Hellenic Fiscal Council

Summary of Autumn Report – November 2018

During the first nine months of 2018 fiscal policy recorded a satisfactory performance being executed within the budgetary targets of the medium-term fiscal strategy (MTFS) 2019-2022. Both the current fiscal performance and the fiscal projections of international institutions point to the estimation that the primary surplus target of 3.5% of GDP will be achieved and an over-performance is highly likely. A payment of the so-called "social dividend" will be made feasible following a significant overperformance.

Indirect tax revenues, especially VAT, overperformed compared to the previous year, being also higher than the MTFS targets. On the contrary, **direct tax revenues** were lower than the previous year and underperformed against the MTFS target. The underperformance against the MTFS target is attributed mainly to lower cash collections of personal income tax and corporate income tax. Thus, a close monitoring of direct revenues developments is necessary over the coming months.

Government expenditures recorded a slight increase compared to 2017 mainly due to the increase of expenditures concerning "salaries and pensions", "social security, healthcare and social protection", "payment of government guarantee calls" and "earmarked revenues" granted mainly to Greek municipalities. However, it has to be noted that the aforementioned expenditure increases, remain within budget targets and are not expected to exceed them on a yearly basis. Furthermore, the estimates of the Ministry of Finance for the 2018 budget execution incorporates the scenario of retroactive costs due to court decisions. These costs are estimated at approximately €800 million. Nevertheless, an extraordinary increase of the number of the beneficiaries (much higher that the estimations) is an extra downside risk of the budget execution for 2018 and subsequent years.

The stock of General Government (GG) arrears has decreased significantly for the second year in a row. However the plan for clearing the outstanding stock of arrears to the private sector by the end of the economic adjustment programme (August 2018) was not achieved. Nevertheless, the aforementioned significant improvement in itself constitute a considerable positive event.

As far as the **public debt** is concerned the debt-to-GDP ratio, followed an upward trajectory during 2018. The debt built-up in 2018 is attributed to the increased accumulation of cash buffers through cash management actions. However, a considerable decrease is expected for the coming years.

The Greek fiscal policy for 2019 relies on two alternative scenarios: a) the baseline scenario predicts a GG primary surplus of 4.2% of GDP and b) the alternative so-called "corrective" scenario (without the implementation of pension cuts) which predicts a GG primary surplus of 3.6% of GDP. In this context, the fiscal target for 2019 is considered as achievable for both scenarios. In any case, the target path is strongly related to the fiscal carry over effect of 2018, the realization of the macroeconomic projections and the outcome of the negotiations within the Eurogroup for the budgetary scenario to be adopted for 2019.

Regarding the macroeconomic developments, the Greek real GDP recorded positive rates of change during the last quarters, however further acceleration is necessary. The estimation of the Ministry of Finance for a GDP growth rate of 2.1% is considered achievable being in line with the baseline scenario of Council's macroeconomic projections.

During the first semester of 2018, private consumption recorded a positive dynamic with the consumer confidence index being improved continuously. A powerful credit expansion is necessary to boost further the private consumption in Greece.

On the contrary, **investments** (measured by the gross fixed capital formation) underperformed during the first semester of 2018. The decrease of private investments is mainly attributed to the category of "transport equipment" due to a strong base effect and due to a significant decrease of investments in shipping. To be noted that all the other categories of investments (machinery, telecommunications equipment, housing, construction, etc.) were higher than last year respective semester.

Constant improvements have been recorded in the **labor market** during 2018, with the rate of unemployment falling below 20 percent, for the first time since 2011. It is positive that the rise in employment over the second quarter of 2018 came from increases in full-time rather than part-time jobs, with the former increasing by 2.4 and the latter decreasing by 3.2 percent relative to the previous year's respective quarter. Consequently, full-time employment reached 90.6 percent of total, slightly increased relative to 90.1 percent in the second quarter of 2017. **Of serious concern remains the long term unemployment whose level surpasses 72% of total.**

The Hellenic Fiscal Council along with other international and domestic forecasts converge to the view that GDP growth for 2019 will lie between 2 and 2.5 percent. Consequently, the rate of 2.5 percent set by the Ministry of Finance, is assessed by the Council as achievable, under certain conditions.

The macroeconomic forecasts are subject to certain challenges and risks for 2019, which should be taken into account:

(a) Normalization of the proper functioning of the Greek banking system, a course that depends crucially on meeting the targets to reduce the proportion of Non-Performing Loans (NPLs) in the Greek banks' asset portfolios as well as on securing the necessary inflows of deposits to the banks. Given the reduction of NPL, the rate of credit expansion in 2019 will be crucial in supporting private consumption and investing.

(b) Improvements in the current credit conditions of the Greek public and private sector internationally, which are linked, to some extent, to the country's creditworthiness. The forecast scenario by the Ministry of Finance foresees a consistent reduction in the Government Bond yields from 6 to 4 and 3.8 percent for the years 2017, 2018 and 2019 respectively. This may lead to further improvements in the investment climate and the economic confidence in Greece.

(c) Demographic trends and migration flows of Greek citizens abroad (the so-called "brain drain"). These are both crucial to the evolution of labor force and unemployment in Greece as well as to the evolution of the share of labor's to total income in the economy. These factors also affect the contribution of labor to the formation of the Greek potential output.

(d) Risks and uncertainties regarding world's economic growth and the international economic environment as well. These refer mainly to the escalation of world trade tensions and the rise of trade protectionism, the increased public and private debt observed in developed countries as well geopolitical tensions fueled by the refugee crisis. In relation to the European Union, managing fiscal consolidation in Italy within the rules of the Growth and Stability Pact and the course of the 'Brexit' constitute two major issues of concern.

e) The destabilizing dynamics of the electoral cycle requires particular attention. These destabilizing effects have been drastically limited during the period of the implementation of the economic adjustment programs but henceforth cannot be underestimated. The prolonged period of fiscal consolidation in Greece may signal the growth of social tensions that will test the consistency of prudent fiscal policy implementation.

Athens, November 15, 2018

The President of the Board of Directors

Prof. Panagiotis Korliras