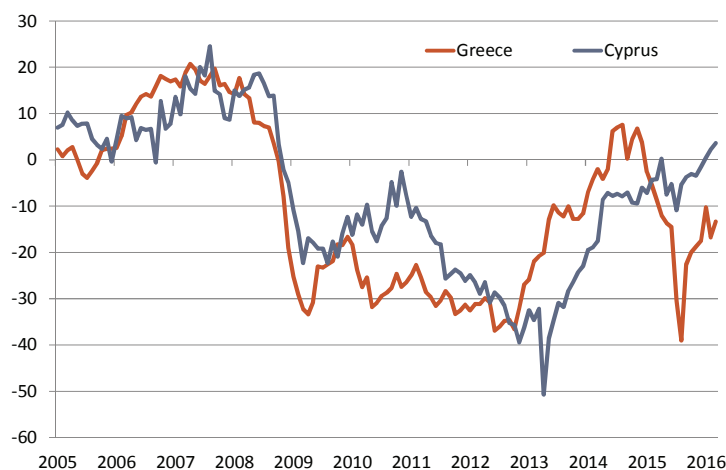


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1 April 2016

## Cyprus versus Greece: a lesson in Eurozone reform

**Mind the gap: corporate confidence in Greece and Cyprus**



Weighted average of sentiment in industry, services, retail trade and construction.  
Source: European Commission, Berenberg calculations

- **Small country, great rebound:** Three years after falling into a deep crisis, Cyprus has successfully left its EU-IMF adjustment programme. Following the return to growth last year, corporate confidence has surged to its best level since September 2008. The island at the Eurozone periphery is on track for a long and strong recovery.
- **The European approach is working:** Cyprus thus follows the examples of Ireland, Portugal and Spain, which also exited their financial support programmes with flying colours. By and large, the European approach to offer conditional credit to euro member countries that implement serious reforms is showing results. Of course, whether these countries will stay on the recovery track will depend on their domestic political will. Serious reform reversals could still turn out to be very costly. As always, life remains full of risks.
- **Greek misery:** Only one of the erstwhile euro crisis countries remains mired in misery, dependent on further external support to prevent a wholesale collapse. What explains the gap between these two close neighbours?
- **Advantage Cyprus:** To some extent, any comparison between Cyprus and Greece is unfair. Cyprus is a small open economy blessed with a fairly flexible labour market that is partly a legacy of British influence. This makes it easier to cope with dramatic shocks, such as the virtual collapse of its overblown banking system some three years ago. But that is less than half the story. After a rough start and despite the occasional hiccups, Cyprus simply did what it had to do, implementing most of the required reforms. The results speak for themselves.
- **A recovery aborted:** To explain why Greece is doing so much worse than Cyprus, Spain and Ireland, we have to look at Greek politics. After a long crisis that was made unnecessarily painful by an overdose of austerity, Greek corporate confidence started to perk up in the summer of 2012. It did so for two reasons. At home, the just-elected prime minister Antonis Samaras got serious about pro-growth structural reforms, working with – rather than against – Greece's only willing lenders. In the overall Eurozone, ECB president Mario Draghi ended the systemic euro crisis by promising to act as a Fed-style lender of last resort if need be for fiscally compliant countries.
- **The Varoufakis effect:** By late 2014, Greek corporate confidence had recovered to an almost six-year high. Greece seemed poised for up to 3% growth in 2015. But politics got in the way. With the rise of political risk in late 2014, confidence started to crumble. When Yanis Varoufakis became finance minister in January 2015, starting to reverse reforms and going for full confrontation with Greece's creditors, Greek confidence plunged like a stone, sending Greece back into recession. Rarely has a finance minister done so much damage in such a short time.
- **Shaky Greece:** Since prime minister Alexis Tsipras finally fired Mr Varoufakis nine months ago, Greek confidence has recovered somewhat. But it will remain weak until Mr Tsipras starts to follow the Cypriot example and simply implements the bulk of the required reforms, instead of picking one fight after the other with Greece's lenders.

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