



Informational Memo

IOBE Quarterly Report on the Greek Economy, presented on July 10th, 2019

Main points:

- **Global economic expansion** continued in 2019 Q1, at a similar pace with the previous quarter, but slower than in the same quarter of 2018. The OECD members average growth rate was 1.8% y/y in 2019 Q1, unchanged from the previous quarter but lower compared to 2.6% in 2018 Q1. The specific rate was the lowest since 2016 Q4. While the average global growth rate has stabilized since early 2019, there are heterogeneous trends among countries. Growth has accelerated in G7 states from 1.8% to 2.1%, which is similar to the rate of last year. Global expansion reflects inter alia the positive impact from pro-cyclical policies in the US, the accommodating monetary policies and expansionary fiscal policy in China. Global outlook faces downside risks, such as the escalation of trade protectionist policies, a Brexit without deal, escalation of tensions between the US and Iran, with side effects on the oil production. For the year 2019, global expansion is expected to decelerate to 3.3% y/y, compared to 3.6% in 2018.
- **The Greek economy decelerated further in the first quarter of 2019 to 1.3% y/y**, 0.3 and 1.3 ppt lower compared to 2018 Q4 and 2018 Q1, respectively. Growth was largely driven by higher investments (+21.2% y/y), of which though the largest share (75.5%) stemmed from an increase in inventories and much less from fixed capital investments. Exports growth by 4.0% y/y had a positive contribution, which was offset by the stronger rise of imports by 9.5% y/y. Regarding domestic consumption, households' consumption increase by 0.8% y/y was offset by shrinking public consumption by 4.1% y/y.
- **IOBE forecasts real GDP growth of 1.8% y/y in 2019**, slightly lower than 1.9% in 2018, driven by higher investment activity, mainly in extrovert sectors and privatization projects (between +8 and +11% y/y) and mild increase of private consumption (+1.2% y/y). Public consumption will remain close to its level last year, or slightly higher. Stronger domestic demand will increase imports (+6.2% y/y), mainly for capital goods and consumption of services. Under the restrictive policies on world trade and the completion of the Q-E extension, exports' growth will lose momentum (+5.5% y/y).
- The Jan-May 2019 **budget targets in cash terms were exceeded**, by €1.29 billion. The over performance was mainly due higher than expected revenues. These are due to higher revenues from sales of goods and services, including an inflow of €1.18 billion from the extension of the

concession agreement for Athens International Airport, and higher revenues from transfers by €538 million, mainly in relation to BoG holdings of GGBs (ANFAs and SMPs).

Comparing forecasts for selected economic indicators, 2019
(at 2010 constant prices, y/y changes in %, unless otherwise stated)

	2018	Projections for 2019 (vintage date in parenthesis)				
	Actual	Ministry of Finance (Nov 18)	European Commission (May 19)	IOBE (Jul 19)	IMF (Apr 19)	OECD (May 19)
GDP	1.9	2.5	2.2	1.8	2.4	2.1
Private Consumption	1.0	1.1	1.3	1.2	1.2	1.0
Public Consumption	-2.5	0.6	3.1	0.5	0.5	2.3
Gross Fixed Capital Formation	-12.0	11.9	10.1	12.0	10.7	1.2
Exports	8.8	5.8	4.7	5.2	5.7	5.3
Imports	2.9	5.2	5.7	6.2	5.2	2.8
Unemployment (% of LF)	19.3	18.2	18.2	18.0	18.5	18.1
HICP (%)	0.8	1.2	0.4	0.4	1.1	0.8
General Government balance (% GDP)		0.6	0.5	:	-0.2	0.1
Current Account balance (% GDP)	-1.5	:	-1.0	:	-2.7	-1.3

Sources: State Budget 2019, Ministry of Finance, November 2018 – European Economic Forecast, spring 2019, European Commission, May 2018 – IOBE, Quarterly Report 02/19, July 2019 - World Economic Outlook, IMF, April 2019 - Fiscal Monitor, IMF, April 2019 - OECD Economic Outlook 105, May 2019

- The unemployment rate was recorded at 19.2% in 2019 Q1, which was 2 ppts lower than in the same quarter of 2018. The reduction of unemployed persons by 94.1 thousands was mainly due to an increase of employment by 2.4% or 90.2 thousand persons (95.9% of the reduction of unemployed persons) and secondarily due to shrinking labor force (-3.9 thousand persons). Most of the new jobs during Q1 were created in sectors such as tourism (+20.2 thousand), education (+20.2 thousand), and Information-Communication (+14.7 thousand), even though production of the latter sector dropped by 2.3% during the same period. IOBE expects further employment increase in 2019 mainly in extrovert sectors and construction. As exports growth will be lower than in the previous year, employment growth will decelerate in tourism and some manufacturing sub-sectors. The trend will be positive in transportation services, as well as in relation to the public sector. Consequently, **IOBE forecasts a milder unemployment reduction trend and the unemployment rate around 18.0% for the year 2019.**
- The HICP **inflation** rate was positive during Jan-May 2019, around 0.8% versus 0.4% in the same period of 2018. Inflationary pressure stemmed mainly from the mild recovery of domestic demand, since core inflation excluding energy products and at constant taxes during Jan-May increased by 0.8%, while the contribution by indirect taxation and energy products was marginally negative (-0.1%) and zero respectively. During the second half of 2019, indirect taxation will have

a further easing impact on inflation, following VAT rate cuts, while the impact from energy products is expected neutral. These effects will be more than offset by rising domestic demand, through further employment increase and following the rise of the minimum wage. **IOBE expects that the annual 2019 inflation rate** will be marginally below the one in 2018, **in the range of 0.3% to 0.5%.**

- During Jan-Jun 2019, the cost of new borrowing by the Hellenic Republic dropped to historically low levels (GGB spread over Bund at 9-year low). Among some positive developments in the banking system: banks share market values recovered, deposit net inflows have been positive, credit towards non-financial corporations recovers after eight years of contraction, banks have fully eliminated their dependence from ELA funding. Despite progress, significant challenges remain for the banks, inter alia reflected though the observed credit contraction towards households and self-employed for a ninth consecutive year, while credit supply to the private sector is expected to improve only gradually during the second half of 2019. In order to accelerate credit recovery, it is warranted to effectively implement recent regulatory reforms, in relation to auctions, the new framework protecting primary residence, the out-of-court workout scheme, and decision making on a systemic solution for the faster reduction of NPLs in line with the revised operational target for NPL ratio below 20% by 2021. In parallel, there is need to change the mix of instruments for NPL reduction, putting more emphasis on sales, securitization and collection from active management, as opposed to write-offs.

The **General Director** of IOBE, Professor **Nikos Vettas** noted during the Report's presentation:

- The electoral process created strong expectations for positive economic developments, through an acceleration of growth rates and improvement of households' well-being. Expectations focus around an ease of taxation burden and an improvement of business environment.
- Ten years after the beginning of the crisis, eight years of support programs which concluded last August, and the economy having stabilized after a prolonged and deep recession, there is a window of opportunity for the new Greek government, in collaboration with the new cabinet of the European Commission, to set the path for stronger economic growth.
- The Greek economy is on a rising path, but through weak expansion rates. During 2019, as already highlighted by IOBE in the last quarters, the annual real GDP growth rate is now expected below 2% y/y, probably around 1.8% y/y.
- Such growth rate is lower than the initial target set by policy makers, a shortfall which has been consistently observed during the last three years. Besides, the underlying economic fundamentals alone, point out to a medium-term steady state of lower growth rates from the current 2% towards the "range" of 1%.

- In this context, economic policy decisions must be targeted, especially if the objective is to systematically boost growth prospects. This is essential, also taking into account the likelihood for turbulences in the external environment during the next few years.
- The level of investments is roughly half compared to the one of other European economies, while unemployment rate is about four times higher. Even in the pre-crisis years, Greece recorded a systematic shortfall of productive investments, as well as low labor participation rates, inter alia as a result of low remuneration for both factors of production.
- The objective cannot be the return to the pre-crisis “normality”, since such return, even if it resulted in a short-term increase of incomes, it would subsequently lead the economy to a low equilibrium and possibly to a new crisis. What is key is the structural transformation of the economy, which has progressed only to a small extent during the last decade.
- The reduction of tax rates cannot be across the board, because this would lead to fiscal derailment. This is time for tough decisions, whereby the reduction of tax rates must focus on enhancing incentives for production and savings, rather than consumption.
- Through the simplification of income taxation, lower tax rates could yield the same fiscal revenues, while in parallel boosting growth and financing Guaranteed Minimum Income schemes for the most vulnerable groups. Good international practices, mainly through electronic payments can be linked with tax discounts in order to better align taxpayers’ incentives.
- Social security contributions to the current pension system must be reduced, and part of them can be shifted to individual retirement accounts, which create incentives for savings, employment and labor participation, especially among the young generation. The gradual transition towards such a system can have relatively affordable cost, while the benefits for the economy will be high.
- Regarding public administration, besides digitalization and interconnection of services, one needs to pave the way towards decoupling civil administration from the political system and the government. The new mindset of the state’s operation is necessary in order to proceed foreign and long-term investment interest.
- In the wider public sector, specific entities have to operate with increased autonomy and accountability. Particularly in the educational system, the degree of tightness of the regulatory framework is unique in the advanced world and is one of the reasons for Greece’s gap with respect to other European countries.
- Markets have to become more open, through competition and profit seeking via innovation.
- Structural changes may contribute so as for expected capital inflows to strengthen the productive activities reflecting the innovative and extrovert part of the economy. Otherwise, capital inflows

may just temporarily tackle problems, which will remain and may emerge in another crisis in the medium term.

- For this reason, it is of primary importance that capital inflows are coupled with growth enhancing structural reforms, in order not to waste the opportunity for setting solid basis for growth.
- Greek economic growth can be strong during the next years, but only upon conditions. The window of opportunity is significant and should not be wasted.