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Should Greece leave the euro?

A number of economists and politicians have suggested that Greece ought to leave the euro zone to restore its economy.

We do not share this viewpoint at all:

- ***Greece has implemented a very significant internal devaluation from 2008 to 2015 that has completely restored its companies' competitiveness and profitability; a devaluation would therefore no longer be useful***

- ***An exit from the euro would involve major risks for Greece: capital flight; exchange-rate risk and rising interest rates; need to default on the euro-denominated external debt; loss of attractiveness for investors.***

So we do not understand this suggestion that Greece should leave the euro: it would create risks while there are no macroeconomic needs.

Author:
Patrick Artus

It is often suggested that Greece should leave the euro

Greece's problems are well known: very high unemployment **(Chart 1A)**, fall in the standard of living **(Chart 1B)**, fall in investment **(Chart 1C)**, very high level of public debt and servicing of the public debt **(Chart 1D).**

Some have suggested that a Greek exit from the euro (and obviously a sharp devaluation of its currency) **would be a good solution in light of these problems. We do not believe so at all.**

Chart 1A
Greece: Unemployment rate (as %)

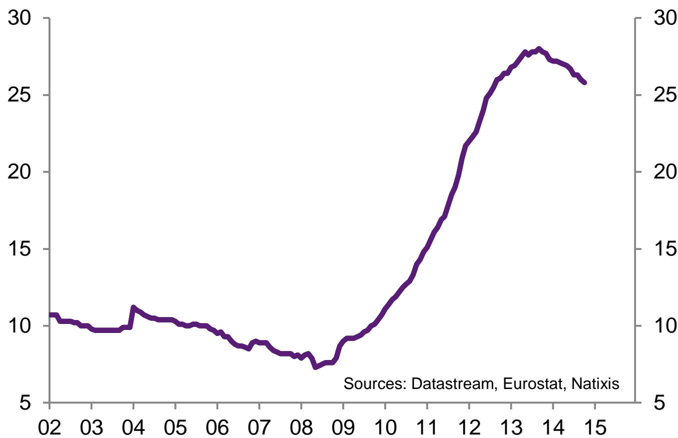


Chart 1B
Greece: Real per capita wage
(deflated by consumer price deflator, 2002:1 = 100)

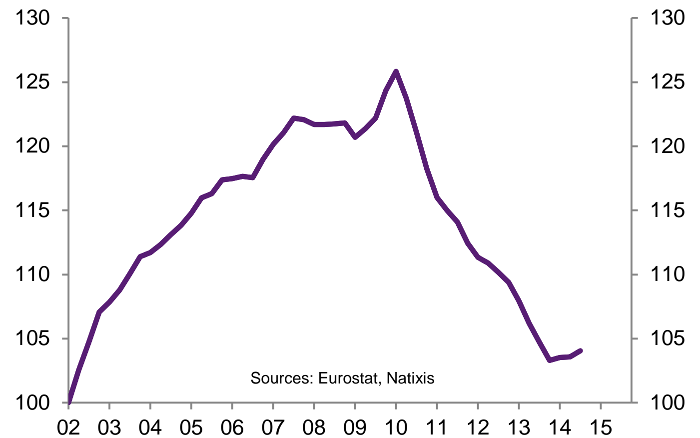


Chart 1C
Greece: Productive investment in volume terms

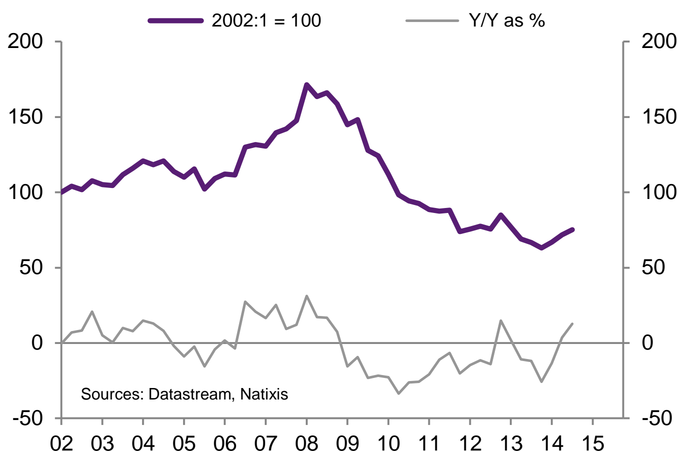
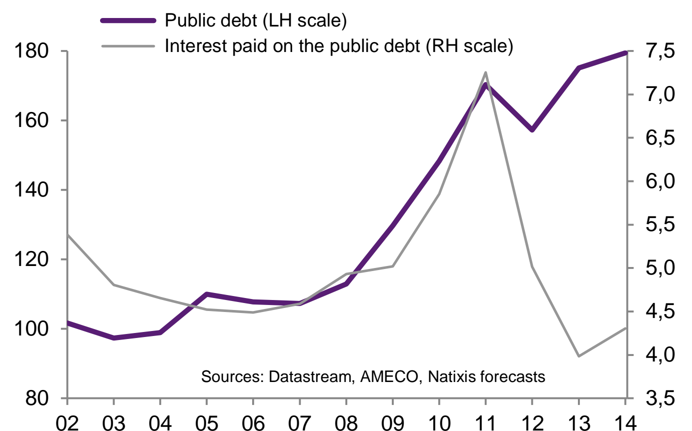


Chart 1D
Greece: Interest paid on the public debt and public debt (as % of nominal GDP)



First argument: Greece no longer needs to devalue

When we look at **the level of unit labour costs** in the manufacturing industry **(Chart 2A)**, we see that **Greece has carried out a very significant internal devaluation since 2008 by reducing its production costs**; this explains **the upturn in Greek exports (Chart 2B)** since 2013.

This internal devaluation (reduction in labour costs) has also given rise to **an improvement in Greek companies' profitability (Charts 3A** and **B).**

This improvement in profitability has paved the way for an **increase in corporate investment in Greece in the recent period (Chart 4).**

All in all, as Greece's internal devaluation has restored its capacity to export and invest, it is pointless for the country to devalue.

Chart 2A
Level of unit labour costs in the manufacturing industry*

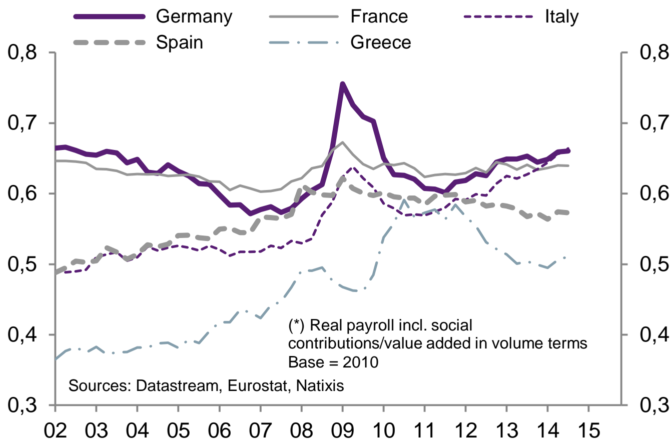


Chart 2B
Global trade and exports (in volume terms, 2002:1 = 100)

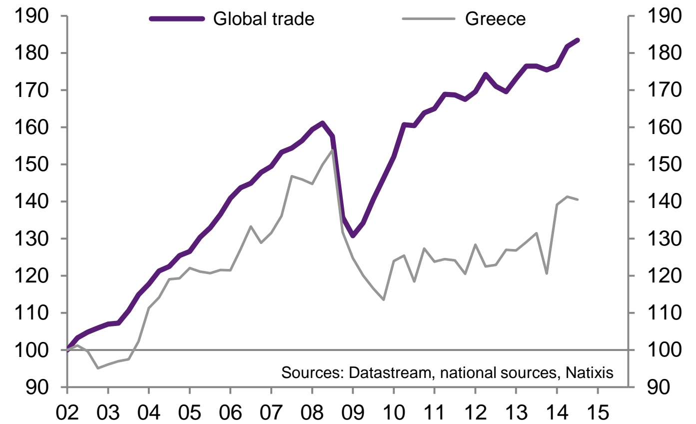


Chart 3A
Profits after tax, interest and dividends (as % of nominal GDP)

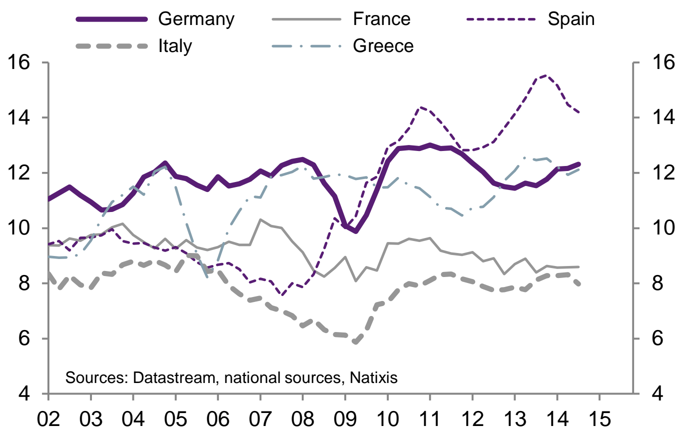


Chart 3B
Greece: Per capita real wage and productivity (2002:1 = 100)

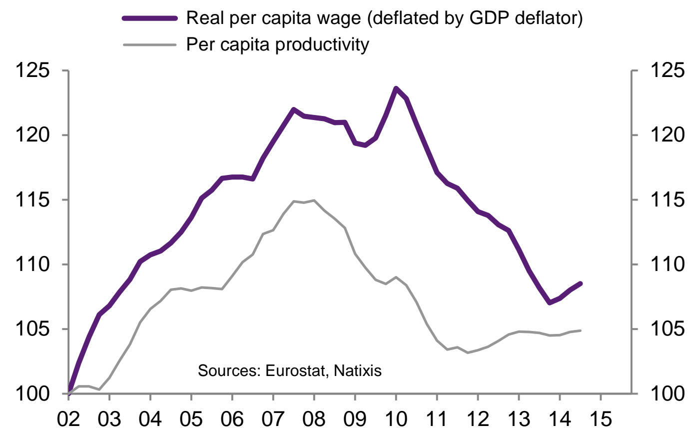
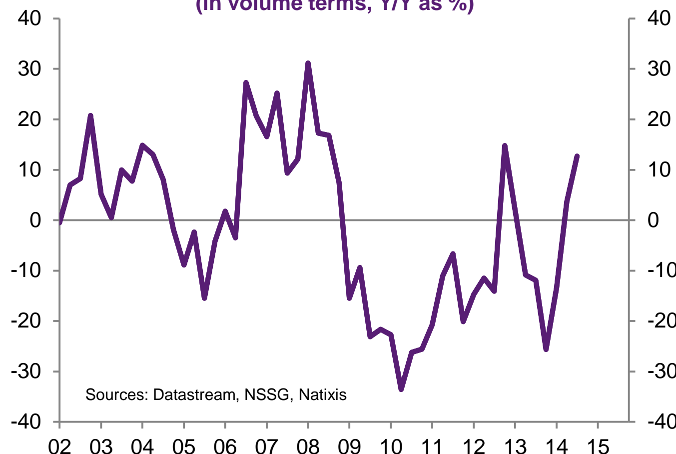


Chart 4
Greece: Productive investment (in volume terms, Y/Y as %)



Second argument: The risks linked to an exit from the euro

The risks linked to a Greek exit from the euro are quite obvious:

1- **Risk of capital flight**, due to the currency devaluation and the weakening of banks. **Chart 5A** shows Greek banks' outstanding deposits, **Chart 5B** Athens share prices: we see the scale of the deposit withdrawals of and the fall in the stock market. **Chart 5C** shows **overall capital outflows from Greece:** very substantial in 2012 and during the euro crisis, and once again in 2014.

Chart 5A
Greece: Outstanding bank deposits (in EUR bn)

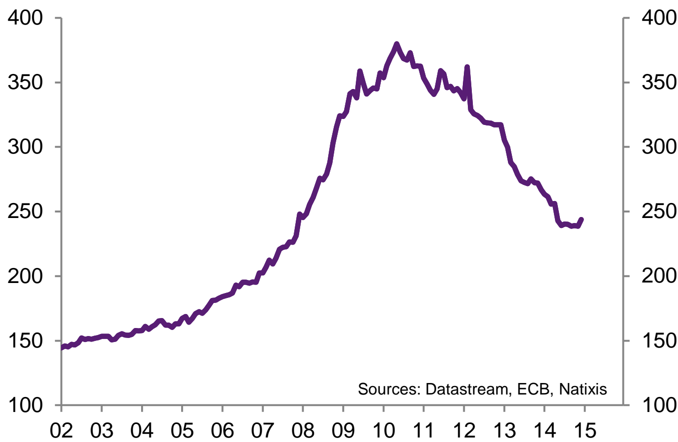


Chart 5B
Greece: Stock market index (ATHEX, 2002:1 = 100)

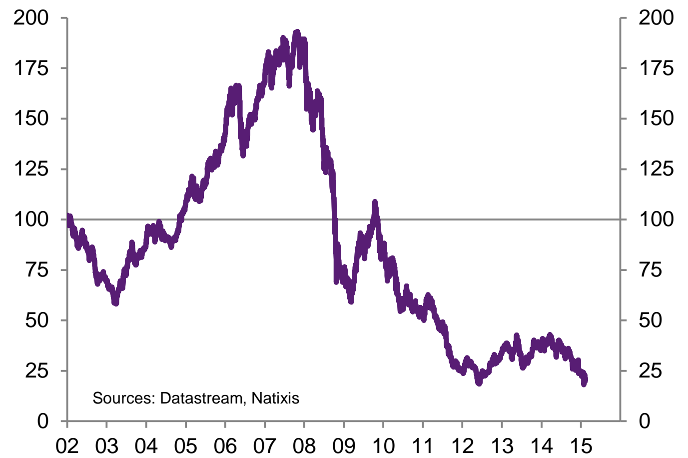
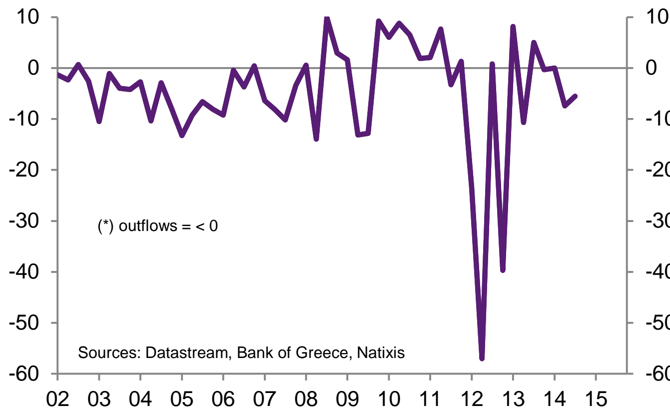


Chart 5C
Greece: Net purchases of foreign equities and bonds by residents* (as % of nominal GDP)



2- Rise in interest rates

The return of exchange-rate risk and probably inflation would lead to a rise in interest rates. The risk that this will happen has driven up Greek interest rates drastically since the end of 2014 and has prevented a fall in interest rates on loans that the other countries have enjoyed **(Charts 6A, B** and **C).**

Chart 6A
Greece: Interest rate on 10-year government bonds (as %)

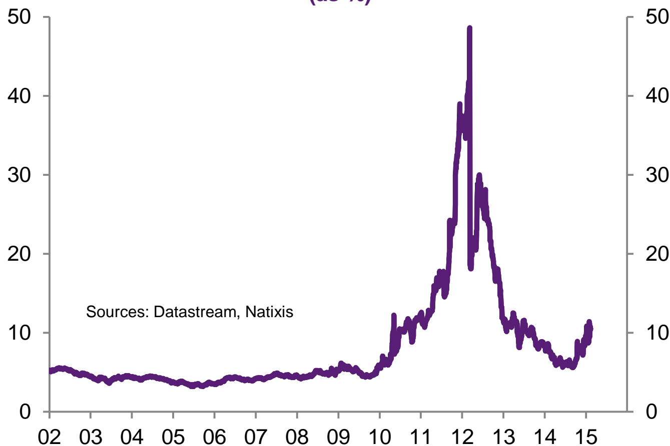


Chart 6B
Interest rate on fixed-rate loans to households (as %)

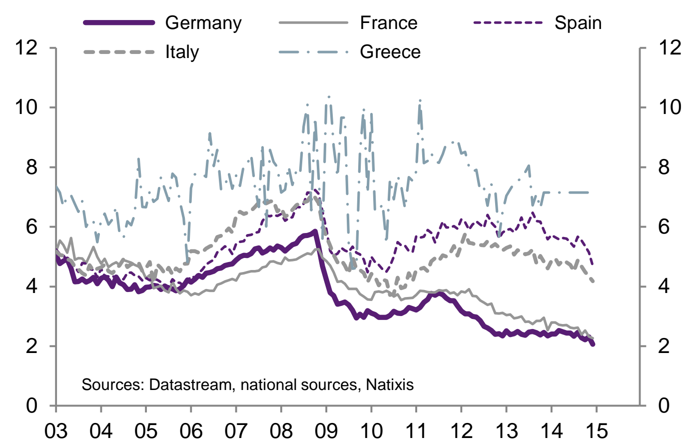
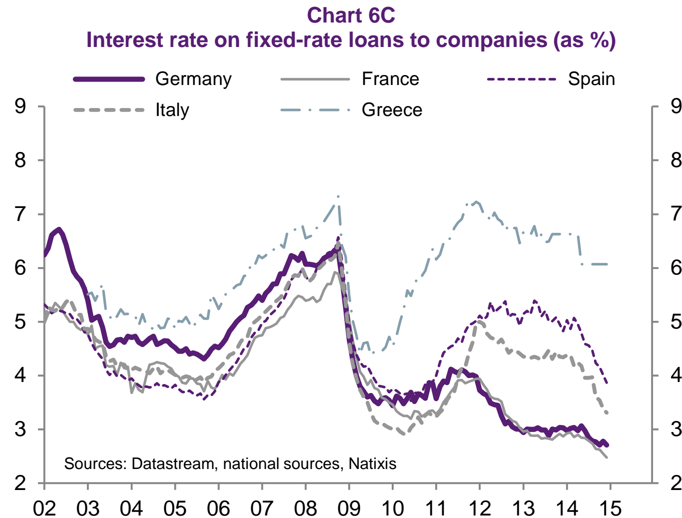


Chart 6C
Interest rate on fixed-rate loans to companies (as %)

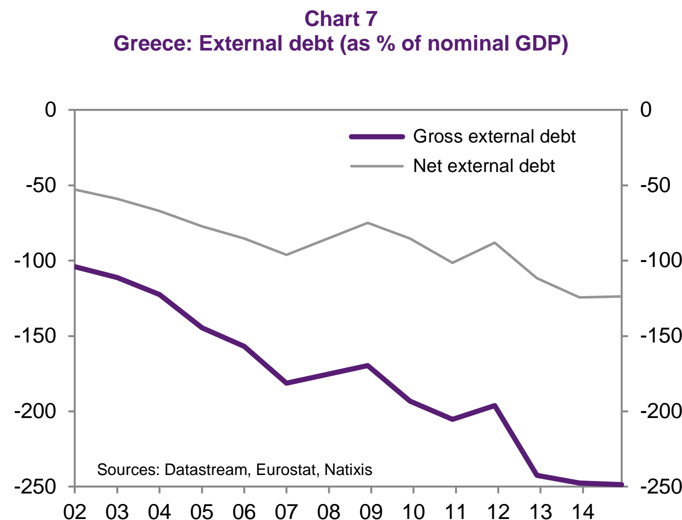


3- Default on euro-denominated external debt

Greece has a massive external debt (Chart 7) in euros.

An exit from the euro and a devaluation would make this external debt even more unaffordable than it is now and **would make a default on this debt inevitable,** cutting Greece off from international financial markets for a long time, even though this debt is currently owed to public lenders.

Chart 7
Greece: External debt (as % of nominal GDP)

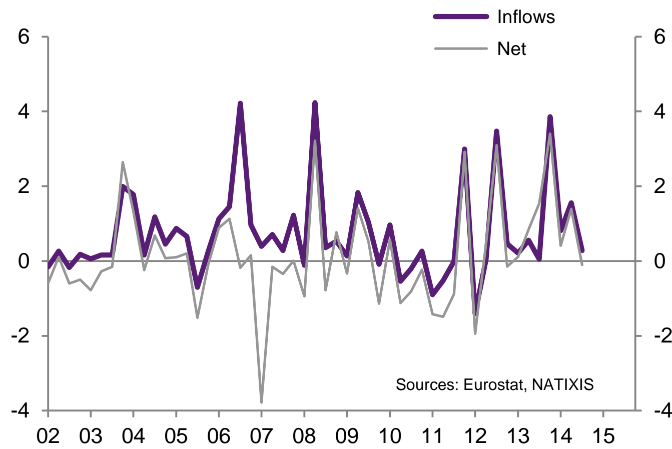


4- Loss of attractiveness for investments

One of the reasons why **companies - and also foreign companies - invest in Greece** (**Chart 4** above, **Chart 8**) is that **Greece is a euro-zone country with low labour costs.**

Greece would obviously become less attractive to companies if the exchange-rate risk between Greece and the euro zone reappeared (research literature clearly identifies a positive effect of a fixed exchange rate on trade).

Chart 8
Greece: Direct investment (as % of nominal GDP)



Conclusion: An exit from the euro would involve major risks for Greece

If Greece currently had a severe problem of corporate competitiveness and profitability, it could consider withdrawing from the euro, devaluing its exchange rate and shouldering the costs associated with an exit from the euro.

But Greece has carried out a very significant internal devaluation (reduction in labour costs): its competitiveness is good, the profitability of its companies is strong and its investment and exports are picking up. So why then incur the costs of an exit from the euro (capital flight, rise in interest rates, default on debt in euros, loss of attractiveness for investments) if a devaluation of the currency is no longer necessary?

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