

Klaus Regling in interview with Kathimerini (Greece), January 2022

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Interview with Klaus Regling, ESM Managing Director

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Kathimerini: Were you surprised by the strength of the recovery of the Greek economy in 2021? What could derail it in 2022?

Klaus Regling: The Greek economy was doing very well until the beginning of 2020, when the Covid-19 pandemic broke out. From the completion of the ESM programme

[August 2018] until then, the performance of the Greek economy was better than the Eurozone average: higher growth rate, more jobs, good fiscal situation, with surpluses. The trend was quite positive.

With the advent of Covid, Greece, given the structure of its economy and its dependence on tourism, suffered more than most European economies, with a 9% drop in GDP in 2020 - a huge drop. But this was inevitable - no one blames Greece for it.

Then the right measures were adopted, both by the Greek authorities and at European level. At European level, unprecedented measures have been taken to support mainly the countries hardest hit by the crisis. This explains the strong recovery this year. Tourism also performed better than expected. My last visit to Greece was in July and already then the data showed that the economy was doing well. This was recently confirmed by the new forecast of the Commission - which sees the recovery continuing into 2022, with growth of more than 5%.

Of course, the pandemic has not subsided. We are already in the fourth wave and there is uncertainty about how the new year will develop and how it will affect the economy.

Are there any risks that specifically concern the Greek economy?

The pandemic affects all European economies - although the economic threat is greater for southern European countries. I want to emphasise that the Greek measures are good - and especially the Recovery and Resilience Plan. It was approved early and deals with the right issues for the transformation of the economy in a green and digital direction, but also to strengthen it, by investing in infrastructure, education, public administration. The crucial thing now is to fully implement the Plan. This will be difficult for many countries, including Greece: we are talking about the need to absorb very large, unprecedented amounts of money. If it is implemented correctly, Greece has a real prospect of entering a higher growth trajectory. This would need to be, of course, underpinned by completing the agreed structural reforms and fiscal discipline.

ESM is the largest creditor in Greece. The country has been borrowing on excellent terms lately, but its debt now exceeds 200% of GDP. Are you worried that lending conditions may worsen in 2022? How important is it for the ECB to continue buying Greek bonds beyond the PEPP maturity

date?

Greek debt in terms of GDP is indeed the highest in Europe and one of the highest in the world. And of course it increased more during the pandemic - although this was inevitable to prevent an even more dramatic drop in GDP. Its level, however, is a vulnerable point.

We still believe that the Greek debt is manageable, over the coming years. This has to do with its structure. The ESM, as you said, is Greece's largest creditor and our lending terms are quite unusual: the average maturity of loans is 32 years and the interest rate is linked to the AAA rating of the ESM, so it is very low. This means that Greece saves a lot of money on debt servicing costs every year.

Other than the 55% of Greek debt held by the ESM, part of it is in the hands of other European institutions, such as the Commission and the European Investment Bank. Their terms are also very favorable. This debt structure is very healthy and reassuring for the financial markets.

The ECB's monetary policy has also helped. We all know that this emergency support will change at some point as the economy returns to normal. Interest rates will not remain as low as they are today - although all indications are that they will stabilise at levels lower than they were 30 years ago. Governments - including the Greek one - need to prepare for this increase, as well as for the additional fiscal burdens imposed by demographic change and the need to tackle climate change. They should also make sure they have the fiscal space to react to the next crisis, whenever it comes.

I am encouraged by Greece's fiscal planning, which foresees a return to primary surpluses in 2023. This is vital to maintain market confidence, underpinning Greece's debt sustainability over the long run - and is the most important aspect, independent of ECB's action.

Are you at all worried that the suspension of fiscal rules for the period 2020-2 has awakened spending instincts in Greece that will be hard to rein in? Or do you consider that the Greek political class has absorbed the lessons of the debt crisis?

When I talk to the Greek government, I am convinced that the latter is true. I do not see any intention to deviate from fiscal strategies agreed long before the pandemic.

Beyond Greece, the issue you raise I think is something we need to pay attention to. Many in Europe, the US and elsewhere – and I repeat I'm not talking about Greece now – have taken the view that additional spending is always a good idea. This can create risks.

Among other things, 2022 will be a year of negotiations for a new Stability and Growth Pact. What makes its reform necessary now? And how confident are you that there will be a political compromise on the issue within the new year?

First of all, it is necessary to have a framework for financial surveillance, as in some areas of EMU, above all monetary policy, responsibilities have been transferred to a central authority, while others, such as fiscal policy, remain under the control of the member states. This can work, but only if we have an effective way of coordinating national fiscal policies.

The SGP has not worked perfectly, but it has very often provided good guidance to member states and it has ensured that fiscal policy in the EU has remained much more within reasonable trends than in other developed economies (US, UK, Japan).

But its reform is necessary for several reasons, which we already knew before the pandemic: first, it had become too complicated, there were too many exceptions, making it unpredictable and not very transparent. This did not contribute to the credibility of EU countries in the markets. Secondly, there were methodological problems with the calculation of some of the variables (output gap, structural balances), especially in the aftermath of the global financial crisis. Third, the pandemic has led to very high debt levels in many countries.

One long-term trend that will make it easier to find an agreement is the low level of interest rates. This means that governments have a greater debt-carrying capacity compared to 30 years ago, which is positive given the public investment that will have to be made in the coming years for the digital and green transition. However, combining the different reform demands into a single package acceptable by all will be a difficult task.

Regarding inflation, do you share the moderately optimistic assessment that this is a temporary phenomenon? Do you see any second-round effects of the uptick in prices on wages in Europe?

On the one hand, we see inflation rates now that are higher than anyone expected. In the short term, there are strong factors, such as energy prices, that are pushing up inflation, but these will ease or disappear completely as we enter the new year. The supply chain bottlenecks, for example, are already showing signs of easing. If there are second-round effects from wages that will become evident in the medium term. We see them occurring a little bit in the US and the UK, but not at all in Europe, at the moment. This is something that the ECB is closely monitoring. The longer the price increases last, the more likely they are to translate into higher nominal wages.

In the long run, we have some indications that the strong deflationary trends of the last 20 years have begun to reverse. Globalisation, for example, which has fueled competition and increased labor supply, is likely to retreat in the coming years. The workforce, both in Europe and in China, has stopped growing due to demographic change. However, academics researching these issues are not concerned about a return to double-digit inflation - just an increase from what we have become accustomed to in more recent years.

Why has no country used Pandemic Crisis Support? Is it a sign that the ESM remains stigmatised in the eyes of Eurozone countries due to the memories of the debt crisis?

The ESM's pandemic credit line was a very useful part of the pan-European response to the economic crisis caused by the pandemic. It has, indeed, not been activated - but it remains available until the end of 2022. It is a precautionary tool, like similar ones deployed by the International Monetary Fund, working as an insurance, which means it is valuable even if it is not used - or particularly - when it is not being used.

How will the new ESM contribute to financial stability in the Eurozone? What is the significance of the early activation of the common backstop?

The ESM, under the amended Treaty, will have - together with the European Commission - greater responsibilities in designing, negotiating and monitoring future adjustment programmes. Unlike in the previous crisis, in which the so-called troika operated, in the future, the EC and the ESM will lead policy work in accordance with the respective roles and mandates. Additionally, the common backstop, which will be activated in early 2022, will contribute to the resilience of

banking union. The ESM, if needed in times of crisis, will provide loans to the Single Resolution Fund (SRF) for the resolution of banks, which will then be repaid with resources from banks. This avoids placing the burden on taxpayers in the resolution process.

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