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Focus notes: Greece

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Agreement between the Greek government and the troika over the €13.50 bn package of measures for 2013-14 still pending; general government developments encouraging but arrears constitute a serious risk for the deficit targets' attainability.

- **Agreement between the Greek government and the troika over the €13.50 bn package of measures for 2013-14 still pending**
- **Source of financing for the requested two-year extension of the programme's duration and credible answers to the concerns on Greek debt sustainability remain open issues**
- **Year-to-August 2012 General Government deficit recorded a 43.2% YoY decrease; end-of-year targets seem attainable**
- **However, General Government arrears increased to ca €7.9 bn at the end-of-August 2012, compared to ca €6.7 bn a month earlier, thereby raising concerns over the attainability of the 2012 deficit target**

Agreement between the Greek government and the troika over the €13.50 bn package of measures for 2013-14 still pending

FinMin G. Stournaras meets today with the troika in an attempt to reach an agreement over the finalization of the measures of the €13.5 bn package, ahead of the October 8th 2012 Eurogroup meeting. Still open issues include:

- The amount of measures for 2013. The Greek government in the draft 2013 Budget submitted earlier this week presented a package of measures of ca €7.8 bn (out of the total €13.5 bn) for 2013. The troika insists on a more frontloaded option with measures of ca €9.5 bn for 2013.
- The GDP growth forecast for 2013. There is no agreement between the Greek government and the troika on the 2013 GDP growth forecast yet. The Greek authorities insist on a forecast close to -4.0% of GDP (the draft 2013 Budget included a GDP growth forecast of -3.8% for 2013) while the troika's forecast is closer to 5.0% of GDP. Note that the growth forecast is crucial for the debt sustainability analysis to be included in the coming Review of the 2nd Adjustment Programme, taking in mind that the IMF requires Greek debt to be on a sustainable path in order to approve the next tranche disbursement.
- The pace of implementation of structural reforms. The implementation of the structural reforms agenda included in the 2nd Adjustment Programme for

Table 1: General Government Monthly Cash Data

	Jan-August 2011	Jan-August 2012	change (%YoY)	FY-2011 Realization	FY-2012 target	change (%YoY)
State budget						
Revenue	32.57	33.10	1.6	53.86	56.16	-4.1
Primary Expenditure	38.50	34.52	-10.3	60.40	57.25	5.5
Primary balance	-5.92	-1.41	-76.1	-6.53	-1.09	500.0
Interest payments	12.48	11.07	-11.3	16.35	13.05	25.3
Balance (+surplus, -deficit)	-18.67	-12.48	-33.1	-22.88	-14.14	61.8
Correction\1	-0.26	1.03	-500.8	-0.32	0.00	
Balance (+surplus, -deficit)	-18.94	-11.46	-39.5	-23.20	-14.14	64.1
Primary balance after implementation of cash correction	-6.19	-0.39	-93.7	-6.85		
Extrabudgetary funds						
Revenue	3.57	3.46	-3.2	7.29		
of which grants from state	1.74	1.23	-29.3	4.07		
Primary Expenditure	2.47	2.67	8.1	4.17		
Primary balance	1.10	0.79	-28.6	3.12		
Interest payments	0.42	0.18	-58.1	0.63		
Balance (+surplus, -deficit)	0.69	0.61	-10.6	2.49	2.37	5.1
Local Governments						
Revenue	4.72	4.44	-6.1	7.84		
of which grants from state	2.91	2.18	-24.9	4.28		
Primary Expenditure	3.62	4.06	12.1	7.01		
Primary balance	1.11	0.38	-65.6	0.83		
Interest payments	0.06	0.07	13.3	0.10		
Balance (+surplus, -deficit)	1.05	0.31	-70.1	0.73	0.00	
Social Security Funds						
Revenue	28.04	26.53	-5.4	43.56		
of which grants from state	11.87	10.31	-13.1	18.16		
Primary Expenditure	28.22	25.87	-8.3	44.27		
Primary balance	-0.18	0.66	-464.1	-0.71		
Interest payments	0.02	0.02	-23.8	0.07		
Balance (+surplus, -deficit)	-0.20	0.64	-417.8	-0.78	-1.53	-49.2
General Government						
Revenue	68.91	67.53	-2.0	112.55		
intra-government transactions	-16.51	-13.72	-16.9	-26.50		
Primary Expenditure	73.07	66.09	-9.6	116.16		
intra-government transactions	-16.51	-13.72	-16.9	-26.50		
Primary balance\2	-4.16	1.44	-134.6	-3.61		
Interest payments\2	13.25	11.33	-14.5	17.15		
Balance (+surplus, -deficit)	-17.41	-9.89	-43.2	-20.75	-13.30	56.0
ESA adjustments				**1.17**	**-0.43**	**-370.4**
ESA 95 general government balance				**-19.59**	**-13.73**	**42.6**
(% of GDP)				**-9.10**	**-6.70**	**35.8**

Source: Ministry of Finance, Eurobank EFG Research

/1 Cash correction

	Jan-August 2011	Jan-August 2012	change (%YoY)	FY-2011 Realization
Advance payments in Dec. against next year's expenditure	0.92	1.17		-0.25
Other expenditure	-1.19	-0.15		-0.07

/2 On a non consolidated basis after the implementation of the cash correction. On a consolidated basis, the primary balance will be smalller by 0.538 bn

Greece seriously lags behind. According to press reports, the troika requires a number of structural reforms to be implemented before the next loan disbursement (prior actions).

The Greek government has a strong interest ιn a swift completion of the negotiation, preferably before the EU summit in October 18. Today's announcement of Angela Merkel's visit to Athens in Tuesday is interpreted as an expression of political support to the Greek government's reform efforts. However, Germany remains adamant in its request for a complete fulfillment of Greece's commitments. In addition, Greek authorities' appeal for a two year extension of the programme's duration still faces the problem of how this would be financed. ECB's President M. Draghi said yesterday that the extension of maturities of the Greek debt that ECB holds constitutes monetary financing. In other words, the financing of the 2-year extension of the programme by the ECB is out of the question. For more information on the two-year extension and the financing gap please refer to Anastasatos & Monokroussos (August 2012) available at:

http://www.eurobank.gr/Uploads/Reports/Economy%20Markets%20August%202012.pdf).

Year-to-August 2012 General Government deficit recorded a 43.2% YoY decrease; end-of-year targets seem attainable but risks exist

According to the recently released general government accounts for year-to-August 2012, the overall deficit on a cash basis reached ca €9.89 bn. The draft 2013 Budget, submitted in the Greek Parliament earlier this week, envisages a deficit of -6.6% of GDP, lower than the respective target of -7.3% of GDP of the 2nd EC/ECB/IMF Adjustment Programme.

Developments in the general government accounts are encouraging. There are a number of reasons why the 6.6% projection for the 2012 deficit seems attainable:

- On the revenue side, given the year-end state ordinary budget net revenue target (€51.41 bn) and the respective year-to-August 2012 revenue, the Government needs additional revenues of ca €20.79 bn until the end of the 2012 fiscal period. Revenues are expected to increase in the following months as a result of the payment of the personal and corporate income tax, the special real estate taxes and the vehicle excise duty. However, the effect of the greater than expected recession in the VAT returns constitutes a significant risk for the achievement of the revenue target.
- On the expenditure side, ordinary budget expenditure should increase by ca 20.17 bn by the end of 2012 (the difference between year-end 2012 target and year-to-August 2012 realized expenditure). This is not overambitious since the rationalization of expenditure is expected to continue in the following months of 2012 and, at the same time, interest expenditure will be lower on a YoY basis due to the PSI. Upside risks still exist because of fiscal slippages and the effect of the recession on social security expenditure.

A closer look at the fiscal accounts for the first eight months of 2012 reveals some interesting developments (Table 2). More specifically:

- The year-to-August 2012 general government deficit on a cash basis decreased by €7.52 bn or 43.2% YoY compared to the respective 2011 period.
- The general government primary balance (i.e., overall balance before interest rate payments) on a cash basis recorded a €1.44 bn surplus for year-to-August 2012, compared to a deficit of €4.16 bn in the respective 2011 period. The draft 2013 Budget target for FY-2012 is for a primary deficit of ca €2.79 bn or 1.4%-of-GDP (in ESA-95 terms), which compares with a primary deficit realization of ca 2.1%-of-GDP for 2011.
- Interest payments decreased by ca 14.5% YoY. Because of the PSI (and more favorable terms on existing and new EA/EFSF loans), full-year interest rate payments in 2012 are projected to be lower by around 4.42bn (or 2.2%-of-GDP) relative to 2011.
- On the revenue side, at the central government level, year-to-August net ordinary budget revenue decreased by 0.2% YoY. Year-to-August 2012 total (direct and indirect) tax receipts were at ca €30.46 bn, increased by 0.5%YoY but lower from the respective eight-month target for FY-2012 (by €0.76 bn).
    - ❖ Direct tax revenue increased by 13.5% YoY as a result of higher taxation on individuals' incomes and property assets, as well as improved collection of tax arrears. However, direct tax revenue undershot by €0.19 bn the respective 8-month target of the FY-2012 budget.
    - ❖ Indirect tax revenue declined by ca 7.9% YoY, underperforming by €0.58 bn the respective 8-month target of the FY-2012, mainly as a result of the ongoing recession. Transaction tax and VAT receipts declined by 11.3% YoY and 10.9% YoY, respectively.
    - ❖ Tax refunds declined by 29.6% YoY.
- On the general government level, year-to-August 2012 revenues of the social security funds excluding grants remained virtually unchanged (+0.3% YoY). It is likely that the rationalization of the revenues process and the collection of social security funds arrears counterbalanced reduced social security contributions from employees and corporates due to reduced domestic economic activity, business closures and higher unemployment.
- On the expenditure side, year-to-August 2012 central government primary outlays (on a cash basis) declined by -9.6% YoY. The published general government accounts did not provide a detailed breakdown of primary spending. The central government budget execution data for the same period revealed that this was mainly driven by a -7.5% YoY reduction in salary and pension payments, by far the biggest item of central government budget expenditure (43.0% of primary expenditure in 2011). In addition, the General Government data reveal a reduction in grants from the central government to other general government

entities. Grants to extra-budgetary funds and local governments for year-to-August 2012 declined by -29.3% YoY and -24.9% YoY, respectively. Grants to social security funds decreased by -13.1% YoY. This development at fisrt glance looks like a continuation of the rationalization process in spending. However, a second interpretation is that the social security funds' arrears will grow in the following months as a result of the decreased grants.

- Other general government expenditure categories revealed a rather mixed picture. Year-to-August 2012 primary spending of extra-budgetary and local governments increased by 8.1% YoY and 12.1% YoY, respectively, whereas social security funds primary outlays decreased by -8.3% YoY.
- The authorities continued, in their recent year-to-August 2012 general government report, the practice of not publishing the monthly general government targets. This poses a certain risk with regards to the better auditing and control of the respective data.

General Government arrears of ca €7.9 bn at the end-of-August 2012; the general government's obligations reporting mechanism revealed a €0.9 bn increase of arrears and caused worries over the attainability of the 2012 deficit target

Total general government arrears - defined as unpaid obligations to third parties for over 90 days - stood at ca €7.9 bn at the end of August 2012, increased by ca €1.2 bn or 10.0% relative to the previous month.

The increase in arrears is due mainly to social security funds' obligations of ca €0.93 bn undertaken during 2011 that were unknown to the Ministry of Finance until recently. Note that the social security funds merged to a single fund in October 2011 (EOPYY) and that the obligations in question were undertaken before October 2011.

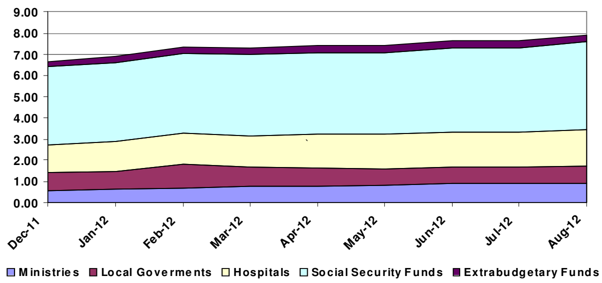
Clearly the developments with these obligations constitute an alarming development. It confirms our past worries regarding the weaknesses in the general government's obligations reporting mechanism and the effect that such a misreporting might have on the attainability of the end of year deficit target.

The revisions of past months (or years) arrears indicate that the respective expenditure data were not properly recorded because of still lingering weaknesses in the general government's data reporting mechanism. This misreporting of past expenditures implies that the general government deficit might be underestimated. In order to solve this problem, the 1st EC/ECB/IMF bailout programme required the implementation of reforms on spending controls and the reporting of outstanding government obligations. Even though most of these control and commitment mechanisms are already in place, recent developments show that implementation is still imperfect.

Arrears increased by ca €1.24 bn or 18.6% relative to December 2011 (and after the upwards revision of the 2011 arrears figures), a fact which also indicates the cash shortage of the various general government entities after the delays on the disbursement of the 2nd EC/ECB/IMF Adjustment Programme's installments.

The largest part of the €7.9 bn arrears is owed by social security funds (€4.12 bn). This figure recorded an increase of 3.9% MoM (on top of the 2011 increase). Hospitals arrears were ca €1.71 bn, an increase of 4.6% MoM, and local government arrears were ca €0.84 bn, increased by 2.6% MoM. Total central government budget arrears were at ca €0.91 bn, decreased by -2.9% MoM and extra-budgetary funds arrears remained unchanged at €0.32 bn.

Graph 2: Evolution of general government arrears



Graph 2 depicts the evolution of general government arrears since December 2011. During 2012 arrears increased again as no official funding was allocated for their clearance.

According to the draft 2013 Budget, €3.5 bn from the next installment of the 2nd EC/ECB/IMF will be allocated for the payment of general government arrears by the end of 2012. Of course the disbursement of the €31.5 bn installment is conditional on the successful review of the 2nd EC/ECB/IMF Adjustment Programme. An additional amount of €3.5 bn from the next installments of the 2nd Adjustment programme will be allocated for arrears payments during 2013.

The difference between the end-of-August 2012 outstanding arrears and the total amount allocated for the clearance of arrears in the draft 2013 Budget is at ca €0.9 bn. This amount together with the expected arrears increase for September and

October (due to the delay of the installment) do not ease our concerns about the risks for the attainability of the general government deficits for 2012 and 2013.

Concluding Remarks

The successful conclusion of the 1st Review of the 2nd Adjustment Programme for Greece, including the final mix of the 11.8 bn measures for 2013-14, a possible extension of the programme until 2016, and a possible debt relief via OSI or other alternative methods, are the main open issues for the Greek Authorities until the end-of-October 2012.

Assuming a successful conclusion of the 1st Review and disbursement of the next loan tranche, the Greek government should focus on the programme's implementation, with a special focus on the implementation of the remaining items on the structural reforms agenda, in order not to lose the momentum of fiscal consolidation that the general government data show.

Table 2: Greece-Key Indicators

	Last	ytd	2011	2010	2009	2008	2007
Macroeconomic indicators							
GDP growth (%YoY, prov. estimate for last, forecast for 2011)*	-6.3 (Q2 12)	-	-6.9	-3.5	-3.2	-0.2	3.0
Budget deficit (% of GDP, 2012 forecast for last)	-7.3	-	-9.1	-10.8	-15.8	-9.9	-6.8
Gross public debt (% of GDP,2012 forecast for last)	163.2	-	165.3	144.9	129.3	113.0	107.4
CPI (%YoY, ytd)	1.7 (08/ 12)	-0.9	3.3	4.7	1.2	4.2	2.9
CPI constant taxes (%YoY, ytd)	-0.1 (06/12)	-	1.3	1.4	1.1	4.2	2.9
Unemployment rate (%YoY, ytd)	23.9 (06/12)	9.2	21.0	14.8	10.2	8.9	8.9
Economic Sentiment (index level, period average)	76.1 (09/12)	75.8	72.8	75.1	76.3	76.1	94.9
Competitiveness Indicators							
Real harmonised comp/ness indicator CPI deflated (%YoY, cum ytd)	-4.4 (07/12)	-2.2	0.3	3.1	1.0	0.9	0.9
Unit Labor Cost (%YoY, cum ytd)	-9.1 (Q1 12)	-9.1	-6.0	-1.2	6.9	7.1	3.6
Labor Cost (%YoY)	-11.1 (Q1 12)	-11.1	-6.0	-2.7	5.3	2.4	3.4
Consumer indicators							
Private consumption in constant prices (% YoY)	-8.0 (Q2 12)	-	-6.9	-3.5	-3.2	-0.2	3.0
Retail sales excl. fuels & lubricants volume (% YoY)	-11.5 (06/12)	1.1	-8.7	-6.9	-9.3	-1.4	2.3
New private passenger car registrations (% YoY, cum. ytd)	-46.7 (08/12)	-43.8	-31.0	-35.6	-17.8	-4.5	4.5
Consumer confidence (index level, period average)	-75.6 (09/12)	-74.8	-74.1	-63.4	-45.7	-46.0	-28.5
Retail trade expectations (index level, period average)	-37.0 (09/12)	-34.5	-35.4	-33.7	-15.4	14.2	34.2
Industrial-activity indicators							
Industrial production (% YoY)	-0.5 (07/12)	23.2	-11.4	-5.9	-6.8	-8.2	2.0
Capacity utilization in industry (index level, period average)	63.6 (08/12)	63.9	67.4	68.6	70.5	75.9	77.0
Industrial confidence (index level, period average)	-21.8 (09/12)	-23.2	-20.6	-22.5	-28.4	-5.9	5.2
Manufacturing PMI (index level, period average)	42.2 (08/12)	41.1	43.6	43.8	45.4	50.4	53.8
Construction sector & other investment-activity indicators							
Cross fixed capital formation in constant prices (% YoY)	-19.4 (Q2 12)	-	-14.3	-9.2	-23.1	-5.5	13.1
Housing investment in constant prices (% YoY)	-30.0(Q2 12)	-	-23.4	-18.4	-20.2	-25.8	-5.8
Other construction in constant prices (% YoY)	-7.4 (Q2 12)	-	-18.9	-5.9	18.2	44.3	-5.5
Private building permits volume (% YoY, cum. ytd)	-40.0(06/12)	-13.9	-39.4	-24.1	-26.8	-17.3	-5.0
Construction confidence (index level, period average)	-58.2 (09/12)	-58.5	-68.3	-55.4	-39.5	-9.6	-9.2
Balance-of-Payments statistics *(€-terms)*							
Current Account (% YoY, cum.ytd)	-181.1 (07/12)	-54.4	-8.3	-11.0	-25.8	6.7	37.2
Tourism revenues (% YoY, cum. ytd)	-2.8 (07/12)	-7.0	9.5	-7.6	-10.6	2.8	-0.3
Transportation revenues (% YoY, cum. ytd)	-2.9 (07/12)	-0.9	-8.6	13.8	-29.4	13.3	18.3
Gross External Debt (% of GDP, cum ytd)	190.6 (Q1 12)	-1.3	171.2	177.6	178.4	155.7	138.5
Customs-based statistics *(€ - terms)***							
Goods exports (% YoY, cum. ytd)	2.8 (06/12)	1.5	37.0	11.6	-18.1	4.5	3.8
Goods exports to EU (% YoY, cum. ytd)	-6.9 (06/12)	-23.8	8.1	10.4	-20.1	4.1	25.0
Goods exports to non-EU countries (% YoY, cum. ytd)	-46.8 (06/12)	-16.1	62.2	13.5	-14.6	3.5	-20.9
Goods imports (% YoY, cum. ytd)	-18.7 (06/12)	-9.6	-10.1	-3.3	-19.2	11.2	9.3
Goods imports from EU (% YoY, cum. ytd)	-19.9 (06/12)	-27.9	-7.3	-12.9	-17.4	5.4	16.4
Goods imports from non-EU countries (% YoY, cum. ytd)	-21.5 (06/12)	-30.6	-32.7	16.6	-32.7	10.9	0.6
Domestic MFI credit to domestic enterprises & households *(oustanding balances and net flows)* & NPLs							
Private sector (% YoY)	-4.8 (07/12)	-	-3.6	0.0	4.2	15.9	21.5
Enterprises (% YoY)	-5.3 (07/12)	-	-2.5	1.1	5.2	18.9	20.8
Households (% YoY)	-4.2 (07/12)	-	-4.3	-1.2	3.1	12.6	22.2
Housing loans (% YoY)	-3.6 (07/12)	-	-2.6	-0.3	3.7	11.2	21.5
Consumer credit (% YoY)	-5.3 (07/12)	-	-5.6	-4.2	2.0	16.0	22.4
Non Performimg Loans (NPLs) (% of total gross loans)	14.7 (Q3 2011)	-	-	10.4	7.7	5.0	4.5
Private-sector credit outstanding (% GDP) ***							
Total domestic enterprises & households	114.1 (07/12)	-	143.1	113.40	107.80	107.20	96.68
Domestic households	53.1 (07/12)	-	52.40	52.00	51.70	50.30	46.70
Stock Indices****							
Athex General Index (level, %ytd, end of year level 2007-10)	790.0	7.8	680.4	1413.9	2196.2	1786.5	5178.8
FTSE/ASE 20 Index (level, %ytd, end of year level 2007-10)	286.4	3.2	264.9	663.1	1125.4	932.5	2752.5
Athex Banks Index (level, %ytd, end of year level 2007-10)	301.6	3.1	262.9	1251.0	2661.7	1899.4	7296.4
Baltic Dry Index (level, %ytd, end of year level 2007-10)	845.0	-50.4	1738.0	1773.0	3005.0	774.0	9143.0
Bond/CDS spreads **, †**							
10yr Bond Spread over Bund (bp, %ytd, end of year level 2007-10)	1761.1	-	3313.4	950.9	238.7	227.4	32.2
5yr Bond Spread over Bund (bp, %ytd, end of year level 2007-10)	-	-	5163.1	1163.1	254.2	264.3	21.2
2yr Bond Spread over Bund (bp, %ytd, end of level year 2007-10)	-	-	13408.3	1134.4	211.9	240.1	26.8
5yr CDS Spread (bp, %ytd, end of year level 2007-10)	-	-	10231.4	1037.3	282.8	238.0	-
T-Bills, Auction Rate							
26-Weeks average rate (%, last auction, last auction of year)	4.54 (04/09/2012)	-	4.95	4.82	0.35	5.09	4.18
13-Weeks average rate (%, last auction, last auction of year)	4.31 (18/09/2012)	-	4.68	4.10	0.59	4.46	4.14

Source: Hellenic Statistical Authority, PDMA, Bank of Greece, ECOWIN, AMECO, Bloomberg, Eurobank EFG Research

* Non-seasonally adjusted GDP data were used for columns Last and ytd. Seasonally adjusted data not available. Growth rates for 2007-9 include the recent ELSTAT's revision. EFG forecast for 2011.

**Note that custom based statistics (Source: ELSTAT) on imports and exports are subject to frequent revisions.

***For 2012 the respective GDP forecast at market prices (€ 203.7 bn) from the IMF's 2nd Greek Bailout Report was used. For 2007-2011 the respective AMECO figures were used

****Stocks, BDI and Bond spread as of 4/10/2012

† Note that according with the Private Sector Involvement (PSI) process, the Greek bonds swap took place on 12/03/2012.

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