

# GREECE MACRO MONITOR

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Focus notes: Greece

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## Latest macro & market developments

### Highlights

- **Part I- Near-term domestic economic outlook deteriorates; more concrete signs of stabilization expected in 2012**
- **Part II- Year-to-July State budget execution broadly in line with revised MTFs projections; deeper than expected recession, accumulating general government arrears posing upside risks to the full-year deficit target**

### Part I

#### **Near-term domestic economic outlook deteriorates; more concrete signs of stabilization expected in 2012**

#### **Near-term domestic economic outlook worsens, with the government now expecting 2011 GDP contraction to exceed prior forecasts**

According to the most recent national accounts statistics released by the Hellenic Statistical Authority (ELSTAT), Greece's real gross domestic product declined by 6.9% YoY in Q2:2011 following an 8.1% YoY contraction in the prior quarter. The Q2 GDP flash report contained only *non-seasonally-adjusted* data. In a rather surprising move, the statistics agency refrained from its usual practice of reporting the corresponding *seasonally adjusted* figures along with the non-seasonally-adjusted ones.

ELSTAT said in a statement that this was due to the break in the time series of quarterly general government data and the resulting availability of data for only a very short period (2009Q1-2011Q2) on which to apply the seasonal adjustment. Note that the method of compiling quarterly data for general government transactions for 2009-2011 have been changed compared with those used for the period 2000-2008, with quarterly estimates now being made with data mainly from direct sources. In contrast, GDP estimates for the period 2000-2008 were conducted by allocating the annual results for general government transactions to the quarters. This methodological improvement in estimating quarterly GDP changes has resulted in a break of the corresponding time series, rendering rather difficult the comparability of the 2008 and 2009 data.

These considerations apparently resulted in ELSTAT's decision to abstain from providing seasonally adjusted data in its flash Q2:2011 GDP report. Yet, given that the statistics agency had actually released seasonally-adjusted data in its quarterly national accounts reports for the first quarter of this year, its failure to provide such data for Q2:2011 appears to have created some confusion in the market this time around.

Bearing in to mind the break in Greece's quarterly GDP statistics in the period 2008-2009, we present below the results of a seasonal adjustment exercise we conducted for mere demonstration purposes (Table 1). Our exercise utilizes the US Census X-12-ARIMA seasonal adjustment program and the corresponding results need to be interpreted with extreme caution for the reasons explained above.

	GDP in 2000 prices ( <u>non</u> seasonal adjusted)		GDP in 2000 prices (seasonal adjusted)		GDP in 2000 prices (seasonal adjusted) US Census X-12-ARIMA methodology	
	EUR mn	%, YoY	EUR mn	%, YoY	EUR mn	%, YoY
1Q 2010	41,036	0.7%	44,053	-2.8%	44,472	0.9%
2Q 2010	43,962	-4.0%	43,488	-3.1%	43,772	-4.1%
3Q 2010	44,977	-4.8%	42,781	-4.1%	42,605	-4.8%
4Q 2010	41,930	-8.8%	41,583	-7.4%	41,202	-8.8%
1Q 2011	37,697	-8.1%	41,651	-5.5%	40,888	-8.1%
2Q 2011	40,908	-6.9%	N.A.	N.A.	40,712	-7.0%

Source: ELSTAT, US Census, Eurobank EFG Research

As to the drivers of the continuing GDP contraction in the second quarter of the year, the Q2:2011 flash report did not contain a more detailed breakdown of GDP components. This should be expected in the revised Q2 GDP report to be released in about a month from now). Nonetheless, ELSTAT noted that the decrease recorded in domestic demand (final consumption, expenditure and gross fixed capital formation) has contributed to the decline in Q2 GDP, with the improvement in the external trade balance partially offsetting this effect.

### Domestic demand remains depressed; external sector adjustment continues

For the full year, the earlier official forecast was for a 3.9% decline in real GDP, following a 4.4% contraction in 2010. However, Greek Finance Minister Evaggelos Venizelos was quoted earlier this week as saying that the Greek economy is now expected to contract at a faster pace (between -4.5% and -5.3%) than forecasted earlier. Certainly, the more recent readings in a range of higher-frequency indicators of domestic economic activity continue to signal further downside risks to the domestic economic outlook.

Among them, *retail sales excluding fuels & lubricants* (volume-terms) were down 10.6% YoY in May, with sales contracting by ca 12.1% YoY in the first 5 months of the year. Elsewhere, the *turnover index for motor trades* fell by 42.9% YoY in Q1:2011 (latest available data), following a 36.5% YoY decline in the prior quarter and having being in a contractionary territory in the prior three years. In a more forward-looking manner, *consumer confidence* hit in July its lowest level on record, with the corresponding European Commission indicator for Greece declining to -76.8, from -75 in the prior month and its -66.5 level in the same month a year earlier. Furthermore, domestic unemployment

recorded a 16.6% high in May (highest rate on record). Although Greece's jobless rate may somewhat stabilize during the summer months on the back of increased temporary employment due to a better tourism season, it doesn't appear to have reached a cyclical peak yet. Of course, another factor weighing on consumer spending so far this year has been broadly stagnant domestic credit creation, with the lack of access to wholesale credit markets by domestic banks arguing against a hasty facing out of ECB's special liquidity support measures to the domestic banking system.

We expect private consumption (-7.8% YoY in q1:2011; -4.6% in full-year 2010) to remain in recession throughout the second half of the year (and during the greater part of 2012), with high and rising unemployment, further wage restraint and higher VAT rates & new fiscal austerity measures from Q3:2011 continuing to weigh on consumer confidence. In a similar vein, public consumption (-3.4% YoY in q1:2011; -8.3% in full-year 2010) will likely continue to contract in the following quarters, under the weight of the government's aggressive fiscal austerity program. Investments growth (-19.2% YoY in q1:2011; -16.5% in full-year 2010) is also expected to remain negative though this year, reflecting weak business confidence and the continuing adjustment in the domestic residential sector. On the latter, note that construction activity in volume terms declined by 32.3% YoY in April (and by 30.7% YoY over the first 5 months of the year). Furthermore, in the domestic industrial sector, conditions remain difficult to say the least, with the more recent statistics (June 2011) revealing respective declines of 13.1% YoY and 12.2% YoY in industrial and manufacturing output.

On a more constructive note, the improvement in external sector dynamics continued in H1:2011, assisted by higher growth in trading partner economies, a good tourism season following two consecutive years of rather disappointing activity and improving competitiveness as a result of significant declines in broad-economy wage costs (Greece's REER deflated by relative ULCs improved by as much as 6ppts in 2010, with a further significant improvement expected this year). Net exports were a positive contributor to overall GDP growth in 2010 (to the tune of more than 2ppts) and they are expected to remain so throughout this year. According to the latest available national account statistics, exports of goods and services (in constant seasonally adjusted prices) declined by 2% YoY in Q1:2011, but their negative effect on GDP growth was more than offset by the concomitant decline of goods and services imports (-15.5% YoY in Q1:2011). Exports growth has turned positive in 2010 (+3.8% vs. -20.1% in 2009) and is expected to accelerate further this year, though downside risks to the outlook have increased lately amid rising headwinds to the external growth environment.

According to the Greek Tourism Enterprises Association (SETE), foreign tourist inflows in Greece rose by 10% YoY in the first months of this year, with H1-2011 tourism revenues growing by more than expected (+12.6% YoY). According to some estimates, tourism accounts for as much as 16 percent of Greece's 230bn euro economy and employs one in five people. Separately, the most recent customs-based external trade statistics recorded a 40.5% YoY increase in merchandise exports in euro terms (exports excluding fuels and ships up 12.1% YoY over the corresponding period). On the other hand, merchandise imports in euro terms declined by 10.8% YoY in H1-2011 (-10.6% YoY excluding fuels and ships).

### **2012 likely to see more concrete signs of stabilization in the domestic economy**

In view of the analysis provided above and the impact of the extra austerity measures incorporated in the government's medium-term fiscal plan (voted in parliament in late June), we broadly subscribe to expectations for a deeper-than-earlier expected recession in the domestic economy this year. Indicatively, our GDP seasonally adjusted exercise shown above indicates that under a relatively mild scenario envisioning broadly flat quarter-on-quarter output growth in the second half of this year (and in the absence of significant upward revisions to the Q1 and Q2 2011 GDP figures), full-year GDP growth in 2011 would still contract by as much as 5.3%. Looking further ahead, we continue to expect some stabilization in the domestic economy in 2012 on the back of an improving investment climate thanks to structural reforms, faster EU structural funds absorption and privatizations. Admittedly though, considerable uncertainty continues to surround the near-term domestic economic outlook, with Greek Finance Minister Evangelos Venizelos saying today that the economy

“may not return to growth” next year, though recession will likely subside “drastically”.

### **Longer-term outlook hinges on rigorous implementation of privatizations program, structural reforms**

For a longer-term perspective, we continue to see room for higher economic growth than that envisioned in the latest IMF baseline projections (4th program review, July 2011), contingent on the rigorous implementation on the government’s program for privatizations and structural reforms. Among others, potential drivers for a return to sustainable medium-term economic growth would include:

Higher FDI inflows as a result of the government’s ambitious plan for privatizations and private-property development (projected revenues of €50bn in the period 2011-2015).

Higher public investment vis changes in the ESPA framework, aiming to reduce the domestic budget’s contribution (please see July 21<sup>th</sup> EU Council announcements). The whole amount available to Greece for the period 2007-2013 is €26.2bn, with the country having already absorbed some €5.7bn or 21.8%.

Higher external sector contribution to GDP growth as a result of reduced domestic wage costs and improving competitiveness (see also analysis above).

Structural reforms to improve the domestic investment environment, including among others, the recently introduced fast-track and new investment laws.

## **Part II**

### **Year-to-July State budget execution broadly in line with revised MTFS projections; deeper than expected recession, accumulating general government arrears posing upside risks to the full-year deficit target**

#### **Year-to-July State Budget execution in line with the MTFS targets**

The latest data for the execution of the State Budget recorded a cumulative central government deficit of ca €15.57bn in January-July 2011. This compares with a revised (seven-month) deficit target of €16.47bn envisioned in the government’s medium-term fiscal plan (MTFS) and a €12.50 deficit recorded in the same period a year earlier. For more analysis on the State Budget execution data please refer to our *August 12, Greece Macro Monitor*, <http://www.eurobank.gr/Uploads/Reports/GREECE%20MACRO%20FOCUS%20August%2012.pdf>

The slightly better than projected State Budget deficit outcome in the first seven months of this year was mainly the result of sharp contraction in public investment expenditure (-37.6% YoY), which broadly offset a further decline in net ordinary budget revenue (-6.4% YoY). Notably, year-to-July VAT revenue amounted to ca €10.25bn covering ca 59% of the full-year target, while revenue from direct taxation (on individuals and corporates) reached €20.55bn, fulfilling ca 49.9% of the corresponding target for the full-year.

On the expenditure side, primary expenditure grew by 4.8% YoY in January-July 2011, broadly in line with the revised MTF target. On a year-on-year basis, the central government deficit rose by 25.1% in the first seven months of the year, compared with the MTF's +32.5% YoY corresponding projection and the government's - 3.9% YoY target for the full year.

By itself, the undershooting of the State Budget deficit by ca €1bn in January-July 2011 suggests that the government remains broadly on track for meeting its full-year fiscal target. The 2.8ppts-of-GDP auxiliary austerity budget for 2011 envisioned in MTF and measures initiated recently to reign in tax and contributions evasion and broaden out the tax base (e.g. new tax law in March 2011 and anti-tax-evasion law voted in April 2011) raise hopes for an improvement in the pace of State Budget execution over the remainder of this year.

On a less positive note, the deepening domestic recession and a continuing accumulation of outstanding arrears in the broader public sector (~2.9ppts of GDP in June 2011) continue to pose overshooting risk to the official deficit target for the full-year. Note that the government target a 3ppts reduction in the general government deficit (to ac €17bn or 7.5%-of-GDP) in 2011, with the H1-2011 deficit reaching ca 86% of the full-year target.

**STATE BUDGET EXECUTION 7 MONTHS - JANUARY - JULY 2010-2011**  
(Fiscal basis - in mio €)

	2010	2011	Change 7/ Months 11/10	2011	2010	2011	2011	Annual change 11/10
	7/Months	7/Months		7/Month s new target	Annual Outcome *	Budget Estimates **	MTFS Estimate s ***	
	(1)	(2)	(3=2:1)	(4)	(5)	(6)	(7)	(8=7:5)
<b>Ordinary Budget</b>								
<b>1. Net Revenue (a+b-c)</b>	<b>28,671</b>	<b>26,846</b>	<b>-6.4</b>	<b>26,876</b>	<b>51,187</b>	<b>55,560</b>	<b>54,042</b>	<b>5.6</b>
a. Revenue before Tax Refunds	31,356	29,940	-4.5	29,861	56,156	59,320	57,802	2.9
b. NATO revenue	3	20		21	13	40	40	
c. Tax refunds	2,688	3,113	15.8	3,006	4,982	3,800	3,800	-23.7
<b>2. Expenditures (a+b+c+d+e+f)</b>	<b>38,196</b>	<b>40,969</b>	<b>7.3</b>	<b>41,238</b>	<b>66,432</b>	<b>70,788</b>	<b>70,225</b>	<b>5.7</b>
a. Primary expenditure ****	28,784	30,174	4.8	30,162	51,649	52,633	52,009	0.7
b. Transfers to hospitals for the settlement of part of their past debt *****	190	434	128.5	450	375	450	450	19.9
c. NATO expenditure (from special revenues)	4	2	-46.0	5	23	40	40	73.9
d. Military procurement programmes	224	116	-48.3	525	1,017	1,600	1,500	47.5
e. Guarantees called to bodies classified outside the General Government *****	80	25	-69.3	49	145	145	224	54.5
f. Interest payments	8,913	10,218	14.6	10,047	13,223	15,920	16,002	21.0
<b>Public Investment Program (P.I.B.)</b>								
<b>3. Revenue</b>	<b>1,276</b>	<b>1,173</b>	<b>-8.1</b>	<b>1,230</b>	<b>3,072</b>	<b>3,922</b>	<b>3,925</b>	<b>27.8</b>
<b>4. Expenditure</b>	<b>4,201</b>	<b>2,620</b>	<b>-37.6</b>	<b>3,343</b>	<b>8,447</b>	<b>8,500</b>	<b>7,550</b>	<b>-10.6</b>
<b>5. State Budget Deficit (1-2+3-4)</b>	<b>12,449</b>	<b>15,571</b>	<b>25.1</b>	<b>16,475</b>	<b>20,620</b>	<b>19,808</b>	<b>19,808</b>	<b>-3.9</b>

\* According to the latest published data.

\*\* According to the data published in the Budget for the year 2011.

\*\*\* Medium Term Fiscal Strategy.

\*\*\*\* Not included in the year 2010, advance payments to LG's of amount 433 mil Euro, which were disbursed in the year 2009 and were included in the deficit formulation of the year 2009.

\*\*\*\*\* This amount does not affect the deficit of the current year 2011 because, according to the implemented ESA 95 methodology, it was included in the deficit of the respective years when it was created.

\*\*\*\*\* Data concerning guarantees called were not published in the corresponding budget execution bulletins of 2010.

Source: Ministry of Finance



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