## Box 11

### PUBLIC MEASURES TO SUPPORT BANKING SYSTEMS IN THE EURO AREA

In response to the intensified financial market stresses in the autumn of 2008, euro area governments implemented coordinated support measures to alleviate strains on their banking systems. These measures complemented the extensive liquidity support that has simultaneously been provided by the ECB.[1] This box summarises the public measures that have been taken and discusses their implications for euro area governments' fiscal balances. It also reviews some issues related to the eventual exit from such measures.[2]

The announced government support measures fall into three distinct categories, namely (i) guarantees for bank liabilities, (ii) capital injections and (iii) asset support schemes. A summary of the measures that were put in place, and the extent of their use so far, is given in the table below. The figures without parenthesis show the volume of support that had been

1 In June 2009, the ECB also started to provide liquidity through longer-term refinancing operations (LTROs) with a maturity of one year. The operations have been conducted as fixed rate tender procedures with full allotment and have been in addition to the regular and supplementary LTROs. On 3 December 2009, the ECB announced that it would discontinue this programme, allotting its last 12-month LTRO on 16 December 2009. In addition, the ECB decided to stop its six-month LTROs in the first quarter of 2010, by carrying out the last operation on 31 March.

2 This box provides an update to Boxes 10 and 11 in the December 2008 and June 2009 issues respectively of the FSR.

**Summary of public support measures in Europe**

(EUR billions unless stated otherwise)

| | Capital injections | | Liability guarantees | | Asset support | | Total commitment |
|---|---|---|---|---|---|---|---|
| | Within schemes | Outside schemes | Guaranteed issuance of bonds | Other guarantees, loans | Within schemes | Outside schemes | as % GDP |
| Europe | 160.7 (244) | 57.6 | 615.2 (2,135) | 233.1 (14) | 299.7 (279) | 71.5 | 26.9 |
| EU | 160.7 (234) | 57.6 | 615.2 (2,095) | 233.1 (14) | 258.5 (238) | 71.5 | 27.5 |
| Euro area | 72.8 (131) | 55.1 | 414.2 (1,677) | 229 (-) | 40.7 (238) | 71.5 | 27.1 |

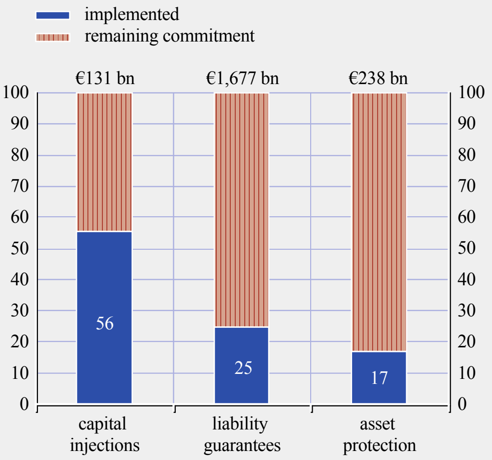
Sources: National authorities, Bloomberg and ECB calculations.
Notes: Data are cumulative since October 2008. The figures in brackets show total commitments for each measure. Some of the measures may not have been used, despite having been announced. Usage of guarantees includes issued bonds, but not guaranteed interbank loans. Capital injections outside schemes are support measures used without a scheme having been explicitly set up.

extended to banks by the cut-off date of this FSR, while the figures within parenthesis show the full amounts to which governments have committed in principle.

Regarding the implementation of the measures, some conclusions can be drawn. The take-up rate has generally been low across all measures, but there are substantial variations: the use of recapitalisation measures has been relatively widespread, while issuance of bank bonds with government guarantees has been considerably lower (see Chart A). It should be noted that there are significant differences between countries and that the volume and use of liability guarantees in absolute figures are far higher than the volume and use of capital injections. Furthermore, it seems that the largest part of the financial support has been targeted to a relatively small number of institutions (see Chart B). Indeed, according to publicly available data, about half of the support extended across each type of measure for the entire euro area has been absorbed by the three largest recipient institutions. For each individual support measure, the three largest recipients, which may differ depending on the measure concerned, represent between 7% and 9% in terms of total euro area banking assets.

**Chart A Take-up rates of public support measures (excluding outside schemes) in the euro area**

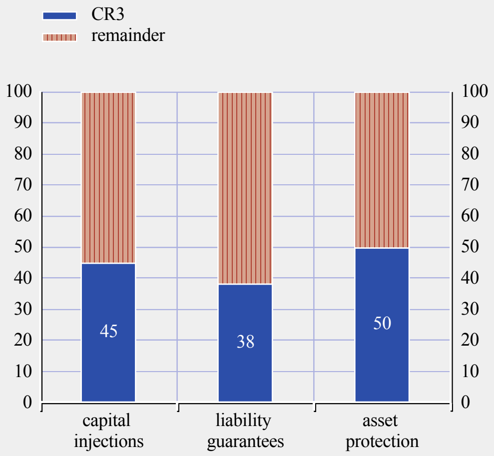
(Oct. 2008 – Nov. 2009; percentage of total and EUR billions)




Sources: National authorities, Bloomberg and ECB calculations.

**Chart B Concentration ratio of implemented public support measures in the euro area**

(Oct. 2008 – Nov. 2009; percentage of total)




Sources: National authorities, Bloomberg and ECB calculations.
Note: The CR3 ratio shows the share of support that is dispensed to the largest three recipient institutions.

The various measures to support the financial sector amount to considerable actual and contingent liabilities for euro area governments. While the governments' budget deficits are not materially affected in the short run, the impact on government debt depends on the borrowing requirements necessary to finance the actual recapitalisation measures. It should be noted that this comes on top of the rapidly rising government deficits and debt due to the economic slowdown and discretionary stimulus measures. At the same time, government budgets are currently benefiting from the remuneration of guarantees and capital injections. The contingent liabilities associated with the support for the financial sector represent major risks for government deficits and/or debt in the medium term. In addition, fiscal risks in the form of rapid changes in market sentiment that lead to less favourable refinancing costs are sizeable for all euro area countries with very large fiscal imbalances.

Mainly on account of the recent improvement in the financial performance of large and complex banking groups, a debate has started on exit strategies from government support measures. However, the discussion of exit strategies from financial sector support should not be confused with their actual implementation. At the current juncture, strains on the financial sector have alleviated, but the sustainability of the improvement in the financial stability outlook may, in the case of some individual financial institutions, remain partly reliant on existing support measures. Until the recovery proves to be firmly established, especially as regards private sector investment and job creation, the risk of setbacks in the improvement of private sector earnings and income prospects remains significant.

All in all, the challenges facing the euro area banking sector in the period ahead call for caution so as to avoid timing errors in disengaging from public support. In particular, exit decisions by governments will need to carefully balance the risks of exiting too early against those of exiting too late. The continuing resilience of financial institutions in the absence of government support will be an important element in deciding upon the timing of exits, since exiting before the underlying strength of key financial institutions is well established entails the risk of leaving institutions vulnerable to adverse disturbances, possibly even triggering renewed financial system stresses. On the other hand, exiting late can give rise to the risk of distorting competition, creating moral hazard risks that come with downside protection – including the possibility of excessive risk-taking – as well as exacerbating risks for public finances. For some banks, especially those that have received state support, fundamental re-structuring will be needed in order to confirm their long-term viability when such support is no longer available. This may entail the shrinking of balance sheets through the shedding of unviable businesses with a view of enhancing their profit-generating capacities. Indeed, such re-structuring is already under way for some large banks in the euro area.