

Klaus Regling in interview with Äripäev

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Interviews

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**Interview with Klaus Regling, ESM Managing Director
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Interviewer: Sirje Rank

The ESM was challenged in the constitutional court in Estonia. Could you briefly sum up the role of the ESM in the euro area recovery?

Klaus Regling: The creation of the ESM is one of the reasons why we have safely left the euro crisis behind us. The ESM provided financial help to countries that were losing market access. Without this help, countries like Ireland, Greece, or Portugal might have been forced to leave the euro area and that would have really changed Europe. But most importantly, as a condition for their loans from us, the programme countries really addressed their problems through painful adjustments to improve competitiveness, repair banking systems, and reduce fiscal deficits. The ECB also played an important role. All this together eventually brought us out of the crisis.

Will the common currency survive the next crisis? What are the elements still missing in the euro area design?

A lot of progress has already been achieved in the last five-to-six years: institutionally, in terms of reforms and in terms of increased monitoring and supervision. We now have the banking union and a permanent fiscal backstop for sovereigns – the ESM. We know that the next crisis will happen eventually. But we are better prepared today than eight-to-nine years ago when the last crisis hit. A broad debate has now started on how to make euro area more resilient and robust. I

think we have identified the areas we need to look at. We need to complete the banking union where elements like the European deposit guarantee system are still missing. Another important question is: do we need a euro area budget and for what? Most member states agree that this would be useful. But what to do with it is one of the most controversial issues. We lack a limited fiscal capacity to address asymmetric shocks that hit one or two countries only. This shock absorber would keep those countries from deviating too much from the overall developments. Some member states want to have more transfers, others want a facility to deal with shocks that hit all countries like in the context of the global financial crisis in 2008-2009. I do not think we need new special facilities for that because we already have the tools. There are also institutional questions like the creation of a euro area finance minister, or developing the ESM into a European Monetary Fund, an EMF. But I think it is more important to agree first on the substance and then think about the institutions.

Greece is the last country under a programme. Is Greece ready to exit next year, has there been real structural change so it can thrive in a monetary union?

We dealt with five countries and four are now success cases – Ireland, Spain, Cyprus, and Portugal. They have been rewarded with above-average growth, so the programme strategy worked well. Greece is the most difficult case, as Greece had the biggest problems and the weakest administration to implement reforms. Also, during the first half of 2015, they steered policies in the opposite direction and lot of the positive developments that became visible in 2014 were lost. The economy declined again. Greece is still in the programme, for the 7th year. But in the current third programme Greece has made significant progress. One striking illustration is the fiscal development: They moved from a deficit of 15.5% of GDP when the crisis hit to a fiscal surplus last year. The number of employees in the public sector has declined by 25%, wages of civil servants and pensions have been cut. There has been a pension reform, health sector reform, tax reform, reforms on labour and product markets. There is still a lot to do. We have 11 more months in the ESM programme and if they implement the remaining reforms they have a good chance to exit next year.

What will Greek debt relief mean for the ESM, Greece`s biggest creditor?

First, it is important to remember that Greece has already received substantial debt

relief in the past, in 2012. Private creditors took a haircut of more than 50% and official creditors improved their lending terms. That helps the Greek budget with debt service payments, which are currently very low. The main reason for that is that about half of the Greek debt is owned by the ESM. We are charging only our own funding costs which are very low due to our high credit rating. For half of their debt Greece has AAA or AA+ financing cost. That saves the Greek budget about €10 billion per year, more than 5% of Greek GDP.

That is the solidarity toward Greece from other euro area countries. It is a big help but no burden for taxpayers in other European countries. That's the result of creating the ESM. And because this will continue for many years, Greece can get out of its debt problems despite a high debt level.

In addition the euro area finance ministers have said that they are prepared to look at additional debt relief if necessary at the end of the programme in August next year. Nobody anticipates any nominal haircuts but what might be considered is making the period of low debt servicing costs even longer.

How has the ESM performed as an investment for its Members?

This is an investment in the future of Europe and the stability of the euro area. All euro area member states benefit from the euro. If a few countries had left during the crisis, the stability of the euro area as a whole would not have been there. And that would have been a cost for all the remaining member states, such as Estonia. That's the most important investment.

Over time we may also generate income through the investment of our paid-in capital, which is based on Members' contributions. This is not the case at the moment as the interest rates are very low. And we invest it very conservatively with the aim of preserving capital.

What is investor interest in the ESM like?

Our funding activity runs from very short term to very long term. In up to five-year bonds we have seen negative rates. We pass on our very low interest rates to support our programme countries.

The ECB buys our bonds in secondary market. On the primary market most of the demand is in Europe but there is also some from Asia and the Middle East. There is a lot of demand from central banks, pension funds, banks etc. We are dealing with 1,200 investors globally on regular basis. And we are planning our first non-euro bond later this year: a USD bond to reach even more investors. Some of them only buy dollar bonds.

What next for the ESM? Why does Europe need its own monetary fund?

We were not prepared when the last crisis started. So back then we were happy to use the expertise of the IMF because the Fund had been doing these rescue operations around the world for 50 years. In the beginning we also needed the IMF's money. The ESM and EFSF were completely new and I could not guarantee that we could issue bonds for €50-60 billion per year as we are doing this year. Now we don't need IMF money anymore and we have accumulated more expertise in Europe. Also, at the IMF there is criticism from non-European shareholders that the IMF is too engaged in Europe. That has led to some problems. So, slowly there has been a consensus developing that in the future, for the next crisis, we should be able to do it on our own.

It is possible that the ESM will get new roles but I prefer that we discuss first the substance: Where do we need new measures? Then we can think about institutions. We could for instance manage a euro area budget. But we would have to agree first on that budget's purpose. There is discussion that the ESM could provide a backstop to the bank resolution fund, the SRF. That is an element of the banking union that is still missing. I see many issues being discussed. But I am not looking for new work for the ESM. We are quite busy with our current mandate.

Where do you see the biggest threat to the euro area at this moment?

We are out of the crisis and I don't see acute problems. If anything, we should not become too complacent. Because economic growth will soon slow down again – the potential growth rate for the euro area is no more than 1%–1.25%, unless we implement substantial structural reforms and invest more. Also, interest rates will start rising and that will put an extra burden on budgets.

Italy has been a concern.

I have heard that for many years. But Italy has never lost market access. Its growth rates have been very low and the country has been falling behind. But more recently things are improving. This process needs to continue.

Juncker said that almost all EU countries should join the euro.

No country will be forced to join. But my own expectation is that in the next 10-to-15 years all the Eastern European countries that are not in the euro area yet will join.

What might change in the German position regarding EMU after elections?

I do not think there will be that many surprises. The polls seem to clearly indicate who the largest party will be as well as who will be Chancellor. If the election results confirm the polls, Chancellor Angela Merkel has a lot of experience and a track record of being a convinced European. Of course, in a coalition government the coalition partner also plays a role and we see that all possible partners differ on several issues including European policies. But the Chancellor has a key say on all policy areas so we can be confident that Germany will not change its pro-European convictions.

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