GREECE

The Greek economy embarked on a modest growth path in 2016, supported by the successful conclusion of the first review of the ESM assistance programme in May 2016. After the Greek government passed a comprehensive fiscal package in early June, including pension and income tax reforms, the ESM disbursed the second tranche of the programme's financing. However, the economy contracted again late in the year and it continues to face numerous challenges. The Greek government must press ahead with reforms to ensure a successful and timely conclusion to the ESM programme, a return to sustainable market access, and long-lasting growth.

The Greek government is committed to reforms that aim to restore fiscal sustainability; safeguard financial stability; boost growth, competitiveness, and investment. For example, it needs to deregulate the energy market, maintain the greater flexibility achieved in the labour market, and reform the public administration. In May 2016, authorities passed a comprehensive package of fiscal reforms – including an overhaul of the pension and income tax system – with the aim of meeting the ESM programme's 2016–2018 fiscal targets. The package included measures to address any fiscal slippage. In response, the ESM governing bodies approved the disbursement of the second tranche of the ESM programme, starting with a first disbursement of €7.5 billion in June 2016, in part earmarked for the clearance of arrears. They followed up with the approval of a €2.8 billion disbursement in October 2016. Hence, €31.7 billion, of the up-to-€86 billion foreseen for the programme, had been disbursed by the end of December 2016, leaving up to €54.3 billion available until August 2018. This amount could decrease given that bank recapitalisation required less financing than originally foreseen. Should the IMF participate and/or Greece implement policy reforms that enable it to return to market financing before 2018, the final amount could fall further.

The economic recovery in spring 2016 was supported by the completion of the first review of the ESM programme. It also benefited from ebbing uncertainty, easing market conditions, and the arrears clearance programme. But the economy stumbled again towards the end of the year. After real output had expanded for two consecutive quarters on the back of stabilising domestic demand, it reversed course in the last three months of the year. Real GDP contracted amid an increasing fiscal burden, decreasing government spending, and faltering confidence in response to renewed uncertainty over the protracted programme review. Government spending declined while private consumption and business investment slowed markedly. For 2016 as a whole, economic activity stagnated as the negative impact from net trade and budget under-execution offset rising consumer spending, according to the Hellenic Statistical Authority's first annual estimate. The European Commission's Spring Forecast published on 11 May 2017 predicts that GDP will rebound by 2.1% in 2017 and further expand by 2.5% in 2018, while the current account deficit is expected to be at -0.5% and -0.3% of GDP, respectively.

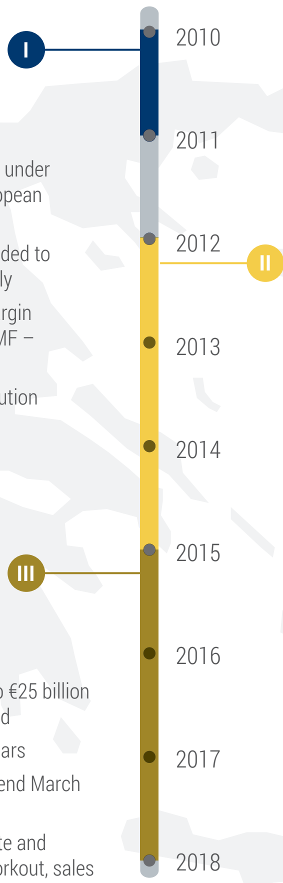
The government posted a primary surplus of 3.9% in 2016, Eurostat said in April 2017, (which translated into 4.2% according to the programme definition), far outpacing the programme target of 0.5% of GDP. This substantial outperformance suggests that fiscal reforms, especially on the revenue side, are bearing fruit. By the end of December, authorities effectively cleared arrears of €3.4 billion in net terms, mostly in the social sector and financed both by ESM funds and the government's own resources. The officially recorded stock of arrears, including tax refunds, amounted to €4.5 billion at the end of 2016. Government debt climbed to 179.0% of GDP in 2016 but is expected to decrease in the short term assuming full and timely implementation of the financial assistance programme.

Following the May 2016 Eurogroup decision to address concerns regarding the sustainability of Greece's public debt, the ESM Board of Governors endorsed a package of short-term debt relief measures on 20 January 2017. The agreed measures consist of: smoothing the EFSF repayment profile under the agreed maximum weighted average maturity; using the EFSF/ESM diversified funding strategy to reduce interest rate risk without incurring any additional costs for former programme countries; and waiving the step-up interest rate margin related to the debt buy-back tranche of the second programme for Greece for the year 2017. According to a statement, the Eurogroup may consider in 2018 a possible second set of measures for the medium term, including a targeted reprofiling of EFSF loans, provided the ESM programme is successfully concluded and the risks to debt sustainability at programme end require such additional measures.

Despite noteworthy programme achievements, Greece continues to face important challenges. Political and economic uncertainty destabilises the business environment. Coupled with a high tax burden and a domestic banking sector plagued by a high stock of NPLs, the overall situation is impeding growth and investment in the private sector. The 2016 reforms to the income tax and pension system were an important step in the right direction. But reconciling necessary medium-term fiscal stability with sustainable growth requires more ambitious initiatives, such as broadening the tax base. Equally, the banking sector must significantly reduce its high NPL ratio, which will help unlock bank lending and support investment, and complete reforms to modernise banks' governance structure. The privatisation programme made some headway in 2016 but its independence from political influence should be enhanced. In the same vein, the government must strengthen the privatisation framework by making the new asset and privatisation fund, the Hellenic Corporation of Assets and Participations, fully operational so that Greece can swiftly proceed with the privatisation programme.

Despite visible signs of recovery, the Greek economy continues to operate in a difficult environment. Any further delays in programme implementation and renewed political uncertainty run the risk of undermining programme achievements and putting considerable strain on the economy. The Greek government – in close cooperation with programme partners – is called upon to address the remaining deficiencies rigorously and lay the necessary foundations for a successful programme conclusion. Meeting these challenges is particularly crucial at this juncture to ensure a smooth transformation of the still fragile recovery into self-sustained long-term growth.

The three financial assistance programmes for Greece



FIRST PROGRAMME

Initial programme amount: €110 billion

Total amount disbursed: €73 billion

Lenders: Euro area countries (except Slovakia) under Greek Loan Facility (GLF) managed by the European Commission: €52.9 billion; IMF: €20.1 billion

Grace period and maturity on GLF loans extended to 10 and 30 years from 3 and 5 years, respectively

Interest rate: priced with Euribor 3M with a margin lowered from 300 to 50 basis points for GLF; IMF – around 3.96%

Key legislated reforms: Pension system, institution building, state budget, public sector benefits

SECOND PROGRAMME

Initial programme amount: €165.4 billion

Total amount disbursed: €153.8 billion

Lenders: EFSF: €141.8 billion (including €48.2 billion for bank recapitalisation, €34.6 billion for private sector involvement and bond interest facilities), of which €10.9 billion for bank recapitalisation was not used by the HFSF and was returned to the EFSF; IMF: €12 billion

Maximum weighted average maturity on EFSF loans extended to a maximum 32.5 years from 7.5

Interest rate: Guarantee fee cancelled on EFSF loans and some interest payments deferred by 10 years; IMF: between 2.85% and 3.78%

Key legislated reforms: Labour market, income tax, public administration, structural reforms

THIRD PROGRAMME

Total amount committed: up to €86 billion

Total amount disbursed: €31.7 billion

Lenders: ESM: up to €86 billion (including up to €25 billion for bank recapitalisation); IMF: to be determined

Maximum weighted average maturity: 32.5 years

Interest rate for cash disbursements: 0.86% (end March 2017)

Key legislated reforms: VAT, pension, corporate and household insolvency law, out-of-court debt workout, sales and servicing of loans (NPLs), establishment of privatisation fund