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Greece economy rallies while Germany stutters but restraint still required

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Finally, some good news from Greece. It appears that the long-running contraction of the country's economy has finally halted and there is some hope it has begun to enjoy modest growth. There is no reason for too much elation just yet as the Greek public finances remain problematic. Even after three bailouts the Greek state labours under a heavy debt burden that will remain well over 170% of GDP for the foreseeable future.

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Yields on Greek ten-year bonds – a measure of the market's enthusiasm for the Greek economy – have not dropped below 7%, and remember, this is the interest rate in euros, not a particularly inflation-prone currency. The good news has so far had no appreciable effect. By comparison, though the German economy has stuttered this quarter, German yields have been well below 0.5% – the difference is the quite elevated risk of Greek default anywhere between now and 2026.

The Greek statistics service data showed an estimate for economic growth in the third quarter of 0.5%. In the second quarter, the rise in gross domestic product was revised up to 0.3%. In Germany, meanwhile, the Federal Statistics Office reported a halving of GDP growth, to 0.2% in the third quarter from 0.4% in the second as weaker exports weighed on the numbers.

Reshuffle

The growth in Greece is in some ways inevitable. An economy can only fall so far when it can rely on some measure of debt relief. Greek Prime Minister Alexis Tsipras understands that implementing the reforms he has promised to obtain support will become progressively more difficult. He recently reshuffled his cabinet to retain the goodwill he still needs from the International Monetary Fund, the European Central Bank (ECB) and his EU partners.

Alexis Tsipras poses with his reshuffled cabinet on Nov 6. EPA/YANNIS KOLESIDIS

Perhaps his mind was focused by the way Portugal nearly lost access to the ECB's quantitative easing programme last month after the last of four ratings agencies threatened to downgrade its debt below investment grade. That followed the introduction of a raft of populist policies by its socialist government this year, reversing the downward trend in its debt burden. This could still happen even though the country just chalked up its fastest growth since 2013 last quarter.

Even if all goes according to plan, this Greek saga will last well past the middle of the century. In 2054 the Greek state will pay the European Financial Stability Facility €6.3 billion and over €1 billion a year to the European Stability Mechanism in each of the five years that follow. Again, that is if everything goes to plan, and that is over a very long and uncertain planning horizon. And so despite the relatively good news coming out of Greece today, the markets remain rightly very cautious about the future of its finances.

Caution remains high in debt markets. autsawin uttisin/Shutterstock

Spending patterns

There is a lesson here for others. Conventional wisdom these days holds that Western countries can safely remove the shackles of austerity and borrow to invest (proponents of government spending always use the word "invest" never "spend"). The rationale goes that this is because interest rates are so low that the borrowing amounts to "free money".

It is wise to remember that not only do the interest payments need to be paid but the principal will need to be either repaid or (more likely) one day refinanced when interest rates are not so low. With its low debt burden, Germany can suffer even a severe recession and still not face a debt crisis, but if Greece experiences even a mild downturn it will need further bailouts.

Some projects may have the effect of growing the economy by enough to justify this extra burden, but this is not "free money". Because that's the thing about money, it is never really free. One thing that unites the politicians of the right and the left, Donald Trump, Hillary Clinton, Theresa May, François Hollande and Jeremy Corbyn, is the belief that tomorrow, or indeed the year 2059 will never come. At least it will only come long after they are gone.

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