EMEA Economic Perspectives

Greece: ticking all the boxes for a strong recovery

Economics

EMEA Emerging

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We raise our 2021 GDP forecast to 7.9% on strong Q2 performance – 260bps above consensus

Economic recovery has been progressing much stronger in Greece than expected. The economy grew by 3.4% q/q in Q2 following an upwardly revised +4.5% q/q in Q1, +3.5% q/q in Q4 2020 and +3.9% q/q in Q3 2020. This puts the sequential acceleration of GDP on the strongest course in the last 20 years and y/y growth rate reached 16.2% y/y. Importantly, GDP had fully recovered from the pandemic shock by Q2 2021. We raise our GDP forecast from 5.6% to 7.9% in 2021 given Q2's rebound, although lower our 2022 growth estimate from 6.0% previously to 5.0% as many recovery gains seem to have been captured earlier. Our forecast is 260bps higher than consensus for 2021 and 20bps above consensus for 2022.

Available data points to a continuous rebound in activity in Q3

Available data is consistent with an ongoing recovery in Q3. Google's mobility data shows that there was a strong surge in activity in July, August and September. This mainly reflects booming consumption (groceries & retail), but also travel via transit stations. Business sentiment jumped to to 113 in August 2021, reaching one of the highest levels since 2000. The rebound in sentiment reflects the optimism in industry and construction. The optimism in industry was also mirrored by the manufacturing PMI rising to an all-time high in August, while in our view the upbeat mood in construction should be also connected to the launch of RRF projects (EUR 4bn received in early August). Anecdotal evidence indicates that tourist arrivals in July and August have substantially improved over the 2020 levels and travel bookings for September and October also show strong demand which could surpass the government's expectations.

Greece to benefit strongly from the RRF flows

Greece should also benefit from the Recovery and Resilience Facility (RRF) flows starting from H2 2021. Greece is eligible for EUR 18bn in grants and EUR 12bn in loans (10% of GDP and 7% of GDP respectively). Based on the Bank of Greece's calculation, the RRF funds in combination with selected structural reforms (improving product markets, increasing labour force participation and enhancing productivity) could boost GDP levels by 30ppt cumulatively in 2021-2026 vs the baseline and create 180k jobs. Importantly, Greece also has more than EUR 10bn in outstanding funds from the 2014-20 MFF (Multiannual Financial Framework), which are yet to be absorbed given that Greece has contracted projects for more than 100% of the available envelope.

Major drop in the budget deficit in 2022, public debt to start declining this year

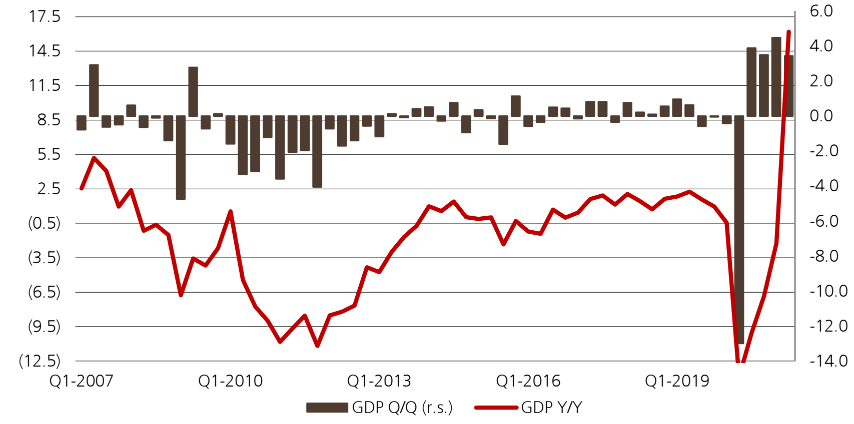
Greece officially targets a budget deficit of -9.9% of GDP this year, with a primary balance target of -7.2% of GDP. This includes EUR 20bn (11% of GDP) costs of Covid-19 related measures. The budget deficit is expected to be cut significantly to -2.9% of GDP in 2022 – which is likely to be driven by the fact that c.90% of the previously introduced spending side measures are likely to be phased out. We expect public debt (as a % of GDP) to decline from 205.6% of GDP in 2020 to 186% of GDP by 2022.

Banks: currently de-risking and ready to lend

Very sizeable non-performing exposure (NPE) securitizations and outright portfolio sales accelerated de-risking of the banks' balance sheet ytd. BoG data shows the aggregate NPL ratio of the sector dropping by more than 11p.p. alone in Q2 21 and by close to 20p.p. since YE'19. With all four systemic banks on a path towards single digit NPE ratios by YE'22 and now sufficient capacity to lend, we expect the sector to contribute significantly to the financing of the economic recovery. Banks' strategic plans hinge on substantial net new lending in order to achieve the targeted >10% RoTEs medium term.

Economic growth and activity

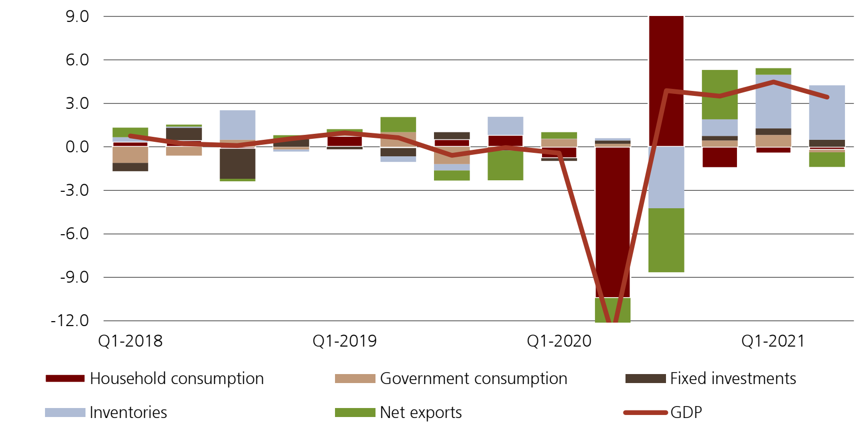
Figure 1: We raise our GDP forecast to 7.8% in 2021



Source : ELSTAT, Haver, UBS

The economy grew by 3.4% q/q in Q2 following an upwardly revised +4.5% q/q in Q1, +3.5% q/q in Q4 2020 and +3.9% q/q in Q3 2020. This puts the sequential acceleration of GDP on the strongest course in the last 20 years and y/y growth rate reached 16.2% y/y. Importantly, GDP had fully recovered from the pandemic shock by Q2 2021. We raise our GDP forecast from 5.6% to 7.8% in 2021 given Q2's rebound (carry-over would imply 7.3% growth in 2021).

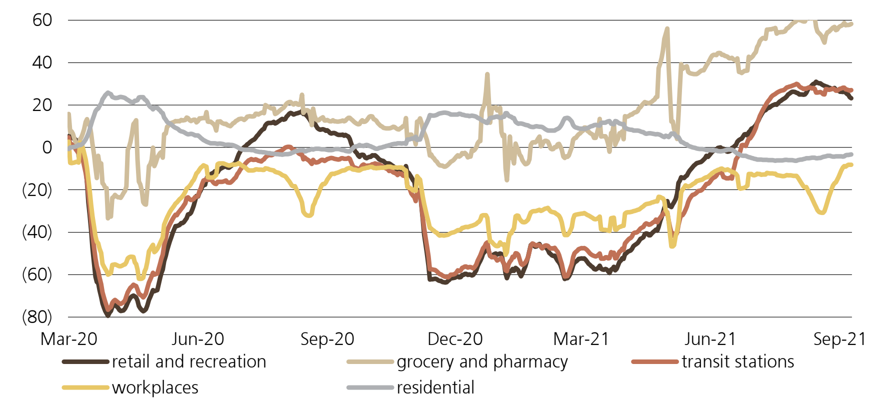
Figure 2: Sequential (q/q) GDP outperformance driven by capital formation and exports, %



Source : ELSTAT, Haver, UBS

During the last three quarters sequential (q/q) GDP growth has been increasingly driven by: a) capital formation – dominantly inventory accumulation – but also gross fixed capital formation (machinery & equipment, intellectual property, and construction); and b) exports – in particular exports of services recently. In addition, the drag from private consumption became smaller.

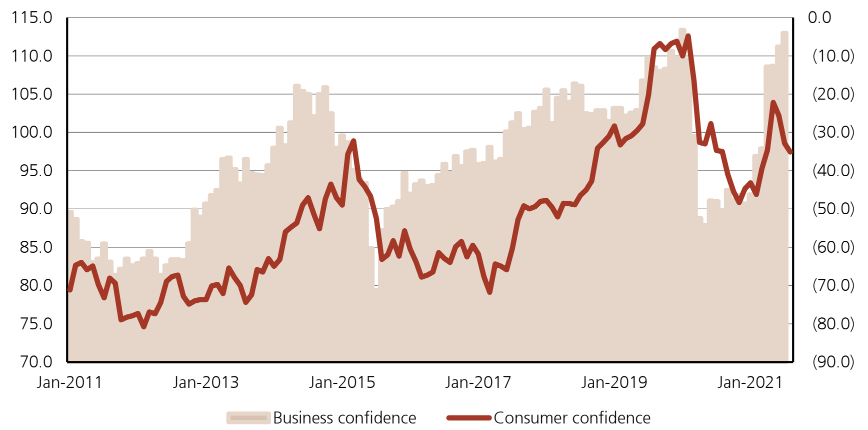
Figure 3: Improving mobility points to a continuous rebound in Q3



Source : Google, UBS. https://www.google.com/covid19/mobility/

Greece started to ease mobility restrictions from April onwards (see [here](#)), which includes the official launch of the tourism season from 15 May. Google's mobility data shows a surge in activity in July, August and September. This mainly reflects booming consumption, but also travel via transit stations. In our view, the makes it very likely that Q3 GDP growth is likely to deliver another quarter of sequential increase, though at a slower rate. The available hard data also points in this direction: July IP up +0.3% versus Q2 average level.

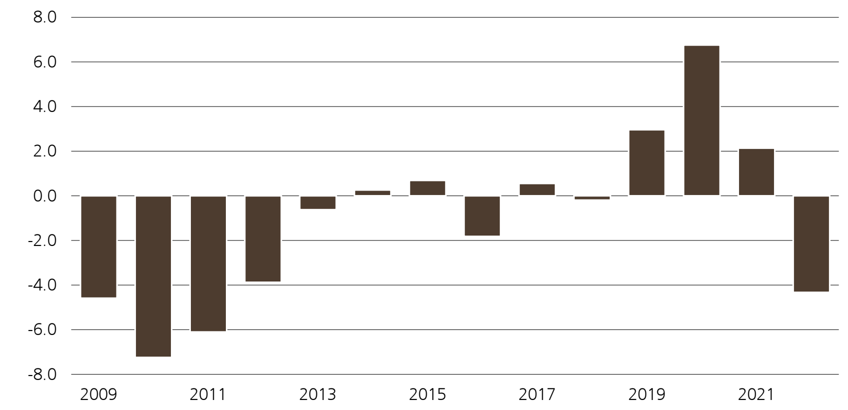
Figure 4: Business sentiment reaches record levels in August 2021



Source : European Commission, Haver, UBS

Business sentiment jumped to to 113 in August 2021, reaching one of the highest levels since 2000. The rebound in sentiment reflects the optimism in industry and construction. The optimism in industry was also mirrored by the manufacturing PMI rising to an all-time high in August (output, orders, employment), while in our view the upbeat mood in construction should be also connected to the launch of RRF projects (EUR 4bn received in early August). The recovery in services and retail sector also gained momentum in June-August. Consumer sentiment, however, remains more depressed.

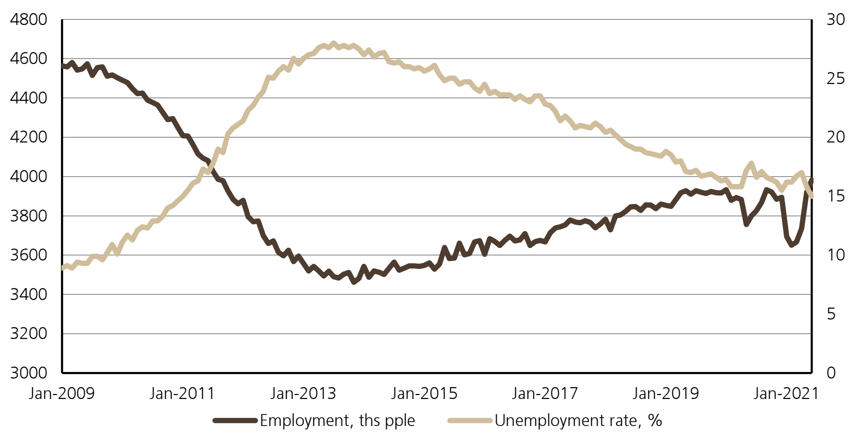
Figure 5: Fiscal policy to remain expansionary in 2021: fiscal impulse, % of GDP *



Source : European Commission, Haver, UBS. *Positive values mean fiscal stimulus.

The 2021 economic recovery is also likely to be assisted by supportive fiscal policy. Following a fiscal impulse of almost 7% of GDP (change in the structural primary budget balance) in 2020, the Greek economy should benefit from another 2.1% of GDP worth of fiscal impulse. The cost of Covid-19 related measures amounted to EUR 23bn (14% of GDP) in 2020 and should reach EUR 20bn (11% of GDP) in 2021. In 2021 the key new discretionary measures were: a) 3ppt reduction in the social security contribution; b) suspension of solidarity tax; c) grants to SMEs; and d) working capital grants to several sectors.

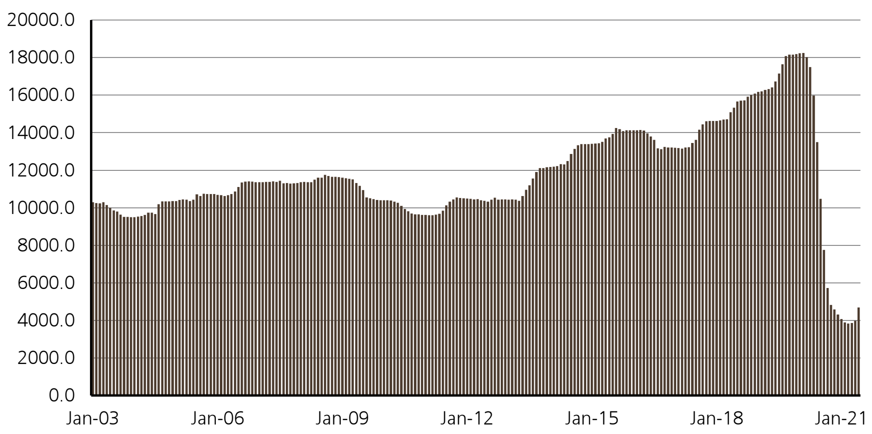
Figure 6: Unemployment falls to new lows, labour market shielded by government programs



Source : ELSTAT, Haver, UBS

Greek unemployment rate fell to 15.0% (seasonally adjusted) in June 2021, the lowest level since 2010. Employment bounced back to close to 4mn level by June (+4.8% y/y), the highest since 2011. The government responded to the pandemic related pressures and supported workers with a temporary suspension in their labour contracts (while keeping their positions). According to the European Commission there were c.547k employees protected under the scheme in March 2021. In addition, the employment subsidy program also created 30k jobs, while the short-term work scheme ('Synergasia') also provided support to 17k employees.

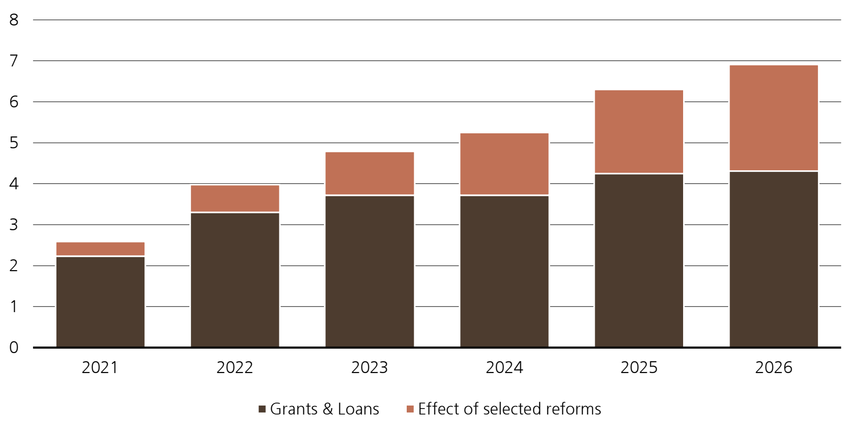
Figure 7: Revival of tourism – can targets be exceeded? Tourism revenues, EUR mn, 12m rolling



Source : Bank of Greece, Haver, UBS

Tourism has also seen a substantial rebound already in June. Anecdotal evidence indicates that tourist arrivals in July and August have substantially improved versus last year (in some places even above the 2019 levels) – and travel bookings for September and October also show strong demand. There is a chance that tourism receipts can surpass the government's EUR 8bn target (40% of the 2019's EUR 18bn record level, but doubling from last year's EUR 4bn). So far in H1 2021 tourism revenues amounted to EUR 1.1bn, but it is important to point out that usually July-September practically accounts for 60% of annual revenues.

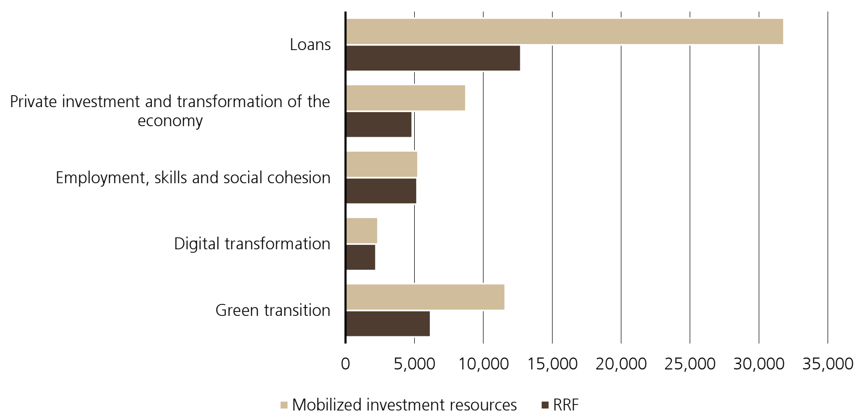
Figure 8: Starting from H2 2021 the RRF flows should also start to add to growth: additional GDP level per year*



Source : Bank of Greece, UBS. *Increase in GDP level in a given year as a result of RRF compared to the steady-state level.

GDP growth should also benefit from the Recovery and Resilience Facility (RRF) flows starting from H2 2021. Greece is eligible for EUR 18bn in grants and EUR 12bn in loans (10% of GDP and 7% of GDP respectively). Based on the Bank of Greece's calculation, the RRF funds in combination with selected structural reforms (affecting product market, increasing labour force participation and enhancing productivity) could boost GDP levels by 30ppt cumulatively in 2021-2026 versus the baseline and create 180k jobs. A large part of the economic impact should come from the private investments financed by loans, and also from increased public investments financed by grants.

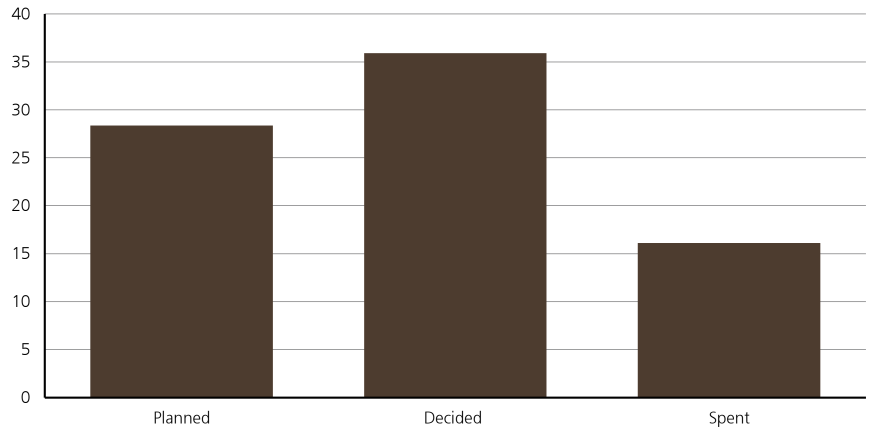
Figure 9: RRF funds distribution by policy priority, EUR bn



Source : Bank of Greece, UBS

Greece will focus on four policy areas when it comes to using the RRF grants: green transition, digital transformation, employment & social cohesion and private investment & economic transformation. Greece is expected to meet the benchmarks for both green spending (38% vs 37%) and for digital transformation (25% vs 20%). Greece also expects to mobilize a broader range of investment resources – particularly in case of loans (3x the target sum of the RRF). Altogether the mobilized investments could reach EUR 60bn or twice the size of the RRF envelope.

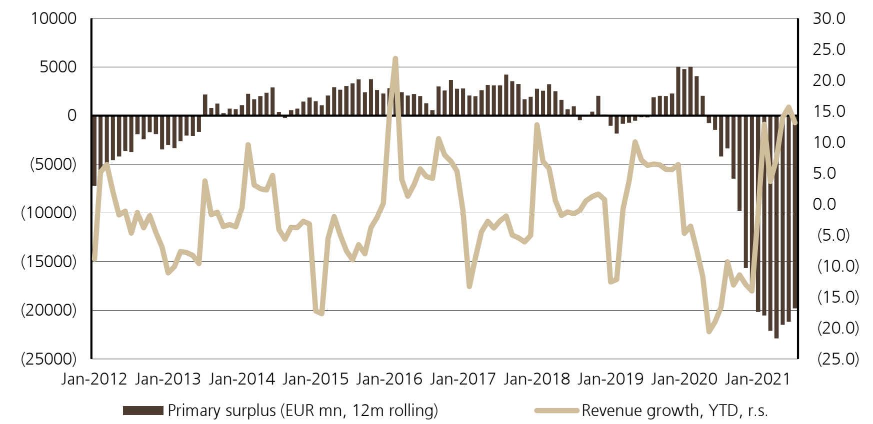
Figure 10: Still more than 40% of the 2014-20 MFF funds have not yet been utilized (EUR bn)*



Source : European Commission, UBS. As of June 2021.

Importantly, Greece also has available funds outstanding from the 2014-20 MFF (Multiannual Financial Framework), which are still outstanding for absorption given that Greece has contracted projects for more than 100% of the available envelope. Greece's actual drawdown was at 57% of the target sum at the end of 2020 – somewhat below the CE3's rate of 58-64%. This still leaves more than c.EUR 10bn available resources for additional growth in 2021-22.

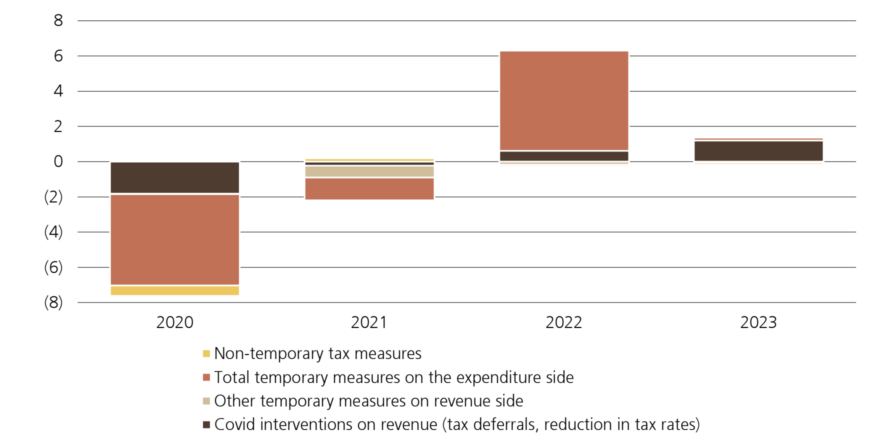
Figure 11: 2021 budget execution runs better than targeted; deficit to be cut visibly in 2022



Source : Ministry of Finance, Haver, UBS

Greece officially targets a budget deficit of -9.9% of GDP this year, with a primary balance target of -7.2% of GDP. As detailed above on Figure 5, this includes EUR 20bn (9% of GDP) costs of Covid-19 related measures – out of which EUR 6.3bn spending has already taken place in January-July 2021. Budget execution so far runs better than targeted: the January-July 2021 primary budget deficit reached EUR -9.1bn, EUR 0.5bn less than the target – driven by spending restraint. The budget deficit is expected to be cut significantly to -2.9% of GDP in 2022.

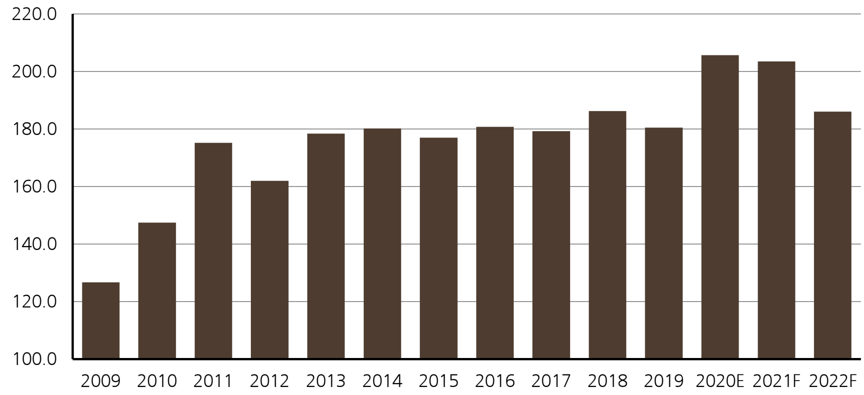
Figure 12: Discretionary stimulus measures in 2020-23, % of GDP*



Source : Ministry of Finance, UBS. * Negative values means stimulus leading to higher budget deficit. The chart does not include the recently announced EUR 4bn worth of mainly tax cuts for H2 2021.

The timing and phasing out of pandemic related stimulus measures explain a large part of the expected changes in the budget balance. Last year Greece deployed 7.6% of GDP worth of discretionary fiscal stimulus, out of which c.70% were rising expenditures (advance payments to businesses, special allowance for firms). This year Greece added new stimulus measures - again mainly in the form of new expenditures (SME grants, working capital measures). However, in 2022 c.90% of the previously introduced spending side measures is likely to be phased out – which should help the budget deficit to fall substantially next year.

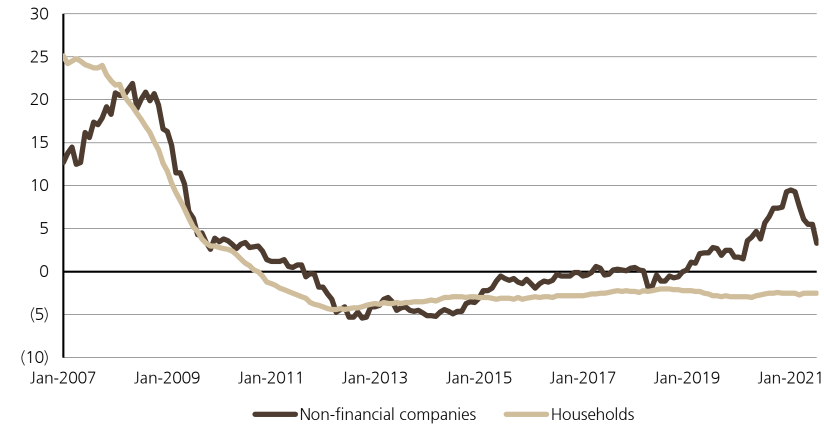
Figure 13: Public debt-to-GDP to start to decline in 2021 and to drop below 190% of GDP in 2022



Source : Ministry of Finance, Haver, UBS

We expect public debt (as a % of GDP) to decline from 205.6% of GDP in 2020 to 186% of GDP by 2022. Greece maintained an active presence on the capital markets, raising EUR 11.5bn from the markets this year (most recently EUR 2.5bn from the simultaneous re-issue of a 5-year and 30-year bond on 1 September). Greece also repaid EUR 3.3bn to the IMF early in mid-March, taking the outstanding stock of debt to the IMF only to EUR 1.8bn. Finally, Greece had a high level of cash reserves (c.EUR 28bn in July). A key issue for Greek government bonds is what happens after PEPP (which includes Greek bonds).

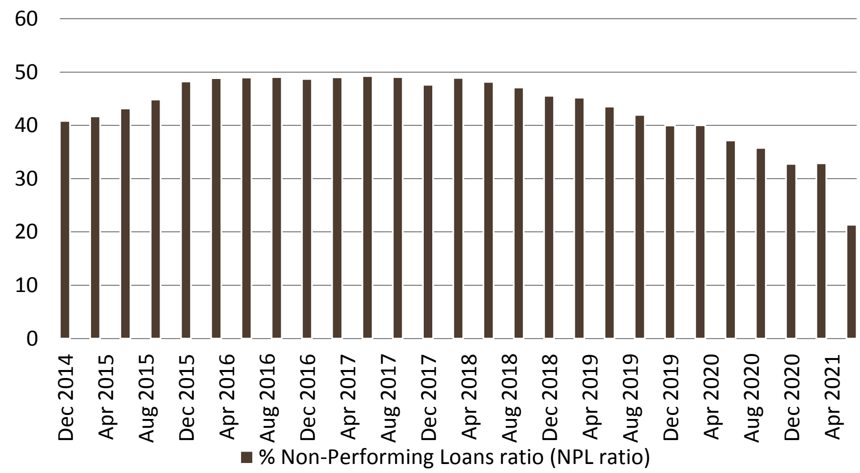
Figure 14: Not much help from lending growth so far (% y/y)



Source : Bank of Greece, Haver, UBS

The rebound in economic activity largely happened without a lot of help from bank lending. The Bank of Greece's data suggest that credits to the private sector increased by 1.2% y/y in July 2021, which is the slowest pace this year – in part reflecting the fact that credit growth accelerated in throughout most of 2020. Corporate lending growth has been expanding in year-on-year terms since 2019, but momentum in this segment has slowed to 3.3% y/y. At the same time, household loan growth continued to decline by around -2.5% y/y. A re-acceleration of credit growth would represent another source of growth for the medium-term.

Figure 15: The bank sector's NPL ratio dropped sharply in Q2 21



Source : Bank of Greece, UBS

Multi-billion € NPE securitizations (benefitting from the government guaranteed Hercules Asset Protection Scheme, HAPS) helped banks reduce NPE and NPL ratios since YE2019, with substantial benefits from de-recognition crystallizing in Q2 21. Systemic banks are targeting single digit NPE ratios by YE2022 through HAPS-guaranteed securitizations, outright portfolio sales, internal workout, and liquidations.

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