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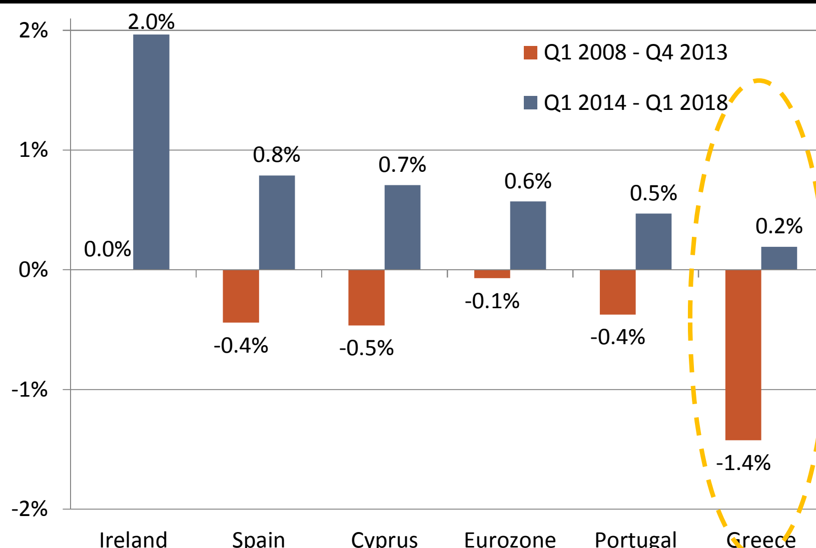
Greece: a fresh start?

- **Six reasons for hope:** After leaving its third bailout programme on 20 August 2018, Greece will have to manage without new loans from its official lenders (ie the International Monetary Fund, European Stability Mechanism, European Commission and European Central Bank) and attract money exclusively from private sources. Will it be able to copy the success stories of other Eurozone ex-bailout countries? We see six reasons for hope. Greece has: (1) implemented important pro-growth reforms, (2) rebalanced its large fiscal and current account deficits, (3) improved its competitiveness, (4) turned around its labour market, (5) brought down its bond yields, and (6) secured more EU funds to support investments. However, high public and private debt, a large stock of non-performing loans, high tax rates, weak educational performance and emigration are among Greece's long-term challenges.
- **Decent growth potential if Greece stays on track:** Ireland, Portugal and Spain enjoyed healthy economic expansions soon after the end of their bailouts. If Greece continues its reform efforts to raise its supply potential and makes its tax rates more competitive, it could turn into a growth leader in the Eurozone. We expect GDP to increase by 2.0% in 2018, 2.2% in 2019 and 2.4% in 2020.
- **However, the margin for error is small:** Greece was already on the path to recovery in 2014. However, a conflict between the Syriza government under the then-finance minister Yanis Varoufakis and Greece's official lenders undid much of the progress and set back the eventual rebound by some three years. To avoid a painful repeat performance, Greece needs to stay on the reform track.
- **How much does the debt relief help?** At the Eurogroup meeting on 21 June, the Eurozone promised Greece a significant debt relief which will reduce the estimated debt/GDP ratio from 127% to 97% in 2060, according to the European Commission. Greece will benefit from a 10-year extension for about one-third of outstanding debt and a longer grace period on interest payments. This will keep its interest expenses manageable.
- **Large cash buffer and tight surveillance:** Greece will remain under tight surveillance by the official lenders and receive benefits which are conditional on further reforms. This reduces the likelihood of Greek policies going astray again. The official lenders also approved the release of funds from the last bailout package so that Greece can build a large public liquidity reserve. As a result, Greece does not need a post-bailout credit line.

Chart 1: GDP Eurozone ex-bailout countries during and after the crisis



Average quarterly GDP growth rate during (Q1 2018-Q4 2013) and after (Q4 2013-Q1 2018) the great financial crisis. Sources: Eurostat, Berenberg calculation.

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Light at the end of the tunnel

The Greek recovery from the post-Lehman trough was the slowest in the EU

Since its post-Lehman trough in Q1 2013, Greece's GDP has only increased by 3%. This is the worst post-Lehman recovery of all Eurozone economies (see Chart 3). The other Eurozone ex-bailout countries, namely Portugal, Spain, Ireland and Cyprus, have enjoyed healthy growth since they hit their individual low points (ranging from a cumulative gain of 9% for Portugal to 48% for Ireland). This is partly due to the fact that the major problem in Greece (excessive public debt) was different to the other euro-crisis countries – which mainly suffered from turmoil in their banking sectors.

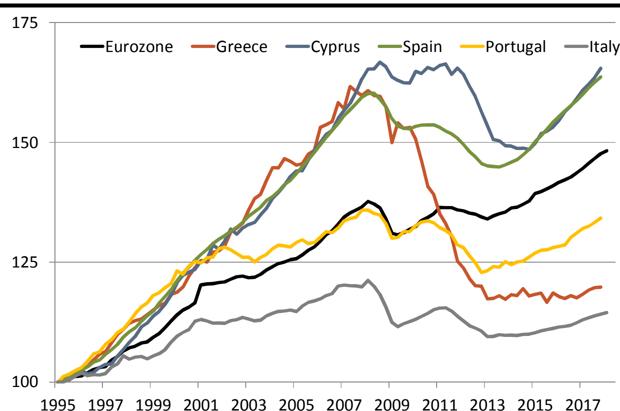
Greece will likely follow the positive growth path of the other ex-bailout countries

After a nearly decade of pain, Greece finally seems ready to move on. The European Union wants to make Greece a success story. Greece now has a good chance to follow the footsteps of the other successful ex-bailout countries. Additional efforts to tackle its low productivity, expensive pension system, large public sector and weak banking sector would add to Greece's chances of success.

Early elections could lead to an even more structural reform-orientated party to winning

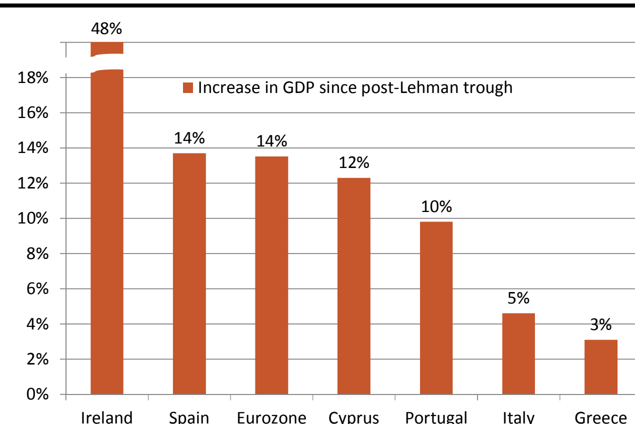
The left-wing Syriza government is on a reform track, but early elections cannot be ruled out as the government majority of prime minister Alexis Tsipras has shrunk this week to two seats in the 300-member parliament. But this does not need to be a bad thing: according to all opinion polls, the even more reform-orientated centre-right New Democracy party would win in such a scenario.

Chart 2: Real GDP since 1995 – only Italy has done worse



Real GDP. Index 100 = Q1 1995
Source: Eurostat

Chart 3: Bottom of the league – real GDP growth since the trough



Change in real GDP since post-Lehman trough. Trough dates are: Ireland Q4 2009, Spain Q3 2013, Eurozone Q2 2009, Cyprus Q2 2014, Portugal Q4 2012, Italy Q1 2013, Greece Q4 2013. Irish GDP adjusted for jump in Q1 2015
Source: Eurostat, Berenberg

Six reasons why Greece will likely succeed

Greece tops the European league for adjustment efforts

Greece tops the EU reform ranking

Despite delays and question marks about Greece's commitment to reform, it has enacted more reforms and undergone a more wrenching adjustment since 2009 than any other EU country. Of course, this has largely to do with its weak starting position: the adjustment requirement was also much bigger than in other countries. According to OECD data and our own calculations, Greece tops the ranking of the 28 EU member states in terms of both reform drive and total adjustment, ahead of success story Ireland (see 2017 Euro Plus Monitor).

Table 1: Cumulative adjustment progress since 2009

Rank			Total score			External adj.			Fiscal adj.			Labour cost adj.			Reform drive		
2017	2016	Country	2017	*Change*	2016	2017	*Change*	2016	2017	*Change*	2016	2017	*Change*	2016	2017	*Change*	2016
1	1	Greece	**7.4**	*-0.2*	**7.6**	**7.3**	*-0.1*	**7.4**	**6.9**	*-0.9*	**7.8**	**7.6**	*0.0*	**7.5**	**7.7**	*0.0*	**7.7**
2	2	Ireland	**6.9**	*0.0*	**6.8**	**5.9**	*-0.1*	**6.0**	**6.3**	*0.0*	**6.3**	**9.2**	*0.1*	**9.1**	**6.1**	*0.1*	**6.0**
3	3	Latvia	**6.1**	*-0.2*	**6.4**	**9.7**	*-0.3*	**9.9**	**5.5**	*-0.2*	**5.6**	**3.2**	*-0.3*	**3.5**	**n.a.**	*n.a.*	**n.a.**
4	4	Romania	**5.9**	*-0.2*	**6.1**	**7.1**	*-0.2*	**7.3**	**5.8**	*-0.2*	**6.0**	**4.9**	*-0.1*	**5.0**	**n.a.**	*n.a.*	**n.a.**
5	5	Spain	**5.9**	*-0.1*	**6.0**	**7.3**	*0.2*	**7.1**	**5.2**	*0.2*	**5.0**	**5.6**	*0.3*	**5.3**	**5.6**	*-0.9*	**6.5**
6	7	Cyprus	**5.6**	*0.0*	**5.6**	**3.8**	*0.1*	**3.7**	**5.5**	*-0.3*	**5.9**	**7.4**	*0.1*	**7.3**	**n.a.**	*n.a.*	**n.a.**
7	8	Portugal	**5.3**	*-0.1*	**5.4**	**6.3**	*0.3*	**6.0**	**4.6**	*0.4*	**4.2**	**5.0**	*-0.2*	**5.2**	**5.4**	*-0.8*	**6.3**
8	6	Lithuania	**5.3**	*-0.4*	**5.7**	**7.1**	*-0.6*	**7.7**	**7.0**	*-0.5*	**7.5**	**1.8**	*-0.3*	**2.0**	**n.a.**	*n.a.*	**n.a.**
9	10	Estonia	**5.1**	*-0.1*	**5.2**	**7.1**	*-0.4*	**7.5**	**2.7**	*-0.8*	**3.4**	**4.5**	*0.4*	**4.1**	**6.1**	*0.5*	**5.6**
10	12	Malta	**5.1**	*0.5*	**4.6**	**7.0**	*0.9*	**6.1**	**4.6**	*0.3*	**4.3**	**3.7**	*0.2*	**3.5**	**n.a.**	*n.a.*	**n.a.**
11	9	Croatia	**5.1**	*-0.4*	**5.4**	**6.2**	*0.1*	**6.0**	**3.1**	*-1.2*	**4.3**	**5.9**	*0.0*	**5.9**	**n.a.**	*n.a.*	**n.a.**
12	11	Slovenia	**5.0**	*0.0*	**5.0**	**7.4**	*0.6*	**6.9**	**5.7**	*0.0*	**5.7**	**4.6**	*0.4*	**4.2**	**2.3**	*-1.1*	**3.4**
13	13	Slovakia	**4.5**	*0.0*	**4.5**	**7.1**	*-0.1*	**7.2**	**4.7**	*0.3*	**4.4**	**1.9**	*-0.1*	**2.1**	**4.3**	*0.1*	**4.3**
14	15	Czech Republic	**4.2**	*-0.1*	**4.3**	**6.3**	*0.4*	**5.9**	**5.5**	*0.2*	**5.3**	**1.0**	*-0.4*	**1.4**	**4.1**	*-0.6*	**4.6**
15	18	Netherlands	**4.1**	*0.2*	**3.9**	**5.5**	*0.3*	**5.2**	**4.2**	*-0.2*	**4.4**	**3.1**	*0.2*	**2.9**	**3.6**	*0.5*	**3.1**
16	17	Bulgaria	**4.1**	*0.0*	**4.1**	**8.4**	*-0.5*	**8.9**	**3.8**	*0.8*	**3.1**	**0.0**	*-0.2*	**0.2**	**n.a.**	*n.a.*	**n.a.**
17	20	United Kingdom	**4.0**	*0.3*	**3.7**	**2.5**	*0.4*	**2.1**	**6.8**	*0.5*	**6.3**	**2.5**	*0.2*	**2.4**	**4.2**	*0.1*	**4.1**
18	14	Hungary	**3.9**	*-0.4*	**4.3**	**6.7**	*-0.3*	**7.0**	**2.6**	*0.2*	**2.4**	**3.0**	*-0.6*	**3.6**	**3.4**	*-0.9*	**4.2**
19	16	Poland	**3.9**	*-0.3*	**4.2**	**5.2**	*-0.2*	**5.5**	**5.6**	*0.2*	**5.4**	**0.4**	*-0.1*	**0.5**	**4.5**	*-0.8*	**5.3**
20	19	Italy	**3.8**	*-0.1*	**3.9**	**4.0**	*0.1*	**3.9**	**3.4**	*-0.2*	**3.6**	**3.6**	*0.3*	**3.3**	**4.3**	*-0.6*	**4.8**
21	23	Belgium	**3.4**	*0.5*	**2.9**	**4.4**	*0.4*	**4.0**	**2.6**	*0.4*	**2.2**	**2.9**	*0.3*	**2.6**	**3.5**	*0.9*	**2.6**
22	21	Denmark	**3.3**	*-0.1*	**3.4**	**3.8**	*0.2*	**3.6**	**2.4**	*0.0*	**2.5**	**3.4**	*-0.1*	**3.5**	**3.3**	*-0.7*	**4.0**
23	22	Luxembourg	**3.1**	*-0.2*	**3.3**	**4.3**	*0.1*	**4.3**	**2.7**	*-0.7*	**3.3**	**3.9**	*-0.3*	**4.2**	**1.6**	*0.2*	**1.4**
24	24	France	**3.0**	*0.2*	**2.8**	**2.2**	*-0.1*	**2.3**	**3.3**	*0.1*	**3.2**	**1.6**	*-0.1*	**1.7**	**4.8**	*0.8*	**4.0**
25	25	Austria	**2.9**	*0.3*	**2.6**	**3.3**	*0.4*	**2.9**	**2.7**	*-0.1*	**2.8**	**0.6**	*0.1*	**0.5**	**5.2**	*0.9*	**4.3**
26	27	Finland	**2.9**	*0.5*	**2.3**	**1.3**	*0.5*	**0.9**	**1.7**	*-0.1*	**1.8**	**4.6**	*1.8*	**2.8**	**3.8**	*-0.1*	**3.9**
27	26	Germany	**2.4**	*0.1*	**2.3**	**3.4**	*0.0*	**3.4**	**2.7**	*-0.3*	**3.0**	**0.4**	*-0.2*	**0.6**	**3.2**	*0.8*	**2.4**
28	28	Sweden	**2.2**	*-0.1*	**2.3**	**2.2**	*-0.1*	**2.3**	**2.1**	*0.0*	**2.1**	**1.7**	*0.2*	**1.5**	**2.8**	*-0.3*	**3.2**
		EZ19	**3.7**	*0.1*	**3.6**	**4.3**	*0.2*	**4.1**	**3.7**	*0.0*	**3.7**	**2.6**	*0.1*	**2.6**	**4.2**	*0.3*	**3.9**

Adjustment progress, scores from 10 (best possible) to 0 (worst). The overall score is the average of four sub-scores for external adjustment, fiscal repair, labour cost adjustment and structural reforms. Sources: Berenberg, Lisbon council, Euro Plus Monitor

More reforms needed to improve public sector performance and access to product markets

The labour market and pension reforms Greece has implemented between 2010 and 2017 have raised its competitiveness and fiscal sustainability. Apart from being ahead in the reform drive category, Greece also scores second in labour cost adjustment and is among the top five in the external adjustment category (see Table 1). However, more pro-growth reforms are needed to improve the long-run potential of the economy and make the public sector more efficient. For example, corruption is still an issue, public services lag behind in going digital and procedures remain far too bureaucratic. Greece also needs to ease the access to product markets, abolish monopolies/oligopolies and eliminate entry barriers in eg the taxi transportation and pharmacy sector.

Greece rebalanced its twin deficits

Imbalances in fiscal and current account balance have been addressed

On the eve of the 2008 global financial crisis, Greece had large double deficits of 15% of GDP for the current account and a 10.2% of GDP fiscal deficit. Thanks to serious efforts, including raising net exports and taxes (VAT by 4ppt, corporate income tax by 9ppt) and cutting social spending (eg several rounds of pension cuts) Greece managed to wipe out its twin deficits. By lowering its reliance on foreign capital, Greece is now less vulnerable than before to the changing whims of global financial markets. Its primary structural fiscal balance improved from a deficit of 13.9% of GDP in 2009 to a surplus of 4.9% in 2017. A positive fiscal correction of 19ppt is double that of any other EU country. Ireland, Portugal and Spain improved their primary structural balances by “only” c8-10% (see Chart 4).

Strong outlook for primary budget surplus

According to the Greek Finance Ministry’s recent medium-term fiscal strategy plan (MTFS), Greece will likely beat its target of a primary fiscal surplus of 3.5% of GDP in the coming years – possibly freeing up a little headroom to reduce taxes over the medium term. The MTFS predicts a primary surplus of 3.6% in 2018, 4.0% in 2019, 4.5% in 2020, 4.5% in 2021, and 5.2% in 2022. The primary surplus reached 4.2% in 2016 and 4.2% in 2017 versus a target of 1.75% set by Greece’s official lenders.

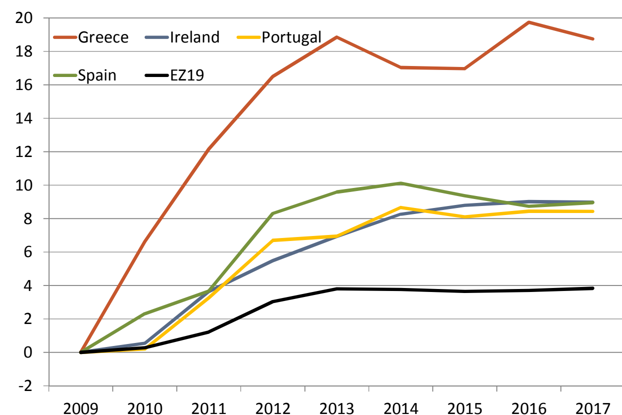
Current account deficit fell from 15% of GDP in 2009 to less than 1% in 2017

Greece’s pre-financial crisis growth model based on debt-financed consumption was unsustainable. The tell-tale signs of growing risk were visible in its fiscal and current account deficits that each consistently exceeded 5% of GDP from 2000 to 2011. The current account deficit peaked at an unsustainably high 15.2% of GDP in 2007 (see Chart 5). The large external deficit was partly the result of a lack of savings. Before the great financial crisis, Greek gross national savings roughly halved between 2000 and 2008 (from 19.9% of GDP to 9.4%), while investments remained elevated at c25% of GDP. This difference was reflected in the yawning current account deficit. The gap started to close from 2009 onwards as investment as a share of GDP declined by more than savings.

In 2015, the difference between savings (9.6%) and investments (9.8%) was below 1% for the first time since 1994. Greece should target an increase in investments or higher spending

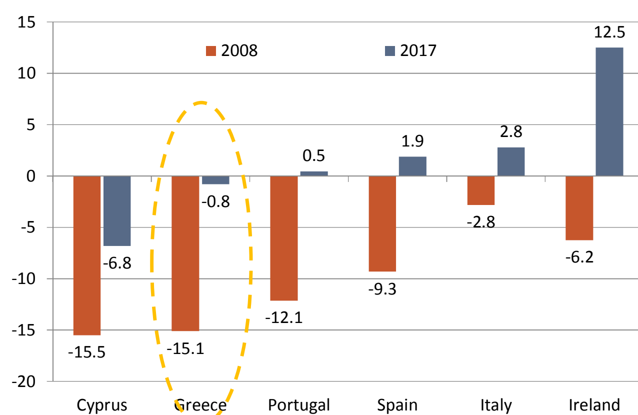
on capital goods (eg machines, computers and factories) as it raises labour productivity and increases efficiency which leads to higher economic growth.

Chart 4: Change in underlying fiscal balance in % of GDP



Cumulative change in the primary structural fiscal balance (revenues – spending) since 2009, in % of GDP, adjusted for the short-term business cycle, interest payments and one-off factors. Source: IMF, Berenberg

Chart 5: Big shifts – current account deficits in % of GDP



Source: Eurostat, Berenberg

Exports are improving while imports remain stable

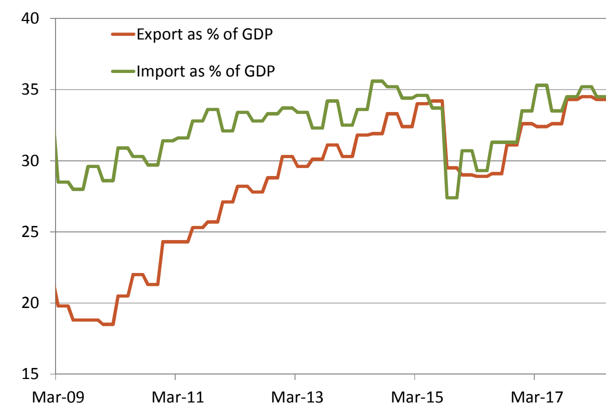
Comparing 2017 with 2007, Greece's current account deficit narrowed from 15.2% of GDP to 0.8% of GDP largely due to rising exports of goods and services and stagnating imports. The trade deficit on goods and services fell from 11.9% of GDP to 0.5% of GDP over the past 11 years (see Chart 6). Considering the large investments the EU and private investors are planning in Greece, the growth in exports will likely continue.

A shift in the primary income balance from a 2.9% of GDP deficit to a 0.1% of GDP surplus during 2007 and 2017 mainly due to improvements in the portfolio investments category also helped. Portfolio outflows contracted sharply as the haircut on private debt in Q1 2012 and low interest rates on official support loans reduced interest payments. After Ireland, Greece had the largest improvement in the current account compared to the other bailout countries.

Tourism will likely continue to be a success story in Greece

Tourism also helped. The sector contributes c20% to Greek GDP. In 2017, 27m tourists arrived in Greece, up 75% from 2012 (see Chart 7). This positive trend continues in 2018. Arrivals are already 12% higher yoy in the January to April period. The tourism ministry expects 2m more arrivals in 2018 beyond the record of last year. Greek tourist companies are building or planning to build a significant amount of luxury accommodation. This should help to boost the average amount of spending per tourist over the coming years.

Chart 6: Greece improved exports significantly



Greek exports of goods and services as % of GDP
Source: ELSTAT, Berenberg

Chart 7: Greek tourism rising nicely

Total arrivals in Greece from abroad, in millions.
Source: ELSTAT, Berenberg

Structural reforms and a fall in labour costs have boosted Greece's competitiveness

Greece improved in international competitiveness surveys

Facing pressure from financial markets, Greece has mostly followed the recommendations of its official lenders since mid-2015. Cutting red tape improved its position in the World Bank's "ease of doing business" index which measures regulations directly affecting businesses. Greece cut down the paperwork and the time it takes to start a new business, improved minority investor protection and reduced drastically the barriers to export. A reduction in the minimum wage has helped to further lower labour costs.

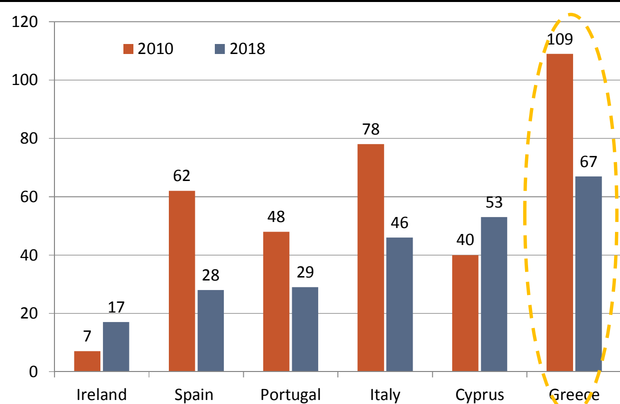
Greece still needs to improve in some categories of the ease of doing business index

Greece climbed in the global ranking of the ease of doing business index from position 109 in 2010 to position 60 in 2016. However, it has slipped seven places over the past two years and ranks now at 67 as other countries have overtaken it. In total, the "ease of doing business" report comprises 11 categories. Greece performs well in the category of trading across borders (rank: 29), mainly because of its participation in the EU single market, starting a business (37) and protecting minority investors (43). But it still has a lot of room for improvement in the categories of registering property (145), enforcing contracts (131), which measures procedures, time and cost to enforce a debt contract, and in the category of ease of getting credit (90), measuring the strength of credit reporting systems and the effectiveness of collateral and bankruptcy laws in facilitating lending.

Labour cost and unit labour costs declined between 2008 and 2017

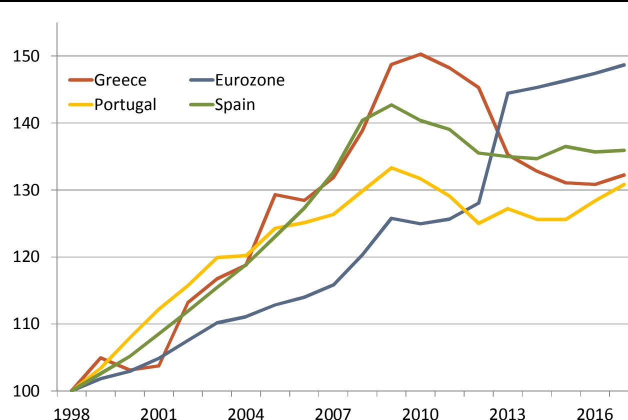
Wages fell by 14% in nominal and by 20% in real terms between 2008 and 2017 relative to an 8% rise in real terms across the EU28. Greece's unit labour costs declined by 5% during the same period, while nominal unit labour costs in the Eurozone rose by 24% on average between 2010 and 2017 (see Chart 7). As a result, it became more competitive and attractive for foreign investors.

Chart 6: Greece improved in the ease of doing business index



Ease of doing business index. 2010 183 countries, in 2019 190 countries
Source: doingbusiness.org, Berenberg

Chart 7: Nominal unit labour costs became competitive again



Average real wages per hour in euro, adjusted for inflation, in 2008 prices.
Source: Eurostat, Berenberg

Employment gains look set to continue

Employment recovery underway

We are confident that employment will continue to increase, as: (1) the economic recovery in Greece and its export markets boosts overall demand; (2) the boom in tourism will continue, requiring more workers; (3) labour unit costs have fallen significantly over the past few years, making Greece more competitive for employers; (4) more EU funding and slowly rising business confidence will support more investments, creating more jobs; and (5) the current capital controls that weigh on economic activity will be eased further and will eventually be fully removed.

Greece added 300,000 jobs since Q4 2013

Although still far below the 2008 peak, Greek employment has rebounded in the past few years. After employment declined by 1.1m (or 24%) to 3.5m between 2008 and 2013, Greece has added c300,000 jobs since Q4 2013.

Bond yields likely to decline further

Bond yields set to fall further

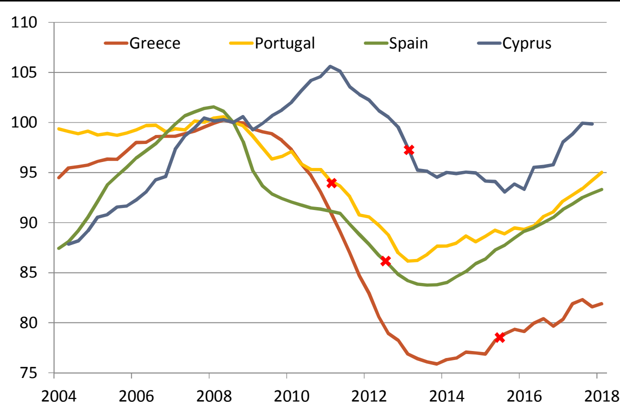
Bond yields are an important benchmark for loan rates. The risk spread indicates the confidence investors have in a country and prices in the likelihood of a default. Greek 10-year bond yields have fallen dramatically since the third bailout in 2015 (from nearly 10% to

close to 4% today). This is similar to the trends in bond yields of both Ireland and Portugal following their final bailouts in November 2010 and May 2011 respectively (see Chart 11). As Eurozone bond yields are likely to remain subdued while the European Central Bank (ECB) normalises its monetary policy only gradually, Greece could see its 10-year benchmark bond yields fall towards 3% next year.

Large liquidity reserve will reduce risk spreads on government bonds

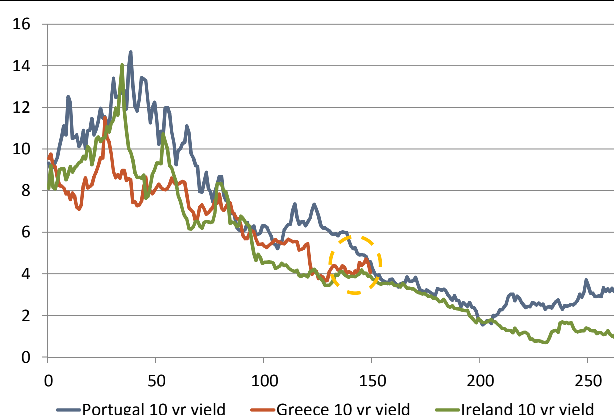
Greece aims for a large cash buffer of EUR24bn, available after the August bailout. This should be enough to refinance the country for nearly two years. The buffer will reduce the amount of bond issuances needed over the next two years. In combination with the other debt relief measures, this should improve Greece's credit rating and lower the risk spread over German bonds.

Chart 10: The rebound in employment continues



Employment rebased to 100 in 2008. Red X signals the date of the start of the last bailout. Source: Eurostat, Berenberg

Chart 11: Government bond yields are falling



10-year bond yields since last bailout announcement, in weeks. Announcement dates are: Ireland: November 2010, Portugal: May 2011, Greece: August 2015. Source: Bloomberg, Berenberg

EU support can accelerate investment growth and keeps interest payments low

EU fund increase may boost investments

Greece is set to receive cash from a series of EU initiatives.

- In 2015, the European Commission (EC) introduced the Jobs and Growth Plan for Greece – this should make it easier for the country to access EU funds. EUR35bn in funding was made available for Greece until 2020 under various EU programmes. To date, Greece has received almost EUR16bn (between July 2015 and early June 2018).
- Relative to the size of its economy, Greece is set to receive the largest contribution of cash from the European Fund for Strategic Investments (EFSI). The EUR2.6bn available under the EFSI could trigger EUR10bn in additional private investments, according to the EC.
- The European structural and investment funds allocated to Greece are set to rise by 8% to EUR19.2bn between the 2014-2020 and the 2021-2027 period – the maximum increase possible according to current EU rules. Divided by the number of years, the EUR19.2bn reflect c1.6% of Greek annual GDP (based on 2017 nominal GDP). This should help to boost investments in Greece.

Greece pays little interest on its debt

Over the past few years, the official lenders, including the European Stability Mechanism (ESM), agreed to reduce the interest rate they charge on Greece's debt. As a result, Greece's interest payments as a percentage of GDP are now at c3.5% of GDP, which is lower than before the great financial crisis (c4.5% of GDP) although its debt levels are now much higher (109% of GDP in 2008 versus 178% of GDP in 2017). Also, Greece pays less interest than Portugal (3.7% of GDP) despite Portugal's debt/GDP ratio being 30% lower (see Chart 12). Low interest expenses give Greece a starting advantage compared to other countries.

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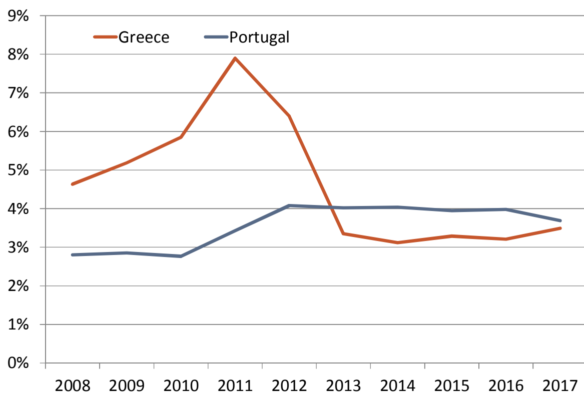
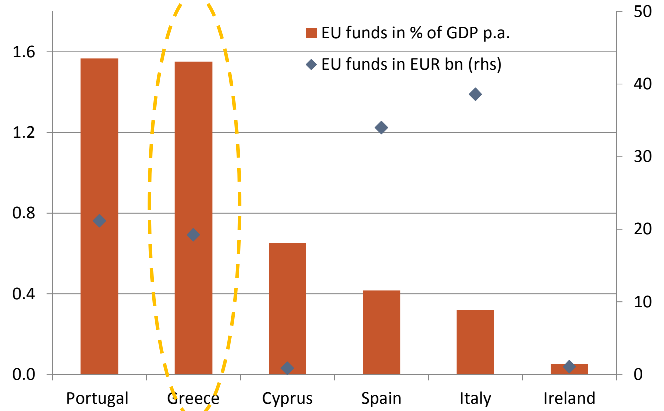
Chart 12: Interest payments



State budget interest payments as % of nominal GDP
Source: Greece's Ministry of Finance, Banco de Portugal, Berenberg

Chart 13: EU cohesion policy allocations, 2021-2027



Proposal for the new long-term EU budget from 2 May in constant 2018 prices, in % of 2017 nominal GDP.
Source: EU Commission, Berenberg

Still, Greece faces significant challenges

Subdued credit growth lowers business confidence

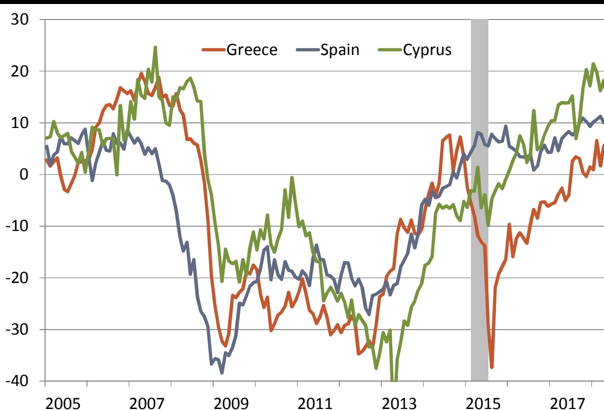
Contracting credit growth

The Greek economy suffers from a weak banking sector due to very high proportion of non-performing loans (c45% of total loans) and a high loan/deposit ratio (c120%). This impedes a recovery in credit growth. While credit growth is gradual rising across the Eurozone and shows signs of improvement in the erstwhile crisis countries (ie Spain and Portugal), credit continues to contract in Greece. In Q1 2018, private credit declined by 7% yoy (see Chart 15).

Subdued business confidence

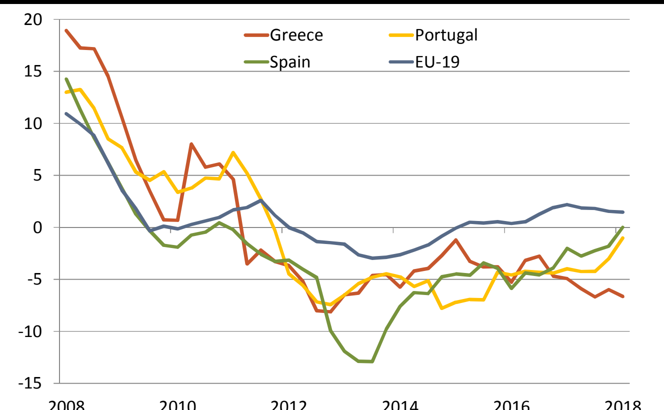
Greece's business confidence improved significantly from the trough caused by the Tsipras/Varoufakis government in early 2015. But it still lags behind the other Mediterranean countries, indicating that Greece might struggle to achieve the same growth rates as them. The business confidence index has a high correlation with yoy rates of GDP growth. The higher the business confidence, the more likely businesses will increase their risk appetite and boost investments, increasing productivity, employment, wage growth and supply.

Chart 14: Business confidence index: Greece still behind



Business confidence: weighted average of confidence in industry, services, construction and retail. Shaded area: radical period of Tsipras/Varoufakis government. Source: EU Commission, Berenberg

Chart 15: Private sector credit growth: Greece credit growth sagging badly



Monetary financial institution lending to the private sector (NSA, EOP), % change yoy.
Source: Local central banks, Berenberg

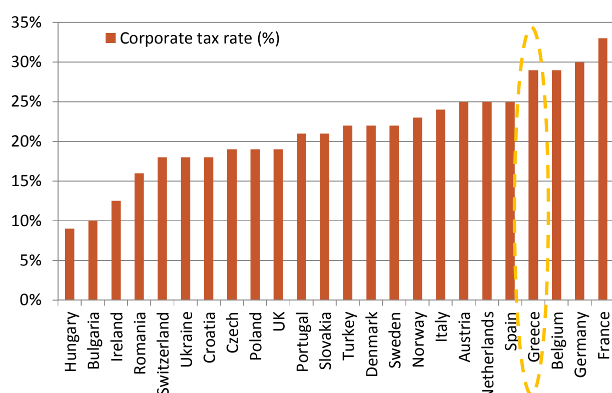
Greece's tax system constrains trend growth

Greece's tax levels are very high

Over the past eight years, Greece has raised the personal and corporate income tax rates (CIT) as well as consumption taxes such as VAT and property taxes. The corporate income tax rate increased from 20% in 2012 to 29% in 2015, one of the highest tax rates in the EU. The personal income tax rate was increased by 3% to 45% in May 2016 and the tax-free threshold lowered. Additionally, the solidarity levy – charged on top of the income tax rate – has been increased, raising the top tax rate to 55%, one of the highest EU income tax rates. The VAT rate was increased twice – by 4ppt in 2010 and 1ppt in 2016 – to 24%.

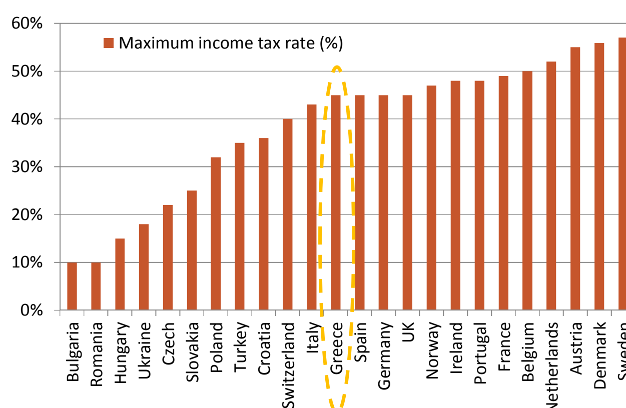
The tax hikes deepened the recession and the high tax burden makes a dynamic recovery more difficult. To raise trend growth, a cut in corporate income taxes would make sense. Other ex-bailout countries such as Portugal and Spain have already cut their CIT in 2014/15 and 2015/16 respectively. While a VAT cut would raise consumption over the short term, which is welcome in a recession, a cut in corporate taxes would boost trend growth also over the long term. Greece will likely generate a rising cash surplus over the next few years – as the primary surplus beats targets – which can be distributed. It would be beneficial for the country to use some of that money to finance tax cuts instead of increasing social spending.

Chart 16: Very high corporate tax rate



Source: KPMG, Berenberg

Chart 17: High personal income tax rate



Source: KPMG, Berenberg

Lack of improvement in education and a serious brain drain problem

Greece's education system performs poorly in international study

The OECD Programme for International Student Assessment (PISA) scores 15-year-old students' performance in mathematics, reading and science among 72 countries. The results are published every three years. Greece ranked 44 in 2015, but dropped in the table across all major categories. The distance to the OECD average widened further except for in mathematics. Greece should reform its education system to boost the performance of its students.

Greece suffers from a severe brain drain

Brain drain: Since 2011, over 650,000 Greeks or c6% of the population left the country. Worryingly, it is mostly young workers in the 18-35 year range who have emigrated. The number of 30-year olds in the country fell from 170,000 in 2011 to only 121,000 in 2017, a decline of 28%. If Greece manages a strong and sustained recovery, these workers may return.

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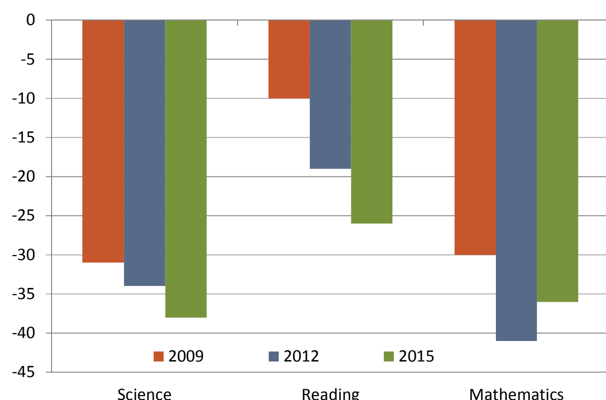
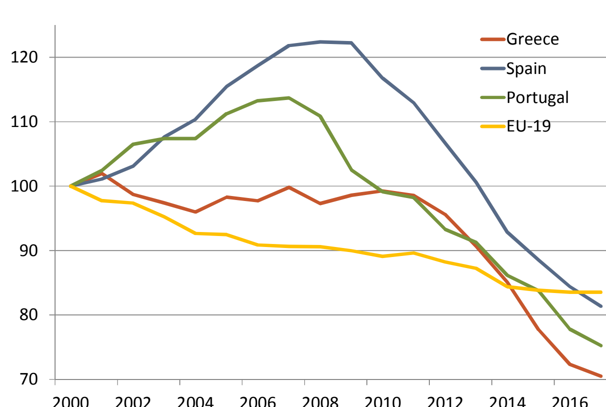
Chart 18: Educational performance: Greece is falling behind



Difference in score points between OECD average score and Greece for science, reading and mathematics. The scale has a mean score of 500 and standard deviation of 100 among OECD countries.
Source: OECD, Berenberg

Chart 19: Young workers emigrate



Population of 30-year olds, rebased to 100 in 2000
Source: Eurostat, Berenberg

Three bailouts and serious debt relief

Economic boom between 1995 and 2008

Up and down: The Greek economy has gone through several boom-bust episodes since the Second World War. During two periods, from 1950 to 1973 and 1995 to 2008, Greece was a growth leader in western Europe.

Financial crisis worsened by harsh austerity, slow implementation of reforms and Varoufakis plans to exit the Eurozone

The last boom came to an abrupt end in 2008 in the wake of the global financial crisis. Greece needed three bailouts to stay solvent, while the economy shrank by 27% between Q1 2008 and Q4 2013. In late April 2010, the Greek/German 10-year bond yield spread surged above 1,000bp, making it impossible to refinance Greece's debt. A few days later, Greece and a troika of international institutions, namely the EU, the ECB and the International Monetary Fund (IMF) agreed on a bailout package of up to EUR110bn over three years. However, this was not enough. In February 2012, Greece needed another EUR130bn bailout. At the same time, private investors faced a c50% haircut on their bonds, reducing Greece's debt load by cEUR130bn.

After serious reforms and painful austerity, Greece started to recover in 2014. However, a conflict between the Syriza government under then-finance minister Yanis Varoufakis and Greece's official lenders undid the progress and set back the eventual rebound some three years. Unlike the other ex-bailout countries such as Spain, Cyprus and Portugal, which were on the path to recovery, misguided economic policies and a clash with its creditors plunged Greece's economy back into crisis. In the summer of 2015, Greece needed a third bailout programme of up to EUR86bn over three years.

Greece receives significant debt relief

In June 2018, the Eurogroup agreed on debt relief for Greece, allowing the country to pass the EC's debt sustainability analyses. The debt relief package includes the following.

- A 10-year extension of the EFSF loan tranche from the second bailout (EUR97bn or around one-third of total debt) so Greece will not have to start repaying this loan until 2034.
- 10 years' additional grace period on interest payments.
- Greece receives EUR15bn from the current bailout programme to repay debt and to increase its liquidity reserve. The Greek government's liquidity reserve target of EUR24bn by August would be enough to cover the country's finances for the next two years.
- Greece receives the return of profits made on Greek bonds by the ECB until 2022 if it sticks to the reform.
- Lenders will review in 2032 if additional debt measures are needed.
- Lenders also committed to further re-profile the debt and defer interest payments in case of an unexpectedly adverse scenario.

- Greece's development will be monitored by the ESM, EC, ECB and IMF on a quarterly basis.

Greece may issue new bonds to increase its liquidity reserve further

The debt relief will lower the expected debt/GDP ratio in 2030 to 131.4% versus 136.6% previously and to 96.8% in 2060 versus 127% projected before the measures. Yearly gross financing needs will stay below 15% of GDP in the medium term and 20% in the long term, according to the EC's calculations. Greece now has a large liquidity reserve and faces little debt redemptions in the short term. There is no rush to issue new bonds. But in case Greece's bond yields are falling from current levels, it may use the opportunity to increase the liquidity reserve further and issue new long-term benchmark bonds.

Greece joining the ECB QE programme is very unlikely

In theory, the ECB could still buy Greek bonds as part of its quantitative easing (QE) programme which is likely to run until the end of this year. But this is very unlikely. The ECB demands that a country is in an official bailout programme or has an investment-grade rating to benefit from this. However, Greece is still rated sub-investment grade by all four relevant rating agencies and will exit the bailout programme at the end of August. Therefore, as Cyprus in 2016, Greece would not be eligible for the QE programme.

Greece forecast summary

On track for slightly firmer GDP growth

We expect Greece's GDP to increase by 2.0% in 2018, 2.2% in 2019 and 2.4% in 2020, after 1.3% in 2017 (on a weekday-adjusted basis). This is a decent performance considering that Greece's public and private sector will continue to delever over the next few years. The GDP growth acceleration in 2018 is mainly driven by an improvement in net exports and investments, while in 2019 and 2020 private consumption should play a slightly more important role.

Table 2: Greece forecast summary

		2017	2018	2019	2020	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
GDP	% y/y	**1.3**	**2.0**	**2.2**	**2.4**	2.3	1.7	1.6	2.4	1.9	2.3	2.5	2.2	2.4	2.3	2.4	2.4
	% q/q					0.8	0.2	0.4	1.0	0.3	0.6	0.6	0.6	0.5	0.5	0.7	0.7
	%q/q ann.					3.1	0.7	1.8	3.9	1.3	2.3	2.6	2.6	2.1	2.1	2.7	2.8
Private Consumption	% y/y	**0.2**	**0.5**	**0.9**	**1.0**	-0.4	0.1	0.9	1.5	1.3	1.0	0.8	0.6	0.8	1.0	1.1	1.2
	% q/q					0.3	0.4	0.4	0.4	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.3
Government Consumption	% y/y	**-1.2**	**1.3**	**1.3**	**1.0**	0.3	1.2	0.6	3.2	4.4	1.4	0.1	-0.5	0.4	0.8	1.2	1.6
	% q/q					-1.7	3.0	1.3	0.6	-0.5	0.0	0.0	0.0	0.4	0.4	0.4	0.4
Investment	% y/y	**9.5**	**6.4**	**7.4**	**8.5**	-10.4	15.1	29.5	-3.4	30.5	6.9	0.9	-3.0	3.0	6.1	10.3	14.7
	% q/q					-28.1	22.0	6.0	4.0	-3.0	0.0	0.0	0.0	3.0	3.0	4.0	4.0
Final Domestic Demand [1]	% y/y	**1.0**	**1.4**	**1.9**	**2.1**	-1.5	2.1	3.9	1.2	5.1	1.9	0.7	-0.1	1.0	1.7	2.4	3.1
	% q/q					-4.5	3.3	1.3	1.0	-0.5	0.1	0.1	0.1	0.7	0.7	0.9	0.9
Net Exports [1]	% y/y	**-0.4**	**0.6**	**0.3**	**0.3**	3.4	0.3	-1.3	0.0	-1.1	0.3	0.9	1.2	0.9	0.5	0.1	-0.3
	% q/q					1.4	-1.0	-0.3	0.0	0.3	0.3	0.3	0.3	0.0	-0.1	-0.1	-0.1
Stockbuilding [1]	% y/y	**0.7**	**0.0**	**0.0**	**0.0**	0.4	-0.7	-1.0	1.2	-2.1	0.2	0.9	1.1	0.5	0.2	-0.2	-0.5
	% q/q					3.8	-2.1	-0.6	0.0	0.5	0.2	0.2	0.2	-0.2	-0.1	-0.1	-0.1
Current Account Balance	EUR bn	**-1.4**	**-0.9**	**-0.6**	**-0.4**	-2.8	-0.9	5.1	-2.3	-2.8	-0.7	5.2	-2.3	-2.9	-0.5	5.2	-2.3
	% of GDP	**-0.8**	**-0.5**	**-0.3**	**-0.2**												
Industrial Production [2]	% y/y	**4.9**	**2.7**	**3.6**	**3.6**	-0.2	3.3	4.1	3.7	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6
	% q/q					0.7	-0.1	2.4	0.7	0.5	-0.1	2.4	0.7	0.5	-0.1	2.4	0.7
Unemployment Rate [2]	%	**21.5**	**19.5**	**17.5**	**15.5**	20.5	19.5	18.8	19.0	18.5	17.5	16.8	17.0	16.5	15.5	14.8	15.0
CPI [2]	% y/y	**1.1**	**0.9**	**1.2**	**1.6**	0.3	0.7	1.1	1.5	0.9	0.9	1.3	1.6	2.2	1.9	1.3	0.9
General Govt. Balance	% of GDP	**0.8**	**0.4**	**0.0**	**0.0**												
General Govt. Debt	% of GDP	**178.6**	**173.2**	**167.4**	**161.0**												

[1] Contribution to GDP growth[2] Period averages. Source: Berenberg, Eurostat

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Christopher Pyle	+44 20 3753 3076

UK (cont'd)

Adam Robertson	+44 20 3753 3095
Joanna Sanders	+44 20 3207 7925
Mark Sheridan	+44 20 3207 7802
George Smibert	+44 20 3207 7911
Alexander Wace	+44 20 3465 2670
Paul Walker	+44 20 3465 2632

GERMANY

Michael Brauburger	+49 69 91 30 90 741
Nina Buechs	+49 69 91 30 90 735
André Grosskurth	+49 69 91 30 90 734
Florian Peter	+49 69 91 30 90 740
Joerg Wenzel	+49 69 91 30 90 743

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Duncan Downes	+41 22 317 1062
Andrea Ferrari	+41 44 283 2020
Gianni Lavigna	+41 44 283 2038
Jamie Nettleton	+41 44 283 2026
Yeannie Rath	+41 44 283 2029
Mirco Tieppo	+41 44 293 2024

COO Office

Greg Swallow	+44 20 3207 7833
Fenella Neill	+44 20 3207 7868

CRM

Laura Cooper	+44 20 3753 3065
Jessica Jarmyn	+44 20 3465 2696
Madeleine Lockwood	+44 20 3753 3110
Vikram Nayar	+44 20 3465 2737
Rita Pilar	+44 20 3753 3066

CORPORATE ACCESS

Lindsay Arnold	+44 20 3207 7821
Robyn Gowers	+44 20 3753 3109
Dipti Jethwani	+44 20 3207 7936
Ross Mackay	+44 20 3207 7866
Stella Siggins	+44 20 3465 2630
Lucy Stevens	+44 20 3753 3068
Abbie Stewart	+44 20 3753 3054

EVENTS

Charlotte David	+44 20 3207 7832
Suzy Khan	+44 20 3207 7915
Natalie Meech	+44 20 3207 7831
Eleanor Metcalfe	+44 20 3207 7834
Rebecca Mikowski	+44 20 3207 7822
Sarah Weyman	+44 20 3207 7801

SALES TRADING

LONDON

Assia Adanouj	+44 20 3753 3087
Charles Beddow	+44 20 3465 2691
Mike Berry	+44 20 3465 2755
Joseph Chappell	+44 20 3207 7885
Stewart Cook	+44 20 3465 2752
Mark Edwards	+44 20 3753 3004
Tom Floyd	+44 20 3753 3136
Tristan Hedley	+44 20 3753 3006
Peter King	+44 20 3753 3139
Simon Messman	+44 20 3465 2754
AJ Pulleyn	+44 20 3465 2756
Matthew Regan	+44 20 3465 2750
Michael Schumacher	+44 20 3753 3006
Paul Somers	+44 20 3465 2753

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EQUITY TRADING

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Gregor Labahn	+49 40 350 60 571
Lennart Pleus	+49 40 350 60 596
Marvin Schweden	+49 40 350 60 576
Omar Sharif	+49 40 350 60 563
Philipp Wiechmann	+49 40 350 60 346
Christoffer Winter	+49 40 350 60 559

LONDON

Christopher Brown	+44 20 3753 3085
Edward Burlison-Rush	+44 20 3753 3005
Richard Kenny	+44 20 3753 3083
Chris McKeand	+44 20 3207 7938
Ross Tobias	+44 20 3753 3137
Robert Towers	+44 20 3753 3262

ELECTRONIC TRADING

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Matthias Führer	+49 40 350 60 597
Sven Kramer	+49 40 350 60 347
Matthias Schuster	+44 40 350 60 463