Hellenic Fiscal Council

Summary of the Spring Report 2019 – May

In 2018, for the third year in a row, **the General Government (GG) budget balance** recorded a surplus, which amounted to 1,991 million euro or 1.1% of GDP. This result is the strongest budgetary performance recorded by the GG in the period 1995-2018 (for which there are actual data). The widening of the surplus over the previous two years reflects the improvement of economic activity, the rise of employment and the improvement of tax administration.

The primary surplus of GG on an annual basis stood at 8,149 million euro or 4.4% of GDP (ESA 2010), considerably higher compared to the primary surplus of 3.9% of GDP in 2017. The primary surplus of the GG, under the terms of Enhanced Surveillance Program, amounted to 4.3% of GDP, which was significantly higher than the target (3.5% of GDP).

Both revenues and expenditures of the GG recorded an increase, but the revenue increase was higher than that of expenditures. **The increase in GG revenues** was due to a boost of the two main revenue categories of GG; a) tax revenues and, b) social security contributions. The revenue categories that recorded an increase over 2017 were mainly revenues from Corporate Income Taxes, VAT and excise duties (excluding fuel tax). **Regarding primary expenditures of GG**, the highest increase recorded on wage costs (by €659 million on a cash basis). The above increase was due to: a) the payment of lump sums to civil servants (retroactive payments for special wage grid earners), b) the increase of social security contributions paid by the state for its personnel, c) the reform of special wage grid and d) the reduced number of retirement withdrawals. Social expenditures have also increased due to increased payments for child-care benefits and the social solidarity allowances.

According to the available data, General Budget on a modified cash basis, is executed on the same level as last year and slightly higher compared to the 2019 target. These results have not yet taken into account the impact of the expansionary fiscal measures adopted by the Greek Government in May 2019 such as: a) the introduction of a 13th pension, b) a reform of “survivors’ pensions” and c) reductions in selected VAT rates. The above measures will have a total fiscal cost of 1.39 billion, according to the ministry of finance estimations.

The Hellenic Fiscal Council estimates that the budgetary target for a primary surplus of 3.5% of GDP for 2019 is marginally achievable. This estimation is taking into account the cost of the new fiscal measures which account to 0.6% of GDP thus consuming the fiscal space (also 0.6% of GDP) that was estimated to the Greek Stability Program 2019-2022. However, the Council considers that the above measures may have, inter alia, a positive dynamic impact on private consumption and thus on tax revenues as a whole.

Based on the fact that the achievement of the budgetary target of 2018 was mainly due to: the strengthening of economic activity and the improvement of revenue collections, the following conditions are cumulatively required to avoid a lag behind fiscal target for 2019:

a) A GDP and an employment growth as it is already forecasted

b) The pre-election period in Greece should not adversely affect the tax administration performance mainly revenue collection and tax audits. Such scenario, would cause significant revenue losses especially during the high touristic season.

c) Constrain public expenditures to the projected levels

d) The avoidance of possible retroactive payments which will increase public expenditures.

As far as the macroeconomic developments are concerned, the Council considers that the Greek economy has started to follow a modest growth path, since a positive growth is recorded for a second consequently year. More specifically, the Greek economy recorded a 1.9% growth which is mainly attributed to the to the increase of private consumption and to the shrinkage of the deficit of the external account of goods and services. A stronger growth is necessary for the coming years in order to enhance further the economic confidence, to support the increase of employment and to reduce the public debt to GDP ratio.

However, the reduction of fixed investments (gross fixed capital formation) by 12,2% during 2018 raises considerable concerns, since the core scenario for the recovery of economic activity is based to the strong growth of fixed investments. Furthermore, the share of fixed investments to the Greek GDP remains low and significantly lower than the EU average. The categories of investments, which underperformed, compared to 2017 were “Constructions” (mainly public investments) and “Transportation and Military Equipment” (mainly imports of ships). On the other hand, the remaining categories of investments (Information Technology Equipment, Machinery, Housing) recorded an increase during 2018.

The downward trend of unemployment continued during 2018, with the unemployment rate been dropped from 21.5% in 2017 to 19.3% in 2018. The number of unemployed fell below 1m. for the first time since 2011.

The current account deficit was increased during 2018 the highest level since 2012. More specifically, the deficit was 2.9% of GDP and it was increased relative to 2017 by 1.1 percentage point. This deterioration is attributed to the increase of the deficits of “goods” account and primary income account, while the service account and the secondary income account recorded a modest increase in their surpluses.

During 2019, the unemployment rate continues to decline without evidence that the recent rise of minimum wage had negative effects to employment. In addition leading indicators concerning Greek manufacturing sector such as “turnover index in industry”, “production index in industry”, “new orders index in industry” and the “Purchasing Managers' Index” (PMI) give optimistic signals.

On the other hand the widening of the current account deficit during the first quarter of 2019 raises concerns and requires further monitoring.

The GDP forecasts for 2019 of domestic and international institutions converge to a range of 1.9%-2.3% real growth; though the Council’s baseline scenario for the real GDP growth is to some extent more pessimistic.

Domestic and external risks remain, while their consequences being difficult to quantified in advance. Specifically:

Regarding the external environment, there is evidence of a possible slowdown in European Economies. This may negatively affect the Greek exports to European countries and may ease the tourism revenue growth. Taking into account that more than 1/3 of Greek exports are directed to European countries and approximately half of the tourism revenues are derived from European citizens, a possible downturn of the European economic activity will have a direct impact on the growth of the Greek economy. Furthermore, the expected recovery of the Turkish tourism market may further negatively effect the Greek tourism revenues.

In addition, there is still the risk of increased financial instability in Europe due to a "no-deal Brexit" withdrawal of the United Kingdom from the European Union. Given that around 15% of Greek tourism revenues are derived from UK citizens a "no-deal Brexit" will have a negative impact to the Greek external balance of services.

A possible risk of escalation of the protectionist attitudes that are present in major economies with adverse impacts on world trade, it will act as a deterrent factor for the Greek exports.

Finally, the external uncertainty is fueled and can be exacerbated by the unpredictable effects of critical geopolitical challenges in the Eastern Mediterranean basin. As a specific example, we highlight the ongoing tension between Turkey and Cyprus on the issues of the Cypriot "Exclusive Economic Zone" (EEZ).

Regarding the domestic environment, the high ratio of non-performing loans in the domestic banking system, which on one hand negatively affects the banks' capital adequacy and profitability and on the other hand, restrain the amount of credit that can be channeled to Greek firms and households. Overall, accelerating the settlement process of the issue could boost bank credit and thus boost investment and consumption.

Athens, May 31, 2019

The President of the Hellenic Fiscal Council

Panagiotis Korliras