February 9, 2017

Remember Greece?

The economic crisis in Greece has receded from Europe's headlines. It has been replaced by other stories: the upcoming Brexit negotiations, the consequences of Trump's election, Europe's crowded electoral calendar, the threat of terrorism, and the continuing migrant crisis. However, while it may have slipped from the media spotlight, the Greek crisis continues to rage unabated.

Greek economy still in dire straits

At first glance, it seems that the worst is finally over for Greece. After having shrunk by about 25%, which is roughly equivalent to how much the U.S. economy shrank during the great depression, the IMF forecasts the economy will grow by 2.7% in 2017. For many Greeks, however, this projected recovery is nothing more than a mirage.

Unemployment stands at 23% overall and nearly double that (44%) among those aged 15-24. It is estimated that more than 20% of Greeks cannot afford heating and that 52% of households rely on pensions to pay their bills. Given that pensioners account for only 25% of the population, this means that many grandparents are supporting their children and grandchildren financially.[1] On top of all this, Macedonia's decision last year to close its border has left Greece stuck with about 60,000 refugees.

Greece, EU and IMF are once again in a standoff over debt

The IMF has reportedly told the EU that it would not participate in further Greek loans unless something was done to restructure the country's massive debt. It has also called for Greece's fiscal surplus target to be reduced from 3.5% of GDP to 1.5%. However, Eurozone creditors led by Germany are against further debt relief. They are calling instead for further spending cuts if deficit targets are not met. With elections looming in the Netherlands, France and Germany, politicians cannot afford to appear soft on the issue for fear of strengthening the popularity of anti-establishment political parties.

The IMF's participation in yet another loan to Greece now faces a new hurdle: the U.S., its largest shareholder, elected President Trump. When asked about Greece back in 2015, Trump said: "We have enough problems; let Germany handle it. Germany will take care of it. This is peanuts for Germany."[2] The U.S. has the power to veto any IMF decision it does not like.

As for Greece, it has warned that further cuts would hurt an already impoverished population and risk triggering even greater political instability. After all, pension payments alone were cut by as much as 40% last year.[3]

In July, Greece faces debt repayments of about 6 billion euros. Without further loans, it will not be able to honour these commitments. Most of Greece's debt is held by public organizations, including the ECB, the IMF and the Eurozone's two bailout funds. This means that any debt relief to Greece would be borne by the taxpayers of other countries.

In a leaked report, the IMF concluded that even if Greece met all of its reform and budget cut targets (which is highly unlikely), its debt profile would continue to worsen without further debt relief. The IMF estimated that, under present conditions, Greece's debt as a percentage of GDP would dip slightly from its current level of 180% to 170% by 2020 but then shoot up to 275% by 2060. This is because the cost of servicing the debt will rise as market financing replaces subsidized official sector borrowing.

The IMF's assessment stands in stark contrast with the Eurozone's official forecast, which projects a debt-to-GDP ratio of only 104.9% by 2060 if Greece fully implements its bailout program.[4]

As a result of this debt standoff, the yield on 10-year Greek government bonds has risen from 6.5% in early December to about 7.8% today.

[1] "A Greek tragedy: how much can one nation take?," The Financial Times, January 20, 2017
[2] "Trump on Greece's Debt Crisis: 'Putin Probably Comes In To Save The Day'," Real Clear Politics, July 1, 2015
[3] "A Greek tragedy: how much can one nation take?," The Financial Times, January 20, 2017
[4] "MF Assesses Greek Debt as 'Highly Unsustainable'," Wall Street Journal, January 27, 2017

New elections in the cards?

The far-left SYRIZA party came to power in early 2015 highly critical of the austerity policies being forced upon Greece by the EU. However, faced with the threat that the ECB would cut financing to Greek banks, SYRIZA backed down and agreed to implement further austerity measures. Not surprisingly, putting into place the very policies that it had vowed to oppose has hurt the government's popularity.

A February poll showed the centre-right New Democracy Party leading with 25.8% of voting intentions, followed by the ruling SYRIZA party with 15.6%. Third place went to the far-right Golden Dawn party with 5.6%, followed by the Communist Party and PASOK (a centre-left party whose support plummeted due to its role in the debt crisis) with 5% each.[5] These numbers suggest that the next government would be a coalition made up of two or more parties.

The current governing coalition controls only 153 of Greece's 300 chamber seats, which means even a minor defection could trigger new elections.

While the EU would welcome the return of a traditional mainstream party to power, a new government would inherit the same challenges and probably end up making many of the same demands regarding debt relief as the prior government.

Potentially more worrisome is the fact that, for the first time since the debt crisis began, a majority of Greeks have turned against the euro. A recent poll by Alco Polling of Greece found that 53% felt the euro was "wrong" for their country. One third were in favour of a return to the drachma.[6]

Conclusion

If the past is any indication of the future, odds are that Greece and its creditors will agree to a series of temporary face-saving measures just before the July payment deadline. However, one thing is certain: Greece's weak economy and fractured political landscape mean its membership in the Eurozone will continue to be questioned. Moreover, polls indicating that for the first time a majority of Greeks now regret joining the Eurozone and reports that the German government is no longer strongly opposed to the idea of Greece abandoning the euro only add to the uncertainty. Only significant debt relief (which most EU creditors oppose) would end this speculation.

The growing challenges surrounding Greece come at a time when Europe is already struggling with the mounting popularity of anti-establishment parties, the threat of terrorism, the migrant crisis and sluggish economic growth in many of its member states.

The Netherlands (March), France (April/May) and Germany (September) will all be going to the polls in 2017. Italy and Greece could also be forced to hold snap elections. Anti-establishment parties are expected to perform well in all of these cases and force mainstream parties to take much tougher positions on the EU in an effort not to lose further public support. This would make it even more politically difficult for the member states to agree on a strategy to meet the EU's many challenges.

The main risk is that a continued debt standoff worsens the socioeconomic climate in Greece and leads to collapse of the government just as Europe is hit by other setbacks. These could include a surprisingly strong showing by anti-establishment parties in upcoming elections and/or the migrant crisis taking a turn for the worse.

Angelo Katsoras

[5] "New Poll Shows New Democracy 10.2% Ahead of SYRIZA," Greek Reporter, February 1, 2017

[6] "Greece has three weeks to deal with 'potentially disastrous' debt," The Guardian, January 31, 2017

Geopolitical Briefing

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Paul-André Pinsonnault
Senior Fixed Income Economist
paulandre.pinsonnault@nbc.ca

Krishen Rangasamy
Senior Economist
krishen.rangasamy@nbc.ca

Marc Pinsonneault
Senior Economist
marc.pinsonneault@nbc.ca

Matthieu Arseneau
Senior Economist
matthieu.arseneau@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
MD, Public Sector Research and Strategy
warren.lovely@nbc.ca