“EU Response to the Sovereign Debt Crisis”

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Note that the views expressed are purely personal

Common Media Headlines

"PIIGS to the Slaughter"

"Euro Meltdown"

"Greek Tragedy"

"Death of the Celtic Tiger"

"Grexit and Spanic"

FT: America and Europe sinking together

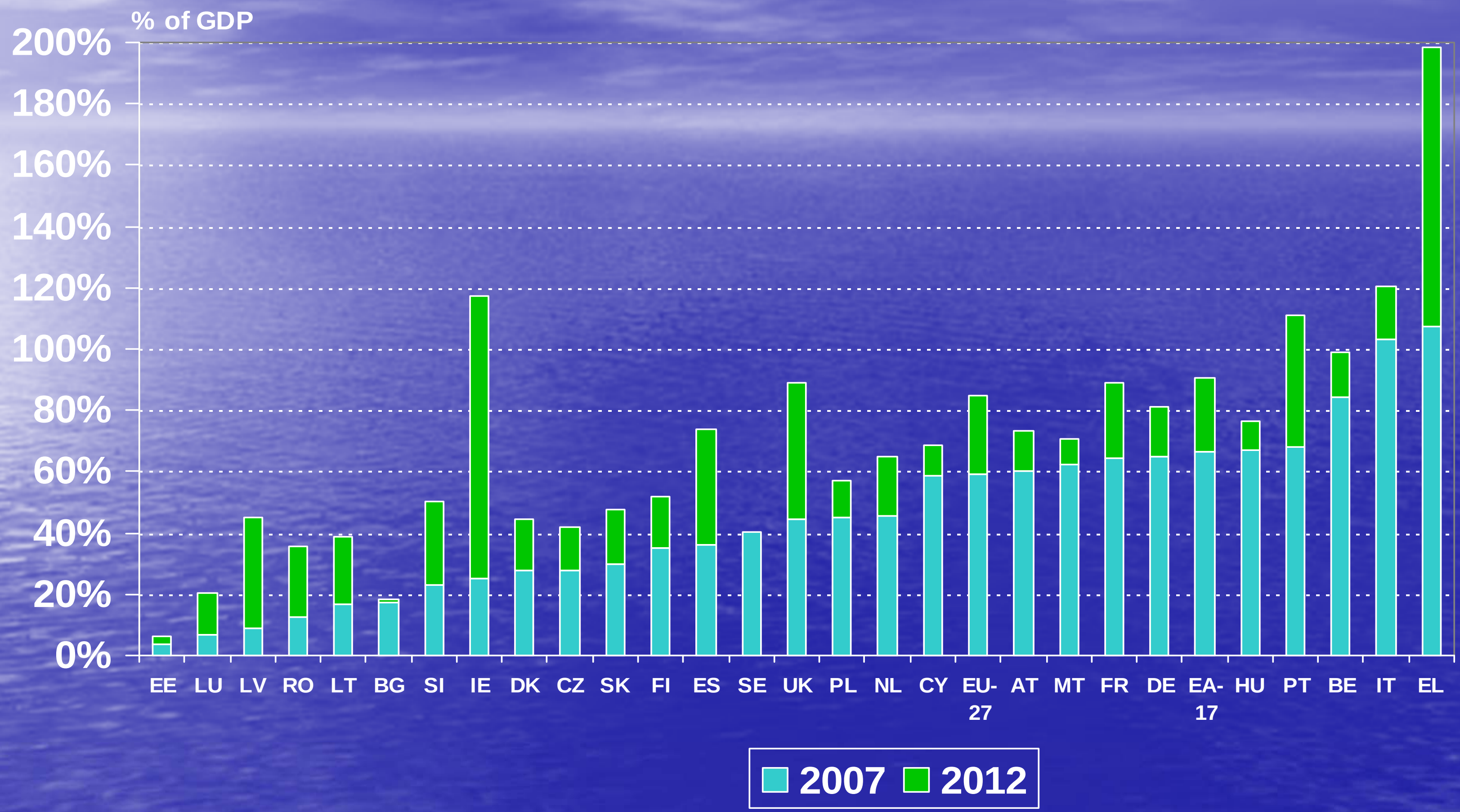
The EU Economy

- EU may be projected to grow only very slowly in 2012 and 2013 **it remains the largest economy in the world**, with a per capita GDP of €25 000 for its 500 million consumers.
- That represents a €12.6 trillion economy. Only the United States (€11.5 trillion) is in the same league; even China (€5.5 trillion) and Japan (€4.8 trillion) are considerably smaller.
- There are 135 European Union companies in the Fortune 500, more than the United States (132), China (75) and Japan.
- 5 of the top 10 countries on the World Economic Forum Global Competitiveness index are EU Members. They make up 6 of the top 10 economies on the INSEAD/WIPO Global Innovation Index.
- This is borne out at a company level too: 28 of Forbes' top 100 companies are headquartered in the EU.

EU still the biggest market in the world

- Europe is the world's largest importer of both manufactured goods and services.
- Largest FDI stocks abroad/world's largest FDI host.
- Even with the crisis our imports continue to rise: the EU imported €740 billion in manufactured goods in the first six months of 2012, up 4.5% on the same period last year.
- The EU is the top trading partner for 80 countries. By comparison, the US is the top trading partner for a little over 20 countries.

EU Debt to GDP Ratios



The EU has low levels compared to Japan and US

Projected EU Budget Deficit 2011 4% vs. US10%, JP 9%

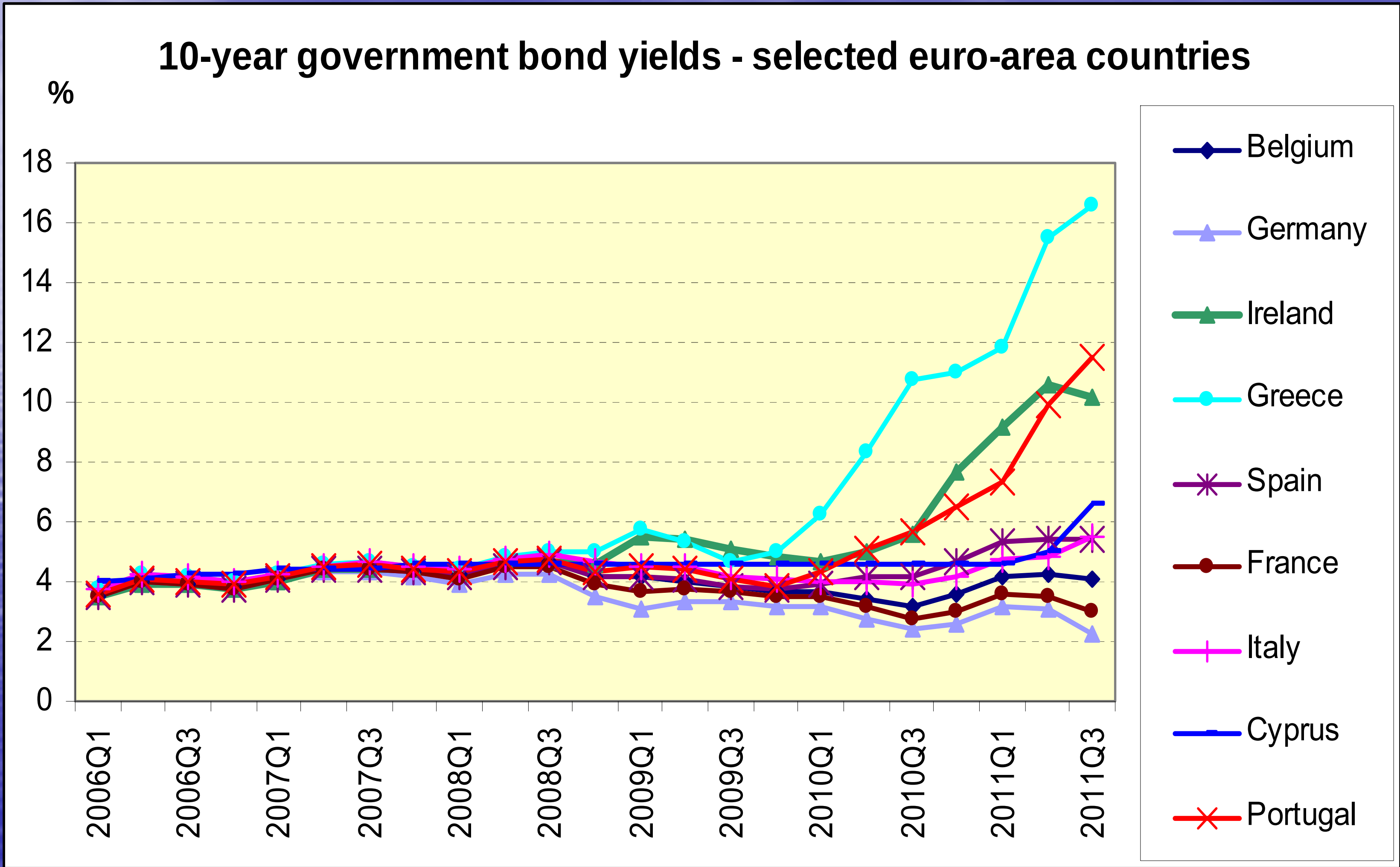
The Present

- Easy for some **to forget the success** that the euro has enjoyed - a **long period of growth and price stability**.
- **Enhanced the functioning of markets** in an **increasingly integrated European economic system**.
- **Helped cross-border trade in goods and services**.
- **Global reserve currency.**
- **Stabilising factor to prevent the previously all-too-familiar currency crises and competitive devaluations** as well as **other self-defeating protectionist measures**.
- The euro area **will emerge stronger after reforms** - a more **robust economic and financial architecture**.

The Past

- **Stability and Growth Pact** 3% & 60% rules
- Peer pressure, sovereignty, credibility
- **Deficit bias**, fiscal policy externality
- Delaying of **structural reforms**
- Monetary but not Political Union
- Economic + Competitive convergence

Rising yield spreads reflect divergence across countries



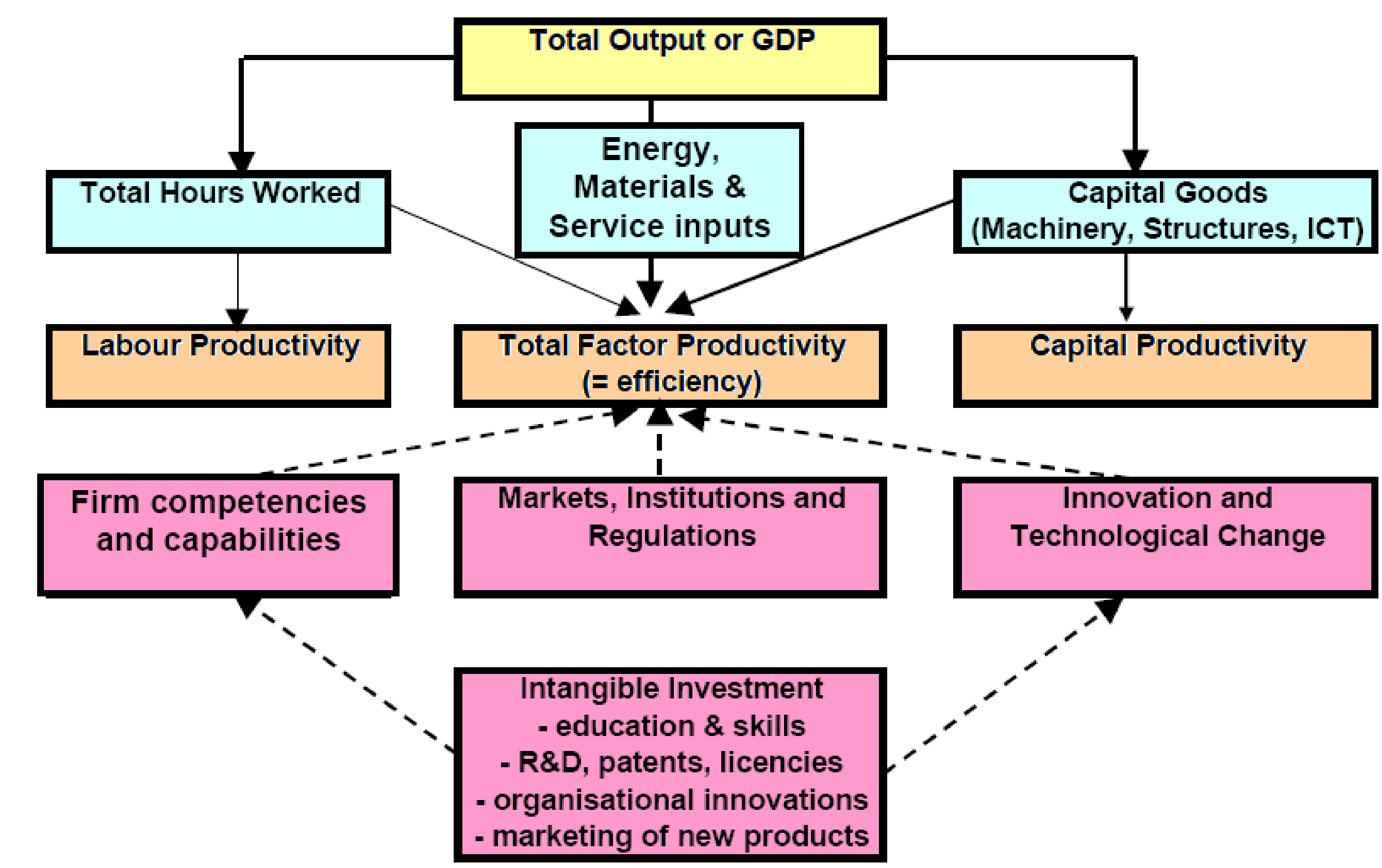
Origins of the Crisis

- **Greece's in Euro - consumption, investment booms.**
- **Interest rate convergence** paradoxically led to **fiscal policy divergence. Competitive convergence?**
- **Wages rise fast - productivity, competitiveness fall**
- **Poor fiscal discipline – tax collection problems**
- **Large revisions to budgetary statistics**
- **Unsustainable pension and health systems**

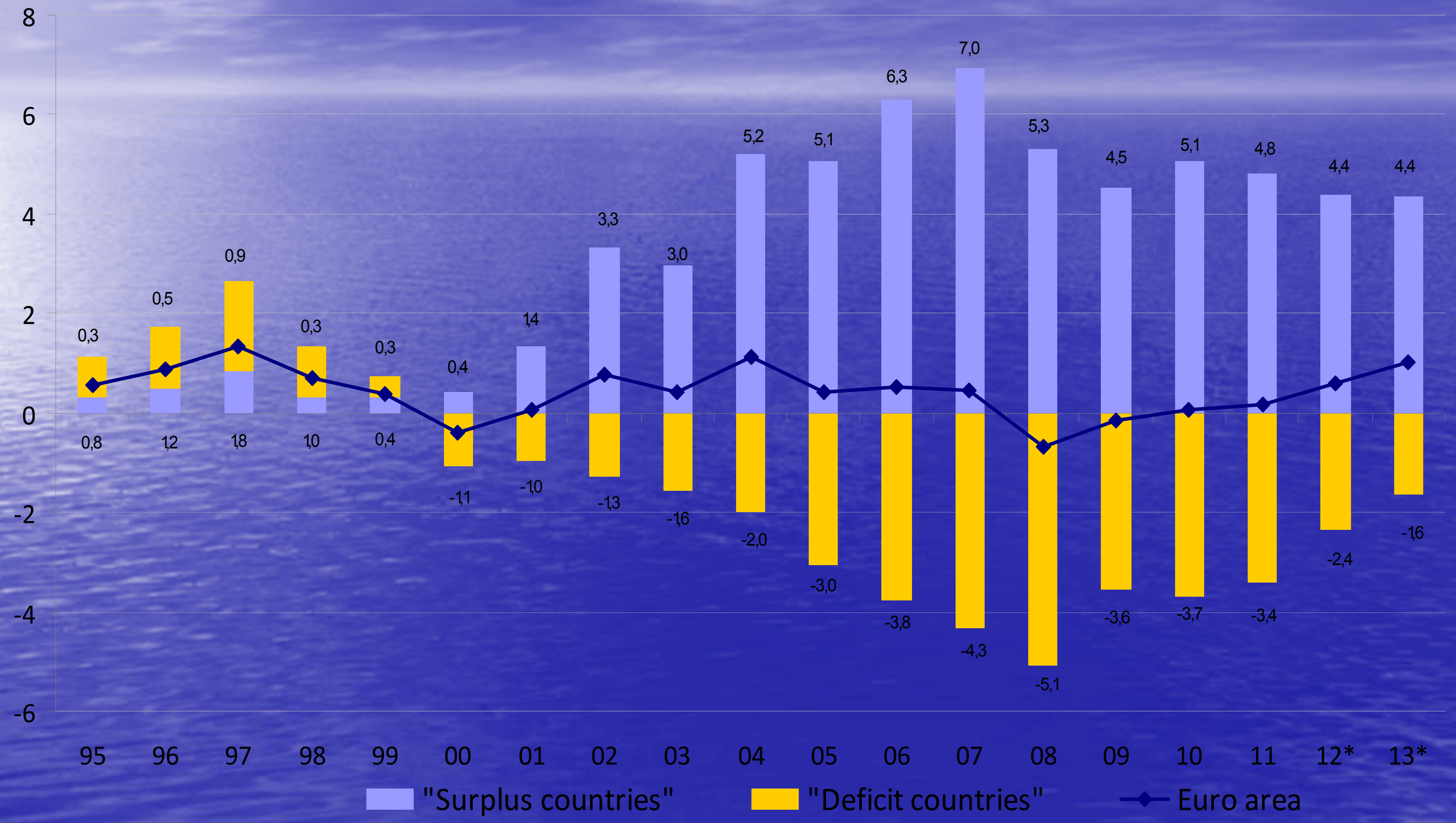
Challenges to be addressed

- The economic leg of EMU has been too weak
- As a result, fiscal imbalances and competitiveness divergences developed in certain euro area countries
- The EU relied largely on more or less voluntary coordination of policies

Economics of Competitiveness



External rebalancing continues…



* ECFIN 2012 Spring Forecast

Addressing the challenges of vulnerable Member States

May 2010: Greece adopts €110bn program supported by the EU and IMF

- **Second programme for Greece**
  - Financing package of EUR 130bn until 2014
  - PSI: nominal haircut of 53.5%
  - OSI: retroactive lowering of interest rates, transfer of ECB income on Greek bonds to Member States to reduce Greek debt
  - Target: public debt down to 120.5% of GDP by 2020
- **Ireland's** adjustment programme well on track
- **Portugal** implementing the programme rigorously
- **Italy's** risk reduced by measures of Monti government
- **Spain** on the way towards fiscal consolidation, structural reform and stabilisation of the banking system

EU response to the crisis

1. Strategy for **growth and jobs** - Europe 2020
2. Adjustment programmes: Greece, Ireland & Portugal
3. Financial backstops: creation of **EFSF and ESM**
4. Governance package (six-pack) adopted Oct. 2011
5. Treaty on Stability, Coordination and Governance in EMU (TSCG) – **Fiscal Compact**
6. First steps towards a possible **Banking Union**
7. ECB – **Outright Monetary Transactions (OMT)**

Completing the Economic and Monetary Union

Make more effective fiscal rules

Bring down debt and deficit levels

Boost growth: 'Europe 2020' strategy

Complete the Single Market

Increase competition

The euro-skeptic view:

Doomed from the start?

European countries too different?

Public debt levels are not sustainable?

Austerity measures are too severe?

Leaving the euro would help?

EUROPEAN UNION
DELEGATION TO THE USA

The case for the euro

EMU will evolve

Political commitment of leaders to defend the euro

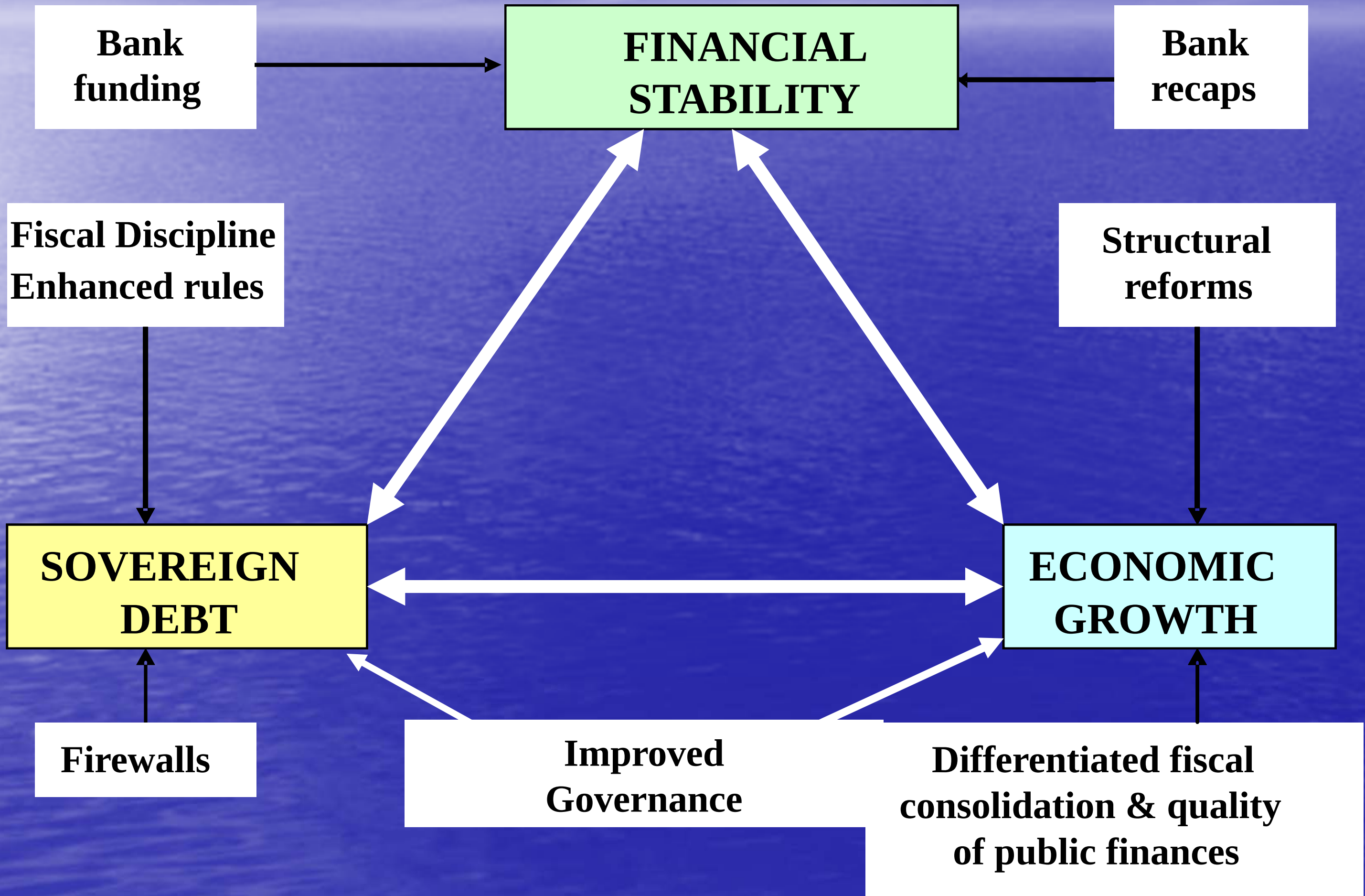
Governance of euro area will be strengthened

More sustainable public finances will help countries

Leaving the euro would involve huge costs, make it harder for countries to borrow

EUROPEAN UNION
DELEGATION TO THE USA

Breaking the negative feedback loop



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Bailout?

- Often the assistance is called **a "bailout" but in fact they are loans with high interest rates**.
- A Member State which requests assistance has to **put its public finances** in order and take **difficult but necessary structural reforms**.
- The assistance packages are effectively instruments for **reforming some of the weakest EU economies**.
- We are currently attempting **a fundamental strengthening of our economic pillar**.

The Future

- **EU's political will to strengthen fiscal governance** should not be underestimated.
- **Proactive role of the ECB.**
- Euro is **not just a technical monetary arrangement**, rather a **core EU political project**.
- It is a symbol of EU political will and determination to **work together for our common good**.
- Ready to **do whatever it takes to defend the euro** and **financial stability in Europe**.

“Towards a genuine EMU”

4 Presidents and 4 Unions – Dec 13-14

Banking Union

Fiscal Union

Economic Union

Political Union

Conclusions

- Of course, Europe still faces significant economic challenges. **Global competition** grows more **intense, unemployment** is still too high and with **rapidly aging populations**, we face **sharply rising welfare costs**.
- **The euro** is not on the **list of problems rather**, it is **part of the solution**

Perceived EU risks to Japan

- **Strong yen** versus the Euro but Japan has a relatively **low export share to EU**.
- **Stock market sentiment**
- **Limited financial exposure** of Japanese financial institutions to EU sovereign debt
- **Contagion effect** to JGB's? Not realistic.
- Japan **GDP growth – declining but solid**
- **Reconstruction demand** to offset against negative impacts from external demand in 2012. Japanese growth prospects remain solid.