

The road to a European Monetary Fund

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Europe has overcome two crises

■ Global financial crisis 2008-2009

- Crisis in the US real estate market
- Excess liquidity
- risk premiums too low

■ Sovereign debt crisis in Europe followed in 2010

- Unsustainable budget deficits and debts, lack of competitiveness, real estate bubbles in several countries
- Gaps in EU institutional structure
- Insufficient supervision of the financial sector
- The unthinkable happened:
 - » Several countries lost market access
 - » Break-up of euro area became a real threat

Europe's comprehensive response to the crisis

1. **Budget consolidation and structural reform in euro area countries**
2. **Closer economic policy coordination in the currency union**
3. **An active monetary policy by the ECB**
4. **Strengthening the banking system**
5. **Firewalls against the crisis: EFSF and ESM**

ESM as lender of last resort for euro countries

■ EFSF and ESM

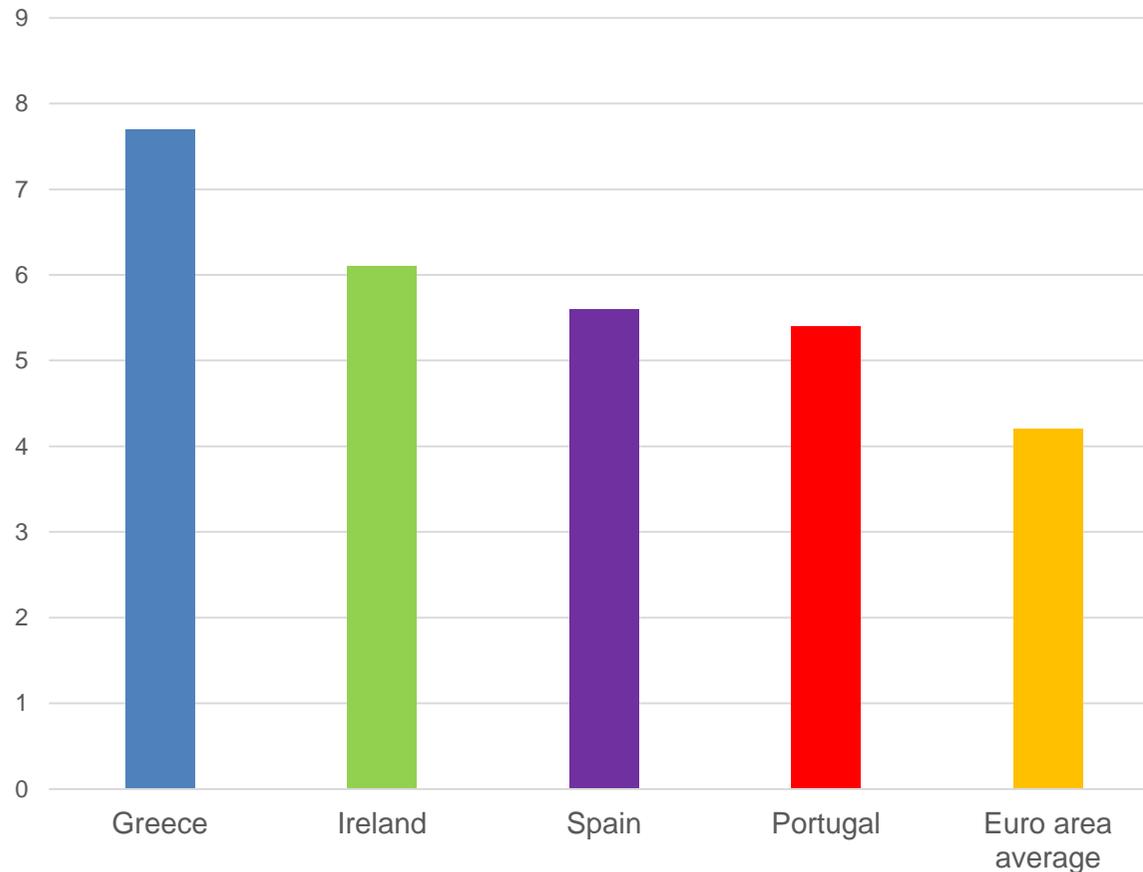
- Total lending capacity: €700 billion
- Since 2011: €279 billion disbursed

■ ESM

- Rescue fund for euro member countries that lost market access
- Highest paid-in capital of all international financial institutions
- Financing via the markets – unlike the IMF
- No direct costs for taxpayers
- Strict conditions (“conditionality”)
- Favourable loan conditions thanks to good rating, strong backing by ESM shareholders

EFSF/ESM programme countries are the reform champions

■ Greece and Ireland ranked highest in the EU in terms of reform efforts



“Due to the adjustment efforts of the periphery in the last five years and some progress at the core, the eurozone as a whole is turning into a more balanced and potentially more dynamic economy” – Lisbon Council

Source: “The 2017 Euro Plus Monitor: Into a Higher Gear”, published by the Lisbon Council. The ranking comprises the 28 EU member states.

Note: Overall adjustment on a scale from 0 /worst/ to 10 /best/.

Budgetary savings as a result of EFSF/ESM lending

Potential savings of EFSF/ESM financing vs theoretical market cost (for 2016)

	In € billion	As percentage of GDP
Cyprus	0.4	2.1
Greece	9.9	5.6
Ireland	0.7	0.4
Spain	2.1	0.2
Portugal	1.3	0.7

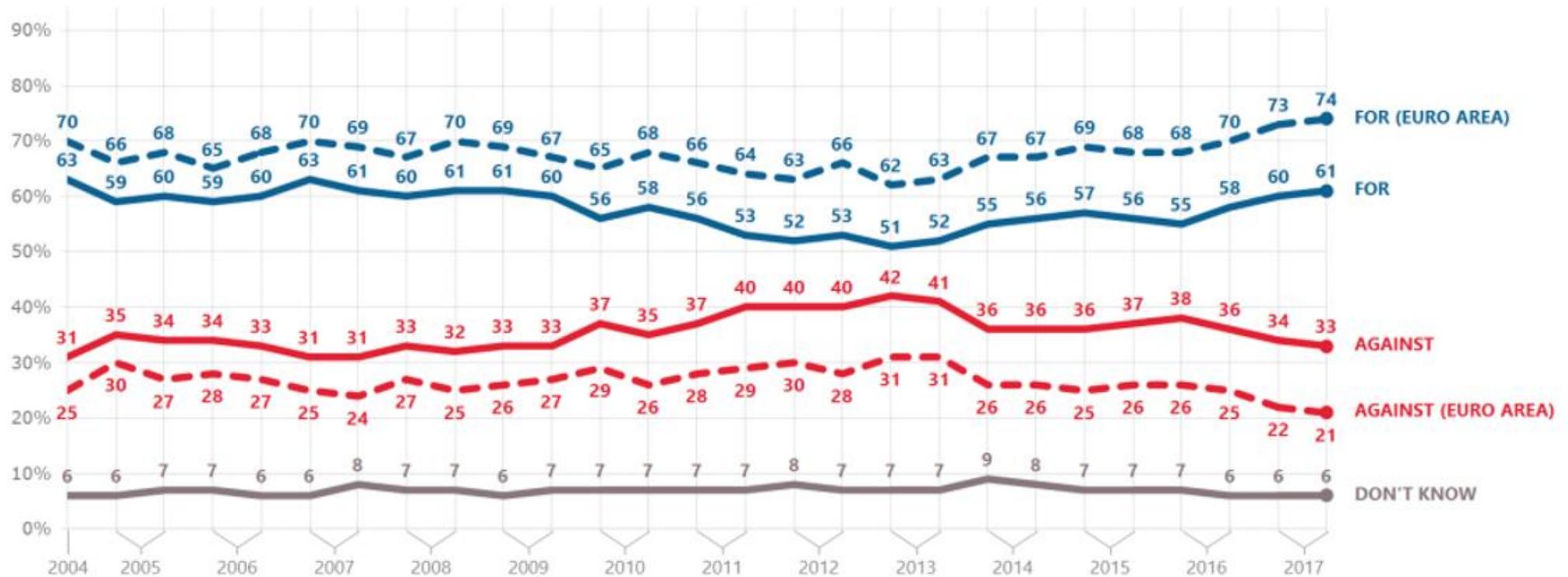
Note: Calculated by comparing the effective interest rate payments on EFSF/ESM loans with the interest payments that these countries would have paid had they covered their financing needs in the market. The yields on 10-year bonds are taken as a proxy long-term market rate.

What have we achieved?

- Per capita growth is again back to long-term pre-crisis levels and in line with the US
- Labour markets are performing strongly – strong increase in participation and employment rates
- Much lower income inequality than in any other region of the world, while the euro area remains a highly open economy

Three out of four citizens in euro area support the single currency

“Are you for or against a European economic and monetary union with one single currency, the euro?”



Source: European Commission – Standard Eurobarometer 88, 2017.

Note: percentage of all respondents in the EU and the euro area.

What challenges remain

- Political risk less than feared, but:
 - Populism remains a political force
 - Threat of protectionism – Immigration - security
 - Brexit
- Promote productivity and raise potential growth:
 - Investment/R&D – Education - Scaling of innovation
- Make monetary union more robust
 - Euro area public debt level still above pre-crisis levels though slightly declining
 - Banking system is safer but still legacies in some countries and low profitability
 - Lower financial market integration than prior to the crisis
 - Institutional change needs to be completed and fine-tuned

Financial integration remains well below pre-crisis levels

ECB indicators of financial integration in euro area

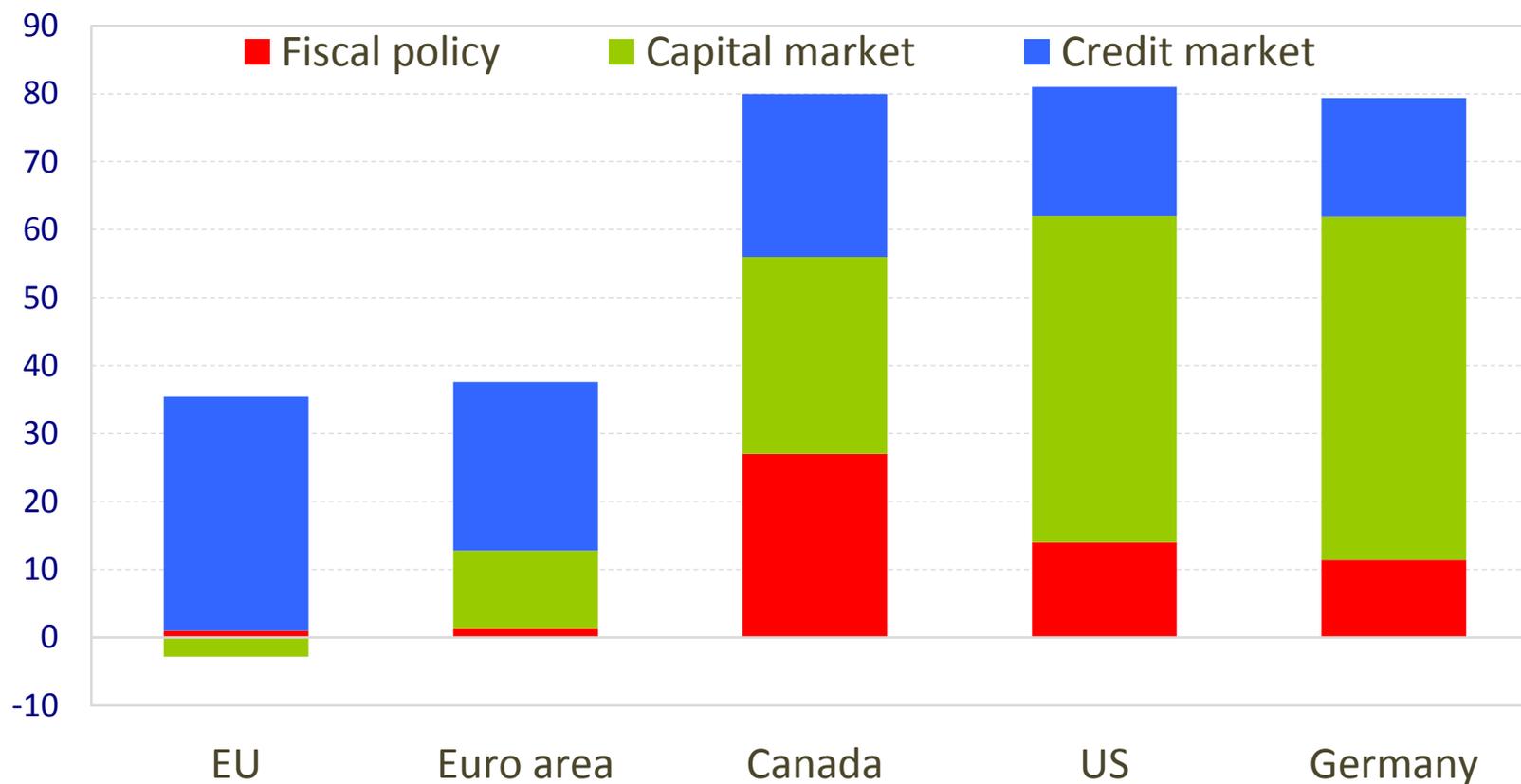


Source: ECB.

Note: The price-based indicator aggregates ten measures covering the main market segments such as money, bonds, equities and banking. The input series relate to price dispersion in EA countries. The quantity-based indicator aggregates five measures, covering intra-EA cross border holdings expressed as a % of EA total holdings. Both indicators are bounded between zero (full fragmentation) and one (full integration). Increases in the indicators signal higher financial integration.

Risk sharing is underdeveloped in the euro area and EU

Percentage of shock smoothed by different channels



Source: IMF.

Deepening EMU: Overview (i)

More financial integration to promote risk sharing via markets

■ **Completing Banking Union**

- **Common backstop** for the Single Resolution Fund (SRF)
- **European Deposit Insurance Scheme (EDIS)** – only after legacy issues solved and further de-risking of banks

■ **Completing Capital Market Union**

- Strengthen European Supervision
- Harmonise insolvency and tax legislation removing debt bias

Deepening EMU: Overview (ii)

■ Strengthening ESM – towards a EMF

- Provide backstop to SRF
- Design and monitor future adjustment programmes (together with the European Commission)
- Being in contact with Member States outside of crises times
- Manage debt sustainability in a crisis resolution framework
- Provide macro-economic stabilisation facility (shorter term loans)

Deepening EMU: Overview (iii)

■ Fiscal – many ideas around – but less consensus:

- Simplify fiscal rules to make them credible again
- Fiscal capacity for macro stabilisation (without transfers, no annual budget) to avoid large crisis; different tools possible:
 - » “Rainy day funds”, or
 - » Complementary unemployment scheme, or
 - » Shorter-term ESM loans
- Other fiscal arrangements to finance public goods possible
 - » e.g. common defence budget

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