Klaus Regling in interview with To Vima (Greece), May 2021

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21/05/2021

Interview with ESM Managing Director Klaus Regling

Published in *To Vima* (Greece) on 23 May 2021

Interview conducted on 14 May 2021

Interviewer: Angelos Kovaios

Original language: English

To Vima: One year after the deal for the EU recovery fund, several European countries have yet to ratify the “own-resources” programmes. Do the delays worry you?

Klaus Regling: There are actually no delays. It’s true that seven countries have not yet ratified, but so far we’re on schedule. The European Commission expects to issue bonds and make the first disbursements in July, so in that sense there are no delays. Reaching an agreement in parliaments, given that there are 27 countries, requires time. This is not unusual; it's a characteristic of Europe. There is still time until June.

Has the pandemic created new kinds of inequalities within the EU? Will countries with higher debt to GDP ratios, like Greece, eventually get under enormous pressure?

Unfortunately, the word “inequality” describes a lot of what we see. At the IMF spring meetings, that was a key word, used again and again, when comparing poorer countries and richer countries. In Europe, we also see more inequality and we see it in every country. Unfortunately, as countries need to run large fiscal deficits to address the pandemic fallout, higher debt will remain as a legacy. We have to find a way to deal with that. But when we look at it in the broader sense, Europe is not in the worst situation.

Greece is in a special situation, because Greek debt is higher than the debt of any other country in Europe in terms of GDP, now above 200%. That makes the Greek economy vulnerable. The government has to pay attention to that. The ESM, of course, follows this very closely. As Greece's largest creditor, we have a very clear interest that the Greek economy develops long after the pandemic. There are vulnerabilities due to the higher debt, but there are also positive factors that will help Greece respond to these challenges.

Could you name these factors?

One is Greece's debt structure: 55% of Greek debt is owed to the EFSF and the ESM and therefore carries AAA interest rates. Another one is the special EU package of funds, the biggest package ever agreed in Europe, to finance public investment and reforms over the next five years. Greece will receive the largest part, in terms of GDP, so it will get the biggest support. That's appropriate and very positive. There was a clear decision to help those countries in the EU that were the most affected by the crisis. That's a clear sign of solidarity. So this package is important, but it is also another challenge, because it has to be used efficiently and implemented well.

To be completely clear, this crisis is not comparable to the crisis ten years ago, where very serious macroeconomic imbalances had to be corrected. We don't have that problem now, not at all. There were no macroeconomic imbalances in Greece in

2019. The fiscal situation was strong, it was the third year in a row with an overall fiscal surplus and the Greek primary surplus was even above the targets that had been agreed.

Additionally, it is clear that two elements will determine debt sustainability over the next decades: growth rates and the interest rates. Growth rates should be positively affected by the NextGenerationEU. If reforms are promoted and public investment goes up, this will have a positive impact on growth. The government and the European Commission estimate that it will raise growth in Greece by seven percentage points over the next five-six years. Some analysts actually forecast a larger impact, so there could be a positive surprise.

Apart from that, before the EU funds flow, economic activity will bounce back. According to the European Commission's latest forecasts, the economy is expected to grow 4.1% this year and 6% percent next year, and there will also be above average growth in coming years.

On the interest rate side, the right policies lead to confidence in financial markets, which in turn would lead to low interest rate spreads for Greek debt. The spread has come down a lot the last few years. And with the right reforms it will remain low, or decline even further.

So you are saying the interest rate for Greece could remain low, even if the ECB programmes come to an end?

It will depend a lot on the reform efforts of the government. When I talk to international investors, they are aware that this could expire. They don't know when and I don't know more than the markets, but I hear from many that they are prepared to look through that. First, because money will start flowing from the NextGenerationEU and second, because they expect Greece will continue efforts to regain "investment grade". We saw the upgrade by S&P a few weeks ago, with a positive outlook. Credit rating agencies will look at reform efforts to determine further steps. Greece can regain investment grade, not this year, but over time. Investors around the world have a similar view, and I think they will be prepared to stay with Greece, if they see that this is a realistic chance.

Since you mentioned it, during the past year we saw this spectacular shift from strict austerity policies to increased public spending, growing deficits etc. Is there a way back to the pre-Covid model?

In this crisis, we are together fighting a pandemic that was not caused by any policy mistakes from previous years. It’s completely different. Looking forward, regardless of what happens with the Stability and Growth Pact and the fiscal surveillance framework, each country has to make sure that its debt remains sustainable. That is the overriding concern

It’s not a question of going back to what we had or to something completely new. Maintaining debt sustainability will be the main issue. For Europe as a whole, we need a coordination framework. For the Monetary Union to function well, it’s absolutely indispensable. We know that the existing Stability Pact needs to be reformed and work on that will start later this year.

Overall, would you say that it’s a “now or never” moment for the Greek economy?

In one important aspect, it is a “now or never” moment. Greece, as other countries in Europe, will not receive so much additional money - including a large amount in grants - again for a long time. But Greece has had a few “now or never” moments the last ten years and rose to those occasions. In a way, now it’s easier, because the money is available and that’s much nicer than correcting imbalances and accumulated problems. It will be important to use that large amount of money well and efficiently.

Are you satisfied with the Greek banking sector's progress in dealing with the non-performing loans (NPLs) problem? The banks’ financing of the private sector, especially the smaller enterprises, remains very poor. Do you see this as threat for the recovery plan?

That is a concern. Banks are in a better situation now than five or ten years ago and that’s positive. They have reduced NPLs significantly, but they have still by far the highest ratio in Europe. So, it’s not the end of the road at all!

So far, Greek banks have reduced NPLs as agreed with the ECB. The progress is important and it must continue. The mechanisms are in place to do that, the “Hercules” scheme is available and will be extended. Progress is good but it must continue.

That said, we are a bit worried that bank lending is limited and the recovery may need more bank financing, particularly for smaller companies. I discussed this in my different meetings with the government in the last few days. They are fully aware and they are working on ways how to help SMEs to get the financing they need to be fully participating in the recovery.

How about the proposal of the governor of the Bank of Greece, Mr. Stournaras, for the establishment of a "bad bank" to address the problem?

Well, it's good to have different proposals but the government believes that 'Hercules' has worked well and it has indeed reduced NPLs. This was the programme agreed with the European Commission. If the government wants to try a different plan, it needs to get approval from the Commission. At the moment, the government doesn't see the need for that.

Europe is already lagging behind the US and China, as the pandemic continues to have a negative effect in the first quarter of 2021. How will it catch up in the coming months?

I don't agree that Europe is lagging behind. China has an average income level that's only one third of the European average. Despite their strong growth in the last forty years, they can continue to grow very strongly to catch up further. We will never have their growth rates.

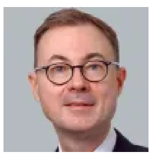
The US is very different. We have seen for decades that during recessions, the US economy declines faster but also recovers faster than Europe. Their economy is much more flexible. On average, the US always grows faster than Europe, because they have a different demographic situation. The US population grows on average 0.5% faster than Europe's so they must grow 0.5% more in order to have the same development of their standard of living as Europe. People often forget that.

At the moment, US President Biden is putting in place a fiscal stimulus programme of unprecedented proportions. I do not recommend that Europe duplicates that, but it does mean that, for a while, the US will grow faster. I believe that is a temporary phenomenon. Europe is putting in place the NextGenerationEU, which will be disbursed more slowly. Unlike the US, which is only supporting demand, in a one-off push for growth, Europe is supporting both the demand and the supply side of the economy. We are creating incentives for reforms and public investment, aiming for a permanently higher growth rate. Europe's approach is much better, even if, in the short run, the impact is more positive in the US.

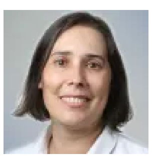
Author

Klaus Regling
Managing Director (2012 - 2022)

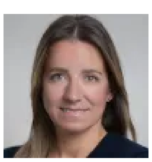
Contacts



Cédric Crelo
Head of Communications and Chief Spokesperson
+352 260 962 205
c.crelo@esm.europa.eu



Anabela Reis
Deputy Head of Communications and Deputy Chief Spokesperson
+352 260 962 551
a.reis@esm.europa.eu



Juliana Dahl
Principal Speechwriter and Principal Spokesperson
+352 260 962 654
j.dahl@esm.europa.eu