

Financial Scenarios Flash

Eurozone increases effective lending capacity to €500bn

- **Eurozone finance ministers have agreed on the new available lending capacity to €500bn.** The Eurogroup will allow the full ESM capacity to go along with the €200 bn already committed by the EFSF. This new lending capacity will be effectively and permanently available on 1 July 2012.
- **The Eurogroup has chosen the least ambitious option considered by the European Commission** (see 26 March Flash), option 1 (i.e. combining the full ESM with the used EFSF capacity), therefore discarding the most ambitious ones (i.e. allowing a transitory or permanent increase in the new lending capacity up to €740 bn beyond the €200 bn already committed).
- **For a transitional period until mid-2013, the EFSF may engage in new programmes in order to ensure a full and permanent fresh lending capacity of €500bn.** This is important because it solves the fact that the capital of the ESM is going to be paid in tranches, does temporary limiting the lending capacity of the mechanism¹. Simply put, it is a transitory substitution (if needed) of the ESM by the EFSF. In addition, the payment of the ESM capital is going to be accelerated and will be fully disbursed by mid 2014. The agreed is compatible with the ESM Treaty and thus a change will not be required².

Bottom-line:- The long waited decision of the Eurogroup on reinforcing the firewall has been disappointing considering the possible options and the remaining concerns on the European debt crisis. The full ESM effective lending capacity (€500bn) might not be enough to reassure markets given the uncertainties surrounding countries under programmes and other (larger) peripherals. Moreover, G20 partners might view it as maintaining the status quo, and thus, today's statement might fall short of providing the necessary credibility to unlock an increase in IMF resources.

1: Given that under the current ESM Treaty the paid-in capital (€80bn) should represent a minimum of 15% of the total possible lending capacity, the Eurogroup decided to accelerate the capital payments: two tranches will be paid in 2012, another two in 2013 and a final tranche in H1 2014. This means that €32bn (of the €80bn) will be paid this year and thus, the ESM could lend up to €213bn this year, short of the €500bn committed.

2: ESM Treaty has been signed and the ratification procedures at national level are ongoing, which are foreseen in July 2012.

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