Quarterly Report on the Greek Economy
01/22

April 19, 2022

ΙΔΡΥΜΑ ΟΙΚΟΝΟΜΙΚΩΝ & ΒΙΟΜΗΧΑΝΙΚΩΝ ΕΡΕΥΝΩΝ

Overview of the report

The war in Ukraine has brought about drastic changes

- The war affects the economy by increasing the cost of basic goods and by creating uncertainty. Real growth rates have moderated, and inflation has more than doubled.
- Much of the world economy has been damaged by the pandemic and over-indebtedness, and its fundamentals are not robust. The elements for a major crisis are present; avoiding it requires proper handling.
- Inflation will be more than double than previously expected and it will last. Inflation above 5% drastically changes policy priorities for the European economy: it can help with debt and deficit management on the one hand, but it reduces real household incomes on the other.
- An extension of the war, even without an extreme escalation, will increase costs exponentially, testing the resilience of the economies as of the end of this year.
- The combination of lower investment rates & lower growth rates with higher inflation could lead to capital market turmoil.
- A turn to safer investments is expected, which will put less developed economies at risk; they are likely to experience capital outflows, currency devaluations, deteriorating trade balances, and rising food prices.
- Within the Western world, the blow to Europe will be greater than that to the US; this, in turn, will affect trade balances, the monetary equilibrium, and productivity in the medium term.

The war in Ukraine has brought about drastic changes

- The world economy is looking increasingly fragile, but the Greek economy is facing its own challenges. Uncertainty up to two years ahead has increased and the growth rates are expected to decline to 3%, mainly due to higher prices.
- What is more crucial is how the medium-term outlook is affected. In sectors such as Transport, Energy, Tourism and Primary production, key facts are changing. Aspects of globalisation are being reversed.
- The return to large twin deficits during the pandemic and the long-term lag in productive investments and innovative products exports, are reasons for vigilance in the new crisis.
- The challenge is huge, considering that the Greek economy has systematic deficits of institutional functions, productivity, and competitiveness; it must also overcome wounds from previous crises.
- In this dire economic situation, there is a risk of complacency on the one hand and extreme fear on the other. Shifting the problem to the public funds and subsequently to lending, will not solve it.
- Over several decades, with successes and failures, the Greek economy has moved into a European framework of stability and convergence of economies. This framework is now being challenged, which makes it imperative to implement policies that will support high growth in the medium term.

Global economy: Pressure put on recovery, high inflation due to the war in Ukraine

- **Recovery in the fourth quarter,** but with a slightly slower pace in several countries, because of the rise in **energy costs.** Faster recovery in developed economies.
  - OECD countries (fourth quarter): 4.9% annual rate of change, up from 4.7% in the previous quarter. It offset the recession of the fourth quarter of 2020 (-2.7%)

- **Inflation** in OECD countries reached in February its highest level in 32 years (7.7%)

- Big impact on global recovery from the **war in Ukraine**
  - Pressure on energy markets, certain raw materials markets, and food markets
  - Side effects from the uncertainty surrounding the duration and effects of the war, further diffusion-recycling of impacts through the supply chains

Global & European challenges in the medium term

Global challenges

- Impact of the Russo-Ukrainian war on energy efficiency and supply chain operations. The rise of other geopolitical tensions is also possible.
- Halting inflationary pressures
  - Restraint inflationary pressures by gradually tightening monetary policy (FED, ECB), without severely affecting the growth dynamics
- Facing new outbreaks of the pandemic in Southeast Asia (e.g., China)

Challenges in Europe

- Diversification of energy sources, energy security policies
- Adjusting the ECB's monetary policy to the current situation
- Implementation of the European Recovery Fund

Greece: Lower growth rate in the fourth quarter of 2021; however, still a significant offset to the 2020 recession.

GDP, fourth quarter of 2021: +7.7%, down from +11.4% in the third quarter of '21 and -7.1% in the fourth quarter of 2020. The 6th strongest recovery in the Eurozone (Average: +4.6%)

2021: 8.3% recovery, followed by a 9.0% recession in 2020

The most important changes in the components of GDP (fourth quarter):

- Exports increased by 24.1% (following a 12.5% reduction in the fourth quarter of 2020)
  - Mainly because of the increase in services exports (+ 63.2%). Exports of products increased less (+4.1%)
  - The external balance deteriorated because imports (+33.2%) increased more than exports; especially imports of products (+29.8%)
- Household consumption increased by 9.6%, following a 10.8% increase in the third quarter and a 7.1% decline a year before
  - Public consumption expenditure decreased by 0.8%; the first decrease since the second quarter of 2020. It increased by 5.5% the year before
- Investment increased by 34.3% (following a 7.6% decline in the fourth quarter of 2020), mainly due to increased fixed capital formation (+ 24.1%)

2022 State Budget: Above target during the first two months, due to lower expenditure

- **General government balance Jan.-Feb 2022: €910 billion deficit; the target was a €2.0 billion deficit**
- **General government primary balance: €840 million surplus; the target was a €239 million deficit**

- Above target on the expenditure side (€2.18 billion less):
  - Less expenditure (€1.5 billion less) on fixed assets, due to arrears of armaments payments
  - Lag in current transfers to EU institutions and states (€194 million less) and guarantees forfeiture (€103 million less).

- Revenue lag of €1.1 billion:
  - Transfers totaled €1.96 billion less than the target, mainly due to the non-collection of the expected installment from the Recovery Fund, amounting to €1.72 billion. It was disbursed on 08/04/2022.

Trends in short-run activity indices

Industry

- Industrial production increased by 2.2% in the first two months of 2022, following an increase of 3.9% in 2021
- Reduction by 0.7% in January 2022 in the Eurozone; it increased by 1.7% a year ago

Construction

- The production index in Construction increased by 7.1% in the last quarter of 2021; losses of 1.0% a year earlier
- Building activity increased by 47.4% in 2021 in terms of surface and by 46.1% in terms of volume

Tourism

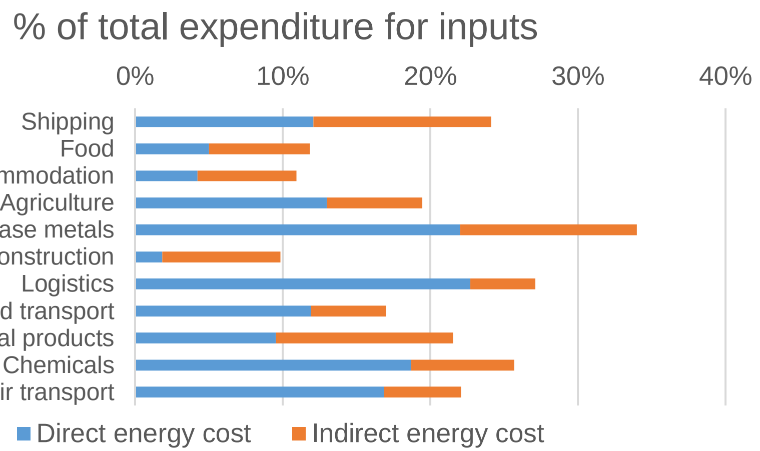
- Activity recovered in 2021, with an 82.1% increase in turnover from 2020 (-62.7% from 2019)

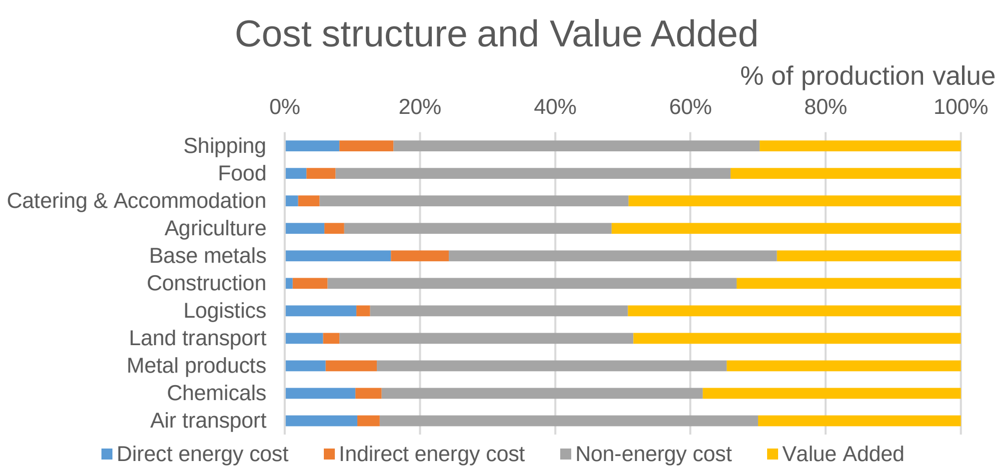
Retail

- 10.4% increase in the volume index of Retail Trade in 2021
- 9.4% increase in January 2022, up from a 2.5% decline a year ago

Significance of energy costs for industries in Greece

Logistics, Basic Metals, Chemicals: high direct exposure to energy price changes. Shipping, Metal Products, Constructions: high indirect exposure





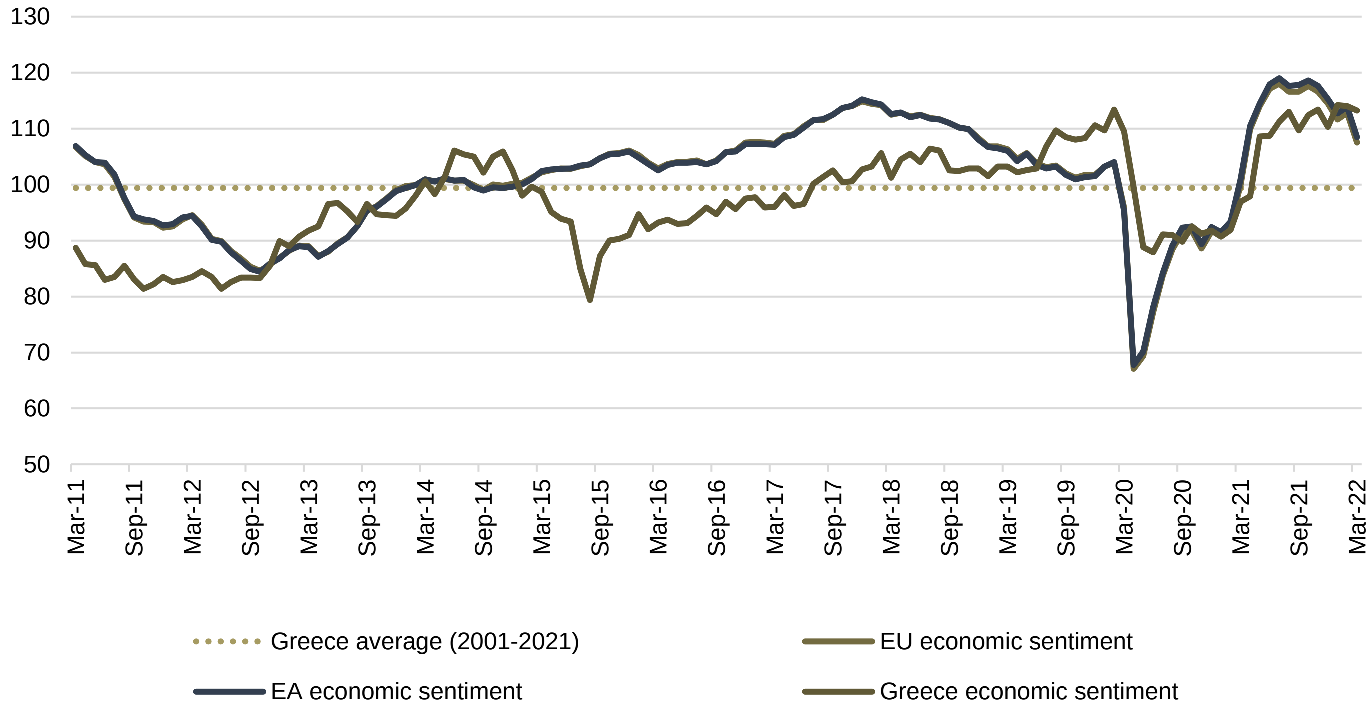
- Direct energy costs: business expenses for oil, gas, and electricity
- Indirect energy costs: the share of expenditure allocated to other inputs, which corresponds to the energy content of these inputs
  - Example: Constructions use cement. Cement production requires burning fossil fuels (natural gas, oil, coal, etc.)
  - Indirect energy costs are calculated using an input-output model
- Indirect energy costs in some industries exceed direct ones
  - e.g.: Construction, Catering & Accommodation, Metal products

Source: Eurostat, IOBE

Intense pressures are also expected in Air transport- the total energy cost (direct and indirect) is high, compared to the added value

Small increase in the Economic Sentiment Indicator in the first quarter of 2022; it reached pre-pandemic levels

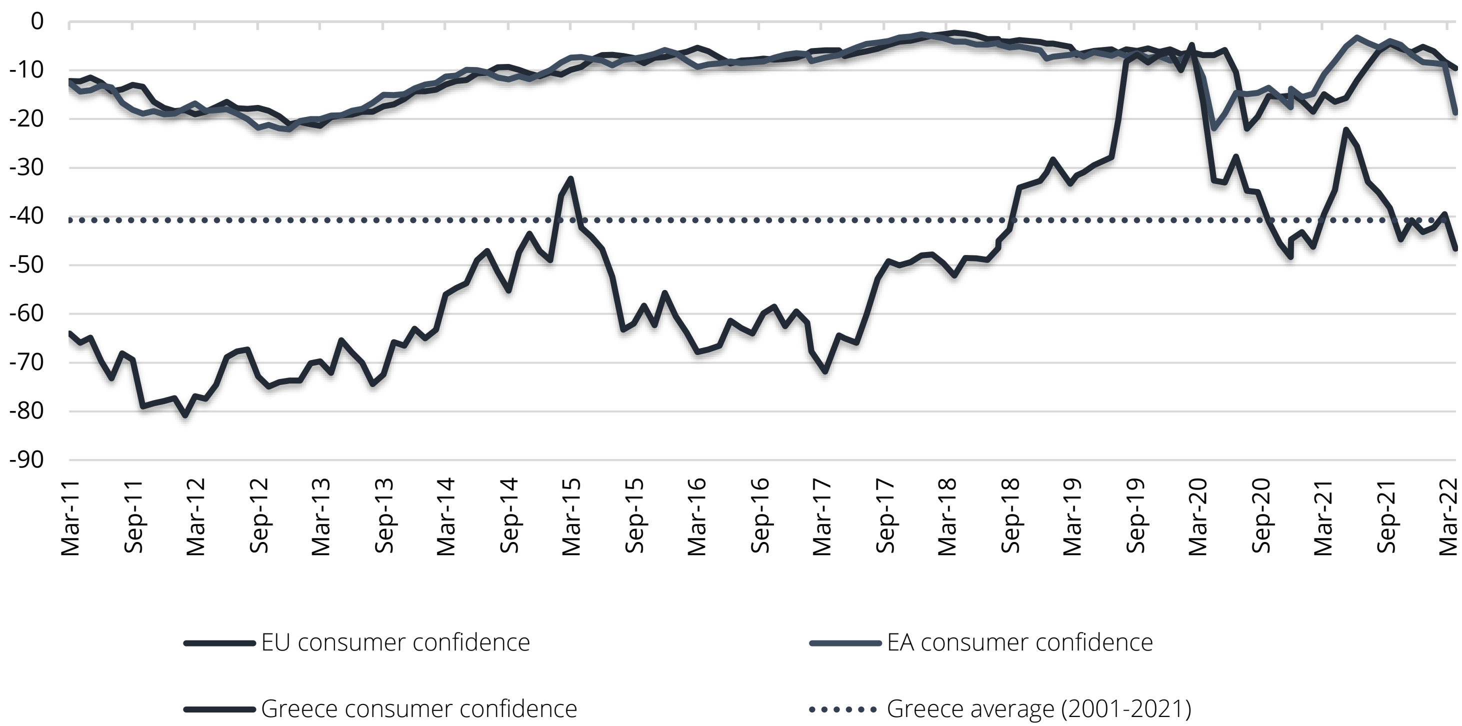
Economic Sentiment Indicator



Sources: IOBE, European Commission

Consumer Confidence in the first quarter of 2022 was the same as in the fourth quarter of 2021 and the first quarter of 2021

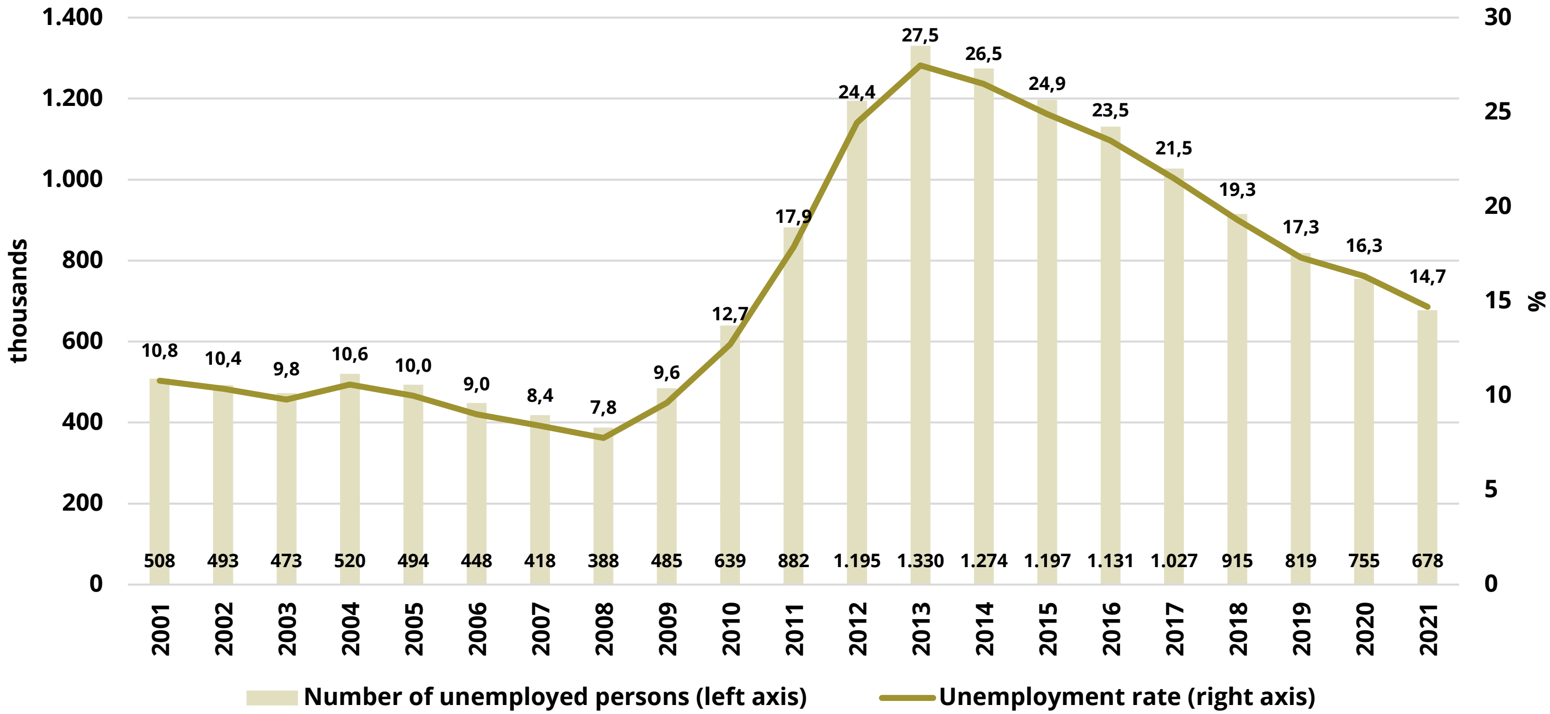
Consumer Confidence Index



Sources: IOBE, European Commission

Unemployment declined for the eighth consecutive year and reached an 11-year low

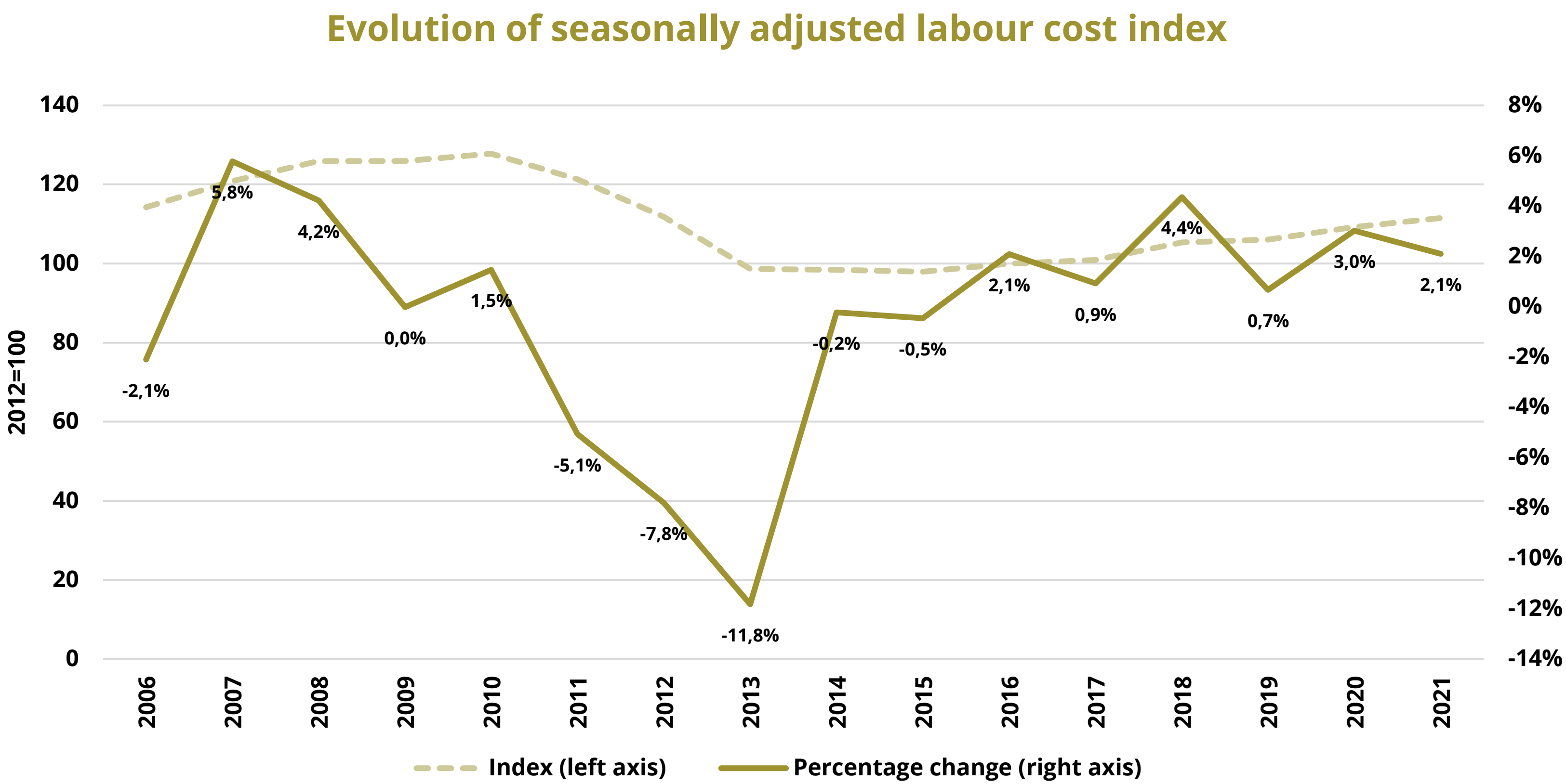
Number of unemployed persons and unemployment rate in Greece



Source: ELSTAT

- **The unemployment rate reached 14.7% in 2021; down from 16.3% in 2020 and 17.3% in 2019. This was the largest decrease in the Eurozone (Luxembourg experienced the same decrease).**
- **Employment increased in 10 industries. Indicatively: Primary sector (+34.0 thousand), Public administration (+33.4 thousand), Professional, scientific, technical activities (+23.1 thousand), Manufacturing (+18.9 thousand).**
- **Employment decreased in 11 industries. Indicatively: Accommodation and catering services (-19.2 thousand), Wholesale-Retail (-16.8 thousand), Education (-11.8 thousand).**

The labour cost index increased for the sixth consecutive year; smaller increase compared to 2020



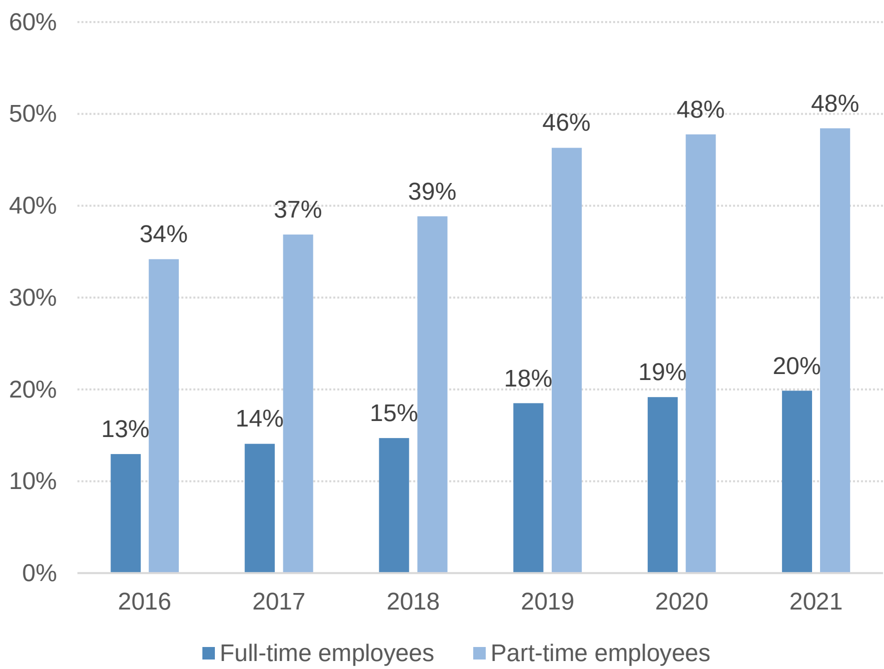
Source: ELSTAT

➢ **2.1% increase in 2021. 14% cumulative increase from 2016-2021.**

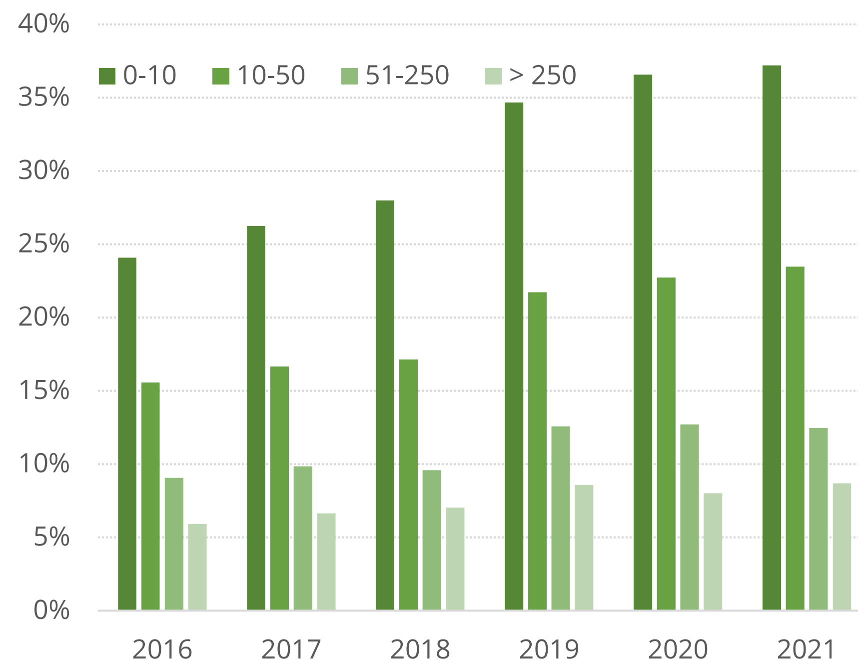
High percentage of minimum wage earners working in small businesses and employees with flexible forms of employment

% of employees performing dependent work who are paid with the minimum wage 2016-2021

By employment type



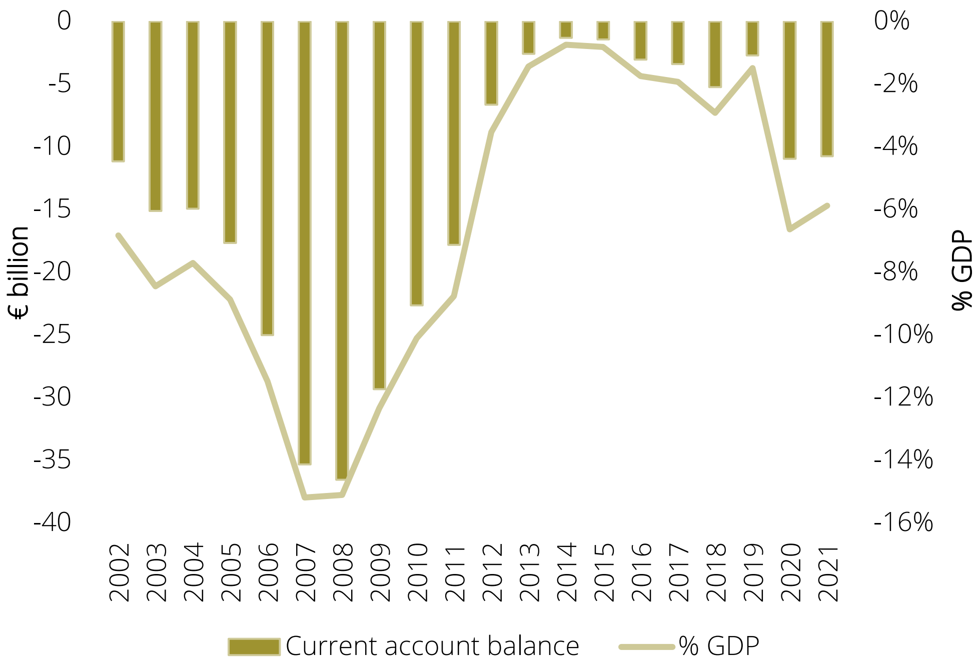
By business size, based on the number of full-time employees

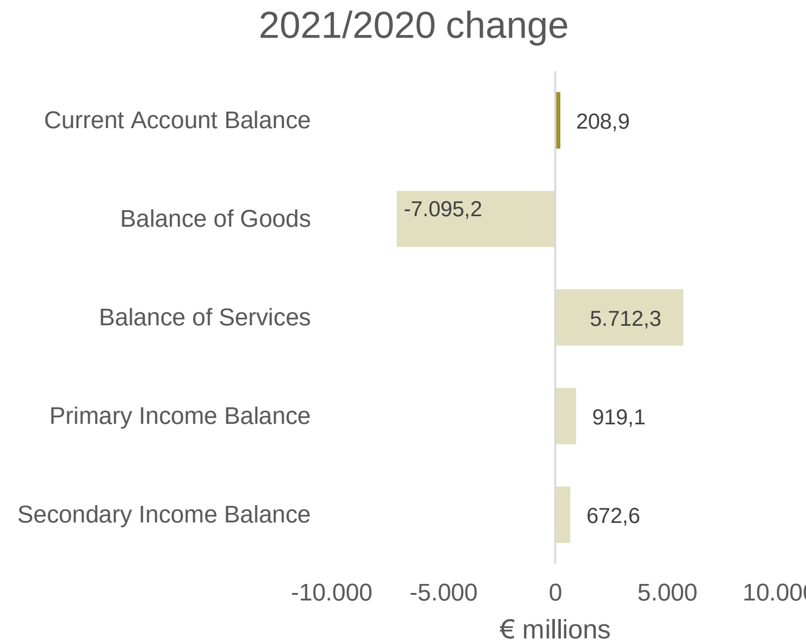


Source: Ministry of Labour and Social Affairs, Ergani information system **Data processing**: IOBE

Wage compression in the private sector, especially for those employed in small businesses and the services sector

The current account deficit in 2021 was 5.9% of GDP, down from 6.6% in 2020

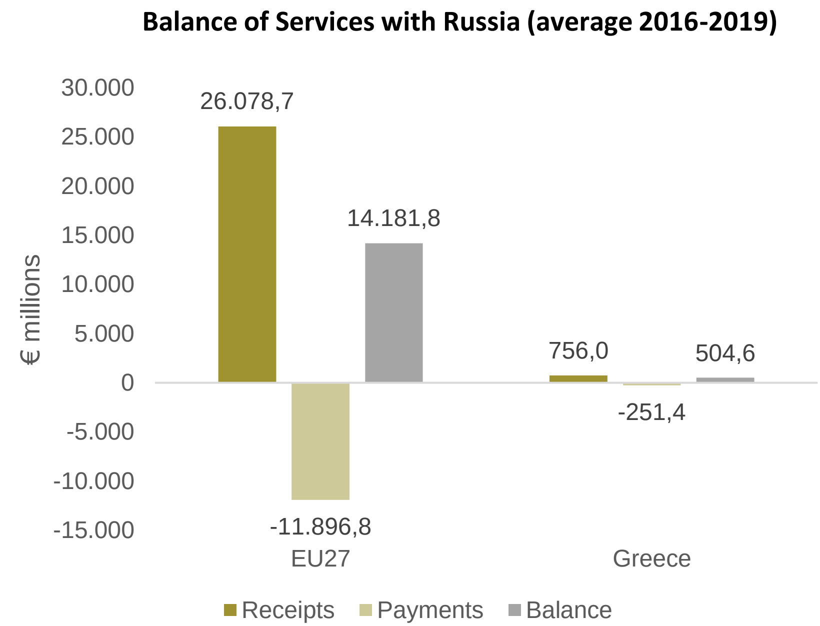




Source: Bank of Greece

- The current account balance deficit was €10.8 billion in 2021, down from €11.0 billion in 2020
- Major deterioration in the goods balance (+€7.1 billion deficit), which was offset by the improvement in the Services, Primary, and Secondary Income balances
- Fuel exports increased by 66%; fuel imports increased by 72%
- The other goods deficit increased by € 4.5 billion
- Tourist revenue reached €10.5 billion (+143%), 58% of their 2019 level

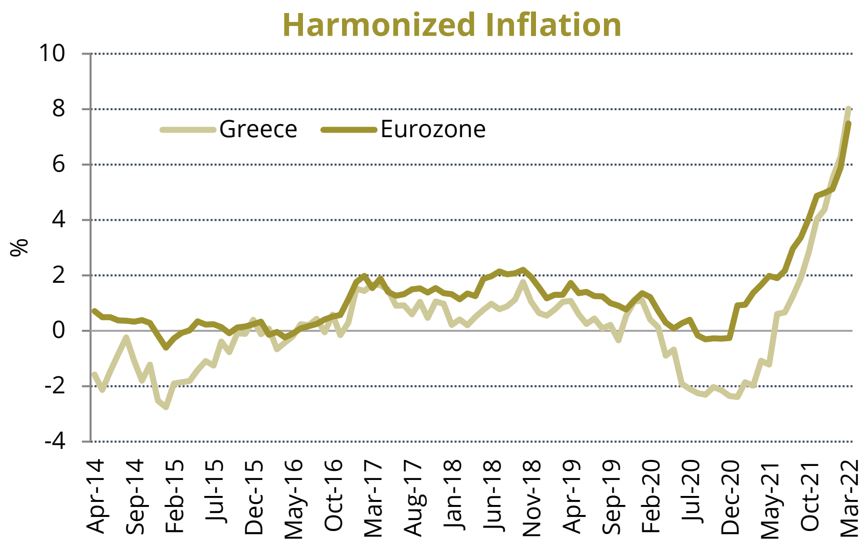
6.9% of Greek imports and 7.4% of EU imports are from Russia. Much less dependence on exports, especially in Greece.

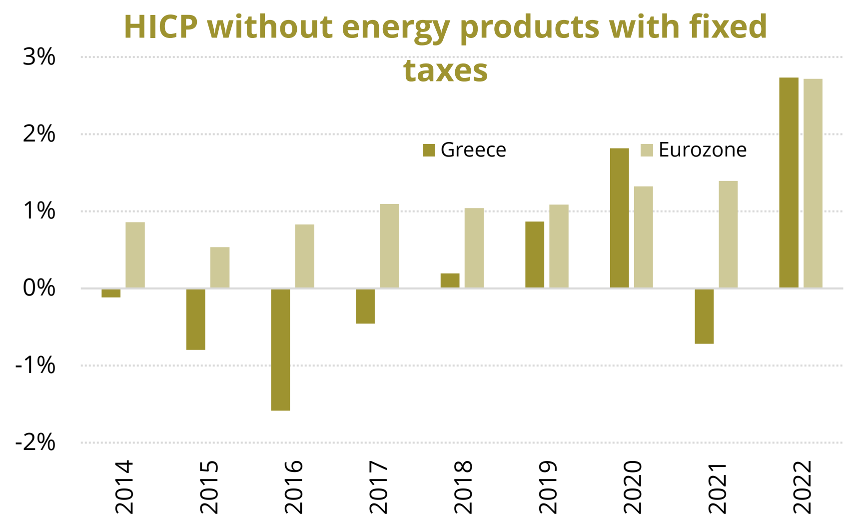


Sources: Eurostat, Bank of Greece

- 22.9% of Greece's fuel imports, 6.4% of Greece's industrial goods imports, and 2.4% of Greece's raw materials imports are from Russia. The EU imports 27.6% of its fuel from Russia.
- The EU depends on Ukraine for oils and fats (13%) and raw materials (5.3%). In Greece, 3% of imports of Raw Materials and Oils and Fats are from Ukraine.
- 98% of Greece's coal imports and 66% of Greece's natural gas imports are from Russia
- Greece maintains a services surplus in its bilateral trade with Russia (€504.6 million) and so does the EU (€14.2 billion)
- 2.7% of Greece's total tourism revenue from 2016-2019 came from Russia; Russian citizens totaled 1.8% of total visitors to Greece during the same period.

Inflation reached a 25-year high in the first quarter of 2022, due to the rise in energy goods prices





Sources: ELSTAT, Eurostat

Eurozone: Excessively high inflation in the first quarter of 2022, 6.2% up from 1.1% a year ago

Greece: The domestic Price Index rose by 8.9% in March and 7.2% in February, the largest increase of the past 25 years. It mainly resulted from the rise in energy goods prices; however, it also came from a base effect (+2.5pp) since there was deflation in the first quarter of 2021.

HICP rate of change (first quarter 2022): +6.6%, up from -2.1% in the first quarter of 2021

- From Jan.-Feb., the increasing effect mainly came from energy goods prices (+3.2%); it also resulted from the increase in domestic demand (+2.8%). Indirect taxes had a small negative effect (-0.2%).

Producer Price Index (Jan.–Feb. 2022): 32.6% increase following a 2.7% decline a year ago; mainly due to the rise in energy prices

Challenges due to the war in Ukraine and high inflation

Impact of the war on energy - raw materials – food supply and on real income

- Impact on energy supply, mainly in Europe (40% of gas imports from Russia). High dependence of Greece on coal and wheat (from Russia), oils-fats, and cast iron (from Ukraine)
- Inflation increased; it reached its highest level in many years weakening real income & consumption and hampering future expectations

There is a need for extraordinary public spending, which will have an adverse impact on the deficit

- More support measures taken in April. Whether the measures will continue (or even escalate) depends on the evolution of the war.
- There is a high level of uncertainty and government bond yields are rising, especially for "peripheral" countries

The Recovery Fund has become more important

- Following the disbursement of the first tranche (€3.56 billion), the 185 activated projects of the Recovery Plan should begin to be implemented
- Focusing on reforms will boost confidence in the economy's prospects, during this crisis

Tourism continues to do well

- Airport traffic was high in March and the tourist season has been extended
- The slowdown in Eurozone recovery and the rising energy costs have had mild effects on demand

The percentage of Non-performing Loans (NPLs) has reached a 12-year low

Positive developments

- Large reduction of NPLs through securitisations
- Disbursement of the first installment of the loan arm of the Recovery Fund for Greece, amounting to €1.84 billion.
- Consistently low cost of bank and private sector financing

Challenges

- Low profitability and poor quality of equity
- Reduction of credit to households
- Halting the upward trend of private deposits
- Favourable conditions for bank financing, largely dependent on ECB policy

Priorities

- Utilisation the resources of the Recovery Fund to co-finance investments
- Continue to reduce NPLs, effectively enforce the Bankruptcy Code and the out-of-court debt settlement mechanism

... however, a significant amount of private debt remains non-performing, while expectations of tighter monetary policy are rising

Macroeconomic forecasting process

Baseline 2022 Scenario:

- The war will continue after the spring-early summer
- Large increase in energy costs: Brent price +30-35%
- Inflation at multiannual high levels
- Extensive measures to support households and businesses will be taken. Their level will be close to the one last year, in order to tackle the impact of the pandemic.
- Broad restrictive measures for the pandemic will not be imposed
- Tourism revenue will reach 70-75% of their 2019 level (up from 58% last year, +€2.1 - €3.0 billion compared to 2021)
- Eurozone recovery will be impeded: 1.5-2.0 percentage points lower than what was expected before the war (2.0-2.5%)
- The Recovery Fund will meet its targets: €3.2 billion in grants, €586 million in loans

Alternative 2022 Scenario:

- The war will end in the spring-early summer
- Increase in energy cost: Brent price +20-25%
- The highest inflation in approx. the last decade
- Fewer measures to support households and business compared to the baseline scenario
- Broad restrictive measures for the pandemic will not be imposed
- Tourism revenue will reach 80-85% of their 2019 level (+€3.9 - €4.7 billion compared to 2021)
- Eurozone recovery will be hurt less than in the baseline scenario: 1.0-1.5 percentage points lower than what was expected before the war (2.5-3.0%)
- The Recovery Fund will meet its targets: €3.2 billion in grants, €586 million in loans

2022 macroeconomic forecasts

Baseline 2022 Scenario

- Public consumption: from -1.5% to 2.5%
- Private consumption: from +1.5% to +2.5%
- Investment: from +13% to +15%
- Exports: from +7% to +9%
- Imports: from +6% to +8%
- **Growth: ≈ 2.5 to 3.0%**
- Unemployment: ≈ 13.5%
- Inflation: ≈ 7.0 to 7.8%

Alternative 2022 Scenario

- Public consumption: from -3.5% to -4.5%
- Private consumption: from +3% to +4%
- Investment: from +17% to +20%
- Exports: from +11% to +13%
- Imports: from +10% to +12%
- **Growth: ≈ 3.5 to 4.0%**
- Unemployment: ≈ 12.8-13,0%
- Inflation: ≈ from 6.2% to 6.8%

Special study

Impact of the proposed revision of the European Climate Policy on the Greek economy

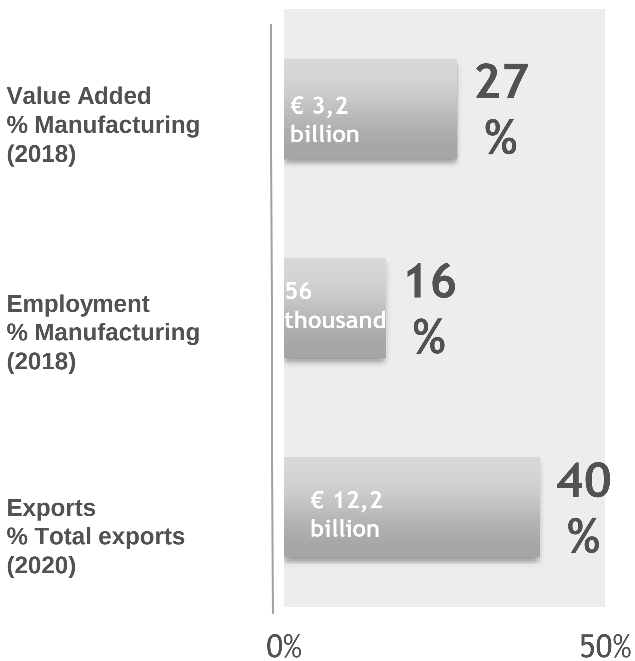
Scope of the study

The study examines the effects of the proposed changes in the operation of EU-ETS and the introduction of EU-CBAM on the Greek economy and the domestic industries

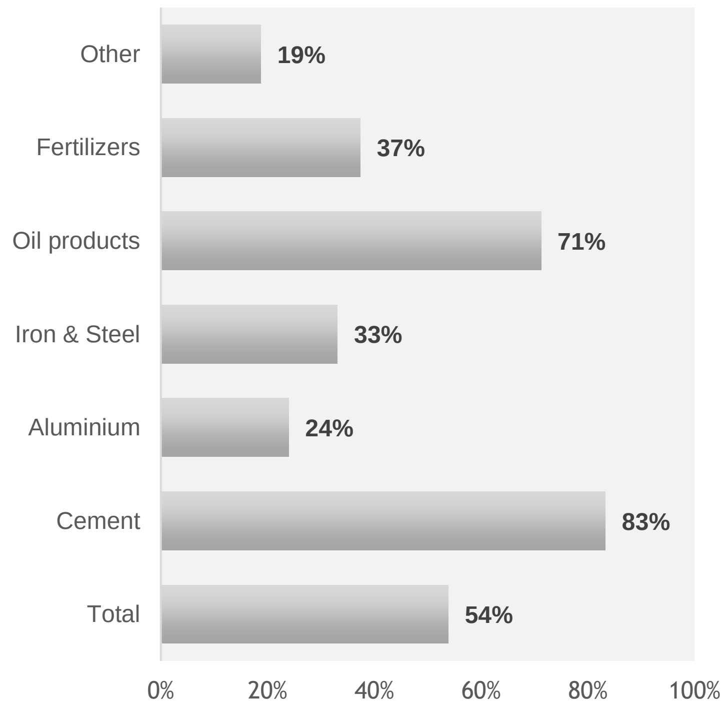
Contents

The "carbon leakage" industries constitute an important part of the manufacturing industry

Contribution of "carbon leakage" sector to Manufacturing and Exports



Percentage of exports to non-EU countries, 2020

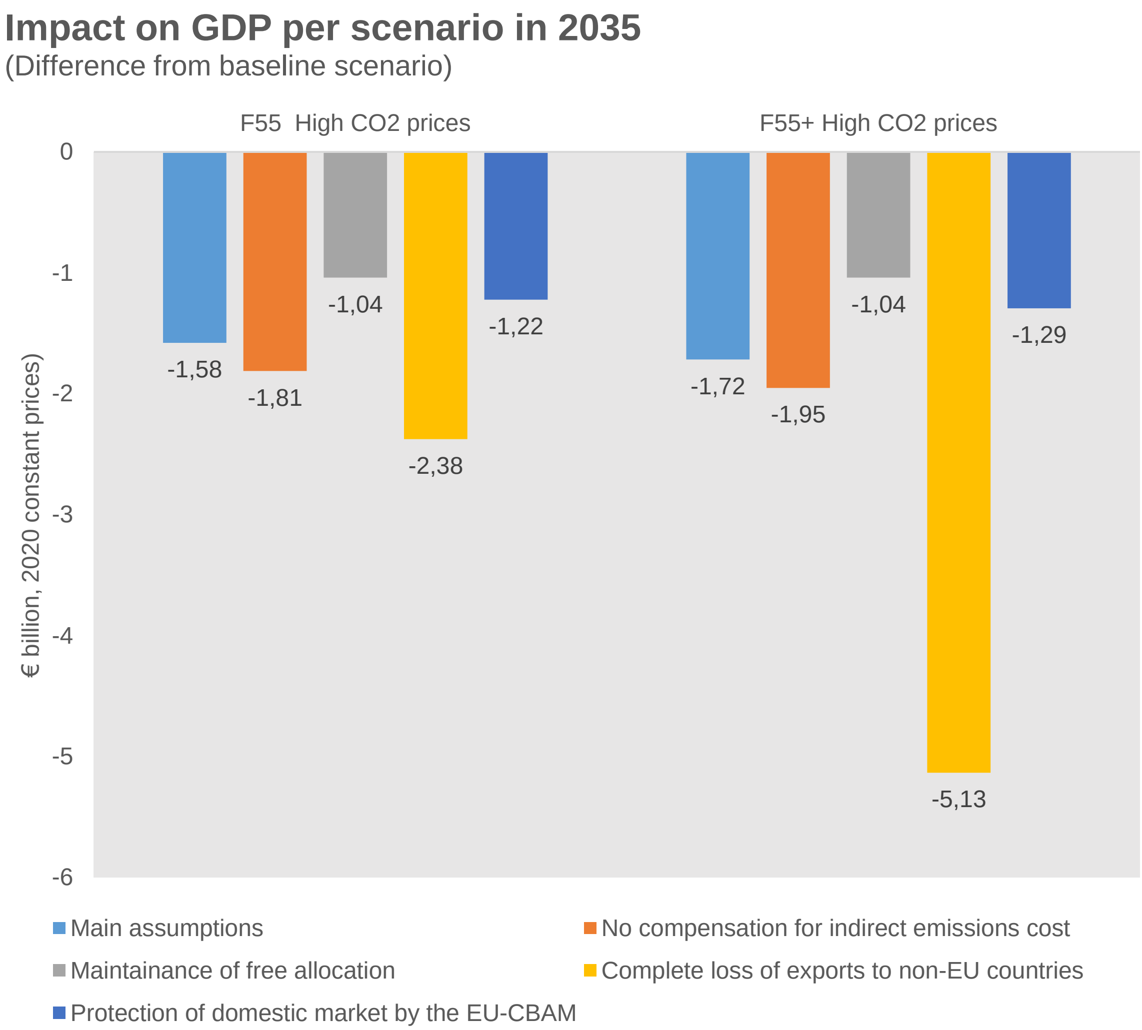


Changes in the regulatory framework that increase the risk of carbon leakage pose risks to the entire Manufacturing industry; they also make it difficult to change the country's growth paradigm.

More than half (54% in 2020) of the exports of "carbon leakage" industries go to non-EU (third) countries

Source: Eurostat, SBS **Data processing:** IOBE.

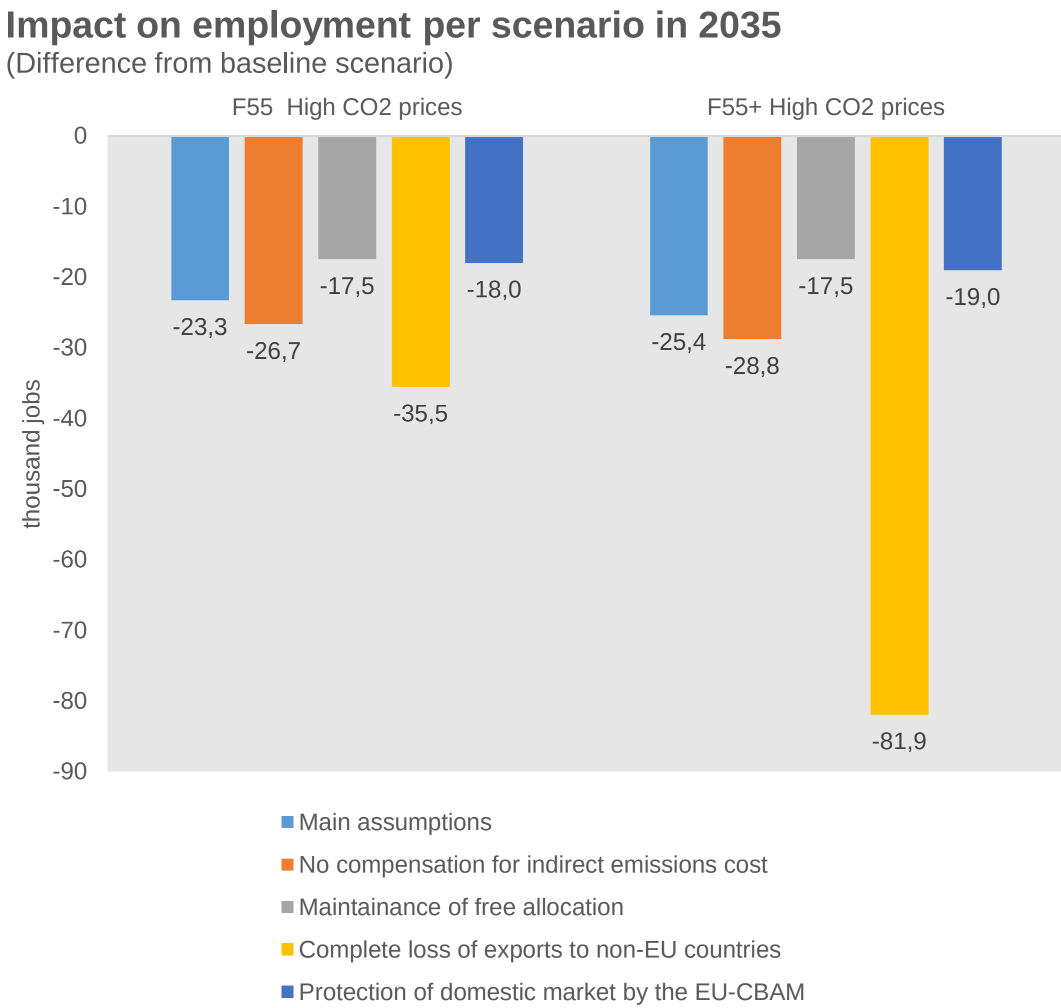
Impact on GDP could reach €1.7 billion in 2035 (0.82% of GDP)



- Impact on GDP reaches €1.95 billion in 2035 (0.93% of GDP) if the **indirect emission cost compensation is abolished**
- The risk of **complete loss of exports to third countries** due to carbon leakage, translates into GDP losses that can reach €5.1 billion (2.6% of GDP)
- **Maintaining the free allocation of allowances** could reduce the impact on GDP by €380-650 million (0.18-0.31% of GDP)
- **Effective protection from the EU-CBAM** limits GDP losses to €1.3 billion.

Source: IOBE

The impact on employment could reach 25,400 jobs in 2035 (0.56% of total employment)



- **Elimination of indirect emission cost compensation** could result in 2,100-3,350 lost jobs
- If there is **complete loss of exports to third countries** the impact on employment can reach 81.9 thousand jobs (1.9% of total employment)
- **Maintaining the free allocation of allowances** would lead to 6-8 thousand fewer job losses by 2035
- Ensuring **full protection of domestic production** directed to the Greek market by the EU-CBAM would lead by 2035 to up to 6.4 thousand fewer job losses

Source: IOBE

Main conclusions

1. There are **serious risks** for the Greek industry from the changes underway in the context of protection against carbon leakage
   - Significant **impact on GDP and employment**
   - Abolishing the **compensation of indirect emission costs would increase the negative effects**
   - **Lack of protection for Greek exports**, especially to third countries, creates a **high risk of adverse effects**
2. **Maintaining the indirect emission cost compensation, as well as the free allocation of emission allowances, with benchmarks** monitoring the technological developments, could reduce estimated losses to some extent
3. **The effectiveness of the implementation of the EU-CBAM** is crucial
4. The utilisation of the **additional revenue** for the State, **only slightly** mitigates the negative economic consequences

Recommendations to mitigate the negative effects

1. **Complementary operation of the EU-CBAM with the free allowances distribution system**
2. Coverage of the additional greenhouse gas emissions costs incurred by EU producers when they **export** to third countries
3. Maintain the **compensation of indirect emission costs**
4. Access to **financing** for companies and implementation of financial support measures
5. Implementation of complementary measures, such as **carbon contract-for-differences (CCDs)**, funded by the Innovation Fund
6. Operation of **market mechanisms** to ensure access and **full coverage of the loads** of electricity-intensive industries with **"clean" energy** at competitive prices

Maintaining the competitiveness will ultimately enhance the effort to implement the necessary adjustments for companies; it will also help them take advantage of the opportunities that arise in the process of transition.

Contact details

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