

The Euro Challenge 2012

The Euro's Challenge: Restoring Confidence and Growth



Delegation of the European Union to the United States
www.euro-challenge.org

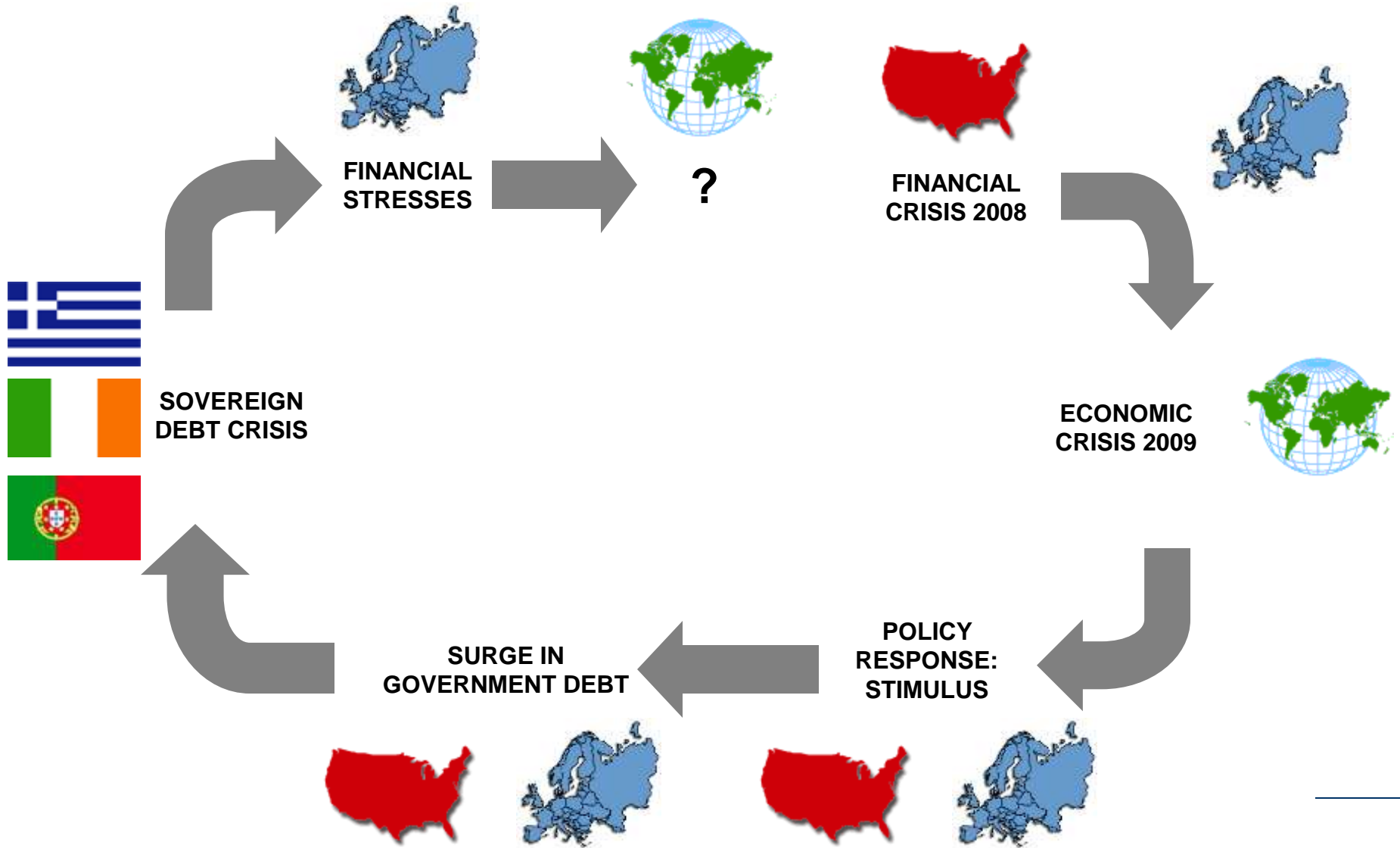


What this presentation will cover

- Understanding the euro crisis: Key concepts
 - Policy responses - what Europe is doing to end the crisis
 - The euro's prospects for survival
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Understanding the euro crisis: key concepts

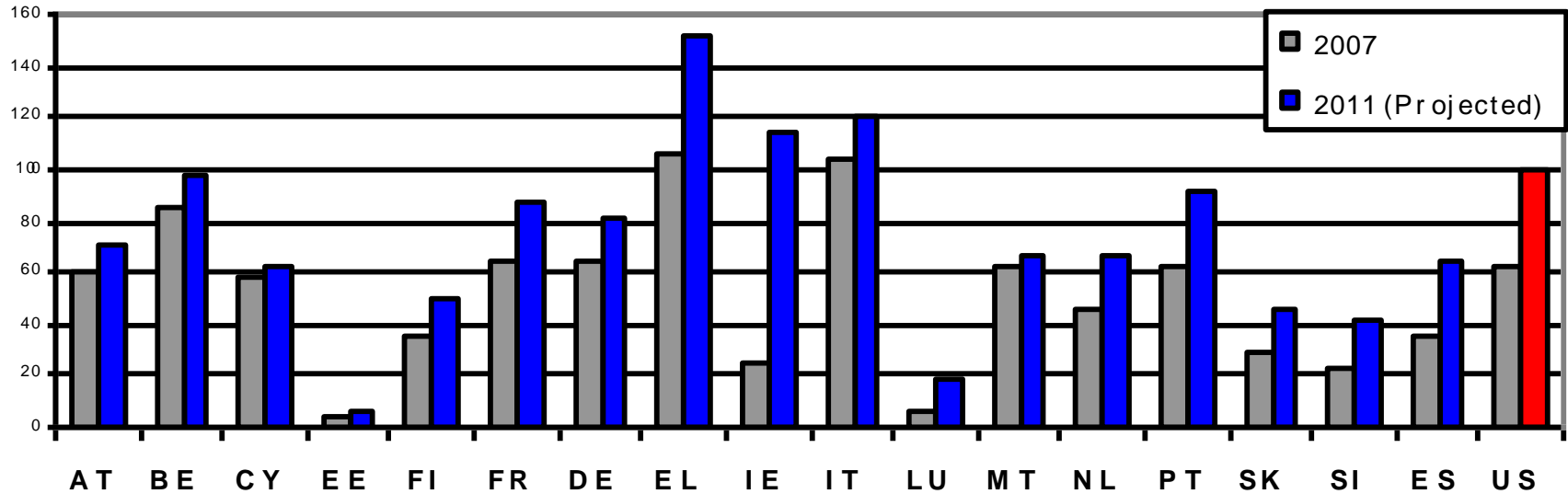
The never-ending crisis?





Government (sovereign) debt levels ballooned

Debt to GDP in the Euro Area Countries and the US (as % of GDP)



Key Economic Concept: Bond Spreads

Governments borrow by issuing bonds

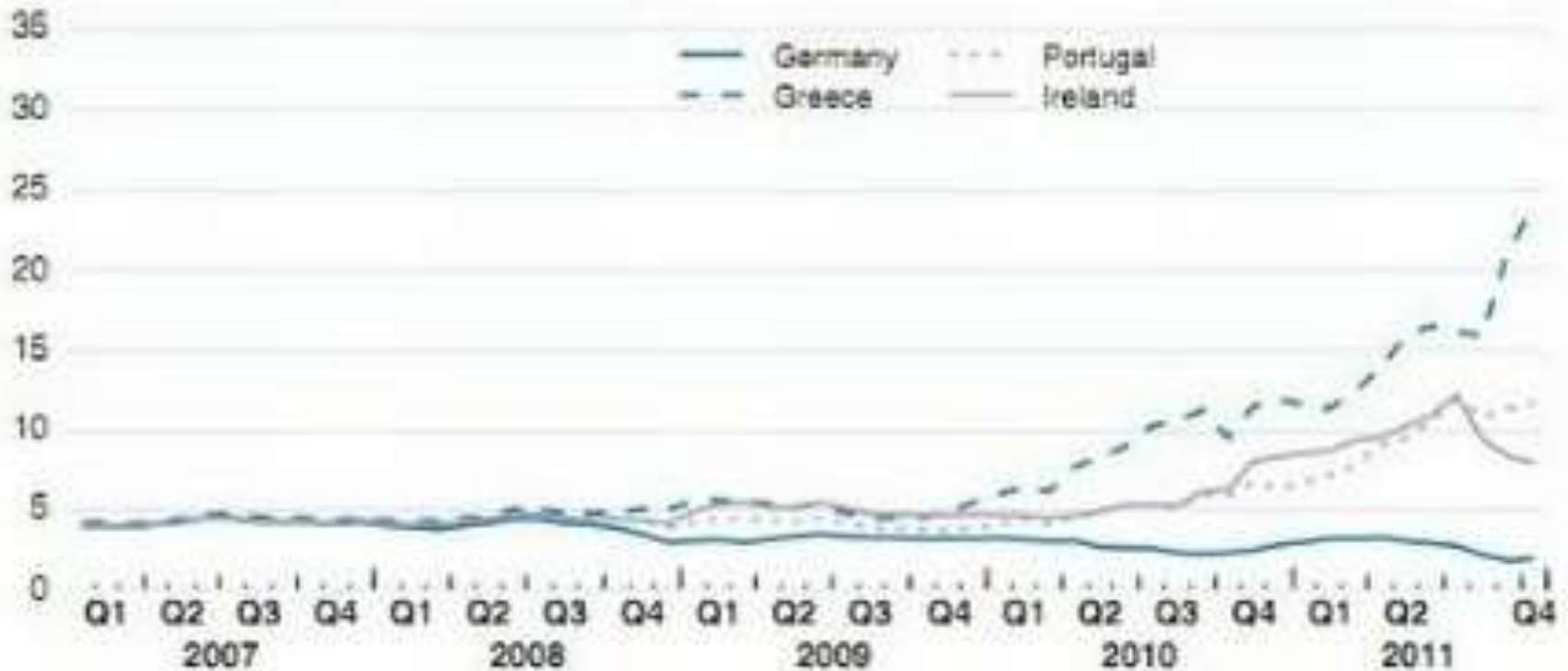
Less riskier borrowers can borrow more easily

Markets try to distinguish between borrowers

The spread is the difference in interest rates that markets charge different borrowers

When investors get nervous, spreads start to widen

Investors started to charge “riskier” countries more to borrow money



The origins of the Greek crisis



Greece's euro membership marked by consumption, investment booms

Wages rise faster than productivity, competitiveness deteriorates

Low interest rates fuel credit growth

Poor fiscal discipline and weak institutions

Large revisions to budgetary statistics

Unsustainable pension, health systems



Other euro area countries have come under pressure as Greece's woes spread



Many countries were confronted by large costs from rescuing their financial sectors



Some countries suffered from burst housing bubbles



Many countries face problems of slow growth and lack of competitiveness



In many European countries, population ageing presents a threat to fiscal sustainability



Diversity vs. Divergence: “core” and “periphery”

“Core” countries:
Germany, France,
Netherlands, Austria, etc.

“Periphery” countries:
Portugal, Ireland, Greece,
Spain



Europe's response to the crisis

Europe's response to the sovereign debt crisis

- **European Stabilization Program 2010:**
EU-IMF assistance for Greece (€110 bn);
Ireland (€ 85 bn); Portugal (€ 78 bn)
- **ECB** purchasing government bonds of troubled countries
- July 2011: EU agrees on new powers to the **European Financial Stability Facility (€440 bn)** and on 2nd program for Greece (€109 bn)
- **Strengthening “fiscal governance”** through tighter monitoring, EU oversight of national budgets
- “Euro Summit” October 26, 2011
- **European Council Dec. 9, 2011**

European
Council



European
Commission

European
Parliament



European
Central Bank
(ECB)

*International
Monetary
Fund (IMF)*





Strengthening the “E” in EMU

Joint financial assistance for countries in difficulty (with strict policy conditions)

Stronger, more effective fiscal rules, and stronger supervision at the EU level



Greater co-ordination of economic policies

Boost growth: ‘Europe 2020’ strategy

What next?

More ECB action?

Increased funding?

Euro bonds?

Fiscal “union”?

Bold, difficult measures for affected countries



Joint EU-IMF programs aim to bring down debt and solve economic challenges (slow growth, lost competitiveness, banking sector issues).

Far-reaching structural reforms being adopted (e.g. landmark pension reforms)

Drastic cuts in public expenditure across all levels of government: necessary, but painful and unpopular.

Program designed to reduce government deficits and stabilize debt (good) can have a negative impact on growth in the short run (bad)



Germany's *Der Spiegel* magazine asks "how a big idea became a threat to Europe"

Will all euro area countries (17) endorse moving toward greater fiscal and economic union? (National sovereignty issues?) How will the "euro-outs" react?

Economically stronger Member States (like Germany) are wary of having to foot the bill for the weaker ones

Concerns about the ECB supporting individual countries ("moral hazard"? Fear of eventual inflation?)

The euro-skeptic view: euro break-up inevitable?

Doomed from the start?

European countries too different?

Public debt levels not sustainable and austerity measures too severe?

Leaving the euro would help?

EU response too little, too late?



The case for the euro

**Strong political commitment
of leaders to defend the euro**

**Break-up or shrinking of the
euro area would be messy,
costly, and potentially
destabilizing.**

**Governance of euro area is
being strengthened, flaws
fixed**

**More sustainable public
finances and economic
reforms will help countries**



**“The euro is at the core of our
European project.”**

**Statement by Heads of State or
Government of the euro area and EU
institutions, Oct. 26th, 2011**