

Managing turbulent times – The ECB and EMU from 2008 to 2013

National Bank of the Republic of Macedonia

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Frank Moss
Director General International and European Relations
European Central Bank

Outline

- 1. Five years of evolving crisis**
- 2. The ECB's response**
- 3. Addressing the shortcomings of EMU**
- 4. Structural reinforcements**
- 5. Euro area outlook**

The unfolding of the crisis – 6 Phases

Spreads between 12-months Euribor/Libor and OIS swap rates; percentages per annum

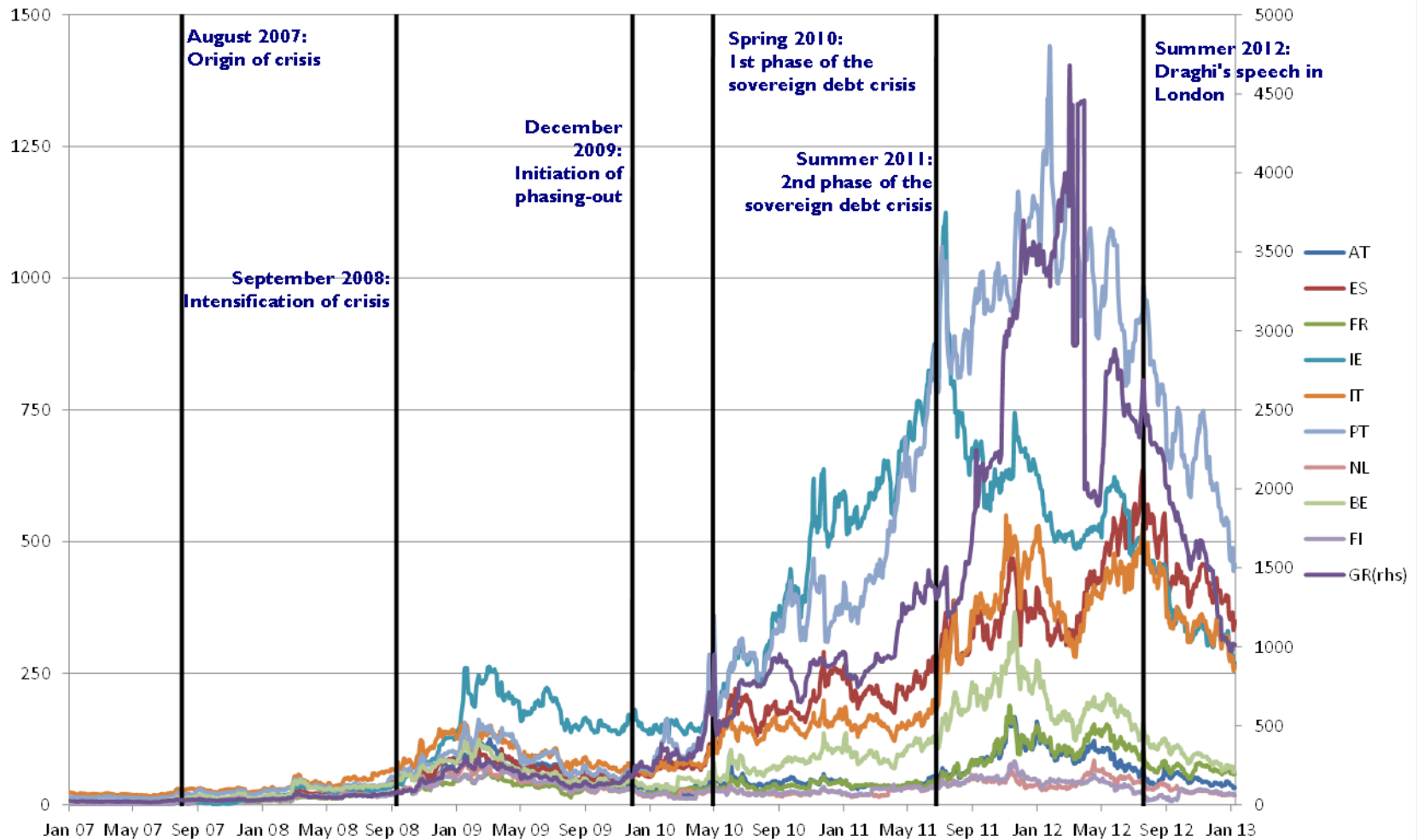


Note: Spreads are the difference between 12-month Euribor/Libor and Overnight Index Swap rates in percentages per annum.

Source: Bloomberg and ECB calculations

Latest observation: 15 January 2013

Government bond spreads in selected euro area countries (*basis points*)



Note: 10-year government bond spread against the German bund.

Source: Datastream and ECB calculations

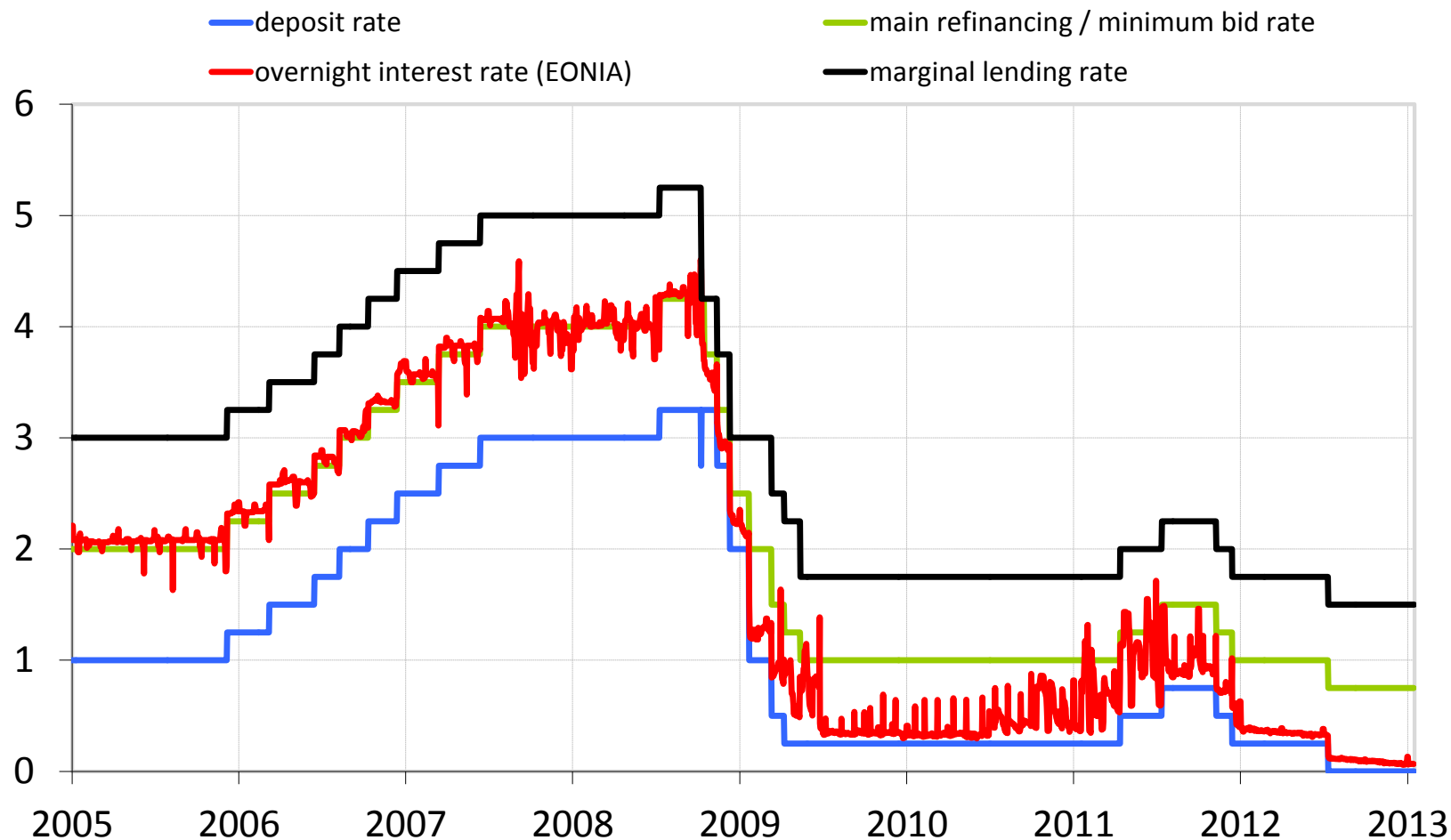
Latest observation: 15 January 2013

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Standard monetary policy during the crisis years

(percentages per annum)



Source: ECB

Latest observation: 15 January 2013

Non-standard monetary policy action during the crisis years

I. Measure to improve bank funding and liquidity conditions

- Fixed-rate full allotment mode in all refinancing operations (since October 2008)
- Lengthening the maturity of the refinancing operations (1, 3, 6, 12 and 36 months)
- Extending the list of eligible collateral (and not fully relying on rating agencies)
- Extending liquidity directly in foreign currencies (USD and CHF)
- Reducing reserve requirements

II. Measures to provide depth and liquidity in malfunctioning financial market segments

A. Covered bond markets

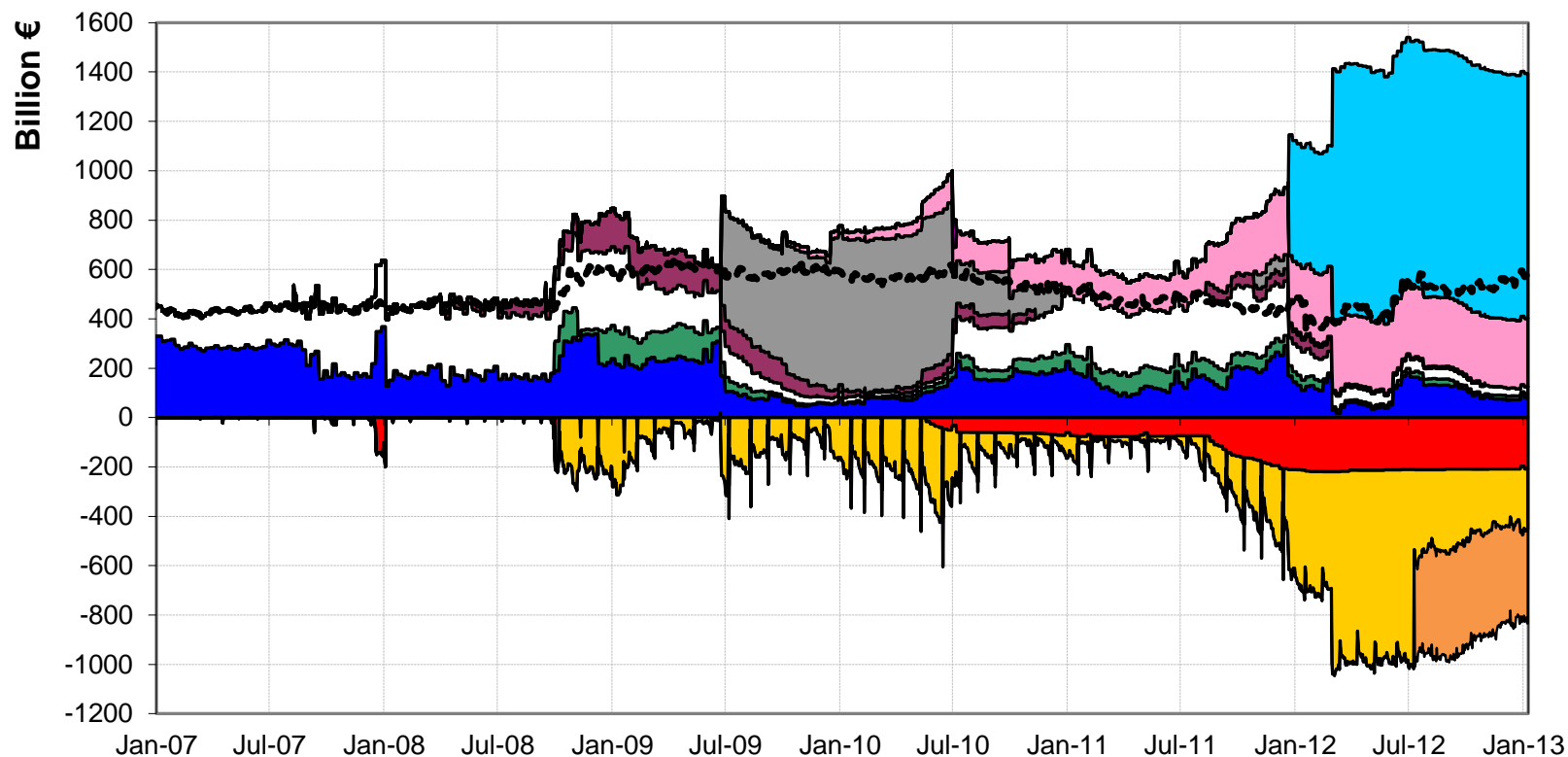
- Covered Bond Purchase Programme I (CBPPI) EUR 60 bn purchased from July 2009-July 2010; CBPP 2 under way for EUR 40 bn (until November 2012)

B. Sovereign bond markets

- Securities Markets Programme (launched in May 2010); (second wave in August 2011); terminated in September 2012)
- Outright Monetary Transactions (decided in September 2012)

Leading to an expanded Eurosystem balance sheet

(EUR billion)



- main refinancing operations
- 3-month longer-term refinancing operations
- 12-month longer-term refinancing operations
- fine tuning providing operations
- fine tuning absorbing operations
- daily reserve surplus under zero deposit rate
- 1-maintenance period refinancing operations
- 6-month longer-term refinancing operations
- CBPPs and SMP
- 3-year longer-term refinancing operations
- net recourse to deposit facility
- liquidity needs (autonomous factors + reserve requirements)

Source: ECB, latest observation: 14 January 2012

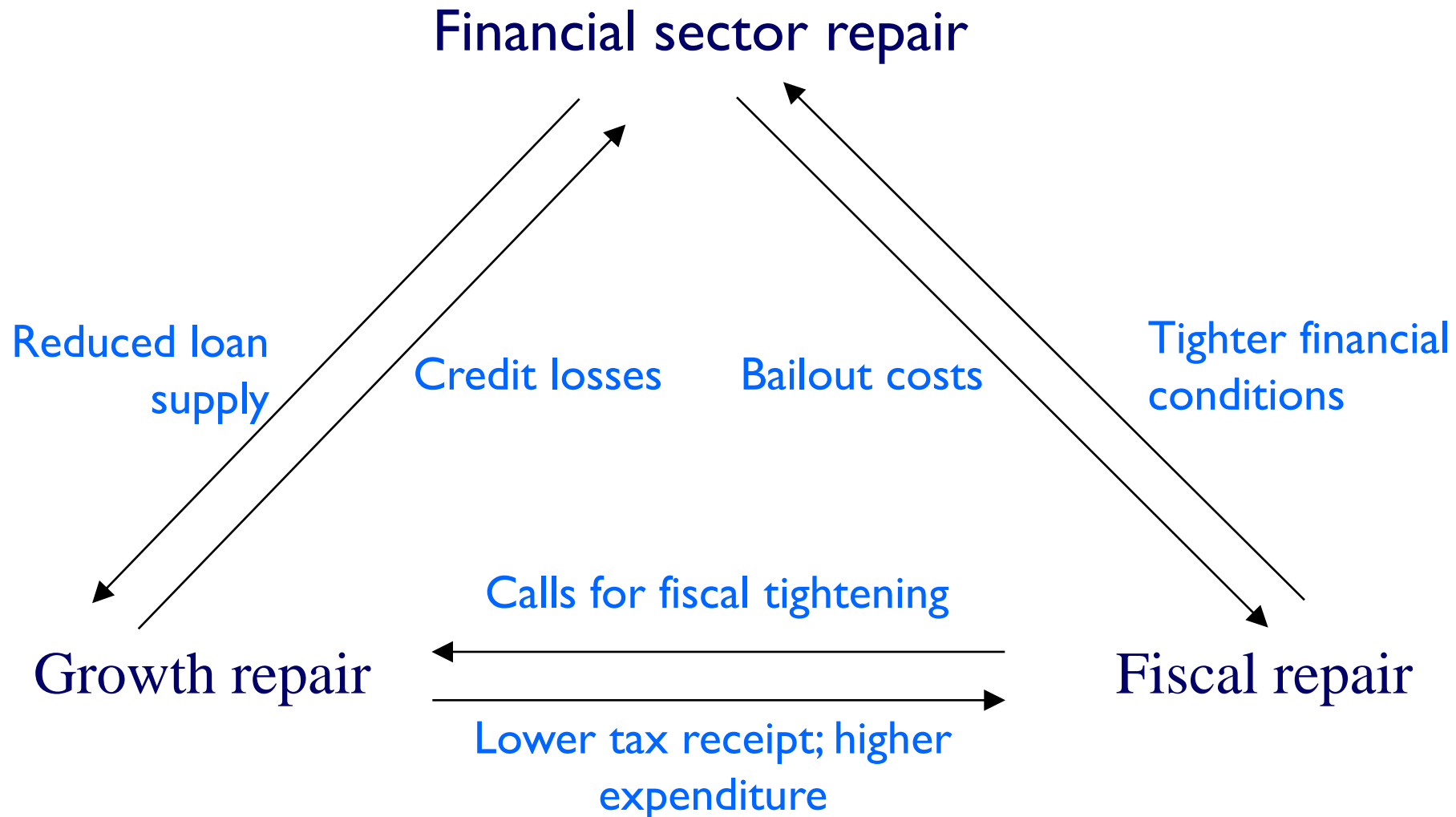
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Four key shortcomings in the governance of EMU

1. Incompatibility between a **single financial market with a supranational currency and national responsibility for banking supervision and resolution**
 - Insufficiently harmonised supervisory rulebook
 - Inadequate supervision
 - Financial crisis resolution entailed major challenges for MS (inadequate legal framework, sizeable fiscal needs, difficult cross-border coordination)
2. Failure to enforce the rules of **the fiscal policy framework -**
 - Insufficient internalisation of EU rules at national level
 - Practice of “non-interference” and weak enforcement by Commission, Eurogroup/EU Council (sanctions never used)
3. Lack of a **competitiveness framework**
 - Lack of surveillance of competitiveness and macro imbalances
 - Processes of surveillance and coordination of structural policies were non-binding
4. No crisis resolution mechanism to provide **financial support** to euro area countries **in case of sudden external financing stops**

Leading to the vicious cycles operating in the current euro area sovereign debt crisis



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Structural reinforcement of the crisis management framework

EFSF

ESM

Private company

LEGAL STATUS

International institution established by ad hoc Treaty

Expires mid-2013

DURATION

Permanent

Guarantees

CAPITAL STRUCTURE

Paid-in & callable capital

Parliamentary approval for changes to instruments

DECISION-MAKING

More flexibility to make changes by unanimity

EFSF debt re-routed to Member States

LIABILITIES

ESM debt not re-routed

Structural reinforcement of the fiscal + macroeconomic frameworks

4 EU legal acts on fiscal matters

Macroeconomic

Surveillance

- Regulation on the strengthening of the surveillance of budgetary positions
 - Preventive arm of the SGP: expenditure rule and stronger consideration of debt (1/20 rule)
- Regulation on speeding up and clarifying the implementation of the Excessive Deficit Procedure
 - Corrective arm: equal footing of the government debt criterion
- Directive on requirements for budgetary frameworks of the MS
 - Minimum requirements for national fiscal frameworks

- Regulation on prevention and correction of macroeconomic imbalances
 - Early warning “scoreboard”, country specific qualitative analyses
 - Excessive imbalance procedure

Enforcement

- Regulation on the effective enforcement of budgetary surveillance in the euro area (EA)
 - Financial sanctions for euro area MS in case of non-compliance with the fiscal rules (at an earlier stage and gradually increasing), decided quasi-automatically (RQMV)

- Regulation on enforcement measures to correct excessive macro-economic imbalances (EA)
 - Financial sanctions for EA MS possible (decided quasi-automatically)

Structural reinforcement of the fiscal framework (I)

The Treaty on Stability, Coordination and Governance in EMU:
Intergovernmental Treaty signed by 25 of the 27 EU Member States in
March 2012

Main elements of fiscal reinforcement compared with the “six-pack”:

- Mandatory national implementation of the **balanced budget rule** and the **automatic correction mechanism**
 - introduced by MS at **constitutional or equivalent level**
 - **European Court of Justice** to verify national transposition
 - National **correction mechanisms** based on principles adopted by the EU Council in July 2012
- **More automaticity** for euro area members in EDP
(Decisions on existence of excessive deficit by reversed qualified majority; not applicable to procedures related to debt criterion)
- Stronger commitment by MS to **rapid convergence towards the MTO**
- Also includes aspects related to economic policy coordination and governance

Entered into force on 1 January 2013 (after ratification by 12 euro area members)

Two additional EU Regulations for euro area members

I. Strengthening of budgetary surveillance and correction of excessive deficits

- **Prior discussion in Eurogroup** of draft national budgets
- **Harmonised time line for adoption** of national budgets
- **Monitoring of in-year budgetary implementation** when in EDP

II. Strengthening of economic and budgetary surveillance of members experiencing or threatened with financial instability

- **Enhanced quarterly surveillance** for countries with financial market tensions and/or that receive financial assistance.
- **Post-programme surveillance** (until 75% of assistance is repaid)
- Member States must consult with EU Council, COM and ECB before approaching international lenders for financial assistance

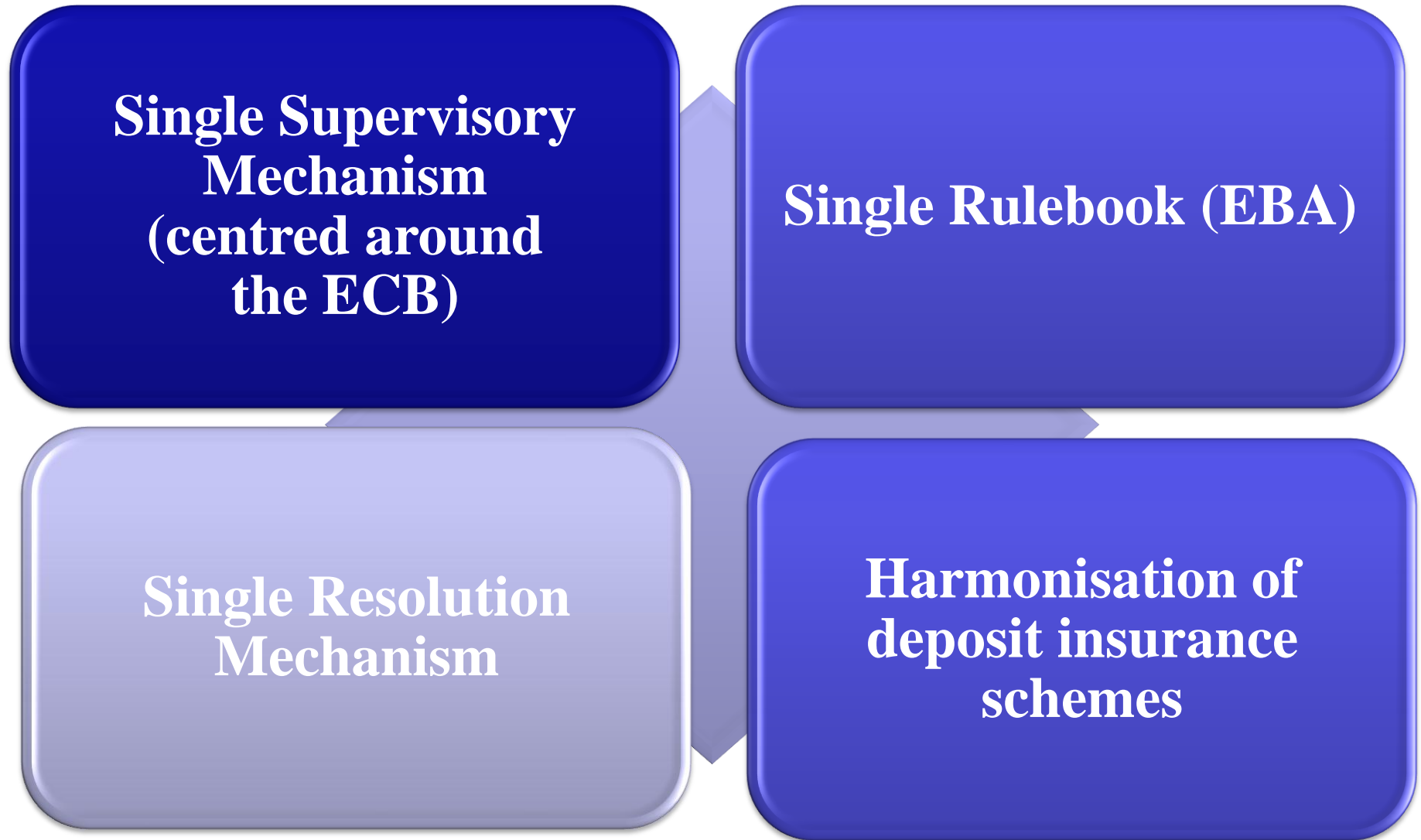
Negotiations between the EP and the Council expected to be concluded soon

Structural reinforcement of macroeconomic framework

Scoreboard – outcome for 2011

	Current account balance <i>(% of GDP, 3 years average)</i>	Net International Investment Position <i>(% of GDP)</i>	Export market shares <i>(5 years % change)</i>	Real Effective Exchange Rate, HICP deflated <i>(3 years % change)</i>	Nominal unit labour cost <i>(3 years % change)</i>	Private sector credit flow <i>(% of GDP)</i>	Private sector debt <i>(% of GDP)</i>	General government debt <i>(% of GDP)</i>	House prices, consumption deflated <i>(y-o-y % change)</i>	Unemployment rate <i>(3 years average)</i>	Financial liabilities <i>(y-o-y % change)</i>
<i>Threshold</i>	+6/-4%	-35%	-6%	+/-5%	+9%	+15%	160%	60%	+6%	+10%	+16.5%
Belgium	-0.3	65.7	-10.2	-0.5	6.2	11.6	236.0	98.0	-0.1	7.8	4.7
Germany	5.9	32.6	-8.4	-3.9	5.9	4.8	128.0	81.0	1.4	6.9	2.1
Estonia	2.8	-57.8	11.1	0.8	-6.2	6.8	133.0	6.0	3.3	14.4	-4.4
Ireland	0.0	-96.0	-12.2	-9.1	-12.8	4.0	310.0	106.0	-15.2	13.3	-0.6
Greece	-10.4	-86.1	-18.7	3.1	4.1	-5.5	125.0	171.0	-5.1	13.2	-3.4
Spain	-4.3	-91.7	-7.6	-1.3	-2.1	-4.1	218.0	69.0	-10.0	19.9	3.7
France	-1.6	-15.9	-11.2	-3.2	6.0	4.0	160.0	86.0	3.8	9.6	7.3
Italy	-2.9	-20.6	-18.4	-2.1	4.4	2.6	129.0	121.0	-2.0	8.2	3.8
Cyprus	-8.4	-71.3	-16.4	-0.9	8.8	16.1	288.0	71.0	-8.5	6.6	-0.2
Luxembourg	7.5	107.8	-10.1	0.8	12.5	2.5	326.0	18.0	1.5	4.8	11.3
Malta	-4.3	5.7	11.7	-3.0	5.8	2.2	210.0	71.0	-2.3	6.8	1.4
Netherlands	7.5	35.5	-8.2	-1.6	5.8	0.7	225.0	66.0	-4.0	4.2	7.2
Austria	2.2	-2.3	-12.7	-1.0	5.9	4.1	161.0	72.0	-8.0	4.4	-0.3
Portugal	-9.1	-105.0	-9.5	-1.9	0.9	-3.2	249.0	108.0	-3.6	11.9	-0.7
Slovenia	-0.4	-41.2	-6.1	-0.3	8.3	1.9	128.0	47.0	1.0	7.1	-1.3
Slovak Republic	-2.1	-64.4	20.9	4.3	4.4	3.3	76.0	43.0	-5.6	13.4	1.2
Finland	0.6	13.1	-22.9	-1.3	9.1	4.6	179.0	49.0	-0.3	8.1	30.8

Source: 2013 Alert Mechanism Report, European Commission. Notes: Cells with black background signal that the indicator exceeded the threshold in 2011, while it had not in 2010. Cells with grey background indicate countries, which already had exceeded the threshold in 2010 and still did in 2011. Shaded cells signal that the indicator does not exceed the threshold anymore in 2011, while it had in 2010.



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Euro area growth projections/forecasts

Comparison of forecasts for euro area real GDP growth

(annual percentage changes)

Institution	Date of release	2012	2013	2014
Eurosystème (BMPE)	06 December 2012 (a)	-0.6 - -0.4	-0.9 - 0.3	0.2 - 2.2
	<i>ch. with September 2012 (b)</i>	(-0.1)	(-0.8)	(-0.4)
European Commission	07 November 2012 (b)	-0.4	0.1	1.4
	<i>ch. with May 2012</i>	(-0.1)	(-0.9)	
IMF	08 October 2012 (d)	-0.4	0.2	1.2
	<i>ch. with July 2012 / April 2012</i>	(-0.1)	(-0.5)	(-0.2)
OECD	27 November 2012 (e)	-0.4	-0.1	1.3
	<i>ch. with May 2012</i>	(-0.3)	(-1.0)	
ECB Survey of Professional Forecasters	2012 Q4 (f)	-0.5	0.3	1.3
	<i>ch. with 2012 Q3</i>	(-0.2)	(-0.3)	(-0.1)
Consensus Economics	13 December 2012 (g)	-0.5	-0.1	1.2
	<i>ch. with November 2012 / April 2012</i>	(=)	(-0.1)	(-0.4)
Euro Zone Barometer	14 December 2012 (h)	-0.4	0.0	1.3
	<i>ch. with November 2012</i>	(+0.1)	(-0.1)	(-0.1)