

## Interview with Klaus Regling, Managing Director, ESM

22 April 2015

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By Angelika Papamiltiadou (MNI)

Angelika Papamiltiadou: There has been talk that the worst part of the crisis is over for the Eurozone and that nearly all countries are on the road to recovery and growth. Do you share this optimism given the fact that we still have high debts and deficits in some countries? Is it a solid road to recovery?

Klaus Regling: I fully share that (recovery prospects). The IMF also shares it in its 2015-2016 forecasts, so I think we have a broad consensus on this, in particular with the countries that went through adjustment programmes and borrowed from the EFSF and ESM. Greece is a special case.

The others are doing well, so are other larger countries such as Italy and France that are adopting structural reforms. Reforms are the key. Of course there are other reasons for doing better such as the falling energy prices, the exchange rate, overall no fiscal headwinds this year. But it's mainly structural reforms.

Of course that does not mean that all problems are solved. More needs to be done such as labour and pension reforms in some countries and as the IMF points out, the banks need to clean their balance sheets, NPLs are high, deleveraging of private debt has not gone very far in Europe. Those are the areas that we need to concentrate on.

AP: In terms of risks on Eurozone recovery, are they manageable?

KR: There are risks but I think that as the IMF put, for the first time in six years the risks are balanced. However regarding the global financial stability report of the IMF, I would like to add that it sounds more like the risks in the financial sector are increasing. So there is some tension here.

I think we need to watch financial market risks and imbalances. Mario Draghi also talked about that. A long period of low long interest rates is a fertile ground for financial sector imbalances. I am afraid this is right. This needs to be watched.

AP: Since you mentioned Mario Draghi: many believe that the QE programme is the last tool in the ECB's kit. And many believe that the recovery is mainly due to the ECB's interventions the past years. What will happen when these decisions unwind?

KR: A few points: First indeed the ECB did a very good job. Exceptional measures for exceptional times and I also agree that the QE is the last arrow and it is working. We see the effect on the exchange rate and on the spreads and the impact was stronger than many expected.

But I think it is wrong that many people believe that it is mainly the ECB that has made the acceleration of growth possible. It is only one important element. See the countries which borrowed from us. Ireland last year had almost 5% growth. That was before QE. The country also benefits from monetary policy but it is mainly through structural reforms that the growth is possible.

And we see it everywhere in Europe, countries that undertake strong structural adjustment have

stronger growth. Take the example of France and Germany. Germany only started to grow faster than France when it implemented very important structural reforms; from 1995 to 2005 France grew on average every year 1 percentage point faster than Germany.

The ECB has done a tremendous job, calming down markets in 2012. QE is important but one should not make the mistake to attribute everything to monetary policy.

AP: Bank of Italy said on Friday that it would revise growth upwards mainly due to QE and not structural reforms that should be taken by the government. Would you agree that some countries are "hiding" behind the monetary policy decisions?

KR: Yes. Italy is a late comer in structural reforms. But if it continues it will also have a positive effect on growth. But we also know the effects are not immediate.

AP: As regards France, it said it would cut its structural deficit by 0.5% of GDP in the next two years less than what the Commission asked. Would they get away with it?

KR: I have not seen the numbers. I saw what minister Sapin said and I need to look into the numbers. The Commission must do the analysis of what measures mean in structural terms so I don't have a final view on that.

AP: Is the Stability and Growth Pact the correct way to go when it comes to credibility?

KR: The SGP covers the fiscal side, we have other instruments that cover the structural reforms. We now have more instruments, such as excessive imbalances procedure and also the country specific recommendations. These tools remove obstacles to growth.

New country specific recommendations will be presented by the Commission next month. People will see that there are structural reforms needed in every country but they are of different country-by-country, all 28 should make stronger efforts to implement them.

AP: Is it fair that countries such as France and Italy are regarded to get special treatment?

KR: There are different views on that. I don't think Italy is such a case as it has no excessive deficit and is in the corrective arm of the Pact and there is more flexibility there. France might be a borderline case. We will see what happens next with the additional proposals made by the French government.

AP: We have been hearing about the establishment of a European Rating House and have been blaming the current ones for causing the crisis. But five years into the crisis and we still don't have an ERH.

KR: It is not easy to create a Rating Agency. It cannot be done by the Commission or the public sector or governments because it would lack credibility. It has to come from the markets. There are not only the 3-4 big ones.

We have more than 180 rating agencies around the world, most of them small and focused on special sectors and countries. They should grow and create more competition.

It is also fair to say that the big ones have improved their analysis, are more cautious, they know they have made mistakes in the past but I think they have improved. They are also under much

tighter regulations adopted by the European Commission on how they must behave so there is some progress.

Angelika Papamiltiadou: While the EMU improves, Greece's Finance Minister warns of unmanageable impacts from a possible credit event, default or Grexit on both Europe and the global economy. Would you agree with this assessment?

Klaus Regling: This is not the baseline scenario. But if it were to happen and we work very, very hard to avoid it, then I think there would be a lot of uncertainty because we don't have any kind of similar experience.

But of course it would be more manageable than 5 or 6 years ago because we have new institutions, the EFSF, the ESM, other countries in the euro area have made tremendous adjustment progress such as Ireland, Portugal, Spain. These countries are in much better shape today.

They are growing again and have very good market access and low interest rates so the vulnerabilities of other countries are much less than 5 or 6 years ago. We have the QE of the ECB so we are much better protected. Still there is uncertainty and it is not the policy objective of anyone to see this happening.

AP: Which do you think is the most possible scenario? A credit event if Greece fails to make a payment or a Grexit?

KR: I will not speculate. We are working very hard to avoid that. Greek authorities have repeatedly been able to mobilize liquidity, more than we've been told before, so I hope this will be possible again. However, at the same time it is true that progress in the negotiation is very slow.

AP: Realistically speaking, what is the problem right now in the negotiations?

KR: We still have not seen a comprehensive reforms plan. We don't know what the budget for 2015 and 2016 will look like and there is also backwards moving in some policy areas which is against the understanding reached on 20th of February. The Greek government is moving backwards in some areas that cost money.

AP: Can you elaborate?

KR: As I understand, there are proposals given to the parliament to increase pension payments, minimum wage, tax issues. All these would increase the deficit. I don't see so far any off-setting measures that would compensate for that.

AP: If the Greek government gives the counter measures to offset the ones you said would you think that the problem is solved?

KR: The Eurogroup said many times that the new government has the possibility to adjust certain measures, to insert their own priorities and preferences. But in the end there has to be a bottom line. If a country wants its partners to finance the remaining gap, it is not possible to take measures that increase the gap without the agreement of the partners because they will be asked to pay and they will not do that.

AP: What about the fact that you don't have access to data?

KR: Yes, that is one reason why the talks are moving so slowly.

AP: What if the Greek side refuses to give you the necessary access?

KR: Then there cannot be an agreement.

AP: During the IMF spring meeting the rhetoric of most officials was more optimistic towards reaching an agreement than in the days before. Is some progress being made that we are not aware of?

KR: I think that the pessimistic tone in recent days went a bit too far. But on the other hand, two weeks ago there was a lot of optimism that in Riga we would have a conclusion that also went too far. There were big mood swings in the markets and the media, too optimistic or too pessimistic. I think we should just continue the work and try to come to an agreement as quickly as possible.

AP: Is the ESM prepared for all scenarios and outcomes?

KR: Of course. But our baseline scenario remains that we will come to an agreement.

AP: Are the three institutions on the same page regarding policy in Greece or are there different demands?

KR: They are basically very similar. Of course when different economists come together they don't always have the same view immediately, one shouldn't expect that. But I don't think any differences in views at the moment are big enough to delay the process. That is not the case.

AP: The Greek government seems to prefer staggered reforms to gradually get liquidity so more progress can be made in June. Mr Varoufakis insists creditors want a comprehensive approach. Is there a middle way or would one of the two or both sides need to back down a little bit?

KR: The Eurogroup has said many times that there needs to be a comprehensive package. I can't comment on what Mr Varoufakis is saying in briefings.

AP: How would you assess the behaviour of the Greek government and how they deal with the negotiations so far?

KR: I think they are new and normally everybody is willing to give a new democratically elected government 100 days to settle in and to learn, it is quite normal. But here we have the problem that Greece is running out of time and liquidity, so everybody is a bit more impatient. But there is also a very clear difference: the new Greek government believes that the strategy of the previous government during the last few years did not work. Governments in the other euro area countries and the institutions have a different view. It has worked and it was beginning to show results, also in Greece like in other countries such as Spain, Ireland, and Portugal. The IMF kept its previous forecasts (on Greece), they have not had enough contact with the new government in order to revise them. These forecasts are probably now unrealistic because there is a lot of uncertainty, arrears are accumulating, less investment. But these IMF forecasts show in which direction Greece was heading. I see it as a confirmation that the strategy was working and was beginning to show positive results. But the new Greek government contests that, says it has not worked and has very different views. This difference that has not been resolved.

AP: Back in October MNI released a confidential document - when Antonis Samaras was still prime minister and figures looked good - that Greece would need a third loan in June. Realistically speaking, if we now reach an agreement would we still need a third loan?

KR: I would not comment on a confidential paper although it would be correct to say that many people were already expecting a small third loan last year, although now everything is up in the air because we don't have the precise numbers.

AP: But is it correct to say that now Greece is running on deficits?

KR: We have the latest figures up to March and it seems that the fiscal situation improved in March but we still have to see the details and see whether this is one-off because it includes the tax amnesty payments or whether it is something that will be carried forward. At the moment I don't have a clear view of the fiscal situation

AP: Do you share the view that the Greek prime minister is more in line to reach an agreement than the finance minister?

KR: I won't comment on this.

AP: You've said before you are prepared for all scenarios but the baseline is to reach an agreement. When do you think it is realistically possible to reach this agreement?

KR: I think it is possible in the next few weeks, if the negotiations accelerate much more than in the last few months.

AP: Provided that the Greek government complies with the creditors demands?

KR: I was commenting on the speed of the negotiations; I don't want to go into the details.

AP: So you are optimistic there would be a convergence of ideas?

KR: I would very much hope there would be an agreement over the next weeks.

AP: The continuous reports about Grexit and reactions of officials to them cause a vicious circle. Does this help the negotiations?

KR: Well, that is true, sometimes it doesn't help but I don't want to get into media bashing. I am afraid that the uncertainty will have a negative impact on the economic developments of Greece, investments are postponed, foreign investors are waiting to see what will happen and all that means that the old forecast for good solid progress in Greece will probably not materialize in the short run. I am still optimistic that growth will come back with a delay but I am afraid that for this year it will be less than expected.

AP: It seems that the Greek government believes that the creditors in the end would back down because they don't want a credit event, or accident. And will give liquidity. What is your comment?

KR: I can't comment on that because I have not heard it from the Greeks. But I can point out that our procedures for providing loans are very clear, and very well established. They are linked with conditionality, it is clearly written in the ESM treaty. We need a unanimous decision of our shareholders and the approval of 6 EU parliaments and the parliaments definitely will check very

carefully whether the conditionality - which is a key requirement - is met.

AP: What about the E1.9 billion from SMP profits? There is some confusion regarding their release. Does it also need approval from the 6 parliaments?

KR: This needs the approval of the Eurogroup. But the Eurogroup linked the disbursement with the conclusion of the review and I believe that the (finance) ministers will also have to explain to their parliaments whether all the conditions are in place or not. At the moment the situation has become so controversial that the ministers will talk to their parliaments first.