

Quarterly Report on the Greek Economy

04 / 19

February 5th, 2020



ΙΔΡΥΜΑ ΟΙΚΟΝΟΜΙΚΩΝ & ΒΙΟΜΗΧΑΝΙΚΩΝ ΕΡΕΥΝΩΝ

Report Overview





Global environment:

Growth slowdown last year, acceleration in 2020

- **Global growth estimates of 2.9% y/y** in 2019, after a 3.6% growth rate in 2018. Mild acceleration to 3.3% in 2020
 - **Negative effects** from continued uncertainty about trade policy, manufacturing downturn, geopolitical tensions, deceleration (China, India) or recession (Turkey, Argentina) in developing economies
- **2019 Q3: Stabilization of growth rates**, in contrast to the previous quarter, **indications of easing pressures on economic activity**
- 1.6% in OECD countries, same as in Q2 2019, from 2.2% in Q3 2017
 - Stagnation of foci of uncertainty, return to supportive monetary policy, indications of easing pressures on manufacturing



Global environment: Mid-term challenges

Globally

- 1st Phase of **US-China trade agreement**, duties in force until the 2nd phase of the agreement, with a partial lift from China
- **Geopolitical tensions** in Middle East and the Mediterranean
- Consequences of China's economic policy on **private debt**
- **Prolonged instability** in Turkey and Argentina

Europe

- **Brexit**: agreement on exiting the EU reached, reduced risk for a break in relations, but implementation remains a challenge
- **Gradual adaptation** of the manufacturing sector to structural changes
- **Supportive ECB monetary policy** (prolongation of low rates – Q-E restart)
- **Relations with Turkey**, dealing with migration flows



Greece: Growth slowdown in 2019 Q3

2019 Q3: **+2.3%**, compared to +2.8% in 2019 Q2 (after revision from 1.9%) and 2.0% in 2018 Q3

Jan-Sept '19: GDP growth 2.2%, versus +2.0% in 2018

Most important changes in GDP components:

- Exports expansion by 6.6%, milder than a year ago (+8.1%)
 - $\frac{3}{4}$ of increase due to more services exports (+10.8%, faster than two years ago), with higher revenues from tourism and international transports. Increase of goods exports by 3.3% (compared to +8.5% a year ago)
 - Smaller increase of imports (+3.3%, same as in 2018), mainly because of more services imports (+5.9%). Goods imports: +2.7%
- Increase of consumption spending due to the election cycle, marginal increase of private consumption
 - Expansion of public consumption by 2.9% (versus -1.2% a year ago), exclusively from Q2 (+9.4%). Marginal increase of private consumption (+0.2%), versus a 0.3% decline in 2018.
- Investment growth of 3.0%, versus a marginal increase of 0.7% in 9M 2018
 - Almost entirely from increase in inventories (69.7%). Fixed Capital Formation +1.0% (versus -6.2% two years ago)



Achievement of State Budget cash targets in 2019

- **Outcome Jan. – Aug. 2019: deficit of €168 million**, versus a target of €839 million and a €4.58 billion deficit two years ago
- **Primary surplus of €5.02 billion**, compared to a target of €4.4 billion and a €91 million surplus in 2018
- **Target achievement mainly by less expenditure:**
 - Under-implementation of the Public Investment Program by €508 million
 - *Payments of €5.64 billion, the lowest since at least 2000*
- **Revenue targets exceeded due to:**
 - Other current revenues, by €447 million
 - Other taxes on specific services, by €87 million

...and a fall behind in revenues from transfers (-€348 million), mainly due to less transfers from EU funds



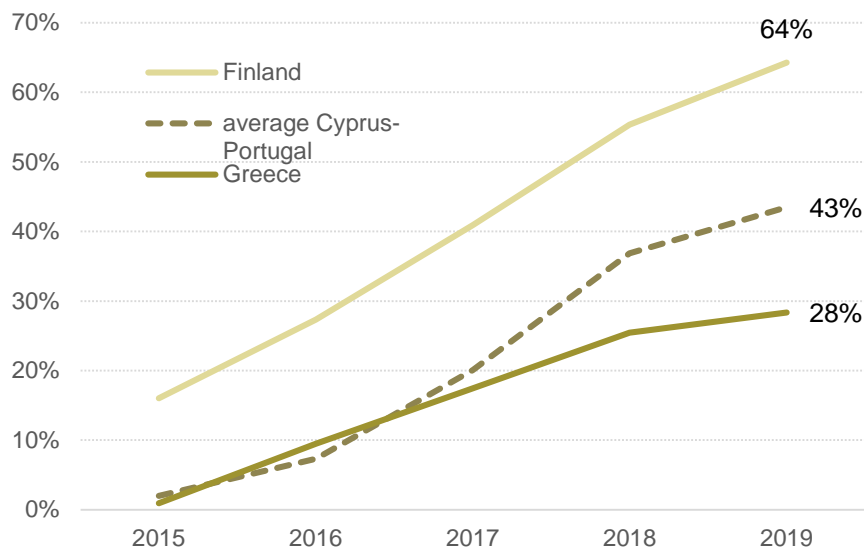
2020 State Budget

- **State Budget Balance 2020: deficit target of €2.45 billion (ESA approach), against €2.2 billion last year**
- **Primary balance: surplus target of €3.55 billion or 1.8% of GDP (ESA approach), against €4.37 billion in 2019**
- Marginal worsening of balance due to higher expenditure (+€772 million) from:
 - More expenditure on Public Investment Program (+€600 million), Other (except for PIP) allocated appropriations (+€1.0 billion) and Employee compensations (+€390 million), mainly for social security contributions
- Increase of net revenues (+€448 million) due to:
 - Higher personal income taxation revenues (+€323 million), more sales of fixed assets (+€306 million), higher excise taxes increase (+€88 million)

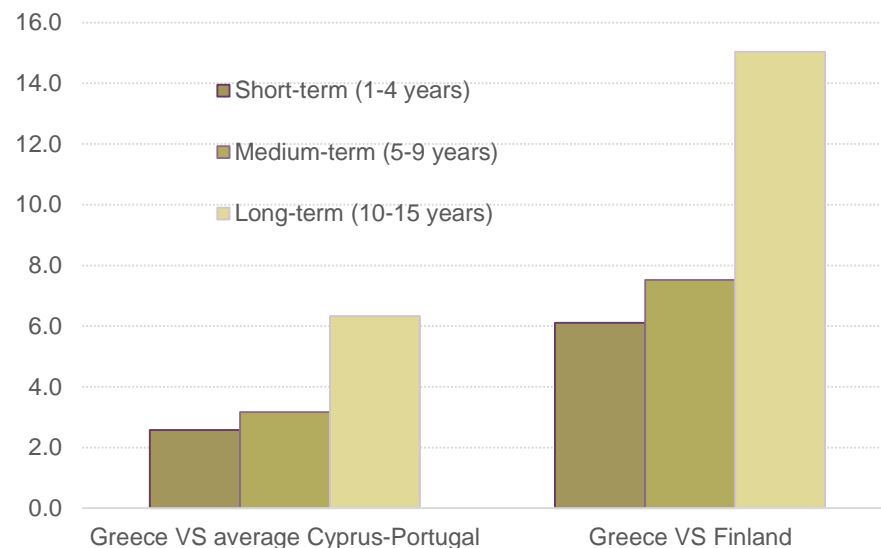


Under-implementation of EU co-financed projects & opportunity cost in terms of GDP (study in progress)

Cumulative EU co-funded investment implementation (% of total budget 2014 -2020)



Estimated average GDP loss in Greece, based on implementation divergence from other countries (€ billion)



Source: European Commission, Data processing: IOBE

- During years 2015-2019, Greece is consistently lagging behind in the implementation of co-funded investments (based on the % of expenditure to total budget for the Programming Period 2014-2020):
 - €790 million less per year compared to Eurozone countries with same characteristics (Cyprus, Portugal), €1.88 billion less compared to the pioneering Finland
- Faster implementation each year, converging to rates of the Eurozone “south”, would result in higher increase of GDP by €0.5 billion in the short-term (1-4 years) and €1.3 billion in the long-term (10-15 years). For period 2015-2019, total short-term GDP increase of €2.6 billion, long-term of €6.3 billion.



Trends in economic indicators

Industry

- Stagnation of industrial production during Jan.-Nov. 2019 (+0.1%) versus a 1.6% increase of in 2018
- At the same period, fall of PIM in Eurozone: -1.5% versus +1.3% a year ago

Construction

- Slowdown of the decline in Construction. Losses of 3.9% compared to a fall of 15,0% two years ago
- Increase in Building Construction but decrease in Civil Engineering

Tourism

- Slowdown of receipts increase during Jan.-Sept., mainly due to low first quarter

Retail Trade

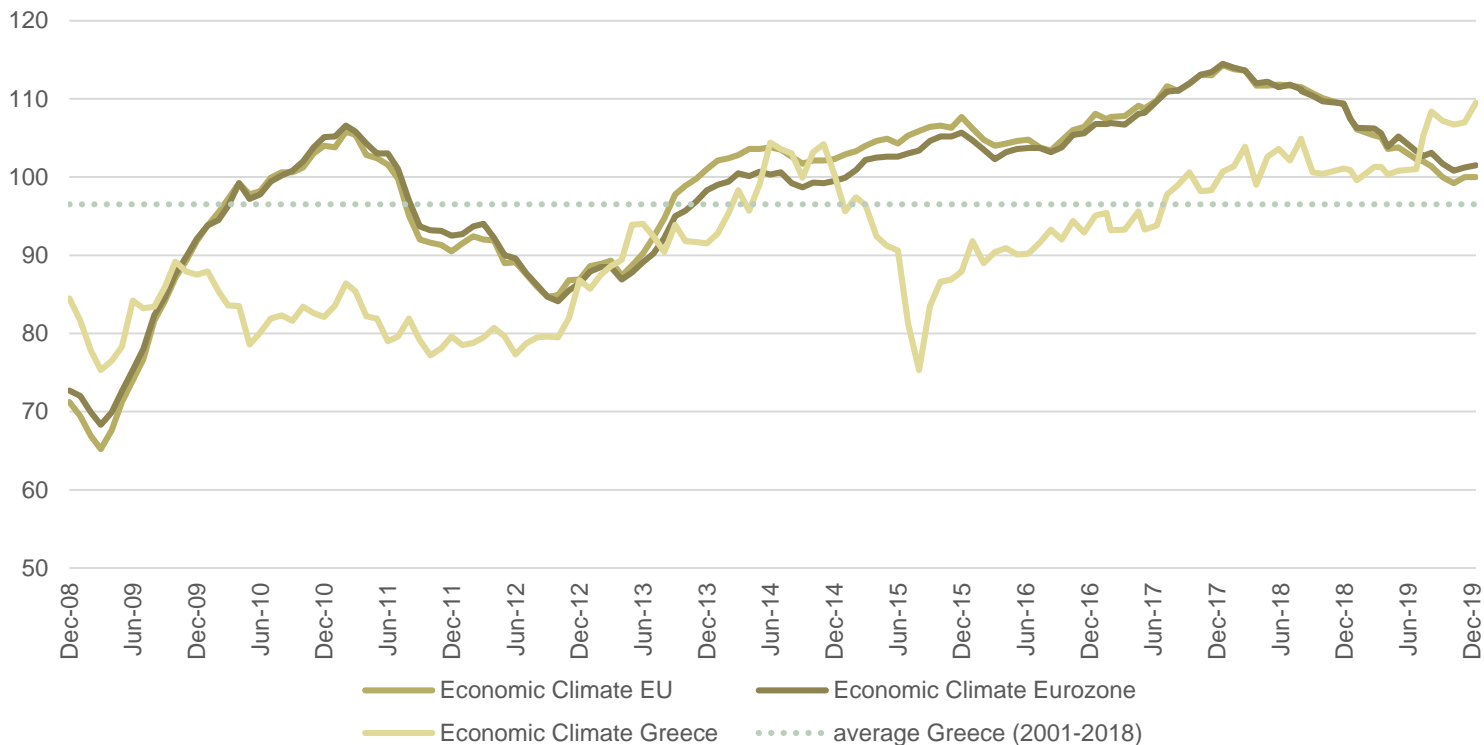
- Increase of the volume of Retail Trade by 0.8% during Jan.-Oct. 2019, versus a 1.4% growth in 2018



Slight increase of the Economic Climate Index in Q4 compared to the previous one, but at the maximum level since 2007 Q4



Economic Climate Index

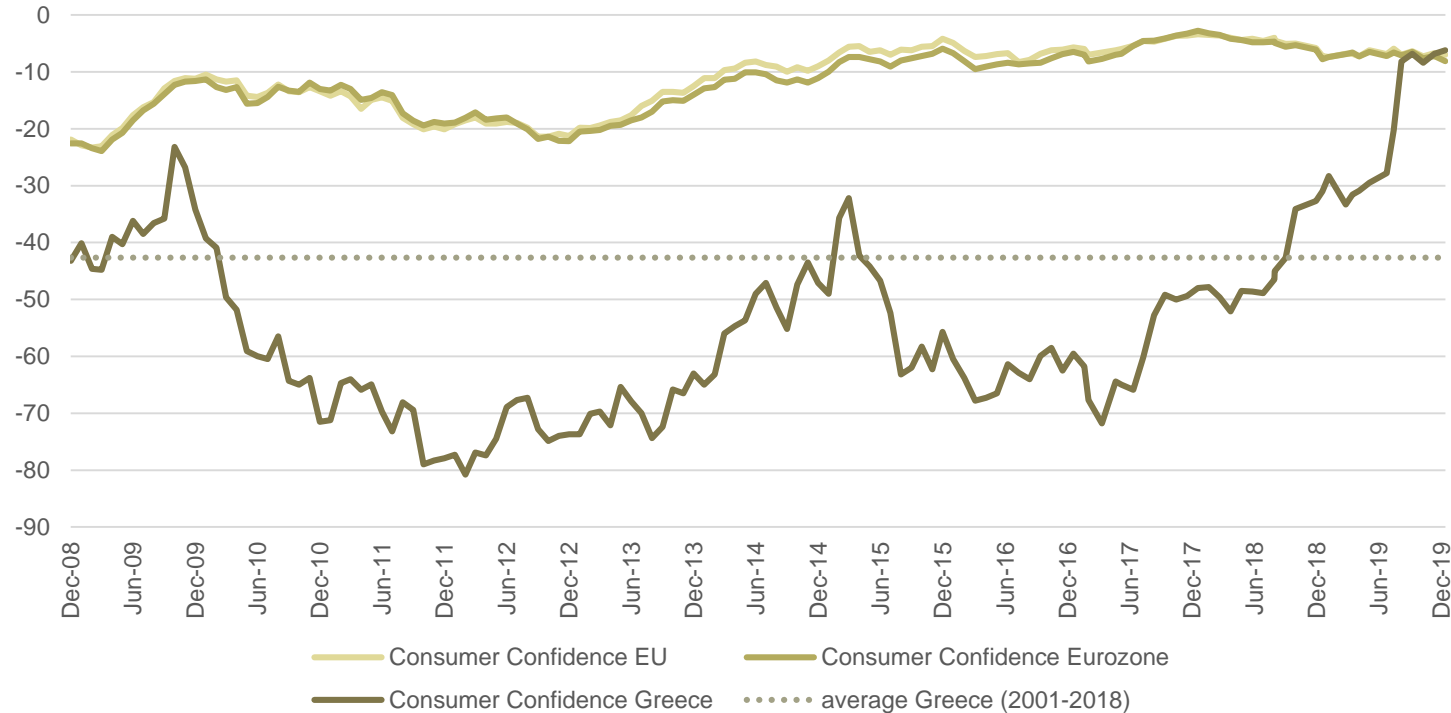


Sources: IOBE, European Commission



Slight recovery of Consumer Confidence in 2019 Q4 compared to Q3. At maximum level since 2002 Q1.

Consumer Confidence

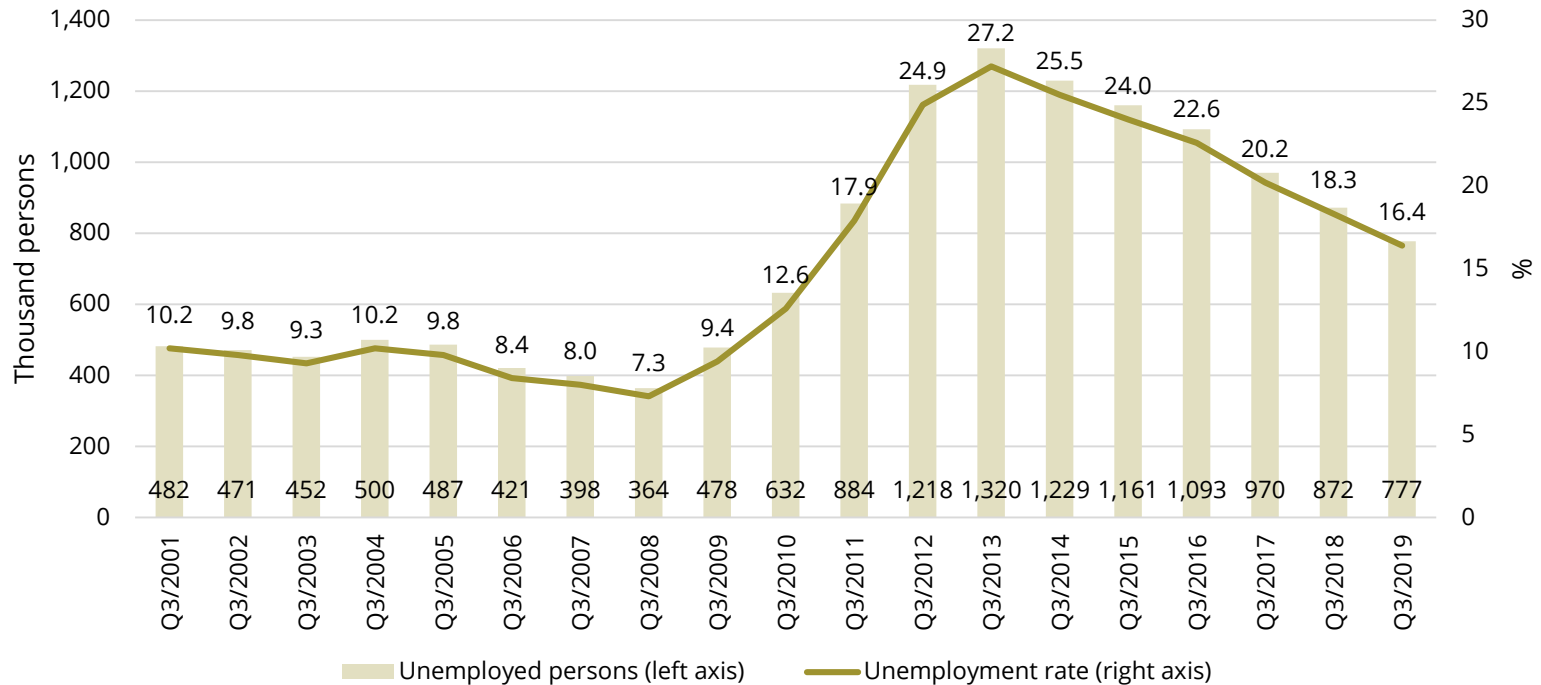


Sources: IOBE, European Commission



Unemployment continues falling

Number of unemployed persons and unemployment rate in Greece



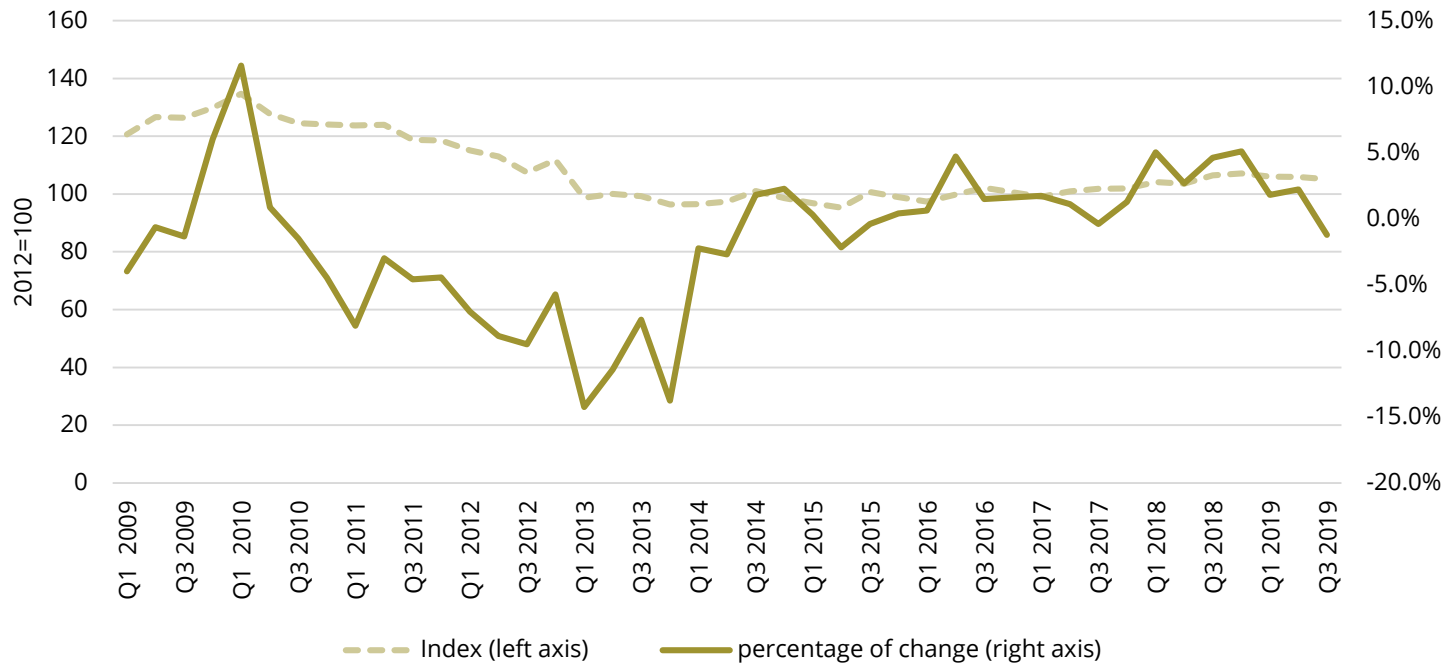
Source: ELSTAT

- Unemployment rate of 16.4 in 2019 Q3, against 18.3% in 2018 Q3
- Increase of employment in 14 sectors. Indicatively: Transportation-Storage (+24.4 thousand), Manufacturing (+22.9 thousand), Tourism (+18.1 thousand), Education (+14.4 thousand).
- Employment fall in 7 sectors. Indicatively: Primary Sector (-24.9 thousand), Wholesale-Retail Trade (-7.6 thousand), Construction (-3.7 thousand), Financial-Insurance services (-2.0 thousand).



Minor fluctuations in the wage cost index in the three recent quarters

Wage cost index, seasonally adjusted



Source: ELSTAT

➤ Index fall by 1.2% in 2019 Q3 compared to 2018 Q3



Wage trends in 2019 and the effects of determining factors

Κλάδος δραστηριότητας	Jan-Sept. 2018 (th.)	Jan-Sept. 2019 (th.)	Absolute change (th.)	Sector trend	Wage compression index
Tourism	251.3	276.1	24.8	↑	69.4%
Education	272.1	291.1	18.9	-	49.9%
Manufacturing	283.7	301.2	17.5	↑	51.1%
Transportation-Storage	126.3	142.9	16.5	↑	35.0%
Wholesale-Retail Trade	426.0	439.7	13.7	↓	59.8%
Public administration-Defense	333.0	344.4	11.4	↓	40.0%
Other services	52.0	51.5	-0.5	-	64.7%
Arts, entertainment and recreation	41.3	40.5	-0.8	↑	53.7%
Electricity-Natural Gas	30.1	28.3	-1.9	↓	27.6%
Financial-Insurance services	76.6	73.4	-3.2	↓	33.1%

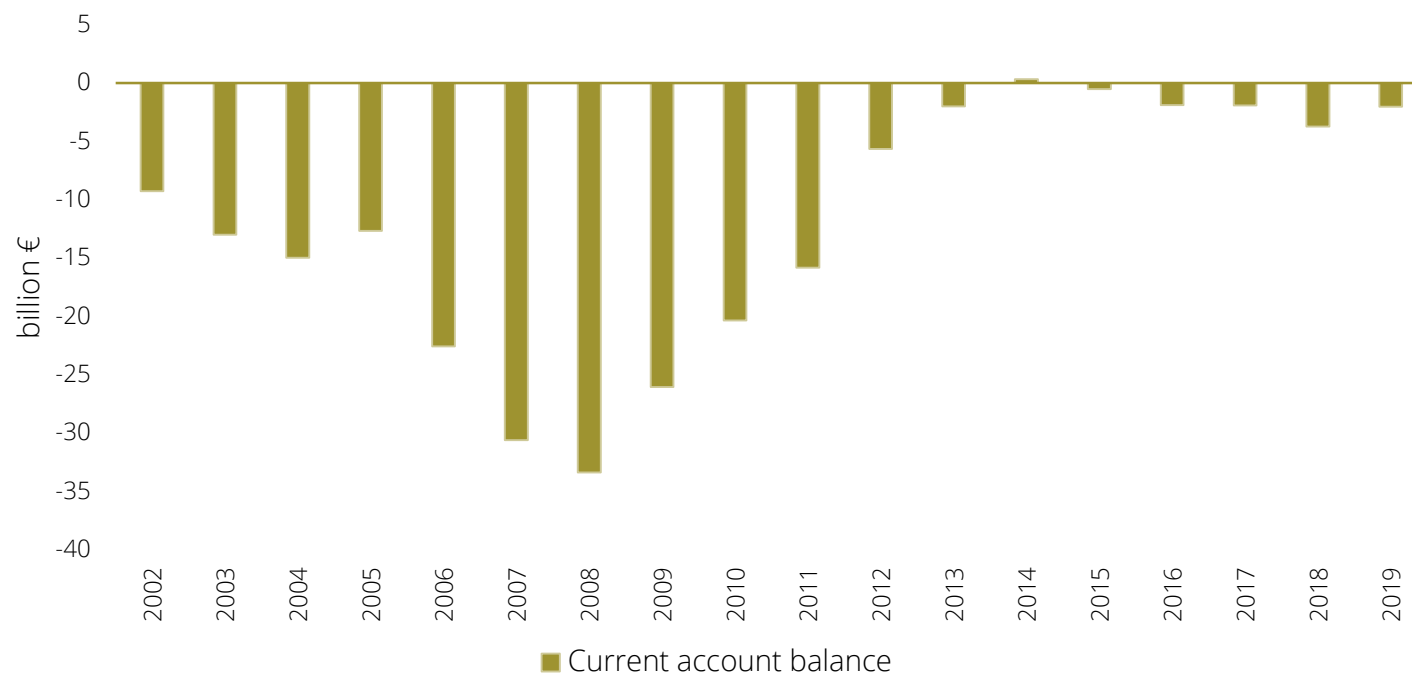
- Greek economy on a growth path for third year, mainly due to exports. Unemployment is also falling, but remains the highest in the EU.
- Changes in the labour market in 2019 (minimum wage increase, reduction in social security contributions).
- Significant job positions growth in 2019 in sectors with rising or stable activity (Tourism, Transportation-Storage, Wholesale-Retail Trade, Manufacturing) and vice versa
- The most exporting or with a rising extroversion sectors are those with the highest employment expansion
- Growth in both high wage-compression sectors (Tourism, Wholesale-Retail Trade) and low wage-compression sectors (eg. Transportation-Storage)

Sources: ELSTAT, ERGANI

- Employment restructuring towards sectors with increasing economic activity and exports
 - ❖ Indication of change in growth model
- Smaller but significant impact of wages compared to trends production - exports



Current account deficit narrows during Jan. – Nov. 2019

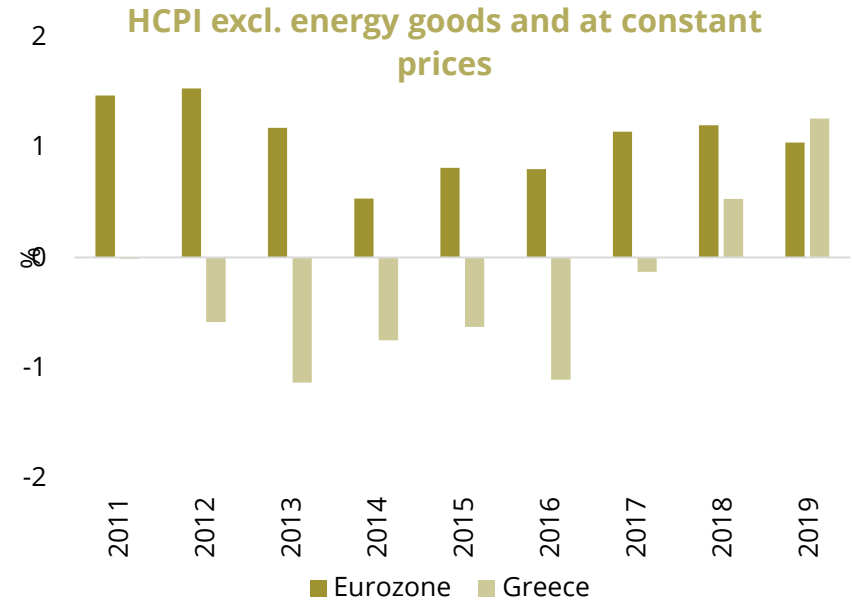


Source: Bank of Greece

- Current account deficit of €2.0 billion compared to €3.7 billion in 2018
- Significant surplus increase in the Services Balance, by €1.8 billion; 85% of the increase from tourism receipts
- Deficit increase in the Goods Balance, through marginal changes in exports and imports compared to two years ago



Mild price increases in 2019, due to domestic demand



Sources: ELSTAT, Eurostat

Eurozone: Milder inflation compared to 2018, from 1.7% to 1.2%

Greece: For third year in a row, positive rate of change in prices, 0.3% versus 0.6% in 2018

- Negative effect from indirect taxation (-0.8%) - Marginally negative effect of energy goods prices (-0.1%). Boost from domestic demand – other factors by 1.3%

Producer Price Index (Jan - Nov. 2019): Unchanged, versus 4.7% increase during the eleven-month period of 2018, because of Electricity, Gas and Electrical Equipment imports prices



Favourable conjuncture for the economy, at many levels

Factors improving the Economic Environment

Implementation of pre-election announcements → More private - public sector resources available, investment incentives, enhancement of confidence

Tax relief for businesses and individuals (Budget 2020)

Measures streamlining public expenditure – increasing tax revenues

New Investment Law

Expectations of businesses and households

Fall of the Greek State cost of borrowing at historically low levels

Sustainable borrowing terms from capital markets for banks - big businesses

Continuous credit expansion to businesses

Continuous return on deposits

Achieving NPL reduction goals

Continuation of trends in 2020, with the aid of the “Heracles” Program

Credit rating upgrade (Fitch)

Attracting foreign capital inflows

Further facilitation of access to capital markets

More upgrades coming soon

Gradually on track for Q-E?



Most important challenges in the following period

Implementation of the Investment Law: secondary legislation needs to be completed in order to avoid delays

Law for social security system: capitalization mechanism needed in the first pillar, more savings options (second & third pillar), capital market orientation and leverage

Implementation of the "Heracles" program

New Bankruptcy Code: changes to the legal protection for first residence, out-of-court debt settlement, with electronic means

Increase of absorption from EU funds

The very good economic climate is a good chance for reforms



Important opportunities, but also foci of uncertainty...

Developments in Turkey

Migration flows escalate, Impact of recession:
Greek exports decline, competitiveness boosted
by devaluation

Geopolitical tensions, internal conflicts in the
Southeast Mediterranean (Libya, Lebanon, Syria)

Consensual Brexit

Q-E reboot by the ECB (indirect positive effects
on Greece)



Estimations for 2019

Small increase of private consumption ($\approx +0.7\%$). Larger increase in Q4 from:

- Decrease of uncertainty after the elections period
- Improved expectations from post-election measures and tax relief measures in the Budget Draft
- Emergency transfers during 1st semester (retroactive payrolls, May 2019 retirement provision) and increase of minimum wage

Increase of public consumption, due to election cycle (+2.0%):

- Strong revision in Q2, +9.4% from +5.3% → cause of revision of 2019 growth rate

Small investment increase (+4-5%):

- Inertia in the pre-election period, but also after the elections, pending policy measures
- Improved expectations from tax reliefs in the Budget
- Continuous credit expansion
- Since September, activation of large companies in the capital markets
- But also weak public investment



Estimations for 2019

Strengthening of exports (6.0%)...

- Tourism above expectations in the summer (but deceleration in Q4), but also higher receipts from Transport
- Weakened products export growth towards Eurozone, significant drop in major destinations (Lebanon, Egypt, Turkey)

...together with milder increase of imports (4.0%)

- Due to small growth of domestic demand and a negative "base effect" on imports of goods in Q3.

New significant fall of unemployment, at 17.4%

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

Growth rate in 2019 close to 2.1%



Forecasts for 2020

Escalation of private consumption (+1.2-1.4%):

- Much improved expectations
- Higher incomes from budgetary and other expected measures, during 2020
- Increase in employment in exporting sectors, Construction, Public Sector

Small decline in public consumption (-0.5 to -1.0%):

- Structural changes in public finance management (overview of expenditure - revenues, performance budget), negative base effect from 2019 Q2

Significant increase of investment (+13-15%):

- Tax reliefs, increasing bank lending, launching of works in major privatization projects, boosting from exports

Increase of exports (5.5-6.0%): Mild escalation of demand from Eurozone and international trade, uncertainty for developments in Mediterranean countries - export destinations, Brexit implications

Acceleration of imports (6.5-7.0%): from higher investments in machinery, transport means, equipment and private consumption

New unemployment fall (15.5%) and rising inflation, driven by increased consumer demand (0.5%-0.8%)

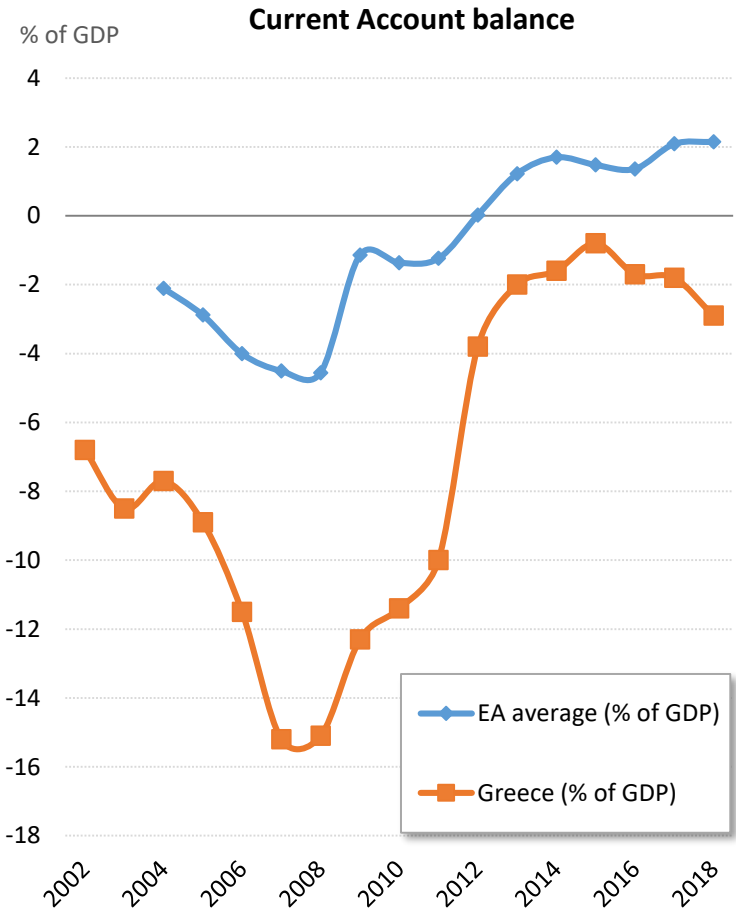
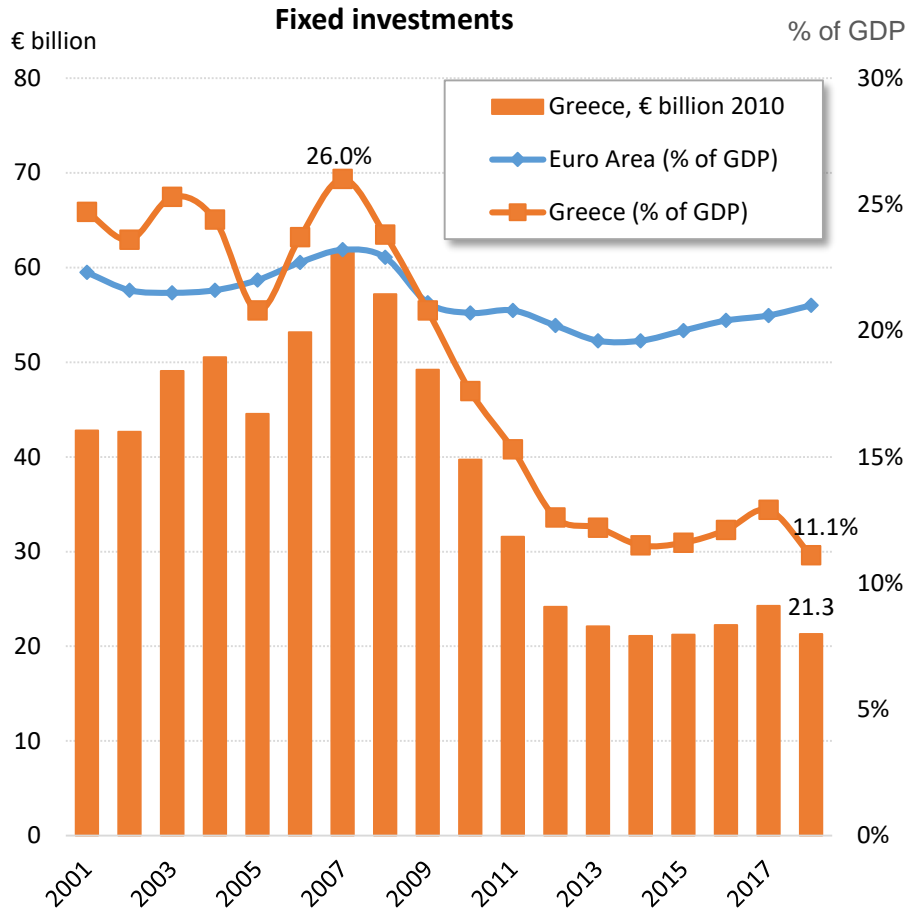
Growth rate in 2020: 2.2 – 2.5%

Special study

Boosting savings and growth through the capital markets



Significant new investments are required for Greece to recover its standard of living

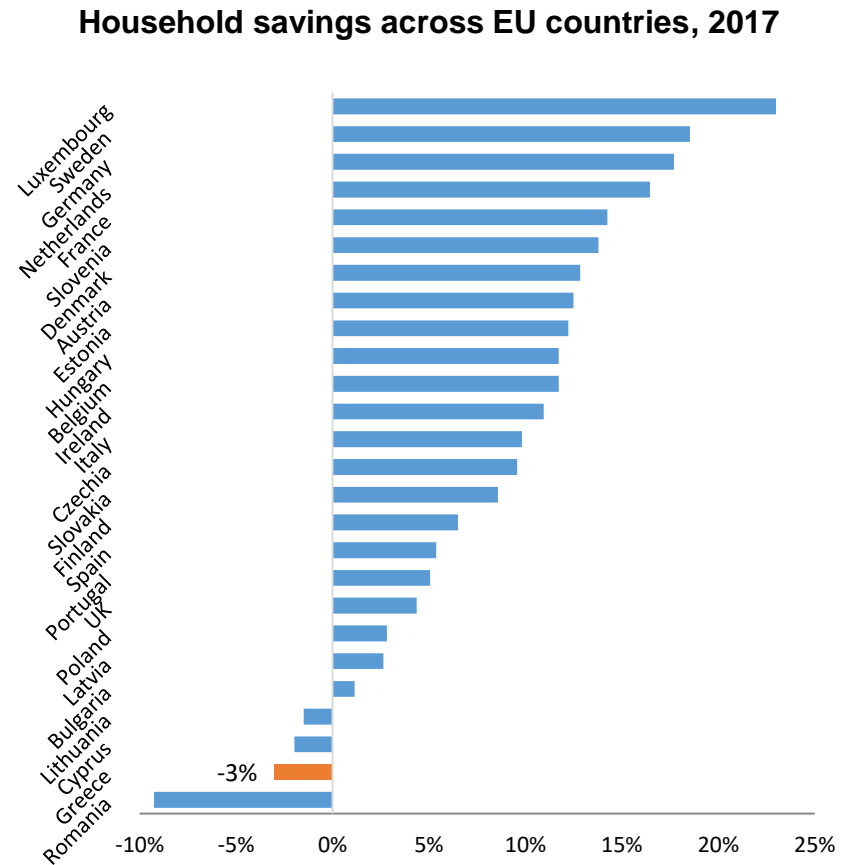
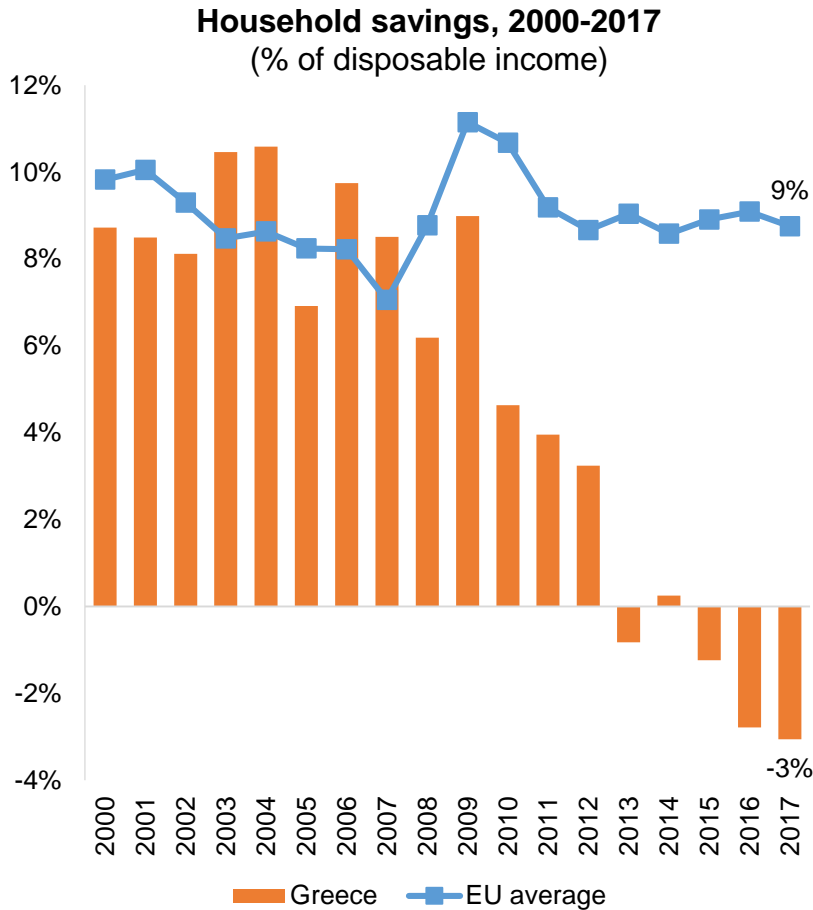


Sources: Eurostat, ELSTAT, BoG

...without their financing being based mainly on current account deficits



Greek households record negative savings during the last years, the second lowest performance in the EU in 2017



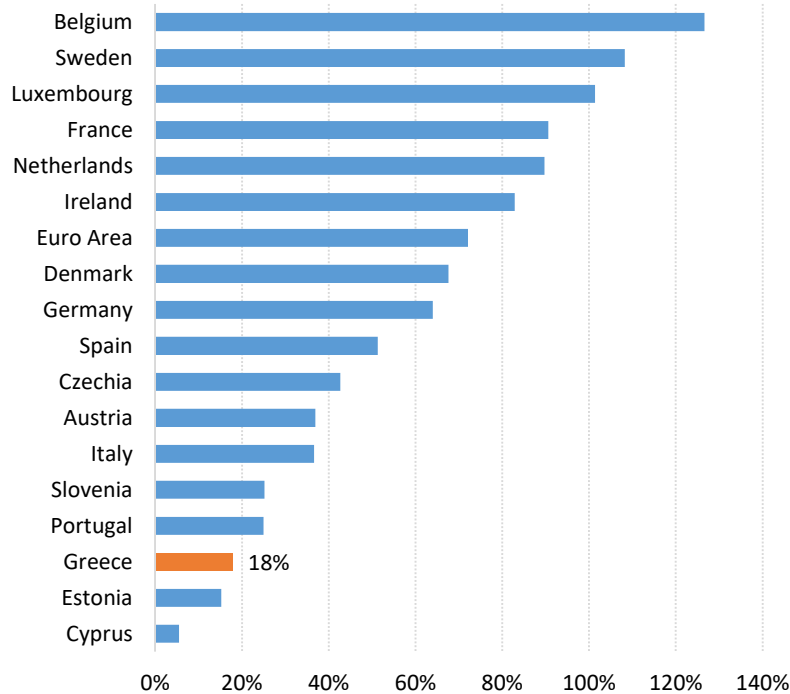
Source: Eurostat

Greek households' "savings gap" during 2008-2017 was on average close to 7.3% of their annual disposable income, and cumulatively close to €94 bln.



Capital markets and banks are the link between savings, investment and growth

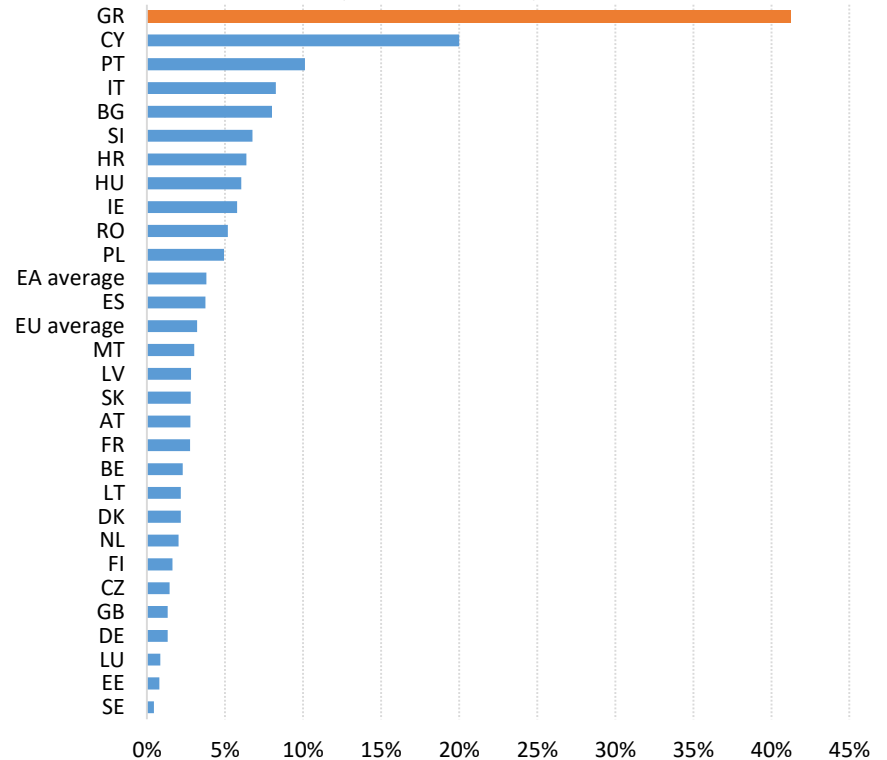
Financial structure across European countries, 2016
(Capital market value/Bank lending to private sector)



Source: World Bank

Capital markets are under-exploited in Greece

NPLs across EU countries, 2018
(% of total loans)



Source: ECB

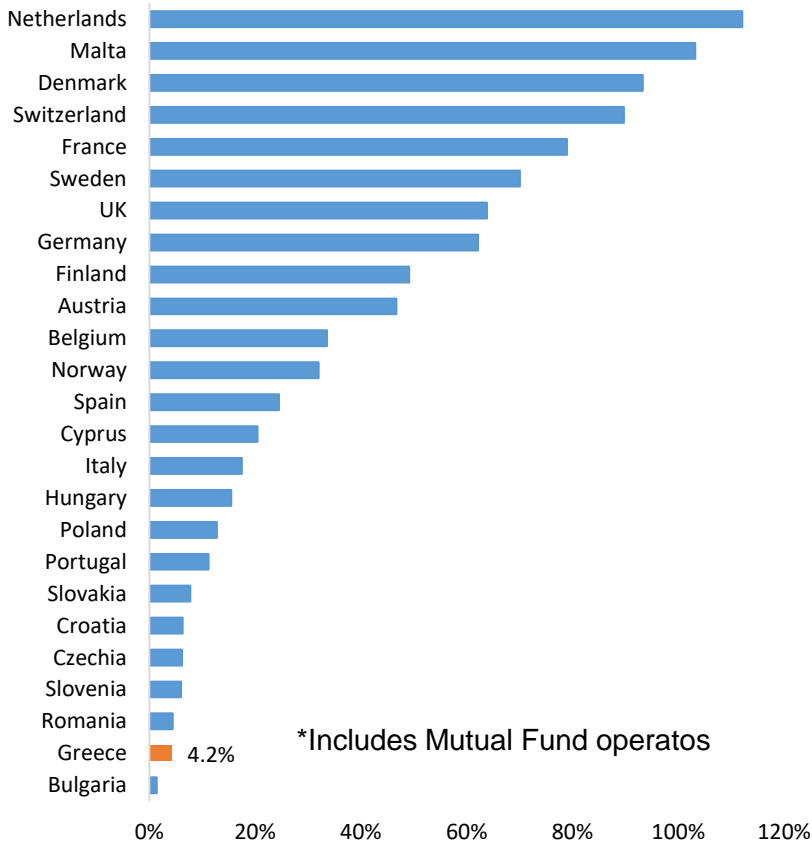
Bank financing faces limitations

It is therefore crucial for the capital market to grow



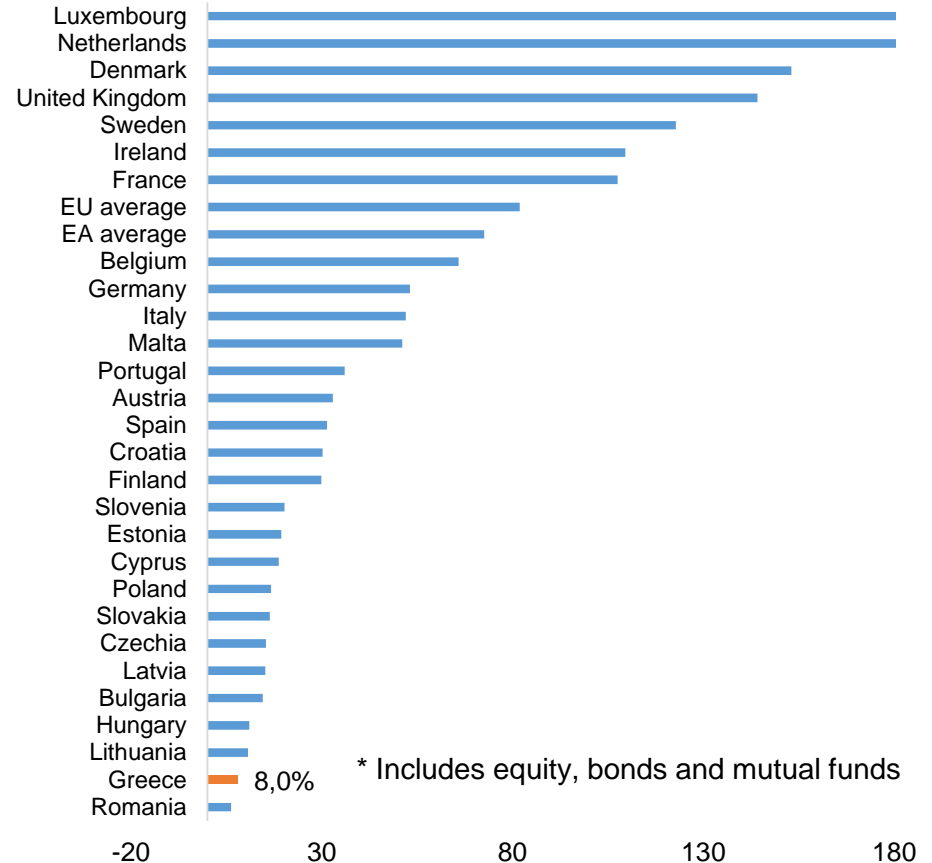
The size of Greek investments in mobile assets by institutional investors is among the smallest in the EU...

Institutional Investors, 2017 (Total invested assets, in % of GDP)*



Source: EFAMA

Total assets by Pensions and Insurance Companies in capital markets, 2017 (in % of GDP)*



Source: Eurostat

... which is largely due to the small size of assets held by Greek pension funds



European practice: Incentives for households' investments via domestic capital markets

Tax incentives upon conditions

- Incentives linked to the level of households' investments in domestic financial assets, up to a ceiling
 - Income tax relief for households investing in specific assets (e.g. in the UK)
 - Reduction or exemption from dividend taxation, interest and capital gain tax from eligible investments (e.g. Italy, France, Poland)

Eligibility criteria

- Mobile assets of domestic or domestically located companies
- Long-term investment horizon
 - 5 years: Italy, France, UK
 - 3 years: Poland
- Possibility to target SMEs and start-ups (e.g. Italy, France)
- Investments in the primary market and indirect investments (through collective vehicles) to boost liquidity of institutional investors

Institutional interventions

- Stock markets active in providing guidance to investors in relation to alternative financing sources (e.g. Italy 2014, Hungary 2016)
- Set up of specialized financial courts (UK 2015, Poland 2019)



Indicative proposal for incentives to invest in Mutual Funds

Investment horizon for eligible assets

- Minimum horizon: 3 years
- Timing of receipt of the tax relief: After the completion of 3 years and on an annual basis thereafter

Percentage of taxable income reduction

- For eligible domestic stock Mutual Funds:
 - 24% cut of taxable income in the 3rd year, times the amount invested
 - 8% cut of taxable income times the amount invested for maintaining the investment position every additional year and up to 12 years
- For eligible domestic bond Mutual Funds:
 - 12% cut of taxable income in the 3rd year, times the amount invested
 - 4% cut of taxable income times the amount invested for maintaining the investment position every additional year and up to 12 years

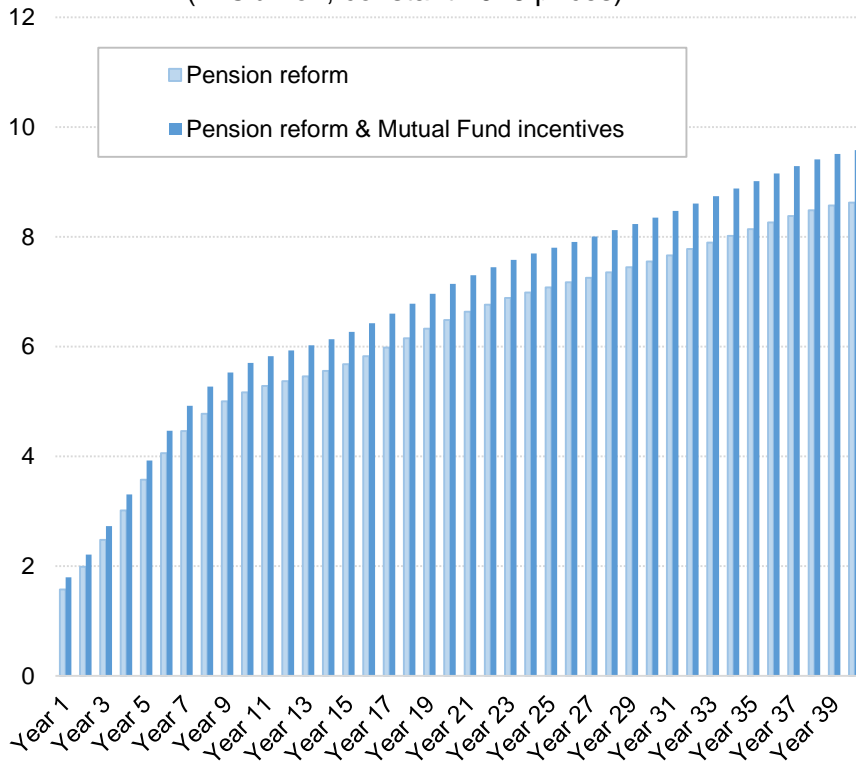
Double ceiling

- Maximum tax discount of €6000 per family per year
- Maximum reduction of taxable income equal to 40% of total annual declared income

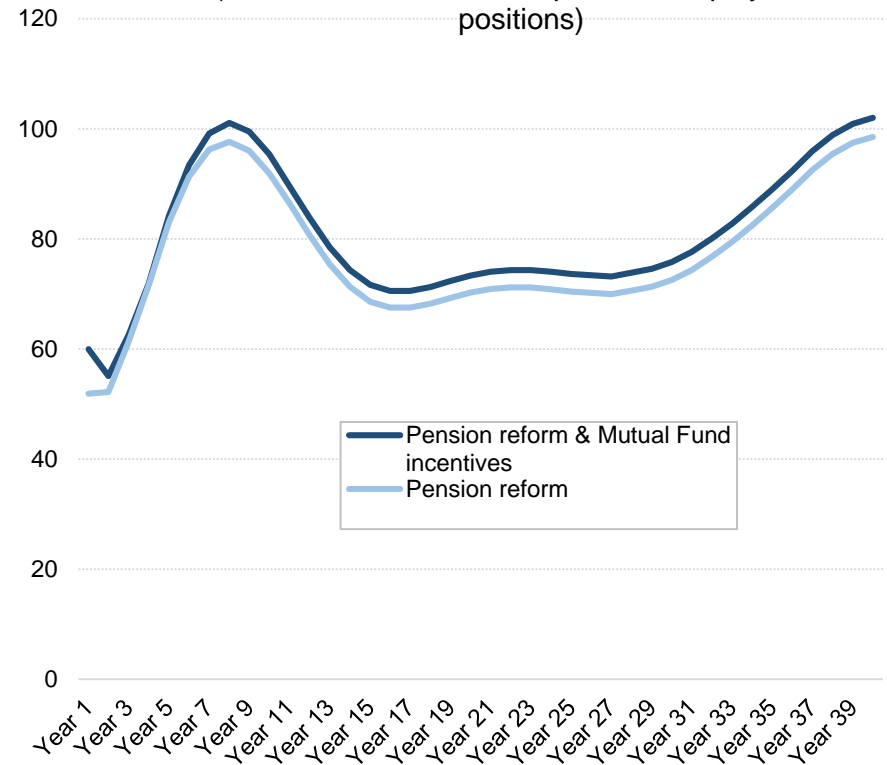


The combination of pension reform and tax incentives to mutual funds contributes significantly to long run growth prospects...

Estimation of annual impact on GDP (in € billion, constant 2016 prices)



Estimation of annual impact on employment (in thousand of full-time equivalent employment positions)



It leads to real GDP growth of €9.6 billion or 5.5% higher compared to the long-term benchmark scenario and a permanent increase in full-time equivalents by 81 thousand people (average period)

Thank you for your attention!

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