Yannis Stournaras: Responses to the euro area crisis and challenges ahead

Welcoming address by Mr Yannis Stournaras, Governor of the Bank of Greece, at EMS Managing Director Klaus Regling speech "Overcoming the Euro Crisis", Athens, 10 July 2014.

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The euro area crisis stems from the fact that Economic and Monetary Union (EMU) is a complete monetary union but an incomplete economic and financial union. Indeed, the roots of the crisis are complex, resulting from an interaction between inadequate architecture and inadequate implementation of the structures that had been put in place.

Five years after the start of the crisis, the outlook appears brighter. The euro area has moved out of recession, intra-euro area macroeconomic imbalances have been significantly reduced and the changes to the institutional framework underpinning EMU have been considerable leading to a stronger architecture.

Response to the crisis (at national and EU level)

In order to address the underlying economic and institutional challenges stemming from crisis, euro area countries had to respond with a comprehensive strategy. This strategy included both measures at the national level as well as at the level of European Union institutions.

First, Europe responded with the creation of the necessary financial backstops. The establishment of the EFSF and, later, the ESM allowed euro area members to grant loans at favourable interest rates and under strict conditionality to countries that had lost market access.

Second, the Governing Council of the ECB was innovative in its conduct of monetary policy, putting in place both standard and non-standard policy measures. These measures helped increase confidence and were directed at restoring the smooth operation of the monetary transmission mechanism. The downward adjustment of interest rates, the provision of sufficient liquidity and the Securities Market Programme all played their role.

As a further step, the ECB announced in September 2012 the Outright Monetary Transactions (OMT) programme, which contributed significantly to the improvement in financial market conditions in the euro area, the decline in sovereign spreads and the gradual reversal of financial fragmentation. The latest non-standard measure, the targeted longer-term refinancing operations, is designed to support lending to the real economy.

Third, there has been a significant correction of external and domestic imbalances in individual euro area countries, with significant progress having been achieved to regain previous losses in competitiveness and cut back fiscal deficits.

At the same time, structural reforms have gathered pace and programme countries in particular have undertaken substantial reforms in order to make the economies more flexible and market-oriented.

Fourth, significant steps have been taken to improve economic policy coordination. These measures included the strengthening of the Stability and Growth Pact, the establishment of the European Semester, stronger emphasis on macroeconomic imbalances and the Fiscal compact.

Last but not least, crucial steps have been agreed to move towards the creation of a Banking Union. The Single Supervisory Mechanism will start operating in November 2014 and agreement on the Single Resolution Mechanism has been reached. These measures will work to reinforce the European banking system, reduce the negative feedback loops between banks and sovereigns and overcome fragmentation in EU financial markets, promoting growth.

Results and challenges ahead

The European strategy to deal with the crisis is delivering results, as interest rate differences between core and periphery countries have been reduced, programme countries have regained market access and the banking sector has been strengthened.

However, many challenges remain. A key characteristic of the euro area economic recovery is the continuing decline in loans to the private sector. The recovery is so far “creditless” at both the euro area as a whole and, in many cases, in individual countries. Because the euro area economy is bank-based, bank lending is especially significant for companies and, in particular, for SMEs, which produce the bulk of goods and services and account for a large share of employment. Consequently, the on-going credit contraction raises the question: Can the recovery be sustained in the presence of negative loan growth? Personally, I doubt it.

Looking ahead, there is a need to deal with limited potential growth in the euro area. To this end, euro area members are increasingly recognizing the need for joint efforts and coordinating national structural policies for growth and jobs, as reflected in the recent conclusions of the European Council.

Today’s speaker

Klaus Regling, as the first Managing Director of the European Stability Mechanism and Chief Executive Officer of the European Financial Stability Fund, has been at the centre of the euro area crisis.

His career has spanned 35 years in senior positions mainly in the public sector. He worked at the IMF in Washington and Jakarta; he spent around 10 years at the German Ministry of Finance, working on preparations for monetary union; he then moved to the European Commission where he was Director General for Economic and Financial Affairs from 2001 to 2008.

He is thus perfectly suited to address the issue of how we overcome the euro area crisis.