Interview with Les Echos

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Excerpts of interview transcript

Excerpts of interview transcript with Klaus Regling, Managing Director, ESM
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Interviewer: Catherine Chatignoux

Les Echos: I read some of your comments that say you're not sure that the UK will actually leave the EU.

Klaus Regling: Well, what I said was I don't think it's 100 percent certain. I think it is the most likely development. One cannot ignore a referendum. But I don't think there's a 100 percent certainty. That's what I wanted to say and I think it's still true.

Because both sides want to avoid it?

I think that's right, both sides see the downside, the risks and the costs. And there may therefore be second thoughts. But it's up to the UK. And the only possibility I see is that in the context of an election campaign, there could be a different mandate for a new government. But that's just a possibility and I don't think the most likely scenario.

What will the financial consequences be of the Brexit, particularly for the peripheral countries such as Spain, Portugal and Italy?

I don't see particular problems for the periphery caused by Brexit, if Brexit happens […] Of course, for the continent as a whole, there will be some negative consequences. Much smaller than the economic consequences for the UK itself. But still, to the extent that growth in the UK slows down, that the exchange rate weakens, obviously this will have an impact on exports from all European countries. The UK is an important export destination. So this is not specific to the periphery, this is also true for Germany for instance, or Scandinavian countries, or France.

Don't you see any problems for the Italian banks? It adds more stress and their shares went down.

There's not much reason why the referendum or Brexit as such would cause additional problems. European banks have seen a decline in their share prices since the second half of last year. It is true that since the referendum, there was another drop, a significant drop. But it's not so clear why a Brexit should lead to such an additional drop. There's one exception: if indeed there's a slowdown in the economy caused by a Brexit, mainly in the UK, and to a smaller degree on the continent, then markets expect – so I'm not forecasting this – the ECB will keep interest rates lower for longer. The market perception, again, is that this has a negative impact on profitability. That's one direct link from the referendum and Brexit on the banks. But that's really the only one, apart from a slowdown in the economy of course, which can also have an impact on stock markets. When that happens, bank stocks often move earlier and faster than others. So these are two reasons, but I would put it in a broader context of a weak banking market since last year.

[Italian Prime Minister] Mateo Renzi looks quite concerned by the situation of the Italian banks and is considering a public rescue plan. Do you think that's realistic, and is it allowed?

Again, the problems that we see in some of the Italian banks are not new, and are not caused by Brexit. But we know that the NPLs [non-performing loans] in Italy are particularly high. They are high in many European countries. Europe has €900 billion in NPLs and one-third of those are with Italian banks. So that's a big amount of money. It's not new. It has been like that for some time. It has actually stabilized, so it's not getting worse. But it's a big chunk of NPLs. It's right that there are very clear rules on what is possible with public money and what is not possible. In the context of the banking union, it has become more difficult to use public funds. There are stricter rules for when it is allowed and when it is not. So I don't know what the Italian government will propose. But clearly, there are common rules that were agreed by everybody and they must be respected.

Question about Greece. Where does the ESM stand in the discussion between the creditors and the IMF about debt sustainability for Greece, and the third memorandum? Do you think the 3.5 percent primary surplus is feasible, or do you think that real debt reduction is necessary?

We have made very important progress over the last year to come to an agreement among the institutions, including the IMF and with Greece, on how to look at debt sustainability. Two, three years ago, the IMF used a different approach to measure debt sustainability. More a stock approach, debt-to-GDP ratios. We were arguing that in a case like Greece, where a lot of money is given at very low interest rates for very long periods of time, a flow concept looking at the annual debt service burden makes more sense. We now have convergence to use that concept. That’s very good. We also have an agreement that what we call the Gross Financing Flow - these are the annual debt service payments in a very broad sense, including capital repayment – which should not exceed 15 percent. And that’s very good progress, we have a common framework.

We also made progress at the Eurogroup meeting in May, to do certain debt relief operations immediately. And then, at the end of the programme, we will look at more debt relief if necessary if Greece implements the programme. And on that point, there’s a disagreement with the IMF. The IMF would prefer to have a decision earlier. But the European institutions and the European finance ministers don’t agree with that. I think they are right. Because we have a different framework in Europe as a result of creating the ESM. The IMF in its normal framework – which is a very good framework, I’m not criticising this at all - when they have to deal with a country, there’s no other official source of financing. So they have to make sure that within a few years, everything is well under control and the country can stand on its own feet again. And if in such a case, debt relief or debt reduction is necessary, they have to make sure that this happens early on.

And then the IMF also wants to be repaid after a maximum of 10 years. But for the European countries, where EFSF and ESM have provided a lot of money – and we today give 90 percent of the money, the IMF only 10 percent – we provide much bigger amounts than the IMF is able to do, at much lower interest rates. The IMF is about 4 times more expensive. [The ESM also provides financing] for much longer, in the case of Greece, on average the maturity is 32 years. So that is a very different concept of what the IMF faces with countries outside Europe. And I'm very much in favour of the IMF continuing to apply its own framework for those countries outside Europe. But for European countries, where the ESM is involved, it's not appropriate. There's a lot of uncertainty over a 30 year period, and it's better to have the commitment that the Eurogroup has given repeatedly that we stand ready to provide more debt relief if needed, and if the reforms continue, of course.

What are your ideas to provide short-term debt relief to Greece?

We are working on that. There are three elements. One is to smoothen the repayment profile, which we are doing. We have the mandate, so we don't need any other decision. And at the moment, because there was a repayment, the average maturity is only 28 years and we're allowed to go up to 32 years. So we can work with that and relatively quickly adjust some of the repayments in order to avoid big jumps in repayments in certain years, and smoothen the profile. That's one. The second is that we have the mandate to look at ways to reduce interest rate risk for Greece. People expect that interest rates will go up in the future, and we're talking here about a 30-year period, and so we're working on ways to protect Greece. And the third one is very technical one. There's a jump in interest rates in the year 2017 on a small part of the Greek debt. And the mandate is to eliminate that. And that will save a few hundred million euros.

Will it cost the member states any money?

No, this does not lead to costs. Of course, whenever maturities are extended, the risk that member states take – because they guarantee our operations – is taken for longer. So that's an indirect cost. But there's no budgetary costs that Europe taxpayers have to take for any of this. Like for all our operations, ESM lending does not lead to any direct cost for European taxpayers.

When will you propose these three measures for short-term debt relief?

We have the mandate. Over the next few weeks, certainly before the end of the year.

Author

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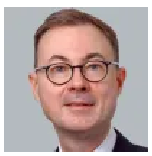

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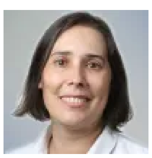

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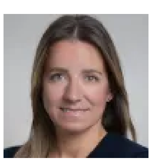

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