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Greece: Threatening Recovery

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Greece: Threatening Recovery

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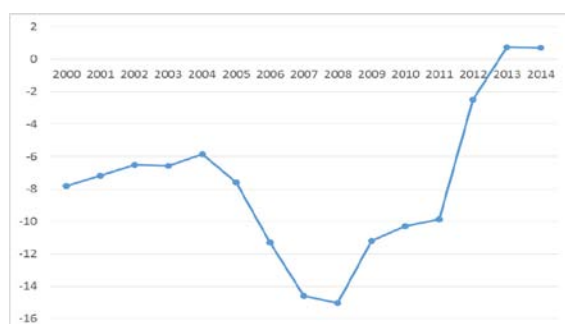
Six Years of Greek Macroeconomic Adjustments

There can be no doubt. Six harsh years lie behind for Greek workers and consumers. The unemployment rate increased from 7.8% in 2008 to 26.6% in 2014. The total number of unemployed rose more than threefold. Real per capita GDP shrank approximately by one quarter, which put the country back to the level of 1999.[1] If one compares the situation in 2008 with the situation now, the political unrest and the landslide victory of a radical leftist party may be understandable. Yet, as this brief review of the recent past will argue, the political change and the current uncertainty are a great danger for the otherwise beginning recovery. While such a recovery obviously was not visible enough for Greek voters, the mere data suggest that the worst may be over and that the uncertainty that is introduced by the current confrontation is threatening this positive development.

Despite the catastrophic phase between 2008 and the end of 2014, much of a previously unsustainable development has been corrected and there are clear signs that the deterioration came to a halt in 2014.

Figure 1: Current Account in Percent of GDP

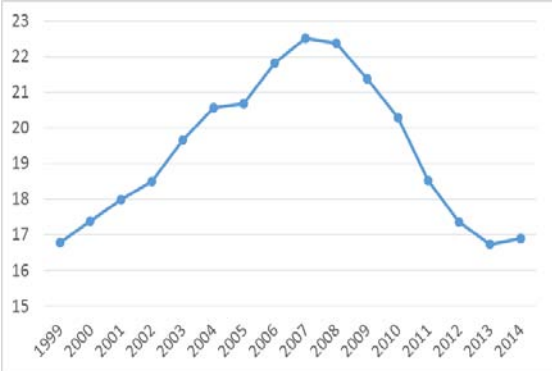


Source: IMF, World Economic Outlook Database.
Note: 2014 figure is IMF staff estimate.

[1] See AMECO database.

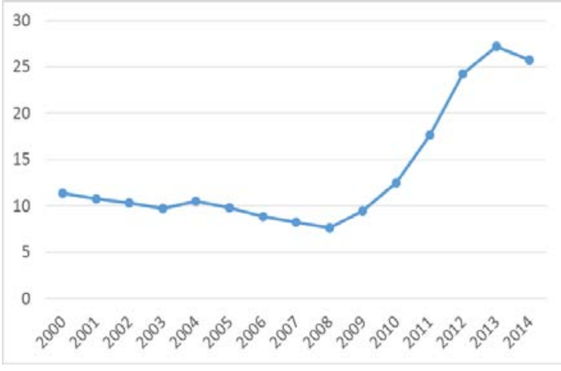
Figure 1 shows Greek current accounts since the year 2000. Between 2000 and 2011, the current account deficit always exceeded five percent of GDP. In 2007, before the financial crisis, the deficit amounted to 15 percent, mainly due to exploding imports. Greece is now in a much more sustainable position and has achieved a more or less balanced current account in 2013 and 2014. Even when it comes to employment and per capita growth, the decline stopped in 2014. Figure 2 illustrates this for the case of real GDP per capita. Figure 3 shows that the unemployment rate has recently stopped increasing.

Figure 2: Real GDP per Capita (in Thousands of Euro, 2010 prices)



Source: AMECO Database.

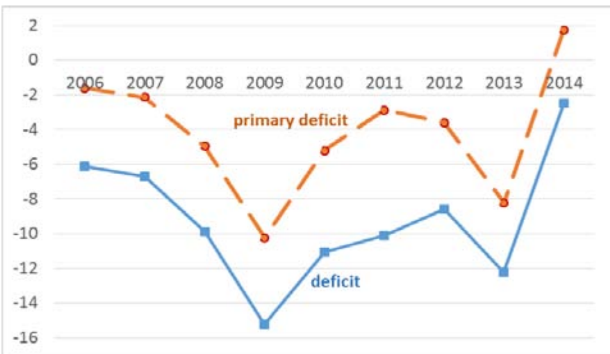
Figure 3: Unemployment Rate (in Percent of Total Labor Force)



Source: IMF, World Economic Outlook Database.
Note: 2014 figure is IMF staff estimate.

A particular pronounced problem was the shape of the Greek public budget. The budget deficit, according to the later data revisions, was above 4% in every year between 2001 and 2007 and it exploded in 2009 when it increased to around 15%. Figure 4 shows progress on this front as well. For 2014 the budget deficit was within the 3-percent band. Further, there was good news from the development of the primary deficit, which reflects the deficit after subtracting interest payments on government debt. The preliminary number for the year 2014 suggests that Greece achieved a primary surplus. While governments may avoid running budget surpluses, a *primary* surplus is necessary in the long run to cope with a preexisting stock of debt.

Figure 4: Government Deficit and Primary Deficit (in Percent of GDP)

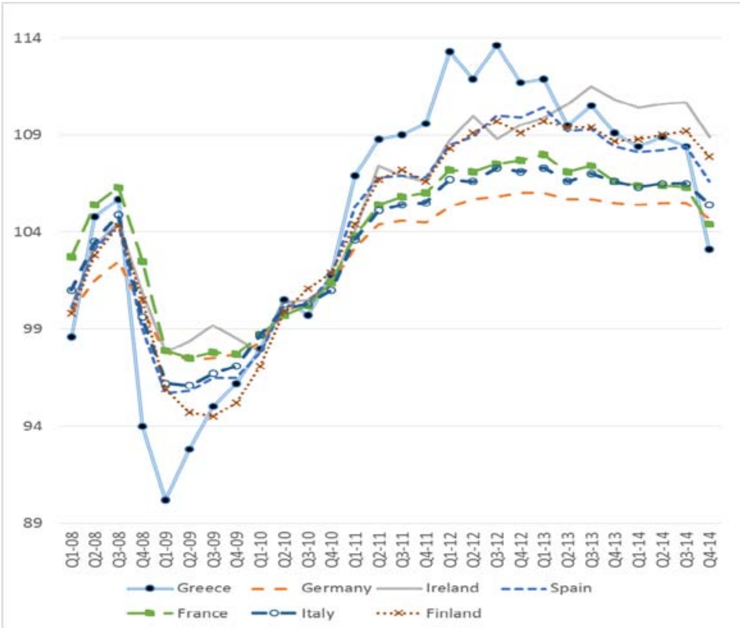


Source: AMECO Database.

The difference between the two lines in Figure 4 sheds light on yet another important macroeconomic variable. The absolute difference between the line of the public deficit and the line for the primary deficit gives the amount of interest payments as a fraction of GDP. Quite in contrast to what one might expect given the current demands for a further debt relief, this amount is actually slightly smaller than before the financial crisis. Due to the previous debt cuts, and the guarantees and programs of the euro area countries, Greece is able to finance a debt of more than 170 percent of GDP at a lower budgetary cost than it did in 2006 and, as a fraction of GDP, the Greek burden of interest in 2014 was lower than that of Italy.

Another imbalance that had built up in Greece during the first years of euro membership was a comparative increase of producer prices and a related loss of competitiveness. At first, the developments after the financial crises did little to repair this. As Figure 5 demonstrates, despite the deep crises that emerged in 2010, the Greek producer prices in manufacturing increased strongly in 2010 and 2011. The producer prices in manufacturing are of particular interest here as they include the tradable sector. [2] However, even here, the data suggest a certain improvement in 2014.

Figure 5: Producer Prices Index, Manufacturing, Selected Euro Area Countries (2010=100)



Source: OECD, http://stats.oecd.org.

[2] Consumer prices may be upward distorted by increases in taxes.

Further Assistance Requires Conditionality

What is publicly known about the priorities of the new Syriza government suggests that they may be going largely into the wrong direction. From the very first day, the government strongly pushed for further debt relief.[3] Yet, as mentioned above, previous measures had effectively adjusted the burden of public debt to a level that, as a fraction of GDP, is lower than before the financial crisis and lower than the burden of Italy. At the same time, the push for further debt relief has created substantial uncertainty. The ten-year Greek government bond spread with respect to Germany, as of February 18, has again risen beyond the 10-percentage point threshold. The upward jump of the Greek target balance in December and January and the additional needs for emergency liquidity funding of Greek banks are signs of further bank withdrawals and capital flight. It seems more than clear that the Greek change of policy is endangering the overdue and starting recovery.

At the moment, it is unclear how exactly the government will continue in the reforms geared towards reducing corruption, improving taxation, privatization, liberalizing markets. Perhaps the Greek government's calculation is that the rest of the euro zone fears large losses, should Greece go into open default. The reaction by all other euro zone members suggests that, while this indeed is a fear, there is also the threat of killing the credibility of budget constraints and the value of contracts in the whole of Europe. While through the revision of Article 136 of the Treaty on the Functioning of the European Union there may be a legal basis for assistance to Greece, expectations of a no-strings-attached loan are unwarranted. The revised Article 136 TFEU clearly spells out that the "granting of any required financial assistance under the mechanism will be made subject to strict conditionality".

[3] This has been understood as the „central request" of the new government (see, e.g., http://www.bloomberg.com/news/articles/2015-02-02/tsipras-debt-demand-met-with-cold-shoulder-from-berlin-to-lisbon).