

“The International Financial Crisis and Greece”

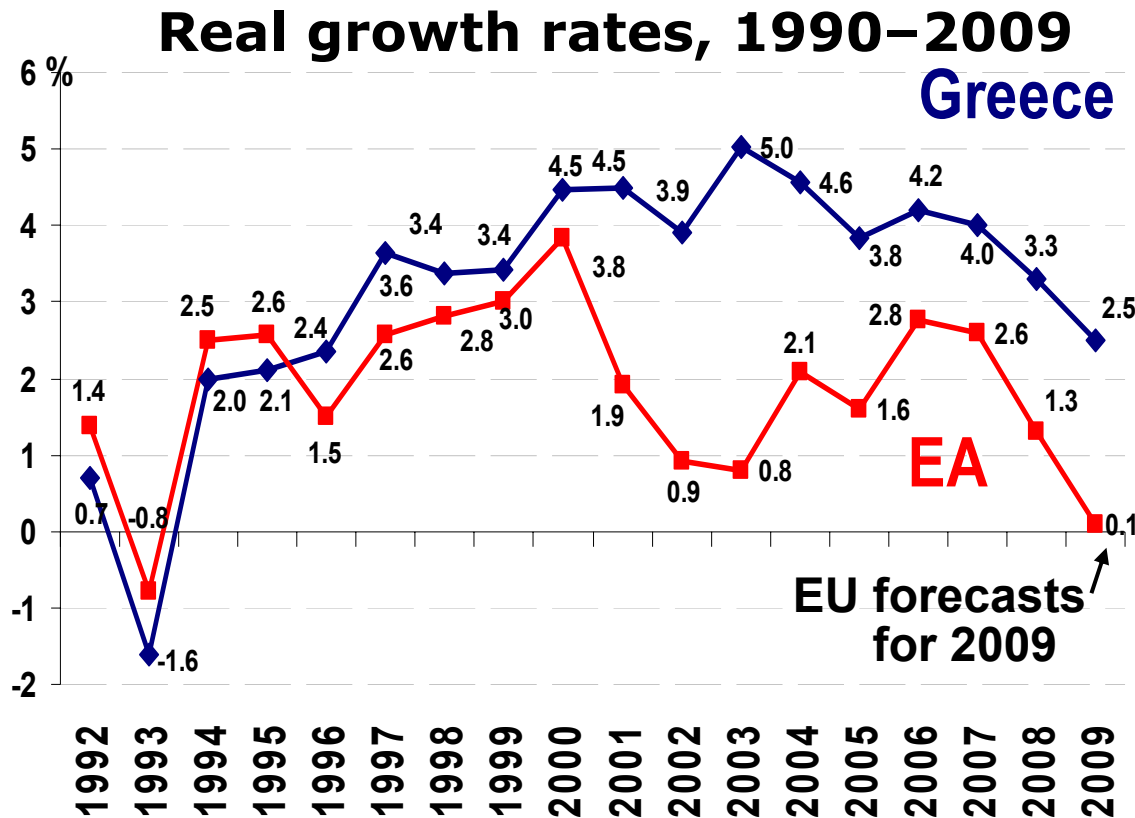
Gikas A. Hardouvelis*

Athens, November 18, 2008

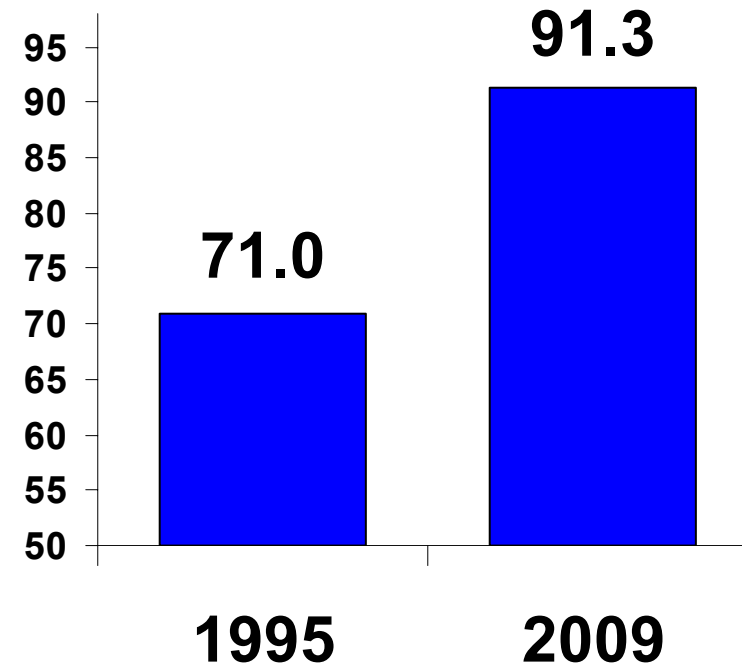
**ECONOMIA CONFERENCE
Athens, Karantzas Megaron**

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Professor, Department of Banking and Financial Management, Un. of Piraeus***

I. Will Greece keep converging to the EU-15 average despite the crisis?



GDP per capita PPS, EU-15=100



Source: European Commission

- ✓ **Investment: the main driver of growth, with growth rates higher than those of consumption**
- ✓ **Until 2005, investment in equipment higher than investment in residential construction**
- ✓ **Is the party over now?**

I. Greece at a crossroads

- Greece's problems are long-term, with competitiveness carrying a large blame
- Surprisingly, Greece can withstand the crisis better than its European counterparts, thanks to its relatively strong banking system, with a projected 2009 rate of growth slightly above 2%
- Yet, if officials remain sluggish to the **elevated demands for active policy**, the crisis may also bring a nightmare scenario of negative growth
- If the recession scenario prevails, then subsequently the lack of policy tools and the long-run problems are bound to depress the economy for a long time

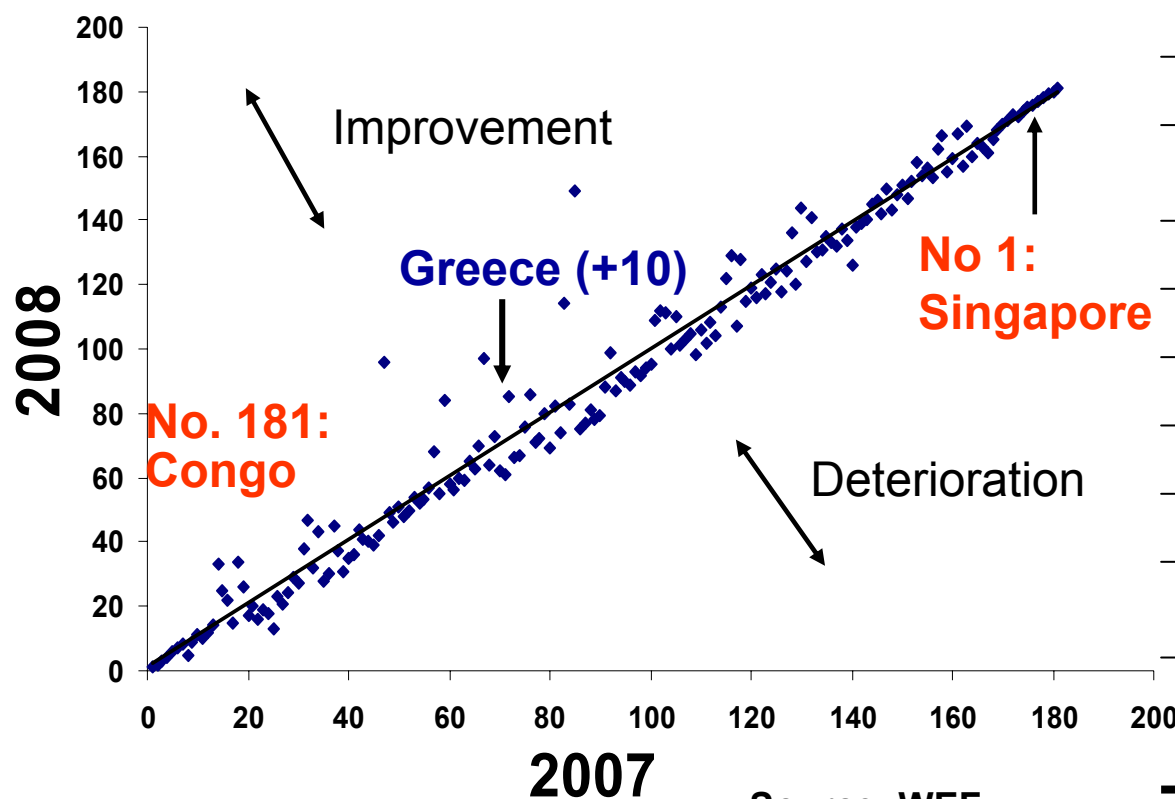
II.

Competitiveness: The Greek Economy's Deepest Problem

II. Competitiveness and Ease of Doing Business

- **Competitiveness is the deepest thorn in the Greek economy**
- **World Bank - Doing Business 2009 report: Greece ranks 96th in 2008 among 181 economies in the ease of doing business, rising 10 places from the 106th in 2007.**
- **Greece remains last among EU-27 countries**

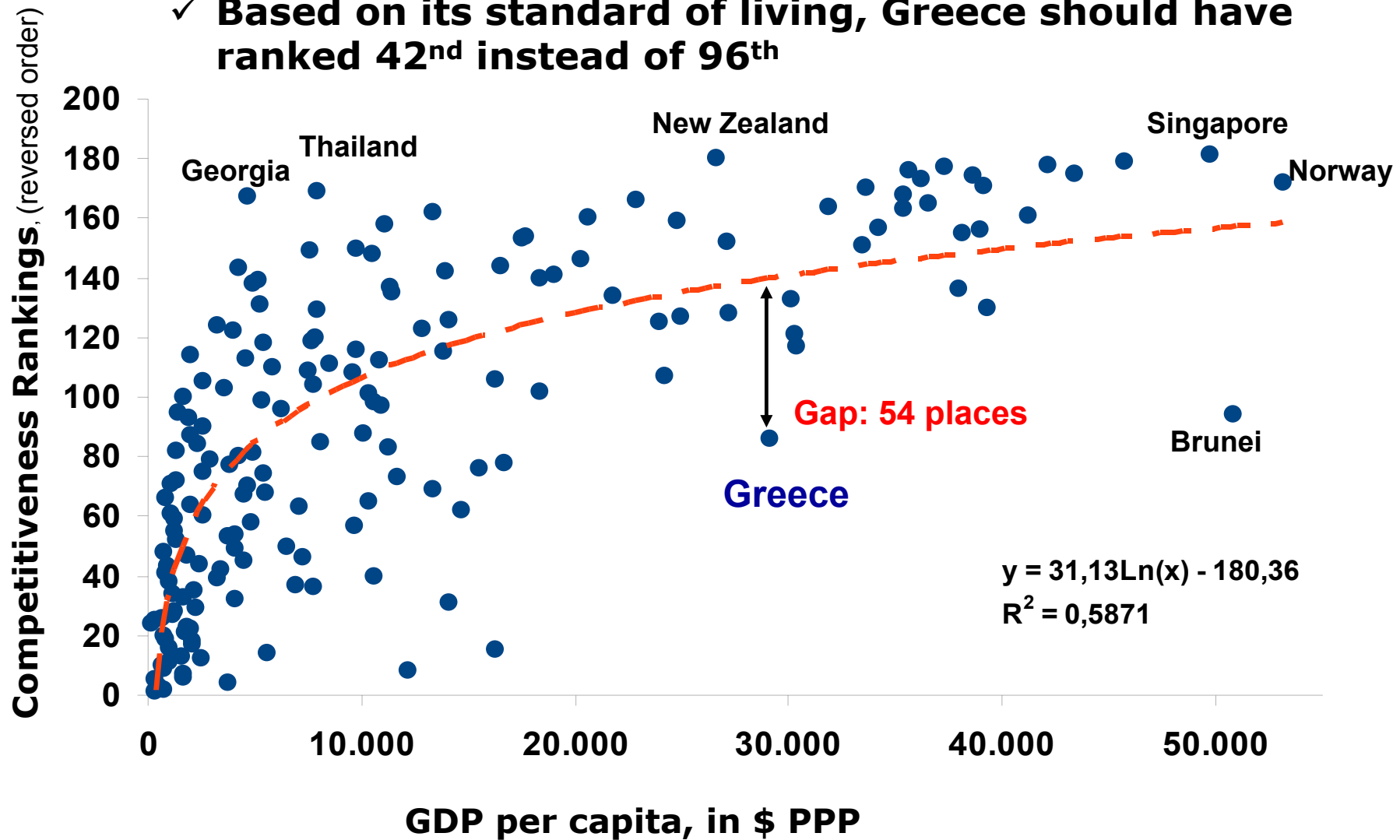
Ease of Doing Business Rankings 2007 – 2008
(rankings in reverse order)



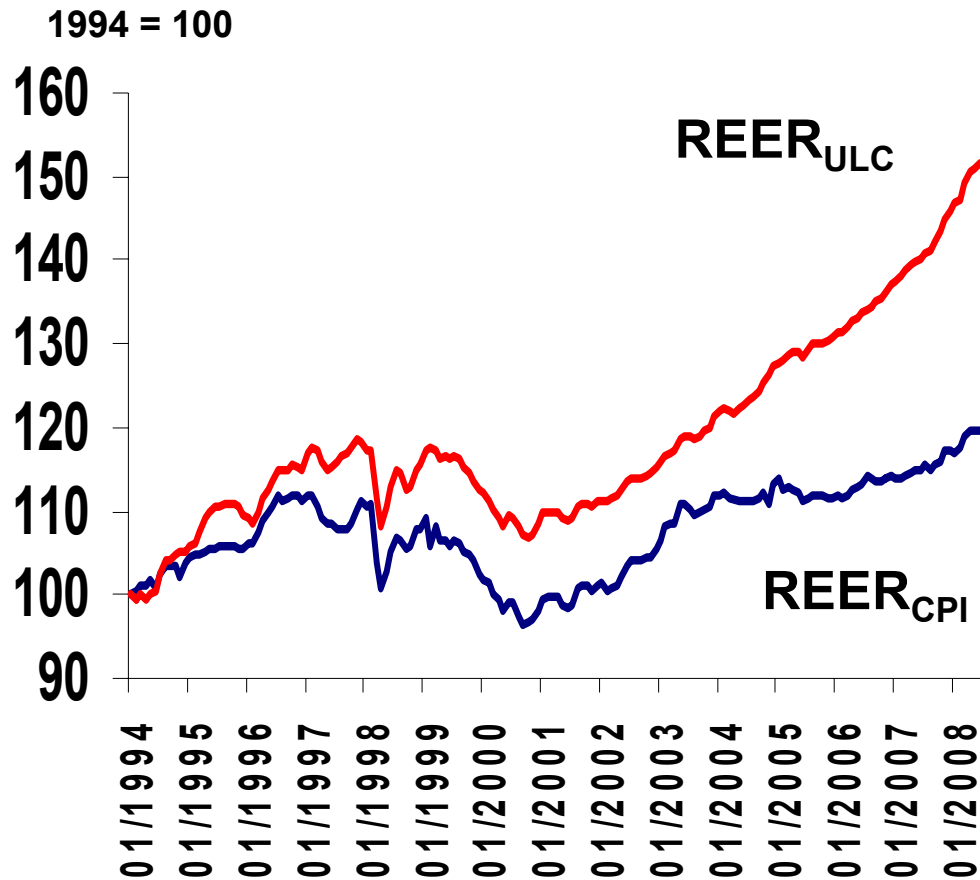
Ease of...	Doing Business 2008 rank	Change in rank from 2007
Doing Business	96	+10
Starting a Business	133	+17
Dealing with Construction Permits	45	+1
Employing Workers	133	+10
Registering Property	101	-5
Getting Credit	109	-7
Protecting Investors	150	+11
Paying Taxes	62	+32
Trading Across Borders	70	-4
Enforcing Contracts	85	-1
Closing a Business	41	0

II. Competitiveness is way below Greece's level of development

✓ Based on its standard of living, Greece should have ranked 42nd instead of 96th



II. Greece is expensive relative to its trading partners ...

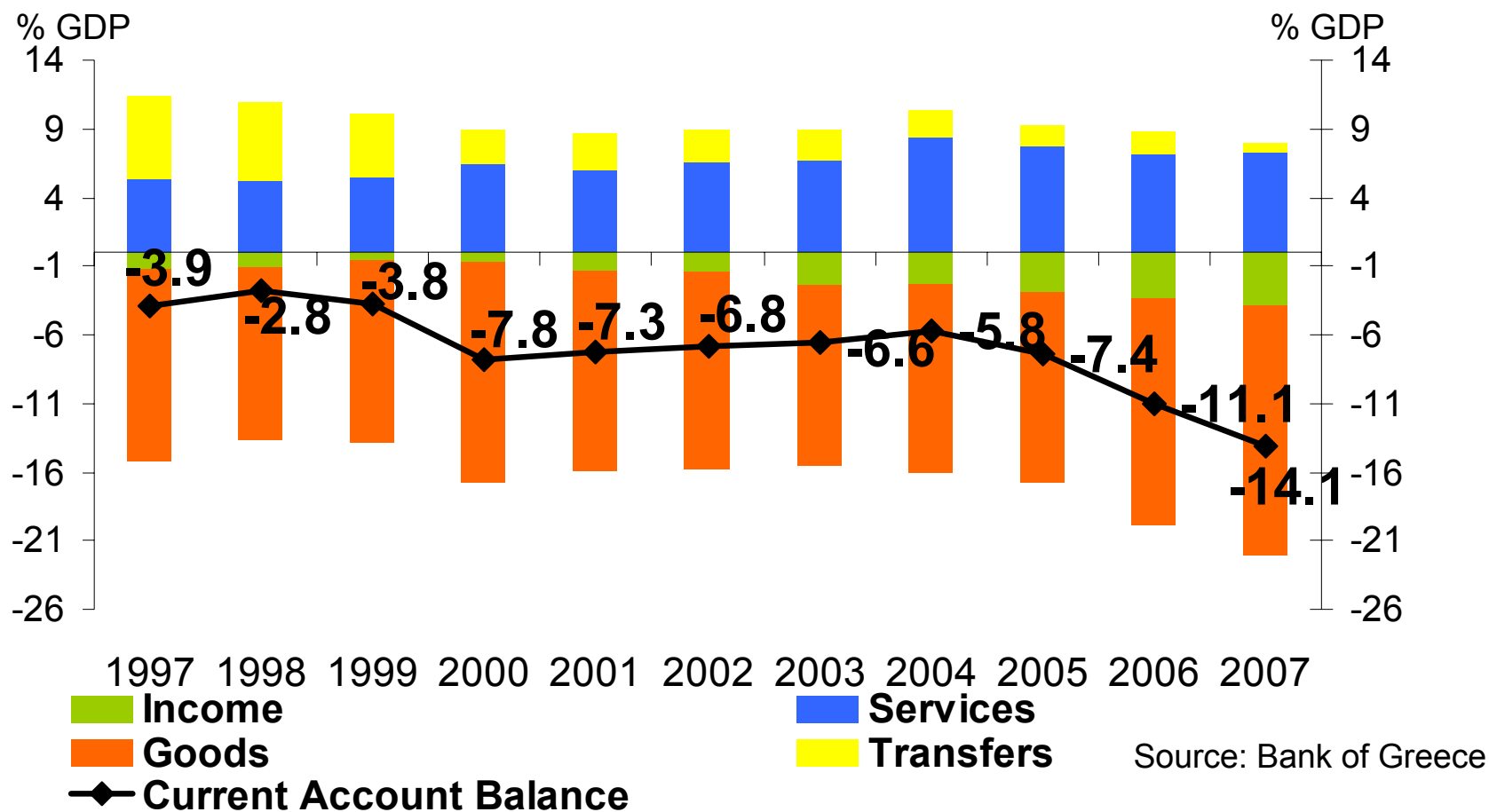


Source: IMF

- ✓ Real Effective Exchange Rates have worsened since 2000
- ✓ The higher CPI inflation in Greece points to lack of competition in product & service markets.
- ✓ Unit labor costs are increasing faster in Greece

II. ... hence, Greece's current account is getting worse

- ✓ **CA deficit** has **tripled** relative to the pre-EMU period, while the growth in aggregate demand is the same as before
- ✓ **CA deficit** can lead to an abrupt **future recession**



III.

The global financial crisis and the relative position of the Greek financial system

III. How large is the short-run correction? The two problems of the global crisis

- ✓ The next 15 months will provide a stress test of the Greek economy
- ✓ Two problems underpin the global financial crisis:
 - 1) **Insolvency**
 - 2) **Lack of liquidity**

Which may lead to **de-leveraging**, i.e. the transmission of the crisis to the real economy

- ✓ Fortunately, structural reforms **did** occur in the Greek banking sector and Greek banks are very strong and healthy relative to their European peers, i.e., are **well-capitalized**
- ✓ Yet, Greek banks are affected by the second factor, lack of liquidity

III. Insolvency: Getting better

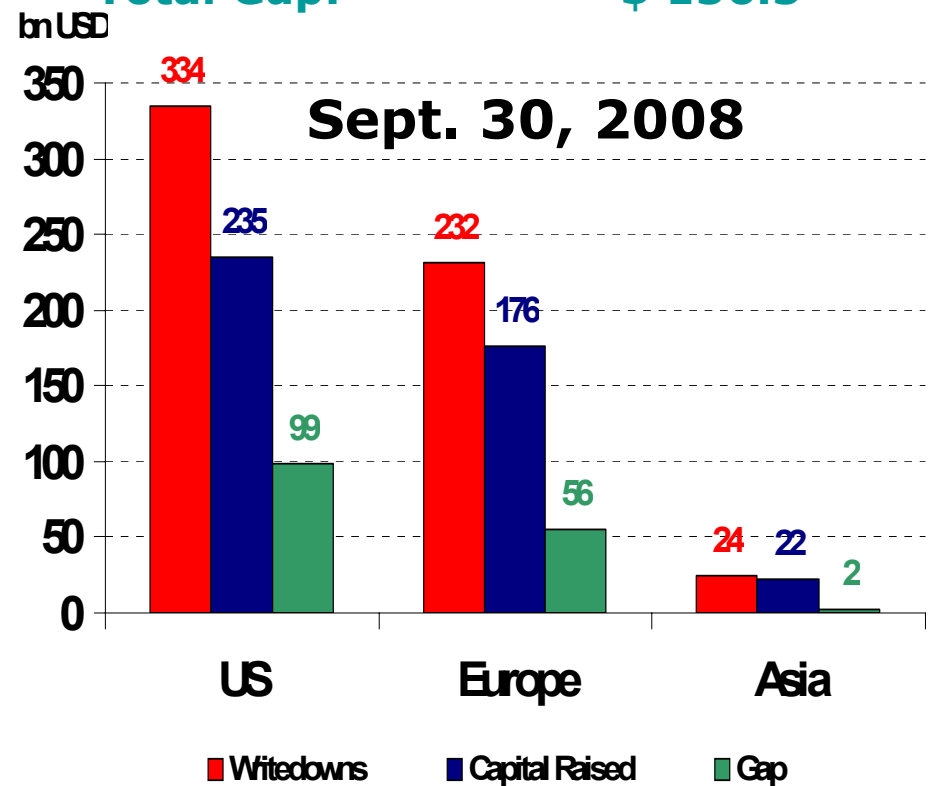
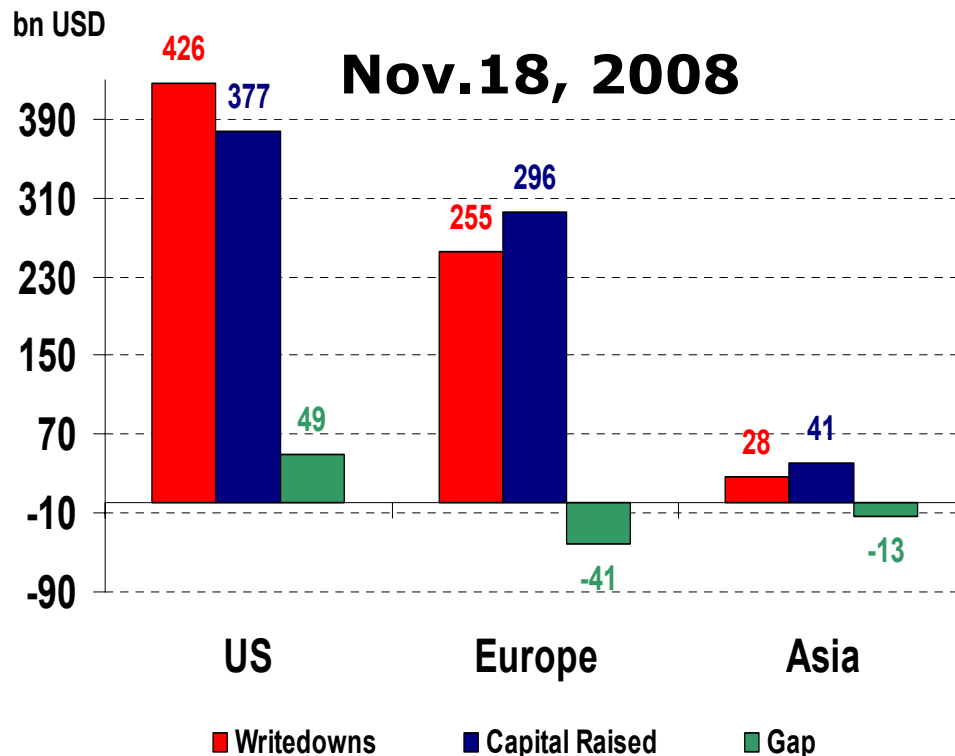
The gap between total write-downs and capital increases has declined sharply in recent weeks due to governments' recapitalizations

IMF: Estimates write-downs for all FIs to reach \$1.4 trillion

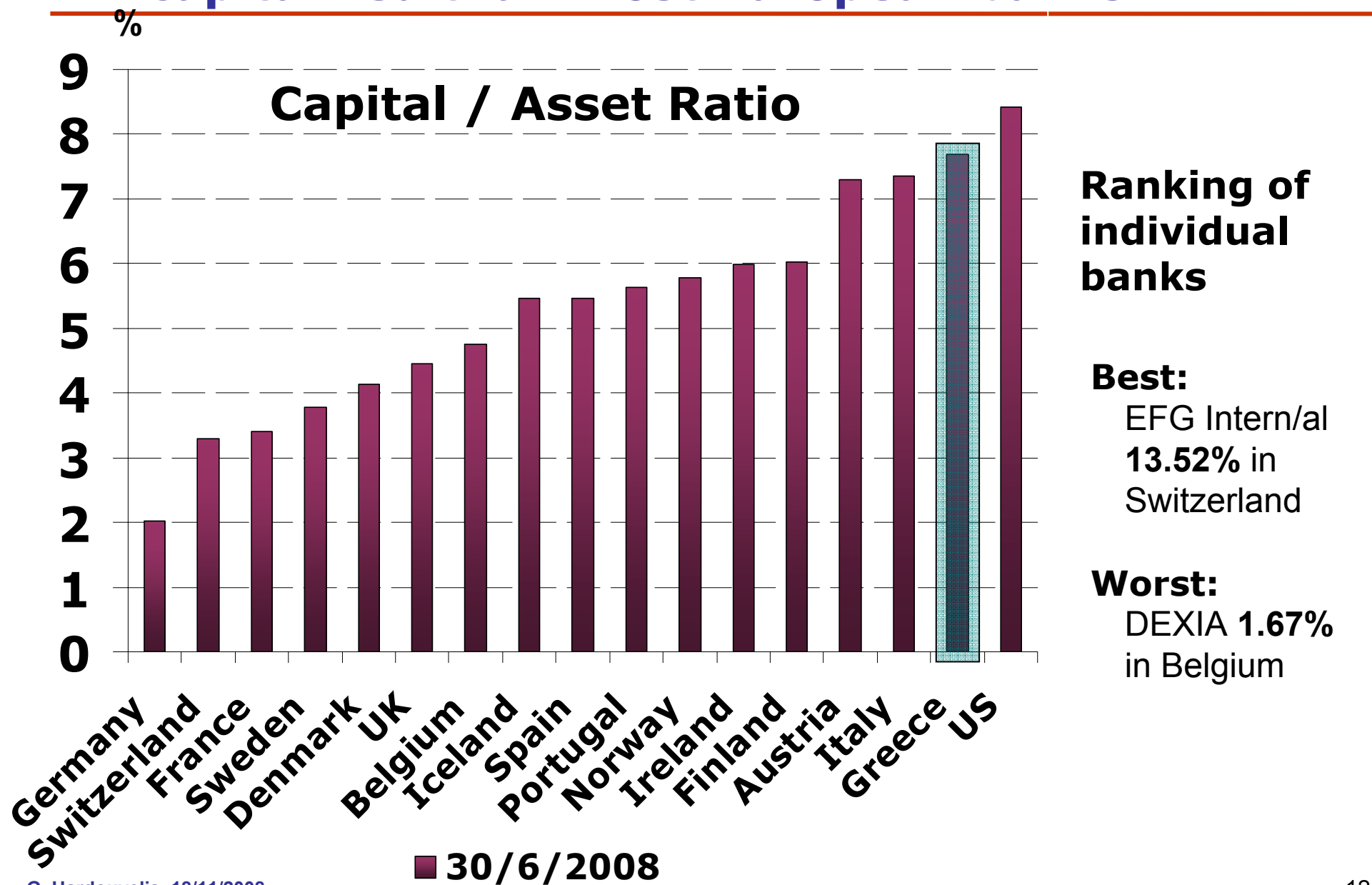
Banking sector only

Total Write-downs: \$ 708.5
Total Capital Raised: \$ 713.7
Total Gap: \$ -5.2

Total Writedowns: \$ 590.2
Total Capital Raised: \$ 433.7
Total Gap: \$ 156.5



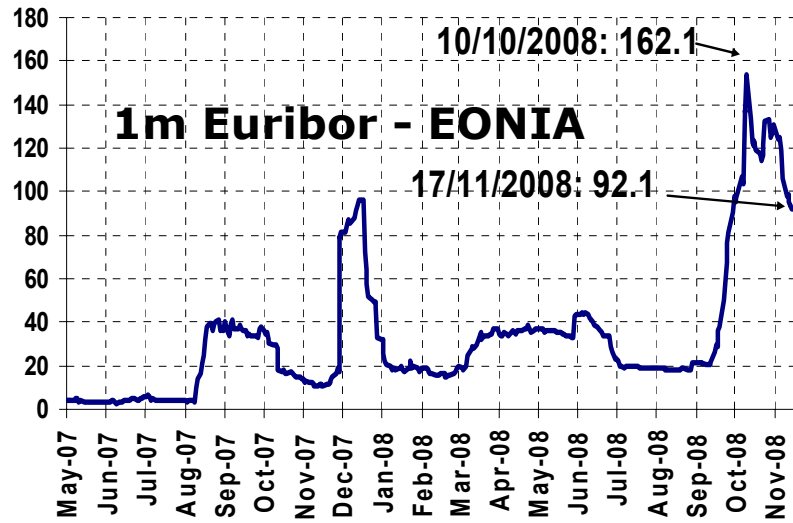
III. Insolvency: Greek banks better capitalized than most European banks



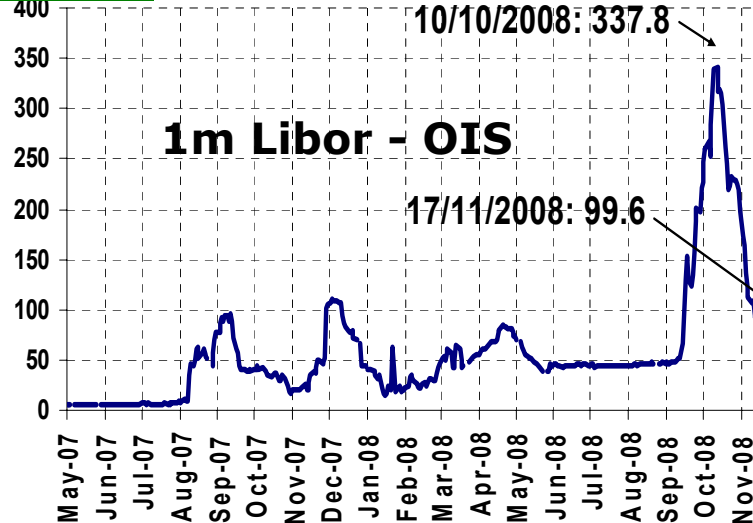
III. Liquidity: Worsening not yet solved in Europe

Euro Area

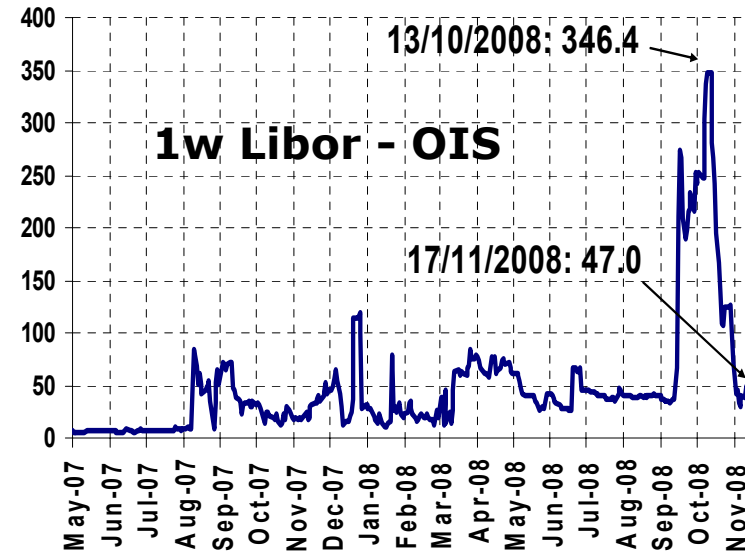
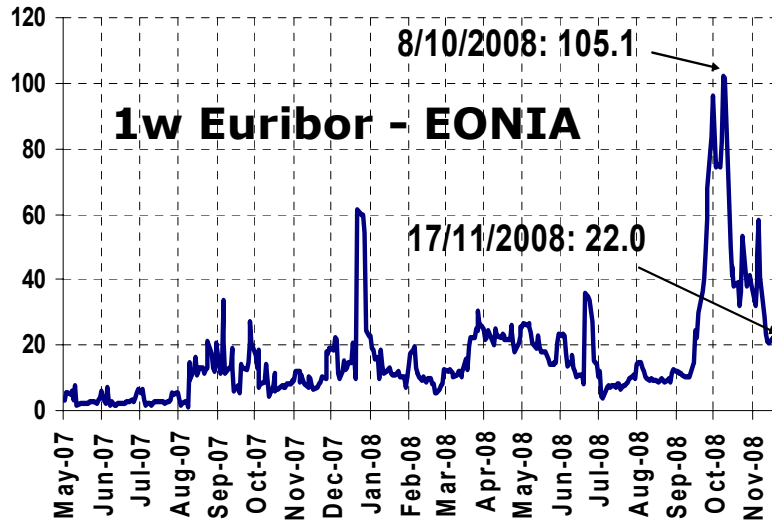
Uncovered minus covered **1-month** inter-bank rates



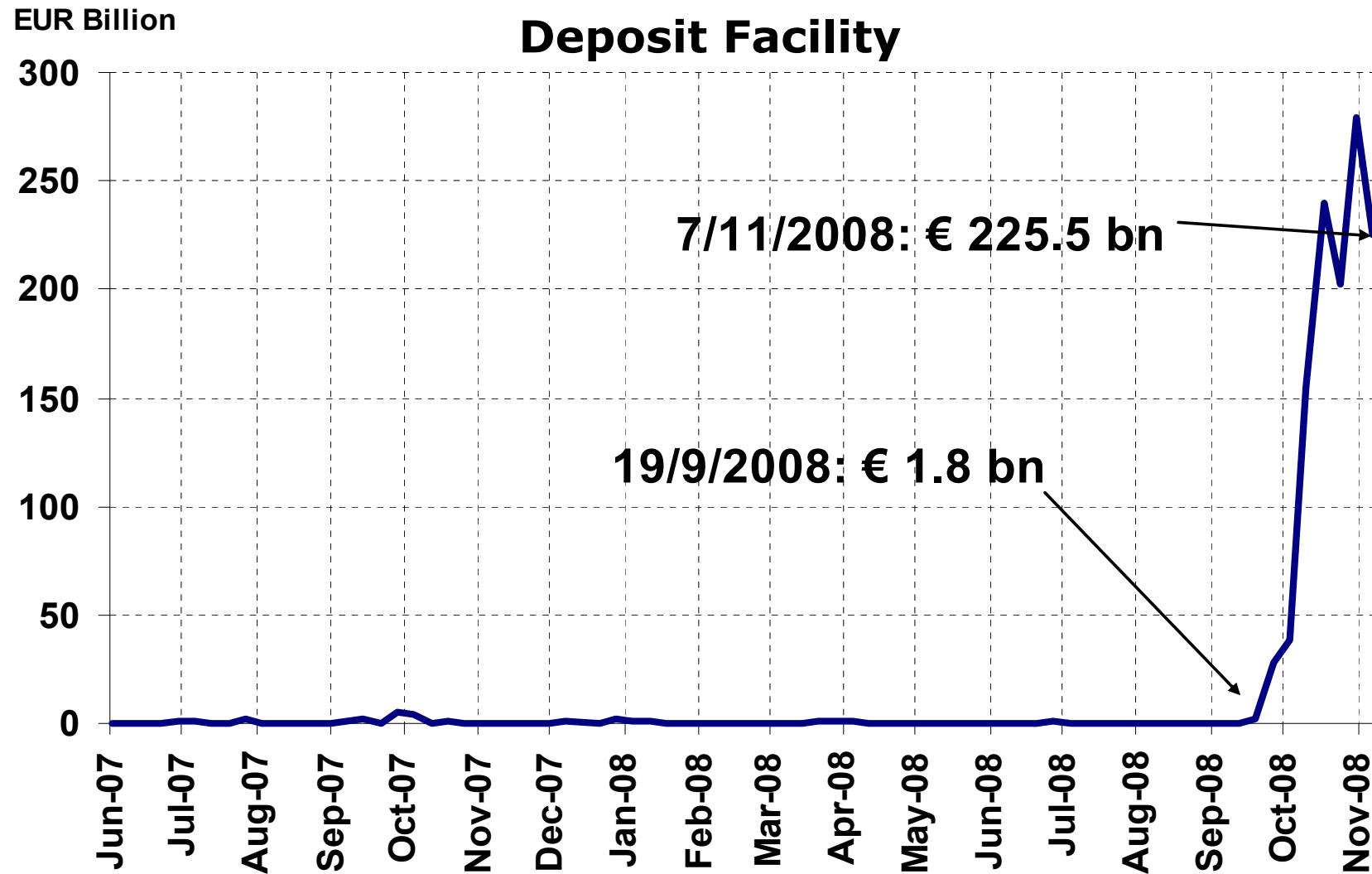
U.S.A.



Uncovered minus covered **1-week** inter-bank rates



III. Liquidity: European banks are hoarding cash



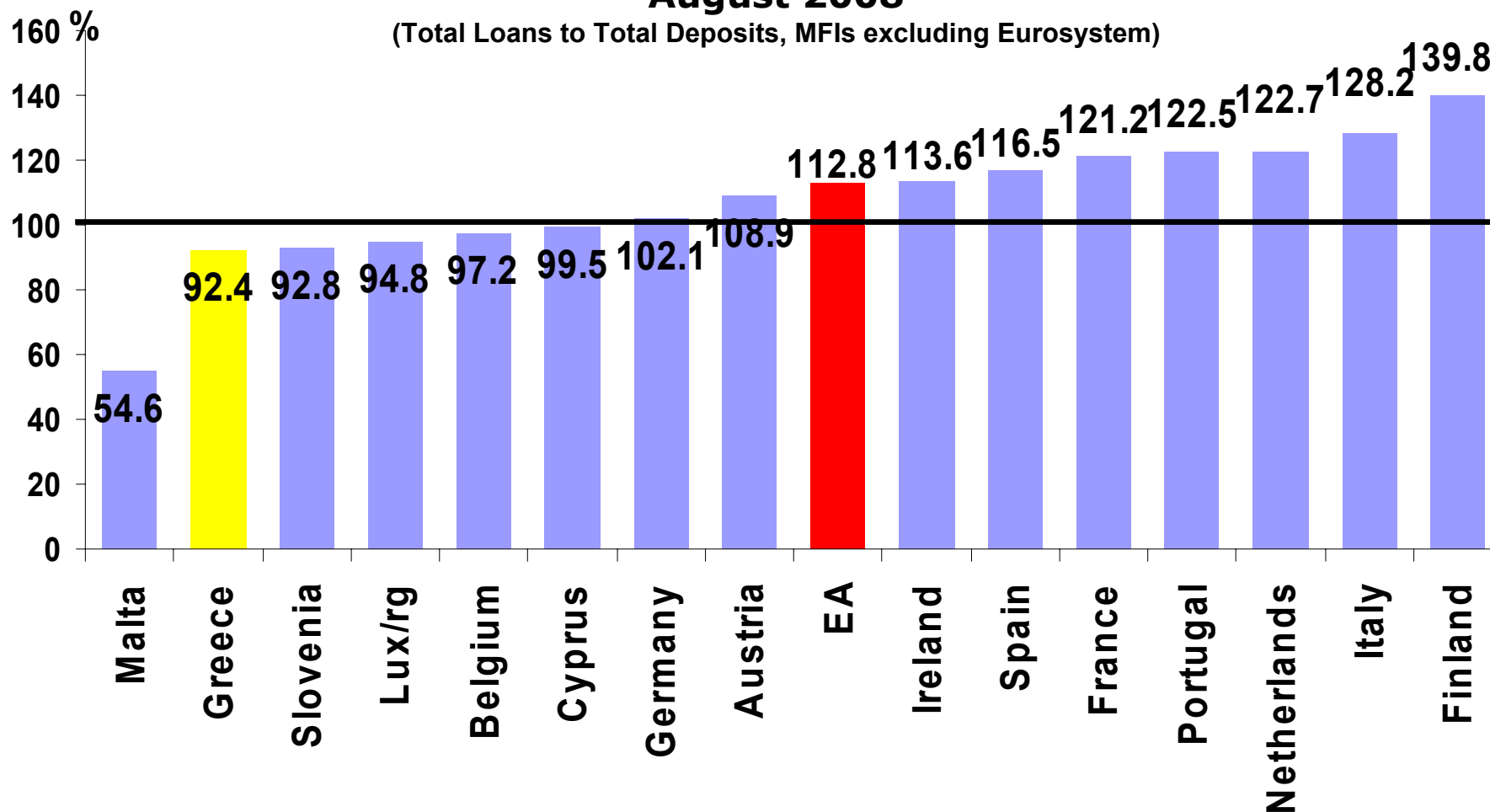
Source: ECB

III. Liquidity: Less of a problem in Greece relative to Euro Area

Loans to Deposits Ratio

August 2008

(Total Loans to Total Deposits, MFIs excluding Eurosystem)

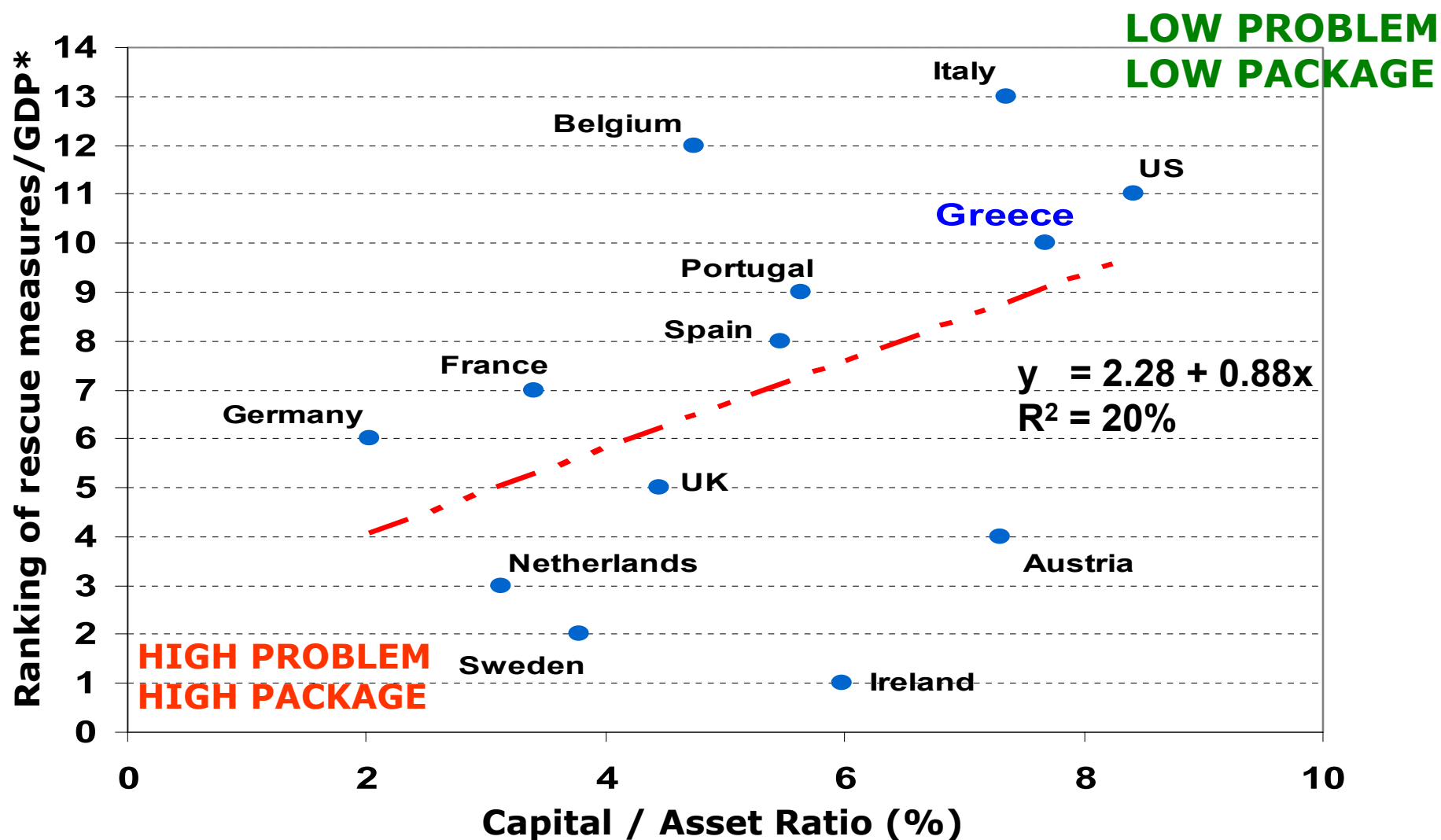


III. Rescue measures ...

	Package Amount	% of 2009 GDP	Partial Adoption
Italy	€ 40 bn	2.5%	✓
Belgium	€ 9.7 bn	2.7%	✓
US	\$ 700 bn	4.8%	✓
Greece	€ 28 bn	10.8%	NO
Portugal	€ 20 bn	11.6%	✓
Spain	€ 150 bn	13.4%	✓
France	€ 360 bn	18.0%	✓
Germany	€ 500 bn	19.5%	✓
UK	£ 500 bn	33.8%	✓
Austria	€ 100 bn	34.2%	NO
Netherlands	€ 220 bn	36.3%	✓
Sweden	SEK 1,500 bn	47.7%	✓
Ireland	€ 400 bn	214.8%	✓
Total EU-27	€ 2,580 bn	20.0%	

- ✓ Greece has offered half the EU-27 package
- ✓ Measures have to be voted into Laws to be operational. Laggards as of 17/11/2008: Greece & Austria
- ✓ Then, we hope to see renewed liquidity in the inter-bank market

III. ... related to the size of the problem



* Sorted from largest (=1) to smallest (=13)

IV.

How much will Greece be affected by the crisis in 2009?

- ✓ **Growth slowdown**
- ✓ **A nightmare scenario can be avoided only through **active policy intervention****

IV. Greece: Channels of negative influence

- 1) Lower economic activity abroad → less exports, lower tourist receipts, less foreign buying of property, lower shipping rates
- 2) Higher interest rates due to liquidity considerations → less credit expansion, lower consumption & investment

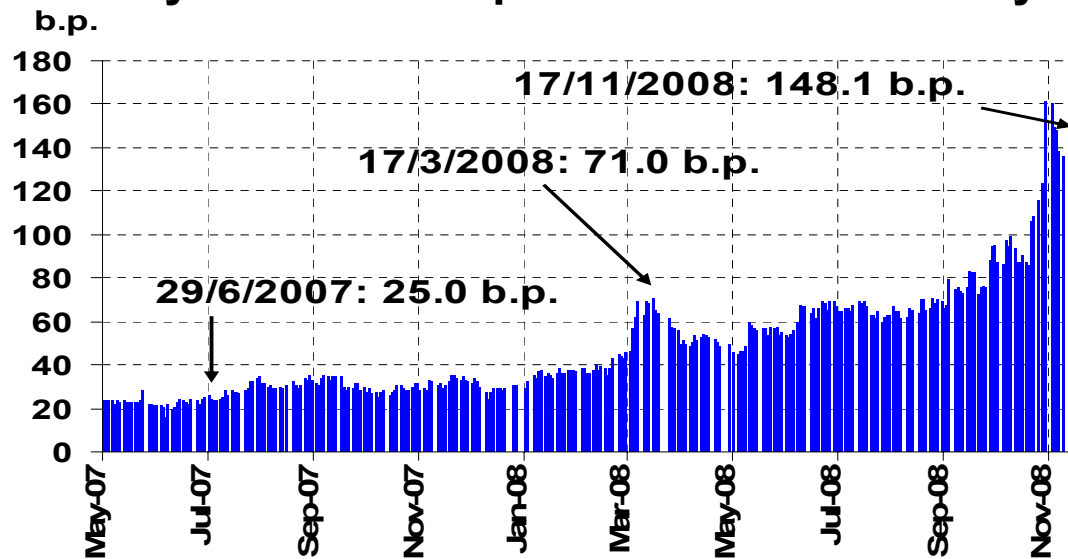
Greece will avoid:

- ✓ Large bank failures and abrupt restriction of credit due to solvency reasons to the same degree observed abroad



IV. Bearish markets are harsh on Greece

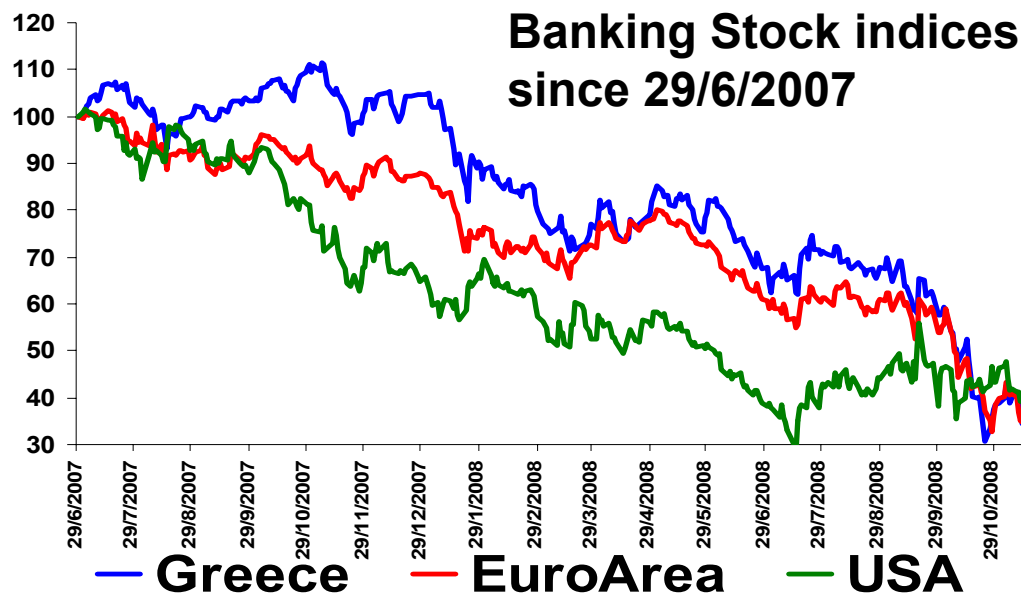
10-y Gov. Bond Spread: Greece-Germany



✓ Recent increase in gov. bond spread is consistent with historical behavior (thus not due to the package): It is explained by similar increases in other EA spreads plus EMBI+

✓ Markets do not see the better position of Greek banks: Banking stocks hard hit

Banking Stock indices since 29/6/2007



Nov 17: **GR 33.04**
EA 32.97
USA 38.44

IV. Greece: Will the good scenario prevail?

- YES, if:**
1. Loan expansion resumes by year-end
 2. Investment growth fills in the slack
 3. Consumption growth declines and imports decline for a longer period than the current global recession

THE GOOD SCENARIO: yoy growth in constant prices	Weights (2007)	EU 2008	EU 2009	GH 2009
GDP	100.0%	3.1	2.5	2.1
Pr. Consumption	71.2%	2.6	2.2	2.0
Pub. Consumption	16.7%	2.9	2.7	2.4
Investment	22.5%	3.2	2.8	2.1
Exports	23.0%	4.2	3.1	2.6
Imports	33.5%	2.6	2.5	2.1
HCPI		4.4	3.5	3.3
Budget deficit (% GDP)		-2.5	-2.2	-2.9
Public debt (% GDP)		93.4	92.2	93.0
Unemployment rate		9.0	9.2	8.7
Current account (% GDP)		-14.3	-15.0	-14.0

V. Conclusions

- ✓ The current crisis has delayed affecting Greece because of the health of its financial sector. **Is the worst in front of us?**
- ✓ Two possibilities for 2009:
 - I. **Good scenario of growth slightly > 2%,**
 - II. **Nightmare scenario of growth < 0**, as past experience shows that Greek recessions are the worst ones in the OECD, with a total mean output loss of **-6.45% of GDP** (*2 times bigger the mean OECD country loss and 3 times the median loss*)
- ✓ Two main risk drivers will determine which scenario will unfold:
 - I. The liquidity issue, as Greece & Austria remain the two countries with no government measures that have become Law
 - II. The need for aggressive fiscal expansion, mainly through investment projects co-financed with the EU
- ✓ In a future environment of low growth, it may be more difficult to carry on with those structural reforms needed to improve competitiveness.
- ✓ In a possible nightmare scenario, our limited macro-economic tools and the long-run imbalances imply that once in a recession → **A long period of stagnation may follow**

THANK YOU FOR YOUR ATTENTION!!

My thanks to the Research department of Eurobank EFG
for able research assistance and support

For more info, please consult the Eurobank website:

<http://www.eurobank.gr/research>



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