Hellenic Fiscal Council

Summary of Spring Report – May 2018

For the second year in a row, fiscal policy performed better than anticipated, as the primary surplus in 2017 reached 4.2% of GDP, much higher than the 'Financial Assistance Facility' target of 1.75%. The improved budget performance in 2017 was largely the result of the increased social security contributions and indirect taxation coupled with tight spending controls (despite the exceptional provision of the so-called 'social dividend'). By contrast, revenues from direct taxation and the Public Investment Fund (PIF) underperformed against the targets. The significant increase in tax refunds to individuals led the State arrears to a notable seven years low.

'Budget-execution' data for the first months of 2018 suggest that the target for a primary surplus of 3.5% of GDP this year is within reach. Compared to last year, revenues from indirect taxation, social security contributions and the PIF increased substantially while social spending grew modestly. Given that new budgetary measures for the current year are rather limited, the attainment of the budgetary target for 2018 is a direct function of the economy's rate of growth.

More crucially, 2018 will be a 'turning point' for the Greek public debt, as debt relief measures are expected to be finalized -following consultations with the official creditors- and the country is set to regain full access to the international capital markets. Pilot attempts at raising market financing have taken place during the last two years with funding of 6 billion euro secured so far. Prospects for Greece's return to market-based financing have improved with sovereign bond yields declining gradually following the upgrade of the country's credit profile by the international rating agencies. However, given uncertainties associated with the recent political turmoil in Italy and Spain, the creation of adequate cash buffers can provide some form of protection against adverse international developments.

As for the macroeconomic outlook, the Hellenic Fiscal Council is of the view that although the Greek economy is emerging from a deep recession, it is pivotal that growth continues to perform in the coming years. In 2017, real GDP rose by 1.4% driven by a **substantial increase in Gross Fixed Capital Formation** by 9.6%. However, the **anemic contribution of Private Consumption to growth is a major source of concern**, as it reverberates the dampening effects of high taxation and social security contributions on household income. On the positive side, the **expansion of the tourism sector propelled exports growth** by 6.8%, albeit on balance, **net trade contribution to economic growth was negative** by almost 5.1 billion euro, given the increase in imports by 7.2% outweighed the rise in exports.

All things considered, the Greek economy seems to be on a stabilizing and thus more predictable path. Uncertainty is gradually reducing and the absence of significant 'structural breaks' helped produce smaller 'growth forecasting errors' compared to the past. In fact, the difference between growth forecasts for 2017 and realized outcomes was the smallest ever recorded in the last eight years.

In 2017, **Harmonized inflation recorded 1.1% annual growth** (up from virtually zero in 2016), driven by the spike in international oil prices and by indirect taxation, with core inflation registering a modest 0.3% rise. **Labor market conditions continued to improve**, as the unemployment rate declined further, aided by the creation of 73 thousand new full-time jobs.

Economic activity (in terms of gross value added) has in general, been uneven, with **expansion in five major sectors** (Mining and Quarrying, Manufacturing, Energy, Agriculture, Arts and Professional activities), reversal of declining trends in two (Wholesale and Retail Trade, Accommodation and Catering) and further contraction in four (Public Administration, Real Estate, Communications and Construction).

The current account deficit (at 1.41 billion euro) improved by almost thirty percent, reaching 0.8% of GDP in 2017, or some 458 million lower vis-à-vis its 2016 level. The improvement was due to **the increase in the surplus of the 'balance of services'** offsetting the increase in the deficit of the 'balance of goods'. The notable increase in the 'balance of services' surplus was mainly due to the **rapid expansion in travel services** (by 13.9%), as well as the **momentum growth in transportation** (by 19.2%).

The first few months of 2018 revealed no sign of significant macroeconomic trends. **Consumer prices (as measured by the Harmonized Consumer Price Index) increased** 0.5% in the first four months of 2018 relative to the comparable period in 2017 and slightly lower than core inflation at 0.7%. The **seasonally adjusted unemployment rate** in February (at 20.8%) inched 0.8% higher relative to the previous month but it was 1.8% lower compared to the corresponding month in 2017. The most recent reading of the **Economic Sentiment Index** (at 103.6) for the first four months of 2018, suggests a marginal increase relative to its level at the end of the year (at 101.3). Moreover, the **Consumer Confidence Index** for March seems to be recovering after a slowdown at the beginning of the year.

In the first two months of 2018, **the current account deficit** (at 1.87 billion euro) increased by a whopping 37.2% compared to the same period a year ago. The shortfall was principally due to a combination of 10% increase in the deficit of the 'balance of goods' and a small reduction in the surpluses recorded in the balance sheet of 'services' and of 'primary' and 'secondary incomes'. On a positive note, **Foreign Direct Investments** maintained growth momentum for three consecutive years.

The Hellenic Fiscal Council regards the recent downward revision of real GDP growth for 2018 (from 2.5% to 2.3%) by the Ministry of Finance, as a more realistic scenario. The growth revision for 2018 was effectively due to the 'carry-over' effect, adjusted to reflect a slightly lower GDP growth for 2017 (relative to preliminary estimates) by the Hellenic Statistical Agency.

The trajectory of macroeconomic developments as forecast by this scenario is subject to uncertainty and a **range of risks** that may result in outcomes across a spectrum of metrics that may be materially different from the projections.

Specifically:

- ✓ The economy's adjustment to a 'post-bailout' environment under European fiscal surveillance
- ✓ Lower 'potential output' of the Greek economy

- ✓ Persistently high unemployment and unfavorable demographic developments
- ✓ Unpredictable consequences of the geopolitical developments in Iran, the Eastern Mediterranean, Syria and Turkey
- ✓ Government instability in Italy
- ✓ The negative effects of high taxes on private consumption, as well as the cumulative negative impact of net imports on GDP.

Athens, May 31, 2018

The President of the Board of Directors

Prof. Panagiotis Korliras