The International Financial Crisis and Greece

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Table of Contents

I.

Is today's Great Recession over?

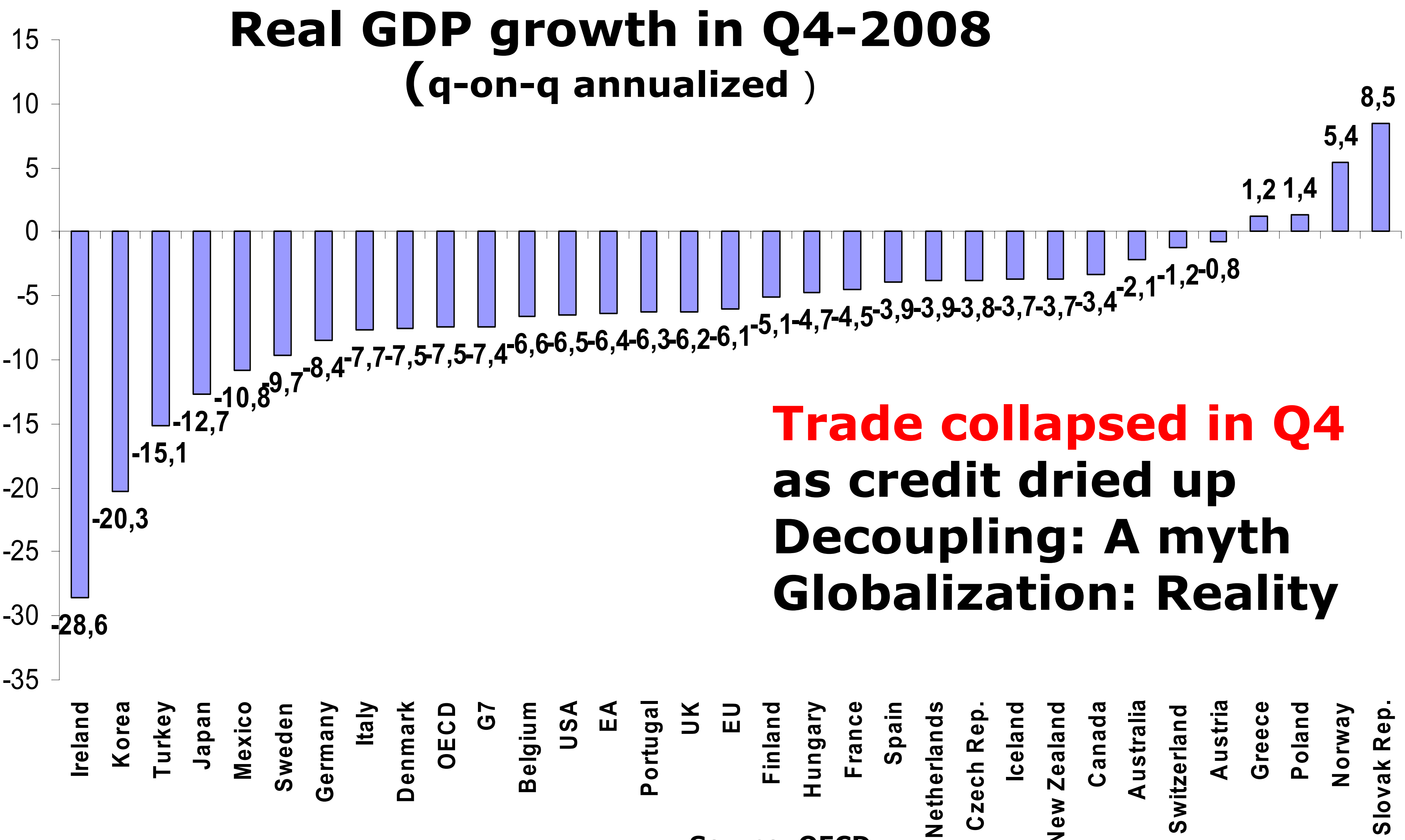
1) The history up to now
2) Is the financial pressure over?
3) Is real economic activity recovering?

I.1 The global economy is facing the deepest – and probably longest – recession of the post-war period

✓ **We expect a significant deceleration in 2009 and a sluggish recovery in 2010**

Source: World Bank, IMF

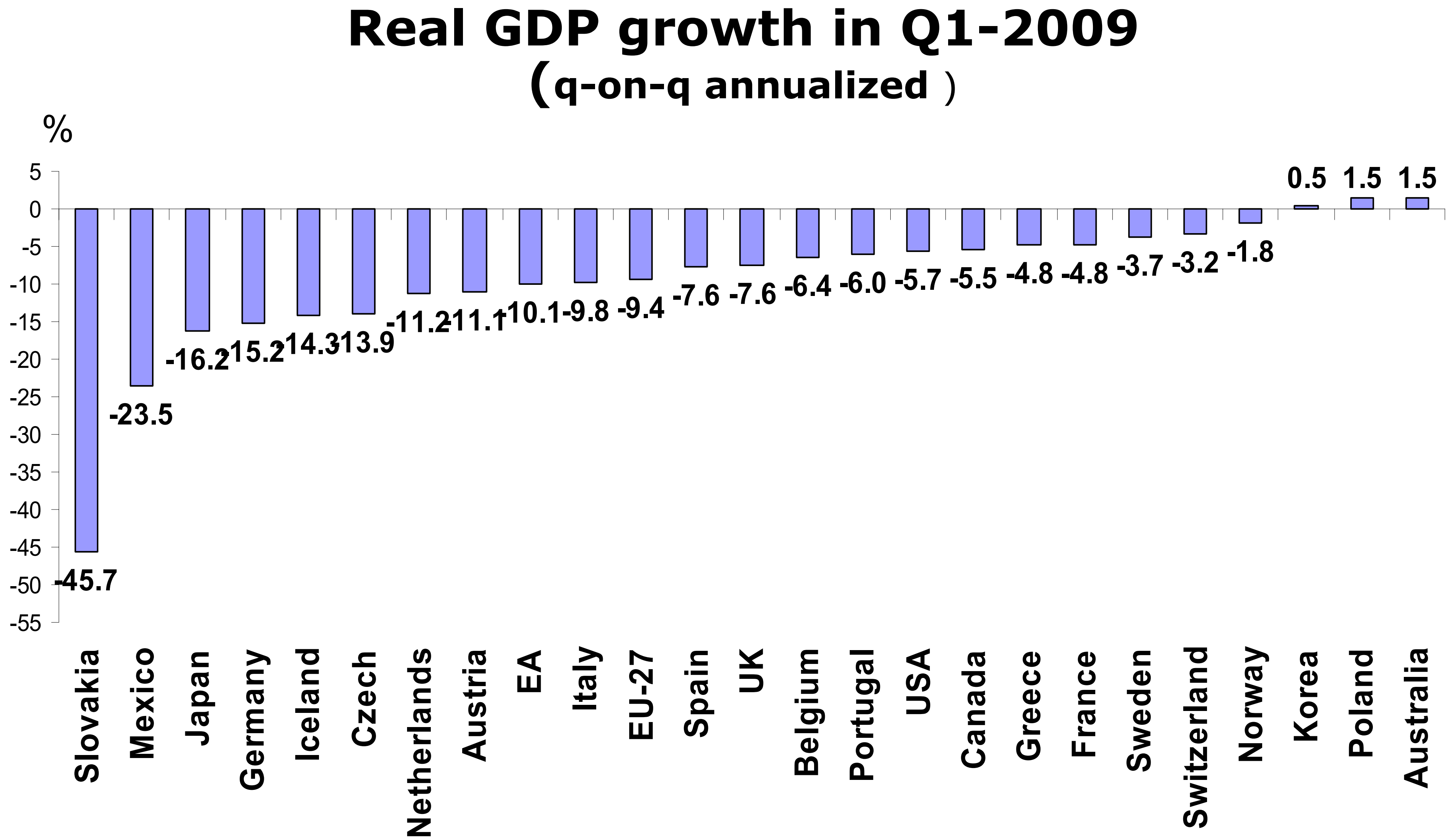
I.1 Fast decline in Q4 2008



Trade collapsed in Q4
as credit dried up
Decoupling: A myth
Globalization: Reality

Source: OECD

I.1 …that continues into Q1 2009

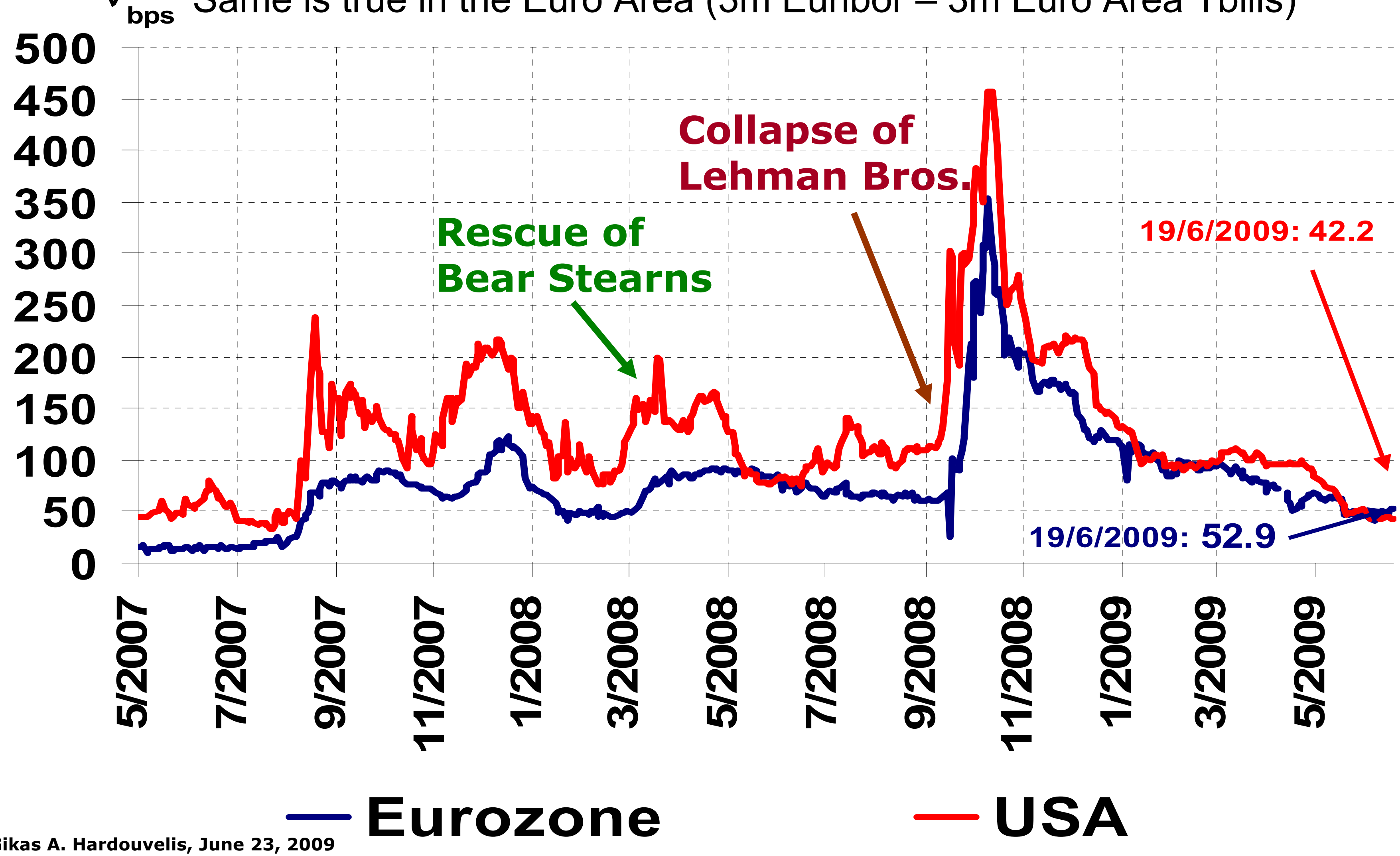


Source: OECD

I.1 History of financial crisis is seen in the rise of short-run quality spreads

Eurobank EFG

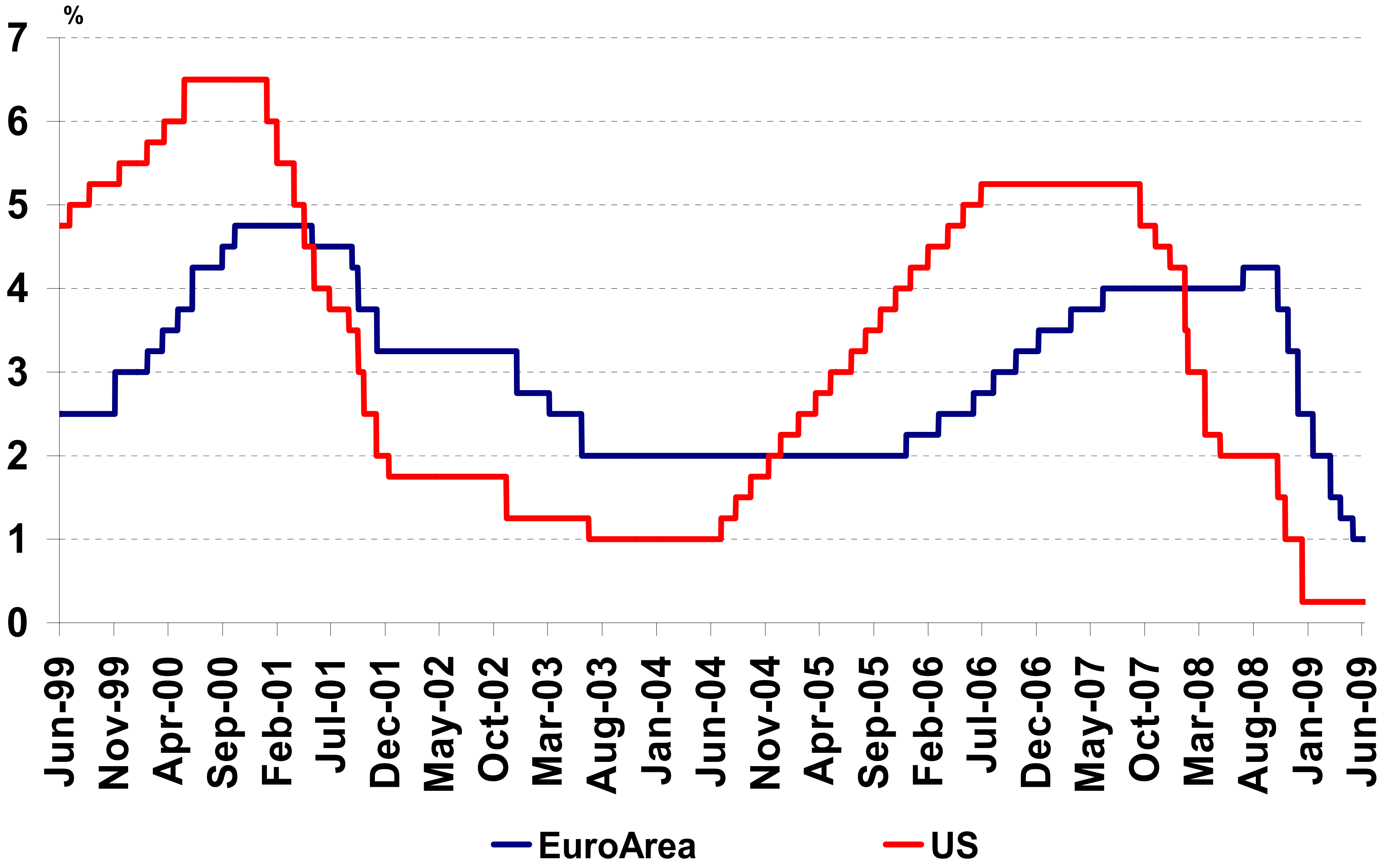
- ✓ US TED spread, 3m Eurodollar - 3m Tbill, points to an increase in **default premia** and a **flight to quality**
- ✓ Same is true in the Euro Area (3m Euribor – 3m Euro Area Tbills)



I.1 It all began in the financial sector

- ✓ The crisis is already 23 months old, growing worse since last September
- ✓ **Many underlying causes**:
  - Large global imbalances ⇨ cheap money or liquidity from surplus countries channeled mainly to US
  - Housing bubbles & the subprime explosion without adequate bank controls on credit risk, e.g. interest rate only loans, etc.
  - Securitization and its new complicated and non-transparent layers in CDOs, CDOs squared, together with new private players outside the reach of Fannie Mae and Fredddie Mac
  - "Greed," i.e. the quest for yield with a simultaneous underestimation of risk, that is, the opposite of the "*Peso Problem*". **This is a recurrent feature of crises and endemic to capitalism**
  - Lax regulation – Abolition of Glass-Steagall Act in 1999, new lenient SEC leverage ratios on investment banks, regulatory arbitrage and SPVs
  - Perverted incentives by Rating Agencies, corporate managers, etc.
  - The new equity culture in traditional banking based on up-front fee generation
  - **Enormous Leverage** based on **short-term** borrowing by FI investing on their own account. This factor is very important in **spreading the crisis**.

I.1 Expansionary monetary policy



I.1 Bank Rescue Plans

	Package Amount*	% of 2009 GDP
Italy	€ 52 bn	**3.2 %**
Belgium	€ 19.6 bn	**5.5 %**
Greece	€ 28 bn	**10.8 %**
Norway	NOK 350 bn	**13.5 %**
Portugal	€ 24 bn	**13.9 %**
USA	$ 2,500 bn	**17.2 %**
France	€ 360 bn	**18.0 %**
Germany	€ 500 bn	**19.5 %**
Spain	€ 250 bn	**22.4 %**
Finland	€ 54 bn	**27.3 %**
Austria	€ 100 bn	**34.2 %**
Netherlands	€ 237 bn	**39.1 %**
Sweden	SEK 1,565 bn	**49.3 %**
UK	£ 1,163 bn	**78.7 %**
Ireland	€ 410 bn	**220.0 %**
Total EU-27	€ 3,460 bn	**26.8 %**

US Rescue Plans

- ✓ Initial Rescue Plan
  "**TARP**" → $700 bn, 5% of GDP

- ✓ New Rescue Plan
  "**Financial Stability Plan**"→
  $2 trillion, 14% of GDP

Nationalizations	
Countries	Financial Institutions
Ireland	Anglo Irish Bank, Bank of Ireland, Allied Irish Bank
UK	RBS, Bradford & Bingley, Northern Rock, Lloyds Banking Group
Germany	Commerzbank
Iceland	Landsbanki, Kaupthing Bank
US	Fannie Mae, Freddie Mac, AIG

* Includes capital injections, asset purchasing and guarantees on debt issuance

I.1 Eurosystem monetary policy: unconventional measures

- ✓ ***9/8/2007****: The ECB was the first Central Bank to provide €95 bn to the market (through a fixed rate operation with full allotment) within a few hours.*
- ✓ ***17/12/2007****: Extension of the duration of main refinancing operations from 1 week to <u>up to 2 weeks</u>, by providing* ***unlimited funds****.*
- ✓ ***4/3/2008****: Extension of the duration of longer-term refinancing operations from 3 months to <u>up to 6 months</u>.*
- ✓ ***15/10/2008****: Expansion of the list of assets eligible as collateral in Eurosystem credit operations*

  (eg. marketable debt instruments denominated in other currencies than the euro, namely USD, GBP and JPY, euro-denominated syndicated credit claims governed by UK law)
- ✓ ***15/10/2008 up-to-date****: Provision of <u>unlimited funds</u> to all main refinancing operations.*
- ✓ ***30/10/2008 up-to-date****: Provision of <u>unlimited funds</u> to all longer-term refinancing operations.*
- ✓ ***7/5/2009****: Extension of the duration of longer-term refinancing operations from 6 months to <u>up to 1 year</u>.*

I.1 Fiscal Packages

	Amount	% of 2009 GDP
US 2008 2009-19	\$ 168 bn \$ 789 bn	**1.2%** **5.5%**
EA-16 2009-10	€ 245 bn	**2.6%**
China 2009-10	CHY 4 tr	**13.0%**

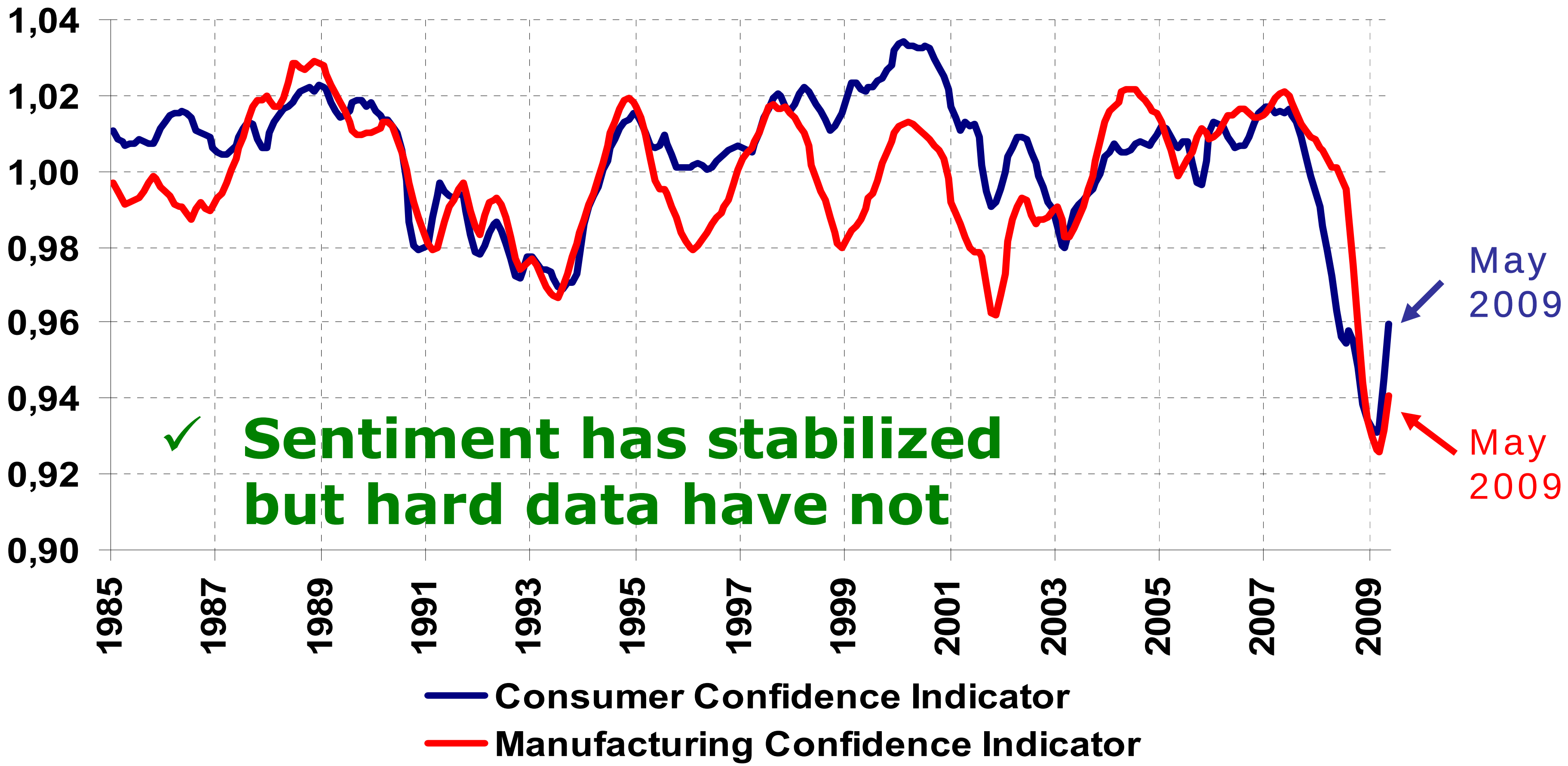
	Fiscal deficit (% GDP)	
	2008	**2009**
US	-3.2%	-11.9%
EA-16	-1.7%	-4.0%
China	-0.4%	-2.8%

Source: European Commission, Congressional Budget Office, Economist

- ✓ **Not enough fiscal stimulus in Europe,** according to the US Administration
- ✓ **Will Western Europe eventually commit funds for Eastern Europe**? It is particularly exposed to Eastern Europe (% GDP: **82% Austria, 53% Switzerland, 49% Netherlands, 42% Belgium**), so there is motivation for help
- ✓ Eastern European External bank liabilities to Western Europe **\$1.51 tr** from a total of \$1.66 tr as of Sept 2008 through BIS reporting banks (Greek banks not included).

I.1 Global Leading Indicators in an early free fall … now have bottomed out

OECD Confidence Indicators of households and manufacturing enterprises



Source: Ecowin, OECD

I.1 Consensus forecasts: Bleaker 2009

		2009f			2010f		
Real GDP growth	2008	Febr. 09	June 09	Delta	Febr. 09	June 09	Delta
US	1.1	-2.1	-2.5	-0.4	1.0	2.3	1.3
Euro Area	0.8	-1.8	-4.2	-2.4	0.8	0.5	-0.3
Japan	-0.6	-2.9	-6.8	-3.9	0.7	1.0	0.3
China	9.0	6.5	7.1	0.6	8.0	8.3	0.3
Brazil	5.1	2.9	-0.2	-3.1	3.9	3.8	-0.1
Russia	5.6	-0.7	-2.9	-2.2	3.2	2.3	-0.9
India	7.4	5.2	4.8	-0.4	6.0	6.3	0.3
Inflation	2008	Febr. 09	June 09	Delta	Febr. 09	June 09	Delta
US	3.8	-0.4	-0.5	-0.1	1.9	2.4	0.5
Euro Area	3.3	1.0	0.0	-1.0	1.8	0.9	-0.9
Japan	1.4	-0.9	-1.5	-0.6	-0.3	-0.3	0.0
China	5.9	0.5	-0.5	-1.0	2.5	1.0	-1.5
Brazil	5.7	5.3	4.5	-0.8	4.5	4.1	-0.4
Russia	14.1	11.0	13.8	2.8	9.1	11.5	2.4
India	8.3	5.4	5.0	-0.4	4.4	4.3	-0.1

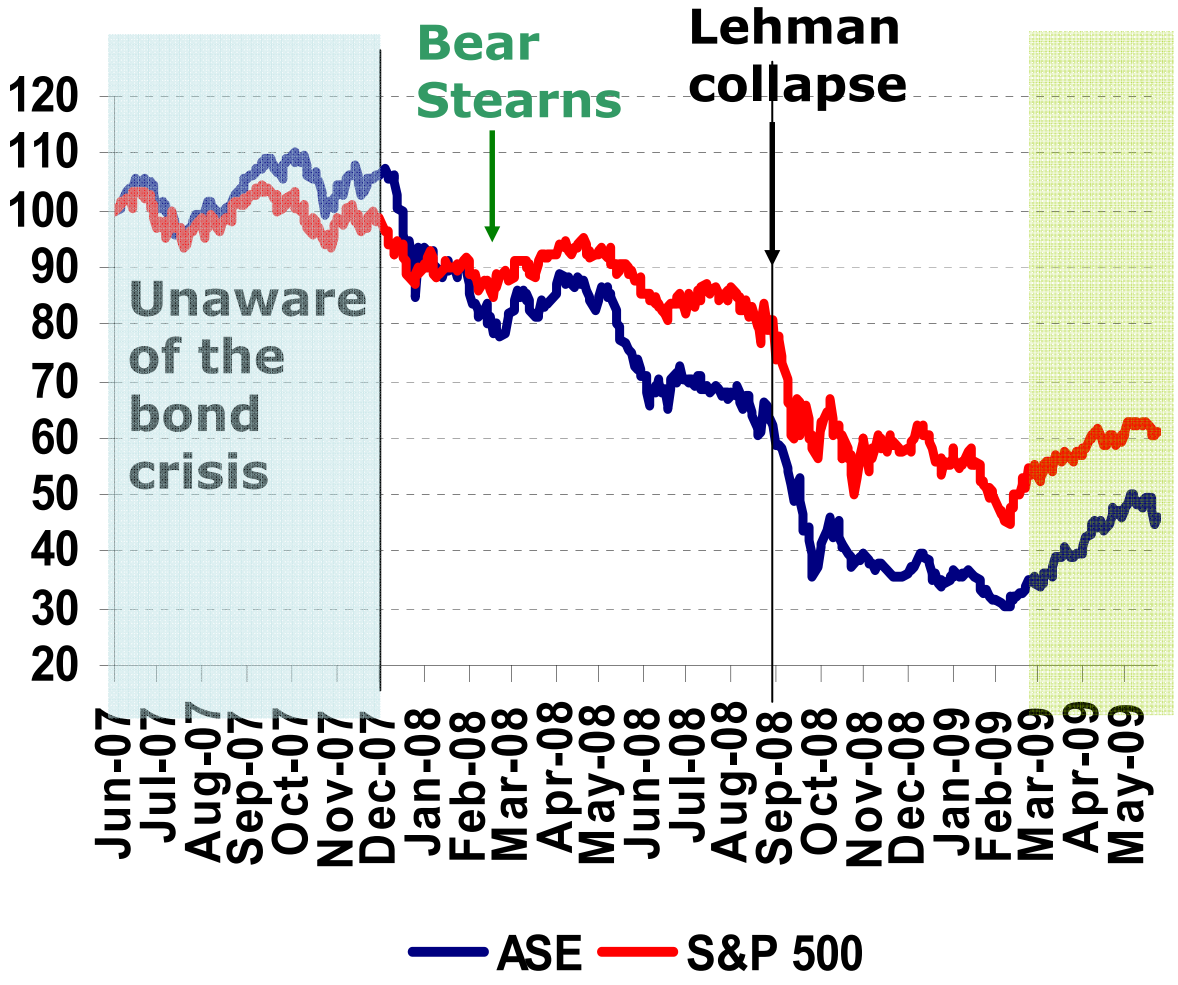
I.2 Is the financial crisis over?

- **The G-20 decisions – especially on financing the IMF - made a positive difference** ***(especially for New Europe)***
- **US stress tests also made a difference, as they have taken out a large part of the uncertainty from the market,** ***(but have not eliminated it)***
- **Financial spreads have shrunk (*****but still remain large by historical standards, hence risk aversion is still present)***
- **Liquidity normalizes** ***(but not fully yet)***
- **Sentiment improves**

- **NPLs will rise with a delay as the recession progresses, extending the financial stress forward**
- **No European stress tests yet**
- **Bank losses are amortized over time ⇨ vulnerabilities remain**
- **Will there be another negative surprise as in September 2008?**
  Some worry about the effects of (i) A sudden collapse of the dollar together with a policy mistake (ii) The commercial real estate market losses

I.2 Stock markets appear to vote for an end of the crisis – Are they right?

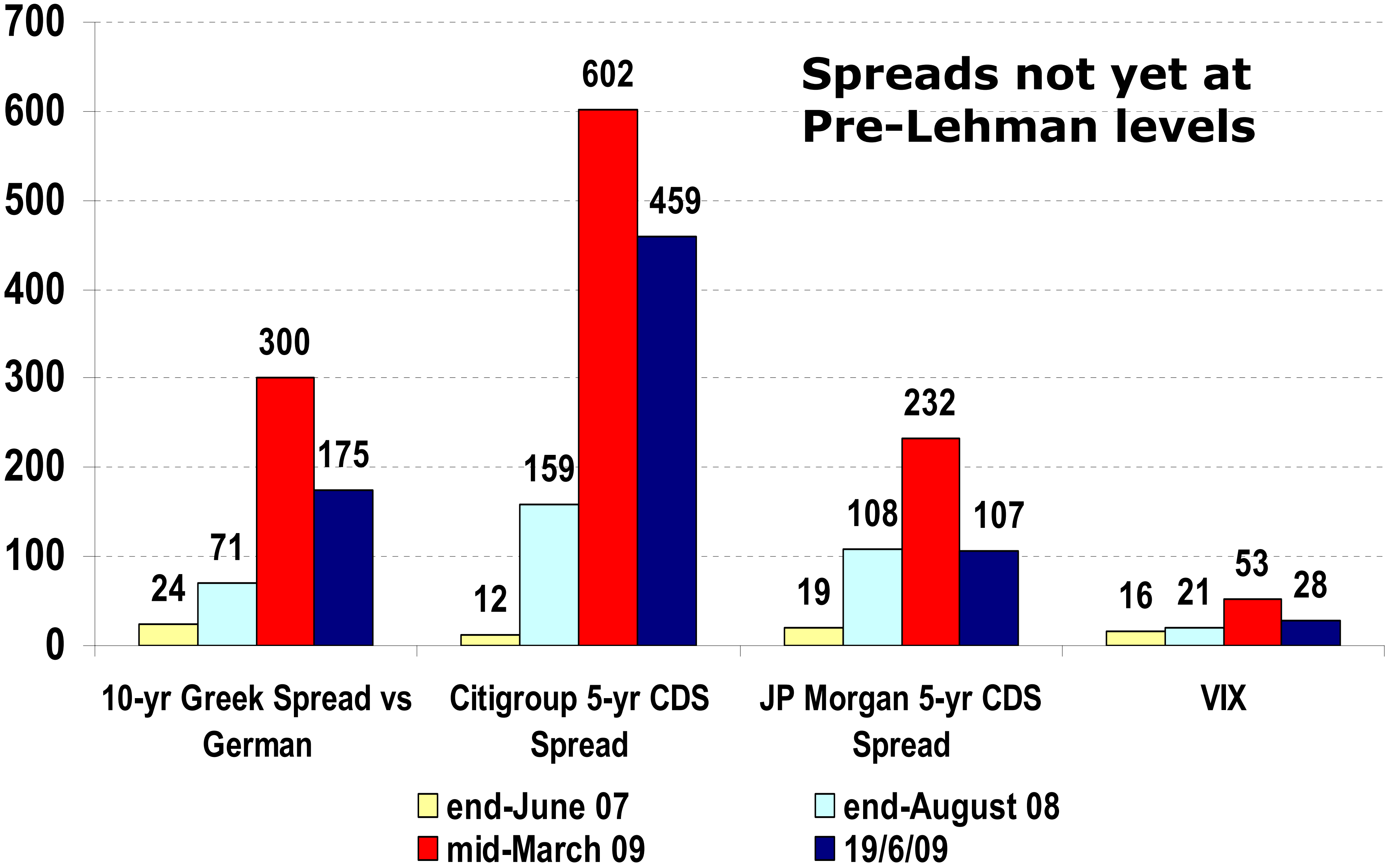
Eurobank EFG



- ✓ Stock markets became aware of the crisis in Jan. 2008
- ✓ Post-Lehman fear & panic (Sept. 2008)
- ✓ Since Mid-March 2009 a bullish rally: (i) mainly **Decline of fear** (risk premia), (ii) plus acceleration of decline in GDP stopped

✓ **Can we trust a market that was oblivious of the crisis for 6 months?**

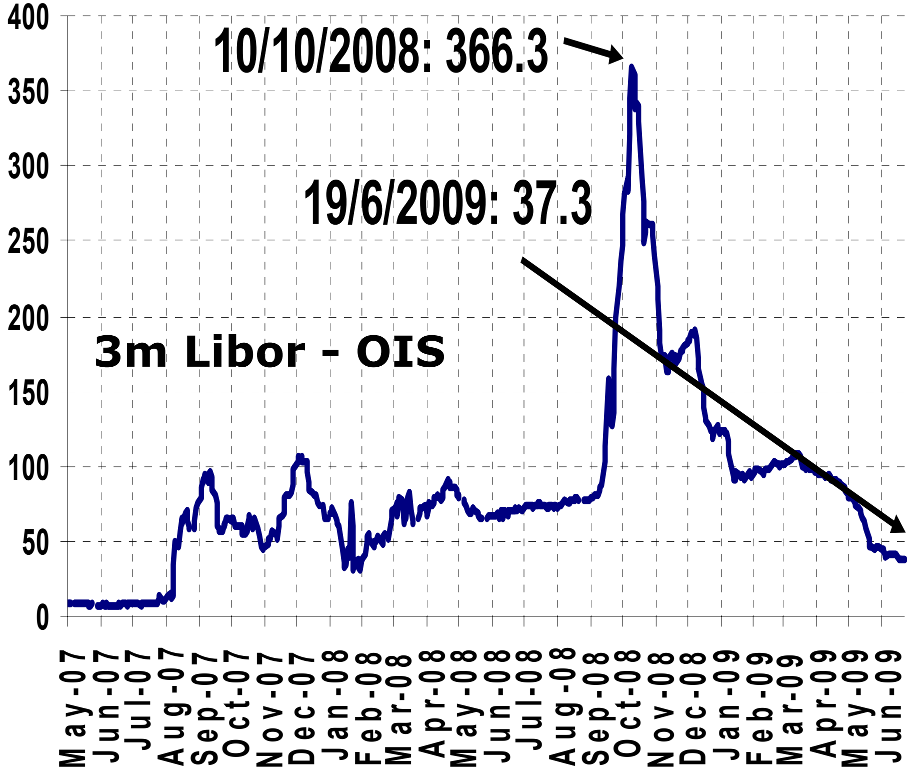
I.2 Risk aversion: Down but not out

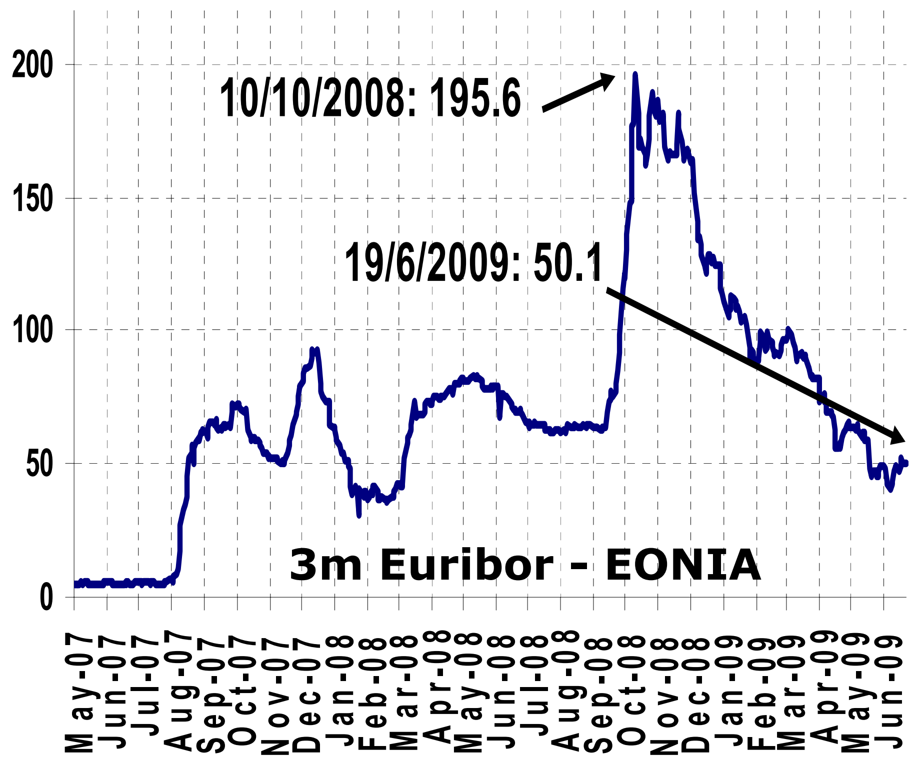


I.2 Liquidity normalizes, but not fully yet

US / Euro Area

Uncovered minus covered 3-month inter-bank rates





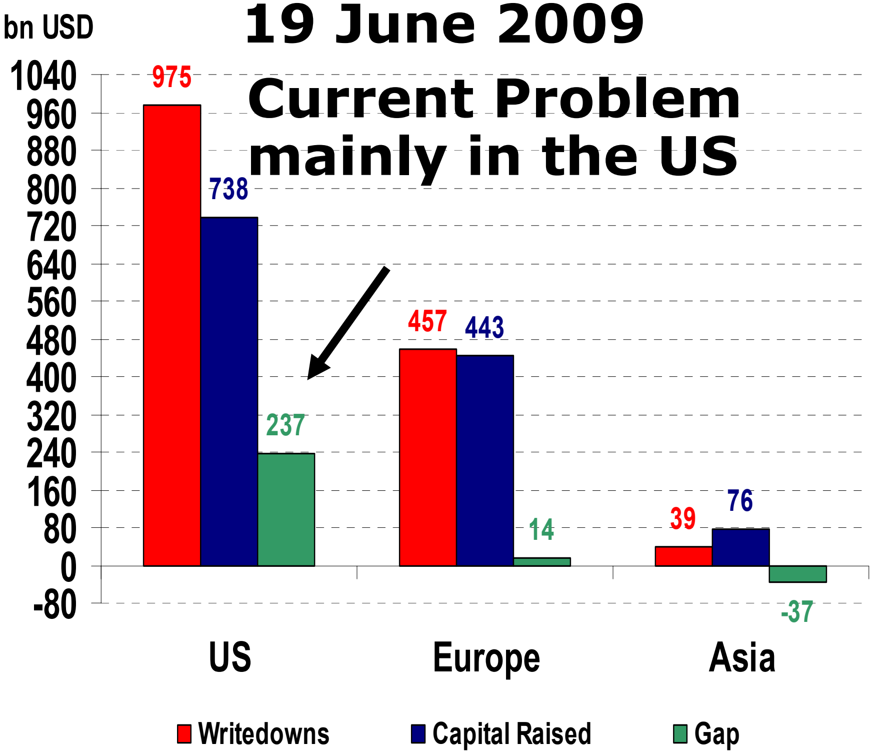
I.2 Write-downs: Not in mid-way yet

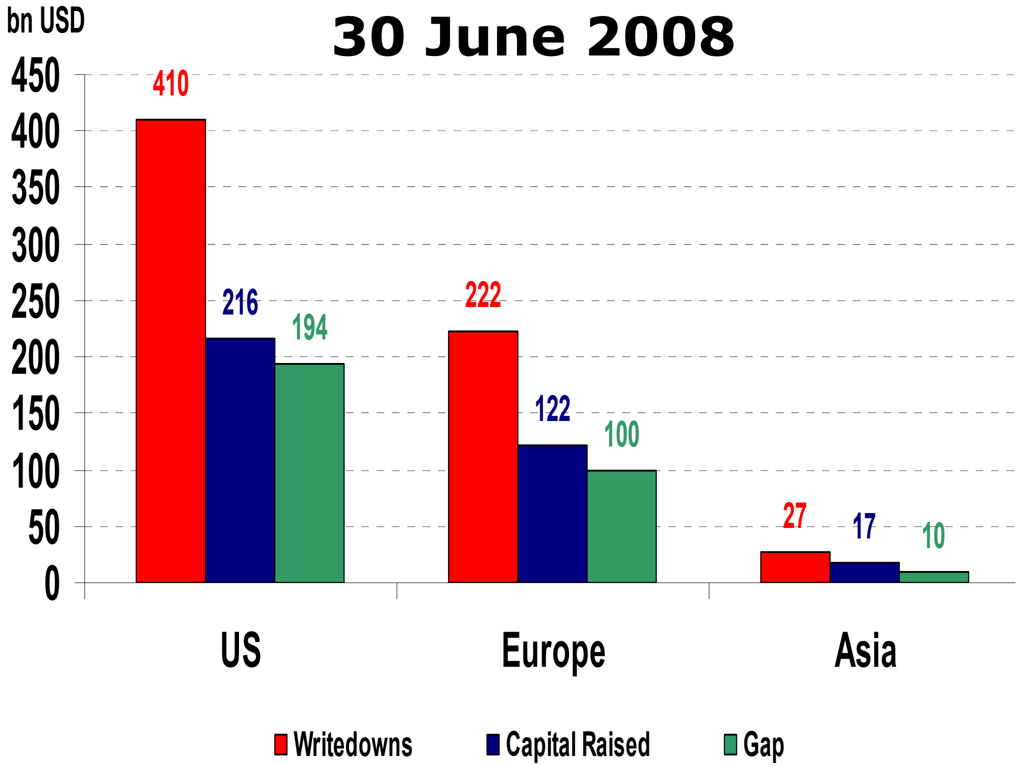
✓ **IMF** estimates that total global write-downs will reach **$4.1 trillion** at end-2010, $2.7 in USA, $1.2 in Europe, $0.2 in Japan

All Financials*

Total Write-downs: $ 1470.7
Total Capital Raised: $ 1256.8
Total Gap: $ 213.9

Total Writedowns: $ 658.5
Total Capital Raised: $ 355.3
Total Gap: $ 303.2





* **Banks/Brokers, Insurers, GSEsx**

Source: Bloomberg

I.2 The removal of toxic assets

Public-Private Partnership Investment Program → $500 bn - $1 tril

✓ Using **$75** to **$100 bn** in **TARP** capital (of its $700 bn), is designed to attract private capital to generate $500 bn to $1,000 bn of purchasing power in order to buy eligible legacy assets from participating financial institutions in partnership with the FDIC, the Federal Reserve and the Treasury.

<u>Sample Investment Under the Legacy Loans Program</u>

Step 1: A bank seeks to divest a pool of residential mortgages of **$100** face value

Step 2: FDIC determines whether or not to leverage the pool at a **6 - to - 1** debt-to-equity ratio.

Step 3: FDIC auctions the pool to several private sector bidders. The highest bid – in this example, **$84** – would be the winner and forms a Public-Private Investment Fund to purchase the pool of mortgages.

Step 4: Of this $84 purchase price, the FDIC provides guarantees for **$72** of financing, leaving **$12** of equity.

Step 5: The Treasury then provides 50% of the equity funding required on a side-by-side basis with the investor. In this example, Treasury invests approximately **$6**, with the private investor contributing **$6**.

Step 6: The private investor manages the servicing of the asset pool and the timing of its disposition on an ongoing basis – using asset managers approved and subject to oversight by the FDIC.

Source: US Department of the Treasury

I.2 US stress test results

- ✓ 19 US banks participated, with year-end 2008 assets above $100 bn, with total assets of about $10 trillion, representing 70% of total bank asset size in USA
- ✓ Banks projected credit losses and revenues for 2009-10 under two scenarios

Scenario	2009	2010
Real GDP		
Baseline	-2.0	2.1
Adverse	-3.3	0.5
EFG Forecasts	-2.9	1.3
Unemployment Rate		
Baseline	8.4	8.8
Adverse	8.9	10.3
EFG Forecasts	9.5	10.0
House Prices		
Baseline	-14	-4
Adverse	-22	-7
EFG Forecasts	-23	-7

Criticism: The tests were anything but stressful

Stress Test Results

(Adverse Scenario)

Estimated losses 2009-2010:	**$599 bn**
Less: losses of Q1-2009 already in capital figures	**$ 64 bn**
Less: Est. revenues 2009-2010:	**$350 bn**
Est. need for additional	**---------**
capital buffer:	**$185 bn**
Less: Planned capital actions and excess Q1 2009 earnings:	**$110 bn**

Total capital requirement	**$75 bn**

I.2 Stress test results: A comparison

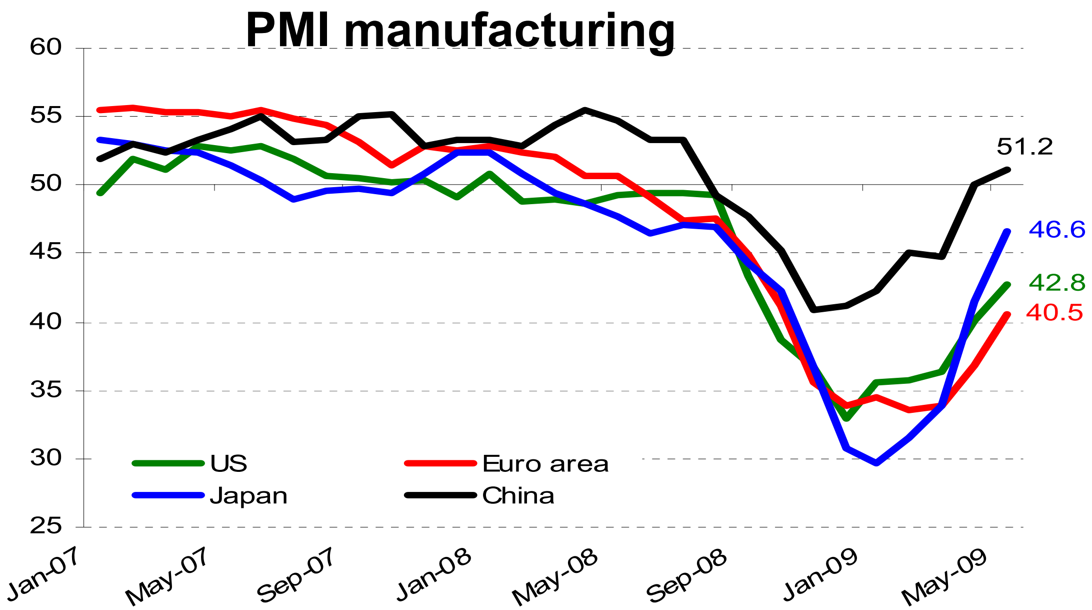
	Fed	IMF	Roubini
Expected write-downs by the 19 banks* in 2009-10	$599bn	$385bn	$875bn
Less: Portion already in capital figures (purchase accounting adjustments)	$64.3bn (Fed's stress test results)	$64.3bn (Fed's stress test results)	$64.3bn (Fed's stress test results)
Net write-downs absorbed by the 19 banks 2009-10	$535bn	$321bn	$811bn
Less: Expected net retained earnings 2009-10 for the 19 banks*	$350bn	$210bn	$210bn
Capital that firms need to add to capital buffers to reach the target SCAP capital buffer at the end of 2010	$185bn	$111bn	$601bn
Total capital requirement	**$75bn**	**$0.6bn**	**$491bn**

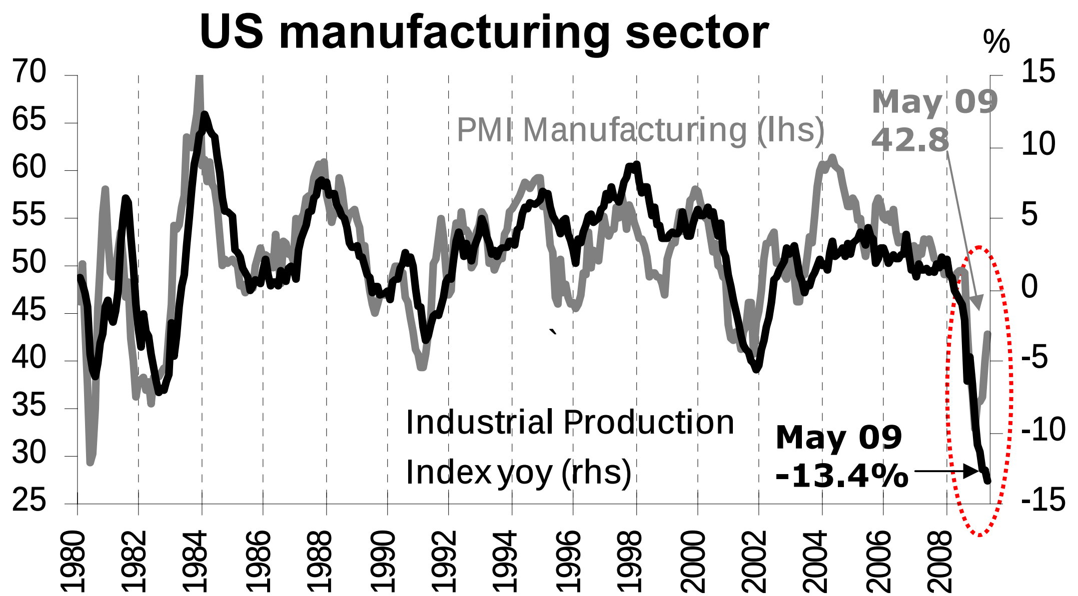
* Assuming that the 19 banks represent the **70%** of system-wide assets.

- ✓ Expected write-downs 2009-10: IMF $550bn, Roubini $1250bn
- ✓ Expected net retained earnings 2009-10 (after taxes & dividends): IMF $300bn
- ✓ According to Fed's stress test results, planned capital actions and excess Q1 09 earnings are $110.4bn. The **IMF** projections imply that the **banks have bottomed out**, while real pessimists (**Roubini**) suggest that we are **far from finished** with the solvency crisis at the banks.

Sources: IMF, Federal Reserve, The Brookings Institution, EFG Eurobank

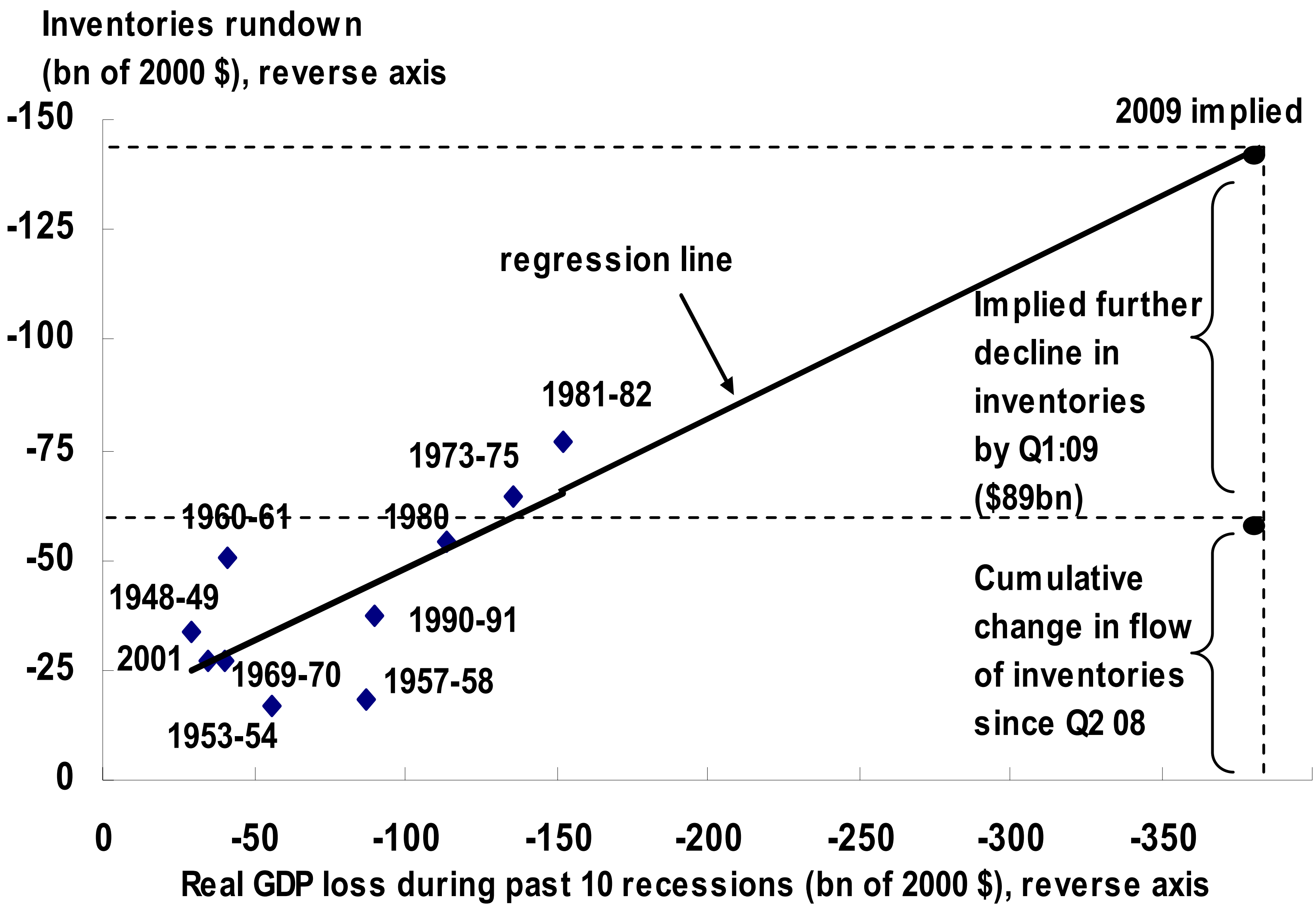
I.3 Is the recession over soon?
Leading indicators of economic activity



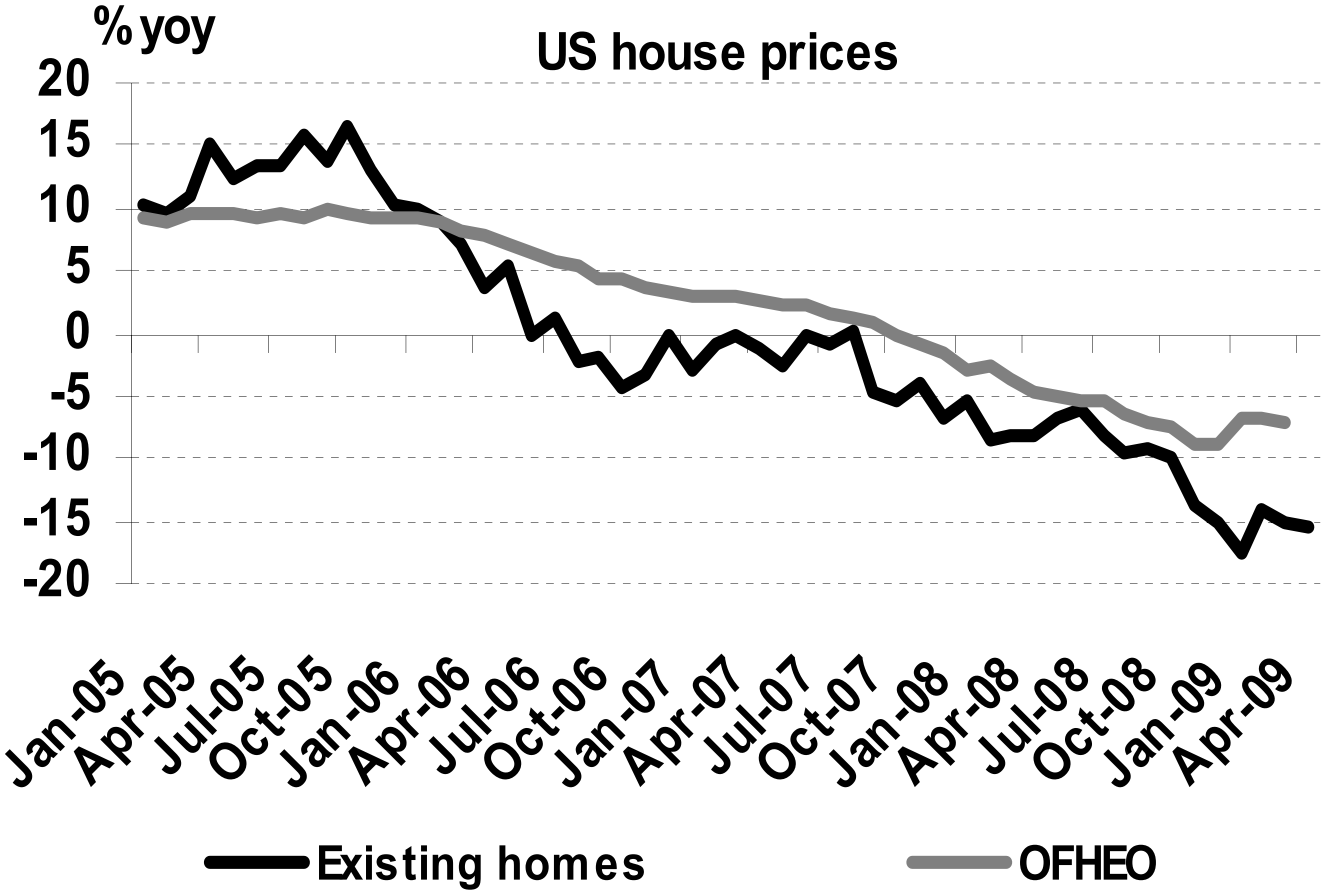


- ✓ Rise in PMI, yet in 5 of 10 previous US recessions, PMI gave a false signal of an economic recovery
- ✓ Industrial production has not yet shown any signs of stabilization
- ✓ Inventory drawdown has further way to go (expected decline over next 3 m = USD 89 bn)
- ✓ Rebound in expectations may be an overreaction to massive government support (negative tail probability vanished)

I.3 Premature to call the end of recession: Inventories may still decline more



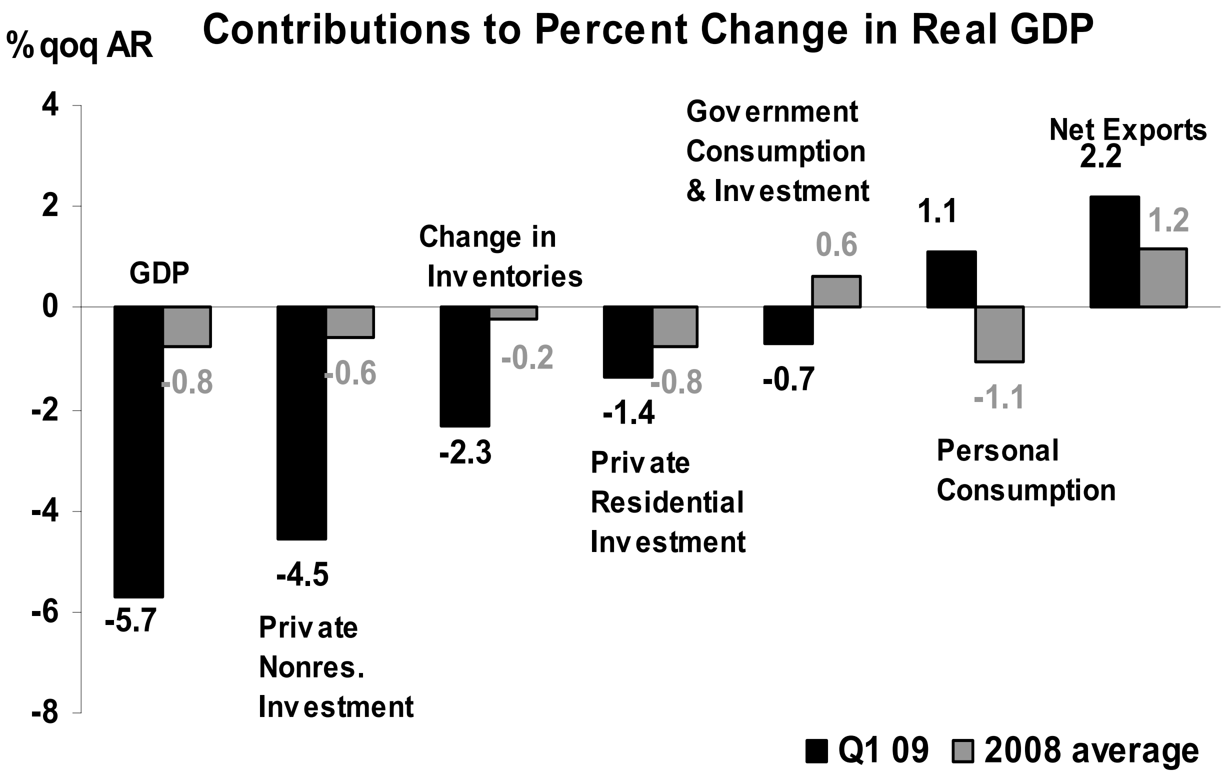
I.3 US housing market perhaps begins to stabilize



- ✓ Housing supply – demand imbalance declined (home sales up, new starts down)
- ✓ House price decline has decelerated

- ✓ **With house prices starting to stabilize, personal consumption has likely seen the worst**

I.3 US Consumer: Signs of stability but risks remain



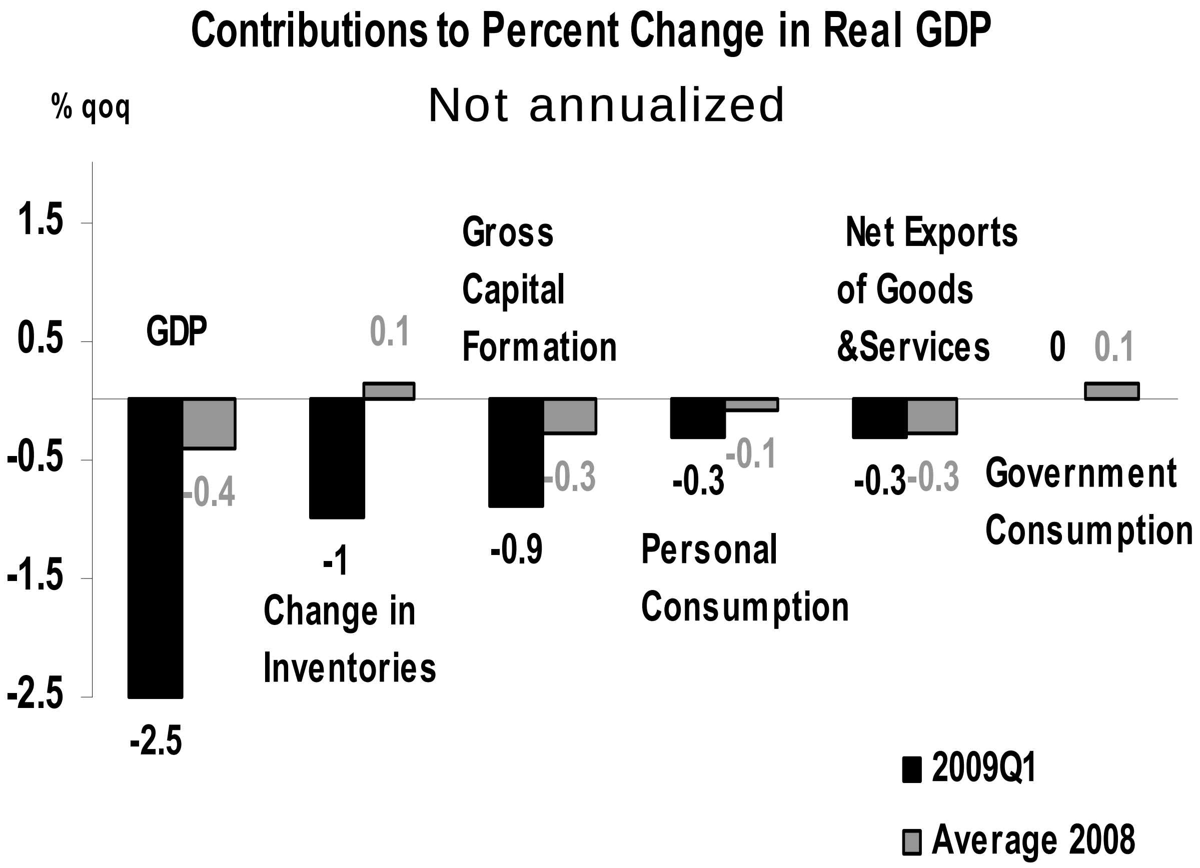
- ✓ Consumer confidence has been on an upward trend since March 2009
- ✓ **Risks**: Real disposable income squeeze, should the fiscal impulse and the tax cuts fade and inflation accelerate due to higher oil prices

- ✓ Real PCE in 2009 Q1 same as 2007 Q1.
- ✓ The increase in 2009 Q1 is tiny: 1.5% qoq saar, after falling by an average of 4.1% in H2 08
- ✓ Lower oil prices, tax rebates and Fed intervention in MBSs support real incomes and real house prices
- ✓ Average consumption growth during the past 10 US recessions **1.5%** yoy vs a **0.3%** yoy average growth since Q4 07

I.3 Risks of a W-shaped recession

- ✓ **Rising commodity prices increasing inflationary pressures**
  - ❖ Oil and energy prices have recently surged. The expected global recovery could result in a generalized commodity price surge. Results: inflationary pressures and negative effects on commodity importers, bringing down their real disposable income and leading to further demand slowdown.
- ✓ **Excessive fiscal expansion will crowd out future private demand (higher interest rates, higher taxation)**
  - ❖ As government support fades, many US tax cuts (on incomes, capital gains, estates, dividends) will expire
  - ❖ Given the excessive public debt, bond yields are likely to increase sharply in 2010, leading to a crowding out of private investment and, ultimately, a second leg in the economic downturn

I.3 EA: recovery lags behind the US



- ✓ The breakdown of GDP shows broad-based weakness.
- ✓ Implementation of fiscal stimulus packages will contribute to a modest & gradual recovery in 2010, with real GDP growth hovering around zero.

- ✓ Recovery in the EA will probably lag well behind the US, due to:
  - (a) Euro strength,
  - (b) Larger dependence on exports,
  - (c) Larger dependence on the banking sector

II.

Open questions for the post-crisis future

II. Looking 5 to 10 years ahead: Slower future global growth? VERY LIKELY

Assuming the financial sector stabilizes gradually,

✓ **where would future growth originate from**? if

- The US consumer is forced to reduce leverage and increase savings – same is true in other countries with high household indebtness
- The Chinese consumer is not ready yet
- India is still a closed economy
- Europe was never a leader, always following the US, even its economic cycle with a lag

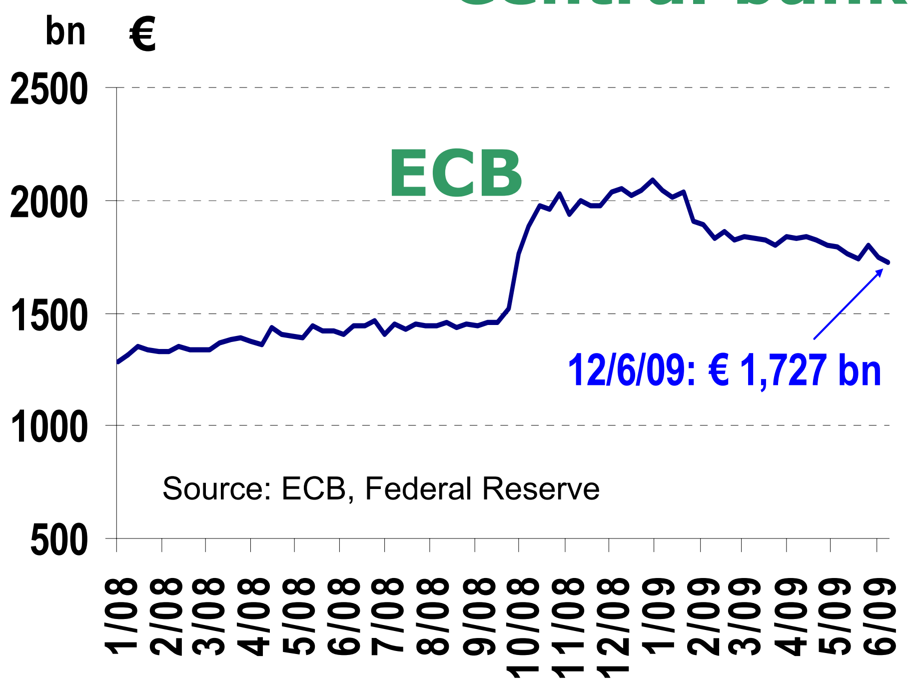
✓ **Large fiscal burdens** ➔ austere fiscal policy

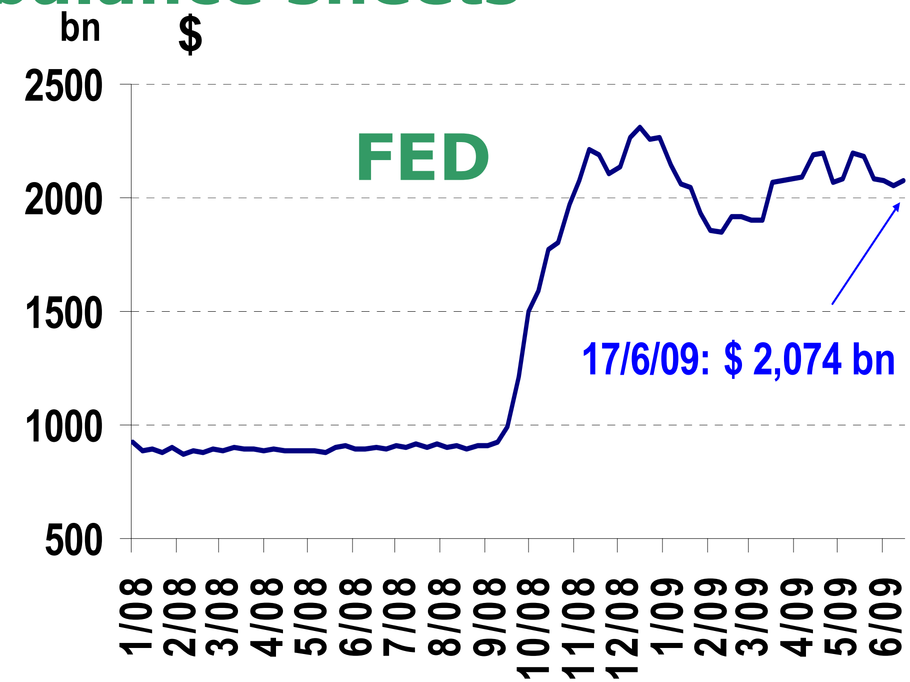
✓ **Higher risk premia** ➔ higher interest rates and cost of capital ➔ lowering investment

✓ Post–crisis central bank **rates** normalize at **higher** levels

II. Looking 5 to 10 years ahead: Higher inflation? PERHAPS

Central bank balance sheets





- ✓ Will **interest rates stay low** for a long period to support the profitability of banks?
- ✓ Is there a US incentive to **inflate away the huge debt** of the non-financial private *(175% of GDP)* and public *(61% of GDP)* sectors?
- ✓ Can the FED manage to **absorb the liquidity** it has released?

II. Looking ahead: Other changes?

- ✓ Economic power ➔ Asia and G-20 gain political power
- ✓ A stronger IMF, better able to fight crises
- ✓ Tighter supervision in Europe and elsewhere
  - ❖ European Systemic Risk Board
  - ❖ 3 European Supervisory Authorities for Baking, Insurance and Securities
  - ❖ White Paper on June 17 in USA (CFPA in, OTS out, FED to regulate anyone threatening financial stability, no merger of CFTC & SEC, …)
- ✓ Counter-cyclical capital ratios are likely: Basel 2 ➔ Basel 2.5
- ✓ Capital charges for bank size ↑ No renewal of Glass-Steagall
- ✓ An extra and more transparent restriction on leverage, i.e. on the ratio of equity capital to tangible assets?
- ✓ Stricter rules on manager compensation, on rating agencies, on securitization, etc.

❖ Yet Wall Street appears to continue to hold considerable **political power <u>against future regulatory restrictions</u>**

II. Summary

- ✓ Prepare for a post-crisis decade of lower growth and perhaps higher inflation
- ✓ Stricter supervision but the jury is out on how much Deeper and Broader regulation will be
- ✓ The G-20 have gained political power, representing a relative shift in global GDP towards the developing world and Asia
- ✓ We should ensure society does not ostracize the motive for healthy profits, and the best way to do it is to pay prime attention to **distributional issues**

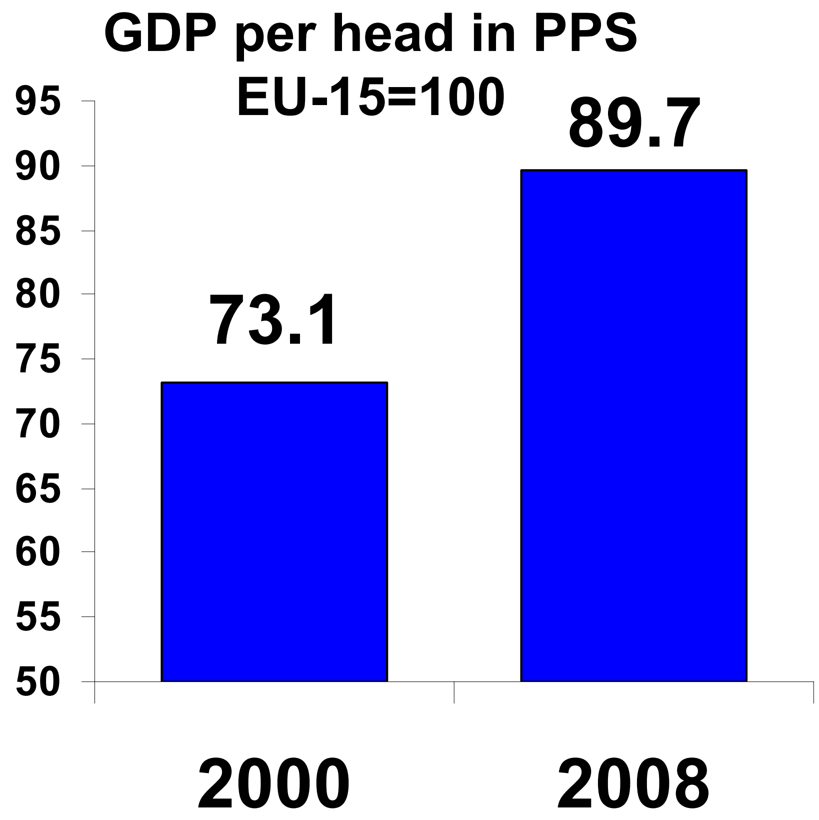
III.

Greece: Opportunity or stagnation and divergence ahead?

1) High living standards so far
2) A delayed recession
3) Significant internal economic imbalances raise the possibility of a long stagnation period ahead

III.1 Greeks enjoy a high standard of living thanks to real convergence

- ✓ According to the UN's **Human Development Index**, Greece ranks 24th among 175 countries
- ✓ HDI is a composite index and captures: (a) life expectancy, (b) $GDP per capita in PPP, (c) knowledge = (2/3) adult literacy + (1/3) gross enrollment
- ✓ Greece still ranks second to last among the EU-15, with Portugal being last.



Recession arrives with a lag,

yet markets focus on the economic imbalances and fear the outcome of long-term stagnation

III.2 Greece can withstand the recession better …

In the **short-run**, Greece **can withstand** the crisis **better** than its European counterparts, thanks to

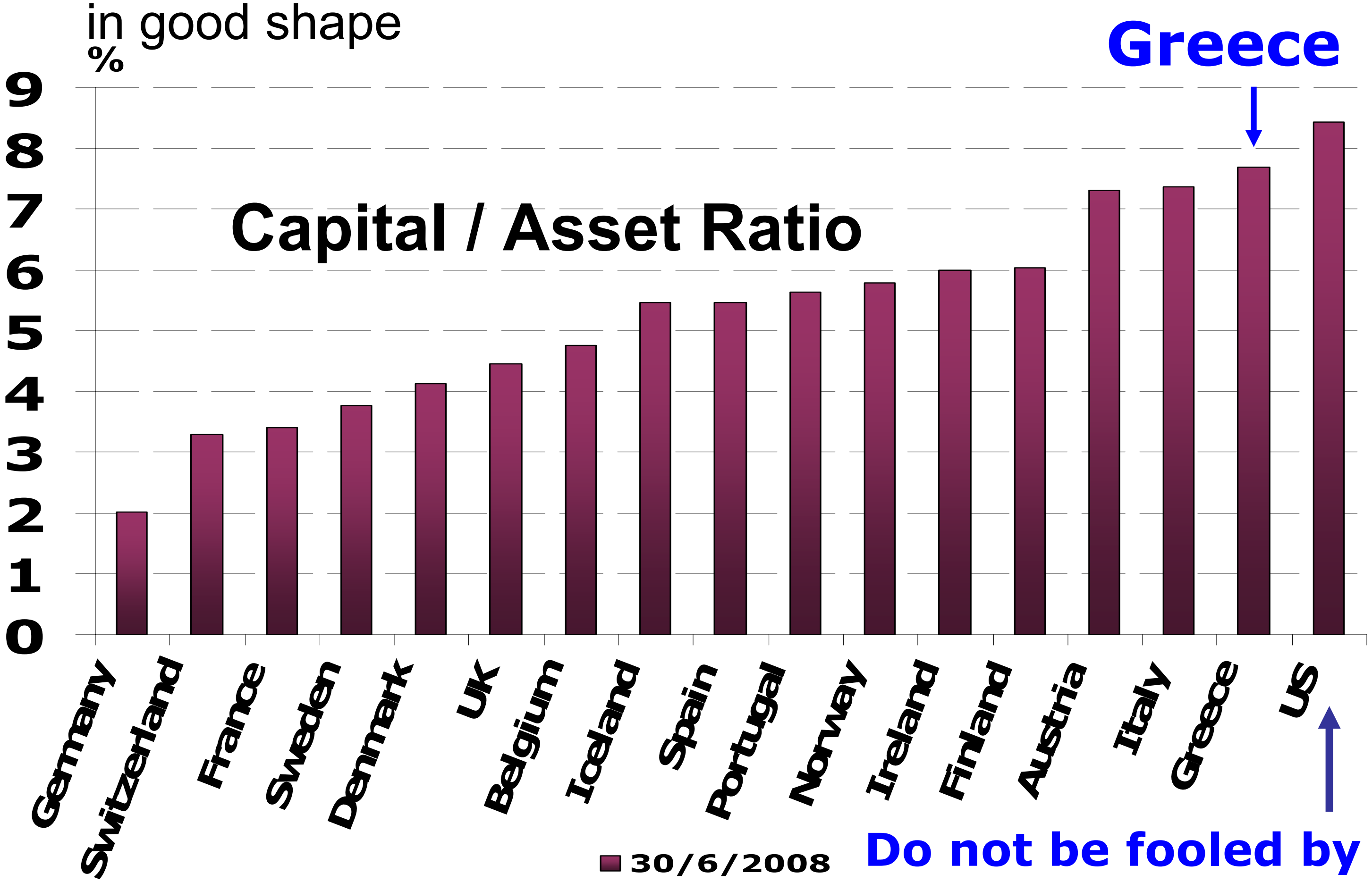
1) A strong banking system that weathers the external financial storm
2) A relatively more closed economy
3) Horizontal diversification of business activity, i.e. absence of vertical integration
4) Strong real wage growth that may keep consumption from dropping

Moreover, **the decline in interest rates** from their peak in Q4-2008 plays a significant role

The above strengths **simply delay** the upcoming recession

III.2 Greece: The strongest FI capital base in Western Europe

✓ this shock has come from abroad and has found the Greek banks in good shape



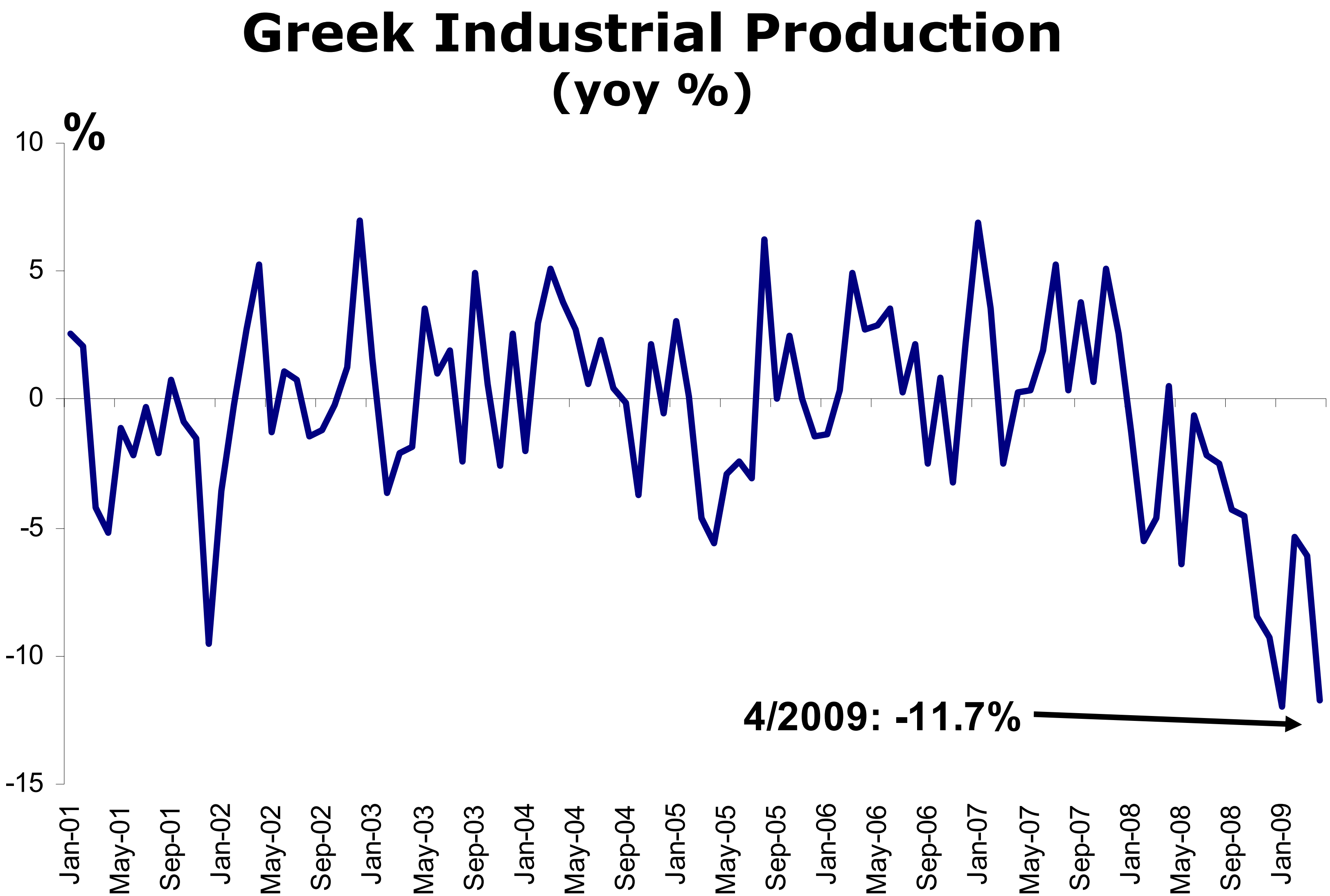
✓ **Best FI**: EFG Intern/al **13.52%**

✓ **Worst FI**: DEXIA **1.67%**

Source: Bloomberg

Do not be fooled by high US capital cushion: SPVs excluded from asset size in the US, which makes balance sheets appear small

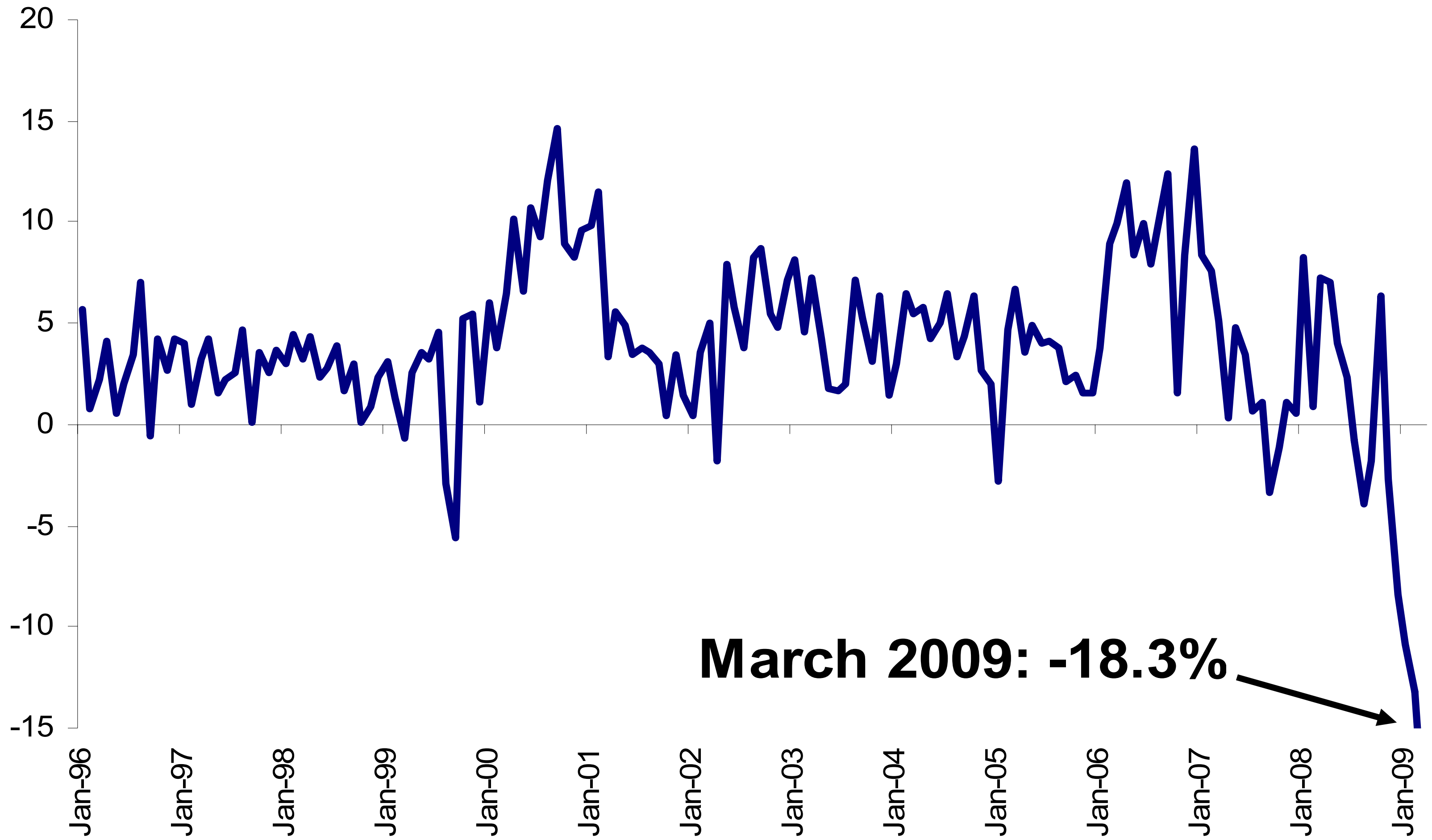
III.2 but … the recession is knocking on our door as industrial production is sliding



Source: NSSG

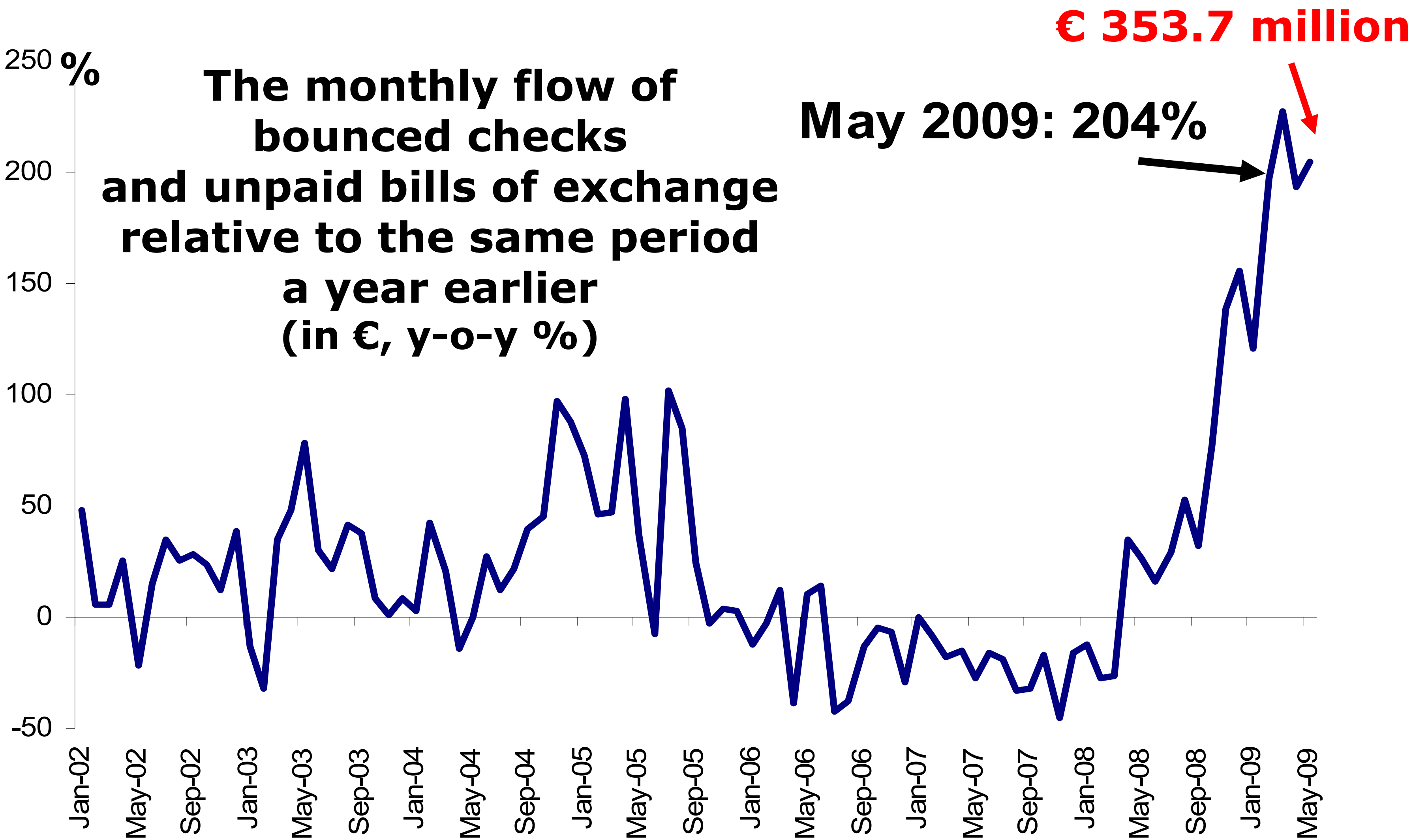
III.2 … and demand is weakening

Greek Retail Sales
(constant prices, yoy %)



Source: National Statistical Service of Greece

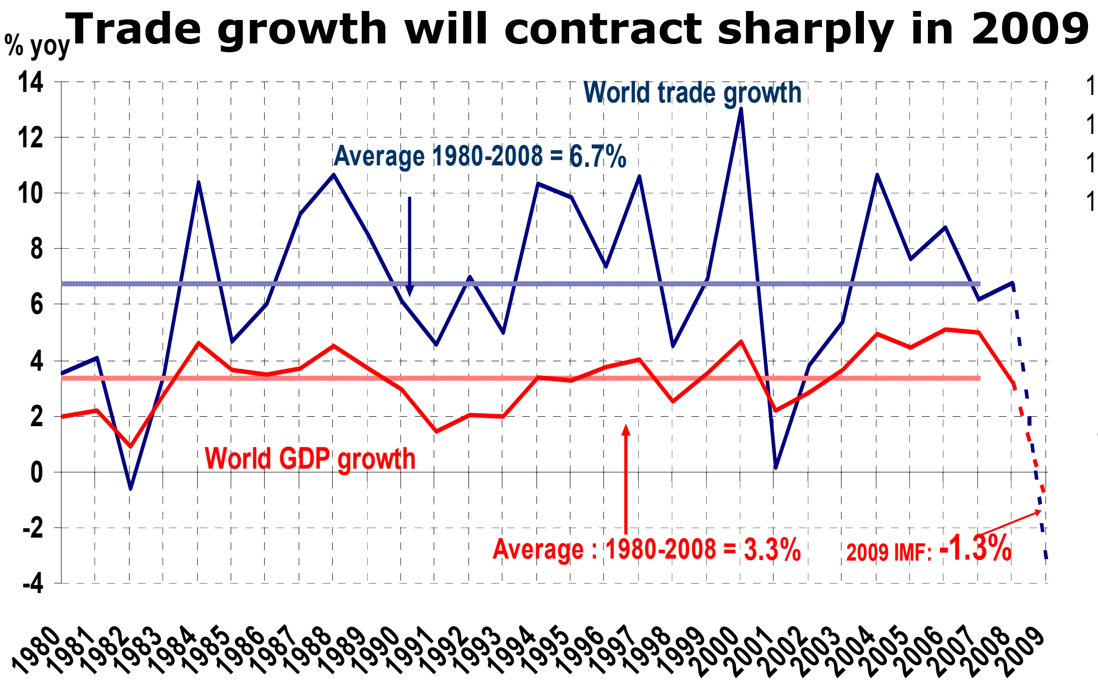
III.2 … with Increased Signs of Financial Strain



Source: TIRESIAS

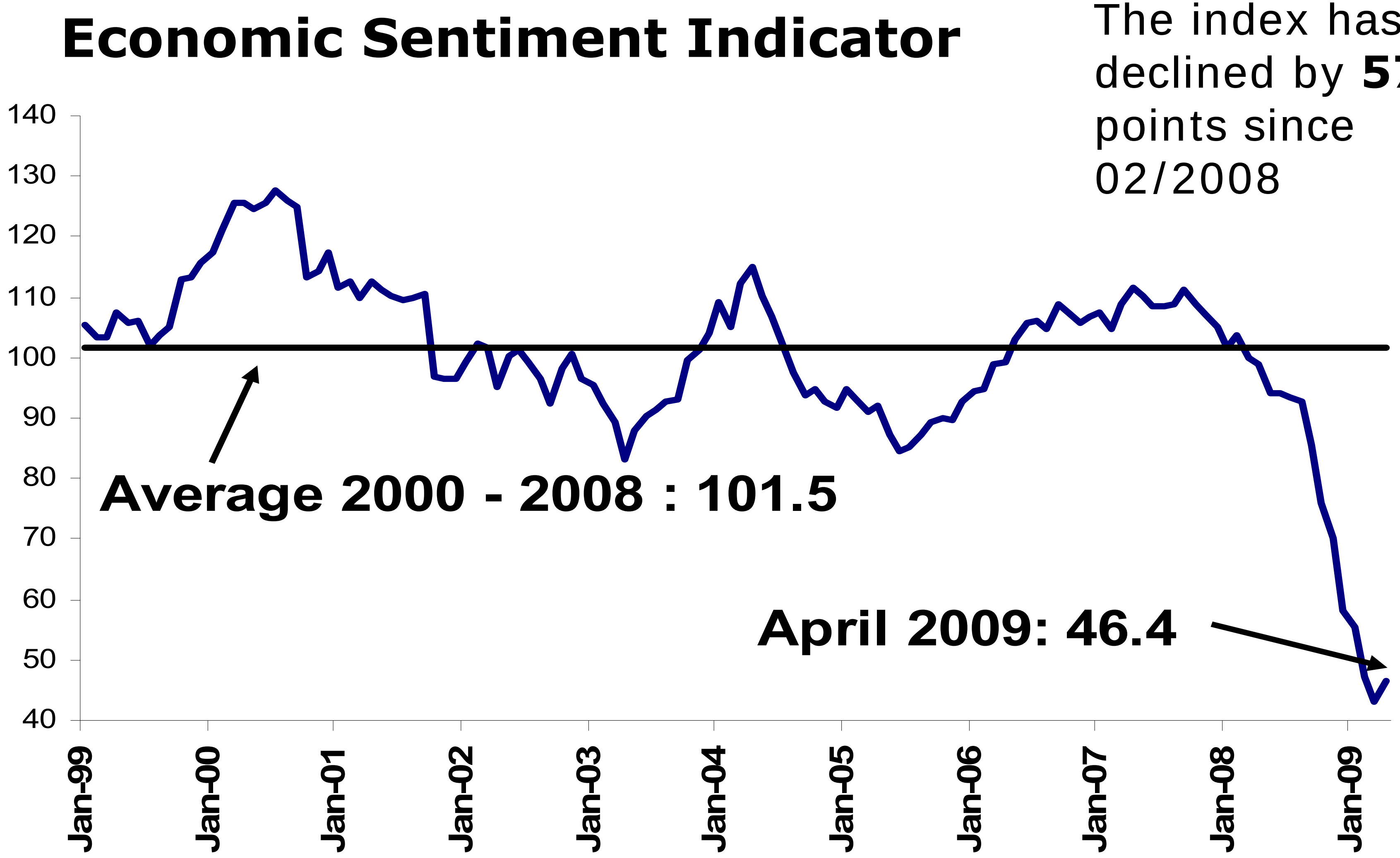
III.2 World Trade, Shipping and Tourism … decelerate fast

Increase in trade = -0.50 + 2.28* GDP growth, R^2 = 67%
(-0.52) (8.11)



- ✓ Lower shipping rates and lower ship values affect Greek economic activity, but a lot less than the underlying assets
- ✓ Early hotel reservations point to a more than 15% summer decline in tourism revenues from abroad

III.2 Business and Consumer confidence have collapsed



The index has declined by **57.2** points since 02/2008

Source: European Commission

III.2 Hence, ... a mild recession is likely

y/y grwoth	**2008e**	**EFG- 2009 Baseline**	EC 2009F
GDP (constant prices)	2.9	**-1.0**	-0.9
Private Consumption	2.2	**0.5**	0.4
Public consumption	3.2	**2.5**	1.9
Total Investment	-11.5	**-7.5**	-5.6
Exports g&s	2.2	**-8.5**	-7.3
Imports g&s	-4.4	**-5.6**	-6.0
National CPI (average)	4.2	**1.1**	1.8
Budget balance (% GDP)	-5.0	**-6.4**	-5.1
Public debt (% GDP)	97.6	**105**	103.4
C/A balance (% GDP)	-14.4	**-12.6**	-11.5

- ✓ **Yet real convergence continues in 2009 as EU-16 expected to grow by -4%**

III.3 Sovereign Credit Ratings deteriorate

Eurobank EFG

	S&P	MOODY'S	FITCH
3/2009	A-	A1	A
12/2008	A	A1	A
2007	A	A1	A
2006	A	A1	A
2005	A	A1	A
2004	A	A1	A
2003	A+	A1	A+
2002	A	A1	A
2001	A	A2	A
2000	A-	A2	A-
1999	A-	A2	BBB+
1998	BBB	Baa1	BBB
1997	BBB-	Baa1	BBB
1996	BBB-	Baa1	BBB-
1995	BBB-	Baa3	BBB-
1994	BBB-	Baa3	
1993	BBB-		

Source: Bloomberg

Rating agencies are worried:

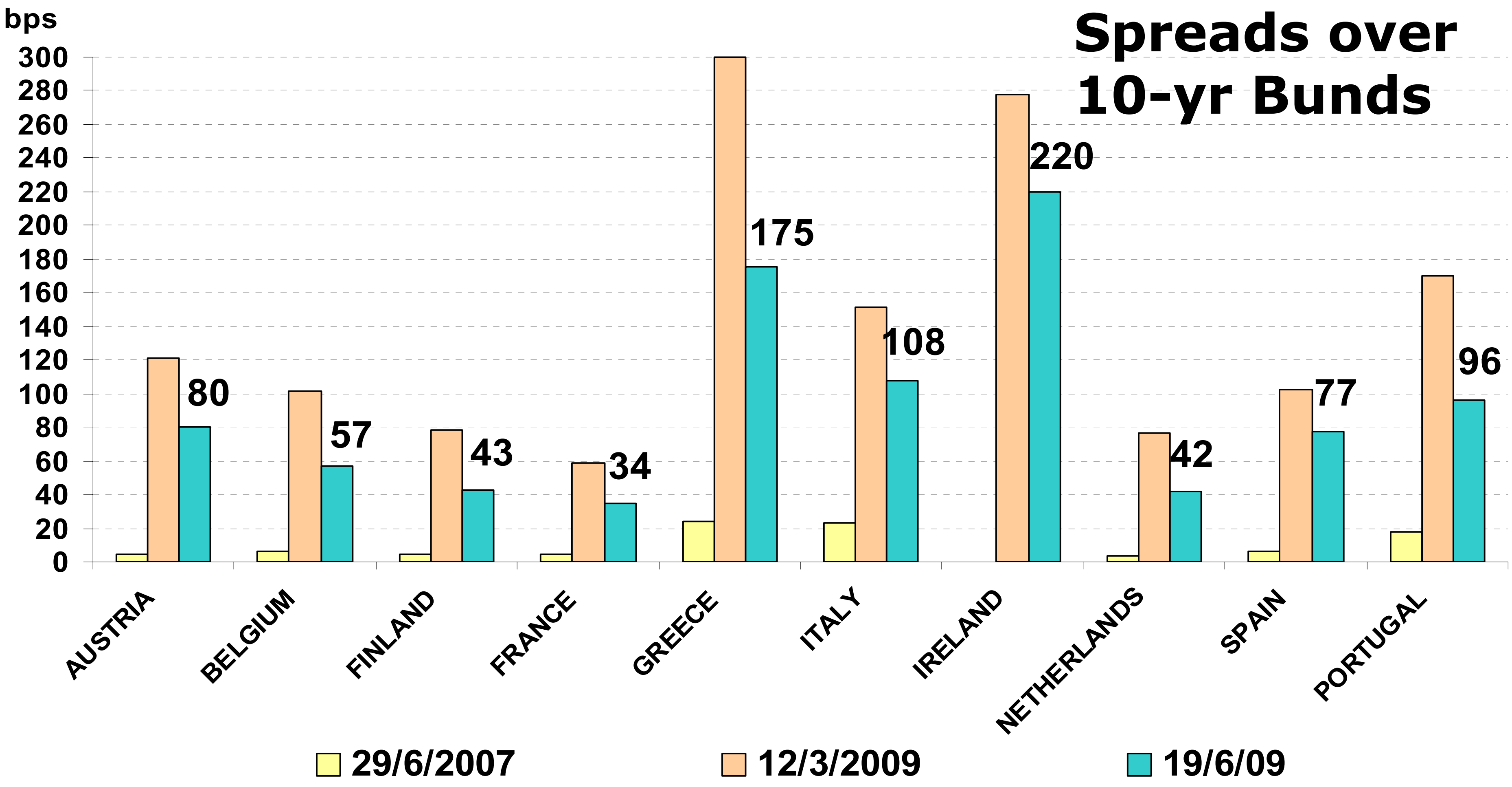
- ✓ Continuous upgrading from 1996 to 2003:

BBB- → A+

was interrupted in 2004:

- ✓ **First** downgrade by S&P, Fitch in 2004
- ✓ **Second** downgrade, in Jan 2009 by S&P due to the worsening international crisis
- ✓ **Another** downgrade by Fitch likely. Fitch already downgraded Greece's outlook to negative from stable on further fiscal deterioration (12/5/2009).

III.3 Yet, financial markets are worried about Greece's ability to pay its debts

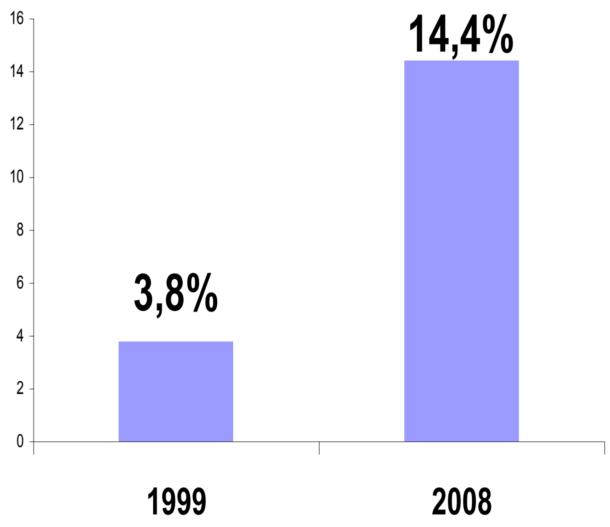


✓ **In March 2009, the probability of complete default of the Greek State over the next 10 years was higher than 20%**

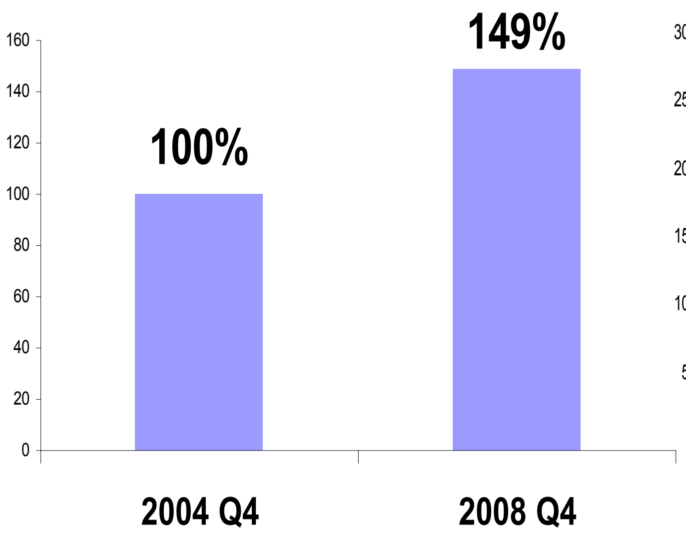
III.3 Imbalances of the Greek economy

Eurobank EFG

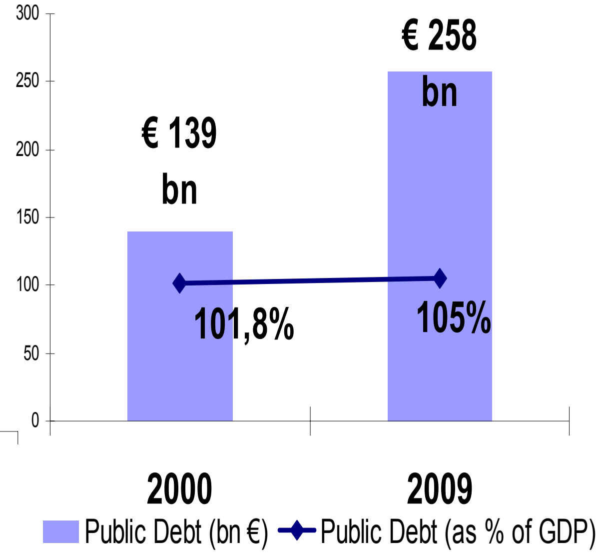
Current Account Deficit



External Debt



Public Debt



i. Competitiveness

Deteriorating, e.g. Current Account Deficit more than tripled since 1999, while prices and costs ↑ relative to trading partners ($REER_{CPI}$: 14%, $REER_{ULC}$: 28.2%) → Gross External Debt ↑ from 100% of GDP in 2004 to 149% in 2008.

ii. An ineffective public sector

✓ Public debt has soared from €139 bn in 2000 to €258 bn in 2009 (*EFG projections*) i.e. from 101.8% of GDP to 105% of GDP

✓ General Government deficit fell under the 3% of GDP limit only once (2006 2.8%).

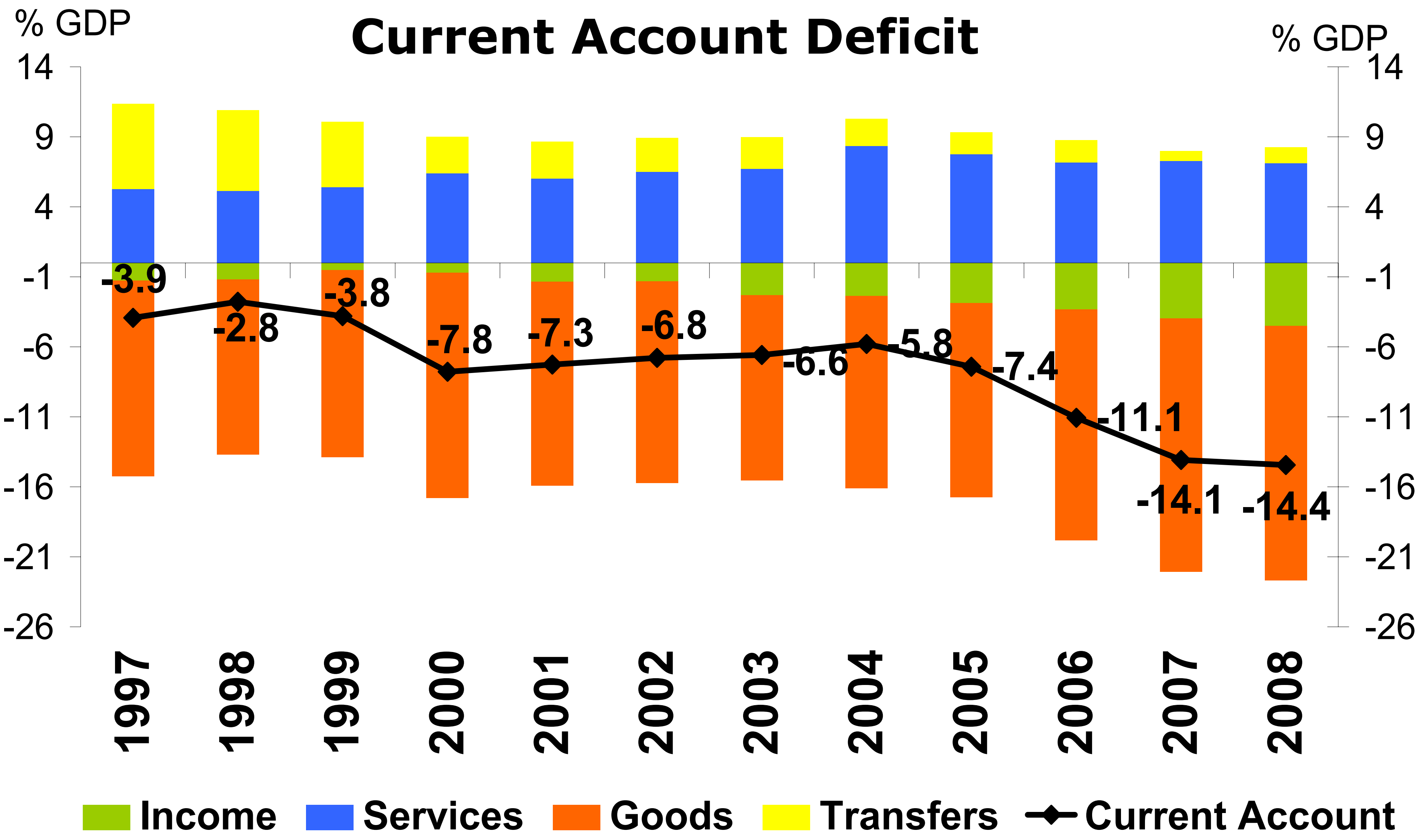
III.3 Aging population & pressures on pensions and debt

	GREECE				
	2005	2010	2015	2025	2050
Health Expenditure (% GDP)	5.1	5.4	5.5	5.7	6.8
Education Expenditure (% GDP)	3.4	3.1	2.9	3.0	3.1
% of older employees (55 – 64)	10.9	12.0	13.6	17.3	17.4
Old-age Dependency Ratio	26.8	28.0	30.3	35.8	60.4
	2007	2020	2030	2040	2060
Pension Expenditure (% GDP)	11.7	13.2	17.1	21.4	24.1

Source: European Commission 2006, SGP 2008-2011

III.3 Competitiveness: A Macroeconomic Perspective

Eurobank EFG



Source: Bank of Greece

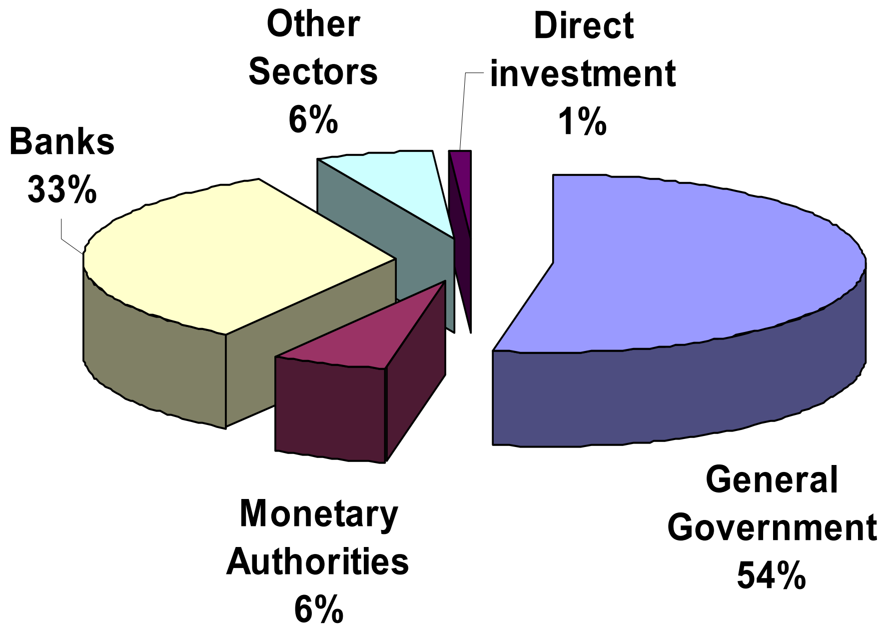
III.3 Greek External Debt deteriorates

Greek Gross External Debt increased by **52.4 p.p.** of GDP, or 220% in 5 years

2Q 2008 : $ 531.7 bn : 138.2% of GDP
2Q 2003 : $ 166.2 bn : 85.8% of GDP

Accumulated Current Account Deficits 2Q 2003 – 2Q 2008 : **49 p.p. of GDP**

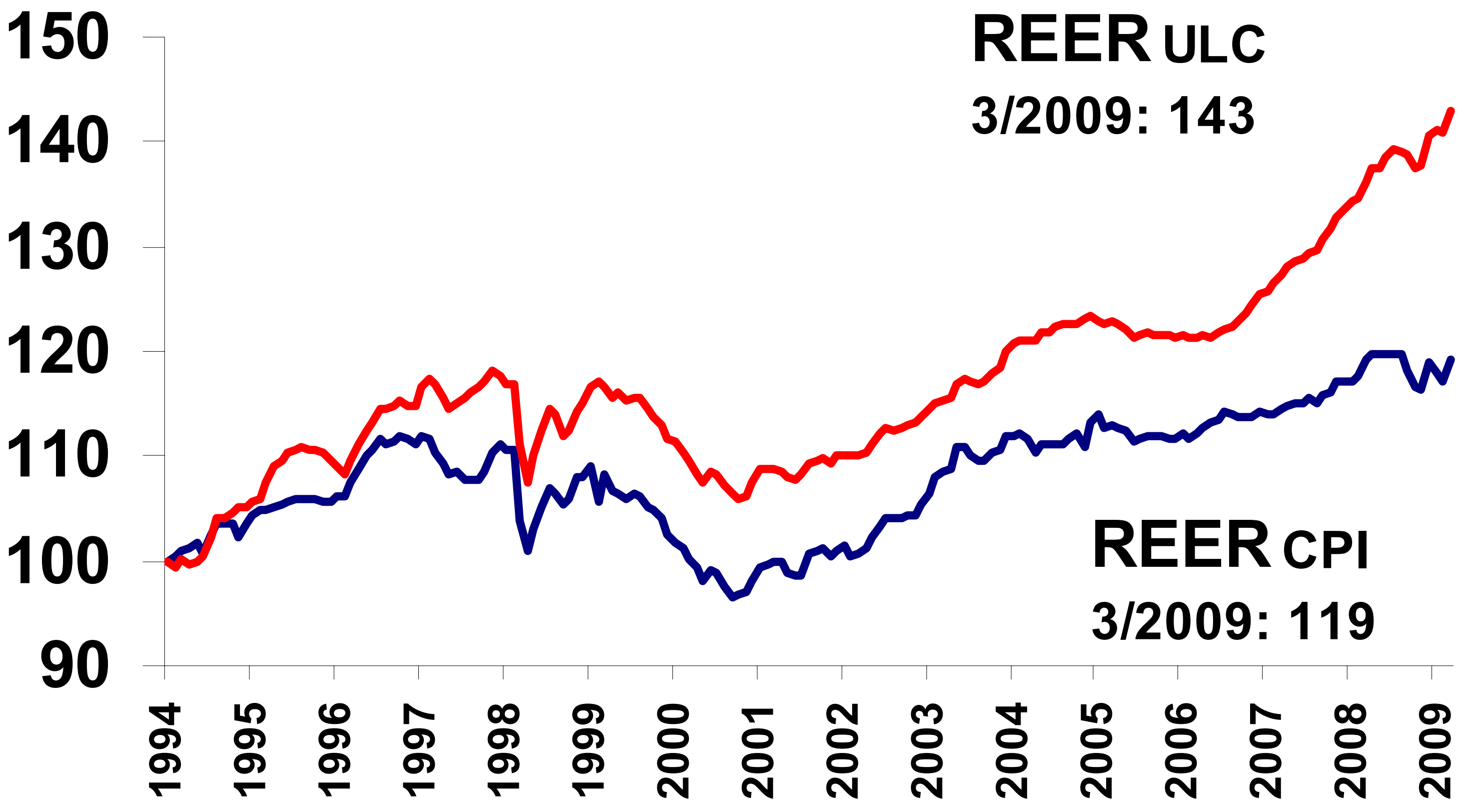
Greek Gross External Debt Composition
(2Q 2008, Total: $531.7 bn)



✓ Banks' ownership of 1/3 of external debt may prolong the current liquidity problem if crisis continues

Source: IMF, OECD, BIS, WORLD BANK Joint External Debt Database

III.3 Price Competitiveness



Source: IMF, IFS

- ✓ Real Effective Exchange Rate shows large **overvaluation**
- ✓ Harmonized Index of Consumer Prices (HICP): In every single month, inflation in Greece was higher than the Euro Area average

III.3 Summary: Urgent need to set priorities

Defensive policies for Greece:

1) Restructure the public sector in order to reverse the fiscal deficits and improve the business environment
2) Implement reforms first on those sectors that are easiest to do, i.e. in the goods and services markets
3) Reform the pension system to relieve future fiscal pressures
4) Implement reforms in the labor market last, only after the public sector is run efficiently, so that state supervision works

Forward-looking policies for Greece:

1) A new growth model is needed in Greece: Cannot be based on consumption, should be export-driven. Emphasize proven sectors, comparative advantages, sectors with potentially strong international demand
2) Improve the quality of factors production, e.g. education, health

THANK YOU FOR YOUR ATTENTION!!

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