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Europe Flash

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Economic Analysis

Europe
Miguel Jiménez
mjimenezg@bbva.com
+34 91 573 73 04

Regulation and Public Policy
Tatiana Alonso Gispert
tatiana.alonso@bbva.com
+34 91 374 61 67

Financial Systems
Ana Rubio
arubiog@bbva.com
+34 91 374 33 42

Financial Scenarios
Sonsoles Castillo Delgado
s.castillo@bbva.com
+34 91 374 44 32

EU Council: a low profile summit

Bottom line: EU Council summit confirmed on June 28 measures of progress towards banking union and deployed measures to foster youth employment and funding to SME's. On banking union, progress was limited to a compromise to reach agreement on the single resolution mechanism by the end of the year. Measures to foster employment could alleviate unemployment somewhat but not to a large extent. Measures to expand credit to SME's through the EIB are positive but will not be immediate and do not clarify an eventual role of the ECB in the scheme.

- ### Banking union

As expected the EU leaders recalled (again) the urgency to break the vicious circle between sovereigns and banks and expressed their strong **support to the Banking Union project.**

In assessing **progress towards Banking Union** the leaders pointed to the new rules on capital requirements for banks (CRDIV pack, to apply since January 2014), and the new Single Supervisory Mechanism (SSM) as main levers for financial stability. They also welcomed the agreement reached at the ECOFIN on draft common rules to wind down banks (the Bank Recovery and Resolution Directive) and urged both the Council and the Parliament to reach agreement on the final text before the year end, as well as on the Deposit Guarantee Scheme Directive.

Regarding the **direct recapitalization of banks** by the European Stabilization Mechanism (ESM), the EU leaders just referred to the initial agreement reached last 20 June by the Eurogroup (the final agreement is expected for the Autumn, see BBVA Research Flash here). This tool is meant to provide a joint fiscal backstop for the resolution of banking crises within the SSM (read: Sept 2014). Although the ECB President Draghi had been actively calling in the past weeks for the tool **to provide a credible fiscal backstop to the forthcoming Balance Sheet Assessment exercise** (summer 2014), **the leaders finally decided to require Member States to put in place national backstops ahead of this exercise.** This suggests that the ESM would only be in operation along with the SSM (read: September 2014) and always following a regular decision by the ESM Board.

Regarding the **Single Resolution Mechanism (SRM)**, a proposal by the Commission will be issued in the next two weeks. There were a few expectations that the Council would shed some light on (i) a few guidelines about its preferred architecture and governance arrangements for the Single Resolution Authority, and (ii) the roadmap for the transition towards the SRM. However, they were not met at all. The leaders just referred to the forthcoming Commission proposal and called the Council to reach agreement on it before the end of the year (with view to adopt it before the end of this Parliamentary term, in May 2014). In the meantime, the Commission will adopt revised State Aid rules for the financial sector in this summer (expected in August) in order to ensuring a level playing-field in resolution decisions involving public funds.

Assessment: The initial (very low) expectations on further progress in the Banking Union front were not met. No new details were given on the general guidelines for the design of a Single Resolution Mechanism (the next natural step in the Banking Union project) and the transition towards it. The only news has to do with a requirement for Member States to put in place a national backstop ahead of the Balance Sheet Assessment, despite the fact that the burden sharing agreement included in the recently agreed operational ESM rules already deals with the issue of legacy assets by requiring Member States to pay for all the capital needed to get banks to a regulatory capital ratio of at least 4.5% and to further assume a 20% of the extra capital needed to reach a 9% level.

- ## Promoting funding to SME's

The council has launched the Investment Plan for Europe, to facilitate financing for SME's. Among other measures, the programme includes financing of the EIB with cofinancing of the private sector, thanks to the recent increase of 10 bn of its capital, with the goal of improving its lending capacity by 40% in 3 years. This initiative is not new.

The programme is very positive, as it **addresses the main weakness of finance to SME's, which is not liquidity but need of sharing risks in a recessionary environment.** In this respect, the Council supports the principle of joint risk-sharing between the EIB and the private sector, and to that end it promotes the expansion of the EIB tool to provide support to SME's (the EIF). There is also an emphasis on gradually promoting trade finance by the EIB, which is welcome as those firms that are likely to generate growth in the current environment are export firms.

However, though the programme extends from 2013 to 2015, it seems that **it will be available only as from next year,** as it asks for a new report on its implementation to the EIB and European Commission for before October this year. In addition, and though the details are not yet known, there does not seem to be any focus on SME's of periphery countries. The access of those SMEs to EIB's funds is more difficult because the rating of their national banks has been downgraded, so the EIB asks for additional guarantors or collateral. This problem has not been covered.

Alternative sources of funding will also be fostered, which is positive as a complementary measure to banking credit. However, non-banking funding will likely have a limited effect, and only in the long term.

The statement **does not mention either the role to play by the ECB** on special financing to SME's. Given the independence of the central bank, this omission seems natural, but we will be looking for what the ECB has to say on this issue in forthcoming meetings.

Assessment: The **programme of the EIB is positive**, especially in its support of the expansion of its role as a tool to provide funding to SME's and on the promotion of trade finance, **but it will be implemented too late and the lack of focus on the periphery** of the new programme will not help to reduce fragmentation.

- ## Measures to promote employment

On youth unemployment, which was one of the voiced goals of the summit, especially for some leaders of periphery countries, the main measure adopted by the EU council confirms the use of structural funds of EUR 6 bn, frontloading them to the period 2013-2015. This is equivalent to less than one year's 0.1% of EU GDP, although it will be focused on countries with high unemployment as the funds will be targeted to those regions with more than 25% of youth unemployment.

Apart from this, the council backs a large list of measures, including support of international mobility (with an "Erasmus+" programme for vocational training), promoting a network of employment services across countries, launching a project of high quality apprenticeships, etc. The council also recommends countries, which are responsible for most labour market policies, to improve active labour market measures and to reduce social security contributions for low skilled workers.

Assessment: The measures approved are as usual a long list filled with many already ongoing projects. **New funds committed are not insignificant, but are unlikely to have a large impact** in those countries with high rates of youth unemployment.

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