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The long overdue emergency loan for Greece is announced. Is it enough?



By [Harris A. Samaras](#)

www.pytheas.net





The long overdue emergency loan for Greece is finally announced... Although there is no agreement yet about the overall amount of money to be disbursed, it is expected that the total figure will be more than €40bn at a 5% interest rate. Additionally, the European Central Bank decided last week to prolong the exceptional collateral regime, which allows banks that own Greek bonds to exchange their assets for cheap central bank funds – a significant announcement that will provide Greece and its creditors with breathing space.

But is it enough? Is it a coherent policy? Will it hold off insolvency?

The adjustment effort Greece is asked to make will be one of the largest in history. But unlike other countries that made a similar effort in the past, Greece cannot devalue; it faces a much more challenging global environment; it has a weak fiscal infrastructure; a low consensus in society in favor of deep reforms; and a fragile financial system.

Greece has a debt-to-gross domestic product ratio of 125%; needs to raise around €50bn in finance for each of the next five years to roll over existing debt and pay interest which adds up to approximately €250bn, or about 100% of Greek annual GDP. Moreover, in 2010, the Greek economy will contract, on the most credible estimates, by between 3% and 5%. Inflation will fall towards zero, so nominal growth will also contract sharply. Nominal GDP will probably contract even more sharply in 2011, and will continue to contract, perhaps at a slower rate, in 2012 and the following years. The reason for the persistent contraction in nominal GDP is that Greece needs to turn a primary deficit of more than 7% into a primary surplus – before interest payments – of at least 5%, a turnaround of more than 12 percentage points, while at the same time improving its competitiveness through wage cuts. The latter implies deflation. As the Greek economy goes through the adjustment process, the debt-to-GDP ratio will deteriorate towards 150% or so.

What is it with Germany though? What is Germany really trying to achieve? We are afraid that it will become clear very soon that this loan agreement represents a net transfer of wealth from Athens to Berlin...

The reluctance of the German government to help Athens is nothing more than an invitation to speculators to bet on the demise of the country (Greece). This will also explain why risk premiums on Greek government bonds will shoot up to unimagined heights in the next few days if nothing of substance is done. As a consequence, the Greek government will have to pay such high interest rates to refinance its debts that it would no longer get by without foreign assistance – despite recent tax increases and massive wage cuts. Then Greece is forced to ask for financial help from other countries and entities.

Moreover, this “German” and EU delay will also “force” credit rating agencies to downgrade Greece even further. Every downgrading of Greece’s status forces banks to sell Greek government bonds. This in turn accelerates the decline in the value of those bonds, leading to even higher interest rates...

Needless to say, that the German government's subsmissiveness to the financial markets and its “cowardice” towards the tabloid local press will get very expensive for German taxpayers as well. Now the aid will actually have to be paid out. And the needless fuss the German government continues to make will not change a thing!

Has the EU provided for a generalized crisis resolution regime? What will happen if Greece fails to repay the loan? Will the bond market interpret the deal as a sign that the EU will not let any member country fail? Or will it start testing the EU's solidarity for Portugal and possibly even Spain or Italy?

The “currency” of these countries needs to fall to reflect their economic position. Europe papered over this underlying problem because the poorer countries were able to borrow vast



sums from banks. If Greece defaults, then the country will leave the Eurozone and their currency will be slashed, plus the debts will be lost. Greece could then start the process of rebuilding. But that leaves the Euro in tatters and the big banks who were "thick" enough to lend to people who could not pay with enormous losses... **If Greece is left to default, it will create such a domino effect within the EU and beyond that its repercussions will be much worse than the 2008 USA "initiated" global financial crisis...**

So far, the EU and its institutions do not come out of this with much glory. The European Council made a political statement on 11 February saying that it is willing to support Greece in principle, while subsequently failing to agree on a firm package. In March, they appeared to suggest they had a deal, when, in fact, they did not. There were a lot of empty promises in the process...

The EU must explain and state credibly and clearly that it will take a shared common responsibility for an equal member of the common internal market. This must include the readiness, under certain conditions and in an emergency, to guarantee payments to Greece. Such declaration will make speculation a lot more difficult, and it will also prevent the further associated dramatic collapse of the value of Greek bonds. It will also increase the chances of Greece to rescue itself on its own. And that will save EU taxpayers a lot of money. Credibility and clarity pay dividends!

The cost of the Greek bail-out is not high compared to the hypothetical alternative of uncontrolled Greek default inside the Eurozone. Portugal is a smaller country than Greece, in terms of GDP, but Spain is the Eurozone's fourth-largest economy... If substantial action is not taken, the effects of the Greek financial crisis could spread throughout Europe and beyond.

The European-led rescue package for Greece must be implemented now. No doubt the EU needs to establish a mechanism to help out countries with financing problems. The very idea of a break-up of the Euro is absurd!

Moreover, unless Germany agrees to play its traditional leadership role in Europe and makes concessions to other members of the euro zone, the single currency itself could be at risk; if the Euro falls apart the EU will fall apart too. We also highlight, while the rescue package for Greece removes short-term liquidity risks, long-term solvency risks remain firmly in place. Greece must be helped at any cost!

And there will come a point when the EU will no longer be in a position to help, even if it wants to!

See also: ["Greece must change or sink!"](#)
["Greece unlikely to escape its worst financial crisis of modern times!"](#)
["The World's biggest debtor nations"](#)

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