8. GREECE

Programme exit amid strengthening recovery

Greece has exited its European Stability Mechanism programme and economic growth is taking hold, though vulnerabilities remain. Sustaining the reform momentum will be instrumental in underpinning investment and convergence. Employment is recovering and exports are expected to perform well by historical standards. Solid growth, in combination with low borrowing needs and high primary fiscal surpluses should help to reduce significantly the debt-to-GDP ratio.

The forecast is based on a no-policy-change fiscal scenario for 2019-2020 with implications for the macroeconomic outlook and as such, it is not directly comparable with the previous forecasts. Once the fiscal package to reach the 3.5% of GDP primary surplus target is finalised, the forecast will be duly adjusted.

Sustained growth

After a strong first quarter of 2.5% (y-o-y) growth, real GDP growth in Greece decreased in 2018-Q2 to 1.8% (y-o-y), corresponding to 0.2% (q-o-q, in seasonally adjusted terms).

Private consumption grew dynamically for the second consecutive quarter, increasing by 0.6% (q-o-q) in 2018-Q2. Exports recorded a strong 3.9% quarterly growth, driven mainly by services. Imports, however, rebounded strongly from the contraction in the previous quarter, so the overall impact of net exports on growth was negative. Investment remained flat, while government consumption decreased.

Commitment to reforms is key to further growth

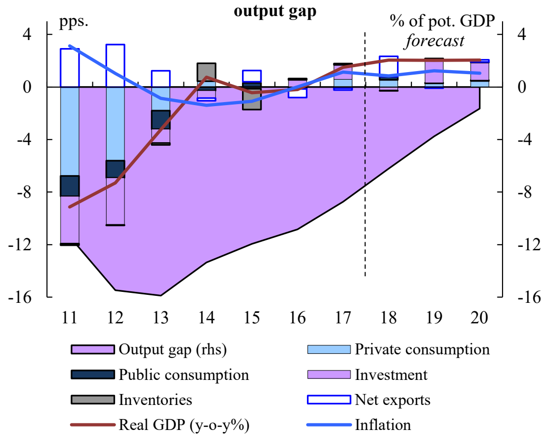
The current forecast rests on an assumption of no policy change for fiscal policy in 2019 and 2020. This is projected to result in a primary surplus of 3.9% of GDP (ESM programme definition). Negotiations for the 2019 budget are ongoing, and it is expected that the final package of measures will lead to a primary surplus of 3.5% of GDP for 2019. In this event, real growth rates would be higher and could reach 2.3% of GDP in 2019-20, which is in line with earlier Commission forecasts.

For 2018, GDP growth is slightly revised to 2.0%, up from 1.9% earlier, on the back of improved consumption dynamics. Investment is expected to contract this year, as the rebound in construction is seen as insufficient to balance the contraction in equipment investment. Greece's export shares have started to increase after several years of decline. Due to falling investment, imports have been markedly lower than anticipated. Net exports are therefore expected to be the main contributor to growth this year.

Based on the no-fiscal-policy-change assumption, growth is forecast to remain at 2.0% in 2019 and 2020. Investment is expected to become an important driver of growth as structural reforms start to bear fruit, provided that post-programme reform implementation is strong. Imports are expected to rise as investment rebounds and net exports thus turn negative.

The labour market recovery continues. Employment is expected to grow by 1.8% in 2018, bringing unemployment below 17% by 2020. HICP inflation is forecast to reach 0.8% this year, and to accelerate further in 2019 as the output gap closes and energy prices rise. With the expected decline in oil prices in 2020, inflation is set to decrease. Real wages are expected to rise gradually, in line with productivity gains.

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



The forecast also assumes that reform momentum will be maintained, providing credibility and a good investment climate. Downside risks include: domestic policy slippages as well as adverse external developments related to international financial markets and geopolitical developments

Public debt is set to decrease rapidly

The general government balance is projected to record a surplus in 2018, the third year in a row.

Building on the fiscal adjustment achieved in recent years, the outcome for 2018 is also expected to benefit from solid growth in the macro bases, a broad-based recovery in taxable profits and higher energy prices. As usual, the forecast assumes a full utilisation of spending ceilings. Underspending would improve the 2018 outturn over and above what is projected at present.

Under a no-policy-change assumption, Greece is set to over-achieve the primary surplus targets agreed in June this year in 2019 and 2020.[68] The main drivers of the emerging fiscal space are the still large output gap, the growing benefits of past pension reforms and ceilings on healthcare spending and new hirings, which help to keep expenditure dynamics in check.

The no-policy-change forecast assumes the implementation of the post-programme package legislated in 2017 to enter into force in 2019 and 2020, in a fiscally broadly neutral manner. The authorities have reiterated their commitment to achieve the primary surplus target of 3.5% of GDP agreed with the Eurogroup in June 2018. At the same time, Greece's Draft Budgetary Plan indicated the government's intention to replace the measures pre-legislated for 2019 by an alternative policy package. The size and the design of the compromise package are still under discussion and it has not been included in the current projection.

While continued improvements in the collection of tax debt represent an upside, there are also important 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 new policy initiatives affecting the public wage bill.

Overall, under the no-policy-change assumption, the general government balance is expected to remain stable at 0.6% of GDP over the forecast horizon. In view of the projected narrowing of the output gap, the structural balance is forecast to gradually decline from around 4.0% of GDP in 2018 to 1.5% of GDP in 2020. Greece's public debt is expected to peak at 182.5% this year and to decline to 167.4% of GDP by 2020 on account of the recovery of growth and the high primary surpluses forecast.

(68) The primary balance monitored under the Enhanced Surveillance excludes *inter alia* SMP and ANFA revenues, revenues from the sale or lease of real estate, bank recapitalisation costs and migration-related expenditure.

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	**2.0**	**2.0**	**2.0**
Private Consumption	123.8	68.7	0.4	-0.2	0.0	0.9	**0.8**	**0.4**	**0.7**
Public Consumption	35.7	19.8	0.7	1.6	-0.7	-0.4	**1.2**	**0.2**	**0.3**
Gross fixed capital formation	23.2	12.9	-3.4	0.7	4.7	9.1	**-2.1**	**14.6**	**9.6**
of which: equipment	10.5	5.8	-0.9	7.3	-11.4	22.2	**-9.4**	**18.5**	**9.5**
Exports (goods and services)	59.5	33.0	4.3	3.1	-1.8	6.8	**8.4**	**5.7**	**4.4**
Imports (goods and services)	61.3	34.0	1.8	0.4	0.3	7.1	**3.6**	**6.1**	**3.9**
GNI (GDP deflator)	181.0	100.4	0.2	-0.6	-0.1	1.4	**1.4**	**2.2**	**2.3**
Contribution to GDP growth: Domestic demand			0.1	0.3	0.4	1.6	**0.5**	**2.1**	**1.8**
Inventories			0.0	-1.6	0.1	0.1	**0.0**	**0.0**	**0.0**
Net exports			0.3	0.9	-0.7	-0.1	**1.6**	**-0.1**	**0.2**
Employment			-0.4	0.7	0.5	1.5	**1.8**	**1.6**	**1.2**
Unemployment rate (a)			13.7	24.9	23.6	21.5	**19.6**	**18.2**	**16.9**
Compensation of employees / head			2.7	-2.4	-0.9	0.5	**0.9**	**1.3**	**2.0**
Unit labour costs whole economy			2.0	-1.3	-0.3	0.6	**0.6**	**0.9**	**1.2**
Real unit labour cost			0.0	-0.9	0.0	0.0	**0.1**	**-0.2**	**-0.1**
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**	**1.2**	**1.0**
Terms of trade goods			-0.1	0.6	-2.3	1.2	**0.4**	**-1.0**	**0.2**
Trade balance (goods) (c)			-14.5	-9.1	-9.3	-10.3	**-9.4**	**-10.2**	**-10.2**
Current-account balance (c)			-9.3	0.1	-0.6	-1.0	**-0.2**	**-0.2**	**0.3**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-7.7	2.5	1.0	0.1	**1.0**	**1.0**	**1.4**
General government balance (c)			-8.1	-5.6	0.5	0.8	**0.6**	**0.6**	**0.6**
Cyclically-adjusted budget balance (d)			-7.0	0.2	5.8	4.9	**3.6**	**2.5**	**1.5**
Structural budget balance (d)			-	2.8	5.1	4.6	**4.0**	**2.3**	**1.5**
General government gross debt (c)			125.3	175.9	178.5	176.1	**182.5**	**174.9**	**167.4**

(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.