RECOVERY LOST

The Greek economy is forced to fight its way back after Covid-19

Nick Malkoutzis
Yiannis Mouzakis*

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Greece has earned plaudits and positive coverage in the international media for managing to suppress the number of deaths and confirmed cases from Covid-19 when many Western European countries struggled with the disease.

Greece went into staggered lockdown measures over several weeks after the first case of the virus was announced on February 26. Schools were shut on March 10 and a broad lockdown was imposed on March 23. The government widened the range of digital services available to citizens, including the ability to receive doctors' prescriptions on their mobile phones, limiting the need for Greeks to leave their homes.

An increase in intensive care beds, targeted testing and a high level of compliance with the restrictions on movement appear to have been vital in suppressing the virus, although Greece's geographic location and the fact that Covid-19 made its appearance during the off-peak tourism season probably helped authorities keep the disease in check.

Unlike the positive outlook in terms of public health, the Greek economy will emerge shaken from the coronavirus experience. The lockdown and the broader impact the disease is having on global trade have halted the recovery from Greece's long economic crisis. The damaging signs were immediately visible in key sectors, such as tourism and shipping, and have gradually emerged in other areas.

Even in the best-case scenario, which envisages most restrictions being suspended by July and Greece receiving at least some tourists, the recession is likely to rival, if not exceed, the worst years of the recent debt crisis.

MOMENTUM FADES

At the beginning of this year, Greece was in the best economic shape it had been for years. During the same week that Wuhan in China went into lockdown, Fitch upgraded Greece's credit rating to just two notches away from investment grade. The following week, Greece issued its first 15-year bond, attracting strong interest and a very attractive yield. Soon, the yield for its 10-year benchmark bond plummeted to 0.92 pct – a level that had been unthinkable just months earlier.

The government was expecting growth of 2.8 pct this year, building on a 1.9 pct increase in 2019. The hope was that Greece's exit from its third bailout in 2018 and the change of government in 2019, when centre-right New Democracy ousted left-wing SYRIZA on a platform of business-friendly reforms and tax cuts, would attract investors and breed greater confidence among Greeks.

The 2020 budget included forecasts for significant increases in investment and private consumption. The government expected no complications in meeting the 3.5 pct of GDP primary surplus target agreed as part of Greece's post-bailout framework, although it was intent on trying to convince the European institutions to reduce this goal from 2021 onwards.

Public debt was expected to fall to 167 pct of GDP as the economy grew, moving Greece further along on the path towards the sustainability that had been one of the cornerstones of the three adjustment programmes it underwent between 2010 and 2018.

By the end of March, though, it became evident that none of these forecasts were relevant anymore and that the crisis triggered by the coronavirus would result in each of those figures being repeatedly erased and re-written, each time reflecting a bleaker outlook.

* Nick Malkoutzis & Yiannis Mouzakis are the co-founders of political and economic analysis website MacroPolis (www.macropolis.gr)

DEEP IMPACT

In a note published at the end of March, the Organisation for Economic Cooperation and Development[1] warned that, among the advanced and emerging economies selected by the think-tank, Greece was most at risk from the coronavirus-inspired shutdown.

Its study suggested that almost 35 pct of Greek GDP could be impacted by the measures adopted to contain the pandemic.

The Covid-19 crisis first struck the Greek economy through external demand. This was initially evident in services, as tourism came to a standstill and shipping routes vanished as global trade seized up.

Exports of goods are also likely to be severely hampered as Greece's largest trading partner, the European Union, is suffering. Beleaguered Italy has consistently been the largest importer of Greek goods over recent years.

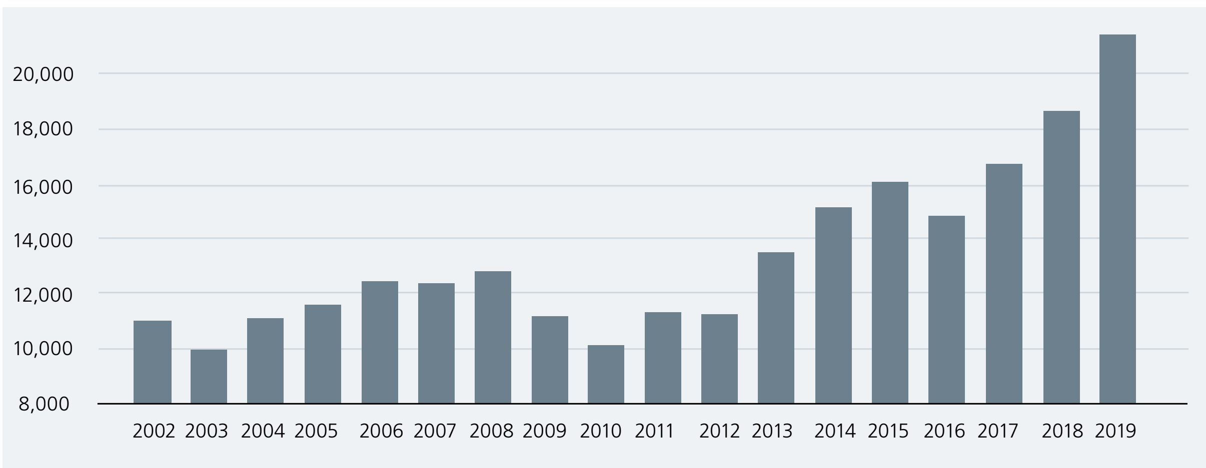
However, the biggest blow will come in the tourism sector, which is the lifeblood of the Greek economy. A study by Institute of the Greek Tourism Confederation (INSETE)[2] indicated that in 2018 tourism contributed between 25.7 and 30.9 percent of Greece's GDP in 2018, also factoring in the sector's indirect impact.

There was a gradual shutdown of the industry in March as cancelations mounted, city hotels and seasonal resorts were forced to close and travel came to a halt. Even under the most optimistic assumptions, the second quarter is a complete write-off. The

Figure 1
The potential initial impact on activity of partial or complete shutdowns on activity in selected advanced and emerging market economies

Source: OECD

Figure 2
Greece Annual Travel Receipts, EUR min



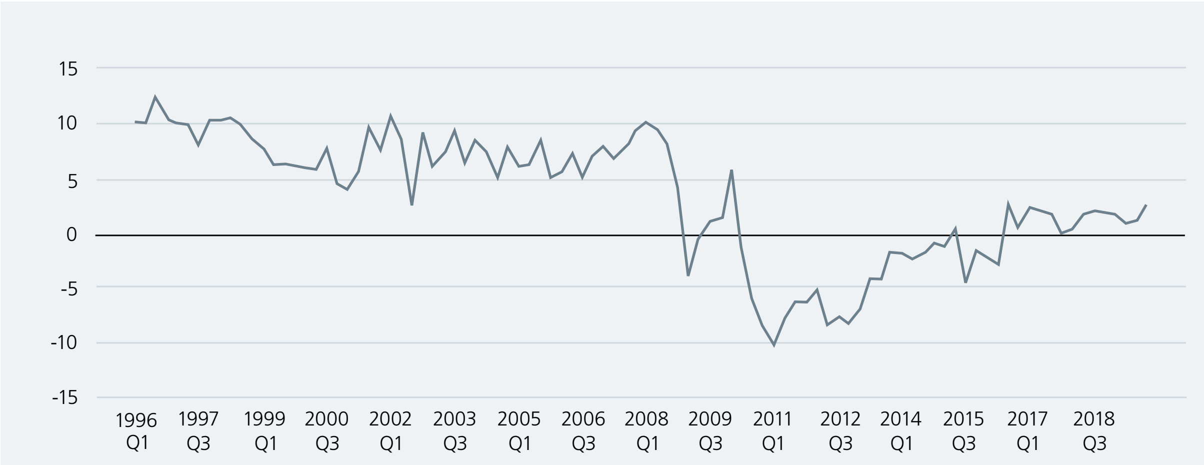
Source: Bank of Greece

1 https://read.oecd-ilibrary.org/view/?ref=126_126496-evgsi2gmqj&title=Evaluating_the_initial_impact_of_COVID-19_containment_measures_on_economic_activity

2 https://insete.gr/wp-content/uploads/2020/02/Tourism-and-Greek-Economy_2017-2018.pdf

Figure 3

Final Consumption Expenditure, Seasonally Adjusted, Households, Current Prices, Year on Year



Source: Hellenic Statistical Authority

make or break challenge will come in Q3, when developments will not only depend on how well Greece has handled the coronavirus challenge but also on whether visitors from other key destinations like the UK, Germany, Italy, France and the USA will be able to travel in large numbers. If travellers stay at home this summer, up to 17 billion euros in revenues could be at risk

The coronavirus crisis is also expected to trigger a sizeable drop in domestic demand. This is another vital element of the Greek economy as private consumption accounts for around 70 pct of Greek GDP. The closure of a wide range of local businesses as part of the lockdown and the financial difficulties faced by Greek consumers will take their toll this year.

The Greek Finance Ministry estimated in March that around 900,000 businesses, or 90 pct of the active total, were receiving emergency support. This accounted for a total of 2 million salaried staff and self-employed, which is just over half of Greece's entire workforce.

A double-digit drop of household spending this year is a near certainty, meaning it could far exceed the dramatic 10 pct drop seen at the peak of the debt crisis in 2011.

The Covid-19 crisis is also expected to slow down investments, just as the new government was targeting an increase of 13.4 pct in investment spending during 2020 on the back of a more market-friendly approach and a series of tax cuts.

It was no surprise, therefore, that when the International Monetary Fund released its latest World Economic Outlook[3] on April 14 it predicted that Greece would suffer the biggest recession of all European economies, with GDP contracting by 10 pct, before a rebound of 5.1 pct in 2021.

Unemployment is seen rising by five points, reaching 22.3 pct. This translates into 1.1 million unemployed. Greece had been hoping to see the jobless figure drop below 700,000 this year.

The threat to jobs was evident in the employment figures for March this year, when there were 41,903 more firings than hirings. This was the worst employment balance on record for March, according to the Labour Ministry's database, known as Ergani.

Although the IMF has traditionally been on the pessimistic side in terms of its forecasts for the Greek economy, there is a consensus among economists that Greece will be dealt a heavy blow this year, even if the contraction does not reach double digits. HSBC expects GDP to shrink by 6 pct, for instance, but Citigroup believes the contraction could reach as much as 14.4 pct. Domestically, the Foundation for Economic and Industrial Research (IOBE) think-tank sees a recession of between 5 and 9 percent, while the Parliamentary Budget Office (PBO) expects GDP to fall by 5.3 to 10.2 pct.

Much will depend on how badly affected economic activity will be over the summer, but there is no doubt that even under a conservative assumption up to 20 billion euros of economic activity could be lost if the crisis leaves a strong mark on the vital second and third quarters of the year.

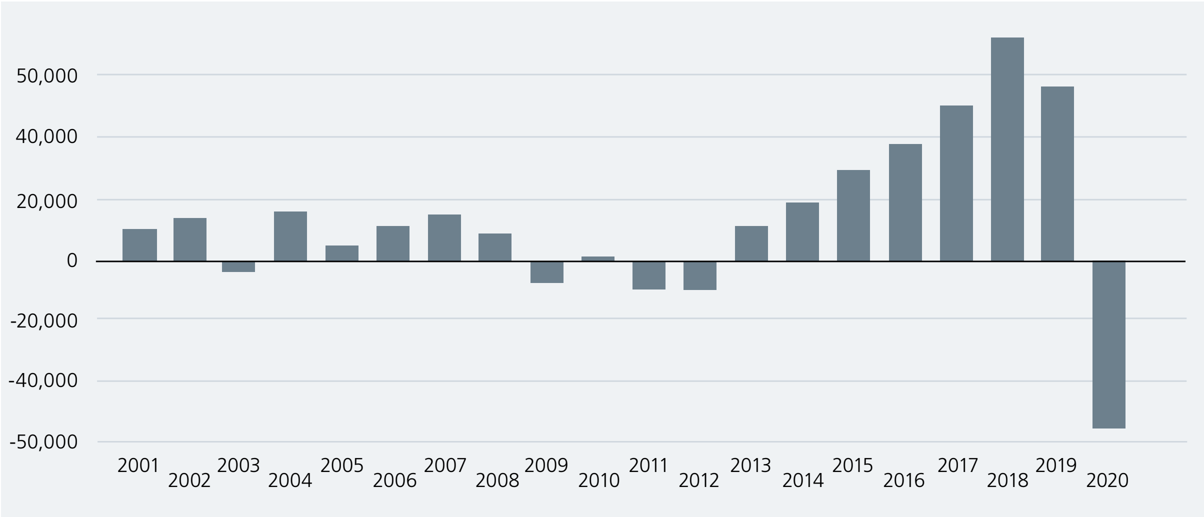
GOVERNMENT MEASURES

In a bid to mitigate the impact of this crisis, the Greek government has adopted a range of fiscal measures aimed at providing businesses and workers with more breathing space and the ability to survive until the worst is over.

An 800-euro benefit was offered in March to as many as 1.2 million employees who work for businesses that have been forced to close because of the lockdown or firms that have experienced a significant drop in revenue. Similar support has

3 https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020

Figure 4
Hirings Balance, March



Source: Labour Ministry - ERGANI

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been made available to up to 550,000 self-employed and freelancers. Combined, these measures cover around 60 pct of the private sector workforce.

In April, Prime Minister Kyriakos Mitsotakis also announced an emergency 400-euro supplement for Greece's 155,000 registered long-term unemployed, as well as training and paid community service programmes for those out of work. Also, an Easter bonus was promised to national health system and civil protection employees.

For businesses, the government has suspended VAT and tax payments for up to 800,000 firms, or 76 pct of all legal entities, and is returning up to 1 billion euros in tax pre-payments to SMEs. Discounts of 25 pct are also being offered to companies that pay their VAT bills on time and in full.

The combined cost of the revenue and spending measures means is estimated at 5.6 billion euros by the PBO. Given that support measures will have to be in place for at least three months – March, April and May – the Greek government has admitted that it will have to dip into its cash reserves, built up in previous years ahead of the exit from the third and final bailout in the summer of 2018, to cover the added expense.

At the time of writing, this cash buffer was estimated at around 36 billion euros. However, roughly 16 billion euros of this consists of money lent to Greece by the European Stability Mechanism exclusively for servicing the country's debt. Greece needs to obtain permission from the European institutions to change the use of this portion, a situation the government would like to avoid.

Finance Ministry sources suggested on April 15 that by the end of June the government will likely use 14 billion euros from the cash buffer to plug holes in the budget, leaving a total of 22 billion, most of which is currently ringfenced for debt payments.

SYRIZA has accused the government of not being proactive enough in its approach, arguing that a strong stimulus is needed now to limit the extent of the recession later in the year. The opposition party proposed 26-billion-euro package of fiscal measures in early April.

EUROPEAN TOOLS

The fiscal pressure being generated by the Covid-19 crisis means the decision taken at the March 16 Eurogroup meeting to excuse Greece from having to meet its post-bailout primary surplus target of 3.5 pct of GDP generated relief in Athens. But the fast pace at which the pandemic's economic consequences developed meant it was soon obvious that this extra fiscal leeway would not suffice.

Within days, Prime Minister Mitsotakis had added his name to those of eight other eurozone leaders calling for the issuance of a special-purpose Eurobond. The Greek leader's participation in this initiative seemed a calculated gamble given that one of his first diplomatic efforts after coming to power last summer was to try to put relations with Germany and the Netherlands, two of the eurozone member states most resistant to the idea of debt mutualisation, on a new footing.

Greek officials made it clear that Athens saw the so-called "corona-bond" as a tool to help with the recovery of eurozone economies rather than one to cover the cost of dealing with the virus. Greek hopes for a post-coronavirus financial boost rest with the idea of an EU recovery fund, if such a tool materialises following discussions between European leaders and technocrats.

In Greece's case, the immediate task of maintaining adequate liquidity had been facilitated by the European Central Bank's decision. In one of the most important moments of this crisis, as viewed from Athens, the ECB announced on March 18 that it will include Greece in its 750-billion-euro Pandemic Emergency Purchase Programme (PEPP).

Greece was not included in ECB asset purchases previously, first due to debt sustainability concerns and then because its credit rating was below investment grade. The adoption of a waiver for Greece made 12 billion euros of its sovereign debt eligible for PEPP. The move immediately calmed investors. Greek yields had skyrocketed by mid-March, with the 10-year benchmark jumping from less than 1 pct to 4 pct, before easing off after the ECB announced that Greece would be eligible for PEPP.

This was followed up a few weeks later by a decision to accept Greek bonds as collateral in the Eurosystem. The eurozone's central bank announced that Greek government bonds (GGBs) would be accepted as collateral even though they remain below investment grade. The decision means Greece can fully benefit from the measures adopted by the ECB in response to tight financial conditions for banks and the sovereigns in the eurozone.

In practical terms, it not only means that Greek banks can use the GGBs they hold (more than 10 billion euros) as collateral to borrow from the ECB at low rates but it also makes the local lenders active players in the market for Greek debt. The latter is a significant boost for Athens as it will have to turn to the markets to borrow more money this year. On April 15, Greece raised 2 billion euros by issuing a 7-year bond that fetched a yield of just over 2 pct. These funds will go towards financing the fiscal hole created by the coronavirus.

The ECB's interventions are also essential in an existential respect because they end a years-long anomaly in the eurozone that meant the member state most in need of cheap liquidity – Greece – was the only one denied access to it. Restoring Greece to its rightful place has been one of the positives of the euro area's response to this new crisis.

Although it went some way to rectifying a negative legacy of the bailout era, the scars of that eight-year period were evident in the lukewarm manner in which Athens reacted to the decision to allow each country in the euro area to access up to 2 pct of their GDP (roughly 4 billion euros in Greece's case) via an ECCL credit line from the European Stability Mechanism.

It was made clear that no extra conditionality would be attached to these funds if the money drawn is used to "support domestic financing of direct and indirect healthcare, cure and prevention related costs." But the idea of going back to the ESM to borrow money, as Greece had done during its debt crisis, was met with trepidation in Athens.

The centre-right government would prefer not to use this resource, or at least avoid being the first administration in the single currency area to ask for a new loan from the ESM because it might spark speculation about a new bailout, reviving the recent and toxic memories of austerity policies and intrusive monitoring by Greece's lenders.

RECOVERY REGAINED?

It is beyond doubt that the Covid-19 crisis will leave a big dent in Greece's economy, one that will likely be larger than many of its eurozone peers. Moreover, the momentum of the post-bailout recovery that promised more jobs, income and security after years of misery and uncertainty, will have dissipated.

This will create a somewhat grim and, in the short-term at least, dispiriting picture at a national level, but also for Greeks as individuals.

For instance, it is certain that the combination of the economy collapsing, fiscal pressures and new debt, or loans, to finance support measures will have a severe impact on Greece's debt, which was expected to continue on a downward path towards 170 pct of GDP in 2020. The IMF expects Greece to run a budget deficit of 9 pct this year, with public debt nearing 200 pct of GDP. Even if this forecast is too pessimistic, it is certain that Greece's debt sustainability assumptions will need to be revised.

Some sectors of the economy will be particularly badly hit, starting with tourism. A survey by the Hellenic Chamber of Hotels (HCH) of more than 1,700 of its members published in mid-April indicated that 65 percent of year-round hotels and 52 percent of seasonal hotels felt that their bankruptcy was possible or very possible this year, with as many as 45,000 jobs on the line.

The loss of jobs is going to put a new strain on many Greek households which were just starting to feel some relief after a difficult decade. For example, the Centre of Planning and Economic Research (KEPE), a research institute in Athens, estimated in a new study that a one percent reduction in GDP would lead to non-performing mortgages increasing by around 3 pct.

This, in turn, would have worrying implications for Greece's troubled banking sector, which has been focussed over the last few years on reducing the volume of bad loans on its books and is not in a position to help finance a strong rebound from the latest crisis.

All this is likely to leave Greece in a precarious position by the end of the year, struggling to find a way back to the recovery path. The government is hopeful that there will be a V-shaped recovery and that after a sharp fall in Q2 and early Q3, Greece will benefit from having handled the pandemic well. In this scenario, local businesses are seen resuming output before the summer and visitors returning to vacation in Greece from July onwards.

In an interview with Kathimerini newspaper[4] on April 18, PM

4 https://www.ekathimerini.com/251830/article/ekathimerini/comment/government-prepared-to-do-what-it-takes-pm-mitsotakis-tells-kathimerini

Mitsotakis said he believes that the recovery in 2021 will be bigger than the recession of 2020. Given the limited impact Covid-19 has had on public health in Greece, this outcome is not out of the question. But it is dependent on a wide range of factors, many of which are beyond Greece's control.

Another relatively positive scenario would see economic activity resuming at a more regular pace in Q3, the virus not having a discernible impact in the autumn and advances in medicine (treatment for Covid-19 sufferers and vaccine development) meaning that there can be a strong recovery in 2021.

Even in this case, though, the economy will be in an extremely fragile state in 2020 and will require the utmost care. Greece will not escape a period, even if it is brief, of rising public debt, escalating unemployment, large budget deficits and increasing non-performing loans. These ghosts of the recent, unpleasant past cannot be allowed to linger.

The government is operating in a confined fiscal space despite the liberating nature of the ECB's decisions and over the coming months it will be looking for more beneficial interventions from the eurozone; not actions drawn from the same toxic well of the previous crisis, but ones which are innovative and convincing, to reflect these extraordinary times.

CONTACT
Friedrich-Ebert-Stiftung
Athens Office
Neofytou Vamva 4 | 10674 Athens | Greece

Responsible:
Ulrich Storck | Director Phone: +30 210 72 44 670

www.fes-athens.org
info@fes-athens.org