Greek Outlook 2016: Backloaded measures require frontloaded action

PIRAEUS BANK

Economic Research & Investment Strategy

June 2016

Ilias Lekkos Lekkosi@piraeusbank.gr
Irini Staggel Staggelir@piraeusbank.gr
Anastasia Aggelopoulou Aggelopouloua@piraeusbank.gr

Déjà vu all over again

The felling of déjà vu for the Greek economy is growing once again. Similar to what we have seen time and again over the last 7 years as soon as the Greek economy starts showing some signs of life there comes a new period of prolonged and intense negotiations between the Government and the Institutions ultimately resulting in a new and substantial wave of fiscal austerity, which in turn drags the Greek economy back to recession. With GDP contracting by 1.4% (YoY) in Q1-2016 and with a new set of fiscal consolidation measures equal to 2.2% of GDP to be introduced in the second half of the year, urgent action is required by all sides in order to limit the depth and duration of economic contraction.

PIRAEUS BANK

Déjà vu all over again

In what follows we estimate a number of macroeconomic scenarios starting from the most pessimistic one where the economy feels the full effect of the austerity measures without any mitigating actions. In that scenario the economy will contract by **-2.8%**. *We believe that the prospect of such an adverse outcome should motivate all policy makers to spring into action.*

We also estimate a scenario under which Greek households, in an attempt to cushion the impact of austerity on their living standards, reduce their savings even further, limiting somewhat the size of economic contraction to **-2.5%**.

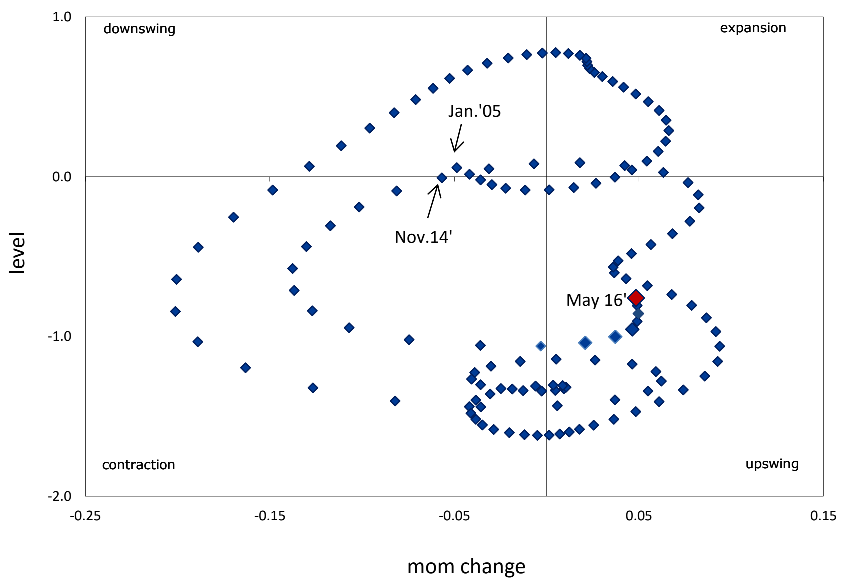
Yet, the only factor with true recession – mitigating potency is the clearance of Government Arrears which ***if distributed timely*** could help limit the level of GDP recession to **-1.1%.**

A bird's - eye view of the Business Cycle

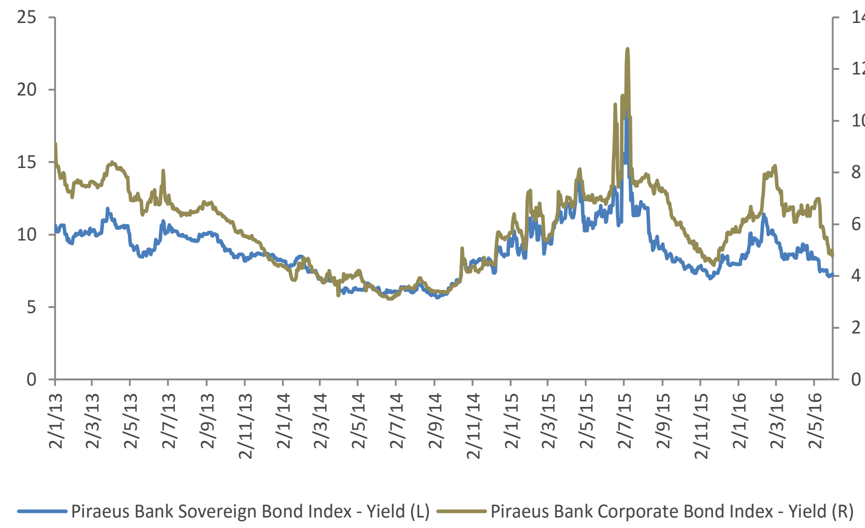
Despite the prolonged uncertainty and speculation regarding the progress of the negotiations and expectations for a new set of substantial fiscal consolidation economic sentiment at 89.7 points remains in the "recovery" stage of the business cycle.

Financial Markets on the other hand have already priced-in the successful conclusion of the negotiations and the disbursement of the next tranche.

Economic Climate Tracer



Piraeus Bank Greek Sovereign & Corporate Bond Index Yields (Weighted Average)



Yet another wave of fiscal consolidation to hit Greek shores

The fiscal path based on **primary surplus targets** (as % of GDP) of:

2015	2016	2017	2018 and beyond…
Target : -0.25% (outcome: +0.7%)	0.5%	1.75%	3.5%

Total new fiscal measures *legislated: 3.0% of GDP, of which 2.2% in 2016*

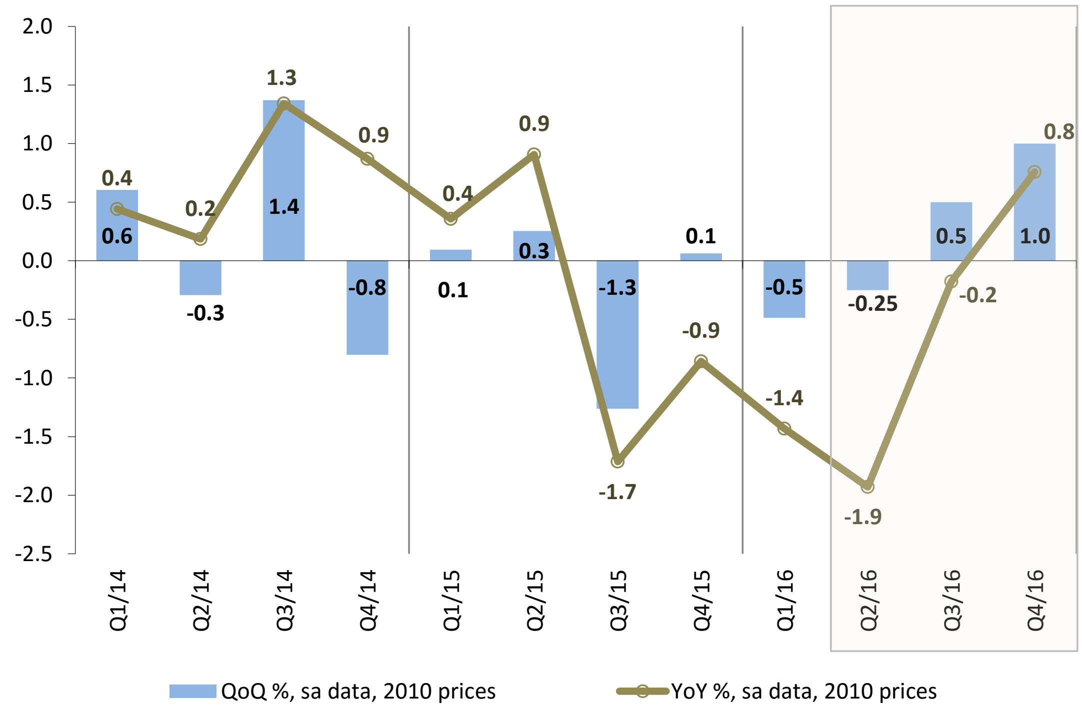
		2016	2017	2018	2019
Measures Legislated Jan.-May 2016	VAT reforms	255	437	437	437
	Tax reforms	298	382	456	456
	Personal income tax reforms	1,700	1,700	1,700	1,700
	Excise duty tax reforms	597	597	610	610
	Pension reforms	1,206	1,903	2,571	2,708
	Other reforms	-221	-234	-247	-260
	Total Measures Legislated Jan.-May 2016 (€ mn)	**3,835**	**4,784**	**5,526**	**5,650**
	as % of GDP	**2.2**	**2.7**	**3.0**	**3.0**

Source: MinFin, European Commission, Hellenic Parliament, Piraeus Bank Research

Pre-agreement Real GDP Scenario (no measures): -0.7%

Following the release of Q1-2016 real GDP figures of -0.5% QoQ (-1.4% YoY) contraction we revised downwards our Q2-2016 estimates from 0% to -0.25% while keeping H2-2016 unrevised.

Real GDP growth rate

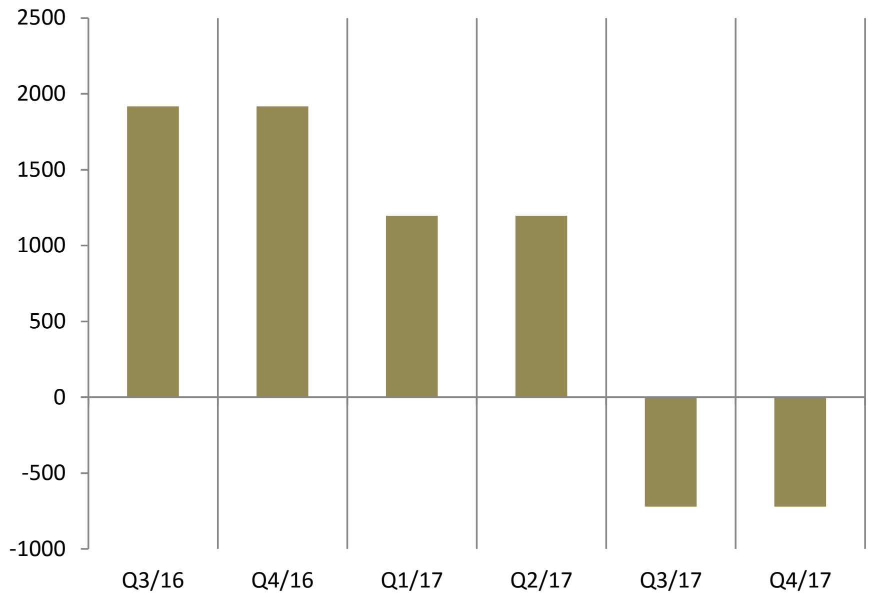


Should Fiscal Multiplier equal 1: Implications for growth

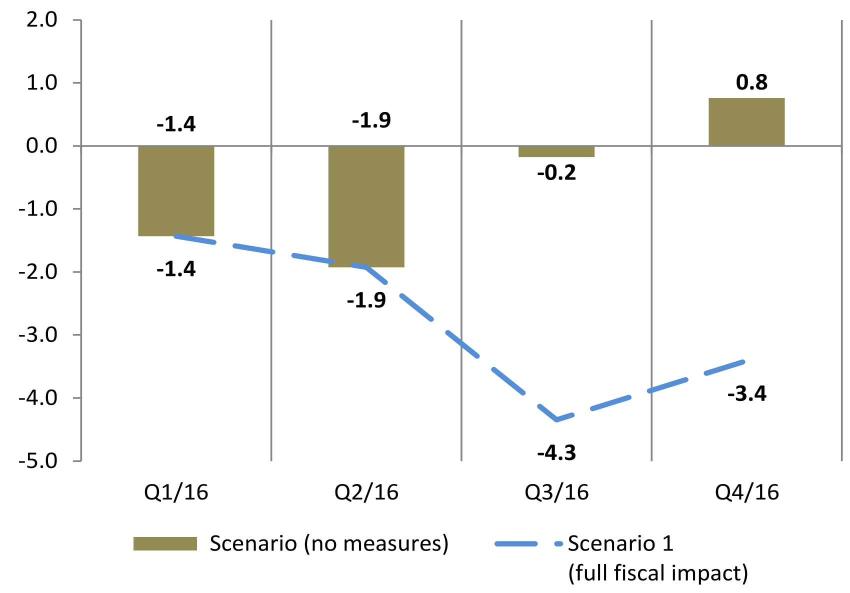
The incremental impact of the new agreement on fiscal revenues is estimated at €3.8 bn in H2-2016 and €0.95 bn for the full-2017. The result of this uneven distribution of the phasing in of the new measures is that the marginal impact of the measures will be extremely severe in Q3 & Q4-2016, will decline in Q1 & Q2-2017 and will even turn negative in Q3 & Q4-2017.

A full pass-through of the measures to growth (fiscal multiplier=1) with no mitigating actions will push ***GDP growth down to -2.8%.***

Incremental Impact of the New Measures (€ mn)



Real GDP growth rate (YoY % change)

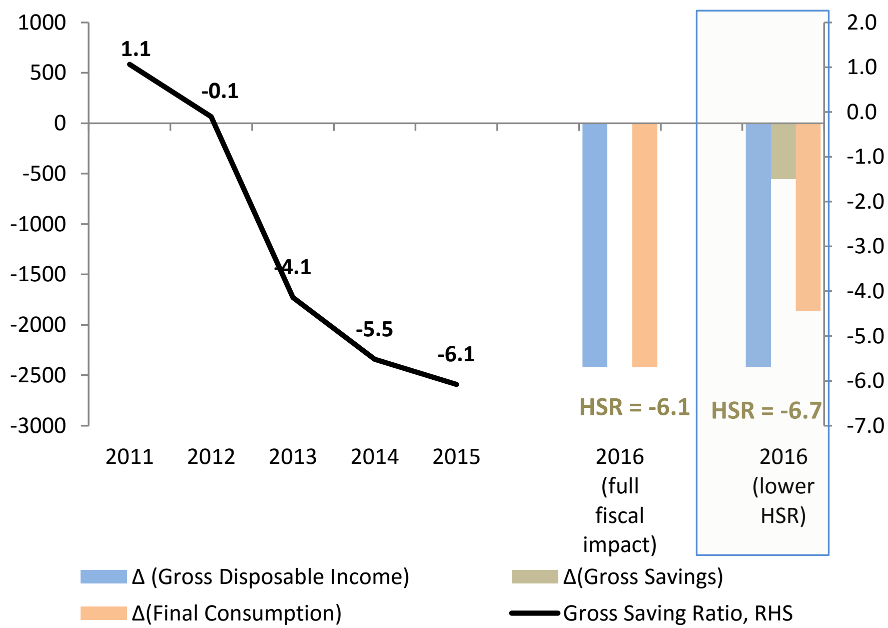


Scenario 2: Savings to cushion the blow

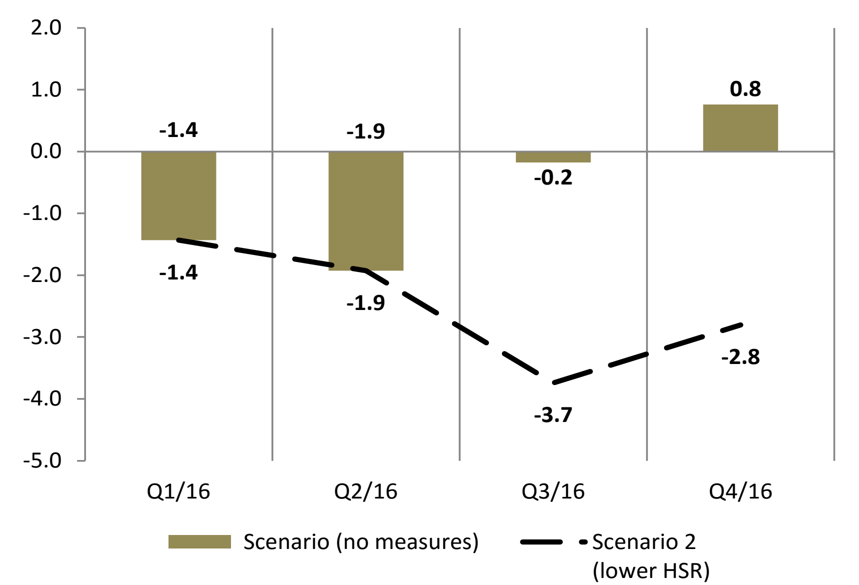
Experience has taught us that Greek households, when buffeted with new austerity measures, lower their saving ratio as they try to maintain their living standards. For example, in 2014 household saving ratio (HSR) stood at -5.5% (of disposable income) which declined to -6.1% in 2015 thus limiting the extend of the recession.

If we assume that HSR will decline by another 0.6% to -6.7%, this will mitigate the impact of the fiscal measures ***limiting GDP contractions to -2.5%.***

Households Saving Ratio (HSR)



Real GDP growth rate (YoY % change)



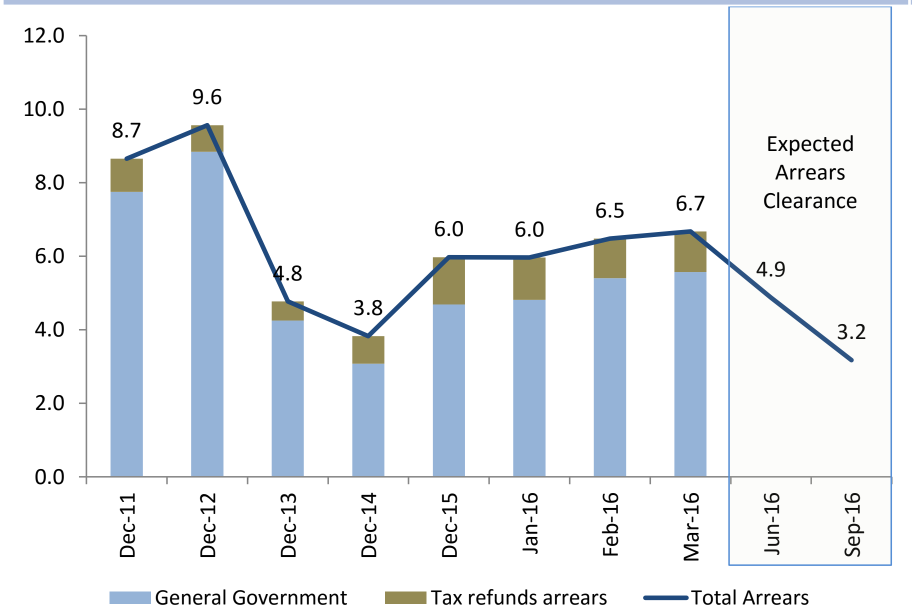
Source: MinFin, European Commission, Hellenic Parliament, ELSTAT, Piraeus Bank Research

Scenario 3: Lower HSR & Partial Arrears Clearance

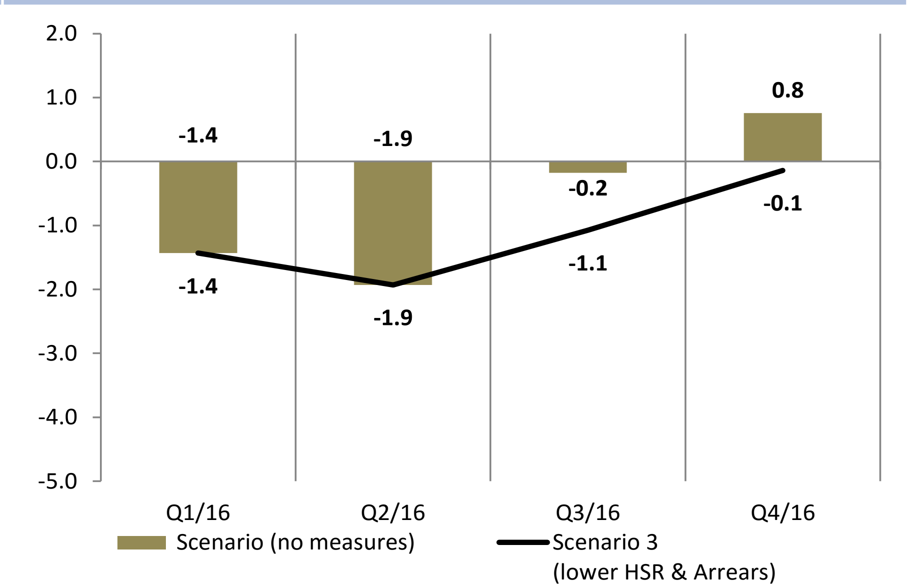
The conclusion of the Programme Review came at a significant fiscal cost but on the positive side brings new funding of at least €10.3 bn, €3.5 bn of which will be used to repay General Government Arrears.

Assuming that 70% of that amount is used for domestic payments to local suppliers or wages (with the remaining 30% used to pay for imports), then this extra "income" can be used to finance additional consumption which in turn has the potential to mitigate the impact of austerity even further. Under that scenario ***the extent of the recession is contained to -1.1%***, slightly worse than the no measures scenario of -0.7%.

Schedule of Arrears clearance (€ bn)



Real GDP growth rate (YoY % change)



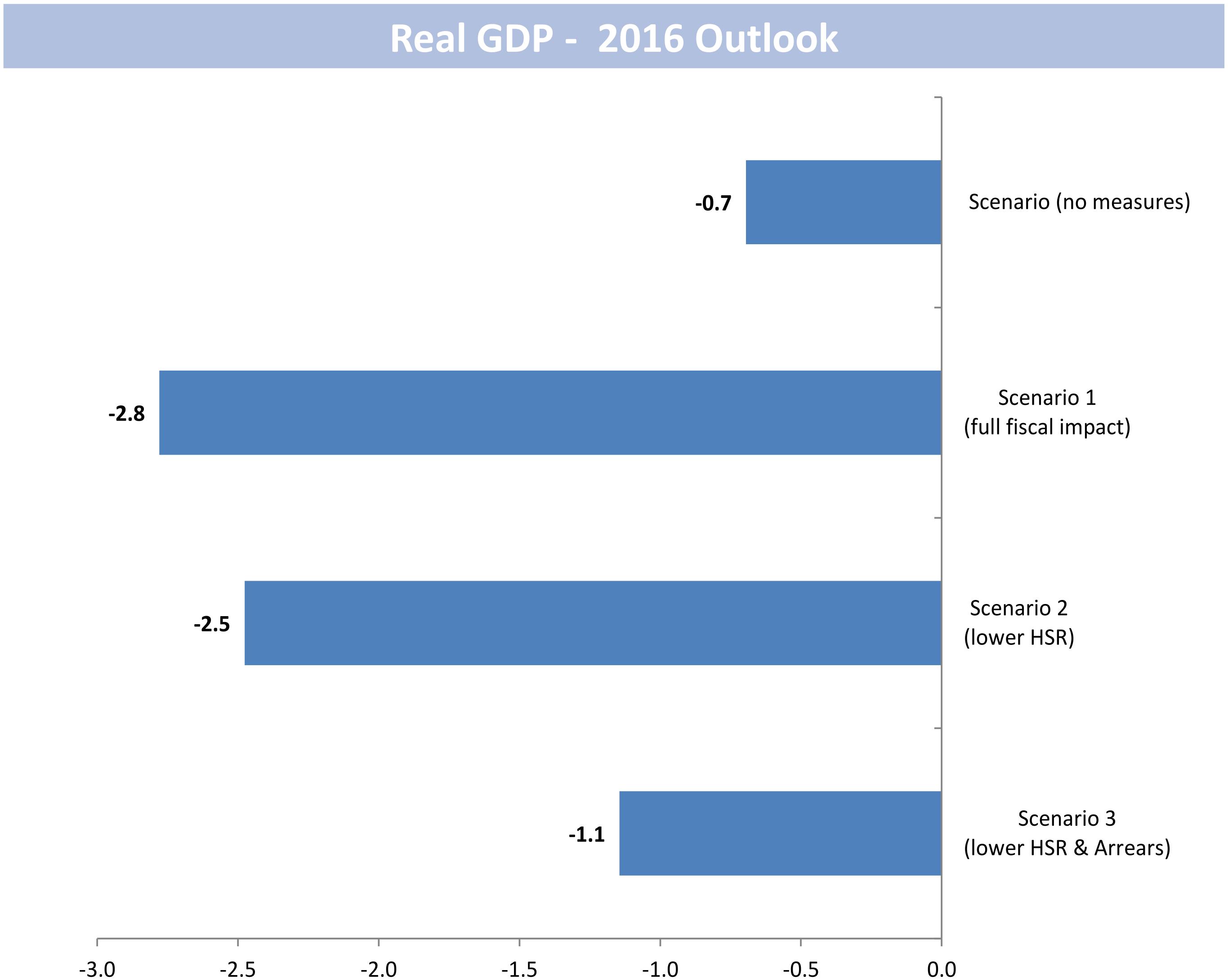
* General Government Arrears are Outstanding arrears to third parties (outside of the general government), not paid within 90 days since the date they were due and Tax Refunds Arrears refer to outstanding refunds data that have been issued and cleared until the last day of each month.

Source: MinFin, State Budget 2016, European Commission, Hellenic Parliament, ELSTAT, Piraeus Bank Research

Scenariology Overview

	Assumptions
Scenario (no measures)	Completion of 1st review based on the measures agreed in August 2015 (i.e. 1.5% of GDP) plus an update of Q1-2016 to -0.5% QoQ (vs previous estimate of -0.25%) and Q2-2016 to -0.25% QoQ (vs previous estimate of 0%)
Scenario 1 (full fiscal impact)	Fiscal multiplier =1 on legislated measures of €3.8 bn evenly distributed in Q3 & Q4-2016.
Scenario 2 (lower HSR)	Fiscal multiplier =1 and Household saving ratio decline to -6.7% from -6.1%.
Scenario 3 (lower HSR & Arrears)	Same as in scenario 2 plus a positive impact from the 70% of cleared government arrears.

Real GDP Outlook: Pick the scenario you like



Source: MinFin, Hellenic Parliament, ELSTAT, Piraeus Bank Research

Disclaimer: This document is produced by the Economic Research & Investment Strategy Department of Piraeus Bank (hereinafter “the Bank”), which is supervised by the Bank of Greece and is sent or provided to third parties, without any obligation of its author. This document or any part of it should not be duplicated in any way without the prior written consent of its author.

The information or opinions included in this document are addressed to existing or potential clients in a general manner, without taking into account the particular circumstances, the investment objectives, the financial ability, the experience and/or knowledge of the potential recipients of this document and, as a result, they do not constitute or should not be considered neither as a solicitation or offer for the conduct of transactions in financial instruments or currencies nor as a recommendation or advice for decision making in relation to those. Taking into account the aforementioned, the recipient of the information contained in this document should proceed with his/her own research, analysis, and confirmation of the information which is included in this document and seek for independent and professional legal, tax and investment advice, before proceeding with any investment decision making.

The information depicted in this document is relied on sources that the Bank considers to be reliable and is provided on an “as is” basis, however, the Bank cannot warrant as to their accuracy and completeness. The opinions and estimates herein are related to the trend of the local and international financial markets at the indicated date (prices at closing time) and are subject to changes without any prior notice. Notwithstanding the above, the Bank might include in this document investment researches, which have been conducted by third persons. In this case, the Bank does not modify those researches, but it presents them on an “as is” basis, therefore, no responsibility is assumed in relation to the content of the aforementioned investment researches. The Bank is under no duty to update the information contained in this document. Considering the above, the Bank, the members of its Board of Directors and the relevant persons assume no responsibility for the information included in the present document and/or for the outcome of any investment decisions made according to such information.

Piraeus Bank Group is an organization with a significant presence in the Greek market and an increasing one in the international markets providing a wide range of investment services. In the context of investment services offered by the Bank and/or any other Piraeus Group companies in general, there might be cases whereby conflict of interests may arise in relation to the information provided herein. Reference should be made to the fact that the Bank, the relevant persons and/or other Piraeus Group companies indicatively:
Are not subject to any prohibition in relation to trading on own account or in the course of providing portfolio management services prior to the publication of this document or the acquisition of any shares prior to any public offering or the acquisition of any other securities.
May offer upon remuneration investment banking services to issuers for whom this document may contain information.
May participate to the issuers’ share capital or acquire other securities issued by the aforementioned issuers or attract other financial interests from them.
Might provide market making or underwriting services to issuers that might be mentioned in this document.
Might have published papers the content of which is different or incompatible to the information presented herein.

The Bank as well as the other Piraeus Group's companies have enacted, implement and maintain an effective policy, which prevents circumstances that may give rise to conflicts of interests and the dissemination of any information among the departments (“chinese walls”) and they also constantly comply with the provisions and regulations relevant to inside information and market abuse. Also, the Bank confirms that it doesn’t have any kind of interest or conflict of interest with a) any other legal entity or person that could have participated in the preparation of the present document and b) with any other legal entity or person that couldn’t have participated in the preparation of the present document, but had access to it before its publication.

It is duly stated that: the investments described in the present document include investment risks, among which the risk of losing the entire capital invested. In particular, it is stated that;
The figures presented herein refer to the past and that the past performance is not a reliable indicator of future performance.
In case the figures refer to simulated past performance, that past performance is not a reliable indicator of future performance.
The return on investments might be positively or negatively affected as a result of currency fluctuations, in case the figures are denominated in a foreign currency (other than Euro).
Any forecasts in relation to future performance, may not be a reliable indicator of future performance.
The tax treatment of the information as well as transactions pertained in this document, depends on each investor's individual circumstances and may be subject to change in the future. As a result, the recipient should seek for independent advice in relation to the applicable tax legislation.

The distribution of the present document outside Greece and/or to persons governed by foreign law may be subject to restrictions or prohibitions according to the applicable legislation. Therefore, the recipient of the present should seek for independent advice in relation to the applicable legislation, in order to look into such restrictions and/or prohibitions.