Greece

Analyst: Rolf Danielsen, Tel : +46 8 763 83 92. E-mail : rolf.danielsen@seb.se

Greece continues a strong recovery in terms of fiscal performance. Over two years, the budget has strengthened more than expected to achieve a virtual balance. That was supported by stronger economic growth buoyed by exports and household optimism. The deep debt relief from its European partners as of last June has now freed the sovereign from servicing most of its huge external liabilities for the next 15 years sharply reducing risk of a sovereign default. .

Country Risk Analysis

Growth recovers gradually. Despite fiscal restraint, growth ticked in at a rate of almost 2% expansion in 2018 on the back of rising consumer spending and a boom in tourism activity. Exports of all goods and service accelerated to 9% growth, outpacing imports with the effect to halve the current account deficit to less than 1%/GDP. Only investment remained sluggish in view of continued slack in resource utilization with unemployment ending year only slightly below 20% although that was down one percentage point (PP) over the year. Consumer price inflation softened slightly but remained positive.

2019 promises more of the same: Despite more headwinds from abroad growth is expected to rise slightly to above 2% in the new year. That will much support investor sentiment as optimism spreads after one more successful government euro issue in late January. That attracted both domestic and foreign investors at a reasonable rate of 3,6% pa on a five years maturity. Combined with the final disbursement of €15bn. of last August under the Eurogroup adjustment program 2015-18, this has left the government with a €27bn. cash balance which should secure its repayment obligations to the IMF and other creditors until 2022 while two-thirds of the government's €360bn debt burden has become almost interest free with no repayment obligations until 2032.

Strong fiscal balance: As in 2017, the government budget posted a stronger than expected performance with the headline deficit ticking in at around zero and as important, the primary surplus ending at 4%/GDP twice as high as targeted by the adjustment program. While that achievement may not be fully repeated in the current year it will still be strong and further encourage investor participation in coming sovereign bond issuances. The government seems bent on following up on recent successes and once again approach global capital markets for another €7bn bond issue later in 2019 provided growth holds up in Europe and neither Italy nor Brexit inflict on investor appetite. Greece is still vulnerable to changes in investor sentiment, not least because of its weak banks.

Banks' credit quality remains extremely poor: Banks’ non-performing loans are estimated to make up for almost half of their loan books of which somewhat less than a half is covered by reserves. Because of this portfolio of very low yielding assets banks' profitability is also very weak. Even though their capital base may in many cases seem strong at more than 20%, much of that is made up of tax-credits representing a potential liability. On the positive side, though, is noted that since last year deposits have started to return despite the recent easing of capital controls that doubled the amount of cash customers were allowed to withdraw. However, the Greek financial system remains shaky and a contingent liability on the government. In a worst case scenario the government may be called on to bail out the system at a cost of some 25%/GDP, which would add as much to its already very high debt standing at almost 200%/GDP -- by some measures a world record among advanced countries.

Projected decline in the debt ratio: Over the next 10-15 years the government debt ratio relative to GDP is projected to decline by more almost a half to 100%/GDP, according to EMS. That is still high but no longer sticking out among peers. This however depends crucially on future growth being raised to around 3% in nominal terms while the annual primary balance continues high at 3,5% before declining to 2,2%/GDP by the end of the next decade.

Are the projections internally consistent? The problem with this projection as pointed out by the IMF, is that a primary surplus at this level might prevent real growth to take off without unrealistic assumptions about increases in productivity and reforms. Against that background some observers note that the government late last year have rescinded plans to cut pension costs which are a major reason for Greece's high marginal tax rates, back-pedaled on labor reforms and proposed to raise the minimum wage in 2019 which could end up excluding many youths from the labor force. Labor reforms regarding wage formation, were among the few landmark reforms introduced since the beginning of the Greek crisis in 2009-10. Although such relapses are unlikely to impinge on the debt agreement with its European partners – this contains not binding political commitments – lower that projected growth would likely have consequences for the health of Greece’s already weak banking system. Another misgiving is the possibility of growing social unrest without faster growth.

Politics: Legislative elections are to be held before the end of the current year and speculations are that such may be announced earlier. Some observers suggest that could explain the government’s recent controversial policy reversals in playing up to unions and other vested interests in the labor market. At 26%, the main coalition party, Syriza, has since long been trailing the main opposition party New Democracy by 10pp or more. As such, next elections could entail a change of government. So far Greece has not witnessed direct populism of the type seen in Italy and France, but that specter may not vanish anytime soon. The share of Greeks in abject poverty or close to it has now widened to 36% of the population from 8% before the onset of the crisis.

Outlook: **The medium term scenario is relatively good**: For the next couple of years Greece is likely to continue at the path projected by the Eurogroup, i.e. with reasonable twin balances and moderate growth around 2-2,5% in real terms and inflation around 1%. Under any circumstances debt service at around €21bn[1] in

[1] Excluding short term debt issued locally and amounting to around €11bn.

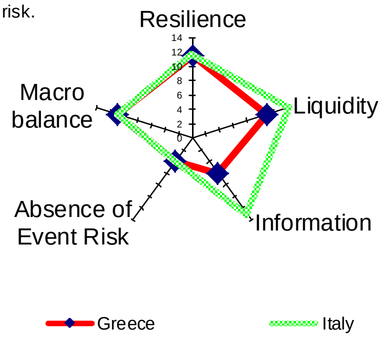
the 2019-21 period should now be well covered by the government's €27bn cash balances which may even grow further if the government succeeds in raising more money in global markets.

External events represent the main risk to that scenario. Those typically include Italy, Brexit or similar with the potential to sour investor sentiment to the Continent in general. In the longer term, Greece faces challenging social issues with a rapidly aging population and associated pension liabilities. Should adverse developments arise in other Euro-countries, politicians there could prove less willing to take a benign attitude to Greece when it meets its new debt relief "test" in 2032.

Ratings: Since it became clear that Greece would receive significant debt relief in 2018, the rating agencies have rapidly upgraded the sovereign by up to 3 notches. That has a clear rationale in a short to medium term perspective depending on how the government will react to a possible banking crisis. For country risk, by contrast the latter is of paramount importance. Cleaning up banks' balance sheets should be a task of high priority for the health of the economy. So far there has been limited progress in that regard representing a draw-back on country risk.

Key ratios	**2019**
Population (millions)	10,7
GDP/capita ($)	18729
GDP (change)	2,1%
Inflation	0,1%
Curr.acc. balance/GDP	0,6%
Reserves/imports (months)	0
Budget balance/GDP(*)	0,4%
Government debt/GDP(*)	188%

Chart key:
Moving out from the center reduces risk.



External ratings:
Fitch: B- (pos)
Moodys: Caa2 (pos)
S&P: B (pos)

Peers:
Pakistan
Ukraina
Argentina

Graph: Like Italy, Greece is strong on liquidity (being an EMU member), and similarly on macro balance but more than Italy is dragged down by event risk reflecting uncertainties of domestic politics and those of the EU.

Key data:	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
GDP (bill. US$)	237	195	193	200	200	200	249	260
GDP/capita (US$)	21786	18066	17877	18642	18685	18729	23294	24383
GDP (change)	0,8%	-0,3%	-0,3%	1,3%	1,8%	2,1%	2,5%	2,4%
Investments/GDP	11%	11%	12%	13%	11%	12%	13%	14%
Budget balance/GDP*	-3,5%	-5,3%	0,6%	0,9%	1,1%	0,4%	0,5%	0,5%
Govt debt/GDP**	191%	189%	197%	197%	196%	188%	180%	171%
CPI inflation (%)	-1,3%	-1,7%	-0,8%	1,1%	0,8%	0,1%	0,2%	1,1%
Money demand (%)	1,2%	-18,0%	-0,4%	3,3%	0,5%	-1,3%	1,5%	2,8%
Stock prices	1149	728	576	742				
Interest rates	0,2%	0,0%	-0,3%	-0,3%	-0,3%	-0,1%	0,3%	0,6%
Exch. Rate ($)	1,33	1,11	1,11	1,13	1,19	1,22	1,25	1,25
Trade/GDP (%)	44%	42%	42%	47%	53%	59%	52%	53%
Oil price (Brent)	$99	$52	$44	$54	$75	$77	$73	$73
billions US $								
Export of goods	39,8	31,9	31,3	36,2	43,2	48,3	53,3	57,3
Imports of goods	65,3	49,6	49,8	57,3	63,2	69,4	75,5	80,1
Other:	21,5	17,9	15,8	19,0	19,1	22,3	23,8	24,6
Current account	**-4,1**	**0,2**	**-2,6**	**-2,0**	**-0,9**	**1,2**	**1,5**	**1,7**
(% of GDP)	-1,7%	0,1%	-1,3%	-1,0%	-0,4%	0,6%	0,6%	0,7%
FDI	-0,3	-0,3	4,6	3,4	1,1	1,0	1,0	1,0
Loan repayments	-7,4	-5,6	-5,6	-5,6	-5,6	-5,6	-5,6	-5,6
Net other capital flows	12,7	6,0	4,3	4,3	5,5	3,2	3,1	2,9
Balance of payments	**0,9**	**0,2**	**0,7**	**0,0**	**0,1**	**-0,2**	**0,1**	**0,0**
Reserves	1,0	1,2	2,0	2,0	2,1	1,9	2,0	2,0
Total debt	506	473	476	478	479	477	476	474
o/w short term debt	52	39	39	39	39	39	39	39

Sources: Oxford Economics and SEB estimates.

Rating history					
Fitch (eoy)	B-	B	CCC	B-	BB-
Moody's (eoy)	Caa3	Caa1	Caa3	Caa2	B3

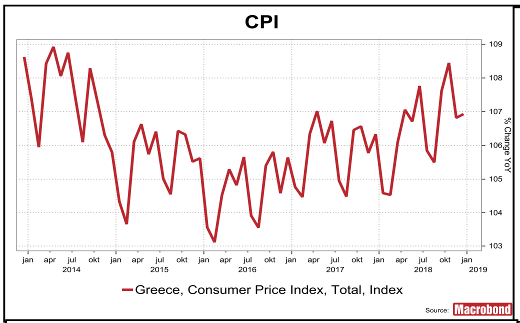
Type of government:

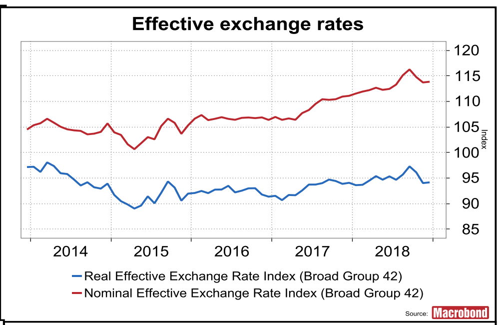
Next elections Presidential Febr. 2020

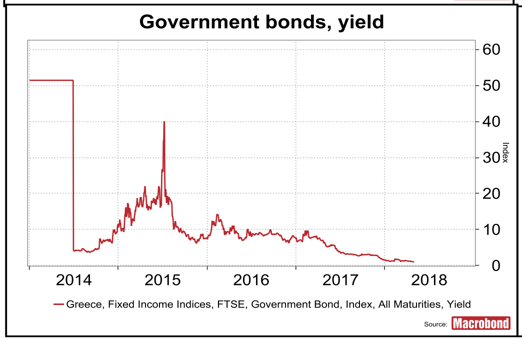
Other: Legislative Sept 2019

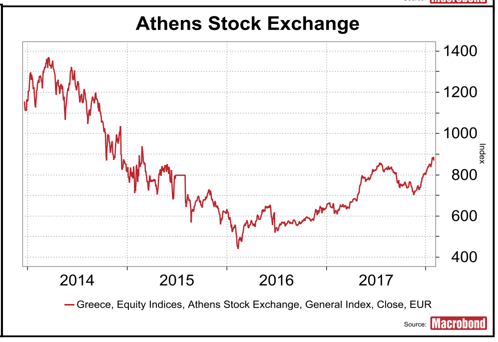
Latest PC deal

Latest IMF arrangements 2012 EFF









Disclaimer

Confidentiality Notice

The information in this document has been compiled by Skandinaviska Enskilda Banken AB (publ) ("SEB").

Opinions contained in this report represent the bank's present opinion only and are subject to change without notice. All information contained in this report has been compiled in good faith from sources believed to be reliable. However, no representation or warranty, expressed or implied, is made with respect to the completeness or accuracy of its contents and the information is not to be relied upon as authoritative. Anyone considering taking actions based upon the content of this document is urged to base his or her investment decisions upon such investigations as he or she deems necessary. This document is being provided as information only, and no specific actions are being solicited as a result of it; to the extent permitted by law, no liability whatsoever is accepted for any direct or consequential loss arising from use of this document or its contents.

SEB is a public company incorporated in Stockholm, Sweden, with limited liability. It is a participant at major Nordic and other European Regulated Markets and Multilateral Trading Facilities (as well as some non-European equivalent markets) for trading in financial instruments, such as markets operated by NASDAQ OMX, NYSE Euronext, London Stock Exchange, Deutsche Börse, Swiss Exchanges, Turquoise and Chi-X. SEB is authorized and regulated by Finansinspektionen in Sweden; it is authorized and subject to limited regulation by the Financial Services Authority for the conduct of designated investment business in the UK, and is subject to the provisions of relevant regulators in all other jurisdictions where SEB conducts operations.