

Greece. The country with the half Drachma

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A few days after the introduction of the bank capital controls and with thousands of pensioners queuing up outside the bank branches, the Prime Minister's Office received a piece of research on the effect of the capital controls on the electorate. The data disclosed were very surprising even counter-intuitive. It was apparent that the closing of the banks had a very small negative effect.



For sure, this was interpreted by the close advisors to the PM as a strong indication of the resilience, and support the people showed towards the negotiation tactics and also of the personal charisma and aura of the Prime Minister Mr. Tsipras.

There is no doubt that hundreds of thousands perhaps millions of people owed money to banks and this made many indifferent – with some even having intense feelings of schadenfreude. Equally true was the huge support that the Syriza government enjoyed at the time, with record approval ratings of more than 70%. However, the small negative reaction may have rather different causes.

Since the onset of the crisis in 2010, companies and individuals tried hard to find ways to protect their business interests, their savings and wealth. They desperately tried to disengage or rather hedge their exposure to the Greek state (Tax) and Greek banking system. In other words a panicky “save ourselves” mode of operation.

We can discern two periods in the money record. The first starts at the end of 2009 and concludes with the elections in June 2012, while the second starts in November 2014 and peaks in the summer of 2015.

In the first period, there was a massive drop in the bank deposits, either through direct transfers abroad or through buying non-domestic funds. The main danger then was Grexit. Most of the money was directed towards the UK, Holland and Germany (not Switzerland as many have reported). At the same time the largest corporates moved their treasury outside Greece.

In the second period we had the flight of more than 45 billion. This time however, most of the money was withdrawn as physical cash that went in bank safes or under bed mattresses. In this case we had a combination of risks, namely, both a possible bank collapse and Grexit.

The result was that most deposit balances dropped below the 100k threshold, no doubt with the deposit guarantee in mind. In addition, thousands of companies moved into Bulgaria and Cyprus in order to circumvent the capital controls. But once they experienced the very low tax environment (10% in Bulgaria) they moved, totally depriving the Greek state of any possible tax revenue.

The result of the above actions was a de-facto disengagement of economic life with the domestic banking system. The economy adapted in an environment that strongly resembles that of the drachma of the 80s. Almost no one is going to a bank for a loan or to deposit cash, but only to pay everyday bills. The capital controls increased the electronic and card transactions, but only for the Euros that were locked in the banking system. The cash according to the Bank of Greece Eurosystem data (so called autonomous factors), outside the banking system only fell from a high of 50 billion in June 2015 to 48.5 billion in November. And this number is after 13 billion of tourist money (much of it in cash) entered Greece during that period. So there is significant part of the economy that now operates with these 50+ billion only in cash.

We also had the resurrection of a black market for “free” euros with a 5-7% premium. In other words, two different

prices, one for the Euros locked up in banks and a different one for the cash outside. All of these, remind us of the glorious drachma days, when there was a fully functioning black market for Deutschmarks and US Dollars and the banks played no significant role in the economy. Today, the role of the drachma is played by the euros that are subject to the capital controls. In other words, we have a half-drachma state of affairs.

The breakup of the economy into two disjoint parts (behavioural hedging) and the high tourist season were probably the main reason why the recession was much lower than expected (only -0.4% compared to -4%). This is the main survival mechanism of the Greek companies/households. Unfortunately for the Greek economy, this development is highly negative long-term. It increases the black economy and deprives the state of taxes.

We also have a zombie banking system that plays no role in the economy. This will take many years to reverse. The recent decision of not forming a bad bank, for the huge amount of non-performing-loans (110bn or 60% of GDP), will have an adverse effect too. As long as these bad loans remain inside the banks, they will cause liquidity and capital shortage, and the danger of bank resolution will hang on them for a long time. These loans are backed by real estate, so until and unless real estate values recover, there will be no bank recovery (see [report here](#)).

Prof. Varoufakis may have not had the opportunity to complete his grand Grexit plan but he was very successful in sending Greece to travel back in time. To be exact, 30 years back, in an environment of half-drachma. Let us hope that in 2016 the government tactics will allow Greece to return to the full Euro rather than the full drachma.

A Greek version was published on [Kathimerini](#).

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