Euler Hermes Economic Research

Country Report

Greece

Is this the end of 6 years of crisis?

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Executive summary

- In 2014, the economy will not contract for the first time In 6 years (0%). In 2015, we expect moderate growth of +0.8%.
- Falling consumer prices and the state of the banking sector remain high downside risks in the short-term.
- The rebalancing process is ongoing: Greece has achieved its first current account surplus in over 60 years.
- The achievement of a primary balance surplus in 2013 increases the likelihood of a new debt relief before the end of the EU/IMF programme in December 2014.

GDP is expected to stabilize at weak levels

The pace of GDP contraction eased in 2013 (see Chart 1) and it reached -0.9% y/y in Q1 2014. Private consumption was up by 0.7% y/y, the first increase since start 2010 while exports accelerated strongly (+5.4% y/y), for the 4th consecutive quarter in positive territory. We expect this positive trend to continue as domestic activity starts to show visible signs of a pick-up. GDP growth should stabilize in 2014 (0%), after 6 years of recession, and grow moderately in 2015 (+0.8%) – see Chart 2. The improvement in business sentiment and the progressive pick-up in economic activity should lead to a drop in business insolvencies in 2015 (-4%) after a moderate rise in 2014 (+3%). Even so, business insolvencies will remain 3 times higher than in 2007.

Falling consumer prices and the state of the banking sector remain high downside risks in the short-term

Credit has been continuously declining since 2011 and the stock of credit to non-financial corporations declined by more than 20% over the period. This coupled with very high unemployment rate (27%), strong internal devaluation through adjustments in wages, overcapacity in the industry and a strong euro has triggered a fall in prices and deflationary pressures have been visible since March 2013. Prices are expected to continue to fall in 2014 (-0.6% after -0.9% in 2013), and to stabilize in 2015 (+0.1%). Greek banks suffered heavy losses on both their investments in Greek sovereign bonds and their loan books, due to the protracted recession of the Greek economy. An

Chart 1: GDP growth and contribution to GDP growth by component

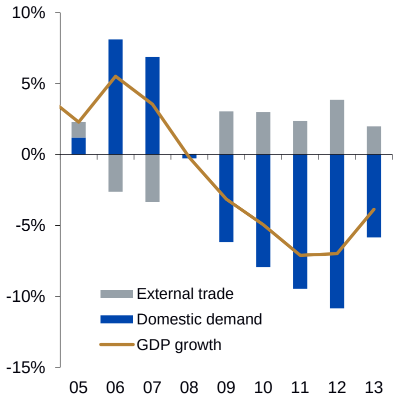
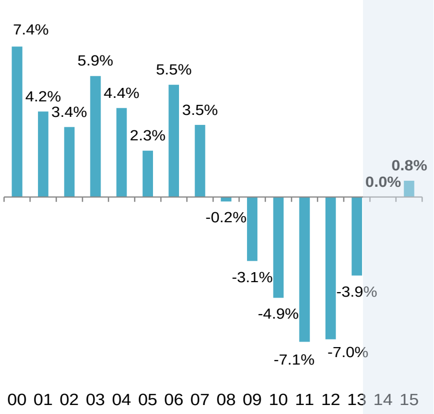


Chart 2: GDP growth forecasts



Sources: IHS Global Insight, Euler Hermes forecasts

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envelope of EUR50bn has already been used for recapitalization but more funds are necessary (EUR6.4bn in the next 3 years) as the banking sector suffers from a high level of non-performing loans (33% of total loans at end-2013). The results of the ECB Asset Quality Review and Stress Tests expected in October will bring more clarity on the state of the banking sector.

Reforms start to pay: first current account surplus in more than 60 years

Greece achieved a current account surplus in 2013, for the first time in over 60 years (see Chart 3). The Services balance improved significantly on the back of increasing tourism receipts, while the Goods balance deficit fell by EUR2.4bn given the fall in imports of goods (-4.5% vs. 2012) and the rise in exports of goods (+2.3%). This is indeed encouraging for the country as it shows that the rebalancing process is ongoing. Indeed, Greece is projected to regain its 1995 labour cost competitiveness relative to the eurozone by 2014. Unit labour costs fell by 20% since 2009. The continuation of structural reforms would allow a sustainable improvement in the current account balance even once domestic demand picks up (increased imports). We expect the current account surplus to average +0.5% of GDP in 2014-15 after +0.8% in 2013.

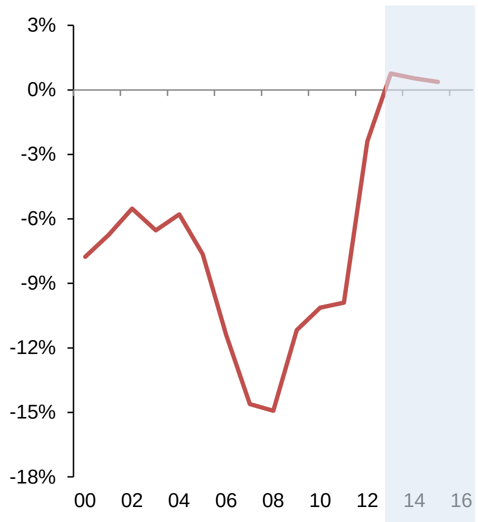
Financial pressure eased significantly

In April 2014, Greece issued EUR3bn of 5-year bonds at a yield of just below 5% after 4 years of no access to the bond market. Demand was very high with an order book of EUR20bn showing strong investor appetite. This was mainly driven by a broad return in confidence in Southern European countries given improving economic prospects since H2 2013, ongoing fiscal consolidation efforts, the successful bailout exit for Ireland last December and the return of capital from emerging markets to Southern European countries that offer a better risk-return ratio. Indeed, the Greek debt is now seen as less risky, given the fact that only 21% is held by the private sector through bills and bonds. Bond yields have decreased considerably and economic sentiment is on a positive trend - see Chart 4.

A new debt relief before the end of the EU/IMF programme in December 2014 ?

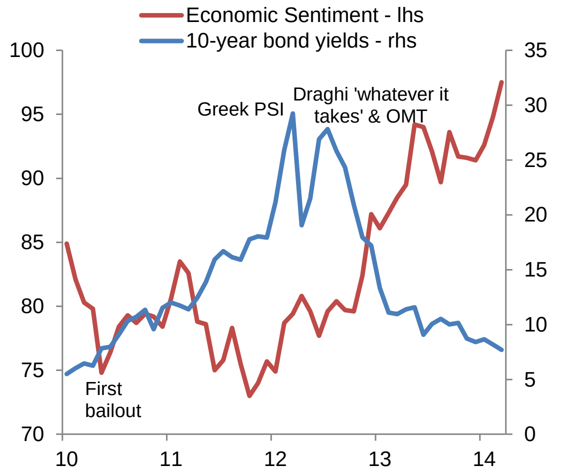
In 2013, primary balance has reached a EUR1.5bn, i.e. 0.8% of GDP that was the imposed condition for Greece to obtain further debt relief from the EU/IMF. Fiscal deficit reached 3.2% of GDP from 6.4% in 2012 and it is expected to attain 3.0% of GDP in 2014. Greece has already obtained a debt relief under the form of higher loan maturity (30 years) and lower interest rates on the EU loans. Recent rumors suggest that some of the EU loan maturities could be extended up to 50 years and/or lower interest rates. This measure seems to be the only solution able to restore debt sustainability (debt/GDP ratio at 175% of GDP in 2014, of which more than 60% is held by the EU and the IMF). The troika estimates that a EUR5bn financing gap has to be covered by mid-2015. As stated by the Greek officials, a full market access is planned for 2016.

Chart 3: Current account balance, % of GDP



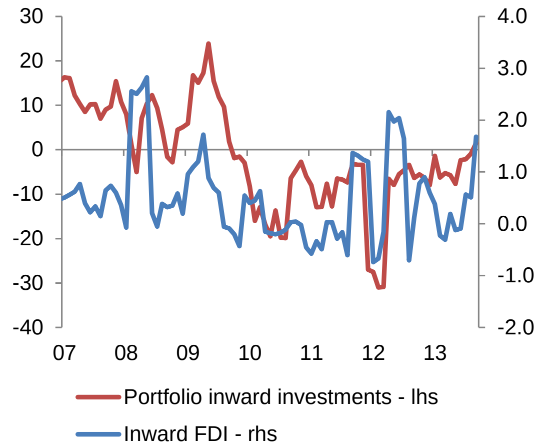
Sources: Eurostat, Euler Hermes

Chart 4: Economic Sentiment vs. 10-year government bonds yields



Sources: Eurostat, Bloomberg, Euler Hermes

Chart 5: Capital inflows, EURbn



Sources: IHS Global Insight, Euler Hermes

General Information

GDP	USD249.099bn (World ranking 42, World Bank 2012)
Population	11.28 million (World ranking 75, World Bank 2012)
Form of state	Parliamentary Republic
Head of government	Antonis SAMARAS
Next elections	2015, presidential

Strengths

- Geographical hub
- Strong tourism revenues
- Strong adjustment in terms of competitiveness
- Current account surplus

Weaknesses

- Weak business environment
- Weak industrial base.
- High fiscal pressure on companies
- Falling consumer prices
- Low R&D expenditures
- Decreasing long term per capita income
- Weak governing coalition

Trade structure

By destination / origin

Exports		Rank		Imports
Italy	9%	1	11%	Germany
Germany	8%	2	10%	Italy
Turkey	7%	3	9%	Russia
Cyprus	6%	4	6%	Netherlands
Bulgaria	5%	5	6%	Other Gulf

Source: Chelem

By product

Exports		Rank		Imports
Refined Petroleum Products	29%	1	16%	Crude Oil
Non Ferrous Metals	6%	2	8%	Pharmaceuticals
Iron Steel	4%	3	7%	Refined Petroleum Products
Other Edible Agricultural Pro	4%	4	3%	Plastic Articles
Preserved Fruits	4%	5	3%	Natural Gas

Source: Chelem

Risk Dimensions

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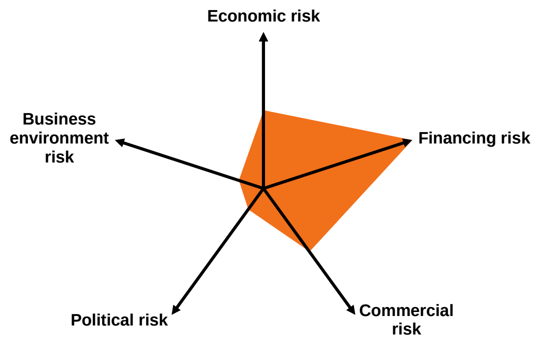

Source: Euler Hermes

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