Greek exit need not be a tragedy

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Troubled times: Supporters of Greece's far-right Golden Dawn party hold a rally in Athens. *Photo: Reuters*

GREECE has greatly contributed to modern Western civilisation but no one can dispute that its current disproportionate impact on the global economy is alarming. From this alarm comes fear, and fear often drives markets in directions few desire.

Putting this fear aside for one moment and calmly reflecting on current events, let's ask ourselves what is the likely impact of a "Grexit" for Europe, China and, importantly, Australia?

We'll let others speculate about what may be the solution for the euro crisis and set aside, for now, the negativity that most propagate, and honestly contemplate what a European Union without Greece means for the global economy and us in Australia.

If you read this far on most commentaries about this subject you'd now be hit with a plethora of 2012 Mayan calendar doomsday anecdotes, patronising warnings and generally a bundle of negative spin that is neither borne out of any qualitative nor quantitative assessment of what's really transpiring. This author would like to suggest a Grexit is a positive outcome and a part-solution to the stagnant quagmire that is the current European economy.

Taking a step back and looking at the forest rather than the trees, what resonates most between the current crisis and arguably its nearest comparison, the Great Depression, is not solely (nor importantly) a crash or correction in equity markets but a hit to credit in the general economy.

It's always fun borrowing lines from movies and the one from the Ben Bernanke character in the 2011 GFC movie *Too Big to Fail* sums up this point with distinct clarity: "Credit has the ability to build a modern economy but lack of credit has the ability to destroy it, swiftly and absolutely."

The absurd levels of debt acquired by the Greeks (or any of a number of other nations for that matter) are not driving the current fear. It is more due to the recent acknowledgement, since 2010, that the debt market grossly undervalued the true risks of sovereign bonds and the direct implications that has meant for credit, at all levels and in all economies.

Whether we personally support or disapprove of the United States' 2009 TARP package, it is clear it has provided immediate and conclusive liquidity to the American interbank lending market and, all else being considered, allowed the Americans in 2012 to enjoy relative growth and stability while others are continuing to play Russian roulette with five rounds in the chamber. An expulsion or resignation of Greece from its Maastricht Treaty accords provides Europe that line in the sand that is now becoming critical.

A Europe that has faced and answered this moral hazard (of bailouts versus expulsion) of mispriced debt can then place a true value on it and, by doing so, provide clarity on what credit should cost commerce.

Greater certainty around the value of credit is not only imperative to the restoration of the European interbank lending market (about a third of the global economy), it is also important for something else that resides in Europe that few understand or appreciate: the reinsurance industry. Banks and commerce greatly rely on the provision of insurance and the insurance industry greatly relies on the reinsurance industry and this industry is primarily domiciled in western Europe. Without it, the merry-go-round stops without warning. Providing clarity to these often overlooked institutions in our global economy allows China to start trading more again with its largest client, Europe, and thus allows Australia to support its most important trading partner in China.

China needs Europe, America needs China and Europe, and ultimately Australia, needs everybody. A Grexit provides closure and certainty and this will provide a path to growth. Without growth in Europe, Australia will likely suffer from the greatest scourge of modern times, inflation.

Why? Without organic growth domestically, Australian businesses have synthetically substituted inflation for what was previously driven by growth, but more alarmingly for Australians, a Europe that is not growing means China slows while the Chinese domestic market matures, ever increasingly consuming more of its own production and thus competing with us for all the products and services we now enjoy from them.

Play a little game for a few moments and try to point to something around you that is not made in China. Good luck with that. This leads to what is referred to in economics as cost-push inflation. Cost-push inflation is caused by substantial increases in the cost of important goods or services where no suitable alternative is available. We all deep down know the Chinese aren't going to back down from their growth path without a fight and the best way for them to substitute demand from Europe is to inflate their current offerings.

Cost-push inflation means not only will we be competing increasingly with the Chinese domestic market but we will be importing more inflation as a consequence of the stagnation in Europe. Don't believe me? Well, you need only look at Japan from the late 1960s until the 1990s and consider where China will be in the 2030s. A restoration in global debt markets brings direct clarity to credit markets, which will then allow the world to get back to business and rely on growth for prosperity, not inflation.

A near-term exit of Greece from the EU will provide that line in the sand. A Greek tragedy may not be so tragic after all.