Greece and the Crisis

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A vulnerable economy…

- Since mid-1990s Greece had high growth (2nd to Ireland). Favourable climate to reduce debt (nominal growth higher than average rate of interest on debt). Opportunity not taken: debt ratio fell only slightly.
- Credibility problem with data. Previous government predicted 2009 government deficit of less than 4% of GDP. New government revised estimate to 12.7%, claiming inaccurate accounting. Government debt of 120% of GDP in 2010 (EU predicts 135% in 2011).
- Eurostat (12 Jan.2010): Greek data had been questioned 5x in 2005-9; cannot be relied upon.

Market pressures…

- All 3 major credit rating agencies have downgraded Greece.
- High bond spreads between Greece & Germany increases cost of borrowing. Peak of 365pp. 25 Jan €8bn bond raised with 350bp spread.
- Greek economy represents just 2.7% of the euro-zone’s GDP and c.3.9% of euro-zone public debt. Yet Greece owes €300bn to foreign banks, with about a third of it to German and French banks.
- Reports of speculators betting $8bn that Greece’s problems will lead to fall in € rate

Yet: limits to crisis

- Greek economy has performed relatively well: fall of 1.2% of GDP in 2009 less than 3.9% of €-zone; but in 2010 fall of 0.3% for Greece & 0.7% growth for €-zone.
- Potential Greek growth of amongst highest in €-zone (C-Suisse). EU/IMF predicts real GDP growth of -0.3 to 2.0% in next 5 years.
- Greece has no severe banking problem: solid domestic deposit base (Merrill-Lynch)
- Rise in Greece's debt/GDP 2007-11 will be 39.8% points, but lower than UK & Ireland, similar to Spain & US.

Crisis for EU

- Greek budget crisis first real test case for €-zone institutional framework (M Stanley).
- Maastricht: no 'bail-out' (Art.125) rule. Known fear. 'Excessive Deficit Procedure' with fines. But also: emergency assistance (Art.122)?No 'gouvernement economique'.
- Easier for IMF loan, but political cost for €?
- Inter-governmental loan?
- Precedent-setting? 'PIGS'?

A critical period…

- Greece needs to raise major financing to allow it to roll-over maturing debt: in April-May 2010 of €30bn (Credit-Suisse); €16.6bn, but €60bn total in 2010 (M Stanley). Markets watching…
- Government promises to reduce deficit to 2.8% (debt of 117.7%) by 2012; reform National Statistics Service; SGP programme foresees adjustment more by raising revenue (2/3) than spending cuts; new stress on structural reforms.
- Differentiate short-term market crisis from medium-term reform programme.

Can Greece reform?

- *Social constraints*: union protests, strikes. Strong public sector voice. No history of successful social pacts.
- *State capacity*: endemic problems of public administration: waste; low-skill; low-pay; strong security; high pensions.
- Poor *budget management systems*. 2009 budget had 14,000 separate budget lines! Lack of information: number of employees; effectiveness of spend. Policy evaluation, impact assessment are alien.
- Coordination and effectiveness must improve.

It's the politics, stupid.

- Changing political mood. Street protests, but polls show public accepts need for major reforms.
- Fiscal adjustments have to be balanced with social sensitivity. Government close to limit.
- 'Tough love' from EU may empower.
- Sensible moves so far….