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ECONOMIC RESEARCH DIVISION

ALPHA BANK

What Drives Economic Growth in Greece? Demand-side Contributors

The recently published national accounts data by the Hellenic Statistical Authority reveal the main features of the evolution and composition of GDP growth in the fourth quarter of 2018[1] and 2018[2] as a whole, shedding light on the growth pattern of the Greek economy during the current phase of the business cycle.
The recovery of the domestic economic activity strengthened further in 2018, with real GDP growing by 1.9% from 1.5% in 2017, despite the entry of q-o-q GDP growth to negative territory in the last quarter of 2018 (-0.1% q-o-q), after nine consecutive quarters with positive sign. As a result, in Q42018 the pace of expansion weakened to 1.6%, on an annual basis, from 2.1% y-o-y in the third quarter of the year.

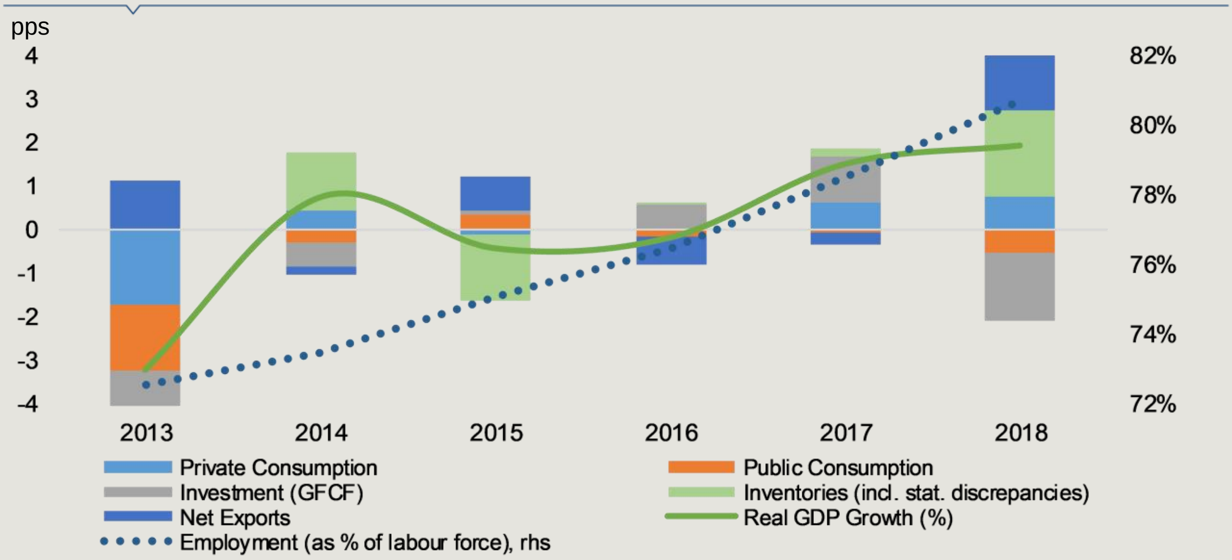
The output expansion in 2018 was primarily supported by net exports, making the largest contribution to growth. The annual growth of exports of goods and services (8.7%) outpaced import growth (4.2%), on the back of the solid performance of tourism (for further analysis, see subsequent section of the Report) and export-oriented manufacturing sectors.

Private consumption increased by 1.1% in 2018 from 0.9% in 2017, contributing to annual GDP growth by 0.7 pps, underpinned by the rise in household disposable income and significant employment gains (for further analysis, see subsequent section of the Report). Despite subdued investment demand, labor market conditions continued to improve during the year. Employment continued to rise in 2018 by 2%, while the unemployment rate fell to 19.3% from 21.5% in 2017.

Gross fixed capital formation declined by 12.2% in 2018, mainly driven by the marked fall in investment in transport equipment. Other machinery equipment and IT/Telecommunications increased by an average of 16.1%, contributing significantly to the revival of physical capital and the incorporation of technological innovations. However, it is worth noting the revival in residential investment, which recorded increases during 2018, for the first time since 2007. The positive dynamics of residential investment during 2018 synchronized with the recovery of residential real estate prices (2018: +1.5%), relating also to the marked development of the short-term rental market over the past years *via* home-sharing economy (e.g. Airbnb and HomeAway platforms).

GRAPH 1

GDP Growth Contributions and Employment Dynamics



Source: ELSTAT

Notes:

[1] Quarterly national accounts, provisional data, seasonally adjusted in volume terms.
[2] Annual national Accounts, 1st estimate for the year 2018, non- seasonally adjusted data in volume terms.

Turning to the developments in the last quarter of 2018, GDP growth decelerated to 1.6% on an annual basis from 2.1% y-o-y in Q32018 and 2.2% y-o-y in the corresponding period of the previous year. Private consumption growth remained roughly stable at 1.1% y-o-y compared to the previous quarter. The significant increase in exports of goods and services by 10.6% y-o-y, offset the rise in imports (2.0% y-o-y), leading to a positive contribution of net exports. On the other hand, public consumption declined by 1.4% y-o-y for the fourth quarter in a row. Gross fixed capital formation dropped markedly by 27.2% y-o-y in Q42018 mainly driven by the large falls in transport equipment and construction (other than dwellings). The pace of quarterly growth of residential investment accelerated further in Q42018 to 8.7% from 7.7% in Q32018.

Carry-over Effect in 2019

The annual average real GDP growth rate is determined by the growth dynamics within the year and the growth dynamics of the previous year, the latter referring to the so-called carry-over effect. Carry-over is derived as the percentage change between the level of real GDP in the last quarter of the year and the average level of real GDP in the year. This is equivalent to the annual average growth rate that would be determined if the level of real GDP in each quarter of the next year remains equal to the level of GDP in the last quarter of the previous year.

Thus, when the level of real GDP in the fourth quarter of the previous year is higher than the average level of the year, then the carry-over effect for the next year is positive. In other words, the stronger the quarterly real GDP growth in the fourth quarter of the year, the higher the carry-over effect in the next year.

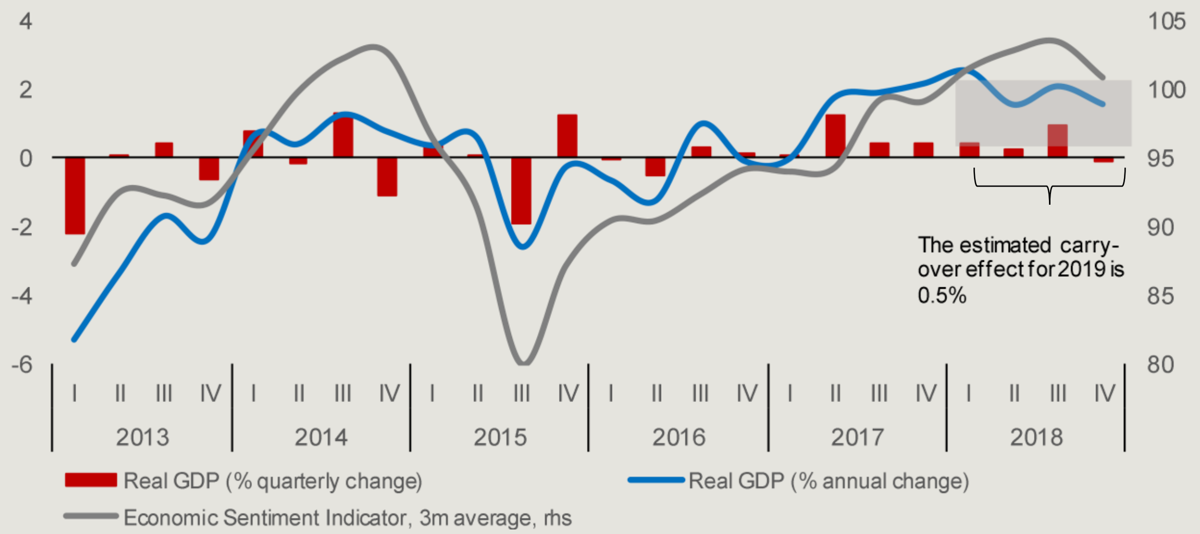
According to the latest available GDP data, the carry-over effect on growth in 2019 from growth in 2018 is estimated at 0.5 pps. Although it is slightly lower than the carry-over effect of the previous year, it is still positive, suggesting that real GDP growth is expected to maintain its current dynamics.

Greek Tourism: 2018 Performance and Challenges Ahead

The latest available data by the Bank of Greece on the balance of travel services for 2018 corroborate the solid performance of Greek tourism, which maintained its upward trend -started since 2012 - both in terms of tourist arrivals (+ 10.8%) and travel receipts (+ 10.1%). In addition, as illustrated in Graph 3, travel receipts cover approximately 72% of the balance of goods' deficit in 2018, from just 37% in 2005. According to the World Travel & Tourism Council, the direct contribution of tourism sector is estimated to have exceeded 8% of gross domestic product in 2018, while its total contribution exceeded 20%.

GRAPH 2

Real GDP Dynamics and Carry-over Effect for 2019 :



Source: ELSTAT, ERD calculations

At the same time, over the past years, the country's position in the global rankings of the Travel and Tourism Competitiveness Index (WEF) has improved, climbing to the 24th (out of 136 countries) position in 2017, from the 32nd position (out of 140 countries) in 2013.The main characteristics of the rising demand for tourism services offered in Greece over the past six years are the following:

First, approximately 40% of tourist arrivals originate from five EU countries, namely Germany, United Kingdom, Italy, France and Romania.

Second, over the past decade, the average expenditure per trip has gradually declined, as the daily tourist expenditure remained broadly stable over this period, while the average length of stay per trip embarked on a downward trend. Graph 4 illustrates these features of Greek tourism per country of origin. The vertical axis measures the spending per overnight stay and the horizontal axis measures the average length of stay while the size of the bubble displays the number of tourist arrivals.

Third, tourism demand is seasonally concentrated in the third quarter (59% of tourist arrivals in 2018), while visitors are mainly destined to five regions in Greece (83.9% of visits in 2017 were allocated to Attica, South Aegean, Crete, Central Macedonia and Ionian Islands).

Turning to the supply side, there is a marked increase in the sector's capacity, both in terms of quantity (rise in the number of beds and rooms by 5.5% and 4.2%, respectively in the period 2011-2017) and quality (increase in the market share of 5* and 4* hotels from 11.7% in 2004 to 20.3% in 2017).

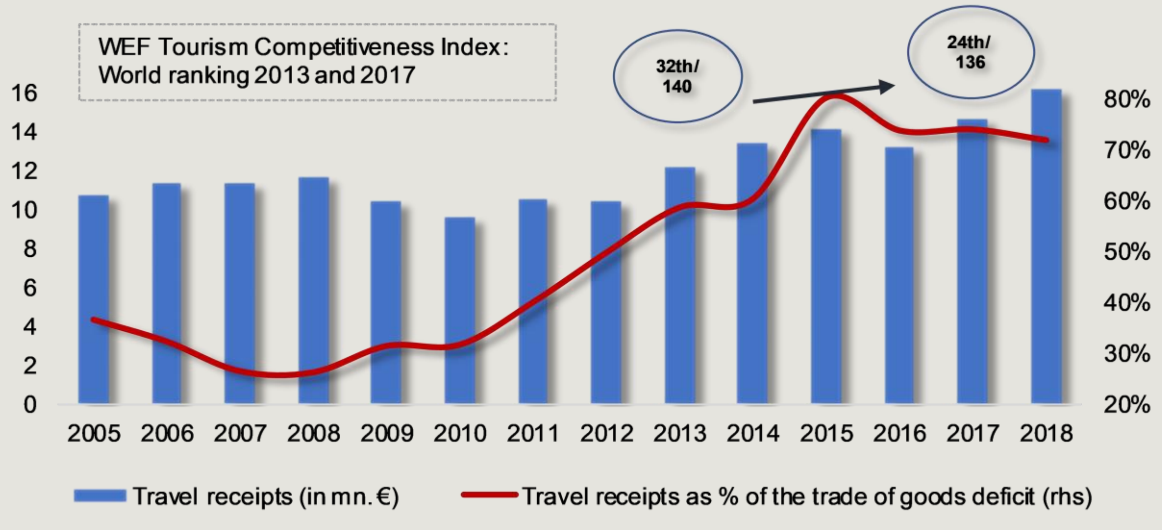
Finally, the rapid expansion of home - sharing economy, as reflected in the over-doubling of the number of dwellings offered for short-term rental in the respective electronic platforms (e.g. Airbnb and HomeAway) over the past three years, may, in part, explain the faster rise in arrivals compared to receipts.

The solid performance of the Greek tourism is expected to continue in 2019, also in line with the rising global tourist flows expected for 2019, on the back of the continuously improving infrastructure in air transport, the relative stability in fuel prices and the increasing flow of visitors from emerging markets according to the World Tourism Organization (January 2019).

However, the prospects for Greek tourism are also surrounded by risks related to (a) the international economic and geopolitical developments including, among others, the projected slowdown in EU-28 growth, (b) the strong base effects given the continuous increase in the number of tourist arrivals over the past five years, (c) the uncertainty stemming from a ''no deal'' Brexit, taking into account the relative weight of the UK demand on the performance of Greek tourism (see, also, Graph 4), as well as, d) the recovery of Turkey as a competitive tourism destination, on the back of political stability and Turkish lira depreciation.

GRAPH 3

Travel Receipts, Competitiveness and Trade of Goods



Sources: Bank of Greece, World Economic Forum

Retail Trade and Private Consumption: Their Contribution to the Current Phase of the Business Cycle

As discussed in the first section of the Report, private consumption was a key driver of economic growth in 2018, while its positive contribution to growth dynamics is expected to remain in the current year. This development is corroborated by the rise in the volume index in retail trade, excluding automotive fuel, which increased by 1.7 % in 2018, compared to 1.3% in 2017.

Graph 5 presents the 6-month moving averages of (a) the annual rate of change of the overall volume index in retail trade (excluding automotive fuel), (b) the annual rate of change of the volume sub-index in super markets and (c) the consumer confidence indicator.

As it can be seen in the Graph, consumer confidence (measured by the 6-month moving average) has improved significantly, despite the small decline recorded in February 2019, standing at -33.3 points against -28.3 points in January 2019. The overall volume index in retail trade (excl. automotive fuel) has been gradually improving over the past three years, standing at 103.5 in 2018, from 101.8 and 100.5, in 2017 and 2016 respectively, while the dynamics of the volume index in super markets (green line) were even stronger in 2018. This development is expected to lead to a further increase in the share of super markets in the food market, although it remains at a lower level compared to EU-28 average. It is noted that the average annual rate of change of the turnover index in non-specialized stores (grocery stores and super markets) stood at 1.9% in the EU-28 in the period 2010-2017, compared to 0.8% for the turnover index in specialized stores during this period. In Greece, the average annual rate of change for the turnover index in grocery stores and super markets in the respective period decreased as a result of the economic recession, albeit to a lesser extent compared to specialized stores.

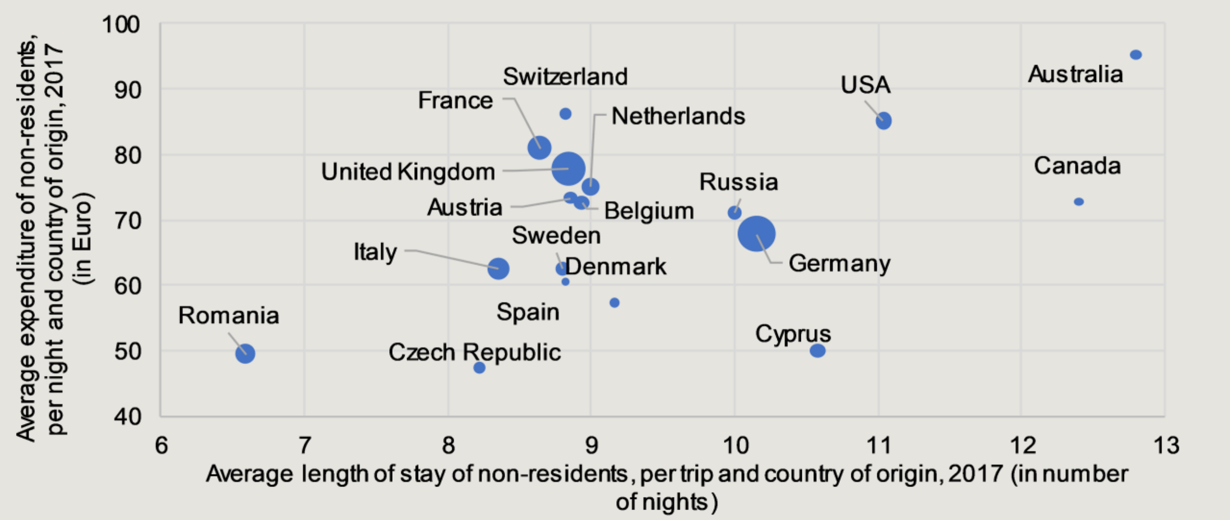
The main factors that determine the dynamics of private consumption are the following:

First, the rise of households' gross disposable income in 2018 (by 3.4%, on an annual basis, in the first nine months of 2018, at current prices), supported by the gradual increase in employment (by 1.8%, on an annual basis, in the first nine months of 2018), as well as, the slight increase in average wage. However, given that the largest share of new jobs concerns part-time employment and job rotation and, thus, it is associated with lower disposable income, the composition of consumption expenditure shifts towards basic goods rather than luxury or durable goods.

Second, households' saving rate remained in negative territory (-7.3% in 2017 and -6.1% in the period January-September 2018), as a result of households' efforts to preserve their living standards and to meet the high tax obligations.

GRAPH 4

Tourist Inflows, Average Expenditure per Night and Average Length of Stay per Trip by Country of Origin



Source: Bank of Greece

Third, the aforementioned increase in consumer and retail trade confidence.

Fourth, the rise in travel receipts in line with the higher inbound tourist flows in Greece, as analyzed in the previous section of the Report.

Fifth, the growth of the home - sharing economy which offered significant opportunities to Greek households for short-term rental of their dwellings, resulting in the increase both in long-term rental prices and in real estate prices in some regions. The subsequent increase in this additional stream of income was mainly allocated to consumption expenditure.

Sixth, the wider use of electronic transactions, especially after the imposition of capital controls, leading to a more accurate recording of the consumption expenditure and, consequently, reducing the size of the shadow economy.

Business Sentiment Developments per Sector: An Overview

Business sentiment in Greece rose up to 102.1 points on average in 2018, having increased markedly by 5.5 points compared to the respective average in 2017. This increase was in line with the EU and the euro area economic sentiment indicators, which also exhibited an upward trend, although more contained (by 0.8 and 1.2 units, respectively). The small decrease in January of 2019 was followed by an increase in February, indicative of the continuation of improvement in the first months of the current year.

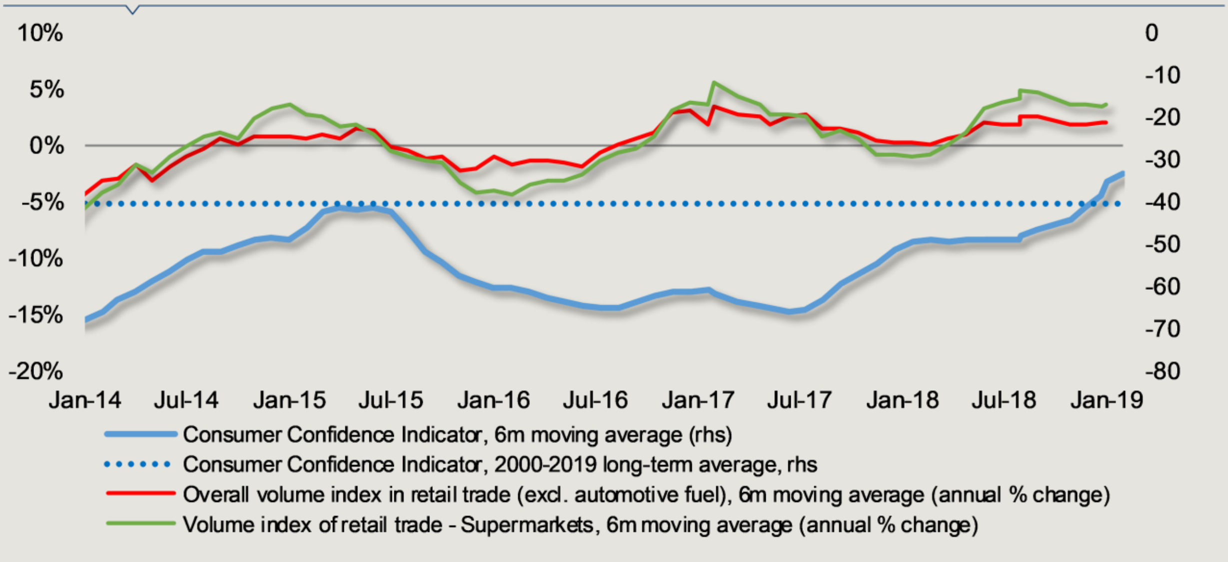
The four major business sectors, which constitute Business Climate, namely Industry, Services, Retail Trade and Construction, exhibited strong increases in 2018. Moreover, from the demand side, the consumer confidence indicator also rose up significantly in 2018, by 14.9 points, to -44 points, returning close to pre-crisis levels.

The sectoral developments from the supply side are due to different variables that affect each of the four basic sectors. The strong increase in industry confidence indicator by 4.7 points in 2018 compared to 2017, resulted from the improvement in all three major variables of the indicator. More specifically, the managers' more optimistic views on the current level of overall order books were accompanied by an improved assessment of stocks of finished products and a slighter amelioration in production expectations.

The markedly higher retail trade confidence (up by 9.9 points) was driven by two of the three basic variables constituting the respective indicator, namely the retailers' more positive views on the expected business situation and their assessment of present business situation (i.e. sales over the past three months).

GRAPH 5

Retail Trade and Consumer Confidence



Source: ELSTAT, European Commission

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