The Financial Crisis and the Region of South Eastern Europe

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The Global Financial Crisis Continues

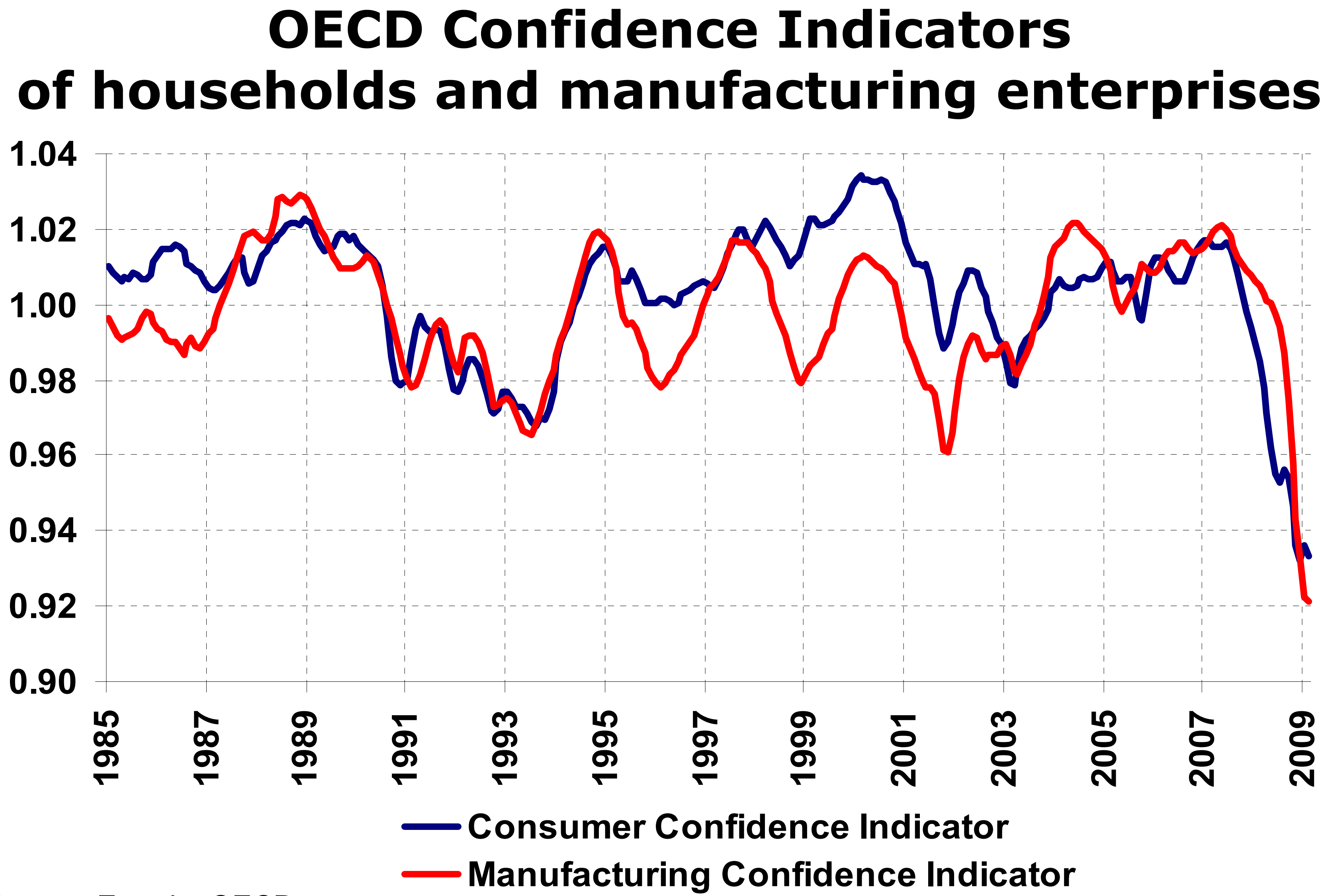
1) A rapid global slowdown
2) Two unresolved key financial problems
3) Authorities' response and the uncertain economic future

I.1 The global economy is facing the deepest – and probably longest – recession of the post-war period

Source: EFG Eurobank Research

✓ **We expect a significant deceleration in 2009 and a sluggish recovery in 2010**

I.1 Global Leading Indicators collapse



Source: Ecowin, OECD

I.1 No country escapes the slowdown

	2007	2008F	2009F
Real GDP Growth (% y-o-y)			
Global GDP growth	3.8	2.2	**-0.5**
US	2.0	1.1	**-2.2**
EA	2.6	0.8	**-2.9**
UK	3.0	0.7	**-3.1**
Greece	4.0	2.9	**0.2**
Japan	2.4	-0.7	**-4.0**
China	13.0	9.0	**6.8**
Russia	8.1	5.6	**-3.0**
India	9.2	7.4	**4.5**
Brazil	5.7	5.0	**0.0**

Source: Eurobank EFG

Three main sources of the global slowdown:

- ✓ Decline in growth of exports attributed to weakening global demand
- ✓ Lower domestic credit expansion
- ✓ The slump of asset prices (stocks, real estate, commodities) plus FX devaluations in some countries

I.1 A slowdown in our region as well

Optimistic scenario for 2009

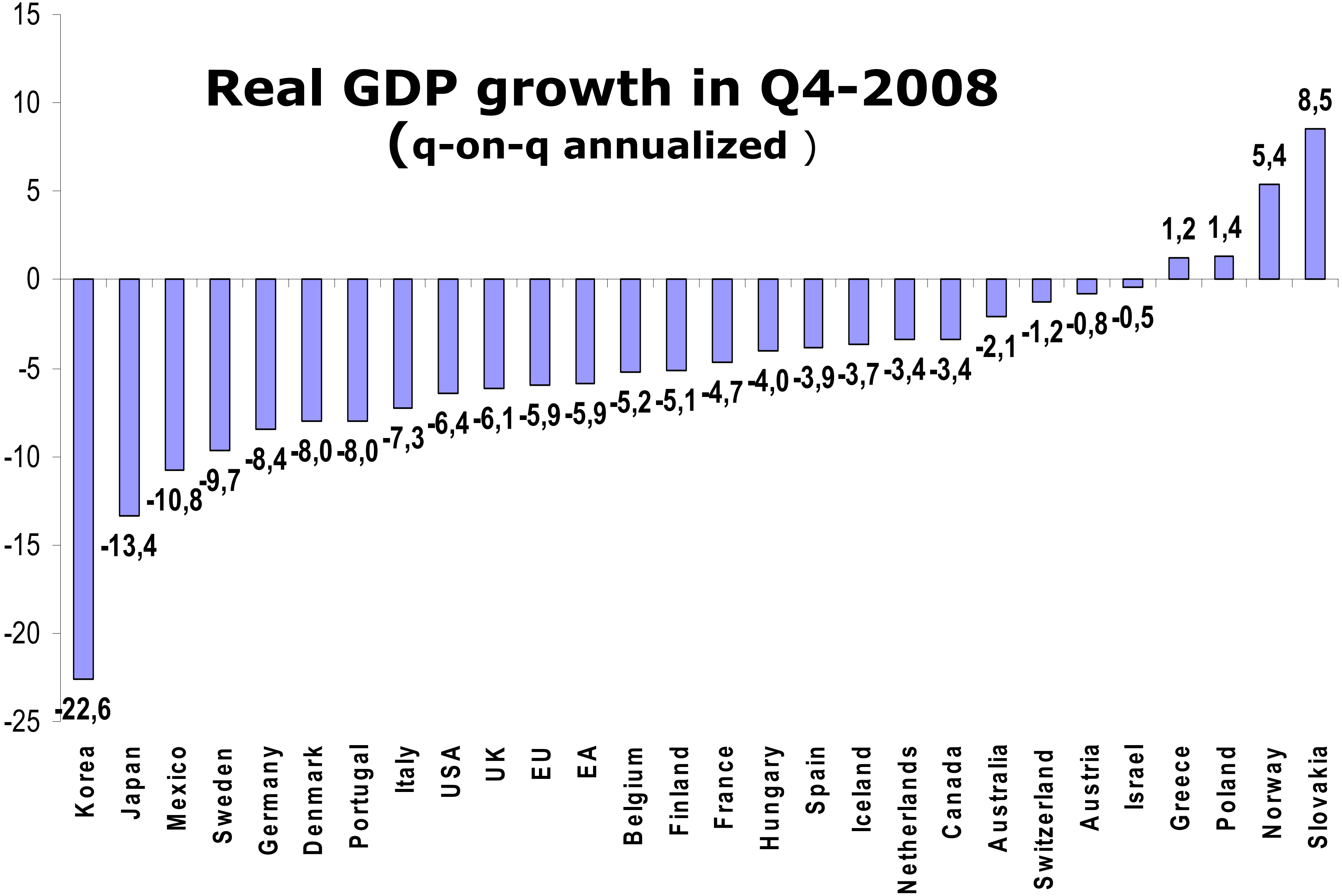
Real GDP Growth (% y-o-y)	2007	2008F	2009F
NE GDP growth	5.9	4.0	**-0.4**
Bulgaria	6.2	6.4	**1.0**
Poland	6.7	5.0	**1.7**
Romania	6.2	7.8	**1.0**
Serbia	7.1	6.0	**1.3**
Turkey	4.6	1.0	**-1.0**
Ukraine	7.6	6.0	**-5.0**

Source: Eurobank EFG

The sources of regional slowdown are similar but more severe:

- ✓ Earlier overheating economies with large credit expansion, a lot in FX
- ✓ Earlier real estate price bubble
- ✓ Huge current account deficits and dependence on foreign credit

I.1 Fast decline in Q4 2008



I.1 How come we missed the crisis? Economists' past illusions

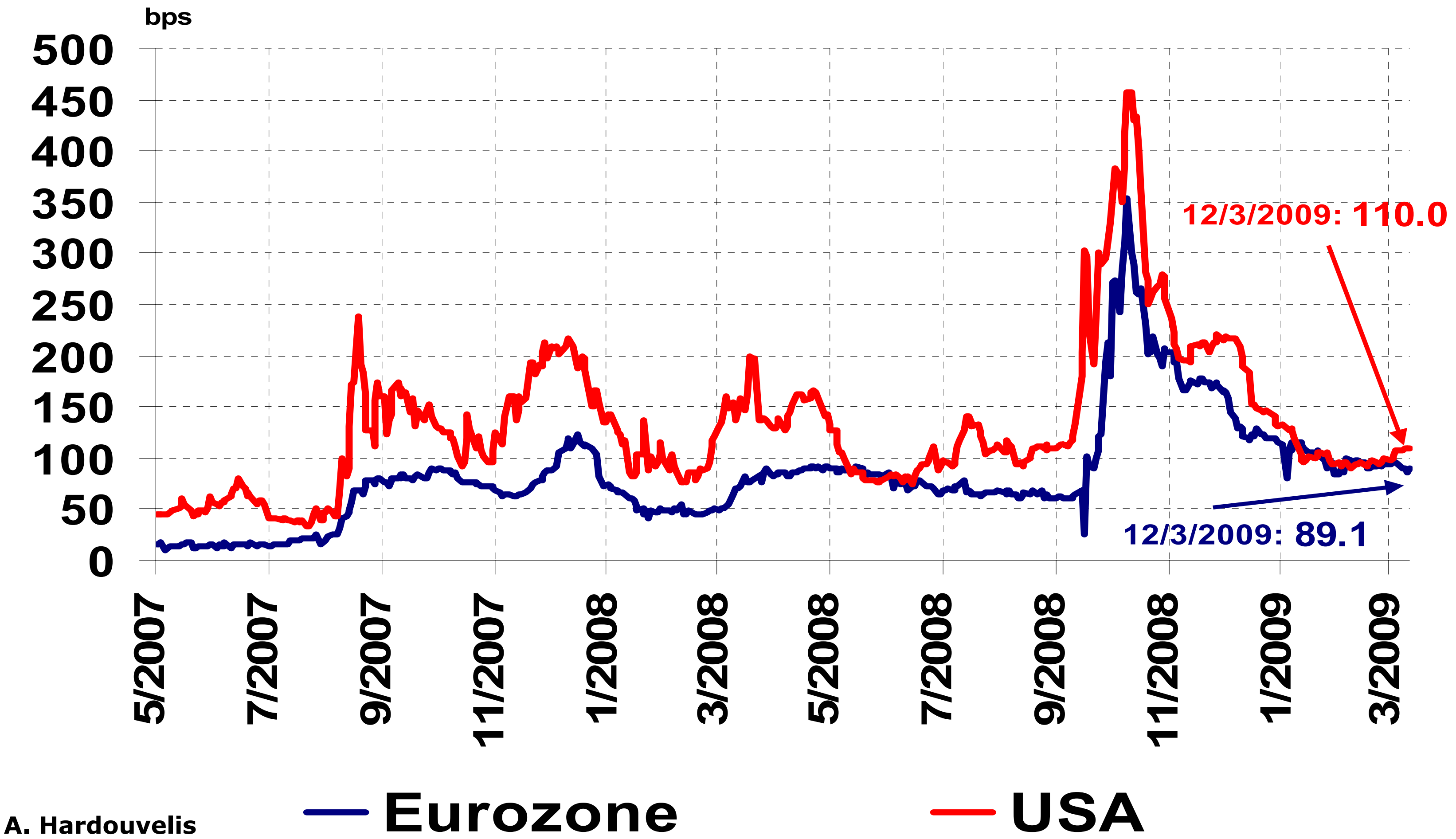
- ✓ **The illusion of conquering volatility**: Macro-economists, oblivious to the underlying asset "bubbles" and global imbalances, were debating up until recently the question as to who takes the credit for the period of "**great moderation**," i.e., the observed low inflation and high global growth
  - The period 2002-2007 records the highest average 5-yr growth of the last 40 years in a low inflation environment
  - Some believed business cycle is dead. Yet data show negative correlation between standard of living and volatility of economic activity
  - Globalization & better methods of communication produced new interconnections and allowed better diversification of small shocks
  - Yet these interconnections allow dominos, thus made the economies vulnerable to the low probability events of large shocks
- ✓ **The illusion that markets can monitor opportunistic behavior**
  - "Free markets" does not mean "unregulated markets"
  - "Greed promotes innovation & growth but when left unchecked by the appropriate institutions and regulations, it will degenerate into rent-seeking, corruption and crime" (D. Acemoglou, who also argues that a third illusion existed that reputation capital suffices for self-regulation by long-living firms)
- ✓ **Yet, pointing the finger at economists is like blaming a doctor as to why she did not predict the common flue would turn into pneumonia**

I.1 It all began in the financial sector

- ✓ Now, the crisis is already 20 months old, growing worse over the last six months
- ✓ **Many underlying causes**:
  - – Large global imbalances ⇨ cheap money or liquidity from surplus countries channeled mainly to US
  - – Housing bubbles & the subprime explosion without adequate bank controls on credit risk, e.g. interest rate only loans, etc.
  - – Securitization and its new complicated and non-transparent layers in CDOs, together with new private players outside the reach of Fannie Mae and Fredddie Mac
  - – "Greed," i.e. the quest for yield with a simultaneous underestimation of risk, that is, the opposite of the "*Peso Problem*". **This is a recurrent feature of crises and endemic to capitalism**
  - – Lax regulation (SEC applied lenient leverage ratios on investment banks) and regulatory arbitrage, especially cross-border
  - – Perverted incentives by Rating Agencies, corporate managers, etc.
  - – The new equity culture in traditional banking based on up-front fee generation
  - – **Enormous Leverage** based on **short-term** borrowing by FI investing on their own account. This factor is very important in **spreading the crisis**.

I.2 The history of the crisis is seen in the rise of short-run quality spreads

- ✓ TED spread points to an increase in default premiums and a flight to quality (USA: 3m Eurodollar - 3m Tbill).
- ✓ Same is true in the Euro Area (3m Euribor – 3m Euro Area Tbills).
- ✓ This led to an increase in household and corporate lending rates in 2008 and 2009.

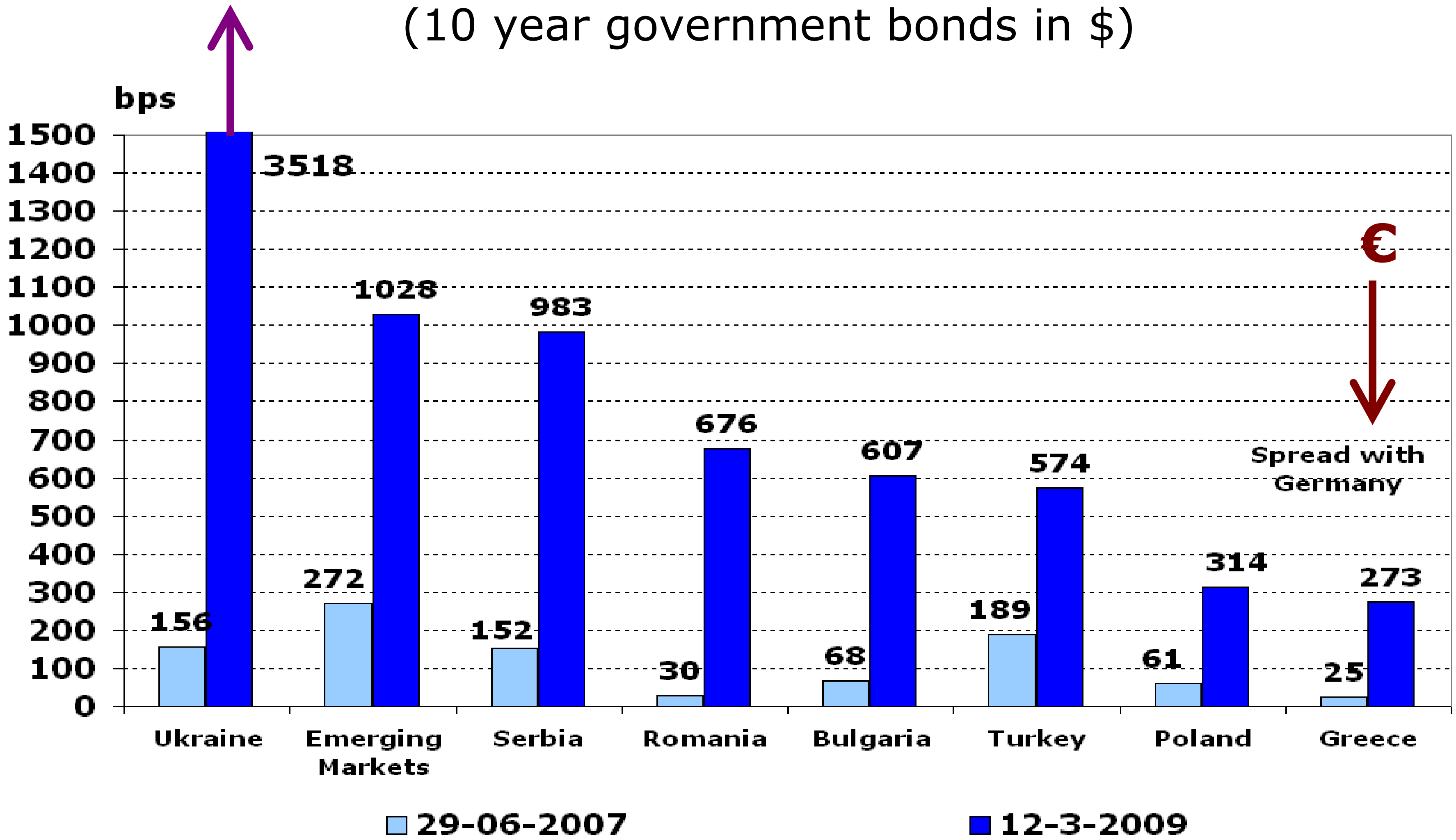


I.2 Global risk aversion pushes up the country premia in New Europe & Greece

Eurobank EFG

Sovereign Spreads

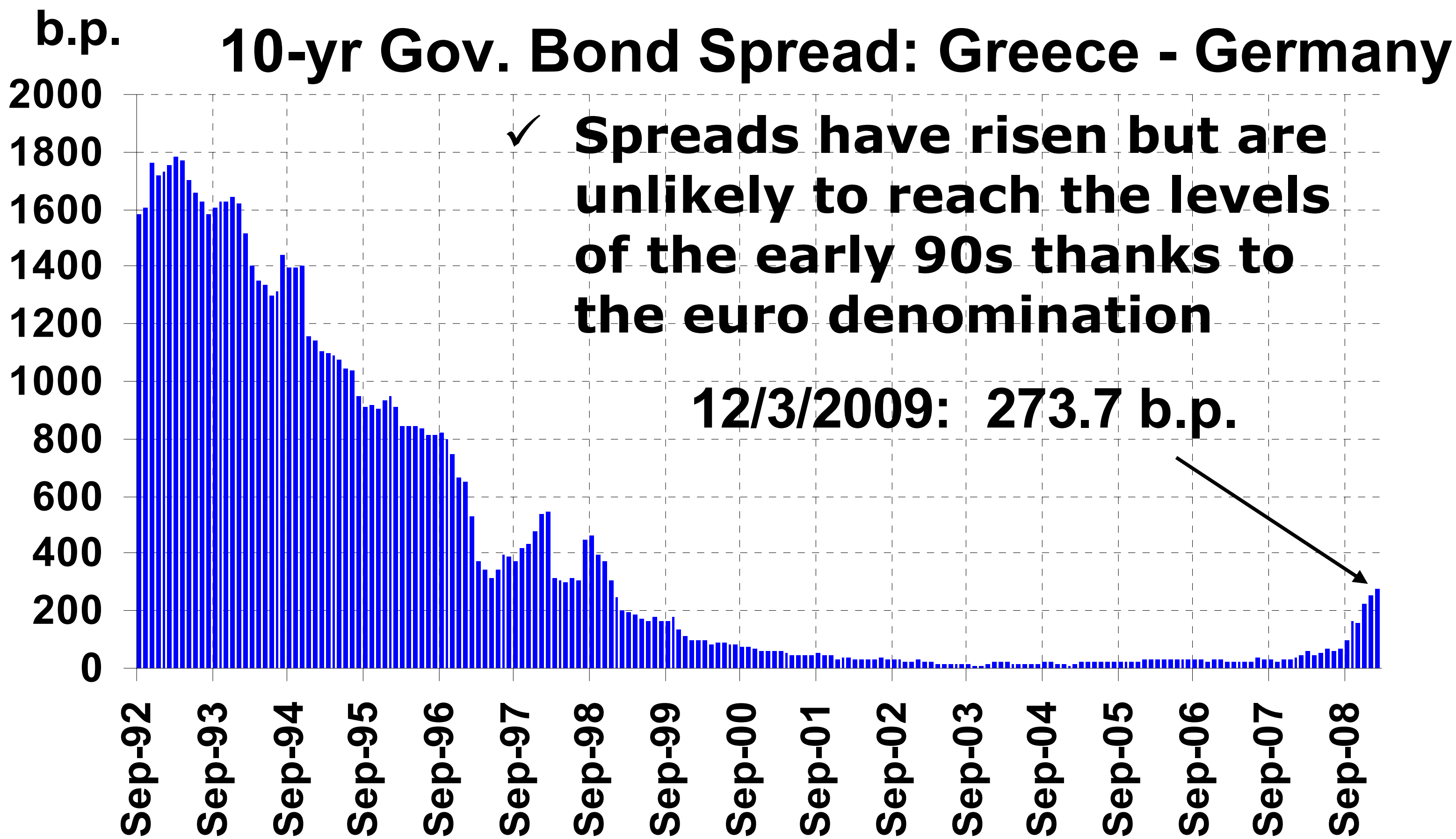
(10 year government bonds in $)



Source : Bloomberg, JP Morgan EMBIG

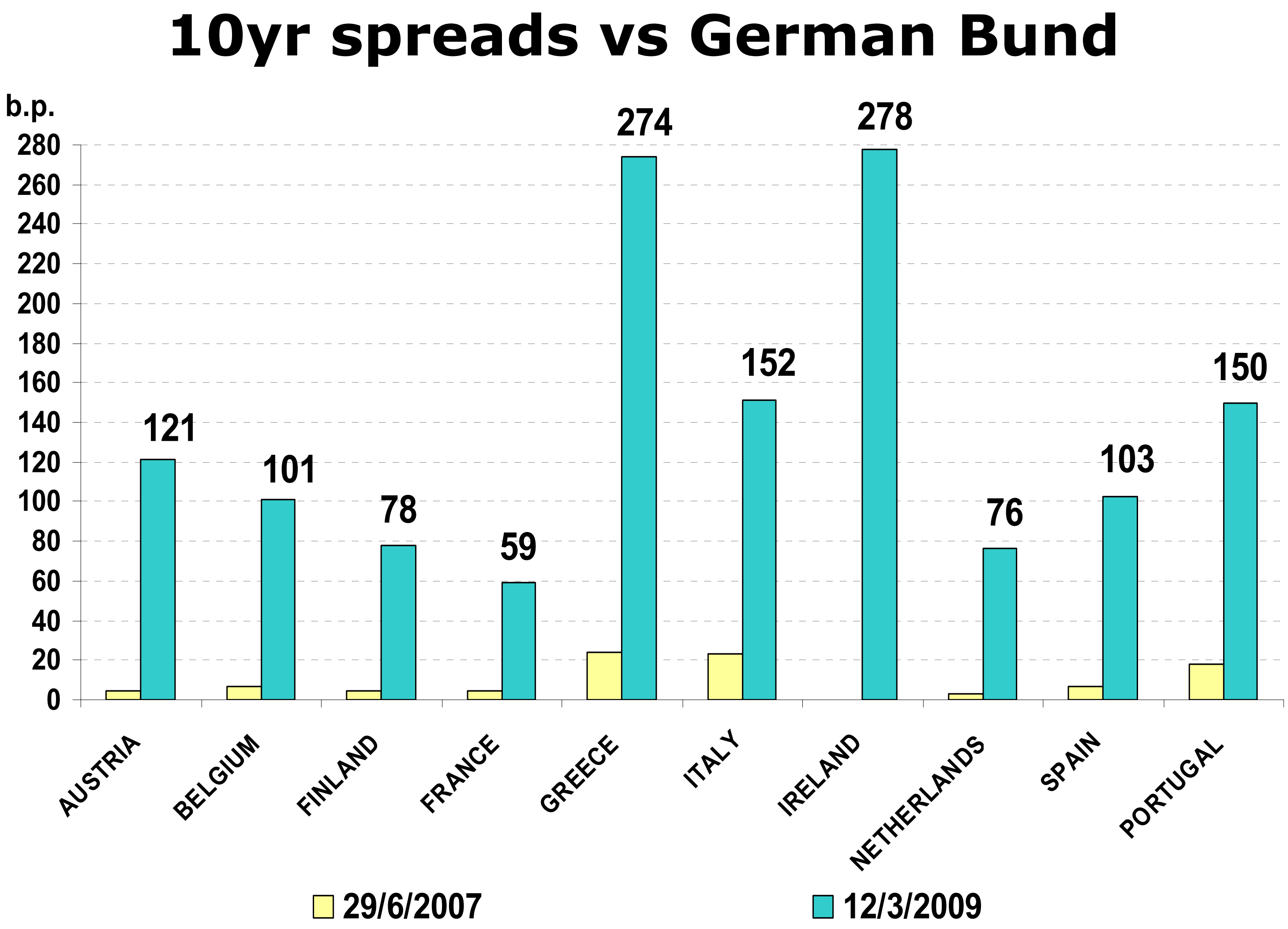
I.2 Could Greece relive the nightmare of high spreads as in the 1990s?

No, because pre-EMU spreads reflected inflation differentials as well



- ✓ **Recent spreads in both 5-year and 10-year government bonds reveal a probability of default as high as 20% in the first 5 years!**

I.2 Rise of spreads: Not only Greek but a European phenomenon as well



- ✓ Increase in Greek spreads consistent with increase in all other spreads and the EMBI+
- ✓ Hence, most of the rise in spreads (2/3) due to global risk aversion, not local factors

Source: Bloomberg, JP Morgan EMBIG, Eurobank EFG

I.2 Two major problems behind the continuation of the current crisis

1) The loss in asset values generates write-downs, which cannot be replenished by new capital increases, thus generating insolvencies
   - Major government interventions since 11/2008
   - Yet new bank losses continue
2) The inter-bank market was effectively shut beyond the weekly horizon
   - Liquidity has particularly dried up post-Lehman
   - Signs of a revival in Jan 2009, particularly in the US

✓ The lack of capital and liquidity force Financial Institutions to **de-leverage by a multiple amount**, restricting new lending and causing a slowdown in economic activity

✓ As long as the insolvency & counterparty risk problems remain unresolved, the crisis is far from over

✓ US administration has to decide what to do with its 20 large banks, if they do not pass the stress test
   - **"Bad" bank** is a bad idea (Buiter & others: create "**Good" banks**)
   - **Another suggestion: Separate large banks into 3 groups: (i) Healthy** ⇨ continue buying their preferred or common shares **(ii) Neutral** ⇨ sell them (or their good parts) **(iii) zombie** ⇨ nationalize them temporarily before liquidation
   - Small banks are presently allowed to fail, 2 or 3 per week in the US

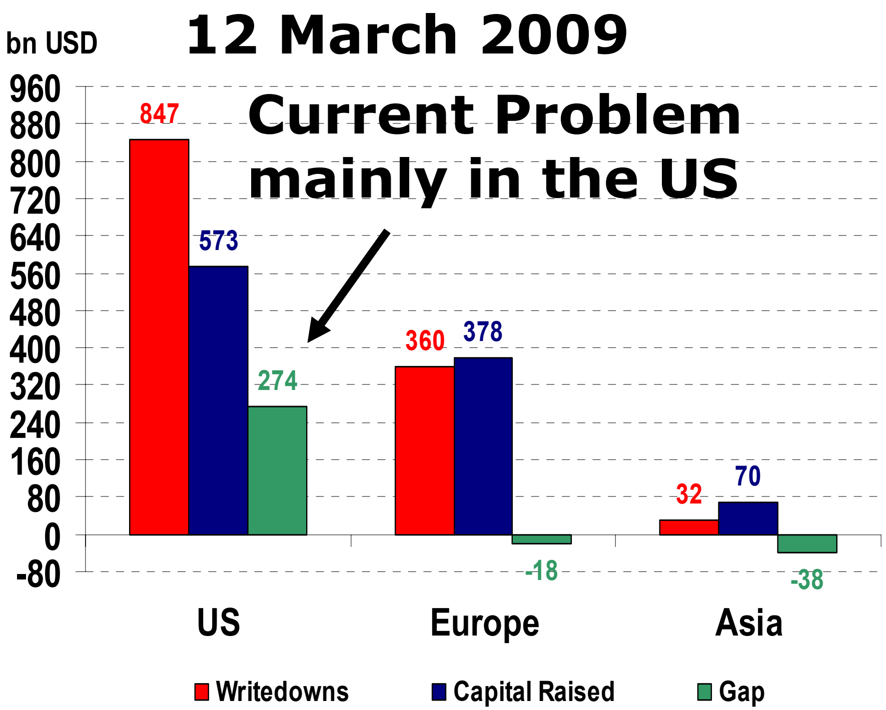
I.2 FI Insolvency: The biggest global risk

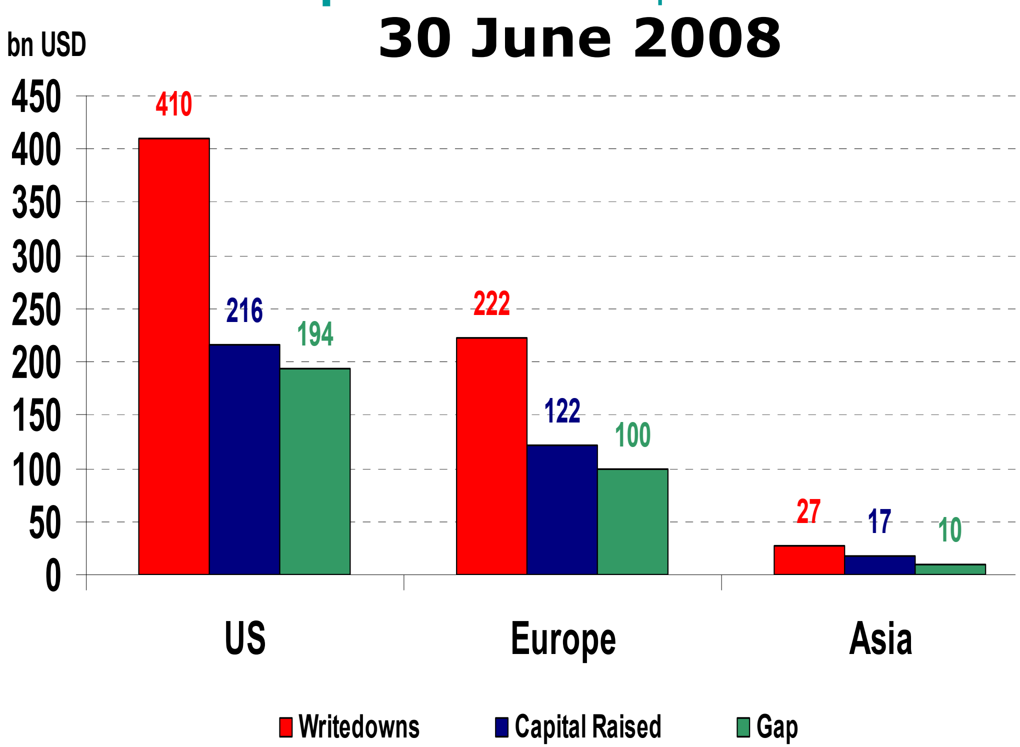
- ✓ The gap between total write-downs and capital increases has declined sharply due to governments' recapitalizations, particularly in Europe.
- ✓ **IMF** estimates that total write-downs will reach $2.2 trillion.

All Financials*

Total Write-downs: $ 1238.5
Total Capital Raised: $ 1021.0
Total Gap: $ 217.5

Total Writedowns: $ 658.5
Total Capital Raised: $ 355.3
Total Gap: $ 303.2

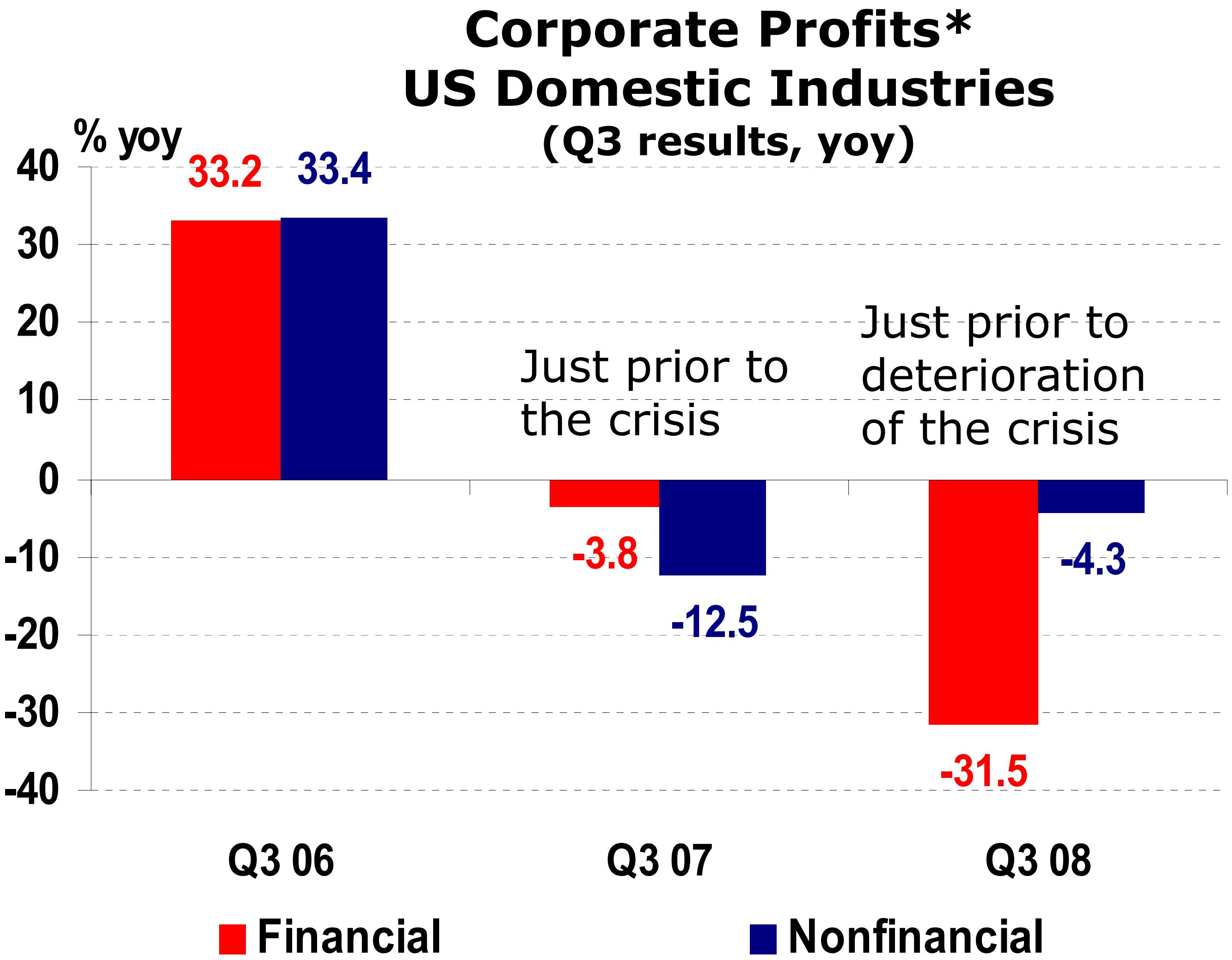




* Banks/Brokers, Insurers, GSEsx

Source: Bloomberg

I.2 FI profits deteriorate

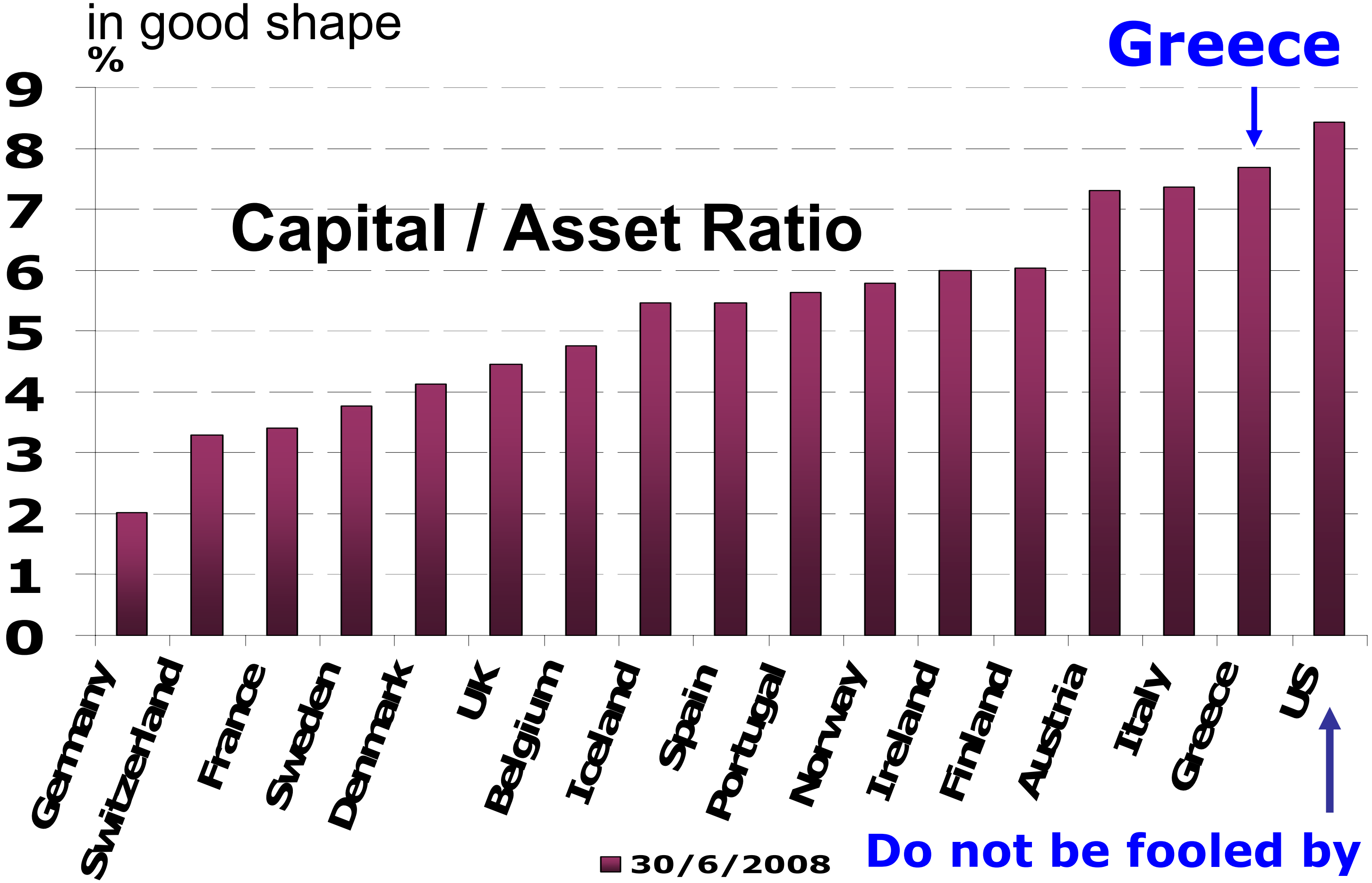


- ✓ Asset losses now affect the Income Statement
- ✓ Effort to hide losses by dressing up the Balance Sheet is no longer feasible as the crisis prolongs for 20 months

Source: US Department of Commerce, Bureau of Economic Analysis, National Economic Accounts

I.2 Greece: The strongest FI capital base in Western Europe

✓ this shock has come from abroad and has found the Greek banks in good shape



✓ **Best FI**: EFG Intern/al **13.52%**

✓ **Worst FI**: DEXIA **1.67%**

Source: Bloomberg

Do not be fooled by high US capital cushion: SPVs excluded from asset size in the US, which makes balance sheets appear small

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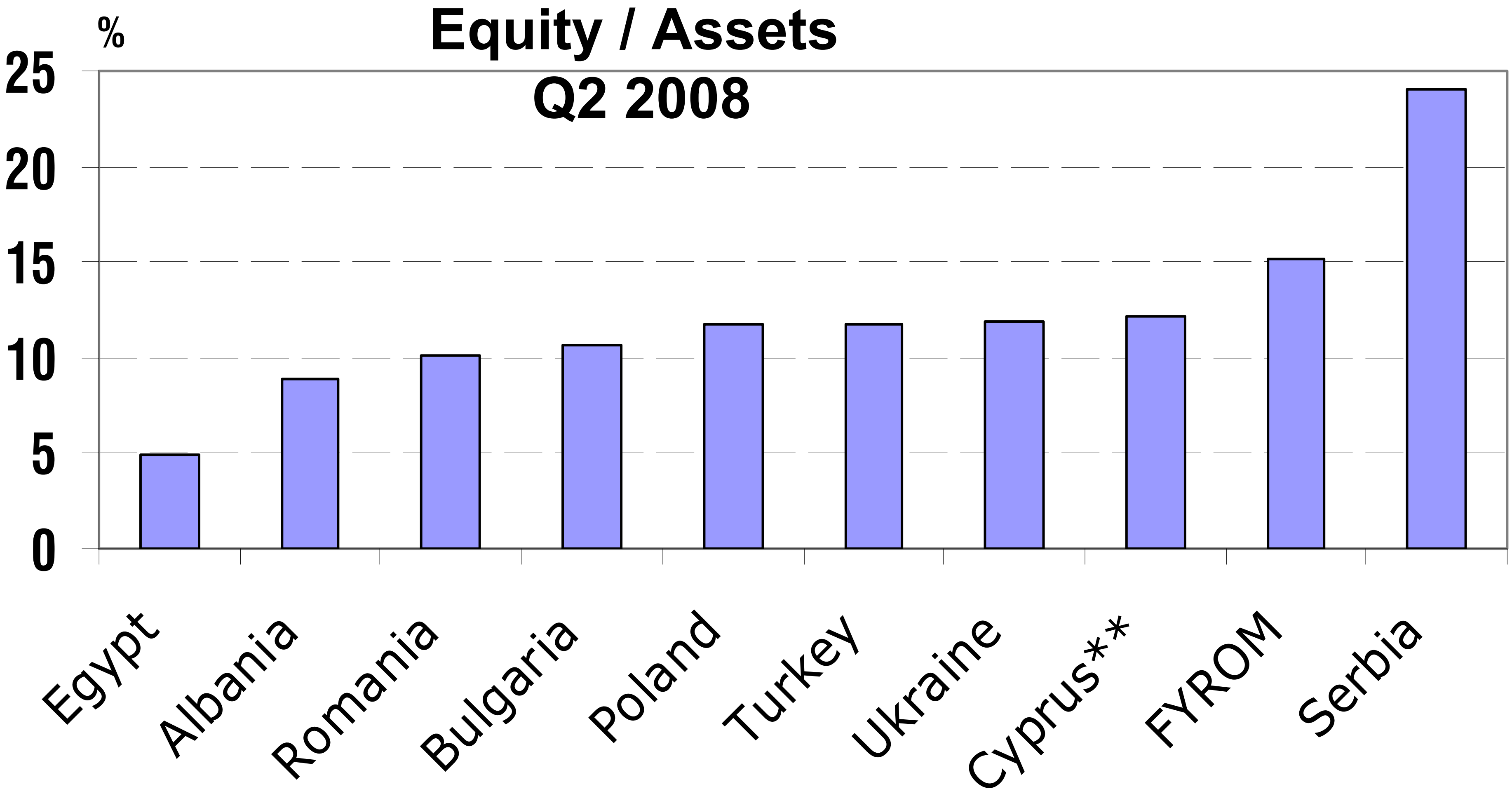
I.2 Banks in New Europe have a stronger capital base than in Western Europe

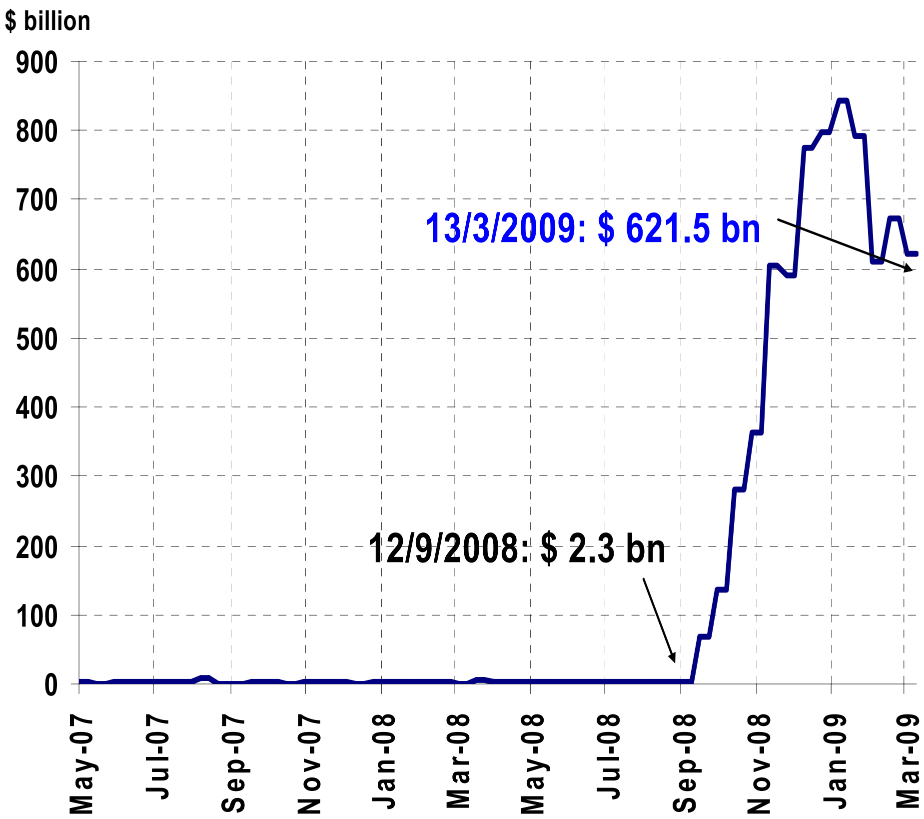


* Albania, data as of December 2007

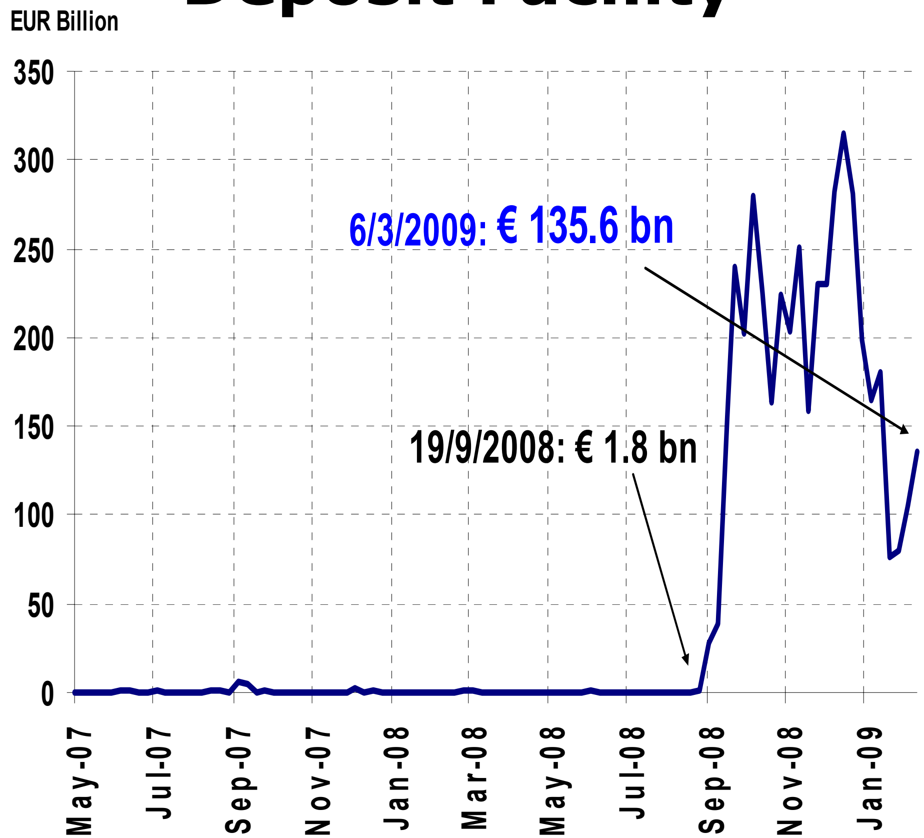
** Cyprus, data refer to Tier I Capital

I.2 Lack of liquidity: The second global problem

USA
Excess Reserves



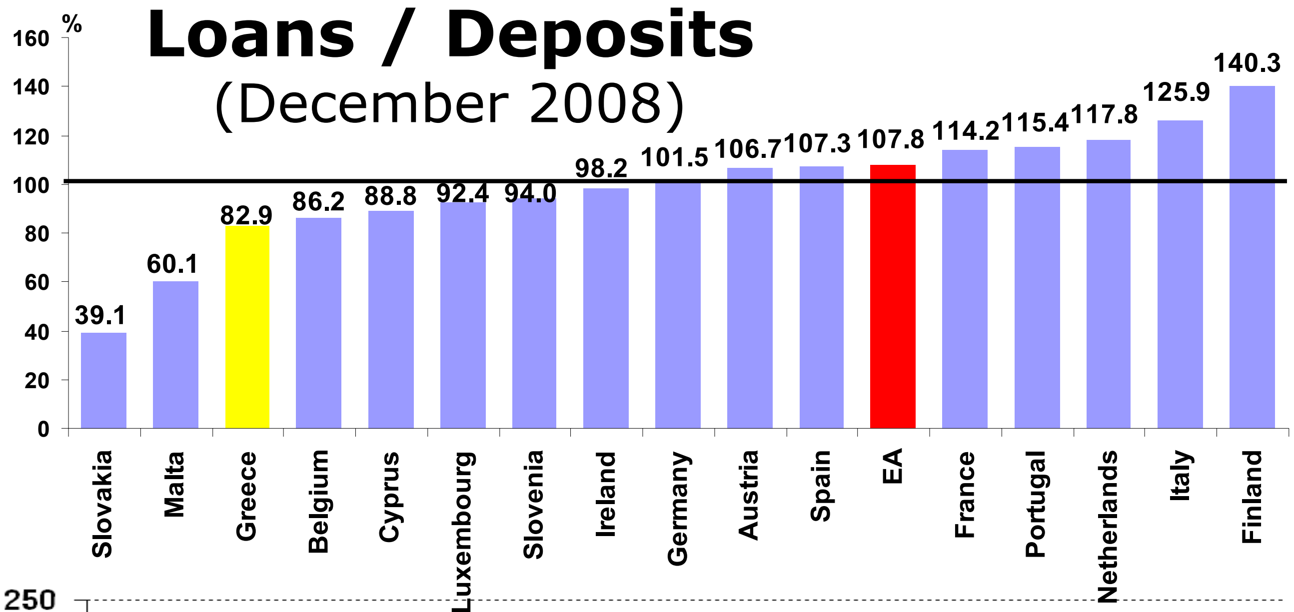
Euro Area
Deposit Facility



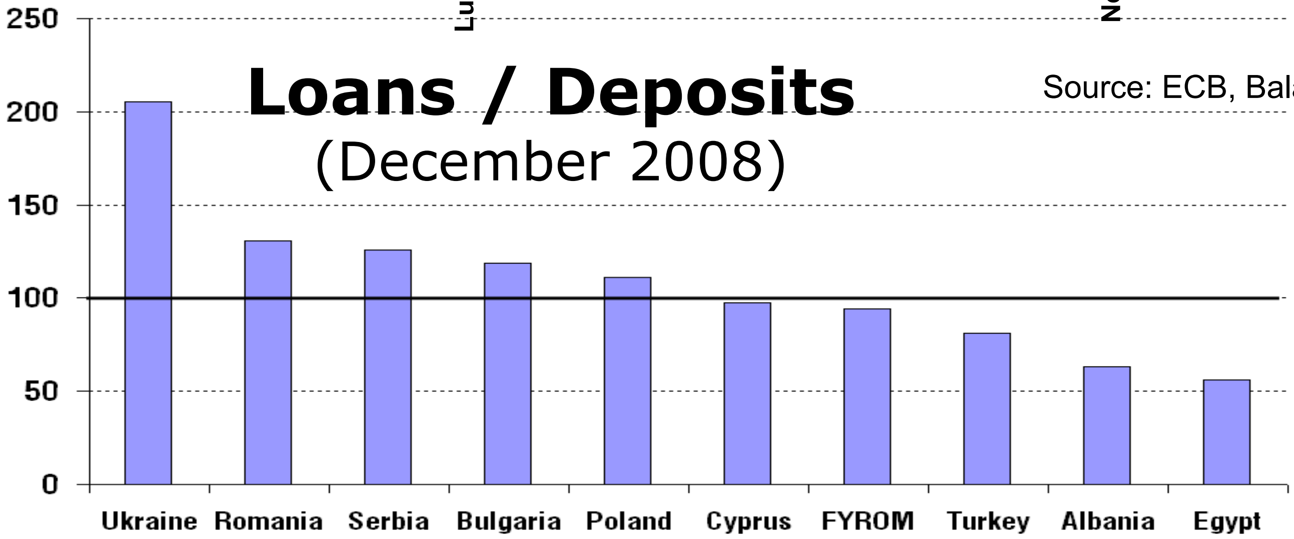
Source: Federal Reserve, ECB

✓ US & European banks are hoarding cash as counter-party risk rises

I.2 Liquidity: Abundant in Greece, lacking in some New Europe countries

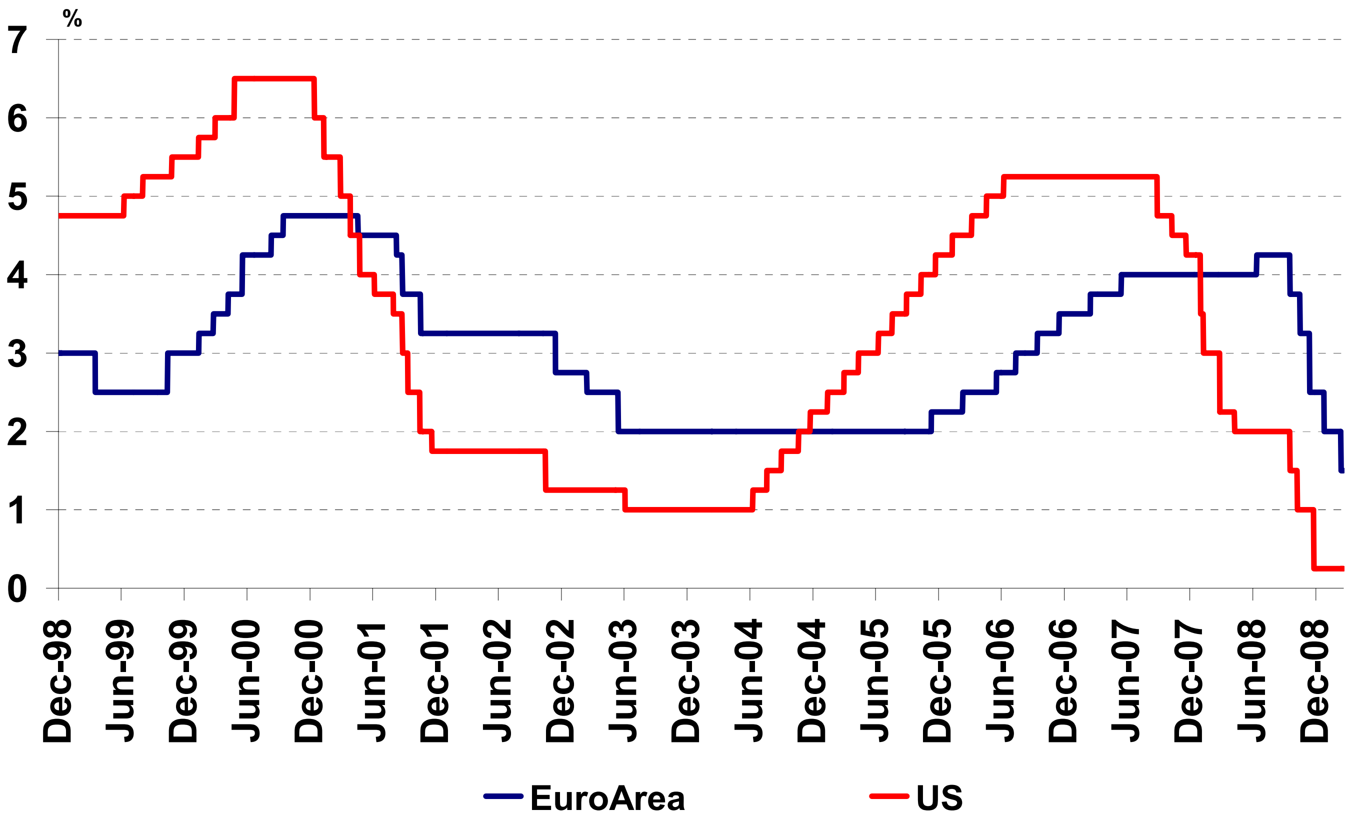


Source: ECB, Balance Sheet Items data



Source: Central Banks

I.3 Intervention Rates



- ✓ **coordinated rate cuts and liquidity injections** by major Central Banks.
- ✓ ECB constrained by its mandate.

- ✓ The transmission mechanism of monetary policy is paralyzed → **Quantitative & Qualitative Easing**
- ✓ **Fiscal Policy** the only effective tool
- ✓ As long as the crisis continues, the problem is **deflation**. Some analysts worry about the risk of inflation resurgence due to the current monetary and fiscal expansion

I.3 Bank Rescue Plans

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	Package Amount*	% of 2009 GDP
Italy	€ 52 bn	3.2%
Belgium	€ 19.6 bn	5.5%
Greece	€ 28 bn	10.8%
Norway	NOK 350 bn	13.5%
Portugal	€ 24 bn	13.9%
USA	$ 2,600 bn	17.9%
France	€ 360 bn	18.0%
Germany	€ 500 bn	19.5%
Spain	€ 250 bn	22.4%
Finland	€ 54 bn	27.3%
UK	£ 500 bn	33.8%
Austria	€ 100 bn	34.2%
Netherlands	€ 237 bn	39.1%
Sweden	SEK 1,565 bn	49.3%
Ireland	€ 410 bn	220.0%
Total EU-27	€ 2,737 bn	21.2%

US Rescue Plans

- ✓ Initial Rescue Plan
  "**TARP**" → $700 bn, 5% of GDP
- ✓ New Rescue Plan
  "**Financial Stability Plan**"→
  $2 trillion, 14% of GDP

Nationalizations	
Countries	Financial Institutions
Ireland	Anglo Irish Bank, Bank of Ireland, Allied Irish Bank
UK	RBS, Bradford & Bingley, Northern Rock, Lloyds Banking Group
Germany	Commerzbank
Iceland	Landsbanki, Kaupthing Bank
US	Fannie Mae, Freddie Mac, AIG

* Includes capital injections, asset purchasing and guarantees on debt issuance

I.3 Fiscal Packages

	Amount	% of 2009 GDP
US 2008 2009-19	\$ 168 bn \$ 789 bn	**1.2%** **5.5%**
EA-16 2009-10	€ 245 bn	**2.6%**
China 2009-10	CHY 4 tr	**15.0%**

	Fiscal deficit (% GDP)	
	2008	**2009**
US	-3.2%	-8.3%
EA-16	-1.7%	-4.0%
China	-0.1%	-2.8%

Source: European Commission, Congressional Budget Office, Economist

- ✓ **Not enough fiscal stimulus in Europe,** according to the US Administration
- ✓ **Will Western Europe eventually commit funds for Eastern Europe**? It is particularly exposed to Eastern Europe (% GDP: **82% Austria, 53% Switzerland, 49% Netherlands, 42% Belgium**), so there is motivation for help
- ✓ Eastern European External bank liabilities to Western Europe **\$1.51 tr** from a total of \$1.66 tr as of Sept 2008 through BIS reporting banks (Greek banks not included).

I.3 Global regulation & supervision

- ✓ Current debate (e.g. G-20 meetings) focuses on the priority of current policies in order to avoid a prolonged global recession, i.e., which one comes first, coordinated fiscal expansion or the cleaning up of banks?
- ✓ Lots of simultaneous discussions on the future of the global financial regulatory system
  - ***No global regulation or single regulator in sight,*** as it contradicts national sovereignty plus even if agreed, it might turn problematic like Basel II. In addition, financial regulation involves a trade-off between financial stability and financial innovation and different countries will prefer a different mix
  - Most likely outcome is an ***agreement on principles and on coordination.*** Such principles would involve: (i) New emphasis on macro-prudential regulation that would be sensitive to credit and other bubbles, global liquidity, the business cycle, market power of individual banks, etc. (ii) An increased emphasis on verifiable public information as opposed to the previous reliance on rating agencies or internal models (iii) Methods to eradicate cross-border regulatory arbitrage (iv) An increased role of supra-national organizations like the IMF, or the Stability Forum
  - ***Deeper and broader regulation required***, e.g. on financial instruments like over the counter derivatives, CDSs plus on all institutions dealing in finance

I.3 Will global economic power shift in the near future?

- ✓ Does the crisis imply a faster decline in US relative global economic power given its over-consumption and the bad shape of its financial system?
- ✓ Will Europe get stronger, as power may be shifting to the East?
- ✓ Super deficit countries like the US, Spain, Greece, New European countries, etc., face a **double problem**:
  - (i) Finding willing lenders to finance their immediate cash needs for their external requirement
  - (ii) Increasing fiscal deficits to spend their way out of the recession. The spending solution implies even bigger imbalances that would be hard to reverse in the future
- ✓ Surplus countries like China, other Asian, Germany, etc. face only a **single problem**: Finding willing buyers of their exports. Their alternative is to expand domestic consumption, which is feasible but takes time.
- ✓ Are we gravitating towards a retrenchment of financial globalization?

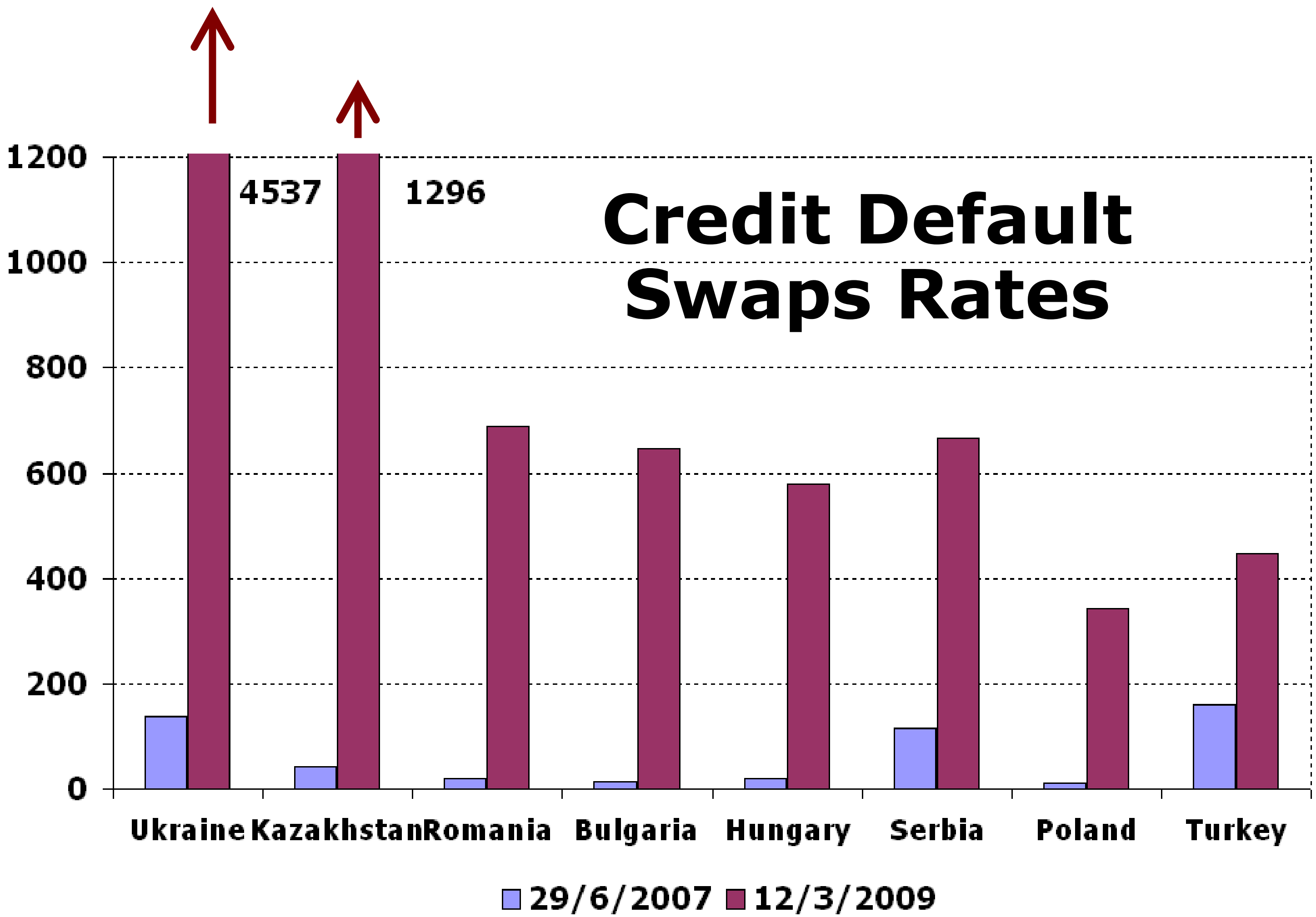
II

Regional Outlook

1) Previous emerging Europe crises were costly
2) How different is New Europe?
3) What are the markets afraid of today?
4) What will the future bring?

Eurobank EFG

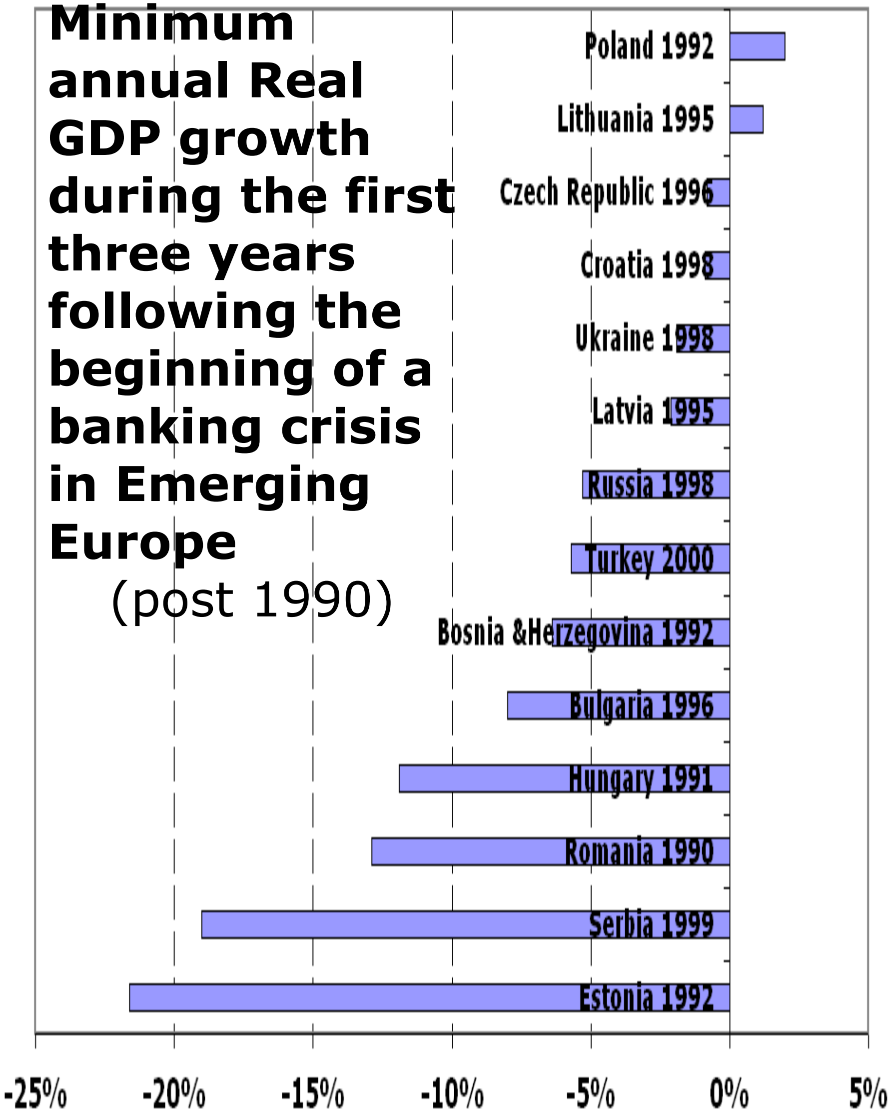
II.1 A rise in NE credit risk premia

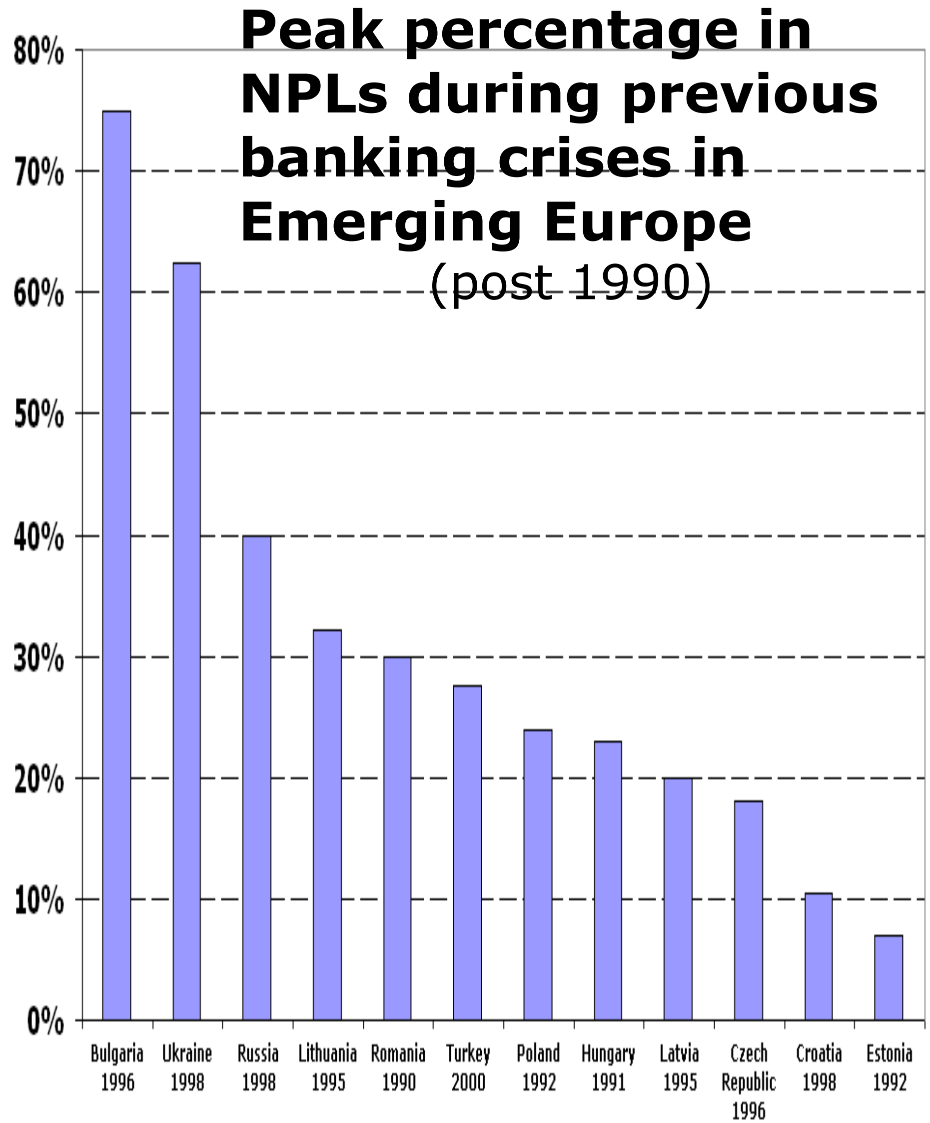


- ✓ **Is the market worry justified?**
- ✓ **We know volatility is high in emerging countries**
- ✓ **In periods of crises, history was not kind to the region**

Source: Bloomberg

II.1 Previous crises were terrible, but most occurred prior to the take-off of the capitalist system





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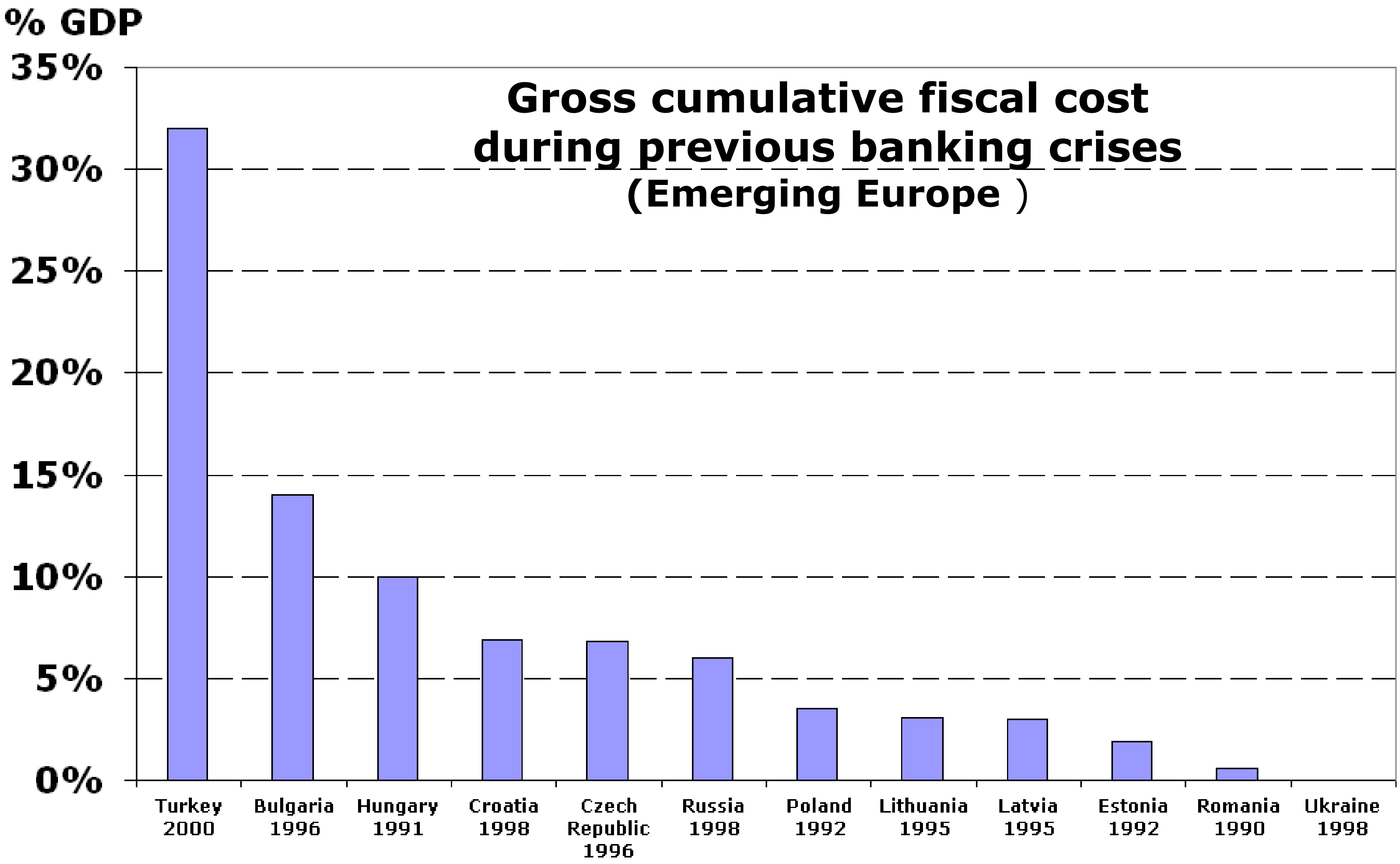
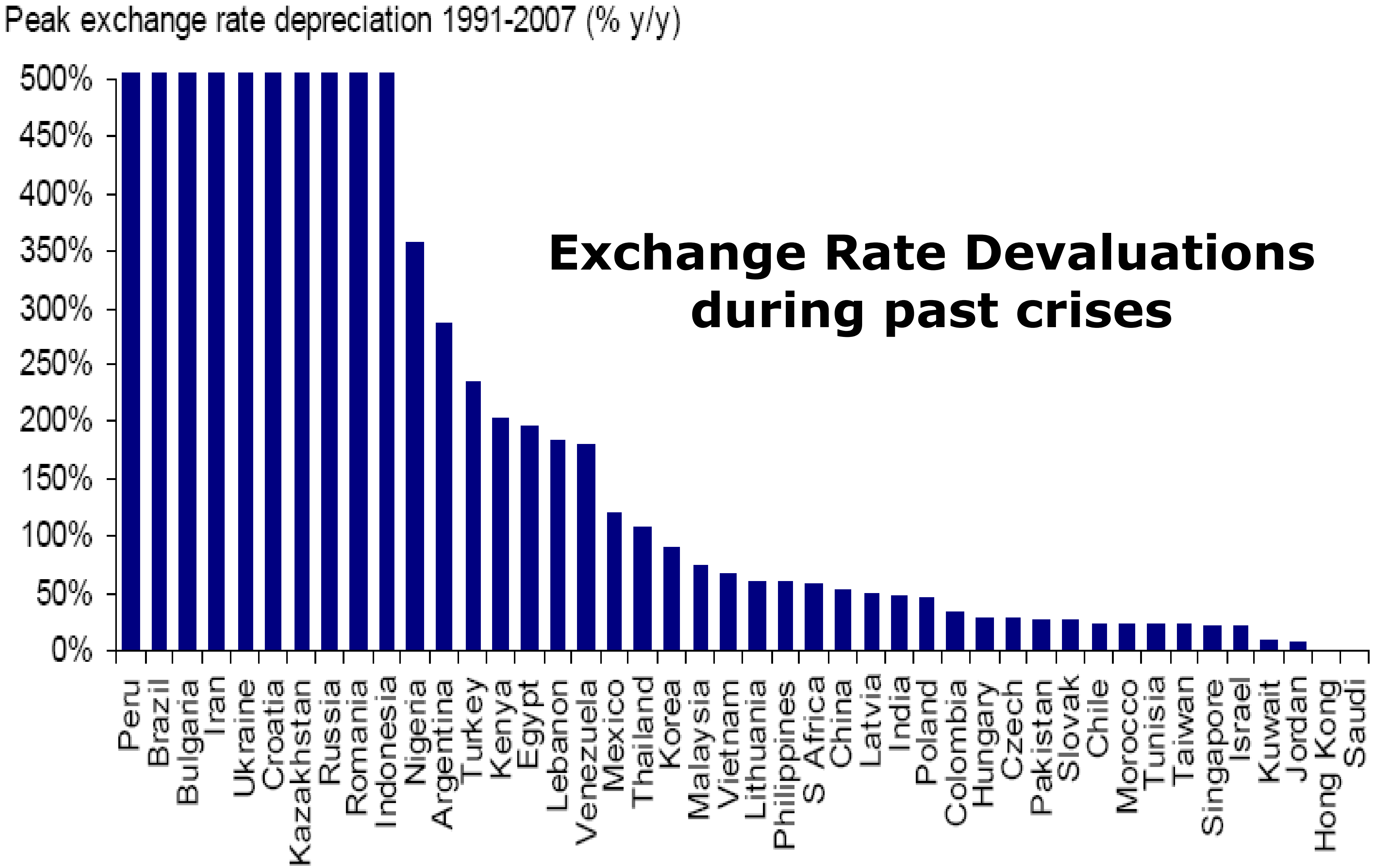
Source: IMF, Laeven and Valencia, Eurobank Research

II.1 Fiscal costs were high ...



Source: IMF, Laeven and Valencia

II.1 … and some terrible devaluations occurred



Source: Bloomberg, Haver, UBS

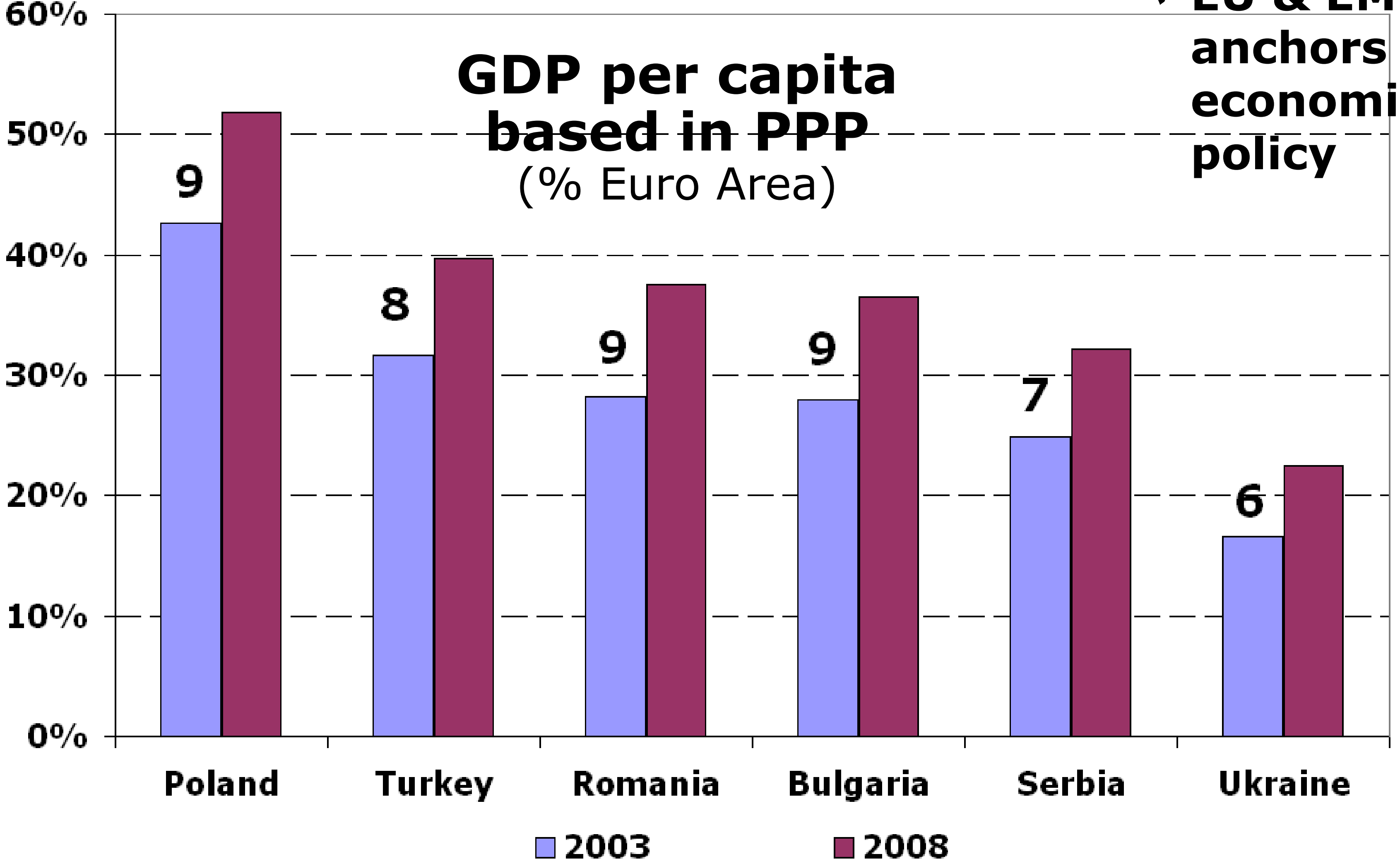
II.2 What is different now in New Europe relative to other emerging regions?

a) Prospective EU and EMU membership acts as a disciplining device (e.g. pushing structural reforms, limiting fiscal expansion, driving total factor productivity, etc.)

b) Large current account deficits and substantial private foreign debt accumulation

c) Banking sector is foreign-owned

II.2 (a) The magnet of EU & EMU: Strong real convergence in NE

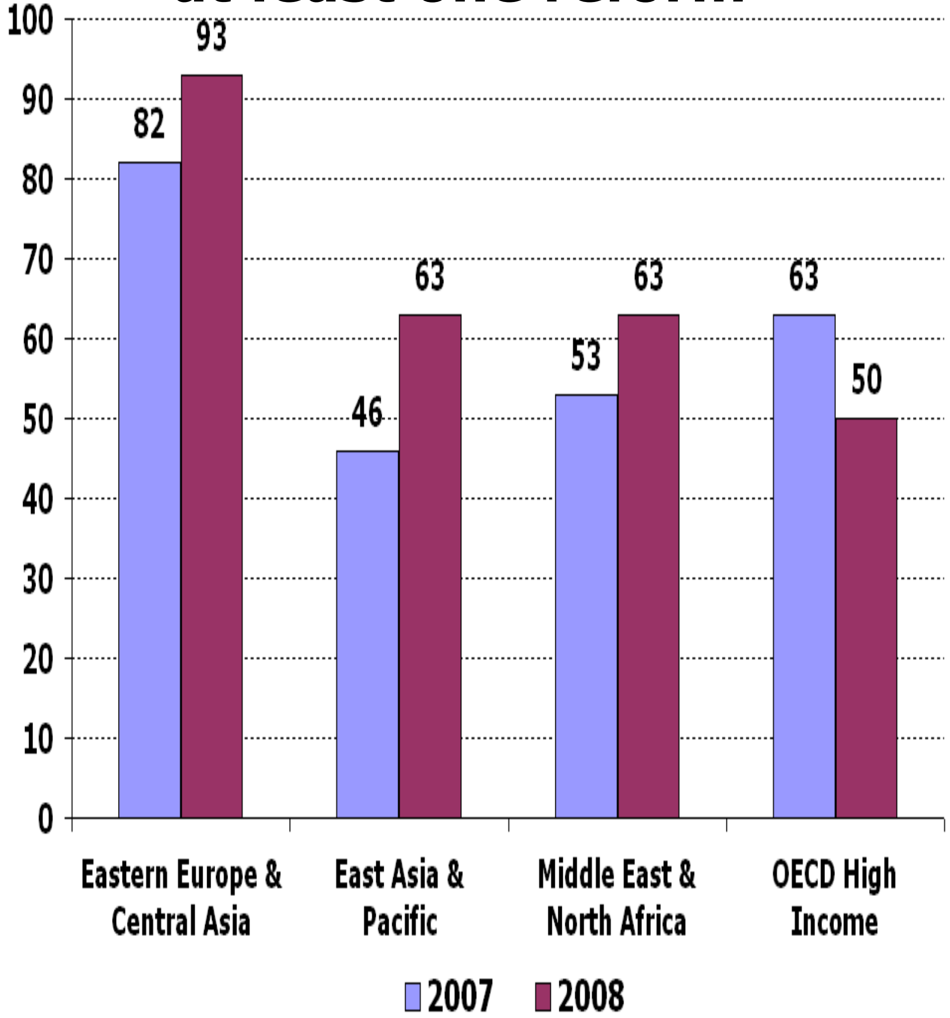


✓ **EU & EMU are anchors for economic policy**

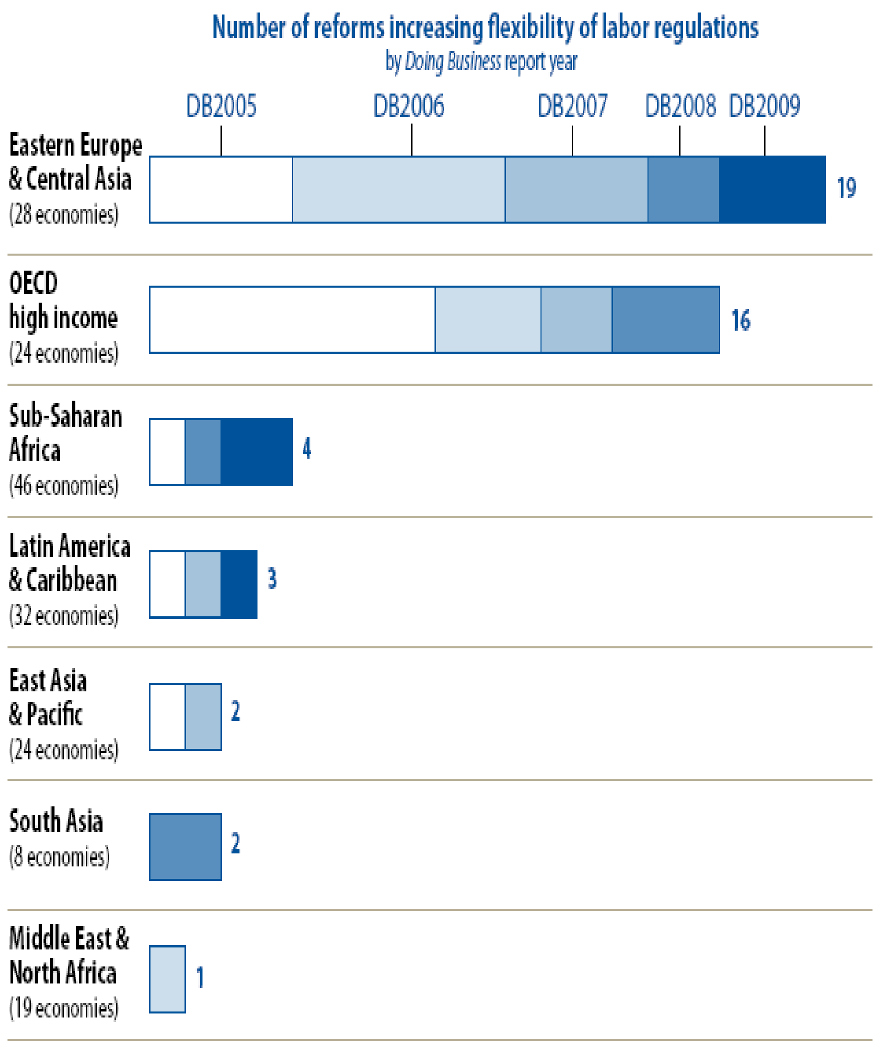
Source: EFG Research

II.2 (a) A fast track on structural reforms

Percentage of countries in a region with at least one reform



Most reforms in Eastern Europe & Central Asia

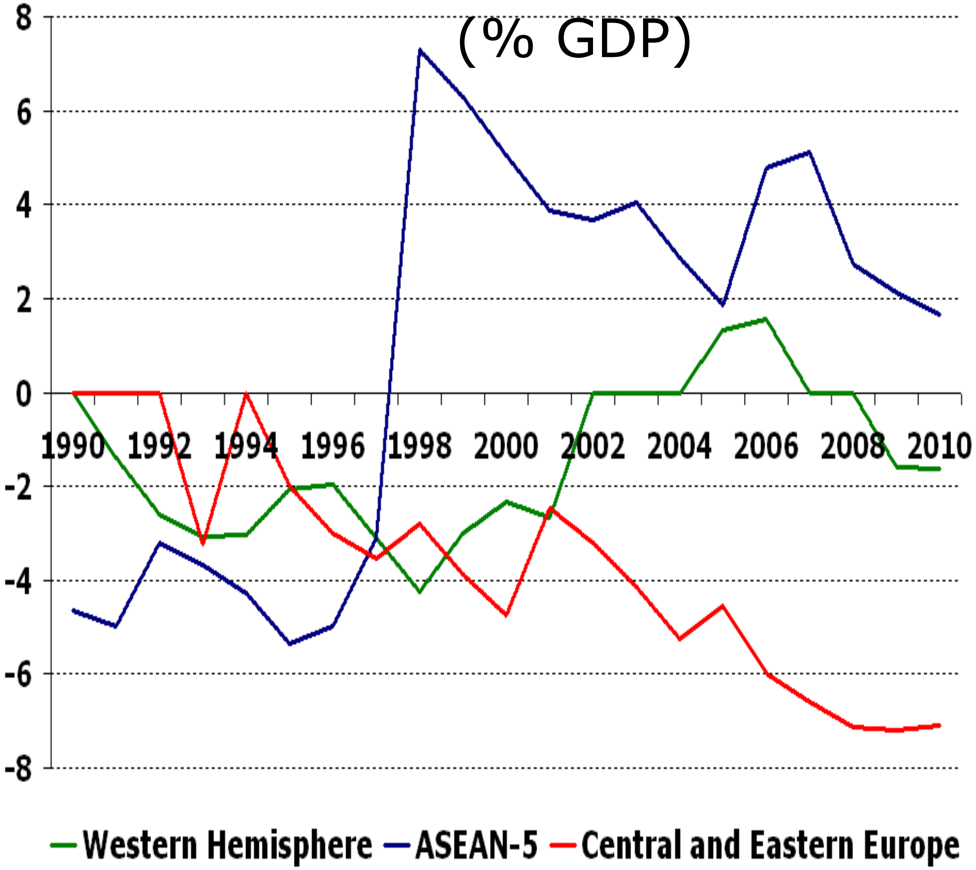


Note: A reform is counted as 1 reform per reforming economy per year.

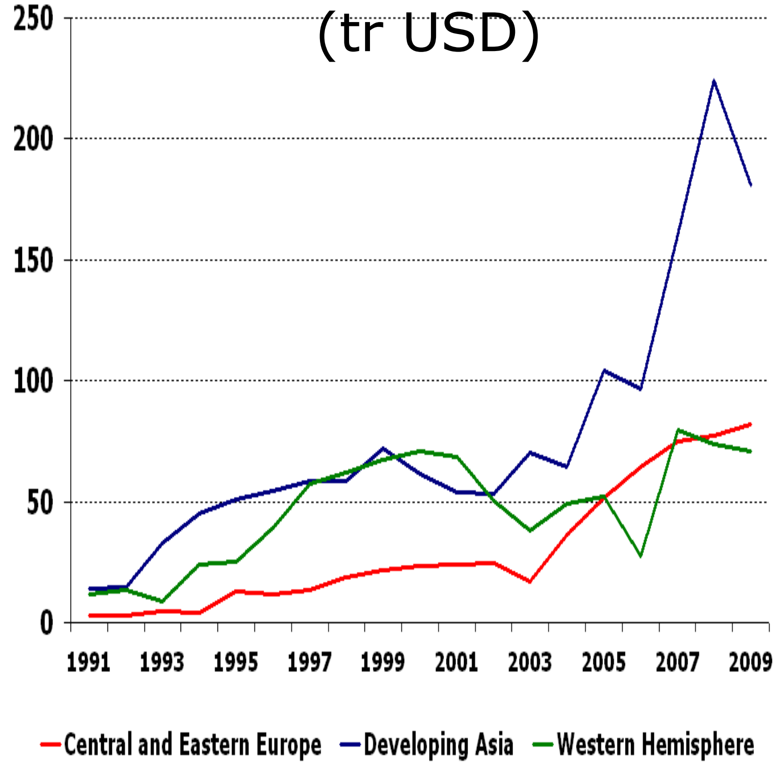
Source: Ease of Doing Business 2009

II.2 (b) Yet, rising current account deficits in Central & Eastern Europe

Current Account Balance
(% GDP)



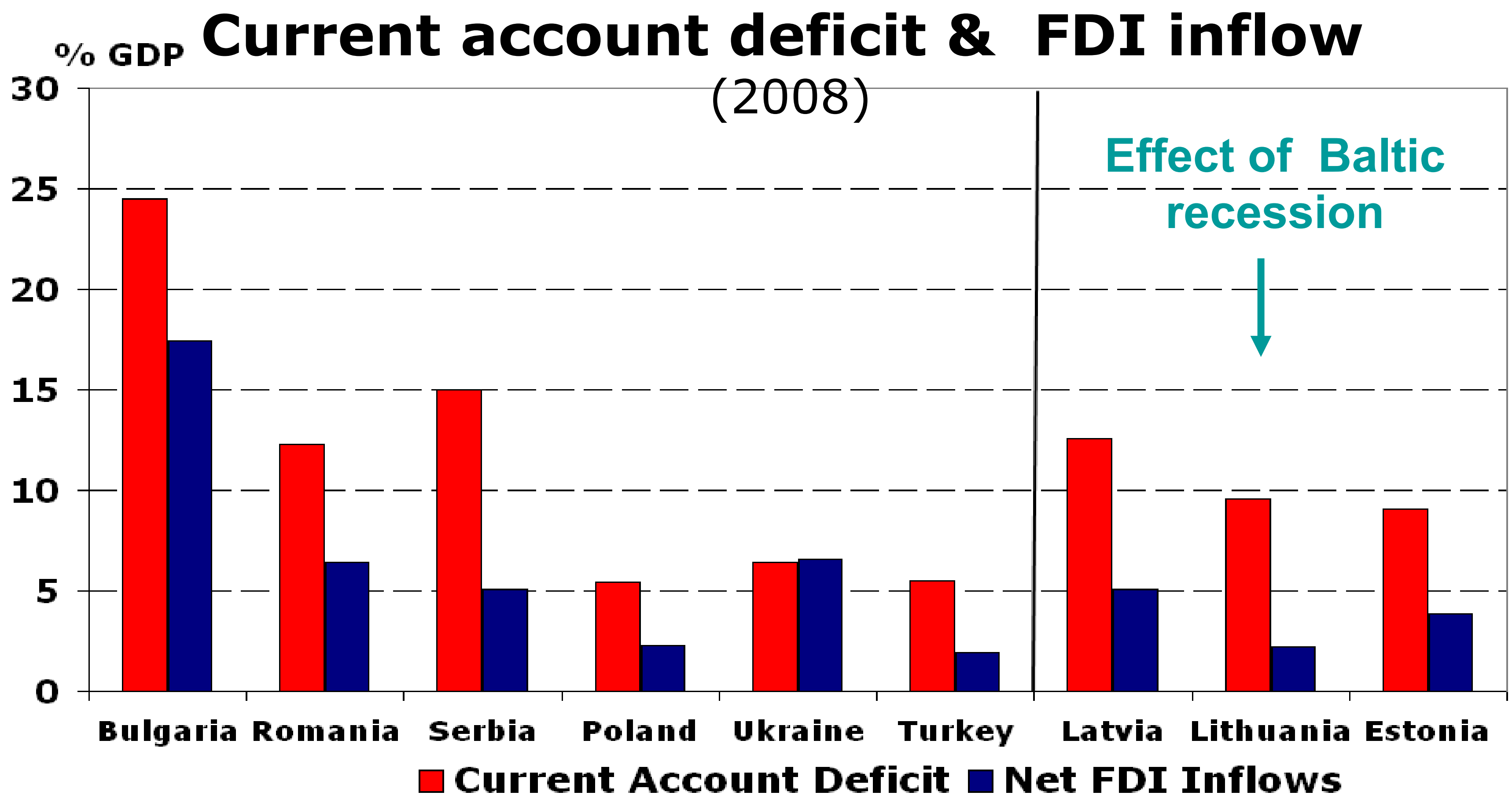
FDI
(tr USD)



✓ **Part of the deficit covered by FDI**

Source: IMF Database, Eurobank Research

II.2 (b) Current account deficits not fully covered by FDI inflows

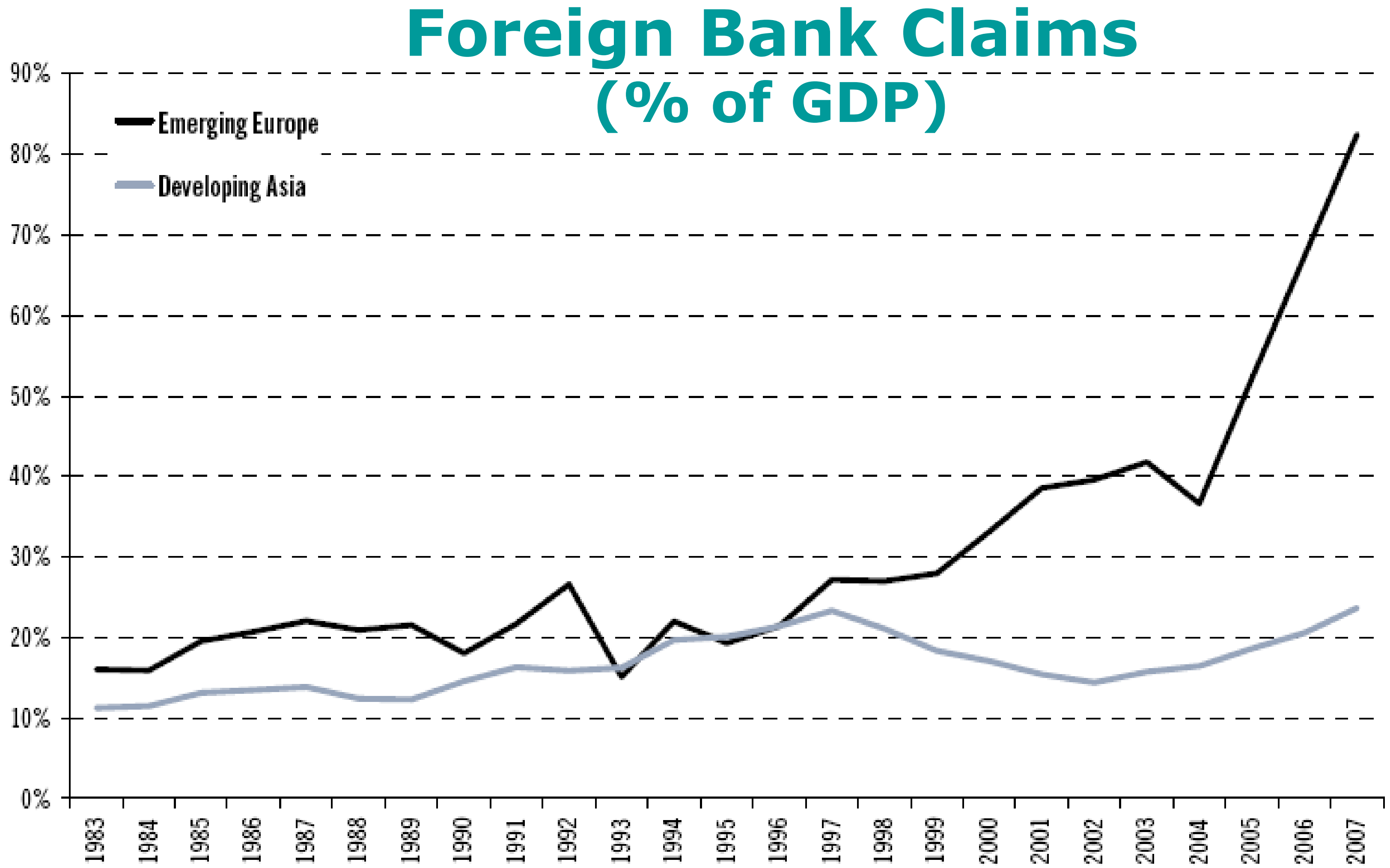


*Ukraine, Latvia, Lithuania Q3 2008

Source: Central Banks, Eurobank Research

✓ Recession in Baltic States already reduced their current account deficits and the FDI coverage

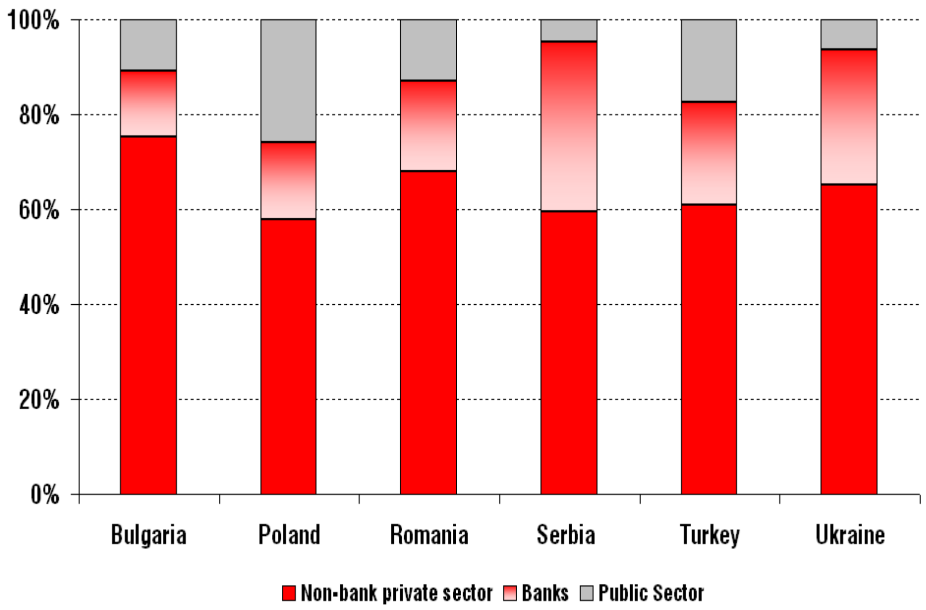
II.2 (b) Rising foreign bank claims



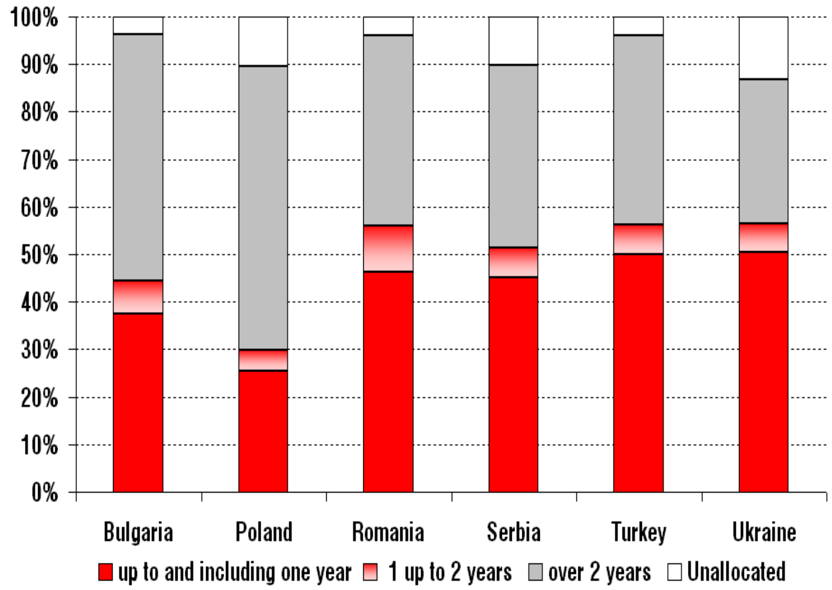
Source: Bank for International Settlements

II.2 (b) Foreign bank claims are mostly private

Decomposition by sector (Q3 2008)



Decomposition by maturity (Q3 2008)



Source: BIS, Eurobank Research

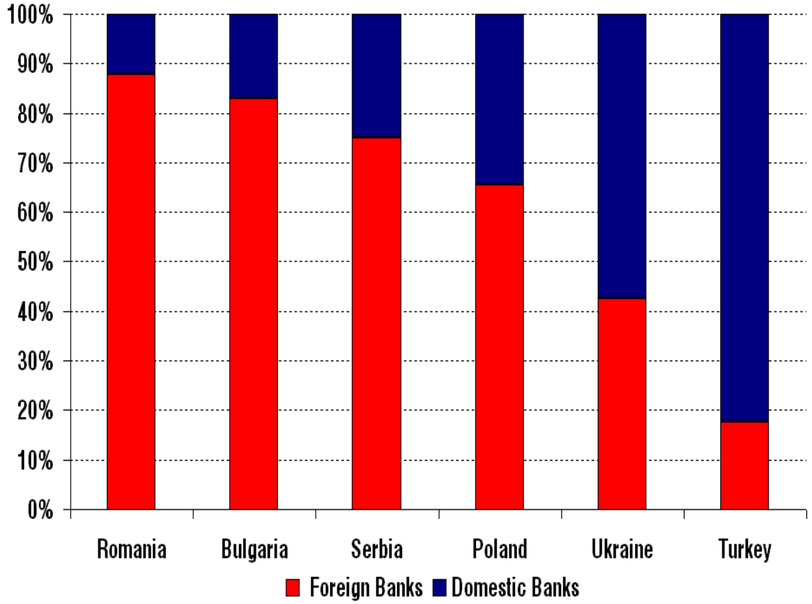
- ✓ Foreign debt comes mainly from the private sector
- ✓ A large component of foreign debt is short-term

Total Claims (bn USD)

Bulgaria	31.2
Poland	126.6
Romania	82.9
Serbia	16.0
Turkey	124.5
Ukraine	36.6

II.2 (c) An SEE diversified banking system by country of bank origination

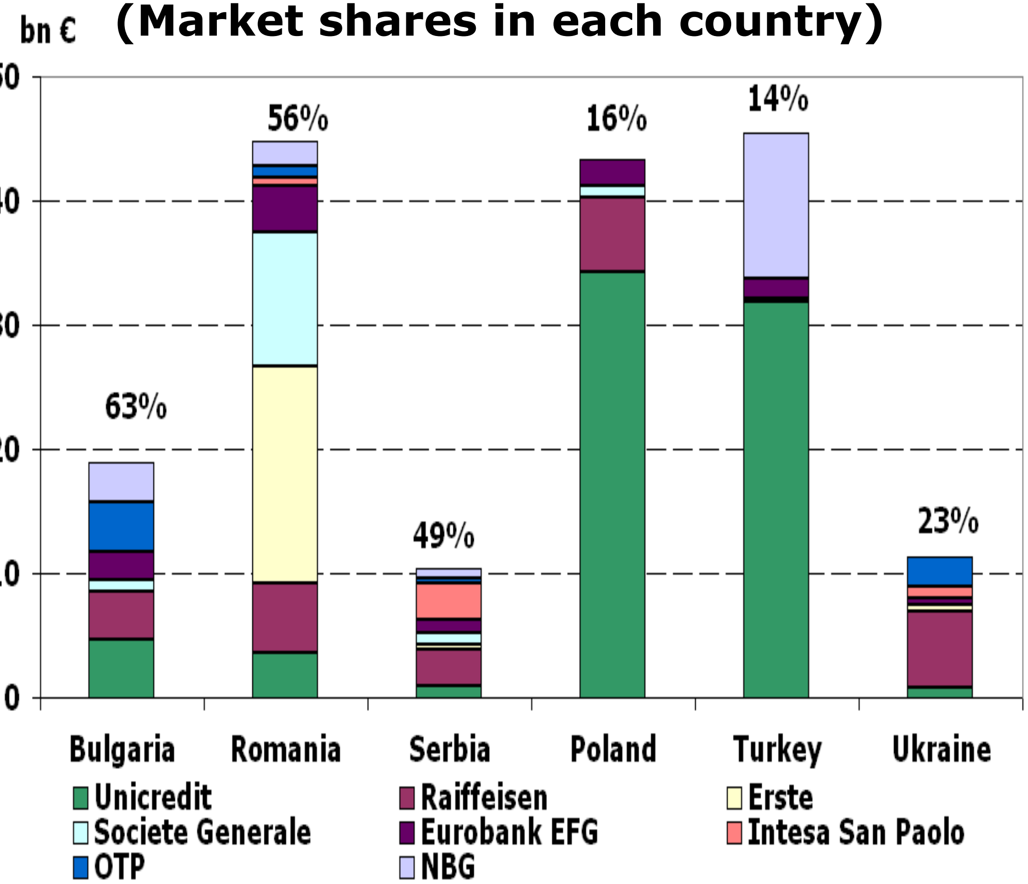
Market Share of Foreign Banks



Source: Central Banks

Assets of key players in CEE countries

(Market shares in each country)



Source: Financial Results

Bank diversification differentiates SEE from the Baltic states

II.3 What are markets afraid of?

(a) A sudden stop in the financing of external debt

(b) A drastic slowdown in credit expansion

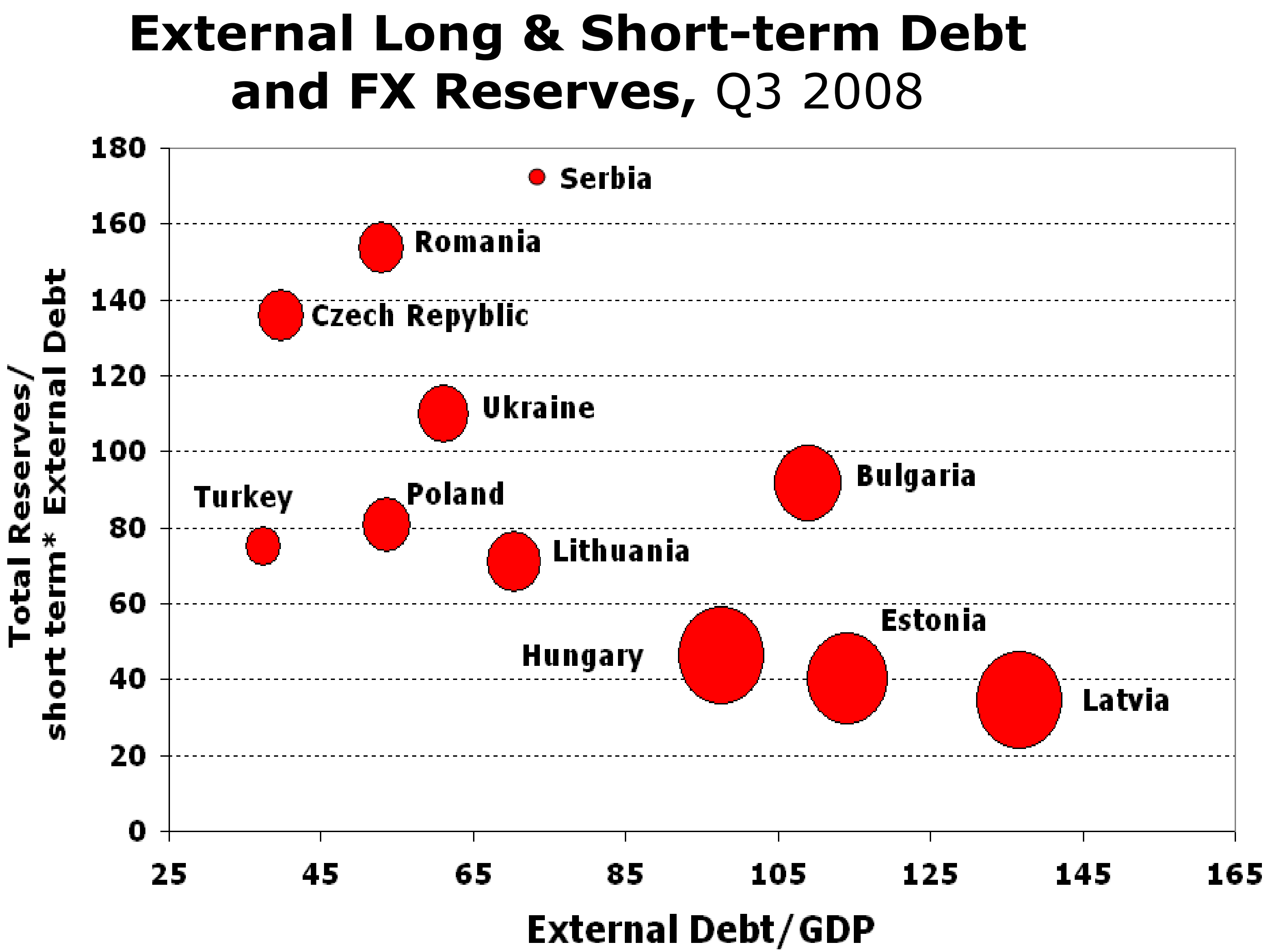
(c) A rapid rise in NPLs

(d) New forms of protectionism

II.3 (a) The financing of external debt

Amounts in bn. Euros				
	Bulgaria	Romania	Serbia	Turkey
Demand for capital inflows	2009	2009	2009	2009
A. Current Account Deficit (2009)	6.5	13.0	5.5	8.0
Implied CA/GDP (2009)	17.5%	10.0%	16.0%	1.7%
B. Total External Debt (End 2008)	36.6	70.1	22.4	207
% of External Debt due in next 12 months	55%	50%	18%	30%
Bn Euros	20.1	35.1	3.9	62.1
Gross External Financing Requirement (A+B)	26.6	48.1	9.4	70.1
Supply of capital inflows				
Net FDI inflows	?	?	?	?
New Lending-Refinancing of maturing debt	?	?	?	?
International Reserves	12.7	28.0	9.0	50.0
International Reserves/ Requirement	48%	58%	96%	71%

II.3 (a) The financing of External Debt



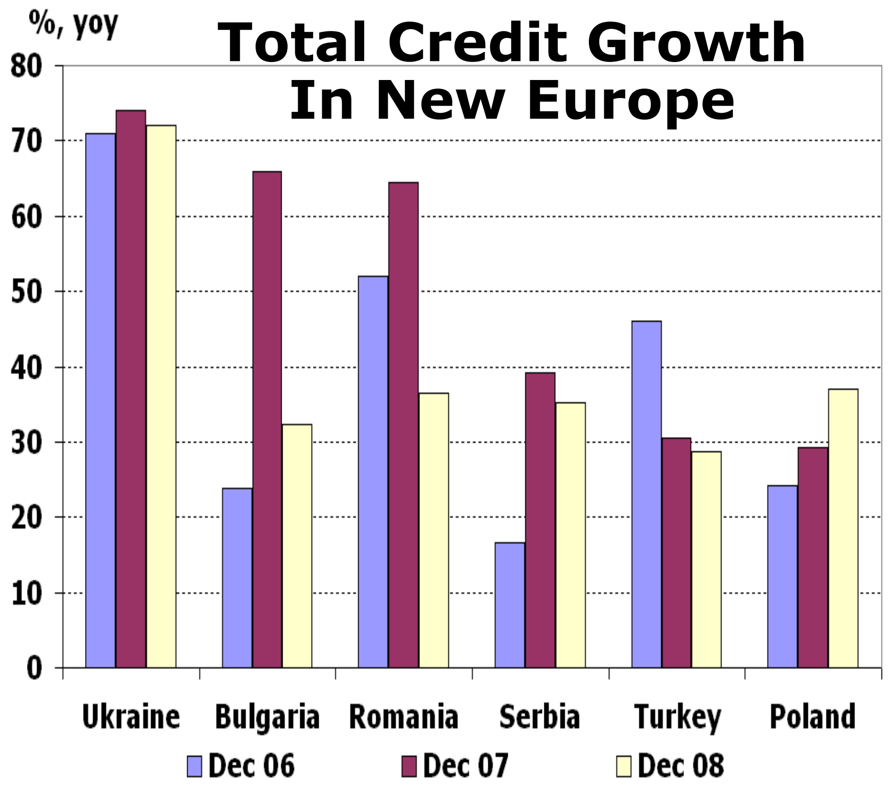
Notes:

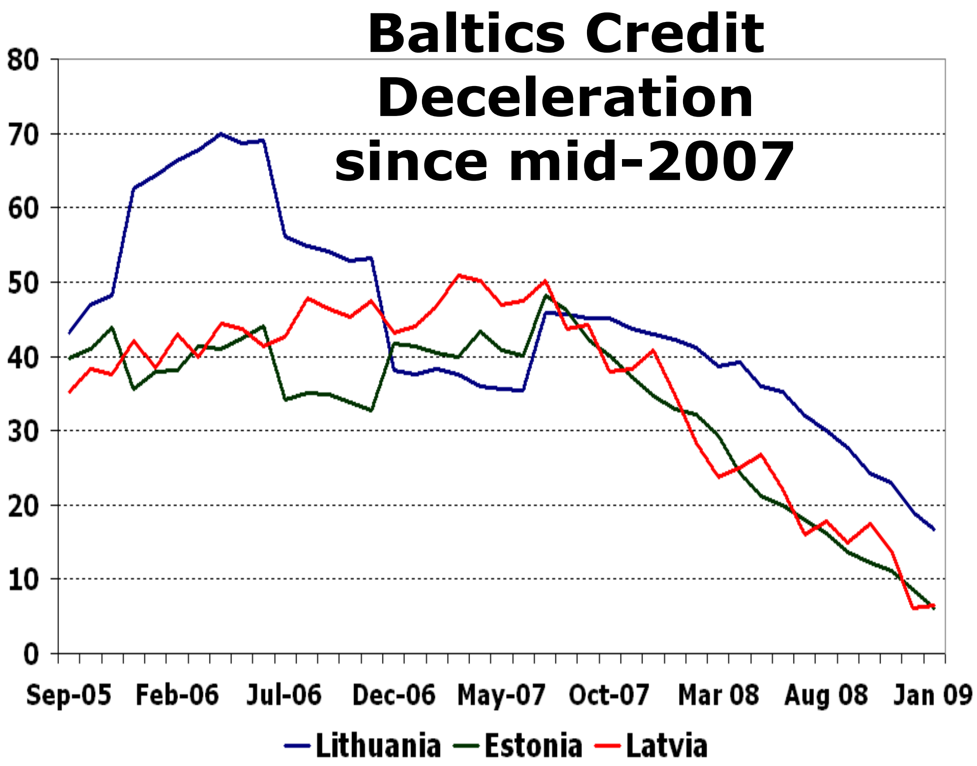
- ✓The area of each pie represents the $ amount of short term debt
- ✓Total external debt (horizontal axis) includes inter-company lending
- ✓Short-term external debt (vertical axis) excludes inter-company lending

* Short Term Debt defined by <u>Original Maturity</u> up to12 months

Source: Central Banks

II.3 (b) Expected deceleration in credit expansion

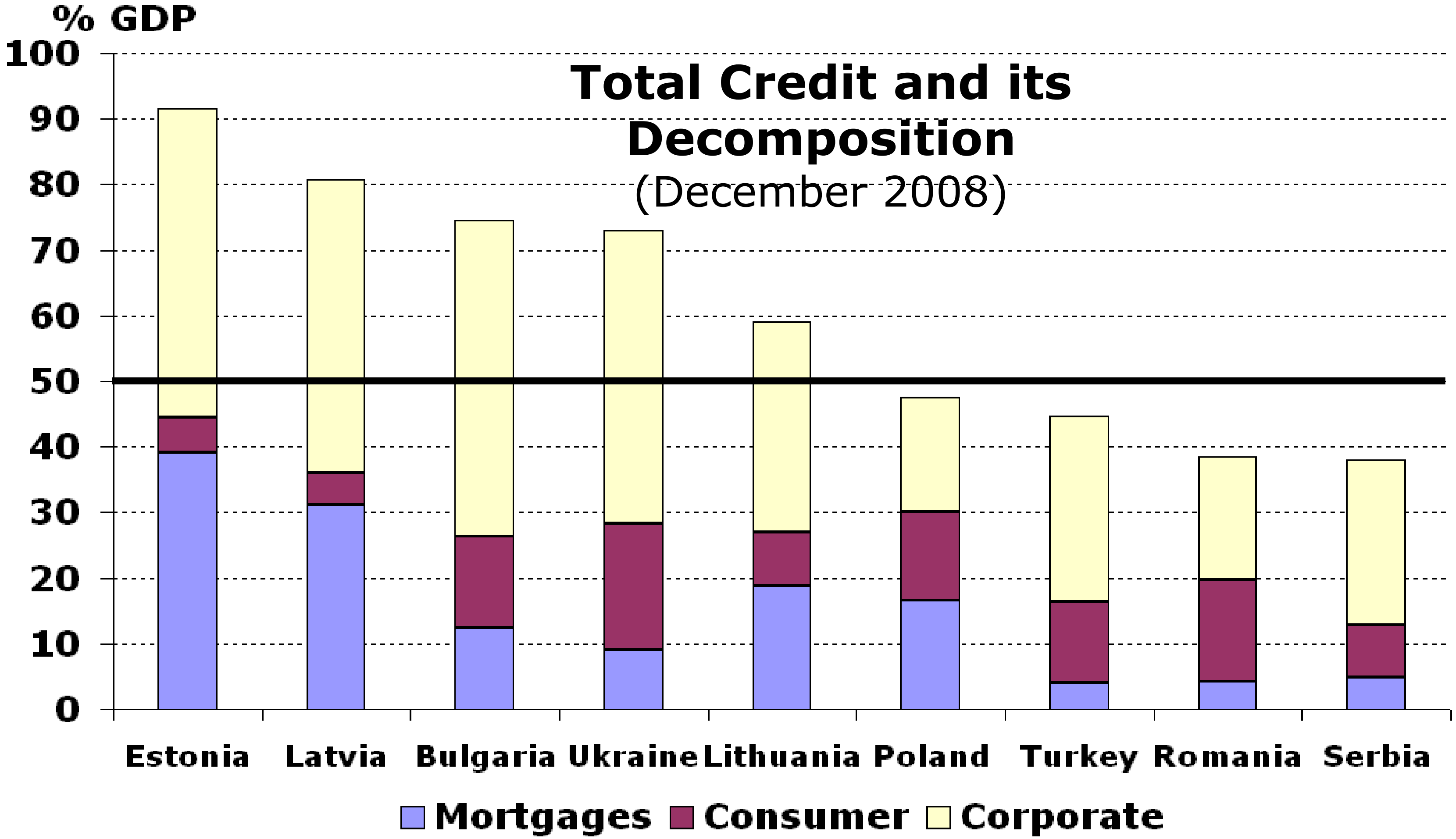




Source: Central Banks, Eurobank Research

- ✓ Credit is expected to decelerate like it happened in the Baltics when the Swedish banks stopped lending in 2007
- ✓ Yet, effect on the economy not the same. Elasticity of nominal GDP to credit growth is 1/3 the elasticity in the Baltics

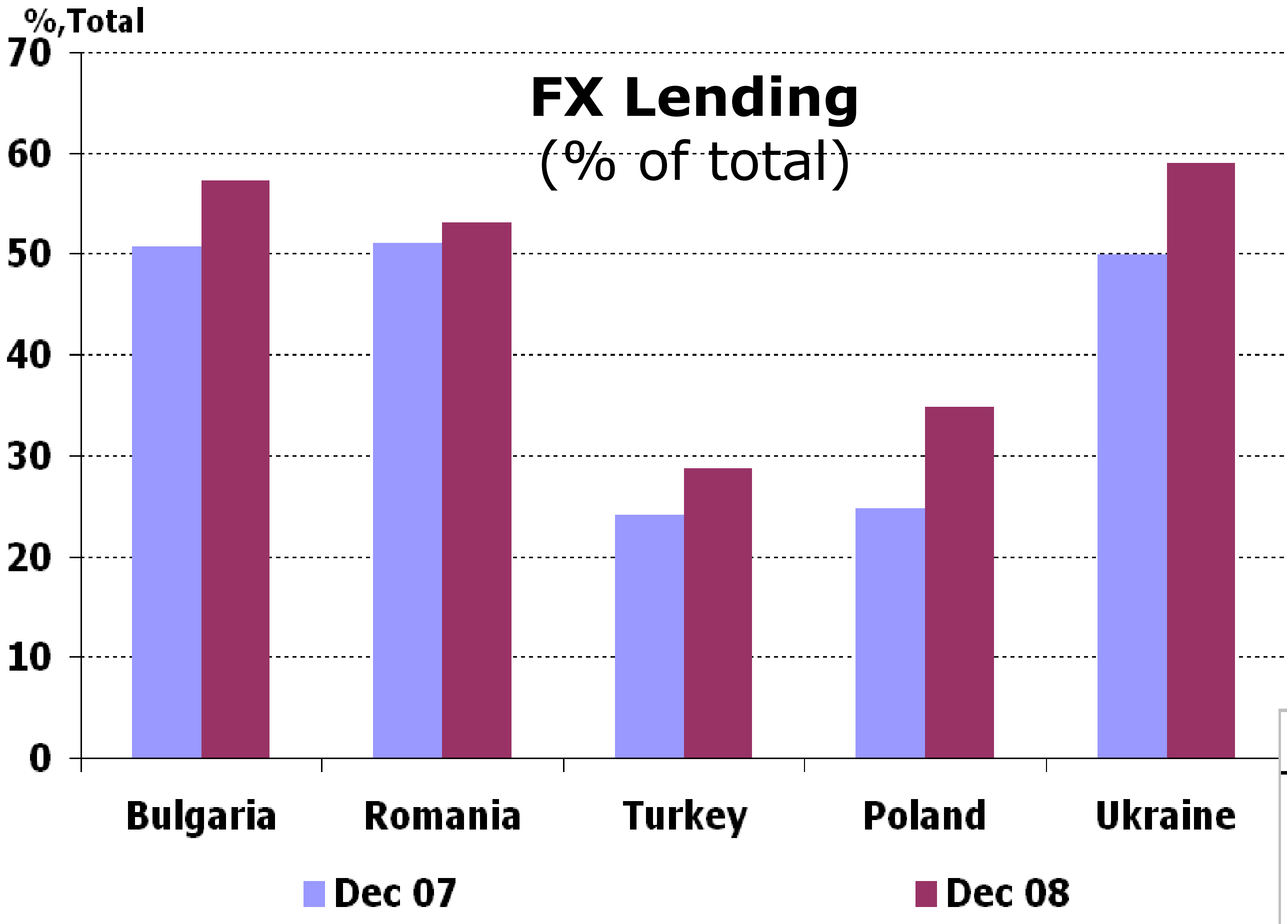
II.3 (b) Private sector not as indebted as in Baltic states



✓ Fortunately, the crisis came early on in the credit expansion, so that no “credit bubble” was generated

Source: Central Banks, Serbia as of Q3 2008

II.3 (c) A large component of domestic lending in FX



Source: Central Banks

- ✓ **A depreciation may increase NPLs**
- ✓ **In Bulgaria, the currency board protects in the short-term, but vulnerable**

FX Lending/Total (%)

	Dec 07	Dec 08
Bulgaria	51	57
Romania	51	53
Turkey	24	29
Poland	25	35
Ukraine	50	59

II.3 What are markets afraid of? (d) New forms of protectionism

- ✓ "Banking sector nationalism" - Western European governments have injected varying levels of capital into their banks. As a result, it is expected that banks keep the liquidity for their domestic businesses only
- ✓ Trade: Governments seem to require that fiscal packages be channeled to provide support for domestic industries and corporations only
- ✓ Remember that protectionism contributed significantly to the 1929-1933 global depression. The G-20 are aware of the problem and made public statements against it, as well as statements for expediting the Doha round of the WTO negotiations.

II.4 What will the future bring to NE?

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Domestic Policy response

- ✓ A more **balanced growth model** with a reversal of current account deficits should have top priority. The recession alone will not take care of the problem.
- ✓ Fiscal stimulus plans must consider **sustainability** of public finances
- ✓ Expansionary Monetary Policy with declining domestic interest rates constrained by depreciating pressure on FX
- ✓ **Deepening of domestic financial markets** needed:
  - — Develop Local currency Bond and Equity markets
  - — Develop derivatives Markets to hedge FX risk

International Policy response

- ✓ IMF support packages (Ukraine, Turkey, Serbia, Romania)
- ✓ International Financial Institutions:
  - — Lending Assistance (Example: 25 bn Euros Joint EIB-EBRD Support package in Emerging Europe)
  - — Technical Expertise
- ✓ Currency Swap Arrangements with major Central Banks (ECB and SNB to Poland)

II.4 Will the crisis affect the regional prospects of joining EU or EMU?

- ✓ EU expansion fatigue may worsen with the Crisis
- ✓ Old EMU members may be unwilling to let new members in EMU without an explicit and reliable structural policy vision, given the experience of Southern Europe and its large current account deficits
- ✓ Public debt to GDP ratios comfortably below 60% in all New Europe states, allowing for a temporary boost in fiscal policy that would exceed the 3% threshold
- ✓ The turmoil in financial markets may push back ERM-II entry (Only Baltic states are in the Mechanism)
- ✓ Investors’ risk aversion may lead to divergence in bond yields between old and new members, threatening to make the interest rate criterion an effective entry criterion
- ✓ HICP may trend upwards driven by currency devaluations- strong pass through to inflation (example Romania), which may delay EMU entrance further

III.

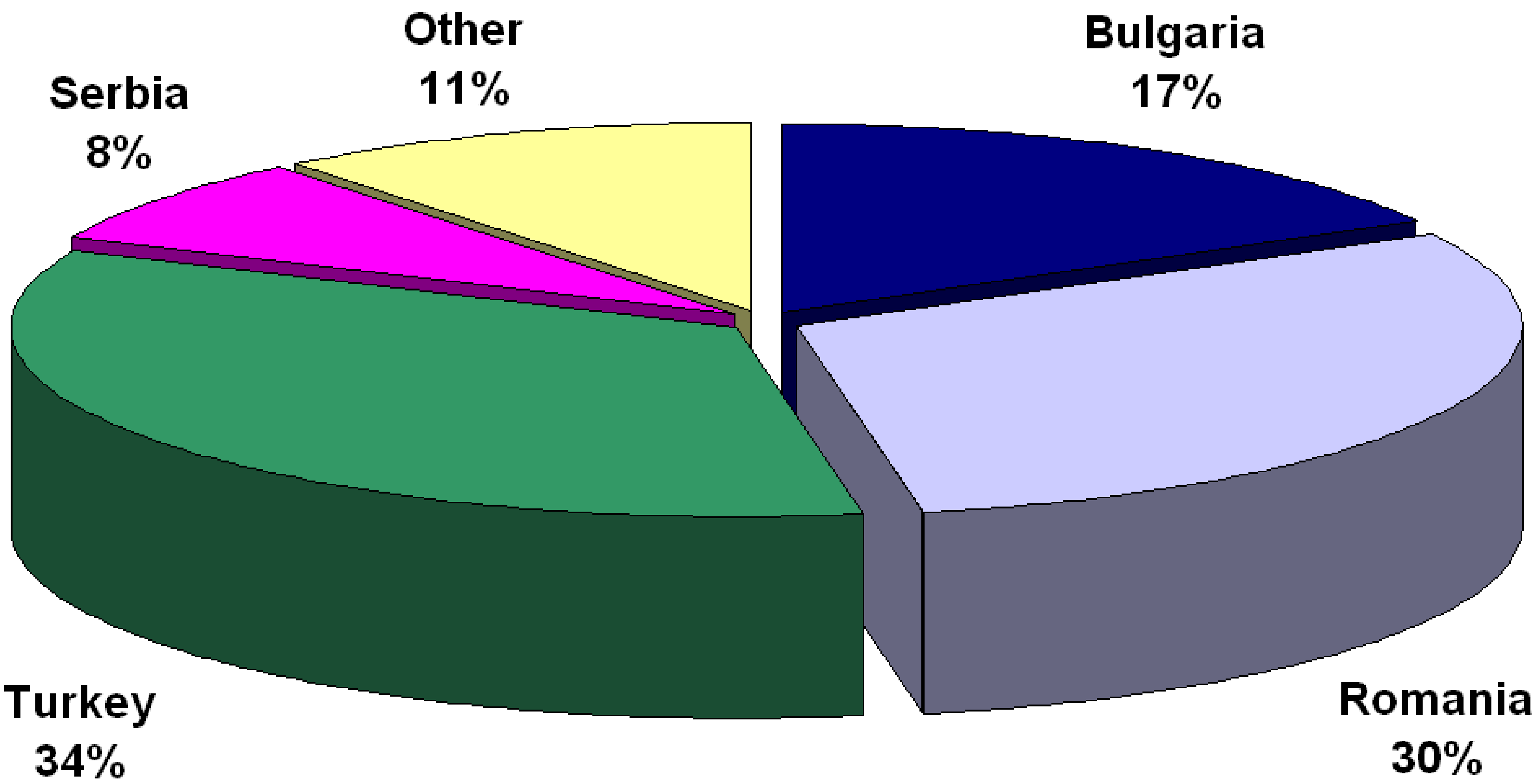
How can Greece survive the crisis?

1) Fewer problems in the short-run with the recession arriving with a delay

2) Significant imbalances in the long-run and strong measures, and of permanent nature, needed to avoid the possibility of a long stagnation period

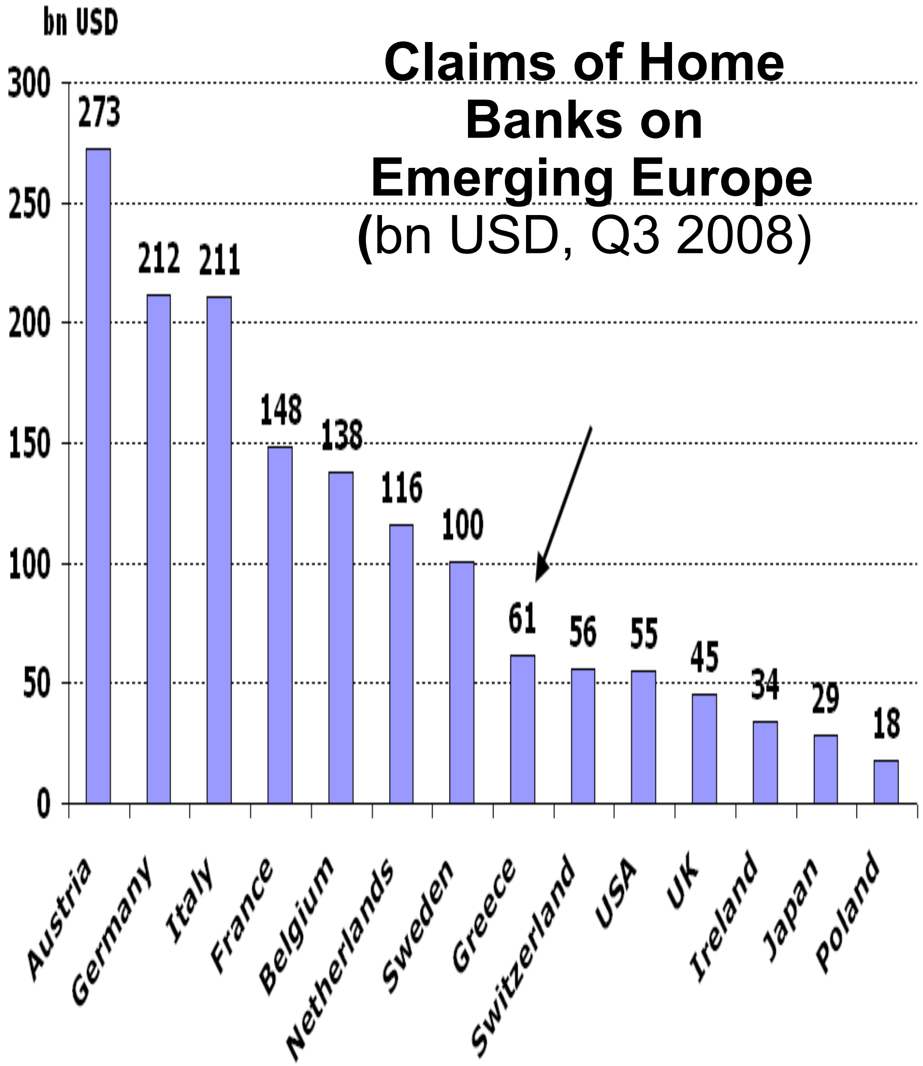
III.1 Greek bank exposure to Emerging Europe by host country

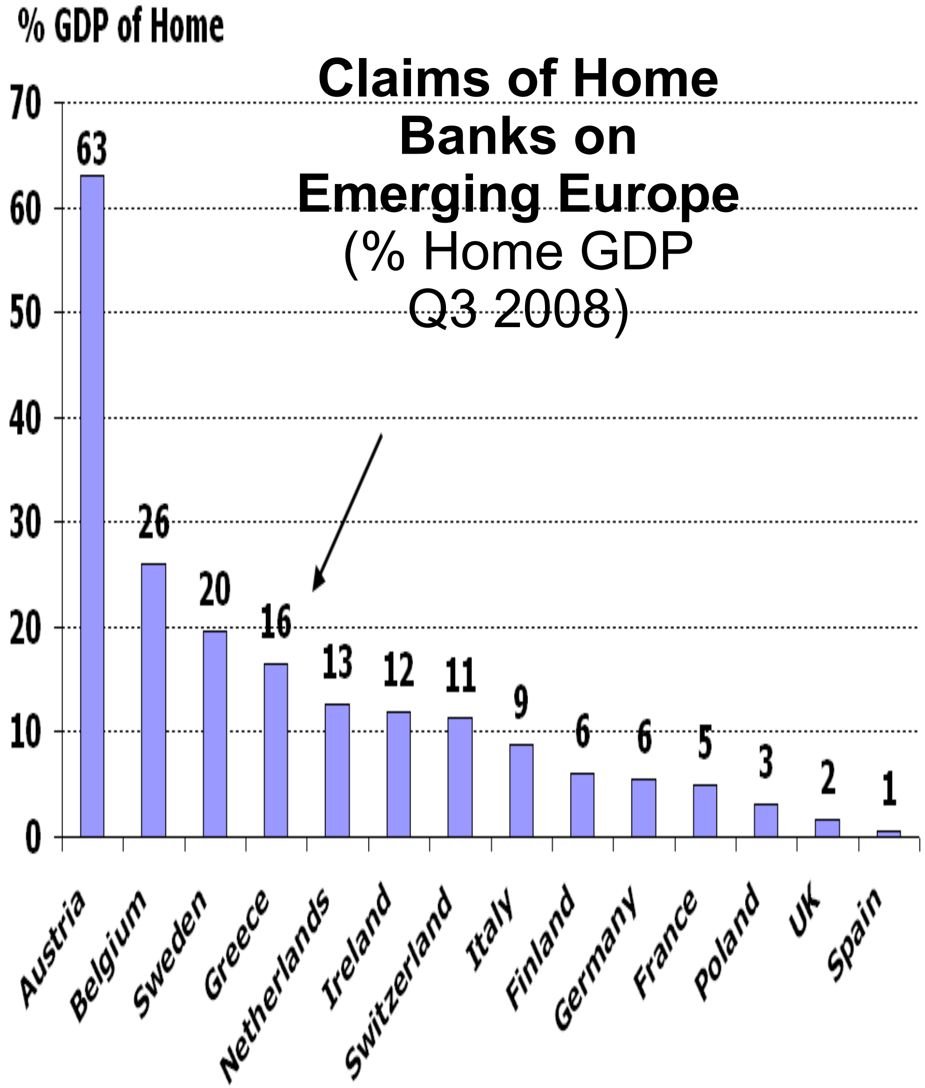
Greek Banks' Exposure: 16% of GDP
(Q3 2008)



Source: BIS, Eurobank Research

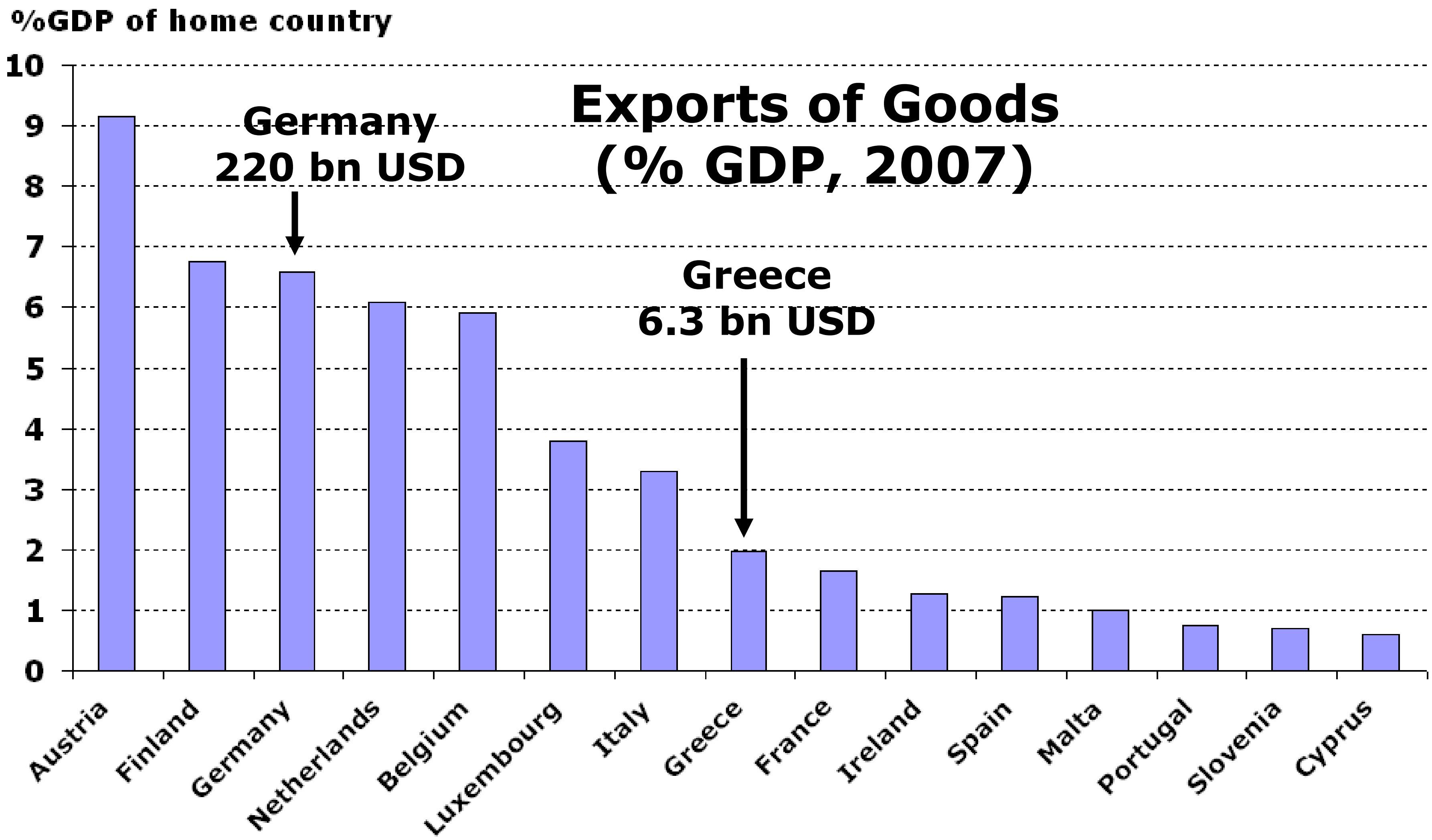
III.1 Exposure of home bank assets to host countries of emerging Europe





Source: BIS, Eurobank Research

III.1 Exposure of goods exports to Emerging Europe



Source: IMF, Eurobank Research

III.1 Greece can withstand the recession better …

In the **short-run**, Greece **can withstand** the crisis **better** than its European counterparts, thanks to

1) Strong real wage growth that boosts consumption, which has the largest share in aggregate demand within the EU
2) A strong banking system that weathers the external financial storm
3) A relatively more closed economy
4) Horizontal diversification of business activity, i.e. absence of vertical integration

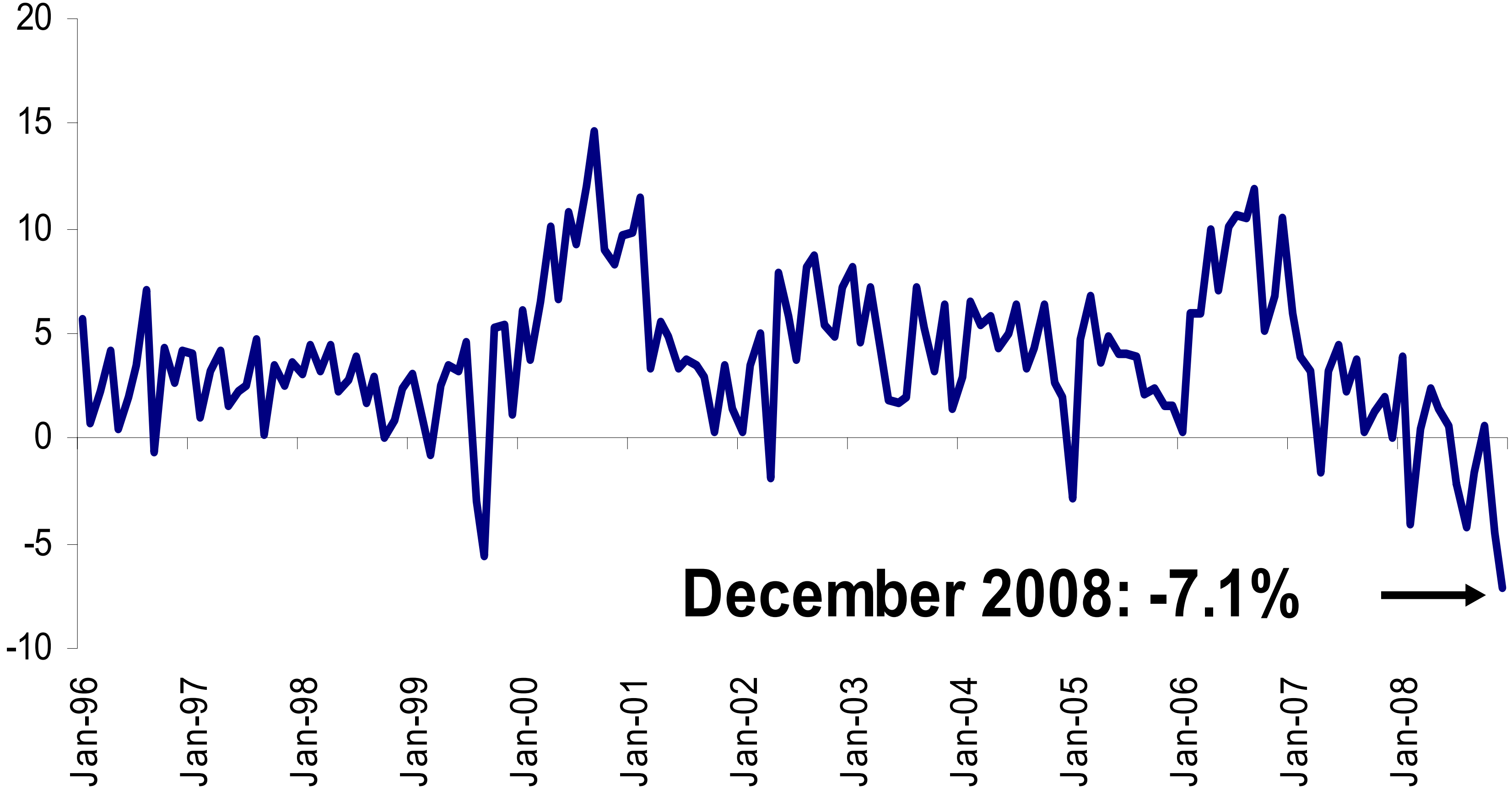
Moreover, **the decline in interest rates** from their peak in Q4-2008 plays a significant role

The above strengths **simply delay** the upcoming recession

III.1 … but the recession is knocking on our door

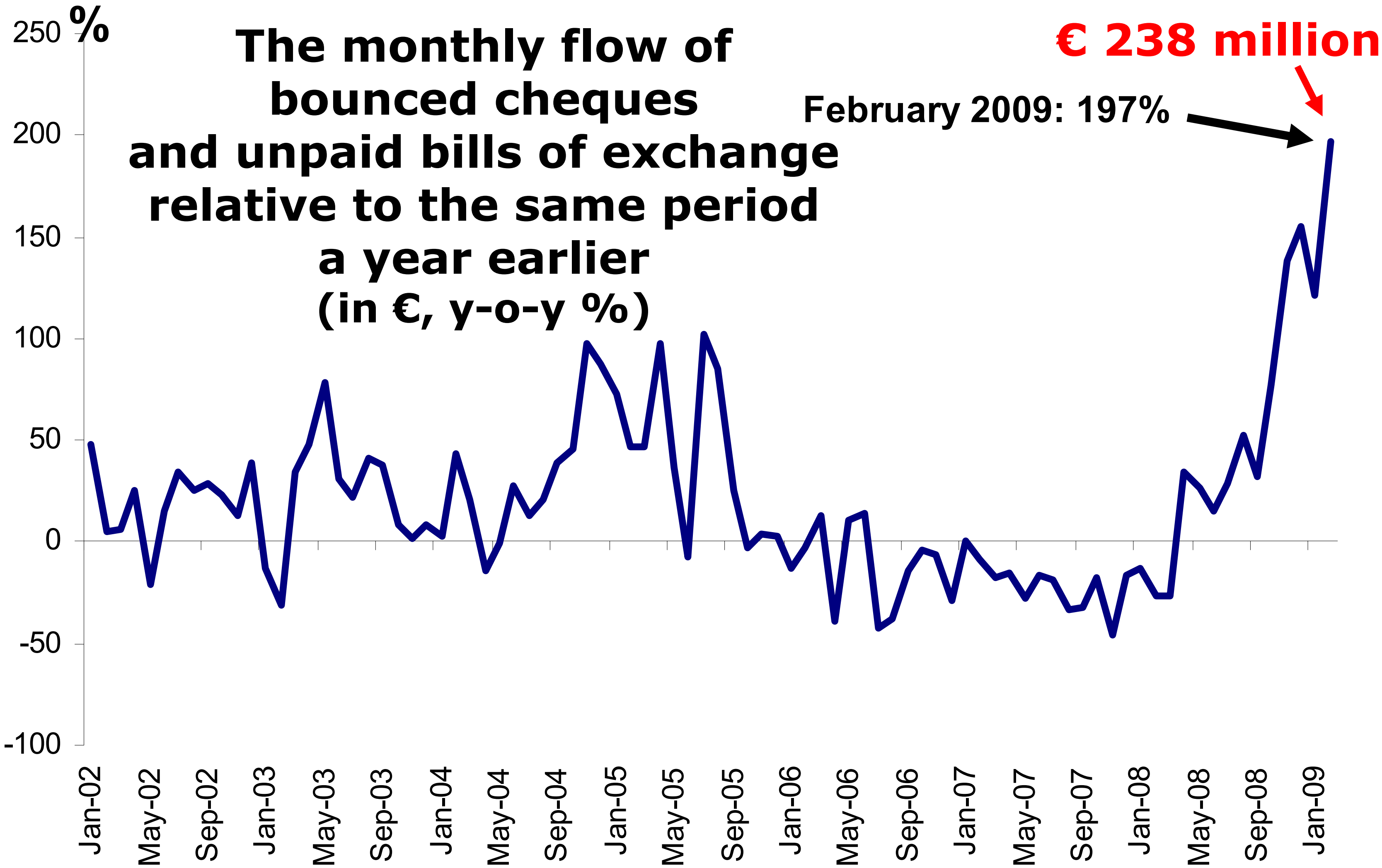
Retail sales in constant prices

(y-o-y %)



Source: National Statistical Service of Greece

III.1 Increased Signs of Financial Strains

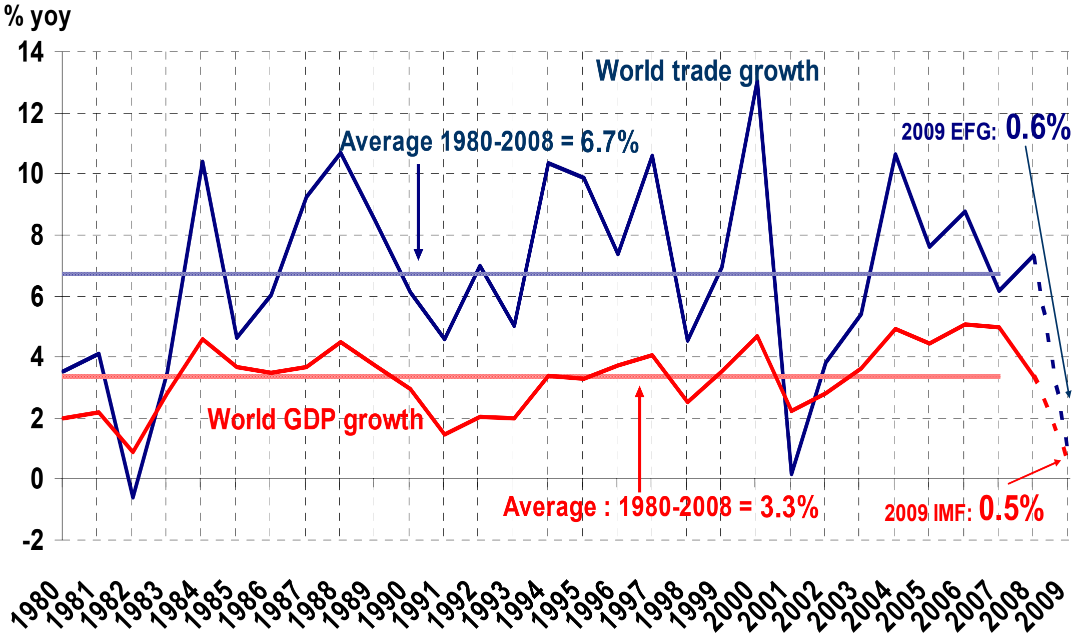


Source: TIRESIAS

III.1 World Trade, Shipping and Tourism decelerate

Increase in trade = -0.50 + 2.28* GDP growth, R2 = 67%
(-0.52) (8.11)

Trade growth will drop to 0.6% in 2009

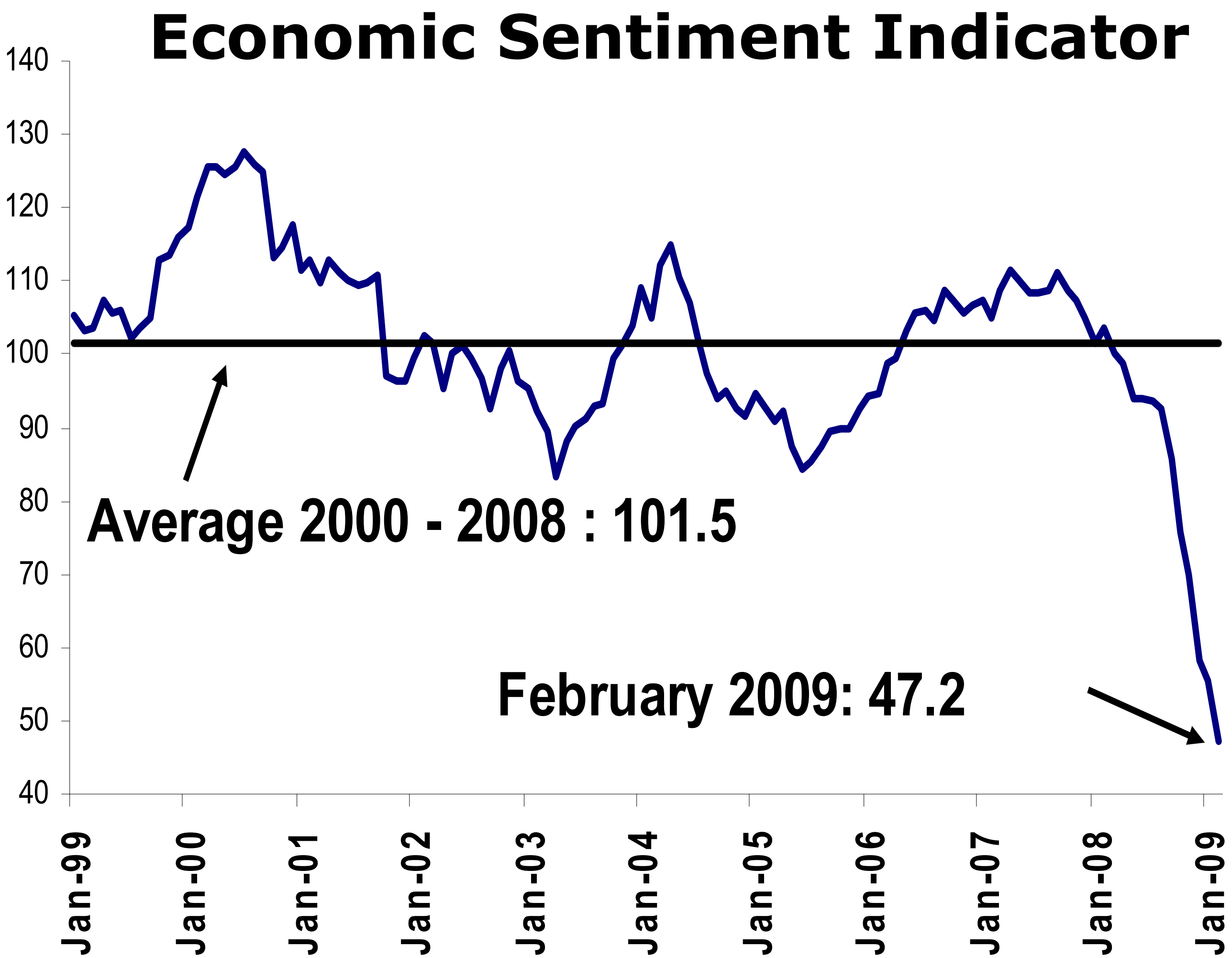


Baltic Dry Index

- ✓ Lower shipping rates and lower ship values affect Greek economic activity, but a lot less
- ✓ Reservations point to a more than 15% summer decline in tourism revenues from abroad

Source: IMF, OECD, Eurobank Research

III.1 Business and Consumer confidence collapse



The index has declined by **56** points since 02/2008

Source: European Commission

III.2 Is the market concern of long-term low growth or stagnation founded?

A prolonged economic stagnation could be the result of deep economic vulnerabilities:

- ✓ Low Competitiveness (due to: Bureaucracy, market oligopolies, etc.)
- ✓ Aging population and future fiscal pressures

A low growth path could result in real divergence instead of continued convergence to old EU-15

Markets are now focused on the above prolonged imbalances and, consequently, government bond spreads with Germany have skyrocketed

III.2 Competitiveness: A Macroeconomic Perspective

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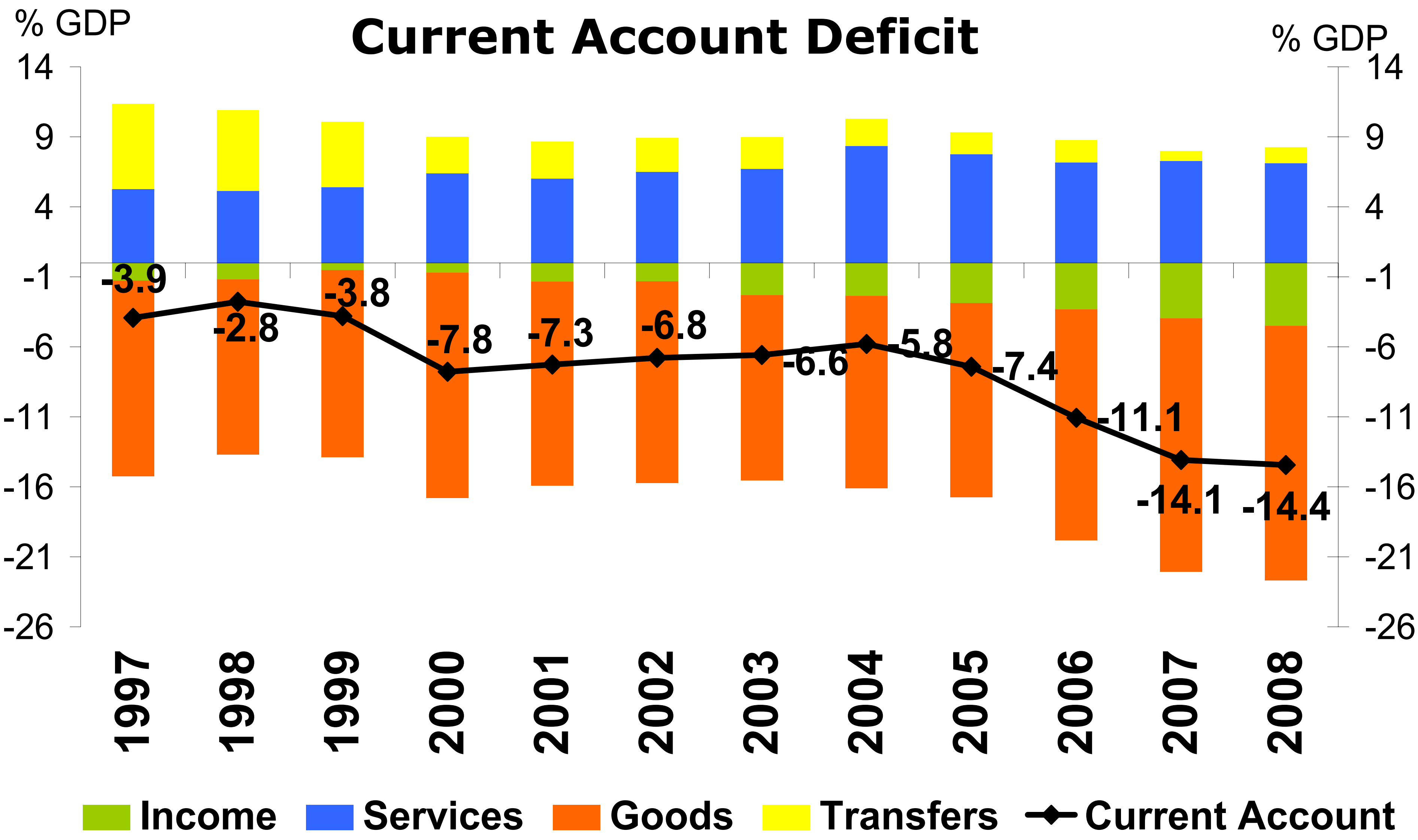


Source: Bank of Greece

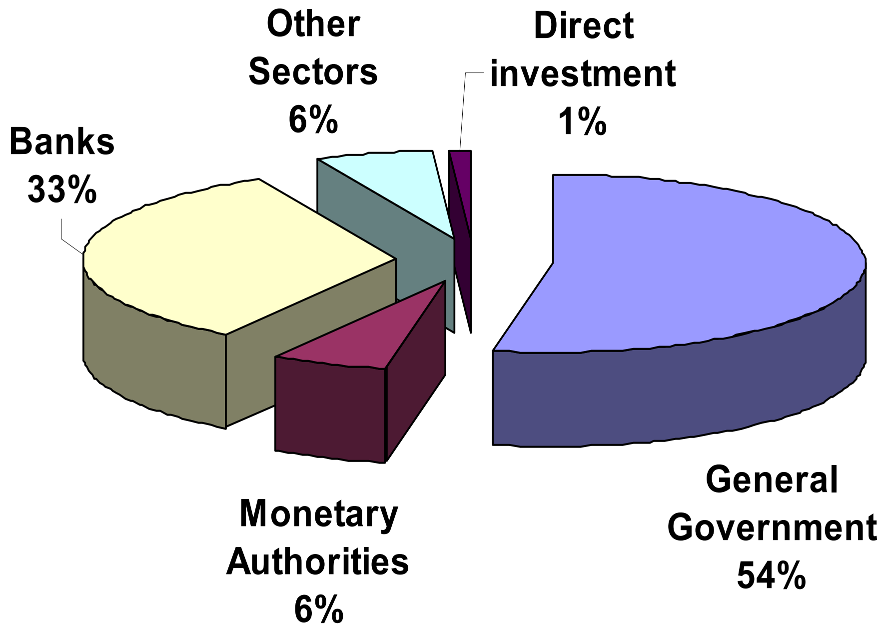
III. Greek External Debt deteriorates

Greek Gross External Debt increased by **52.4 p.p.** of GDP, or 220% in 5 years

2Q 2008 : $ 531.7 bn : 138.2% of GDP
2Q 2003 : $ 166.2 bn : 85.8% of GDP

Accumulated Current Account Deficits 2Q 2003 – 2Q 2008 : **49 p.p. of GDP**

Greek Gross External Debt Composition
(2Q 2008, Total: $531.7 bn)



✓ Banks' ownership of 1/3 of external debt may prolong the current liquidity problem if crisis continues

Source: IMF, OECD, BIS, WORLD BANK Joint External Debt Database

III.2 Aging population & pressures on pensions and debt

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GREECE

	2005	2010	2015	2025	2050
Health Expenditure (% GDP)	5.1	5.4	5.5	5.7	6.8
Education Expenditure (% GDP)	3.4	3.1	2.9	3.0	3.1
% of older employees (55 – 64)	10.9	12.0	13.6	17.3	17.4
Old-age Dependency Ratio	26.8	28.0	30.3	35.8	60.4
	2007	**2020**	**2030**	**2040**	**2060**
Pension Expenditure (% GDP)	11.7	13.2	17.1	21.4	24.1

Source: European Commission 2006, SGP 2008-2011

IV.

Policy Priorities
&
Conclusions

IV. Immediate policy priorities to avoid a deep recession

- ✓ **An IMF study shows that past recessions in Greece were deeper than the OECD average, lasted longer and cost four times more in cumulative GDP loss.**
- ✓ **Hence, it is necessary to take urgent measures in order to avoid a deep recession**

1) **Expenditure reallocation**
   i. Allocate funds according to an announced plan based on a cost-benefit analysis with an explicit list of priorities and do not succumb to interest groups via handouts and cheap talk
   ii. Expedite investment projects through use of EU money & PPPs
   iii. Improve incomes of citizens with high marginal propensity to consume, i.e. the low-income groups
   iv. Safeguard the public sector's credibility in its monetary obligations to citizens during today's difficult times
2) **Revamping the system of tax collection**
   i. Improve transparency further through carrots and sticks and the use of technology and fight corruption
3) **Allow for budget overruns in 2009** but ensure they are of temporary nature and a return to fiscal discipline is possible once the crisis is over
4) **Ensure the continued expansion of loans** to households and enterprises (the expected credit expansion rate is only 5% for 2009)

IV. Additional policy priorities to ensure long-term growth

1) Restructure the health care system as competition with the private sector is accelerating
2) Expedite the restructuring of many public sector companies
3) Tackle the oligopolistic practices in trade & commerce that create a wedge between producer and consumer prices
4) Reconnect the educational system with the needs of contemporary society
5) Reform the Social Pension System (OECD report)

IV. Conclusions … for the world

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- ✓ The international crisis began outside the traditional banking system but quickly spread due to high leverage
- ✓ **We are in the middle of the crisis and the future is still uncertain**: The US is hesitant in cleaning up its banks and Europe in expanding fiscal policy further. The correct Chinese emphasis on domestic consumption is at an early stage for visible immediate results
- ✓ The future of relative global economic power is at stake as countries with the largest imbalances take the most risks
- ✓ Deeper and broader regulation in the future is the likely outcome, but no single global regulation or regulator
- ✓ We need a global banking system that will return to its traditional intermediary role and a global economy that will turn to innovation and growth
- ✓ We should ensure society does not ostracize bankers and the corporate sector or the motive for healthy profits, and the best way to do it is to pay prime attention to distributional issues
- ✓ We should emphasize policy coordination in a global village and avoid new protectionism in disguise
- ✓ The expanding path of Globalization in question

IV. Conclusions … for the region

- ✓ The region will be hit hard, but long term prospects continue to be bright as economic policy is anchored by EU and EMU
- ✓ Main risks are (i) sudden stop in capital inflows (ii) slowdown in credit expansion (iii) rise in NPLs originating from large depreciations
- ✓ The longer the crisis stays, the bigger the regional problems and the larger the output losses
- ✓ Greece has a strong banking sector and a relatively more closed economy, hence the recession arrives with a delay
- ✓ The Greek problems are longer term: Lack of competitiveness, rising fiscal pressures from a graying society. They could turn a recession into a prolonged stagnation if aggressive measures are not taken
- ✓ The markets are over-reacting to Greece's long-term problems, as spreads with Germany imply a probability of bankruptcy of 20% within the next 5 years!
- ✓ The crisis provides a chance to awaken to the challenges of the future

THANK YOU FOR YOUR ATTENTION!!

My thanks to the Research department of Eurobank EFG for able research assistance and support

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