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Hellenic Observatory and Hellenic Bankers Association public lecture

Lessons from the Greek Crisis

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Chair, National Bank of Greece and Hellenic Banking Association

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Prof. Louka T. Katseli
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London School of Economics, UK
January 28, 2016

The Chronicle of the Greek crisis

Phase I
2008-2010: Eruption of the Crisis and the First MOU

DATE	EVENT
December 9, 2008	The Greek Parliament passes Law 3723/2008 on the enhancement of liquidity in the economy so as to deal with the impact of the international financial crisis
April 27, 2009	Council decision on the existence of an excessive deficit in Greece and recommendation on measures to correct the excessive deficit by 2010 (Excessive Deficit Procedure)
October 4, 2009	PASOK wins elections
October 20, 2009	The newly elected Greek government announced that the 2009 fiscal deficit would be 12.7 per cent of GDP, more than double the previous government's projection. (It was brought up to 15.4per cent of GDP in November 2010).
October 22, 2009	Greece's credit rating is downgraded by Fitch from A to A-
December 8, 2009 December 16, 2009 December 23, 2009	Greece's credit rating downgraded by Fitch from A– to BBB+ Greece's credit rating downgraded by S&Ps Greece's credit rating downgraded by Moody's
January 21, 2010	The Greek/German 10-year debt yield spread surpasses 300 basis points
April 28, 2010	The Greek/German 10-year debt yield spread surpasses 1000 basis points
May 3, 2010	**First MOU:** €110 billion bailout loan to rescue Greece from sovereign default and cover its financial needs until June 2013, conditional on implementation of fiscal measures, structural reforms and privatization of government assets.

The Chronicle of the Greek crisis

Phase II
2011-2014: The Second MOU, PSI and Bank Recaps

DATE	EVENT
October 26, 2011	Euro-Summit: PSI agreement. Private investors were asked to accept to write off 53.5% of the face value of Greek governmental bonds they're holding.
February 12, 2012	**Second MOU:** €164.5 billion additional bailouts extended by European creditors and IMF.
March 9, 2012	Bondholders holding 85.8% of Greece's Greek law bonds agreed to a bond swap. The activation of Collective Action Clauses lifted the participation rate to 95.7%. This led to a 53.5% reduction in the nominal face value of Greek debt held by private investors corresponding to a reduction in the debt stock of approximately €107 billion for Greece.
March 2012	**First recapitalization of the Greek banking system:** The BoG completed a strategic assessment of the banking sector and identified four "core" banks as viable based on regulatory criteria and an assessment of their business fundamentals. Capital needs for all Greek commercial banks were estimated in May 2012 at €40.5 billion, of which the €27.5 billion corresponded to the four "core banks".
June 17, 2012	Elections. Coalition government formed under PM A. Samaras
June 23, 2013	Successful completion of the first recap. HFSF contribution to the recapitalization for the four banks: €28.59billion.
January 14, 2014	Greece posts a primary budget surplus of 1.5% of GDP for 2013
April 2014	**Second recapitalization of the Greek banking system**: BoG estimated capital needs at 5.8 billion to 6.2 billion euros. Recap reached 8.3bn, entirely financed by private shareholders.
May 23, 2014	Greece's credit rating is upgraded by Fitch from B− to B

The Chronicle of the Greek crisis

Phase III
2015- today: The Third MOU and the Third Recap

DATE	EVENT
January 25, 2015	General elections. Syriza wins and forms a new coalition government under PM A. Tsipras
January-June 2015	Renegotiation on content of 2nd MOU
June 27, 2015	PM Tsipras announces a referendum on bailout agreement, to be held on July, 5 2015
June 28, 2015	Bank holiday. Imposition of capital controls
June 30, 2015	Greece misses a payment on an IMF loan and falls into arrears.
July 5, 2015	The Greek bailout referendum is held. Over 61% vote against the proposed measures by the Junker Commission, the ECB and the IMF.
July 13, 2015	**Third MOU**: Greece and Europeans creditors agreed to 86 billion euros bailout over three years, to be approved by parliaments of the Eurozone member states. This includes a buffer of up to 25 billion euro for the banking sector recapitalization.
July 20, 2015	Greek banks open again, but capital controls remain. The Greek government repays two loans to the IMF and ECB
August 14, 2015	Third MOU voted by Government and major opposition parties.
September 20, 2015	General elections. Syriza wins and forms a new coalition government under PM A. Tsipras
October 31, 2015	**Third recapitalization of the banking system**: Comprehensive assessment by the ECB reveals total capital shortfall of €4.4 billion and €14.4 billion at the four significant Greek banks under the baseline and the adverse scenarios respectively
December 4, 2015	Third recap completed. Piraeus Bank and National Bank of Greece required additional state aid through the HFSF(5.4 billion euro total), funded by the ESM.
January 22, 2016	Standard and Poor's upgraded Greece’s credit rating to "B-" from "CCC+

Five lessons

1. In a small open economy, growing twin deficits enhance vulnerability and generate debt unsustainability

2. Aggressive front-loaded restrictive policies can erode the sustainability of public finances

3. The choice and sequencing of accompanying “structural reforms” is critical.

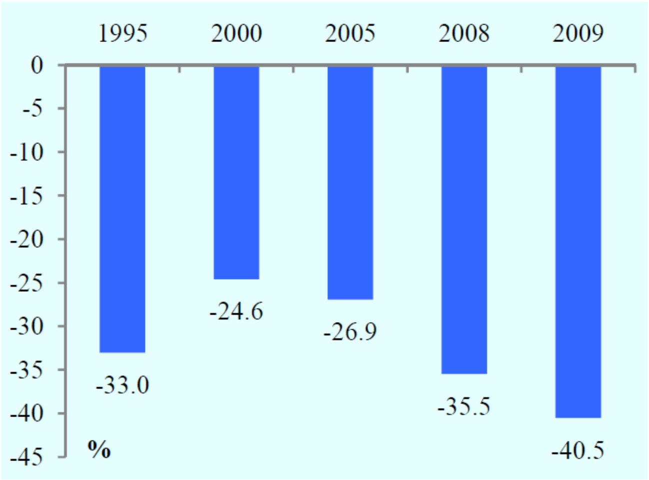
4. Upholding policy coherence and an effective social protection system is a prerequisite for sustainable public finances.

5. To manage crises effectively, EU institutions need to promote financial stability but in a way consistent with decent livelihoods and democratic legitimacy

1. In a small open economy, growing twin deficits enhance vulnerability and generate debt unsustainability

- Despite high growth rates in the 1980s and 1990s Greece faced a serious competitiveness gap.

Competitiveness gap of the Greek economy by year (%), 1995-2009



Sources: European Economy, 192/2014

1. In a small open economy, growing twin deficits enhance vulnerability and generate debt unsustainability

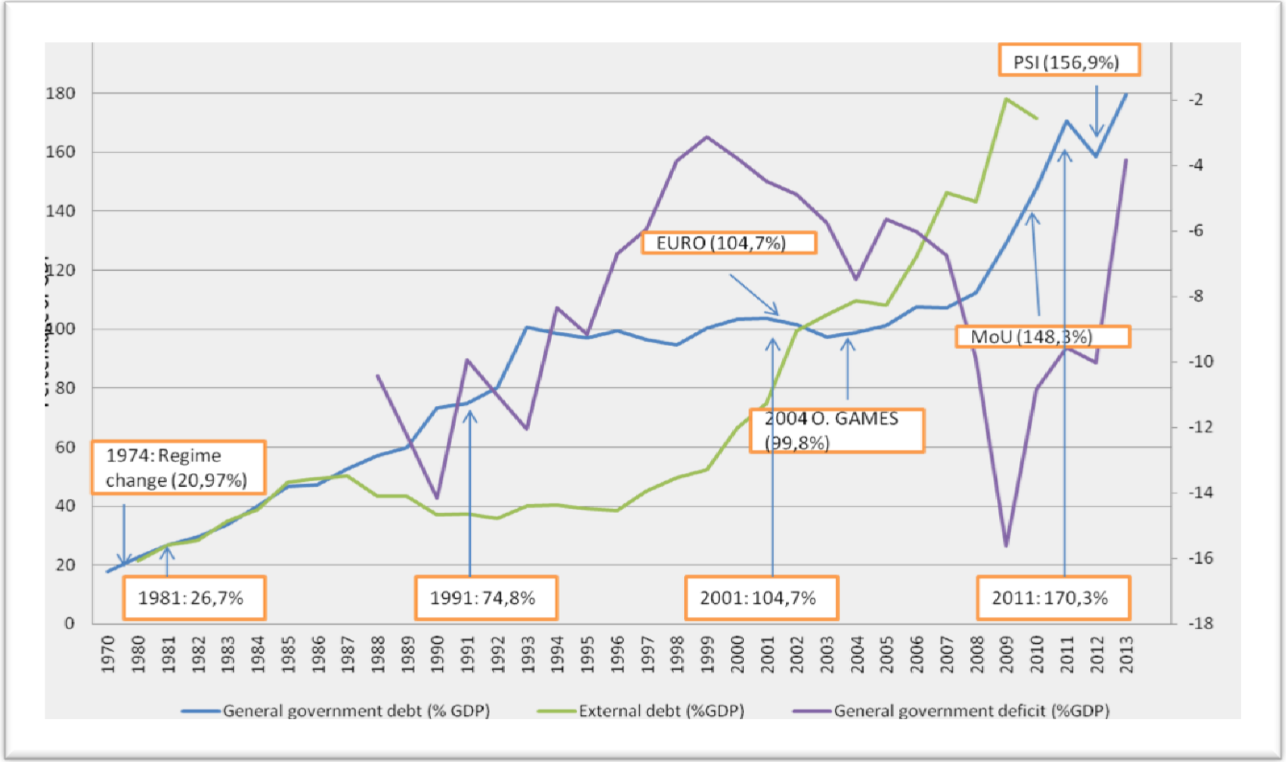
- Budget and current account deficits (twin deficits) were unsustainable and allowed Greece to become vulnerable to a speculative attack.

- Policy makers delayed timely actions.

- External debt rose rapidly after 1998, especially following Greece's entry into the Eurozone (2002).

1. In a small open economy, growing twin deficits enhance vulnerability and generate debt unsustainability

Greece: General Government Debt, External Debt and General Government Deficit, (%) GDP



Source: European Commission

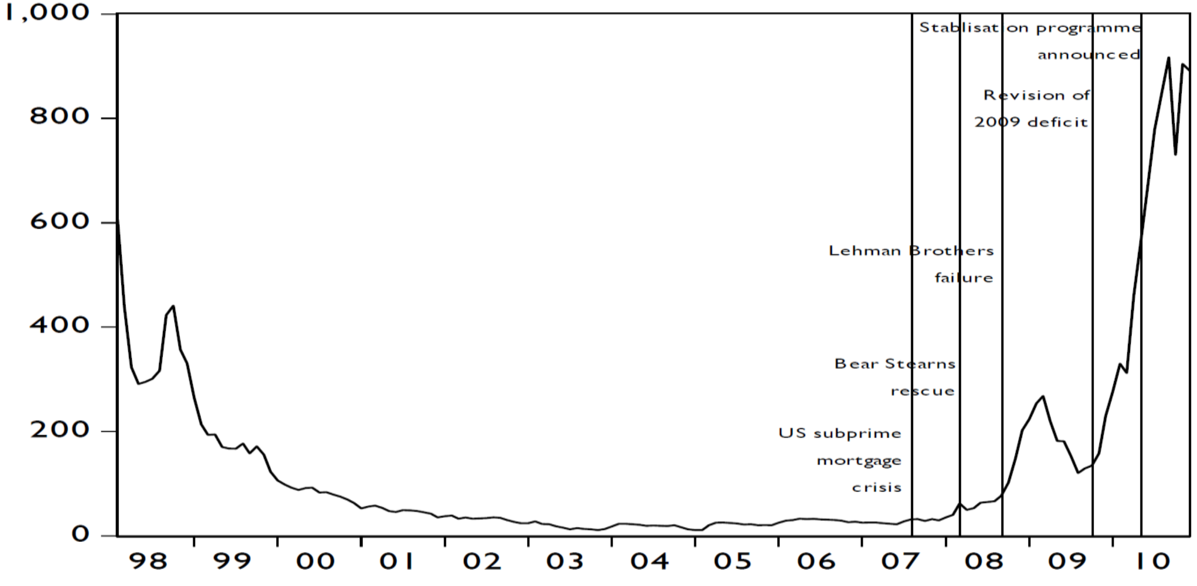
1. In a small open economy, growing twin deficits enhance vulnerability and generate debt unsustainability

- A speculative attack against Greek sovereign bonds and the euro erupted between December 2009 and April 2010 with spreads on Greek bonds rising to unprecedented levels.

- Speculators who had proceeded since 2007 to cover themselves against a possible default through purchases of CDSs, unloaded Greek sovereign bonds.

1. In a small open economy, growing twin deficits enhance vulnerability and generate debt unsustainability

Greek spreads 1998-2010
(yields on Greek over German 10-year bonds – basis points)

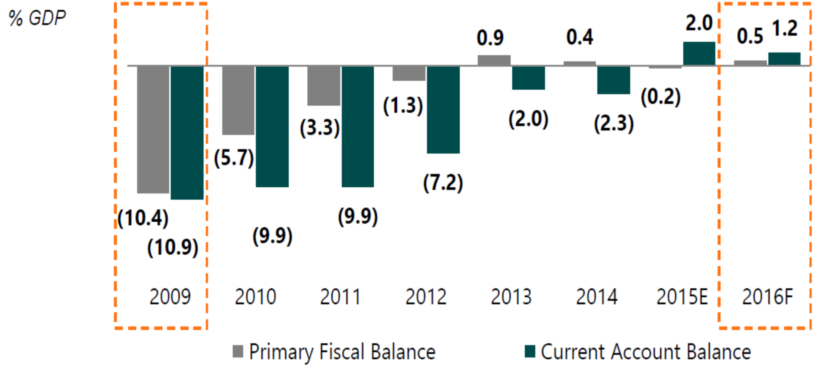


Source: ECB and BoG, Working Paper 124/2011

2. Aggressive front-loaded restrictive policies can erode the sustainability of public finances

Primary fiscal balance declined sharply…

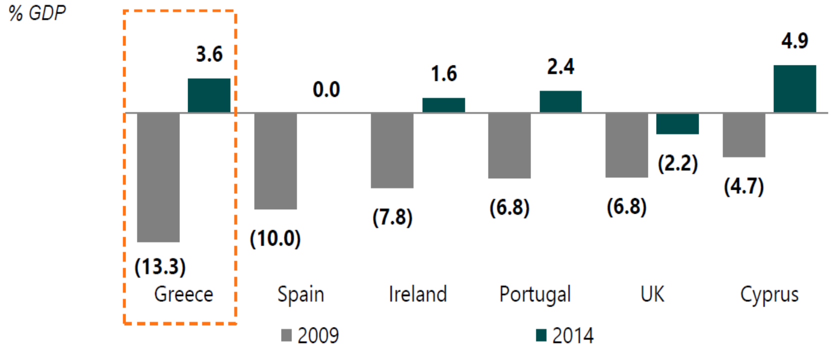
Current account and primary fiscal balance



Commentary

- During 2009 – 2015E, the Greek economy achieved significant fiscal and current account rebalancing
- Decline of primary fiscal balance of c. 10% and of current account balance of 13% of GDP during 2009 – 2015E

Cyclically adjusted primary balance - comparison

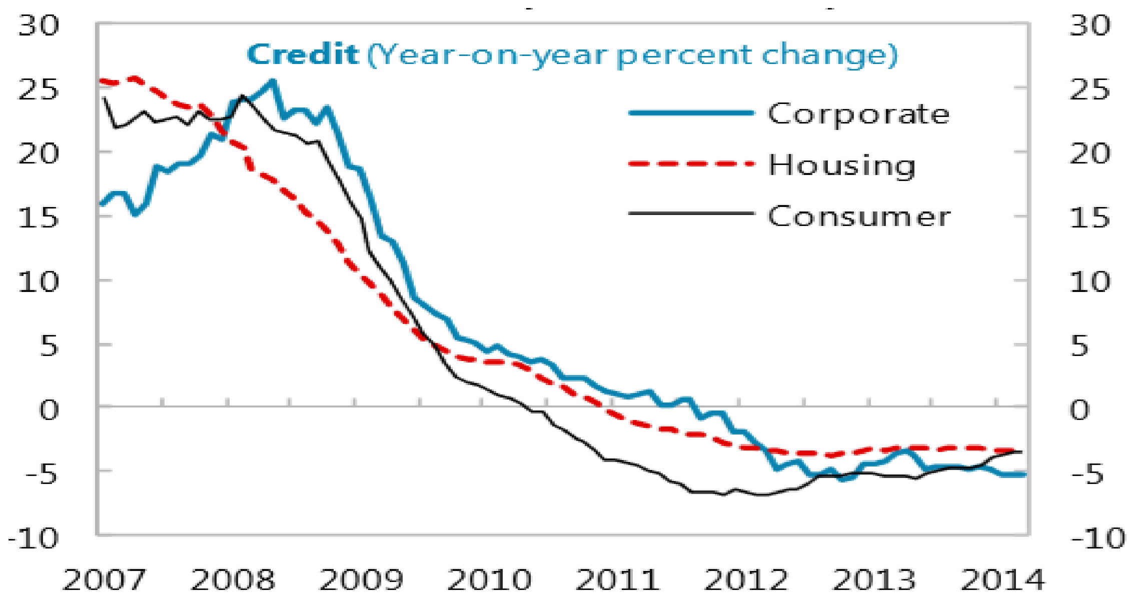


Commentary

- Amongst countries that underwent an economic adjustment programme, Greece achieved the fastest and most intense fiscal correction/adjustment
- Cyclical adjusted primary fiscal balance improved by 17% of GDP during 2009 – 2014

2. Aggressive front-loaded restrictive policies can erode the sustainability of public finances

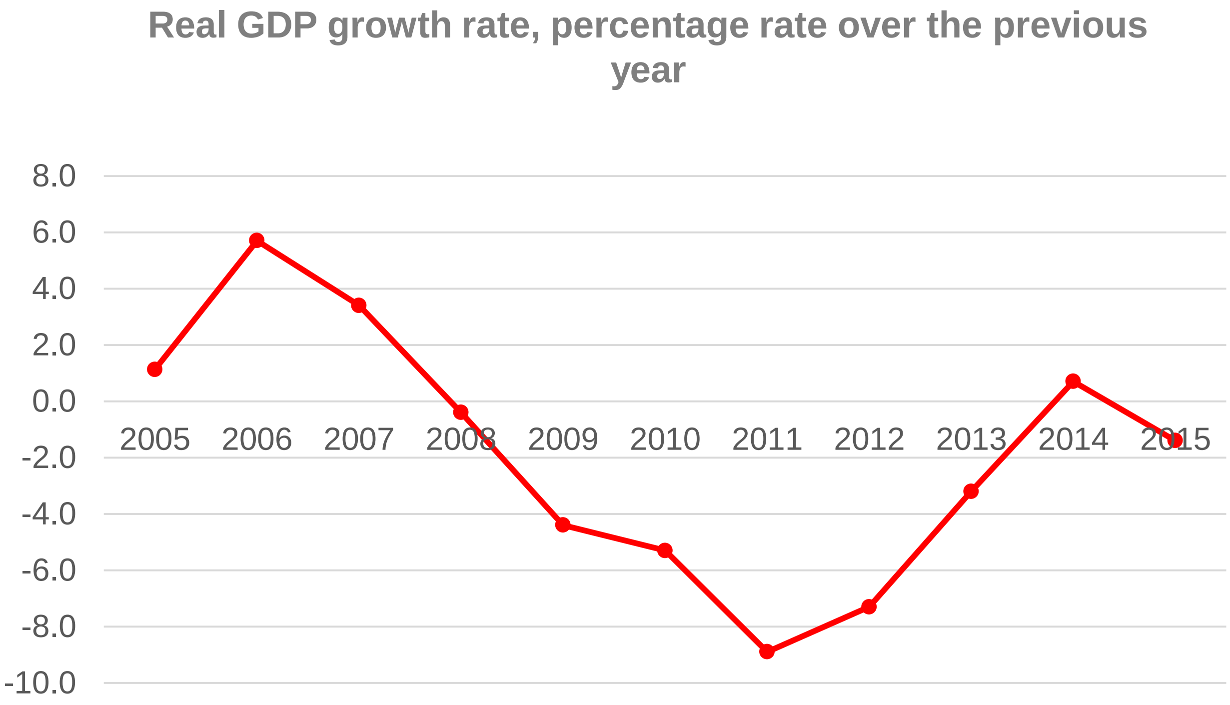
and liquidity was reduced dramatically



Source: Bank of Greece

2. Aggressive front-loaded restrictive policies can erode the sustainability of public finances

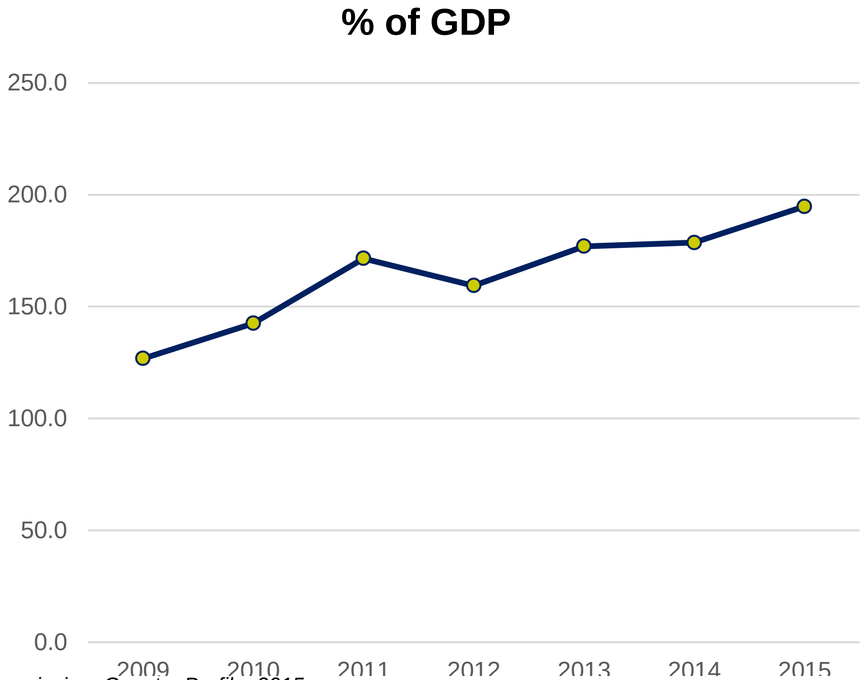
The result has been a sharp reduction of economic activity: Real GDP declined by close to 25% since 2007…



Source: European Commission, Country Profile, Nov. 2015

2. Aggressive front-loaded restrictive policies can erode the sustainability of public finances

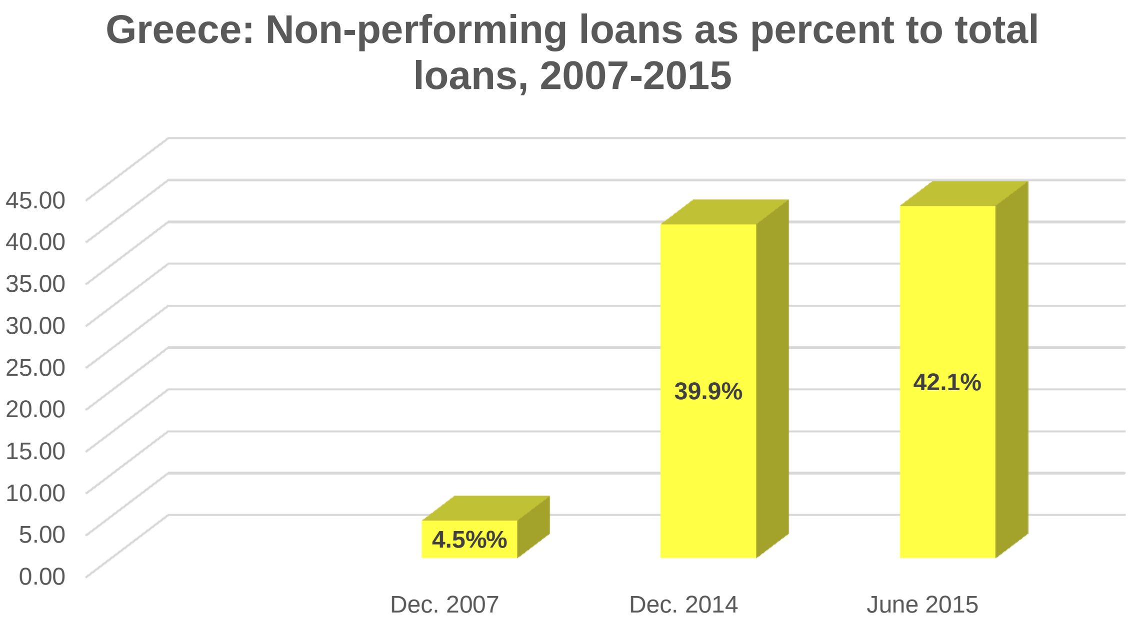
The recessionary impact of fiscal consolidation increased the Gross Public Debt to GDP ratio by c. 48ppts-of-GDP between end-2009 and end-2014…



Source: European Commission, Country Profile, 2015

2. Aggressive front-loaded restrictive policies can erode the sustainability of public finances

…while NPLs have risen dramatically



Source: Bank of Greece

3. The choice and sequencing of accompanying "structural reforms" is critical

Structural reforms on average do not appear to have strong short-run growth effects…

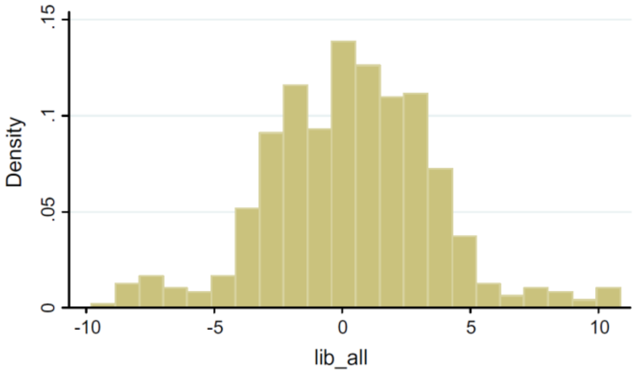


Fig. 1. Histogram of the *t*-statistics of coefficients of structural reforms on economic growth: 515 coefficients from the 46 papers listed in Appendix A (excludes five outliers: coefficients whose *t*-statistics exceed three standard deviations).

Source: Rodrick (2015), Babecký and Campos (2011)

3. The choice and sequencing of accompanying “structural reforms” is critical

Greek labour-market reform agenda: A telling example of the distortions that can ensue as a consequence of improper policy design and sequencing, largely due to an inadequate understanding of the macroeconomic environment in which these reforms are introduced and the structural features of the economy on which they are applied.

3. The choice and sequencing of accompanying "structural reforms" is critical

The Greek labour market reform agenda

1. Rights at Work & Retirement
- Minimum Wage
- Working Hours & Compensation (Intermittent, Temporary, Part-time)
- Retirement Benefits

2. Equality of Treatment
- Anti-discrimination laws
- Gender-specific policies
- Youth

3. Collective Bargaining
- Structure of collective agreements
- Degree of implementation of more favorable provisions
- Automatic extension of sectoral agreements
- Equal treatment provisions

4. Employment Protection
- Probationary Period
- Employment Agencies
- Dismissal Procedures
- Notice & severance pay
- Collective dismissals
- Intermediation/ Arbitration Policies
- Unemployment Benefits

Sources:
L.T. Katseli & P. Boufounou, 2014, "The impact of Greek Labour Market Reforms on Competitiveness", (unpublished)
A. Lymperaki, C. Meghir & D. Nikolitsas, "Labour Market Regulation & Reforms in Greece" (unpublished)

3. The choice and sequencing of accompanying “structural reforms” is critical

Labour market reforms resulted in severe horizontal wage and pension cuts

✓Wages have been reduced by approximately 30%

✓The gross amount of non-farm sector pensions have been reduced by approximately 50% (Tinios, 2013)

Source: IMF Country Report No. 14/151

3. The choice and sequencing of accompanying “structural reforms” is critical

The ensuing recession and adverse profitability expectations have offset the potentially beneficiary impact of “internal devaluation” on:

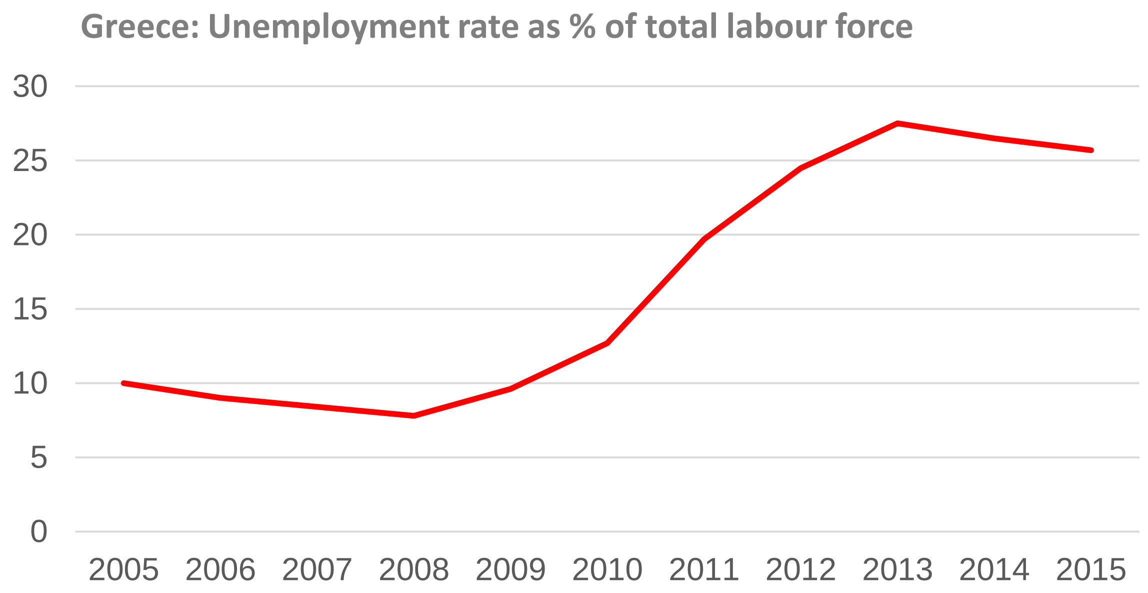
✓Employment

✓Private investment and

✓Competitiveness

3. The choice and sequencing of accompanying “structural reforms” is critical

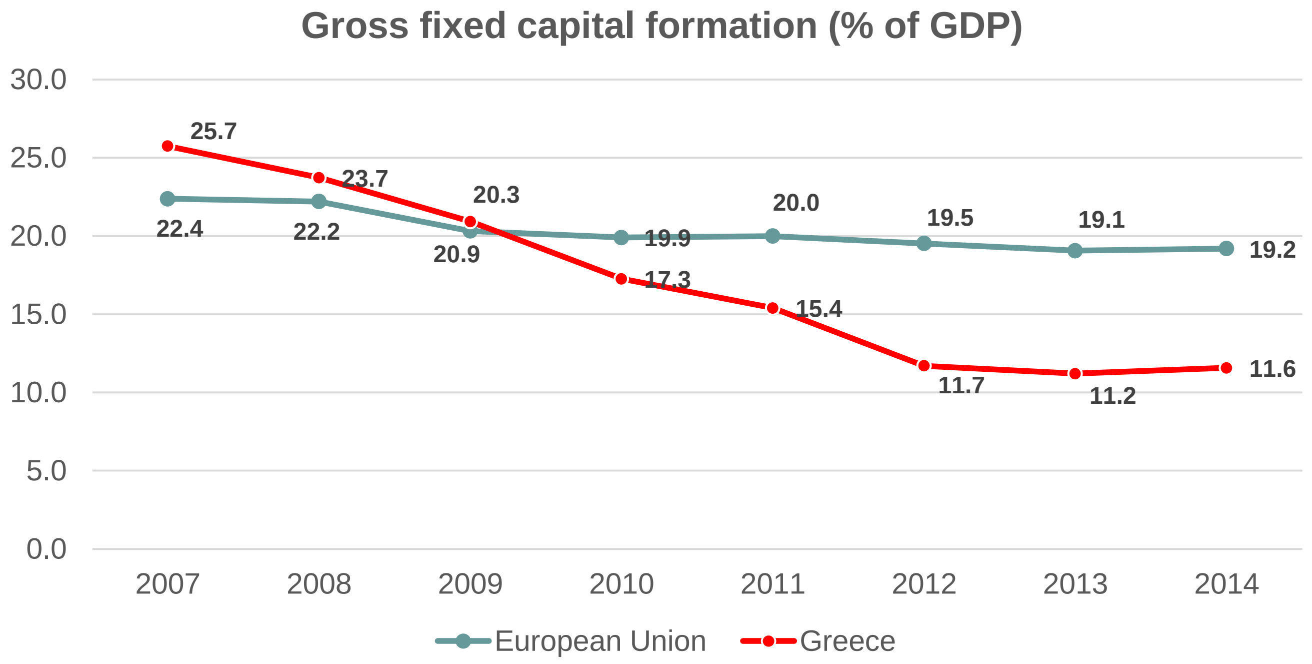
Unemployment rates rose to unprecedented levels



Source: European Commission, Country Profile, Nov. 2015

3. The choice and sequencing of accompanying "structural reforms" is critical

Gross fixed capita formation as a percentage of GDP fell dramatically

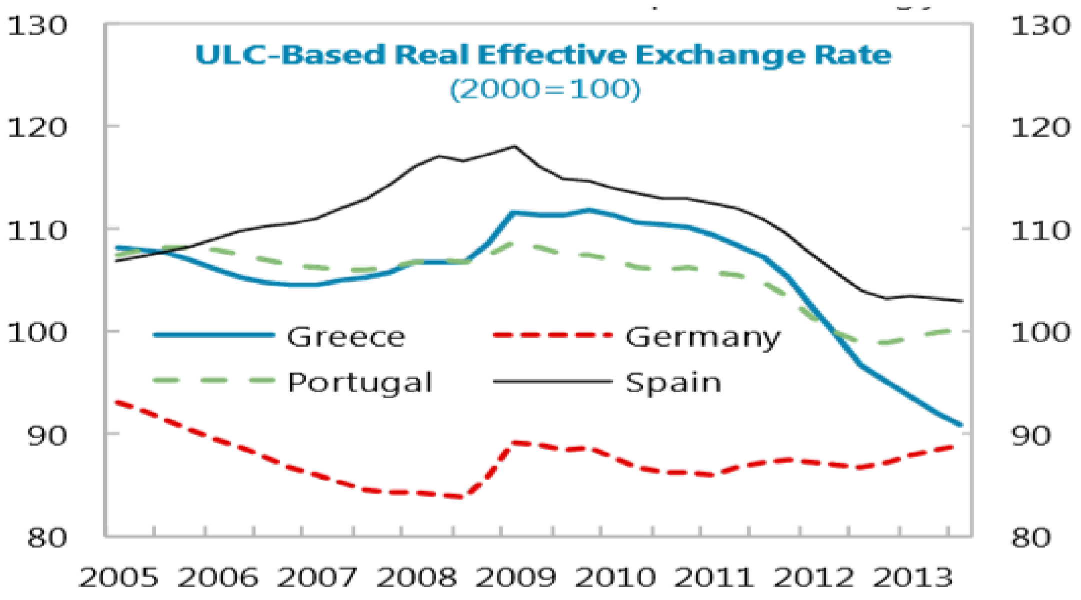


Source: World Bank national accounts data, and OECD National Accounts data files, 2015

3. The choice and sequencing of accompanying "structural reforms" is critical

While price competitiveness as measured by ULC has improved…

(ULC-based REER has depreciated by 16.5% since 2005)

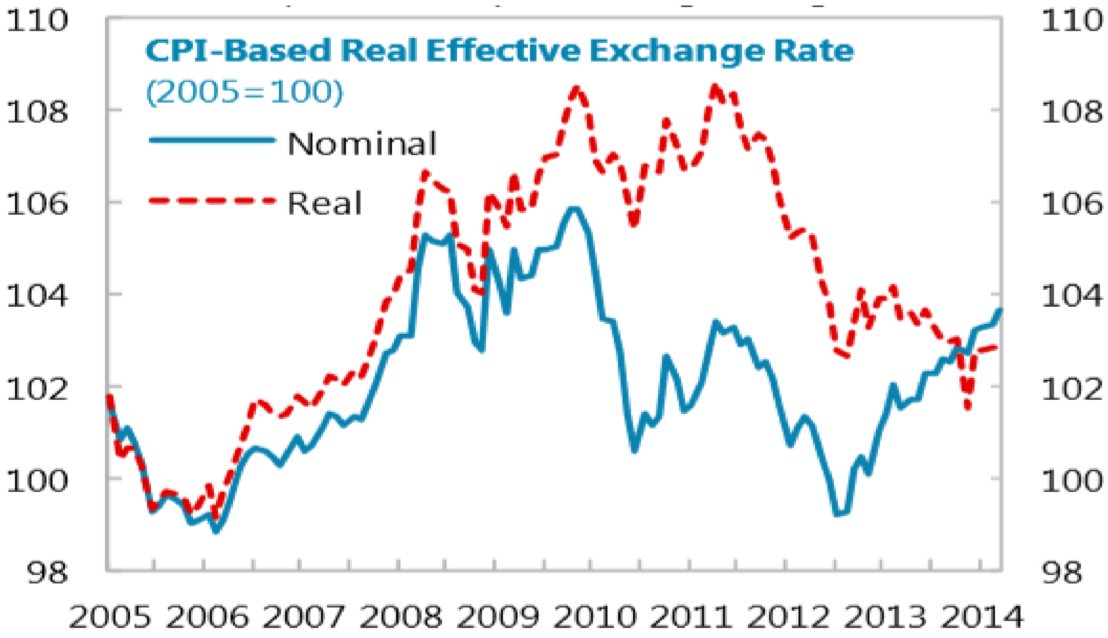


Source: IMF Country Report No. 14/151

3. The choice and sequencing of accompanying "structural reforms" is critical

…competitiveness has deteriorated as measured by final good prices due to energy and tax cost increases

(CPI-based REER has depreciated by only 5.6% since 2009)



Source: IMF Country Report No. 14/151

3. The choice and sequencing of accompanying "structural reforms" is critical

While product-market reforms were mentioned on paper, neither the Greek governments nor the Troika placed them, at least till recently, on their "high- policy agenda" by identifying them as "prior actions" for a positive evaluation of the programme. As a result, a massive redistribution of income took place from wages to profits and from debtors to creditors.

4. Upholding policy coherence and an effective social protection system is a prerequisite for sustainable public finances

Prolonged recession and the dramatic rise of unemployment have reduced disposable incomes and led to firm closures:

•More than 44% of Greeks were at risk of poverty in 2013 up from 20% in 2008 with poverty line defined at the 60 percent of median income (ILO, 2014)

•Average household consumption expenditure (at constant 2013 prices) went down by almost 32% since 2009 (Kaplanoglou and Rapanos, 2015)

Change in household consumption inequality between 2008 & 2013 (in per cent)

•400,000 families with children and no working parents

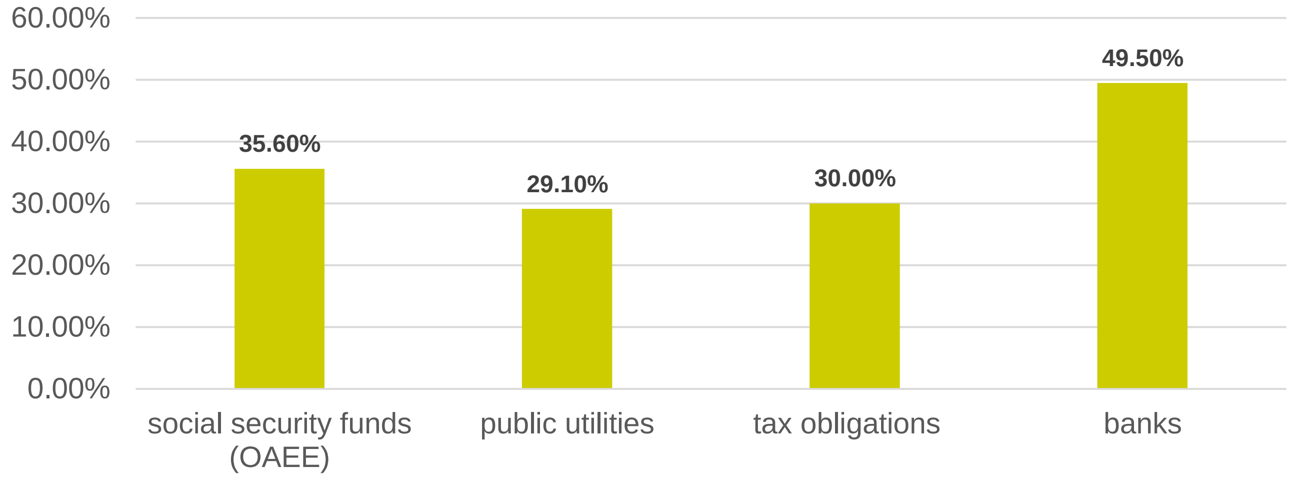
•250,000 SMEs have shut down since 2009

4. Upholding policy coherence and an effective social protection system is a prerequisite for sustainable public finances

BUT

It has also reduced households’ and firms’ capacity to pay taxes, social security contributions and debt obligations

Delinquent obligations for Small and Medium-sized Enterprises (July 2015)



Source: The Small Enterprises’ Institute of the Hellenic Confederation of Professionals, Craftsmen and Merchants (IME GSEVEE), Survey, 2015

5. To manage crises effectively, EU institutions need to promote financial stability but in a way consistent with decent livelihoods and democratic legitimacy

- Weak democratic accountability of the Troika in programme countries at national level.
- Inter-governmental process lengthy and inadequate to mitigate systemic crises.

- Potential conflict of interest within the Commission between its role in the Troika and its responsibility as guardian of the Treaties, especially in policy areas such as investment promotion, social cohesion and social policy.

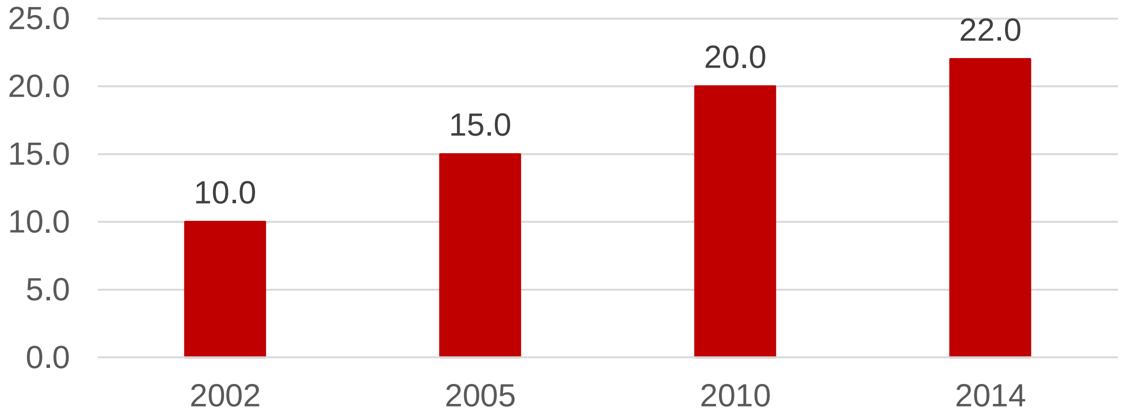
- Mutualization of risks in Eurozone needs to be enhanced.

- Potential conflicts in supervisory and regulatory roles of ECB vs Commission.

- EU institutions portrayed as the scapegoat for adverse effects in Member States' macroeconomic adjustment, leading to increased Euroscepticism.

5. To manage crises effectively, EU institutions need to promote financial stability but in a way consistent with decent livelihoods and democratic legitimacy

Europeans with a negative image of the EU (%)



Source: Standard Eurobarometer 82 Autumn 2014

Looking ahead: Better prospects despite major challenges

The 3rd MOU (86 bn euro for next 3 years) is more “manageable” with reduced recessionary impact.

- ✓ Reduced primary surpluses required.
- ✓ Bank recapitalization provisions, new restructuring plans and corporate governance improvements.
- ✓ Hellenic Republic Asset Development Fund to monetize assets over 30 year period to meet loan repayments to the ESM, debt to GDP reduction and investment needs.
- ✓ Priority given to product-market reforms, combating tax evasion, expansion of tax base and pension reform.
- ✓ Debt renegotiations to be initiated following successful completion of the first evaluation.

GREECE 2020

Strategic Objective: Promote a national agenda for sustainable economic and social transformation driven by new investment in tradable sectors

Strengths

- Geo-political considerations
- Strong comparative advantage in agro-food sector, tourism, real estate, shipping, cultural and business services ICT, pharmaceuticals
- Highly-educated, skilled and innovative labor force
- Renewable energy sources

Challenges

- Reduce cost of doing business
- Enhance stability and simplicity of tax and regulatory system
- Speed-up resolution of disputes by courts
- Improve quality of governance and public administration

AND

Rebrand GREECE as a country of opportunities

Thank you

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