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GREECE MACRO MONITOR

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Focus notes: Greece

Latest macro & market developments

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Highlights

- **Economy contacted more than expected in Q4:2010**
- **Higher-frequency indictors still not signaling an imminent turnaround in domestic economic activity**
- **Current account deficit down sharply in December; pace of external-sector adjustment to accelerate this year**
- **Reporting of general government accounts improves, but problems remain as regards to the coverage of outstanding arrears**

Economy contacted more than expected in Q4:2010

Greece's real GDP growth declined by a preliminary 6.6% YoY in Q4:2010, following a (downwardly revised) rate of -5.7% YoY in the prior quarter. This was significantly worse than market expectations, as *e.g.* a Reuters poll conducted ahead of the data release showed a median analyst forecast of -4.8% YoY. The flash Q4 GDP report did not provide a detailed breakdown, but according to the statistics office, the output contraction was primarily the result of a further significant decline in consumer spending that was only partially offset by the positive contribution of net exports.

The Greek statistics office also announced a number of revisions to GDP data for the period Q1:2006-Q3:2010, in a move to: **a)** bring the revised quarterly estimates in line with the annual GDP figures reported in the EDP notification of November 2010, and **b)** incorporate the calculated quarterly general government accounts for the year 2009, which are consistent and comparable with the corresponding quarterly data of the year 2010.

As a result of these changes, the revised annual GDP growth rates in the period 2006-2010 are as follows:

2006 GDP revised to **5.2%** from 4.5% reported previously

2007 GDP revised to **4.3%** from 4.2%

2008 GDP revised to **1.0%** from 1.1%

2009 GDP revised to **-2.0%** from -2.6%

2010 GDP estimated at **-4.5%** vs. -4.2% forecasted earlier

On a quarter-on-quarter basis, the flash national accounts report showed a slowdown in the pace of GDP contraction in Q4 to -1.*4* (seasonally & calendar days adjusted figures), from -1.7 in the prior quarter and respective rates of -1.8% and -1.9% in Q2 and Q1: 2010. Although the latest revisions to Q1:2006-Q3:2010 national accounts introduce some difficulties in deriving the past quarterly and annual changes of GDP components, we estimate real private consumption to have contracted by ca 4.5% YoY last year. Public consumption is also estimated to have declined by 9% YoY or more in 2010, while the pace of contraction in gross fixed capital formation has likely exceeded -18% YoY. In the external sector, imports of goods and services are estimated to have declined by ca 12% YoY, while exports recorded a marginally positive growth. Looking ahead, we forecast the annual pace of GDP growth contraction to remain in the - 5.5% to -6.0% region in Q1 2011, reflecting weak consumer and business moral, the ongoing fiscal consolidation and stagnant credit creation as a result of tight liquidity conditions in the domestic banking system and the ongoing sovereign debt crisis in the euro area. We continue to expect the first signs of stabilization to appear in late 2011, with the rate of decline of full-year GDP likely to exceed 3% YoY.

Higher-frequency indictors still not signaling an imminent turnaround in domestic economic activity

As we have alluded in a number of recent *Greece Macro Monitor* reports, the majority of higher-frequency indicators of domestic economic activity has yet to send out any convincing signs of an imminent bottoming out in domestic economic activity. Among others, Greece's **unemployment rate** remained in a rising trend in November, jumping to a fresh record high of 13.9% from 13.5% in October and 10.6% the same month a year earlier. The jobless rate, which is usually a lagging indicator of the domestic economy, is expected to increase further this year (to 14.6%, according to the 2011 budget projections), as the economy will experience its third consecutive year of recession.

Elsewhere, **retail sales** by volume continued to decline in November, weighed down by continuing wage restraint and higher taxation. Sales excluding fuels and motor lubricants fell by 13.6% YoY, a higher pace of decline compared to the prior month (-10.2% YoY), pointing to a further significant contraction in consumer spending during the fourth quarter of last year. With respect to domestic **credit developments**, the growth of private-sector borrowing weakened further in December, coming in at 0.2% YoY from 0.4% YoY in November and 4.1% YoY in the same month a year earlier. Credit growth to businesses also slowed to 1.0% YoY in December from 1.6% YoY in the prior month and 5.1% YoY in December 2009. Consumer credit continued to contract, falling by 1.4% YoY after shrinking 0.6% YoY in November. In a similar gloomy tone, the net flow of housing loans was negative in December, with its annual growth rate shrinking -0.4% after rising by a meager 0.3% YoY a month earlier. We expect private-sector credit to remain broadly stagnant or even move to negative growth territory in the months ahead, reflecting weak domestic demand and tight liquidity conditions in the domestic banking sector. Separately, after remaining in a downward trend over the last few months, **business and household deposits** with domestic banks posted a tentative sign of stabilization in December, coming in at €208.86bn, little changed compared to the prior month's level. For the whole 2010, business and household deposits fell by €29.1bn or 12.2%yoy. Shrinking deposits since early 2010 have added to the strains of Greek banks which have become heavily reliant on ECB funding for their liquidity needs.

Adding to the recent string of negative domestic macro releases, **industrial production** dropped by 5.2% YoY in December. This was a slower pace of contraction relative to November (-7.6% YoY), thanks to improved exports of base metals, chemicals and food staff. Yet, the **Markit manufacturing purchasing managers' index (PMI)** hit a seven-month low of 42.8 in January 2011, deviating further away from the 50-points threshold that separates growth from contraction in the manufacturing sector. Specifically, the pace of contraction in output and employment accelerated, while new orders declined for the 17th straight month. Input price inflation hit a 30-month peak, putting upward pressure on manufacturing charges.

On a slightly better tone, the **overall economic sentiment index** for Greece -- which is compiled by the Foundation for Economic and Industrial Research (IOBE) --, edged up to 75.6 in January from 73.3 in the prior month on the back of a modest improvement in manufacturing and retail trade sectors. Consumer confidence improved slightly, remaining though close to an all-time low recorded in December 2010. Moreover, according to the latest customs-based statistics, **goods exports** recorded double-digit growth in Q4:2010, bringing the corresponding full-year rate to +8.3%. On the other hand, **imports** continue to decline at a significantly pace in the fourth quarter, recording a 13% contraction for the year 2010 as a whole. The sharp increase in goods exports in Q4 and recent anecdotal evidence pointing to a 10%-15% rise in tourism inflows this year strengthen our belief that the ongoing compression in domestic wages *via-a-vis* the main trade-partners has already started to have a beneficial impact on competitiveness. According to our estimates, Greece's real wages declined by ca 8% in 2010, compared with a 2% increase in the euro area.

Current account deficit down sharply in December; pace

of external-sector adjustment to accelerate this year

Greece's current account deficit shrunk by 38.5% YoY in December, reaching €1.89bn. This was mainly attributable to a lower trade deficit and, to a lesser extent, to a small rise in the surplus of the services balance. These improvements more than offset a higher deficit in the incomes account and a decline in the current transfers balance. For the full-year 2010, the current account gap declined by 6.9% YoY, reaching ca €24bn or 10.5% of estimated GDP vs. 11.0%-of-GDP in the prior year. The outturn for 2010 as a whole reflects mainly a fall in the trade deficit and a rise in the surplus of the services balance. By contrast, the surplus of the current transfers balance narrowed considerably, while the income account deficit recorded a slight increase.

Specifically, the overall trade deficit declined by ca €2.49bn last year, mainly as a result of a €3.8bn decrease in the trade deficit excluding oil and ships. The import bill for goods excluding oil and ships fell by 12.6% YoY, while the corresponding export receipts declined by 1.3% YoY. By contrast, the net oil import bill rose by 13.6% YoY, while net payments for purchases of ships grew by 7.9% YoY. With respect to the services balance, the €0.59bn increase in the corresponding surplus last year mainly reflects higher net transport receipts (chiefly from merchant shipping) and, to a lesser extent, lower net payments for other services. In particular, gross transport receipts grew by 13.8% YoY in 2010, more than offsetting a concomitant 15.3% YoY rise and in the corresponding payments. On the other hand, net travel receipts fell, as travel spending in Greece by non-residents dropped by 7.6% YoY, while travel spending abroad by residents declined by 10.2% YoY.

Elsewhere, the income account deficit widened by ca 2.7% YoY in 2010, mainly reflecting higher net payments for interest, dividends and profits, while the surplus of the current transfers balance also recorded a decline relative to the prior year. Moreover, the capital transfers balance recorded a €2.1bn surplus in 2010, compared with a surplus of €2.0bn in the prior year. This was mainly the result of higher EU capital transfers to the general government. The overall transfers balance (current transfers plus capital transfers) recorded a surplus of €2.3bn, compared with a surplus of €3.3bn in 2009. Reflecting these developments, the overall deficit of the combined current account and capital transfers balance came to €22bn last year, down by ca 7.7% relative to 2009.

From the financing side, net direct investment recorded a net inflow of €0.69bn in 2010, mainly reflecting increase of foreign investors' participation in the share capital of Emporiki Bank and Geniki Bank. On the other hand, a net outflow of €20.9bn was recorded under portfolio investment, following a net inflow of €27.9bn in the prior year. This development mainly reflected outflows in the form of corresponding decreases of ca €33bn and €1.1bn in non-residents' purchases of Greek bonds/Treasury bills and shares of Greek firms. Finally, under "other" investment, a net inflow of €42bn (vs. a net outflow of €3.6bn in 2009) was mainly attributed to general government net borrowing of €30bn from official lenders (including the IMF and other EMU states).

Looking ahead, we expect the pace of external sector adjustment to accelerate this year, reflecting negative growth of goods & services imports as a result of the domestic recession and higher exports due to favorable developments in relative until labor costs, strong shipping receipts and higher tourism revenues. The latest IMF projections (Dec. 2010), are for a decline in the current account-to-GDP ratio to ca 7%-of-GDP this year, a forecast we generally concur with.

Reporting of general government accounts improves, but problems remain with respect to the coverage of outstanding arrears

In accordance with the requirements of the EU/IMF stabilization programme, the Greek Ministry of Finance continues the publication of monthly (cash) data on the general government's fiscal accounts. The move is considered to be a major step towards better cost management and fiscal transparency in the broader public sector. Nevertheless, the data are not yet complete since a large number of local authorities have so far failed to provide relevant spending and areas related data. Notably, in the months of September, October and November last year only a respective number of 489, 353 and 394 of such sub-national entities (out of a total of 1,078) reported their arrears. According to the most recent data, total reported arrears in September-November period amounted to € 2.98bn *(general government level),* excluding hospital's debt that was settled by law N.3867/2010.

According to a number of recent press reports, the unreported arrears of the local authorities and other sub-national entities as well as a still problematic accounting system are delaying the official publication of the final estimate of the general government deficit last year, which, according to the government's and the EC/ECB/IMF's projections, is expected to range between 9.4%-of-GDP and 9.6%-of-GDP.

The general government budget reporting is expected to be improved in the following months as a result of a) the "Kalikratis" reform of local authorities, b) new accounting standards to be adopted by all sub-national-level entities and c) the electronic registry and auditing of all general government entities.

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