



FOUNDATION FOR ECONOMIC & INDUSTRIAL RESEARCH

**The Greek Economy
Quarterly Bulletin
04-2014**

January 29th, 2015

Main aspects

- Clear and tangible signs of growth
- Uncertainty about important aspects of the economic environment, both in the short term and in the medium term
- The groundwork has been laid for economic recovery to continue, and indeed accelerate
- Whether recovery will actually be sustained will depend on economic policy decisions

The economy has stabilised

- Consolidation of public finances: primary budget surplus, balance in the external sector, stability in the banking system.
- The foundations are in place for domestic consumer confidence to be gradually restored and for foreign demand for services to increase, leading to strong growth.
- The overall momentum of the economy could lead to a growth rate over 2% in 2015, coupled with a drop in unemployment by two percentage points and a shift in the deflationary trend.

Global economic developments

- Falling energy prices: falling production costs will allow Greek output and exports to grow
- ECB policies and the falling exchange rate of the euro also help improve the competitiveness of Greek products and boost their demand

Domestic developments

- Delays in reaching an agreement regarding the review of the Greek Economic Adjustment Programme, followed by political uncertainty and ultimately snap polls
- Since the start of the 2015, gradual fall of investment, deterioration of lending terms for businesses, delays in tax collection and difficulties in the implementation of the budget
- Economic sentiment, regularly tracked by IOBE, deteriorated considerably over the past month. This is unusual, as expectations normally improve before elections.

Uncertainty regarding economic policy

- The new government contests the framework of the current agreement with the country's partners and creditors. This was expected, considering the statements made during the campaign trail by the winning parties in the recent elections.
- However, the economy is in a very fragile state, which could easily be destabilised.
- Therefore, despite the very important fact that the government explicitly affirms that its economic policy will be drawn within the context of the Euro area and of fiscal stability, uncertainty emerges over many aspects of the country's prospects.
- Uncertainty will persist, and perhaps will grow more intense, until a new agreement with the EU is reached.

Positive prospects, provided that certain conditions are met

- First condition: there should be no risk that Greece will exit the Euro area.
- The cost of such an exit for Greece would be immense.
- The prospect of such an exit, emerging even as a threat by any side, complicates the problem and obstructs the solution.

Investment

- Growth cannot be achieved without investment.
- The main problem with Greek economic adjustment so far was that the momentum in investment, as well as in exports of goods, was particularly weak.
- Investment is very low, as a percentage of GDP, and should almost double over the coming years, in order for Greece to achieve the high growth rates the country wants and needs.
- The key priority for economic policy is now to attract investment of every sort and from every source. Without investment, the necessary reduction of unemployment will not be feasible.

Regulatory framework

- Investment requires stability and transparency in the economy and in the regulatory framework.
- Fiscal consolidation and debt management, despite their tremendous importance, are not the most crucial aspects of the country's economic adjustment.
- The first priority is to change the structural framework of rules and institutions in the economy, in a thorough and comprehensive manner, instead of implementing minor improvements on the existing system.
- Many of the changes necessary for Greece to substantially converge to the Euro area's most advanced economies follow a common pattern: reducing governmental control on the economy, while reinforcing the independence of the various organisational branches of public administration from the central government.

At a crossroad – discussions for a positive agreement?

- “... a new, mutually beneficial agreement between Greece and the European Union.
- This agreement should be aimed at correcting the flaws that have now become apparent and most importantly at ensuring the convergence of the Greek economy with the Eurozone’s core.
- The foundation for this agreement should be the new growth model for Greece, focused on innovation and exports, along with investment to support them.
- Greece should commit to implement the necessary structural reforms, starting with those that will improve the entrepreneurial environment and the efficiency of the public sector.

Positive solution

- Greece should decide how each goal will be pursued and should be responsible for achieving these goals
- Maintaining the agreed fiscal balance is necessary, but without further fiscal adjustment, which would probably have a negative impact on investment, on the reform effort and ultimately on growth.
- The partners and creditors of Greece should ensure that the burden of servicing the Greek public debt will remain sufficiently small in the foreseeable future.
- In addition, both investment in the infrastructure necessary for growth and private productive investment should be supported by all available means...”

Prospects

- The Greek economy's prospects could be very positive.
- A necessary condition for a positive development is an agreement with the European partners that would enable consistent increase of investment and growth, within the context of the rules of the Eurozone.
- This agreement could and should be achieved as soon as possible.

Overview of the Quarterly Bulletin on the Greek Economy

The global economy continues to grow, however recovery in the Eurozone is frail

- **The global GDP** increased (3rd quarter 2014): **3.7%** (q-o-q)
 - Forecast for the fiscal year 2014 (IMF): **3.3%** y-o-y (same as in 2013)
- Growth by **2.4%** in the **USA** in 2014 due to the gradual implementation of fiscal measures, the favourable monetary policy, a boost in employment and increasing investment
- Abrupt recession in **Japan** in the 3rd quarter (-1.1%) and marginal growth 0.1% in 2014, mainly due to increased taxation. The yen fell sharply.
- Weak recovery in the **Eurozone**: **+0.8%** both in the 3rd quarter and in the fiscal year 2014. However, the recent bold ECB intervention, providing quantitative easing, is expected to counter deflation and boost the European economy.
- **China**: **+7.4%** in 2014

Main Dangers in the Euro area:

- Persistent tensions in Ukraine, causing uncertainty, particularly regarding investment
- Sanctions against Russia and their economic impact
- Volatile political situation

Growth!

- **Significant GDP growth in Greece (July – September 2014): +1.6%**, against -3.5% in the 3rd quarter of 2013
- **According to the new National Accounts calculation methodology, the growth rate was positive since the 2nd quarter of 2014 : +0.4%**
- **First nine months of 2014: +0.6%**, against -4.3% a year earlier

Growth stemmed from:

- **Considerable increase of private consumption (+3.1%, against +1.0% in the 2nd quarter)**
- **Rising exports (+8.6%):**
 - Sharp rise of exports of services (+16.4%), in Tourism, Information and Communication Technology Services
 - Exports of goods continue rising, yet at a slower rate (+1.7%, against +5.0% in the 1st quarter)

Growth!

GDP components:

- **Investment continues to shrink, at a much faster rate: -17.7%**, against a drop by 4.3% in the 2nd quarter
 - This came exclusively from shrinking inventories (approx. €650 million)
 - Marginal increase of fixed capital formation (for the first time since 2008)
 - Investment in housing shrank
- **Public consumption started to shrink again: -2.4%**, against +2.2% in the preceding quarter
- **Growth of imports slowed down: +2.9%**, from +8.2% in the 2nd quarter
 - Imports of services shrank (-6.5%, against +8.1% a quarter earlier)
 - Growth of imports of goods slowed down (+5.0%, against +8.4%)

Trends – developments in the last quarter of 2014

- **Long tourist season, more foreign visitors**
 - Job positions were preserved, incomes and consumption were boosted
- **The results of the stress tests on the 4 largest Greek banks were positive**
- **Output increased** in most sectors (Industry, Retail Trade, Construction), **the shrinking of housing construction eased**
- **Gradual rise of uncertainty due to delays in the negotiations, rumours about the debt and about the adjustment programme**
 - Foreign investors show little interest in Greece
- **The growth rate is expected to be higher in the 4th quarter of 2014**

Taking into account data revisions, after the implementation of ESA 2010, the forecast for growth in 2014 is revised upwards, to around 1%

State Budget 2014: Towards the end of the year the implementation of the budget diverges from the target for the primary surplus

- **State Budget January – November 2014:**

Deficit of €1.8 billion, against a deficit of €3.2 billion a year earlier

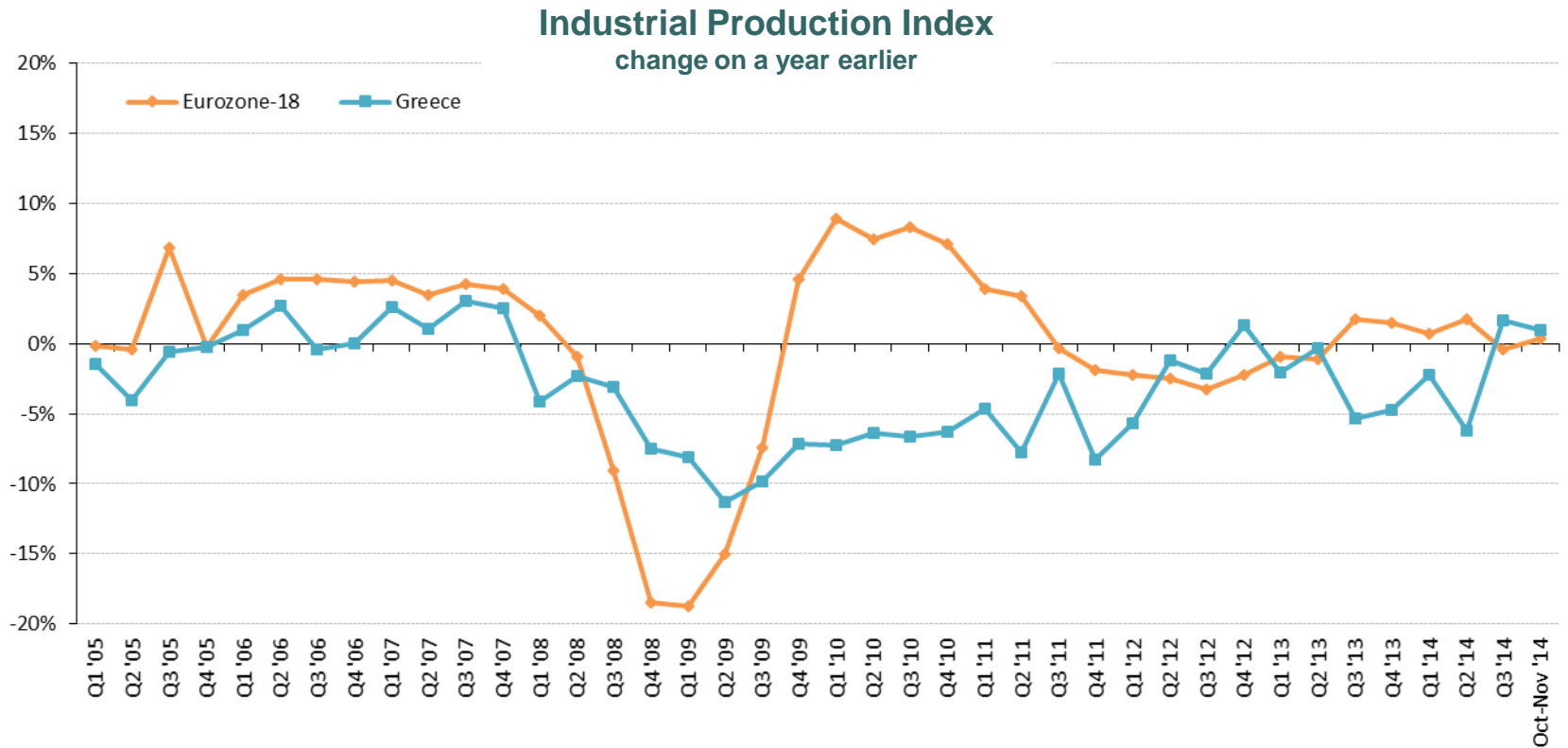
- **Nevertheless, the improvement of fiscal parameters lags behind 2015 budget targets**

- **Consolidation achieved exclusively by shrinking budget expenditure (-€3.2 billion)**

- **The targets are probably not achievable**

- €9.4 billion revenue should be collected (including revenue from the Securities Market Programme – SMP) within just one month
- €1.9 billion revenue from the Securities Market Programme was not transferred to Greece, because the review of the adjustment programme was not completed

Industrial production shrank at a slower rate



Sources: ELSTAT, Eurostat

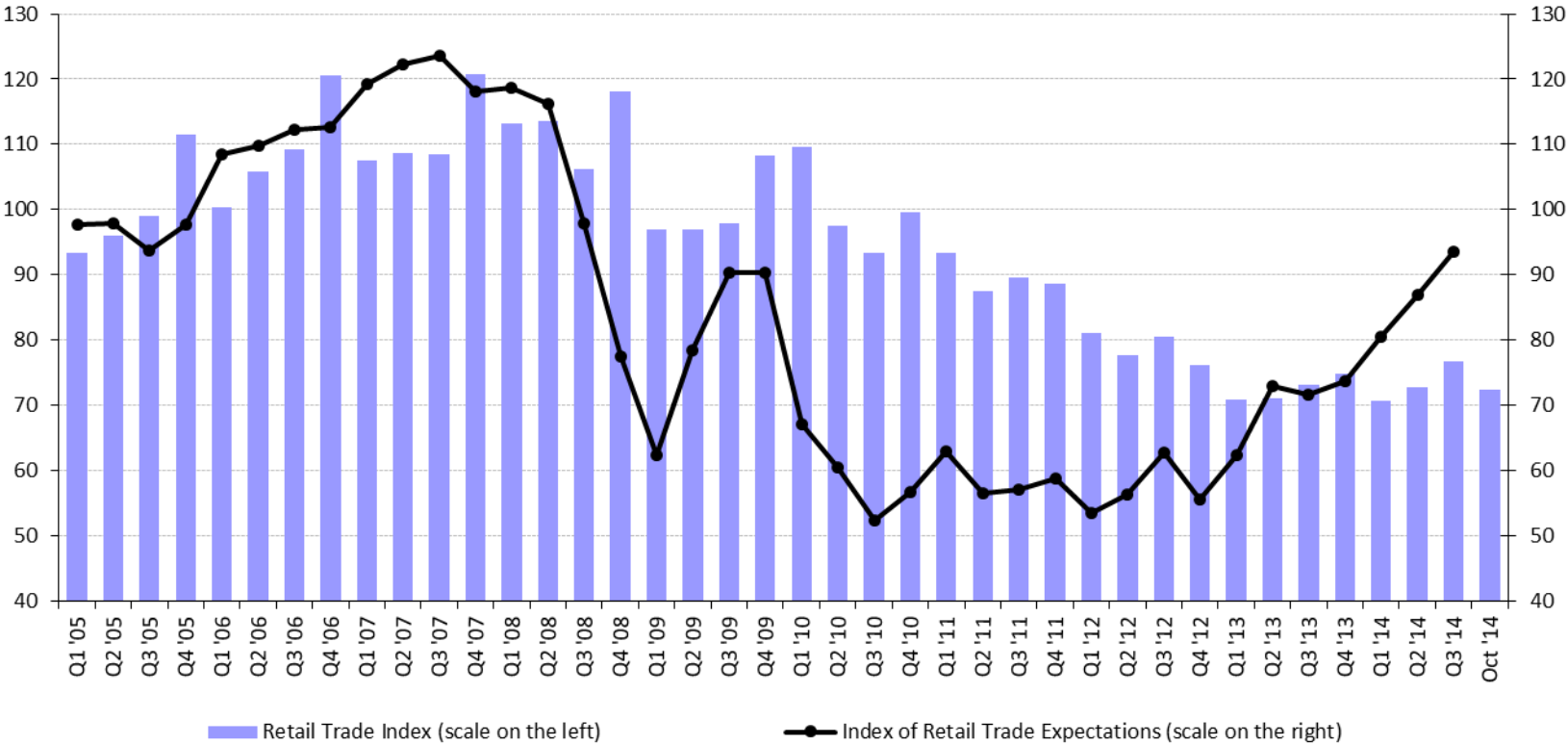
First eleven months of 2014: -2.4%

First eleven months of 2013: -3.3%

- Electricity generation: -13.2%
- Manufacturing: +0.6%
- Mining - Quarrying: +0.5%

Retail trade was boosted by 2.5%. Activity in half of its sub-sectors increased, relative to a year earlier.

Retail Trade Index (2005=100) and Index of Retail Trade Expectations (1996-2006=100)

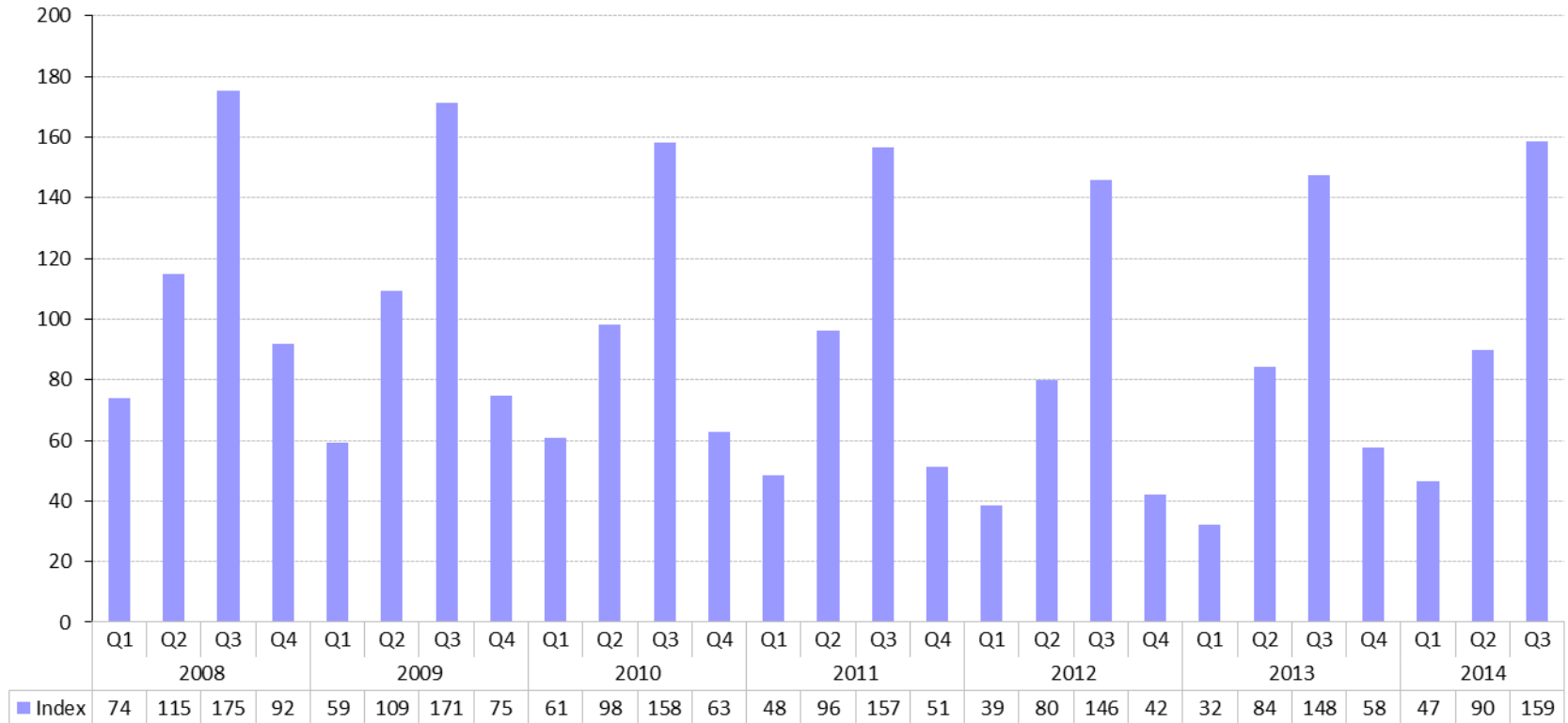


Sources: IOBE, ELSTAT

Retail Trade volume index: -27.0% compared with the base year 2005
First ten months of 2014: +2.5%
First ten months of 2013: -9.2%

However, output in services contracted at a faster rate, with the exception of tourism

Turnover Index in Tourism (Accommodation and Food Services activities)

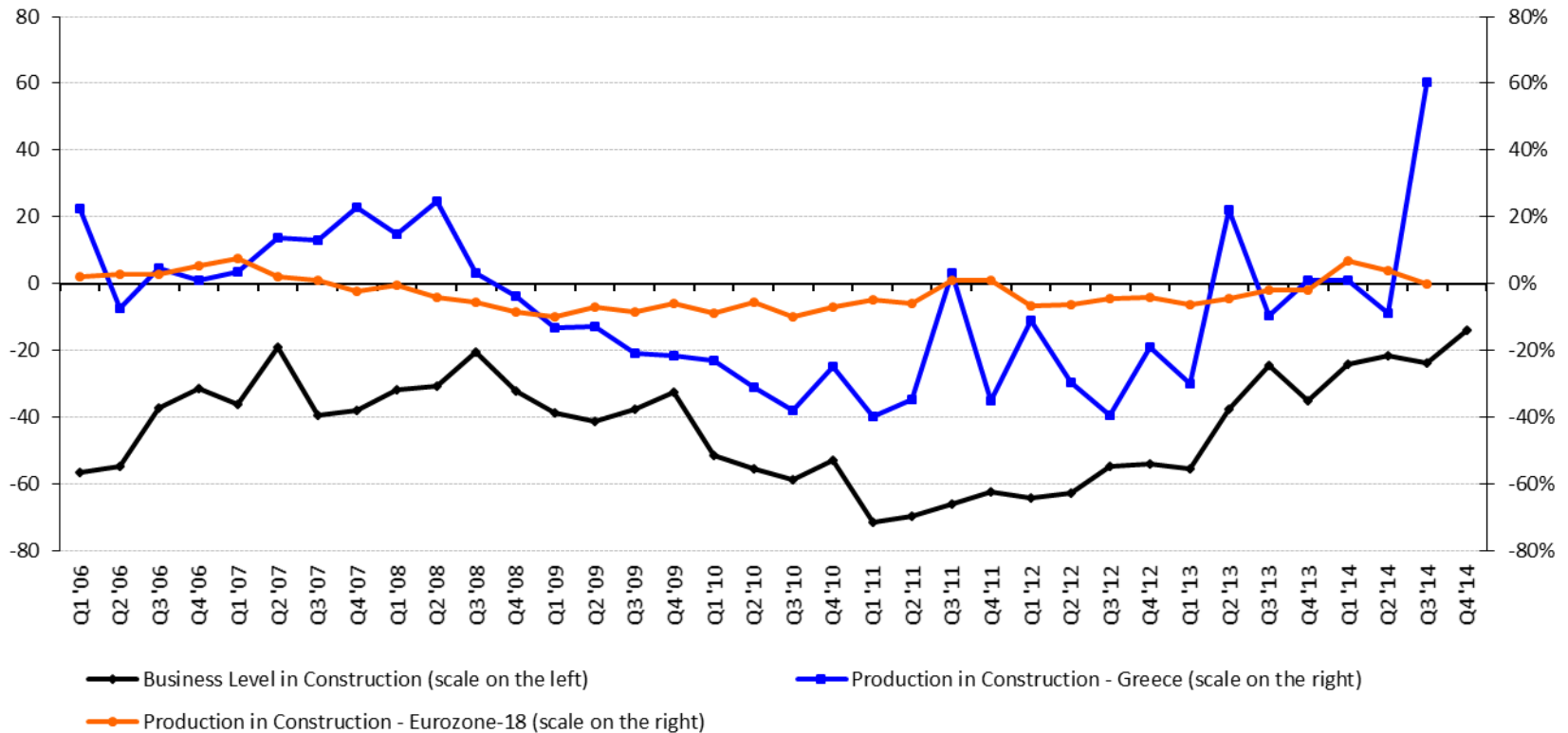


Sources: IOBE, ELSTAT

Output contracted in 10 out of 13 sub-sectors of services, despite improved expectations for 2014

Construction was boosted by 16.8% in the first nine months of 2014, for the first time in many years

Production in Construction Indices and Business Level in Construction Index



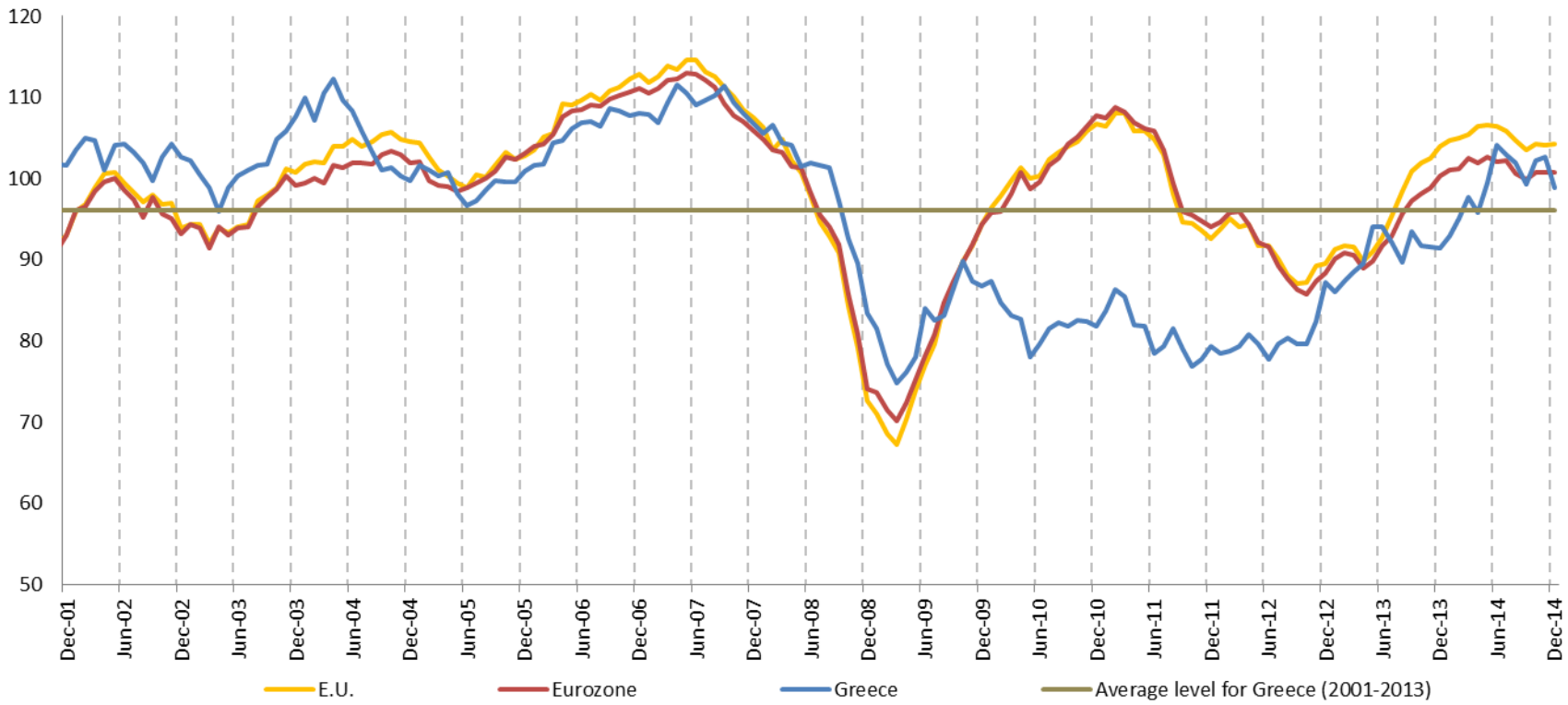
Sources: ELSTAT, Eurostat

3rd quarter of 2014: +61.3%
3rd quarter of 2013: -4.7%

First nine months of 2014: 16.8%
First nine months of 2013: -6.1%

The economic sentiment indicator stabilised at a high level in the fourth quarter, however it fell significantly in December

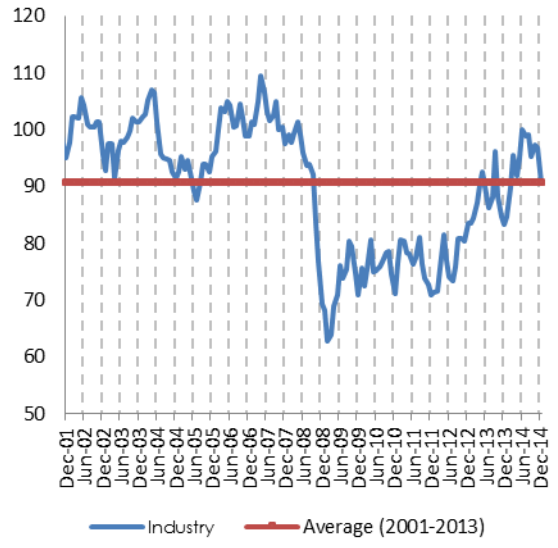
Economic Sentiment Indicators



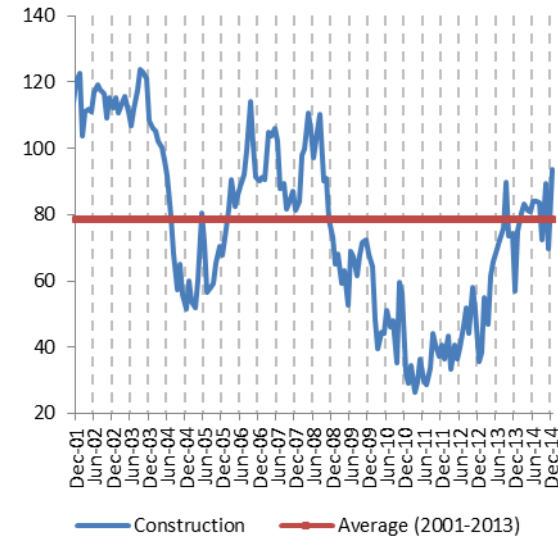
Sources: IOBE, European Commission

4th quarter: expectations improved in Retail Trade and in Construction, deteriorated in Industry and in Services

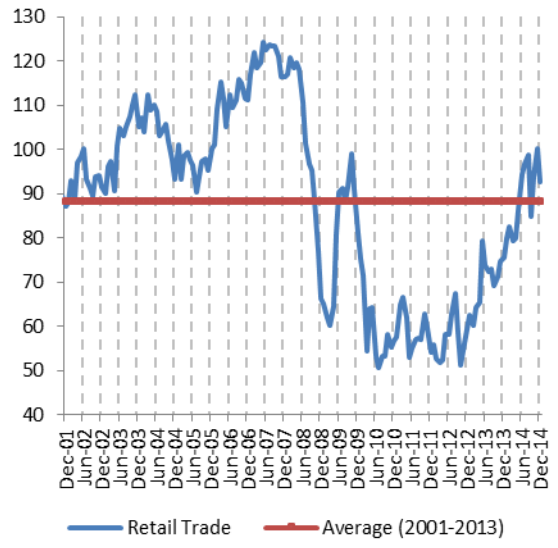
Industry



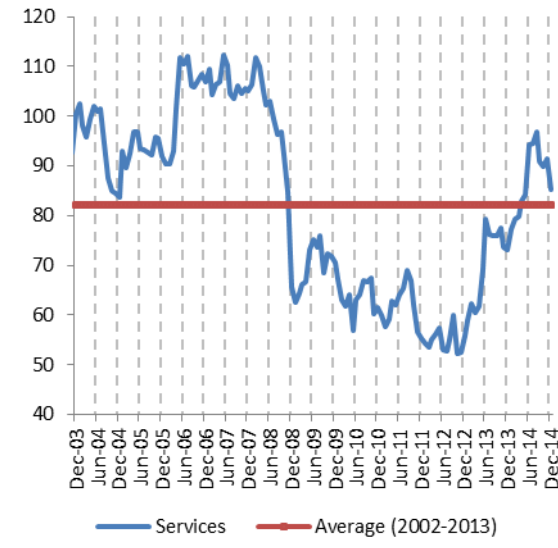
Construction



Retail Trade

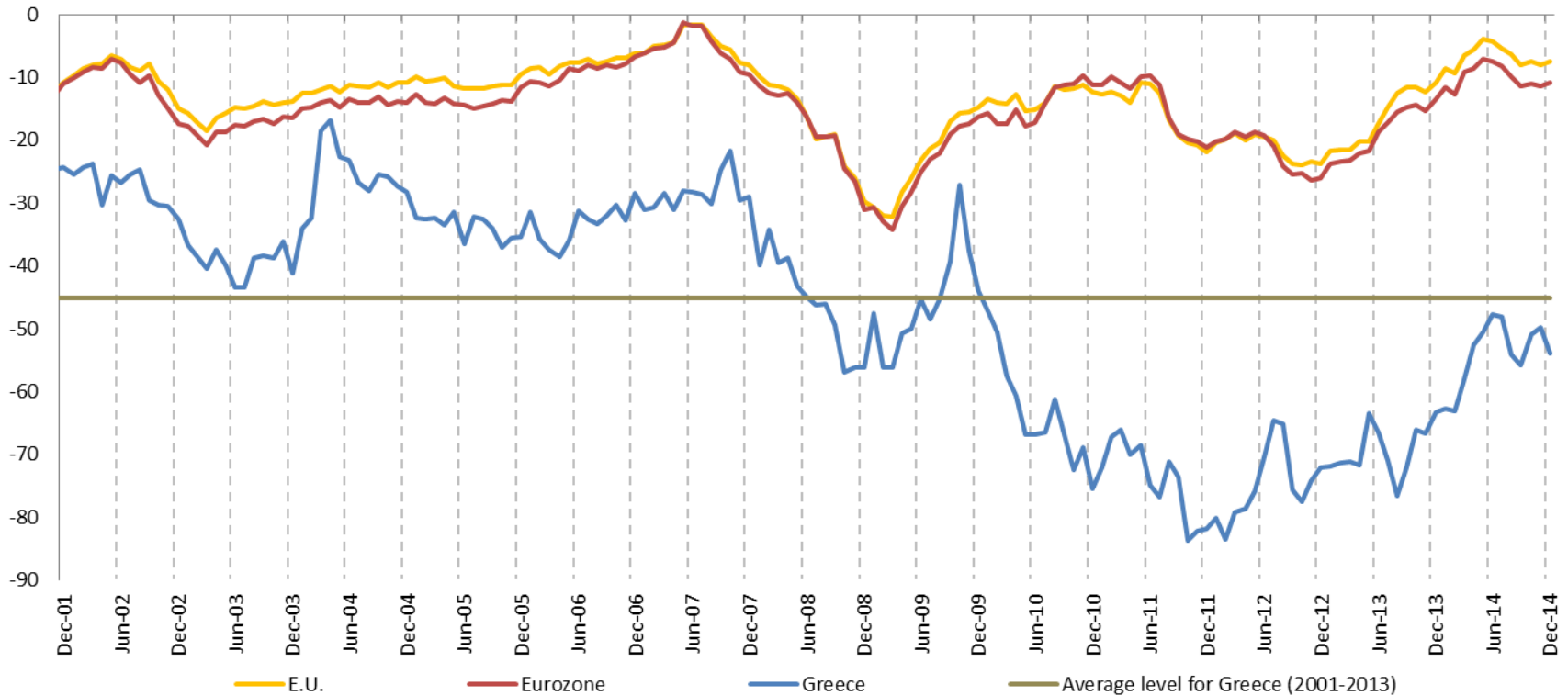


Services



Consumer confidence was high in 2014, though it dropped after summer. Small deterioration of expectations also in Europe.

Consumer Confidence Indicators



Sources: IOBE, European Commission

The trade deficit (trade of goods) increased by 6% in the period January – October 2014

January – October 2014

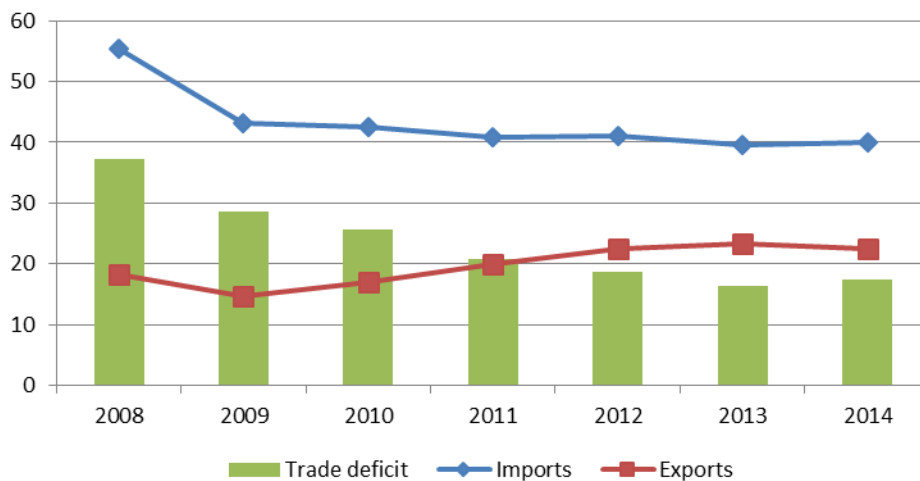
- **Exports:**
 - 3.3% (€22.3 billion, incl. petroleum products)
 - 1.1% (€13.5 billion, excl. petroleum products)
- **Imports:** +0.5% (€39.1 billion)
- **Trade deficit:** +6.0%

- **Sharp contraction:** Agricultural Products (-7.4%) and Fuels (-6.4%)
- **Growth:** Industrial Products (+2.9%)

Markets:

- **Decrease of Greek exports towards:** Eurozone-15 (3.3%), North Africa and the Middle East (2.7%), Italy (6.2%), Germany (0.3%), Bulgaria (6.9%), Turkey (1.7%), USA (16.6%), China (37.1%), Russia (10.0%)
- **Increase of Greek exports towards:** South-East Asia (25.0%), Cyprus (10.0%), Egypt (28.8%), Saudi Arabia (87.6%), Albania (24.5%), Malta (60.2%), Finland (7.9%), India (14.6%)

Value of Greek exports and imports, January – October (€ bn, 2008-2014)



January – October 2014

(ELSTAT estimates)

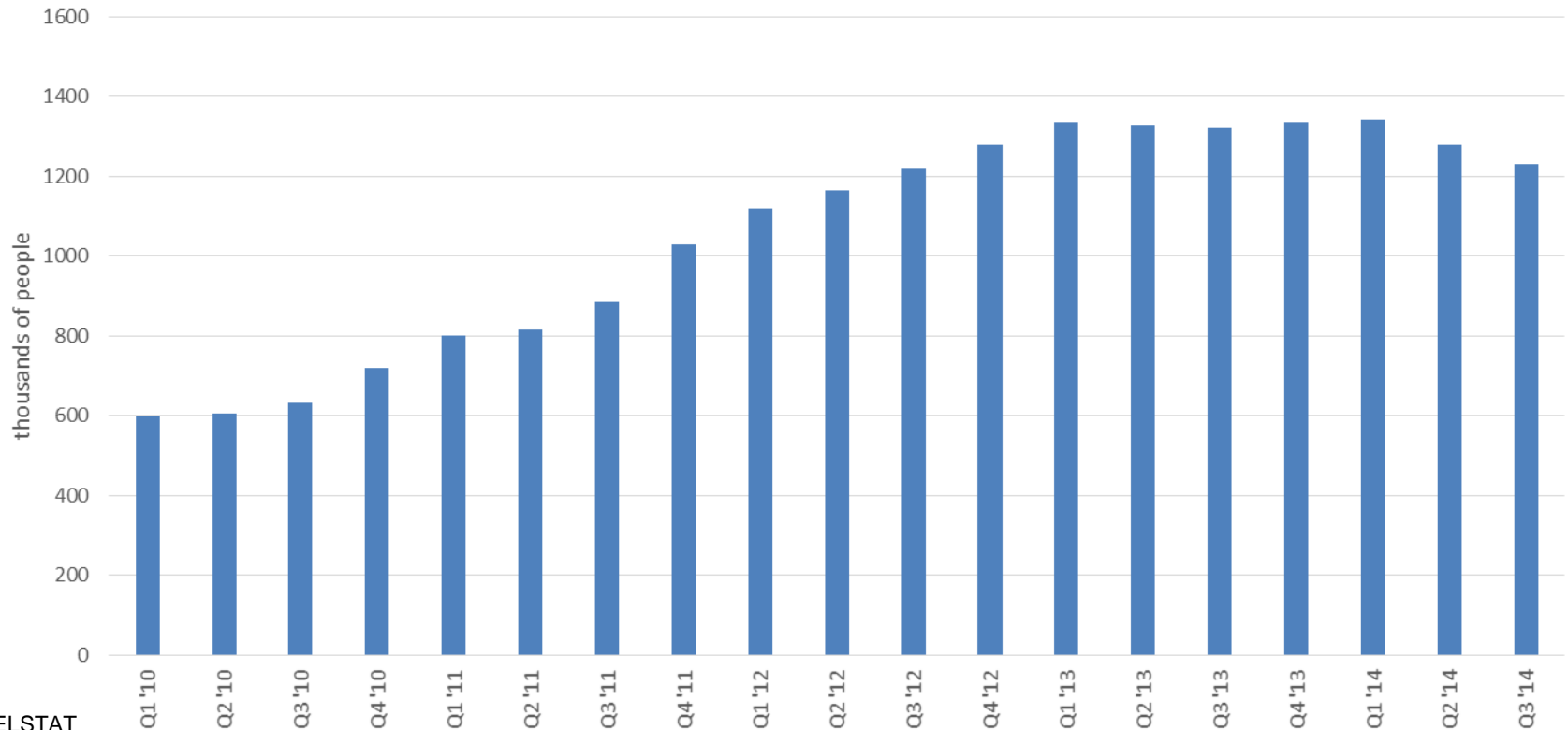
Exports: -3,1% (€22.5 billion)

Imports: +1.0% (€39.9 billion)

Trade deficit: +6.9%

Unemployment falls in the 3rd quarter

Number of unemployed in Greece

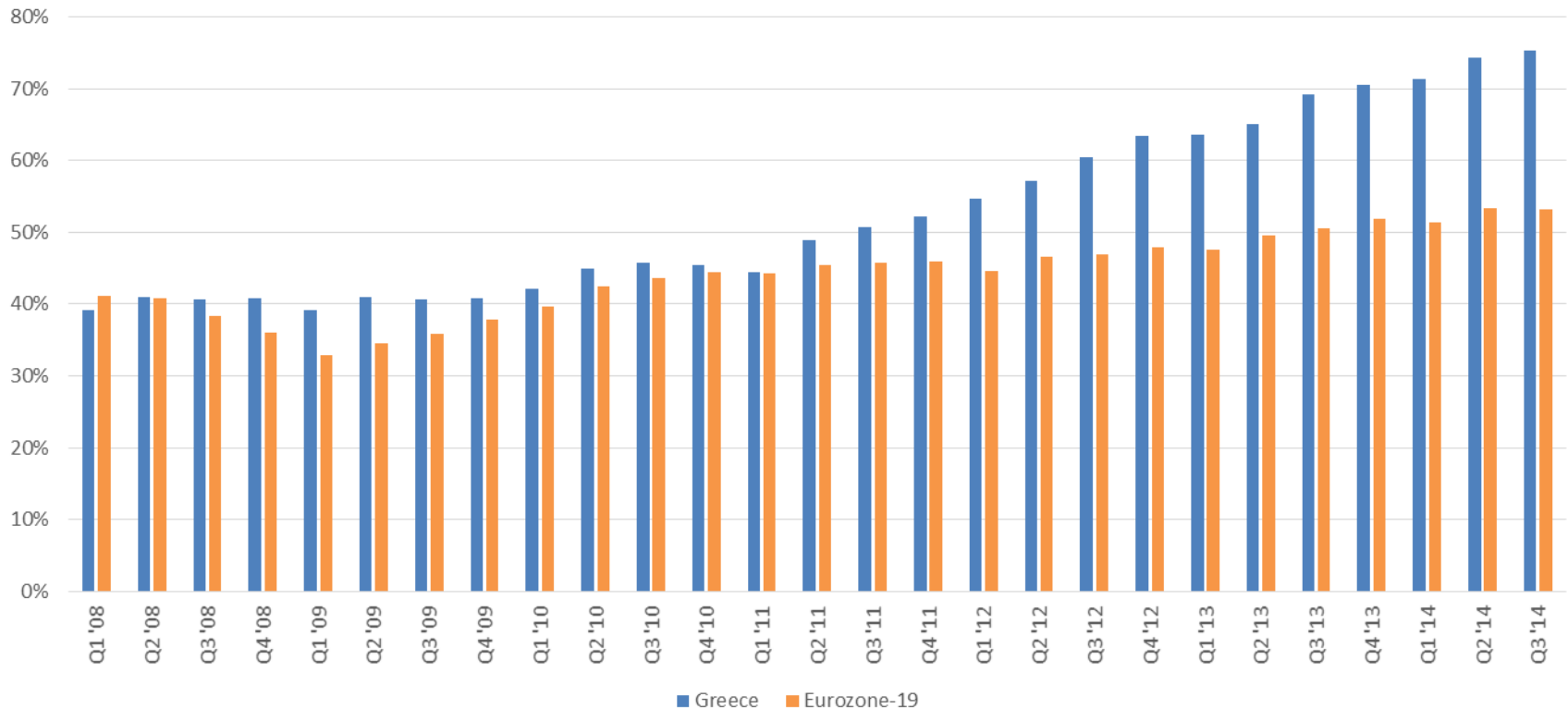


Source: ELSTAT

- The unemployment rate was 25.5% in the 3rd quarter of 2014, against 26.6% in the preceding quarter (approx. 100,000 fewer unemployed in the 3rd quarter of 2014 compared with a year earlier)
- The greatest decline in unemployment in the Eurozone-19
- Nearly 51,000 more jobs in Accommodation and Food Services than in the 3rd quarter of 2013. However, 20,700 fewer jobs in Financial and Insurance activities.

Long-term unemployment keeps rising

Long-term unemployed, as a share of all unemployed

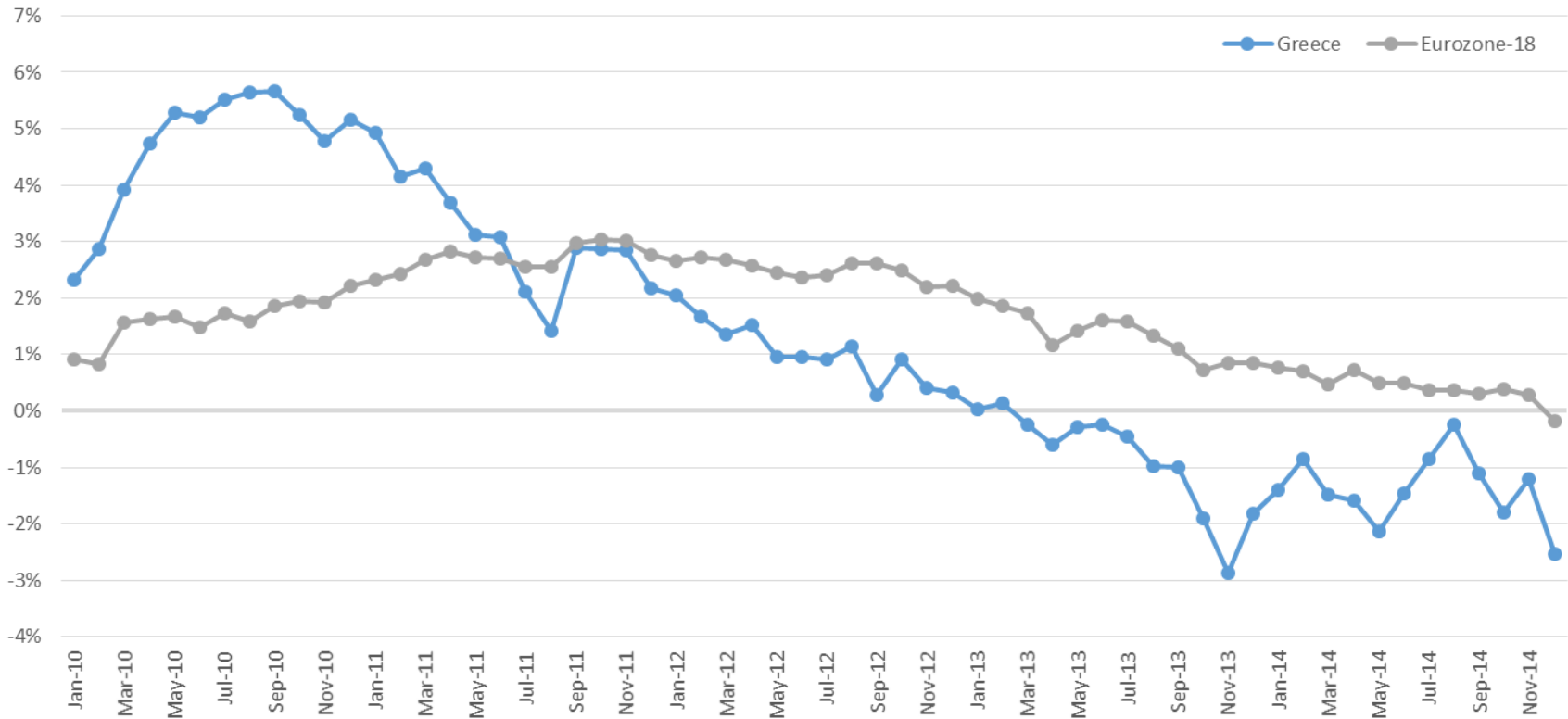


Source: Eurostat

Long-term unemployment increased by 5.4% in the 3rd quarter of 2014, markedly exceeding the Eurozone-19 average

Persistent deflation

Inflation rate

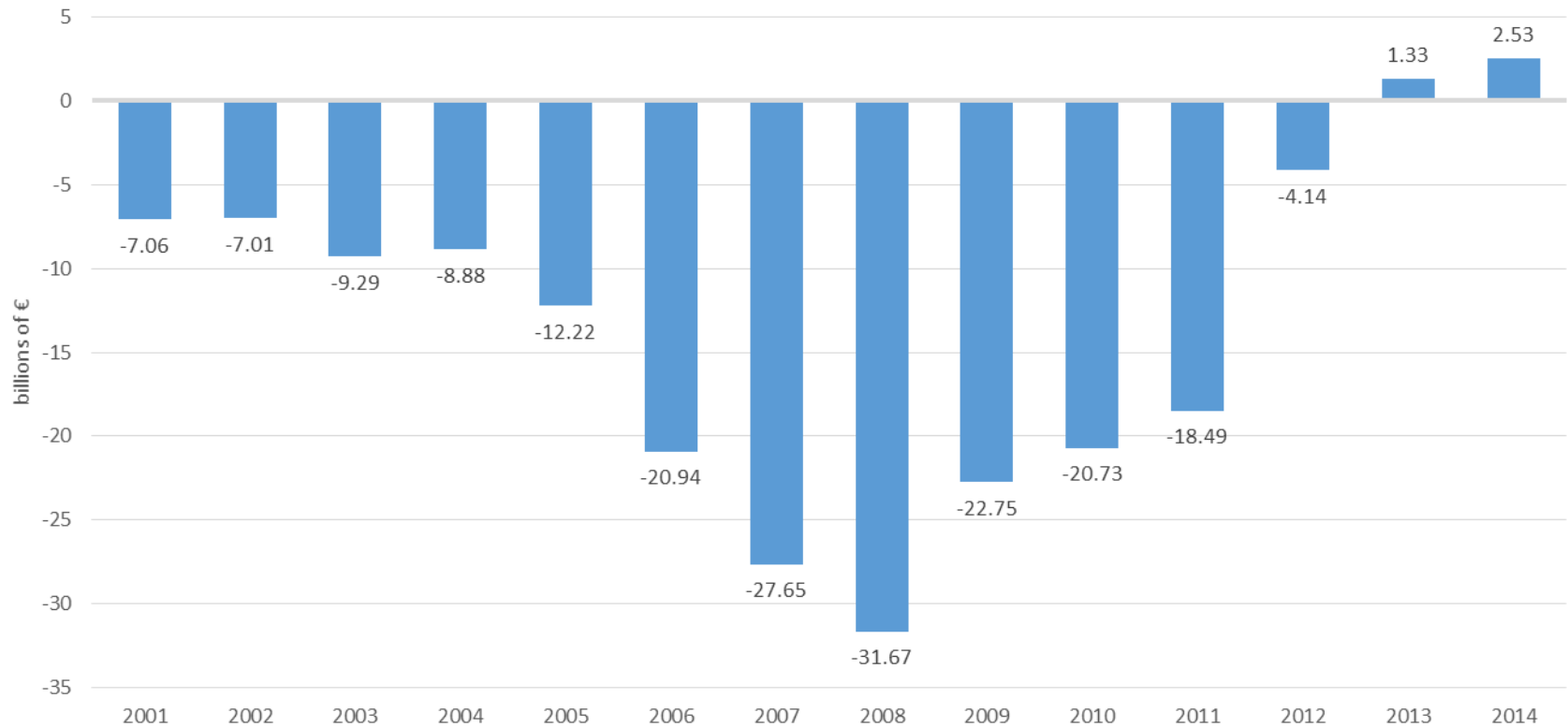


Source: ELSTAT, Eurostat

- Greece had the highest deflation, by 2.5%, in the Eurozone-18 in 2014.
- Sharp price drops in Housing (-7.1%), milder price decreases in Transportation (-4.2%) and in Clothing and Footwear (-3.9%).
- The Producer Price Index (covering both the domestic and the foreign market) declined for second consecutive year, faster than in 2013 (-2.5%, against -0.9% in 2013)

The current account surplus increased in the first eleven months of 2014, despite the growing trade deficit.

Current Account Balance, January – November 2001-2014

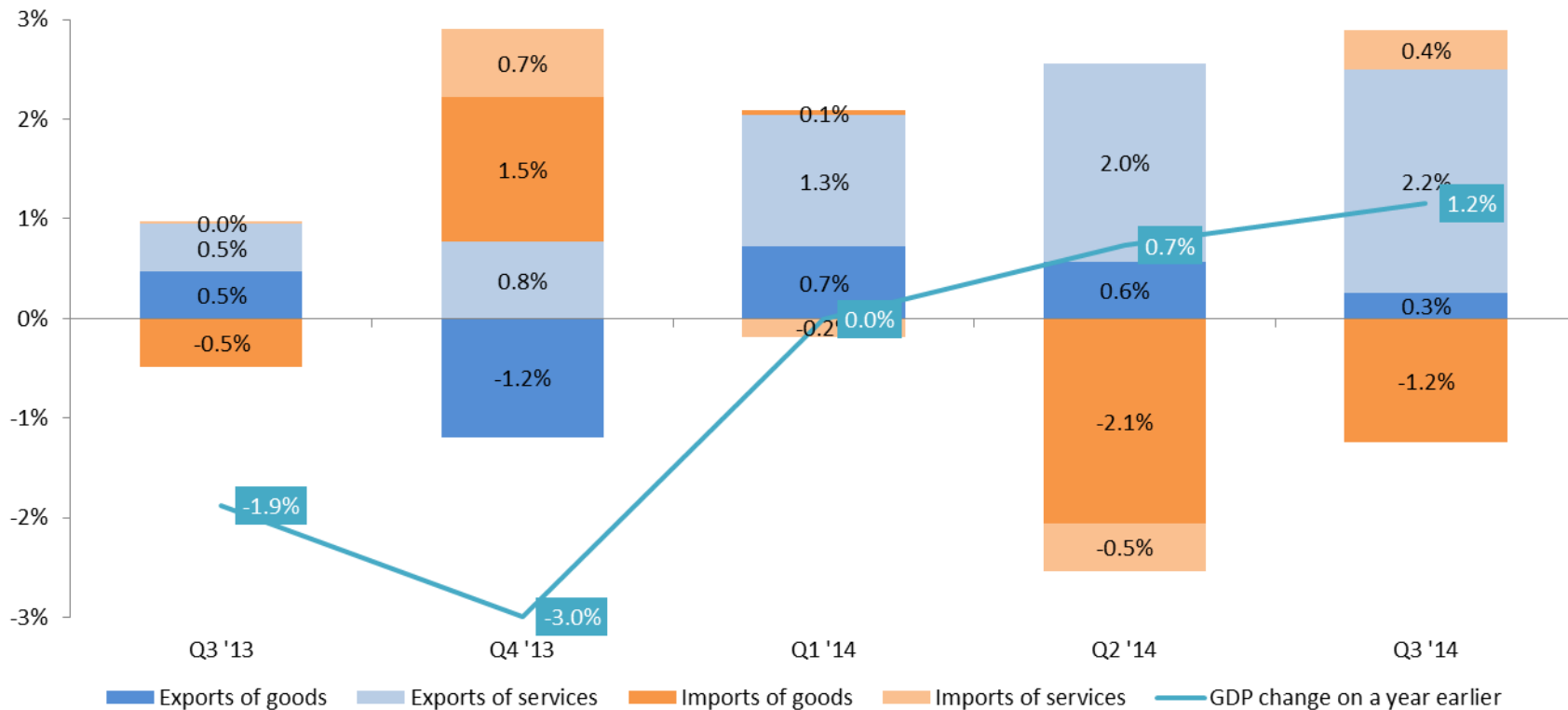


Source: Bank of Greece

The surplus in the balance of services outweighed the trade deficit by €2.3 billion.

Stronger positive contribution of exports of services to GDP (2.2% in the 3rd quarter of 2014, against 0.5% a year earlier)

The components of Net Exports and the rate of change of the GDP



Source: ELSTAT, data processed by IOBE
 Chained volume indicators, the base year is 2010. Seasonally adjusted data.

Prospects for 2015

The country's position at the start of 2015

- **The recapitalization of the Greek banks is completed**

There is scope for substantial improvement of financing terms in 2015

- **A new round of negotiations with the troika**

Foreign stakeholders are cautious regarding the next steps. Reforms in the public sector? Structural reforms? Privatizations?

- **Fiscal adjustment is still under way:**

In 2014 some fiscal targets were not met. However, this was largely due to reasons unrelated with the performance of the tax administration (a transfer under the Securities Market Programme is still pending, people expect a new programme providing favourable terms for tax debt servicing and thus delay payments)

- **Two fortunate international developments (plus quantitative easing by the ECB):**

- Falling exchange rate of the Euro: boosted Greek competitiveness (more tourists from non-Eurozone countries visited Greece)
- Persistently low oil prices: energy costs for enterprises fell, consumption increased

Prospects for 2015

The new policy decisions are the most crucial factor

- Uncertainty regarding the policy priorities and the ultimate decisions of the new government makes domestic and foreign stakeholders cautious
 - The result of the new round of negotiations with the country's creditors will be of paramount importance
 - Households and enterprises in Greece will delay decisions, waiting for the result of the negotiations
 - Similarly, foreign households and firms will be cautious – e.g. bookings for visits to Greece may be postponed, travelers may choose other vacation destinations
- The impact of the negotiations on the Greek economy will depend on the country's access to alternative sources of liquidity.
- If the negotiations are successful, a strong boost in economic activity may follow.

Forecasts for 2015

The main objectives of the new government and the policy instruments it intends to use are not yet clear – forecasting is difficult

- Potential for growth of private consumption by more than 2%
 - Unemployment will keep falling, possibly faster than in 2014
 - Deflation will continue to ease
- Public consumption will increase slightly (+0.5%)
- Investment will recover, driven by the private sector (+7% to +8%)
- Demand for Greek exports of goods will grow faster outside the Euro area, due to the depreciation of the Euro: Tourism will grow, albeit at a slower rate
 - Exports will grow by about 4.5% in 2015
- Imports will grow, driven by increasing consumer demand (possibly, imports of machinery and equipment will also grow)
 - Imports will grow at about the same rate as in 2014 (4%)

The trends of the GDP components lead to a growth potential of
2.3% in 2015

Forecasts for 2015

- **Unemployment will keep on falling**

IOBE forecast for the unemployment rate in 2015: **24.4%**

- **Price-drops will slow down** in the first half of the year

Marginal deflation in 2015