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Greece Economy briefing:

Economic conditions in Greece

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Economic conditions in Greece

The Greek economy returned to growth in 2017 and grew by 1.1% in the first three quarters of the year compared to the same period of the previous year. The estimation for 2017 is 1.6% and for 2018 2.5%. This goes in line with performance in previous years. Already in 2015 and 2016, the Greek economy demonstrated greater resilience compared to initial expectations as real GDP fell by a mere 0.3 % in 2015 and by 0.2% in 2016. Moreover, the labour market situation is improving. Following the deceleration of employment during 2015 and 2016, the most recent figures from the national accounts point to an increase in employment growth in 2017, reaching an average of 1.8 % in the first three quarters of the year. The estimation for 2017 is 1.9% and for 2017 1.7%.

As far as fiscal targets are concerned, Greece is likely to overachieve the 1.75% of GDP primary surplus target agreed for 2017 by a margin of at least 0.5 % of GDP. The expected over-performance for 2017 is to a large extent driven by underspending against the 2017 budget ceilings and to a smaller part by overall better-than-expected revenue dynamics despite the large shortfall of revenues from direct taxation. The fiscal strategy enshrined in the budget of the Greek government for 2018 is consistent with reaching the agreed primary surplus target of 3.5 %. This budget projects a primary surplus in programme terms of 3.8% of GDP in 2018, which is somewhat more optimistic than the 3.5% projection of the European institutions.

ESM Programme

The European Stability Mechanism (ESM) programme for Greece is generally on track. The Greek government did recently conclude the third review of the bailout (with a few small exceptions). In particular, the staff level agreement on the policy package was reached on 2 December 2017 and the eurogroup on 22 January 2018 welcomed the implementation of almost all of the agreed prior actions for this review. It also called on the Greek authorities to complete the outstanding prior actions as a matter of urgency and mandated the eurogroup Working Group (EWG) to verify the full implementation of the outstanding prior actions on the basis of an assessment by the European institutions.

A positive report on the full implementation of the outstanding prior actions will pave the way for the release of the fourth tranche under the European Stability Mechanism (ESM) programme. The tranche will amount to €6.7 billion, of which €5.7 billion will be disbursed immediately upon implementation of all prior actions and cover debt servicing needs, allow for further clearance of arrears, and support the build-up of cash buffers. The remaining €1 billion will be used for arrears clearance and will be disbursed in spring 2018. This will be subject to positive reporting by the European institutions on the clearance of net arrears using also own resources and a confirmation from the European institutions that the unimpeded flow of e-auctions has continued.

Challenges Ahead

2018 is a critical year for the national economy. Although the principal obligation of the Greek government in the next months is to conclude the fourth and last review of the bailout, attention is turned toward the post-summer period. That is because the third bailout will expire in August and next steps have to be decided by both the Greek government and its creditors. Specifically, after eight years of international supervision the Greek government is seeking a gradual return to international markets. On 8 February 2018, it organised a seven-year bond action. The auction drew significant investor demand despite recent upheaval in global markets. It achieved a yield of 3.5 percent – against a starting rate of 3.75 percent – and was more than twice oversubscribed, attracting offers of more than €6 billion.

This afore-mentioned was the third bond issue since last summer. The Greek government naturally welcomed the impact of the auction. Prime Minister Alexis Tsipras, for example, made particular reference to the 'huge demand'. And Finance Minister Euclid Tsakalotos was confident that Greece would be able to raise new money by investors under difficult conditions. However, there are some economists who still doubt that the country will normally access capital markets after the end of August in order to alone cover all its financial needs. The theme remains debatable. Some confidence has returned indeed but it does hardly suffice.

From another perspective, the post-bailout cooperation between Greece and its international creditors is a theme to be discussed in the next months. European Economic Affairs Commissioner, Pierre Moscovici, visited Athens at the beginning of February and met with government officials. Moscovici said the fourth and final review of the current Greek bailout could be finalized by late June and added it would be important for the Greek government to manage its own growth strategy. The nature of post-bailout surveillance will be an issue of hard negotiations. While the Greek wants a clean break from lenders, a precautionary credit line could be required. Also, as Moscovici has clarified, Greece would need some sort of supervision after the end of the bailout. That is because many of the programme commitments will continue to be implemented long after it ends.

Debt Relief

As far as the potential debt relief is concerned, Greece's creditors need to decide on some measures during this summer. According to the eurogroup statement on Greece on May 2016: *The possible debt relief will be delivered at the end of the programme in mid-2018 and the scope will be determined by the Eurogroup on the basis of a revised Debt Sustainability Analysis (DSA) in cooperation with the European Institutions for purposes of taking into account the European policy framework, subject to full implementation of the* *programme*. Measures to be negotiated will possibly include longer grace and payment periods which can be used, if necessary, at the end of the ESM programme as well as such measures as the use of the Securities and Markets bond-buying programme (SMP) and Agreement on Net Financial Assets (ANFA) equivalent profits.

Four scenarios are discussed on Greece's debt. According to the first, Greece's debt-to-GDP ratio is expected to reach 181.1% in 2017, 165% in 2020, 127.2% in 2030 and 96.4% in 2060. In scenario B, the assumed growth rate for nominal GDP is lowered by 0.25 p.p. per year compared to the scenario A between 2023 and 2060, settling at 3%. Moreover, in scenario C, nominal GDP growth is reduced by 0.65 p.p. per year on average compared to scenario A between 2023 and 2060, reaching a long-run level of 2.7%. And the scenario D assumes more favourable long-term growth and a better fiscal performance. Growth is assumed to be 0.2 pp higher compared to the scenario A after 2030. The overall primary surplus is assumed to average at 2.3% of GDP in the 2023-60. In this scenario debt-to-GDP is at 165% in 2020 and 126 % in 2030, before decreasing to 79% in 2060.

The International Monetary Fund (IMF) has not yet decided if it will participate in the third bailout having repeatedly voiced concern at the sustainability of the country's debt pile. Greek Prime Minister Alexis Tsipras met IMF Managing Director Christine Lagarde recently in Davos. On this occasion, Lagarde underscored that the completion of the reform agenda and provision of debt relief by Greece's European partners are essential to support sustainable growth and a successful exit from official financing later this year.

Generally speaking, the IMF often exerts pressure on the EU to proceed to more radical measures and write off part of the Greek debt. But Germany rejects such as scenario and refers to the 'no bailout clause' of the Lisbon Treaty. It only seems open to discuss a mild debt-restructuring or a re-profiling. Within this framework, Germany might find itself in an awkward dilemma to keep the IMF in the scheme. Ironically, the position of the IMF and that of Athens will be rather similar as far as the sustainability of the Greek debt is concerned despite their fundamental disagreements on other fronts. But experience from August 2015 until the beginning of 2018 demonstrates that Germany and the IMF are able to find formulas of cooperation for the Greek case.