Klaus Regling in interview with CNBC on ESM reform

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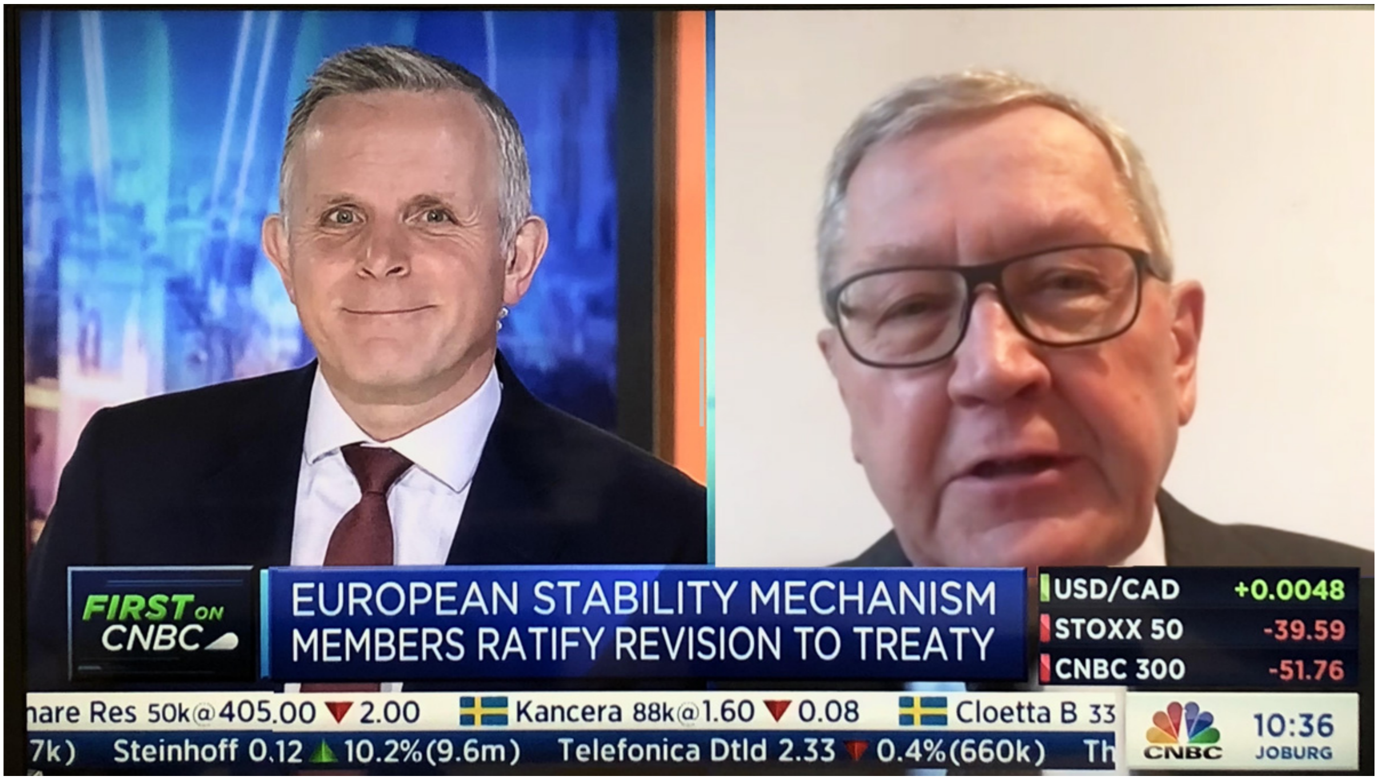

Transcript of interview with ESM Managing Director Klaus Regling
CNBC Squawk Box Europe, 28 January 2021
Interviewers: Steve Sedgwick and Geoff Cutmore

CNBC: In terms of what has changed, the new, improved ESM II, what have we got?

Klaus Regling: Good morning, one very important step for the ESM and for banking union was taken yesterday. The revised ESM Treaty was signed by our member states, with the exception of Estonia. They have a new government, but they made it very clear they will sign soon.

Politically, the reform was agreed last November by the Eurogroup, and then at the Euro Summit. But yesterday was an important legal step, so that now we can begin the ratification process. As the ESM Treaty is an international treaty, it must be ratified by parliaments in all 19 ESM member states.

The main changes are that we will be authorised to provide a backstop to the Single Resolution Fund (SRF), for bank resolution. As you know, they are building up their own funds, but in a big crisis, that may not be enough. In other countries, e.g. in the US, the Federal Deposit Insurance Corporation (FDIC) has a credit line with the US Treasury. We don’t have a treasury in the euro area, so the ESM was asked to provide this service. So we will set up the backstop for the SRF.

The other main changes in the ESM Treaty are things like revamping our toolbox - precautionary credit lines will become easier to use. And it has been verified that if there were another adjustment loan needed for our member states, then in the future, the ESM would work very much together with the European Commission to negotiate such a programme – something that was done in the past by the Troika, which no longer exists.

Has this changed the stigma attached to accessing the ESM? I think in part you answered that, because you mentioned the credit lines will be easier to use.

Stigma has several meanings. It’s very clear there is no stigma in the markets. That has been confirmed again and again by market participants. And that’s often what people understand when they hear stigma. But one could argue there is also a political stigma; in some countries, governments are reluctant to use the ESM because they think there’s conditionality attached, painful reforms. And I think you referred to our latest facility that was adopted last May. It is available to all our member states but has not been used. That’s fine – it is a precautionary credit line; it is available and the markets know that, the countries know that. And this has already helped to calm down markets. It’s something that the International Monetary Fund (IMF) also offers to its member states – precautionary credit lines that are available when needed. This political stigma may be there in some countries, but I think with the ESM Treaty reform, there is a good way to get out of that.

Let’s talk about political stigma. You’re a man who understands capital markets and funding. The AFME, the trade body for Europe’s wholesale capital markets, thinks there is a potential €600 billion hole in company balance sheets as a result of the pandemic. Which capital market are they going to be able to go to fund that hole, given that the EU is unwilling to give equivalence to London – the deepest capital market in Europe?

I don’t know whether that is a key problem here. Let me say first that there is a lot of uncertainty; I cannot confirm any number that is a possible hole for the corporate sector. But it’s clear that the pandemic, the way it is playing out, the lockdowns lasting longer, it’s not only now as a result that fiscal deficits are going up and public debt. Also many companies in the corporate sector will suffer; some do very well, but others suffer. The travel industry, obviously - restaurants, hotels, airlines. And there will be problems in the balance sheets. Up to now, much of that is taken up by guarantees or liquidity provision by governments. But then it will run out eventually, and I don’t think anyone has a good estimate at the moment of how big that problem will be. But there will be insolvencies, there will be balance sheet problems. Some of the corporate problems may need to be taken over by the public sector, and that will again increase public deficits. So I think it’s good to be prepared for that, but I think it’s too early to know what the precise numbers are.

You have fast feet when it comes to avoiding the politics of Europe and getting the ESM wired into some of the national-level debates. But you have been targeted in this row in Italy; Matteo Renzi wanted to draw the ESM into financial support for post-pandemic spending, and that’s part of the reason that the Conte government failed. How do you feel about getting dragged into the politics of Italy?

In a way, we are always dragged into the politics of our member states. That’s not unusual; when I think back ten years, we provided loans to Greece, Ireland, Portugal, Spain and Cyprus, we were very much in the middle of politics in these countries. We try to be helpful; that’s why we were created, to help countries. Right now we are called in a different situation. We created this new facility in response to the crisis, what we call Pandemic Crisis Support. It would be up to 2% of a member state’s GDP. But it’s a precautionary credit line; whether countries use it or not, they have to decide themselves. It’s not surprising there are debates about that.

In Italy there are also very intense debates how to use the money that can come from the Next Generation EU provided by the European Commission, which is more money than the ESM can provide; they also use grants. There is a big debate on that, and there should be a debate because it’s a lot of money that is available. And it’s very important that it’s used well, because the intention of this facility is very clear: to promote growth through more investment and reforms. And Italy can potentially get more money out of that than any other country in the EU. This is a once-in-a-lifetime chance, and it’s very important the money is used well. And therefore to have a debate on that - it would be worrying if it were different.

The last ECB meeting I thought was very interesting. The language seems to have changed a little around the pandemic emergency purchase programme (PEPP) envelope, what we’re calling an envelope now, not a target, on that €1.85 trillion. In your opinion, is monetary policy done here? Is it time now for that much vaunted restructuring, that need for proper fiscal policy from national governments, is it time for national governments to deliver?

You said the last ECB meeting was interesting; I think almost all ECB meetings are interesting. And they always have to take into account what’s happening in the economy, and there are changes all the time, and during this pandemic, probably more than normal. And it’s very clear that fiscal policy in Europe, but also in the US, Japan, the UK, around the world, even in emerging markets, is playing a stronger role than in the past. And therefore making it also a bit easier for monetary policy. And this will continue. The fiscal deficits this year in Europe, but even more so in the US, where the fiscal deficits are twice as big as in Europe, unheard of in peace times. This is unfolding, this is the right approach in response to the pandemic. Monetary policy is important, but fiscal policy has to set in to support the labour market, to support corporates, and to have more public investment – I think this is the best way to get out of the crisis, which is the deepest crisis since World War II everywhere. So I think it’s not a question of monetary policy or fiscal. Everybody has to come together here, including European and international institutions like the ESM; we do our little share here. We all have to work together.

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