8. GREECE

Recovery backed by domestic demand and exports

After a mild contraction of real GDP by 0.2% in 2015, economic activity is expected to gradually pick up as of the second half of 2016 and accelerate markedly in 2017, on account of strengthened economic sentiment after the conclusion of the first review of the ESM programme, and stabilisation of public finances. Unemployment is set to continue decreasing from very high levels.

Investment and labour market improvement to support expected growth

Real GDP growth in the first half of this year was flat compared to the second half of last year and lower than the first half of 2015. While private consumption declined mildly compared to the second half of 2015, investment increased over the same period driven by a strong increase in machinery and equipment investment in the second quarter of 2016. In the first semester of this year, exports decreased more than imports, resulting in net exports detracting from GDP growth.

Real GDP growth is expected to gradually pick up during the second half of the year notably driven by improved economic sentiment following the conclusion of the first review of the ESM programme and higher liquidity in the corporate sector amid clearance of arrears. Still, for the year as a whole, real GDP is expected to mildly contract by 0.3% in 2016. Economic recovery is expected to return strongly in 2017 with growth at 2.7%, on account of the assumed gradual normalisation of the financial sector, which should lead to the gradual relaxation of capital controls over time. Domestic demand is expected to increase, with investment fuelling a positive net exports contribution. Investment is expected to take off in 2017 backed by improved credit conditions and EU funding. Real GDP is expected to continue recovering at a robust pace in 2018, with growth forecast to reach 3.1%.

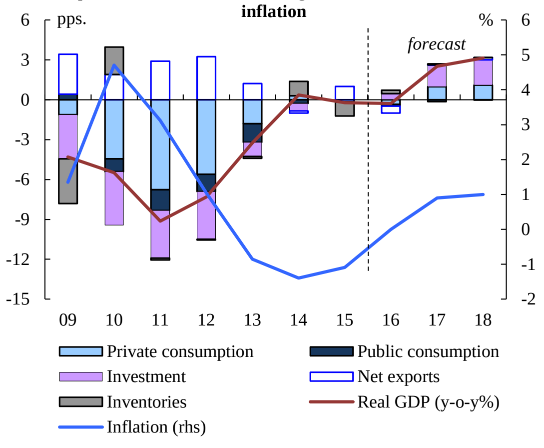
The labour market performed better than expected in the first half of 2016, with unemployment declining to 23.2% in July from an annual average of 24.9% in 2015. Employment increased by 2.7% in the period January–July 2016 compared to an annual average growth rate of 0.5% in 2015. Employment is projected to rise at a broadly stable pace until 2018 and unemployment to keep decreasing, reflecting lagged effects of economic recovery, still subdued wage dynamics and the impact of labour market reforms.

The external sector contribution to GDP growth is expected to be negative in 2016, with both exports and imports declining substantially due to capital controls still being in place. Net exports' contribution to growth should turn positive in 2017 on account of increased goods exports driven by recent competitiveness gains and higher investment in the sector.

Deflationary pressures have eased in 2016, mainly due to the increase in indirect taxation. The HICP is expected to increase slightly in 2016 before picking up over the next two years as domestic demand strengthens. Wages are expected to increase along with economic recovery.

Downside risks are related mainly to uncertainties over the completion of the second review of the ESM programme that may trigger a reversal of the current positive sentiment and expectations, as well as external factors such as regional geopolitical tensions and the refugee crisis.

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



Strong budget execution offsets impact of downward revision in 2015 fiscal outcome

The October 2016 EDP notification revised the 2015 headline general government deficit to 7.5% of GDP, up from 7.2% of GDP notified in spring. The revision was driven by regular methodological refinements and improved data availability. As a result, the 2015 primary budget balance according to the programme definition [78] was revised to 0.2% of GDP, well above the target of -0.25% of GDP but lower than the surplus of 0.7% of GDP notified in spring 2016.

Greece is forecast to reach the programme's primary surplus target of 0.5% of GDP in 2016, with the composition of the fiscal adjustment tilted more to the revenue side. The stronger-than-forecast revenue outcome primarily stems from higher VAT revenue (reflecting the prudent initial estimates of the VAT reform and improved tax compliance) and higher corporate income taxes thanks to positive y-o-y growth in taxable profits. These gains were partially offset by spending slippages, mainly in the wage bill and the health sector. The achievement of the primary surplus target combined with reduced interest expenditure will result in the headline general government fiscal deficit falling to 2.5% of GDP in 2016.

By end 2016, the authorities will legislate the 2017 Budget and Medium-term Fiscal Strategy 2017-20, including any adjustments in fiscal policies needed, to ensure the achievement of the ESM programme primary balance targets of 1.75% of GDP in 2017 and 3.5% of GDP in 2018.

An upside risk to this forecast is the persistence of the strong revenue performance seen so far this year on the back of the improving macro-economic performance and revenue administration reforms. Downsides include ongoing spending slippages and potential deviations in the yields of the large fiscal reforms worth 1.6% of GDP (personal income tax, pensions) agreed in the first review for 2017, which have high implementation risks.

The debt-to-GDP ratio is expected to increase from 177.4% in 2015 to 181.6% in 2016 due to the fiscal deficit, the clearance of arrears and still declining nominal GDP. Interest expenditure, however, is projected to decrease over the forecast years due to declining interest rates for financial assistance loans and updated interest consolidation confirmed by the October 2016 EDP notification. The improved fiscal position and positive GDP growth in 2017 are expected to put the debt-to-GDP ratio on a declining path starting in 2017. [79]

[78] The programme definition of the primary balance excludes the one-off cost of bank recapitalisation, SMP and ANFA revenues and part of the privatisation proceeds, which in total were equal to 4.2 % of GDP in 2015.

[79] The debt forecast presented in the table is in line with the Eurostat convention that differs slightly from the debt sustainability analysis of the ESM programme.

Table II.8.1:

Main features of country forecast - GREECE

	2015		Annual percentage change						
bn EUR	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	175.7	100.0	1.0	-3.2	0.4	-0.2	**-0.3**	**2.7**	**3.1**
Private Consumption	122.8	69.9	1.1	-2.6	0.4	-0.2	**-0.5**	**1.5**	**1.6**
Public Consumption	35.3	20.1	1.2	-6.4	-1.4	0.0	**-0.7**	**-0.7**	**-0.1**
Gross fixed capital formation	20.3	11.5	-1.1	-8.4	-4.6	-0.2	**4.0**	**13.7**	**14.2**
of which: equipment	8.3	4.7	0.6	-4.5	21.0	-1.5	**6.9**	**15.8**	**15.2**
Exports (goods and services)	56.1	31.9	5.3	1.5	7.8	3.4	**-4.0**	**3.6**	**4.7**
Imports (goods and services)	55.8	31.8	3.1	-2.4	7.6	0.3	**-2.8**	**3.0**	**4.2**
GNI (GDP deflator)	176.3	100.3	0.9	-4.0	0.7	-0.1	**-0.5**	**2.7**	**3.1**
Contribution to GDP growth: Domestic demand			1.1	-4.3	-0.6	-0.2	**0.0**	**2.5**	**2.9**
Inventories			-0.1	-0.1	1.1	-1.0	**0.1**	**0.0**	**0.0**
Net exports			0.1	1.2	-0.2	1.0	**-0.4**	**0.2**	**0.2**
Employment			0.0	-2.6	0.0	0.5	**2.2**	**2.2**	**2.3**
Unemployment rate (a)			11.6	27.5	26.5	24.9	**23.5**	**22.2**	**20.3**
Compensation of employees / head			4.5	-7.5	-2.1	-2.9	**0.2**	**1.0**	**2.0**
Unit labour costs whole economy			3.5	-6.9	-2.4	-2.2	**2.7**	**0.5**	**1.2**
Real unit labour cost			0.5	-4.6	-0.6	-1.2	**2.9**	**-0.4**	**0.0**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			2.9	-2.4	-1.8	-1.0	**-0.2**	**0.8**	**1.2**
Harmonised index of consumer prices			3.3	-0.9	-1.4	-1.1	**0.1**	**1.1**	**1.0**
Terms of trade goods			-0.3	1.7	0.9	0.6	**0.1**	**0.0**	**0.0**
Trade balance (goods) (c)			-14.7	-9.8	-10.8	-9.1	**-8.6**	**-8.9**	**-9.0**
Current-account balance (c)			-9.7	-2.2	-2.6	0.0	**0.0**	**0.2**	**0.3**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-8.1	0.5	-0.6	2.1	**1.9**	**2.1**	**2.1**
General government balance (c)			-7.8	-13.2	-3.6	-7.5	**-2.5**	**-1.0**	**0.9**
Cyclically-adjusted budget balance (d)			-7.9	-6.1	2.4	-2.1	**2.6**	**2.7**	**3.0**
Structural budget balance (d)			-	2.4	2.4	1.9	**2.6**	**2.7**	**3.0**
General government gross debt (c)			115.3	177.4	179.7	177.4	**181.6**	**179.1**	**172.4**

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