Euro Area Viewpoint

Greece: expect overperformance to continue

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Growth on track to overperform Euro area

Since our Year Ahead publication (see the report, Europe Economic Weekly: Year Ahead: fragile and weak growth, a lot of disinflation and reluctant cuts, 24 November 2023), we retain the view that the Greek economy is on track to overperform the Euro area average in 2024/25. We expect growth at 1.1% in 2024 and 1.7% in 2025, higher than our Euro area growth projections at 0.4%/1.1%, respectively.

Three drivers: capex, more moderate ECB pass-through…

This view reflects three factors. First, capex should remain the main engine of growth, after years of underinvestment and amid full absorption of EU funds. Second, Greece is benefitting from a more moderate monetary policy pass-through given the country-specific structure of Recovery and Resilience Plan (RRP, so-called Greece 2.0) and of domestic indebtedness. Also, the Greek banking sector remains focused on limiting risks related to non-performing exposures. All in all, evidence of a more mitigated impact on credit tightening in Greece versus the rest of the region has emerged when it comes to funds availability, credit appetite and borrowing costs.

… and continued fiscal prudence and structural reforms

Third, Greece remains committed to fiscal prudence and structural reform implementation. We think that these are being facilitated by the current phase of political stability after the June 2023 elections and by boosted sentiment after the recent rating upgrades to investment grade by S&P and Fitch in autumn 2023. That said, some long-standing structural challenges are yet to be tackled. Also, while country-specific risks are limited, Greece remains vulnerable to external shocks.

Recovery plan on track, but implementation risks remain

Under the revised national RRP, the country should benefit from ca EUR36bn of EU funds in 2021-26 and expects a crowding-in effect from public to private capex, with the total amount of mobilized resources at EUR32bn (half of what was initially expected in 2021 amid a macro backdrop less supportive of capex plans). As of December 2023, Greece has received ca EUR14.7bn from the EU, consistent with the achievement of ca 26% of Greece 2.0's total objectives. However, most of the achievements so far were on the reform agenda, while EU funds' spending is proceeding more slowly. Going forward, we caution about implementation delays to actual spending – the main source of country-specific risks to the outlook, in our view.

GGBs: more resilient, more tightening

Macro and technical fundamentals remain constructive. The main risk short-term is the potential of (short-lived) underperformance driven by fast money offloading residual in money positions perhaps faster than market liquidity allows. That said, we think that the 10-year GGB-DBR spread could trade between Bonos and PGBs in the 10-year. We expect up to another 30bp of tightening from here.

ca: circa

GGB-DBR: Greek government bond-German government bond

PGB: Portuguese government bond

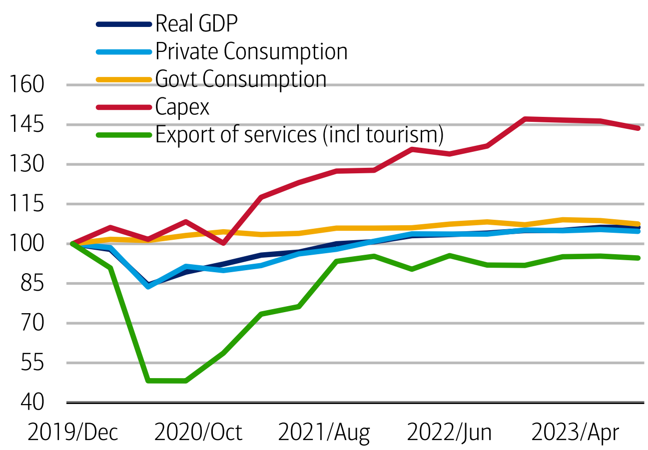
Greece Year Ahead 2024: overperforming the Euro area

We expect growth of 1.1% in 2024 and 1.7% in 2025. With our Euro area growth projections at 0.4%/1.1% for 2024/2025, respectively, we maintain our view that Greece will outperform the regional average within the forecast horizon. That said, our forecasts remain below market consensus for 2024/25 of 1.5%/2.3%, respectively.

After solid growth in 1H23, driven primarily by consumption and net exports (amid a strong recovery in tourism), the economy stagnated in 3Q23, entering a phase of unspectacular growth momentum. For the following three quarters, we expect private consumption to lose traction as well as more downbeat capex and net trade dynamics, courtesy of the lagged impact of ECB tightening, the poor external backdrop and modest fiscal policy tightening. That would be consistent with average growth of 0.2% qoq. When the ECB starts to cut rates, lower inflation allows real income recovery and the external environment improves, we expect Greek growth to re-accelerate in 2H24 (to 0.4% qoq on average) before converging to an average pace of 0.5% qoq in 2025.

Exhibit 1: GDP and its main components (4Q19=100)

Investment and services activity have been the main drivers of post-Covid/energy shock recovery



Source: Eurostat, BofA Global Research

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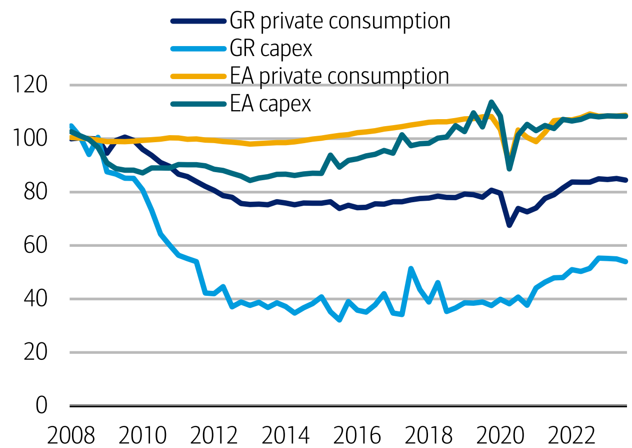
Exhibit 2: Capex and consumption – Greece versus Euro area (2008=100)

After years of underinvestment, domestic demand (and capex in particular) has plenty of room to catch up



Source: Eurostat, BofA Global Research

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Capex, more moderate ECB pass-through, fiscal prudence and structural reform

We identify three main drivers of expected Greek overperformance versus the rest of the region:

1. Investment, which should remain the main engine of growth, building from a narrowing of the gap versus the Euro area (Exhibit 2) and supported by the full implementation of Greece's RRP (Greece 2.0).

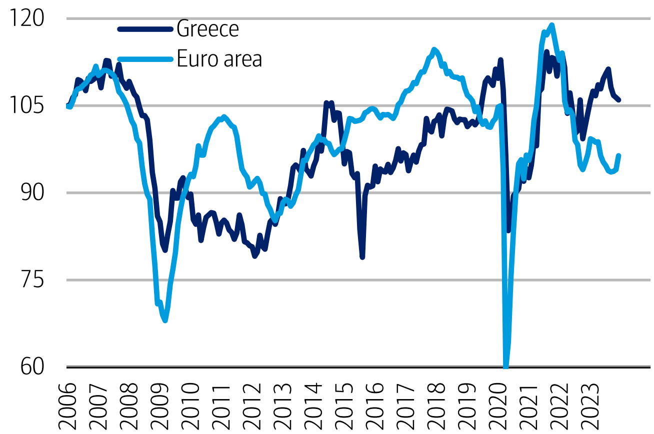
2. A more mitigated pass-through of monetary policy given the country-specific structure of RRP but also of domestic indebtedness and given the Greek banking sector's focus on limiting risks related to non-performing exposures.

3. Fiscal prudence and structural reform commitment, which we see as being facilitated by the current phase of political stability after the June 2023 elections and by boosted sentiment after the recent rating upgrades to investment grade by S&P and Fitch in Autumn 2023.

These drivers should help to keep domestic confidence more upbeat than Euro area levels (Exhibit 3), feeding into spending plans and more resilient domestic demand dynamics.

Exhibit 3: Economic sentiment indicator – Euro area vs Greece

In the aftermath of the two shocks (Covid/energy), domestic confidence has been consistently higher than in the Euro area



Source: Eurostat, BofA Global Research

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Exhibit 4: "Greece 2.0" for 2021-26 – changes in the past 2 years (EUR bn)

The modified Greek RRP comprises ca EUR36bn, of which 18.2bn is in grants and 17.7bn in loans support

	2021	2022	2023
Tot RRF envelope	30.5	30.5	35.9
grants	17.8	17.8	18.2
loans	12.7	12.7	17.7
private sector involvement	57.5	59.0	32.0

Source: Stability Plans for 2021, 2022, 2023, BofA Global Research

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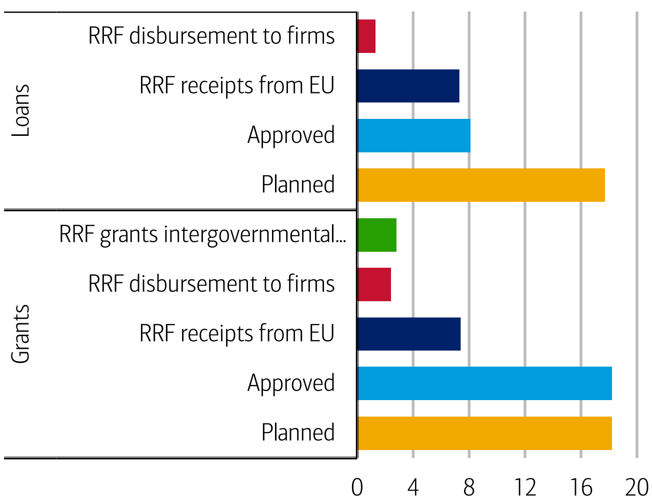
Capex supported by continued fund absorption under Greece 2.0

We think that Greece has space to leverage EU funding and reduce the investment gap with the rest of the Euro area (see the report, Euro Area Viewpoint: Investor trip to Greece: Key Takeaways, 6 October 2023). Full absorption of EU funds under the national recovery plan is a key assumption for our view on Greek capex dynamics. Where do we stand on Greece 2.0?

Exhibit 5: RRF funds (2021-Dec23, EURbn)

Actual disbursements to firms are advancing at a slower pace



Source: Greek Ministry of Finance, BofA Global Research

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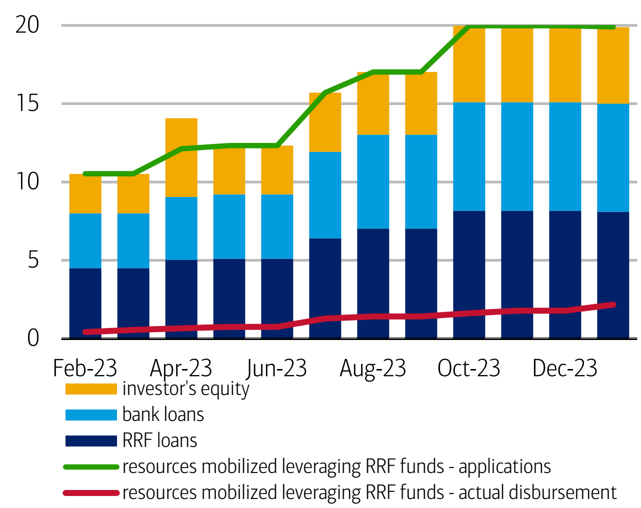
Exhibit 6: RRF loans with leverage (2021-Dec23, EURbn)

Out of applications for projects cum worth EUR20bn, actual disbursement has been so far 2.17bn (of which 1.3bn in RRF loans)



Source: Greek Ministry of Finance, BofA Global Research

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The initial plans for Greece 2.0 comprised EU funds worth ca EUR30.5bn (of which EUR17.8bn is in grants and EUR12.7bn in loans) and expected a crowding-in effect from public to private capex, with the total amount of mobilized resources at EUR57.5bn. In August, Greece submitted a revised program, including an additional EUR5.0bn in loans and EUR0.8bn in grants. As the revision was approved early in December, cumulatively the country should benefit from ca EUR36bn of EU funds under Next Generation EU (NGEU) in 2021-26 (Exhibit 4). It is worth noting that expected private sector participation has been halved (in the Draft Budget Plan 2024) versus the previous plan, accounting (rightly so, in our view) for a macro environment less supportive of animal spirits. As of December 2023, Greece had received the payment of the 1st, 2nd and 3rd instalments, which, with the pre-financing in 2021, amounts to EUR14.7bn. This is consistent with the achievement of ca 26% of Greece 2.0's total objective.

However, most of the achievements so far were on the reform agenda, while RRF fund spending is proceeding more slowly. Of the total grant envelope, cash receipts from the EU amount to EUR7.4bn, of which EUR1.95bn has been disbursed to firms and EUR2.8bn transferred from the state to other general government entities. As for loans, cash receipts from the EU amount to EUR7.3bn, of which EUR1.3bn has been disbursed to firms (Exhibit 5). While the shift from reform towards investment should support capital expenditure, we caution that implementation delays to actual spending tend to be higher than in the phase of structural reform/eligible project approval process.

Monetary policy pass-through appears mitigated in Greece

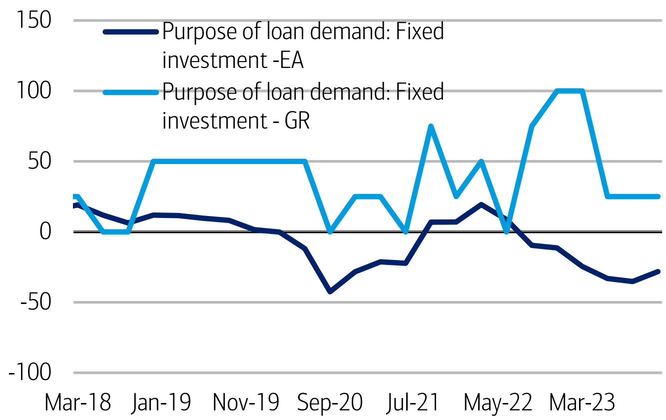
In 2021, we highlighted that private sector involvement factored into Greece 2.0 with respect to the channel for loan usage, which was peculiar (and very much country-specific). The aim of using RRF loans to leverage bank lending and co-finance loans to the private sector was twofold: on the one hand, to benefit from banks' screening processes; on the other, to limit the crowding-out effect from public capex. Two years (and one energy shock and inflation problem) later, there appears to be another advantage of Greece's RRF loans use: mitigating the tightening in credit conditions related to the ECB's policy pass-through. Within Greece 2.0, investments in prioritized sectors of the economy (such as green and digital) are financed up to a maximum of 50% with RRF funds, ca 30% from the financial institutions participating in the deal and at least 20% from the investors' own funds.

This funding structure is helping to mitigate the ECB pass-through, in our view. This adds to two factors in the context of monetary policy transmission channels: 1) the relatively low leverage of Greek households and non-financial corporates (NFCs) and 2) a banking sector in better shape, with a strong focus on continued asset quality improvements (this year's initiative across the main banks to cap borrowing costs for mortgages for 12 months from May is an example). All in all, evidence of a more mitigated impact on credit tightening in Greece versus the rest of the region has emerged when it comes to funds availability, credit appetite and borrowing costs.

Looking at the ECB's Bank Lending Survey (BLS) and Survey on Access to Finance of Enterprises (SAFE), we note that capex purposes (Exhibit 8) remained supportive of credit demand in the latest quarters, while they turned into negative drivers for the Euro area. Also, Greek small and medium-size enterprises (SMEs) appear to benefit from better availability of funds (Exhibit 7) than peers in the rest of the region.

Exhibit 7: Purpose of loan demand: capex

Capex purposes are still supportive of Greek credit demand



Source: ECB BLS, BofA Global Research

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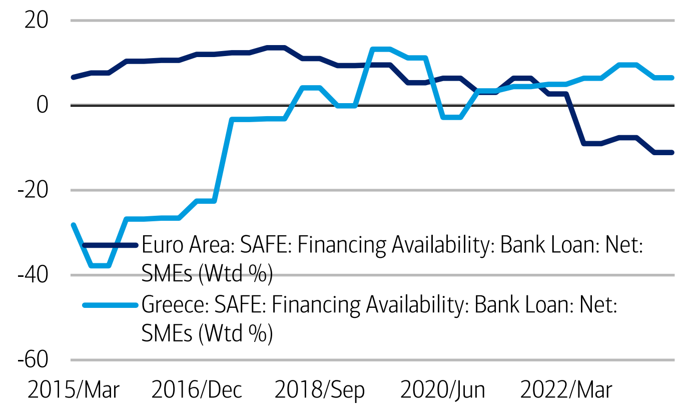
Exhibit 8: Bank loan availability for SMEs

Greek SMEs appear to benefit from better funds availability



Source: ECB SAFE, BofA Global Research

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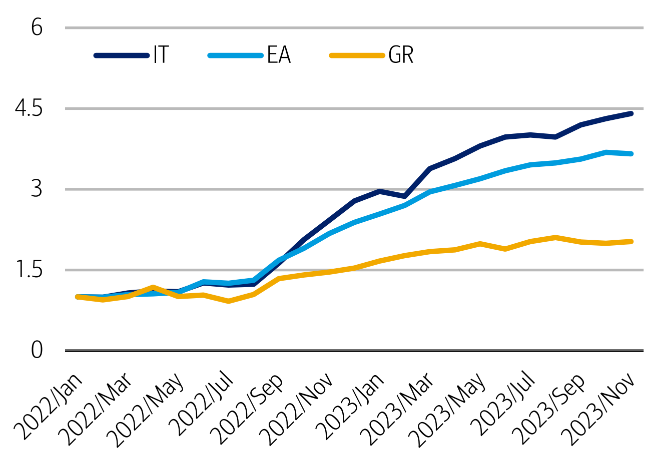
Although borrowing costs are high in absolute terms (the corporate composite rate was 6.2% in November 2023), the repricing associated with the ECB hiking cycle has proved to be more moderate than in the rest of the region (Exhibit 9). Finally, credit origination in February-November 2023 amounted to ca EUR1.7bn of lending to NFCs – and we estimate that ca EUR1.4bn was loans co-financed by the RRF under Greece 2.0 (Exhibit 6).

Exhibit 9: Cost of borrowing for non-financial corporations (January 2022=1)

The repricing of borrowing costs associated with the ECB hiking cycle has proved to be more moderate in Greece



Source: ECB, BofA Global Research

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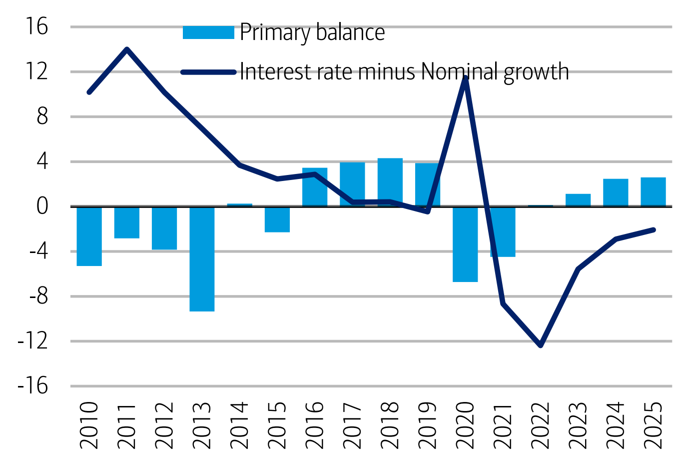
Exhibit 10: Primary balance and "*snowball effect*"

Nominal growth still outpacing interest rates and primary surpluses should lead to a decline in the debt-to-GDP ratio in 2024/25



Source: European Commission, BofA Global Research

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Fiscal prudence set to remain

Our more constructive view also applies to the Greek fiscal outlook. While the combination of softening growth and a higher interest burden complicates fiscal matters, a snowball effect should still reduce the debt ratio in 2024/25E (stemming from nominal growth outpacing interest rates). We note that a slow interest rate pass-through reflects the long average debt maturity (close to 20 years) and the structure of Greek public debt. In addition, the latest fiscal plans unveil a commitment to achieve a primary surplus from 2023 onwards. That should guarantee a firm downward trajectory in the debt-to-GDP ratio within the forecast horizon. We expect the ratio to decline significantly from 172.6% of GDP in 2022 to 161.5% in 2023E, 155.2% in 2024E and 152.9% in 2025E (down 54ppt from 2020 highs).

Exhibit 11: General government fiscal outlook (% of GDP)
2024 budget plan foresees a 1% of GDP improvement in primary balance per year in 2023/24E

	2021	2022	2023	2024
Deficit	-7.0	-2.3	-2.1	-1
Primary balance	-4.5	0.1	1.1	2.1
Debt	195	172.6	160.3	152.3
Memo items:				
One-off pandemic fiscal package (incl. guarantees without leverage)	8.6	1.6	0.1	0.1
Of which: with effect on budget	8.2	2.1	0.0	0.0
Energy measures	0.5	5.0	1.2	0.5
Of which: with effect on budget*	0.1	2.2	0.0	0.0

Source: ELSTAT (2021-22) and Ministry of Finance, Budget 2024 (2023-24). * From 2023 they are fully financed by resources of the Green Transition Fund.

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In 2023, the primary surplus of ca 1.1% of GDP reflected the phasing out of energy-crisis measures and better-than-expected fiscal revenues (despite one-off expenditure related to natural disasters in the summer, Exhibit 11). According to the 2024 budget, the primary surplus should further improve this year, to 2.1% of GDP, helped by better tax collection from ongoing electronic payments reform. The official headline deficit targets are set at 2.1% and 1% in 2023/24E. We note that the EU Commission regarded Greek plans to be in line with the current EU rules.

Primary surplus targets and conservative expenditure assumptions in the fiscal plan send a signal of Greece's continued commitment to fiscal consolidation, in our view. This was also one of the reasons for the return to an investment grade rating by S&P and Fitch. We think that the rating upgrades will, in turn, cement the government's commitment to consolidation and reform momentum in the near term. The clear majority in the 2023 election should help to ensure political stability and policy continuity too. All in all, we retain the view that short-term public finance risks are limited.

Long-standing structural challenges and risks to the outlook

The more buoyant short-term macro picture should not eclipse the long-standing structural vulnerabilities. Improving productivity through structural reforms and more efficient resource allocation, strengthening competitiveness and shifting towards a more resilient growth model remain pending challenges. In the medium term, those should drive a current account adjustment. However, in the short term, the current account deficit is likely to remain among the highest in the Eurozone and leave the economy exposed to external risks. We note that the high import content of capex is also likely to offset the net trade gains from better global demand in 2H24 and thus slow down the adjustment within the forecast horizon.

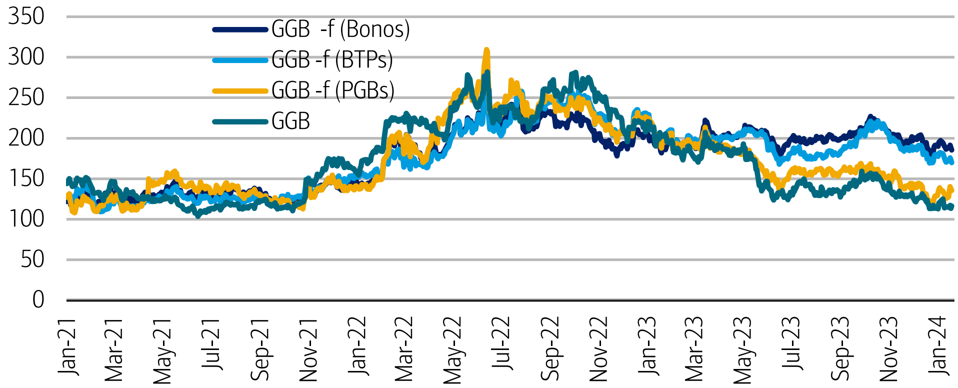
While country-specific risks to the outlook are limited (and mainly clustered around the punctual implementation of the national RRP), the list of exogenous risks is long, from geopolitics (including the Ukraine/Israel situations and more recent Red Sea disruptions) and their impact on prices (energy/shipping costs) to the weaker-than-expected global growth backdrop (see the report, Europe Economic Weekly: Back to school: it's really never easy 12 January 2024). On the flip side, faster-than-expected disinflation should support a quicker purchasing power recovery, All in all, despite short-term overperformance, we caution that the Greek economy and assets remain highly vulnerable to external shocks.

GGBs: more resilient, more tightening

Since our investor trip to Greece on 6 October 2023 (see the report, Euro Area Viewpoint: Investor trip to Greece: Key Takeaways 06 October 2023), GGB yields have tightened by about 38bp relative to Germany. This is 2.5x/4x the move we saw in Bonos/PGBs, respectively, over the same period of time.

Exhibit 12: 10y GGB-DBR spread level actual versus regression value versus Bonos, BTPs, PGBs

GGBs have significantly outperformed peers since 2022 outright and in directionality-adjusted terms



Source: Bloomberg. GGB-f are the values of GGB-DBR 10y spread obtained by the regression of the Bonos, PGB, BTP spreads in basis points

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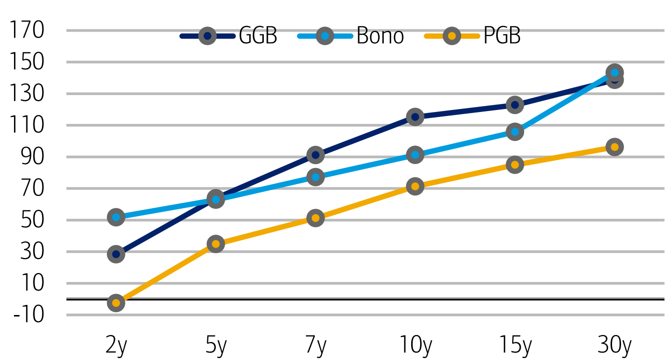
Macro and technical fundamentals remain constructive. Positioning is still essentially short GGBs from real money investors, and the recent inclusion to IG indices (in the January rebalancing) is adding sticky investor positioning on the order of €10-16bn.

This narrative also means that directionality of GGB spreads to risk-on/risk-off gyrations is now much softer. The main risk short-term is potential (short-lived) underperformance driven by fast money offloading residual in the money positions perhaps faster than market liquidity allows.

All in all, we think that the 10-year GGB-DBR spread could trade between Bonos and PGBs in the 10-year. We expect up to another 30bp of tightening from here (current level: 115bp). YTD changes indicate a similar such dynamic already at play in the front end, while the 10-year sector is likely discounting concession from the front loading of supply typically seen in January/February.

Exhibit 13: Greek, Spanish, Portuguese spread to Germany curves

Greek front end richening relative to the 10-year



Source: Bloomberg. Values in basis points. Interpolated rates

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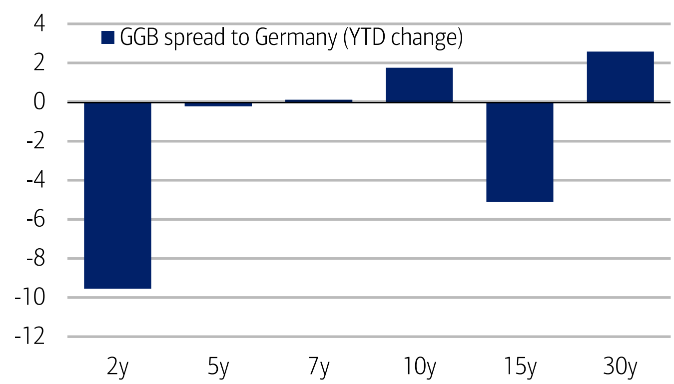
Exhibit 14: YTD GGB-Germany changes by tenor

Front end dominating GGB spread tightening YTD



Source: Bloomberg. Values in basis points. Interpolated rates

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