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Debt, unemployment, deflation: The reality in Greece

by Michael Heise

Athens hopes to return to the financial markets. In a number of areas the country has indeed made substantial progress. But it is still too early to sound the all-clear.

When it comes to Greece's economic outlook, optimists are pretty much a fringe group. Not surprisingly. For the past six years the Greek economy has been in a nosedive, since 2009 gross domestic product has shrunk by almost 25 percent and the unemployment rate has soared to just under 28% (among young people to almost 60%). Since 2010 the country has been hanging on the drip of the various European rescue schemes (sucking in a total of EUR 240bn). At the political level, a plucky, but rather fragile, coalition is battling on day by day. Strikes and mass demonstrations are almost a daily occurrence; euro-skepticism is spreading on both margins of the political spectrum.

Against this backdrop, is a spot of optimism allowed? The night is darkest shortly before dawn. In December 2013 the purchasing managers' index reached a four-and-a-half year high. And our annual Allianz Euro Monitor shows that there are now several lights at the end of the long tunnel, even if the path ahead remains bumpy. In our gauge of balanced growth based on 15 indicators Greece improved its overall score to 4.4 in 2013, after 3.6 in 2012 and 2.2 in 2011 (on a scale of 1 to 10). Although still a modest score, improvements are evident in many areas.

Greece's best performance is in terms of the change in competitiveness. In this category its score has doubled since 2011, helped by a sharp reduction in unit labor costs, a more or less balanced current account and stabilization of Greece's world market share. Greece also performs fairly well when looking at corporate debt, which is easing downwards at a relatively low level.

At the same time, however, much remains amiss. On seven indicators Greece still gets the worst possible score. Alongside unemployment, public finances and domestic demand continue to top the worry list. However, thanks to the interest-rate relief agreed in late 2012, the interest burden has eased despite rising debt levels. What is more, the successes on the consolidation front are not adequately reflected in the current deficit ratio. If the bank recapitalization had not been included, the Greek budget deficit in 2013 would have been considerably lower. For the first time in ten years Greece recorded a primary surplus. And, not to be sniffed at, the reform of the Greek pension system is likely to have reduced the future demographic burden on the Greek budget.

Market skepticism still runs deep. And efforts to get further relief on rescue fund loans have so far hit a stone wall in Brussels. Greek politicians warn that further austerity measures could trigger social unrest and political instability, even the downfall of the government. Not exactly dazzling prospects.

As earlier examples have demonstrated, perseverance is the key to ultimate success. Although consolidation and the reforms are starting to work, for the population at large progress is not yet really tangible. But, as EU Commission President Barroso said at the inaugural ceremony in Athens in early January: "Programs work."

While arguments with the Troika about the hole in the 2014 budget rumble on (according to the Troika EUR 1.5bn, according to the government “only” EUR 700m), some observers are now raising the specter of deflation. At the end of last year the overall consumer price level was 1.7% down on a year earlier. Given high unemployment and the related steep drop in wages, this is hardly surprising. However, a declining price level as a result of falling costs also reflects a restoration of competitiveness – as already evident in Greece’s current account. It would only be a threat should the expectation of permanently falling prices take hold, reinforcing the reluctance to spend. But with business sentiment brightening up, this is evidently not the case.

What is needed now, if regrettably late, is a targeted growth and investment initiative at the EU level in order to give the Greek population a perspective again. The EU has dawdled far too long. Correctly, the focus of the Greek EU presidency is to be on economic growth and tackling unemployment. However, with EU leaders having postponed a decision on possible “reform contracts” (the German chancellor has long been pushing for binding agreements between member states and the EU Commission on the implementation of reforms and backed by solidarity mechanisms) until October at the earliest, it is unclear what measures, if any, are feasible.

Certainly, the road is still long before the “Mission accomplished” banners can be unfurled, but increasingly the insight is gaining ground that the worst of the crisis is over. In Greece, too. The maxim now: Persevere.