



# The Financial Crisis and the EU Policy Responses



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Globalisation, European integration and  
economic crisis



# Structure of the presentation



- The crisis
  - Origin of the crisis
  - The crisis in figures
  
- EU policy responses
  - Coordinating Member States
  - Direct financial support to MS
  - Application of state aid rules
  - Regulatory responses
  - Exit strategies



# The crisis





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# Origin of the crisis

## Macroeconomic roots

- Abundant global liquidity, real estate bubble
- Rapid credit growth, high leveraging
- Supervisory failure : supervision too focused on individual institutions, no global picture



**Domino effects  
and feedback  
loops when  
bubbles pop**



## Microeconomic roots

- Originate and distribute model
- Complex and opaque financial products (CDS...)
- Conflicts of interest of rating agencies
- Incentives for short-run risk taking (Compensation schemes...)
- Maturity mismatches in banks balance sheet





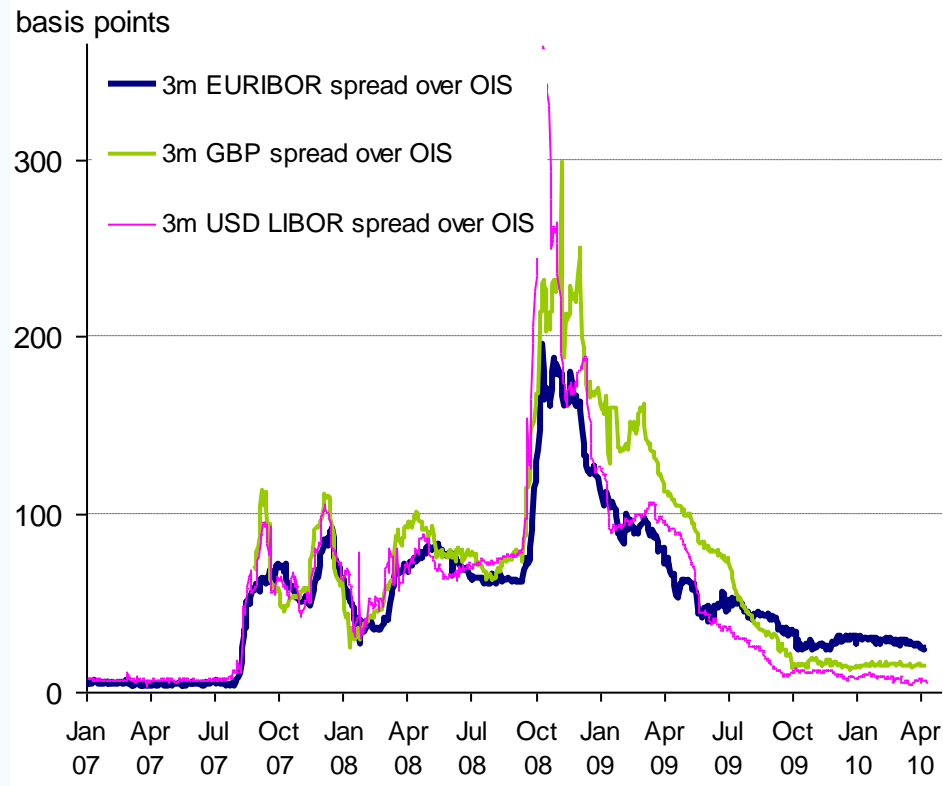
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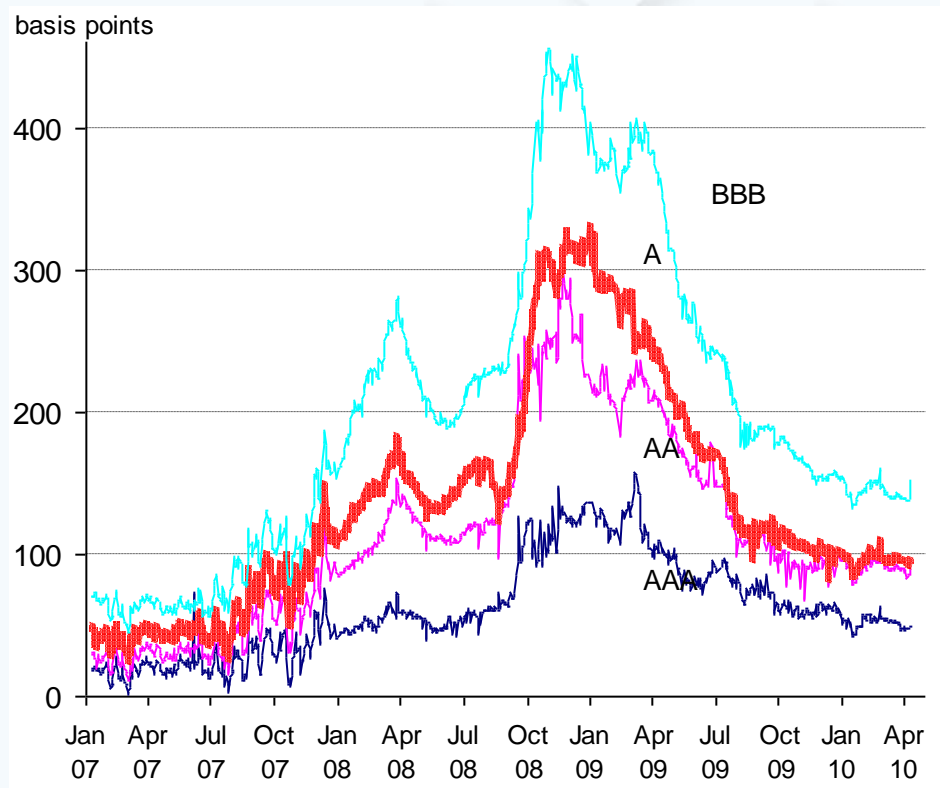
# Crisis in figures: Interbank market



Source: EcoWin



# Crisis in figures: Corporate bonds spreads

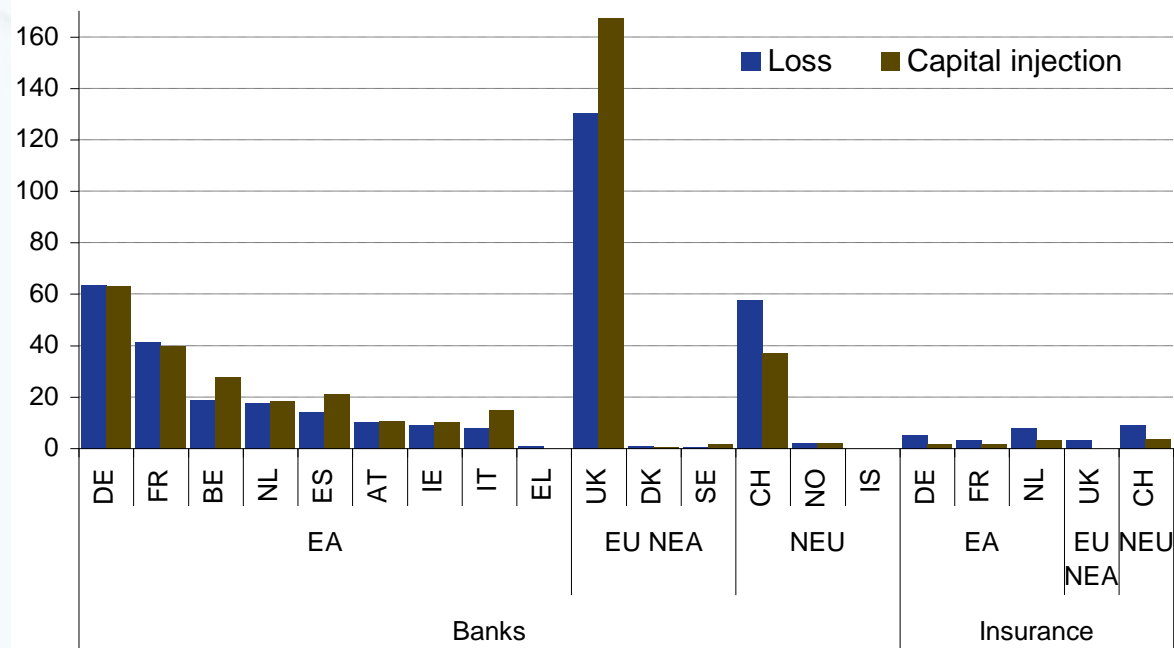
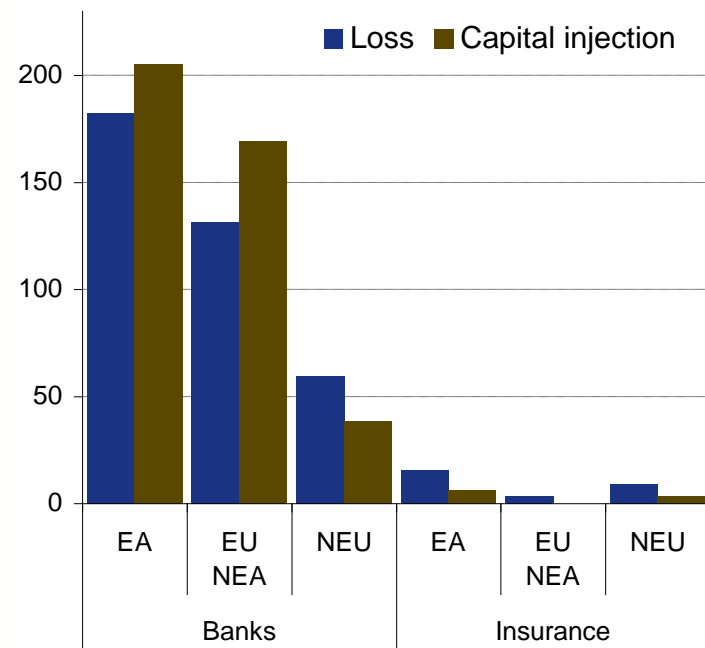


Source: EcoWin, own calculations





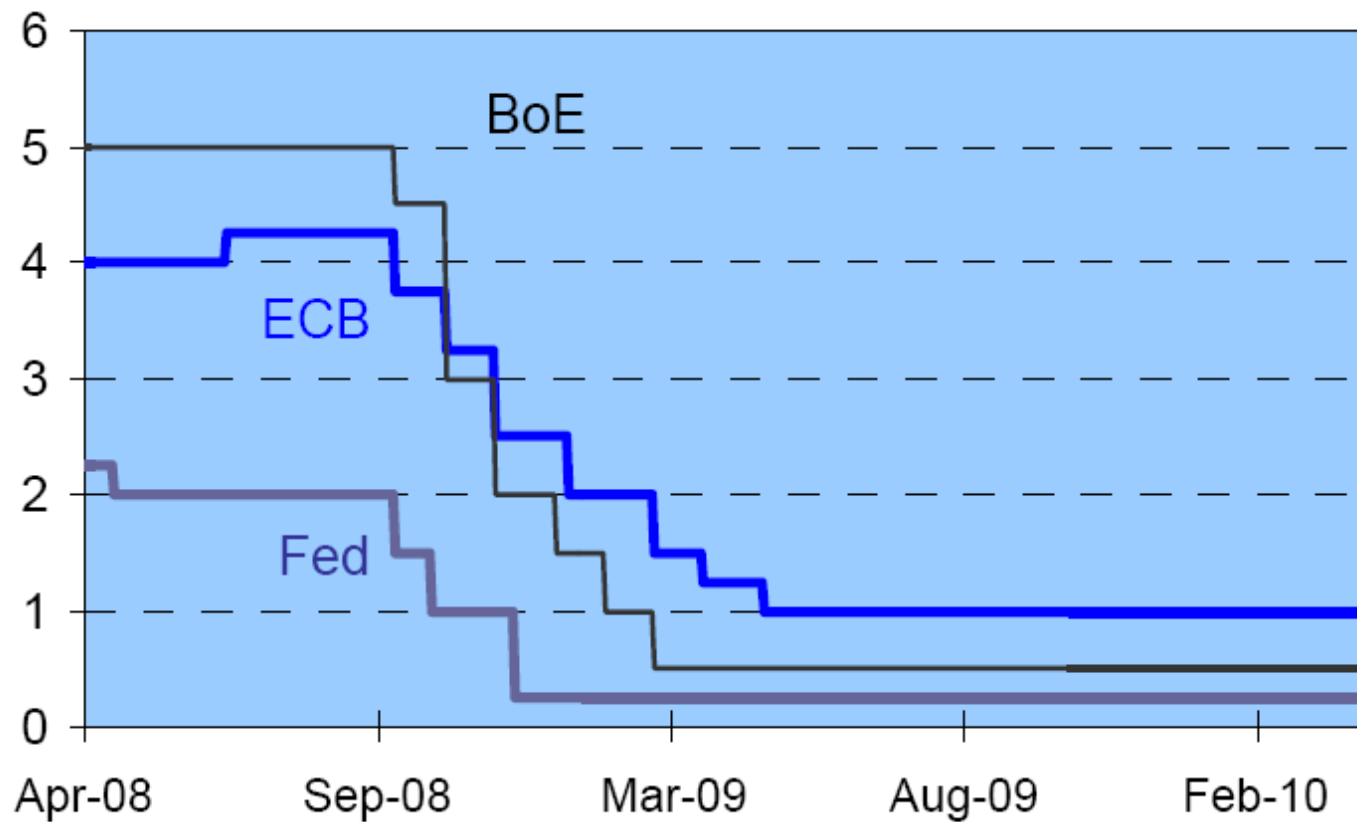
# Crisis in figures: losses and capital injections in the EU (banks and Insurance companies)



Source: Bloomberg. Cutting date 16/02/2010

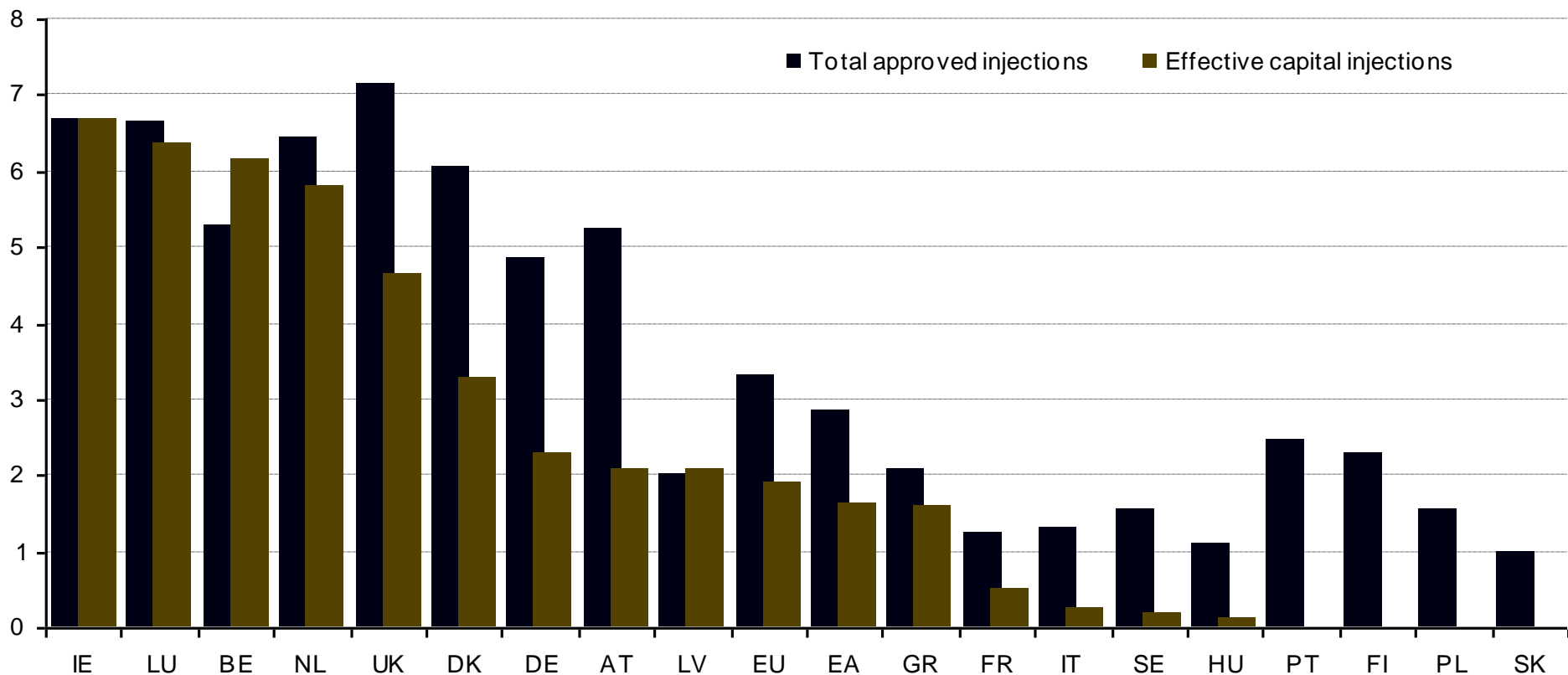


## Central bank rates





# Crisis in figures : Capital injections in the banking sector (as % of GDP)

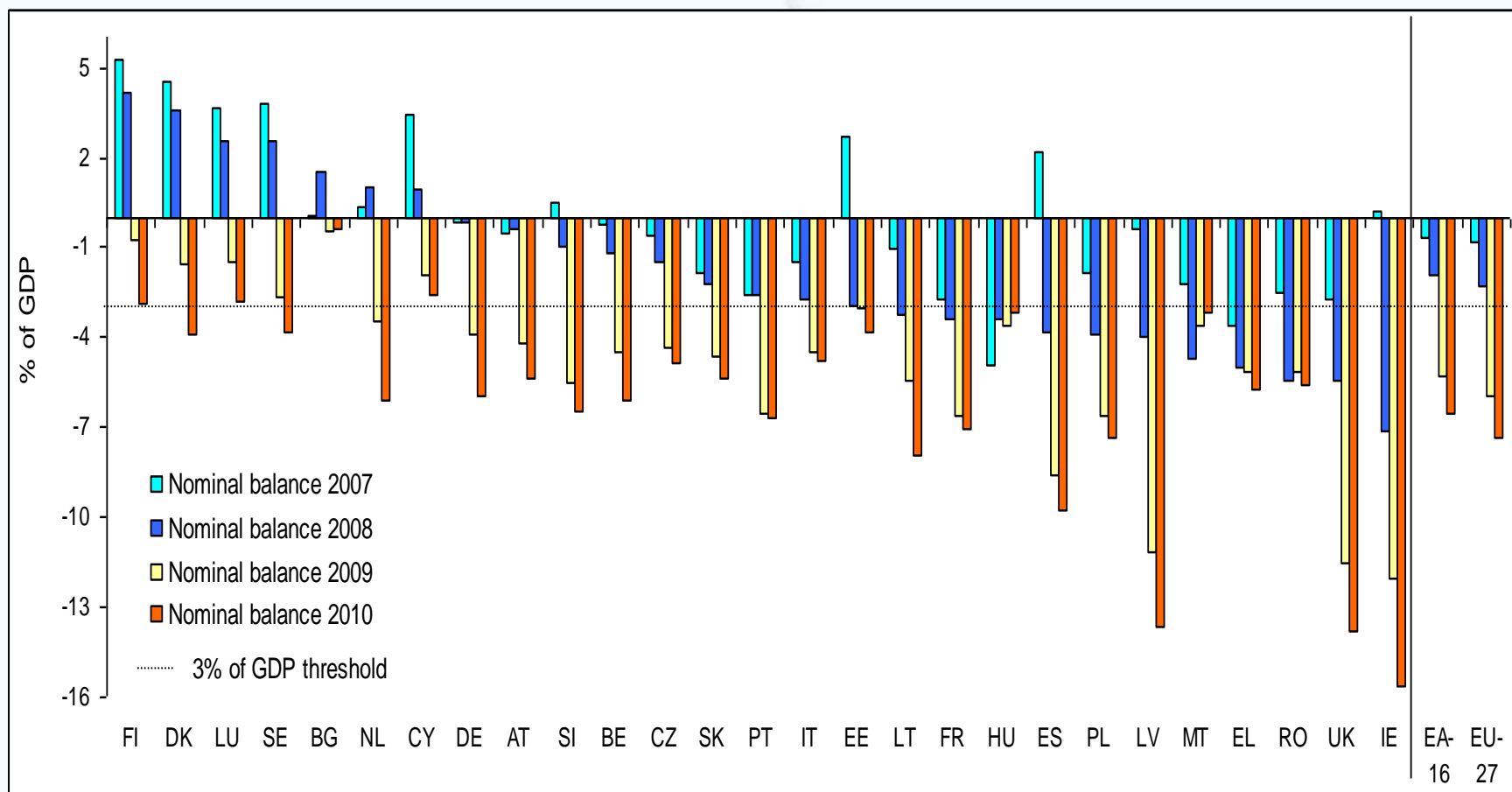


Source: Commission Services,  
cutting date 31/12/2009



# Crisis in figures :budget deficits (% of GDP)

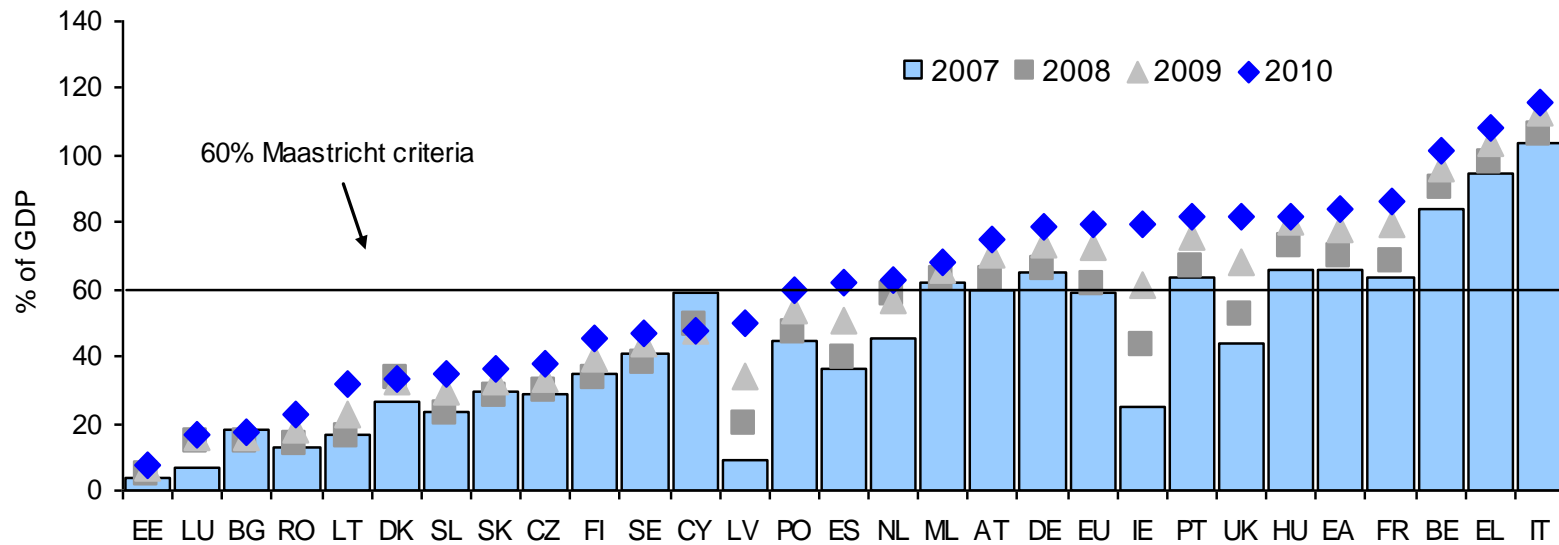
Source : Commission Spring forecast





# Crisis in figures: public debt

## Public debt

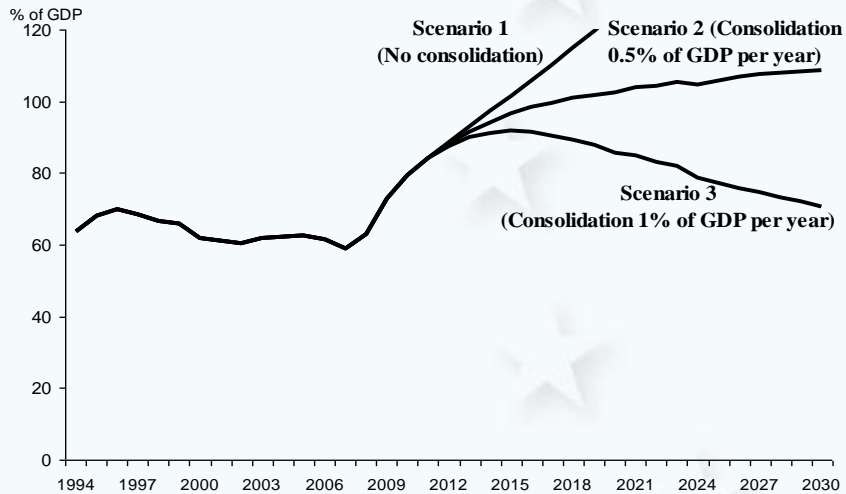


Source: European Commission

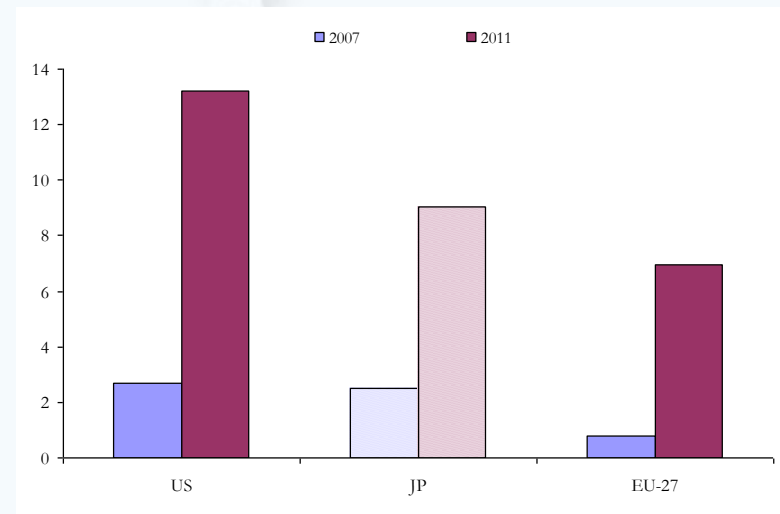


# Public Finance

Public debt level and medium term projections



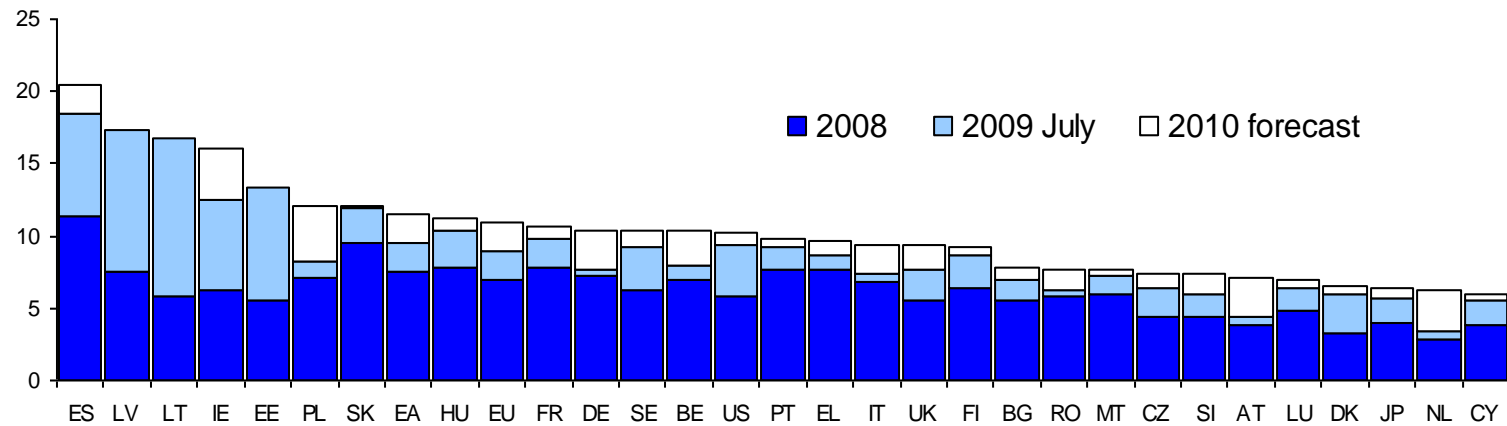
Budget deficit as % of GDP in EU, US and Japan





# Crisis in figures: unemployment

*Unemployment rate in the EU*



Source: Commission services.



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# Coordinated EU response

- G20 Summits
- Commission Communications :
  - Driving the European recovery
  - Financial Supervision in Europe
- ECOFIN roadmaps





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# Direct financial support to MS

- Ceiling increased from EUR 12 to EUR 50 billion
- 3 MS benefit from the mechanism (HU / RO/ LV)
- Conditionality
- Coordinated action with IMF



	HU	LV	RO
<i>Total assistance</i>	20	7,5	20
% PIB	21,7	40,5	17,1
<b>European Union</b>	6,5	3,1	5
Instalment 1	2	1	1,5
Instalment 2	2	1,2	
Instalment 3	1,5		
<b>IMF</b>	12,5	1,7	13
Instalment 1	4,9	0,6	5
Instalment 2	2,3	0,2	1,9
Instalment 3	1,4		
Instalment 4	0,1		
<b>Others</b>	1	0,5	2



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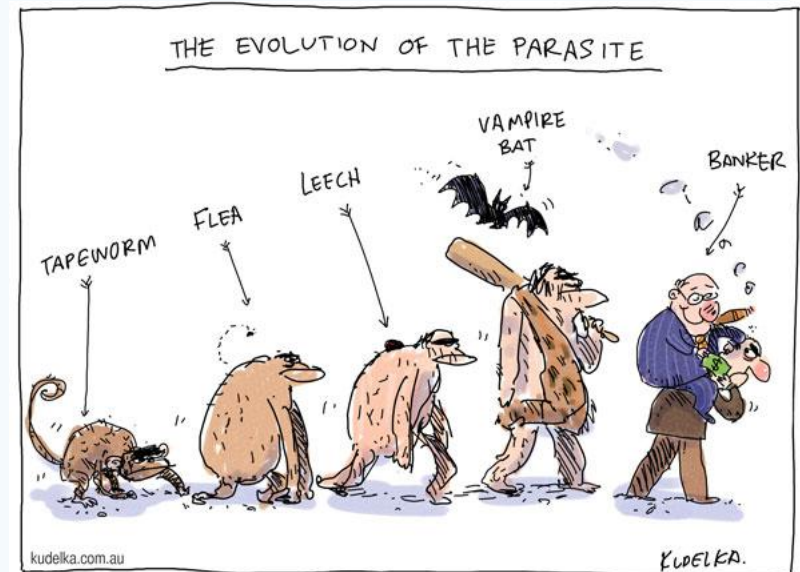
## Application of State aid rules

- 4 Commission communications on the issue :  
Application of state aid rules to measures taken in relation to financial institutions ; Recapitalisation of financial institutions, Treatment of impaired assets, Assessment of restructuring measures.
- The objective : Ensuring a level playing field in Member States' support to banks in a flexible way.



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# Regulatory responses

- 5 priorities:
  - Developing a more efficient supervisory structure
  - Enhancing capital requirements
  - Mitigating procyclicality
  - Improving crisis management
  - Extending the perimeter of regulation and supervision



## Developing a more efficient supervisory structure

- De Larosière Report
- A ‘macro pillar’ : the European Systemic Risk Board (ESRB), responsible for macro-prudential supervision
- A ‘micro-pillar’: the European System of Financial Supervisors (ESFS)
- The day-today supervision remains at national level





# More and better capital in the banking system

- **CRD 2:** colleges of supervisors, better liquidity management, retention clause for securitised assets
- **CRD 3:** higher capital requirements for re-securitisations and trading book items
- **CRD 4** (under discussion): Definition of capital, liquidity ratios, leverage ratio.
- Specific measures for the 'big ones' ? (Obama's proposals on systemically important institutions)
- Testing the resilience of the EU banking system : the CEBS stress test



## Mitigating procyclicality

- **CRD 3:** remuneration schemes
- **CRD 4:** Dynamic provisioning, countercyclical capital buffers
- Accounting issues : role of the Fair Value accounting



# Towards a EU crisis management framework ?

- Crisis management
  - Commission public consultation on crisis management
  - Reflection on burden sharing and bank resolution
  - Discussions on bank levy, stability funds (SE and DE initiatives)
  
- Deposit Guarantee Schemes
  - Protected amount raised from EUR 20 000 to EUR 100 000
  - DGS currently under review in the EU



## Extending the scope of regulation

- Hedge Funds
- Credit Rating Agencies
- On-going reflections on the trading of credit derivatives (over-the counter trading vs trading through CCPs)
- Non cooperative jurisdictions



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# Exit strategies

- Exit from State guarantee schemes first
- Case by case approach for banks under restructuring
- Fiscal exit : fiscal consolidation should start in 2011 at the latest