

## Greece: An election test amid competing tax cut promises

Domestic demand is now the main growth driver in Greece as the external environment deteriorates. With legislative elections due in July, tax cuts are dominating the campaign



Alexis Tsipras, the Greek Prime Minister

### Domestic demand drive in 1Q19, with net exports dragging

After out-performing most Eurozone countries over 2018 on an exports drive, the Greek economy lost some steam as the year turned. In 1Q19 Greek GDP expanded 0.2% QoQ (1.3% YoY), with the domestic demand drive more than compensating for the net exports drag. On the domestic demand front, private consumption continued to benefit from underlying improvements in employment, which continued expanding at a healthy 2.2% YoY clip over the quarter. This, in conjunction with the rise in the economy-wide minimum wage, likely contributed to the improvement in consumer confidence. A VAT reduction legislated in May also helped, as did the reinstatement of the '13th month' pension which should also help drive private consumption throughout the second half of the year.

The gross fixed capital formation rebound was mainly driven by the non-residential and residential construction components, with a non-negligible contribution coming from the transport

component. Developments in the external channel reflected both the negative impact on Greek exports of a softer international demand backdrop and, very likely, the high import content of gross fixed capital formation expenditure.

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*Consumer confidence is now close to its pre-crisis level*

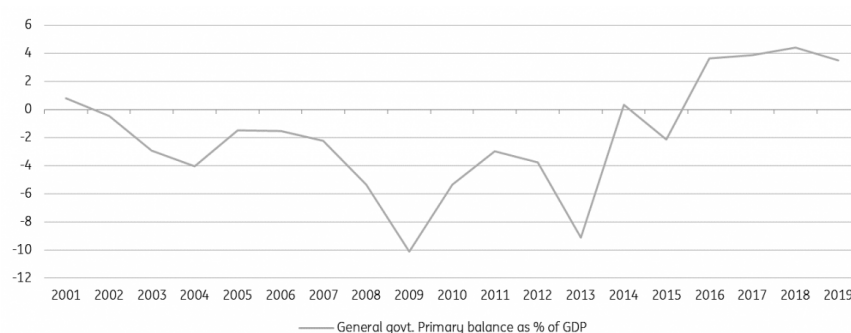
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Looking ahead, business and consumer confidence indicators continue to point to a degree of optimism for short term Greek economic developments. Consumer confidence is now close to its pre-crisis level, and manufacturing has managed to reverse a declining trend which began in August 2018. Confidence in the service sector also improved of late, possibly reflecting a good demand flow for tourism-related businesses. A continuation of the investment recovery will be essential to meet growth targets. This remains vulnerable to developments on the credit front; Greek banks continue to offload non-performing exposures at an impressive rate, but the NPL ratio remains very high.

## Expansionary budget and handouts not enough to boost Syriza in European vote

Final government data for 2018 proved to be even better than expected. The primary surplus came in at 4.3% of GDP, improving for the third year in a row the 3.5% maximum target set in the Enhanced Surveillance Framework. The fiscal over-performance resulted from a combination of effective primary expenditure control and of a surplus in the social security system. It over accommodated for the mildly expansionary 2019 budget and likely prompted the Greek government to risk launching a new set of expansionary measures in May, consisting mainly of VAT rate cuts for some processed food and non-alcoholic beverages, restaurant services and for electricity and gas, and also in the permanent reinstatement of the 13th month pension. The package, clearly timed with an eye on the 25 May European election, proved not enough to hand PM Tsipras assured electoral success.

## Electoral cycle threatens 3.5% primary balance target



Source: Reuters Datastream

## A parliamentary election to follow on 7 July

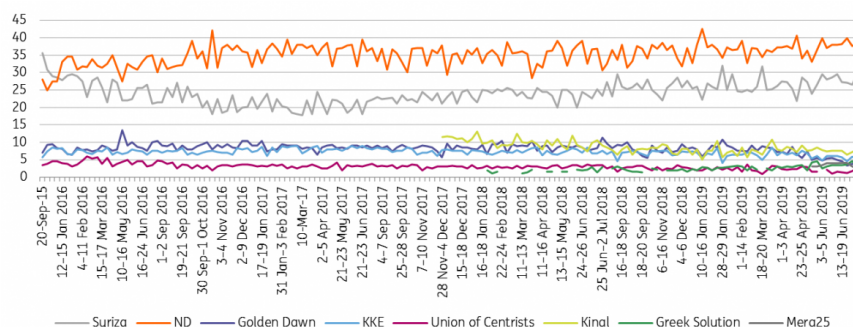
The verdict of the polls, which followed an inward-looking campaign, was unambiguous: Mitsotakis' New Democracy (ND) party beat Tsipras' Syriza by a 9pp+ margin and also won in 12 out of 13

regions where a local election was jointly held. Having missed his electoral targets, PM Tsipras had little alternative to call snap elections, which will take place on 7 July. In order to avoid the end of June tax payments date to be too close to polling day, the government decided to grant a one-month delay for the filing of tax declarations.

## Tax cuts dominate the campaign battlefield

Since the start of the political election campaign, it has become apparent that the big theme would be the economy and, more specifically, reducing the tax burden. PM Tsipras took the initiative first, announcing that he would introduce an amendment before the vote cancelling a lower threshold for income tax, which was due to come into force in January 2020. It was worth an estimated 1% of GDP. The same thing had been proposed by New Democracy before the European elections and, with both parties promising additional tax relief, it's quite clear that the 3.5% primary surplus target will soon be under threat.

## Opinion polls confirm European elections ND lead margin over Syriza



Source: Wikipedia, ING

## Opinion polls point to ND victory

The latest opinion polls indicate that ND might get around 37.5% of votes, with a 9pp lead over Syriza. Such a result might in principle put ND very close to obtaining an absolute majority in the new Greek Parliament, but we believe Mr Mitsotakis would search for wider parliamentary support to launch his ambitious supply-side tinged reform plans. We do not expect a new Mitsotakis government would aim at a revision of fiscal targets for the 2020 budget but would eye 2021 instead... food for thought for the new EU Commission.

The outgoing Commission, meanwhile, has preferred not to impose itself in the Greek election campaign. In its third enhanced surveillance report on Greece (closed before the last batch of measures were announced), it simply pointed out the risk that, after the recent measures, the 3.5% primary surplus target would not be met, while also noting a slowdown in reforms. This will likely be on the agenda at the 13 September Eurogroup meeting.

This article is taken from the Eurozone Quarterly, which you can find [here](#)

## The Greek economy in a nutshell (%YoY)

	2022	2023F	2024F	2025F
GDP	6.0	1.7	1.6	1.7
Private consumption	7.9	3.3	1.4	1.4
Investment	11.6	7.1	4.8	4.1
Government consumption	-1.5	1.7	0.4	0.4
Net trade contribution	-2.8	2.3	-0.5	-0.2
Headline CPI	9.3	3.7	2.0	2.0
Unemployment rate (%)	12.4	10.8	11	10.9
Budget balance as % of GDP	-2.3	-1.8	-1.0	-0.8
Government debt as % of GDP	171.3	165.4	160.6	156.5

Source: Datastream, all forecasts ING estimates

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