Transcript of Klaus Regling's interview for the Financial Times

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Interviews
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Full transcript of the *Financial Times* interview with ESM Managing Director Klaus Regling
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Interviewer: Sam Fleming

Financial Times: The last European summit requested a proposal from the Eurogroup in two weeks' time, but did not give an explicit direction on where leaders would like to go in terms of the collective economic response, apparently because of the lack of consensus on this. I wondered if you could start by telling us what the Eurogroup is focusing on, what the work will be focused on in the coming days and weeks.

Klaus Regling: Yes, I think everybody in the Eurogroup is aware that we are in a big crisis, as Mario Draghi said in his contribution last week, that probably this is the biggest economic and humanitarian crisis in our lifetime. And that means everybody has to contribute to find a solution. This is true for the member states, of course, and they are working on it and they have already taken decisions to help with the immediate financing costs for the health system, to help corporates to get through this period where they may not have any revenue. They are providing guarantees, budgetary support. The European Central Bank (ECB) has taken action. I don't need to talk about it. You have covered that extensively. And this was very important, as that leaves the European institutions and I see three. They all do something, are ready to do more. And I think one has to distinguish between the short term and long term.

The European Commission has identified €37 billion in its remaining budget. As you know, the budget cycle ends at the end of this year, so there are limited resources. But €37 billion has been identified to support member states in this immediate period. The European Investment Bank (EIB) is one of the active European institutions; even during normal times, last year, they provided loans of €62 billion, for instance. They are looking for ways to increase that. And I think they can do that. And the president of the EIB Hoyer has suggested €25 billion in additional guarantees from member states, which could be used as leverage to mobilise €200 billion in additional financing to SMEs and mid-caps.

And the European Stability Mechanism (ESM) is available with an unused lending capacity of €410 billion, and we are looking for ways how to mobilise some of that. So I think that is the right approach. One has to look at the different contributions that can come from all the possible different sources. Otherwise we will not be able to handle this.

That's the short term I would distinguish between the short term, which I've mentioned so far, and the longer term, let's say everything after the end of this year. After that there will be additional possibilities, of course. For example, the EU budget. The situation there would change considerably. In 2021 the next seven year period will begin. President von der Leyen has already indicated that there will be a new proposal for the EU budget.

Anyway, the old proposal that has been discussed for some time is two years old, and a new proposal will rightly focus also on how to react to the consequences of the coronavirus. Hopefully from next year we will no longer be dealing with the immediate health care cost, but it will be then the question of how to finance a recovery. Given the damage that the containment measures bring, this is unavoidable. These containment measures will have this unavoidable cost because we will have big declines in Gross Domestic Product (GDP) in all our member states. So it's good that the EU budget from next year on will also focus on that.

That doesn't mean that all the old priorities are obsolete - green issues will continue to be also important, but some re-focusing, as announced by President von der Leyen is appropriate. Also, then with the new budget cycle, that might be a way for the Commission to issue European debt more than they have done so far. And some of the EU budget could be used as leverage for that. Looking beyond this year, the EIB could raise its capital, which would allow it over the coming years - when we will have to deal with recovery from the damage done by the coronavirus to the economy - to lend more, which would help. And all this means issuing more European debt; I think that's an important point to remember.

There is a heated debate about what some call coronabonds, other call eurobonds. But looking at the facts, it's very clear that we do have European debt. We have had it for decades, actually. Because whenever the EIB issues bonds and when the Commission issues bonds and when ESM issues bonds, this is mutualised debt. When you add together what the three institutions have outstanding at the moment, it's more than €800 billion. That can be increased if the EIB increases its lending activities. There will also have to be more bonds if the Commission, maybe after next year, uses some of its available budgetary resources to guarantee debt; they can issue more debt. And the ESM is there whenever we issue debt. This is mutualised debt - I call it European debt.

So it's there, it can be increased in the long run. Of course, one can also create a new institution if that is what the member states want. But here, maybe our experience is useful because when the ESM was created and before that, the European Financial Stability Facility (EFSF), we know how long it takes from the moment a new institution is created until it's possible to issue debt. The EFSF was able to do it in seven months, seven months from the creation till the first bond. This was a world record; when I look at other multilateral banks in the last few decades, like the European Bank for Reconstruction and Development (EBRD) in 1991, it took them about a year and a half to issue their first bond. When I look at the Asian Infrastructure Investment Bank (AIIB), based in Beijing, created in 2015 or 2014, I think, it took them three years to issue their first bond.

So that's why I would argue that in the short run, one should use existing institutions that have experience in doing all this, with the existing instruments, and they can be adapted to some extent in the longer run, other possibilities exist. But again, it takes time for a new institution. And there should be no misunderstanding: if a new institution is designed to issue European debt, it would need capital or guarantees or the assignment of future revenues. One cannot create bonds out of nothing. So these are the implications.

Nine member states are hoping and looking for coronabonds; it's not entirely clear to me what exactly this means in terms of detailed policy proposals. Can you envisage a coronabond solution that wins broad support?

I just tried to explain what the preconditions are if you create a new institutions to do that. It would take 1, 2 or 3 years, and member states have to come up with capital or guarantees, or assign future revenue. That would be if you ask a completely new institution to do that. If you use existing institutions, the Commission can do much more from next year. The EIB could do it immediately. The ESM is there. They can all issue mutualised European debt. So if one wants to cover short-term financing needs, which is one thing that is needed in response to the corona crisis, to finance immediately the expansion of the health care system, and finance some of the action needed to keep corporates going, then I think the only way is to use existing institutions with existing instruments. Otherwise, it takes a while. And also don't forget, as I mentioned, one needs capital, guarantees, or assigned revenue. Otherwise, there can be no new European debt that's issued.

This is clearly a very divisive topic, and some member states like Germany are very reluctant to go down the road of coronabonds. Are you arguing that people are too wary of the idea of coronabonds? Is there a role that you can see for something along these lines in the current crisis?

Well, I see that apart from the national response, which is strong, and growing, we also need a European response. And I think we need solidarity in Europe, because if we want to protect the single market, it's not enough to rescue your own economy. I think every EU member state has an interest to also make sure that all of the other EU member states can overcome this crisis, the biggest since World War II.

So I think there's a case for solidarity. I also want to point out that solidarity is one of the founding principles of the European Union. We have had solidarity since 1957 via the EU budget. And there are actually transfers. Sometimes academics question whether there are any transfers in Europe - they should look at the EU budget. Since 1957, the principle has been that the richer countries pay more into the EU budget than they get out. They are the net contributors. And the poorer countries get more out than they pay in. And it has changed over time. When Ireland joined the EU in the 80s, it was the poorest country, they were a strong recipient of EU funds. Today they are the second richest country and they are net contributors. With the next Multiannual Financial Framework (MFF), and now that the focus will shift also to fighting the consequences of the coronavirus, one can take into account for instance which member states are particularly badly hit by the coronavirus, with particularly strong negative economic consequences.

Maybe in that context one could think about whether it makes sense that Italy is a net contributor, of 5 billion euros per year. Maybe under the current circumstances that's no longer justified. So I think the EU budget is an important element here. Again, you've tried to talk about coronabonds; I tried to explain how I see it. We do have mutualised debt; the coronabond is presumably mutualised European debt. We have that - we have more than €800 billion of it already. It can be increased, but in the short run only through existing institutions and existing instruments. In the longer term, there are other options. But they do require capital, guarantees or assigned revenue. I need to repeat that so that it should be clearly understood.

Do you see, in the course of the crisis, the need to increase the lending capacity of the ESM, or the other existing institutions, particularly the ESM which is the one you are in charge of? Do you think the financing needs are going to be so huge that indeed the ESM needs to expand its lending capacity beyond the current capacity of €410 billion?

No, I don't think that's an urgent question because there are €410 billion in unused lending capacity. And I don't think we need to now waste energy on thinking about increasing that. There is a lot available. I look at it all together, all the European institutions. I think it's important to refocus the EU budget as President von der Leyen announced. And then there is money available. Of course it's never easy to come up with the right decisions, and there will be political disagreements on how to do it. But to refocus it makes sense. The EIB has made proposals and I think at the

EIB one can go and look at the future beyond the current proposals. The EIB has requested €25 billion in guarantees so that they can leverage that and mobilise €200 billion. The ESM has enough lending capacity at the moment, so I don't think we need a debate on how to raise our capital or the size of the ESM, that's not the most urgent at the moment.

Currently the work at the ESM is focusing on the Enhanced Conditions Credit Line. What is the benefit of ECCL in this crisis? What is it going to bring to the table?

Obviously, the EFSF and ESM were set up during the euro crisis. Today's crisis is completely different, many people have said that. And I think that's right. We deal today with a symmetric crisis that was not caused by policy mistakes in individual countries. So that's why I think it makes a lot of sense now to look at instruments that were not used before. It's a safe institution. But we have instruments that were not used during the euro crisis that seem to be quite appropriate now. So I think the ESM is evolving. And one can compare that with the International Monetary Fund (IMF). The IMF was created after the Second World War. In a way, it was created in response to the global depression. And for 25 years, its task was to make sure that we had stable exchange rates - the Bretton Woods system. When that was abandoned in the early 70s, in response to the oil crisis, the IMF didn't close its doors. It adapted its instruments and remains highly useful and necessary today, under very different circumstances.

They are, for instance, now adapting their emergency lending facility, which is very different from its normal facilities. And they are talking with more than 80 of its member states how to support them financially. At the ESM, we are an institution created during the euro crisis. But we are proposing to use very different instruments today, compared to ten years ago. And the precautionary credit line seems to be the most suitable under the current circumstances. And you know how precautionary credit lines function. Again, the IMF has used them in the past.

The idea is that one agrees on a credit line. Ideally, in the baseline, the money will not be needed and will not be activated. But circumstances can change, and then, if a country needs money, the money can flow very quickly, because there is an arranged facility in place. The IMF has used this over the last few years very successfully, with countries like Mexico, Colombia and Poland. We never used it in the past. I think it would be a good option right now. And one can adapt maturities to the needs that are there at the moment.

The conditions under which they could be made available would be completely different from 10 years ago because this is a different crisis. Conditions could be, for instance, to earmark the money, if it's made available, for expenditures in the health sector, for financing the measures needed to counter the economic consequences of the corona crisis. Of course, these are loans. So we also have to make sure that we are repaid. That's why there should also be a commitment to respect EU surveillance frameworks, which of course is an obligation anyway for all EU member states. But I think it would also have to apply in these circumstances. And it would be no more than that. So I think this could be an option and it would demonstrate that indeed this crisis is very different from the last crisis, and therefore we would propose to use a different instrument.

Clearly, politically, one of the countries that that is under a great deal of pressure now is Italy. But politically, there is huge reluctance there to avail themselves of any ESM instrument. How do you get over that political reluctance?

Well, I think we are now in a discussion process in the Eurogroup. I can only note that Italy has not lost market access; they issued a bond last week. So we are not feeling there is any acute risk of loss of market access as we did 10 years ago. And I think more generally, when one looks at how different this crisis is from the last crisis, as I said, it's symmetric. But also all our member states are in much better shape. There are no huge macroeconomic imbalances in the euro area, which is very different from 10, 12 years ago, where many countries had fiscal and current account deficits of more than 10 percent of GDP. That just doesn't exist at the moment. By the way, we also have much stronger and additional institutions at the European level that did not exist 10 years ago, like the banking union and its different institutions, the Single Supervisory Mechanism (SSM), Single Resolution Board (SRB), and also the European Systemic Risk Board (ESRB), European Banking Authority (EBA), the ESM.

We have a different type of crisis, but we also have a different environment in Europe and no member state at the moment has lost market access. That's why the precautionary credit line seems to be the most suitable, because it is for countries that do have market access at the moment, but where there might be problems in the future, and then money could flow quickly.

Part of the concern is the issue of stigma. That was why initially there was a suggestion that perhaps the ECCL could be thrown out to all member states, but that no longer seems to be the plan. How do you address this issue of stigma that could attach to countries if they do use the ESM?

Again, I think the answer is that we are proposing a very different instrument compared to 10 years ago. Precautionary credit lines have a positive impact on markets. We saw that at the IMF when countries applied and agreed on the IMF's precautionary credit line; there was no negative effect on the markets. Actually, it can be reassuring for markets because they know if something unexpected happens, if against the baseline assumption, money needs to flow, it will be made available very quickly.

The preamble to the Treaty talks about the IMF's role. Do you think the IMF needs to have a role if there was a precautionary credit line offered?

In a general sense, one should always remember that every member state of the euro area is also a member state of the IMF. So the IMF in that sense is involved, through its annual consultations. I have been talking with the IMF in the last few days. They do not expect any financial involvement in Europe under the current circumstances to some extent, because they believe that Europe can handle itself, but also importantly, as already mentioned, they are swamped by requests from other member states outside Europe, more than 80 requests for IMF resources. This has never happened in the IMF's history. It again underlines that this is a global crisis, of huge consequences. Therefore, more countries than ever before are now talking with the IMF and they are getting to the limit of what they can handle, so they for that second reason, do not expect to get involved into any financial arrangement. But of course, European countries are members of the IMF, and there will be relationships, there will be a dialogue.

Some economists argue that an important aspect of the ECCL is that it potentially unlocks the use of the OMT. Can I get a sense from you of the relevance of the OMT when it comes to the ECCL's role in the current crisis?

I think the arguments in favour of the Enhanced Conditions Credit Lines (ECCL) are already convincing on their own because member states may have huge financing needs and it is a very different instrument from the past, with very, very different conditions. It's up to the ECB to decide whether the decision of September 2012, where it was made clear that to activate OMT, an ESM programme with conditionality would be needed, still applies. And the ECCL was mentioned in that context. It would have to be seen whether that is still relevant because the situation has changed. Our ECCL, as I see it, would have very limited conditions, which basically make sure that the money is spent in the correct way and that the ESM will be repaid one day. So this is a decision that the ECB council would have to take.

You mentioned the fact that the loans obviously have to be repaid one day. What kind of maturity are you expecting for the ECCL, if it's used?

There we have flexibility. No decision has been taken. We don't have any limits, in that sense we are more flexible than the IMF, for instance, where there are firm rules for different facilities, what is the maturity. This is something that the Eurogroup will discuss over the next 10 days or so. There is flexibility.

And you do tend to think that consensus is coming around for the use of the ECCL, as discussed in the last Eurogroup, but also around the conditionality that will be attached to this? Do you think there is now a consensus on this among ministers?

Probably not today, because since the summit, the ministers have not met again. That's the work that is continuing in the background and I hope we can reach a consensus. But I would not expect, and you should not expect that there's a consensus today because ministers have not met since the summit.

Do you see the same risk that we saw in the last euro crisis of the single currency itself coming under question, that the coherence of the single currency is coming under question? How great is the threat to Europe this time around?

I think it's not very large. I know that many people like to write about it. I don't see it. I think all the member states of the euro area have now to fight with the consequences of the virus and we will all move into a recession. All 19 countries together. We do have instruments to get out of this together. And I don't see why this be should be a risk of the euro as a whole. I think the world should get used to the idea that there is one currency for these countries, for the 19 countries at the moment. This will continue to grow, the number of countries that use the euro. And I think that's just not appropriate, whenever there's a problem, to say also that the euro is at risk.

The next question I wanted to ask you about the scale of the public finance challenge that you now envisage. I'm interested in the guarantees that are being offered. I think the Eurogroup quantified these as 13 percent of euro area GDP. But the concern is I mean, obviously these are contingent liabilities now, but these could be called up. And given the scale of the bankruptcies, we see the pressure on these economies, quite a lot of these guarantees can be called up. How large do you think the pressure is going to be on public finances from these guarantees, as well as from the immediate fiscal spending and loss of tax revenue?

No doubt there will be fiscal pressures. Because as the Eurogroup also said, so far, member states have adopted fiscal measures amounting to 2 percent of GDP. I think the Commission said in the last few days that this has now gone up to 2.3 percent of GDP. But on top of that, the automatic stabilizers will work. And it has also been agreed that they should work fully. That means the deficit will go up by more than 2.3 percent on average because of the automatic stabilizers, there will be a loss of revenue and additional spending needs. And then indeed, there are the implicit liabilities. But I don't think one should assume that the entire 13 percent would become relevant here. Some of it, I'm sure. How much, I think will very much depend on how quickly we get the virus under control, because that will determine how deep the recession will be, how much GDP will drop this year and nobody can be sure about that. That will determine the extent of the automatic stabilizers, the impact coming from that. And the extent to which the guarantees, the implicit liabilities will be needed. So I don't think one can have a real number on that at the moment. But I I'm sure it will not be 13 percent. There will be some. How much depends on the length of the virus problem.

I do want to ask about the banks as well. Obviously, the ESM has a role to play here, too, potentially. We've seen profound falls in bank share prices

in a number of countries, including Italy, but other large lenders as well. How much pressure are you now seeing the banking system come under? And do you see the potential for this economic crisis once again to have significant damaging consequences for the banking sector in Europe?

Well, first, I think we have to remember that European banks are much better capitalised today than they were ten or twelve years ago. So that helps a lot. Then some of the measures taken by governments, the guarantees that we just talked about, are for banks, so that they are able to provide additional loans or allow overdraft facilities to be drawn. So if there are problems in the future, then they will not land on the balance sheet of banks, they will land on the balance sheets of governments. But to some extent of course, banks are affected, we will have a recession. Every country will have negative growth rates this year.

So this very positive trend in non-performing loans (NPL) reduction that we have seen over the last five years, and they have made a lot of progress there, in all countries, particularly those that started this with very high NPL levels, to some extent will be reversed. And NPLs will go up. Probably, I would expect that in all 19 euro area member states, all 27 member states. So, yes, there are problems, but I think we are starting from a much better starting point. And a lot of the additional lending that will now happen will be guaranteed by governments. So I think it will be contained.

You referred earlier to Mario Draghi's piece in the FT that eventually the costs of this crisis will have to be absorbed by the public sector balance sheet. Do you think the public sector can actually shoulder, can withstand the sheer enormity of what is going to be taken on? And clearly, we're now beginning to hear people talk about the need, or the inevitability of some debt monetization. We've been seeing that in the U.S. right now. What's your perspective on that angle?

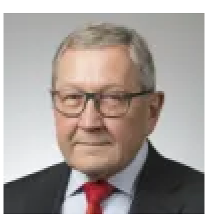
I agree with Mario Draghi's analysis that this is a huge crisis, and I think he said it's a human tragedy of potentially biblical proportions - that is right, unfortunately. Certainly the biggest crisis, economic crisis in our lifetime. First of course, the losses in life, in all our member states. But then we have to deal with the huge and unavoidable economic cost of that. And a lot of that will end up on the balance sheets of governments.

It also means we will have a lower standard of living with a decline in GDP. Incomes will come down, one day they will recover. With the right policies at the national level, but also with the contribution from the three European institutions to minimise that. But there will be problems all over. Public debt will be higher by 10-20 percentage points of GDP, one cannot have a precise number because again, it depends on how quickly the virus will be brought under control because that determines then how deep the recession will be.

But it will be a jump in public debt. At the moment, we'll see interest rates the way they are. That will be manageable. And I don't see, with such big output gaps appearing not only in Europe but around the world, that there will be inflationary pressure. So I think interest rates can be low for a long time and that the higher debt will be manageable.

Thank you very much.

Author



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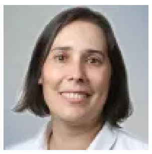

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