Overcoming the Crisis in Greece

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FUTURE GROWTH MODEL, REQUIREMENT #1: EMPHASIS ON INVESTMENT & EXPORTS

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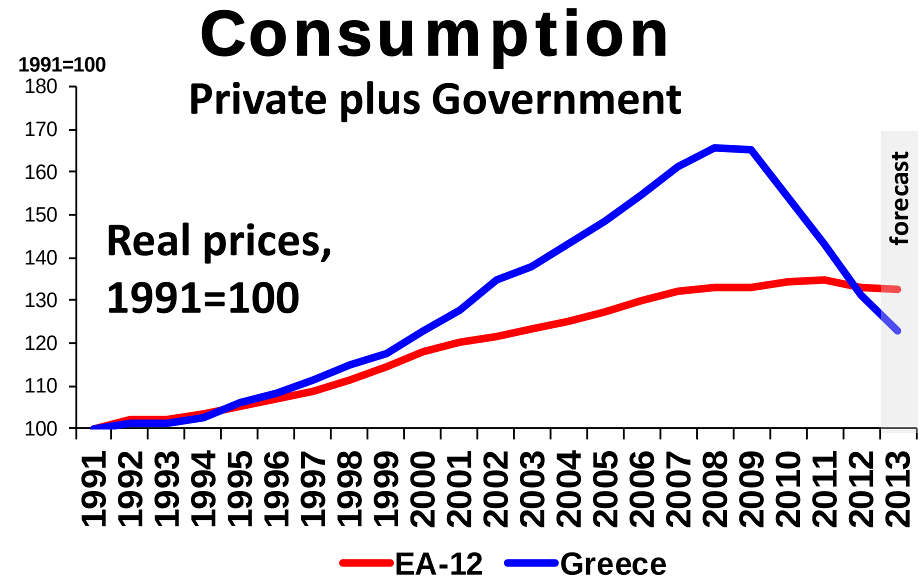
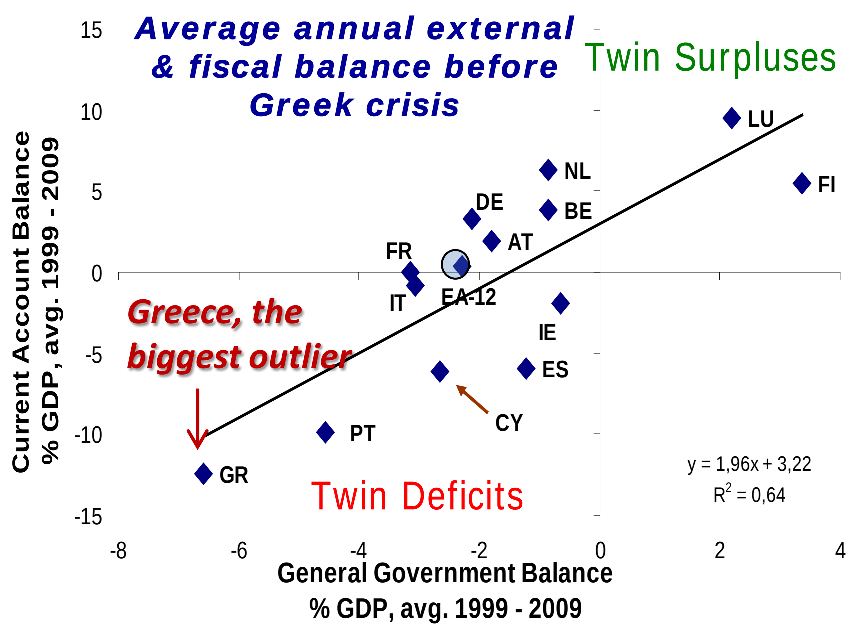
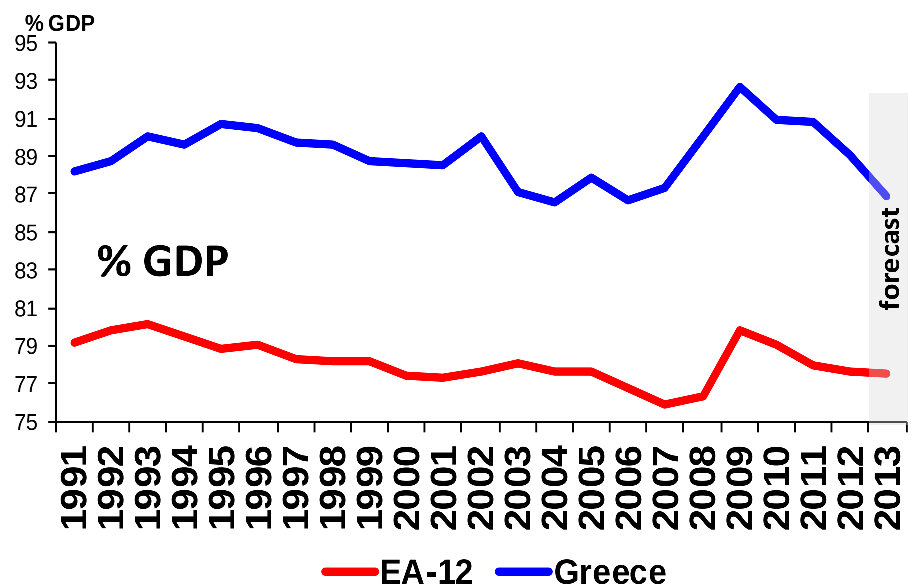
2012 SHARE in nom. GDP	Greece	EA17
Private consumption	73.7%	57.5%
Public consumption	17.8%	21.5%
Total investment	13.2%	18.3%
Exports	27.0%	45.8%
Imports	32.0%	43.2%

Oil Exports in 2012 were € 10.4bn or 5.3% GDP
Oil Imports in 2012 were € 17.9bn or 9.2% GDP







Source: European Commission

Source: European Commission

FUTURE GROWTH MODEL, REQUIREMENT #2
CONSUMPTION SHOULD GROW TOO, BUT AT A LOWER RATE

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- ✓ THE GROWTH MODEL: In the future, consumption should grow at rates lower than investment & exports
- ✓ For recession to stop, mainly consumption has to stabilize, plus investment has to reverse its trend
- ✓ Private Consumption will stabilize if disposable income stabilizes, i.e. no more taxes, no drastic wage & pension cuts
- ✓ The short and long-term growth paths are inter-linked: If recession continues, all risks explode plus capital & labor inputs get destroyed, hurting future potential growth

	2012 Share in Nom. GDP	2013 growth Real	2014 growth Real
Private Consumption	73.7%	-7.1%	0.5%
Government Consumption	17.8%	-7.2%	-3.1%
Tot. Consumption	91.4%	-7.1%	-0.2%
GFCF	13.6%	-9.9%	1.5%
Domestic Demand	105.0%	-7.5%	0.0%
Imports	32.0%	-9.8%	0.6%
Exports	27.0%	2.9%	2.1%
GDP (nominal)	193.748		
Real GDP		-3.9%	0.4%
GDP deflator		-1.5%	-0.5%
Unemployment (avg)		27.6%	28.5%

Source: Eurobank Research

RECOVERY GUARANTEED BY A NEW LOAN PACKAGE, YET DOWNSIDE RISKS ABOUND

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RECOVERY IN 2014:

The best solution that guarantees recovery is another loan adequate to close the financing gap of 2014-2015

1. **External Risks**
   - **Hardliners** emboldened by the Cypriot Bail-in Solution and by the balancing of the Greek current account (which minimizes contagion) ⇨ insist on **new fiscal** contractionary measures (instead of insisting on reforms) ⇨ new cuts in primary and secondary pensions in order to address expected fiscal shortfall (Gov.: €0.5-1.0bn, Troika: €2.0-2.5bn) ⇨ recession continues
   - Although the market thinks otherwise, Debt **sustainability** remains an issue in the eyes of the IMF, which refuses credit. Yet, OSI is politically difficult prior to European Parliament elections in May 2014 ⇨ **Package solution** for debt sustainability & financing gap **delays** ⇨ resolution of uncertainty postponed ⇨ both liquidity and investment do not pick up momentum on time
2. **Domestic Risks**
   - Government **raises taxes**, hence disposable income continues its earlier decline
   - Government **fails** to design a **concrete growth model** ⇨ no anchor exists for expectations, sentiment stops improving, FDI does not arrive, etc.
   - Population does **not see the greenshoots** ⇨ climate ⇩for investment & consumption
   - **Ownership** of reforms has failed and now with primary surpluses, reforms stall as they touch the **DEEP STATE**, privatizations stall ⇨ toughening European stance

THE 2014 CENTRAL NEGOTIATING FEATURE: DSA – CONTINUOUS PRIMARY SURPLUS MATTERS

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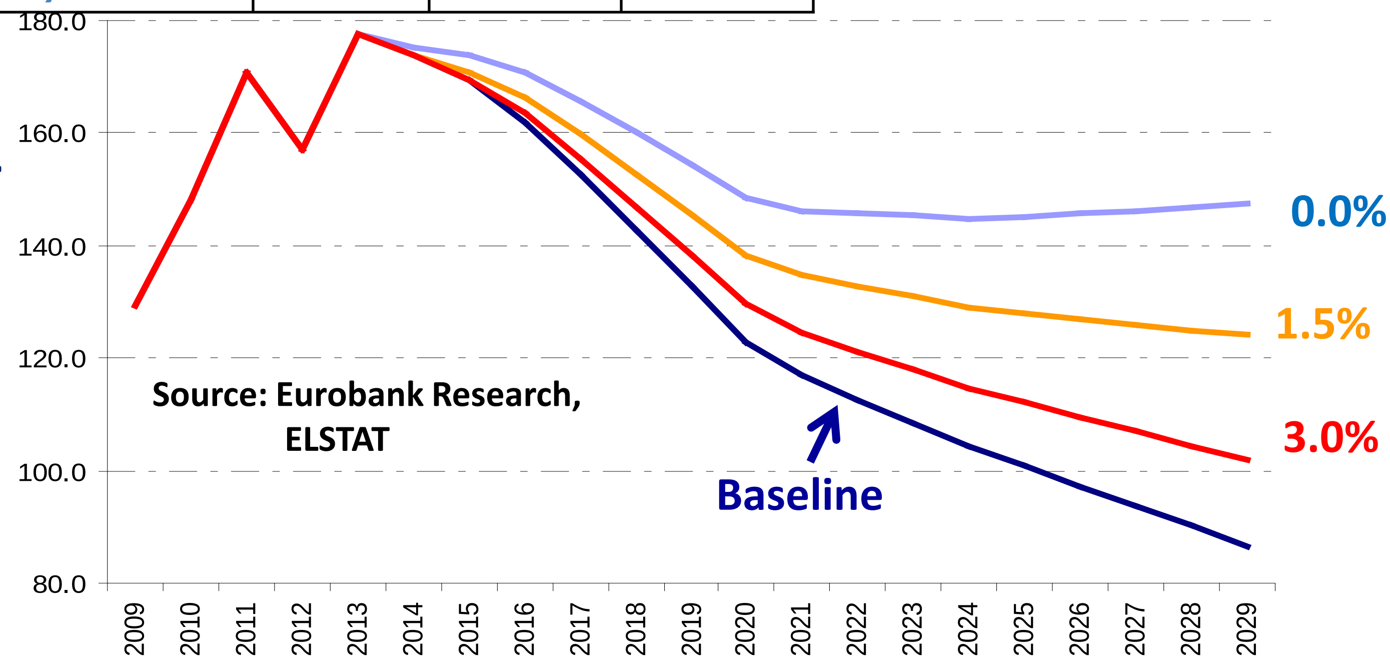
DSA – Sensitivity to primary surplus			
	2012	2021	2030
Debt Baseline (€ bn)	304.6	292.3	301.3
Nominal GDP - Baseline (€ bn)	194.1	247.3	348.3
Debt Baseline (%GDP)	156.9	118.2	86.5
PS at 3% after 2015 (%GDP)	157.5	124.4	98.5
PS at 1.5% after 2014 (%GDP)	157.5	134.6	120.5
PS at 0% after 2013 (%GDP)	157.5	146.2	143.9

BASELINE ASSUMPTIONS

- **Positive Growth from 2013 onwards with average growth at 2.3% of GDP for 2014-2030**
- **Primary Balance at 0.0% in 2013, 1.5% at 2014 3.0% at 2015 and on average 4.1% of GDP for 2016-2030**

- ✓ **Not only growth, but also primary surplus matters for debt sustainability**
- ✓ **Attaining a large primary surplus is <u>not easy</u> politically**
- ✓ **OSI could help as official holders, excluding the ECB, own €217bn**



CAN WE SAY MORE ABOUT THE GROWTH MODEL?

- ✓ **There is a tendency,** especially among consultants who are pressed to give concrete advice, **to pick certain sectors of the economy on arguments of:**
  - comparative advantage (which is usually assumed to be obvious)
  - or large multipliers (without concrete estimation results)
  - or export importance of domestic value added,

  and claim those sectors ought to provide the basis for growth, e.g. tourism, agri-business, information technology, large infrastructure projects, energy, etc.
- ✓ **In choosing the sectors, one has to remember:**
  - The sector recipe advice tends to be similar for many countries, yet, no one says why is Greece different than, say, Croatia. (Answer: institutional & business environment)
  - Past sector performance does not guarantee future results, as world demand may shift in the future
  - Tourism is everyone's favorable sector in Greece and may indeed prove the counter-example: While it has silently shrank in importance over the last fifteen years, there is a loud anticipation that world demand for its services would rise over time
- ✓ **Supporting policies ought to shy away from subsidies and, instead, reward risk taking**
- ✓ **Another feature is the small size of enterprises across all sectors in Greece ⇨**
  - Need for policies that support consolidation and do not keep marginal enterprises artificially afloat
  - A large fraction of micro-enterprises in Greece survive because they cheat on taxes

ADDRESSING THE LONG-TERM: PROGRESS IN CERTAIN SOURCES OF GROWTH

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- The country is addressing some of those factors with success, see Table in RHS:
- A more specific growth path is hard to pin point with precision as it depends on the evolution of both demand and supply factors (potential GDP). Nevertheless, we know:
  - **The procrastination of recession destroys labor skills and capital** and constrains growth over the next decade
  - **Lack of population growth or immigration abroad also reduces growth**

1. **Competitiveness improving**
2. **Openness is improving: (Exports + Imports)/GDP from the 57.7% average over 2001-2009 is 59.0% in 2012**
3. **Inflation is improving: From 3.3% in 2001-2009 to 1.0% in 2012 (expected at -0.8% for 2013)**
4. **The size of government consumption is declining, from 18.4% in 2001-2009 to 17.8% in 2012**
5. **The initial condition will be lower at the end of 2014, which makes convergence easier**

Relative Living Standards

EE-15=100 in PPS

1991	75.5	2003	80.7
1995	71.7	2007	80.9
1999	71.0	2014	65.4

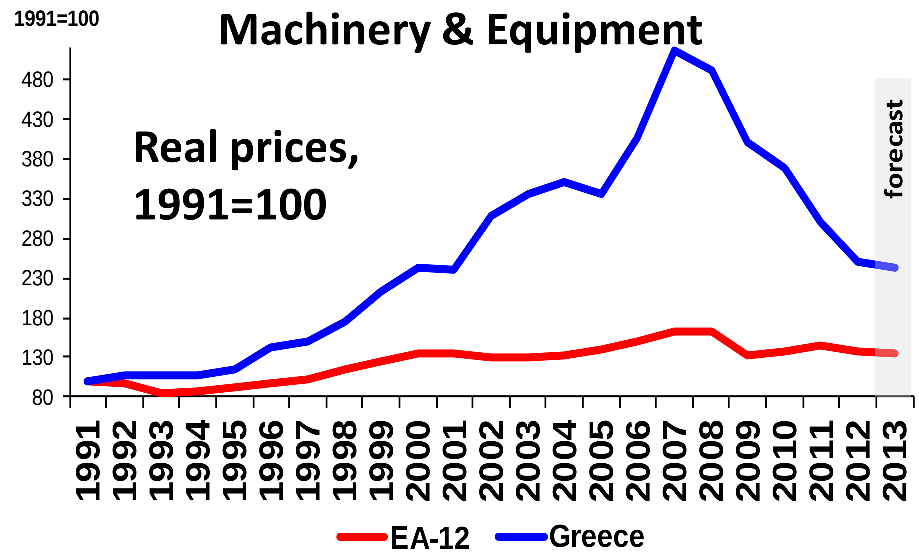
LAGGING BEHIND IN OTHER SOURCES OF GROWTH

	Greece	EA-12
1. Investment (% GDP)		
2001-2009	22.8	20.6
2012	13.1	18.4
2. Corruption Perceptions Index 2012 (0-100)	36.0	70.6
3. Rule of Law 2011 (score -2,5 to 2,5)	0.57	1.41
4. Government Effectiveness 2011 (score -2,5 to 2,5)	0.48	1.36

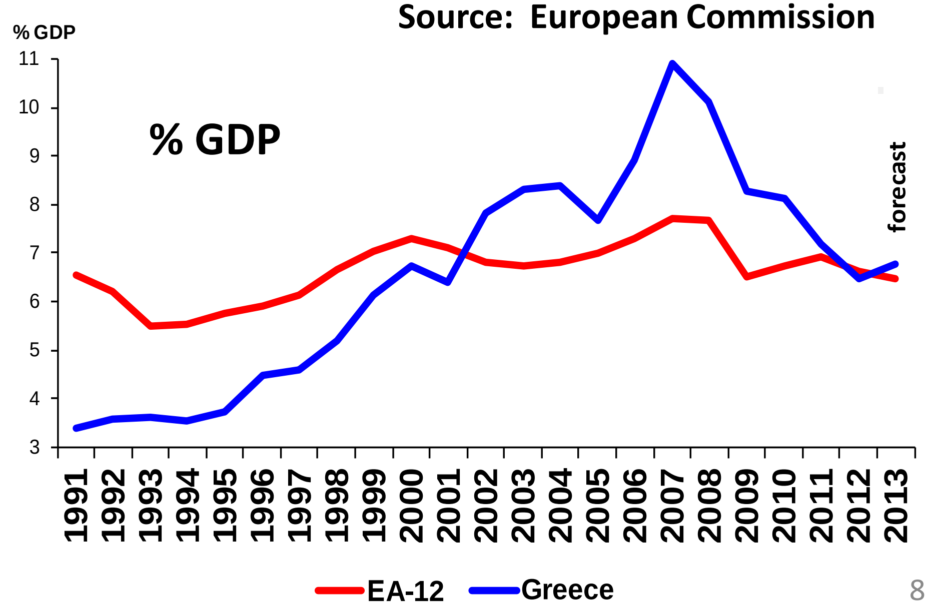
Source: EUROSTAT, Transparency International, World Bank

5. Labor force participation and quality of education are also factors that lag behind

Investment



Source: European Commission



SUMMARY: OVERCOMING THE CRISIS IN GREECE

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- ✓ **THE NEW GREEK GROWTH MODEL requires a <u>delicate balance</u> between (i) a strong emphasis on exports & investment, and (ii) the requirement that consumption increases more modestly, i.e. at a lower rate than GDP, so that its share declines gradually to more normal levels without being a drag on domestic aggregate demand**
- ✓ **Two inter-related questions are pressing today:**
  1. **When will the economy stop shrinking? We expect in 2014**
  2. **How will long-term equilibrium come back? We are setting the ground for it**
- ✓ **The two questions are inter-linked because the sooner the recession/depression is over, the better the long-term prospects become, as**
  - **we need to reverse the trend of destruction in the factors of production, i.e. capital becoming obsolete, labor skills being destroyed, the youth immigrating, childbearing diminishing, etc.**
  - **Europeans ought to place an emphasis on Greek reforms and not so much on more drastic fiscal consolidation**
  - **Reforms have now touched the DEEP STATE and test government's willingness to proceed: <u>OWNERSHIP OF REFOMRS NEEDED</u>**
  - **The reform recipe ought to go ahead even if recession continues**

LET US NOT FORGET: Fixing our country is our problem and no one else's

Thank you
for your attention

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I wish to thank my colleagues at Eurobank for their comments