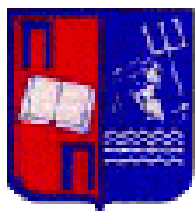


# ***A Decade-Long Economic Crisis: Cyprus vs. Greece***



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# TABLE OF CONTENTS

## A Decade-Long Economic Crisis: Cyprus vs. Greece

**I. Two countries, two different stories**

**II. Why so different?**

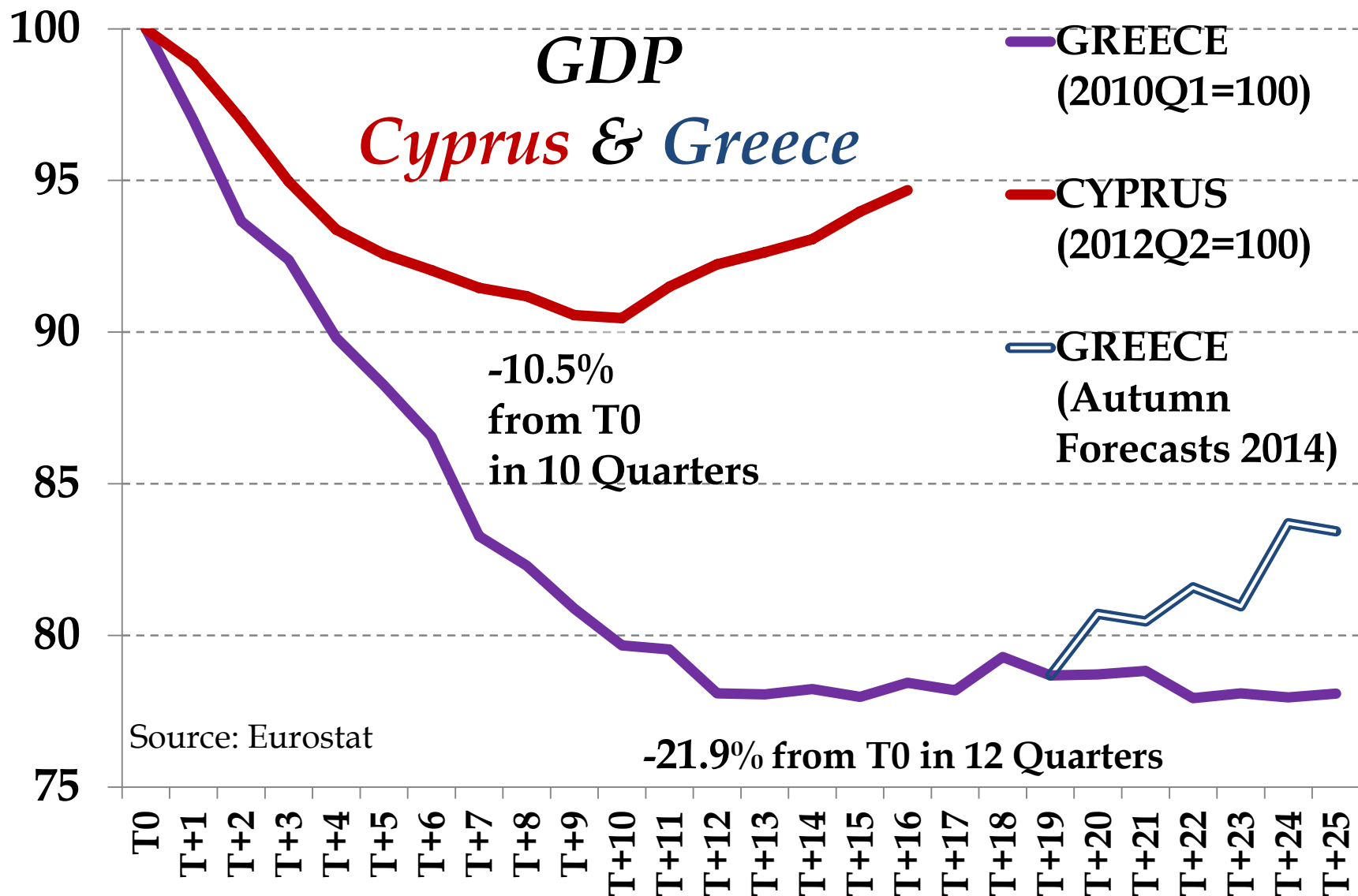
1) Differences **prior to the rescue** package

2) Different policy responses **after the rescue**

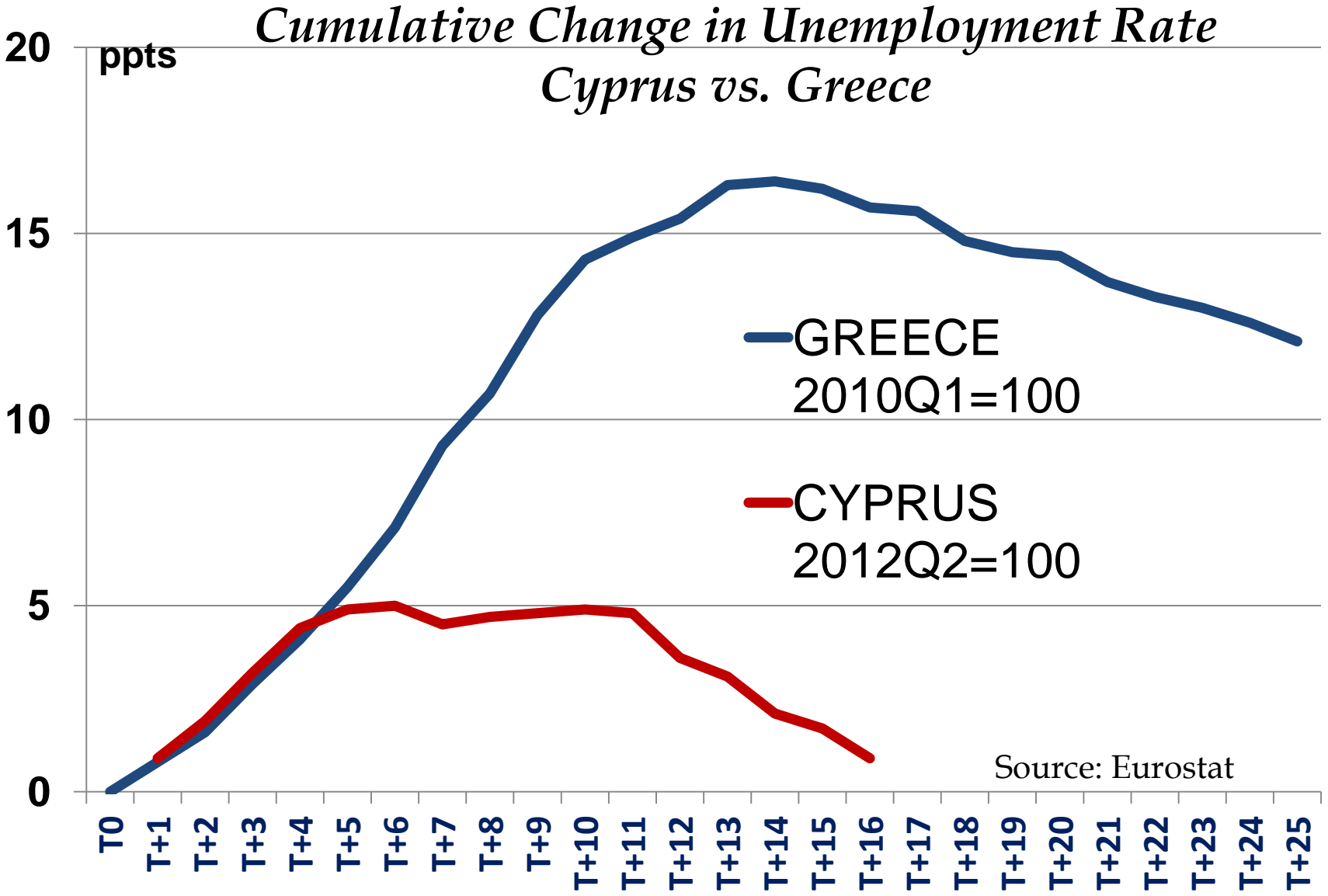
**III. Common risks today**

**IV. Concluding remarks**

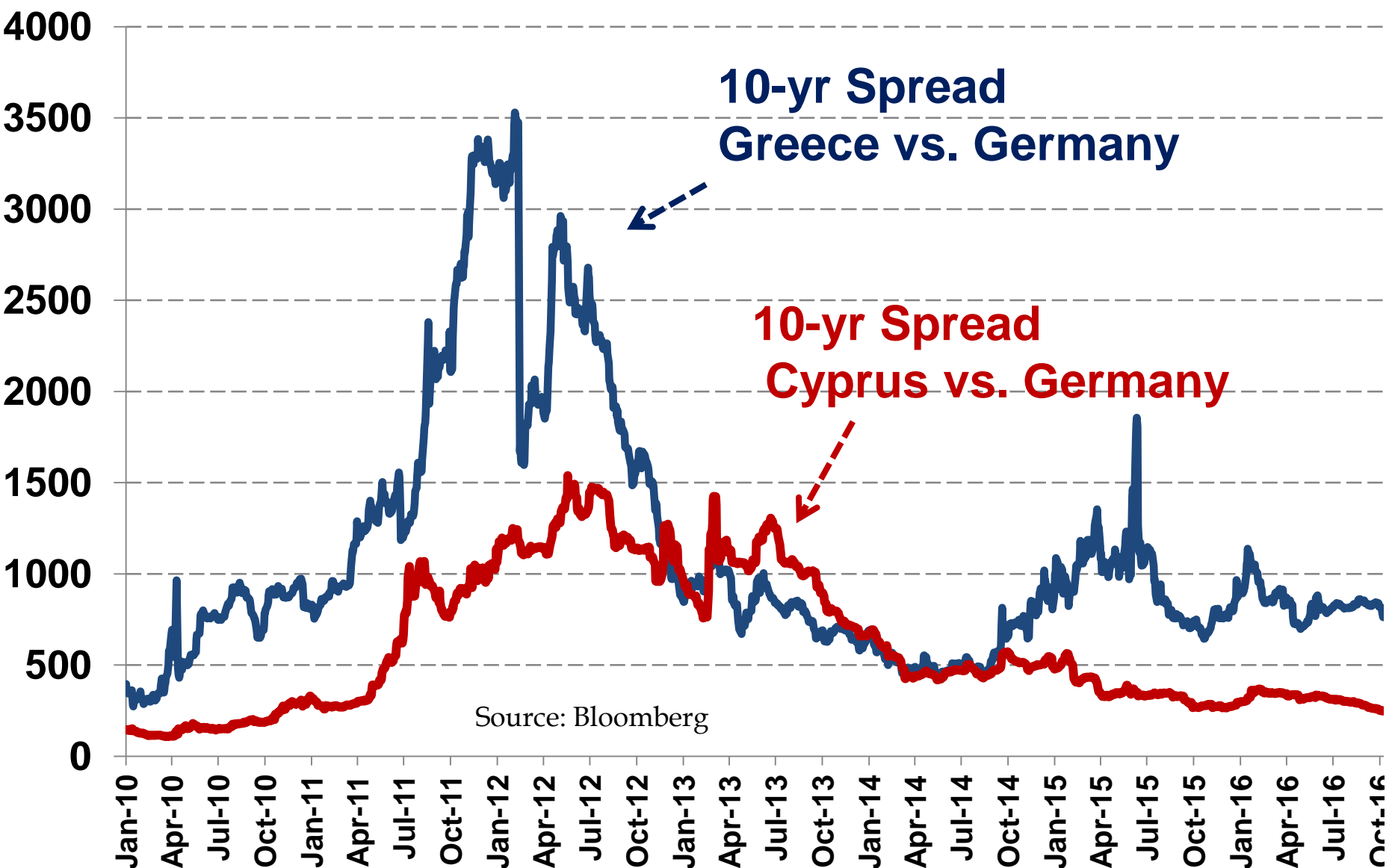
# I. A very different economic trajectory: Small loss in Cyprus, huge loss in Greece



# I. A very different economic trajectory: Unemployment back to its pre-crisis level in Cyprus

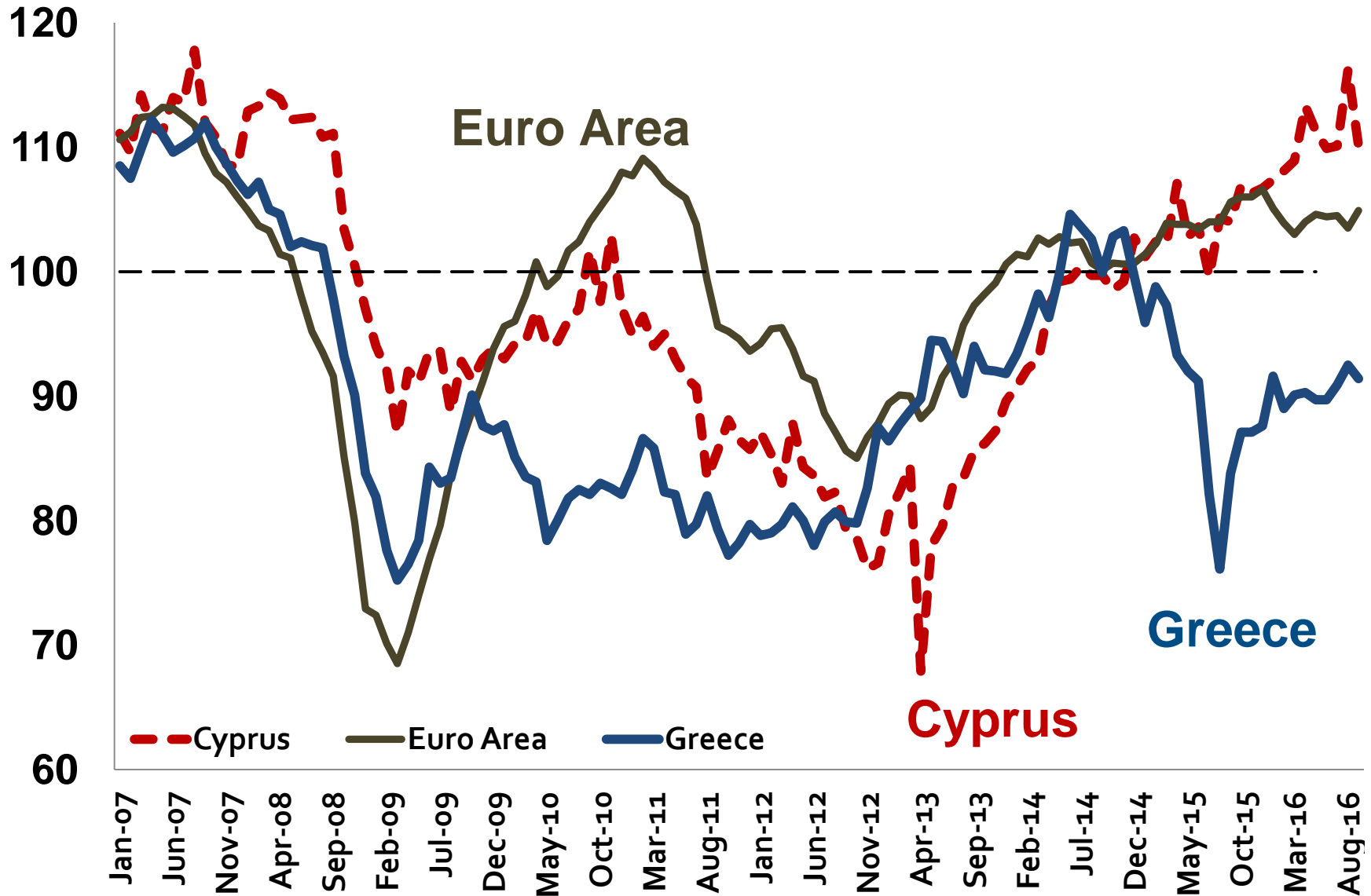


# I. A very different economic trajectory: Country risk is lower in Cyprus



Source: Bloomberg

# I. A very different economic trajectory: Optimism in Cyprus, decoupling in Greece



# I. Hence ... different policy targets today

## CYPRUS

- ❑ Escaped the crisis without losing its international competitive advantages
- ❑ Can afford to focus on its long-term growth path
- ❑ Major long-term risks: high NPLs, low investment

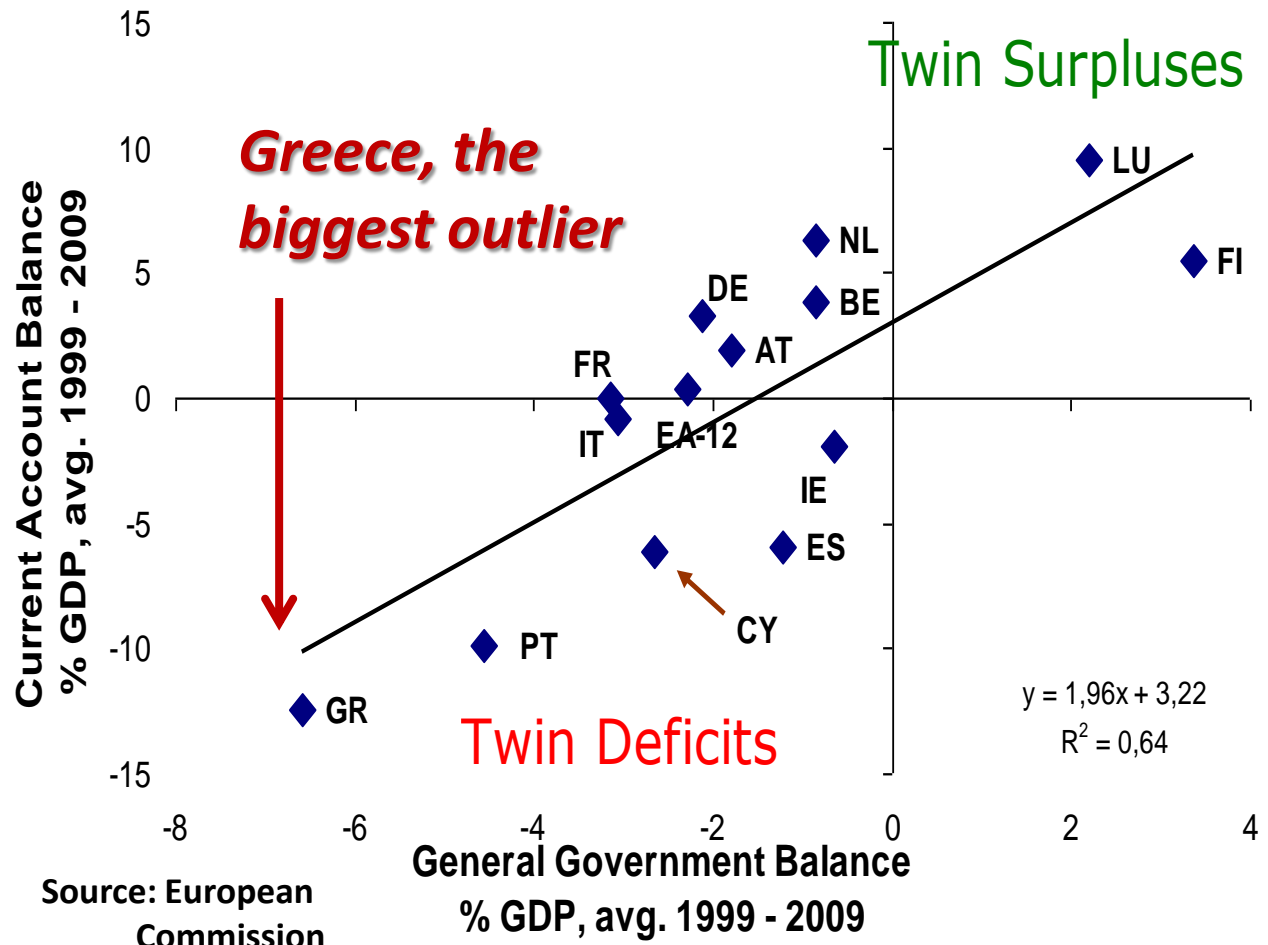
## GREECE

- ❑ Still in recession, in a 3<sup>rd</sup> Program, no ownership of reforms, excluded from QE, unable to access financial markets
- ❑ Hopes for a cyclical recovery
- ❑ For the Long-term:
  - Public debt is unsustainable since 2015
  - A new policy of Over-Taxation since 2015 constrains long-term growth
  - Has no specific plan for long-term growth, no credibility and appears hostile to FDI
- ❑ Major long-term risks: high NPLs, low investment

# II.1 WHY? Differences prior to the rescue package

## Comparison across the Euro Area

Eurozone Years up to the Greek Crisis



- ❑ Market failure:  
Markets ignored the differences between countries and lent easily to both private & public sector
- ❑ Two major imbalances, fiscal & external competitiveness
- ❑ Greece was an outlier in the Euro Area, carrying twice the imbalances of Cyprus

- ❑ Other imbalances: Private sector credit. Cyprus has a problem, Greece no



## II.1 Differences just prior to the rescue package

<b>Initial Conditions</b>	<b>Greece</b> (April-May 2010 or 2009)	<b>Cyprus</b> (March 2013 or 2012)
<b>Primary Balance (% GDP)</b>	<b>-10.3%</b>	<b>-2.9%</b>
<b>General Gov. Balance (% GDP)</b>	<b>-15.2%</b>	<b>-5.8%</b>
<b>Gross Public Debt (% GDP)</b>	<b>127%</b>	<b>79%</b>
<b>Current Account Balance (% GDP)</b>	<b>-12.3%</b>	<b>-6.0%</b>
<b>Doing Business Distance to Frontier</b> (best = 100)	<b>62.4 (2010)</b>	<b>69.1</b>
<b>REER (ULC total economy deflated, 1999Q1 = 100)</b>	<b>123</b> (2010Q1)	<b>110</b> (2013Q1)
<b>Private Sector Debt (% GDP)</b>	<b>117%</b>	<b>328%</b>
<b>Banks Assets (% of GDP)</b>	<b>213%</b>	<b>750%</b>

- 1) **Differences in Fiscal statistics: Greece in worse position**
- 2) **Differences in Competitiveness statistics: Greece in worse position**
- 3) **Differences in Financial sector statistics: Cyprus in worse position**

## **II.1 More Differences prior to the rescue package**

### **4) Crisis arrived in Cyprus 2 to 3 years after it arrived in Greece**

- a) Later crisis-outbreak made Cyprus worse-off because:**
  - **European economy was growing in 2012-13**
  - **in 2012-13 Europe had developed defense mechanisms (ESM, Banking Union, etc) and was not worried about contagion**
- b) Later crisis-outbreak made Cyprus better off because:**
  - **Cyprus had the benefit of hindsight, observing earlier crisis-hit countries: Greece, Ireland, Portugal, and even Spain**

### **5) Speed in concluding the negotiations**

- **Greece concluded the details of the MOU and signed in a month**
- **Cyprus applied in June 2012 and signed in March 2013**

### **6) Different government relations with the central bank**

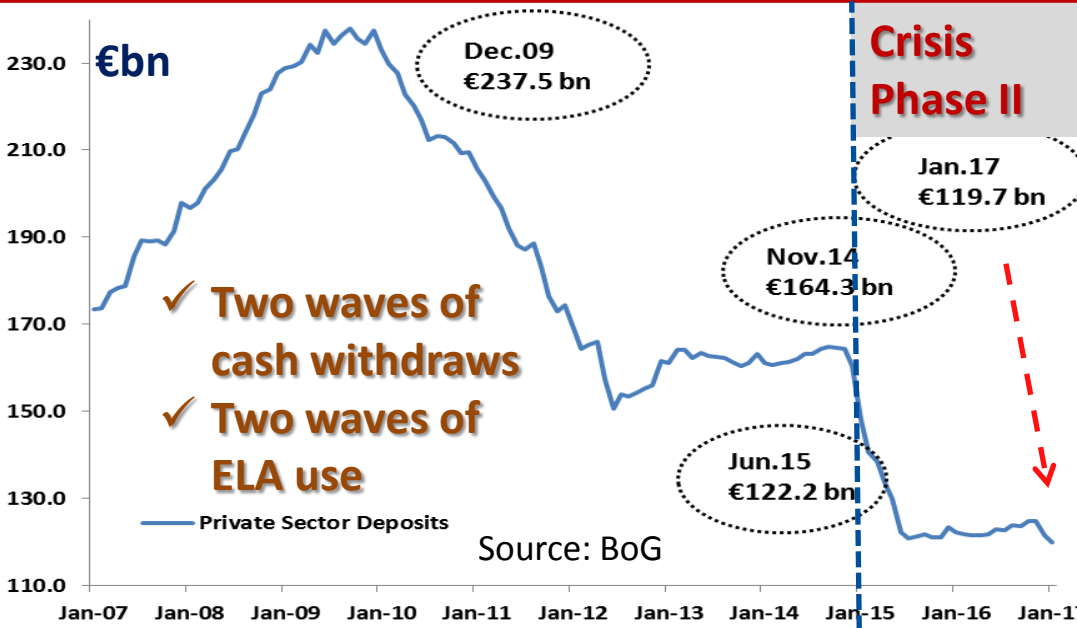
### **7) Different types of political parties in power**

## II.2 Differences in policy responses

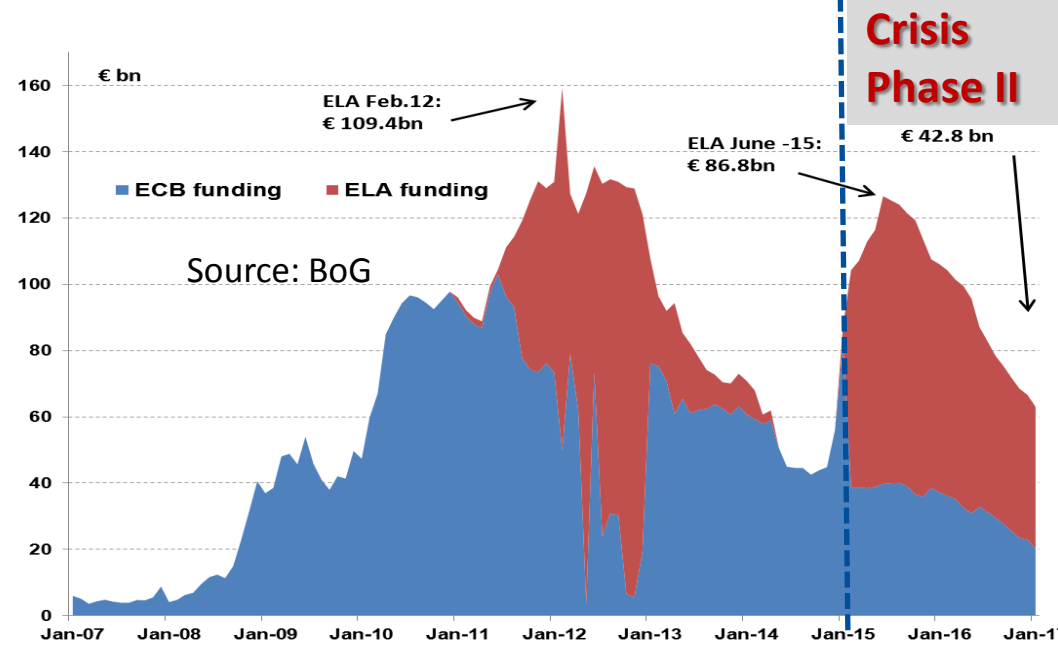
- ❑ **Lenders' policy response: Harsh on Cyprus, lenient on Greece**
  - ❖ **In Cyprus, a Bail-in with immediate capital controls**
    - **loss of wealth, yet primarily by foreigners**
    - **lower public debt due to the bail-in**
  - ❖ **In Greece, a Bail-out with the PSI delayed by 1.5 years**
    - **Greek debt unsustainable after Crisis-Phase II**
- ❑ **Domestic policy response: Very different**
  - **Program ownership in Cyprus, absent in Greece**
  - **Capacity to implement reforms in Cyprus, not so in Greece**
  - **Timely implementation of reforms in Cyprus**
  - **Package of fiscal measures were front-loaded in Cyprus**
  - **Cyprus exited the program in three years, Greece had a Phase II version of the crisis in 2015 just after its economy had picked up momentum and was ready to exit its MoU**

# II.2 Crisis-Phase II in Greece

- A second wave of cash withdrawals in 2015 plus a disappearing inter-bank market leads banks to ELA:
  - ELA was zero at the end of 2014, yet it peaked again in 2015
  - It remains at €43bn today
  - Capital controls still imposed
  - Unless credibility returns, cash will stay outside the banks
  - After re-introduction of ECB waiver in July 2016, gradual improvement in ELA dependence



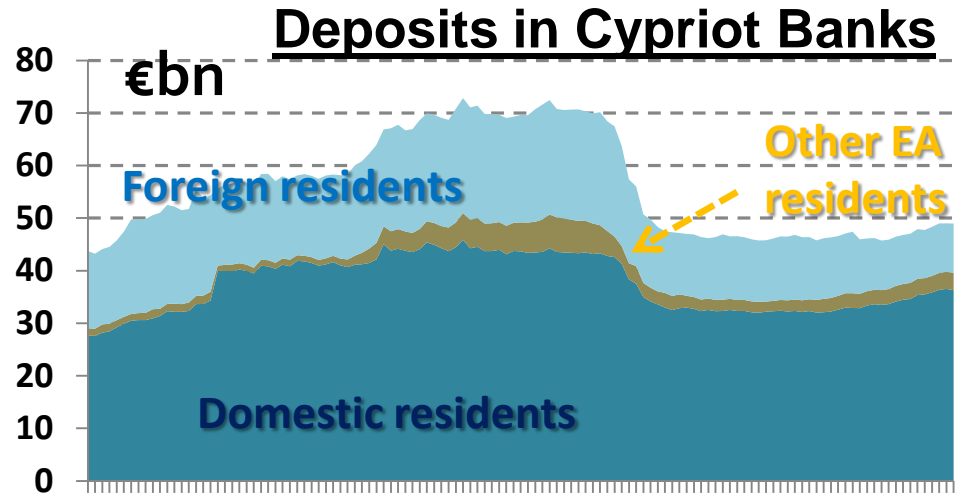
- Bank stock prices collapsed in 2015H1, State lost over €25bn in value, and a necessary 3<sup>rd</sup> recapitalization in Nov 2015
- State owner-ship of systemic banks shrank: NBG (40.4%), Piraeus (26.4%), Alpha (11.0%), Eurobank (2.4%)
- Capital (excl. CoCos & Prefs) strong, yet depends on DTA, 49% of €8.92bn in Alpha, 64% of €7.89bn in Piraeus 66% of €7.74bn in NBG, 78% of €6.25bn in Eurobank



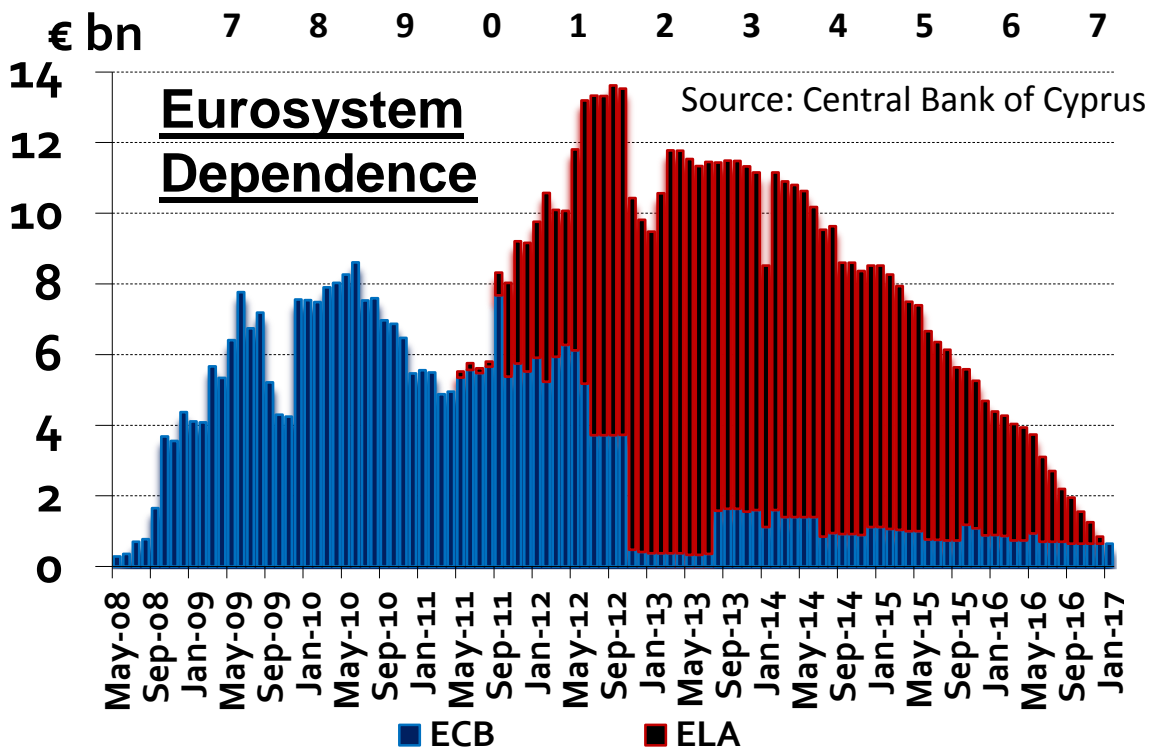
# II.2 In Cyprus deposits return and Euro-system dependence is again minimal

Contrary to Greece, the liability side of Cypriot banks' balance sheet has recovered

- Resident deposits have begun to increase
- Overall Eurosystem dependence at pre-2008 levels with ELA at zero

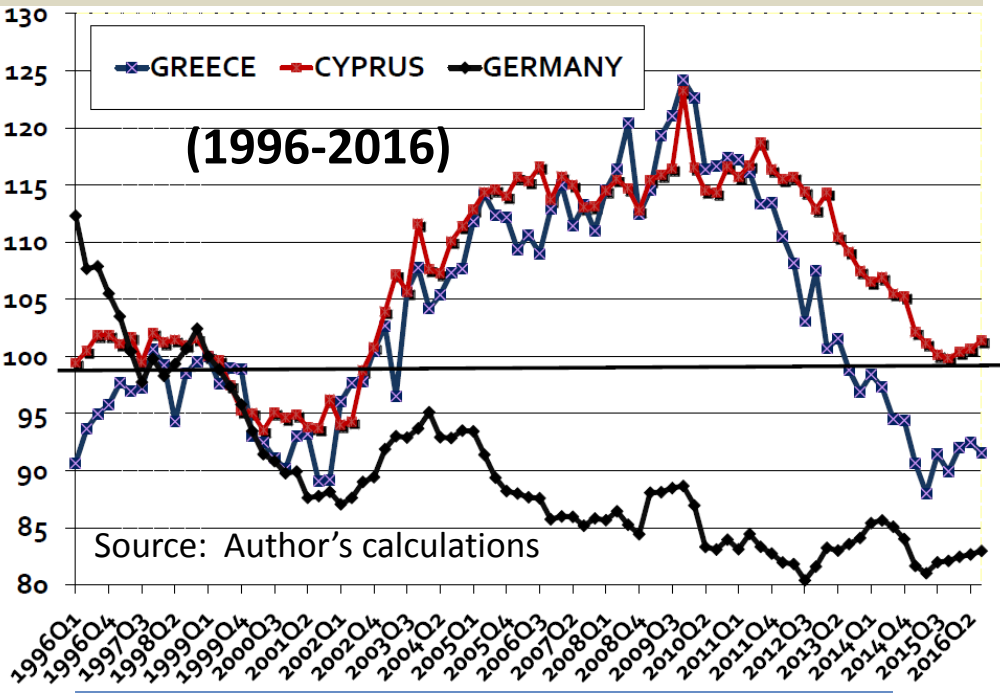


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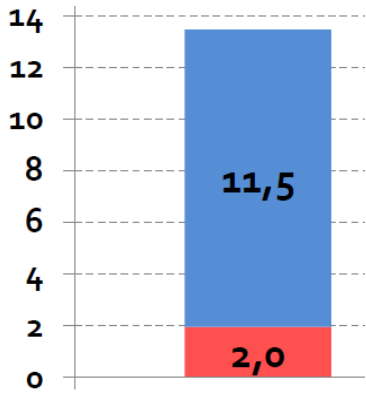


# II.2 Cost competitiveness improves, yet exports' performance differs with Greece being the outlier

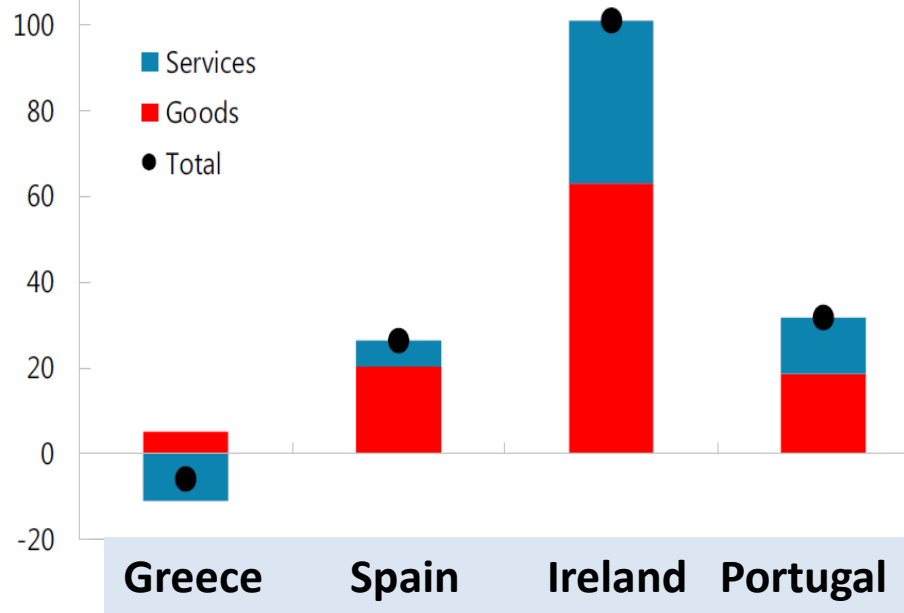
## Wage Cost Competitiveness Real Effective Exchange Rate



## Exports 2015 as % of 2008



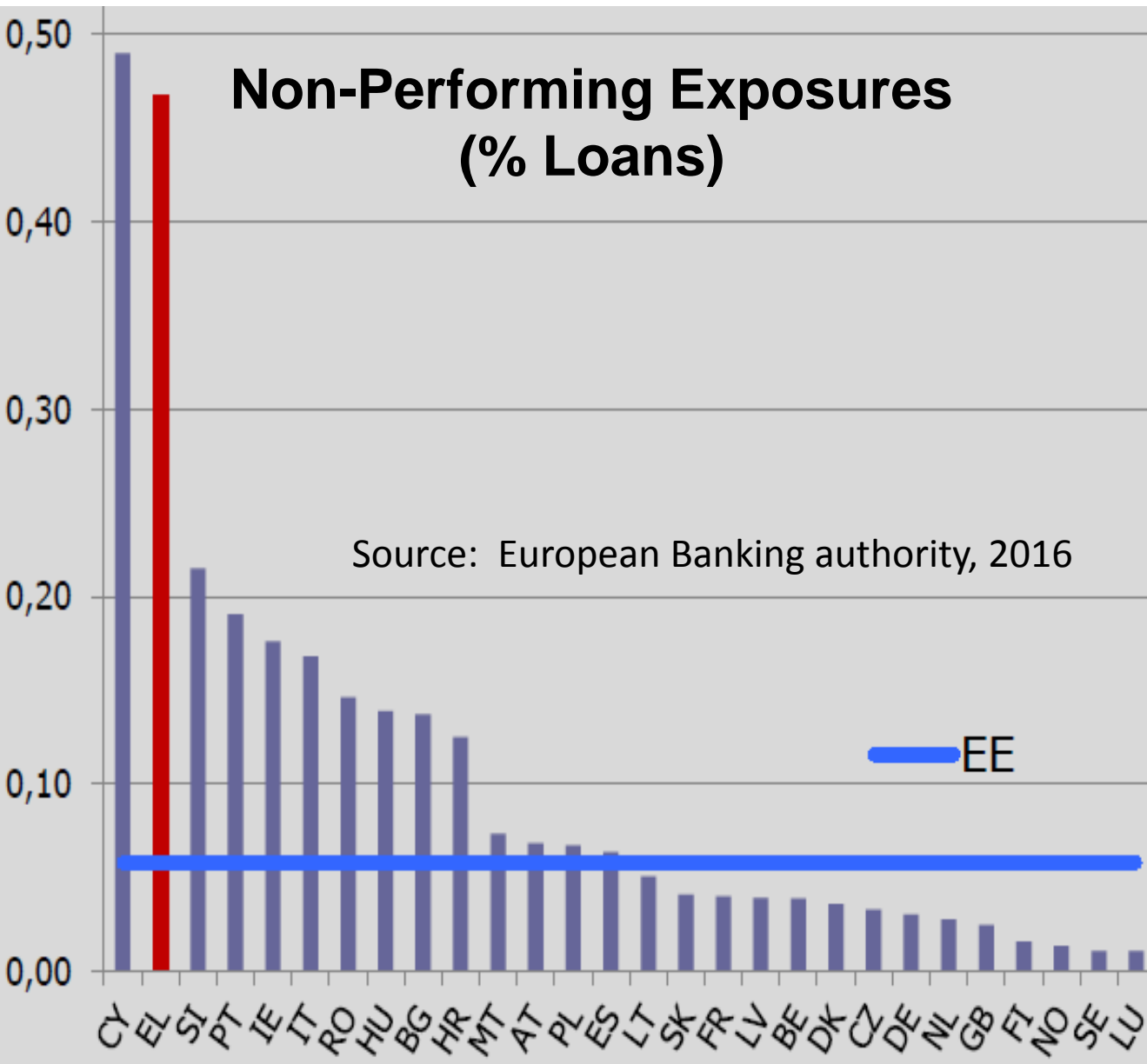
Source: Author's calculations



Source: IMF

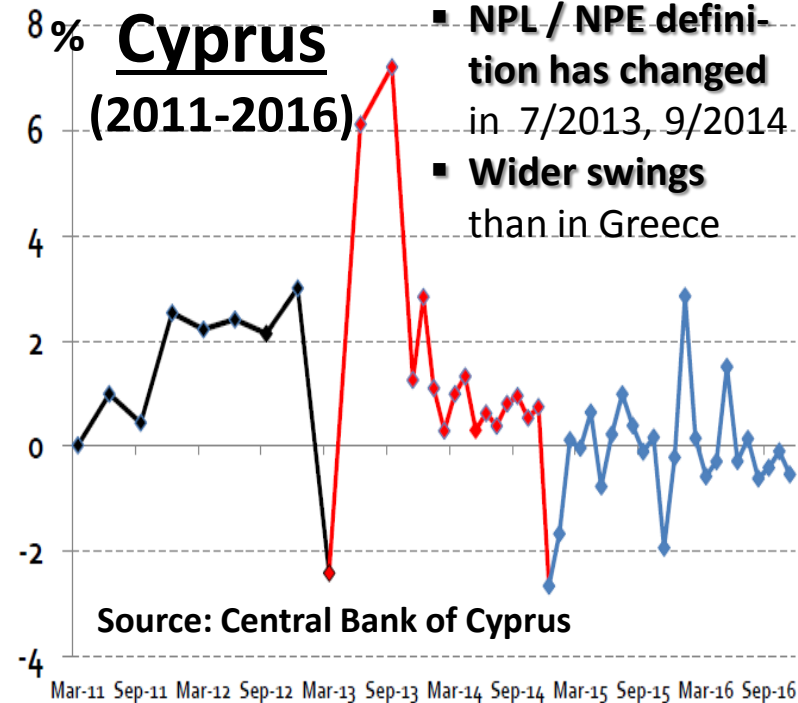
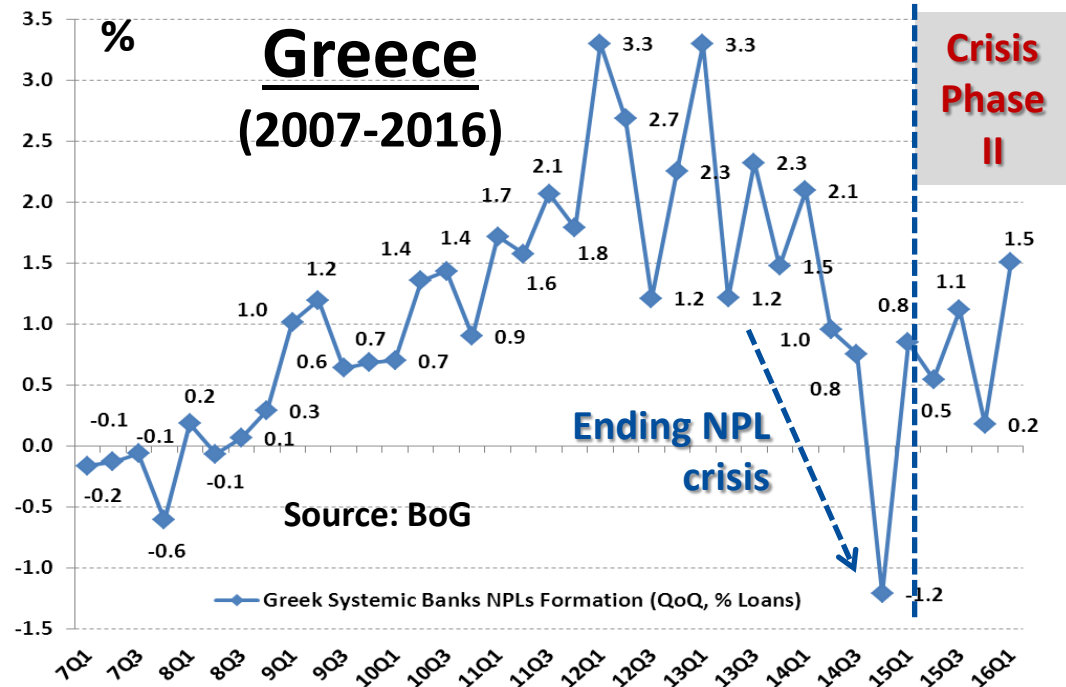
Greece is the only Program country showing lower value of exports in 2015 relative to 2008 (see EC "The Puzzle of Missing Greek Exports.") Yet, this is partly due to the drop in the price of oil, which represents about 30% of Greek exports. Ships are also affecting the value of services, which were affected by capital controls.

# III. Common risks today: Non-Performing loans



- ❑ Huge NPE problem in Cyprus & Greece
  - Due to a banking crisis in Cyprus
  - Due to a fiscal crisis in Greece
- ❑ Slovenia, Portugal, Ireland, Italy, the next problematic countries
- ❑ Then Romania, Hungary, Bulgaria, Croatia

# III. NPLs over time: Still a problem in Greece



## □ In Greece, NPLs still increase

- NPL improvement of late 2014 was reversed due to Phase-II of the crisis
- Target NPL reduction of 40% until 2019, yet legal obstacles continue (out-of-court settlement still pending, legal responsibilities of bankers, etc.)
- Economy does not help

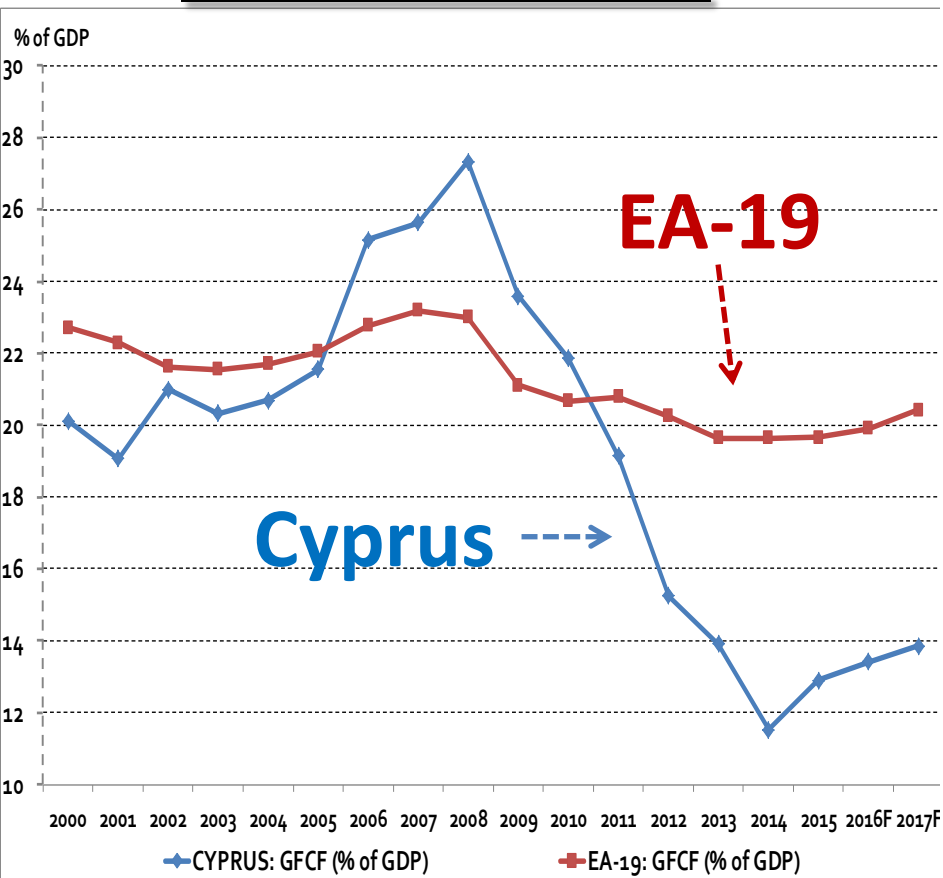
## □ In Cyprus, NPLs are declining

- Banks aggressive in pursuing NPL reduction (debt-to-asset swaps, write-offs)
- Insolvency-foreclosures framework in place since April 2015 (part of MoU), intense restructuring effort (internal units-importing know-how early on)
- Economy helps

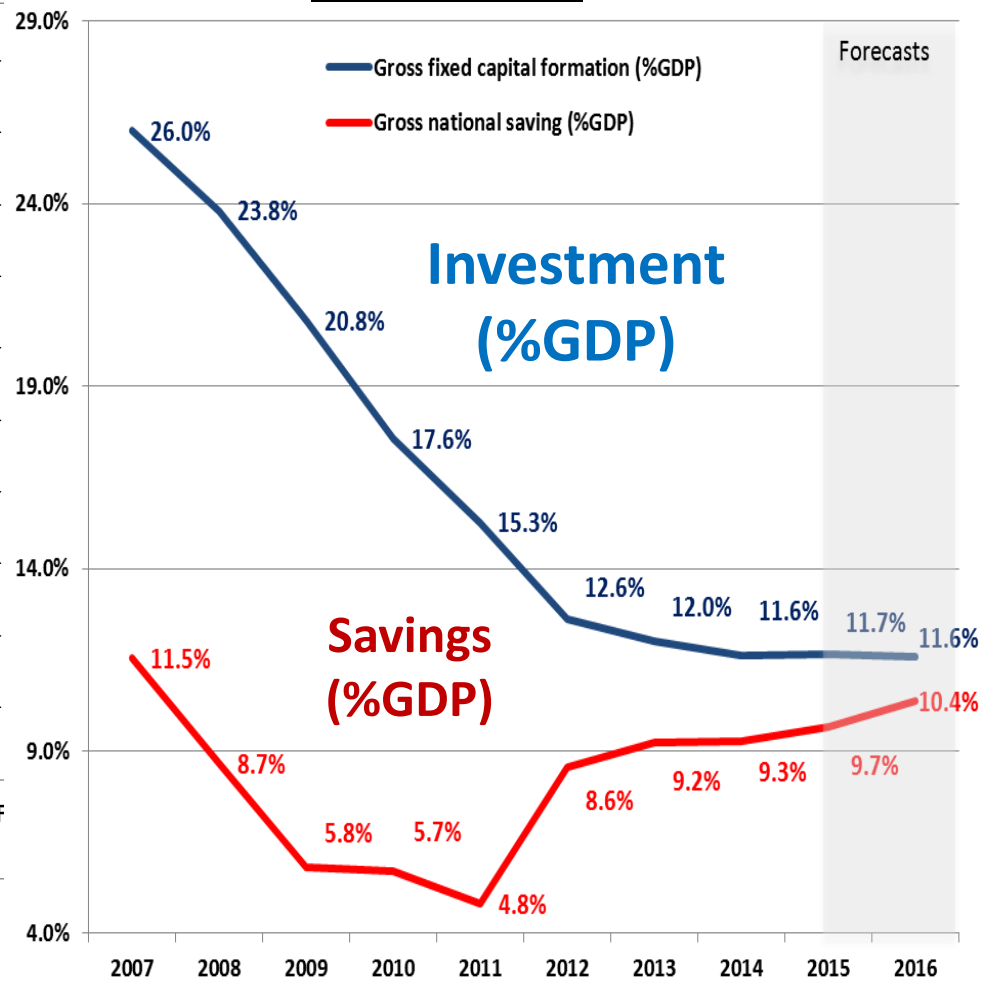


# III. Common risks today: Investment too low

## Investment / GDP



## GREECE



# IV. Cyprus: Is high long-term growth possible?

Cyprus can focus on its own growth recipe. One possibility would be to:

1. Safeguard macroeconomic stability and market credibility. Keep the fiscal budget balanced and ensure the pension system remains stable in the new era of low fertility rates. Macro stability may not be a sufficient condition for growth, yet it is necessary
2. Keep the political consensus on the geostrategic choice of EMU
3. Improve cost competitiveness, continue to reform and push the competitive advantages of the country. Besides low tax rates and specialized legal and accounting services, the country need to invest more in IT services
4. Improve the share of Investment in GDP. View the discovery of natural gas as a bonus
5. NPLs are 1.5 times the size of GDP. This is the biggest vulnerability of the country. Their resolution requires a delicate policy path, which will not disturb society, avoid a further collapse of asset prices and allow for their smooth recovery

# IV. Greece: Stuck in stagnation?

Can Greece shake-off its dismal prospects?

1. Safeguard macroeconomic stability by resolving the pressure on the budget from pension transfers → Major Pension Reform
2. Expand the tax base and reverse the high taxation policy → Serious switch in strategy, hence unlikely by current government
3. Reduce NPLs fast
4. Continue the reforms to improve competitiveness and attract FDI
  - Ownership is still lacking
  - OECD toolkits
  - Privatizations
  - Public sector reform
  - Land use, cadastre
  - Justice system
  - Energy
5. Develop a long-term growth strategy

# A Decade-Long Economic Crisis: Cyprus vs. Greece

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**Thank you  
for your attention!**

Gikas A. Hardouvelis

