Greece
Economic & Financial Outlook

In a Nutshell…

The completion of the 2nd Review has set a positive tone by strengthening recovery prospects, as indicated by the improvement in confidence indicators.

The economy returned to growth, as real GDP has expanded both in Q1 and Q2 2017, against a fall in Q4 2016 (Q4 2016: -1.1%, Q1 2017: +0.4%, Q2 2017: +0.8%, yoy changes).

Both soft and hard data point to the recovery of economic activity. In particular, business sentiment index, retail sales, industrial production, tourism industry and car sales all exhibit positive trends, supporting the economy and the employment rate.

The growth rate of economic activity is expected to gradually accelerate during 2017 and peak in the last quarter.

Residential property prices remained in negative territory in H1 2017, albeit demand from abroad is soaring (H1 2017: +63.4% yoy increase in net capital inflows from abroad for property purchasing in Greece).

It is essential for the Greek economy to address the challenges such as:

(a) the pursuing of structural reforms, especially the ones aiming to liberalise the product markets, thus improving the conditions for attracting foreign investment and supporting export-oriented businesses;

(b) the acceleration of the privatisation programme necessary to boost confidence;

(c) the specification of additional measures needed for debt sustainability, combined with a downward adjustment of the primary surplus targets;

(d) the efficient management of the high stock of NPEs and the further decrease of the Greek banks' funding from the Emergency Liquidity Assistance mechanism.

Greece's recovery is gaining momentum

The adjustment programmes implemented in Greece during the last seven years managed to address macroeconomic imbalances, resulting in substantive progress in terms of fiscal consolidation, external imbalances and structural reforms in the labour, product and services' markets. These developments started to bear fruit and the economy returned to growth, as real GDP expanded in Q1 and Q2 2017, against a fall in Q4 2016 (Q4 2016: -1.1%, Q1 2017: +0.4%, Q2 2017: +0.8%, yoy changes) (Chart 1).

The completion of the 2nd Review and the subsequent disbursement of €7.7 bn in July, triggered a series of positive developments. Firstly, it allowed the partial clearance of government arrears to the private sector to resume, thus easing liquidity conditions (Sept. 2017: €4.5 bn vs Aug. 2017: €6 bn). It also set a positive tone by strengthening recovery prospects, as indicated by the improvement in the economic sentiment index (Chart 2). Furthermore, It has triggered a decline in Greek bond spreads and an upward trend in deposits, observed in May-August 2017.

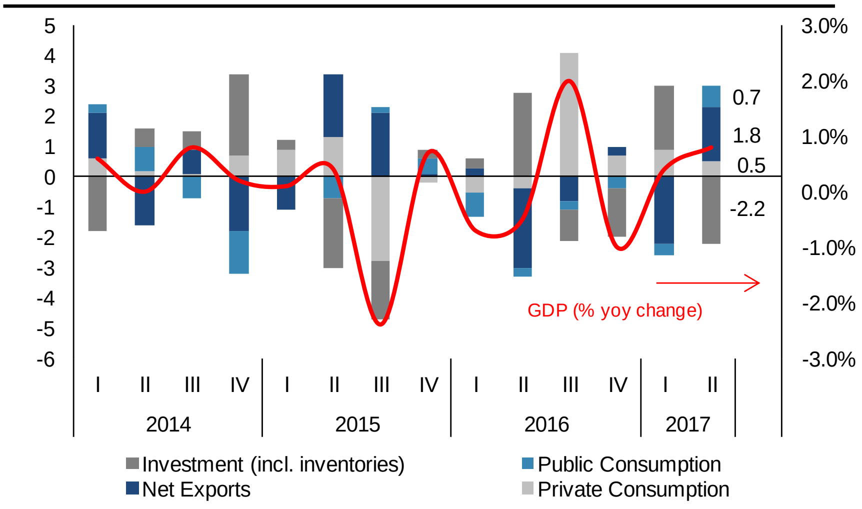
All the above allowed Greece to tap the markets for the first time since 2014, as the Hellenic Republic successfully issued a 5-year bond at the end of July 2017.

The Greek government adopted the Medium Term Fiscal Strategy 2018-2021 and a new package of fiscal measures on both the revenue and the expenditure side – mainly income tax and pension reforms – in order to meet the medium-term fiscal targets. Moreover, the government committed to implementing a range of reforms to further liberalise the labour and product markets. Actions were also taken to step up the privatisation process.

Both soft and hard data point to the recovery of significant aspects of economic activity. In particular, economic sentiment index, retail sales, industrial production, tourism industry and car sales all exhibit positive trends, supporting the economy and employment.

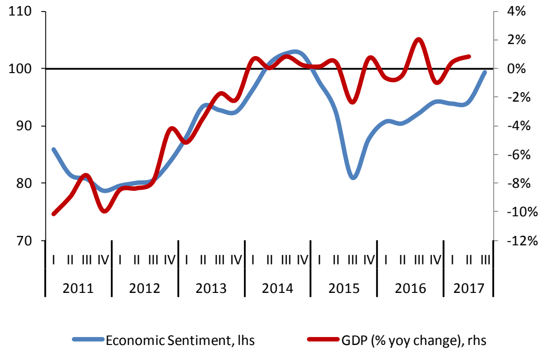
Chart 1. GDP Growth Drivers and the 2017 Turnaround

(GDP Components' Contributions)



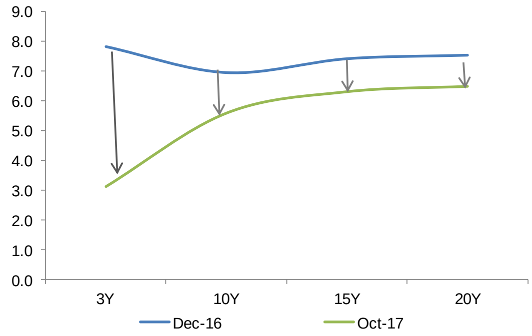
Source: Hellenic Statistical Authority (ELSTAT), Alpha Bank Economic Research calculations

Chart 2. GDP and Economic Sentiment Index



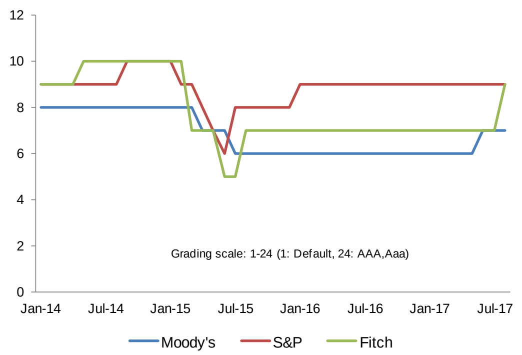
Sources: ELSTAT, IOBE

Chart 3. General Government Bond Yields
(monthly average, %)



Source: Bank of Greece

Chart 4. Sovereign Debt Ratings



Sources: Bloomberg, Alpha Bank Economic Research calculations

The growth rate of economic activity is therefore expected to accelerate gradually during 2017 and peak in the last quarter.

Regarding fiscal adjustment, the execution of the 2017 Budget in 9M 2017, in combination with the new fiscal measures and the ratification by the parliament of the Medium Term Fiscal Strategy 2018-2021, indicate the attainment or even the over achievement of the primary surplus target for the whole year (i.e. 1.75% of GDP).

The positive impact on the economic climate following the completion of the 2nd Review is also reflected in the downward shift of the government bond yield curve (Chart 3), as well as in the upgrading of the Greek sovereign debt ratings by the rating agencies (Chart 4).

The timely completion of the 3rd Review will further reinforce business confidence, which presupposes the continuation of reforms and the acceleration of the privatisation programme. As uncertainty dissipates, growth dynamics are shifting into higher gear. Our baseline scenario, which takes into account solely the expected impact of economic developments and of the fiscal measures announced so far, estimates an output expansion of around 1.5% in 2017.

A positive contribution is expected from all GDP components, with private consumption to be the main contributor, together with investment, reflecting the gradual restoration of confidence. GDP is expected to rebound by more than 2% in 2018-2019, with a more balanced growth in favour of investment and exports. The revival of investment, combined with the improvement in employment and productivity, are the key elements for sustainable recovery.

Moreover, the 3rd Review provides for crucial reforms in the Greek public sector, notably aiming to improve the quality and efficiency of the public administration and the functioning of the educational and judicial system. These developments may, in turn, bring forward regular access to the financial markets, with some sort of EU precautionary credit line to be agreed before the programme is completed.

In the coming years, it is essential for the Greek economy to address several challenges in order to not only reignite but also to sustain growth. The main challenges ahead are:

(a) The pursuing of structural reforms, especially of those aimed at liberalising the product markets, thus improving the conditions for attracting foreign investment and supporting export-oriented businesses. The latter is essential in order to achieve the necessary reallocation of production resources towards the tradable sectors.

(b) The acceleration of the privatisation programme necessary to boost confidence mobilising investment and thus fostering employment as well as economic growth.

(c) The specification, by the creditors, of the additional measures needed for debt sustainability, combined with a downward adjustment of the primary surplus targets.

(d) The efficient management of the high stock of NPEs and the further decrease of the banks' funding from the Emergency Liquidity Assistance mechanism, which is a precondition for the normalisation of liquidity conditions in the economy. The resolution of the NPLs issue is expected to increase bank credit supply, ensuring a level playing field for viable businesses.

GDP growth picks up in Q2 2017

In Q2 2017, the economy continued to grow at a faster pace, as GDP increased by 0.8% yoy, from 0.4% yoy in Q1 2017. The GDP expenditure breakdown shows that in Q2 2017 the main drivers were private and public consumption as well as net exports, while investment and inventories were negative contributors.

In particular, private consumption increased by 0.7% yoy in Q2 2017, for a fourth consecutive quarter, contributing positively to GDP growth by +0.5 pps. In H1 2017 private consumption increased by 1.0% and is expected to register a positive growth rate for the whole year, despite the tax hikes. This scenario is supported by the increase in the number of employees by 1.9% in H1 2017, which boosts households' disposable income, despite the fact that employment gains are mainly coming from part-time jobs. Moreover, increased private consumption is also reflected in the upward trend of retail sales (+3.3% in H1 2017) and the improvement in the consumer confidence indicator (Aug.2017: -57 units, Jul. 2017: -61.5 units), although the level of the index remains very low. Public consumption also increased by 3.3% yoy in Q2 2017 – against a fall by 1.9% yoy in Q1 2017 – adding +0.7 pps to GDP growth.

In the external sector, the substantial increase in the exports of goods and services by 9.5% in Q2 2017, which outpaced the corresponding increase in imports (+3.5%), led to a positive contribution of net exports by 1.8 pps. The adjustment programmes managed to address, to a large extent, the external imbalances, as exports of goods surged by 33% between Q1 2009 and Q2 2017 (Chart 5). Exports of goods and services are expected to keep increasing as a result of the strengthening of the activity of exporting companies and of the increases in tourist arrivals and tourism receipts for 2017. Therefore, net exports are expected to have a positive contribution in 2017.

Finally, investment recorded a deep fall by 17.1% yoy in Q2 2017, due to the decline in all investment components, most notably in investment in machinery and equipment, which fell by 3.4% yoy (Chart 6). It is noted however that this investment had increased significantly by 30.6% yoy in Q2 2016, therefore the fall in Q2 2017 can be partially attributed to base effects. Moreover, investment in dwellings continued to decline by 5.1% yoy in Q2 2017.

However, due to the property market collapse during the crisis, residential investment currently accounts for only 0.6 pps of GDP, compared to 9.9 pps of GDP in 2007. As a result, its negative contribution was only 0.03 pps. Finally, investment in construction, excluding dwellings, declined by 9.3% yoy in Q2 2017, reflecting the restrained expenditure of the Public Investment Budget, which amounted to € 0.9 bn in H1 2017, from € 1.3 bn in H1 2016 and against a targeted €1.2 bn for H1 2017. Inventories also had a negative contribution to GDP by 1.7 pps.

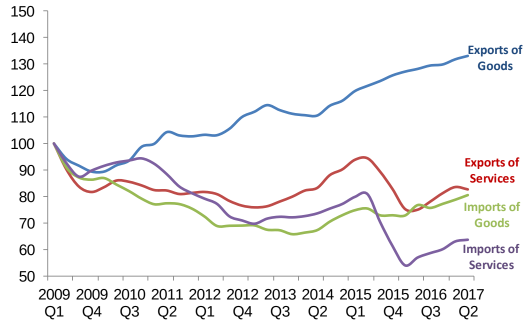
A notable rebound in Economic Sentiment

Following the successful completion of the 2nd Review, the Economic Sentiment Index in Greece (European Commission data) edged up to 100.6 units in September 2017, the highest level since December 2014. However, in October 2017 the economic climate fell slightly to 98.3. It is noted that in the euro area, the economic climate improved anew to 114 units in October (September 2017: 113.1) (Chart 7).

At sectoral level, expectations in services have decreased slightly but remain at a high level, mainly on the back of tourism-related activities. Consumer confidence remains almost unchanged in October 2017 and still remains at a very low level.

Chart 5. Imports-Exports Growth

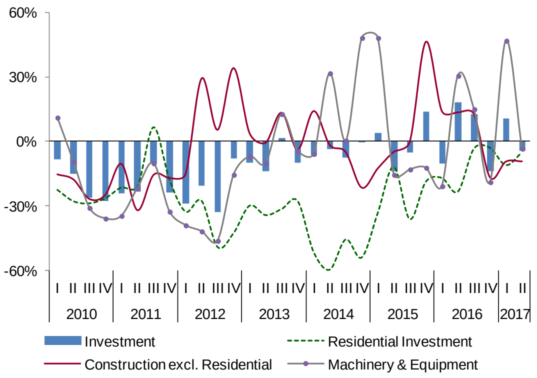
(Q1 2009=100, 3month moving average)



Sources: ELSTAT, Alpha Bank Economic Research calculations

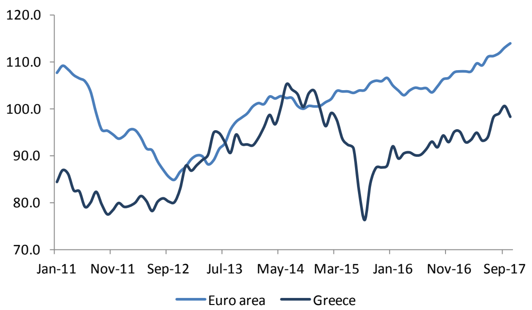
Chart 6. Investment

(% yoy change)



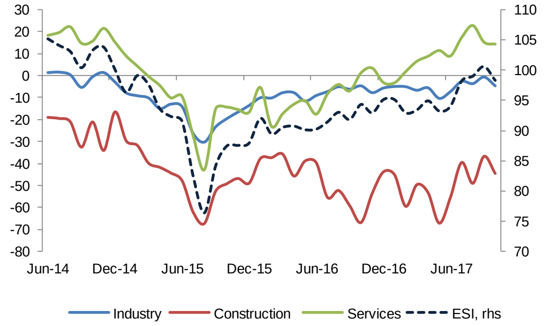
Source: ELSTAT

Chart 7. Economic Sentiment Index



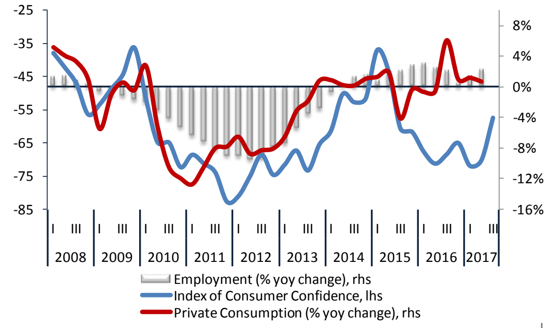
Source: European Commission

Chart 8. Business Confidence



Source: European Commission

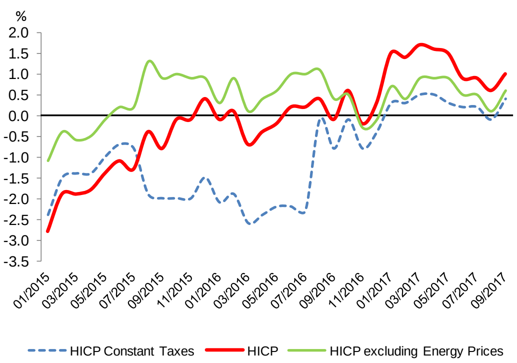
Chart 9. Consumer Confidence



Sources: ELSTAT, European Commission

Chart 10. Harmonized Index of Consumer Prices

(% annual changes)



Sources: ELSTAT, Eurostat

In particular, expectations in services stood at 14.4 units in October 2017, from 15.3 units in September and 1.3 in October 2016 (Chart 8). Regarding the consumer confidence indicator, it stood at -54 units in October 2017, from -53.7 in September 2017 and -63.6 in October 2016. It is noted that the long-term average of the index stands at -40.7 units (Chart 9). The sub-indicator reflecting household ability to save over the next 12 months remains extremely low (-78.6 units in October 2017).

In contrast, the retail trade confidence indicator improved to 2.0 units in October 2017, from 0.0 units in September 2017. Business expectation in construction fell to -44.7 units in October 2017, from -36.9 in September. Finally, the indicator of business expectations in industry declined to -4.7 units in October 2017, from -0.7 in September, though it remains at a fairly high level compared to the average of the crisis period (2008-2017: -14.4 units).

The factors determining the CPI trend

The annual rate of change of the National Consumer Price Index (according to ELSTAT) remains positive since the beginning of 2017. In particular, in September 2017 CPI inflation stood at 0.9%, against -1.0% in September 2016. The harmonized Index of Consumer Prices also increased and stood at 1.0% yoy in September 2017.

In the first nine months of 2017, inflation increased due to the combined effect of three factors: the rebound in international energy prices, the increase in indirect taxes, and the stronger economic activity. These factors are expected to continue to determine the evolution of the consumer price index over the short and medium term.

In particular:

(a) Higher oil prices

Since November 2016, inflation has been affected by the upward trend in oil prices. As shown in Chart 10, from November 2016 onwards, harmonised inflation including energy prices (red line) is higher than the price index excluding energy prices (green line). According to the Energy Information Administration forecast (EIA, Aug. 2017), the oil price (Brent) is expected to rise, on average, by 16.5% in 2017.

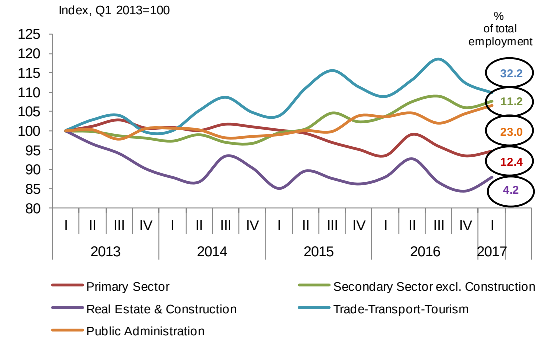
(b) Increased indirect taxation rates

Since August 2015, the impact of VAT hikes on prices for a wide range of goods and services has been strong. As depicted in Chart 10, the harmonized inflation at constant tax rates (blue line) is lower than the general consumer price index (i.e. including the effect of taxation). In particular, in the first nine months of 2017, harmonized inflation stood at an average of 1.2%, while excluding the tax burden, it stood significantly lower at 0.3%.

(c) Rebound in economic activity

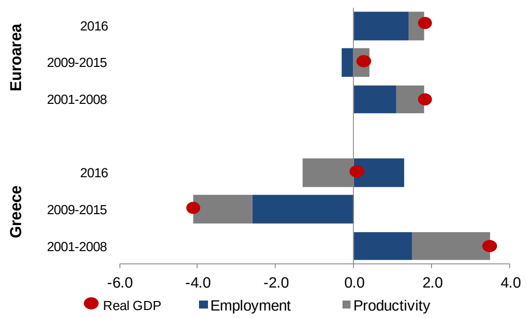
In 2017 the estimated increase in domestic demand, as a result of stronger economic activity, is expected to have a positive impact on prices.

Chart 11. Employment per Economy Sector
(% of total employment)



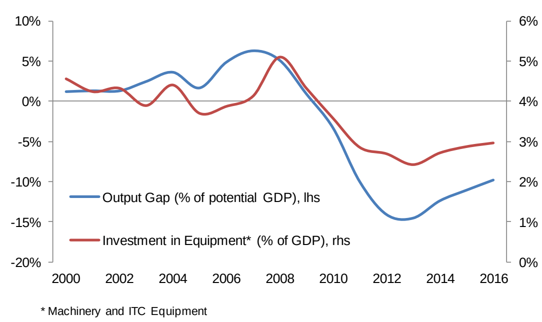
Source: ELSTAT

Chart 12. GDP, Employment and Labour Productivity
(% yoy changes, period average)



Sources: European Commission, Alpha Bank Economic Research calculations

Chart 13. Investment in Equipment and Output Gap



Sources: ELSTAT, European Commission

Box 1: Recovery in the labour market - Developments in productivity and employment

The Medium Term Fiscal Strategy 2018-2021 provides for a projected growth of GDP by 2.4% and of employment by 1.5%, on average, during the period from 2018 to 2021. Should these growth rates materialise, then the unemployment rate is expected to drop below 20% in 2018. Labour market conditions continue to steadily improve throughout 2017, characterised by increasing employment and decreasing unemployment.

Since 2013, an improvement in employment is evident. Across sectors, employment gains were registered mainly in the trade, transport and tourism sector, as depicted in Chart 11, which accounts for 32.2% of total employment. The expected increase in tourism activity in 2017 points to a further strengthening of employment prospects in tourism, transport and trade. Another positive development is the increase in the employment in the industry sector (excluding construction). In contrast, employment in real estate and construction has weakened since 2013, as a result of the collapse of the real estate market.

Nevertheless, the unemployment rate remains uncomfortably high. In order for unemployment to decrease substantially, a sharp increase in employment gains and labour productivity is required. As shown in Chart 12, in the pre-crisis period (2001-2008) Greece experienced high labour productivity growth rates which outpaced those of the euro area in the same period. GDP expansion by 3.5%, on average, during 2001-2008, was mainly attributed to the growth of productivity by 2%, while employment increased by 1.5%. Over this period, GDP in the euro area increased by 1.8%, driven primarily by the growth in employment. During the economic crisis, GDP, productivity and employment fell significantly. In 2016, GDP stagnated, as the number of employed persons increased yet productivity kept declining. According to the EC Spring Forecast 2017, both productivity and employment are expected to increase in 2017 though at a slow pace.

The subdued improvement in productivity reflects the collapse of investment. In particular, investment in machinery and equipment dropped to 3% of GDP in 2016, from 5.1% in 2008 (Chart 13). In order for the Greek economy to remain on a sustainable growth path, output losses must be recaptured by increasing productivity and absorbing the unemployed in productive sectors such as the export-oriented ones.

Hard data indicate an economic rebound

Industrial Production: The General Index of Industrial Production increased by 5.4% yoy in the first eight months of 2017, compared to a much smaller increase by 2.4% in the corresponding period of 2016. The improvement of the Greek industry stemmed from the significant increase in manufacturing by 3.8% yoy (Chart 14) and electricity production by 12.6% yoy. This development confirms the increase, observed after 2010 in the export activity of the Greek manufacturing industry, which managed to channel a significant part of its output to foreign markets.

Retail Sales: The volume index in retail trade increased by 2.1% yoy in the first eight months of 2017, compared to a decline by 1.8%, in the corresponding period of 2016. This index is calculated by deflating the retail trade turnover index, using the consumer price index (CPI) as deflator. The turnover index in retail trade recorded an increase of 2.6% yoy in the first eight months of 2017, compared to a decrease by 3.5% in January- August 2016. The above difference observed in the two

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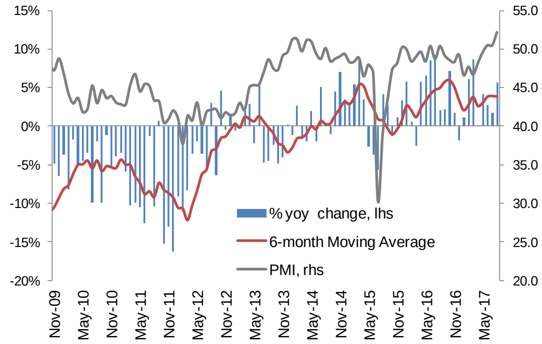
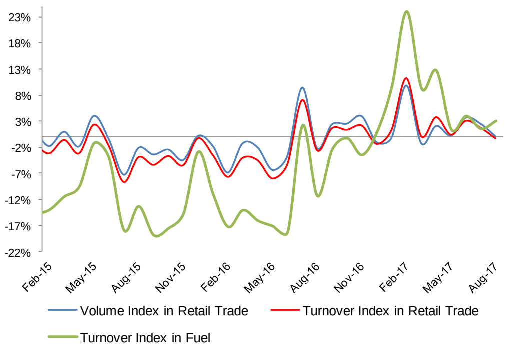
Chart 14. Manufacturing Production Index
(% yoy change)



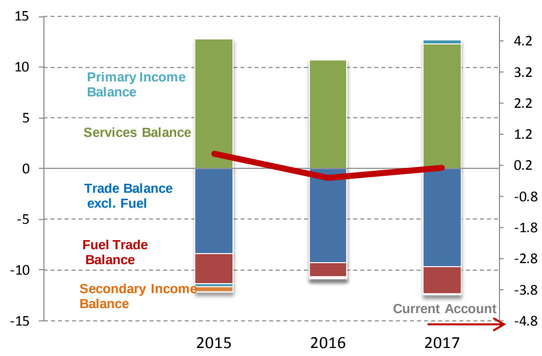
Source: ELSTAT

Chart 15. Turnover and Volume Index in Retail Trade
(% yoy change)



Source: ELSTAT

Chart 16. Balance of Payments
(January–August, in € bn)



Source: Bank of Greece

indices is mainly due to the positive impact of the retail sales index in fuel, which increased by 8.0% yoy as a result of the increase in oil prices. Nevertheless, in August 2017, as shown in Chart 15, the index in retail trade decreased marginally by 0.3% yoy.

New Passenger Car Registrations: According to ELSTAT, new passenger car registrations increased significantly, by 35.0% yoy in September 2017, compared to a smaller increase of 6.1% in September 2016. In the first nine months of 2017, the number of newly registered cars rose by 21.5%, compared to an increase by 12.8% in the same period of 2016. This increase in new cars was due to the increase in used vehicles sales, which grew by 54.6%, while in the case of new cars this increase was much lower (10.5%).

Private Building Activity: In January- July 2017, private building activity recorded a 21.1% yoy increase in volume, a 10.7% increase in building permits issued and a 23.0% increase in the total surface built.

External Sector: Concerning the Balance of Payments (Bank of Greece data), the current account (CA) surplus amounted to €123.4 mill in January-August 2017 compared to a deficit of €211 mill in the corresponding period of 2016 (Chart 16). The deficit of the balance of goods widened but the surpluses of the services balance and primary incomes improved. It is noted that the increase in the trade deficit in the first eight months of 2017 is due to the widening of the deficit in the balance of fuels, which increased by 85.8%, from a 50.5% drop in the first eight months of 2016. Nevertheless, the trade deficit excluding fuels also deteriorated slightly as it increased by 3.8% yoy. The deficit in the balance of goods and services, which accounts for the largest part of the CA, widened by €74.2 mill in January-August 2017. The value of exports (goods and services) increased by 14.9%, while the corresponding value of imports increased by 15.1%.

Labour market: Conditions in H1 2017 continued to improve, mainly as a result of the increase in salaried employment and the fall in the number of unemployed. During the same period, the new job creation was mainly due to new hirings in view of the good prospects for the tourism industry. In particular, in H1 2017 the unemployment rate fell to 22.2%, from 24.0% in H1 2016, as the number of unemployed fell by 7.6% and the number of employed increased by 1.9%. The fall in unemployment and the increase in employment are expected to continue, as economic activity picks up.

The total contribution of tourism to GDP is expected to increase in 2017

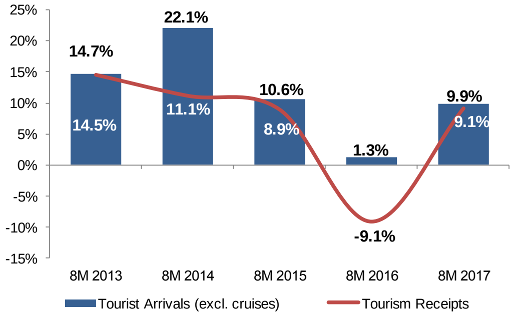
In 2017 tourist arrivals are expected to hit a new record high and tourism receipts to recover from last year's decline, as Greece is considered to be a safer destination compared to its neighbouring peers and is offering high quality hospitality.

According to the latest Bank of Greece data, tourist arrivals (excluding cruises) in the first eight months of 2017 increased by 9.9% yoy, compared to an increase of just 1.3% in the same period of 2016, while travel receipts increased by 9.1%, compared to a sharp drop by -9.1% in the first eight months of 2016 (Chart 17). Especially in August 2017, tourism receipts increased by 16.4% yoy (from -13.0% yoy in August 2016) and arrivals by 14.3% yoy (from +1.8% in 2016). In August alone, foreign visitor arrivals reached 5.8 million – the highest number ever for this month (Chart 18).

According to Greek Tourism Confederation estimates (May 2017), in

Chart 17. Tourist Arrivals and Tourism Receipts

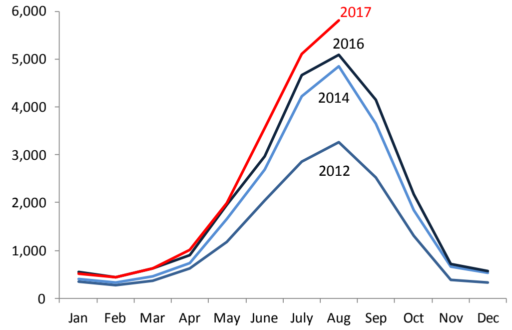
(% yoy change)



Source: Bank of Greece

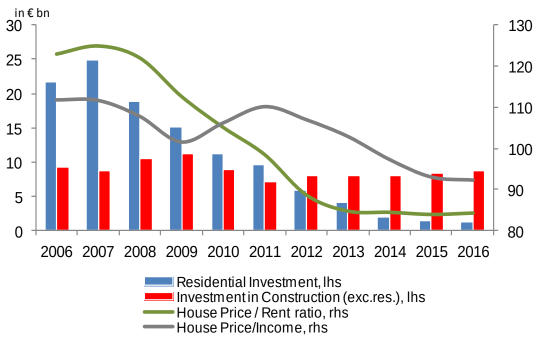
Chart 18. Tourist Arrivals per month

(thousand people)



Source: Bank of Greece

Chart 19. Affordability and Profitability Ratios



Sources: OECD, ELSTAT

2017 tourist arrivals (including cruises) are expected to reach approximately 28.5 million and receipts to increase by 7.5% yoy. In addition, according to the World Travel and Tourism Council, the total contribution of tourism to GDP in 2017 is expected to increase by 6.9% to approximately 20%.

Demand in the housing market remains sluggish

The housing market remains sluggish both in terms of prices and of the number of transactions. We analyse below the determinants of this situation, as well as the prospects of (domestic and foreign) demand for the housing market.

Disinvestment in Real Estate Construction

According to the latest Hellenic Statistical Authority (ELSTAT) data, the construction industry and especially investment in dwellings show no signs of recovery yet. As illustrated in Chart 19, from 2012 onwards the value of residential investment has been significantly lagging behind investment in construction (excluding residences). It is indicative that in 2016 investment in dwellings was only 0.7% of GDP, against 9.9% of GDP in 2007, and has cumulatively declined by €23.6 bn over the 2008-2016 period. In 2016 in particular, residential investment declined by 12.6% yoy, while non-residential investment recovered slightly, increasing by 4.8% yoy.

Housing Market Indicators: Profitability and Affordability Ratios

Chart 19 presents two indicators which reflect housing market conditions: (i) the ratio of house prices to rent, and (ii) the house price index over the per capita disposable income.

(i) The house prices-to-rent ratio compares the cost of acquiring a house against the cost of renting the property (profitability ratio). This index peaked at 124.9 points in 2007, the year before the economic crisis, capturing the largest increase in house prices compared to rents. Since then, house prices have declined significantly, by 40.2% cumulatively over the 2007-2016 period, reflecting the strong decline in demand for housing. This resulted in oversupply and a sharp drop in the price-to-rent ratio.

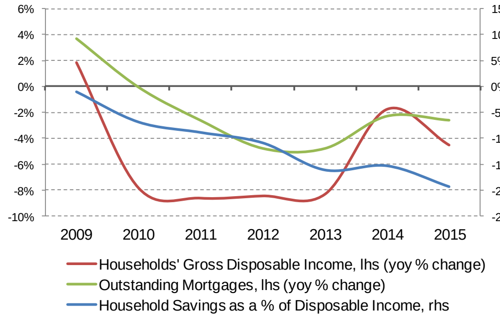
(ii) The house price index over the per capita disposable income reflects the ability of acquiring a house and/or servicing the debt obligations attached to it (affordability ratio). This index too followed a similar downward path, afflicted by the economic crisis in Greece. More specifically, although lower than the cumulative fall in house prices, the cumulative decrease in disposable income between 2008 and 2016 amounted to 31.7%, leading to the downward trend of the index since 2011. In 2016, the house price index over the per capita disposable income stood well below the long-term average (2000-2016: 103.8 points), thus demonstrating the degree of depreciation of house values. This implies that the housing market is undervalued and could possibly present significant investment opportunities. However, it is difficult for this market to promptly recover and return to its pre-crisis levels, as a number of factors hinder growth in housing demand.

Determinants of Subdued Demand

The main factors which caused the decline in housing demand have been the following:

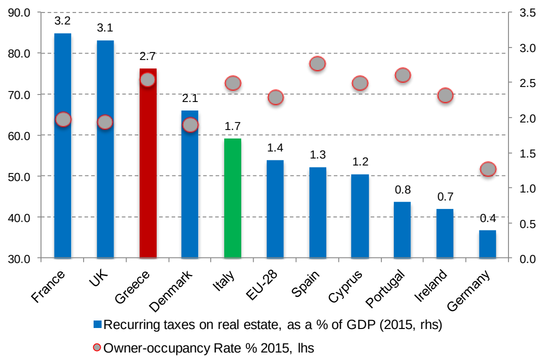
First, the large drop in household disposable income, which has been shrinking since 2010 as a result of the fiscal adjustment and the internal depreciation policy implemented for regaining competitiveness. Demand for housing loans decreased, as evidenced by the evolution of the balance of housing loans in Chart 20, despite the decrease in the

Chart 20. Disposable Income, Savings and Mortgages



Sources: OECD, Ameco

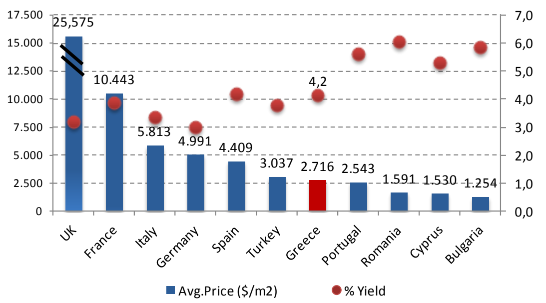
Chart 21. Owner-occupancy Rate* and Taxes on Real Estate



Sources: Eurostat, European Commission

**2016 data for Denmark, Greece, Spain and UK*

Chart 22. House Prices and Rental Yields



Source: Global Property Market, July 2016

average mortgage rate.

Second, the jump in the unemployment rate coupled with the increase in tax burden, has further squeezed household incomes, resulting in a sharp drop of the savings rate on disposable income from 2012 onwards.

Third, the heavy taxation, especially on real estate, and the frequently changing tax rulings, has also drastically affected the real estate market. As illustrated in Chart 21, recurring taxes on real estate as a percentage of GDP ranked Greece at the third highest level among EU countries after France and the United Kingdom. The relatively low real estate tax rates in force before 2010 contributed to a high owner-occupancy rate in post-war Greece, since investment in property was considered a secure placement in an environment of high inflation. However, the owner-occupancy rate has been declining after 2010, although it is still higher than the EU-28 average.

Housing Market Prospects

Domestic demand for housing is expected to be sluggish, since: (i) household disposable income is not expected to increase significantly in the near future; (ii) the unemployment rate is forecast to remain in double digit figure until 2030 (according to the European Commission, the 2015 Ageing Report, January 2017); and (iii) the extraordinary tax imposed on real estate property looks set to become permanent.

Given that domestic demand for housing is not expected to recover soon, it is worth exploring the potential demand originating from abroad. Chart 22 shows that, in terms of value, housing in Greece is attractive compared to other Mediterranean countries though not to South-eastern European ones. However, according to the Global Property Guide, rental yields remain moderate and are lower than those in neighbouring countries such as Romania, Bulgaria and Cyprus.

In order to attract foreign investors, Greece offers a residence permit (valid for five years with the possibility of renewal) to non-European citizens who buy a house worth more than €250,000. In addition, in 2010 the real estate transfer tax was reduced from 10% to 3% on the property's fair value. The above incentives resulted in partially revamping residential investment interest in 2016, with FDI for residential property increasing to €250 million from €186 million in 2015.

Overall, the recovery of the housing market in Greece is largely related to improving the investment climate and reducing tax burdens. Still, given that domestic demand for housing is expected to remain subdued, residential investment is not expected to support GDP growth to the degree it did before the economic crisis. At the same time, any demand for housing coming from abroad is directly related to the restoration of confidence in the economy.

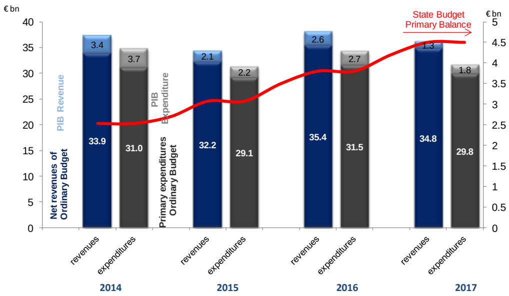
Fiscal outcome in 9M 2017 in line with Target

The fiscal outcome in the first nine months of 2017 was in line with the target set for the period, despite the lag against the target, exerted from the revenue side. In particular, the primary balance of the state budget stood at €4.5 bn, higher than the primary surplus of €3.8 bn in January-September 2016.

As it can be seen from Chart 23, the smooth execution of the budget in the first nine months of 2017, year-on-year, was based on (i) the decrease in the current primary expenditure by €1.7 bn, and (ii) the decrease in the expenditure of the Public Investment Budget (PIB) by €0.9 bn.

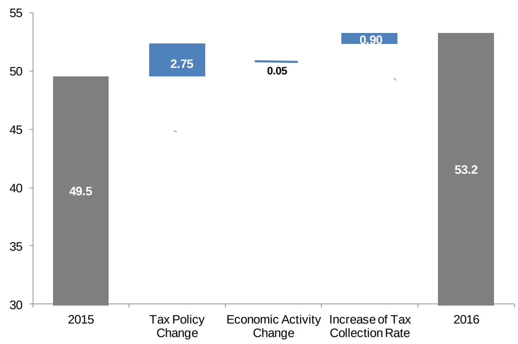
On the contrary, net current revenues fell by €2.3 bn against the target

Chart 23. State Budget Revenues and Primary Expenditures
(9M of each year)



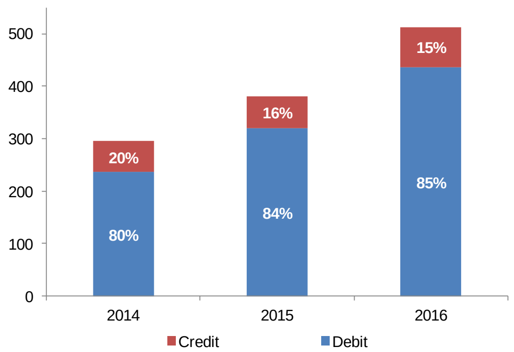
Source: Ministry of Finance

Chart 24. Determinants of Primary Balance Tax Revenues Increase in 2016 (€ bn)



Sources: Ministry of Finance, Bank of Greece, Alpha Bank calculations

Chart 25. Number of Transactions with Payment Cards



Source: Bank of Greece

set for the nine month period and by €0.6 bn on a yearly basis. The deviation from the target is mainly attributed to the increased tax refunds, which (excluding those from the arrears clearance programme) amounted to €4.0 bn, against the target for €2.3 bn.

The evolution of the net revenues of the Budget in January-September 2017 (latest available data) shows:

- A significant increase in indirect taxes year-on-year, also observed in 2016, a development attributable to the increase in VAT rates and in the excise duty on energy products. However, despite the increase in VAT on tobacco products, revenues in this category in the nine-month period of 2017 are lagging behind compared to the corresponding period of 2016.
- A decrease in direct tax revenues in January-September 2017 by €862 million relative to the corresponding period of 2016, mainly attributed to the due date of the first installment of ENFIA 2017 set in September, instead of August, which was initially projected.

Regarding the evolution of government arrears to the private sector, a significant increase in private sector arrears to the State was recorded until the end of August 2017. However, in September 2017, the repayment schedule of government debt arrears accelerated, as the amount fell by €1.5 bn, to €4.5 bn.

Overall, in 2017 the fiscal outcome is expected to exceed the programme's target of a primary surplus of 1.75% of GDP. According to the draft Budget 2017 the primary surplus is estimated at 2.2% of GDP.

Apart from the overall upward trend in revenues, it is useful to analyse to what extent tax revenues in 2016 were determined by:

(a) the changes in tax policy, i.e. the change in VAT and the excise duty and the change in the income tax scale;

(b) the economic activity;

(c) the increased tax collection rate[1] due to improved tax administration, the wider use of electronic payment means and the reinforcement of control mechanisms.

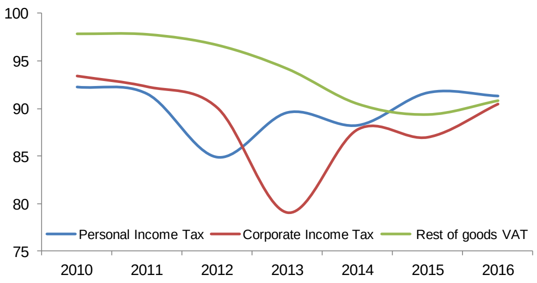
In Chart 24, we disentangle the change in total tax revenues (direct and indirect taxes) originating from factors (a)-(c). As far as factor (c) is concerned, revenues in 2016 increased more than expected on the basis of the tax changes adopted. Consequently, €0.9 bn represent an increase in the tax collection rate and can be attributed to the upgrade of the tax administration, the wider use of electronic payments and the efforts made to reduce tax evasion, either through controls or through the adoption of measures for enforced collection of unpaid taxes.

In particular, regarding the use of electronic payments, as reported in the Overview of the Greek Financial System (Bank of Greece, July 2017), in 2016 the total number of transactions made using payment cards increased by 34.6% to 513 million transactions (Chart 25). The bulk of these transactions was carried out using debit cards, accounting for 85% of all card-based transactions in 2016.

As shown in Chart 26, since 2014 the tax collection rate has been improved for personal income tax, corporate income tax and collection of VAT for other goods. Especially for the latter, an increase in receipts by 1.46 percentage points is observed (Bank of Greece), after five consecutive years of decline.

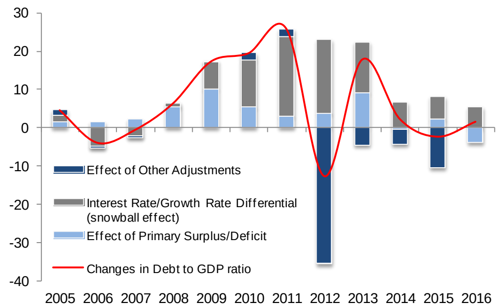
In 2016, income tax burdens on individuals and primarily on legal entities had a positive effect on direct tax revenues, while the increased tax rates imposed on various categories of goods and services led to an

Chart 26. Tax Collection Rate of Personal and Corporate Tax



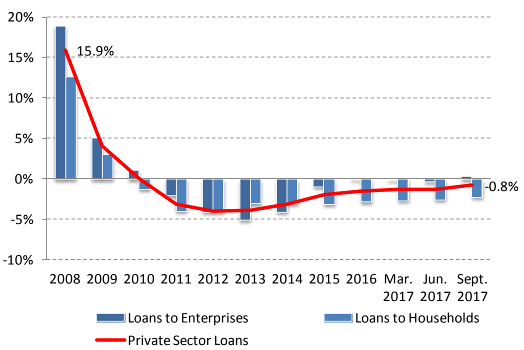
Source: Bank of Greece

Chart 27. Contributors to the Change in the Debt to GDP Ratio



Sources: Bank of Greece, Ministryy of Finance

Chart 28. Credit to Domestic Private Sector
(% yoy change)



Source: Bank of Greece

increase in indirect tax revenues. Additional tax increases introduced in early 2017 had a positive impact on indirect tax revenues in the first eight months of 2017. However, the increasing tax burden on households and businesses will eventually make it harder for these entities to meet their obligations; therefore the capacity to ensure increasing tax revenues through tax hikes over the medium term remains largely an open question.

Note:
1. Tax collection rate: Receivables before refunds/liabilities after write-offs.

Box 2: Debt Relief and Sustainability Exercise: Realism and More Specificity are Needed

Changes in the debt-to-GDP ratio from year to year are determined by three factors: (a) the size of the primary surplus, (b) the difference in the government's interest rate from the nominal GDP growth rate, and (c) other adjustments, i.e. expenditure or revenues which do not affect the deficit but increase or decrease the debt, respectively, such as the privatisation receipts.

The effect of the change in GDP growth rate with respect to the interest rate (factor (b), known as the “snowball effect”[1], reflects the change in the weighted average nominal interest rate (debt servicing costs) above the nominal growth rate, multiplied by the debt-to-GDP ratio of the previous year.

Chart 27 presents the impact of the above variables on the debt-to-GDP ratio over time. It is noted that in 2016, although the higher primary surplus achieved led to a sharp fall of debt, this was not enough to offset the increasing impact from factors (b) and (c). As a result, public debt rose by 1.6 percentage points of GDP. The increase in other adjustments (factor c) largely reflects increased borrowing in order to finance the general government's arrears to the private sector as well as holding increased cash flows, while the positive impact of privatisation receipts was limited, as it only reached 0.28% of GDP.

Note:
1. $(i_t-g_t)/(1+g_t)\times D_{(t-1)}/Y_{(t-1)}$, where:
$D_{(t-1)}/Y_{(t-1)}$: Debt-to-previous-period-GDP ratio
i_t: Average nominal interest rate paid by the State
g_t: Nominal GDP growth rate

Banking System, Financing and Liquidity Conditions

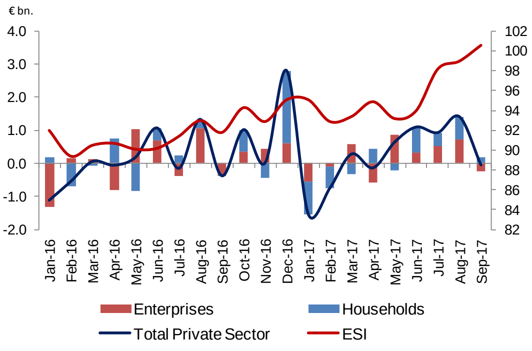
In 2016 and in 2017, Greek banks showed signs of stabilisation, while maintaining high levels of capital adequacy. In particular, the capital adequacy of the banking system was further improved in 2016 as the Common Equity Tier 1 (CET1) stood at 16.9%[1], compared to 16.2% in December 2015. The financial system is expected to improve further, along with the strengthening of the macroeconomic conditions.

At the end of June 2017, non-performing exposures declined further to €101.8 billion or 50.6% of total exposures[2], mainly as a result of loan write-offs (particularly in the business and consumer portfolios). The NPLs ratio stood at 36.1% at the end of June 2017, slightly down from 36.2% at the end of December 2016. The NPLs ratio improved for business loans (June 2017: 35.5%, December 2016: 36.2%) and consumer credit (June 2017: 49.9%, December 2016: 50.0%), while it deteriorated for residential loans (June 2017: 32.5%, December 2016: 31.3%).

The contraction of credit to the private sector[4], which started in Q2 2012 as a result of the economic recession, continued at a slower pace in

Chart 29. Private Sector Deposit Flows

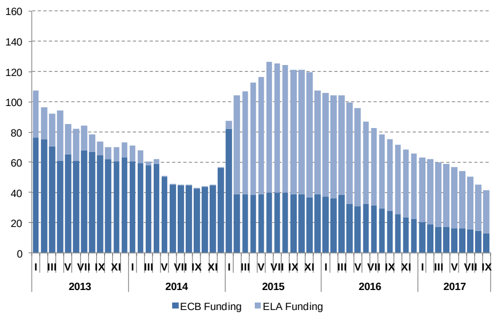
(in € bn)



Sources: Bank of Greece, IOBE

Chart 30. Greek Banks' Funding from the Eurosystem

(in € bn)



Source: Bank of Greece

2016 and 2017, while in September the negative growth rate stood at 0.8%[5] (Chart 28). In particular, at the end of September 2017 the private sector loans outstanding amounted to €187 bn, from €195.1bn at the end of December 2016.

The private sector deposits outstanding[4] stood at €122.6 bn. in September 2017. Household deposits amounted to €100.7 bn and accounted for 82.1% of total private sector deposits, while enterprise deposits amounted to €21.8 bn. Following the successful conclusion of the 2nd Review, the improvement in confidence has been reflected also in the monthly flows of private sector deposits, according to data published by the Bank of Greece (Chart 29). In particular, the sum of the monthly inflows of private sector deposits from May to September 2017 amounted to €4 bn, of which €1.9 bn were household deposits.

Finally, total deposits in the banking system, (private sector and general government deposits) amounted to €133.2 bn in September 2017, registering a 4.7% yoy increase.

The restoration of confidence in the economy and the banking system is related to a reduction in the reliance of Greek financial institutions on the Eurosystem's Emergency Liquidity Assistance (ELA). As seen in Chart 30, since end-2016 the Greek banking system's reliance on the ELA has been steadily decreasing, standing at €28.5 bn in September 2017. Total Eurosystem funding (i.e. ELA plus ECB funding) to the Greek banks amounted to €41.7 bn in September 2017, from €75.4 bn in September 2016 and €121.4 bn in September 2015.

The main challenges for the banking system in the near future remain the efficient management of the high stock of NPEs and the further decrease of the banks' funding from the ELA mechanism.

Notes:

1. Bank of Greece: on a consolidated basis, The Overview of the Greek Financial System, July 2017)
2. Bank of Greece: Report on operational targets for non-performing exposures.
3. Excluding the off-balance sheet items and a current loan to the Greek State, which has been excluded from target-setting.
4. According to the Bank of Greece, as of December 2016 the deposits and loans of the Consignment Deposits and Loan Fund are excluded from domestic deposits and credit, as the institution has been reclassified from the financial sector to the general government sector.
4. Credit growth rates are calculated taking into account reclassifications and loan write-offs, exchange rate variations and corporate bonds and loans transferred by credit institutions to their non-resident subsidiaries.

ALPHA BANK

Economic Data – Greece

as of 6/11/2017

Macroeconomic Environment	ANNUAL				QUARTERLY					MONTHLY								
	2013	2014	2015	2016	2016			2017		2017								
					II	III	IV	I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.
AGGREGATE DEMAND																		
GDP at current prices (€ billion), SA	180.7	178.7	176.3	174.2	43.9	44.3	43.8	44.1	44.0									
(annual % change)	-5.5	-1.1	-1.3	-1.2	0.2	1.8	-0.7	1.1	0.2									
GDP at constant prices 2010 (€ billion), SA	184.2	185.6	185.0	184.6	46.0	46.4	45.9	46.2	46.4									
(annual % change)	-3.2	0.7	-0.3	-0.2	-0.5	2.0	-1.0	0.4	0.8									
Components (annual % change, at constant prices)																		
Private Consumption	-2.6	0.6	-0.5	0.0	-0.6	6.1	1.0	1.2	0.7									
Public Consumption	-6.4	-1.4	1.2	-1.5	-1.5	-1.3	-2.0	-1.9	3.3									
Gross Fixed Capital Formation	-8.4	-4.7	-0.3	1.6	18.1	12.7	-14.0	10.8	-4.6									
Exports of Goods and Services	1.5	7.7	3.1	-1.8	-10.3	10.8	5.0	5.2	9.5									
Imports of Goods and Services	-2.4	7.7	0.4	0.3	-2.1	13.9	3.5	11.7	3.1									
LABOUR MARKET (annual % change)																		
Nominal Unit Labour Costs (1)	-6.3	-2.7	-1.2	1.9	4.7	-0.4	1.0	1.5	1.3									
REER Unit Labour Costs (2)	-5.3	-2.4	-5.8	1.1	1.5	0.9	1.7											
Unemployment Rate (%) (3)	27.5	26.5	24.9	23.5	23.1	22.6	23.6	23.3	21.1	23.1	22.6	22.0	21.8	21.6	21.3	21.0		
PRICES (average annual % change)																		
National CPI	-0.9	-1.3	-1.7	-0.8	-0.9	-1.0	-0.4	1.4	1.3	1.2	1.3	1.7	1.6	1.2	1.0	1.0	1.0	0.9
National CPI excl. Fresh Fruits - Vegetables & Fuels (BoG)	-1.7	-0.7	-0.5	-0.1	0.3	-0.3	-0.7	-0.4	0.2	-0.6	-0.7	0.1	0.2	0.2	0.4	0.6	0.3	0.3
HICP (Harmonised Index)	-0.9	-1.4	-1.1	0.0	-0.1	0.2	0.2	1.5	1.3	1.5	1.4	1.7	1.6	1.5	0.9	0.9	0.9	1.0
GDP Deflator, SA	-2.4	-1.8	-1.0	0.1	0.7	-0.2	0.4											
PUBLIC FINANCES																		
General Government Primary Balance (€ billion, cumulative) (4)	2.9	0.5	0.7	7.0	3.4	5.3	5.0	2.0	2.6	1.4	2.6	2.1	2.6	2.2	2.6	4.1	3.5	4.5
G.G. Primary Balance (% of GDP)	1.6	0.2	0.5	3.9														
General Government consolidated Gross Debt (€ billion) (8)	320.5	319.7	311.7	314.9	328.3	323.7	326.4	326.5	325.4									
G.G. Gross Debt (% of GDP)	177.4	179.7	177.4	179.0														
EXTERNAL BALANCE & COMPETITIVENESS INDICATORS																		
Current Account Balance (€ billion.) (5)	-3.6	-2.9	0.2	-1.1	-2.6	1.6	-1.1	-2.5	-2.8	-0.3	-1.2	-2.5	1.3	-0.5	-0.6	1.6	1.8	
Current Account Balance (% of GDP) (5)	-2.0	-1.6	0.1	-0.6	-1.5	0.9	-0.6											
Greece: Real Effective Exchange Rate Index (CPI based) (6)	-0.7	-1.8	-4.5	0.7	1.4	0.2	0.5	-0.3										
Greece: Nominal Effective Exhange Rate Index (6)	2.0	0.7	-2.7	-1.7	2.0	0.8	1.1	0.1	0.6	0.5	-0.4	0.2	-0.1	0.6	1.2	2.1	2.6	
Tourism Competitiveness Index (rank out of 140) (7)	32		31															

Sources: Hellenic Statistical Authority, EC, UNWTO, BoG, Min Fin

(1) NSA, Nominal Unit Labour Cost based on hours worked (2) Compared to 37 countries. (3) Defined as unemployed/labour force (seasonaly adjusted data, period average).

(4) Yearly data are according to the definition of primary balance used under the Economic Adjustment Programme, while quarterly and monthly data are compiled from cash based public accounting data (without the impact of the support to financial institutions)

(5) Quarterly data are cumulative.

As of reference month July 2015, the Bank of Greece will implement a significant change to its balance of payments compilation methodology, using ELSTAT's trade statistics instead of the settlements data used until June 2015 inclusive.

(6) The index is CPI-based and includes the 28 main trading partners of Greece. A positive sign denotes loss of competitiveness of Greece's trade partners

(7) Travel and Tourism Competitiveness Report 2015. The smallest the number, the better

(8) Yearly data as defined in the Maastricht Treaty

Business Economy	ANNUAL				QUARTERLY					MONTHLY									
	2013	2014	2015	2016	2016			2017		2017									
					II	III	IV	I	II	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.
(annual % change unless otherwise indicated)																			
INDUSTRY																			
Industrial Production Index (1)	-3.2	-1.9	1.0	2.5	5.1	2	3.8	9.4	2.8	7.1	11	10.1	0.8	6.3	1.6	1.7	5.6		
Manufacturing Production Index	-1.1	1.8	1.8	4.2	7.8	5.3	2.2	6	2.6	0.9	6.4	10.2	-0.3	5.3	2.8	1.3	3.1		
Turnover Index in Industry	-5.9	-1.1	-10.1	-5	-12.5	1.3	5.2	24.5	12.5	27.4	21	25.2	9.8	19.7	8.1	8.6	6.1		
CONSTRUCTION ACTIVITY																			
Production Index in Construction (WDA, 2010=100) (1)	-8.2	15.5	3.1	22.9	15.5	76.8	18.6	9.8	-1.0										
Index of Apartment Prices	-10.9	-7.5	-5.1	-2.4	-2,5	-1.5	-1.0	-1.7	-1.2										
Private Building Activity (volume in 000m^3) (2)	-25.6	-5.8	-0.2	-6.9	-30.9	38.4	-9.5	16.7	24	-14.1	-0.1	71	22.1	52.7	25.1	10.0			
TRADE																			
Turnover Index in Retail Trade (3)	-8.6	-1.1	-2.8	-2.1	-5.8	1.9	0.6	4.1	2.5	1.4	11.2	0.1	3.8	0.4	3.1	1.8	-0.3		
Turnover Index in Wholesale Trade (3)	-12.2	0.2	-4.4	-1.6	-3.7	2.8	-0.6	7.4	2.6										
CAR TRADE																			
Turnover Index in Car Trade (3)	-3.1	18.6	7.8	7.2	15.4	18.6	-2.1	16.2	-6.1										
New Passenger Car Registrations (2)	3.1	30.1	13.8	10.7	19.5	16.8	4.0	37.8	4.0	24.8	46.2	45.2	-7.3	-5.3	30.6	35.1	38.0	35.0	
SERVICES					(cumulative)														
Tourism Receipt, BoG (incl. cruises)	16.4	10.2	5.5	-6.4	-5.8	-5.5	-6.4	-4.8	7.1	-2.4	-3.1	-7.8	11.3	1.7	14.2	5.3	16.4		
Tourism Receipt (€ million)	12,152	13,393	14,126	13,220	3,929	12,085	13,220	513	4,114	165	145	203	484	1,093	2,047	2,925	3,522		
Tourist Arrivals, BoG (excl. cruises)	15.5	23.0	7.1	5.1	-1.6	3.5	5.1	-1.8	6.6	-6.9	2.6	-0.2	12.0	1.5	13.0	10.2	14.3		
Tourist Arrivals (in thous. people)	17,919	22,033	23,559	24,799	7,446	21,345	24,799	1,592	7,941	520	444	628	1,010	1,982	3,356	5,142	5,813		
Turnover Index in Tourism (hotels & restaurants) (3)	4.8	11.8	3.1	0.1	-1.3	2.9	4.1	0.9	7.3										
EXPECTATION INDICES (units)																			
Economic Sentiment Indicator	91.6	100.5	89.7	91.8	90.3	92.1	94.1	93.8	94.0	95.1	92.9	93.4	94.9	93.2	94.0	98.2	99.0	100.6	98.3
Index of Consumer Confidence	-69.4	-54.0	-50.7	-68.0	-71.2	-68.4	-65.0	-71.8	-70.2	-67.8	-73.3	-74.4	-72.2	-69.7	-68.8	-61.7	-57.0	-53.7	-54.0
Index of Bus. Expect. in Industry	87.8	94.6	81.9	91.2	91.9	91.1	91.2	92.0	91.1	90.5	91.8	93.7	93.3	88.0	92.0	91.6	91.0	99.0	94.1
Index of Bus. Expect. in Construction	65.0	80.4	56.4	55.7	62.8	43.9	48.1	52.0	42.9	58.1	46.2	51.8	47.7	32.1	49.1	59.8	49.0	68.2	62.3
Index of Bus. Expect. in Retail Trade	70.1	89.1	81.0	98.0	100.2	98.6	99.5	94.0	92.7	102.5	90.1	89.6	91.7	96.4	90.0	86.1	84.2	85.7	91.5
Index of Bus. Expect. in Services	70.4	87.2	70.6	76.3	74.9	79.3	82.0	77.9	86.5	78.5	76.9	78.3	82.4	86.3	90.9	92.5	94.4	92.6	92.1

Sources: Hellenic Statistical Authority, Bank of Greece, IOBE

(1) Production at constant prices, SA. (2) Bank of Greece data (3) Turnover at constant prices.

Blank indicates not available data.