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DURING THE LAST TEN YEARS, GREECE HAS BECOME MORE TIGHTLY LINKED TO THE OUTSIDE WORLD. ITS DEGREE OF OPENNESS HAS RISEN FROM 43% IN 1995 TO 49% IN 2005 (FIGURE 1), REFLECTING AN EXPANSION OF EXPORTS INTO CENTRAL AND SOUTH-EAST EUROPE. THOSE EXPORTS REPRESENT OVER A QUARTER OF TOTAL GREEK EXPORTS (FIGURE 2).

Greece and Global Expansion

BY PROF. GIKAS A. HARDOUVELIS

Greece's connection to Europe was also enhanced by its Eurozone membership. Greek financial markets are integrated into the European markets, interest rates are practically the same as in the EU-12 and foreign financial investors are the key players in the domestic stock and bond markets. Greece is, therefore, affected more by the world economy today than in the past.

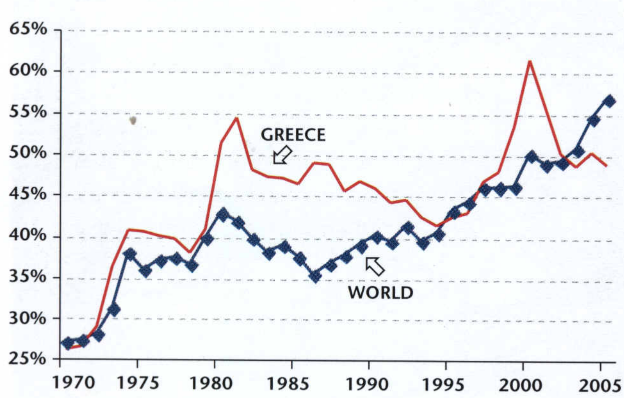
Over the last four years, world-wide economic growth has been above the historical average of 3.4% of the last 30 years. This growth is diversified across the globe, characterizing both developed and developing countries and is forecasted to continue. Figure 3 presents the IMF's 2007 forecasts for a representative sample of countries. It is not just China, India, Brazil, Russia or Eastern Europe that are expected to continue growing fast. The developed economies of Western Europe, the United States and Japan also show remarkable growth strength.

Presently, there is concern about a bigger than anticipated slowdown in the U.S., but there the problem is domestic, driven by the U.S. housing market, which is not expected to spill over to the rest of the world. The U.S. importance as a destination of individual countries' exports has diminished over the years. Similarly, Greece is not directly affected by U.S. developments, as its export share to the U.S. is small (Figure 2).

There are other risks to the benign 2007 world growth scenario, which originate from the unusually large U.S. current account deficit (7.1% of GDP) and the possibility that surplus countries may stop financing it, generating a run on the dollar and a rise in U.S. long-term yields, which may subsequently push European yields up, with a simultaneous run on emerging markets' stocks and bonds. A financial meltdown can have serious repercussions, first on the Greek stock market, which behaves like an emerging market, and later on the economy, through reduced exports and tourist receipts. But the probability of such an abrupt event in 2007 is small, plus policy makers across the globe are watching closely in order to take the necessary corrective actions.

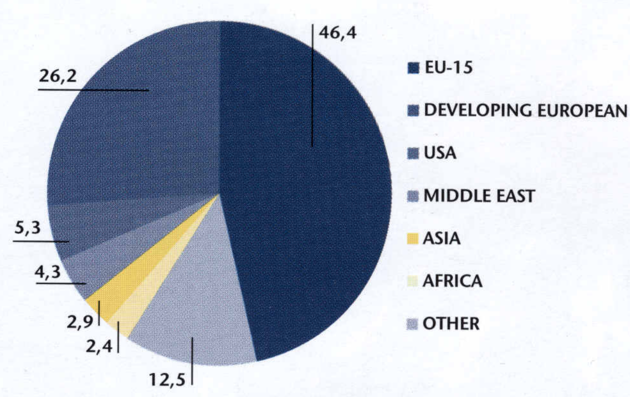
The benign external environment should continue boosting Greek exports and tourist receipts, which lately have shown substantial strength. On the domestic front, consumption should continue leading demand, despite the gradually higher nominal in-

Figure 1
Openness: Trade as a percent of GDP



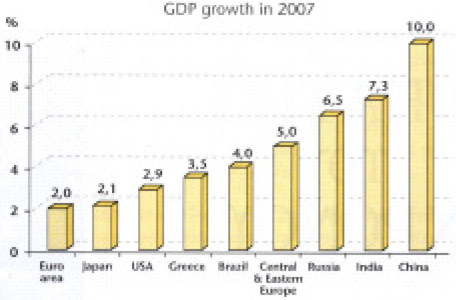
Source: Author's calculations, World Bank, National Statistical Service of Greece

Figure 2
Percentage Distribution of Greek Exports (2004-2005)

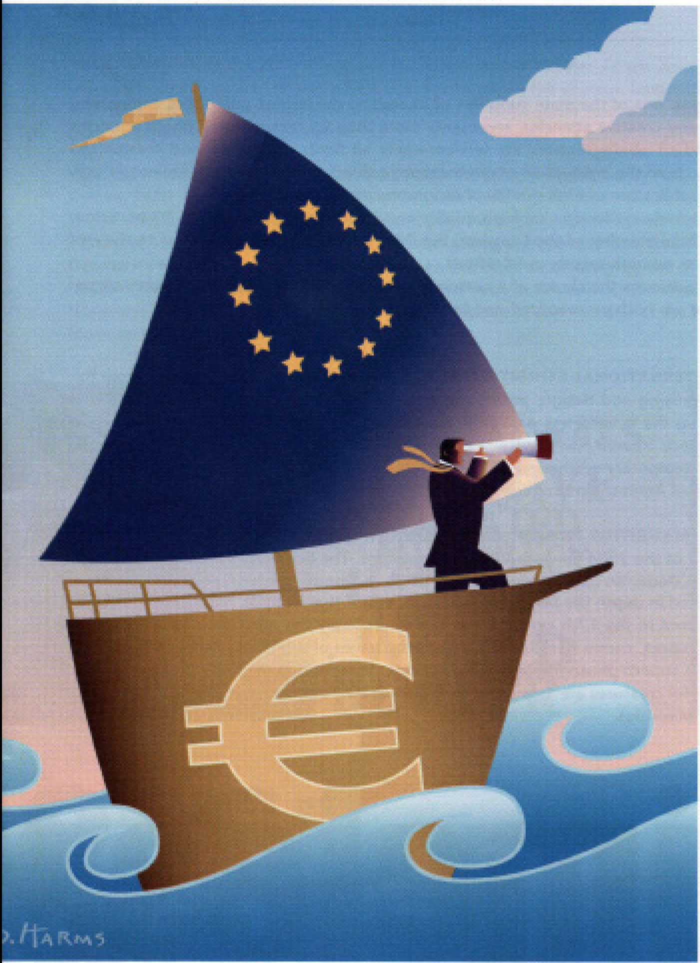


Source: Author's calculations, IMF Direction of Trade Statistics

Figure 3
GDP growth in 2007



Source: IMF World Economic Outlook, September 2006



terest rates by the ECB. Eurozone interest rates simply represent a small upward adjustment to normal levels, plus real—inflation-adjusted—interest rates in Greece continue to stay at historical lows. Investment, which was the leading component of growth during the Simitis years of 1996-2003, is more of a question, as during the last two years, public investment suffered severe budget cuts, the execution of projects under the EU structural funds lagged way behind schedule, real estate investment cooled down over the past summer, and the recently-announced drastic upward revision of the GDP numbers by approximately 25% seriously threatens the future inflow of EU funds. But given the strength of the external sector, the low real interest rates, and the loose stance of fiscal policy, growth in 2007 should reach the IMF forecast of 3.5% and perhaps surpass it.

Yet the real risks for Greece are longer term and are serious. The recent abrupt rise in the current account deficit to the record level of 11% of GDP provides an ominous warning on the country's deteriorating competitiveness. Eurozone membership immunizes Greece from financial crises—for example, a drachma devaluation and an interest rate upheaval would have taken place by now, given the huge current account deficits. But the absence of a crises induces a hypnotic absence of market discipline on policy makers, enabling them to shy away from taking the proper fiscal and microeconomic actions on time, always postponing unpopular decisions to the future. Structural reforms in the public sector, the pension system, or the functioning of markets, as well as fiscal discipline are now more necessary than ever. Policy making should replace politicking around the GDP revisions. The latter can only hurt in the medium run.

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