Interview with Rolf Strauch

ESM Management Board Member, Chief Economist

EFE news agency (Spain), 23 March 2017

Interviewer: Laura Perez Cejuela

(References to Greece in this interview do not refer to ongoing discussions this week in Brussels between the Institutions and Greece)

EFE: The Greek government and the institutions were unable to reach a technical agreement during the last mission to Athens. What is blocking the discussions?

Rolf Strauch: We have made progress in many areas, particularly in the financial sector, which the Eurogroup recognised earlier this week. There are, however, still a number of issues to be fully settled. Labour market and pension reforms are probably the most sensitive points. These are traditionally difficult reforms for all countries, but we have been discussing them for several months now and we need to bring these discussions to a close as the delays are starting to damage the economy. To move these matters forward, the Eurogroup asked the institutions this week in Brussels to intensify talks with Greece. The ESM is working hard on this and I hope all parties are prepared to move so that we can conclude the review quickly.

Can we expect an agreement (first technical, then political) to close the second review in the short term?

The objective is to finalise the second review as soon as possible. As per usual practice, this requires a staff level agreement and the updating of the Memorandum of Understanding. For Greece, given the comprehensiveness of reforms, we also often ask for prior actions to be taken before the review can be fully concluded and a disbursement decision is taken.

How urgent is it to close the second review, given that Greece is facing payments of €7.4 billion in July?

There is indeed a big repayment deadline approaching in summer but this is not the only important issue. The greatest damage from delays in concluding the review is the resulting uncertainty. These delays to the second review are proving costly to the economy, with both private investment and consumer confidence suffering. In addition, Greece needs to avoid accumulating new arrears, which experience shows us have a destructive impact on growth and employment. A positive review conclusion will reassure investors that the programme is continuing. The government must show ownership of the reform measures for Greece to return to the markets.

Do we risk a stand-off similar to the one in the spring of 2015?

I think the situation today is very different from early 2015. Different, as in better. This government received a clear mandate in the 2015 election to implement a package of sound policies to secure the ESM financial assistance programme. Thus, there is not a stand-off as early in 2015, where the entire adjustment agenda was called into question. Greece has since implemented additional structural reforms in the context of the ESM programme. These reforms have borne fruit: Greece is returning to positive growth and it is now running a very substantial primary surplus.

Would the ESM be open to continuing the programme without the IMF if that would allow it to move forward?

We are doing our best to get the IMF on board. The ESM is mandated by its Treaty to pursue IMF participation whenever possible. Additionally, several member states agreed to the ESM programme with the political understanding that the IMF would join in.

Would the ESM consider further debt relief for Greece, apart from the short-, medium- and long-term measures already on the table?

We are already delivering on our commitment to continue to improve debt sustainability to Greece, with no additional cost for the European taxpayer. To do so, the ESM is currently implementing a set of short-term debt relief measures which should cut up to 20 percentage points off Greek debt by 2060. Medium-term measures may be considered once the programme is successfully completed in mid-2018 if they are necessary to achieve sustainability. And, as the Eurogroup mentioned in its May 2016 statement, even long-term debt measures could also be considered later on, again if absolutely needed.

These are clear commitments on which euro area finance ministers agreed to ensure debt sustainability for Greece. They go beyond a number of debt measures taken since 2012, which already included, for example, a 10-year interest rate deferral, an interest rate reduction, and a maturity extension. The economic impact of the debt measures already taken for Greece is the equivalent of 51% of 2015 Greek GDP.

The Institutions insist that the Greek economy is growing and the country is exceeding fiscal expectations, but the parties still cannot agree on the fiscal path and yet more efforts are asked of Greece: do we risk adding on so much pressure that it puts the Greek Government on the verge of collapse?

Greece has already accomplished the most difficult part of the adjustment. To attain the 2018 3.5% fiscal surplus that the programme requires, the European institutions believe that Greece already has agreed to the necessary measures, and is implementing them. The new steps on income taxation and pensions, which are currently under discussion, should result in a more balanced and growth-friendly Greek budget that provides the fiscal space for some social measures. Greece also committed in the Eurogroup to keeping to the programme's primary surplus target over the medium-term after the programme ends in 2018. Discussions on finalising the second review may set a more precise timeframe for this medium-term period.

Euro area

The euro has survived the hardest part of the crisis and its future is now less questioned than it was in 2015. What are the challenges ahead (Italy? elections?)

Europe clearly came out of the crisis stronger. We have now experienced some years with growth at or even above our longer-term potential. This was possible through a comprehensive reform package, which: reinforced the coordination of national economic policies; tackled the key national imbalances that fuelled the euro area crisis; reinforced the banking system through more capital; and created backstops such as the EFSF/ESM for countries in financial stress.

But we still need to address the legacies of the crisis and anchor high and equitable growth. We must tackle substantial non-performing loans, high unemployment, in particular for young people, and the excessive debt levels in both the public and the private sector. Higher growth must be achieved through rising productivity, so that people can benefit from better wages without destroying competitiveness again. The loss of competitiveness led to the crisis in the first place and we need to move to a pattern of sustainable growth.

The euro area should also be made even more resilient for the future. We must continue to improve our institutional set-up by completing Banking Union and creating a real Capital Markets Union. Member States could also consider a further step in our fiscal union, which can be done through a risk-sharing instrument that would not entail either permanent fiscal transfers or debt mutualisation.

How do you see the future of the ESM? The European Parliament proposed making it a European Monetary Fund, while Transparency International advocate to regulate it under the treaties for stricter oversight... What is the perspective from the inside?

There is now a broad debate on this issue. We see this proposal to build a future European Monetary Fund on the ESM as a sign of confidence in our work. To manage expectations, it is worth noting that all these proposals deal with the future. No one is proposing an institutional change for the ongoing ESM programme in Greece. For now, we plan to stick with the current set-up.

It is important to note that the ESM's role has been evolving ever since it was created. The ESM is now part of all the review missions along with the other institutions. As the biggest official creditor for most of its programme countries, the ESM has also started to look into the issue of debt sustainability. Recently, it also launched an evaluation of all concluded programmes whose results will be made public in June. In future, member states may decide to change our mandate. That will have to be agreed by the 19 ESM Member States and it may also require ESM Treaty change.

Spain

Contrary to the Greek programme, the Spanish one is broadly considered to have worked well. What is the ESM assessment?

Our assessment is very positive. Spain is a good example of the success of ESM assistance programmes. Five years ago it was a crisis country and now it has one of the highest growth rates in Europe. Unlike other programme countries, Spain's request for assistance only targeted the banking sector. The ESM made up to €100 billion available to Spain for this purpose but in the end, only €41.3 billion was needed. In return for this financial assistance, Spain modernised the sector, reformed bank ownership structures, and improved risk management practices. Spain successfully exited its programme in December 2013 and is now giving a strong signal of returning to normal by voluntarily repaying the ESM loans earlier than required.

We are now judging the role of the Spanish Central Bank in the crisis, the fact that they may have underestimated the risk in Bankia's case. How do you asses the work of supervisors during the crisis?

What matters from an ESM perspective at this stage is that the Bank of Spain fulfils its mandate in the Eurosystem and the macro- and micro-prudential framework which we have created in the euro area and in Europe more broadly. Policy-makers have learned the lessons of the crisis in creating a common rule book for banking supervision, and strengthening the macro-prudential monitoring and toolbox. Moreover, the supervision for big banks was moved to the European level to facilitate a European banking market and interbank transactions. The Bank of Spain is playing its role in this new setting making use also of all the new tools at its disposal.

A frequent criticism of the rescue programmes is that, despite the money banks received, they are still not sufficiently financing the "real economy". Do you agree with that?

Due to the deleveraging process that is taking place in firms and households, aggregate credit growth is still in negative territory. Yet, new credit is now flowing to the real economy. We should see renewed dynamics in credit volumes once the balance sheets of the private sector have been fully repaired. This processes may take place sooner than expected given the strong economic growth of the Spanish economy.

What, in your view, remains to be done in Spain to strengthen the economic recovery?

The European Commission, in the context of European economic policy coordination, provides all countries with useful policy recommendations for reforms, which are endorsed by all the countries in the European Council, including Spain. I would welcome Spain to focus on policies to reduce long term unemployment and to increase competition in product markets. Additionally, given the persistent excessive deficit in Spain, under its Excessive Debt Procedure, the Commission has made specific recommendations to ensure a durable correction of the fiscal imbalances.