HELLENIC FISCAL COUNCIL

Bi-annual report, June 2020 - Executive Summary

The COVID-19 pandemic has caused severe turbulence in the world economy and the current economic situation is considered much worse than the financial crisis of 2007-2008. The pandemic is adversely affecting the Greek economy due to the economic uncertainty and the containment measures that have been taken. The recession for 2020 is projected to be deep though the exact figure cannot be precisely determined at this point.

Compared to the previous year GDP decreased by 0,9% in the first quarter of 2020 while compared to the previous quarter the recession reached 1,6%. On a yearly basis GDP dropped after twelve positive consecutive quarters. The roots of the contraction can be traced in the decrease of private consumption by 0,7% and the slump in the gross capital formation by 6,4% , mainly due to the sizeable drop in the value of the investment category "transport equipment and military systems" by 44,6% compared to the first quarter of 2019 which primarily refers to ships imports.

Deflationary pressures are evident in the first quarter of 2020 mainly due to the pandemic. The year on year percentage change of the HPCI in April was -0,9% while taking out the impact of energy, food, alcohol and tobacco (structural inflation), it remained zero.

It is inevitable that the recession will affect employment, either measured in working hours or expressed in the absolute number of employees. The impact of the lock-down in economic activity is monitored by the "ERGANI" employment information system which records the first signs of drop in employment. For the January-April 2020 period, hirings reached 512.791 while separations amounted to 539.940, resulting in a negative balance of 27.149. Compared to the same period of 2019, a negative difference by 186.924 working positions is noted.

After a stabilizing trend in total savings during 2019, data from the first quarter show an increase in total saving which was particularly accelerated during March and April. Households' deposits were increased by 1,7 bil. euros in April and by 3 bil. euros in April and March together. Given the suspension of the majority of economic activity by mid-March and April, the observed spike can be possibly attributed to the low consumers' confidence during this period. Households, not affected, increased their deposits given the reduced consumption at that period. The consumption behavior needs continuous monitoring since remaining on the low consumption trend, even after lifting the restrictions, will negatively affect the macroeconomic performance.

The impact of the pandemic also becomes evident in the fiscal performance since the state budget execution between January and April points to a deficit of 4.074 mil. euros against a 1.516 mil. euros deficit target. At the same time the primary balance was also negative and amounted to -1.516 mil. euros while in 2019 the primary balance was positive and reached 1.463 mil. euros for the same reference period. The GPD contraction and the need for expansionary policy to cushion the recessionary impact of the pandemic are heading towards an exceptionally high fiscal deficit for 2020.

With a view to tackle the adverse consequences of the pandemic, certain measures have been adopted and more are in the pipeline in order to boost the domestic and global economy.

For the first time in the history of the Stability and Growth Pact (SGP), the European Commission activated the general escape clause on the 20th of March, 2020 which was approved by the European Council on the 23rd of March. This entailed the suspension of the fiscal discipline provisions of SGP and Member States were granted fiscal flexibility in order to take all the necessary steps to support the health and safety of their citizens as well as to tackle the economic impact of the pandemic in a coordinated fashion. In this context, the country specific primary balance target of 3,5% under the enhanced surveillance framework for Greece is also suspended.

On the 18th of March ECB announced that Greek sovereign debt will be eligible for transactions under the QE programme, which led to a rapid drop of the Greek bonds yields after a period of consecutive increases that led to a yield as high as 3,8%[1]. According to May ECB data and given the total QE size of 750 bil. euros , Greek bonds purchases account to 4,69 bil. euros out of 186,6 bil. euros of total purchases so far. This support will not only be limited to the 40 bil. euros of Greek bonds currently on the market but will also extend to new issuances for as long as Greek bonds will remain eligible.

On the 9th of April, the finance ministers of the Eurozone agreed that a common strategy to counteract the adverse economic impact of the pandemic is necessary. This strategy includes the activation of the procedure that is based on the existing precautionary credit line of the European Stability Mechanism (ESM). Each of the

[1] As of 18/6/2020 the 10 years Greek bond yield is around 1,3%.

affected countries can draw credit from ESM resources up to 2% of its last year's GDP. This means that if all Member States benefit from this tool, the total available liquidity will be 240 bil. euros. Access to the credit line will be unconditional, provided that all resources will be directed to face the direct and indirect costs that are associated with the pandemic. In this respect, the maximum amount that Greece can claim under this facility is 3,8 bil. euros (2% of 2019 GDP).

On the 27th of May the European Commission announced a medium to long-term ambitious financing plan of 750 bil. euros with a view to support European economy and strengthen the prospects for a sustainable recovery. This plan will take the form of loans and subsidies, with the latter not being recoverable as it will be the case with loans. This plan comes on top of the financial assistance that has been agreed under the ESM framework as well as the SURE programme (for assisting employment) and the EIB funds and amounts to total 540 bil. euros. The maximum amount of resources that can be directed to Greece both in loans and subsidies could be 32 bil. Euros, while it needs to be noted that this provision does non substitute the regular flow of resources that originate from the EU structural funds. However, certain aspects of the plan are not yet clarified.

Given the acute conditions, the Government adopted a series of economic measures aiming at containing the negative economic impact of the pandemic crisis. According to the 2020 Stability and Growth Programme the total fiscal burden on the 2020 state budget will be around 9,5 bil. euros[2]. This impact does not only concern the expenditure side but also includes the drop in revenues stemming from measures such as the deferral of tax obligations or tax deductions. In this case the budgetary impact is due to the loss of revenues that were expected to materialize within 2020 but have been deferred for the future. 73.7% of the total 9.5 bil. euros of measures concern transfers, 16.4% are related to suspension or extension of tax and insurance payments, 3.6% are linked to tax reductions and finally 6.3% will be translated into public consumption.

A major concern for 2020 is the possibility that a pandemic rebound may occur and new containment measures will be placed, impacting again economic activity and shrinking consumption as a result of the generalized uncertainty. If that happens the recessionary pressure will be even higher and the budgetary impact more severe.

[2] A further 2 bil. euros are expected to be mobilized in the form of guaranteed loans through the Greek Development Bank

The effectiveness of the measures that have been adopted to contain the recession will largely depend on their timely and efficient implementation, particularly when it comes to the 2 bil. euros guarantee through the guarantees fund of the Greek Development Bank. According to the Ministry of Finance, these guarantees are expected to mobilize 7 bil. euros in resources, a projection that is likely to prove overambitious. Additionally, the credit that will be directed towards the guaranteed loans may not necessarily reflect new funding, being merely a reshuffling of existing funds that would had been allocated anyway by banks to other beneficiaries. In case this happens, the state intervention will be distortive to the extend that funds will be transferred to less efficient investment projects, possibly leading to a new generation of NPEs, increased forfeitures and ultimately fiscal burden.

An additional downside risk that could slow down the economic recovery is related to the possible non-temporary nature of wages reduction that will prevent private consumption from returning to pre-crisis levels.

Although 2020 fiscal targets have been suspended, the terms of the agreement with the European Partners regarding the future targets are yet not known. If a tight fiscal agenda is back on the table, recovery will be jeopardized.

The economic prospects of the Member States and of Europe as a whole rely heavily on the decisions taken at the European level. If a political agreement regarding the nature and magnitude of the support is not swiftly in place, uncertainty will soar and the ability of EU to adopt the necessary measure to tackle the crisis will be questioned.