Klaus Regling in interview with Bloomberg TV

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Transcript of interview with ESM Managing Director Klaus Regling
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Interviewer: Haslinda Amin

Bloomberg TV: Klaus Regling spent a decade at the German finance ministry where he helped prepare for Economic and Monetary Union. It is great to have you with us and it is great to see you again. Can we talk about Italy, when you look at the Eurozone, it's been growing above potential. Is that sustainable given what we are seeing, the challenges, especially with trade?

Klaus Regling: Economic developments are good. The euro crisis is behind us. Even Greece left its adjustment programme in August this year. So have now five countries that needed financial support during the crisis that are all doing well, because they put in place many reforms. Europe as a whole has been growing at almost twice potential for the past two years. That is great. But it cannot continue at that rate. That is clear. As long as there is an output gap, growth can be high, it has been twice the potential growth rate. So it has to come down. We see that in the most recent IMF forecasts that are produced for the annual meetings in Bali. And growth this year will be a bit less than last year and growth next year will be a bit less than this year. And of course, there are risks around that. And I think the risks are mainly on the downside at the moment, coming particularly from trade worries, the US-China trade war that seems to be happening. So it could be worse, but at the moment the central scenario that the IMF is presenting to us in Bali looks quite good.

So if the trade war gets prolonged, how much of an impact?

It is difficult to quantify. There are different models. People have tried to estimate. It depends how bad it gets and we all hope it won’t get too bad. But just – without giving numbers – the worse it gets the less good it will be for the world economy. Economists are convinced that trade is good, that trade opening is good for growth. We know it has contributed greatly to world growth the last fifty years. Trade liberalization stopped a decade ago. Now we seem to be moving in the opposite direction. So the trend and the direction are not good.

Growth is above trend. But there are pockets of problems. Italy is one of them. It seems to have deviated from its budget plans. How concerned about that?

Italy, I think it is good to put it into perspective. On the one hand, Italy has been problematic on growth for the last 20 years. Italian growth has been roughly only about half of the euro area growth the last 20 years. That shows there is a problem. But that is not a new problem. It also has not much to do with the euro. It is a long-term situation that I think comes from the lack of convincing reforms. But at the same time, Italy never lost market access. Even during the peak of the crisis in 2011 and 2012, when other countries like Greece, Ireland and Portugal had problems, Italy never lost market access. They have some strong points. They have a current account surplus. We know that a lot of their public debt is financed from domestic sources. Private households in Italy have been saving for a long, long time. They have a stock of savings that is invested domestically. That is very different from other countries. So there are some strong points.

But the issue with Italy is that it does not want to change its fiscal goals. We had di Mayo say that he is sick of austerity. What are chances of a showdown between EU and Italy?

What we see is worrying because the fiscal targets announced by the new government that came into office a few months ago are out of line with the agreed fiscal framework that the euro area countries have given themselves unanimously. All governments agreed on that including the Italian government at the time. And what the new government is announcing is out of line with that. So they have already adjusted a little bit in response to the criticism. So we have to wait and see. But there is a potential for a conflict.

Are you concerned with the response of the markets to Italy’s budget?

Of course, because this is not good for the Italian economy. The Italian public sector will not feel it very quickly because their debt is financed on a long-term basis, average maturities are eight years. But we see it in the banking sector that suffers almost immediately, because they are linked to the sovereign. The funding cost goes up. They have a lot of public debt in their balance sheets and they may have mark-to-market for some of that. So we see that impact on the banking sector. That is a weak spot and I hope the Italian government will take this into account.

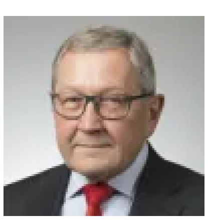
Do you think the Italian government can finance itself successfully? What will that take?

I think for a while they can. Because despite the fact that the Italian debt-to-GDP ratio is high, the average maturity of Italian debt is quite long. And actually, even when they refinance at the moment with interest rates that are now higher than six months ago, they are lower than a let’s say 10-year bond that is maturing now. Because that had for ten years a higher interest rate than the new one will have. So there is no really immediate negative impact coming from that side. It is more the banks where we see the impact much faster.

Italy is meant to submit its draft budget by October 15. Do you think it can do that or is there a plan B?

They will submit their plan. All the member states in the EU do that. That is the traditional approach, it is agreed and I assume that will happen. And only then we will see all their details behind their projections, which are important to get a complete picture. And then the European Commission will assess the situation.

Author



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