

Today's Global Economy: Prospects for Greece

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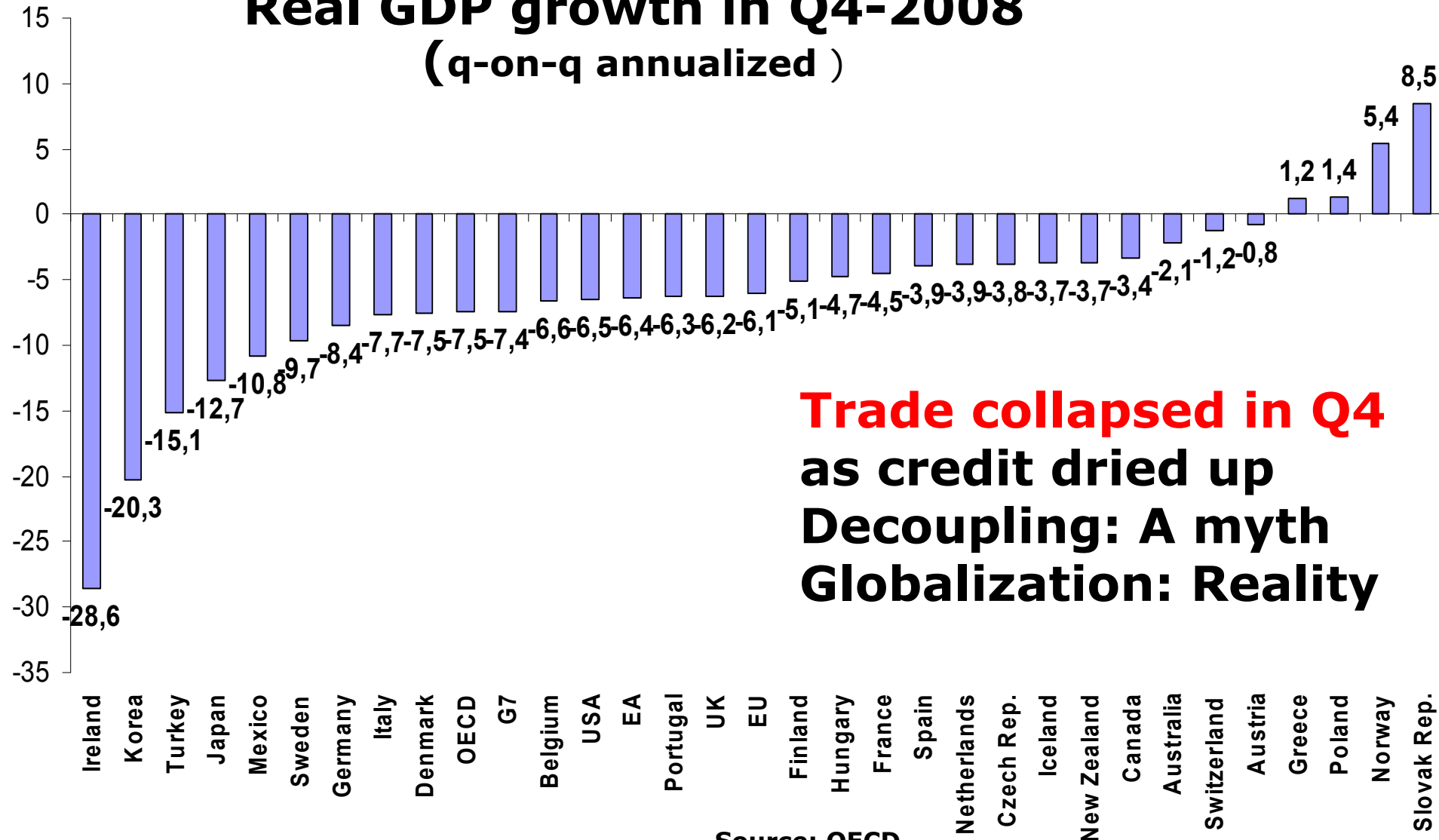
I.1 The global economy is facing the deepest – and probably longest – recession of the post-war period



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

I.1 Fast decline in Q4 2008

Real GDP growth in Q4-2008 (q-on-q annualized)

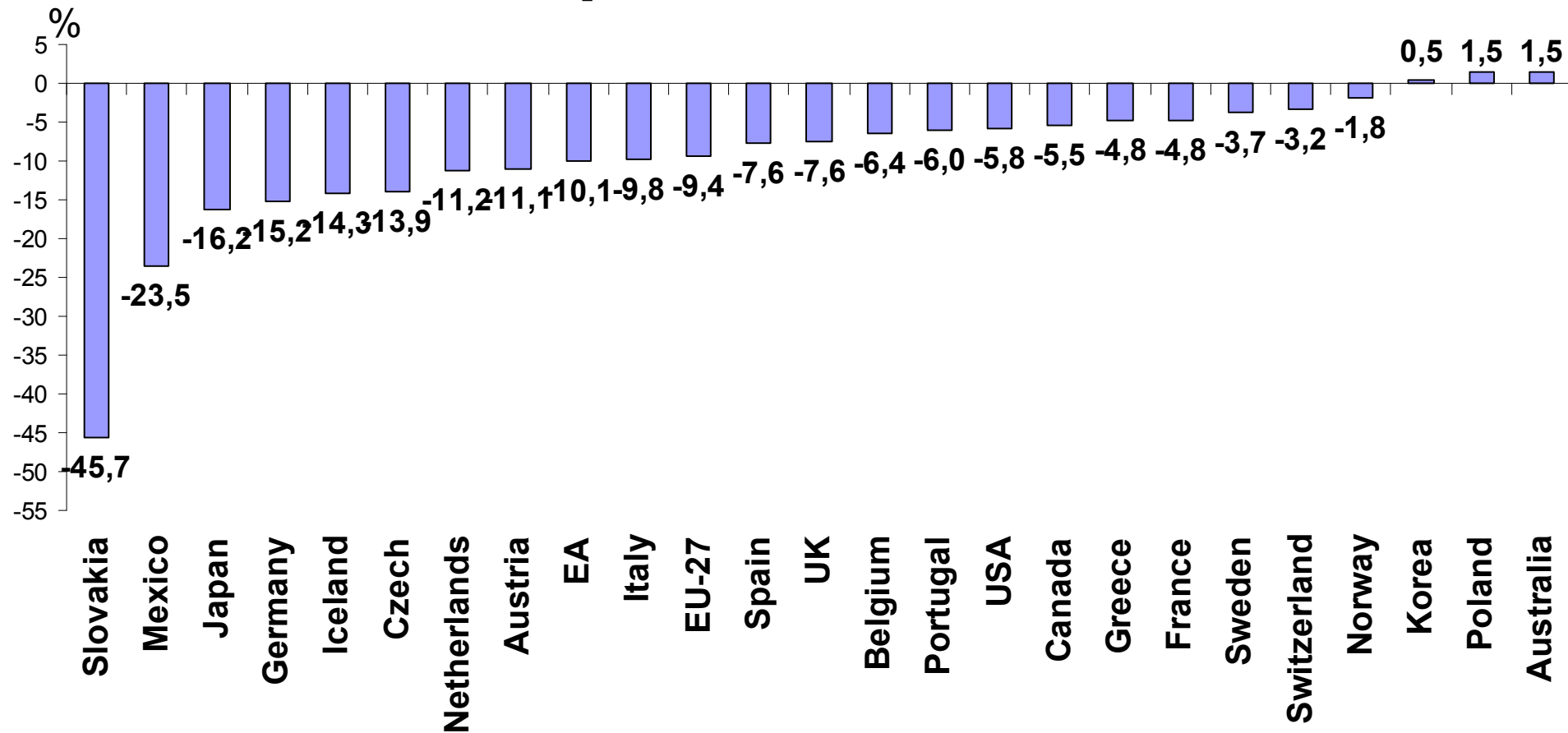


Trade collapsed in Q4
as credit dried up
Decoupling: A myth
Globalization: Reality

Source: OECD

I.1 ...that continues into Q1 2009

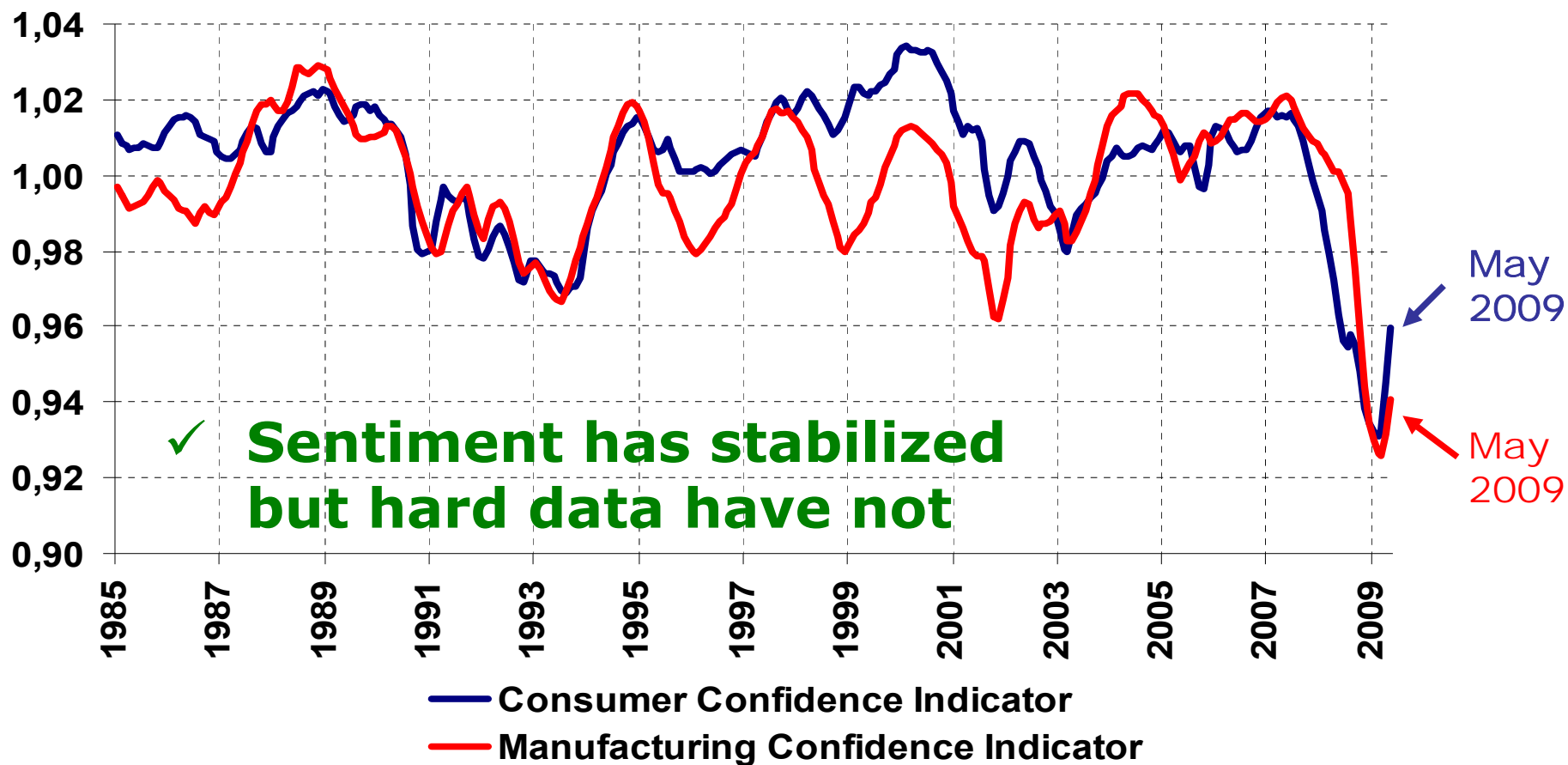
Real GDP growth in Q1-2009 (q-on-q annualized)



Source: OECD

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

OECD Confidence Indicators of households and manufacturing enterprises



Source: Ecwin, OECD

I.1 Consensus forecasts: Bleaker 2009

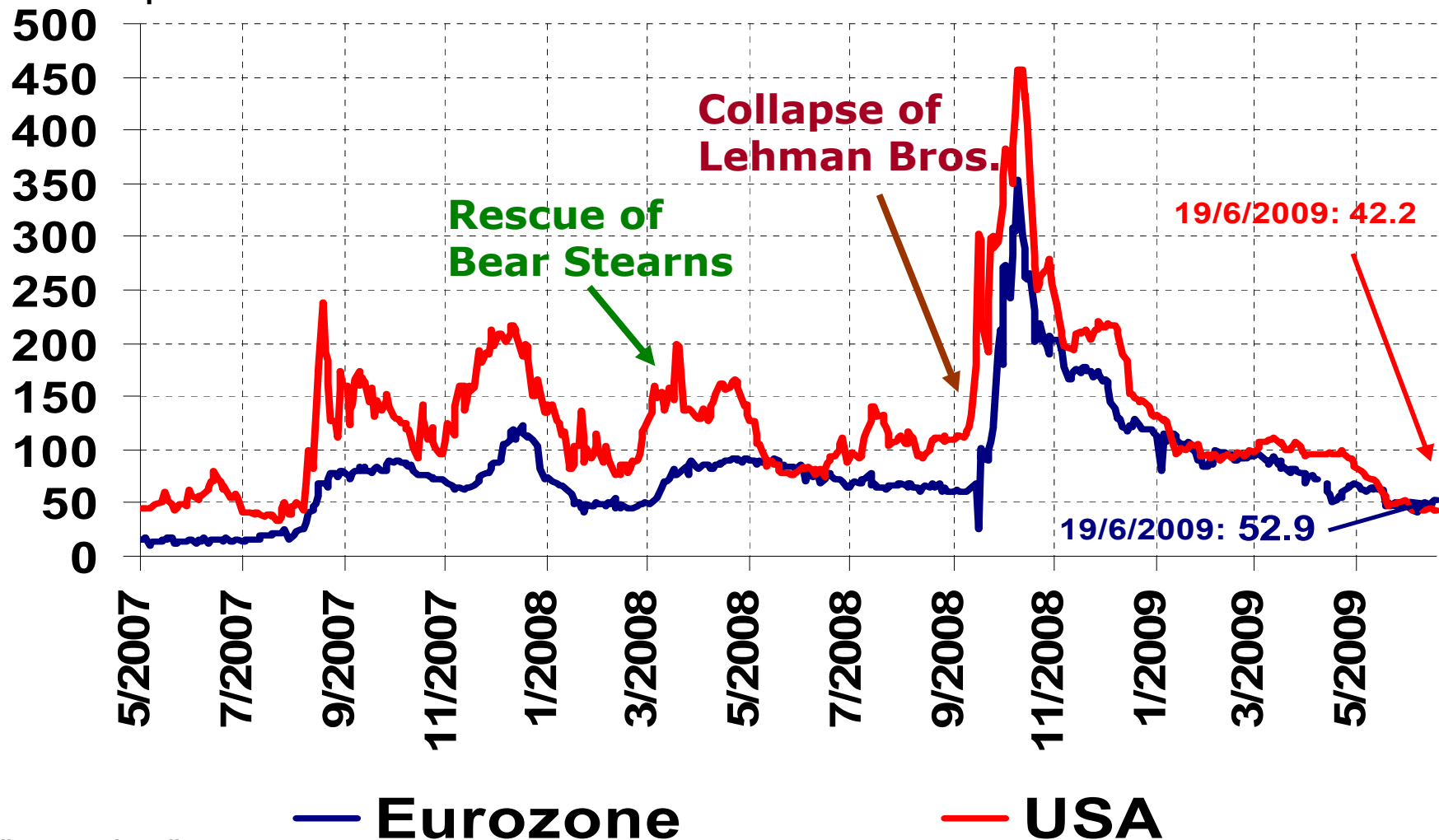
Real GDP growth	2008	2009f			2010f		
		Febr. 09	June 09	Delta	Febr. 09	June 09	Delta
US	1.1	-2.1	-2.5	-0.4	1.0	2.3	1.3
Euro Area	0.8	-1.8	-4.2	-2.4	0.8	0.5	-0.3
Japan	-0.6	-2.9	-6.8	-3.9	0.7	1.0	0.3
China	9.0	6.5	7.1	0.6	8.0	8.3	0.3
Brazil	5.1	2.9	-0.2	-3.1	3.9	3.8	-0.1
Russia	5.6	-0.7	-2.9	-2.2	3.2	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?

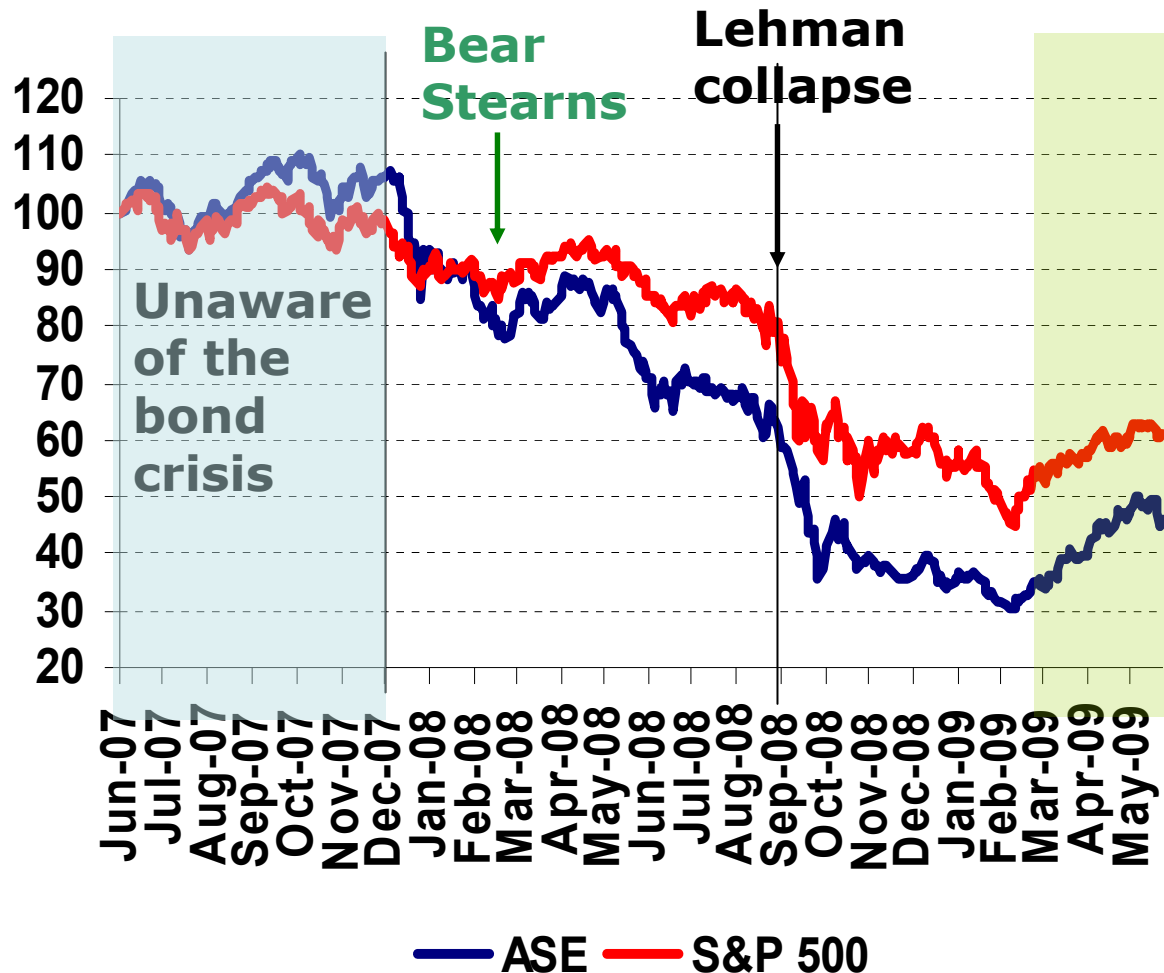
- ↑ The G-20 decisions – especially on financing the IMF - made a positive difference *(especially for New Europe)*
 - ↑ US stress tests also made a difference, as they have taken out a large part of the uncertainty from the market, *(but have not eliminated it)*
 - ↑ Financial spreads have shrunk *(but 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 History of financial crisis is seen in the rise of short-run quality spreads

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



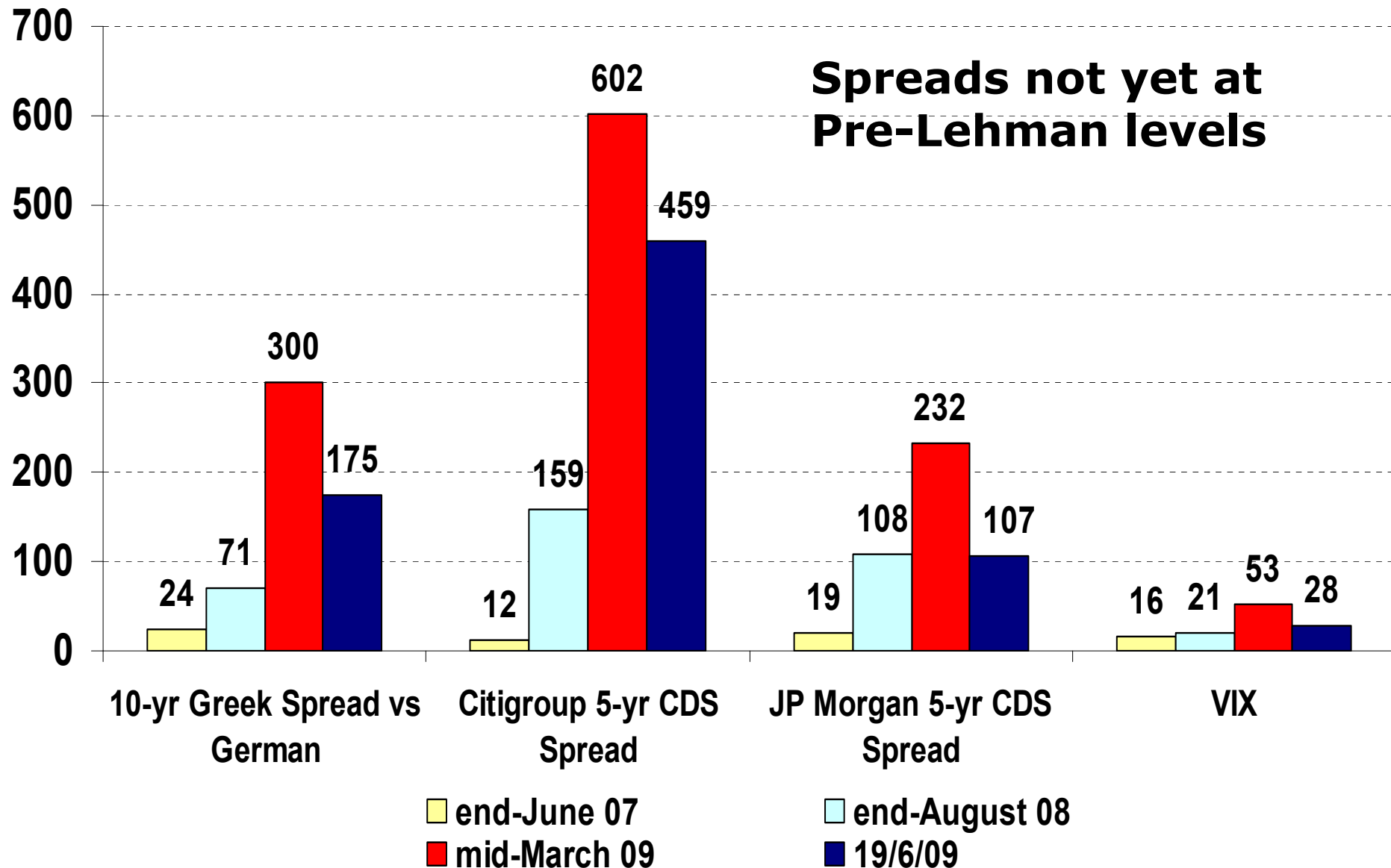
I.2 Stock markets appear to vote for an end of the crisis – Are they right?



- ✓ 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?**

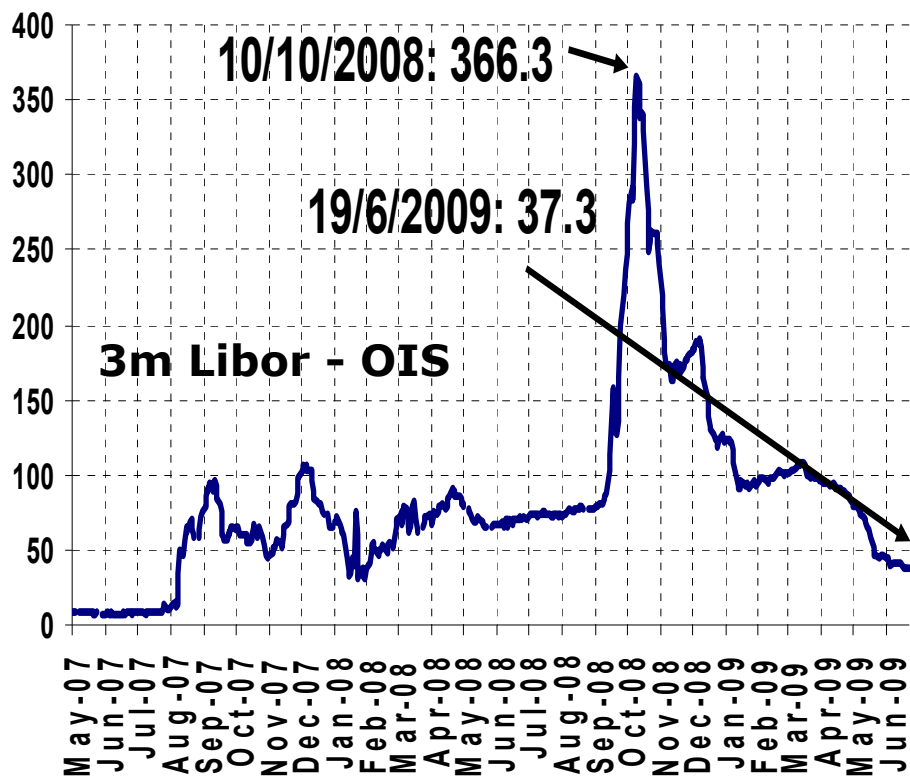
I.2 Risk aversion: Down but not out



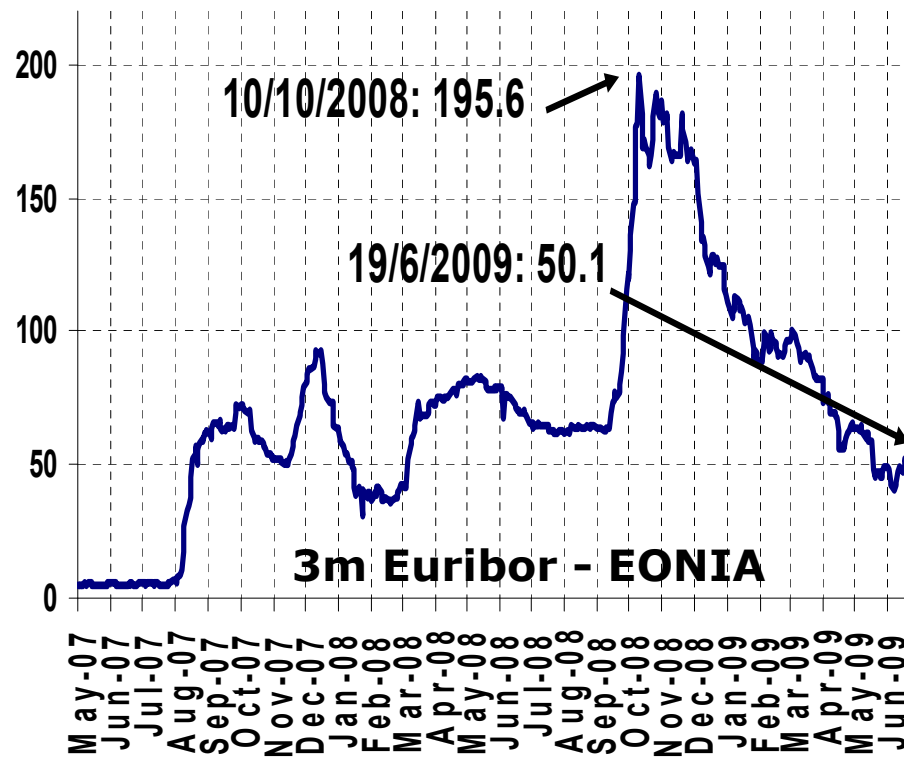
I.2 Liquidity normalizes, but not fully yet

US

Uncovered minus covered 3-month inter-bank rates



Euro Area



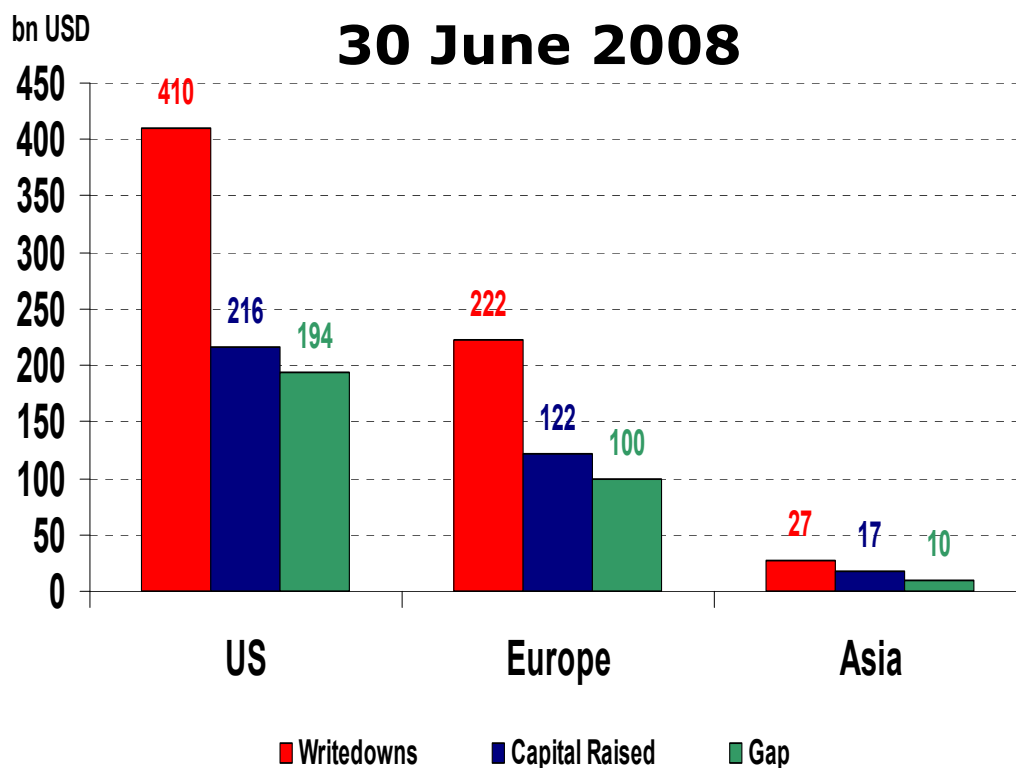
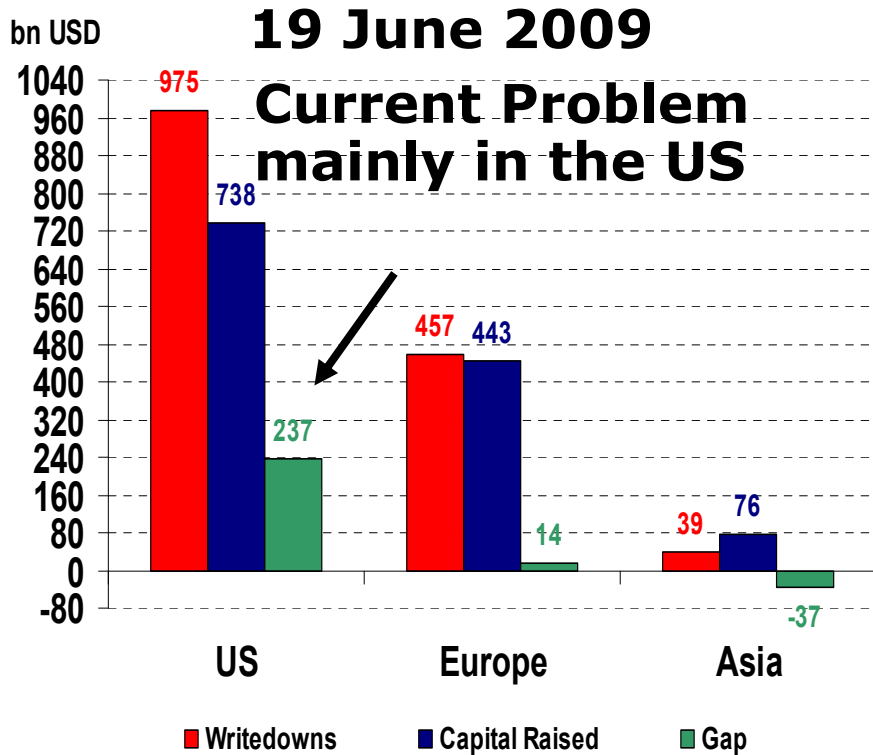
I.2 Write-downs: Not in mid-way yet

✓ 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

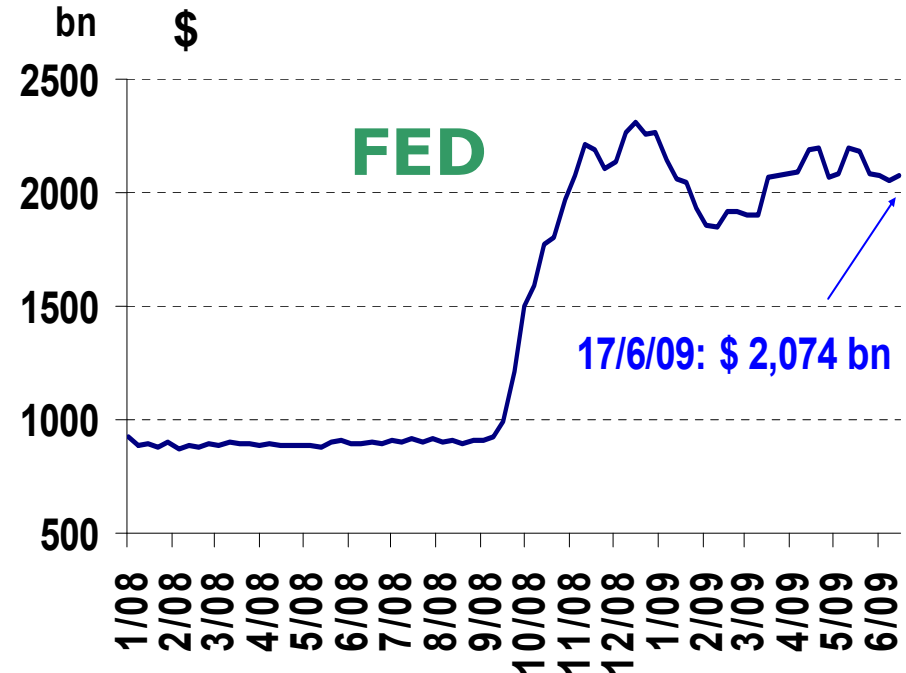
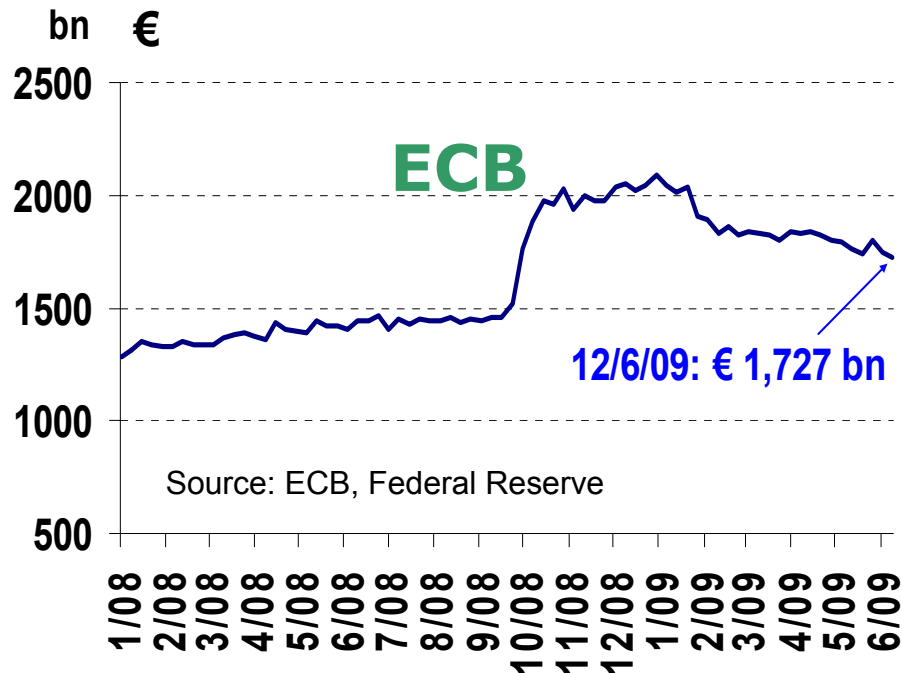
I.2 Looking 5 to 10 years ahead: Slower future global growth? **VERY LIKELY**

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 indebtedness
 - 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

I.2 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?

I.2 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 Banking, 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 against future regulatory restrictions**

I. Summary

- ✓ A large part of the uncertainty is out – yet look for stabilization in asset prices before you think the crisis is over
- ✓ 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**

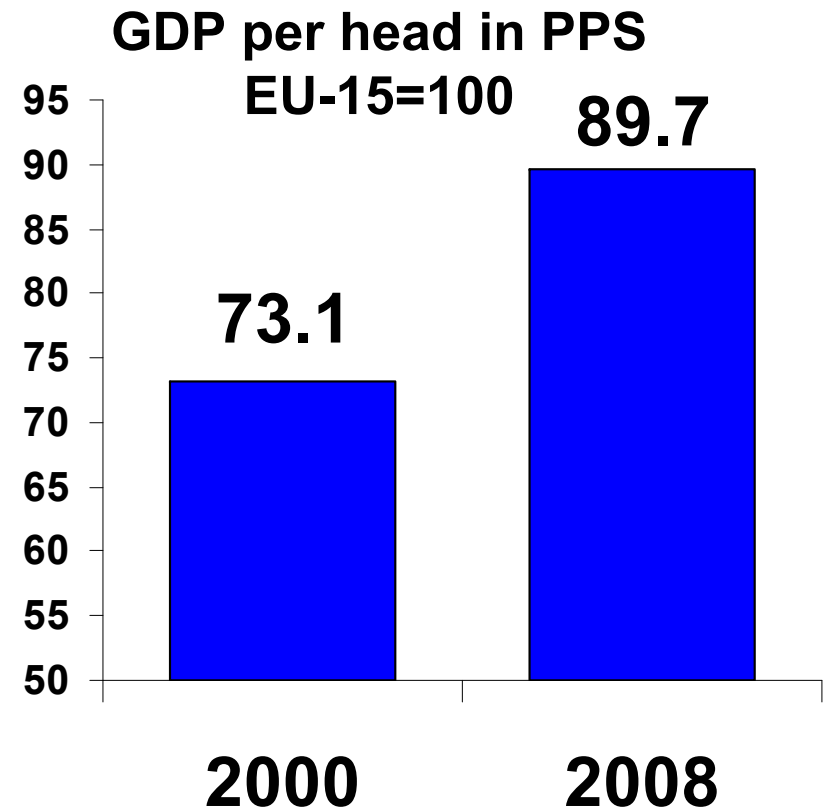
II.

Greece: Opportunity or stagnation and **divergence** ahead?

- 1) High living standards & high growth so far
- 2) Yet, significant internal economic imbalances raise the possibility of a long stagnation period ahead

II.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

II.2 Sovereign Credit Ratings deteriorate

	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:

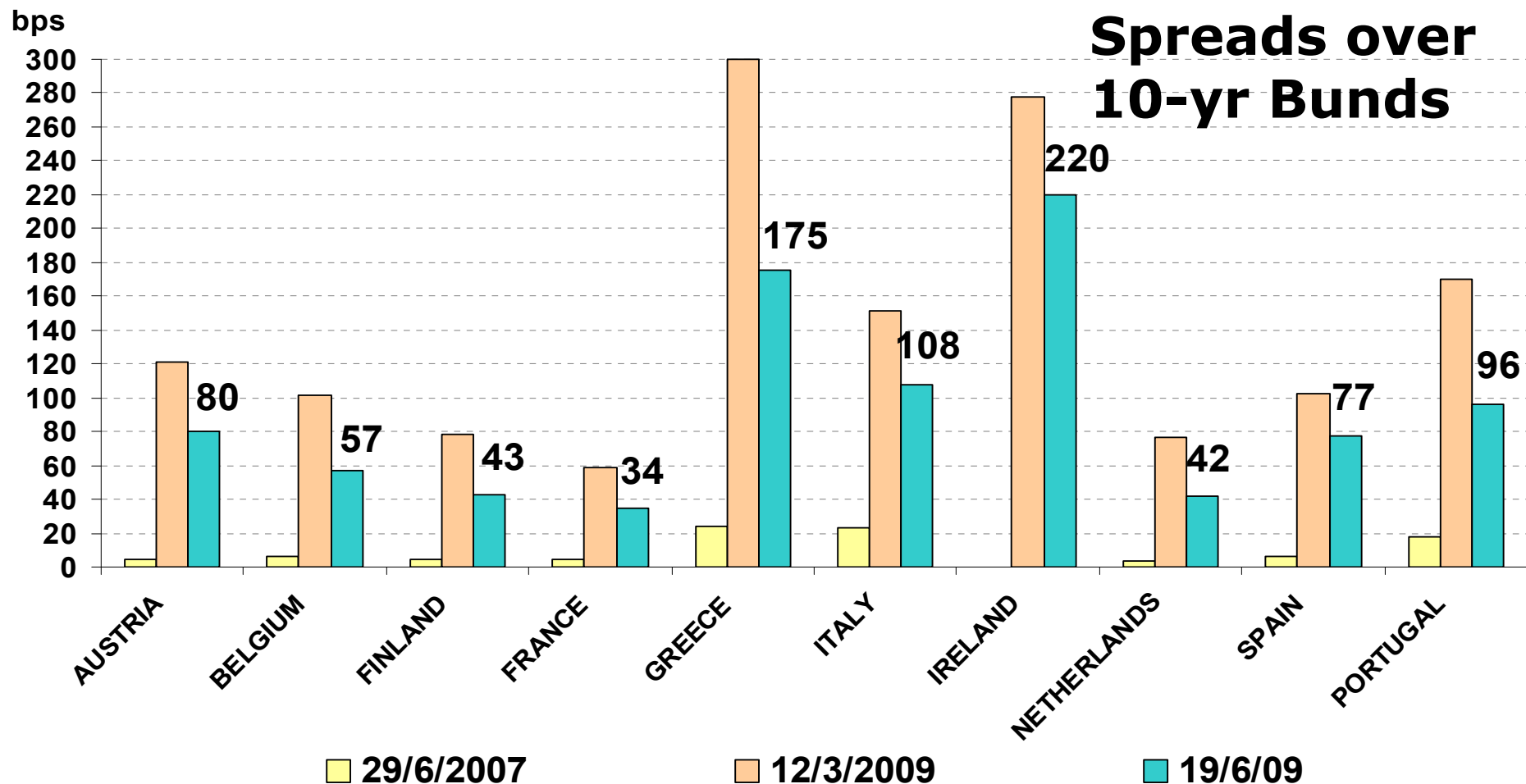
- ✓ Continuous upgrading from 1996 to 2003:

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).

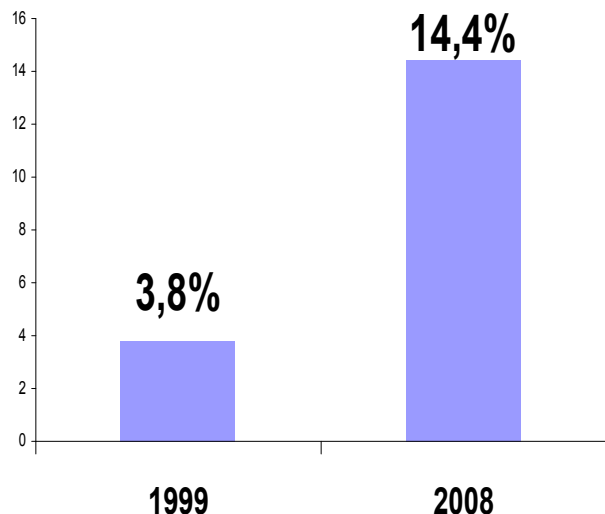
II.2 Yet, financial markets are worried about Greece's ability to pay its debts



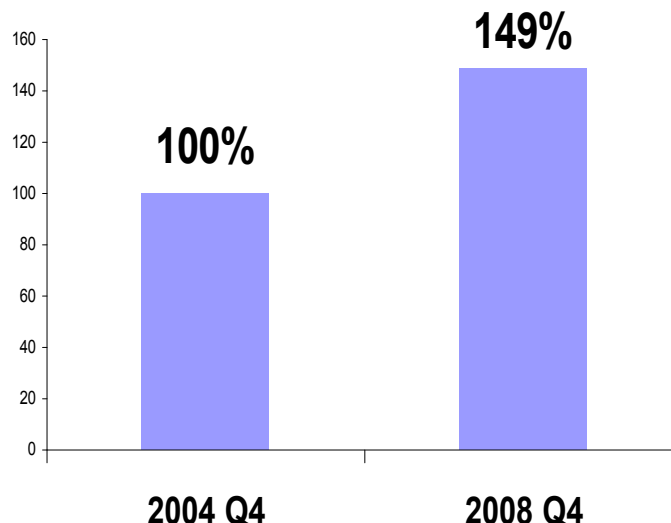
- ✓ In March 2009, the probability of complete default of the Greek State over the next 10 years was higher than 20%

II.2 Imbalances of the Greek economy

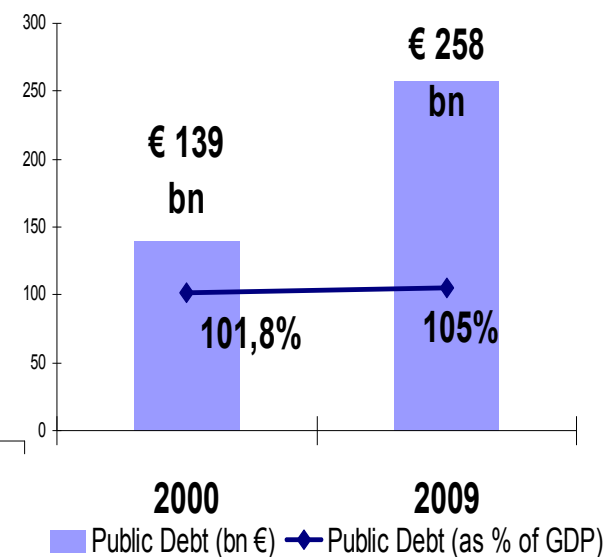
Current Account Deficit



External Debt



Public Debt



i. Competitiveness

Deteriorating, e.g. Current Account Deficit more than tripled since 1999, while prices and costs \uparrow relative to trading partners ($REER_{CPI}$: 14%, $REER_{ULC}$: 28.2%)
 \rightarrow Gross External Debt \uparrow 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%).

II.2 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

II. 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!!

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

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