Klaus Regling in interview with CNBC

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Transcript of interview with ESM Managing Director Klaus Regling
CNBC “Squawk on the Street”,
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Interviewer: Geoff Cutmore

CNBC: Let me just ask about Brexit if I might, to start off this conversation. We saw a couple of clips of tape there, including Boris Johnson, saying we now have a deal. We have a basis upon which to go forward. How excited should we be about that?

Klaus Regling: Well, it's good to have a deal. In the city where we are right now, people like deals, I think. But we have to wait and see what happens tonight because at the moment, the deal is between the U.K. government and the European Commission. That's important but it needs to be endorsed by 27 other member states tonight at a summit, which I would expect to happen. But then the difficult part comes on Saturday and we don't know. Actually, indications are that there might not be a majority for the deal in the British parliament. And then we are back where we were six months ago. Theresa May also had a deal with the European Commission and the other member states and then it fell through in the parliament. So let's wait and see.

Part of the problem with this Brexit story is it's created uncertainty among businesses and investors on both sides of the channel, I think. If we can make progress here and move beyond the Saturday parliamentary session

with a deal intact, are you encouraged that we might see something of a relief rally for Europe - a releasing of deferred investment that we've seen over the last three years?

There might be a relief rally on the markets. But I think it's more interesting to see what happens in the real economy and indeed, investment has slowed down significantly in the UK. There are also some costs on the continent but it's much higher in the UK. With a no-deal Brexit, it would be much, much higher. So if there is a deal which everybody hopes, with a well-orchestrated departure of the UK, then one can minimize the cost and of course, after transition period there will be trade again between the continent and the UK. There was trade before the UK joined the European Union and investment will start again when uncertainty disappears. So there is a cost for the UK economy but it's minimised if there is a deal. So that's why we should hope that it goes through.

In particular, do we need to focus on Ireland? It's an economy that you've been involved in bailing out. They have obligations to you. Would you be concerned - if there is no deal - that the Irish economy may actually suffer as a consequence of that and that will have consequences for them and their ability to pay you back?

Sure. Ireland is a member of the euro area. It's a member of the ESM. We gave them a lot of money but I'm not worried about their repayment capacity. That's not my concern. But it would be a pity if the Irish economy that has been doing very well since the crisis - when they lost market access, they got an ESM programme and have been recovering very, very well - if that came to a standstill or reversed partly. They are doing very well at the moment so they can probably sustain a lot. But it would be a pity if unemployment goes up a lot, and there are estimates from the Irish government what a hard Brexit would mean. So that's one more reason to try to avoid a no-deal Brexit. If it's a well-organised departure, then of course the cost for Ireland will be less but they will be more effective than any other European country outside the UK.

We know what the risks are. And I think they've been clearly stated here in Washington this week by the IMF in particular - the eurozone and Europe more broadly looks like a candidate for gradual stagnation here. The ECB has worked very hard; Mario Draghi has done a lot to try and give

governments cover for reform and banks the opportunity to deal with their non-performing loans. Arguably that hasn't happened as it should have done and now we are where we are, with discord within the European Central Bank.

First, I think one should get the analysis right - we are not close to stagnation. When I look at the forecasts that the IMF put out this week - the World Economic Outlook - Europe is growing basically at its potential growth rate, which is not very high; somewhere between 1.25 and 1.5%. People may think it's too low but that's the growth rate. And the forecast from the IMF indicates it's growing at that rate. So this is not at all a stagnation. So I think one has to be very clear about that. Then there are risks, and a hard Brexit would be one such risk, so we try to avoid that. If the trade war intensifies, that's another risk. It's costly already for everybody in the world economy, including for Europe, but in the baseline scenario, Europe still grows at its potential growth rate, so one should be a little bit more relaxed about that.

But it's taken an awful lot of ammunition from the ECB just to stimulate that modest growth profile. We have negative rates now and we are heading back in to bond purchases as part of the September package. That's not something we should be particularly proud of in Europe. Is it all the fact that we now have discord on the [ECB] governing council that makes your job much harder?

I also would prefer to have less discord. Different views - that's normal because we are dealing with serious questions and there are serious questions about monetary policy. And they need to be discussed and they are also discussed here by the IMF with a slightly different tone from the past. The new director of the IMF said she wants to have more analysis, more research into the cost of low interest rates. The Global Financial Stability Report that was published yesterday talks about that, also saying that monetary policy so far has supported growth but in the medium and long term, it increases vulnerabilities.

So I think we have reached a moment where one needs to reassess this and the critics of the monetary policy say it's not very effective, therefore the link between monetary policy and this phase in growth may be less than it was five years ago. I don't have a final view on that, but it's good to do the research and look into that. The Federal Reserve is doing a review of its monetary policy framework and we'll look into all of this because they are also puzzled that inflation is not higher than it would have been under comparable circumstances in the past. The ECB will do such a policy review - Christine Lagarde has announced that in her hearing at the European Parliament. So I think it's the right moment to put the pieces together and see where we really are.

You are a German economist. The German economy has managed to expand spending on social welfare since 2014 without incurring increased debt. It's the prudent approach that so many economists encourage other governments to follow. And yet, the conclusion at this meeting seems to be the Germans should be spending more; they should use their fiscal headroom to help everybody else. Isn't it a little unfair on the Germans to expect them to bail out the spenders when they've been the savers.

First, I don't see myself as a German economist - I'm more a European or global economist because I worked 30 years of my life outside Germany. But of course what's happening in Germany is very interesting. It's very good to understand why growth was so good compared to other European countries in the last 10 years, and why the slowdown now is so rapid. Because it is much more rapid than in the other European countries. So I think it's quite clear why they did well for quite a long period. Competitiveness was good; there were reforms 10 years ago. Germany has an open economy; more open than France, for instance. It benefited as long as world trade was doing well, and then importantly, Germany managed to really drive up developments in the labour market. The participation rate, employment rate today is 10 to 15% higher than in several other large European economies. That's almost 20 percentage points higher than in Italy (the employment rate) and almost 10 percentage points higher than in France. This contributed very strongly to growth. The unemployment rate fell significantly to the lowest number in 50 years but it also means one cannot go much further where other European countries have room to catch up.

Germany has reached that level and that's also reflected in the GDP level. But it cannot do much more of that type and therefore growth is coming down, and as an open economy, they are also hurt more than others by the trade wars. So it's a very special and very interesting situation in Germany. And then there's a fiscal surplus and the current account surplus. And I would also say there's an investment gap that also contributed to lower growth now. There are things to be done. But it's something where if it happens, the rest of the world should not expect that it will rescue them. Germany is a big economy but not that big.

When we came out of the last financial crisis, I remember speaking to you and others who said that we must never have another financial crisis where we don't have the tools to tackle the risks and consequences. And there were great commitments made to further integration in the eurozone and you've been a part of that story. But where is the Eurozone bond? Where is the banking union? Where is the deposit protection scheme that was promised, and so on. The pace of change in Europe has been glacial. We go into a new crisis potentially with our pants around our ankles.

I think the situation is not that bad. We are not heading into a crisis like ten years ago. Nobody is arguing that. Sometimes reading the media it sounds like we are heading back to what happened 10 years ago. It's not the case. We don't even have stagnation as you earlier thought. We have growth at potential, but there are risks. So we have to be careful that we know that in our way economic system there will be crises from time to time. We must do everything to try to prevent it but it happens and always comes from a different corner. So we should not assume that there will never be another crisis, despite all the efforts, and the efforts have been strong. A lot has happened on banking regulation for instance. We do have 80% of the banking union in place and one important piece of the puzzle will be the backstop that the ESM will provide to the Single Resolution Fund. That's one element how we develop the ESM further.

What's missing is indeed the European deposit insurance scheme, but most politicians agree that it should happen one day. The arguments are over the preconditions that need to be in place to make it possible. And that's OK. I have no problem with that as long as it's clear that at the end of the process, it will come. The ESM is being developed; we are amending the ESM Treaty to give the ESM additional mandates to be more active during peaceful times but then play clearly a stronger role in future crisis programmes, which may not happen for a long time, but when they happen in the future, the ESM will be in charge, together with the European Commission, to design, negotiate and monitor an adjustment programme. We did not have that mandate in the past.

So things are happening. It may be a bit in the background because we are not in a crisis, which is good. Not being in a crisis also means things move a bit slower. We also demonstrated, I think, over the last 10 years that when there is a crisis, we can move much faster. So I have no problem that now it's a bit slower. But work is ongoing. It's not in the headlines. What is also missing is the fiscal capacity for macroeconomic stabilisation. But these are the final elements. Otherwise we have achieved a lot. The euro area today is less vulnerable and more resilient than 10 years ago. And that's a big achievement.

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