“Kathimerini” interview with ESM Managing Director Klaus Regling

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You are in daily contact with world investors. How worried are they about a possibility of national elections and change of government in the coming months? What is your take on the possible change?

Financial markets are monitoring the political situation and possibility of government change in every country. It’s normal that markets get more worried when the opposition has radically different views on the situation in the future. In Spain, Portugal and Ireland governments changed but the programmes were not interrupted, details were adjusted but the new government that came in after an election supported the overall direction, therefore markets were reassured. In Greece there seems to be more uncertainty.

Do you agree that in the past month the Troika’s position has hardened? There was the feeling that the review would close easier this time and that there would be concessions from both sides and not only from the Greek.

I don’t think the Troika position has hardened. The reviews have always been difficult and unfortunately delays are quite common. There has been very impressive progress with reforms in Greece. Greece’s ranking in the World Bank’s recent “Ease of Doing Business Index” is a good example of the great progress Greece has achieved, but also of what Greece still needs to do. Greece advanced in the ranking by 48 positions since 2010, which makes it one of the countries with the biggest progress in that period. But even after this huge jump, Greece is still only ranked 61st out of 189 countries. In other words: tremendous progress, but still one of the lowest rankings among EU countries. The progress has to be recognized and in the Eurogroup we recently applauded this progress. But the Eurogroup also stressed that the reform agenda is not finished. In Greece’s real economy, the turning point is now behind us. Growth has been coming back in the last quarters and the forecasts for next year are encouraging. What is also very encouraging is that the structural reforms are starting to pay off. For example, the OECD is estimating trend growth over the next 20 years. According to the OECD estimates, Greece will have the highest potential growth of all euro area countries, provided the reforms continue.

The biggest problem in the negotiations seems to be the fiscal gap. What the Troika projects on one hand is kind of fuzzy- seems like it keeps changing the targets and on the other hand the Greeks say there is no fiscal gap. Since the Troika has miscalculated our fiscal gap for the past two years why do you think they maintain such a hard line?

I don’t think it is a question of a hard line. There is always a degree of uncertainty with forecasts. It’s true that a few measures were taken in Greece recently that could lead to a larger deficit. One example is the decision to allow the payment of tax arrears in 100 instalments - that was a surprise for the Troika. I won’t go into details but the disagreement is not only on the fiscal side, it’s also about progress on structural reforms. This is why the Eurogroup extended the EFSF program until the end of February, to allow for more time to enable the Greek side and the Troika to come to a common understanding.

In the case of Greece why did the markets react so negatively to the prospect of a "clean exit", while not in Portugal and Ireland? Even when we are reform champions, as you said.

Greece is clearly a reform champion in the euro area. But at the same time, the reform gap in Greece was much wider when the programme started than in the other programme countries. Despite all the progress, there still is a lot to do in Greece. When Portugal and Ireland were about to exit their programmes they had a cash buffer that covered over 12 months of their financing needs. Greece does not have such a comfortable buffer. Also, in Portugal and Ireland there was a relatively broad consensus among political parties and social groups about the reforms needed for the country. This reassured the markets. They felt that the people and politicians had ownership of the programme and that everyone embraced the painful but necessary reform effort.

In the Eurogroup of November 2012 there was an agreement that if Greece achieves a primary surplus there would be a Greek debt reduction. Today you say that this is not going to be necessary. What has changed your position?

The key objective of the euro finance ministers is very clear and I share it fully: we want to make sure that Greece returns to a sustainable debt situation. There are many ways to get there. An important way is that Greek debt sustainability is improved by the very favourable terms of EFSF lending to Greece. The effect of these very favourable EFSF lending terms was underestimated in the beginning. Our lending terms include very long loan maturities of over 30 years and very low interest rates of only around 1.5%. Also, since 2012 and until 2022 Greece does not pay any interest on the EFSF loans. These hugely favourable conditions of our loans provided savings in the volume of EUR 8.6 billion for the Greek budget in 2013. That is equivalent to 4.7% of the Greek GDP and this benefit will be repeated every year for the foreseeable future. This is unprecedented solidarity from the euro countries to Greece and goes much beyond of what was expected in November 2012. The Eurogroup will look again at Greek debt sustainability next year. It will take into account several elements: reform progress, the uncertainty around current forecasts, markets expectations and general global developments.

In that same Eurogroup, the return of the ANFA profits to Greece was also decided in an effort to reduce further Greek debt. This has not happened either. Will it take ever place?

When the question of rollover of ANFA holdings came up, it was clear that it would have to be subject to certain conditions. One of the conditions was that national central banks would check if it was legally possible and their reply was negative. According to the Maastricht Treaty, central banks in the euro area are not allowed to directly finance governments. As the return of the ANFAs would have been in contradiction with this prohibition of monetary financing, the idea had to be dropped.

In the last Eurogroup an ECCL by the ESM was agreed for Greece, if and when the review concludes. Do you think it was a right decision?

Just to be precise: it was not yet agreed. The Eurogroup said it is favourably disposed to grant an ECCL, in other words a precautionary credit line by the ESM. Whether or not this credit line can be granted depends on whether Greece finalizes the reform measures that are still pending on the current review. It also depends on the talks about the continued involvement of the IMF in Greece. Lastly, all the relevant national procedures in some euro Member States needed to agree on an ECCL precautionary credit line by the ESM have to be completed. We are moving towards an ECCL, once the current programme comes to an end. The IMF has used a similar instrument many times and it proved very useful to help a country regain market access. Markets know that in principle the country doesn't need this emergency financing. But markets are reassured that in case something goes wrong, or in case a bond issuance does not work as expected, the ESM can step in and support the country within the predetermined amount in its precautionary credit line.

ON CYPRUS

(please note that the questions and answers related to Cyprus were only part of the interview version of Kathimerini's Cyprus edition)

After the stress tests in the Cypriot banks, there is EUR 1 billion left for recapitalization purposes of the banks. The Cypriot Central Bank governor said in October that this money will return to relieve the debt of the country. Is that the case and when will it happen?

All Cypriot banks did pass the ECB stress-test and this is very positive news for Cyprus. In the case of the Bank of Cyprus and Hellenic Bank, they passed the test because of additional capital they raised from the markets. The co-op banks were already sufficiently capitalized by the money from the ESM programme. This EUR 1 billion that was not needed for bank recapitalization remains in the programme envelope.

Cyprus has expressed the desire for an early exit. Under which circumstances would it be possible and when do you see that happening?

The ESM programme offers several advantages for Cyprus. It serves as an umbrella of protection against adverse market conditions. Also, it gives Cyprus a substantially lower cost of borrowing compared with what would be possible on the market. Lastly, the programme gives Cyprus the necessary time to implement the reforms. Recent weeks have shown that the market mood can swing around and turn negative very quickly. Cyprus has made a lot of progress. But I am not convinced that foregoing the protection of this umbrella already now would bring additional benefits to the country. The reforms that the Cypriot government has decided to implement are all aimed at bringing Cyprus back to a sound growth path. Returning the umbrella already now could leave Cyprus exposed to possible storms on its path to recovery without any protection.

Do you believe that Cyprus has completely avoided the risk of derailment? Many economists characterize the problem of Non-Performing-Loans – the so-called NPL - as a "bomb" in the foundation of the banks. Do you think it is as serious as they describe?

Overall, Cyprus has been very good at implementing the reforms in the first half of the ESM programme. In principle, the country is now well placed to take the programme to a successful finish. The very high level of NPLs – more than half of the loan-book – is weighing on the economy and the banks: this problem needs to be fixed. Therefore it is all the more regrettable that the House of Representatives in Cyprus decided to suspend the implementation of the Foreclosure Law until January 30th, 2015. We are all the more disappointed as this happened just a few days after the ESM disbursed EUR 350 million to Cyprus on the assumption that the law be adopted. To get the NPL problem fixed, and this can be done, Cyprus needs a sound and effective debt restructuring framework. Banks need tools to handle strategic defaulters, the ones who are able but unwilling to pay. Leaving NPLs unaddressed will hold banks back from financing the economy at more competitive terms and will increase risks to the successful completion and exit from the ESM programme.