

## No end in sight to Greece's economic pain

Entering the fifth year of recession, Greece is writing its name in the book of unwanted records for one of the deepest economic slumps of modern times. The Greek economy shrank 6.8% in 2011, leaving the level of output an estimated 16% below its pre-crisis peak. Unemployment has soared to more than 20% from 7.7% in 2008. In Ireland, the fall in GDP from peak to trough during the financial crisis has been 12% to date but at least the former 'Celtic Tiger' economy appears to have bottomed and is set to post positive, albeit modest, economic growth in both 2011 and 2012.

Argentina suffered a 20% peak-to-trough drop in output as it defaulted on its debts in 2001, while Latvia's economy contracted by 24% because of the 2008 global financial crisis. With more belt-tightening in store in return for a proposed €130bn international bailout, Athens is on course to join their ranks, and possibly overtake them. On the current path, which is unsustainable in our view, we may well see Greek GDP go down 25-30% in overall terms, which would be historically unprecedented. All in all, for ordinary Greeks, the outlook is dire.

World Bank figures show that Russian output dropped 44% between 1989 and 1998, dwarfing the 29% drop in the United States during the Great Depression. But since Russia's economic reversal was compounded by the break-up of the Soviet Union, analysts tend to exclude the episode when examining severe recessions. Furthermore, comparing crises is like comparing apples and oranges. Every country is different, economically and politically. But, Greece stands out in one important respect: its downturn has already lasted twice as long as the average crisis and yet there is no end in sight.

## Financial crisis and austerity in numbers

Measure	Euro zone					Latvia	Argentina	Mexico	Indonesia
	Greece	Ireland	Portugal	Spain	Italy	2007	2002	1994	1998
GDP fall peak to trough*	-16%	-12%	-5%	-4%	-5%	-24%	-20%	-8%	-13%
Peak unemployment	21%	15%	14%	23%	9%	17%	24%	8%	6%
Private consumption peak to trough*	-15%	-14%	-6%	-6%	-2%	-27%	-25%	-9%	-4%
Real disposable income peak to trough**	-23%	-9%	-8%	-4%	-6%	-24%	-24%	-5%	-18%
Government expenditure peak to trough*	-34%	-14%	-7%	-4%	-2%	-18%	-7%	-9%	-25%
Currency fall vs. USD 1 month after crisis							-51%	-40%	-7%
Currency fall vs. USD 1 year after crisis							-70%	-54%	-83%

\*Fall from peak to Q4 2011 for euro zone

\*\*Argentina numbers nominal



Source: Thomson Reuters Datastream, Oxford Economics, IMF

Athens has repeatedly frustrated the European Union, the International Monetary Fund and the European Central Bank – "the troika", by failing to implement the reforms it promised in exchange for its first bailout (€110bn) in 2010. Apart from missing targets for reducing its budget deficit, Greece has dragged its feet on laying off workers from its bloated public sector, privatising state assets and opening up closed trades and professions to competition.

Yet one critical measure, the primary budget balance, which excludes interest payments, shows Athens has made serious adjustments by raising value added taxes and cutting pensions, salaries and public servants. The primary balance was in deficit in 2009 to the tune of 10.4% of GDP. This year, it is projected to show a surplus of 0.2%. Although Greece has not received much credit for what it has done, there are not many countries that have brought their primary deficit down as quickly as Greece has.

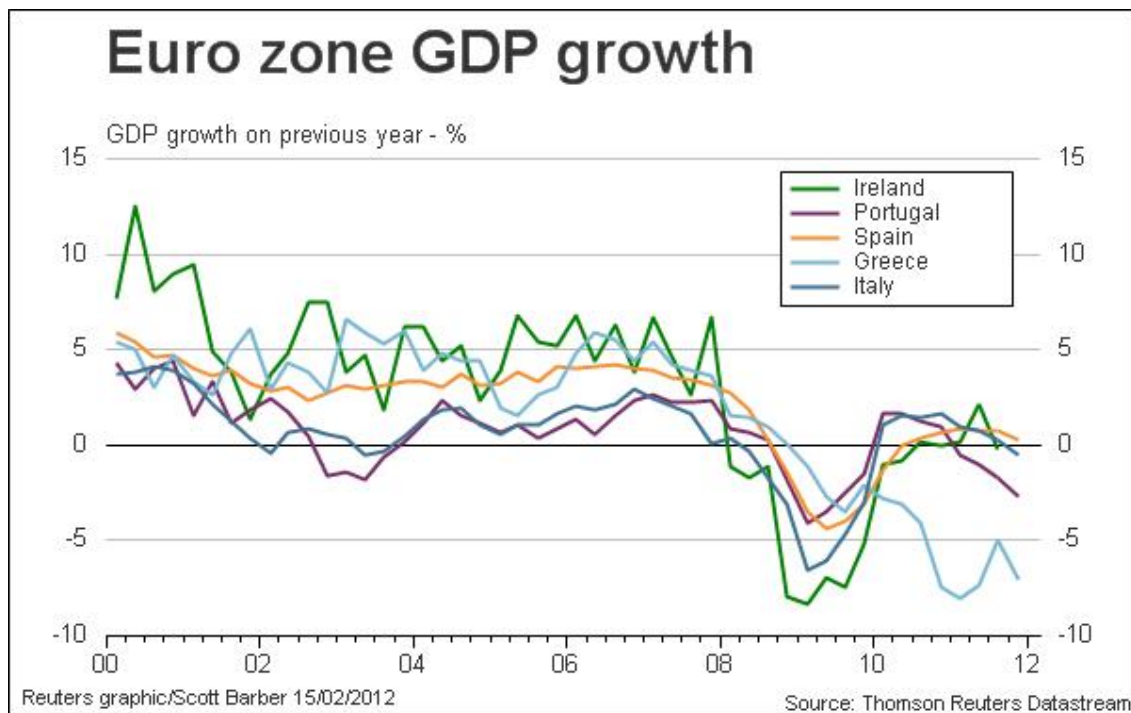
But the interest-rate burden is weighing Greece down. The planned interest burden is the highest in the world, except for Jamaica, according to the Centre for Economic and Policy Research, in Washington. At this juncture there's simply no light at the end of the tunnel for Athens. Government expenditure and real disposable incomes in Greece have already fallen much further since the onset of the crisis than in fellow Euroland members Portugal and Ireland, which have also received EU/IMF bailouts. Private consumption has also declined more steeply than in Ireland. Yet the IMF and EU have built into Greece's economic programme an assumption that personal spending will drop by a further 4.7% in 2012 and 1.4% in 2013. Meanwhile, unemployment will still be at 18% in 2015.

And the risks, acknowledged by the IMF in its December review of Greece's progress, are on the downside. If austerity dampens growth and squeezes tax revenues, the budget deficit will be forced higher, requiring a fresh round of belt-tightening. That is what happened in 2011. The 6.8% drop in GDP reported on Tuesday exceeded the 6.0% fall that the IMF had penciled in as recently as December, which itself was a revision from an earlier projection of a 4.5% contraction.

Countries typically break out of such a vicious circle by devaluing. Output and employment initially fall hard but recover rather quickly, as the examples of Argentina, Russia and the countries hit by the 1997/98 Asian financial crisis showed. Indonesia's currency fell by more than three-quarters after it devalued. Swathes of the banking system were wiped out, and millions of people were plunged into poverty. Yet its peak-to-trough drop in output was milder than Greece's. Today, the country is thriving and enjoys, unlike Greece, an investment grade rating.

These and other examples are keeping the question alive whether Greece should quit the Eurozone and devalue. Ireland and Latvia, whose currency is pegged to the euro, have shown that devaluation is not the only way out. Competitiveness can also be regained through budget and wage cuts, a so-called '*internal devaluation*'. Portugal, Spain and Italy are ploughing the same furrow.

But Greece's plight is now so serious it may take the risk and abandon the euro. If Greece left Euroland it could potentially do quite well, just like Argentina, growing rapidly after a brief crisis. However, in our view, if Athens said goodbye to the single currency, chaos would ensue. Not only would the government go bankrupt as international lenders withdrew aid, but banks and most of the private sector would collapse as a steep devaluation of the '*new drachma*' would make it impossible to service euro-denominated liabilities.



Ultimately, though, the question is one for the Greek people and their politicians. How long will they put up with austerity? Economic comparisons cannot answer that question.

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