Quarterly Report on the Greek Economy
03 / 19

24th October 2019

ΙΔΡΥΜΑ ΟΙΚΟΝΟΜΙΚΩΝ & ΒΙΟΜΗΧΑΝΙΚΩΝ ΕΡΕΥΝΩΝ

Report Review

Global environment: Further slowdown in 2019, acceleration in 2020

- Deteriorating projections about global growth this year: **3.0%, from 3.3% earlier**. A small acceleration is expected for 2020 (3.3%).
  - **Negative impact** from escalating trade protectionism measures, pressures on the EU car industry, particularly in Germany (environmental standards – decrease of Chinese demand), uncertainty about Brexit, expiration of tax incentives in China

- **2019 Q2: Mild further deceleration,** compared to the previous quarter: 1.6% growth y/y in the OECD countries, compared to 1.7% in the previous quarter and 2.7% in 2018 Q2
  - Unlike manufacturing, the resilience of the services sector in several developed countries under pressure, contributes to job creation

Global environment: Medium-term challenges

Globally

- Continued trade protectionism ➔ Difficulty in restoring US – China trade relations
- Impact of geopolitical tensions in the Middle East
- Impact of economic policy on private debt in China
- Prolonged instability in Turkey and Argentina

Europe

- Brexit: uncertainty about implementation of the UK -EU agreement
- Problems in car industry
- Relations with Turkey - dealing with migration flows
- Accommodative ECB monetary policy (prolongation of low rates – Q-E restart)

Greece:
Acceleration of growth in 2019 Q2

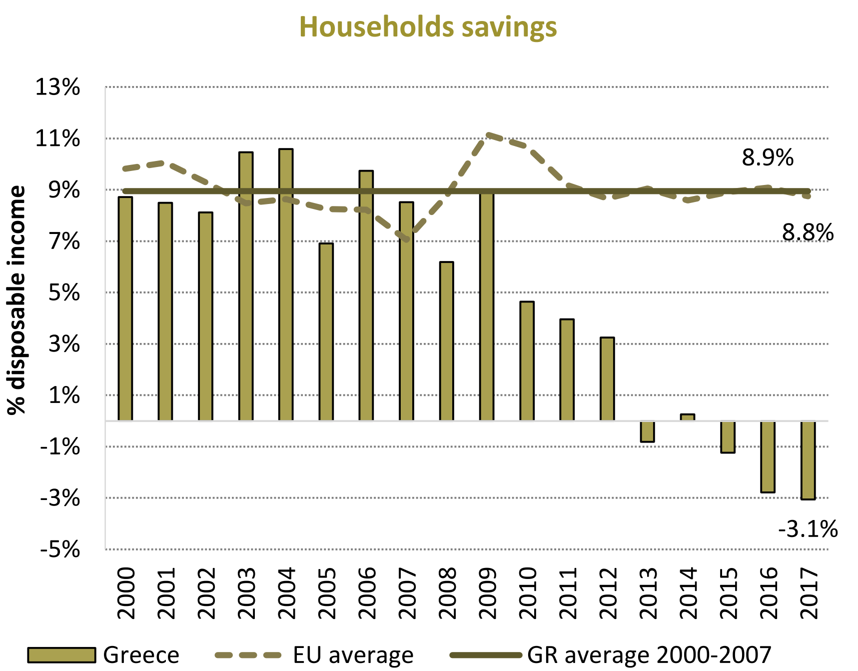
2019 Q2: **+1,9%**, compared to +1.1% in 2019 Q1 and 1.5% in 2018 Q2

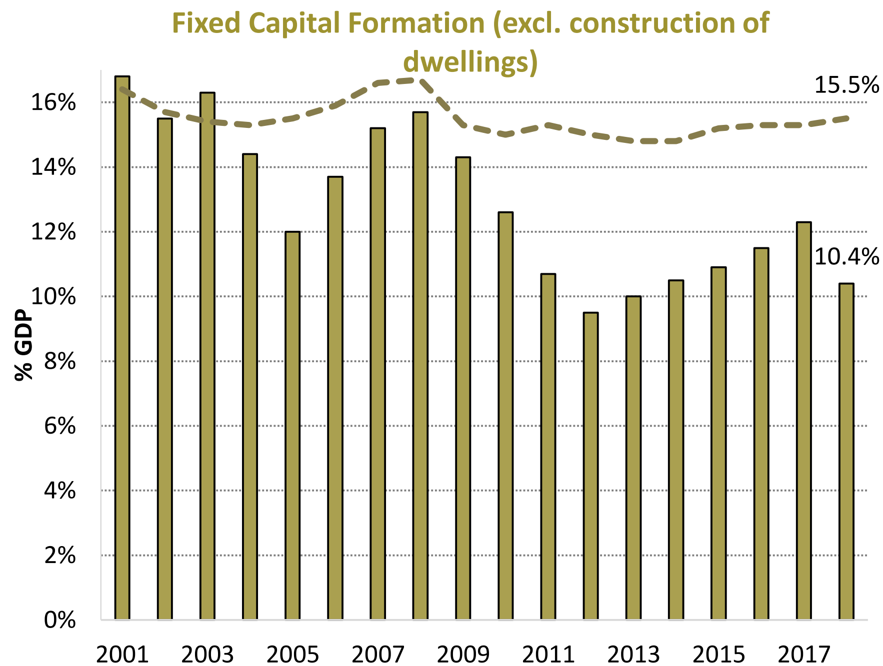
2019 a' semester: GDP growth 1.5%, versus +2.1% a year ago

Most important changes in GDP components:

- Exports expansion by 4.8%, in contrast to a 8.9% increase a year ago
    - ¾ by more services exports (+ 8.0%, almost year-on-year), by higher revenues from tourism and international transport. Slight increase in exports of goods (+ 1.8% versus 8.9% a year ago)
    - However, the external sector deficit worsened, driven by higher imports (+ 6.7% from -2.5%), primarily due to more product imports (+ 6.9%). Services: +4.5%
- Increase in investments by 7.6% y/y, vs. a 13.8% fall in the 1st semester of 2018
    - Almost entirely from an increase in inventories (90,9%). Fixed Capital Formation +0.7% (+4.4% a year ago)
    - Increase in fixed capital formation in Transportation equipment (+43,6%) and Dwellings (+13.1%)
- Stagnation of private consumption, widening in public consumption spending, due to elections cycle
    - Expansion of public consumption by 1.9% (+2.1% a year ago), exclusively from Q2 (+5.3%). Unchanged private consumption (-0.1%), vs. an increase of 1.0% a year ago.

Savings and investment in Greece follow parallel trends

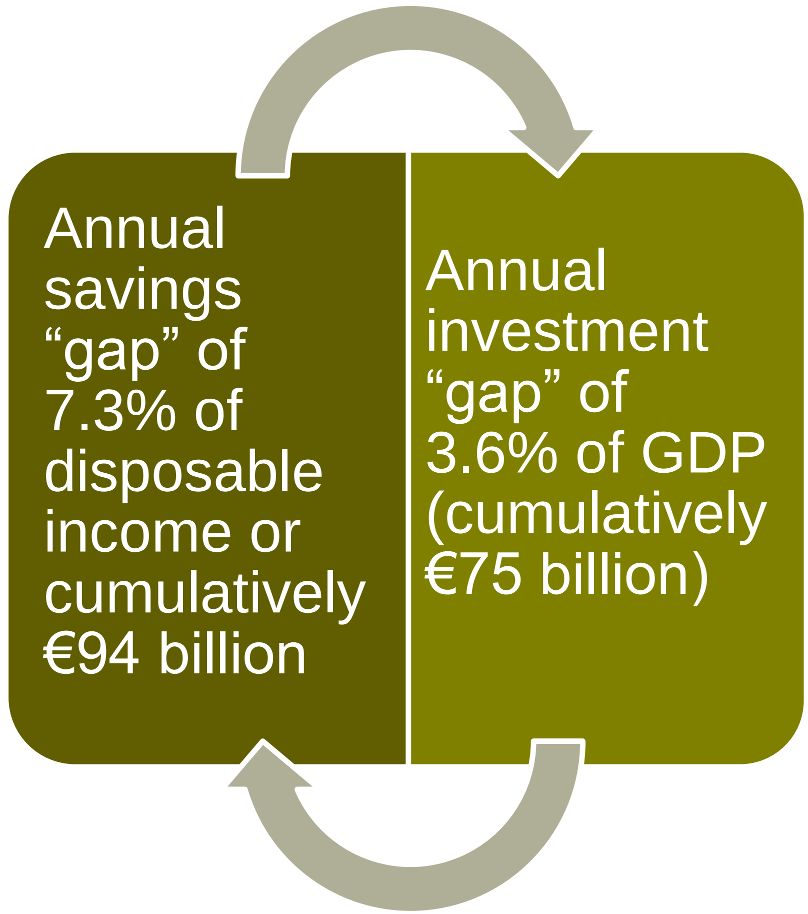




Sources: Eurostat, **Data processing:** IOBE

- The savings rate in Greece during 2009 - 2017 lagged on average against the EU by 7.3% of disposable income (cumulative hysteresis of €94 billion)
- At the same time, the country's productive investments recorded an annual "investment gap" compared to the EU average, around 3.6% of GDP

During the 2009 – 2017 crisis period, savings “gap” and investment “gap” are closely linked



Sources: Eurostat, FEIR/IOBE processing

Achievement of State Budget cash balance targets in Jan.-Aug.

- **Results Jan. – Aug. 2019: deficit of €1.59 billion,** versus deficit target of €4.98 billion deficit
- **Primary surplus of €2.91 billion,** versus a deficit target of €272 million, as well as a surplus of €1.12 billion in the previous year

- Higher primary surplus mainly due to higher, extraordinary revenues
  - More sales of goods and services by €1.1 billion
    - *Receipts of €1.12 billion in revenues from extending the Athens International Airport (AIA) concession contract*
  - More revenues from transfers by €858 million
    - *From government bonds held by the Bank of Greece (ANFA's and SMP's)*
  - Higher VAT receipts from other products and services by €653 million, of which € 272 million from the VAT on the sale of AIA
- Limited expenditure due to smaller guarantees called and under - implementation of defense spending and Public Investment

2020 State Budget draft

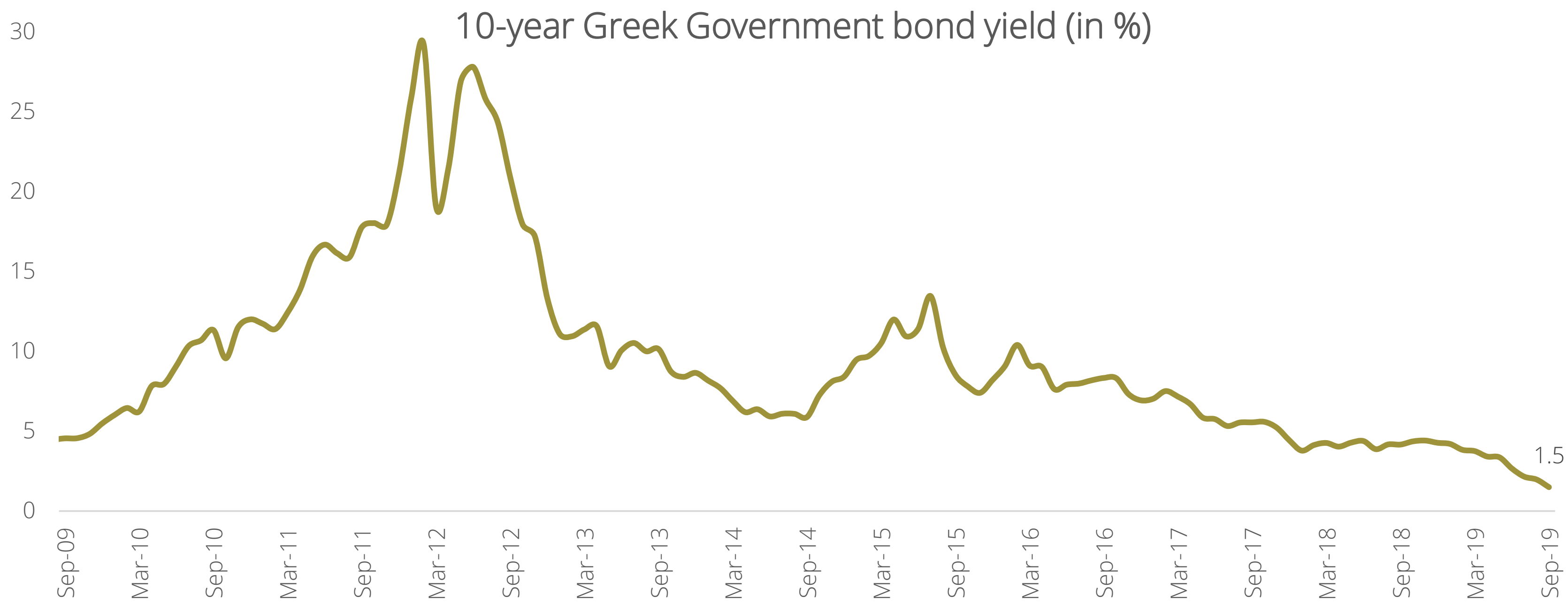
- **General Government Balance: deficit of €1.59 billion**
- **Primary balance: surplus of €7.03 billion (3.56% of GDP)**

- New fiscal interventions
  - Tax reliefs – subsidies, for businesses and individuals
  - Measures to streamline public economics and to combat tax evasion

- State budget deficit of 1.5% of GDP (€2.9 billion), versus 1.1% this year. Widening due to:
  - More not allocated expenditure (+ €2.0 billion), losses from corporate income tax cuts (- € 457million) and increased employee benefits due to higher social security contributions (+ € 415million)

- Expected achievement of the fiscal target from surplus of social security organizations (€1.67 billion) and State-owned enterprises (€1.84 billion)

Extensive cost reduction of new borrowing of the Hellenic Republic 2019 Q3



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

- Average 10-year Greek government bond yield at historically low level in September
- Spread from German Bund at its lowest level since 2009 (≈ 200 basis points)
- Very important development, impacting the effectiveness of the "Hercules" plan to reduce NPLs through the provision of State guarantees

Trends in short-term indicators

Industry

- Minor increase in industrial production during the eight months of 2019, +0.7%, against +1.1% last year
- At the same period, fall of IPI in the EZ: -1.2% versus +2.1% a year ago

Construction

- Slump of 12.1% during the first semester of this year, versus a decline of 2.8% a year ago
- Downfall in both Building activity and Civil Engineering projects

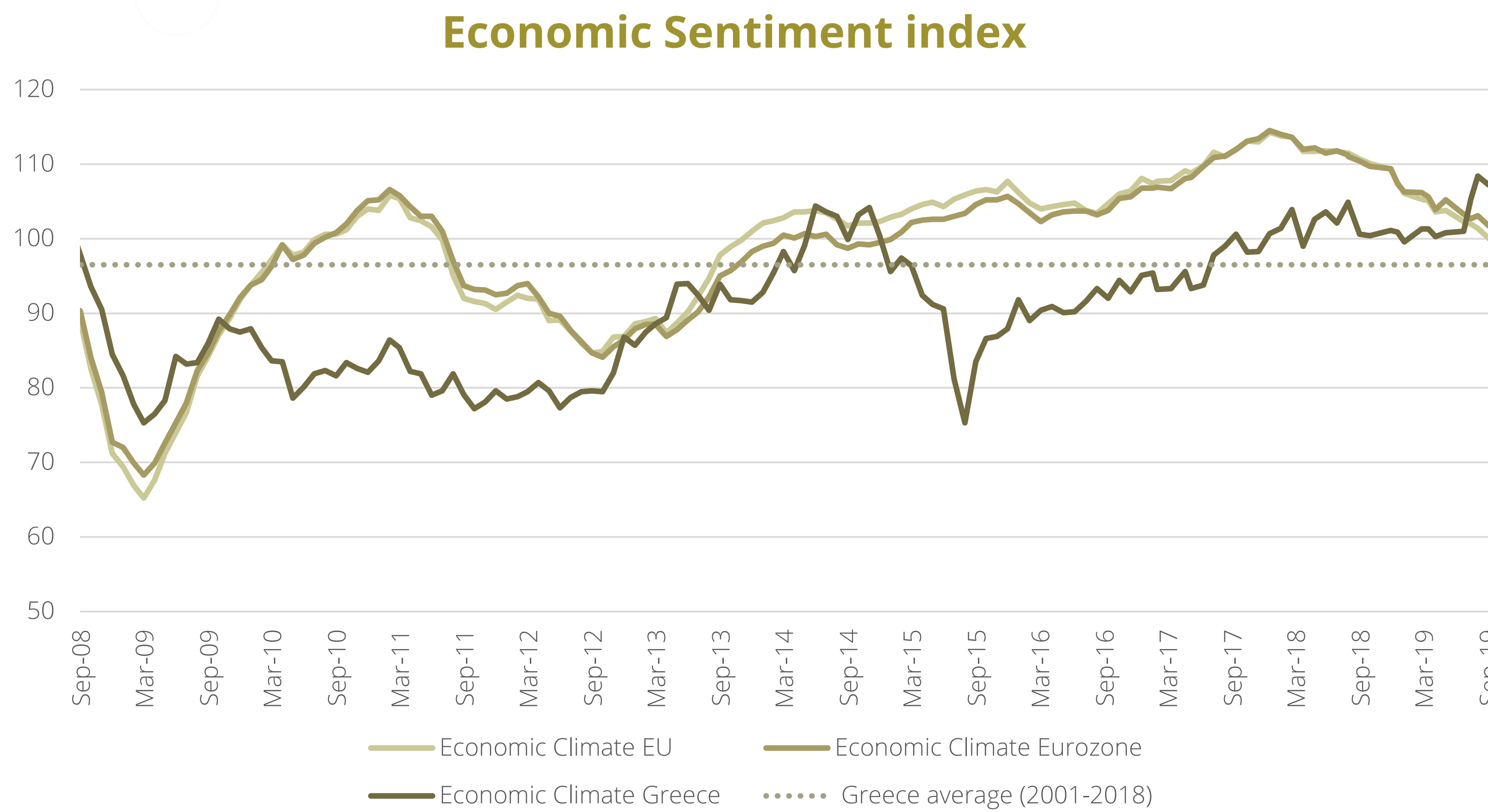
Tourism

- Turnover growth slowdown in the first half of 2019, to 2.9%, from 10.6% in the respective period of 2018

Retail Trade

- Fall of the volume of Retail Trade by 1.0% during Jan. – July , versus an increase of 1.7% a year ago

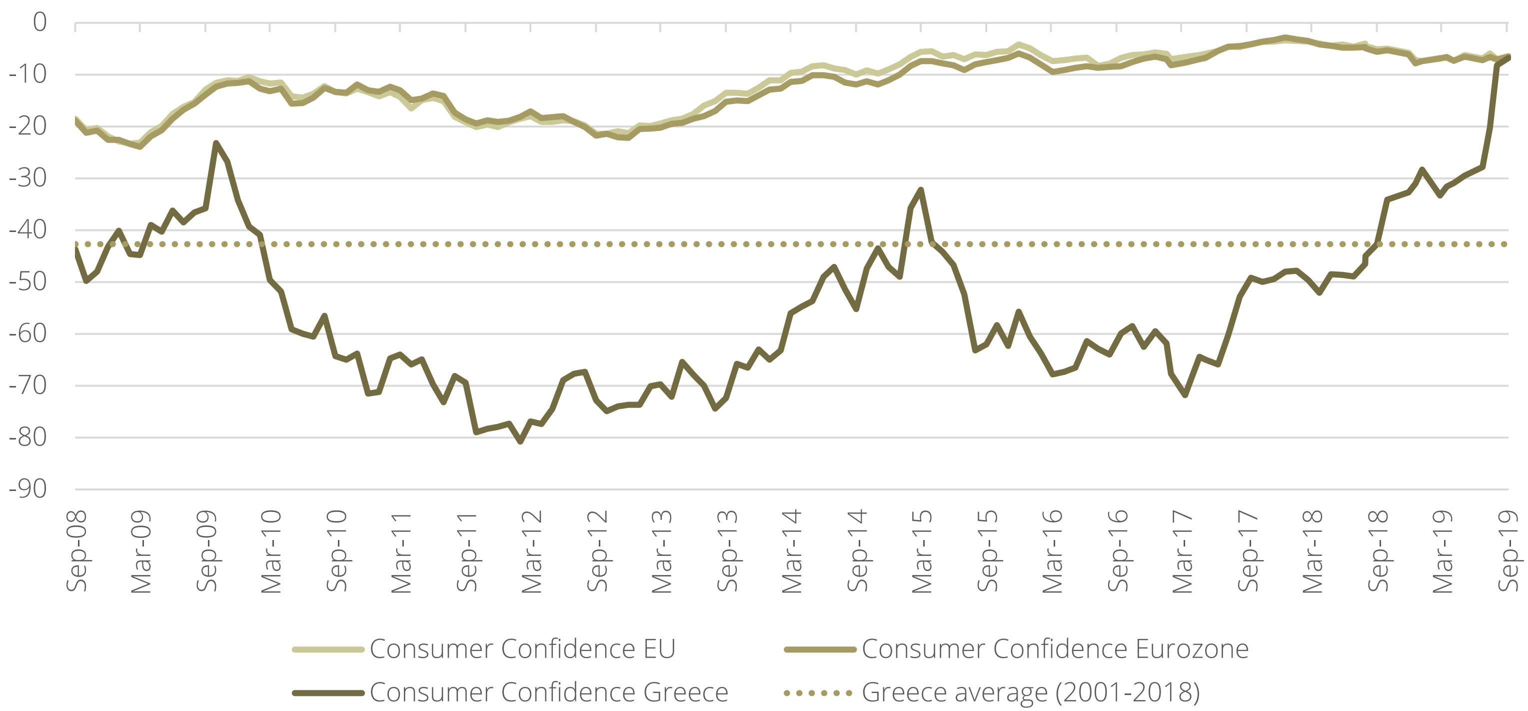
Economic Sentiment Index strong increase in 2019 Q3, compared to the previous quarter. At maximum level since 2007 Q4.



Sources: IOBE, European Commission

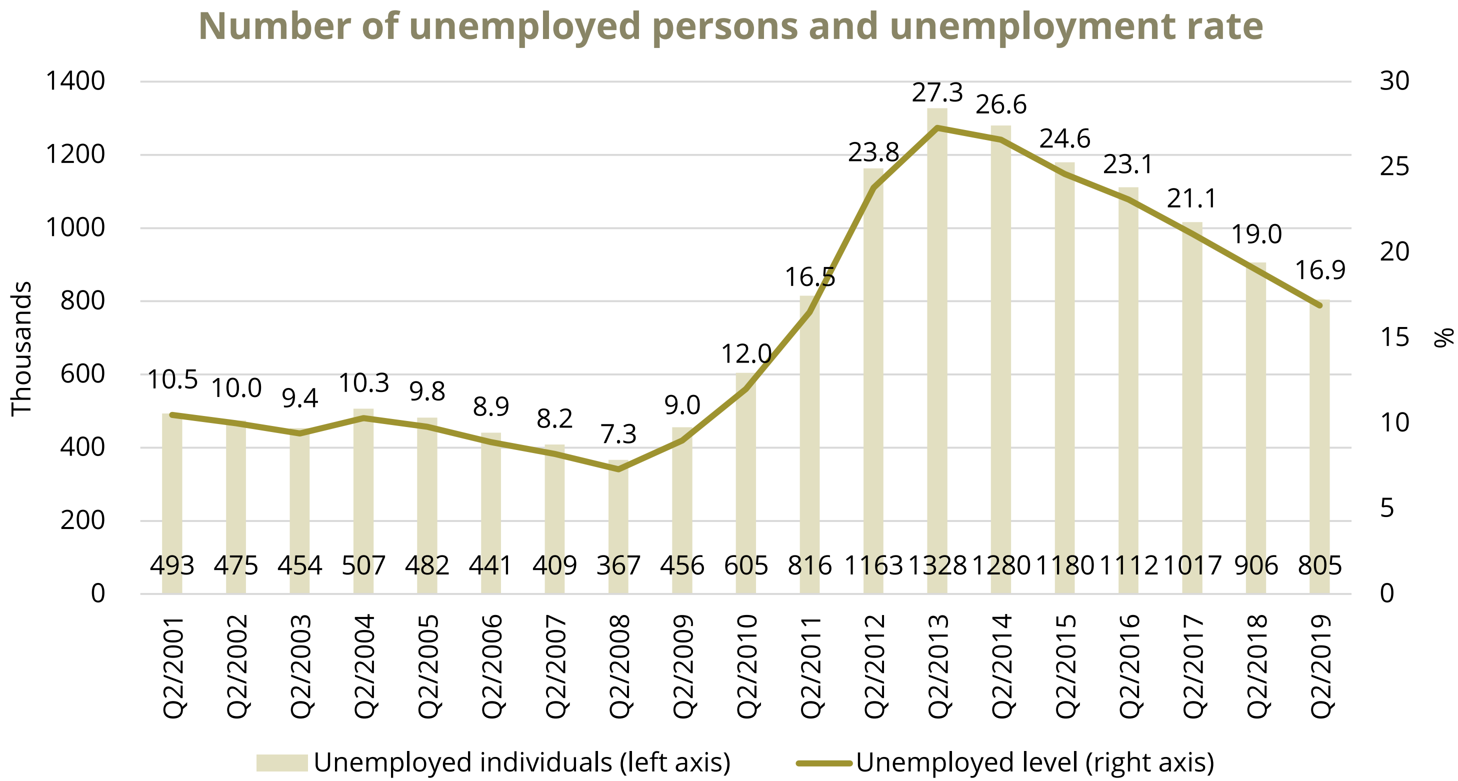
New, significant increase in Consumer Confidence during 2019 Q3, reaching its highest level since 2002 Q1

Consumer Confidence index



Sources: IOBE, European Commission

Decline of unemployment continues



Source: ELSTAT

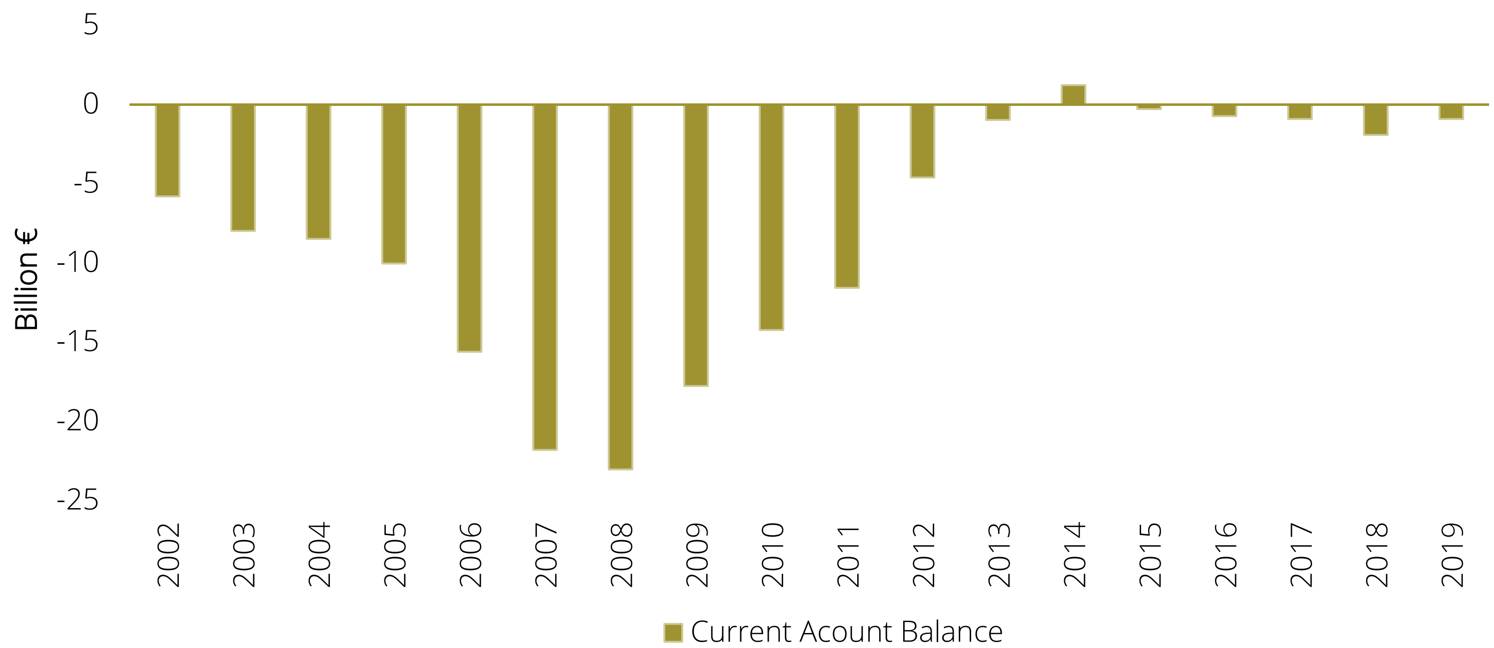
- **Unemployment rate at 16.9% in 2019 Q2, against 19% a year ago**
- **Employment increase in 15 sectors.** Indicatively: Education (+25.6 thousands), Transportation - Storage (+21.4 thousands), Tourism (+20.5 thousands), Manufacturing (+20.2 thousands), Public Administration (+13.8 thousands).
- **However, employment dropped in 6 sectors.** Indicatively: Primary sector (-16.5 thousands), Household activities as employers (-5.0 thousands), Wholesale - Retail trade (-4.1 thousands), Financial and Insurance activities (-2.5 thousands)

Increase of seasonally adjusted wage cost for 7th consecutive quarter

Source: ELSTAT

➢ **Rise of the index by 2.2% y/y in 2019 Q2, following an increase by 2.7% in 2018 Q2**

Current account deficit narrowed during Jan. –Aug. 2019

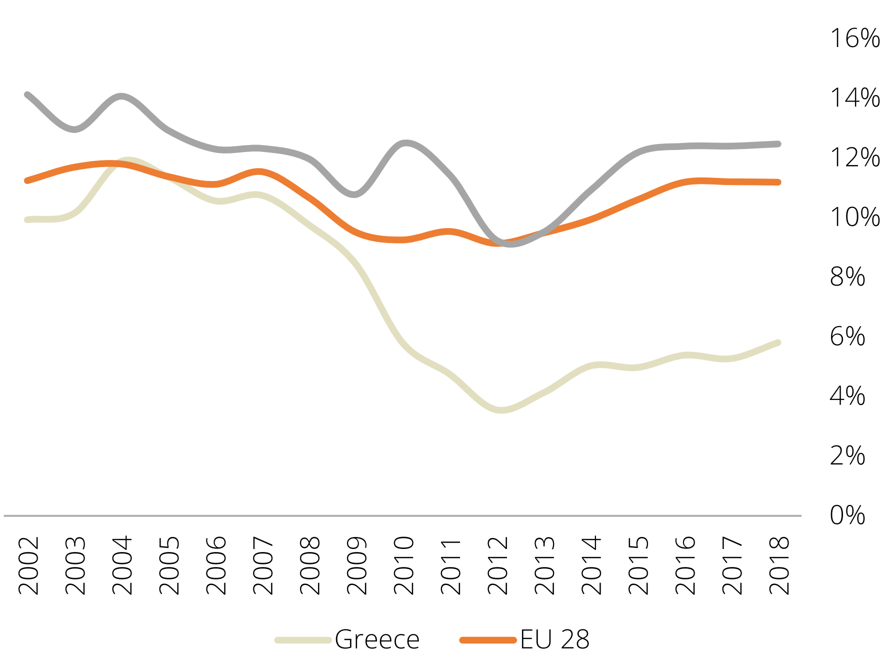


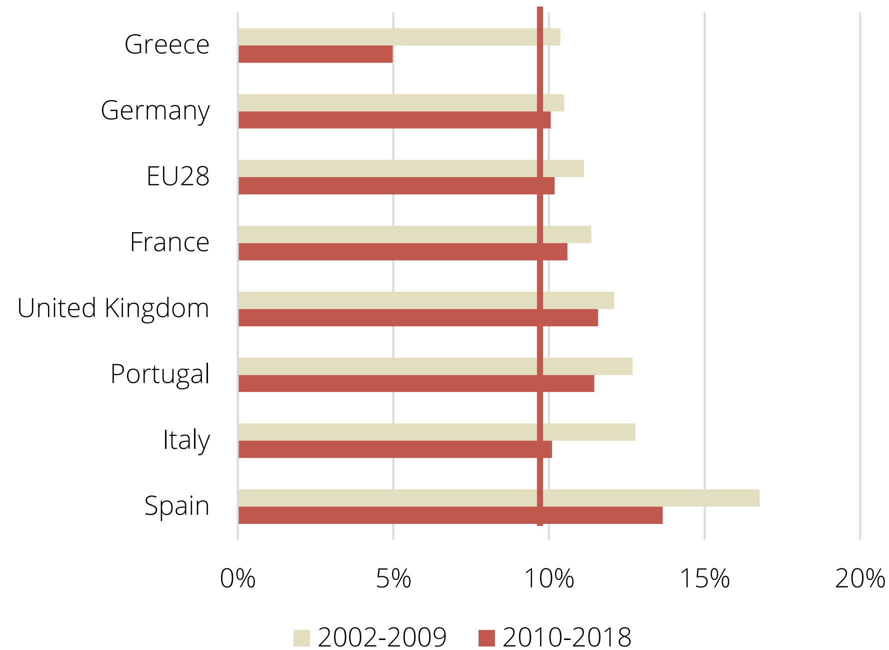
Source: Bank of Greece

- Current account deficit of €911 million, against €1.9 billion a year ago
- Much higher surplus in balance of services, by €1.6 billion ➔ 70% of increase from Tourism
- Widening of the deficit in goods, after a much smaller increase in both exports and imports compared to 2018

Imports of new vehicles in Greece during years 2004 – 2009 accounted for 10.4% of total imports (excl. fuels)

Share of imported new vehicles in total imports (excluding fuels)

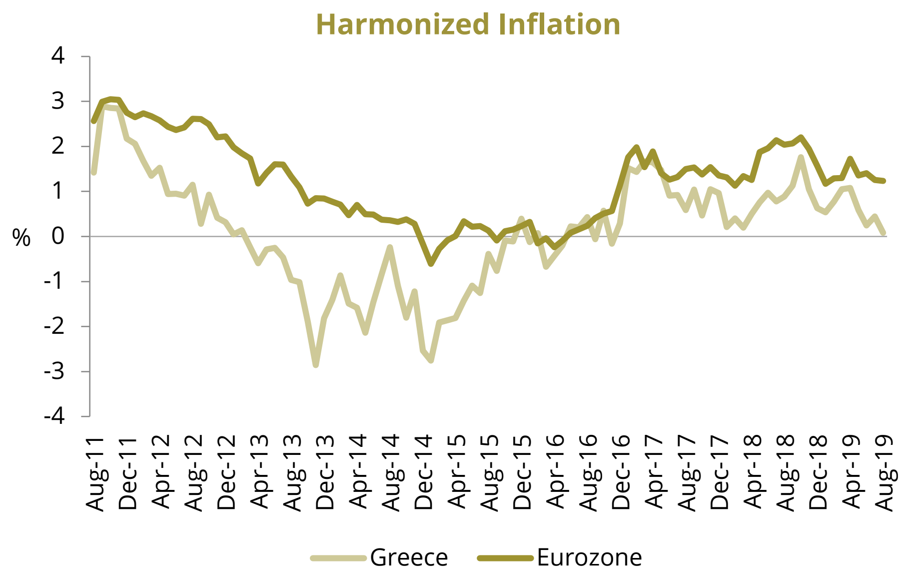


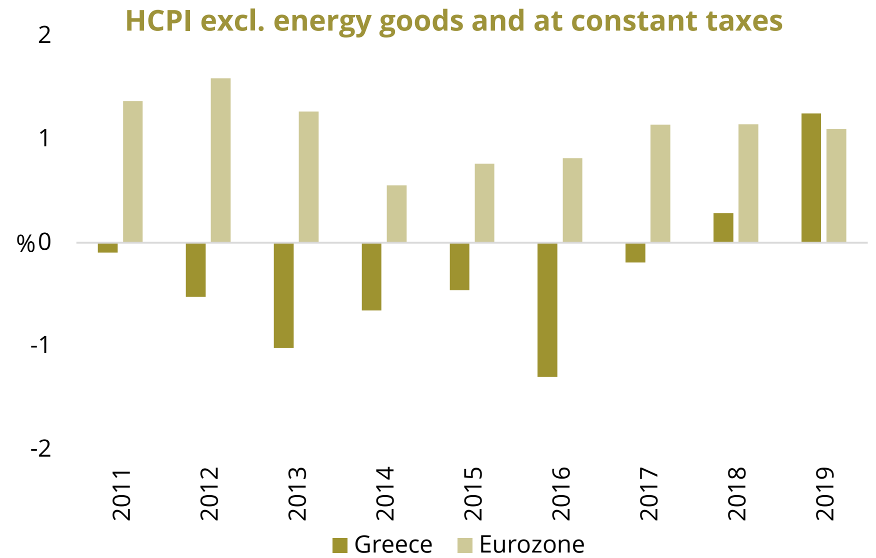


Source: Eurostat

- The share of vehicle imports to total imports in Greece was below the EU-28 average (10.4% versus 11.1%), but also below countries - manufacturers (Spain, France, Germany) ➔ Not stronger effect on Current Account Balance
- Share decline to 5.0% in 2010-2018, half the EU average, as the vehicle market suffered more from domestic crisis compared to other categories of imports. Bigger fall in the employment of the vehicle trade industry.

Weaker increase of prices compared to January - September 2018





Sources: ELSTAT, Eurostat

Eurozone: Steady inflation (1,3%) compared to Jan.- Sep. 2018 (+1,7%)

Greece (Jan.- Sep. 2019): For third consecutive year, inflation remains at the positive price territory: **0.3%, versus 0.5% during the respective period of 2018.**

- Negative impact from indirect taxation, zero effect from energy goods. Rise in prices exclusively from domestic demand – other factors for second time after 2011

Producer Price Index (Jan- Aug. 2019): +0.7%, versus +4.3% in the respective eight months of 2018, due to increases in electricity and natural gas

Good and crucial conjuncture for the economy that should be appreciated

Factors improving the Economic Environment

Usual post-election improvement of expectations

Implementation of pre-election announcements ➔ Enhancement of confidence

Reduction of real estate property tax, extension of 120 doses for debt settlement to businesses

Tax reliefs for businesses and individuals (Budget draft 2020)

Measures to streamline public expenditure - increase tax revenues are needed (relevant actions in Budget draft 2020)

Hellenic Republic borrowing costs have fallen at historically low levels

Sustainable lending terms from capital markets for banks - big companies

Continuous, increasing credit expansion to businesses

Stable return on deposits, achievement of 'red loans' goals

Trends continuation in 2020

Increase of international tourism for another year

Good and crucial time for the economy to be exploited

The very good economic climate and the post-election period favor the implementation of reforms

For Businesses and Investors: Simplification of transactions with the public sector – reduction of bureaucracy, speeding up of judicial processes, facilitation of starting or expanding / changing business activity, privatisations (delays in 2019)

For citizens: health, social security system, education, transactions with the State, operation of internal security mechanisms

Reforms are a necessary prerequisite for credit rating upgrade ➔ inclusion to **ECB's new Quantitative Easing program**

Opportunities and Risks

Capital controls lifting after 4 years

Recent developments in Turkey

Escalating migration flows because of war
Strong recession effects: large drop in exports

Brexit

Budget for the EU Programming Period 2021 - 2027

Main goals for the faster reduction of NPLs and credit expansion to the real economy

Positive Developments

- Approval of Bank Assets Protection Scheme by the EU for the faster reduction of NPLs ("Heracles")
- Completion of lifting of restrictions on capital movement after 4 years
- Continuation of the gradual increase in private deposits
- Stronger credit expansion towards non-financial businesses (NFBs)

Challenges

- Ambitious goals to reduce NPLs up to end-2021 below 20%, using a better mix of actions: more sales and securitizations, less write-offs
- Continuing credit contraction to households, as well as higher costs of lending for new businesses than in other EU countries

Expectations: Small expansion of net new credit expected in 2020, mainly to NFBs, despite the continued shrinkage of mortgages

2019 Forecasts

Small increase of private consumption (≈ +0.5%):

- Stagnation in the first half of the year, despite a rise in minimum wage, one-off transfers (retroactive payroll payments for special wage grids, May pension provision). On the other hand, household savings increased.
- Decline of cautiousness after the election cycle
- Boosting of expectations from recent measures and tax cuts in the Budget Draft

Rise of public consumption (+1.3%):

- Mainly due to the effects of the election cycle (+5.3% in Q2)

More investments (+6-7%):

- Stagnation over the pre-election period, but also earlier decline of political uncertainty as it was smaller than expected
- Continuous, escalating credit expansion, easier access to capital markets
- Improvement of expectations from tax cuts in the Budget draft
- Impact of vagueness about the suspension of VAT on new buildings

2019 Forecasts

Increase of exports (5.0% - 5.5%)...

- Decline of exports towards major destinations in the Mediterranean, ease of exports growth towards Eurozone and US, new significant boost by Tourism and Transport

...and moderate increase of imports (3.5-4.0%)

- Due to lower domestic demand growth, negative "base effect" on exports in 2019 Q3

New significant unemployment decline, to 17.3%

- More Jobs in exporting sectors and Education. Slight decline in Construction.

Minor increase of prices (≈ 0.1 – 0.3%)

- Mostly driven from stronger consumer demand, as the negative effect of taxation on prices will be intensified by the VAT cuts.

Growth rate for 2019 up to 1.8%

2020 Forecasts

Mild increase of private consumption (≈+1.0%):

- Boost to incomes from direct taxation - insurance contributions cuts
- Increase of employment in export sectors and Construction

Stagnation or small reduction of public consumption:

- Structural changes in public finances (overview of expenditure - revenue, performance budget)

Significant investment boost (+15%):

- Tax cuts, increasing bank lending, launch of works in major privatisations, boost from exports

Rise of exports (4-5%): Increase of Eurozone demand, uncertainty over Brexit implementation, developments in Turkey

Escalation of imports (6-6.5%): due to higher investment in machinery, transport means, equipment and from private consumption

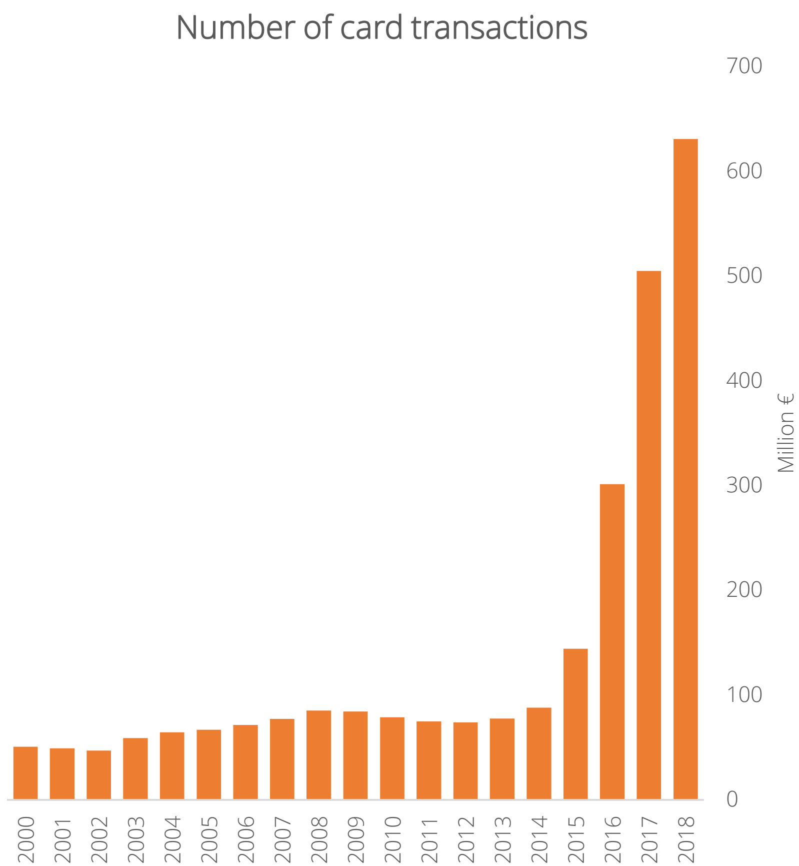
Declining unemployment (15.5%) and low inflation (0.3%-0.6%)

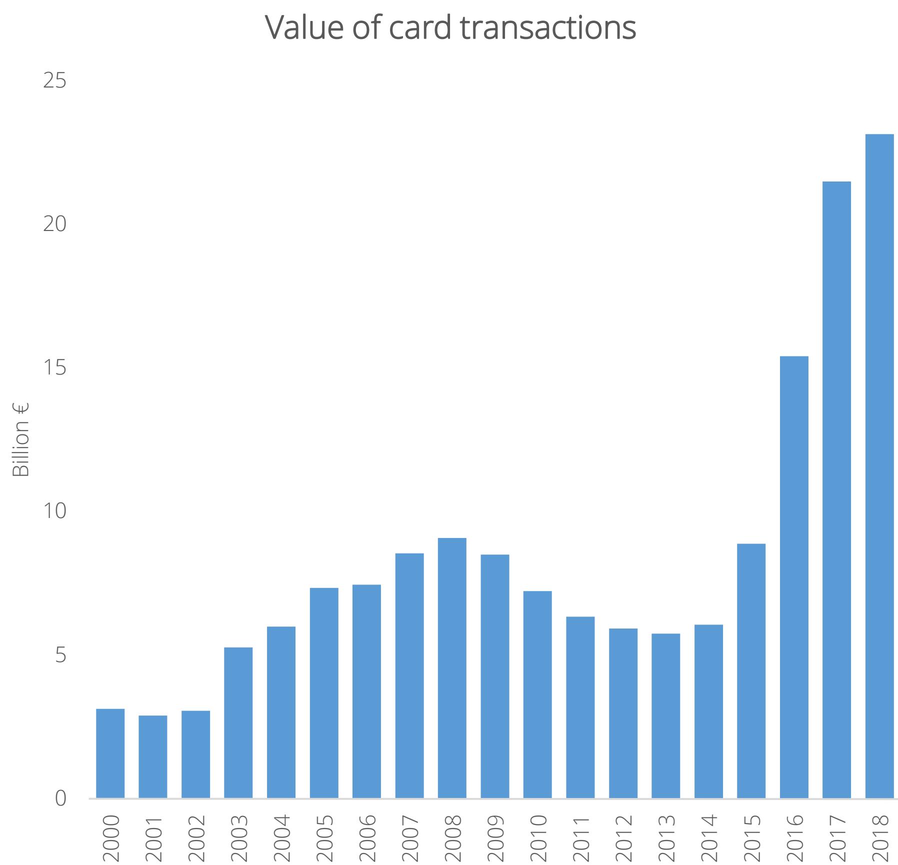
Expected growth rate of 2.3 – 2.5% for 2020

Special Study

Measures to boost the use of e-payments and tax revenues

The use of electronic methods of payment (EMP) in Greece has sharply increased since 2015

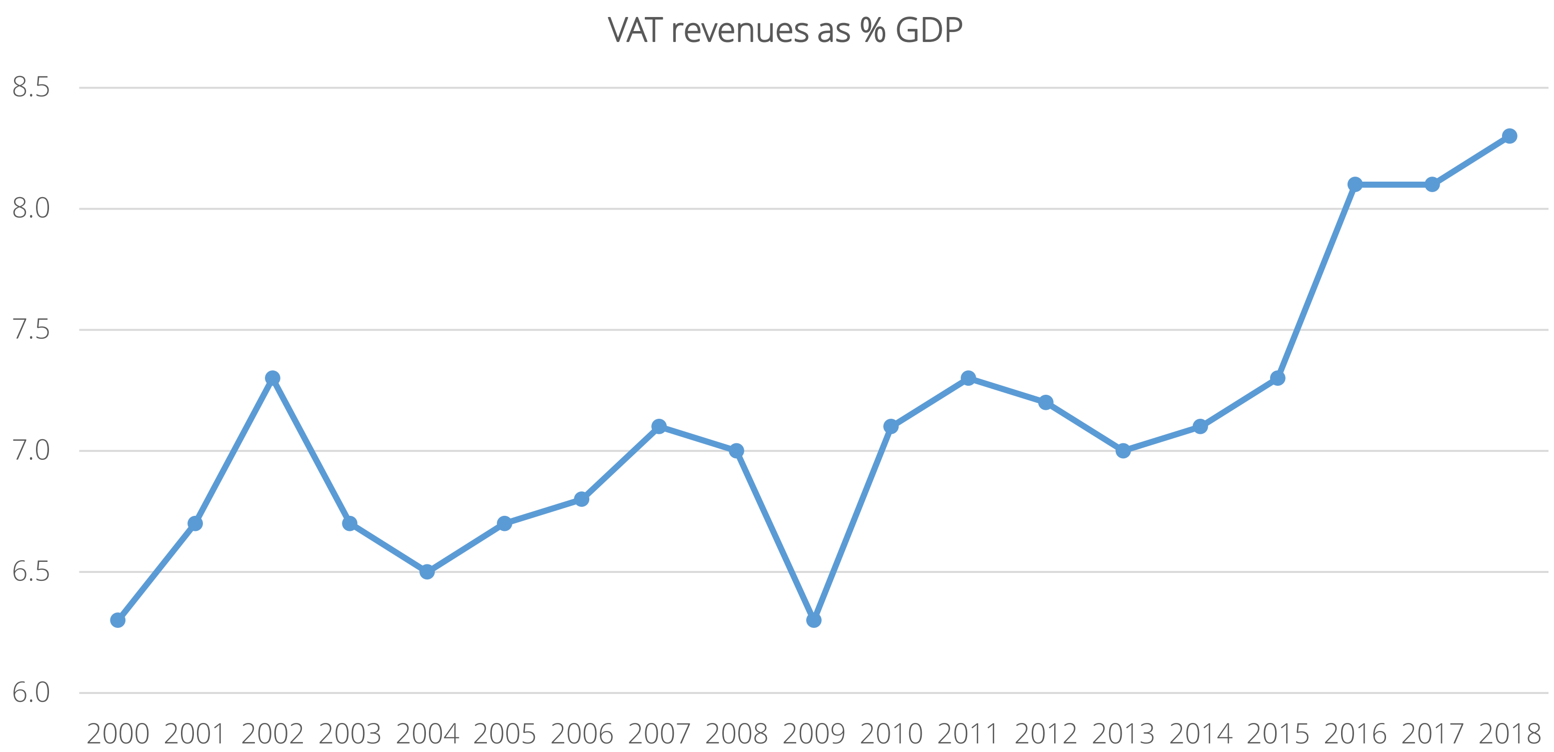




Source: ECB

The value of card transactions rose from €6.1 billion in 2014 to €23.1 billion in 2018, while the number of transactions increased from 88.0 million payments in 2014 to 631.1 million payments in 2018

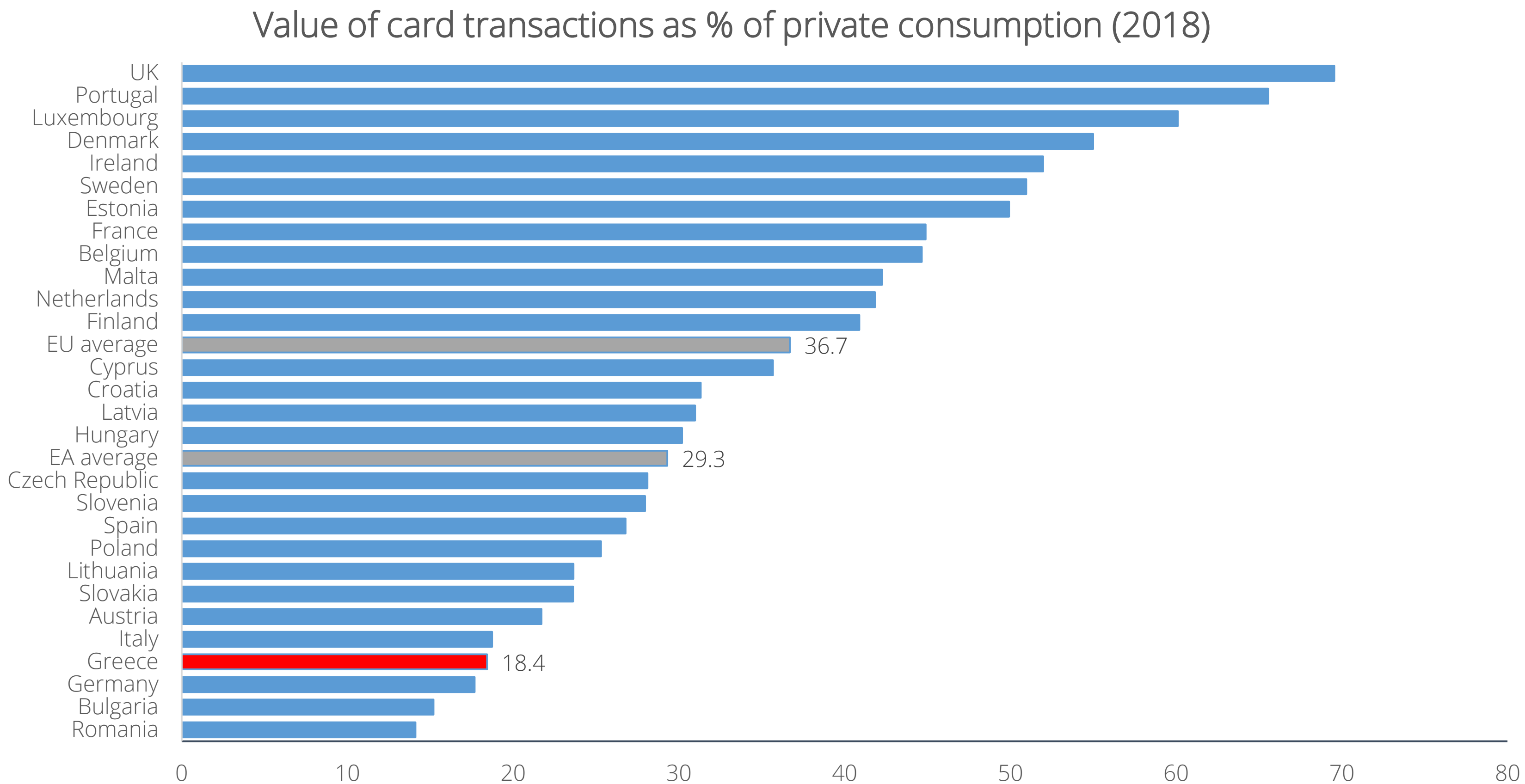
During the same period, VAT revenues also increased significantly



Source: Eurostat

As a percentage of GDP, VAT revenues reached 8.3% in 2018 and 8.1% in 2017 (from 7.1% in 2014), which are the best performances since at least 2000

However, there is ample room for further limiting the shadow economy by enhancing EMP's use



Source: Eurostat

The value of card transactions is estimated at 18.4% of private consumption in Greece, compared to 29.3% in Eurozone and 36.7% in the EU, while VAT revenues are lower than expected by 29% or €6 billion (VAT "gap")

Proposals to improve existing measures: Lotteries based on electronic payments

Taxpayer wins big lottery prize in Slovakia

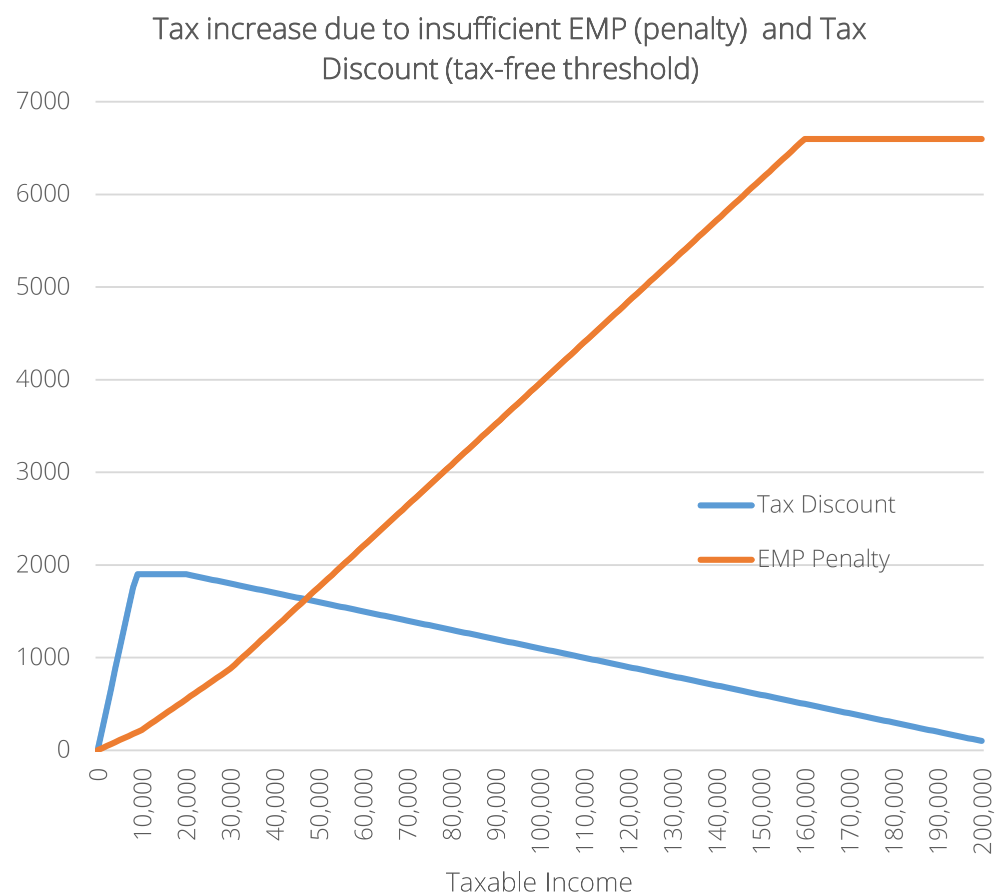
Source: New York Times, “In Slovakia, Real Lottery Prize Goes to Tax Man”, 19/4/2014

Key weaknesses of the measure and proposals for change

Weakness	Proposals
Poor targeting	• It is advisable to focus on high-risk transactions • Alternatively, differentiation of the number of lotteries awarded, depending on the risk of tax evasion
Poor public visibility	• Portugal: fewer winners, bigger prizes and more advertising • Serbia: fewer draws, more press coverage

The lottery should focus on transactions with a high risk for tax evasion and, following the examples of other countries, have bigger public visibility

Options to reinforce existing measures
Tax increase due to insufficient EMP transactions



Source: Eurostat

Key weaknesses of the measure and proposals for change

Restricted to incomes from wages and pensions

- Extension of the measure to other income categories

Disincentives to saving for higher incomes

- Reduction of the tax surcharge ceiling (from € 6,600)
- Determination of incentives to strengthen savings
  - Tax deduction for long-term investment to domestic securities
  - Strengthening of the second and third pension pillars

There is no targeting of transactions with increased risk of tax evasion

- Reduce weight or exclusion of transactions with low tax evasion risk
- Link between part of the existing tax discount and sufficient EMP use for transactions with increased risk of tax evasion

It is only punitive

The weaknesses of the existing measure relate to the notional link with the income tax discount (tax-free threshold) on incomes from wages and pensions

It is preferable to introduce new, “non-punishing” measures, which also do not increase the complexity of the system

Consumers

- 5% refund of the value of card transactions in targeted transactions
- Small income tax discount in case of high use of EMP in medium & high risk tax evasion sectors

Companies

- Lottery or tax discount for freelancers achieving EMP penetration targets
- Option for exemption of spending paid only through EMP
- Implementation of electronic pricing

Government

- Supervision of the timely and full implementation of Law 4446/2016
- Mandatory statement of all accounts used by businesses and freelancers
- Penalties for non-compliance

The direct implementation of more targeted incentives to strengthen the use of EMP will lead to higher tax compliance and broaden the tax base

Thank you for your attention!

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