Quarterly Report on the Greek Economy
01 / 19

18th April 2019

ΙΔΡΥΜΑ ΟΙΚΟΝΟΜΙΚΩΝ & ΒΙΟΜΗΧΑΝΙΚΩΝ ΕΡΕΥΝΩΝ

Report Overview

Global environment - Further slowdown in 2019

- **Global growth of 3.6% y/y** in 2018 vs. 3.8% in 2017.
  - **Stimulus in 2018** from short-term US growth
- Prospect for **annual growth of 3.3% y/y** in 2019
  - **Downside risks** from escalation of trade protectionism, slowdown in China, the US and Europe, prolonged trouble in Brexit negotiations

- **Significant Eurozone growth deceleration** in 2018, to 1.8%, from 2.4% in 2017, estimates at 1.1% for 2019
  - **Positive impact** from prolonged high liquidity and low unemployment rate
  - **Negative impact** from worsening expectations (uncertainty over Brexit) and a slowdown in exports (trade protectionism measures) and investment, sharp deceleration in Germany and Italy

Global Environment: Medium-term challenges

Globally

- Continued trade protectionism -> Positive turn of negotiations between China and the USA
- Further slowdown in China
- Instability in Turkey and Argentina
- Trends in oil production (OPEC, US sanctions on Iran, Venezuela)

Europe

- Brexit: high uncertainty about an agreement with the EU
- Direction of the ECB's monetary policy (extension of low interest rates)
- Increased Euroscepticism, reflected in the upcoming European elections

Slower Growth in Q4 of 2018

2018 Q4: +1.6% y/y, versus +2.1% in 2018 Q3 and 2.2% in 2017 Q4

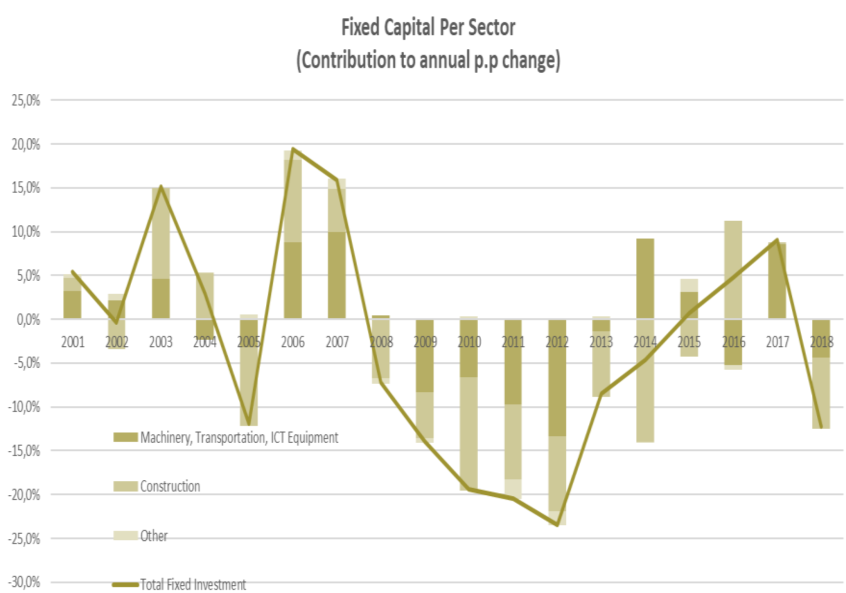
2018: GDP Growth 1.9% y/y, versus +1.5% a year ago

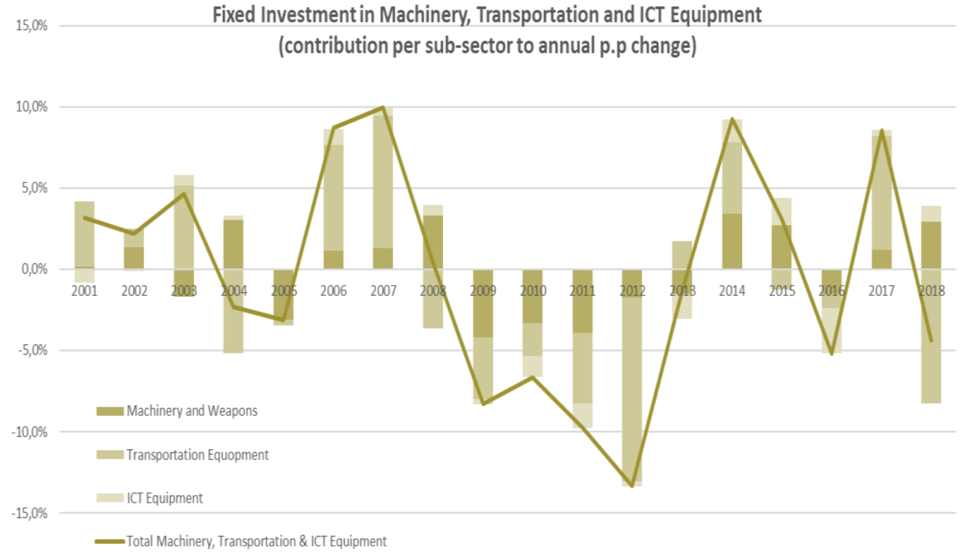
(Growth outturn close to IOBE projection, 03/17 Report: 2.0%)

Main trends in GDP components:

- External sector deficit decrease to 1.2% of GDP (-59% compared to 2017)
  - Continued exports expansion for the second consecutive year (8.8% from 6.9%)
  - Exports of goods and services at historic high absolute level and as % of GDP (18.8% & 34.1%)
  - Minor increase in imports by 2.0% y/y, following an increase of 7.4% y/y a year ago, almost exclusively as a result of higher imports of services (+14.4%). Negative factor on imports of goods being ships
- Slight increase in investments by 1.6% y/y, vs. an increase of 9.0% y/y in 2017
  - Impact exclusively from a different trend in inventories compared to 2017 (+€1,48 billion from -€1,78 billion). Fixed capital formation 12% lower in 2018
  - Drop of investments in Transportation, mainly ships, and other Constructions (due to PIP)
- Mild expansion of private consumption, cuts in public consumption
  - +1.1% in private consumption, vs. +0.9% in 2017, -2.5% y/y in public consumption (vs 1.8% in 2017)

Limited momentum of fixed investments, despite their "productive" restructuring





Source: Eurostat

- Gradual shift during the Adjustment Programme period of investment from Housing to more "productive" options (Transportation Equipment, Machinery, Other Constructions)
- Fixed investments severely lag behind the Eurozone average (11.1% of GDP in 2018, -10 p.p of Eurozone Average)
- Large changes in inventories (statistical adjustments): Determining factors of investment trends in 2014 – 2018 (exc. 2017)

State budget cash targets met in early 2019

- **Jan.-Feb. 2019 cash balance outcome: deficit €1.14 billion,** versus deficit target of €2.15 billion
- **Primary surplus of €822 million,** versus deficit target of €196 million, but also last year's surplus outturn of €2.7 billion (earlier receipt of BoG revenues)

- **Targets' overperformance** stemming from:
  - Lower spending
    - Less credit under distribution by €595 million
    - Includes retroactive payments, Public Investment Programme expenditure
  - Oveperformance in some revenue categories:
    - VAT (+€140 million)
    - Revenue from transfers (+€127 million)
    - Partly offset by lower tax returns by €98 million

Trends in short-term economic indicators

Industry

- Minor increase in industrial production in 2018, lower than the one recorded at the same period of 2017 (+1.1 vs +4.1%)

Construction

- Marginal increase in Construction by 1.0%, from building activity, not public works, compared to a 15.1% decrease in 2017
- Building permits stable, increase in volume by 22.8% (vs. 18.4% in 2017) and surface 21.4% (vs. 19.5%)

Tourism

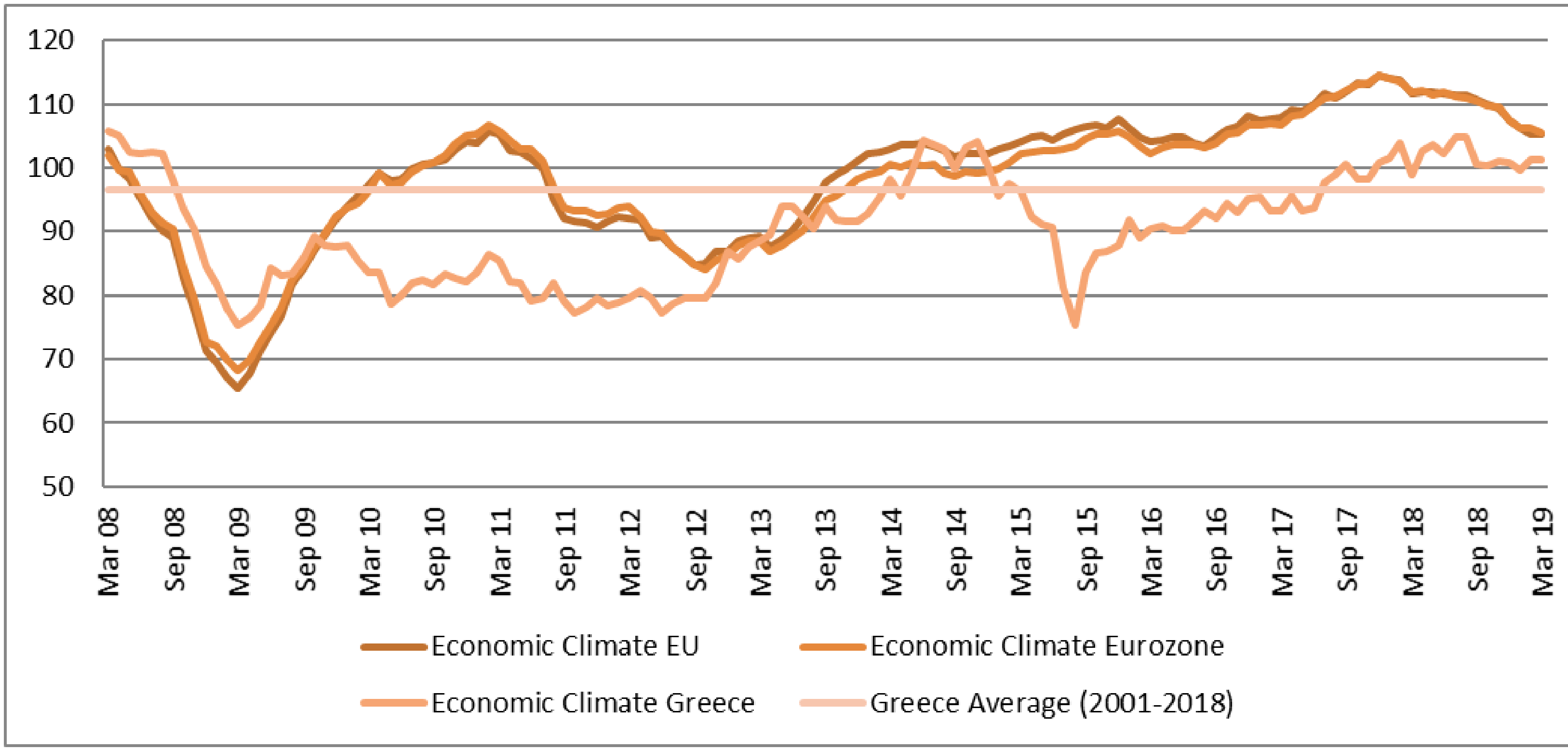
- Acceleration to 9.0% in 2018 compared to 8.2% in 2018. Important boost in revenue at the beginning of the year (+53.2% in January)

Retail Trade

- Continued expansion last year, slightly higher than in 2017 (1.5% y/y vs 1.2% y/y)

Slight deterioration of economic sentiment in Q1 2019, compared to Q4 2018 and 2017

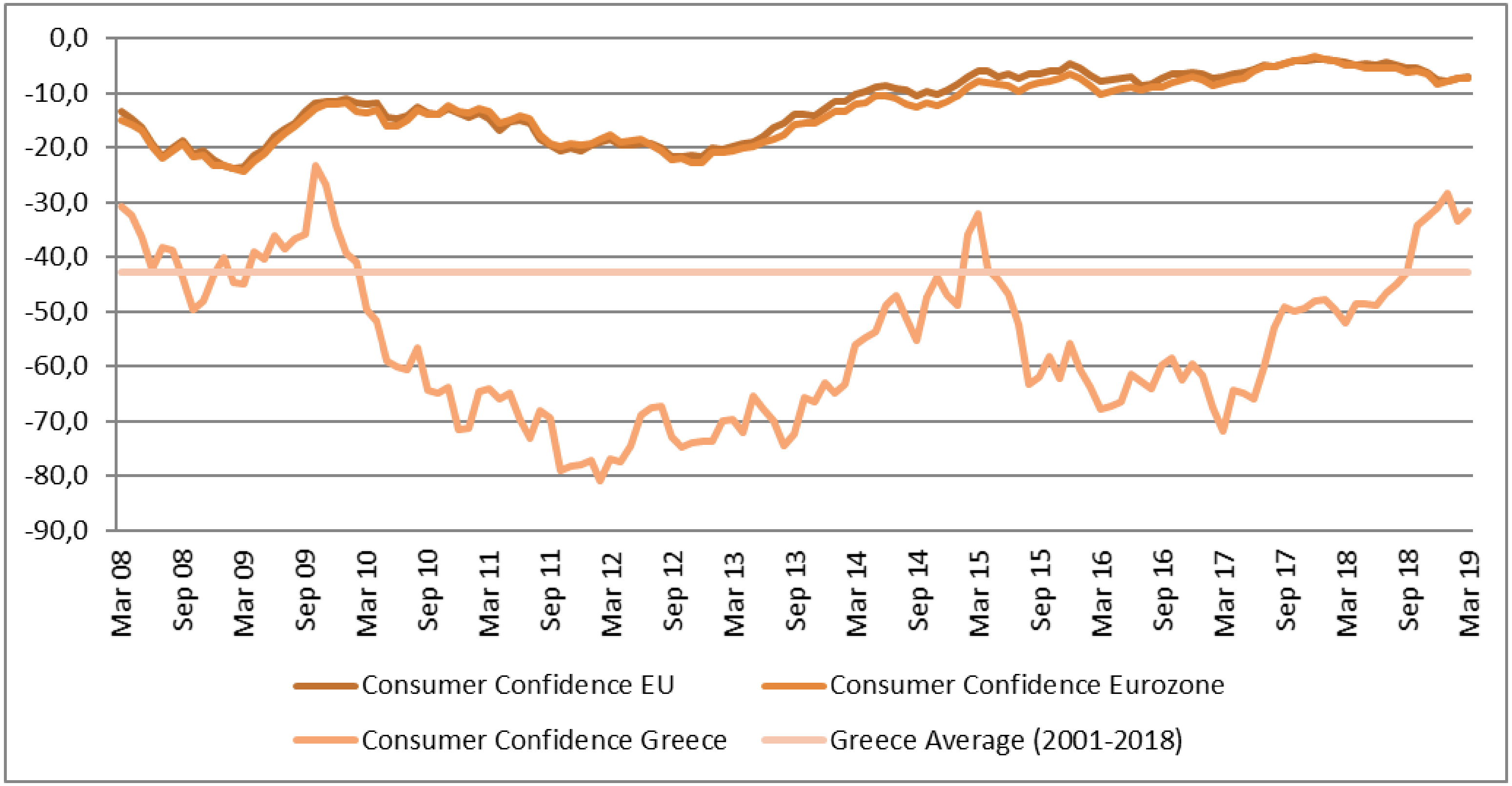
Economic Sentiment Index



Source: IOBE, European Commission

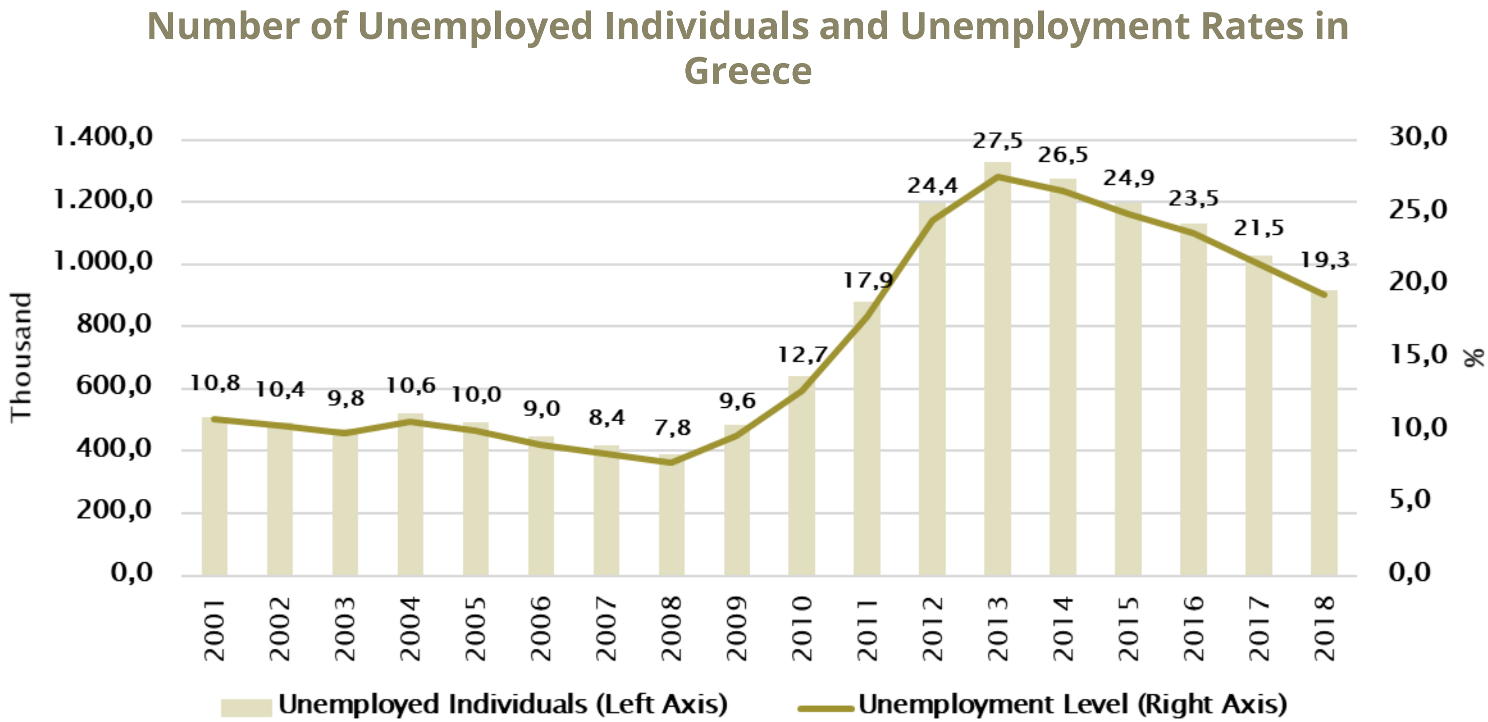
Mild recovery of consumer confidence in Q1 2019, compared to Q4 2017

Consumer Confidence



Sources: IOBE, European Commission

Continued decline of the unemployment rate for the fifth consecutive year

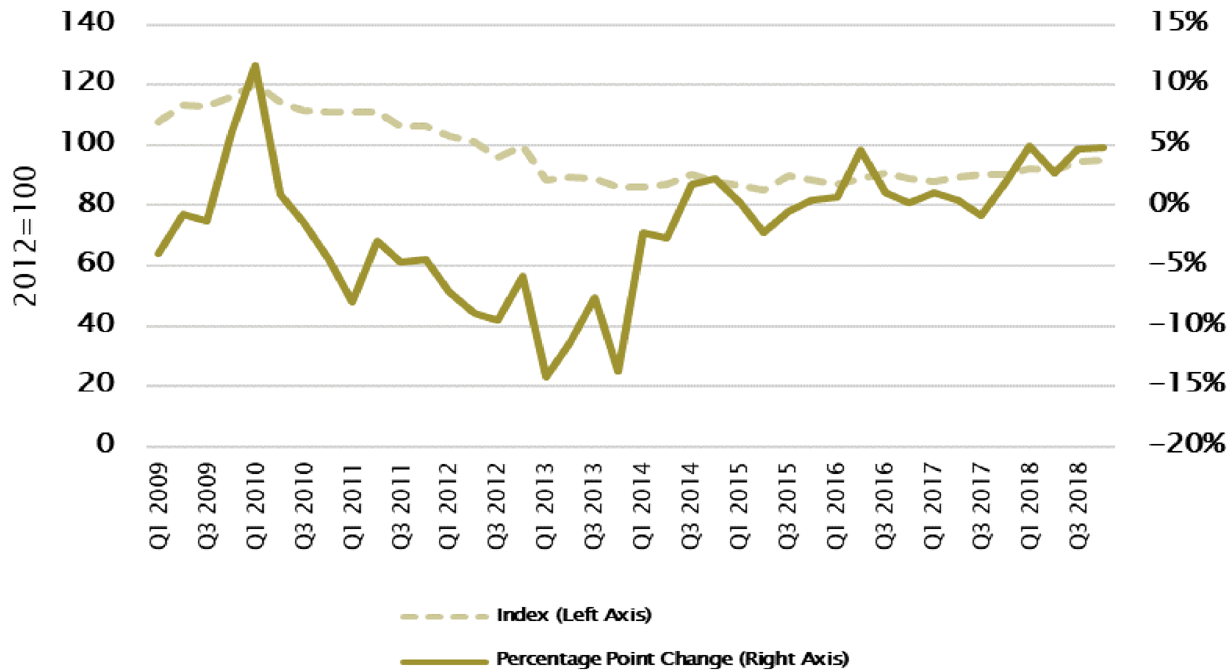


Source: ELSTAT

- **Unemployment rate at 19.3% in 2018, from 21.5% in 2017. Non-seasonally adjusted level of unemployment at 19.6% in Jan 2019 from 20.9% in Jan 2018**
- **Employment increase in 13 sectors.** Indicatively: Agriculture-Forestry-Fishing (+16.3 thousands), Tourism (+11.0 thousands), Health and Social Work Activities (+11.0 thousands)
- **Employment drop in 8 sectors**. Indicatively: Household activities as employers (-5.2 thousands), Financial and insurance activities (-5.1 thousands)

Increase of s.a. wage cost index for third consecutive year

Seasonally adjusted wage cost index



Source: ELSTAT

➢ **Rise of the index by 4.3% y/y in 2018, following a 0.7% rise in 2017 and 1.6% in 2016**

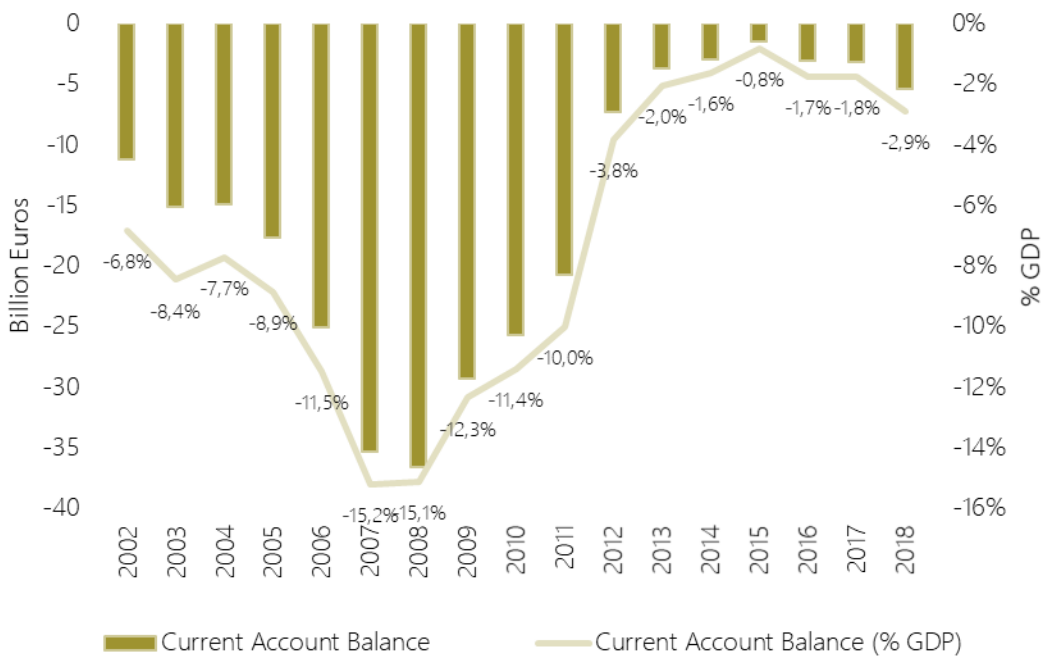
A reduction in wage costs often, but not always, leads to increased employment in terms of hours worked

SECTORS	Change in Work Hours (million hours)	% Change of Wage Cost	% Change in Final Product
Tourism	126,589	7.8%	6.0%
Management-Supporting Activities	**70,923**	**-7.1%**	**27.3%**
Wholesale-Retail Trade	**38,164**	**-13.3%**	**4.7%**
Construction	**29,825**	**-12.8%**	**3.7%**
Professional-Technical-Scientific Activities	**21,878**	**-32.1%**	**-6.2%**
Transport-Storage	12,643	0.1%	-6.0%
Arts-Entertainment-Recreation	8,900	7.6%	-4.4%
Information-Communication	**7,910**	**-13.9%**	**-13.0%**
Electricity-Gas-Steam-Air Conditioning	7,425	17.3%	-4.0%
Human Health-Social Work	6,374	-0.4%	-2.9%
Real Estate	3,486	3.0%	7.3%
Water Supply-Sewage Treatment-Waste Management	**1,846**	**-22.6%**	**-2.0%**
Education	454	13.7%	-3.5%
Mining-Quarrying	-1,666	3.6%	-32.7%
Other Services	-7,982	4.5%	5.7%
Public Administration-Defence	-8,008	12.3%	0.7%
Manufacturing	-9,088	0.7%	2.1%
Households as Employers	-11,922		-27.5%
Financial-Insurance Activities	-19,414	-3.1%	-15.6%
Agriculture-Forestry-Fishing	-30,828		11.7%
SECTOR TOTAL	247,509	1.7%	0.8%

Source: ELSTAT, Eurostat

- There are however sectors with increased wages and employment (eg. Tourism, where the largest increase in working hours was recorded, Energy)
- Some sectors with a large increase in employment – decrease in wage also record an increase in product, larger than the domestic average (Trade, Construction) ⇨ impact on demand

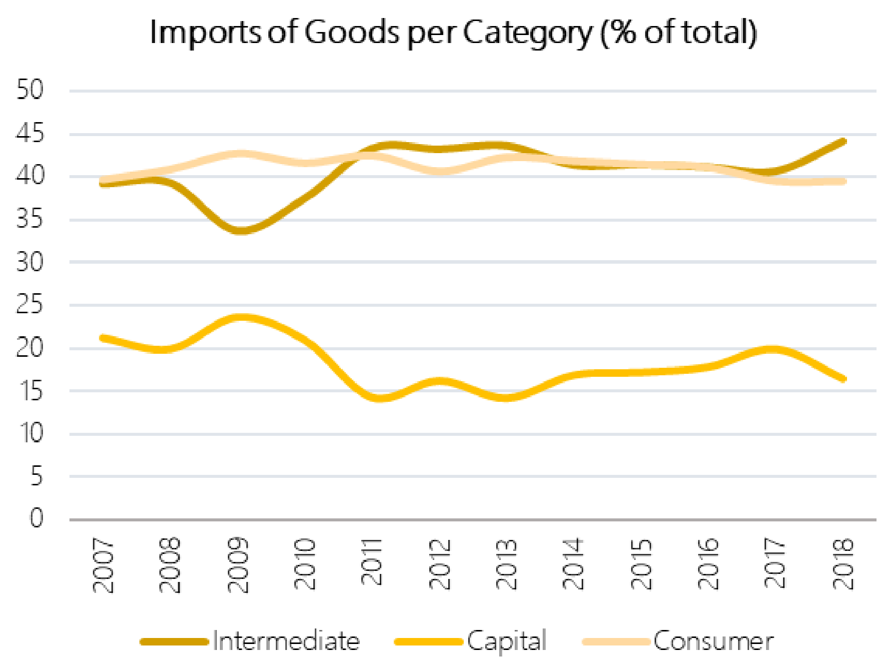
Widening Current Account deficit in 2018, at €5.3 billion (2.9% of GDP) versus €3.2 billion in 2017



Source: Bank of Greece

- Deficit increase by €2.7 billion in the balance of goods and €871.3 million in the primary income
- Partially offset by a services balance improvement by €1.3 billion
- Increase in tourism (+9.9%) and Transportation revenues (+14.9%)

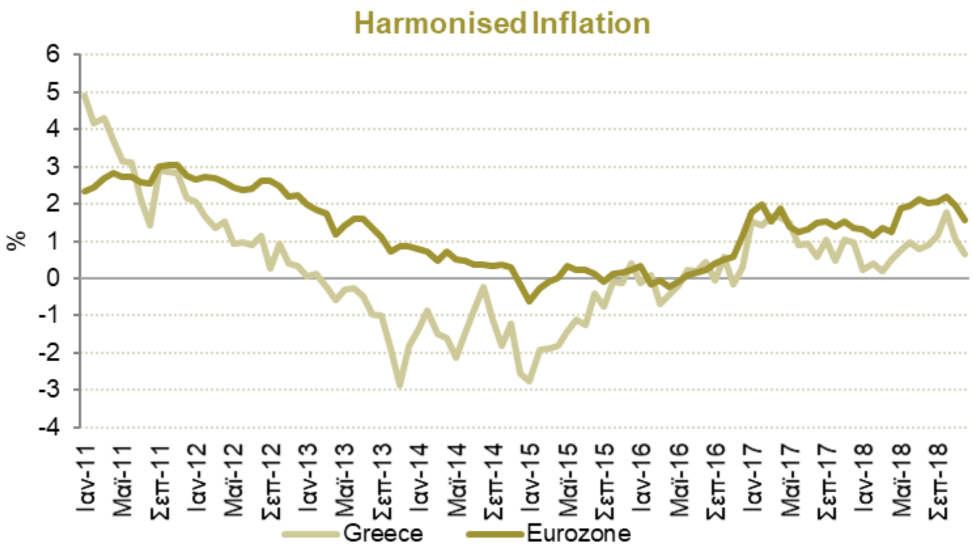
Share of consumer goods' imports unchanged, drop in the share of capital equipment

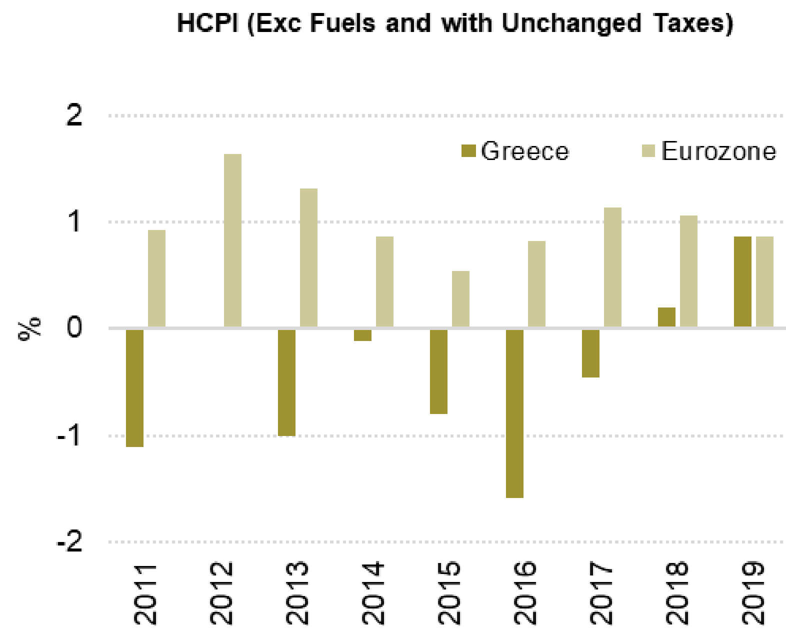


Source: Eurostat

- Total imports of intermediate and capital goods in 2017-2018 at 60.6%, same as in 2007 (60.4%)
- Slightly higher share of consumer goods during the interim period
- For the time being, the composition of imports does not reflect increased productivity / productive restructuring
- The substitution of imports by domestic production is not clear

Return of Inflation
Higher prices compared to Q1 of 2018





Sources: ELSTAT, Eurostat

Eurozone: Steady inflation at 1.2% in comparison to the first two months of 2018

Greece (Jan-Mar 2019): the rate of price changes is positive, at 0.7%, vs. -0.1% in the respective period of 2018: Negative impact from indirect taxation and energy goods, recovery of demand – other factors, for the first time since 2011.

Producer Price Index (Jan-Feb 2019): +1.5%, vs +0.7% in the first two months of 2018, due to energy

“Post-Memorandum” environment characteristics

Key Parameters of the Economic Environment

- ❖ Changes in the fiscal mix (no pension cuts, tax reliefs, increased allowances)
- ❖ Without review from the institutions, impact on the financing flows. Now under enhanced monitoring and need to tap the markets.
- ❖ Consecutive election cycles
- ❖ Changes in the labour market (increase in minimum wage – abolition of sub-minimum wage, expansion of collective agreements)
- ❖ Intense political developments globally
- ❖ On-going restructuring of liabilities in the banking system and attempt to remove the capital controls

Improvement in households' expectations:

- Changes to fiscal measures (cancelation of pension cuts, further tax discounts, social security contribution reduction, hirings) → signs of pre-election period
- Payment of social dividend, retroactive transfers to special wage grids (in 2019)
- Increase in the minimum wage – abolition of the youth sub-minimum wage
- Partially offset by limits in the protection of primary residences

Despite the removal of capital controls for domestic transactions:

- *the recovery of private deposits, mainly by households, was halted during September 2018 - February 2019*
- *Weak demand in Retail trade since the end of 2018*

Changing environment for entrepreneurship

- Pre-electoral inertia among firms
- Weak credit expansion despite the reduction of NPLs according to the targets
- Increase in the minimum wage – extension of collective agreements
- Deteriorating global environment (decelerating Eurozone and China)

But at the same time:

- Gradual (slow) reduction in the corporate income tax rates and distributed profit tax rates
- Improved climate for the domestic financial market -> Reheating of financing possibilities through the capital market
- Boosted liquidity from a significant increase of the global trade for the second consecutive year last year
- Amongst worsening global conditions, a continued –albeit milder- increase of exports is possible for this year, perhaps also applying to tourism

Critical period for the banks

Focus on the effective reduction of NPEs, without repercussions on fundamentals

- ❖ Reduction of NPL achievable, but mainly through write-offs and sales, having negative impact on financial statements
- ❖ New, stricter framework for the protection of primary residence
  - o Awaiting the acceleration of court processes
- ❖ A significant challenge is the revision of the strategy for NPE reduction
  - o *Pending assessment of the HFSF plan by the European Commission*
  - o *Need for focus on the qualitative characteristics of NPE reduction (e.g. liquidations, collections)*
- ❖ Stagnation of private deposits
- ❖ Expectation for hardly any change in the trend of credit supply, at least in the first half of 2019, and possibly for the year as a whole

Small boost on liquidity – investments from the public sector

- Mild contribution from PIP for one more year
  - Downward revision of the PIP by €550 million for 2019, again circa €6.75 billion, in order to implement new measures
  - Given its back-loaded execution last year (60% of subsidies in December), quicker execution is feasible this year

- Low clearance of outstanding arrears to private sector firms
  - Payments around €446.9 million during Nov 18-Feb 19. Total of €1.28 billion since March 2018
    - *Estimates of available funds from the third programme, including national participation at €688 million, however €2.07 billion are still pending*
  - The 2019 State budget neither specifies the timing for their clearance, nor includes targets for the current year

Forecasts for 2019

Acceleration of private consumption (≈ +1.3%):

- Mainly due to changes in fiscal policy (no further pension cut, higher social spending, tax reliefs)
- Boost from minimum wage increase, uncertain mid-term impact, linked with sectoral developments in productivity
- Falling positive impact from exports on employment-income, offset by employment boost in the public sector and Constructions

Expansion of public consumption (≈ +1.8%)

- Disbursement of larger retroactive payments this year
- Impact from consecutive elections

Investment escalation (+8-11%):

- Increased activity in privatizations-concessions
- Boost from increased exports in previous years (Manufacturing, Tourism, Transportation)
- Higher exploitation of capital markets' funding instruments
- But also: many firms in pre-electoral "wait-and-see" attitude and credit contraction from banks

Forecasts for 2019

Milder exports increase (5.0%-5.5% y/y)…

- Impact from trade protectionism measures, weakening QE impact on Eurozone demand, recovery of competitive tourism destinations

…with simultaneous escalation of import demand (5.0%)

- Due to higher private consumption and investment

Slowing decline of unemployment, slightly below 18.0%

- More employment positions in public sector, trade and construction

Similar to last year price level increase (≈ 0.5% - 0.7%)

- Mostly driven by recovery of private consumption, while neither new indirect taxes were imposed, nor existing ones were increased and oil prices will be lower, on average

Growth rate for 2019 around 2%, possibly lower

Special Research

Property Taxation and the Future of Constructions in Greece

Contents and Aim of the Research

Contents

1. **Short Review of the current trends in the Constructions Sector**
2. **Current trends in the real estate market**
3. **Property taxation and its impact on the economy**
4. **Property taxation in Greece**
5. **Estimations of the economic and fiscal effects from changes in property taxation**
6. **Conclusions and suggestions**

Aim of the Research

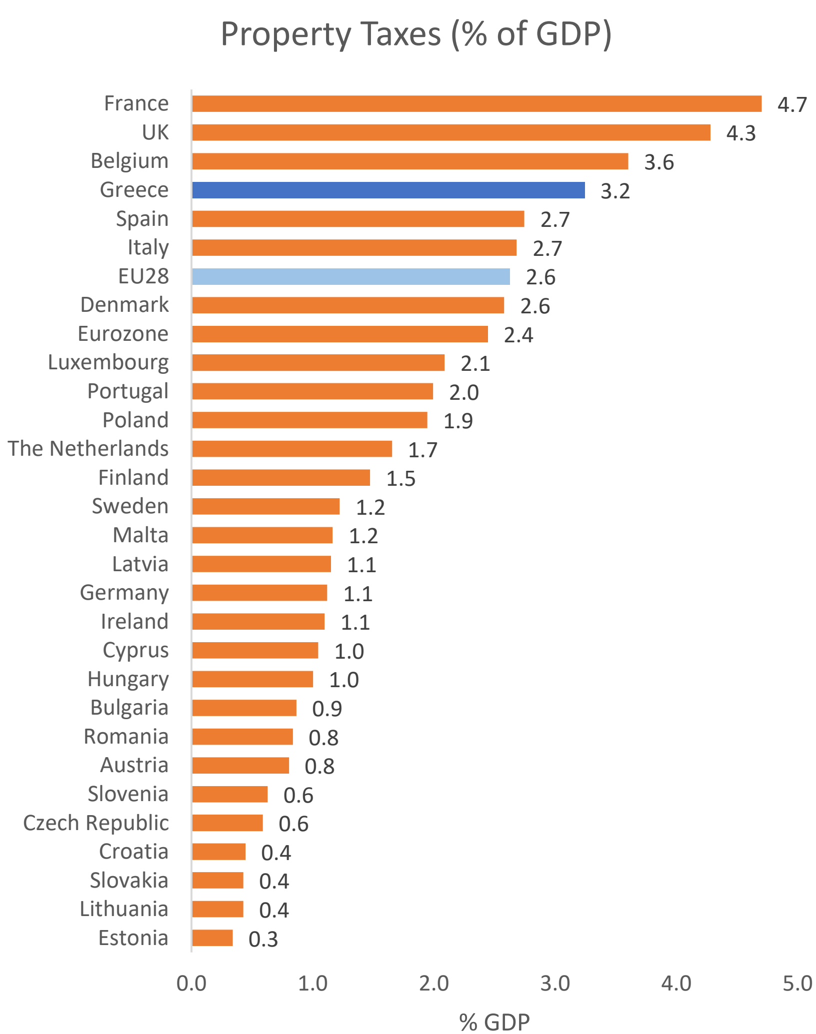
- **Analysis of the property taxation in Greece and its impact on the Constructions sector and the Greek economy**
- **Estimation of the economic and fiscal outcomes from changes in property taxation would have, such as a reduction in VAT for new residences and the abolition of the supplementary property tax**

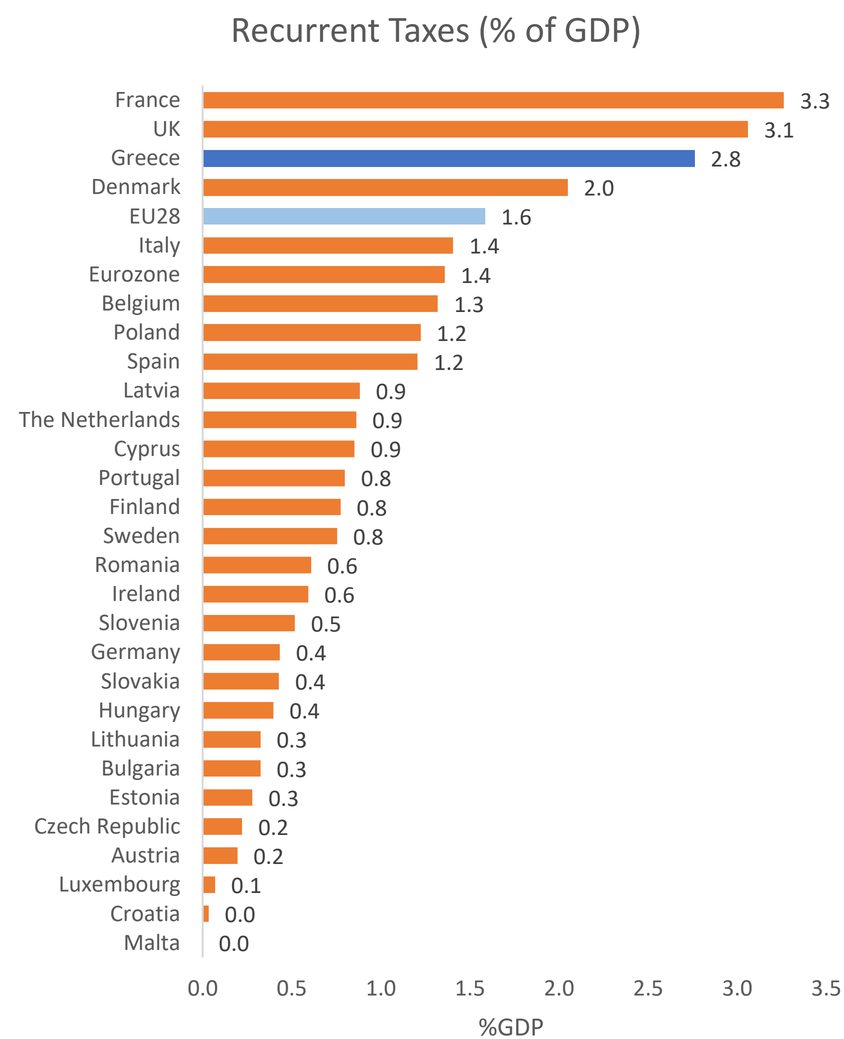
Globally, property taxes have a smaller share in total tax revenue in comparison to taxes on income and consumption

Source: OECD

In Greece, property taxes have a higher share in total tax revenue in comparison to the OECD average

Greece ranked high in the EU w.r.t. property taxes





Source: European Commission

Some problems regarding property taxation in Greece

Taxation of total property and progressiveness

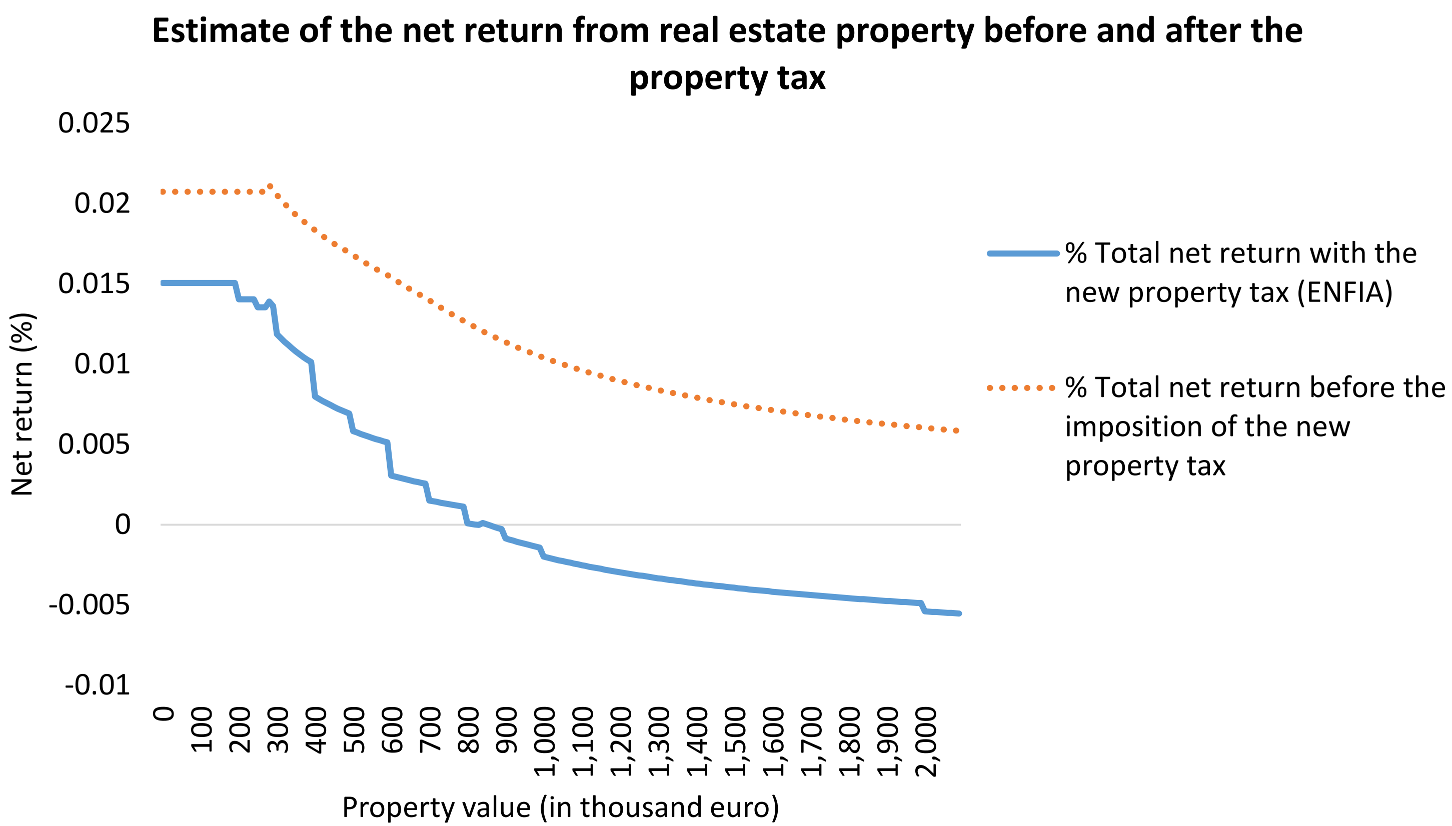
Measures from the Central vs Local Governments

Simultaneous multiple taxation on real estate property

Statutory values not in line with market values

Economic Conjuncture

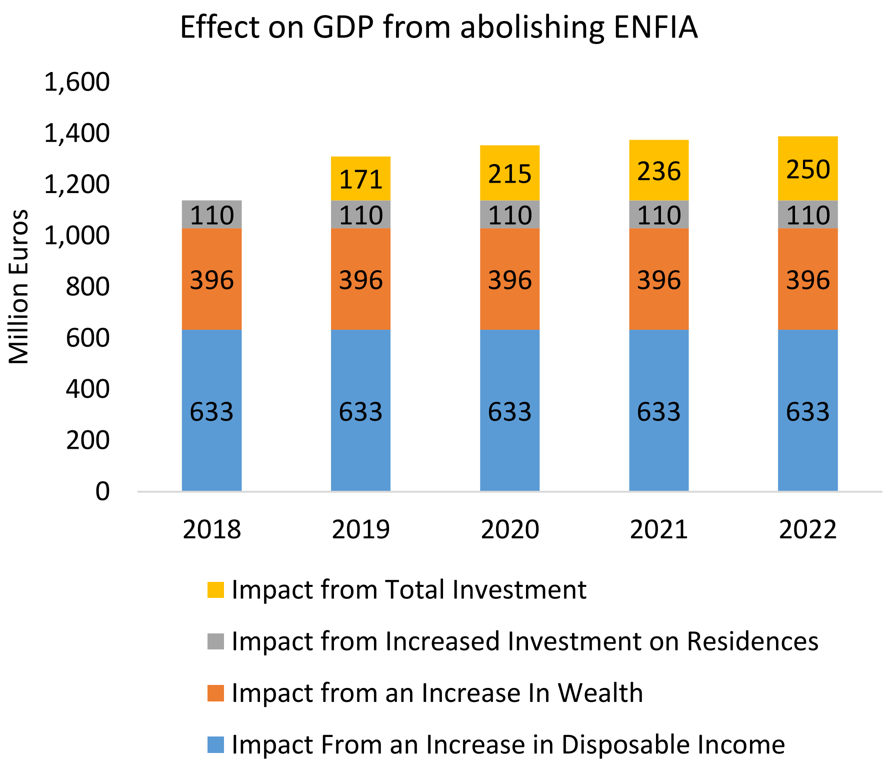
The imposition of a property tax significantly affected returns from investment in property

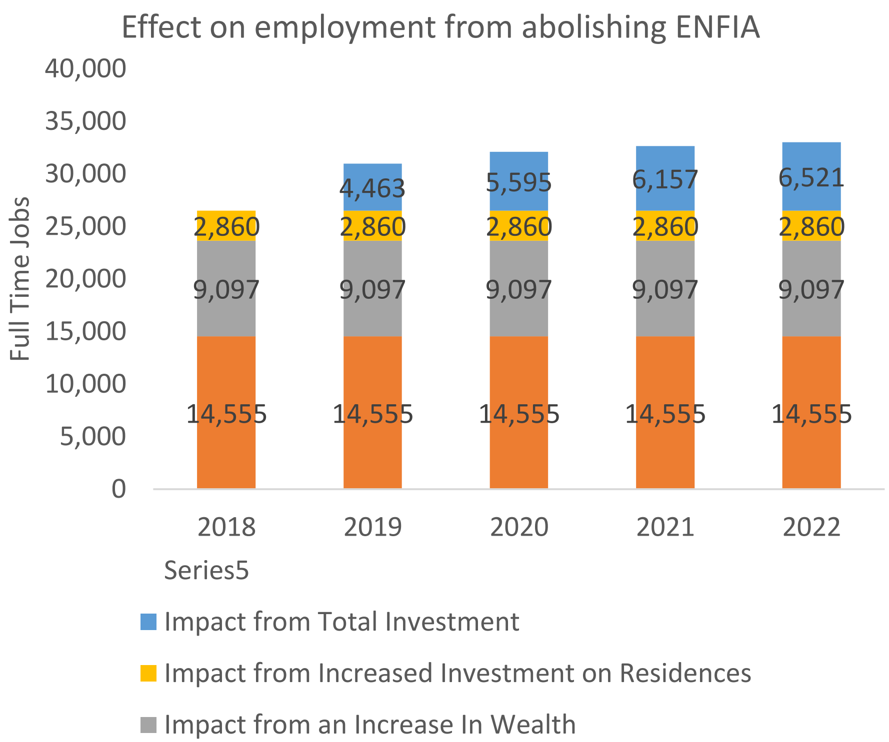


Source: IOBE

Due to the complimentary ENFIA and progressive income taxation from rents, net returns from investment in real estate become less attractive as the total value of the property of a taxpayer increases

Abolition of the complimentary ENFIA would strengthen the disposable income of households, increase real estate prices and boost the supply of residences





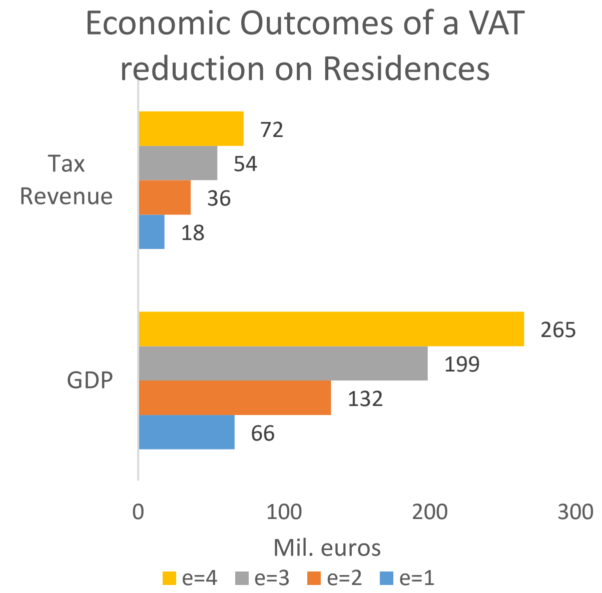
Source: IOBE

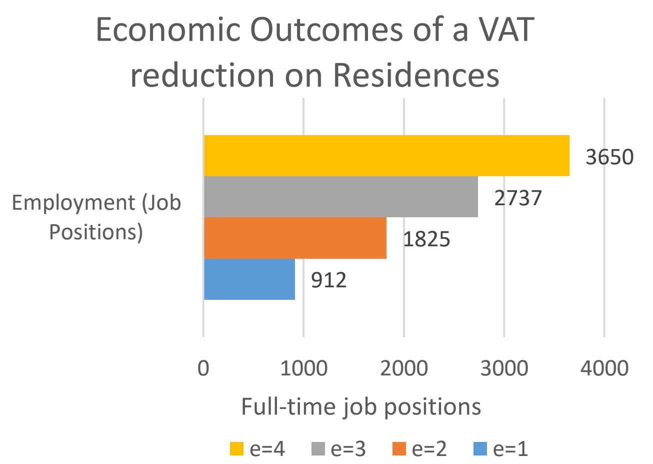
Effects on employment will be positive, as it is estimated that it will by 33.000 jobs in 2022

A VAT reduction to 13% (with the property transfer tax unchanged) will boost investment in housing

Parameter	Current State (VAT 24%)	Reduction of VAT rate to 13%	Change
VAT Rate	24%	13%	-11.0%
Implicit VAT (% final price)	19.35%	11.50%	-7.9%
Net Construction Cost (NCC) (excl. VAT)	100	100	0.0%
Labour and Social Security Contributions (% NCC)	48%	48%	0.0%
Goods and services subject to VAT (% NCC)	52%	52%	0.0%
VAT on goods and services (% NCC)	12.48%	12.48%	0.0%
Final Price (2 * NCC+VAT)	248	226	-8.9%
VAT of Goods and Services (% of final price)	5.03%	5.52%	0.49%
Non-Compensated VAT (% of final price)	14.3%	6.0%	-8.3%
Net Constructor Price	212.5	212.5	0.00%
Investment in Housing in 2016 (million euros)		1,127.1	
Percentage of residences that are not owner-occupied (primary residence)		35%	

Source: IOBE





Conclusions

- **Property taxation in Greece creates significant problems** in the economy and the Constructions sector
- The **abolition of the complimentary ENFIA** is justified by the over-taxation and the distortions it creates on investment yields, in comparison to alternate investments
- A **reduction of the VAT** on new houses will lift a significant distortion and increase investment in housing
- The **outcomes will be positive for growth, employment** and the Constructions sector, while it is estimated they will be **neutral** for public economics

Other interventions (indicatively)

- **Development of a property valuation system** which will reflect developments in the real estate market
- **Reduction in the main property tax**

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