Greece:
Conditions for a Sustained Recovery

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February 2017

Conditions for a Sustained Recovery

1. Setting the stage:

- The scale of the Greek crisis in perspective

2. How did it all start:

- Twin deficits, sudden stops, and fiscal credibility

3. Managing a crisis when policy space is constrained

- Real-life policy options and counterfactuals

Conditions for a Sustained Recovery

4. Examining past consolidation efforts:

- Why has the recovery taken so long?

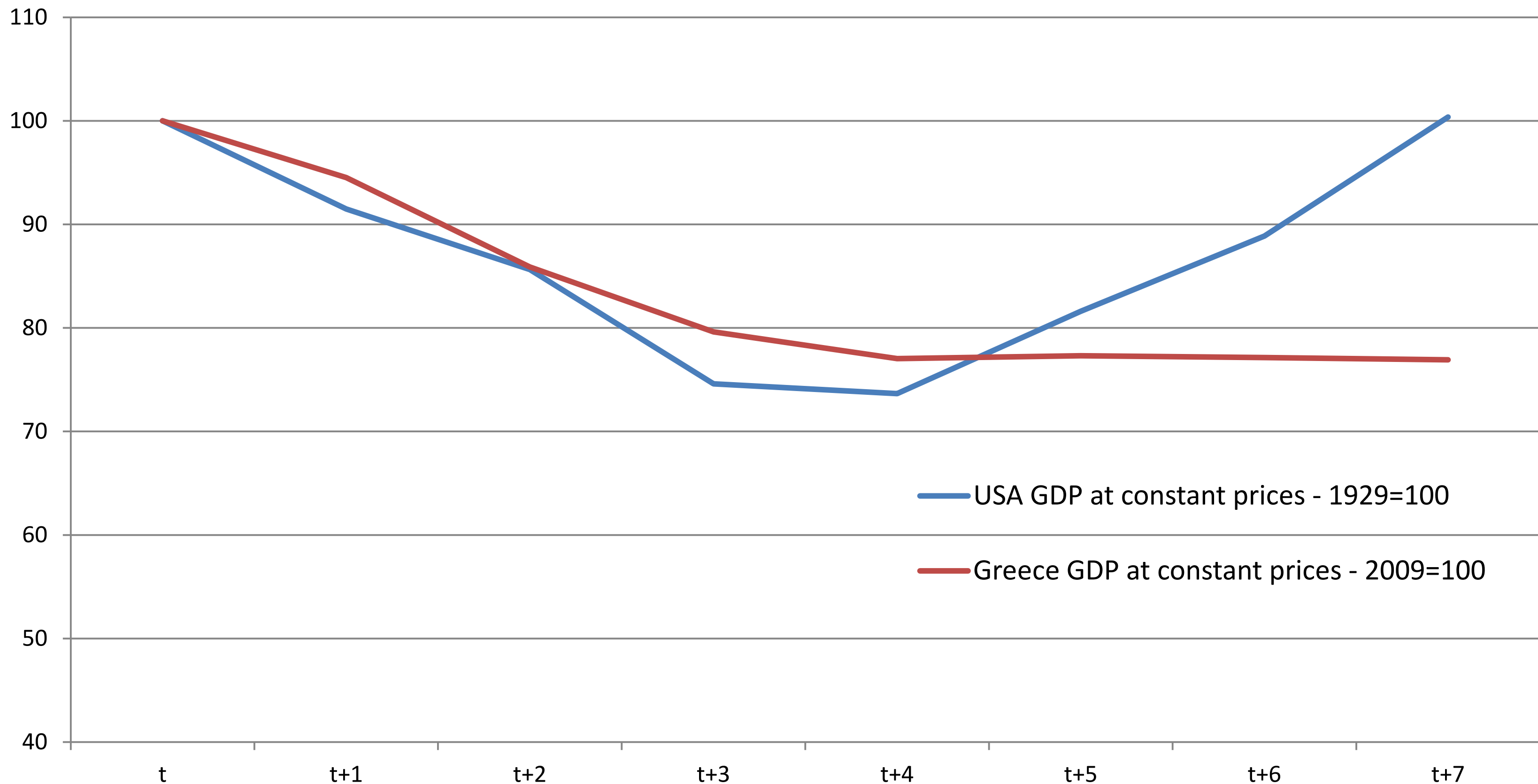
5. What have we learnt from past errors:

- The design of the third bail out program

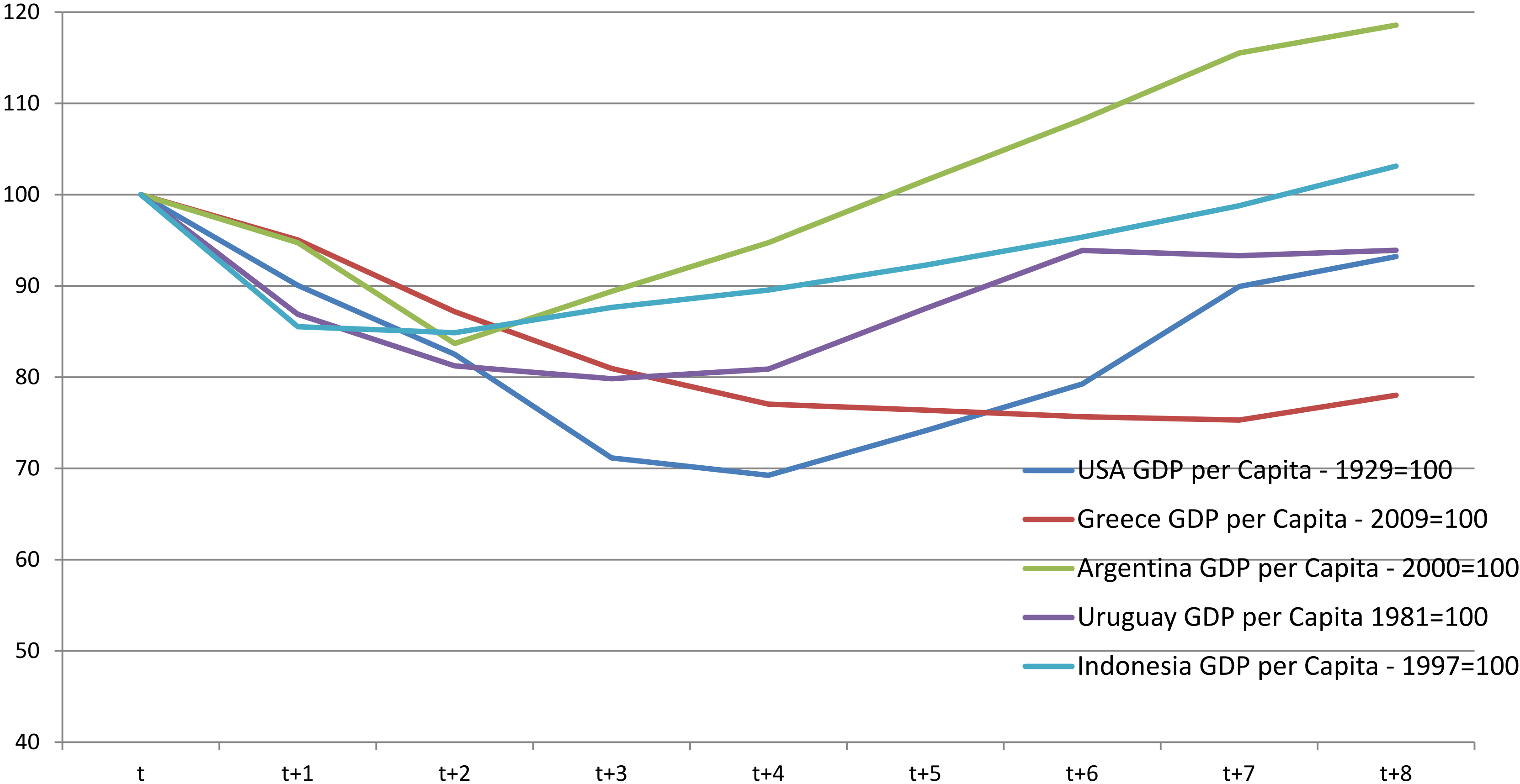
6. Looking ahead:

- Opportunities, challenges, and risks.

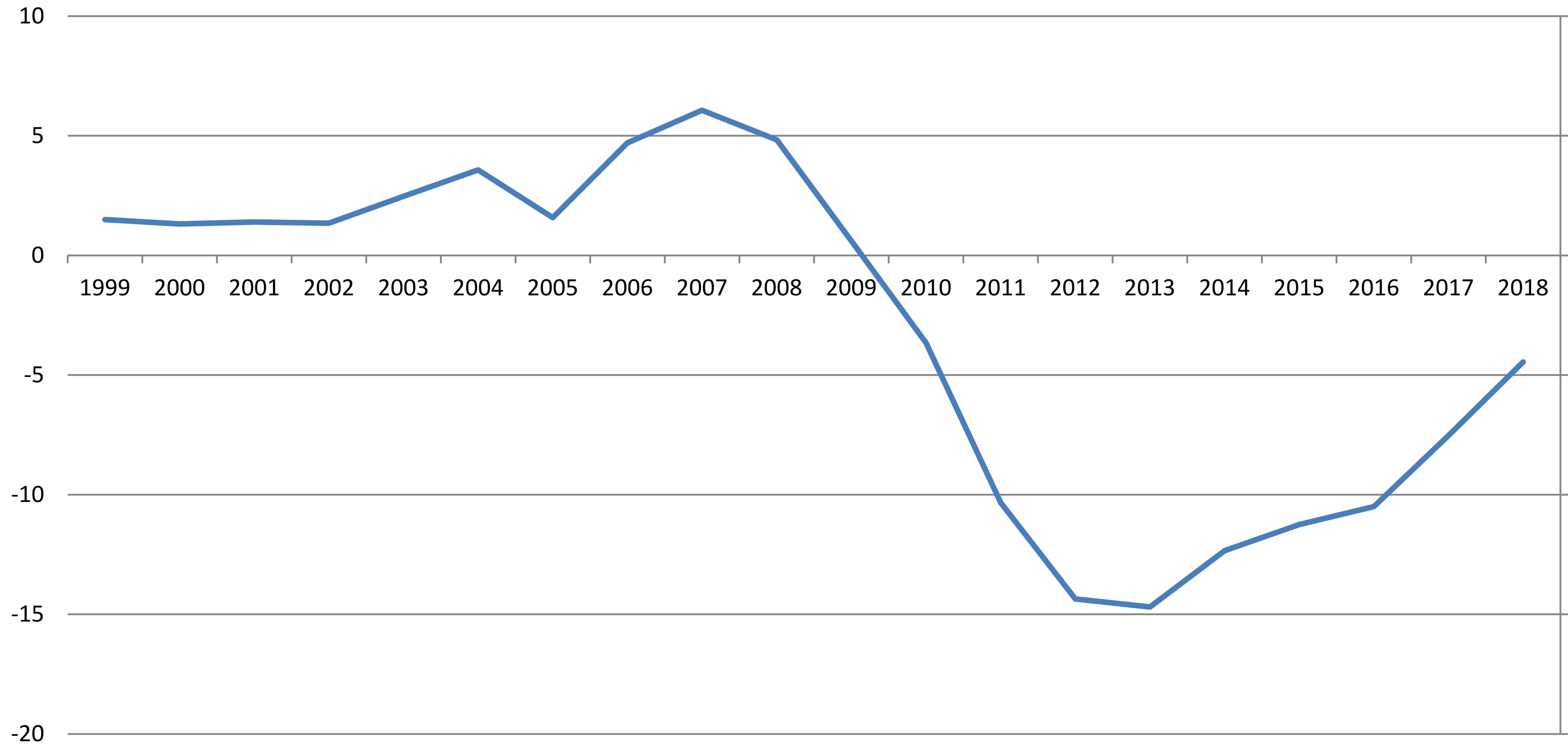
The Current Economic Crisis in Comparative Perspective



The Current Economic Crisis in Comparative Perspective



The Greek Output Gap



How did it all start?

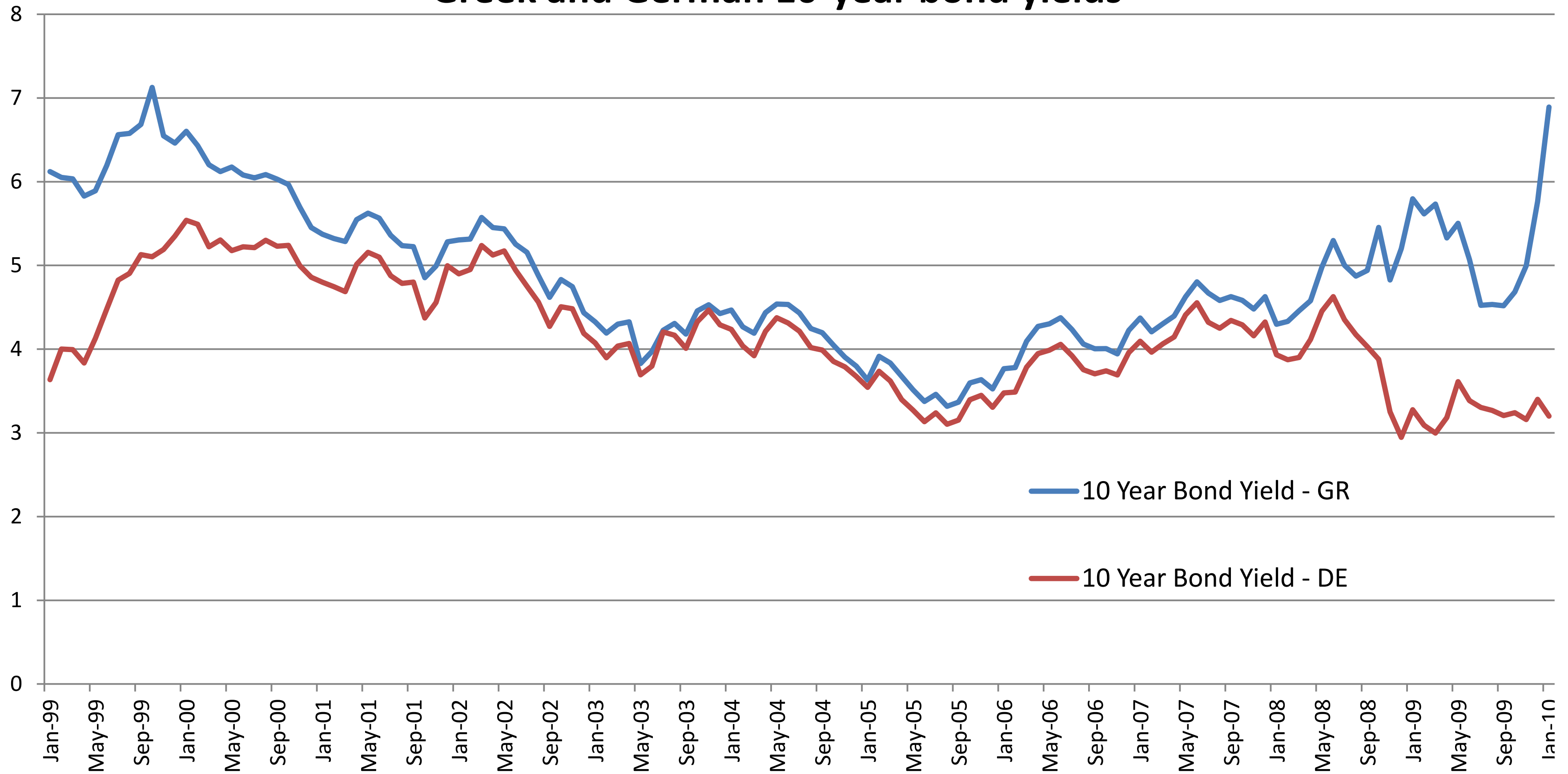
1. The proximate cause: *the twin deficits*

- Private and public sector external borrowing at very favourable terms (the euro effect)

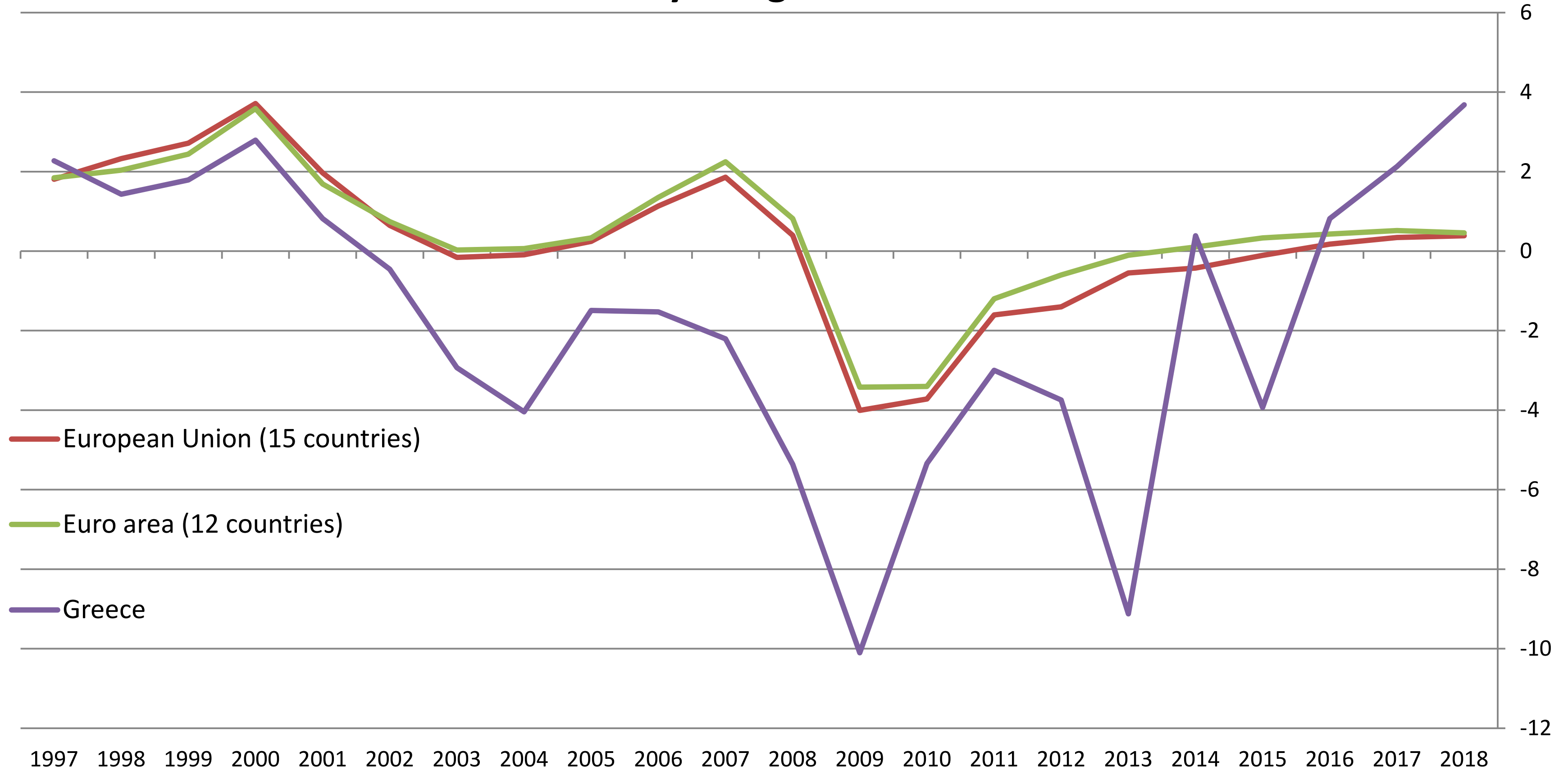
- Widening budget deficits and overheating

- Real exchange rate overvaluation and deteriorating current account deficits

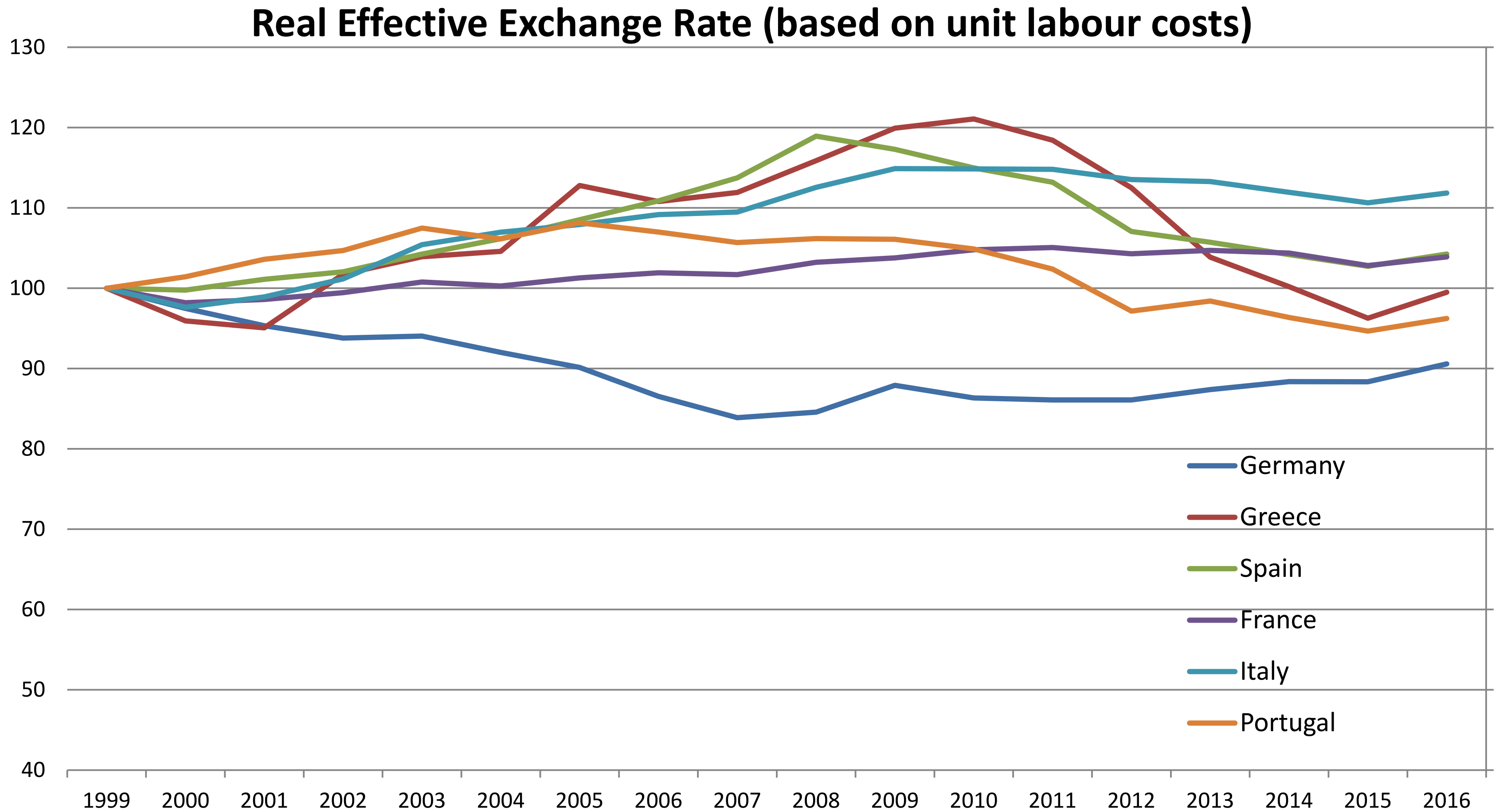
Convergence in Borrowing Costs



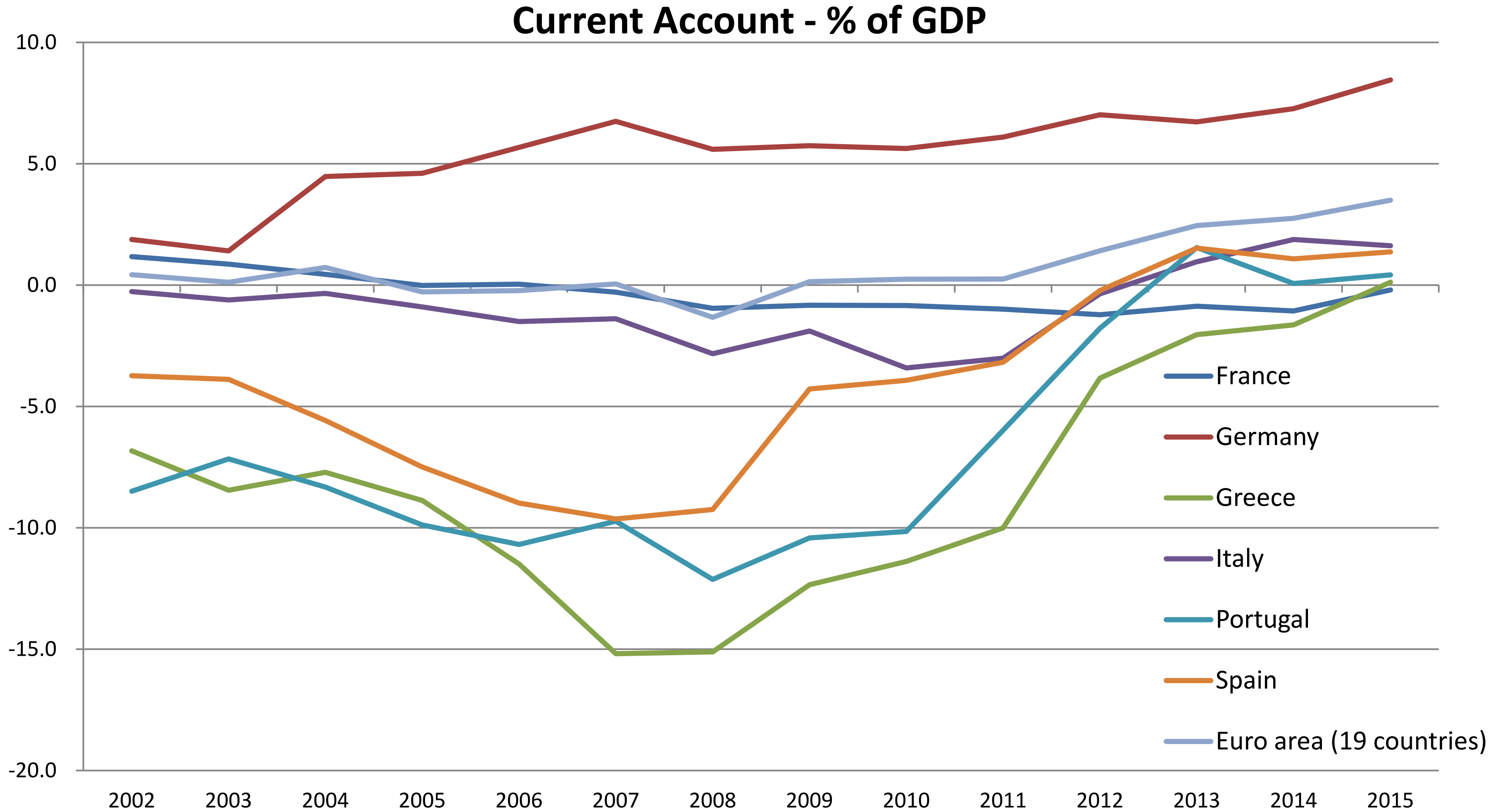
Budget Deficits



Deteriorating Competitiveness



Current Account Deficits



How did it all start?

- The trigger: *a sudden stop to capital inflows*
- The ultimate cause: *weak fiscal institutions*

- *Lack of fiscal discipline*
- *Low compliance rates*
- *Low collection rates*
- *Deficit bias*

How did it all start?

- A similar set of stylized facts characterized all previous debt default episodes (1843, 1893, 1932):

- Over-borrowing in foreign currency at favourable rates during periods when Greece adhered to fixed exchange rate systems
- Exogenous triggers led to sudden stops and currency crises

How did it all start?

- Currency devaluation and currency mismatch led to an increased probability of default and recession.

(See Reinhart and Trebesch, Calvo and Reinhert)

Managing a crisis when policy space is constrained

- The counterfactual of a closed economy facing an adverse demand shock
- The counterfactual of a small open economy outside a currency union:
- devaluation, restructuring, fiscal adjustment
- maybe successful if policy institutions credible

Managing a crisis when policy space is constrained

- A small open economy in a currency union:
- No fiscal space
- No exchange rate policy
- No monetary policy
- Expectations management

Managing a crisis when policy space is constrained

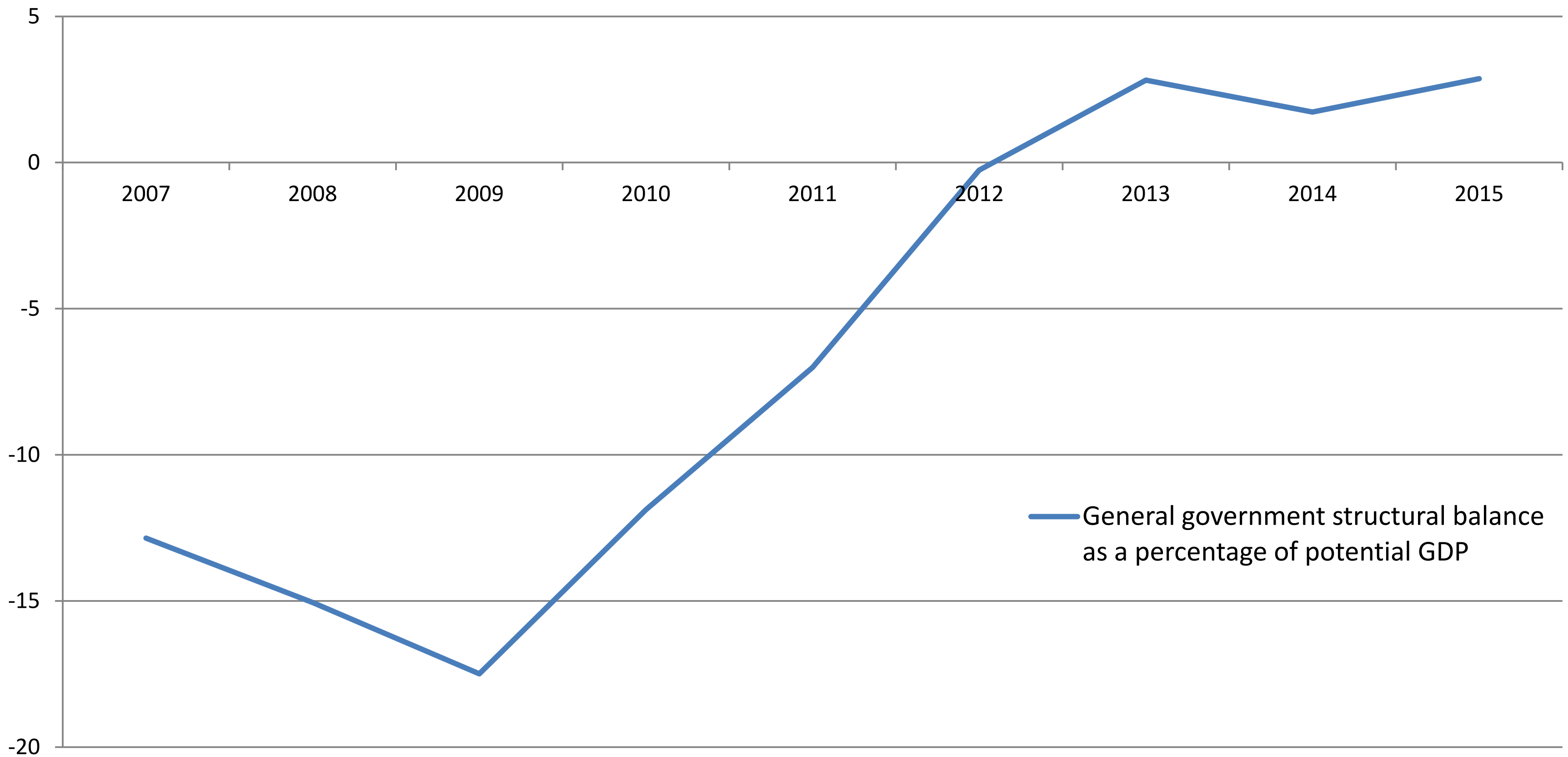
- In the context of EMU:

- GLF/EFSF loans
- Coordinated consolidation with no willingness for fiscal stimulus where there is fiscal space
- Initial reluctance to offer a financing envelope that would make adjustment more gradual

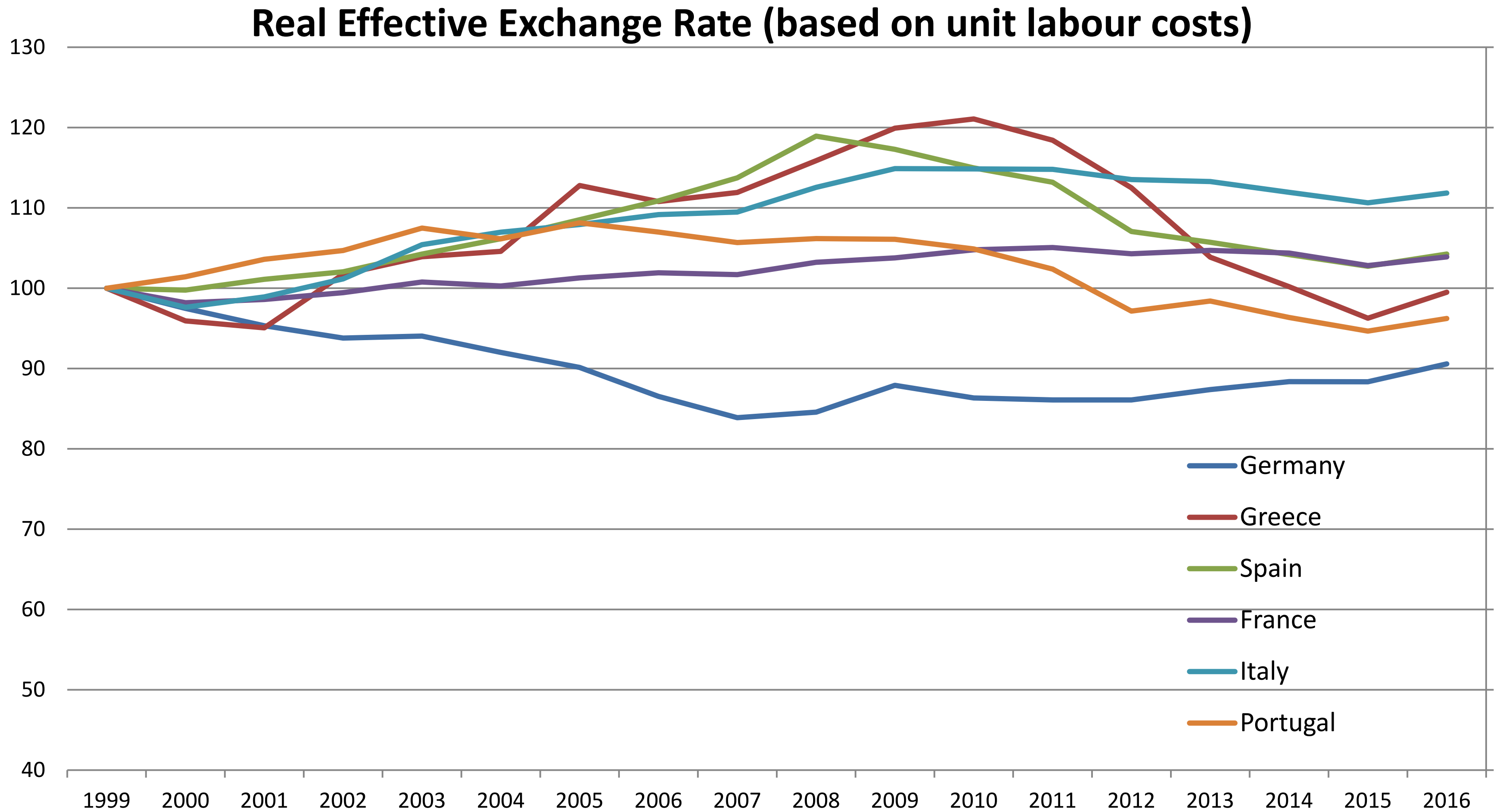
Examining past consolidation efforts

- Frontloaded fiscal adjustment with ambitious fiscal targets when pace matters
- Sequencing of reforms was wrong
- Debt relief should come upfront
- Communication failures
- Why Ireland and Portugal did so much better?

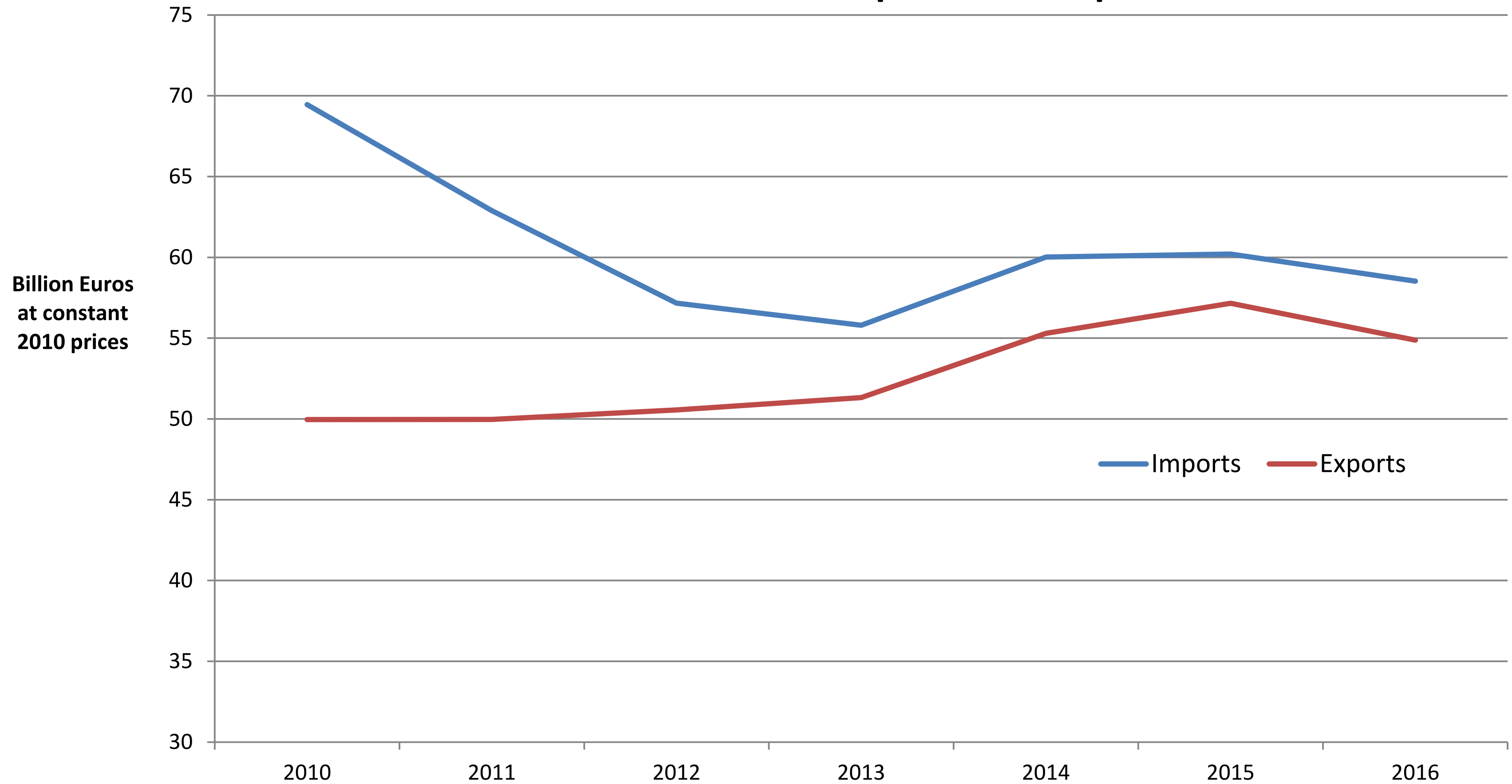
Budget Deficits



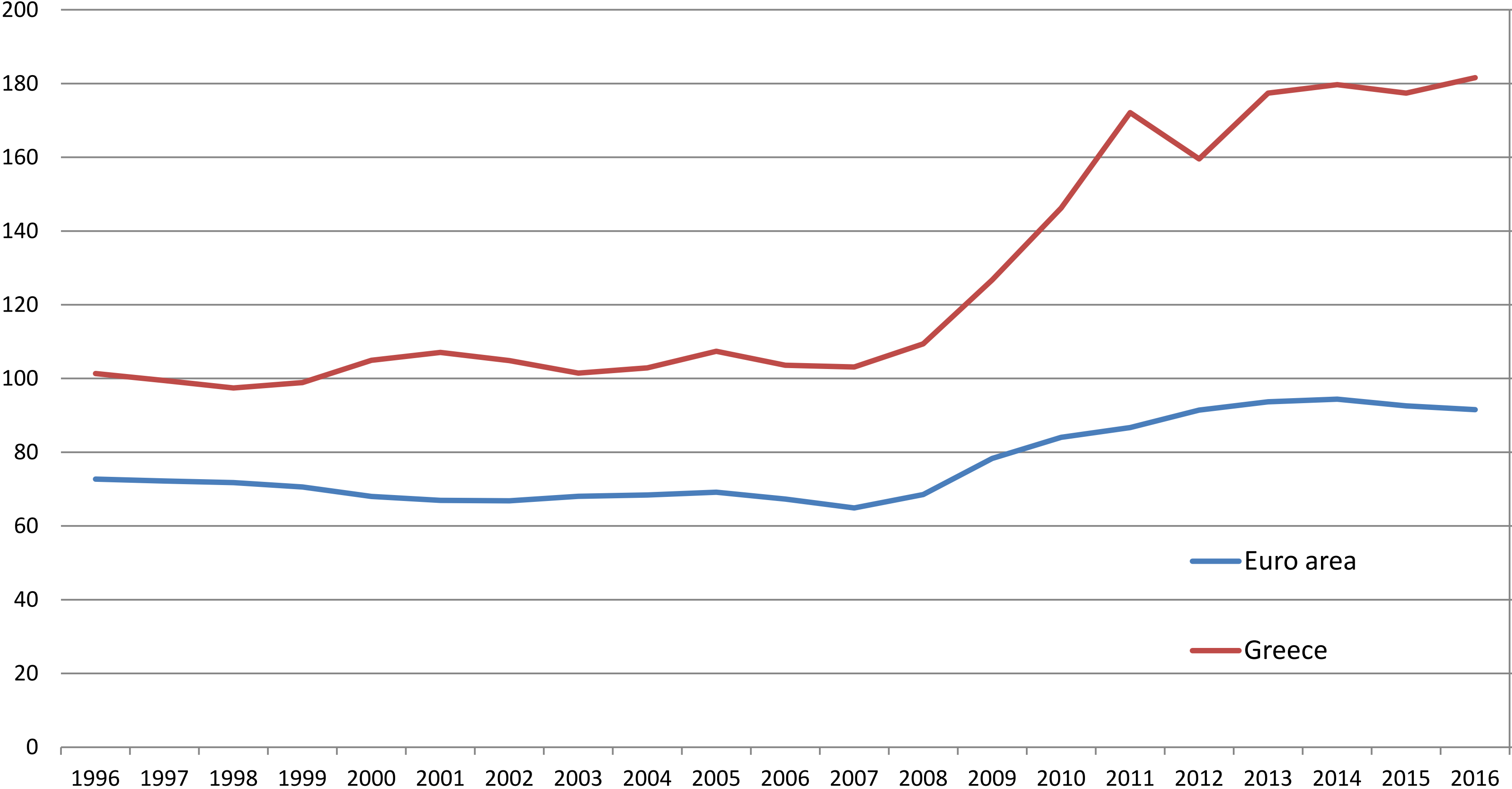
Deteriorating Competitiveness



Current Account Deficits



General Government Debt-to-GDP



Irish Programme Conclusion

- 10-year bond yield:
  - 4%, 6 months before conclusion
  - 3.5%, at month of conclusion (December 2013)
- 7-year bond yield:
  - 3.5%, 6 month before conclusion
  - 2.7% at month of conclusion (December 2013)
- No Credit Line needed at conclusion
- 20bn cash buffer, enough for 1.5 year

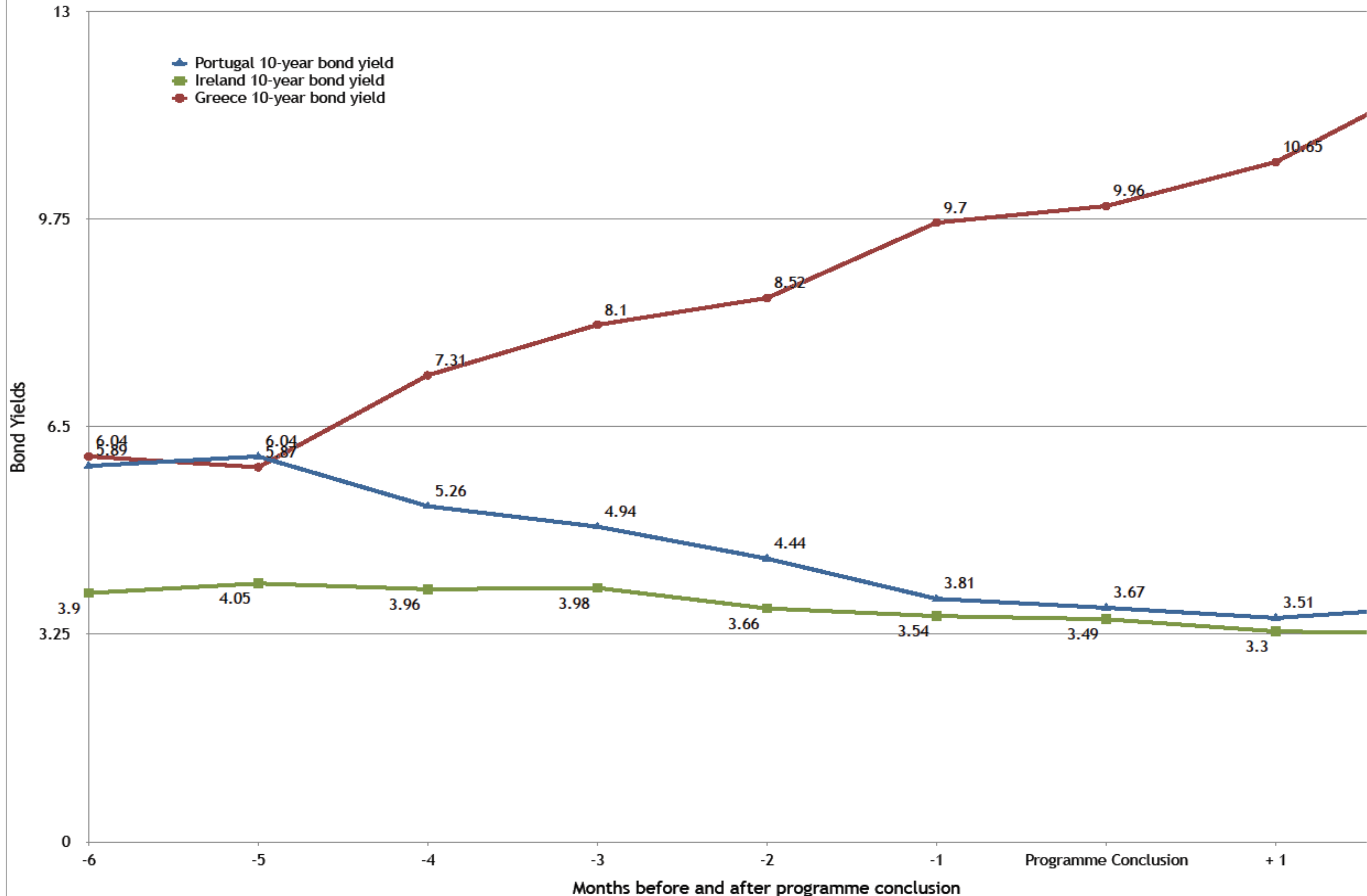
Portuguese Programme Conclusion

- 10-year bond yield:
  - 6%, 6 months before conclusion
  - 3.5%, at month of conclusion (May 2014)
- 7-year bond yield:
  - 6%, 6 months before conclusion
  - 3%, at month of conclusion (May 2014)
- No Enhanced Conditions Credit Line needed
- Cash buffer for 1 year
- Three 10-year bond issuances and one 5-year bond issuance in 6 months following programme conclusion

2nd Greek Economic Adjustment Programme

- 10-year bond yield:
  - 6%, June 2014
  - 8%, October 2014
- 5-year bond yield:
  - Bond issuance in April 2014 at 4.75%
  - 6.5% in autumn 2014
- No cash buffer

Comparison of bond yields before and after programme conclusion



Comparison of other Programme Countries and Greece

- Falling bond yields 6 months before and 6 months after programme conclusion
- Greek bond yields steadily increasing 6 months before conclusion
- Significant cash buffer in other countries vs no cash buffer in Greece
- Positive GDP growth in other programme countries, almost zero growth in Greece
- In Greece reforms stopped several months before programme conclusion

Looking ahead

- How to turn the current rebound into a sustained recovery:
- Enhance further fiscal credibility
- Create space to promote inclusive growth
- Mend fragile credit system
- Promote product market reforms
- Improve communication