What has been going on in the Eurozone since 2009?

by Helmut Wagner

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A) Macroeconomic Development
Unit Labour Costs

Unit labour costs (annual, total economy), index OECD base year (2005=100). Data source: OECD
Unit Labour Costs: GIIPS and DE

Unit labour costs (annual, total economy), index OECD base year (2005=100). Data source: OECD
Current account balances (% of GDP, annual, estimates start after 2010). Data source: WEO Database Oct2011
Current account balances (% of GDP, annual, estimates start after 2010). Data source: WEO Database Oct2011
Government Deficit

Government Deficit: GIIPS and DE


Government Debt: GIIPS and DE

Governement gross debt (% of GDP, annual, estimates start after 2010). Data source: WEO Database

Oct2011
Gov. Bond Yield Spreads: Euro Area

Euro area (monthly) 10 year government bond yield spread vis-a-vis Germany. Data source: ECB
GIIPS (monthly) 10 year government bond yield spread vis-a-vis Germany. Data source: ECB
B) Policy Measures to Counteract the Sovereign Debt Crisis in the Eurozone
Policy Measures to Counteract the Sovereign Debt Crisis in the Eurozone

• member states of the E(M)U
  – financial rescue for member states “in need”
  – austerity, reform, ...
  – propping up of banks (i.p. prevent a vicious cycle)

• European Central Bank (ECB)
  – suspending the application of the minimum credit rating threshold in the collateral eligibility requirements for member states “in need” (May2010 Greece, Mar2011 Ireland, Jul2011 Portugal)
  – buying of government bonds (from member states “in need”)
  – more expansionary monetary policy
(1) Strengthening of Governance on the European Level: Fiscal Policies

- **Stability and Growth Pact (SGP)** is being strengthened
- SGP will be supplemented by the **European Semester**
- new procedures to avoid excessive disequilibria, i.p. new “**excessive imbalances procedure**” (EIP) and an **alert mechanism** via a scoreboard
- Euro+ Pact: incl. EU member states outside Eurozone
- Europe2020: broad and consistent growth strategy
- improving efficiency
(1) Strengthening of Governance on the European Level: Financial Sector

- reform of financial market regulation:
  European System of Financial Supervision (ESFS):
  new financial supervision institutions, i.p. for better macroprudential oversight

European Systemic Risk Board (ESRB):
- European Banking Authority (EBA)
- European Insurance and Occupational Pensions Authority (EIOPA)
- European Securities and Markets Authority (ESMA)
- Joint Committee of the European Supervisory Authorities (ESAs)
(2) Instruments of Crisis Management

• May 2010 last-minute set-up of a loan facility for Greece
• May-Jun 2010 set-up of the temporary European safety-net: European Stabilisation Mechanism (ESM)
• Oct 2011 reforming the European Financial Stability Facility (EFSF): i.p. increase resources via leverage guarantees; Eigenhilfe; no financial transfers?
• Agreement to set up a permanent ESM Mar 2013? fiscal centre, support mechanism for member states
• Use of established IMF practice
(3) Assessment of the Policies

- purchasing of time; need of structural reforms in the problem countries

- scaling up will become necessary; political conflicts probable
(4) Not-Chosen Alternatives

- exit/exclusion of Greece from the Eurozone → contagion?
- division of Eurozone in North- and South-zone → political earthquake?
- exit of Northern member countries (Germay at al.) → political earthquake in Southern member countries; recession in Northern countries
- Eurobonds + ECB as lender of last resort (French proposal) → moral hazard
C) Prospects of EU-Integration
Prospects of EU-Integration

(1) 3 scenarios

- positive: calming down; stabilization
- medium: “muddling through” with recurring crises (developing liability association)
- chaos and breaking up of the Eurozone

medium scenario most likely
Prospects of EU-Integration

(2) Divergence or Convergence

• within Eurozone
• between Eurozone insiders and outsiders
  → reputation effects; development of spreads?
• dependent upon ...
Role of Convergence

• Only with convergence a MU can/will be an enduring success.

• As long as there are wrong incentive mechanisms in the EMU promising unconditional financial support to laggards/drones, there will be divergence or artificial convergence based on financial transfers from rich / more solid member countries. The latter however tend to produce systemic sovereign debt crises in the EMU.

• This will be a major topic in my paper for the joint omnibus volume.
D) Conclusions
Conclusions
Thank you for your attention!
Rescue Packages for Member States (so far ...)

- **Greece**
  - agreed: 2.May2010
  - amount originally: €110bn bilateral loans
    + €100bn incl. refinancing of Greek banks + private sector involvement

- **Ireland**
  - agreed: 28.Nov2010
  - amount: up to €85bn so far

- **Portugal**
  - agreed: 17.May2011
  - amount: up to €78bn so far
Exposure to sovereign debt issued by PIIGS, non-PIIGS and non-EMU countries

<table>
<thead>
<tr>
<th>Country</th>
<th>In billions of euros</th>
<th></th>
<th></th>
<th>Total exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>EMU</td>
<td>PIIGS</td>
<td>non-PIIGS</td>
</tr>
<tr>
<td>Austria</td>
<td></td>
<td></td>
<td>2.8</td>
<td>18.5</td>
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<tr>
<td>Belgium</td>
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<td>40.0</td>
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<td>51.9</td>
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<td>Cyprus</td>
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<td>2.3</td>
<td></td>
<td>1.0</td>
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<tr>
<td>Denmark</td>
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<td>1.4</td>
<td></td>
<td>6.3</td>
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<tr>
<td>Finland</td>
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<td>0.1</td>
<td></td>
<td>0.9</td>
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<tr>
<td>France</td>
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<td>24.9</td>
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<td>55.3</td>
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<tr>
<td>Germany</td>
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<td>36.2</td>
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<tr>
<td>Greece</td>
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<td>36.5</td>
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<td>0.6</td>
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<tr>
<td>Hungary</td>
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<td>0.0</td>
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<td>Ireland</td>
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<td>Italy</td>
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<td>121.0</td>
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<td>Malta</td>
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<td>Netherlands</td>
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<td>10.7</td>
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<td>Portugal</td>
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<td>10.4</td>
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<td>Spain</td>
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<td>54.1</td>
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<td>1.8</td>
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<td>Sweden</td>
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<td>1.5</td>
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<td>15.5</td>
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<tr>
<td>United Kingdom</td>
<td></td>
<td>28.1</td>
<td>122.6</td>
<td>65.1</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>375.5</td>
<td>433.5</td>
<td>216.4</td>
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</table>

Exposures to sovereign debts of banks aggregated at the level of EU member states in bn € and % of bank assets. Data based on the EU-wide stress tests conducted under the auspices of the Committee of European Banking Supervisors in early 2010, covers 91 European banks, representing 65% of the European banking market in terms of assets. Source: CEPR DP No. 8661.
Exposure to PIIGS

Stability and Growth Pact (SGP) Reform

• stronger preventive action
  – member states are required to make significant progress towards medium-term budgetary objectives (MTO)
  – non-interest bearing deposit of 0.2% of GDP imposed on non-compliant member states

• stronger corrective action
  – debt levels above 60% of GDP to be reduced
  – financial sanctions kick in at earlier stage
  – non-compliant member states:
    • non-interest bearing deposit of 0.2% of GDP
    • not refundable fines of 0.5% of GDP maximum

• facilitation of action through majority voting rules
The European Semester (1)

- aim: reinforce the ex ante dimension of economic policy coordination
- how it works: timetable to enhance consistency of policies, covering all elements of surveillance, including fiscal, macroeconomic and structural policies, while keeping them legally and procedurally separate
The European Semester (2)

<table>
<thead>
<tr>
<th></th>
<th>Policy guidance for the EU and euro area as a whole</th>
<th>Country-specific guidance</th>
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<tbody>
<tr>
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<td>February</td>
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<td><strong>Member States</strong></td>
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</table>

Continuous: surveillance and, if warranted, recommendations under the preventive and corrective arms of the Stability and Growth Pact

Source: ECB monthly bulletin Mar2011
Excessive Imbalances Procedure (EIP)

- a framework for enhanced and broader macro-economic surveillance for all member states focusing on imbalances
  - preventive arm to avoid the build-up of imbalances
  - corrective arm: strong enforcement mechanisms for euro area members where spill-overs are stronger, interest bearing deposits or fines of 0.1% of GDP, reverse quality majority voting

- broad scope of surveillance
  - external imbalances
    - external positions (e.g. current accounts, net international investment positions)
    - competitiveness developments (e.g. REERs, ULCs) export performance (e.g. export market shares)
  - internal imbalances
    - private sector indebtedness (e.g. credit, debt)
    - assets markets (e.g. housing)
Alert Mechanism

• combination of a transparent review of a small set of indicators (i.e. the scoreboard) with economic analysis
• how it works: scoreboard indicators violating certain thresholds trigger in-depth analysis which will be the basis for policy recommendations
  – indicators: structural indicators from Lisbon process strategy
  – thresholds: distribution over time and across countries, quartiles for upper and lower thresholds, ...
    e.g. 3 year average of current account balance may not exceed +6/-4% of GDP
European Stabilisation Mechanism (ESM)

up to €750 provided by

- the European Financial Stabilisation Mechanism (EFSM)
  European Commission borrows up to €60bn in financial markets on behalf of the EU under an implicit EU budget guarantee

- the European Financial Stability Facility (EFSF)
  special purpose vehicle, backed by guarantee commitments from the Euroarea member states for a total of €780bn → lending capacity of €440bn

- the International Monetary Fund (IMF)
  additional funding with the size of 50% of the above loans = up to €250

plus

- possible ECB purchases of sovereign debt