Interview with Klaus Regling, Managing Director, ESM

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Can Greece leave the euro? Is there a risk it happens?

Greece has been the most difficult case in the euro area crisis. Greece had to adjust more than any other country. Both politically and economically, it was a very difficult starting position back in 2009 and 2010. But the country has come a long way. Today, the vast majority of people want to stay in the euro area. The percentage of people who want to keep the euro rose from 70% to 80% in recent weeks. I find this remarkable because the Greek people had to take a lot of pain from the adjustment. So I think that Greece will clearly stay.

The euro area does not foresee that a Member State leaves the currency union. Note that all the rumours that have been spread in recent weeks came from press reports, not statements of governments. The governments of the euro area have not changed their views, they want every country to stay. But they also want all countries with problems and which received emergency financing to do their homework, to improve the economic situation through reforms and fiscal consolidation, where necessary.

This applies also to Greece. Greece made a lot of progress but the country is not at the end of the process. It is in the interest of the Greek economy that they complete this process, that they go all the way and recover a good rate of growth. According to the OECD, the Greek growth rate would be the highest in the euro area if reforms continue. So it is in the interest of Greece to stay on this path and it is also in the interest of the euro area that they do so.

The idea of Greece leaving the euro is not only being spoken about in Greece. Rumours come from several sides. Even the president of the IFO institute suggested a temporary exit. It is feasible?

Academics can afford the luxury of making proposals that are fairly unrealistic. Governments and people, who would have to decide this, never supported this view.

What about a debt write-off? Is that something that can be discussed?

There is already a commitment of the euro area, dating from late 2012, to take a look at debt sustainability in Greece if the country implements all agreed reforms. This may happen. At the same time, it is important to realise what has already happened. It was not only the private creditors who in 2012 accepted a substantial 'haircut', more than 50% of the debt. Official creditors also conceded substantial relief of the Greek debt burden by agreeing to longer maturities, lower interest rates, and an interest deferral for ten years. This happened mainly through the EFSF, which is now by far the largest creditor of Greece: we have 44% of the total Greek public debt in our books. The very favourable terms - very long maturities, very low interest rates - of this loan provided substantial benefits to the Greek budget. The savings are enormous, more than 4.5% of GDP each year. This is a benefit to the budget and thus for the economy, because otherwise these savings would have to be financed through taxes or additional spending cuts. Economists have a way to calculate all this in the so called net present value terms and, when we do that, the very beneficial conditions of our loan are equivalent to a 40% cut in net present value terms of our claims. This is already a substantial contribution for Greece to return to debt sustainability. I don’t think a lot is needed on top of that.

It's important to understand that many things have already happened. But I am sure that the Eurogroup, if reforms continue, will take another look.

Greece needs to resume the programme before the Eurogroup decides on that, right?

Yes, of course, this is important for several reasons. If Greece continues its reform efforts and implements the measures that have been agreed with the troika, there may be immediate disbursements of the EFSF and the IMF. It could open this discussion for some - and I want to emphasize some – additional debt relief [as announced by the Eurogroup in November 2012], because a lot has already happened. Most importantly, these reforms are not needed to please Brussels, Berlin or Washington. These reforms are really in the interest of the Greek economy, because with the continuation of reforms, Greece faces a really good economic perspective. According to the OECD, the economic potential of Greece is higher than any other country in the euro area. The OECD estimates a potential growth rate of 2.5% for Greece. This growth will not happen if the reforms stop or are reversed. So ultimately, more than for any other reason, it is in the interest of the Greek population and the Greek economy to do these reforms.

What if the party that wins the election does not want to resume the programme?

We have to wait for the results of the elections. If reforms do not continue, there will be no further disbursements of the EFSF and the IMF. There will not be a discussion on the possible additional relief of debt service payments. So the process would come to a halt and the Greek economy would suffer. But let's wait for the results of the elections, it is very clear that the troika and governments of the euro area will talk with the new government. This is the normal process, we live in a democracy, we have to wait for the election results and not speculate about what goes on during election campaigns.

Can a quantitative easing programme by the ECB help Greece?

I do not think the ECB is considering a quantitative easing because of one individual country. They discuss this possibility internally because they want to improve the monetary transmission mechanism in the euro area as a whole. And that's an important goal. And also because we live in a period of very low inflation in the euro area. I'm not talking about deflation, but a very low inflation period. This is undesirable because it makes adjustments in the euro area more difficult. The ECB wants to push inflation and inflation expectations up to its own target of just below 2%. All the debate is ongoing and we will only know the outcome, or the possible outcome, when the ECB meets, in two weeks' time. But it will not happen because of Greece.

Do you believe that quantitative easing is the correct move from the ECB to fight the risk of deflation?

That's a big debate and I'm happy to leave it to the ECB. They played a very important role in the last five years and I fully support what they did, there have been many important steps to keep the euro area together. The quantitative easing is a very difficult issue. To some extent, it has already happened through other means. To some extent it's difficult because the structure of the financial sector in Europe is different from the United States. Interest rates are already very low, including in the periphery. That is why it's a difficult balancing act. I am very confident, knowing the ECB, that they will come to the right conclusion.

Is Portugal reversing the results achieved during the programme? What is your assessment of the country right now?

We must look at the overall context here. Portugal has seen tremendous progress since the EFSF started disbursing emergency financing in May 2011. At that time, looking at the market indicators, the interest rate for ten-year government bonds was 16.6%, this was its peak. Today this rate is down to 2.6%. So in the last three years we saw an improvement of 14 percentage points, this is a clear indication that markets have regained confidence in Portugal. They see the progress that has been achieved.

At the same time, perhaps understandably, there seems to be some reform fatigue. Not all reforms that the Government committed to have been implemented. It's clear that the budget deficit needs to continue to fall, it cannot stay at the level where it is today, or last year, of more than 4%. One can discuss the speed of reduction but there is a clear understanding in the troika, the European Commission and the Eurogroup, about the need for further improvements. I hope that the budget deficit this year falls below the 3% of GDP threshold, which is quite important in the context of the Stability and Growth Pact. The latest European Commission forecasts indicate that it will not happen. I hope the Government is right and they will be able to achieve it, otherwise Portugal will not be able to leave the excessive deficit procedure. I think that achieving this goal would be a good signal to the markets and an important step for the economy.

We know that there are risks, also from the structural reform side, not everything has been done. This is not a request to please anyone in Brussels, Washington, Berlin, or Luxembourg. This is for the benefit of the Portuguese economy because economic history is very clear: countries that implement structural reforms will, after a while, reap benefits in terms of higher growth and more jobs. This is absolutely clear. Politically, it is not easy to bridge the time until the positive effects of structural reforms become visible for everybody, but the experience is very clear. We see it now also in Europe. Countries that have implemented more reforms have better growth prospects than others.

You can also see it when you compare Germany and France. Germany is obviously doing very well right now, but we should not forget that 15 years ago it was the opposite. For a number of years, between 1997 and 2003, France was growing substantially faster than Germany every year, by above one percentage point. Germany was declared the sick man of Europe by a weekly economic magazine, and I think it was a correct assessment. Ten years ago, Germany implemented a substantial program of economic reforms and that's the only reason, or the main reason, why Germany is today doing so well compared to France, which did not implemented such a reform program. But I am confident that France, which is now discussing these reforms, will get there, and the same will occur: after a while, the positive impact of the reforms will show up and France will do well again. All countries that have political problems to implement reforms should look at these experiences and draw the right conclusions.

As it is not easy politically, may the elections exacerbate the risk of Portugal not doing what has yet to do?

Certainly the elections can make this process more difficult. But elections are normal in a democracy. We all live in democracies in Europe and that's good. Politically, it is often difficult to implement reforms. That is why they often come later than economists would like. But it is important to explain to the population that they are in the interest of the general public. The vested interests will typically lose something and will not like these reforms, but to the general public, and for the economy as a whole, the reforms will have positive results after a while.

The goal of the deficit may be at risk. According to the European Commission, there are risks of not achieving the target. Should Portugal come up with the necessary measures to guarantee the target or should we expect that the Government is right?

It is the Government's task to look at it. I know that the Government argues that the budget will in the end look better than the Commission forecasts show. But unfortunately it's not only the Commission forecasts: most other forecasts also indicate that the result may not be as good. No one can be absolutely sure. There is some indication that the economy may grow more than expected, due to the impact of the fall in energy prices in the purchasing power and thus domestic consumption and domestic demand. This is likely to lead to higher growth and more revenue, so the adjustment may come from a different channel that was not anticipated a few months ago. We have to wait and see what happens, I know that the Government follows this in much more detail than outside observers. I'm willing to give them the benefit of doubt. But at the same time, the Government should be aware of the risks that exist, which is why the Commission makes forecasts. It would be a pity if the target of bringing the deficit below 3% of GDP, which would allow it to leave the excessive deficit procedure, was missed. So I hope that the Government is right and they reach the agreed target.

Can Portugal follow Ireland and proceed with the early repayment of the IMF loan? Would you support this decision?

In principle, this is possible for all the countries financed by the EFSF but it has not even been discussed. For Ireland, the economic argument was strong, because the Irish refinancing costs in the market fell a lot and are substantially below the cost of Portuguese market cost. Let's see what the future brings. In Ireland there was a good reason to do it and so I gave my support. Portugal is not yet in this same situation, but the more progress Portugal is able to make in the fiscal and structural reform side, the more likely it is to get to a situation that could be similar to Ireland.