

Greece Business Forecast Report Q2 2014

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Abstracts

Core Views

We expect a return to positive economic growth in 2014 following six years of depression.

The prospect of further spending cuts and tax hikes will ensure that demonstrations and national strikes remain a key feature of the political landscape over the medium term.

The current account deficit has collapsed faster than we had expected, raising the prospect of a return to surplus over the medium term. This is symbolic of Greece's transition towards a more balanced and sustainable economic growth model.

Major Forecast Changes

We have revised down our 2014 real GDP growth forecast to 0.5% from 1.1% previously. We have also revised our current account surplus forecast to 1.3% of GDP from 1.7% previously.

Key Risks To Outlook

Upside Risks To Deficit Forecasts: The severity of the fiscal consolidation programme and the public backlash mean that the scope for slippage will remain pronounced.

Downside Risks To Economic Growth Forecasts: A fragile recovery in the eurozone could yet go in reverse unless policymakers push forward with structural reforms and the ECB provides additional monetary stimulus. A failure to do so would risk prolonged stagnation in the euro area, which will in turn dent demand for Greek exports and further undermine the recovery.

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Moving Closer Towards Additional Debt Restructuring
We believe that a return to positive economic growth following six years of depression will not be enough to prevent further debt restructuring in Greece. Lingered political instability alongside a weak macroeconomic outlook suggest that driving the debt burden down towards the troika's 124% of GDP target by 2020 is unlikely in our view.
Table: Political Table
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A Decade Of Austerity And Instability
Greece's political landscape is likely to become more tumultuous in the coming years. The legacy of fiscal profligacy and economic distortions will leave an indelible mark on the Greek economy and society, with political voices potentially becoming more fragmented. We therefore expect a prolonged bout of austerity and instability in the decade ahead.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis
BMI Economic Risk Ratings
Economic Activity
Recovery At Risk From Weak Eurozone Demand
We expect the Greek economy to return to positive growth in 2014, but this will be a far from triumphant return or a ringing endorsement of internal devaluation. Both private and public sector deleveraging will continue to play out, which will keep the onus on net exports to provide some support to headline growth. Indeed, even with a conclusion to the six-year depression, the positive growth we expect in 2014 will be more of a statistical construct rather than a fundamental improvement in economic conditions on the ground.

Table: ECONOMIC ACTIVITY**Balance Of Payments****CA Rebalancing Taking A Breather**

Although the pace of adjustment in Greece's balance of payments has slowed recently, we still expect the current account to post successive surpluses over the medium term. This will be predicated on some gains in exports, alongside persisting weakness in domestic demand which will eat into imports. We continue to stress that although an external surplus will help mitigate external financial risks, the lack of substantial competitive gains further suggests that Greece's long-term growth potential is weak. Moreover, we warn that if the eurozone recovery fails to pick up steam in 2014, the near-term outlook for the Greek current account and broader economic recovery could be affected.

Table: CURRENT ACCOUNT**Economic Activity II****Another Year Of Deflation In 2014**

We expect the current deflationary trend in Greece to play out further in 2014 even as the economy gradually emerges from the sixyear depression. Record high unemployment, fiscal austerity and weak credit growth will conspire against demand side inflationary pressures, while weak inflation across the eurozone and the potential for a correction in global commodity markets as emerging market growth cools, pose downside risks to our forecasts.

Exchange Rate Policy**EUR: Monetary Policy Decoupling Will Weaken The Euro**

We expect euro strength against the dollar and on a trade-weighted basis to persist in H114. However, we continue to argue that the economic and monetary policy cycles in the eurozone are lagging further behind peers in the US and UK, which will trigger a repricing of the euro towards the end of 2014. Indeed, we believe that weak eurozone economic growth and lingering deflationary risks will spur the European Central Bank into loosen monetary policy further.

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The Greek banking sector has yet to break out of the multiyear deleveraging cycle. With banks continuing to shed assets through to the end of 2013, we have adjusted our medium-term forecasts and now expect another year of industry balance sheet contraction this year. Weighed down by a weaker long-term economic growth trajectory, we expect only modest industry growth when the broader economy recovers. In the meantime, we highlight the European Central Bank (ECB)s Asset Quality Review as providing an element of uncertainty for our medium-term forecasts.

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The Greek Economy to 2023

Lower Growth Path To Emerge Over The Long Term

With international credit conditions unlikely to return to pre-2008 levels over the foreseeable future, we expect both consumer and investment spending to be more subdued over the longer term, anchoring the Greek economy onto a lower growth path than that seen leading up to the global credit crisis. Moreover, while trade rebalancing has closed the current account gap, the adjustment process has been driven more import compression rather than substantial competitiveness gains in the export sector, which suggests that Greece's longer-term growth trajectory will be adversely affected.

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