

## 8. GREECE

### Uncertainty reverses economic recovery

*The Greek economy is projected to slip back into recession in 2015 after a period of heightened uncertainty culminated in a bank holiday and introduction of capital controls. The latter is set to have lasting effects on the economy, expected to remain in recession in 2016. The implementation of the new ESM programme will enable a rebound in confidence and investment that is set to support positive growth and the reduction in the general government deficit to below 3% of GDP in 2017.*

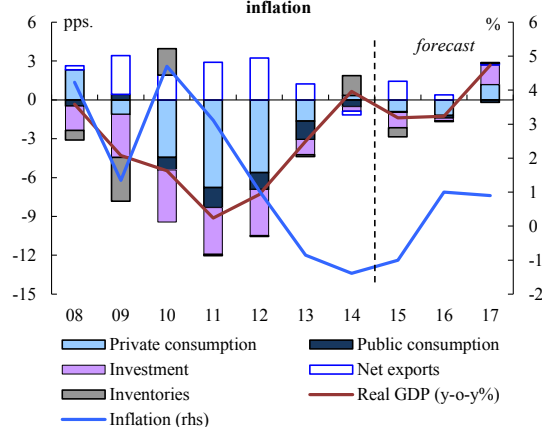
#### Back into recession

The Greek economy built up positive momentum in 2014. However, the unsuccessful conclusion of the 2<sup>nd</sup> Adjustment Programme, the referendum called in June 2015, the ensuing bank holiday and the introduction of capital controls raised uncertainty and deteriorated the growth outlook. Confidence suffered, reflected in the Economic Sentiment Indicator (ESI) and the Purchasing Managers Index (PMI), the latter plummeting to historically low levels in July and August 2015.

Despite the uncertainty, real GDP grew by 1.0% in the first half of 2015. This unexpected outcome most likely reflects consumers advancing spending amid fears of depositors suffering losses. It also reflects a fall in imports, as trade credit tightened significantly, and is set to impact on production with a lag. Available hard data seem not to fully reflect the turmoil at the beginning of the summer and the impact of capital controls. The fiscal drag, expected to weigh negatively on disposable income in the second half of the year as the deadline for tax payment was back-loaded, the standstill of investment and the poor availability of credit are set to take a heavy toll on economic activity. On the positive side, the tourism sector performed exceptionally well for the second year in a row. Despite a drop in goods exports, net trade is projected to contribute positively to growth, due to the larger drop in imports. Overall, the Greek economy is forecast to contract by 1.4% in 2015.

Recovery is expected in the course of 2016, supported by a rebound in confidence, the stabilisation of the financial sector following the banks' recapitalisation expected at the end of 2015, and the consequent re-launching of investment and privatisation projects. Nevertheless, the economy is projected to contract by 1.3% in 2016 amid negative carryover effects from 2015. In 2017, GDP growth is set to gather speed and is projected at 2.7% as implemented structural reforms strengthen aggregate demand.

Graph II.8.1: Greece - Real GDP growth and contributions, inflation



The projected improvement in Greece's current account deficit in 2015 is due to the decrease in imports, while it is expected to turn into surplus in the forecast horizon as past and ongoing structural reforms create new opportunities.

The decreasing trend of unemployment, followed since the peak in 2013, is expected to be interrupted in 2015 and 2016, before resuming in 2017. Compensation per employee is projected to decline further in 2015, before starting to rise again in 2016. HICP inflation is expected to be negative in 2015, as the impact of lower oil prices and the weak demand outweigh the impact of VAT reforms raising many items to the standard rate. Inflation is expected to start increasing from 2016 onwards in line with the economic recovery.

Upside risks to the growth outlook are related to the public sector settling arrears and the full absorption of EU structural funds by the end of the year. On the downside, failure to adequately recapitalise the banking sector within the agreed timeframe or to fully deliver on the reform programme would undermine growth prospects.

#### Adjusted fiscal dynamics with swift action

The prolonged uncertainty and the turnaround in the economic cycle also had a negative impact on public finances in the first half of 2015, especially

on revenues, which led to a revision of fiscal targets. The fiscal policy measures agreed with the authorities in the 3<sup>rd</sup> adjustment programme that were partly implemented already in July and August 2015 are expected to yield savings of over 1% of GDP in the second half of 2015 and up to 4% of GDP cumulatively through 2017. With this significant fiscal consolidation, the primary balance is projected to record a small deficit in 2015 (0.25% of GDP) before returning to surplus in 2016 (0.5% of GDP). Moreover, the Greek government has committed to legislating in autumn 2015 an additional fiscal package to ensure a primary surplus of 1.75% of GDP in 2017. Based on this primary balance path, the headline deficit is projected to fall from 4.6% of GDP in 2015 to 2.2% of GDP in 2017. Downside risks include increased spending due to the marked migration inflows whose impact is still being assessed.

The fiscal projections do not include (i) the return of SMP and ANFA profits to the Greek Government, reflecting the Eurogroup statement of 27 June 2015 to suspend these transfers, and (ii) the forthcoming recapitalisation of the Greek banking sector, that will have a substantial but temporary negative impact on the general government balance, which cannot be determined before the operations take place. The full bank

recapitalisation envelope of up to 25 billion euros (14% of GDP) envisaged in the ESM programme has been included into the public debt figures starting in 2015, although it remains to be seen if all funds need to be drawn.

The general government debt-to-GDP ratio is expected to peak in 2016 at 199.7% before declining in 2017 to 195.6%. A favourable interest rate outlook, better cash management and the back-loaded amortisation schedule for European Financial Stability Facility (EFSF) loans will keep medium-term interest payments and gross financing needs low despite the high stock of debt.

Graph II.8.2: Greece - General Government Revenue, Expenditure and Deficit

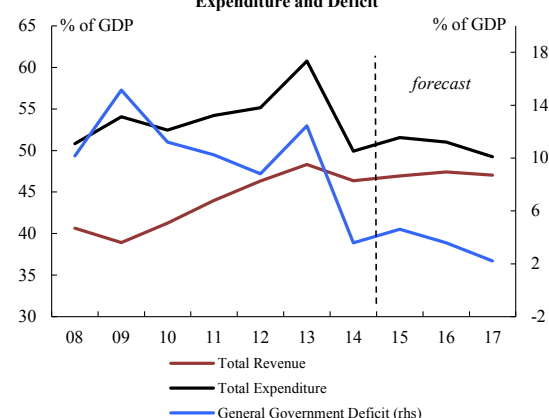


Table II.8.1:

### Main features of country forecast - GREECE

	2014			Annual percentage change						
	bn EUR	Curr. prices	% GDP	96-11	2012	2013	2014	2015	2016	2017
GDP	177.6		100.0	1.6	-7.3	-3.2	0.7	-1.4	-1.3	2.7
Private Consumption	125.0		70.4	1.8	-8.0	-2.3	0.5	-1.3	-1.7	1.7
Public Consumption	35.4		19.9	1.9	-6.0	-6.5	-2.6	-0.2	-1.0	-0.9
Gross fixed capital formation	20.6		11.6	1.1	-23.5	-9.4	-2.8	-10.2	-2.0	14.7
of which: equipment	8.7		4.9	4.9	-36.5	-0.6	18.7	-9.3	-3.0	15.0
Exports (goods and services)	58.0		32.7	5.5	1.2	2.2	7.5	0.1	1.2	4.1
Imports (goods and services)	62.6		35.2	4.3	-9.1	-1.9	7.7	-4.0	0.0	3.7
GNI (GDP deflator)	177.5		100.0	1.3	-4.1	-3.8	0.7	-1.1	-1.1	2.9
Contribution to GDP growth:										
Domestic demand				2.0	-10.5	-4.3	-0.6	-2.1	-1.6	2.5
Inventories				-0.1	0.0	-0.1	1.5	-0.7	-0.1	0.1
Net exports				-0.2	3.2	1.2	-0.3	1.4	0.4	0.1
Employment				0.3	-6.3	-3.6	0.1	0.4	-0.6	2.0
Unemployment rate (a)				10.7	24.5	27.5	26.5	25.7	25.8	24.4
Compensation of employees / head				5.3	-3.0	-7.0	-2.1	-2.0	0.1	0.8
Unit labour costs whole economy				4.0	-2.0	-7.4	-2.6	-0.2	0.8	0.1
Real unit labour cost				0.5	-1.6	-5.0	-0.4	0.9	0.2	-0.6
Saving rate of households (b)				-	-	-	-	-	-	-
GDP deflator				3.4	-0.4	-2.5	-2.2	-1.1	0.6	0.7
Harmonised index of consumer prices				3.7	1.0	-0.9	-1.4	-1.0	1.0	0.9
Terms of trade goods				-0.2	-0.2	1.7	0.9	-3.3	-0.8	0.0
Trade balance (goods) (c)				-14.8	-10.9	-10.5	-11.7	-10.7	-11.2	-11.3
Current-account balance (c)				-9.7	-4.3	-2.1	-2.9	-1.0	-0.3	0.1
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-8.1	-2.5	0.5	-1.1	1.0	1.7	2.0
General government balance (c)				-	-8.8	-12.4	-3.6	-4.6	-3.6	-2.2
Cyclically-adjusted budget balance (d)				-	-2.7	-6.5	0.8	-0.8	-0.3	-1.0
Structural budget balance (d)				-	-0.4	2.0	0.6	-1.1	-0.3	-1.0
General government gross debt (c)				-	159.4	177.0	178.6	194.8	199.7	195.6

(a) as % of total labour force. (b) gross saving divided by gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.