What has the "Juncker Plan" achieved?

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- The European Council will soon decide whether or not to boost the scale of the "Juncker Plan" – a plan to boost investment in the EU.
- We evaluate what the "Juncker Plan" has achieved since its inception in November 2014. We find that it has already delivered some results in terms of facilitating and mobilizing investment across Europe. The countries that have taken most advantage of it tend to be those undergoing austerity and/or suffering from less abundant banking credit (for riskier SME lending).
- Given chronic underinvestment in Europe (both public and private) over many years, the EU should approve the boost in financing for the "Juncker Plan", and it should discuss ways it can commit more than the additional few billion euros it has proposed so far.

1. The European Fund for Strategic Investment 2.0

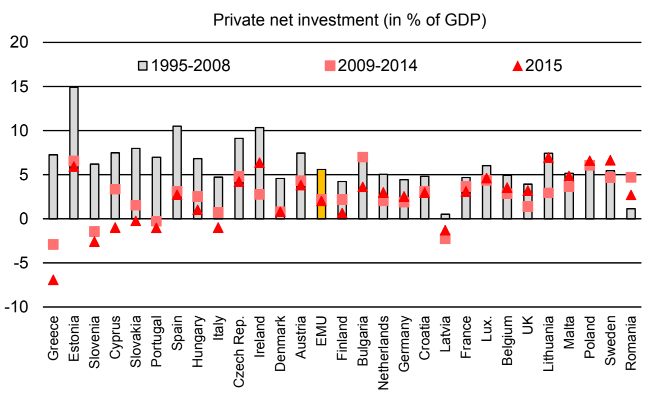
During his mid-September speech on the state of the union in 2016[1], European Commission (EC) president Jean-Claude Juncker put forward a proposal regarding the future of the European Fund for Strategic Investment (EFSI) which is the key financial component of the "Juncker Plan" (formally known as the Investment Plan for Europe [IPE]). On the same day, the EC presented an amendment to EU regulation that mainly aims to double the duration and the financial capacity of the EFSI. The so-called EFSI 2.0 is thus projected to mobilize at least EUR 500bn (about 3.5% of EU GDP) of additional strategic investments throughout Europe by 2020, from the EUR 315bn (2.2% of GDP) initially targeted by mid-2018.

The European Council and the European Parliament have now been called on to urgently examine and vote on the EC's amendment. When the "Juncker Plan" was first announced in November 2014, the European Parliament and the European Council were able to quickly adopt the EFSI-enabling legislation in July 2015. This is expected to occur at a similar pace again this time. After waiting for an independent evaluation of the EFSI's achievements to be carried out in November, the European Council appears to be aiming to reach an agreement on the negotiating position of the European Council at the meeting of the Economic and Financial Affairs Council on 6 December. Slovakia, which currently holds the rotating presidency of the European Council, endorses this objective. After that, debate concerning the proposed amendment within the European Parliament will likely begin.

[1] http://europa.eu/rapid/press-release_SPEECH-16-3043_en.htm; http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016DC0581

The logic of the revised "Juncker Plan", if approved, will most likely remain the same: to utilize EU public funds as a first loss-guarantee to crowd in private and public investment, with the ultimate aim being to boost growth and employment in Europe. The current economic recovery has so far not provided any material improvement to the significant investment shortfalls that emerged in most European countries in the wake of the global financial crisis. In Europe, private net investment has dropped to 2.4% of GDP, on average, since 2009. This is about 3.0pp less than its level during the previous fifteen years. Seventeen out of 28 EU countries still suffer from having investment shortfalls, relative to the pre-crisis period, of above 2.0pp of GDP (see chart 1)[2]. Some of these shortfalls (first and foremost, that of Greece) have hit record highs. The picture is no different regarding net investment in the public sector[3], the decline of which has been mainly fuelled by the sovereign debt crisis in 2011 and the austerity adopted thereafter.

CHART 1: EUROPEAN PRIVATE INVESTMENT SHORTFALL



Source: EC, AMECO database, UniCredit Research

Therefore, Europe's need to adopt a plan to significantly boost investment remains – indeed, it is even stronger now that support from foreign demand will probably be limited. In this note, we build on evidence from the first nineteen months of the EFSI's existence to take stock of the progress the plan has made so far. We also discuss some of the pending issues and examine the EC's proposal for the EFSI's extension.

[2] Data in chart 1 have been sorted for the size of the investment shortfall existing between the 2015 level of private net investment/GDP and its average before the global financial crisis.

[3] At the European level, the public net investment declined to about 0.3% of GDP, on average, in the period 2011-2015, from 0.7%, on average, in the period between 1995-2010.

2. What is the EFSI (the financial pillar of the "Juncker Plan")?

The EFSI is the financial pillar of the "Juncker Plan" and its principal aim is to unlock additional investment. The EFSI is implemented by the European Investment Bank (EIB) and by the European Investment Fund (EIF) – together these are referred to as the EIB group. The EFSI mainly consists of a EUR 16bn guarantee provided to the EIB group by the EU[4]. This guarantee is complemented by EUR 5bn of capital from the EIB itself. The EFSI has two objectives (known as windows): it seeks to support infrastructure and innovation projects (via its Infrastructure & Innovation Window [IIW]) and to increase access to finance for SMEs and mid-cap firms (via its SME Window [SMEW]). In the end, the plan is to mobilize at least EUR 315bn of investment by July 2018. How does the EFSI achieve this? The EU guarantee and the EIB's contribution are intended to enable the EFSI to generate slightly more than EUR 60bn of indicative additional financing provided by the EIB group (an internal multiplier of approximately 3x). This, in turn, is expected to trigger expected investment that is worth five times the EIB group's contribution (an external multiplier of approximately 5x) by mainly attracting private sources of financing to the projects.

3. The financial pillar of the plan is going well

Since the plan's start in March 2015, 361 transactions have been approved to receive total EFSI financing of EUR 24.8bn[5]. The bulk of EFSI financing (70%) has been approved for the EFSI-IIW and deployed by the EIB directly, while the rest has been earmarked for the financing of SMEs and mid-cap firms via the EIF, as part of the SMEW. According to EC estimates, EFSI financing so far is expected to trigger about EUR 138bn of total investment (44% of the target) twenty months ahead of the deadline (i.e. mid-2018). Table 1 contains a summary of the available information. Unfortunately there is little information on actual disbursements. According to the EIB, at the end of 2015, its disbursed exposure amounted to about EUR 1bn (slightly above 15% of the total EFSI IIW financing at end-2015 and about 35% of the signed EFSI IIW financing), suggesting that the plan is probably lagging behind in this area.[6]

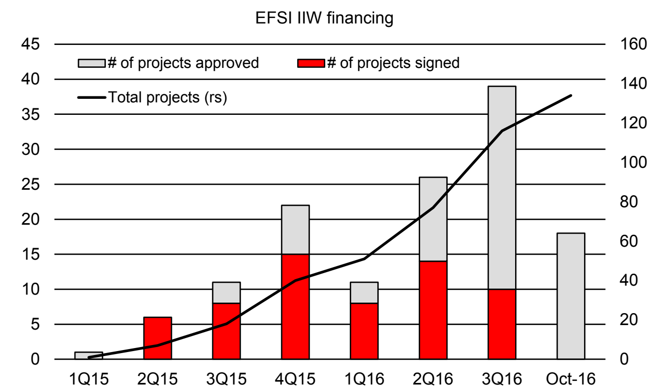
TABLE 1: EFSI 1.0 IN A NUTSHELL

	Total		IIW		SMEW	
EU & EIB contribution	21		16		5	
Additional EFSI financing	61		49		12	
Investment to be mobilized	315		240		75	
	Total		**IIW**		**SMEW**	
As of 12 October 2016	Total	of which Signed	Total	of which Signed	Total	of which Signed
Number of projects	361	271	134	61	227	210
Amount of financing	24.8	13.8	17.4	6.9	7.5	6.9
In % of target	*41*	*23*	*35*	*14*	*62*	*58*
Total investment	138.3	-	78.3	-	60	-
In % of target	*44*	-	*33*	-	*80*	-

Source: EIB, EIF, EC, UniCredit Research

Some details about the projects funded by the EFSI IIW can be found on the EIB's website. Although this information is still incomplete[7], it sheds sufficient light on the EFSI IIW for one to gain an understanding of the program. First of all, the number of projects approved or signed has progressively increased. Therefore, it is reasonable to assume that this number will grow even more in 2017.

CHART 2: AN EXAMPLE OF THE EVOLUTION OF THE PLAN



Source: EIB, UniCredit Research

Second, by country, and excluding multi-country operations, project distribution involves 21 countries (out of 28). Many small EU countries – for instance, Slovenia, Cyprus and Hungary – still lack the ability to propose projects despite the fact that they still suffer from high investment shortfalls. As chart 3 shows, single-country infrastructure and innovation projects from Italy, France and Spain have so far been approved in larger numbers. Nevertheless, the UK has utilized a substantial amount of resources made available through the EFSI, even after accounting for the fact that the EFSI financing distribution also reflects the economic weights of countries within the EU.

[4] A guarantee fund has been created with existing resources from the EU budget. The endowment of the fund, which is worth EUR 8bn, should be completely funded with EU funds by 2020 and will make up 50% of the EC's total guarantee. The other EUR 8bn remains unfunded at this stage, mainly because the initial endowment is expected to itself act as an EU guarantee, and additional funding is expected to be derived from the ROI of the projects. Also, the EC assumes that not all investments will fail (at the same time).This, in turn, implies a reserve fund rate of 50% for this guarantee fund.

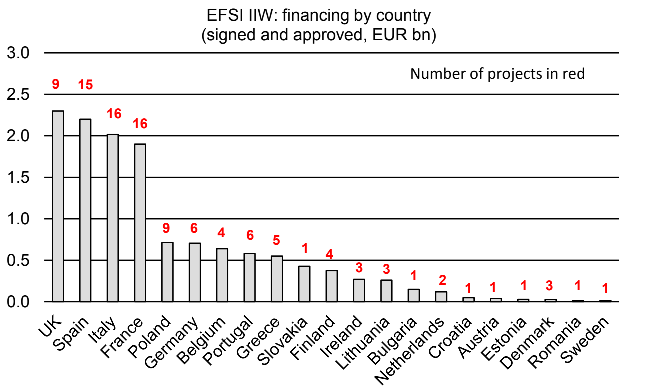
[5] Information is available on **1.** projects approved by the EIB group, and **2.** projects that have already been signed, i.e. contractual terms have been agreed with partners.

[6] Although it needs to be taken into account that there could be a time lag between the finance contracts being signed and the amount being paid to the counterparties.

[7] The list of approved EFSI IIW operations is available at http://www.bei.org/efsi/efsi-projects/index.htm. In some cases (18 out of 134), the amount of EFSI financing and/or total expected investment (in 48 cases out of 134) for a given project is not provided with the description. According to the EIB, this is mainly due to sensitivities and confidentiality agreements. Where possible, we integrated the EIB's information with country factsheets (current as of Aug 2016) provided by the EC.

Italy, which ranks among the top both in terms of the number of its projects that have been approved for EFSI eligibility and in the amount of financing won, has received EFSI support to principally finance private investment (ranging from the rolling out of high-speed broadband services to the purchase of new transport equipment) and, to a lesser extent, public investment (mainly in utilities).

CHART 3: GEOGRAPHICAL DISTRIBUTION SKEWED TOWARDS WESTERN EUROPE'S LARGEST COUNTRIES



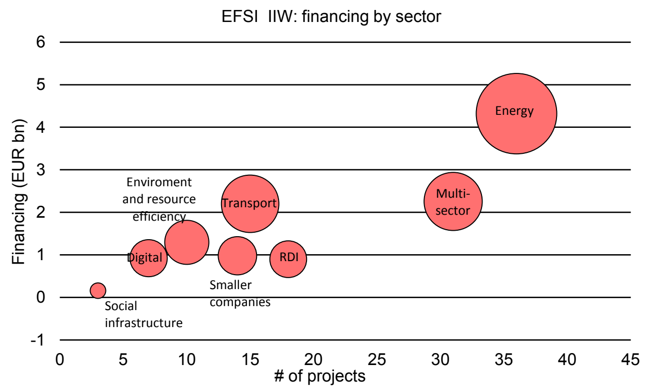
Source: EIB, EC, UniCredit Research

Third, although EFSI support for projects is, in theory, driven by demand, the geographical distribution of the projects tends to skew towards western Europe's largest countries. This comes as less of a surprise if one takes into account that the ability of western Europe's large countries to leverage experience and familiarity in dealing with the EIB has probably tipped the scales in their favor[8]. Indeed, a look at the EIB's financial report from 2014 – one year before the launch of the "Juncker Plan" – and especially at the EIB signed operations by country, shows that four EU member states (Spain, Italy, France and UK) accounted for 50% of the EIB's total project financing. These were followed by Germany, Poland and Belgium. It appears that the EFSI, with its first loss guarantee, has further increased the chances that projects (probably already in the pipeline) with higher risk profiles, than the usual EIB activity, get support from the EIB and attract more investment. In contrast, Germany's EFSI-eligible projects seem to suggest either that it has less compelling needs, as a result of its safer strategic projects and/ or firms, or that it really has no more projects that are at the stage where they are ready to be realized. However, Germany, together with France and the UK, has so far been inclined to submit a larger number of applications for cross-border strategic infrastructure projects (10 out of the 26 multi-country projects under the EFSI IIW).

[8] In addition, the EIB received a mandate to building up the portfolio in the ramp-up phase of the plan, while organizing itself for increasing the offer of new products allowing for higher risk taking (equity-type financing compared to investment loans) that better comply with the needs of the IPE.

By sector, the bulk of the infrastructure and innovation projects funded by the EFSI are concentrated within the energy sector (36 projects out of 134, more than EUR 4.0bn of EFSI financing approved and signed, see chart 4). This is followed by projects focused on the fields of transport and Research Development & Innovation (RDI) and by support that goes to smaller companies, which makes up about one third of the total number of operations approved for EFSI IIW funding. The EIB data also show that, among energy sector projects, 20% of them are arranged in the UK (40% of the EFSI financing for the sector); one of the most prominent projects financed is the Smart Meter Rollout program. At the same time, the data shed light on the large scope of cross-sector infrastructure and innovation projects eligible (31 projects out of 134, about 23%). Of these, 70% of those that applied for EFSI funding originated in a single country, while the rest are multi-country/multi-sector projects.

CHART 4: THE ENERGY SECTOR MAKES A FULL HOUSE



Source: EIB, UniCredit Research

EFSI support designed to increase access to finance for SMEs – via financing agreements the EIF conducts with financial intermediaries – consists of 227 operations so far. Almost 300,000 SMEs in 27 EU members states are expected to benefit from EFSI financing (with only SMEs from Cyprus being excluded). Thus, the EFSI's SMEW appears to have achieved a broader reach than the IIW.

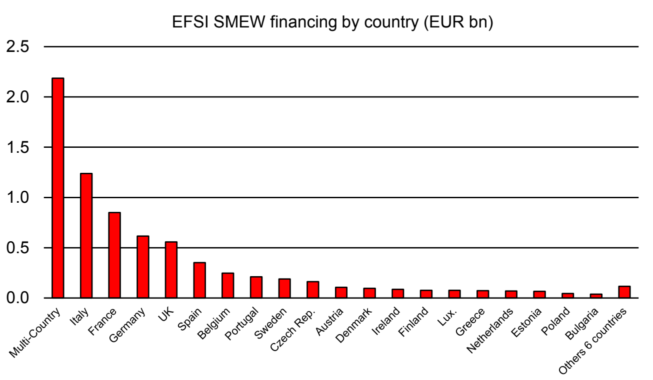
Chart 5 shows that, in terms of the SMEW, Italy, France and Germany's SMEs receive the greatest share of EFSI financing[9], followed by SMEs from the UK and Spain. Italy's SMEs are noteworthy here as they have had 39 transactions approved (more than double the amount of transactions approved for Germany or France), representing around 15% of total EFSI financing.

[9] The EIF agreed to use the SMEW to accelerate the implementation of its existing EC or EIB mandates (mainly COSME and InnovFin mandates), which are deemed appropriate to be used for EFSI purposes. COSME and InnovFin, in particular, are two EU programs introduced in 2014. COSME offers both a guarantee to financial institutions providing financing to SMEs and risk capital to equity funds investing in SMEs. InnovFin offers guarantees and loans to support research and innovation projects. It is not therefore surprising that the SMEW sector distribution sees projects supporting smaller business and RDI as the most prominent sectors (covering about 80% of total SMEW financing).

More than twenty financial intermediaries (mainly cooperative and mutual banks) have been involved so far in providing financing to Italian SMEs.

Much like the EIB's role in the IIW, in the SMEW the EIF uses the EUR 5bn from the EC and EIB contribution to further absorb risk related to financing SMEs, easing how much they can weigh on the balance sheets of banks with probably limited space to increase more risky exposure.

CHART 5: THE SMEW'S BROADER GOVERAGE



Source: EIF, UniCredit Research

4. What can we learn further about EFSI's achievements?

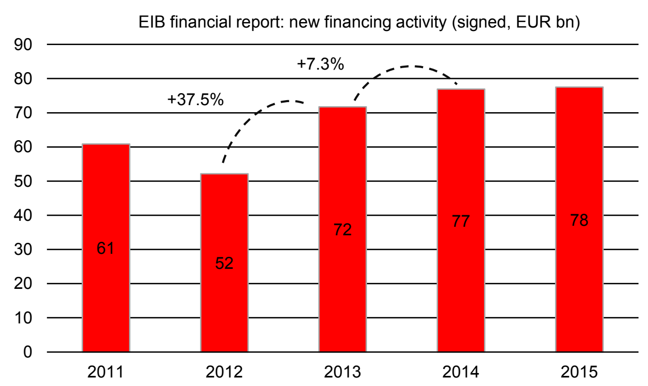
The evidence gleaned from the operations of the EIB and EIF suggests that the EFSI is running broadly as planned – albeit with some adjustments to the EFSI mechanism necessary to really boost investment in Europe. In particular, better geographical (and sectoral) distribution of projects supported by the EFSI should be sought, perhaps in accordance with a greater effort to involve CEE countries. Moreover, progress is needed in increasing the relevance of multi-country projects, where supranational investment makes particular sense.

A number of national governments in Europe are currently debt constrained and need to undergo fiscal consolidation, while the new regulatory environment forces banks to continually improve the quality of their balance sheets. The plan is a form of risk-pooling (across the EU) that any EU state can access, while allowing more frontloaded use of multi-year budget resources. Encouragingly, positive effects can be expected; especially for Western European countries, which might be able to turn out potential investment worth 0.5-1.0% of their GDP utilizing only the ESFI financing approved so far. This helps ease concerns that the "Juncker Plan" is not able to make much of a difference to investment, somewhat easing the potential drag on economic growth going forward.

Still, many concerns accompanied the launch of the EFSI and, although the information is highly fragmented, partly outdated and not readily available, it is worth discussing some of these issues.

i. What has been (and is expected to be) the involvement of the EIB, through which the EFSI principally flows? The EIB's latest financial report shows that the expansion in EIB activity, in terms of flow of new financing, was very limited indeed in 2015. Total incremental approved financing rose by 5.0% yoy in 2015, of which less than 1.0% went to newly signed operations. Still, as chart 6 shows, this cannot be interpreted as a lack of proficiency on the part of the EIB in the first year of the EFSI's implementation. In fact, 2015 was the last of the three years in which the EIB had already committed to sizably increasing its activity, following the EUR 10bn capital increase approved by EU member states in 2012. The newly reached high volume of signed financing for the EIB is now expected to be maintained over roughly three years, starting in 2016 – in contrast to the previously targeted decrease of EIB activity to business volumes similar to pre-capital-injection levels (around EUR 50bn per year). These targets should also help mitigate the risk that traditional EIB financing will be crowded out.

CHART 6: EIB FINANCING ACTIVITY



Source: EIB, UniCredit Research

ii. Additionality. EIB projects receive the EU guarantee contribution if they satisfy an additionality criteria[10]. Due to the lack of detailed, project-specific information, it is hard to assess the EFSI selection process and thus whether EFSI investments are truly additional. A general concern therefore remains as to whether projects approved so far really help address suboptimal investment situations and whether these would have also been carried out in the absence of the EFSI by private sector financing or national governments.

[10] According to EFSI regulation, projects have to indicate **1.** suboptimal investment situations and **2.** would, in principle, not have been financed in the same period by the EIB without EFSI support – or not to the same extent. The EFSI Investment Committee is responsible for approving individual operations for inclusion in the EFSI portfolio.

Attention seems to principally be focused on the EFSI's contribution towards absorbing part of the risk involved in triggering additional investment. Projects appear to be selected by the EFSI if they carry a degree of risk that corresponds to that associated with the EIB's special activities, i.e. activities for which the EIB's internal rating is below investment grade. According to the EC[11], the annual volume of new EIB special activities is expected to rise from about EUR 4bn at the end of 2015 to at least EUR 20bn. Given that the overall volume of the EIB's new lending is likely to remain near its 2015 level, special activities might reach about one-fourth of the EIB's total new lending volume to entities within the EU. Thus, the relevance of these special activities to the EIB's total loan portfolio is set to increase, from representing just 5% in recent years. This could be a welcome change in that it could allow EIB to move away from its risk-averse culture and thus help boost investment in the EU. Obviously, close monitoring that this really happens will be needed. In addition, it will be important to verify that project selection will boost EIB activity towards not only high-risk projects but also towards those that promise to deliver high financial returns.

Otherwise, there is a risk that the EFSI will be used to fund pure market failures (high-risk/low-return), which should instead be supported by the public sector.

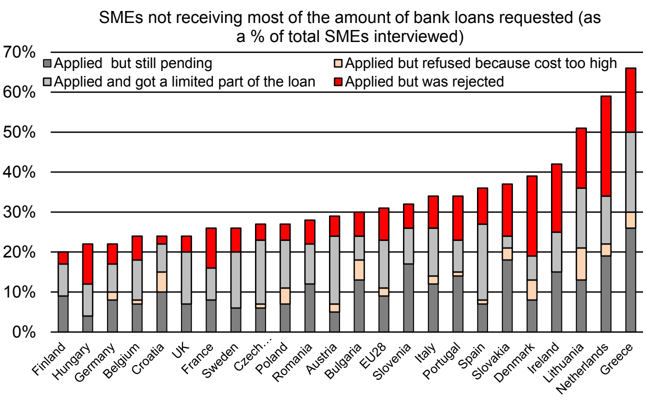
iii. The EFSI's multiplier. The EUR 315bn targeted size of the "Juncker Plan" consists of combined contributions to the EFSI from the EU and the EIB of EUR 21bn, to which the target multiplier effect of 15x is applied. We acknowledge that the EFSI's multiplier effect can only be calculated at the end of the investment period. In fact, the goal of the EFSI should be to finance any eligible project, and the achievement of a weaker-than-expected multiplier effect for some projects cannot act as a constraint. Still, any additional information made available could be useful for an interim assessment outside the EU organizations.

Indeed, for the SMEW, the EIF reports both the EU's and the EIB's contribution and the EFSI financing, and it has been deduced from 227 operations funded by the SMEW that the anticipated multiplier effect is about 16x and therefore above the targeted multiplier effect of 15x. The anticipated external multiplier for these operations appears to be slightly above the 5x and has more than offset an internal multiplier of slightly below 3x. Regarding the EFSI's IIW, we only know that the external multiplier is now close to 5x, therefore broadly in line with expectation, while information regarding the EU's and EIB's contributions to the EFSI's IIW financing has so far not been made publicly available. As table 1 shows, in terms of project approval, financing for the EFSI's IIW passed the 35% mark in October 2016 (EUR 17.4bn in financing out of the targeted EUR 49bn). Therefore, this financing is proceeding somewhat slower than it is for the EFSI's SMEW (at 62%). Although this can be easily explained by the different features of the projects supported by the two programs, the EU's organizations might assess the factors behind this development to verify that this is in line with the EFSI's initial objectives. However, the final assessment of the EFSI multiplier will be made on the entire portfolio, with some compensation possible between the two windows. At the end of the three-year period, this will be the preferred criteria against which the "Juncker Plan"'s effectiveness at channeling Europe's abundant liquidity towards new investment will most probably be judged.

iv. Access to finance. Developments so far suggest that the EFSI's SMEW has been encouraging strong participation by financial intermediaries across the EU to provide finance to SMEs and to mid-cap companies. At the same time, we know that spreads that dramatically fragmented credit between large corporates and SMEs in EMU have vastly disappeared, and access to finance appears to be no longer the biggest constraint to investment for European firms. Thus, it begs the question as to whether the increase in SME financing, one of the main outcomes of the EFSI, is, in a sense, a waste of the EU guarantee.

An answer to this is difficult to ascertain. We note that European SMEs mainly rely on bank financing and they are still vulnerable. As chart 7 shows, while the overall picture has been improving over the last few years, current rejection rates for SMEs in some European countries remain significant.

CHART 7: ACCESS TO BANK FINANCING IS STILL AN ISSUE



Source: EC Survey on Access to Finance, UniCredit Research

In addition, some firms still receive less financing than they request. As a result, about a third of European SMEs do not get all of the financing they ask for from banks. Over time, this might continue to hamper investment in some European countries.

[11] See http://ec.europa.eu/priorities/sites/beta-political/files /1_en_act_part1_v11.pdf.

However, given the significant pressure on banks to deleverage while improving the quality of their balance sheets, it is without doubt that access to equity financing needs to be especially supported. Indeed, EU surveys on Access to Finance clearly signal that SMEs' needs for raising equity capital are increasing. Therefore, to be successful, the EFSI should also maintain a commitment on diversifying funding sources for European SMEs.

5. How to finance the "Juncker Plan" 2.0

As mentioned earlier, in mid-September the EC proposed a boost to the EFSI. This means that its duration and financial capacity will be increased, but also that, for instance, the coverage of the EFSI will probably be extended, the concept of additionality reinforced – with the transparency of the process for selecting projects improved – and the endowment of the SMEW increased.

The EC's proposal for the EFSI 2.0 deserves credit, at the very least because the investment shortfalls in Europe remains a compelling issue. Still, first indications about how EFSI 2.0 will be financed raise some concerns once again about its effectiveness going forward.

The EU's new proposal states that "*the EC increases the EU guarantee from EUR 16bn to EUR 26bn and the EIB increase its capital from EUR 5bn to EUR 7.5bn. This leads to an increase of the EFSI from EUR 21.0bn to EUR 33.5bn*". With the same leverage effect, this will lead to an increase in the total investment target from EUR 315bn to EUR 502bn. However, the EC stated that the EFSI's extension will not require an expansion of the EC's multiannual financial framework since very limited EU resources will be used (probably EUR 1.0bn – less than 15% of the initial allocated EU funds). With only few additional EU funds allocated, the new EU guarantees will be raised by EUR 10bn to EUR 26bn. This is not just a matter of math but also depends on the reserve fund rate that the EC will probably use in the future; it will not be more 50% but is likely to fall to 35%. The progressive increase in the size of the portfolio – and therefore the emergence of a diversification effect – helps explain the EC's adoption of a less-conservative assumption. However, there is no doubt that it makes the difference. If the EC had confirmed the current reserve fund rate (at 50%), the investment target could have been increased from EUR 315bn to about EUR 390bn, rather than the planned EUR 502bn.

With information on the total amount of the EU funds used so far fragmented, it is very difficult to come to any conclusion. Nevertheless, an increase in EU funds is key in our view for the EFSI, and particularly the EIB, to be able to further increase its business volume over the coming five years and thus to continue to maintain the positive momentum.

If the "Juncker Plan" is a key priority – and it has already delivered concrete results – the EU should decide to support its continuation and in doing so it should discuss ways it can commit more than the additional few billion euros it has proposed so far.

6. Concluding remarks

The evidence available so far on the ability of the EFSI to facilitate and mobilize investment is encouraging. It will take time to be implemented in full, and the support to growth from the potential reversal of the investment shortfall may only be felt over time, but there could be upside risk to the medium-term investment outlook.

Certainly, the EFSI alone will not be sufficient to turn the tables in Europe. The plan comprises several other aspects, such as: a new investment advisory hub, a new portal for encouraging project planning, cooperation with national promotional banks, the establishment of investment platforms, and the EU's commitment to improve the investment environment and adapt EU regulation to facilitate investment. Such commitment is likely to be the hardest goal to achieve, as it also involves individual EU member states being even more proactive on economic reforms. The EC will continue to provide guidance by updating its assessment on the challenges facing each EU country's investment environment in preparation for the 2017 European semester process.

In the next few months, however, the responsibility for planning the future of the EFSI lies mainly with the European Council and the European Parliament. Hopefully, these decisions will be based on assessments of the EFSI's effectiveness (pros and cons). Given chronic underinvestment in Europe (both public and private) over many years, the EU should approve the boost in financing for the "Juncker Plan", but it should discuss ways it can commit more than the additional few billion euros it has proposed so far.

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