



The European sovereign debt crisis and the future of the euro

Peter Beks

European Commission

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Outline of Presentation

The current economic situation

- **The global financial crisis**
- **The euro-area economic outlook**

Responses to the sovereign debt crisis

- **5 point plan**



The global financial crisis has evolved through phases

- ✓ **Phase 1: US mortgage market crisis**
- ✓ **Phase 2: Global credit crisis**
- ✓ **Phase 3: Global economic and financial crisis**
- ✓ **Phase 4: Sovereign debt crisis**

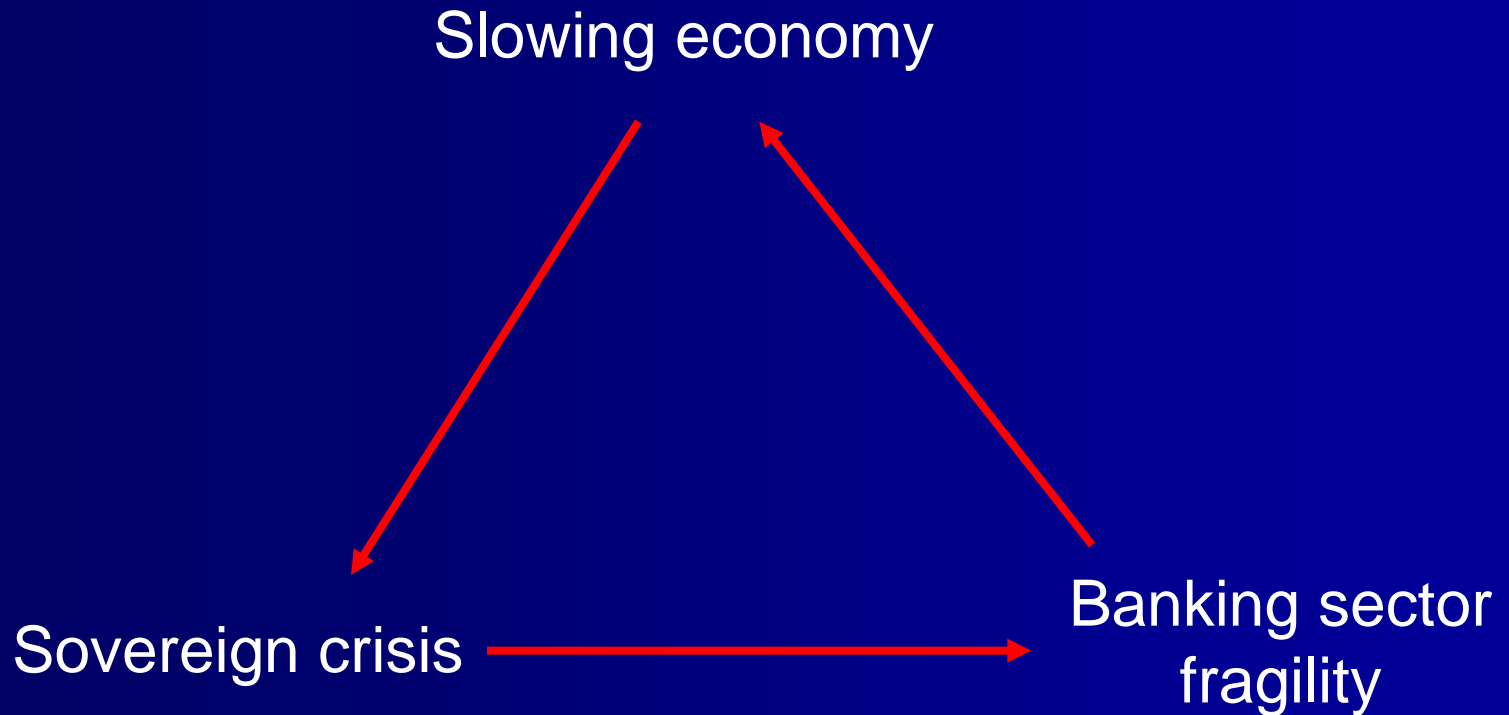


Interaction of sovereign and bank-balance sheets

- ✓ **Credit risk transferred from banks to government 2008/9**
- ✓ **Government finances weakened further by recession**
- ✓ **Investors focus on public debt sustainability**
- ✓ **Pressure in sovereign debt markets**
- ✓ **Banking sector vulnerable via sovereign exposures**



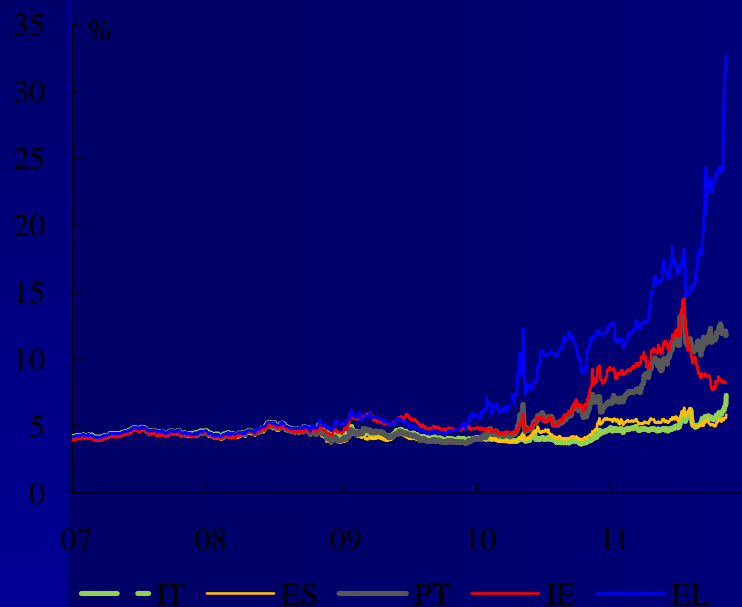
The vicious circle





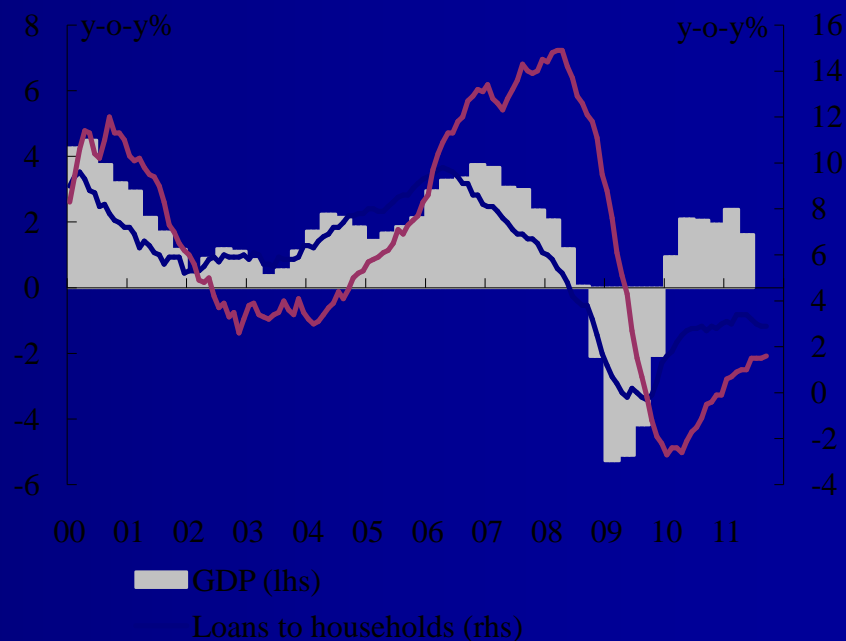
Deepened sovereign-debt crisis

Sovereign bond yields, selected Member States



Source: Ecwin

Bank lending to households and non-financial corporations, euro area



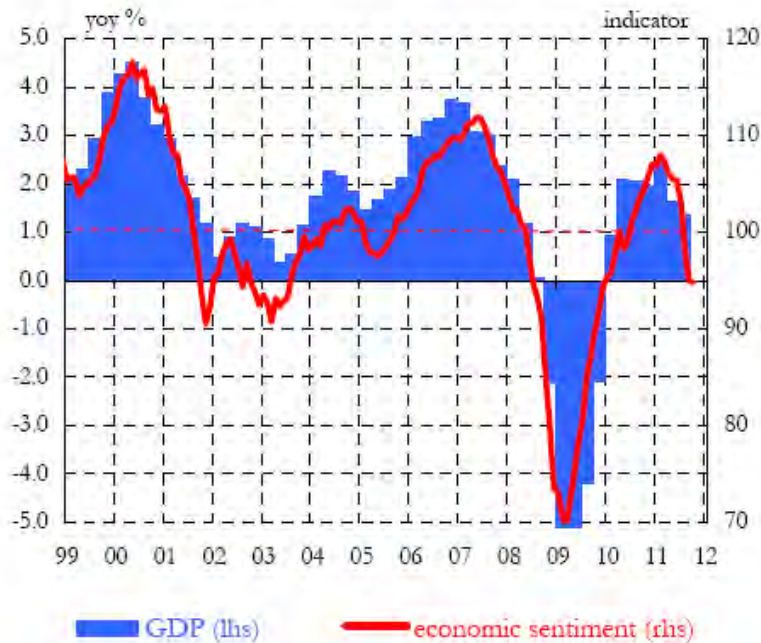
Source: European Central Bank and European Commission



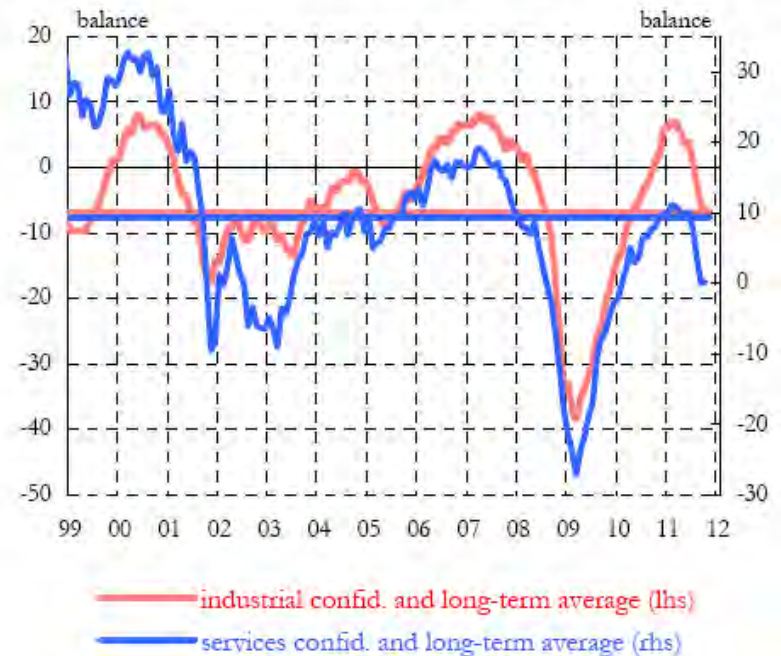
Sharp deterioration in leading indicators

Overall survey indicators, EU

GDP and Economic Sentiment Indicator



Industrial and services confidence

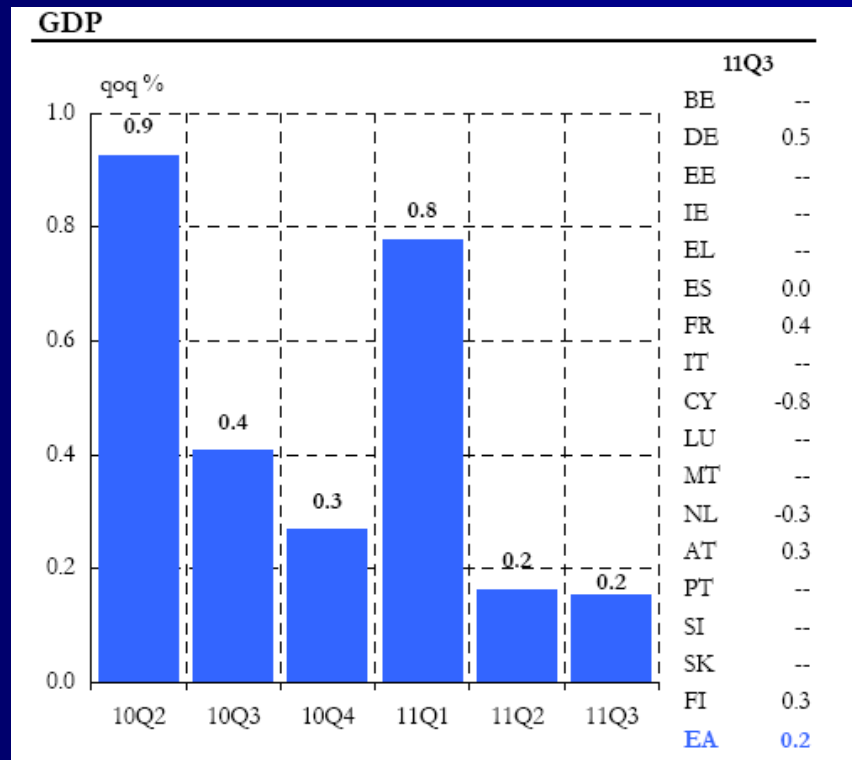


Source: European Commission



The recovery has come to a halt

Real GDP, euro area

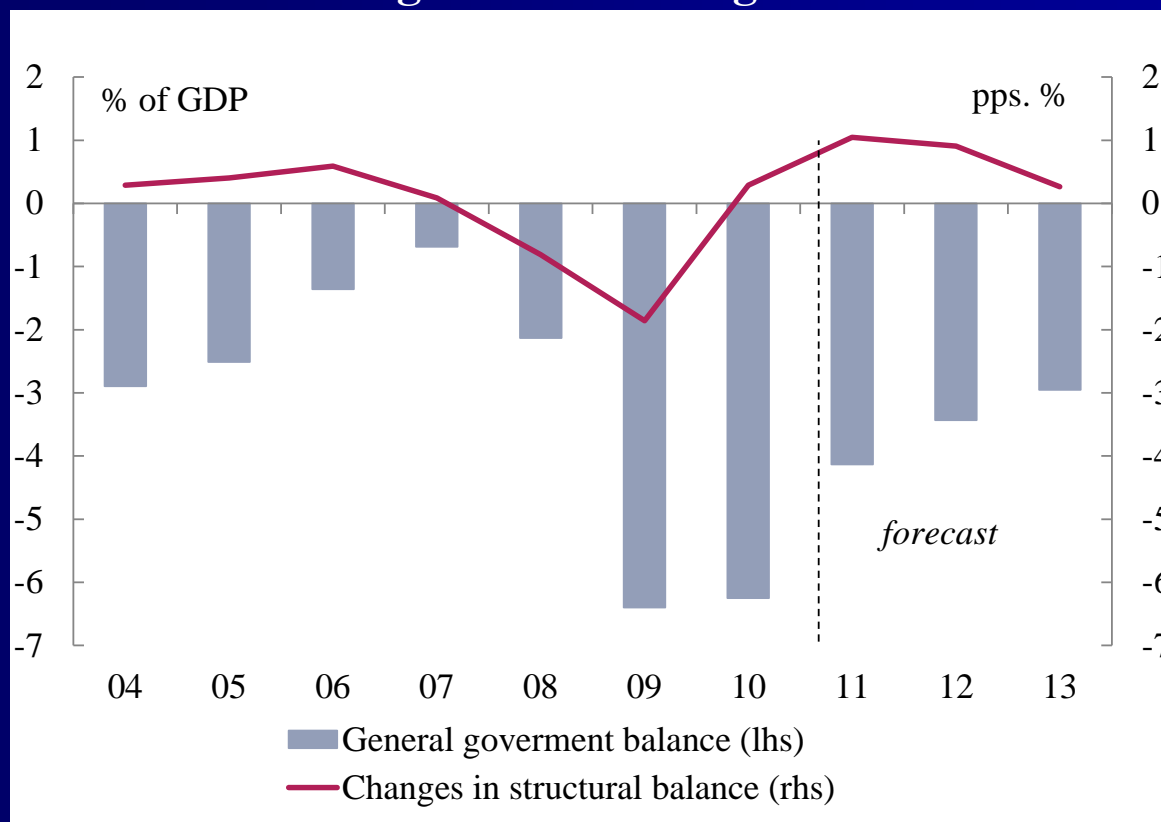


Source: European Commission



Public deficits continue to recede

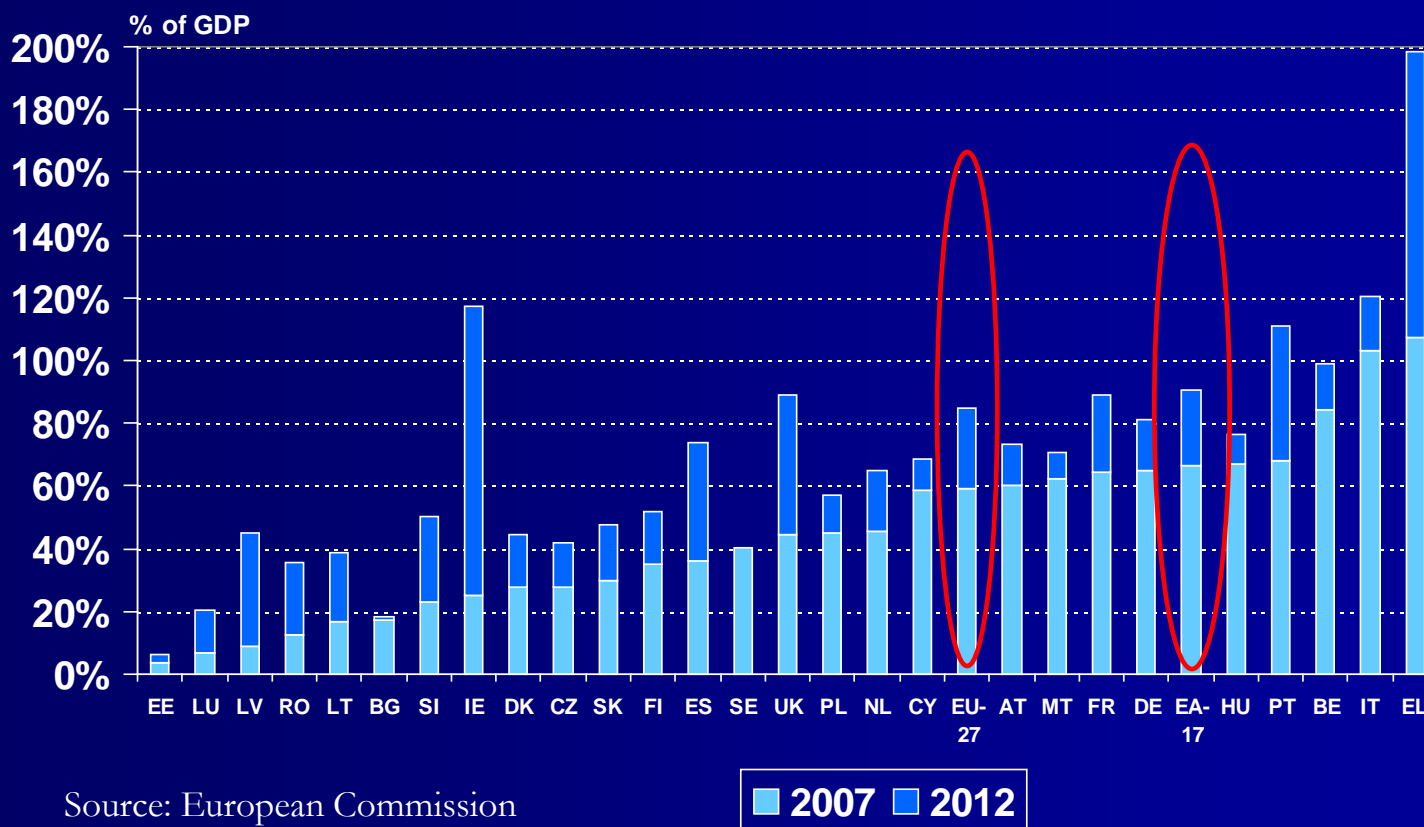
General government budget balance



Source: European Commission



Short-term impact of the crisis on public debt



Source: European Commission



Responses to the crisis

- Remove market uncertainty relating to Greece
- Budgetary consolidation and growth in vulnerable Member States
- Firewall against contagion in sovereign debt markets
- Reinforcement of the EU banking sector
- Strengthening of euro-area governance framework



Greece

- Early 2010: confidence lost
- May 2010: € 110 bn package
- Mid-2011: new package, easier conditions for existing loan
- End-2011: upward revisions deficit, slower growth



Action on vulnerable Member States

- Ireland: good programme implementation → market confidence is returning
- Portugal: structural reforms aim at switch from consumption to exports
- Italy: new government adopted package to address twin challenges
- Spain: new government adopted package for fiscal reform at all levels of government



Firewall 1

Up to €750 bn financial stability package
(support in the form of loans under strict conditionality)



EFSM - €60 bn
European Financial
Stabilisation Mechanism



EFSF - €440 bn
European Financial
Stability Facility



IMF – up to €250 bn
International Monetary
Fund



Firewall 2: ESM

- Capital size and structure:
 - Size: € 500 bn
 - Paid-in capital; callable capital; guarantees;
 - AAA rating

- Instruments:
 - Loans (ESM stability support)
 - Bond purchases (Primary market support facility)

- Pricing: in line with IMF pricing



Reinforcing the banking sector

- Restore confidence
 - ➔ 9% capital ratio
 - ➔ submit plans to deal with shortfall
- ECB measures
 - ➔ easing of collateral requirements
 - ➔ reduce reserve requirements
 - ➔ LTRO with 3-y maturities



Governance Reform

- Strengthening the SGP
- Preventing and correcting macroeconomic imbalances
- Reinforcing economic surveillance



Reform of the SGP

- More focus on public debt

- Strengthening Enforcement
 - Wider range of sanctions
 - Triggered at an earlier stage
 - More automaticity



Macroeconomic Surveillance

- Preventive arm:
 - Alert mechanism – scoreboard
 - In-depth country analysis
 - Recommendation on how to tackle imbalances

- Corrective arm:
 - Excessive imbalances position
→ stricter surveillance



Europe 2020

- Structural reforms to raise potential growth
 - Smart consolidation
 - Reforms with low costs for the budget
 - Priority to growth-stimulating reforms



Fiscal Compact

- Legally binding balanced budget rule
- Automatic correction mechanism
- Ex-ante coordination of debt issuance
- Ex-ante coordination of major economic policy reforms
- Euro Summit meetings

