



GREECE MACRO MONITOR

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Focus notes: Greece

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State Budget Execution in January-May 2012 Signals Government Still on Track to Meet Full-Year Deficit Target, Despite Rising Overshooting Risks

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State Budget Execution in January-May 2012 Signals Government Still on Track to Meet Full-Year Deficit Target

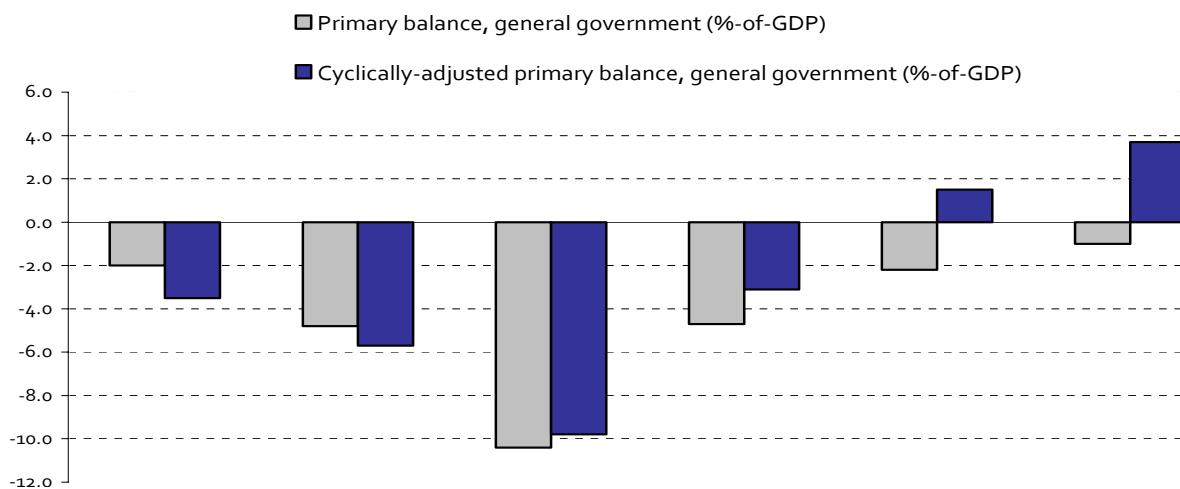
The deeper than expected economic recession and prolonged political uncertainty ahead of a new national election on June 17th have re-ignited worries over the attainability of this year's fiscal targets. In an attempt to step up tax collections and make up for the revenue slippage recorded in the most recent State budget execution data, caretaker Finance Minister Giorgos Zannias announced recently a number of extraordinary measures to deal with the situation. These include, among others: i) an increased focus of tax authorities on companies and self-employed that are withholding value-added tax payments; ii) the delivery of notices to taxpayers with outstanding debts to the State in excess of €3,000, calling them to settle their debts or face immediate seizure of property, bank deposits or other assets; and iii) a tighter monitoring of taxpayers with sizable wealth and real estate assets. Separately, he called for the immediate mailing to taxpayers of the Single Property Tax (ETAK) clearance documents for 2009, which are hoped to bring to state coffers additional revenues of up to €100mn by June 30, 2012. This scheme is applied to all taxpayers, single or married, who had properties with a total objective value that year of at least €100,000 and €200,000, respectively. The Single Property Tax clearance notices for 2009 were ready for delivery by early April, 2012 but their mailing was postponed ahead of the May 6 general election. The notifications for the 2010 real estate tax, called Property Tax (F.A.P) that replaced ETAK, will reportedly be sent to property owners after the June 17 ballot. This specific levy is applied to all households whose property has a total objective value at least €400,000.

Undoubtedly, recent macroeconomic and political developments in Greece portray a worrying picture for fiscal developments in the period ahead, with the government's cash reserves reportedly approaching depletion again and the ongoing demand contraction continuing to weigh on tax revenue. Notwithstanding the present crucial state of government finances, the most recent official data provide some encouragement, despite the ongoing weakness in tax receipts and the continuing

accumulation of government arrears. Among others, the most recent data on the State budget execution revealed that, over the first five months of this year the government was broadly on track to meet this year's deficit targets. Specifically, the cumulative central government deficit in January-May 2012 was lower by around €2bn (or 1% of projected GDP) relative to the corresponding 5-month target envisaged in the 2012 Supplementary Budget. This was despite much higher interest payments (by ca 1.3ppts-of-GDP) relative to the same period a year earlier. On the other hand, the corresponding central government primary shortfall (which excludes interest costs) declined by 48.5% YoY relative to the first five months of 2011 and it was lower by €1.9bn (or 0.92% of projected GDP) compared to the corresponding official target for the January-May 2012 period. For the full-year 2012, the overall interest payments bill is projected to decline by €3.6bn or 1.6ppts-of-GDP relative to 2011.

As a reminder, Greece's 2012 supplementary budget targets a reduction in the general government deficit to 6.7%-of-GDP, from 9.1%-of-GDP in 2011. Separately, the IMF's latest country report on Greece (March 2012) forecasts a slightly higher overall deficit this year (7.3%-of-GDP) along with a general government primary shortfall of 1.0%-of-GDP. Finally note, that, contrary to what many investors currently appear to believe, the applied austerity program has yielded significant fiscal results over the last two years. Among others, the general government primary deficit has declined by more than 8ppts-of-GDP since 2009 with the corresponding improvement in cyclically-adjusted terms (11.3ppts-of-GDP) easily exceeding what has ever been attained by any OECD country (GRAPH 1). Furthermore, besides the significant up-front reduction in the public debt stock due to the recently completed debt exchange (PSI), future debt servicing costs are expected to decline significantly in the years to come, facilitating the attainment of the fiscal targets and improving the State's solvency outlook. According to our calculations, annual interest rate payments will decline by more than 4ppts-of-GDP on average in 2012-2020 as a result of the PSI and the more favorable terms on existing and new EA/EFSF loans.

Graph 1: Greece's general government Primary Balance (%-of-GDP)



Year-to-May Central Government Deficit Lower Than Targeted

According to the latest preliminary data for the execution of the State budget, the central government deficit amounted to around €10,88bn in January-May 2012 or ca €2bn lower than the corresponding 5-month target envisaged in the 2012 Supplementary Budget (Table 1). On a year-on-year basis, the overall State budget deficit rose by 4.5%, but this was almost exclusively due to higher interest payments compared to the January-May 2011 period (up by 45.9% YoY to ca €8.5bn or 4.2% of projected full-year GDP). On the other hand, the primary central government deficit declined by 48.5% YoY relative to the first five months of last year and it was lower by €1.9bn (or 0.92% of projected GDP) compared to the corresponding official target for the January-May 2012 period.

On the receiving side, ordinary budget *net* revenue in the five months to May 2012 amounted to ca 18.8bn, undershooting the target set in the 2012 Supplementary Budget by ca €0.67bn. The shortfall was partly due to: (i) lower income receipts (by €0.25bn) relative to the corresponding target as a result of an extension, until June 8, given to domestic corporations for submitting their tax

declarations; and (ii) lower transaction tax receipts (by ca €0.5bn relative to the budget targets) as a result of a the sharper-than-earlier-expected contraction in domestic demand. On a more positive note, the aforementioned shortfall was partly counterbalanced by a sharp decline of tax refunds (-44.9% YoY in January-May 2012), improved collection of tax arrears and receipts from vehicle tax duties. In the absence of a notable improvement in domestic economic activity, state revenue from transaction taxes is expected to continue underperforming the corresponding budget targets during the remainder of the year, with improved income tax collections from June onwards providing some offset.

On the expenditure side, ordinary budget primary outlays declined by 5.6% YoY in January-May 2012, coming in some €1.1bn (or 0.55% of GDP) lower than the corresponding budget target. A more detailed breakdown of cumulative State budget expenditure in the first five months of the year is not out yet, but the final data for the four months to April 2012 revealed a 5.5% YoY reduction in the overall bill for salaries and pensions. The latter constitutes the biggest item of State budget expenditure, amounting to ca 27% of total central government outlays in the four months to April 2012. Separately, total Public Investment Program (PIP) revenue amounted to ca €1.49bn in the first five months of the year, undershooting the corresponding official target by around 0.27bn. The slippage was mainly due to certain delays in EU payments, part of which the government expects to receive in June. On the expenditure side, total PIP outlays in the five months to May 2012 declined by 23.7% YoY, coming in ca €1.4bn lower than the corresponding 5-month target envisaged in the 2012 Supplementary Budget.

Table 1-State Budget

	Jan-May 2011	Jan-May 2012				FY-2011	FY-2012	FY-2012
	Realization €mn (1)	Realization €mn (2)	Realization YoY % (3)	Target (*) €mn (4)	Deviation €mn (4)=(2)-(3)	Realization €mn (5)	Target €mn (6)	Target YoY % (7)
I. Ordinary budget balance (A-B)	-9,389	-11,076		-11,919	843	-20,044	-11,589	
A. Ordinary budget net revenue (a1+a2-a3)	18,358	18,168	-1.0%	18,834	-666	50,091	51,409	2.6%
a1. Ordinary budget gross revenue	20,592	19,399	-5.8%	20,150	-751	54,217	54,949	1.4%
a2. Special revenue from licencing and public rights	0	0		40	-40	1,157	270	
a3. Tax refunds	2,234	1,232	-44.9%	1,356	-124	5,283	3,810	-27.9%
B. Ordinary budget expenditure (b1+b2+b3+b4+b5)	27,747	29,244	5.4%	30,753	-1,509	70,135	62,998	-10.2%
b1. Primary expenditure	21,292	20,095	-5.6%	21,219	-1,124	51,548	47,685	-7.5%
b2. Grants to hospitals for the settlement of old debts	375	392	4.5%	390	2	435	400	-8.0%
b3. Military procurements	64	72		230	-158	359	700	
b4. Guarantees called	172	160		252	-92	1,445	1,163	
b5. Net interest payments	5,844	8,525	45.9%	8,662	-137	16,348	13,050	-20.2%
II. Public investment budget (PIB) (C1-C2)	-1,028	195		-977	1,172	-2,838	-2,550	
C1. PIB net revenue	673	1,493	121.8%	1,758	-265	3,770	4,750	26.0%
C2. PIB expenditure	1,701	1,298	-23.7%	2,735	-1,437	6,608	7,300	10.5%
III. Central government budget balance (I+II)	-10,417	-10,882	4.5%	-12,896	2,014	-22,882	-14,139	-38.2%
Central government primary balance (III+b5)	-4,573	-2,357	-48.5%	-4,234	1,877	-6,534	-1,089	-83.3%

Source: MoF, Eurobank EFG Research

Year-to-April General Government Primary Deficit down sharply from a year earlier

The general government deficit on a cash basis rose by 39.2% YoY in the first four months of 2012, reaching around €7.62bn or 3.8% of projected full-year GDP. However, this was exclusively due to higher interest payments relative to the same period a year earlier. On the other hand, the government's primary position (which excludes interest payments) was broadly balanced in January-April 2012, compared to a deficit of €1.48bn or ca 0.7%-of-GDP recorded in the first four months of last year.

A closer look at the general government accounts for the first four months of this year (Table 2 on page 6) reveals some interesting developments. Specifically,

- At the central government level, total revenues grew by 6.9% YoY in January-April 2012. Other general government revenue categories (outside the State budget) also recorded positive growth compared to a year earlier. It should be noted though that a certain part of these proceeds were in the form of transfers and grants from the central government. State budget grants to extra-budgetary funds and local governments in the four months to April 2012 declined by 21.6% YoY and 32.8% YoY, respectively, whereas grants to social security funds increased by 2.6% YoY. The latter reflects reduced social security contributions from employees and businesses as a result of reduced domestic economic activity, business closures and higher unemployment.
- At the expenditure side, central government primary outlays (on a cash basis) decline by 4.2% YoY in January-April 2012. The published general government accounts did not provide a detailed breakdown of primary spending, but the State budget execution data for the corresponding period revealed that the aforementioned improvement was mainly driven by a 5.5% YoY reduction in salary and pension payments, by far the biggest item of State budget expenditure (~ 27% of total central government outlays in the four months to April 2012). On a less comforting note, grants to the social security sector grew by 7.8% YoY in the first four months of 2012, already covering 42.2% of the corresponding full-year target.
- Other general government expenditure categories revealed a rather mixed picture. Primary spending of social security funds declining by 3.2% YoY in January-April 2012, whereas primary outlays of local governments and extrabudgetary funds increased by 45.8% YoY and 9.8% YoY, respectively.

General government arrears remain at elevated levels

Total general government arrears - defined as unpaid debts to third parties for over 90 days - stood at ca €6.28bn at the end of April 2012 (or 3.1%-of-projected GDP), broadly unchanged from a month earlier, but up by ca €0.69bn since the beginning of the year. The largest part of these arrears (€2.82bn) was owed by social security funds. Hospitals arrears stood at ca €1.59bn in April 2012, up by 7.3% compared to a month earlier, while local government arrears were ca €0.80bn, down by 9.8% relative to their level at the end of March 2012. On the other hand, total arrears of the State budget and extra-budgetary funds stood at 0.79bn and €0.27bn respectively in April 2012, broadly unchanged from a month earlier.

Graph 2 below depicts the evolution of general government arrears since January 2011. The total stock of such outstanding debts remained above €6.5bn throughout the May-November 2011 period, partly as a result of delays in the disbursement of the 4th and the 5th loan installments under 1st EU-IMF bailout programme (Greek Loan Facility). Note that the Quantitative Performance Criterion on the non-accumulation of arrears as of the end September 2011 was missed as a result of fiscal slippages and the delayed completion of the 5th EU-IMF programme review (December 2011). The loan disbursement following the completion of that review provided some financing for the settlement of outstanding government debts, with their total stock declining as a result by €0.93bn to €5.73bn in December 2011. However, in the first three months of 2012 arrears increased again as no official funding was allocated to clear outstanding government debts over that period.

The current stock of arrears does not necessarily constitute a risk for the achievement of the 2012 general government deficit target, as it is measured on an accruals basis. However, the creation of new outstanding debt in the following period may increase overshooting risks. The latter view is particularly relevant given lingering weaknesses in the reporting of general

government obligations. The first EU-IMF bailout programme required domestic authorities to provide by the end of last year a comprehensive plan for the full clearance of the arrears in 2012 as well as the implementation of reforms on spending controls and the reporting of outstanding government debts. The government failed to meet the end-2011 deadline for the preparation of such a plan and the quality of arrears reporting remaining far from satisfactory. According to new EU-IMF support programme for Greece, official financing for the clearance of general government arrears will take place in a progressive manner. Note that the settlement of outstanding government debts is also important for releasing much-needed liquidity to the domestic real economy.

Graph 2: Evolution of general government arrears (€bn)

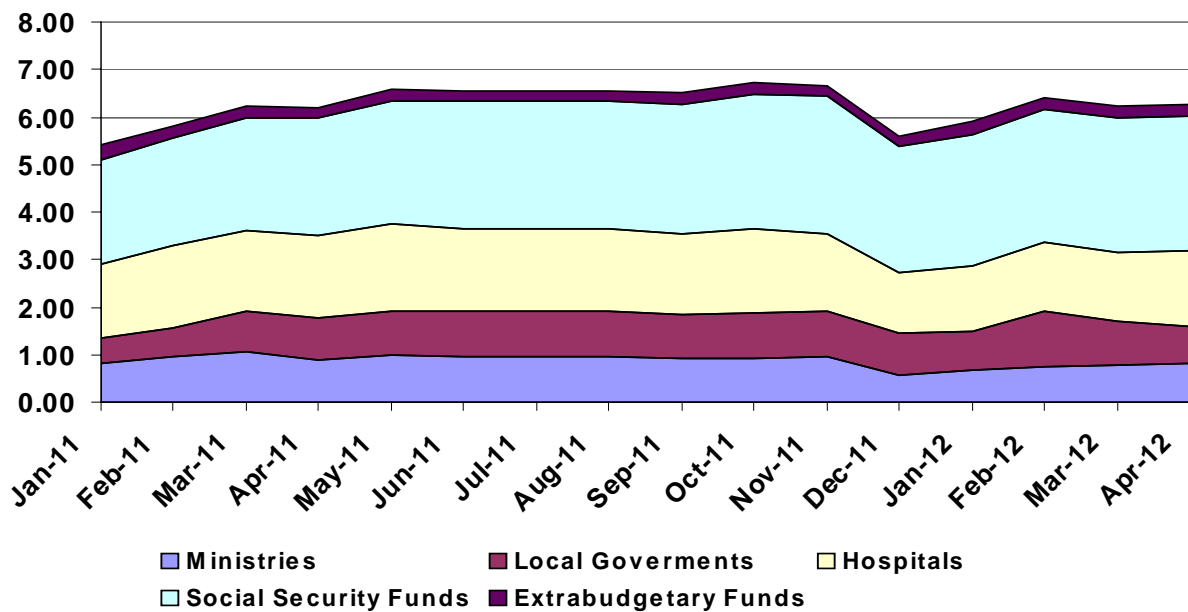


Table 2 - General government accounts
cash-basis provisions data in mn €

	Jan-Apr 2011 Realization	Jan-Apr 2012 Realization	YoY, % Change	FY-2011 Realization	FY-2012 Target	YoY, % Change
A. State budget						
a1. Revenue	15,103	16,146	6.9%	53,861	56,159	4.3%
a2. Primary expenditure	18,659	17,873	-4.2%	60,395	57,248	-5.2%
a3. Interest payments	3,819	7,419	94.3%	16,348	13,050	-20.2%
A1. Balance (a1-a2-a3)	-7,375	-9,146		-22,882	-14,139	
Correction/1	920	1,056		-316	0	
A2. State budget balance (after corrections)	-6,455	-8,091		-23,198	-14,139	
B. Extrabudgetary funds						
b1. Revenue	1,691	1,428	-15.6%	7,289		
<i>of which grants from State</i>	643	504	-21.6%	4,065		
b2. Primary expenditure	1,239	1,361	9.8%	4,169		
b3. Interest payments	147	146		628		
B1. Balance (b1-b2-b3)	305	-79		2,492	2,371	
C. Local governments						
c1. Revenue	2,233	2,122	-5.0%	7,839		
<i>of which grants from State</i>	1,489	1,001	-32.8%	4,279		
c2. Primary expenditure	1,257	1,833	45.8%	7,007		
c3. Interest payments	21	27		101		
C1. Balance (c1-c2-c3)	955	262		730	0	
D. Social security funds						
d1. Revenue	13,529	13,653	0.9%	43,560		
<i>of which grants from State</i>	5,549	5,691	2.6%	18,158		
d2. Primary expenditure	13,802	13,355	-3.2%	44,269		
d3. Interest payments	3	6		71		
D1. Balance (d1-d2-d3)	-276	291		-779	-1,533	
E. General government						
e1. Revenue (a1+b1+c1+d1)	32,556	33,349	2.4%	112,549		
<i>of which intra-government transactions</i>	-7,681	-7,195		-26,502		
e2. Primary expenditure (a2+b2+C2+d2)	34,036	33,367	-2.0%	116,155		
<i>of which intra-government transactions</i>	-7,681	-7,195		-26,502		
e3. Primary balance (e1-e2) / 2	-1,480	-18		-3,607		
e4. Interest payments (a3+b3+c3+d3)	3,990	7,598	3,608	17,148		
E1. Balance (e3-e4)	-5,470	-7,616	39.2%	-20,755	-13,301	
<i>ESA adjustment</i>				1,168	-432	
ESA 95 general government balance				-19,586	-13,733	
(% of GDP)				-9.1%	-6.7%	

Source: FinMin; Eurobank EFG research

Notes

/1 Correction

Advance payment in Dec 2011 against next year expenditure

Other expenditure

/2 On a non-consolidated basis

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