

NOVEMBER 2016 SEMI-ANNUAL REPORT SUMMARY

Chapter 1: Current Fiscal Developments

Budget implementation: January – September

In relation to the exceptional circumstances and conditions in the economy during the previous year, the General Government's (hereinafter GG) 2016 budget implementation is carried out under more normal conditions. The developments' normalization along with the successive fiscal measures (including interventions in the insurance system) taken from July 2015 to June 2016, contributed to the improvement of the fiscal performance over the nine months, and to the strengthening of the prospects for the annual budget targets' achievement. ***Nevertheless, it should be noted that some of the implemented fiscal measures do not seem to comply with other equally significant objectives (such as the financial system normalization)*** and are generally not targeted towards the principal goal's achievement which should be to restore the economy's growth. As proven by the recent Greek experience, ***no fiscal position is sustainable on a medium term under the current juncture of protracted economic recession.***

The 2015 GG deficit of 1,4% of GDP turned to a surplus of 0,4% this year. The GG primary surplus, respectively, reached 3% of GDP, compared to 1,4% for the same period of 2015. The improved GG results are mostly due to the increase of tax revenue (+13,1%) and of social insurance contributions (+5,6%) of the State Budget (SB), from respective 2015 receipts. On the contrary, the GG expenditure recorded an increase of 4,2% (or € 2.241 million) throughout the nine-month period. The expenditure increase is mainly due to purchase of goods and services, and to transfers, whilst the payments for pensions, which represent 4/5 of the social expenditure, are reduced compared to 2015. But, ***it should be pointed out that Social Security Funds (SSF), the larger component of the GG behind State Budget (SB), face serious difficulties,*** despite the fact that over the nine-month period, there was an increase in both revenue from insurance contributions, and transfers from the SB, compared to 2015. It is telling that, at the end of September, the cumulative arrears of SSF and Hospitals represented 80,4% of the GG total debts.

The State Budget (hereinafter SB) balance recorded a slight surplus of € 593 million or 0,3% of GDP, against a deficit of € 1.904 million in 2015 and a deficit target of € 3.023 million. Accordingly, the SB primary surplus amounted to € 5.441 million, or 3,1% of GDP, against a surplus of € 3.072 million in 2015 and a primary surplus target of € 1.907 million. This positive image is primarily attributable to the SB expenditure restraint (RB and PIP) against targets (by € 3.101 million) and, secondly, to the strong improvement of RB revenue (before tax refunds) by € 1.538 million against target. ***However, there is a strong likelihood that the trends will be partly reversed in the remainder of the year and the budgetary figures will be reaching the targets.***

The Regular Budget (RB hereinafter) revenue before tax refunds has increased by 9,2% compared to 2015 receipts and amounted to € 37.397 million. There are two reasons for this positive result: on the one hand, the fact that the 2015 revenue is markedly low, consequently, there is a significant base-effect and on the other hand, the number of tax measures laid down from July 2015 on. The revenue increase resulted from direct taxation (from which revenue increased by 12,9% compared with 2015 and amounted to € 14.944 million), and indirect taxation (with its revenue increasing by 10,6%, respective to 2015 and amounting to € 18.169 million). It should be noted that 2/3 of this increase is related to VAT which has been favourably affected from (a) the application of a 23% rate – from 13% to a wide range of goods and services, (b) the increase of standard rate from 23% to 24% as of 1 June 2016, (c) the abolition of reduced VAT in many islands, (d) the continuously increasing use of credit cards for transactions after the enforcement of capital controls (which seems to have restricted tax evasion) and (e) the intensification of controls from the beginning of August 2016.

The RB expenditure presented a slight increase of 1,5% compared to the corresponding 2015 payments and amounted to € 34.550 million, whereas it fell below the target by € 2472 million. This restraint is almost entirely visible in the RB primary expenditure, which, however, rose by 2,2 % against 2015. Lastly, the expenditure on interest payments declined by 2,6%. The RB expenditure restraint against the target corresponds to 45,4% of the high SB primary surplus recorded over the nine-month period. ***Therefore, it is crucial to see if this expenditure restraint has a permanent structural nature and be lasted until the end of the year.***

The Public Investment Program (PIP hereinafter) budget recorded a deficit of € 105 million. This result came from the shortfall of receipts from the EU Funds. However, both the PIP revenue and expenditure show, on a regular basis, great deviations within the year, thus, the nine-month period developments shall not be regarded as a reliable indicator in determining them on an annual basis. According to the Preliminary Draft, the annual PIP deficit is estimated at € 2.374 million, marginally increased compared to the 2016 Budget (€ 2.330 million). An actual realization of € 4.069 million expenditure during the last quarter of the year, as well as revenue's receipts of € 1.800 million, would prove the above estimate true.

Estimates on 2016 budgetary target achievement¹

A sine qua non condition for the budgetary target achievement is the successful 2016 SB² implementation, as well as the configuration of annual aggregates according to

¹ According to the method used by the Financial Assistance Facility Agreement (FAFA), the target for the GG primary surplus has been set at 0.5% of GDP for 2016.

² With reference to the General Government Bulletin (September 2016) the SB receives about 2/3 of GG revenue and spends ¾ of GG expenditure

³ According to the method used under by the Financial Assistance Facility Agreement (FAFA), the corresponding target for the GG primary surplus has been set at 1.75% of GDP for 2017.

the estimates included in the SB Preliminary Draft. It should be pointed out that in the Preliminary Draft, the primary surplus for 2016 is estimated at 0,63% of GDP, which exceeds country's commitment. Taking into account that the PIP, on a yearly basis, is not expected to present substantial variations, the RB successful execution is a prerequisite for the achievement of the agreed primary surplus target.

The annual SB (RB and PIP) annual aggregates for 2016 are more likely to meet the Preliminary Draft estimates. These estimates are consistent with the estimated primary surplus target (0,63% of GDP), as well as with the contingent reversal of the trends recorded in the nine-month period, pertaining to both RB revenue and RB expenditure, over the last quarter of 2016. In fact, it is thought that, failing to meet the annual target – due to, i.e. contingent slowdown in the high revenue growth rate (9,2%) over the nine-month period – would require, in the fourth quarter of the year, a drop in revenues higher than 7,8% over the corresponding receipts of 2015. The occurrence rate of the aforementioned scenario is low. On the expenditure side, since, during the latest years, the Ministry of Finance seems to have greater potential for narrow monitoring and control over expenditure, the SB annual expenditure aggregates are mostly likely to reach their estimated values. ***It is underlined that the, without deviations, SB successful implementation will significantly contribute to (without safeguarding it) the GG 2016 primary surplus fiscal target achievement.***

Estimates for achievement of budgetary target for 2017³

The budgetary targets achievement for 2017 is significantly subject to a set of conditions and circumstances, the majority of which are not satisfied, for the time being. The early establishment of favorable circumstances and conditions (i.e. economic climate improvement, prompt clearing of banks' loan portfolio e.t.c.) will increase the likelihood of budgetary target achievement, and vice-versa.

The forecast for tripling the primary surplus as a percentage of GDP (increase by € 2,2 billion or 1.8% of GDP) is mainly underpinned by the forecast for SB result, which is projected to be enhanced by about € 2,8 billion, relative to 2016. On the contrary, the other GG entities, on an accrual basis, do not contribute to the anticipated rise of the primary surplus.

In particular, an increase of tax revenue is projected which is mainly triggered by the tax measures laid down in May 2016, some of which have been implemented as of June 1st 2016 or will be implemented as of January 1st 2017. From the series of interventions (covering 19 months), approximately 4/5 concern tax measures and only 1/5 expenditure cuts. Specifically, the measures coming into force on January 1st 2017 are almost exclusively related to tax regulations.

The difference between the multiplier effects of expenditure cuts versus those of tax increases on the real economy, the attempts to widen the tax base and limit the tax evasion, the maintenance of the core of welfare state and the adoption of growth

enhancing fiscal measures³ are highlighted, inter alia, as crucial issues for the conduct of budgetary policy, particularly under the current conditions which call for the need for putting Greece's public finances on a sustainable path.

Chapter 2: Macroeconomic Developments and Prospects

*Evaluation of Macroeconomic Forecasts*⁴

The macroeconomic forecast-target for the GDP is certainly achievable for 2016, while next year's goal remains feasible under certain conditions. The forecast for 2016 lies within the limits set by the Council's autonomous econometric analysis as well as by other domestic and foreign private and public forecasting institutions (official European agencies, private financial institutions, etc.). For the year 2017, there is an overall belief, by both international and domestic institutions that the year will mark the beginning of a strong economic recovery (over 2%) after eight years in recession (with the exception of the weak recovery of 2014).

Despite the recent downward data revision regarding private consumption and employment in 2015, GDP growth forecasts for 2016 and 2017 remained unaltered. The recent data revision made by the Hellenic Statistical Authority (ELSTAT) led to a slight downward revision in employment forecasted trends, balanced by a parallel upward revision of the estimates for the external sector; exports growth reached 0,8% of GDP (instead of -6.3% as previously estimated in the State Budget Preliminary Draft), while imports reached to 2.7% (relatively less than the -2,6% forecasted in the State Budget Preliminary Draft).

The main economic components driving the magnitude of GDP growth forecast for 2017 are private investments and the external sector of the economy (mostly exports); however, the timing these strong economic recovery forces will be activated, is not clear yet. Doubts are cast on the advent of sufficient conditions for significant improvement in the economic climate, relaxation of capital controls and inclusion of Greece in the Quantitative Easing Program, provided by the European Central Bank. All of the above largely depend on the outcome of the Second Review of the country's Economic Adjustment Program as well as on international developments regarding the settlement of Greek external debt issue. According to calculations made by the Council, the negative 'carry over' effect of 2015 may not be exhausted within 2016, but preserve its negative pressure in 2017.

³A relevant annex of the Report evaluates the degree of achievement of the fiscal adjustment realized in the past.

⁴The Preliminary Draft State Budget for 2017 reports annual forecasts for the annual change of real GDP equal to -0,3% for the current year and 2,7% for 2017.

Serious doubts are cast concerning the projected increase in private consumption for 2017, given further implementation of aggravating fiscal measures and current lack of credit for firms and households in the economy. The adequacy of factors driving such a favourable scenario are put in question, such as the forthcoming repayments of General Government's (GG) arrears towards individuals and the employment growth, through the creation of new jobs, as part of a new model of production and development to be adopted by the Greek economy.

Exports and imports are expected to recover in 2017, after their previous significant reductions due to capital controls, fall in freight rates, and recession which restricted imports. It should be noted that the impending economic recovery should be combined with a change in the country's import-export profile so that trade deficit expansions, which undermine external debt sustainability, are avoided in the future.

Review of Macroeconomic Risks

Sources of macroeconomic risks are traced upon (a) the process of Greek financial institutions' portfolios consolidation and their expansion in the economy, (b) implementation of structural reforms improving Greek economy's competitiveness, (c) investment capital attraction (d) State's solvency assurance and public debt sustainability (e) pursuing fiscal adjustment (f) ensuring social cohesion. Each aforementioned process causes significant (up- or downwards, depending on the outcome) divergence from the forecasted macroeconomic scenario. It is therefore important to exert sound economic policies effectively and on time. This can be achieved, also, through regular consultations with country's international creditors, pursuing state solvency. Positive developments in the discussions concerning country's debt restructure will largely restore investment confidence. However, there are also exogenous factors that affect the outcome of international consultations, such as the cooperation among European partners.

Especially critical external factors are considered to arise from (a) United Kingdom's decision to withdraw from the E.U., (b) divergences in the implementation of the agreement between E.U. and Turkey on the refugee issue and (c) international tensions and conflicts between countries in the Middle East and Eastern Mediterranean as well. The "Brexit" consequences in Greek economy (via turbulences in financial markets and in the intra-E.U. trade) are expected to be gradually felt as UK's exit process advances. It is important that E.U. timely adopts preparation measures so as to meet upcoming challenges, such as securing the European banking system against phenomena similar to the recent Deutsche Bank crisis. On the other hand, Eastern region's geopolitical developments may exert direct influence on the external sector of the economy (Foreign Direct Investments, Tourism, etc.). They could also spread out widely disrupting international geopolitical balances and triggering additional migrant-refugee flows.