Infomail

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A Different Kind of Greek Odyssey

The market talk for the last few weeks has been all about Greece. The Greek bailout program previously negotiated expires on Tuesday (June 30th) and as I put pen to paper, any serious talks have fallen apart.

With a few days to go, it's crunch time. Euro finance ministers are meeting one more time to try to thrash out a reforms-for-cash deal after Greek PM Tsipras threw a curveball into negotiations on Friday with talk of a referendum. During today's (Saturday) meeting, the finance ministers rejected Greece's request for a one-month extension.

Greece is due to pay the International Monetary Fund (IMF) 1.5 billion Euros on Monday, so obviously, with no deal this weekend, they will miss that payment.

Here are the insurmountable hurdles facing Greece this summer:

Greece Scorching Summer of Debt Obligations		
June	€1.5 billion	IMF
	€5.3 billion	S-T Bills
July	€452 million	IMF
	€2.0 billion	S-T Bills
	€3.5 billion	ECB
August	€176.0 million	IMF
	€1.0 billion	S-T Bills
	€3.2 billion	ECB

From 1960 to 1973, Greece actually ran a federal budget surplus. Once "civilians" regained control of the government in 1974, deficits have occurred each and every year since. When the Socialists took control in 1981, the deficit to Gross Domestic Product (GDP) was less than 3%. After that, the deficit rose significantly above 3% of GDP. Now, debt holders are asking for Euro 2 billion in spending cuts and pension haircuts, which are now an incredible 16% of GDP.

Keep in mind Greece and austerity go together like oil and water. Since the financial crisis of 2008-09, there have been many debates on how to fix the situation. One school of thought is doing more of what got you into trouble in the first place. I guess I would relate that to the "hair of the dog" approach to cure a hangover.

The other school of thought would be simple common sense: Do the opposite of what got you into trouble, which would mean less government, less entitlement, and lower taxes.

Instead, politicians (Note Ontario, the Obama Administration, etc…) make small spending cuts, hike taxes a lot, and then call it "austerity." It simply doesn't work.

Greece, France, Italy, Spain and Portugal all raised taxes and only got lower growth. Check out these figures:

Higher Taxes, Lower Growth

Changes in top income tax rates 2007-13 and average annual growth of real GDP

Increased top income tax rates	2007	2013	% GDP growth
Greece	40.0%	46.0%	-3.7
France	45.8	54.5	0.6
Italy	44.9	48.6	-1.0
Portugal	42.0	56.5	-0.7
Spain	43.0	52.0	-0.4
Ireland	41.0	48.0	-0.3
Denmark	59.7	60.4	-0.4
Finland	50.5	51.1	0.1
Japan	50.0	50.8	0.4
Slovenia	41.0	50.0	0.1
United Kingdom	40.0	45.0	0.6
United States	41.4	46.3	1.1
Low or reduced top income tax rates			
Czech Republic	32.0%	15.0%	0.9
Estonia	22.0	21.0	0.7
New Zealand	39.0	33.0	1.6
Poland	40.0	32.0	3.7
Slovak Republic	19.0	25.0	3.1
Turkey	35.6	35.8	3.5

Source: OECD

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But it wasn't "true" austerity because <u>all</u> of their government spending went even higher:

Redefining 'Austerity'
Government spending as a percent of GDP

	2007	2013
Greece	46.8	59.2
France	52.2	57.1
Italy	46.8	50.5
Portugal	44.5	50.1
Spain	38.9	44.3
Ireland	36.0	40.5

Source: Eurostat

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So the time has come for Greece to make real, serious concessions which means lower taxation and greatly reduced government spending. Or simply secede from the EU and take your chances. Greece is between a rock and a hard place, and have no one to blame but themselves. They will go back to the Drachma, suffer hyperinflation, high unemployment, and there will not be any money to tax, nor will there be money to spend.

Even if a late deal is done, it is simply a band aid or a futile "kicking the can" down the road. Eventually, Greece will have to go on its own.

I think the most likely scenario an 11^{th} hour agreement gets done to provide short-term financing to Greece. It is simply the lesser of two evils for the Greeks. The long run sustainability of Greek public debt would remain in question, and the proposed fiscal concessions will be a drag on economic growth.

I would suspect the contagion of the Greek crisis to the rest of the Eurozone is unlikely, and if a deal is reached, uncertainty about any contagion will decline and peripheral bond markets (Portugal, Spain, or Italy) would rally.

In the event of a "Grexit," markets will certainly worry about another member following suit, and higher risk premiums or market stress would be the likelihood. This could be the catalyst for the much looked for correction and would be another buying opportunity.

Stay tuned,

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