Greek Crisis Phase II:

Is it over?

or

there is more pain in sight?

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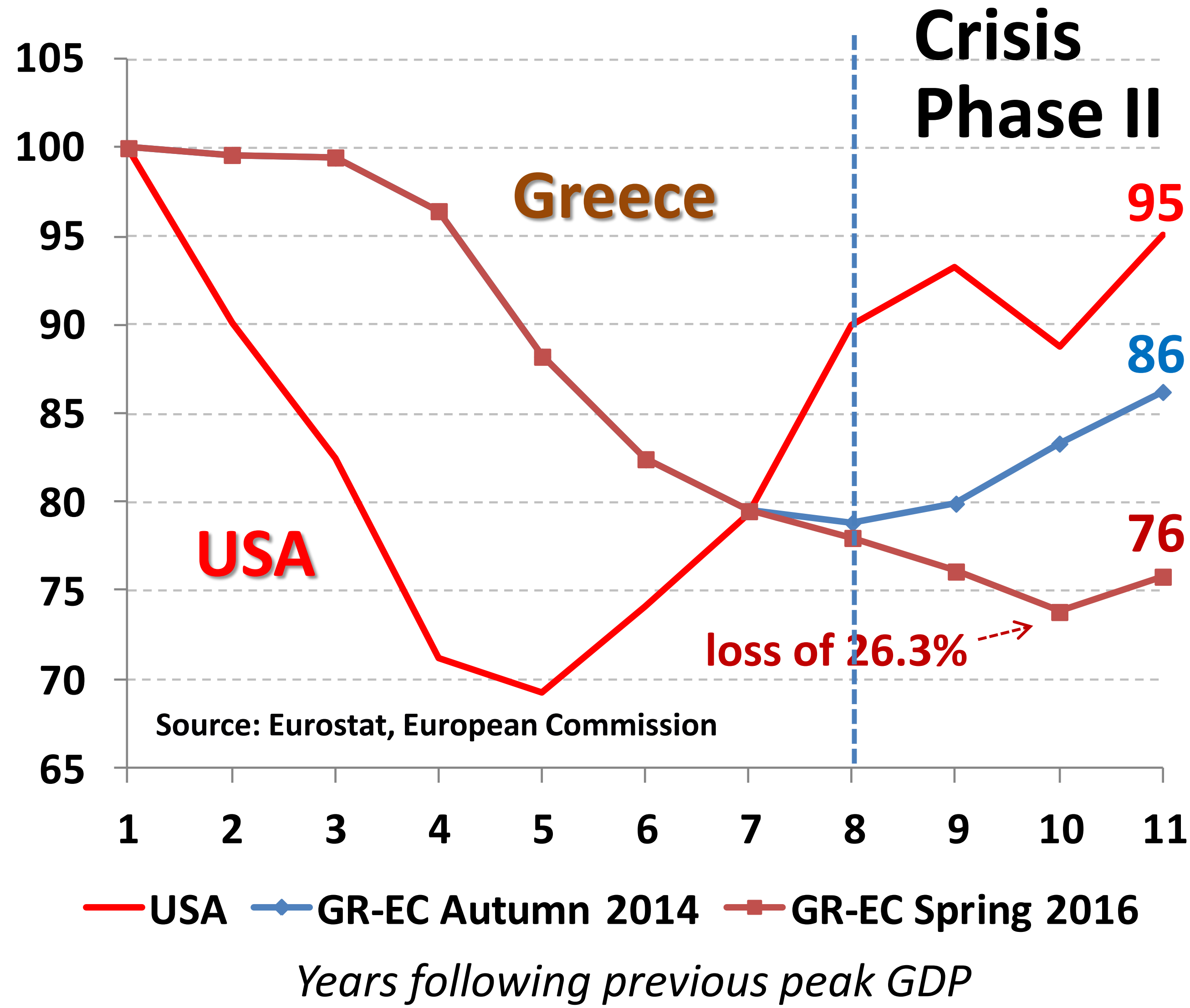
June 22, 2016

Introduction

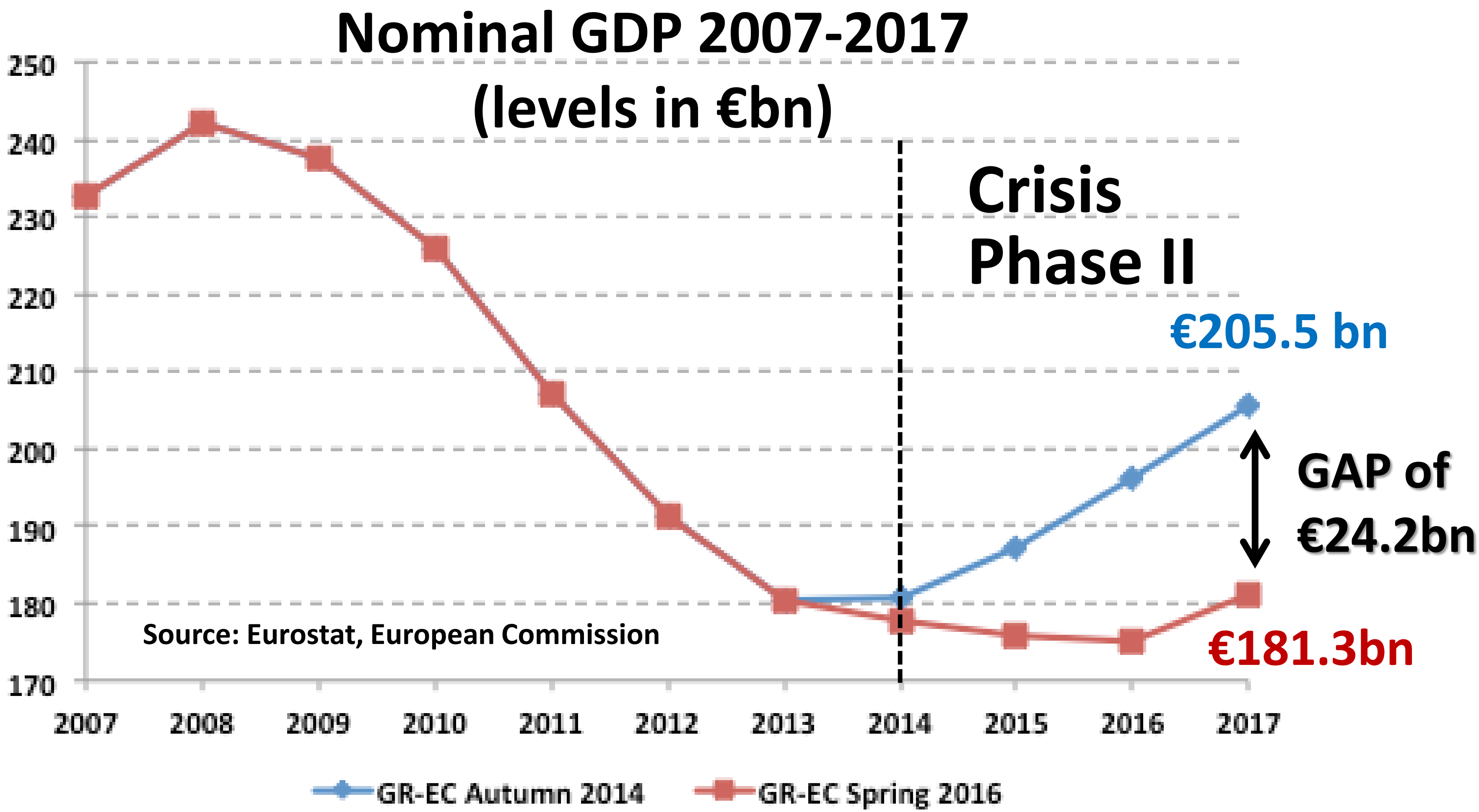
- **Phase I of the Greek-only Crisis** (2010-2013):
  - Huge loss in incomes, increase in unemployment
  - Yet remarkable adjustment of earlier disequilibria
  - **We then (in 2014) thought the crisis was over!**
- **But … Phase II of the Greek Crisis began in January 2015**
  - Phase II of the crisis <u>cannot be blamed</u> on earlier economic disequilibria, but on …
  - A new political reality, confrontation with the lenders, stalling and declining output, capital controls
  - A 3rd Adjustment Programme 2015-2018
  - 3rd bank recapitalization, sluggish economic policy, NPLs rising again
- **The big question today: Will growth come back and how?**

Greek crisis brought a worse recession than the Great Depression in the United States

- Date 1 is 1929 for the US and 2007 for Greece and real GDP is at 100
- After 10 years, the US was at 95 in 1939 but Greece at 76 in 2017
- In the Fall 2014, Greece was forecasted to be at 86: A loss of 10 ppts. over 2015-2017
- Phase II of the crisis began in 2015



Phase II of the crisis: Viewed in terms of nominal GDP, a permanent gap of over €20bn per year



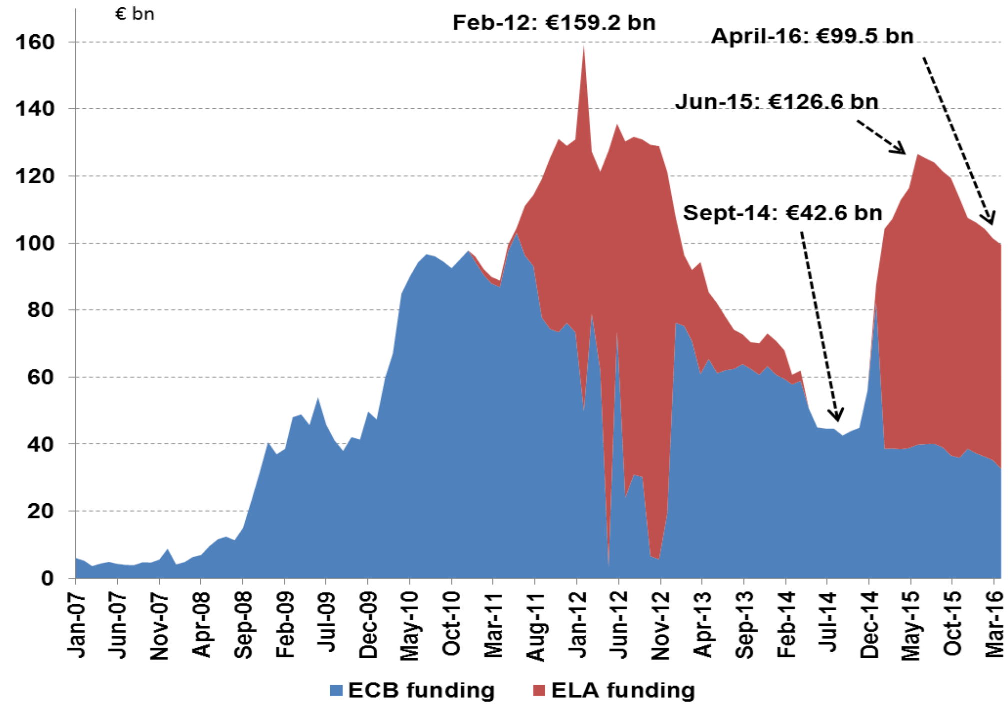
- This is a permanent loss of around €2000 per capita

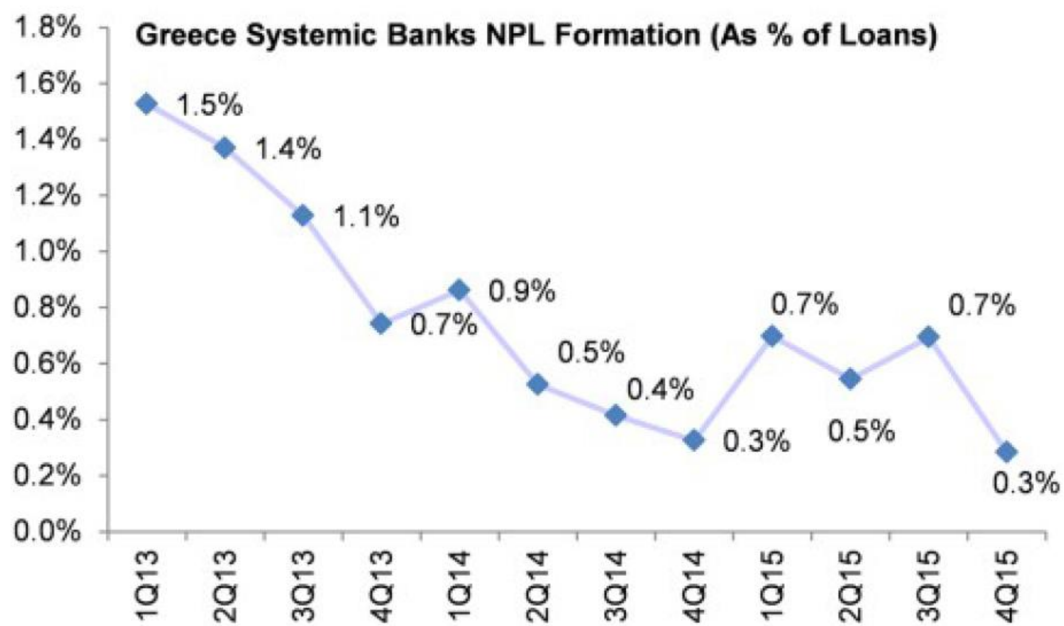
Crisis Phase II: Bad news not only on GDP, on Nominal Debt as well

- **Bad news on Nominal Debt**, which will, ceteris paribus, deteriorate by approximately **€50bn or 30% of GDP**:
  - By 7.75% of GDP or €13.5bn from the lower primary surplus targets up to year 2018
  - By 14% of GDP or €25bn from the loss in bank stock value under State ownership since the summer of 2014
  - By another 4% of GDP or €7.1bn of the required new capital infusion into domestic banks since November 2015 just in order to keep the new much lower stock participation intact.
  - By possibly another 3% of GDP or €5bn from the collapse in asset prices and the reduced value of privatization receipts
- All the above together with a **much lower growth trajectory past 2018** than earlier anticipated (i.e. a growth rate of 2% instead of 3.0%-3.5%) make the Debt-to-GDP ratio clearly unsustainable
- Debt relief is now a must. This is the IMF view. It is thus puzzling the Greek government chose to make the IMF its "enemy." Perhaps due to their insistence on reforms.

Crisis Phase II: Financial sector deteriorates more

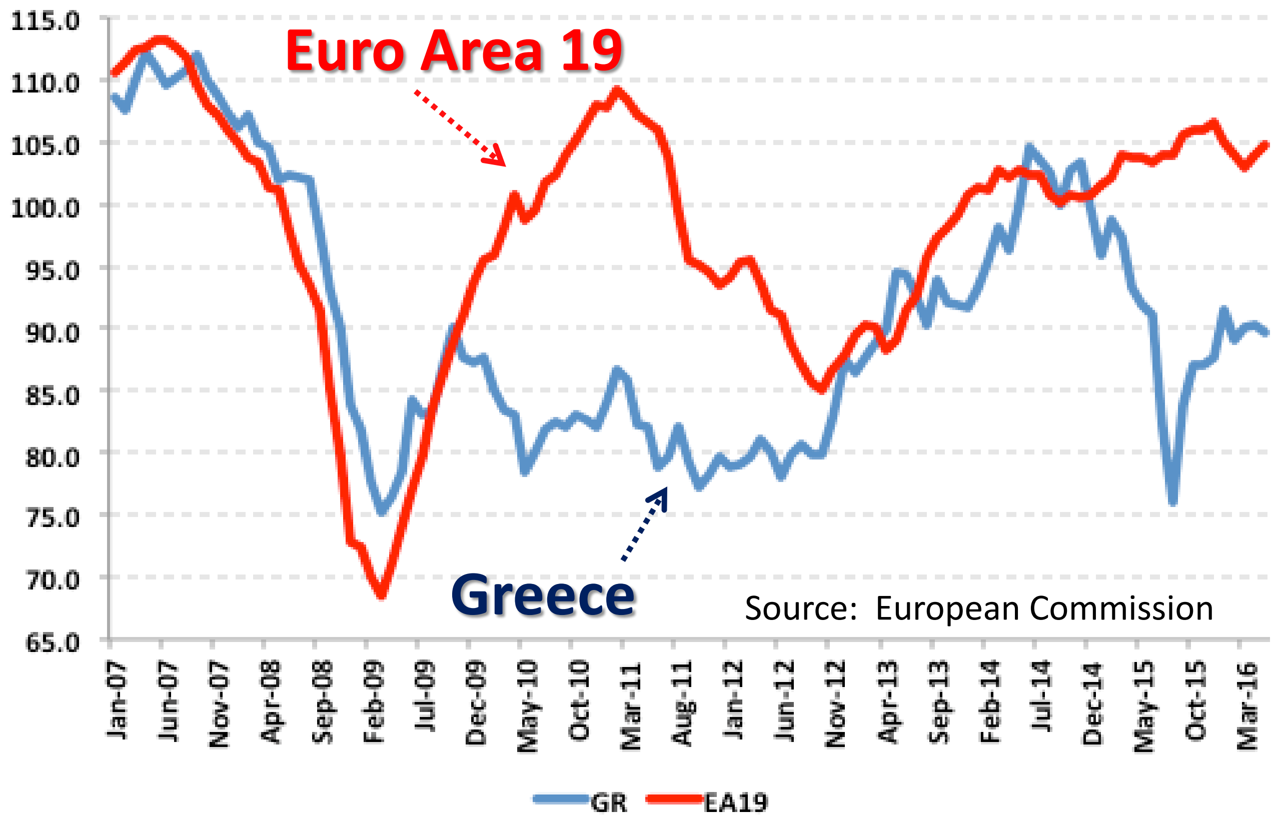
- Crisis Phase II in the financial sector as well:
  - Use of ELA was zero at the end of 2014, yet it peaked again in 2015 and its need continues despite the upcoming waiver
  - Creation of new NPLs was declining in 2014 but began rising again in 2015
- Some promising positive signs in 2016 in lower new NPLs
- After 3rd recap, State owner-ship of systemic banks shrank: NBG (40.4%), Piraeus (26.4%), Alpha (11.0%), Eurobank (2,4%)





Phase II of the crisis: Shows up in Economic Sentiment

- The sentiment index in Greece moved together with sentiment in EA until late 2009, both declining
- Decoupling during the Greek crisis until October 2012
- 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

The million dollar question: Can growth come back beyond simply a cyclical recovery?

- Has Phase II of the Greek Crisis caused a permanent damage or it simply represents a 2-year delay to an inevitable growth take-off which began in 2014?
- <u>NEGATIVES:</u>
  1. Economic policy remains unfocused: There is no clear growth strategy, no commitment for reforms and credibility is still wanted → **dismal Long-run prospects**
  2. Fiscal mix provides wrong incentive for growth, as Greeks are <u>overtaxed</u> → **dismal Long-run prospects**. Also, fiscal multiplier implies a drop of GDP by 3%
  3. The youth is immigrating and companies are registering abroad → **dismal Long-run prospects**
  4. Debt relief is postponed for 2018, after German elections
  5. Delays : The first Review of the 3rd program was supposed to have been concluded last October. Yet, only recently it got settled. This affects growth negatively
  6. Financial sector cannot help, this time the economy ought to improve on its own
  7. Risk of further automatic restrictive fiscal measures if targets not met
- <u>POSITIVES</u> **are of cyclical nature only**
  1. Arrears of €9bn may be paid back, yet with a delay up to June 2017
  2. ECB reestablished the waiver on Greek banks plus it may include Greek bonds in its QE program, which would drastically reduce bond yields

An Optimistic Macroeconomic Outlook for 2016-17

	2015, €bn (nominal)	2015 Real YoY%	2016 Real YoY%	2017 Real YoY%
GDP	176.0	-0.2	-0.3	2.7
Private Consumption	123.8	0.3	-0.4	1.8
Government Consumption	35.2	0	-0.5	-0.1
Gross Capital Formation	17.3	-13.1	-1.0	12.7
Gross Fix. Capital Formation	20.5	0.7	-0.9	11.6
Exports	53.0	-3.8	0.5	4.2
Imports	53.3	-6.9	-0.1	3.8
GDP Deflator (yoy%)		-0.6	-0.2	0.8
Unemployment Rate (%)		25.0	24.7	23.6
Priv. Sector Deposits (yoy%)		-23.0	6.3	7.5
Private Sector Credit (yoy%)		-3.6	-1.0	2.7

Source: ELSTAT, EC, own forecasts for 2016, official forecasts for 2017

- Key assumptions
  - Global economy evolves in line with the latest official sector forecasts
  - Political ownership of the reform agenda implementation, which is questionable

Concluding remarks: An uncertain future ahead of us

- Europe faces major challenges that go beyond BREXIT
- Greece faces even bigger ones
  - Greeks may have reached their limit in absorbing tax increases → Immigration of people and companies
  - Avoiding persistent stagnation becomes increasingly more difficult
  - Country needs fiscal breathing space – a reduction in taxation - and a willingness to reform (program ownership)
  - No external force exists to counteract a potential downward economic slide: Europeans have stopped paying attention to Greek growth prospects as contagion risk has diminished, hence their pressure for reforms in Greece has subsided

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**Thank you
for your attention!**

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