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The Road to Recovery: Are Greek banks able to finance Greece's economic recovery? [1]

1. Introduction

The question dominating the public dialogue in Greece these days is whether the conditions are in place for the economy to return to a path of strong and sustainable economic growth. A year after the country signed its third Adjustment Programme with European partners, many wonder whether the steady and timely implementation of the reforms and fiscal consolidation measures contained in the agreement alone is enough to ensure that happening, or additional initiatives are necessary.

For an economy plagued by a multi-year, double-dip recession, record unemployment, anemic investment and high public debt, a return to growth should be the main priority of economic policy, the targeted cure for the economic malaise. Just as importantly, it is a key prerequisite for the program's success.

However, the road to recovery hinges on several critical pre-conditions being met. Perhaps the most important of all is the ability of Greek banks to provide the credit needed to support economic growth. Will Greek banks have the financial strength, liquidity, capital and risk appetite to finance the recovery cycle of the Greek economy?

The answer depends on how Greece -- and the Greek banks -- navigate five key challenges ahead. Namely:

- Restoring normal liquidity conditions.
- Successfully managing a large stock of bad and problematic loans.
- Diminishing official sector interference in banking operations.
- Tackling the sweeping, transformational changes now gripping the European banking sector as a whole.
- Restoring positive Credit demand growth.

These challenges critically affect the ability of the Greek banks to deliver sustainable profitability and grow their business, but also seriously complicate strategic decisions, priorities, operating and business models and risk management. This article aims to offer comprehensive answers to those questions, thereby assessing the current shape of Greek banks and, consequently, their ability to fund growth in the immediate and longer-term future; it concludes with policy suggestions.

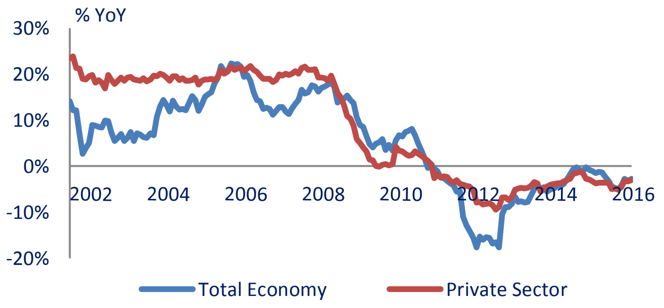
[1] The author wishes to thank Dr. Tassos Anastasatos, Eurobank's Deputy Chief Economist for his valuable contribution.

2. A creditless recovery?

All international organizations, including the International Monetary Fund, are currently forecasting a resumption of economic growth in Greece from 2017 onwards. Yet, credit expansion to the private sector remains in negative territory.

According to the latest data available at the time of writing, bank lending (Including to the General Government) shrank at an annual rate of 2.7% in July 2016, further extending a roughly five year-long downtrend. Lending to households and corporates in particular was even worse, shrinking at a 3.1% rate year-on-year in July 2016 (Graph 1).

Graph 1: Credit to Total Economy & Private Sector, YoY Rates of Change, Greece, 2002 - 2016



Source: Bank of Greece, Eurobank Research

Research shows that instances of a creditless recovery are rare in world economic history -- and when they do happen, tend to be associated with very weak and halting upturns. This becomes even more critical factor in Greece because it is combined with high real lending rates and deflationary trends. In Greece, where the banking sector plays a pivotal role in funding economic activity, it is hard to overstate the importance of the Greek banks. An estimated 97% of total outstanding household and corporate debt originates from the Greek banking system.

Eurobank's own economic research confirms that point. Our analysis shows that for every percentage point increase in Greek bank lending, Greece's economy responds with a 0.35% increase in real gross domestic product after six quarters.

Of course, equilibrium in the market for loanable funds depends on both demand and supply. Credit demand depends on factors such as the level of GDP and rate of real economic growth, interest rate cost, economic climate and expectations, inflation and the rate of unemployment. Hence, credit demand should be expected to increase along with the forecasted normalization of economic conditions and return to economic growth in 2017. However, if credit supply is seriously constrained, it will be unable to meet this demand and thus it is likely to limit economic growth prospects.

If bank lending proves weak, could financing for the recovery come from other sources? One could argue that the international capital markets could theoretically be an alternative source of funding for corporate and other economic entities. However, there are only a handful of major Greek companies and public utilities that have the required qualifications, size and credit rating today to borrow internationally, even assuming that global capital markets open up for Greek risk. Therefore, it seems that this is not a materially significant option for the future funding of the economy.

3. Coping with a liquidity squeeze

One of the biggest challenge facing Greek banks right now is the **tight liquidity conditions**. The liquidity squeeze mainly stems from the substantial funding gap between outstanding loans and deposits and the sluggish deposit recovery. The problem is compounded by the limited access Greek banks have to the international capital markets. These twin problems have forced banks to become heavily dependent on the Eurosystem – ECB and the Bank of Greece- for funding.

In my view, the return of Greek banks to the international debt markets is likely to proceed in tandem with the return of deposits to the Greek banking system. For that to happen, it is of paramount importance that the Greek government pursues a set of policies that improve Greece's policy credibility, investment climate and market confidence.

Note that, as recently as 2013-2014, Greece's improving credibility and market confidence in the prospects of the Greek economy allowed Greek banks to raise more than €5 bn of liquidity via debt issuing from international markets. Furthermore, around €17 bn of domestic resident deposits returned to the banking system over the period July 2012-July 2014, while banks were also able to raise billions of euros in fresh private equity through a recapitalization process.

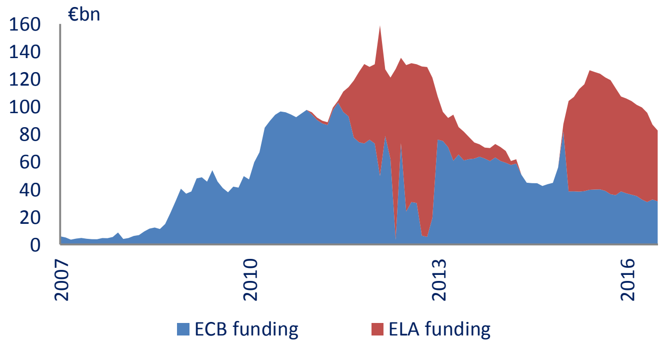
Since the beginning of the crisis, the Greek banking system has lost c. €124 bn of total deposits from their peak levels – a staggering 45% decline. Relative to the size of the economy, that equates to ca 70% of current GDP, one of the worst global performances ever.

Due to capital controls, as well as lingering economic and political uncertainty, bank deposits have remained stagnant for months. However, during the second quarter of 2016 (April – July), there is some evidence of deposit repatriation into the banking system with ca €2.8 bn returning, ca €1.8 bn from the Government and ca €1bn of corporate deposits. This is a positive development, especially if this trend continues in the following quarters.

Overall, the current liquidity conditions in the Greek banking system are as follows:

- As of July 2016, total deposits and bank repos stood at €157.2 bn, against total loans at €222.4 bn. Thus, there is a funding gap of approximately €65 bn.
- Greek banks' dependence on Eurosystem funding remains at very high levels, albeit reduced from the 2015 peak (Graph 2): at €78.5 bn in August 2016 (according to the latest Bank of Greece data) , with €48.9 bn of that total drawn from the Bank of Greece's Emergency Liquidity Assistance (ELA) facility, and the rest from the European Central Bank. Over the medium term, Greek banks are obliged to eliminate their ELA borrowing, and reduce their total borrowing from the ECB to approximately €25 bn, based on current ECB rules.

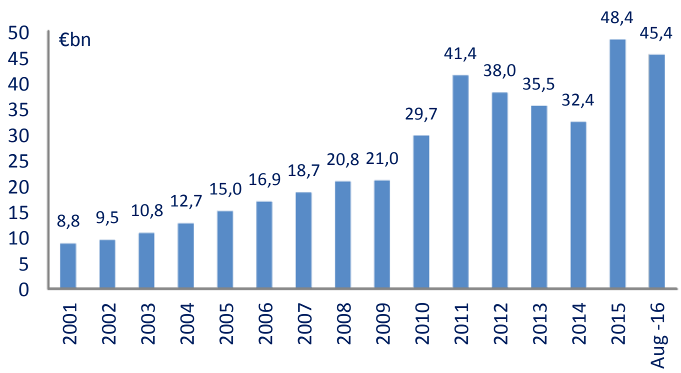
Graph 2: Eurosystem (ECB & ELA) Funding of Greek Banks, 2007-2016



Source: Bank of Greece

- The total amount of banknotes in circulation in Greece (August 2016) remains at extremely high levels at €45.4 bn (equal to 27% of GDP vs a 9% average in the Eurozone). To put that in context, before the crisis, the average stock of banknotes in circulation in Greece was €20 bn. (Graph 3)

Graph 3: Banknotes in circulation, Greece, 2001-2016

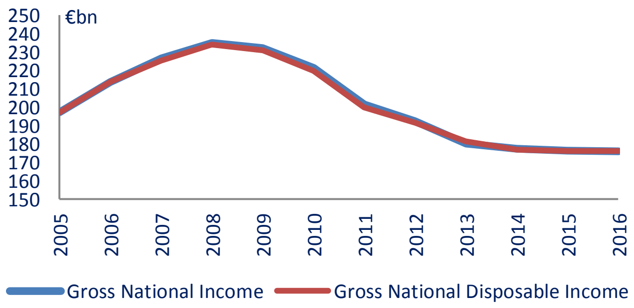


Source: Bank of Greece

- A large number of mid-sized and large corporates transferred their cash reserves abroad before the imposition of capital controls last year. In addition, it is highly likely that they are not repatriating their proceeds from export activities. Total corporate deposits now stand at €15 bn compared to €38 bn before the crisis.

- Gross national income continues to shrink and gross national disposable income remains stagnant (Graph 4). Substantial additional tax charges recently imposed by the Greek government are mainly being funded through a draw down in savings, further reducing, ceteris paribus, the deposit base.

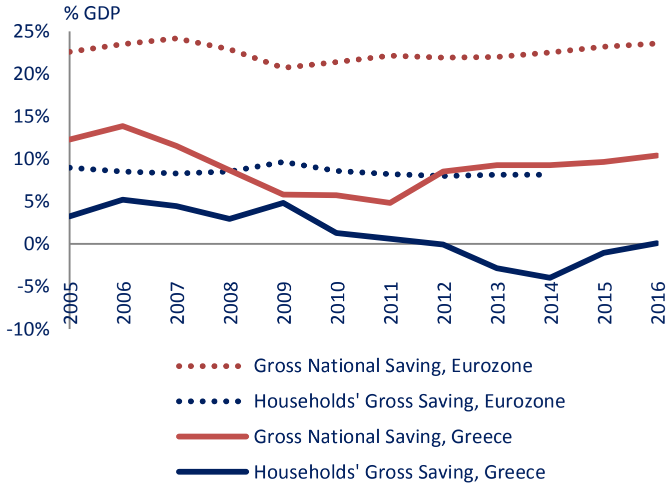
Graph 4: Gross National Income & Gross National Disposable Income, Greece, 2005-2016



Source: Ameco

- Gross national savings have collapsed, dropping in 2015 to 9.7% of GDP from a pre-crisis peak of 16.4%, and compared to an average of 23.2% in the Eurozone today. Household gross savings are currently negative (at -1% of GDP), compared to 4.8% before the crisis and a current average of 8.4% in the Eurozone (Graph 5). In order to maintain a certain standard of living, households, ceteris paribus, are in effect gradually depleting their savings and liquidating other real and financial assets.

Graph 5: Gross National Saving & Households' Gross Saving as % GDP, Greece & Eurozone, 2005-2016



Source: Ameco, Eurobank Research

- The maintenance of capital controls seriously hinder the process of orderly restoring sound liquidity conditions. Recent liberalization initiatives are in the right direction and would help accelerate the return of deposits, mainly "bank notes under the mattress", into the banking system. However, the full lifting of capital controls will have to go hand by hand with the restoration of confidence.

- Domestic credit expansion remains negative, as mentioned above (end of July at -2.7% yoy, -3.1% yoy for private sector); the same is true for foreign capital inflows (i.e. net foreign direct investment at – €260 mn in 2015). With both credit and foreign capital inflows shrinking, the traditional money multiplier effect does not work as an accelerator for deposit generation.

In my view, and based on my own estimates, if market confidence and policy credibility improve considerably and risk premia start declining rapidly, approximately €25 bn of deposits could return to the Greek banking system over an estimated period of 18-24 months. That estimate includes €10 bn worth of bank notes now being kept outside the banking system, €10 bn in corporate deposits currently placed abroad and €5 bn in private deposits abroad that might be repatriated or else return to the banking system through asset switching. Altogether, that is more than one-third of the funding gap Greek banks need to cover. Therefore, we need additional initiatives to further boost liquidity and restore sound local liquidity conditions.

In addition, in an improving macro, political and market environment, increased access to the international capital markets for unsecured debt and other assets could provide Greek banks with additional liquidity via debt issuance between €5 bn and €8 bn during the same 18 to 24-month period.

It is worth noting that Greek banks' access to international capital markets is gradually improving, at least for high quality collateral. In the last few months, Greek banks have been able to repo roughly €20 bn using mainly high quality EFSF paper and covered bonds as security. However, the global financial markets are not yet open for unsecured Greek debt, which is critical for improving liquidity.

Ultimately, market access for the Greek banks depends, to a great extent, on external factors not directly controlled by the banks themselves. It mainly hinges upon restoring market confidence, the credibility of economic policies and the Government's commitment to reforms. In other words, it is a political issue rather than a commercial one.

The government has to convince international markets that it intends to comply with Greece's reform program, thereby providing the basis for a sustainable economic recovery, fiscal sustainability, financial stability, a complete lift of capital controls, and promoting growth and investment. As long as the markets are not convinced, risk premia remain excessively high, especially because and Greece's implementation track record is weak. In such a case, Greek banks will continue to face a liquidity challenge and, thus, will not be able to support investment and economic growth in Greece.

4. Managing the stock of bad loans

A second major challenge Greek banks are facing today is the efficient management and the orderly substantial reduction of the huge stock of **non-performing loans.**

Greek banks are gearing up to tackle a major challenge they can no longer underestimate: the enormous stock of troubled and bad loans currently on their books. At roughly € 115 bn at group level, based on the NPEs definition, they equal to more than half of the country's GDP (EU average 5.7%).

Taking into account sluggish economic growth, high interest rates, capital controls and limited access to international markets, Greek banks can realistically aim at reducing troubled loans by at least € 10 bn per year over the next years without excessively squeezing NPE asset prices via forced sales. The target can easily be overshot if GDP growth and financial market conditions improve substantially.

Reducing the NPEs stock hinges critically upon sustainable growth, job creation, declining risk premia and interest rates as well as full lifting of capital controls and regained access to wholesale funding markets. These would clearly lead to improved corporate turnover, personal income and property prices as well as lower debt servicing cost and narrower bid/offer spreads for NPE assets. The latter constitutes a key precondition for the creation of an active secondary market for NPEs, which would be instrumental in improving default and re-default rates.

There are no easy solutions to Greece's huge NPEs problem. The country's four systemic banks have made use of recent legislation and created their own internal "bad banks" units. However, the buildup of bad loans has not yet been reversed. This points to the need for a strategic shift rather than kicking the can further down the road by merely extending interest and principal payments. The current very low curing rates and the high re-default rates support this argument. Greek banks should use all available tools and methods for viable restructuring solutions, with a dynamic model of loss allocation, debt forgiveness and write offs.

The necessary ammunition is already in place. Greek banks have piled up a stock of more than € 57 bn provisions against NPEs, while troubled loans are more than 60%-65% collateralized, mainly with real estate assets. In addition, they run a healthy annual PPI of € 4.3 bn (in 2015), which is a sizable capital buffer, along with strong capital positions, following three successful recapitalizations and stress test exercises. The challenge for Greek banks today is not capital adequacy but a strong management resolve, along with a comprehensive plan and the proper restructuring and bankruptcy framework, in order to use effectively the substantial stock of provisions and collaterals to clean up NPE portfolios. Pressure from regulators and shareholders are mounting to orderly reduce the NPEs stock and, for this purpose, annual targets and indicators are being set and monitored.

Failure to do so would fuel uncertainty over capital strength, keeping market valuations at very low levels, discouraging investors, delaying access to capital markets, tying up valuable liquidity, forcing regulators to impose higher minimum capital ratios and impairing the ability of banks to fund the economy.

We need an effective NPE resolution process and we need it fast.

Some important steps in the right direction have indeed been made recently. The Greek parliament passed landmark legislation that dramatically improves the legal and institutional framework for managing troubled loans. More needs to be done to improve bankruptcy and pre-bankruptcy procedures, which remaining excessively time consuming and protecting mainly the interest of debtors. For the first time ever, Greek law provides for licensing loan servicers and/or the sale of performing and non-performing loans to qualified third parties. However, in the areas of regulation and tax policy there is a need to facilitate the write-off of non-collectable loans, make effective use of the debt-to-equity conversion tool as well as reduce delays and the backload of cases in the judiciary, by expanding out-of-court settlements and creating specialized courts and judges.

The current situation frequently incentivizes otherwise solvent individual borrowers and corporate shareholders to become strategic defaulters. Meanwhile, by keeping afloat non-viable companies, unfair market competition intensifies. At the same time, performing companies should not be overburdened with higher interest rates in order to cover the cost of keeping afloat problematic, non-viable companies.

In actively managing their portfolios of bad debt, Greek banks will have to balance efficiently the interests of different stakeholders, i.e. regulators, shareholders, depositors, investors, creditors, NPL companies, business competitors and the government. In addition, care must be provided for the employees of the problematic companies under restructuring, because they are the least to blame.

While regulators want to see the banks quickly reducing their stock of bad debts, their shareholders are naturally interested in getting top dollar for the assets marked for disposal. In that respect, they would be against a strategy of forced sales as a matter of principle. That may conflict with investors, both foreign and domestic, who are looking to pick up problem loans – or problem companies – cheaply. Taking into account the uncertainties surrounding the outlook of the Greek economy, foreign investors expect a high return on investment to compensate for the risk undertaken. Thus, there is currently a wide gap between bid and offer prices for NPLs, which hinders the creation of a market for the purchase and sale of such distressed assets.

As the restructuring of the Greek economy gathers pace, healthy competitors of troubled -- but viable -- companies will put pressure on banks to close them down. Moreover, any debt restructuring at problem companies may be seen by them as stoking unfair competition.

At the same time, domestic banks will likely face pressure from the government, unions and suppliers of troubled companies to rescue them at any cost in order to preserve jobs and the unsecured claims of suppliers.

There is an urgent need for new tools and policies to deal with strategic defaulters, so as to allow banks to take over problematic companies more quickly, by removing managers and shareholders who refuse to cooperate by contributing financially to restructuring or block other investors or creditors. Taxpayers and bank shareholders must not end up paying for the restructuring costs of indebted companies to the benefit of existing shareholders. The latter must pay the bill to stay involved.

Failure to tackle the huge stock of NPEs in a swift and orderly manner would seriously hamper ongoing efforts to put the banks back on a solid footing and the economy on a sustainable recovery path.

There is little doubt that Greek banks have recently accelerated their efforts. They set detailed annual NPEs reduction targets, completed the technical infrastructure work and suitable staffing requirements. Now, they need time and better regulatory, macro and liquidity conditions to get the job done. Greece's banking sector has the required capacity and managerial resources to meet the challenge. Massive forced sale of NPEs under distressed prices would do more harm than good in the prevailing adverse economic environment. Such a policy would certainly raise questions about banks' capital adequacy, fueling renewed deposit outflows, prolonging capital controls and curtailing market access. It would also raise serious questions about private capital availability for a new (fourth) bank recapitalization that would dilute and devastate current shareholders. Return to growth, reduction in risk premia and improved credibility of policies would certainly provide a more suitable environment for active NPE sales.

Having said that, Greek banks should make more active use of external NPL servicers -- as Eurobank and Alpha Bank have done recently via their cooperation with KKR and EBRD --, sell selectively long dated NPL assets and examine with no prejudice the possibility of jointly establishing a "bad bank" with the HFSF and private investors. That applies especially for common, larger NPL corporate exposures.

5. Meddling in management

Since the outbreak of the global financial crisis in 2007-2008, Greek banks have received substantial state aid in the form of government guarantees, capital injections and liquidity facilitation schemes. However, that aid has come at a price: **official sector meddling in how banks do business.**

Greek banks had to agree on a restructuring plan with the European Commission's competition authority and the Greek State. This includes reorganizing and downsizing of their operations, selling off mainly non-core and international assets and complying with a number of constraints on management and staff. Collectively, these restrictions have seriously impeded Greek banks' ability to effectively manage their balance sheets and grow their businesses.

Greek banks today are dependent on official sector support for their capital and liquidity needs in three main areas:

- Through a series of capital increases, Greece's four big banks have issued additional equity, some of which was bought by the HFSF over the last three years. Currently, the HFSF's total holdings in the four banks, valued at current market prices, amount to €1.25 bn. The Fund's direct equity stake in each of the four banks is as follows: Eurobank 2.54%, Alpha Bank 11.25%, Piraeus Bank 25.6% and National Bank of Greece 43%.
- Greek banks have issued so-called Pillar II bonds, which are senior debt obligations carrying a guarantee of the Greek State. These bonds are used to fund the banks via the ELA facility. The four banks have used Pillar II bonds to tap a combined €5.1 bn in system liquidity (August 2016 data - Eurobank: €2.0 billion, Alpha Bank: €3.1 bn, NBG: zero, Piraeus Bank: zero). These government guaranteed bonds, which constitute a very costly source of funding (all in costs over 3%), will be eventually cancelled, as banks gradually restore market access and deposit inflows accelerate and/or through the use of other eligible assets for accessing cheaper funding from the Eurosystem.
- Greek banks have issued perpetual preference shares bought by the Greek State, which will stop however counting as core capital from December 31st, 2017 and will at some point have to be repaid; Eurobank has €950 mn worth of preference shares outstanding, while NBG has converted them into equity in the last recapitalization. Piraeus Bank and Alpha Bank have fully repaid their preference shares.

As a consequence of State aid, Greek banks also face additional obligations and restrictions beyond those detailed in their respective restructuring plans with DG Comp.

These obligations include:

- Restrictions on fixed and variable remuneration of senior management.
- Obligatory representation of the Greek state and the HFSF on the Board of Directors.
- Appointment of a European Commission monitor to the board of directors and key board committees, tasked with overseeing business development, risk management and other essential business decisions.
- Signing an RFA with the HFSF, defining the degree and extent of the latter's intervention in banks' management decisions.

Since Eurobank and Alpha Bank did not receive additional state aid in the last capital raising that took place in the fourth quarter of 2015, they face lighter restrictions compared to Piraeus Bank and NBG. Nevertheless, all four banks must fully implement their restructuring plans no later than the end of 2018. Therefore, this is the earliest that Greece's systemic banks would be completely free from State, HFSF and European competition commission interference in their management decisions.

In this respect as well, restoration of market confidence, the credibility of economic policies pursued and commitments undertaken are key for restoring banks' access to international capital markets and for accelerating deposit repatriation into the domestic banking system. That would accelerate the return of sound liquidity conditions in the Greek market and the removal of state and official interventions in their management.

6. A changing European banking landscape

Looking beyond Greece's borders and the challenges stemming directly from the domestic economic crisis, Greek banks face additional headwinds from the rapidly changing landscape in the European financial sector. These headwinds are forcing Greek banks to reconsider and redirect their strategic priorities.

Though it may take years for the changes to play themselves out, the transformational challenges -- from new regulations to new technology -- facing Europe's banks will substantially reshape the sector from top to bottom. In the process, , market structure, business models, profitability and strategic priorities are bound to be affected.

The following are some key emerging trends and developments, which are currently forging a more competitive and challenging landscape for European banking:

- A prolonged period of deflation, negative interest rates and sluggish economic growth that adversely affects revenue generation, profitability and deposit gathering.
- Intense competition from emerging, mostly niche, non-bank financial entities (shadow banking), which are less regulated, enjoy considerable flexibility, specialization and lower operating costs.
- The growing role of capital markets in Europe -- which are still quite underdeveloped compared to the U.S. -- as an alternative channel to banks for depositors, investors and borrowers.
- Sweeping and costly regulatory changes aimed at enhancing banking supervision, prudential risk management, transparency and corporate governance.
- Growing restrictions in management and staff remuneration, aimed at aligning stakeholder interests and discouraging excessive risk taking.
- Stricter reporting and monitoring requirements from the ECB and the SSM, as well as tougher thresholds for capital, liquidity and leverage ratios that constrain profitability, growth and return on equity.
- Far-reaching technological innovation that is fundamentally transforming the operating and business models of banks and the channels for serving corporate, household and institutional clients. The Fintech phenomenon grows at an explosive rate, challenging the banks' status quo.
- New burden sharing rules on depositors and debtors in the case of a bank failure. All things being equal, these rules further encourage banking disintermediation by requiring higher core equity capital ratios and raising the cost of capital to banks.

All the above, ceteris paribus, would have a detrimental effect on economic growth and especially on investment.

Bureaucratic, hierarchical and heavy organizational structures currently exist in most banking institutions. Relatively inflexible processes and procedures, expensive staff and inflexible labor contracts, significant internal inertia and resistance-to-change attitudes, low internal transformation appetite and strong silos' structures and legacy issues, including business culture, all serve as obstacles to change. Overall, the above factors undermine banks' ability to compete effectively in the new banking and financial markets landscape.

In this challenging banking environment we should expect:

- Banks to further strengthen their capital base via additional capital increases, restructuring and downsizing.
- Banking disintermediation to accelerate significantly, intensifying competition. Then, the main challenge is: who would provide cheaper, comprehensive, quality client services via multiple channels.
- Local and cross-border mergers and acquisitions to pick up, as banks attempt to capture economies of scale, address possible capital shortfalls and dilute infrastructure

investment and regulatory costs. Consolidation in the industry is inevitable, as in Europe there is one bank per € 118 bn of GDP, compared to one bank per € 302 bn in the USA (PWC 2016 study).

- General focus on deposit gathering efforts, rather than on extending credit.
- Selling non-core assets and existing sub-optimal business activities.
- Possible cut back of riskier activities and credits with heavier capital charges.
- Further rationalization and streamlining of operating costs.
- Substantial investment in technology and transformation initiatives.

These significant changes, especially in technology, will gradually transform the European banking landscape and banks have to adapt and consolidate via a multi-paced transformation. Most significantly, these changes will also have a material impact on the strategic decisions, priorities, business development, operating models and planning of Greek banks, as the country slowly returns to more normal economic and market conditions and re-integrates into European markets. Banks need to be prepared for disruptive competition, especially if they delay to take up these transformation challenges. The biggest enemies of systemic banks today are inertia and underestimating the seriousness of the challenge.

7. Is Capital Adequacy an Issue?

After nearly eight years of heavy output losses , an unprecedented sovereign debt restructuring, repeated stress tests, and three successive capital increases, Greek banks are now among the best capitalized financial institutions in Europe.

In my view, Greek banks are in a position to deal effectively with adverse market conditions, while at the same time manage their stock of non-performing loans and finance economic growth.

Point of fact, as of the end of the second quarter of 2016, Greece's big four systemic banks had:

- Core tier I capital adequacy ratios averaging 18.3%, among the highest in Europe and well above the EU average of 12.5%.
- A substantial stock of provisions for non-performing loans totaling €57.4 bn at the group level, and a provisions-to-loans ratio of 24.9%, among the highest in Europe.
- High provisioning coverage ratios of both NPL and NPE portfolios, at 68.7% and 50.2%, respectively, among the highest in Europe.
- Pre-provision operating income of €4.2 bn in 2015 (and rising in 2016), which constitutes a strong annual buffer before capital is hit in the case of additional losses occurring.
- Between 60% and 65% of their total loan portfolios being collateralized, mainly with real estate assets valued at current depressed prices.
- Billions of euros in other valuable assets that could be sold or merged with third parties so as to create additional capital buffers, if needed.

In addition, the Greek banks:

- Have gone through three full stress tests in the last three years, the latest by the European Central Bank, which led to an additional €60 bn capital injection to cover even the most adverse economic or market scenario.
- Returned to operating profitability in the first quarter of 2016 -- the first time since 2010 -- and are currently generating internal capital.

Recently, the IMF took the position that Greek banks are not adequately capitalized. It claimed that the banks lacked the required capital buffers to deal effectively with the huge stock of NPEs/NPLs and, at the same, adequately finance a Greek economic recovery.

The IMF assessment is a bit surprising given that it has never carried out its own stress tests on Greek banks. The SSM, the Eurozone's official banking regulator that carried out the last exhaustive stress test and oversees the banks' business plans clearly disagrees, having publicly stated that Greek banks are adequately capitalized.

The only genuine risk factor that I can see would be one induced by an unexpected regulatory change. That would only materialize if the European Commission competition authority, or the SSM itself, suddenly changed the rules on deferred tax credits, negatively affecting the capital base of the Greek banks.

What is striking though in the IMF's recent assessment is that its own official forecast sees Greece's economy rebounding strongly in 2017 and beyond. If that is the case, then the Greek banks should see the pressure on bad loans ease, asset quality improve, and profitability grow. Hardly an adverse case scenario.

This brings us back to our central question and conclusion. Today, Greek banks have more than adequate capital structures to support economic growth and effectively reduce the large stock of bad loans.

8. Conclusion: Weathering the Storm, Planning the Next Day

This article argues that the main challenges facing the Greek banking system today are related to:

- Overcoming tight liquidity conditions and regaining access to international capital markets.
- Effectively managing and substantially reducing their stock of bad loans.
- Removing the fetters of the official sector that impede business development and growth.
- Adapting to a rapidly changing European banking environment.

The conclusion of the analysis is that Greek banks have more than adequate capital to simultaneously fund economic growth and effectively reduce the large stock of bad loans. However, I argued that the repatriation of deposits and the access to international financial markets hinges upon the Greek government demonstrating a convincing commitment to implementing the present stabilization programme as well as pro-market and pro-growth economic policies. Restoring market confidence in the Greek economy and promoting a sound business environment are a *sine qua non* for a Greek economic recovery.

Greece needs to undertake front-loaded, groundbreaking policy initiatives, which would impress international markets, open-up access and improve dramatically liquidity conditions in Greece. Such developments would lead to a substantial reduction of risk premia and interest rates, resumption of positive credit creation, significant repatriation of deposits and widening possibilities for Greek economic agents to raise debt and equity internationally on attractive terms.

Moreover, renewed Greek access to money and capital markets would enhance the negotiating power of the Greek government vis-à-vis official lenders and improve liquidity conditions, facilitating the financing of the economic recovery and promoting private investment.

These front-loaded initiatives should encompass a drastic reduction of tax rates and a crackdown on tax evasion along with an ambitious privatization agenda and aggressive liberalization of domestic product and services markets. Other important steps in this direction should include initiatives aimed at strengthening the banking sector's credibility and its ability to fund the economy, the lifting capital controls, administrative reforms in key areas of the public administration, such as the justice system, and the front-loaded implementation of measures enhancing the sustainability of public debt.

In order to further normalize liquidity conditions, a number of additional initiatives must be taken.

Initiatives to speed up the inclusion of Greece in the ECB's quantitative easing programs (PSPP and CSPP) and Targeted Longer-Term Refinancing Operations (TLTROs), which would be instrumental in substantially improve the country's credit ratings down the road.

An effective and just program for legalizing unreported income and wealth inside and outside Greece (without bearing the characteristics of a tax "amnesty", which could be detrimental for payments' culture), tax and other incentives to attract foreign capital flows and foreign direct investments.

Particularly helpful would also be a comprehensive and ambitious program of cooperation between Greek banks and international official financial institutions (EIB, EBRD, EIF and IFC) as well as with state-controlled European Development Banks (i.e. KFW) to provide financing, debt and equity to SMEs, infrastructure projects and small businesses.

Moreover, the government should draft a full plan for a front-loaded absorption of EU structural funds and the full use of the opportunities offered by the Juncker Plan, which could amount up to € 50 billion in the next three years. The government should also exercise moral suasion on Greek and multinational companies operating domestically to repatriate substantial liquidity maintained in foreign banks, as well as their proceeds from exports and other activities, which are estimated to exceed in total € 30 billion.

To wit, if the question is ***Can Greek banks help in financing Greece's economic recovery*?** Then the answer is ***Yes, if Greece and the Greek government can help its banks to recover by undertaking groundbreaking and convincing policy initiatives to improve credibility and market confidence, and to restore growth potential.***

Part of the problem is inadequate communication. The country, in my view, does not do enough to communicate effectively to international market, opinion makers and investors progress recorded so far, our commitment to reforms and why Greece could be an interesting and attractive investment opportunity. This is a serious shortcoming in a competing global environment.

In a juncture of multiple financial and political uncertainties globally, in Europe and in the region, we do not have the luxury of any more back and forth. We all have to cooperate and act effectively and swiftly. Time is not on our side.

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