Watching a Greek Tragedy Unfold.... (as at 08 Jul 2015)

On Sunday (06/07/2015), the Greek people took to the polls to vote in a controversial referendum asking if they were happy to go with the terms of extended financing to their Government from the European leaders, or not.

The answer has been a resounding NO.

Greece defaulted on an International Monetary Fund (IMF) loan repayment on 30 June, and at this stage, the IMF has not stated whether it will continue with a pre-planned bailout funding agreement.

Greece is supposed to make further payments totaling almost €3.5 billion to the European Central Bank (ECB) and other institutions on July 20.

Even if the ECB provides cash to Greece this week, it is tipped to turn off the tap by July 20 unless new bailout terms are agreed.

THE HISTORY

Problems with the Greek economy were well established long before Greece joined the EU in 1981, and adopted the common currency, the Euro, when it was launched in 2001.

Arguably, there are three main systemic problems with Greece.

The public sector i.e. the Government departments, are heavily influenced by politics.

Many of the top jobs are political appointments, and the Civil Service has historically paid exorbitant salaries.

It was not uncommon to get 14 months pay as an annual Christmas bonus, and Greek civil servants were also paid bonuses for arriving at work on time each day.

The Government departments have very few IT and data management systems in place, information is hard to come by, and often is not consistent.

One Greek superannuation fund (IKA) is in the process of recovering €1.9 billion which it has paid to pensioners who have died, at which point payments should have been stopped. It estimates that there is a further € 7.1 billion that has been fraudulently claimed in pensions.

Secondly, corruption and bribery are rife right through the economy, from the Government all the way down to small business.

Tax evasion is a national pastime.

The average EU country collects 37% of its GDP in tax revenue. In Greece, the Government collects 29% (source: www.gls.london.eu)

Despite the low tax take, Greece has until very recently had one of the lowest retirement ages in the world. In 2013, it was 57. Today, it is 63. 75% of people retire before the National retirement age, as the law allows you to retire if you have worked for 37 years.

If you started work at 20, you can therefore retire at age 57, and most people do.

Thirdly, the private sector is heavily regulated, which creates monopolies and reduces pricing competition. Businesses are heavily taxed, with lots of interference from local government. There are inefficient processes within Government, which result in long delays in obtaining compliance. And there is the ever present need to pay bribes to secure business.

Greek unemployment is currently 25%, and for youth, that rate is 50%.

None of these issues are going to go away overnight.

WHERE TO NOW FOR GREECE?

Greece currently owes €321,000,000,000 in debt.

Its largest creditors are Germany (€56 billion), France (€42 billion), private bonds (€48.8 billion), Italy (€37 billion), the IMF (€32 billion), Spain (€25 billion) and the European Central Bank (€20 billion) (source: www.moneymorning.com)

Arguably, there is absolutely no way that Greece is ever going to be able to repay that level of debt, ever. The only way that they will ever be able to survive is for some of this debt to be “forgiven".

Some calculations indicate that half of the current debt will need to be forgiven for Greece to have a chance of repaying its debt and surviving as a nation.

It is highly unlikely that the IMF will continue with the bail out programme unless some austerity measures are agreed to.

This means that Greek banks will not have enough money to open for business and this could be an ongoing issue. It is highly unlikely that there will be any assistance from outside sources.

Despite the “no” vote, Greece doesn’t have to leave the EU. They could choose to go back to using the drachma (their pre Euro currency), and depreciate this substantially against the Euro.

This would create inflation and kick start the economy. It would also make it an extremely attractive and extremely cheap tourist destination, so tourism would boom.

However, any person or business who had their mortgage or business lending denominated in the Euro currency would have to declare bankruptcy, as they would be unable to manage their capital or interest payments using a heavily depreciated drachma.

The social implications are also huge. Greece has gone through several years of austerity measures – of falling pensions, of reduced salaries, of higher taxes. Many pensioners are now living below the poverty line.

With the NO vote, it is likely that the circumstances for the Greek people will get worse before they start to get better. At this point, the Government does not have money to pay pensioners, to pay teachers, to pay hospital staff.

There could be a significant breakdown in living conditions in Greece.

However, the NO vote does give the Government a political mandate to start down the rocky path to independence.

WHAT DOES IT MEAN FOR NEW ZEALAND?

We have seen some volatility in share markets world wide. Share markets do not like economic uncertainty of any kind.

However, it is quite possible that this volatility will be short lived once Greece can signal what path it is going to take, moving forward. Markets have been waiting for Greece to default since 2009 – this was not a “surprise”. Bond markets have also responded in kind, but once again, it is quite possible that the overall long term effect will be small.

Our NZ dollar has fallen against the US dollar, with some commentators reporting that this is due to a “flight to quality” as investors head for the security of the US Dollar. I also think that the continued falling dairy prices were also a contributor to the fall of the dollar in the last couple of days.

We don’t export a lot of our products to EU countries. Germany is our 9th largest trade partner, Holland is 15th and France is 20th as of 31/12/14. (source: Statistics NZ).

If these countries are negatively impacted by the loss of the money that they have lent to Greece, this could impact their economies in the short – medium term.

Unfortunately, the Greek tragedy (and I mean that analogy sincerely) is likely to be a 9 day wonder to most of the world’s economies. It certainly won’t be that simple for the Greek people – the ramifications of the current situation in Greece are going to be felt for generations.