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GREECE: HIGHER GDP GROWTH AT WHAT COST?

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Notwithstanding the turbulent conditions in the global economy, the Greek economy grew in 2022 at a higher rate than the eurozone average. GDP growth, driven mainly by large increases in public expenditure, helped the economy achieve very desirable results, including lower unemployment, a primary budget surplus (albeit small) and a decrease in the ratio of nominal public debt to GDP. The increase in inflation contributed significantly to lowering the public debt ratio from 208.3 percent of GDP in 2021 to 173.3 percent in nominal terms. Rebounding from the COVID-19 pandemic shock, GDP grew rapidly in 2022 and has exceeded its 2019 level, according to available data.[1] This welcome news did not come without problems, however.

The latest current account balance of payments (BoP) data published by the Bank of Greece show the largest deficit since the 2009 Great Recession (Figure 1). The dramatic contractionary impact of that earlier crisis, worsened by austerity policies that followed, had reduced the current account deficit from its higher, pre-2008 levels. The strong performance of the tourism sector in subsequent years also positively contributed to bringing the current account deficit down to less than €3 billion in 2019. Then, the COVID-19 shock changed matters again, due to the abrupt drop in tourism, with receipts from "travel" in the BoP falling from €18 billion in 2019 to only €4 billion in 2020. The end of the lockdowns and other restrictions related to the COVID-19 pandemic marked a restart for the tourism industry: even though tourism receipts have yet to recover to their 2019 record levels, they came close, registering €17.6 billion by the end of 2022.

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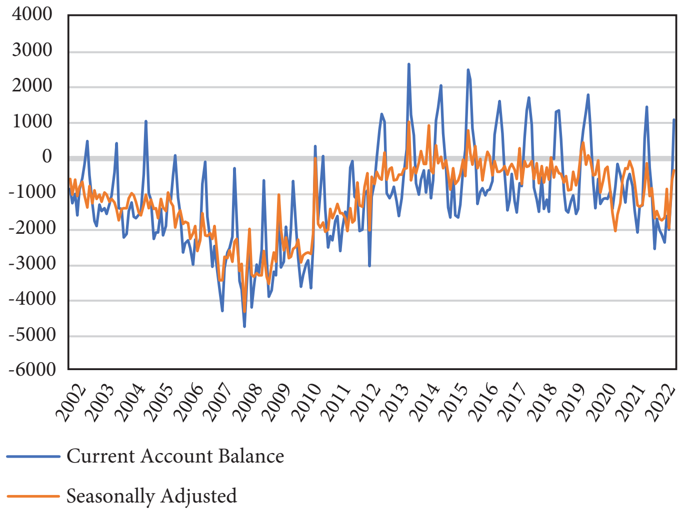
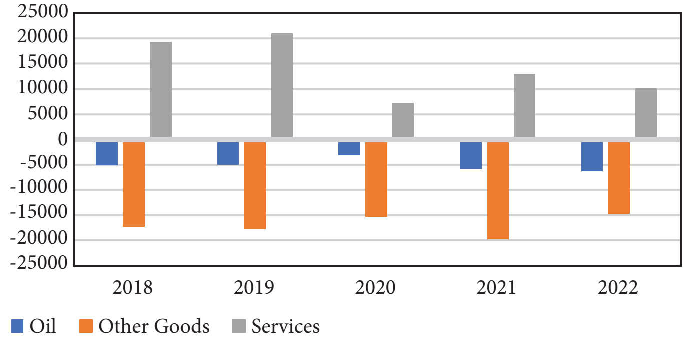
Figure 1 **Greece: Current Account (€ millions)**



Source: BoG

Figure 2 **Greece: Components of the Current Account Balance (€ millions)**



Source: BoG

Since our very first policy contribution on the Greek economy (Papadimitriou et al. 2012), we have pointed out that the multiple challenges faced by this economy are to be found not in its fiscal profligacy, but rather in its excessive current account and trade deficits, largely caused by private sector imbalances.

As we have argued several times in our reports, the major source of macroeconomic fragility is a deficit position of the private sector as a whole, which implies that this sector is selling its assets to other sectors—that is, to foreigners—and/or borrowing from abroad. Simple macroeconomic accounting shows that the private sector's excess of saving over investment, which equals the increase in net financial assets, is always equal to the sum of the current account balance and government deficit.

It is therefore relevant to identify the major determinants causing the deterioration of the current account balance in order to adopt appropriate policies—taking into consideration the absence of the capacity of currency devaluation under the euro regime.

In Figure 2 we report the decomposition of the trade balance into oil, non-oil goods, and services. As the figure shows, exports of services increased substantially in 2022, by about €7 billion, but the deterioration in imports was much larger, with an increase of €7 billion in net oil imports, and an increase of €5 billion in the net imports of other goods.

Part of the problem lies in the dynamics of world oil prices. In principle, these prices should not affect the net oil balance, since Greece is importing crude oil, refining it, and exporting the output—reflecting the current price value of both sides (imports and exports). However, our estimates show that the price elasticity of Greek oil imports is low with respect to the price elasticity of exports, meaning that the increase in world prices did not considerably reduce the quantities being imported, but did somewhat reduce Greek oil exports. We have verified the outcome for similar countries specializing in refining imported oil that were subjected to the same shock stemming from the war in Ukraine. In the euro area, a similar pattern can be traced in the oil trade balances of the Netherlands, Finland, and Lithuania. All three countries register higher gross imports of crude and gross exports of refined petroleum than the world average. These countries experienced a deterioration in the oil balance, with only Finland recovering in the last quarter of 2022.

Another reason for concern is the dependency of the Greek tourism industry on imported goods. Our estimates show that an increase of 1 percent in exports of services (tourism) will have an immediate impact on real imports of goods of 0.1 percent, and a long-term impact of about 1.1 percent. As exports of services (tourism) have increased by 9.9 percent YoY in 2022, this helps explain a non-negligible portion of the increase in imports of goods, which increased by 11.2 percent over the same period, given that private expenditure—the sum of household consumption and gross capital formation—increased by only 10.5 percent over the same period. Government expenditure on goods and services decreased instead by 1.6 percent from 2021 to 2022.

It would be interesting to obtain a precise picture of the financial counterpart of the current account deficit. However, relevant data are not yet available for the last quarter of 2022, other than for the financial account of the balance of payments, which shows an increase in new foreign loans to the government in 2022 (€4.5 billion, compared to €957 million in 2021)—part of which is mainly related to NGEU funds, an increase in incoming foreign direct investment, and a smaller increase in the domestic demand for foreign financial assets. Data on the external debt position, also published by the Bank of Greece up to the third quarter of 2022, show that domestic loans have been transferred to foreign financial institutions, so that private debt with Greek banks has translated into higher liabilities against the rest of the world.

Our approach, based on the financial balances of the private, government, and foreign sectors, suggests that when the private sector balance turns negative, financial fragility increases. In Figure 3 we show the dynamics of the three financial balances, which are based on the following accounting identity:

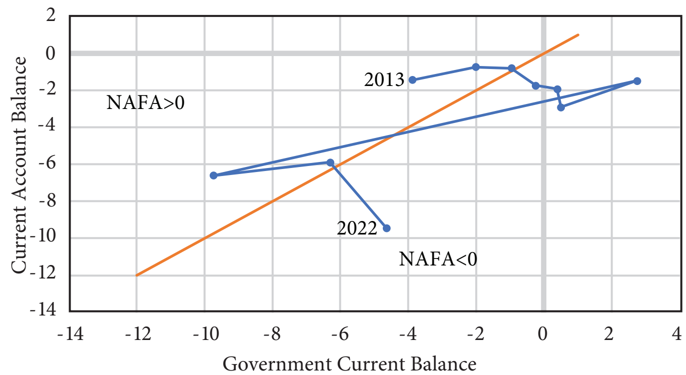
$$NAFA = GD + CA$$

NAFA represents the net acquisition of financial assets of the private sector, GD the government deficit, and CA the current account balance. The accounting principle behind the identity is that an increase in credits of one sector must correspond to an increase in debt of at least another sector. The private sector can therefore accumulate financial assets, or reduce its financial liabilities, only if the government runs a deficit or the foreign sector is injecting more liquidity than it is withdrawing—or, in other words, there is a surplus in the current account balance.

Figure 3 measures the government surplus on the horizontal axis and the current account balance on the vertical axis, both scaled by GDP. The main diagonal represents the situation in which a government surplus equals a current account surplus and the private sector is neither borrowing nor lending. Combinations to the right of (or below) the diagonal imply a negative value for the NAFA: the private sector is either running down its financial assets or increasing its financial liabilities, or both. This is the situation that preceded the 2001 and 2008/9 recessions, as pointed out by Wynne Godley (1999, 2000, 2003; Godley et al. 2005) in the case of the United States, and as we also discussed for Greece (Papadimitriou et al. 2012).

Clearly, the strong performance of the Greek economy in 2022 has created a significant problem with the country's

Figure 3 **Greece: Sectoral Balances (percent of GDP)**



Source: BoG; ElStat

deteriorating current account balance. Greece is still dependent on borrowing from the open markets abroad. The country's government bonds are still below investment-grade and the terms of its financing reflects the country's credit rating in the interest rates it pays. Given the ECB's monetary policy of attempting to curb inflation by increasing interest rates, this does not bode well for the country's continued need for new and rollover borrowing. The higher interest rates will consequently worsen its current account deficit and BoP.

Early reports indicate that tourism will increase further this year (2023), perhaps reaching the amount of €22 billion in gross receipts, implying an even higher level of imports and placing further stress on the current account balance. Thus, no celebration is in order for an increase in tourists, unless appropriate policies are implemented aimed at import substitution of tourism-related goods.

Finally, it is incumbent on policymakers to support the private sector's initiatives for renewable energy sources, especially taking advantage of the country's windy and sunny days.

Implementing policies aimed at import substitution of tourism-related goods while increasing the country's financial net benefit of tourism will simultaneously improve the country's net exports and current account balance. Policies aiming at developing renewable energy sources can lessen the country's dependence of energy from abroad and thus further improve its external financial position.

Notes

1. ElStat released the data for the fourth quarter of 2022 on March 7, 2023, with a note underlining that the figures are still preliminary and subject to revisions. In the table reporting annual data, real GDP increased by 7.3 percent in 2022 over 2021, but in the table reporting quarterly figures, the increase is a smaller 5.9 percent. In our last report (Papadimitriou et al. 2022), we projected an increase of 5 percent.

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