

The Euro (Greek) Crisis – Santiago 2010

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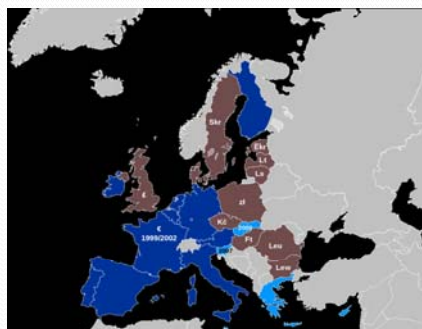


The Euro: Largest Planned *Dollarization*

➤ January 1, 1999, the currencies of 11 countries were fixed against a new currency, the Euro.

➤ January 1, 2002, the Euro became the official mean of payments.

➤ Today about 329m people have handed over monetary sovereignty to an entity at arm's length from national politics: the European Central Bank.



A Currency without a State

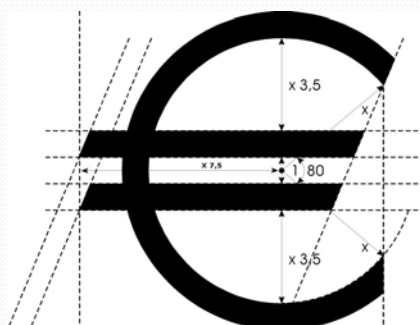
- A Big Bet!
- Not even clear what the objectives were ...or are!
- Signed by the same people that fought WWII...



Not Even on the Keyboard...

The Question: Is it Working???

- Data from 17 countries in Europe of which 11 adopted the Euro
 - Adoption of the Euro has increased the Market-to-Book Ratio (Tobin's Q) by 17%
 - Part of the increase is explained by *the decrease in interest rate and the decrease of the cost of equity*



Larger Scope: Insurance vs. Incentives

- **Success:** Economic Stability
- **Disappointment:** Growth

The hope was that countries stripped of the license of cheapens their currencies would be forced to compete directly, and that competition would beget more flexible markets and higher productivity.



Stability in Numbers

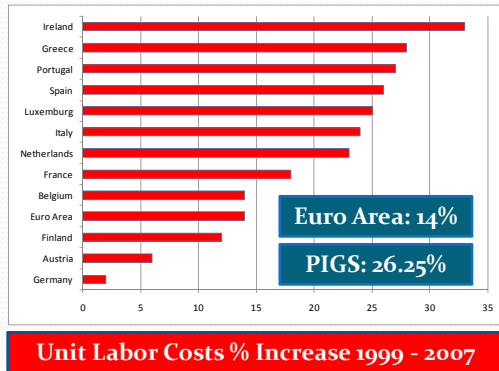
- The advantages of the Euro membership were clear as soon as the crisis (financial crisis) hit.
 - *Ireland vs. Iceland*
Capital drained from Iceland and the small country was close to bankruptcy. Same structural problems in Ireland, but with much less troubles during the crisis



Growth

- Dismal!
- Why?

Some members are struggling with the rigors of the currency union.



Two Europes!

➤ The ECB's monetary policy cannot be perfectly tailored for any individual member country

- Germany & France, Greece, Italy, Spain, and Portugal have different structural problems and needs.
- Quite the same problem within countries – Two Italies!



One Size Fits
None!

Different Strokes

➤ The protection that the Euro offered its members also worked against reform.

➤ Until a couple of years ago, Greece was able to borrow at only 16 basis points higher than Germany...



Athens has the highest per capita percentage of Porsche Cayenne in Europe

2010 Greek Crisis

➤ The outcome of many ingredients:

- Exogenous
- Endogenous



Exogenous Factors

➤ The outcome of many ingredients:

- Tax Evasion
- Government Statistics

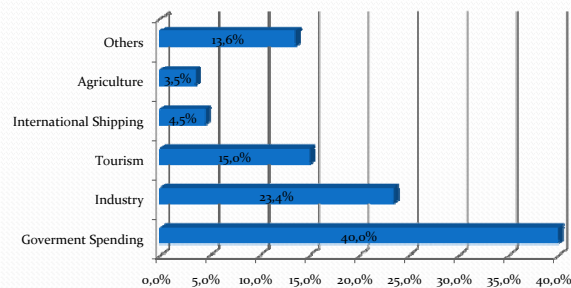


I do not see anything wrong.
And she is my daughter!

Endogenous Factors

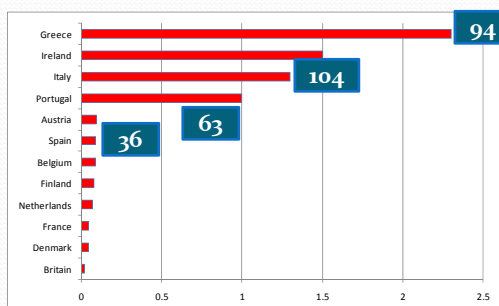
➤ A different economy

Greece GDP Composition



Endogenous Factors II

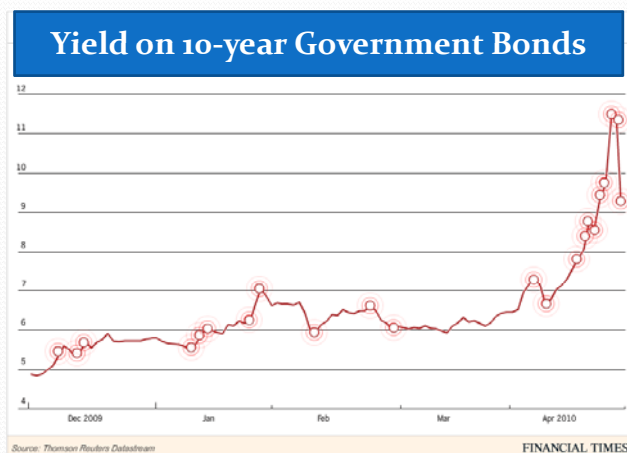
- A different economy
- and a lot of debt...



2008 Ten-year Government Bond Yield Spreads over German bonds, percentage points

Government Debt as % of GDP

The Two Faces of the Same Coin



The Two Faces of the Same Coin



Implications & Reactions

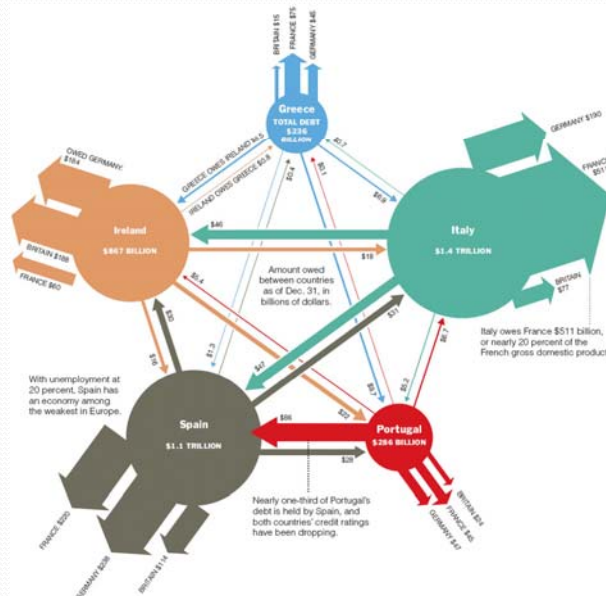
- Economic measures...
(mainly countercyclical)



Implications & Reactions

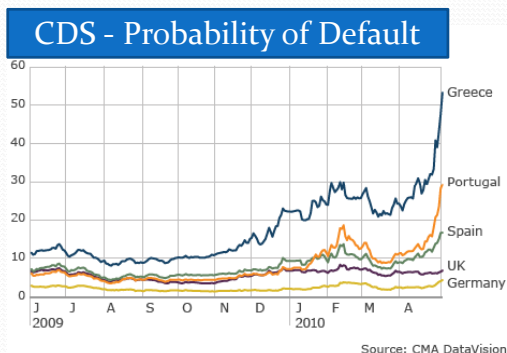
- Economic measures...
(mainly countercyclical)
- Why such interest in such a small country???
- **Greece owes:**
 - France US\$75b
 - Germany US\$45b
- ...but also
- **Italy owes:**
 - France US\$511b
 - Germany US\$190b
- **Spain owes:**
 - France US\$220b
 - Germany US\$238b

Pentagram of Death



Implications & Reactions

- Economic measures...
(mainly countercyclical)
- Why such interest in such a small country???
- Yet, markets are still not very convinced...



What About Exiting???

- No matter who you are, the costs of getting out of the Euro are very high!



Exit by Weaker Members...

➤ For the PIIGS (include Ireland), it would be a very risky, and costly choice:

- Change of all the liability would be a nightmare
- If business converted their debt in a local currency that would be technical default (they could still pay in Euro, but that would create risk management nightmares)
- Government borrowing would be very hard after
- Advantages: Devaluation in the short period



If PIIGS could fly...

Exit by Stronger Members...

➤ Strategic Default:
Breakaway by a group of low debt and cost competitive countries (Germany & France) :

- The idea: Leave the countries with high debt to themselves and enjoy the lower costs and high flexibility
- Costs: Revaluation and lose competitive strength.



You can check in any time at night,
but you cannot ever leave

What's Next???

- They all seem committed, or at least committed until the next crisis;
- Borrow Greece out of crisis...
- Will it work?



Which Star is Greece?