

Greece: No sign of an ideal solution

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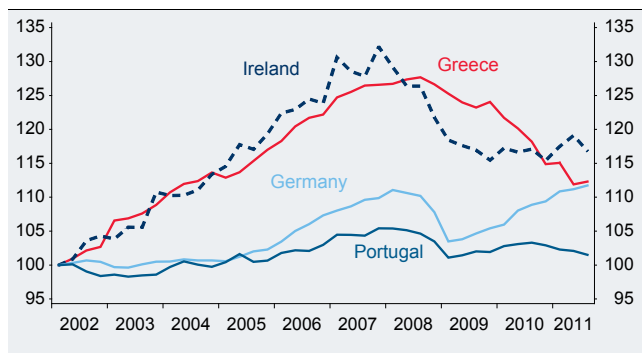
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The dramatic austerity measures and economic reforms that are needed are placing heavy burdens on the domestic political situation in Greece, partly because such measures go hand in hand with a severe adjustment recession. In mid-2011, protests and disputes not only between the government and the opposition, but also within the Papandreou government itself, created doubts about the will to continue with the reform policies. After a courageous start the government failed to meet the targets agreed in May 2010 within the framework of the three-year support package put together by the EU and the IMF comprising € 110 billion in total. The sixth tranche of the support package that was due to be disbursed in autumn 2011 was held back until the government assured it would take further consolidation measures. These include more salary cuts for civil servants and state employees, the reduction of public sector jobs and the introduction of a property tax. In order to be better able to implement these measures, in November 2011 a transitional government with broad backing in the parliament was set up under prime minister Papademos. This consisted of the social democratic party PASOK, the conservative Nea Dimokratia and the right-wing LAOS party. Foreign demands for the involvement of the opposition in the austerity measures played an important role in this step. However, the new government's mandate is limited to stabilising the budget situation in the near term and to signing a voluntary debt agreement with private creditors – both of which are prerequisites for further disbursements from the existing support package and for a second, follow-up aid package to be put together by the EU and the IMF. New elections are planned for after the Greek Easter holiday in mid-April.

The Greek economy grew very dynamically before the crisis, which presumably blinded observers to the untoward developments that were taking place. Too little heed was paid to the structural deficiencies, such as an uncompetitive industry, inefficient state-owned companies, protected professional groups and markets, as well as an encrusted bureaucracy. If the Greek state had created fewer jobs and indulged in less deficit-driven financing, gross domestic product would presumably have grown as lethargically as in Portugal. There, too, competitiveness deteriorated as a result of rising unit labour costs and delays in implementing reforms, except that the public finances remained more orderly there.

Party time until 2008, followed by a nasty hangover

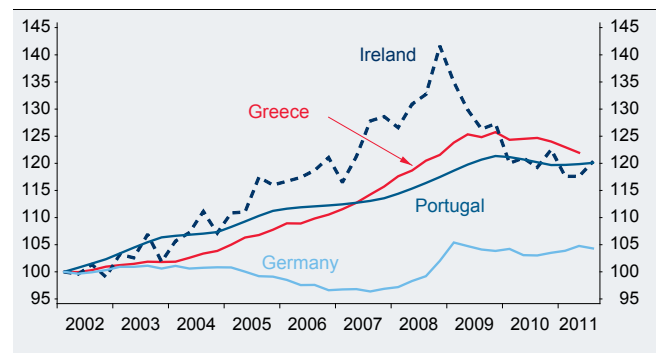
Real gross domestic product, index: Q1 2002 = 100



Sources: EcoWin, Helaba Research

Unit labour costs need to be adjusted more sharply

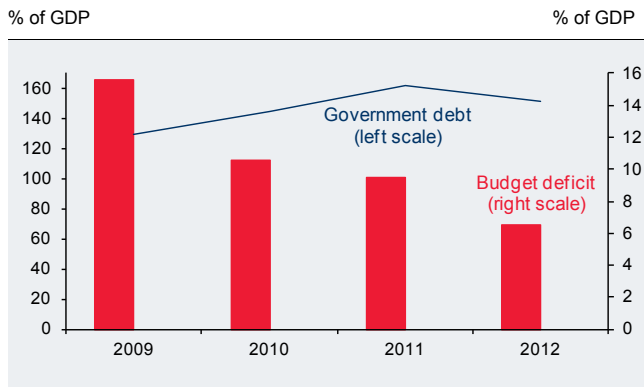
Index: Q1 2002 = 100



Sources: EcoWin, Helaba Research

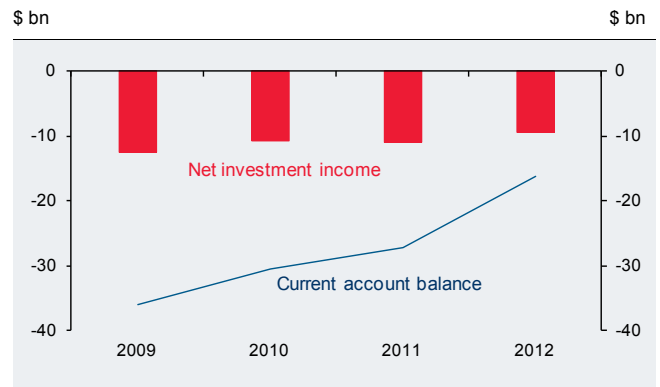
The Greek austerity programme will, therefore, only be successful in the long term if – at the same time – the economy becomes more efficient. The reforms that have been planned to this end will, however, have a positive effect only gradually. After falling by 6 % in 2011, GDP will probably fall in 2012 by another 3 % at least. Initially, the structurally weak exports of goods and the far more important exports of services (tourism, shipping) will increase only modestly. The current account deficit (in 2011 this was still equivalent to 9 % of GDP) will probably only fall rapidly because of the steep decline in domestic demand.

Fiscal weaknesses



Sources: IMF, EU, EIU, Helaba Research

Foreign trade weaknesses



Sources: EIU, Helaba Research

The Greek government, the EU and the IMF already reached agreement in October 2011 on a second rescue package. This is to have a volume of € 130 billion and is intended to close the financing gaps left after the end of the first package in 2014. The goal is to get Greek debt down by 2020 to 120 % of GDP, which is regarded as viable provided the reforms are successful. A component of this agreement is a voluntary haircut for private bond creditors of at least 50 %, supplemented by the new 20- to 30-year fixed-income bonds with reduced interest rates. The new bonds are to add up to around 35 % of the existing bond volume, approximately 15 % of private creditors' claims are to be repaid immediately. Private creditors, who currently hold around € 205 billion of the overall national debt of over € 350 billion, are represented in the negotiations by the Institute of International Finance (IIF). According to IMF forecasts, due to the planned haircut for the private creditors, government debt will fall from 162 % of GDP in 2011 to 151 % in 2012 and will then continue to fall steadily. The private creditors' share in government debt would be reduced from around 80 % (2011) to roughly 40 % (2012).

Danger of a moratorium

On the one hand, the debt to private creditors is to be rescheduled and the new support credit disbursed by the EU and the IMF as fast as possible so that the Greek government is able to refinance the € 14.5bn government bond due on 20 March. On the other hand, the economic policy measures and the current budget situation still have to be reviewed by the so-called Troika, which consists of experts from the EU Commission, the ECB and the IMF. At the same time, the forthcoming haircut is dogged by uncertainties about the size of the private creditors' participation. This creates a risk that the "gradual" solution of the debt problem is not feasible. In this case the Greek government would be forced to officially declare a moratorium on its debt. Existing agreements on the reform programme and its financing would then be obsolete. Since the Greek government cannot print money, it would initially be dependent on bridge-over financing from the EU governments and the ECB until a solution that is viable in the long term were found. Such a process would not only take a long time, but would presumably also lead to a higher haircut than envisaged in the second rescue package. In addition, a general suspension of payments by Greece would still weigh heavily on the European capital markets and require additional support measures from the EU and the ECB in order to contain the danger of contagion for other crisis-stricken countries such as Portugal. All participants will, therefore, presumably make every effort to avoid a moratorium as the imponderables and costs that are associated with it would be considerable.

Economic data Greece

		2009	2010	2011s	2012p
GDP	in \$ bn	326	306	300	268
real GDP growth	% y/y	-3,3	-3,5	-6,0	-3,0
Per capita GDP	\$	29.042	27.118	26.596	23.696
Population	in millions	11,2	11,3	11,3	11,3
Unemployment rate	%	9,5	12,6	17,0	20,0
Budget deficit	as % of GDP	-15,6	-10,6	-9,5	-6,5
Inflation rate	%	1,3	4,7	3,0	1,0
Current account balance of payments					
Income	\$ bn	72,4	71,7	79,0	73,5
Expenditure	\$ bn	108,4	102,1	106,1	89,6
Current account balance	\$ bn	-36,0	-30,5	-27,1	-16,2
"	as % of GDP	-11,0	-10,0	-9,0	-6,0
Foreign debt (net)	as % of GDP	87	103	116	105
Net investment income	\$ bn	-12,5	-10,8	-11,0	-9,3
"	as % of Income	-17	-15	-14	-13

s = estimate, p = forecast

Sources: IMF, EU, EIU, Helaba Research



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