Imbalances in the Current Account of the Greek Economy: Causes and Policy Recommendations*

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This paper focuses on one of the main macroeconomic imbalances of the Greek economy: the current account deficit. The competitiveness of the Greek tradable sector improved significantly after the crisis, mainly due to the reduction of labour costs, leading to a significant increase in exports. However, the import dependence of the economy means significant import increases during periods of growth, leading to a worsening of the trade deficit. Policies to reduce the deficit should aim at: (a) exports growth, through the increase in price competitiveness via structural reforms in the goods market, which would result in reduced profit margins; and (b) imports reduction, through the support of capital producing businesses. Finally, a well-designed financing programme to support export-oriented companies and/or high-tech companies would further enhance export performance.

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The cut-off date for the data was March 2023.

1. Introduction

Long-term macroeconomic imbalances in a small and open economy, as is the case of Greece, may emerge and be measured in several different ways; in all cases, though, their main cause and common denominator is an ineffective production model. Primary fiscal deficits, income inequalities, an investment gap and current account deficits are the most evident manifestations of the Greek economy's macroeconomic imbalances.

The paper sheds light on the issue of the current account deficit. In particular, it presents Greece's persisting current account problem over time, attempting an investigation of its causes, and suggests alternative policies to correct it.

The current account balance is a key macroeconomic aggregate which measures the current account position of a reference country relative to the rest of the world, reflecting the productive capacity and competitiveness of the reference economy. More specifically, the current account balance consists of the following accounts:

(a) The balance of trade, namely total exports of goods and services less total imports of goods and services; (b) the primary income account, namely net income from labour (wages, salaries), investment (interest, dividends, profits) and other primary income; and (c) the secondary income account, namely net receipts from the general government and other sectors.

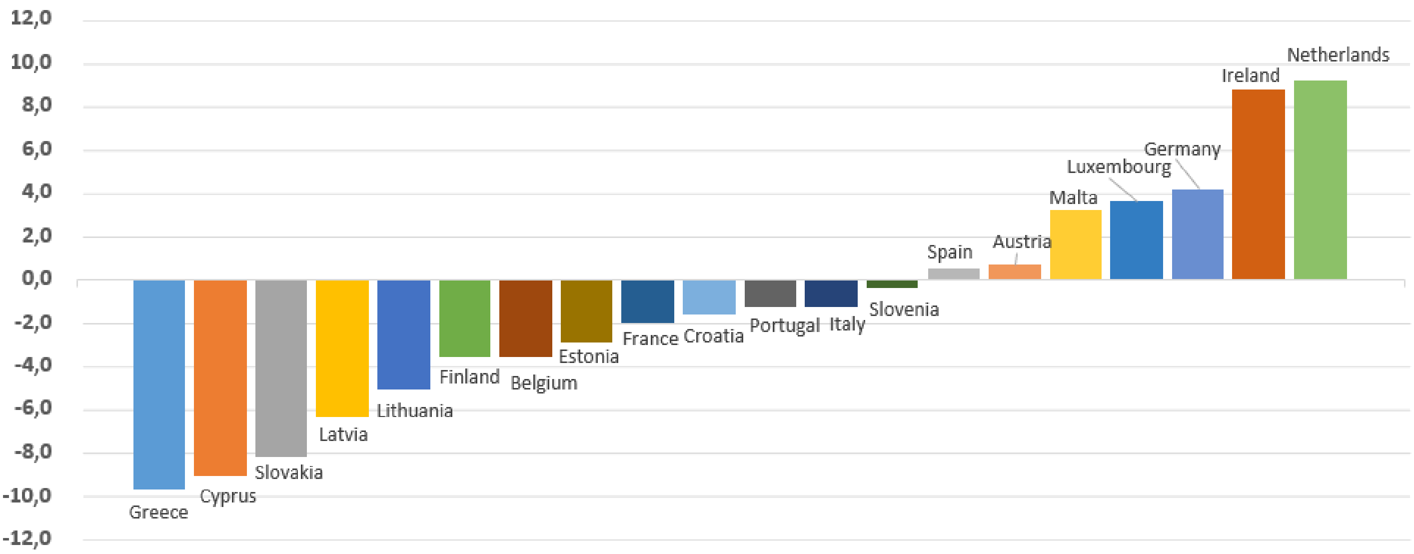
A current account surplus points to an economy that is a net creditor vis-à-vis the rest of the world. This means that the country produces more than it needs and thus provides resources to other economies in exchange for money. By funnelling its excess resources abroad, a surplus country enables other economies to cover their domestic needs in consumption and investment. This process is called "deficit financing".

Conversely, the current account deficit reflects an economy that is a net debtor vis-à-vis the rest of the world. It invests and consumes more than it saves from its own resources and therefore it has to use resources from other economies as well to meet its domestic needs.

2. Developments in the current account balance of the Greek economy and sources of imbalance

The Greek economy recorded the highest current account deficit, i.e. -9.7% of nominal GDP, in 2022 relative to all other euro area countries, following an already very high deficit (-6.8% of GDP) in 2021 (see Chart 1).

Chart 1: Current account balance as a percentage (%) of GDP across euro area countries in 2022



Source: [Statistics | Eurostat (europa.eu)](https://ec.europa.eu/eurostat).

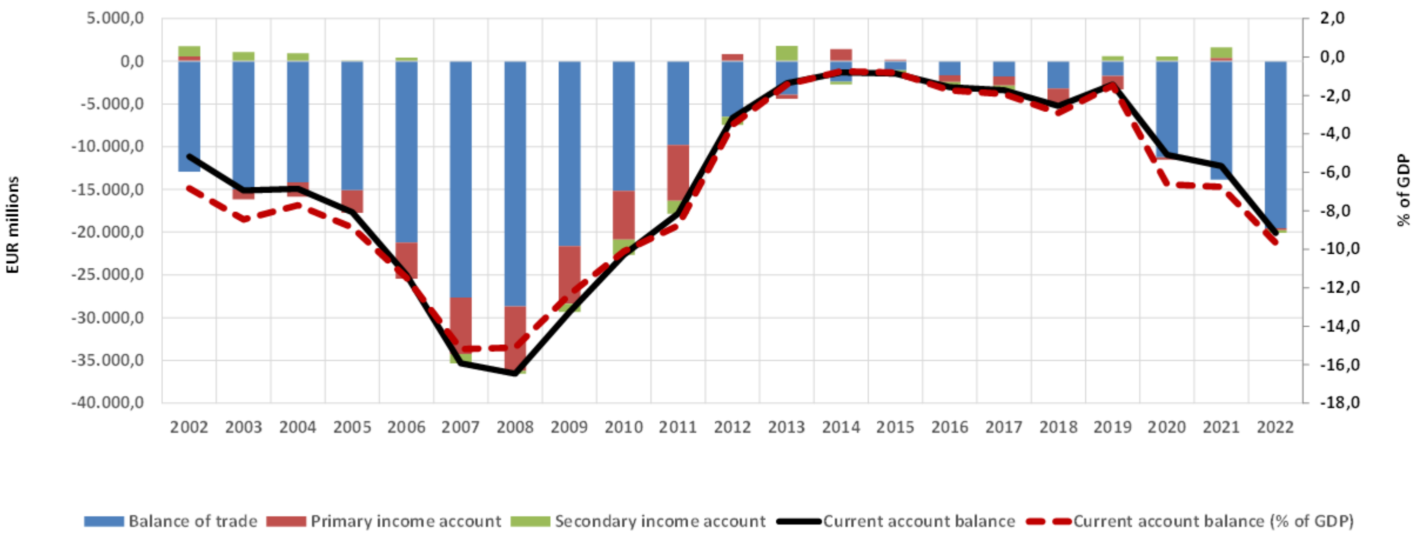
In comparison with a set of competitive economies of Southern Europe, such as Portugal, Spain and Italy, Greece has registered over time the worst current account positions as a percentage of nominal GDP. In more detail, Greece's current account deficit over the period 2002-2022 averaged -6.8% of nominal GDP, compared with a deficit of -4.3% for Portugal, a deficit of -1.9% for Spain and a surplus of +0.3% for Italy.

Greece failed to achieve a current account surplus during the period under review on account of consistent trade deficits. The balance of goods (oil, ships and other goods) has steadily run deficits throughout the reviewed period, as opposed to the services balance (travel, transport and other services) which has registered surpluses (see Charts 2 and 3).

More specifically, the current account balance deteriorated substantially over the period 2002-2008, particularly in the years 2007-2008 when the deficit surpassed -15.0% of GDP, amounting to EUR 36 billion. Over the period 2009-2012 the current account deficit improved considerably on the back of a large improvement (narrowing) of the trade deficit. However, the trade deficit diminished mainly due to a reduction in goods and services imports, which stemmed from a substantial decline in national income and thereby in domestic demand, and secondarily due to robust export performance, driven by an improvement in price competitiveness. Over the period 2013-2019 the current account deficit reached historically low levels (-1.6% of GDP on average), with relative price competitiveness gradually recovering and the trade deficit stabilising close to EUR 2 billion on average.

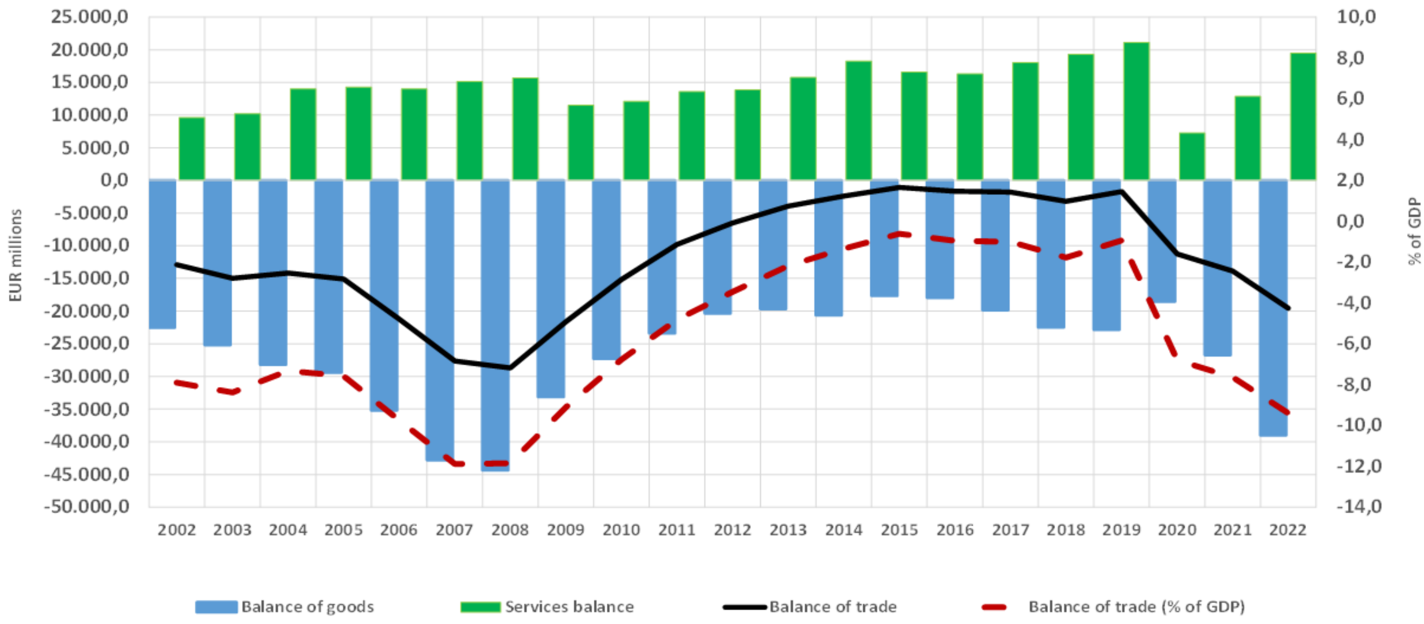
By contrast, in 2020–2022 the current account deficit rose sharply, as the trade deficit had greatly deteriorated for three consecutive years to reach EUR 20 billion in 2022 (see Charts 2 and 3).

Chart 2: Evolution of Greece's current account balance as a percentage (%) of GDP and its components in 2002-2022



Source: Bank of Greece and author's calculations.

Chart 3: Evolution of Greece's balance of trade as a percentage of GDP and its components in 2002-2022



Source: Bank of Greece and author's calculations.

More specifically, the current account deficit increased by around EUR 7.8 billion in 2022 year-on-year, reaching -9.7% of nominal GDP. The main factors behind the worsening of the current account balance were:

(a) The non-oil balance of goods, owing to higher imports of consumer goods, which are associated with pent-up consumer demand, as well as higher imports of intermediate goods, which are associated with domestic industrial production, while the increase in non-oil exports partly offset the deterioration. On the other hand, the services balance, despite the COVID-19 pandemic crisis, which weighed heavily on tourism receipts during 2020-2021 (due to cross-border mobility restrictions), continued to have a positive contribution to the balance of trade on the back of sustained surpluses (EUR 19.5 billion in 2022, up from EUR 7.3 billion in 2020).

(b) The oil balance, due to rises in fuel prices and imports volume.

(c) The secondary income account, due to the delayed payments of ANFA/SMP profits and of the second tranche from the Recovery and Resilience Facility (RRF), which was disbursed in the first quarter of 2023 instead of the second half of 2022. This deterioration was counterbalanced to a certain extent by the increased surplus of the travel services balance.

Finally, a significant increase of 14.0% in nominal GDP, reflecting a rise of 5.9% in GDP at constant prices, but also high inflation (the GDP deflator rose by 8.1%), had a positive contribution to the narrowing of the current account deficit as a percentage of GDP, but did not suffice to offset the remaining aggravating factors.

To sum up, the main external imbalance of the Greek economy is attributable to the balance of goods, which is the primary cause of the trade deficit and subsequently of the current account deficit over time.

The high elasticity of imports to GDP, due to the high import content of investment (41%), exports (31%) and private consumption (25%) [Bank of Greece, *Monetary Policy Report* 2017-2018], as well as the concurrent low substitution of imported intermediate industrial inputs with domestic production, coupled with the current investment gap, may be seen as sources of imbalance in the external sector of the Greek economy over time.

However, it should be noted that developments over the past three years (2020-2022) have changed as compared with prior to the Greek crisis, when the widening of the current account deficit was almost exclusively attributable to the considerable worsening of cost and price competitiveness and the absence of structural reforms in key sectors and institutions of the Greek economy. The recent widening of the current account deficit is largely driven by conjunctural factors, which are mainly related to the pandemic and surging energy prices. To a smaller extent, this is also attributable to higher imports of capital goods, which however amplify the productive capacity of the Greek economy and –through exports– lead to an improvement in the external balance over the medium term. Another major driver of the wider current account deficit are the imports of intermediate goods, possibly reflecting supply shortages but also indicating a positive outlook for the expansion of Greek industry and its greater integration into global supply chains.

3. Policy recommendations

The Greek economy is now much stronger than before, as numerous structural reforms have been implemented, mainly in the labour market but also, to a lesser extent, in product markets, the country's credibility has been enhanced and market expectations about the prospects of the Greek economy are positive. Institutional interventions e.g. to speed up the delivery of justice, cut red tape, accelerate and streamline the approval of export-oriented, productive investment projects could boost the extroversion of the Greek economy and contribute to the improvement of the current account balance.

Export boosting policies should aim at supporting exporting firms and improving price competitiveness, as it has been observed that in the Greek economy the improvement in competitiveness is mainly attributable to lower labour costs and much less to lower prices due to the opening of product markets.

The appropriate policies to reduce imports should be geared towards a shift in the productive model of the economy by supporting capital producing businesses, in order to reduce import dependence in the areas of both investment and durable goods.

Non-price factors, such as investment and technology usage, play a decisive part in shaping the exporting landscape of a country, especially in the longer run. Investments and the deployment of technology enhance the quality of the goods and services produced and enable the establishment of recognisable brand names in international markets (global branding).

Changes in prices are affected by changes in both unit labour costs and profit margins. For instance, if unit labour costs drop but profit margins increase, prices may be higher despite lower labour costs. Effortless and high profit margins, due to the oligopolistic structure of the Greek economy, provide a weak incentive for domestic businesses to seek extroversion and openness to foreign markets, thus leading to lower export performance and making businesses more introvert and vulnerable to any downward movements in domestic demand (Bragoudakis 2014, 2017, 2018).

Finally, the increase in bank lending using European resources to SMEs that are active in tradable, export-oriented sectors with a comparative advantage, as well as in high-tech sectors, is expected to contribute to the shift of the Greek economy's productive model and improve current account imbalances in the medium term.

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__Zacharias Bragoudakis__ is Deputy Director and Head of the Econometric Forecasting Section in the Economic Analysis and Research Department at the Bank of Greece. He represents the Bank of Greece in several important working groups of international organizations such as the European Central Bank (ECB), the Organization for Economic Co-operation and Development (OECD), and the European Commission (EU). He has also worked in the General Economics Department of the European Central Bank (ECB) during the period 2002-2003. In 2014 he won the ECB's best forecaster award in the Eurosystem Macroeconomic Projections Competition.

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