Greece: full-year GDP likely to contact by less than expected earlier

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Barring any major revisions in Q2 data, full-year GDP is likely to contact by less than expected earlier

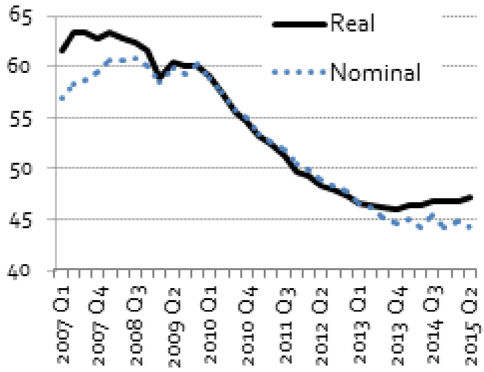
Based on the analysis presented in this note and taking into account the above-consensus Q2 GDP reading, we see upside risks to the official (and our earlier) forecast for Greece's full-year real output growth. Whereas our earlier *NOWcasting* model estimates & short-term forecasts pointed to a full-year real GDP growth reading of -2.05% (and the respective European Commission forecast stands at -2.3%), we now see considerable upside risks to the above projections, looking for a realization closer to -1.5%. That is, provided that: *i)* the revised national accounts data for Q2 2015 (due on August 28) will not deliver any major surprises in the form of sizeable downward revisions to the Q2 flash GDP estimate; *and ii*) the just-announced September 20th national election will not lead to a prolonged period of domestic political uncertainty. For next year, our baseline scenario for real GDP growth falls close to the current European Commission forecast of -1.3%. The latter assumes a quick recovery of economic activity after a relatively weak start in early 2016 that would be sufficient to more than offset the negative carryover from the expected weakening of the domestic economy in H2 2015.

Q2 2015 GDP surprises to the upside

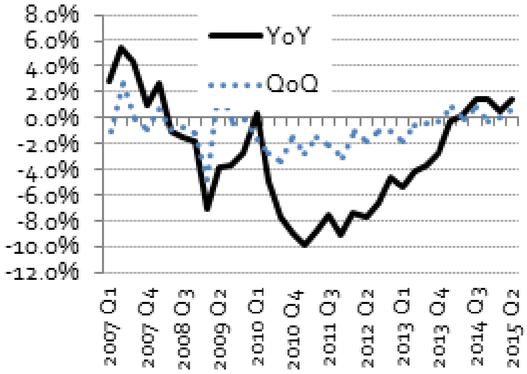
According to national account statistics for the second quarter of 2015 (flash estimate), Greece's real gross domestic product in seasonally and calendar adjusted terms grew by +0.8%/+1.4% QoQ/YoY. This was well above market expectations for a contraction of domestic economic activity in Q2 and compares with a 0.0%/+0.5% QoQ/YoY reading in the prior quarter.[1] Furthermore, revised data for the prior several quarters showed that quarter-on-quarter real GDP growth was flat in Q1 (compared to an earlier reported -0.16%) with the respective year-on-year rate remaining positive for the fourth quarter running. In nominal terms, quarter-on-quarter output growth contracted by 0.7% in the second quarter (+0.1% YoY) due to continued deflation (*Graphs 1.1, 1.2 & Table A in Appendix*). Greek statistics agency is scheduled to publish on August 28 updated GDP data for Q2 2015 and although certain revisions should not be excluded we do not expect any major downside surprises (see analysis below).

[1] Eurobank Research predicted a real GDP growth contraction of -0.5%/-0.6% QoQ/YoY in Q2 2015; see *Greece Macro Monitor, "Greek GDP NOWcasting for Q2, Q3 & Q4, 2015; preliminary estimates of the impact of the new austerity measures", 27 July, 2015*.

Graph 1.1 - Gross Domestic Product in EUR bn (seasonally & calendar adjusted figures)



Graph 1.2 - Gross Domestic Product QoQ and YoY growth (seasonally & calendar adjusted data)



Source: EL.STAT., Eurobank Research

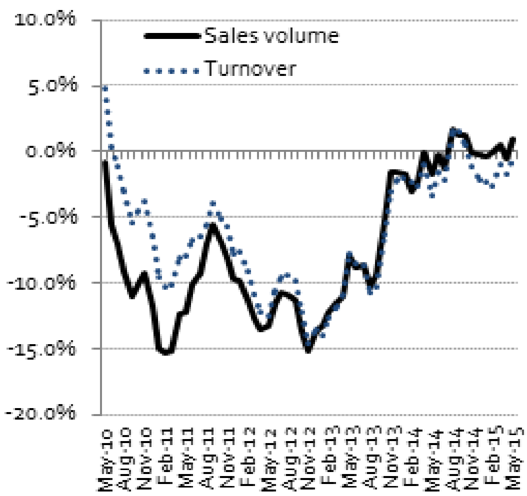
Potential drivers

Detailed data on Q2 national accounts are not yet available, but we believe that the main driver of the better-than-expected Q2 GDP reading was relatively firm private consumption dynamics, arguably on the back of consumer optimism about an eventual agreement with official creditors. Other potential explanations include: i) increased purchases of durables (purportedly seen as a store of value) in anticipation of a possible "Graccident" down the road; and ii) a faster than anticipated contraction of imports due to increased trade-finance problems facing Greek importers.

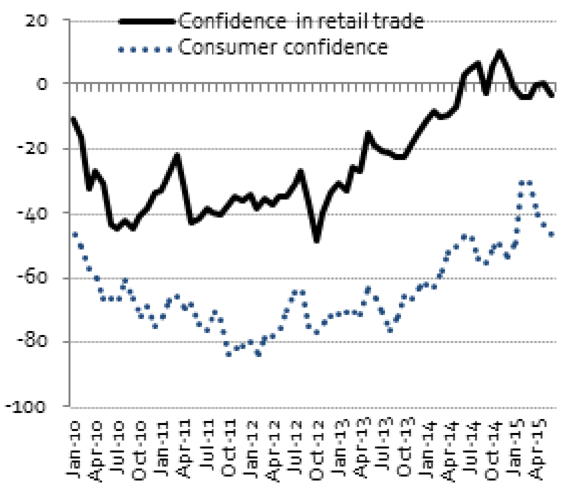
Relative resilience of consumer spending despite tightened liquidity conditions

Recent readings in a range of high frequency indicators pertaining to the second quarter of 2015 point to relative resilience of consumer spending despite increased political uncertainty and tightened liquidity conditions in the domestic economy. Among others, the volume of retail sales in seasonally adjusted terms grew by 3.9% YoY in May, with the biggest increases recorded in clothing and footwear (+7.3% YoY) and the books, stationary and other goods component (+8.2% YoY). A broadly similar picture is portrayed by the seasonally adjusted turnover index in retail trade which rose by 2.2% YoY in the same month (Graph 2.1). According to our calculation, retail sales account for slightly less than 40% of the private consumption component of GDP. In the first 5 months of 2015, the volume of retail sales increased by an average annual rate of 0.7%, compared to a 1.7% contraction in the same period a year earlier, while the turnover index declined by a somewhat slower pace than in January-May 2014 (-1.0% vs. -2.5%). Separately, the consumer and retail trade confidence indicators for Greece hit multiyear highs in February-March 2015, arguably as a result of improved consumer expectations for a swift agreement with official creditors following the January 25 national election (and the agreement reached at the Eurogroup of February 20th) to only embark on a gradual downward trend in the following couple of months, reflecting tightened liquidity conditions in the domestic economy (Graph 2.2).

Graph 2.1 - Retail trade sales volume & turnover s.a. (2010 = 100) _ 3mma YoY growth



Graph 2.2 - Retail trade and consumer confidence indictors for Greece



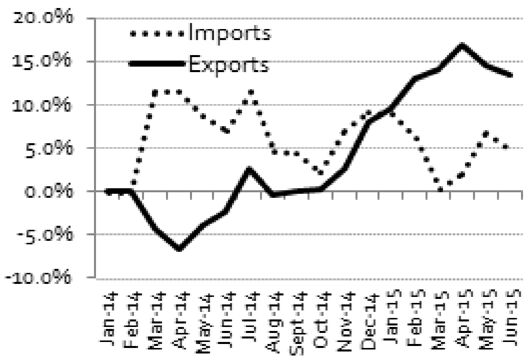
Source: EL.STAT. , EC, Eurobank Research

As regards consumption of durables, car sales grew by 16.9% YoY in Q1 2015 (latest available data), while the number of road motor cars (both new and used from abroad) that were out into circulation for the first time remained strong throughout the first half of the current year, recording a 21.7% increase in June 2015.

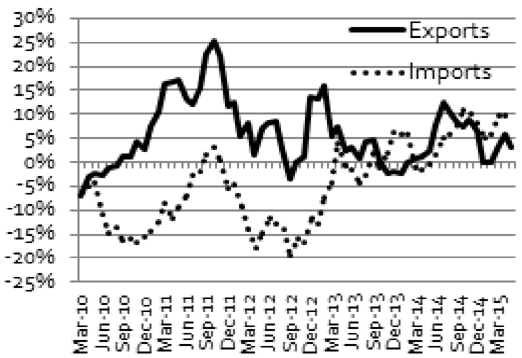
External trade statistics point to anything but a collapse of imports in Q2 2015

The most recent customs-based statistics of external trade revealed that the total value of merchandise imports and exports (in euro terms) contracted by c. 5.3% YoY and 1.9% YoY in the second quarter of the current year. However, it appears that this was partly due to exchange rate and oil price developments. In fact, merchandise imports and exports excluding oil grew by 4.3% YoY and 13.3% YoY, respectively in Q2, painting a picture resembling anything but a collapse of import activity (Graph 3.1). A broadly similar picture is portrayed by BoG's balance-of-payments statistics, which showed a 5.2% YoY increase in goods imports excluding fuels and ships along with a 3.6% YoY decline in corresponding exports in May 2015 (Graph 3.2). For the five months to May 2015, goods imports (exports) excluding fuels and ships grew by +7.9% YoY (+0.7% YoY), following annual rates of growth of -1.2% YoY (+1.5% YoY) in the same period a year earlier. Looking next at the services balance, the all-important travel (tourism) and transportation (shipping) revenue components grew in the first 5 months of the year by 15% YoY and 2.5% YoY respectively, having recorded respective increases of 8.7% YoY and 6.9% YoY in the same period of 2014. In line with the aforementioned, the current account deficit in the 5 months to May 2015 increased by 4.7% YoY, coming in at 1.6%-of-projected GDP.

Graph 3.1 – Customs-based external trade statistics: merchandise imports and exports excluding oil (3mma, YoY %)



Graph 3.2 – BoP statistics: goods exports & imports excluding fuels and ships (3mma YoY,%)

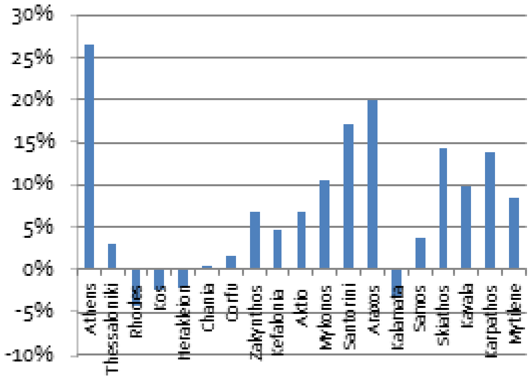


Sources: EL.STAT., BoG, Eurobank Research

Activity in Greek tourism industry may not have been overly affected by capital controls

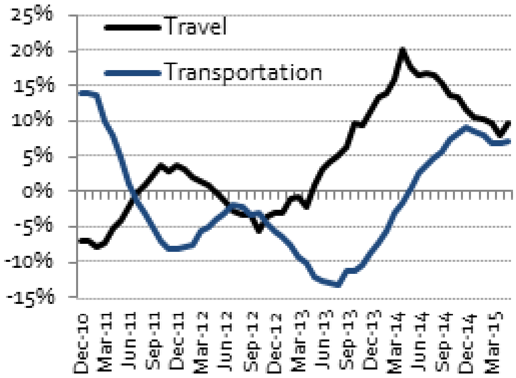
According to recent (provisional) data released by SETE Intelligence, international arrivals at main Greek airports in the first 7 months of 2015 grew by 6.9% from a year earlier to reach c. 17.4 million visitors, while arrivals at the Athens airport recorded a 26.5%YoY increase (Graphs 4.1 & 4.2). Importantly, total airport arrivals increased by 5.3% YoY (Athens airport up 27.8% YoY) in July, helping to dispel earlier worries that the imposition of capital controls would have a significant effect on tourism activity. Note that July 2015 was the first month following the imposition of capital controls, while domestic banks remained closed during the first 3 weeks of that month. Two potential explanations of the strong tourism activity so far this year include: i) during Greece's bank holiday (June 27-July 20, 2015) there was no limit on cash withdrawals from ATMs for foreign visitors maintaining accounts in banks abroad; and ii) subsiding Grexit/Graccident risks following the Jul 13th Euro Summit agreement and the subsequent (August 11) endorsement of a new 3-year bailout package for Greece. Note that tourism is the most important industry for the Greek economy in terms of gross value added and employment. The association of Greek hoteliers (SETE) estimates that in 2014 tourism had a direct contribution to Greek GDP of 9.5ppts, with its overall contribution (direct and indirect) ranging between 20 to 25ppts.

Graph 4.1 – International arrivals at main Greek airports, provisional data for January-July 2015 (YoY, %)



Source: Civil Aviation Authority (CAA) and Athens International Airport (AIA) - Processing: SETE Intelligence

Graph 4.2 – Travel (tourism) and transport (shipping) revenue (12mma, YoY, %)

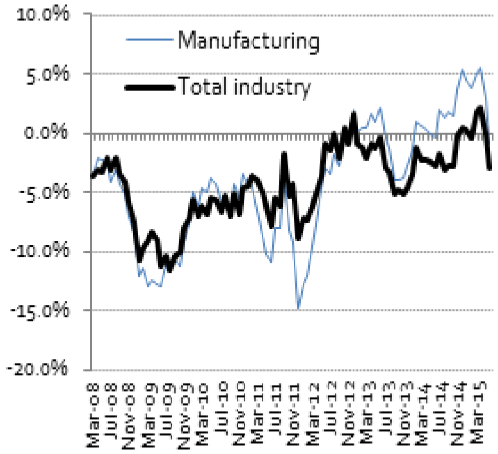


Source: BoG, Eurobank Research

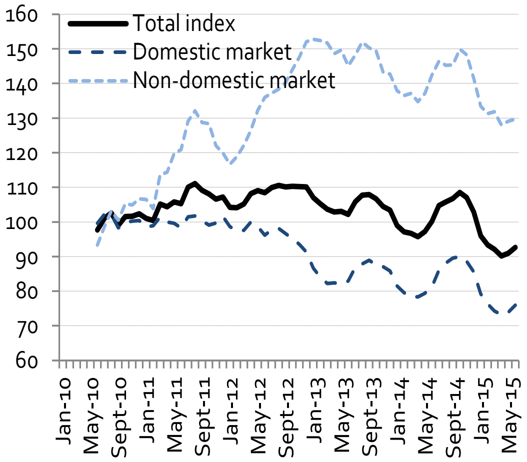
Industrial output growth slipped into negative territory in Q2, reversing the positive trend recorded in the prior three quarters

After bouncing back into a positive territory in the second semester of last year, output growth in the domestic industrial sector remained positive in Q1 2015, assisted by improved domestic demand dynamics and rising exports due to the softening euro and improving conditions in main trade partner economies. In that quarter, the seasonally adjusted indices of total industrial and manufacturing output recorded average annual growth of 5% YoY and 1.7% YoY, compared to respective rates of 0.6% YoY and -2.2% YoY in the same period a year earlier (Graphs 5.1 & 5.2). As seen in the graphs below, the positive trend in domestic industrial activity deteriorated anew in the second quarter of the year, arguably reflecting increased trade-financed problems facing Greek exporters and subsiding internal demand for domestically produced industrial products.

Graph 5.1 – Industrial and manufacturing production s.a. (YoY %, 3mma)



Graph 5.2 – evolution of turnover index in industry 6mma (base year 2010 =100)

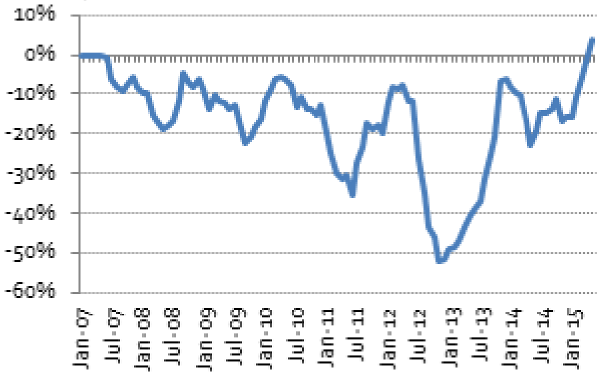


Source: EL.STAT., Eurobank Research

Construction activity continued its slow recovery in H1 2015, following sharp declines in the prior years

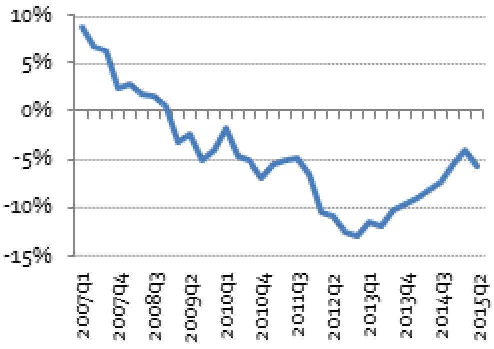
Following steep declined in the prior 5-6 years, domestic construction activity as measures by the number of issued building permits staged a gradual recovery in the second half of last year and over the greater part of the first six months of 2015, though from a sharply reduced base. In a similar vein, the growth rate of residential housing and commercial real estate prices (as measured by the annual percentage change in the relevant BoG indices) continued to recover in the first two quarters of 2015, remaining though in a negative territory.

Graph 6.1 – Construction activity based on number of building permits (6mma, YoY, %)



Source: EL.STAT., Eurobank Research

Graph 6.2 – Residential housing prices (YoY, %)

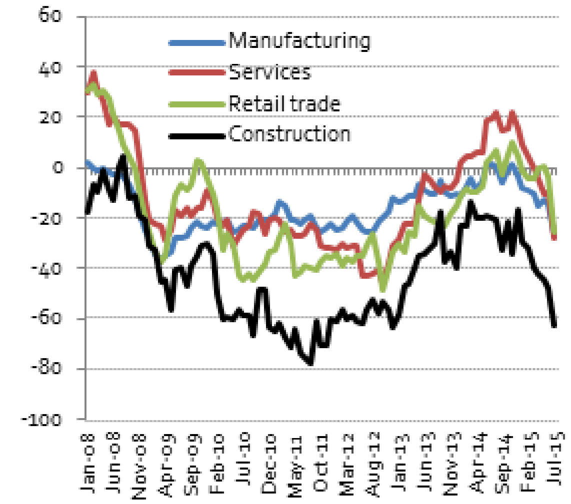


Source: BoG, Eurobank Research

Capital controls, uncertainty over euro area membership prospects instigated sharp drop in domestic business and consumer sentiment in July 2015

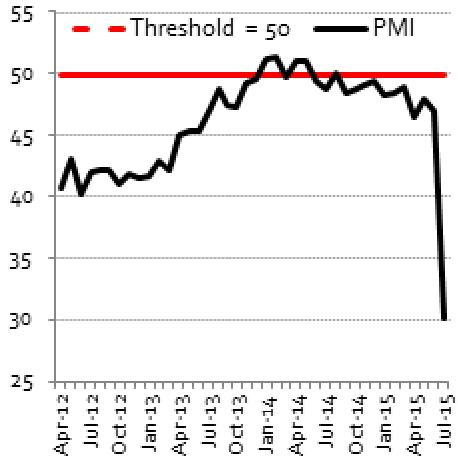
The announcement of the temporary bank holiday and capital controls in late June conspired with uncertainty about Greece's euro membership prospects due to the surprise announcement of the July 5th referendum to instigate a sharp drop in a range of survey data and sentiment indicators of domestic economic activity (Graphs 7.1 & 7.2).

Graph 7.1 – Greece: sectorial confidence indicators



Source: IOBE, EC

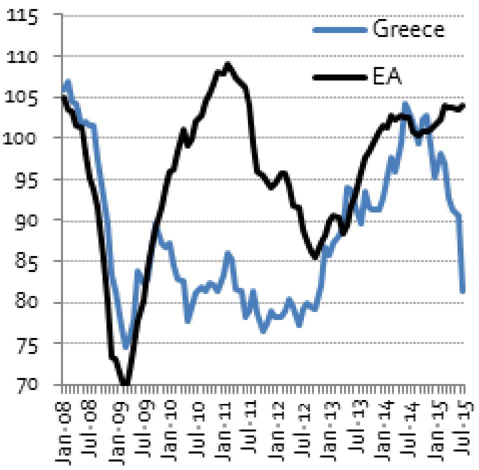
Graph 7.2 – Greece: Purchasing Manager Index (PMI)



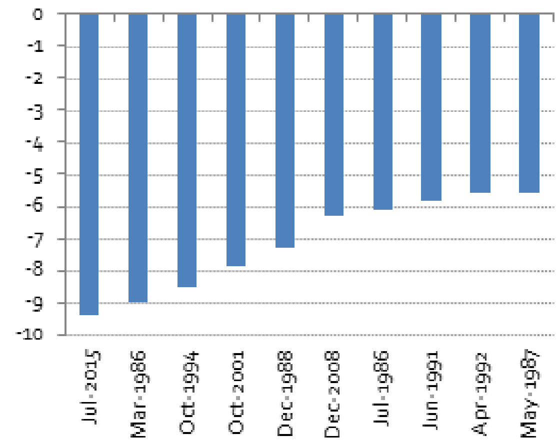
Source: Markit

The aforementioned developments also caused a sharp decoupling of Greece's key economic sentiment indicator from the level recorded by the respective aggregate euro area measure in July 2015, with the Greek index posting its biggest decline on record (Graph 7.3 & 7.4).

Graph 7.3 – Economic Sentiment Indicator



Graph 7.4 – Biggest declines in Greece's Economic Sentiment Indicator



Source: IOBE, EC, Eurobank Research

Although it is still early to judge how the sharp decline in consumer and business confidence has affected the real economy over the last 1 ½ months, released readings for a few *hard* indicators pertaining to the prior month (July) portray a rather problematic picture. Among the very few relevant activity indicators released thus far, road motor cars (both new and used from abroad) were put into circulation for the first time, recording a 23.9% decrease compared with the corresponding month of 2014. On a better note, total airport arrivals increased by 5.3% YoY in July, with arrivals in Athens airport rising by 27.8% YoY.

GDP outlook in H2 2015 and beyond

In view of recent economic and political developments we continue to expect a worsening of GDP dynamics in the second half of 2015. Primary drivers of this development will likely include the transaction- and demand-related impact of capital controls as well as the effect of new fiscal austerity measures in the context of the new (3^{rd}) bailout program agreed with official creditors. In a recent simulation which was based on certain assumptions for impact multiplier values as well as multiplier persistence and hysteresis we estimated the potential recessionary impact of the new measures to be between 0.5 and 1 ppt of GDP this year and slightly over 1ppt of GDP in 2016.[2] Note that the new fiscal package is estimated to be worth €7.5bn, with its impact in 2015 to be skewed towards the second semester. As regards the recently imposed capital controls, our *Greece Macro Monitor* of July 31st attempts a preliminary analysis of their potential impact on the domestic economy.[3] It is important to note that there is currently little consensus in the theoretical and empirical literature on the macroeconomic effects of capital movement restrictions and the same applies in the case of Greece. Nonetheless, following the termination of the bank holiday in Greece (27 June until July 20) there has been some gradual relaxation of capital controls[4], with the easing process expected to continue in the following weeks and months. For instance, in view of the *well documented* large import content of the Greek economy, it is important to note that the maximum daily allowed limit for import payments abroad was lately increased to €150k per invoice, from €100k a few weeks earlier, without necessitating a permission by the relevant Committee at the Ministry of Finance and being subject to the *overall* day limit for each individual bank. Overall, our understanding is that there is a gradual normalization of imports as many domestic importers had already adapted their operations to deal with a multitude of problems encountered over the last several years and this helped them to better cope with capital controls. The same applies for the electronic clearing of checks, as a considerable part of customer transactions was done electronically even before their imposition. From a longer term perspective, two other factors that may prevent a new significant recession of the Greek economy in the period ahead include: i) a further significant relaxation of the annual general government primary surplus targets to: -0.25, 0.5, 1.75 and 3.5 percent of GDP in 2015, 2016, 2017 and 2018 and beyond, respectively and ii) the front loading of up to €35bn of EU funding to Greece to boost investment and job creation[5].

Revised forecasts for Greek GDP in 2015-2017

Based on the aforementioned analysis and taking into account the above-consensus Q2 GDP reading, we now see upside risks to the official (and our earlier) forecast for Greece's full-year real output growth. In more detail, whereas our earlier *NOWcasting* model estimates & short-term forecasts [6] pointed to a full-year real GDP growth reading of -2.05% (and the respective European Commission forecast stands at -2.3%), we now see considerable upside risks to the above projections, looking for a realization closer to (if nor lower than) -1.5%. That is provided that: *i)* the revised national accounts data for Q2 2015 (due on August 28) will not deliver any major surprises in the form of sizeable downward revisions to the Q2 flash GDP estimate and *ii)* the just-announced September 20th snap national election will not lead to a prolonged period of domestic political uncertainty. For next year, our baseline scenario for real GDP growth falls close to the current European Commission forecast of -1.3% (Table 1). The latter assumes a quick recovery of economic activity after a relatively weak start in early 2016 that would be sufficient to more than offset the negative carryover from the expected weakening of the domestic economy in H2 2015.[7]

**We will review our Greek GDP forecasts after the release of the revised Q2 2015 national accounts statistics and we will publish any revisions once we see more higher-frequency macro data pertaining to the current quarter.*

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[2] *"Greek GDP NOWcasting for Q2, Q3 & Q4, 2015; preliminary estimates of the impact of the new austerity measures",* Greece Macro Monitor, Eurobank Research, 27 July, 2015.
http://www.eurobank.gr/Uploads/Reports/GREECE%20MACRO%20FOCUS%20July%20272015GDP%20Nowcasting.pdf

[3] "Some preliminary thoughts on the macroeconomic effects of capital controls in Greece", Greece Macro Monitor, Eurobank Research, 31 July, 2015. http://www.eurobank.gr/Uploads/Reports/GREECE%20MACRO%20FOCUS%20July%2031%202015.pdf

[4] Among others: i) at any date and time of the week (and no later than Friday) a depositor may now withdraw from bank branches or ATMs the maximum allowed weekly amount of €420, whereas during the bank holiday the maximum allowed daily amount per card holder per credit institution was €60; ii) cash withdraws in foreign currency are now allowed from bank branches up to the daily limit of the equivalent of €60, based on the current daily exchange rate. Beneficiaries are allowed to transfer their respective daily limit to another day of the same week; and iii) the use of credit, debit and prepaid cards for the purchase of goods and services is now not only allowed within Greece as it was the case during the bank holiday, but also outside Greece and via internet (up to the maximum allowed amount laid down in the respective contact agreed with the bank and within the daily limit approved for each individual bank by a special Committee).

[5] See e.g. *"Marathon Euro Summit reaches tentative agreement on Greece: Summary and brief assessment of underlying conditionality and funding envelope",* Greece Macro Monitor, Eurobank Research, 13 July, 2015.
http://www.eurobank.gr/Uploads/Reports/GREECEMACROFOCUSJuly%20132015.pdf

[6] *"Greek GDP NOWcasting for Q2, Q3 & Q4, 2015; preliminary estimates of the impact of the new austerity measures",* Greece Macro Monitor, Eurobank Research, 27 July, 2015.
http://www.eurobank.gr/Uploads/Reports/GREECE%20MACRO%20FOCUS%20July%20272015GDP%20Nowcasting.pdf

[7] Even assuming fully-year real output growth of c. -1.0% this year, we estimate the negative carry over into 2016 GDP to be close to -2ppts.

Table 1 – European Commission forecasts for Greek Gross Domestic Product
(Seasonally and calendar adjusted figures)

	Real GDP in EURbn (chain linked volumes; reference year 2010)	**Real GDP growth** (YoY, %)	**Nominal GDP in EURbn** (current prices)	**Nominal GDP growth** (YoY, %)
2014 (r)	186.5	0.80%	179.1	-1.80%
2015 (f)	182.3	-2.30%	173.4	-3.20%
2016 (f)	179.9	-1.30%	172.2	-0.70%
2017 (f)	184.8	2.70%	178.1	3.40%

Source: EC

Appendix

Table 1 – Greece's GDP in million euros (seasonally and calendar adjusted figures)

	Chain linked volumes (reference year 2010)	YoY	QoQ	At current prices	YoY	QoQ	Implied GDP deflator (%, YoY)
2012 Q1	49.178	-7.4%	-1.0%	49.745	-6.8%	-1.2%	0.7%
2012 Q2	48.301	-7.7%	-1.8%	48.787	-7.2%	-1.9%	0.5%
2012 Q3	47.831	-6.6%	-1.0%	48.189	-6.9%	-1.2%	-0.3%
2012 Q4	47.358	-4.7%	-1.0%	47.591	-5.5%	-1.2%	-0.8%
2013 Q1	46.539	-5.4%	-1.7%	46.564	-6.4%	-2.2%	-1.1%
2013 Q2	46.313	-4.1%	-0.5%	46.025	-5.7%	-1.2%	-1.6%
2013 Q3	46.106	-3.6%	-0.4%	45.148	-6.3%	-1.9%	-2.8%
2013 Q4	46.039	-2.8%	-0.1%	44.548	-6.4%	-1.3%	-3.7%
2014 Q1	46.432	-0.2%	0.9%	44.931	-3.5%	0.9%	-3.3%
2014 Q2	46.395	0.2%	-0.1%	44.303	-3.7%	-1.4%	-3.9%
2014 Q3	46.777	1.5%	0.8%	45.238	0.2%	2.1%	-1.2%
2014 Q4	46.671	1.4%	-0.2%	44.239	-0.7%	-2.2%	-2.0%
2015 Q1	46.682	0.5%	0.0%	44.650	-0.6%	0.9%	-1.2%
2015 Q2	47.041	1.4%	0.8%	44.336	0.1%	-0.7%	-1.3%

Source: EL.STAT., Eurobank Research

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