Greece Economic Depression: Inflationary Consequences for the European Union

Surge in retail prices

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Global Research, May 06, 2010
Market Oracle 5 May 2010

Region: Europe
Theme: Global Economy

Greece, Europe's Achilles Heel continues to implode under its budget deficit and total debt burden sending a series of strengthening shock waves across Europe's credit and financial markets. Whilst many western economies bounce back from the Great Recession of 2008-2009, Greece's economic depression continues as the economy is set to contract by further 4% during 2010 which is much worse than the 2.5% contraction of 2009 and looks set continue contracting for several more years. Greek Unemployment is soaring to 12% this year up from 9.5% in 2009 and is set to continue higher to 13.5% in 2011.

All of the austerity measures implemented to date are only going to narrow the Greek budget deficit to about 10% of GDP for the current year, and contrary to ECB and Greek government announcements Greece is NOT going to meet the 3% deficit target in 3 years time. Meanwhile missing from the whole too and fro is that the Greece debt mountain will continues to mushroom ever higher demanding ever greater interest payments to service it as a % of GDP despite the bailout which effectively caps Greece's borrowing rate at 5% for 3 years.

So Greece is in economic depression carrying a huge debt burden that continues to deleverage, so why are we not hearing debt deleveraging deflation in Greece ? Especially as Greece unlike the non Euro Zone countries such as the UK CANNOT devalue their currency OR print money because they they gave up those sovereign powers to the ECB. All of this suggests that Greece should be experiencing deep price deflation as many workers are being forced to suffer 30% pay cuts as a consequence of being forced to cut the governments budget deficit to back under 3% of GDP.

Surely if there was one place on Earth where deflation should now be rampant as per the debt deleveraging deflationary academic and BlogosFear models than it should be in Greece ?

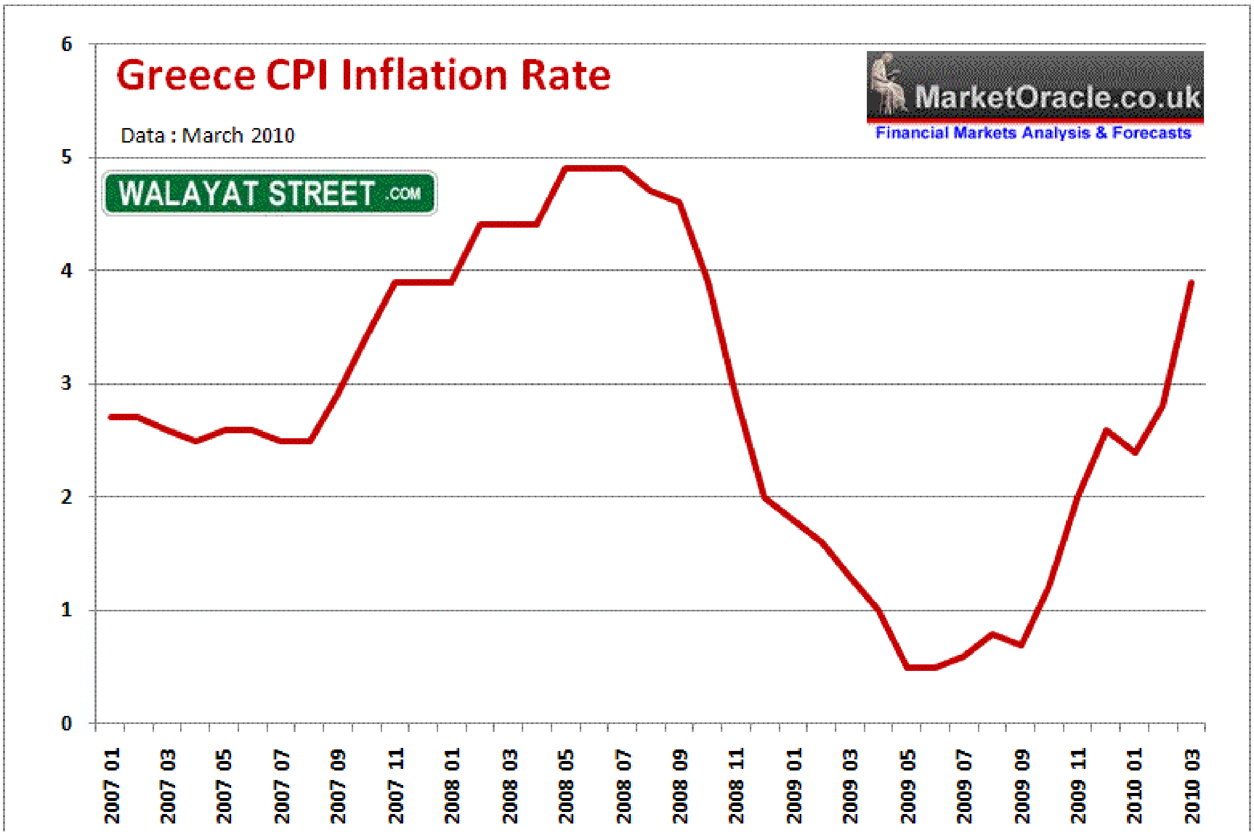
Instead of Deflation the Greek Inflation rate has soared to CPI 3.9% for March 2010, against a low of CPI of 0.5% just 10 months ago in June 2009.

Greece CPI Inflation 2010

Jan 2010 2.4%

Feb 2010 2.8%

Mar 2010 3.9%



The ivory tower theoretectical economic models again FAIL in the real world.

Whilst my inflation mega-trend ebook (FREE DOWNLOAD NOW) focuses primarily on the UK economy, however as stated, many of the primary drivers of inflationary mega-trend impact on ALL of the western debt ridden economies that have NO CHOICE but to deploy INFLATIONARY mechanisms which in Greece's case comes down to a defacto debt default the bill for which is being picked up by predominantly Germany and France which signals surging inflationary consequences across the Eurozone that will continue to manifest itself in a weaker Euro currency as the European Central Bank is forced to ramp up the printing presses towards the monetization of bankrupting Euro-zone nations debts.

ALL Central Banks are only good at One Thing and that is PRINTING MONEY ! – The ECB IS PRINTING MONEY for Greece, and soon will PRINT hundreds of billions of more Euros as the other PIIGS line up one by one each with their own Euro's begging bowls.

People have to understand that the inflation mega-trend is a GLOBAL PHENOMENA, not just a Greek problem, Euro Problem, UK problem, for ALL of the countries central banks are printing money as they are engaged in continuous competitive devaluations of their fiat currencies that continue to feed the fires of the inflationary mega-trend that will eventually reach ALL shores of ALL budget deficit running, money printing, debt accumulating economies and even those that have well managed economies and national accounts are engaged in highly inflationary pegs against bankrupting currencies that ensures inflation will be imported whilst such pegs exist.

Eurozone Bailout to Save German and French Banks from Bankruptcy

Most of Greek debt is held by German and French imbecilic banks, include the debt of the other potential defaulters Spain, Portugal and Greece and the amounts to $1.3 trillion of debt of which about 60% is held by French and German banks. Therefore the bailout of Greece is to prevent another banking sector collapse that would hit German and French banks hard and soon soon engulf the whole global financial sector and markets as the banking system again once more freezes, though this time the sovereigns as a consequence of the first bailout are not in a position to embark upon Global Financial Bailout 2, not when the markets expect, no DEMAND deficits to be cut or else they will dump the Triple AAA's down to Junk status.

The Euros 110 billion Greece bailout to finance the next 3 years of budget deficit and debt rescheduling will eventually amount to an INCREASE in Greece's debt burden by approx another 30% of GDP. Therefore Greece will remain stuck in an INFLATIONARY depression as it is FORCED to import inflation whilst at the same time its economy stagnates in nominal terms and deflates in real terms. In the meantime the credit markets will remain closed to Greece and increasingly to the other PIIGS.

Germany Profits From Keeping Bankrupt Countries on Life Support

Germany directly profits from the European PIIGS debt crisis as Germany's highly competitive industrial machine is able to export its goods and services to other European countries that cannot competitively devalue against Germany. Germany is further boosted by global exports as the Euro is KEPT Relatively WEAK against its major export markets such as the United States. If the Euro did not exist then the Deutschmark would have shot through the roof during the financial crisis which would have crippled German industry. In actual fact the German economy is bouncing back strongly whilst weak Euro-zone economies such as Greece are stuck in what is amounting to an Inflationary Depression, but there does come a point when Germany itself will suffer the consequences of inflation and thus be forced to RAISE Euro-zone interest rates which yes you've guessed it puts the whole Eurozone under an increasing debt interest burden.

Greek Bond Investors Wiped Out

The Bond Investors have been wiped out. Greece has defaulted in all but name, Greek Bonds have crashed by over 60% as bond investors face as much as 70% loss on the value of their holdings. Greek 2 year bonds are yielding 20% against German 2 year notes at just 0.8%. The only question is how much of these losses will be covered by Germany and France as both fear what would happen to their own imbecilic mega banks that hold over a $1 trillion of PIIGS debt.

All Countries Trending Towards Bankruptcy

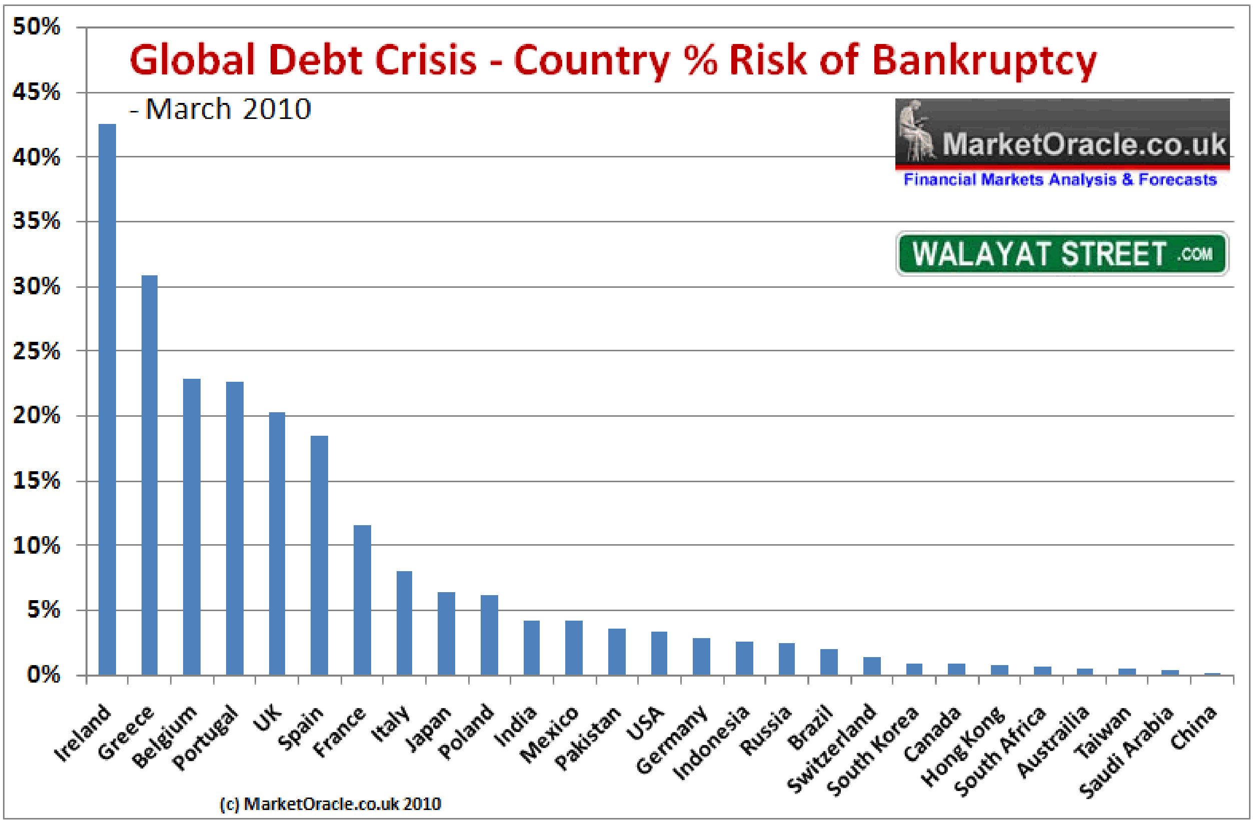
The Greek contagion is spreading, Portugal Spain and Ireland are gearing up to default on their debts to some degree which is resulting in a dash for relative safety, notable US, German and UK Bonds have benefited over the past 2 weeks. My in depth analysis of 3 weeks ago (13 Apr 2010 – Britain's Accelerating Trend Towards High Inflation and UK Debt Default Bankruptcy) concluded :

The bottom line is that Britain over the next 4 years is projected to borrow an ADDITIONAL £300 to £350 billion to be added to Britain's £870 billion official debt mountain. However this does not mean that Britain will go bankrupt either imminently or during the next 4 years because the bond markets on balance trust Britain's credit worthiness more than the likes of *the PIIGS, which does give the country some breathing space to run higher deficits without Greece and Iceland style panics. But there is a limit, we are NOT the United States that has the benefit of having the worlds reserve currency and never having defaulted on its debts before (Britain has at least twice).*

This lack of imminent default risk is providing for a boost to Britain's ability to finance its own huge issuance of new debt which is short-term supportive of sterling against the Euro as bond holders seek a safe haven home in the dollar and sterling.

Greece Tip of Euro Zone the Iceberg

My in depth analysis of (13 Apr 2010 – [Britain's Accelerating Trend Towards High Inflation and UK Debt Default Bankruptcy]()) included a list of countries that were at the greatest risk of going bankrupt –



Whilst the mainstream press these past two months has been obsessed with the Greek debt crisis, the above graph clearly illustrates that a far larger debt crisis looms in Ireland that could soon transplant Greece in the debt crisis headlines over the coming months, similarly a number of other Euro Zone countries head the risk towards bankruptcy league table with Belgium and Portugal not far behind Greece. The price that these countries pay for being stuck in the Euro single currency is that they cannot devalue to try and gain some competitive advantage for their economies and therefore try and grow and inflate their way out of a high debt burden that stifles economic activity.

As the above excerpt illustrates Greece is just the tip of the Eurozone debt ice-berg as illustrated by other countries such Ireland, Belgium, Portugal and Spain fast lining up for a Euro-zone (German) bailout to OFFSET the pain of economic contraction that implies they too will witness a surge in inflation right across the Eurozone.

Britain, as I elaborate at length in the 100 page Inflation Mega-trend ebook is going down a different route towards bankruptcy that will witness the systematic destruction of its currency as the government attempts to inflate and grow its way out of the debt crisis, to be frank, the Labour government is NOT going to implement any serious cuts, and even those proposed by the Conservatives amount to a mere pin prick against an annual deficit of £167 billion as illustrated ny the talk about the difference of between £6 billion and £12 billion annually between the two parties as if that amounts to huge difference when set against the £167 billion black hole that will suck the economy into a debt singularity with a wage price spiral emerging from the other side of the debt equation.

Greece Will Go Bankrupt Due to the Debt Interest Spiral

Greece public government debt stands at about $300 billion, on which it currently pays 5% interest (market interest rates have surged far higher), which amounts a debt interest burden on the Greek economy to the tune $15 billion per year which is set against the Greek economy of $300 billion (and shrinking) and Greek government revenues of about $115 billion. Therefore the Greek government is currently forced to pay about 10% of its annual revenues as interest on debt per year which it cannot afford to do i.e. the Government is running a budget deficit of 12% of GDP. It is about 25% short of revenues against what it spends. What this means is that the debt interest is being financed by NEW debt that is continuously added to the Greek debt mountain and there in lines the debt interest spiral, as the greater the total debt the greater the interest the country has to pay which results in even greater debt and thus greater interest payments due each year.

However throw into the debt spiral the fact that bond investors are ‘usually’ not stupid, they are not going to wait around for a country to go bankrupt, they will demand a higher interest rate to hold the riskier Greek debt which means instead of paying 5% interest, suddenly the annual debt interest burden jumps far higher as we are witnessing in the crash of the Greek bond market, which results in a further escalation of the debt interest spiral, and as the risk ratchets up so does the interest rate demanded by the market to continue to hold Greek debt until eventually the Greek government gives up and defaults on the debt as there is no way it can finance the deficit as a function of the burden of servicing the annual debt interest.

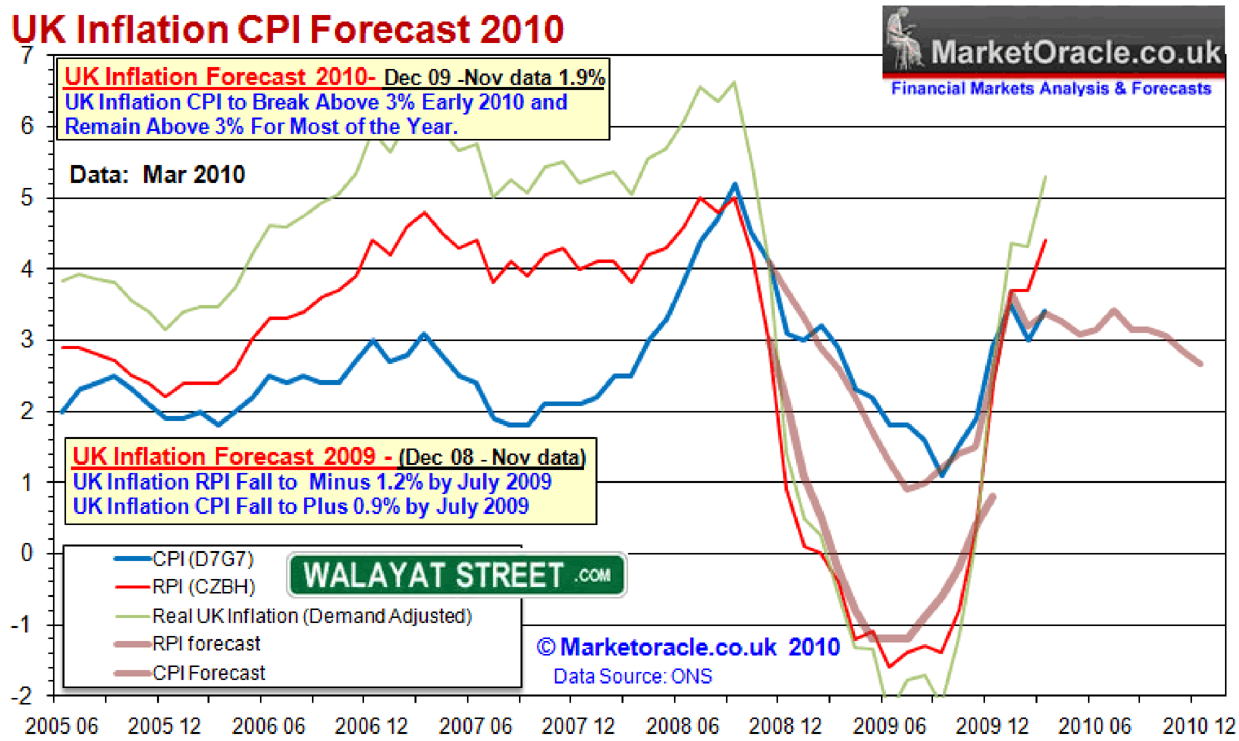
The Euro bailout of Greece is not going to stop Greece form going bankrupt as at the end of the day the bailout is just a loan at 5% interest i.e. more debt to pile on top of existing debt that Greece cannot service.

Who Will finance the Issuance of New Global Government Debt?

The problem is that all of the countries in the Euro zone are running large deficits requiring funding, even Germany is running a deficit of about 8% of GDP. If this was just a Eurozone sovereign debt problem then it could be manageable as the Euro devalues, but it is not, it is a global sovereign debt crisis with the big deficit elephants in the room comprising the United States, Japan and UK, that combined are seeking to finance a deficit of $2.8 trillion this year alone.

The answer does NOT come at near zero interest rates, the deficits can only be financed (for a short-while) at significantly higher interest rates which suggests that regardless of what the U.S. Federal Reserve or the Bank of England or the ECB says, global interest rates are going to rise, and much sooner than anyone expects with Greece acting as the interest rate canary in the coal mine signaling global bond market interest rates will rise several % points higher over the coming SIX months, both short-end and long end regardless of the manipulated official interest rates. This outlook is inline with the inflation mega-trend and as illustrated in the UK Interest Rate Forecast (13 Jan 2010 – UK Interest Rate Forecast 2010 and 2011).

Off course higher interest rates means higher interest payments and thus an increasing debt burden which feeds the inflationary debt spiral ever higher (03 Dec 2009 – Britain's Inflationary Debt Spiral as Bank of England Keeps Expanding Quantitative Easing)



VAT TAX RISE Ensures UK Post Election Inflation Spike

A post UK election VAT hike to 20% from 17.5% is near certain to bring in extra revenue of about £13 billion per year. This will have the effect of both spiking inflation sharply higher and maintaining the ongoing longer-term inflationary mega-trend, therefore I would not be surprised that following the implementation of a VAT tax hike that CPI spikes above 4% and RPI as high as 6%! Which would further discredit the Bank of England's mantra of "Don't Worry Folks its Only Temporary".

Who else is seeking to raise VAT ?

Greece, VAT going up from 21% to 23% which means more inflationary pressures for the Greek economy pushing up prices whilst wages are cut by between 20% and 30%.

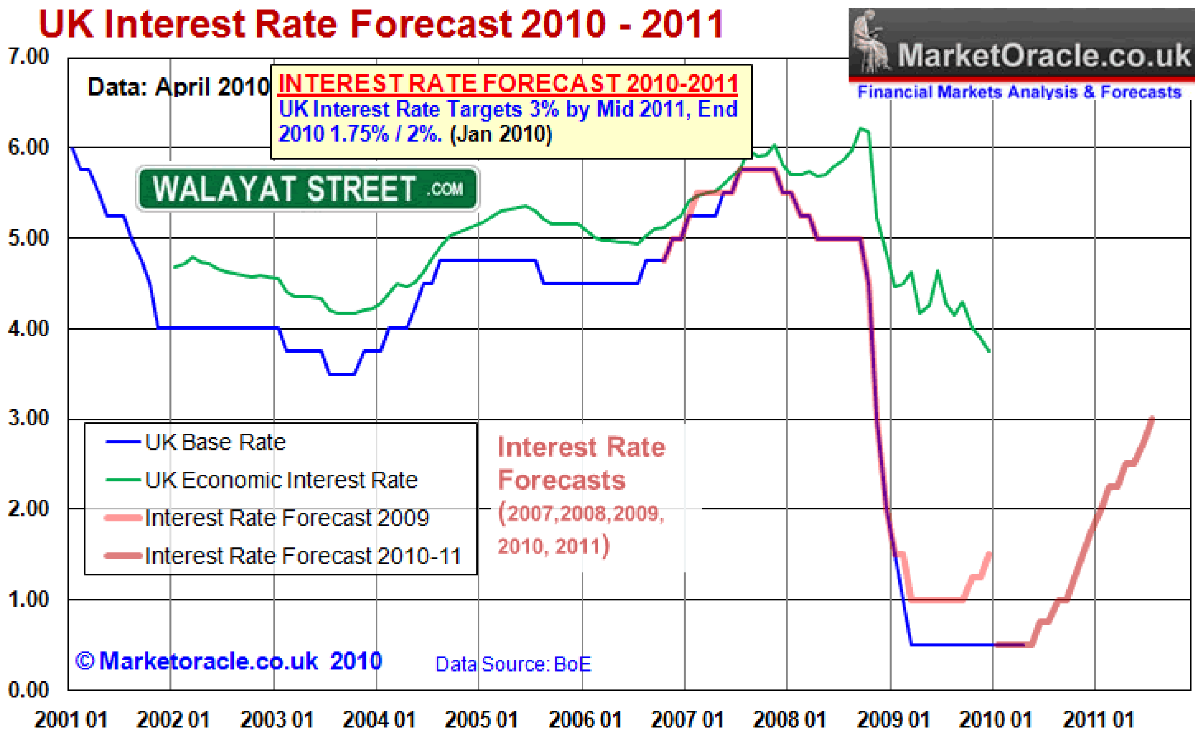
New wave of E.U. economic migration heading Britain's way from European FAILED States such as Greece and the string of other PIIGS soon to join them.

Interest Rate Rises Inevitable

Market interest rates are soaring as evidenced by the retail and bond markets. The artificially low official interest rates such as the UK base rate will soon be literally yanked significantly higher as Consumer Price INFLATION Forces Central banks to ACT. The UK target inflation rate is 2%, it is now at 3.4%. Will the Bank of England still sit twiddling its thumbs when CPI soars above 4%? or will it be Forced to RAISE the base interest rate to prevent sterling going into a free fall death spiral dance?

UK Interest Rate Forecast (13 Jan 2010 – UK Interest Rate Forecast 2010 and 2011)

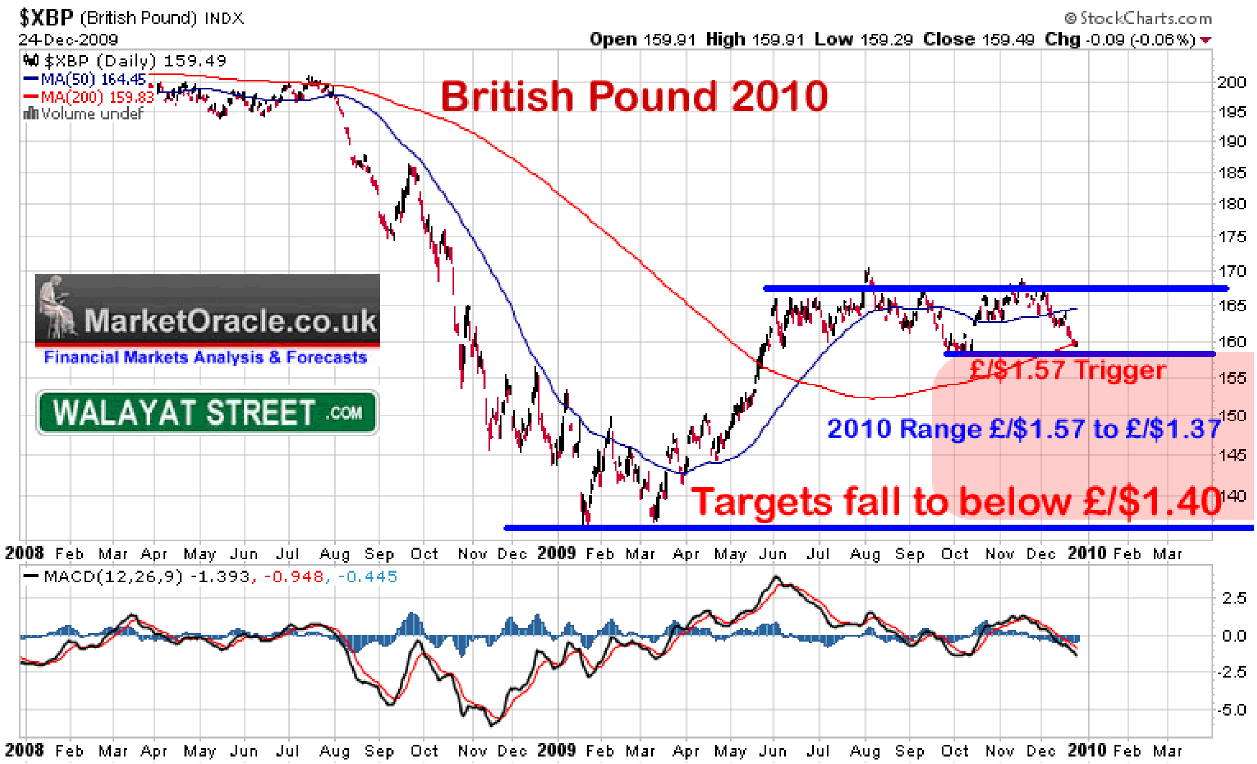
UK Interest Rates Forecast 2010-11: UK interest Rates to Start Rising From Mid 2010 and Continue into end of 2010 to Target 1.75% / 2%, Continue Higher into Mid 2011 to Target 3%.



U.S. Dollar Achieves Forecast Target of USD 84

So much for the perma U.S. Dollar collapse mantra of the past year, the global flight to safety in the wake of the sovereign debt contagion spreading has today seen the U.S. Dollar hit USD 84, achieving my un-revised bull market target as of November 2009, USD 76.35 (01 Nov 2009 – U.S. Dollar Bull Market Scenario Update), an in depth update will soon be forthcoming that will aim to map out the Dollar trend for the next 6 months.

The British Pound continues to oscillate around £/$1.50 in advance of the target low of £/$1.40 as elaborated in the Inflation Mega-trend Ebook and earlier forecast (26 Dec 2009 – British Pound GBP Forecast 2010 Targets Drop to Below £/$1.40)



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1. That sterling is targeting immediate support at £/$1.57 which implies it may temporarily bounce from there back through £/$1.60 before the eventual break.

2. That a break below £/$1.57 would target a trend to below £/$1.40. On a longer term view, the chart is indicative of trading range between £/$1.57 and £/$1.37, on anticipation of the eventual break of £/$1.57. On average this implies a 10% sterling deprecation against the trend of the preceding 6 months or so.

The Bottom Line

Inflation continues to surge higher even in countries that supposedly should be experiencing Deflation according to the bankrupt ideology of academic economic theorists that populate the mainstream press, financial institutions and large areas of the BlogosFear. Market interest rates are following inflation higher, the markets will soon force the official short interest rates higher too. Higher interest rates will mean WIDENING of budget deficits as debt interest payments on accrued debt Increases which will be met by more money printing, falling fiat currencies all of which will continue to feed the inflationary mega-trend not just for this year, or next year, but for a decade as there is no way that ANY DEBT will be actually paid down for the next 10 YEARS! Instead it will be INFLATED AWAY.

So I repeat my warning of November 2009 (18 Nov 2009 – Deflationists Are WRONG, Prepare for the INFLATION Mega-Trend)

The warning of November 2008 of the worst case scenario of Hyperinflation has not only NOT diminished over the past 12 months, but it has been greatly reinforced, where 2010 looks set to the year of INFLATION NOT DEFLATION and 2011 may be Far worse as the Deflationists lose every penny they own and hold in Government Bonds that they so vocally now profess to pile into!

After the deflationary correction of 2008 we are about to witness the INFLATIONARY MEGA-TREND of the NEXT DECADE! the consequences of which are many.

Little has changed, instead of recognising the flaws in the deflationary argument, deflationists are delusionally playing around with what actually constitutes Inflation, no not the Inflation Data such as CPI that 99.99% of the people on the planet recognise as a measure of inflation of general prices in an economy but obscure credit statistics that supports the theory of deflation whilst in the real world inflation rages, destroying the value of hard earned wealth.

Many governments have already abandoned inflation targeting in all but name, Look at the UK, CPI is at 3.4%, RPI is at 4.4%, the Bank of England comes out with its regular monthly nonsense that the inflationary surge is temporary, despite the fact that inflation continues to rise the following month. Its not the Bank of England’s fault, for it is not in the MPC’s nature to admit that they are incompetent at targeting UK Inflation at ANY level let alone at 2%. If anything the UK and many other economies are heading for an inflation shock THIS YEAR that will make today’s 3.4% CPI rate look LOW.

Protect your wealth from the inflationary mega-trend that has boosted asset and commodity prices in most cases by more than 50% during the past 12 months whilst most still question the existence of the inflationary mega-trend and ramble on about NON Existant Deflation (CPI is at +3.4% NOT -3.4%). My FREE EBOOK contains 50 PAGES of of how to protect and grow your wealth as ever higher fiat currency supply seeks a home in scarce limited supply resources and asset classes as private sector and sovereign debt mountains EXPLODE into Much Higher inflation as we are witnessing with Greece today, especially as government’s induced asset price inflation to prevent economic depression is increasingly spilling over into consumer price inflation the only response to which is to RAISE interest rates.

As was the case in March 2009 (15 Mar 2009 – Stealth Bull Market Follows Stocks Bear Market Bottom at Dow 6,470), once the academic’s and talking head pundits wake up to the INFLATION MEGA-TREND in the real world, it is by then always already too late to act as the markets will have long since MOVED!

Source: http://www.marketoracle.co.uk/Article19199.html

***Nadeem Walayat** has over 20 years experience of trading derivatives, portfolio management and analysing the financial markets, including one of few who both anticipated and **Beat the 1987 Crash**. Nadeem’s forward looking analysis specialises on UK inflation, economy, interest rates and the housing market and he is the author of the **NEW Inflation Mega-Trend ebook** that can be downloaded for Free. Nadeem is the Editor of The Market Oracle, a free Daily Financial Markets Analysis & Forecasting online publication. http://www.marketoracle.co.uk*

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