8. GREECE

Contraction combined with a rebound in confidence

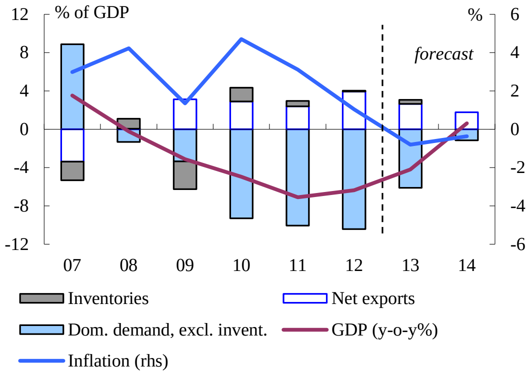
Is 2013 the last year of recession?

Greece entered the sixth consecutive year of recession in 2013, but a recovery is expected to start by the turn of the year, supported by improved confidence and the return of liquidity.

While hard data is still generally negative, softer survey indicators continue to improve since the re-launch of the adjustment programme last autumn. Confidence is supported by the achievement of fiscal targets despite the recession, by the high credibility of the recently-legislated reforms and measures supporting the fiscal adjustment, by strong improvements in cost competitiveness and by the return of deposits and liquidity to the banking system following significant EU/IMF disbursements and debt-reducing measures.

Nevertheless, in the short run, growth for 2013 is still projected to contract by 4.2%, due to a strongly negative carry-over. The high level of unemployment together with cuts in wages and social transfers will continue depressing private consumption. Investment is likely to continue underperforming in the short run, as the majority of businesses still face liquidity constraints.

Graph II.8.1: **Greece - GDP growth and contributions, inflation**



The repayment of government arrears, planned to amount to 4% of GDP in 2013, and the faster absorption of the EU and EIB funds through major projects involving foreign lending consortia, could alleviate liquidity constraints. The bank recapitalisation process and the overall stabilisation of the economy are setting the preconditions for a return of capital to the country. Against this background, domestic demand is expected to start expanding again in 2014 with annual GDP growth of 0.6%.

The unemployment rate has increased sharply, reaching 24.3% in 2012 and is forecast to rise to 27.0% in 2013, as falling aggregate demand offsets sharp reductions in labour costs. Structural reforms in wage setting have already contributed to sharp reductions in unit labour costs and improving competitiveness. Thus unemployment is expected to decrease to 26.0% in 2014 as the economy picks up.

The current-account deficit is projected to further decrease in 2013. In 2012, this adjustment was driven largely by declining imports. A rebound in exports is expected in 2013. Pre-booking data already suggest an improvement in tourism receipts for summer 2013. In addition, the agreed government debt restructuring measures will improve the primary income balance through lowering interest payments.

Inflation continues the deceleration that started in 2010. Consumer prices are expected to fall moderately by 0.8% in 2013 and 0.4% in 2014, reflecting weak domestic demand, falling ULCs and the implementation of product market reforms.

The fiscal position continues to improve

While the headline general government deficit amounted to almost 10% of GDP in 2012, this reflected one-off costs of almost 4.0% of GDP associated with the resolution of three banks last year. Net of these one-off measures, despite continued headwind from the deep recession, Greece is estimated to have achieved a slightly better fiscal outcome than expected for 2012.

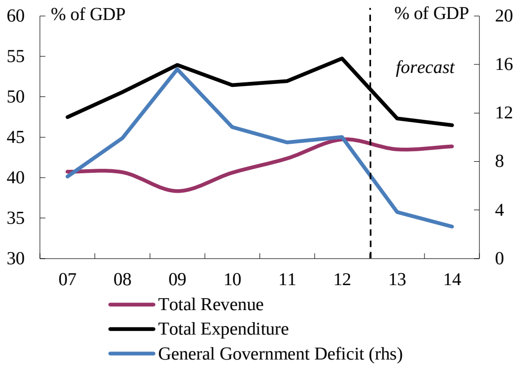
On the basis of measures taken in November 2012 in the context of the programme, Greece is expected to achieve primary balance in 2013, contingent on the effective implementation of the budget. However, the bank recapitalisation taking place in the first half of 2013 will have a very significant impact on the headline deficit compared to the figure currently forecast (this impact will instead change the current debt projections only marginally as the latter already include the funds borrowed to carry out the bank recapitalisation). The exact nature and size of such impact on the deficit depends on the ultimate form of the operations, which were not yet finalised at the cut-off date. The forecast does not take into account the equivalent of SMP profits transferred by euro-area Member States to Greece as the statistical treatment is under consideration. Interest payments are lower than expected in the winter forecast, due to lower short-term interest rates.

In 2014, the fiscal balance is expected to improve further due to the implementation of consolidation measures already legislated and the pick-up in economic activity.

In structural terms, the improvement is even more significant over the forecast period, leading to a projected structural balance of 2% of GDP in 2014, up from some-14¾% in 2009, reflecting a clear turnaround in the fiscal position compared to the beginning of the crisis.

The ratio of public debt to GDP is expected to rise in 2013. However, from 2014 and onwards, the debt ratio is projected to decline at an accelerating pace as the fiscal balance continues improving and economic growth resumes.

Graph II.8.2: **General Government Revenue, Expenditure and Balance**



Risks to the baseline outlook

On the upside, a faster return in confidence or a stronger impact of liquidity infusions through arrears clearance could lead to an earlier recovery than predicted. On the downside, slippage with policy implementation could undermine confidence. Furthermore, interest projections reflect very low short-term interest rates, which could increase earlier than expected.

Table II.8.1:

Main features of country forecast - GREECE

	2011			Annual percentage change					
	bn EUR Curr. prices	% GDP	92-08	2009	2010	2011	2012	2013	2014
GDP	208.5	100.0	2.9	-3.1	-4.9	-7.1	**-6.4**	**-4.2**	**0.6**
Private consumption	155.6	74.6	3.1	-1.6	-6.2	-7.7	**-9.1**	**-6.9**	**-1.6**
Public consumption	36.2	17.4	2.6	4.9	-8.7	-5.2	**-4.2**	**-4.0**	**-6.2**
Gross fixed capital formation	31.6	15.1	4.3	-13.7	-15.0	-19.6	**-19.2**	**-4.0**	**8.4**
of which : equipment	12.8	6.1	9.8	-18.4	-8.2	-18.1	**-17.3**	**-3.4**	**10.0**
Exports (goods and services)	52.2	25.1	6.0	-19.4	5.2	0.3	**-2.4**	**3.1**	**4.6**
Imports (goods and services)	69.1	33.1	6.1	-20.2	-6.2	-7.3	**-13.8**	**-6.5**	**-1.9**
GNI (GDP deflator)	202.5	97.1	2.7	-2.3	-5.3	-7.2	**-3.1**	**-5.3**	**-0.1**
Contribution to GDP growth : Domestic demand			3.5	-3.3	-9.3	-10.1	**-10.4**	**-6.1**	**-1.1**
Inventories			-0.1	-2.9	1.4	0.6	**0.1**	**0.4**	**0.0**
Net exports			-0.6	3.1	2.9	2.4	**4.0**	**2.7**	**1.8**
Employment			1.3	-0.6	-2.6	-5.6	**-8.3**	**-3.5**	**0.6**
Unemployment rate (a)			9.7	9.5	12.6	17.7	**24.3**	**27.0**	**26.0**
Compensation of employees/head			7.3	3.5	-2.6	-3.4	**-4.2**	**-7.0**	**-1.5**
Unit labour costs whole economy			5.6	6.2	-0.1	-1.8	**-6.2**	**-6.3**	**-1.5**
Real unit labour costs			-0.4	3.8	-1.3	-2.9	**-5.5**	**-5.3**	**-1.2**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			6.0	2.3	1.1	1.0	**-0.8**	**-1.1**	**-0.4**
Harmonised index of consumer prices			-	1.3	4.7	3.1	**1.0**	**-0.8**	**-0.4**
Terms of trade of goods			0.0	-3.5	1.8	0.6	**-1.0**	**-0.1**	**-0.1**
Merchandise trade balance (c)			-15.8	-16.1	-14.3	-14.0	**-11.3**	**-9.6**	**-8.4**
Current-account balance (c)			-7.8	-14.4	-12.8	-11.7	**-5.3**	**-2.8**	**-1.7**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-13.3	-11.0	-9.8	**-2.9**	**-1.1**	**0.0**
General government balance (c)			-6.7	-15.6	-10.7	-9.5	**-10.0**	**-3.8**	**-2.6**
Cyclically-adjusted budget balance (c)			-7.0	-15.0	-8.4	-5.1	**-4.2**	**2.4**	**2.2**
Structural budget balance (c)			-	-14.8	-8.8	-5.4	**-1.0**	**2.0**	**2.0**
General government gross debt (c)			100.0	129.7	148.3	170.3	**156.9**	**175.2**	**175.0**

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.