8. GREECE

Consolidating growth to support sustained debt reduction

Economic growth in Greece strengthened in 2018, primarily due to a buoyant export performance. GDP growth is forecast to increase over the forecast horizon, despite a deteriorating external environment, helped by ongoing improvements in domestic demand. The general government balance recorded a surplus in 2018 for the third year in a row, and Greece is projected to achieve its agreed fiscal targets in 2019 and 2020. Against this background, public debt should commence a declining path, though fiscal risks need to be monitored.

Economy strengthens but investment remains lacklustre

Greece's economic recovery continues: real GDP grew by 1.9% in 2018, driven mainly by net exports. With real growth of exports at 8.7%, Greece managed to increase its world market shares in both goods and services, while imports remained subdued. Private consumption maintained its momentum and provided a further contribution to annual GDP growth. Investment, however, registered a major setback, partly due to heavy underspending of the public investment budget. Under-execution of the budget also put a drag on public consumption and thereby on GDP. Change of inventories showed a large increase, although this component remains sensitive to regular statistical revisions.

Growth expected to remain resilient despite external slowdown...

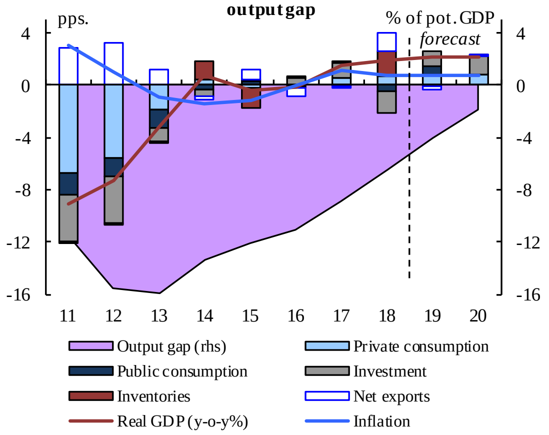
In 2019, real GDP growth is expected to strengthen to 2.2%. The slowdown of the external environment will have a negative but limited impact on Greece's export performance, due to the low income elasticity of demand for Greece's main export commodities. This drag from the external side should be offset by private consumption, which received a short-term boost through the recent hike in the minimum wage. Assuming full execution of the budget, public consumption and investment should support growth, while private investment growth is set to remain subdued. The expected increase in private consumption and total investment can be expected to boost import demand, thereby lowering the contribution of net exports to growth.

2020 is forecast to see a rebound in private investment growth, although increased labour costs will squeeze the profit margin of some firms, thereby limiting their potential to invest without additional external financing. This increase in labour costs is projected to translate into some loss in competitiveness. Greece is nevertheless expected to continue to increase its world market shares in goods and services exports.

The labour market recovery continued in 2018, but some slowdown is expected due to the recent increase in the statutory minimum wage. Employment is expected to grow by 1.5% in 2019 and 1.3% in 2020, bringing the unemployment rate down to 16.8% by 2020.

Despite lower oil prices, HICP inflation is forecast to remain at 0.8% in 2019 and 2020. The minimum wage increase is expected to have a moderate additional inflationary effect both in 2019 and 2020.

Graph II.8.1: **Greece - Real GDP growth and contributions, output gap**



Although some upside risks are present (e.g. improving bank lending to provide more support to private investment), the forecast is dominated by downside risks, related mainly to a repeated under-execution of the public investment budget and the possibility that the slowdown in Greece's trading partners could have a bigger impact on exports.

...and facilitate achievement of fiscal targets

The general government balance reached 1.1% of GDP in 2018, recording a surplus for the third year in a row. Building on the fiscal adjustment achieved in recent years, the outcome for 2018 benefitted from solid GDP growth, a broad-based recovery in taxable profits and a further reduction in operational and investment expenditure. As in recent years, under-utilisation of budget ceilings improved the outturn over and above what was previously projected.

Greece is set to achieve the agreed primary surplus targets in 2019 and 2020. The main drivers of the projected primary surpluses are the still large output gap, the growing benefits of past pension reforms, and the ceilings on healthcare spending and new hirings, which help to keep expenditure dynamics in check.

While continued improvements in the collection of tax debts and ambitious targets of the authorities for clearance of unprocessed pension applications represent possible upside risks, there are significant downside risks, such as ongoing court cases that could trigger a partial reversal of earlier reforms and give rise to fiscal liabilities. Additional pressure could arise from policy initiatives affecting the public wage bill. [82] As is customary, the forecast is conditioned on the working assumption that budget ceilings will be used fully. The projection takes into account the announcement not to implement the 2020 tax reform, which will be further discussed in the context of enhanced surveillance.

Overall, under a no-policy-change assumption, the general government balance is expected to reach 0.5% of GDP in 2019, factoring in the one-off positive impact of debt measures agreed on 5 April 2019. The 2020 balance is projected to decrease to -0.1% of GDP in 2020, because of rising interest payments and the absence of further conditional debt relief measures in the baseline. In view of the projected narrowing of the output gap, the structural balance is forecast to decline from 5% of GDP in 2018 to around ¾% of GDP in 2020. Greece's public debt is expected to have peaked at 181.1% in 2018 and to decline to 168.9% of GDP by 2020 on account of the growth recovery and the high primary surpluses.

(82) The forecast also assumes that the unused part of the reserve, which was created in the 2019 Budget against the risk that the payment of December 2018 wage refunds slips to the first months of the current year, will remain unused.

Table II.8.1:

Main features of country forecast - GREECE

	2017		Annual percentage change						
bn EUR	Curr. prices	% GDP	99-14	2015	2016	2017	2018	2019	2020
GDP	180.2	100.0	0.3	-0.4	-0.2	1.5	**1.9**	**2.2**	**2.2**
Private Consumption	123.8	68.7	0.4	-0.2	0.0	0.9	**1.1**	**1.3**	**1.2**
Public Consumption	35.7	19.8	0.7	1.6	-0.7	-0.4	**-2.5**	**3.1**	**0.4**
Gross fixed capital formation	23.2	12.9	-3.4	0.7	4.7	9.1	**-12.2**	**10.1**	**10.8**
of which: equipment	10.5	5.8	-0.9	7.3	-11.4	22.2	**-10.2**	**4.2**	**8.9**
Exports (goods and services)	59.5	33.0	4.3	3.1	-1.8	6.8	**8.7**	**4.7**	**4.2**
Imports (goods and services)	61.3	34.0	1.8	0.4	0.3	7.1	**4.2**	**5.7**	**4.1**
GNI (GDP deflator)	180.6	100.2	0.2	-1.0	-0.3	1.7	**0.8**	**2.5**	**2.2**
Contribution to GDP growth: Domestic demand			0.1	0.3	0.4	1.6	**-1.3**	**2.6**	**2.1**
Inventories			0.0	-1.6	0.1	0.1	**1.8**	**0.0**	**0.0**
Net exports			0.3	0.9	-0.7	-0.1	**1.5**	**-0.4**	**0.0**
Employment			-0.4	0.7	0.5	1.5	**1.7**	**1.5**	**1.3**
Unemployment rate (a)			13.7	24.9	23.6	21.5	**19.3**	**18.2**	**16.8**
Compensation of employees / head			2.7	-2.4	-0.9	0.5	**1.3**	**2.4**	**1.7**
Unit labour costs whole economy			2.0	-1.3	-0.3	0.6	**1.1**	**1.6**	**0.8**
Real unit labour cost			0.0	-0.9	0.0	0.0	**0.5**	**0.5**	**-0.4**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			2.0	-0.3	-0.2	0.6	**0.5**	**1.1**	**1.2**
Harmonised index of consumer prices			2.6	-1.1	0.0	1.1	**0.8**	**0.8**	**0.8**
Terms of trade goods			-0.1	0.6	-2.3	1.2	**-1.0**	**0.4**	**0.7**
Trade balance (goods) (c)			-14.5	-9.1	-9.3	-10.3	**-9.9**	**-10.5**	**-10.5**
Current-account balance (c)			-9.3	-0.3	-1.2	-1.1	**-1.4**	**-1.0**	**-0.8**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-7.7	2.1	0.4	0.0	**-0.1**	**0.5**	**0.9**
General government balance (c)			-8.1	-5.6	0.5	0.7	**1.1**	**0.5**	**-0.1**
Cyclically-adjusted budget balance (d)			-6.9	0.7	6.3	5.4	**4.4**	**2.6**	**0.9**
Structural budget balance (d)			-	3.3	5.6	5.1	**5.0**	**1.9**	**0.8**
General government gross debt (c)			125.3	175.9	178.5	176.2	**181.1**	**174.9**	**168.9**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.