

Cyprus vs. Greece: The way Forward

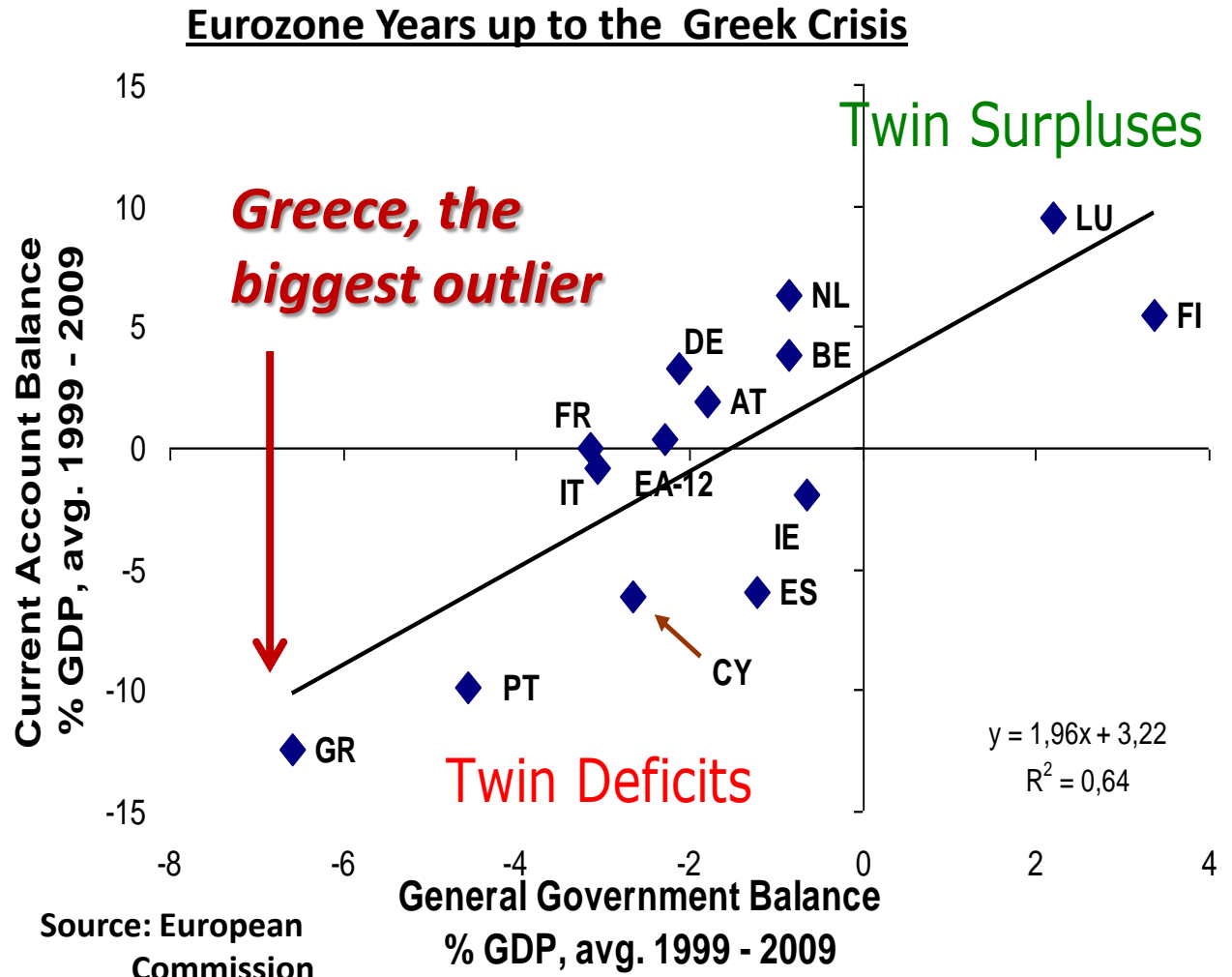
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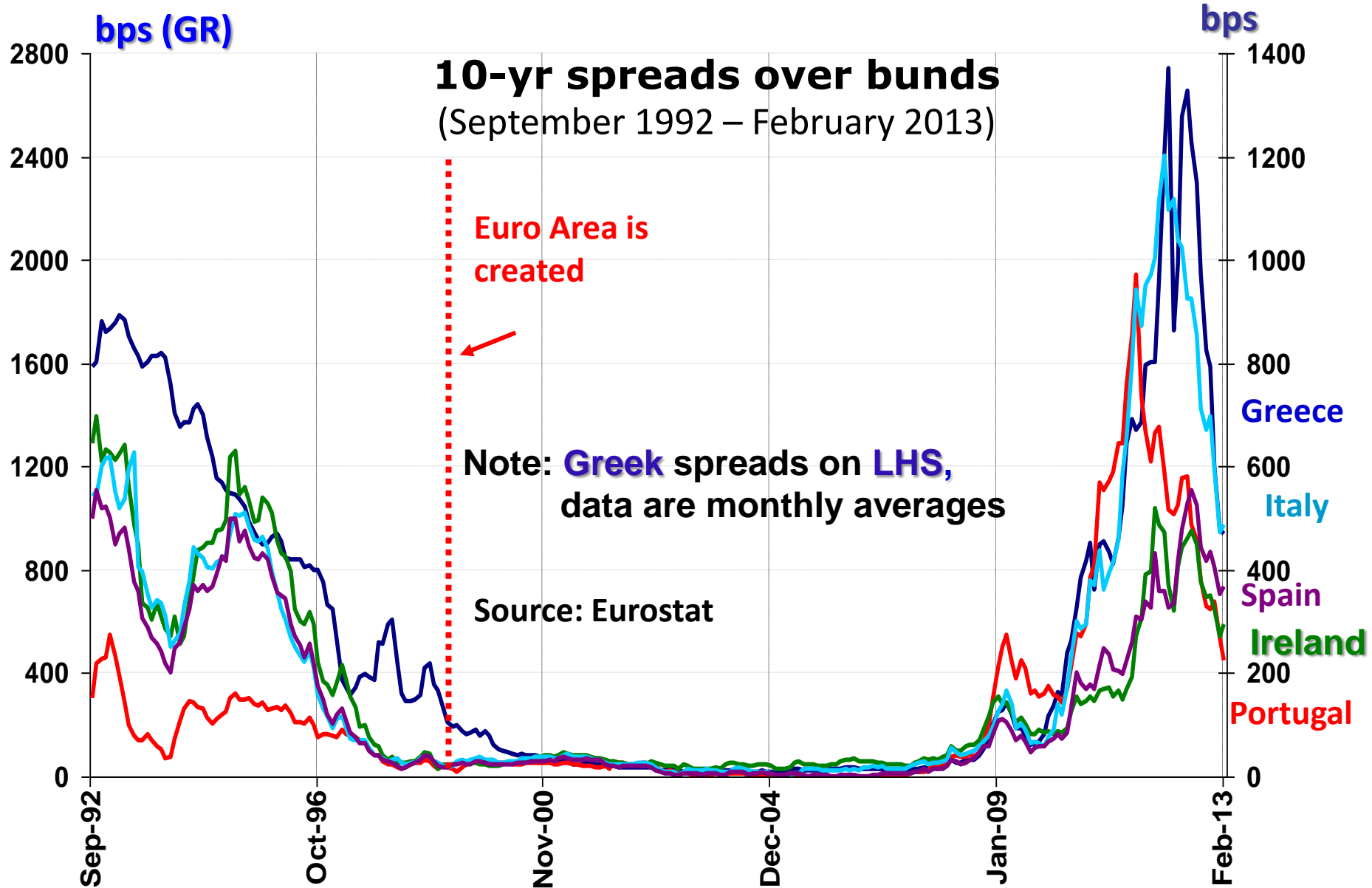
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Nicosia, Cyprus, April 21, 2016

EMU sad story: Instead of real convergence, serious imbalances ...

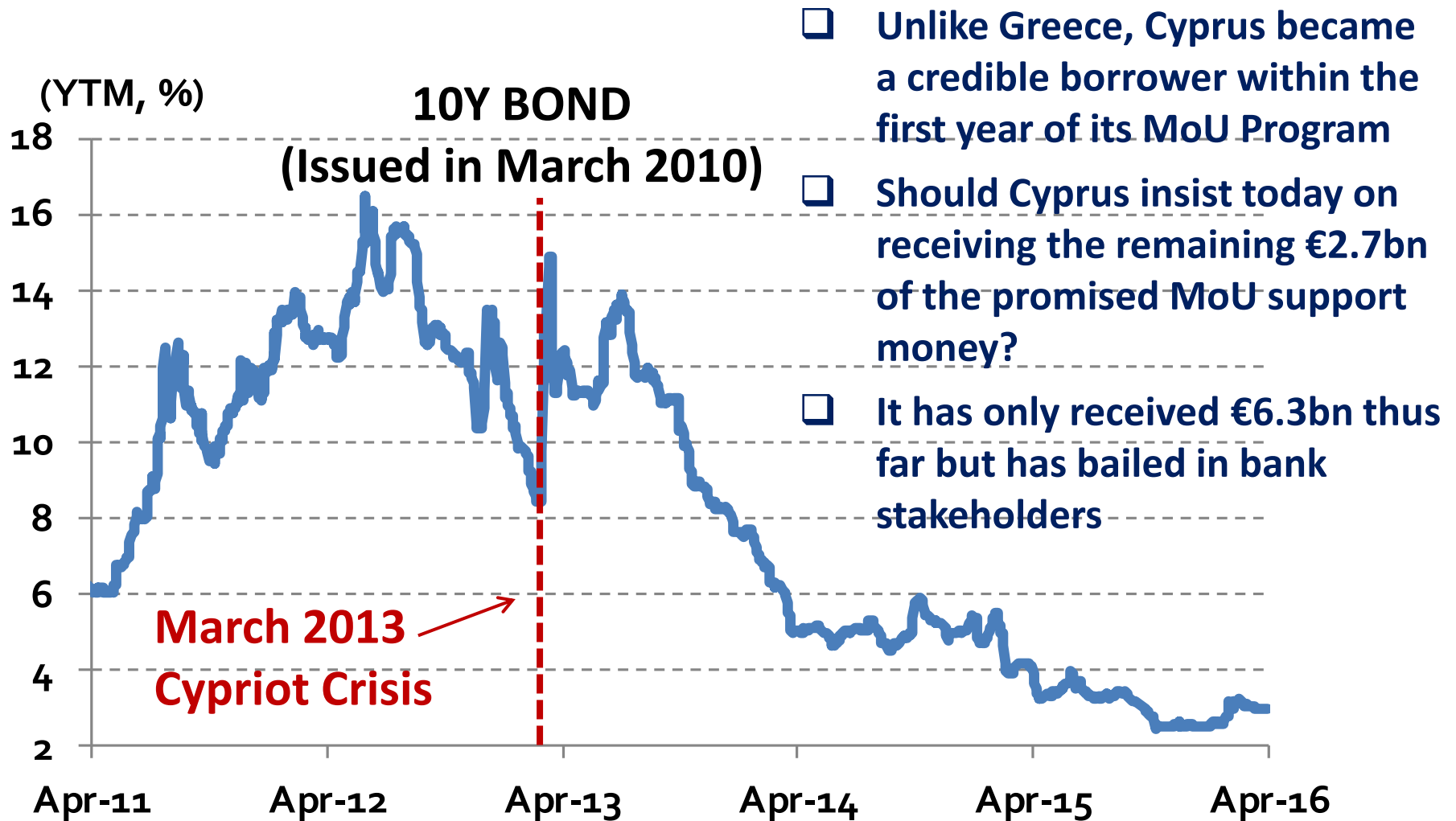
- ❑ Market failure:
Markets ignored the differences between countries and lent easily to both private & public sector
- ❑ Two major imbalances, fiscal & external competitiveness
- ❑ Greece was an outlier in the Euro Area
- ❑ Other imbalances: Private sector credit. Cyprus has a problem, Greece no



The Market View of EMU

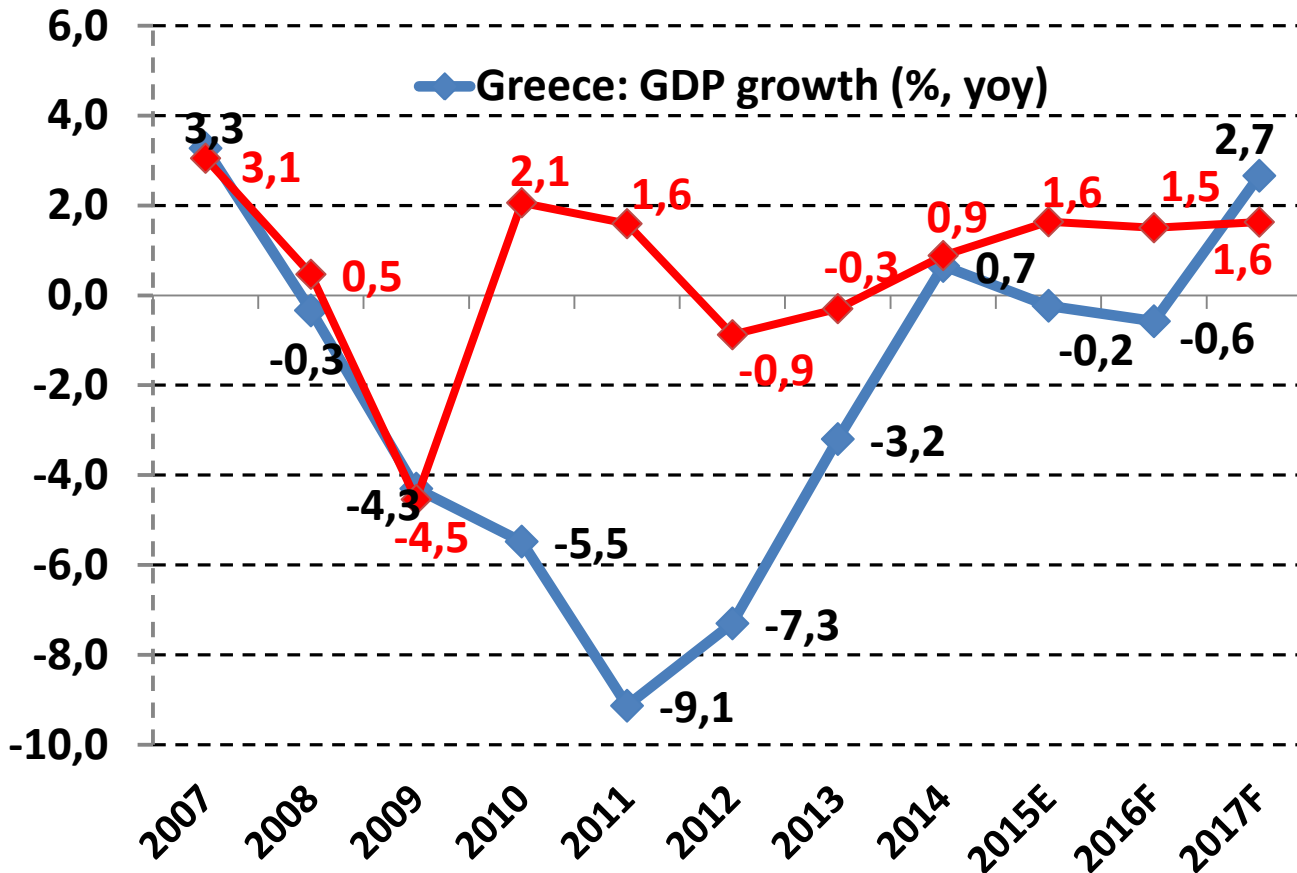


Market View of Cyprus over the last five years



Greece: Why such a huge recession until 2013?

1. Macroeconomic imbalances worse than anywhere else in the Euro Area
2. Closed economy, dominated by small firms, with inefficient public administration, unstable tax policies, ...
3. Liquidity crunch
4. Serious program errors by domestic politicians and lenders



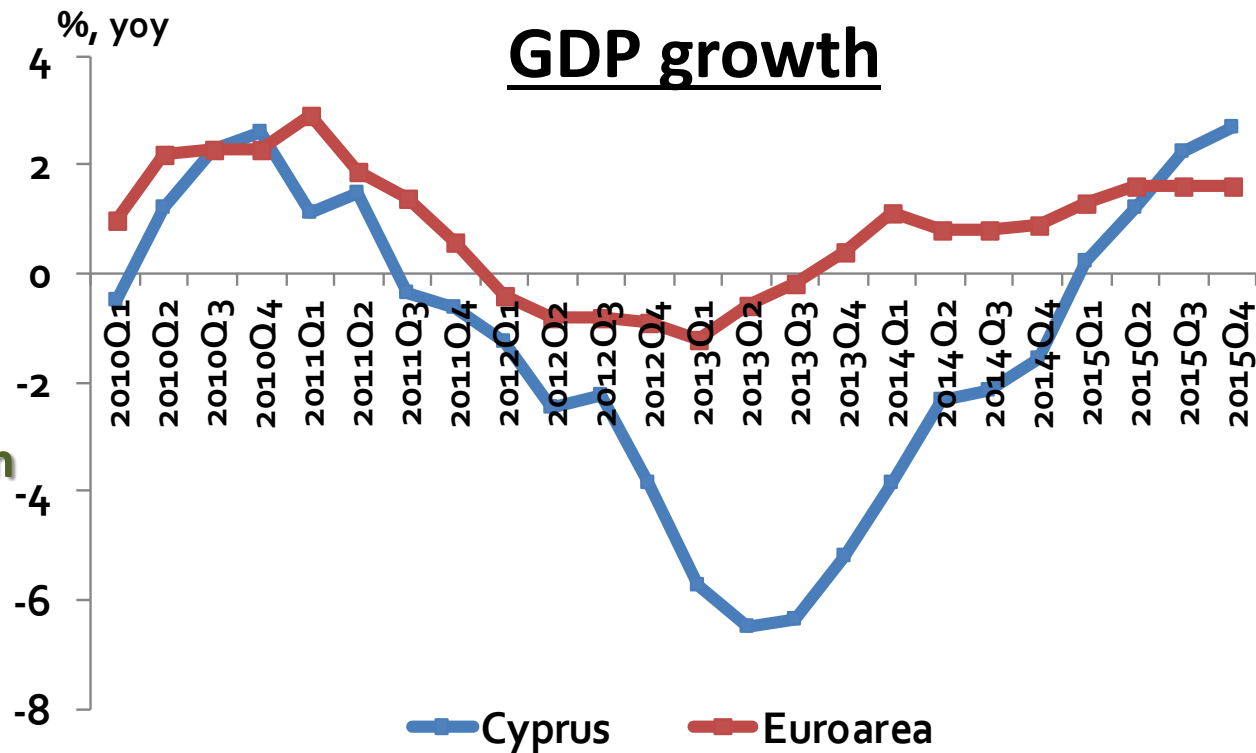
- Parties in opposition consistently took extreme positions, unlike in other programs countries. Hence, no ownership of reforms, “MoU “ a dirty word
- Lenders insisted on the wrong sequencing of reforms

5. A “political shock” in 2015, brought a W-shaped recession

Cyprus: Milder Recession – why?

Four of the five Greek reasons not present in Cyprus

1. Not as big macro-economic imbalances as in Greece
2. More open economy than Greece, with more efficient public administration, low tax rates
3. No serious program errors by domestic politicians or foreign lenders
4. Parties in opposition did not take extreme positions, unlike in Greece.



5. Yet, big Liquidity crunch as in Greece

→ An NPL problem plagues the future as well
Unlike Greece, the crisis in Cyprus did not only arise from a fiscal & competitiveness problem, but also from a banking and private sector leverage problem

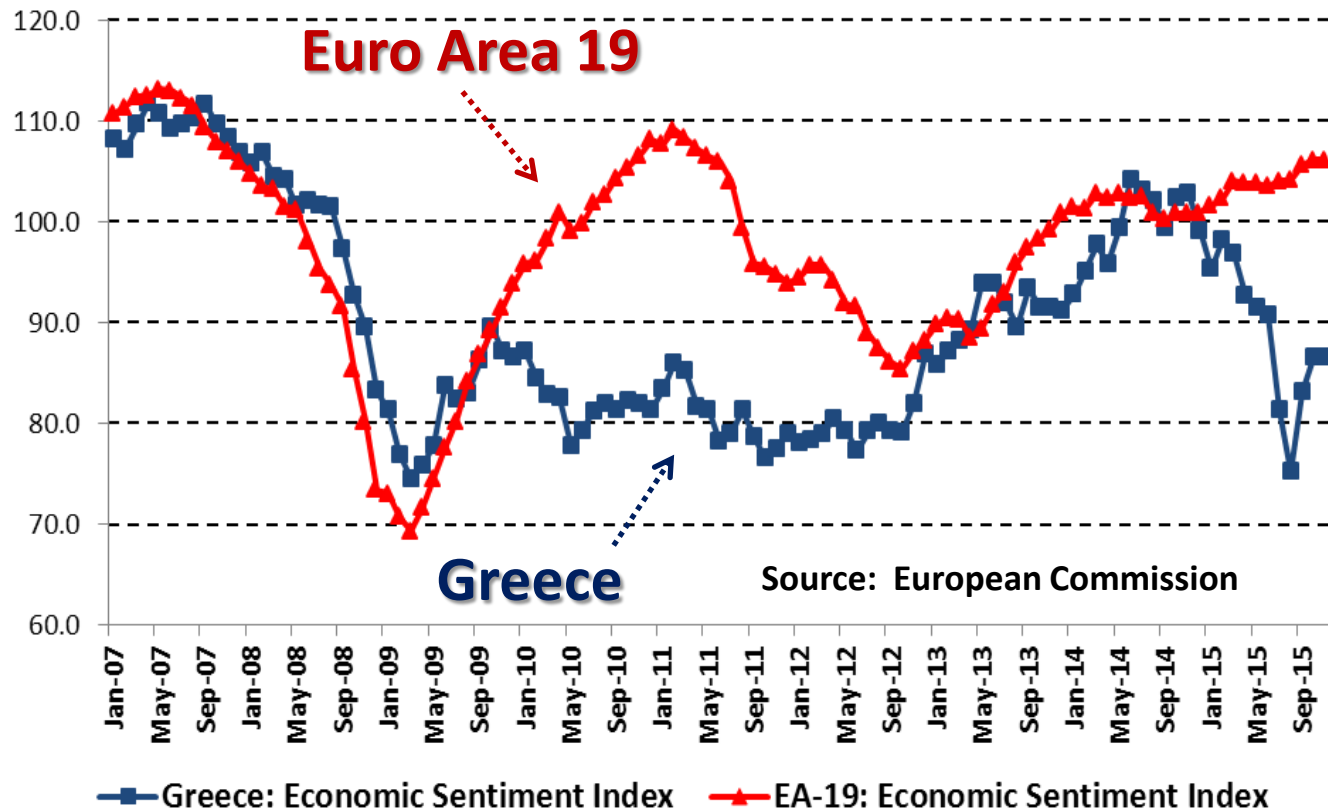
Do Politics matter?

YES, in a big way *and hopefully Cyprus will continue to avoid its bad influence*

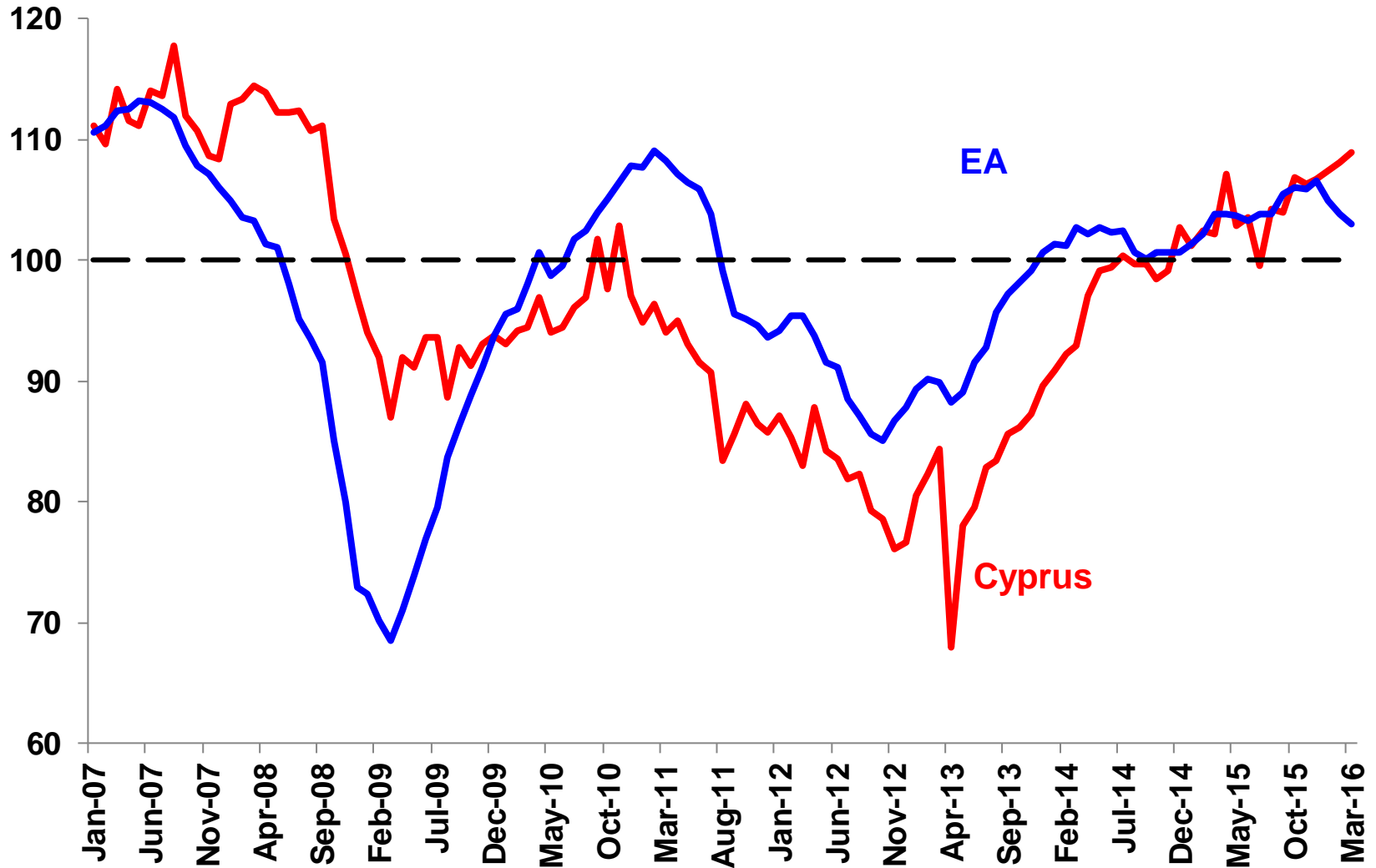
1. We already claimed politics was one of the factors which caused a deeper recession in Greece, where no rational analysis of the crisis took place and people were divided into for-or-against the MoU. Most Greeks thought the MoU brought the crisis, not that the crisis brought the MoU
2. Yet there is a second sad influence of Greek politics on Growth: Politics destroyed the economic take-off that began in 2014. A new leftist government openly confronted the lenders (something Cypriots never did), destroyed credibility, caused population panic and brought capital controls and a second recession.
 - The result is now a new vicious cycle: Instead of one billion euro worth of measures that were agreed in December 2014 for generating Primary surpluses of 3.5% of GDP, now we are talking about €8bn measures and with no growth prospects in sight!
 - Huge losses in forgone incomes, in bank stock values which were in the hands of the State, in the privatizations momentum!
3. The evolution of Sentiment reveals a lot about the differences in politics between the two countries

Greece: Economic Sentiment decoupled from Oct 2009 to Oct 2012 and from January 2015 on ...

- The sentiment index in Greece moved together with sentiment in EA until late 2009, both declining
- Decoupling during the Greek crisis
- From late 2012 on, Greek sentiment moves upward and again together with EA sentiment
- Greek sentiment peaked in the period June 2014 - November 2014, but subsequently began a fast downward slide as the political landscape deteriorated and generated new uncertainty, thus decoupling a second time from the rest of EA



Cyprus: Economic Sentiment moved in line with Euro Area Sentiment even during the Cypriot Crisis



Cyprus: Is sustainable growth possible?

What are the risks ahead?

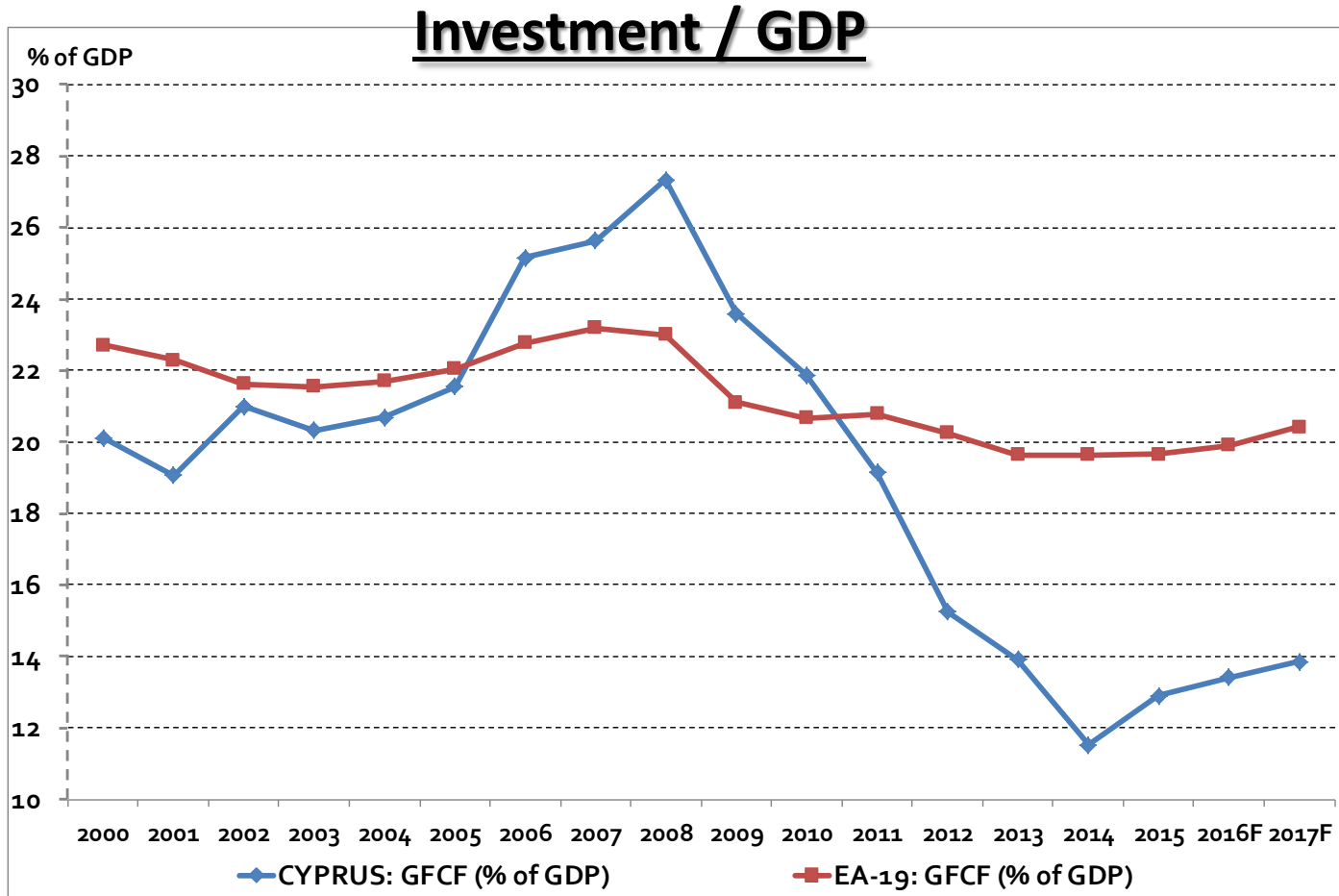
Three years ago I had listed three main risks to recovery in the medium term:

- 1) Credit growth and non-performing loans,**
- 2) The 2015 uncertain recovery as forecasted in the Program, and**
- 3) The possibility of a fiscal crunch in 2015 and a vicious cycle.**

Only the first risk remains today. Yet Cyprus does need to find its own growth recipe, its own growth model. My proposal would be:

- 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 belonging to 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 and improve Social Welfare. 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**

Greece & Cyprus share a common problem: Low Investment/GDP



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**Thank you
for your attention!**

Gikas A. Hardouvelis

