

MARKETS IN MOTION

developments that matter in financial markets

Crisis in Greece: A Challenge for the Euro Zone

"The Commission has been actively working with euro area member states to design a mechanism, which Greece could use in case of need. Such a mechanism would be in conformity with the current Lisbon Treaty, in particular, with the no bail-out clause. It would include stringent conditionality."

José Manuel Durão Barroso, President of the European Commission

Greece became one of the 16 members of the European Union in 2001.

Criteria for Euro Zone Economies

Members of the European Union are required to maintain the following:

1. A budget deficit, which does not exceed 3% of GDP.
2. A debt-to-GDP ratio of 60% at the most (additional inflation, exchange rate and interest rate targets are set for first adopters of the euro).
3. If the European Council decides that any member state is breaking these targets and takes no action to rectify this within 16 months of the decision, sanctions can be imposed.

How the Norms Have Not Been Met

Greece is found to be persistently incurring high budget deficits for several years since 2001, much above the EU conditionalities, and external debt rose abnormally due to massive current account deficits coupled with unbridled spending. Moreover, Greek debt and deficit figures were reported to be understated to maintain membership of the European Monetary Union.

For example, Greece entered into a special kind of cross currency swap deal in 2002 with notional exchange rates to enable it to receive a far higher sum than the actual euro market value of 10 billion dollars or yen. This credit, disguised as a swap, didn't show up in the Greek debt statistics.

Impact on European Union

Currently, Greece's debt is about 300 bn euros (\$419bn). Greece must refinance a large chunk of that debt or risk defaulting on its loans, which would be a huge blow to the credibility of the euro zone economy. As 16 nations share the single currency, the economic problems of Greece will trigger a domino effect, toppling other weak members of the euro zone such as the so-called "Piigs" — Portugal, Ireland, Italy and Spain as well as Greece — all of which face challenges rebalancing their books.

Comparison of Government Debt Risk

	Budget deficit 2010 (% GDP)	Debt-to-GDP 2010	External Debt % (Debt)	Shortterm Debt (% GDP)*	Current Account 2010 (% GDP)
Greece	-12.2	124.9	77.5	20.8	-10.0
Portugal	-8.0	84.6	73.8	22.6	-9.9
Ireland	-14.7	82.6	57.2	47.3	-1.7
Italy	-5.3	116.7	49.0	5.7	-2.5
Spain	-10.1	66.3	37.0	5.8	-6.0

*Includes Debt from monetary authorities due in one year or less
 Source: European Commission, World Bank, IMF

Action Proposed

Greece proposes to cut the budget deficit below 3% by 2012 through reduced spending on public sector works, defence and healthcare, as well as increased tax collection. After examining these ambitious targets, financial markets reacted negatively, based on the difficulty of achieving the tough fiscal target.

Comparison of Growth and Fiscal Projection of Greece

Greek Plan	2010	2011	2012	2013
Real GDP growth (%)	-0.3	1.5	1.9	2.5
Budget deficit (% of GDP)	-8.7	-5.6	-2.8	-2.0
EC/IMF Forecast	2010	2011	2012	2013
Real GDP growth (%)	-0.3	0.7	1.1	1.6
Budget deficit (% of GDP)	-12.2	-12.8	-	-

Source: BNP Paribas, European Commission, IMF

Abandoning the euro will have significant legal and technical hurdles. The costs of adopting a new currency would certainly be high, requiring changes in physical infrastructure, causing a significant burden on accounting, as well as causing problems of re-denomination of existing claims. Thus major economies in the euro zone are thinking of various plans to help Greece to come out of the crisis.

Policy Options

Bailout by European Union

Legally speaking, the EU can do little to help Greece. The Maastricht Treaty was designed with a 'no bailout' clause to mitigate potential problems of moral hazard.

IMF Assistance

Greece is unlikely to qualify to meet the criteria of a Flexible Credit Line or a Stand-by Arrangement, the most likely form of IMF assistance, should it be required.

Devaluation

Devaluation is impractical as EUR is the common currency of 16 member states.

The crisis of Greece has led to instability and uncertainty for the entire euro zone and is testing the strength and concept of the European Union when the economy of one of the members passes through a bad phase.

FTKMC
 FINANCIAL TECHNOLOGIES KNOWLEDGE MANAGEMENT CO.

MARKETS

- Equities
- Commodities
- Currencies
- Debt
- Banking
- Insurance
- Financial Services

PRACTICE

- Executive Education
- Financial Literacy
- Certification
- Consultancy
- Research
- Advisory Services

FORUMS

- The Strategy Dialogue
- Financial Markets Forum
- fINET
- Commodities Camp

REPORTS

- Financial Markets Review
- Market Briefings

SPL PROGRAMMES

- Markets in Motion
- Global Financial Markets Practice
- Winter School

CERTIFICATION

**NATIONAL
SIMULATION LAB**

www.catchthefuture.in
 www.ftkmc.com

Published by
Financial Technologies Knowledge Management Company
 Exchange Square, 1st Floor, Suren Road,
 Chakala, Andheri (East), Mumbai - 400093, India.
 Tel: +91 22 6731 8888 - Fax: +91 22 6726 9541
 Email: marketinmotion@ftkmc.com • Website : www.ftkmc.com

Forthcoming Event

For details, write to:
knowledgeformarkets@ftkmc.com
safeconference@ftkmc.com

SOUTH ASIAN CAPITAL MARKET CONFERENCE

APRIL 22 - 25, 2010, HOTEL MARITIM, MAURITIUS
 Annual Convention of Exchange Industry in South Asia