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Summary

The Impact on the Greek Banking System from the Subordination of Greece in the EU/ECB/IMF Support Mechanism

- The impact of the subordination to the joint EU/ECB/IMF Support Mechanism compared to a default scenario
- The lines of defense of the Greek banking system
- IMF's interventions in Europe: it never proposes measures harmful to depositors
- On the contrary, it always sets the stability of the financial system as a high priority, exactly because it recognizes this as a crucial prerequisite of the economic stabilization efforts

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Executive Summary

The announcement by the Greek Government in 23/4/2010 that it resorts in the joint EU/ECB/IMF Support Mechanism for ensuring the refinancing of the public debt, spurred a renewed interest in the debate on the consequences of this decision for the economy in general and the Greek banking system in particular. The debate acquired a more definite context with the announcement in 2/5/2010 of the painful measures which were imposed as prerequisites for the provision of funding. The present study compares the economic and strategic consequences of the subordination of Greece in the EU/ECB/IMF support mechanism with the consequences of a default scenario. In addition, the impact of the resort to the support mechanism on Greek banks and depositors is explored.

The financial system has several lines of defense against any issues of liquidity or capital adequacy that could arise as a result of the crisis. The arsenal includes own initiatives relating to the lending policies, as well as the utilization of tools provided by the support framework set up by the Greek government and –most importantly- the Eurosystem and the decisions of the ECB for the acceptance of Greek bonds as collateral for the provision of liquidity to Greek banks. Furthermore, in 9/5/2010, the EU announced the disposition of €750 bn to countries facing difficulties and the –sterilized- purchase by the ECB of public and private debt. These measures lend support to the view that various national and European institutions have the ability to intervene in the secondary bond market and pressurize whoever bets in Greece's default or the destruction of the Euro, increasing their risk of losses. Finally, the Support Mechanism sets up another powerful tool, the creation of the Financial Stability fund (FSF). The FSF shields the capital adequacy of Greek banks and it will work complementarily to the existing tools which enhance liquidity.

The creation of the FSF is consistent with the high priority that the IMF always gives to the objective of ensuring financial stability. The study conducts a systematic investigation of cases of European countries in which the IMF intervened during the last decade. The problems which led countries in resorting to the IMF are described, as well as the measures of macroeconomic policy that accompanied the provision of funding. Emphasis is given on actions relating to the financial sector. As a first remark, the IMF's strategy in recent years is characterized by diversification across countries of the terms accompanying programs, so that these terms can flexibly adjust to the nature and causes of the problems facing each

country. In addition, the IMF now pays increased attention to the growth prospects of indebted countries, in order to enhance their debt repayment ability in the medium term. Next, the study explains how Greece's situation and structure of the economy differs from that of Argentina and, consequently, why a more appropriate basis of comparison should be the case of other European countries that resorted to the IMF. The problems which led these countries to the IMF vary widely among them. However, analytic presentation of those cases documents that the IMF never proposed measures with harmful consequences for depositors (e.g. restrictions in withdrawals or expropriation of deposits). On the contrary, the IMF insists in all cases on the close monitoring and enhancement of the capital adequacy and liquidity of banks. This happens exactly because it is recognized that defending the financial system's health is a crucial prerequisite for the success of the economic stabilization effort. This is also true for the case of Greece.

Table 1: Macroeconomic policy measures that accompanied the IMF interventions in Europe

	Fiscal Policy	Monetary Policy	Exchange Rate Policy	Structural Reforms
Serbia, March 2009	Reductions in wages & numbers of civil servants and public consumption, taxes on dividends, options, real estate and cars, preservation of investment and social protection expenditure, quarterly expenditure monitoring	Disinflation monetary policy (inflation targeting)	Managed floating	Improvements in tax administration, privatizations, restructuring & liquidation of public organizations, structural measures for reducing cost of launching entrepreneurial activity and increasing potential GDP
Latvia, December 2008	Reductions in wages & numbers of civil servants, hikes on direct and indirect taxes, taxes on real estate, broadening of the tax base, limitation of government guarantees, preservation of investment and social protection expenditure	Disinflation monetary policy	Maintenance of currency peg	Law of fiscal responsibility, facilitation of switch towards production of tradeable goods, restructuring of private debt
Hungary, November 2008	Reductions in wages & numbers of civil servants, limits on expenditure on social security, current needs and local government, taxes on real estate, low-pension earners were exempted from measures	-	-	Modernization of tax administration, FinMin delegates in line ministries, creation of fiscal reserves, programs budgeting
Ukraine, November 2008	Restraint of expenditure, minimum wage and pensions, taxes on energy, preservation of unemployment and solidarity benefits	Disinflation monetary policy (short term by monitoring narrow money supply, Long term by inflation targeting)	Managed floating, gradual lifting of capital controls	Reform of the tax law and the pension system, privatizations
Iceland, November 2008	Countercyclical fiscal policy for 2009, expenditure cutbacks afterwards, restraint in incomes policy, revenue increases	Policy rate at 18%, limits to access to credits from the Central Bank	Maintenance & stabilization of free float, capital controls in the short term	Medium term fiscal framework
Romania, May 2009	Reductions in wages & numbers of civil servants and public consumption, taxes on goods and real estate, preservation of unemployment and solidarity benefits	Sustainable reduction of inflation at 3,5% (±1%)	-	Restructuring of public services, new budget process, reform of tax administration
Turkey, May 2001	Hikes in indirect taxes and social security contributions, reductions of current expenditure, wages, subsidies to public enterprises, prices of goods & services, guarantees and procurements, preservation of social protection, broadening of the tax base	Operational independence granted to the Central Bank, monitoring of monetary aggregates in the short term, inflation targeting in the longer term	-	Improvement of transparency in budgeting, privatizations, sale of public land, motives to boost entrepreneurial activity and to attract FDI, opening up of closed markets

Table 2: Measures for the Banking system that accompanied the IMF interventions in Europe

	Bank Recapitalisation	Liquidity Reinforcement	Bank Reform	Surveillance	Guarantees	Restrictions
Serbia, March 2009	-	Yes	-	Yes	deposits	-
Latvia, December 2008	Yes, with own & government funds	Yes	Liquidations, bad bank creation	Yes	deposits	Deposits Withdrawal (Parex Bank)
Hungary, November 2008	Yes, with government funds	Yes	Yes	Yes	Interbank loans	-
Ukraine, November 2008	Yes, with own & government funds	Yes	Yes	Yes	deposits	international capital movements, early withdrawal of term deposits
Iceland, November 2008	Yes, with government funds	Yes	Bank Splits	Yes	deposits (in branches abroad)	Access to credits from the Central Bank, international capital movement etc.
Romania, May 2009	Yes, with own funds	Yes	-	Yes	deposits	-
Turkey, May 2001	Yes, with government funds	Yes	Liquidations, bad bank creation	Yes	deposits & loans	overnight borrowing, interest rates, risk undertaking

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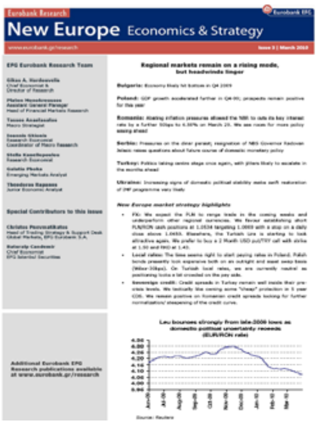
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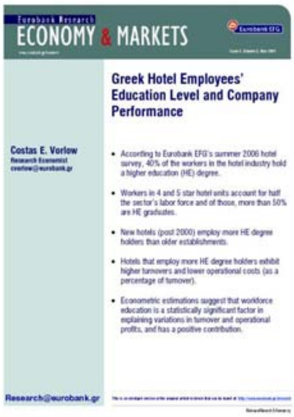
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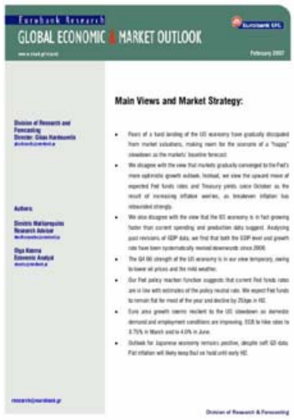
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