Klaus Regling in interview with Delo (Slovenia)

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Interviews

Interview with Klaus Regling, Managing Director, ESM

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DELO: Mr Regling, what is the purpose of your visit in Slovenia?
Klaus Regling: Slovenia is one of our 19 Members and one of my tasks is to visit these Members from time to time. On this occasion, your finance minister invited me to come and talk to the committees of the Slovenian parliament about the ESM and particularly about our latest programme for Greece.

In April 2013, Slovenia was on the radar of financial markets and foreign media as the "next country to fall" in the euro area, [in other words] on the way to requesting international financial support. However, with the troika at the door, the government decided to solve the issues itself, without applying for available external funds, including from the ESM. Was this the right decision?
You are right. Two or three years ago, […] we were still in crisis in the euro area. There were rumours about which country might ask for financial assistance. One of the rumours was about Slovenia, that's right, but there were other cases as well. There were reasons for those rumours. GDP, or economic activity, dropped by almost 10% during the crisis. There were particular problems in the banking sector, in part related to this big drop in economic activity. Non-performing loans went up; banks needed more capital. But then the authorities took the right actions. They recapitalised the banks and the Bank Asset Management Company was founded. [This latter company] is doing a good job now. Slovenia also has some advantages

compared to other countries that needed help from the EFSF and ESM, such as Ireland or Cyprus. The banking sector is smaller in Slovenia, around 140% of GDP, while in Cyprus it represented 700% and in Ireland and Greece, about 300% to 400% of GDP. These are big differences. The Slovenian government was able to turn the situation around and convince markets to provide financing again. I am very happy that it turned out this way.

How do you see the developments in Slovenia since the spring of 2013 and the current economic position of our country?

Your country has come a long way since the crisis. In the last year and in the first half of this year growth is quite solid, almost 3% on an annualised basis. That's above the euro area average. That is positive. Of course, there are challenges. In the banking sector, restructuring continues. Bank lending is still not there, the stock of outstanding bank loans is still falling. This indicates that banking sector restructuring is not yet concluded. On the fiscal front, efforts continue to bring the deficit down to within the rules of the Stability and Growth Pact. So I think overall Slovenia is on the right track. But clearly there are still things to do.

Let's focus on the European level. The ESM is now the owner of more than 40% percent of Greek public debt. Is it very important for the ESM who wins the upcoming Greek parliamentary elections?

You are right, the EFSF and the ESM combined, actually own now, after the last disbursement, 45% of Greek public debt. That is an enormous amount. And we will take on more if everything goes according to plan. There are elections in Greece in two weeks. But because there was a very large majority in the old parliament, more than 80%, in favour of the programme, and because [the programme] was basically supported by all the parties, for me it is not so important who is in the next government. Besides, one should not interfere in the democratic process. We are happy to work together with any future government in Greece. What is important is to have a workable government as soon as possible. The reforms which were interrupted in the first half of this year – but then restarted […] in a significant way [with the most recent programme] because many actions had to be taken before we made our first disbursement – are very much in line with the ambitious programme. So it is important that the reforms continue as quickly as possible after the elections.

Grexit? Is this scenario still possible for you, and if so, under what

conditions?

Well, everybody worked very hard in the last months to avoid Grexit: the Greek side and the creditors. So therefore I think this is a rather hypothetical question which is not very relevant at the moment. In theory it is always possible, but it is not a scenario we are working with.

Nobel prize-winning economist Paul Krugman suggested that the Greek economy can recover from the severe recession by exiting the euro area and launching a new national currency, the drachma. What is your view?

We are used to getting a lot of advice from very famous economists, particularly from those outside Europe. We believe we know better what works in Europe and what doesn’t. It’s very clear that Greece has an enormous reform agenda to conclude. They actually implemented substantial reforms during the first two support programmes between 2010 and 2014. There was improvement: the fiscal deficit came down from around 15% of GDP six years ago to only 3% in 2014. In 2014, one could see the first benefits of all these adjustments and reforms. Growth returned in 2014. It was the first year of positive growth after five years of negative growth; unemployment also began to fall last year. And Greece was also able to return to the market with two bond issues. There was progress with reforms and with the economic situation. All this was interrupted during the first half of this year. But now I think Greece is back on track. The government has made very clear commitments.

What is the position of the ESM regarding two Greece-related proposals put forward by the IMF: a haircut that yields a reduction in debt of over 30% of GDP, and the extension of the grace period until mid-century?

The IMF has not proposed a haircut – that is not correct. The head of the IMF, Christine Lagarde, just said recently that this is not on the table, and I am also convinced that it is not needed for Greece to return to debt sustainability. The Eurogroup, the 19 finance ministers of the euro area, including the Slovenian finance minister, of course, have given the commitment that if reforms are implemented as agreed and if there is a need for further debt relief – and that is not a haircut – the Eurogroup is prepared to talk about that. If it’s needed, it will mainly consist of further extension of maturities and possibly interest deferrals. One could also restart disbursing central bank, ECB, profits from previous purchases of Greek government bonds to Greece. These are elements one can think about. But it has been made very clear that there will be no nominal haircuts.

Ok, but will the IMF now really take part in the third Greek programme?
They were very much part of the negotiations of the latest programme, but they are thinking about restarting their own programme which could happen in November. They are looking for more details on fiscal adjustment, on pension reform and they want additional debt relief. In the view of the IMF, that is necessary. Again, not haircuts, but debt relief. And as I've said, the Eurogroup will consider that, and then I am quite confident that the IMF will be part of the programme later this year.

What are the ESM's main tasks till the end of this year?
We'll do our normal business. We, the EFSF and ESM together, have loans outstanding now in five countries: Greece, Ireland, Portugal, Spain and an ongoing programme with Cyprus which is going very well. The developments in Cyprus are better than expected, so we continue to make disbursements to Cyprus. We have to refinance our other country loans which all have maturities between 12 and 22 years. That is why the two institutions, the EFSF and ESM, are very active in the markets. We are one of the largest issuers of euro debt. This is an ongoing activity. And of course, the issuance and volume has to increase as we continue to finance Greece.

What about the QE programme, carried out by the ECB. Is it working properly?
This is not for me to judge. The ECB is like all other major central banks around the world still in crisis mode. Quantitative easing is what they are all doing. This is not a normal monetary operation but a crisis response. And it is successful because the balance sheet of the ECB is going up as planned, with moderate increases compared to other large central banks around the world.

How do you see the current macroeconomic situation in the euro area in terms of debt, GDP growth, unemployment etc.?
I see a normalisation in terms of growth. It's not a very strong expansion, as we are coming out of the crisis, but growth rates are steady in almost all of the countries of the euro area. There is a concern because inflation rates are around zero, which is not in line with the ECB target of inflation of below, but close to, 2%. The ECB is trying very hard to get there with its QE programme and other policy measures. The recent drop in oil prices, which is good as it supports economic activity, makes it very hard to reach the inflation target. There are also challenges in the banking

sector in many countries, like in Slovenia, that make it harder to get bank lending going again. There are still debt overhangs in a number of countries, not only on the public debt side, but also on the private debt side, so deleveraging is still required. Reforms are needed in many countries. The experience today makes clearer than ever that structural reforms do lead after a number of years to more growth. We see that very clearly in countries that benefited from an EFSF or ESM programme. For instance, Ireland and Spain today have the highest growth rates in the euro area, because they underwent substantial economic reforms. Some other countries need to catch up with reforms in order to strengthen their growth potential.

Which reforms are most needed in our country?
I've already talked about the banking sector, bringing back bank lending continues to be high on the agenda. Privatisation is an important reform item for the government because we know from many other countries that privatisation can lead to more competition and efficiency in the economy. On fiscal consolidation: I think Slovenia is on the right track. But it must continue, in line with government targets, to bring its fiscal deficit this year below the 3% limit and then continue on to a structural budget balance, which is in line with European rules and also appropriate in light of the debt levels we find in this country.

Is the ESM capable of managing all the future financial challenges of the euro area?
We have our clear mandate. We were created to provide emergency financing to countries that lose market access, always in exchange for their implementing reforms. We would never provide any financing without this so-called conditionality. At the moment, I don't see any other country that would need such emergency financing. We have a substantial lending capacity left unused.
When I deduct commitments we've made to Greece, we have about €380 billion left unused. It is very good to have such a big number. It is the same for the IMF: they have a much larger lending capacity than what they need because this is reassuring to the market. That is part of the reason we were set up – to reassure the markets. So we are prepared from that side for what might happen. But it's more important that countries do their homework, conclude their reform agendas, bring their fiscal situation in line with agreed rules. That is the best insurance against the need to provide additional emergency financing.

What was the toughest decision you have had to make so far at the ESM?

Each of the programmes was difficult. If I look further back it was difficult five years ago to set up the institution. There was nothing. To set up an institution that is able to issue large amounts of bonds on markets is not easy. We wanted and we received very good ratings from the rating agencies. That is the only way to provide cheap financing to countries that lose market access. And the low interest rates we are able to charge go back to this very good rating. These low interest rates provide a good chance for countries to return to debt sustainability. Each programme has been difficult, mainly for the countries, but also for the creditors. But I think the last five years have shown that the decision to set up such an institution, the EFSF/ESM, has been very helpful for the euro area to overcome the crisis.

One could say that the ESM is now the most influential institution in Europe. Do you agree?
I don't agree. Because we are a crisis institution, we are particularly active in a crisis. The idea is that we become less active as the situation normalises, while other important European institutions, such as the ECB or the European Commission, have permanent tasks. So I don't want to compare my institution to big European institutions which are much larger and have much broader mandates than we have.

There are many different views on how to settle the debt situation in Europe. French economist Thomas Piketty said in July: "We need a conference on all of Europe's debts, just like after World War II. A restructuring of all debt, not just in Greece but in several European countries, is inevitable." Your view?
This sounds a bit academic to me. It is a typical sort of advice academics like to give, very general. Not specific enough to be really used for policy decisions. Let me just make one comment in this context on Greece. We often read that Greek debt is unsustainable and that a haircut is needed. I don't agree with that. The reason is that we provide so much financing to Greece at such favourable terms that we can reach debt sustainability for Greece in a different way than through a haircut. We created a new framework in Europe that the world has not seen yet: a lot of financing at very favourable terms which can lead over time to debt sustainability because the actual annual burden on the Greek budget and the Greek economy is relatively low. Much lower than the debt/GDP ratio of almost 200% would suggest. Such a high ratio would suggest that the country is not able to service its debt, but this is a wrong conclusion in the case of Greece. Because, as you pointed out earlier, most of their public debt is to the EFSF and ESM – at very low interest rates. It is

possible for Greece to service the high amount of debt with very low interest rates and very, very long maturities and to become sustainable again over time. Many observers don't take that enough into account, they look only at the debt/GDP ratio and then they come to the wrong conclusions.

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