GREECE UPDATE

The Return of Recession

State Budget

Final data for January-February 2015 indicate a state budget deficit of 0.1% of GDP compared to a surplus of 0.3% of GDP last year and a primary surplus of 0.7% of GDP compared to a primary surplus of 1.2% of GDP in 2014. The decline in ordinary revenue (-5.5%), due to tax revenue shortfalls relating mainly to VAT, tax arrears and personal income tax, was almost compensated by ordinary expenditure under-execution. The resulting shortfall relative to the period target came in at €0.1 billion. Meanwhile arrears to the private sector are again rising.

Deposit Outflows

Deposit outflows continued in March, though at a declining pace compared to February and January. Specifically, in February 2015, non-financial private sector deposits recorded, for the third consecutive month, a high outflow (the third highest ever), amounting to €7.3 billion; most of this outflow (3/4) stemmed from households.

Syntagma Square at noon today

A Miserable Outcome

A return to recession is now on the cards

According to sources Greece has gone back into recession in the first quarter of 2015 and now most analysts predict another recessionary year. All indications are that the economy will not be able to survive the protracted negotiations and the lack of any positive proactive policy measures that should have been taken by now.

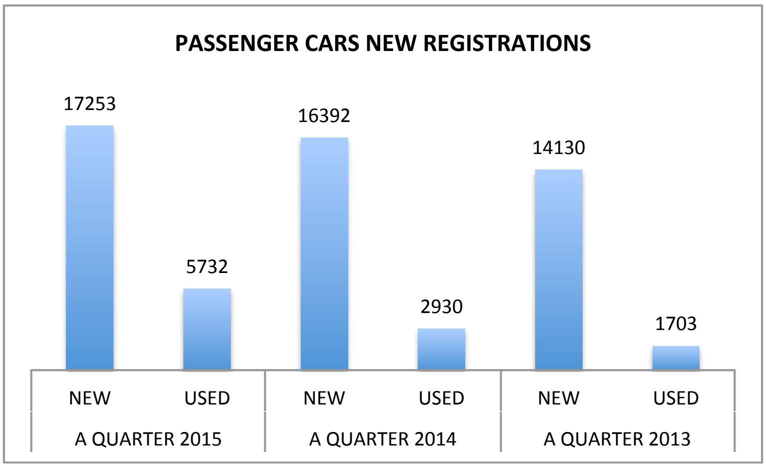
The real economy has stalled. The lack of credit is killing off the last healthy companies in most sectors. Most contractors have been waiting for payments from the state for over 3 months while their obligations mount.

Manufacturing PMI in March remained in negative territory (48.9 against 48.4 in February) indicating a further contraction of the manufacturing sector, though at a decelerating rate. The production sub–index was negative but closer, to the threshold of 50 (49.5 against 48.5 in February), while the new orders sub–index remained almost unchanged within a negative area.

The economic sentiment index declined in March to 96.8 from 98.2 in February. Employment plans in March deteriorated in all sectors.

The positive trend in new private cars registrations continued in March mainly due to the rise of second hand cars. The increase is largely due to replacement trends as the vehicle fleet is ageing. But in general new vehicles are smaller an of lower value while a shift to petrol engines is also recorded.

All privatisations have been stalled. Contradictory statements have fuelled confusion around the issue. The most important deal in terms of value involving the concession of regional airports is uncertain whether it will be concluded. Some ministers have proclaimed that they will review the draft contract asking for completely different terms. This may lead to either a much lower value for the government or to a collapse of the privatisation.



The threat to competitiveness is real

Labour cost competitiveness has improved significantly since 2009 due to substantial labour market reforms and sizeable declines in wage costs due to the prolonged recession. As a result, the cumulative loss in labour cost competitiveness between 2000 and 2009 has almost been recovered. Its improvement is estimated at 7.3% in 2013 and 3.4% in 2014.

Price competitiveness has been gaining momentum from 2012 onwards as the inflation differential with main trading partners has been negative since then. Its improvement is estimated at 0.7% in 2013 and 1.8% in 2014.

Non-price or structural competitiveness has also been improving since 2013. Although Greece still ranks at the lowest end of advanced economies according to several indices, it was the country with the highest responsiveness to OECD recommendations (OECD, Going for Growth 2013).

The overall competitiveness of the economy has been improving. The WEF **Global Competitiveness Index** for 2014/15 indicates that Greece has climbed ten positions from 91 to 81 in the space of one year.

However, if the government's pre-election promises are honoured regarding the minimum wage and a return to collective bargaining reversals in competitiveness are inevitable.

Negotiating tactics at two fronts

The outcome of the current negotiations is difficult to predict. However, Mr. Tsipras has to negotiate with the creditors and his party and thus the equation has too many unknowns. I expect that the government will accept some budgetary measures and pension reforms as there is no alternative. However, they will seek a re-affirmation of some kind of debt relief to be agreed by June in order to be able to get the measures through parliament. Over the last weeks it has become clear that both the Chinese and now the Russians are not prepared to offer Greece a helping hand. The government has nowhere else to turn at this hour of need.

Mr. Tsipras may decide to call a snap election or even a referendum but if he does this it will be the last nail on the coffin of the economy as further outflows of deposits and a complete standstill of the real economy will make irrelevant any outcome of the vote!