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July 8th Eurogroup expected to approve release of the next EFSF/IMF loan tranche

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Troika staff-level agreement reached on 4th programme review

According to a statement issued earlier today (July 8, 2013) by the EC/ECB/IMF troika of official lenders, the 4th review of Greece's adjustment programme was concluded, after a staff-level agreement was reached with the domestic authorities on the economic and financial policies required to facilitate fulfillment of the agreed targets. As per the said statement, policy implementation is behind in some areas, though important progress continues to be made. Against this background, the Greek government has committed to take corrective actions to ensure fulfillment of the fiscal targets for 2013-2014 and to facilitate a return to primary surpluses as early as in the current year. Such corrective measures include, among others, concrete steps to contain health sector overspending and to ensure the proper implementation of agreed reforms in key arrears such as: (i) income and property taxation (in progress); (ii) establishment and proper functioning of a semi-autonomous revenue administration (in progress); (iii) pubic administration; and (iv) domestic banking system restructuring and recapitalization (already in advanced stage). According to the troika statement, the government's proposal for a VAT rate reduction on catering and restaurants was rejected in the context of the current review, but the issue will remain under discussion. As regards Greece's growth prospects, the troika sees the domestic macroeconomic outlook remaining broadly in line with programme projections with prospects for a gradual return to growth in 2014. Troika inspectors and Greek Minister of Finance Yiannis Stournaras left Athens late on Sunday to attend the July 8th Eurogroup.

July 8th Eurogroup expected to approve release of the next EFSF/IMF loan tranche

The staff-level agreement in the context of the 4th programme review is expected to pave the way for a political Eurogroup approval of the release of the next EFSF loan tranche to Greece. The said tranche amounts ca €6.3bn and consists of: (i) €5.6bn in (frontloaded) EFSF funding, comprising of the two installments initially scheduled for Q3 & Q4 2013 (€3.0bn and €2.6bn, respectively); and (ii) €0.636bn from the FY-2013 income accruing to Eurosystem National Central Banks from their Greek government bond holdings in their ANFA (i.e., investment) portfolio. The latter is part of the debt relief measures for Greece agreed at the 26/27 November 2012 Eurogroup. In addition to the aforementioned amounts, the IMF Board is expected to decide on July 24 on its contribution (€1.8bn) to the next loan tranche for Greece, raising the overall amount of external financing to €8.1bn.

A key precondition for the release of the next EFSF/IMF loan tranche - reportedly, to be disbursed either as a lump sum amount or in the form of monthly installments - is the issuance of a number of related ministerial decrees and the parliamentary approval of a multi-bill containing the required legislation for the implementation of the agreed milestones. Submission of the said omnibus bill to Greek Parliament (under an emergency procedure) is expected on July 9th, with a vote taking place by the end of the current week.[1] Given the government's determination to deliver on its programme commitments, the most likely scenario is the multi-bill to easily pass through Parliament, provided also that there is no clear indication at this point that any deputy from the two governing coalition parties would oppose it. The coalition government currently controls 155 seats in the 300-seat parliament (*New Democracy* controls 127 and socialist *PASOK* 28).[2]

The number of in-favor votes may rise even further, given that Andreas Loverdos, ex-PASOK Deputy and Head of the *newly-established Agreement for a New Greece* made clear recently that he opposes early elections and he would support the new coalition government if needed. Independent MP (and ex-PASOK Deputy) Christos Aidonis adopted a similar stance. In-favor votes may also come from the Democratic Left camp, after President Fotis Kouvelis said recently that his party would provide support the government on a case by case basis. It is also worth noting that in a recent emergency meeting of the DP's Parliamentary Committee, 11 members voted in favor of the party's decision to pull out of the government, one abstained and two, Grigoris Psarianos and Vasillis Oikonomou, voted against, opposing openly the official party line.

Conditional on the parliamentary approval of the said multi bill, the Euro Working Group is reportedly expected to endorse by July 19 the disbursement of the next EFSF loan tranche to Greece. According to European Commissioner Olli Rehn, the next tranche may be probably be split into monthly installments, with their disbursement being subject to the fulfillment by the Greek side of certain program milestones, given that "official lenders have become increasingly frustrated with Greece's slow pace of overhauling public administration"

Measures agreed in the context of the 4th programme review

In the context of the 4th programme review, the two sides reportedly reached agreement on a number of measures and policies aiming to facilitate fulfillment of programme targets. These include, among others: (i) a 3-month extension of the deadline for the transfer of 12.5k public employees to the *so-called* mobility scheme; (ii) payment of the special real estate levy (EETHDE) for 2013 in five installments, in line with the government's proposal; (iv) downward revision in the privatization proceeds target for FY-2013; and (v) completion by end-July 2013 of the sale of the two bridge banks, New Hellenic PostBank and Nea Proton Bank, currently controlled by the Hellenic Financial Stability Fund (HFSF). In more detail:

Public administration reform

- Following the government's failure to meet the end-June-2013 structural benchmark for the transfer of 12.5k public employees to the so-called mobility scheme, the troika accepted a request by *newly-appointed* Minister of Administrative Reform and E-Governance Kyriakos Mitsotakis to allow a 3-month extension (to September 2013) of the initial deadline.
- In return, the Greek side accepted a reduction in the duration of the mobility scheme to 8 months from 12 months previously. Under the agreed plan, civil servants transferred to the mobility scheme will be receiving 75% of their basic monthly salary for 8 months before being subject to permanent separation, in case they fail to be reappointed in the broader public sector to fill in vacant positions. This is part of a broader committee to reduce public sector employment by 15ok by 2015, relative to the end-2010 level (target likely to be outperformed, in our view).
- The first wave of transfers to the mobility scheme (ca 4.25k employees) will have to be completed by end-July 2013 and, will come from the following polls:

    (i) 2.2k employees from the Ministry of Internal Affairs, *e.g,* school crossing guards and cleaners;
    (ii) 2k secondary school teachers of different specialties, who will be transferred to administrative positions in line ministries;
    (iii) 50 employees from the Ministry of Administrative Reform and E-Governance, upon identification of redundant positions following the completion of staffing plans for line ministries.

[1] According to Article 67 of the Constitution of Greece, the Hellenic Parliament cannot resolve on Bills (or law proposals) without an absolute majority (50% +1) of the attending MPs, which cannot be less than one-fourth of the total number of parliamentary deputies (i.e., 75).

[2] Note that ex-junior coalition partner, Democratic Left (DL), which occupies 14 seats in Parliament, announced last month its decision to pull out of the government (and withdraw its four ministers from the cabinet),.following an internal government rift over the closing

down of national broadcaster (ERT).

The remaining 8.25k transfers that will need to be completed by end-September 2013 will come from the following pools;

(i) 3.5k municipal police officers who will be transferred – after undergoing an evaluation test and some kind of training- in the ranks of the Hellenic Police (ELAS), where shortfalls in active police units have been identified. The re-hiring rate for this group of employees will reportedly be 3-to-1, *e.g.* for every 1 employee transferred to the main police force, another three will be dismissed;
(ii) 2k from line ministries;
(iii) 1.5k secondary school teachers currently employed in administrative positions in line ministries; and
(iv) 1.25k from local government entities.

- As laid out in the updated MoU, an additional 12.5k of public employees will have to be transferred to the mobility scheme by the end of this year, so as to create the space needed for the hiring of new staff, particular young and highly qualified in several priority areas. These pending transfers (along with the planned layoffs of 15k public employees in 2013-2014) will mainly come from the following pools:

(i) the restructuring of the State deference industries, involving Greek Defense Systems (EAS), Hellenic Aerospace Industry (EAB) and the Greek Vehicle Industry (ELVO);
(ii) merged and closed-down pubic organizations and private-law entities resulting in redundant positions. The first list of state bodies that are to be merged and/or abolished was announced last month, featuring 17 public organizations and 46 public libraries, research centers and academies, employing a total of 416 staff;
(iii) employees who will be found guilty of breaching the code of conduct upon completion of legal procedures, or/and have been appointed with false documentation or/and have been unjustifiably absent from their work for a protracted period of time.

- According to the local press, the troika rejected a government proposal to have the 2,65k employees of the Hellenic Broadcasting Corporation (ERT) that was shut down last month be counted in the list of 2k layoffs planned for Q3 2013. As per the same sources, the troika is not willing to accept that the government has carried out any permanent dismissal so far, until they receive more details about the hiring plans of a transitional broadcast service, expected to start running by September 2013. Under the updated MoU, the Greek government has committed to carry out 2k mandatory exits by end Q3 2013 and 4k cumulatively by the end of the current year, while an additional 11k will have to be removed by the end of 2014.

Special real estate levy (EETHDE) for 2013 to be paid in 5 installments; new Single Property Tax to be collected through tax offices

- The special real estate levy (EETHDE) for 2013 will be paid in five installments, through electricity bills. Reportedly, the troika had initially insisted the said levy is paid in four installments, amid concerns that the last installment, to be collected after February 2014, will result in a revenue shortfall of €400mn in the FY-2013 Budget.
- The new Single Property Tax, to be introduced in 2014, will replace both the national-level Property Tax (FAP) applied to all real estate holdings and the special levy (EETHDE). The new single tax will be calculated based on 33 different tax rates (according to a new list of property objective values) and will be collected through tax offices. The troika had initially proposed a simpler tax system for real estate and the continuing collection of the new property tax though electricity bills, so as to secure projected revenues of at least €3.2bn/annum, *i.e.,* the total amount currently collected via all property taxes.
- Aiming to broaden the tax base, the new Single Property Tax will be imposed on properties which are currently exempted, such as farmland and fields that fall outside urban planning, city or settlement limits. No-tax free threshold will be imposed, while the only property owners to be exempted will be the long-term unemployed and taxpayers with income below the poverty line.

- A draft bill determining the implementation framework of the new Single Property Tax will be submitted to Parliament in September 2013.

Sale of New Hellenic PostBank and Nea Proton Bank to be concluded by end-July 2013

- According to a number of local press reports, the troika accepted a government proposal to extend by a fortnight the deadline for the sale of the two bridge banks currently controlled by the HFSF, *i.e.,* New Hellenic Postbank (TT) and Nea Proton Bank. Note that the sale of these two banks is a key structural benchmark under the present adjustment programme.
- Binding offers for the sale of New Hellenic Postbank are expected on July 9, 2013. According to local press, three systemic Greek banks i.e., Eurobank, National Bank of Greece and Alpha Bank as well as two foreign funds have already expressed interest in acquiring New Hellenic Postbank.
- In the context of the present bank restructuring programme, Hellenic Postbank was broken-down in January 2013 into: (i) the so-called "good part", to which all deposits and sound assets (loan portfolios and securities) were transferred; and (b) the "bad part" where the bad loans portfolio was transferred. These transactions involved an upfront cost for the HSFS of around €4.5bn. Reportedly, total deposits of the good part of Hellenic Postbank are estimated at ca €11bn, its network includes ca 200 branches and its loan portfolio is assessed at €7bn with a loan to deposits ratio no higher than 65%.
- Looking further ahead, domestic authorities in cooperation with the EC/ECB/IMF staff will have to prepare shortly a comprehensive strategy for the domestic banking system (structural benchmark) addressing, among others, options and operating steps for the HFSF to promptly proceed with the disposal of the shares to the private sector of the core banks that were not able to remain under private management control. During the last round of negotiations, the troika reportedly insisted on a swift return of Eurobank under private management control, with a 20%-30% stake in the Bank to be sold by September 2o13. As a reminder, Eurobank became the first fully-recapitalized systemic Greek bank after its Board decided in late April 2013 to have the €5.8bn capital requirement being fully subscribed by the HFSF.
- Separately, Greek authorities, in cooperation with the troika staff, will have to finalize by end-July 2013 a stress testing methodology for the domestic banking system taking into consideration that the domestic economic conditions have changed significantly since the BoG's last stress test which was based on bank data and macroeconomic projections as of mid-2011. The new stress test, based on end-June 2013 bank-related data and updated macro scenarios, will have to be completed by the end of this year helping to clarify potential future capital needs.

Downward revision in privatization proceeds target for FY-2013

- The two sides reportedly agreed on a downward revision in this year's privatization proceeds target by €1bn to €1.6bn after the Hellenic Republic Asset Development Fund (TAIPED) failed to secure bidding bids for the sale of Public Gas Corporation (DEPA). The sale of DEPA was estimated to yield ca €1bn, an amount equal to ca 40% of the initially projected privatization revenues for FY-2013.
- Cumulative privatization proceeds target for FY-2014 will be reportedly revised upwards to €5.5bn from €4.5bn previously. Projected revenues for the remaining program period 2015-2020 will be left unchanged compared to these envisaged in the most recent programme review (June 2013); €6.5bn by end-2015, €8.5bn by end-2016 and €22bn by end-2020 with the main bulk expected to be raised from concession contracts on public sector property. The earlier-envisaged amount of €50bn in cumulative privatization revenue remains valid, though, it is now expected to take longer than initially expected to be realized. Privatization proceeds are paid directly to a special segregated account held in the Bank of Greece. Disbursements to this account cannot be used for any other purposes than debt servicing to official creditors (law 4063/2012).
- As laid out in the updated MoU, in case of a shortfall in privatization proceeds (relative to programme targets) for two consecutive quarters, the pace of the fiscal adjustment will need to accelerate. According to the agreed *fiscal policy reaction mechanism*, the primary surplus target would need to be raised by an amount equivalent to 50% of the shortfall in proceeds and the required incremental adjustment will have to be achieved via additional expenditure

cuts. The adjustment within any year will be capped at €1bn. That is, in case no other adjustments are agreed with official lenders.

- Aiming to ease fears over the potential activation of the said mechanism due to delays in the privatization programme, Greek Minister of Finance Yiannis Stournaras said recently that any privatization revenue shortfalls will be covered by sources secured through the faster execution of other structural reforms. Specifically, Mr. Stournaras noted that any projected funding gap could be bridged with the leftovers from the €50bn package earmarked for the recapitalization and resolution of the domestic banking system, upon completion of the new bank stress test. BoG currently estimates bank recap leftovers at ca €13bn, including (i) an original €5bn contingency buffer; (ii) €3bn from the participation of the private sector in the share capital increase of three core domestic banks. The latter amount may increase even further, if non-core domestic banks will be recapitalized successfully (thought private sources); (iii) €2.5bn from synergies expected to be materialized due to mergers in the domestic banking sector ; and (iv) €3bn from the sale of non-banking operations and subsidiaries, as envisioned in the banks' new business plans.

Proposed reduction of VAT rate on food catering and restaurants

As per the EC/ECB/IMF statement, the government's proposal for a reduction on a pilot basis (6-months) of the value-added tax rate on food catering and restaurants from 23% currently to 13% was rejected by the troika on concerns that it would jeopardize the agreed fiscal targets. According to local press, that said measure would yield a budgetary shortfall of ca €200mn in 2013. As per a study published recently by the Association of Hellenic Tourism Enterprises (SETE) the VAT hike has led to a 40% drop in the sector's turnover over the period 2011-2012, while some 40 enterprises have closed down and more than 30k jobs have been lost.

Measures to bridge projected borrowing gap in 2013-2014

A budgetary shortfall as high as ca €2bn in 2013-2014 was reportedly identified by the troika staff, mainly as a result of:

(i) a shortfall of ca €1.2bn in the National Healthcare Provision Organization EOPPY (€600mn in 2013 and €600mn in 2014);
(ii) a shortfall of ca €600mn (€150mn in 2013 and €450mn in 2014), due to the government's decision not to impose a 2‰ annual tax on business turnover in favor of Freelancers Insurance Organization (OAEE), as envisaged in the updated Medium-Term Fiscal Strategy (MTFS) for 2013-2016; and
(iii) a shortfall of ca €200mn in 2014, resulting from the government's decision not to apply the new wage grid for the uniformed pensioners.

The agreement reached as regards the coverage of the projected shortfall entails the following:

(i) The two sides agreed the projected budgetary shortfall in EOPPY to be mostly covered by the implementation of a mechanism of rebates (automatic claw-back) to be paid by private clinics and diagnostic centers exceeding the agreed ceilings of in-patient/outpatient pharmaceutical expense. The ultimately goal is to secure Greece's total inpatient/outpatient expenditure will not exceed certain budget limits. In line with the MoU conditionality, the mechanism of rebates is already applied on pharmaceutical producers. According to press reports, there is still a budgetary shortfall of €100-150mn for 2013 in EOPPY.
(ii) In lieu of the imposition of the 2‰ annual tax on business turnover, the troika reportedly accepted the government's proposal for the abolishment of certain exemptions in OAEE pensions.
(iii) The two sides accepted half of the projected budgetary shortfall ensuing from the government's decision not to apply the new wage grid for uniformed pensions to be bridged by cuts in arms programs to the tune of ca €100mn. It is unclear so far which alternative measures were chosen for the coverage of the remaining €100mn shortfall.

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