Written by Bruce Walker on October 3, 2011

Greek Problems Underestimated — Again

After the cabinet meeting, the Finance Minister said that the Greek national deficit would be $25.2 billion or 8.5 percent of the nation's GDP, compared with the target goal of $22.8 billion or 7.6 percent of GDP. Even this projection was issued with caution. In an official statement the Finance Ministry said: "Three critical months remain to finish 2011, and the final estimate of 8.5 percent of GDP deficit can be achieved if the state mechanism and citizens respond accordingly."

In that cabinet meeting on Sunday, a draft budget for 2012 was approved. It was this meeting that produced the projected deficit of 8.5 percent. It issued more bad news: The Greek economy will shrink even more quickly than was previously stated. A 5.5 percent reduction in GDP is now projected for this year. The government tried to sound steady and sure. Minister George Papandreou told an extraordinary Cabinet meeting Sunday to approve a 2012 draft budget: "I want to repeat that we will be unswerving in our goal — to fulfill all that we have promised to ensure the credibility of our country." We have a single and steady goal — to meet our commitments so that we guarantee our credibility." Papandreou's budget called for reducing the pay, firing, or forcing into early retirement 30,000 government workers.

The Greek government also announced that without a bailout from the European Union of $10.8 billion, it will not be able to pay its bills this month. It has been dependent upon loans from the eurozone and the International Monetary Fund since May of last year, when it received a $150 billion loan. Although it received a loan of slightly less in July, it is interesting that the details on that last loan are still being worked out. The May 2010 loan had certain targets that, in theory, were required in order for Greece to access the loan funds. These goals included paying off bondholders of Greek loans and paying salary and benefit obligations of the government.

A "troika" of representatives was created to insure that Greece complied, and these individuals represented the European Commission, the European Central Bank, and the International Monetary Fund. The group will be meeting in Athens, and they will review closely the financial records to see if it is appropriate to provide access to more funds by the Greek government. The pressure is on that troika. The pressure is also now on the Finance Ministers of the eurozone. Michael Hewson at CMC Markets notes: "Greece continues to be the major source of market angst as we head into the final quarter of 2011. Today's meeting of finance ministers will continue to delay the inevitable and look at ways and means of avoiding a Greek default."

Professor Yannis Varoufakis, who teaches economics at the University of Athens, noted the very difficult situation now: "The vicious circle continues for the government. We have disappointing revenues, missed targets and this will bring new measures and new austerity." The measures proposed are very unpopular in Greece, and a nationwide strike has been planned for October 19 in the country by the two largest public-employee unions. These unions have also vowed a campaign to bring down the current Socialist government of Papandreou. Protesters had already gathered at Syntagma Square, in front of the Greek Parliament. Sofia Vardaki, a 49-year-old public employee, said: "I've been honestly working for 25 years. They have no right to throw me out now. I don't want to sit on my couch doing nothing. I want to work."

Germany's DAX stock exchange dropped 2.4 percent down to 5,372 and the CAC-40 stock exchange in France also fell 2.2 percent to 2,926. The FTSE 100 index of British stocks fell a bit less, 1.9 percent to 5,030. The crisis is growing more serious for several different reasons. First, the almost certain need for funds to bail out the Greek government means that the financial structure of all the rest of Europe takes a hit. As one example, banks have invested in the sovereign debt of other nations. Italian banks, for example, have some Greek bonds in their portfolio. As Greek bonds are downgraded, the assets of those Italian banks must also be downgraded. French banks, in turn, own sovereign debt of Italy as part of their assets. So when Greek bonds drop, Italian banks are pulled lower, as well as the French banks. Collapse is too strong a word for the short-term effect, but weak banks mean all sorts of problems in the rest of the eurozone.

This is a particularly tricky political problem because nations such as Germany, Holland, and Austria, which have been more responsible regarding their national deficits, are the ones who may be called upon to be the ultimate firewall to collapse.

Second, the downgraded growth rates for Greece portend a weaker general economy in Europe. Although normally a drop in the price of oil would be very good news, it actually reflects the weakening of the economies of Western-style major industrial nations. With few exceptions, growth data is anemic throughout these nations.

Third, the resistance to "austerity" for Greek government employees in the face of an utterly untenable situation for the government may mean that the reaction of other nations on the border of disaster may cause the same threats of strikes. Europe has labor unions with more political clout than in America, and resistance "to the death" (so to speak) in these nations, when austerity is required, may mean no way out of the crisis.

Fourth, the other economies that might be able to lift Europe out of the doldrums are also in bad shape: The American economy is a mess, with huge federal debt a major drag; Japan, also, faces serious problems; and the Chinese "miracle" may be more mirage than miracle: hyper-speculation in business and residential development, for one example, may have overextended businesses as many malls and business offices are vacant.

The fifth area of concern has more to do with that most precious commodity of all: trust. The news from

Greece over the last few years has consistently been bad. That means government official estimates, when revised, are almost invariably revised to show largest deficits, slower growth, and smaller tax revenues. This is a pattern in troubled Europe. As was reported here in January, the Irish Central Bank printed its own euros and used part of the money to pay bonuses to bank executives. This was one month after the Irish Finance Minister, Brian Lenihan, provided information on the amount of bonuses paid in December, which at the time was reported as zero. Later it transpired that the amount of bank bonuses was actually in the tens of millions of euros. This was not, technically, counterfeiting — the bank was allowed to print euros upon notification to the eurozone financial regulators — but it certainly looked questionable, especially at a time in which Ireland was receiving emergency loans to prevent default. Greece is a small nation, but its impact on the economic future of Europe looms large. There are models of how healthy economies work — America before the New Deal, Switzerland, Hong Kong, and a few others — but the eurozone looks like it is a long spiral into chaos.

Photo: AP Images