

Klaus Regling in interview with Cyprus News Agency

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Interviews

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Interview with Klaus Regling, ESM Managing Director

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How would you describe the economic performance of Cyprus one year after its exit from the economic adjustment programme?

At the ESM we are very happy that Cyprus is our fourth success case. The EFSF/ESM have provided loans to five countries. One - Greece - is still continuing with its programme. The other four countries - Ireland, Portugal, Spain and Cyprus - have all exited their programmes, and they are doing well. These four countries are now among the best performing economies in Europe. I am very happy that Cyprus is one of them - looking at the numbers the case is very convincing. Growth is about 3.5%, unemployment is coming down rapidly and there is a fiscal surplus. All these are very positive developments and I hope they will continue. Of course, there are also problems, every country has some problems to solve, even the most successful ones. In Cyprus, the banking sector still has a lot of problems dealing with non-performing loans (NPLs). Profitability is low, partly as a consequence of high NPLs. So banks, with the help of the government, need to think about a strategy to deal with that. Some banks may have to think about their business models. And then, apart from the banks, it is clear that reforms should continue. A few important ones are outstanding like more privatisation, reform of the public sector, and reform of

the legal system. So there are challenges, but we have to see the broader context which is better than expected over the last few years.

What do you think lead to the quick turnaround? Looking back to the moment that the programme with Cyprus was agreed in 2013, the projections were gloomy.

I remember very well that we had to spend two weekends in Brussels to reach an agreement in March 2013. Your President and the Finance Minister were there. What we tried to do was unprecedented: to cut the banking sector in half, address all the problems in the banking sector, and also the problems with competitiveness and on the fiscal side. The magnitude of the problems was such that the loan to Cyprus was the biggest ever, far more than 100% of GDP. It was very difficult to say how quickly things would turn around. There was a lot of uncertainty because of the magnitude of the problems. The problems were huge and unprecedented. Looking back, the turnaround came faster than most people expected. One should not forget that many people become very pessimistic in a crisis. I have seen that in many other crises, in Europe and around the world. When a crisis happens and people begin to suffer - and people suffered in Cyprus, I know that very well - it is very difficult to see the light at the end of the tunnel.

But the turnaround always comes. And in Cyprus it was faster than expected because the government was really committed and determined to implement the agreed reform agenda. It worked very well: all the reviews were on time and in the end the country needed less money than was committed, only about 70% was really needed, which is good. It was a collective effort of the population and of the authorities that helped to turn things around faster and more convincingly than expected.

Looking ahead what are the challenges that need to be addressed?

I already mentioned the banking sector. Most people would agree it has a problem - there are challenges with the high level of NPLs. Of all the loans, 44% are non-performing, according to the latest numbers. That is a lot, although one has to say provisions are also high. A comprehensive strategy is needed to tackle this problem. Banks have to work on it, and the government has to make sure the legal framework is in place. The European Commission is setting up a blueprint for national asset

management companies (AMC), or bad banks. One has to wait for the results to see whether Cyprus could use this. There is no silver bullet here: there will have to be a comprehensive range of measures. This is not a Cyprus-specific issue. It is particularly large in Cyprus, but the fact that the Commission, the ECB and the ECOFIN Council are looking at this problem shows that it is affecting several countries in the EU and the euro area. The measures that are under consideration, such as facilitating securitisation, are all important. Cyprus cannot expect that one measure will do the trick, it has to be a comprehensive approach.

There is talk in Cyprus concerning the creation of an AMC. What are the preconditions for such a company to be set up in Cyprus?

An AMC cannot be the only solution. It could be one element of a comprehensive strategy. We have to wait for input from the European Commission to see how exactly an AMC would work. It is not easy to get the balance right between state aid, what banks can do themselves, and the legal framework to enable securitisation and asset sales. Banks need to recapitalise. So it is not easy to know the details today. The important point now is that an AMC can only be one element of a much wider strategy.

Such an AMC should include state involvement and private investors?

Yes, and therefore the role of the government will be very narrow. But that is exactly what the European Commission is working on. The EU's current framework is different from a few years ago, because we have a new resolution regime, new rules on state aid. We need to see what a national AMC could look like in this environment. It is a difficult legal and financial issue - we should wait for that input.

What are the preconditions for Cyprus to achieve sustainable market access? The government will face another challenge when it has to start repaying the ESM and IMF loans later.

I think that has already been achieved. It is true that Cyprus will face another challenge to repay the ESM and other creditors, but compared to the challenges in the banking sector it is a far smaller issue. I am very confident that the country will be able to manage that process. It is important to continue with reforms in order to have high potential growth rates - that is the most promising way to be able to repay

debt. It makes sense that the Cypriot authorities first prepay debt that is expensive, such as the IMF loan and the Central Bank of Cyprus loan. Starting next year the Russian loan will also start to be repaid. ESM maturities will fall due relatively late, the first repayment will be in December 2025, that's another eight years.

That is good for the Cypriot economy because our loans are very cheap compared with all the other creditors. We charge only our funding cost, at the moment that is around 1%, compared with other creditors this is very low. It is in the interest of Cyprus and the Cypriot economy that we are the largest creditor and we want to be a good partner for Cyprus and for the Cypriot economy. I am certain it won't be a particular burden for the Cypriot economy to start repaying the ESM in 2025, if it continues to use its time well, like it did in the last few years, if its growth performance continues to be good, and if it continues to maintain a fiscal surplus.

Let's talk about the envisaged deepening of the Monetary Union. Do you believe that 2018 will be the year of more integration?

Yes. We don't know exactly what it will look like, but 2018 is the year that it should happen. The debate has started. We heard the speeches from President Macron of France, we heard what Commission President Juncker had to say, there is a momentum there. We got out of the crisis stronger. The euro area is doing well economically and institutionally and we have done a lot in the last few years. Banking Union was created with all different institutions like the SSM, the SRB, the SRF. The ESM was created. The economy overall is doing well, in Cyprus particularly, but also on average in the euro area. We have the best growth figures in a decade. The debate has started among governments, among the institutions, the Eurogroup has scheduled several rounds of discussions on deepening EMU. There will be a euro area summit in December of this year and another in June next year. I think that is the moment when some decisions might be taken. And that is good, because in 2019 our member states will be busy with other political projects such as elections for the European Parliament. That will lead to a new Commission, and a new Commission President. Later we will need a new ECB President, a new Council President. So 2018 is a good year to think about deepening EMU, to discuss it and to come to conclusions. And the main issues are very clear, to complete the banking union, to do something on the fiscal side and to develop the ESM towards a European Monetary Fund.

Will we see the establishment of a European Monetary Fund?

We don't know exactly what the outcome of the debate among our governments will be. But there is a broad agreement that the role of the ESM should be strengthened in the future - for a number of reasons. When we think about completing the Banking Union, one of the technical but important elements is to have a backstop for the Single Resolution Fund. The ESM will probably be asked to provide that backstop. Another point is that there is broad agreement that the IMF will probably have less of a role in a future crisis in the euro area than in the past. This is because we have developed our own capacities, our technical expertise and also our ability to provide financing, which we could not have done seven years ago. We were very happy to have the IMF on board at the time, but in the future we can do it ourselves. And in a future crisis, if one day another country programme is needed - which will not happen for quite a while - then this will probably be done together by the European Commission and the ESM. These are some elements indicating that the role of the ESM might be strengthened and whether we call it European Monetary Fund is not that important.

Will there be any overlap with the Commission in terms of surveillance?

The EU Treaty states that the European Commission has a number of responsibilities and competences to supervise and surveil EU member states. There is no intention to take that away from the Commission. We currently already cooperate with the Commission in the so-called post-programme monitoring. At the ESM we call this our Early Warning System. The ESM, together with the Commission, visits countries and we do the analysis jointly. This is necessary because in those countries we are typically the largest creditor, so we need to know what is going on. We need to make sure that the countries will be in a position to repay us. But we do this in a very efficient and productive way with the Commission. That is what I would envisage in the future in other countries. In the past we had the Troika (EC, ECB and the IMF) and then the ESM joined. At the moment, we have four institutions dealing with Greece. In the future, there should be only two. And I'm sure we will organise this in a very productive and efficient way to avoid any such overlap.

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