

## 8. GREECE

### Persistent and large structural imbalances take their toll

#### Economic activity slowed in 2008

Economic activity has been slowing down since the beginning of 2008, posting an annual real GDP growth rate of 2.9%, down from 4% in 2007. The heightening uncertainty - especially in the second half of the year - has proven to be detrimental to both consumer and business confidence, undercutting economic activity and future prospects. Weakening private consumption and more importantly, declining investment, were the main reasons behind the recorded slowdown. Tightening credit conditions, financial uncertainty and deteriorating economic sentiment brought about a sharp contraction in construction activity, especially in dwellings. After recording some positive growth in the first half of 2008, corporate investment declined strongly thereafter and contracted on an annual basis. Overall, domestic demand made a negative contribution of almost  $\frac{3}{4}$  pp. to GDP growth, compared with a positive contribution of more than  $4\frac{1}{2}$  pps. in 2007. On the external front, in spite of eroding competitiveness, a deteriorating external environment and slowing economic activity in the euro area, real export growth remained in positive territory, especially towards extra-EU trading partners. Imports, on the other hand, contracted strongly and by more than domestic demand, leading to a significantly positive contribution of net exports to growth, which contrasts with the continuous contraction of net exports recorded in recent years.

#### Contraction in 2009

Activity is expected to be further affected by the ongoing economic crisis and prevailing

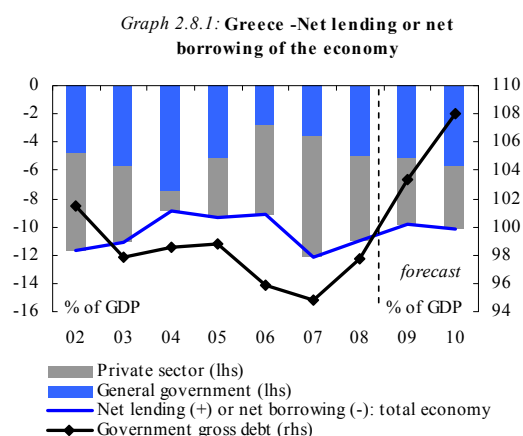
uncertainty. Although remaining above the euro area average, economic growth will turn negative in 2009 for the first time since 1993. Private consumption is projected to decelerate strongly but remain in positive territory, on the back of still positive credit expansion and real wage growth. Public consumption growth in turn, is expected to fall below 2%. The fall in investment in housing is forecast to ease in 2009, leading to a slight downward trend thereafter. Public and corporate investment growth is expected to benefit from EU structural funds inflows and the launch of public-private partnership investment projects, thus avoiding a further strong contraction in 2009 and 2010. Overall, domestic demand is projected to make a negative contribution to GDP growth in 2009.

On the external side, imports are projected to decrease further, in line with domestic demand. Shrinking international trade volumes and further worsening of competitiveness are expected to result in a significant fall of exports of goods. Exports of services should also follow a similar path, with tourism and transportation receipts being heavily affected by the depressing effects of the international crisis. As a result, the contribution of net exports to GDP growth is projected to remain broadly neutral over the forecast horizon. In view of developments in the external sector, the external deficit is projected to decline somewhat, while staying high, at around 10% of GDP in 2009 and 2010. With portfolio investment remaining the main source of its financing, Greece's external position becomes more vulnerable.

#### Persistent competitiveness losses

The contraction in economic activity will lead to a declining employment outlook over the forecast horizon. The decrease in unemployment observed in recent years is accordingly expected to end. Nevertheless, nominal wages in the private sector should rise faster than productivity, thus pushing unit labour cost growth above those of the euro area and other trading partners. This will further worsen the country's competitive position, especially in the goods sector.

Following the developments in oil and commodity markets, HICP inflation decelerated strongly in the



first quarter of 2009 and is projected to be 1¾% in 2009 and above 2% in 2010.

### Fiscal imbalances persist: debt to exceed 100% of GDP once again

According to data notified by the Greek authorities in April 2009, the general government deficit reached 5% of GDP in 2008, 1¼ pps. of GDP higher than the estimation included in the Stability Programme.

The official deficit target for 2009 is set at 3.7% of GDP (including deficit-decreasing one-off measures amounting to 0.5 percentage points of GDP). In spite of the worse-than-expected budgetary outturn in 2008, the target for 2009 has not changed. A set of deficit reducing measures taken by the authorities after the submission of the Stability Programme is meant to compensate for the higher-than-expected outturn of 2008. However, the budgetary impact of these measures is estimated at around ½ pp. of GDP, half of which is temporary in nature.

The revenue-to-GDP ratio is projected to grow by almost 1 pp. of GDP in 2009, on the back of a tax revenue-enhancing package, included in the Stability Programme. The Greek authorities

envisage a number of measures to be implemented in the course of 2009, which are aimed at constraining primary public expenditure, excluding social transfers. Given the lack of room for fiscal manoeuvre, the Greek government has not adopted a short-term stimulus package, with total expenditure remaining around the level of previous year. On account of a less favourable growth scenario and a prudent assessment of revenue enhancing measures, consistent with past outcomes, the Commission services project a deficit of just above 5% of GDP in 2009. Measured by the cyclically-adjusted balance net of one-offs, the structural balance would improve by ¾ pp. in 2009. Under the customary unchanged policy assumption, the 2010 deficit is projected at 5¾% of GDP.

Gross debt is projected to reach 108% of GDP by 2010, from 97¾% in 2008. Apart from the rising deficit and declining GDP, a sizeable stock-flow adjustment contributes to the strong rise in the debt ratio. Possible debt-increasing financial transactions within the framework of the financial sector support package may put further upward pressure on the debt-to-GDP ratio.

Table 2.8.1:

#### Main features of country forecast - GREECE

	2007		Annual percentage change							
	bn Euro	Curr. prices	% GDP	92-04	2005	2006	2007	2008	2009	2010
GDP at constant prices	228.3	100.0		3.0	2.9	4.5	4.0	2.9	-0.9	0.1
Private consumption	162.5	71.2		2.8	4.3	4.8	3.0	2.2	0.4	0.5
Public consumption	38.2	16.7		2.7	1.2	0.0	7.7	3.2	1.9	1.9
Gross fixed capital formation	51.3	22.5		4.9	-0.5	9.2	4.9	-11.5	-5.6	0.7
of which : equipment	19.7	8.6		10.2	-1.0	14.2	9.1	-9.6	-9.5	1.5
Exports (goods and services)	52.5	23.0		6.5	4.2	10.9	3.1	2.2	-7.3	0.8
Imports (goods and services)	76.4	33.5		5.9	1.4	9.7	6.7	-4.4	-6.0	0.9
GNI at constant prices (GDP deflator)	221.8	97.1		2.7	2.0	4.0	3.2	2.1	-1.2	-0.1
Contribution to GDP growth :										
Domestic demand				3.5	3.1	5.5	4.6	-0.7	-0.5	0.9
Stockbuilding				-0.1	-0.7	-0.3	1.0	1.5	-0.6	-0.7
Foreign balance				-0.4	0.5	-0.6	-1.5	2.1	0.3	-0.1
Employment				1.1	1.0	2.1	1.3	1.2	-1.1	-0.1
Unemployment rate (a)				9.9	9.9	8.9	8.3	7.7	9.1	9.7
Compensation of employees/head				8.5	4.9	1.0	9.1	7.5	4.4	1.9
Unit labour costs whole economy				6.5	2.9	-1.3	6.3	5.7	4.1	1.7
Real unit labour costs				-0.5	-0.5	-4.4	3.3	2.2	2.0	-0.9
Savings rate of households (b)				-	-	-	-	-	-	-
GDP deflator				7.0	3.4	3.2	2.9	3.3	2.1	2.7
Harmonised index of consumer prices				-	3.5	3.3	3.0	4.2	1.8	2.3
Terms of trade of goods				0.1	-7.8	1.3	0.0	-1.1	5.4	-0.8
Trade balance (c)				-15.4	-16.8	-16.8	-18.7	-16.9	-14.8	-15.0
Current account balance (c)				-5.6	-10.6	-11.4	-14.0	-12.7	-11.5	-11.9
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				-	-9.3	-9.1	-12.1	-11.0	-9.8	-10.2
General government balance (c)				-6.8	-5.1	-2.8	-3.6	-5.0	-5.1	-5.7
Cyclically-adjusted budget balance (c)				-6.5	-5.7	-3.7	-4.7	-6.1	-4.9	-4.7
Structural budget balance (c)				-	-5.7	-4.1	-4.5	-6.5	-5.7	-4.7
General government gross debt (c)				99.4	98.8	95.9	94.8	97.6	103.4	108.0

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