



The Greek crisis

A real drama for Australians, or a non-event?

Until recently Greece was a Mediterranean playground where the world flocked to enjoy blue skies, sparkling seas and white beaches. Now it has become a monetary war zone with the threat of national bankruptcy poised to destroy the Euro and the fiscal credibility of the European Union (EU), and damage the world economy. Somewhere between these two extremes lies the truth and the all important answer to the question of how the Greek crisis could affect Australian investors.

It all started in 1968, with France and Germany determined to create a single European community, a strategy to make themselves and Europe more competitive against the economic superpowers. The European Union (EU) began with six members – France, Germany, Belgium, Italy, Netherlands and Luxembourg – but by 2007 the group had grown to 27 countries, including less robust economies such as Greece, Slovakia, Cyprus and Bulgaria. In 1999 the Euro was introduced as the common currency in all member countries, except the UK which kept the pound sterling.

The EU was never a group of equals. Its member nations included the large and small, the rich and poor, all sharing a common currency and customs union. None of that seemed a problem while times were good and Europeans prospered from a common market. But the 2008 financial crisis has mercilessly exposed flaws in the union as more and more European countries – from once mighty Britain to recently prosperous and newly poor Ireland – faced rising unemployment, stagnant growth, and a slow road to recovery. However, it took focus on the Greek debt crisis to bring Europe to the brink of disaster.

Why? Because Greece threatened to cross the line into national bankruptcy and

default on its foreign loans. An economy under pressure with growth at zero or going backwards is one thing; it is quite another if that country can no longer cover its debts. Greece was the first EU member to pose this threat, but is by no means the only one or even the largest.

Thirteen of the 27 EU countries have debt levels above the agreed limit of 60% of gross domestic product, including Britain and France. Estimates based on International Monetary Fund (IMF) data suggest German banks alone hold €28 billion in Greek bonds, half held by banks newly owned by the German taxpayer. Greece does not have the resources to service these and many other foreign loans.

But Greece also owes Portugal US\$10 billion, Portugal owes Spain US\$86 billion, Spain owes German and French banks upwards of US\$550 billion, and so on. If Greece defaulted there would be repercussions not only in the lending countries, but all over the world. Not surprisingly, international markets went into shock as investors feared Greece would trigger yet another major financial meltdown.

Clearly, Germany and France could not allow Greece to fall – there was too much at stake. The future of the battered Euro and of the EU itself were threatened.

The result was an IMF-sponsored €110 billion bailout package to get Greece back on its feet and pull other struggling European economies, and the Euro, back from the brink.

This package, announced on 2 May 2010, seems to have averted the immediate danger of a worldwide financial implosion, but is it a bandaid or a long-term solution? This is the question economists are asking, for there is no doubt that Greece's problems were in part caused by its inability to cut infrastructure spending and its notoriously inefficient tax system. Understandably, these problems will not simply be fixed with a bailout package.

Fortunately for Australian investors, the Greek crisis has so far not meant another market meltdown, largely because of one dominating reality: Australia's economic future is linked to China, not Europe, and the Chinese economy continues to forge ahead and purchase mountains of Australian resources, irrespective of events in Europe. Unlike Greece, we have succeeded in moving away from debt, not into it. We saw proof of this in the Budget projections that the borrowings to finance the stimulus package last year would be repaid within three years instead of six, and the Australian economy would be back in the black by 2013.