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Weekly Briefing

Greece economy briefing:

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The Greek economy in 2020

In January 2020 Greece's creditors sent their technical team to Athens to consult with Greek authorities in the context of the 5th post-bailout assessment. The Greek government is presenting its priorities to the lenders while the national economy is continuing its recovery. The announcement of the closure of the IMF office in Greece symbolizes the end of an era. Challenges remain high though. Not only remains the country under supervision but it is unclear whether it will succeed in some of its goals, for example the reduction of the primary surplus targets for 2021 and 2022.

In December 2019 the governmental majority of 158 New Democracy MPS approved the 2020 budget, According to the budget the national economy will grow by 2.8 percent in 2020 (from a projected 2.0 percent in 2019) and will generate a primary surplus of 3.58 percent of GDP (from 3.73 percent in 2019). It also includes tax breaks of almost €1.2 billion. Approximately 50 percent of the new expansion package comprises tax relief for corporates that will perhaps have a high growth multiplier affecting business decisions for investment, employment and production. In particular, the tax rate on corporate income will be reduced from 28 percent to 24 percent for the fiscal year 2019 and the dividend withholding tax from 10 percent to 5 percent for profits distributed from 2020 onwards. The rest of the measures aim at supporting personal income through measures such as the lowering of tax-rates for incomes up to €10.000 and the decrease of social security contributions.

The Eurogroup of December 2019 welcomed the adoption of the budget for 2020. However, it stressed the need for Greece to accelerate reform momentum. As key reforms were identifies the reduction of arrears to zero, recruitments in the public sector and privatizations. According to Eurogroup's statement it will be crucial to continue and strengthen the implementation of other financial sector reforms, especially with regard to the clearance of state loan guarantees on an expedited basis, clearing of the household insolvency backlog at the courts and further improvements to the framework for e-auctions. These will continue to be monitored in the context of enhanced surveillance.

Concerning the 2020 outlook, it is positive. The European Stability Mechanism announced in January the decision to reduce to zero the step-up margin due from Greece for the period between 17 June 2019 and 31 December 2019. This is part of the medium-term debt relief measures agreed. The value of this reduction amounts to €122.15 million. Moreover, Fitch raised Greece's rating from 'BB-' to 'BB'. In its report Fitch said that the sustainability of Greek debt continued to improve, supported by a stable political framework and a sustainable increase in gross domestic product. Perhaps political stability should be considered as the most important reason for this upgrade. Greece is expected to have a stable government until 2023. Also, Greece attracted record orders for its first 15-year bond sale in January. The bond will yield around 1.87 percent.

As far as Greece's priorities for 2020 are concerned, Greece aims at boosting its banking sector by helping lenders shed a higher number of bad loans. This is mainly happening because the systemic banks, namely Piraeus Bank SA, Eurobank Ergasias SA, Alpha Bank AE and National Bank of Greece SA, have been under pressure by Greece's creditors to cut non-performing loans by circa €50 billion by the end of 2021 in order to be able to gradually inject more capital into the real economy. As Finance Minister Christos Staikouras said in an interview with Bloomberg, 'Greece will eventually approach a single-digit non-performing loans ratio'. According to recently released data by the European Central Bank Greek banks had the highest ratio of non-performing loans in the eurozone though. They were followed by Cypriot, Portuguese and Italian banks.

Moreover, Greece has pushed for the potential usage of proceeds from bonds that central banks bought during the economic crisis – under the Security Market Program (SMP) and the Agreement on Net Financial Assets (ANFA) – for investments rather than for debt payments. In November 2019 Germany opposed the creation of an additional fiscal space on that basis. One month later, the ESM made a transfer to Greece amounting to €644.42 million, equivalent to the income earned on SMP/ANFA holdings following a relevant Eurogroup meeting. Staikouras then submitted a proposal for investments to be boosted when Greece's creditors visited Athens in mid-January 2020. *Kathimerini* newspaper reports that this proposal provides for the €4.2 billion of bond profits that will be returned to Greece in installments by 2022 to ideally be split almost equally between public and private investments. The important eurogroup decision is expected to be made in June 2020.

In addition, Greece will perhaps negotiate with its creditors the reduction of the primary surplus target from 3.5 percent of gross domestic product for 2021 and 2022 to 2 or 2.5 percent of GDP. This had been a pre-election promise of Mitsotakis but he refrained from discussing it after he became primer minister. Furthermore, the Greek Prime Minister attempts to persuade his European counterparts that a substantial amount of funds will need to be allocated in the context of the new EU Multiannual Financial Framework. The national position is that budget to be decided should not correspond to amounts lower than 1,14 percent of the Gross National Income of the EU-27.

Another significant development is the closure of the International Monetary Fund (IMF) Athens office. The IMF participated in Greek bailouts from 2010 onwards but after the summer of 2015 its role was mainly of technical assistance. Prime Minister Kyriakos Mitsotakis met with IMF Managing Director Kristalina Georgieva in Washington on 7 January 2020 where this announcement was made. As the Greek Premier said: ‘We are looking forward to a completely new chapter in our relationship, which will be a relationship of positive cooperation. And in that sense, I also welcome our common decision to close down the IMF office in Athens within the next months and continue to cooperate as a country that has actually exited from this tight framework of IMF supervision’. For his part, former Finance Minister George Papaconstantinou believes that the announcement of the closure of the IMF office in Greece symbolically marks ‘the end of an era’. However, he explains that the IMF is not substantially leaving from Greece because it remains its lender. He also reminds us that the Fund’s staff will regularly visit Greece in the context of the periodic evaluation of the economies of IMF member-countries.

The announcement of the closure of the IMF office in Greece is a good opportunity to assess its performance during the Greek crisis. The discussion cannot but revolve around the vicious circle of recession Greece was entangled in for many years. In the view of the Director of its European Department Poul Tomsen, the Fund did initially underestimate the fiscal multipliers and therefore the impact of the fiscal consolidation on the national GDP. But the quarterly program reviews, he says, relatively quickly allowed it to modify the multipliers and acknowledge that additional financing and a longer adjustment period would be required. Tomsen believes the root cause of the crisis lies deeper and cannot be simply explained by insisting on the underestimation of fiscal multipliers. He largely attributes the continuation of the Greek crisis for years to the lack of political consensus. The political fragmentation led to the rise of the SYRIZA party to power that almost led Greece outside the eurozone in the summer of 2015.

Papaconstanstinou also joins the debate by underlining positive and negative aspects. In his opinion positive aspects include IMF insistence on extending the period of adjustment for Greece and raising the issue of debt restructuring relatively early. On the negative side, the former Finance Minister criticizes the attitude of the Fund to push for some reforms such as the reduction of wages but not the opening up of the market for products and services. As a result while the purchasing parity decline with prices not necessarily taking the course of salaries. He also focuses on wrong macroeconomic projections and the difficult relationship between the IMF and other parts of the so-called Troika, namely the European Central Bank and the European Commission.

Conclusion

Perspectives for the Greek economy in 2020 are positive but challenges remain high despite the symbolic departure of the IMF. The fifth post-bailout assessment that began in January will be important as it will pave the way for major decisions in the coming months as the one on the usage of profits of the SMP and the ANFA for potential investment purposes. While attention is being directed towards Greek-Turkish relations, the continuous recovery of Greece requires the implementation of careful policies in line with European guidelines. European funds to be released according to the new Multiannual Financial Framework of the EU will be therefore of utmost significance. A critical question is also whether the need of Greece to reinforce its national defense will have an impact on its fiscal performance. This will be perhaps largely discussed throughout the year, especially if Greece will buy new military equipment.