Rolf Strauch in interview with El Confidencial (Spain)

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Interview with Rolf Strauch, ESM Chief Economist
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El Confidencial: What is the state of the development of the banking union, the European Deposit Insurance Scheme – EDIS, and the Single Resolution Mechanism?

Rolf Strauch: We have made a lot of progress regarding banking union, and we are now focusing on the completion of the financial arm. We created a Single Supervisory Mechanism and the Single Resolution Board. They centralise the banking supervision and resolution regimes at the European level and that is very important. To complete banking union, first, we need a common backstop for the Single Resolution Fund, and second, we need a common European deposit insurance scheme. The European Stability Mechanism will be the common backstop for the Single Resolution Fund and it will become effective at the latest in 2024. We are now discussing the details on how to implement this. A final decision is likely to be taken at the end of 2020 whether the backstop can start earlier than 2024.

Regarding the European common deposit insurance scheme, this issue is still being discussed, but we are making progress. It is important to have a European common deposit insurance scheme and it has been part of banking union since it was originally announced. Overall, a common deposit insurance scheme would help create common conditions in banking union and yield stability. The ESM programmes in the last crisis could have been smaller if we had had a European common deposit insurance scheme in place. It would have given confidence to savers. Euro area finance ministers are now discussing the way forward to achieve this objective in the next couple of years. To progress with this agenda, the right balance must be found between risk reduction and risk sharing to build trust among Member States.

Are the European institutions prepared for the current economic slowdown and for an eventual future crisis?

There is currently a slowdown but I don't see any crisis. And Europe is much stronger now to face any possible problems. One example is the creation of the ESM as a crisis resolution mechanism, others are banking union, better policy coordination at European level and impressive reforms in a number of countries. There are obviously further things to do and this is why the Euro Summit in December adopted a reform package to deepen the monetary union. One of them is that the ESM will have a broader mandate; we also need to complete banking union, and we are discussing a euro area budgetary instrument.

Focusing on the ESM and its broader mandate, there are different elements that will make the ESM even more efficient as a crisis resolution mechanism. The first, as I mentioned, is the backstop for the Single Resolution Fund. The second element is the fact that in the future the ESM, together with the European Commission, will design the policy conditionality of programmes, which will allow us to contribute with our perspective as a lender. We will do this in cooperation with the European Commission. The third element is that we revised the instruments we have available to make the precautionary credit line more effective as a tool to protect countries that are innocent bystanders. So on that basis, we hope we will be even more efficient in the future whenever there is a crisis.

Interest rates will probably remain low during a long period. Is the ESM worried about the profitability and solvency of banks and about financial stability?

My view of the European banking sector is that it should be safe, profitable and integrated. We have made great progress in terms of safety of the banking sector, because banks are now much better capitalised than they were before and during the crisis. Also banks have worked very much on reducing the amount of non-performing loans (NPL) that were built up in the crisis. Still, further progress is needed in some countries, where the level of NPLs is still relatively high, like Greece and Cyprus.

The other element is profitability, and there the picture is more mixed. Overall, profitability for the European banking sector is certainly not stellar. Banks need to work on their costs and see where they can be cut, and they also need to be aware of the changing environment. You see the development of fintech - both by small fintech companies, but also big technology firms, which are entering the banking sector, for example in the payments area. Banks need to make an effort to stay up-to-date with technological developments and incur cost savings where possible.

The final element that I mentioned is integration to create a true euro area banking sector. This doesn´t mean that every bank has to work across borders, but the banking sector overall should be able to provide services across borders within Europe and also outside. Banks should be able to operate in a level playing field within banking union, without unnecessary barriers.

What is your opinion about potential mergers between banks from different countries?

From our perspective, as I said, what matters is to create the basis for a safe, profitable and integrated banking sector. Then banks need to decide and develop their business models to fill this economic space to serve the European economy. What is the precise structure for that? That’s for the banks to determine. Overall, I am sure that we will achieve an efficient banking structure, where some banks will work across borders and others won’t, if we have the conditions in place to create a level playing field and remove barriers to cross-country integration.

Will Spain be the European country that grows the most in next years? What worries do you have about Spain?

Spain is a success story for the ESM. The country has performed very strongly over the last years, with growth rates substantially above the euro area average. At the same time, Spain has managed to convert a current account deficit before the crisis into a current account surplus, even in the latest years of high growth. That shows the strength of the economy. It has also improved its competitiveness. This strength translated into job creation.

But, there are challenges that relate to the overall economy and to the banking sector. Private and public debt levels are comparatively high. The labour market, despite the job creation achieved, does not work perfectly yet as the unemployment rate is still high relative to the euro area average, and productivity growth is still rather low. This creates a strain on growth.

On the financial sector side, the programme has achieved great gains. It has made the Spanish financial sector safer and work better, being more competitive and achieving profitability. There are still some elements to be addressed. One is Sareb's more persistent-than-expected losses that create a contingent liability for the state, as an owner of Sareb. Another is the fact that capital levels are still not in line with the overall European average, so banks should be encouraged to increase capital to have better buffers for the future.

What reforms does Spain need?

Again, Spain has performed strongly and has conducted reforms that go beyond the immediate financial sector programme, but there are challenges. The European Commission has formulated country-specific recommendations that would help Spain address those challenges. One issue is the segmentation of the labour market and finding ways to ease the transition toward permanent employment contracts. On productivity, more steps can be taken in terms of education, in particular digital skills, and also research and development.

Finally, on the fiscal front, Spain exited the corrective arm of the Stability and Growth Pact and moved into the preventive arm of the Stability Pact. This is an achievement but the country now has to live up to the requirements under the preventive arm. This means that in the coming years, fiscal targets should be fulfilled. In this context the European Commission suggests constraining spending and undertaking a fiscal consolidation effort, which would also help to bring down debt.

What is the risk for Spain if the political paralysis continues, without reforms?

It is not up to me to comment on Spanish domestic politics. As I said before, there are challenges for the country, and reform proposals for the country expressed by the European Commission, and I would very much hope for Spain that there can be a government soon and one that is strong enough to accomplish these reforms.

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