Klaus Regling in interview with CNBC in Davos

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Interviews
ESM
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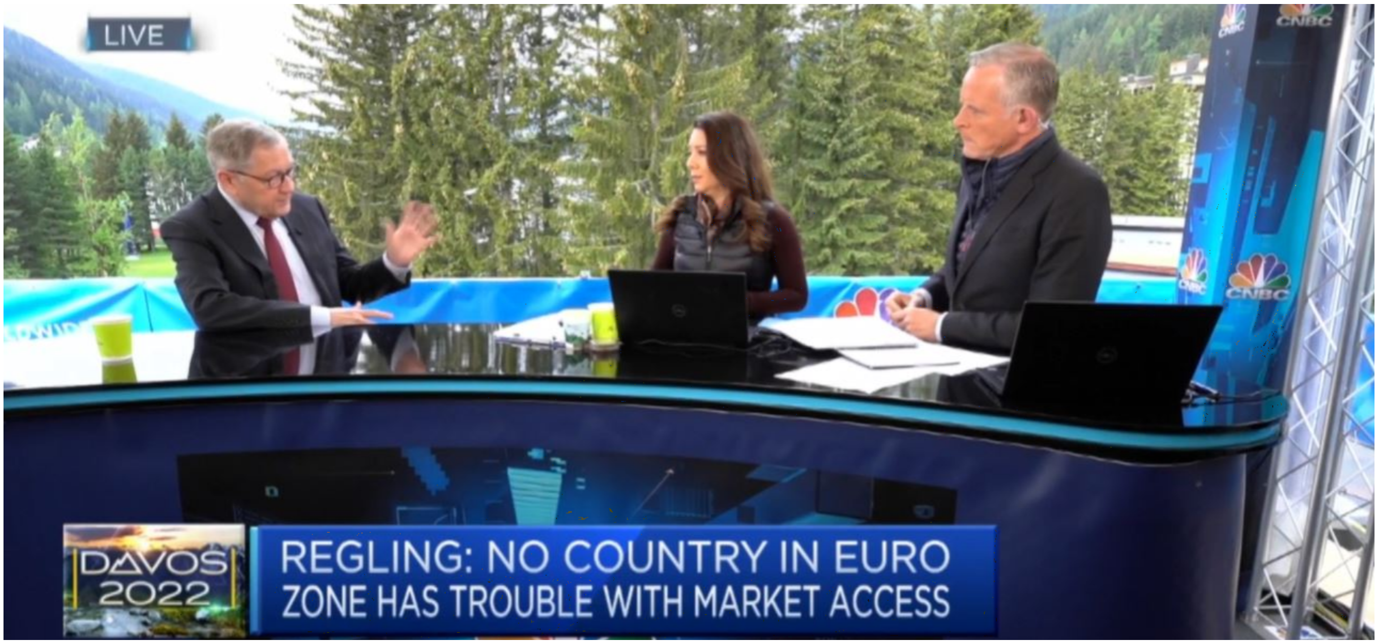

Transcript of interview with ESM Managing Director Klaus Regling
CNBC Squawkbox in Davos, Switzerland
26 May 2022
Interviewers: Steve Sedgwick and Karen Tso

CNBC: Klaus Regling, the Managing Director of the ESM joins us live. Someone we've had some great conversations with over, what, the last twelve years in your role? Are you gonna miss it? You're off in October.

Klaus Regling: That's right, my term expires. I've known that for ten years, so there is no surprise. But I think it's time for somebody else to take over. I built up the ESM. I think it's functioning well and a new leadership can be very useful.

Well, we'll find out hopefully in the next few weeks who that will be after a couple of rounds of voting maybe as well. It's (the ESM) an insurance policy. It's an insurance policy for Europe or Europe's capitals or the sovereigns as well. But I don't know if you saw a piece in the FT in April and it was a bit, I thought a bit tough in many ways. [The newspaper says] that the ESM has been struggling to find its purpose in recent years and it goes on to say, I am quoting, but it has more recently taken on a "slightly forlorn air." How do you respond? What it's basically saying is that funding has come for capitals, from elsewhere, without the historic stigma which borrowing from the ESM has as well. You dispute what FT is saying I'm sure.

I have read that many times. But I think what you said in the beginning, that is the right way to look at it. The ESM provides an insurance to our Member States and that is very important. And we had to disburse enormous amounts of loans earlier, to five countries. That saved the euro area and was very useful. Now that we are not lending, I would look at that positively because it means there is no country in the euro area at the moment that has problems accessing the markets, quite different from ten years ago. And that's positive. That's what we were working for.

I get that. But I would maybe take a slightly different interpretation. You've got hundreds of billions of euros available for funding for European countries as well. And the reason why that hasn't been tapped - I would be interested in your interpretation - is because there has been such largesse from central banks, such largesse from the Commission on common funding as well, that, actually, they found it too easy to borrow, in many cases. At very generous rates. They've had too many grants and loans which haven't, necessarily, led to fiscal discipline.

We have had special situations in last few years. We went first through the pandemic. Now we are suffering from the war in Ukraine. Of course, the people in Ukraine suffer most, but economic consequences of that are felt throughout the world. So that's why macroeconomic policies were different in the last few years, than during normal times. Monetary policy will normalise. That's very clear. The speed may be unknown, but the trend is very clear everywhere around the world. The Federal Reserve started, the Bank of England followed. The ECB will follow in the next few months. We heard that again here from Christine Lagarde. So we are coming out of a very special situation, and, of course, that also made it easier for our Member States to borrow. But again, we are a rescue fund. We are there for difficult situations when some Member States have problems accessing the markets. And ten years ago, there were five who had problems because they really had messed up their macroeconomic situation. There were serious imbalances that needed to be corrected. We don't have that situation now. There's no country in the euro area right now with macroeconomic imbalances like we saw in five countries ten years ago. And that's positive.

And that's why funds like the ESM, that is there for emergencies, is not needed right now. That's positive. The IMF globally has had very similar experiences. Sometimes they are in high demand, and then when times are quieter, they are not. And that's how it is for a rescue fund. We are not in the business of providing loans to Member States every year.

There's been a lot of criticism over the past decade about Europe kicking the can down the road. It's a phrase we used a lot. But if we consider now it's time to normalise policy, as you say, but we're not normalising fiscal discipline. There are moves to try and kick out the time frame again to 2024. Is that the wrong move? When all the ministers have been talking about monetary and fiscal policy moving in the right direction, should we also get back to normalising fiscal disciplines?

Yes, well, this kicking down the road phrase, I think it was a very popular expression a few years ago. During the last few crises, Europe has demonstrated that we are able to act quite quickly, and also markets are impressed by that. It's good. The reputation of the euro area today in the world - I was in Singapore last week on a roadshow - is so much better than a few years ago, and that has a lot to do with our crisis management. Our crisis management has become better. Maybe we needed some practice and we had more practice than we wanted the last few years.

On the fiscal side, we do see fiscal adjustments. The deficit this year will be much smaller than last year, and I think it would not be advisable to move much faster. We do have now clear recommendations from the European Commission that next year, basically the fiscal stance should be neutral. But that means given what happened in the last few years, where we needed a lot of fiscal action, that deficits in a number of countries will still be above the famous 3% of GDP, but the trend is very clearly downwards.

And we had a good fiscal situation when Covid-19 happened in 2019. No country had deficits above 3% of GDP. So that was a solid, good starting point. With the pandemic, with the economic consequences of the war in Ukraine, it was unavoidable to take fiscal action and run larger deficits but we are on the way back.

If we stay, down the line, around this interest rate hiking cycle now. Consider you've got nations across Europe like Italy, with a debt to GDP of 155%, Portugal with a debt to GDP of more than 130%, Spain more than 120%. Some nations are clearly more in debt than others. And you've seen already at this early stage that the market is assessing those which have higher debt levels. We know the dynamics in some of these countries, too, poverty rates are higher, and some populations are more pressured by the food and the energy crisis that is playing out. Do you have concerns about a number of member countries are not really surviving this rate hiking cycle as well as others?

No. Looking at the numbers, that is not the case, because what really hurts an economy and what makes it difficult for the management of a budget in the country is not the debt level but the actual interest paid on that debt. And when you look at Italy, for instance, they have higher debt today than a few years ago, unavoidable like most countries. But what they pay on that debt in terms of GDP, around 3.5% of GDP is the lowest number in Italian history, after World War II. It was three times more 20 years ago. On top of that, Italy, like many other countries, has used the last few years of low interest rates to lengthen the maturity of that debt. It's now between eight and nine years. So only after 8 or 9 years the full impact of any interest rate increase would show up as a burden on the budget. Right now, when a 10-year Italian sovereign bond matures, issued 10 years ago, and is refinanced by issuing a new ten year bond, Italy saves money because ten years ago they paid 4%. From now on, they pay 2.5% or 2.8%. So right now, Italy continues to be in the process of saving more money on their debt.

That's not a very, dare I say, an Austrian interpretation, and coming from a German as well.

I'm a European.

You're also a German. And there is a lot of concern from the likes of [Member of the Executive Board of the European Central Bank] Isabel Schnabel and others about higher debt levels and potentially more common issues as well. I listened in detail to everything you just said, and I appreciate where you're coming from, you mentioned the famous 3%, I'll mention the famous 60% as well. And Commissioner Gentiloni, as well, is now pretty much as soon as he can, as soon as the current crisis subsides, going to lobby for a significant change to the Growth and Stability Pact, which basically means that we accept that we're at 100% GDP rather than the 60% level, that was in Maastricht Treaty. But I don't think there has been a big adjustment in the fiscal setting. I appreciate what you're saying about the lengthening of term, but Italy hasn't made any meaningful decline in its debt this century. It is now at over 150% debt to GDP. The Greeks are over 180% debt to GDP. The Spanish are at 117% debt to GDP. These are terrifyingly high levels. If we are going to see sustained inflation going forward. I don't think we repaired the roof, as Mr. Osborne once said, while the sun was shining. In fact, if anything, we compounded debt upon debt, albeit with what you were saying about the maturity is lengthening.

Of course, it would be better if all countries had lower debt. But I was answering the question whether there is an imminent debt crisis and that I don't see at all for the reasons I mentioned. Every country is different, of course. Look at the numbers. It's not true to say that Italy never reduced its debt ratios. It happened in the 90s. It happened last year. The debt ratio came down by 4.5% of GDP. And I talked to the Italian finance minister here yesterday and he said the aim is to do exactly the same again this year, to reduce the debt to GDP by 4.5%. Greece, for example, which has an even higher debt ratio than Italy, is not an immediate concern because more than half of the debt is held by my institution, financed at AAA interest rates, because we pass on our own funding costs. And then we have also protected Greece by using derivatives and other operations to freeze interest rates. So for a large chunk of Greek debt, any increase in the markets now will not affect them at all, because we protected them.

So, and I am only talking about the next few years, I would not worry. It does not mean that one should not be very careful, because we know there will be another crisis one day. Every country should prepare for that and have fiscal space to use it.

On that point of crisis, at some point, can I just ask you very quickly, what is the chance of a recession in Europe? Is it 50/50 still?

It depends how you define a recession. We know this year we benefit in our growth rate a lot from the strong momentum we had moving out of the pandemic. The carryover from last year is almost two percentage points. So even if within the year 2022 there's no growth, quarter by quarter, we would still have an average growth rate of 2%.

So you're saying technical recession is possible?

If you look at two negative quarters, that's possible, but it's not a crash or a crisis like we saw earlier in the pandemic or during the global financial crisis. We are far from that. Of course, this is a baseline scenario. Everybody knows their risks and we are here also to discuss risks. And if all of a sudden, the gas imports from Russia are stopped by Russia, we know that then we are in a different scenario.

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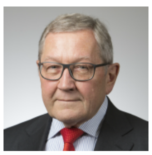

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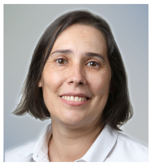

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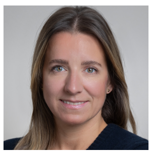

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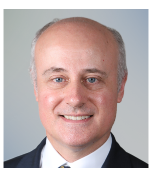

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