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GREECE MACRO MONITOR

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Marathon Euro Summit reaches tentative agreement on Greece

Summary and brief assessment of underlying conditionality and funding envelope

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After 17 hours of difficult negotiations, the Euro Summit reached a tentative agreement on Greece. As per the official statement issued after the conclusion of the euro leaders' meeting, Greek authorities have committed to legislate by mid-July a first package of prior actions that would set the ground for a "possible" future agreement on a new 3-year ESM programme. This should aim to fully cover program financing needs between €82bn and €86bn over the said period, including the establishment of a buffer for addressing potential bank recapitalization and resolution costs. The new programme would come with strengthened conditionality (over and above the measures proposed by the Greek side) being laid out in a concrete timeline of quantitative targets and structural benchmarks. Upon completion of the first programme review, official lenders would be ready to consider additional actions for restructuring Greek public debt. Such measures could potentially include a further extension of EU loan maturities and debt service grace periods, but not outright forgiveness in the form of nominal haircuts. Under the said programme, EU funding up to €35bn could be made available to Greece for boosting investment and job creation. Finally, the possible future agreement on the ESM programme would envisage the creation of an independent privatization fund, established in Greece and be managed by the Greek authorities, with a view to monetize assets worth up to €50bn. Out of this amount, €25bn would be used for the repayment of the programme funds committed for bank recapitalization and other assets, €12.5bn for retiring government debt and another €12.5bn for boosting domestic investment.

Euro Summit agreement on Greece: *conditionality and funding envelope*

Prior actions to a "possible" agreement on a new ESM programme

As a necessary gesture to rebuild trust with official creditors, the Greek authorities have committed to legislate in the following days a first set of measures, which, in fact, constitute prior actions for a "possible" future agreement on a new ESM programme. The relevant timeline for passing these prior actions thought the Hellenic Parliament is as follows:

by 15 July

- a major tax reform aiming to streamline the VAT system and broaden the tax base;
- upfront measures to improve long-term sustainability of the pension system;
- safeguarding of the full legal independence of the Greek statistics agency (EL.STAT.);
- full implementation of the relevant provisions of the treaty on Stability, Coordination and Governance in the EMU (full operation of the Fiscal Council before finalizing the MoU and quasi-automatic spending cuts in case of deviations from agreed primary surplus targets);

by 22 July

- adoption of the Code of Civil Procedure, with a view to accelerate the judicial process and reduce costs in the civil justice system;
- transposition of the BRRD with support from the European Commission.

As per the Euro Summit statement, a necessary precondition to mandate the Institutions to negotiate a Memorandum of Understanding (MoU) with the Greek government is the legal implementation of the first four of the aforementioned measures as well as the endorsement by the Greek Parliament of *all* commitments included in the said statement.

Reform measures to set the basis for a successful conclusion of the MoU

As per the Euro Summit statement, the reform measures submitted by the Greek government need to be "seriously strengthened" in a number of areas identified by the Institutions, so as to take into account the recent deterioration in the domestic macroeconomic and fiscal outlook. In addition, a clear timetable for legislation and implementation (including relevant structural benchmarks, milestones and quantitative benchmarks) is required with a view to provide clarity on the direction of policies over the medium-run. More specifically, the Greek government, in agreement with the institutions, should implement comprehensive reforms in the following arrears:

Social security system

- social security reforms in line with the proposal submitted by the Greek government (see Appendix);
- identification of policies to fully compensate for the fiscal impact of the Constitutional Court ruling on the 2012 pension reform;
- implementation of the zero deficit clause (or *mutually-agreeable* alternative measures) by October 2015;

Product market reform

- full implementation of all OECD recommendations in the so-called *toolkit I*, including
    - further liberalization of Sunday trade and sales periods;
    - relaxation of existing restrictions as regards ownership of pharmacies;
    - further liberalization of milk trade and the operation of bakeries;
    - further liberalization of the market of over-the-counter pharmaceutical products;
    - opening up of "macro-critical" closed professions (e.g. ferry transport);
- inclusion of manufacturing sector in the follow-up OECD *toolkit-II*;

Energy markets

- privatization of the electricity transmission network operator (ADMIE), *unless* alternative measures are taken with equivalent effects on competition (any such measures should be agreed with the institutions);

Labour markets

- rigorous reviews of collective bargaining and industrial action;
- modernization of legislative framework for collective dismissals, in line with the relevant EU directive and best practice;

Financial sector stability

- implementation of "decisive" measures to address non-performing loans;
- measures to strengthen the governance of the HFSF and the domestic banks;
- elimination of any political interference, especially in the appointment processes;

Privatization

- transfer of valuable Greek assets to an independent fund, with a view to monetize the assets through privatization and other means;
- said fund should be established in Greece and be managed by the Greek authorities under the supervision of the relevant European institutions;
- targeted privatization revenue under the said scheme should amount to €50bn, out of which: €25bn to be used for the repayment of the recapitalization of banks and other assets, €12.5bn for retiring government debt and another €12.5bn to be used for investments;

Public administration

- development of a comprehensive pubic administration reform program, aiming to boost operational capacity, further reduce costs and eliminate political interference (a first proposal should be provided by 20 July, after discussions with the Institutions);

Working methods with the Institutions

- implementation of the necessary work on the ground in Athens, to improve programme implementation and monitoring;
- advance consultation and agreement with the Institutions on all draft legislation before submitting it for public consultation or to Parliament;
- Greek authorities to request by 20 July support from the Institutions and Member States for technical assistance;

Potential amendments to legislation introduced counter to the February 20 agreement

- with the exception of the humanitarian crisis bill, the Greek government shall reexamine with a view to amending legislations that were introduced counter to the February 20 agreement or, alternatively, identify clear compensatory equivalents for the vested rights that were subsequently created;

Programme funds to cover State financing needs

- as per the relevant estimates derived by the Institutions, Greece's financing needs under the 3-year ESM programme requested by the Greek government will amount to between €82bn and €86bn;
- as per the Euro Summit statement, the Institutions are invited to explore possibilities for reducing the said financing envelope through *e.g.* an alternative fiscal path or higher privatization proceeds;
- as regards Greece's imminent state funding needs, the Euro Summit statement calls for a swift progress in reaching a decision on a new MoU so as to allow the release of official sector financing of €7bn by 20 July and an additional €5bn by mid-August;

Bank recapitalization and resolution costs

- establishment of a buffer between €10bn and €25bn (within the total envelope of a possible new ESM programme) for addressing potential recapitalization and resolution costs; with €10bn to be made available immediately in a segregated account at the ESM;
- a comprehensive assessment of the domestic banking system shall be conduct by the ECB/SSM after the summer, so as to identify any possible capital shortfalls;

Public debt restructuring

- the Euro Summit statement opens the door for additional debt relief, potentially consisting of longer grace and repayment periods (but not nominal haircuts) so as to further improve the serviceability of Greek public debt;
- such measures would be conditional upon full implementation of the measures to be agreed in a possible new programme and will be considered after the positive completion of the first review;

EU funds to boost domestic investment and job creation

- potential mobilization of up to €35bn in EU funding to help support domestic growth and job creation over the next 3-5 years;
- increase of the level of pre-financing by €1bn.

Latest on the domestic political front: rising market talk over an imminent government reshuffle

After sealing a tentative agreement with EU creditors on a possible 3-year ESM programme, the next imminent hurdle for the Greek government is to secure parliamentary approval by July 15 of the first set of prior actions (see analysis above). Purportedly, Prime Minister Alexis Tsipras may have to rely again on pro-European opposition parties New Democracy, To Potami and Pasok to pass the measures from Parliament. As a reminder, at last week's parliamentary vote to mandate the government resume negotiations with official creditors on the requested ESM loan facility, out of a total of 291 attending deputies, 251 casted a positive vote. These included 145 lawmakers from the governing coalition partners SYRIZA and ANEL along with all 106 MPs from the three pro-European opposition parties. As many as 17 SYRIZA parliamentarians either abstained from the voting procedure or did not vote in favor, including two incumbent ministers[1] and the Parliament Speaker. To complicate thing further, 15 out of the 132 SYRIZA lawmakers who casted a positive vote, issued a statement soon after the completion of last Saturday's voting procedure warning that they may vote against the relevant laws required for the implementation of the agreed prior actions.

Against this background, market talk over an imminent government reshuffle has increased significantly over the last couple of days. This holds especially after the Prime Minister suggested soon after the conclusion of the Euro Summit that he desires his

[1] .e.g., Minister of Productive Reconstruction, Environment and Energy Panagiotis Lafazanis1 and Deputy Minister of Social Security, Dimitris Stratoulis.

government to take ownership of the "difficult" agreement". Separately, Terence Quick, a member of junior coalition partner ANEL was quoted saying in a local TV station yesterday that any government deputy who did not vote in favor of the government's proposal should resign adding that there is a decent chance of a government reshuffle within the next 48 hours. Along similar lines, Panos Skourletis, Minister of Labour and Social Affairs, reportedly said that the strength of the government's parliamentary majority is currently in question stressing that that dissident ministers should be replaced and the SYRIZA lawmakers who did not cast a positive vote on Saturday should follow the party rules and resign their parliamentary seats.

Under the SYRIZA party's code of conduct, all 149 lawmakers have been committed to give back their seats in parliament if they disagree with the party line on key issues so as to be filled by another SYRIZA deputy. As regards the Speaker of the Parliament who voted present, the regulation of the Hellenic Parliament entails that –assuming she does not resign- a written motion of no confidence by at least 50 MPs has to be submitted (Article 150). High-level politicians from the three pro-European opposition parties have reportedly suggested that their parties will continue to support the Greek government's efforts in the current negotiations with the country's creditors. Yet, they have indicated that their parties are not willing to purse the role of a coalition partner in a SYRIZA-led government. According to some press reports, the alternative scenario would be the formation of a national unity or special purpose government with a mandate to run at least until September when, if everything goes as planned, a new ESM loan facility is expected to be signed with official creditors. As a reminder, the ruling coalition currently enjoys the support of 162 lawmakers; SYRIZA controls 149 and ANEL 13 seats.

Appendix- Table of measures & prior actions submitted by the Greek government

	Adoption of relevant legislation by:	Brief analysis of measures	Comments	Projected savings			
				2015	2016	2017	2018
Adoption of a supplementary budget for FY-2015 & medium-term fiscal strategy (MTFS) for 2016-2019	July 1, 2015						
New general government primary surplus targets (%GDP)		FY 2015: 1.0% FY 2016: 2.0% FY 2017: 3.0% FY 2018: 3.5%	The fiscal path for reaching the medium-term primary surplus target of 3.5% will be discussed with the institutions, in light of recent economic developments				
Contingency measures to address potential fiscal shortfalls		• Increase in income tax rate for rents to: (i) 15% (from 11%, currently) for annual incomes below €12,000 (additional revenue projected: €160mn/annum); and (ii) to 35% (from 33%) for annual incomes above €12,000 (additional revenue projected: €40mn/annum) • Increase in corporate income tax rate by an additional 1ppt to 29% (additional revenue projected: €130mn/annum)					
VAT reform	July 1, 2015	• 23% for restaurants & catering • 13% for basic food, energy, hotels & water (excl. sewage) • 6% for pharmaceuticals, books & theaters • Discounts on islands to be gradually abolished (by end-2016); the measure will be initially implemented on most popular tourist islands & those with higher incomes. The most remote islands will be exempted. Fiscally neutral measures to be adopted to compensate low-income habitants)	The increase of the VAT rates may be reviewed at the end of 2016, provided that equivalent additional revenues are collected through measures taken against tax evasion and to improve collectability of VAT. Any decision to review and revise shall take place in consultation with the institutions	1.0%-of-GDP per annum			
Fiscal structural measures	July 1, 2015 July 1, 2016	• Increase of corporate income tax rate by 2ppts to 28% • 100% advance payments for corporate income Gradual increase in advance payments for individual business income tax by 2017 • Phasing out preferential income tax treatement for farmers by 2017 • Increase in solidarity surcharge • Abolishment of subsidies for excise on diesel oil for farmers • Abolishment of special tax treatement for agricultural income • Halving of heating oil subsidies expenditure for farmers in 2016 Budget • In view of any revision of the zonal property values, property tax rates to be adjusted, if needed, for safeguarding annual property tax revenue target of €2.65bn for 2015 & 2016 • Introduction of new Criminal Law on Tax Evasion & Fraud • *Shipping industry:* Increase in the tonnage tax rate; phasing out special tax treatments of shipping industry • *Health care:* reduction in the price of all off-patent drugs to 50% & all generics to 32.5% • *Health care:* Prices review of diagnostic tests to bring structural spending in line with claw back targets • *Health care:* 2014 clawback for private clinics, diagnostics and pharmaceuticals to be collected in full • 2015 clawback ceilings to be extened to 2016 • *Military spending:* expenditure ceiling to be reduced in 2015 & 2016 via, inter alia, a reduction in headcount and procurement • Income tax code to be reformed • Tax on television advertisements • International public tender for acquisition of television licenses • Increase in luxury tax rate from 10% to 13%; to be also applied on recreational vessels in excess of 5 meters (to be in effect from the collection of 2014 income taxes & beyond) • 30% gross gaming revenue taxation on VLT games (to be installed in H2 2015 & 2016) • Generation of revenues through issuance of 4G and 5G licenses		€2.65bn €100bn	€2.65bn €200bn		

(continued on next page)

Pension reform	July 1, 2015	• Strong disincentives to early retirement; adustment of early retirement penalties, implementation of the limit of statutory retirement age of 67 years or 62 and 40 years of contributions by 2022, except arduous professions and mothers with children with disability (effective from July 1, 2015)	The institutions could take into account other parametric measures of equivalent effect to replace some of the measures proposed by the Greek government in the area of pension reform	0.25-0.5%-of-GDP	1%-of-GDP per annum
		• Implementation of the full 2010 pension reform law (3683/2010)			
		• All supplementary pension funds to be integrated into ETEA (effective from January 1, 2015)			
		• All supplementary pension funds to be only financed by own contributions			
		• Increase in OGA uninsured pension			
		• Phasing out gradually solidarity grant (EKAS) for all pensioners, to be completed by end-December 2019			
		• EKAS to be abolished on top 20% of beneficiaries as of March 2016			
		• Monthly guranteed contributory pension limits in nominal terms to be frozen util 2021			
	July 1, 2015	• Contribution rules for all pension funds to be harmonized in line with the structure of contributions to IKA (effective from July 1, 2015)			
		• Adoption of legislation to fully offest the fiscal effect from the implementation of court rulings on the 2012 pension reform			
Public Adminsitration, Justice and Anti Corruption	January 1, 2016	• Unified wage grid to be reformed; adoption of key parameters in a fiscally netural manner			
	January 1, 2016	• Alignment of non-wage benefits with best EU practices			
	Q4 2015	• Within the new MTFS, establishment of ceilings for the wage bill & the level of public employment so as to secure fulfilment of the fiscal targets and declining path of the wage bill relative to GDP unitl 2019			
		• Introduction of a new permanent mobility scheme			
		• Strenghtening ELSTAT governance			
		• Strenghtening controls in public entities and especially SOEs			
Tax administration		• Establishment of autonomous revenues agency			
		• Amendment of the 2014-2015 tax and debt instalment schmes to exclude those who fail to pay current obligations, shorten the duratio for those with the capacity to pay earlier; introduce market-based interest rates			
		• *Garnishments:* elimination of the 25% ceiling on wages & pensions; lower all thresholds of €1,500 while ensuring in all cases resonable living conditions			
		• Combat fuel smuggling			
		• Comprehensive plan for combating tax evasion			
		• Development of a costed plan for the promotion of the use of electronic payments			
Financial sector		• Amend the corporate & household insolvency laws so as to cover all debtors; amend the household insolvency law so as to separate strategic defaulers from good faith debtors and addresse large backlog of cases			
		• Implement comprehensive strategy for the domestic financial system with a view of returning the banks into private ownership by attracting international strategic investors and achieving a sustainable medium-term funding model. Adoption of a holistic NPL resolution strategy			
Labour market	Q4 2015	• Review the whole range of existing labour market arrangements, taking into account best practices elshwere in Europe. Consultion to be provided by international organisations, including ILO			
Product market		• Liberalize restricted professons of engineers, notaries, actuaries, bailiffs and tourist rentals			
		• Eliminate non-reciprocal nuisance charges; aling reciprocal nuisance charges to the services provided			
		• Reduce red tape via, inter alia, adoption of horizontal licensing requirements of investments, based on OECD recommendations			
		• One-stop shops for businesses			
		• Gas market reform			
		• Privatisation of the electricity transmission company ADMIE (or provision of an alternative scheme by October 2015)			
Privatisation		• The Board of Directors of the Hellenic Republic Asset Development Fund (HRADF) to approve its Asset Developmetn Plan which will include all the assets for privatisation under HRDAF as of 31/12/2014; the Cabinet to endorse the plan			
		• To facilitate completion of tenders, domestic authorities to conclude all government pending actions for the regional airports, TRAINOSE, Egnatia, as well as the port of Pireaus, Thessaloniki and Hellinikon. Binding bid dates for Piraeus and Thessaloniki ports to be announced no later than end-October 2015			
		• Trasnfer of the state's shares in OTE to the HRADF			

Source: Press reports, Eurobank Economic Analysis and Financial Markets Research

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