8. GREECE

Recovery ahead and better-than-expected fiscal performance

After a setback in the fourth quarter of 2016, the recovery is expected to restart this year. However, the recovery looks set to remain moderate due to the delays in the closure of the second review of the ESM programme. Improving consumer and investor sentiment is expected to be the fundamental driver of growth in the near term. Public finances strongly outperformed the 2016 fiscal target and the outlook remains positive.

Weak Q4 growth led to stagnation in 2016

After a strong performance in 2016-Q3, Greece's GDP contracted by 1.2% (q-o-q) in 2016-Q4 in seasonally-adjusted terms, which corresponds to a y-o-y decrease of 1.1%. This was driven by a sharp decline in public consumption, and a moderation in net exports, while private consumption and gross fixed capital investment remained resilient compared to the previous quarter. Overall, GDP growth in 2016 as whole was stagnant, resulting from divergent processes. While private consumption grew steadily most of the year, contributing by 1.0 pp. to the annual growth rate, this was offset by the negative contribution of government consumption and net exports of -0.4 pps. and -0.5 pps. respectively. Gross fixed capital formation had no significant growth contribution. Short-term indicators available for 2017 underpin the view that the recovery is fragile and crucially dependent on the closure of the 2nd review.

Recovery to return this year

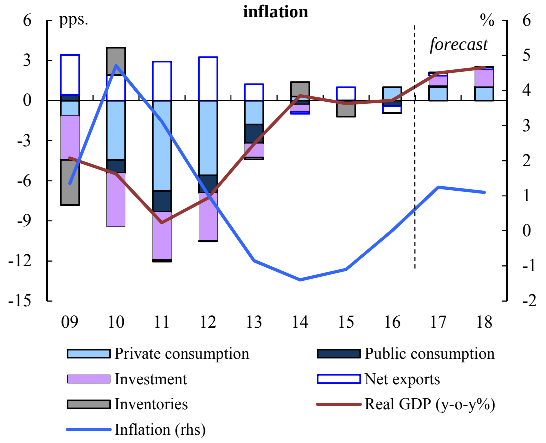
Real GDP is expected to grow 2.1% in 2017 and 2.5% in 2018, revised down compared to the 2017 winter forecast. Firstly, the poor economic performance of 2016-Q4 implies a much lower carry-over effect to 2017; secondly, the return of investor and consumer confidence is set to be delayed as the 2nd review was not completed in Q1. Based on its observed resilience, private consumption is expected to be the main driver of growth in 2017, supported by the increase in employment. Assuming that the 2nd review will close in the first half of the year, the business climate is expected to improve, leading to the return of investment. However, the constraints of the financial system to finance investment will ease only gradually, dampening the increase in gross fixed capital formation.

As Greece's tourism sector is experiencing increased demand, services' exports are set to gain momentum in the coming years. Although investment and consumer demand will deteriorate the goods balance, the improvement in the services balance will more than compensate for this, thus net exports are projected to contribute positively to growth in both 2017 and 2018.

The labour market remained on an improving trajectory for the last two years. Employment grew by 1.3% in 2016. Unemployment declined to 23.6% on average in 2016, and is expected to moderate further as the recovery accelerates.

2017 is expected to see the return of inflation. The increase in energy prices and the hike in excise duties on selected products are expected to push up headline inflation. Core inflation, however, should only increase gradually, along with the recovery of domestic demand and wage increases.

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



Risks mainly relate to uncertainties over the completion of the second review of the ESM programme and external factors such as international and regional geopolitical and economic tensions.

Ambitious reforms augur well for the achievement of fiscal targets

Greece reached a general government surplus of 0.7% of GDP in 2016 and significantly – by about

3½% of GDP – over-performed the primary surplus target of 0.5% of GDP for 2016 according to the ESM programme definition. [42] The composition of the fiscal adjustment was broadly balanced in 2016. Revenues were bolstered by a dynamic growth in underlying tax bases but also by several one-off factors related to clearing tax liabilities from previous years, higher claims on EU funds and stock-piling effects in view of the 2017 hike in the tobacco tax. Primary expenditure decreased largely due to exceptionally low military deliveries and a gradual completion of the motorways concession project but also due to continued rationalisation of intermediate consumption and staff salaries.

Greece is projected to achieve the primary balance targets of its programme both this year and next (1.75% of GDP in 2017 and 3.5% of GDP in 2018). This takes into account the fiscal package adopted in the context of the 1st review, which is projected to yield 3% of GDP through 2018 and the measures agreed under the 2nd review aimed to partly offset the national roll-out of the Social Solidarity Income scheme. It does not, however, take into account the ongoing revenue administration reforms and is consistent with cautious assumptions on the absorption of EU funds, which implies considerable upside risks. Downside risks include the possibility that the fiscal reforms could yield less than expected due to incomplete implementation and the effects of a further delay in the completion of the second review of the ESM programme.

Overall, the general government balance is expected to reach -1.2% of GDP in 2017 before improving to 0.6% of GDP in 2018. In structural terms, given the still-large output gap, the general government balance is forecast to reach 2½% of GDP in 2017 and 3.1% of GDP in 2018.

Greece's debt-to-GDP ratio increased from 177.4% in 2015 to 179.0% in 2016. The increase in the debt ratio was related to positive stock-flow adjustment due to elevated cash deposits and reduction in accounts payable (arrears clearance) which was partially offset by the fiscal surplus in 2016. The debt-to-GDP ratio is projected to remain broadly stable in 2017 as the arrears clearance programme will continue. In 2018 the fiscal surplus and the stronger GDP growth are expected to put the debt-to-GDP ratio on a declining path.

[42] 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.

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	**0.0**	**2.1**	**2.5**
Private Consumption	122.8	69.9	1.1	-2.6	0.4	-0.2	**1.4**	**1.4**	**1.4**
Public Consumption	35.3	20.1	1.2	-6.4	-1.4	0.0	**-2.1**	**0.5**	**0.1**
Gross fixed capital formation	20.3	11.5	-1.1	-8.4	-4.6	-0.2	**0.1**	**6.3**	**10.8**
of which: equipment	8.3	4.7	0.6	-4.5	21.0	-1.5	**-0.6**	**9.5**	**13.2**
Exports (goods and services)	56.1	31.9	5.3	1.5	7.8	3.4	**-2.0**	**3.8**	**4.2**
Imports (goods and services)	55.8	31.8	3.1	-2.4	7.6	0.3	**-0.4**	**3.0**	**3.8**
GNI (GDP deflator)	176.3	100.3	0.9	-4.0	0.7	-0.1	**-0.2**	**2.1**	**2.4**
Contribution to GDP growth: Domestic demand			1.1	-4.3	-0.6	-0.2	**0.5**	**1.8**	**2.3**
Inventories			-0.1	-0.1	1.1	-1.0	**0.0**	**0.0**	**0.0**
Net exports			0.1	1.2	-0.2	1.0	**-0.5**	**0.2**	**0.1**
Employment			0.0	-2.6	0.0	0.5	**1.3**	**1.4**	**1.7**
Unemployment rate (a)			11.6	27.5	26.5	24.9	**23.6**	**22.8**	**21.6**
Compensation of employees / head			4.5	-7.5	-2.1	-2.9	**0.8**	**1.5**	**2.1**
Unit labour costs whole economy			3.5	-6.9	-2.4	-2.2	**2.1**	**0.9**	**1.3**
Real unit labour cost			0.5	-4.6	-0.6	-1.2	**2.0**	**-0.3**	**0.2**
Saving rate of households (b)			-	-	-	-	**-**	**-**	**-**
GDP deflator			2.9	-2.4	-1.8	-1.0	**0.1**	**1.2**	**1.2**
Harmonised index of consumer prices			3.3	-0.9	-1.4	-1.1	**0.0**	**1.2**	**1.1**
Terms of trade goods			-0.3	1.7	0.9	0.6	**-2.2**	**0.2**	**0.1**
Trade balance (goods) (c)			-14.7	-9.8	-10.8	-9.1	**-9.3**	**-9.7**	**-9.7**
Current-account balance (c)			-9.7	-2.2	-2.6	0.0	**-0.5**	**-0.5**	**-0.3**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-8.1	0.2	-0.6	2.1	**1.4**	**1.4**	**1.5**
General government balance (c)			-7.8	-13.1	-3.7	-5.9	**0.7**	**-1.2**	**0.6**
Cyclically-adjusted budget balance (d)			-7.9	-6.1	2.3	-0.6	**5.5**	**2.5**	**3.1**
Structural budget balance (d)			-	2.4	2.4	3.4	**5.5**	**2.5**	**3.1**
General government gross debt (c)			115.3	177.4	179.7	177.4	**179.0**	**178.8**	**174.6**

(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.