Klaus Regling in interview with Kathimerini Cyprus

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Interview with Klaus Regling, ESM Managing Director
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Panagiotis Rougkalas: What is your assessment of the financial aid given to Cyprus during the past crisis? Was it well used, given the agreed plan?

Klaus Regling: Cyprus suffered a very severe crisis in 2012 and 2013, like some other euro area countries. During the first decade of Monetary Union, macroeconomic imbalances accumulated in several countries and needed to be tackled. And, although sometimes painful, the adjustments led to positive results. The assistance programme in Cyprus was well implemented. Since 2015, the Cypriot economy has been doing quite well, in terms of employment and growth rates, and actually performed better than many people expected in 2013. Looking at 2019, the last year before Covid-19 hit, the Cypriot economy was even doing better than other economies in Europe. The country was in a solid economic position to deal with the Covid-19 health crisis. This is also, in part, due to the huge efforts made during the euro crisis.

Was the programme for Cyprus successful in terms of the necessary reforms?

Cyprus received a lot of support from its European partners, the European Stability Mechanism, the institution I manage, committed €9 billion, although only €6.3 billion was needed in the end, and the IMF lent another €1 billion. It was a loan with very low interest rates, at a time when interest rates in the market were much higher, an expression of euro area solidarity. The country adopted reforms to cut down the size of the financial sector and regain competitiveness, and that worked. This does not mean that Cyprus from now on does not have to do any more reforms. Indeed, the Recovery and Resilience Plan includes some of the reforms that are still needed, to make the economy more competitive and more diversified. That has the potential of driving the economic growth rate higher. This crisis, painful in many ways, does offer the opportunity to transform our economies, to make them greener, more digital. We should seize that.

What is your assessment of the banking system in Cyprus today? Did it manage to absorb the shock of 2013 events or do you see threats still hanging there?

Cyprus was successful in cutting the size of its banking sector in a significant way. Non-performing loans (NPLs) in the Cypriot banking sector decreased by over 80% since 2015. This is a sizeable reduction but the country still has an NPL ratio that is the second highest in the European Union. That indicates, on one hand, a big success but, on the other, that efforts to reduce NPLs further should continue, so that banks can play the role they need to play to support the economy. An effective application of the insolvency and foreclosure framework will be important in this respect.

Cyprus's debt level after the pandemic is higher than before the outbreak. Is this alarming for Cyprus’s economy?

Debt ratios went up in all euro area countries. It was unavoidable, due to the economic impact of Covid-19. Without additional fiscal actions, the situation could have been worse. And, although vulnerabilities went up for all countries, public debt is currently sustainable in all member states of the monetary union. For several decades, we have been seeing a long-term decline in interest rates. Countries now have a higher debt carrying capacity than what was assumed in the Maastricht Treaty. Interest rates will eventually go up, but economic research indicates that they will remain lower than 20-30 years ago. In that sense, the higher debt ratio can be digested more easily than 20-30 years ago.

That does not mean that countries don’t need to be careful. We know that in the next 10 or 20 years, the ageing population will require higher pension and health costs that will weigh on public budgets. It is important for every country, not only Cyprus, to create fiscal space to face any future crisis. Hopefully we will not face one again soon, but crises are always unexpected. Countries will have a higher capacity to service debt, but that does not mean that they don’t have to constantly monitor their debt sustainability.

I would like your thoughts about the reform of the EU fiscal framework and how these potential changes will impact countries like Cyprus with high debt to GDP ratios?

It is important to remember that a monetary union needs a credible fiscal surveillance framework. In a monetary union, monetary policy is centralised and there is only one exchange rate, but fiscal policy is still done at national level, in a decentralised way. We need a fiscal surveillance framework to make sure fiscal policy is well-coordinated. And it has worked for the most part. But it has also become very complicated over time, full of exceptions and working with unobservable economic variables, which make it difficult to understand and implement. And, as I said the interest rate environment has changed because of the long-term, secular trend towards lower interest rates that we observe globally. The Stability and Growth Pact, as it stands now, does not reflect this changed macroeconomic environment. So we need to reform it.

What is your opinion about the EU recovery fund and its set of targets? Are they a little bit ambitious?

Cyprus can receive a total of €1.2 billion euros in grants and loans from the Recovery Plan and Fund of “NextGenerationEU” to support the economy. The efficient and effective implementation of the plan is the key task. It is an ambitious programme. The Recovery and Resilience Plan that the Cypriot government submitted is good and, if well implemented, it can raise its growth potential and transform the economy. That does require timely implementation of ambitious reforms for the financial sector, public administration and others, to diversify the economy and make it more competitive. If that happens, then the growth outlook may even look better than before the pandemic. Having ambitious targets makes sense because this is a once-in-a-lifetime opportunity. Not only for Cyprus, but for all European countries.

What are your predictions / prospects for the European economy and Cyprus economy specifically for 2022?

The latest European Commission’s autumn forecast is a good prediction. We are still in the phase of recovering the lost output of 2020 in response to Covid-19 and the lockdowns. The EU economy is projected to keep expanding over the forecast horizon, achieving a growth rate of 5%, 4.3% and 2.5% in 2021, 2022 and 2023, respectively. After a 5.2% drop in economic activity in Cyprus last year, the latest European Commission forecast points to a recovery of 5.4% in 2021 and 4.2% in 2022, which is about the same as the EU average.

Do you believe that the European economy is now more resilient to address a crisis like the current one? What are the lessons learned?

Europe faced two big crises in the last 12 years. They are two very different crises. In response to the euro crisis a decade ago, important initiatives were taken to make our Economic and Monetary Union (EMU) more resilient. We set up several new institutions, like the SSM, the SRB, ESRB, EBA, ESMA and, of course, the ESM – that increased the effectiveness of crisis prevention and crisis management. These institutions helped a lot to address the second crisis, caused by the pandemic, and I am sure that they are going to help again in whatever future crisis we will face. The most important development in response to this crisis is the opportunity that the NextGeneration EU Funds bring in stimulating reforms and investment, and transitioning to greener and more digital economies.

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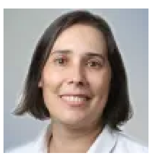

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