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Greece: Overview of latest developments & agenda of 1st programme review

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Formal talks on 1st programme review expected to commence by January 22

The Eurogroup convenes later today (Thursday, January 14) and Greece's stabilization programme features high on the Agenda. Official discussions are expected to place particular emphasis on the progress made thus far by the Greek side in implementing a number of agreed milestones and particularly on the overhaul of the social security system, which constitutes one of the prior actions required for the completion of the 1st programme review. To this end, the Greek government submitted to the institutions earlier this month a draft of the planned reform targeting savings of around 1%-of-GDP in 2016, in line with the MoU conditionality. Greece's proposal is currently under evaluation and will be further discussed during the next visit of the EC/ECB/IMF/ESM mission heads. According to press reports, they are expected to arrive in Athens by January 22, with an intention to complete the review by the end of February. As per the same sources, several stumbling blocks exist in the way to reaching a staff level agreement on relevant prior actions. Speaking at a press conference earlier this month, Eurogroup President Jeroen Dijsselbloem was quoted saying that Greece's review "may take months rather than weeks" as official creditors and Greek authorities have to bridge their differences on all open issues, most notably on the overhaul of the social security pension reform.[1]

Completion of 1st review is a key prerequisite for the release of additional official funding, initiation of debt relief discussions

Eurogroup President Jeroen Dijsselbloem has recently clarified that the successful completion of the 1st programme review is a key precondition for: i) the release of additional official funding under the 3-year ESM loan facility; and ii) the initiation of official discussions on additional debt relief measures for Greece. Furthermore, he appeared adamant on the IMF's involvement in the new bailout programme and expressed the view that the Fund intends to participate financially, not just as a technical consultant, as long as the prerequisites it has set are fulfilled. Among others, these include the overhaul of the social security pension system and provision by EU creditors of further debt relief so as to strengthen sustainability of Greek public debt. With regard to a potential reintroduction of a Greek collateral waiver, ECB President Mario Draghi said earlier this week that the strong commitment to the financial assistance programme and a demonstration of ownership by the domestic authorities constitute key preconditions. According to recent press reports, the ECB may revisit the issue by next month, on the condition that official discussions in the context of the 1st review are at an advanced stage and heading into a positive outcome. Speaking to a local newspaper earlier this month, Greece's Alternate Minister of Finance Giorgos Houliarakis indicated that the completion of the review would open the way for the release of the next ESM loan tranche amounting to €2bn for the clearance of State arrears to third parties.[2]

[1] According to the OECD report "*Pensions at a Glance 2015*" published late last year, public pension spending in Greece amounted to 14.5%-of-GDP in 2014 compared to an average of 7.9%-of-GDP across OECD countries.
[2] Out of c. €86bn financing committed under the new ESM loan facility, Greece has received so far €21.43bn (*i.e.*, €16bn in cash + €5.430bn in ESM notes that was required for the completion of the share capital increase of Greece's four systemic banks, part of the €10bn sub-tranche earmarked for bank recapitalization and resolution purposes. Arrears clearance is estimated at c. €7bn over the programme period.

Greek government's proposed social security pension reform plan

Upon agreement with official creditors on the main modalities of the social security pension reform, the Greek government reportedly intends to submit to the Hellenic Parliament the relevant bill by January 25, with an intention to have it voted by February 10. In a recent interview to a local newspaper, Minister of Labour, Social Insurance and Social Solidarity Georgios Katrougalos appeared reassuring that the relevant bill will be approved by all 153 SYRIZA-ANEL coalition MPs. It is yet unclear whether the aforementioned bill will be in the form of a single-bill or an omnibus that will also incorporate the relevant legislation for the implementation of all prior actions attached to the 1st review.

Table 1- Greek government's initial plan of social security pension reform - key items

- Adoption of a new scheme for the calculation of new pensions. These will be determined as the sum of two components: the basic pension that will depend on total working years and revised replacement rates + a national state guaranteed pension of €384/month that will be granted to pensioners at the age of 67 provided they have covered at least 15 of insurance years.
- Existing pensions will remain unchanged until July 2018.
- Increase in social security contributions by 1.5% cumulatively for a period of 3 years (1.0% for employers and 0.5% for employees) as a means to averting any further cuts in existing main pensions or a horizontal reduction in supplementary pensions. Aiming to facilitate a swift completion of the 1st programme review, the representatives of the country's biggest employers' associations agreed with the Greek government earlier this month to an increase in social security contributions up to 1% on a temporary basis (reportedly around 2-3 years). On its part, the government has reportedly vowed to promote measures aiming to improve the business environment and lure investment flows in the Greek economy.
- Establishment of a ceiling at €2.304/month net (=€384*6) for the main pension and €3.072/month net (=€384*8) for multiple pensions.
- Adoption of a new scheme for the calculation of pension lump sum payments.
- Reduction in new supplementary pensions.
- Integration into National Social Security Entity (EFKA) of all main pension funds.
- Imposition of stricter eligibility criteria for granting EKAS allowance (social solidarity allowance for retired persons), with an intent to have it abolished by December 2019.
- Social solidarity allowance of €360/month to uninsured elderly.

Source: Local press, Eurobank Economic Research

Government's red lines on the planned overhaul of the social security

Echoing earlier comments by Greece's Prime Minister Alexis Tripras, Minister of Labour, Social Insurance and Social Solidarity Georgios Katrougalos made clear in a recent newspaper interview that the government has set red lines on certain items of the planned overhaul of the social security pension system. These include: (i) no further reduction in existing pensions; (ii) no adoption of income eligibly criterion for the provision of the national state guaranteed pension; and (iii) the national state guaranteed pension to be granted to pensioners having covered at least 15 years of insurance. The minister also appeared optimistic that Greece will fulfill its commitment for savings of c. 1%-of-GDP in 2016 (or c. €1.74bn) from the planned overhaul of the social security pension system. In more detail, he clarified that relevant measures with an estimated total impact of c. €1.1bn have already been penciled in the FY-2016 Budget that was approved by the Parliament in late November 2015, while the remaining shortfall of c. €600mn will be mostly covered through an increase in social security contributions. On their part, official creditors reportedly insist, inter alia, on: (i) introduction of income eligibility criteria for the provision of the national state guaranteed pension to pensioners with no less than 20 years of insurance; (ii) implementation of relatively lower replacement rates; and (iii) gradual abolishment of the pension lump sum payments. As per the same sources, it is yet unclear whether they are keen to accept an increase in social security contributions as a means to avert any further cut in main pensions.

Greece's 1st programme review- key deliverables

In what follows we provide some analysis on a number of important prior actions for to the completion of the 1st review of Greece's new adjustment programme.

- ***Overhaul of the social security pension system***
  See analysis in the prior section.

- ***Income tax reform***
  The planned overhaul of the income tax system will reportedly include, among others: (i) abolishment of the preferential tax treatment for agricultural income (i.e., increase in farmer income to 20% in 2016 from 13% currently and to 26% in 2017); (ii) integration of the solidarity surcharge into the income tax code; (iii) increase in the income tax rate for rents to 15% (from 11%) for annual income below €12,000 and to 35% (from 33%) for annual income above €12,000; (iv) new income tax brackets; and (vi) collection of receipts through banking transactions or/and the use of credit and debit cards so as taxpayers to be eligible for the tax-free threshold and certain tax discounts (reportedly, the said measure will not be applied to taxpayers more than 75 years old and those who live in remote areas). Under the MoU conditionality, Greece has committed to legislate additional fiscal measures projected to yield at least 0.75%-of-GDP in 2017 and 0.25%-of-GDP in 2018, so as to help attain the medium term primary balance target of 3.5%-of-GDP.

- ***Labor market reform***
  Under the MoU conditionality, the Greek government has pledged to launch a consultation process, headed by a group of independent experts to review with the collaboration of the International Labour Organisation (ILO) the existing labour market framework, taking into account best practice in Europe and internationally. Against this background, key items in the agenda of the upcoming official discussions will reportedly include, inter alia: (i) collective dismissals and the veto power of the Labor & Social Security Minister; (ii) reassessment of the existing regulatory frameworks dictating labor unions' operation, including the procedure applied for engaging in a strike; (iii) industrial action (e.g., lockout); and (iv) collective bargaining.

- ***Finalization of outstanding issues related to the NPL resolution framework***
  These include, inter alia, NPLs related to primary residence, SMEs, consumer loans and State-guaranteed loans.

- ***Fulfilment of agreed fiscal targets for fiscal year 2016, 2017 and 2018***
  Official creditors are reportedly concerned that some of the measures already approved by Parliament are not properly implemented. Against this background, they reportedly estimate that the Greek government may have to adopt additional measures - beyond those already agreed under the existing MoU- so as to secure fulfillment of the agreed fiscal target for primary surpluses 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, they anticipate a fiscal gap of 0.5-1%-of-GDP to arise in 2016 and up to 3%-of-GDP cumulatively by FY-2018.

- ***Establishment of an Independent Privatization Fund***
  Under the MoU conditionality, the Greek government has agreed to the establishment of an independent Privatization Fund, managed by domestic authorities under the supervision of the relevant European institutions. The task of the Fund will be to quickly identify, transfer over the lifetime of the programme and manage valuable Greek assets –including shares in Greek banks - through privatization and other means with a view to monetize assets worth up to €50bn.[3]

- ***Restructuring of public administration.*** Under the MoU conditionality, the main elements of this strategy will include, inter alia: stronger coordination of policies, better recruitment processes for managers, HR planning to timely assess and fulfil the hiring needs, a fiscally-neutral reform of the wage grid and a modern performance assessment system.

- ***Opening up of certain closed professions and services***

[3] Out of this amount, €25bn will be used for the repayment of the programme funds committed for bank recapitalization and other assets, €12.5bn for retiring government debt and another €12.5bn for boosting domestic investment

Timeline of events

In what follows we present a timeline of the key dates and events that deserve close monitoring in the crucial weeks ahead.

<u>January 2016</u>

– *January 14*

Eurogroup meeting. According to the official agenda, euro area finance ministers are scheduled to discuss, among others, the state of play in the implementation of Greece's economic adjustment programme and the relevant timeline.

– *January 15*

€1bn T-bills redemption

– *January 21*

S&P reassess Greek sovereign debt rating

<u>February 2016</u>

– *February 1-10*

The Hellenic Parliament votes on a bill incorporating the legislation required for the implementing of the social security pension reform.

– *February 1*

IMF debt payment of €138.8mn

– *February 5*

€1bn T-bills redemption

– *February 11*

Eurogroup

– *February 12*

€1.4bn T-bills redemption

– *February 21*

ECB monetary policy meeting

– *February 22*

Moody's reassess Greek sovereign credit rating

<u>March 2016</u>

– *March 4*

€1.4bn T-bills redemption

– *March 7*

Eurogroup

IMF principal payment of €306.6mn

– *March 10*

ECB monetary policy meeting

– *March 11*

Fitch reassesses Greek sovereign credit rating

€1.6bn T-bills redemption

– *March 16*

IMF principal payment of €574.9mn

– *March 18*

€1.6bn T-bills redemption

April 2016

– *April 8*

€1.4bn T-bills redemption

– *April 13*

IMF principal payment of €459.9mn

– *April 15*

€812.5mn T-bills redemption

– *April 21*

ECB monetary policy meeting

– *April 30*

IMF debt payment of €0.17mn

May 2016

– *May 1*

IMF debt payment of €120.3mn

– *May 6*

€1.4bn T-bills redemption

– *May 17*

Eurogroup

June 2016

– *June 2*

ECB monetary policy meeting

– *June 7*

IMF principal payment of €306.6mn

– *June 10*

€2bn T-bills redemption

– *June 16*

Eurogroup

July 2016

– *July 7*

€2bn T-bills redemption

– *July 13*

IMF principal payment of €459.9mn

– *July 20*

Two GGBs mature for a total notional amount of €2.3bn

– *July 21*

ECB monetary policy meeting

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