

Rolf Strauch in interview with Kathimerini Money Review (Greece)

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13/04/2021

Interviews

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Interview with Rolf Strauch, ESM Chief Economist

Published by *Kathimerini Money Review (Greece)*

13 April 2021

Interviewer: Vassilis Kostoulas

Original language: English

Kathimerini Money Review: How do you assess the performance of Greece in managing the economic impact of the pandemic? To what extent have the lockdowns overturned the country's reform course and the growth dynamics of its economy?

Rolf Strauch: It is clear that Greece as other European economies has suffered immensely from the economic impact of the pandemic. Last year there was a strong decline in GDP of 8.2%, the strongest decline since the euro area debt crisis. That was driven by the economic measures necessary to preserve the health of people and contain the pandemic. The government has acted very strongly to curb the economic impact of the pandemic and they have done so rightly, to help firms and households. In parallel, the government has broadly pursued the reform agenda that was agreed with the European partners. From that perspective, the overall policy course is appropriate, as we see it. In the coming weeks, we will continue our talks with the government, on further actions - specifically in view of the next decision regarding the agreed debt relief measures, which will further add support to the Greek economy. That decision will have to be taken later in summer.

What does the pandemic crisis mean for Greece in the fiscal sector? How worrying is the impact of the urgent support measures on the Greek state funds?

Greece entered the pandemic with a very strong budget position and that obviously helped tremendously in allowing the government to react to the pandemic. It was a consequence of the fiscal measures taken in the past and the overall structural adjustment made to the economy. Clearly, the measures to fight the economic lockdown have a strong fiscal impact. Last year, the fiscal impact of discretionary measures amounted to 5.8% of GDP, plus automatic stabilizers that work through the economy and further increase the deficit. It is very important is that these discretionary measures are targeted and temporary, and that has indeed been the case. So from that perspective the crisis response has been appropriate. Obviously, the impact will reverse once the economy rebounds after the pandemic. At that time, the measures don't need to be maintained any longer and can be ended. So, I'm rather confident that, with the government's continued efforts, and also with the European support, the government can regain a strong fiscal position after the pandemic.

What risks do you see for the Greek debt in the medium term? Are favourable debt repayment conditions still balancing the vast debt stock? For how long?

I can clearly say that the sustainability of the Greek debt is not an immediate worry for us. The situation is very different compared to the past crisis. There are mainly

four factors contributing to that. The first one is the very strong budgetary position with which Greece entered the pandemic situation. The second is the very favourable debt structure that Greece has. In no small part due to the ESM loans. We hold 55% percent of total public debt and as you know, our loans have a very long maturity of 31 years on average- and very low current interest payments to be made. On top of that, there is the secular decline in the market interest rates that also alleviates the costs of servicing the debt. And finally, there is strong support from the European partners, notably from the ECB's purchase programme and the money that will be made available through the Next Generation EU programme.

Those factors together lead to a setting where Greek debt seems well manageable. We have argued for some time that one needs to change the perspective, not just focusing on the stock of debt but also looking at the debt flows. From that perspective, the Greek debt burden looks very reasonable. So, there is no immediate concern about Greek debt. Obviously, there are challenges in the longer term. It will be important that Greece returns to a strong budgetary position, with fiscal buffers that will allow the government to address future challenges such as aging and climate change. When this happens, and if the appropriate focus is put on enhancing growth, then debt challenges can be met in the long term.

When the ECB withdraws the PEPP, Greece will again face the fact that its bonds are not eligible for QE. Do you think that at that point in time Greece may need a credit line from the ESM, which in turn will enable it to join the QE?

Greece entered the pandemic in a rather strong fiscal position and I expect that Greece can return to that position. This supports market confidence and debt sustainability. This position is matched by the government's strong commitment to a growth plan. On top, Greece has a favourable debt structure and big liquidity buffers, also supporting market confidence. From this perspective, I would not predict that Greece would need a credit line when the ECB's purchase programme expires. The ECB has made clear that it will be very cautiously assessing financing conditions in view of the overall economic situation when phasing out its programme.

Irrespective of monetary policy, of course, there is a pandemic support credit line from the ESM available until the end of 2022. So, if the Greek government would find it helpful, we could finance 2% percent of GDP through that credit line. But this has

nothing directly to do with a change in monetary policy.

The pandemic brings a new generation of NPLs. Is the Hercules program enough? Or will we need solutions like a bad bank?

Clearly, as you suggest, the economic fallout of the pandemic on the corporate sector will be visible and one can expect an increase in the ratio of NPLs. At this stage, it is very hard to estimate the magnitude of that impact and give a clear prediction of the extent to which NPLs may increase. We see that the banks are proactively taking measures to mitigate the emergence of NPLs in their loan books and that is helpful. The success of the Hercules project has prompted the government to request its extension, which the European Commission has just approved. This will, in addition, help to reduce NPLs, complementing the banks' efforts. We welcome any systemic initiative and proposal that will reduce NPLs further. Of course, it needs to be feasible and viable from a regulatory and fiscal perspective. We find the progress made in the new solvency framework, which will become effective in June, very positive. It is, in our view, an efficient means to address NPLs in the future. The government now needs to focus on its implementation.

What does the European Recovery Fund mean for Greece? What kind of interventions and in what sectors do you think Greece needs in order to give added value to this money?

The Next Generation EU Funds and the recovery and resilience plan that comes with it is really a unique opportunity for the post-pandemic recovery of Greece. We very much welcome the government's emphasis on investments, both on the public and the private side. There are several elements, as the government has emphasised, which really matter. Strengthening the business environment, alongside digitalisation as part of the investment initiatives; improving the justice system and the insolvency framework that I mentioned before playing an important role; enhancing the infrastructure, related to transport and connectivity, where Greece lags behind its peers; and strengthening labour market participation, particularly female participation in the labour market. These would be the reform areas that could improve the business environment and enhance overall growth potential of the Greek economy.

When do you see the pandemic ending and consequently when do you see tourism actually recovering?

That is evidently an important question not only for Greece but obviously also for other European economies. A clear policy priority must be to accelerate and manage the vaccination campaign as efficiently as possible vaccination, to ensure a safe and successful tourist season. The European objective of having 70% of adult population vaccinated by June would be extremely helpful in normalising our lives, including tourist activity. It is very hard to predict how successful we will be in getting there eventually, and when normality will be fully restored, given that health questions are arising with new virus mutants. But, making good progress on vaccination is key here.

What growth rates will Greece need in the coming years?

Given the sharp reduction in growth last year, we need strong growth in the years to come, and this is also what is projected. If you look at the latest IMF forecast, there is an expected rebound this year and even stronger growth is expected next year, reaching 5%. With the opening of the economy, the normalisation is expected to take on its own dynamic to some extent, and supporting this recovery, as strongly as possible, is essential. The key issue is to which extent Greece will be able to catch up with its past pre-pandemic growth trend. If Greece makes the best possible use of the Next Generation EU funds and the recovery and resilience plan, it will actually be possible to overcome the gap caused by the pandemic and to unleash a long term growth potential going even beyond the growth path from before the pandemic.

Which reform would you characterise as a game changer for Greece?

The Next Generation EU and the whole policy package that comes with it is the unique opportunity, the game changer. Combining reform measures - modernising public administration, strengthening the financial sector, boosting human capital through training - and effectively directing investment into the right areas, will play a major role reigniting the growth engines of the Greek economy. It will also allow Greece to be prepared in the long term for the challenges of climate change and the ageing of population.

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