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Eurozone (debt) crisis: Country Profile Greece

Economic Comment
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To the Eurzone (debt) crisis overview page

- **Weak private and public finances prior to the crisis are to blame for the severity of the recession and the public debt crisis**
- **Harsh austerity measures and large-scale economic reforms triggered a process of sharp economic contraction**
- **The economic outlook is very bleak with still sky-high unemployment and debt**

Diagnosis

In Greece, both large private sector imbalances and debt build-up and very weak public finances prior to the crisis are to blame for the severity of the recession and public debt crisis.

Greece had accumulated an enormous amount of debt relative to GDP in the years before the crisis as a result of structurally weak fiscal policy. In the years following Greece's accession to the eurozone, economic growth relied mainly on credit-driven private consumption and debt-financed public expenditure rather than on saving and investment. Meanwhile, any attempt to pursue structural reforms was met with strong and effective resistance. Public spending kept increasing, while revenue growth could not keep pace. Large fiscal deficits and historically high levels of public debt were the result, despite the unprecedented low interest rates that euro membership brought to Greece. With the outbreak of the global financial crisis in 2008 markets started to reassess credit risk on sovereign debt, worsening credit conditions considerably for the Greek government. Early 2010, the Greek government announced that its deficit in 2009 turned out to be 13.6% of GDP instead of the initially expected 6.7% of GDP. This further stressed markets. Not much later, Greece could no longer finance its deficits with market funding.

Crisis response

In May 2010 Greece was the first euro member state to receive foreign financial support. A three-year lending facility of EUR 110bn was set up by the Troika in May 2010. In February 2012, a second three-year conditional support package worth EUR 130bn was provided, and about EUR 197bn privately owned sovereign debt was restructured. This lowered the overall Greek debt stock by about EUR 107bn. Furthermore, the maturity of

official sovereign debt was lengthened, while interest rates were lowered and grace periods extended. Even after restructurings, Greece's public debt as a percentage of GDP remained very high. In the end, it was only after Mario Draghi's promise in July 2012 to do "whatever it takes" to preserve the euro and the subsequent announcement of Outright Monetary Transactions that bond yields started to decline.

In return for the financial support packages, Greece was required to implement harsh austerity measures and large-scale economic reforms. This triggered a process of sharp economic contraction. Ultimately, its economy shrank by more than a quarter in volume terms until the start of 2014 and unemployment rose to unprecedented ratios of more than 25%. Of all the crisis countries, Greece undertook the deepest fiscal adjustment (according to Eurostat) and implemented the most structural reforms (according to the OECD). Unlike in the other member states that received conditional financial support, pressure from the Troika has been continuously required, however, to force the government to continue to reform the economy. The crisis has been substantially prolonged and aggravated by the combination of (i) low domestic ownership of the reform process (ii) the size of the necessary economic overhaul, and (iii) the inability to effectively reform the very weak institutions; to tackle large vested interests; and to also place some of the burden of adjustment on the rich.

On top of that, increased political instability end 2014 and the victory of SYRIZA in the national elections at the start of 2015 has derailed a nascent economic recovery. Economic growth had turned positive in the second quarter of 2014 and a large public primary budget surplus was forecast to be achieved in 2015. All has been undone. After the Greek voted for the populist party claiming to undo reforms and end harsh austerity measures, uncertainty over Greece's future grew. Uncertainty over ongoing, necessary, financial support from the "institutions" (formerly known as the Troika) triggered deposit flights from Greek banks in the first half of 2015, bond yields to rise and households and business to defer investment and paying taxes. Even though a deal on a third bailout package has been reached in August 2015, a rapid recovery is unlikely.

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