

Pierre Gramegna in interview with Het Financieele Dagblad

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Interviews

Interview with Pierre Gramegna, ESM Managing Director

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Italy is currently blocking a greater role for the European emergency fund ESM. Director Pierre Gramegna does not give up the fight. 'We are like fire insurance. You're glad to have it when your house is on fire. But if there is no fire, you are also happy with it.'

During a conversation in the Amsterdam Hilton hotel, Pierre Gramegna keeps a close eye on the time. A day in the Netherlands means talking to the press, with investors who want to buy the AAA bonds of 'his' European Stability Mechanism (ESM), but also a quick visit to DNB President Klaas Knot. Later this year, investor roadshows elsewhere in Europe and beyond are scheduled.

The former Minister of Finance of the Grand Duchy of Luxembourg succeeded Klaus Regling in December 2022 as Managing Director of the ESM and he also heads its still existing predecessor EFSF. That temporary emergency fund no longer lends new money, but it still accounts for the

bulk of the €300 billion in loans to Spain, Portugal, Cyprus, Greece, and Ireland made during the European debt crisis. The ESM, created in 2012 as a kind of International Monetary Fund for countries in the eurozone, provided its last loans to Greece in 2018. Both organisations are regarded as one by the outside world.

"Because of our AAA rating, we borrow cheaply, and we pass on that advantage to beneficiary countries," Gramegna emphasises.

In 2021, the euro countries signed the amended Treaty, thereby signalling their political agreement to it. This would ensure that the ESM also functions as an additional safety net for the Single Resolution Fund (SRF), an emergency fund filled by banks' contributions, not by taxpayers' money, that can help the Single Resolution Board to resolve failing banks. For the backstop to become operational, the amended Treaty needs to be ratified, not only signed, by all members countries. But at the end of last year, the Italian parliament voted against ratifying it.

What does the Italian vote against a new ESM treaty mean for the eurozone?

"Italy's failure to sign is bad news for the banking union. The SRF has been gradually filled with contributions from the banks themselves, which now amount to €80 billion. The ESM has set aside €68 billion as an additional guarantee. That backstop can only be used if the new treaty enters into force, and that cannot happen unless all euro area members ratify it.

We must respect the decision of a democratically elected parliament. But 19 other countries have ratified, so it is clearly not a pleasant situation we are in. Fortunately, we are now in a period without acute problems."

Italy has no desire to pay for the problems of non-Italian banks.

"Many arguments have been given. It is mainly internal Italian politics. In Italy, the ESM has been criticised for a long time. The backstop is for the benefit of all euro countries. The risk of a future crisis and contagion is ever-present. We saw last year that cross-border turbulence can arise very quickly in the financial markets. The sums of money needed to shore up banks are quite high. Not having a backstop weakens our resilience."

Aren't the Italian objections emotional? After the major reforms in Greece, the ESM is seen as a ruthless reformer that you would rather not call on.

"The countries we supported lost access to the financial markets due to inappropriate policies. Our programmes were accompanied by tough measures to get them back in order. That is of course never very popular. But we also have precautionary loans, which have not yet been used. The amended treaty not only includes the backstop, but also the modernisation of this preventive instrument, making it more accessible.

A turn in Rome could give the ESM a much bigger role in the future, Gramegna is saying. "Since its founding in 2012, we have realised that financial instability in a country can also arise without it making any mistakes. I mean a pandemic, a war. The ESM can then be very useful. We must realise that a lender of last resort is always needed. We are like fire insurance. You're glad to have it when your house is on fire. But if there is no fire, you are also happy with it."

Don't many eurozone countries see the European Central Bank as the ultimate firefighter? If interest rates rise too much in a certain country, the fire can go out without the country itself having to put its affairs in order.

"It is important to distinguish between the role of the ECB and the role of the ESM. The ECB is responsible for monetary policy. The new purchasing instrument TPI (Transmission Protection Instrument) was devised to guarantee a smooth, even transmission of monetary policy to all Member States and to prevent large interest rate differentials in this regard.

We are responsible for crisis situations. That is a different situation in which access to financial markets disappears. And then there are the precautionary loans with which a country asks for support if access is still available, but such a crisis threatens. Prevention is less expensive."

Doesn't the doubt also have to do with the fact that you have to contact the ESM yourself? Many politicians see that as a loss of face. They prefer the ECB to buy up bonds on its own initiative.

"Certainly. That has always been the case, including at the IMF: a hesitation to go to the lender of last resort. That is why these precautionary loans are so important, they are subject to less demanding conditions. And countries can also come

together to ask for help, in the event of a kind of generic crisis. That is possible."

What can you do to convince Italy?

"The new treaty could be presented again to the Italian parliament after six months. Since I was appointed as Managing Director at the ESM, I have been talking to all 20 Member States. How can the ESM be useful in the event of exogenous shocks that affect all countries at the same time? People must realise that the ESM is for everyone."

Gramegna makes a calculation. The capital contributed is €81 billion, necessary to maintain the highest credit status, AAA. The ESM's maximum lending capacity is €500 billion. Today, its available lending capacity is €422 billion, according to the Luxembourg citizen. "That's our firepower. We are talking about the most strongly capitalised international financial institution in the world, stronger than the IMF. So we have to use that optimally."

Do you fear a new debt crisis? Debts have risen, as have interest rates.

"We are following this closely. Due to the long maturities, it takes some time before higher interest rates fully take effect. But it is clear that interest costs are increasing. That will put pressure on all countries and limit the space for public investments. Not good news. Fortunately, the new Stability and Growth Pact is designed in such a way that countries can be given more time to consolidate their budgets in case they pursue reforms."

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