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Government announces new fiscal measures in an effort to facilitate fulfillment of the 2011 fiscal target

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In his annual keynote economic speech at a trade fair in the northern city of Thessaloniki on Saturday, Greek Prime Minister George Papandreou vowed to do whatever it takes to "avoid a disaster for the country and its people and to stay in the euro". Thessaloniki's international fair has been traditionally used by Greek prime ministers as a venue for announcing the key parameters of future economic policies, underling the main elements of the new government budgets and, at times, promising handouts to appease voters.

This time around, expectations ahead of Mr. Papandreou's speech were severely constrained by the tough economic and fiscal realities of a steeper-than-expected domestic recession, concerns about the prospects of the 5th EU/IMF program review and, reportedly, increased headwinds to the process of ratification of the July 21st Council decisions by national EU parliaments.

Market doubts over the country's ability to deliver on its fiscal consolidation and structural reforms programs have reached a climax early last week, prompting Greece's Deputy Premier and Finance Minister Evaggelos Venizelos to make a number of concrete policy announcements in an effort to reassure investors of the government's determination to meet its earlier commitments to international lenders. *(A more thorough analysis of Mr. Venizelos' recent announcements can be found in Eurobank EFG Research, Greece Macro Monitor, "Government vows to accelerate structural reforms: An assessment of y-day's announcements" September 7, 2011).*

Sentiment towards Greece took a turn for the worse over the past few days amid statements by a number of key euro area policy makers linking the release of the next official loan tranche to the successful completion of the 5th EU/IMF program review and a number of reports casting doubts over the country's ability to avoid default or even its membership in the single currency area. Reflecting on these developments, Prime Minister George Papandreou said on Sunday that such scenarios were not serious, as an exit from the euro would "create a domino effect, which would lead to the break-up of the euro zone". In what follows, we highlight some of the key takeaways of the Premier's key note speech (and accompanying press conference) as well as a number of important announcements made by Greece's Finance Minster following y-day's extraordinary cabinet meeting.

Government signals its determination to stick to the EU/IMF-agreed fiscal targets. The 2011 and 2012 targets for the general government budget deficit remain at ca €17.1bn and €14.9bn, respectively. In line with the EU/IMF program projections these should facilitate a shift in the primary balance from a small deficit (ca 0.8%-of-GDP) this year to a surplus of slightly over 1%-of-GDP in 2012. Provided that these targets are met, the government's primary fiscal position would undergo a dramatic improvement, following respective deficits of 4.9%-of-GDP and 10.3%-of-GDP in 2010 and 2009. *Our comment:* Given the steeper that expected GDP growth contraction this year, the €17.1bn figure for the 2011 general government deficit translates into a slightly higher deficit ratio than the EU/IMF program target of 7.6%-of-GDP. According to a number of recent reports, the last troika mission in Athens estimated that the deficit overrun solely attributed to the steeper-than-expected recession this year should not exceed 0.3ppts-0.4ppts-of-GDP.

Government announces a new tax on real estate to bridge projected gap in this year's budget. In a move to ensure fulfillment of this year's fiscal deficit target and bridge a projected gap of ca €2bn (~0.9%-of-GDP) in the 2011 budget, the government announced a new levy on property, which would range from €0.5 to €10 per square meter of construction *(or around €4 per square meter in average-weighted terms).* The levy will be in effect for two years and its size will vary with the estimated value of property (based on an official list of objective values) and a number of social criteria , so as to maximize its social fairness. According to Mr. Venizelos, the new levy will take the form of an equiproportional increase in electricity bills, so as to produce quick results without having to rely on a (still inefficient) tax collection mechanism. Our comment: the new property levy comes on top of a number of additional austerity measures incorporated in the government's recently-unveiled medium-term fiscal plan (MTFS). The latter introduced additional austerity measures worth ca €6.8bn (~2.8%-of-GDP) to help ensure fulfillment of the 2011 fiscal target. These included, among others, a 10ppts VAT rate hike in restaurant and catering services from September 1st, a higher consumption tax on heating oil from mid-October, a reduction in the tax-except threshold for personal annual incomes to €8,000 from €12,000 earlier, a special fixed charge of €300 applied retrospectively to self-employed individuals for incomes earned in 2010 and a number of other special levies on higher incomes and property, based on certain objective (*e.g.* standards-of-living) criteria. *(A thorough assessment of the thrust of fiscal austerity and structural measures envisioned in MTSF can be found in Eurobank EFG, Greece Macro Monitor, June 30, 2011 http://www.eurobank.gr/Uploads/Reports/June%2030%202011GREECE%20MACRO%20FOCUS.PDF).*

Government expects pace of 2011 GDP contraction to exceed earlier forecasts; PM rebuffs early elections speculation

Prime Minister George Papandreou admitted that state mechanism, militant unions and vested interests were hindering reforms, but he reinstated his determination to do whatever it takes to ensure full implementation of the reforms program agreed with official lenders. In a separate note, Greek Finance Minister Evaggelos Venizelos said that the government now expects real GDP growth to decline by 5.3%, recording a steeper pace of contraction relative to earlier forecasts (-3.9% according to the IMF's July 2011 baseline scenario).

Concluding remark

To the extent that the budgetary impact of the newly announced property tax will not be offset by the potential incremental reduction in other revenue categories -- *e.g. lower receipts from VAT and corporate income tax as a result of the ensuing drag on disposable incomes and business profitability* – the measure is expected to help bridge the expected fiscal gap in this year's budget. The latter view was echoed by EU Economic and Monetary Affairs Olli Rehn who said in a statement that new property levy "will go a long way in meeting the fiscal targets". On a less comforting note, according to the European Commission's new EMU public finances report released earlier today, Greece fiscal deficit is now expected to reach 9.5%-of-GDP in 2011 and 9.3%-of-GDP in 2012. Yet, our understanding is that the latter projections do not incorporate the most recent fiscal measures announced by the Greek government.

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