History of the euro, current challenges and the road ahead

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6 December 2011
Outline of presentation

1. Historical perspective on the euro – background and first ten years

2. The crisis explained and the current economic outlook

3. Responses to the crisis
Part 1

Historical perspective on the euro – background and first ten years
Rebuilding Europe after WW II
European Union (EU) today

27 countries

500 million people

~ 20% of world GDP
Euro Area (EA) today

17 member countries:
Belgium, Germany, Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Luxembourg, Malta, Netherlands, Austria, Portugal, Slovenia, Slovakia & Finland

2 opt-outs: Denmark and the United Kingdom

8 derogations: countries not yet fulfilling the membership criteria
## Comparative data

<table>
<thead>
<tr>
<th>2010(11)</th>
<th>EU 27</th>
<th>Euro Area</th>
<th>USA</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (millions)</td>
<td>502</td>
<td>332</td>
<td>312</td>
<td>1340</td>
</tr>
<tr>
<td>GDP p.c. (thousands of EUR in PPS)</td>
<td>24</td>
<td>27</td>
<td>38</td>
<td>5</td>
</tr>
<tr>
<td>Share of world GDP (%)</td>
<td>20.7</td>
<td>14.8</td>
<td>19.5</td>
<td>13.6</td>
</tr>
<tr>
<td>Exports, G&amp;S (% of GDP)</td>
<td>15.5</td>
<td>22.7</td>
<td>12.5</td>
<td>26.4</td>
</tr>
<tr>
<td>Imports, G&amp;S (% of GDP)</td>
<td>15.9</td>
<td>22.0</td>
<td>15.9</td>
<td>21.8</td>
</tr>
<tr>
<td>Share of world trade (%)</td>
<td>16.4</td>
<td>15.7</td>
<td>13.8</td>
<td>12.3</td>
</tr>
</tbody>
</table>
Why create the euro area?

- Economic and monetary union (EMU) as an important stage in the process of economic integration

- Customs union (1968)
- Single market (1993)
- Economic and Monetary Union (1999)
- Full economic integration
Expected benefits of EMU

- Elimination of exchange costs and currency fluctuations
- Price transparency and comparability
- Price stability and low interest rates
- Major international currency
Expected costs of EMU

- Loss of exchange rate and interest rate as policy tools
- Loss of national sovereignty over monetary policy
- Costs of changeover to new currency – the euro
Successes in the first decade

- Price stability
- Job-rich growth
- Increased financial market integration
- Sound public finances
- Role of the euro as an international currency
Inflation convergence

Euro-area inflation
(annual average per decade)
Financial market integration

10-year yield spreads against the German bund

-2.0 0.0 2.0 4.0 6.0 8.0 10.0

Belgium  Ireland  Greece  Spain  France  Italy  Netherlands  Austria  Portugal  Finland
Despite the successes...

- GDP growth remained slow in some countries, due to unsatisfactory productivity performance
- Rising divergences in competitiveness and large current account imbalances
- Evidence of internal imbalances in some countries
- Banking and financial markets remained predominately nationally organized and supervised
Large variation, but overall modest growth in the EA ahead of the crisis.
Diverging competitiveness trends in EA countries (REER-ULC vs RoEA)

Index 1999 = 100

European Commission, Economic and Financial Affairs
Delegation of the European Union to China
EA current account in balance, but sizeable differences across countries

-20 -15 -10 -5 0 5 10

% of GDP

1999 2008

BE DE IE EL ES FR IT CY LU MT NL AT PT SI SK FI
Part 2

The crisis explained and the current economic outlook
Understanding the crisis: Triggers of the sovereign-debt crisis

The crisis originated in the US. The financial, banking and economic crisis resulted in:

- Banking and financial sector problems, incl.:
  - Financial market volatility
  - Risk aversion, capital flight
  - Rating downgrades
  - High borrowing costs
  - Contagion - domino effect- herd behaviour
  - Need for recapitalisation

- Weaker growth prospects
- Increasing fiscal imbalances
- Risk reassessments and changing risk perception
Understanding the crisis: Specific EA problems fuelling the crisis

- **EA internal institutional and governance weaknesses**
  - Incomplete EMU
  - Insufficient firewalls
  - Surveillance and enforcement
  - Structural flaws in the financial sector

- **EA internal imbalances**
  - Competitiveness and productivity imbalances
Understanding the crisis:
Key breaking the feedback loop

- Financial stability
- Sovereign debt
- Economic growth
Dealing with the crisis while the global recovery weakens

World trade and global manufacturing output

Source: EU Commission services’ 2012 Autumn Forecast

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Financial-market tensions have eased...

Ten-year government-bond yields, selected euro-area Member States

Stock-market indices, euro area

Source: EU Commission services’ 2012 Autumn Forecast
...although banks' credit standard remain tight
# Economic outlook for the euro area

## Euro area: Forecast

<table>
<thead>
<tr>
<th></th>
<th>Real GDP growth</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2012</td>
<td>2013</td>
<td>2014</td>
</tr>
<tr>
<td>ECB</td>
<td>6 Sep</td>
<td>(-0.6;-0.2)</td>
<td>(-0.4;1.4)</td>
<td></td>
</tr>
<tr>
<td>Consensus</td>
<td>8 Oct</td>
<td>-0.5</td>
<td>0.2</td>
<td>1.2</td>
</tr>
<tr>
<td>IMF - WEO</td>
<td>9 Oct</td>
<td>-0.4</td>
<td>0.2</td>
<td>1.2</td>
</tr>
<tr>
<td>European Commission</td>
<td>7 Nov</td>
<td>-0.4</td>
<td>0.1</td>
<td>1.4</td>
</tr>
</tbody>
</table>
Gradual recovery from 2013 on

GDP at constant prices, EU

Source: EU Commission services’ 2012 Autumn Forecast

European Commission, Economic and Financial Affairs
Delegation of the European Union to China
Outlook (and challenges) differ across countries:

Country cases I

<table>
<thead>
<tr>
<th>GDP growth</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>3.0</td>
<td>0.8</td>
<td>0.8</td>
<td>2.0</td>
</tr>
<tr>
<td>Spain</td>
<td>0.4</td>
<td>-1.4</td>
<td>-1.4</td>
<td>0.8</td>
</tr>
<tr>
<td>France</td>
<td>1.7</td>
<td>0.2</td>
<td>0.4</td>
<td>1.2</td>
</tr>
<tr>
<td>Italy</td>
<td>0.4</td>
<td>-2.3</td>
<td>-0.5</td>
<td>0.8</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1.0</td>
<td>-0.3</td>
<td>0.3</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Euro area</strong></td>
<td><strong>1.4</strong></td>
<td><strong>-0.4</strong></td>
<td><strong>0.1</strong></td>
<td><strong>1.4</strong></td>
</tr>
<tr>
<td>Poland</td>
<td>4.3</td>
<td>2.4</td>
<td>1.8</td>
<td>2.6</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.9</td>
<td>-0.3</td>
<td>0.9</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>EU</strong></td>
<td><strong>1.5</strong></td>
<td><strong>-0.3</strong></td>
<td><strong>0.4</strong></td>
<td><strong>1.6</strong></td>
</tr>
</tbody>
</table>

Source: EU Commission services’ 2012 Autumn Forecast
Outlook (and challenges) differ across countries: Country cases II

<table>
<thead>
<tr>
<th>GDP growth</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
<td>8.3</td>
<td>2.5</td>
<td>3.1</td>
<td>4.0</td>
</tr>
<tr>
<td>Latvia</td>
<td>5.5</td>
<td>4.3</td>
<td>3.6</td>
<td>3.9</td>
</tr>
<tr>
<td>Lithuania</td>
<td>5.9</td>
<td>2.9</td>
<td>3.1</td>
<td>3.6</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.4</td>
<td>0.4</td>
<td>1.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Portugal</td>
<td>-1.7</td>
<td>-3.0</td>
<td>-1.0</td>
<td>0.8</td>
</tr>
<tr>
<td>Greece</td>
<td>-7.1</td>
<td>-6.0</td>
<td>-4.2</td>
<td>0.6</td>
</tr>
</tbody>
</table>

Source: EU Commission services’ 2012 Autumn Forecast
Public finances to improve further

General gov. budget balance, EA

General government debt, EA

Source: EU Commission services’ 2012 Autumn Forecast

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Part 3

Responses to the crisis
A global crisis called for a common response – G20

- G20 emerged as the premier forum for international coordination in the midst of the crisis, better reflecting today’s multi-polar world
- Financial sector reforms key - need to stabilise financial markets and restore capital flows, as well as to address the root causes of the crisis, e.g. regulation and supervision
- Depression avoided – through unprecedented and strongly coordinated fiscal and monetary stimulus; framework for “strong, sustainable and balanced growth” launched
Comprehensive crisis-response strategy in the EA

1. Supporting vulnerable countries
2. Creating EA/EU financial safety nets
3. Enhance growth through structural reforms
4. Provide robust and integrated economic governance: moving to a genuine Economic and Monetary Union
(1) Particular challenges in some countries called for EU-IMF programmes under strict conditionality

- **Greece** - €110 bn, Apr. 2010
  - Preserve financial stability;
  - Restore debt sustainability;
  - And boost competitiveness

- **Ireland** - €85 bn, Nov. 2010
  - Reform banking system;
  - Fiscal consolidation;
  - And structural reforms

- **Portugal** - €78 bn, May 2011
  - Measures to enhance growth;
  - Fiscal consolidation;
  - And ensure financial stability

- **Spain** - up to €100 bn, Jul. 2012
  - “Financial Assistance Programme” for the recapitalisation of banks

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(1) Progress in vulnerable countries

- **Ireland** has been able to re-access the markets earlier than envisaged.

- **Portugal** records stronger-than-expected export growth, which is helping to offset weaker domestic demand.

- **Greece** has achieved more than is often recognised in terms of fiscal consolidation and structural reforms.

- **Spain and Italy**: There is some regain of interest among international investors to buy bonds. Especially OMT has contributed to a renewed interest by international investors.
(2) Making European banks more robust

- December 2011: EBA bank recapitalisation exercise
- Restoring confidence in the EU banking sector
- Ensuring the medium-term funding of banks to avoid a credit crunch
  - ECB support: two 3-year LTROs
    - € 489 bn for 523 participating banks (21/12/2011)
    - € 529 bn for 800 participating banks (29/02/2012)
  - ECB announces OMT, to buy government bonds unlimited provided country program (04/09/2012)
- Enhancing the quality and quantity of bank capital to withstand shocks
  - Core Tier 1 ratio of 9% to be achieved in 2012
(2) Creating a permanent crisis mechanism for the EA: the ESM

- **The European Stability Mechanism** (ESM), the permanent crisis mechanism for the EA, was created in Oct. 2012, 9 month ahead of schedule.

- **ESM** has an **effective lending capacity of € 500 bn**.

- **Aim**: “to safeguard financial stability in Europe by providing financial assistance to euro-area Member States”

- **Instruments**: loans; primary and secondary market purchases; precautionary programmes and bank recapitalisations through loans to governments.

- **All assistance is linked to appropriate conditionality**.
Priorities in the 2013 Annual Growth Survey (AGS):

- Pursuing differentiated, growth-friendly fiscal consolidation
  (e.g. cutting back on research and education expenditures could be short sighted)

- Restoring normal lending to the economy
  (beyond the measures to strengthen the banking sector, boost financing of SMEs by better mobilising structural funds and implementing "project bonds" for European infrastructure)

- Promoting growth and competitiveness for today and tomorrow
  (with the “Compact for Growth and Jobs” e.g. highlighting the full implementation of the Single Market Acts in the area of IT, services, patents and energy; with a reinforced industrial policies etc.)

- Tackling unemployment and the social consequences of the crisis
  (focus on improving employability levels and promoting social inclusion, with a particular emphasis on youth unemployment e.g. suggesting a “youth guarantee” of a job / further study or traineeship within 4 months)

- Modernising public administration
(4) From fragmentation to integration: Moving towards genuine EMU

1. Banking union
   - Common EU supervisor for European banks (proposal published by European Commission on 12 September)
   - To be considered: Common-deposit insurance
   - To be considered: EU bank-resolution mechanism

2. Fiscal union: integrated budgetary structure

3. Economic union
   - Further development of system for coordination economic policies

4. Political union: legitimacy and accountability
Breaking the negative feedback loop via completing EMU architecture

Overarching: Completing EMU Architecture

- Commission proposal for Single Supervisory Mechanism
- OMT
- Up to EUR 100 bn to cover financing needs of the Spanish banking sector
- ESM: fully operational since October

Financial stability

- Bank funding
- Bank recaps
- Structural reforms

Sovereign debt

- Firewalls
- Fiscal discipline

Economic growth

- Programmes in vulnerable countries
- Differentiated fiscal consolidation & quality of public finances

Compact for Growth and Jobs
The crisis – both a challenge and an opportunity

- Problems clearly identified within the first decade of the EA
  - growing macroeconomic imbalances
  - lack of ambition on fiscal consolidation and debt reduction
  - financial sector increasingly susceptible to shocks

- Action was taken by the Member States and the EU
  - strengthening financial market supervision
  - national austerity packages and reforms to enhance competitiveness
  - strengthening the Stability and Growth Pact
  - new procedure to identify and tackle emerging macroeconomic imbalances

- Through adjustment, reform and better governance
  - European economic and monetary union will function better
  - Europe will play its role in the international monetary system and in shaping globalisation

We are in all this together: "If you want to go fast, go alone. If you want to go far, go together."
Thank you for your attention

For more information on the euro, check out our websites at:

ec.europa.eu/dgs/economy_finance/index_en.htm
ecb.europa.eu
eu-in-china.com