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Attainability of 2013 fiscal target, medium-term financing gaps and the case for new OSI

1. Summary of Views

This note provides an assessment of the attainability of fiscal targets and the evolution of the general government borrowing needs and sources of funding over the forecasting horizon of the present adjustment programme. It also discusses the case for some new OSI to improve the sustainability of Greek public debt. The main views expressed herein can be summarized as follows:

The 2013 fiscal target of eliminating the ESA95 general government primary deficit (or even creating a small primary surplus) remains a viable proposition, as:

i. the significant outperformance of the central government deficit target in H1 creates a considerable cushion to cover any potential fiscal slippages in the remainder of the current year;
ii. the government has already agreed with the troika measures aiming to offset some newly-identified shortfalls that could purportedly generate fiscal slippages equivalent to as much as 0.5ppts-of-GDP/annum in 2013-2014; and
iii. (iii) there is currently little uncertainty as regards the implementation of this year's fiscal package, as most of it relies on (already-implemented) cuts in wages, pensions and operating expenditure.

From a longer-term perspective, a 4.5%-of-GDP primary surplus by 2016 remains a credible target, given the extent of the present adjustment and past experience with major fiscal consolidation efforts in Greece.

Our analysis on the evolution of the general government borrowing needs and sources of funding in the context of Greece's present adjustment programme broadly concurs with the troika baseline macro scenario, which envisages funding gaps equivalent to €4.6bn in H2 2014 and €6.5bn in 2015-2016. Assuming fulfillment of programme targets as regards privatization revenue and the general government primary balance, we do not expect the coverage of the aforementioned gaps to prove an insurmountable hurdle, especially as the European Commission already hinted on ways to cover the 2014 financing gap and the generation of primary surplus would open the door for additional relief measures from the official sector (OSI).

Taking account of the explicit commitment by the 26/27 November 2012 Eurogroup to consider further relief measures for Greece once the country reaches an annual primary surplus, we estimate that additional relief measures worth up to 7ppts-of-GDP will be needed to bring the gross public debt-to-GDP ratio to 124% in 2020 and to levels "substantially lower" than 110% by end-2022 (under the present macro baseline scenario). On the latter issue, our estimates suggest that a mere reduction of the interest rate charged on the bilateral euro area loans disbursed in the context of the 1st adjustment programme (GLF) would not be enough to generate the necessary reduction in the debt ratio. As such, we concur with a recent IMF assessment (IMF Country Report No. 13/20, page 84) that large reductions in EFSF interest rates, principal haircuts on the GLF and/or other strategies would be needed to meet the agreed debt targets.

2. Where do we currently stand with respect to the execution of the State Budget, the availability of programme financing and the timeline of loan disbursements

2.1 H1 2013 budget execution reveals lower-than-projected headline deficit

Preliminary data for the state budget execution in the first six months of the year revealed a lower-than-expected headline deficit. The central government balance recorded a deficit of around €5.0bn (or ca 2.6%-of-GDP), which compares with a shortfall of €12.5bn in H1 2012 and a €7.2bn deficit target for H1 2013 envisaged in the revised medium-term fiscal plan (MTFS 2013-2016). As a result, the central government budget gap in H1 2013 covered around 59% of the MTFS's full-year deficit target. This compares with an 80% coverage of the 2012 deficit attained in first 6 months of last year. More importantly, the state budget primary balance (i.e., which excludes interest payments) recorded a shortfall of around €1.52bn (or ca 0.6% of GDP), compared to a 6-month deficit target of around €3.88bn (revised MTFS) and a shortfall of €3.32bn recorded in January-June 2012 (Table A).

Ordinary budget *gross* revenue (i.e., *before* tax refunds) declined by 8.9% YoY in January-June 2013, underperforming by ca €1.6bn the corresponding 6-month target set in the revised MTFS. Thanks to much lower tax rebates relative to the same period a year earlier, the annual rate of decline of *net* ordinary budget revenue (i.e., *after* tax refunds) was a bit lower, coming in at -3.9% YoY and resulting in a undershooting of the corresponding MFTS target by around €0.9bn (or ca 0.47ppts-of-GDP). The main culprits of the aforementioned slippage can be traced in the following revenue categories: (i) Personal income tax (PIT) receipts, which underperformed the relevant target by €178mn (or 34%) mainly as a result of an extension given to the submission of PIT declarations. (ii) Direct tax arrears, which undershot the corresponding target by €109mn (or 52.1%), due to delays in collecting the property tax of 2011. (iii) Lower-than-targeted VAT revenue (by €114mn or 11.7%). (iv) A slippage of €145mn (or 18.9%) in consumption taxes. The latter deviation was partly the result of a strike of tax employees in the last two working days of June, which is estimated to have led to the rolling over of as much as €200mn in revenue into the first two days of July 2013. (v) A drop in non-recurring revenue by €707mn (or 65.1%), mainly as a result of the delay in collecting from the banks the 10% return on the preferred shares in the context of the liquidity support plan and the lower ANFAs receipts (which does not affect the General Government deficit in an accrual basis). On a more positive note, revenue from property taxation outperformed the corresponding target by €34mn. Furthermore, receipts from other consumption taxes and other indirect taxes exceeded the targeted amounts by €42mn and €67mn, respectively.

On the expenditure side, ordinary budget primary outlays in January-June 2013 declined by 23.3% YoY, undershooting by €1.98bn (ca 1ppt of GDP) the corresponding MTFS target. Furthermore, net interest payments declined by 62% YoY, thanks to the debt restructuring (PSI) and buyback operations conducted last year. A detailed breakdown of primary expenditure in H1-2013 has not yet been published, but available data for the first five months of this year reveal some interesting developments. Specifically, central government salary and pension payments - by far the biggest item of state budget expenditure -, declined by 7.8% YoY, covering around 40.2% of the corresponding full-year budget target. Moreover, grants to the social security sector dropped by 21.1% YoY, covering 41.8% of the full-year target.

In the Public Investment Budget, higher revenue (+15.1% YoY) and lower expenditure (-12.8% YoY) facilitated the attainment of a better-than-expected central government deficit outcome in H1-2013. As we will explain in more detail below, the aforementioned development points to a considerable fiscal cushion in H1 2013 to cover any potential slippages from program targets incurred in the remainder of the current fiscal year.

Table A – State Budget execution in January-June 2013 (modified cash basis data in EURmn)

	Jan-Jun 2012	Jan-Jun 2013				FY-2012	FY-2013		
	Realization	Realization		Revised MTFS (2013-2016) target	Deviation	Realization	Revised MTFS (2013-2016) estimate	Budget 2013 target	
	€mn (1)	€mn (2)	YoY % (2)/(1)	€mn (3)	€mn (4) =(2)-(3)	€mn (5)	€mn (6)	(7)	YoY % (6)/(5)
I. Ordinary budget balance (A-B)	**-11,947**	**-4,955**	**-58.5%**	**-6,024**	**1,069**	**-13,174**	**-6,730**	**-9,480**	**-48.9%**
A. Ordinary budget net revenue *(a1+a2-a3)*	**21,689**	**20,837**	-3.9%	**21,743**	**-906**	**48,325**	**46,727**	**46,322**	-3.3%
a1. Ordinary budget gross revenue *(before tax returns)*	23,465	21,371	-8.9%	22,988	-1,617	51,482	49,542	49,137	-3.8%
a2. Special revenue from licencing and public rights	0	65		39	26	15	86	86	
a3. Tax refunds	1,776	600	-66.2%	1,284	-684	3,172	2,901	2,901	-8.5%
B. Ordinary budget expenditure *(b1+b2+b3+b4+b5)*	**33,636**	**25,792**	**-23.3%**	**27,767**	**-1,975**	**61,499**	**53,457**	**55,802**	**-13.1%**
b1. Primary expenditure	24,202	21,407	-11.5%	23,322	-1,915	47,529	45,150	45,050	-5.0%
b2. Loan disbursement fee to EFSF	0	112		113	-1	541	130	75	-76.0%
b3. Military procurements	99	59	-40.7%	180	-121	410	750	750	82.9%
b4. Guatantees called	174	733	321.3%	835	-102	796	1,027	1,027	29.0%
b5. Net interest payments	9,160	3,480	-62.0%	3,317	163	12,224	6,400	8,900	-47.6%
II. Public investment budget (PIB) (C1-C2)	**-530**	**-42**	**-92.1%**	**-1,170**	**1,128**	**-2,513**	**-1,714**	**-1,714**	**-31.8%**
C1. PIB net revenue	1,503	1,730	15.1%	1,680	50	3,601	5,136	5,136	42.6%
C2. PIB expenditure	2,033	1,772	-12.8%	2,850	-1,078	6,114	6,850	6,850	12.0%
III. Central government budget balance (I+II)	**-12,477**	**-4,997**	**-59.9%**	**-7,194**	**2,197**	**-15,687**	**-8,444**	**-11,194**	**-46.2%**
Central government primary balance (III+b5)	**-3,317**	**-1,517**	**-54.3%**	**-3,877**	**2,360**	**-3,463**	**-2,044**	**-2,294**	**-41.0%**

Source: MoF, Eurobank EFG Research

2.2 Programme financing till the end of October 2013: schedule of disbursements & prerequisites

Following a staff-level agreement between the Greek government and the troika on the 4th review of the present adjustment programme, the Eurogroup of July 8, 2013 mandated the Eurogroup Working Group (EWG) to approve the next EFSF installment, which amounts to €3.0bn. According to an accompanying official statement, the said installment will be disbursed in two sub-tranches, subject to the fulfillment by the Greek side of a number of agreed programme milestones. As per Table B below, the first EFSF sub-tranche (€2.5bn) is expected to be disbursed by the end of July, with the second one (€0.5bn) being scheduled for end-October 2013. In addition to new EFSF financing, Greece is also expected to receive, over the said period: (i) €2.0bn equivalent to the income on the SMP portfolio accruing to euro area national central banks (NCBs); and (ii) €1.8bn from the IMF under the present Extended Fund Facility. Note that, the next IMF Board meeting is scheduled for July 29, 2013. Furthermore, the disbursements coming from the profits accruing to the SMP portfolio will also be released in two sub-tranches, with the first one (€1.5bn) expected by the end of July (along with the 1st EFSF sub-tranche) and the second by end-October 2013 (along with the 2nd EFSF sub-tranche).

Table B - Next EFSF/IMF disbursements (EURbn) & programme milestones

Schedule of disbursements	Amount (EURbn)		Milestones
July 2013 disbursement			
EFSF	2.5		- parliamentary approval of omnibus bill incorporating required legislation for implementation of agreed prior actions (implemented already) -transfer of 4,200 public employees to mobility scheme - Income Tax Code - sale of New Hellenic PostBank and Nea Proton Bank (completed) - other (see Greece Macro Monitor, Eurobank Research, 8 July 2013
SMP portfolio	0.5		
August 2013 disbursement			
IMF	1.8		
October 2013 disbursement			
EFSF	1.5		- transfer of another 8,300 public employees to mobility scheme -2k mandatory exits of public sector employees - restructuring of Hellenic Aerospace Industry (EAB), Greek Vehicle Industry (ELVO) & General Minining and Metallurgical (LARCO) - clearance of state arrears to Athens Water (EYDAP) & Thessaloniki Water (EYATH) -adoption of new code for lawyers - other (see Greece Macro Monitor, Eurobank Research, 8 July 2013)
SMP portfolio	0.5		
Total (Jul.-Oct. 2013)	**6.8**		

Source: July 8, 2013 Eurogroup, Eurobank Research

As shown in Table B, the next EU/IMF installment to Greece will sum up to €6.8bn, an amount lower than that expected ahead of the July 8th Eurogroup (€8.1bn). According to press reports, the last Eurogroup actually discussed the possibility of approving at this point the release of a higher EFSF installment (i.e., one incorporating part of the €3bn EFSF tranche earmarked for December 2013), but such a frontloading of official financing would constitute a deviation from the present funding programme, necessitating a special approval by national parliaments. Although the size of the new EFSF disbursement is a bit lower than expected earlier, the overall amount of the next EU/IMF installment is deemed adequate to cover the government's funding need until the end of October 2013. Looking beyond that period, Greece's finance minister was quoted as saying that official lenders are likely to consider after October the timely release of the remaining installment for the current year, earmarked fro Greece under the present funding programme.

As regards the government's funding needs for the remainder of this year, these incorporate: (i) ca €3.3bn in maturing sovereign debt (next major bond redemption comes on August 20, for a notional amount of €2.17bn); (ii) ca €2.9bn in interest payments; (iii) ca €500-700mn/per month for the clearance of government arrears to suppliers and other third parties (as per the current planning); (iv) any remaining budgetary needs that may arise in the following months. On the other hand, Greece has reportedly paid €1.8bn year-to-date for maturing Greek government bonds (GGBs) in the euro area NCBs investment (ANFAs) portfolio. According to press reports quoting Greece's finance minister, the potential rollover of ANFAs holdings as a means of securing additional financing to Greece is currently under discussion with euro area authorities. As per the European Commission report on the first review of Greece's second adjustment programme (Dec 2012, page 54), the revised troika baseline scenario for the general government financing needs and sources of funding assumes a rollover of ANFAs holdings on equal terms, while acknowledging that this option would still need to be assessed and independently decided by NCBs. Such a rollover would reduce the financing need and smoothen the debt repayment profile over the programme period, without having a significant impact on the evolution of the debt-to-GDP ratio. As per the same source, the overall financing secured by the rollover of ANFAs holdings would amount to €3.7bn in 2012-2014 and €1.9bn in 2015-2016.

2.3 Measures identified to cover projected fiscal shortfalls this year and the next

After measures had been taken in the context of an earlier programme review (May 2013) to prevent projected deviations from the fiscal targets this year and the next, the last troika mission to Greece (4-19 June & 1-7 July 2013) identified new shortfalls that could potential generate fiscal slippages, equivalent to as much as 0.5ppts-of-GDP/annum in 2013-2014.[1,2] .Although the sizeable (and heavily front loaded) fiscal austerity package for 2013-2016 continues to be largely implemented, a number of shortfalls over 2013-2014 were identified.[3] In an effort to address these shortfalls, the government has committed to adopt by end-July 2013 a number of offsetting measures, as a prior action to the next EFSF/IMF loan disbursement (Table C).[4]

Table C – Projected budgetary shortfalls in 2013-2014 & offsetting measures agreed

Projected shortfalls	Offseting measures agreed
Expenditure overruns in main health care fund EOPYY *(projected shortfall of as much as 0.3ppts-of-GDP in 2013)*	*Short-term:* claw-back mechanism to cap public expenditure on diagnostics and private health care clinics (July 2013 benchmark). *Long-term:* additional structural measures to rationalize healthcare provision and prevent misuse of publicly funded services .
Delays in the issuance of property tax bills and extension given to the submission of PIT declarations *(projected revenue shortfall of 0.2ppts-of-GDP in FY-2013 accrual period)*	Special solidarity surcharge on income from interest & dividents. Frontloading of measures planned for 2014 (luxury tax; increase in court fees for lawsuits; docking fee for leisure boats). Further rationalisation in defence expenditure. Plan for reduction in social security contribution rates over the coming years in a budgetary neutral manner (due in autumn 2013). One-off effect of a surge in capital concentration tax related to the bank recapitalisation (0.1ppts-of-GDP). Higher-than-assumed proceeds from bank guarantee fees paid to the state, in the context of one of the liquidity support schemes (0.2ppts-of-GDP)
Downward revision in the projected yield of some earlier-agreed measures *e.g.* in the area of social security contributions. *(projected shortfall of ca 0.2ppts-of-GDP in 2013)*	
Government decision not to implement some of the previously agreed measures for 2014, including a special solidarity contribution for self-employed and the application of the new wage grid for armed forces *(projected shortfall of 0.4ppts-of-GDP in 2014)*	
Source: EC (July 2013); Eurobank research	

As regards the projected fiscal gaps for 2015-2016, these will to be addressed in the context of the next (5th) programmme review (see analysis below).

[1] For a comprehensive review of the measures agreed with the troika in May, so as to address potential fiscal slippages in 2013-2014, see *Eurobank Research, Greece Macro Monitor, "3rd programme review concluded: projected shortfall in 2013-2014 to be fully covered without new austerity measures", April 26, 2013.*

[2] As per the current adjustment programme, Greece needs to generate a balanced general government primary position this year, before a primary surplus of 1.5%-of-GDP is achieved in 2014.

[3] The new fiscal package was agreed with the troika as a prior action to the 26/27 November 2012 Eurogroup agreement on further debt relief measures for Greece and the resumption of official financing in the context of the present adjustment programme. The new package mainly relies on sizeable expenditure cuts in pensions, wages, social transfers and operating costs and is worth over 6.5ppts-of-GDP in 2013-2014 & ppts-of-GDP in 2015-2016.

[4] See European Commission, "The Second Economic Adjustment Programme for Greece"; Draft Third Review; July 2013.

3. Assessing the attainability of fiscal targets in the context of the present adjustment programme

This section provides a preliminary assessment of the attainability of the fiscal targets in the context of Greece's adjustment programme. For 2013, the present programme targets a balanced general government primary position, following a lower-than-expected primary deficit of 1.3%-of-GDP in 2012 (Table D1). At this point, considerable risks continue to surround Greece's short- and medium-term fiscal outlook, in view of the severity of the ongoing recession and uncertainty regarding the potential impact of a range of fiscal structural reforms currently underway.[5] To complicate things even further, the last troika mission to Greece (4-19 June & 1-7 July 2013) identified a number of shortfalls that could presumably generate deviations from the agreed fiscal targets in 2013-2014, to the tune of 0.5ppts-of-GDP/annum (see previous section). Furthermore, as envisaged in the revised MoU agreed with the EC/ECB/iMF troika ahead of the unlocking of programme funding to Greece in late 2012, the two side will have to identify and agree measures worth around 1.75ppts-of-GDP and 2.1ppts-of-GDP for the years 2015 and 2016, respectively so as to ensure attainability of the agreed fiscal targets over that period. The latter fiscal package will be high on the agenda of discussions during the next (5th) programme review, which is scheduled for August/September 2013.

Table D1 – Greece adjustment programme baseline macro scenario and fiscal targets

	2011	2012	2013	2014	2015	2016
Real GDP (%)	-7.1	-6.4	-4.2	0.6	2.9	3.7
HICP inflation (%)	3.1	1.0	-0.8	-0.4	0.3	1.1
General gvnt balance (% of GDP)	-9.4	-6.3	-4.1	-3.3	-2.1	-0.8
General gvnt primary balance (% of GDP)	-2.3	-1.3	0.0	1.5	3.0	4.5
General gvnt debt % of GDP)	170.3	156.9	175.2	175.0	169.8	160.9
Source: EC July 2013						

With cumulative real output losses since the crisis erupted en route to approach 25ppts by the end of the current year, the unemployment rate already near a post WWII high of 27% and the new two-party coalition government controlling a slim majority in Parliament, the present economic and sociopolitical realities in Greece are not conducive to the introduction of additional austerity measures, over and above those already incorporated in the present adjustment programme. This is especially true, taking into account the broadly horizontal nature of the fiscal measures incorporated in the 1st adjustment programme, the overwhelming emphasis of the new austerity package on aggressive cuts in wages and pensions (Table D2) and the fact the effective tax rates in Greece remain much lower than in the euro area, despite high statutory rates.[6] The latter is a reflection of widespread tax evasion, especially among self-employed, a phenomenon authorities now try to address through a comprehensive revenue administration reform.[7,8]

[5] These reforms aim to, among others, downside and improve the efficiency of the public sector, rectify revenue administration and improve financial management in the broader public sector.
[6] See Papageorgiou et al. (2011) and IMF Country Report No. 13/155.
[7] The ongoing reform envisages, among others, the establishment of a semi-autonomous General Secretariat for Public Revenue (in progress).
[8] In a cross-country study estimating the size of the shadow economy during 1999-2010, Schneider and Buehn (2012) estimate a figure of around 27% of GDP for Greece, compared to an OECD average of 20.2%. Furthermore, based on banks' perception of true income, Artavanis et. al (2012) estimate the annual unreported income in Greece to exceed €28bn or ca 15% of GDP.

Table D2 – Package of new austerity measures 2013-2016

(Percent of GDP)

New Fiscal Measures	2013-14	2015-16
Expenditure Measures	5.10	0.04
Compensation of employees	0.79	0.01
Social Security transfers	3.23	0.04
Subsidies	0.09	0.01
Intermediate consumption	0.75	-0.01
Gross fixed capital formation	0.24	0.00
Revenue Measures	2.06	0.02
Direct taxes	0.90	0.01
Indirect taxes and sales	0.61	0.00
Social security contributions	0.38	0.00
Total	7.15	0.06
Memorandum item:		
Tax administration gains	0.34	1.30

Source: IMF staff estimates
1/ Fiscal measures introduced at the first review

To the above list of problems, one also needs to incorporate what proved out to be a significant underestimation of the recessionary impact of fiscal austerity in Greece, especially as regards the macroeconomic projections of the 1st adjustment programme.[9] In view of the aforementioned considerations, it is of outmost importance that the government ensures the rigorous implementation of the agreed fiscal and structural reforms programme for 2013-2016, so as to minimize the possibility of future slippages that would necessitate the implementation of new austerity measures.

3.1 Attainability of 2013 fiscal target

In what follows, we provide a few basic arguments supporting our expectation for a broadly balanced general government primary position this year, in line with the present adjustment programme targets.

i. Despite ongoing weakness in tax revenue, the latest available *cash-basis* data on the state budget execution in H1 2013 showed that the overall central government deficit undershot by ca €2.2bn (or 1.2ppts-of-GDP) the respective target envisaged in the revised medium-term fiscal plan (MTSF 2013-2016). Furthermore, despite delays in the issuance of property tax bills and a decision to extend the deadline for the submission of income tax declarations, the realized central government shortfall in the first six months of this year covered around 59% of the respective MTFS full-year deficit target, a much lower coverage rate relative to that of the same period a year earlier (ca 80%). These developments point to a considerable fiscal cushion created in H1 2013 so as to cover any potential slippages in the remainder of the fiscal year.

ii. The latest troika mission to Greece identified a number of shortfalls over the 2013-2014 period that could generate deviations from the agreed fiscal targets, equivalent to as much as 0.5ppts-of- GDP/annum this year and the next. Presumably, these shortfalls could be generated by, among others, delays in the issuance of a number of property tax bills. According to troika staff calculations, the latter could result in a revenue slippage of around 0.3ppts-of-GDP this year, as the tax collection will shift in part beyond the 2013 accrual period. More specifically, between July 2013 and February 2014 Greek taxpayers will need to pay as many as nine different taxes, for a total notional amount, which, according to some reports, may exceed €8bn (or 4.5% of GDP).[10] Such a backlog of tax payments due in a relatively short period of time could lead to tax collection delays and also

[9] See Monokroussos and Thomakos (2013), *"Greek fiscal multipliers revisited: Government spending cuts vs. tax hikes and the role of public investment expenditure"*, Eurobank Research, March 2013.
[10] These include: the personal income tax (PIT) for incomes earned in FY-2012 (issuance of PIT declarations began already); special levy on self-employed; special solidarity levy; wealth tax on property (ΦΑΠ) for the fiscal years 2011, 2012 and 2013; PPC levy collected through electricity bills (5 installments); new luxury tax; and annual vehicle registration duty.

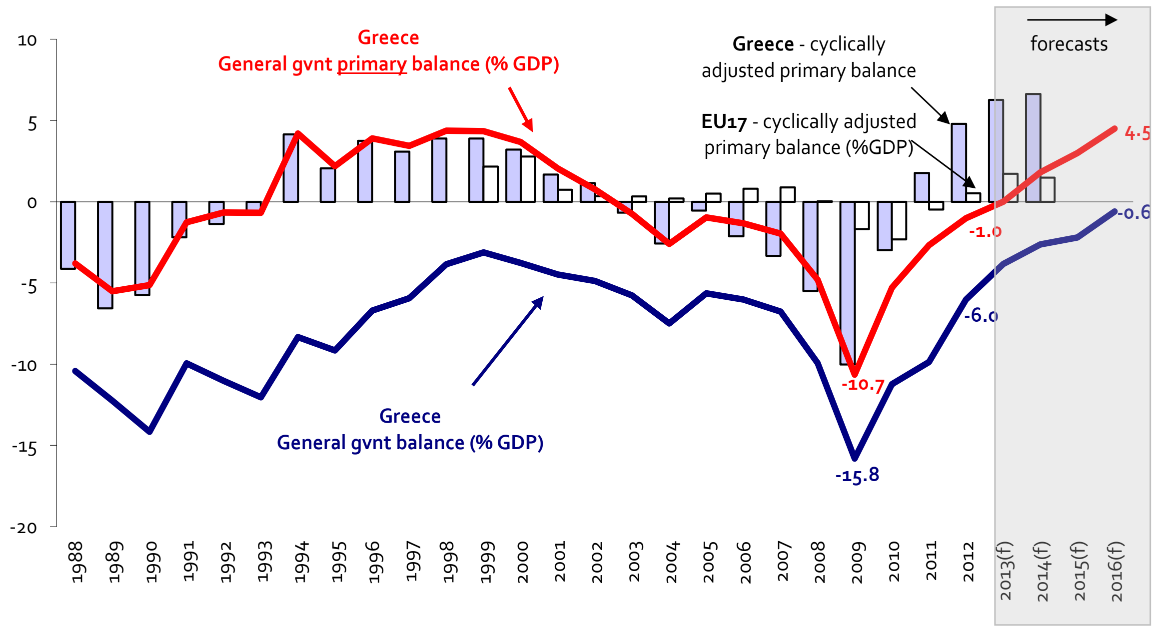
depress disposable incomes, exacerbating the ability of taxpayers to service their tax obligations.[11] However, as we explained already, the government has already identified (and agreed with the troika) a number of new measures, aiming to offset the aforementioned slippages. The government's intention is to have these measures adopted by end-July 2013, so as to ensure the timely disbursement of the next troika loan tranches.

iii. Notwithstanding the aforementioned problems, there is currently little uncertainty as regards the implementation of the fiscal package for 2013 & 2014, as most of it relies on (already-implemented) cuts in wages, pensions and operating expenditure (Table D2).

3.2 Fiscal outlook 2014-2016

As we have noted already, Greece's medium-term fiscal outlook continues to be surrounded by considerable risks, not least because of the severe domestic economic situation and uncertainty regarding the longer-term impact of current efforts to downsize the public sector and repair the tax collection mechanism. Nonetheless, in the absence of substantial implementation slippages over the applied adjustment programme (and/or sizeable deviations from the envisaged baseline macro scenario), the key medium-term term target of reaching a 4.5ppts-of-GDP primary surplus by 2016 does not seem out of reach, especially if one interpolates from past experience with major fiscal adjustment efforts in Greece. As Graph 1 below demonstrates, a major fiscal effort over the 7-year period preceding euro area entry resulted in considerable primary surpluses, to the tune of 3.6%-of-GDP/annum on average in 1994-2000. Given then the significant fiscal effort currently underway (Greece's cyclically-adjusted primary balance by far the highest in EU-17, currently), we don't see why Greece could not generate primary surpluses of the targeted size over the coming years.

Graph 1 – Current fiscal adjustment is unprecedented by historical standards



[11] At the end of 2012, unpaid obligations reached €56bn for taxes and more than €12bn for social security contributions. To deal with this problem, the Greek government introduced recently a couple of installment schemes (a basic one and one-off "Fresh Start' installment scheme) that will replace a multitude of earlier schemes, carrying amnesty-like features.

4. The case for new OSI

The Eurogroup of 26/27 November 2012 announced a number of relief measures for Greece, aiming to improve debt dynamics and reduce rollover risks over the adjustment programme's projection horizon and beyond (Graphs 2.1 & 2.2). In addition, these measures imply that over 90% of Greek public debt is now being held by the official sector, while the average maturity of debt has been extended to ca 17 years *i.e.,* around double the corresponding euro area average. Furthermore, the average nominal interest rate on the overall debt stock is currently expected to remain lower than 3% over the coming decade *i.e.,* among the lowest in the euro area (Table E1).

Table E1 - Greek Central Government debt composition at the end of 2012 (EURmn)

	Funding Source	Amount	All-in Cost	Notes
A.	**Troika loans (A.1+A.2)**	**182,900**		
A.1	IMF loans (1st & 2nd programme)	21,700	*2.80%*	[1]
A.2	EU loans	161,200		
	EU Billateral loans (1st programme)	52,900	*1.70%*	3M Euribor +1.50% [1.1]
	EFSF (disbursed under 2nd programme until Nov. 2012)	74,000	*2.20%*	[2]
	EFSF (December 2012 disbursement)	34,300		
B.	**Tbills**	**14,942**	4.30%	4.30%
C.	**Greek government bonds - GGBs (C.1+C.2)**	**88,625**		
C.1	Old GGBs	59,125		
	PSI hold-outs (estimate)	6,000	3.95%	3.95%
	EA National Central Banks and ECB (estimate)	46,400	4.50%	[3] & [4]
	Related to preference shares	5,225	1.66%	6M Euribor + 1.30%
	Related to ETEAN	1,500	0.99%	6M Euribor + 0.63%
C.2	New GGBs (post-PSI & post-buyback)	29,500	2.00%	fixed 2% [5]
D.	**Special Loans**	**17,447**	2.90%	[6]
E.	**TOTAL (A+B+C+D)**	**303,914**		

Source: Greece's FY-2013 Budget, IMF, EC (Dec 2012 & Jan. 2013), Eurobank Research

Explanatory note to Table 1

1	The IMF loan cost is roughly the weighted average cost of underlying currency Tbills plus a spread of 1%. For amounts which are over a country's quota there is an additional charge of 2%. Finally, for loan amounts outstanding more than 3 years, the all-in-cost increases further by 1%
1.1	Interest rate on EU bilateral loans disbursed under 1st bailout programme has been reduced to 3M Euribor + 50bps (26/27 Nov 2012 Eurogroup agreement)
2	EFSF lends to EU countries at a cost which is calculated as the average cost of all funds raised by the EFSF, including Tbills, plus a margin of 15bps. EFSF interest payments have been deferred by 10-years, as per the 26/27 Nov. 2012 Eurogroup agreement
3	Euro area (EA) governments where central banks currently hold GGBs have already agreed to pass on to Greece any coupons accruing on their GGB investment portfolios until 2020
4	ECB holdings of Greek government bonds (SMP) are estimated to be around EUR 34bn. The return of any coupon payments and the diffence between the purchase price and par (roughly 20%) will also be passed on to Greece (via EA governments), as per the 26/27 Nov. 2012 Eurogroup agreement
5	New GGB coupon increases to 3% after 2015
6	Special loans include old BoG loans (5.214 bio), Titlos, old EIB loans, etc

In addition to the relief measures highlighted above, the official statement released after the completion of the 26/27 November 2012 Eurogroup read that euro area Member States would be ready to consider further measures and assistance, if needed, including inter alia lower co-financing in structural funds and/or further interest rate reduction of the Greek Loan Facility, in order to ensure that Greece can reach a debt-to-GDP ratios of 124% in 2020 and "substantially lower" than 110% in 2022. As per the said statement, these new relief measures would be considered when Greece reached an annual primary surplus, as envisaged in the MoU, and would be conditional on the full implementation of programme conditionality.

Table E2 below shows the contributors to the projected decline in the Greek public debt ratio in FY-2020, assuming: (i) full implementation of relief measures announced at the 26/27 November Eurogroup; and (ii) additional contingency (not yet identified) measures, required to facilitate the required reduction in the debt ratio towards 124% by end-2020 (under the new baseline macro scenario). Over the full projection horizon (2013-2022), the necessary contingency measures to reduce (under the troika baseline macro scenario) the debt ratio to sub-110% levels should amount to around 7ppts-of-GDP on a cumulative basis (Eurobank Research forecast).

Table E2 - Contributors to the projected decline in the Greek public debt ratio in FY-2020, as envisaged in the 26/27 November 2012 Eurogroup statement (in ppts)

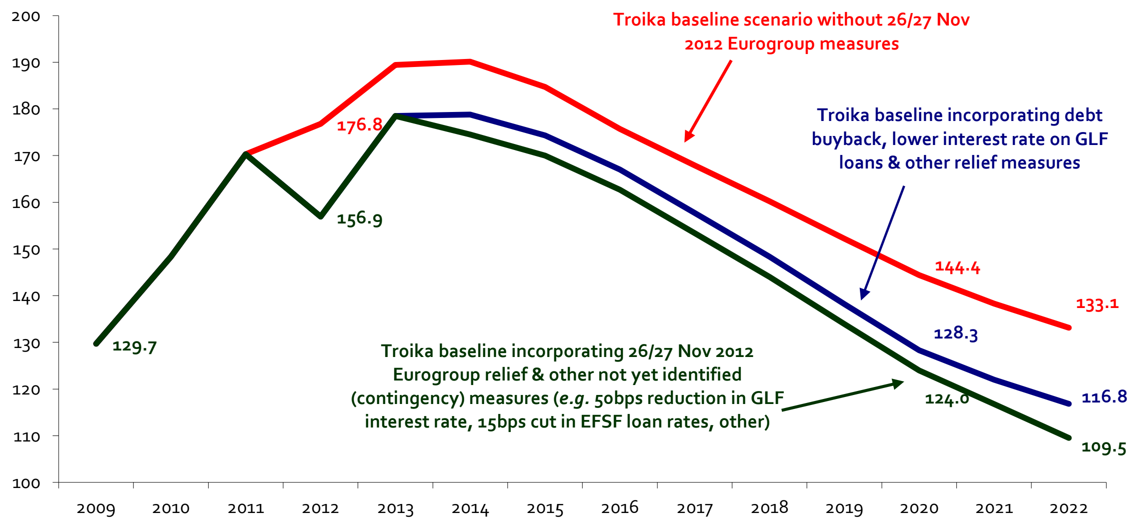
	Δ Gross public debt-to-GDP in FY-2020 (ppts)
Debt buyback (due to upfront reduction in the public debt stock)	-8.8
Debt buyback (due to reduced coupon payments)	-2.8
100bps cut in GLF interest rate	-1.7
10bps reduction in EFSF guarantee fee	-0.5
Return of SMP profits	-3.8
EFSF interest payment deferral & loan maturities extension	0.0
Increased T-bills issuance	0.9
Deferral (and reduction in the size of) cash buffer	0.0
Contingency measures (implementation assumed after 2016)	-3.2
Total	-20.0

Source: EC, IMF, Eurobank Research

As things stand at this point, a mere reduction of the interest rate charged on the bilateral euro area loans disbursed in the context of the 1st adjustment programme (GLF) and/or of the interest charge on loans disbursed from the EFSF under the 2nd adjustment programme, might not by themselves be adequate to generate the necessary reduction in the debt ratio. That is because the interest rate on GLF loans currently stands at 3-month euribor + 50bps and a further reduction of that rate by, say, 50bps would generate savings no higher than €265mn/annum or ca €2.65bn (1.4ppts-of-GDP) over a 10 year period (i.e., by end-2022).[12] Furthermore, the EFSF currently lends EU countries (Greece included) at a cost that is calculated as the average cost of all funds raised by the EFSF, including T-bills, plus a margin of 15bps.[13,14] If we assume a 15bps reduction in the interest rate on EFSF loans to Greece, total savings accrued to the country over a 10-year period would not exceed €2.2bn (or 1.1ppts-of-GDP). Therefore, additional measures would likely be needed to reach the agreed programme targets for the debt to GDP ratio *i.e.,* 124% at the end of 2020 and “significantly below” 110% by end-2022. Such measures should involve much larger reductions in EFSF interest rates and/or principal haircuts on the GLF (see IMF Country Report No. 13/20, page 84) and/or other strategies. All in all, the generation of a small primary surplus in the 2013 general government balance may open the door for additional OSI as early as in H1 2014.

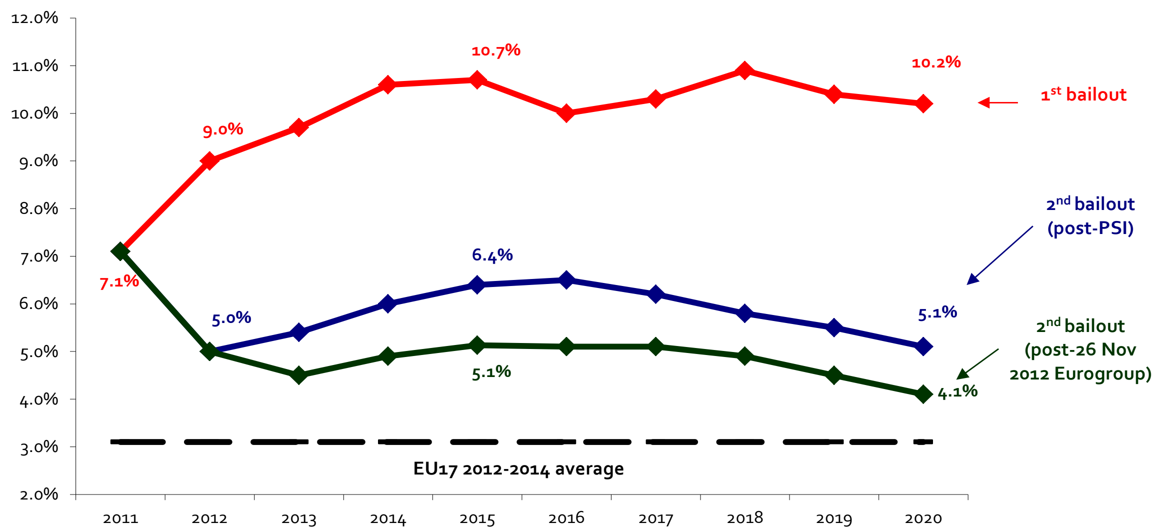
[12] Total troika funds disbursed under the 1st programme amounted to €73bn, with €52.9bn of that amount constituting bilateral loans from other euro area member states.
[13] Total troika funds earmarked for Greece under the 2ndt programme amount to €172.6bn. Of that amount, €144.6bn correspond to EA/EFSF financing over the period 2012-2014.
[14] In the context of Greece’s 2nd adjustment programme, EFSF interest payments have been deferred by 10 years, as part of the relief measures announced by the 26/27 November 2012 Eurogroup.

Graph 2.1 – Projected path of Greek gross public debt to GDP ratio before and after the relief measures announced at the 26/27 November 2012 Eurogroup



Source: EC, IMF, Eurobank Research

Graph 2.2 – Projected path of government interest payments (% of GDP) before and after the relief measures announced at the 26/27 November 2012 Eurogroup



Source: EC, IMF, Eurobank Research

5. General government borrowing needs & sources of funding - ***Projected funding gap in H2 2014 to be covered by bank recap cash buffer***

Table F below shows the projected evolution of the general government borrowing needs and sources of funding over the period Q3 2013-Q4 2014, as reported in the European Commission's draft 3rd review of the second economic adjustment programme for Greece (July 2013). A funding gap is expected to arise in H2 2014, accumulating to ca €4.6bn by the end of next year, assuming of course that all relevant variables (primary balance, privatization revenue etc) will evolve as presented in the table below.

Table F - General government financing requirements & sources Q3 2013-Q4-2014 (EURbn)

	3Q 2013	4Q 2013	1Q 2014	2Q 2014	3Q 2014	4Q 2014
	Financing needs					
A. Government cash deficit	**1.5**	**0.6**	**1.3**	**0.5**	**1.3**	**0.3**
primary deficit ("-" denotes a surplus)	-0.5	-0.3	-0.7	-0.7	-0.7	-0.7
Interest payments	2.0	0.9	2.0	1.2	2.0	1.0
B. Other gvnt cash deficit	**1.5**	**1.9**	**0.5**	**0.6**	**0.1**	**0.2**
Estimated cash adjustments/1	0.1	0.2	0.5	0.2	0.1	0.2
Arrears	1.4	1.7	0.0	0.0	0.0	0.0
Cash buffer	0.0	0.0	0.0	0.0	0.0	0.0
ESM capital contribution	0.0	0.0	0.0	0.5	0.0	0.0
C. Debt maturities	**3.8**	**1.3**	**3.5**	**11.7**	**7.5**	**2.6**
Bonds & loans after exchange (c1+c2)	3.0	0.3	2.2	9.8	5.7	0.3
c1 Bonds after PSI and buyback	*2.8*	*0.0*	*1.9*	*9.5*	*5.4*	*0.0*
c2 Other incl. loans	*0.3*	*0.3*	*0.3*	*0.3*	*0.3*	*0.3*
EU payment	0.0	0.0	0.0	0.0	0.0	0.0
IMF payment	0.7	1.0	1.3	1.9	1.9	2.3
Short-term debt	0.0	0.0	0.0	0.0	0.0	0.0
D. Bank recap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
E1. Gross financing needs (A+B+C+D)	**6.7**	**3.8**	**5.4**	**12.8**	**9.0**	**3.0**
	Financing sources					
F. Private financing sources	**0.8**	**0.7**	**0.2**	**0.6**	**2.3**	**0.4**
Market financing	0.0	0.0	0.0	0.0	0.0	0.0
Privatization	0.8	0.7	0.2	0.6	2.3	0.4
G. Additional financing sources (ANFA & SMP profits)	**2.1**	**0.0**	**0.0**	**0.5**	**1.9**	**0.0**
H. Troika loan disbursements	**6.6**	**3.9**	**9.2**	**3.3**	**1.8**	**1.8**
EA/EFSF	4.8	2.1	5.7	1.5	0.0	0.0
IMF	1.8	1.8	3.5	1.8	1.8	1.8
E2. Gross financing sources (F+G+H)	**9.5**	**4.6**	**9.4**	**4.4**	**6.0**	**2.2**
Z. Projected funding gap (E1-E2) / negative values denote a surplus	**-2.8**	**-0.8**	**-4.0**	**8.4**	**3.0**	**0.8**
Cumulative funding gap Q3 2013-Q4 2014	***-2.8***	***-3.6***	***-7.6***	***0.8***	***3.8***	***4.6***
Source: EC (July 2013); Eurobank Research						

In a move to dispel some recent speculation that certain shortfalls may arise in Greece's funding programme, a European commission spokesman said on July 17th that the small shortfall expected in late 2014 could be covered by an unused buffer of ca €7bn in the €50bn programme envelope used to recapitalize domestic banks. Following the recent recapitalization of Greece's four systemic banks (and the sale of 2 bridge banks earlier this month), Bank of Greece will conduct a new stress-test on the domestic banking system with updated data up to June 2013. Both the Greek government and the troika believe that the current buffer of the bank recap envelope would be adequate to address any additional capital needs resulting from the new stress test.

Looking further ahead, the troika's baseline scenario projects a funding gap of €6.5bn in 2015 (see IMF Country Report No. 13/153, page 43) with the government funding need being fully covered by internal sources (*i.e.,* primary surplus, privatization revenue and T-bills issuance) in 2016.[15] Provided that the agreed fiscal consolidation plan will continue to be implemented without major deviations, we believe that the coverage of the aforementioned funding gaps will not be an insurmountable problem, especially as some new OSI could also provide additional (indirect) programme financing. For demonstration purposes, Table Z below depicts the cumulative financing provided by the relief measures agreed at the 26/27 November 2012 Eurogroup.

Table C – Estimated impact of new relief measures on the general government borrowing requirement in the period 2012-2016 and beyond (EURbn) - Negative (positive) sign signifies reduction (increase) in the cumulative borrowing need

	Δ Net cumulative borrowing need in 2012-2016 (EURbn)	Δ Net cumulative borrowing need in 2012-2022 (EURbn)
Increase in funding need due to debt buyback 1/	11.3	11.3
Reduced coupon payments on outstanding *privately-held* government bonds (post-buyback)	-2.9	-9.2
100bps cut in GLF interest rate	-2.1	-5.1
10bps reduction in EFSF guarantee fee	-0.6	-1.4
Return of SMP profits (coupons & capital gains)	-7.2	-10.5
EFSF interest payment deferral	-13.4	-43.8
Extension of GLF maturitities	0.0	0.0
Extension of EFSF maturitities	0.0	0.0
Increased T-bills issuance 2/	-9.0	-9.0
Higher interest payment due to increased T-bills issuance 2/	2.0	2.0
Cash buffer deferral (and reduction in size) 3/	-2.0	-2.0
Total	-23.9	-67.8

Source: EC, IMF, Eurobank Research

[15] We broadly concur with the aforementioned estimates, see e.g. *Greece Macro Monitor, "successful debt buyback opens the way for the unlocking of official funding to Greece, implementation of new package of debt relief measures", Eurobank Research, 13 December 2012.*

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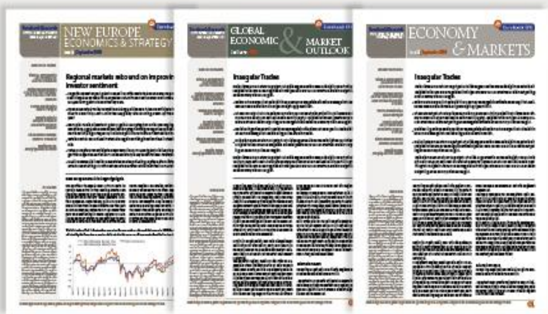

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