May 2023

GREECE

ECONOMIC & FINANCIAL OUTLOOK

ECONOMIC RESEARCH DIVISION

Fiscal policy tightening and robust nominal GDP dynamics compress the debt-to-GDP ratio

The strong economic growth recorded between 2021-2022 paved the way for a better-than-expected performance of public finances in 2022, eliminating primary deficit (+0.1% of GDP), despite sizeable policy interventions adopted by the Greek government during the year. This development, combined with the return to primary surpluses from 2023 onwards, the sharp decline of public debt to GDP ratio by 35 pps during the last two years (2020-2022), the accumulated cash buffer and the increased contribution of investment to real GDP growth, supported by the inflow of RRF funds to the Greek economy, are expected to support the regaining of the investment grade within 2023.

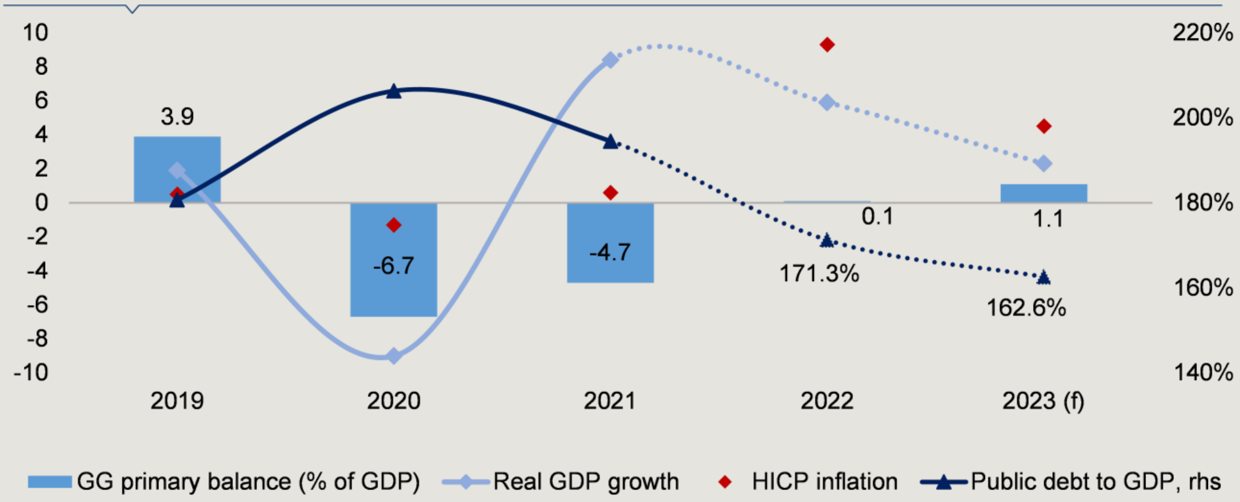
According to the latest release by ELSTAT, fiscal outturns surprised on the upside. The general government (GG) primary balance returned to positive territory, standing at 0.1% of GDP (€273 mn), exceeding earlier estimates (MoF Budget 2023) for a deficit of 1.6% of GDP (€3.4 bn). This remarkable improvement in the GG primary balance, decreasing by 4.8 percentage points compared to 2021, is one of the highest among EU countries.

The better-than-initially expected performance of public finances in 2022 is mainly attributed to the overperformance of tax revenues, combined with the strong economic recovery recorded over the past two years (8.4% in 2021; 5.9% in 2022), factors that contributed to the creation of sufficient fiscal space, achieving to prevent the derailment of the primary balance from the target set in the 2023 Budget. This outturn, compared to earlier estimates, is also supported by the inclusion of ANFAs/SMPs revenues.

Greece is expected to remain strongly committed to fiscal discipline, with a further increase of primary surplus planned in 2023 (estimated at 1.1% in Stability Programme 2023). According to available preliminary data on the State Budget execution on a modified cash basis, the State Budget Primary Balance in Q12023 amounted to a surplus of €3.1 bn, against the primary surplus target of €28 mn which has been incorporated for the same period of the 2023 Budget.

GRAPH 1

Primary surplus, real GDP growth and inflation dynamics push public debt to GDP downwards



Sources: ELSTAT, Ministry of Finance Stability Programme 2023

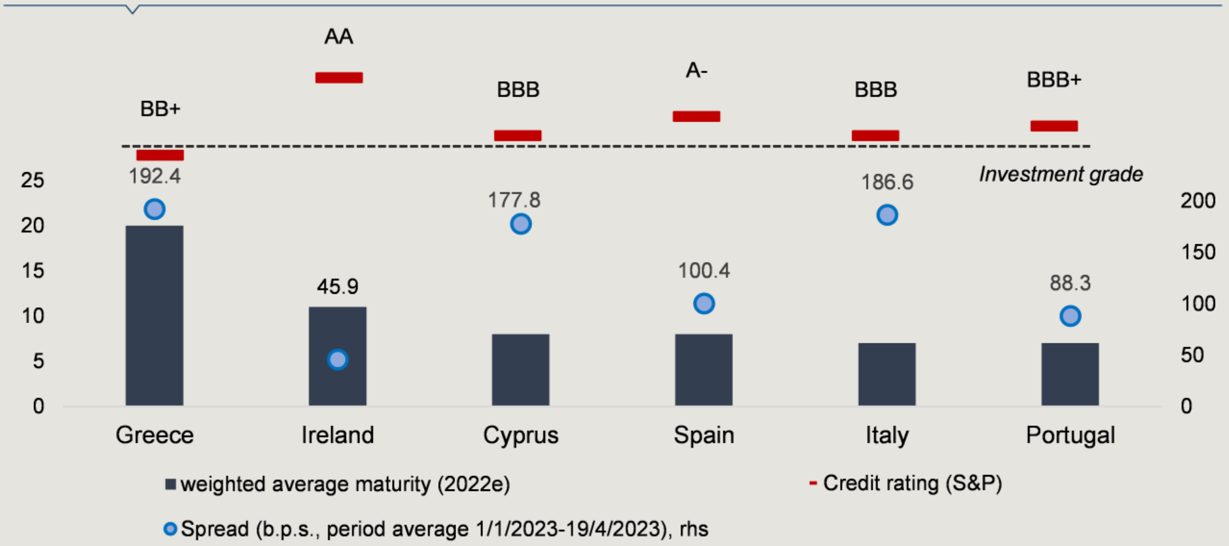
Furthermore, in 2022, Greece recorded the largest annual reduction in public debt as a percentage of GDP, among EU countries, by 23.3 percentage points, reaching 171.3% of GDP. These developments, combined with the accumulated cash buffer and the rising contribution of investment to real GDP growth, underpinned by the inflow of RRF funds to the Greek economy, are expected to support the regaining of the investment grade in 2023. As recently noted by S&P, in the light of the above-mentioned developments, «it is expected to upgrade Greece within the next 12 months if fiscal discipline is maintained over their forecast period through 2026». Ratings upgrade would also likely hinge on the next government maintaining the pace of structural reforms, thereby boosting Greek economic competitiveness. The ECB's monetary policy tightening in 2022, in response to strong inflationary pressures pushed interest rates as well as ten-year government bond yields upwards, especially for highly-indebted countries such as Greece and Italy (*Graph 2*). Specifically, for Greece, standing currently one notch below investment grade, this rise in GGB yields was larger. Therefore, regaining investment grade within 2023 is expected to contribute to the de-escalation in GGB yields, allowing better liquidity conditions for the State, the banks and the firms.

In addition, the favourable characteristics of the Greek government debt mitigate, at least in the medium term, interest rate risk. In particular, according to the Public Debt Management Agency (PDMA): (i) the largest part (almost 100%) of Greek public debt is linked to fixed interest rates, (ii) almost 75% of the debt stock is held by official sector and the weighted average maturity is very high (20 years maturity at end-2022, significantly higher than in other EU countries as depicted in *Graph 2*), while (iii) interest rates are relatively low as most of the loans were granted in the context of Economic Adjustment Programmes (1.5% annual effective weighted average interest rate). Moreover, gross financing needs within the next few years stand below 15% of GDP, lower than peers holding an investment grade, i.e. Italy, while interest debt payments as a share of total GG revenues maintained its downward trend, reaching 4.8% in 2022 from 6.9% in 2018 and 11.3% in 2012. Despite its relatively high ratio of public debt to GDP, Greece records lower interest debt service to total GG revenues compared to countries above the investment grade (i.e. Italy (8.1%), Spain (5%) and Portugal (4.9%)), and remains significantly below average of Baa-rated sovereigns' based on Moody's relevant ranking.

Public debt-to-GDP ratio decreased by 23.3 percentage points in 2022, reaching 171.3% down from 194.6% in 2021, and, according to MoF (*Stability Programme 2023),* it is expected to further drop to 162.6% in 2023 and 150.8% in 2024. This downward course of public debt to GDP in the medium term, is underpinned by factors that lead simulatenously to a decrease (increase) in the numerator (denominator). More specifically, the swift return to fiscal discipline through the achievement of primary surpluses from 2023 onwards, combined with reduced interest debt payments, is expected to lower the numerator. On the other hand, strong economic growth, together with persistent inflationary pressures -albeit to a milder extent - are expected to further increase nominal GDP (i.e., the denominator of the fraction) and therefore squeezing the debt-to-GDP ratio in the coming years.

GRAPH 2

Credit ratings, government bond yields and average maturity



Sources: ELSTAT, PDMA, Trading Economics

According to PDMA (*Funding Strategy for 2023*), the funding strategy in 2023 is expected to primarily target continued presence in international capital markets, further debt-to-GDP decrease and maintenance of the cash buffer. More specifically, financing needs for 2023 amount to €15.4 bn, of which €7.2 bn relate to debt servicing costs and €4.7 bn in interest payments. Less than half of the State's financial needs for 2023 will be covered *via* new issuances, i.e., a total of €7 bn, while 90% of the amount (€6.3 bn) has already been drawn during January-April through new issuances of a 10-year (€3.5 bn in 17/1/2023) and a 5-year government bond (€2.5 bn in 29/3/2023) as well as the reopening a 10-year government bond (€0.3 bn in 19/4/2023).

Drivers of economic growth in 2023: ongoing employment gains, sizeable investment contribution and improved business confidence

Greece recorded a strong economic rebound in 2022 for the second consecutive year (2021: 8.4%), remaining resilient to adverse external shocks and strong inflationary pressures. Greek economic activity rose by 5.9% in 2022 (*Graph 3*), at a stronger pace compared to the euro area and EU-27 averages (3.5%), amid earlier fears of recession in the EU, soaring energy and food prices, the tightening of the monetary policy stance in response to persistent inflation and elevated geopolitical uncertainty. Solid economic growth in 2022 is mainly attributed to:

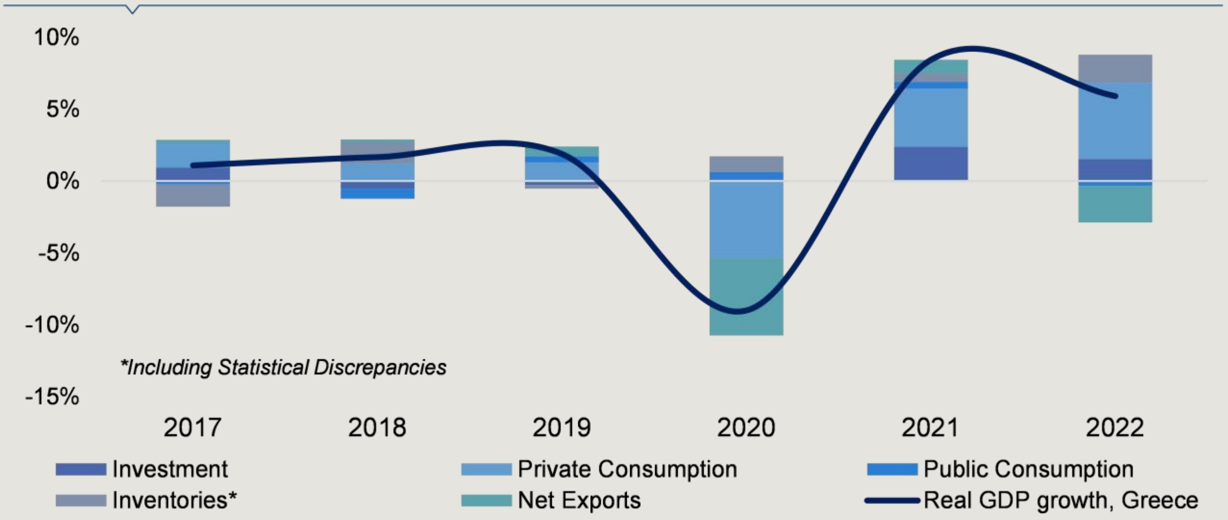
- the **better-than-expected performance of exports of services** (9.9%), due to the remarkable recovery of tourism (in 2022 tourism receipts amounted to €17.6 bn, down by 3% compared to 2019, while travel arrivals reached 27.8 mn persons, down by 11.2% vs. 2019)
- the **strong private consumption growth** (7.8%), making the largest contribution to overall GDP growth (5.3 pps), underpinned by ongoing employment gains and fiscal measures adopted to shield households against rising energy cost, as well as,
- the **sizeable investment growth** (11.7%), on the back of a remarkable FDI revival (2022: €7.22 bn or 3.5% of GDP).

Although real GDP growth is expected to moderate, several factors spark optimism for the better than-earlier-foreseen growth performance in 2023. The main factors that are expected to underpin a stronger growth expansion compared to earlier estimates are the following:

First, labor market conditions continued to improve in 2022; the (annual average) unemployment rate in 2022 stood at 12.4%, 2.3 percentage points lower than in 2021, while employment recorded significant gains, rising by 5.4%. The total number of employed persons exceeded 4 mn persons in 2022, reaching its highest level since 2011, while unemployed persons were reduced by 14.2% compared to 2021, reaching 585 thousand persons. Moreover, the labor force increased by 2.5% in 2022.

GRAPH 3

Growth dynamics to moderate in 2023 as purchasing power erodes



Sources: ELSTAT, Alpha Bank ERD calculations

Around 25% of jobs created last year were in the accommodation and food services sectors, while employment in education, industry, wholesale and retail trade also recorded significant increases. Furthermore, in March 2023, the seasonally adjusted unemployment rate stood at 10.9%. The ongoing improvement in labor market conditions along with fiscal measures adopted to safeguard households against soaring energy costs and the rise of monthly minimum wage to €780 (from €713) in effect from April 1st 2023, are expected to support domestic demand.

Second, the Economic Sentiment Indicator (ESI), a leading indicator for the economic activity, remains its long-term average value (100), exceeding the respective euroarea ESI since May 2022 onwards (*Graph 4*). ESI in Greece reached 108.8 units in April 2023, while the respective euro area ESI reached 99.3 in the same month. The rise in ESI in recent months is mainly due to the improvement in business expectations in construction, followed by retail and industry, while consumer confidence has also improved significantly. Moreover, business expectations for employment (Employment Expectations Indicator (EEI)) remained on an upward course in recent months, rising sharply since November 2022. More specifically, in April 2023, EEI reached 124.6 units from 121.9 units in March, while compared to October 2022 it has increased by a total of 25 units, with employment expectations improving in all sectors of economic activity (*Graph 5*).

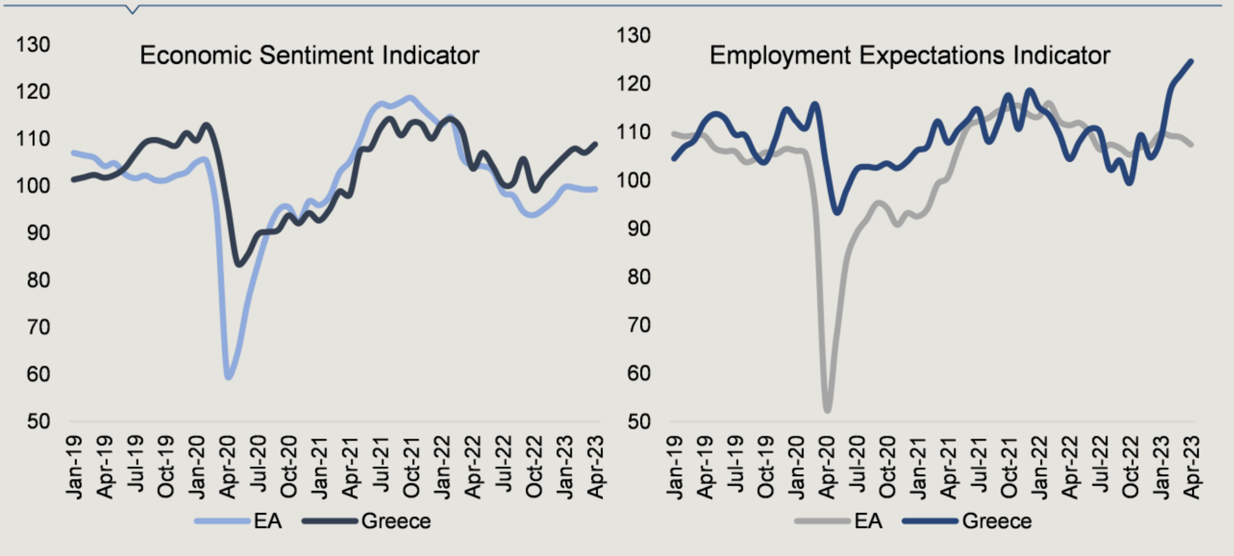
Third, the large, positive carry-over effect on growth in 2023, estimated at 1.5 pps. Carry-over effect is derived as the percentage change between the level of real GDP in the last quarter of the year and the average level of real GDP in the year. This is equivalent to the annual average growth rate that would be achieved if the level of real GDP in each quarter of the next year remains equal to the level of GDP in the last quarter of the previous year. In Q4 2022, the (seasonally adjusted) real GDP strengthened further for the 10th consecutive quarter rising by 1.4% on a quarterly reading, while on an annual basis, real output expanded by 5.2%.

Fourth, the strengthening investment dynamics in the last three years, which are expected to be maintained in 2023. Investment increased by 11.7% in 2022, contributing 1.5 pps to output growth. The rise in investment was broad-based across all categories, though more prominently in housing and other construction investment (36.1% and 21.5%, respectively). The positive dynamics of housing investment (2020: 19%; 2021: 27.3%; 2022: 36.1%) synchronized with booming residential real estate prices (2020: 4.5%; 2021: 7.6%; 2022:11.1%, nominal provisional figures). Further output expansion in the coming years is expected to be investment-driven as Greece is one of the largest beneficiaries of the RRF programme from which the country has already received a total amount of €11 bn.

So far, 392 investment projects with a total budget of €12.33 bn have been submitted in the RRF loan facility while 617 projects, with a total budget of €17.86 bn including VAT, have already been approved and included in the RRF grants programme.

GRAPHS 4 & 5

Economic Sentiment Indicator (ESI) and Employment Expectations Indicator (EEI), Greece vs Euro area



Source: European Commission

In a similar vein, foreign direct investment (FDI) in 2022 recorded its highest performance in the last two decades, reaching €7.2 bn (or 3.5% of GDP) from €5.4 bn in 2021 (or 2.9% of GDP).

Fifth, exports of goods and services underpinned economic growth in 2022, rising by 4.9%. More specifically, exports of goods increased marginally by 0.4%, while the exports of services increased by 9.9%, mainly due to overperformance in the tourism industry. On the contrary, imports of goods rose by 11.2% and imports of services by 7.2%. Despite the almost complete rebound of tourism to 2019 record highs, the percentage of trade deficit coverage by tourism revenues did not exceed 45%, compared to 70%-80% a few years ago. The widening of trade deficit in 2022 is largely attributed to the deterioration of the terms of trade, as energy prices rose sharply in 2022 and Greece is a net importer of energy. However, the rise in imports is also linked to the upsurge in investment, as they concern capital equipment, as well as to the rise of imported consumer goods, which traditionally record an increase in Greece during periods of economic growth.

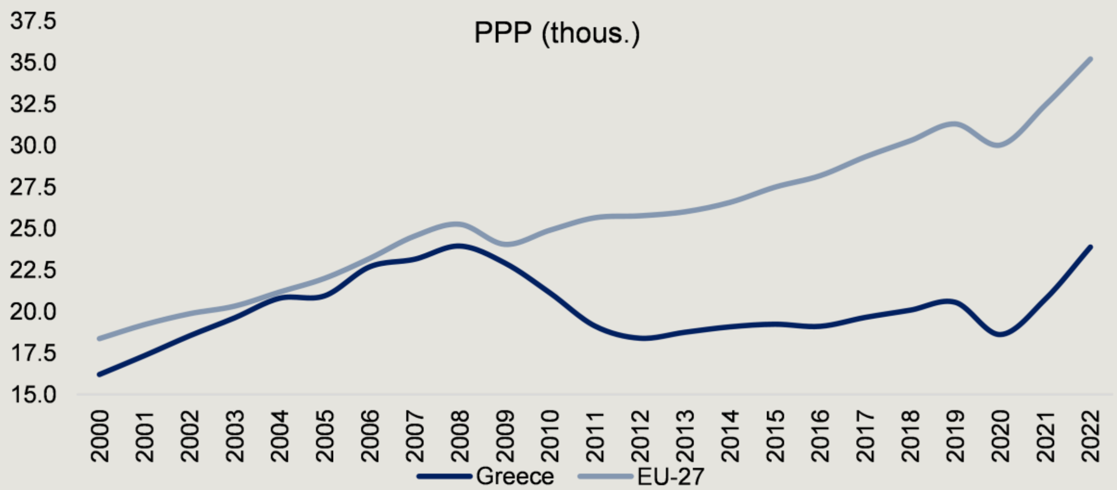
Speed of economic convergence towards the European Union average: output gap and potential GDP

Economic convergence has come at the forefront of policy discussions in the aftermath of the pandemic, on the back of stronger economic recovery recorded in Greece compared to EU peers. Greece's 2022 real GDP per capita (based on Purchasing Power Parities (PPPs)) reached the level recorded in 2008, the year the global financial crisis began. However, the degree of convergence with the European average, i.e. Greece's GDP per capita as a percentage of the EU average, has not approached the 2008 level, since, from 2009 to 2018, Greek economic growth was either negative or below the European average. Despite the fact that GDP per capita increased by 15% in 2022 (*Graph 6*), the convergence rate is still quite low, standing at 68% (*Graph 7*) compared to the period before the 2008 global financial crisis. Indicatively, Greece's GDP per capita in 2002 amounted to 93.3% of the EU-27 average.

According to European Commission (European Economic Forecast, Spring 2023), Greece’s real GDP is expected to grow by 2.4% in 2023, higher than the EU average (1%), while, according to recent forecasts by the IMF and the Bank of Greece, it is expected to exceed 2%. As a result, the ratio of GDP per capita to the European average is expected to slightly improve. Moreover, the difference between potential and real GDP has narrowed, primarily due to strong growth in consumer and investment demand. However, this is not sufficient for a faster convergence of Greece's GDP per capita to the EU-27 average. The latter requires, in the medium and long term, further expansion of potential output through the strengthening of the country's labour force and physical capital, as well as improvement in total factor productivity.

GRAPH 6

Greek per capita real GDP evolution and comparison with EU average (in PPPs)



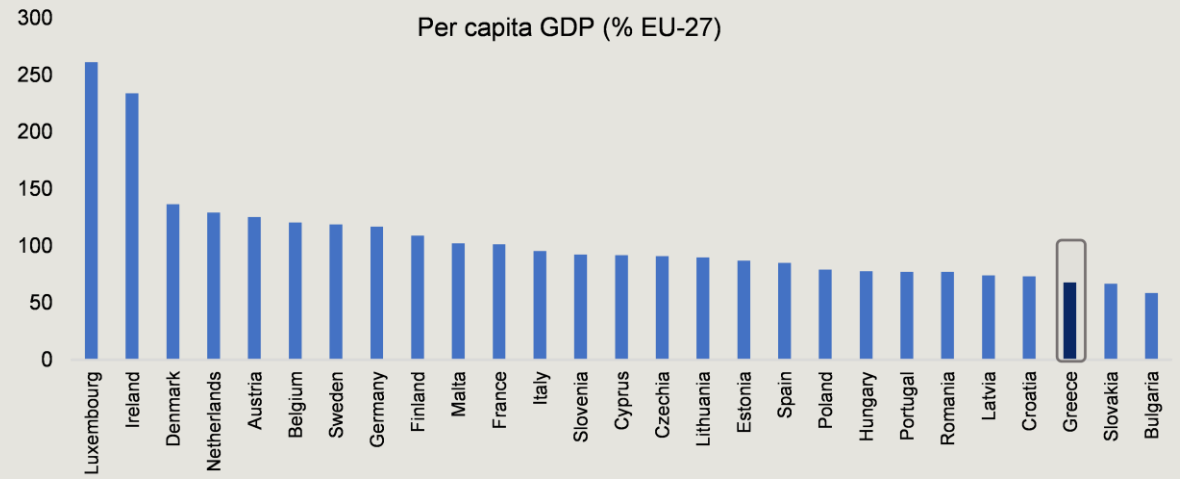
Source: Eurostat

The investment injection, supported by the RRF, combined with structural reforms aiming at strengthening labour market participation, overall productivity and the competitiveness of the Greek economy, are expected to have a strong multiplier effect, contributing to the improvement of potential output. On the other hand, adverse demographic developments and the country's ageing population are expected to weigh on the evolution of potential GDP.

The return to positive economic growth rates since 2017 onwards led to the gradual narrowing of the output gap, which - despite its temporary widening in 2020 - due to the pandemic and the restriction of economic activity, stood at -1.1% in 2022, according to estimates by the European Commission (European Economic Forecast, Spring 2023). Output gap (as % potential GDP) is expected to turn positive over the next two years, reaching 0.8% in 2024, while, according to IMF estimates (World Economic Outlook, April 2023), it is expected to reach zero this year.

GRAPH 7

Convergence rate: per capita GDP (as % of EU-27)



Source: Eurostat

Annual data	2018	2019	2020	2021	2022	Annual % Changes
GDP at constant prices 2015 (annual % change)	1.7	1.9	-9.0	8.4	5.9	
Private Consumption	1.7	1.9	-7.7	5.8	7.8	
Public Consumption	-3.5	2.1	2.6	2.2	-1.6	
Gross Fixed Capital Formation	-4.3	-2.2	1.1	20.0	11.7	
Exports of Goods and Services	9.1	4.9	-21.5	24.1	4.9	
Imports of Goods and Services	8.1	2.9	-7.3	17.7	10.2	
National CPI, (annual % change, period average)	0.6	0.3	-1.2	1.2	9.6	
Unemployment Rate (%, period average)	19.3	17.3	16.3	14.7	12.4	
G.G. Primary Balance (% of GDP)	4.3	3.9	-6.7	-4.7	0.1	
G.G. Gross Debt (% of GDP)	186.4	180.6	206.3	194.6	171.3	
Current Account Balance (% of GDP)	-2.9	-1.5	-6.6	-6.8	-9.7	

Business Environment	2022	2022			*Last available data*	Quarterly data (annual % changes)
		Q2	Q3	Q4		
Economic Activity (annual % change)						
Volume Index in Retail Trade (excl. automotive fuel)	1.9	0.9	2.0	-1.8	2.5 (Jan.23)	
New Passenger Car Registrations	6.7	4.5	9.4	-0.5	23.6 (Jan.-Mar. 23)	
Private Building Activity (volume in '000 m3)	-2.2	-11.2	-12.7	7.0	-2.2 (Jan.-Dec. 22)	
Manufacturing Production Index	4.4	4.7	4.2	3.3	7.1 (Jan.-Feb. 23)	
Confidence indicators						
Purchasing Managers' Index (PMI)	51.8	53.2	49.2	47.9	52.8 (Mar. 23)	
Economic Sentiment Indicator (ESI)	105.4	105.2	102.3	101.4	106.8 (Mar. 23)	
Index of Bus. Expect. in Industry	105.5	108.0	99.6	97.3	109.2 (Mar. 23)	
Index of Consumer Confidence	-50.7	-53.0	-53.6	-52.6	-41.4 (Mar. 23)	
Credit Growth (% annual change, period end)						
Private Sector	6.3	4.5	6.1	6.3	4.8 (Feb. 23)	
Non-financial corporations	11.8	9.7	12.3	11.8	9.7 (Feb. 23)	
Individuals	-2.5	-2.1	-2.2	-2.5	-2.5 (Feb. 23)	
- Consumer Loans	1.3	0.7	0.9	1.3	1.6 (Feb. 23)	
- Housing Loans	-3.7	-3.0	-3.2	-3.7	-3.6 (Feb. 23)	
Prices and Labour Market						
National CPI, (annual % change, period average)	9.6	11.2	11.7	8.3	4.6 (Mar. 23)	
Index of Apartment Prices (annual % change)	11.1	10.4	11.7	12.2	12.2 (Q4 22)	
Unemployment Rate (%, period average, sa)	12.4	12.6	12.3	11.8	11.4 (Feb. 23)	
GDP at constant prices 2015 (annual % change)	5.9	7.3	4.4	5.2	5.2 (Q4 22)	
Private Consumption	7.8	8.7	5.6	4.2	4.2 (Q4 22)	
Public Consumption	-1.6	-0.5	-2.8	-1.9	-1.9 (Q4 22)	
Gross Fixed Capital Formation	11.7	10.1	8.3	14.8	14.8 (Q4 22)	
Exports of Goods and Services	4.9	12.1	-3.6	-3.5	-3.5 (Q4 22)	
Imports of Goods and Services	10.2	14.6	5.3	7.5	7.5 (Q4 22)	

Sources: Bank of Greece, ELSTAT, IOBE, IHS Markit

1/ Primary balance defined here as General Government balance (according to ESA 2010) minus interest expenditure of General Government entities to other sectors. The effect of support to financial institutions is excluded in this measure of the primary balance. The measure of the primary balance presented here differs from the definition of primary balance used under the Enhanced Surveillance Framework for Greece.

2/ Credit growth rates are derived from the differences in outstanding amounts corrected for loan write-offs, exchange rate valuations and reclassifications.

3/ Provisional historical figures for residential real estate prices since Q1 2022.

4/ Provisional historical figures for real GDP since 2019.

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