

Transcript of CNBC interview with Pierre Gramegna

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Interviews

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CNBC: Joining me right now is Pierre Gramegna, the Managing Director of the ESM and a man who's very well positioned to talk all things related to the European economy and some of those downside risks that Christine Lagarde was mentioning overnight. Let me just ask you this: in your conversations here, do you get the sense that people are worried about Europe and European growth trajectory?

Pierre Gramegna: I would say that quite a few are a little bit surprised how resilient the European economy has been in this very difficult context. Let's not forget that we have a war going on the continent in Ukraine, that we have high inflation, that we've seen rising interest rates at a very quick pace. And despite all of that, the last numbers indicate that we will not have a recession in Europe but very close to 1% growth. And the last revisions, the last outlook of the IMF, are slightly more positive for Europe. So, when I think back six months ago, we thought that we would enter into a recession, and we have been resilient. And this good news is also due to the fact that we took the right policy mix and that we also did the right thing in terms of supporting the economy, the people, the consumers in the context of high energy

prices.

When I think about the ESM, I think about it as sort of an emergency toolkit if sovereigns or even the banking system starts running into trouble. And what's interesting is we have had two shocks in Europe over the last couple of years. We've had the pandemic, we've had the energy crisis and the ESM was not tapped into, even though it's got a lending power of almost €500 billion. Do you think that we are far from the point that countries and banks would have to lean on the ESM?

Well, basically what you're saying is good news that we didn't have to tap into the €500 billion firepower that the ESM has. On the other hand, the ESM was ready to reach out to the countries in the pandemic, as we put together a package - the Commission, the European Investment Bank and the ESM, in the context of the pandemic. It was not used, also due to the fact that there was very accommodative monetary policy and that we did the NextGenerationEU programme at European level. So, in fact, there was a lot of support for the economy and for the people in that context. So in fact, it is good news but we are obviously ready to help when necessary.

Do you think that there's a stigma attached to countries taking up that lending from the ESM?

Well, I think that the ESM has worked quite well in the past years in helping five countries. In fact, if you look at the situation of those countries, the results of the support that they got is quite good. A country like Greece, for example, reduced its public debt [to GDP ratio] by 30% last year. Those countries - I also think of Portugal - are reaping the benefits of the structural policy changes that they did. On the other hand, I think as the new Managing Director, I've been asked by the member countries to think how we could use the firepower of the ESM more efficiently or eventually differently, by playing a role in preventing crises. So this is something I'm working on. And last but not least, we are also scheduled to play a role as a backstop for the Single Resolution Fund for banks. So there's quite a lot of ways the ESM can be useful and efficient.

Let me take you up on that point about preventing crises. We maybe almost had a banking crisis, in the US obviously, a couple of their regional banks came under pressure. And Europe, we have the case of Credit Suisse

in Switzerland for a while. It seemed a little hairy for a few days; the European banking system as a whole came under some selling pressure. Since then, we have recovered. What is your read on what has happened in the last couple of months? Vis-a-vis the financial system?

I think this is an excellent question and we need to look at it very closely. Why has it settled down so quickly? And, in my opinion, very convincingly for probably quite a few reasons. Once we have learned the lessons of the past crises that lived through worldwide, and particularly in Europe, the framework of finance is much more elaborate. We have now a Single Supervisory Mechanism. That means that the European Central Bank monitors the largest banks in Europe. That's very credible. We have set up the ESM, which did not exist in the past. We have macroprudential policies that did not exist in the past, and we have a few [new regulatory] agencies. So I think the architecture that we have built has helped us anticipate and is also deemed credible by markets. And that explains, I think, the resilience also of the financial sector.

But do you see any reasons for concern going forward?

Well, I think someone who would say that there is no concern would not be credible. But let's face it, if you had told me a couple of weeks ago that we would have a stabilisation on the markets so quickly, I would have signed immediately.

I was speaking to Paschal Donohoe, the head of the Eurogroup, and the question invariably that people ask out of this is what's going to happen with the banking union, and whether the events in the last couple of weeks are actually going to engender real discussion on that third pillar, the deposit insurance guarantee scheme. To your mind, has it become a lot more necessary, given the flare-ups we had and given that the catalyst actually in the case of Credit Suisse, was the scale of deposit outflows?

I think we can learn a lot by what happened in the last couple of weeks, and that is that we need a deposit insurance scheme. Definitely at European level, we have it at the national level, but it is really absolutely necessary. Second, we realize that today a crisis can unwind in a couple of hours because of social media, because of the Internet. So we need to react fast. And the lesson I draw from it is that we need to integrate that thought in the future of the banking union, and I encourage the Commission and the Member States to come forward with additional measures. And

I think it's in the making. The Commission is working on it and will come up with a proposal quite soon.

With the backdrop of all of this, you did mention you're relatively new to the role, Managing Director of the ESM. You talked about some of the changes that you would like to introduce. There's obviously a lot of talk about the reform of the ESM as an institution, but one country is not so happy about it, and that is Italy, because they think if you do go down that route, it means that the likelihood of them being forced to restructure at some point in the future would be higher. What are you going to do to bring Italy on board?

Well, first and foremost, I am reinforcing the dialogue with Italy. Italy was around the table when the negotiation took place to strengthen the role of the ESM back in 2019, 2020. I was at that time Finance Minister for Luxembourg, so I was part of those negotiations. And I think nobody doubts the fact that the revised treaty would be particularly useful when you have turbulences, as we have witnessed them on financial markets right now, as the ESM will become the backstop of the Single Resolution Fund when there is a need, and this addition to our role will be helpful for all the countries. So I think a lot of explanations are necessary. At the same time, I keep on telling the Italian government that it's up to them, obviously, to convince their parliament, and it's a sovereign country, and unfortunately, if Italy were not to ratify, it would block the other 19. So I count, and I expect that Italy will show solidarity with the others.

Are you confident it's going to pass, ultimately?

Yes, I am confident. I'm a born optimist. Fortunately, this is what you need for the job.

Given you are born optimistic, I'm going to ask you a pessimistic question. Where do you think the biggest downside risk is? Because in your capacity in the ESM, obviously you're watching out for potential fires. Where do you think it could come from?

Well, there are potential risks out there because the hikes of interest rates were so fast. So it is always difficult when you have such dramatic changes in a short period of time to do adjustments, and sometimes we lose sight of the medium-term benefits. Let me take this example: with higher interest rates, we reduce the

vulnerabilities of high asset prices, which many people were criticising. So we're not talking about that because we're now focused on the short term. So I think we need to give a little bit of time and not lose sight on the medium term. So that's the optimistic view, the pessimistic view is that something I would not overlook are prices in real estate, both for private people and for commercial real estate, where we see downward pressure both in the United States and in Europe. So that would be the one thing I would follow very closely.

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