Stock Market Review

What's in store for Greece after the second bailout?

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Although the EU finance ministers finally agreed to approve a second Greek bailout of €130 billion in the early hours of Tuesday morning, helping the country to avoid a default next month, many economic and financial analysts believe that the Greek situation will continue to deteriorate in the coming months and years ahead in view of the significant new austerity measures agreed to by the Greek Parliament.

Recent data indicates that macro-economic conditions in Greece are deteriorating further as the economy contracted in each of the past five successive years. The Greek economy registered the worst performance in the eurozone shrinking by seven per cent in 2011 while the budget deficit remained marginally unchanged from 2010 at 10 per cent of GDP.

However, the level of unemployment shot up to 21 per cent in 2011 and these dire indicators suggest that the fresh round of austerity measures which include additional reductions in pensions and wages to public sector employees coupled with another 150,000 of public-sector job cuts over the next three years are difficult to impose as they will fuel further social unrest and lead to increased looting among the population. The banking system is also in disarray with an estimated outflow of circa €60 billion in deposits since the escalation of the crisis.

Greece's debt-to-GDP ratio is currently above 160 per cent, however the measures imposed since the initial €110 bailout in May 2010 together with the additional austerity programme that was recently passed through the Greek Parliament should reduce the overall debt burden to 120.5 per cent of GDP by 2020, according to the International Monetary Fund. Although this is very close to the 120 per cent level that was earmarked by the IMF, some analysts claim that this level remains too high and many question whether Greece can service and eventually repay this large debt overhang.

Greece has consistently missed its targets since the May 2010 initial bailout and this is partly due to the deepening economic recession. However, there are growing concerns among the "troika" of rescuers (the European Central Bank, the International Monetary Fund and the eurozone governments) that a new Greek government which is likely to be elected following the next general election scheduled for April 8 may take different approaches to implement the policies that the current administration have agreed to. This, in spite of the fact, that all the political parties in Athens have provided written commitment to keeping the terms of the bailout package.

One often cited example of the lack of progress in sticking to its bailout conditions is the delay in the privatisation programme. The terms of the May 2010 bailout included requirements for a privatisation programme that would generate up to €50 billion by 2019. However, after only €1.7 billion was raised in 2011 (from the projected €5 billion), the overall privatisation target figure has been reduced to €19 billion.

Does the second bailout address the serious problems facing Greece? The €130 billion bailout will be directed mainly to cover this year's sizeable budget deficit as well as to enhance the bond-swap deal with private investors and to inject capital into the Greek banks. Meanwhile, some financial analysts believe that the additional austerity measures requested by the EU are unlikely to succeed due to the fragile economic conditions and the growing unrest.

So what could be the solution to the serious developments in Greece? There has been increased talk across the international media on the possibility of Greece exiting the euro and re-adopting the drachma. Although this is widely viewed as the only possible solution for the country to regain competitiveness and for the economy to start growing, there is no legal mechanism as yet for a country to opt out of the single currency.

The Greek Prime Minister does not seem to agree that exiting the euro is the correct solution. In a recent warning to all parliamentarians ahead of a key vote for approval of the additional measures to secure the bailout, Lucas Papademos warned that failure to achieve the second bailout would result in a "disorderly default that would create conditions of economic chaos and social explosion".

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In a historic speech, the Prime Minister explained that such a default will place the savings of all Greek citizens at risk. "The state would be unable to pay salaries, pensions and cover basic functions, such as hospitals and schools, and the country would lose all access to borrowing and liquidity would shrink". Lucas Papademos argued that a default would send the country into "a long spiral of recession, instability, unemployment and prolonged misery". The Prime Minister also warned that eventually this will also lead to an exit from the euro wiping out private savings caused by a severe devaluation and widespread bankruptcy across the private sector.

The stern warnings from the Prime Minister helped convince many parliamentarians to approve the plans with a substantial majority voting in favour. However, 43 MPs were expelled from their parties after voting against the caretaker government.

Although this second bailout will avoid an immediate default and will enable Greece to maintain the euro, some financial analysts point that the re-adoption of the drachma may be the only plausible solution. These analysts claim that despite the new additional austerity measures being introduced, even if these achieve the required results, Greece will still have an overall debt to GDP ratio of 120.5 per cent in 2020. They also argue that Greece should emulate countries such as Argentina that have defaulted and devalued their currency achieving a successful quick turnaround as economic competitiveness is restored. These same analysts also claim that the uncertainty prevailing in Greece despite the assurances of the second bailout and continuing speculation of a return of the drachma have stalled investment in the country.

The protracted negotiations over recent months and this week's second bailout agreement enabled Greece to avoid defaulting on its €14.5 billion bond repayment on 20 March next month. However, it has not solved the region's sovereign debt crisis as it has failed to address the inherent problems of the eurozone bloc which requires a co-ordinated fiscal policy, structural reform and a reduction in leverage in the banking system. A continued dampening of sentiment across the eurozone and an increased likelihood that Portugal is shortly about to start discussing its own second bailout are bound to keep the eurozone crisis rumbling on.