



# *Policy Note*

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2023 / 2

## THE CHALLENGES FOR THE NEW GREEK GOVERNMENT

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The instability in the global economy did not prevent the Greek economy from growing at a higher rate than the eurozone average in 2022. This GDP growth, driven mainly by large increases in public spending, helped the economy deliver very desirable results, including a reduction in unemployment, the achievement of a primary (albeit, small) fiscal surplus and, at the same time, a reduction in the ratio of nominal public debt to GDP (Papadimitriou et al. 2023). The increase in inflation (Figure 1) contributed significantly to the reduction of the debt-to-GDP ratio from 194.5 percent in 2021 to 168.9 percent in nominal terms in 2022 according to the latest statistics from ElStat. Greece thus achieved the fastest reduction of its debt ratio in the European Union (EU)—decreasing by 25.6 percentage points in one year—even though it remains the EU country with the highest debt ratio, by far (with Italy the second highest).

This welcome success was not achieved without a number of concerning developments. According to the latest data from the Bank of Greece, the current account balance of payments during 2022 flirted with levels that brought back memories of the Great Recession of 2009. It should be noted that the decline from the pre-2008 highs came about because of the crisis exacerbated by the subsequently implemented austerity policies. The performance of the tourism sector in the following years contributed positively to reducing the current account deficit below €3 billion in 2019. Then, the pandemic shock reversed the course due to the sharp drop in tourism, with receipts falling from €18 billion in 2019 to just €4 billion in 2020. When the COVID-19-related

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restrictions ended, a reboot for the tourism industry began: travel receipts approached the 2019 record levels, fetching €17.6 billion by the end of 2022 (Figure 2). The resurgence of tourism, augmented by private and public sector spending increases, brought the current account deficit to a new high. In absolute terms, exports of goods stood at €21.2 billion in 2008, compared to €65.5 billion in goods imports, while in 2022 the respective amounts were €54.7 billion and €93.0 billion. The current account deficit contributes to the increase in public debt, which will be one of the most difficult thorns that the new government will face, whatever the outcome of the elections.

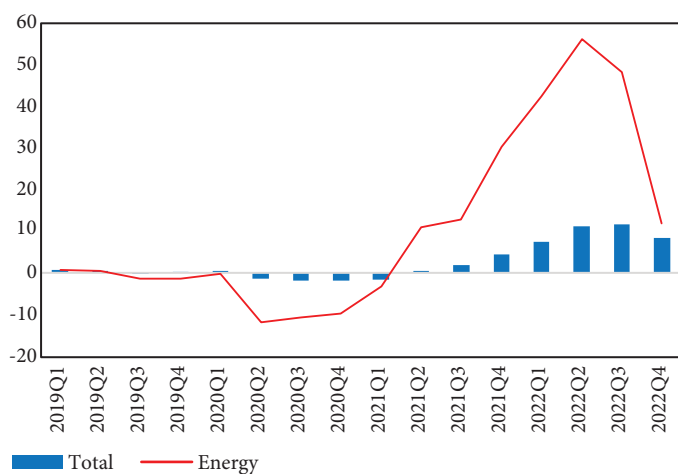
The European Commission (EC) and the International Monetary Fund (IMF) have, all along, been proposing a strict fiscal policy for Greece, with primary surpluses and austerity. The EC (2023b) is calling for a cap on the increase in net primary expenditure in 2024 at 2.6 percent, while also expecting that there will be higher primary budget surpluses. Under the IMF's (2023) proposal, a primary surplus of 0.4 percent of GDP should be achieved for 2023, rising to 1.4 percent in 2024 and 2 percent by 2028 (EC 2023b). Taking into consideration the servicing costs of public debt, the overall fiscal balance is expected to be in a deficit of 3.7 percent of GDP, falling to 2.8 percent in 2024, and 1.9 percent by 2028. This will only be achieved by further reducing government expenditure relative to government revenues.

As mentioned at the beginning of this policy note, there was a significant increase in general government spending on social benefits during the three-year period 2020–22, due to

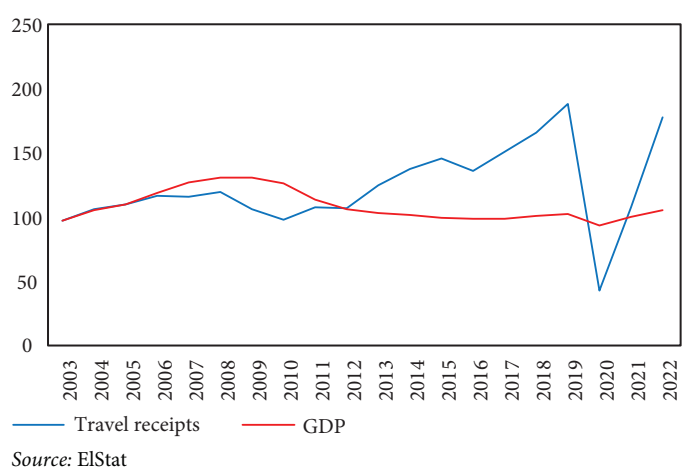
significant interventions in the social components of the budget, not only because of the pandemic that lasted from 2020 to 2022, but also because of the energy crisis in 2022 (Figure 1).

The government interventions in 2020 totaled 6.6 percent of GDP. Estimates by ElStat—based on official data from the 2023 official government budget and announcements from the Ministry of Finance (2023)—indicate that funding to address the energy crisis is expected to hit 6 percent of GDP in 2022. This percentage is also in line with the estimates of other international economic research organizations. Based on the data so far and the relevant government announcements in January 2023, the ratio is expected to increase to 6.1 percent of GDP if spending interventions continue in 2023 (Liargovas et al. 2023). Although it is not expected that these interventions will continue in 2023 and beyond, it can be clearly surmised that these one-off expenditures have had a very significant impact on the country's GDP. Such interventions will not be easily repeated, in light of the IMF's (2023) and the EC's expectations that the country will implement a large deceleration of public spending starting this year. For the IMF, government spending is expected to decrease from 55.5 percent of GDP in 2022 to 50.3 percent of GDP in 2023 and gradually decline further to 47 percent of GDP in 2024. An impact assessment of international travel receipts and government consumption shows that government spending has much stronger multiplier effects than tourism, and that the strength of the government consumption multiplier, relative to tourism, is even stronger in Greece compared to the average economy (Rodousakis and Soklis 2020).

**Figure 1 Greece: Total and Energy Inflation (percent)**



**Figure 2 Greece: Travel Receipts and GDP (2003=100)**

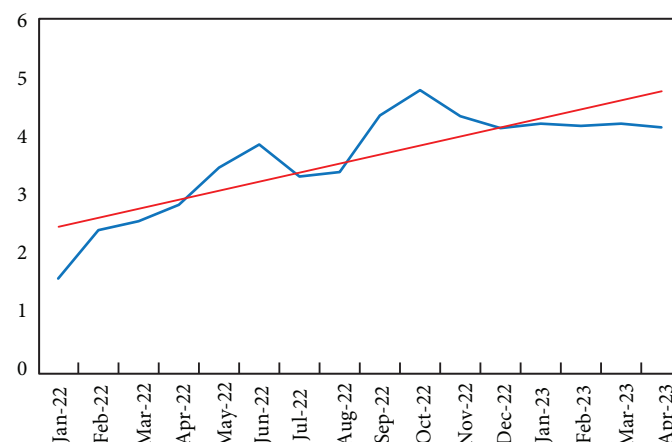


Thus, in terms of GDP for 2023, apart from the expected decreases in government spending, the positive impact of tourism on GDP is expected to be relatively small, unless it significantly exceeds the historically high levels of 2019 (Figure 2). The New Generation EU (NGEU-Recovery) Fund, according to both the EC (2023a, 2023b) and the OECD (2023), also provided notable support to the economy in 2022. Should energy prices rise again, however, the government will be unable to use any mitigation funding to support households or businesses as it did in 2022, since the EC has called for an end to the energy support measures in place. Instead, the EC has called for using the associated savings to reduce the budget deficit. More specifically, for 2023 the EC (2023b) projects (1) a reduction in the rate of inflation, which is expected to gradually reduce the burden on real household income and thus benefit private consumption, (2) timely and effective implementation of the NGEU funds, which are again expected to be the key driver for expanding investment, and (3) a small increase in tourism revenues—all of which will help achieve the projected 2.4 percent growth in 2023.

Focusing on the outlook for the country’s fiscal picture, according to a statement by ElStat and Eurostat, in 2022 the country’s fiscal balance ended with a primary surplus of 0.1 percent of GDP, or €273 million. The government forecast called for a primary deficit of 1.6 percent, based on the 2023 budget (MinFin 2023). This excess, as well as the excess in revenues in the first months of 2023, is due mainly to the increased revenues from value-added taxes (VAT) collected as a consequence of the inflation of goods and services prices. This is evidenced from the data for the five-month period (January–May) this year, where the primary budget surplus was found to have increased by €2 billion. It is worth noting that, according to the IMF (Gaspar et al. 2023),

for countries with debt exceeding 50 percent of GDP, each percentage point of unexpected (‘surprise’) increase in inflation reduces public debt by 0.6 percentage points of GDP, with the effect lasting for several years. As inflation becomes persistent and better anticipated, however, it stops contributing to declining debt ratios. Likewise, deficit-to-GDP ratios initially decline as spending fails to keep pace with the rise in the monetary value of the economy’s output. But such effects fade even quicker.

**Figure 3 Greece: 10-Year Greek Bond (percent) and Its Trend**



Source: BoG

Moreover, borrowing this year will be on different terms than before. In January 2022, Greece borrowed €3 billion at an interest rate of 1.84 percent. The interest rate on the 10-year Greek bond is now close to 3.98 percent (Figure 3). In order to meet its borrowing needs for the year—and knowing only too well that the European Central Bank (ECB) will continue raising interest rates at even higher levels in the coming months—the new Greek government will have to be extremely careful in managing its borrowing needs. The ECB has raised interest rates to their highest level in 22 years (May 2001 marked the previous peak), with Christine Lagarde signaling that there is no intention of pausing monetary tightening until inflation is tamed and reaches the 2 percent target. The consequences of rising interest rates are already affecting projections, as the Ministry of Finance predicted that the total gross debt of the country would reach €395.03 billion at the end of 2023. As of April, however, the debt is already €8 billion higher than that level and will most likely continue to rise in the remaining months of the year. The increase in debt is, to some extent, due to new and higher borrowing costs of the redeemed securities that matured and needed to be refinanced.

Another challenge for the new government will be the increase in private sector debt. In recent years, private debt has increased by around €40 billion. Nonperforming loans (NPLs) now amount to €111 billion. In total, 4.2 million citizens have bad debts to banks, funds, tax authorities, and the National

Social Security Fund, while 1 million bank accounts have been seized. In more detail, the stock of NPLs on the books of Greek banks only amounted to €13.2 billion in December 2022, down by €5.2 billion compared to December 2021 and by around €95.5 billion when compared to March 2016, when the highest level of NPLs was recorded. This significant improvement is mainly due to bad bank loans being sold through the utilization of the Hercules program, and secondarily due to collections facilitated through active management and support measures by the government and loan restructuring by banks, intended to ease borrowers' repayment conditions. Regarding the categories of NPLs, about two-thirds are business loans, one quarter are housing loans, and the rest are consumer loans. According to the Hellenic Loan Servicers Association (Imerisia 2023): (1) there are 600,000 properties involved and (2) of those properties, 50 percent are residential while the remaining 50 percent are other categories of properties (industrial or other commercial, warehouses, parking lots, etc.) for which any sale would be both politically and financially difficult to implement.

Finally, a new report from Eurostat, as reported by Eurobank Research (2023), indicates that the “share of people at risk of exclusion in 2022 (persons that have an equivalent disposable income below the risk-of-poverty threshold—was at 26 percent in Greece [...] being the third highest in EU-27.” Implementing decreases in social programs and the lack of employment opportunities will be another, even thornier issue for the stability of the new government.

In summary, we have shown that there are a number of challenges that the new government will face in order to ensure positive GDP growth rates while managing the very large public and private debts. The new government will need to devise policies that support private-sector initiatives to increase exports and import substitution, where possible. A suggestion in this direction is to vertically integrate tourism with the other sectors of the economy, thereby improving the net benefit of tourism and at the same time increasing the country's finances and improving its current account balance. Other policy objectives, such as strengthening networks and developing renewable energy sources, can reduce external energy dependence and further improve the current account balance. Addressing import dependence through targeted policies to promote domestic production can lead to a more robust and less dependent economy, gradually reducing debt and ensuring long-term sustainability and growth. Efforts should also be made for further analysis of

the intersectoral structure of the Greek economy, together with the identification of the key sectors that are considered suitable for the implementation of short- and long-term economic policies to stimulate growth and improve the current account balance—both of which should be the goals of the new government.

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