Not managing an economic crisis

Lessons from Greece

Presentation to International Consulting Economists' Association
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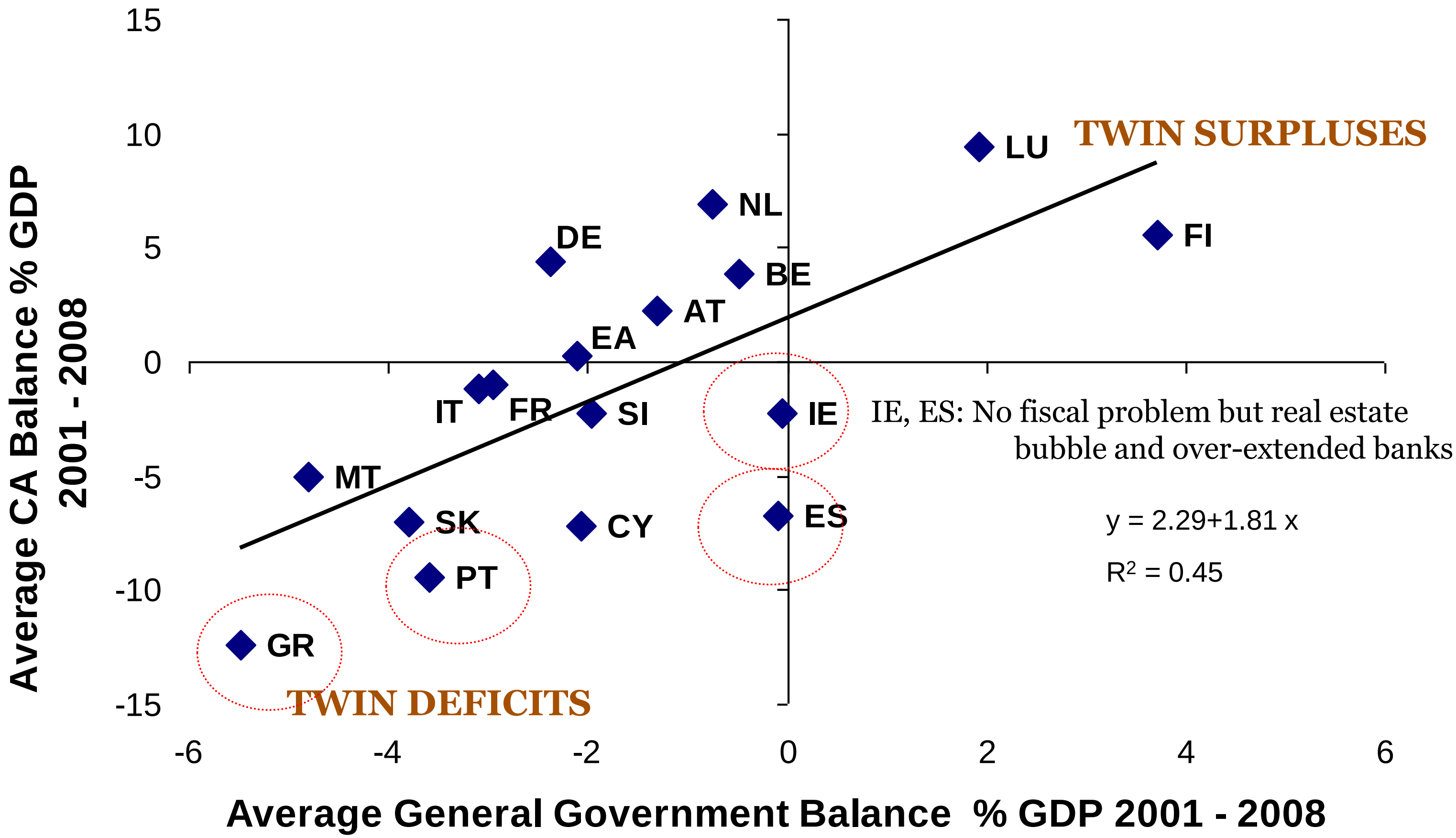
February 2016

The early signs

The early signs
Huge double deficits

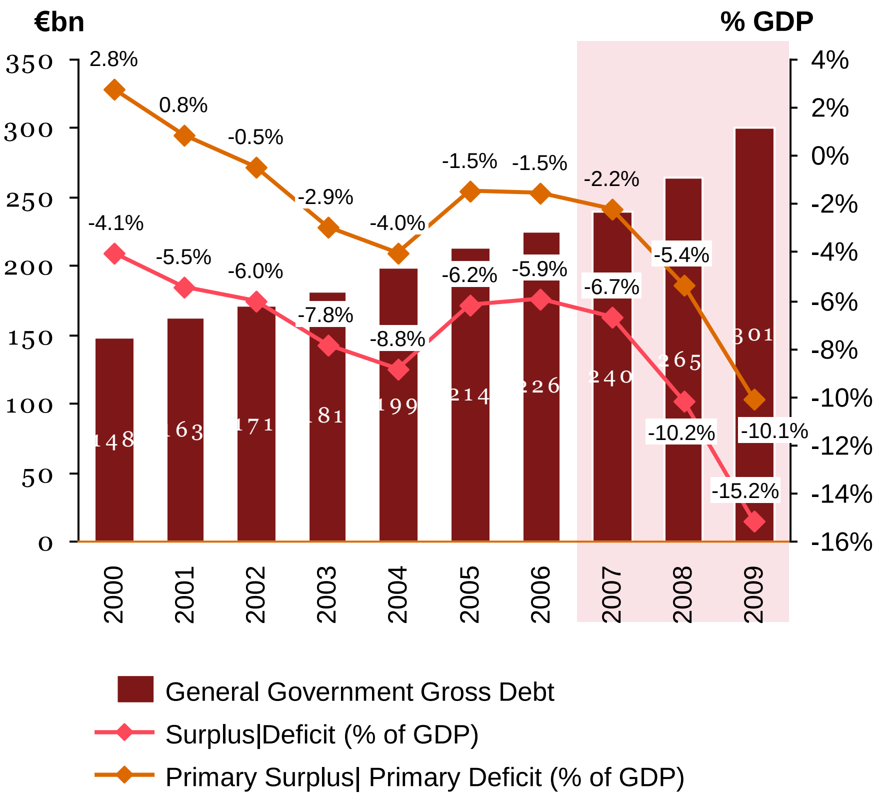


Source: European Commission (AMECO)

The early signs

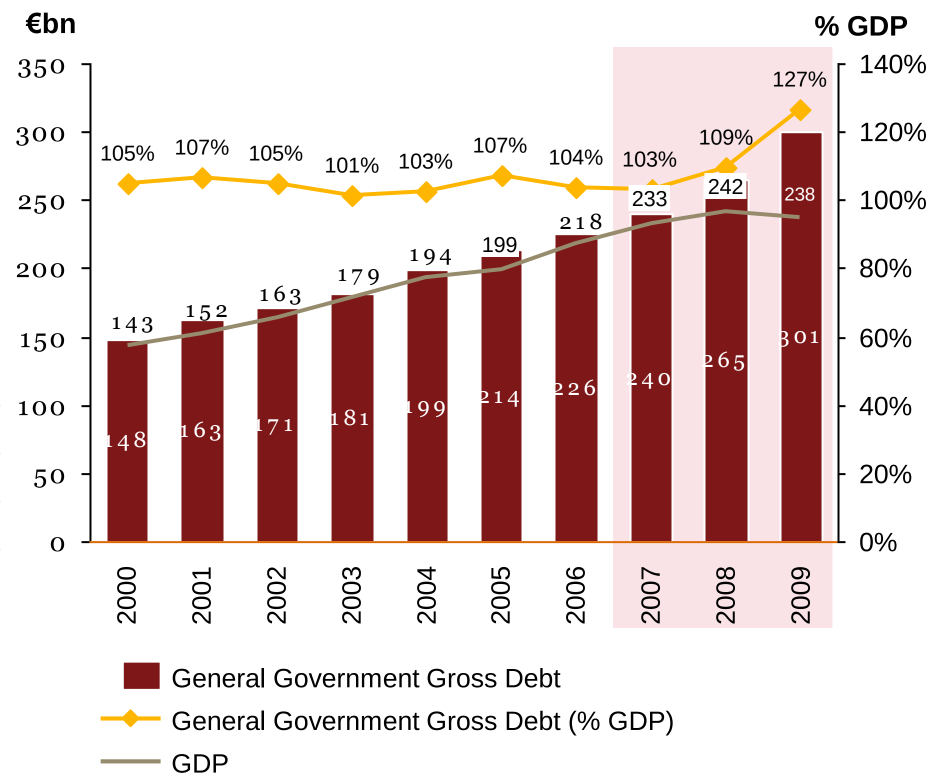
A state fuelling the economy through debt

General Government Debt vs Budget Balance



Source: European Commission (AMECO)

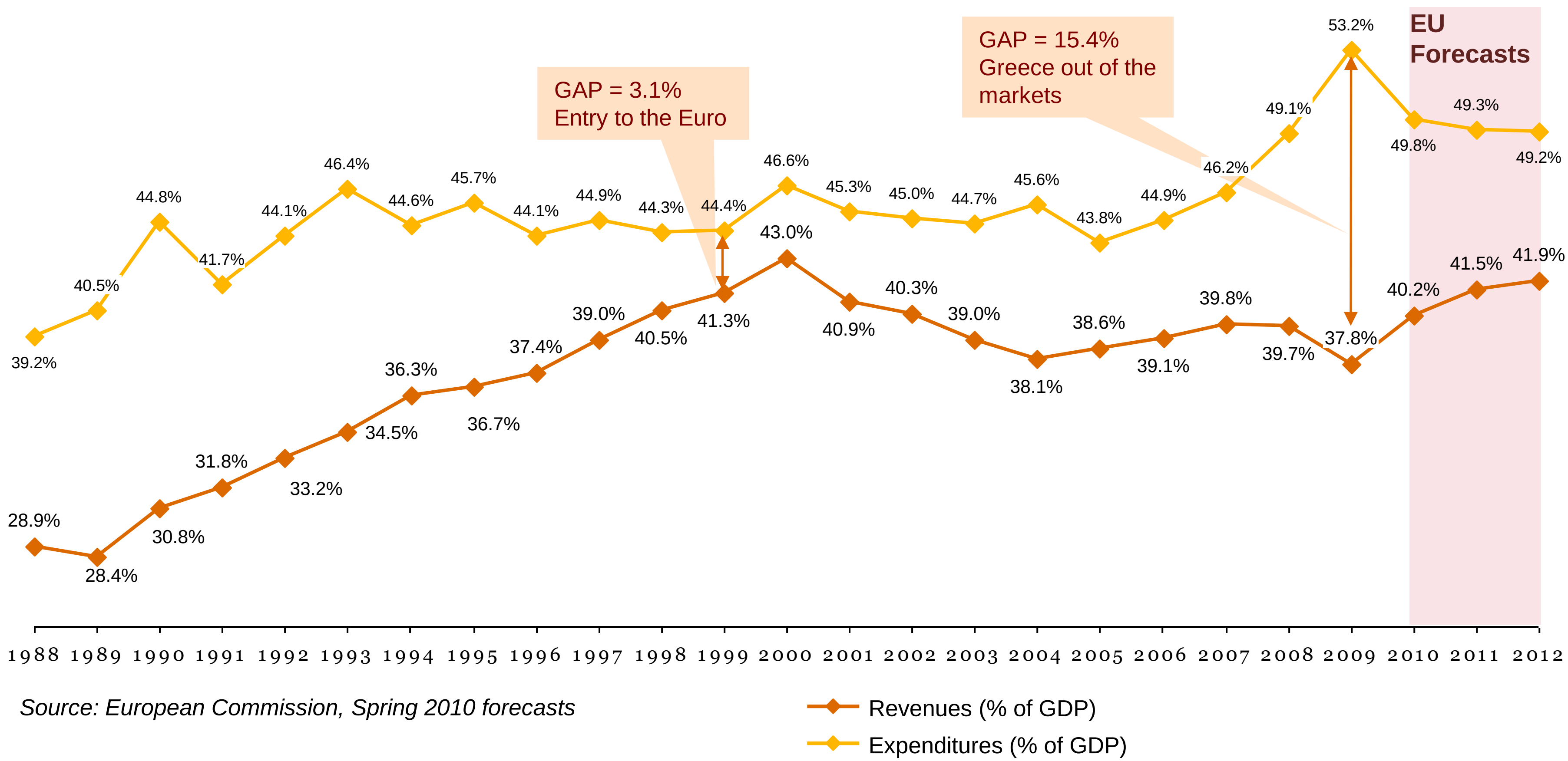
General Government Debt vs GDP



Source: European Commission (AMECO)

The early signs

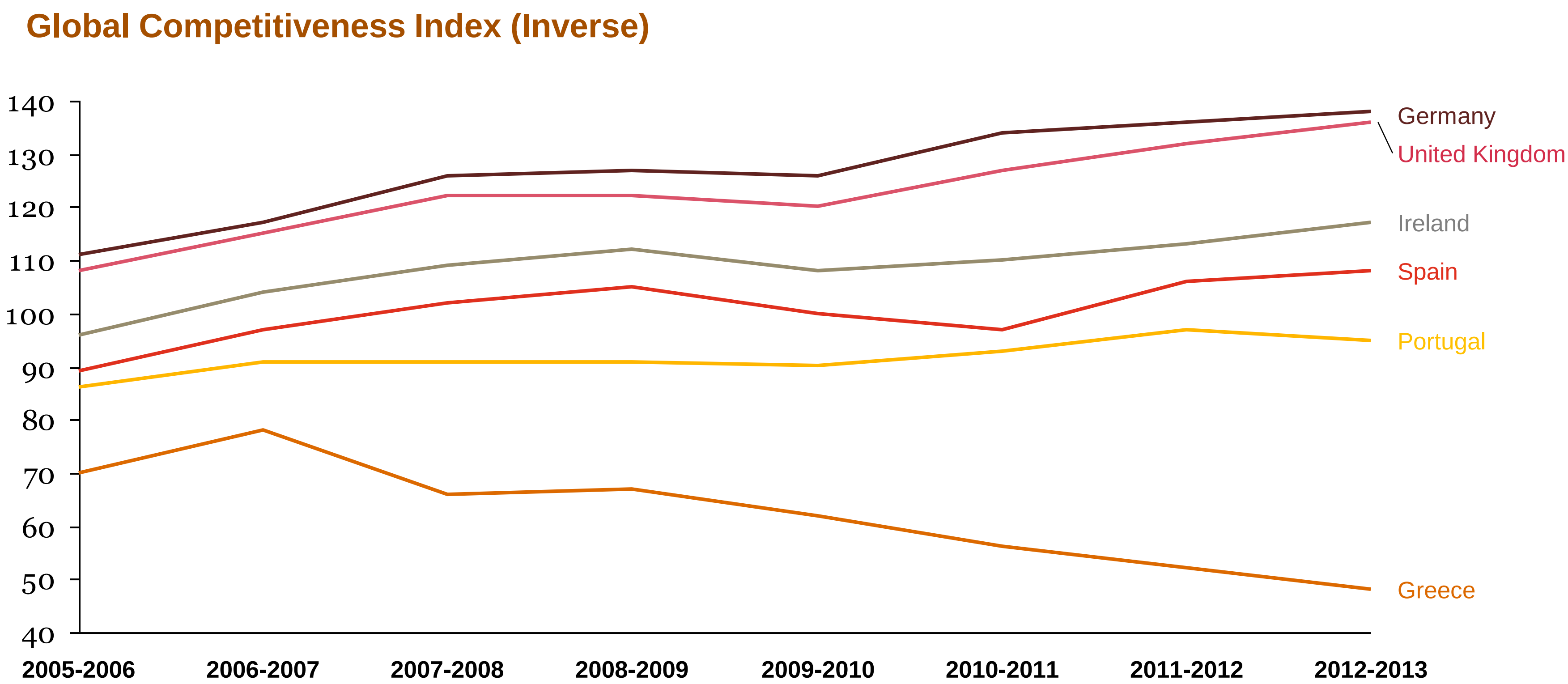
Receipts / payments mismatch



Source: European Commission, Spring 2010 forecasts

The early signs

Competitiveness Collapse



Source: World Economic Forum, Global Competitiveness Report

The realisation

The realisation

Cut off the markets- the story

Before the Crisis

2002 January – Euro replaces drachma

2004 February – Kostas Simitis calls March elections and stands down as Pasok leader

2004 March – Conservative New Democracy party led by Costas Karamanlis wins general election, ending over a decade of Pasok government

2004 December – European Commission issues formal warning after Greece found to have falsified budget deficit data in run-up to joining eurozone

2007 September – Prime Minister Karamanlis wins a narrow majority in the poll. He says he now has a mandate for more reforms but also pledges to make national unity a priority

2009 Greece's €300bn debt plunged the country into crisis in 2009

2009 October – Opposition Pasok socialist party wins snap election called by PM Karamanlis. George Papandreou takes over as new prime minister

The Crisis

2010 May – Greece reaches agreement with the **International Monetary Fund**, the **European Commission** and the **European Central Bank** on a **€110bn** 3-year **financing plan**(€ 80bn to be disbursed form EC and €30bn from the IMF)

2011 November – George Papandreou announces his resignation. Lucas Papademos, a former head of the Bank of Greece, becomes interim prime minister of a New Democracy/Pasok coalition with the task of getting the country back on track in time for elections scheduled provisionally for the spring of 2012

2012 March – European Union leaders approve a **second major bailout for Greece** over its debt crisis by channelling the undispersed amounts of the first programme plus **€130bn** through the **European Financial Stability Facility**

2012 May – June - Early parliamentary elections see support for coalition parties New Democracy and Pasok slump, with a increase in support for anti-austerity parties of the far left and right. The three top-ranking parties form a working coalition

2014 May – Anti-austerity, radical leftist Syriza coalition wins European election with 26.6% of the vote

2015 January – Alexis Tsipras of Syriza becomes prime minister after winning parliamentary elections, and forms a coalition with the nationalist Independent Greeks party

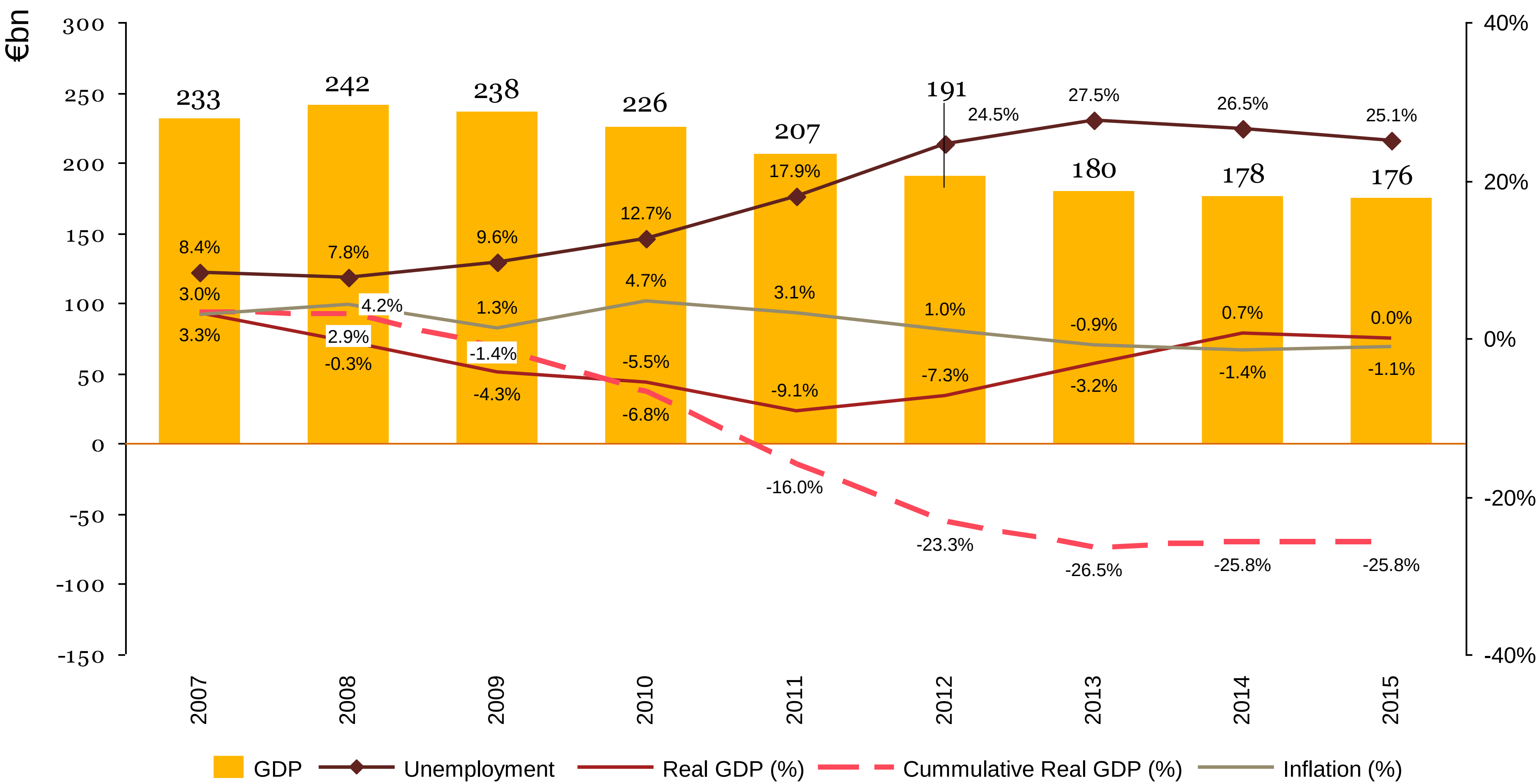
2015 June-July – European Central Bank ends emergency funding. Greece closes banks, and imposes capital controls. **V**oters overwhelmingly reject EU bailout terms in July referendum

2015 August – Greece and its creditors agree a third bailout package of € 86bn, imposing further spending cuts on the country and returns to avoid bankruptcy and exit from the Eurozone

2015 November – Elections give Syriza a renewed majority to implement the agreement between the creditors

The realisation

Recession at -26% and unemployment at 27.5%



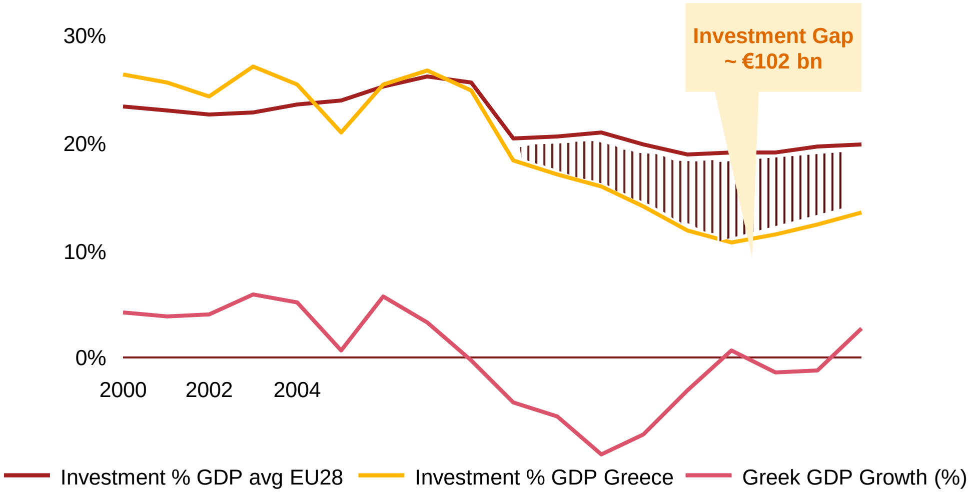
Source: European Commission (AMECO)

The realisation

Investment gap

Historically, investment in Greece was close to the European average. From 2008 onwards, there is an increasing divergence

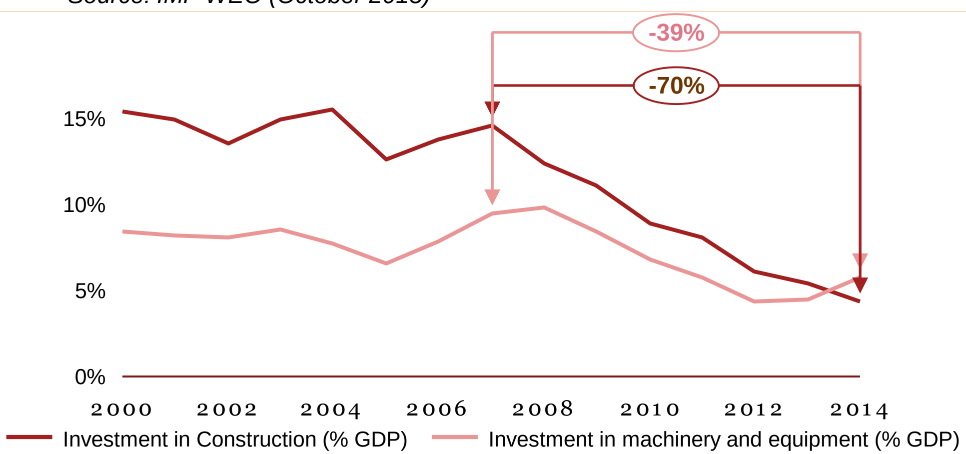
For 2014, the total investment in Greece amounted to 11% of GDP, c.8.4pps (or about €16bn p.a.) lower than the average of 2000-2008



Source: IMF WEO (October 2015)

Investment gap

The collapse of the construction industry by 70% between 2007 and 2014, which along with the shrinkage of the investment rate in the industry by 39%, explains largely the investment gap in the economy

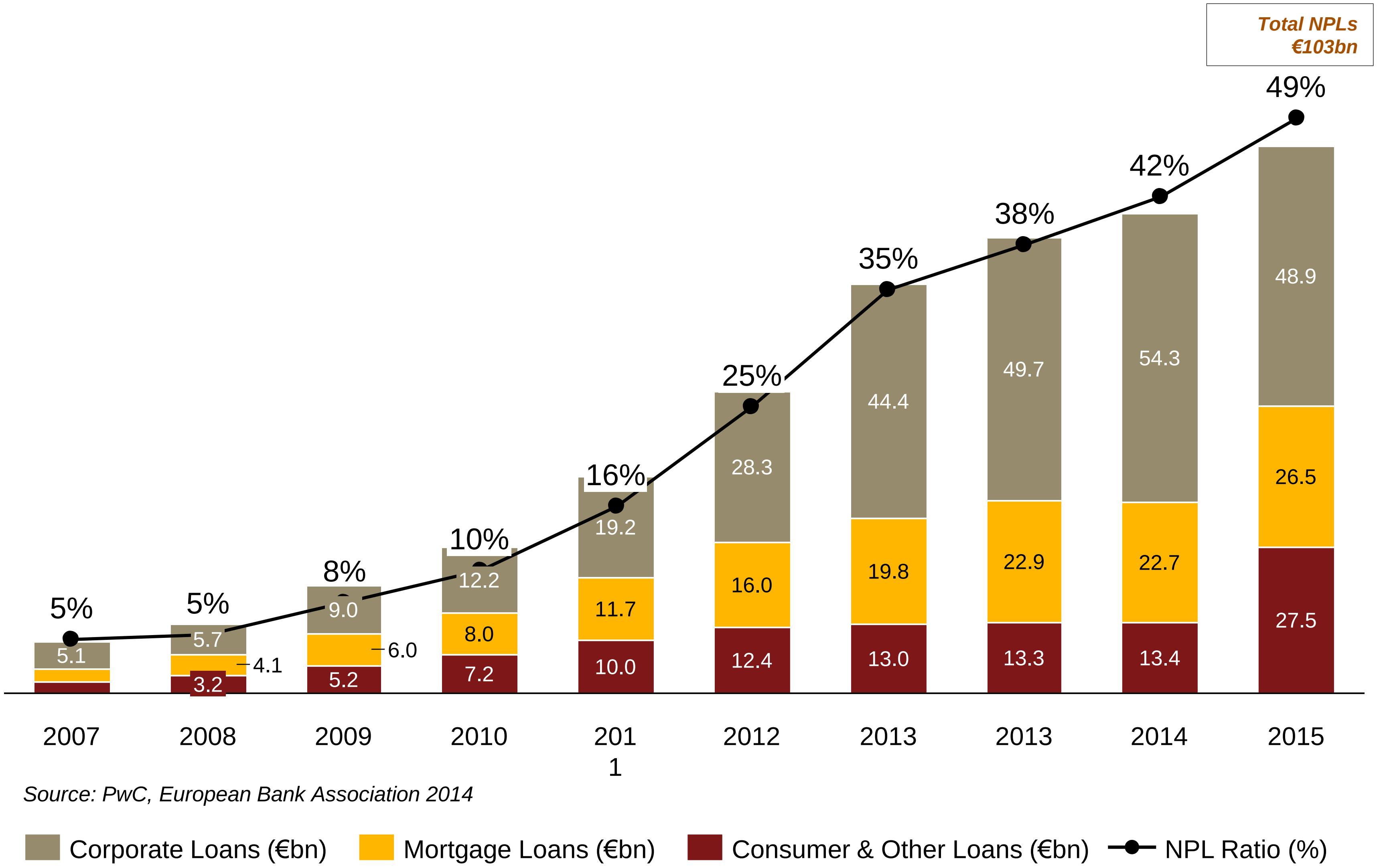


Source: EL.STAT.

Investment in Construction and Industry

The realisation

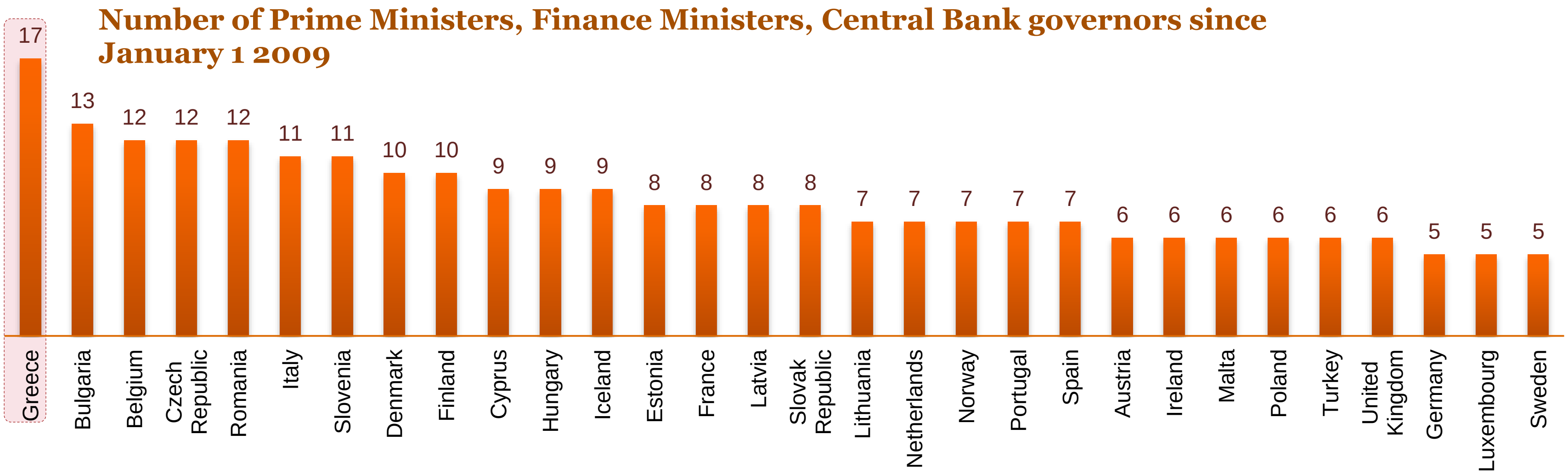
NPLs explosion

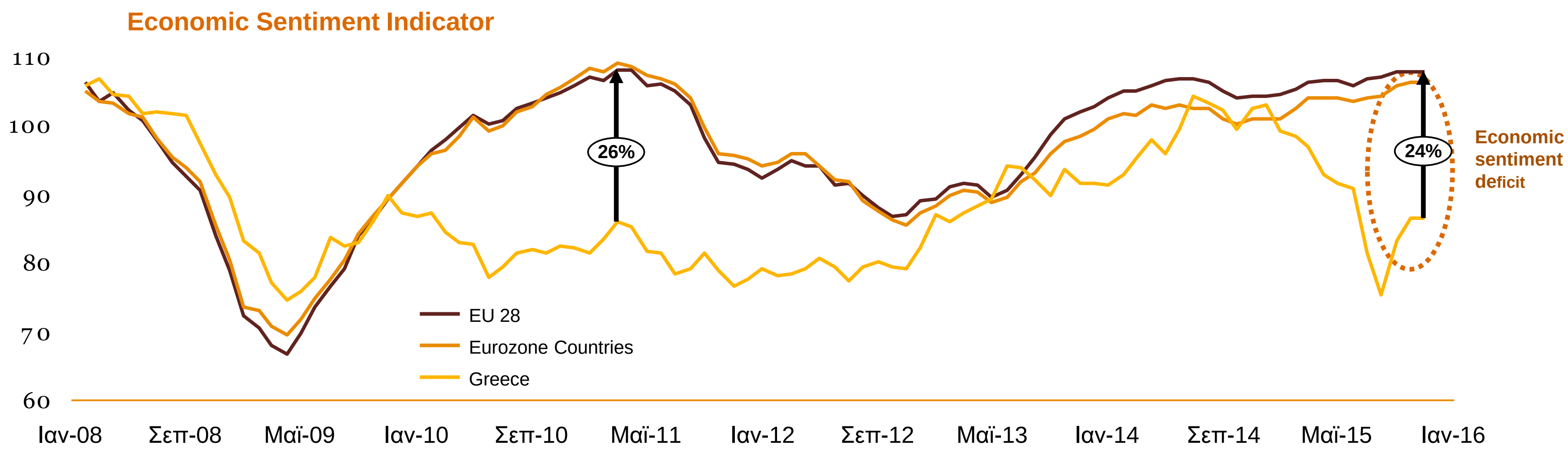


Source: PwC, European Bank Association 2014

The realisation

Political instability and economic uncertainty

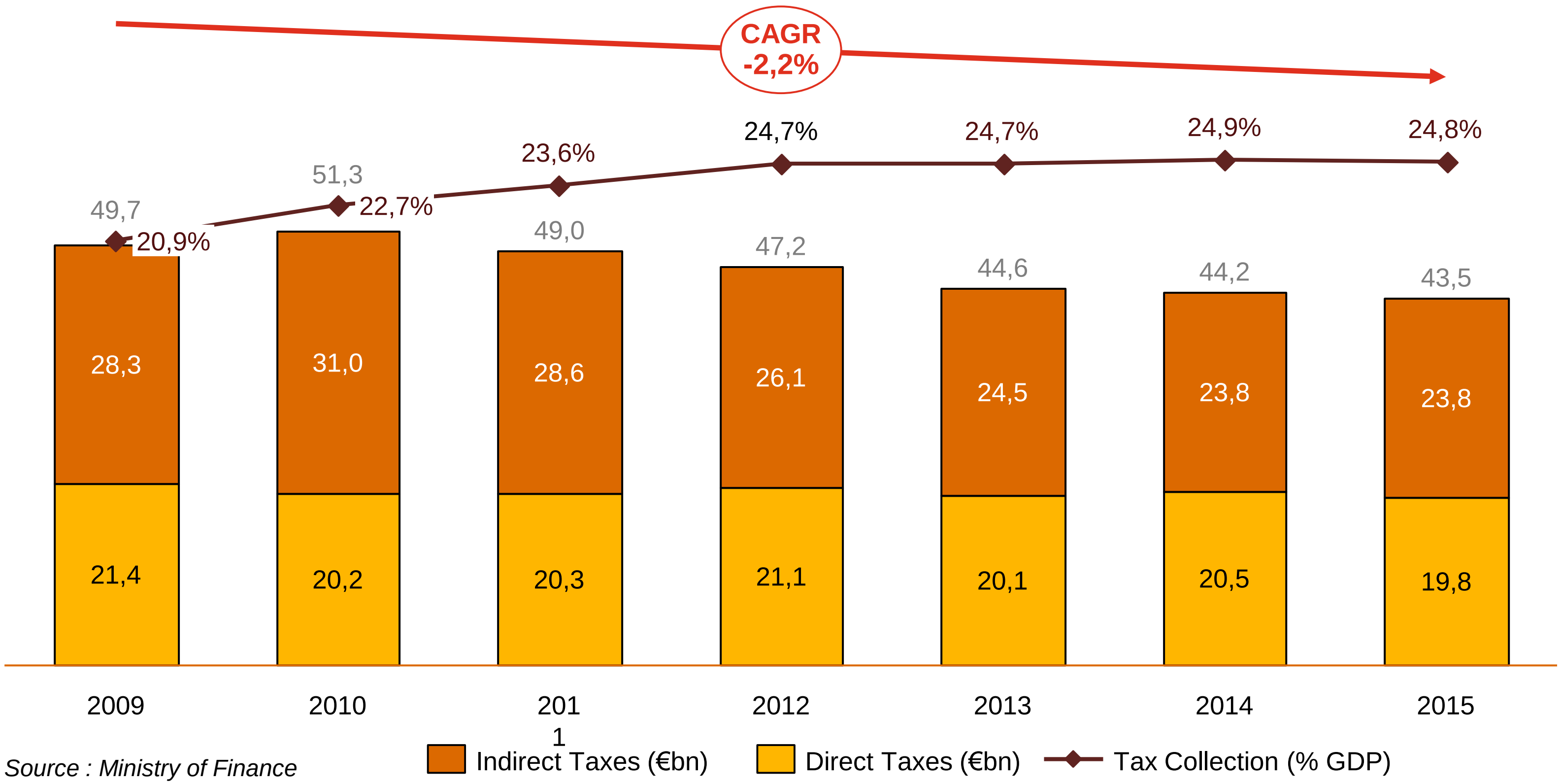




Source: Eurostat

The realisation

No improvement in tax collection over the years



Source : Ministry of Finance

- Measures combating tax evasion (broadening the VAT rate, linking household tax obligations to living standards, forcing households to show the means of having accumulated visible wealth)
- Abolishment of exemptions and special tax regimes, and simplification of tax structures
- Rebalance of current tax rates (VAT, PIT, other) so as to strengthen the non-evasion incentives

The response of the official creditors

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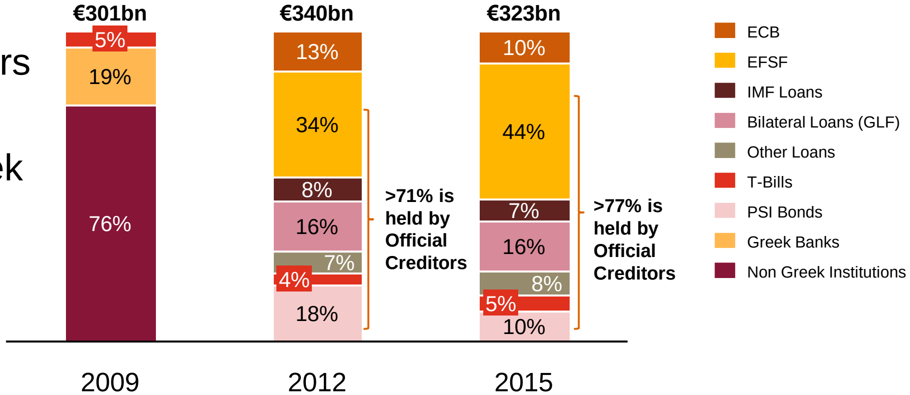
Greek debt was predominantly in the hands of international institutions and EU had no firewalls in place

- Saving European and US banks from another default was the prime driver for Eurozone members deciding to have the Eurozone taxpayers acquiring Greek debt
- Greek banks were holding in 2009 €56bn of Greek government debt and any Greek default would require their recapitalisation to survive
- EU had no institutions in place in 2009 to handle such a major refinancing (only the EMU). EFSM and EFSF were invented then



Source: GS Global ECS Research, Eurobank Global Market Research

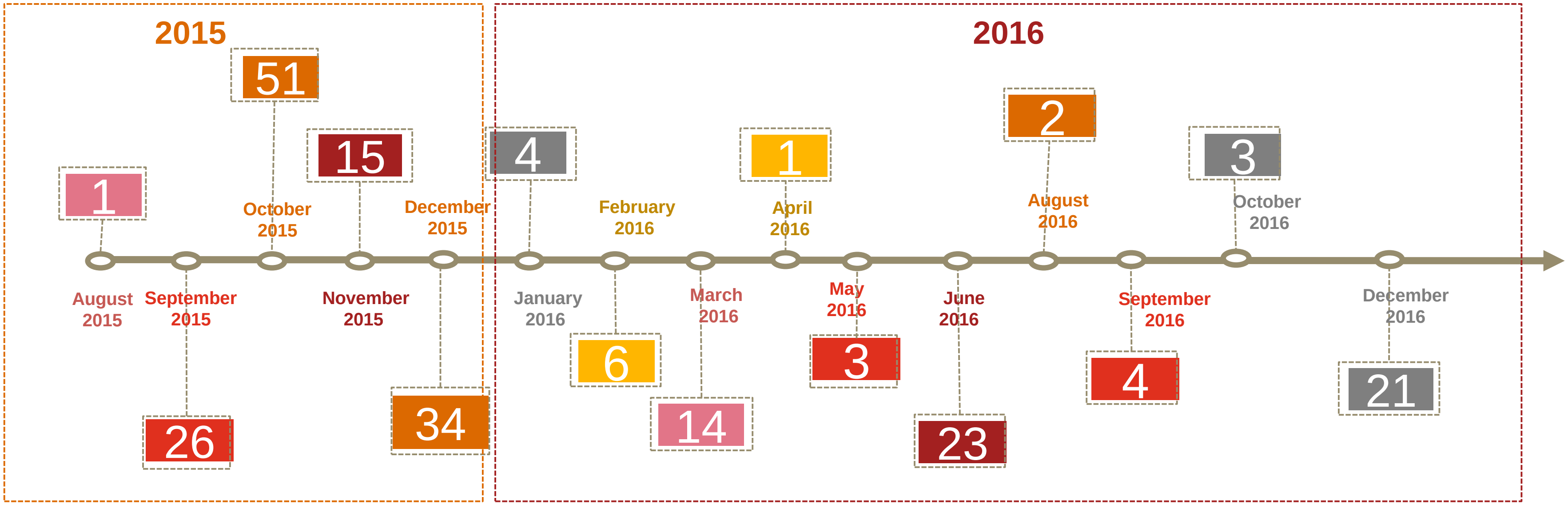
	EFSM	EFSF
Mechanism endorsement procedure	ECOFIN, qualified majority	Eurogroup, approval from member states national parliaments
Activation date	From 5/2010	8/2010 - 6/2013
Size of funding	€ 60 bn	€ 440 bn
Source of funding/ guarantees	EU Budget, bilateral loans	Euro Area countries, Issuance of EFSF bonds
To whom it applies	All EU members	All Euro Area members
Activation procedure	ECOFIN, qualified majority after recommendation from the European Commission and the ECB	Eurogroup, unanimous decision after recommendation from the European Commission, the ECB and the IMF

- Now there are in place also a bank resolution mechanism (SSM), a financial stability mechanism (ESM) and a European Central bank with renewed powers

The response of the official creditors

The official creditors used the MoU (agreement with creditors) as the main tool for pushing and managing the Greek economy

The example of the 3rd MoU (225 actions)



- The Greek Government must have completed 127 actions up to 31.12.2015, and should complete 178 until 06.30.2016 and 208 until 12.30.2016 respectively
- More than 100 actions (103) relate to the business environment, financial stability , the regulated business and tax reform
- 30% of the actions are considered to be key deliverables and will form prior action for each evaluation

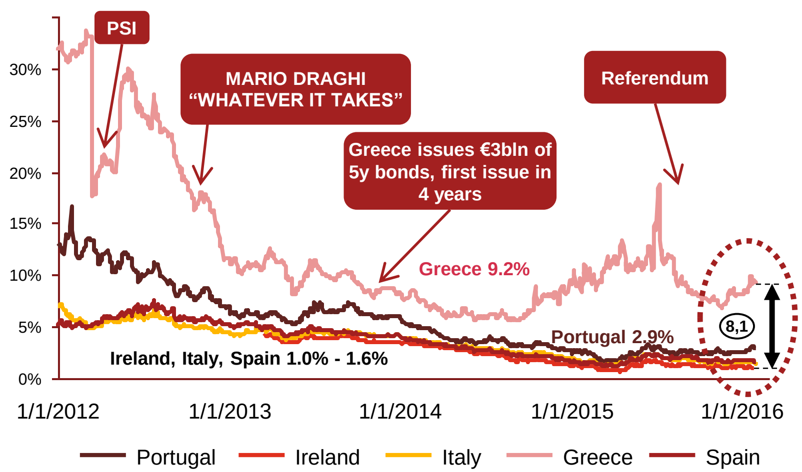
A huge number of actions for implementation with total lack of focus has led to non ending discussions and little impact on the economy

The response of the official creditors

At the end, all interventions failed to secure Greece's re-financing from the markets or to improve the business climate

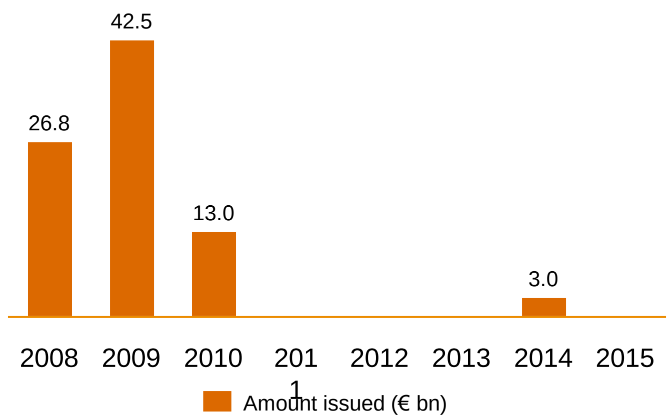
- The "trust gap" remains large and not closing, with continuing political uncertainty and capital controls leading to it widening
- Since late December 2014, the trust gap shot back to 2012 levels and rocketed to 18pps during the period prior to the referendum
- The economic sentiment has declined, located about 24pm lower than in other European countries, reflects the fragile economic environment that prevailed in 2015

Yields of 10-years Government Bonds PIGS



Source: Bloomberg

Greek Government Borrowings from international markets (2008-2015)



Source: PDMA

How did other countries fare?

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How did other countries supported by EU, ECB and IMF fare?

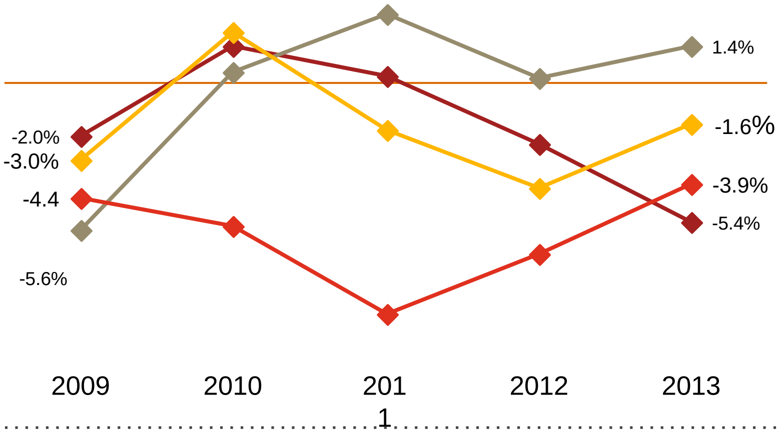
Financial Assistance Programms				
	Reasons for asking financial assistance	**Date of entering financial assistance**	**Amount**	**Return to the markets**
Portugal	Fund the troubled country's deficits and provide capital for the banks	May 2011	€ 78bn	April 2014
Ireland	The growing reliance of country's banking sector on ECB, and the ballooning government debt (from 25% in 2007 to about 100% of GDP in 2010) after the salvation of the banks	November 2010	€ 85bn	January 2014
Cyprus	Country's banking system accounting for about 8 times the GDP, went bankrupt. Bail-in scheme for the restructuring of the banking sector	May 2013	€ 10bn	March 2016 (expected)

Source: World Economic Forum - Global Competitiveness Report

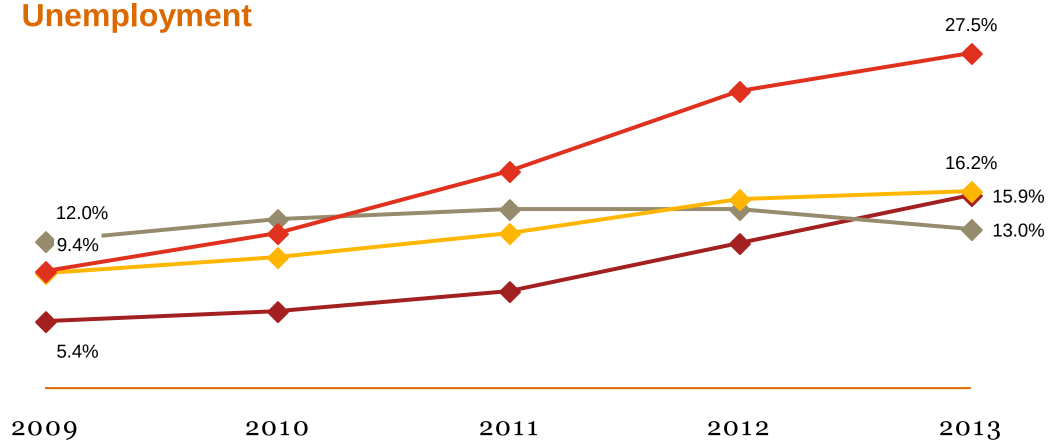
How did other countries fare?

They all fared considerably better than Greece

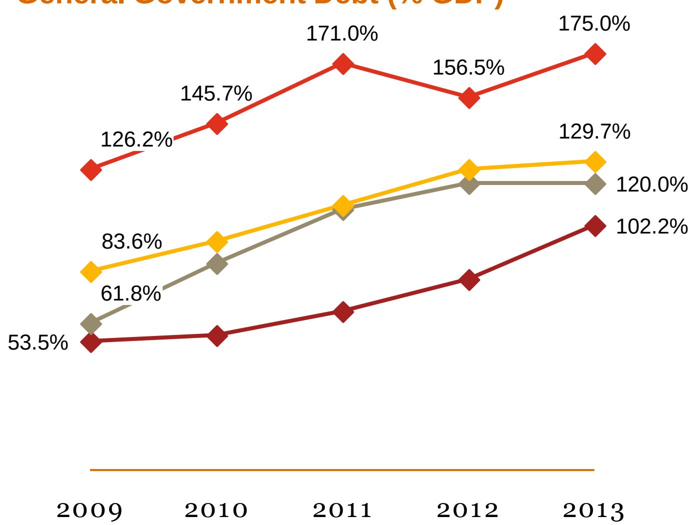
GDP (%)



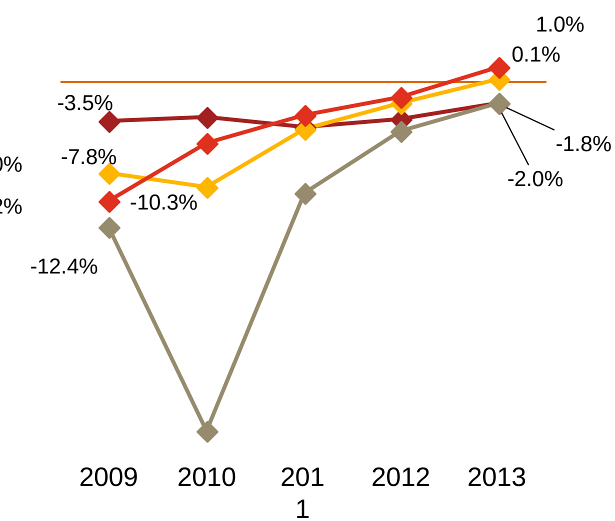
Unemployment



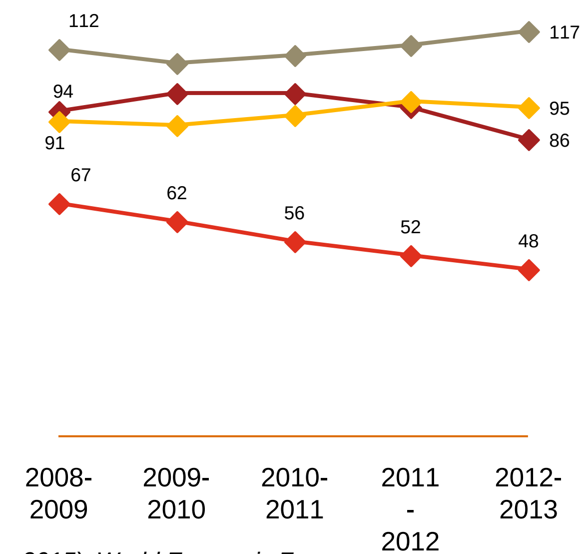
General Government Debt (% GDP)



Primary Budget Balance (% GDP)



Competitiveness



Cyprus Ireland Portugal Greece

Source: IMF (WEO October 2015), World Economic Forum

After 3 MoUs where does Greece stand now?

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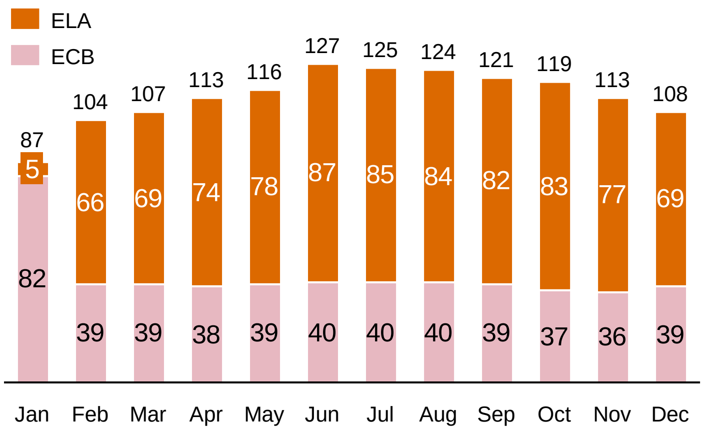
Capital controls imposed in early July 2015 still remain in place

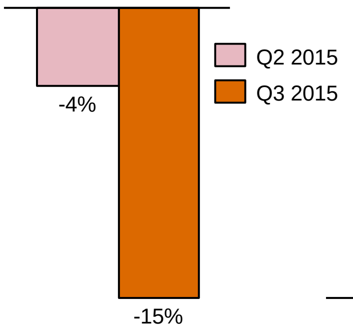
- **Corporate transactions are not unduly restricted**, with the flow of imports having recovered to 86.2% of the 2014 levels (for the period January – September).
- **Capital controls on withdrawals by individuals remain very strict** at €420/week per account
- **Exports appeared to have suffered**. Tourism receipts were 4.7% higher than 2014 (for the period January – September), partly compensating for the loss of goods exports
- **Deposits have not recovered from their June 2015 levels,** although the liquidity provided by ELA has been recently reduced from €87bn to €69bn
- The **impact of capital controls** was greater for SMEs than larger corporates

Greek Banking - Eurosystem Funding Evolution (€bn)



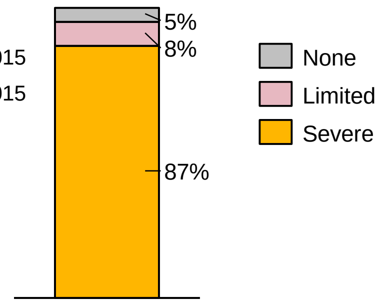
Source: Central Bank for Greece

SMEs Sales Growth 2015



Source: NBG

Short-terms problems due to capital controls



After 3 MoUs where does Greece stand now?

Zero Liquidity

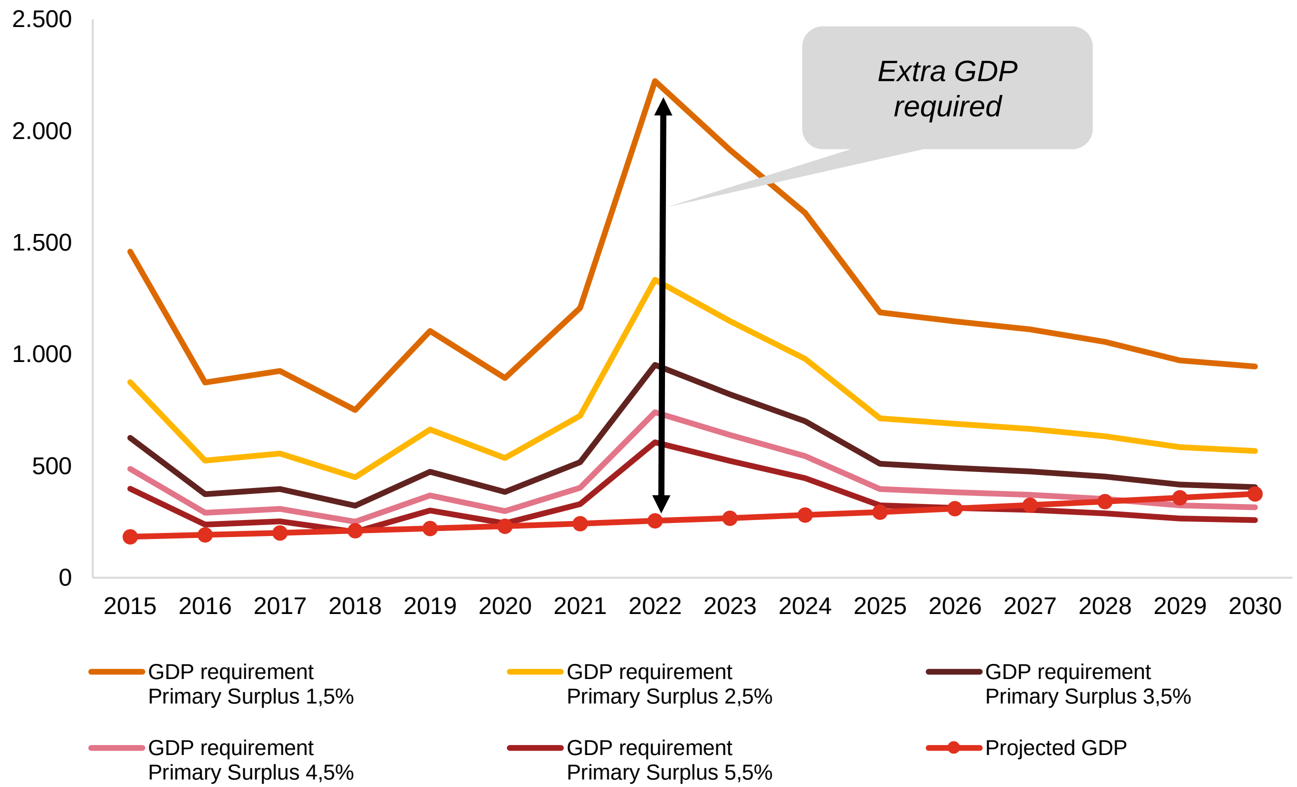
- The central government runs arrears to suppliers in excess of €4.5bn and has outstanding tax return of €0.7bn
- State owned enterprises and local authorities suffer from severe liquidity squeeze
- Deposits have not recovered from their June 2015 levels, although the liquidity provided by ELA has been recently reduced from €87bn to €72bn (16 January 2016)
- The liquidity of the banking system is at a critical point, completely dependent on the ECB and the ELA, while pledges have fallen to approx. €20 bn. At the same time banks have to manage the "mountain" of € 103bn arrears to almost half of their assets
- Without a positive assessment and releasing of the funds by the institutional investors (€ 10.6bn) the economy will be suffering from lack of liquidity and investment activity will be kept to a minimum

After 3 MoUs where does Greece stand now?

The IMF and the other institutional creditors are committed to reducing the burden from debt over the early years, providing relief to the State

Greek debt, as currently structured, is unsustainable over the period 2020 – 2028

Required GDP to Service Debt



What were the real causes of mishandling the Greek crisis

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Failure to understand the real problem

- The Greek government at the time (2009) failed to comprehend that Greece was about to be cut off of the markets and default on its debts
- The EU and the ECB also failed to notice the inevitable and the magnitude of the problem for Greece and EU
- The Troika had, and still has, a limited understanding of the Greek economy and politics and as a result most of its prescriptions find difficulties in being implemented
- Greek politicians showed both very limited understanding and at the same time almost boundless recklessness. The conservative party when in opposition was anti MoU but in government implemented it. The social democratic party dissolved incapable of explaining why they did not move earlier what they were aiming at thereafter. Lesser parties played power games. The party currently in government undermined the implementation of the 1st and the 2nd MoUs just to sign and implement the third one

No institutions in place

- Neither Greece, nor the EU had any institutions or mechanisms to cope with this type of emergency. All the then existing EU institutions had neither the mandate and the funding nor the technical skills to purposefully intervene

Slow and non commensurate response

- When EU, ECB and IMF intervened, through the first MoU and the PSI, it was late against the underlying dynamics and the impact of the intervention is small
- Even when they got really involved the EU, the ECB, the IMF failed to focus on quickly returning Greece to the markets and pursued a dual objective of simultaneous structural reforms and fiscal adjustment

What were the real causes of mishandling the Greek crisis

Continuous negotiation

- The “programme” is and have been in continuous negotiations across many dimensions with the Troika relentlessly pushing for implementation along the whole front and all governments evading it
- These continuous negotiations and the raising of different flags every now and then shunk the prime objectives of the programme, which was to return the country back to the markets

Lack of trust

- The minimum amount of trust which is necessary for any discussion between partners in Europe and between creditors and debtors was never there, with the negative peak reached at the time of the referendum in 2015
- The Greek government, unlike the Irish and the Cypriot governments, never saw the crisis as an opportunity and as a result never pushed through the truly necessary reforms or made a believable call for investment

And what have we all learned?

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But there were a few gains

Euro and the Eurozone were threatened in real, but survived in fact through renewed political commitment

Firewalls and crisis management mechanisms were put in place in the Eurozone

European banks were tested and strengthen their balance sheets and Greek banks were recapitalized

The probability of GREXIT has in practice disappeared form the political agenda

Certain reforms were implemented in Greece

And what have we all learned?
And coping with the next crisis

Institutions	There must be a set of institutions at county and EU level with the mandate, the skills and the funds to act on any crisis
Focus and Prioritisation	Crises compress time, and it is not opportune during them to address the backlog of problems which created them. First, you need to return to normality and then prioritise actions avoiding future crises
Reading early signal and acting` on them fast	Monitoring for parameters getting out of the envelope is the best safeguard against any crisis. Returning them quickly back into the folder is the next best safeguard
Better over than under reacting	Given the immense time pressure and the information flooding in a crisis, actions must be commensurate to the magnitude of the threat as projected in the future
Little negotiation and a lot of trust	During crisis you solve the problem of survival and that leaves little room for real negotiation with those offering the lifeline. Trust is required to compensate for the lack of reliable information. When conditions return to normality there will be ample time for find tuning in a trust environment. Morally, the reverse also applies
Less presumption and more professionalism	A crisis is by definition an unknown situation. This leaves no margin for fixed ideas and recipes, but it calls for focus, speed, discipline and skills. Fixed ideas come from ideological preconception, which typically fail to meet reality at critical times. Focus, speed, discipline and skills is the definition of professionalism which needs to complement politics in such times

Thank you