DOC. N.º 129

Greece and Portugal face 'slow death' over debt crisis

Greece and Portugal are likely to suffer a "slow death", as higher debt costs cause the economy to "bleed" economic potential, Moody's credit ratings agency has warned.

A man walks by a graffiti reading 'eat the rich', sprayed on the wall of a bank office in central Athens Photo: EPA

By Angela Monaghan, Economics Reporter

7:33PM GMT 13 Jan 2010

Moody's Investors Service said unless the two countries reverse their large current account deficits, wealth generated would increasingly have to be used to pay off rising debt costs as investors demand more to hold Greek and Portuguese bonds.

To compensate, the governments would have to keep raising taxes, which in turn could smother investment and drive out wealth creators, Moody's said.

"The risk of a 'sudden death' is negligible, but the likelihood of a 'slow death'...is high," the report said.

Moody's warned that the window of time the countries have in which to act "will not be open indefinitely", adding that Greece would have "significantly less time" than Portugal.

The report highlighted the difficulty facing European sovereign debt issuers in 2010. It said that if markets were to become concerned about the threat of inflation, market rates could rise significantly, making debt less affordable and "testing" the credit ratings of the more highly indebted countries.

Government borrowing in Britain is on course to hit £178bn this year, and agencies have warned that it may not be immune to a credit downgrade. Moody's said it would be "interesting" to see what happened to gilt yields once the Bank of England £200bn quantitative easing programme came to an end, at which point the Government will be dependent on the private sector to fund the deficit.

Describing the shift from Labour's policy of spending its way out of recession, to the inevitable fiscal tightening in the UK once recovery is underway and the election is over, it said: "The current UK government may have started the crisis as "crass" Keynesians, the next one is likely to be Ricardian to its core," referring to the economic theories of John Maynard Keynes and David Ricardo.