

Klaus Regling in interview with Euro Finance magazine (Germany)

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Interviews

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Interview with Klaus Regling, ESM Managing Director

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Euro Finance: At the ESM, some reforms have been initiated. Is that sufficient?

Klaus Regling: At the Euro Summit in December, changes were achieved that I expected and that had been prepared by the euro finance ministers before that. Without doubt, there are still topics where one could have gone even further. But that was not the point now. We have accomplished a deepening of the monetary union. The ESM plays an important role in that, although not the only one.

Would you have wanted more?

No, that was all in the context of what was politically feasible. Don't forget that the ESM Treaty has to be changed now and that it has to be ratified by the 19 parliaments of the euro countries. There is the potential for some hurdles and delays.

You talked about the necessary deepening of the currency union. How about its robustness?

The resilience is much stronger today than it was 10 years ago. There is no doubt

about that.

What are the reasons?

The countries that had massive problems during the financial and euro crisis and that had to ask us for loans have managed to tackle their problems thanks to wide-reaching reforms. Think of the budget deficit in Greece that was above 15% in 2009. Today, no country in the euro area has a budget deficit of over 3%. Also, the current account deficits were between 10 and 15% of GDP at the time. Today, we see small deficits or even surpluses. The competitiveness has increased significantly.

Why were there no rescue mechanisms before that?

It was simply unimaginable that a country that had cleared all the hurdles to adopting the euro could subsequently lose market access. Even I could not imagine that when I was working on the preparation of monetary union in the 1990s.

The growth forecasts for the euro area are going down. Are you worried?

I see a normalisation of growth rates. The rates that we have seen in the past years were significantly above potential growth. This cannot continue forever. The output gap, in other words the deviation of GDP from potential output, has been closed. The consequence is a slowdown of growth rates. That is not surprising. The word normalisation contains the word normal.

But there are additional risks?

I agree with you. There are more risks than would like to think of, including Brexit, trade wars and also the rise of populist parties. That can affect growth. But we must not forget that potential growth in Germany and in the euro area is at around 1.5%. We seem to be moving towards that now. There are reasons why we can be confident with regard to the strength of the economy.

And what are they?

The unemployment rate in the euro area is declining again. Simultaneously, wages are rising. That leads to additional employment with rising wages. This strengthens

the purchasing power. Consumption and domestic demand are supported by this. At the same time, the willingness to invest increases, because the capacity utilization is high and workers often cannot be found. There is money for innovation because in general, companies are profitable.

We are surprised by your optimism. The competitiveness in the southern countries has not been good.

One moment, please. The south of Europe comprises many countries. Spain, Greece and Portugal are three southern countries that have requested an ESM programme and as a result of the reforms linked to that, they have increased their competitiveness significantly. This is the reason why the current account deficits have gone down markedly.

But the structural problems of these countries have not been solved.

Yes, they have.

In your view, their competitiveness is sufficient compared to other countries?

Yes.

In Spain, industrial production has not returned to pre-crisis levels.

That is not the result of competitiveness. The decline of the share of industry in the economy is a phenomenon that we know from all industrialised countries. Exports are going well.

So you see Spain on the right track?

Not only that. Spain is fully competitive.

We don't want dwell on pessimism but one has to be worried about Italy.

Italy has had problems for a long time. That is the reason why there is low growth. In Italy, I am worried that there has been insufficient will to reform for the past 25

years. But that has nothing to do with the financial and the euro crisis. Italy has never lost market access. Italy has a current account surplus. The country was never a client of the ESM despite the fact the many observers have predicted that again and again.

Still, we are surprised by your optimism.

I think the pessimism is exaggerated.

Can we at least agree that many countries in Europe - also Germany - should not decrease their reform efforts?

Of course. Reforms are necessary in all countries. The European Commission publishes every year recommendations for all member states how to strengthen growth. Implementation is very uneven, to phrase this kindly.

Is there a lack of a sanction mechanism that kicks in when reforms are not implemented?

It is an illusion to think that the European Union would ever have such a sanction mechanism.

The flow of payments to such countries could be stopped.

This would contradict the idea of the European Union, which is not the United States of Europe. The majority of the population does not want that. The competence for economic policy is at the national level.

But there are areas where the EU is responsible.

Absolutely. The EU is more than a group of independent states. We have transferred national competencies in monetary policy and exchange rate policy and we have common rules for budgetary policy. But many other areas continue to be national. In economic policies, only those countries that implement reforms will be able to keep up. Whoever does not do that inflicts damage on himself, first and foremost.

This has consequences for everybody. Banking union does not progress

because we cannot agree on a common deposit insurance scheme. In Germany the banks and savings banks fear a mutualisation of debt.

There is some fear-mongering for which there is no reason. Also, there was no redistribution in the past euro crisis. Furthermore, there have been no transfers in the context of the ESM. The ESM grants loans that have to be repaid.

But there are transfer payments within the EU.

Yes, but they have existed since the treaty of Rome, signed over sixty years ago. There are affluent countries that pay more into the EU budget than they get back, and there are poorer countries that pay less than they receive. That is done on purpose in order to achieve convergence of living standards across Europe. That is the right approach and it helps the currency union to function.

But there could be additional transfers in the future.

Whether we talk about deposit insurance, banking union or fiscal instruments for more convergence: all that can be designed that there are no additional permanent transfers. On this occasion I would also like to recall that during the global financial crisis – before the times of the euro crisis – Germany spent more for the rescue of banks than most other EU countries. That needs to be remembered when talking about transfers. It is a wrong perception that money is always only flowing from the North to the South.

But the deposit insurance is not advancing because Germany is fearful of such transfers.

There are some who have these fears. But we should distinguish between those who are fundamentally opposed to the deposit insurance and those who first want to reach an agreement on how the conditions should be that precede its introduction.

When do you expect progress on this topic?

The deposit insurance will not come next year. Before that, the legacy issues of the crisis need to be reduced, such as the high proportion of non-performing loans and also the high ratio of domestic government bonds in the balance sheets of many

banks. But the goal should remain to establish the insurance deposit scheme in order to complete banking union.

What is a realistic time frame?

That will certainly take some years, but not decades. A date is not so important. What is important is that a lot happens by then. In Italy, non-performing loans have decreased by one quarter in the past two years. I think that is a success.

How problematic is the strong interconnectedness between banks and countries?

That is a problem for both sides. During the crisis we saw how bank problems had repercussions for the country or how budgetary problems had repercussions for banks. That is how it was in Greece, for example, where the banks did not have any problems in the beginning. We now have to clarify the level of sovereign bonds in the bank portfolios. There are no rules so far. There are proposals, also from the German Bundesbank. I think it makes a lot of sense to continue discussing this.

The federal economy minister has announced a national industrial policy and is also protecting the [domestic] banks. Do you think that makes sense?

No modern economy can operate without banks. That was the reason – as unpleasant as it was – why we need so much public money to prevent bank failure. That would have had heavy consequences for the population and that is the reason why a bank is not just another company. Banks have an impact on the entire economy and that is the reason why the state has to make sure that bank risks are minimized. Supervision is taking this into account. But some connections between national supervisors and banks of the same country seem to have been too close, in hindsight. That has improved with the common European banking supervision.

How important are national or even European champions in the banking sector?

There is a very strong fragmentation in the euro area, due to the fact that we do not really have a European financial market, but nineteen national financial markets.

That is why creating a capital markets union is so important. Once everything is in place, it ultimately does not matter where the location of a bank is. And then it would certainly make sense if banks could consolidate their activities across borders. This makes sense, because in Europe there are too many banks. Profitability lags far behind US banks. The costs are too high; something has to happen. But the question of acquisitions must be a private-sector decision.

However, the capital markets union is still a longer way away than deposit insurance.

There is something happening, but the topic is complex. I want to mention the insolvency law. This has developed over several centuries in some states and varies considerably across Europe. There should be harmonisation for a single capital market, at least in those areas that are relevant to market activity. That's technically difficult. It is an important goal, but it will take time.

Is it really a realistic goal?

Yes. We have achieved a lot in Europe; we can achieve more. In the present, you always think, there is no progress. In retrospect, however, one realises how much has been achieved.

You travel a lot around the world and meet international investors. How is Europe perceived in the world?

It depends where you go. In the West, scepticism is usually greater than in the East. However, that has improved a bit over the years. During the euro crisis in 2010-2012, many people on Wall Street or even in the City of London believed that the euro would disappear. That's why investors did not want to buy my bonds there. I can understand that. In the meantime, people have understood that they lost a lot of money. That's a good lesson.

And in Asia?

Even in difficult times, the mood towards Europe there was much more positive. This certainly has to do with the fact that the Chinese and Japanese have a stronger belief that states can solve problems. During the euro crisis, we sold 40% percent of

our bonds in Asia. That was an unusually high number, which has normalised to a much lower level today. Overall, we also see that the crisis has helped investors understand Europe much better.

How so?

Before the crisis, many investors made investment decisions without ever having travelled to Europe. For many, there was no difference between Spain, Greece or Ireland. That was all Europe. Only with the crisis it became clear that there are differences between the countries.

The dollar is the world's dominant currency. How can the euro catch up?

Large international investors increasingly do not want to invest only in dollars in order to have broader diversification. This helps in the talks to sell euro-denominated bonds, and we sell them. In addition, American economic policy does not currently raise much confidence in terms of sustainability. This makes Europe more attractive. This also shows that the euro crisis is clearly over. In the years following the 2010-2012 crisis, Europe has become something of a safe haven.

The euro as reserve currency?

I think that in the next one to two decades, we will move into the direction of a multipolar monetary system, where there may be three or four equivalent currencies. The dollar will be dominant but no longer important on its own. The euro and renminbi are catching up.

Eurobonds would make sense in enhancing the euro's significance.

To strengthen the international role of the euro, several things are necessary. Of course, if it was possible to create a broad and liquid market for safe assets, comparable to the size of the US Treasury market, it would strengthen the attractiveness of the euro for international investors. But this requires that compliance with the Stability and Growth Pact is improved; only in this way, trust between the member states will flourish again. I have already mentioned the importance of the capital markets union and other fiscal instruments.

French President Emmanuel Macron made some proposals to further strengthen the EU. Do they include a budget for the euro area?

The concept of a Eurozone budget is that you have revenues and expenses every year. In my opinion, macroeconomic stabilisation requires a revolving fund. In some years, the money may not be needed and that's why it stays there. In case the money is needed, it should be repaid within a business cycle for it to be available again. So there are no additional permanent transfers. It is worth thinking about this concept.

Could this pot be under the responsibility of the ESM?

This would be a possibility; there are other possibilities. The crucial question must always be: what is a good solution for the European Monetary Union?

Has the crisis taught us that for a country, it might be better to leave the monetary union for a while?

No, I do not think so. It would have been the most expensive response to the crisis – for everyone involved, by the way. We see now with Brexit, and it is not even about leaving the euro area in that case, how complicated a withdrawal can be. [If a country had withdrawn], the monetary union would have been perceived as temporary, in which one can get in and out as one likes. That would have profoundly shaken the confidence in the euro.

Would the exit of a country from the monetary union have been the end of the euro?

The euro will never end.

Would Bundesbank President Jens Weidmann be a suitable candidate as president of the ECB?

Of course!

Mr. Regling, thank you very much for this interview.

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