HELLENIC FISCAL COUNCIL

Autumn 2020 report – November

Executive Summary

In the second quarter of 2020, GDP was sharply reduced by 15.2% (y-o-y) while the overall downturn in the first semester was recorded at 7.9%. All GDP components deteriorated. More specifically, during the first semester private consumption dropped by 6,1%, public consumption by 1% , fixed capital formation by 8,4% and exports by 15%. Imports were also reduced by 9.2% offsetting to a small extent the loss in the export activity.

The added value of most sectors of the Greek economy suffered a significant contraction in the first half of 2020, on an annual basis. The "retail, wholesale, catering and hotels etc." sector experienced a significant decrease of 19,5%, much higher than the EU average (-14,5%). Similarly, in sectors such as the "arts-entertainment etc." (-22,3%), the professional, scientific, technical and administrative services (-12,7%), the financial services (-8,3%) and the agricultural sector (-6,8%) the drop was higher than the European average as well.

HFISC in the Assessment of the Macroeconomic Forecasts of the 2021 preliminary Draft Budget[1], had already pointed out that the projected GDP downturn of 8,2% by the Ministry of Finance (MoF) in 2020 was more optimistic than the HFISC's adverse scenario. In this vein, HFISC is of the view that the GDP downturn is likely to exceed its adverse projection of 9,8% for the current year.

During the first 9 months of 2020 the general price index turned negative, particularly after the Covid-19 outbreak and as result Greek economy recorded a deflation of -2,3% in September.

According to the latest data, employment in August 2020 was contained further by 3.821,2 employees and thus leading to a decline in total employment by 99,4 thousand employees compared to August 2019. The Greek Database for Unemployment Registration "Ergani" also showed a negative trend regarding the

[1] https://www.hfisc.gr/en/ekfrasi-gnomis/assessment-macroeconomic-forecasts-2021-draft-budget

employment evolution. The final employment balance in the first half of 2020 was limited to 43,394 jobs, compared to 296,466 thousand jobs in the corresponding period in 2019.

The coronavirus outbreak led to a significant deterioration of the current account balance. For the period of January-August 2020 the deficit reached €7,869 million, higher by €6,865 million compared to the same period of 2019. The current account deficit reflects the reduction by €10,676 million in the surplus of the services balance (-70%) which can be decomposed into a drop in the travel balance by €9.331 million (-81.7%) and a drop in the transport balance by €1,222 million (-30.4%). It is highlighted that due the pandemic the inbound tourism was contained to just 4.8 million people in 2020 against 21.8 million arrivals in 2019. In this respect, receipts from tourism were reduced by €10.5 billion (-80%), reaching to €2.7 billion, much lower than €13.2 billion in 2019.

The positive trend on corporate deposits in the Greek banking system following the pandemic outbreak was maintained and increased by 7.5% in March, 6.2% in May and 9.5% in July while deposits in September increased by 3.7% as well. As of March 2020, corporate deposits have been increased by €5.6 billion while households deposits increased by €2.6 billion in absolute numbers. This expansion in deposits amid pandemic apart from being essentially a “forced” deposit driven by the restrictions in consumption due to the confinement measures, may also reflect a negative effect on economic sentiment. At the same time, especially with regard to the increase in corporate deposits, it is likely that part of the government's grants and transfers would ultimately be directed towards savings, which, at the current juncture, is not a positive development.

Although it is rather early to estimate the additional burden to the economy of the new coronavirus containment measures, it is now quite clear that the economic downturn in 2020 is likely to be much deeper than what has been initially projected by the Ministry of Finance (8.2%). Hence, the projected GDP growth of 7.5% by the MoF in the year to come, is considered to be highly unlikely due to the resurgence of the pandemic this autumn.
The major downside risks for the 2021 macroeconomic developments are:

- The lower than anticipated macroeconomic performance in 2020
- The carryover of the negative effects of the pandemic in 2021.

- Uncertainties regarding the frontloaded absorption of funds under the Recovery and Resilience Facility
- The weak rebound in employment and wages
- The cautious fiscal policy as depicted in the preliminary draft budget.
- The possible geopolitical tensions in the N.E. Mediterranean.

Between January and September, the State budget recorded a deficit of more than €9 billion due to excessive spending and the drop in revenues. The fiscal balance is expected to deteriorate by the end of the year due to:

- The recent restrictions on economic and social activity.
- The additional supportive fiscal measures.
- The retroactive payment of 1.4 billion euros in pensions stemming from court decisions.

In this light, it is very likely that the General Government's primary deficit in 2020 will exceed 6% of GDP while public debt is expected to increase above 200% to GDP at the end of the year.

Despite the restriction of economic activity affecting Europe as a whole, the yields of the ten-year Greek bonds recorded a historically low level below 0.8%, undoubtedly assisted by the ECB decision to accept Greek bonds as collateral during Covid-19 pandemic mainly to the ECB Pandemic Emergency Purchase Programme (PEPP).

Since fiscal policy in 2021 will include €2.7 billion interventions so far as supportive fiscal measures, the projected increase in tax revenues can be attributed to two sources: a) the recovery of economic activity b) the gradual repayment of 2020 tax and insurance liabilities that have been suspended, in the context of the government's one-off measures to mitigate the economic consequences of the pandemic.

Furthermore, the MoF's scenario for a GG's deficit of 3.7% of GDP and a primary deficit of 1.1% of GDP in 2021, is based on uncertain assumptions. More specifically:

- The assumption that the increase in private consumption by 6.5% would result in an increase of 22.6% of VAT revenues.
- An increase in employment income by 8% will bring about a growth in income tax by 4.1% under the precondition that will affect the higher income class.

- The estimation of a 8.5% change in nominal GDP will lead to an increase of tax revenues by 11.1% is not supported by historical data. The historical rule shows that the percentage increase in tax revenue falls short of the percentage change in GDP.

The government fiscal balance of 2021 will be largely affected by two decisive parameters: (a) Nominal GDP growth and (b) the potential prolongation of the health crisis in 2021. Should the projected GDP growth is not materialise and the impact of the pandemic is maintained beyond the first quarter of 2021, then additional fiscal measures will be required burdening further the public finance compared to MoF's fiscal projections.