



## Factor model forecasts for the short-term prospects in GDP

Economic forecasting unit

According to the short-term forecasts of KEPE, obtained via the application of a dynamic factor model, the annual rate of change of real GDP is estimated at -6.1% in 2012. Less adverse developments are anticipated for 2013, with the rate of change of the GDP estimated at -3.5%. It is noted that these estimates do not incorporate the potential impact of the new fiscal adjustment measures.

The present bulletin provides the updated short-term KEPE forecasts concerning the evolution of the rate of change in Greek real GDP. The forecasts are obtained via the application of a dynamic factor model, a detailed description of which can be found in Issue 15 (June 2011) of the Greek Economic Outlook. It should be noted that the resulting estimates do not incorporate the potential impact of the new fiscal adjustment measures, the major part of which is expected to be finalised and implemented within a short-term horizon. In particular, negative effects on GDP from these measures are anticipated to operate already from the fourth quarter of 2012, through interventions concerning special wage regimes.

According to the model forecasts (see Table 1), the mean annual rate of change of real GDP is estimated at -6.1% in 2012, representing an improvement in comparison to KEPE's respective previous forecast of -6.7% and to the depth of the economic recession in 2011, which reached -6.9%. It should be pointed out that the underlying, more favourable, forecast for 2012 incorporates both the actual evolution of the Greek GDP during the first two quarters of the year and the model forecasts for the third and fourth quarters of 2012. Concerning the course of GDP in 2013, the forecasts also point to less adverse

developments, with the rate of change of the GDP estimated at -3.5%.

The above presented slightly improved prospects can be associated, on the one hand, with the additional information incorporated in the most recently available data for the time period April-June 2012, and, on the other hand, with the potentially less adverse dynamics characterising some of the factors underlying the developments in GDP. Inspecting the evolution of the economic built-in variables, several cases are observed of either a small improvement or a weakening of adverse trends. Certain variables, among the ones exhibiting such trends, refer to the evolution of important sectors of the Greek economy, while others reflect expectations. In particular, a more favourable path in the second 2012 quarter, as compared to the first one, is recorded in the industrial production index, the general turnover index in industry and several of the individual sectoral indices. Additional less adverse developments are registered in competitiveness, as indicated by the small-scale reduction in the real effective exchange rate and the labour cost index. Improvements can be further observed in the business expectation indices in construction, retail trade and manufacturing, mirroring a weakening of the particularly adverse perceptions of economic

agents participating in the respective sectors of economic activity with reference to the upcoming prospects. Furthermore, and with regard to some of the main demand components, such as the general government final consumption expenditure, gross fixed capital formation and exports of services, the recorded mean negative rates of change in the first half of 2012 have been less unfavourable compared to the respective ones for 2011. Accordingly, the mean reduction in imports of both goods and services has been more pronounced in the first half of 2012, as compared to 2011.

While reference to the course of the above variables helps to explain why the model employed leads to the aforementioned estimates, the forecasted deceleration of the recession in the course of the year 2013 may be further justified on the basis of a wider rationale regarding the prospects of the Greek economy.

In particular, following a long period of deep recession, the Greek economy has made considerable progress with respect to curtailing non-viable activities, thus gradually minimising the margins for further sharp contraction in sectors encompassing such activities. Furthermore, upon the condition of smooth progress of the fiscal adjustment programme, the country may soon witness a weakening of several critical recessionary factors. Adverse liquidity conditions, for example, are bound to subside considerably with the receipt of the next tranche of the bail-out package and the completion of refinancing of the banking system. Such a

development, in conjunction with a series of other repercussions of the adjustment programme, such as the freeing-up of resources via the reduction of the fiscal deficit, the decrease in labour costs and the progress of structural reforms, would be expected to have a positive influence upon both exports and investment incentives, while also possibly improving the potential for attracting foreign direct investment. An important role in enhancing economic prospects may also be played by the anticipated unwinding of uncertainty in the near future, via the weakening of adverse scenarios regarding Greece's European future and the restoration of a climate of stability and reliability. In contrast to the positive prospects just mentioned, it is important to point out the absence of similar positive indications from the point of view of consumption, mainly due to the adverse conditions in labour markets and the overall negative developments in households' disposable income.

In view of the above, it is important to point out that the impact of the new fiscal measures, which as already noted has not been accounted for in the above forecasts, although it has been estimated to be negative in the short-term (in the order of  $-1.0\%^1$ ), may also partly contain positive elements with a potential to boost Greece's prospects of economic recovery over the medium term.

Table 1. Real GDP rate of change  
(%, y-o-y)

	2012		2013			
Quarters	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
<b>Quarterly rate of change</b>	-7.9	-3.3	-4.5	-4.1	-3.1	-2.9
<b>Mean annual rate of change</b>	-6.1		-3.5			

*Note:* Seasonally adjusted by the use of the X12 filter.

<sup>1</sup> According to estimates obtained using KEPE's 'small scale macroeconomic model'.