China-CEE Institute
中国—中东欧研究院

ISSN: 2560-1601

Vol. 10, No. 2 (GR)

September 2018

Weekly Briefing

Greece Economy briefing:

Can Greece return to the markets?

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Can Greece return to the markets?

The post-bailout period creates opportunities but also risks for the Greek government. On the one hand, Greece can theoretically return to the financial markets and issue sovereign bonds as a normal Eurozone member-state. But on the other hand, this return to the markets is not an easy process. The implementation of significant reforms remains a top priority as markets need to be convinced Greece will respect its post-bailout commitments. Also, the recovery, which has already started bringing results such as the return to growth, the creation of a budget surplus and the reduction of unemployment, will be reversed if the Greek government deviates from already agreed fiscal targets and austerity measures.

The exit of Greece from the bailouts in August 2018 finds the country in a relatively good and stable economic shape. Numbers are demonstrating an ongoing recovery. According to the Hellenic Statistical Authority the GDP increased by 0.2 percent in the second quarter in comparison with the first quarter of 2018 and by 1.8 percent in comparison with the second quarter of 2017. This said, it is positive that exports of goods and services increased by 3.9 percent in comparison to the 1st quarter of 2018 and by 9.4 percent in comparison to the 2nd quarter of 2017. As far as consumption is concerned, expenditure increased by 0.5 percent in comparison to the 1st quarter of 2018 and by 0.8 percent in comparison to the 2nd quarter of 2017.

Furthermore, unemployment is decreasing. The June rate was 19.1 percent compared with 21.3 percent in the same month last year. Unemployment among young people aged below 24 years old dropped below the 40 percent mark for the first time in years this June (39.1 percent this June from 43.4 percent last June). The Hellenic Statistical Authority also shows how tourism is kicking off the construction sector after years of inertia. Specifically, total construction activity in June amounted to 1,374 building permits constituting an annual increase of 16.2 percent. The greatest growth was recorded in the region of the Southern Aegean, which is particularly popular with tourists as well as in Attica.

The way forward

The end of the bailout period opens a new chapter in its economic course. The main purpose for the country – now with stabilized public finances and steadily recovering – is to return to the markets and gradually become financially independent. The process is not easy as trust needs to be built. European Central Bank Governing Council member Benoit Coeure has warned the markets could be harsher than the institutions monitoring the progress of the Greece economy. The Greek government of SYRIZA and Independent Greeks has already issued bonds during the bailout program. This happened in July 2017 when it successfully issued 5-year bonds with a 4.625 percent interest rate. Money raised reached €3 billion. It also happened in February 2018 when the Greek government successfully issued a 7-year bond with a 3.5 percent interest rate. Money raised amounted at circa €3 billion.

The main difference of the period starting after the end of the third bailout in comparison to the one before is that Greece does not ant longer benefit by the protection provided by the EU and the IMF. Although the existence of a cash buffer of €24.9 billion can help the country cover its financial needs for approximately 21 months, the absence of a post-bailout credit line deprives it of the possibility to have access to steadily low interest rates. At the time of writing, the yield of the 10-year Greek bond is 4.20 percent and its August average 4.18 percent (Bank of Greece data). But the long maturities – according to the June 2018 Eurozone decision on the Greek debt – facilitate debt servicing.

Greece needs to avoid the pathogenies of the pre-2010 phase, which had created the so-called twin deficits, the budget and the current account ones. The framework of the enhanced surveillance imposed by the EU does not permit dramatic deviations from already agreed measures but there is always some room for maneuvering. The SYRIZA-Independent Greeks government is keen on exceeding surplus targets – via high taxation – in order for it to create what Prime Minister Alexis Tsipras calls as fiscal space. This fiscal space allows the consideration of some welfare measures, especially for citizens with low income. Tsipras often addresses the issues of inequality and poverty, although his economic policies are largely neoliberal in the context of Greece's bailout commitments.

Speaking in the Thessaloniki International Fair on 8 and 9 September the Greek Prime Minister was optimistic that measures such as pension cuts will be reconsidered during the ongoing negotiations between his government and its creditors. Tsipras wants to avoid these cuts ahead of the new national election but the easy promises he gives do not generate the confidence markets requires to trust Greece will remain on track. ESM Managing Director Klaus Regling did not want to intervene in Greek domestic politics and criticize the government only a few weeks after the exit from the bailout and diplomatically commented on this subject. He said it was important that Tsipras wanted to 'stick to targets' and underlined fiscal space should be used to strengthen the growth potential. But European Commission President Jean-Claude Juncker insisted measures agreed between Greece and its creditors have to be implemented.

Technocrats warn against the reconsideration of measures such as pension cuts. An example is former IMF staff member Miranda Xafa. In her view, intergeneration equity cannot be achieved if Greece does not slash the so-called personal difference. This refers to the distinction between pensions which were affected by the 2016 pension reform and the ones which were not affected as they had been issued before. If the personal difference is maintained, pensioners with the same years of service and the same contributions will received lower pensions (new pensioners affected by the pension reform) and higher pensions (old pensioners not affected by the pension reform) respectively. In addition, Xafa argues, fairness will be introduced as many of the old pensioners receive pension which exceed their lifetime contributions. And she agrees with the IMF position that pension cuts can safeguard the viability of the pension system, which is linked to debt sustainability.

Beyond the theme of pension cuts that is largely politicized, Greece's recovery and potential return to the markets should be accompanied by a sustainable growth rate. Although the country has returned to growth after many years in recession, the real economy requires an efficient push. During the crisis many small and medium-size enterprises could hardly find access to cheap credit and had either to close down or dramatically reduce the scope of their activities. Greece has already taken measures to restructure its banking sector – via settling non-performing loans – but the quality of Greek banks' capital remains lower in comparison to other Eurozone countries. As only strong banks can provide credit to healthy companies facilitating thus economic growth, the country has to persuade markets it will not delay or abandon the implementation of critical financial reforms. It also needs to convince them it will not become involved in banks' credit decisions as such an involvement might discourage both domestic as well as foreign investors from realizing their projects in the country.

In parallel with internal factors, external ones can equally influence the smooth return of Greece to financial markets. Last May, for example, the agenda of the new Italian government caused some turmoil and led to an increase of interest rates in the periphery of the Eurozone. More recently, the Turkish economic crisis is impacting on emerging markets having a similar effect on yields of Greek bonds. As already mentioned, a cash buffer has been created to protect Greece against external anomalies. But this cash buffer will be of limited duration and will not act as Deus ex Machina to save Greece in the long term. If the country continues to respect its commitments, it will be less susceptible to external factors.

Conclusion

For Greece to become financially independent and return to the markets has been a national objective since it received its first bailout in May 2010. Eight years later and after requiring financial assistance by the EU and the IMF two more times – in February 2012 and in August 2015 – the current Prime Minister Alexis Tsipras announced the country's exit from the bailout out a few weeks ago. For political reasons he appears triumphant Greece will now be alone able to decide its financial fate. However, as the country is placed under enhanced surveillance, it is hard to deviate from already agreed measures and fiscal targets. It has the ability to negotiate with its creditors about the economic recipe though.

The balance the Greek government needs to find delicate. While it wants to show to the Greek electorate it has created the necessary fiscal space permitting a better social policy, it is encountered with the skepticism of financial markets. The Greek government relies on the cash buffer but its main priority should be the continuation of structural reforms to support sustainable growth. This is how interest rates for Greek bonds will be relatively low in the long-term and the harmonious return to the markets will be fulfilled.