



FOUNDATION FOR ECONOMIC & INDUSTRIAL RESEARCH

The Greek Economy Quarterly Bulletin 01-2014

April 16th, 2014

Conditions for growth of the Greek economy

Positive developments in the last quarter:

- High primary surplus, sooner than expected
- Structural changes in the markets for goods and services
 - Real changes, not only “on paper”

Positive effects:

- No need for additional fiscal measures in 2014
- Completion of the negotiations with the “troika”
- Return to the financial markets
- The mitigation of the financing problem seems to be coming earlier than expected
- Weakening of the likelihood of breakdown of the single currency

Caution is required: Not all problems have been resolved

- The stabilisation of the economy (fiscal, external, GDP) **does not imply completion of the adjustment**
- Equilibration primarily by "transferring" the imbalance to the **production side and the labour market**

High growth rates without any new deficits are required henceforth

Factors of steady growth:

- ❖ Increase in investment and exports
- ❖ Transfer of resources from non-tradable to tradable goods and services
- ❖ Import substitution

Implementation of reforms is the necessary next step

- The imbalance between consumption and low competitiveness must be resolved
- The trends in investment and exports in the last two years raise concerns
 - ❖ The significant reduction in unit labour costs did not boost investment

A shift to a new production model is required

- The reduction of uncertainty and instability contribute toward this shift
- However, first and foremost irreversible structural changes are needed

Implementation of reforms is the necessary next step

Conditions for the implementation of reforms:

- Break with interest groups
- Wider political and social consensus
- Specialised knowledge of the particular problems at hand
- Clarity on economic policy
- Real “ownership” of the reform programme

Implementation of reforms is the necessary next step

IOBE-FEIR has repeatedly highlighted the necessary specific reforms

- Without substantial radical changes the Greek economy will transform at a very slow pace and/or will shrink
- There are great possibilities and opportunities that should be utilised through reforms, under the new production model

The new model should:

Be based on innovative and export-oriented entrepreneurship

Be a guide for renewing the relationship with the EU

Overview of the Quarterly Bulletin

World economic growth is accelerating and the signs of recovery in the Eurozone are strengthening

2014: Significant boost in the global economic growth to **3.6% (IMF)**

- Significant acceleration of growth in the **US: 2.8%** in 2014, following recent agreements on the budget and the debt ceiling
- **China:** a **7.5%** growth is expected in 2014, with a shift in the growth model from consumption to investment
- **Japan: 1.4% growth** in 2014, combining expansionary monetary policy and loose fiscal policy
- Return of the Eurozone to positive growth rates in the last quarter of 2013 (**0.5%**)
 - ✓ 2014: boost of growth to 1.2% with main pillars investment and consumption

Key Risks:

- Geopolitical developments in Ukraine / Russia, with the risk of diffusion of their economic impact to the wider region, especially in the energy sector
- Continuous low inflation in the Eurozone, creating risks of growth in real debt in the long-term
- In China, the vulnerable financial system is the most significant risk factor for the growth momentum of the economy

Gradual weakening of the recession in late 2013

GDP contraction (Oct.-Dec. 2013): **-2.3%**, compared to -3.2% in the 3rd quarter of 2013 and -4.9% in Q4'12 → **smallest GDP decline since the beginning of the Economic Adjustment Programme (EAP)**

It came from:

- **Stabilisation of household consumption:** -0.2% (Q4'13), from -8.1% (in the previous quarter) → -6.0% annually (-9.3% two years ago)
 - The economic climate has stabilised, unaffected by delays in the negotiations, unlike the case in previous EAP reviews
- **Moderate reduction in public consumption** (-2.6%, against +1.7% in Q3'13)
 - 4.1% lower public consumption expenditure in 2013 against -6.9% in 2012
- **Reduction of imports**, which improved the external balance (-5.6% in Q4'13) → 5.3% contraction in 2013, the weakest decline in five years

Gradual weakening of the recession in late 2013

In contrast:

- Marginal increase in exports (0.5% in Q4'13), as the exports of goods decreased (-1.7%) for the first time in eighteen months, while the exports of services strengthened (+3.4%)
- Annual increase of **exports by 1.8%** compared to a similar drop in 2012: value of exports stable at about €43 billion since 2010
- **Milder drop of investment:** -6.7% last year against -17.8% in 2012
 - **Recurring trend shifts each quarter** due to year-on-year differences in inventories formation
 - **Steady decline in fixed capital formation throughout 2013, -11 to -12%**
 - Given the fixed capital stock in 2012 (€ 745 billion), **last year's investment** (2.7% of the capital stock) is not sufficient to cover the depreciation expenses

Total reduction in **GDP by 3.9% in 2013**, compared with a **revised 7.0% recession in 2012 (from 6.4%)**

The revision confirms the estimates of IOBE-FEIR during that year (-6.6% to -6.9%)

The primary surplus in 2013 was much larger than the target

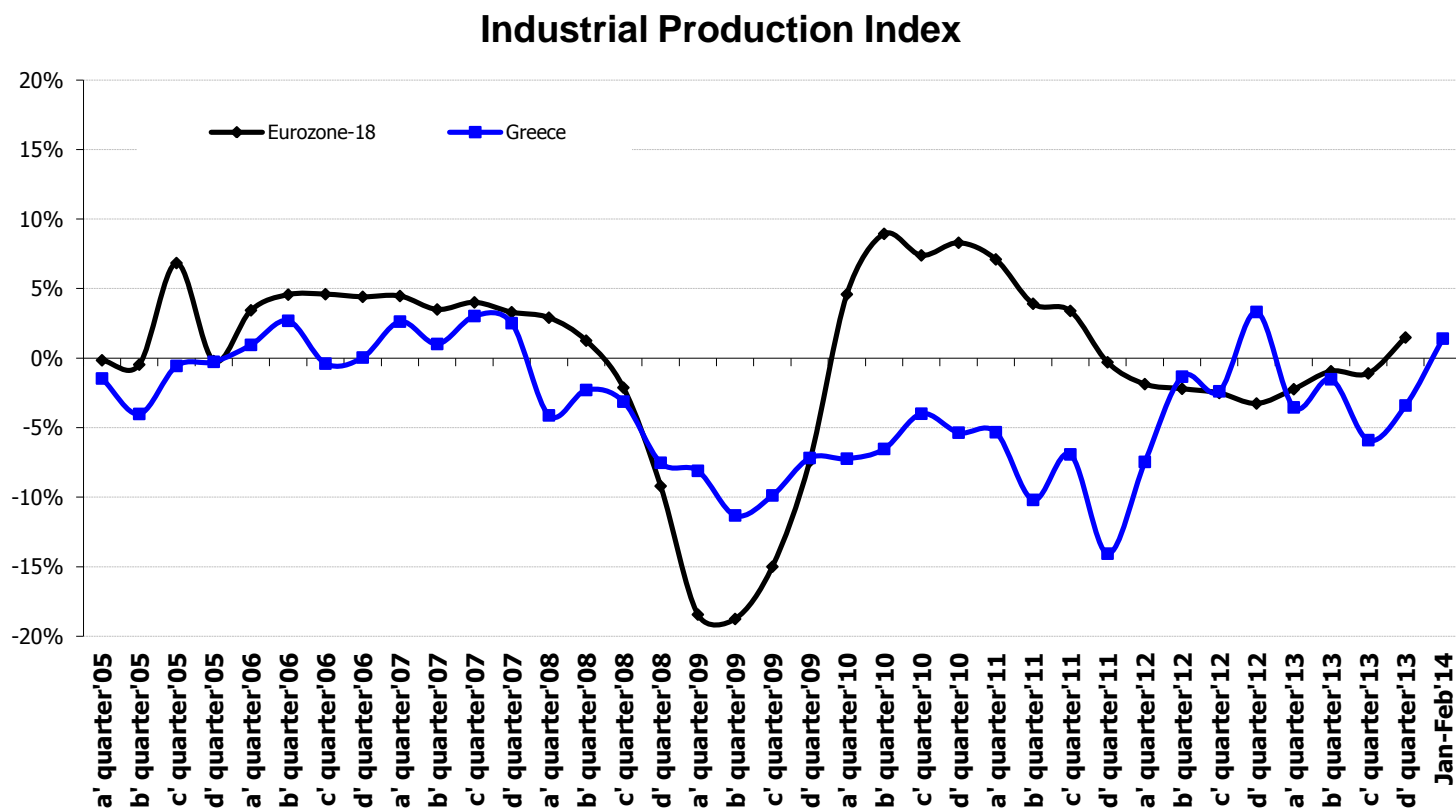
- **General Government Balance:** €3.84 bn deficit in 2013 (2.1% of GDP) from €11.94 bn in 2012 (6.2% of GDP)
 - **€5.6 bn lower** than the Budget target of 2013
- **General Government Primary Balance:** Surplus €3.39 bn (1.9% of GDP), instead of €2.29 bn deficit two years ago (1.2% of GDP)
 - **€2.6 bn higher** than the budget target of 2013

The Greek fiscal consolidation is unique in Europe in terms of extent and duration... albeit at high recessionary cost

State Budget 2014: on the path to keep last year's surplus

- **State Budget January-March 2014:** Surplus of €1.6 bn → €690 million more than the target.
- **Increase of revenues by 9.6%**, instead of the target of 3.2%, stemming from:
 - Very high non-tax revenues (e.g. from structural funds)
 - Tax revenue before tax refunds lower by 1.1%, against a target of 2.3% growth
- **Contraction of primary expenditure: 13.7%**, much higher than this year's target (-5.4%)

Recovery in industrial production...



Source: ELSTAT, Eurostat

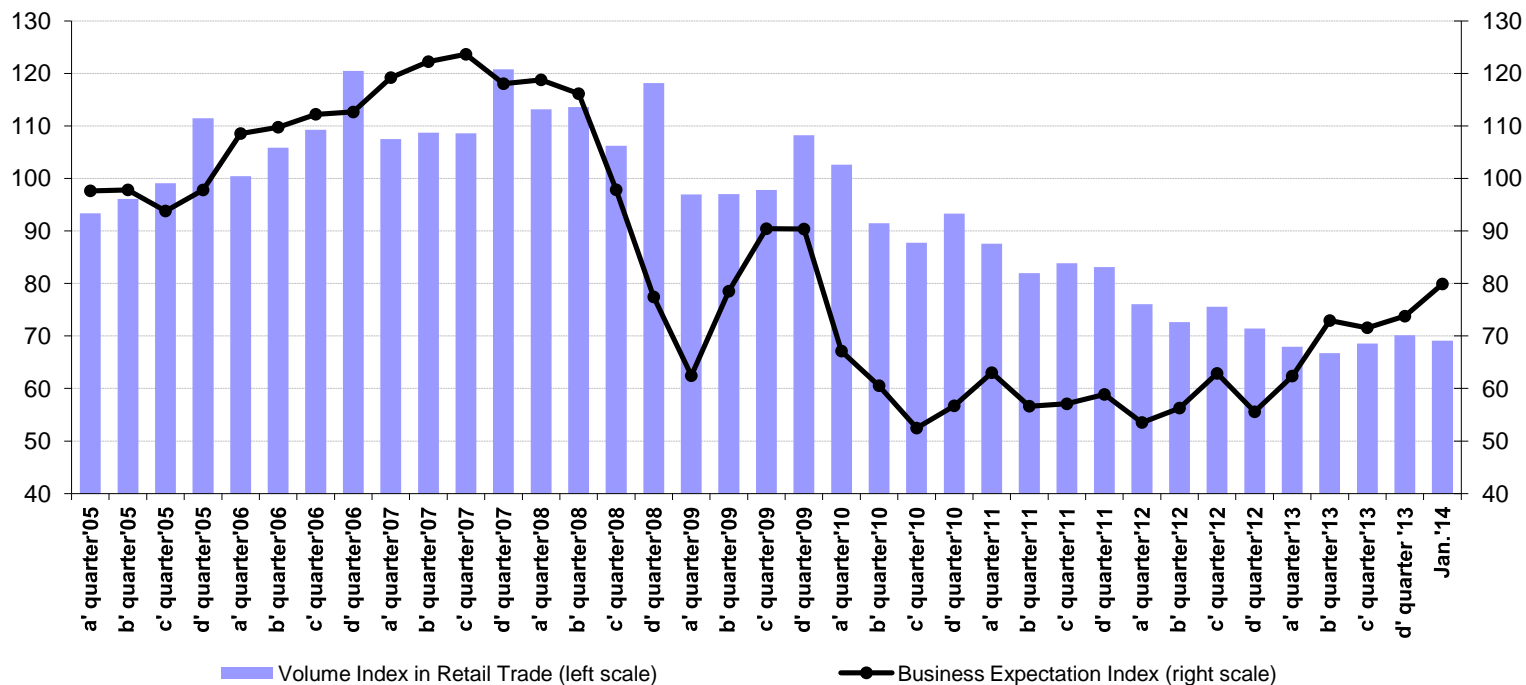
First two months of 2014: +1.4%

First two months of 2013: -4.6%

- Electricity generation: +1.9%
- Manufacturing : +1.5%
- Mining-Quarrying : +1.3%

... significantly weaker contraction in retail trade, with improving expectations

Retail trade index (2005=100) and Index of Retail Trade Expectations (1996-2006=100)



Source: IOBE-FEIR, ELSTAT

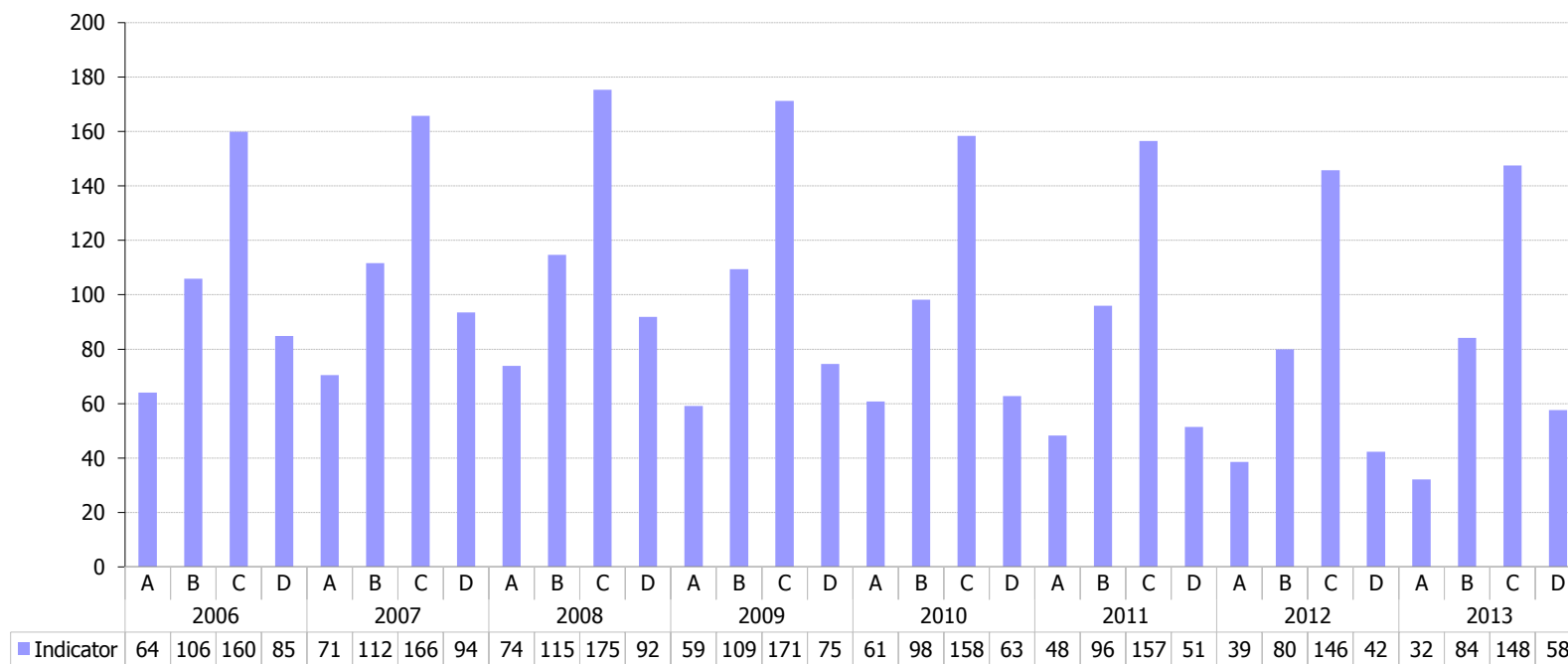
Volume index: -32% compared to the base year 2005

First two months of 2014: -1.9%

First two months of 2013: -16.6%

Services: the contraction continues at a strong pace. The Tourism sector is the only exception

Turnover Index in Tourism (Accommodation and Food Service activities)

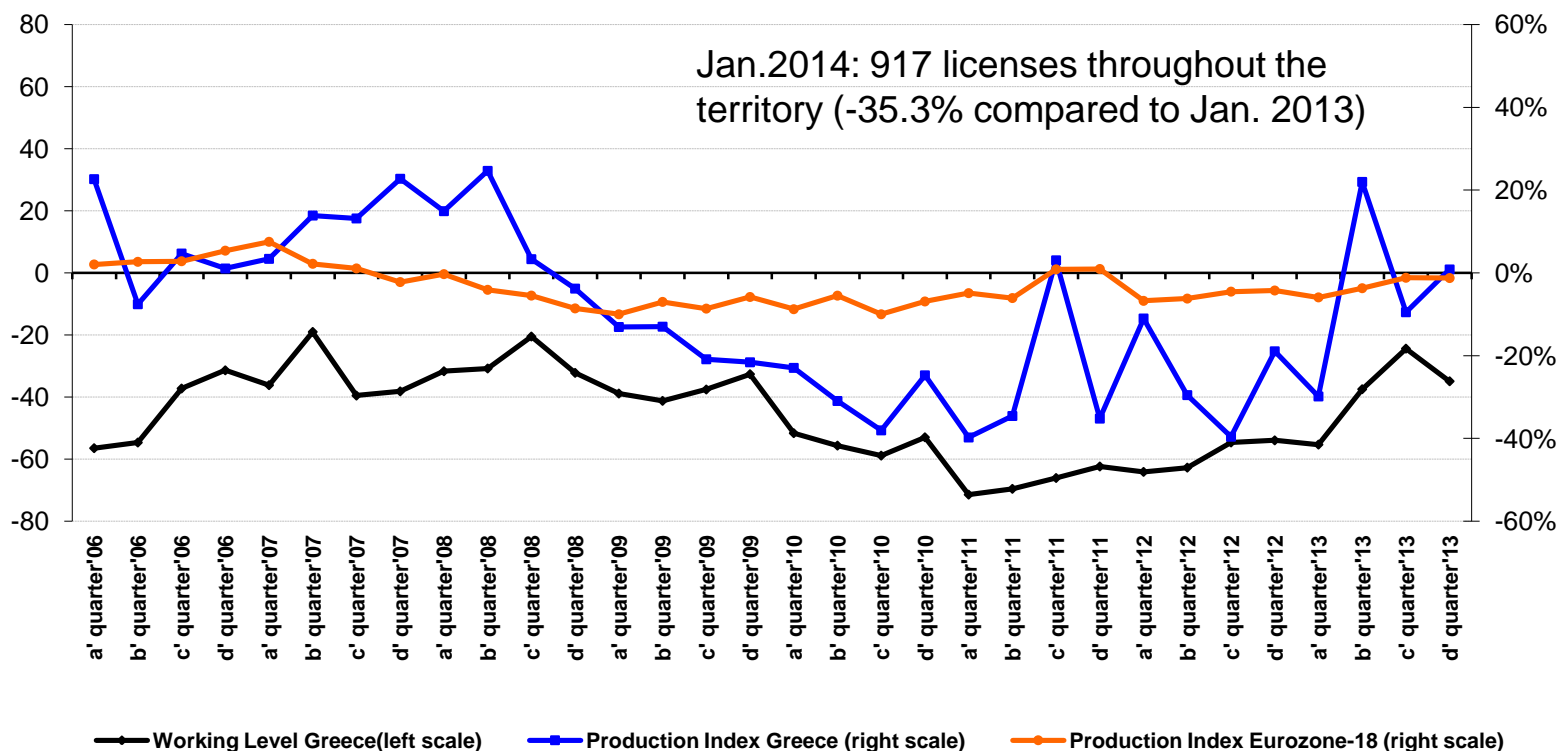


Source: IOBE-FEIR, ELSTAT

2013: +4.8%
2012: -12.9%

Milder decline in construction in 2013, but -62% compared with the base year

**Construction Production Index and Business Level Index
(quarters changes)**

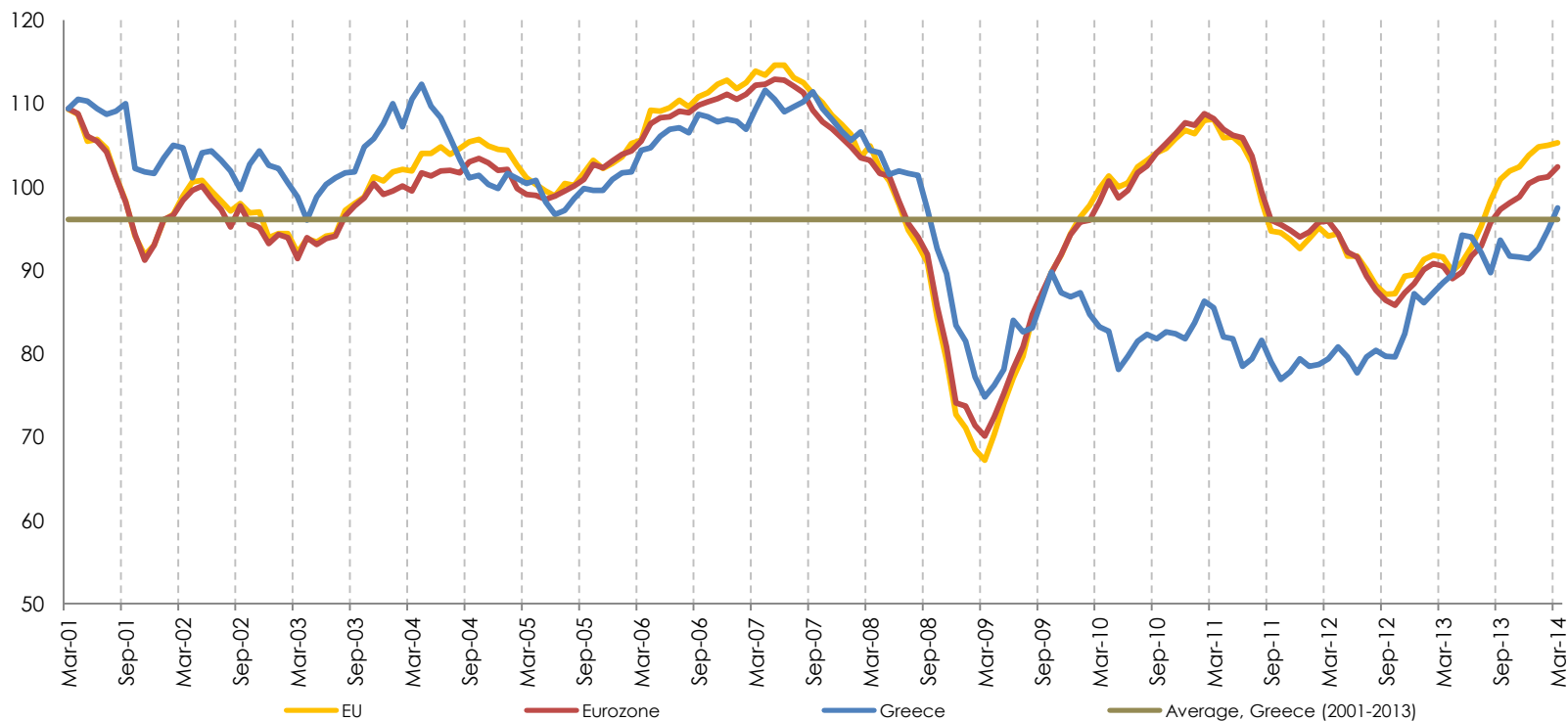


Source: ELSTAT - Eurostat

2013: -4.1%
2012: -26.1%

Recovery of the economic climate in the first quarter of 2014: At its highest level in 5 ½ years

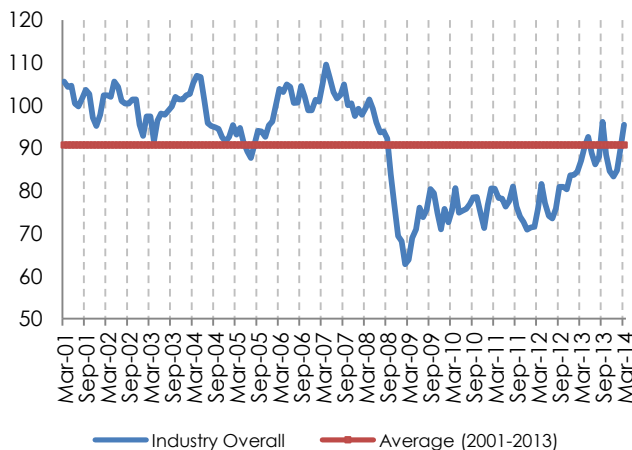
Economic Sentiment Indicator



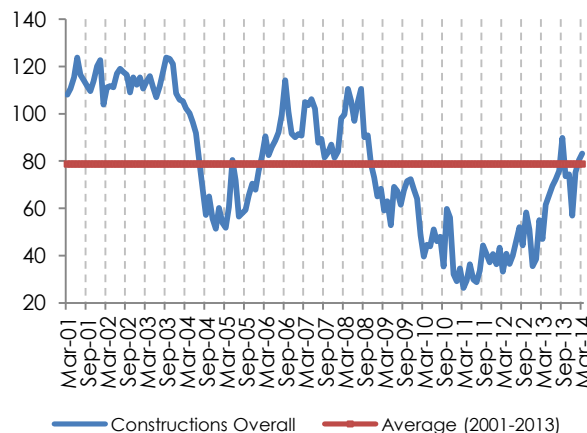
Source: IOBE-FEIR, European Commission

Improved expectations in all sectors, stronger in Construction and weaker in Industry and Services

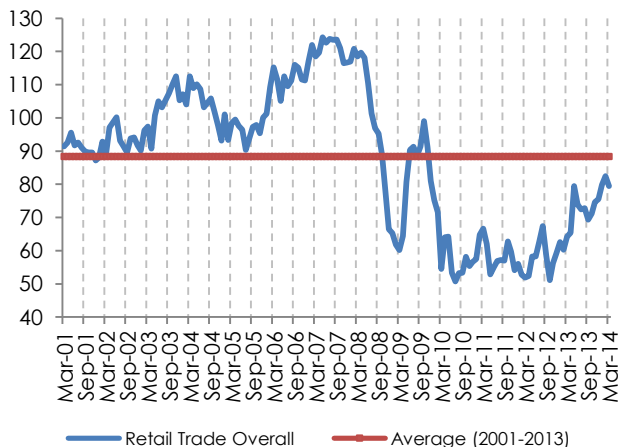
Industry



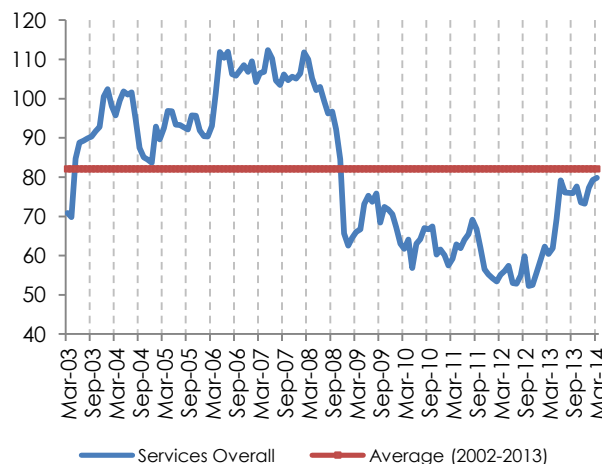
Constructions



Retail Trade

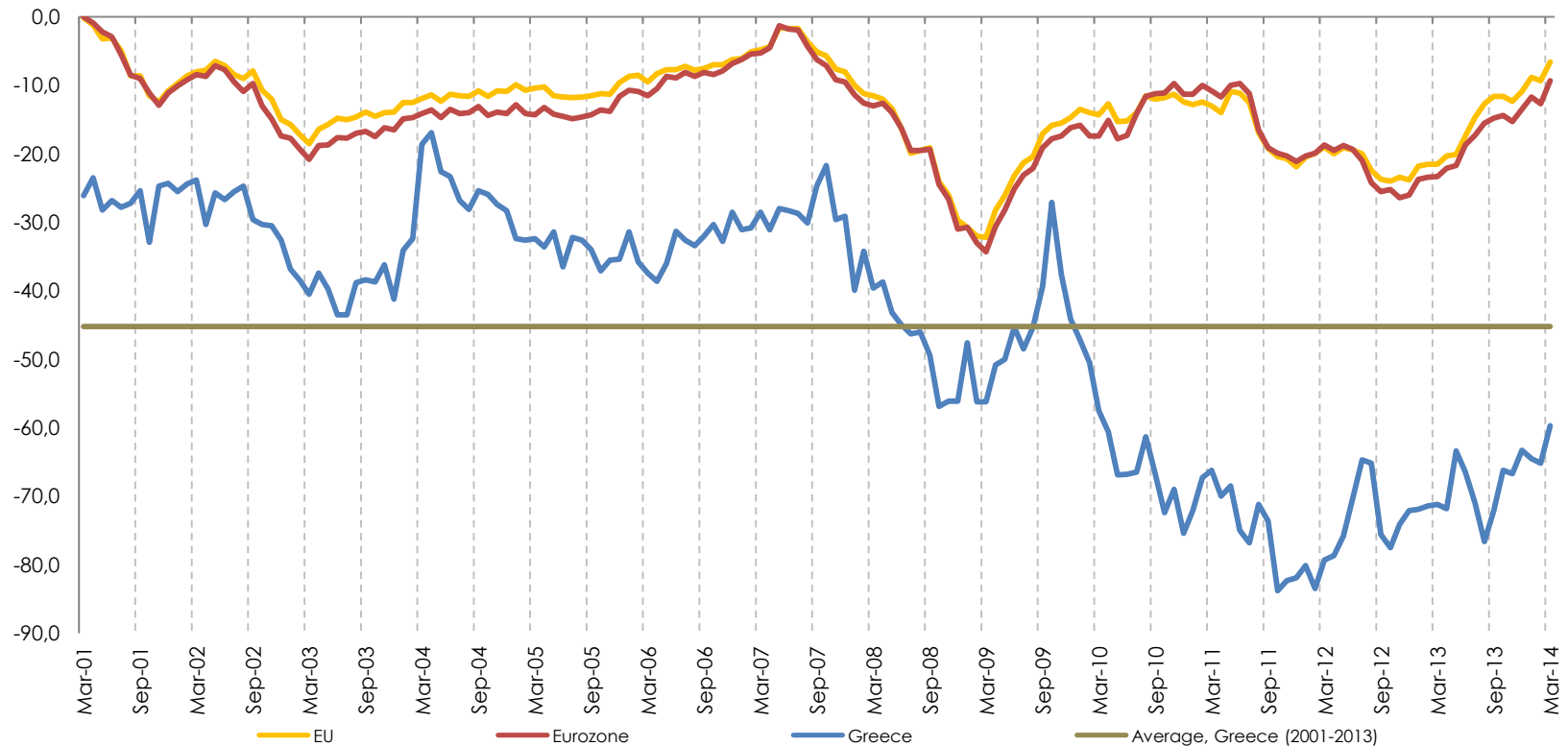


Services



Improving consumer confidence, at a higher level w.r.t. last year as well.
Recovery of the European average indicators too

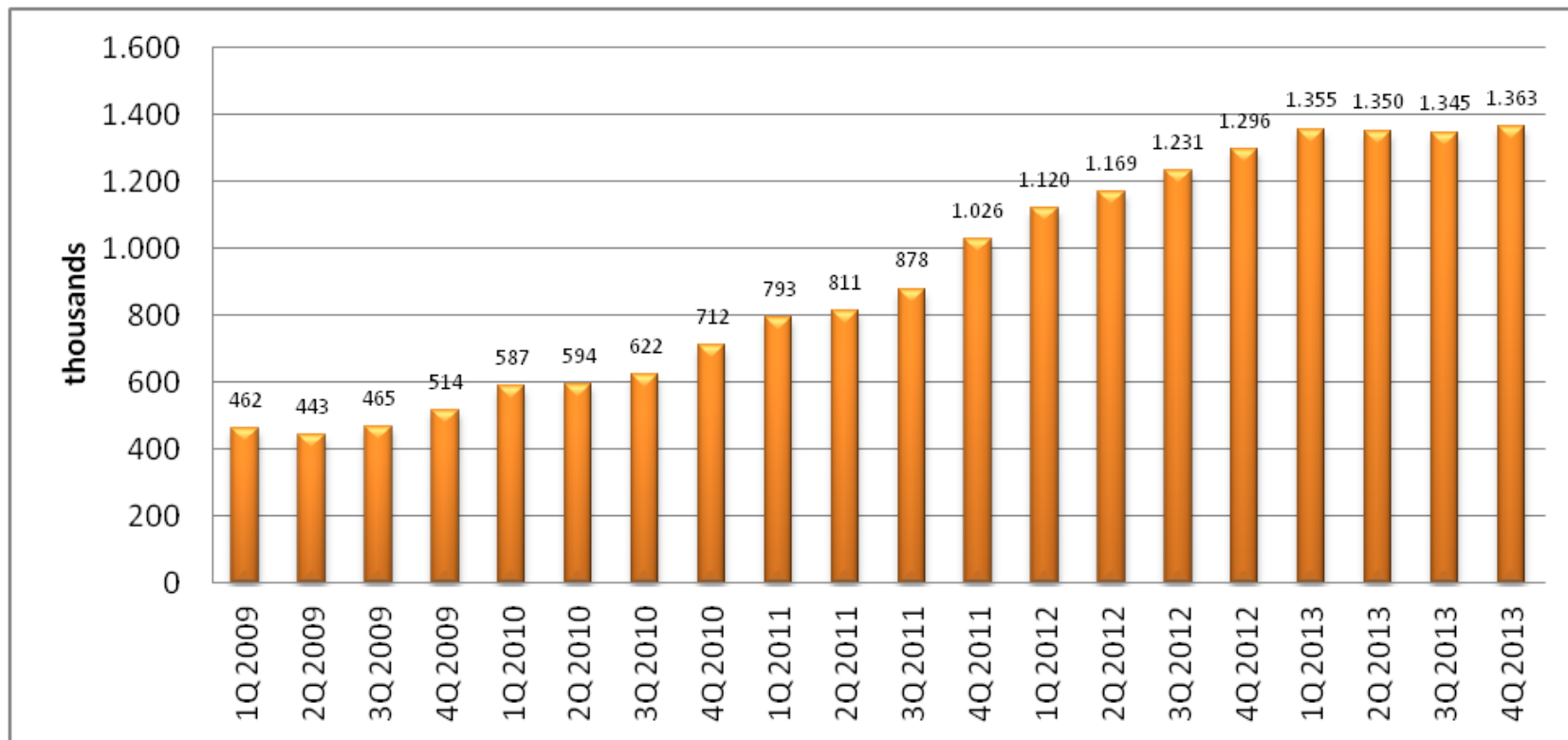
Consumer Confidence



Source: IOBE-FEIR, European Commission

Stabilisation of the number of unemployed persons, but with a new record high in late 2013

Number of unemployed in Greece, first quarter 2009 – fourth quarter 2013

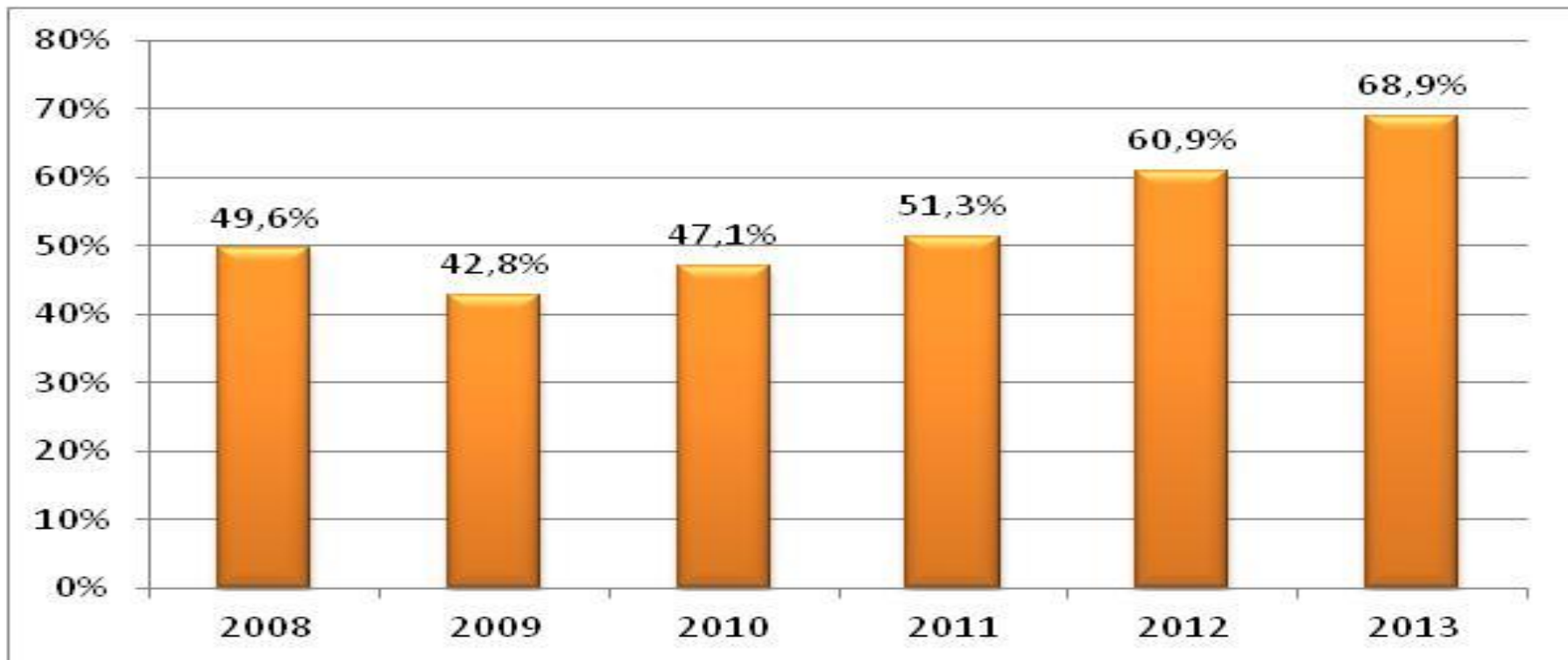


Source: ELSTAT

- Unemployment at 27.5% in Q4'13. At 27.3% in 2013, against 24.3% in 2012
- Y-o-y employment growth in Power Supply (+8.3%), Information and Communication (+7.4%), Water Supply (+2.7%), Public Administration (+ 0.3%)
- In contrast, employment fell in Tourism by 4.3%
- Marginal reduction earlier this year: 26.8% in January, y-o-y 0.8 points lower

.. steadily high long-term unemployment

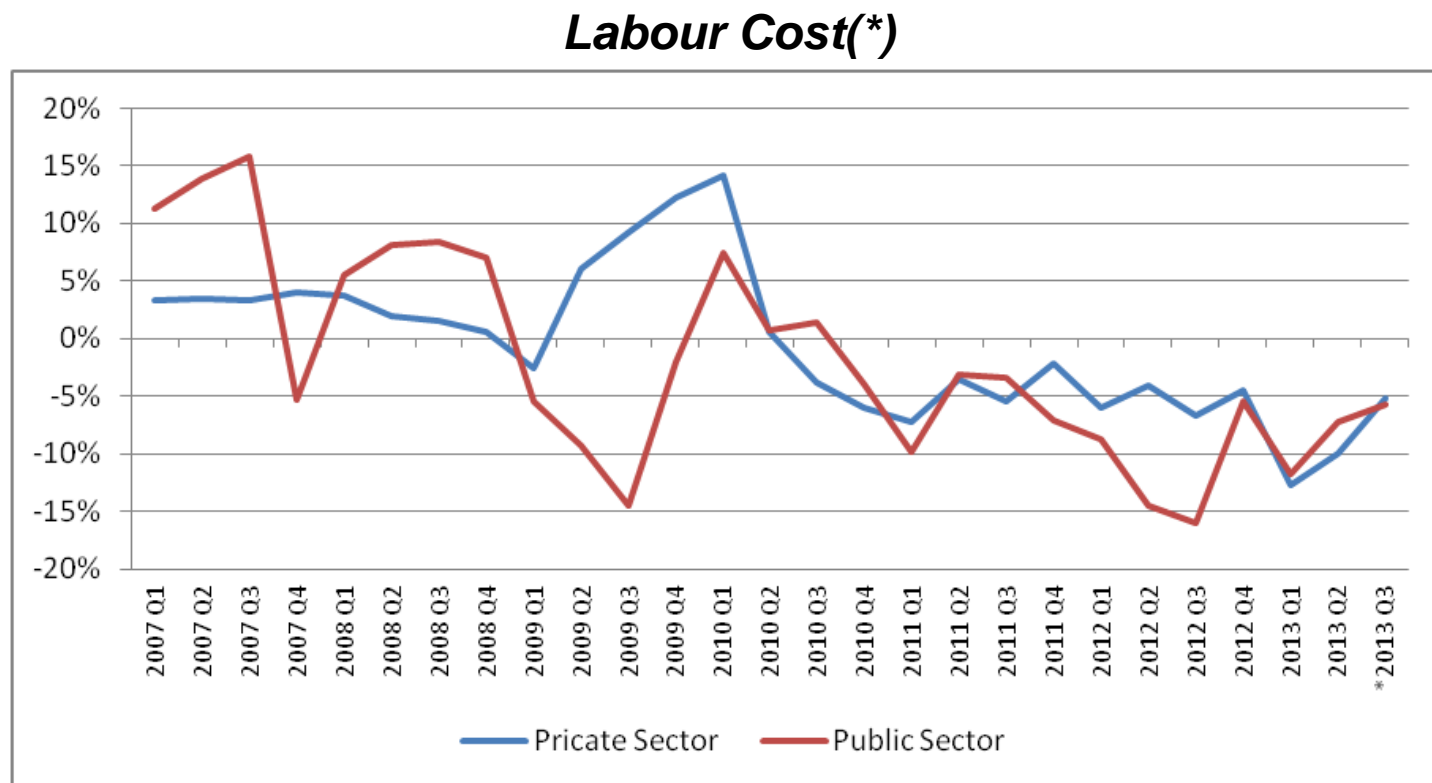
Long-term unemployed (>12 months) as a percentage of total unemployed



Source: ELSTAT

- The number of long-term unemployed (>12 months) in 2013 increased almost fivefold since 2008 (932k against 187k)

Significant decline in labour costs in the private and public sectors



Source: Eurostat, ELSTAT

(*) Temporary data. The labour cost index of ELSTAT is seasonally adjusted, but has not been adjusted for the number of working days, as the relevant data of Eurostat are

The weakening of the contraction continues - labour costs fell by 5.2% in the private sector in the third quarter of 2013. A similar trend is observed in the public sector.

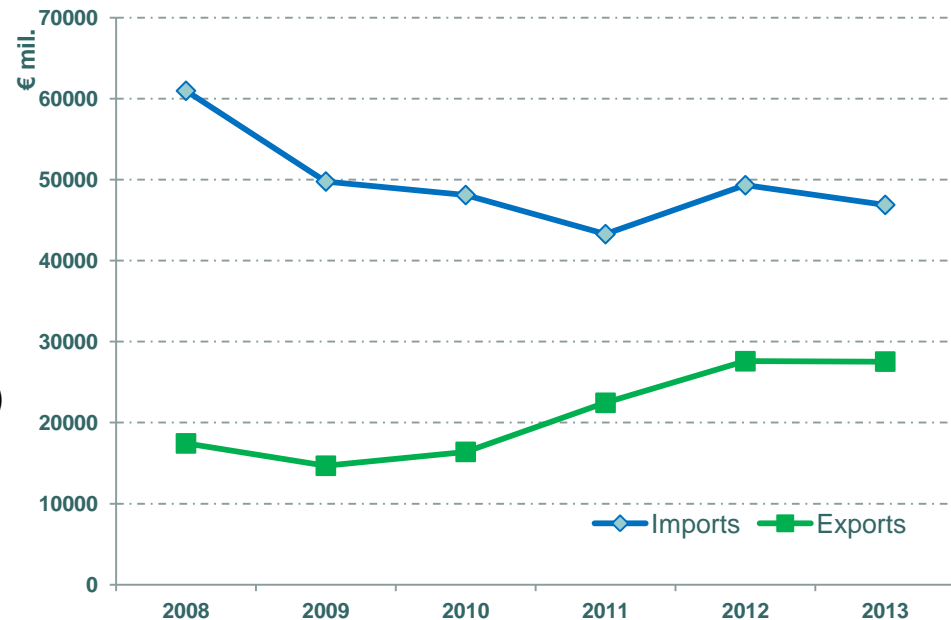
Significant fall in the trade deficit of goods in 2013

- **Exports:** -0.2% in 2013 (**€27.3** bn, including petroleum products)
 - -2.1% (€16.8 bn) without petroleum products
- **Imports:** -5.2% (€46.1 bn)
- **Trade deficit:** -11.5%
- Growth of the exports of “Agricultural Products” (+3.5%) and “Fuels” (+2.2%)

Markets: reduction in the Balkans (-7%), Cyprus (-14.4%), USA (-9.2%), France (-4.2%) and Russia (-12.3%), but growth in China (+10.2%)

- **Increase** in EU15 (+6.4%): Italy (+15.5%), UK (+13.5%), Spain (+6.5%), Austria (+20%), Germany (+1.1%) and Turkey (+8.6%)

Value of Greek exports and imports, 2008-2013



Jan.- Feb. 2014

Exports: -4% (€4,1 billion)

Imports: -5.6% (€7.7 billion)

Trade deficit: -2.16%

Greece: one of the lowest inflation rates in the Eurozone, with the CPI at historically low level

2013: -0.9%

Q1 2014: CPI: -1.2%

- EZ: 0.7% (first two months)

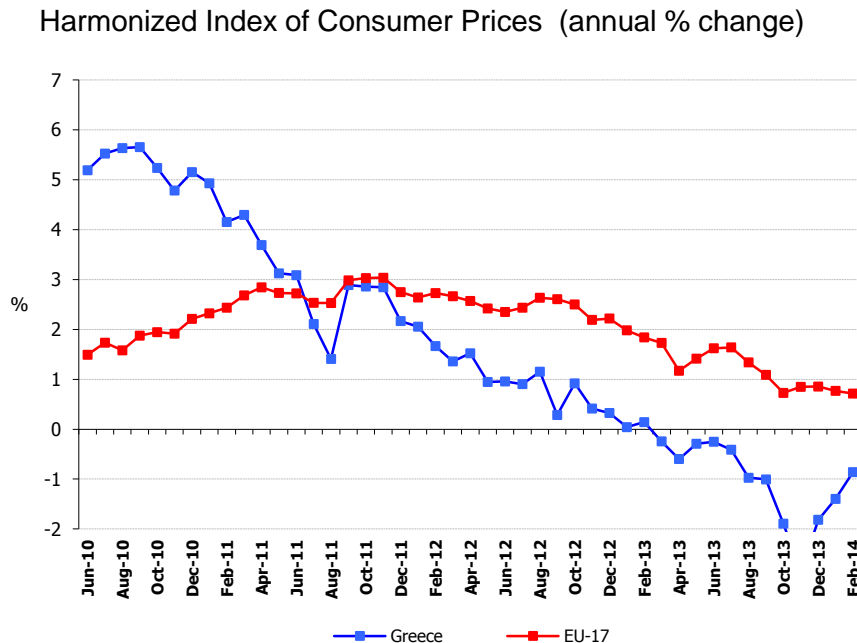
• Negative inflation in most categories of goods

• **January 2014:** decrease in prices of imported raw materials:

-2.6% against -0.5% in EU17

• Domestic Market Index:

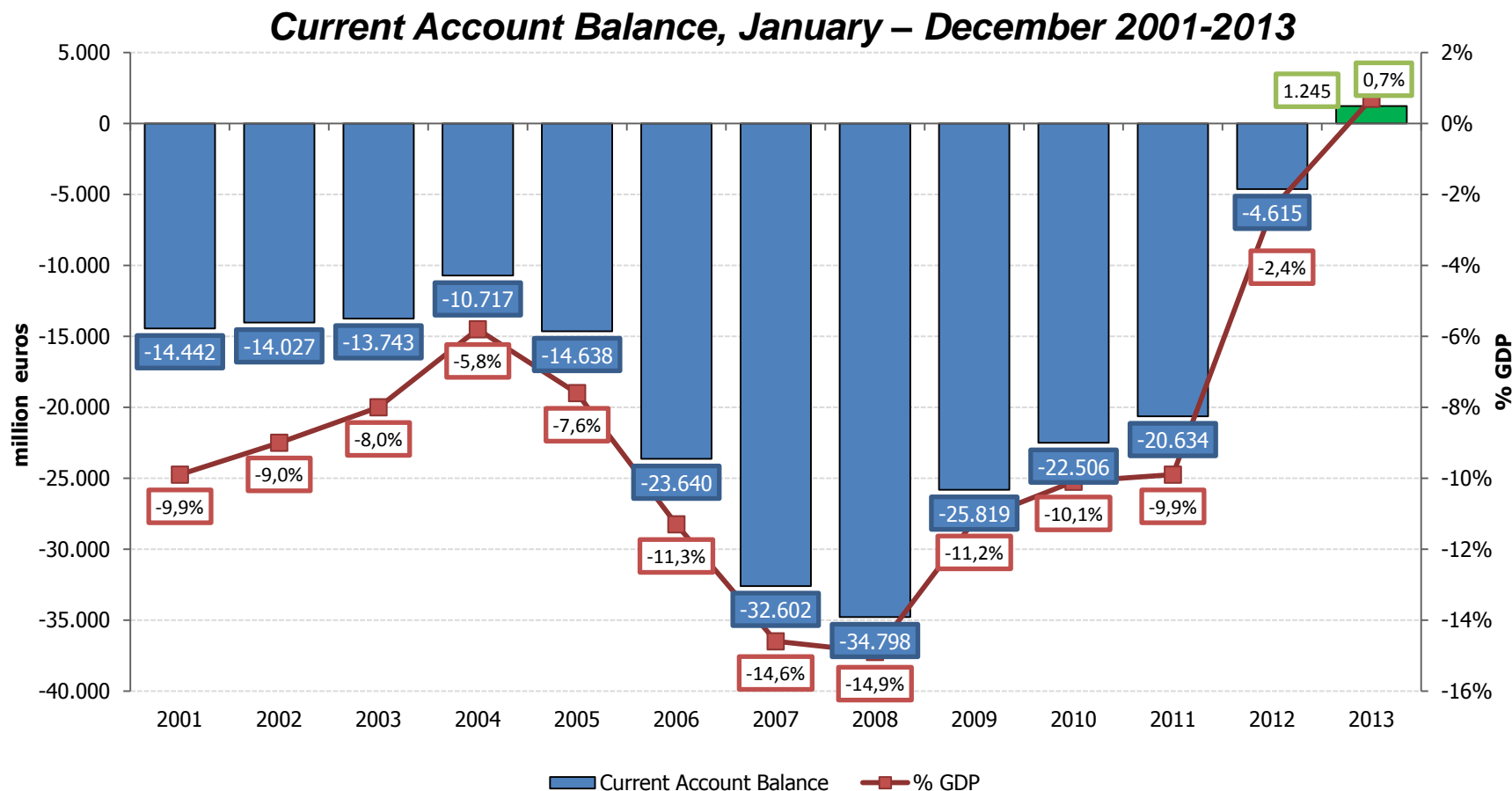
-2% (first two months of 2014) against a 5.5% increase a year ago



DEPA-Gazprom: **15% reduction** in the price of natural gas → industrial and consumer tariffs, **-10.5%**

Estimation of IOBE-FEIR for 2014: -0.6%

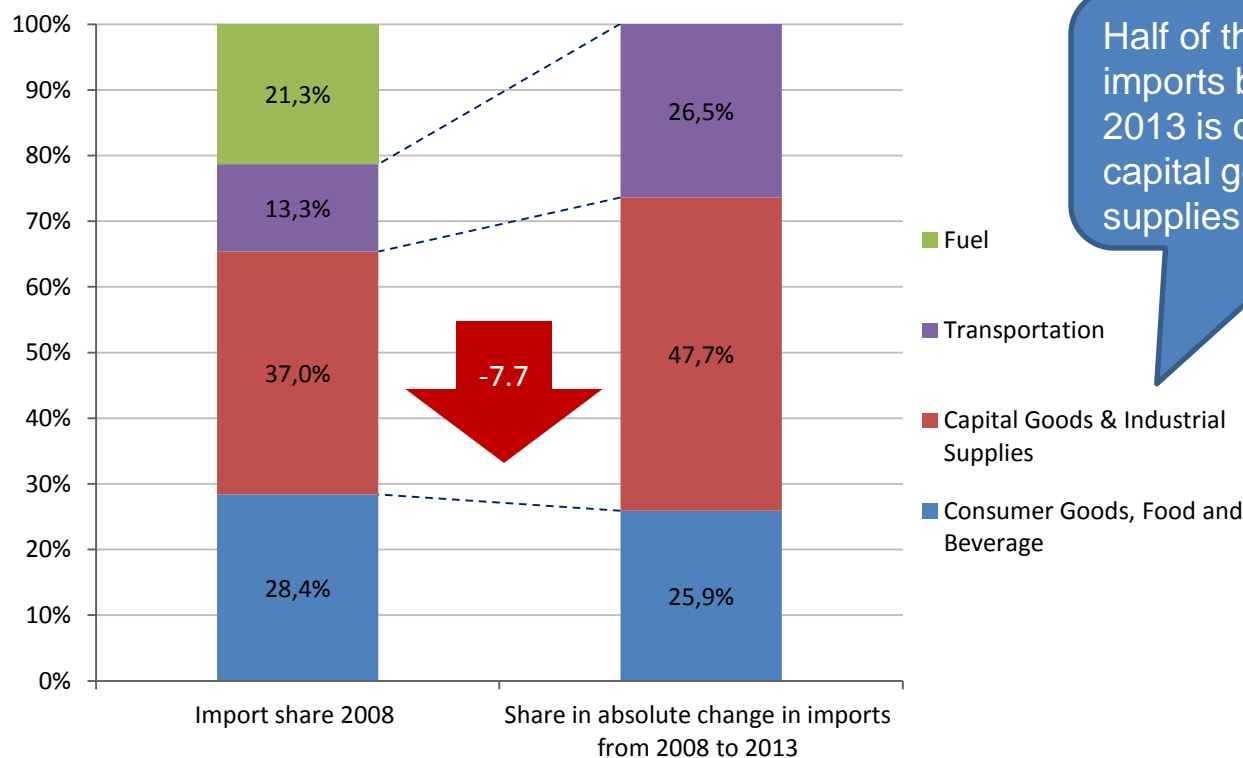
The Current Account Balance turned into a surplus* in 2013 for the first time in almost 30 years



Source: Bank of Greece

*Mainly due to the payment of the first installment of the Securities Markets Programme (SMP) from ECB

The decline in imports accounts for $\frac{3}{4}$ of the trade balance adjustment since 2008...



Half of the €20.4 reduction in imports between 2008 and 2013 is owed to the decline of capital goods and industrial supplies

Source: Eurostat

... however, the decrease was largely driven by a decline in imports of capital goods, which are necessary to boost economic productivity

Medium-term developments

- **Implementation of decisions stemming from the negotiations with the troika**
 - Additional measures are not necessary
 - Return of part of last year's primary surplus to vulnerable groups - categories of civil servants
 - Continuation of the restructuring in public sector employment
 - Structural changes in markets and professions that were repeatedly postponed
 - No postponing for the tax measures that were decided last year (e.g. elimination of tax exemptions, increase of retention tax from pensioners, taxation of more individuals as legal entities)
- **Effects from the return of the Greek state to the capital markets**
 - Eases the isolation → Strengthens international confidence in the country's potential to overcome the current difficult phase
 - **A significant part of the country's credibility** that was lost in the previous year **has been retrieved** - Increased confidence of partners-lenders and international investors
 - The cost of short-term government borrowing is declining
 - The ground is prepared for the return of banks to the capital markets → gradual boost of liquidity in the economy

Medium-term developments

- **The shielding of the banking system continues, coming close to its completion**
 - Share capital increases to ensure capital adequacy, with significant participation by foreign investors → proof of confidence in the stability of banks
 - Gradual return to the international capital markets:
 - ❖ The first steps are visible (Piraeus Bank)
 - ❖ More activity anticipated shortly, following the release of the Greek government bond
 - These developments create significant potential to support liquidity and investment after the stress tests by the ECB
- **Negotiations for debt relief to ease the burden**
 - The high primary surplus is a trump card in the negotiations
 - Further expected easing:
 - ❖ Start-maturity swaps of interest and capital payments
 - ❖ Interest rates reduction
 - ❖ Probable revaluation of part of the debt (government assets, value of shares in banks and future requirements of the Eurozone)

Forecasts 2014

- Weakening of the household consumer spending contraction: ~-1.5 to -2.0% from ~-6.0% in the previous year
 - Pressures on the income of retired and employees through widening of direct taxation / tax base and the elimination of tax exemptions
 - Counteracted by strengthening employment through: extensive structural changes in the labour market, seasonal employment in tourism, Employment Agency programmes → boost of income & consumption
- Continuation of the consolidation of public consumption
 - Restructuring of firms under state control and public sector employment → **Smaller reduction in public consumption: ~-3.0% (2013: ~-4.1%)**
- Improvement in investment climate - growth of investment (~5-8%)
 - o Acceleration of the Public Investment Programme by 80% in the first two months of 2014
 - o Greater activity of the Hellenic Republic Asset Development Fund (despite the already observed delays)
 - o Boost of the confidence of international investors after the publication of the financial results and the return to the markets → increase of the investor interest (privatisations, direct investment)
 - o Liquidity and investment support by banks after equity capital issues, return to markets and ECB stress tests
 - o **Structural problems remain in the investment environment:** constantly changing tax system, energy costs

Forecasts 2014

External Sector

- **Larger growth of exports this year :~+4.0% from ~+1.8%**
 - **Higher demand for exports of services:**
 - ❖ Further growth of international tourist arrivals
 - ❖ Stronger transport activities (e.g. through the Port of Piraeus)
 - Eurozone, the main export destination of Greek products, does not exhibit the anticipated demand growth momentum
- **New import contraction, milder than in the previous year (~-2.0% to -3,0%)**
- **Primary surplus in the external balance is expected**

Stabilisation of the GDP of the Greek economy in 2014. A small increase is also possible

Forecasts 2014

- **Unemployment reduction**, for the first time since 2008

- Structural changes in the labour market (including reduction in social security contribution)
- Higher seasonal employment in tourism
- Programs by the Employment Agency

Forecast of IOBE-FEIR for unemployment in 2014: **26.0%**
(2013:~27.3%)

- **Continuous fall of prices**

- Increase or imposition of new indirect taxes is not expected in the current year
- Price decline from most interventions in the operation of markets (OECD recommendations)
- Milder consumption contraction counteracting the fall of prices

- **Deflation in 2014 as well: -0.6%, against -0.9% in 2013**

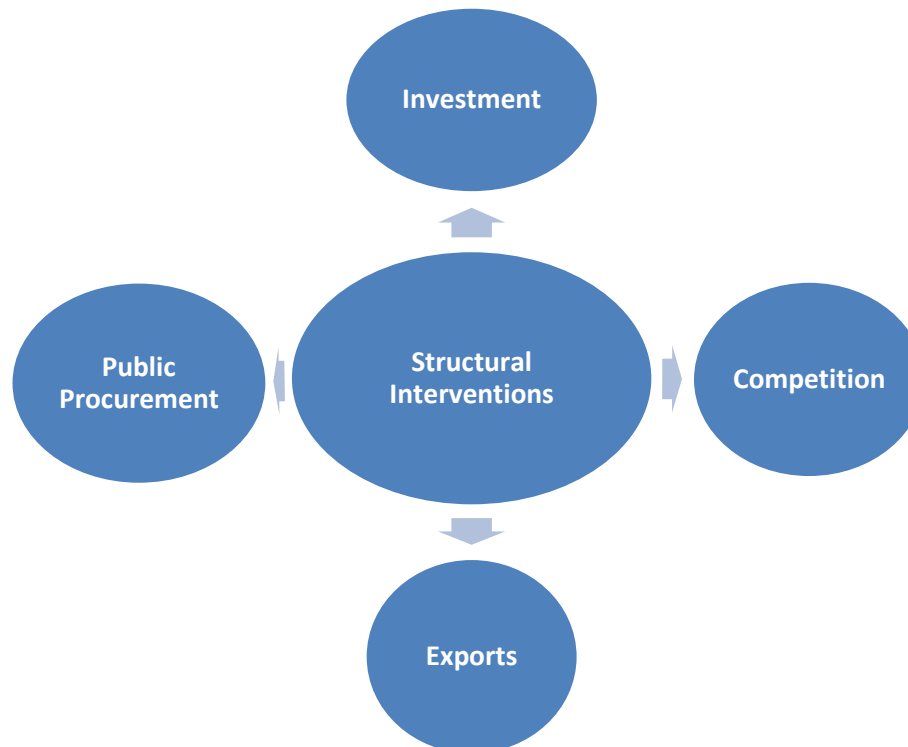
Special report of IOBE-FEIR

THE ECONOMIC IMPACT OF REFORMS

The implementation of structural reforms will have multiple economic and social benefits

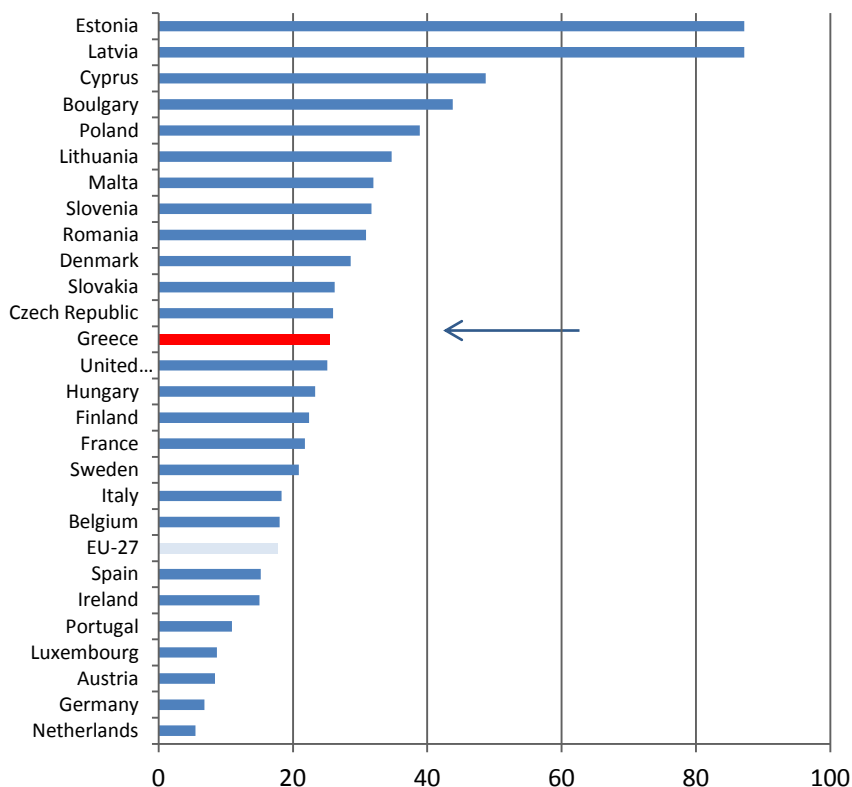
- Adopting structural measures can substantially contribute to
 - Business environment improvement
 - Encouragement of investment and internationalisation and
 - Enhancement of competition in the markets for goods and services

The scope of the study is to outline reform interventions in key aspects of the business environment

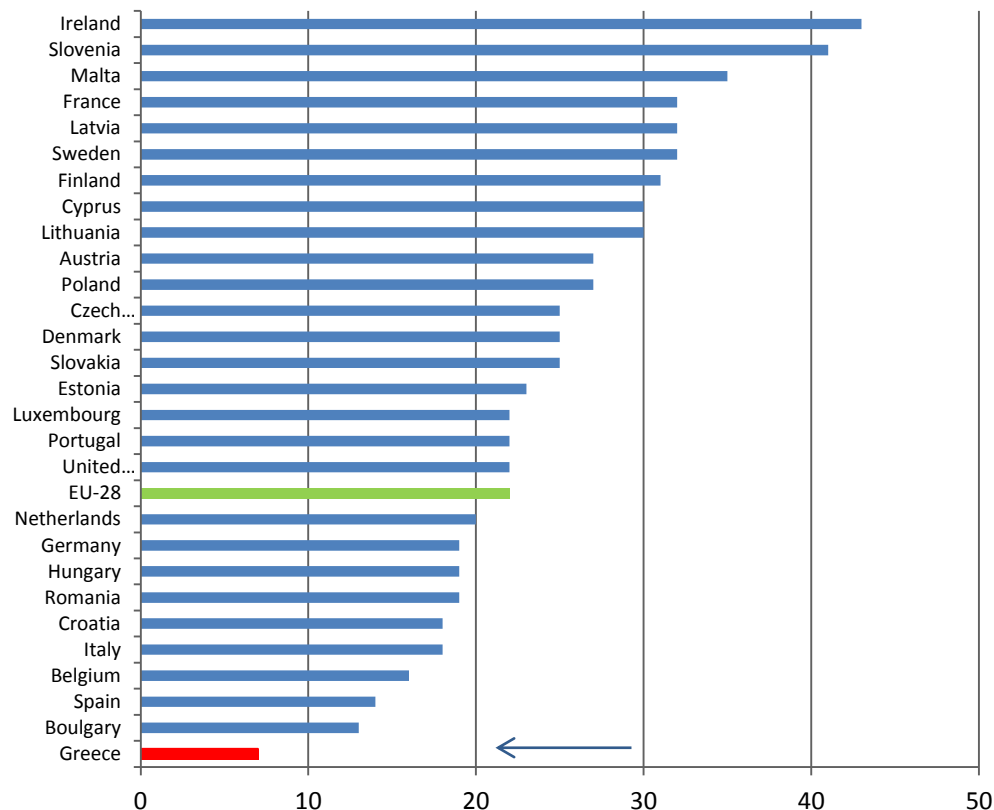


The improvement of the procurement system is one of the main priorities of the EU

Value of calls in Tenders Electronic Daily, 2011



Use of electronic tendering systems by companies, 2012



Source: Eurostat

The rate of calls published in the European platform TED is relatively high. However, other European countries have had national electronic systems in operation for years

The use of public procurement systems in Greece by businesses is significantly lagging behind

Reforms in public procurement in Greece

- Single Public Procurement Authority
 - Established in September 2011 to ensure transparency and efficiency of the process of procurement and execution of contracts.
- Adoption of electronic means for public procurement (e-procurement)
 - Since 2014, the Central Government agencies are required to conduct the tenders (for projects with a budget of more than €60k) through the National Electronic System of Public Procurement
- Increase of the proportion of contracts awarded through the central purchasing bodies and simplification of the institutional framework

Empirical analysis

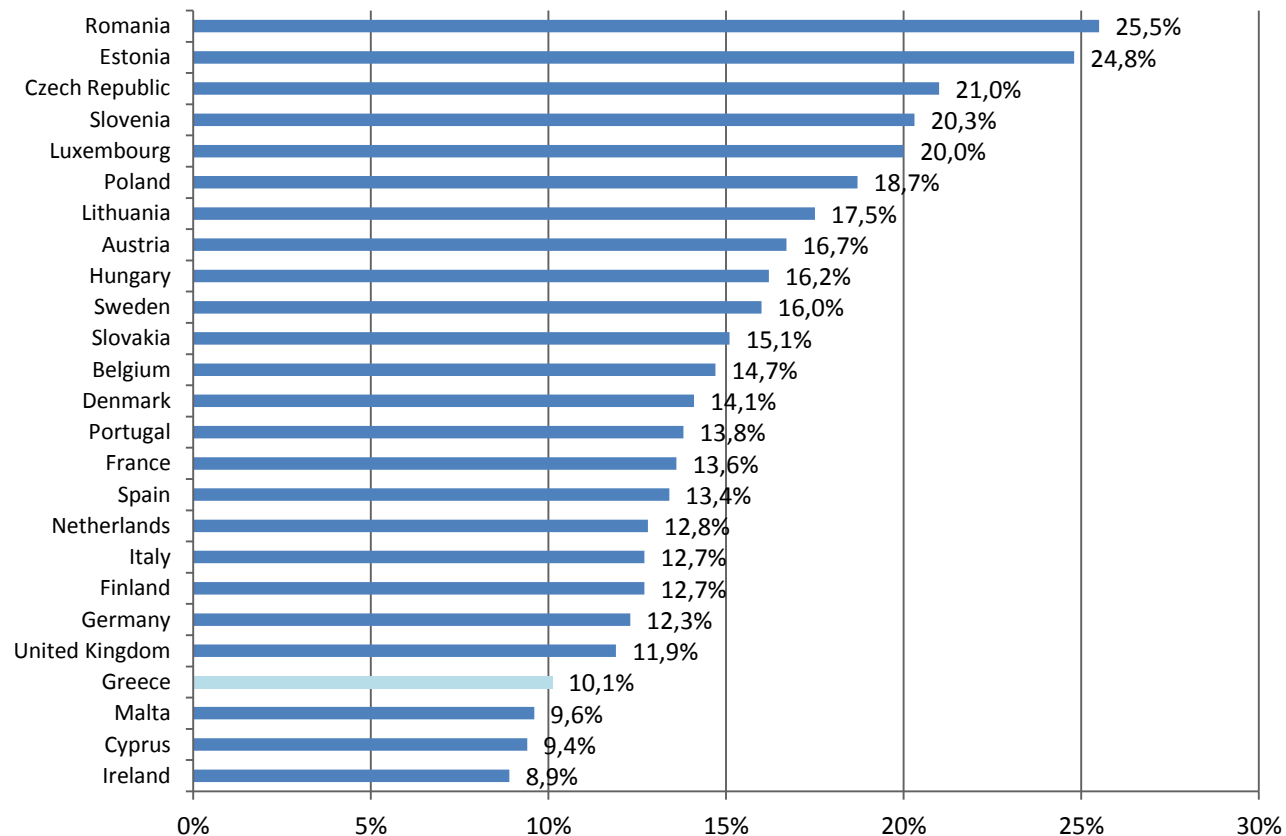
The effect of improving transparency on the cost of public procurement in Greece was examined, using data from 2218 public procurement contracts.

The results suggest that improving transparency through the establishment of the Single Public Procurement Authority has reduced procurement costs by 3.5%.

Boosting investment is a prerequisite for economic recovery

- The contribution of investment (business, foreign direct) in gross domestic product is low

Investment (excluding buildings) as % of GDP in EE-27, 2012



Source: Eurostat

Reforms concerning investment in Greece

- Licensing of new businesses and investment projects
 - Adoption of a 'one-stop shop' for the establishment of partnerships and limited companies (June 2010)
 - Acceleration of the implementation of strategic investment projects (fast track, December 2010)
 - "Business Friendly Greece" (Law No 4072/2012, February 2012)
 - New corporate legal form - Private capital company with a capital requirement of one € (February 2012).
- Land-use cadastre and operation of industrial areas

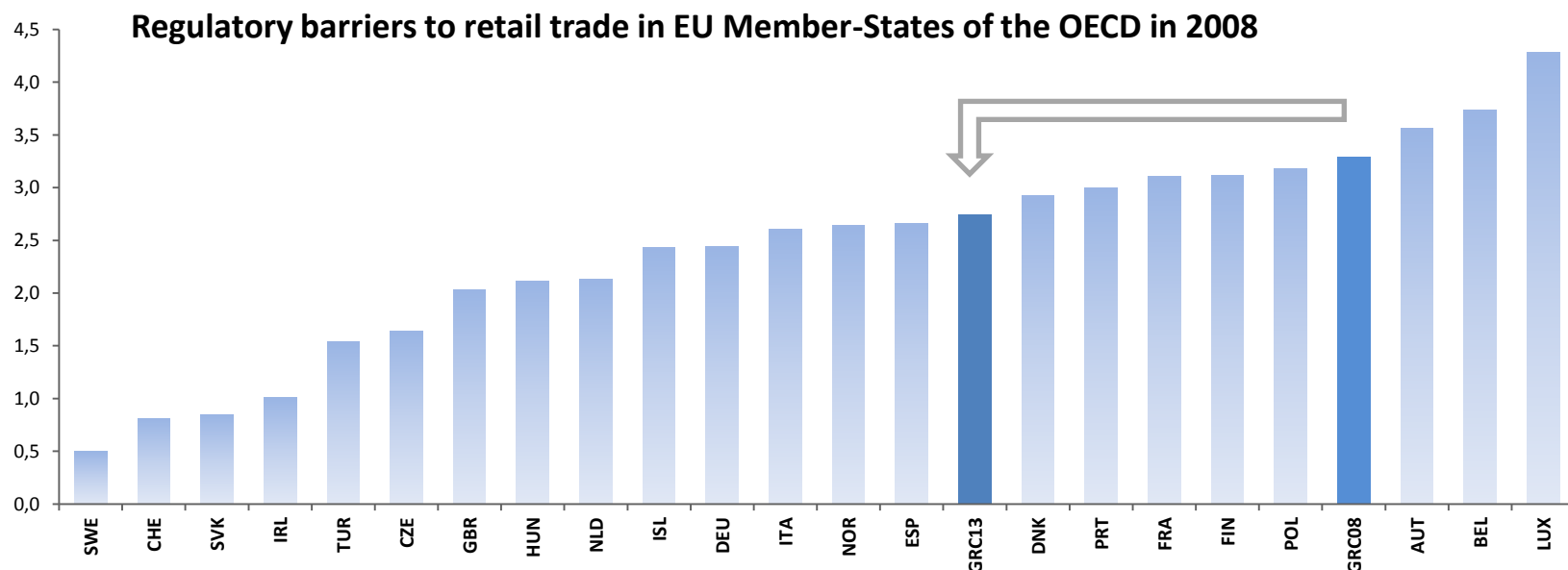
Empirical analysis

Reducing the administrative burden has a measurable impact on business investment. The potential benefit of the reforms in the business environment in Greece during 2010-2013 amount to 0.9% of GDP (€ 1.6 billion).

The empirical assessment indicates that further simplification of the procedures for establishing businesses could bring an additional increase in investment by 0.4% of GDP or € 730 million annually.

Competition – Reforms were instituted to liberalise markets in various sectors of economic activity

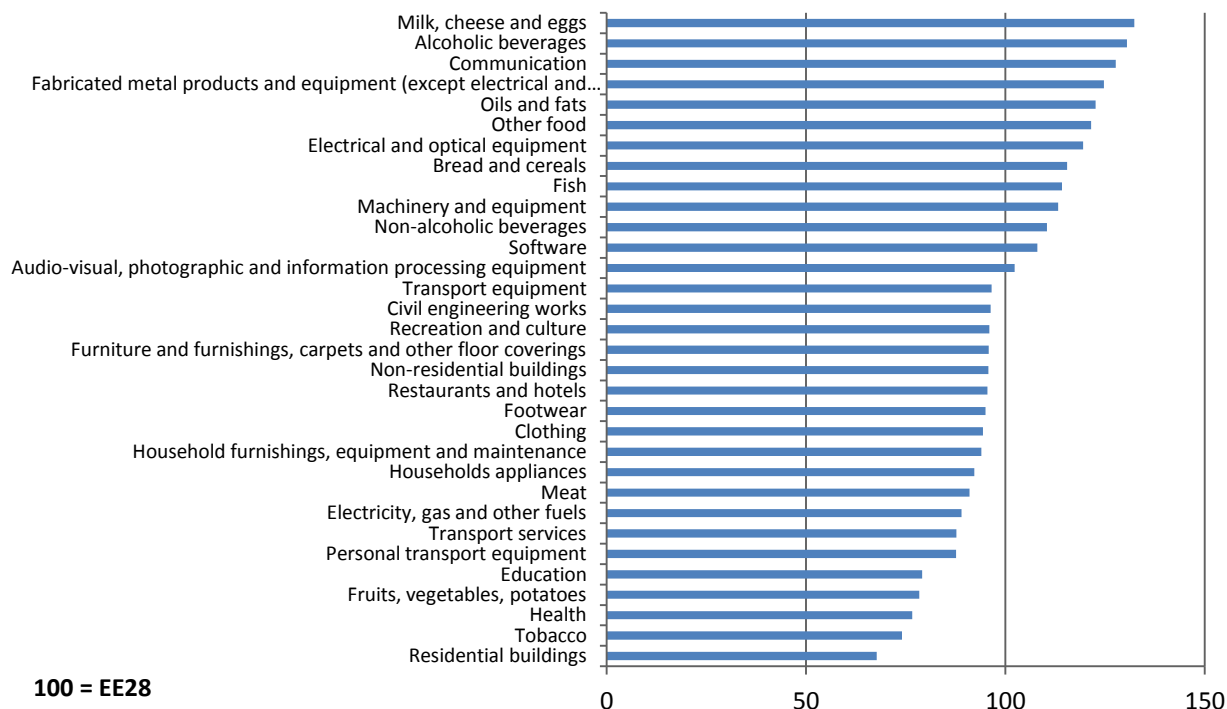
- L. No 3959/2011 to promote competition in markets
 - Legislative measures in specific markets (e.g. Law No 3872/2010 for cruise ships with third-country flags and Law No 3887/2010 for the gradual liberalisation of road transport for goods)
- Review of the legal framework, with the OECD Competition Toolkit, to identify constraints / barriers in the areas of food processing, retail, building materials and tourism



Source: OECD

In quite a few markets for goods and services there are still barriers to competition between firms

Comparative price level in Greece, 2012



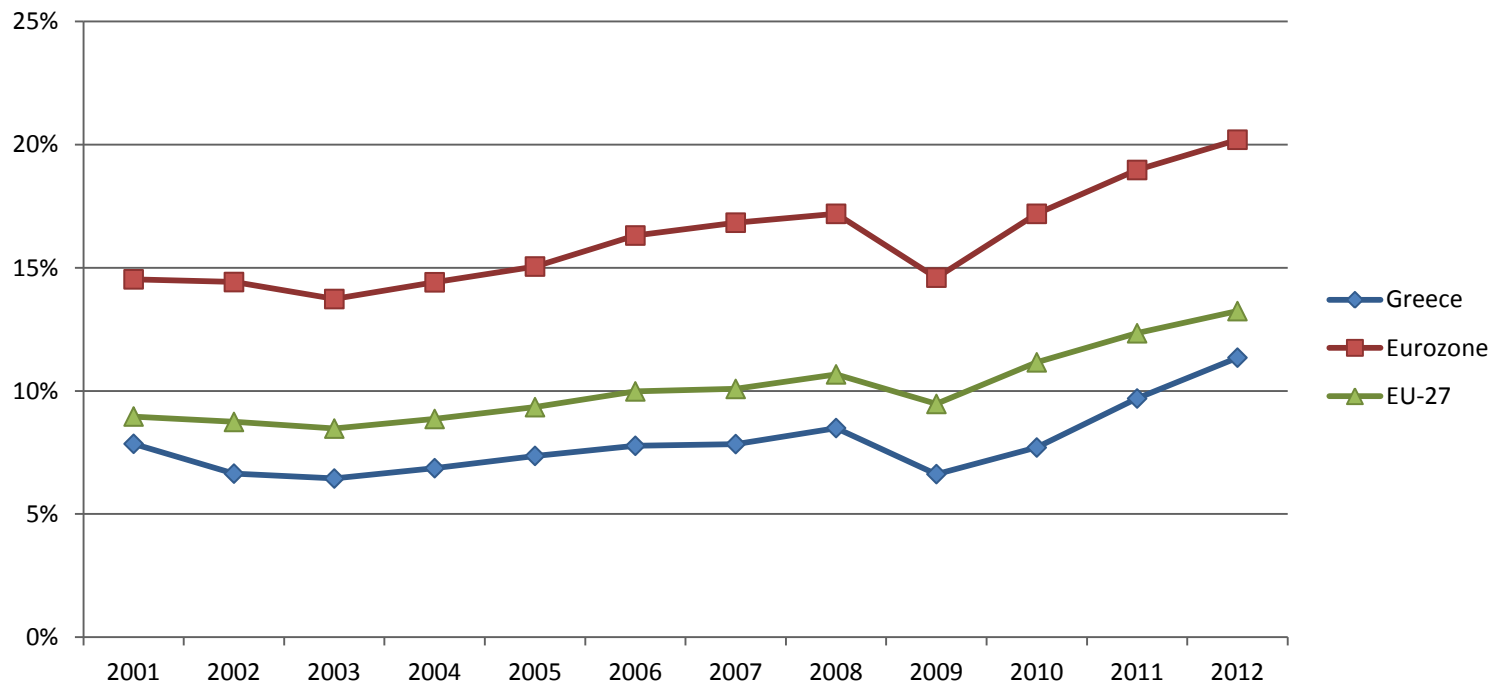
Empirical analysis

According to data on indicators related to the regulation of product markets in 24 member-countries of the OECD, in 1998, 2003 and 2008, the convergence of Greece to the EU average in the index "Barriers to services" is associated with an average drop in the prices of services by 4.4%. Similarly, the empirical results indicate that if Greece converges to the EU average in the indicators "Legal barriers to entry" and "Obstacles to entrepreneurship" could increase employment by 52k and 88k job positions.

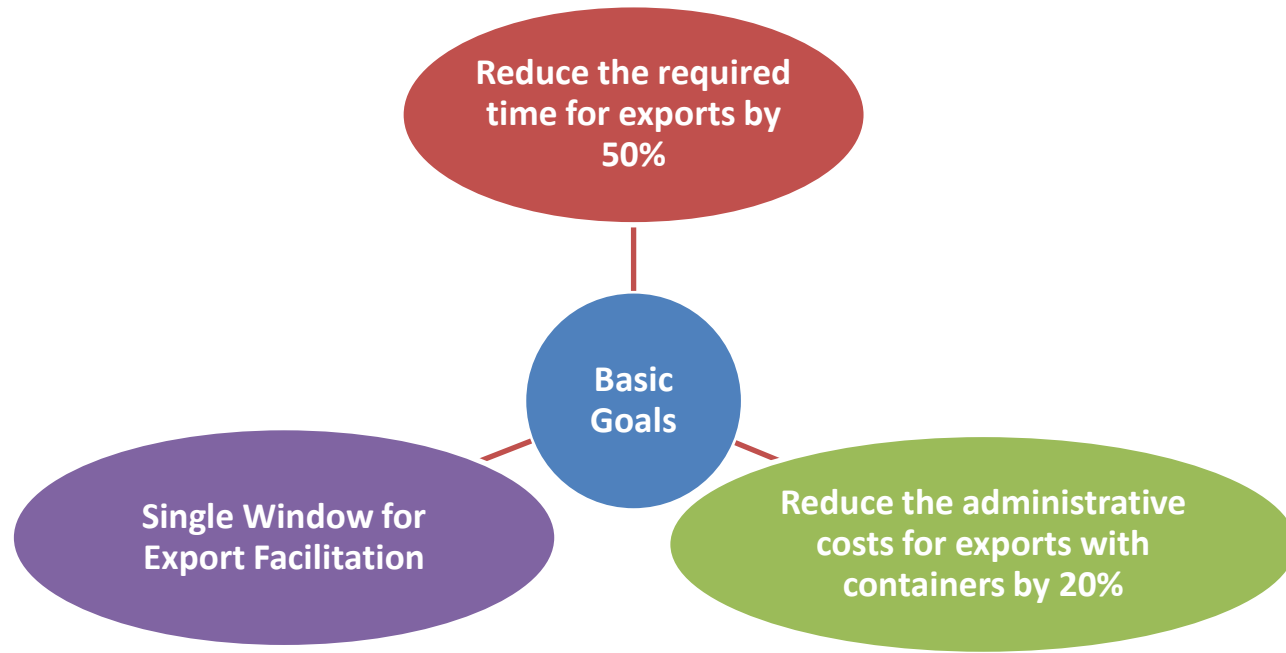
Exports promotion: a key pillar of the new growth model that the Greek Economy is required to adopt

- However, the share of the exports of goods in GDP is almost half compared with the corresponding average of the Eurozone countries

Exports of goods as a percentage of GDP in Greece, Eurozone and EU-27, 2001-2012



National Strategy & Roadmap in order to facilitate foreign trade in 2012-2015



Empirical Analysis

The positive effect on exports from faster processing of exports is confirmed through empirical analysis. Based on data from the EU member countries for the period 2005-2012 (panel data analysis), it was revealed that one day of reduction in the required time to export goods in 2012 would lead to an increase of exports by almost 1% of GDP.

Summary

- The implementation of structural reforms is crucial in order to make the country's production system work more efficiently and to create jobs
- As the reform areas are interconnected, e.g. market opening – investment facilitation, the multiplier benefit to the economy and society could potentially be very high
- Verification of these arguments with an analysis of the effects at macroeconomic level
 - The implementation of structural reforms in a reliable way can gradually lead the economy to higher levels of production and employment, through flexibility in the markets and the price system.

The studies are available at:

http://ec.europa.eu/commission_2010-2014/president/taskforce-greece/index_en.htm
http://ec.europa.eu/commission_2010-2014/president/pdf/tfgr/indicators_final_report_en.pdf
http://ec.europa.eu/commission_2010-2014/president/pdf/tfgr/macro_narrative_report_en.pdf
http://ec.europa.eu/commission_2010-2014/president/pdf/tfgr/micro_effects_business_environment_reforms_en.pdf