A GREEK REVIVAL?

a. Some promising signs on the horizon

Reports of a full Greek revival may be greatly exaggerated but some signs of reversal in the fortune of Greece are discernible.

First, this current spell of reforms introduced by the Greek government is the more prolonged and consistent effort ever since the start of the crisis back in 2009. This has to be credited to the Prime Minister Mr. A. Samaras and to the Minister of Finance Mr. Y. Stournaras.

Second, labour market reforms have led to a dramatic decrease in labour costs and this is acting as a boost mainly to export oriented companies.

Third, in anticipation of the recapitalization of banks some tranquility has returned in the financial sector.

Fourth, a strong recovery in tourists' arrivals is also having a positive impact on economic activity.

Fifth, some investment funds are taking positions and have returned to Greece.

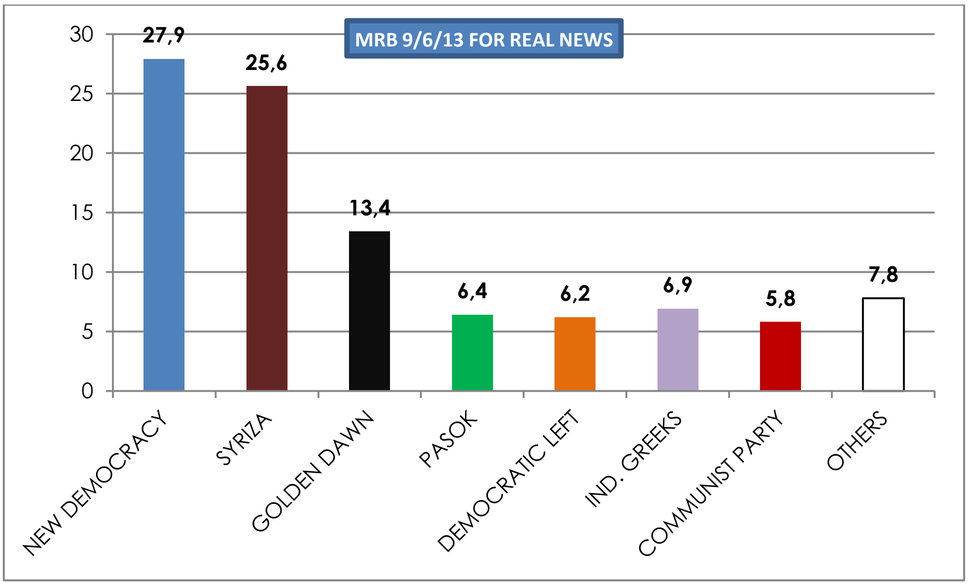
Finally, a series of positive statements from European leaders indicate that Greece has gained considerable credibility over the last 12 months.

For these six reasons an improvement in sentiment has occurred and foreign investors have started to return bargain hunting.

b. Built to last or gone with the wind?

However, the current stability is fragile and rests on precarious political and economic foundations.

First, the stability of the government arrangement is questionable as the two junior parties of the coalition (PASOK DIMAR) are encountering major problems in persuading their traditional electoral base for their continuing support of the troika based policies. In any case PASOK is going through a period of decomposition and its long term survival is questionable. The overhaul of the political centre long overdue cannot be accomplished with the current political personnel. The political electoral landscape that emerged in the last elections was a transient one. The outlook is that the political system is moving gradually back towards a two party system but at a lower level. With the existing electoral system one of the two main parties will be the backbone of the next government. The choices are clear, but the question is whether the electorate will vote positively supporting the party which consistently followed the troika prescriptions as a way out of the crisis or negatively punishing the party that has caused a lot of pain. A slow jobless recovery will not help New Democracy and the Prime minister.

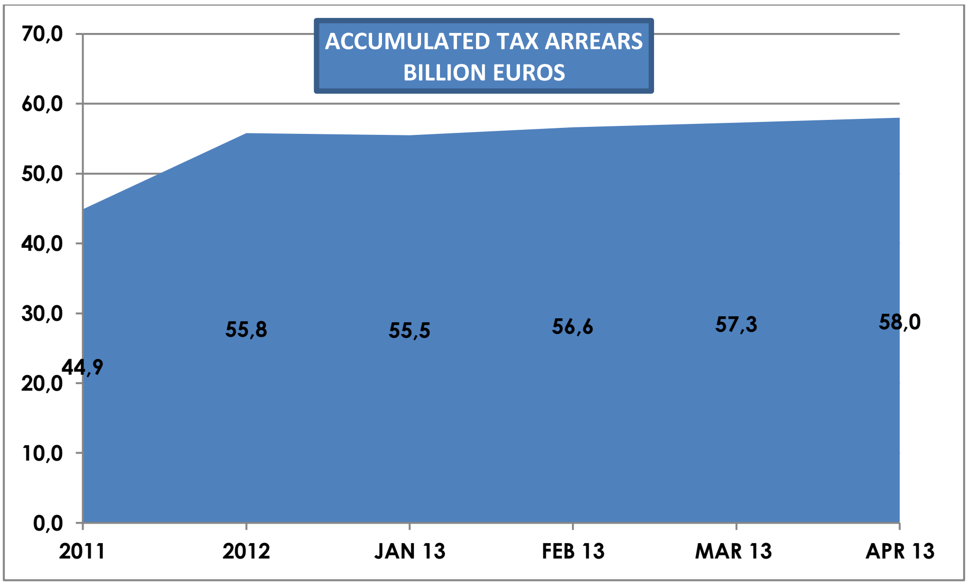


The mechanics of alliances and coalition politics is further complicated as the only party with a clear electoral dynamic GOLDEN DAWN cannot be part of any governing arrangement. The Communist Party has also ruled itself out of any coalition. Therefore, if New Democracy is the first party after the next elections it will have to rely again on the remnants of PASOK and DIMAR to form a government. SYRIZA may also if it comes first rely on DIMAR and possibly the Independent Greeks which have taken a vehemently anti troika position. The first party must have a clear win over the second with at least a 30% of the popular vote for a viable government to be formed.

Second, the management capabilities of this government are limited as few of its members are reform minded and even fewer have an above average implementation record. Reforms have been slowing again as the privatisation program is encountering major difficulties and attracting limited international interest. Poor preparation and lack of coordination have hampered the process. OPAP the jewel in the crown has attracted only one valid firm bid at below par. DEPA and DESFA the gas distribution and infrastructure corporations have also attracted limited interest from mainly Russian companies (GASPROM and SIDEZ). The deficiencies in the organization of the privatization process and the architecture of HRADF are now evident and the government has to take immediate additional steps to quickly address the main weaknesses.

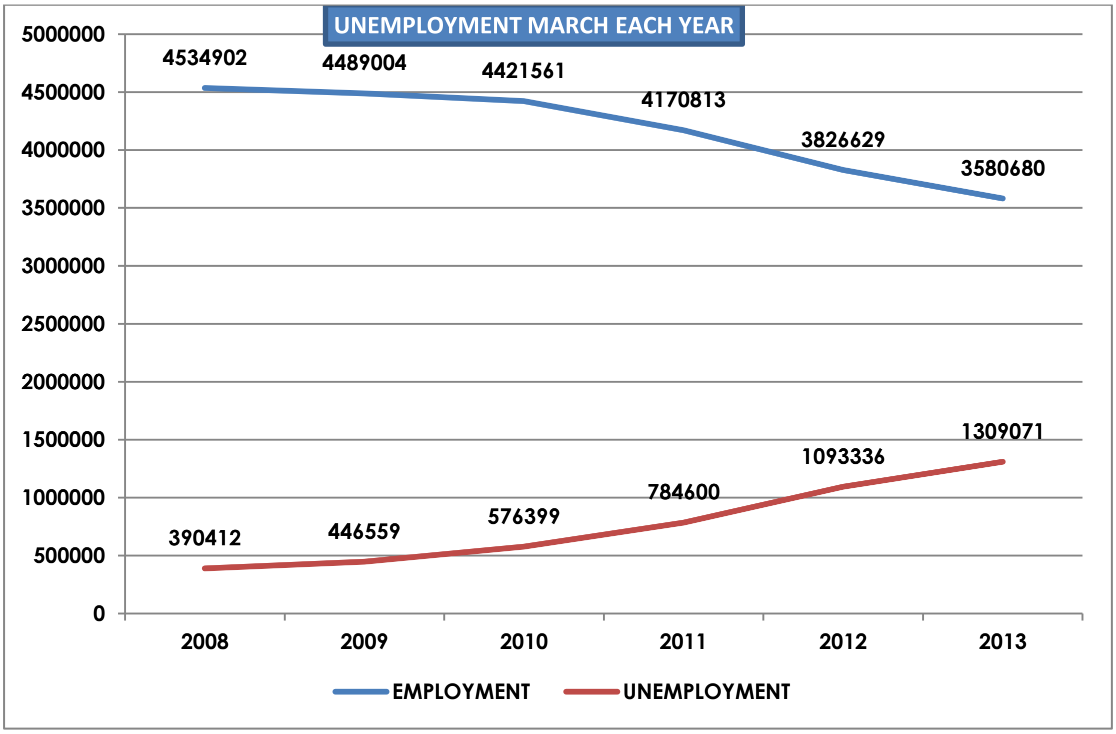
Public sector consolidation is way off target with redundancies continuously postponed by the government. A new painful pension reform will be soon required as the current state is unsustainable with the government failing to combat social security contributions' evasion. The current troika discussions will be as difficult as ever and there will be little respite until the end of the year. Whether the government will be able to avoid difficult decisions in the current round of negotiations is a matter of speculation but the self-criticism made by IMF is not going to change anything over the medium term.

Furthermore, the continuing reliance on the revenue side of consolidation is having a huge impact on people and corporations. The limitations of this attitude are evident as tax arrears have increased by 10 billion euro from 2011 to 2012 and by another 2 billion euro in the first quarter of 2013.

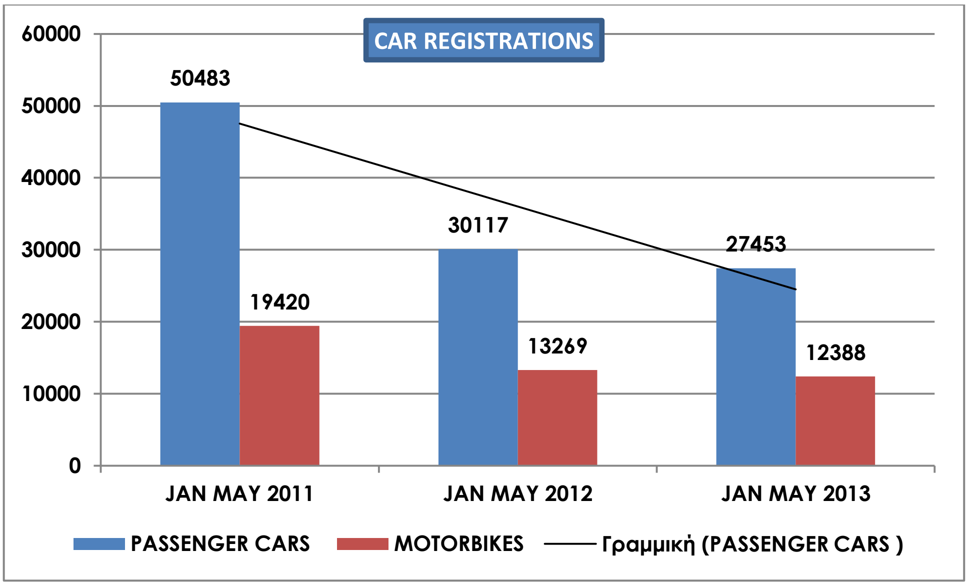


Third, the real economy is not reacting to reforms. Most of the large companies are crippled by overindebtness and are unable to undertake major investments. Non-performing loans continue to grow and interest rates remain high compared to other European economies. According to market sources corporate non-performing loans have exceeded 27 billion euros or about 25% of the total in the first quarter of 2013.

The corporate sector continues to shed labour and the unemployment is moving from one record to another. The restart of major road construction works has been delayed and hiring is running behind schedule. EU sponsored programs for the creation of local jobs opportunities are poorly designed and fail to have an impact. Youth unemployment is rampant and scientists' migration is gaining momentum. Highly qualified doctors, educated at a very high cost, are migrating to Germany Sweden and Australia.



Conjectural indicators show few signs of reversal. Car registrations continue to decline although at a slower pace. Retail sales volume is also declining but at a slower pace.



Full recovery is still possible if the reform effort is sustained and qualitatively improved. However, a new external shock is again required to keep up the reform and recovery momentum and a reduction in Greece's debt may be seen as a reward for the toils of the people and an offset for the mistakes of the creditors.

The main risk remains political as the coalition government faces major difficulties and unless a sustained reduction in unemployment takes place soon, political stability is not guaranteed.

S. Travlos 9/6/2013