“Mercados, Especulación y Gobernanza: El caso del Euro”

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Josep Borrell, Presidente del’IUE
Structure Presentation

1) EMU and the eurozone: Structural weaknesses and the 2010/11 crisis
2) Initial EU reactions
3) Structural and ongoing reforms
4) Open issues and the way ahead
5) Conclusion
1) EMU and the eurozone: Structural weaknesses and the 2010/11 crisis
Structural problems of the European Monetary Union (EMU) and the eurozone

- Monetary union without economic and fiscal union
  → “Limping leg”
- No political union
- Political requirements overriding economic realities
- “Optimum currency area”?
- Diverse national economies and diverging competitiveness
Balance of payments, selected countries (in % GDP)

Source: Alternatives Economiques
Harmonised consumption prices, 2009 (basis 100=1997)

Source: Alternatives Economiques
Relative unit labour cost (2000=100)

Source: European Commission, Ameco, De Grauwe
Development of hourly salaries in Europe, industry and merchant services (in %, 2007=100)

Source: Eurostat / Le Monde
Real disposable income (2008, Q1=100)

Source: IMF
Exports of goods and services as % of EU27 exports

Source: D. Gros / European Parliament
The 2010 crisis – What happened? (1/3)
Competitiveness and other issues seemed to be no problem for first 10 years, but then...:

- Global financial and economic crisis 2008/2009
- Strong recession
- Bank rescue plan
- PIIGS: fear of sovereign debt crises
- Account and fiscal deficits
- Rise in CDS prices / bond yields
- Crisis of confidence, market pressure
Real GDP growth rate euro area

Source: Eurostat
Public balance EU27 (2007)*

*Net borrowing/lending of consolidated general government sector as a percentage of GDP; Source: Eurostat
Public balance EU27 (2009)*

*Net borrowing/lending of consolidated general government sector as a percentage of GDP; Source: Eurostat
Public balance, selected countries*

*Net borrowing/lending of consolidated general government sector as a percentage of GDP; Source: Eurostat
*General government consolidated gross debt as a percentage of GDP; Source: Eurostat
General government debt EU 27 (2009)*

*General government consolidated gross debt as a percentage of GDP; Source: Eurostat
General government debt, selected countries (2009)*

*General government consolidated gross debt as a percentage of GDP; Source: Eurostat
Eurozone budget balance / Gross government debt (% of GDP)

Source: Financial Times
Gross external debt (% of GDP), breakdown by sector

Source: D. Gros
Household and government debt in eurozone (% of GDP)

Source: De Grauwe
The 2010 crisis – What happened? (2/3)

- Greek “falls” in Spring 2010
- Relatively small country’s debt degenerate into generalised government debt crisis in eurozone
- Looking into the abyss
- Weaknesses in initial EMU construction made obvious by crisis
The 2010 crisis – What happened? (3/3)

- Core weaknesses/problems:
  - Money and finance fully integrated, but different tax, fiscal, spending… policies
  - One-dimensional focus on SGP
  - Excessive lending
  - Greece disaster with huge government debt
  - Explosion of private debt (Ireland/Spain)
Convergence of long-term government bond rates 1990-2010

Source: IMF
Credit developments euro area

Source: IMF
2) Initial EU reactions
Reactions to the crisis (1/2)

- Reactions first rather uncoordinated and confusing
- Then: Three step ‘bail-out’-mechanisms/safety nets:
  1) April/May 2010: Immediate loan for Greece
  2) May 2010: Temporary European Financial Stability Facility (EFSF)
  3) March 2011: Permanent European Stability Mechanism (ESM, from 2013)
Reactions to the crisis (2/2)

- Apart from loan mechanisms, various propositions for general overhaul (Taskforce Council, ECB, EP, Commission)
- “European semester”
- October 2010 Council: Permanent mechanism, Change of SGP, Treaty adaptation
- Important steps, but again:
  Focus on budgetary discipline and household/fiscal control
3) Structural and ongoing reforms
Councils and decisions in March 2011 (1/2)

• Serious of Councils and meetings in March 2011
• “To do whatever it takes”/”Grand bargain”
• Most important decisions:
  o Better deal for Greece
  o Allows haircuts on sovereign debt
  o EFSF becomes permanent from 2013 onwards as European Stability Mechanism (ESM)
  o Fund to buy bonds on primary market
**European Financial Stability Facility**

A temporary bail-out fund created by the 17 eurozone states in June 2010

- **Capital**: €440bn
- **Lending capacity**: €250bn

Eurozone states provide varying guarantees:
- **3.5%** Belgium
- **27.1%** Germany

- Has a triple-A credit rating by Standard & Poor’s and Fitch Ratings
- Cannot be used to buy sovereign bonds on the primary or secondary market

**European Stability Mechanism**

A permanent bail-out mechanism that will replace the EFSF in mid-2013

- **Capital**: €700bn
- **Lending capacity**: €500bn

- Requires €80bn in cash as well as €620bn in guarantees and callable capital
- Eurozone members will provide guarantees plus €16bn of cash every year for five years, starting in 2013
- Eurozone countries will speed up their payments into the fund if a large country requires a bail-out and the mechanism has insufficient funds
- Can be used to buy bonds on the primary market when a borrower agrees to a bail-out and austerity programme

Source: FT research

Source: Financial Times
Councils and decisions in March 2011 (2/2)

- Euro Plus Pact (DE/F: “Competitiveness Pact”/”Euro Pact) to:
  - Increase competitiveness
  - Budgetary and macro-economic surveillance
  - Council to monitor developments
4) Open issues and the way ahead
Open issues and the way ahead (1/3)

On the positive side:

- EU went through difficult but at the same time creative and crucial period – Crisis as opportunity
- Much reached that was unimaginable a while ago
- New dimension of EMU and EU
Open issues and the way ahead (2/3)

On the negative side:

• Details of ESM still unclear
• Euro Plus Pact still far from proper economic governance
• Only emergency facility
• Many grave problems not tackled
• Solutions simply bought time
Open issues and the way ahead (3/3)

- Politics vs. economics
- Role of the markets and expectations
- Banking sector
- Plan A (conditional loans, austerity,...) has failed
Gross government debt (% GDP) vs. 10-year government bond rates, UK vs. ES

Source: P. De Grauwe
Government debt ratio, US vs. eurozone

Source: European Commission, Ameco, De Grauwe
Government debt holders, % of total, 2010

Source: Barclays Capital, Economist, De Grauwe
Banking sector exposure*

*Claims on domestic banks and public sector, % of equity of banks with foreign exposure
Source: IMF, Financial Times
GDP change (%)

The Great Divide | Quarterly change in GDP, annualized rate

Germany and its neighbors have bounced back... As countries on the periphery fall farther behind.

Source: Wall Street Journal
Projected real GDP growth 2011-12

Source: IMF staff estimates.
Government 10-year bond yields

Source: Financial Times
Open issues and the way ahead (3/3)

• After Plan A failing, what could be elements of Plan B?
  o Carry on and pile debt on debt
  o Debt restructuring and default mechanism
  o Euro bonds
  o Fiscal union
5) Conclusions
Conclusions

• Options: serious change or break-up
• Implications for European integration process / Institutional dimension
• Missing political will and “vision”
• Basic problem: No political union

• Eurozone lesson/implications for economic global governance and its reform?