Klaus Regling in interview with Capital.gr (Greece) - April 2022

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Interview with Klaus Regling, ESM Managing Director
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Capital.gr: After the pandemic, a war in Ukraine. Although it is still too early to estimate, what do you think will be the impact on the growth of the European economy?

Klaus Regling: There is a lot of uncertainty. The war on Ukraine will undoubtedly have an impact on the European economy, that was otherwise recovering strongly in the aftermath of the pandemic. How much growth will slow depends on how the war evolves. The higher energy and food prices that we already see will weaken purchasing power of households. This paired with the elevated uncertainty and new impairments of supply chains might significantly reduce growth this year. But there are also positive aspects. We were experiencing strong growth momentum until the invasion, which is counterbalancing the negative effects of the war. Countries in Europe are implementing additional reforms, supported by financing from NextGenerationEU. That strengthens the growth potential. Also, consumers accumulated a sizeable stock of savings during the two years of the pandemic, savings that go beyond what they would have accumulated without the pandemic. This additional stock of savings can help cushion the decline in purchasing power that is caused by higher energy prices.

In the pandemic crisis, the EU acted swiftly, setting up the RRF. Do you think that joint funding mechanisms at European level would be the answer also in the case of the energy crisis, investment on defense, and the effects of war in general?

This is a discussion taking place among the European Union leaders. We need to recognise that the situation today differs from the pandemic, when temporary financial support was needed until the recovery took hold. Now, the energy crisis and investment in defence may require a permanent increase in spending, which cannot easily be provided by European sources. Also, given higher debt levels, the general support provided during the pandemic to households and companies seem less appropriate now. Finance ministers, in their statement following the last Eurogroup, rightly favoured targeted and temporary measures. However, NGEU funds can be used to increase Europe’s strategic independence from Russian energy imports. And this can be strengthened, as not all money has been requested by governments so far. This represents an important strategic support, at the European level, which can be provided quickly.

Is the extension of the general escape clause to 2023 inevitable?

The European Commission will reassess its fiscal guidance in May, in light of the new European forecast presented then. Given the uncertainty we face, this is very reasonable. On that occasion, the Commission will also assess whether the General

Escape Clause needs to be extended.

Are you worried about a new European debt crisis in the wake of countries borrowing for the pandemic and supporting societies for the crises?

The policy response to the pandemic was needed. It inevitably brought about higher deficits which, together with lower economic growth, have pushed public debt-to-GDP levels higher. Despite the increase, this is still manageable. However, countries with high debt need to reduce their debt levels over time and ensure that debt service remains manageable also in the future. But I think they have the time, or budgetary flexibility, to do this in a way that supports growth.

Inflation has reached historic highs in Europe. Do you think it is here to stay?

The shock from commodity prices that the euro area is facing has historical dimensions. It has now reached magnitudes comparable with the big oil price shock of the 1970s. Energy and food prices may remain high for some time. This will depend on the war and further development of commodity prices. Fortunately, longer-term inflation expectations and wages still seem to be well aligned with the ECBs objective of price stability and we do not see second-round effects in the labour market so far.

Greece is paying off the expensive IMF loans and GLF loans. What does this mean for the ESM?

The full early repayment of Greece’s outstanding IMF loans, as well as the prepayment of a portion of its GLF loans, sends a positive signal to markets about Greece’s financing position. It will also have a positive impact on Greece’s public debt profile and will generate some savings for the Greek budget. These are welcome developments for the ESM and EFSF, who hold around half of Greece’s public debt. Our interests are aligned.

This summer marks the end of the enhanced surveillance period for Greece. However, there is still one pending tranche. What do you think should be done? Is there any chance of continuing the enhanced surveillance?

We know that Greece will be under Enhanced Surveillance until late summer as decided by the Commission in January when it renewed it from February until August 2022. What happens afterwards, and under which conditions the final tranche of debt relief measures can be disbursed is still under discussion between the Greek government, the European institutions and other member states.

There are some concerns that Greece will not be able to stand on its feet without enhanced supervision. What do you think?

Over the years, Greek governments have introduced many reforms to modernise the country; its debt structure and fiscal position have improved; and banks have drastically reduced non-performing loans, while strengthening capital ratios. Greece is in a better position today than before. However, the ESM is a long-term partner of Greece. We are its largest creditor, together with the EFSF. Our collaboration with Greece's authorities and people will not cease with the end of enhanced surveillance. We will continue to work together to support efforts to boost the country's long-term growth potential, which is key for maintaining debt sustainability.

And then what? Will Greece return to its agreed 2.2% primary surplus commitments from 2023? Is this feasible in the new circumstances?

I appreciate that the government has announced its intention to have a primary surplus in 2023. It's important that the primary surplus remains very close to the agreed levels. Fiscal prudence going forward will be vital to maintain debt sustainability and market confidence. Furthermore, the fiscal path is an important factor that rating agencies will look at when deciding to upgrade the country's rating to investment grade.

During the pandemic, Greek debt exceeded 200% of GDP. The Commission recommends expenditure restraint and gradual adjustment in countries with high debt. What is your opinion?

I agree with that recommendation from the Commission, also for Greece. Greece has, by far, the highest debt ratio in Europe. But, we should not forget that the structure of Greece's debt is also unique. The vast majority of Greece's public debt is held by official-sector creditors. ESM and EFSF are the largest, as I have already mentioned. Therefore, high debt levels do not imply immediate risks to Greece's debt sustainability. ESM's lending terms are very favourable, with long maturities and low interest rates linked to our strong credit rating. In any case, as I said before, fiscal prudence is key and will underpin Greece’s debt sustainability over the long run.

We are in a period of consultation on the reforms to the Stability and Growth Pact. At the heart of this is the ESM proposal for a 100% debt limit. What do you think should be the key points of change in this?

Europe’s Stability and Growth Pact has worked reasonably well but needs to be reformed. Investors today have little confidence in the current framework with its complexity and many exceptions and a credible framework for fiscal policy is essential in our monetary union. The Pact’s main elements date back to its introduction in the 1990s and do not reflect the changed macroeconomic environment. Interest rates, for example, will not remain as low as they are today, but they will still be lower than at the time of the negotiation of the Maastricht Treaty, as I mentioned before. This means that higher debt targets could be acceptable. I am not implying that countries don’t need to be careful. The Stability and Growth Pact’s key objective of ensuring debt sustainability in all countries at all times, remains. I hope that we can use the time in which the EU rules on budget deficits are suspended to agree on an improved, simpler, and more credible budgetary surveillance framework.

There are two main “schools of thoughts” on the approach to reforms: one of the "frugal" one and the other is coming from the South of Europe claiming that we should take the lessons from the previous crises. Which one do you agree more with?

This is a good opportunity to drop archaic and artificial antagonisms, e.g., between ‘North’ and ‘South’. The euro area countries have far more common interests than conflicting ones and this should be emphasised more in the public discussion. The European economy is in global competition and must be better prepared for it. A more resilient monetary union is in the interest of all its members.

Your term of office at the ESM is coming to an end. What has been the most important moment in this period? What decision would you change if you could turn back the clock?

For four decades, my work has revolved around European integration and the euro. I believe that the euro is an essential element of European integration and that its

role is crucial for strengthening European sovereignty. I am proud that the EFSF and later the ESM contributed to the euro's resilience and helped keep the euro area intact. Without them, some countries, including Greece, could have been forced to leave the monetary union and that would have meant even more hardship for Greek citizens. Preventing that was very important.
As with all paths, mine has not been a straight line, but I would not turn back the clock to change it.

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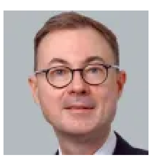

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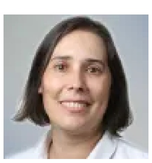

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