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www.eurobank.gr/research
research@eurobank.gr

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Upcoming troika review of Greece's adjustment programme

Agenda, progress in meeting key programme targets and assessment

Paraskevi Petropoulou
G10 Markets Analyst
ppetropoulou@eurobank.gr

Editor
Platon Monokroussos
Assistant General Manager
Head of Financial Markets Research
pmonokrousos@eurobank.gr

This report takes a close look at the agenda of the next troika review of Greece's economic adjustment programme. It presents the key milestones and analyses the progress made by the Greek authorities in fulfilling the agreed structural benchmarks and quantitative programme targets. In a nutshell, the upcoming review is expected to be a challenging one, especially taking into account the conditionality involved and the implementation hurdles stemming from a difficult socio-economic environment. From a more comforting note, recent press reports and official comments suggest that this time around domestic authorities are better prepared than in earlier programme reviews to address a number of difficult negotiation issues.

Upcoming troika review of Greece's economic adjustment programme: *what's on the agenda?*

The heads of the next troika mission to Greece are due to arrive in Athens on September 22 for the inception of the next review of the country's economic adjustment programme.1 Official discussions will reportedly focus on the progress made by domestic authorities in fulfilling: (i) a number of prior actions for the release of the next EU loan disbursement; and (ii) a range of quantitative targets and structural benchmarks required for the completion of the programme review. Table A below presents the prior actions for the release of the next EU loan disbursement to Greece. This will constitute the last sub-tranche of the loan installment approved by the July 2013 Eurogroup and will amount to €1bn (= €0.5bn from the EFSF + €0.5bn from the income on the SMP portfolio accruing to euro area national central banks).2 According to the current planning, these amounts are scheduled for release by the end of next month.3 Besides the aforementioned milestones, the upcoming programme review will assess the progress made by the domestic authorities in fulfilling a wide range of quantitative targets and structural benchmarks as laid out in the revised MoU. These will include inter alia: (i) public administration reform; (ii) observance of the agreed privatization targets; **(iii)** identification of measures

[1] A technical team of troika officials is expected to arrive in Athens on September 16th to prepare the ground for the upcoming discussions with domestic authorities in the context of the next adjustment programme review.
[2] The first EFSF sub-tranche (€2.5bn) of the €3bn loan installment approved by the July 2013 Eurogroup as well as €1.5bn from the profits accruing to the SMP portfolio of euro area national central banks (NCBs) were disbursed to Greece in late July, upon fulfillment by the Greek side of a number of agreed programme milestones, including, among others, the transfer of 4.4k employees to the mobility scheme and the sale of two bridge banks (New Hellenic PostBank and Nea Proton Bank) to a *systemic* Greek bank (Eurobank).
3 Specifically, if the troika review of the necessary milestones is successfully concluded by early October 2013, then euro area finance ministers will reportedly give the green light for the said release at their upcoming scheduled meeting on October 15, 2013. However, if all goes well, one should not exclude an even earlier approval, i.e., by the euro working group (EWG) which convenes in early October.

for the coverage of a projected fiscal gap in 2015-2016 (as well as a reassessment of a possible budgetary shortfall in 2014), coinciding with the preparation of the 2014 budget and the updated medium term fiscal plan (MTFS); **(iv)** further steps needed to safeguard financial stability in a four-pillar banking sector; **(v)** reassessment of the implementation framework of the new single property tax; **(vi)** flexibility in the domestic labor market; and **(vii)** progress in removing product market restrictions, especially as regards access to and exercise of regulated professions. According to a number of press reports, the time period required to complete the next programme review may well extend beyond 15 October 2013, when the Eurogroup is expected to give the final approval for the disbursement of the next EU loan tranche to Greece. Speaking before the European Parliament's Financial Affairs Committee last week, Eurogroup President Jeroen Dijsselbloem said that official discussions on Greece's financing gap over the implementation horizon of the current programme are expected to begin in October and conclude by November.[4]

Table A – Prior actions for the next EU loan disbursement

i. Adoption of irreversible decisions (to be implemented by December 2013) as regards the restructuring or resolution of *Hellenic Vehicle Industry (ELVO), General Mining and Metallurgical Company (LARCO)* and *Hellenic Defense Systems (HDS)*. ***Comment:*** The troika reportedly rejected an initial plan submitted by the Greek government for the restructuring of the aforementioned public entities, on the basis that it was deemed to be neither "viable" nor "realistic", from both an *economic efficiency* and a *budgetary* standpoint. As per the same sources, the troika argues that the submitted plan fails to address the problem of State subsidies provided over the last few years to HDS and LARCO, noting that the option of closure/liquidation for all three companies should also be taken into consideration.

ii. Validation by general government entities of outstanding water and drainage bills to the Water Supply & Sewerage companies of Athens and Thessaloniki (EYDAP, EYATH) and agreement on the direct payment of all undisputed claims from the programme envelope earmarked for the clearance of State arrears. Under the current privatization plan, EYDAP and EYATH are scheduled for privatization in Q3 and Q4 2013, respectively. ***Comment:*** General government entities reportedly own more than €500mn to EYDAP and around €300mn to EYATH.

iii. Placement of 12.5k employees in the mobility scheme. ***Comment:*** After transferring 4,401 of public employees to the mobility scheme in July 2013 (as a prior action for the release of the July EFSF/IMF loan tranche) the government *is reportedly on track* to live up to its commitment by placing an additional 9,241 to the said scheme by end-September 2013.The second batch of transfers will reportedly consist of: (a) 3,000 municipal police officers; and (b) 6,241 public employees from line ministries, with nearly half of them coming from the Ministry of Wealth & Welfare and the Ministry of Education, Lifelong Learning & Religious Affairs. Overall, the two waves of transfer (July & September) will amount to a total 13,643 of employees, outperforming by 1,143 the respective programme target. Arguably, this should provide a cushion in case the troika raises certain objections in the upcoming negotiations.

iv. Adoption of a new Code of Lawyers. ***Comment:*** The new Code of Lawyers was submitted to Parliament late last week and a voting session will reportedly take place by the end of September 2013. Among others, the new Code will reportedly envisage, (a) elimination of unjustified entry *restrictions e.g.* elimination of restrictions for the advertisement of law firms and their establishment across the country and abroad; (b) revision in the fee structure *i.e.*, abolition of minimum fees and fixed contract sums for each procedural act or court appearance by lawyer; (d) elimination of the mandatory presentation of lawyers in the drafting of contracts; and (d) elimination of any kind of minimum wages for salaried lawyers working in the private sector.

Source: European Commission, Occasional Papers 159/July 2013, *"The Second Economic Adjustment Programme for Greece, Third Review-July 2013"*.

[4] Furthermore, the Eurogroup President reiterated that any decisions on improving the sustainability of the Greek sovereign debt will be put off until April 2014 (i.e., when Eurostat will confirm whether or not Greece will have generated a primary surplus in FY-2013).

I. Public administration reform

Table B1 below presents some of the key issues in the area of public administration to be examined in the context of the upcoming troika review

Table B1
<u>Upcoming troika review - Public sector reform agenda</u>

- **(i)** Transfer of 12.5k employees to the mobility scheme by end-September 2013 (prior action for the release of the October EU loan disbursement).
- **(ii)** Preliminary discussions on the placement of an additional 12.5k of employees to the mobility scheme by December 2013.
- **(iii)** Evaluation framework for assessing whether employees placed in the mobility scheme possess the necessary qualifications to fill in vacant positions in the broader public sector, with those failing to meet these requirements being subject to permanent separation.
- **(iv)** Staffing plans covering 400k public sector employees.

Source: European Commission, Occasional Papers 159/July 2013, *"The Second Economic Adjustment Programme for Greece, Third Review-July 2013"*.

<u>Comments & assessment</u>

<u>Comment 1:</u> Greece's Minister of Administrative Reform and E-Governance said recently that the government plans to request an extension of the December 2013 deadline for the transfer of an additional 12.5k of public employees to the mobility scheme.[5] As laid out in the updated MoU, a total of 25k public employees should have been shifted to the said scheme by the end of this year, so as to create the space needed for addressing areas and functions featuring a deficit of skilled staff.[6] Public employees transferred to the mobility scheme will be receiving either 75% of their basic monthly salary for eight months (from twelve months originally) or one-third of that, in case of disciplinary suspension. The Minister added that the government intends to establish a permanent tool for the reallocation of personnel, so as to enhance human resources management in the broader public sector.
<u>Comment 2:</u> According to local press, the Greek government has already completed the evaluation framework for assessing employees transferred to the mobility scheme.[7]
<u>Comment 3:</u> The Greek government is reportedly to track to complete (by end-September 2013) staffing plans involving as many as 400k employees. As laid out in the updated MoU (July 2013), staffing plans covering the broader public sector need to be adopted by end-2013 while plans for the hiring and re-allocation of positions for 2014 should be approved in autumn and be included in the 2014 Budget.[8]

[5] Local media reported recently that in the context of the upcoming troika review the government will also negotiate the inclusion of some 5k contractual staff in the pool of employees that will be subject to outright dismissals in 2013-2014 (15k in total). The latter has been agreed as part of a key programme target for reducing public sector employment by 150k in 2010-2015, mainly via natural attrition and the application of a 1:5 hiring rule.
[6] According to the updated MoU, each dismissed employee will be replaced by a new recruit, through a meritocratic process. Yet, the aforementioned 1:1 hiring rate will have to be adjusted downwards in due course should it risk violating the agreed target for a reduction in the public sector by 150k over the period 2010-2015.
[7] The said framework will examine, among others: (i) whether or not the employee has been hired via the Supreme Council for Personnel Selection (ASEP); (ii) her educational qualific ations; (iii) her administrative experience; (iv) whether or not the employee has ever been accused for breaching the code of conduct; and (iv) her score in a number of evaluation tests.
[8] Through end-June 2013, staffing plans were prepared for only 361k employees against an official target of 450k.

II. Additional steps needed to safeguard financial stability in a four-pillar banking sector

Post the successful completion of the bank recapitalization and resolution programme,[9] the updated MoU envisages additional steps for the development of a comprehensive banking sector strategy aiming to safeguard financial stability and to facilitate a swift restoration of liquidity conditions in the domestic economy (***Table B2***). An assessment of preparatory work already made by the Greek side as regards the implementation of the said strategy will feature high on the agenda in the upcoming discussions with the troika.

Table B2
Financial sector policies - Additional steps to safeguard stability in the domestic banking system

(i) Domestic banks will have to undertake a new stress test exercise by end-2013, based on end-June 2013 bank-related data and updated macro scenarios. The said exercise will update domestic banks' capital needs and will be conducted by the Bank of Greece (BoG) under the oversight of a steering committee comprised of representatives from the EC/ECB/IMF troika and EBA. Greek authorities have already engaged Black Rock consultant to conduct a new asset quality review of domestic banks, with an interim deadline of completion by end-October 2013 and delivery of the final report by end-November 2013.

(ii) The BoG, in cooperation with official lenders, has committed to present options for the prompt disposal by end-March 2014 of a "substantial" Eurobank equity stake to private investors. To this end, an evaluation metric for potential investors will be developed by end-October 2013 and potential bidders will be allowed to start a due diligence process no later than end-November 2013.

(iii) Divestments out of non-core assets. As part of this strategy, the four systemic banks are required to reassess their restructuring plans and submit them for validation to the European Commission's Director General for Competition by end-September 2013.

(iv) Improved management of non-performing loans (NPLs). The BoG, in consultation with domestic banks and EC/ECB/IMF experts, has committed to issue by end-2013 a time-bound framework for banks to facilitate settlement of borrower arrears. In this direction, banks are required to present by mid-September 2013 a strategy for improving their distressed credit operations *e.g.* by strengthening internal arrears management and/or contracting external work-out specialists.

Source: IMF Country Report No. 13/241, July 2013

Comments & assessment

Comment 1: Notwithstanding a number of steps already taken to improve the effectiveness of NPL resolution activities, the updated financial sector strategy agreed with the troika envisages further initiatives to facilitate the clean-up of bank balance sheets. These include, among others, an enhanced debt enforcement and collateral recovery framework as well as the establishment of an effective out-of-court restructuring mechanism.[10,11]

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[9] The banking sector recapitalization was completed successfully in June 2013 (structural benchmark for the last programme review), in accordance with the BoG requirements (a minimum core tier 1 capital ratio of 9% of risk-weighted assets as of end March 2013) and the recapitalization framework laid out in Greek Law 3864/2010 and the Cabinet Act 38/2012. Three out of the four systemic banks, National Bank of Greece, Alpha Bank and Piraeus Bank, exceeded the 10% minimum requirement of private investment in the capital increase process (thereby, remaining under private management control), with the Hellenic Financial Stability Fund (HFSF) covering the remaining amount through the issue of common shares. The fourth systemic bank, Eurobank, opted for full recapitalization via the HFSF.

[10] Aiming to the facilitate the handling and resolution of bad debts, the Greek Parliament approved in June 2013 amendments in the s0-called "Katseli" household insolvency law (3869/2010). The modifications to the said law intend to improve the payment culture and to remove a number of moral hazard creating aspects of the previous framework by, inter alia, introducing a mandatory minimum monthly payment until the court hearing date and by allowing a specific majority of creditors to take a decision on an out-of-court settlement of household debts. Moreover, the Greek Parliament approved early this summer legislation for the implementation of a new restructuring scheme for mortgage loan payments (i.e., the so-called "Facilitation Program"), which allows heavily indebted households, businesses and self-employed to restructure their mortgage loan with more favorable terms. The newly adopted scheme determines eligibility criteria (i.e., debtor assets and income) and debt repayment installments in accordance with the debtor's financial affordability.

[11] MF Country Report No. 13/241, Fourth Review Under The Extended Arrangement Under The Extended Fund Facility, And Request For waivers Of Applicability And Modification Of Performance Criterion", July 16, 2013.

Comment 2: According to press reports, Greece's Prime Minister Antonis Samaras and Deputy Prime Minister Evaggelos Venizelos agreed recently on a gradual suspension (as of January 1st 2014) of a moratorium of forecloses for primary residences that was first applied in 2009 and renewed each year since then. As per the same sources, the most vulnerable social groups (e.g. long-term unemployed, handicapped, those having more than three children) will be exempted from the measure.[12] More specifically, the government reportedly intends to introduce a rolling 5-year suspension of foreclosures. This effectively means that primary residences will not be auctioned before the expiration of a 5 year period, commencing when the mortgage loan (or consumer loan or credit cards amounting to more than €20k) was deemed non-performing *e.g.* the borrower has failed to make interest or principal payments for more than 90 days. Should the moratorium on primary residences is finally lifted, it is reportedly estimated that ca 6k-7k properties will be auctioned each year.[13] Currently, the limit for primary residence foreclosure is set at €200k (and goes up to €450k depending on the debtor's marital status and number of children). According to reports, the government is considering to reduce the aforementioned threshold by up to 10% per year, while vacation houses, professional and commercial properties will be auctioned after the expiration of the 5-year period, irrespective of their objective value.

Comment 3: All major opposition parties have opposed vehemently the purported plan for a gradual lifting of property foreclosures. Turning to the government camp, as many as three deputies from the two coalition parties have openly opposed the said plan, with 9 more reportedly favoring an extension of the moratorium on foreclosures for another year.

Comment 4: As per the latest EU Commission report on Greece (July 2013), NPLs in Q1 2013 reached €63.6bn or 29% of total bank loans, up from 24.2% at end-2012 with 60% of them attributed to the corporate sector. Restructured loans amounted to 5.6% of total loans over the same period. The coverage of NPLs including restructured loans by provisions increased slightly from 39.7% at end-2012 to 40.4% in end-Q1 2013. Furthermore, write-offs increased by 168% to €3.9bn in Q1 2013 (1.7% of total loans), while recoveries decreased by approximately 56.8% to €0.34bn over the same period.

III. Observance of agreed privatization program targets

A comprehensive assessment of Greece's privatization programme will be high on the agenda in the upcoming troika review. As a reminder, the privatization proceeds target for 2013 was recently adjusted downward (by €1bn to €1.6bn) after Greece failed to secure binding bids for the sale of Public Gas Corporation (DEPA)[14,15] According to the Hellenic Republic Asset Development Fund's latest report, privatization proceeds over the first quarter of this year amounted to just €69mn, generated from the granting of a concession contract on the International Broadcasting Center (IBC) to Lamda Development last summer. For the rest of the year, the Greek privatization fund expects additional revenue to come from the privatization projects listed in ***Table B3.***

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[12] Additional criteria will reportedly include: (i) the outstanding amount of the loan; and (ii) the borrowers' willingness to agree on a payment plan.
[13] See e.g. *Kathimerini* newspaper, 23 August, 2013.
[14] The sale of DEPA was estimated to yield ca €1bn.
[15] Cumulative projected privatization revenues over the period 2011-2020 have been revised as follows: €6.7bn by end-2014 vs. €6.1bn expected earlier; €8.7bn by end-2015 (vs. €8.1bn), €10.7bn by end-2016 (vs. €10.1bn projected initially); and €24.2bn by end-2020 (from €23.6bn previously). The main bulk of privatization proceeds is expected to be raised from concession contracts on public property and infrastructures. The earlier-envisaged amount of €50bn in cumulative privatization revenue remains valid, though it is now expected to take longer to materialize.

Table B3 – Privatization programme 2013

(i)	Sale of a 33% stake in gambling company OPAP to Greek-Czech investment consortium Emma Delta Fund (up-front payment of €622bn, upon *finalization* of the transaction, plus €30mn in ten equal annual installments). The said transaction has already been approved by the Court of Auditions and its finalization remains subject to approval by the relevant competition authorities (*reportedly* expected by end-September 2013).
(ii)	A 12-year contract signed with Hellenic Lotteries SA (a consortium formed by OPAP Investment Limited, Intralot Lotteries Limited and Scientific Games Global Gaming S.á.r.l).for the operation of State Lotteries. The concession agreement has already been approved by the Court of Auditions, the Hellenic Parliament and the Greek competition authority, involving: ***a)*** €580mn in 12 annual installments (€30mn in the first year and €50mn/annum afterward) and ***b)*** an upfront payment of €190mn (out of which, €38mn has already been paid to a special segregated account, €95bn is due upon finalization of the concession and the remaining €57bn is expected in early 2014). Finalization of the transaction is subject to approval by the competition authority of Cyprus (reportedly expected by end-September/early October 2013).
(iii)	Sale of a 66% stake in National Gas Transmission Network Operator DESFA (31% owned by HRADF *plus* 35% owned by Hellenic Petroleum S.A) to Azeri state energy company Socar for €400mn. Finalization of the transaction remains subject to approval by the EU competition authorities (reportedly expected by end-2013).
(iv)	Completed sale of four State properties abroad, *i.e.,* London, Nicosia, Brussels and Belgrade (ca €33mn).
(v)	Sale of three State properties in the mainland (ca €7.4mn).
(vi)	Granting of a concession contract to NCHF Capital for the exploitation of the Kassiopi area in the island of Corfu for 99 years (€23mn via the acquisition of the leasehold).
(vii)	Other privatization projects included in the 2013 privatization programme (European Commission Occasional Papers 159/July 2013 *"The Second Economic Adjustment Programme for Greece Third Review – July 2013"*., page 27)

Source: Hellenic Republic Asset Development Fund (HRAD), Local Press

Comments & assessment

Comment 1: Progress has already been made by the Greek side in preparing state assets for privatization (title clearance, licensing etc.). Around 3,140 real estate properties with an estimated value of ca €10bn were identified and pre-valued in early 2013 to provide the basis for sales over the next 2-3 years. Out of them, 1,000 are scheduled to have been transferred to the Hellenic Republic Asset Development Fund (HRADF) by end-2013, targeting 250 transfers per quarter. Yet, the overall speed of the privatization process is considered as being far from satisfactory. Indicatively, the total number of state assets transferred to the HRADF year-to-date, reportedly amount to ca 290, less than officially planned.

Comment 2: As per the July 2013 IMF report on Greece, potential governance changes to the HRADF "would need to be considered in the context of the next review," should delays in the implementation of the privatization programme "continue taking on a systemic character".[16]

Comment 3: Both the Greek government and the European Commission dismissed recent press reports suggesting that the next troika review may consider the adoption of a plan envisioning the transfer of state-owned assets (not currently in the privatization pipeline) to a Greek-owned Special Purpose Vehicle (SPV) based in Luxembourg and run by foreign experts. As per the same sources, the purported plan has been prepared by the European Stability Mechanism (ESM), targeting among others, the issuance of asset-backed bonds, in an effort to overcome implementation hurdles (e.g. administrative, bureaucratic and legal complexities).undermining the agreed privatization plan targets

[16]HRADF Chairman Stelios Stavridis was dismissed last month on "ethical reasons".

IV. Reassessment of the implementation framework of the new single property tax

The new single property tax is scheduled to come into force on January 1, 2014, levying around 5.6mn taxpayers (***Table B4***). It will replace both the wealth tax on property (FAP) and the special levy (EETHDE) currently collected via electricity bills. The Hellenic Parliament is expected to vote by end- September 2013 on a draft bill determining the implementation framework of the new single property tax (structural benchmark).

Table B4
Single Property Tax: key features

(i)	The new tax will effectively target properties rather than individuals. It will have a broader base, including items which are currently tax exempted such as commercial, industrial and agricultural properties as well as farmland and fields that fall outside urban planning. The said items will share 25-30% of the overall tax burden and, as a result, it is estimated that the new framework will lessen the burden on currently taxed properties.
(ii)	The new property tax will be calculated based on 33 different zone price bands (according to a new list of property objective values dating from 2007) compared to just 9 applied on the EETHDE, so as to more accurately reflect the underlying value of property.
(iii)	The new tax is intended to be revenue neutral, generating €2.7-2.9bn/annum.

Source: IMF Country Report No. 13/241, July 2013

<u>Comments & assessment</u>

<u>Comment 1:</u> The latest IMF assessment of Greece's adjustment programme (July 2013) estimates an annual collection rate of 70% for the new single property tax (preliminary estimate). This effective suggests that in order to secure the required tax revenue (i.e., €2.7 to €2.9bn/annum) total assessed taxes should amount to €4.15bn, with any uncollected amount (€1.45bn/annum if a 70% collection rate is realized) accruing to outstanding tax arrears On their part, Greek authorities have reportedly completed the implementation framework of the new single property tax assuming an 80% collection rate. The latter implies that assessed taxes under the new tax should amount to no more than €3.6bn. As a result an upward revision in some (or all) of the assumed 33 zone rates should not be ruled out in the context of the upcoming troika review.
<u>Comment 2:</u> As per the July 2013 IMF report on Greece, achieving good compliance rates for the unified property tax may prove out to be a major challenge for the Greek authorities, especially at the outset, as the General Secretariat of Revenue is already engaged with a number of other major reforms including, strengthening its autonomy and operational efficiency. Additionally, the collection of the said tax will be reliant on self-assessment i.e., similarly to the current FAP and in contrast to the special PPC levy (EETHDE) which is collected via electricity bills. On that account, the troika believes that domestic authorities should consider extending the implementation horizon of the PPC levy beyond end-2013, provided that certain modifications are made to take into account concerns about its constitutionality.

V. Assessment of domestic labor market conditions

Undoubtedly, the comprehensive labour market reform introduced in late 2011 and in early 2012 as a prior action to the 2nd troika bailout agreement has already induced significant flexibility in the domestic jobs market, facilitating a rapid decline in wage costs.[17,18] Yet, in its latest assessment of Greece's economic adjustment programme (July 2013), the IMF claims that employment protection rules in Greece remain very rigid, especially on collective dismissals. As per the said report, labor market related issues will be taken into consideration in the next troika review (September 2013).

Comment: Some local press reports speculated recently that the next troika review may consider the adoption of new structural measures aiming to enhance flexibility in the domestic labor market and further compress wage costs. As per the same sources, the troika has requested: (i) doubling the 5% monthly limit of layoffs in companies with more than 150 employees; (ii) elimination of the 13th and 14th salary installments in the private sector; (iii) a further reduction in the minimum monthly wage (currently, €586 in 14 monthly payments or €684 in 12 monthly payments); and (iv) an additional decline in the lay-off compensation for dismissed employees.[19] Responding to the aforementioned reports, Greece's Minister of Labour, Social Security and Welfare said recently that there is no question of abolishing the 13th and 14th salary installments in the private sector or reducing further the minimum wage. On the latter, the Greek minister stressed that the minimum wage will remain frozen until at least January 1, 2017, when the recently adopted Law 4093/2012 comes into force.[20]

VI. *Progress in removing restrictions to the access and exercise of regulated professions*

An assessment of reforms undertaken so far by domestic authorities in removing restrictions to the access and exercise of regulated professions will be conducted in the context of the upcoming troika review of Greece's economic adjustment programme.

Comment: Greece has already undertaken a number of steps towards removing restrictions on entry, minimum prices and mandatory use for a number of regulated professions and economic activities (e.g. actuaries, oenologists). Yet, some key professions/activities have yet to be fully liberalized. Aiming to address this issue, the Greek government has committed to, among others: (i) undertake by end-September 2013 a number of steps towards the full liberalization of the professions of geotechnicians, engineers and chartered valuers; (ii) adopt by end-August 2013 the required legislation for the liberalization of long-distance bus services and the sale of selected products outside pharmacies; and (iii) present by end-September 2013 certain proposals to official lenders for the elimination of the minimum duration period for commercial rentals. Additionally, as a prior action for the release of the October EU loan disbursment; the Greek side has committed to the adoption of a new of Code of Lawyers.

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[17] As a prior action to the signing of the 2nd EU/IMF rescue programme, the Greek Parliament approved in early 2012 legislation intended to compress wage costs and to further liberalize the domestic labor market via: (i) removal of the permanent employment status from all labor contracts and freeze of maturity coefficients (i.e., automatic salary increases irrespective of productivity or cyclical conditions); (ii) limiting the length of the so-called "after effects" of collective contracts to three months from six previously (i.e., in the absence of a new contract, wages fall close to the minimum wage three months after a contract expires); (iii) recourse to arbitration for settling negotiation disputes to be allowed only if both parties (employee and employer representatives) agree to it; (iv) collective agreements to be limited to a maximum duration of 3 years; and (v) a 22% reduction in the minimum wage at all levels along with a further 10% decline for new entrants under the age of 25.

[18] By 2014, Greece is projected to have regained its 1995 labor cost competitiveness, primarily through lower wages

[19] Under the current legislation, lay-off compensation for dismissed employees is capped at 16 gross monthly salaries, even in cases employees have worked for more than 16 consecutive years with the same employee.

[20] The said law was adopted by the Greek Parliament in June 2013. Among others, it allows the determination of wage floors through a ministerial decision.

VII. *Identification of measures for the coverage of the projected fiscal gaps in 2015-2016, reassessment of a possible budgetary shortfall in 2014*

The baseline macroeconomic framework assumed in the latest European Commission report on Greece's economic adjustment programme projects fiscal gaps worth around 1.75%-of-GDP in 2015 and 2%-of-GDP in 2016 (on a cumulative basis).[21] The coverage of these shortfalls is deemed necessary to help attain the envisaged targets of a primary surplus of 3.0%-of-GDP in 2015 and 4.5%-of-GDP in 2016 (***Table B5***).

Table B5 - General government primary balance targets & projected fiscal gaps (ppts-of-GDP)

	2012	2013	2014	2015	2016
Primary balance target	-1.3	0.0	1.5	3.0	4.5
Fiscal gap	0.0	0.0	0.0	1.75	2.0
Source: EC (July 2013)					

In accordance with the conditionality laid out in the present programme, specific measures to close these gaps should be identified in the context of the upcoming troika review, coinciding with the preparation of the 2014 budget and the medium term fiscal plan (MTFS) update. As noted in the latest European Commission report on Greece (Occasional Papers 159/July 2013 page 24), the aforementioned fiscal gap estimates rely on the assumption of significant progress in strengthening the capacity of the tax and social security revenue administrations to increase collection and on stronger compliance incentivized by the recent tax reforms. The said report also read that in the autumn 2013 new macroeconomic and fiscal data will provide more complete information on the size of any remaining gaps. In these lines, the last IMF assessment of the Greek adjustment programme clarified that the next troika review will reassess the effectiveness of a range of measures agreed in the context of the last programme review (July 2013).[22] The aforementioned measures were adopted as part of the prior actions to the latest EFSF/IMF loan disbursements and aimed to bridge a number of fiscal shortfalls (worth as much as 0.5ppts-of-GDP per annum) that could create deviations from the agreed fiscal targets in 2013 and 2014.[23,24] As things stand at this point, it is not yet clear what specific strategy will be chosen to deal with the aforementioned fiscal gaps, but, presumably, some guidance may be provided by the January 2013 IMF report on Greece. The said report reads that *"To close the estimated gap of up to €4 billion, the authorities intend to focus on retaining expiring measures, base broadening, and gaining efficiency savings from long-term structural reforms. The largest gains would come from extending expiring revenue measures (i.e., the solidarity surcharge on PIT). Staff also sees potential in continuing the reforms of the social benefits system, which remains complicated and inefficient. The fifth review, coinciding with the preparation of the 2014 budget and MTFS update, will aim to define specific measures".*

[21] European Commission Occasional Papers 159/July 2013 *"The Second Economic Adjustment Programme for Greece Third Review – July 2013".*
[22] IMF Country Report No 13/241, July 2013.
[23] For a more thorough analysis on the issue see *Greece Macro Monitor, "Adjustment in twin deficits continues; signs of stabilization in domestic economic activity increase despite lingering risks".*
[24] These measures included, among others, the frontloading of a luxury tax, the imposition of a special solidarity surcharge on income from interest and deposits, an increase in fees for lawsuits and a claw back mechanism in healthcare expenditure on diagnostics and private clinics so as to prevent expenditure deviations from fiscal targets.

<u>Comment:</u> According to local press reports, the Greek government now forecasts an overall fiscal gap *no* higher than €2.5bn over the period 2015-2016. This compares with a troika baseline projection for a fiscal shortfall of around €4bn arising in the aforementioned period.[25] The government's more optimistic projection is reportedly based on a relevant assessment by Greece's General Accounting Office (GAO) arguing that, in view of the improved GDP growth dynamics, government revenue may well exceed the relevant medium term fiscal plan (MTFS) targets by as much as €500mn in 2014 and €1.8bn in 2015.[26] Furthermore, the argument goes, the financial benefit from the overhaul of the public sector does not seem to have properly been taken into account in the troika's baseline calculations as regards the 2015-16 fiscal gaps. In his keynote speech at the Annual Thessaloniki International Fair last week, Greek Prime Minister Antonis Samaras stressed that he is categorically opposed to new austerity measures (*i.e.*, as a means of addressing the said fiscal shortfalls). Moreover, local press reports suggested recently that in an effort to address the aforementioned issue, the government will instead propose a number of structural measures, including, among others, the closure or merging of universities, hospitals and arm camps.

VIII. Coverage of projected financing gap in H2 2014, so as to keep the current programme fully-funded on a 12-month forward basis

Under the troika's baseline macro scenario, Greece's adjustment programme is fully financed through July 2014, but a financing gap is expected to open up in August 2014, requiring additional financing so as to keep the programme fully funded. This issue is expected to be high on the agenda in the upcoming negotiations with the troika. ***Table B6*** provides an analytic depiction of the projected evolution of the general government borrowing needs and sources of funding over the remaining time period of the present official financing programme (Q3 2013-Q4 2014). As shown in the said table, a funding gap is expected to arise in H2 2014, accumulating to ca €4.6bn by the end of that year. That is, assuming that all relevant underlying variables (*e.g.* primary balance and privatization revenue) will evolve broadly in line with the troika's present macroeconomic scenario. In a move to dispel 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 in the €50bn programme envelope used to recapitalize and restructure domestic banks.[27,28]

<u>Comments & assessment</u>

Judging from recent official comments on the aforementioned issues, one could envisage a number of strategies to deal with the financing gap that is expected to arise in the 2nd half of next year. These could include, among others: **(i)** the rollover of maturing Greek government bonds (GGBs) in the investment portfolios (ANFAs) of euro area national central banks; and **(ii)** increased EU co-financing rates in Greece's next National Strategic Reference Framework (NSFR) for 2014-2020. As regards item

[25] See e.g. European Commission Occasional Papers 159/July 2013 "The Second Economic Adjustment Programme for Greece Third Review – July 2013"; Table C1 – page 97.

[26] According to the most recent national account data, Greece's real GDP contracted by 3.8% YoY in Q2 2013, a slower pace of decline than the -4.6% YoY reading reported in the flash GDP report, bringing the average rate of contraction in the first half of the year to -4.7% YoY. The improvement was mainly due to net exports as a result of higher export receipts and the continuing compression of imports. In view of these developments, it appears quite likely that the 2013 full-year GDP reading will outperform the -4.2% official projection. Further ahead, the troika's baseline scenario (to which we broadly concur) forecasts a switch to positive growth rates from 2014 onwards.

[27] According to a report released recently by the Hellenic Financial Stability Fund (HFSF), the said buffer stood €11.3bn at the end of H1 2013.

[28] Following the recent recapitalization of Greece's four systemic banks, Bank of Greece will include 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.

(i), this will be high on the agenda of the EuroWorking Group in early October 2013. Over the first seven months of the year, Greece has reportedly paid €1.8bn for maturing GGBs held in the ANFA portfolios. As per the European Commission report the first review of Greece's present 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. In relation to item (ii) above, recent reports suggested that the government intends to propose the 95% co-financing rate of investment subsidies for the National Strategic Reference Framework (NSFR) for 2007-2013 to be maintained in the new NSFR for the period 2014-2020.

Table B6 - 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						

Research Team

Editor, Professor **Gikas Hardouvelis**
Chief Economist & Director of Research Eurobank

Financial Markets Research Division

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Theodosios Sampaniotis: *Senior Economic Analyst*
Theodoros Stamatiou: *Research Economist*

Eurobank, 20 Amalias Av & 5 Souri Str, 10557 Athens, tel: +30.210.333 .7365, fax: +30.210.333.7687, contact email: Research@eurobank.gr

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