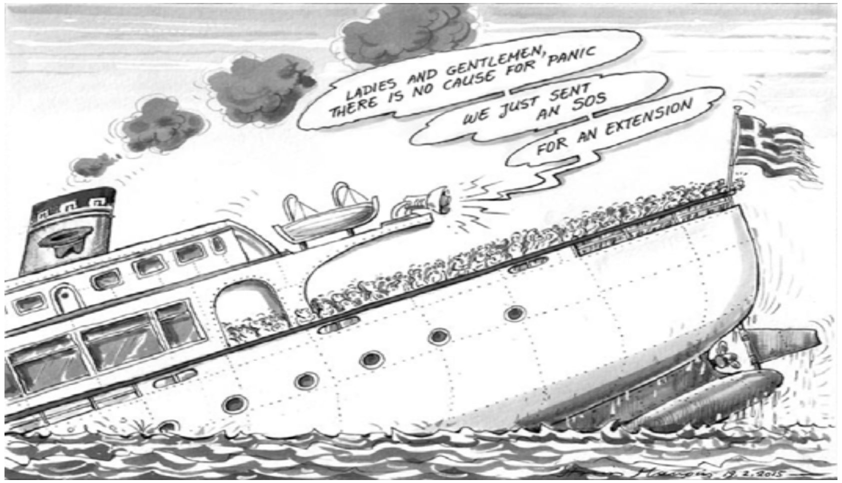
Post-election risks of the Greek economy



Gikas Hardouvelis & Dimitri Vayanos

ESRB- Advisory Scientific Committee

Frankfurt, Feb 26 , 2015

Post-election risks of the Greek economy

I. **Imbalances - evolution of the Greek economy during the crisis and the last six months**

II. **Events after the elections (state of public finances, capital flight); new measures announced by the new government**

III. **Assessment of possible scenarios (default, bank run, exit from the euro) and of the consequences of each scenario for systemic stability of euro area countries**

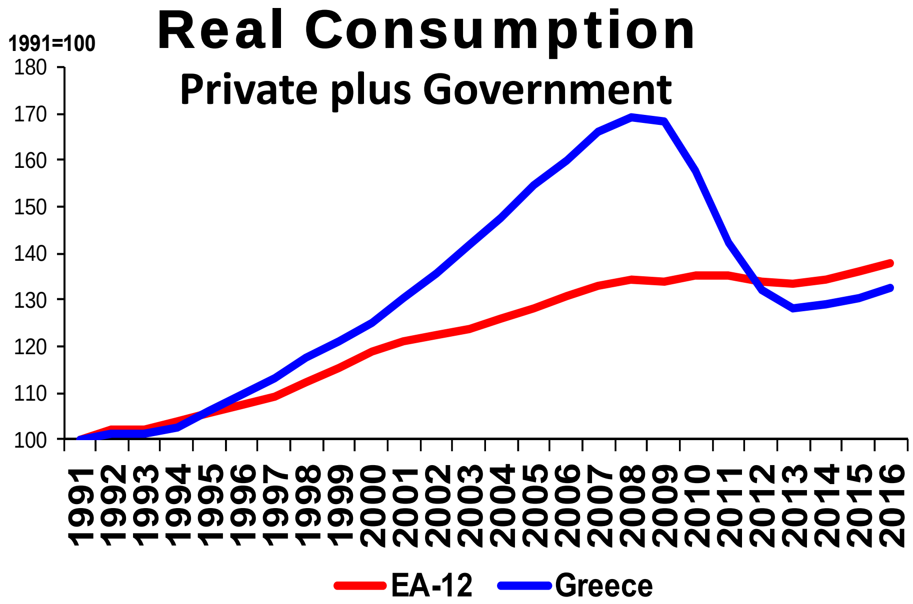
I.

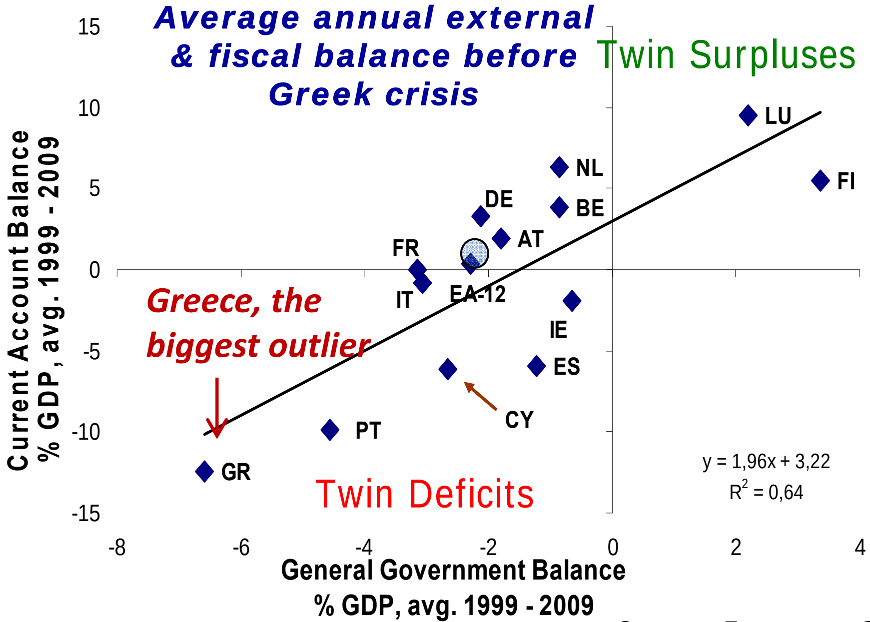
Imbalances and evolution of the Greek economy during the crisis and over the last six months

GREEK GROWTH MODEL, REQUIREMENT #1: NEED TO CORRECT THE DISEQULIBRIA

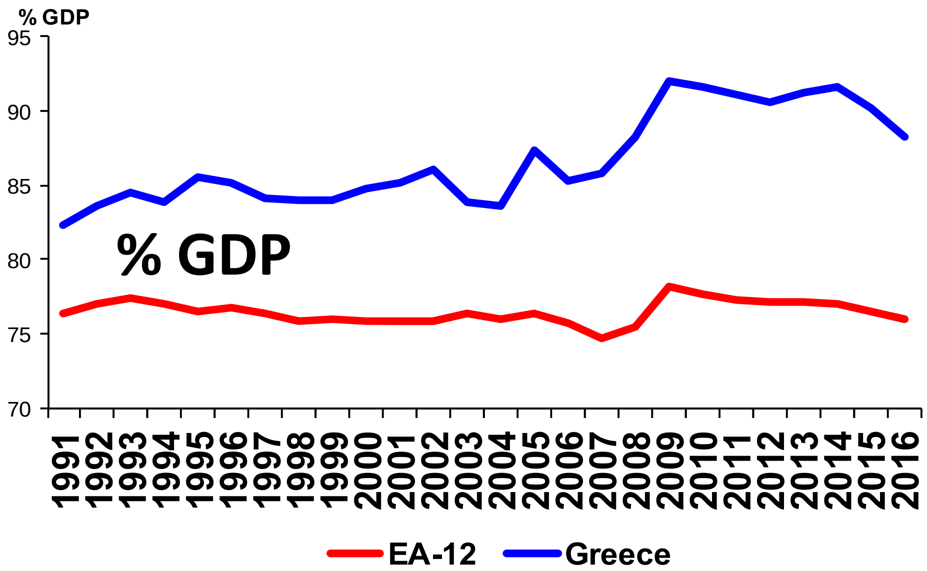
2013 SHARE in nom. GDP	Greece	EA18
Private consumption	71.2%	56.0%
Public consumption	20.0%	21.1%
Gross Fixed Capital Formation	11.2%	17.7%
Exports	30.2%	43.8%
Imports (Source: European Commission)	33.2%	40.4%

Oil Exports in 2013 were € 7.9bn or 4.3% GDP
Oil Imports in 2013 were € 15.6bn or 8.6% GDP
BoG data





Source: European Commission



Source: European Commission

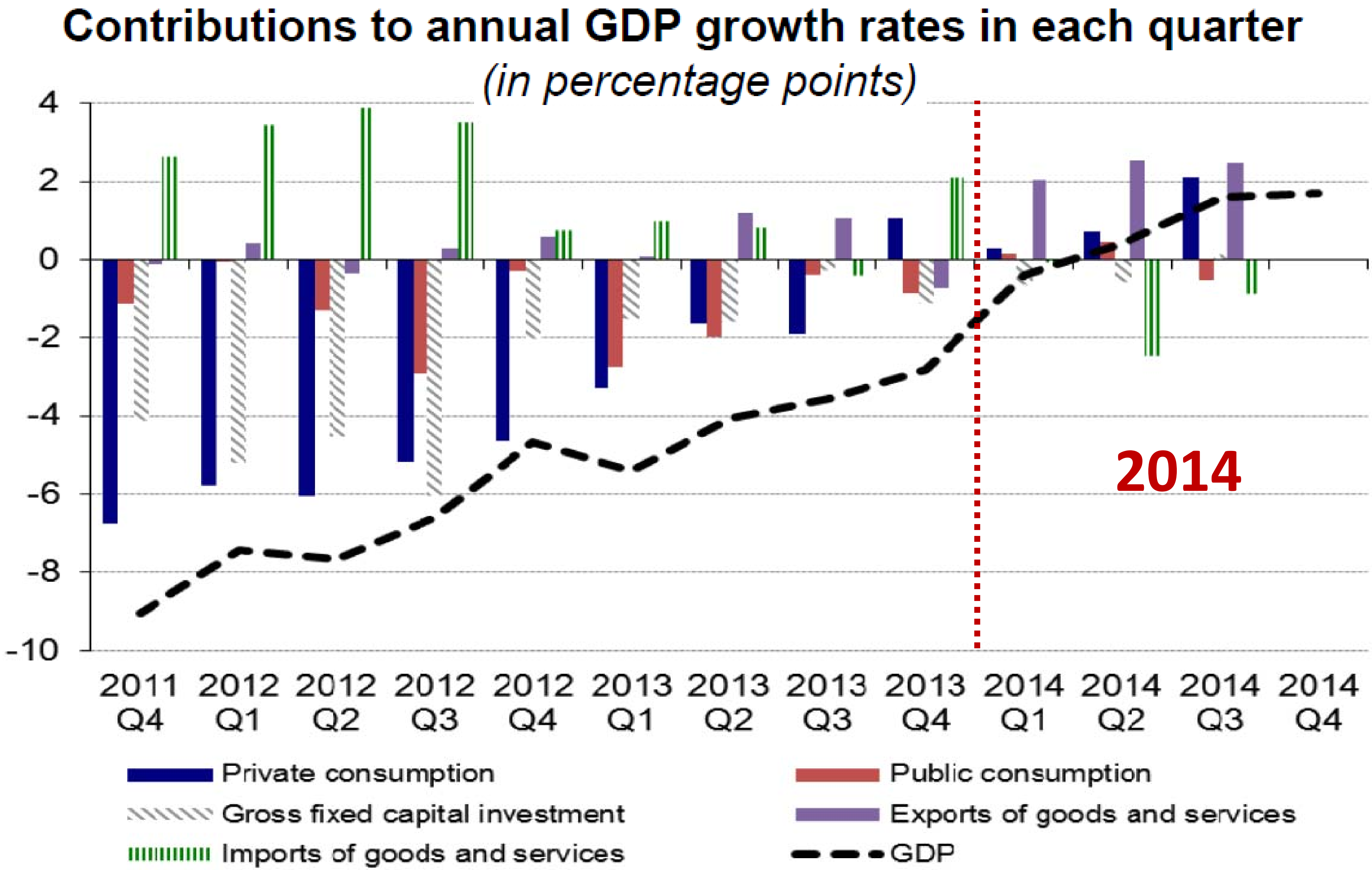
GREEK GROWTH MODEL, REQUIREMENT #2: CONSUMPTION SHOULD GROW TOO, BUT AT A LOWER RATE

- ✓ THE GROWTH MODEL: In the future, consumption should grow at rates lower than investment & exports
- ✓ In 2014, model requirement #2 began taking hold: Consumption improved, investment stabilized & exports picked up momentum
- ✓ The short and long-term growth paths are inter-linked: If expansion gains momentum, capital & labor inputs improve, raising potential growth

	2013 Share in Nom. GDP	2014 growth Real	2015 growth Real
Private Consumption	71.2%	+1.4%	+1.7%
Government Consumption	20.0%	-1.1%	-0.9%
Tot. Consumption	91.2%	+0.8%	+1.1%
GFCF	11.2%	+0.8%	+8.4%
Domestic Demand	102.4%	+0.8%	+1.9%
Imports	33.2%	+4.7%	+4.0%
Exports	30.2%	+8.0%	+5.6%
GDP (nominal, € bn)	182.4		
Real GDP		+1.0%	+2.5%
GDP deflator		-2.2%	-0.2%
Unemployment (avg)		26.6%	25.0%

Source: European Commission

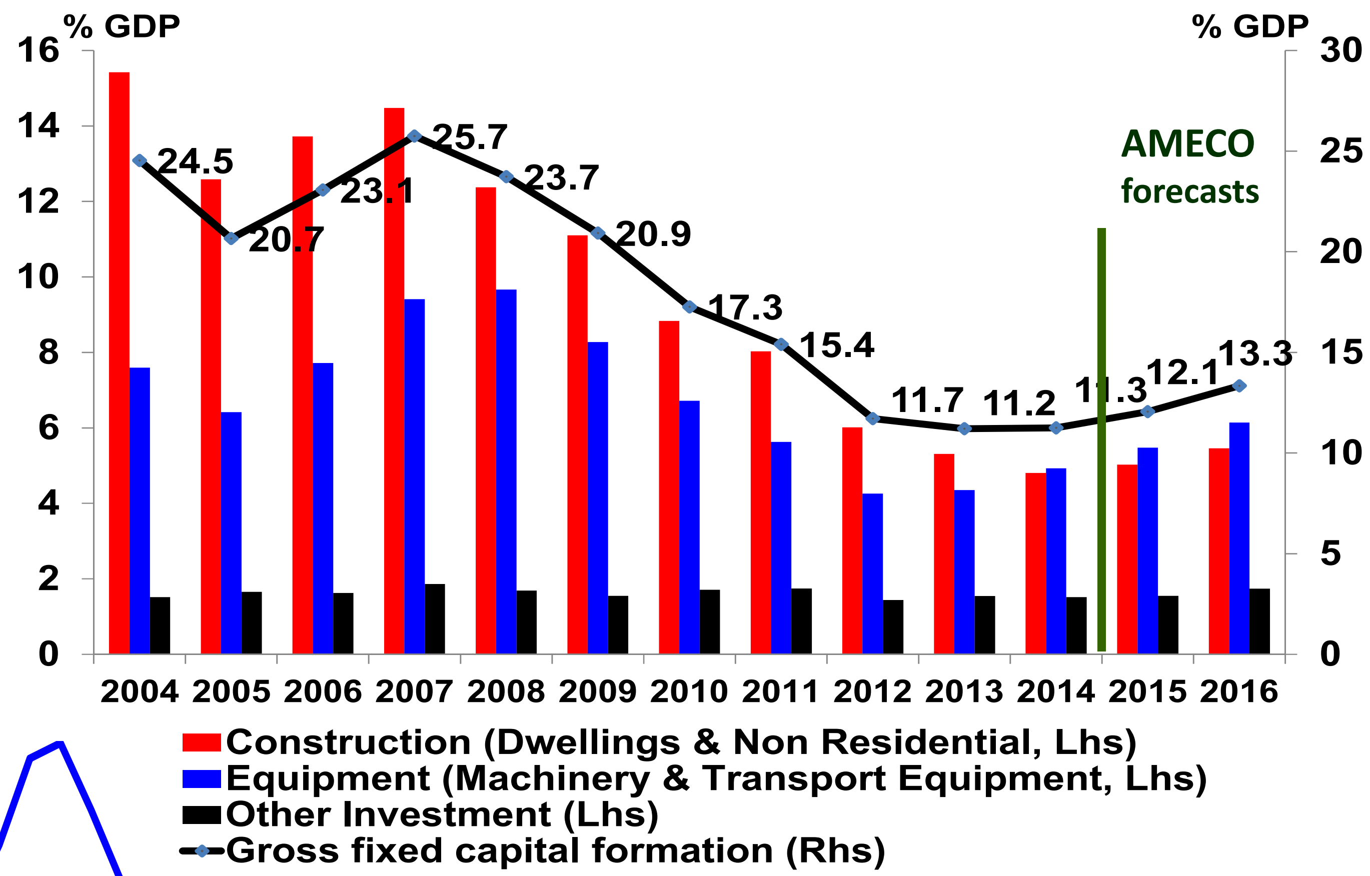
RECESSION STOPS IN 2014

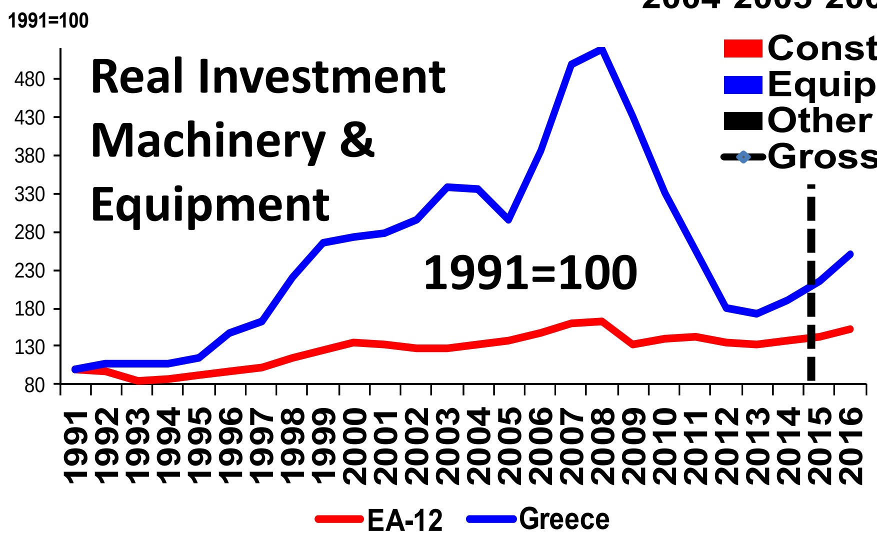


Source: EL.STAT, National Accounts.

GREEK ECONOMY – GOOD NEWS

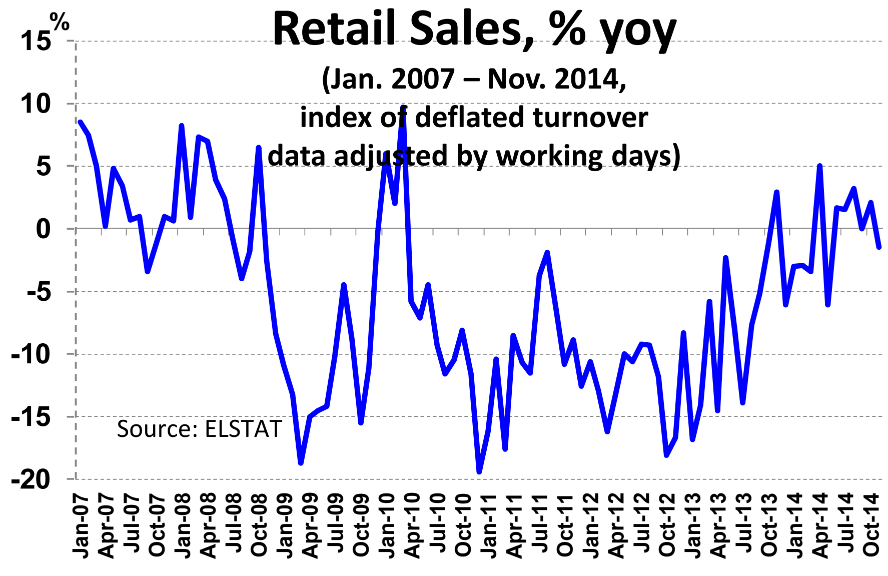
- ✓ In 2013 & 2014, investment in machinery & equipment improved
- ✓ Machinery & equipment embody technological change, preserve potential for productivity growth

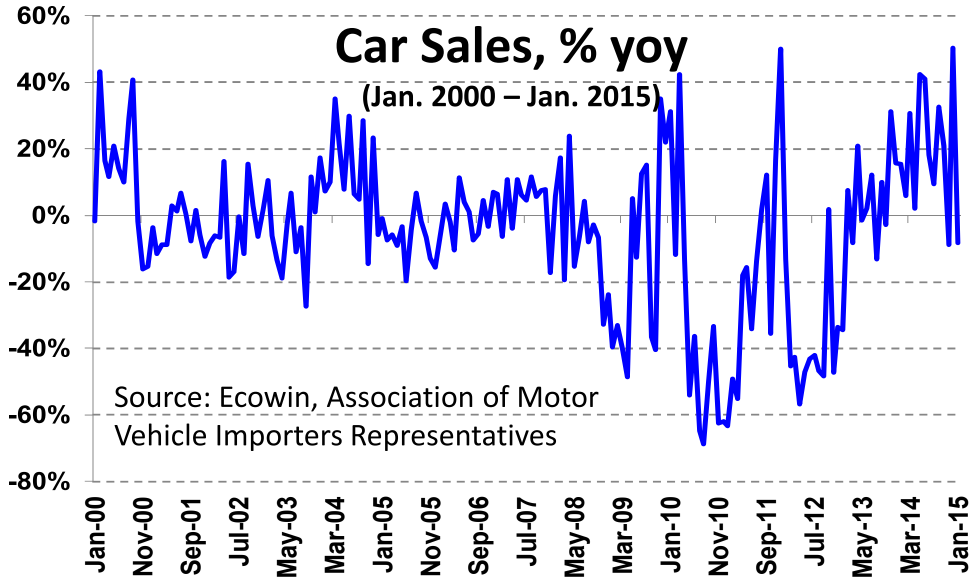


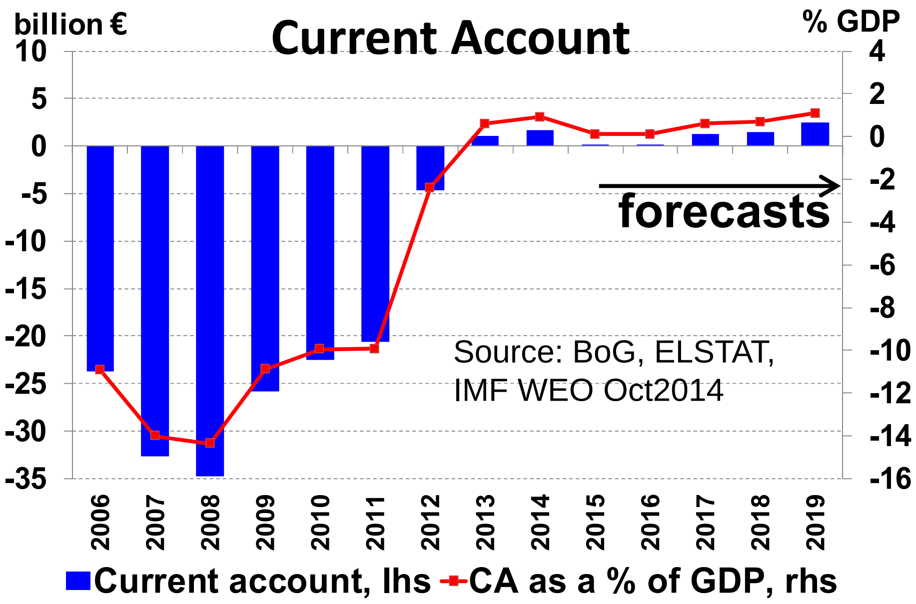


Source: European Commission, AMECO Database

GREEK ECONOMY – GOOD NEWS

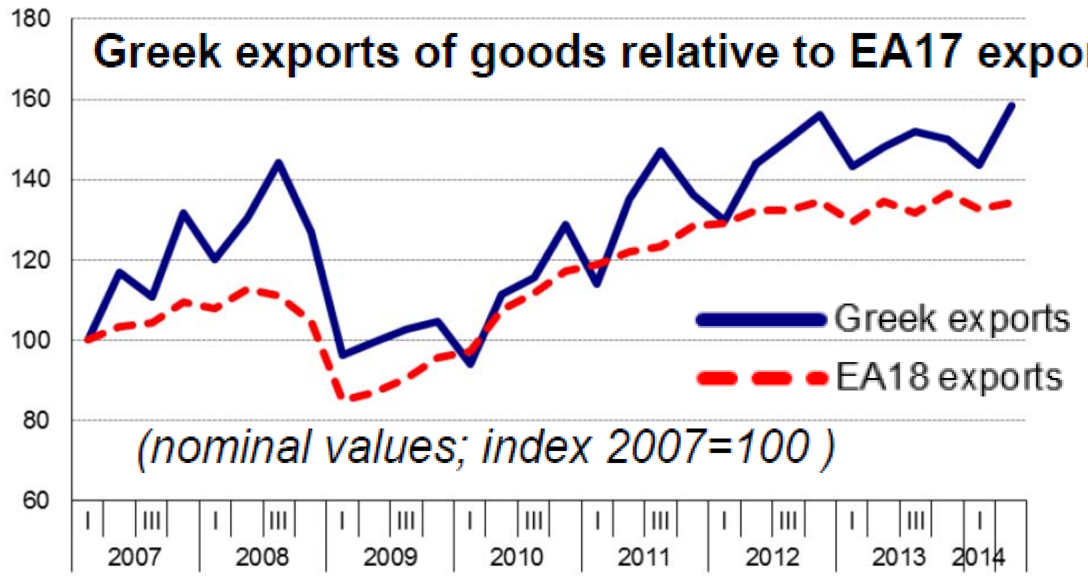






Source: Bank of Greece

FORECASTS OF POSITIVE GROWTH ….



✓Exports of goods are the weakest component of GDP growth, but ok

Source: Bank of Greece (BoP statistics)
ECB (BoP statistics for the euro area)

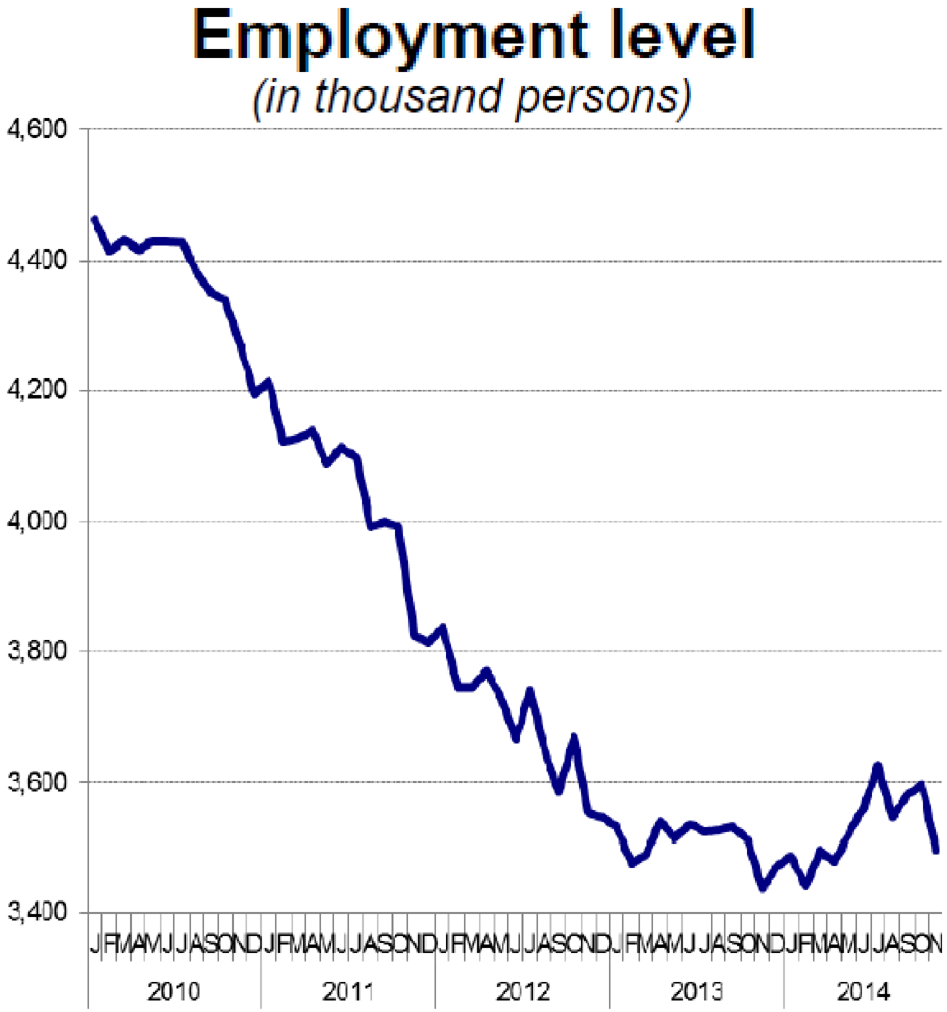
✓ **2015 GDP growth forecasts are old, hence over-estimates**

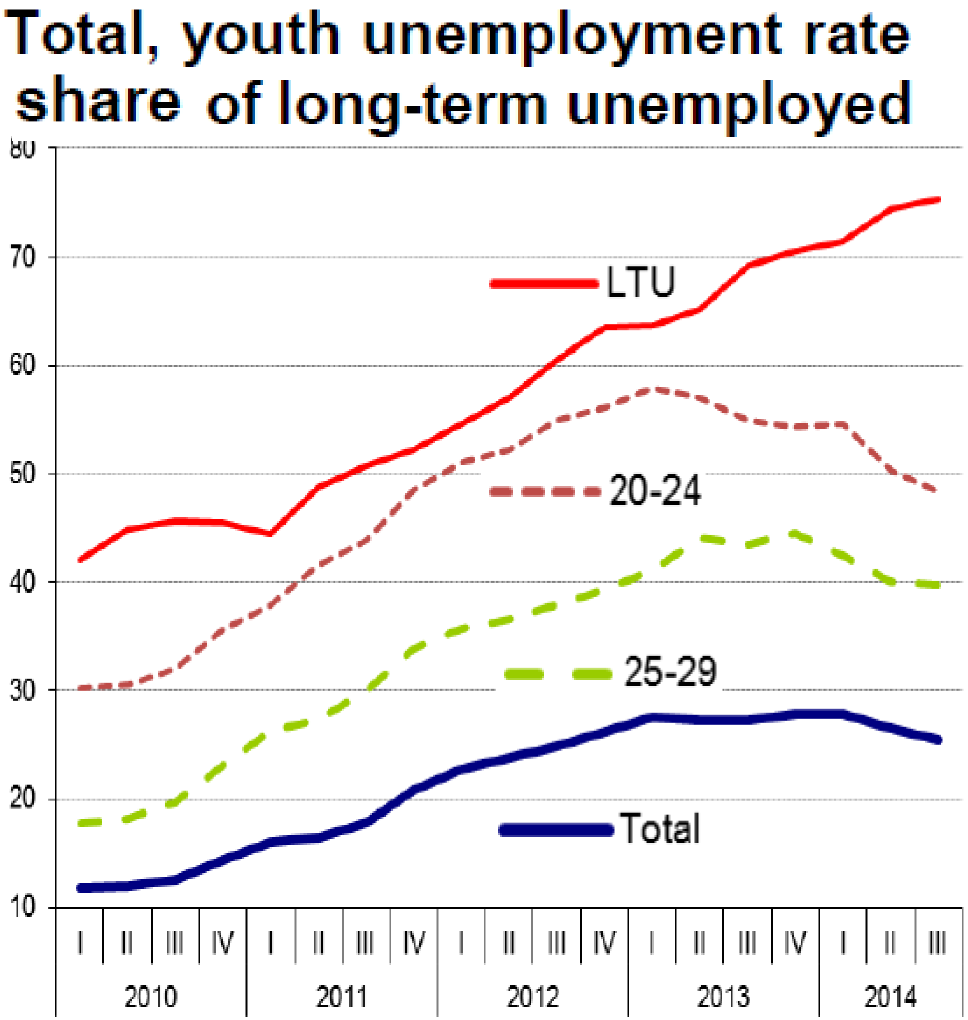
Projections for Greek GDP by international organizations and the BoG

Percentage changes on a year earlier	**Release date**	**2013**	**2014**	**2015**
OECD	Nov-14	-3.9	0.8	2.3
European Commission	Apr-14	-3.9	0.6	2.9
IMF	Oct-14	-3.9	0.6	2.9
Consensus	Oct-14	-3.9	0.2	1.9
NIESR*	Nov-14	-3.9	0.3	1.8
BoG	Dec-14	-3.9	0.7	2.1

* Britain's National Institute of Economic and Social Research

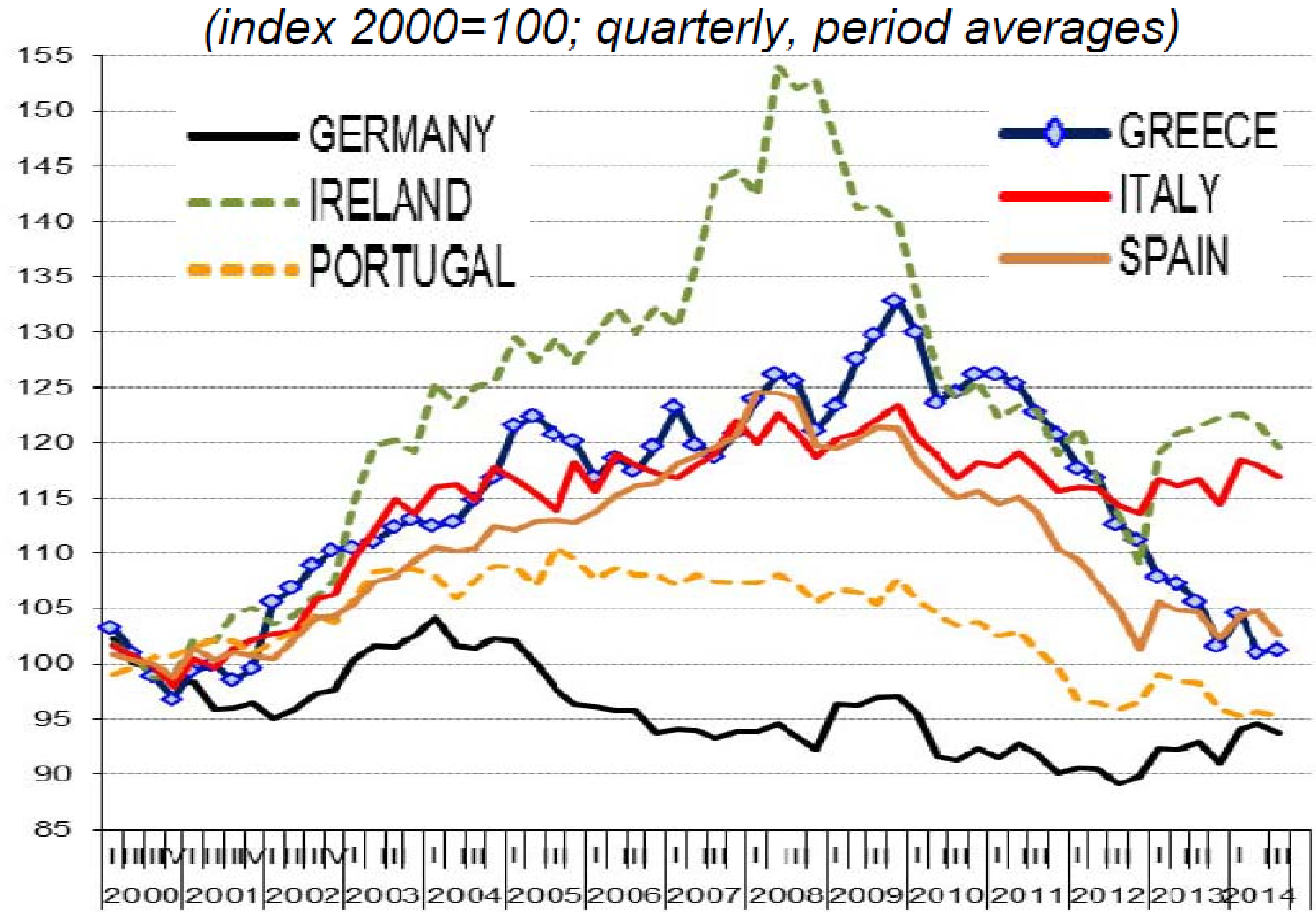
LABOR MARKET





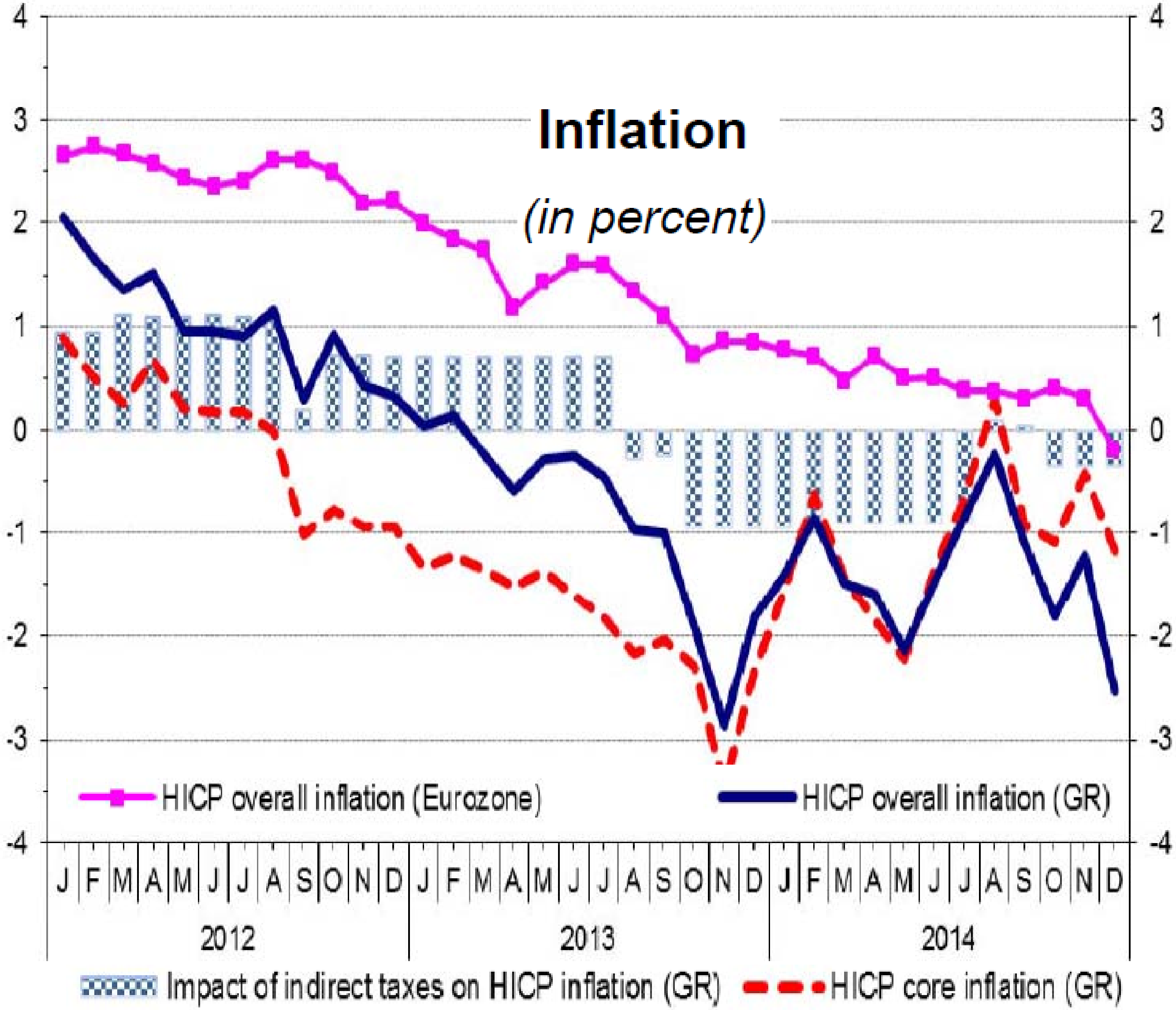
Source: EL.STAT, Labour Force Survey

LABOR COST COMPETITIVENESS



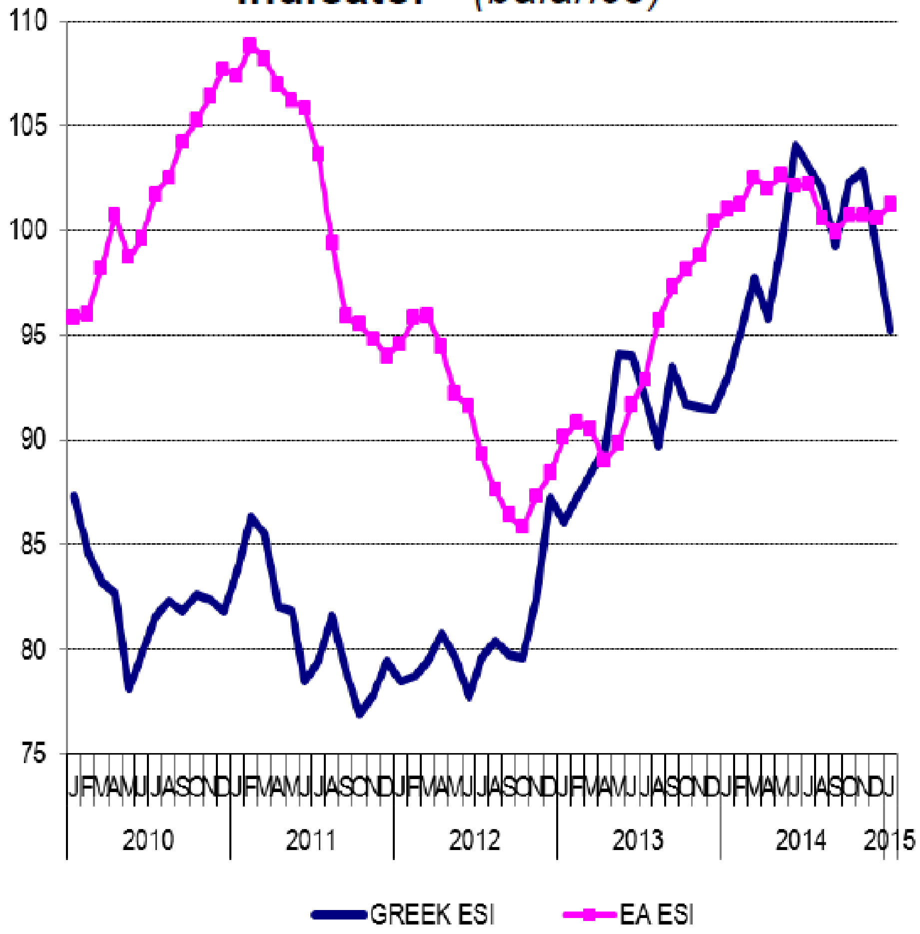
DEFLATION SINCE 2013

- ✓Deflation arrived much earlier in Greece, by 2013 Q1
- ✓Deflation is mainly due to non-tradables, a much needed adjustment



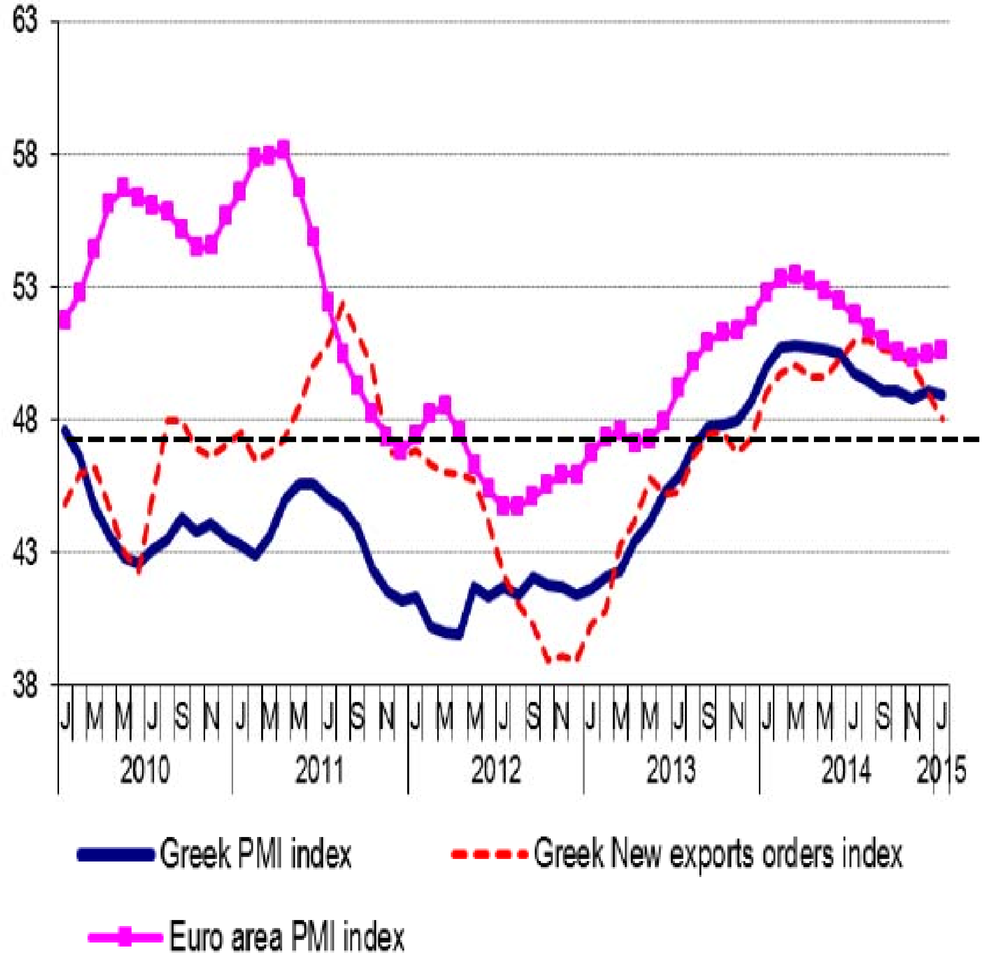
… YET RECENT SOFT DATA SHOW ECONOMY HAS STALLED

Greek and Euro Area Economic Sentiment Indicator *(balance)*



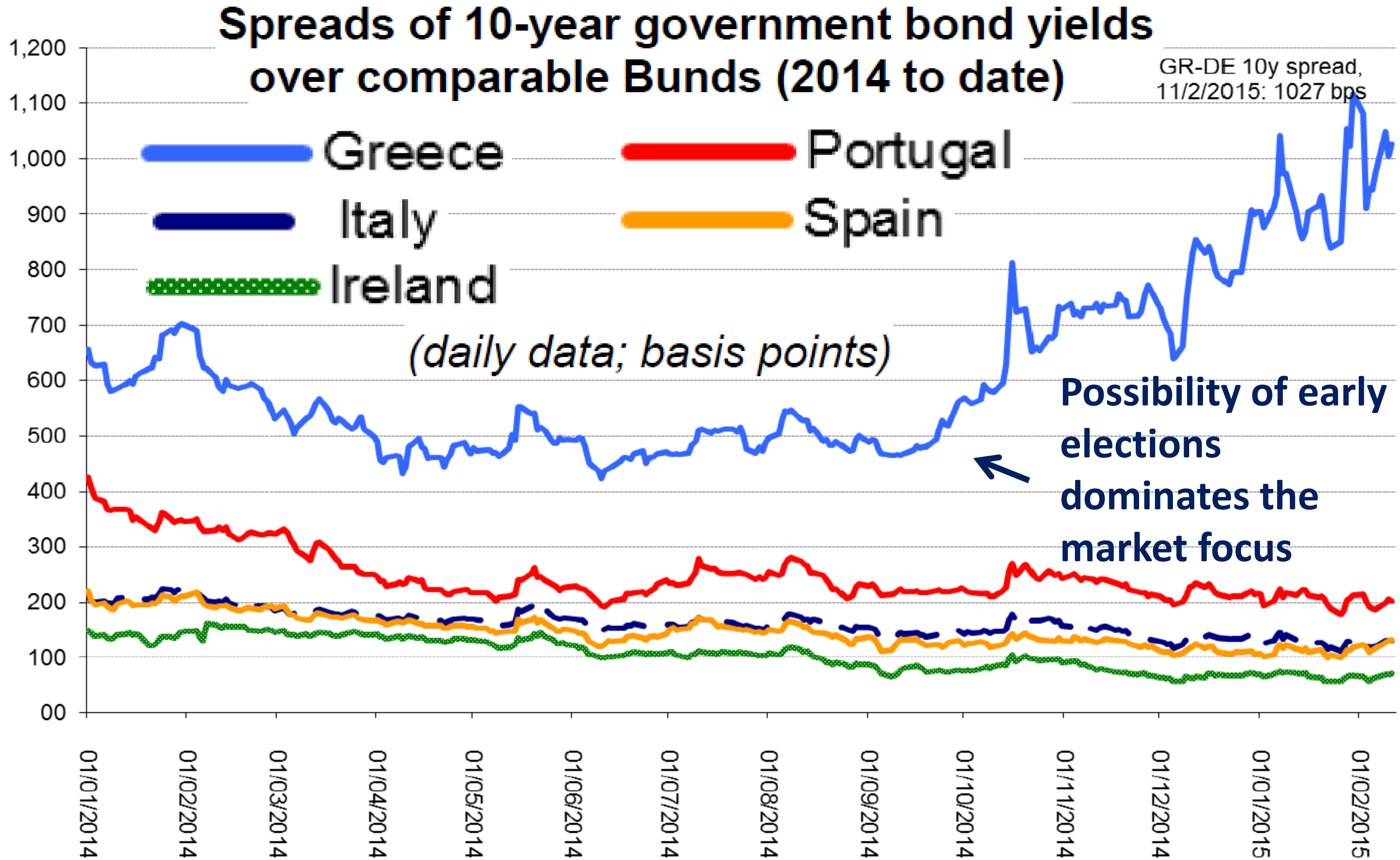
Source: European Commission.

PMI overall index and new export orders component



Source: Markit

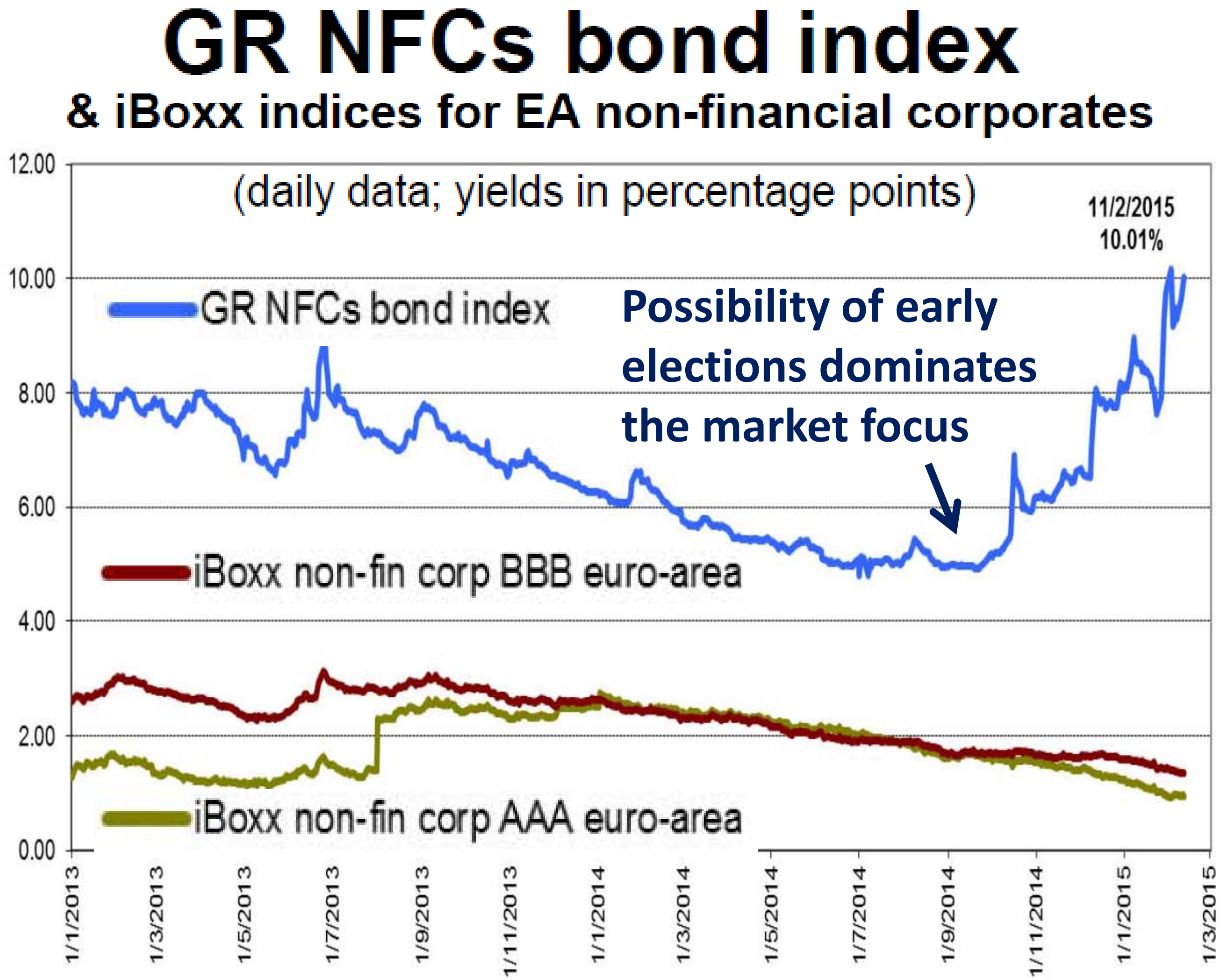
BOND MARKETS UNSETTLED SINCE EARLY NOVEMBER



Source: Thomson Reuters, Datastream

DECOUPLING FROM THE REST OF EURO AREA SINCE EARLY NOVEMBER

- ✓ Decoupling not only in sovereign bond spreads but in corporate bonds as well
- ✓ Markets became worried of the possibility of elections and a SYRIZA win
- ✓ Markets have a short-term view on the conse-quences of GREXIT



Source: (GR index) Bank of Greece; (iBoxx indices) Thomson Reuters, Datastream

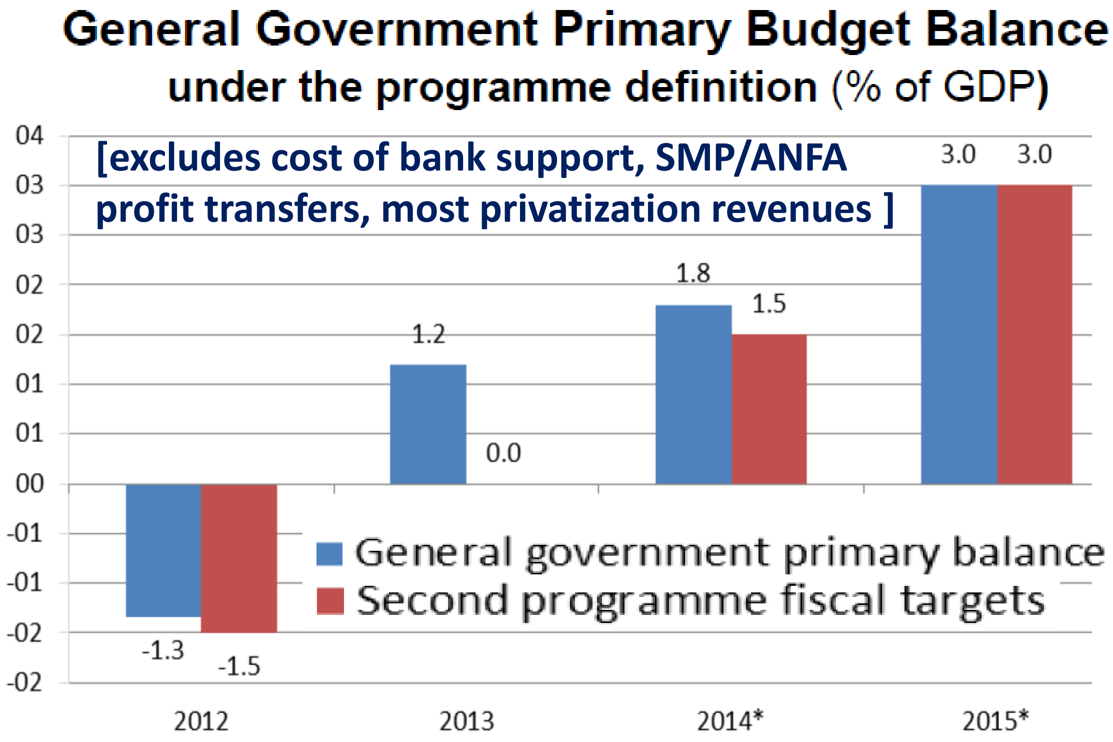
II.

Events after the elections:

1) State of public finances
2) Capital flight
3) 4-month extension is granted in late February 2015 after new Greek government adopts MoU guidelines

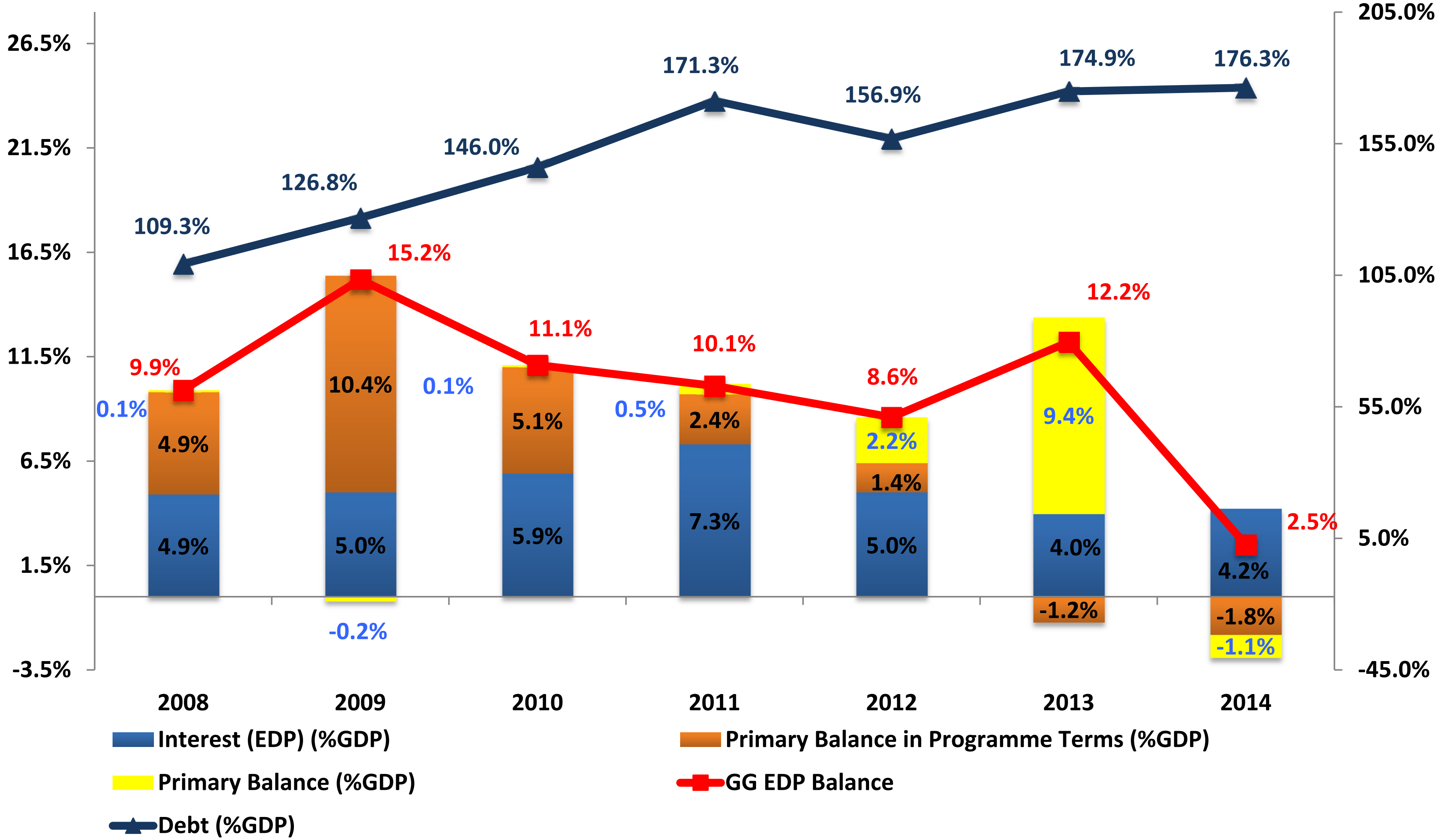
FISCAL SPACE IS LIMITED

- ✓ Huge fiscal consolidation, from a deficit of 15.2% DGP in 2009 to probably around 3.5% in 2014
- ✓ For 2015, the previous government was forecasting a primary surplus of 3% GDP, yet Troika insisted on a fiscal gap of €2.6bn
- ✓ The new elections have caused the economy to stall since November and revenues to lag behind
- ✓ Without closure of the 5th Review, €7.2 bn would be missing at least until May
- ✓ Gov has topped up its sources of short-term funding and is shut out of the market



- ✓ Assuming full coverage of the T-bill auctions, in March 2105, €4bn are still missing. This will cause arrears to increase
- ✓ April and May obligations will squeeze the State even further
- ✓ This implies growth will lose its momentum and earlier forecasts become optimistic

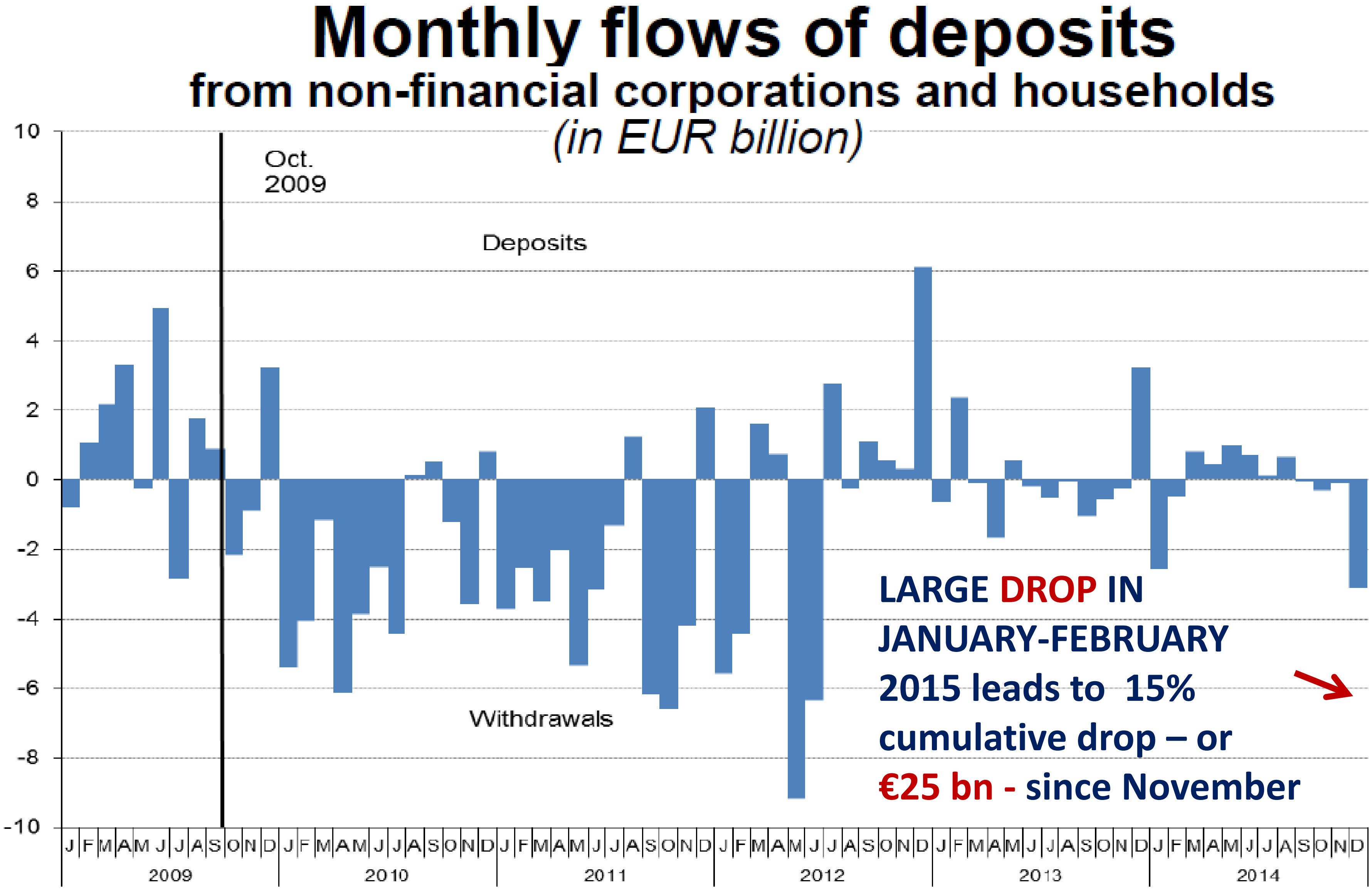
HUGE FISCAL CONSOLIDATION SINCE 2009



Source: European Commission, ELSTAT, 2015 Budget

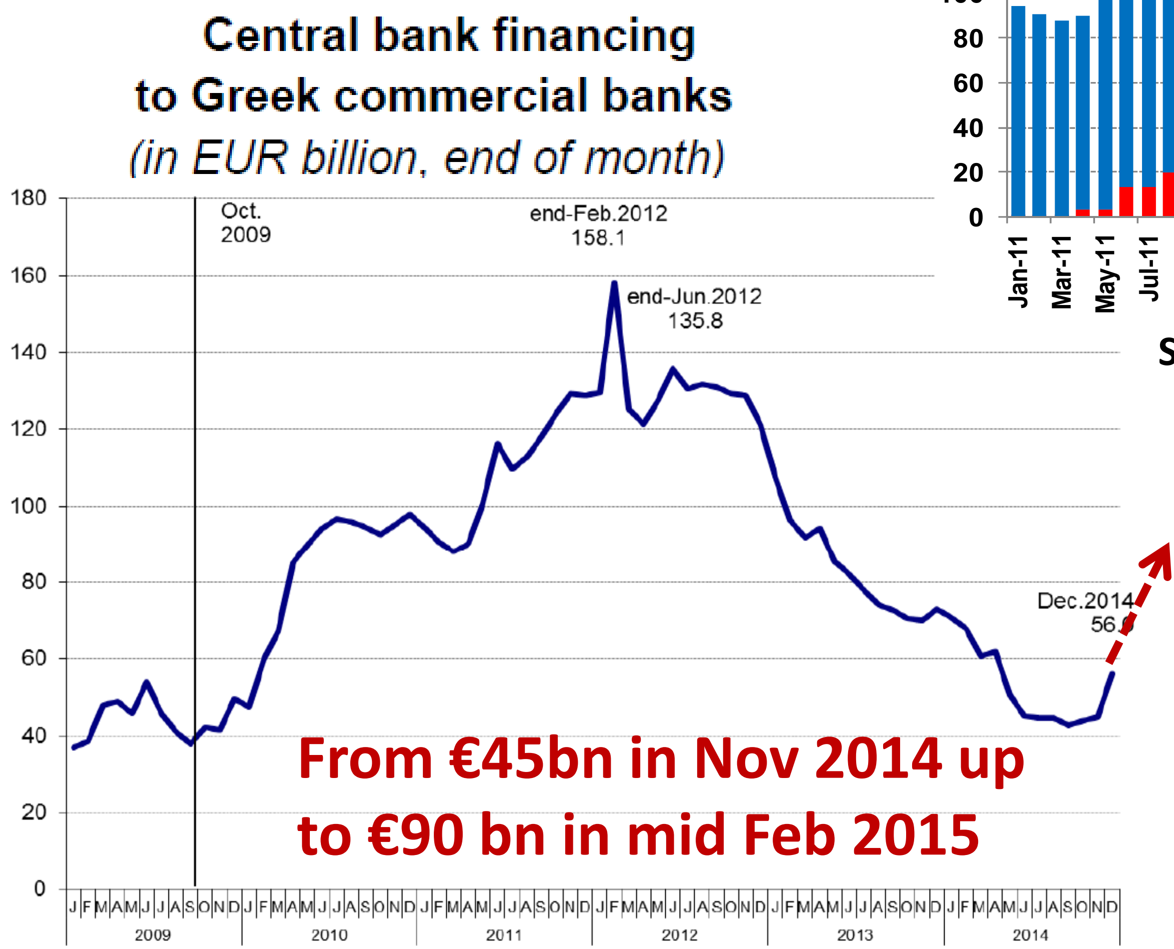
*2015 Budget Projections for 2014

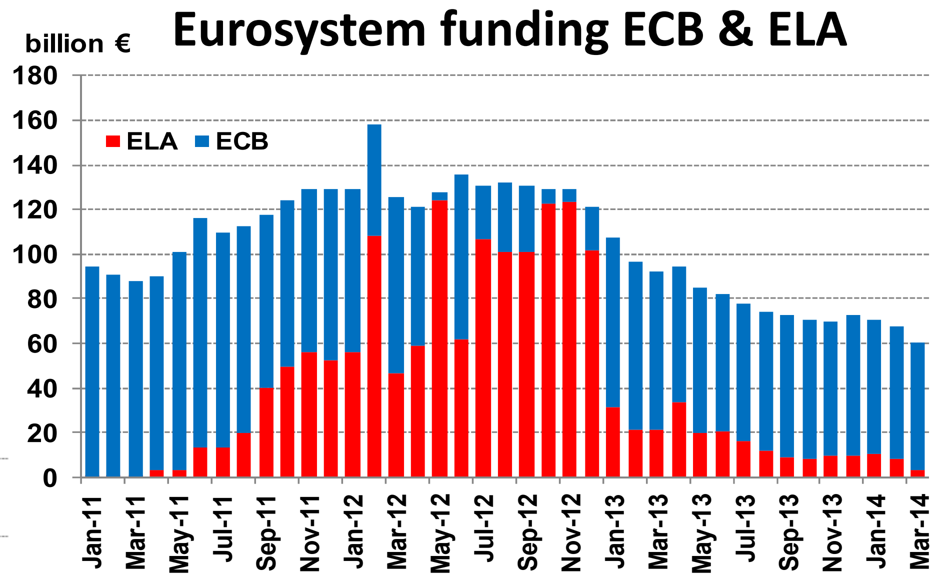
A NEW ROUND OF DEPOSIT OUTFLOWS



BANK FUNDING FROM THE EUROSYSTEM RISES

(a) DEPOSIT OUTFLOWS PLUS
(b) SHUTING DOWN OF INTERBANK MARKET LED TO A DOUBLING OF EUROSYSTEM DEPENDENCE SINCE NOVEMBER





Source: BoG, Bloomberg

- ✓ The persistent drop in Eurosystem borrowing that began after the June 2012 elections stopped in November 2014, as new elections were now been forecasted with a SYRIZA win

BANK COLLATERAL VALUES DECLINE

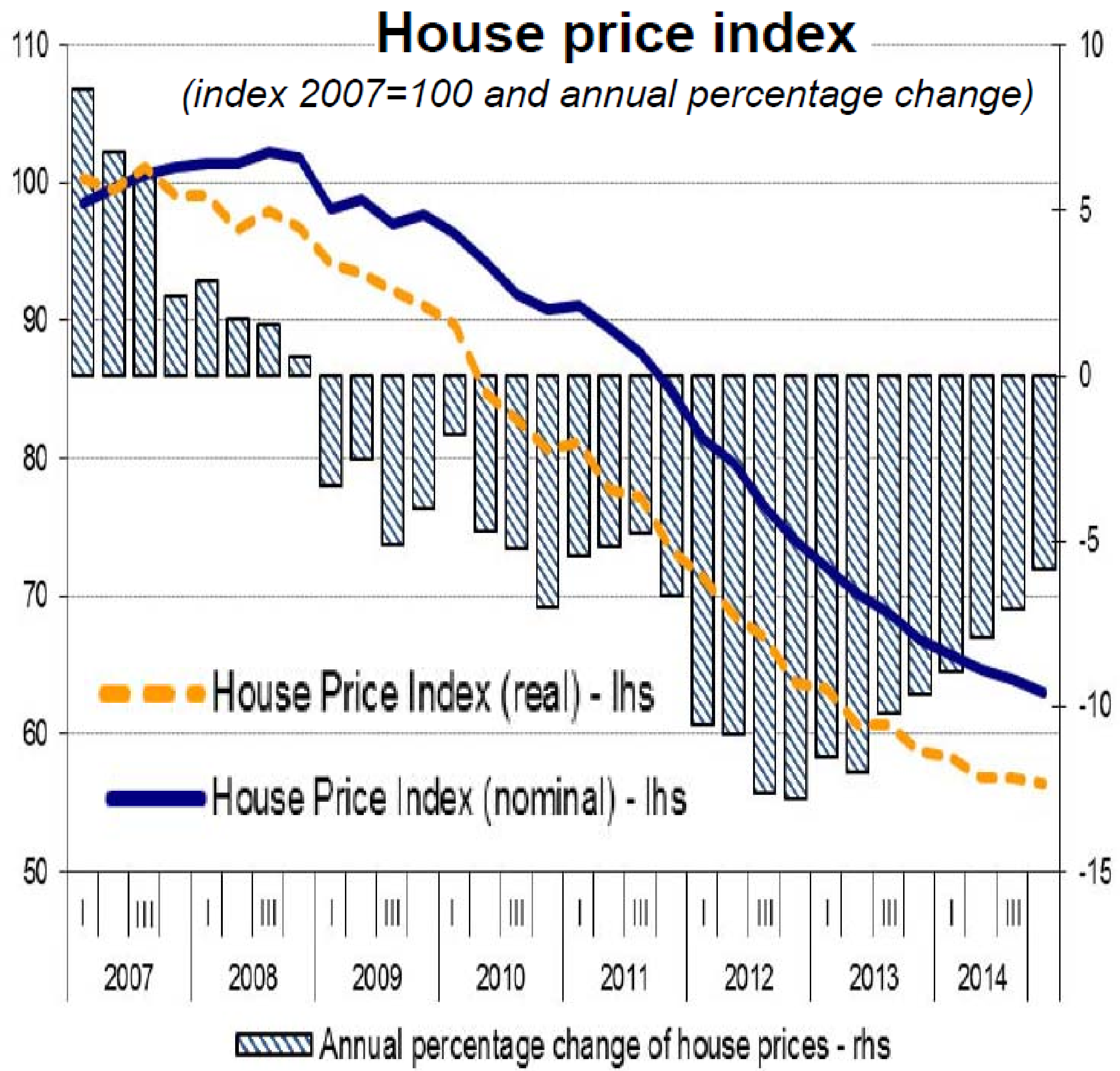
Value of Bank Collateral affected by

1) Country's worsening outlook and credibility, as ratings decline

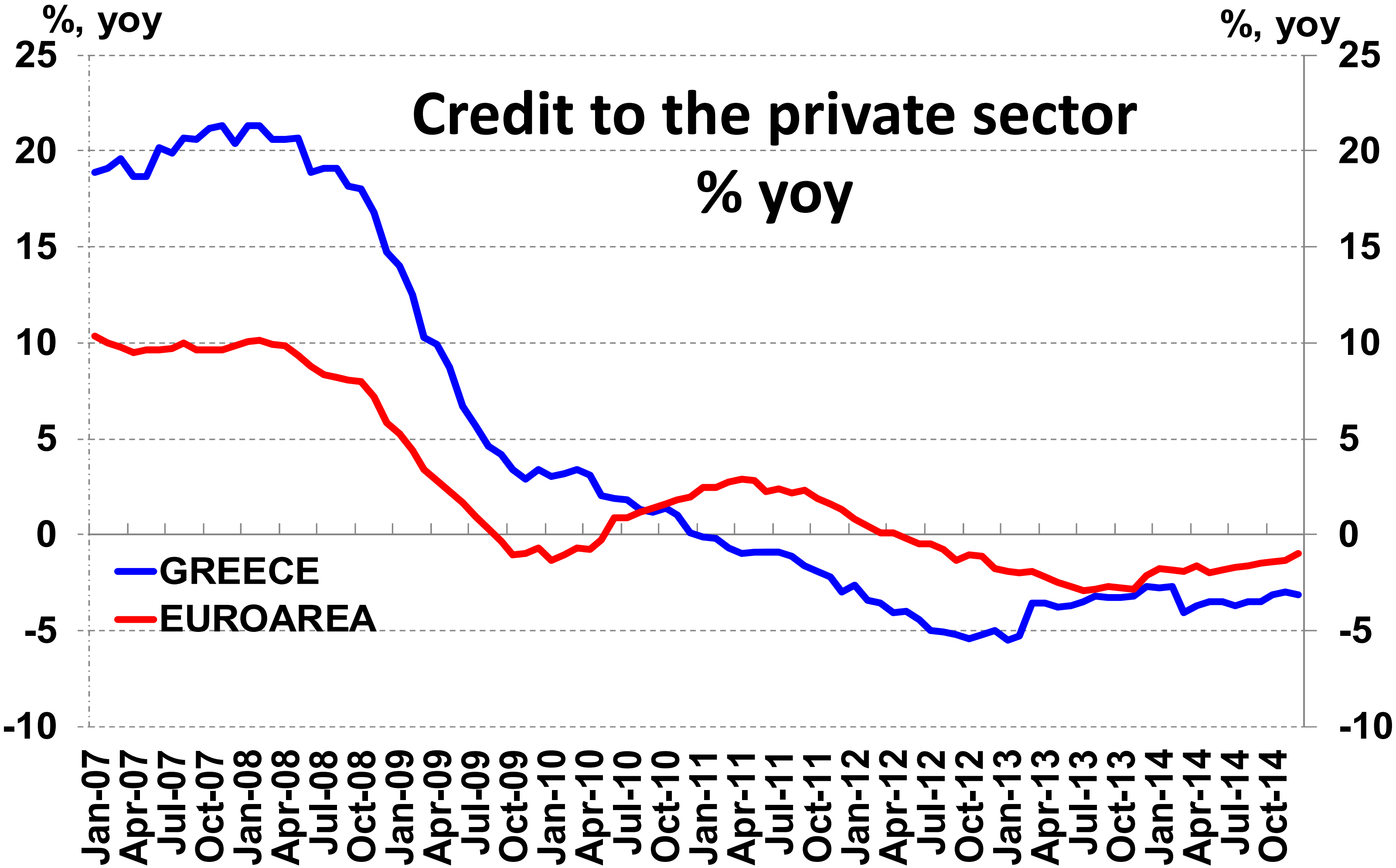
2) Decline in home values, affecting particularly credit to households

3) Rising Non-Performing Loans

February last minute Extension of the Program by 4 months avoids further deterioration

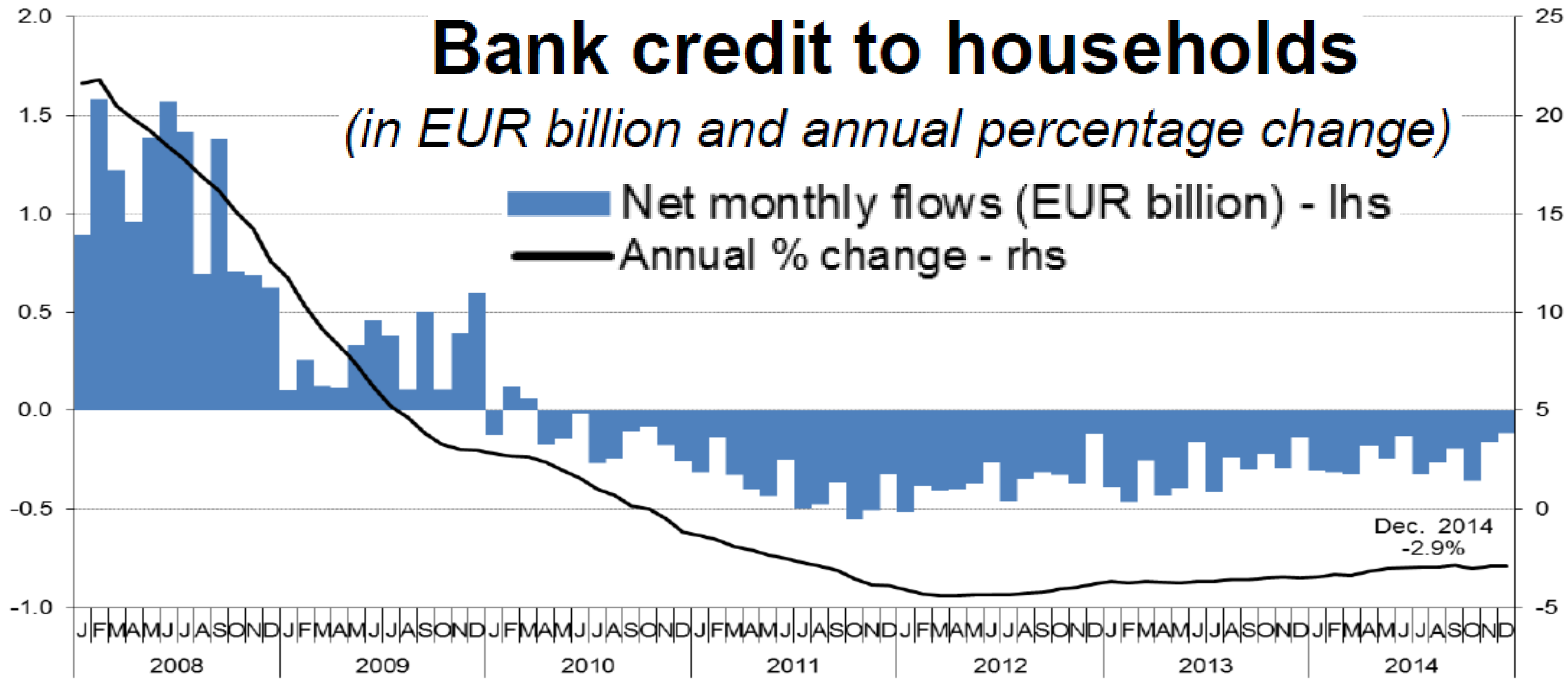


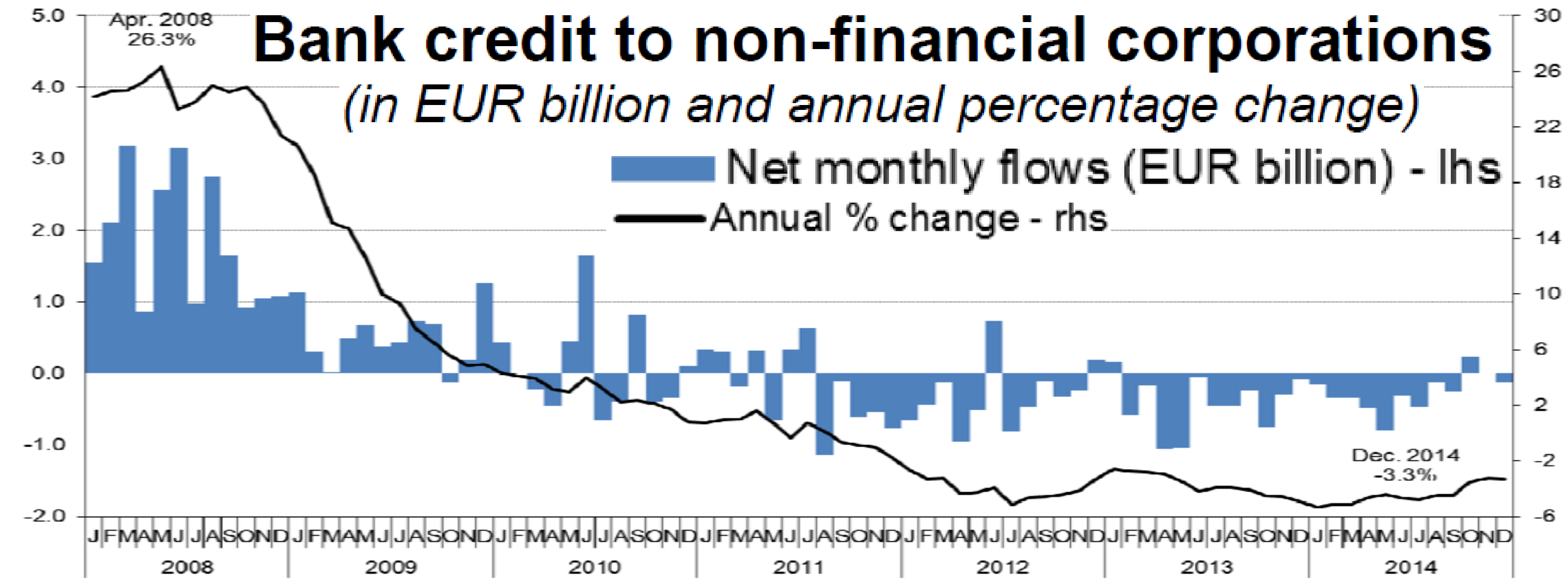
CREDIT TIGHTER THAN IN EURO AREA



Source: ECB, Ecowin

TIGHT CREDIT CONDITIONS PARTICULARLY FOR HOUSEHOLDS





PROPOSED POLICIES ON FEBRUARY 24

I. Fiscal structural policies

a) Tax policies
b) Public Finance Management & Revenue Administration
c) Public Spending
d) Social Security Reform
e) Public Administration & Corruption

II. Financial Stability

a) Installment Schemes
b) Banking and Non-Performing Loans

III. Policies that Promote Growth

a) Privatizations and Public Asset Management
b) Labor Market Reforms
c) Product Market Reforms, better Business Environment
d) Reform of the Judicial System
e) Statistics

IV. Humanitarian Crisis

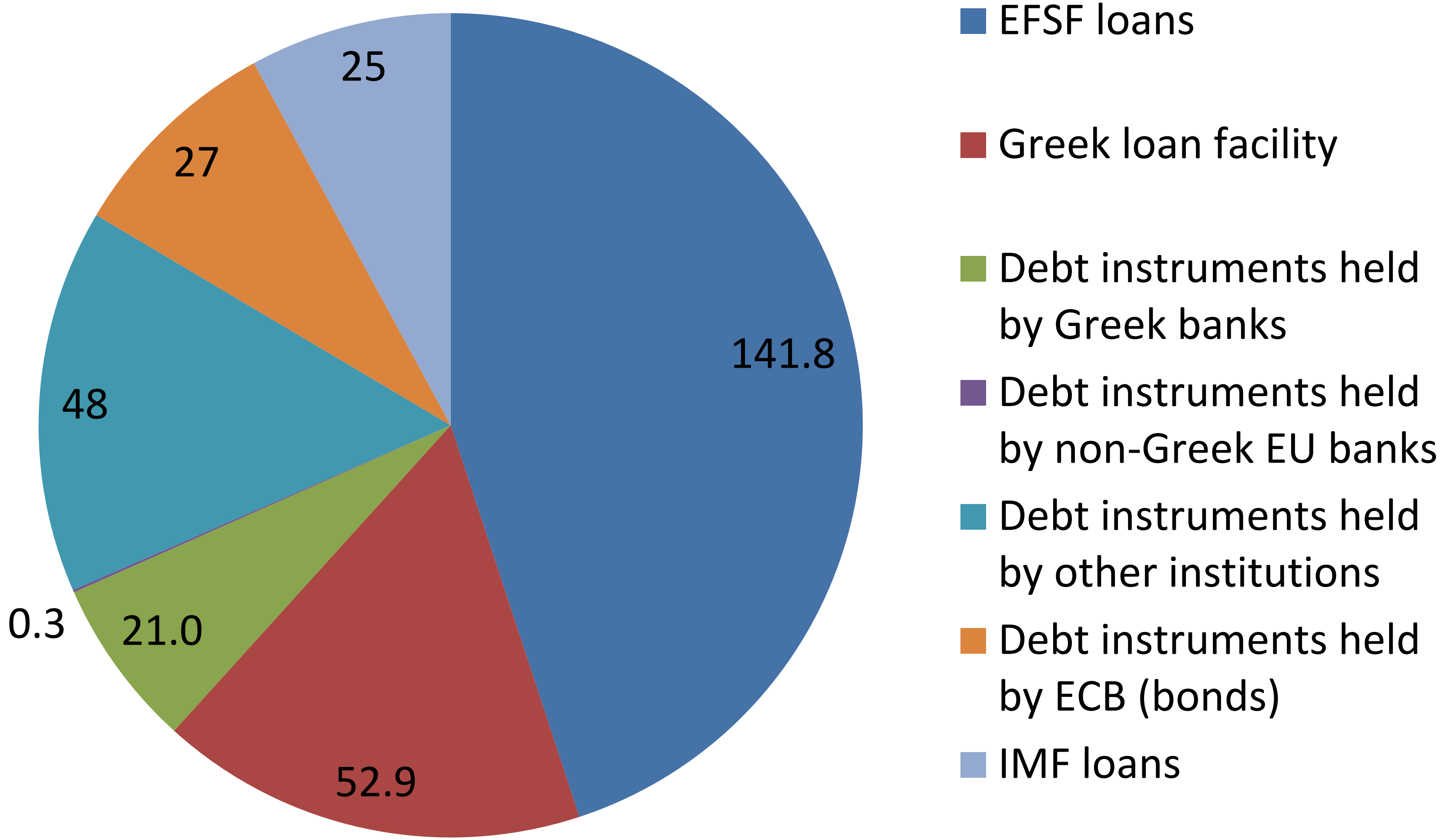
a) Absolute poverty, Minimum Guaranteed Income Scheme, no negative fiscal impact

- ✓ **The unutilized €11.4 bn were transferred back to EFSF, destroy-ing the possibility of an ECCL and raising the prospects of a 3rd rescue program in June**
- ✓ **The lower growth due to the elections overwhelms any reduction in the primary surplus target**
- ✓ **The proposed policies require intimate knowledge of the negotiations that ended in December**

III.

Assessment of possible scenarios and consequences for systemic stability of Euro Area countries

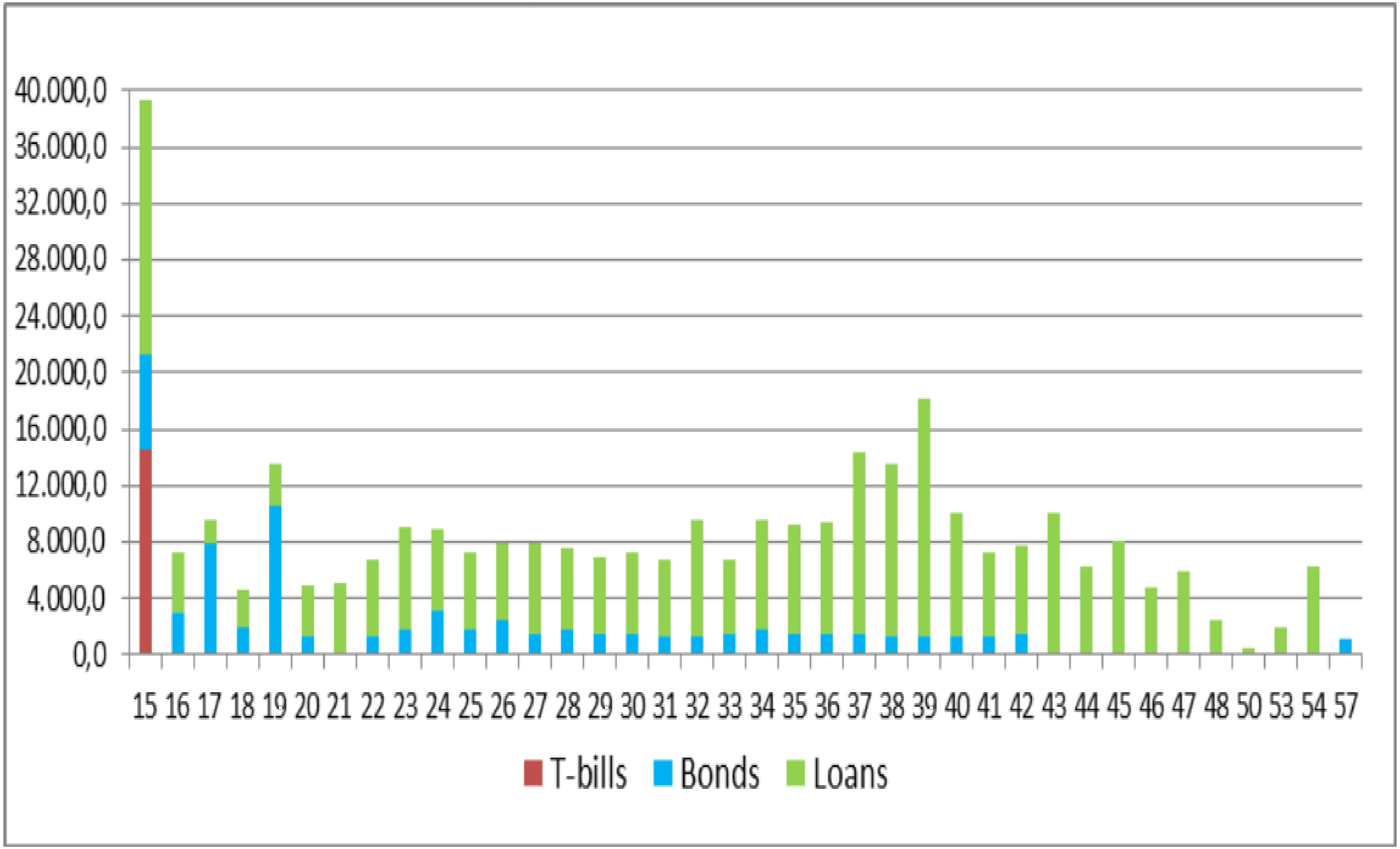
HOLDINGS OF GREEK SOVEREIGN DEBT (bn EUR)



Total (notional) value of Greek sovereign debt outstanding: **315.5bn EUR**

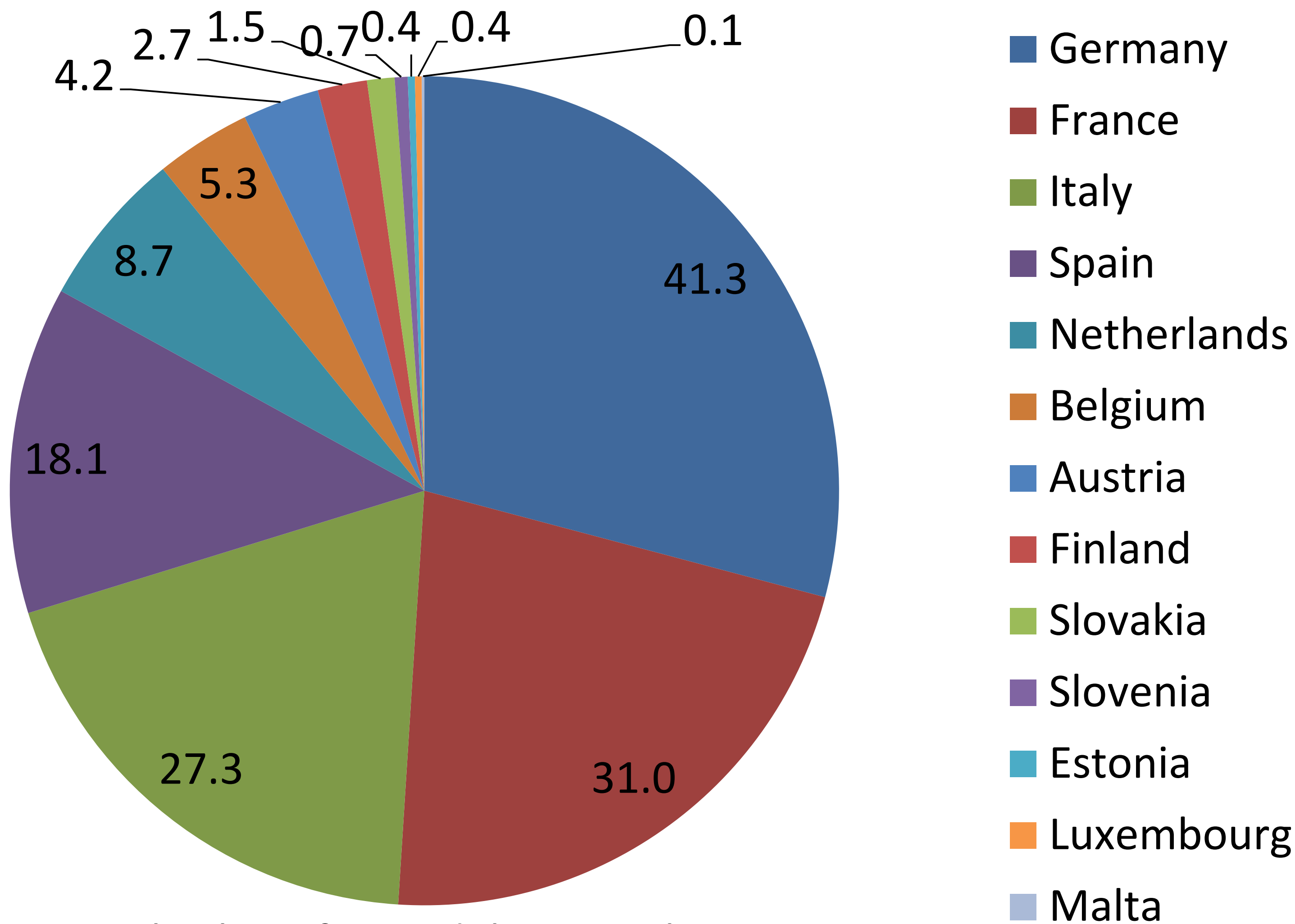
Source: Bloomberg, EBA

MATURITY PROFILE OF GREEK SOVEREIGN DEBT



Source: Greek Public Debt Management Agency

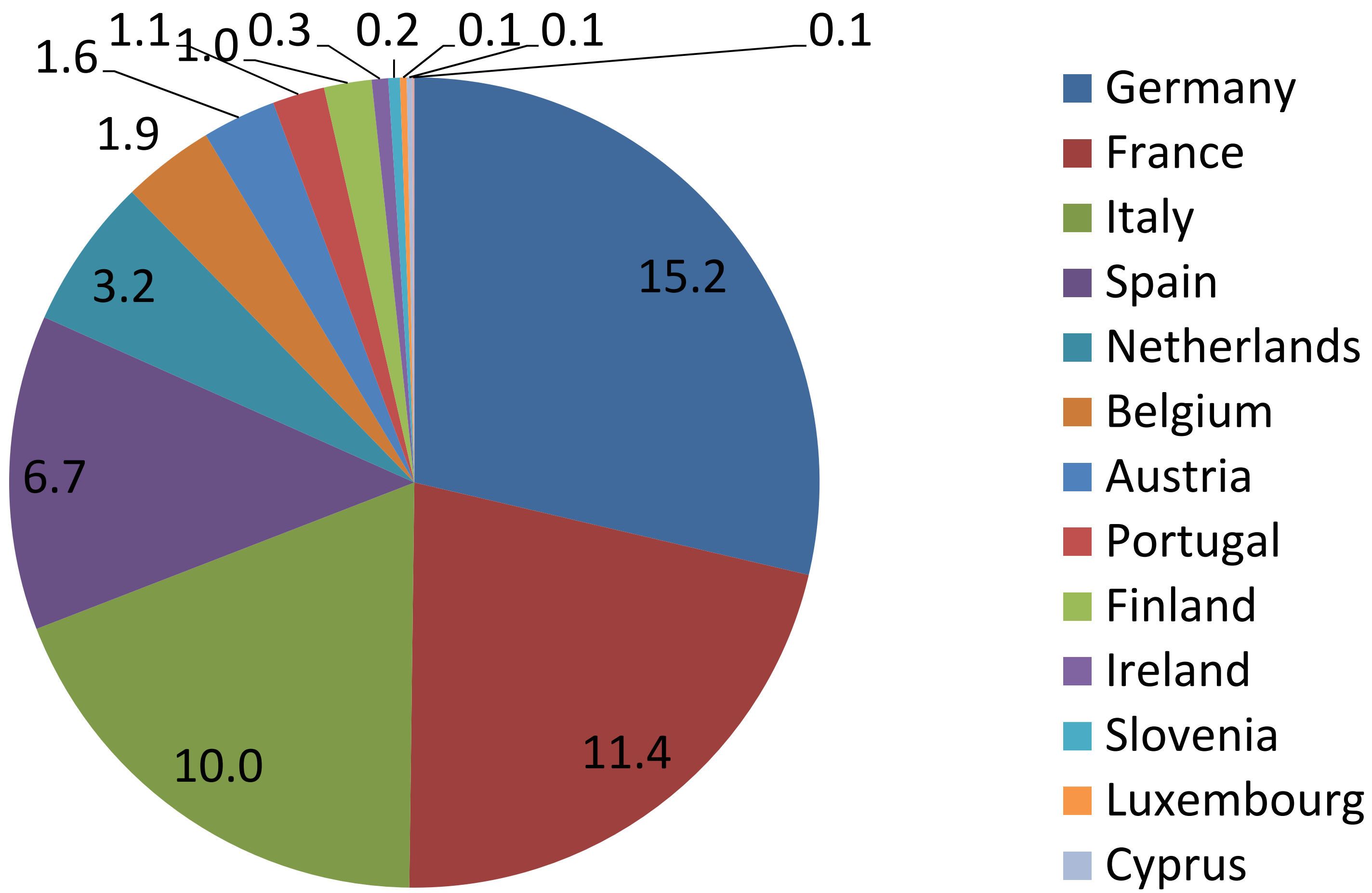
BREAKDOWN OF EFSF DEBT BY COUNTRY (bn EUR)



Total value of EFSF debt: 141.8bn

Source: EFSF

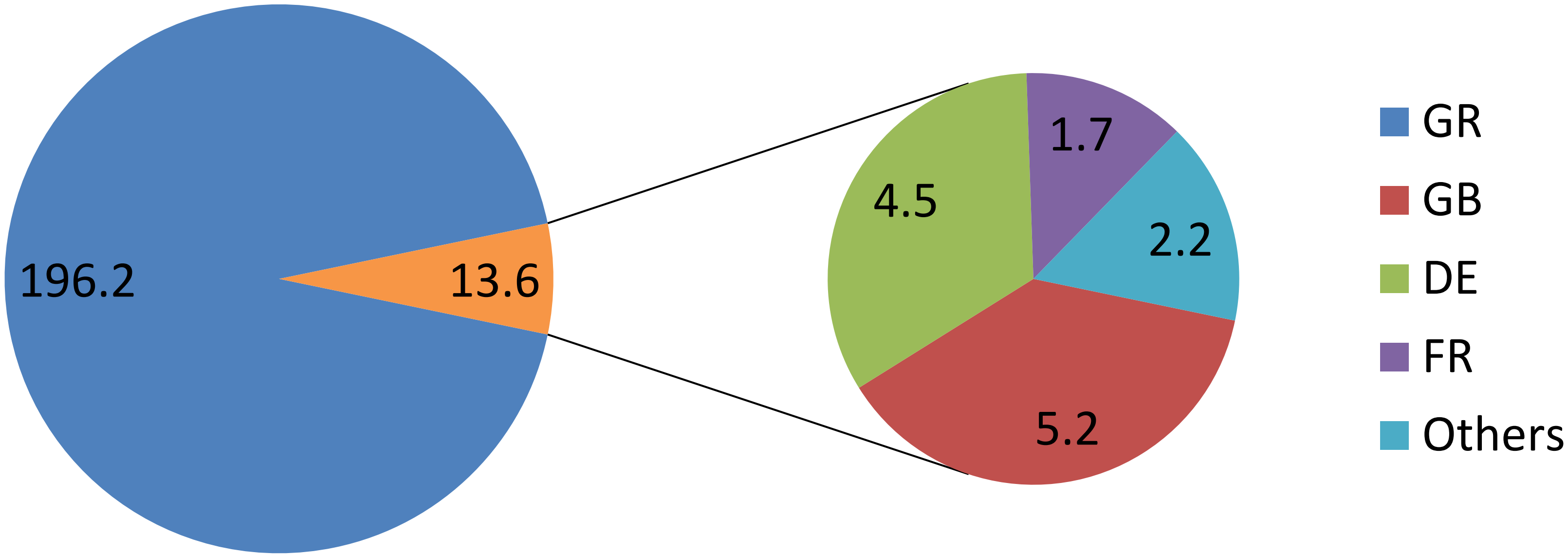
BREAKDOWN OF GLF DEBT BY COUNTRY (bn EUR)



Total value of GLF debt: 52.9bn EUR

Source: The Netherlands Court of Audit

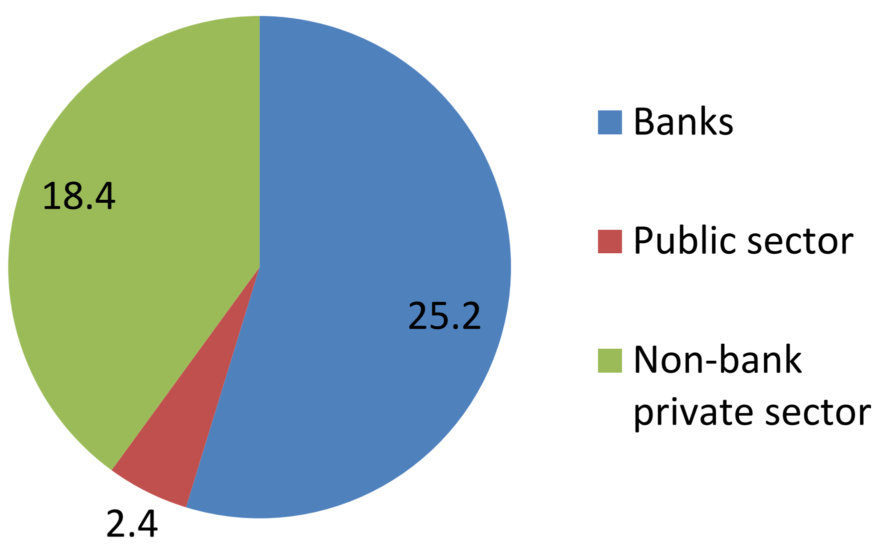
CLAIMS TO GREEK PRIVATE SECTOR, EXCL. MFIs, BY COUNTRY (bn EUR)

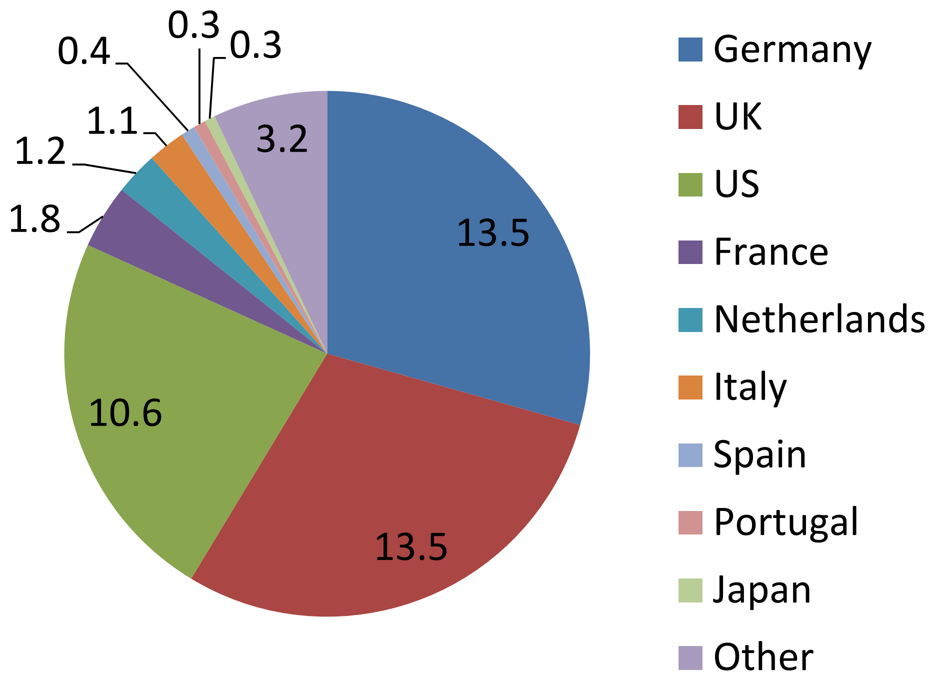


Total claims on Greek private sector, excl. MFIs: **209.8bn EUR**

Source: COREP

BANK CLAIMS TO GREECE
BY TYPE OF BORROWER AND BY COUNTRY (bn USD)

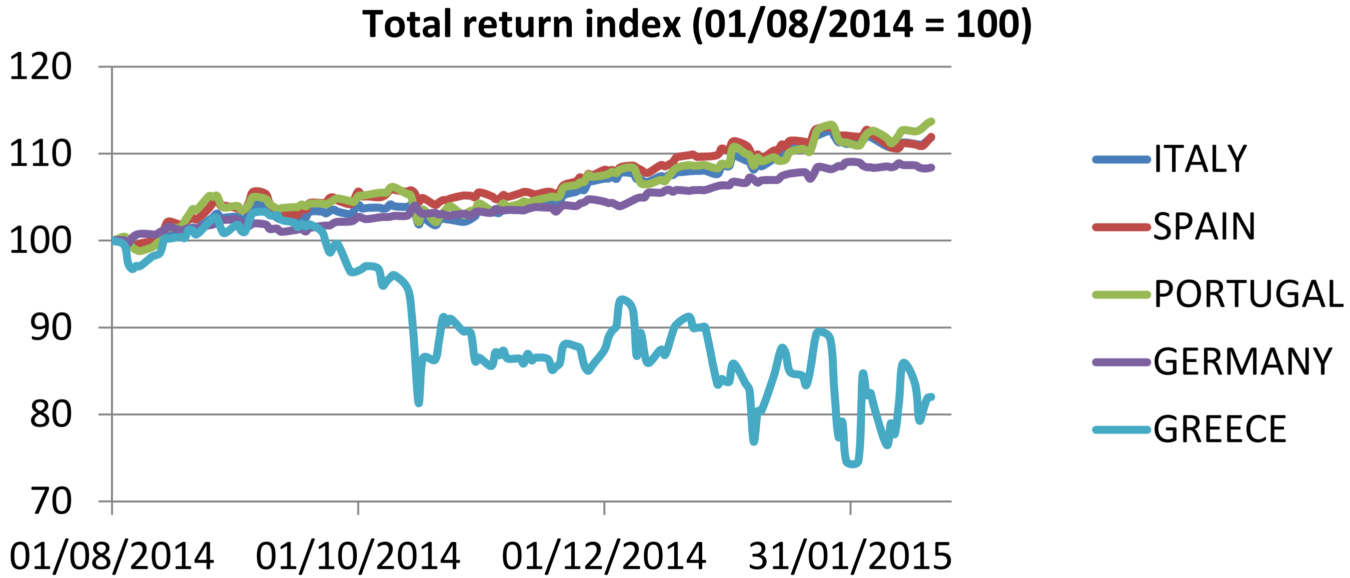


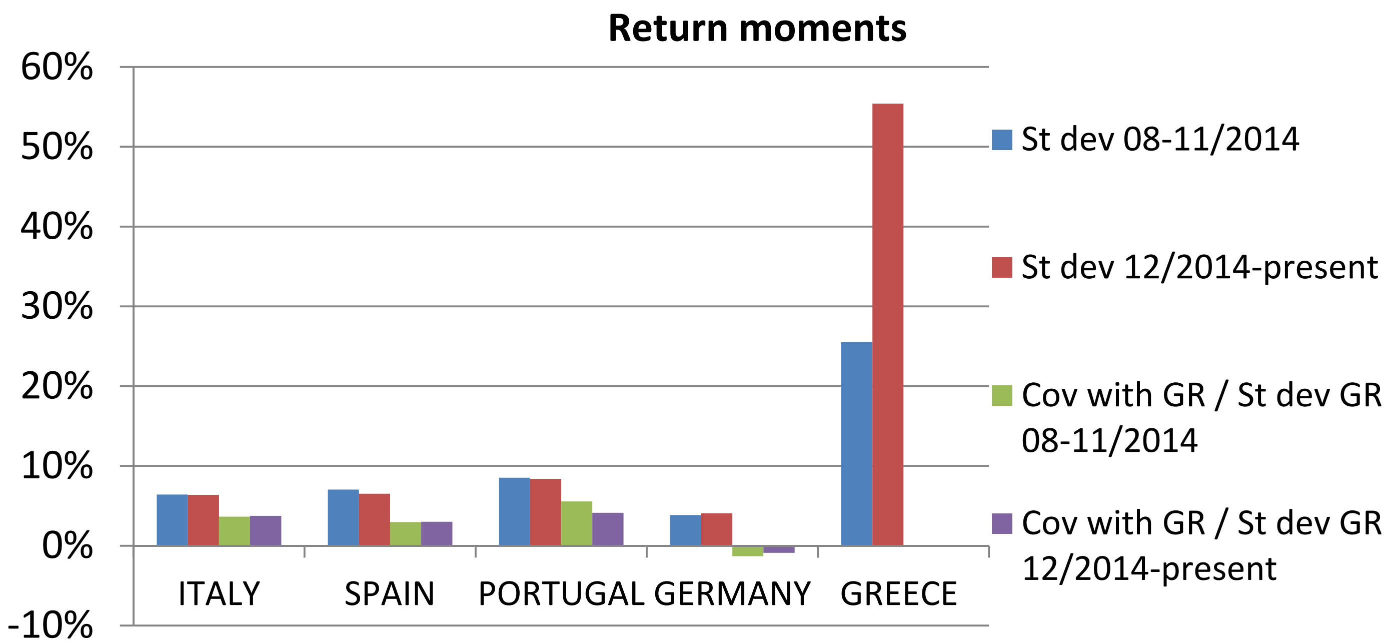


Total bank claims on Greece: **46bn USD**

Source: BIS International Claims of Banks – Ultimate Risk Basis – 09/2014

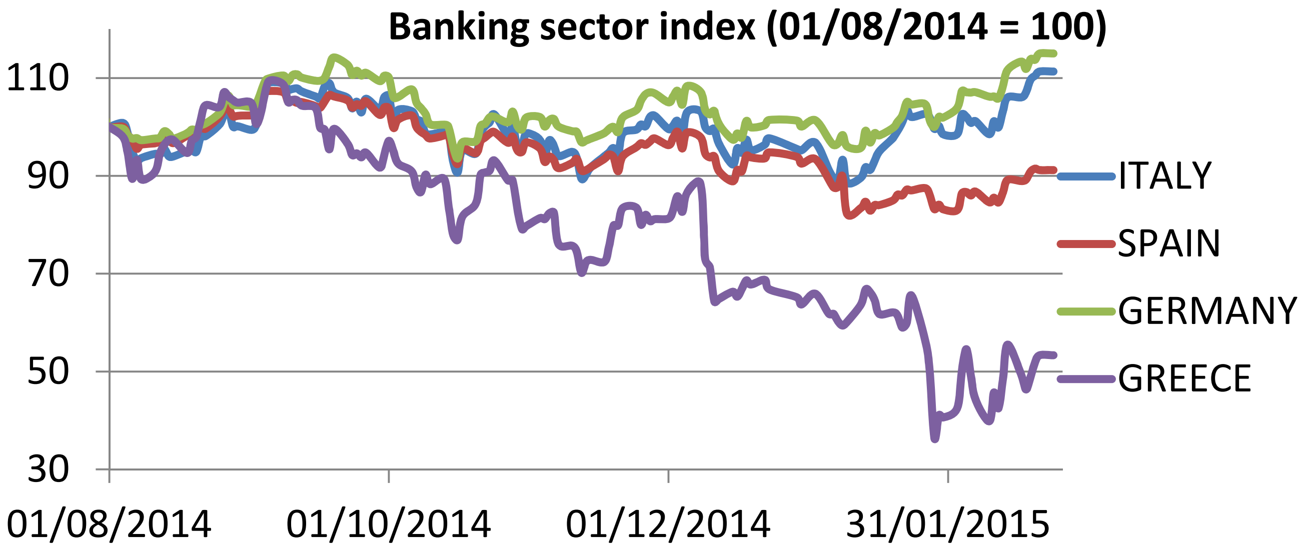
MARKET DATA: 10-YR GOVERNMENT BONDS

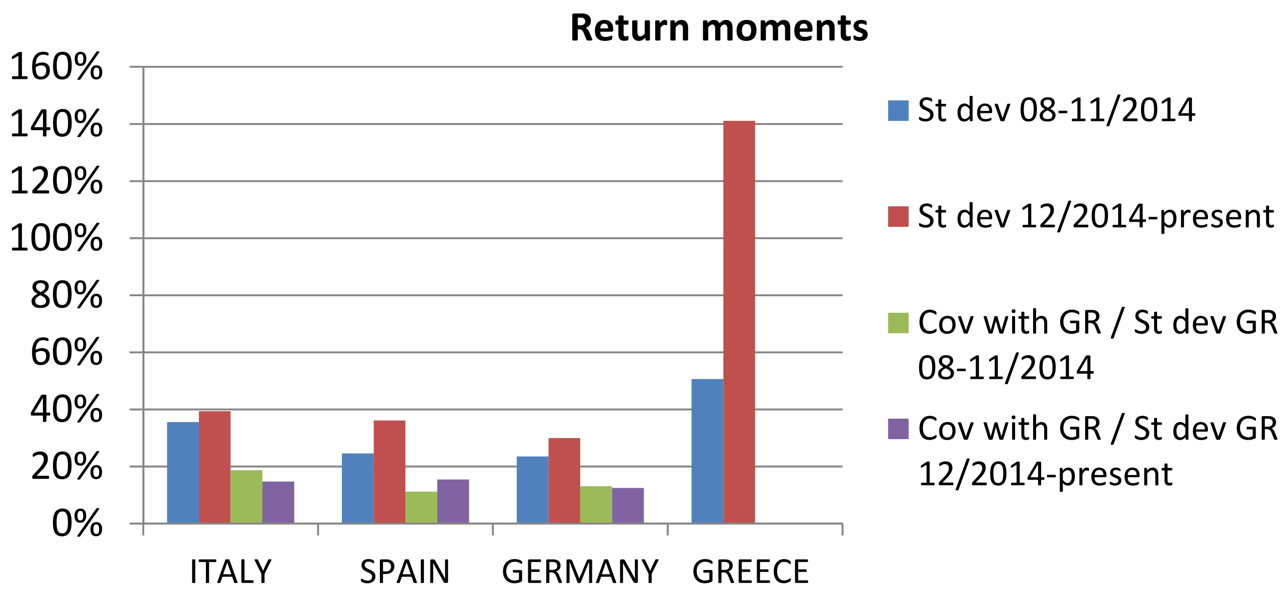




- ✓ **Decoupling: Bond prices decrease for Greece but increase for the other countries.**
- ✓ **Standard deviation of daily bond returns increases sharply for Greece since Dec 2014.**
- ✓ **No such increase for the other countries. St. dev. "explained" by Greece (= Greek systematic risk) also does not change.**

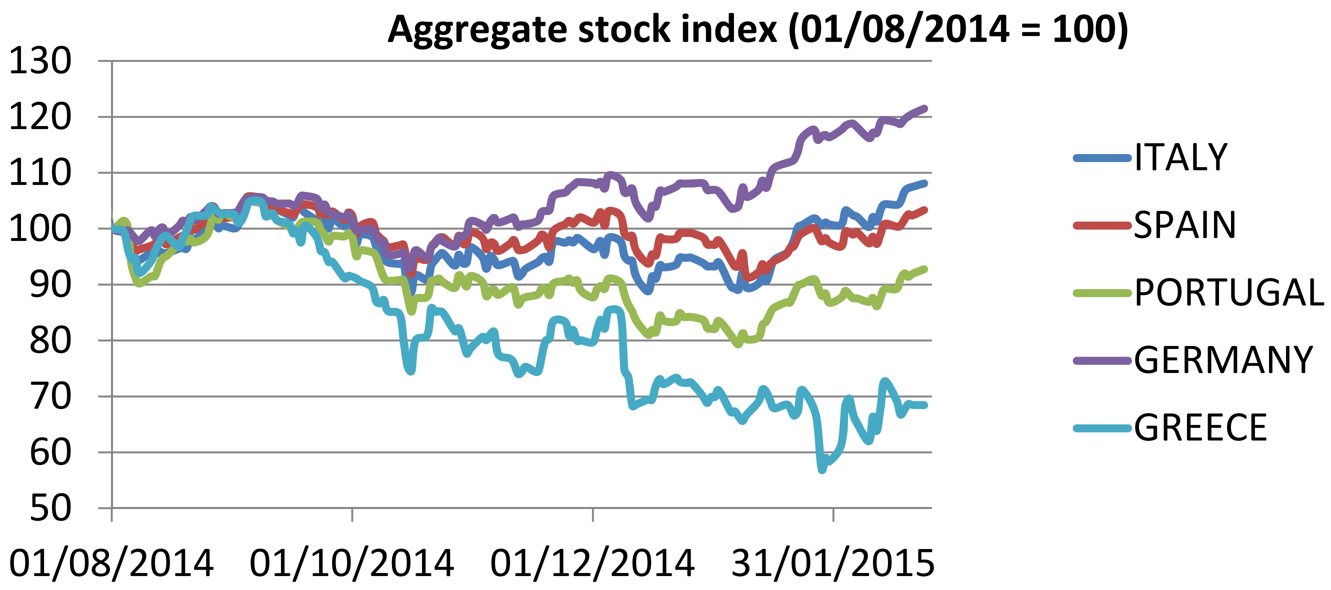
MARKET DATA: BANKING SECTOR INDICES

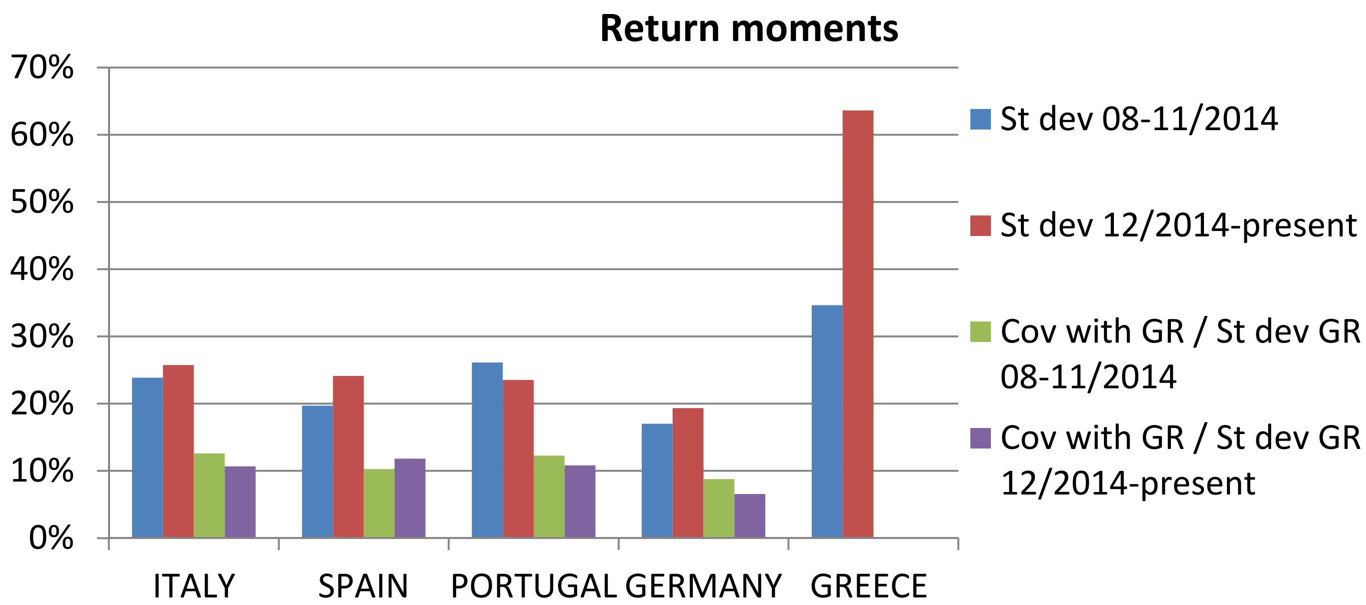




- ✓ **Bank share prices decrease sharply for Greece but remain stable for the other countries.**
- ✓ **Standard deviation of daily stock returns increases sharply for Greece since Dec 2014.**
- ✓ **Smaller increase for the other countries. St. dev. explained by Greece increases only for Spain.**

MARKET DATA: AGGREGATE STOCK INDICES





- ✓ **Stock prices decrease for Greece, but remain stable or increase for the other countries.**
- ✓ **Standard deviation of daily stock returns increases sharply for Greece since Dec 2014.**
- ✓ **Smaller increase for the other countries, with the exception of Portugal. St. dev. explained by Greece increases only for Spain.**

CONCLUSION

- ✓ Greece struggles with major disequilibria, accumulated over decades of easy credit and political neglect
- ✓ A necessary fiscal consolidation and a credit crunch caused a prolonged recession from 2008 to 2013
- ✓ The economy stabilized in 2014 and began growing, with market access becoming reality in mid 2014 , accompanied by foreign investor interest
- ✓ A switch in domestic politics and its anticipation have stalled the economy over the last 4 months
- ✓ Risks have risen as evidenced by the capital flight, a renewed dependence on the Eurosystem, a rise in NPLs, a substantial drop in stock prices and rise in yields
- ✓ Risks can be tamed as new government has started the well anticipated 180-degree turn from its excessive rhetoric
- ✓ Contagion is less of a problem today than three years ago

CONTAGION RISK

- ✓ **Exposures:**
  - ✓ **Large for official sector.**
    - ✓ **247bn EUR of EZ/ECB/IMF (notional) holdings of government debt.**
    - ✓ **90bn EUR of central-bank lending to Greek banks.**
  - ✓ **Small for private sector.**
    - ✓ **41bn EUR of bank claims to Greece (sovereign, banks, non-bank private sector). 31bn EUR for EU banks.**
    - ✓ **Most remaining exposures are by investment funds.**
- ✓ **Market data:**
  - ✓ **Government bond market:**
    - ✓ **Decoupling.**
    - ✓ **No evidence of contagion.**
  - ✓ **Stock market:**
    - ✓ **Limited evidence of contagion.**