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Greece

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Reaching the inflection point?…stronger indications that the Greek economy is rebalancing

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Greek economy reaching an inflection point?

Introduction

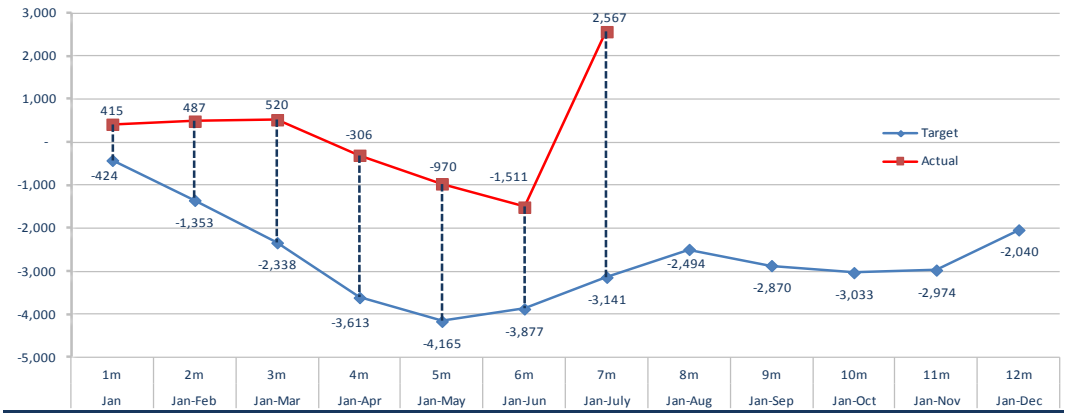
Recent improvements in both soft and hard data are pointing to a bottoming out of the Greek crisis, potentially indicating that the economy maybe reaching an inflection point. Greece continues to address fiscal imbalances and structural deficiencies, leading to improved competitiveness and thus providing the necessary framework for sustainable economic growth going forward.

Key macroeconomic developments

Greece is heading for a primary surplus for 2013

The **Primary balance** on a cyclically-adjusted basis has improved by a whopping **15% of GDP** since 2009. Importantly, Greece remains on target to achieve a FY13 primary fiscal balance. In this context, recent preliminary July central government budget figures indicate that the government remains determined to reach a FY13 primary fiscal balance and possibly even outperform the Troika target through the achievement of a (small) primary surplus. Importantly, the achievement of a primary surplus combined with continued program execution, will potentially trigger the implementation of additional Eurogroup decisions that will ensure that Greece's debt-to-GDP ratio stands at 124% of GDP in 2020 (recall Eurogroup statements at December 2012 that euro area Member States were prepared to take additional measures to ensure that this objective is met).

Central Government Primary Balance: January - December'13 (Target vs. Actual) (EURmn)

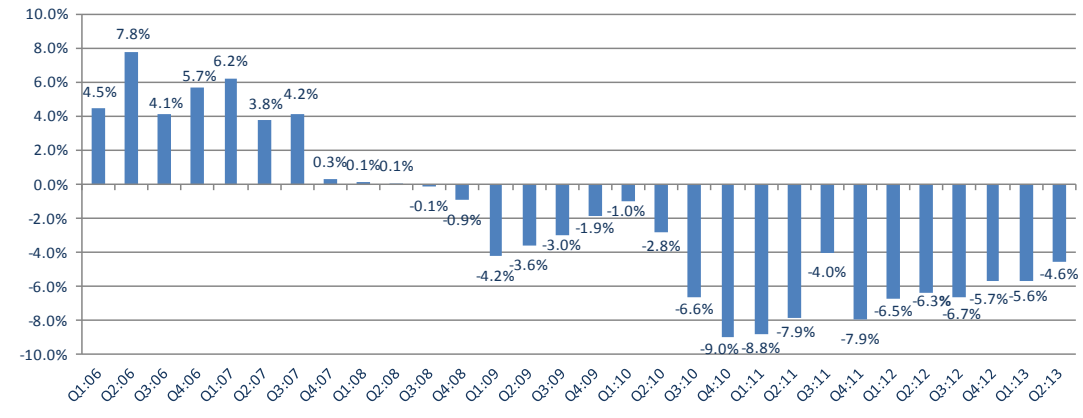


Source: Ministry of Finance, Axia Ventures Group

GDP contraction is progressively decelerating

It is important to note that **output contraction** is slowly decelerating (Troika GDP13e: -4.2%), while fiscal measures that weigh towards the expenditure side (80% costs vs. 50% previously) indicates relatively higher effectiveness in terms of achieving fiscal targets. Moreover, recently released Greek GDP (provisional data) figures for Q2:13 indicate that the economy contracted by 4.6% y-o-y (non-seasonally adjusted) versus a 5.6% y-o-y contraction in Q1:13 and a 6.3% y-o-y contraction in Q2:12.

GDP evolution: Q1:06 – Q2:13 (y-o-y % ch.)



Source: ELSTAT, Axia Ventures Group

On the other hand, the output contraction remains significant and needs to be counter-balanced by growth enhancing initiatives and supply-side shocks (i.e. structural reforms).

Tourism and exports will have a positive impact on GDP dynamics

Nevertheless, there are positive signs in areas like tourism and exports that should help accelerate the economic rebound. More specifically, the recent pick-up in tourism (expecting c17m visitors this year, with potential for c18m tourists in FY14) should cushion the contraction this year and lead to positive flow-on effects vis-à-vis GDP14 (projections calling for mild 0.6% growth). In addition, we also note that recent improvements in **economic sentiment** (economic sentiment back to pre-crisis 2008 levels at 91.7 in July versus 79.4 at July 2012) are also seen to positively contribute.

Unemployment rising at a decelerating pace, but still remains a major underlying concern

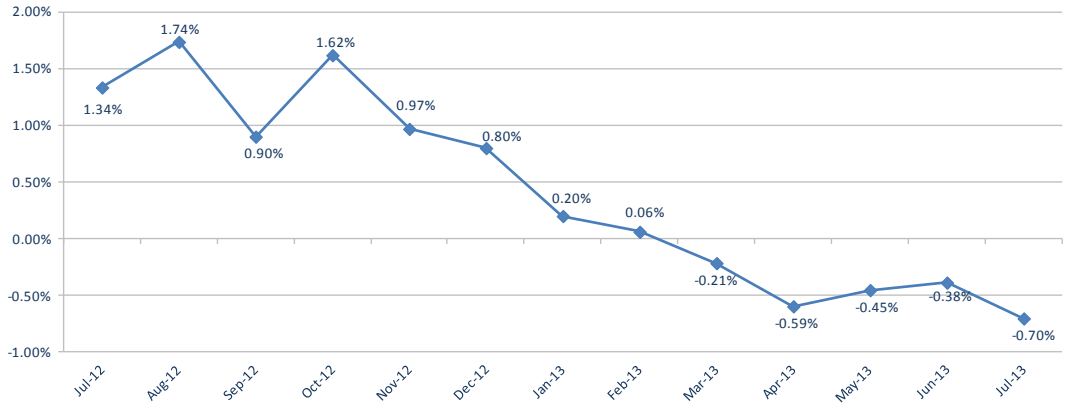
Unemployment continues rising but at a decelerating pace. More precisely, there has been a considerable pick-up in hiring at 6M13 (i.e. Hellenic Labor Inspector noted that hiring for 6M13 at +37.9% y-o-y), mainly related to seasonal jobs to accommodate the higher demand for tourism services. In addition, recent July data provided by the Ministry of Labor indicates that net employment remains positive for the 5th consecutive month, presenting the highest 7M figure since 2008. Hence, for 7M13, 91,611 net employment (+174% y-o-y) has been achieved, while the shift towards part-time employment points to improving flexibility in labor arrangements. Notwithstanding the above, we note that the extreme level of unemployment (May 2013: 27.6%), resulting in ongoing social hardship, remains the number one risk to on-going program implementation.

Regaining lost competitiveness…inflation at all time lows

The **Competitiveness adjustment** in Greece has been extraordinary by all accounts, with Greece projected to have **regained its 1995 labor cost competitiveness** (primarily through lower wages) by 2014. Greece has also closed its labor cost gap versus EU17 and EU25, coming in lower versus other EU periphery countries as well (ULC13e: -14% since FY09, despite 25% cumulative GDP contraction => translating to c35% reduction in Greek OPEX => ULC13e Index at 97.5 vs. EU17 at 111.7, while Greek ULC14e Index at 95.5 vs. EU17 at 113).

Inflation has now entered **negative territory** and is projected to remain under the EU average, pointing to continuing internal devaluation. In July 2013, CPI decreased by 0.7% y-o-y versus +1.3% y-o-y at the same time last year, while the Harmonized Index of Consumer Prices decreased by 0.5% y-o-y. Greece has also improved in a number of structural competitiveness indices, including improved rankings (11 places) in the 2013 World Bank Doing Business Indicators, indicating the government's resolve to continue with key structural reforms.

CPI: July'12 – July'13 (y-o-y % ch.)



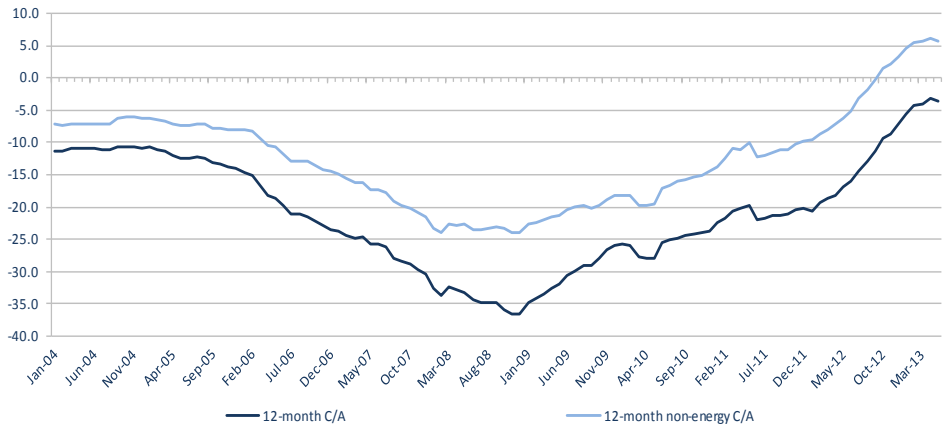
Source: ELSTAT, Axia Ventures Group

Current Account Balance is also impressive

Stronger contribution from exports and improvements in competitiveness are helping **headline C/A deficit**. C/A deficit has been improving, with May 2013 producing a **small C/A surplus** (including energy) versus a EUR 1.2bn deficit at same period last year (note that Troika estimates for C/A deficit stand at c0% at FY13 vs. 15% at FY08).

Moreover, **12mth trailing C/A excluding energy** at **May 2013** stands at positive EUR6.3bn (9th monthly consecutive surplus), while when including energy, **12mth trailing C/A deficit** at **May 2013** stands at only EUR2.3bn (c1.3% of GDP13e) vs. EUR16.1bn 12mth trailing C/A deficit at same period last year.

12-month Trailing C/A Balance: Jan'04 – May'13 (EURbn)



Source: BoG, Axia Ventures Group

Injecting much needed liquidity into the system remains a must…

Clearance in government arrears adds much needed liquidity to the domestic economy

Albeit slow up until end-June, **clearance in arrears** is starting to pick-up (latest data points to EUR7bn outstanding arrears, though given recent passing in parliament of amendments to specific law, payments of arrears is expected to pick up in coming months, which by all accounts is positive for market liquidity). In addition, Greek PM Antonis Samaras has stressed that EUR1.4bn outstanding EOPYY debts (EOPYY: National Organization for the Provision of Health Services), must be paid by year-end (note approval of payment has already been received).

EU Structural Funds – Absorption rates on the rise

EU Structural Funds have increased with July 2013 alone standing at EUR2.2bn, while the government has also successfully increased absorption rates (note that private sector **CAPEX/GDP12 stood at c14% vs. 50 year average of 22%**, allowing for significant upside potential vis-à-vis absorption of additional EU Structural Funds). Moreover, total EU Structural Funds until 2015 allocated to Greece amount to **cEUR11bn (c6% of GDP)**, with Greece being required to finance only 5% of total outlay.

As the government now has the ability to finance its part and as existing legal and financial hurdles for key infrastructure projects are removed, the absorption of these funds should accelerate further.

More specifically, the aim is to fully absorb EUR3.89bn (c2.1% of GDP) this year. In addition, it is also noted that further financing can be sourced via the European Investment Bank (EIB), which has already announced the disbursement of EUR1.44bn, while also supporting trade agreements via the provision of guarantees of up to EUR500m, the recycling of which could reach EUR1.5bn per annum. These funds have been earmarked towards infrastructure and energy projects, but importantly will also assist SMEs in sourcing liquidity. Finally, we note that Greek banks have already started channeling EIB funds to SMEs.

Delays in 2013 privatizations, but 2013-14 revenue targets remain…

Despite considerable delays, underlying determination still exists…

The **Finance Minister** has acknowledged delays in the **privatization program** mainly due to the fact that the DEPA (natural gas company) sale did not proceed as initially planned (reportedly should restart late this year or early next year), but expects targets for 2013-14 period to be met (Privatizations include: OPAP, VLT Licenses; DESFA; IBC; State Lotteries; Cassiopi; Mobile telephony frequency bands; real estate buildings abroad; Submissions of binding offers - 2nd stage: ODIE, EYATH, Astir Vouliagmenis, etc).

…while FDIs remain crucial to restructuring key areas of the economy

FY13 and FY14 projected receipts stand at EUR5.1bn cumulative, while the government is focusing on a number of privatization projects including regional airports, ports and marinas, motorways, sale/repo buildings, etc. The country requires **significant FDI**, with the privatization program providing the necessary framework for significant investments.

Alternative methods, such as asset securitization, are also currently being assessed by the Ministry of Finance in order to raise additional revenues, beyond what is currently foreseen in the privatization plan, thereby covering the shortfall in revenues from privatizations due to delays experienced to date.

Other factors to take into consideration:

(i) **Greek PMI in manufacturing** (Markit) hit a 43-month high in July, coming in at 47 versus 45.4 in June (rising for 6 of the past 7 months), highlighting a sustained slowdown in the pace of contraction in Greece's manufacturing sector. Markit also notes that one factor helping lift the headline PMI towards the all-important 50.0 threshold was a slower decline in output, with the July decrease being the least marked since April 2011 and substantially slower than the pace of contraction seen at the start of the year. Markit notes similar trends in new orders and job losses, pointing towards a flattening out of Greece's recession.

(ii) **Turnover index in retail sales** have recorded a remarkable improvement on a y-o-y and m-o-m comparison. Starting from February'13, retail sales decreased slightly by -0.62% m-o-m compared to a -3.4% m-o-m in February'12, while from March'13 and for 3 consecutive months thereafter, retail sales value Index (incl. fuel) posted positive m-o-m growth (March'13 at +2.5% m-o-m vs. March'12 at -6.6%; April'13 at +0.5% m-o-m vs. April'12 at +11.2%; May'13 at +5.4% m-o-m vs. May'12 at -8.1%).

(iii) **Number of cars** (new and used from abroad) in circulation for first time are up 19.1% m-o-m and 13.9% y-o-y at July. New circulation amounts to 8,532 road motors cars vs. 7,160 in June and 6,837 in May '13 and 7,490 in July '12.

(iv) **Major infrastructure projects** will recommence in H2:13 and will also drive growth for the Greek economy (i.e. motorway concessions).

(v) Market leaders in various **non-financial sectors** have started showing signs of stabilization in their businesses. Jumbo in retail toys sector, Plaisio in retail electronics, Sarantis in cosmetics, have already posted results, confirming that conditions have started to improve. Moreover, companies that addressed their cost base and restructured early on, will start seeing the results in market share gains and hence management efforts will begin to bear fruits.

Financial Stability Preserved: Bank Recapitalization Completed

Recapitalization of core banks completed with cEUR3.4bn of private funds raised

Three of the core banks, namely NBG, Alpha Bank and Piraeus Bank, were successful in raising more than 10% of capital needs from the private sector and thus stayed under private sector management.

Attica Bank was the only non-core bank that avoided resolution by raising private sector capital. Conversely, ATEbank, T-Bank and FBB were resolved via Purchase and Assumption transactions, while New Proton Bank and New Hellenic Postbank were resolved into bridge banks and later sold to Eurobank. Probank was also resolved into a bridge bank, with the 'good' bank acquired by NBG.

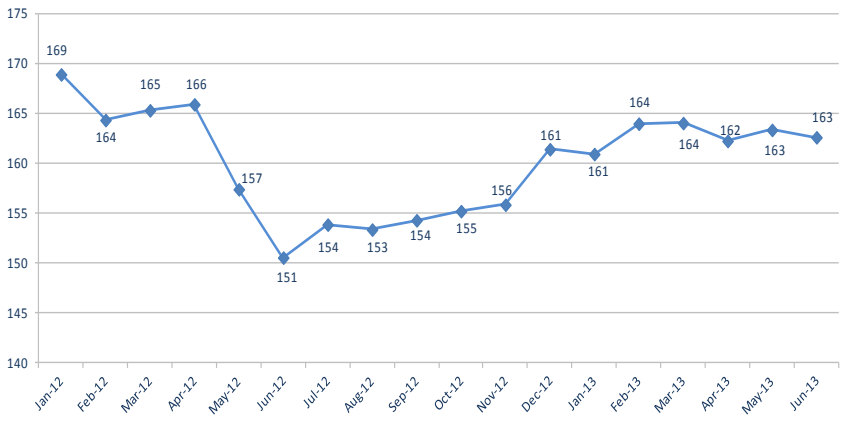
Foreign-owned banks have been acquired by Greek core banks, namely Alpha Bank acquired Emporiki Bank and Piraeus Bank acquired Geniki Bank, Millennium BCP and the Greek branches of Cypriot banks.

The reorganization of the banking sector has preserved financial stability and protected depositors, whilst providing the necessary means to support economic growth. The government has also announced that it will place a substantial equity stake in **Eurobank** to a privately owned strategic international investor by end-March 2014, while the BlackRock diagnostic review (based on H1:13 data), which is already underway, will provide the necessary visibility vis-à-vis underlying capital adequacy levels going forward.

Importantly, the HFSF has utilized cEUR39bn out of the total EUR50bn financial envelope provided for the recapitalization of the Greek banking sector. Moreover, this has resulted in the HFSF holding a cEUR11bn buffer, which safeguards against any potential further capital needs under an adverse scenario as per the new BlackRock diagnostic review (note that initial buffer for additional capital needs under the EUR50bn financial envelope stood at EUR5bn versus current EUR11bn buffer).

The conclusion of Blackrock's new diagnostic review is expected in early Fall and should provide guidelines for the next few critical years. Additionally, the Central Bank of Greece has requested from the four systemic banks the submission of their respective business plans, inclusive of deleveraging moves, sale of non-core assets and actions to address bad loan portfolios. It is also important to note that post the June 2012 elections, the banking system has witnessed significant deposit inflows, especially after the second disbursement under the EU-IMF program in December 2012.

Corporation and Household Deposits: January'12 – June'13 (EURbn)



Source: BoG, Axia Ventures Group

Concluding Remarks…

After significant pain the Greek economy seems ready to enter a new phase…

Overall, we view that the market has underestimated the amount of transformation that the Greek economy has been subject to over the last few years, while at the same time market participants have not yet fully grasped the vast levels of fiscal and structural reforms.

Importantly, on-going structural reforms will provide the necessary impetus for sustained economic growth, transforming a previously consumption based economy into an outward looking, modernized and structurally competitive one.

…as Greece awaits further actions on its public debt…

Although external debt remains a key focus point, we draw your attention to recent Eurogroup comments that this issue will be addressed (at the earliest) in April 2014, despite recent press reports indicating the contrary given the upcoming German elections.

In addition, assuming that Greece achieves a primary surplus budget and continues with reforms, we note that additional debt relief measures could include: (a) extension to debt maturities; (b) further reduction on borrowing rates, especially with regards to bilateral loans under the first Greek loan facility; (c) retroactive application under the EU Banking Union directive, for part of the EUR50bn recapitalization funds to be lifted from the government balance sheet and transferred to the European Stability Mechanism; etc.

We feel that for the moment the Greek economy has started showing signs of stabilization in specific sectors and is not far, given improved sentiment, to being transformed, thus providing new investment opportunities. In addition, the increase of EU Structural Funds absorption rates combined with EIB related programmes and payment of state arrears, will add much needed liquidity to the market. An EU-funded plan, above and beyond already budgeted funds, for national infrastructure projects and public projects at the local level, would clearly benefit, providing the necessary stimulus for a quicker recovery.

Although inherent risks for Greece still remain (i.e. political front as portrayed in the recent political crisis), it is evident that the current coalition government is determined to continue with the necessary reforms. This will in our view become more pronounced leading up to the September Troika review, which will undoubtedly put pressure on the government to ensure that all "prior" actions have been met.

That said, should progress continue to move in the right direction, results should become obvious before year end, thus allowing for the commencement of a sustainable economic recovery.

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