cepAdhoc

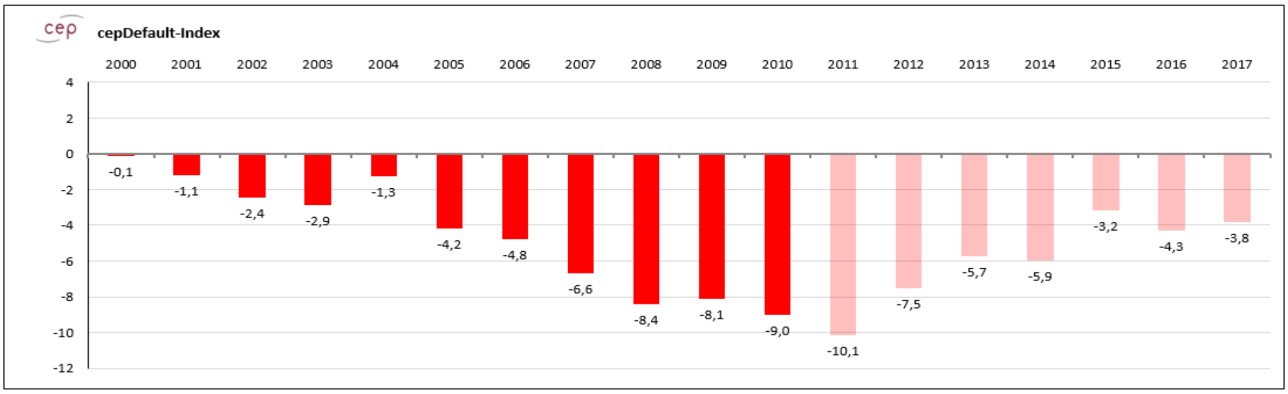
20-08-2018

cepDefault-Index Greece 2018

Greece is still not creditworthy despite completion of the adjustment programme

Prof. Dr. Lüder Gerken and Dr. Matthias Kullas

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Risk category	3	3	3	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4
I^c	6,5	6,9	5,8	7,0	6,0	3,8	5,4	6,8	5,8	3,4	0,6	-1,8	-5,1	-5,9	-5,8	-5,6	-5,2	-3,8
NTE	-6,6	-8,0	-8,2	-9,9	-7,3	-8,0	-10,2	-13,4	-14,2	-11,5	-9,6	-8,3	-2,4	0,2	-0,1	2,4	0,9	0,0
I^c + NTE	-0,1	-1,1	-2,4	-2,9	-1,3	-4,2	-4,8	-6,6	-8,4	-8,1	-9,0	-10,1	-7,5	-5,7	-5,9	-3,2	-4,3	-3,8



On 20 August, the third economic adjustment programme for Greece comes to an end. This has prompted cep to examine the trend in Greece's creditworthiness:

- Greece is still not creditworthy. Regaining creditworthiness remains a long way off. Whether Greece will manage without aid on a permanent basis is doubtful.
- Greek capital stock has been in decline since 2011. This trend has slowed down in the last few years but has still not come to a stop.
- The positive growth in GDP last year does nothing to change this finding. It results from the fact that consumption has increased and net investments were not - after all - quite as negative as in the previous year. However, the import surplus increased. This shows that Greece remains uncompetitive.

1 Introduction

Greece's third economic adjustment programme comes to an end on 20 August 2018. The country has been dependent on financial assistance for eight years - significantly longer than the other eurozone crisis states. At € 289 billion, Greece has also received 1.5 times as much financial aid as the other four eurozone crisis states put together. As a result of the low interest rates and long maturities of the grants, Greece saved over € 30,000 per inhabitant in interest payments.[1] This does not take account of the relief provided by the haircut in 2012. Despite the long maturities and low interest rates, it is unclear whether Greece will be able to refinance itself on the capital market in the long term. The heavy debt burden, in particular, which most recently reached 180.4% of GDP[2], gives rise to doubt. On 21 June 2018, in order to ensure that Greece will nevertheless be able to borrow money on the capital market, the eurozone countries committed to comprehensive debt relief, above all extended maturities and deferred interest payments on the EFSF loans that have been granted[3]. It aims to ensure that Greece's gross borrowing requirement does not exceed 20% of GDP in the near future.

A large part of the debt relief is subject to the proviso that Greece continues the reforms that have been started, such as that of the social security system, and achieves an annual primary surplus[4] of 3.5% of GDP. The EU Commission, the European Central Bank, the International Monetary Fund and the European Stability Mechanism are going to monitor this proviso quarterly.

The procedure following the end of the third adjustment programme differs significantly from previous practice. Although economic and fiscal development in the other countries that received financial assistance is also regularly monitored, these checks only take place half-yearly. Above all, however, at the end of their adjustment programmes, the other eurozone crisis states did not receive any debt relief nor did they have to make commitments to international lenders to make further reforms. The fact that Greece is subject to a different procedure indicates that the need for reform and restructuring remains significant. At the same time, the confidence of the governments of the eurozone countries in the Greek government's willingness to make reforms and savings remains low.

Due to uncertainty as to how far Greece will be able to cover its capital shortfall without financial assistance in the future and due to the lack of confidence in the Greek government to continue along the same path after the adjustment programme comes to an end, the cepDefault-Index for Greece, which measures creditworthiness trends, has been updated as follows.

2 Structure and significance of the cepDefault-Index[5]

The cepDefault-Index measures the creditworthiness trends of an economy as a whole – i.e. not only those of the state sector. In addition to the state sector, it also takes account of the credit behaviour of the financial sector, business and consumers. The Index records the level of capacity enhancing capital formation (C) in a specific period and the net lending or net borrowing of the total economy (NTE) which

[1] Cf. Kullas et al. (2016): Redistribution between the Member States.
[2] As of end 2017.
[3] For further information on the European Financial Stability Facility (EFSF) see Kullas et al. (2016): Redistribution between the Member States.
[4] The primary surplus shows the public deficit without taking account of debt interest payments.
[5] For a detailed explanation see Gerken/Kullas/Brombach (2017): cepDefault-Index, Section 2.

illustrates an economy's borrowing requirement. The Index is formed from the sum of C and NTE; both values are indicated as a percentage of gross domestic product (GDP): cepDefault-Index = C + NTE.

Risk Category 1 (green light) means: Creditworthiness is increasing. Risk Category 2 (amber light) means: The trend in creditworthiness is unclear. Risk Category 3 (red-amber light) means: Creditworthiness is falling. Risk Category 4 (red light) means: Creditworthiness has been falling continuously for three or more years; the erosion of creditworthiness is not a temporary problem but a structural one; complete loss of creditworthiness is impending or has occurred.

3 cepDefault-Index for Greece

Summary: Greece is still not creditworthy. The financial assistance which began in May 2010 and is due to end in August 2018 has not changed anything in this regard.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Risk category	3	3	3	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4
I^c	6,5	6,9	5,8	7,0	6,0	3,8	5,4	6,8	5,8	3,4	0,6	-1,8	-5,1	-5,9	-5,8	-5,6	-5,2	-3,8
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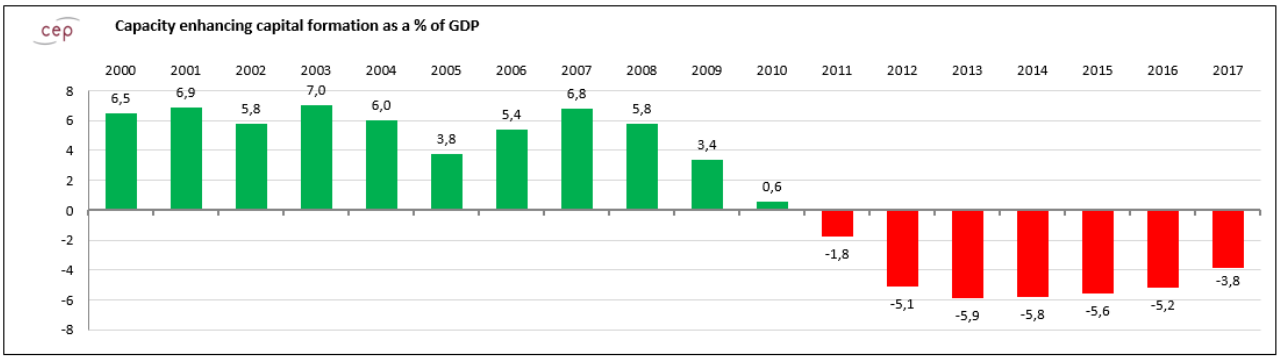
I^c + NTE	-0,1	-1,1	-2,4	-2,9	-1,3	-4,2	-4,8	-6,6	-8,4	-8,1	-9,0	-10,1	-7,5	-5,7	-5,9	-3,2	-4,3	-3,8

Capacity Enhancing Capital Formation (C): Greek capital stock has now been declining for seven years. In the last year alone, it fell by 3.8% of GDP. Nevertheless, this process has been continuously slowing down since 2014, which is in particular due to an increase in equipment investments. Greece has almost reached the eurozone average for this type of investments. Still weak, however, are investments in intellectual property. Greece is far below the eurozone average in this regard.

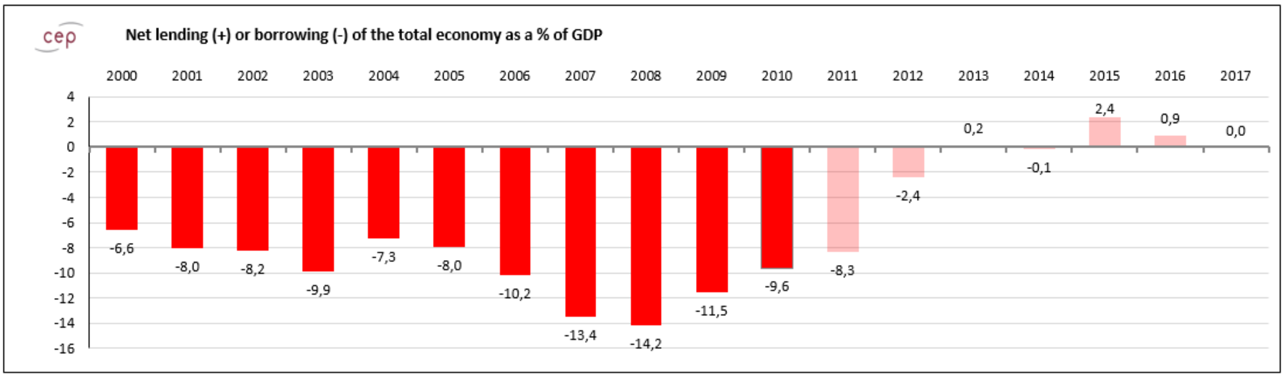
The continuing decline in capital stock is primarily due to a lack of private investment. In 2017, public net investments were positive.[6] The savings measures called for by international lenders have thus allowed enough room for public investment.



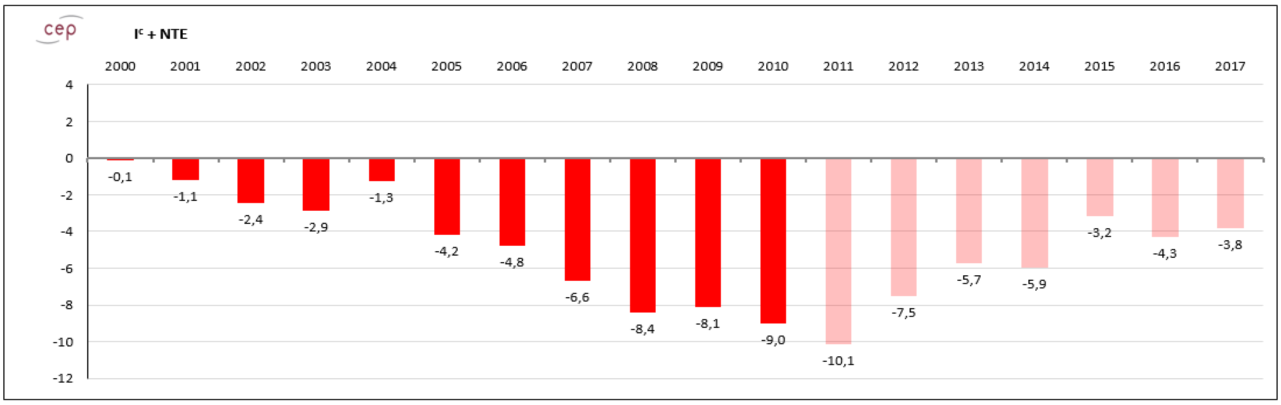
Net lending or net borrowing of the total economy (NTE): Between 2000 and 2012, Greece was a net borrower: The country incurred foreign debt in order to cover its borrowing requirements. From 2010, financial assistance replaced private borrowings. In 2013 and 2014 this was counteracted by increased capital flight due to political uncertainty and a lack of attractiveness for investors so that, the balance was

6 Cf. Database of the European Commission, Ameco, online at: http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm, accessed on 17.08.2018.

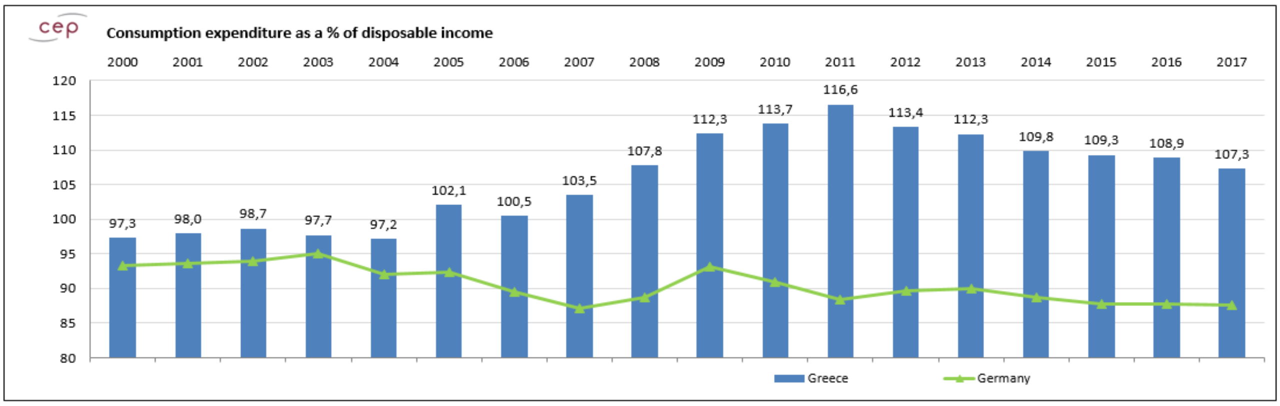
almost level. In 2015, on balance, the country even exported capital. Instead of investing in Greece - at least in terms of depreciation - equity holders preferred to invest capital abroad. After the introduction of controls on the movement of capital in mid-2015, capital exports fell by almost two thirds in 2016 and were back to zero in 2017.



C + NTE: Since 2000, C + NTE has been negative. Up until 2010, this was caused by the sometimes huge levels of borrowing. Since 2012, the main cause has been the decline in capital stock.



Consumption rate: Although the Greek consumption rate has been falling since 2012, this is happening too slowly and to an insufficient degree. In 2017, it was still at 107.3% of available income - as compared with 87.6% in Germany and 93.1% in the EU as a whole. The country has therefore been living beyond its means for 13 years in succession. Money that is urgently needed for investment is instead being spent on consumption. This impedes the consolidation process and foments doubts about the country's willingness to consolidate.



4 Conclusion

Result: Greece is still not creditworthy. Regaining creditworthiness is still a long way off. The decisive factor will be the willingness of the Greek government to carry out reforms and restructuring, and the willingness of the population to reduce consumption. After eight years of privation, there is a danger that the end of the third adjustment programme will cause the tentative signs of improvement to stall. Whether Greece will manage without financial assistance on a permanent basis is therefore doubtful.

Cause: Since 2011, the erosion of Greek creditworthiness has been the result of declining capital stock. This trend has slowed down in the last few years but has still not come to a stop. In addition, the country remains uncompetitive. The fact that Greek GDP grew last year by 1.4% should not blind us to this because the growth results solely from the fact that consumption has increased, and net investments were not - after all - quite as negative as in the previous year.[7] The trend in the current account surplus[8] has on the other hand produced a negative contribution to growth as imports have increased more than exports. This and the continuing negative investment – the economy also disinvested in 2017 – show that Greece remains uncompetitive. The EU Commission does not expect the current account surplus to contribute anything to economic growth in 2018 and 2019 either.[9] Overall, there is therefore a risk that the current economic upswing will not be sustainable.

The Greek economy's propensity for excessive consumption also remains problematic. The consumption rate is falling but if the economic growth proves to be unsustainable, the consumption rate could shoot up once again.

Recommended action: The Greek government must remain committed to continued budgetary consolidation. In addition, measures must be undertaken to increase competitiveness and raise attractiveness to investors. That is the only way to ensure that the economic growth is not solely dependent on domestic demand. The measures by the Greek government should also aim at bringing down the consumption rate to below 100%. This would increase the savings rate thus making more capital available for investment. With attractive investment conditions, the reduction in capital stock could be halted and thus also the decline in Greek creditworthiness.

Against this background, it is appropriate that the eurozone countries continue to have an influence on the actions of the Greek government even after the end of the third adjustment programme. It was for this reason that a large part of the debt relief, promised on 21 June 2018, was made subject to the proviso that the Greek government implements further reforms.

7 Cf. EU Commission (2018): Spring 2018 Economic Forecast – Greece, p. 87 et seq.
8 The current account surplus arises from the change in the volume of exports minus the change in the volume of imports.
9 Cf. EU Commission (2018): Spring 2018 Economic Forecast – Greece, p. 89.