Juncker-Tremonti doc on E-bonds, dec 2010

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Article d'actualité

"Issuing E-bonds: a way to overcome the current crisis": tribune de Jean-Claude Juncker et Giulio Tremonti publiée dans le Financial Times

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Despite recent far-reaching decisions by the European fiscal and monetary authorities, sovereign debt markets continue to experience considerable stress. We believe that Europe must formulate a strong and systemic response to the crisis in the very short run, sending a clear message to the global markets and European citizens of the political commitment to economic and monetary union and the irreversibility of the euro.
We are convinced that this can be achieved by launching E-bonds, European sovereign bonds issued by a European Debt Agency (EDA), the successor organisation of the EFSF.

Time is of the essence. At the forthcoming meetings, we will invite our colleagues at the Eurogroup and Ecofin to support this initiative. The European Council could already decide in December to institute the EDA, with a mandate to issue E-bonds, gradually reaching a total of 40% of GDP the EU and of each Member state.

Two steps would be taken in parallel, which could make the E-bond market the most important in Europe and progressively reaching liquidity comparable to that of US Treasuries.

First, the EDA should finance up to 50% of gross issuances by EU Member states, allowing the E-bond market to reach sufficient depth and liquidity. In exceptional circumstances, Member states whose market access is impaired may finance up to 100% of their gross issuances in this way, thereby insulating them from the evolution of secondary markets. The expected net issuance of E-bonds will be defined according to the consolidation plans, setting a hard ceiling to fiscal deficits.

Second, with the remaining amount to reach 40% of GDP, the EDA should offer, as soon as possible, a switch between E-bonds and outstanding national bonds. The nominal conversion rate will be at par, but the switch will be made through a discount option where the discount is likely to be higher, the more a bond is experiencing “market stress? Knowing in advance the evolution of such spreads, Member States will have a strong incentive to reduce their deficits significantly, in line with the exit strategy decided at EU level.

The issuance of E-bonds will bring six crucial benefits to Europe:

First, it will halt disruption of the sovereign bond markets, preventing negative spillovers across national markets. In the absence of well-functioning secondary markets, investors are weary of being forced to hold their bonds to maturity and ask for increasing prices when underwriting primary issuances. So far, the EU has addressed this problem in an ad hoc fashion , by issuing bonds on behalf of Member states only when their market access has been seriously disrupted, while the ECB is trying to stabilise the secondary market with small purchases, but significant enough in view of the risk of undermining its own mandate to fight inflation.

Second, it will ensure that private bondholders bear the risk and ultimate responsibility for their investment decisions, in line with market principles, as agreed by the Eurogroup on 28 November. Providing clarity about the permanent mechanism will help restore confidence, allow markets to expose losses, and ensure proper market discipline in the future. This can be achieved by allowing investors to voluntarily switch national bonds with the E-bonds offered by the EDA, which may also enjoy a higher status as collateral for the ECB. It is likely that the bonds of Member states with weaker public finance fundamentals will be converted at a discount, implying that banks and other private bondholders immediately incur the related losses, thus ensuring transparency about their solvency and capital adequacy.

Third, it will provide assistance to Member states in difficulty without leading to moral hazard. Governments will be granted access to sufficient resources at the interest rate enjoyed by the EDA, giving them time to consolidate their public finances without being exposed to the risk of speculative attacks in the short term. However, this will also oblige them to honour their obligations in full. Benefiting from cheaper and secure funding, however, does not imply that the incentives for reforms are reduced as E-bonds will be embedded in a strict policy framework and Member states want to avoid excessively high interest on their borrowing requirements not covered via E-bonds.

Fourth, it will ensure that ultimately, it is the EU that benefits from this operation. The profits from the conversion of existing bonds would accrue to the EDA, thereby reducing effective interest rates on the E-bond. The latter could then exhibit interest rates comparable to the current best performers. EU taxpayers and Member States currently under attack will not have to foot the bill of the current crisis.

Fifth, it will create a liquid global market for European bonds. In itself, this will not only insulate sovereigns from speculation, but it can also help to keep existing capital and attract new flows into Europe and foster the integration of financial markets in Europe, favouring investment and thus contributing to long term economic growth. These wider economic benefits will ensure that the move to E-bonds will effectively end up as a positive-sum game for all Member States.

Sixth, it will strengthen Europe as a whole, as all its benefits can be extended to all EU Member States that are willing to join. Countries outside the euro should assume the exchange rate risk of receiving financing in euro. But since most of them have a significant part of their debt already denominated in euro, this should not be a barrier to join the E-bond initiative.

We firmly believe that our E-bond proposal provides a strong, credible and timely response to the ongoing sovereign debt crisis that could be implemented within the Treaty framework. It will endow the European Union with a robust and comprehensive framework that does not only address the issue of crisis resolution but also contributes to the prevention of future crises by fostering fiscal discipline, supporting economic growth, thus deepening European integration.

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E-bonds would end the crisis

By Jean-Claude Juncker and Giulio Tremonti
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In spite of recent decisions by European fiscal and monetary authorities, sovereign debt markets continue to experience considerable stress. Europe must formulate a strong and systemic response to the crisis, to send a clear message to global markets and European citizens of our political commitment to economic and monetary union, and the irreversibility of the euro.

This can be achieved by launching E-bonds, or European sovereign bonds, issued by a European Debt Agency (EDA) as successor to the current European Financial Stability Facility. Time is of the essence. The European Council could move as early as this month to create such an agency, with a mandate gradually to reach an amount of outstanding paper equivalent to 40 per cent of the gross domestic product of the European Union and of each member state.

That would bring sufficient size for it to become the most important bond market in Europe, progressively reaching a liquidity comparable to that of US Treasuries. But to ensure this happens, two further steps must be taken. First, the EDA should finance up to 50 per cent of issuances by EU members, to create a deep and liquid market. In exceptional circumstances, for member states whose access to debt markets is impaired, up to 100 per cent could be financed in this way. Second,the EDA should offer a switch between E-bonds and existing national bonds.

The conversion rate would be at par but the switch would be made through a discount option, where the discount is likely to be higher the more a bond is undergoing market stress. Knowing in advance the evolution of such spreads, member states would have a strong incentive to reduce their deficits. E-bonds would halt the disruption of sovereign bond markets and stop negative spillovers across national markets.

In the absence of well-functioning secondary markets, investors are weary of being forced to hold their bonds to maturity, and therefore ask for increasing prices when underwriting primary issuances. So far the EU has addressed this problem in an ad hoc fashion, issuing bonds on behalf of member states only when theiraccess has been seriously disrupted. This week the European Central Bank took further steps to stabilise the secondary market. With a single European market, primary market disruptions are in effect precluded, reducing the necessity for emergency interventions in the secondary market.

A new market would also ensure that private bondholders bore the risk and responsibility for their investment decisions. In this way, the E-bond proposal usefully complements recent decisions aimed at providing clarity about a permanent mechanism to deal with debt restructuring. It would help to restore confidence, allowing markets to expose losses and ensuringmarket discipline. Allowing investors to switch national bonds to E-bonds, which might enjoy a higher status as collateral for the ECB, would help to achieve this. Bonds of member states with weaker public finances could be converted at a discount, implying that banks and other private bondholders immediately incurred the related losses, thus ensuring transparency about their solvency and capital adequacy.

An E-bond market would also assist member states in difficulty, without leading to moral hazard. Governments would be granted access to sufficient resources, at the EDA's interest rate, to consolidate public finances without being exposed to short-term speculative attacks. This would require them to honour obligations in full, while they would still want to avoid excessive interest rates on borrowing that is not covered via E-bonds. The benefits from cheaper, more secure funding should be considerable.

A liquid global market for European bonds would follow. This would not only insulate countries from speculation but would also help to keep existing capital and attract new flows into Europe. It should also foster the integration of European financial markets, favouring investment and thus contributing to growth.

Ultimately the EU would benefit too. Profits from conversions would accrue to the EDA, reducing effective E-bond interest rates. As a result EU taxpayers, and those member states currently under attack, would not have to foot the bill. All these benefits could be extended to member states that remain outside the eurozone.

We believe this proposal provides a strong, credible and timely response to the ongoing sovereign debt crisis. It would endow the EU with a robust and comprehensive framework that not only addressed the issue of crisis resolution but also contributed to the prevention of future crises by fostering fiscal discipline, supporting economic growth and deepening European integration.

The writers are prime minister and treasury minister of Luxembourg and Italy's minister of economy and finance