

CURRENT DEVELOPMENTS IN GREECE: Can economic policy change with a new government?



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**CURRENT DEVELOPMENTS IN GREECE:
Can economic policy change
with a new government?**

- I. Introduction and summary**
- II. The state of play at the end of 2014**
- III. An enigmatic policy strategy following the January 2015 elections**
- IV. Will the Review of the 2nd Economic Adjustment Program close on time?**
- V. Conclusion**

I. Introduction and Summary

- ❑ Greece is again at the epicenter of world media attention; an aberration to the positive growth in the rest of Europe
- ❑ Greek economy on a dive, as possibility of default has negative effects on: business prospects, exports, FDI, privatizations, investment, economic sentiment, bond yields, stock prices, bank deposits
- ❑ Yet, only a few months ago the country was close to a major take off! Reforms were on a roll and 2015 growth was forecasted at 2.9%
- ❑ Current disarray is self induced, entirely due to domestic politics
 - New government lacks practical experience, is full of ideological illusions, and faces severe cash constraints
 - New government adopted wrong strategy in dealing with lenders, creating long delays for the receipt of €7.2bn (4% of GDP)
- ❑ A policy of reforms is necessary for the country to escape its current predicament: ***ECONOMIC POLICY CANNOT CHANGE WITH A NEW GOVERNMENT.***
- ❑ My baseline scenario: *No default, but Muddle Through* until new point of take off – perhaps with intervening political developments

II. A Bird's Eye View on Greece

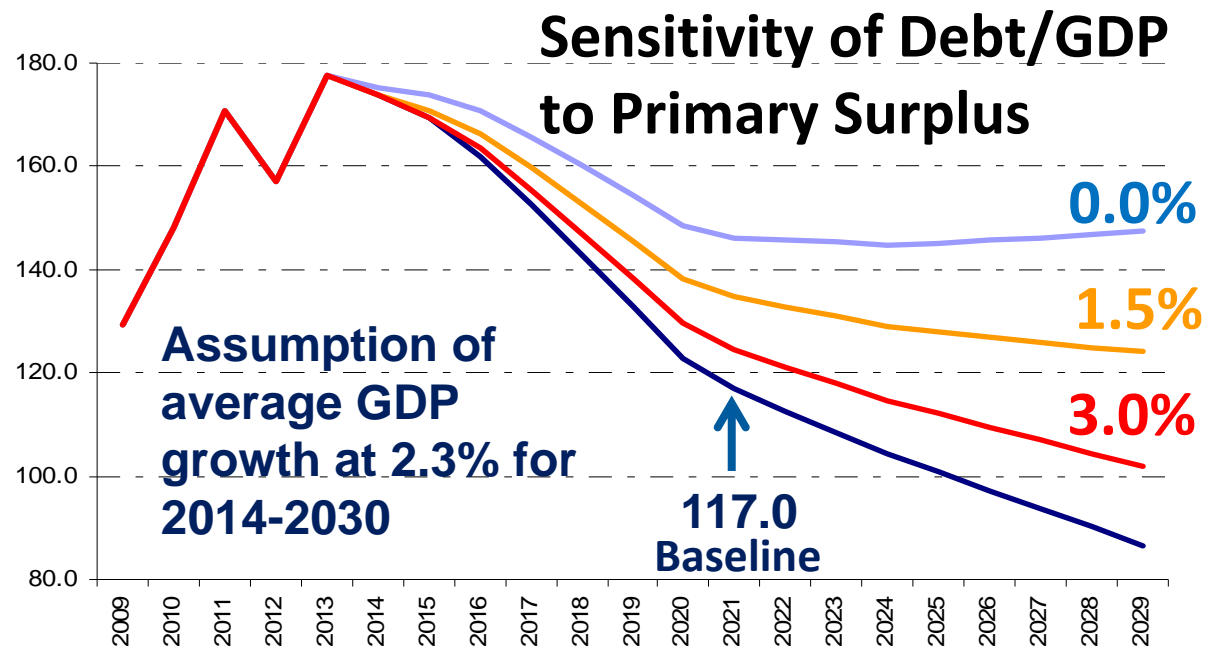
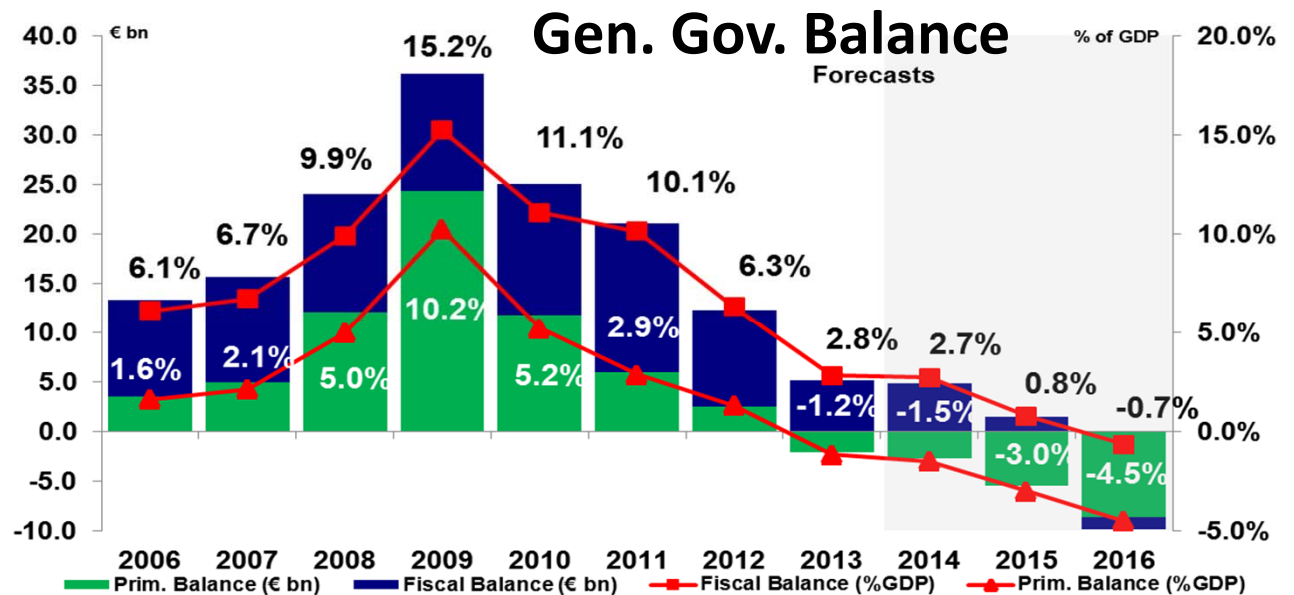
| | 2012 | Greece | EA17 | World |
|---|------|--------|---------|--------------|
| Population (mil.) | | 11.3 | 333.5 | 7,056.7 |
| Geographical Area (thousand km ²) | | 132.0 | 2,624.0 | 148,940 |
| GDP per capita (€) | | 17,146 | 28,460 | 9,729.1 |
| Human Development Index (2011 UN ranking among 194 countries) | | 29 | | |
| Life expectancy (years) | | 80.0 | 79.8 | (EU-27) 71.2 |
| Motor vehicles per 1000 inhabitants (2010) | | 624 | 593 | 175 |
| Suicides / 100 thousand inhabitants (2010) | | 2.9 | 9.1 | |
| Primary Sector (% GDP) | | 3.4 | 1.8 | 4.3 |
| Secondary Sector (% GDP) | | 16.4 | 25.2 | 29.3 |
| Tertiary Sector (% GDP) | | 80.2 | 73.1 | 66.4 |
| Tourism (Total contribution, % GDP) | | 16.4 | 8.3 | (EU-27) 9.2 |
| Construction (% GDP) | | 2.1 | 5.9 | |
| Public Sector (Prim. Gen. Gov. Exp. % GDP) | | 45.4 | 46.7 | |
| Exports (% GDP) | | 27.2 | 45.8 | |
| Imports (% GDP) | | 32.1 | 43.1 | |
| Private Consumption (% GDP) | | 74.6 | 57.5 | |
| Gen. Gov. Debt (% GDP) | | 161.6 | 93.1 | |

II. State of Play prior to January elections

❑ Enormous fiscal consolidation since 2009 when Gen. government expenses were **€128.2 bn** and Gen. government revenues **€91.9 bn**. In the budget of 2015, the corresponding expenses and revenues were both projected at **≈€80bn**.

❑ Debt sustainability on track, Average Maturity from 6 years to 17 years, interest rates low

❑ Soon out of the MoU, into ECCL with Euro Area, and a pre-cautionary agreement with the IMF



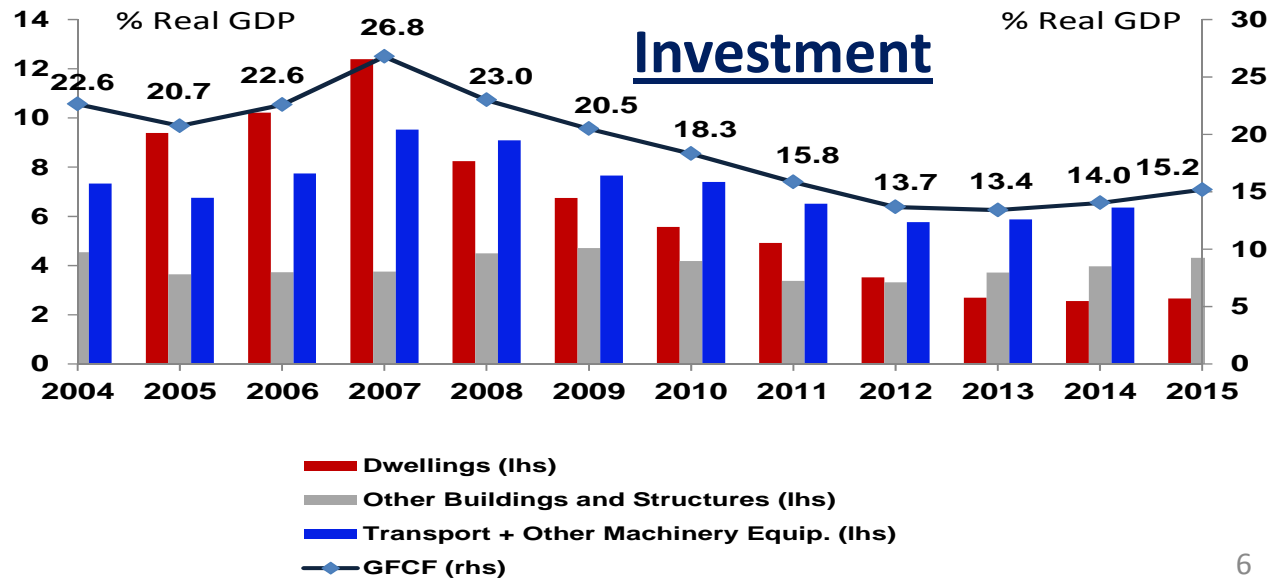
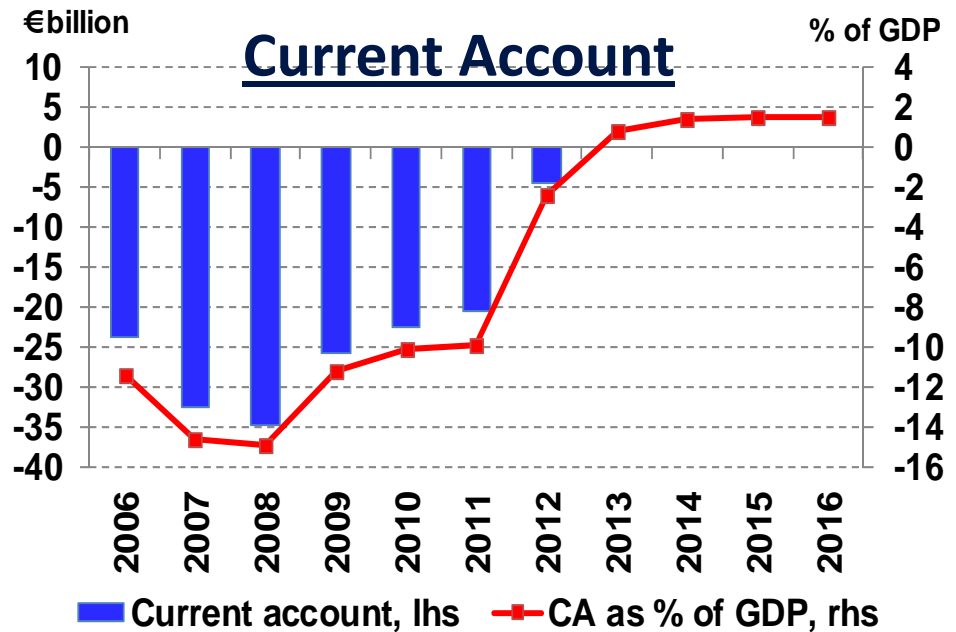
II. State of Play at the End of 2014

☐ Foundations of an extrovert and competitive economy via reforms:

- ✓ Evidenced by country rankings in competitiveness
- ✓ Current account in surplus after years of deficits
- ✓ 2014 growth of 0.7%, after a cumulative drop of ca 26%
- ✓ FDI in 2013 and 2014 exceeded 2007 level

- ✓ Privatizations picked up momentum
- ✓ Investment in machinery & equipment up

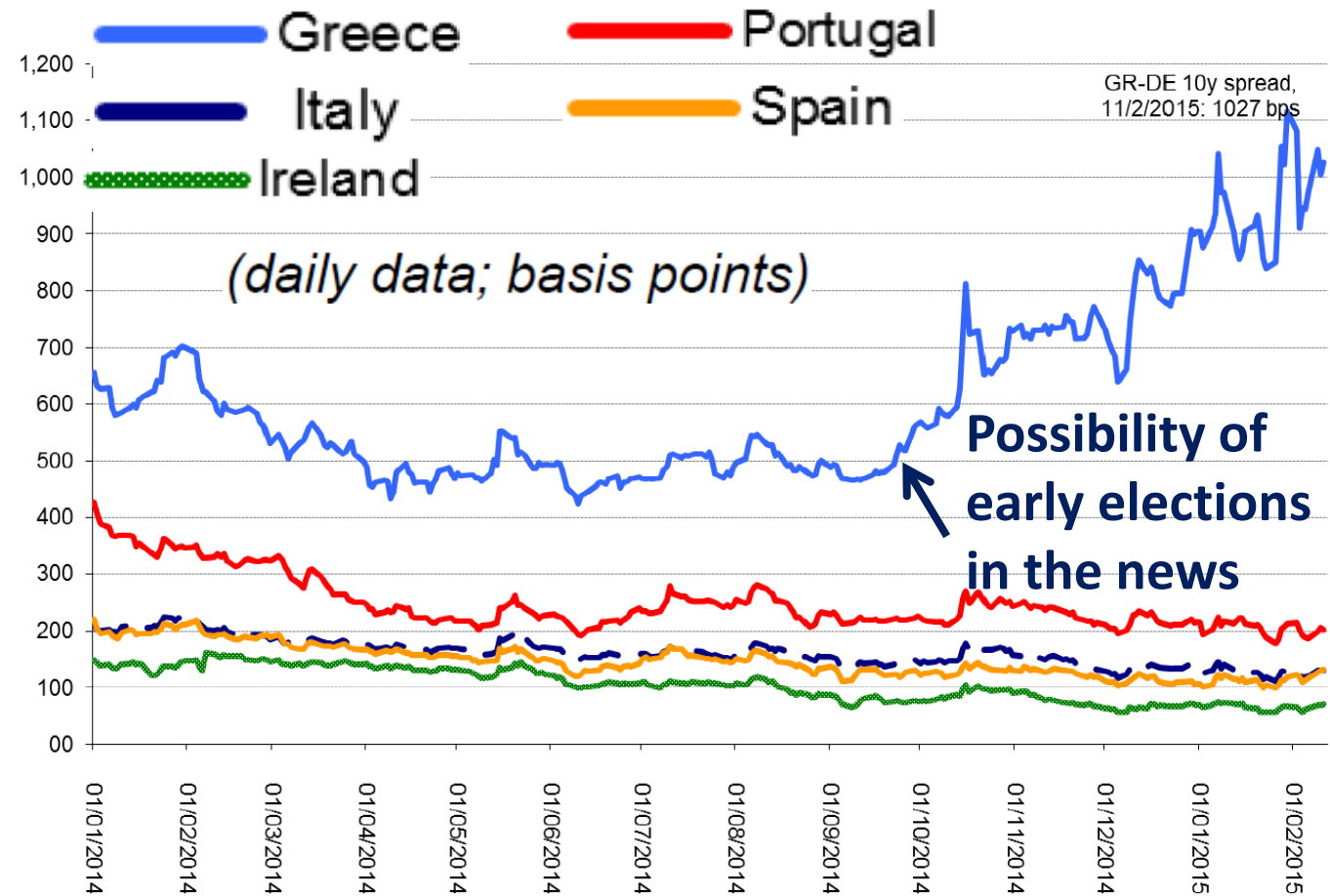
☐ A new Growth strategy based on 3 pillars: institutions, education, competitiveness



II. Decoupling since early October 2014

- Prospective presidential elections in 2015 Q1 gave power to the opposition parties to force governmental elections a year & a half early
- Since October, markets worried about it, with bond yields de-coupling from the rest of European yields
- And rationally so, judging from the post-election inaction & stalemate

Spreads of 10-yr government bond yields over Bunds



Source: Thomson Reuters, Datastream

III. An enigmatic Strategy

- ❑ **New government's top priority at end -January 2015 was to reduce the size of public debt, instead of worrying about the foundations on which the economy is built - Yet debt is not of immediate concern**
- ❑ **Other enigmas:**
 - 1) **Disregard of the need to bring cash into the economy; "we do not need it" was the original statement of MinFin**
 - 2) **Slow response in decision making and lots of cheap talk. The lack of cash caused the creation of arrears and a crowding out of the private sector. Hence economic stagnation**
 - 3) **Overall strategy unclear and confused. Did not behave cooperatively, but rather insulting to the other Europeans**
 - 4) **Brushed away issues of moral hazard. Should have tried to gain perks without appearing of having broken any major rules or signatures**
 - 5) **Treated the European side as if Europeans worry about CONTAGION, which they do not as much as the Greek side believes. Yet GREXIT may be caused by accident even if other European countries think that a Greek departure is not beneficial to the long-run stability of EMU**

IV. Will the Review close on Time?

- ❑ On February 24, 2015 the new Greek government requested a 4-month extension of the 2nd Adjustment Program (the earlier MoU) & promised explicit actions on a number of policy areas:
 - I. Fiscal structural policies (taxation, revenue administration, public spending, social security reform, public administration)
 - II. Financial Stability (installment schemes, Non-Performing loans)
 - III. Policies that Promote Growth (Privatizations, Labor market reforms, product market reforms, better business environment, reform of the judiciary, statistics)
 - IV. Humanitarian Crisis (Guaranteed Minimum Income Scheme, policies to deal with absolute poverty that have no negative fiscal impact)
- ❑ A stalemate followed, with a jump-start occurring after PM visit to Brussels & Berlin, and with Lenders getting impatient about Greek stalling on pension reform, VAT reform, privatizations, etc.
- ❑ Budget execution difficult, with onerous liquidity squeeze: Even T-bill issuance difficult as foreigners abstain from rolling-over their past T-bills. Expected inability to pay lenders in full in July & August or even earlier.

IV. Will the Review close on Time?

Economy badly affected

Huge challenges ahead before the Review can close:

- 1) The fall in growth makes primary surplus target extremely difficult to attain even if it comes down to 1.5% of GDP from 3%. Recall that in November 2014, lenders already had claimed there was a €2.6bn fiscal gap in 2015 under the assumption of 2.9% growth.
- 2) Banking sector fragile
 - as fear of GREXIT led to massive exodus of bank deposits and disappearance of interbank market, with costly borrowing from ELA and no access to QE. Half of bank lending financed by the Eurosystem
 - NPLs have not stabilized and Government lost control of EFSF €11.4bn
- 3) Exports are difficult to materialize as demand shrinks and obstacles rise
- 4) Private sector companies are on the verge of collapse, with a weak banking sector unable to help
- 5) Economic sentiment declines drastically

V. Conclusion

- ❑ Lower oil prices, a weakening euro and QE are pushing Europe into strong growth trajectory in 2015. Also, prudent policies have helped Ireland, Portugal and soon Cyprus to get out of the strict EU surveillance.
- ❑ Yet, only one country follows its own lonely negative trajectory because of its inability to face reality: Greece. It took just 3 months of contradictory statements, ambiguity, bravado appearances, domestic media manipulation, ideological stereotypes, and lack of action, to almost destroy the efforts and pain of the previous five years.
- ❑ There is a pessimistic and an optimistic reading of the future:
 - A. The pessimistic envisages capital controls, a further drop in economic activity and even a possible separation from the EU
 - B. The optimistic is my baseline scenario. It envisages a muddle through and economic stagnation for a while, yet a subsequent new beginning free of illusions and ideology. It assumes a new maturity among the full spectrum of Greek political parties, which is enforced on the politicians by the citizens, who are more rational than is assumed.

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ANSWER:

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**THANK YOU FOR
YOUR ATTENTION**