Interview with Nikkei

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NIKKEI interview article on 8 July 2013 with Mr. Klaus Regling, Managing Director of the European Stability Mechanism

Interview by Mikio Sugeno, Senior Correspondent

The euro area economy has been suffering from the recession for six successive quarters because of the harsh austerity measures. What's your view?

We do not believe in Europe that the current situation is caused by austerity only. Countries like Spain and Ireland have to go through an adjustment process by reducing the excessively high contribution of the construction sector to their respective economies. In countries like Greece and Portugal competitiveness has to be restored through cuts in nominal incomes. The reason of the current difficulties in Europe lies in the whole spectrum of structural adjustment. Obviously in countries with very high deficit and debt levels, such as for example Greece, budgetary consolidation is necessary. Otherwise it is just impossible to put the economy back on a sustainable basis. It is crucial to underline that the efforts of the euro area member states and the institutions are having a positive effect. The risk of the euro area breaking up is no longer there. In addition, the contractionary effect coming from fiscal adjustment is decreasing. In terms of GDP it is only about half this year compared to last year, when fiscal consolidation it was 1.5 percentage points of GDP. This year it is only three-quarters of a percentage point. Looking forward, the central scenario indicates that growth will come back later this year. For next year growth is estimated to be between 1-1.5% which is around the current potential growth rate in the euro area.

Would you say that the euro crisis is already behind us?

No, it's not over. But it's a lot better than a year ago. Of course, the ECB's announcement that OMT would be available played an important role in changing the market perception. But there are many other reasons why the markets are more confident today. Competitiveness is improving in all southern European countries. Current account deficits are basically disappearing in all these countries. Fiscal deficits are much smaller than before. As regards competitiveness, I think about two-thirds of the adjustment has happened. On the fiscal side, at least half has been done. Secondly, we have much better rules, stronger, broader rules for economic policy coordination among the euro area member states and a stronger Stability and Growth Pact for fiscal consolidation. And we are moving towards banking union with a single supervisor as a first step. To sum up: there are improvements but we are not out of the woods yet. Further efforts will be required.

How concerned are you about the recent political instability in Portugal in terms of reforms?

We are obviously concerned with the events in Portugal and I hope all political actors realise what is at stake. Staying on the course of reform is absolutely the key to regain market access and credibility. I hope Portugal will overcome this moment of hesitation and reassure investors of its determination to complete the correction of its imbalances. A lot has been done. Reducing the public deficit and increasing competitiveness has been rewarded by the markets and a successful exit strategy was within sight. It would be a real shame if Portugal stopped this process now, having already put so much effort and hardship into this adjustment.

The euro area still faces the problem of a fragmented banking sector which creates great discrepancy of the lending rate to companies within the single market.

That's right. Lending to corporates, especially to SMEs is very weak, particularly in southern Europe. The data from the ECB show that there is a difference of two to four percentage points in the lending rates. That of course makes it even tougher for the weak countries to do the adjustment because the corporate sector has to pay significantly higher capital costs. In order to make up for the higher capital costs companies are squeezing salaries and wages. As a result domestic demand and GDP continue to drop which is a real problem. That's the reason why banking union is so important. The recent agreement by finance ministers on bank resolution and direct bank recapitalization are very good steps.

How is the ESM preparing for the direct recapitalization of banks?

By engaging in direct bank recapitalization the ESM will contribute to breaking the link between sovereigns and banks. But the ESM can only start using this new instrument once the Single Supervisory Mechanism, the so called SSM is operating. The ECB expects this to be the case by September 2014. So the ESM has time to prepare and to recruit the necessary staff.

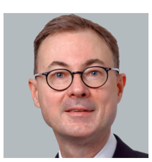
It has taken one year after the basic agreement on establishment of banking union to decide on the framework. Isn’t that too slow decision process?

The euro area consists of 17 democracies. It should not come as a surprise that important decisions may take more time than in just one democracy. But the euro area has shown that decisions can be taken very quickly if there is an urgency. Two years ago when there was a need to expand the size of the EFSF this happened in just one week. And the markets have understood that this is how Europe works.

The new economic policy in Japan called Abenomics with aggressive monetary easing by Bank of Japan has been criticized by some Germans. What is your view on that?

I don’t want to comment on Japanese economic policies. Only one point: I wish Governor (of the Bank of Japan) Kuroda success in switching the expectations of the Japanese population from deflation to modest inflation. That would be very helpful.

Contacts



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