European Stability Mechanism

Interview with Klaus Regling, Managing Director, ESM

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Berlingske Business: What interest rates do countries pay on your loans?

Klaus Regling: Our system is very simple: we charge our own funding cost, which can change every day. It is the average of all the money we take up in the market. For our three and six-months bills we charge negative interest rates, for two years already. And for the bonds from one year to thirty years there is of course a positive interest rate. Today we issued a 10-year bond, and the yield was 1.07 percent. So we put all this money that we raise in the markets into one pot. Whenever we issue, it changes slightly, because we calculate our average cost every day. And that's what we charge to our borrowing countries. We add a very small fee to cover operational cost. But basically we are charging our funding cost, and that makes these loans so advantageous for the borrowing countries. The interest rates that we charge are so low, that they have a huge benefit. It depends on the country, of course. Ireland has returned to the market very successfully, and their funding costs are only around one percentage point above our funding cost. But for a country like Greece, it would be around 10 percent. Even if we assume for Greece a more normal funding cost, of let's say 5 percent, we have done some calculations on how much money they save. The annual savings for Greece are 8 billion euros, which for them is more than 4 percent of GDP. And that's a big number. Academics often say, Greek debt is not sustainable, Greece needs a haircut. But they don't understand that Greece already has huge savings in its budget now, and these savings will continue year after year, and therefore Greece has a good chance to return to debt sustainability. Of course Greece needs to implement reforms to boost their growth, but the actual savings every year are already tremendous. And therefore one can argue that there is no debt overhang in Greece today.

And they have a surplus on their primary balance?

They had a surplus late last year. This year because the reforms were interrupted and the economy is deteriorating again, there will be a primary deficit. But if they follow the programme that we agreed with them, they will return to a primary surplus. And they have these big savings, so it can all add up. This is really the solidarity provided by the euro area to Greece. In exchange they implement reforms. It can be very painful for the population, when the pensions are cut by 30 or 40 percent. But they get something in exchange from the other euro area countries.

Do you earn money on the lending as well?

No. We only charge our funding costs. We make a small surplus (on our capital), but it's minimal considering the amount of money we lend, and it will decrease as our lending decreases. We are not in the business of making money. That is not our objective. We want to help the countries to return to the market, for them to have sustainable debt. And therefore the cheaper we are in our lending, the better for the countries. That is our objective.

Is the fund now big enough to rescue a larger country such as France or Italy?

The new Greek programme has a volume of up to 86 billion euros. Some of that will very likely be taken up by the IMF, some can also be covered by privatisation receipts. But if I include all the 86 in our commitment the ESM has an unused lending capacity of 370 billion euros, which is not committed. It's available, we don't need it at the moment. That's the way to be for a crisis institution. You need the capacity to act quickly if something unforeseen happens. At the moment we don't foresee any other country needing our financial support. But it could happen one day and 370 billion would be a lot of money even for large economies. Also, the history of the last five years has shown that if there were another crisis one day, our governments are willing to do more if needed. Not pre-emptively, but if needed. They have done this repeatedly.

Is the European economy heading in the right direction?

Yes, we see solid growth. Not spectacular growth, but above the potential growth rate. The potential growth rate in Europe is not very high, it's around 1 percent, partly because of poor demographics. The growth we see for this year and next year is around 1.5 – 1.7 percent, maybe up to 2 percent. So this is above the potential growth rate, if not a lot. There is always uncertainty, but there are also some upside risk. The low potential growth rate is a result of our poor demographic trends. The immigration that we see at the moment, which may create some social and political problems, can have a positive effect on the economic side. Poor demographics all of a sudden are turned upside down and the decline in population that we saw happening in some countries, including in Germany, is now changing quite suddenly. At the moment, the German population is not declining, it's increasing, and only because of immigration. So there's a positive upside risk here, though we have to see how it plays out and how quickly these immigrants can be integrated.

Despite all these things you're saying, public debt in many countries still seems very high.

Public debt has gone up the last 5, 6 years because governments took a deliberate decision at the peak of the crisis in late 2008, early 2009 to act and to add fiscal stimulus. This is not something that happened by accident, this was a deliberate decision of all EU countries and also all G20 countries. This increased deficits and therefore added to the debt level quite substantially, in all countries. In the United States, the debt to GDP ratio today is around 30 percentage points higher than 7, 8 years ago. The same in Europe. But there's also a clear decision now to move back to low deficits in line with the requirements of the Stability and Growth Pact. So all countries are moving first to deficits below 3 percent of GDP and then towards a structural balance.

But the deficits will be very large in many countries in 20 years' time, right?

No, that's not what we see, because euro area countries have fairly small deficits. The countries that borrowed from us are all reducing their deficits and the euro area as a whole has a deficit of around 2 percent of GDP overall, while the US, UK, Japan have deficits that are two to three times higher. And we continue to consolidate, so over time we will move to a situation where deficits are very small if we manage to have reasonable growth; then over time the debt to GDP ratio will fall. It will take some time, but the turning point in which the ratios will stop rising is this year or next year. It will start to fall again and that's what we need because the levels are high. So not everything is negative in Europe.