

Rolf Strauch in interview with Salzburger Nachrichten (Austria)

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Interviews

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Interview with Rolf Strauch, ESM Chief Economist

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Salzburger Nachrichten: Mr Strauch, what are you currently worried about as ESM Chief Economist?

Rolf Strauch: During the euro crisis, there were plenty of reasons to worry. But the euro crisis is over now. During the euro crisis, there were many reforms that have made the euro area more robust. These include banking union, the creation of the two rescue funds EFSF and ESM, the ECB's unconventional monetary policy and profound reforms at national level, especially in the euro area countries, which needed a programme with us. This has removed economic imbalances and weaknesses in the institutional architecture of the monetary union that accompanied the first decade of the euro. Therefore, we are much better positioned today than before the crisis. And it is good that since then, the ESM has been a permanent institution whose job it is to ensure financial stability in the euro area.

What is the risk of a no-deal Brexit for the stability of the euro area?

Brexit is certainly a risk for further economic slowdown. The growth forecasts have already weakened. But we have no crisis scenario at the ESM. First, Brexit – as a change – has been in the room for a while. Market participants are well prepared, so

there should not be a strong market reaction. And second, it was clear that the high growth rates of recent years cannot last. After strong growth, we are now experiencing a phase of normalisation. I think that Brexit will impact the UK more than the euro area. In the UK, investment has been slowing down for some time due to the uncertainty. If there should be a no-deal Brexit, this uncertainty will most likely continue.

Italy's government has revised the growth forecast. The economy will stagnate, the deficit will be higher. How dangerous is Italy for the Eurozone? In other words, will the country be the next customer of the ESM?

No, I do not expect that. The question of Italy has been asked for ten years. But it never came to that. The high level of debt is indeed a risk. But the debts are structured very long term. Therefore, the situation is not worrying. Moreover, Italy was able to stabilise its debts with its high primary balance (budget surplus without interest payments). The government must maintain this course, in order to maintain the confidence of the financial markets. Because I think it is in Italy's interest to keep financing costs low.

Greece was the most difficult case for the ESM. Is the country permanently saved?

The ESM is interested in long-term growth in Greece. With the support programmes, many structural reforms have been implemented that contribute to this. Success has also been achieved in the short term: the Greek economy is growing at more than two percent, and the budget targets have been met. This has led to an improvement in Greece's credit rating. Therefore, the risk premiums on the capital market are much lower than during crisis times. This is a good basis for Greece, like the other former programme countries (Portugal, Spain, Ireland, Cyprus) that have become success stories. However, it is important that the government remains on the agreed path to reform. And we will regularly review the reform efforts - until Greece has repaid all its debts.

The euro has proven itself, but lags significantly behind the dollar in importance. What can be done to strengthen its role in the world?

As an institution that issues securities internationally, we are interested in a strong international role of the euro. The best thing that can be done is to create stability

and liquid markets. This includes the deepening of Economic and Monetary Union, the completion of the banking union, the capital markets union and strengthening the ESM.

Would Eurobonds not be an instrument to make the euro more attractive to investors?

We support the idea of a safe European asset. This would make the euro more attractive to international investors. It would also help to ensure more uniform financing conditions in the euro area. Overall, the effect would be positive. The prerequisite for this is that the member states regain confidence in the fiscal policies of other euro countries. Further steps are needed to get countries ready to jointly issue bonds.

When is the right time for eurobonds?

Not in the foreseeable future. Before that euro countries have to regain trust in the budgetary policies of their partners in the common currency. Should that happen, one could think about mutualising a part of the national debt in perhaps 10 or 20 years.

But would that prevent investors from betting on the collapse of a country?

Yes, that is true. In turn, that would increase financial stability in the euro area. But there are no shortcuts on the way there. There is still a long way ahead of us.

Europe's banks have recovered. But there are, in certain countries, still large piles of bad loans. How stable is the banking sector in the euro area?

The banking sector has clearly become safer in the past years. The capital base is much better than before the crisis, the rules have become tougher. A lot has happened. In some euro countries, there is still the legacy of non-performing loans. But also here the situation has improved: for example in Greece, the non-performing loans have decreased by over €20 billion since 2016. It is still too high, but there is progress. In the long run, we need a European banking sector that is safe, profitable and integrated and that serves the European economy. Work is still required on profitability – for example through lowering costs, mergers and new technologies. There are a lot of banks that still cannot cover their cost of capital.

A common deposit insurance is still missing in order to complete banking union. Would that create more safety?

The deposit insurance is a central element for strengthening financial stability in the euro area. It provides safety for depositors across borders in the same manner. From our point of view, a European common deposit insurance would make the banking sector more secure. The risks and costs of a crisis would decrease. The risk of a bank run when depositors withdraw their money from banks would decrease. And had a European deposit insurance been in place before, the volume of loans in the context of ESM assistance programmes would have been significantly lower. But it is also clear that the legacy problems in the banking systems of some countries have to be further reduced, even though a lot has already happened in this field.

The ESM will be the backstop to the Single Resolution Fund. This fund is supposed to be equipped with €60 billion in 2024. Is that enough to back up a large bank in a worst case?

The ESM will provide the backstop to the Single Resolution Fund. According to calculations, this should be enough to resolve even large banks. With banking union, banks have to take precautionary measures in order to have enough own capital in case of a crisis. That is the first step. Only after that, the fund comes into play. In case the fund is not enough, the ESM comes in as the backstop. But we act according to the principle of fiscal neutrality. In other words: taxpayer money will not be used. These are loans that the banking sector has to repay.

After the crisis, the mantra was that taxpayers would no longer be asked to pay for failed banks. Is this promise being kept?

That is true. Several measures were taken and institutions created in order to ease the burden on taxpayers in a crisis situation. Part of that is the introduction of “bail-in” (creditor participation). That means that investors are asked to contribute. Creditors have to participate in the losses of a bank – in the course of a restructuring or resolution – in case of a pending insolvency. With this, the promise was kept that taxpayers no longer have to pay for bank rescues.

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