



# ***GREEK ECONOMY: A NEW PATH FORWARD***

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***YPO Conference***

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# ***GREEK ECONOMY: A NEW PATH FORWARD***

## **MAIN THEMES**

- I. IS THE INTERNATIONAL FINANCIAL CRISIS OVER?**
- II. THE GREEK LONG-RUN IMBALANCES UNCOVERED**
- III. IS THE CURRENT RESPONSE ADEQUATE?**
- IV. CONCLUSION**

# I.

## IS THE INTERNATIONAL FINANCIAL CRISIS OVER?

- ❖ **Yes, but risks remain**

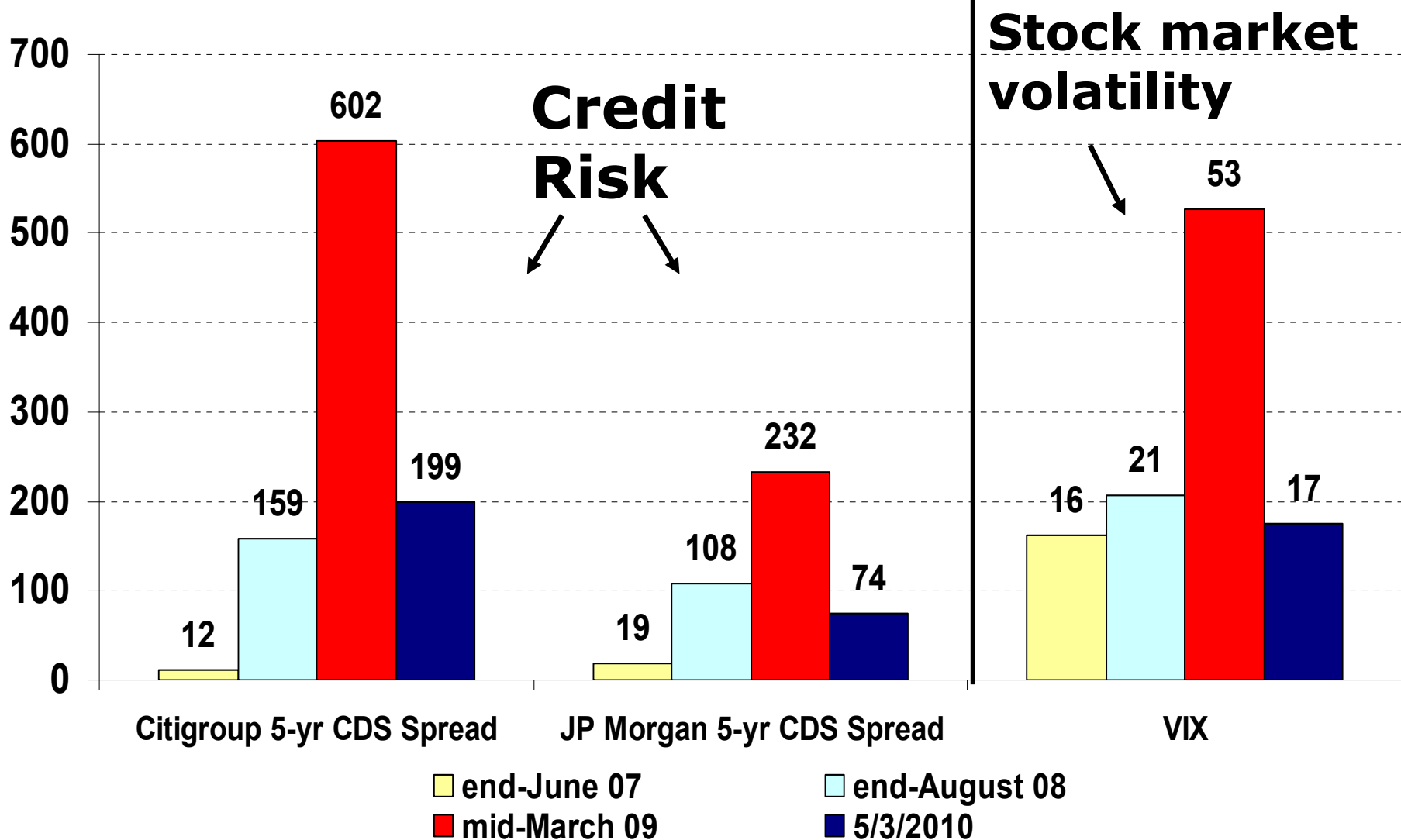
# I.1 Consensus Output Forecasts for 2010

## Real GDP

	2008	2009	2010f
<b>USA</b>	<b>0.4</b>	<b>-2.4</b>	<b>2.9</b>
<b>Euro area</b>	<b>0.6</b>	<b>-4.1</b>	<b>0.7</b>
<b>Japan</b>	<b>-0.7</b>	<b>-5.0</b>	<b>1.5</b>
<b>China</b>	<b>9.6</b>	<b>8.7</b>	<b>9.6</b>
<b>Brazil</b>	<b>5.2</b>	<b>0.0</b>	<b>5.5</b>
<b>Russia</b>	<b>5.6</b>	<b>-7.9</b>	<b>4.5</b>
<b>India</b>	<b>7.5</b>	<b>6.5</b>	<b>8.0</b>
<b>Greece</b>	<b>2.0</b>	<b>-2.0</b>	<b>- 2.8,-4.7</b>
<b>Bulgaria</b>	<b>6.0</b>	<b>-5.1</b>	<b>-0.8</b>
<b>Poland</b>	<b>5.0</b>	<b>1.7</b>	<b>2.6</b>
<b>Romania</b>	<b>6.2</b>	<b>-7.2</b>	<b>1.0</b>
<b>Serbia</b>	<b>5.4</b>	<b>-2.9</b>	<b>1.5</b>
<b>Turkey</b>	<b>0.9</b>	<b>-5.5</b>	<b>5.0</b>

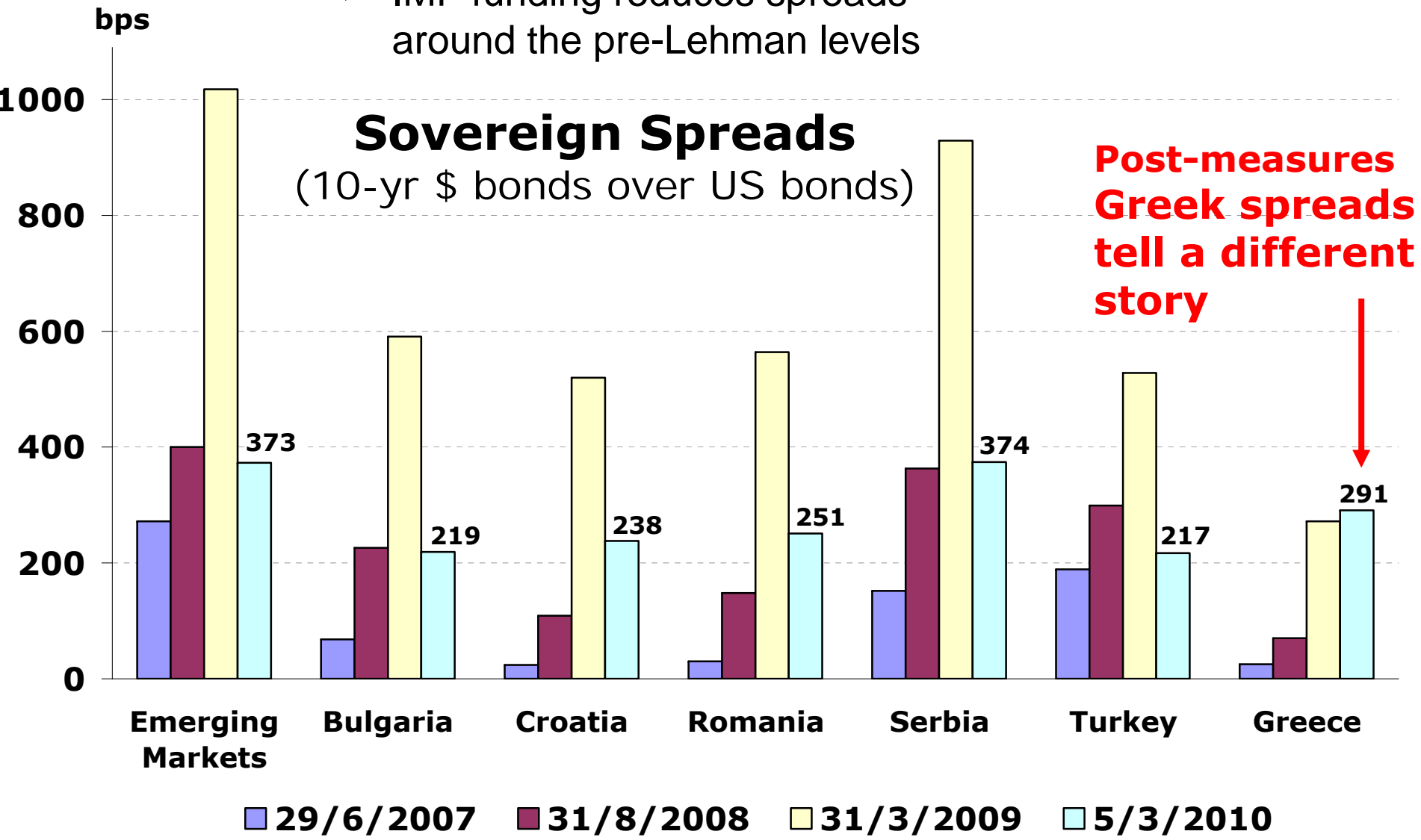
- ✓ We avoided a repetition of the 1930's by transferring the associated costs to the future
- ✓ Stronger recovery in the US
- ✓ Recovery depends on Exit strategy of monetary & fiscal authorities
- ✓ Sluggish recovery in our region, with Turkey showing the best prospects

# I.1 Is the crisis over? Spreads down but not at pre-crisis levels



# I.1 Is the crisis over in our region?

✓ IMF funding reduces spreads around the pre-Lehman levels



## I.2 Slower future world growth ahead

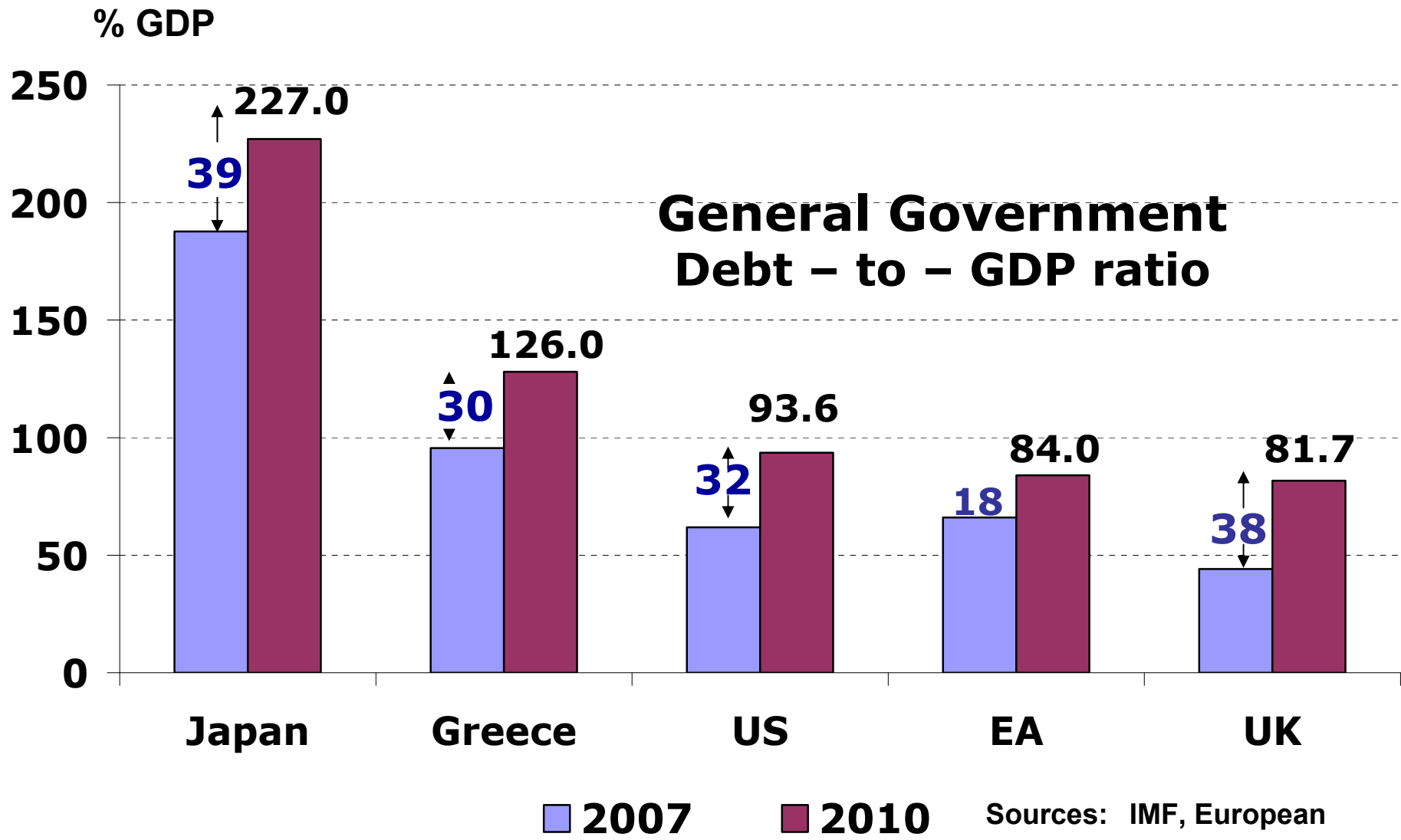
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**It was not the Great Depression or Capitalism's 1989, but this Great Recession is likely to leave its permanent marks**

**My long-term view is for lower growth than the period leading up to the crisis**

- 1 Higher real interest rates ahead
  - ✓ Risk premia to stay high
  - ✓ Higher demand for new bank equity capital will increase the cost of intermediation
  - ✓ Fiscal debt will compete with private debt for funding (crowding out)
  - ✓ Central bank intervention interest rates expected to go back up
2. Future de-leveraging of the government sector, hence restrictive fiscal policy
3. Mediation of global imbalances: The US consumer is forced to reduce leverage and increase savings – hence lower exports by third countries to the US
  - ✓ The Chinese consumer is not ready to close the gap yet
  - ✓ India is still a closed economy
  - ✓ Europe depends on exports

# I.2 The financial crisis is transformed into a debt crisis





## II.

# THE GREEK LONG-RUN IMBALANCES UNCOVERED

**Two major idiosyncratic imbalances:**

- i. Lack of Competitiveness**
- ii. Fiscal laxity**

## II.1 Ease of Doing Business rankings reveal lack of competitiveness

### ➤ World Bank:

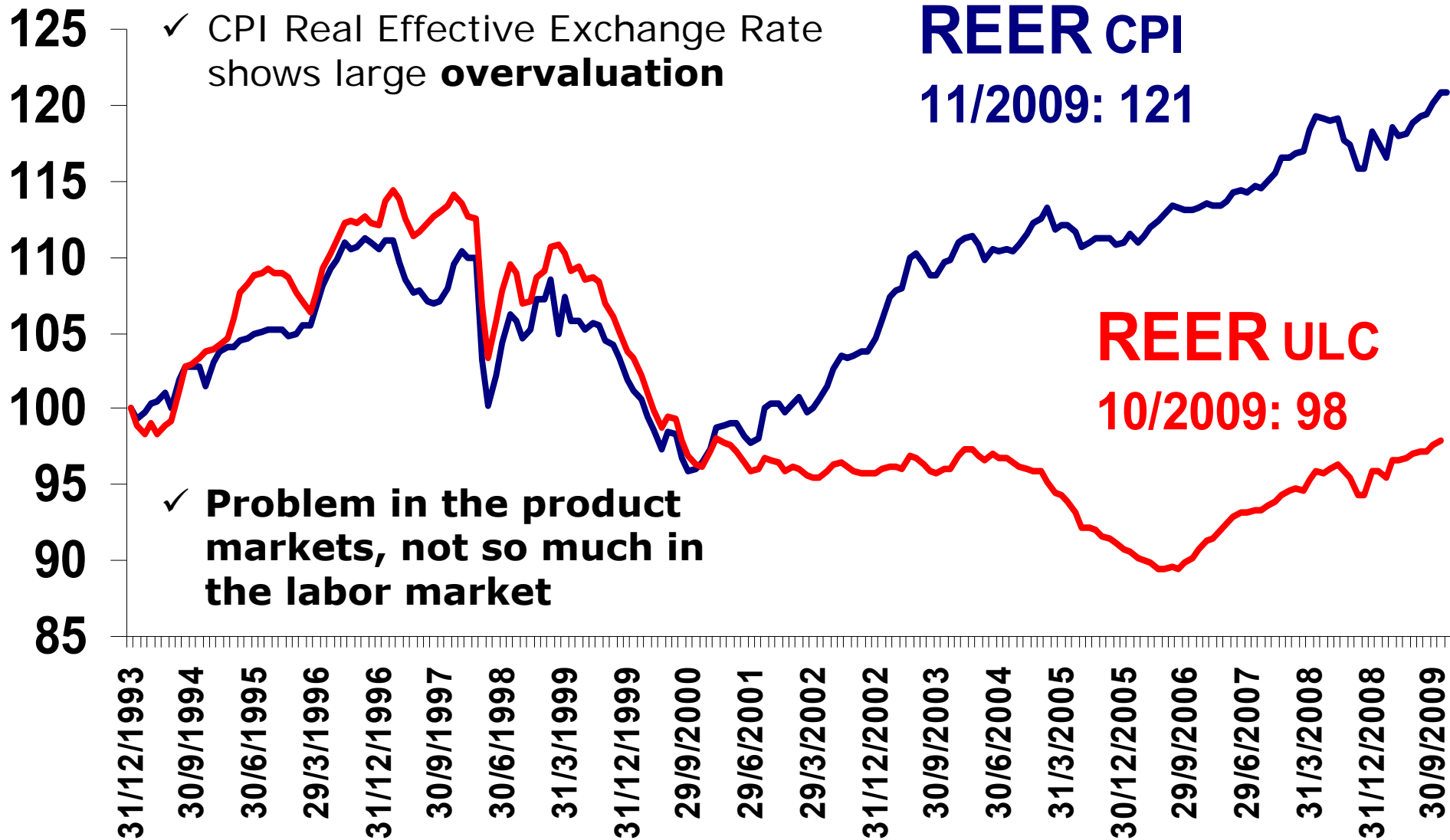
**In 2009 Greece ranked 109<sup>th</sup> out of 183 countries**

	Rank	Starting a business (days)	Difficulty of hiring (0-100)	Protecting Investors (0-10)	Exporting Goods (days)	Paying Taxes (hours per year)
<b>Greece</b>	<b>109</b>	<b>19</b>	<b>44</b>	<b>3.3</b>	<b>20</b>	<b>224</b>
<b>OECD</b>		<b>13</b>	<b>26.4</b>	<b>5.8</b>	<b>10.5</b>	<b>194.1</b>
<b>Portugal</b>	<b>48</b>	<b>6</b>	<b>33</b>	<b>6</b>	<b>16</b>	<b>328</b>
<b>Czech Rep.</b>	<b>74</b>	<b>15</b>	<b>33</b>	<b>5</b>	<b>17</b>	<b>613</b>
<b>Turkey</b>	<b>73</b>	<b>6</b>	<b>44</b>	<b>5.7</b>	<b>14</b>	<b>223</b>
<b>Bulgaria</b>	<b>44</b>	<b>18</b>	<b>17</b>	<b>6</b>	<b>23</b>	<b>616</b>
<b>Romania</b>	<b>55</b>	<b>10</b>	<b>67</b>	<b>6</b>	<b>12</b>	<b>202</b>

✓ Intention to reduce the number of starting days from 19 to 1!

Source: World Bank *Ease of doing business 2010*

## II.1 Price Competitiveness declines post-EMU

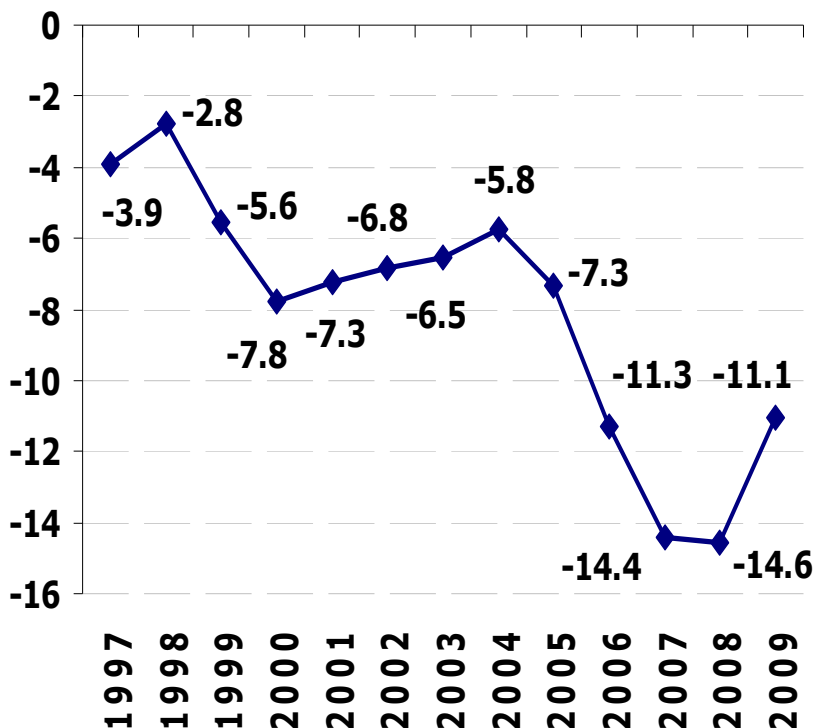


Source: IMF, IFS

# II.1 Lack of competitiveness shows up in current account as well as in inflation differential

## Current Account Balance

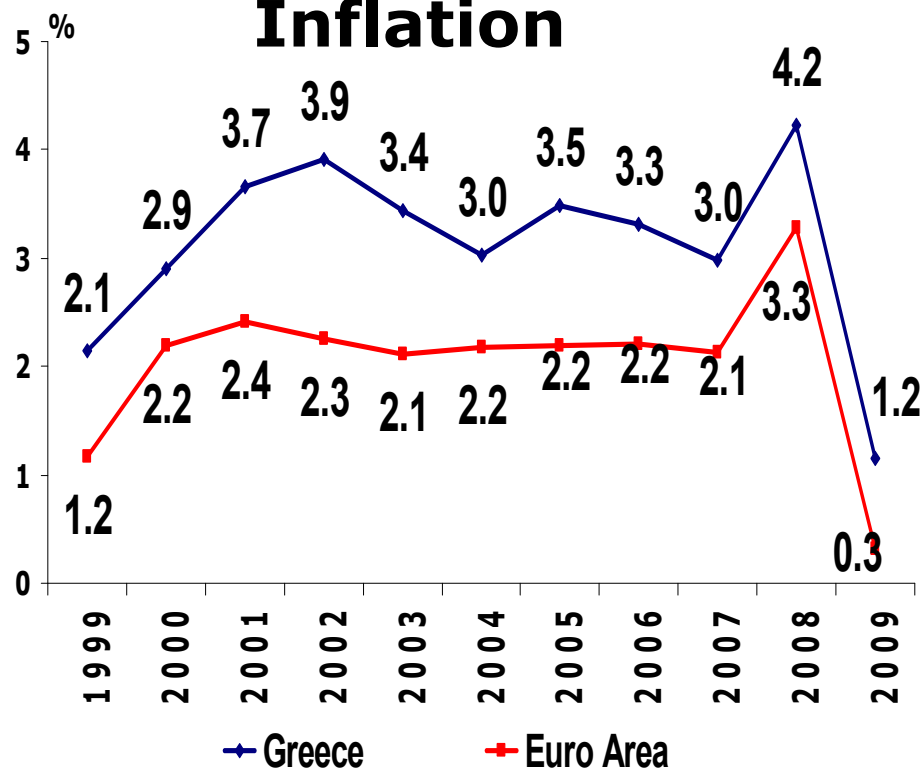
% GDP



Source: Bank of Greece

✓ In every single month, inflation in Greece was higher than the Euro Area average

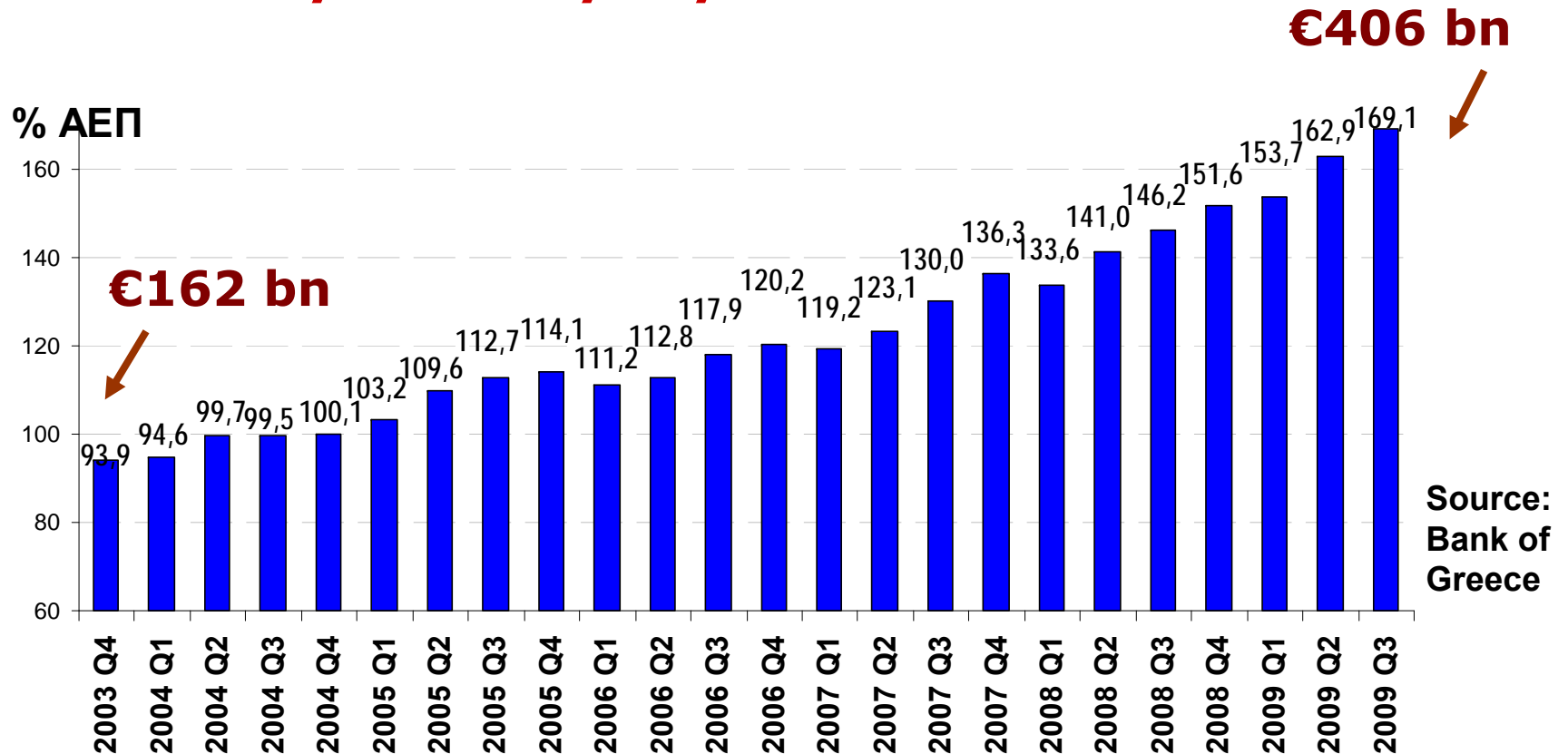
## Inflation



Source: European Commission

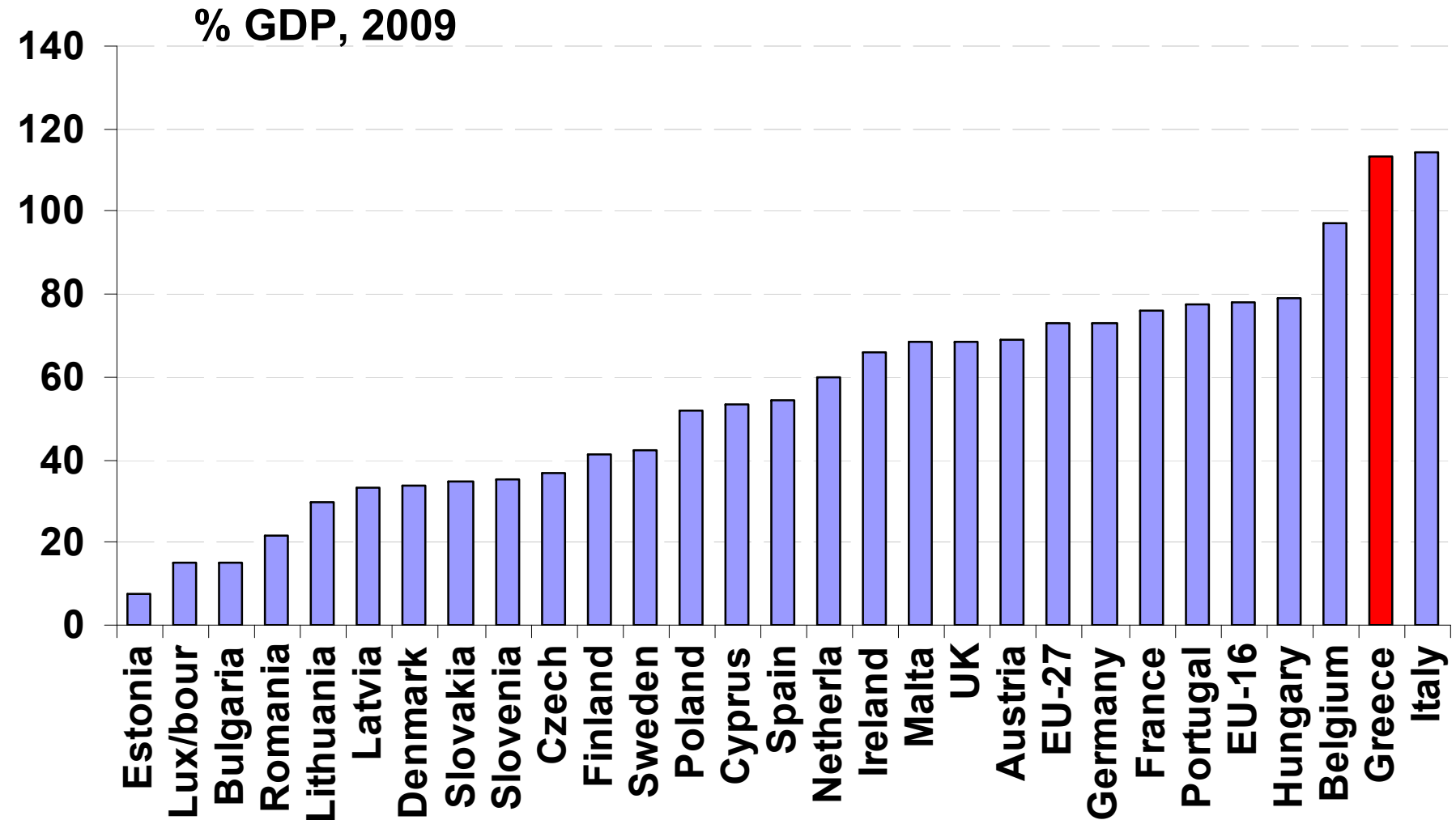
## II.1 Gross External debt shoots up

- ✓ The competitiveness deterioration is the deepest problem
- ✓ **The country lives way beyond its means**



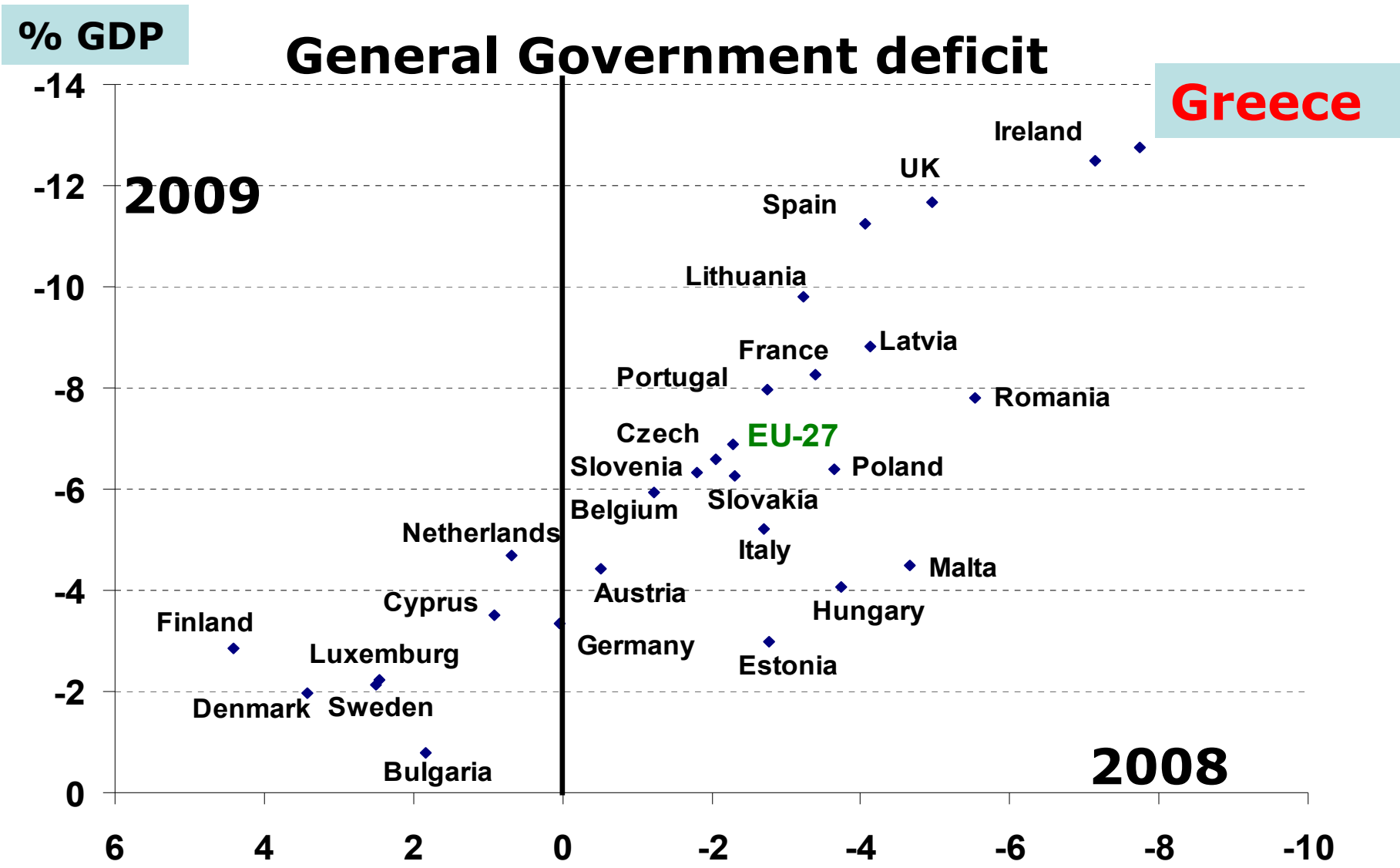
- ✓ The 6-year rise in external debt was more than 75 pp of GDP or €244 bn

## II.2 Fiscal laxity is the second problem: Greek government debt soon to be the worst in EU-27



Source: European Commission

# II.2 Fiscal laxity: 2008 & 2009 Greek government deficits were the worst in EU-27



## II.2 More fiscal problems ahead thanks to the unreformed pension system

- ✓ *Pension system future pressures bigger in Greece*
- ✓ *Lack of credibility of Greek fiscal statistics*

	Greece			
	2010	2020	2035	2060
Pension Expenditure (% GDP)	11.6	13.2	19.4	24.1
Pension system dependency ratio (%)*	56	59	78	102

	Euro Area			
	2010	2020	2035	2060
Pension Expenditure (% GDP)	11.2	11.6	13.2	13.9

\* *Number of pensioners relative to the number of contributors in public pension schemes*

Source: European Commission 2009

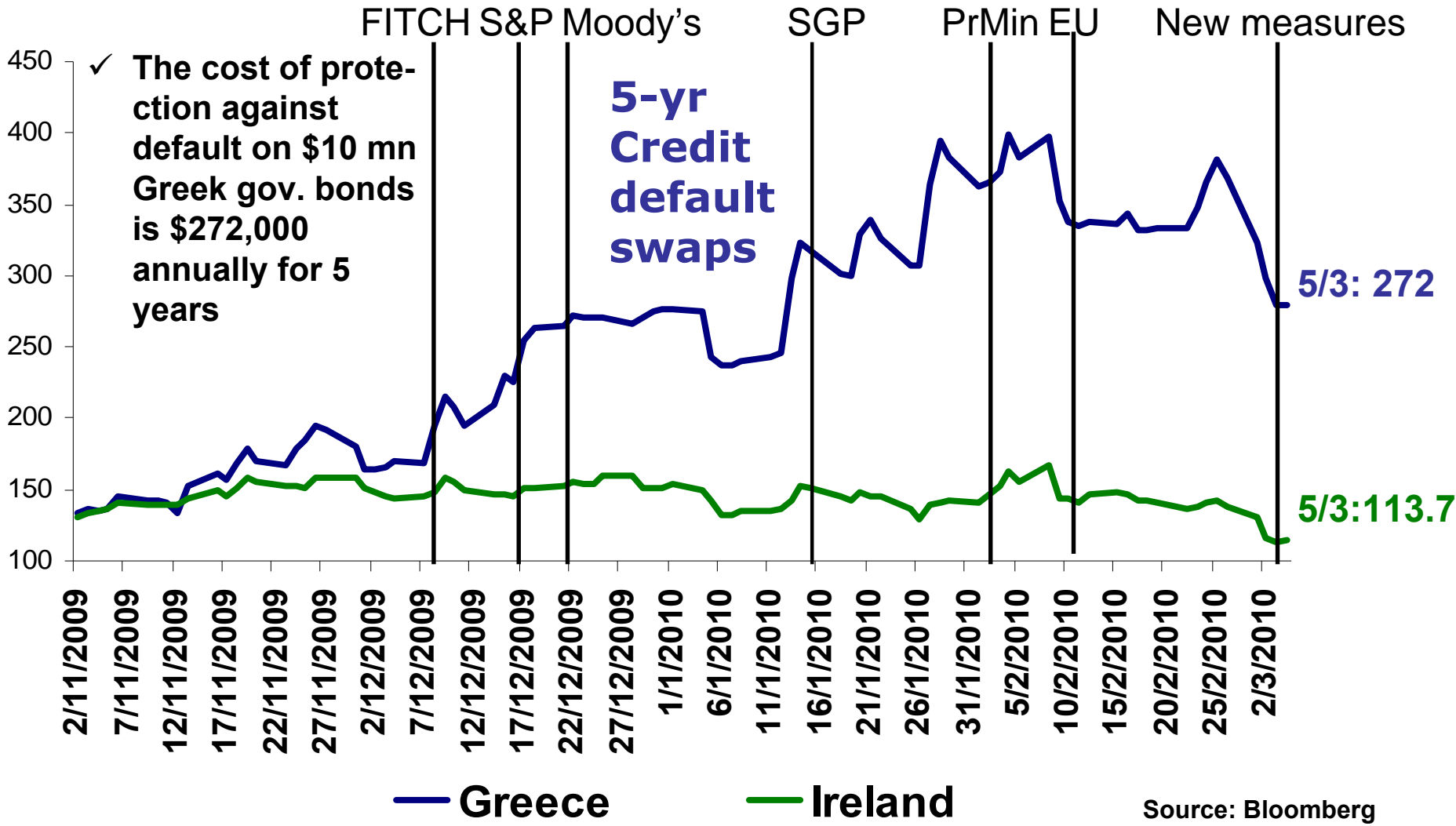


## **III.**

# **IS THE CURRENT RESPONSE ADEQUATE?**

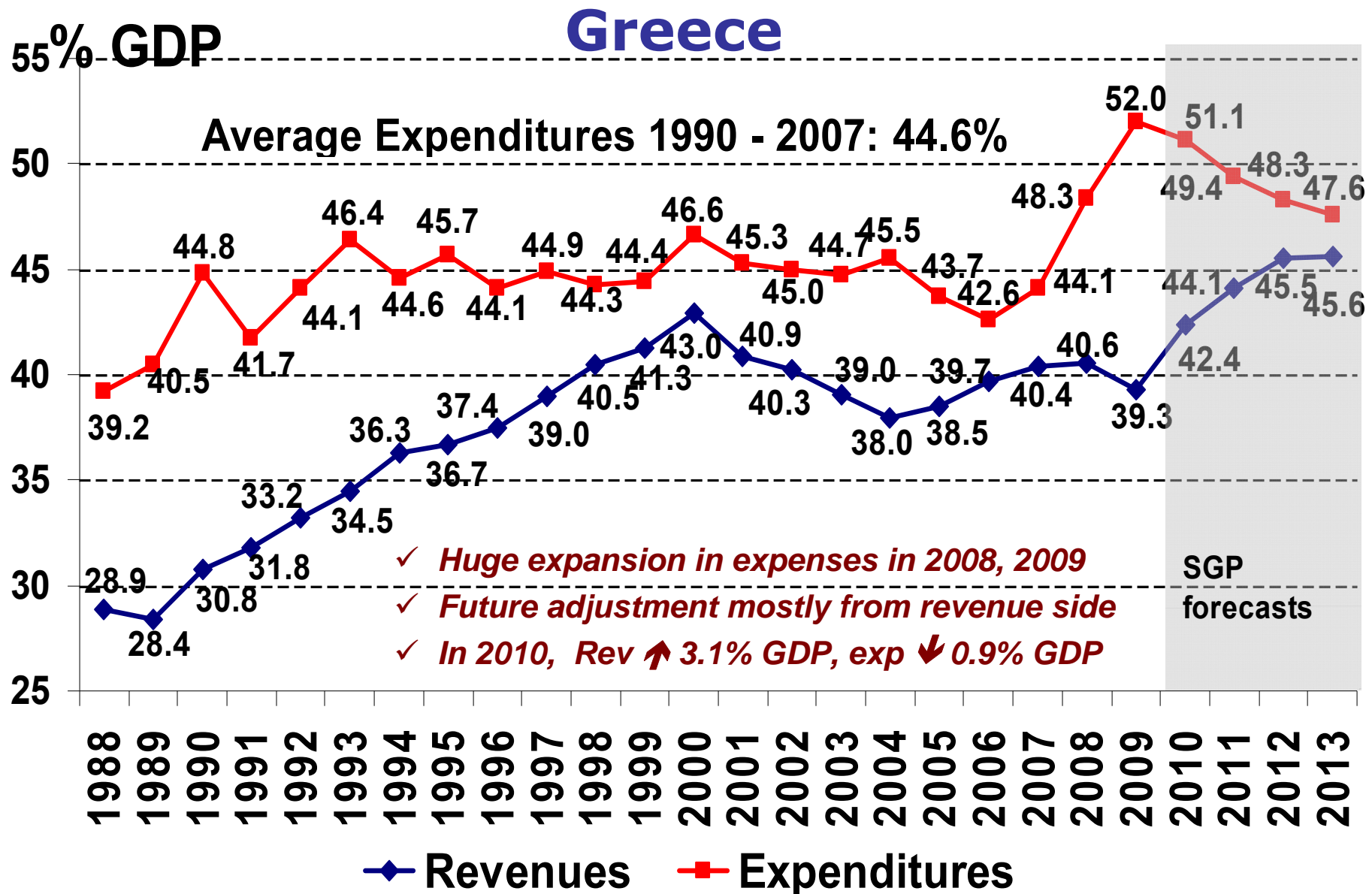
- 1) The gloomy market view**
- 2) Greek SGP and its required revisions**
- 3) When and how can the economy recover?**

# III.1 Markets focused on Greece in early December

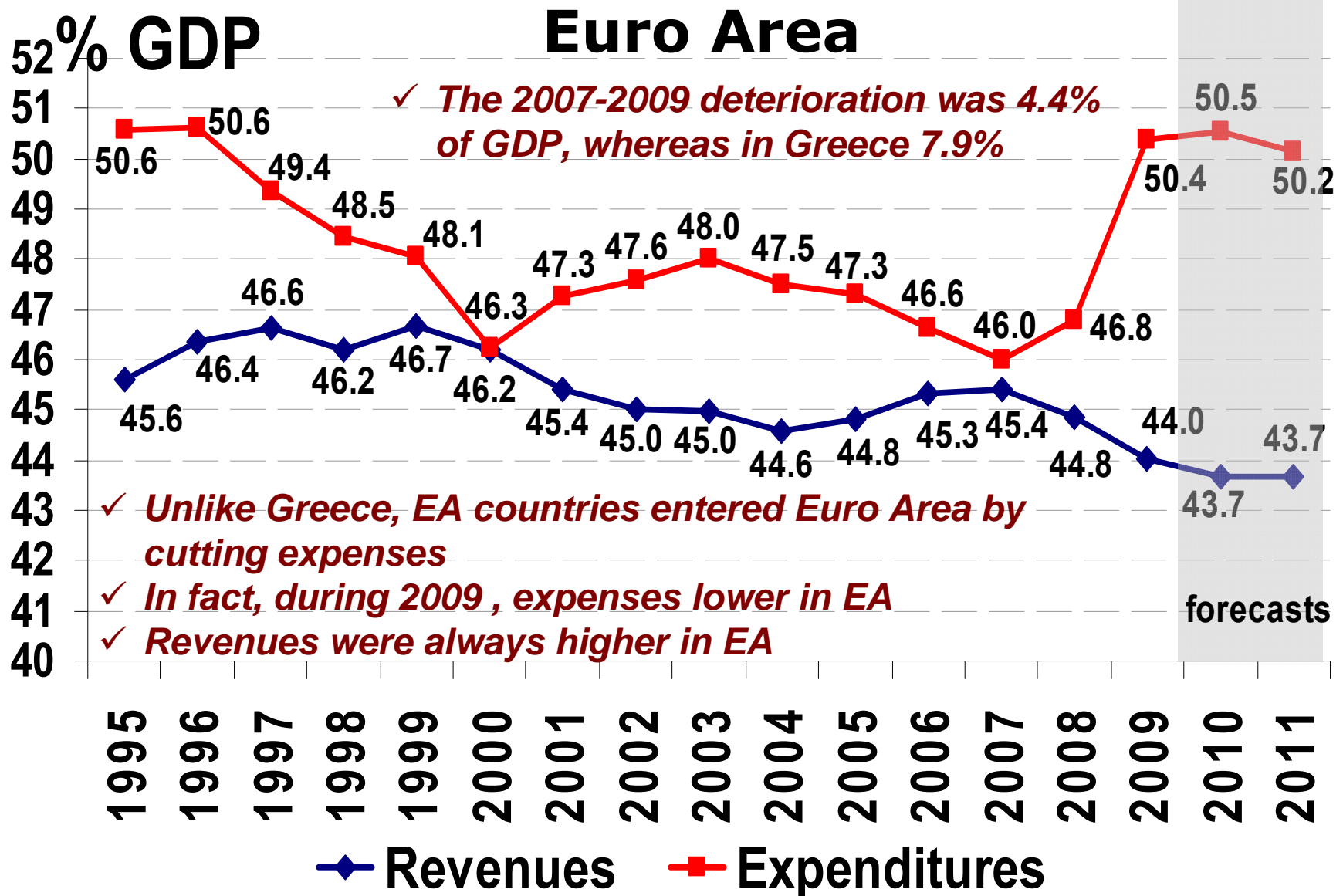


✓ Crisis began after Fitch downgrade and BoG statements on liquidity withdrawal

# III.2 SGP: General Government Revenues and Expenditures



## III.2 Euro Area expenses also show deterioration in 2008, 2009



## III.2 Greek Response: SGP's strong points

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- ✓ Re-designing the budget framework
  - ❖ Single Payments Authority will become operational
  - ❖ Establishment of "fiscal rules" to ensure budget execution
  - ❖ Creation of a 10 percent contingency reserve
  - ❖ Ministries required to submit three-year budgets by end-January
  - ❖ "zero-basis" for the re-evaluation of all applications for funding
  - ❖ Monthly reporting requirements for key ministries
  - ❖ Creation of a Parliamentary Budget Office
  - ❖ National Statistical Agency becomes independent
  - ❖ Use of external auditors in public sector entities
- ✓ Tax reform with tax base broadening and a fight against tax evasion
- ✓ A hiring freeze in 2010, and a 5:1 rule from 2011 in the public sector
- ✓ Pension system reform soon
- ✓ Expenditure switch: More investment and less gov. consumption
- ✓ Privatisation revenues of approximately 2.3 % of GDP per year
- ✓ Willingness to proceed with missed structural reforms and a new export-oriented growth model

## II.5 Greek response: New Fiscal Measures

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### ✓ **Measures announced on February 3rd**

- ❖ Increase in fuel tax rate
- ❖ Wage freeze in the public sector
- ❖ Increase in retirement age

### ✓ **Measures announced on March 3rd**

- ❖ **60% cut** in public employee **14<sup>th</sup> salary**, additional wage cuts (30% cut in overtime pay, abolition of special public-sector committees compensation, elimination of bonuses)
- ❖ **12% cut** in public employee **wage allowances**
- ❖ **Horizontal freeze** in all **state pensions**
- ❖ **VAT rates increase** (21% from 19%, 10% from 9% and 5% from 4.5%)
- ❖ Increase in excise taxes on tobacco products, gasoline, electricity and luxury goods
- ❖ Marginal tax rate on personal incomes in excess of €100k from 40% to 45%.
- ❖ Tax rate on property worth over €5mn will be raised to 2.0% from 0.1%, currently.
- ❖ Effective tax rate applied to real estate owned by offshore companies to 15% from 3%
- ❖ Taxation of church property and income.
- ❖ The public investment budget (PIB) for 2010 will be slashed by €500mn, plus €200mn from Min Education.
- ❖ 1% special levy on individuals that declared incomes in excess of €100k in FY 2009
- ❖ Cuts in special transfers to local governments, other public sector entities, reduced subsidies to OTE and PPC pension funds

## III.3 Recent fiscal measures corrected SGP weaknesses and minimized nightmares

<b>Greek GDP Growth (%)</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Plan A - SGP	<b>-0.3</b>	<b>1.5</b>	<b>1.9</b>	<b>2.5</b>
Plan B - SGP	<b>-0.8</b>	<b>1.0</b>	<b>1.5</b>	<b>2.0</b>
Feasible (Baseline scenario)	<b>-2.8</b>	<b>-0.7</b>	<b>0.5</b>	<b>1.2</b>
Possible (pessimistic)	<b>-4.7</b>	<b>-1.2</b>	<b>0.2</b>	<b>0.8</b>

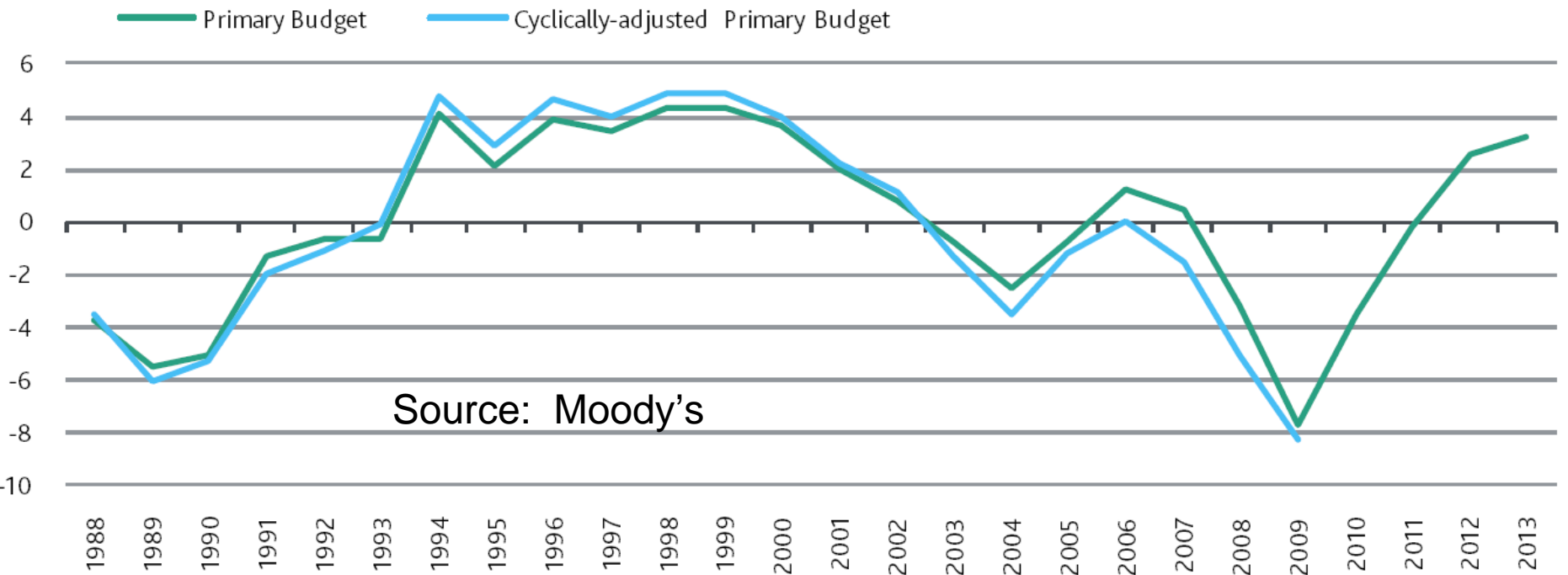
✓ Both scenarios assume the recovery is back in H2-2011

<b>Greek Gen. Gov. Debt (%GDP)</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
SGP (Plan A & B)	<b>120.4</b>	<b>120.6</b>	<b>117.7</b>	<b>113.4</b>
Feasible* (baseline scenario)	<b>124.1</b>	<b>130.5</b>	<b>132.6</b>	<b>133.1</b>
Primary surplus	-3.5	-1.3	1.7	2.4
Possible (pessimistic)	<b>127.7</b>	<b>135.1</b>	<b>137.8</b>	<b>139.4</b>
Primary surplus	-4.8	-1.6	1.6	2.1

\* Without new additions from calling to honor past guarantees of €26 bn or 11% of GDP

✓ **Implementation risks are high and the length of the recession unknown**

# III.3 A balanced recent view from Moody's



✓ **Moody's released an assessment on March 3 defending its A2 rating with a negative outlook**

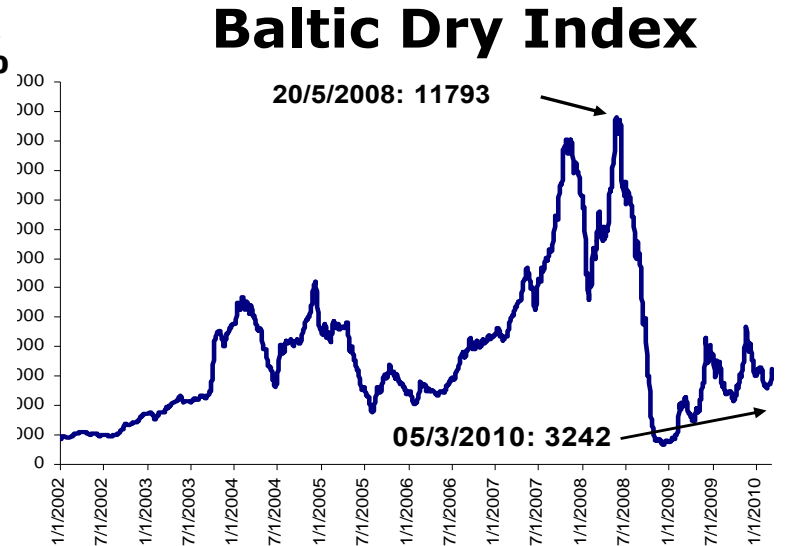
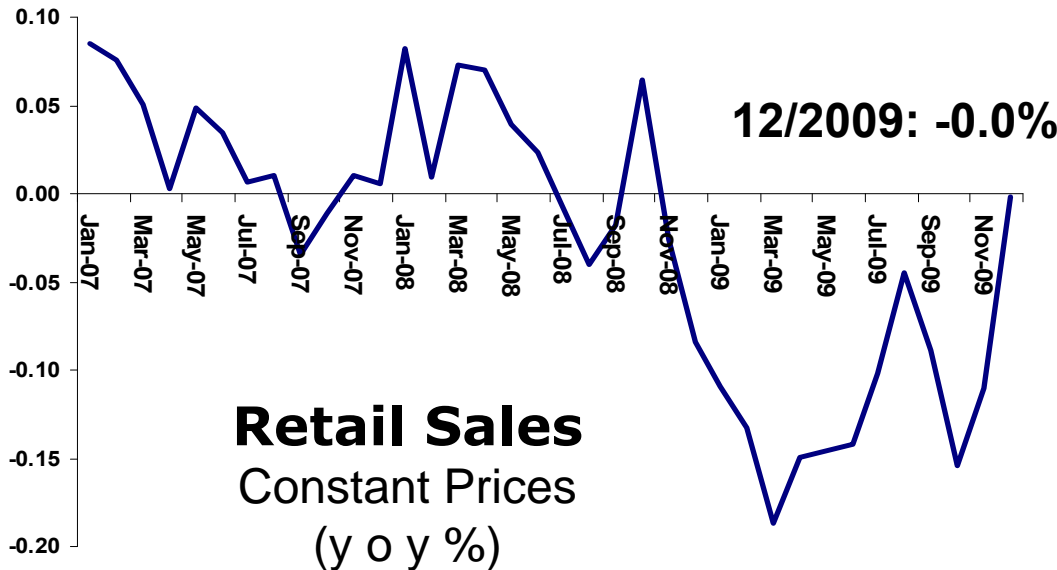
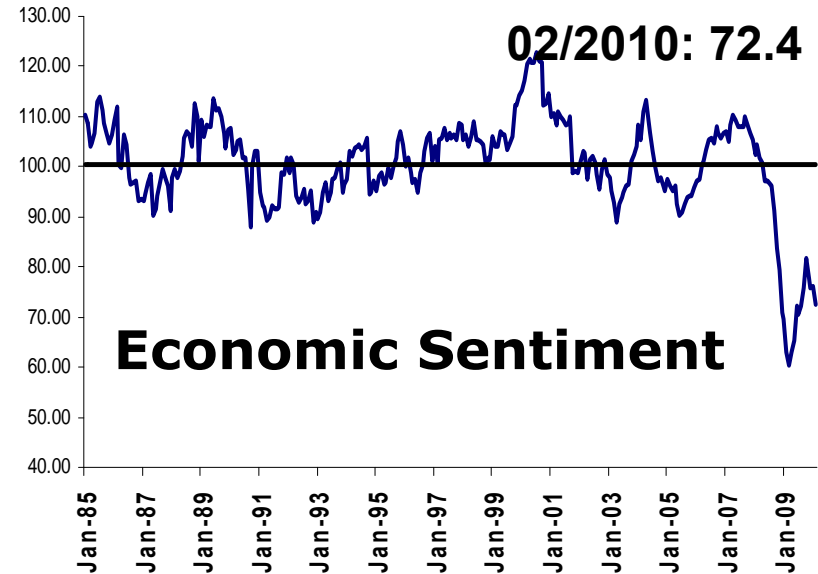
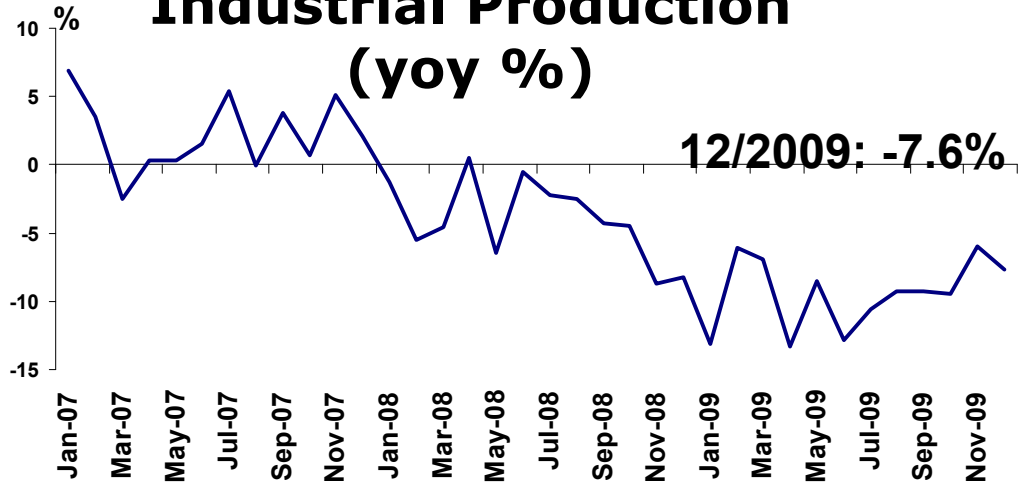
✓ **It will closely watch the size of the primary balance and within a couple months know if it is going to downgrade Greece further**

- » The country is rich although the government is rather poor.
- » Greece's membership of the Eurozone – while forcing it to make economic adjustments through painful internal devaluation and difficult productivity increases – is sheltering the country from external payment crises that might typically affect other A-rated countries (like Korea or Poland).
- » Short-term liquidity risk is very limited.
- » Greece's creditworthiness faces a risk of long-term erosion given the need to deleverage the economy (starting with the public sector) in a context of weak competitiveness and slow regional growth.
- » The additional fiscal measures announced by the Greek government on 3 March 2010 are consistent with the current A2 rating and are a clear manifestation of the government's resolve to regain control of public finances. These measures increase the probability of debt stabilization provided that they, and the other previously announced policy measures, are fully implemented.



# III.3 When will Greece recover?

## Industrial Production (yoy %)



Sources: ECOWIN, Bloomberg

## **IV. Conclusions**

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- ✓ **A weak global recovery in 2010 and lower world growth in the next 5-7 years with strong pressures on international banking**
- ✓ **The crisis was imported in the region in 2008Q4, yet it uncovered the two major imbalances of the Greek economy, the lack of competitiveness and the lack of fiscal discipline**
- ✓ **The EU supervision plus the market pressure are likely to trigger the structural reforms the country never dared to undertake before**
- ✓ **The Greek SGP put an anchor on economic policies but required major correction, which took place in early March**
- ✓ **Bond spreads are unlikely to rise unless fiscal implementation lags behind its targets**
- ✓ **More fiscal measures may be needed if revenues do not materialize**
- ✓ **A consensus for mutual sacrifices is required among Greek households and business owners**
- ✓ **Politicians ought to reform themselves and begin viewing the state not as a source of political perks and benefits but as a engine to be managed**
- ✓ **Competitiveness will be established only when the state sector becomes efficient, complementing rather than fighting the private sector**