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WHAT'S AHEAD FOR THE GREEK ECONOMY?

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While the effects of the COVID-19 pandemic have been broadly similar for individuals, families, societies, and economies globally, the policy responses have varied significantly between countries. The human costs of this deadliest crisis since the pandemic flu of 1918–19 have been devastating. The increasing death toll in most countries in Europe from the spreading virus—even after the initial flattening of the curve—will have long-lasting, worldwide consequences for livelihoods, as countries impose strict lockdowns that include travel restrictions and business shutdowns. These restrictions—more targeted—will continue in the winter as the infections continue to increase. Public health systems have been stretched to their limits and governments focus on measures such as shutdowns, mask-wearing, social distancing, and contact tracing, while the search for treatments for symptomatic infected individuals and an effective vaccine are intensified.

The OECD, in its latest report, noted that GDP for the G20 countries contracted by 4.5 percent in 2020Q2—a significant increase over the worst quarter of the 2007–9 Great Recession, while in its October World Economic Outlook, the IMF confirmed its earlier projection for a 2020 global contraction on the order of -4.4 percent. Most governments around the world are attempting to come to terms with the economic and societal damage to incomes, employment, social relations, etc., brought by this crisis. Unemployment levels have risen dramatically and many of the jobs lost may disappear forever, while workers who were recalled or work remotely are experiencing cuts in hours and wages; many such jobs are in the hardest hit sectors, such as manufacturing, services, arts and entertainment, travel-related activities, and financial services. Many commentators suggest that before the end of this crisis, we should expect more job losses to occur as demand decreases and relaxed fiscal and monetary policy stances ultimately come to an end. In addition, the economic damage extends to increases in private debt, indicating difficult long-term implications.

This Strategic Analysis report is the joint product of the Levy Economics Institute of Bard College and INE-GSEE (Athens, Greece). It will be simultaneously issued in both English and Greek. The Levy Institute's Macro-Modeling Team consists of President Dimitri B. Papadimitriou and Research Scholars Gennaro Zezza and Michalis Nikiforos. All questions and correspondence should be directed to info@levy.org.

In the case of Greece, as we noted in our latest report (Papadimitriou, Nikiforos, and Zezza 2020), the pandemic abruptly ended a fragile recovery of the country's economy, and we projected a severe contraction, with real GDP falling by 10.4 percent in 2020. As we wrote, we expected some of the fiscal stimulus programs funded by government reserve funds and European-funded structural programs to have been implemented, offsetting some of the pandemic's distortions. To date, there is no evidence of a significant impact from any of the programs announced and/or implemented. It could be argued, however, that matters might have been worse if no governmental action had been taken at all.

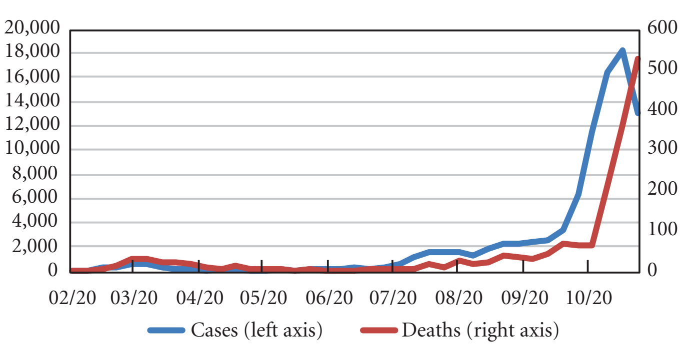
After the summer, the COVID-19 contagion started again, and in October the average number of deaths attributed to the virus was higher than in the pandemic's first wave in March (Figure 1), prompting the government to take further action in restricting economic activities for the winter months. Moreover, more government attention has turned to the challenged public health system and the risks it entails as infection and hospitalization rates spiked again beginning in October.

Given the impact of this second wave of contagion, not only in Greece but in all European countries, the European Commission (2020) has revised downward its growth projections for 2021, and prospects for the beginning of a recovery before the end of 2020 have died out.

Recent Evidence on the Impact of the Pandemic

The data now available for the first half of 2020 have indeed confirmed the contraction we projected, with a fall in real GDP of 15.2 percent year-over-year in 2020Q2, following a contraction of 0.5 percent in the first quarter. Data on GDP and its components for 2020Q3 are not available yet, but receipts from tourism from the balance of payments show a fall of €5.8 billion (75 percent!) for July and August against the previous year, and a fall of 13 percent year-over-year in the exports of goods for the same months. The worsening trend in travel receipts continued in September as well. The Bank of Greece reported that for the period of January to September 2020, travel receipts amounted to €3.5 billion, versus €16.1 billion in the same period in 2019—a decline of 78.2 percent—while there were 6.2 million fewer foreign visitors year-over-year.

Figure 1 **Greece: New Cases and Deaths Attributed to COVID-19**



Source: Wikipedia

The industrial production index in August 2020 was 3 percent below the same month from the previous year, while the volume index in retail trade in July was 2.7 percent below its previous level year-over-year. Even though the pandemic seemed to have come to an end in 2020Q2, neither trade nor domestic demand restarted once the emergency measures taken to reduce contagion were lifted.

The gross value added in the first half of 2020 decreased for the majority of sectors. Specifically, the "wholesale and retail trade-catering-accommodation, etc." sector experienced a significant decrease of 19.5 percent, greater than the EU average. A drop greater than the EU average is also observed in the arts (-22.3 percent), professional, scientific, technical, and administrative activities (-12.7 percent), financial activities (-8.3 percent), and agriculture (- 6.8 percent). The real estate management sector, which is twice the size of the European average, shrank marginally by -0.7 percent.

Significant exceptions to the Greek economy's general contraction in production were observed in the construction and public administration sectors. These sectors have a large share in the total value added of the Greek as well as the European economies. More specifically, the construction sector in Greece recorded a notable increase of about 20.6 percent, accelerating the positive dynamics it has developed in the last two years, while public administration increased its production value by 1.1 percent, mainly to meet the increased demand for health care.

Moreover, in 2020Q3, turnover fell by 15.8 percent, as compared to the same quarter of 2019. In fact, turnover in the finance and the food and accommodation sectors was reduced by 47.2 percent and 50.4 percent, respectively. In manufacturing, turnover fell by almost 13 percent, while in logistics the fall was equal to 31.3 percent. On the other hand, the public administration sector's turnover increased by 10.6 percent.

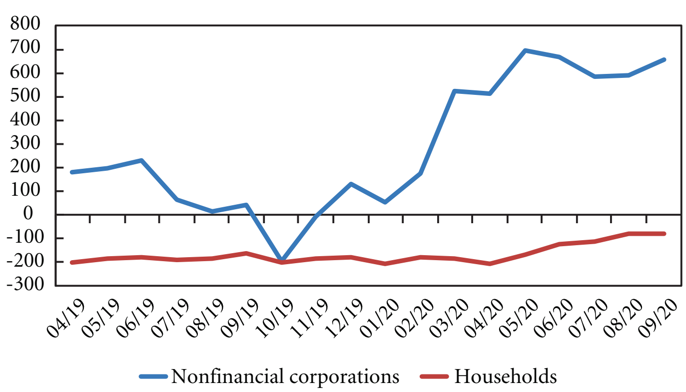
We turn our focus now to the 205,980 Greek firms whose activities were suspended in March. Alongside the attrition in the accommodation and food sectors, which experienced a decrease of 31 percent and 61 percent, respectively, it is commonly known that the arts and entertainment sectors suffered a very severe blow from the pandemic. The decrease in the number of art and entertainment firms, the activity of which was suspended, was equal to 45.1 percent, in addition to the decrease in film and gaming firms, which was even higher to the tune of 61.6 percent.

Regarding the effects in the financial sphere of the economy, the deleveraging of the household sector continued steadily during the first nine months of 2020. Net new loans toward households declined by €165 million per month on average (Figure 2). Nonetheless, the drop has been somewhat mitigated since April, presumably due to the reduction of income flows. This is also reflected in the rise of the amounts in arrears. According to the latest data provided by the Bank of Greece, in March and June arrears increased by more than €200 million. This also applies to the nonfinancial corporations (NFCs), the arrears of which increased by €565 million in March, €663 million in June, and another €797 million in July. Yet, net new loans granted to them rose significantly since March. Given the reduction of investment in the same period, new credit aimed at providing liquidity due to the higher state of uncertainty.

This is also reflected in the evolution of their stock of deposits, which were increasing quite modestly prior to the pandemic's outbreak (Figure 3). Since March, their growth rate has risen considerably. Between February 2019 and February 2020, deposits were growing at a rate of 0.8 percent; since March, the growth rate increased to 4.1 percent. On the other hand, the steady growth of household deposits slightly slowed after the first lockdown. The corresponding growth rate fell from 0.52 percent to 0.36 percent. It appears, then, that households rely more on their deposits to finance consumption and meet their debt service obligations.

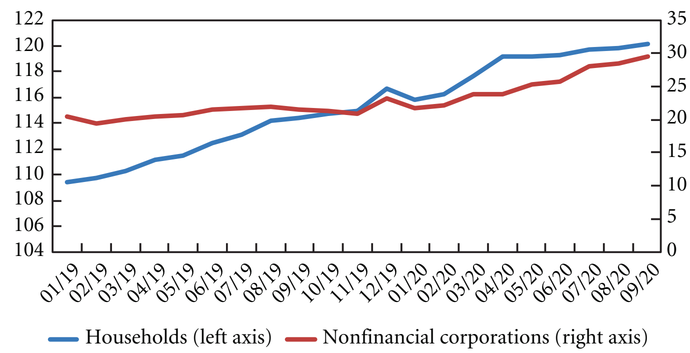
Given all of the above, the economic impact of the pandemic crisis could potentially destabilize the financial sector. The current financial state of both households and NFCs is fragile, given the reduced cash flows and the associated illiquidity. The reduction of nonperforming loans (NPLs) stopped in 2020Q2 (Figure 4). This is particularly evident for consumer and housing NPLs, while the reduction in corporate NPLs was

Figure 2 **Greece: Net New Loans Granted by Domestic Financial Institutions (€ millions, four-period moving average)**



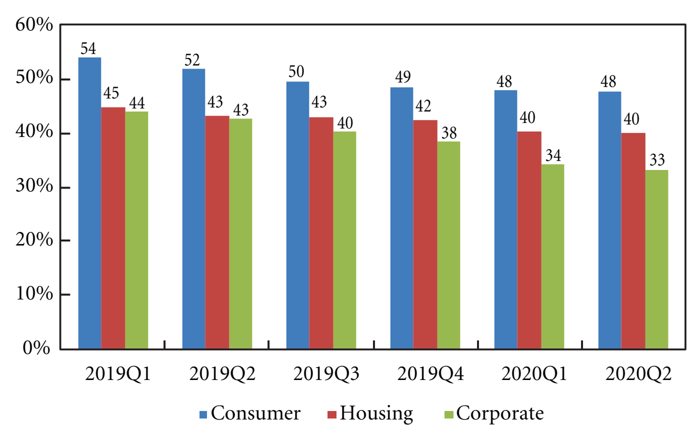
Source: Bank of Greece and authors' calculations

Figure 3 **Greece: Deposits of Households and Nonfinancial Corporations (€ billions)**



Source: Bank of Greece

Figure 4 **Greece: Share of Nonperforming Loans in Total by Type of Loans (percent)**



Source: Bank of Greece and authors' calculations marginal. The private sector's illiquidity is expected to increase as more lockdowns are expected to continue though spring 2021.

The consequences of this induced financial fragility will be unequal, given that a significant part of the population is already in financial distress. At the time of this writing, 1,517 foreclosure auctions had been scheduled to take place through the end of the year.[2] The overall financial distress led Greek authorities to announce that during the lockdown all enforcement measures will be suspended and there will be a further delay of the auctions. Even if the delay relieves those who are in an unfavorable financial situation, the issue of private debt still hangs over the Greek economy. The private sector's stock of loans in arrears (€234 billion) comprise €106 billion owed to the public sector and €92 billion to banks and other financial institutions managing private debt, while the rest of €36 billion are arrears toward insurance companies.

Households' worsening conditions in an already fragile environment and the NFCs' illiquidity are expected to have a contagion effect on the balance sheet of the financial sector. In fact, one of the four largest banks in the Greek banking sector, Piraeus Bank, is already facing financial distress. Profits in 2020Q3 dropped sharply as compared with the previous quarter on the back of higher loan impairment provisions and weaker trading income. The bank, which is 26.2 percent owned by the Hellenic Financial Stability Fund (HFSF), a bank rescue fund, reported a net profit from continued operations of €3 million, down from net earnings of €85 million in the second quarter. Piraeus Bank reported that loan impairment provisions rose 10 percent quarter-over-quarter to €175 million between July and September, up from €160 million in the second quarter. There is a high chance that the bank will be nationalized, increasing the HFSF's holding in it from 26.2 percent to 61.3 percent. If the nationalization does take place, it will be for a short period, with procedures toward a share capital increase starting immediately, so as to strengthen private investors' participation in the bank, along with its loans shifting to the development of a "bad bank" contemplated by the Bank of Greece.

Given the above, in order to reduce the possibility of a liquidity squeeze and improve the private sector's financial conditions, appropriate fiscal measures ought to be in place. Much of the current fiscal measures are dedicated to the provision of loans to firms; loans that, on the one hand, provide liquidity, but on the other fuel insolvency dynamics. In this respect, it would be more appropriate to provide liquidity to both the household and NFC sectors through grants and subsidies.

In this report, we update our previous analysis in light of new statistical evidence and discuss the prospects for the Greek economy over the 2021–22 period, conditional on the availability of additional European funding and the implementation of adequate investment and employment strategies.

Projections for 2021-22

Baseline Projection

The properties of any macroeconomic model are seriously affected by a major shock to both supply and demand, such as the one given by the pandemic and the shutdown of most economic activities. Moreover, with quarterly data, so far we only have two observations in the available sample for evaluating the pandemic's impact, which are too few to obtain a reliable estimate of possible modifications in the parameters governing the model's behavioral equations. We have, therefore, chosen to restrict the estimates to the prepandemic part of the sample and to use our first round of model simulations to obtain a measure of the gaps between the actual components of GDP in the first two quarters of 2020 and the model's predictions for that same period. In this way, we evaluate that private expenditure in Greece has been €1.7 billion (5 percent) below what would have been predicted on the basis of its key determinants in 2020Q1, and €4.3 billion (14 percent) lower in Q2. Exports of goods were also lower by €1 billion (16 percent) in the second quarter compared to the model prediction. These values are the basis on which we can evaluate the deviation of private expenditure and exports due to the pandemic, on top of the effects that the shutdown has imposed on income, wealth, and the other determinants of GDP components.

In order to project the model variables over the 2020–22 period, we assume that, after a brief improvement in 2020Q3, private expenditure will suffer a hit in Q4 similar to that registered in Q2. We further assume that the shutdown's effects will be gradually reduced in the first half of 2021 and the situation will gradually improve starting in 2021Q3.

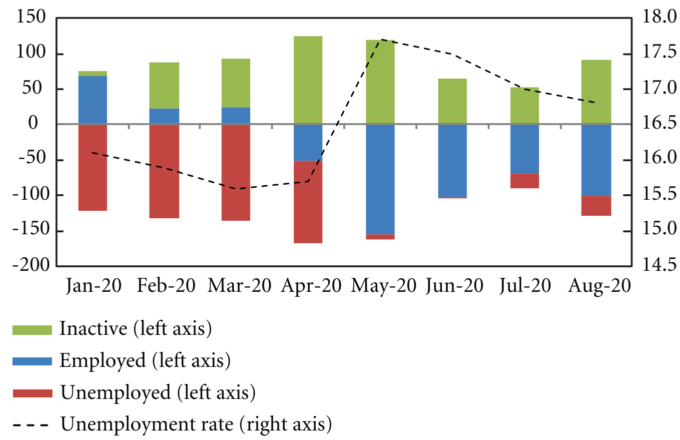
Our fiscal policy variables are assumed to stabilize by the projected end of the shutdown's effects in 2021Q2, and we further assume that public expenditure will be lowered in Q3, when emergency funds to offset the shutdown would no longer be needed and concerns about the size of the public deficit would again be taken into account.

In line with our previous projection, we assume that monetary authorities will continue to guarantee an accommodative monetary policy. The determinants of foreign demand for

Table 1 Greece: Key Indicators under Alternative Scenarios

	2019	2020	2021	2022
Baseline				
Real GDP (growth rate)	1.9	-10.8	3.4	5.3
Gov. total surplus (percent of GDP)	1.0	-10.6	-10.1	-7.4
Gov. primary surplus (percent of GDP)	3.9	-7.5	-6.8	-4.2
Current account (percent of GDP)	-2.1	-5.6	-7.6	-7.0
External balance (percent of GDP)	0.9	-3.5	-5.4	-4.9
Scenario 1: Recovery Fund				
Real GDP (growth rate)	1.9	-10.8	6.1	8.6
Gov. total surplus (percent of GDP)	1.0	-10.6	-8.8	-5.0
Gov. primary surplus (percent of GDP)	3.9	-7.5	-5.7	-2.0
Current account (percent of GDP)	-2.1	-5.6	-5.5	-3.1
External balance (percent of GDP)	0.9	-3.5	-3.3	-1.2
Scenario 2: Job Guarantee Program				
Real GDP (growth rate)	1.9	-10.8	6.8	9.9
Gov. total surplus (percent of GDP)	1.0	-10.6	-9.1	-5.6
Gov. primary surplus (percent of GDP)	3.9	-7.5	-6.0	-2.7
Current account (percent of GDP)	-2.1	-5.6	-5.5	-3.3
External balance (percent of GDP)	0.9	-3.5	-3.4	-1.4

Figure 5 Greece: Change of Employed, Unemployed, and Inactive Persons (thousands people, year-over-year) and the Unemployment Rate (percent)



Source: ELSTAT and authors' calculations

Greek exports of goods and services, including tourism, are taken from the latest projections from the IMF's October 2020 "Economic Outlook."

On the basis of these assumptions, the model projects a fall in real GDP of 10.8 percent in 2020: given the more pessimistic assumptions emanating from additional shutdowns in response to the second wave of COVID-19 infections, our projections are somewhat worse compared to the 10.4 percent contraction we projected in May. Since the impact of the new shutdowns will also be felt in the first half of 2021, our projected recovery is also more feeble than that previously projected (see Table 1).

We chose not to include our evaluation of the Next Generation EU funds' impact in our baseline projections, since they are still subject to final approval, which may impact their size and timing. We evaluate them instead in our first alternative scenario, to which we turn next.

Scenario 1. Recovery Funds

Our new recovery fund scenario assumes that Greece will start receiving its share of grants from the European budget in 2021Q3. We assume that €2 billion will be spent each quarter until the end of the simulation period in 2022.[3]

Should European funds materialize with the timing and size we estimate, our projection shows a more sustained recovery in 2021 and especially in 2022; GDP might, however, accelerate, if the new stimulus triggers additional investment from private investors. On the other hand, European funds will have to be channeled to predefined targets, which may not necessarily match the Greek economy's priorities given their extremely high level of unemployment. We therefore evaluate the impact of a public service job guarantee program in a second scenario, similar to the one proposed in Antonopoulos et al. (2014), and to which we turn next.

Scenario 2. Increasing Employment

The most recent (August 2020) seasonally adjusted employment numbers show an unemployment rate of 16.8 percent, with more than 770,000 people looking for a job. Despite the large number of unemployed persons, the picture is far from being indicative of the current labor market conditions. Employees in suspension for a duration that exceeds three months and/or receive less than 50 percent of their wage are registered as inactive. This explains the surge of inactive persons since April, as denoted in Figure 5. It is, therefore, far more important to focus on employment, on which the first lockdown in March had a severe effect. Compared to the respective months in 2019, employment was reduced by 50,000 persons in April 2020 and 155,000 persons in May. Since then, changes in employment remain in negative territory and, given the renewed lockdown, are expected to remain so until the end of the year.

Furthermore, the brunt of the adjustment during the pandemic crisis has been laid mostly on flexible forms of employment. During the first lockdown more than 30,000 persons in part-time and temporary employment lost their jobs (INE GSEE 2020a). Between March and September of 2020, layoffs exceeded new hires; net flows of flexible contracts have declined at a -7.5 percent rate. By contrast, net flows of full-time jobs have been positive. The intense procyclical movement of flexible employment is a clear indication of the labor market's precarious nature. For instance, in 2020Q2, the share of employees reporting an income of €0–200 rose from 1 percent to 12 percent (INE GSEE 2020b). Once the economy is set for recovery, part-time and nonpermanent employment growth is expected to resurge, following the pattern that prevailed prior to the pandemic when more than half the new jobs were part-time or time-limited contracts. We wait to see what direction the European funds will take so as to determine how much and in what form employment will grow, since the restructuring of production to more capital-intensive sectors is imperative. This de facto implies slower growth in employment once the economy recovers, thereby reinforcing the risk of stubbornly high unemployment characterized by a significant part of jobs being of low quality.

The prospects in the labor market can be improved significantly by implementing an employment scheme that would absorb the bulk of unemployed and inactive workers by offering quality jobs. For this reason, in scenario 2 we evaluate the impact of a public job guarantee program where the government, through its local authorities and in collaboration with non-for-profit institutions, will provide a job at a minimum wage to anyone currently unemployed, able, and willing to work (Antonopoulos et al. 2014).

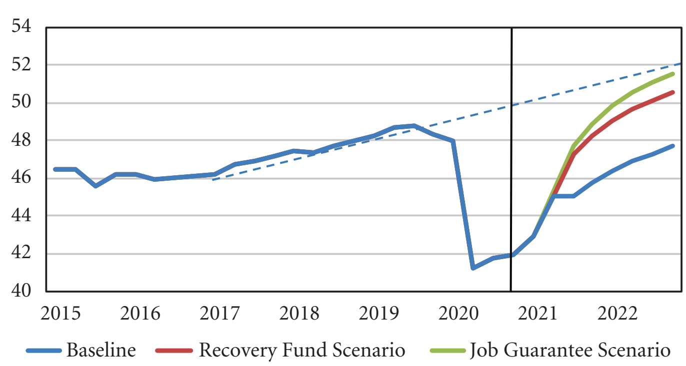
We assume the program will start in 2021Q2, progressively employing 75,000 people each quarter at a monthly unit cost of €700, which should cover both a minimum wage of €650 and associated overhead costs. We assume that the program will expand to a maximum of 300,000 people by 2022Q1, with an associated cost of €630,000,000 per quarter.

The impact on key economic variables is reported in Table 1. As denoted in Table 1, the baseline scenario projects a decline in the current year's GDP growth to -10.8 percent, worse than our previous projection and those of the government, IMF, EC, and OECD, while the primary budget deficit increases to 7.5 percent of GDP. The corresponding numbers for 2021 and 2022 project GDP growing at 3.4 percent and 5.3 percent, respectively, with primary budget deficits at 6.8 percent and 4.2 percent of GDP. The effects of the COVID-19 pandemic and the necessary government lockdowns resulted in the end of the private sector's deleveraging process, as shown in Figure 2. The private sector's stock of debt remains abnormally high and does not bode well for an economy in recession.

Conclusion

Governments around the globe have changed their fiscal and monetary policy stances to shore up businesses and jobs. The European Central Bank has increased its stimulus programs dramatically and has urged the EC to relax fiscal policy to support member states' efforts to combat the COVID-19 pandemic and its economic consequences. Once approved, the Next Generation funds, notwithstanding some member states' objections, would be one important initiative toward achieving this goal. Wealthier member states than Greece (i.e., Germany, France, and Spain) have enacted large emergency fiscal measures toward this goal. The nonwealthy countries (including Greece) have also provided emergency programs, but more numerous and effective ones need to be established. In this report, we urge that European funds be used for shoring up employment, not only of the officially unemployed, but also for those who are marginally attached to the labor market. We propose enlarging the scale of the current Public Benefit Programs—established back in 2016 with favorable results—for the programs' beneficiaries and the broader economy. Our second alternative scenario shows the impact on GDP growth—depicted in Table 1 and Figure 6—and employment of such an augmented employment program.

Figure 6 **Greece: Real GDP under Alternative Assumptions (€ billions, 2010 prices)**



Source: Authors' calculations

The results of our projections for the "business as usual" (baseline) scenario are not very encouraging and, while more pessimistic than most other projections, show that a V-shaped recovery is not in the cards. The other two alternative scenarios bring Greece much closer to a V-shaped recovery, but still not very close to their precrises real growth trend.

The Recovery Funds scenario projections differ from those of our earlier report in being more pessimistic for 2021—in concert with the emergence of the virus's second wave and the economic consequences of business shutdowns and further employment loss—and more optimistic for 2022, anticipating that the deployment of the Recovery Funds will begin in 2021Q3.

A more robust GDP growth rate and the consequent growth in employment can be realized with the combined effects of the Recovery Funds together with an enhanced public benefit jobs program, as illustrated in the projections for scenario 2 (Table 1 and Figure 6). It is this mix of policies that can gain traction and bear fruit in putting the Greek economy on a path to sustainable and inclusive growth.

Notes

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2. Please see: www.eauction.gr/Home/HlektronikoiPleistiriasmoi?conductFrom=11/11/2020&conductTo=30/11/2020&sortAsc=true&sortId=1&page=1
3. The size of the program is estimated on the basis of the "Grants allocation per Member State" in 2021–22, as published by the European Commission.

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