

Greece: Monitoring the Crisis

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Will 2014 Mark Greece's Turn Around?

Greece has been experiencing six years of continuous recession that produced the longest and deepest depression in history during peacetime. Deep crises polarise society and drive a wedge between the 'official version' and the reality on the ground. Every year, the Athens government (and there have been three different ones over the last six years), along with the European Commission, issue optimistic statements according to which the crisis is "about to end" and recovery is around the corner. Yet, every year the crisis deepens and the social fabric is further depleted.

The question, therefore, is: Can 2014 be the year when the official forecasts are, finally, vindicated by the facts? Will 2014 be the year that the Greek economy turns around?

According to the 'official version,' all the signs are pointing to recovery. The government budget has been brought into primary balance (i.e. excluding any debt repayments), the nation's balance of payments has yielded a small surplus for the first time in many decades, the rate of GDP contraction has slowed to -2% (from a height of -7%), banks are managing to attract overseas capital to their share offerings, the stock exchange is higher than it has been for a while, tourism is booming, bond yields are stabilising at 5% (down from 30%) and, importantly, the European Commission and the European Central Bank are confirming that Greece has stabilised and is about to recover.

Before throwing critical light upon these claims, it is important to consider the vested interests hidden behind them. In early 2010, the Greek public sector became insolvent. To prevent a default, and in the absence of a fiscal union within the eurozone, the European Union (in association with the International Monetary Fund), decided to extend to the Greek government the largest loan in international history on condition that national income would be cut drastically (for an economy that could not devalue its currency). Simple arithmetic sufficed to forecast that the nation's debt would become hopelessly unsustainable, local businesses and banks would also become insolvent and investors (Greek and otherwise) would go on a prolonged, abrupt investment strike, therefore deepening the insolvency of both the private and public sectors.

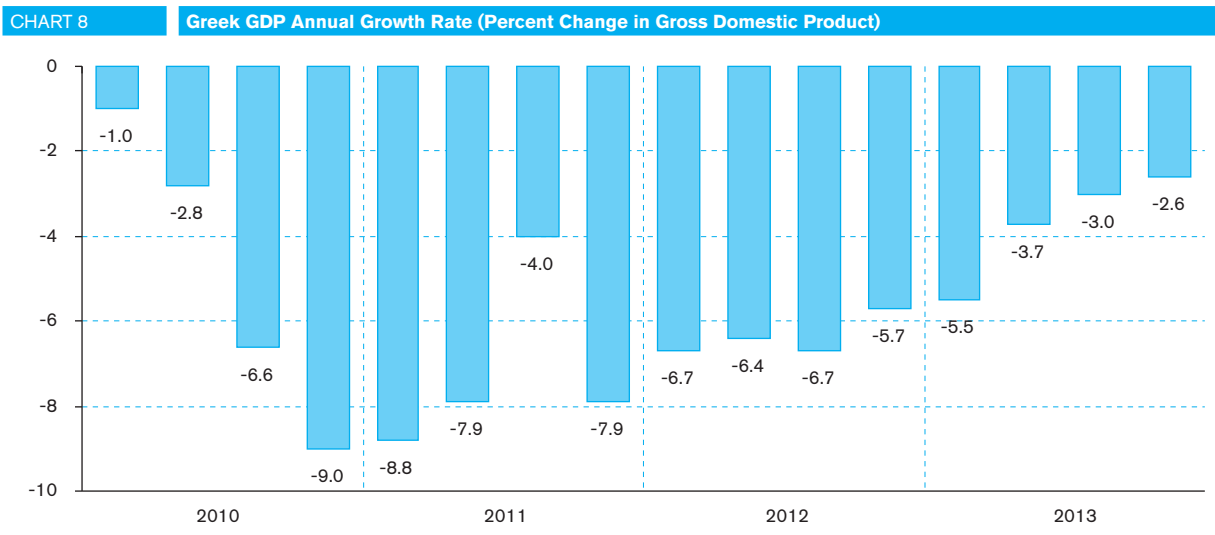
This is precisely what happened. As the table below shows, the combination of the collapse in national income with a rising public debt (in spite of a substantial haircut amounting to €100 billion worth of privately owned Greek government bonds in early 2012) produced utterly unsustainable debt dynamics which, in turn, bankrupted the private sector and caused severe social dislocation, absolute poverty and mass emigration of the most talented young Greeks.

TABLE 4 Public Debt

	2010	2014
Public Debt	€300 billion	€330 billion
GDP	€235 billion	€180 billion
Debt-to-GDP	127.7%	183.3%

Burdened by this 'guilty past,' it is understandable that the authorities in Athens and in Brussels are keen to suggest that the tough medicine has paid off

¹ This article was finalised in March 2014. All the data used in tables and charts are provided by www.tradingeconomics.com



and that Greek recovery is around the corner. Throughout 2013, they claimed that Greece was stabilising and that 2014 would be the year of the long awaited recovery. The fact that their forecasts had been wrong for five years and that they have a vested interest to keep issuing over-optimistic forecasts, does not necessarily mean that, this time, they will be proven wrong again. Only time will tell. Meanwhile, however, what we can, and ought to, do is look carefully at the claims regarding Greece's 'stabilisation' during 2013 and to look for clues in the data as to whether recovery is likely in 2014.

The Real Economy: the Contraction Accelerated in 2013

According to the government and the EU, 2013 was the year the recession decelerated. It did no such thing. While it is true that, in real terms, the rate of shrinkage declined (see Chart 8), the reality is less heroic.

If we look at nominal GDP, a far more poignant statistic than real GDP in times of recession,² we shall be horrified to discover that the recession picked up speed in 2013, even compared to the abysmal years: 2012, 2011 and 2010. Indeed, as the figures below show, whereas nominal GDP fell from 2011 to 2012 by a modest 1.1%, between 2012 and

2013 it shrank by as much as 14%. In this sense, the Greek economy's performance in 2013 was even worse than that of 2010 and 2011 – the first two years after Greece's implosion.

TABLE 5 GDP Growth

Year	Nominal Annual GDP Growth
2010	-7.5%
2011	-8.9%
2012	-1.1%
2013	-14.0%
Overall: 2009-13	-27.08%

None of this is surprising if we look more closely at what was going on in the guts of the real economy. Manufacturing output was shrinking at between -4% and -15% for the first two and a half years of the Memorandum (2010-12). Once the ECB announced its Outright Monetary Transactions programme (OMT) in the summer of 2012, steadying the markets' nerves, and the German Chancellor confirmed that Greece was not to be forced to leave the eurozone (September 2012), there were some quarters when Greek manufacturing stopped shrinking further (see below: the blips between August 2012 and July 2013). However, since the autumn of 2013, manufacturing output has started shrinking again. Indeed, the latest figures for January 2014 confirm this 'incredible shrinking' act: we are in -5% territory again.

² It is like this for two reasons. Firstly, during recessions the GDP deflator overestimates the price drops that affect the majority of people. Secondly, in an economy with gigantic debt overhang (private and public), nominal output and income is crucial, since the nominal value of the debts remains constant. The evolution of the inflation rate confirms, for those that have not seen it before, that Greece is in the clasp of deflation.

CHART 9 Greek Manufacturing Production

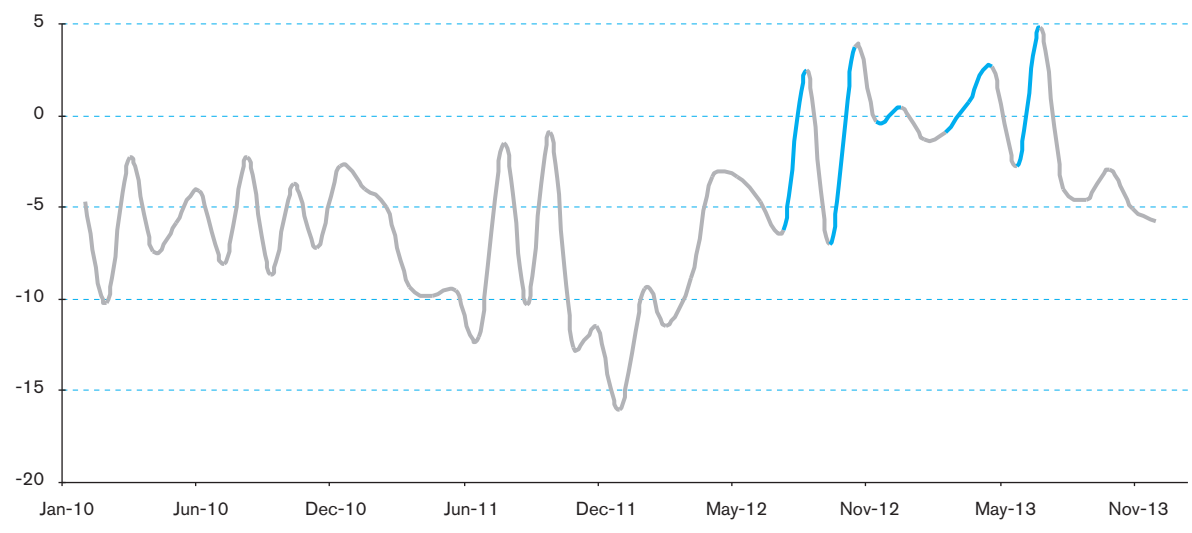


CHART 10 Greek Industrial Production

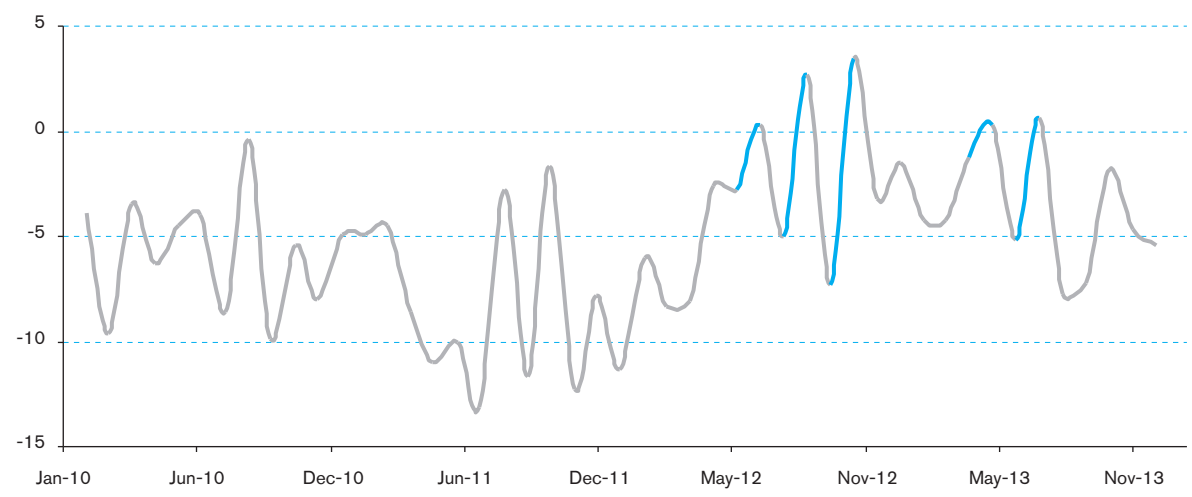


CHART 11 Greek Gross Fixed Capital Formation

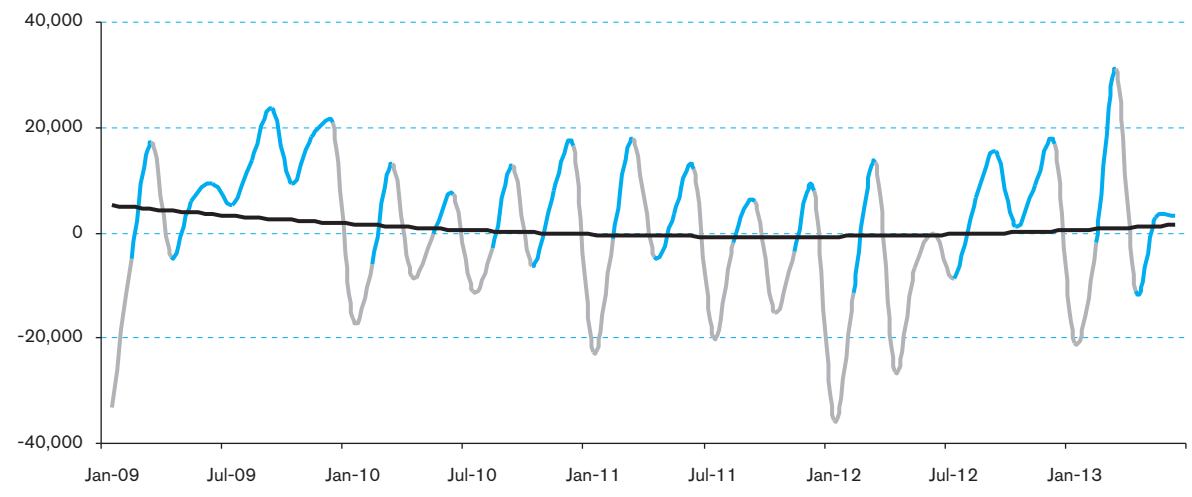
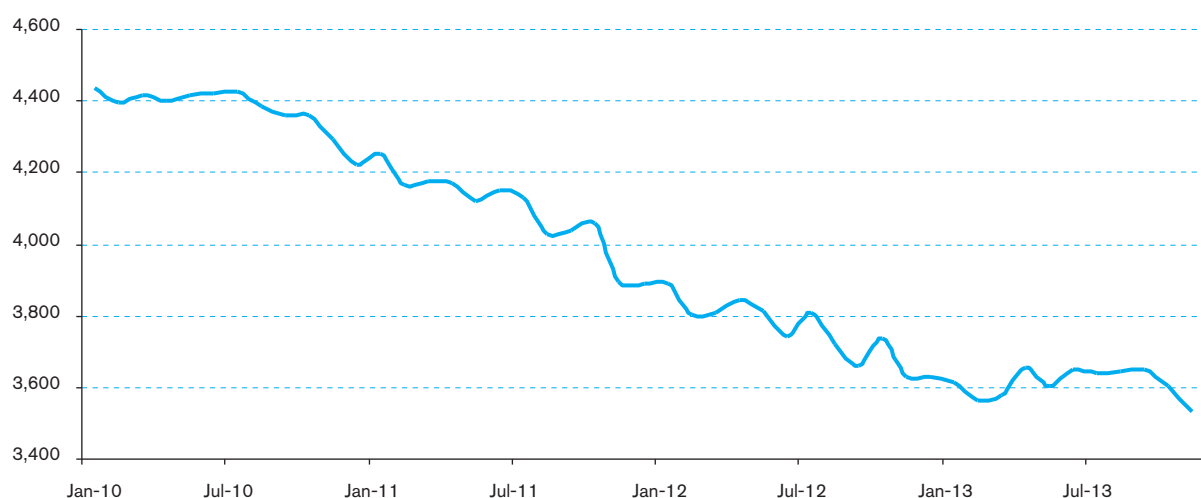


CHART 12 Greek Employed Persons



What of industrial production more generally? As chart 10 shows, Greek industry is also continuing to shrink by around 5% annually.

Might the government and EU's optimistic verdict that Greece's economy is stabilising be due to good news on the investment front? A brief look at the data of Chart 11 confirms that nothing of the sort is in train. Gross fixed capital formation has flat-lined at 0%, leaving net investment firmly in negative territory. What about employment? Did the huge reduction in minimum wages (of -35%) cause employers to take on more workers instead of investing in machinery? Is labour-capital substitution favouring labour over capital goods given the latter's 'cheapening'? As chart 12 demonstrates, employment is continuing its downward slide, confirming that wage cuts in the midst of a multi-dimensional, cruel recession is bound to fail to instil badly needed confidence in employers' hearts and minds. The lower the minimum wages, the more pessimistic Greek employers became about finding paying customers for the wares that freshly hired employees might produce.

The Money Market

Another source of optimism for the Greek government and its EU-IMF supervisors was the banking

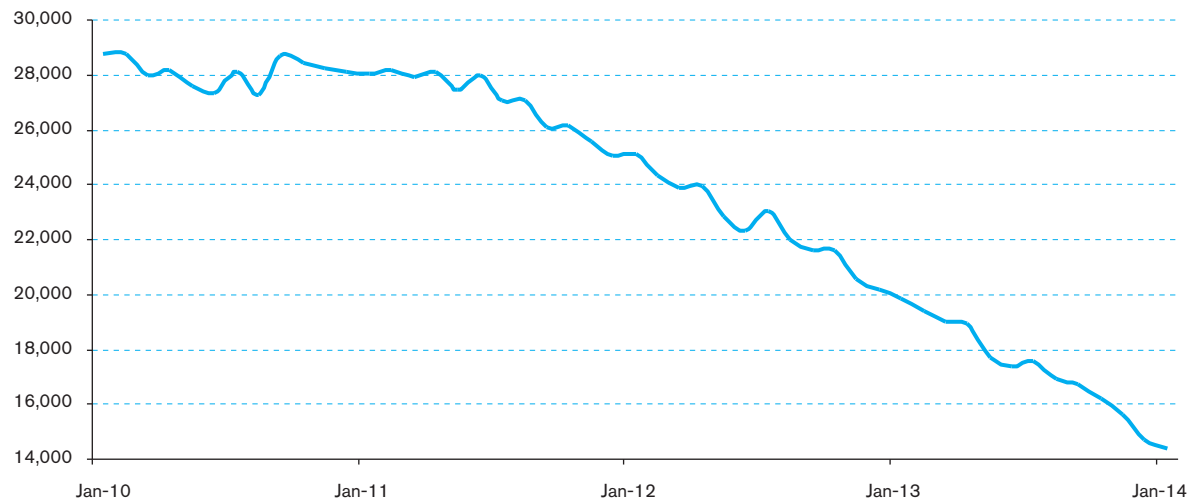
system's recapitalisation. Having borrowed €41 billion from the European Stability Mechanism (ESM) to hand over as capital to the bankers (without daring to demand that the boards of these bankrupt banks are cleared of the bankers that saw the banks fail), the authorities proclaimed that liquidity was about to hit the markets. Indeed, the Greek PM, Mr Samaras, made it his crying call in early 2013: "Once the recapitalisation is complete, by the Spring of 2013," he repeated on a number of occasions, "businesses will regain access to loans and Greek-covery will be on its way."

This, of course, was never going to happen – for the simple reason that the true capital needs of the banks were always much greater than what was acknowledged. Had they been acknowledged, the bank owners would have had to forfeit their majority stakes.

In February 2014, the IMF and the ECB began frantically signalling that Greece's banks need at least another €20 billion.³ And since the proof of the pie must be in the eating, Chart 13 makes for interesting reading: not only has liquidity in the private sector not returned but, in addition, the rate of its decline has risen sharply throughout 2013. Indeed, according to the Bank of Greece, credit fell by 3.9% in December 2013 and, even more ominously, fell again by another 4% in January 2014.

³ For a recent report in the *Financial Times* see: www.ft.com/intl/cms/s/0/90df6be6-9ca7-11e3-b535-00144feab7de.html?siteedition=intl#ax-z2ubV6FVJg

CHART 13 Greek Loans to the Private Sector

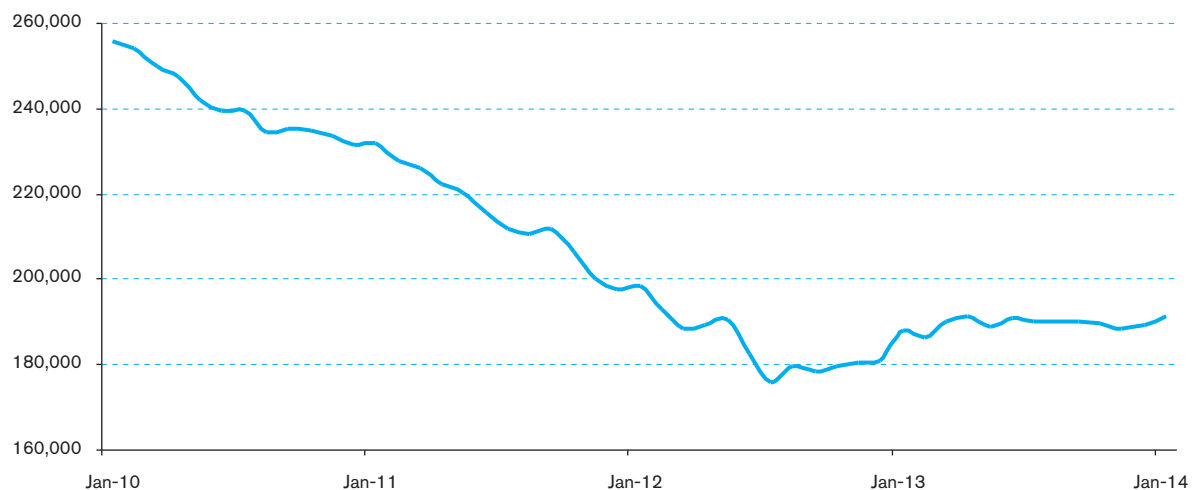


Despite all this, the Central Bank of Greece (part of the European System of Central Banks) is hailing the banks' recapitalisation as a success story, criticising the IMF for exaggerating the banks' capital black holes. In fact, the Governor of the Central Bank of Greece stated in March 2014 that "too stringent stress tests would be bad for the confidence in those who may wish to invest in Greek banks." In other words, the Central Bank of Greece, that is meant to regulate the private banks, is opting for a cover-up of the terrible state of the banks' asset books in order to make them more attractive to investors. This is hardly a situation that inspires confidence in the regulatory authorities

and in the prospect that the banks, whose asset books remain in a poor state, will start lending again to businesses and households. Indeed, the Governor's own *Annual 2013 Report* reports that the rate of non-performing loans has increased from 29.3% in the second quarter of 2013 to 31.2% in the third.

Turning now to the money supply, Chart 14 confirms the lack of élan in the Greek marketplace. The supply of M2 money was falling steadfastly from the moment the Greek State was found to be insolvent, and the economy embarked on its never-ending recession, until the summer of 2012. Around election time, while the establishment parties were investing

CHART 14 Greek Money Supply M2



in fear of a Greek exit from the eurozone, cash was hoarded at alarming rates. Some of that liquidity returned by early 2013, along with a fraction of the bank deposits that had fled the country. For the rest of the year, however, M2 remained flat when even a modicum of growing economic activity would have caused M2 to rise. It did not. Why? Because economic activity has not picked up (as shown in chart 14).

Privatisations

2013 was a disastrous year for the privatisation programme. The spectacular failure to sell a public monopoly to Gazprom (which refused to buy at almost any price, citing the deflationary forces raging in the Greek economy as the reason for its withdrawal), left the government with a single success story: the sale of the state lottery OPAP to a shadowy consortium at a low, low price and under conditions that will prove, undoubtedly, to be detrimental to the government's long term financial benefits.

Perhaps the most distressing news from the privatisation front is that it seems impossible to stage a genuine auction; not even for supposedly valuable assets. Once Gazprom walked away from the energy market, the privatisation of the public energy company just fell through – for there was no other bidder. Likewise, OPAP was, in the end, sold to the only bidder. The fact that a goose laying golden eggs (i.e. a monopolistic lottery) was not only sold at a knock-down price, but was also incapable of drumming up competitive bidding, is quite telling. The latest news on this trend is perhaps the greatest real estate deal Greece has to offer: the old Athens airport site at Hellinikon. Even though Hellinikon is a prime seaside plot, covering more than twice the area of London's Hyde Park, and located next to the most upmarket suburbs of Athens, once more only one bidder⁴ appeared during the privatisation process.

Public Debt and Bond Yields

The Greek government is celebrating that its bond yields have fallen to less than 5%, from 30% eight-

een months ago. Is this not cause for some celebration? It is, but only for those ignorant of the Greek State's public debt structure.

Following two massive official loans (one in 2010, another in 2012), Greece's debt remains more or less what it was when the country imploded in early 2010 – north of €310 billion (while GDP is 27% lower, of course). So, what did these official loans achieve? They simply shifted the Greek public debt from the private sector to the official sector. In combination with the PSI (haircut of bonds held by the private sector) in the spring of 2012, this substitution meant that only 10% of Greek government debt remains in the hands of privateers – primarily hedge funds. Also, and this is important to the hedge funds' calculations, the bonds remaining in private hands are all English Law contracts, which make it hard for Greece and Europe to haircut them again.

The gist of this is simple: it is now common knowledge that, while Greece's public debt is spectacularly unsustainable and will be haircut again (one way or another), the bonds still in private hands will not be touched. It is simply not worth fighting the vulture funds over them in the courts of London or New York as they represent a small portion of the total debt. This common knowledge inspires confidence in the bond markets regarding these few, remaining post-PSI Greek government bonds. Herein lies the paradox: everyone knows that Greece's debt will be restructured, and yet no one really fears that the bonds still with the private sector will be haircut. Is it any wonder that their yields have fallen? No, of course not. Is that fall a sign that Greece's creditworthiness has risen? Not at all. (For that, we would need to observe the yields of fresh issues of Greek government bonds. Only there have not been any fresh issues since... 2010.)

Everyone knows that Greece's debt will be restructured, and yet no one really fears that the bonds still with the private sector will be haircut

Looking forward, the EU's *Plan A* for Greece's public debt is that:

⁴ A consortium called Lambda Development, a vehicle for Global Investment Group, which in turn comprises Abu Dhabi company Al Maabar, China's Fosun Group and several smaller European investors.

1. The Greek debt will only be very mildly restructured in the summer of 2014 (with no haircut to the principal, a long extension to the repayment schedule and a small reduction in interest rates; i.e. with a haircut of its present value, but not its face value).
2. The ad-infinitum-bankrupt Greek State will be allowed to return to the markets, by the third quarter of 2014, under the oversight of the ECB, whose implicit OMT threat will ensure that investors are prepared to lend at interest rates of around 4% to 5%, to a state that they know is bankrupt (and which they are prepared to lend to only because of the ECB's OMT).
3. The above will be conditional on another troika-administered Memorandum of Understanding, which may (for the purposes of political marketing) be called something different.

In summary, new bonds will be issued when the above steps have been taken, and Athens proves that it can acquiesce fully and reliably to such a plan, even after the present government has folded its tent. The essence of Berlin's plans for a third Greek 'bailout' is that it will **not** be funded by European taxpayers through the ESM, but instead will be funded by privateers under the pressure/guarantee of the ECB's OMT – assuming, of course, that the latter remains a credible threat following the German Constitutional Court's referral of OMT to the European Courts.

Current Account

Greece is now a surplus nation! At least in current account terms. If this small surplus were due to a significant rise in exports, and some strong import substitution (with domestically produced goods and services edging imported competitors out), this would have been excellent news. Only this is not the reason Greece has a current account surplus today. The sorry reason for this surplus is that the deepening recession shrunk imports by a further 11% while tourist income last summer rose a little as Turkey and Egypt's political troubles diverted tourists to Greek shores. What about exports? They were lower in 2013 than in 2011, when they were much lower than in... 2008.

Still, the media were only too quick to hail the miracle of a Greek current account surplus. Foolish as they tend to be, they added that "Greece has not posted a current account surplus for many decades." That is quite so. What they failed to add, however, is the year when Greece's current account was positive last: 1943 – under the Nazi occupation, when Greeks could not afford to eat (let alone import goods from abroad), but still managed to export a few oranges, apples etc. Today, once more, the collapse of domestic demand, even in the absence of an export drive (due to the lack of credit to export-oriented businesses), has produced a 1943-like situation. This is hardly cause for celebration.

Beyond the statistics

Besides the wretched data above, there are other facts that paint a more accurate picture of Greece's current state of affairs. Here are some of them:

- There are 10 million Greeks living in Greece (and falling fast due to migration), 'organised' in around 2.8 million households that have a 'relationship' with the Tax Office. Of those 2.8 million households, 2.3 million have a debt to the Tax Office that they cannot service.
- 1 million households cannot pay their electricity bill in full, forcing the electricity company to 'extend and pretend,' thus ensuring that 1 million homes live in fear of darkness at night while the electricity company is insolvent. Indeed, the Public Power Corporation is disconnecting around 30,000 homes and businesses a month due to unpaid bills.
- For 48.6% of families, pensions are the main source of income, expected to be cut even further. The €700 pension has been reduced by about 25% since 2010 and is due to be halved over the next few years.
- Minimum wages are down (on the troika's orders) by between 35% and 40%
- Social transfers have been cut by more than 18%
- 40% say they will not be able to meet commitments this year
- Of the 4.9 million people constituting Greece's labour force, 1.4 million are jobless

- 3.5 million employed people have to support 4.7 million unemployed or inactive Greeks
- Of the 1.4 million jobless only 10% receive unemployment benefits and only 15% *any* benefits at all
- The rest must fend for themselves. E.g. of the self-employed who have been driven out of business, none receives benefits
- Of those employed in the private sector 500,000 have not been paid for more than three months
- Contractors who work for the public sector are paid up to 24 months *after* they provided the service and pre-paid sales tax to the Tax Office
- Half of the businesses still in operation throughout the country are seriously in arrears *vis-à-vis* their (compulsory) contributions, their employees' pensions and social security fund.
- 34.6% of the population live at risk of poverty or social exclusion (2012 figure)
- Households' disposable income contracted 30% since 2010
- Healthcare has been cut by 11.1% between 2009 and 2011 – with a significant rise in HIV infections, tuberculosis and still births

Epilogue

2013 was not the year when Greece's economy stabilised. Will 2014 prove different? In real GDP terms, there is little doubt that there will be stabilisation, allowing Athens and Brussels to claim that the recession is over. But this will be due

not to any increases in output, investment and employment. It will happen, instead, because:

- a) price deflation will continue, thus propping up the ratio of output to prices
- b) tourism will remain a strong contributor (courtesy of Egypt and Turkey's continuing strife)
- c) capital that is flowing into the European Union from emerging markets will also come into Greece in a speculative search for bargains (e.g. shares in the poorly regulated banks) and convinced that the German government is no longer considering pushing Greece out of the eurozone
- d) a small increase in structural funds from Brussels will compensate for the further drop in domestic demand.

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In short, in the absence of any evidence whatsoever of a recovery in investment and/or bank lending to businesses, 2014 seems most likely to signal the end of Greece's recession and the beginning of a period of stagnation that pins an exhausted social economy onto a terrible equilibrium.