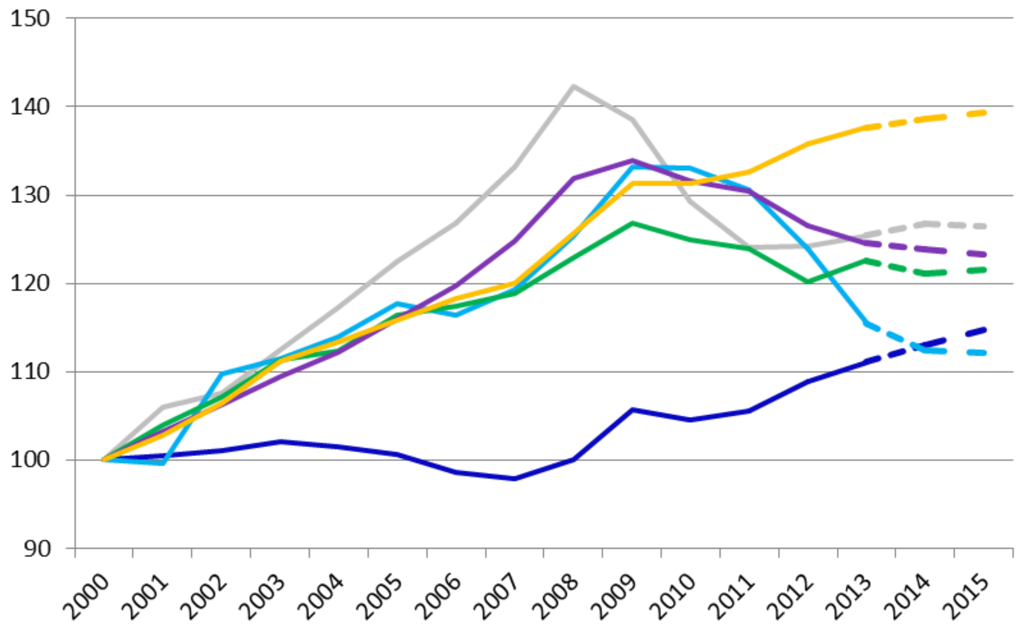

Source: "Adjustment Progress Indicator" in *2013 Euro Plus Monitor* published by the Lisbon Council

The ranking comprised 17 euro area countries + UK, Poland and Sweden

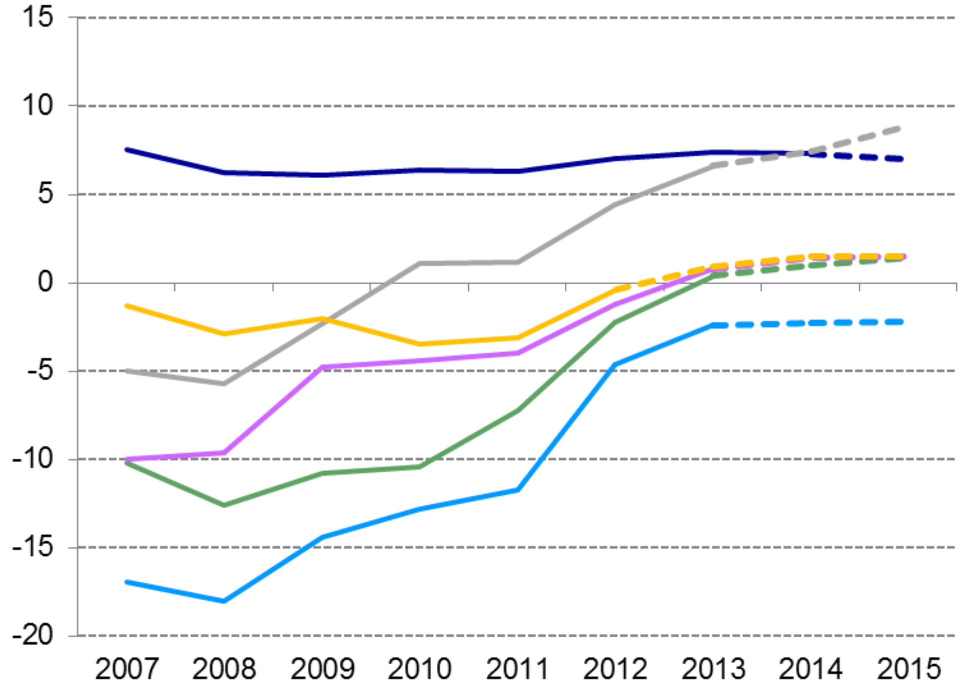
# The strategy is delivering results - competitiveness

- Divergences within EMU are declining
- Competitiveness is improving in all Member countries having requested EFSF/ESM financial assistance

Nominal unit labour costs, whole economy
(2008=100)




Current Account Balance (as % of GDP)

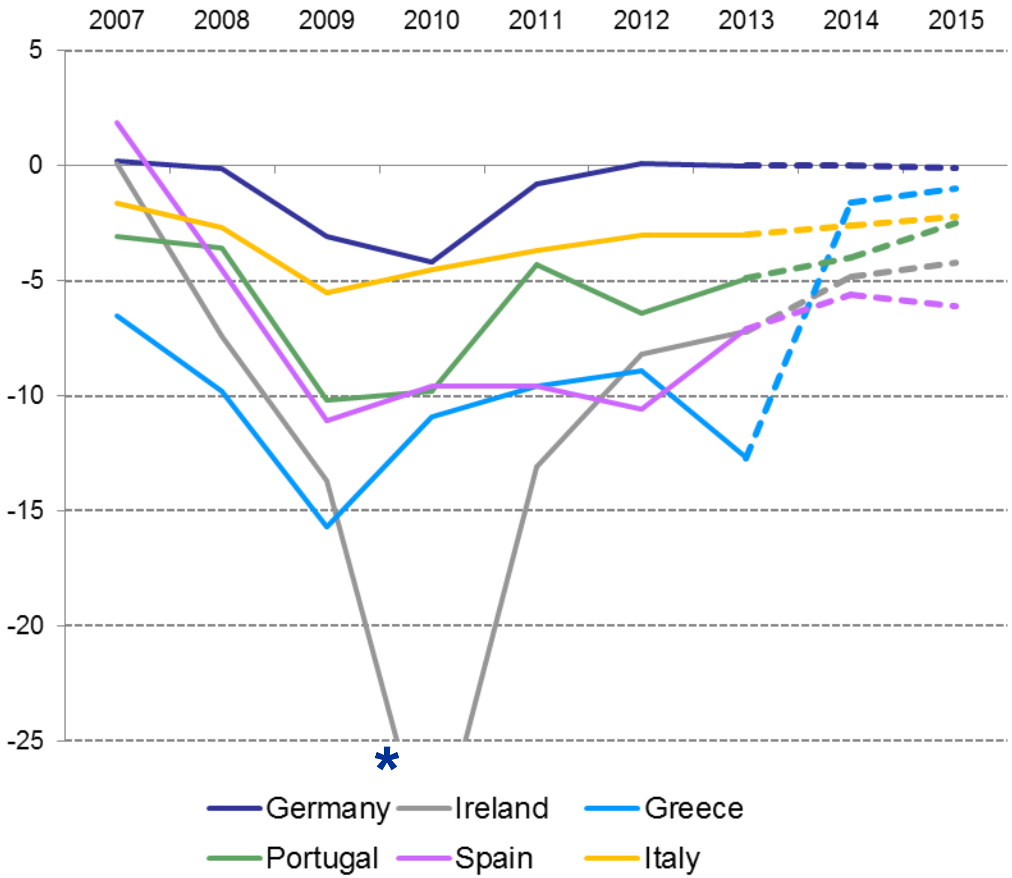



Germany Ireland Greece
Portugal Spain Italy

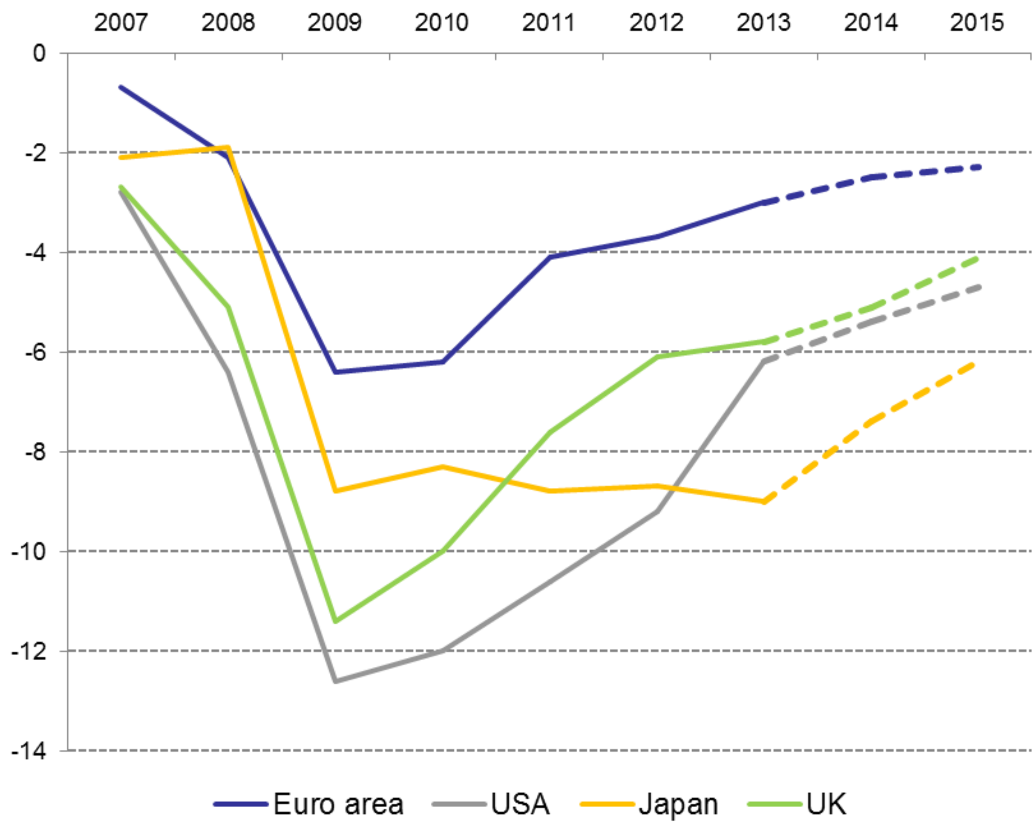
Source: Eurostat,
EC European Economic Forecast - Spring 2014

# The strategy is delivering results - fiscal

Fiscal balance, euro area Member States
(as % of GDP)




Fiscal balance, Euro area vs USA and Japan
(as % of GDP)

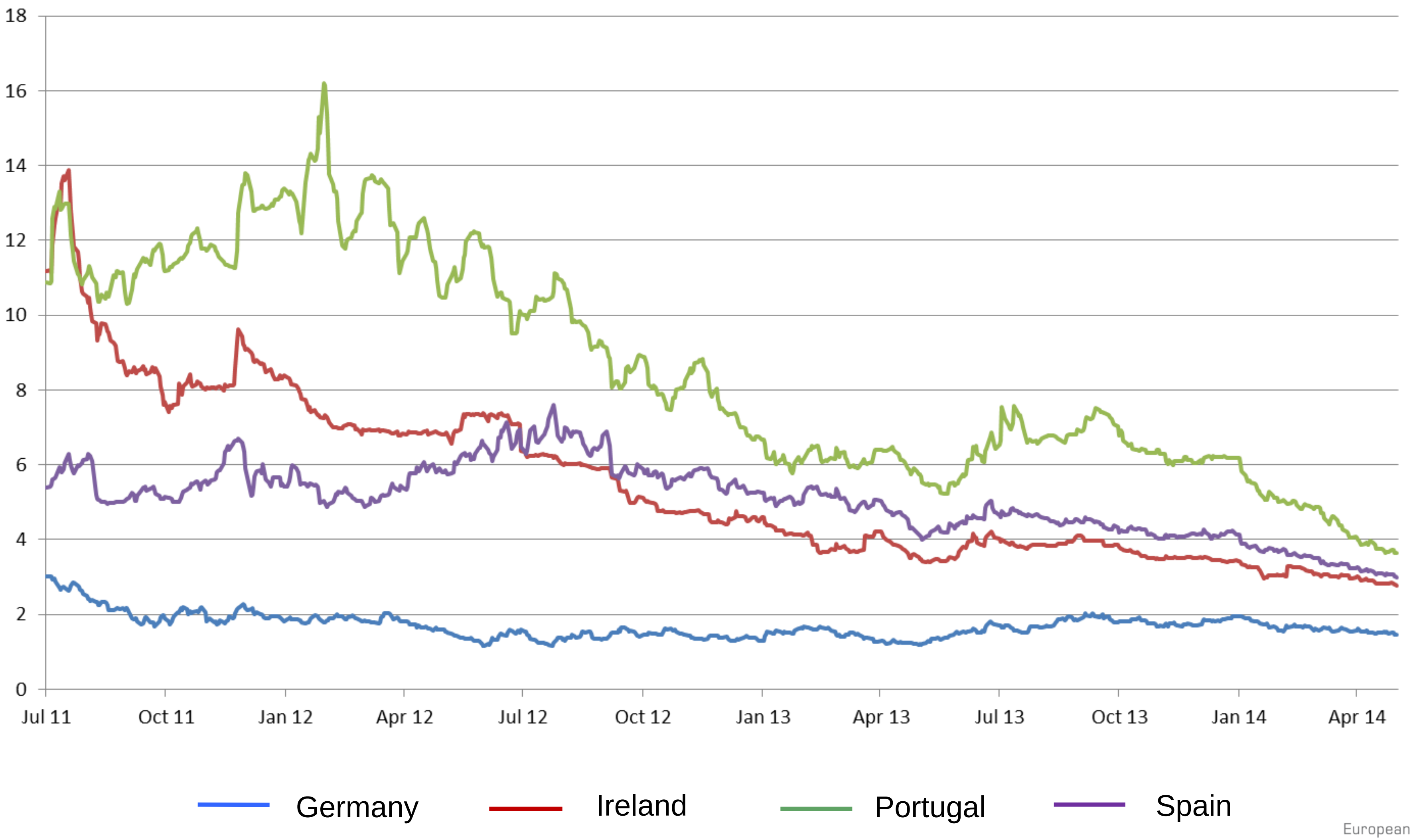



Source: European Commission, European Economic Forecast – Spring 2014

* Actual figure for Ireland in 2010: -30.6%

# The strategy is convincing the market

## 10-year government bond yields




Source: Bloomberg

# … and allowing countries to once again borrow at sustainable rates

**Ireland**

- Successfully regained market access with the issue of a 10-year bond in March 2013; new issue in January 2014
- Interest rates have fallen (for 10y bond) from 15.15% in July 2011 to 2.7% in May 2014

**Portugal**

- Successfully returned to markets with the issue of a 10-year bond in May 2013
- Interest rates have fallen (for 10y bond) from 16.6% in Jan. 2012 to 3.6% in May 2014

**Spain**

- Maintained access to long-term capital markets
- Remained a regular long-term borrower
- Interest rates have fallen (for 10y bond) from 7.56% in July 2012 to 2.9% in May 2014

# Latest euro area growth figures are encouraging

- **GDP growth positive again** in Q2 – Q4 2013 after 6 quarters of economic contraction
- **Euro area GDP** rose by 0.3% in Q4 2013
- **Industrial production** in euro area grew 0.2% in February 2014
- **Business activity** and **consumer confidence indicators** in euro area rose significantly in final months of 2013
- European Commission forecast for growth in euro area: **1.2% in 2014 and 1.7% in 2015**

Source: Eurostat, European Commission

## Improved economic policy coordination in the euro area

- 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 rules** are to be introduced in national legal systems
  - **European Semester**: yearly cycle of economic policy coordination
  - Stronger emphasis on **avoiding macroeconomic imbalances**
  - New focus: **avoid "spillovers"** of bad economic policy from one euro country to another

# 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****

**All assistance is linked to appropriate conditionality**

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

European Stability Mechanism

esm

# EFSF/ESM lending and assistance

- **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: €229.6 bn
  - Macroeconomic adjustment programmes for Greece and Cyprus
  - EFSF may no longer engage in new financial assistance programmes (as of 1 July 2013)
  - Ireland exited its EFSF financial assistance programme on 8 December 2013
  - Spain exited ESM programme in support of the banking sector on 31 December 2013)
  - Portugal announced a “clean exit” from its financial assistance programme

- **Potential concerted ESM – ECB intervention (Outright Monetary Transactions/OMT)**
- ESM programme provides conditionality
- The ECB could engage in secondary market purchases

European Stability Mechanism

# “Clean exit” from financial assistance programmes by Ireland and Spain

- ## Ireland
  - EFSF financial assistance programme **concluded on 8 December 2013**
  - Ireland received a total of €67.5 bn in loans from international lenders; **€17.7 bn from the EFSF**
  - Thanks to international support and a macroeconomic adjustment programme, Ireland’s **GDP is expanding** and **unemployment has been declining**
  - Ireland’s banking sector has undergone **significant correction** (downsizing, recapitalisation and deleveraging)

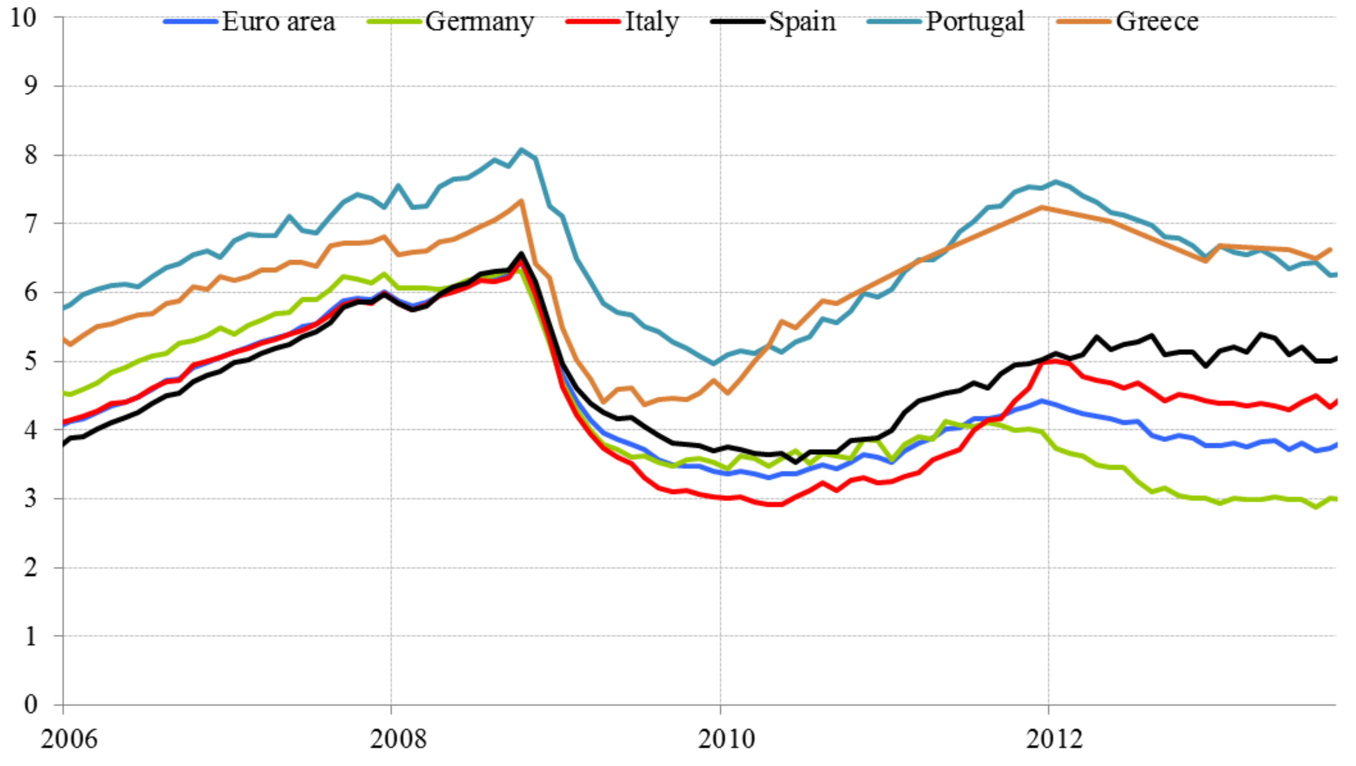
- ## Spain
  - ESM financial assistance programme (loan to Spanish government for bank recapitalisation) **concluded on 31 December 2013**
  - Spain received **€41.3 bn** in loans (debt securities) from the ESM
  - Thanks to ESM assistance, **banks have strengthened their capital, improved access to private funding and regained soundness**
  - Successful bank restructuring has paved the way for Spain’s **real economy to rebound**

# Reinforcing the banking system

- Europe is pushing ahead with **financial market reforms**
  - The progressive implementation of the “Basel III” capital accord has started
- EU established three new **European supervisory authorities – EBA, EIOPA and ESMA**
- The new **ESRB (European Systemic Risk Board)** for identifying and monitoring **macro-prudential risks** is functioning
- EBA decided **higher capital requirements for banks –** Core Tier 1 capital ratio is **raised to 9%**
- Banks **increased their capital base** by over **€200 billion** in 2012 and by **€450 billion** since 2008
  - ¾ through fresh capital
  - ¼ through decreasing assets
- Programmes for Ireland, Greece, Portugal and Cyprus **include assistance for bank recapitalisation, €41.3 billion** has been transferred to **Spain** to **support the banking sector**
- Problem: **renationalisation of the capital market** in the euro area

# Renationalisation of capital market in euro area

- Dispersion of bank lending rates to the non-financial private sector **…**
- **…** and of overall financing costs for the corporate sector **has increased considerably** across the euro area throughout the recent crisis period




Source: Haver Analytics, ECB
Last observation: December 2013

**Bank lending rates to non-financial firms, small loans (%)**

European Stability Mechanism

# Towards Banking Union

- **Single Supervisory Mechanism** (SSM) for euro area banks will be operational in November 2014
- **Bank Recovery and Resolution Directive** (BRRD) will create a uniform framework for bank recovery at national level
- **Single Resolution Mechanism** (SRM) with **Single Resolution Fund** (SRF): preliminary agreement between European Parliament and Council of the EU reached in March 2014
- **ESM Direct Recapitalisation Instrument** will be operational once SSM enters into force and euro area MS unanimously approve
- Harmonisation of **national deposit guarantee frameworks**

# Measures to boost growth in EU

- Progress in resolving the euro crisis **removes important uncertainties for investors, consumers, banks and financial markets**
- **EFSF/ESM programmes include long list of structural reforms**
- **Coordinated action at national and EU level for Growth and Jobs**
  - Member States take action to achieve specific competitiveness goals
  - Member States coordinate policies to pursue growth-friendly fiscal consolidation and to restore lending to the economy
  - European “Marshall Plan” against youth unemployment
- **European Investment Bank (EIB)**
  - 90% of its lending supports sustainable growth and job creation
  - €10bn capital increase, which will raise lending capacity by €60 bn
  - EU-EIB Project Bond Initiative

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