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Greece: Overview of latest domestic developments & key deliverables for 1st programme review

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Progress made in the first round of official talks in the context of the 1st programme review; discussions likely to resume next week

At a press briefing earlier this week, European Commission spokesman Margaritis Schinas acknowledged that the first phase of discussions between the Greek government and official creditors in the context of the 1st programme review was "constructive" and that "substantial progress" was made on several issues. He pointed out that the EU Commission will do the best in its power towards a swift conclusion of the review calling all involved parties to cooperate closely. Along similar lines, the ECB President Mario Draghi stressed during his recent hearing before the European Parliament that it is imperative that the review be finalized as early as possible noting though that its reliability is just as important. Along these lines, Greece's Central Bank Governor Yannis Stournaras cautioned that the timely conclusion of the review is crucial for strengthening market confidence towards the Greek economy and encouraging a gradual return of bank deposits. According to press reports, technical teams representing official creditors are expected to arrive in Athens early next week and, provided that discussions evolve as planned, after a fortnight hiatus the heads may return a few days later. Responding to a relevant question before the European Parliament (MEP) earlier today (February 17th), EU Commissioner Pierre Moscovici said that discussions on a technical level between the Greek authorities and official creditors are "on the right track" with a view to reaching a staff level agreement by Easter. However, the Commissioner avoided to specify whether he meant the Catholic (March 27th) or the Orthodox Easter (May 1st).

Greece's 1st programme review- key deliverables

In what follows we provide an updated analysis on the required prior actions for the successful completion of the 1st programme review.

Overhaul of the social security pension system

According to recent remarks by Poul Thomsen, Deputy Director of the IMF's European Department, Greece's pension system is deemed "unaffordably generous" and major savings are required through, inter alia, a cut in pensions, to safeguard the long-term viability of the system.[1] The IMF official pointed out that the overhaul of the social security pension system and the provision of further debt relief –the two key preconditions for the Fund's financial involvement in the new bailout programme- are both of crucial importance for securing the long term sustainability of Greece's public debt. On its side, the Greek

[1] Echoing recent comments by IMF Managing Director Christine Lagarde, Poul Thomsen wrote on the Fund's blog last week that "the Greek budget needs to transfer some 10%-of-GDP to cover the gaping hole in the pension system, compared to a European average of some 2.5%-of-GDP".

government has set a red line on further cuts in existing pensions insisting that they have a broader social function as they often constitute the sole household income. In an effort to reach a compromise on that issue, the Greek side is reportedly mulling certain amendments to the social security pension plan earlier submitted to official creditors. According to the same sources, these include, inter alia, the following:

Provision of a lower national state guaranteed pension.[2] Provision of a lower national state guaranteed pension of €360/month to pensioners with 67 years of age or above provided that they have covered at least 20 years of insurance, in line with official creditors' proposal.[3] As a reminder, the government's initial plan reportedly envisioned the provision of a €384/month pension to pensioners with a minimum of 15 years of insurance. Yet, the Greek government insists on granting a national state guaranteed pension, albeit lower than €360/month, to pensioners with 67 years of age and at least 15 years of insurance.

Establishment of a ceiling for main & multiple pensions. Establishment of a ceiling no higher than €2.000/month for the main pension compared to €2.773/month currently and €2.304 (=€384*6) initially proposed. In addition, multiple pensions should not exceed €3.000/month vs. €3.600/month currently.

Downward revision in replacement rates. Downward revision in initially proposed pension replacement rates so as to ensure a closer link between contributions and benefits, in line with official creditors' proposal.

Increase in social security contributions accompanied with a cut in higher auxiliary pensions. Increase of 0.5% in social security employee contributions compared to 1.5% initially proposed (1% for employers + 0.5% for employees) as a means to avert a further reduction in existing main pensions and a horizontal cut in supplementary pensions. Under such a scenario, the Greek government reportedly estimates that it could secure savings of c. €170mn/annum, less than €550mn/annum initially projected. With €1.1bn having purportedly been covered already through relevant measures that have been penciled in the 2016 Budget, the remaining amount required for securing targeted savings of c. €1.8bn (or 1%-of-GDP) in 2016 through the overhaul of the system could reportedly be covered mainly via a cut in relatively high auxiliary pensions (>€150-€170/month). Though the IMF reportedly opposes any increase in social security contributions on the basis that it would harm business competitiveness, the European Commission seems willing to accept a 0.5% rise under the condition that it will be on a temporary basis (for up to 2 years).

Reduction in pension lump sum payments. Reduction of c. 10%-20% in pension lump sum payments. On their side, official creditors insist on the annulment of those payments considering the country's dire financial condition.

Imposition of a tax on certain bank transactions. As a counter proposal to official creditors' suggestion for the implementation of the zero deficit clause on supplementary funds (projected revenue of c. €300/annum), the Greek government is said to consider alternative sources of revenue, including, inter alia, the exploitation of the property of ETEA (Supplementary Insurance Unified Fund) and the imposition of a tax on certain bank transactions (e.g., payment of electricity, water supply and telephone bills).

Fulfilment of agreed fiscal targets for years 2016, 2017 and 2018

Official creditors are said to be concerned that some of the measures already approved by Parliament have either not been properly implemented or their projected fiscal impact has been overestimated. Against this background, the IMF projects that the Greek side has to adopt additional measures – beyond those already agreed under the existing MoU conditionality- so as to secure fulfillment of the agreed fiscal target for a primary surplus of 0.5%-of-GDP in FY-2016, 1.75%-of-GDP in FY-2017 and 3.5%-of-GDP in FY-2018. As per the same sources, the Fund anticipates a fiscal gap up to 4-5%-of-GDP to arise cumulatively by FY-2018. On its side, the EU Commission reportedly adopts a relatively optimistic stance arguing that any fiscal gap for the period up to FY-2018 will probably not exceed 3%-of-GDP cumulatively. Meanwhile, official creditors are said to have proposed to the Greek side the elimination of existing special tax exemptions (projected budgetary revenue of €320mn/annum). Under the MoU conditionality, the Greek government has committed to implement additional fiscal measures for 2017 and 2018, projected to yield at least 0.75%-of-GDP and 0.25%-of-GDP respectively.[4]

[2] According to the Greek government's proposed scheme the calculation of new pensions would be determined as the sum of two components: (a) the basic pension that will depend on total working years and; (b) revised replacement rates + a national state guaranteed pension.

[3] The number of pensioners is reportedly estimated at c. 2.657mn.

[4] Under the MoU conditionality, the Greek government has also committed to take further structural measures in October 2016 if needed to fulfill the agreed fiscal targets for a primary surplus of 1.75%-of-GDP in FY-2017 and 3.5%-of-GDP in FY-2018. These may include a reduction in national defense expenditure, reforms to the personal income tax (PIT) and freezing of statutory spending.

Operation of the new Privatization Fund

The MoU conditionality envisages the establishment of an independent Privatization Fund, managed by domestic authorities under the supervision of the relevant European institutions. The Fund's mandate should be to manage valuable Greek assets –including the shares of the Greek recapitalized banks- through privatization and other means with a view to eventually monetize assets worth up to €50bn during the programme period. As part of the conditionality attached to the release of the last ESM loan installment (amounting to €1bn) in late December, the Greek side appointed an independent Task Force to identify options and prepare recommendations of the operation goals, structure and government of the Fund. Yet, the finalization of the relevant bill incorporating the required legislation dictating the operation framework of the Privatization Fund, is still pending.

Finalization of outstanding issues related to the NPL resolution framework

The NPLs regulatory framework agreed between the Greek government and official creditors late last year authorizes non-banking institutions to offer management services for all categories of NPLs. Yet, potential repurchases are permitted solely with respect to NPLs of large corporations (with a turnover in excess of €50mn/annum and more than 250 employees). With regard to the remaining categories of NPLs, the Greek government reportedly insists on certain exemptions from potential repurchase, including: (i) loans up to €500k granted to SMEs; (ii) loans up to €250k granted to freelancers; (iii) mortgages pertaining to first residence; and (iv) consumer loans up to €20k. On their side, official creditors have reportedly adopted a more liberalized stance insisting on the repurchase of all NPL portfolios arguing that any protection should apply only to the socially and financially vulnerable groups.[5] Under an agreement reached between the two sides during the first phase of discussions in the context of the 1st programme review earlier this month, the relevant regulatory framework has to be approved by the Hellenic Parliament by March 15th.

Main coalition partner SYRIZA and pro-Euro opposition parties publicly reject the scenario of snap elections

Market concerns that the 1st programme review may not be completed in a reasonable time frame and ongoing protests against the government's social security and income tax reform plan, have given way to rumours of the SYRIZA/ANEL coalition government triggering early elections. Fueling snap election jitters, a number of high level SYRIZA officials have publicly revealed that the government is mulling to undertake the necessary initiatives required for certain amendments in the current electoral law.[6] Separately, the President of the junior coalition partner ANEL, Panos Kammenos, warned earlier this month that if official creditors insist on "unreasonable demands" (…) "the Greek people will once again have a say".[7] On its part, major coalition partner SYRIZA has repeatedly attempted to put an end to such speculation with Prime Minister Alexis Tripras emphasizing that the government was re-elected just a few months ago and continues to enjoy its legitimacy. Along similar lines, the leaders of the pro-EU opposition parties represented in the Hellenic Parliament have also publicly demonstrated their opposition to a new snap election. Speaking to a local TV station earlier this month, Kyriakos Mytsotakis, the newly elected President of main opposition New Democracy (ND), revealed that his party does not intend to trigger an early ballot while, for the time being, his main priority is ND's reorganization. On her part, the President of Democratic Coalition Fofi Gennimata stressed that the government should assume its responsibilities and rule out early elections. Yet, in case the government does opt to resign, she made clear that her party would support a government consisting of all parties with parliamentary representation, mainly the two biggest ones, SYRIZA and ND. Echoing the above, Stavros Theodorakis, the leader of party "The River" ("To Potami") warned that the scenario of an early election should be avoided as it would be tantamount to "a suicide" for the country. Last but not least, Vassilis Leventis, the leader of the Union of Centrists party, which entered the Parliament at the September 20th 2015 general election for the first time ever, called on the Prime Minister to resign opening the way for a national unity government. He insisted that current domestic problems are "complex" and cannot be addressed by a "fragile" government controlling just 153 seats in the 300-seat Hellenic Parliament (Graph 1 in Annex depicts the current composition of the Hellenic Parliament).

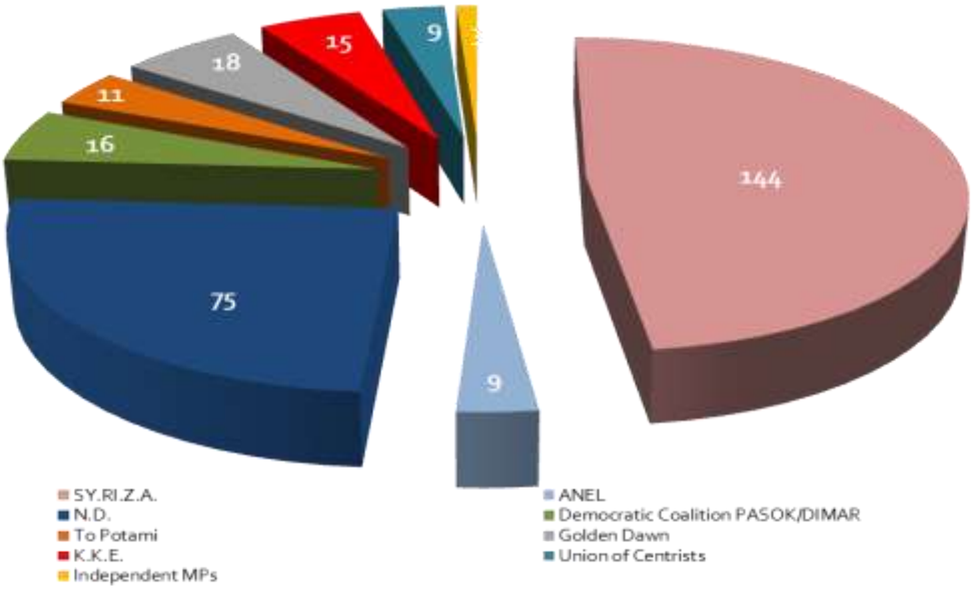
[5] According to recent comments by BoG Governor Yannis Stournaras, some 20% of the country's NPLs (or about €20bn) come from strategic defaulters.

[6] According to some press reports, the government in considering certain amendments to the current electoral law (3231/2004) including, inter alia, a reduction in or annulment of the 50 parliamentary seats bonus awarded to the party with the largest share of votes in a national election. Under the Constitution of Greece, the next general ballot could take place based on a revised electoral law on the condition that the existing 300-seat Parliament approves the relevant bill with an absolute majority of 2/3 of MPs (*i.e.,* 200). Should the new law be endorsed by an absolute majority of 50%+1 MPs (*i.e.*, 151) it would apply to the general election after the next.

[7] Greece faced two general elections last year in a space of just nine months (January 25th & September 20th, 2015) while the Prime Minister called a referendum last summer (held on July 5th, 2015) on the package of austerity measures which had been proposed by the country's creditors at that time, in return for a few months extension of the previous (2nd) adjustment programme.

Annex

Graph 1- Allocation of seats in the Hellenic Parliament



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