Eurobank Global Markets Research
www.eurobank.gr/research
EurobankGlobalMarkets
Research@eurobank.gr

Eurobank

GREECE MACRO MONITOR

November 12, 2015

November 9th Eurogroup gives Greece a week to accomplish pending prior actions; dissociates bank recapitalization from completion of 1st programme review

This note analyses briefly the outcome of the November 9th Eurogroup and provides an overview of the pending prior actions for the release of the next ESM loan installment (€2bn). Furthermore, it presents a timeline of key dates and events that deserve close monitoring in the period ahead.

Paraskevi Petropoulou
G10 Markets Analyst
ppetropoulou@eurobank.gr

DISCLAIMER
This report has been issued by Eurobank Ergasias S.A. ("Eurobank") and may not be reproduced in any manner or provided to any other person. Each person that receives a copy by acceptance thereof represents and agrees that it will not distribute or provide it to any other person. This report is not an offer to buy or sell or a solicitation of an offer to buy or sell the securities mentioned herein. Eurobank and others associated with it may have positions in, and may effect transactions in securities of companies mentioned herein and may also perform or seek to perform investment banking services for those companies. The investments discussed in this report may be unsuitable for investors, depending on the specific investment objectives and financial position. The information contained herein is for informative purposes only and has been obtained from sources believed to be reliable but it has not been verified by Eurobank. The opinions expressed herein may not necessarily coincide with those of any member of Eurobank. No representation or warranty (express or implied) is made as to the accuracy, completeness, correctness, timeliness or fairness of the information or opinions herein, all of which are subject to change without notice. No responsibility or liability whatsoever or howsoever arising is accepted in relation to the contents hereof by Eurobank or any of its directors, officers or employees.
Any articles, studies, comments etc. reflect solely the views of their author. Any unsigned notes are deemed to have been produced by the editorial team. Any articles, studies, comments etc. that are signed by members of the editorial team express the personal views of their author.

Eurogroup gives Greece a week to accomplish pending prior actions; dissociates bank recapitalization from completion of 1st programme review

In an official statement released after the conclusion of the November 9th Eurogroup, euro area finance ministers acknowledged that "a lot of progress and work" has been made so far towards implementing Greece's new economic adjustment programme. However, they refrained from approving the release of the pending loan installment of €2bn as a number of attached prior actions are still pending (see section below). Furthermore, they urged Greek authorities to implement in the course of the current week: (i) all relevant outstanding milestones; and (ii) some of the programme deliverables regarding the governance of the banks. More importantly, the Eurogroup clarified that compliance with the aforementioned deliverables would pave the way for the release of both the pending loan installment and the sub-tranche of €10bn earmarked for potential bank recapitalization and resolution purposes. That said, the Eurogroup seems to have dissociated the bank recapitalization process from the completion of the 1st programme review, which in turn requires full implementation of: (a) the whole set (49 in total) of prior actions for the release of the €2bn pending installment; and (b) a second set of milestones for the unlocking of another loan installment of €1bn. According to press reports, the latter (second) set of milestones will incorporate a number of contentious and politically sensitive items including, inter alia: (a) additional pension reforms; (b) abolishment of the preferential tax treatment for agricultural income and overhaul of the income tax code; and (c) establishment of an independent Privatization Fund.[1]

Pending prior actions for the release of the next ESM loan instalment

Reportedly, the government has so far fulfilled 40 of the 49 prior actions required for the release of the next ESM loan installment (€2bn). Items *I.* to *IV.* below represent some of the most difficult (pending) issues in the agenda of ongoing negotiations with the institutions for the release of the said installment.

[1] In line with the MoU conditionality, the Greek government has committed to proceed with further reforms to strengthen long-term sustainability of the pension system targeting savings of around 0.25%-of-GPD and 1%-of-GDP in 2015 and 2016, respectively. Note that the first phase of pension reform (e.g., disincentives to early retirement and gradual adjustment in statutory retirement age) was approved by the Hellenic Parliament in mid-August as part of the conditionality incorporated in the relevant law enacting the ESM bailout programme. As regards agricultural income tax rates, these should increase from 13% currently to 20% in 2016 and to 26% in 2017. Finally, the new MoU conditionality envisages the establishment of an independent Privatization Fund, managed by domestic authorities under the supervision of the relevant European institutions (*initially planned for October*). The task of the Fund should be to manage valuable Greek assets – including shares in Greek banks after their recapitalization- through privatization and other means with a view to eventually monetize assets worth up to €50bn.

I. Protection of primary residence from foreclosure

As part of the conditionality incorporated in the law enacting the new rescue programme, the Greek government has committed to proceed, subject to official creditors' approval, with certain modifications in the so-called "Katseli" household insolvency law (3790/2009) with a view to introduce relatively tighter eligibility criteria for the protection of primary residence. In this direction, official creditors have reportedly proposed that (a) the objective value of primary residence should not exceed €120k, regardless of the debtor's marital status and number of dependent children[2]; (b) the debtor's gross annual income to be maximum €23.967;[3] and (c) the debtor's total debt to not surpass €120k. On the other hand, the Greek government reportedly submitted to the November 9th Eurogroup a revised (improved) proposal containing the following eligibility criteria: (a) objective value of primary residence no higher than €180k for a single homeowner[4]; (b) a maximum threshold of €30k for a debtor's gross annual income; and (c) debtor's total debt no higher than €180k. Reportedly, the revised eligibility thresholds proposed by the Greek government cover c. 55% of indebted households which have applied for the "Katseli" scheme, but a judicial verdict (on their application) is still pending. This compares to a coverage rate of c. 72.5% implied by an earlier proposal made by the Greek side and a rate of just c. 40% demanded by official creditors. According to reports circulated in the local press over the last couple of days, official discussions on the issue continue and some convergence between the two sides appears to be emerging.

II. Amendments to the installment scheme for overdue tax payments & social security contributions

Official creditors have reportedly proposed the imposition of more stringent criteria to the 100-month installment scheme for overdue tax payments and social security contributions, aiming to ensure payments are commensurate with the taxpayers' ability to meet their debts.[5] Without first securing official creditors' consent, the Hellenic Parliament approved last November a new scheme allowing up to 100 monthly installments in the payment of overdue tax and social security liabilities verified up to October 1, 2014. Even though the Parliament approved last month an increase in the respective interest rate charge (to 5.05% from 3%, previously) for taxpayers who own more than €5k, official creditors continue to deem the aforementioned scheme as overly "generous". In more detail, they have reportedly proposed taxpayers enrolled in the scheme to be removed if they miss a due payment by more than a day. On its part, the Greek side wants the existing 26-day grace period to remain in place and be gradually reduced, depending on the performance of the domestic economy.

***III.* Offsetting measures to replace VAT on private education**

Arguing that the European VAT Directive does not allow EU countries to apply reduced rates on education, official creditors have rejected a government proposal for the imposition of a gradually increasing VAT rate on private education instead of a 23% flat rate agreed initially[6]. To overcome this problem, the government has reportedly decided to impose a €0.05 levy on each column of the gambling games of the Greek Organization of Football Prognostics SA (OPAP), as an offsetting measure for the coverage of the ensuing budgetary shortfall estimated at €240bn/annum.[7] OPAP has strongly opposed the imposition of a player levy, insisting that such a measure would have an adverse impact on its gross revenue. The gaming company has also claimed that relevant State proceeds would not exceed €52.4mn/annum compared to a €330mn/annum figure projected by the government. The said offsetting measure has been reportedly submitted to official lenders but it is still unclear whether it has been approved.

IV. Modified pricing policy for off-patent drugs and generics

Fulfilling one of the prior actions underlying the conditionality for the release of the €2bn ESM loan installment, Greece's Minister of Health issued in mid-October a ministerial decree envisaging the reduction in the price of all off-patent drugs to 50% and all generics to 32.5% of the patent price by repealing the grandfathering clause for medicines circulating in the market since 2012. Furthermore, if the average of the three lowest prices for a given drug in EU markets yielded a lower price than that including the aforementioned price cut then the former would be chosen. Based on another relevant ministerial decree that was issued earlier this year, the Greek side has reportedly requested the already approved lower pricing policy to be applied solely to off-patent drugs and generics that cost more than €12 and €7.8, respectively. As per the same sources, they have also requested the said pricing policy to be phased

[2] The "Katseli" household insolvency law currently protects primary residency with objective value up to €375k, depending on lender's marital status and number of children.

[3] The proposed annual income threshold stands for households with up to three dependent children. For households without children the proposed threshold stands at €13.917 (i.e., +3.350 for each child), while for a single homeowner the respective figure is €8.180.

[4] For households without children the proposed threshold stands at €230k, increased by €50k for each child (up to three).

[5] According to the latest data from the Secretariat General for Public Revenues, cumulative tax arrears totaled €80.04 in September 2015, out of which ca €5.6bn was accumulated in the first nine months of this year.

[6] The Greek government had reportedly proposed the imposition of a 6% rate on foreign language schools, dancing/music/vocation schools & tuition centers, a 13% rate on private schools of primary and secondary education and no VAT tax imposed on kindergartens and nurseries.

[7] Under an agreement signed between Greece's Ministry of Finance and the European Commission in early 2013 regarding the taxation alignment of the gambling games markets, a 30% tax is applied on OPAP's gross gaming revenue for the period between 01.01.2013 and 12.10.2020.

gradually over a two year-horizon. On their side, official creditors reportedly insist on the imminent implementation of the said policy to all off-patent drugs and generics irrespective of their price.

Rising expectations that next EWG will open the door for releasing the next ESM loan installment

The November 9th Eurogroup mandated the Euro Working Group (EWG) to reconvene early next week at the latest to evaluate the progress made by the Greek side in implementing all outstanding milestones for the disbursement of the pending ESM loan installment of €2bn as well as some of the programme deliverables regarding the governance of the banks. Furthermore, subject to a positive EWG assessment, an ESM Board of Governors meeting would convene afterwards to give the green light for the release of €10bn (or part of that amount if needed) for recapitalizing Greece's four systemic banks. On its part, the Greek government is reportedly planning to submit to Parliament by late next week a multi-bill incorporating the required legislation for all pending prior actions for the unlocking of the aforementioned loan amounts. Meanwhile, the EC/ECB/IMF/ESM mission heads have returned to Athens earlier this week to resume negotiations with domestic authorities in the context of the 1st programme review. As per the same sources, completion of the pending prior actions and the identification of the second set of milestones are expected to dominate the agenda. The heads will reportedly depart by the end of the week and return later this month for the completion of the first programme review.

Total amount of ESM loan facility for Greece may prove smaller than initially envisaged

Speaking at the press conference following the November 9th Eurogroup, ESM Managing Director Klaus Regling stated that the results of the ECB's Comprehensive Assessment on the four Greek systemic banks were better than expected, adding that the ESM loan facility will probably be smaller than c. €86bn envisaged in mid-August. The said assessment identified capital shortfalls totaling €4.4bn in the baseline scenario and €14.4bn in the adverse scenario, after taking into account €9.2bn aggregate Asset Quality Review (AQR)-adjustments (see *Appendix* at the end of the document).[8] In view of the aforementioned, it is likely that the amount earmarked for potential recapitalization and resolution needs of the domestic banking system (up to €25bn) will not be needed in its entirety. The four systemic banks have already submitted their capital plans to the Single Supervisory Mechanism (SSM) explaining how they intend to cover the entire shortfall of €14.4bn. In addition, these banks have already undertaken certain actions (*i.e.*, LME exercises, commencement of institutional offering book building) with an intention to cover a minimum of €4.4bn (that corresponds to the baseline shortfall) by private means. In an interview to a local newspaper last week, Chairperson of the Supervisory Board of the SSM Daniele Nouy stressed that the recapitalization of the Greek banks has to be concluded before the end of the year so as to avoid the risk of the application of the Bank Recovery and Resolution Directive (BRRD) which will come into effect on January 1st 2016 and extends, under certain conditions, into the bail-in territory.

Timeline of key dates and events

In what follows, we present a timeline of the key dates and events that deserve close monitoring in the crucial weeks ahead.

<u>November 12</u>

Eurobank commences the book-building process. Eurobank announced the launch of its book building process and subscription commitments of about €353mn from institutional investors with the option to increase their subscription up to a total amount of €584mn. This is in relation to the bank's proposed share capital increase to raise up to €2,122mn so as to fully meet its capital requirements that were projected from the Stress Test under the adverse scenario of the ECB's Comprehensive Assessment. The European Bank for Reconstruction and Development will invest up to €80mn.

<u>November 14-15</u>

EC/ECB/IMF/ESM mission heads depart from Athens

<u>Week commencing November 16</u>

The Hellenic Parliament votes on a multi-bill incorporating the required legislation for the implementation of: (i) pending prior actions attached to the release of the €2bn ESM loan installment; and (ii) some of the programme deliverables regarding the governance of the banks.

[8] The ECB's Comprehensive Assessment consists of two components: (i) the Asset Quality Review which evaluates the accuracy of the carrying value of banks' assets as of 30 June 2015; and (ii) the Stress Test, examining the resilience of all four systemic banks against two separate scenarios (baseline and adverse), spanning from June 30th 2015 to December 31st 2017. The four systemic banks were estimated to hold total assets of €296bn at the end of June 2015, accounting for approximately 90% of domestic banking sector assets.

November 16

Euro Working Group (EWG) convenes.

November 17

ESM Board of Governors meets.

November 21

Final 2016 Budget submitted to Parliament.

November 23

Eurogroup meeting.

End November

Greek government submits to Parliament for approval the 2016-2019 Medium-Term Fiscal Strategy (MTFS) (*key deliverable for the completion of the 1st programme review).* In line with MoU conditionality, the MTFS will envisage additional fiscal measures projected to yield at least 0.75%-of-GDP in 2017 and 0.25%-of-GDP in 2018, so as to help attain the medium-term primary balance target of 3.5%-of-GDP.

End November/Early December

- Hellenic Parliament votes on a multi-bill incorporating the required legislation for the implementation of the second set of prior actions required for the release of the final instalment of the €3bn outstanding sub-tranche, amounting to €1bn.

- EC/ECB/IMF/ESM mission heads return to Athens for the completion of the 1st programme review.

- 1st programme review is completed. According to the MoU, a staff level agreement on core issues underlying the 1st programme review is a key precondition for the initiation of official discussions on additional debt relief measures to Greece. Furthermore, successful completion of the said review is one of the key preconditions for the IMF financial participation in Greece's new bailout programme.

December 3

ECB Governing Council convenes.

December 7

- Eurogroup discusses new debt relief for Greece (conditional on the successful completion of 1st programme review).

- IMF principal payment of ca €310mn.

December 16

IMF principal payment of ca €580mn.

December 21

IMF principal payment of ca €348mn.

End-December

Completion of the bank recapitalization process.

Appendix

Table A- ECB Stress Test- Key macro financial variables for the Greek economy

	Baseline scenario			Adverse scenario		
	2015	**2016**	**2017**	**2015**	**2016**	**2017**
Real GDP growth YoY%	-2.3	-1.3	2.7	-3.3	-3.9	0.3
HICP inflation YoY%	-0.4	1.5	0.9	-0.7	0.6	-1.0
Unemployment rate (%, eop)	26.9	27.1	25.7	27.3	28.1	27.5
House price growth (%, YoY average)	-7.5	-5.0	-1.0	-7.8	-8.8	-7.8
Prime commercial property price growth (%)	-3.4	-1.2	1.1	-3.6	-3.4	-2.1

Source: ECB 2015 Greek Comprehensive Assessment (October 2015)

Table 2- Capital shortfalls & adjusted CET-1 ratio (baseline & adverse scenario)

		National Bank of Greece	Eurobank	Alpha Bank	Piraeus Bank	System
	Starting point CET-1 ratio- June 2015	11.60%	13.74%	12.69%	10.84%	**12.10%**
	Post-AQR adjusted CET-1 ratio	8.14%	8.59%	9.64%	5.48%	**7.80%**
Baseline scenario	CET-1 ratio adjusted for stress test	**6.79%**	**8.59%**	**8.98%**	**5.18%**	**7.80%**
Baseline scenario	9.5% CET-1 ratio- Identified capital shortfall (EURmn)	**1,576**	339	**263**	**2,213**	**4,391**
Adverse scenario	CET-1 ratio adjusted for stress test	**-0.22%**	**1.30%**	**2.10%**	**-2.35%**	**7.8**
Adverse scenario	8.0% CET-1 ratio- Identified capital shortfall (EURmn)	**4,602**	**2,122**	**2,743**	**4,933**	**14,400**

Source: ECB 2015 Greek Comprehensive Assessment (October 2015)

Eurobank Economic Analysis and Financial Markets Research

Dr. Platon Monokroussos: *Group Chief Economist*
pmonokrousos@eurobank.gr, + 30 210 37 18 903

Dr. Tassos Anastasatos: *Deputy Chief Economist*
tanastasatos@eurobank.gr, + 30 210 33 71 178

Research Team

Anna Dimitriadou: *Economic Analyst*
andimitriadou@eurobank.gr, + 30 210 3718 793

Ioannis Gkionis: *Research Economist*
igkionis@eurobank.gr + 30 210 33 71 225

Stylianos Gogos: *Economic Analyst*
sgogos@eurobank.gr + 30 210 33 71 226

Olga Kosma: *Economic Analyst*
okosma@eurobank.gr + 30 210 33 71 227

Arkadia Konstantopoulou: *Research Assistant*
arkonstantopoulou@eurobank.gr + 30 210 33 71 224

Paraskevi Petropoulou: *G10 Markets Analyst*
ppetropoulou@eurobank.gr, + 30 210 37 18 991

Galatia Phoka: *Research Economist*
gphoka@eurobank.gr, + 30 210 37 18 922

Theodoros Stamatiou: *Senior Economist*
tstamatiou@eurobank.gr, + 30 210 3371228

Eurobank Ergasias S.A, 8 Othonos Str, 105 57 Athens, tel: +30 210 33 37 000, fax: +30 210 33 37 190, email: EurobankGlobalMarketsResearch@eurobank.gr

Eurobank Economic Analysis and Financial Markets Research

More research editions available at http://www.eurobank.gr/research

- **Daily Overview of Global markets & the SEE Region:** Daily overview of key macro & market developments in Greece, regional economies & global markets
- **Greece Macro Monitor:** Periodic publication on the latest economic & market developments in Greece
- **Regional Economics & Market Strategy Monthly**: Monthly edition on economic & market developments in the region
- **Global Economy & Markets Monthly**: Monthly review of the international economy and financial markets

Subscribe electronically at http://www.eurobank.gr/research
Follow us on twitter: http://twitter.com/Eurobank