Interview with Klaus Regling, ESM Managing Director

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Capital: Why didn't we have an SLA (staff level agreement) on Monday? What was missing?

Klaus Regling: We have made considerable progress on Monday and now the institutions will continue their work with the Greek government. We have already a common understanding in some areas, as the Eurogroup made clear in the statement and the chairman of the Eurogroup said at the press conference. In particular there is an agreement with the European institutions on the 2017 budget which confirms the primary surplus target of 1.75% of GDP in 2017. This allows for the rollout of the guaranteed minimum income. That is an important step for the Greek economy, because it establishes a real social safety net. I think we all agree that so far it was very much the responsibility of the pension system to cover social needs. That is how it developed historically but for an efficient social safety net it is better to limit the pension to its core function and have other complementary elements there. So I think there will be good progress here.

We don't yet have the full agreement on 2018. There is still a small fiscal gap to reach the agreed targets in 2018. And we need to see more reforms to enhance growth and cost competitiveness, such as opening closed professions and removing barriers to investment. Also, the management for the HCAP (Hellenic Corporation of Assets and Participations - the new privatisation fund) is not yet in place. This will also be a condition to conclude the second review because the privatisation fund should be fully operational. It is an important element of the agreement reached in July 2015. So there are a number of reasons why we are not there yet but progress is clear, so there is no reason to be pessimistic.

From what they tell you (the Greek side), do they have the intention to fulfil all that's missing?

Of course, and we continue to work together to implement the ESM programme.

What is stopping the Europeans and the IMF from agreeing on the 3.5% primary surplus and its trajectory?

We know that there are different forecasts. We had that situation before. Different forecasts can exist and we believe as the ESM that the forecast of the European institutions is correct. The IMF has a more pessimistic forecast. We are convinced that our forecast is a good one but no one can be 100% sure. Forecasts are of a necessity uncertain. We have to respect that other institutions come to different conclusions. The Eurogroup asked the institutions to develop a mechanism that can handle this. We have had contingency measures in the past. We can build on that but we should make it a bit stronger – this is one of the tasks of the institutions in the next few weeks.

Is it correct to link the 3.5% primary surplus with the medium-term measures on debt?

Medium-term measures on debt will not be agreed before the end of the programme. That was also confirmed by the Eurogroup on Monday. These possible measures were already identified in May, so we already know what might be done in the future. At the end of the programme it will be decided whether they are really needed. We will then have a new debt sustainability analysis, so we need to wait another year and a half, and a lot can happen by then. By then we will also know for sure whether the forecasts from the European institutions are correct or whether the IMF's pessimistic view is confirmed. That is one reason to wait. But I think the Eurogroup has been very clear on that: we do the short-term measures now but medium-term measures will only be decided at the end of the programme in light of reform progress and after a new DSA is produced. We will then know whether such medium-term measures are really needed.

What did Eurogroup President Dijsselbloem mean by substantial structural measures?

As you know there is a debate on structural reforms to strengthen the economy. There is no agreement yet on that. Privatisation is an issue and there is the electricity sector. The fiscal measures should also be reviewed. We know tax rates are relatively high and the tax basis relatively narrow. We are not advocating more revenues, but I think the structure of the revenue system is not efficient and not growth-friendly. In general this is also true in many other countries. To have a broader tax basis which allows lower tax rates to reach the same revenue target – that would be a good step. And on the expenditure side, there should be a review of the expenditure system to also make it more growth friendly. So I think these are important elements where we all have the same objective: to make the Greek economy more efficient, more productive, and sustainable.

Are the reforms already made on the pension system, or would it require more?

The pension system so far takes a lot of revenue from the budget. A reform of the pension system was adopted and we have to wait for the full impact of those measures, which is coming in slowly. The European institutions believe that this pension reform will have a positive impact but of course Greece faces problems like many other European countries; demographics are unfavourable. That may require additional reform efforts like in many other countries. It is not something special in Greece. One should not exclude the need for further steps but at the moment I would recommend waiting and seeing what the full impact of the recent reform measures is.

In terms of Quantity versus Quality, some argue the reform already done is quite one sided, heavily tilted toward savings from private sector pensioners.

That might be something to look into. It may be more efficient to merge all the various pension funds but I am not saying that these are conditions to conclude in the context of the second review. Pension systems are, in my experience, something that every country in Europe is well advised to constantly review and assess the need for additional reforms as demographics deteriorate.

When are the short-term measures going to be enacted?

The Eurogroup accepted the proposals I made on Monday – the entire package. We will start implementing from now on. We need a few formal legal decisions from our boards but that will happen in the next few weeks. And then we will start implementing. Some of the measures can be implemented fairly quickly, like bringing the weighted average maturity of the loans from 28 to 32.5

years. That we can probably do in January. There is no impact from that in the near future because it deals with the medium- and longer-term repayment profile. The idea is to help Greece smooth the repayment profile. Without this, there would be humps in certain years, but not the next two or three years, so this is something for the medium term. This is positive but don't expect any immediate impact. Another measure that will have an impact in 2017 is the elimination of the step up interest rate on a certain tranche of the EFSF loan. That will save the Greek budget 200 million euros in 2017 alone. That will become effective early in the year. Then there are measures to reduce the interest vulnerability. These short-term measures will be implemented over time because these are market operations like interest rate swaps, like switching from short-term notes to long-term bonds. That can only happen over time and may take 12-to-18 months depending on market conditions. Initially there is no big impact here or even a slightly negative impact but in the longer run these operations will lead to substantial savings for the Greek budget and the Greek economy.

Does all that affect the lending capacity of the ESM?

No, it does not affect our lending capacity and does not affect the other countries that borrow from the EFSF and the ESM, but it will keep us busy. We need to implement it: find counterparties and do these transactions in the markets. So it is more work and it does not affect our financial strength or capacity for other countries.

You are starting to implement the short term-measures, without the SLA?

Yes, that is what the ministers decided. That also follows from the May statement of the Eurogroup where it was said that these short-term measures could be implemented after the end of the first review. This is behind us and the implementation of these measures could continue until the end of the programme. The starting point is now and we aren't waiting for any other agreement. The ministers authorised us to start implementing now.

Is it going to be enough for the IMF?

I think it will be one important element that they will take into consideration. The IMF will account for these measures because they will improve the debt sustainability. They may not be sufficient to reach full debt sustainability, but they are an important step in that direction.

Does all that require a final political decision, over the staff decision?

You have to ask the IMF. According to IMF procedures, in the end it is the IMF board that has to decide, while the IMF staff has to prepare and make proposals.

Do you see any disparity between the IMF staff and the top brass in the IMF?

I don't want to speculate what the Managing Director or the IMF staff think. Madame Lagarde is in charge. She is also the chairperson of the IMF board. So I don't think I want to interpret any differences of views here. But it is a big institution. There are views, but in the end there will be one view.

If the IMF publishes a headline figure for the medium-term debt measures, and the Eurogroup does not follow its lead, would that destabilise the deal the Eurogroup reached?

I don't know what the IMF will do. We should know before Christmas when there will be the discussion of the IMF board of the regular Article IV consultation. That will include an economic analysis and an analysis of the debt situation. Then we will know more.

So when do you expect market access to be restored? After all we do everything for market access

Market access is an important objective of the programme. Basically we do everything so that the Greek economy recovers, growth returns, unemployment falls, and financial and fiscal sustainability are ensured. Those are the key objectives. When we achieve that, market access will almost automatically follow. So I would not say that we do everything to achieve market access but the other way around. So I am convinced when we reach the other objectives market access will be there.

In the course of 2017?

I have said that before that there is a good chance of that. I can't say when exactly. I agree with what I have heard from the Greek government. There should be bond issues before the end of the programme, which is August 2018. We have also seen this in the other programme countries. We never had a situation where there was no market access until the end of the programme and then suddenly the next day there is 100% market access: that is not how markets operate. So it is very wise to start issuing bonds well before the end of the programme and that might be towards the end of 2017 or early 2018. And if programme implementation continues, I am sure that it is possible.

Since market access will be more expensive, do you envisage the need for a 4th program or loan?

No, I do not see that. Of course, ESM financing is a lot cheaper than market financing, but we have already seen over the last few weeks that the yields in the secondary market for Greek debt have been decreasing as the programme progresses, also on the back of the short-term debt measures that were just agreed.

And if reforms continue to be implemented, there is a good chance that yields will continue to decline. It will still be more expensive than borrowing from the ESM of course, but Greece doesn't want to rely permanently on new financing from the ESM. If the third programme is fully disbursed, the EFSF and the ESM will have two thirds of all the Greek debt on our books. Our loans will continue to be there for more than 30 years with very low interest rates.

That is a big advantage for the Greek economy. I think you are familiar with our calculations that the Greek budget saves €8 billion every year, which is 4.5% of GDP. This is the solidarity that the other countries of the euro area provide to Greece in exchange for Greece implementing painful reforms. So there are substantial savings here and they will continue to be there for many years. Also after the end of the programme when Greece returns to the markets and for decades we will make sure that our financing costs are low and that will help the Greek budget and the Greek economy. So I don't see the need for a fourth programme.

But the precondition is political stability? Remember what happened in 2015?

That was a very costly episode.

Do you see it being repeated?

No, not at all. I don't see a repetition, because there is good cooperation with the Greek government. I think that Prime Minister Tsipras got a very different mandate when he was elected the second time in September of 2015. The way I see it he received the mandate to implement the reform programme that was agreed with the other euro area countries at the highest political level. That is happening. There have been some delays and it is not implemented fully on schedule but the direction is very clear and as I said: if this continues, if reforms continue, programme implementation continues then by the end of the programme in August 2018, market access should have been regained and Greece shouldn't need additional emergency financing from the European partners.

What happens after the programme expires, in terms of surveillance?

At the ESM we have something called Early Warning System where we basically protect our claims. We do that by monitoring the Greek economy with missions where we join the European Commission's post-programme surveillance. We want to be repaid one day, when loans are due. That is why we, as the largest creditor, have the obligation to monitor Greece closely. We do this also in the other former programme countries. Of course Greece, like all member states of the euro area, is also subject to the commonly agreed surveillance frameworks. On the fiscal side there is the Stability and Growth Pact and the Fiscal compact. That is a framework we have in the euro area and it is an important framework because we centralised our monetary policy at the ECB and we have kept fiscal and other economic policies at the national level. There has to be coordination and that happens through the fiscal frameworks. Greece, like any other euro area country, is subject to this framework and to certain obligations which come from that.

When Greece is entering the QE?

That is for the ECB to decide.

Do you see the ESM transforming into a European IMF in the aftermath of the five presidents' report?

There are many proposals out there. You mentioned the five Presidents' report. There will be a follow-up document from the European Commission soon called the white paper. Some governments in Europe have made proposals, think-tanks like Bruegel, the European Parliament had already talked three years ago about developing the ESM into a European monetary fund. So, there are many proposals out there. Some of them are contradictory, they are not compatible, but I take note that many people want the ESM to have a broader mandate. We have to be realistic because some of these proposals would require a change of the EU treaty. Taking competences away from the European Commission would require a change in the EU treaty and I don't expect that to happen for many, many years. So I think we could have a debate later in 2017 about further institutional developments of the monetary union, further deepening of the monetary union and that is good. We have come a long way already and we have used this crisis for very important steps towards more fiscal union, towards more political union. At the same time, I am in the camp of the people who believe that we do not need a full fiscal union or full political union to make monetary union work successfully. We only need a few more small steps on top of what has already happened. We will have that debate later in 2017–2018.