Rolf Strauch in interview with Kathimerini (Greece)

Interview with Rolf Strauch, ESM Chief Economist
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Kathimerini: What is the role of the ESM in Greece and why does the ESM monitor economic developments in Greece?

Rolf Strauch: The ESM’s mission is to safeguard financial stability in the euro area. We make sure, within our mandate, that the euro and its members are safe. The ESM has been a close partner for Greece for over ten years and our unique cooperation will continue in the future.

The Greek economy is much more resilient and dynamic today also thanks to the reforms that were undertaken during the financial assistance programmes. This has allowed it to overcome the large economic shocks we have faced over the past years.

We want to continue to help Greece to further strengthen its economy and make it fit for the challenges of tomorrow. We have a vested interest in Greece's economic success and prosperity.

What do you think should be the priorities of the new government?

It is important to maintain the reform momentum, keep the focus on sustainable growth and prudent fiscal policy to ensure that the debt is sustainable and reach the investment grade rating, which will help to strengthen the market access of the country, the banks, and corporates.

Creating a vibrant private sector, making the banks stronger, and improving the governance and efficiency of its state-owned companies should be top priorities. This will help modernise the economy and increase the attractiveness of the economy to investors.

In this respect, it is important to enable independent state institutions - particularly HCAP [Hellenic Corporation of Assets and Participations] and HFSF [Hellenic Financial Stability Fund] - to fulfil their mandate. These funds manage valuable assets for the state and play a fundamental role in introducing best practices in governance and efficiency. These improvements will ultimately benefit all citizens.

What is currently supporting government revenues in Greece? To the extent that their good performance is due to high inflation, might we see a worse picture once inflationary pressures subside?

Greece's fiscal performance over the past two years has been quite remarkable. A significant factor behind this strong performance was the rapid increase in tax revenue.

Tax collections benefited from a variety of factors. Inflation certainly helped, but also let's not forget that Greece's economy rebounded strongly from the pandemic and proved very resilient in the face of the energy-price shock and the war in Ukraine.

And the authorities have been successful in fighting tax evasion, a long-standing problem in Greece.

Greece's economy is significantly larger than we expected a year ago. And a larger economy generates more tax revenue also in the time to come. This is positive for the outlook for government revenue.

How much harder will primary surplus targets become for Greece from 2024? Is fiscal tightening at risk of undermining growth momentum?

A responsible and sustainable fiscal policy remains a critical priority for Greece in the time ahead. Fortunately, Greece's economic outlook is built on a resilient base. The surge in public and private investment under Greece's recovery and resilience plan has created a strong momentum, helping to modernise the Greek economy with state-of-the-art technology and high-quality jobs.

We also see that demand for tourism remains very strong, and few countries are as well positioned to take advantage of this demand as Greece.

Finally, Greek government debt, although still very high, enjoys very low interest rates at very long maturities, also thanks to the ESM, which shields the government, to a large extent, from the rapid increase in market interest rates that we have witnessed over the past 18 months or so.

Greek public debt has fallen by 23% as a percentage of GDP due to inflation and growth. But in absolute terms, it has increased to the region of €400 billion. Do you agree with the analysis that it is not the nominal value of the debt that matters, but the ability to service it?

As I mentioned above, the structure of Greece's debt has improved a lot. This is due in large part to the very favourable lending terms provided by the ESM and its predecessor, the EFSF, and the liability management exercises under the ESM programme. The ESM holds around 55% of Greece's public debt and the weighted remaining maturity of the ESM/EFSF loans is around 30 years – much longer than that of the remaining debt stock. Due to the low interest rate on these loans – thanks to the ESM's own low, AAA-rated cost of funding over that period – Greece's annual costs for servicing these loans is lower than expected for its total debt level.

Government debt is, always and everywhere, ultimately backed by the government's ability to raise the necessary tax revenue to service and repay the debt. The outlook for government revenue collection remains positive given the growth outlook. Growth improves the economic pie, being the basis for taxation.

This, in principle, augurs well for Greece's ability to service its debt pile in the years ahead. However, given the large size of the debt, the government should keep a responsible and sustainable fiscal policy. And government expenditures should stay prudent and be directed to areas that will bolster the potential of the economy in the future – such as education, on-the-job training, and infrastructure.

Do you agree with the view that lower tax rates bring in higher revenue at the end of the day, through increased economic activity and consumption? In this sense, would it help - from a fiscal point of view - for more tax cuts to follow in Greece?

Let me start with a general point. Tax cuts typically reduce government revenue. There are not many experiences internationally or in Greece where tax cuts as such eventually led to higher overall tax collections, which are mainly due to higher growth.

That said, Greece continues to have high marginal tax rates, particularly on people who earn their living with a salary as well as for investors who put funds into new projects. And high marginal rates act as a break on these types of activities.

For that reason, we think it is reasonable to investigate whether the government has scope to further reduce marginal tax rates, if these are high by international standards. But at the same time, it should broaden the base on which taxes are levied. Concrete examples for this base-broadening include removing tax exemptions, increasing the tax take from the self-employed and the tourism industry, and further fight against tax evasion.

What benefits will Greece get after regaining investment grade and how do these relate to debt servicing?

The investment grade rating is a crucial goal for Greece, its economy, the banks, investors, and Greek citizens. In a nutshell, it will help to make the country and its economy more resilient to shocks.

It will be a reward after years of fiscal efforts, bank restructuring and reforms. The investment grade rating will make Greece's market access stronger and more resilient; it will also have a positive impact on the country's sovereign spread strengthening the sustainability of the debt.

Furthermore, the investment grade will enlarge the number of investors that can invest in Greece. This means the entire economy and society will benefit. For example, it will allow to attract good, strategic, and stable investors in banks' capital when their privatisation process will start.

What is the reality that high-interest rates shape for Greek banks and how serious is the risk of complications in the stability of the system?

It is not easy to quantify the final impact of rising interest rates on banks' balance sheets and profitability. There are many transmission channels acting in different directions; it is not straightforward to understand which one will prevail at the end.

For example, banks' profitability benefits from the repricing of their loan book, but the increase in interest rates also means their own cost of funding goes up. It also increases the cost of borrowing money for households and businesses. This means that an increase in insolvencies becomes more likely.

Overall, Greek banks should benefit in the short term from rising interest rates thanks to a temporary improvement of their profitability, which should give them more room for manoeuvre in absorbing a possible deterioration in asset quality and further strengthen their capital.

Banks should use this improved profitability to invest in modernising their infrastructure, and in particular investing in IT and digitalisation to become more efficient.

Is the current account deficit worsening in Greece due to energy inflation or is it based on broader factors as well? Is this something that worries the ESM?

We were somewhat surprised at the size of the deterioration in the current account deficit – the difference between the value of Greece's exports over imports – over the past two years.

High energy prices contributed to the deficits, but that is not the whole story. Household spending for consumption has been extraordinarily strong. Companies have been ramping up their investment plans, also because of the favourable financing available from the Next Generation EU funds. These developments helped the economy to grow but also created strong demand for imports.

Greece’s current account deficit will shrink over the years to come. The challenge is to ensure that this happens in an orderly fashion. The thing we watch out for is for household spending and demand to return to more normal levels after years of strong growth. Also, over time, we would like to see further improvements in Greece’s export performance, with Greece becoming more competitive in key sectors such as agriculture, energy, and digital services.

A country's capacity for sustainable growth rates is defined by indicators such as the productivity of its economy. How far does Greece have to travel at this level?

Greece has shown itself to be more resilient than many expected in the aftermath of the pandemic and during the large shock from the war in Ukraine.

To ensure that this positive trend continues, Greece needs to become more productive, innovative, and efficient. In fact, I believe that this is the overarching challenge for the economy in years to come.

Fortunately, there is a clear roadmap for Greece to follow – the recovery and resilience plan. Implementing the reforms and investments under this ambitious plan will go a long way towards overhauling the Greek economy and generating a self-reinforcing cycle of productivity, investment, and new jobs.

We are encouraged that Greek authorities share this perspective: the successful implementation and use of the EU funds coming from the Next Generation EU programme is a once-in-a-lifetime opportunity for Greece and its people.

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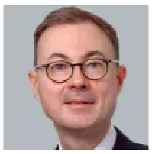

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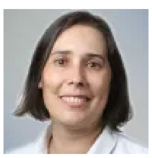

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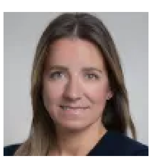

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