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››› Five years of 'whatever it takes': three words that saved the euro

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We pay tribute to the President of the European Central Bank and the determined words he spoke exactly five years ago that brought the crucial turnaround of the euro crisis.

No ordinary summer morning

In the morning of 26 July 2012, Mario Draghi steps up to the microphone to address some 200 business executives, politicians and investors in London. He is a speaker at the 'Global Investment Conference' with which the UK government wants to strengthen the country's international business relations one day before the official opening of the Olympic Games. At the same time, the financial markets are rife with concerns over an imminent break-up of the euro.

The ECB president kicks off his speech with an analogy between the euro and a bumblebee – an insect that, due to its physiognomy, shouldn't be able to fly but does anyway. Draghi then speaks at length about the strengths of the euro area which he believes are being overlooked during those days. In the second half of his speech, he finally utters the words that would bring about a turnaround of the crisis at the time:

'Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.'

Financial markets respond immediately

Even though the ECB, as the guardian of the euro, had previously declared that it could take measures at any time to contain the crisis, it is these very words that fall on fertile ground: In the days, weeks and months that follow, the spreads on government bond yields of the so-called peripheral countries drop to manageable levels after trending upwards for three years (Figure 1). The credit channel opens and states regain sovereignty over their finances. According to a study conducted by KfW Research, in the years that follow the euro heavyweights Germany, France, Italy and Spain together pay more than EUR 200 billion less in funding costs than they would have if bond yields had remained on the increased level.[1]

Figure 1: Spain's and Italy's spreads decrease at last

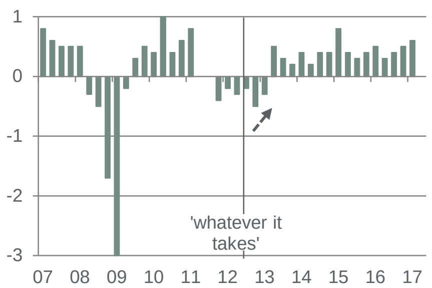
Yield spreads on 10-year Spanish and Italian government bonds in relation to German government bonds (in basis points)

Sources: Bloomberg, KfW Research

In addition, stock markets steadily trend upwards. Business confidence stabilises at first and then improves significantly. Finally – with a time lag of a good half year – euro area GDP returns to growth (Figure 2). A new upturn has taken root.

Figure 2: The end of recession

Rate of change of seasonally adjusted real euro area GDP on previous quarter (in per cent)



Sources: Eurostat, KfW Research

Sustained easing opens new scope for action

In this significantly less strained environment the euro states gain time and financial scope to initiate and implement necessary reforms. Spain is particularly successful, as it restructures its national budget, stabilises its financial sector and makes its labour market more flexible in order to recover competitiveness.

The euro is safe – and it can get even better!

In short, it was only a handful of words that saved the euro and the euro area exactly five years ago. Today, 'whatever it takes' are winged words that stand for courage and determination. They attest to a particular sensitivity to the psychology of international investors. And they also signify a strong commitment to Europe. What is fascinating is that the ECB at first did not have to make any (financial market) interventions to bring about the desired changes. Their announcement alone was sufficient.

We are reaping the fruits of the speech of 26 July 2012 to this day. We are reaping them in the form of strong economic growth in the euro area, which has brought record employment and national budget surpluses in Germany, among other things. We have also learned that the ECB can be relied upon to look after the euro, the euro area and the European project as a whole.

The Brexit vote just over a year ago was a warning shot for the European idea. But recently, especially since the election in France, the chances have grown that governments will again push ahead with shaping the euro area and Europe – with words and with deeds. May the single currency's bumblebee flight continue for a long time to come! ■

[1] Cf. Ehmer, P., 'Monetary policy has reduced fiscal pressure in the euro area – but interest rate turnaround is coming', KfW Research, Focus on Economics No. 176 of 26 July 2017.

Note: This paper contains the opinion of the authors and does not necessarily represent the position of KfW.