Greece: From vicious to virtuous cycle – Is this time for real?

Katharina Utermöhl,
Senior Economist Europe
Athens, October 17 2017
1. Global growth outlook: The global economy is getting its mojo back
2. Greece’s main trade partners: Risks and opportunities
   Greece: From vicious to virtuous cycle – Is this time for real?
The global economy is back to business

Global growth shifted up a gear in Q2 2017 - especially in the US, the Eurozone, China and Japan

As a result we revise up our 2017 and 2018 global growth forecasts from +2.9% to +3.0%: mainly due to upside revisions in Europe

Global GDP growth forecasts (%)

<table>
<thead>
<tr>
<th>Country</th>
<th>2016</th>
<th>2017</th>
<th>Latest forecast</th>
<th>Revision (pps)</th>
<th>2018</th>
<th>Revision (pps)</th>
</tr>
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<td>3.0</td>
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<tr>
<td>United States</td>
<td>2.9</td>
<td>1.5</td>
<td>2.0</td>
<td>-0.2</td>
<td>2.2</td>
<td>-0.1</td>
</tr>
<tr>
<td>Latin America</td>
<td>-0.3</td>
<td>-1.3</td>
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<tr>
<td>Brazil</td>
<td>-3.8</td>
<td>-3.6</td>
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<tr>
<td>United Kingdom</td>
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<td>1.8</td>
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<td>Eurozone members</td>
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<td>1.8</td>
<td>2.1</td>
<td>0.2</td>
<td>1.8</td>
<td>0.1</td>
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<tr>
<td>Germany</td>
<td>1.5</td>
<td>1.8</td>
<td>2.2</td>
<td>0.3</td>
<td>2.0</td>
<td>0.3</td>
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<td>France</td>
<td>1.0</td>
<td>1.1</td>
<td>1.7</td>
<td>0.2</td>
<td>1.7</td>
<td>0.2</td>
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<tr>
<td>Greece</td>
<td>-0.3</td>
<td>0.0</td>
<td>1.0</td>
<td>=</td>
<td>2.5</td>
<td>=</td>
</tr>
<tr>
<td>Italy</td>
<td>0.7</td>
<td>1.0</td>
<td>1.4</td>
<td>0.2</td>
<td>1.1</td>
<td>0.1</td>
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<td>Spain</td>
<td>3.2</td>
<td>3.2</td>
<td>3.0</td>
<td>0.2</td>
<td>2.3</td>
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</tr>
<tr>
<td>Russia</td>
<td>-2.8</td>
<td>-0.2</td>
<td>1.5</td>
<td>0.2</td>
<td>1.9</td>
<td>0.3</td>
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<tr>
<td>Turkey</td>
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<td>5.2</td>
<td>1.5</td>
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<tr>
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<td>China</td>
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<td>6.7</td>
<td>6.7</td>
<td>=</td>
<td>6.3</td>
<td>=</td>
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<tr>
<td>Japan</td>
<td>1.2</td>
<td>1.0</td>
<td>1.5</td>
<td>0.2</td>
<td>0.9</td>
<td>=</td>
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<tr>
<td>India</td>
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<td>=</td>
</tr>
<tr>
<td>Middle East</td>
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<td>4.5</td>
<td>2.1</td>
<td>=</td>
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<td>=</td>
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<tr>
<td>Saudi Arabia</td>
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<td>1.7</td>
<td>0.5</td>
<td>-1.0</td>
<td>2.0</td>
<td>=</td>
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<tr>
<td>Africa</td>
<td>2.9</td>
<td>1.3</td>
<td>3.4</td>
<td>1.0</td>
<td>3.2</td>
<td>=</td>
</tr>
<tr>
<td>South Africa</td>
<td>1.3</td>
<td>0.3</td>
<td>0.6</td>
<td>=</td>
<td>1.2</td>
<td>=</td>
</tr>
</tbody>
</table>

Sources: Bloomberg, Euler Hermes, Allianz Research

*Weights in global GDP at market price. 2016
*NB: The revisions refer to the changes in our forecasts since the last quarter

Sources: IHS, Euler Hermes, Allianz Research
Global trade is getting its mojo back – but will it last?

Dollar depreciation is driving values a bit further up. Volume growth is only back to 2013-14 figures.

Short-term indicators confirm that volume growth should plateau sooner or later.

**Global exports of goods and services**

**Merchandise trade and Euler Hermes Trade Momentum Index**

Sources: Bloomberg, Euler Hermes, Allianz Research

Sources: IHS, CPB, Euler Hermes, Allianz Research
Strong upside surprises from the Eurozone, while acceleration in Emerging Market was expected

There are good reasons to be bullish on the Eurozone: Sentiment indicators are above long-term average

Emerging economies formerly in recession are back to (low) growth; yet Emerging Markets are not accelerating broadly speaking

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**Europe: Consumer confidence vs. Business confidence**

*August 2017 value minus the respective average since 1990.*

**Emerging Markets: Growth per country group**

Brazil, South Africa, Russia and CIS.

Sources: Bloomberg, Euler Hermes, Allianz Research

Sources: IHS, Euler Hermes, Allianz Research
Inflation should normalize gradually

Wage growth is still below its pre-crisis trend, except in Germany

Core inflation still trending downwards; swings in headline inflation driven by oil

Inflation will exceed +2% in the US in 2018, but should stay below +2% in the Eurozone

**Wages (NCU at current prices, y/y period average, %)**

<table>
<thead>
<tr>
<th>Country</th>
<th>2001 to 2007 average</th>
<th>2008 to 2016 average</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>3.1%</td>
<td>1.7%</td>
</tr>
<tr>
<td>Germany</td>
<td>3.1%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Italy</td>
<td>3.9%</td>
<td>1.2%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>3.5%</td>
<td>2.2%</td>
</tr>
<tr>
<td>United States</td>
<td>3.5%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Spain</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Consumer prices (headline, core) vs. oil price (Brent)**

**Headline Inflation Forecasts (y/y, %)**

**Sources:** OECD, Euler Hermes, Allianz Research

**Sources:** Datastream, Euler Hermes, Allianz Research

**Sources:** IHS, Euler Hermes, Allianz Research
Monetary policy normalization is on the horizon

Inflation pressures should intensify: Output gaps in main economies are persistent, but should close by 2019

This should go along with monetary policy normalization. Along with interest rate hikes, global liquidity will be tapered.
1 Global growth outlook: The global economy is getting its mojo back

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3 Greece: From vicious to virtuous cycle – Is this time for real?
US: Following solid Q2 growth, hurricanes will weigh on growth momentum in the near term

2018 GDP growth should be helped by fiscal stimulus – assumed to be to the tune of 1.2% of GDP.

Short term: Hurricanes to take a toll on output - disrupting an upward trend in industry.

GDP growth (y/y, %)

Industrial production (indices, base 100=Jan. 2014)

Sources: Euler Hermes, Allianz Research

Sources: Datastream, Federal Reserve, Euler Hermes, Allianz Research
China: Financial tightening is starting to bear fruit at the expense of short-term economic dynamics

Financial imbalances start to reduce with more sustainable credit growth and lower risky credit flows.

The downside is that credit intensive activity expenditures are slowing.

Sources: IHS, Euler Hermes, Allianz Research
**Eurozone: Economic momentum accelerated in line with receding economic policy uncertainty**

After reaching a peak in January 2017 global economic policy uncertainty has declined substantially.

As political uncertainty took a backseat economic momentum shifted up another gear.

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**Global economic policy uncertainty Index (lhs) & CBOE VIX (rhs)**

- Sources: Thomson Reuters Datastream, Allianz Research.

**Composite PMI**

- Sources: Thomson Reuters Datastream, Allianz Research.
**Eurozone: A recovery with strong legs – upswing supported by all GDP components**

Catch-up potential: Investment still below pre-crisis levels even ten years after the Global Financial Crisis

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**Eurozone: GDP and its components (Index: Q1 2008=100)**

- Private consumption
- Investment
- Government spending
- Export
- Import
- Stocks

**Eurozone: GDP growth (%) & growth contribution of components (pp)**

- 2015:
  - Private consumption: 2.0
  - Investment: 1.8
  - Government spending: 2.1
  - Export: 1.8
  - Import: -3.0
  - Stocks: -2.0

- 2016:
  - Private consumption: 1.8
  - Investment: 2.0
  - Government spending: 1.8
  - Export: 1.8
  - Import: -2.0
  - Stocks: -1.0

- 2017:
  - Private consumption: 2.1
  - Investment: 1.8
  - Government spending: 2.1
  - Export: 2.1
  - Import: -1.0
  - Stocks: -0.0

- 2018:
  - Private consumption: 1.8
  - Investment: 1.8
  - Government spending: 1.8
  - Export: 1.8
  - Import: -0.0
  - Stocks: 0.0

**Sources:** Thomson Reuters Datastream, Allianz Research.

**Domestic demand is still the backbone of the economic upswing, but exports are adding momentum**
Germany: Buoyant upswing, with real GDP expanding by 2.2% in 2017 and by 2.0% in 2018

Upward trend in business expectations signals robust upswing to continue

Refuting common perception: Growth in recent years powered by consumption, not by exports. Investment disappoints

Ifo index: Manufacturing (2005=100)

Cumulated growth and growth contributions of different components since 2008*

* Annual average 2017 on annual average 2008

Source: Thomson Reuters Datastream.
Sources: Thomson Reuters Datastream, Allianz Research, own forecasts.
Italy: Favorable cyclical outlook with GDP growth of 1.4% in 2017 and 1.1% in 2018 – but will it last?

2017 GDP growth rate highest since 2010 thanks to ongoing recovery in domestic demand and favorable export demand.

But structural problems still loom large: To exit the low-growth/high-debt/fragile-banks trap Italy is in dire need of more reform.

Sources: Istat, Datastream, Allianz Research, Euler Hermes

Sources: European Commission, Datastream, Allianz Research, Euler Hermes
**UK**: GDP growth will slow to +1.4% in 2017 and +1.0% in 2018 in line with cooling domestic demand

UK consumers face double-whammy blow: High inflation and sluggish wage growth put a squeeze on living standards.

External sector not making up for slowing domestic demand with exporters responding to weak Sterling by raising export prices, putting profit before volume.

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**Headline inflation, retail price inflation, core inflation & compensation per employee (y/y, in %)**

![Graph showing Headline inflation, retail price inflation, core inflation & compensation per employee (y/y, in %)]

**GBP/EUR (lhs) & export prices index (2013 =100, rhs)**

![Graph showing GBP/EUR (lhs) & export prices index (2013 =100, rhs)]

Sources: Datastream, Allianz Research, Euler Hermes
Emerging Europe: Region continues to surprise on the upside

Growth in the region as a whole to pick up to +3.1% in 2017 (+1.8% in 2016) as EU members accelerate (+3.9% in 2017), Turkey rebounds (+5.2%) and Russia has left recession (+1.5%). Monetary policy in EU member states set to tighten gradually by end-2018.

Sources: National sources, IHS, Euler Hermes, Allianz Research

GDP growth in 2016 and 2017 (forecast) and short-term country risk as of Q3 2017

Monetary policy interest rates

Sources: National sources, IHS, Euler Hermes, Allianz Research
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2. Greece’s main trade partners: Risks and opportunities

3. Greece: From vicious to virtuous cycle – Is this time for real?
**Greece: Back to growth – Cyclical outlook brightening with GDP expected to grow by +1.0% in 2017 and +2.5% in 2018**

Economic sentiment has improved markedly in 2017 reaching the highest level in 2.5 years pointing at a return to growth.

Private consumption is key driver of improving growth prospects but support from exports and investment set to strengthen.

### Euler Hermes forecasts

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Greece</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>-0.3</td>
<td>0.0</td>
<td>1.0</td>
<td>2.5</td>
</tr>
<tr>
<td>Consumer Spending</td>
<td>-0.3</td>
<td>1.4</td>
<td>1.2</td>
<td>3.2</td>
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<tr>
<td>Public Spending</td>
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<td>2.1</td>
<td>1.6</td>
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<tr>
<td>Investment</td>
<td>-0.2</td>
<td>0.0</td>
<td>0.3</td>
<td>5.8</td>
</tr>
<tr>
<td>Stocks</td>
<td>-0.9</td>
<td>0.2</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>Exports</td>
<td>3.1</td>
<td>-1.7</td>
<td>5.0</td>
<td>5.2</td>
</tr>
<tr>
<td>Imports</td>
<td>0.3</td>
<td>0.6</td>
<td>6.8</td>
<td>8.1</td>
</tr>
<tr>
<td>Net exports</td>
<td>*</td>
<td>-0.7</td>
<td>-0.7</td>
<td>-1.1</td>
</tr>
<tr>
<td>Current Account (% of GDP)</td>
<td>0.1</td>
<td>-0.6</td>
<td>-0.9</td>
<td>-0.7</td>
</tr>
<tr>
<td>Employment</td>
<td>1.9</td>
<td>1.8</td>
<td>2.7</td>
<td>2.8</td>
</tr>
<tr>
<td>Unemployment rate (average)</td>
<td>25.0</td>
<td>23.6</td>
<td>21.6</td>
<td>20.5</td>
</tr>
<tr>
<td>Inflation</td>
<td>-1.7</td>
<td>-0.8</td>
<td>1.0</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Government balance (% of GDP)</strong></td>
<td>-5.9</td>
<td>0.7</td>
<td>-1.5</td>
<td>-0.5</td>
</tr>
<tr>
<td><strong>Public debt (% of GDP)</strong></td>
<td>177.4</td>
<td>179.0</td>
<td>176.8</td>
<td>175.2</td>
</tr>
</tbody>
</table>

Change over the period, unless otherwise indicated: * contribution to GDP growth, ** euro billions

Sources: Thomson Reuters Datastream, Allianz Research
Greece: Return of the consumer – Favorable labor market trend to lend a helping hand to private consumption

Positive labor market trend to provide tailwind for private consumption with unemployment close to a six-year low

Retail sales have posted positive growth for the past 12 months. Given the sharp rise in consumer confidence the outlook remains bright

Sources: Thomson Reuters Datastream, Allianz Research
**Greece: Export strategy paying off – Rebalancing of the economy underway supported by competitiveness gains**

Unit labor cost adjustments have been significant after 2009 but momentum has stalled recently.

Tradeable sector is becoming increasingly more important for the Greek economy.

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**Nominal unit labor costs per person employed, Index, 2000 = 100**

- **Germany**
- **Greece**
- **Spain**
- **France**
- **Italy**
- **Portugal**

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**Relative size of tradeable to non-tradeable sector (index: 2010=1)**

- **Gross Value Added**
- **Prices**
- **Volume**
- **Employment**

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Note:

Relative prices are based on (implicit) price deflators of value-added. Tradeables: agriculture, industry, business and financial services, telecommunications and services related to tourism (transport and accommodation and restaurants). Non-tradeables: else except public administration and non-market services.

*Sources: Thomson Reuters Datastream, Bank of Greece calculations, Eurostat, Allianz Research.*
**Greece: Export motor heating up thanks to favorable momentum in traditional key markets**

While high-growth markets gained in importance in recent years, majority of Greek exports destined to EU countries

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**TOP 10 exports destinations outside EU, % of total exports**

<table>
<thead>
<tr>
<th>Country</th>
<th>% of Total Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turkey</td>
<td>8%</td>
</tr>
<tr>
<td>United States</td>
<td>5%</td>
</tr>
<tr>
<td>Egypt</td>
<td>4%</td>
</tr>
<tr>
<td>Lebanon</td>
<td>3%</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>3%</td>
</tr>
<tr>
<td>FYROM</td>
<td>2%</td>
</tr>
<tr>
<td>Albania</td>
<td>1%</td>
</tr>
<tr>
<td>South Korea</td>
<td>1%</td>
</tr>
<tr>
<td>UAE</td>
<td>1%</td>
</tr>
<tr>
<td>Serbia</td>
<td>1%</td>
</tr>
</tbody>
</table>

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**TOP 10 exports destinations EU, % of total exports**

<table>
<thead>
<tr>
<th>Country</th>
<th>% of Total Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>11%</td>
</tr>
<tr>
<td>Germany</td>
<td>7%</td>
</tr>
<tr>
<td>Cyprus</td>
<td>6%</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>5%</td>
</tr>
<tr>
<td>UK</td>
<td>4%</td>
</tr>
<tr>
<td>Romania</td>
<td>3%</td>
</tr>
<tr>
<td>Spain</td>
<td>3%</td>
</tr>
<tr>
<td>France</td>
<td>3%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2%</td>
</tr>
<tr>
<td>Poland</td>
<td>1%</td>
</tr>
</tbody>
</table>

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Greece can expect export gains to the tune of EUR 3.4 bn in 2018 due to rising demand from traditional key markets

**Additional demand for Greece in EUR mn by country in 2018 (based on import growth of each partner)**

<table>
<thead>
<tr>
<th>Country</th>
<th>Value (EUR mn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>200</td>
</tr>
<tr>
<td>UK</td>
<td>200</td>
</tr>
<tr>
<td>Romania</td>
<td>150</td>
</tr>
<tr>
<td>Spain</td>
<td>100</td>
</tr>
<tr>
<td>Germany</td>
<td>500</td>
</tr>
<tr>
<td>Italy</td>
<td>500</td>
</tr>
<tr>
<td>United States</td>
<td>200</td>
</tr>
<tr>
<td>Egypt</td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td></td>
</tr>
<tr>
<td>Cyprus</td>
<td></td>
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<tr>
<td>Turkey</td>
<td></td>
</tr>
</tbody>
</table>

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Sources: Chelem, Allianz Research
**Greece:** Energy, agri-food and chemicals sectors key drivers of export gains, strong EUR poses downside risk

The energy, agri-food and chemicals sectors to show greatest momentum in 2018

<table>
<thead>
<tr>
<th>Sector</th>
<th>Additional Demand in EUR Mn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Textile</td>
<td>17</td>
</tr>
<tr>
<td>Non-ferrous</td>
<td>55</td>
</tr>
<tr>
<td>Electric</td>
<td>64</td>
</tr>
<tr>
<td>Electronic</td>
<td>71</td>
</tr>
<tr>
<td>Commodities (excl. energy)</td>
<td>99</td>
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<tr>
<td>Wood Paper</td>
<td>109</td>
</tr>
<tr>
<td>Ferrous</td>
<td>123</td>
</tr>
<tr>
<td>Machinery &amp; Equipment</td>
<td>192</td>
</tr>
<tr>
<td>Vehicles</td>
<td>205</td>
</tr>
<tr>
<td>Chemicals</td>
<td>288</td>
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<tr>
<td>Agri-food</td>
<td>580</td>
</tr>
<tr>
<td>Energy</td>
<td>1,551</td>
</tr>
</tbody>
</table>

The appreciation of the EUR vs. other major currencies since the turn of 2016/17 may keep a lid on export momentum

Sources: Thomson Reuters, Datastream, Allianz Research
Greece: Export opportunity #1 – Overhauling the agri-food sector’s strategy to unleash its full export capacity

Fully exploiting the sector’s comparative advantage requires updating sectoral strategy, investment in production & branding

An updated strategy for the agro-food sector

- **Boost agricultural production efficiency:** Increase technological sophistication & farm size

- **Increase manufacturing component of food supply chain:** Move away from bulk towards high-value added products

- **Focus on branded products:** National champions that can weather intense competition in high-income countries while commanding higher premia

Vast majority of agri-food products cater to EU market, but Greece could benefit from shifting focus to high-potentials (USA & Japan)

**Agri-food exports, % total**

- North America: 42.7%
- Africa, Near and Middle East: 6.7%
- Asia and Oceania: 4.9%
- South America, central America and Caribbean: 9.9%
- Germany: 13.8%
- Netherlands: 12.9%
- Rest of EU: 4.6%
- Others in Europe: 1.9%

Sources: Chelem, Allianz Research.
More demand expected from reliable traditional markets (Germany, Italy & the Netherlands) but targeting “emerging markets” (Bulgaria, Romania, Poland) offers great potential

Turnover index vs. travel receipts

Number of tourists coming to Greece, change 4Q/4Q in Q2 2017, '000

Sources: IHS, Allianz Research

Sources: Bank of Greece, Allianz Research.

Sources: Bank of Greece, Allianz Research.
Greece: Investment – The only way is up? Boost from rising capacity utilization & improving demand outlook

In 2017 investment will make its first positive growth contribution in a decade

Capacity utilization has risen markedly in the past two years with the long-term average moving in sight

Sources: Thomson Reuters Datastream, Allianz Research

Sources: Thomson Reuters Datastream, Allianz Research
Greece: Investment – Financing conditions remain very restrictive given the severe liquidity shortage

With a brief exception at the turn of 2014/15 credit has remained firmly in negative territory since 2010

Private sector deposits – a reliable measurement of sentiment – has seen inflows since April

Credit to Greek non-financial corporations & consumers, outstanding amounts, y/y in %

Private sector deposits, flows, EUR million

Sources: Bank of Greece, Allianz Research
**Greece:** From short-term growth outlook to long-term economic success – How to kick-off a virtuous circle?

Investor sentiment has improved notably, but a successful return to capital markets requires additional work.

A sustainable recovery of the Greek economy is conditional on investment – foreign and domestic: What needs to be done?

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**Setting in motion a virtuous circle: Step by step**

- Complete 3rd review on time & stick to reform path
- Develop & implement strategic growth plan for Greece
- Return to financial markets after program ends in August 2018
- Deal with NPLs to encourage return of deposits
- Full abolition of capital controls

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Sources: Thomson Reuters Datastream, Allianz Research.
Greece: The case for a pro-growth strategy – Despite Herculean reform efforts the business environment still needs to become friendlier

Eurozone countries with a more favorable business environment experienced a stronger economic recovery

Key challenges to tackle: Introducing a more growth-friendly fiscal policy mix, keeping a lid on political uncertainty & restoring the health of the banking sector

Sources: World Bank, Allianz Research.

Sources: WEF Executive Opinion Survey 2017, Allianz Research.