Speech by Werner Hoyer

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DZ-OMFIF breakfast discussion:

"The changing role of Europe in a world of transition"

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Ladies and gentlemen,

Good morning. And thank you to OMFIF for the opportunity to contribute to this discussion. You have chosen a very “hot” topic. In the European Investment Bank, as one of the EU’s key institutions for delivering economic policy, this is obviously a topic which is very close to our hearts.

In Europe today, to be frank, we face a risk of being overtaken by events. The events I am thinking about are both global and ones that have taken place – or could take place – within Europe.

I am thinking about the migration crisis that flared up in Europe last year, and that is still far from resolved. This crisis is itself is a reflection of the dramatic changes and ongoing instability in our immediate neighbourhood to the south and the east.

I am thinking of the internal challenges we are facing in the EU in terms of maintaining political support for the project of European solidarity and cooperation. The result of the Brexit referendum in the United Kingdom is both a set-back for the EU and a massive wake-up call. The impact on the EU economy is expected to be mildly negative in a scenario involving limited disruption to trade, but with a downside risk of prolonged and difficult negotiations that could lead to a reversion to trading under WTO rules.

Brexit shows us the urgency with which we need to demonstrate that European collaboration is the way to deal with many of the common issues we face.
As we look forward, we can see up-coming elections in the Netherlands, France and Germany, and a constitutional referendum in Italy, all of which could see

some shifts in power towards EU-critical parties, making the way forward more difficult.

The economic programme in Greece has dropped out of the news headlines recently. But nonetheless, fundamental issues remain, and the controversial question of Greek debt restructuring may still force its way back onto the agenda.

I am also thinking of global changes and the challenges that may be around the corner for the EU economy. One issue is that of Federal Reserve normalisation, as well as the question of the future of monetary policy easing more generally, and the consequences of monetary policy asymmetries that may between, for example, the Federal reserve, the Bank of Japan and the ECB.

As you know, any shifts in this area may have important impacts on global credit conditions, with emerging markets appearing particularly vulnerable. China may be no exception here, as its private sector debt has mushroomed. China appears able to achieve growth targets in the near-term, but growth remains dependent on unsustainable levels of capital expenditure. The necessary adjustment is hard to imagine without a significant reduction in growth that would have global implications.

These represent significant challenges and potential challenges for the EU economy. Against this background, we can say that we are making progress, but things could also be moving faster. The good news is that the EU and euro area economiesare in a recovery phase.

Private consumption and gradually strengthening investment increasingly underpin EU growth. But nonetheless, real GDP growth has barely reached the historical average of 1.8%. This is in the context, what is more, of what should be very favourable conditions: extraordinary monetary policy support has compressed risk- and term-premia, oil prices are low, the euro has been weak, and fiscal policy has recently been marginally supportive. We should be doing much better and we need to do better if we are to satisfactorily address issues like structural unemployment, debt overhangs and low productivity growth.

We must also acknowledge just how much we have achieved, particularly since the sovereign debt crisis in Europe. EU-wide stress-tests underline that EU banking systems have taken important steps toward stability. Policy measures that facilitated this process include extraordinary monetary policy support, recapitalisations, more stringent regulatory requirements, and important steps towards a Banking Union.

Monetary policy has had to carry a heavy burden. It has supported asset prices, helped stabilise the banking system and provided much-needed succour to the real economy during the crisis. Yet we must admit that this recovery does look rather fragile in the face of the challenges and risks I have mentioned.

We have very limited policy buffers:

Slow growth is hampering fiscal rebalancing and corporate deleveraging, while underpinning low inflation.The resistance of the very low inflation rate to monetary stimulation is limiting the scope for conventional monetary easing because of the zero lower bound. There also seems to be a growing consensus that we are approaching the limits of what unconventional monetary policy can do, with narrow interest rate margins beginning to undermine the profitability of banks and – increasingly importantly – pensions and insurance funds.

The EU financial system remains fragmented.

Despite the achievements of the ECB and the Banking Union in lowering geographical spreads, cross-border lending has not recovered within the euro area. This implies a sub-optimal allocation of resources and continued vulnerability.

Indeed, vulnerabilities remain in the EU banking sector – notably where NPLs exceed 10% or even 20%.

And finally, fiscal space is extremely limited in many EU countries. And those countries with fiscal space are not those where fiscal stimulus is most required. The fiscal space issue is thus compounded by a lack of consensus across the EU on how to combine fiscal prudence with making optimal use of the little fiscal space that we have in order to promote recovery and re-balancing across the Union.

So how are the members of the EU going to tackle this challenge? On this, I think the State of the European Union address by Commission President Juncker and the Bratislava Summit of EU leaders last month were revealing.

The Bratislava Summit in particular set out a pragmatic approach of identifying common priorities and making sure we make real progress on those, rather than risking stalemate by attempting a radical rethinking. This is surely a realistic approach. Whether it succeeds is still going to depend on the level of urgency and ambition with which this work proceeds.

In terms of the policy mix needed, it is important not to forget structural reforms at both national and EU-levels. These are essential to enhance incentives for investment and job creation, and to raise productivity growth. Such reforms will raise potential growth over the medium term and improve resilience to future crises.

Concerted efforts at the EU level are needed to realise the full benefits of Europe's huge internal market, to support growth, cohesion and to reduce vulnerability to shocks.

They should include:

☐ a successful Capital Markets Union to diversify the forms of finance that firms can access, and to further combat the root causes of financial fragmentation;

☐ investment in physical infrastructure links needed for economic cohesion, such as energy and transport networks;

☐ investment in digital infrastructure to realise a Digital Single Market and enhance intra-EU trade in services; and

☐ investment in education, R&D, and young innovative companies to support future productivity growth and competitiveness.

It is also worth mentioning, in this context, the role that we play at the EIB. In a way, we already act as a significant EU-level instrument for stabilisation and re-balancing. But we do this in a way that is specifically focused on addressing structural weaknesses in the EU economy, raising our growth potential over the medium to longer term.

The need to take action to address investment shortcomings, through the EIB, is in fact one of the ways in which we are, as a Union, really moving forward and taking action together.
Let me just say a few words about the EIB, as we are not as well-known as we might be.

The EIB, the EU Bank, is unique as a banking institution owned by all 28 EU Member States, not just the euro area countries. This is why we call ourselves “the EU bank”. We mobilise finance as an issuer of what are, in effect, European bonds. We finance investment projects that address Member State structural needs and contribute to EU-wide objectives.

We are also, in fact, the largest multi-lateral lender and borrower in the world. We have a balance sheet of around 570 billion euros, lending 78 billion euros last year. This lending will support an even greater investment in the real economy—around 230 billion euros.

These are not insignificant amounts. According to one modelling estimate we have carried out, the investment we supported during the 2013-2015 period may have the effect of increasing the EU's GDP by around 1.1% by 2030, adding about 1.4 million jobs.

The 2013-2015 period was in fact, one in which we rapidly increased the volumes of our operations in response to the effects of the sovereign debt crisis, using a 10 billion euros capital increase to mobilise additional resources.

Since last year, we have been building on that experience through the implementation, in close collaboration with the European Commission, of the Investment plan for Europe. One element of this is the European Fund for Strategic Investment – what we call "EFSI". EFSI is 21 billion euros guarantee that allows us to expand the scope and extent of EIB Group operations. Of these 21 billion euros, 16 billion comes from the EU budget and 5 biilion from the EIB. The guarantee allows us to focus specifically on higher risk, higher impact investments.

The plan to relaunch investment has three parts, and they must all work for the plan to succeed. Regulatory reform is essential to enhance incentives to invest.

Our lending under EFSI is on track to meet its target of supporting 315 billion euros of investment in the economy in 3 years. Some 127 billion euros is set to be mobilised so far by over 22bn of approved EIB Group financing.

These 324 operations are spread across 27 member States. The targeted annual investment under EFSI is significant: although it represents only 3.9% of EU investment, it is 12% of investment in targeted areas such as R&D, education facilities, transport, energy and digital infrastructure.

So you see, it is important to understand that in the current policy juncture, there is much that is being done at the EU level to support investment.

As well as addressing long-term structural needs and potentially playing a countercyclical role, the EIB also helps to address EU economic imbalances through its lending in support of EU convergence objectives. By design, EIB exposure as a percentage of Member State GDP is strongly biased in favour of so-called “less developed” and “transition” regions of Europe.

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It is also useful to understand how the different EIB Group products perform different policy functions, all of which can be targeted in terms of region, sector and cyclical timing:

☐ Guarantees and securitisation act on the lending channel, providing capital relief to banks to support lending to the corporate sector, particularly SMEs.

☐ Intermediated lending acts through the lending channel to enhance access to finance for SMEs and mid-caps.

☐ Direct lending and equity products promote specific infrastructure investments and innovation.

Lastly, I should not forget to mention that we are also the strategic partner of the EU when it comes to development financing, lending nearly 8 billion euros a year, and with a long track record supporting EU external policy objectives.

We are now targeting just over a third of our lending outside the EU at climate objectives. At the same time, through our resilience initiative we are intensifying our focus on addressing the causes of migration and supporting neighbouring regions to manage the impact of migration flows.

It is not surprising that in the context of the ongoing risks to the recovery in Europe, there are calls for EFSI to be extended.

Indeed, in his State of the European Union speech last month, Commission President Juncker made a very strong proposal to extend EFSI to a target of 500 billion euros mobilised by 2020 – or even to 630 billion euros by 2022 – with a proportional increase in resources and further encouragement for Member States to contribute further financial resources to the plan.

At the EIB, the EU Bank, we welcome this. It is not only important that this support to investment continues; it is also important that investors and would-be project promoters are able to know in advance that this policy support is going to be there. It is important to maintain encouragement for the often long process of project development.

This is an area in which we have to keep momentum going and avoid contributing to even more policy uncertainty. We are now waiting on decisions that will be taken in December following an independent evaluation of the programme.

I started this speech on a rather pessimistic note, but in fact I am an optimist. Many are now looking around for policy options that can complement monetary policy, yet without over-burdening public finances.

In this environment, I think the experience of the EIB offers a very positive example.
Thank you very much.