

GREECE: THE ROLE OF DIVISIVE POLITICS

Stavros Panageas

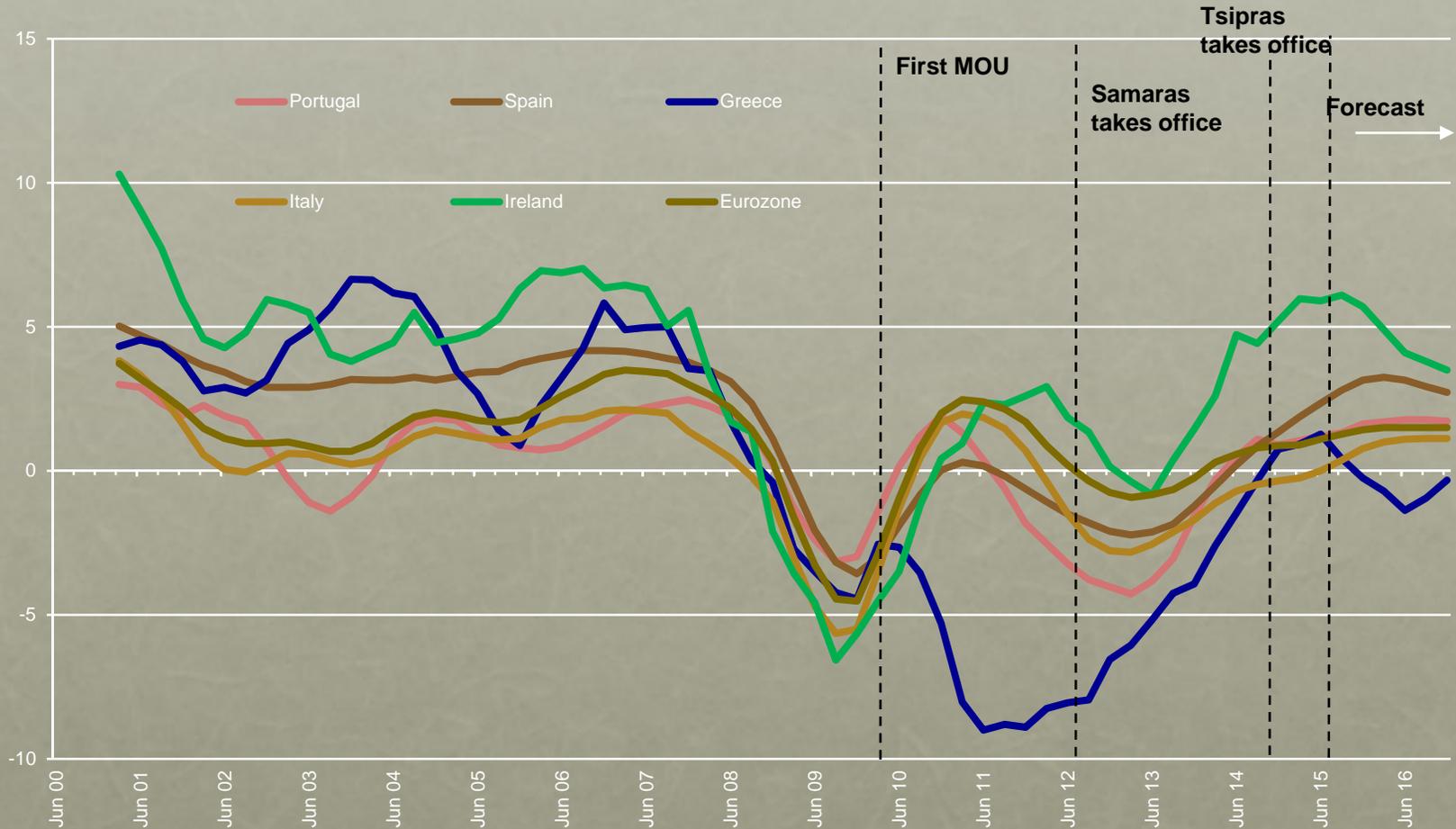
Associate Professor of Finance

University of Chicago

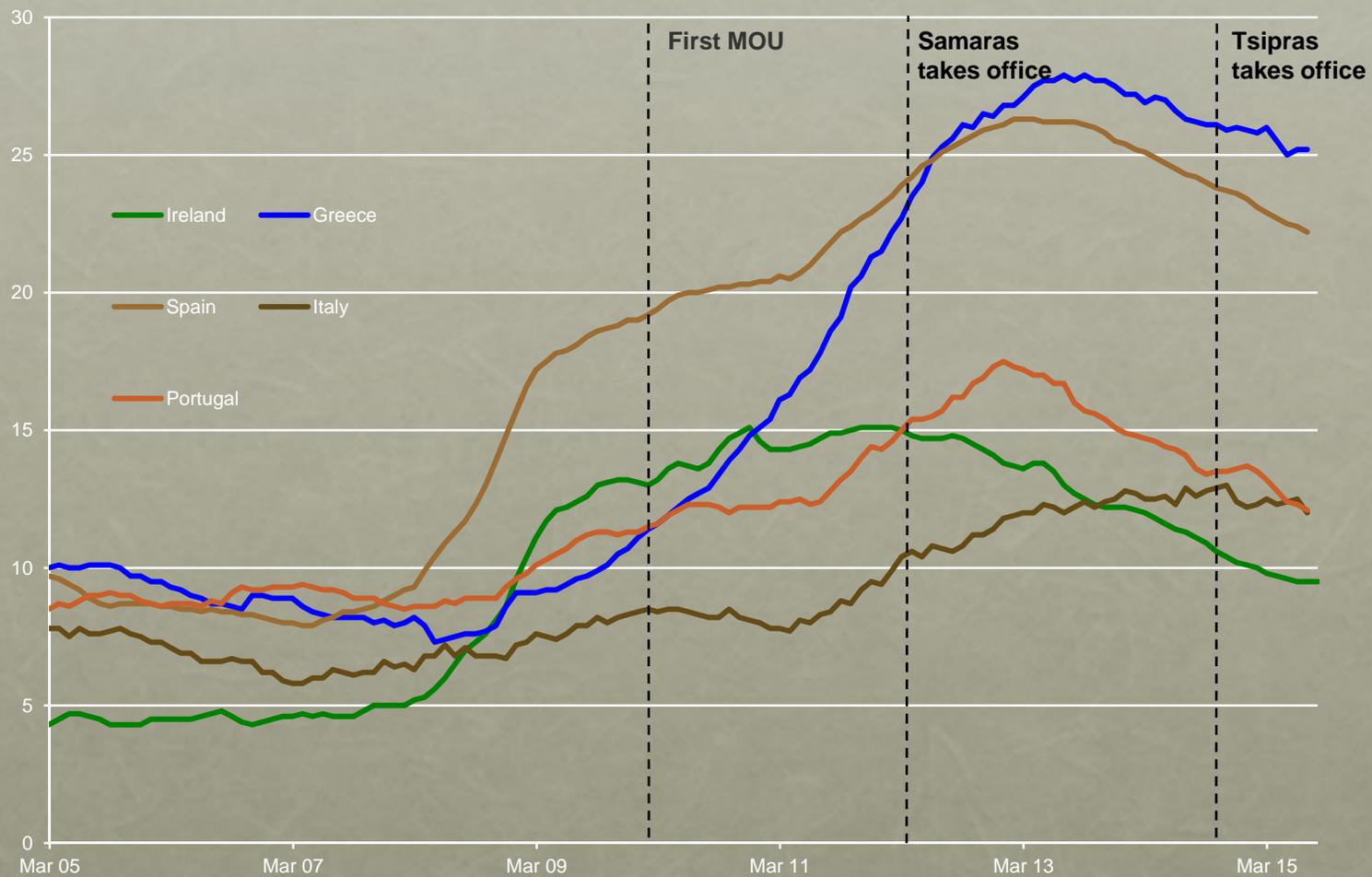
Booth School of Business

James S. Kemper Foundation Faculty Scholar

QUARTERLY GDP GROWTH (4-Q MOVING AVERAGE –ANNUALIZED)



UNEMPLOYMENT



MAIN TAKEAWAYS

- Most periphery countries have by now returned to growth
 - The recessionary effects of austerity are largely mitigated for most countries
- Two things stand out for Greece
 - Greece had a massive recession, presumably due to the more adverse initial conditions
 - Greece covered remarkable ground between June 2012 and January 2015
 - This recovery was largely interrupted in January 2015

WHAT MAKES GREECE SO DIFFERENT?

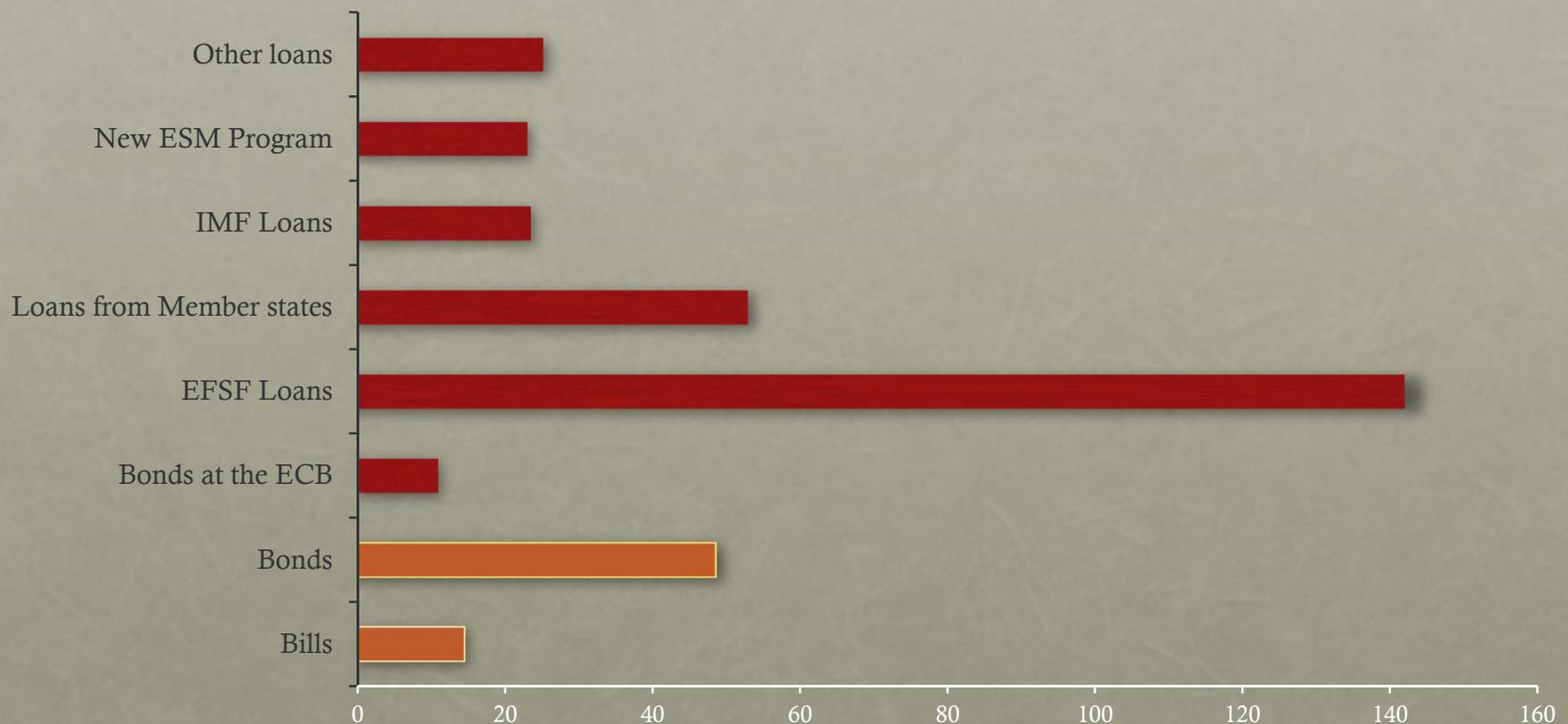
- The political “ownership” of the memorandum
 - Unlike Portugal, where all parties signed on the memorandum, in Greece the memorandum (and more generally austerity) became a populist way to win elections
 - Papandreou won the elections in 2009 questioning the need for austerity (“Lefta Yparxoun”).
 - In the end, he signed the first memorandum
 - Samaras and Nea Dimokratia voted “no” to the first memorandum and won the election of 2011 promising an alternative economic plan (“Zappeion”).
 - They immediately reversed course and followed the memorandum once elected into power
 - Tsipras became a political phenomenon due to his anti-memorandum rhetoric.
 - He ended up signing a third memorandum after 6-month-long negotiations that had severe economic impact

WHY THE LACK OF POLITICAL OWNERSHIP HAS DESTROYED GROWTH

- Trust between creditors and the country has been repeatedly destroyed
 - As a result, the threat of Grexit was always implicitly or explicitly on the negotiation table.
- Due to the fear of Grexit, foreign investors have stayed on the sidelines.
 - Hence, the extraordinarily attractive yields by Greek issuers were ineffective at attracting large amounts of foreign investment
- Domestic investment suffered as well
 - Faced with slow runs, banks became extremely reluctant to lend to anyone
- Of additional importance
 - No credible solution to the debt sustainability problem yet.
 - The debt sustainability problem is intertwined with (lack of) nominal growth

THE CORE OF THE DEBT SUSTAINABILITY ISSUE

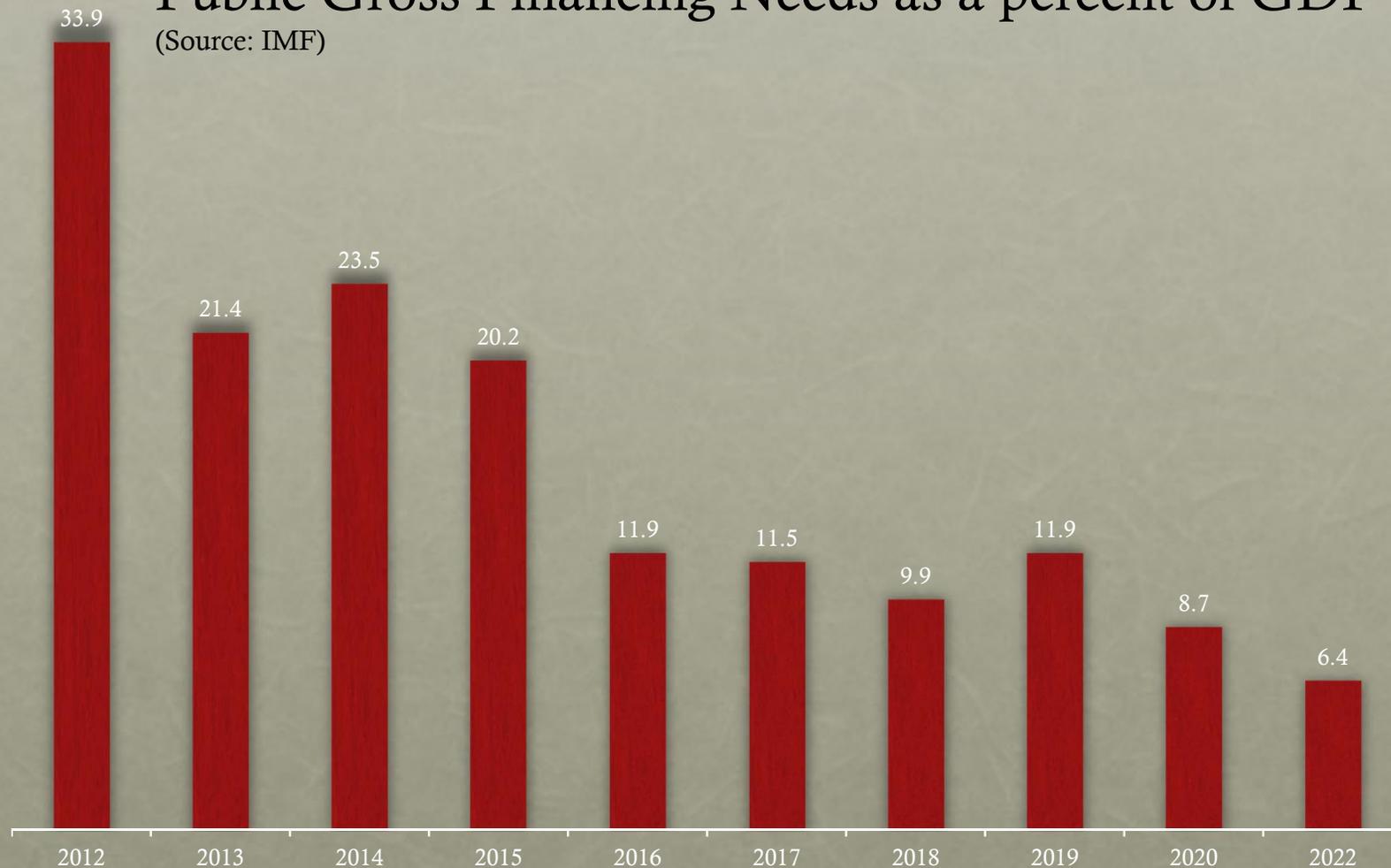
- Main Thing to keep in mind. At this point most Greek debt is official debt and also quite long term



CASH FLOWS: THE CAN IS WAY DOWN THE ROAD

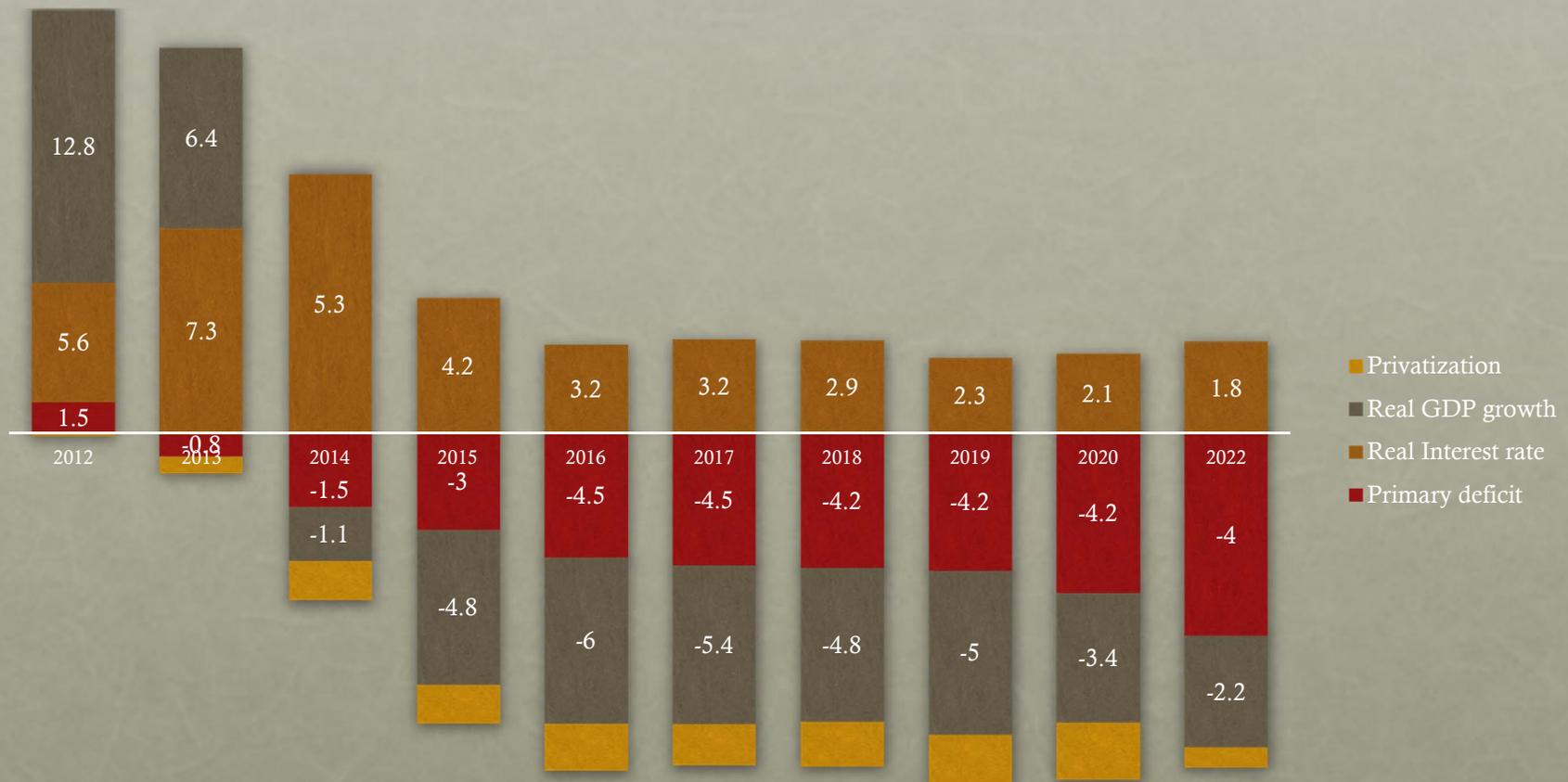
Public Gross Financing Needs as a percent of GDP

(Source: IMF)



IMF'S ASSUMPTIONS ON DEBT SUSTAINABILITY (AS OF LAST YEAR)

Projected change in debt-to-gdp-growth by source



DEBT SUSTAINABILITY

- Normally, debt sustainability is associated with rollover risk.
 - However, when almost all debt is official and long term, debt sustainability should be about something different
- Sustainable debt service costs that do not kill growth
 - By IMF's assumptions the biggest contributor to debt sustainability is the assumed growth rate
 - ...and the end of the deflation period
- Hence the real issue is: how does the country get back to a path of nominal growth.
 - Politics can be again the key to answering the question

3 SCENARIOS FOR THE FUTURE

- Scenario 1: Powerful, effective, and stable Tsipras government
 - Having shown that he has no intent of taking the country out of the Eurozone,
 - Having crushed his internal opposition and gained a decisive victory over the opposition,
 - Tsipras keeps going on with the reforms, gaining the trust of markets and creditors who know that whatever reform gets accomplished now is for good
 - Favorable tailwinds from investors who reach for yield in Euros
- Scenario 2: Weak, unstable and capricious Tsipras government
 - Tries to undermine reforms in a passive aggressive way
 - Incompetent administrators stall the reform process and aggravate the creditors
 - Further fragmentation of the political landscape
 - Grexit scenario resurfaces

3 SCENARIOS FOR THE FUTURE

- Scenario 3
 - Banks get recapitalized, capital controls get lifted, some half-baked solution to the debt sustainability problem
 - the economy gets a small boost
 - However, international investors keep treating Tsipras with skepticism
 - No foreign investment despite low valuations
 - Reluctant and slow reforms
 - Weak and slow recovery, but without major threats of Grexit
 - Political erosion of Tsipras, with voters evaluating his government more on results (or lack thereof) rather than hopes