Interview with Klaus Regling, Managing Director, ESM

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Interviewer: Iannis Antypas

Iannis Antypas: We've had a rough start with the government, especially its previous term. Are you satisfied with the current state of the economy, given that in 2014 there was a token growth rate and the 2015 negotiations took place right afterwards?

Klaus Regling: Things are improving. We know that, as the Greek government is implementing reforms, the economy is improving, there is positive growth again. We already saw positive growth in Greece in 2014. That was the 1st year after a five-year period of negative growth. Unemployment started to fall, and the government was able to issue bonds in that year. So now I think we are back to that situation. Unfortunately, 2015 was a 'lost year', because policies during the first half of the year went in the opposite direction. The effect became very visible, as 2015 had negative growth and so we needed a third adjustment programme in Greece, with much bigger amounts than anyone expected in 2014. But now we are back to a much more normal situation. If reforms continue to be implemented as agreed, I'm quite confident that growth in 2017 will be stronger than in 2016. So growth should accelerate, that is what the Greek people are waiting for. That will have a positive impact on the labour market, and employment. I think that the preconditions for that are in place.

Given this do you think Greek wages will eventually start recovering lost ground? Especially if we have some news on the debt area as well?

For me that is not so much linked to the debt issue. Certainly wages will begin to grow again. But I think it's very important to look back and to understand what happened. Wages, salaries, and pensions had to be reduced during the last five years. But that was in response to what happened the previous 10 years. In the first decade of the monetary union, up until 2008, incomes in Greece grew faster than in any other EU country. That is often forgotten. Wage growth was excessive, it went far beyond the productivity gains during those years. That's why competitiveness was lost and that's why the trade and current account deficits became very large, exports suffered and there had to be a correction. The correction was a reaction to the excessive developments in the previous 10 years. I know very well that this correction is painful for many people. But I think that the process has come more or less to an end now, so there is a new basis. From now on, if growth comes back in response to reforms, incomes can start growing again from this lower base in line with productivity developments. A lower base had to be reached because the previous level was not in line with Greek competitiveness, not in line with productivity. This wage correction was unfortunate, painful, yet unavoidable, because Greece had the highest income growth of any EU Member State for 10 years.

Have we already reached the lowest base? Can it now only go higher?

Yes. This may differ from industry to industry, and I cannot judge that for all industries. But for the economy overall, I think the level of income now is much more in line with productivity levels. Therefore I think it's fair to say that from now on there is again the basis for wage growth, we will see it in the growth figures of the overall economy. That means that income can start rising again. As I said, it was really necessary to bring wages in line with productivity. If growth returns, as the forecasts of the IMF, the OECD, and the EU Commission indicate, and if growth is as expected above 2%, then of course it will be reflected in the beginning of wage increases, but more importantly employment growth. One should be careful: if incomes grow again too fast it will not be good for employment growth. There are trade-offs. Future growth depends on the implementation of structural reforms, the more that happens the more growth we can expect in the medium and long term.

The ESM proceeded with the disbursement of the €2.8 billion, when and how much will the next tranche will be?

The 'when' is very clear, not because of the calendar but because of what needs to be in place. The institutions are in Athens to work on the second review of the ESM programme, and to conclude it. It's all in line with the agreed ESM programme which has been in place since August last year. The next disbursement will happen when the second review is concluded. Everyone agrees this should happen soon, but we also know that some difficult issues must be settled, including the question of when the IMF is prepared to join. This is difficult, thus I don't dare make a prediction on the timing. I suppose the Greek government is undertaking efforts to complete the review quickly. Regarding the amount of the next ESM disbursement to Greece, I can't be specific at this moment. The Greek programme still has a substantial amount of money left. The overall ESM programme has a volume of up to €86 billion. Some of that amount will be subtracted when the IMF joins. Also, we know that nearly €20 billion of ESM funds that were foreseen for bank recapitalisation will not be needed. So far, around €32 billion have been disbursed under the ESM programme. There are still substantial amounts available through mid-2018 when the ESM programme ends. How much will be linked to the second review is not clear at the moment because it will depend on that review. The review includes making forecasts about the economy, the budget, and the financing gap. We will only know at the conclusion of the 2nd review what the right amount is. Whatever the amount is, it will be made available by the ESM.

Greece claims that there needs to be a clear road map on debt. Otherwise the markets won't take this as a positive message. Do you think that the short-term measures and the ones after 2018 are enough to reassure markets?

In my view, there is a road map. It is in the statement of the Eurogroup in May. It includes short-term measures, medium-term measures, and long-term commitments. The short-term measures are more precise. Then there is a commitment from the Eurogroup to look, at the end of the ESM programme, to see what else is needed. Then there is a commitment for the long term, which I think is very favourable for Greece. It's very positive for Greece that the Eurogroup repeated its commitment to continue to support Greece, within an agreed framework that was also part of this May agreement. So we do have a framework on how to look at Greek debt. As long as Greece continues to implement the agreed reforms and to comply with the European requirements, the Eurogroup is prepared to continue to support Greece. I think there are very strong commitments on two issues: on the medium term after 2018 and on the long term. Given that we are talking about a long-term time horizon there is necessarily a lot of uncertainty. We know that the forecasts even for next year are uncertain. Everybody makes the best effort to make a good forecast, but things can change and are often outside the control of government. But this commitment is therefore very valuable. It's understandable that the euro area does not want to provide more debt relief than is needed within the Greek framework. But one has to keep in mind that if there was a decision now, or in 2018, then that might not be enough for Greece in the longer term. So the Eurogroup commitment to always be there for Greece is very valuable and markets understand that. Therefore there really is a road map for Greece. It does not have all the specifics and details. But it is favourable to Greece because it takes account of this uncertainty which unavoidably is there when you talk about very long time horizons.

Again on the debt matter, Mario Draghi claims that for Greece to go into the QE we need a viable debt. Is the short term debt plus the ones post 2018 enough for Greece to be admitted into the QE?

I think that is for the European Central Bank to decide and I will not comment on that.

German Finance Minister Wolfgang Schäuble has called for the ESM to have a supervisory role on the budgets of Member States. Can the ESM do this and do we need a treaty change for that?

There is a wide discussion across Europe how to improve the way the euro area functions even further. I see Minister Schäuble's proposals in the context of this discussion. We have also seen other proposals from the Commission, the European Parliament, several euro area ministers and think tanks. These proposals will be discussed at one stage. Today the ESM clearly could not play such a broad role. We are far too small for that. More importantly, we have to wait and see how Member States assess the different proposals which are out there. At the moment, we work extremely well with the European Commission to assess the viability of the Greek economy and its prospects. Our mandate is clearly described in the ESM treaty: we safeguard financial stability in the euro area. If our Member States would want to change our mandate they would need to reach a unanimous agreement to change the ESM treaty.

Greece continues to have economic problems and to be the weak link in the euro zone. Could you talk a bit more about the weaknesses of the euro zone and the potential challenges we face?

We have come a long way to correct many weaknesses of the euro area. We have now new institutions which did not exist at the start of the crisis in 2010: the ESM and Banking Union, the latter of which has created a number of new institutions. A lot has happened. The euro area is also much stronger because the five countries that needed emergency financing from the EFSF and ESM have undertaken wide-reaching reforms. If they stay on the reform path, the weak link disappears. But to improve competitiveness through structural reforms is an ongoing task for all countries. All EU Member States receive recommendations every year from the Commission. We call them country specific recommendations. They show how to remove obstacles to growth. They address every country, also Germany, Austria, the Netherlands. Each country has challenges to work on, which can be politically difficult. But that's how growth can be strengthened in Europe. I think overall we are on a good path, because we have done those crucial changes in countries that really have removed many serious problems, and overall growth is above the potential growth rate in Europe. Our potential growth is low because of demographic trends. Now for the third year, actual growth is above potential. As a result the output gap is being closed, unemployment is falling in many countries, much more than in Greece. But if Greece continues its structural reforms it can catch up and then over the next five to 10 years, with the continuation of reforms, Greece has a very good chance to grow above the euro area average, because there are productivity gains possible with the right economic policies.