

Greece

By Theodore Mitrakos, Central Bank of Greece

Macroeconomic Overview

The Greek economy is currently facing its most severe fiscal adjustment challenge for many decades. Against market pressure, Greece needs to refinance sizeable debt as well as a large fiscal deficit. From this perspective, the Greek Government recently presented an ambitious new Stability and Growth Programme supported by the EU and IMF. This programme aims to bring the structural deficit down by over 10% points, to below 3% of GDP by 2014. The size of this fiscal adjustment corresponds to an average annual reduction in deficit of 3.2%. The adjustment will need to focus on expenditure cuts by shrinking the role of the state, and on the revenue side by widening the tax base by reducing rampant tax evasion, raising the already relatively high tax rate levels and eliminating large exemptions. The request by the Greek Government for the activation of the EU/IMF financial support mechanism was accompanied by the announcement of a new set of strong measures amounting to a combined impact of 7.0% of GDP in 2010 and an estimated average annual fiscal adjustment for the years 2011-2014 of 1.5% of GDP each year. These supplementary austerity measures include the abolishment of the 13th and 14th months' salaries of civil servants (corresponding to Christmas, Easter and summer holiday allowances) with an additional cut on the remaining allowances by 20%, the abolishment of the 13th and 14th months' pension payments for all retirees and the imposition of an additional tax (with a progressive rate of 5% to 9%) for pensioners earning more than EUR 1,400, plus an additional 20% increase in VAT rates. Moreover, the civil servant wage and full economy pension will freeze until the conclusion of the consolidation programme.

In 2009, year-on-year real GDP growth rate decreased by 2.0% (-1.0% in Q1, -1.9% in Q2, and -2.5% in both Q3 and Q4). On average in 2009, private consumption fell by 1.8%, gross fixed capital formation by 13.9% (of which residential investment was -21.7%) and exports of goods and services by 18.1%. The negative effect of these developments was partly offset by the increase in government consumption by 9.6% and by the fall in imports of goods and services by 14.1%. In 2009, adverse developments in the global economy obviously had a negative effect on Greek exports of goods and services. In the domestic market, the slowdown in credit expansion to households and enterprises and the fall in confidence obviously had a negative effect on private consumption as well as on business and residential investment.

In Q1 2010, economic activity continued to contract (by 2.3% year-on-year), while the economy is expected to experience a deeper recession in the following quarters, with GDP recording a negative growth of 4% on yearly average in 2010. As regards 2011 forecasts, the Government, the European Commission, the ECB and the IMF expect a negative growth of 2.6%, while a recovery is projected for 2012 and after.

The unemployment rate remains on a sharply upward trend, climbing up to 12.1% in February 2010, while employment decreased by 1.9%, reflecting the ongoing weakening of demand in the key-sectors of economic activity such as retail and wholesale trade, business services and construction. The labour market is expected to remain under considerable strain in 2010 (the fall in total employment is expected to exceed 2%), boosting the average unemployment rate above 12%, with a further rise expected in 2011 (about 14%) and 2012.

Housing and mortgage markets

The positive growth rates recorded in residential property prices in Greece started decelerating at the beginning of 2007, and this trend continued until the end of 2008. Thereafter, and throughout 2009, growth rates in residential property prices turned negative for both "new" and "old" dwellings. On the basis of the data collected by the Bank of Greece, nominal prices for all types of apartments are estimated to have decreased by 3.6% in 2009 (in Athens by 4.6%) and 2.6% on a yearly basis in Q1 2010 (in Athens by 2.0%). This decrease was slightly larger for old apartments (4.5% in 2009) than for new ones (2.2%), which seems to reflect the relatively larger resilience of the new buildings' segment.

On the basis of available data, the Greek residential property market is characterised by a relative resilience of prices. At the same time, it is estimated that the Greek market does not exhibit any significant signs of overpricing, given that the residential price index to the index of rents (Price-to-Rent ratio) has been decelerating in the past three years. This was the result of the steady deceleration of growth rates in residential property prices after 2006, as well as of the relative stability of the increase in rents (the average annual national growth rate in rents was 4.5% in 2007, 3.9% in 2008 and 3.6% in 2009). The ratio of residential property prices to rents is expected to keep decelerating (albeit at a moderate pace) also in the coming quarters, leading to a further small drop of prices.

In the past two years, the Greek real estate market has been characterised by relative cautiousness from the demand side and some oversupply. Households are cautious because of the high uncertainty linked to employment conditions and future incomes, which is aggravated by the general economic outlook and the fiscal problems of the country. Furthermore, households expect that residential prices will drop in the future, which makes them postpone home purchase decisions. On the other hand, the current financial crisis has made banks be more cautious and selective in granting new housing loans, a factor which has also contributed in reducing demand for residential property.

On the supply side, the surplus that has been created in recent years seems to be gradually absorbed, despite the relative cautiousness from the demand side. The deceleration of private construction activity in 2007 and 2008 was much faster than the respective decrease in the number of transactions in real estate. The number of new building permits decreased by 5.3% in 2007 and 15.6% in 2008, against a decrease of 3.0% and 5.8% in the number of real estate bought or sold in the respective years. It should also be noted that, on the basis of permits issued, the volume of building activity decelerated by 5.0% in 2007, 17.1% in 2008 and 27.6% in 2009. It is estimated that the gradual absorption of excess stock in the real estate market was maintained also in 2009.

The number of transactions for the residential properties sector dropped by 36.0% in 2009, against a 21.7% decrease in 2008 (this data is collected by the credit institutions). The corresponding deceleration of both the volume index (39.3% in 2009, on the basis of total square meters) and the total value (40.4%) was slightly larger. The fact that the volume and the value of transactions dropped at a slightly faster rate than the number of transactions, reflects a shift of households towards smaller and lower-value apartments.

The construction confidence indicator (including both dwellings and other private and public construction) registered a 31.4% average annual decrease in 2009, compared to the average annual increase of 3% in 2008, 1.5% in 2007 and 44.6% in 2006. According to the survey carried out by the Bank of Greece in real estate agencies, conditions and expectations in the housing market reveal a slightly worse situation in Q1 2010. This slightly dimmer outlook seems to be related with uncertainty concerning changes in real estate taxation (e.g. objective values, tax brackets etc) as well as the overall economic situation of the country (fiscal difficulties, structural changes, etc). Together with the gradual normalisation of financial markets, the risk of a marked correction of prices in the Greek real estate market is removed, although the downward price pressure will most probably continue in the coming months. The intensity of this pressure will primarily depend on the general economic and financial conditions in Greece. The recovery of the real estate market in the coming quarters is directly linked to households' expectations about employment and future incomes, credit provision from the banking system and the general economic recovery. Clear signals coming from an effective handling of the fiscal and structural problems of the Greek economy will help warm up the real estate market. Lastly, the finalisation of pending issues relating to the taxation of real estate (objective values, tax brackets, taxation of large real estate, etc.) is also expected to lead to a reactivation of the housing market, as these issues affect both supply and demand for residential property.

Lending activity to businesses and households slowed down to 3.5% on a year-on-year basis in March 2010 from 4.2% in December 2009. In particular, lending to households continued at the same rate as in February, i.e. 2.7%, compared to 3.1%

in December 2009. There was a continuing slowdown of the growth rate in outstanding housing loans (March 2010: 3.5%, December 2009: 3.7%). Lending activity to the private sector is expected to remain very low over the coming months and might possibly enter zero or negative territory, as the weakness of economic activity is dampening demand for loans. The main constraint, however, would be on financing lending activity and together with rising NPL ratios would probably lead to tightened lending criteria in the period ahead. However, the ECB's decision concerning collateral rules is a positive development.

Bank interest rates on loans, which on average had been rising until October 2008, started falling in November 2008 and have continued to fall until January 2010. In February and March 2010 there was a small increase in interest rates on all categories of loans to both businesses and households.

	EU27, 2009	Greece, 2009	Greece, 2008
GDP growth (%)	-4.2	-2.0	2.0
Unemployment rate (%)	8.9	9.5	7.7
Inflation (%)	1.0	1.3	4.2
% owner occupied	68.2	80.0	80.6
Residential Mortgage Loans as % GDP	51.9	33.9	32.5
Residential Mortgage Loans per capita, EUR thousand	12.37	7.15	6.93
Total value of residential loans, EUR million	6,125,727	80,559	77,700
Annual % house price growth	-6.8	-3.6	1.7
Typical mortgage rate (euro area), %	2.71	3.08	4.92
Outstanding Covered Bonds as % outstanding residential lending	23.2	8.1	6.4

Source: EMF, Eurostat, ECB, Bank of Greece, National Statistical Service of Greece

■ **Notes:**

■ Typical mortgage rate in the euro area refers to the APRC (Source: ECB)

■ EU owner occupation rate average derived from EMF calculations based on latest available data.

Greece= 2009