



ΙΔΡΥΜΑ ΟΙΚΟΝΟΜΙΚΩΝ &
ΒΙΟΜΗΧΑΝΙΚΩΝ ΕΡΕΥΝΩΝ

Quarterly Report for the Greek Economy 4 - 2016

January 26th, 2017

Current conditions

- Stabilisation of the economy (macroeconomic, fiscal, short-term indexes) in 2016 compared to 2015
- Uncertainty concerning the Programme evaluation, public debt, dynamic of reforms and the overall implementation of memorandum still remains
- Expected growth of the Greek economy by 1.5-2% in 2017
- The 2.7% growth target is hard to achieve because of delays and underestimation of the increase of imports
- The issue is whether conditions for growth in the medium-term are created

Prospects

- Is the improvement in “twin deficits” sustainable;
- External sector: growth shall attract imports, thus an increase of exports (both of goods and services) is required.
- Fiscal policy: mix of taxation and government spending
- The economy has already undergone a major part of the necessary adjustment. It “has pulse” and under the appropriate conditions, a growth period could start
- The uncertainty about targeting and credibility constitutes an impediment
- The pressure for high primary surpluses in the future reflects a lack of confidence to the Greek economy

Evaluation

- The impression that the possibility of catastrophic scenarios have not been totally eliminated is created. This fact disrupts credibility and worsens the perspectives of the Greek economy.
- The high growth from 2000 to 2008 was supported mainly by capital inflows and positive expectations. An equally positive contingency is vital. Yet, it should be founded on the gradual increase of productivity, whereas funding will be limited compared to the past.

Costs of the delay in the review

- Most poor and weak population strata
- Important investment on human capital (e.g. universities)
- Potential risks and challenges emerging from the global environment (developments in the EU, restrictions on free trade)

Free market economy

- Growth within the globalisation context
- Entry and mobility barriers – employees and entrepreneurs confined within the “walls” of the Greek economy

Quarterly Report Overview

International environment: economic, (geo)political uncertainties

- Small deceleration of global growth in 2016, to **3.1%**, against **3.2% in 2015**, despite the important sources of uncertainty
- Major slowdown of international trade growth in 2016 (1.9%), against a 2.7% increase in 2015
 - Projection of a significant acceleration until 2018, to 4.1%, through boost from the developing countries
- Improvement of the economic sentiment in all the economic zones in Q4'16, even in the Eurozone and the EU,
- Fragile growth rates in the EU and Euro-Area:
 - **Eurozone growth rate:** +1.7% (2016) compared to +2.3% to 2015
 - Constantly increasing public and private consumption
 - Equal deceleration of the growth rate of exports and imports

International environment: economic, (geo)political uncertainties

Uncertainty factors in 2017

- Brexit management: not stable economic and political environment in the EU
- Increasing oil prices:
 - Weakens growth prospects in some oil-importing countries,
 - On the other hand, higher demand from oil producers, because of higher oil receipts
 - Conditions for boosting inflation in the Eurozone (QE)
- Strengthening of protectionism in many Western economies
 - Potential hazard of further de-escalation of global trade from developed economies
- Increasing private debt (especially in China), declining profitability of firms and capital outflows from emerging economies (dollar appreciation)
- Low goods prices which undercut growth prospects in developing economies
- Geopolitical turbulences are a major factor of uncertainty: civil wars in Middle East and North Africa, immigration flows, terrorist threats.

The only positive development is the intensification of expansionary fiscal policy in the US and in China (also in Germany and Japan)

Growth in Q3 '16, due to a low basis in 2015

GDP increase (July - Sept. 2016): **1.8%**, against a recession of 0.5% in Q2 '16 and a decline of 2.2% in Q3 '15

Growth of 0.2% in the first nine months of 2016, against a recession of 0.6% in the same period of the previous year

Change of trend due to the low level in the respective period of 2015, because of political turbulence – capital controls

Most important changes in the GDP components:

- **Strong increase of household consumption (+5.1%, against -1.2% in Q2 '16): Use of “plastic money”**
- **Intense increase of exports, but the external balance deteriorated**
 - Increase of 10.2% due to the low base effect. More exports of goods (+9.5%), but also higher exports of services (+10.5%)
 - Bigger increase of imports compared to exports (+12.0%), from the relaxation of capital controls
 - Widening of the deficit of external balance, from €1.6 bn to €3.3 bn

State Budget 2016

- Overperformance: primary surplus of €4.44 bn, compared to a primary surplus of €2.27 bn in 2015 (target €1.98 bn).
- Achievement of targets, mainly through the restraint of primary expenditure:
 - *Lower than expected spending on social welfare, grants for social security funds*
 - *Decline of arrears during the second half of 2016: -€1.8 bn, after payments of €2.56 bn → €756 million of new arrears*
- Increase of the Ordinary Budget revenue:
 - *13.7% higher corporate income tax revenue, due to the increase of the corporate tax rates and higher tax advance payment*
 - *Almost all revenue targets concerning indirect taxes were met*
 - *The wider use of credit - debit cards boosted revenue*

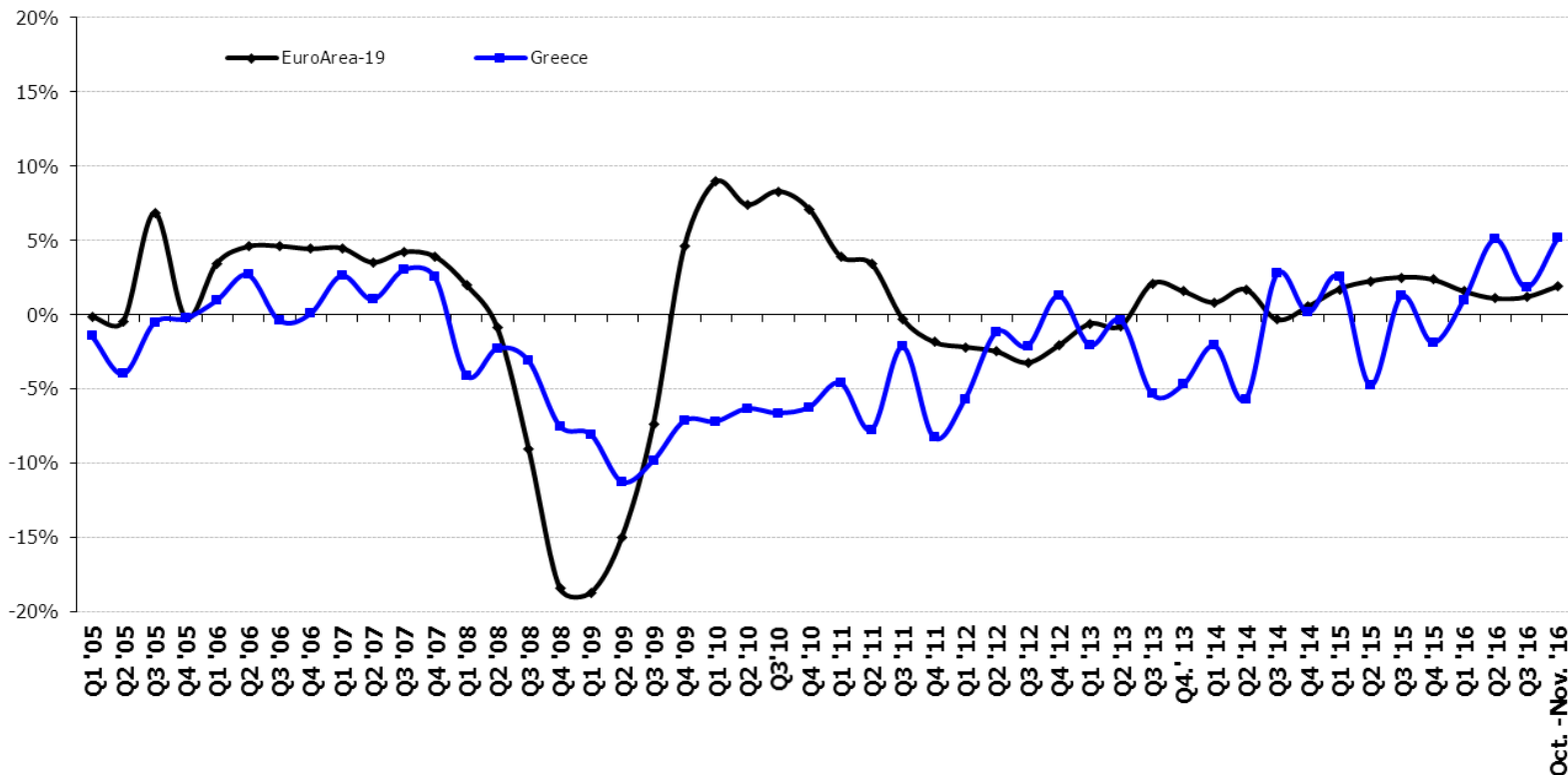
State Budget 2017

- **Primary surplus target: €4 bn (2.2% of GDP)**
 - Through projected higher State Budget revenue (+€2.4 bn)
 - Higher than initially expected receipts from non-tax revenue (+ €1.36 bn), from privatisations completed in 2016 and personal income taxation (+€1.16 bn)
 - Fewer revenue by corporate taxation (-€232 million)
 - Small reduction of the Ordinary Budget expenditure: -€440 million (-0.9%)

The effort to achieve a higher primary surplus in 2017 implies additional tax burden mainly for households

Increase of Industrial Production continues (mainly Manufacturing)

Industrial Production Index

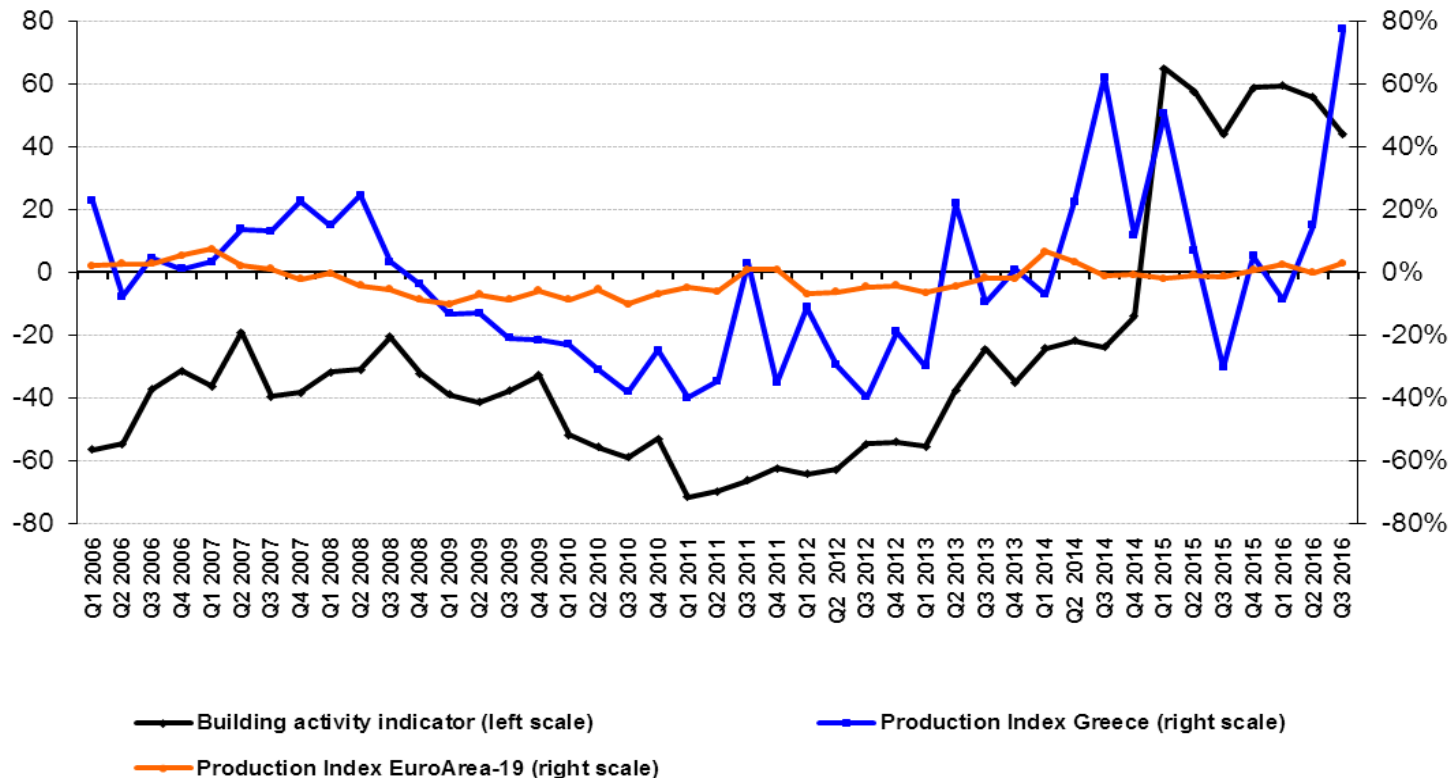


Sources: ELSTAT, Eurostat

Jan. – Nov. 2016: +2,3%, instead of Jan.-Nov. 2015: +0.5%
Manufacturing +4.6%

Construction: Slight increase during the 1st half of 2016

Production index in Construction and Building Activity Indicator
(quarterly y-o-y changes)

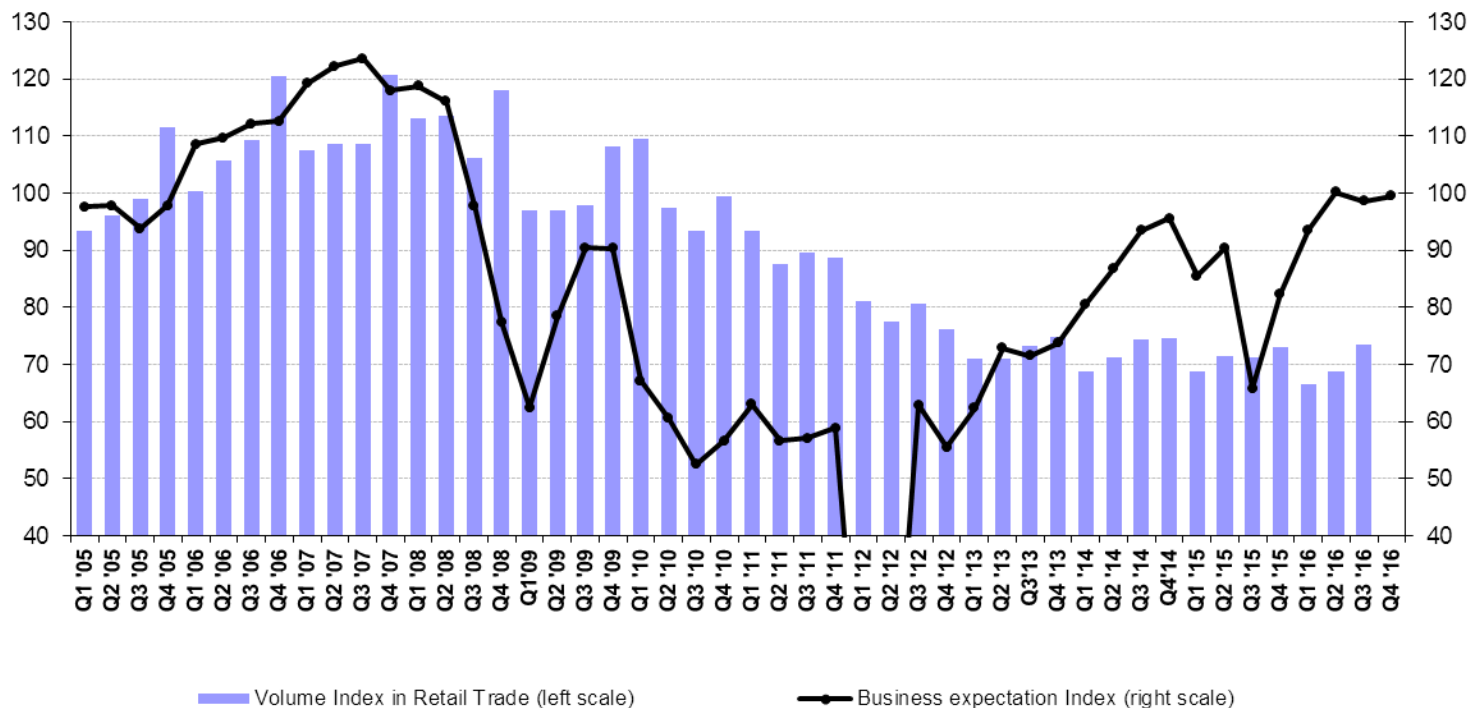


Sources: ELSTAT, Eurostat

Jan. – Sept. 2016: +25.0%
Jan. – Sept. 2015 : +1.2%

Downturn in Retail Trade, but stabilization of expectations

Volume Index in Retail Trade (2010=100) and Business Climate Index in Retail Trade (1996-2006=100)

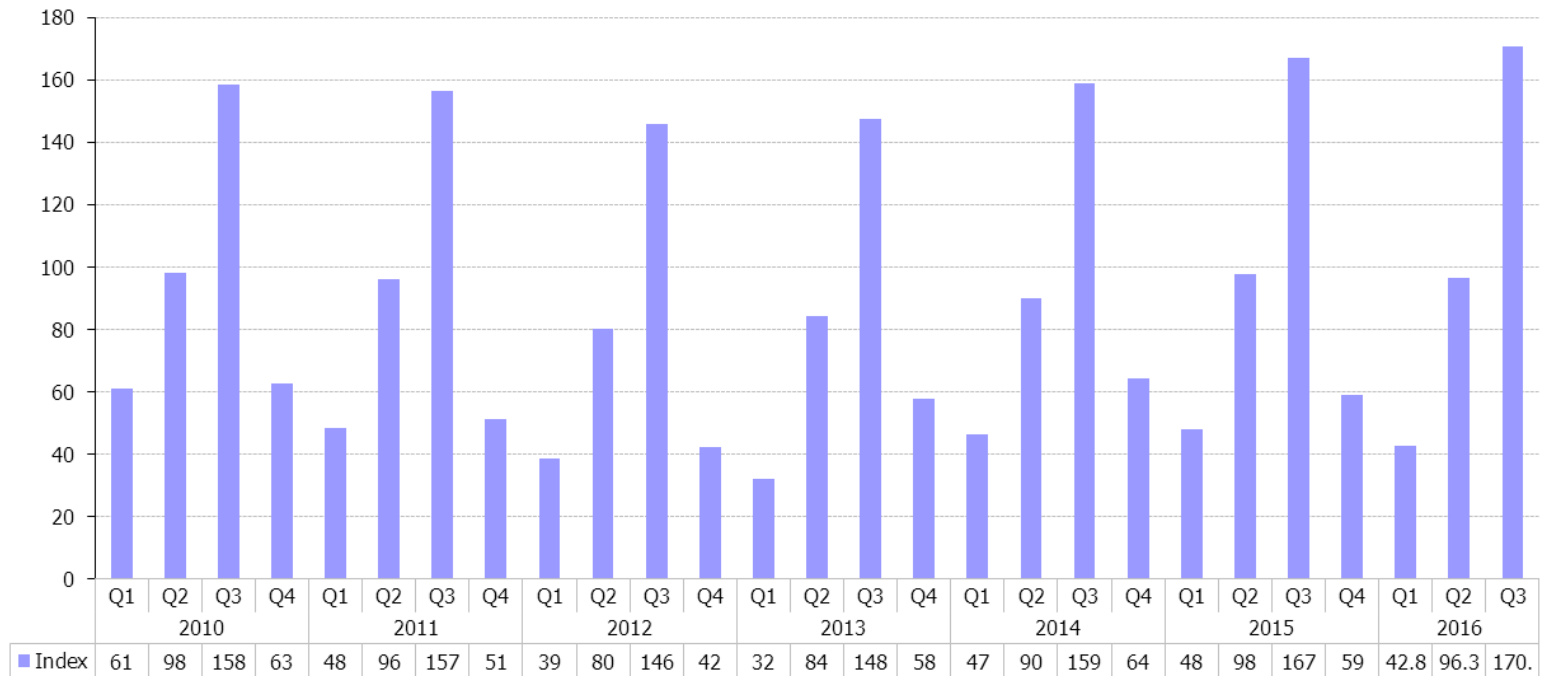


Sources: IOBE, ELSTAT

Jan.-Oct. 2016: -1.0%, instead of -1.4% in the same period of 2015
Excl. fuels & lubricants: +0.1%, instead -0.3%

Mixed trends in Services

Turnover Index in Tourism (Accommodation and Food Services)

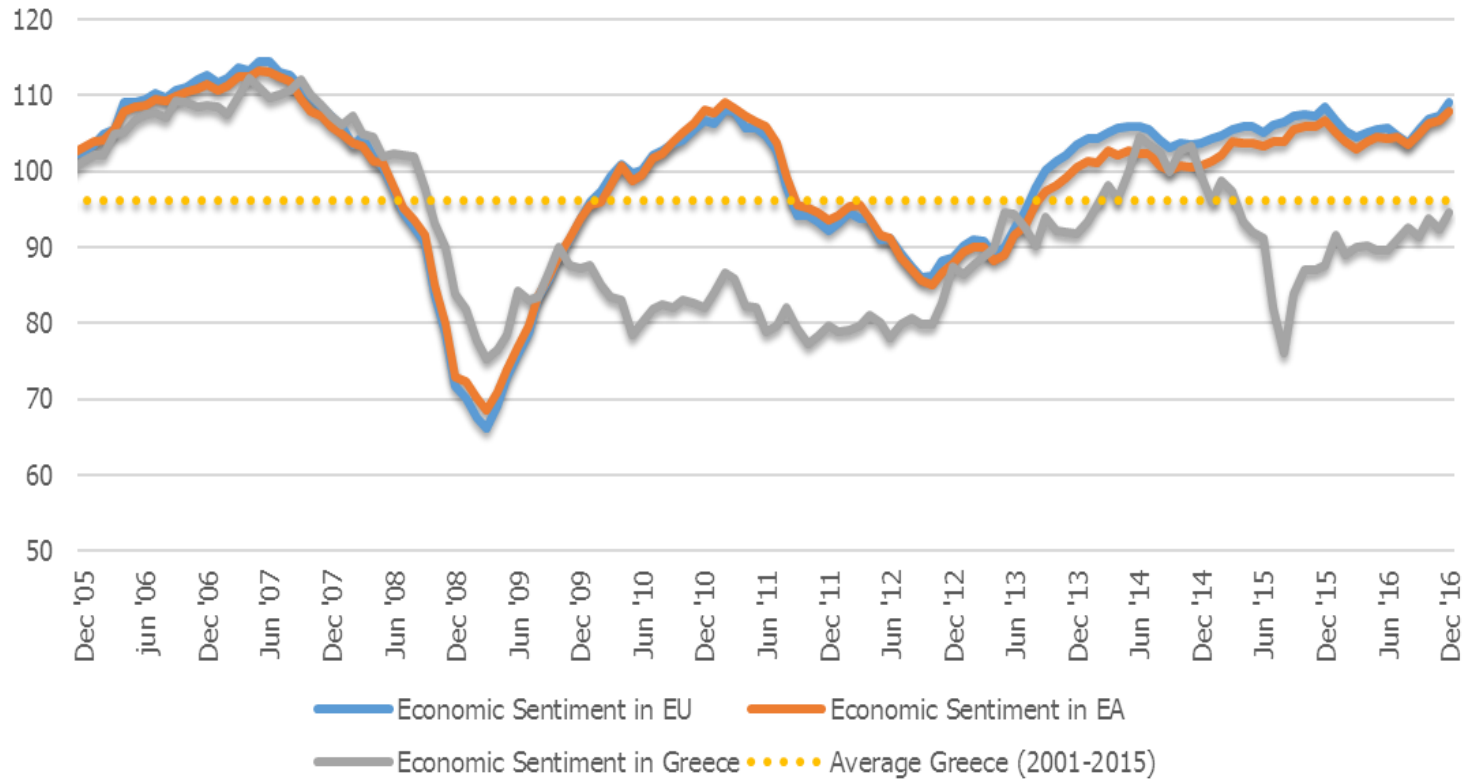


Source: ELSTAT

Jan. – Sept 2016: Downturn in 8 out of 13 subsectors
Improvement of expectations w.r.t. the previous year

The economic sentiment in Greece gradually improved during 2016, reaching a significantly higher level compared to the previous year. Improvement of the economic sentiment in the Euro Area and the EU in Q4 '16

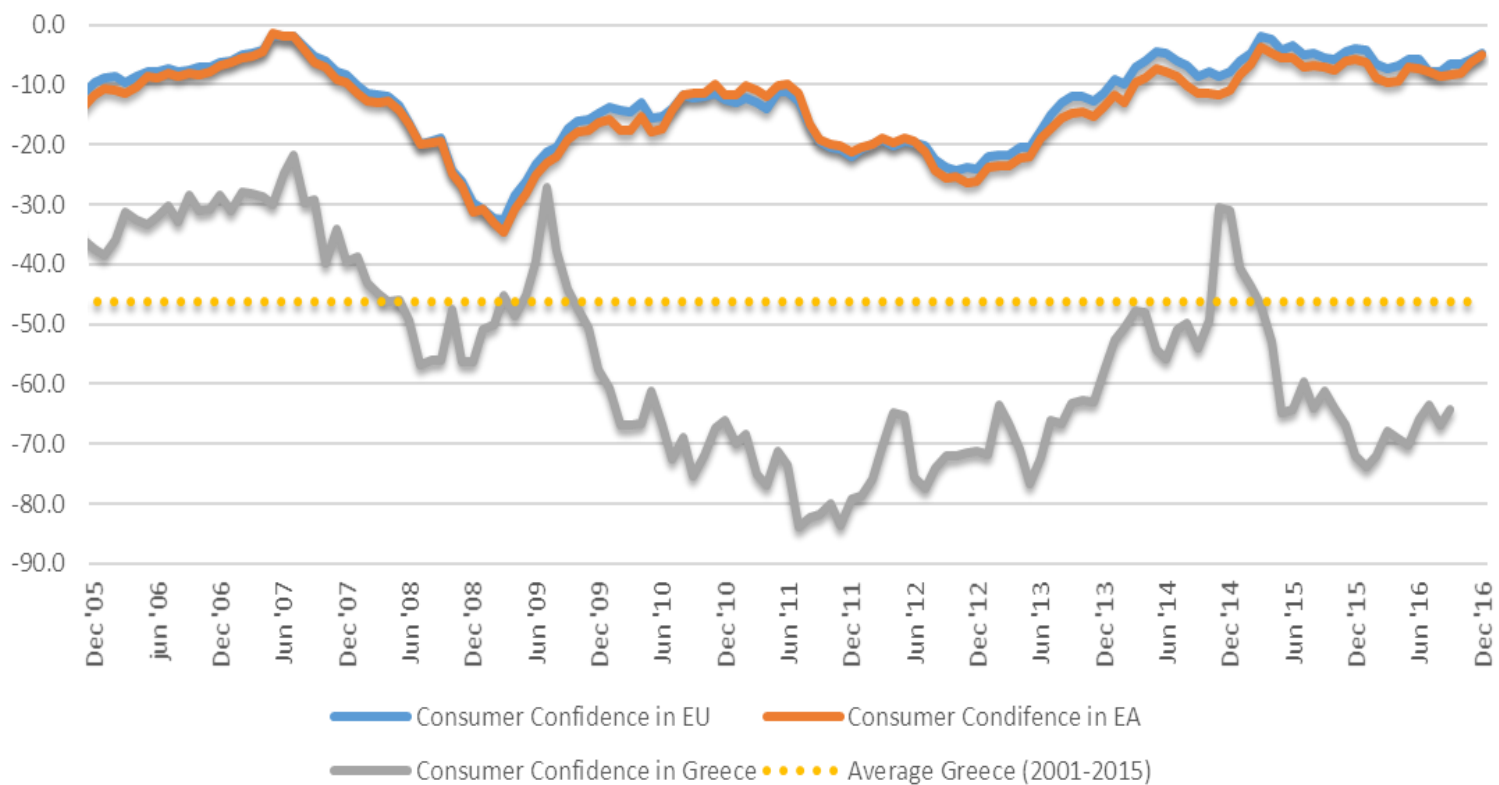
Economic Sentiment Indicator



Sources: IOBE, European Commission

Improvement of the Consumer Confidence in Greece, from very low levels: Decline of the strong pessimism

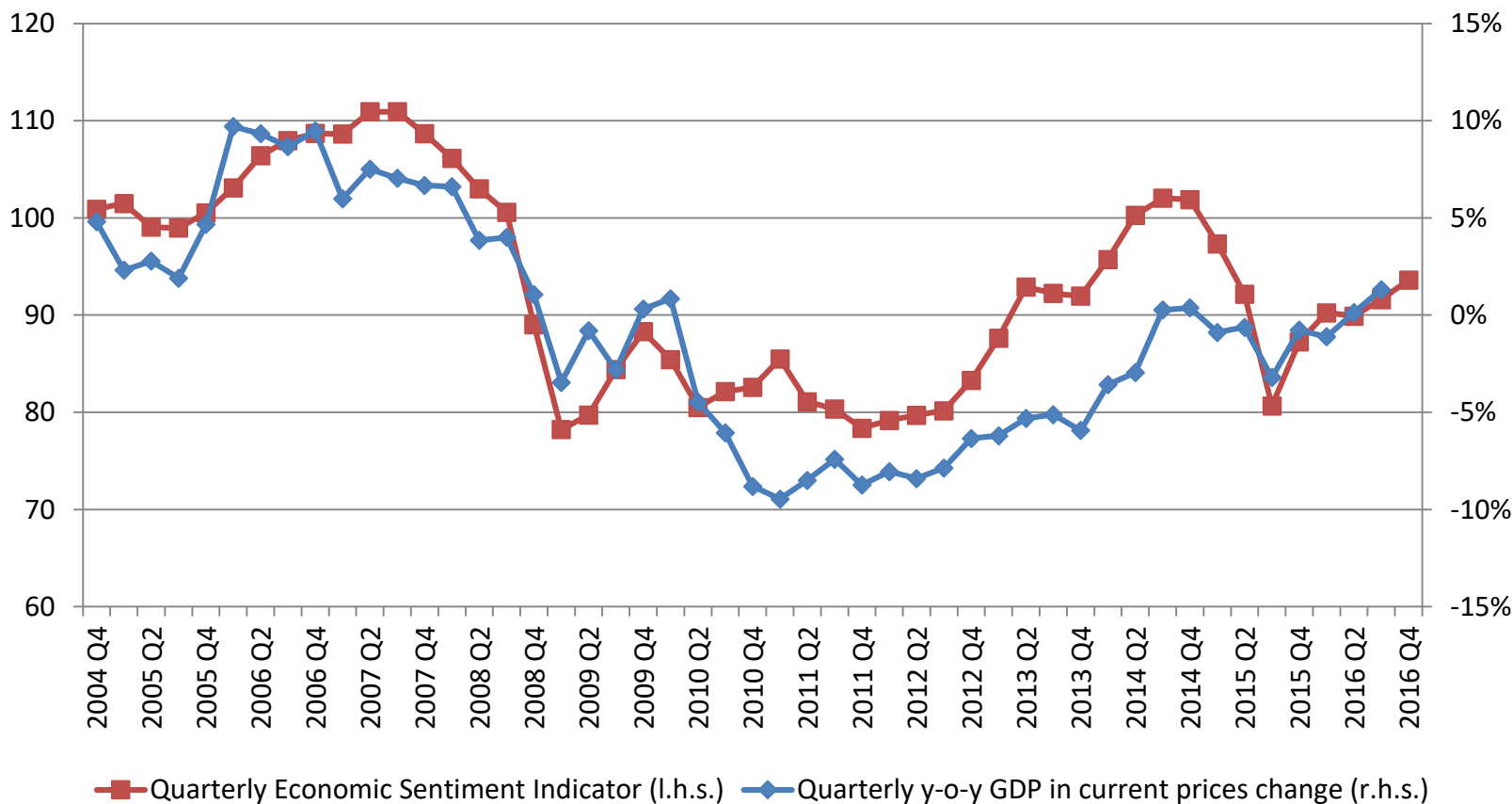
Consumer Confidence



Sources: IOBE, European Commission

ESI: Leading indicator of the Greek GDP

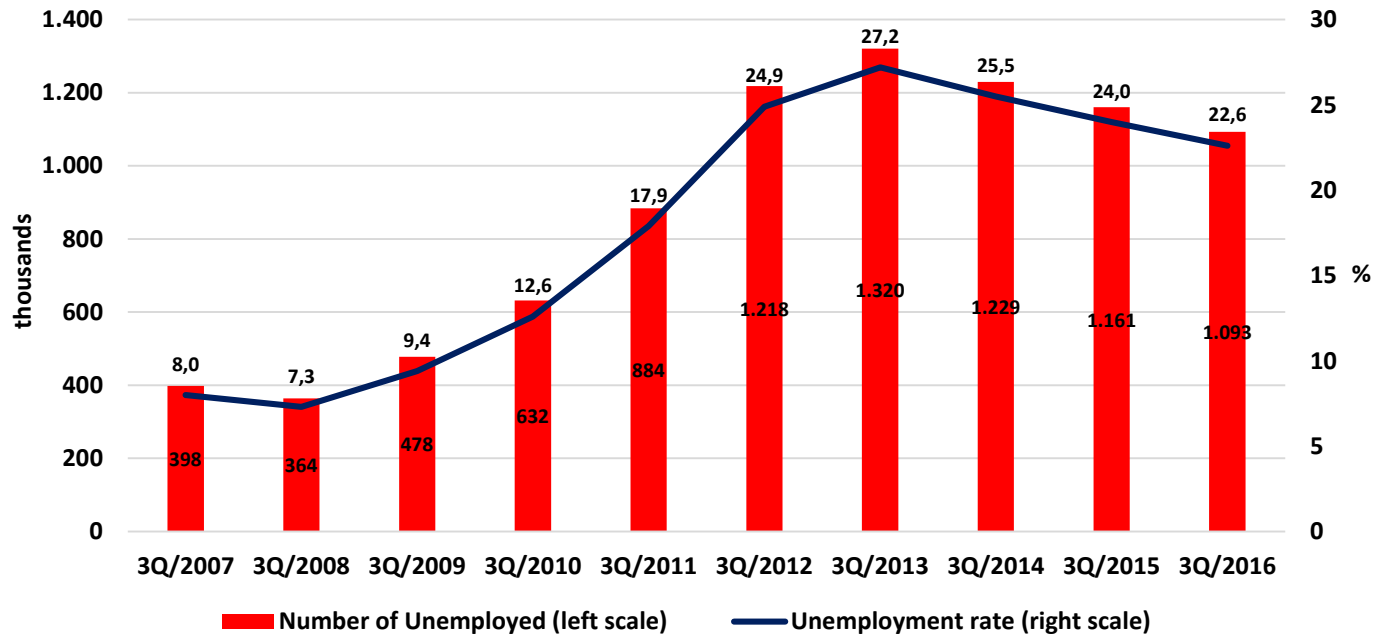
Economic Sentiment Indicator and GDP change



Sources: IOBE, European Commission

Unemployment decline (10th consecutive quarter)

Number of unemployed people and unemployment rate 3Q/2007-3Q/2016



Source: ELSTAT

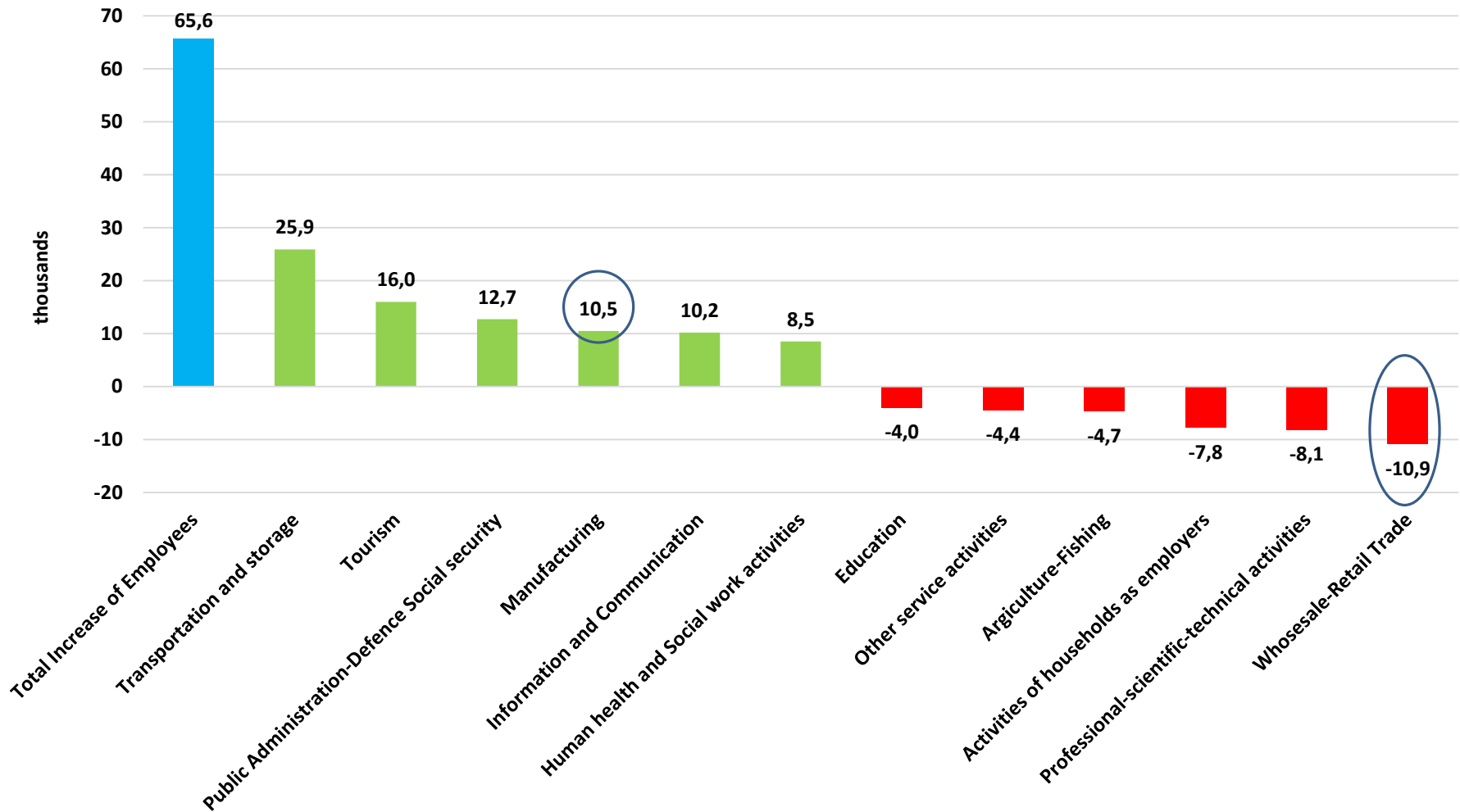
- Unemployment rate reached 22.6% (Q3 '16), from 24% in 2015
- Higher employment in 13 sectors / lower in 8 sectors.

Increase: Transport and storage (+15.5) Public administration - defense (+4.0%), Manufacturing (+3.0%).

Reduction: Professional and technical activities (-3.8%), Wholesale-retail trade (-1.6%), Education (-1.4%), Construction (-0.3%).

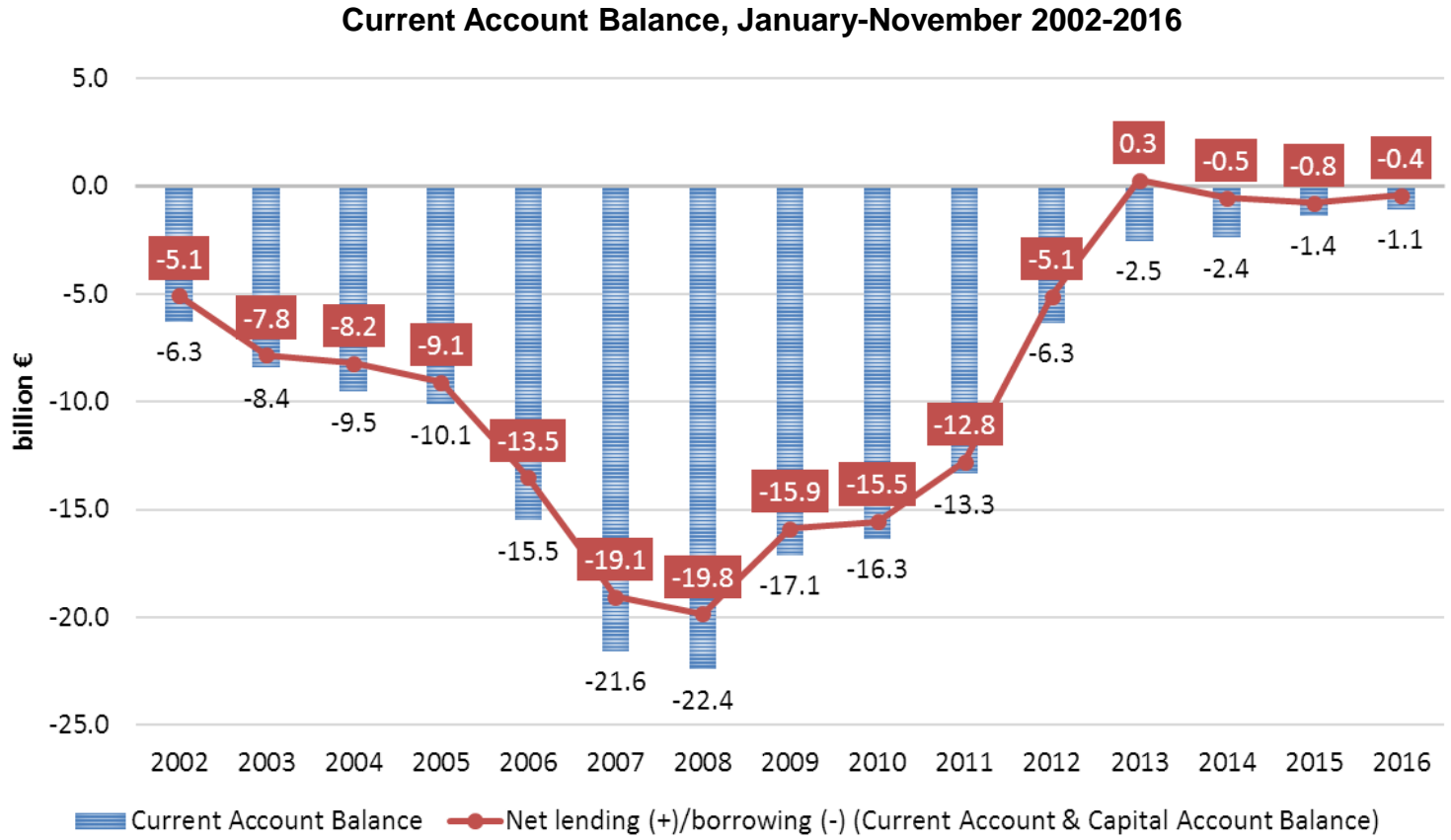
Transport – storage and Tourism sector significantly contribute to the increase of employment

Contribution to employment increase in Q3 '16



Source: ELSTAT

Small current account deficit during Jan.-Nov. 2016...



Source: BoG

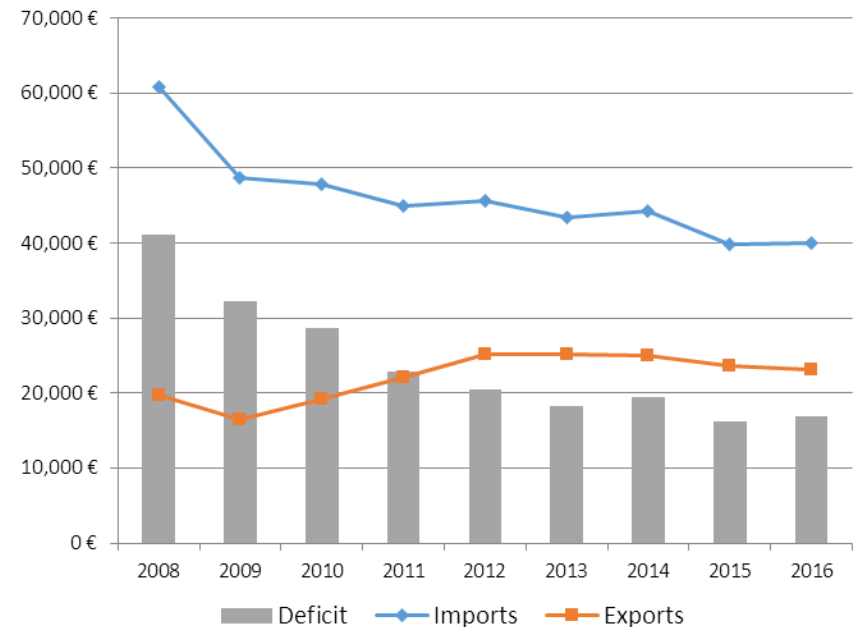
...and a significant reduction in the surplus of the balance of service (-€1.8 bn), contrary to the improvement of the balance of goods

Increase in the trade balance deficit by 3.4% in the period Jan. – Nov. 2016

January - November 2016:

- **Exports:** -1.9% (€22.9 bn, including fuel)
 - **+1.9% (€16.85 bn excluding fuel-shipment)**
- **Imports:** +0.2% (€39.1 bn)
- **Trade deficit:** +3.4%
- **Strong decline:** «fuels» (-12%), «commodities and transactions not classified» (-11.7%)
- **Increase:** «Agricultural Products»(9.3%). «Industrial goods» (0.3%)

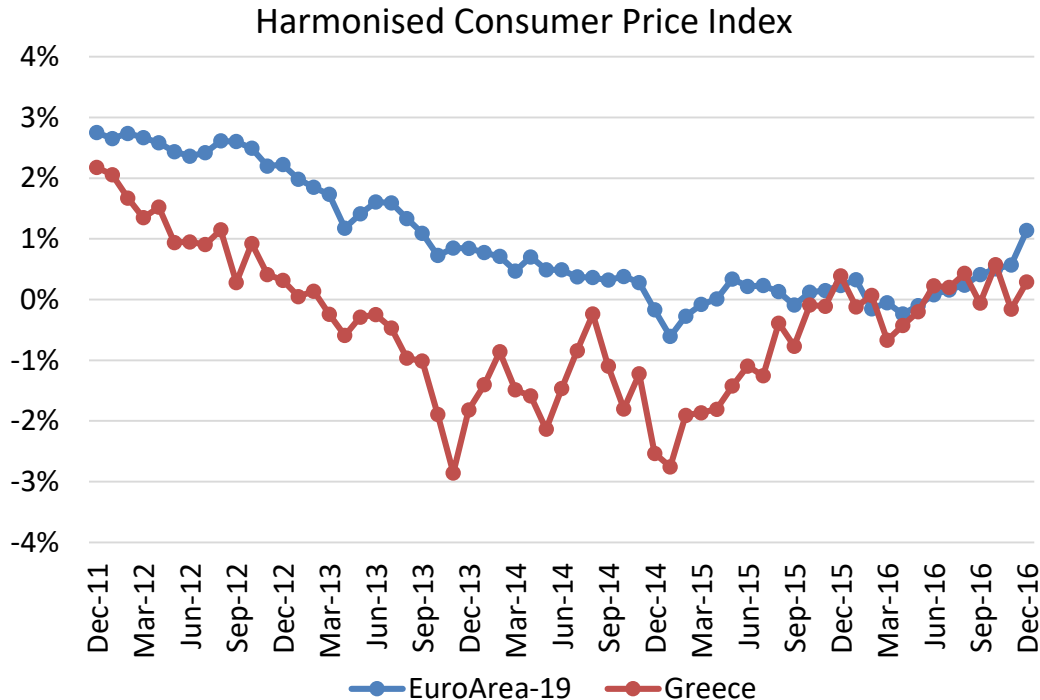
Value of Greek exports and imports, Jan.-Nov. 2008-2016



Markets:

- **Losses:** Turkey (26%), Italy (1.8%), United Kingdom (1.8%), Bulgaria (2.4%), Russia (0.4%), USA (6.1), Tunisia (37.5%), Egypt (26.3%),
- **Increase:** E.A.(3.6%), EU-28 (3.4%), France (9.1%), Netherlands (23.3%), Portugal (10.4%), Germany (4.1%), Poland (20.3%), China (48.1%)

Completion of the “deflationary cycle”?



- CPI: -0.8% against -1.7% in 2015
- Intense deflation de-escalation in Q4 '16
- Major price oil increase since October

- Increase of the total Producer Price Index (internal and external market) in 2016 by 6.7% (against -7.2% in 2015).

Medium-term developments

Factors defining current developments – perspectives: Second Evaluation – short-term debt relief measures

- For one more time, **prolonged process** → almost constantly under evaluation - uncertainty → Underestimation of the implications (small improvement of expectations / small return of deposits/ stagnant investment attractiveness)
- Most important implication: delay of the possible entry to the ECB quantitative easing program (Q-E)
 - The best opportunity to improve capital adequacy – liquidity of banks
 - Strong indication of fiscal sustainability – banking sector credibility
 - Improvement of confidence → return of deposits, foreign capital inflows → ease - lifting of capital controls, stimulation investment

Medium-term developments

The banking system is in a turning point

- Prolonged change of boards of directors
- Small return of deposits
- Delay in the settlement of NPL's (also due to pending changes in the regulatory framework)
- Pending inclusion in the Q-E

- Stagnant bank credit policy – small investment funding
- Uncertainty in view of the next stress test (2018)

Awaiting for reforms – stabilisation of business environment

- Except from decisions about macroeconomic issues (public debt, Q-E), investors are interested in the quality of the business environment
- Significant reform in the labour market under negotiation, especially for new investment
- Excess Charges – Concerns about high volatility due to successive changes in taxation and social security system

Medium-term developments

Continuation – escalation of the effects from fiscal measures

- Further pressure mainly on persons providing professional services – farmers
 - Prolonged ambiguity over final regulatory changes, rearrangements (e.g. change of company legal status) → economic activity fall, less tax revenue
- Decline of real disposable income from the increase of tax rates – imposition of new ones

Other Public sector effects

- Public Investment Programme unchanged
- Beginning of investments in completed privatisations
- Contribution of employment programs in community services to the temporary reduction of the unemployment rate

Medium-term developments

Continuation – escalation of the positive effects from the international environment

- New increase of exports of goods (excl. fuels) in 2017
- Continuation of geopolitical tensions in the Southeast Mediterranean → positive impact on the Tourism sector
- Low euro / dollar exchange rate
- Positive prospects for Transports (operation of a new pier in Piraeus)

Factors of economic uncertainty globally

- Increasing trend of the oil price
- Policy priorities (fiscal – trade) of the new administration in the U.S.
- Brexit
- Immigrants inflows – Rise of national protectionism
- Elections in the Euro Area countries

2016 Forecasts

New increase of the GDP in Q4'16, mild compared to Q3

- Increase of private consumption: +1.0% in 2016
- Small reduction of public consumption: -0.5%
- Higher investment: +7.0% in 2016
- Exports: -0.7%
- Higher growth of imports: +2.5 - 3.0%

**Growth in
2016:
+0.4%**

Unemployment: 23.4% in 2016

2017 Forecasts

- **Private consumption rise (≈ 1.5 to 1.7%)**, as a result of declining unemployment in sectors of tradable goods - services (Manufacturing, Tourism)
 - Limiting effects of the fiscal measures agreed during the first evaluation, including those implemented after 1/1/2017, along with potential new ones (special public sector payrolls)
- **Mild increase of public consumption**
- Continuation of fiscal adjustment in 2017 mainly through higher tax revenue (Budget 2017), not from expenditure cuts
- **“Reheating” of investment ($\approx 12\%$)**
 - New increase of economic activity in sectors of tradables, such as Manufacturing and Tourism
 - Capital support of banks (pre-condition: Greece enters the Q-E)
 - Start of investment in completed privatisations - concessions

On the other hand:

- Deterring effects from higher corporate taxation, changes in direct taxation- insurance contributions of persons working in professional services
- Pending settlement of corporate NPL's

2017 Forecasts

External sector

Exports increase (5.5-6.0%) from:

- «base effect» due to capital controls
- low euro/dollar exchange rate
- Higher tourism receipts
- Growth of the Transport services sector

Stronger demand from imports (7.5-8%), due to increased domestic demand, easing of capital controls in July '16

- Limiting factors: Oil price and exchange rate increases

Recovery prospects in 2017, by 1.5-1.8%

2017 Forecasts

Further, yet slower unemployment fall

- Employment expansion in **Tourism – Manufacturing**
- Stimulating effects of structural changes in the labour market
- Continuation – intensification of the boost to employment by the **Public Sector**, mainly through temporary employment programs
- Pressure from new measures since 01/01/2017 on private consumption (direct – indirect taxation etc.), as well as on employment in **Retail Trade**

Unemployment rate fall by almost 1 percentage unit in 2017 (22.3%)

- Change of trend in prices after 4 years of deflation, because of oil price increase, higher indirect taxation and imposition of new taxes.

Inflation rate in 2017: 1.3%

Recent IOBE studies

(1) The economic impact of the increase in excise duties on fuels in Greece, October 2016

(2) The impact from the planned increase in the excise duty on tobacco products, November 2016

Objective of the studies

Background:

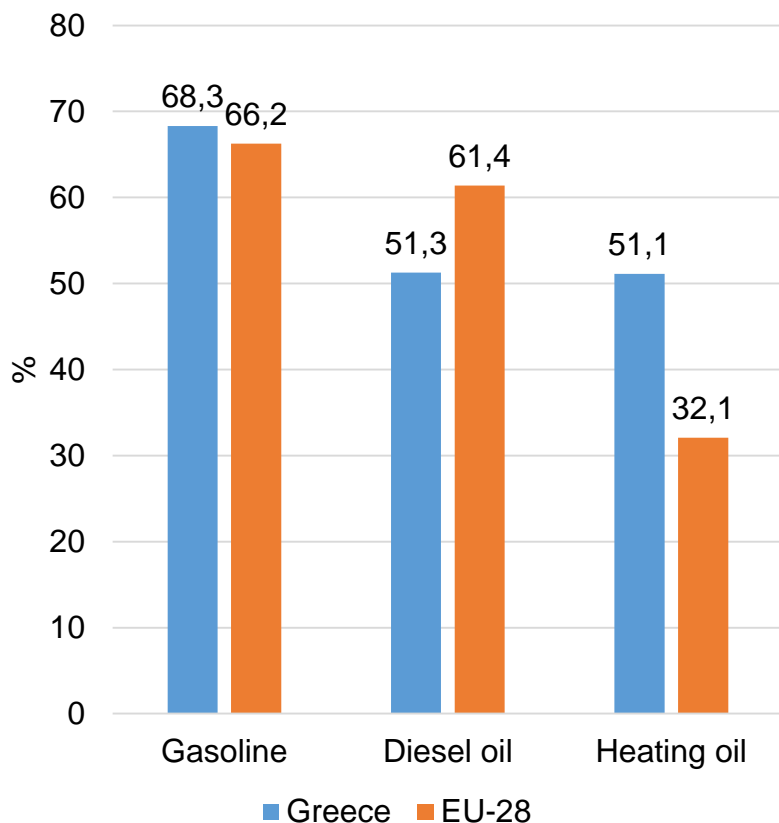
A large part of the estimated rise in tax revenue in 2017 is projected to come from an increase in the taxation of **fuel** and **tobacco products** (law No. 4389/2016)

Objective:

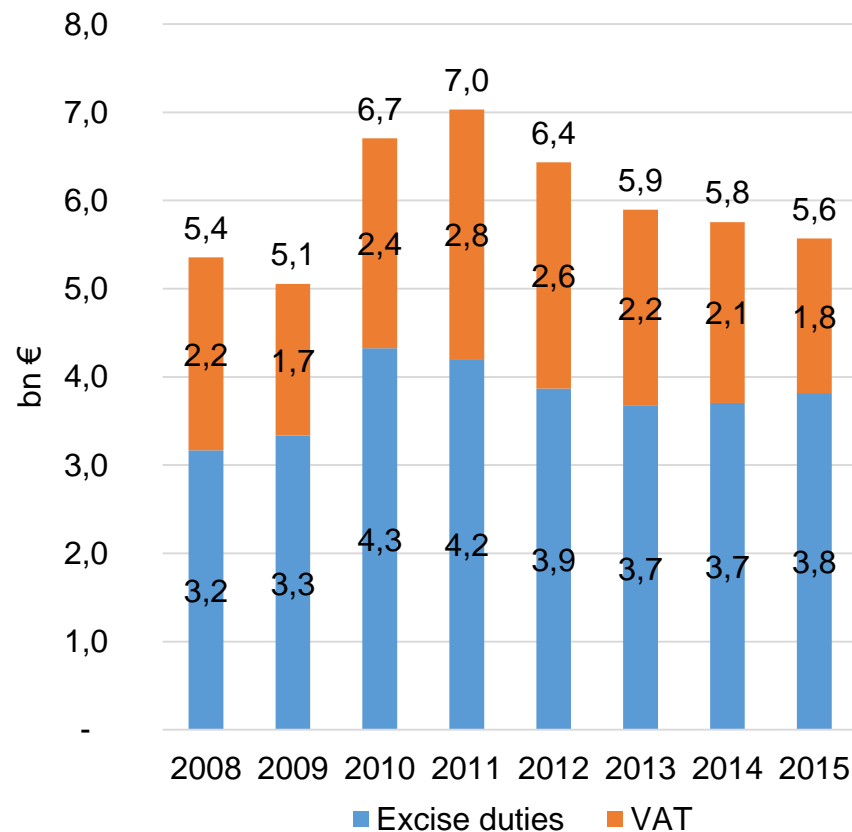
What is the **financial impact** from the increase in the excise duties imposed on these products and how realistic are the relevant **targets for additional revenues**

Fuel taxation in Greece is one of the highest in the EU, while revenue from taxes on fuel products are a significant proportion of the total tax revenue (11.8% in 2016)

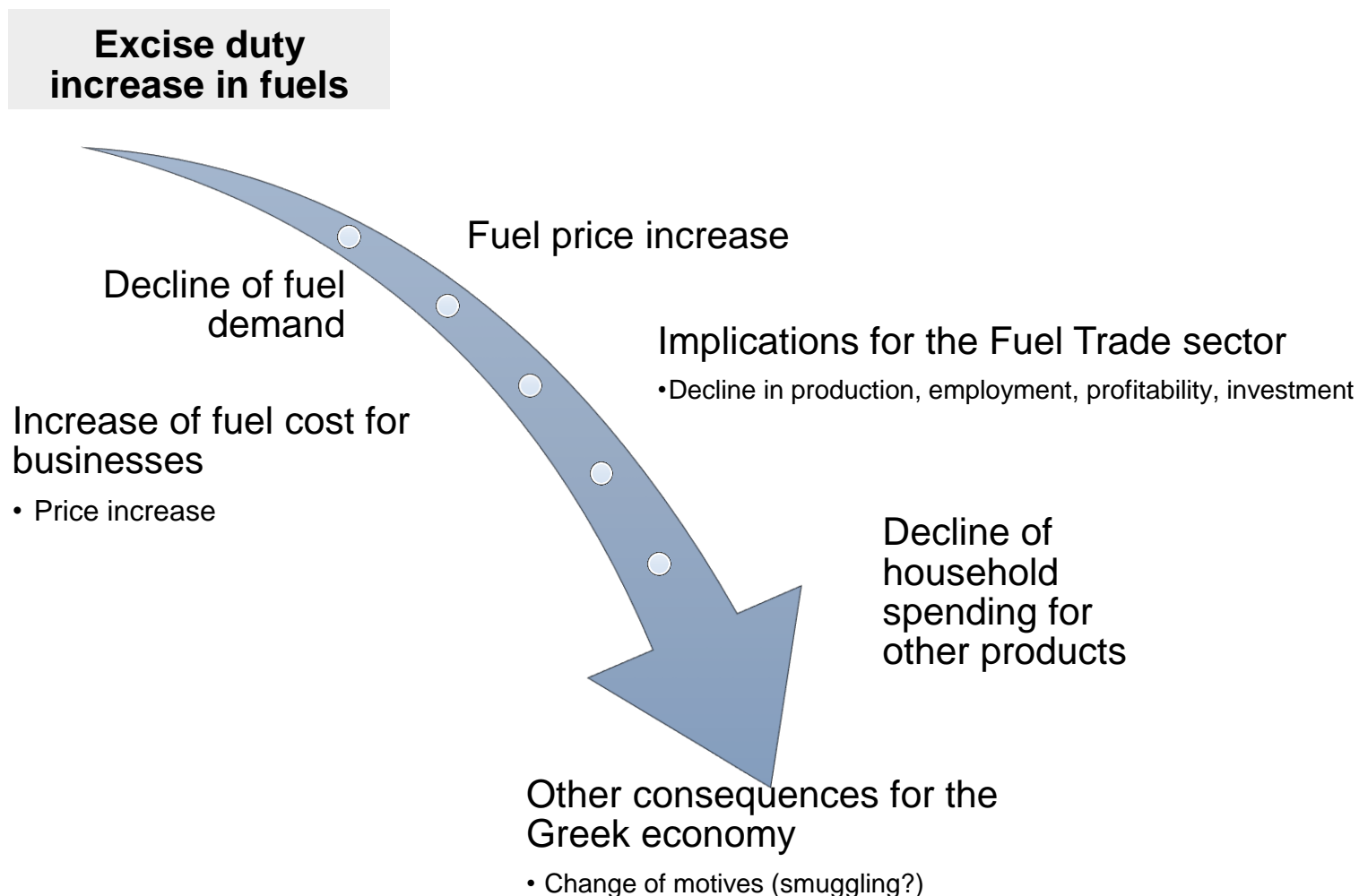
Share of taxes on retail prices (avg. Jan.-Aug. 2016)



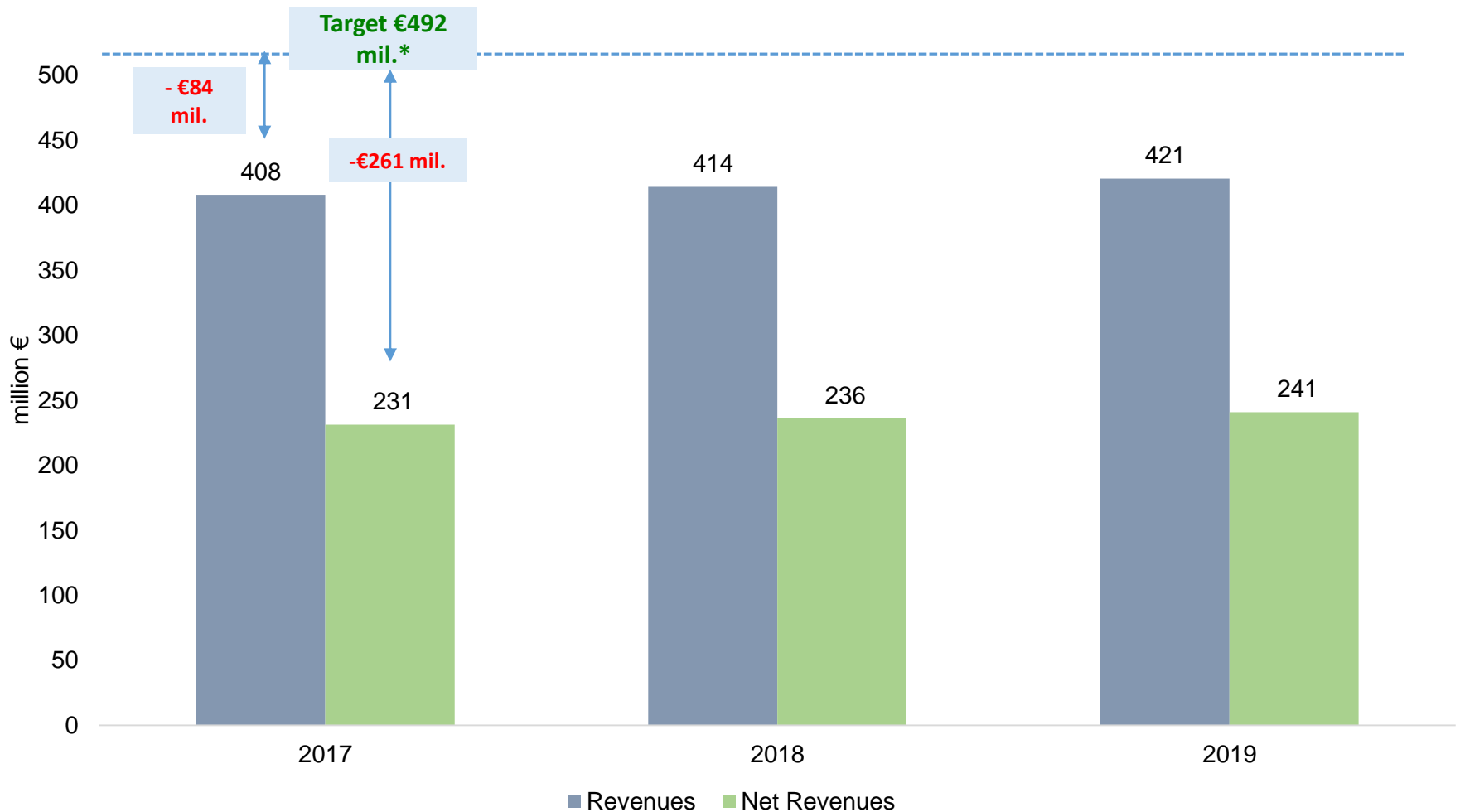
Tax revenues from oil products



The recent increase in the excise duty in fuels, targeting to an increase of State revenue, has a range of implications for the Greek economy

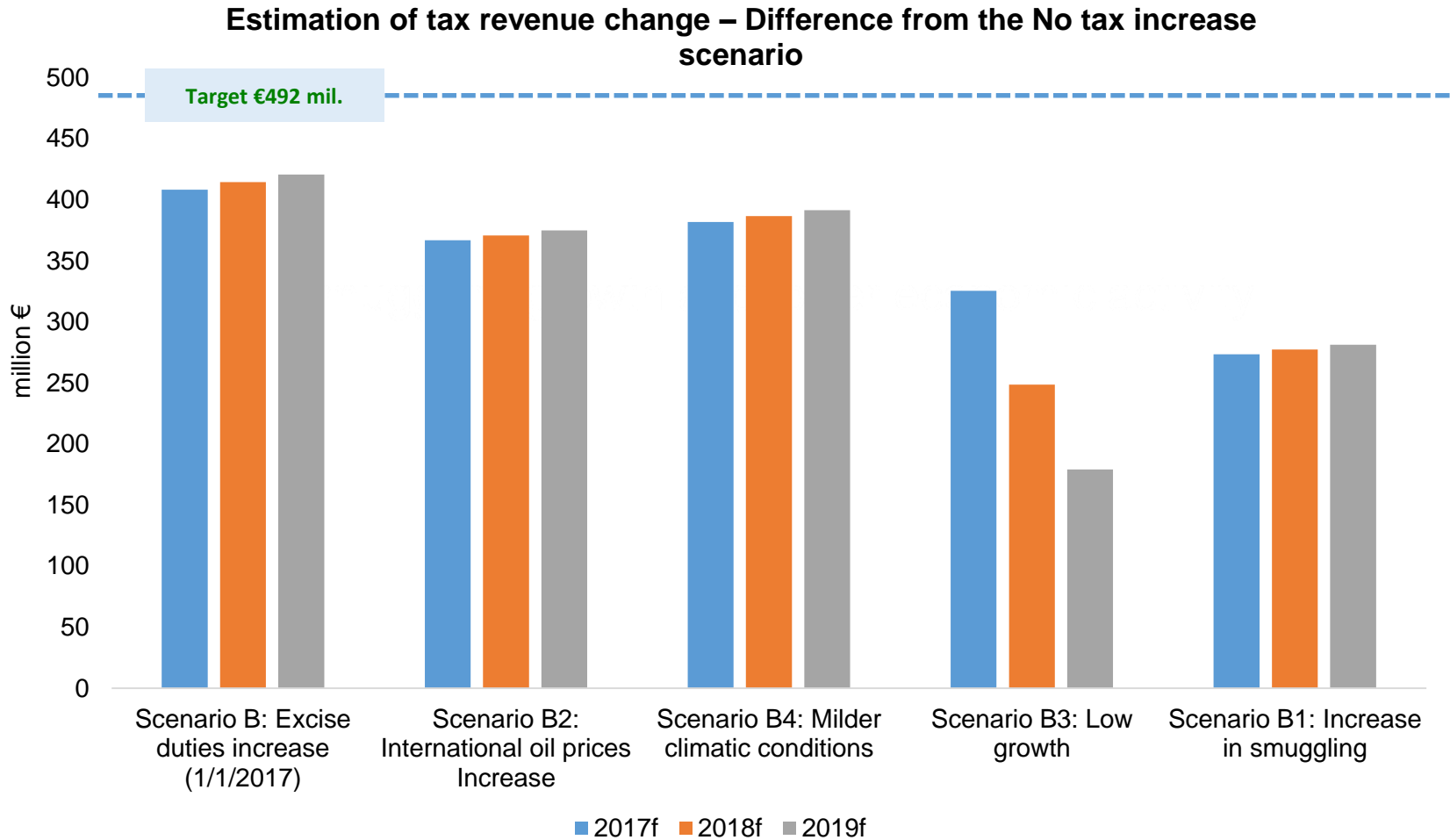


If losses in taxes and contributions from the decline in economic activity and the increase in unemployment are taken into account, the fiscal outcome may significantly fall short of the relevant target



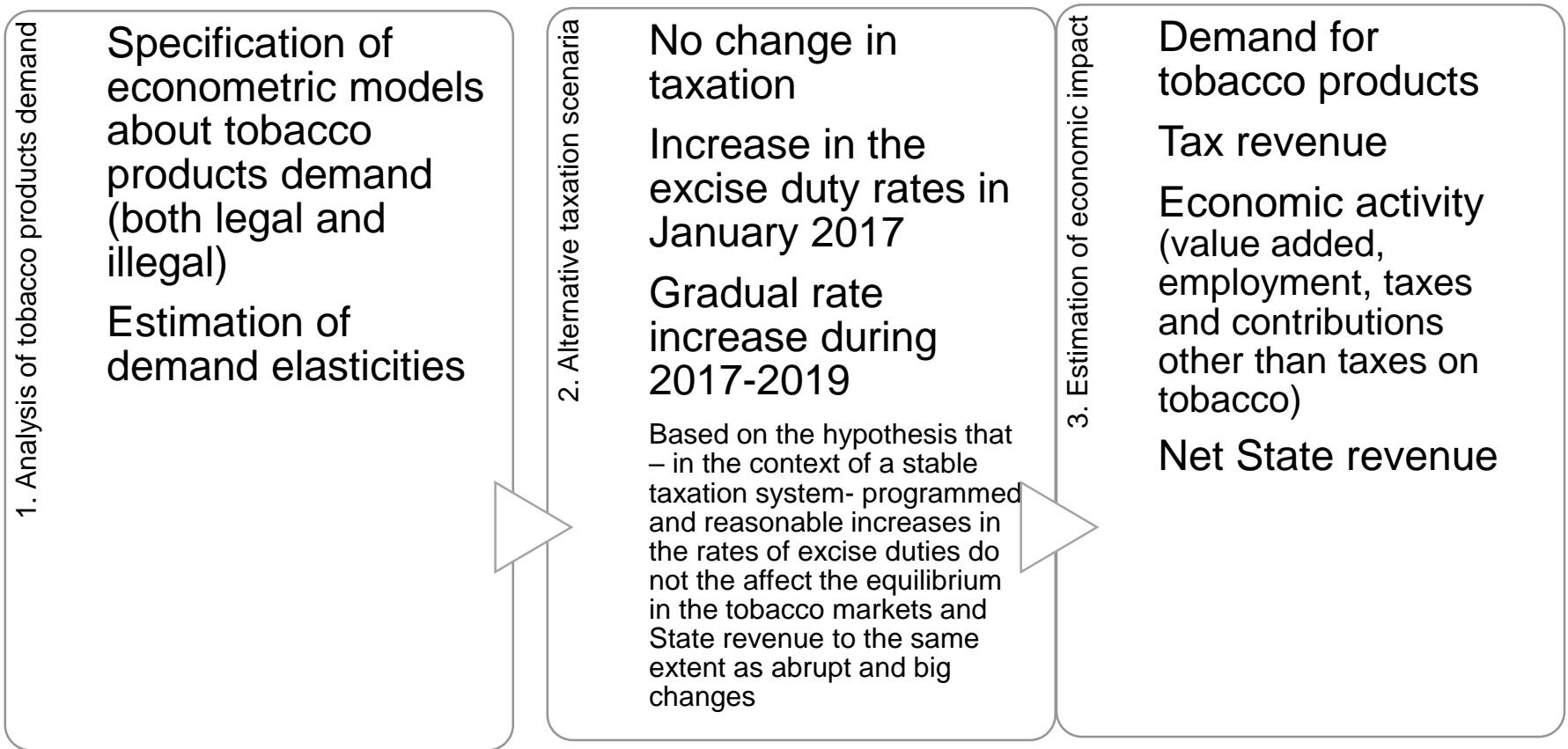
Source: IOBE analysis. **Note:** Revenue for 2017 are probably overestimated, as a high stock building is expected to take place in December 2016, which will lead to less revenue in 2017. It is also noted that VAT revenue significantly depend on the price level.
*Report on the evaluation of consequences of Law No 4389/2016.

Excluding further State revenue losses, smuggling growth and lower economic activity are the main threats for revenue

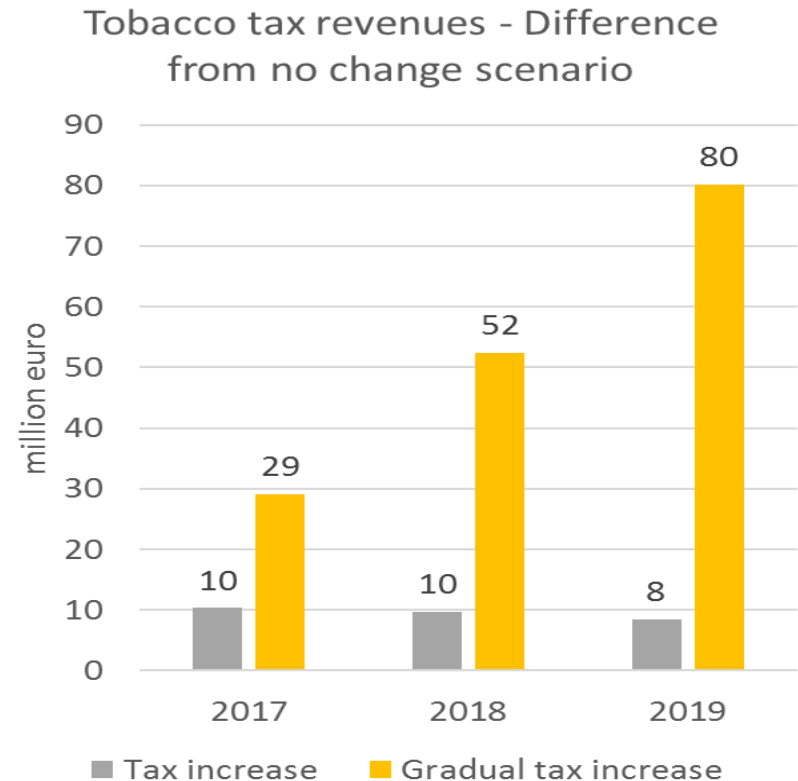
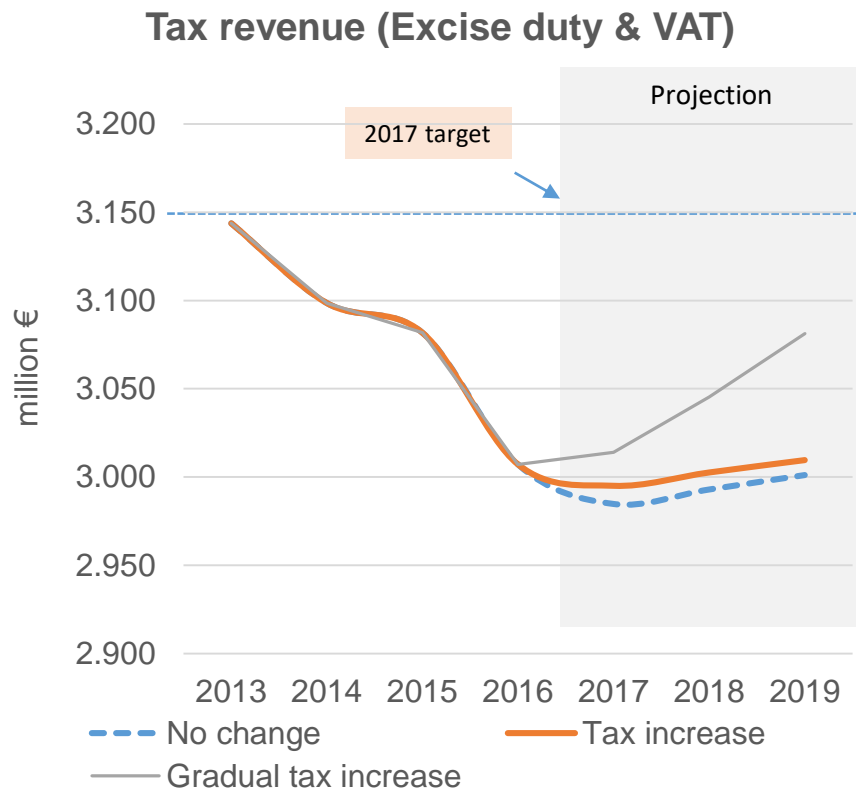


Source: IOBE analysis

In the case of tobacco products, the analysis and the estimation of the economic impact was carried out through a three-step procedure



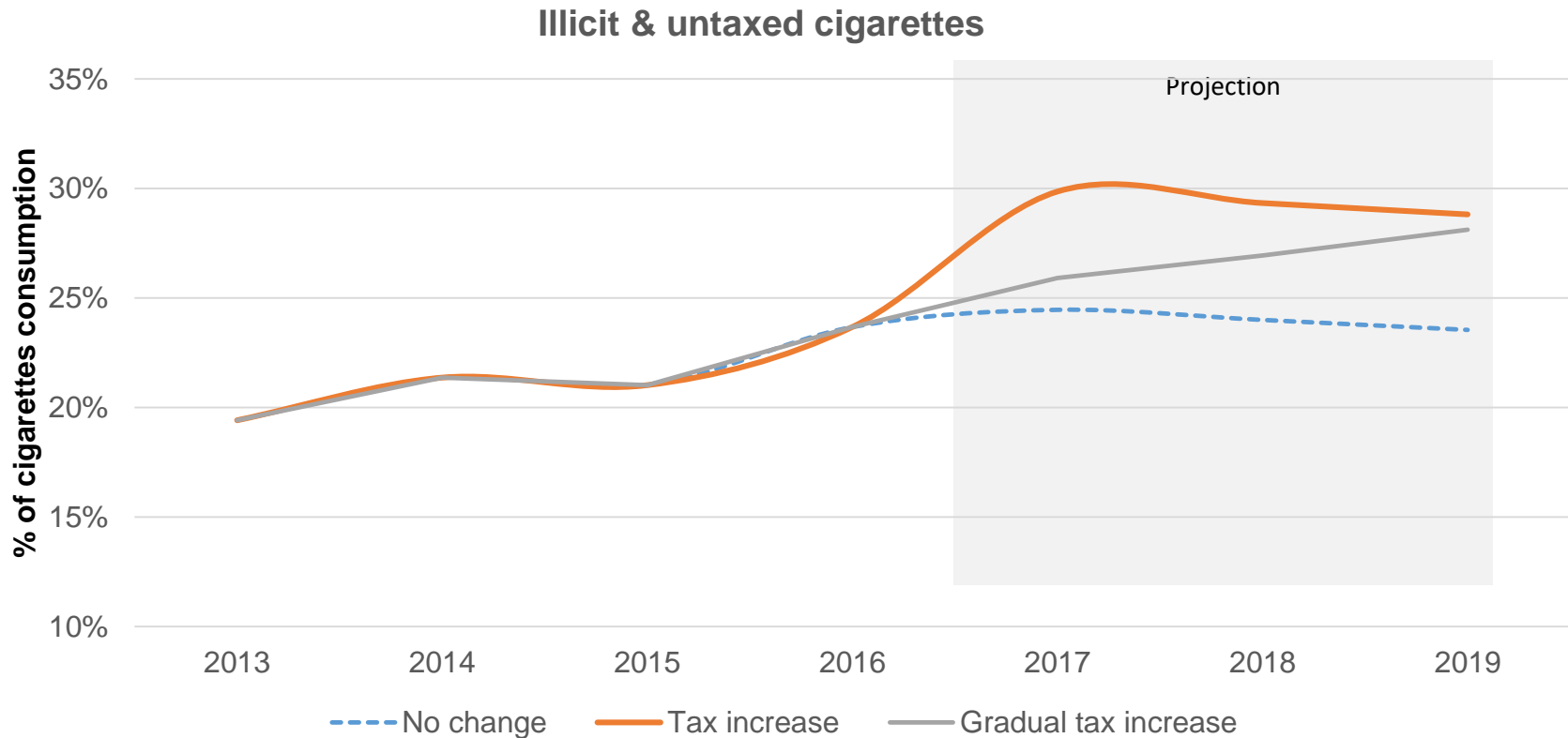
Estimated tax revenue from tobacco products are approximately €100 mil. less than the relevant Budget target*



Estimated greater revenue increase through a gradual increase of the excise duty tax rates on tobacco (but the Budget target is not achievable)

Source: IOBE analysis. *Revenue estimations are based on projections about the evolution of demand. Possible stock building of products due to tax increases, which will change the revenue profile by reducing revenues in the first year of implementation of the new taxation, is not taken into account.

The increase in tax rates is expected to increase smuggling* – The penetration of illegal cigarettes will significantly increase, by more than 5 percentage points (to 30% of total cigarette consumption)



A gradual increase in the excise duty rates on tobacco products is expected to mitigate the increase in cigarettes smuggling

Conclusions

- For both categories of products, targets for higher revenue in 2017 are extremely optimistic and hard to achieve.
- If the additional negative implications of the downturn in economic activity due to the increase in taxation are taken into account, the negative impact on revenue becomes bigger.
- One of the main factors leading to these estimations is smuggling, which is widespread in these categories of products and reduces the possibility of further increasing revenue after the increase of the tax rates.

Thank you!

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