Greek Economic Crisis
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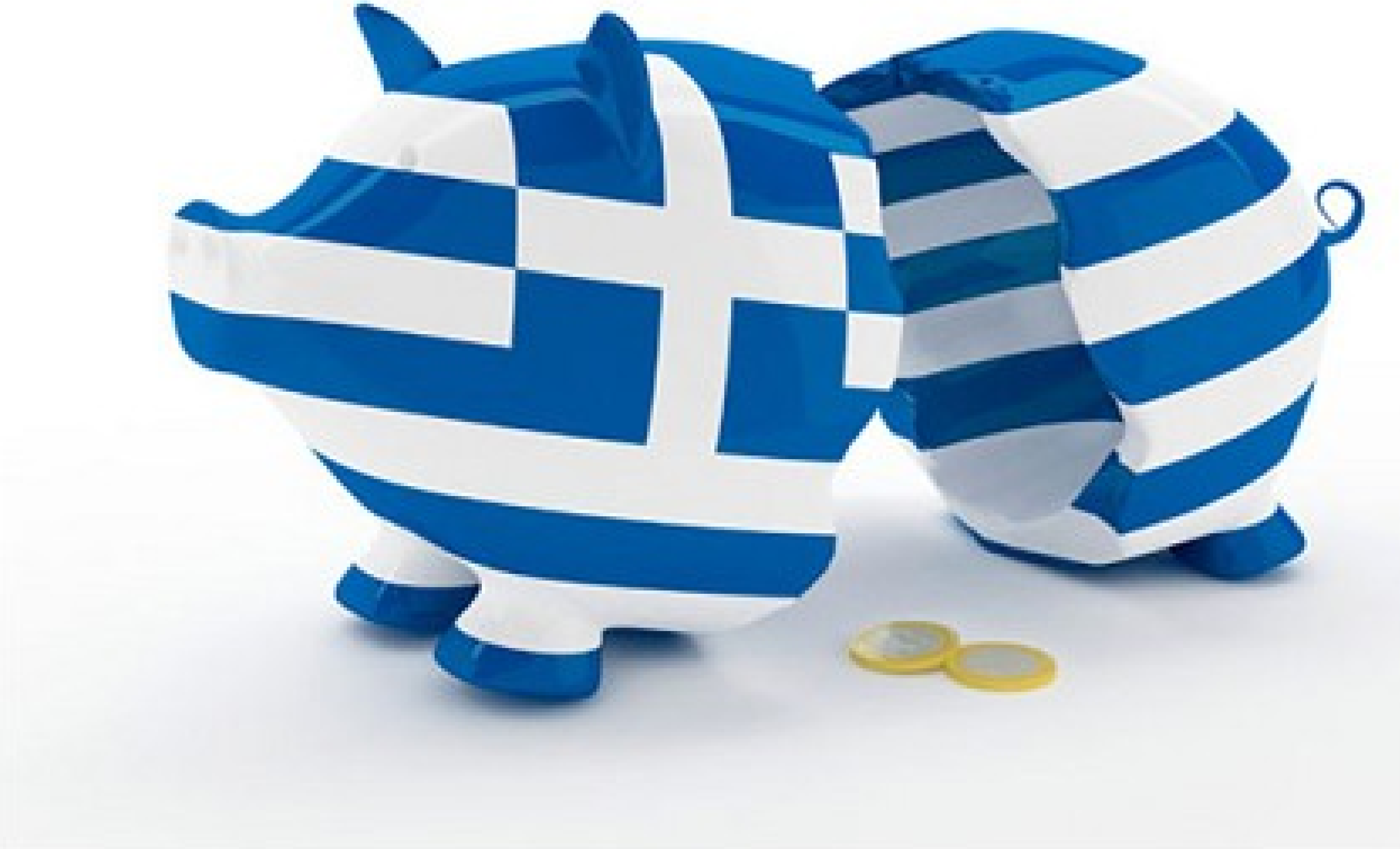
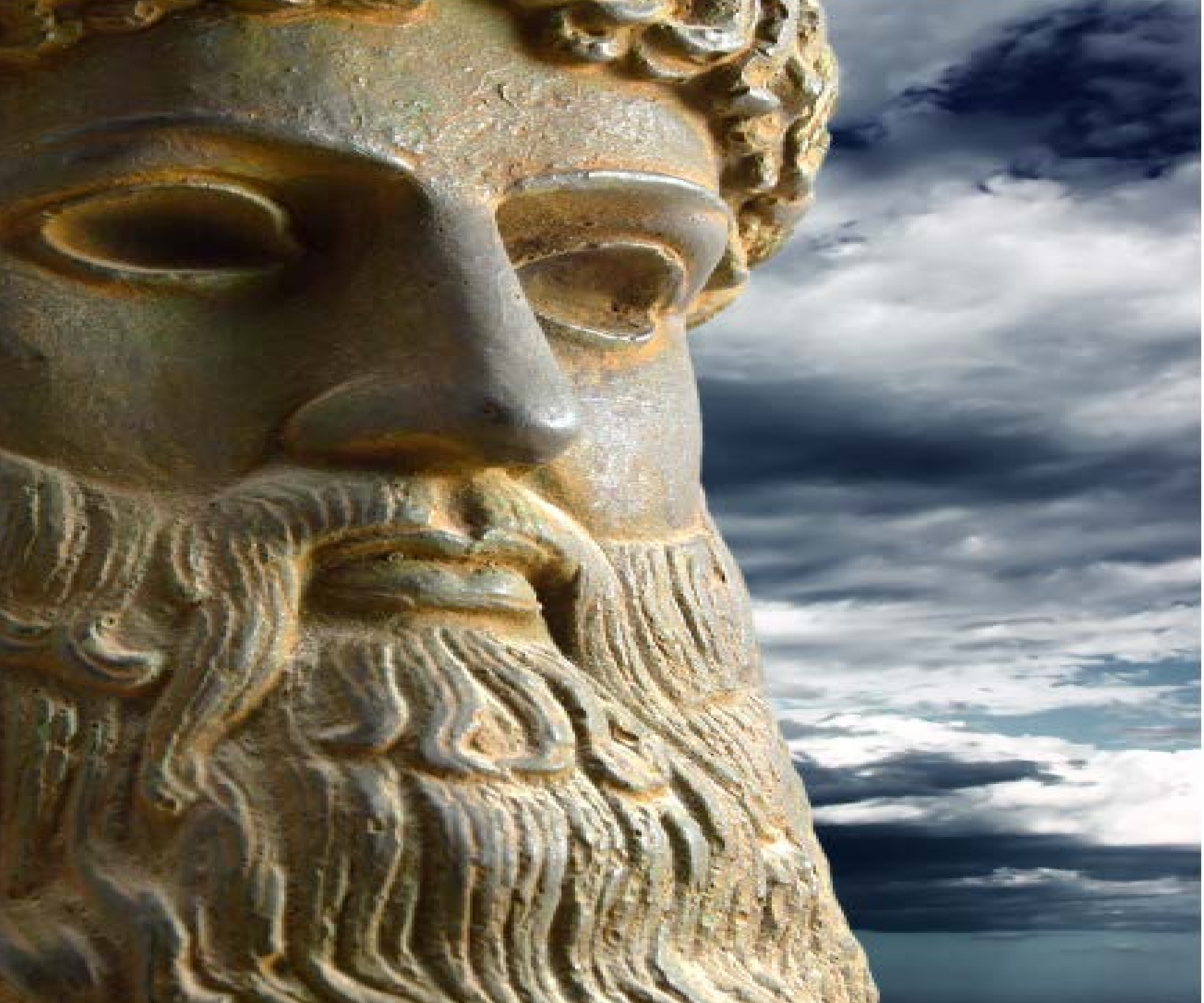




In 2010, Greece had the worst problems in the Eurozone

- Very large State budget deficit, 15%
- Very large debt as percentage of GDP
- Very large State sector; 800,000 employees in a country of 11 mil.
- Lack of competitiveness of parts of the private sector
- The Mnemonia did not cause any of these problems

The EU and IMF dealt with the crisis by helping Greece

(1) Reduce budget deficit (reducing spending, increasing taxes)

(2) EU lent to Greece at very low interest rates

- Current average program rate for Greece is 1.82%

(3) Recapitalize banks

(4) Facilitate reductions in privately held sovereign debt -- PSI ("Private Sector Involvement"), "haircut"; restructuring of official sector debt

(5) Increase competitiveness by opening markets to competition and other "structural reforms"

Varying degrees of success

(1) Reducing budget deficit (reducing spending, increasing taxes)

- Not enough State budget cuts, mostly increases in taxes
- Significant mistake (not of the EU/IMF) but of successive Greek governments
- Budget cuts were across the board; no serious attempt to evaluate civil servants and retire the ones of unneeded functions or low productivity

Grave consequence of the mistake of increasing taxes

- Created 5 years of deep recession
- The State sector is huge and highly inefficient and weighs down on the private sector
- Depth and extent of the recession could have been avoided if State sector was cut and taxes were <u>not</u> increased

(2) EU lent to Greece at very low interest rates

- EU lent to “program countries” including Greece at very low interest rates
  - Current average program rate for Greece is 1.82%

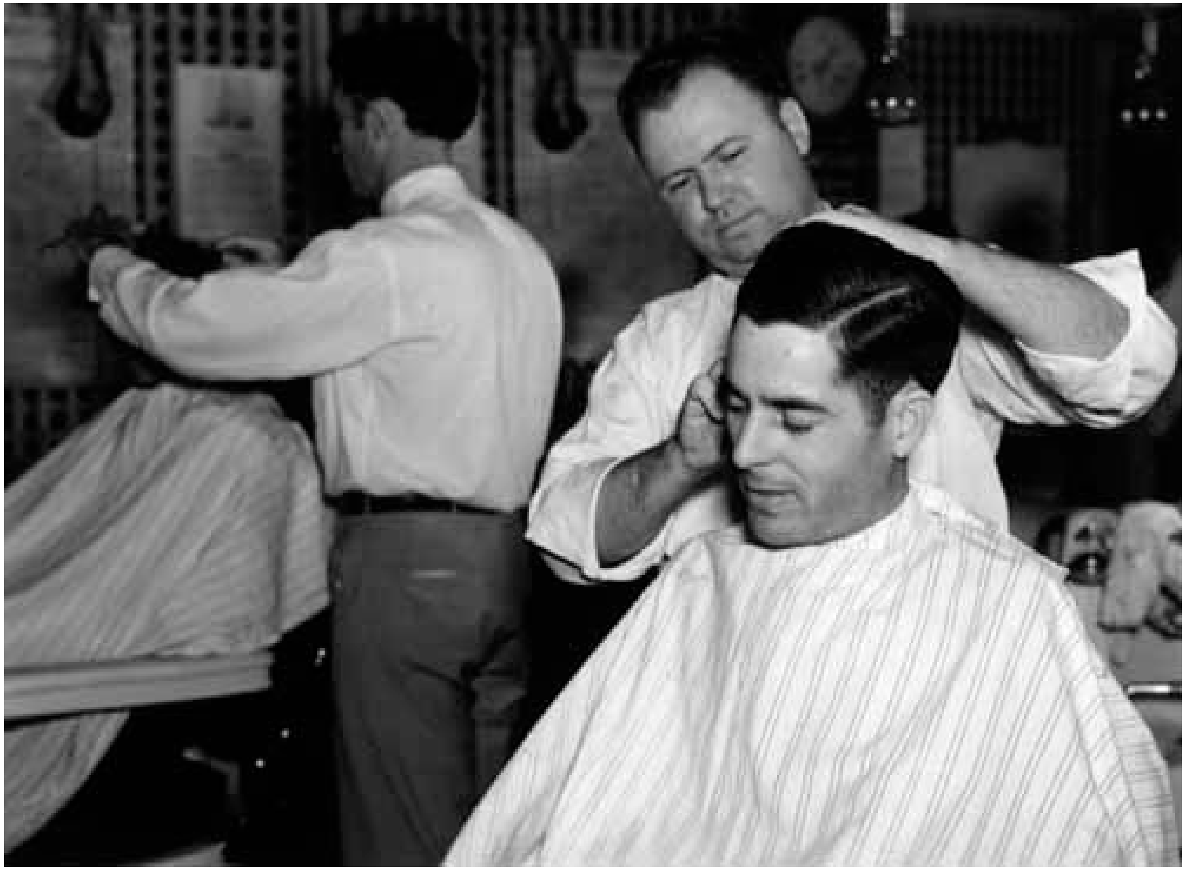
(3) Recapitalize banks

- Rescued banks
  - Greece borrowed 50 bil from EU to rescue banks
  - Financial stability loans for recapitalization of banks appear as state loans (€50 bil. in the case of Greece) – does not make sense
  - Gives primacy to State and fractures the banking system

The EU banking rules during the crisis

- Reduced the quality of EU banks compared to US banks
  - By declaring that large bank deposits in Europe can be subject to haircuts
- In contrast, in the US, FDIC insures 100% deposits to $250,000 per person per bank and has not imposed a haircut on any small or large depositor of a failing bank since WWII

(4) “Private Sector Involvement” (PSI) Greek Debt Not Held by the EU and IMF cut by 74% in March 2012: Debt Haircut



Restructuring of official sector debt (has not happened)

- OSI (Official Sector Haircut)

1. No direct haircut (direct gift to Greece, politically unfeasible)
2. Solution: move debt maturity to 75 years
   - 52.9bil 17-year bilateral loans to 75 years
   - 139.9bil 23-year EFSF loans to 75 years
3. Reduce rates to *fixed* interest rate of 1%
4. This process will save Greece at least 50% of its Official Sector debt obligations in terms of net present value
5. Keep not paying interest (except to the IMF). *Invest (not consume)* the saved interest (2.5% of GDP) to reduce unemployment

(5) Increase competitiveness by opening markets to competition and other “structural reforms”

- Needed structural reforms
  - Open closed professions
  - Allow private universities
  - Shrink the State
  - Simplify state procedures for businesses
  - Cut corporate tax rates
  - Reform tax collection mechanism and reduce tax evasion
  - Create tax courts that decide in 6 months
  - Give a zero tax period for new businesses for 5 years
  - Go forward with privatizations
- Very little of these were done

However, in Spring 2014 things looked good

- Ireland recovered and left the program; Portugal was close to leaving
- Greece that had the highest budget deficit
  - In 2014 had a primary surplus (gov. budget surplus disregarding interest)
  - Participated again in international money markets (issued new bonds in April-May 2014 at 3.5% and 4.5%)
- But unemployment & recession problems remained

The situation deteriorated

- after Syriza's share increased in European and local elections in May 2014
- The Troika wanted more than the Samaras government could deliver facing a prospect of early elections
- Syriza promised an infeasible program
  - A reversal of all reforms and privatizations
  - Increasing the State sector
  - Increasing wages and pensions, including reestablishing the 13th salary
- Greece was excluded again from money markets

Conditions in Greece now. Syriza elected on 1/25/15

- Greece is in a money crunch
- Europeans ask for reforms
- Syriza wants to reverse reforms and not implement new ones

Greece is in a money crunch! (1)

- People did not pay taxes for months, expecting Syriza will cut taxes or eliminate them
- Political and economic uncertainty lead to a very significant reduction of deposits in Greek banks
- Greece cannot borrow from money markets
- Greece cannot borrow from the EU, IMF without proceeding with reforms
- State will run out of money very soon

Greece is in a money crunch! (2)

- To finance itself, the gov. wants to issue 3- and 6-month T-bills and wants the banks to buy them
- Two ceilings imposed by ECB
  - Greece not to issue more than €15 bil
  - Total held by Greek banks not more than €9 bil (which they hold now)
- Remaining 6 bil held by Greek pension funds and the Bank of Greece
- Gov. wants to issue more and Greek banks to buy €10 bil more
- ECB said “no” except if the Eurogroup authorizes

Greece is in a money crunch! (3)

- Greek gov. delays all payments except salaries, pensions, and external loans
- Gov. took money from pension and other funds in exchange for 3-month T-bills (2-3 bil)
  - Bad precedent of Bank of Greece in 2012 that forced pension funds to buy GGB subject to the PSI resulting in big losses for Funds
  - Just a temporary reprieve. Will need to pay these back. Also Greece will need more funds very soon if ECB does not authorize more lending

The trilemma: bankruptcy with Grexit, bankruptcy in the Euro, or deal

- Grexit is a total disaster, of a similar magnitude to the Asia Minor disaster
  - Full scale bank run
  - Big immediate devaluation, inflation, extreme poverty, shortages of basic goods, irresponsible money printing, hyperinflation
- Bankruptcy in the Euro
  - Probably not manageable by the gov.
  - Requires tremendous support by the ECB
  - Likely to lead soon to Grexit

Deal with the EU is by far the best outcome. Should (1)

- Reduce State sector
  - Evaluate civil servants and reduce their number
- Decrease taxes
  - Reform tax collection mechanism and reduce tax evasion
- Create incentives for investment
  - Lower corporate taxation
  - Create tax courts that decide in 6 months
  - Give a zero tax period for new businesses for 5 years
  - Reduce bureaucracy
  - More business-friendly environment
- Allow for public investment

Deal with the EU is by far the best outcome. Should (2)

- Rationalize the pension system so that pensions correspond to contributions
- Revamp corrupt government procurement through competitive auction processes
- Open "closed sectors" of the economy (such as pharmacies and trucking)
- Proceed with privatization of trains, airports, ports, and energy
  - Sectors starved of investment for years
  - Private parties would provide investment as well as run them more efficiently.
- Labor market liberalization is essential

New investment in Greece

- Objective: to reduce unemployment from 25% to 15% in two years by creating real jobs
- Get exemption from the Mnemonio on public investment
- Sectors
  - Tourism
  - Renewable energy
  - Infrastructure
  - Export industries
  - Specialized agriculture

Bottom line

- 4 years of hard work and balancing the budget are almost all lost
- 3-year Greek Gov. bonds, issued at 3.5% in 4/14 now trade at 25-29% implying a probability of bankruptcy in the Euro or Grexit of 45-55%

The situation is grave

- A deal (as outlined) is needed immediately!
- And needs to be implemented!