The Greek crisis: Can we turn it into an opportunity?

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3rd Risk Management & Compliance Forum
Ε.Ι.Π. / Ε.Ε.Δ.Ε.
PRMIA (Professional Risk Managers International Association)

ATHENS MUSIC HALL, Banquet Room

MAY 12, 2011

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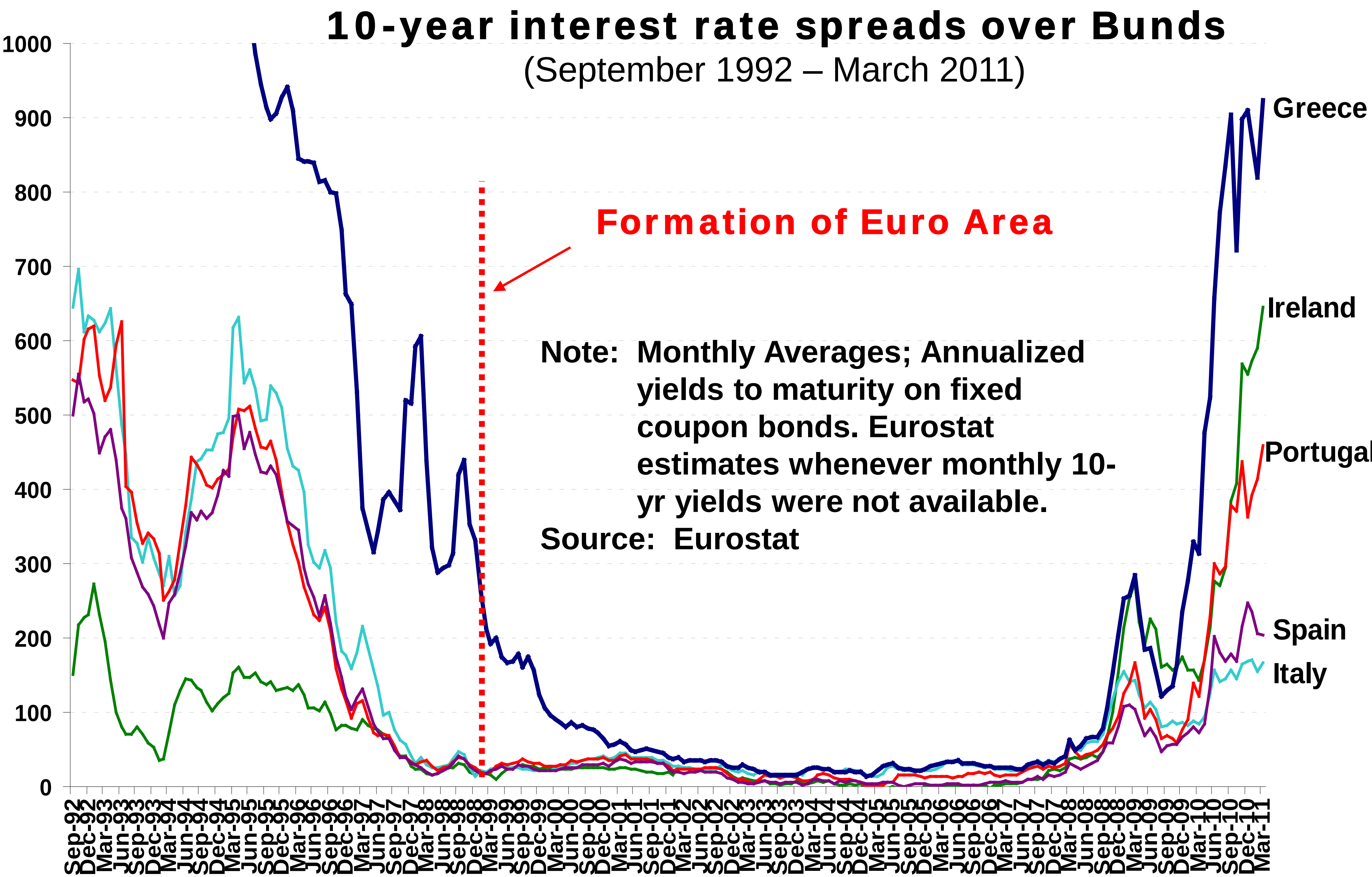
CONTENTS

I. Markets woke up to Euro Area imperfections



I. Different euro area countries face different problems today

✓ **IRELAND**

- ↓ Housing market
- ↓ Banks → public debt ↑
- ↓ High private debt

✓ **PORTUGAL**

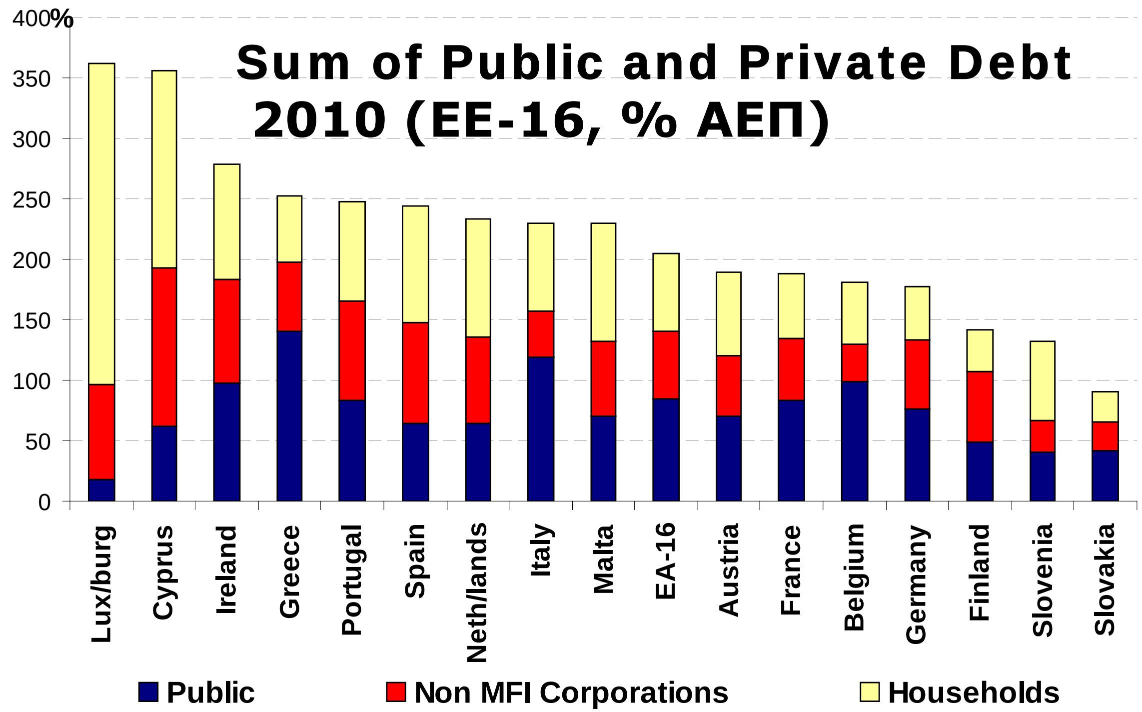
- ↓ Low competitiveness
- ↓ Large fiscal deficits, but not debt
- ↓ High private debt

✓ **SPAIN**

- ↓ Low competitiveness
- ↓ Housing market
- ↓ Small savings banks
- ↓ High private debt

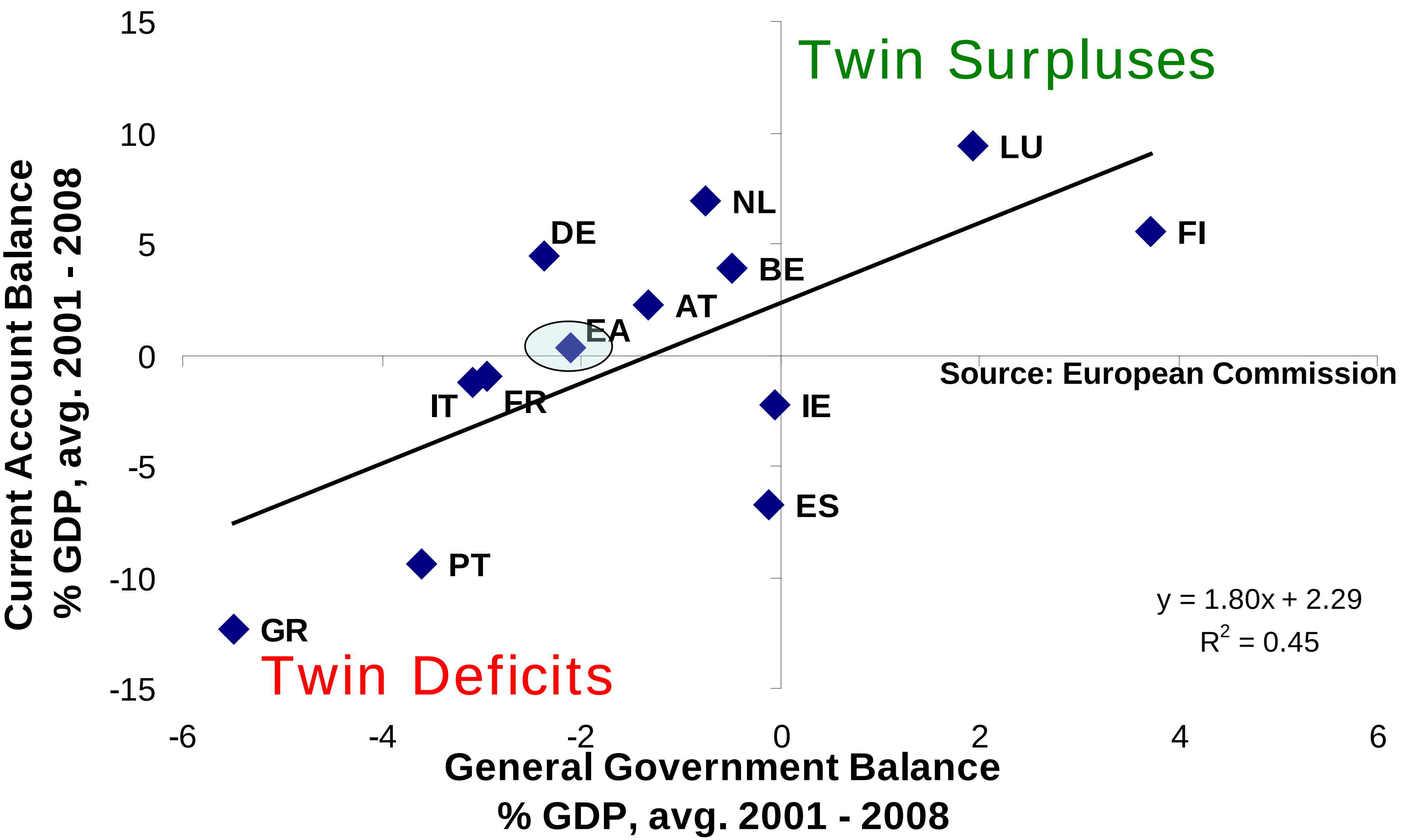
GREECE

- ↓ Low competitiveness
- ↓ High fiscal deficits & debt
- ✓ In Greece Private Debt is low, below EA average, 9th largest



I. External and internal (fiscal) imbalances became large

- Uncompetitive South vs. completive North
- Fiscal profligacy almost everywhere



II.

I. THE EURO AREA CRISIS: HOW DID WE GET TO HERE?

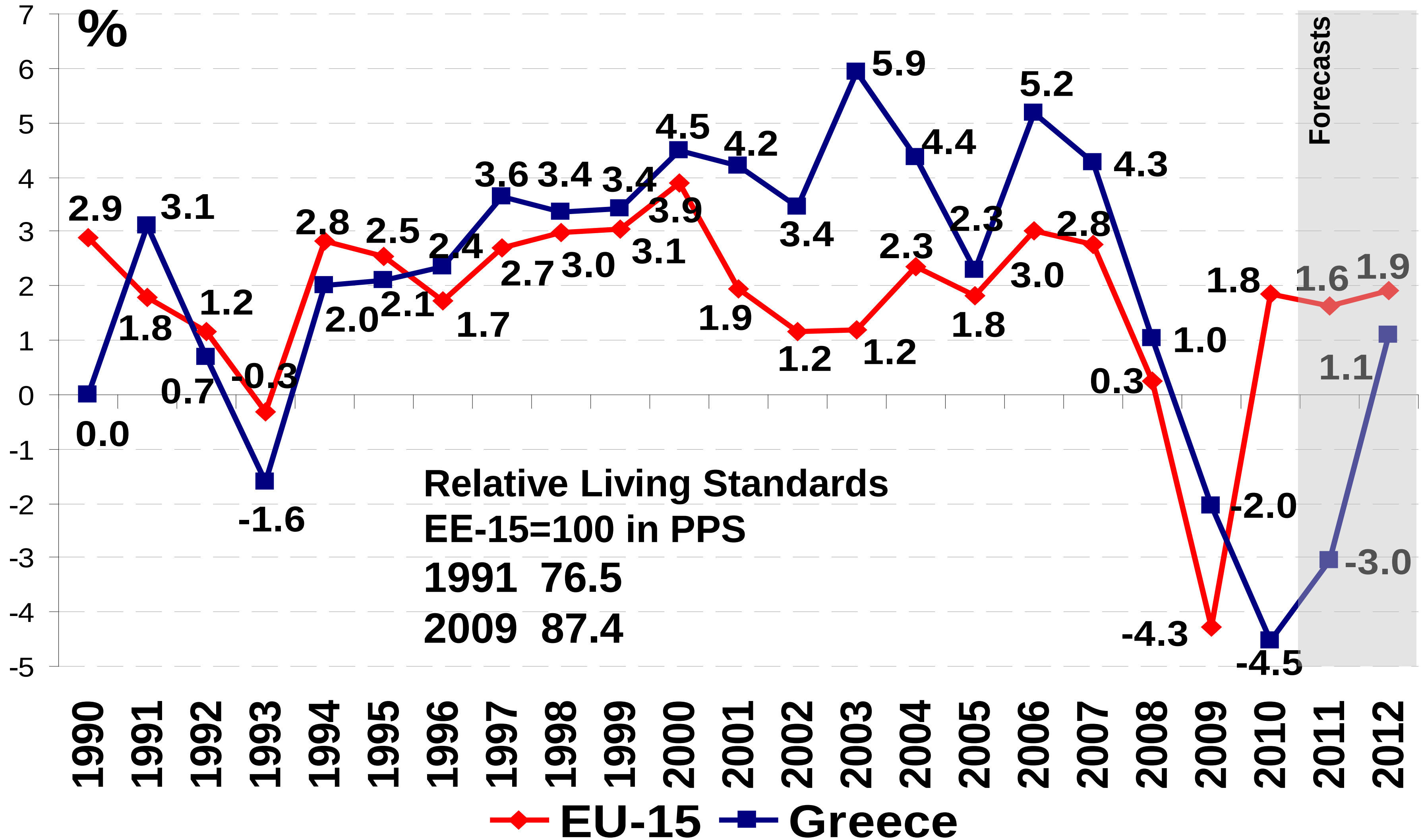
II. GREEK IMBALANCES IN MORE DETAIL

III. THE EU/IMF/ECB PROGRAM, RISKS & OPPORTUNITIES

IV. OPPORTUNITIES FOR A NEW EURO AREA ARCHITECTURE

II. Real growth rates in Greece were higher than in EU-15 from 1996 through 2009

Greece: From boom to bust. How come?
Answer: **Not an equilibrium growth**



Source: EU, IMF, Eurobank Research

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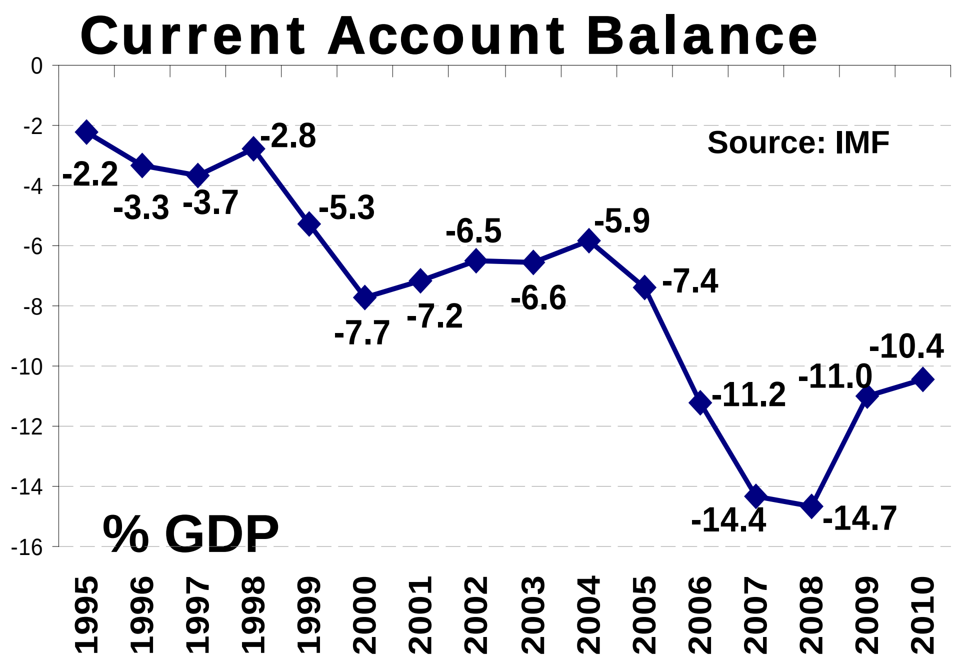
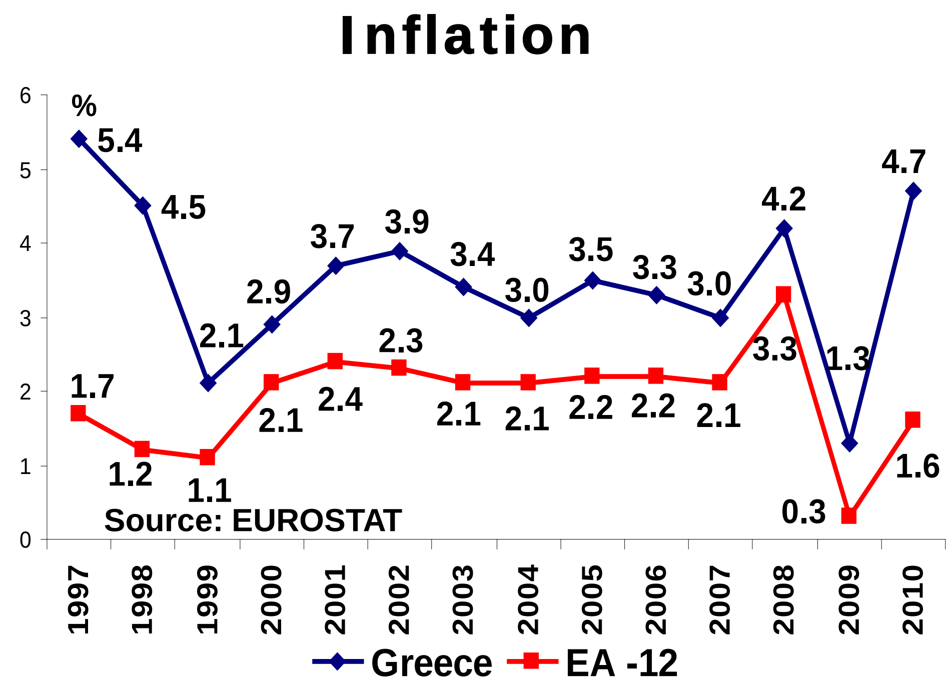
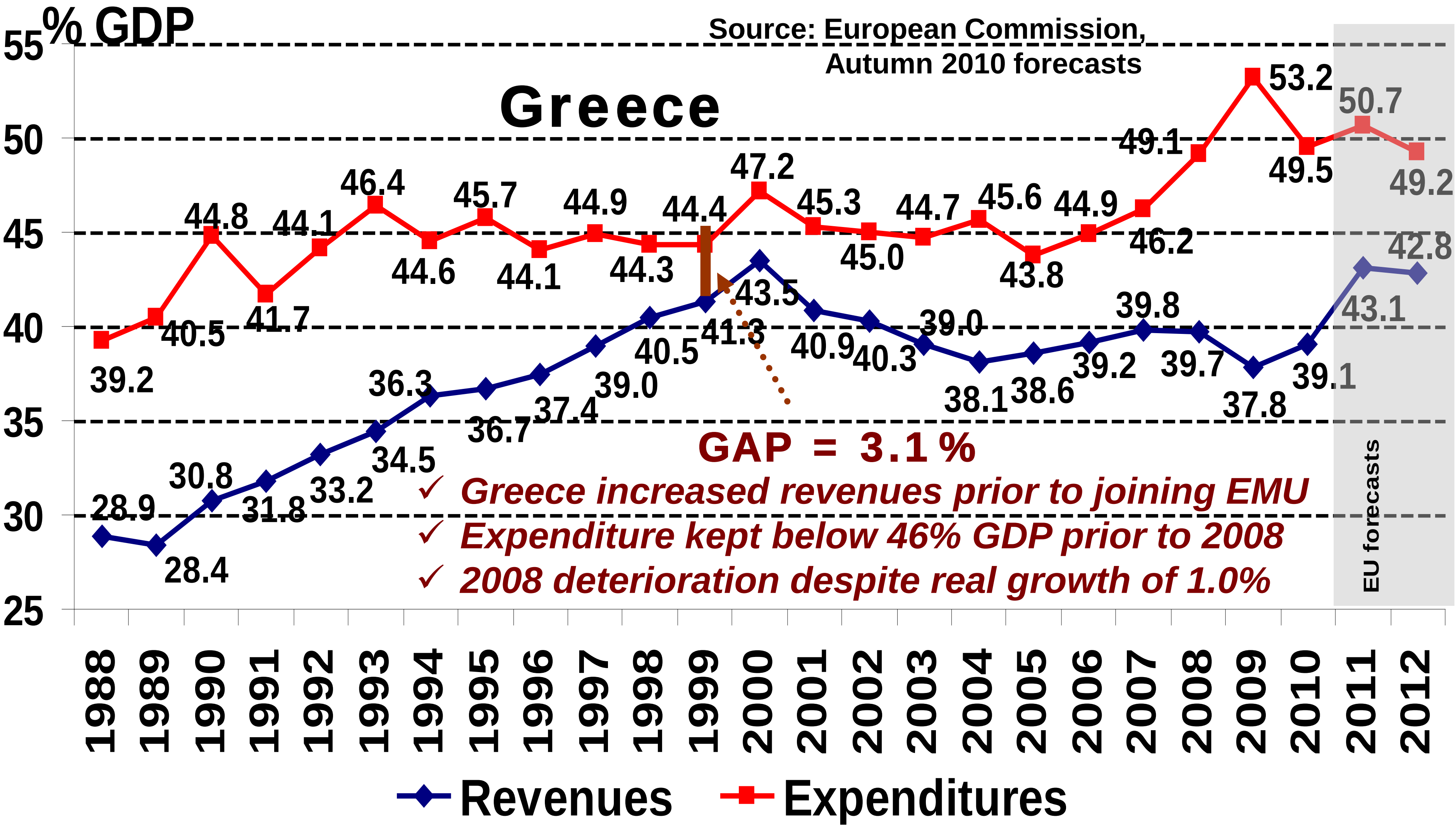
II. Lack of competitiveness showed up in inflation differentials and deteriorated the current account





2010	€ mill.	% GDP
Current Account	-24,060.5	-10.4
Goods	-28,279.6	-12.3
Services	13,248.5	5.8
Income	-9,228.3	-4.0
Current Transfers	198.9	0.1

II. Another disequilibrium: Fiscal laxity



✓ Greece was almost always in fiscal trouble, but fiscal mess grew prior to the onset of the 2009 recession

II. A related long-run disequilibrium: An imbalanced pension system

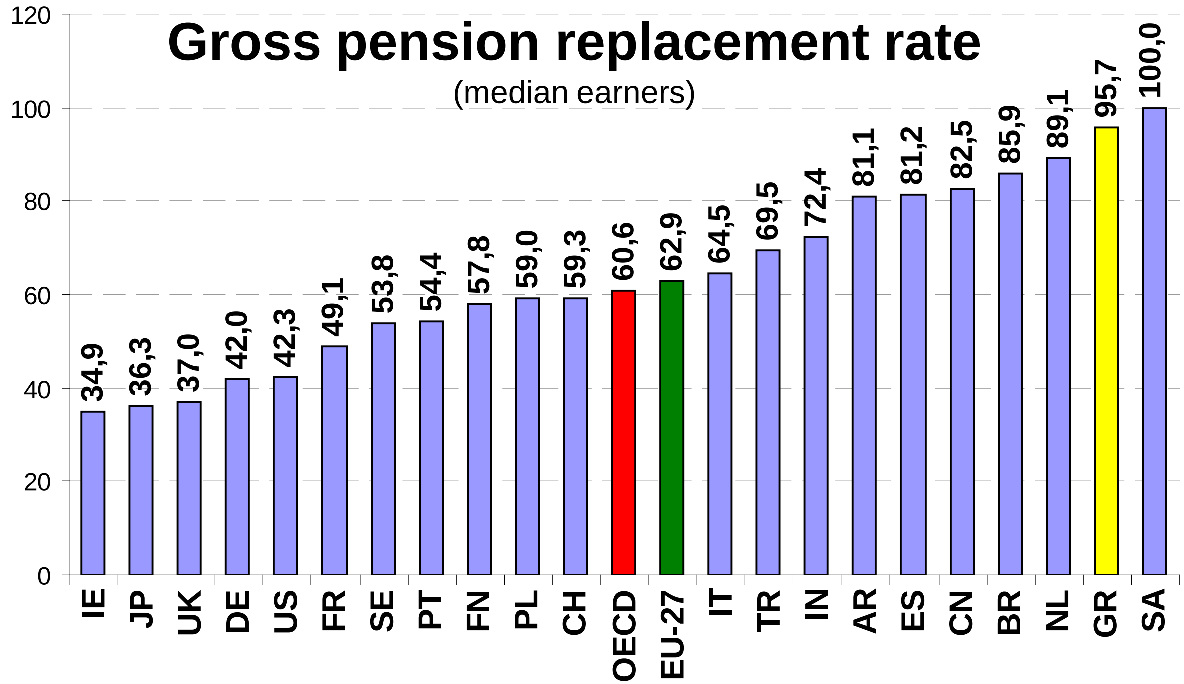
New pension Law adopted on July 2010:

- Fix system's parameters ⇨ reduce the expected increase in future annual state pension liabilities (by 2060) from 12.5% of GDP to 2.5% of GDP.
- Retirement age **for everyone** at 65 by 2015, increasing in line with life expectancy after 2020 with minimum contributory period of 40 years by 2015
- **Early retirement** restricted to the age of **60** by 2015, will be penalized more than before (6% loss per year, including those insured prior to 1993)
- Size of pension linked to **life-time contributions**
- List of heavy and arduous professions to be reduced drastically, under a ceiling of 10% of labor force

Old Regime	2010	2020	2035	2060
Pension Exp. (% GDP) GR	11.6	13.2	19.4	24.1
Dependency*	56	59	78	102
Pension Exp. (% GDP) EA	11.2	11.6	13.2	13.9

Source: European Commission 2009

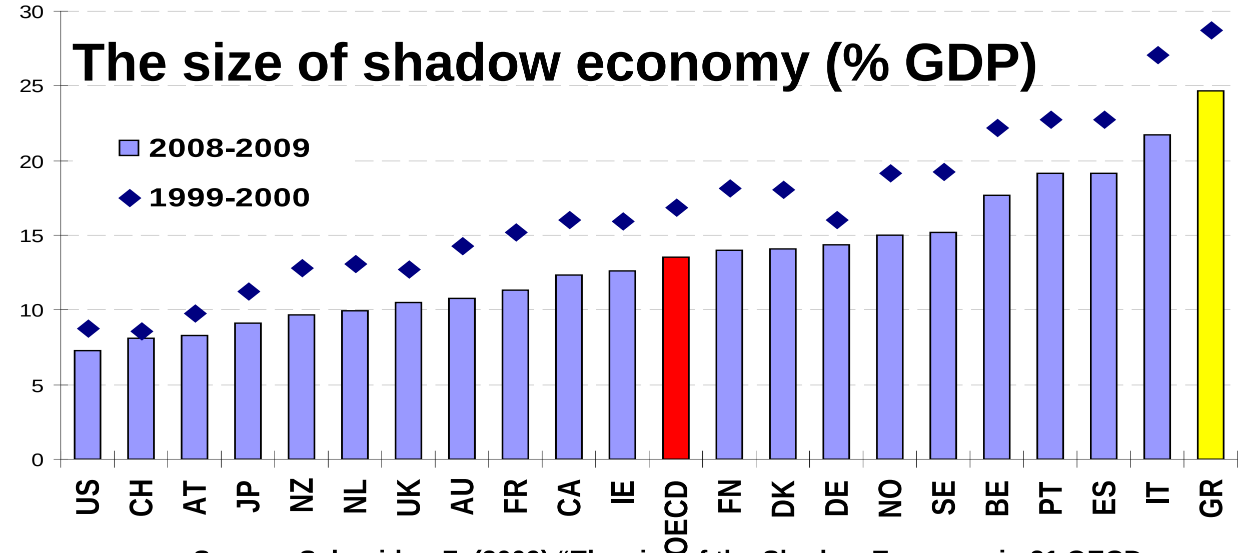
** Ratio of pensioners to contributors*



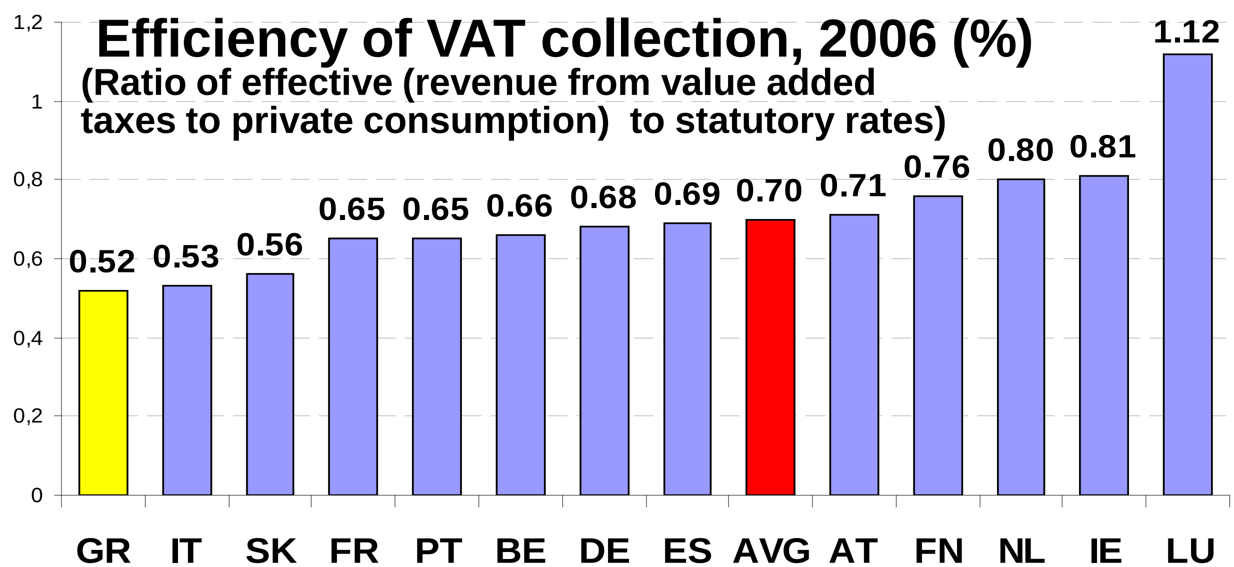
Source: OECD Pensions at a glance 2011

II. Is there a common denominator among the disequilibria after EMU entrance?

- ❖ Yes, lack of structural reforms and in particular, the disorganized & neglected inefficient public sector
- ❖ EMU acted as a sleeping pill not to do the required structural reforms, exactly when most needed
- ✓ The disorganization of the public sector is evident in the size of the underground economy or in the lack of ability to collect taxes



Source: Schneider, F. (2009) "The size of the Shadow Economy in 21 OECD Countries Using the MIMIC and Currency Demand Approach"



Source: OECD Economic Surveys Greece 2009

III.

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III. Main characteristics of the EU/IMF/ECB program

- ✓ **Greek economy:**
  - ❖ Real GDP growth around **2.8%** from 2015 on, below the 1996-2008 average.
  - ❖ Inflation subdued, never above ECB target of 2%: Its necessary to break up oligopolistic market structures
  - ❖ Current Account Balance of -4.4% GDP in 2015 (still no external equilibrium)
- ✓ **Downsizing of the public sector:**
  - ❖ Primary Expenditure from 47.9% of GDP in 2009 to 30.5% in 2020, meaning a huge reduction in the relevant size of the public sector.
  - ❖ Primary Balance (-10.1% GDP in 2009) from -3.2% GDP in 2010 to 6.0% in 2014, a huge change of 9.3 b.p. of GDP between 2010 – 2014
  - ❖ Interest expense from €**14.6** bn in 2010 to **21.4** in 2015, **23.7** in 2020 or 7.3% of GDP
- ✓ **Interest rates follow a decreasing course:**
  - ❖ Spread over Bunds 300 b.p. in 2013, 250 b.p. in 2020: a conservative assumption The expected increase of the Bund rate to 3.5% points towards the right direction.
  - ❖ **Negative snowball effect:** Nominal interest rate at 5.7% - 6.0% which is higher than the nominal growth rate (4.2 – 4.8%): Huge primary surpluses needed in order to obtain fiscal sustainability. **Challenge to reverse** the current nominal interest rates – nominal GDP growth relation
- ✓ **The public debt burden eases gradually as a % of GDP from 2013 onwards**
  - ❖ Public debt at **130%** of GDP in 2020. With1 ppt higher growth each year 2020 public debt at **91%.** Alternatively, if only privatizations are used as debt reduction mechanism 2020 public debt at **112%.**

III. Greece: EU/IMF/ECB baseline scenario

	2009	2010	2011	2012	2013	2014	2015	2020
GDP Growth (%)	-2.0	-4.5	-3.0	1.1	2.1	2.1	2.7	3.0
GDP deflator (%)	1.5	2.3	1.6	0.4	0.8	1.2	0.6	1.8
Nominal GDP (€ bn)	235	229	226	229	236	244	252	315
Current Account (% GDP)	-11.0	-10.5	-8.2	-7.1	-6.6	-5.5	-4.4	----
Interest Rate (%)	4.8	4.9	4.6	5.0	5.4	5.7	5.7	5.9
Bund Rate (bps)	----	225	275	350	350	350	350	350
Spread over Bund (bps)	----	550	525	350	300	300	300	250
Interest Expense (€ bn)	12.4	14.6	15.1	17.3	19.7	21.2	21.4	23.7
Interest Expense (% GDP)	5.3	6.4	6.7	7.5	8.3	8.7	8.5	7.5
Primary Expenditure (% GDP)	47.9	43.5	44.0	41.7	38.5	33.2	32.2	30.5
General Gov Revenues (% GDP)	37.8	40.4	43.1	42.8	42.0	39.3	38.5	36.5
Primary Balance (% GDP)	-10.1	-3.2	-0.9	1.0	3.5	6.0	6.3	5.9
General Gov Deficit (% GDP)	-15.4	-10,5*	-7.5	-6.5	-4.8	-2.6	-2.1	-1.6
General Gov Deficit (€ bn)	-36.2	-22.0	-16.9	-14.9	-11.3	-6.3	-5.3	-5.0
General Gov Debt (% GDP)	127	143	153	159	158	154	151	130
General Gov Debt (€ bn)	298	327	345	364	373	375	381	409

EC/ECB/IMF Adjustment programme, Eurobank EFG Research

*** After Eurostat's recent revision (26/04/2011)**

III. Turning the risks into opportunities in Greece

i. *Will the recession end soon?*

Growth may resume through an increase in exports, the stabilization of the economic climate, an increase in investments and a resolution to the EMU crisis

ii. *Will the economy attain the growth rates of the past?*

Zonzilos (2010), Buis & Duval (2011) estimate an increase in GDP of 17%.

iii. *Will the Greek banking system remain stable and strong?*

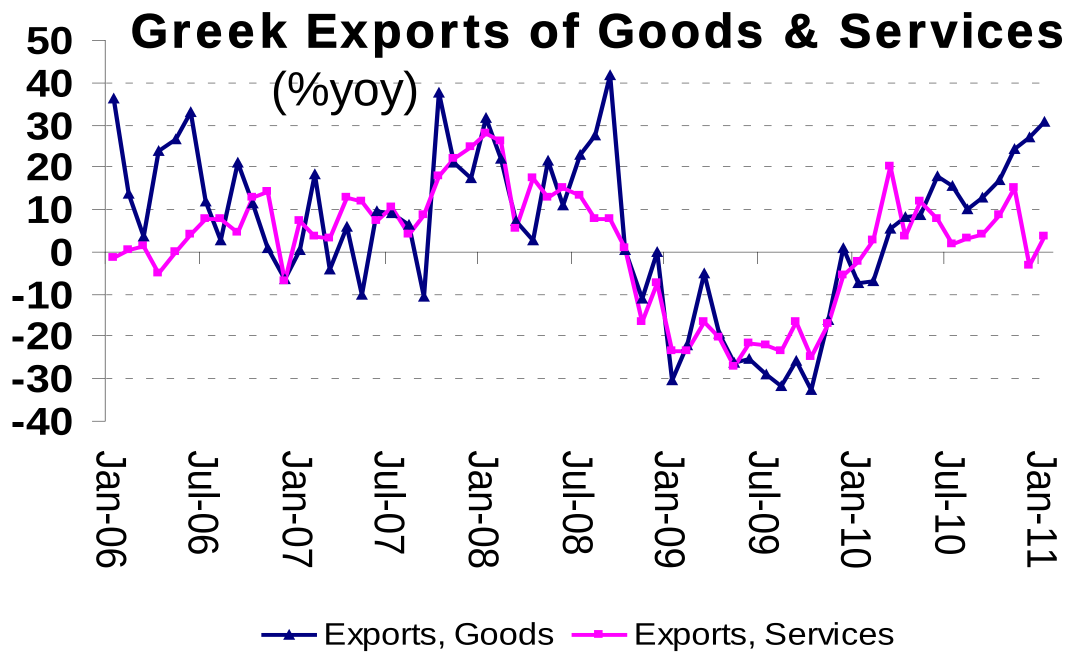
Depends on the continuing support from the ECB (€ 88 bn), the opening up of the interbank market for Greek banks

iv. *Will Greece be able to tap the market in March 2012?*

A restructuring discussion began following the internal German debate

III.1 Will the recession end soon?

- If **Investment** returns to positive territory in 2012; privatizations and public property exploitation schemes can jump start the process (attract FDI, improve confidence in debt sustainability / growth prospects).
- If cracking down of tax evasion & restructuring of loss-making public utilities ⇨no additional measures that would hurt disposable incomes of low-income earners (who have higher propensity to consume)



- External Sector leads the recovery and counterbalances a projected 2011 decrease in consumption (IMF: public-8.5%, private -4.6%)
  - ✓ imports expected to shrink by another 6%, exports can outperform the projected +6.3% due to ULC gains (just -0.5% projected by IMF),
  - ✓ positive indications in tourism (increased reservations), shipping fares increasing, recovery of global economy and trade continue.
  - ✓ 30% of Greek firms already export part of their production, hence expansion possible without huge initial costs (distribution channels, knowledge of markets)

III.2 Will long-term growth come back?

Long term: an export-led paradigm of growth (to replace the failed consumption-led one) depends on improving price- and quality-competitiveness. Also, the smooth reduction in the size of the public sector requires care.

Elements of strategy:

- ❖ Accelerate structural reforms; a critical mass needs to be reached quickly to boost the supply side (reducing bureaucratic cost to business, opening-up of markets and closed professions, emphasis on education and R&D)
- ❖ Supporting switch from non-tradeables to tradeables sectors; happens already, more energetic policies needed (info campaigns, PPPs, free-up resources from the public sector, credit to tradeables)
- ❖ Normalization of business climate and interest rates (reduction in spreads) to support investment and interest rate-sensitive parts of consumption: only when markets are convinced about Greek commitment on fiscal adjustment and continuation of EU support.
  - ✓ However, FDI does not depend on domestic interest rates; institutional factors important (fight on corruption, simplification and transparency of legislation, stability of tax regimes)
  - ✓ Improving absorption of Cohesion Funds' resources

III.2 Reforms are drastic and continue …

Fiscal Reforms passed already from the Parliament

- ✓ "Kalikrates" Law for local authorities
- ✓ New Financial Management Law that amends the budget process
- ✓ 3-yr Budgeting process with specific fiscal conditionalities (see Medium Term Fiscal Plan 2012-2015)
- ✓ Single Payment Authority becomes gradually operational
- ✓ Monthly data on general government budget execution became publicly available
- ✓ OMB-equivalent in the Parliament and a budget revenue rule
- ✓ Independence of the Statistical Agency
- ✓ Reform of the tax legislation in order to fight tax evasion
- ✓ Reform of Public sector enterprises and the railroads sector
- ✓ Healthcare reform

Reforms aiming to boost the competitiveness of the Greek economy

- ✓ Competitiveness & Business environment measures (business start-ups, adoption of the Services Directive, general electronic commercial registry, one stop shops for start ups, etc)
- ✓ New investment law and the "fast track" law for large investment projects
- ✓ Opening up of the closed professions and liberalization of the road freight transport
- ✓ Law strengthening the independence of the Hellenic Competition Committee

For the immediate period the focus of the government should be on the actual implementation of the reforms agenda

III.2 Are privatizations on track?

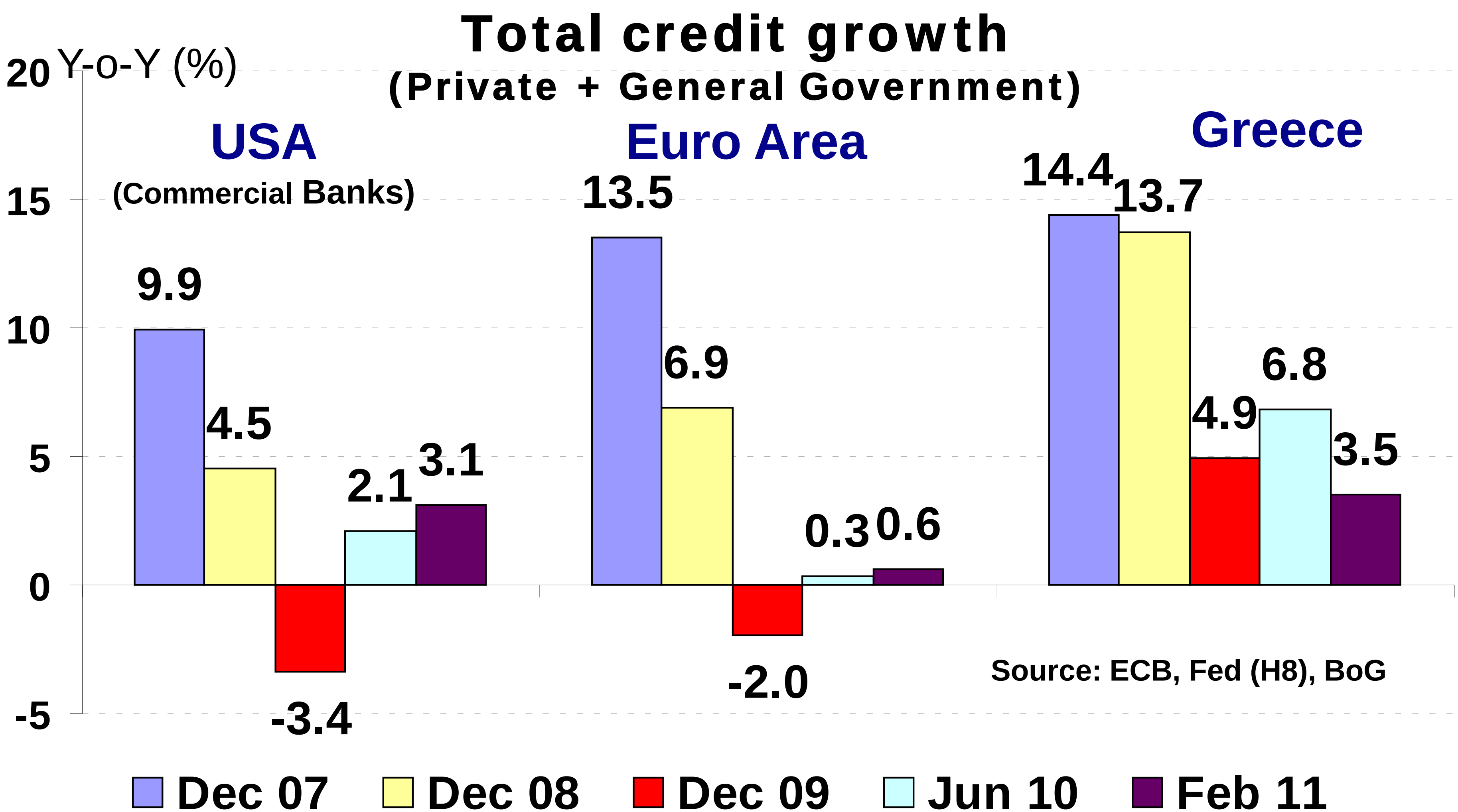
Privatizations gain some momentum

- ✓ Ongoing reform programmes in Public Firms and organizations will improve their chances for privatizations
- ✓ The registering and evaluation of the State's real estate assets already started by the appointed financial advisors
- ✓ A first list of real estate assets ready for development will be presented to the EC/ECB/IMF officials by mid-May 2011, ahead of the planed delivery of the first portfolio of real estate assets (June 2011)

But

- ✓ Given the strong doubts expressed by analysts and the markets, the government **has to over-privatize** to regain the lost credibility
- ✓ Many Politicians and Unions seem to resist the implementation of privatizations
- ✓ Legal impediments exist in many real estate assets
- ✓ Certain Local Authorities are opposed to the planned real estate development
- ✓ Huge bureaucracy problems
- ✓ Despite the December 2011 fast track law, nothing has yet to come out of it

III.3 Adequate credit growth given the recession

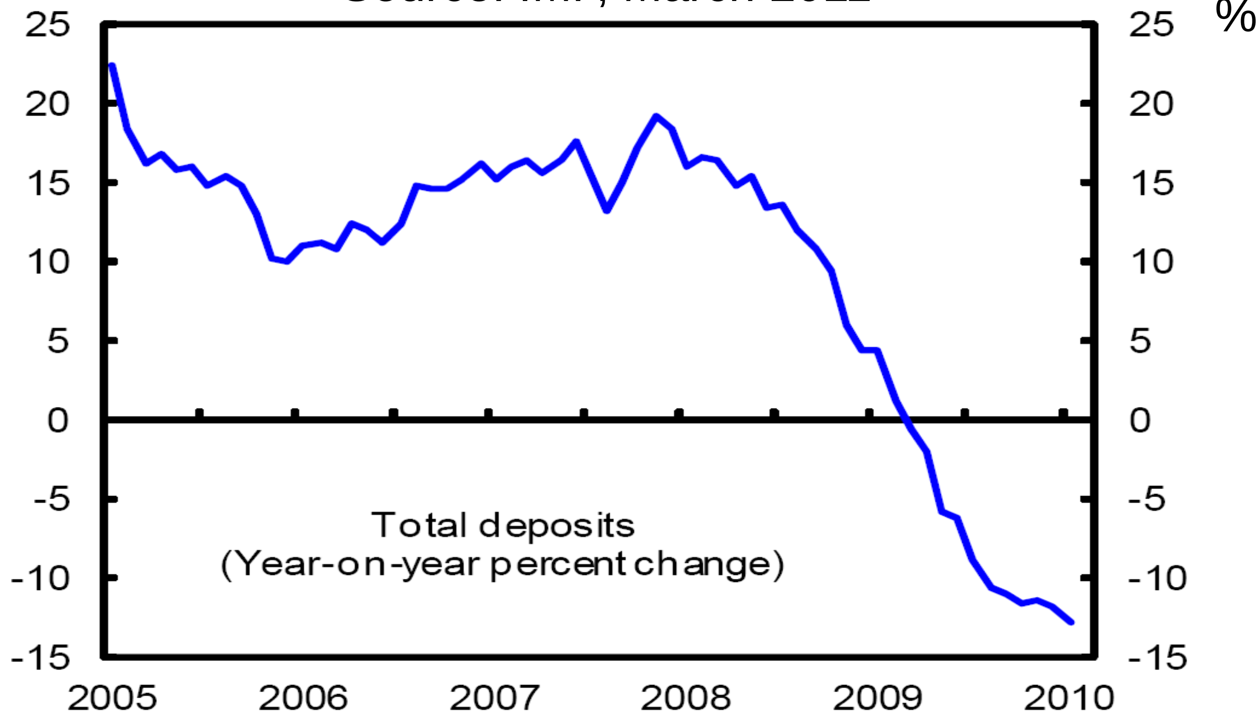


Greece: Domestic private sector credit growth decelerated further to -0.4% yoy in March 2011, from -0.3% in February 2011 and 0.0% in December 2010.

III.3 Deposit deceleration poses risk to banks but is driven primarily by the recession

- ✓ February 2011: Deposits & repos of non MFIs €273.4 bn or 118.8% of GDP
- ✓ Of this amount, €206.5 bn belong to domestic residents
- ✓ Citizens typically confuse the bond restructuring discussion with a loss of their personal deposits

Source: IMF, March 2011



- ✓ Only a small part of the drop in deposits is reflected in capital outflows, since households and corporations are using deposits as a cushion to declining incomes and/or credit restrictions
- ✓ Yet, trust in institutions among citizens has to come back

III.3 High dependence on the ECB

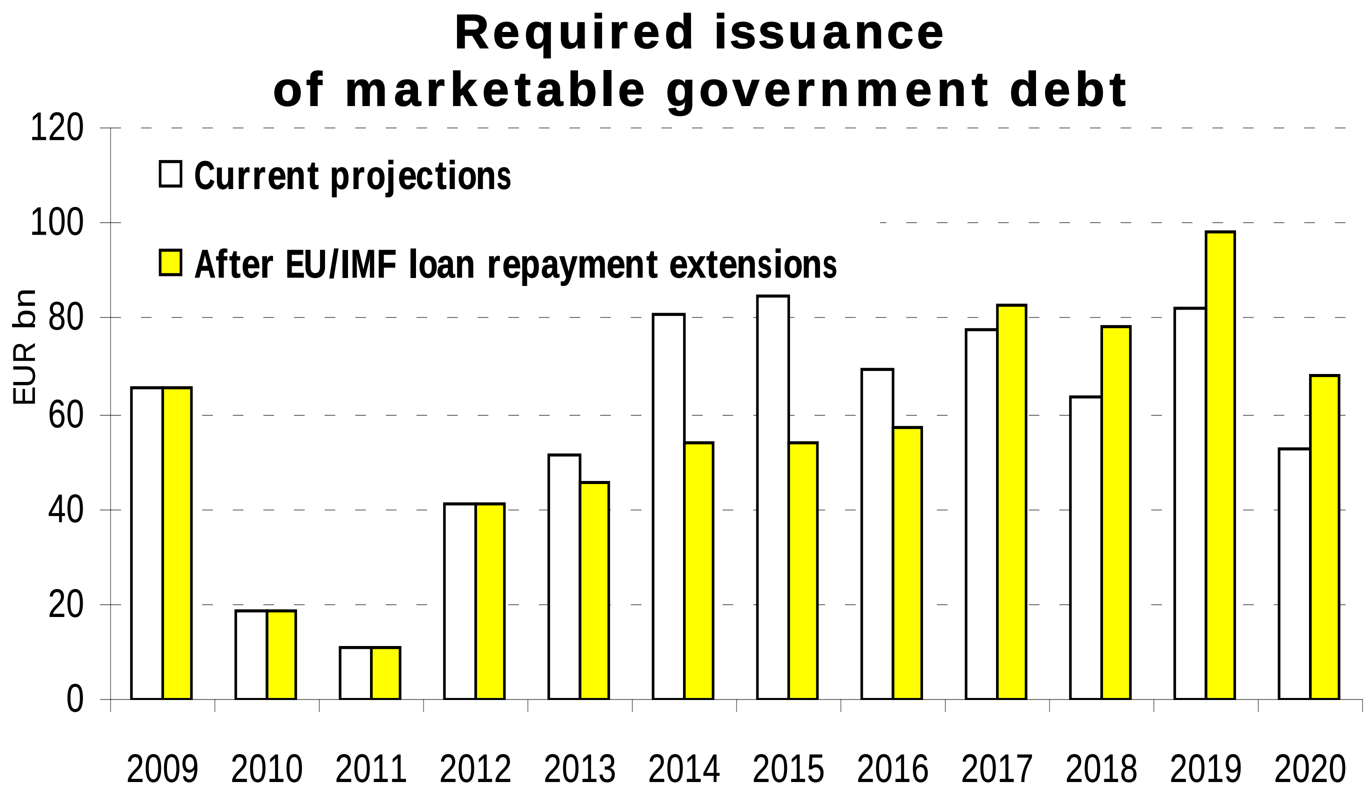
Borrowing from the ECB	EA-16			Greece		
	a	b	c	a	b	c
Jun-07	464.6	28,026	1.7	4.3	353.0	1.2
Dec-07	637.1	29,494	2.2	8.8	391.3	2.2
Jun-08	483.0	30,839	1.6	11.6	424.5	2.7
Dec-08	843.2	31,830	2.6	40.6	464.5	8.7
Jun-09	896.8	31,803	2.8	54.0	490.6	11.0
Dec-09	728.6	31,145	2.3	49.7	491.9	10.1
Jun-10	870.4	32,564	2.7	94.3	543.2	17.4
Dec-10	546.7	32,205	1.7	97.8	514.1	19.0
Mar-11	435.7	31,697	1.4	88.0	498.6	17.6

(a) Total Lending from the ECB (€ bn), (b) Total Banks Assets (€ bn), (c) % ratio a/b

- ✓ De-leveraging abroad is not a solution for Greek banks as current profitability comes from abroad, exactly where the liquidity need arises
- ✓ Continued support from the ECB is required for the stability of the system

III.4 Can the market be tapped in March 2012?

- Only if Greece were to gain credibility on the sustainability of its debt profile
- This appears difficult in the short-run, hence another solution has to be found
- The solution will be an EMU decision
- Secretive meetings in Luxemburg over the weekend of May 6-7



Source: EC/ECB/IMF Dec. 2010 forecasts, Greek Finance Ministry, Eurobank EFG

- Calculations do not incorporate potential receipts from privatization and other asset sales
- Calculations do not incorporate savings from lower interest rates on EU loans (~€6bn)

- The solution has to be credible to markets and for this to happen Greece has to follow its **fiscal consolidation and privatization program at a faster pace** than up to now, and show concrete results

III. 4 GGB restructuring debate, particularly following revelation of secretive meetings

- ✓ Financial market analysts (W. Buiter (10/05/2011), N. Rubini (10/5/2011), C. Wyplosz (29/04/2011) among others) are in favor of a restructuring solution for the Greek issue. Reprofiling is considered as a half-measure.
- ✓ On the other hand the IMF, the European Commission, the European Central Bank and other Eurozone member states' officials are strictly against the restructuring solution (see D. Strauss-Kahn (05/04/2011), O. Rehn (10/04/2011), J-C. Trichet (10/04/2011), J-C. Juncker (27/04/2011), C. Lagarde (14/04/2011) among others).
- ✓ Previously, a number of German officials and analysts were in favor of a Greek restructuring (see W. Schaeuble (14/04/2011), W. Hoyer (15/04/2011), L. Feld (09/05/2011) among others).
- ✓ Nevertheless, the German government changed its tone recently. M. Meister, the parliamentary finance spokesman for Merkel's Christian Democratic Union, said on May 10th that Germany would consider more aid to avoid restructuring and its consequences
- ✓ O. Rehn, the European Union Economic and Monetary Commissioner, on May 10, 2011, did not rule out a new loan decision for Greece but postponed the necessary decisions until early June 2011.

❖ Restructuring discussions trigger further downgrades by rating agencies

❖ **Restructuring acts as a pretext in Greece to stall the reforms**

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IV. Need for a new architecture

- ✓ Euro Area, **a political undertaking** based on **two pillars**:
  1) The independence of the European Central Bank
  2) The Stability and Growth Pact

     plus the NO BAILOUT threat

  What is there to do? **Not politically possible:**

  I. Dissolve EMU

  II. Establish a fiscal union with fiscal transfers & little national authority

  Hence,
- ✓ Euro Area needs a new architecture based on the following issues:
  1) Conflict resolution mechanism
  2) Fiscal coordination
  3) Competitiveness divergences among EMU members
  4) Stability of the financial system
- ✓ Therefore, a four-front approach:
  1) Permanent European Stability Mechanism
  2) Strengthening of the SGP with the inclusion of the Van Rompuy proposals
  3) Euro + : Decrease the competitiveness gap among the Eurozone members
  4) Stricter supervision of the Financial sector

IV. Discussion on the new Euro Area architecture

1) Stricter fiscal discipline - ***Van Rompuy proposals*** to be made concrete by June. (reverse majority rule, debt reduction = 5% of excess debt, stricter surveillance, fiscal rules, better policy coordination – "European semester" etc.)

2) ***Euro Plus Pact*** will further strengthen the economic pillar of EMU, with the objective of improving competitiveness, fostering employment, enhancing public finances sustainability and financial stability: Common objectives, progress monitoring on the basis of indicators, concrete yearly commitments (*reviewing of wage setting arrangements, wages to follow productivity, opening of sheltered sectors, improve education systems and promote R&D, improve the business environment, "flexicurity", aligning of pension systems to the national demographic situation, national fiscal rules "debt brake", tax policy coordination etc).*

3) ***European Stability Mechanism***: €500bn, IMF participation, no-bailout clause is gone, ability to intervene in primary markets, private sector participation, Collective Action Clauses

4) Stricter supervision of the Financial sector (Basel III: stricter capital requirements, new leverage and liquidity ratios; European Systemic Risk Board plus 3 European Authorities for Banks, Insurance companies and financial markets from January 2011)

✓ Eurobonds seem to be out (Objections that they reduce the incentive for compliance; Yet Eurobonds can be issued for European Infrastructure projects; They are created indirectly through the ESM loans)

IV. Greek choices in the new Euro Area architecture

- ✓ The new Euro Area architecture aims to improve coherence and overall competitiveness; it is not a zero-sum game
- ✓ The **new architecture does not impose additional restrictions** on Greece
  - ❖ Those restrictions are already present, triggered by the Greek crisis and the subsequent Economic Adjustment Program.
  - ❖ The discipline enforced by the creditors (EC/ECB/IMF) is more severe than the requirements of the new Euro Area architecture.
- ✓ As a result Greece is in favor of the new Euro Area architecture
- ✓ The new strict Euro Area architecture imposes **long term discipline** even after a decade, when Greece will hopefully have freed itself from the debt burden
- ✓ As a result, the new Euro Area architecture implies that the current adjustment process of the Greek economy **will not derail**; it is an one-way road

V. Summary: The crisis as an opportunity for change

- ✓ The EMU crisis is an opportunity for fixing its internal fiscal mechanism
  - ❖ Van Rompuy Task Force proposals will bring added fiscal discipline, plus ESM could bring long-run stability; E-bonds could materialize
- ✓ Greece is in a transitional stage:
  - ❖ It either does nothing and gets trapped in a prolonged period of stagnation and huge unemployment, with contracting living standards
  - ❖ or uses the 3-year EU/ECB/IMF lending window efficiently to fix itself up, yet carrying the burden of past sins in the form of both higher unemployment and higher debt
- ✓ Indeed, the Greek crisis is an opportunity to fix its long neglected general public sector and pursue the structural reforms that were avoided for decades
  - ❖ Despite huge risks, Greek society is ready
  - ❖ Pension reform a big plus and can be supplemented; Labor reforms induce flexibility
  - ❖ Many reforms still pending: Health sector, Public sector enterprises, Local governments, Educational reform
  - ❖ State has to capture the underground economy, simplify the tax system and, subsequently, reduce marginal tax rates
- ✓ The stricter the EU supervision, the more likely it is for Greece to succeed

THANK YOU FOR YOUR ATTENTION !

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