ISSN: 1791-35 35

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GLOBAL ECONOMIC &
December 6, 2017 MARKET OUTLOOK

Eurobank

FOCUS NOTES

State of play in the implementation of the 3rd ESM programme for Greece

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This report presents the main elements of the recent Staff Level Agreement between the Greek authorities and the European institutions as well as the next steps in the period ahead.

Overview

The 4th December Eurogroup endorsed the staff level agreement reached between the Greek authorities and the European institutions on the policy package under the 3rd review of the European Stability Mechanism (ESM) programme for Greece. As was acknowledged by all parties involved, the 3rd review was conducted in a productive and collaborative spirit and the staff level agreement was reached significantly faster than in the two previous reviews of the programme. The Greek authorities must now legislate or otherwise implement the remaining prior actions as soon as possible[1] so that the review may be politically sealed at the January 22nd Eurogroup. This will open the way for the disbursement of the next loan tranche (c. EUR 5.5billion) by mid-February 2018.

It should be noted that the IMF's role in this review was to assess the current economic situation and status of policy implementation and report back to its Board of Directors. As regards the Stand-by Arrangement that the IMF approved for Greece in July 2017, it will become effective contingent on the provision of debt relief to ensure that Greece's economic situation is sustainable.

Main elements of the staff level agreement

The following section presents the main issues of the 3rd programme review, the progress in their implementation and what has been agreed for the short-term period ahead.

Projected 2017 primary surplus. The institutions shared the projection of the 2018 State Budget (expected to pass in the Hellenic Parliament on December 22 2017) for a 2017 primary surplus of 2.44% of GDP in Financial Facility terms, incorporating the social dividend of EUR1.4 billion that will be granted to low income persons, pensioners and the Public Power Corporation for the coverage of services of general interest. It should be noted that the projected 2017 primary surplus is well above the respective programme target of 1.75% of GDP.

NPLs. The reduction of the NPLs is among the central issues of the 3rd Economic Adjustment Programme as it will critically affect the upcoming stress tests for Greek banks and the potential need for fresh capital injections. During the previous two programme reviews, a number of measures were legislated towards this direction: liberalization of the servicing & sale of NPLs, modernized insolvency frameworks for household & corporate debts, out-of-court workout legislation to facilitate corporate debt workouts bypassing time-consuming judicial procedures and adoption of operational targets agreed by the banks and the SSM to reduce NPEs by 40% by 2019.

Under the 3rd review, the following additional steps were taken:

- Launch of electronic auctions. The first electronic auctions took place on November 29th and their number will gradually increase with an aim to reaching 18,000 by the end of 2018. According to press reports the average price will be in the area of EUR150 thousand. At the same time, physical auctions at the competent courts will gradually decrease so that by the end of 2018 around 90% of all auctions will be carried out electronically.

[1] According to Declan Costello, European Commission's Mission Chief to Greece, out of a total of 110 prior actions attached to the 3rd programme review, around 1/3 has so far been completed. However, he clarified that many of these items are just formalities that will easily be resolved.

- Changes in Law 3869/2010 ("Katseli Law"). According to press reports, it was agreed that the bank secrecy will be lifted and preventive audit will be conducted to the assets of anyone applying for protection under Law 3869/2010 right from the outset of the procedure so that strategic defaulters will be detected and excluded.
- Protection of notaries. After a number of violent incidents at courts during auctions, it was decided that the blocking of auctions will be ex-officio prosecuted so that notaries will not have to file a lawsuit themselves. Legislation is pending.
- Independent Credit Assessment Authority. According to press, legislation for the establishment of an Independent Credit Assessment Authority is to be voted by the end of the year. The new Independent Authority will assess the creditworthiness of citizens and assign them a "score" on the basis of their debts not only to banks but also to the State. Under certain circumstances, this score will be disclosed to other stakeholders who may be interested in doing business with this citizen, including suppliers and lessors.

Energy sector. Reforms in the energy sector – and especially those pertaining to the Public Power Corporation (PPC) – constitute yet another area where progress is a pre-requisite for the completion of the review.

- **Divestment of PPC units.** Negotiations between the Greek government and the European Commission Directorate General for Competition have borne fruit and an agreement has been reached regarding the lignite-fired PPC units that will be divested, which are: Megalopolis 3, Megalopolis 4, Meliti 1, the license for the construction of Meliti 2 and the quarries of these units. Additionally it was agreed that the market test will be conducted in December under the surveillance of the European Commission while the call for the expression of interest may take place even before the end of this week. The market test will last one month and will be followed by a revised proposal by the Greek side which will incorporate the comments made by the investors who will participate in the market test. Then, by end of March 2018 the European Commission will issue a decision, which will render the divestment of the lignite-fired units legally binding and in May or June 2018 the tender will be launched. The whole procedure is expected to be concluded by the end of 2018. It should however be noted that at this stage a number of matters remain unresolved including a more detailed timetable for the divestment, the treatment of existing loans and contracts of the units that will be sold and the obligations of the investors vis-a-vis these units' personnel, which in total amounts to 1,300 employees. To appease the concerns of local communities who strongly object to the deal, the Minister of Energy George Stathakis will reportedly meet their representatives after the Christmas recess.
- **Sale of 17% of PPC.** The HRADF is to sell its 17% stake in the PPC possibly through the issuance of a convertible bond. The procedure is to begin in June 2018, once the picture around the divestment of the lignite-fired units is clearer. The 2018 State Budget foresees revenues in the area of EUR100 million in 2018 from this sale.
- **Public Gas Corporation (DEPA)**. As of January 2018 all customers will have full ability to choose their own gas supplier. Nevertheless, according to the institutions, in order to boost competition in the market further, the incumbent DEPA is to decrease its stakes in the gas supply companies (EPA). To this end, the Greek side has proposed the sale of the stake of DEPA in the Thessaloniki-Thessalia EPA and the increase of its stake in the Attica EPA, in order for it to keep its position in the Attica retail market. Although initially the institutions had suggested DEPA reduce its stakes in both the Thessaloniki-Thessalia and Attica EPA to a maximum of 33% in each, according to press reports, they might eventually accept the Greek proposal. Once this issue has been clarified, a tender will be launched for the sale of 65% of DEPA to a strategic investor in March 2018. The 2018 State Budget foresees revenues in the area of EUR250 million in 2018 from this sale.
- **Hellenic Petroleum (HELPE).** A tender for the sale of c. 35% of HELPE is to be launched in March 2018. HELPE's current shareholders are Paneuropean Oil and Industrial Holdings S.A. (45.5%), HRADF (35.5%), institutional investors (11.0%) and private investors (8.0%). According to press reports, the tender may also include the sale of a stake by Paneuropean Oil and Industrial Holdings S.A. so that the strategic investor acquires 51% of the company and gains control of the management. The 2018 State Budget foresees revenues in the area of EUR500 million in 2018 from this sale.

Quorum for first-degree union strikes. It was agreed that the quorum for first-degree trade unions to vote on a strike should be increased to 1/2 of trade union members from 1/3 currently. The relevant legislation is pending.

Pensions. The Greek authorities and the institutions reportedly agreed that all applications for main and auxiliary pensions that were submitted in 2016 as well as 30% of those that were submitted in 2017 must be recalculated and processed according to the new benefit rules (Law 4387/2016) by March 2018. By June 2018 this procedure must be completed for all pending pensions.

Benefits. The family benefits are to be reformed with the adoption of a single child allowance for all families with children. The allowance will start from c. EUR 60 per month and will increase based on the number of children and income criteria. With regard to disability benefits a new disability certification scheme must be finalised in January 2018 and implemented nationwide by May 2018.

Items transferred to the 4th programme review

At this stage it is our understanding that a number of issues that were included in the conditionality of the 3rd review will most likely be transferred to the next one. A clearer picture on the conditionality of the 4th programme review will be gained once the compliance report of the current review is prepared, most probably in January 2018. As regards the timetable, as things stand, it is expected that the next review will be completed by June 2018. The items that will likely be transferred to the next review are:

- A decision pertaining to the adoption of a fiscal package enacted in May 2017 but which would enter into force as of 2019[1]. This package provides adequate guarantees to the achievement of the fiscal targets in the medium term in view of the divergences in projections between the European institutions and the IMF. According to European officials, even if the Stand-By Arrangement for Greece is not activated, the agreed measures will still have to be implemented.
- Privatisations: establishment of the Public Holdings Company, appointment of BoD members to HCAP subsidiaries, completion of pending items for the financial closing of the concession of Hellinikon, submission for clearance of the new policy for toll pricing for Egnatia motorway and its vertical axes, completion of the sale of the Port of Thessaloniki (OLTH), submission of binding offers by the preferred investors for the acquisition of 66% of DESFA.
- Property taxes: alignment of property tax assessment of zonal values with market prices
- Reforms in the public administration

Post-programme period

As the completion of the 3rd Economic Adjustment for Greece approaches its completion (August 2018), focus shifts to the post-programme regime for Greece. In late September 2017, during a visit in Athens, Eurogroup President Jeroen Dijsselbloem claimed that there would be some kind of post-programme surveillance as in all countries that carried out economic adjustment programmes. According to European sources, the post-programme period would entail the obligation to: attain the agreed primary surplus targets of 3.5% of GDP over the medium term, complete the agreed structural reforms and not backtrack from already implemented ones, complete the agreed privatisation programme and adopt a development strategy based on technical and economic assistance by the European Union. With regard to the cash-buffer that Greece must have built by August 2018, the Greek government has reportedly expressed the intention to proceed to 2 or 3 more bond issues, namely a 7-year bond in February followed by a 3-year and a 10-year bond later on, to secure funds in the area of EUR 6 billion by the end of the programme. These funds along with c. EUR 9 billion ESM funds will provide a cash buffer for the post-programme period, which will help keep interest rates at acceptable levels.

A critical parameter of the post-programme period will be the medium-term debt-relief measures, which may be linked to the implementation of reforms. In any case, at this point, no further talks on debt relief are to take place not least because according to the May 2016 Eurogroup, a possible second set of measures (on top of the already agreed short-term ones) will be adopted, if needed, after the successful implementation of the 3rd programme by Greece. This position was re-affirmed after the December 4 Eurogroup by the ESM Managing Director Klaus Regling who added that the decision will be largely based on the Debt Sustainability Analysis that will be conducted at the end of the programme. On the subject, Euroworking Group President Thomas Wieser had stated in September that if debt relief is deemed necessary, it will be implemented after the completion of the programme with parts of it being implemented one-off and others, such as the return of SNP and ANFA profits, gradually. As regards the potential redemption of IMF loans with ESM ones, to the extent that it reduces Greece's debt cost it would be welcome by the IMF and could be discussed in the context of debt relief.

Timeline until the completion of the 3rd Economic Adjustment Programme

- December 2017 – early January 2018: implementation of all remaining 3rd review conditionality
- 11 January 2018: Euroworking Group asserts the fulfillment of the 3rd review conditionality and prepares compliance report
- 22 January 2018: Eurogroup politically endorses the closing of the 3rd programme review
- Late January – early February 2018: disbursement of next loan tranche (c. EUR5.5bn)
- February 2018: Initiation of stress tests for Greek banks
- February 2018: Potential decision by IMF BoD regarding the activation of the Stand-by Arrangement for Greece
- May 2018: Release of stress tests' results
- June 2018: Potential completion of all programme conditionality
- August 2018: Completion of 3rd Economic Adjustment Programme

Conclusion

Taking into consideration the progress made in the 3rd programme review as well as the good climate under which this review was carried out so far, it is our view that the review will be completed in January 2018 as planned. Further down the road we believe that the political agenda of the government is in alignment with the successful completion of the programme in August 2018 which is also the desire of the European institutions that appreciate the efforts on behalf of the Greek side and appear willing to help the country stand on its feet. Internally, resistance to reforms is milder than in the past whereas the main opposition party is explicitly pro-reform. Therefore, we see no major risks in the period ahead as regards programme implementation.

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