European Stability Mechanism

Transcript of interview with ESM Managing Director Klaus Regling

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The interview was conducted by Tomoko Hatakeyama in Tokyo on 26 January 2016

Yomiuri Shimbun: Since the beginning of this year, the stock markets all over the world began to dive. Stock prices have been fluctuating because of worries about a sharp decline in crude oil prices and about emerging countries' economies. How do you think this situation will affect the European economy and how do you think the European economy will look this year?

Klaus Regling: It is correct that stock markets have been declining in the few weeks since the beginning of this year. This trend was a little less marked in Europe than in other parts of the world. But I think this was to a large extent a correction of the very large increase in stock prices over the previous periods. Such corrections are quite normal after strong increases. They can be triggered by events such as the ones you mentioned. But it is just the trigger, it does not have to be the real cause of these corrections. I don't think it has had, up to now, an impact on European economic developments. In Europe, we have moved out of crisis and back to a very normal situation in the last few years. Economic growth in Europe is quite good. It is between 1.5 and 2% last year, this year and it is also projected to be like this next year. When the IMF revised its own World Economic Outlook last week, it was good to see that the IMF revision for European growth was on the positive side marginally. Europe was the only region in the world where the latest forecast wass better than the previous forecast. For many other parts of the world the IMF had a small downward revision. I think that confirms that we're on the right track in Europe. Growth will not be extremely strong. But given demographic trends in a number of European countries, a growth rate of 1.7% as projected by the IMF is actually quite positive.

It's been a year since Alexis Tsipras became the Greek Prime Minister. How do you assess the progress of structural reform and fiscal consolidation in Greece?

I would like to start from a broader point of view about what has happened in the five countries where we were and are active. As part of moving out of crisis mode in Europe, the ESM has provided a lot of financing to five countries that needed emergency financing. Four out of these five countries are by now success cases. These successes contribute to the fact that growth is returning. These four countries are now in a good situation after going through difficult adjustments and reforms. The four countries are Spain, Ireland, Portugal, and Cyprus. Greece is the fifth country that received a lot of emergency financing. It has always been the most difficult case. We agreed in the summer of last year on the third adjustment programme for Greece. That already indicates that Greece is a particularly difficult case. All the other countries only needed one programme that ran for two to three years. Greece had the biggest macroeconomic imbalances. They had problems on the fiscal side, on the competitiveness side, current account deficits were very large and there was a lack of structural reforms. Greece has made progress. Some important international institutions like the OECD, World Bank and the World Economic Forum try to measure progress in structural reforms. They all agree that Greece has implemented more structural reforms than the other countries. However, this does not mean that everything is now fine in Greece. Greece was coming from a very low level. It is encouraging that there has been progress in bringing down the fiscal deficit. Also, competitiveness has improved considerably. The reason is that wages, salaries, and pensions had been cut by 30 to 40%, real cuts in nominal terms. All this must continue because the starting point was so difficult. So it is not over. Greece now has another 2.5 years to complete its reform agenda in the context of its ESM programme. At the moment, important items are being discussed in Greece, like pension reform and the budget for 2017 and 2018 although we agree on the fiscal targets. But there is no agreement yet on the measures that need to be taken to reach those targets. This is happening right now and it is difficult. But I am confident that the government of Prime Minister Tsipras, who was elected for a second time in September with a very different mandate from his first mandate, will take the necessary steps. When he was elected for the first time, a year ago, he had the mandate to stop reforms and he tried a very different strategy. That failed and it was very costly for the Greek economy and the population. When he was elected for a second time in September, he had the clear mandate to continue with the reform process and to keep Greece in the Euro area. That is his new mandate and it is very different from the first one. So I'm confident that he will continue to implement that mandate.

How long do you think it will take until Greece has finished its structural reforms and the country can return to normality?

In very general sense, structural reforms are never over for any countries, neither for Germany nor for Japan nor for Greece. Structural reforms should always continue. We see in the world economy that structural reforms happen in a crisis, then the situation improves, then countries stop implementing reforms and a new cycle starts and the situation will deteriorate again. In that sense, structural reforms are never over. It's an ongoing agenda for every country in the world. But Greece of course has to catch up a lot. They had a very poor starting position. The structure of the economy needed more reforms five or six years ago than the other countries in Europe. As I said, according to the OECD and the World Bank they have made more progress than anybody else. But they are still in a relatively weak position. So reforms must continue: the pension reform, labour market reform, privatisation, and deregulation in certain sectors like the energy market. It is a full agenda.

The term of IMF's second bailout for Greece will expire this March. What measures do you expect from the IMF?

You're right. The current IMF programme expires. There has been no disbursement under this program since 2014. The Greek government has requested a new programme from the IMF and the Greek government is committed to that, the request is still valid. IMF staff have been in all the meetings that the European institutions have had about Greece since last summer. So in this sense they have been fully involved. They are fully informed on what has happened in the last few months. But the IMF has to make up its own mind because the IMF programme will run in parallel with the European programme, as in the past. The Greek government wants that, the other European countries also want the IMF to be on the board. We know that the IMF wants to wait until there is more clarity on the fiscal measures that are currently under discussion in the context of the so-called 'first review'. And they want more clarity on debt relief which will be negotiated after they conclude the first review. But I very much hope that then conditions are in place and the IMF can come on board. The IMF will not provide a lot of money. When the euro crisis started, the IMF typically provided around one third of the programme money and the EFSF (the temporary predecessor organisation to the ESM) and the ESM provided two-thirds. More recently, as in the case of Cyprus, it was only 10% from the IMF and 90% from the ESM. That's fine with us because we are strong enough to provide the largest amount of programme financing. But it is still useful to have the expertise that the IMF brings to the table on board and to also have the IMF programme agreed.

In an article you mentioned that you can't accept a haircut on Greek debt. I would like to hear your opinion of how a Greek debt restructuring can be achieved and what measures can be taken to lessen the Greek debt burden.

There is a long-standing commitment from the other euro area countries that if Greece continues to implement reforms and if they need additional debt relief, that additional debt relief will be provided. We have to remember that we have already provided substantial debt relief to Greece. Private creditors accepted a haircut in 2012. They gave up more than 50% of their claims. That was more than €100 billion, the biggest haircut in history. The public sector did not do a haircut, that is the traditional division of labour, typically the public sector does not accept haircuts But instead provides additional fresh money. That is what we have been doing also in Greece. The private sector accepted the haircuts and we provided fresh money. But what is the special about the situation in Europe is that ESM lending is provided at very favourable terms for the borrowing country. It is much more favourable than IMF lending. Our interest rates are very low and our loan maturities are very long. That means for quite some time that the actual debt service payments from the Greek budget are very, very low. As a result at the moment there is no debt overhang in Greece. But starting in 2022, according to the current agreements, more debt service will fall due. So this annual payment from the Greek budget will rise. And we will look at that issue. We can agree, for instance, to lengthen the loan maturities or to have interest deferrals if that is necessary for additional debt relief. But all the negotiations only start after the first review is concluded. So that will be in another two months or so. Then we will sit down and talk about it. It is not clear at the moment what exactly will happen. But the commitment is there to grant more debt relief if needed. If the Greek government continues to implement reforms, that commitment is there and it is very firm.

Last week ECB President Mario Draghi mentioned the possibility of taking an additional monetary easing measure. How do you assess the ECB's quantitative easing measures?

So far, the monetary policy of the ECB has been successful. The ECB played a very crucial role during the euro crisis on several occasions to stabilise market expectations and make sure that we get out of the crisis. Of course, the ECB role has to be seen together with the other elements of our crisis strategy. There was the creation of the EFSF and ESM and the lending, the adjustment efforts of the countries concerned, the strengthening of the banking system, and better economic policy coordination in Europe. So the ECB is one important element in this overall crisis response. It has taken very crucial steps over the years. More recently, the ECB has been focusing on bringing up inflation expectations, much like what the Bank of Japan is trying to do here in Japan. Also, the ECB wants to encourage the banks to start lending again. Here we see some initial successes. Outstanding credit in the euro area, which had dropped for a number of years, has been growing again over the past 12 months. That is a clear success of monetary policy. On inflation expectations, the situation of course is overshadowed by falling energy prices. That is the same around the world, here in Japan, but also in Europe of course. That has kept headline inflation very low, around zero just like here in Japan. Core inflation is bit higher. But we know that inflation expectations have a lot to do with current headline inflation. So it is very difficult to measure how successful the policy has been. Without falling energy prices, it would have been more successful.

You don't think more additional measures should be taken?

I cannot judge that. It depends on the developments of the next few months. It is true that Mr Draghi announced – as he has done in the past – that more measures are available, if needed. But it is up to the ECB to make the assessment whether that is needed and when.

As you visit Japan this time, how do you evaluate the Japanese economy right now?

I think there is a lot of progress in Japan. Economic growth is more solid. On the inflation side, the same is true here as is true in Europe. Given the sharp drop in energy prices inflation remains low. For the real economy that is positive. But for inflation numbers, of course, it doesn't help. I also consider it positive that during the last two or three years wage increases have gone up year by year. We will see what kind of impact falling energy prices will have, but so far that has also been positive. The unemployment rate is very low in Japan. That certainly is a big success. So I think overall the economic policy has been quite successful.

There're some expectations in the market that the BOJ should decide to take an additional quantitative easing measures at the monetary policy meeting this Thursday. I'd like to hear your assessment of the BOJ's QE measures and the necessity of taking some additional measures to overcome this situation where energy prices are falling.

I don't want to comment on that because this will happen on Thursday and I don't think it would be appropriate for me. I can only say again that given the falling energy prices, it is very difficult to measure the effect of monetary policy on nominal values. For the real economy, the falling energy price is positive.

When was your last visit to Japan?

About 10 months ago.

So you feel that the economy in Japan is stronger than 10 months ago?

Yes. Looking at the numbers, that is quite obvious. Looking at growth, wage developments, and the labour markets, all of this is very positive.

Are wage increases in Japan enough to reach its target inflation rate of 2%?

That is one important element. It is very hard to see how inflation can go up to its target level if wages do not increase. The other important element is what is happening with investment. We know that the corporate sector is more profitable than ever. But investment is still not very strong. So that is another important element. If both things happen and energy prices stabilise or even go up again, then I think it will all add up and it is easier to see that the inflation target will actually be reached.