GREECE Macro Flash

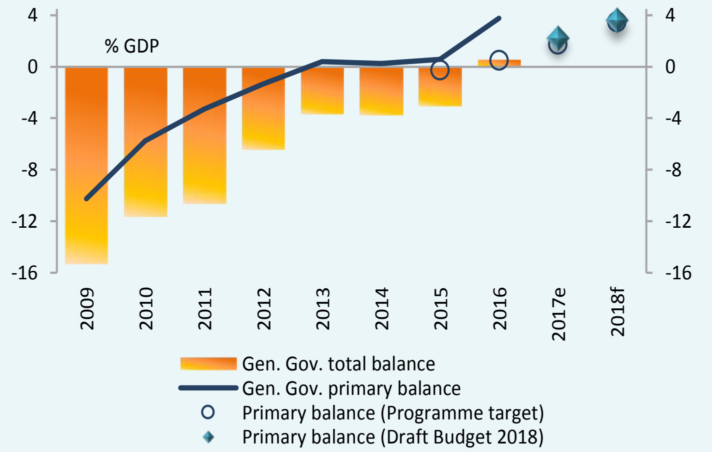
Draft Government Budget 2018

NATIONAL BANK OF GREECE

Fiscal policy continues towards ambitious targets

- The draft government budget for 2018 foresees a primary surplus (programme definition) of 2.2% and 3.6% of GDP, respectively, in 2017 and 2018, above programme targets of 1.75% and 3.5% of GDP.
- The prospective overperformance in 2017 compared with programme targets is estimated to reflect an improvement of 1.1% of GDP in the State balance, mainly through expenditure reduction.
- For 2018, the draft Budget aims at an increase in the primary surplus by an additional 1.4% of GDP, which will bring the surplus slightly above the programme target of 3.5% of GDP. The adjustment in 2018 is skewed towards revenue.
- Specifically, ordinary budget (net) revenue in 2018 is projected to increase by 0.6% of GDP, buoyed by the implementation of about 0.3% of GDP of new revenue measures, with the residual improvement expected from supportive efficiency gains and cyclical effects.
- A reduction in primary spending of 0.3% of GDP, along with an improvement in the fiscal position of other general government entities (by 0.5% of GDP), on the back of an increase in the surplus of the social security funds, will comprise the remainder of the adjustment effort.
- The implied fiscal drag related to the 1.4 pp adjustment in the primary surplus in 2018 is estimated by NBG at 0.7% of GDP, creating limited downside risks for economic activity.

General Government balance



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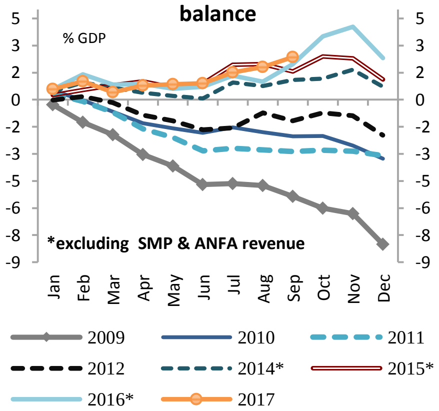
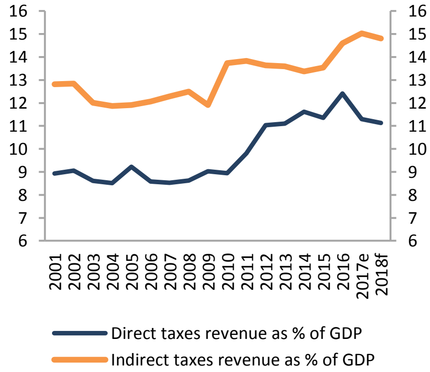
The draft government budget for 2018 aims to maintain the positive momentum and foresees a primary surplus (programme definition) of 2.2% and 3.6% of GDP, respectively, in 2017 and 2018, compared with programme targets of 1.75% and 3.5% of GDP. The primary surplus in 2017 is estimated to be 1.6% of GDP lower than in 2016, when it reached 3.8% of GDP (according to the programme definition and NBG estimates based on the 2[nd] notification of fiscal data in October 2017), when it strongly outperformed the programme target of 0.5% of GDP for 2016. However, the 2016 fiscal outcome was buoyed by a once-off improvement in the financial position of general government entities, namely extra budgetary funds, public enterprises, and the social security and health systems of the order of 3.6% of GDP in total.

Greece - State Budget Primary balance



In contrast to 2016, the prospective overperformance in 2017 compared with programme targets mainly reflects a sustainable improvement in the State balance, especially expenditure reduction. In fact, the ESA-adjusted primary balance of the State budget is envisaged to improve by 1.1% of GDP in 2017, reaching a surplus of 1.0% of GDP from a small deficit of -0.1% in 2016. This outcome is expected to be driven by a reduction in primary spending of 1.3% of GDP, mainly due to lower transfers to the pension system (0.7% of GDP lower than in FY:2016), in conjunction with a lower level of called guarantees and debt assumptions to General Government entities in 2017 (0.6% of GDP lower than in 2016). These savings counteracted the small annual increase in operational spending of 0.15% of GDP. State budget implementation trends in 9M:2017 are consistent with the above targets, with primary spending declining by -5.5% y-o-y vs an increase of +3.0% y-o-y in 9M:2016.

Direct & indirect taxes revenue as % of GDP



Source: MoF , ELSTAT and NBG estimates

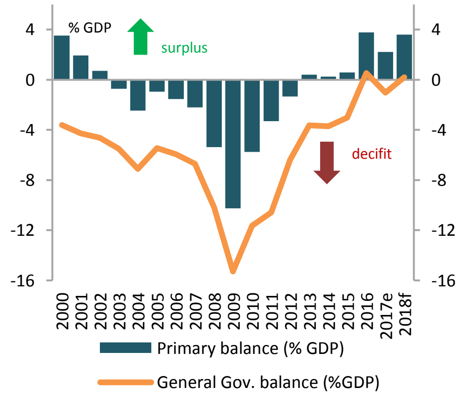
Total ordinary budget net revenue and recurring revenue of the State budget in 2017 are expected to remain broadly unchanged compared with 2016, with significant overperformance on indirect taxes, offsetting a disappointing outcome for direct taxes. In fact, the decline in personal income tax revenue by 0.8% of GDP in FY:2017 is expected to be fully offset by an increase in indirect tax revenue compared with the previous year. The shortfall in PIT revenue is estimated by NBG to reflect a milder-than-initially-expected economic recovery in 2017, compounded by subdued wages, additional pension cuts, as well as a higher-than-expected decline in the personal income tax base due to higher social security contributions (on non-wage income) introduced in 2017. Positive trends in indirect tax revenue are mainly driven by the continuing overperformance in VAT (+6.1% y-o-y in 9M:2017), which has been supported by improving compliance related, *inter alia*, to increased cashless payments, a favorable carry in H1:2017 of the VAT hike in July 2016, and some additional changes in indirect taxes in effect since January 2017.

In fact, according to NBG estimates, State budget implementation trends in 9M:2017 bode well for the achievement of draft budget estimates for 2017, with primary surplus in State budget reaching 3.1% of GDP in 9M:2017 (ESA-adjusted basis) against a draft budget projection for a surplus of 1.0% of GDP in FY:2017 and a 9M:2016 outcome of 2.2% of

GDP. Indeed, primary spending in 9M:2017 remains about 1.4% of GDP lower than in 9M:2016, with the draft budget forecasting an annual contraction of 1.3% of GDP in FY:2017. Moreover, tax revenue increased by 0.5% y-o-y in 9M:2017 (buoyed by higher-than-budgeted proceeds from indirect taxes).

However, the c. 1% of GDP increase in the primary state surplus is estimated to be more than offset by a significant, but mostly expected, reduction in the surplus of other general government entities from an extraordinary surplus of 4% of GDP in 2016 to 1.4% in 2017, leading the estimated general government primary surplus in 2017 to 2.2% of GDP from an estimated 3.8% in 2016. This deterioration is expected to mainly reflect a shrinkage in the (expected) surpluses of social security funds and state enterprises of 1% of GDP each, and a deterioration in balances of hospitals and local governments of 0.5% of GDP and 0.3% of GDP, respectively (ESA-adjusted basis).

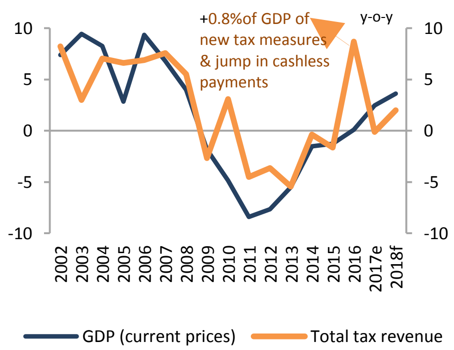
Primary and total general goverment balance



For 2018, the draft Budget aims at an adjustment of 1.4% of GDP, which will bring the primary surplus slightly above the programme target of a surplus of 3.5% of GDP in 2018. The fiscal adjustment is skewed towards revenue. Ordinary budget net revenue is projected to increase by 0.6% of GDP, buoyed by the implementation of about 0.3% of GDP of new revenue measures, consisting of an abolishment of some remaining tax credits, the imposition of an overnight stay tax ranging between €0.50 - €4 per night, depending on the quality of the accommodation, and a reform of the rental sharing tax.

According to NBG estimates, the net returns from the new tax on accommodation could be significantly higher than official estimates, pushing the net returns of the revenue package to above 0.5% of GDP in 2018. Another 0.3% of GDP of revenue improvement is expected to reflect supportive cyclical effects and efficiency gains. The elasticity of revenue from direct and indirect taxes to the estimated nominal GDP growth (projected at 3.6% y-o-y in 2018 from 2.5% in 2017) is conservatively assumed to be lower than 0.6 versus 0.72 in 2017, adding to the credibility of revenue forecasts for 2018. Revenue growth is also expected to benefit from an intensification of fiscal authority inspections and a further upgrade of the tax authorities' capacity to electronically cross-check taxpayers' income, wealth and spending profiles by end-2017, alongside the new legislation for obligatory acceptance of cashless payments for several sectors of economic activity in two stages (June 2017 and January 2018), which will further discourage transactions in the shadow economy.

Total tax revenue & nominal GDP



***Sources**: MoF , ELSTAT, Draft Budget 2018*

The key contributors to expenditure restraint -- a reduction in primary spending of 0.3% of GDP -- include net savings from a further streamlining of the allowance structure (including the abolishment of the tax credit for medical expenses, a further reduction in the heating oil allowance) on the basis of the ongoing social welfare review and the extension of clawback on healthcare expenditure. Moreover, the fiscal position of other general government entities is projected to improve by 0.5% of GDP, supported by an increase in the surplus of the social security funds of 0.6% of

GDP. The improvement in the social security funds balance is expected from a further adjustment in pension benefits from 2015 and 2016 legislation, which will be fully phased in by 2018, in conjunction with higher revenue from the increase in statutory social contribution rates for the self-employed, along with supportive cyclical factors (annual decline in the unemployment rate of 1.2 pps, in conjunction with a prospective pick-up in wages).

Though the targeted increase in the annual primary surplus of 1.4 pps in 2018 presages a higher drag on GDP growth compared with 2017, when the surplus declined by 1.6 pps of GDP relative to 2016, a closer look at the structure of the adjustment in 2018 versus 2017 suggests that downside risks to activity are not significant.

Specifically, about half of the adjustment on the revenue side, or 0.3% of GDP, is estimated to reflect supportive cyclical effects, while at least 0.2-0.3% of revenue growth in 2018 will relate to the new overnight stay tax and the tax on rental sharing, which are borne by non-residents, and thus have a relatively limited impact on domestic demand conditions. Therefore, the effective impact on activity of new revenue measures in 2018 is limited to below 0.2% of GDP. Similarly, about ⅓ of the 0.3% of GDP reduction in primary spending is estimated to reflect additional savings from the extension of the clawback on healthcare expenditure, which typically has a very limited impact on macroeconomic conditions in contrast to more conventional spending cuts that directly affect government consumption or social transfers. Finally, almost 0.2% of GDP of a total net adjustment of 0.5% of GDP to the rest of general government balance will reflect higher spending efficiency related to the completion of a spending review in general government entities along with supportive base effects from 2017. Against this backdrop, the implied fiscal drag related to the 1.4 pp adjustment in the primary surplus in 2018 is estimated by NBG at 0.7% of GDP.

Table 1

Key aspects of fiscal adjustment (ESA adjusted data as % of GDP)

	ESA-10 adjusted data				*cash basis*	
f,e=2018 draft budget forecasts/estimates	**2015**	**2016e**	**2017f**	**2018f**	9M:2016	9M:2017
	% of GDP					
Primary Gen Gov. balance (Programme target)	-0,3	0,5	1,8	3,5	...	...
Primary Gen Gov. balance (Draft budget 2018 forecasts)*	0,6	3,8	2,2	3,6	...	...
State budget primary balance	-0,7	-0,1	1,0	2,3	2,2	2,6
State budget primary balance (ESA-10 adjustment for tax refunds in 9M:2016/17) →					2,2	3,1
	annual change as % of GDP					
Annual change in primary Gen. Gov. balance **	0,3	3,3	-1,6	1,4	0,8	0,3
main adjustment drivers (change from previous year)						
Total contribution (-i+ii-iii+iv)	**0,2**	**3,6**	**-1,6**	**1,2**	**2,2**	**-0,5**
i. Primary spending	-0,8	0,6	-1,3	-0,3	0,5	-1,0
ii. Ordinary budget gross revenue	-0,2	0,7	0,0	0,5	1,9	0,1
of which						
Direct taxes	-0,2	0,3	-0,8	0,2	1,0	-0,5
Indirect taxes	0,1	0,3	0,8	0,3	1,0	0,6
Other tax & non-tax revenue	-0,1	0,1	0,0	0,1	-0,1	0,0
iii. Tax refunds	-0,2	0,1	0,3	-0,1	0,1	1,1
iv. Rest of General Government (+ stands for net improvement)**	-0,6	3,6	-2,6	0,3	0,9	-0,5

Source: Draft Budget 2018, Budget 2017, MTFS 2018-21, NBG estimates.

**Primary surplus figures for 2015-2016 based on 2nd notification of fiscal data (Oct 2017) & Draft Budget 2018 adjustments*

***Cash data for General Government refer to 8M*

Greek Economy: Selected Indicators

	2015					2016					2017					2017f
	Q1	Q2	Q3	Q4	year aver.	Q1	Q2	Q3	Q4	year aver.	Q1	Q2	Q3	Most recent		
Real economy (y-o-y period average, constant prices)*																
GDP*	0,1	0,4	-2,4	0,7	-0,3	-0,7	-0,5	2,0	-0,9	0,0	0,4	0,8	…	Q2:17	0,8	1,6
Domestic demand*	1,1	-1,5	-4,5	0,6	-1,1	-1,0	2,1	2,9	-1,3	0,7	2,5	-0,9	…	Q2:17	-0,9	1,3
Final Consumption*	0,6	0,7	-2,4	0,0	-0,3	-1,2	-0,9	4,0	0,6	0,6	1,0	1,2	…	Q2:17	1,2	0,9
Gross fixed capital formation*	4,0	-14,0	-5,2	13,9	-0,2	-10,4	18,1	12,7	-14,0	0,0	10,8	-4,6	…	Q2:17	-4,6	7,1
Exports of goods and services*	12,6	11,2	-7,7	-2,7	3,1	-10,2	-10,3	10,8	5,0	-1,7	5,2	9,5	…	Q2:17	9,5	7,3
Imports of goods and services*	15,1	4,0	-14,1	-2,7	0,3	-10,2	-2,0	13,9	3,5	0,6	11,7	3,1	…	Q2:17	3,1	6,1
Coincident and leading indicators (period average)																
Retail sales volume (y-o-y)	0,0	0,6	-4,2	-2,1	-1,5	-3,3	-4,0	3,1	1,7	-0,6	2,8	2,1	…	Jul	2,3	…
Retail confidence (15-yr. average: -1,5)	-3,0	-1,3	-25,6	-11,1	-10,3	0,9	5,1	10,8	10,5	6,8	5,8	0,4	-1,6	Sep	0,0	…
Car registrations (y-o-y)	19,2	33,2	-2,2	2,1	13,8	-0,3	19,5	16,8	4,0	10,7	37,8	4,0	…	Jul	35,1	…
Consumer confidence (15-yr. average: -43,4)	-37,0	-43,6	-60,6	-61,6	-50,7	-67,5	-71,2	-68,4	-65,0	-68,0	-71,8	-70,2	-57,4	Sep	-53,7	…
Industrial production (y-o-y)	3,0	-2,5	1,4	2,5	1,0	-1,0	5,1	2,0	3,8	2,5	9,4	2,9	…	Aug	5,6	…
Manufacturing production (y-o-y)	6,7	-0,6	-0,5	2,1	1,8	1,2	7,8	5,3	2,2	4,2	6,0	2,7	…	Aug	3,1	…
Capacity Utilization (15-yr. average: 72,8)	67,1	67,0	62,0	65,2	65,3	65,9	66,4	67,5	69,6	67,4	68,2	68,7	…	Aug	71,5	…
Industrial confidence (15-yr. average: -6,1)	-9,1	-14,0	-26,6	-16,6	-16,6	-9,4	-9,5	-6,2	-6,1	-7,8	-5,6	-7,8	-2,4	Sep	-0,7	…
PMI Manufacturing (base=50)	48,5	47,1	37,5	48,5	45,4	49,1	49,5	49,4	48,7	49,2	47,0	49,4	51,8	Sep	52,8	…
Construction permits (y-o-y)	29,2	-5,6	-22,4	5,9	-0,3	-11,9	-30,9	38,4	-9,5	-6,9	16,7	32,0	…	Jul	10,0	…
Construction confidence (15-yr. average: -21,9)	-33,9	-44,8	-60,9	-48,5	-47,0	-37,1	-41,6	-55,9	-55,0	-47,4	-51,6	-58,8	-41,9	Sep	-36,9	…
PIP Disbursements (y-o-y)	-40,9	-57,6	-21,0	43,9	-2,8	7,0	18,0	35,7	-14,8	-1,8	-36,9	-24,9	…	Sep	-61,9	…
Stock of finished goods (15-yr. average: 12,2)	13,0	15,0	17,4	15,3	15,2	12,5	11,1	14,9	12,2	12,7	10,7	11,8	12,7	Sep	10,2	…
External sector (period average)																
Current account balance (% of GDP)	-1,9	-0,4	3,1	-1,0	-0,2	-1,5	-0,3	2,2	-1,4	-1,1	-1,6	-0,2	…	Aug	1,0	-0,3
Current account balance (EUR mn)	-3295	-750	5482	-1841	-404	-2560	-608	3822	-2526	-1872	-2783	-427	…	Aug	1827	…
Services balance, net (EUR mn)	1297	4757	9062	1816	16932	716	3776	8641	2179	15311	1006	4212	…	Aug	3826	…
Primary Income Balance, net (EUR mn)	477	-575	-185	699	416	759	-184	-636	57	-3	951	-233	…	Aug	-216	…
Merchandise exports-- non-oil (y-o-y cum.)	10,0	7,5	4,2	1,9	1,9	-1,1	-2,5	0,1	1,4	1,4	8,5	9,5	…	Aug	9,1	…
Merchandise imports-- non-oil (y-o-y cum.)	4,6	-1,6	-7,4	-7,8	-7,8	-3,3	-2,8	3,8	3,2	3,2	7,2	6,4	…	Aug	7,0	…
Gross tourism revenue (y-o-y)	10,5	9,6	4,7	-4,4	5,2	3,8	-10,7	-6,7	8,0	-6,0	-4,9	10,1	…	Aug	16,9	…
International tourist arrivals (y-o-y)	45,6	15,0	2,6	-2,1	7,1	-6,2	-0,2	6,5	15,9	5,1	-1,8	9,0	…	Aug	14,3	…
Employment																
Unemployment rate	25,8	25,1	24,8	24,3	25,0	24,0	23,6	23,3	23,4	23,6	22,6	21,6	…	Jul	21,0	21,8
Employment growth (y-o-y)	0,9	2,1	2,1	2,8	2,0	3,1	2,4	2,1	0,5	2,0	1,4	2,4	…	Jul	2,5	…
Prices (y-o-y period average)																
Headline inflation	-2,4	-2,1	-1,8	-0,6	-1,7	-0,9	-0,9	-1,0	-0,4	-0,8	1,4	1,3	1,0	Sep	1,0	1,2
Core inflation	-0,7	-0,9	-0,5	0,3	-0,5	0,2	0,3	-0,3	-0,7	-0,1	-0,4	0,2	0,4	Sep	0,3	0,2
Producer prices excl.energy	-0,1	0,2	0,2	-0,2	0,0	-0,6	-0,8	-0,9	-0,6	-0,7	0,4	0,3	…	Jul	0,3	…
Fiscal policy																
Gov. balance/GDP (Programme definition, according to Draft Budget 2018)	…	…	…	…	-3,1	…	…	…	…	1,0	…	…	…	…	…	-0,8
Government debt/GDP (according to Draft Budget 2018)	…	…	…	…	177,4	…	…	…	…	179,0	…	…	…	…	…	176,8
Revenues--Ordinary budget (cum. % change)	-1,8	-5,7	-6,7	-0,8	-0,8	4,3	6,9	9,7	7,6	7,6	0,4	-1,1	0,4	Sep	0,4	…
Expenditure--Ordinary budget (cum. % change)	-2,2	-6,7	-5,3	0,2	0,2	-2,3	2,7	1,5	0,7	0,7	-0,8	-3,2	-4,7	Sep	-4,7	…
Monetary sector (y-o-y, end of period)																
Private deposits (adjusted for the reclassification of the Consignment Deposits and Loan Fund)	-15,1	-26,0	-26,6	-23,5	-23,5	-12,0	0,5	1,6	3,4	3,4	3,1	3,4	…	Aug	4,3	…
Loans to private sector (incl. sec. & bond loans)	-2,5	-1,7	-1,5	-2,0	-2,0	-2,1	-2,0	-1,6	-1,5	-1,5	-1,3	-1,3	…	Aug	-0,9	…
Mortgage loans (including securitized loans)	-3,3	-3,4	-3,5	-3,5	-3,5	-3,4	-3,4	-3,4	-3,5	-3,5	-3,3	-3,2	…	Aug	-3,0	…
Consumer credit (including securitized loans)	-2,5	-2,3	-2,8	-2,3	-2,3	-1,7	-1,5	-0,7	-0,8	-0,8	-0,7	-0,7	…	Aug	-0,4	…
Interest rates (period average)																
10-year government bond yield	10,0	11,6	10,8	7,9	10,1	9,5	8,2	8,2	7,5	8,3	7,2	6,1	5,5	Sep	5,5	…
Spread between 10 year and bunds (bps)	967	1112	1011	730	955	919	805	823	733	820	689	577	502	Sep	513	…
Exchange rates (period average)																
USD/euro	1,13	1,11	1,11	1,10	1,11	1,1	1,13	1,12	1,08	1,11	1,07	1,1	1,18	Sep	1,19	…

*Sources: BoG, NSSG, MoF, ASE,NBG,Bloomberg / *Real Economy data are based on the latest provisional ELSTAT Quarterly National Accounts data for the 2nd quarter of 2017*

This analysis can be viewed at:
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