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GREECE FOCUS NOTES

A Note on 2024-2026 GDP forecasts

Table 1: Greece – GDP and Expenditure Side Components

1: 2023, bn € (nominal)

2: 2023, shares in real GDP, %

3: 2024, real rate of annual change, %

	1	2	3
GDP	220.3		*2.0*
Private Consumption	150.7	70.0	2.0
Gov. Consumption	43.4	19.9	0.6
Gross Capital Formation	37.1	15.7	5.0
Exports	98.8	38.7	2.0
Imports	109.7	43.9	2.4

Sources: ELSTAT, AMECO, Eurobank Research

1. Introduction

In 2023, the Greek economy continued its over-performance vs the Eurozone for a third consecutive year, achieving a real GDP growth rate of 2% (vs 0.4% in the Eurozone). This was accompanied by a decline in the average annual unemployment rate to 11.1% of the labor force, from 12.4% in 2022, and de-escalation of the HICP inflation rate to 4.2% YoY, from 9.3% YoY in 2022.

Yet, the economy presented a picture of a slow-down during the year, partly as a result of the unfavorable external environment but also due to domestic reasons and the more general post-pandemic slowdown. Even more importantly, growth largely came from continued growth in private consumption (+1.8%), which contributed 1.3 percentage points out of 2ppts in total. By contrast, investments in fixed assets, which are an important requirement for the transformation of the growth model, registered a mild increase of 4% (0.6 ppts contribution to growth), despite the start of the implementation of the investment plans of the Recovery and Resilience Fund - RRF (and partly due to the delay in the implementation in some of them), while total capital formation decreased by -0.5% due to a decrease in inventories. Furthermore, in terms of the composition of investments, the increase came primarily from housing (+20.7% YoY at constant prices) and secondarily other constructions (+10% YoY), while the important for long-term growth segments of mechanical and transport equipment, as well as ICT equipment, fell by -3% and -12% respectively. For an order of magnitude of investment levels, with the increase of 2023, fixed capital formation in constant prices just surpassed 2011 levels, while as a percentage of GDP,

Contributing Authors:

Dr. Tasos Anastasatos
Group Chief Economist
tanastasatos@eurobank.gr

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it stood at 14.3% vs a 21.3% average in the Eurozone.

As for the external sector, it recorded a slight positive contribution to GDP (0.5 ppts), as exports of goods and services increased by +3.7% YoY, while imports by +2.1% YoY. The resilience of exports in an environment of international stagnation is important, however, from the data of the BoG it appears that the increase comes from services and especially tourism (+15.7% YoY at current prices), while exports of goods except fuel and ships declined (-3% YoY at current prices). The mix of growth is also reflected in the reduction of unemployment, which continues, but at a slower pace, and also remains at a much higher level than that of the Eurozone. The completion of the cyclical recovery leaves the "core" of unemployment in which there are structural mismatches between both the supply and demand of labor that do not bend easily, since the economy does not yet have the technological depth to create the kind of jobs desired by the workforce, which in turn does not seem to possess the kind of skills that are demanded in the workplace.

In terms of production, the increase in domestic economic activity in 2023 came from services (tourism and business services) and construction, while the agriculture-forestry-fisheries sector had a negative contribution (large contraction in terms of gross value added in Q4 2023, -13.9% QoQ, due to the impact of the Daniel storm).

The trends of 2023 largely continued into Q1 2024. The real GDP growth rate of the Greek economy accelerated in Q1 2024 to +0.7% QoQ / +2.1% YoY, from +0.3% QoQ / +1.3% YoY in Q4 2023, beating the market consensus forecast of 1.7% annual growth, and once again outperforming the Eurozone (+0.3% QoQ / +0.4% YoY in Q1 2024).

At the sectoral level, the acceleration of the quarterly real growth rate in Q1 2024 reflects the partial recovery of agricultural production from the floods in Thessaly, the resilience of manufacturing, the strengthening of the growth rate of construction activity and also of service sectors, such as arts- entertainment. From the perspective of the components of demand, GDP growth was again largely supported by private consumption, which grew by 2.2% YoY, faster than GDP growth, or 0.2% QoQ (starting from an already high base). Fixed investment, after four (4) consecutive quarters of decline, recovered in Q1 2024 at a rate of 7.1% QoQ / 2.9%YoY. Yet, this falls short of the 2024 Budget target for a 9.1% fixed investment growth in 2024. The increase in fixed investments in the first quarter comes from Other Constructions (+10.6%YoY) and Mechanical Equipment – Weapon Systems (+6.8%YoY). The former probably concerns to a significant extent the infrastructures financed by RRF, while the latter is probably also strengthened by the payments of weapons systems delivered to the country. On the contrary, residences, which last year were the main driver of investment growth, decreased by -14.0% YoY and ICT investments by -1.7%YoY.

The course of the external sector is a source of concern. Net exports of goods and services had the most negative contribution to the annual change in GDP. Exports of goods and services decreased by -5.7% YoY and by -2.4% QoQ. This comes from goods' exports fall by -8.8%YoY/-2.7%QoQ, after another -1.6% QoQ in the previous quarter. This is probably related to lagged effects from the stagnation in the Eurozone. Despite strengthening their contribution to GDP, service exports have not returned to pre-pandemic crisis levels, while goods exports are consistently higher than they were. In contrast, imports of goods and services increased by

3.1%YoY. According to BoG data on the Balance of Payments, the increase comes mainly from non-oil imports of goods and services, an indication that this is related to the high import content of flamboyant domestic demand. It should be noted that total imports remained above 44% of GDP for four consecutive quarters up to Q1 2024, the longest period at such a level since at least 2011, when comparable data are available.

In general, the continuation of economic stagnation in the Eurozone indicates weak external demand in 2024 as well, while the restrictive monetary policy exerts contractionary pressures on the economy. On the other hand, de-escalation of inflation in combination with a pickup in wages mitigates the past impact of inflation on disposable incomes. Also, tourism defies economic sluggishness in main markets and heads for another record in arrivals and (nominal) revenue. However, in order for the outperformance of the Greek economy to continue in the medium term, it is imperative that the implementation of investment projects and structural reforms related to the RRF are accelerated, not only for supporting growth in the current year, but, most importantly, to support the transformation of the long-term growth model in the direction of introducing more knowledge and extroversion in production.

2. 2024 Baseline Scenario

The modelling approach is the growth accounting-based technique internally developed. The estimate is conducted with information dating July 2024, as long as hard data, leading indicators and fiscal measures announced are concerned. 2023 real GDP growth was at the time estimated to be 2%YoY. This and other macro variables (disposable income, unemployment, HICP), some from official sources and some internally estimated, were used as a basis for the 2024 GDP forecast, which was estimated at 2.0%, a tad below the forecast of the EC at the time (2.2%).

In 2024, GDP is expected to continue receiving a positive boost as projects funded by RRF, MFF 2021–27 and EIB funds start to be implemented. In addition, tourism is expected to have another strong season (tourist revenues and arrivals already higher by 16.2% YoY and 20.6% YoY in Jan-24 to May-24), despite the slowdown in Europe, and reclaim of investment grade by the Sovereign may help in the attraction of investment. On the other hand, while inflation declines, it remains above target and core inflation shows the dispersion of price pressures deeper in the economy, domestically and Eurozone-wide. Hence, the ECB is expected to maintain a cautious and data-dependent stance in implementing further rate cuts (after the initial one in June 2024). The still high current level of interest rates -425 basis points higher compared to Jun-22- comprises a drag on growth, despite the banking system's ample liquidity (private sector's loans-to-deposits ratio at 61% on average in H1 2024); RRF loans will help in retaining credit expansion towards businesses at positive levels. Fiscal boost will also diminish as support measures are phased out and the Government targets a higher primary surplus at 2.1% of GDP.

Disposable Income drivers & Private Consumption

Net national disposable income at current prices (EUR bn), stood at €189bn at end-2023.

Impacts:

a) The EC (July 2024) expects a primary fiscal surplus of 2.3% of GDP, from 1.9% in 2023, (€5.3bn vs €4.1bn in 2023) on the back of phasing out of support measures; we concur this is feasible as revenue overperformance due to (nominal and real) economic growth and nonindexation of the tax scale may outweigh any slippage of public expenditure, hence we assume a fiscal drag in disposable incomes of -€1.2 bn or a -0.6% decrease in nominal net disposable income.

b) Increase in capital profits: 4.0% increase (vs 3.1% EC) due to increase in economic activity but also inflation, times ca 44% share of capital in GDP,[1] i.e. €3.9bn or 2.1% increase in nominal net disposable income.

c) Decline in unemployment: 10.6% of labor force from 11.1% in 2023, ca 24k less persons unemployed compared to 2023 (labor force of ca 4710k persons). Assuming a per person loss in disposable incomes from unemployment approximately equal to €16.7k (difference between the per capita gross income and the unemployment benefit), the projected decrease in unemployment will increase total net nominal disposable income by ca €0.4bn or 0.2%.

d) Wages (nominal compensation per employee): 4.5% increase (vs 4.1% in EC-AMECO forecast) on the grounds of reported shortages in most sectors of the economy in combination with non-reversal of brain-drain and inflation being still above target; times ca 56% share of labor on GDP (at current factor cost), i.e. €5.6bn or 2.9% increase in nominal net disposable income.

In total, net nominal disposable income is projected to increase by ca €8.7bn or 4.6%. In addition, and in accordance with historical experience, we pencil consumption of €1bn of savings by households in an effort of households to intertemporally smooth their consumption.[2] This may happen at a lesser extent than in 2023 as wage growth points to a preservation of the purchasing power of incomes from -still above target-inflation; yet, households in Greece tend to save less and be more optimistic about their future incomes. Hence, nominal disposable incomes plus consumption of savings should increase by €9.7bn or by 5.1%. Eurobank Research projected in July 2024 an HICP change of 2.9% (2024 average), due to persistence in services inflation and secondary effects. Hence, real disposable incomes (plus consumption of savings) should increase by €4.2bn or 2.2%. Again, according to the historical experience, which is consistent with intertemporal consumption smoothing, income elasticity of consumption is 0.9, hence increases in real disposable incomes (plus consumption of savings) translate into real increase in private consumption by 2% (vs +1.7% EC forecast).

Government consumption: +0.6% change (vs +0.4% EC forecast) assuming slight fiscal slippage.

Gross capital formation: the most important tool supporting investment is the RRF; assuming full disbursement of resources by the EC by 2026 and also full allotment of grants to the final beneficiaries by 2026 (in equal tranches per year), an amount equal of €4.9bn per year could be distributed to final beneficiaries per year between 2024-2026 in grants. This is an optimistic scenario that assumes that the totality of funds can be distributed in final recipients by 2026. On the loan segment, and given delays in a number of countries, there is a Europe-wide discussion about a possible extension of the allotment period up to 2029. In such a case, and again assuming equal allotments in all coming years up to 2029, another €2.5bn may be disbursed on loans in 2024, and yearly between 2025-2029.

[1] Includes SMEs and sole proprietors.

[2] Total deposits will continue to grow, however, due to economic growth, credit expansion and the good course of tourism, inter alia.

RRF funds also mobilize private sector funds: in the loans segment we estimate that requirements for own funds of the corporates and bank capital being utilized, result in €2.4 being mobilized in total for every €1 disbursed by RRF funds; in the grants segment, we estimate that €1.4 are being mobilized in total for every €1 of RRF funds due to synergies with private sector initiatives. Hence, by RRF alone, an amount of €13.2bn of investment could be carried out in 2024 (this is an indication only, not an exact estimate).[3] However, this is still ca 40% of fixed investment (or ca 1/3 of total investment, including inventories) that has to be implemented in 2024 in order for the 2023 size of investment to be reached. Hence, purely private investment has to be reinvigorated as well. In this respect, it has to be noted that RRF also causes some crowding out of investments that would be carried out anyway by private funds in the absence of RRF. Also, purely private investment faces the headwinds of high ECB rates, geostrategic uncertainty, high cost of intermediate inflows and low availability of personnel in certain areas. It is characteristic that in 2023, although the mobilization of RRF grants and funds was not too dissimilar than the estimated one for 2024, GFCF grew by a meagre 4%. Considering that little has changed in the aforementioned headwinds, we pencil in a slight only acceleration to 5% this year (vs a 7.4% real growth of GFCF assumed by the EC).

Exports of g&s: a 5% real increase is expected in tourism and 5% in transports, which comprise 17% and 23% of 2023 total exports of goods & services respectively; flat fuel exports (given market projections for oil prices), which are ca 17% of g&s exports. For the rest, a zero real change in external demand is expected given weak growth and subdued global trade, which is consistent with weak dynamics observed in goods' exports the first months of the year (a -6.9%YoY decline in the Jan-May 2024 period in real non-oil goods' exports). Overall, an 2% increase in exports is expected (vs 4.2% EC forecast).

Imports of g&s: considering the resilience of private consumption and a historical import elasticity of consumption of 1.2,[4] an increase of 2% in consumption results in an increase of imports by 2.4% (vs 3.8% EC forecast). This is compatible with a 4.9% nominal increase of imports of goods & services observed in the Jan-May 2024 period.

3. 2025 and 2026 real GDP growth rates

After 4 consecutive years (2021-2024) in which the Greek economy overperformed the Euroarea, the output gap has closed and actually in 2023 the economy was operating at levels above full employment (positive output gap of +0.3%, from a trough of -18.5% in 2012 according to EC calculations). However, overperformance is expected to continue in the medium-term horizon on the basis of RRF funds and structural reforms boosting investment and thus expanding potential output (a cumulative increase of 7ppts compared to the case of no RRF, according to Bank of Greece estimates). Then, we add cyclical factors and the (negative) impact of shocks emanating from geopolitical factors and the continuing change in the energy mix in the context of Green Transition.

[3] Obviously, this is just a scenario, in another scenario that eg. in both the loans and grants segments an extension is granted up to 2029, €3.545bn in grants may be distributed in 2024; along with loans and funds mobilization, a lower amount of €9.7bn of RRF-initiated investment could be carried out in 2024.

[4] Assuming import intensity of private consumption and production of harshly equal size.

From this perspective, a **2.4% real GDP growth for 2025** is seen as the sum of the following marginal impacts:

- **1.6 ppts** potential GDP growth rate (EC's AMECO estimate as of July 2024).
- **0.6 ppts** overheating (EC's AMECO calculated overheating of 0.9ppts as the Greek economy was 0.3ppts above full employment already in 2023 and this is expected to increase to 1.2 ppts above full employment in 2024, we assume this is mediated somehow by RRF-driven expansion of productive capabilities).
- **-0.3 ppts** decline from the impact of the supply shock emanating from geostrategic frictions and their impact on global supply chains and global trade.
- **0.5 ppts** increase of potential GDP due to the impact of projects funded by RRF grants and loans

Similarly, **for 2026, a 2.4% real GDP growth** prevails from:

- **1.5 ppts** from a slight decrease of potential GDP growth rate towards long-term steady state.
- **-0.2ppts** from the impact of the geostrategically-driven supply shock slightly fading out.
- **0.7 ppts** from the effects of the RRF magnifying due to projects maturing and catching up with the initial schedule.
- **0.4 ppts** overheating as assumed improvement in the international economic environment is balanced out by the need to close the positive output gap.

4. Risks to the projections

- Escalation/prolongation of war in Ukraine and/or the Middle-East leading to re-emergence of energy-driven supply shocks, increases in commodities prices and stagflation or a recession in the Eurozone
- Risk of political turmoil from elections in the US
- Persistence of inflation leading to delay in rate cuts
- Cliff effect from expiration of support schemes
- Delays in the disbursement of RRF funds or non-optimal utilization
- Delays or lack of ambition in implementation of RRF-related and national reforms
- Fiscal risks emanating from the interest deferrals of the EFSF loan
- Prolongation of external sector imbalances
- Intensification of climate risks and natural disasters
- Growth model overly reliant on tourism and consumption

Research Team

Dr. Tasos Anastasatos | Group Chief Economist
tanastasatos@eurobank.gr | + 30 214 40 59 706

Marcus Bensasson
Research Economist
mbensasson@eurobank.gr
+ 30 214 40 65 113

Dr. Stylianos Gogos
Research Economist
sgogos@eurobank.gr
+ 30 214 40 63 456

Maria Kasola
Research Economist
mkasola@eurobank.gr
+ 30 214 40 63 453

Dr. Konstantinos Peppas
Research Economist
kpeppas@eurobank.gr
+ 30 214 40 63 520

Paraskevi Petropoulou
Senior Economist
ppetropoulou@eurobank.gr
+ 30 214 40 63 455

Dr. Theodoros Rapanos
Research Economist
trapanos@eurobank.gr
+ 30 214 40 59 711

Dr. Theodoros Stamatiou
Senior Economist

+ 30 214 40 59 708

Michail Vassiliadis
Research Economist
mvassileiadis@eurobank.gr
+ 30 214 40 59 709

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