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Country report **GREECE**

Summary

Due to the self-defeating character of the huge austerity package, the Greek economy still experiences a deep recession while the government did not manage to continue narrowing the budget deficit substantially. Despite the second bailout and the significant debt relief as a result of the PSI, the sustainability of the Greek government debt is still highly questionable. As the progress under the rescue package is subject to large implementation and political risks, the possibility of a further (disorderly) default is elevated and even a eurozone exit cannot be ruled out entirely.

Things to watch:

- Parliamentary elections and resulting support for bailout program.
- Level of progress regarding austerity measures and reforms in second bailout program.
- Future political willingness of Europe and the IMF to assist the Greek government.

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Greece

National facts		
Type of government	Parliamentary republic	
Capital	Athens	
Surface area (thousand sq km)	132	
Population (millions)	11.3	
Main languages	Greek (99%)	
	Other (1%)	
Main religions	Greek Orthodox (98%)	
	Muslim (1.3%)	
	Other (0.7%)	
Head of State (president)	Karolos Papoulias	
Head of Government (prime-minister)	Lukas Papademos	
Monetary unit	EUR	

Economy		2011
Economic size	*bn USD*	*% world total*
Nominal GDP	299	0.43
Nominal GDP at PPP	298	0.38
Export value of goods and services	68	0.31
IMF quotum (in mln SDR)	1102	0.51
Economic structure	*2011*	*5-year av.*
Real GDP growth	-6.9	0.3
Agriculture (% of GDP)	4	3
Industry (% of GDP)	17	18
Services (% of GDP)	79	78
Standards of living	*USD*	*% world av.*
Nominal GDP per head	26537	246
Nominal GDP per head at PPP	26375	214
Real GDP per head	20089	247

Social and governance indicators	rank / total
Human Development Index (rank)	29 / 187
Ease of Doing Business Index (rank)	100 / 183
Index of Economic Freedom (rank)	119 / 179
Corruption Perceptions Index (rank)	80 / 183
Press Freedom Index (rank)	70 / 178
Gini index (income distribution)	34.3
Population below $1.25 per day (PPP)	n.a.

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
Germany	11	Germany	11
Italy	11	Italy	10
UK	7	Russia	10
Bulgaria	7	South Korea	6
Main export products (%)			
Food, drinks and tobacco			22
Chemicals and related products, n.e.s.			14
Machinery and transport equipment			12
Mineral fuels, lubricants, and related materials			11
Main import products (%)			
Machinery and transport equipment			24
Chemicals and related products, n.e.s.			24
Food, drinks and tobacco			15
Mineral fuels, lubricants, and related materials			11
Openness of the economy 2011			
Export value of G&S (% of GDP)			23
Import value of G&S (% of GDP)			29
Inward FDI (% of GDP)			0.1

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Full report:

The Greek economy suffers extremely hard from the harsh austerity measures which are being implemented as a condition to the first EU/IMF bailout agreed on in May 2010. GDP contracted by 3.5% and 6.9% in 2010 and 2011 respectively, mostly due to waning household consumption and business investments. The real Greek tragedy consists of the fact that, due to lagging implementation of growth enhancing reforms and the self-defeating character of the austerity measures, the budget deficit improved only slightly, from 10.6%-GDP in 2010 to 9.1% in 2011. The gross government debt increased with 20%-points in a single year to 165%-GDP in 2011. Based on very low levels of leading indicators, it is expected that the Greek economy will remain in a deep recession during 2012. The latest IMF forecast shows another annual contraction of 4.8% this year. Note that the IMF is way more optimistic than the EIU which forecasts an annual GDP-contraction of 7.1%. Given the unsustainably high interest rates on Greek government bonds it is crystal clear that the assumption under the first bailout package that Greece could gradually return to the markets in 2012, has turned out completely unrealistic. As the contagion risk to other peripheral countries of a disorderly Greek default, let alone of a eurozone exit, was considered too high, the eurozone countries and the IMF decided to bail out Greece for a second time.

Second bailout package

A precondition for new IMF and eurozone financing (worth of €130 billion) was participation of private bond holders (PSI). Based on the enforced collective participation of all holders of debt under Greek law and the so far voluntary participation of a part of the holders of debt under foreign law, at least €197 billion of debt will be subject to a debt exchange with a net present value loss of 70-75%. Until 2016 this will reduce the financing need of the Greek government by at least €86 billion and therefore has a substantial effect on the evolution of the government debt in the coming years.

The public and private financing will be given under strict preconditions, with a focus on three areas: 1) restore public finances, 2) stabilize the financial sector and 3) increase competitiveness. It should be noted that reforms in the abovementioned three areas interact with each other. For example, muted wage growth (internal devaluation) might boost competitiveness, but hampers economic growth in the short term, which makes the budget target more difficult to attain. Therefore the IMF has decided that this year the focus will be on increasing competitiveness, by altering collective bargaining and reducing both minimum wage and non-wage labor costs. The size of this year's austerity measures will then be limited to 1.5%-GDP, while in 2013 and 2014 a combined effort of 5.5%-GDP is required. In 2014 the budget deficit should be brought back to 2.1%-GDP, an extremely challenging target. As part of the rescue package, also the Greek banking sector needs to be stabilized. Greek banks need to be recapitalized due to sharply rising non-performing loans (14.7% in 11Q3), but – more importantly – due to the PSI-losses on government bonds. According to the IMF, these losses accumulate to €22 billion, which almost equals their total Tier-1 capital. An amount of €50 billion is reserved to stabilize the Greek financial sector, half of which will be used directly for recapitalization needs.

The outlook

Based on the PSI and all policy measures in the Memorandum of Understanding, Greek government debt should peak in 2013 at 167%-GDP and then trend downwards to 117%-GDP in 2020. This is based on the assumptions that the Greek economy will start growing aging during 2013 (annual growth 0%) and that the deficit will be brought back from 9.1%-GDP in 2011 to 2.1%-GDP in 2014. Amid all reforms to boost competitiveness, the current account should show a small surplus by 2020. However, we believe there are considerable downside risks to this optimal consolidation path, which is even admitted by the IMF itself. For example, if growth were to be 1%-point lower than the IMF's anticipation over the forecast period (2012-2020), then the debt ratio will be 129%-GDP instead of 117%-GDP. Given the difficult market conditions the estimated privatization cash flows might also be less than estimated (€50 billion, of which €19 billion should be sold by 2015). By end-2011, Greece had only sold €1.6 billion of public assets, compared to its target of €5 billion.

During the period of the rescue package, we believe the main threats of undershooting the targets (thereby risking the provision of a new tranche) are implementation risks due to weak bureaucratic capabilities and political risks due to limited political willingness. The first moment to test the political willingness will be the parliamentary elections. Both parties in the current interim cabinet of Lucas Papademos, New Democracy and PASOK, gave their explicit commitment to the conditions of the second bail-out. Many small left parties oppose to the bailout, but it is very questionable whether they will be able to form a coalition as they are highly divided. Based on current polls, a majority coalition of New Democracy and PASOK should be attainable, if needed backed by further pro-bailout seats. Such an election result would support political dedication to the current bail-out conditions.

Even when Greece manages to comply with the conditions of the rescue package until 2014, it is very questionable whether they will be able to return to the market as is assumed from 2015 onwards (for an amount of €9 billion). However, eurozone leaders expressed their commitment to provide sufficient support to Greece, also beyond the package, to let Greece retain market access as soon as possible. We believe the commitment to provide financial assistance beyond the second bailout package is dependent on the achieved Greek economic and fiscal progress and the political willingness by that time. Currently, a disorderly Greek default or even a eurozone exit is expected to lead to contagion to other peripheral member states. However, in a couple of years, this contagion risk might be more limited and the future of Greece might be less directly connected to the future of the eurozone. Therefore, given the risk of additional Greek financing needs both during and beyond the bailout program, we cannot rule out the possibility of a further (disorderly) default or even a Greek exit from the eurozone.

Greece

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	3.0	-0.2	-3.3	-3.5	-6.9	-7.1	-1.9
Consumer prices (average % change pa)	2.9	4.2	1.2	4.7	3.3	-0.1	-0.4
Current account balance (% of GDP)	-14.6	-14.9	-11.1	-10.1	-9.8	-5.1	-4.3
Economic growth							
GDP (% real change pa)	3.0	-0.2	-3.3	-3.5	-6.9	-7.1	-1.9
Gross fixed investment (% real change pa)	5.4	-6.7	-15.2	-15.0	-20.7	-3.3	0.0
Private consumption (real % change pa)	3.7	4.0	-1.3	-3.6	-7.1	-10.2	-2.4
Government consumption (% real change pa)	7.6	-2.1	4.8	-7.2	-9.1	-11.0	-9.0
Exports of G&S (% real change pa)	6.9	3.0	-19.5	4.2	-0.3	1.1	2.6
Imports of G&S (% real change pa)	14.6	3.3	-20.2	-7.2	-8.1	-14.2	-2.1
Economic policy							
Budget balance (% of GDP)	-6.8	-9.9	-15.8	-10.8	-9.3	-7.8	-5.4
Public debt (% of GDP)	107	113	129	145	162	158	165
Money market interest rate (%)	4.3	4.6	1.2	0.8	1.4	1.0	0.8
M2 growth (% change pa)	13	15	5	-11	-14	-2	1
Consumer prices (average % change pa)	2.9	4.2	1.2	4.7	3.3	-0.1	-0.4
Exchange rate LCU to USD (average)	3.7	3.7	3.7	3.7	3.7	n.a.	n.a.
Recorded unemployment (%)	8.3	7.7	9.4	12.5	17.3	21.7	23.3
Balance of payments (mln USD)							
Current account balance	-44686	-51173	-35972	-30484	-29323	-13030	-10320
Trade balance	-56880	-64778	-42867	-37522	-37884	-25120	-24050
Export value of goods	23911	29137	21342	22664	28158	26470	26860
Import value of goods	80792	93915	64209	60186	66042	51590	50910
Services balance	22741	25200	17611	17578	20373	21420	21500
Income balance	-12728	-15652	-12518	-10804	-12618	-11290	-10110
Transfer balance	2181	4057	1801	264	806	1960	2340
Net direct investment flows	-3303	2527	323	-541	-530	-530	-540
External position (mln USD)							
International investment position	-315727	-249377	-288501	-282171	n.a.	n.a.	n.a.
Total assets	279777	313339	375109	308456	n.a.	n.a.	n.a.
Total liabilities	595504	562716	663610	590627	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-18.6	-18.9	-13.3	-12.4	-12.7	-9.9	-10.0
Current account balance (% of GDP)	-14.6	-14.9	-11.1	-10.1	-9.8	-5.1	-4.3
Inward FDI (% of GDP)	0.6	1.5	0.7	0.1	0.1	0.2	0.2
International investment position (% of GDP)	-103.4	-72.8	-89.4	-93.6	n.a.	n.a.	n.a.

Source: EIU