GREECE UPDATE

Time is running out but Greece may just survive for the time being

The new proposal to the creditors is very close to the one proposed by the institutions and rejected in the referendum. It is a positive contribution in the right direction but it may not be enough.

Deepening recession

The delay in accepting the institutions offer and the subsequent exit from the program has led to capital controls a collapse in banking and a halt in the real economy. The timing of the government action may not be more unfortunate as its actions destabilised tourism the only sector that could pull the economy out of recession. Public works were completely destabilised much as the government has stopped paying contractors in order to be able to pay pensions and salaries. Following the capital controls car and durables sales collapsed by almost 50%.

With the economy in a standstill and confidence collapsing we expect a recession to at least 3% for 2015 not taking into account the recessionary measures of the new proposal. The only counter weight force is the structural funds related projects if there is time to start them within the year. Lengthy tendering procedures combined with the weaknesses of the public sector and the lack of available bank finance might delay any early recovery in the public works.

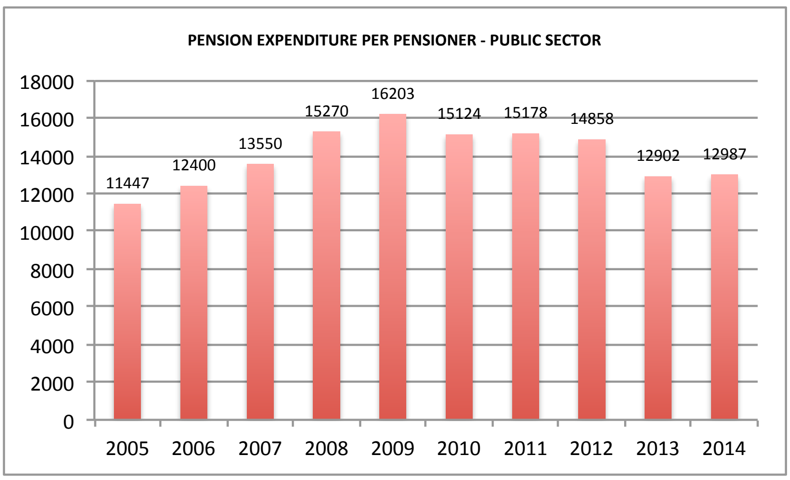
Banks on the brink

Capital controls and unfortunate announcements by the government have completely undermined the credibility of banks. Discussions about haircuts in deposits further exacerbate the situation. Financial fragility is now endemic. Even if banks reopen soon a generation of Greeks will stop having confidence in the domestic banking system. The government has to react with draconian measures in order to revive the system. But they are doing the opposite. They have moved from the absolute protection of secrecy to the full denial of it. They keep asking the banks for deposit movements for more than 1.2 million of accounts going back to the year 2000. They are threatening to open safe boxes inside banks and count money and jewellery. At the end Greeks will transfer abroad (or under the mattress) all their savings.

Regaining confidence is the key. Recapitalisation of banks must be the first step. A hair cut on deposits may not be avoided but it must be a fair one and take consideration of the many specific issues that have arisen. The treatment of corporate reserves is a key parameter. A haircut on these accounts although a very attractive proposition will lead to more failures and job cuts.

Running out of Options

The creditors may decide to accept the Greek proposal to avoid GREXIT but somewhere down the road it will be difficult to avoid new measures in order to reach even the revised surplus targets. One safety valve is the pension review



in October 2015. A run away deficit at that time may lead to new curbs on pensions. It is difficult to comprehend the government's insistence not to take additional measures in this area especially regarding pensions in excess of 1500 euro per month. An ageing population with skyrocketing unemployment is unable to sustain pension expenditure at these levels. Public sector pensions remain above the 2006 levels despite cuts in the earlier years of the program[1].

The way ahead

The government assisted by the European Commission has to implement fast an investment program that will overcome all the usual weaknesses. The government needs urgently assistance in the areas of investment incentives for the private sector and social programs for those in need and the unemployed. In these areas we have witnessed major failures in the past. All the governments (especially the current one) have lost time to negotiate and adopt reforms and public finance measures while they failed to restart the economy. Off course confidence remains the key and with the recent setbacks none expects an early recovery in this area. The main obstacle remains the suspicion about the real motives and the ability of this government to accept the role of the private sector in any recovery. Ideology and lack of experience is making things difficult but there is no alternative on the horizon. As things are public works will again be the only growth lever that will be available for a long time.

In this context Greece may again have to face further difficult dilemmas down the road. Staying in the EURO is the right option but it requires first and foremost a sea change in attitudes by this government and the entrepreneurial elite. The latter have clearly understood that continuing with old habits leads to nowhere. The former might take some time to digest reality.

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[1] http://www.protagon.gr/?i=protagon.el.oikonomia&id=41772