Interview

Klaus Regling, Managing Director of the ESM, with Cinco Días, Spain (English version)

11 November 2013

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Cinco Días (CD): Mr Regling, you are just back from Madrid, maybe one of your lasts trips before the end of the Memorandum. What was your impression?

Klaus Regling (KR): I didn't go to assess the programme, that's not my role. I went to a conference organized by [bank] Santander and also met with officials from the government and the central bank. In my view the programme has been going very well. All the reviews passed successfully so the troika and the Eurogroup are happy. It's also positive that the commitment of last year to provide up to €100 bn to the Spanish banks was not fully needed. Only €41 bn was used, which shows that the problem was not quite as big as it could have been. It's positive that now, a month away from the programme expiring, everybody is confident, including the Spanish government. No more emergency financing is needed.

CD So, looking back, it seems that there was a kind of panic, that the Spanish programme was done in a rush to avoid the contagion risk for countries like Italy or even France. Maybe Spain was used as a scapegoat by the Eurogroup.

KR No, when Spain made the request in June last year we were in a very difficult moment in the euro area. That was a period when many people in the financial sectors in London or New York thought that the euro would disappear. And therefore it was important to communicate to the world that the euro area was prepared to help when help was needed - always with conditionality, of course. Showing big amounts of money available was very useful to calm down markets. In the end it was less than expected, and I think that's very positive for Europe and for Spain. It's the same when you look at the EFSF and the ESM: we have a combined lending capacity of €700 bn. We are very happy that only less than one third of that amount is actually committed. Most of it is available and that's important for markets to know. They should know that if there's any unexpected problem, the ESM has enough money to help.

CD Now that the programme is coming to an end, would you recommend to Spain to ask for a precautionary line to keep markets quiet?

KR I don't think that's needed, because Spain is able to refinance itself in the market at very reasonable interest rates. Spain did not have an overall macroeconomic adjustment programme as the other borrowing countries; it was 'only' to support the restructuring of the banks. But of course, I will encourage Spain to continue with the reforms and it will also be good for Spain to look at the recommendations coming from EC, ECB and EU Council very carefully and consider how to best implement them.

CD Do you think that the AQR and the stress tests could reveal new problems in the banking sector?

KR : I don't expect that. Nor does the ECB expect that. The ECB does not expect major surprises, in particular not in Spain nor in the other countries under programme because in these countries the troika and the ESM staff scrutinised repeatedly the balance sheets of the banks. There has been a scrutiny of the banks in the five countries that borrow from us, with the help of external advisers.

That's why we can be very confident that we understand the banking systems in those countries quite well.

CD. But Mr Draghi said that in order to give credibility to the tests, some banks have to fail. And the markets are looking at countries like Italy, France, Spain or Germany…

KR I cannot say whether Mr. Draghi had any particular country in mind.

CD: As you said, the Eurogroup and the troika claim that the rescue has been a success. But everybody in Spain, from companies to households, and even the Spanish Government, is complaining about the lack of credit. So, why is it being hailed a success if the financial system is not working properly yet?

KR: It's a success in the sense that the Spanish banking system is again on sound footing. Banks have been recapitalized, and we do not expect, nor does the ECB expect, any particular problem when the AQR and the stress tests are done. The Spanish banks can be on their own feet again. This does not mean that all the other problems are suddenly over. These problems come from the property bubble, which inflated during several years, becoming huge by 2008 and 2009. The construction sector became far too big in Spain and needed to be cut in half. That's a very difficult process. In Germany there was a similar problem after reunification. I know by that experience that it's difficult. But in the end it's a temporary adjustment. The process of reducing the construction sector to an appropriate size in the economy means some problems for banks, because unavoidably NPL go up. And then unemployment goes up because people lose jobs either directly or indirectly related to the construction sector. So it's a very difficult period, particularly for the population. But once the adjustment process has run its course things will look better. Also because Spain is, in the meanwhile, introducing important structural reforms, in particular labour market reforms. So all in all I'm very optimistic about the mid-term perspective for the Spanish economy.

CD. Any timeline for that perspective? Because the Spanish people have to pay back 41 billion euros and are wondering when the benefits of this loan are going to be seen?

KR. The average maturity of the loan is 12.5 years. I expect the benefits to show much earlier. The latest Commission forecast signals growth next year by 0.5% and 1.7% in 2015. Quarter on quarter, we know Spain moved into positive growth again in the 3rd quarter of this year and, according to the Commission, the next few quarters will all be positive. It's probable that the growth figures will become more positive. So, in that sense, the turning point is behind us. And that's a result of all the adjustment efforts and the hardship taken by the population.

CD Still, some people in Spain complain that the banks have been rescued but not the people. How would you explain to the people that they pay back 41 billion with interest….

KR. Without the special emergency financial help of the ESM, the adjustment would have been much tougher, also for the people. I don't know any country where it's popular to spend public money on banks. But as an economist, I know that no economy can work without a well-functioning banking system. It is politically unacceptable that banks make big profits, and particularly bank managers make big profits in good times, and then when there are losses, they are taken on by the public sector. But the entire world is working on that issue. It's not a specific Spanish problem. It's something discussed at the G-20, at the Basel Committee and the Financial Stability Board. For the last three years, they have been working on better rules for banking supervision in order to avoid these kinds of problems in the future, and that's very important. In the meanwhile, to let the banks go bankrupt would have had much more serious consequences for the population.

CD You claim that the Spanish banking rescue has been a success, so can we take it as a model for the future?

KR Every country is different. We have seen it during the crisis. The 5 countries that have programmes with us are all very, very different. Spain is the only one that has a programme that is entirely devoted to bank restructuring. There may be another case like that, but every country is different. We have the instrument available, but I don't see another case at the moment.

CD I was thinking more in the general framework, because in the Spanish rescue even the junior debt has suffered losses as a condition for the public money to be injected. Will that condition be maintained in other countries?

KR In that area, the approach is evolving. It's not related with the ESM instrument, but how the European competition authorities look at the state aid rules. As you know, the state aid rules for banks have been reformulated and became effective in August. According to these new rules, in the future it will always be necessary to have bail-in, including junior debt, before public money can be used for banks. That follows the Spanish example, not because of ESM conditionality but in a wider context where the state aid rules are clearer than in the past.

CD But Mr Draghi is asking for an exception of these rules in the case of solvent banks that after the stress tests need to increase its regulatory capital. Do you support that approach?

KR I understand why he has made this point, because this is a very special situation, where a bank is not insolvent but could be if the conditions of stress test materialized. So I understand why he made his point, but so far the Commission and the Eurogroup have not decided to follow up on that view. It may still be discussed, but at the moment the legal situation is clear that state aid rules have to be applied in Europe, unless another decision is taken.

CD Is there margin for the interpretation that Mr. Draghi proposes?

KR Only the European Commission has the competence to change state aid rules.

CD Coming to the stress tests, it's the third time in less than five years that the EU will try to dispel the doubts about the banking sector. Do you think that the markets will be convinced this time?

KR We had some disappointments in the past. Markets are watching very carefully how it is done this time. And I know that the ECB, which now is for the first time playing this role, is also fully aware how important it is. It's important for the ECB's credibility to get it right. It's a difficult job, technically complex, but I'm convinced that the ECB will try very hard to impose uniform rules, and a uniform rulebook. They want to have really good, honest, credible results.

CD Would you be in favour of applying a haircut to the public debt of certain countries held by the banks?

KR That's a difficult question, and there's still under discussion on how to handle that. There are pros and cons in both directions. And that decision has not been taken to the best of my knowledge.

CD But in 2011, the EBA applied a haircut. Wouldn't be strange to do it otherwise now that the stress tests are supposed to be tougher?

KR As far as I know it has not been decided yet.

CD Do you think that there has been any political mistake in the management of the rescues that has provoked a division between North and South in the EU?

KR I think in that area some countries in Northern Europe made communication mistakes, like saying that people in the South are lazy and should work more… That was just wrong to say, it didn't help the mood. Unfortunately it is unavoidable that countries that are going through this adjustment programme do have problems that need to be adjusted, and this is not easy, it's painful, but there's no way around this. But the impression that the rest of Europe has not shown solidarity is wrong. The amount of money that we have disbursed in two and a half years from the EFSF and the ESM is €215 bn euros. This came at very, very low interest rates, with long maturities. This is a significant concession to every country that receives financing. Because none of the five countries could have borrowed at such low interest rates.

CD The former Spanish prime minister, José Luis Rodríguez Zapatero, said in Brussels a few days ago that "solidarity with conditions cannot be called solidarity. It's another thing".

KR I haven't heard it. If that's really what he said, I think it's a mistake. I would not agree with that. Drawing on my experience working for more than a decade at the IMF, I have seen that solidarity with conditionality really works. And we see in Europe that it works, because we see in those five countries that borrow from the EFSF and the ESM that they are improving their fundamentals significantly. Otherwise, one would get into a system of permanent transfers payments, which would not be acceptable to anybody and will not happen.

CD But there's discussion among the economists about the rhythm of the adjustment, especially in the case of Greece. Do you think that this country will be able to return to the markets without further help or a new haircut?

KR. Yes, of course. It will be able to do that over time, for the simple reason that no one will finance Greece permanently. There's no alternative. What we are doing is to provide financing for a number of years, and maybe Greece needs financing for some more years, but it will always be temporary. Nobody in Europe will provide permanent transfers, so they have to be back on their own feet. They are getting there through structural reform and fiscal consolidation. Progress in Greece is significant. According to the latest Commission forecasts, the Greek budget deficit in 2014 will be only 2% of GDP, lower than in the majority of euro area countries.