Greece in the Euro Area: From Crisis to Growth

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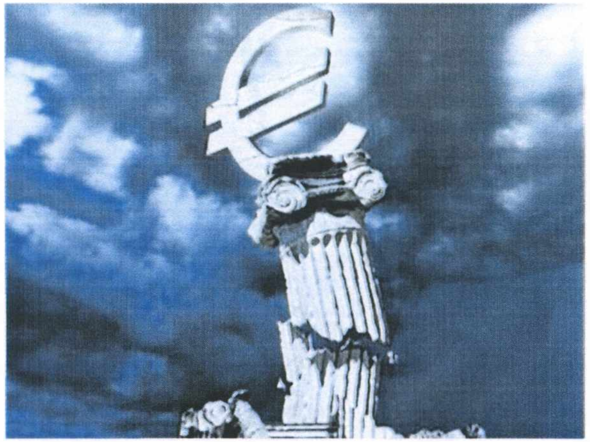
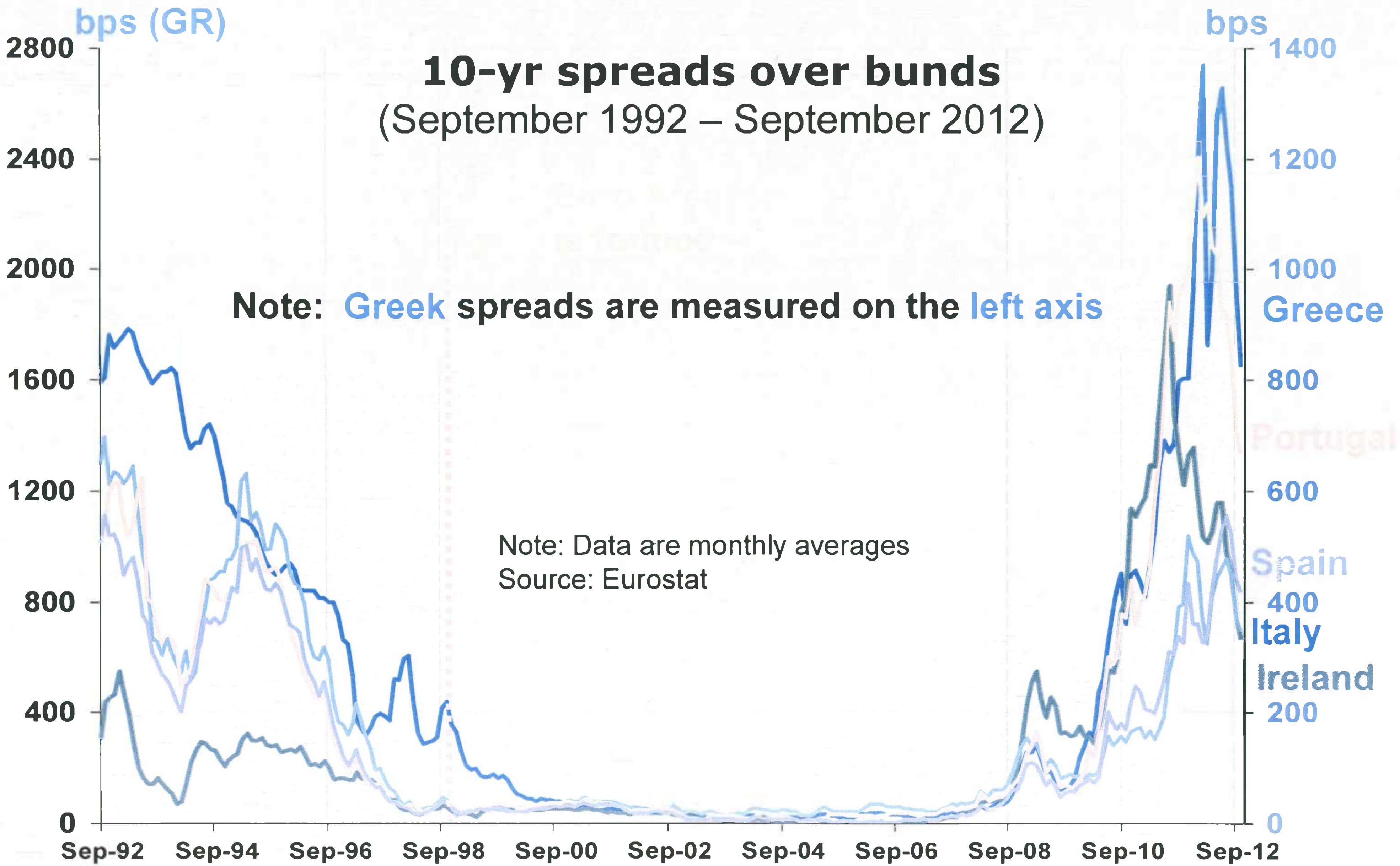
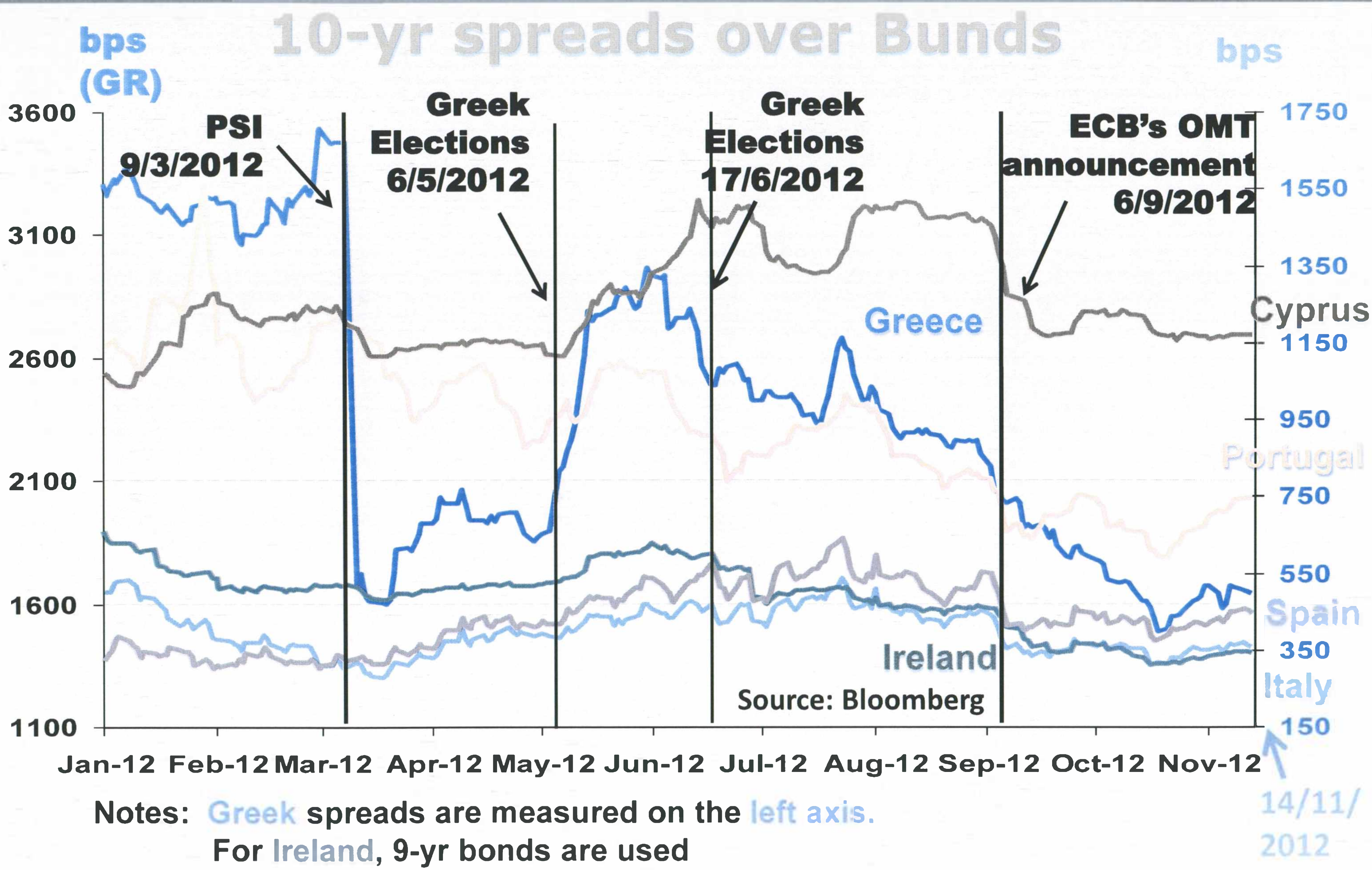


I. MARKET VIEW OF THE CRISIS: BACK TO THE FUTURE BUT DRESSED UP IN EURO

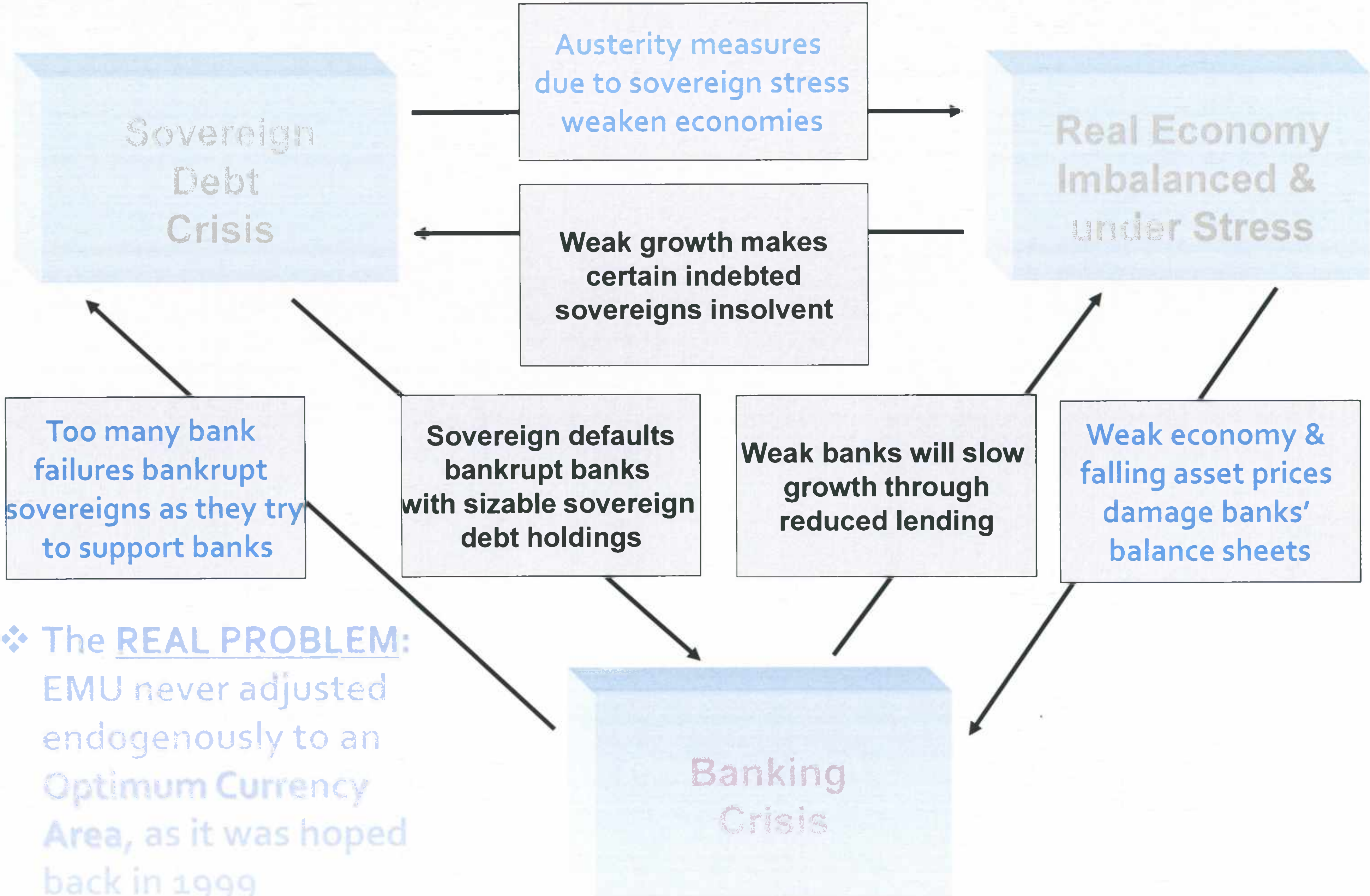


I. GREEK ODDS OF EXIT DECLINE BUT REMAIN HIGH with CYPRUS ENTERING THE PICTURE



Notes: Greek spreads are measured on the left axis.
For Ireland, 9-yr bonds are used
For Cyprus, the bond had a 10-yr maturity in Aug 2011

I. THE UNHOLY TRINITY: THREE INTERELATED LEGS OF THE EMU CRISIS

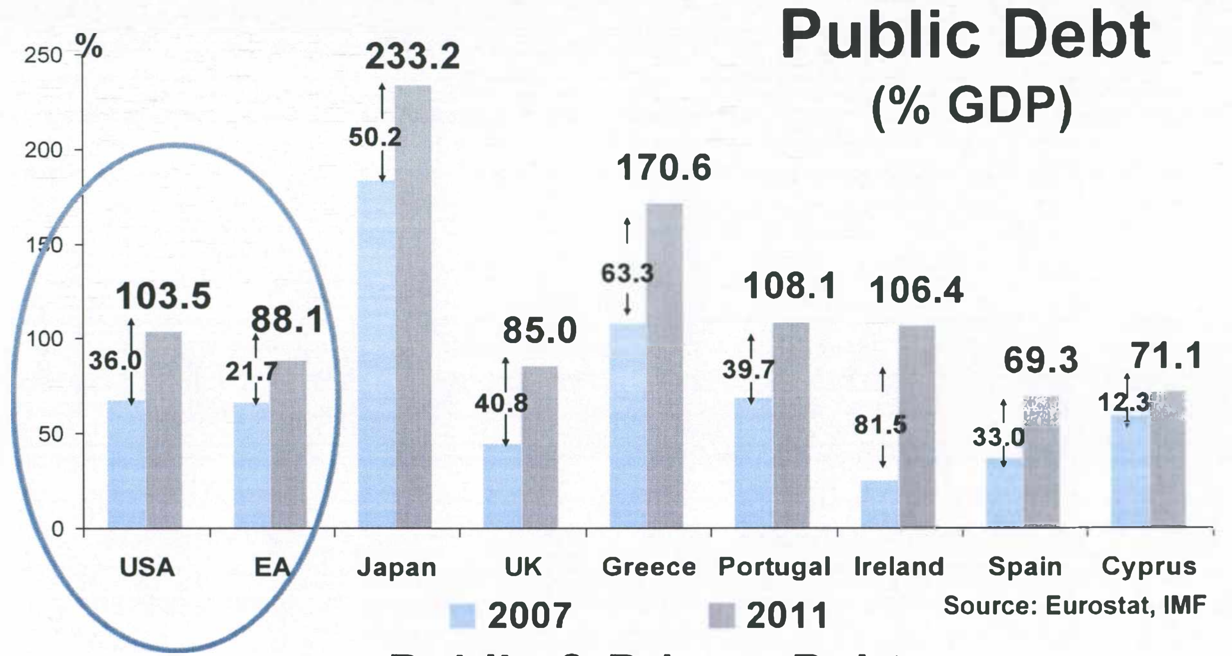


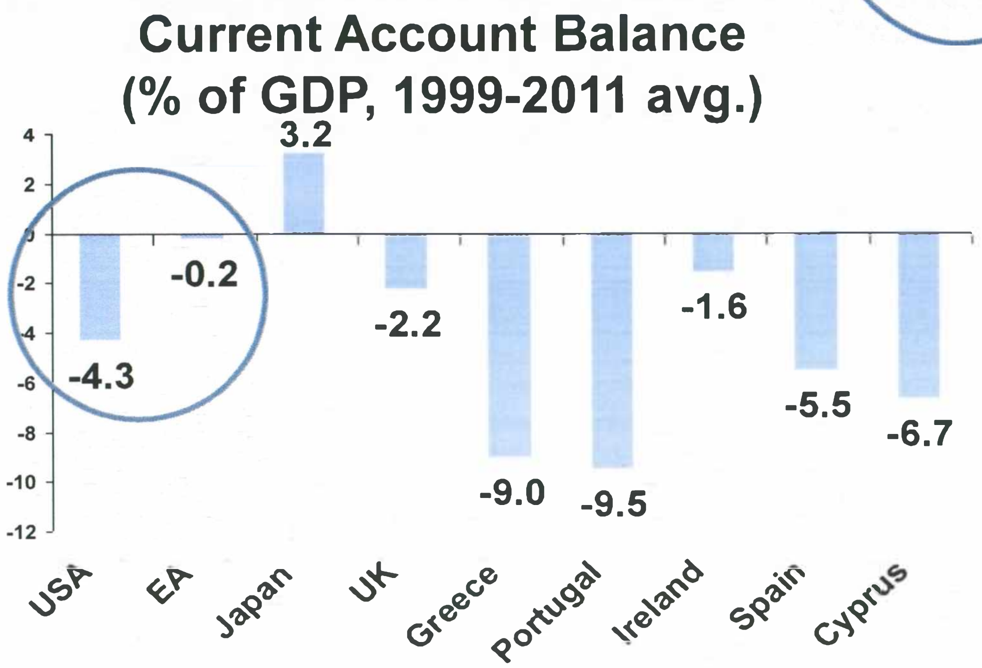
- The **REAL PROBLEM**: EMU never adjusted endogenously to an Optimum Currency Area, as it was hoped back in 1999

Source: BPEA (2012)

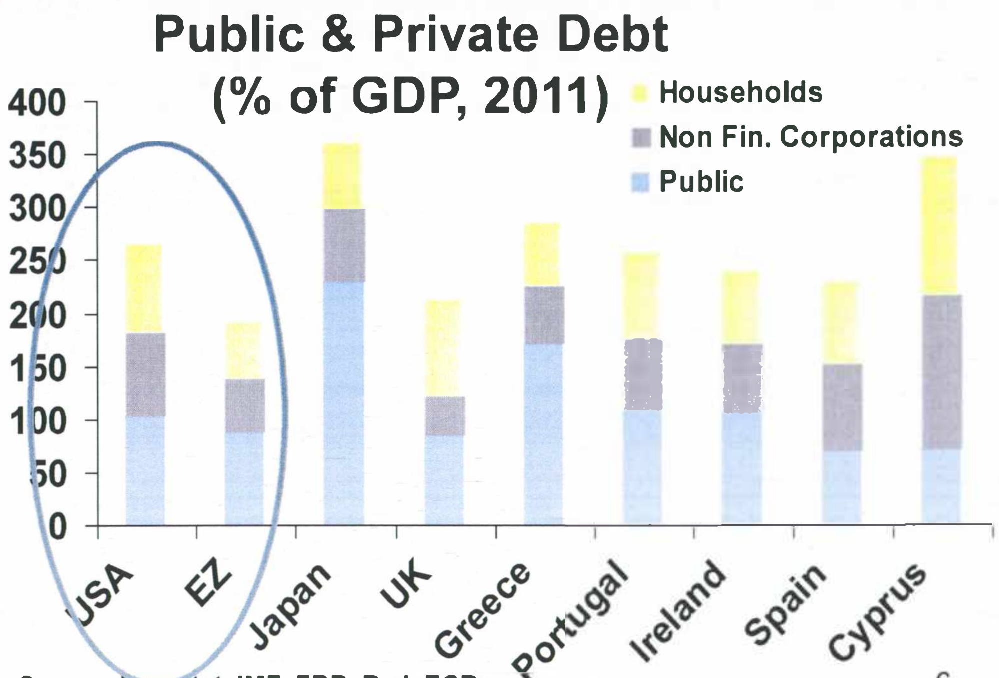
I. AGGREGATE EMU STATISTICS NOT NECESSARILY WORSE THAN THOSE IN USA, YET CRISIS IN EMU

- A crisis of cohesion as Euro Area in better shape than USA
  1. US Public Debt/GDP worse
  2. US current account balance negative
  3. International banking crisis started in the US, but US policy makers managed it better than Europeans





Source: Eurostat, IMF

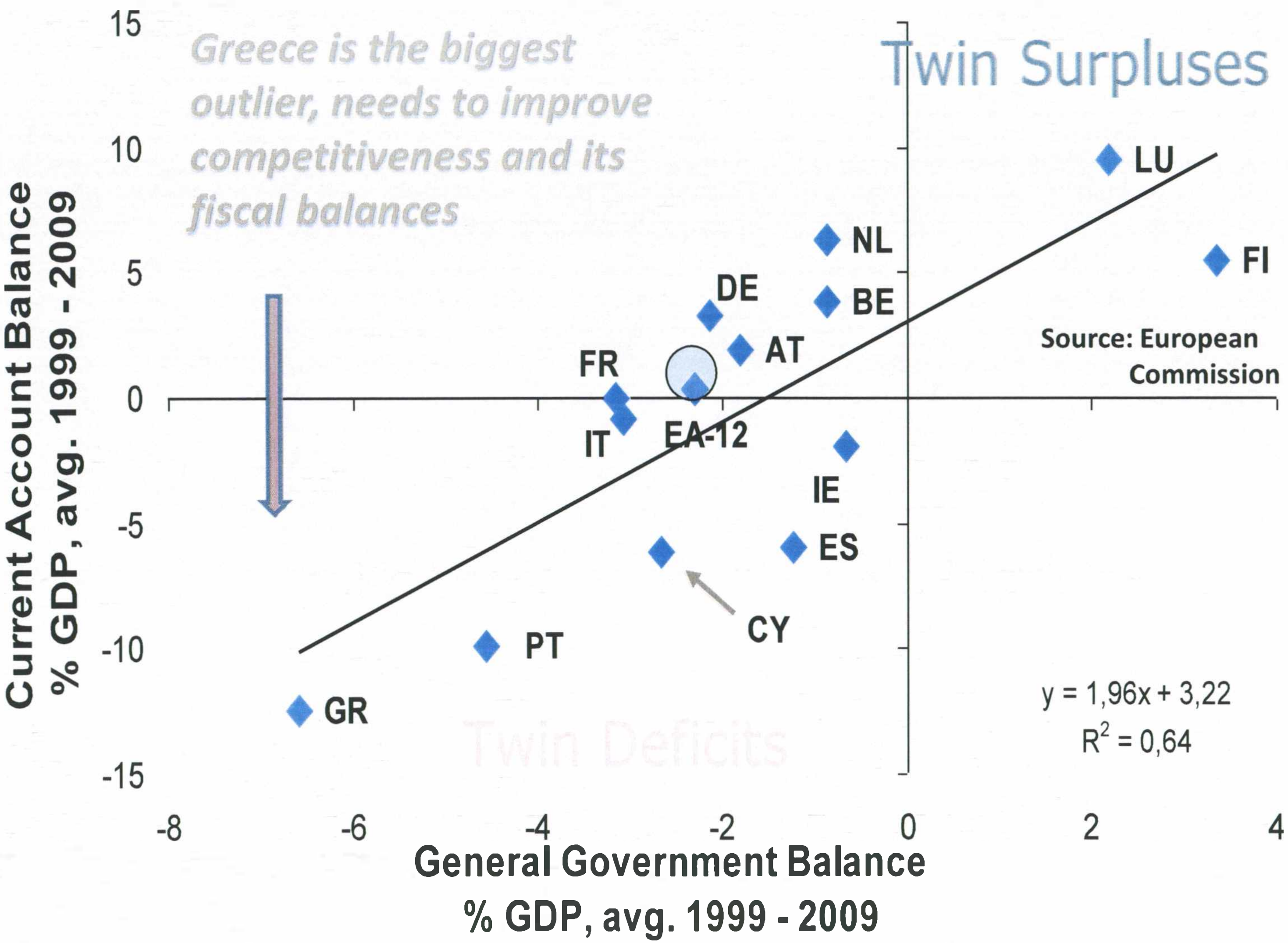


Source: Eurostat, IMF, FRB, BoJ, ECB

I. GREECE WAS AN EARLY OFFENDER IN TWO OF THE THREE LEGS OF THE EMU CRISIS

- Greece suffers from **lack of fiscal discipline and competitiveness** as shown in the Figure
- The third leg, the **banking crisis** in Greece was caused by the **state's PSI and *the continuing recession that drives up*** **NPLs**
- Post-EMU, a **competitive North** and an **uncompetitive South** emerged

Average annual external and fiscal balance in EA-12 before the Greek/EMU crisis hit in early 2010



I.1 POLICIES TO REDUCE THE DEBT-TO-GDP RATIO

1. **Country Bailouts** – the "no bailout" principle was abandoned
   a) Bilateral loans, originally at punitive interest rates
   b) Creation of EFSF (ESM) but the back stop is small and the agency has little freedom to act
   c) Haircuts on sovereign debt held by private sector. Greek PSI, supposedly voluntary, it came too late to reduce the size of debt substantially, **worsened the banking crisis**

2. **Austerity** measures to generate primary surpluses
   a) **Problem** as a primary surplus affects the economy negatively, **reducing the growth rate,** often causing a rise in debt-to-GDP, hence worsening the sovereign crisis
   b) Recent **IMF & Eurobank studies** show that the **negative fiscal multiplier is higher** than previously thought and was incorporated in the MoUs signed in the different crisis countries

I.2 POLICIES TO REBALANCE THE ECONOMY AND BRING BACK GROWTH

1. **Structural reforms**

   a) They improve potential output, e.g. Deregulating retail markets, liberalizing professions, streamlining rules for investment, make labor markets more flexible, etc.

   b) Most of them do not carry a fiscal cost, only political costs

   c) Yet today's problem in Greece is lack of demand and policies that improve supply in the long-run may cause a further contraction in demand

2. **Internal devaluation**

   a) Hard to accomplish in an environment of low inflation as prices are sticky downward. Few are the successful cases of internal devaluation: Hong-Kong (1990), Japan (late 90s-early 2000), Ireland (2008-present), Latvia (2008)

   b) The reduction in wages do not necessarily translate into lower prices, especially when labor cost is a small fraction of producer prices, only 22% in Greece. In addition, product & labor market reforms were delayed. They should have preceded the labor reforms (Hardouvelis(2007)).

I. 3 POLICIES TO RESOLVE THE BANKING CRISIS

1. **Stress tests**
   a) Did not work since they avoided to include the scenario markets were afraid off: A sovereign default. In addition, the backstop for the capital needed was supposed to be given by the local governments, hence often too small for the task
2. **Liquidity provision by the Eurosystem**
   a) SMP was too small (€208.5bn as of Nov 9, 2012) – the so-called "nuclear option"
   b) LTROs (€1.047 tr. as of Nov 9, 2012) only after the Italian crisis in the summer of 2011. Even here ECB merely lends with collateral, it is not taking bad assets out of the system like the FED did in 2007-2009. LTROs can be used to fund the governments and increase the banks' dependency on the State
   c) OMTs with strict conditionality, Spain has to make a move now
3. **National Bank support & bank bailouts**
   a) Support schemes from late 2008
   b) Bailouts transferred the debt to tax-payers and caused sovereign crisis in Ireland
4. **Discussion for a Banking Union**
5. **WRONG POLICY: Increase in capital requirements**
   a) A pro-cyclical policy that causes banks to sell assets and refrain from lending, hence worsening the economic slowdown

I.4 POLICIES FOR THE SUSTAIBABILITY OF EMU

EMU leaders seem to follow rather than lead markets. Yet, for EMU to survive it cannot stay still. It needs bold policies that turn EMU closer to an Optimum Currency Area, implying closer unification

i. Proceed with banking union policies beyond a common regulatory framework to also a common resolution scheme with a fiscal backstop

ii. Proceed with deeper fiscal integration through Eurobonds in the form of e-bonds and blue-red bonds, through a common unemployment insurance framework, through an increase in the central EMU budget. Fiscal Compact is not enough.

iii. Establish policies that improve labor mobility across the Euro Area, e.g. common pension policies, common tax policies, etc.

IN ADDITION,

i. Follow expansionary fiscal policy in the EMU North (politically difficult) in order to generate demand in the South and resolve the imbalances within EMU

ii. Help heavily indebted countries in their debt sustainability efforts

   a) Allow crisis countries to enjoy positive inflation despite their internal devaluation, hence let ECB interpret price stability as a target inflation of larger than the current 2% , so that Northerners can have inflation > 2%

   b) Capitalize problematic banks directly from the ESM without raising national debts

II.

I. The EMU crisis: Overview

II. Earlier times of euphoria

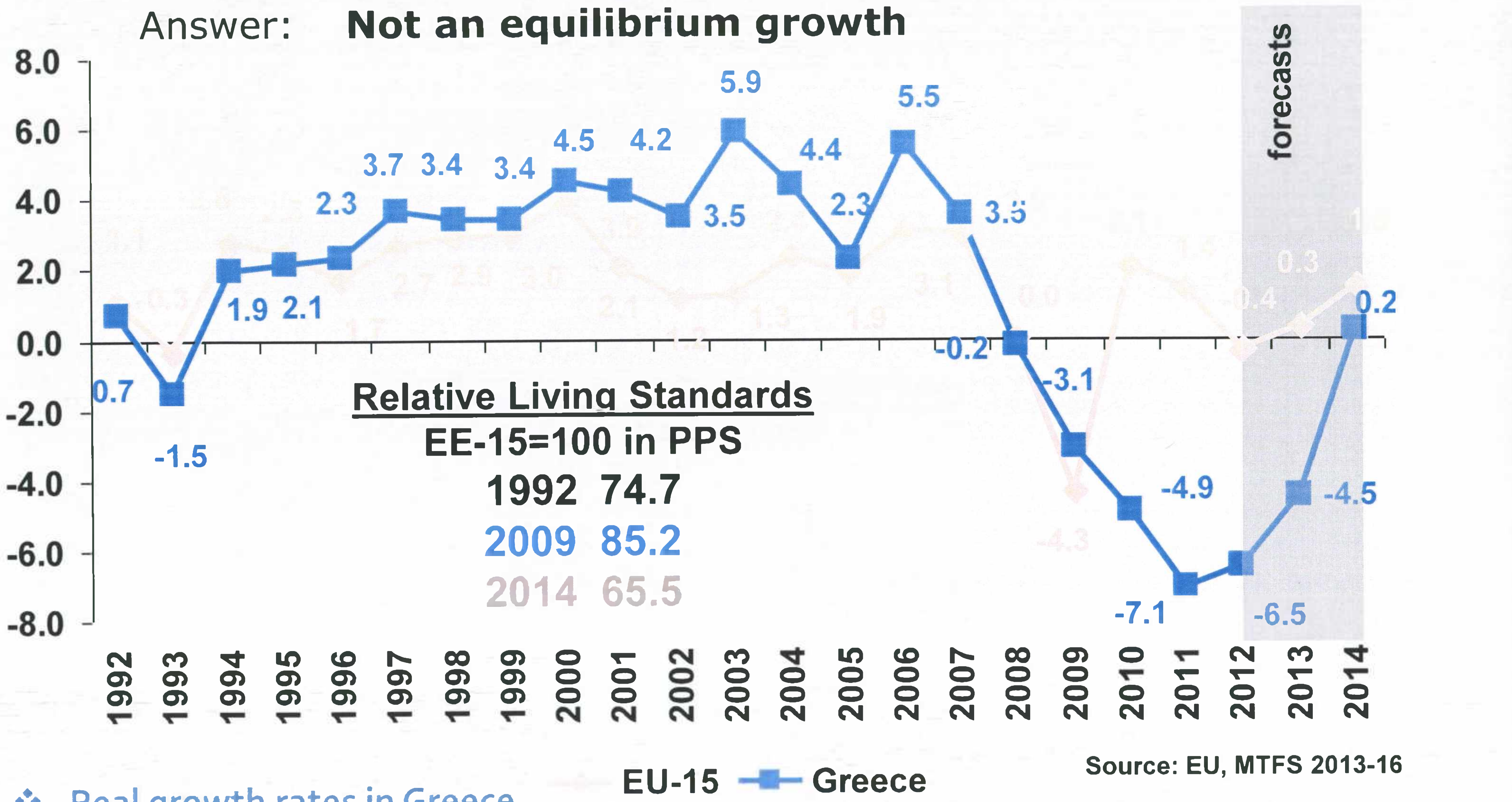
III. Greek accomplishments in the midst of crisis

IV. Can growth come back in a period of austerity?

II. HIGH GREEK GROWTH RATES ... YET BASED ON AN IMBALANCED ECONOMY

Greece: From boom to How come?

Answer: **Not an equilibrium growth**

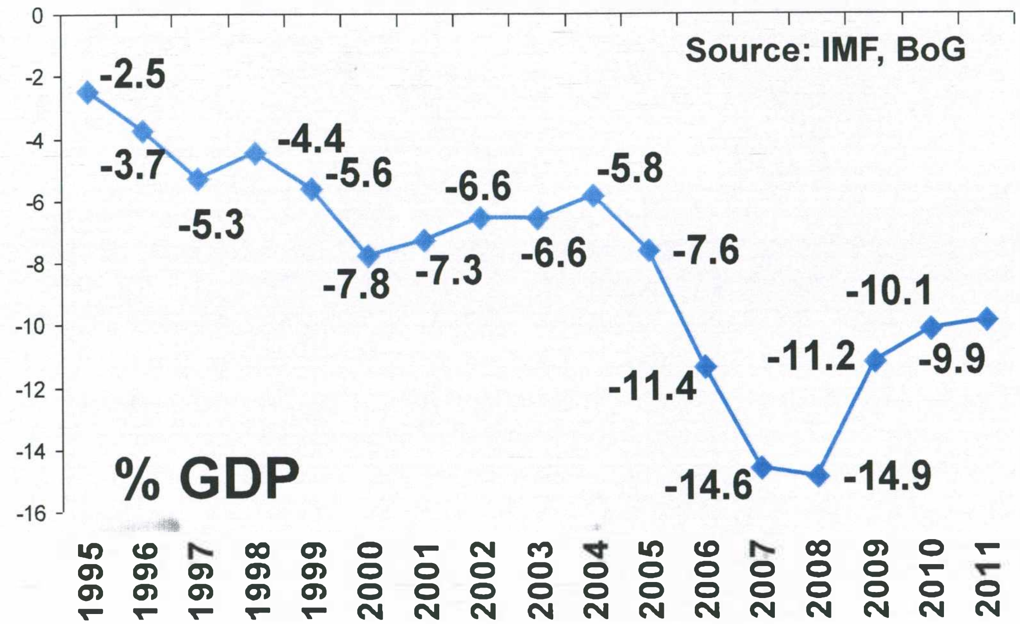


Source: EU, MTFS 2013-16

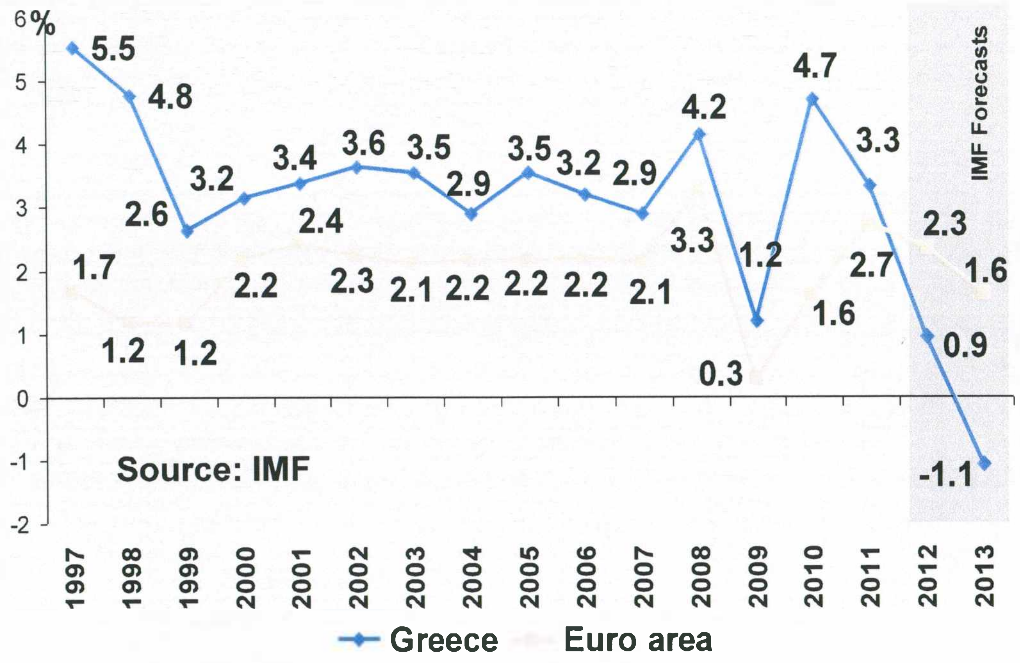
- Real growth rates in Greece were higher than in EU-15 from 1996 through 2007
- Remember politicians fighting about the rate of convergence? HUGE DIVERGENCE

II. THE CRISIS IS ABOUT LOSS OF COMPETITIVENESS EXACERBATED INSIDE THE EURO AREA

Current Account Balance

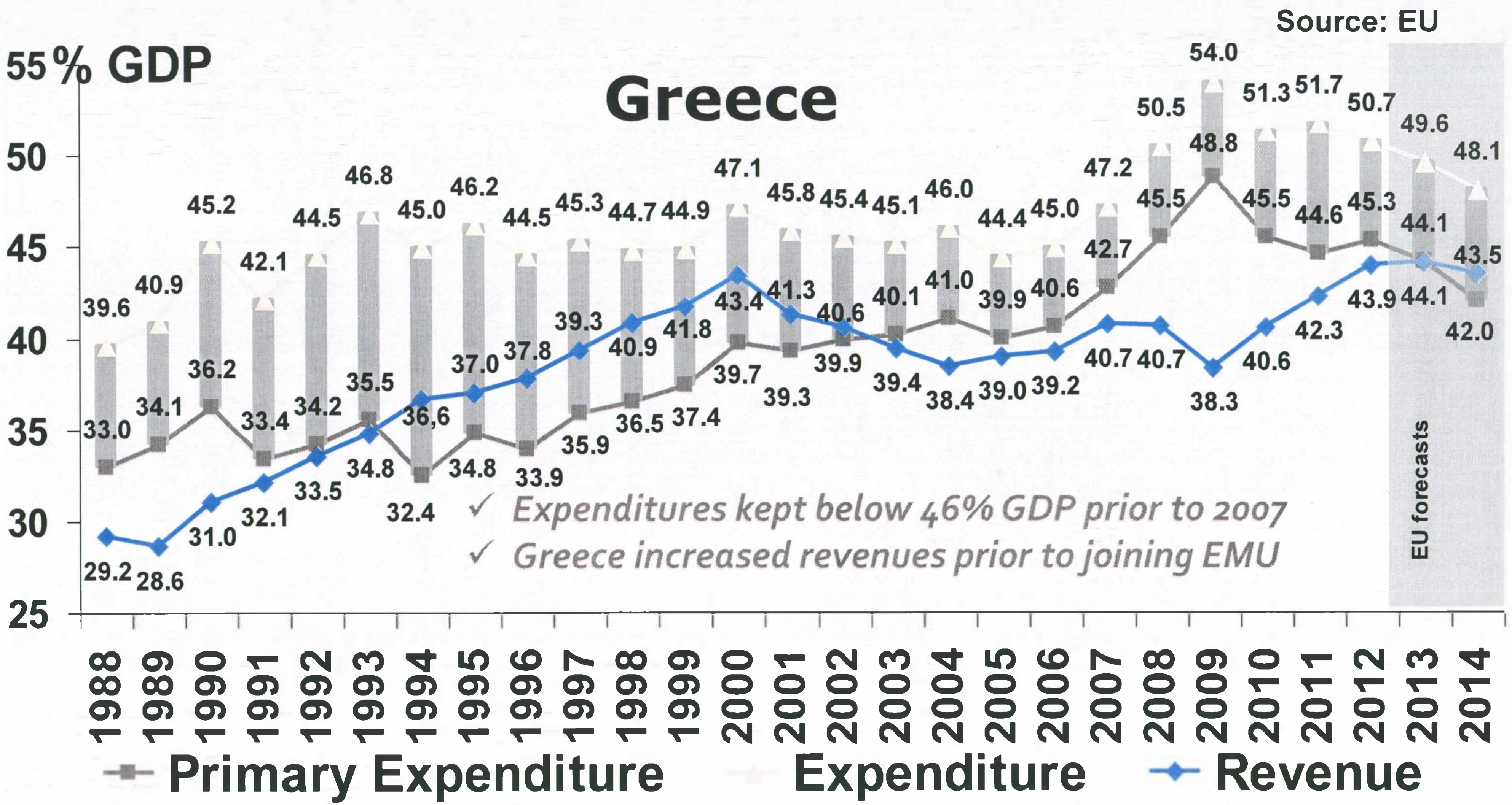


Inflation



2011	€ mill.	% GDP
Current Account	-20,633.5	-9.9
Goods	-27,229.1	-13.1
Services	14,629.6	7.0
Income	-8,594.8	-4.1
Current Transfers	560.8	0.3

II. FISCAL DEFICITS GREW WORSE AFTER 2006



✓ Greece was almost always in fiscal trouble, but the fiscal mess grew way prior to the onset of the 2008 recession, during 2006

✓ The period of primary surpluses was from 1993 to 2003, and hopefully from 2013 on

II. THE BREAKDOWN OF RUNAWAY EXPENDITURE

General Government, € bn

Source: European Commission

	2001	2009	2012	2014	% Δ 2001-09	EU27 - %Δ 2001-09	% Δ 2009-12	EU27 - %Δ 2009-12
Total Expenditure	66.5	124.7	98.9	88.9	87.6	**35.7**	-20.7	**5.9**
- Interest	9.5	12.0	10.5	11.1	26.1	-6.6	-11.9	25.2
Primary Expenditure	57.0	112.7	88.4	77.8	97.9	**39.1**	-21.6	**4.8**
- Employee Comp	15.2	31.0	23.9	21.0	104.3	31.4	-23.0	4.2
- Social benefits	22.5	49.0	45.5	39.1	117.7	35.5	-7.1	9.4
- Interm. Consumption	9.1	17.1	9.3	8.8	88.8	45.6	-45.7	6.4
- Other Expenditure	1.6	3.6	2.1	1.6	128.2	59.8	-39.6	7.5
- Capital expenditure	8.5	12.0	7.5	7.3	41.3	49.2	-37.4	-17.9
Total Revenue	59.9	88.6	85.7	80.5	47.8	**21.4**	-3.3	**13.3**
-Direct Taxes	12.5	19.1	19.8	18.3	52.8	13.8	3.2	15.3
-Indirect Taxes	19.5	26.2	25.9	23.8	34.0	20.7	-1.0	15.8
Primary Balance	2.9	-24.1	-2.8	2.7	-917.3	**-364.1**	88.6	**83.7**
GG Balance	-6.5	-36.1	-13.3	-8.4	-452.2	**-460.0**	63.2	**41.9**
GDP (nominal)	145.1	231.1	195.0	185.0	59.3	**22.7**	-15.6	**10.1**

- ✓ The adjustment in expenses over 2009-2012 was large but could not undo a decade of runaway expenses
- ✓ Social transfers grew enormously, Intermediate consumption is already cut substantially and Capital expenditure has declined

III.

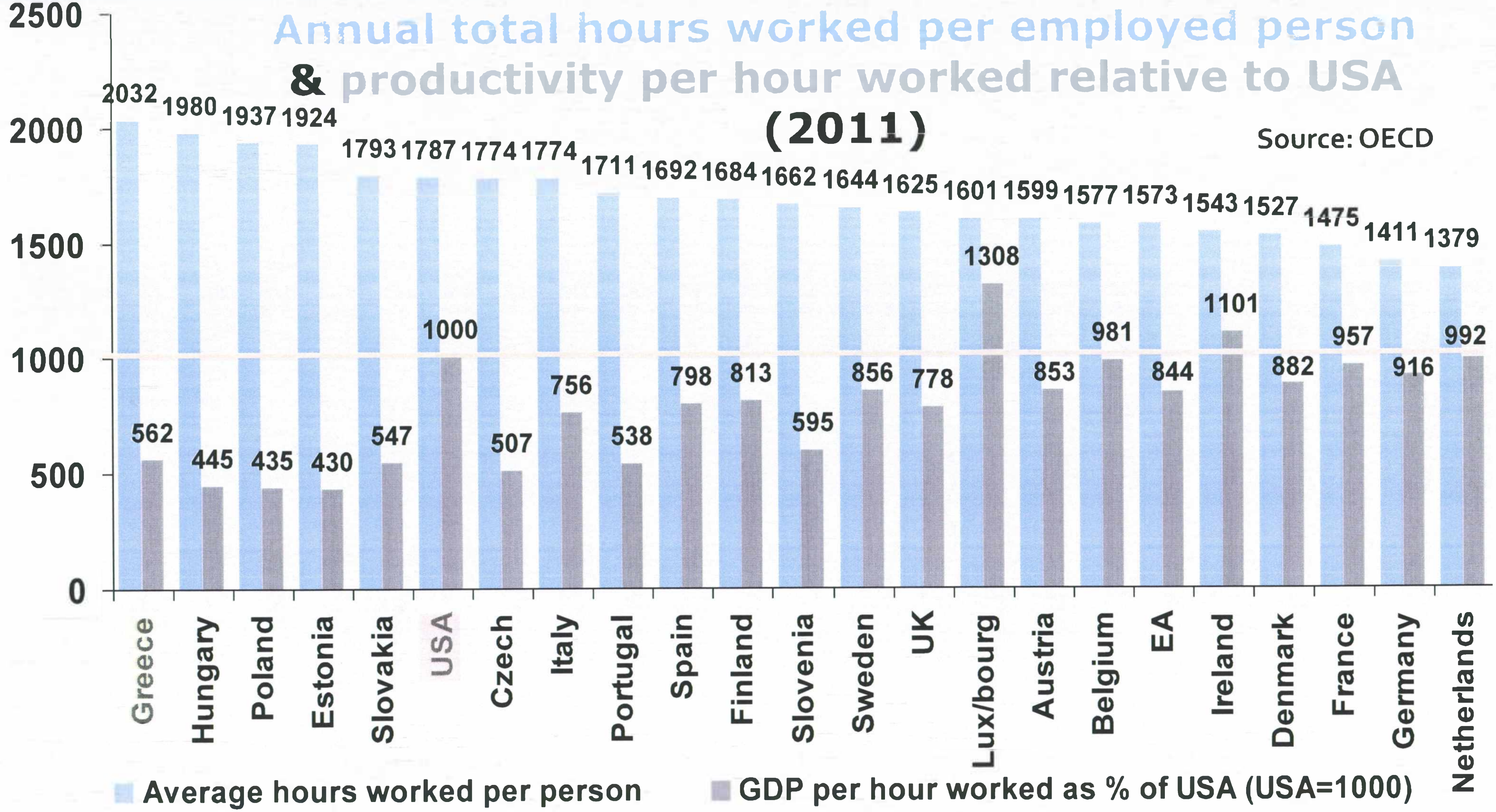
I. The EMU crisis: Overview

II. Earlier times of euphoria

III. Greek accomplishments in the midst of crisis

IV. Can growth come back in a period of austerity?

III. THE CRISIS IS NOT ABOUT LAZY GREEKS: THEY ARE THE HARDEST WORKING IN EUROPE!

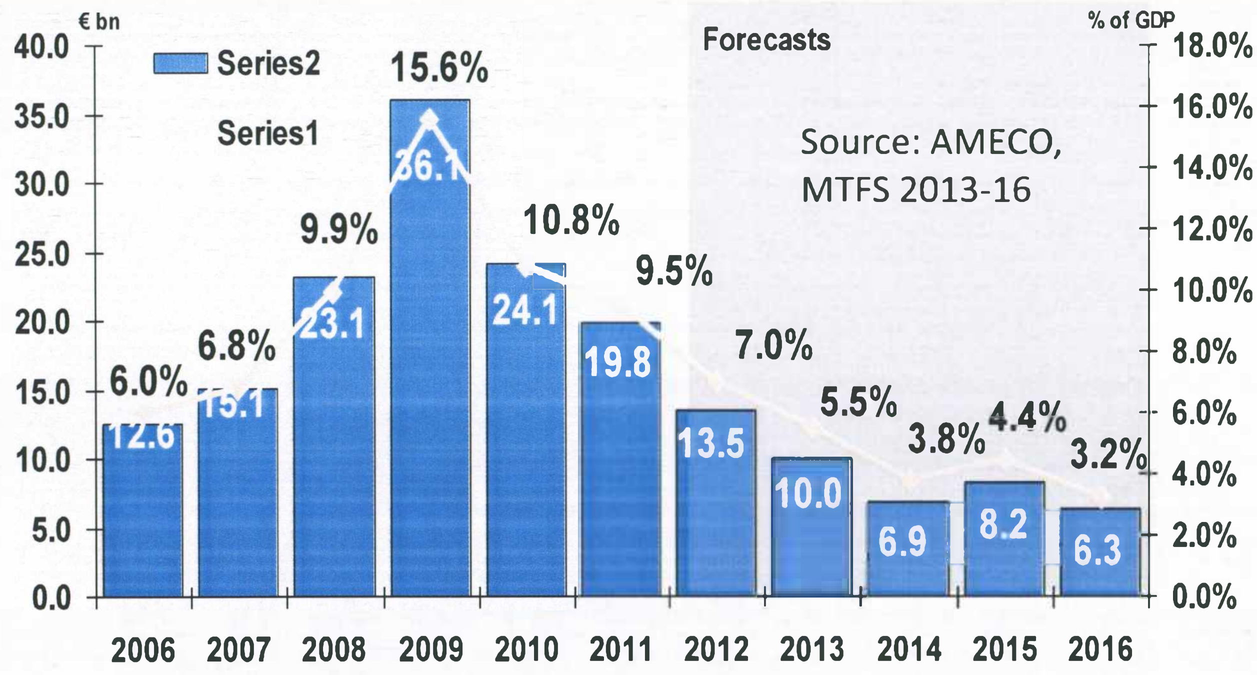


Note: 1. Assuming a 40-hr work-week, Greeks work 50.8 weeks per year, 13.7% more than Americans (44.7 weeks), and 44% more than Germans (35.3 weeks)

2. In Greece, productivity per person is at 70% (= 56.2 + 13.7) of US productivity

III.1 DRASTIC FISCAL CONSOLIDATION AFTER 2009

- From 2009 to 2012 expenditure was cut drastically
- Revenues managed to remain high despite the ~20% cumulative recession
- Primary balance improved by 9.1 pp of GDP
- Yet taxes have fallen on the usual suspects, the law-abiding citizens

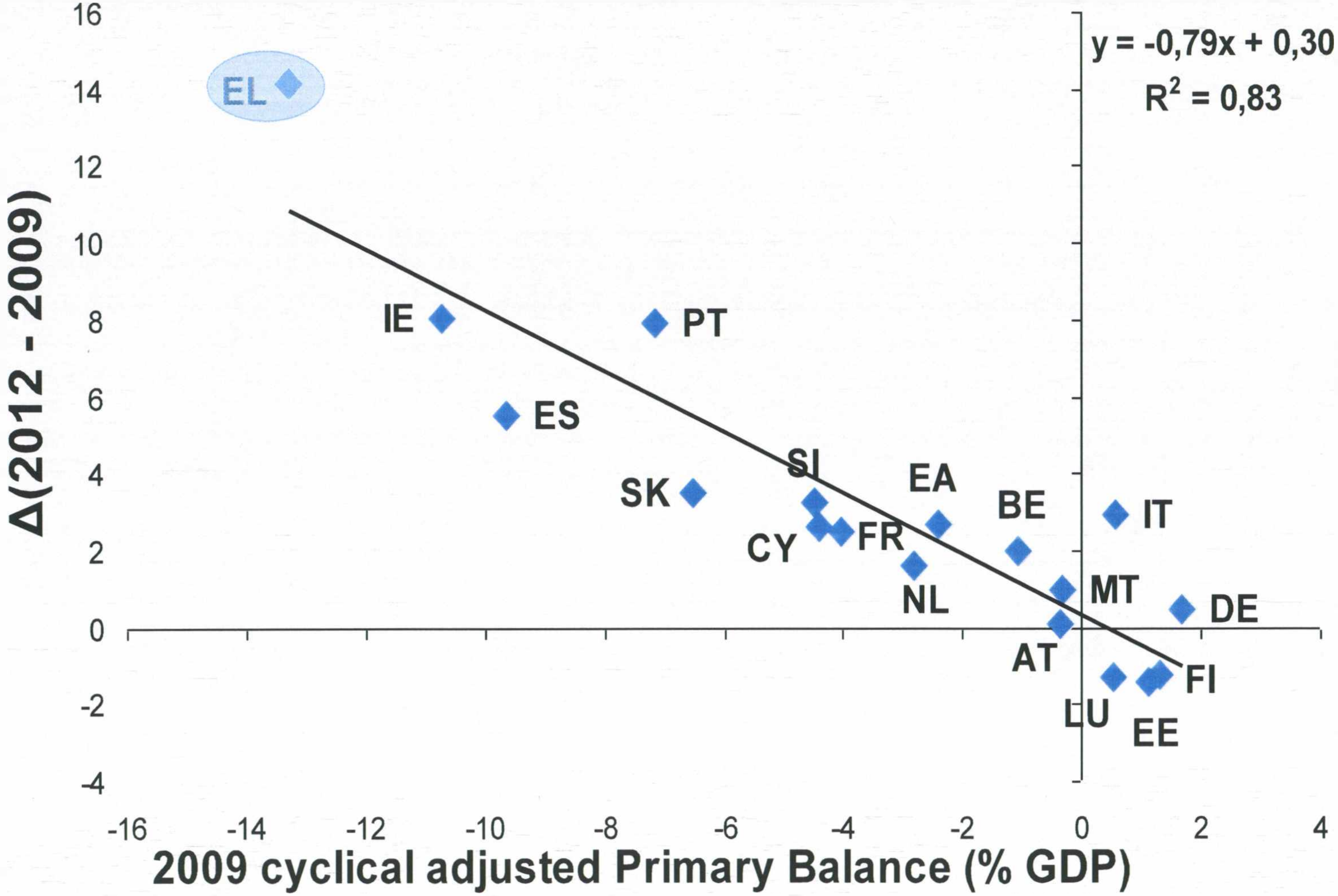


Greece: General Government, Fiscal Progress

	Revenue (€bn)	Primary Expenditure (€bn)	Expenditure – Wages, Pensions, Benefits (€bn)	Primary Balance (% GDP)	Deficit (% GDP)
2009	88.6	112.8	80.0	-10.5	-15.6
2010	90.2	101.1	75.0	-4.9	-10.8
2011	88.2	93.0	73.1	-2.3	-9.6
2012	85.7	88.4	71.1	-1.5	-7.0

III.1 DRASTIC FISCAL CONSOLIDATION COMPARED TO OTHER COUNTRIES

- Compared to other countries, the Greek fiscal adjustment in the three years between 2009 and 2012 is huge, both:
  - in absolute terms as % GDP
  - and in relative terms, as a function of the starting point, i.e. above the regression line



Source: European Commission

III.2 SUCCESSFUL REFORMS

LABOR MARKET REFORMS

- **Adjustment / Reduction of wage floors:**
  - 22% reduction in the minimum wage
  - 32% reduction in the minimum wage for employees under the age of 25
  - Reduction of severance payments
  - Abolition of automatic (3-year) wage increases
  - Annulment of the marriage allowance
- **Structural measures to level the playing field in collective bargaining**
  - Shortening length of collective contracts and reduction of their 'after effects' time
  - Removal of 'tenure' (contracts with definite duration defined as expiring upon age limit or retirement) in all existing legacy contracts in all companies.
  - A freeze of 'maturity' (referring to all automatic increases in wages dependent on time) until unemployment falls below 10%.
  - Elimination of unilateral recourse to arbitration
- **Adjustment to non-wage labor costs:**
  - Close earmarked funds engaged in social expenditures (OEK, OEE)
  - Decrease by 1.1% in employer contributions to social security funds as of Nov 1, 2012
- **Elimination of other restrictions**
  - On minimum/maximum time between morning and afternoon shifts
  - Increase from 5 to 6 per week maximum workdays in retail establishments

III.2 SUCCESSFUL REFORMS

PENSION & HEALTH CARE REFORMS

- Future rise in public pension expenditure not to exceed 2.5 % of GDP or the EU-wide average of 14% - (5/2010)
- Retirement age in line with life expectancy, already 67 from 65 previously; benefits linked to lifetime contribution; disincentives for early retirement
- Health expenditure not to exceed 6% of GDP (2nd MoU)
- Social security funds merged into one (EOPYY), equalizing benefits and contributions
- Overhaul of the list of difficult and hazardous occupations, Disability criteria and rules revised (since Sep. 2011)
- Pharmaceutical expense reduction (2nd MoU)
- Increased contribution of insured

PUBLIC SECTOR REFORMS

- **Single Payment Authority** established
- **Wage grid** adopted aimed at creating simplified uniformed remuneration system
- **Census of civil servants** (717,792 employees on public payroll)
- **Local government reform**
  - Municipalities reduced from 1034 to 325
  - Local authority entities reduced from 6,000 to 1,160
  - Decrease of elected officials from 30,795 to 16,657

III.3 EASE OF DOING BUSINESS 2013: GREECE RANKS 78th FROM 89th IN 2012

	Rank	Δ(2011-12)	Starting a business (days)	Protecting Investors (0-10)	Exporting Goods (days)	Resolving insolvency (years)	Paying Taxes (hours/year)
OECD			12	6.1	10	1.7	176
US	4	0	6	8.3	6	1.5	175
GR	78	11	11	4.7	19	2.0	202
CY	36	1	8	6.3	7	1.5	147
DE	20	-2	15	5.0	7	1.2	207
FR	34	-2	7	5.3	9	1.9	132
IT	73	2	6	6.0	19	1.8	269
ES	44	-2	28	5.0	9	1.5	167
IE	15	1	10	8.3	7	0.4	80
PT	30	0	5	6.0	13	2.0	275

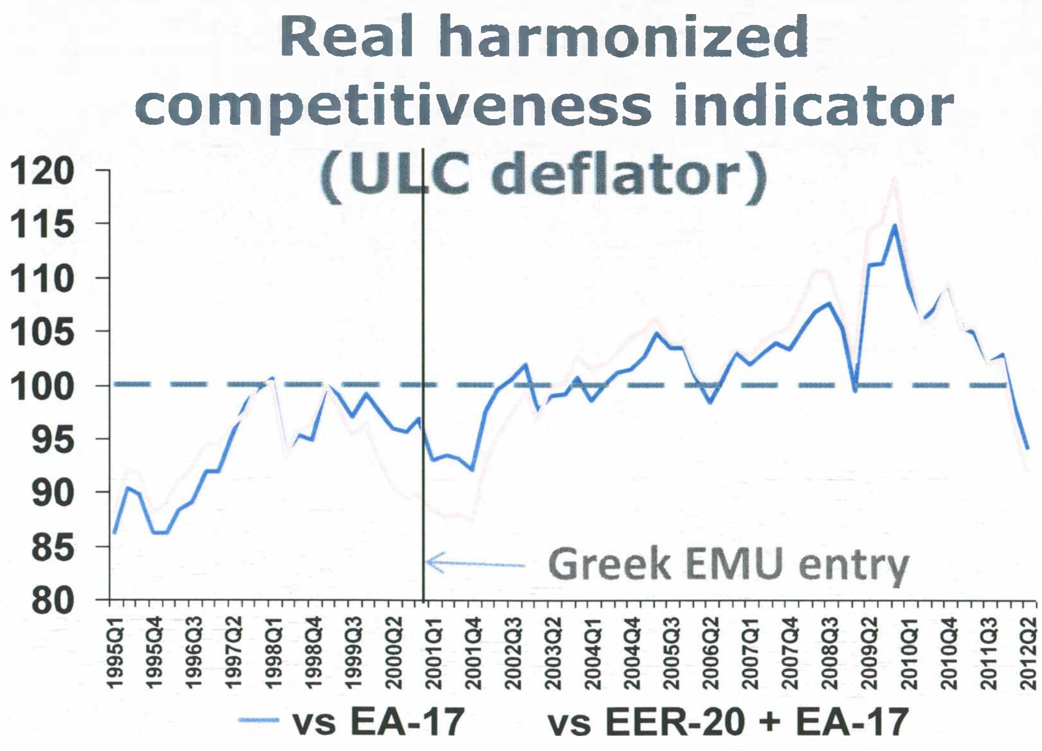
- The first improvement in years in a competitiveness index. Columns include results from selected questions that compose various sub-indices
- Greece is among the 10 economies globally that improved the most
- The DB 2013 covers 185 countries and describes the regulatory environment of each country measured from June 2011 through May 2012.

III.3 A GRADUAL IMPROVEMENT IN GREEK COST COMPETITIVENESS HAS BEGUN

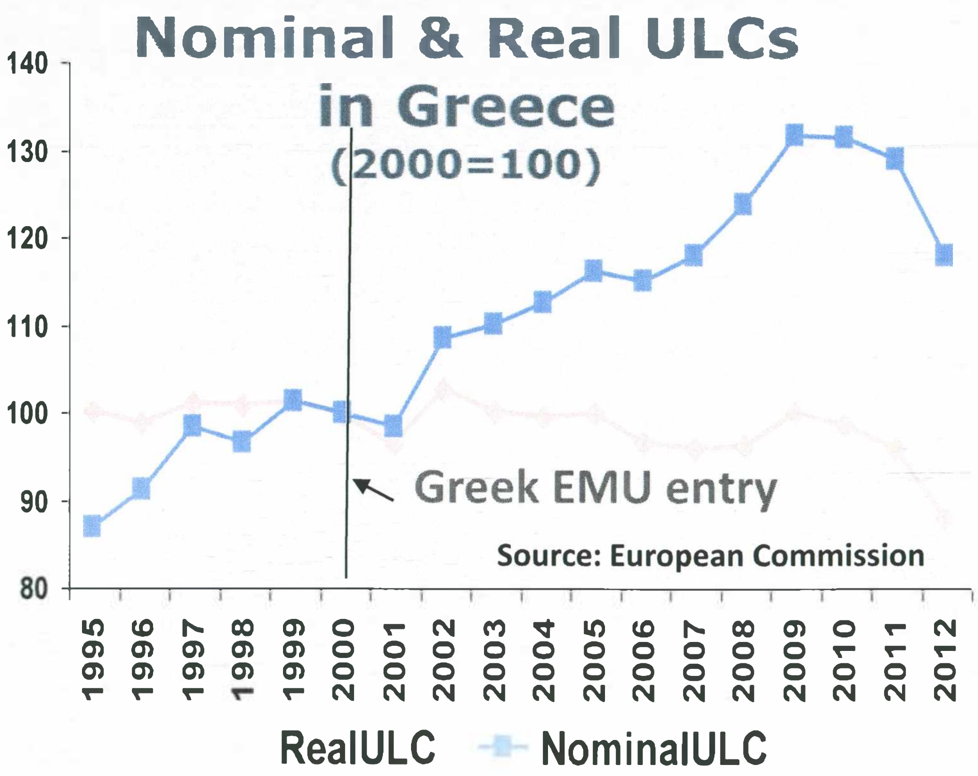
NOMINAL UNIT LABOR COSTS

% Δ	GR	CY	DE	FR	IT	ES	IE	PT	US	EA17	EU27
2000 - 2009	33.2	31.0	5.6	22.4	31.4	33.8	34.6	26.8	18.2	21.0	23.2
2009 - 2012	-10.5	2.0	3.1	3.9	2.7	-6.0	-10.3	-6.1	3.3	1.5	2.4

Source: European Commission



Source: ECB

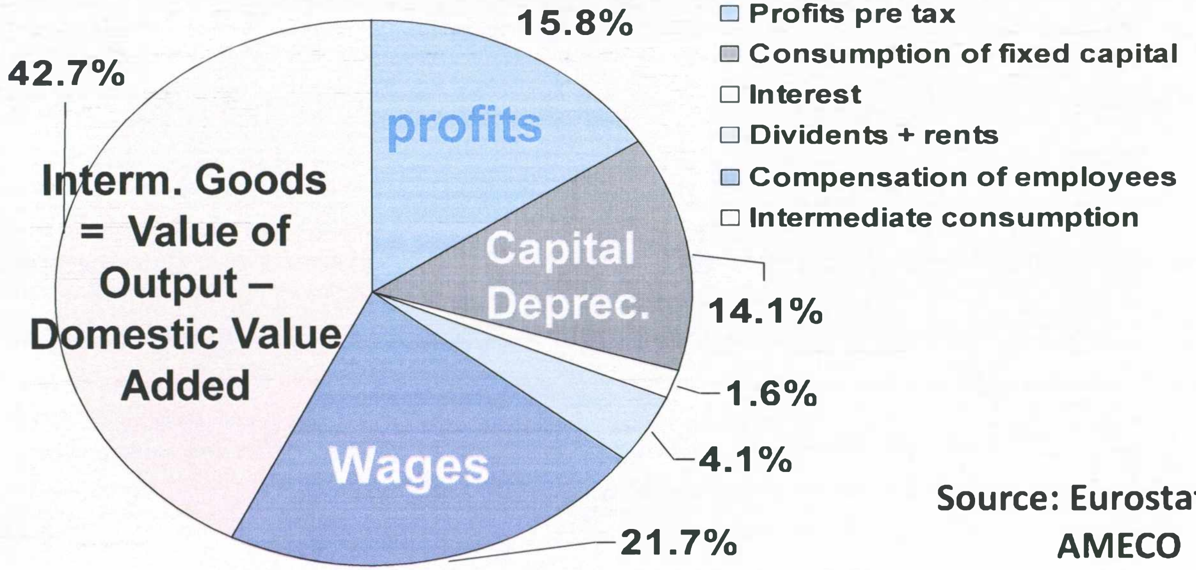


III.3 PROCUCT MARKET REFORMS : IMPLEMENTATION & DELIVERY CAN TAKE TIME

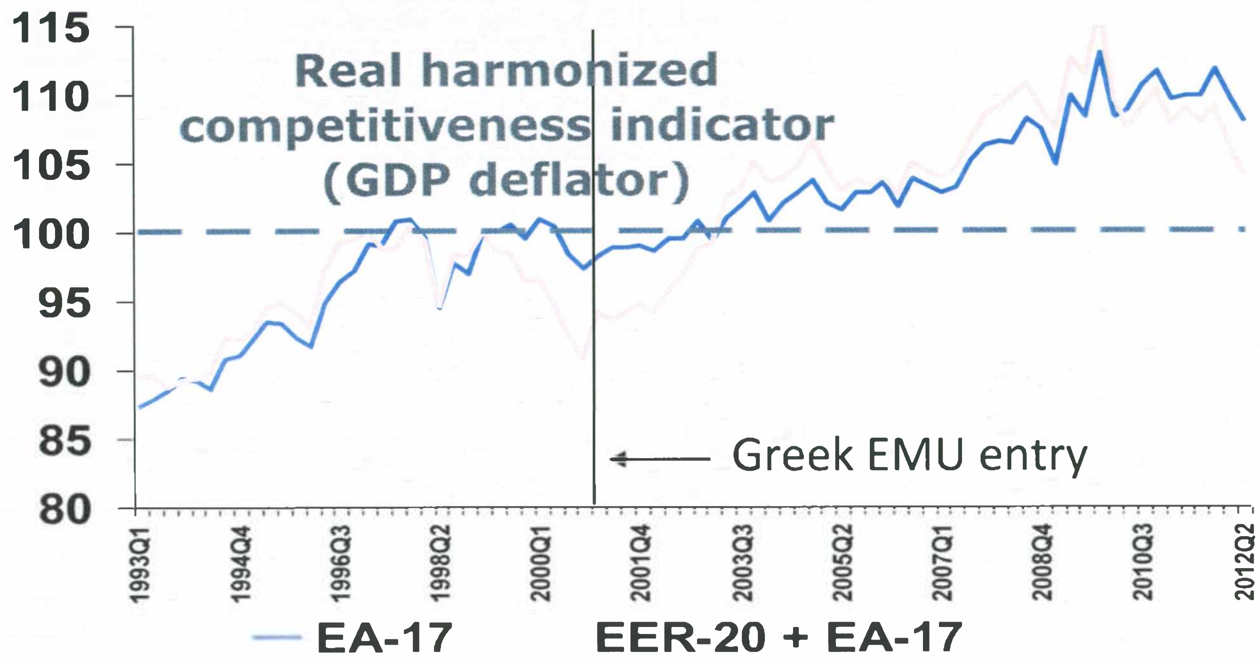
- Prices are not falling as fast as wages, partly due to small share of labor cost (22%) in output price of domestic non-financial private sector
- Yet this also indicates *ceteris paribus* that competition in product and service markets remains a challenge
- Resistance of many interest groups
- Unlike the labor market, product & service markets are many and diverse, hence the effort requires commitment and trained human resources

Producer Price Pre-tax Decomposition

(% of Production Value of Non-Financials)

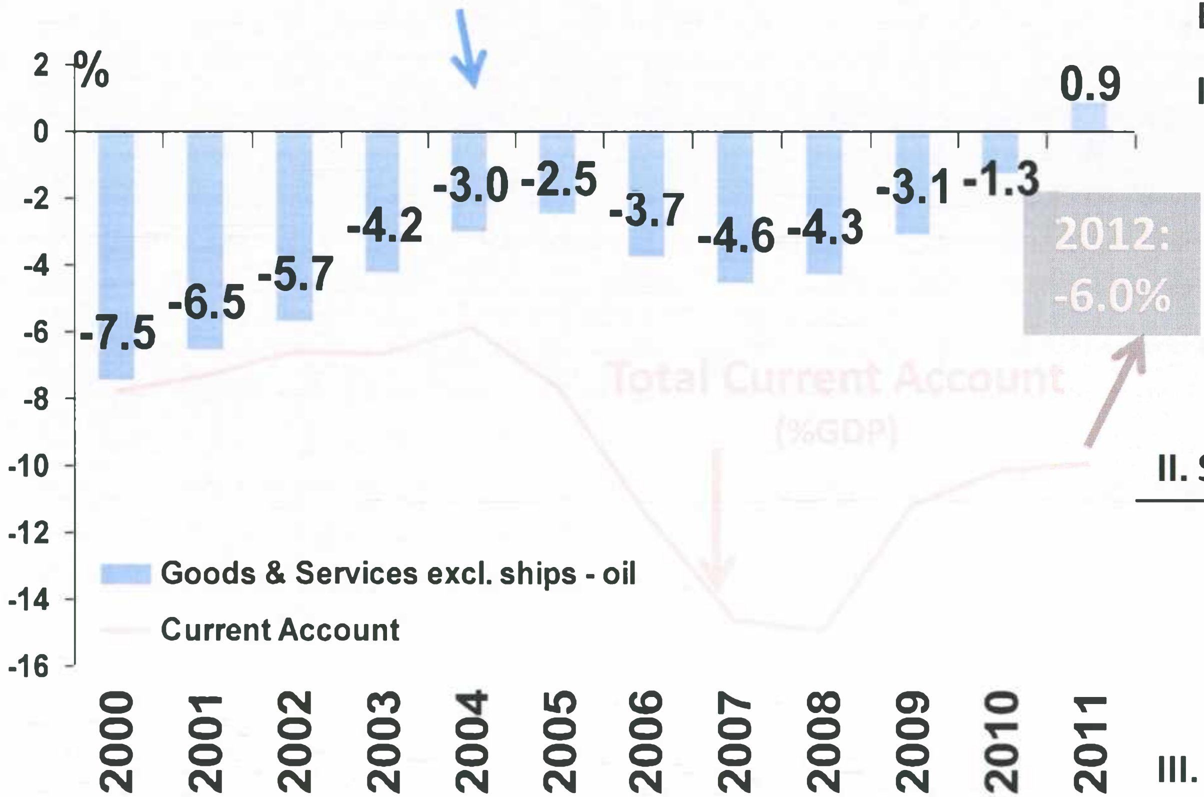


Source: Eurostat, AMECO



III.3 EXTERNAL SECTOR ADJUSTMENT

Balance of Goods & Services
excl. Ships and oil
(% of GDP)



Source: BoG, Eurobank EFG Research

2011	€ bn	% GDP
Current Account (I+II+III+IV)	-20.6	-9.9
I. Goods	-27.2	-13.1
Exports	20.2	9.7
Imports	47.5	22.8
Oil Balance	-11.1	-5.3
Trade Balance excluding oil	-16.1	-7.7
Ships' Balance	-3.3	-1.6
Trade Balance excl. oil - ships	-12.8	-6.2
II. Services	14.6	7.0
Travel	8.2	4.0
Transportation	6.9	3.3
Other services	-0.5	-0.2
III. Income	-8.6	-4.1
Compensation of employees	-0.3	-0.1
Investment income	-8.3	-4.0
IV. Current Transfers	0.6	0.3

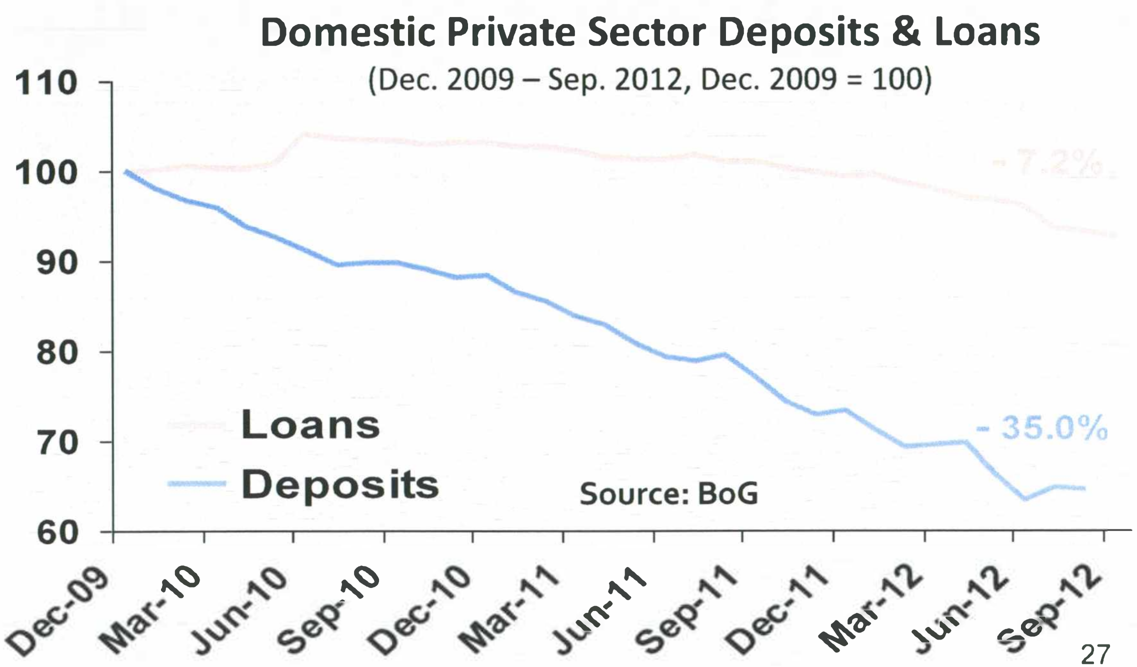
III.4 BANKS CONTINUE TO PROVIDE INTERMEDIATION

- Loans fell by less than deposits as banks continue to **restructure loans,** keeping low the NPL increase
- **Deposit withdrawal** stopped after June 2012 elections
- **Bank liquidity support from the State**
  around **€150bn**, mostly in the form of State guarantees (not a cost for the State Budget), utilized (along with other bank assets) for obtaining **ca €130bn** in Eurosystem liquidity (ECB & ELA facility), so as to cover
  - deposit withdrawals (> €80bn since 2009)
  - buy Greek government bonds & bills

Domestic Private Sector

(€ bn)	Loans	Deposits		Loans	Deposits
2007	215.1	197.9	Jan. 2012	248.7	169.0
2008	249.3	227.6	Mar. 2012	244.7	165.4
2009	249.3	237.5	May 2012	241.7	157.4
2010	257.5	209.6	Jun. 2012	239.8	150.6
2011	248.1	174.2	Jul. 2012	233.9	153.9
			Aug. 2012	232.6	153.4
			Sep. 2012	231.4	154.3

Source: BoG



III.4 EUROSYSTEM PROVIDES LIQUIDITY SUPPORT … BUT NOT A LENDER OF LAST RESORT

- ECB intervened to provide liquidity to the banking system, thus averted the typical ***Sudden Stop*** in financing imports to Greece, which usually accompanies a country crisis
- Yet ECB does not act as proper lender of last resort as the ELA mechanism is more costly (extra 2pps). **Periphery suffers from restrictive monetary policy at a time of restrictive fiscal policy**!

Bank Borrowing from the ECB

	EA			Greece		
	a	b	c	a*	b	c
Jun-07	464.6	28,026	1.7	4.3	353.4	1.2
Jun-08	483.0	30,839	1.6	11.6	424.7	2.7
Jun-09	896.8	31,804	2.8	54.0	491.2	11.0
Jun-10	870.4	32,578	2.7	94.3	544.7	17.3
Jun-11	497.5	31,736	1.6	103.1	502.5	20.5
Jun-12	1,260.9	34,181	3.7	135.8	437.6	31.0
Aug-12	1,209.8	34,158	3.5	131.8	438.5	30.1
			CY	13.3	134.7	9.9

(a) Total Lending from the ECB (€bn)

(b) Total Banks Assets (€bn)

(c) % ratio a/b

* plus lending from the BoG through ELA

IV.

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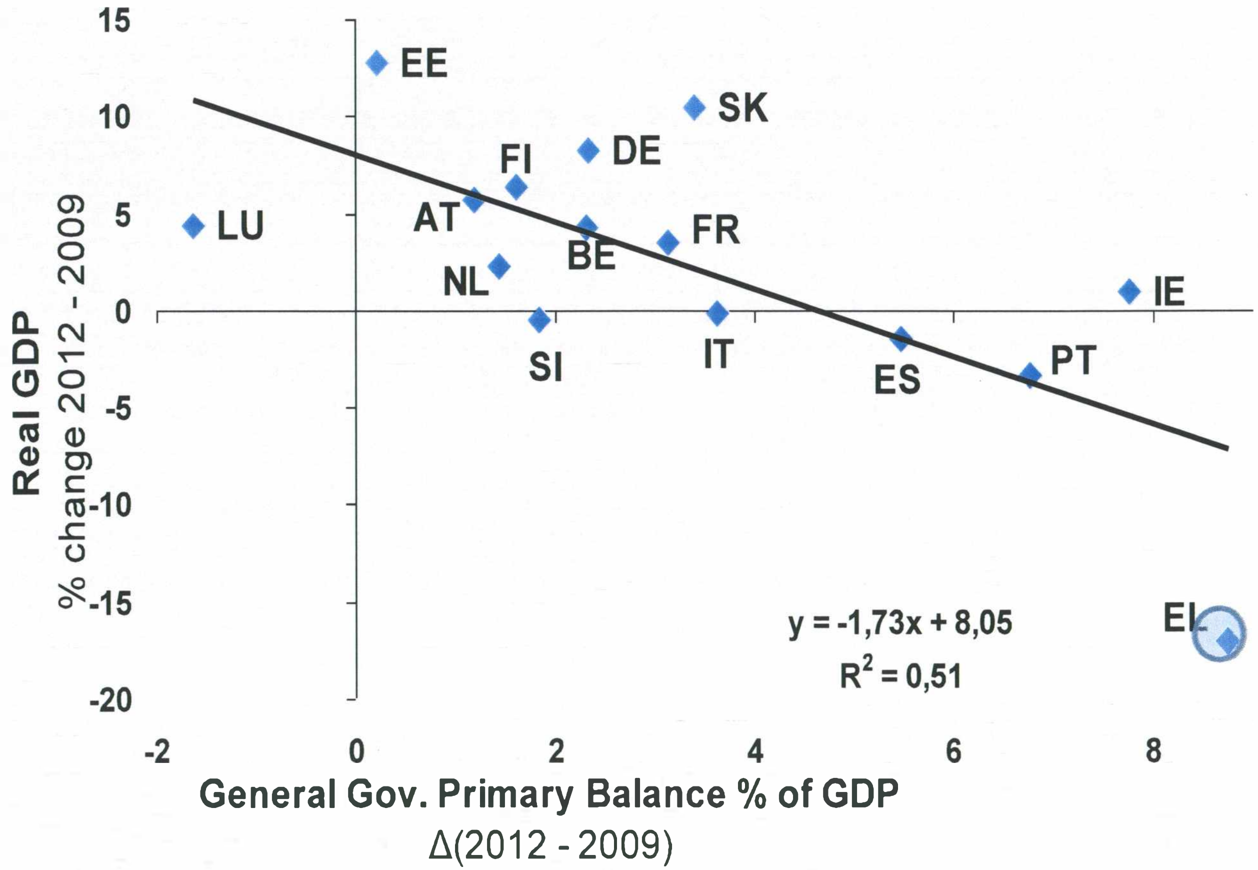
GREECE: TWO LEGS OF THE UNHOLY TRINITY ARE PARTICULARLY PROBLEMATIC

- Growth as # 1 concern: Recession deepens as fiscal multiplier bigger than assumed in the MoUs, also causing hysteresis and threatening the sustainability of debt
- Forecasts of the 2013-2016 Fiscal Adjustment Program are based on a success scenario & a 2-yr extension, unclear yet how it will be funded
- Danger of a major economic implosion present, given that political risk is high: Intermediate fiscal program voted by a narrow margin of 153/300 on Nov 7, 2012 and with no in-depth debate of available choices
- Debt sustainability a major concern, Troika divided on financing method
- The third leg of the Unholy Trinity, the banking crisis, although serious, can be solved endogenously by an economic recovery

IV. FISCAL AUSTERITY PROLONGS THE RECESSION

- Recent IMF and Eurobank studies confirm that the fiscal multiplier is larger during recessions
- From 2009 to 2012, a reduction in primary deficit of 9% GDP was associated with a drop of 17% in real GDP
- A vicious cycle is in progress, with more fiscal austerity causing a deeper recession
- Hence, a further reduction in the primary balance of 6% GDP could possibly add another cumulative contraction of over 10%

Greek MoUs underestimated the size of the fiscal multiplier



IV. MEASURES OF FISCAL CONSOLIDATION

POLICY TARGET	2009	2010	2011	2012	2013	2014	2015	2016
Primary Balance (€ bn)	-24.1	-10.9	-4.8	-2.9	0.0	2.7	5.6	8.8
Primary Balance (% GDP)	-10.6	-5.0	-2.4	-1.5	0.0	1.5	3.0	4.5

- Fiscal consolidation to make the Greek public debt sustainable
- The cut in the primary deficit by over 9% of GDP from 2009 to 2012 is scheduled to be followed by a further cut of additional 6% of GDP
- This further consolidation is expected to prolong the recession

Austerity Package, 2013-2014	€bn
1. Expenditure cuts (α+β)	9.8
α. Wages, Pensions and Benefits	6.1
β. Other Expenditure cuts	3.7
2. Revenues	3.8
Total (1+2)	13.6
Austerity Package 2015-16	
A. Identified measures for 2015-16	0.7
B. Unidentified measures for 2015-16	4.6
Total (A+B)	5.3
Austerity Package for 2013-2016	18.9

Source: MTFS 2013-16, 11/2012

IV. YET, IS PUBLIC DEBT SUSTAINABLE ?

	2007	2009	2010	2011	2012	2013	2014	2015	2016
Debt (€ bn)	239.3	299.7	329.5	355.7	340.6	346.2	350.1	357.7	363.4
GDP (€ bn)	223.2	231.1	222.2	208.5	194.0	183.0	182.7	187.7	196.5
Revenues (€ bn)	90.9	88.6	90.2	88.2	82.4	77.5	78.4	78.1	81.5
Expend. (€ bn)	106.0	124.7	114.3	108.0	95.9	87.5	85.3	86.3	87.9
Deficit (€ bn)	15.1	23.1	36.1	24.1	13.5	10.1	6.9	8.2	6.3
Interest (€ bn)	10.7	11.9	13.2	15.0	10.4	10.1	11.0	12.1	12.7
Debt (%GDP)	107.2	129.7	148.3	170.6	175.6	189.1	191.6	190.6	184.9
Revenues (%GDP)	40.7	38.3	40.6	42.3	42.5	42.3	42.9	41.6	41.5
Expend. (%GDP)	47.5	54.0	51.4	51.8	49.4	47.8	46.7	46.0	44.7
Deficit (%GDP)	6.8	9.9	15.6	10.8	7.0	5.5	3.8	4.4	3.2
Interest (%GDP)	4.8	5.1	5.9	7.2	5.4	5.5	6.0	6.4	6.5
Debt (%Rev)	263.3	338.3	365.3	403.3	413.5	446.8	446.7	457.8	445.7
Interest (%Rev)	11.8	13.4	14.6	17.0	12.6	13.0	14.0	15.5	15.6
Real Growth (%)	3.5	-3.1	-4.9	-7.1	-6.5	-4.5	0.2	2.5	3.5
GDP deflator (%)	3.3	2.3	1.1	1.0	-0.5	-1.2	-0.4	0.3	1.1

Source: AMECO for 2007-2011, MTFS 2013-16 for 2012-2016

IV. ADDITIONAL MEASURES AS FORECASTS CHANGED AND ELRLIER MESURES REVEALED THEIR EFFECTIVENESS

TARGETS for end-2012	May 2010 (1st MoU)	Dec 2010 (1st review)	Jul 2011 (1st MTFS)	Oct 2011 (1st PSI)	Mar 2012 (PSI)	Nov 2012 (EU draft)
Total Measures* (2010-2012, € bn)	33,1	41,0	42,5	49,7	48,9	>48,9
Total Measures (2010-2012, % GDP)	14,5	17,8	18,7	22,6	22,6	>23,3
Estimated Real GDP(% Δ 2009)	-5,5	-6,1	-7,6	-11,4	-14,4	-17,0
Nom. GDP (%Δ 2009)	-3,9	-1,3	-3,1	-8,5	-12,1	-15,6
Prim Balance (€ bn)	2,2	2,2	3,0	0,2	-2,0	-2,9
Prim Bal (% GDP)	1,0	1,0	1,3	0,1	-1,0	-1,5
Prim Bal (Δp.p. 2009)	9,6	11,1	11,6	10,4	9,6	9,0
Fiscal Balance (€ bn)	-14,9	-14,9	-14,9	-14,9	-14,8	-13,4
Fiscal Bal (% GDP)	-6,5	-6,4	-6,5	-7,0	-7,3	-6,9
Fisc Bal (Δp.p.2009)	7,1	9,0	8,9	8,4	8,5	8,7
Public Debt (€ bn)	340,1	363,8	367,5	384,7	327,0	344,7
Debt (% Δ 2009)	24,4	22,1	23,0	28,8	9,2	15,0
Debt (% GDP)	148,7	156,9	161,3	181,3	160,5	176,8
Debt (Δp.p.2009)	33,9	30,1	34,2	54,2	31,2	47,1

* including measures taken on government's will, outside an MoU plus carry-over impacts. Troika adjusted the measures based on effectiveness on earlier measures and revisions of estimates of future nom. GDP growth

IV. COMPOSITION OF PRE-PSI (2011) & POST-PSI (2012) DEBT

- Decline in public debt between end-2011 and end -2012 of only € 15.1 bn
- Released loans until November 14, 2012
  - EFSF: € 74.0 bn
  - IMF: €1.7 bn
- Remaining amount to be released by end-of 2012
  - EFSF: €39.7 bn
  - IMF: €4.8 bn
- End-2014 total official assistance (2nd MoU) €164.5 bn, of which €120.8 bn to be disbursed by end-2012 (including the €44.5 bn)

End-year General Government Debt in € bn

Source: IMF, AMECO, MTFS 2013-16, Brugel, Eurobank Research	2011	2012	2012 % of total
Restructured bonds	199.2	62.8	18.4%
Hold-outs	6.4	5.5	1.6%
T-Bills	15.1	15,1	4.4%
Others	4.7	4.0	1.2%
ECB/NCBs holdings	56.5	45.1	13.2%
IMF loans	20.7	27.2	8.0%
Bilateral EU loans	53.1	53.1	15.6%
EFSF loans (PSI Notes & Accrued Interest)	0	34.5	10.1%
EFSF loans (2nd programme)	0	93.3	27.4%
Total	355.7	340.6	100.0%

Note: The EFSF (2nd Program) money of €93.3bn is a residual that brings total debt to €340.6 at end-2012. A gap of € 14.3bn exists.

IV. THE LONG-TERM REAL ECONOMY CHALLENGE: REBALANCING THE COMPOSITION OF GDP

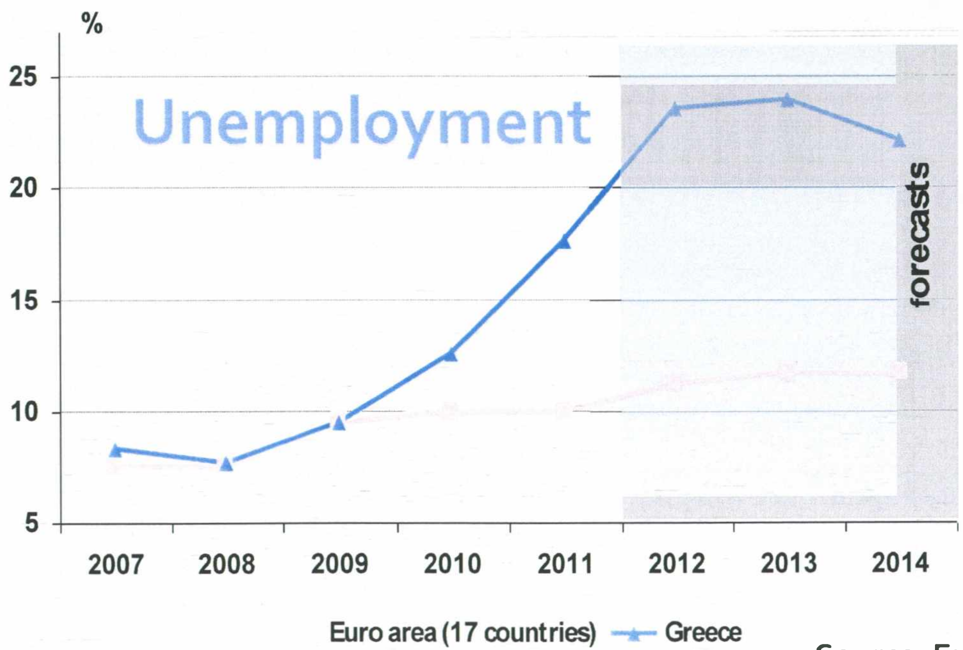
- Greek society over-consumes and under-produces, as evidenced by the large share of private consumption in output and the large gap between exports & imports
- The reduction in the share of consumption in output is necessary, yet it has to proceed smoothly to avoid an economic crash

(2011, % of total GDP)	Greece	EA-17
Private Consumption	**74.6%**	**57.4%**
Public Consumption	**17.4%**	**21.6%**
Private Investment	**11.3%**	**17.1%**
Public Investment	**2.9%**	**1.7%**
Exports	**25.1%**	**44.0%**
Imports	**33.1%**	**42.6%**
GDP (€ bn) - 2011	**208.5**	**9420.6**

- The investment share is dangerously small, around 14% of GDP from 25% a decade ago. In 2011, depreciation was larger than new investment, resulting in negative net investment and a destruction of capital stock
- Public investment declined instead of going up to counter the recession
- Exports ought to continue their rise but liquidity constraints bite

IV. GREECE SUFFERS FROM LACK OF DEMAND AS CUMULATIVE RECESSION REACHES RECORD LEVELS

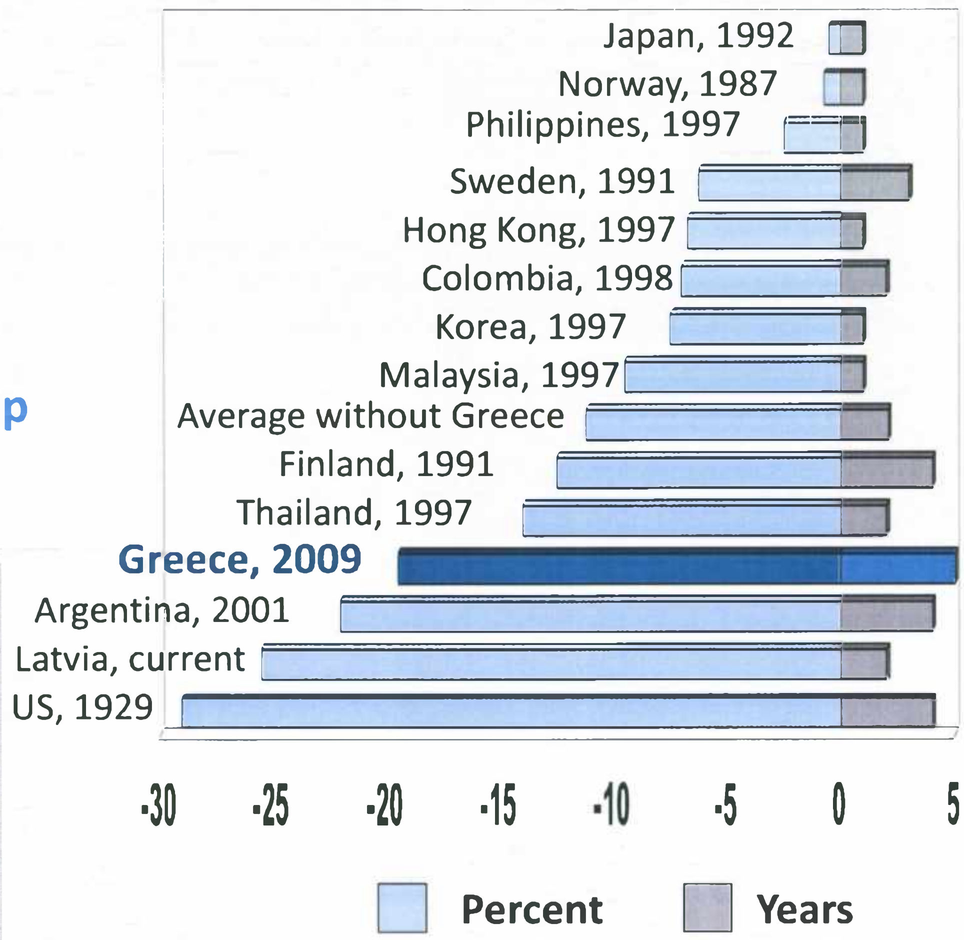
- The cumulative recession will continue into 2013 and is one of the worst in global history over the last 80 years
- Risk of social upheaval rises as incomes collapse and unemployment worsens
- Some policies that improve potential GDP may hurt current demand
- The most important policy task is to stop the recession



Source: Eurostat, Draft 2013 Budget

Historical Crises:

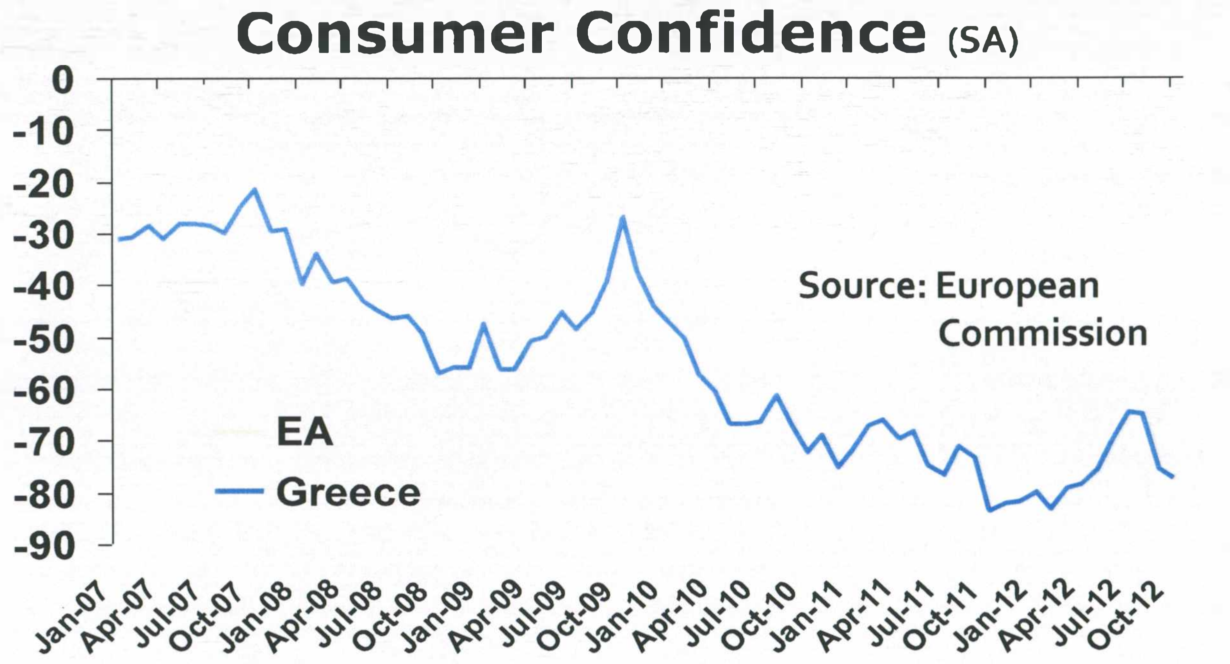
% Cumulative loss in Output & Duration

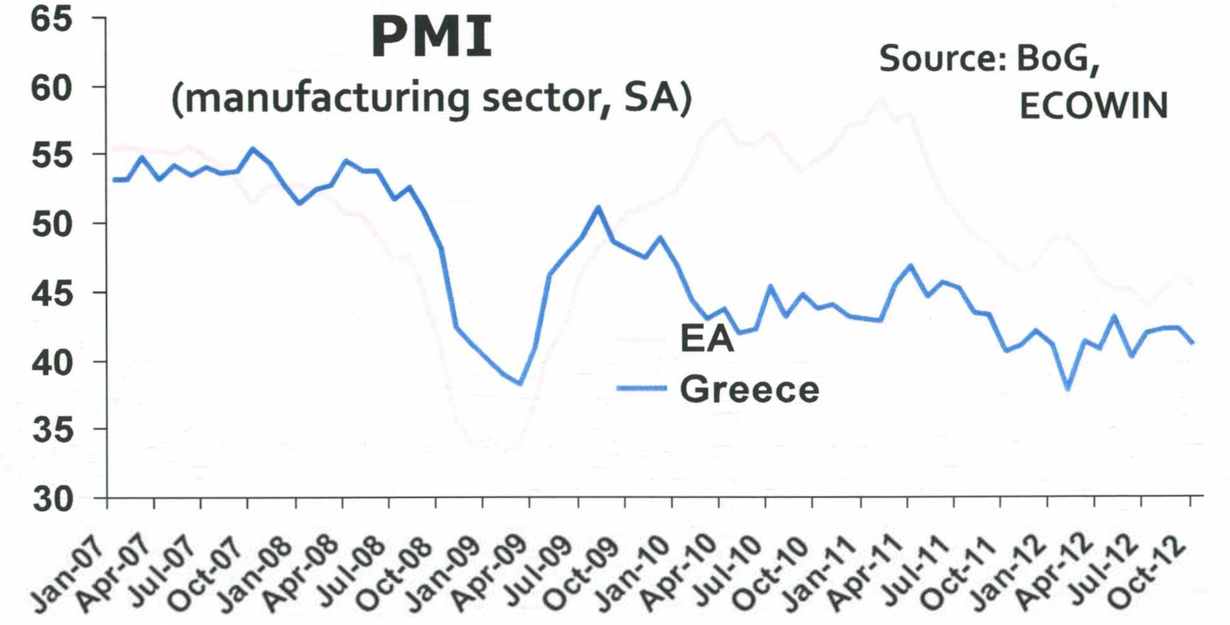


Source: IMF (2010), Reinhart & Rogoff (2009)

IV. AT TIMES OF AUSTERITY, FOR THE RECESSION TO STOP, A NUMBER OF PREREQUISITES EXIST

- Political stability & Credibility, which would improve if,
  - Reforms proceed at a faster pace, particularly the taxation of self-employed
  - Government re-invents itself
- Liquidity, which is a suffocating constraint even for exports, thus
  - front-loading the economy with cash
  - Resolving debt-sustainability
- Reversal of Sentiment and investment pessimism
- Increase in Public Investment
- Restructuring of the State sector





IV. PRIVATIZATIONS NEED A JUMP-START, CAN IMPROVE CREDIBILITY

- Assets to be privatized are in real estate (55% of value), infrastructure (35%) and other (10%), which include lottery, banks, energy and old industrial firms (including selling the HFSF bank shares after their recapitalization)
- Privatizations expected to generate €9.6 bn by 2016 (€2.6 bn in 2013). The privatizations programme will continue after 2020 in order to achieve the €50 bn target.
- So far revenues of only €1.8bn
- New management team
- Major risks for the privatizations process a) GREXIT scenario and related uncertainty, b) political cost considerations, c) legal disputes over the real estate portfolio

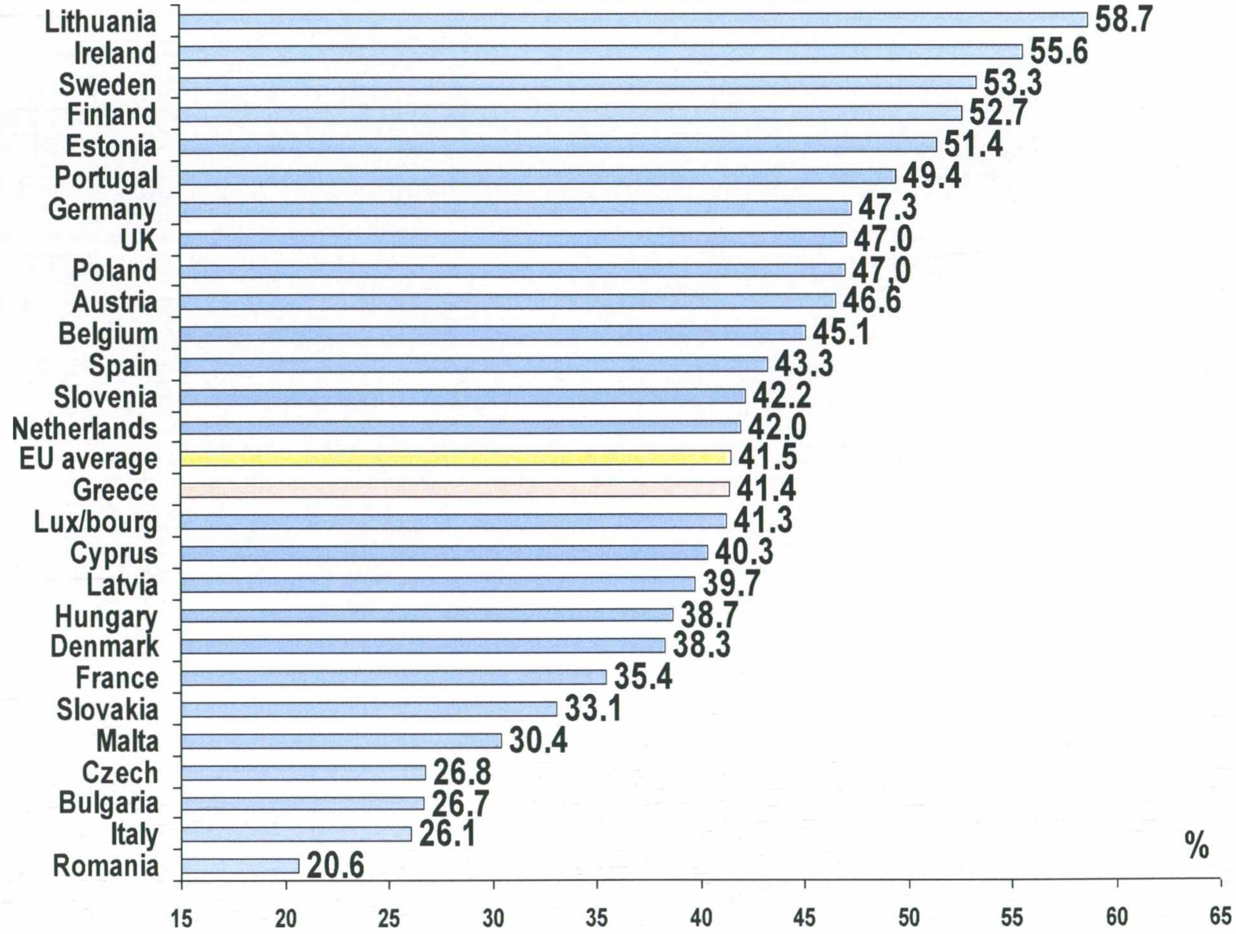
Cosco Pacific, an example of a past successful privatization

- Cosco Pacific, a unit of China Ocean Shipping, paid around € 4.0 bn in October 2009 for an initial 30-year (with a 10-year extension option) concession to develop and run container operations in Piraeus
- Greek state receives a minimum annual fee during the 30 years
- Cosco concession is the main driver for the upgrade of the Piraeus port:
  - Cosco bought a pier and upgraded a second one in June 2012 , Pier 11, increasing annual capacity by 1 million TEUs to 2.6 million TEUs
  - Cosco to build a third pier before 2015, which will add 1.1 million TEUs
  - Piraeus Port is a star performer in Cosco's terminal portfolio, a 69.5% YoY volume increase in June 2012, with Singapore ranking second with a 28.8% YoY increase

IV. ABSORPTION OF STRUCTURAL FUNDS

- ~ **€14bn** of public (EU + national) funds or **1.9%** of GDP/annum available
- ~ **3 years** left to utilize them
- Close to the **EU average** in **absorption rates.**
- Yet, MoU 2012 absorption targets at risk due to liquidity & bureaucratic problems
- In 2014-2020 programming period, Greece expected to receive around **€12bn**, much less compared with the **€20.4bn** available under the NSRF
- This estimate can increase only if the recent economic crisis on Greek regional GDP will be taken into account in calculating relative living standards across EU-27

EU Member States absorption rates (% of funds allocated per Member State already disbursed by the Commission) (end of July 2012)



Source: EU Commission

SUMMARY

- Current **EMU crisis** has **three legs**: Sovereign, competitiveness, banking, which are inter-related, thus complicating the policy solutions
- This is a deep crisis as the culprit is **lack of EMU cohesion**, which originates from the **absence** of **OCA** and **requires tighter EMU integration**, instead of piecemeal measures that respond to market pressure: **Time for politicians to be strategists**
- In 2009, **Greece** suffered from only **two legs** of the crisis and responded by
  - Fundamental reforms in social security, central administration and labor markets, yet a less aggressive attitude in remaining reforms that were politically sensitive
  - An unprecedented-in-magnitude fiscal contraction, which is scheduled to continue despite the recession and the political turmoil, thus shrinking the state sector from 1/2 to 1/3 of the economy
- **Stopping the vicious cycle of austerity & recession is a major challenge**
  - Requires credibility, liquidity, improved sentiment : Investment & Exports have to fill in the gap in Aggregate Demand as consumption adjusts downward
  - Europeans have to act smartly and front-load the economy with cash
- Need to **revamp tax collection mechanism** and **jump start privatizations, free up product & service markets** and **re-organize State sector**
- Debt sustainability remains an issue, although less pressing as growth picks up
- Improved cost competitiveness, a new export-led economic paradigm, a re-capiltalized financial sector and structural reforms imply that, once recovery starts, **growth can take off**