Greeks set to pay price for feelgood years

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NEWS ANALYSIS

Greece is struggling for a soft landing for an economy that is one of the worst out of kilter, writes Ralph Atkins

A strength of the eurozone economy, at a time of global financial turmoil, is its lack of any great "imbalances", Jean-Claude Trichet, the European Central Bank president, is fond of saying.

The fact that – unlike the US – the 15-country region exports roughly as much as it imports and its consumers have generally spent only what they earn (or less), helps to explain why the ECB remains relatively upbeat about the economic fundamentals.

However, if Mr Trichet repeats such statements after the bank's governing council meets in Athens tomorrow, his hosts will shuffle nervously in their seats.

Among the world's out-of-kilter economies, Greece is one of the worst offenders. Its current-account deficit relative to its gross domestic product is currently larger than that of the US and even Spain – two of the economies seen most at risk of a sharp economic correction in the coming months.

Last year's figure of 14 per cent of GDP resembled ratios seen in emerging Balkan markets next door to Greece, rather than in its eurozone partners.

The risk of a painful correction has worried policymakers for years – and the current-account deficit has continued rising. Eurozone membership could have helped shield the country from financial crises. But Greek luck might soon turn, say analysts.

"We are in an environment where countries with deficits are under much greater pressure to adjust," said Julian Callow at Barclays Capital. "On that logic, Greece is in the same company as Turkey or Spain or the US."

Spain – until recently among the eurozone's best performing economies – has shown how quickly sentiment can deteriorate. The collapse of the country's house-price boom, and the impact on construction, has sent economic confidence plunging.

In Greece, the sharp fall in borrowing costs after entry into the eurozone drove a consumer spending boom. Like its Balkan neighbours, Greece had plenty of catching up to do after a long period in which mortgages were unavailable and small enterprises had scarcely any access to credit.

At the same time, strong public and private investment, which has outpaced the eurozone average by as much as 5 percentage points yearly, has increased demand for imported goods and services.

"We're not a manufacturing country, so we have to import producer durables. That makes quite a dent in the current account," said Plutarchos Sakellaris, chief economic adviser at the finance ministry.

Greece has sustained growth at about 4 per cent yearly over the past decade, thanks partly to generous handouts of EU aid to modernise infrastructure. A recovery in tourism, expansion into Balkan markets by Athens-based companies and a Greek shipping boom based on transporting commodities to China added to the feelgood factor.

Within a monetary union, currency devaluation no longer offers a way out. But the risk now is that wage growth, consumer spending and business investment will bear the brunt of an inevitable adjustment process.

Unit labour costs have risen much faster in Greece than elsewhere in the eurozone – undermining competitiveness – and recent figures suggest that a marked deceleration in activity is already under way. GDP growth has slowed for three successive quarters, although the government still expects a 3.5 per cent expansion in GDP this year – above the eurozone average.

"Part of the slowdown is due to Europe – tourism is going to suffer. And shipping volumes are going to come down," said Paul Mylonas at the National Bank of Greece. It was too soon to say whether the recent high rates of investment would bring export-led growth to ensure a soft landing.

"There's no clear evidence that we've reached critical mass, though we're competitive at a European level in a few sectors," Mr Mylonas added.

Even a soft landing would push up Greece's jobless rate, currently at about 8 per cent – the lowest since records began, although still above the eurozone average.

Analysts believe that a sharp slowdown could result in an exodus of Greek workers to western Europe for the first time since the 1960s.

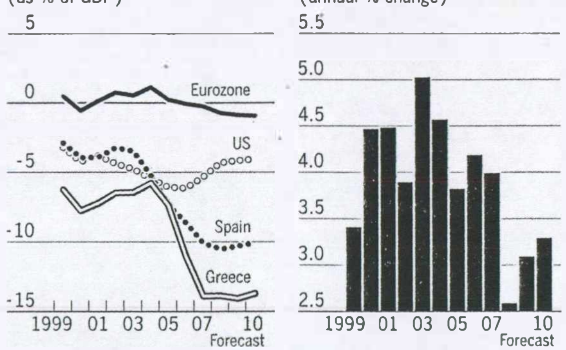
ECB discomfort

Sharply diverging performances by the eurozone's main economies have added to the European Central Bank's discomfort before tomorrow's interest rate-setting meeting in Athens, according to survey data. Growth accelerated in Germany in April but slowed markedly in France – while the Spanish economy contracted sharply. Full story: **www.ft.com/europe**

At risk

Current account balance (as % of GDP)

Greek real GDP (annual % change)



Sources: IMF; Thomson Datastream; EIU