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

Written by:

Tasos Anastasatos
Senior Economist
Tanastasatos@eurobank.gr

The full version of the report was published by Eurobank Research on April 2010 in Greek only.
http://www.eurobank.gr/research
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>
<thead>
<tr>
<th>Country</th>
<th>Fiscal Policy</th>
<th>Monetary Policy</th>
<th>Exchange Rate Policy</th>
<th>Structural Reforms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Serbia, March 2009</td>
<td>Reductions in wages &amp; 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</td>
<td>Disinflation monetary policy (inflation targeting)</td>
<td>Managed floating</td>
<td>Improvements in tax administration, privatizations, restructuring &amp; liquidation of public organizations, structural measures for reducing cost of launching entrepreneurial activity and increasing potential GDP</td>
</tr>
<tr>
<td>Latvia, December 2008</td>
<td>Reductions in wages &amp; 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</td>
<td>Disinflation monetary policy</td>
<td>Maintenance of currency peg</td>
<td>Law of fiscal responsibility, facilitation of switch towards production of tradeable goods, restructuring of private debt</td>
</tr>
<tr>
<td>Hungary, November 2008</td>
<td>Reductions in wages &amp; 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</td>
<td>-</td>
<td>-</td>
<td>Modernization of tax administration, FinMin delegates in line ministries, creation of fiscal reserves, programs budgeting</td>
</tr>
<tr>
<td>Ukraine, November 2008</td>
<td>Restraint of expenditure, minimum wage and pensions, taxes on energy, preservation of unemployment and solidarity benefits</td>
<td>Disinflation monetary policy (short term by monitoring narrow money supply, Long term by inflation targeting)</td>
<td>Managed floating, gradual lifting of capital controls</td>
<td>Reform of the tax law and the pension system, privatizations</td>
</tr>
<tr>
<td>Iceland, November 2008</td>
<td>Countercyclical fiscal policy for 2009, expenditure cutbacks afterwards, restraint in incomes policy, revenue increases</td>
<td>Policy rate at 18%, limits to access to credits from the Central Bank</td>
<td>Maintenance &amp; stabilization of free float, capital controls in the short term</td>
<td>Medium term fiscal framework</td>
</tr>
<tr>
<td>Romania, May 2009</td>
<td>Reductions in wages &amp; numbers of civil servants and public consumption, taxes on goods and real estate, preservation of unemployment and solidarity benefits</td>
<td>Sustainable reduction of inflation at 3,5% (±1%)</td>
<td>-</td>
<td>Restructuring of public services, new budget process, reform of tax administration</td>
</tr>
<tr>
<td>Turkey, May 2001</td>
<td>Hikes in indirect taxes and social security contributions, reductions of current expenditure, wages, subsidies to public enterprises, prices of goods &amp; services, guarantees and procurements, preservation of social protection, broadening of the tax base</td>
<td>Operational independence granted to the Central Bank, monitoring of monetary aggregates in the short term, inflation targeting in the longer term</td>
<td>-</td>
<td>Improvement of transparency in budgeting, privatizations, sale of public land, motives to boost entrepreneurial activity and to attract FDI, opening up of closed markets</td>
</tr>
</tbody>
</table>
Table 2: Measures for the Banking system that accompanied the IMF interventions in Europe

<table>
<thead>
<tr>
<th>Bank Recapitalisation</th>
<th>Liquidity Reinforcement</th>
<th>Bank Reform</th>
<th>Surveillance</th>
<th>Guarantees</th>
<th>Restrictions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Serbia, March 2009</td>
<td>-</td>
<td>Yes</td>
<td>-</td>
<td>Yes</td>
<td>deposits</td>
</tr>
<tr>
<td>Latvia, December 2008</td>
<td>Yes, with own &amp; government funds</td>
<td>Yes</td>
<td>Liquidations, bad bank creation</td>
<td>Yes</td>
<td>deposits</td>
</tr>
<tr>
<td>Hungary, November 2008</td>
<td>Yes, with government funds</td>
<td>Yes</td>
<td>Yes</td>
<td>Interbank loans</td>
<td></td>
</tr>
<tr>
<td>Ukraine, November 2008</td>
<td>Yes, with own &amp; government funds</td>
<td>Yes</td>
<td>Yes</td>
<td>deposits</td>
<td>international capital movements, early withdrawal of term deposits</td>
</tr>
<tr>
<td>Iceland, November 2008</td>
<td>Yes, with government funds</td>
<td>Yes</td>
<td>Bank Splits</td>
<td>deposits (in branches abroad)</td>
<td>Access to credits from the Central Bank, international capital movement etc.</td>
</tr>
<tr>
<td>Romania, May 2009</td>
<td>Yes, with own funds</td>
<td>Yes</td>
<td>-</td>
<td>Yes</td>
<td>deposits</td>
</tr>
<tr>
<td>Turkey, May 2001</td>
<td>Yes, with government funds</td>
<td>Yes</td>
<td>Liquidations, bad bank creation</td>
<td>Yes</td>
<td>deposits &amp; loans</td>
</tr>
</tbody>
</table>
References


Iceland (2008), Letter of Intent and Technical Memorandum of Understanding, November 15.


Latvia (2010), Letter of Intent and Technical Memorandum of Understanding, January 22.


Eurobank EFG Economic Research

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

- **New Europe: Economics & Strategy**
  Monthly edition on the economies and the markets of New Europe

- **Economy & Markets**
  Monthly economic research edition

- **Global Economic & Market Outlook**
  Quarterly review of the international economy and financial markets

Subscribe electronically at http://www.eurobank.gr/research

---

Economy & Markets: The Impact on the Greek Banking System from the subordination of Greece in the EU/ECB/IMF/Support Mechanism