

Interview

**Klaus Regling, Managing Director of the ESM, with the Expresso, Portugal
(English version)**

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According to some government members, Portugal expects start negotiating a precautionary programme in the beginning of 2014. Are there already any contacts on this?

This has not been discussed in the Eurogroup, which is the decisive body to give a mandate to the Troika to prepare another programme of whatever kind. If one wants to go that way, a formal request from the government is the first step. We've not seen that and I do not expect to see that for a while because there's no need now. So the answer to your question is no.

Taking in account the current situation what kind of support would Portugal need: a new bail out, an ECCL or a PCCL?

It's far too early to say. The current programme has another 8 months to run. Let me emphasize that in my view Portugal has come a long way, it has made significant progress. The real economy is showing some encouraging signs. I know it's a very difficult situation for the population, with high unemployment and a long time of negative growth, but we can see the turning points. The signals are very clear: growth in the second quarter of 2013 was strongly positive again, unemployment is beginning to fall from high levels and exports are doing very well. I think it's important to continue with the current programme because we see the results. When the programme started the Portuguese government made it very clear that it would be a painful period, and that was unfortunately true. Structural adjustment, fiscal consolidation always comes with pain. But now that one sees the positive results of that it's really important to continue in order to see the full positive results of this adjustment effort, which has been significant. And then one can see sometime next year what is needed. I think nobody would want to take a very firm view on that now.

How much longer would Portuguese people have to endure this?

The largest part of the adjustment is done but it's not over. The fiscal deficit for this year is expected to be 5,5% and it can't stay at that level, that's obvious, it's not possible to have a permanent deficit of that kind. It needs to be brought down to a balanced budget in a cyclically normal situation, which means as a structural balance in the budget. In that sense, additional efforts are unavoidable.

Meaning more years of austerity...

The deficit has to disappear, eventually.

Looking ahead at the eventual support that Portugal might need to return to the markets, would it be important to have all the main parties on board, including the main opposition party?

We don't know what will happen next year. But it's always good to have a broad consensus in the country to support the reform policies. In the end it's crucial to have a majority in the parliament to implement them.

With the implementation of this budget, is the threat of a second bail-out out of the table?

I can't tell you what will happen in the middle of next year. It's good that there is more time with the current programme, which is going well. And indeed the troika came to the conclusion that it's broadly on track, which is very positive. Let's use the full possibilities offered by this programme, and that means implementing fully the current budget and in 2014 next year's budget. And also structural reforms should continue because that's how growth can, with a time lag, be generated. We know that structural reforms do lead to more growth and jobs, every country that goes through these difficult adjustments will again see growth and jobs when such reforms are implemented. The problem is that this doesn't happen immediately, there's a time lag. And we see that already now, the reforms that were implemented two years ago show some positive results, I can only encourage the government to continue on this way.

The goal of returning to markets by mid-2014 without a second bailout is still realistic? Just to clarify the difference between this and some kind of precautionary programme.

All these are instruments available from the ESM, but I can't predict now whether they will be needed. Of course the ultimate objective of the current programme is that Portugal will be able to return to the market and to refinance itself at reasonable interest rates. I'm not ruling out at all that this is possible next year. Portugal was on a very good way until earlier this year, then there was the political crisis and that was a setback. But until then interest rates had dropped significantly. Why can't this trend return? If the policy is clear, if the policy intentions of more reform and continued fiscal adjustment take place I think markets can react to that very positively. And if there's a need I'm sure that European partners will continue to support Portugal, but it's not possible to say now whether this will be needed.

Can Ireland return to markets without some kind of support?

It's up for the Irish government to make a choice. It has to make a request if it wants more support and this has not happened. Ireland has come a long way. They've fully implemented the programme, there's never been any delay, all the reviews were always concluded as scheduled, so the programme was always on track and markets are rewarding this. 10-year government bonds are at an absolutely sustainable level of around 3,5%. I can't predict whether at the end of the programme they will search for continued support from their partners to help this exit.

Was Portugal able to regain some of the market confidence lost after the July crisis?

It's quite visible that there's some recovery. An easy way to see it is to look at interest rates in the secondary market for government bonds. Now they're down again to around 6,2% (23/10/13), not to the level where they were before the cabinet crisis but halfway roughly. That is an indication that Portugal is on a good way, part of the problem has been recovered. I'm sure that if policies are implemented as agreed Portugal can continue to go back to the old levels. Ireland is a good example of what can be achieved when policies are implemented in a convincing way.

If the trend continues will Portugal be able to make 5 and 10 year emissions still this year?

I don't know whether the authorities want to do it and whether it's really necessary this year since the cash position is quite comfortable. But eventually this is the objective of the programme.

What do you think of the new setup of the Portuguese government to deal with the troika?

It's up to each government to organise itself, not for me to comment. What is important is that the cabinet fully supports what is agreed and then to have a majority in the Parliament - that's what really counts from my perspective.

Will the disbursement of the financial tranche corresponding to the last troika mission be kept on hold pending the developments in Portugal concerning the budget?

This disbursement was already endorsed by the Eurogroup, it only needs to go through our internal legal procedures, but Eurogroup has already given the green light, so I don't expect any problems with this particular disbursement of €3,7billion.

The government identifies the Constitutional Court as one of the main risks for the implementation of the adjustment programme and next year's budget. The IMF and the EC also voiced their critical concerns about the Court. Do you share the idea that the Court's decision might be one, if not the biggest problem in the implementation of the programme?

I would not call it the biggest problem. If the Court concludes that one or several measures are not constitutional this will be an important event because the government will have to find other measures that have an equivalent result, but we have to respect rulings of CC's, that's true in every country. We saw in the past that when this happened, it created difficult moments for the government but I find it encouraging that the government was always able each time to find quickly measures to compensate the ones ruled unconstitutional by the Court. It doesn't make the life of the government easy, but in democracies we have certainly to respect the role of courts.

The CC of your own country played a big role in some of the more important decisions concerning the management of the euro crisis. And now EU officials talk about "political activism" to describe the action of the Portuguese CC. How do you react to that?

I don't know who talked about political activism; I would not use those words.

Do you think that some kind of restructuring of the Portuguese public debt will be unavoidable?

The answer is clearly no. The troika took a clear view on this saying that the debt is sustainable. Given that we finance a third of the Portuguese programme from the EFSF side for 22 years average maturity at fairly low interest rates, at the moment 1,5%, we know that looking ahead this will have a very positive impact on debt developments. Initially, there was a debt increase and that's normal in every programme and IMF programme, but with these favourable long term financing conditions it's very easy to see how it comes down over time. Therefore I have no doubt that the debt is and will remain sustainable and there's no intention of having any debt restructuring.

Could the issue of maturities extension be raised again?

There's no debate at the moment about this and I don't see the need for that because the maturity extension from 15 to 22 years was very recent. It was an important step that helped significantly Portugal to improve debt sustainability

Can Portugal use the remaining money in the programme for the banks to finance the state instead?

It may be possible. But first we have to wait and see how much is really needed for the banks. I know there's money unused at the moment but it's good to have a safety margin here in case banks do need more and then we'll see.

Access to credit is the main problem faced by Portuguese companies. How can this change? Do they have to wait for the banking union to be in place to see the situation changing?

This is indeed a problem, not only in Portugal but also in the other programme countries. Interest rates are higher not only for the government but also for the private sector. That has been well identified as a problem and when you think about ways to reduce those spreads, the most important of course is to continue with the programme successfully, to implement the programme fully, because that will lead to more market confidence. Then indeed at European level banking union is designed to deal with this problem and we're making progress here. I'm sure we will come to conclusions before the EP ends its term next year. And once we'll have the main elements of the banking union in place this will also help. But from the Portuguese side implementing the programme is the key.

When you refer to structural reforms, what do you have in mind exactly?

The programme that's financially supported by us and the IMF is not only about fiscal consolidation or austerity; it's always a combination of fiscal adjustment and structural reforms. In every country one has to see what the obstacles to higher growth and productivity are; it differs very much and this is part of the MoU. In Portugal what's striking is that even before the crisis growth was low. It's very different from Greece and Ireland: productivity gains were low and one has to look very carefully at what is the reason for that. This is identified in the MoU and it's crucial to generate growth and employment. Typically this includes deregulating certain professions, increasing competition and one has to look sector by sector where competition might be not fully developed.

Would you attribute the recent positive growth figures to the implementation of the programme?

One should be careful not to exaggerate the importance of quarterly data because there's seasonal fluctuation. We also had the ports closed for a while in the first quarter and therefore there was a catching up in the second quarter, so these are relatively normal cyclical fluctuations. But the overall trend is now towards the positive and that I would clearly attribute to the reforms that have been implemented.

Could Portugal benefit from a reduction in the commission/rate it pays for the European loans?

When the EFSF started indeed there was a margin added to our funding cost but that was abolished very soon after the beginning of the Portuguese programme. Since then we charge our funding costs and there are few basis points for the administrative costs. Our lending rates are half the rate of the IMF and they are the same for Ireland, Greece and Portugal, 1,5%, while the IMF charges more than 3%. There's no room to cut it any further.

Was the dropping of this margin the recognition that the burden was too heavy for these countries?

All this was new for Europe. In the beginning we looked at what the IMF was charging and said we would do something comparable. And the second reason was to discourage the use of the EFSF because some feared that too many countries might want to ask for loans if it was too cheap. But after a while it was realised that this concern was not relevant. After a while the focus shifted to debt sustainability, and obviously the lower the interest rate we charge, the best that is for debt sustainability. That has been the predominant focus and therefore it was decided to charge as little as possible and that is equivalent to our funding cost.

Was there a paternalistic rationale of punishing these countries?

I would not accept that. It was not paternalistic. There was a concern that there would be too many requests and therefore it was decided to establish a higher rate, which was never higher than the IMF, by the way. But then the focus shifted to debt sustainability, because everybody wanted to help these countries. This is solidarity from the rest of Europe and this solidarity is quite sizeable and often underestimated how much money the country saves. We charge 1,5%, if you take a market rate of 6%, you save 4,5 pp. If you project this for the total 26 billion and for 22 years, that's roughly a billion every year in savings. That's solidarity.

Looking back, would you say that the overall approach of the sovereign debt crisis was the correct, with the right solidarity/austerity balance?

One can always argue about details, but in general we know that countries like Portugal, Greece and Ireland have made a tremendous adjustment, very painful, but unavoidable to correct the accumulated economic imbalances. And the other European countries were prepared to provide substantial amounts of money. 26 billion is about 15% of Portugal's GDP, with annual savings of at least 1 billion, for 22 years, that's a lot of solidarity.

Was the 3 years length of the adjustment the right one? Shouldn't it have been done over a longer period of time?

We also took the IMF as a model and 3 year is the normal length. And beyond that it becomes very difficult to plan.

Would you expect any significant changes in the way the new German government will deal with the Eurozone and in particular the programme countries?

I can't comment on the internal discussions between the two parties that will very likely form the next government. But judging from the view of the German population I don't expect big changes.