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GREECE

2013 ARTICLE IV CONSULTATION

June 2013

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2013 Article IV consultation with Greece, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 15, 2013, with the officials of Greece on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 20, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its May 31, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Greece.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

GREECE

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

May 20, 2013

KEY ISSUES

In the midst of a sharp and socially painful recession, Greece is making important progress in overcoming deep-seated problems. Progress on fiscal adjustment has been exceptional by any standard, with the cyclically-adjusted primary balance having improved cumulatively by about 15 percent of GDP during 2010–12. Labor market reforms are helping to realign nominal wages and productivity; this internal devaluation has reduced the competitiveness gap by about half since 2010. And financial stability has been preserved, notwithstanding public debt restructuring and the recession. This progress has been facilitated by considerable European and international support.

But Greece is adjusting mainly through recession, not through productivity-enhancing reforms. Beyond the labor market, broader structural reforms have fallen well short of the critical mass required to transform the investment climate and boost potential growth. With fiscal adjustment set to weigh on demand for several more years, growth must come from private investment and exports. Thus, restoring growth and reducing unacceptably high unemployment will require full and timely implementation of ambitious reforms that firmly puts to rest uncertainty about the authorities' willingness to tackle vested interests. The key priorities:

- Undertaking structural reforms to lower barriers to entry would reduce product prices and facilitate re-allocation of resources to more productive activities.
- Reinforcing the governance framework in the financial sector and reversing the rising tide of non-performing loans are key to effective financial intermediation.
- Broadening the tax base and strengthening revenue and public administration would improve the quality of adjustment (the burden has fallen excessively on those earning a salary or pension) and underpin further fiscal effort to reach medium-term targets.
- Ensuring that debt sustainability concerns do not continue to weigh on investment requires timely delivery of Greece's European partners' undertakings on debt relief.

The last Article IV consultation was concluded in July 2009. This report focuses on developments since then and on policies to overcome current challenges.

Approved By
Reza Moghadam and Hugh Bredenkamp

Discussions for the Article IV consultation were held during April 8–15. The mission met with the Minister of Finance, Governor of the Bank of Greece, and other Cabinet Ministers; and staff in these and other ministries. The mission also met private banks, think tanks, and employer associations. The staff team comprised P. Thomsen (head), M. Flanagan, W. McGrew, G. Gottlieb, N. Hobdari, W. Maliszewski, and M. Shamloo (EUR); I. Petrova (FAD); S. Lanau and B. Rayner (SPR); O. Frecaut, M. Oliva, and D. Monaghan (MCM); and G. Esposito (LEG). B. Traa, S. Eble, M. Athanasopoulou, G. Gatopoulos, and M. Kalimeri (IMF resident representative office) assisted the mission. J. Manning and C. Piatakovas (EUR) assisted from headquarters.

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CONTEXT

A. Build-Up to the Crisis

1. Fiscal expansion after euro accession led to a buildup of large economic imbalances. By 2009, both the flow and stock imbalances were among the highest in the euro area: the overall fiscal and current account balances were in double digits (-15½ and -11 percent of GDP, respectively), public sector debt reached 115 percent of GDP (revised subsequently to 130 percent of GDP), and the net international investment position stood at -86 percent of GDP. These imbalances were largely a result of fiscal expansion that was financed by external borrowing at lower post-euro accession interest rates. Channeled through transfers, subsidies, and investments, fiscal expansion lifted private income and consumption, which in turn boosted tax revenues and masked the true size of the underlying fiscal gap. Lower post-euro accession interest rates also stimulated a private sector borrowing spree. But private borrowing started from a low level, and private sector liabilities remained relatively small.

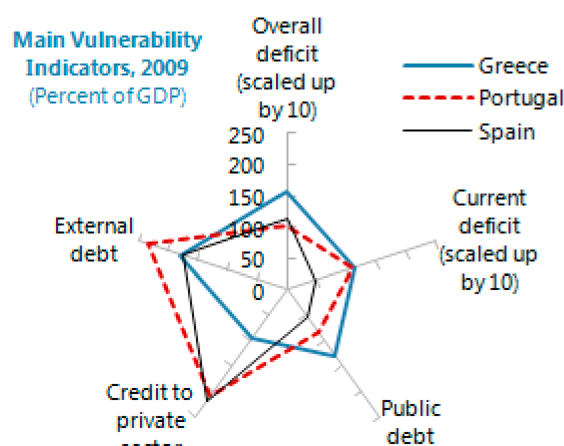
Key Fiscal Indicators

(Percent of GDP)

	2001	2009	Change
Primary balance	2.0	-10.5	-12.5
Revenue	40.9	38.3	-2.6
Of which:			
Total tax revenue 1/	34.4	32.4	-2.1
Primary expenditure	38.9	48.8	9.9
Of which:			
Wages	10.4	13.4	3.1
Social benefits	15.4	21.2	5.8

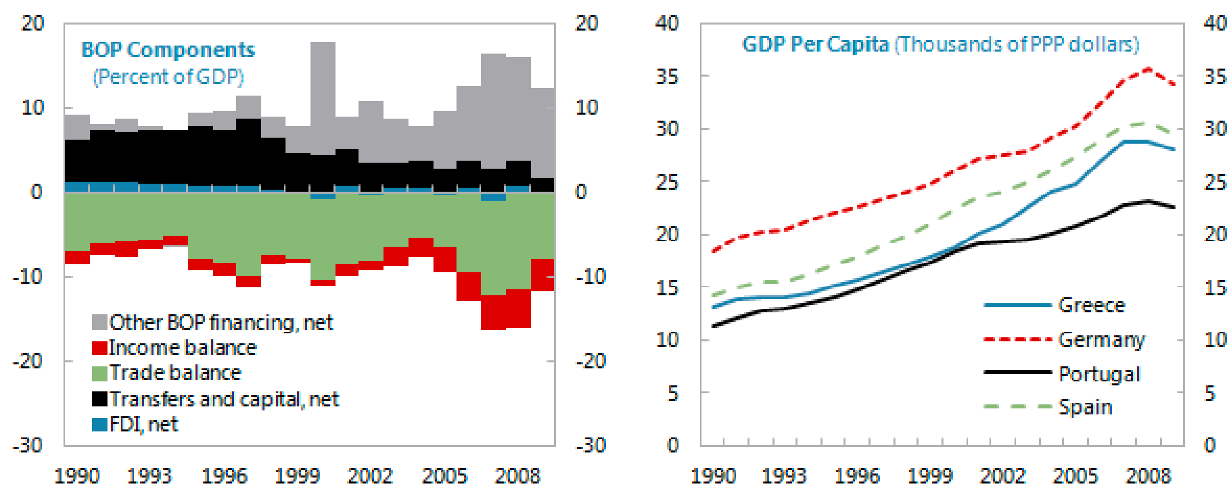
Source: IMF staff estimates.

1/ Includes direct taxes, indirect taxes, and social contributions.

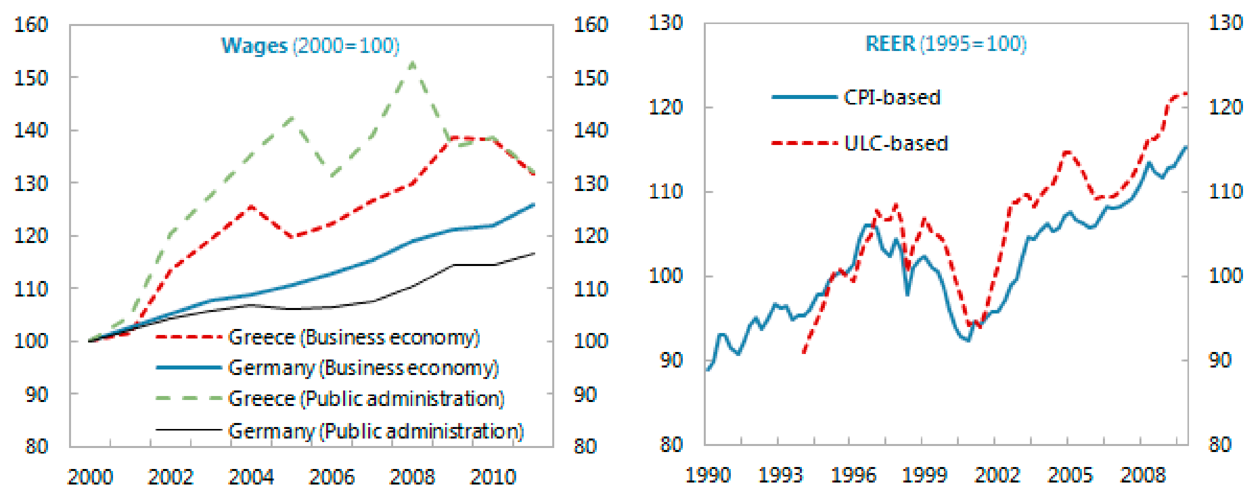


Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

2. The global financial crisis in 2008 led to a retrenchment of cross-border flows and unmasked Greece's underlying fiscal and structural imbalances. In an economy constrained by some of the most stringent regulations in Europe, the external credit-fueled pre-crisis boom led to large and persistent structural current account deficits. Imbalances continued to widen, notwithstanding the Stability and Growth Pact, signaling worsening competitiveness problems. Re-pricing of risks in 2008, large government debt data revisions, and the deterioration in Greece's fiscal balance alerted ratings agencies and the markets to the size of the needed adjustment. As a result, spreads rose sharply and banks lost access to wholesale funding after sovereign downgrades.



Sources: Bank of Greece; IMF, World Economic Outlook; and IMF staff calculations.



Sources: Elstat; Eurostat; and IMF staff calculations and estimates.

B. Crisis Response

3. **In response, an ambitious multi-year adjustment program was put in place.** The May 2010 EC/ECB/IMF supported program had two broad aims: to make fiscal policy and the fiscal and debt position sustainable, and to improve competitiveness. Given an overall fiscal deficit of 13½ percent of GDP in 2009 (revised to 15½ percent of GDP shortly after program approval), the program entailed significant front-loaded fiscal consolidation (with provisions to shield low-income households from the brunt of the adjustment), in addition to comprehensive structural reforms to boost productivity and a strategy to backstop the banking system. In this regard, the authorities were convinced when the program was put in place that Greece's large potential for catch-up gains in productivity—together with the expectation that the crisis would mobilize broad political support for comprehensive structural reforms to unlock this potential—meant that direct measures to force down wages and achieve accelerated internal devaluation would not be necessary.

4. Growth underperformed considerably. Although nominal GDP was from the outset assumed to contract substantially in 2011–12, actual performance was worse than projected. Several adverse and mutually reinforcing factors combined to undermine investor sentiments during this period, of which the following stand out:

- **Bouts of political turmoil left increasing doubts about support for reforms.** The program was from the outset not supported by all mainstream parties and increasing opposition began to emerge from inside the governing party in early 2011. A government reshuffle in mid-2011, followed by an aborted attempt at galvanizing public support through a referendum, failed to mobilize broader political support. Such support was only achieved after the Cannes Summit in November 2011, when European leaders explicitly raised the euro exit option, prompting the two main political parties to support a technocratic interim government. By then, however, the deep recession had already seriously undermined public support, and the two parties' share of the vote in two rounds of elections in early 2012 fell from 80 to 42 percent. At present, the program is supported only by a slim majority of pro-program parties in a fragile coalition.

- **Structural reforms stalled**. Against a backdrop of political turmoil, vested interests opposed to reforms were increasingly emboldened. After a strong start in 2010, and aside from labor market reforms in early 2012 by the technocratic interim government, reforms were hesitant and piecemeal, falling well short of the critical mass needed to transform the investment climate.

- **Investors were unsettled by increasing uncertainty about the external financing strategy**. In a reversal of the initial strategy, key euro area member states started calling for a bail-in of investors at the Deauville Summit in October 2010. The reduction in spreads achieved during the previous months was quickly lost, and by the time consensus among Greece's European partners had shifted firmly in favor of a PSI one year later, spreads had risen to near default levels.

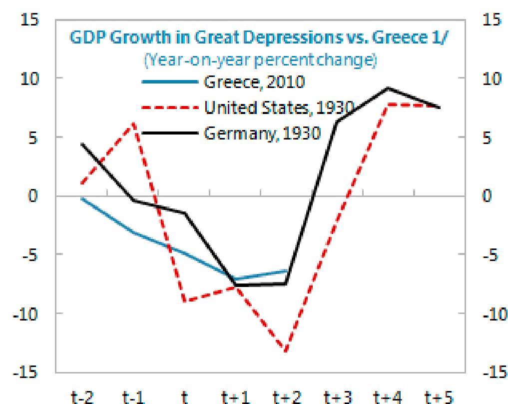
- **Debt sustainability concerns were increasing**. Under the program's baseline in May 2010, public debt-to-GDP was expected to increase dramatically—peaking at about 155–160 percent (including an expected data revision)—as a result of the contraction in nominal GDP. In the event, the much deeper-than-expected recession caused an even sharper increase in the debt ratio, and debt sustainability concerns were increasingly weighing on sentiment.

These mutually reinforcing factors contributed to a steady deterioration in investor sentiment and a large outflow of deposits, especially as the increasing doubts about political support for the program gradually raised the specter of euro exit. The assumed recovery in the investment climate failed to take hold. Instead, a continued contraction in investment amplified the negative output effect of the large upfront fiscal impulse and deepened the recession.[1] Thus, Greece has adjusted mainly through recession, rather than through productivity-enhancing reforms.

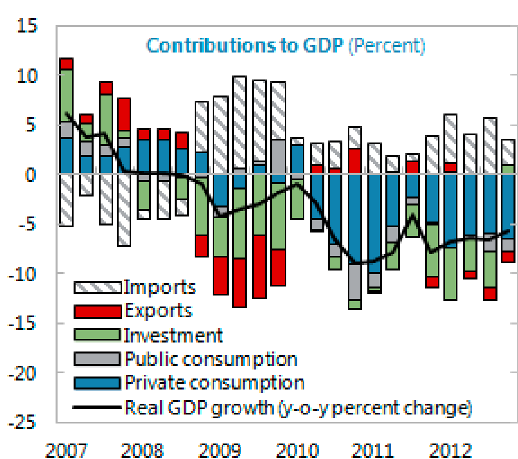
[1] As a result, with the benefit of hindsight, the macroeconomic assumptions at the initiation of the program proved optimistic (see also the Ex Post Evaluation report and Box 1). In this regard, an earlier debt restructuring exercise—if it had been feasible—could have provided for a somewhat more gradual fiscal adjustment path.

C. Developments

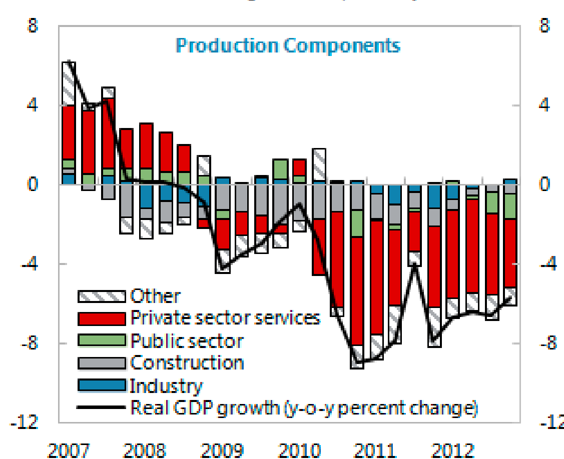
5. The recession has been one of the deepest peacetime recessions in industrialized economies (Figure 1–3 and Table 1–2). Overall, the economy contracted by 22 percent between 2008 and 2012 and unemployment rose to 27 percent; youth unemployment now exceeds 60 percent. As domestic demand shrank across all categories, net exports provided support largely through shrinking imports.



Sources: Groningen Growth and Development Centre; IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Year in legend corresponds to year t.

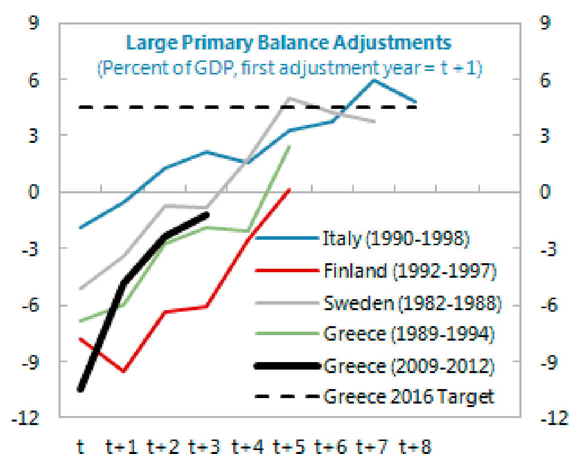


Sources: Elstat; and IMF staff calculations.

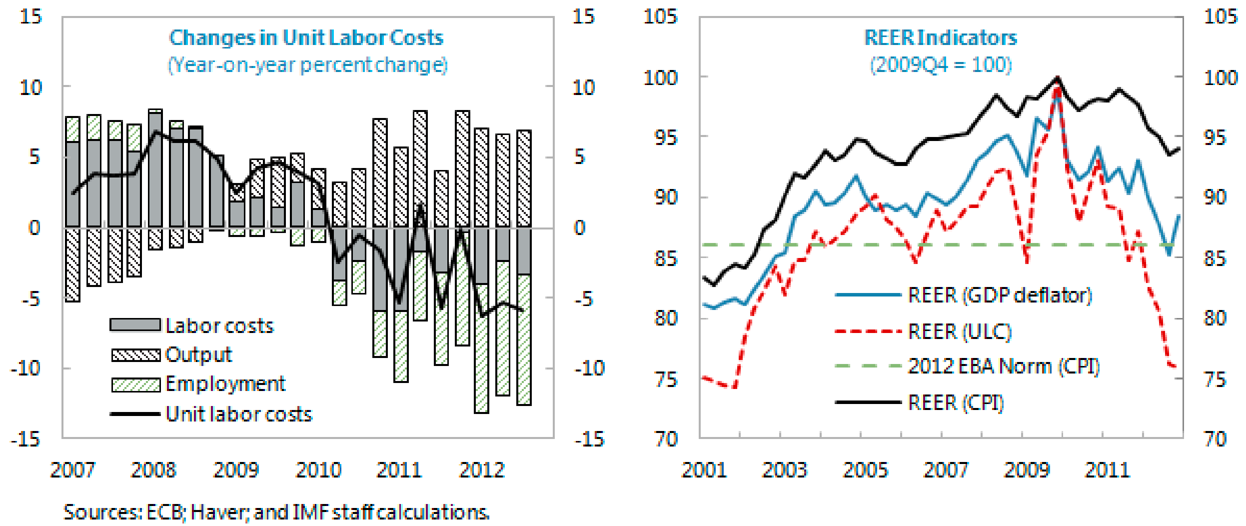


6. At the same time, Greece has made significant progress in redressing its imbalances.

- **Greece has achieved one of the largest fiscal adjustments to date** (Table 3–5; text Figure). The primary adjustment in 2010–12 amounted to 9 percent of GDP, and was much higher (15 percent of GDP) in cyclically-adjusted terms. Following a major cut in public sector wages and pensions in 2010, measures in 2011 relied mostly on tax increases. But the new government has refocused the fiscal consolidation on deep expenditure cuts, including to wages and pensions. These cuts have been socially painful, but necessary, given that these expenditures were the primary source of spending pressures leading up to the crisis.



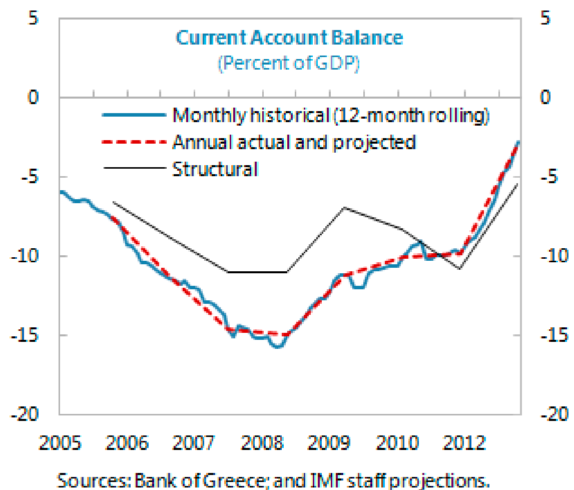
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.



Sources: ECB; Haver; and IMF staff calculations.

- **There have been substantial gains in cost competitiveness.** The far-reaching labor market reforms put in place in early 2012 have contributed to deeper wage corrections than in other recent crisis cases and substantial adjustment in the ULC-based REER. Less encouraging has been the weak and delayed response of prices to wage reductions, owing largely to product market rigidities. This asymmetry in price adjustment has led to a substantial erosion in real incomes and demand, and placed a disproportionate burden on wage earners relative to the self employed and the corporate sector. It has also left the CPI-based REER overvalued in 2012 by about 9 percent (Box 2). With the headline inflation now in negative territory and a widening inflation differential with the euro area, the extent of overvaluation is gradually reducing and relative prices between the tradable and nontradable sectors are adjusting.

- **Greece's current account deficit improved from 15 percent of GDP in 2008 to 3½ percent in 2012** (Table 6). The improvement was initially gradual, with high public sector savings offset by private dissaving (facilitated by funding via the TARGET2 system). However, initial consumption smoothing (and import demand) by the private sector gave way to large increases in savings in 2012. As a result, imports contracted substantially in 2012. The current account adjusted significantly in headline and structural terms, improving by 6½ percent of GDP (of which about 1 percent can be attributed to the impact of lower official debt servicing costs and debt buyback discussed below). Nevertheless, the still insufficient improvement in price



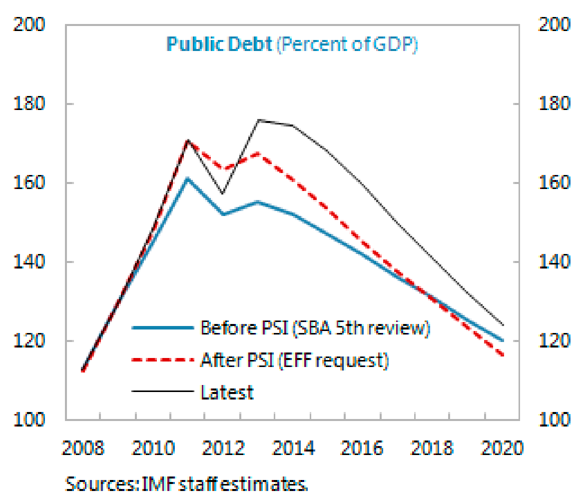
Sources: Bank of Greece; and IMF staff projections.

competitiveness has hindered export growth. The structural current account balance, estimated at -5½ percent of potential GDP, is still somewhat weaker than the estimated norm of -2½ percent, and points to the need for some further adjustment (Box 2).

7. Notwithstanding extraordinary international support, the high-debt-low-growth outcome made sovereign debt restructuring inevitable.

- **Greece received unprecedented international support**. Given the high initial public debt-to-GDP ratio, it was explicitly recognized in May 2010 that investors were likely to be unsettled and question debt sustainability. To give the authorities the breathing space needed to establish a strong record of policy implementation and in view of potentially devastating spillover risks of bail-in, the SBA assumed that Greece would have to be "taken out of the market." A three-year financing package of €110 billion was put together.[2] A further €173 billion was made available with approval of the EFF arrangement in 2012 (about €136 billion of which was financing over and above the undisbursed portion from the first package).

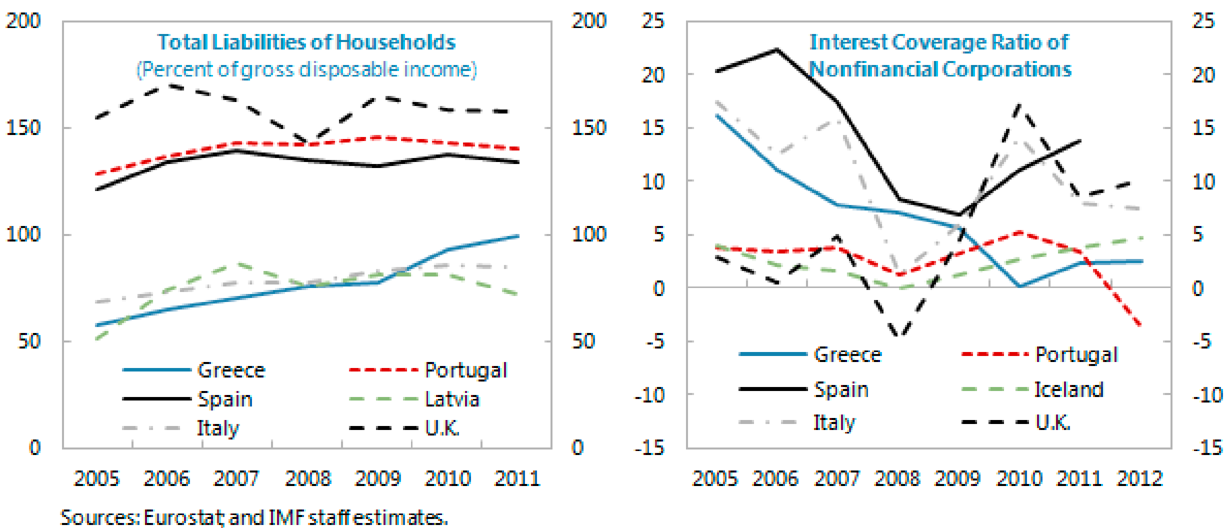
- **Failure to reinvigorate growth required debt restructuring—through both private sector involvement (PSI) and official sector involvement (OSI)—to keep public debt on a sustainable path.** The PSI, including the subsequent buyback, generated a haircut equivalent to 65 percent of GDP. Although public debt still stood at 157 percent of GDP at end-2012 and is projected to rise before a more sustained decline in the medium term, the debt burden has fallen markedly. Rollover risks are contained since 90 percent of Greece's public external debt is owed to the official sector, and the average maturity of Greek debt at 17 years is twice the euro area average. Near-term financing needs have been covered through committed European and IMF loans. Furthermore, the effective interest rate at 2½ percent is among the lowest in the euro area, leaving debt service to GDP in line with the euro area average. Greece's European partners also committed to provide further relief in early 2014 and 2015, if primary balance targets for 2013 and 2014 are met and if needed to bring the projected debt-to-GDP ratio to 124 percent by 2020 and to substantially below 110 percent of GDP by 2022. Still, despite this framework for debt reduction now in place, the debt burden is set to remain exceptionally high well into the next decade.



Sources: IMF staff estimates.

[2] This bail-out strategy also helps explain the sharp increase in the ECB's exposure to Greece and other countries in the periphery during 2010 (e.g., through its Securities Market Program).

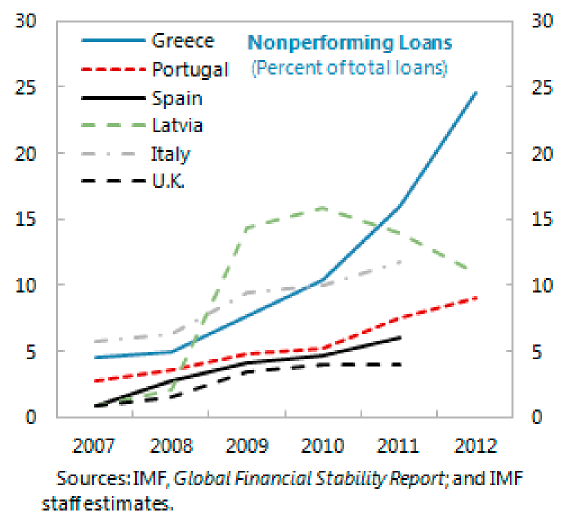
8. Debt restructuring frameworks are being put into place to deal with private debt, given the impact of the crisis on household and corporate sector balance sheets. In the household sector, the fall in disposable income nearly doubled the debt-to-disposable-income ratio between 2009 and 2011 to 96 percent (higher than the peak observed in Latvia). Falling property prices raised mortgage loan-to-value ratios from around 70 percent on average before the crisis (lower than in European peers) to close to 90 percent in 2012 (higher than in Spain). In the non-financial corporate sector, there has been a considerable sectoral variation, but the decline in profits has affected firms' ability to service debt: the interest coverage ratio dropped from 24 percent in 2001 (one of the highest in Europe) to 2.4 percent in 2012 (higher only than Portugal). However, the overall private sector balance sheet is supported by a positive net international investment position vis-à-vis the rest of the world.



Sources: Eurostat; and IMF staff estimates.

9. Heavy damage has been inflicted on the banking system that started with relatively low leverage, and the government has stepped in to recapitalize the system (Tables 7–9).

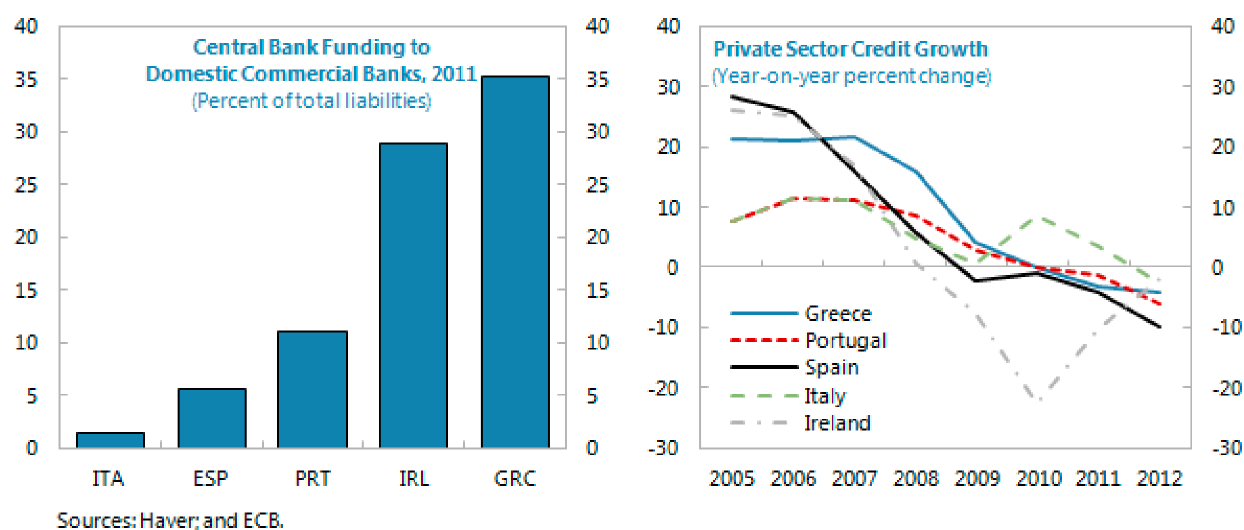
- Banks lost access to wholesale funding markets in 2010 and had to replace close to €60 billion in maturing liabilities with other sources. The funding gap became wider with deposit outflows, which began in 2010 and reached €83 billion by summer 2012, due to a drawdown on savings and fears about euro exit (outflows reversed after the elections and completion of the first/second review under the EFF arrangement, and €17 billion has since returned). On the asset side, the government debt restructuring generated a €38 billion loss to the banking system, wiping out the capital



Sources: IMF, *Global Financial Stability Report*; and IMF staff estimates.

base already eroded by the recession-related deterioration of the loan portfolio. NPLs have been rising fast, reaching 30 percent of total loans at the end of 2012 (including restructured loans).

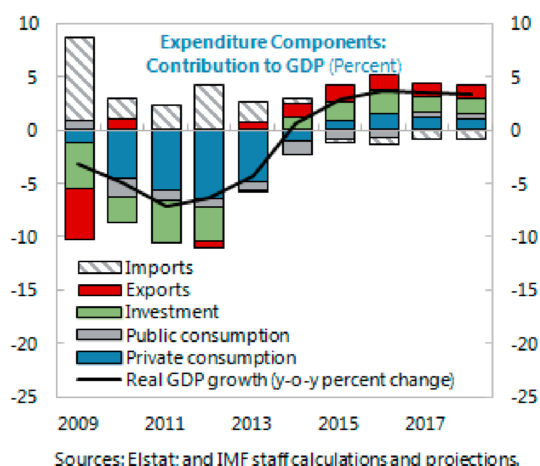
- In response to liquidity pressures, banks' reliance on central bank funding peaked at about €135 billion in 2012 (with heavy reliance at times on ELA). Further, the banks intensified their deleveraging efforts by reducing loans by about 12 percent since end-2009 and focusing their activity on restructuring rapidly rising NPLs. By 2012, a further deterioration in asset quality and the PSI required a total of €50 billion to recapitalize four core banks and restructure smaller banks and cooperatives through mergers and resolution. Capital injections have now put the banking system largely under state ownership, and steps are being taken to ensure that banks continue to operate on a commercial basis (through maintaining private control in banks where private investors contributed 10 percent of the capital needs; installing monitoring trustees; enhancing supervision for the non-core banks; and addressing failures in their internal procedures through a forthcoming distressed asset review).



Sources: Haver; and ECB.

D. Outlook

10. Greece's recovery is expected to be gradual, similarly to experiences with internal devaluation elsewhere. Staff projections are based upon implementation of productivity-boosting structural reforms, albeit at a more measured pace than assumed previously and consistent with what has been evident about the constraints on the pace of these reforms thus far.

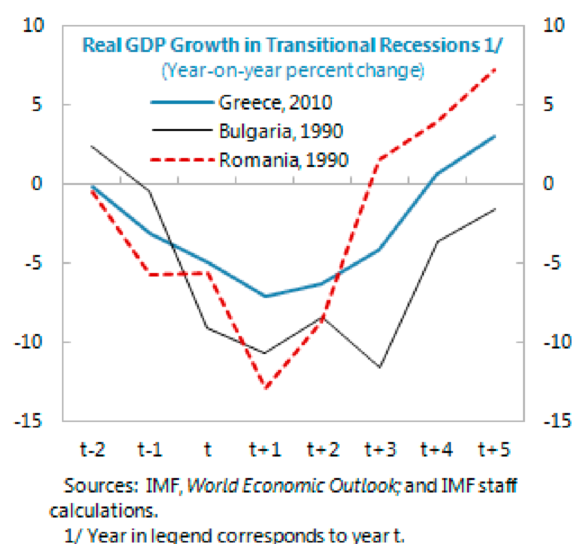


Sources: Elstat; and IMF staff calculations and projections.

- **Staff projects a return to modest growth in 2014.** Steady program implementation is expected to help turn around expectations, improve liquidity

conditions, and lead to a recovery beginning in 2014. The cyclical recovery is projected to accelerate with growth peaking at 3¾ percent in 2016 due to stronger investment (reflecting both pent-up demand and new profit opportunities), net exports (reflecting further improvements in competitiveness), and ultimately private consumption (when real incomes recover). Fiscal adjustment will remain a drag on growth, subtracting over 2 percentage points from the 2013 growth, but considerably less beyond 2013 when adjustment needs start to taper off.

- **The speed of recovery is projected to be weaker than after previous recessions.** The cyclical rebound will be muted since part of the physical and human capital has become obsolete during the crisis and will likely continue to deteriorate, and the need to rebuild balance sheets will be a drag on demand. It will also take time to fully unwind the competitiveness gap, given lags in the transmission of ULC improvements to prices. Present estimates suggest that the competitiveness and output gaps could persist until late in the decade. Overall, the dynamics of the Greek recovery resemble those in transition economies in the 1990s, where large reallocations were undertaken in an unstable macroeconomic environment albeit alongside exchange rate depreciation (text Figure).



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Year in legend corresponds to year t.

- **In the long-term, growth in Greece is projected to gradually settle at around 1¾ percent per annum.** Total factor productivity growth is projected to be about 1¼ percent per annum (in line with the literature on long-term effects of structural reforms and estimates for Greece; see Selected Issues Paper or SIP). But growth will be held back by demographics, with the working age population falling by about ¼ percentage point per annum.

11. The recovery hinges on a number of factors, pointing to risks.

- **Steadfast implementation of structural reforms is critically assumed, absent which investment and growth will likely disappoint.** Delayed or incomplete implementation would adversely impact expectations and investments, and have longer-term repercussions for resource re-allocation and productivity growth. Moreover, high unemployment and difficult policy measures could undermine social and political cohesion. A tail risk under such a scenario—dependent also on political reactions in Europe—is an exit of Greece from the currency union, which would have further sharp short-term adverse impacts on the economy and potentially spillovers to other currency union members.

- **Financial intermediation needs to be fully repaired.** A well-functioning financial system is necessary to support investment by allocating scarce resources to the most productive uses.

Failure to strengthen the governance framework of banks and contain the rise of NPLs could result in a mis-allocation of resources and a drag on growth.

- **Reform of tax and public administration is essential to improving the distribution of the adjustment burden and completing the remaining fiscal adjustment in a growth-friendly manner.** Improvements in revenue administration that broadens the tax base, and mandatory redundancies that create room for new, well-qualified and motivated staff and modernize the public sector, would deliver the adjustment in a socially fair manner. Otherwise, further raising the tax rate or cutting spending would risk not only exacerbating adverse demand impacts on the economy but also undermining support for the program.

- **A credible framework for reducing Greece's high debt is needed to limit the drag on investment and growth.** The commitment of Greece's European partners to further conditional debt relief is key in this regard, as high debt could continue to weigh on investment.

12. Spillover risks—both outward and inward—have come down, but remain elevated:

- **Direct outward spillover risks have receded.** Private sector exposure to Greece has fallen to below 1 percent of euro area GDP, and official exposure is relatively small at around 2 percent of creditor countries' GDP. There are lingering risks in countries with a large presence of Greek bank subsidiaries, which are being managed through policy actions (recapitalization of the Greek banking system) and coordination among national authorities.

- **Contagion risks remain elevated**, as fears of a possible Greek exit from the euro area have not yet been fully taken off the table. Potential spillovers to other currency union members have been explored in recent Greece staff reports—the output costs of a Greek exit is fundamentally uncertain and of a very large magnitude in certain scenarios (see Box 2 in the Staff Report on the Request for an EFF arrangement, and Box 2 in the Staff Report for the First and Second Review under the EFF arrangement).

- **Adverse developments in the rest of euro area would have large spillovers to Greece** (see Table 10). A deeper and more prolonged recession in euro zone would have a substantial impact on growth given the projected reliance on exports to drive the recovery. Moreover, while Greece is not projected to tap the market in the near future, a wider re-assessment of risks in the euro area could affect Greece through higher borrowing costs from the ESM (if the ESM's borrowing costs increase).

- **The direct impact of the crisis in Cyprus has been relatively contained**: the direct trade impact is projected to be limited, and spillovers from Cypriot bank branch operations in Greece have been dealt with through their absorption into a Greek bank. The largest risks are indirect, in particular from deposit outflows, if perceptions were to take hold that uninsured depositors in Greek banks may also be subject to haircuts, policy efforts notwithstanding (see Box 1 in the accompanying third review staff report).

13. The authorities acknowledged the above downsides to growth, but highlighted also some upside potential. They noted that improvements in cost competitiveness and reductions in barriers to entry are creating profit opportunities, which will boost investments once uncertainty is resolved. They pointed, however, to financing constraints for the private sector, and stressed that improving liquidity conditions in the economy is key to jump starting investments and growth.

POLICY DISCUSSIONS

14. There was consensus on the main achievements to date and the key challenges still ahead. There was agreement that Greece had made considerable progress in overcoming deep-seated problems, in particular, that fiscal policy had been extremely strong and that far-reaching labor market reforms were now facilitating a rapid rebalancing. However, there was also agreement that progress in other areas of structural reforms had been considerably less than hoped for, and that this—together with political turmoil and doubts about debt sustainability—had prevented the expected recovery in investment, leaving the economy to continue to contract in response to the strong negative fiscal impulse.

15. Against this background, discussions focused on the key policy actions needed for Greece to complete its adjustment and return to a balanced growth path. In particular, the discussions focused on strategies to: (i) restore growth by speeding up structural reforms and the process of internal devaluation; (ii) ensure adequate support for the recovery from the financial system; (iii) complete the remaining fiscal adjustment in an equitable way; and (iv) reduce public debt to sustainable levels.

A. Restoring Growth

16. Structural rigidities have played a key role in raising Greece's adjustment cost (Figure 4). While rebalancing from non-traded to traded sectors would be challenging in any circumstance, particularly when undertaken in a fixed exchange rate regime, rigidities in product and labor markets have contributed to especially high adjustment costs in Greece (see SIP for an empirical analysis). The improvement in the trade balance by 9 percentage points coincided with output contraction by 22 percent—a much worse 'sacrifice ratio' than in other economies.

- **Burden of regulation.** The key factors include: (i) state ownership and restrictions on use of important assets, which remain underutilized (e.g., because of land zoning restrictions) or subject to monopolies (network utilities); (ii) excessive regulations, with permits, licensing and export-import requirements well inferior to EU best practice; and (iii) barriers to entry into closed professions and new markets, including from excessive bureaucracy, corruption, and opaque tax and labor regulations. These factors have limited competition (including from FDI), kept prices and margins well above the EU average, and preserved an economic model based on small and inefficient enterprises.

- **Rigid labor market regulations that protect insiders.** The labor market has traditionally suffered from a closed and inflexible system of collective bargaining, very high firing costs (severance payments and redundancy notification periods), a high national minimum wage relative to competitors, and high non-wage labor costs.

17. Potential gains from addressing labor and product market frictions to foster adjustment are large. Simulations from a calibrated model for Greece indicate that the labor market reforms that have been undertaken have the potential to substantially improve the external position of the economy through adjustment in real wages and imports, and boost GDP growth during the transition to new steady-state equilibrium by around ¼ of a percentage point per annum. Eliminating barriers to entry in the product markets could add an additional ½ of a percentage point to growth during the transition period by stimulating investments, lowering prices, and restoring purchasing power and consumption of households. In the long term, these labor and product market reforms are estimated to raise GDP by about 3 and 7 percent respectively (these results are broadly in line with previous theoretical and empirical studies). These reforms would also enhance the flexibility of the economy to adjust to future shocks, improve burden sharing of the cost of adjustment, and help create an environment to better reap the benefits from membership in the monetary union.

18. With labor market reforms well advanced, removing barriers to entry in product markets is now the main priority. Reducing formal and informal restrictions in product markets is inherently a multifaceted and lengthy process. Identifying the multitude of restrictions takes time, and tackling those faces opposition from vested interests and is difficult administratively. Reforms in some areas have advanced and the authorities plan to remove many remaining restrictions (e.g., in the retail sector, certain regulated professions, transportation services, as well as in reducing border-related red tape). But the process remains well away from the needed critical mass of reforms, and some key reforms are still at the preparatory stage. They include identifying and removing barriers to competition in tourism, machinery, food processing, and construction materials; reducing the burden of administrative red tape and regulations; and passing anti-corruption legislation in line with international standards and implementing the authorities' anti-corruption plan without delay. Speeding up the judicial process through civil procedure reform will be key to improve contract and tax enforcement. Progress in privatization will be necessary to open up markets, and here too the work has only just started.

19. In addition, the authorities are considering other potential measures to facilitate investment. These include setting up a development bank and tax free zones, and targeting subsidies (or tax expenditures) to specific sectors. It is not clear, however, whether such measures will deliver benefits. The international evidence on the benefits for growth is mixed at best, while costs include diverted resources, potentially lost revenue, and a more complex system to administer.

Authorities' views

20. The authorities accepted that performance on structural reforms had been disappointing in part because of political turmoil. They noted that progress had been achieved in many areas, but concurred that a policy mix involving greater structural reform implementation would have helped smooth the recession to date, and can help going forward. In this regard, they were confident that there is a broad realization in Greek society that deep across-the-board changes are needed to modernize the economy, and a growing realization at the political level that this is becoming a matter of urgency. They argued that the potential for catch up of productivity remains large, and they felt that potential growth could be higher than projected by staff. On the near-term priorities, a review is planned of the progress achieved in opening up the 20 largest closed professions, with a view to further lowering entry barriers, and the pace of privatization is set to pick up with the first major sale about to be completed. The authorities also accepted that the scope for additional pro-growth spending by the public sector is strictly limited, although they noted that EU grant-financed projects provide some fiscal space.

B. Financial Sector: Supporting the Recovery

21. The growth strategy relies on shifting resources to more productive uses, and repairing the financial system is important to facilitate this process (Tables 7–8 and Figure 5). The restructuring and the nearly-completed recapitalization of the banking system are important milestones. But credit growth is expected to lag the recovery in output for an extended period of time. This reflects constraints anticipated on the funding side (a slow return of deposits offset by a reduction in central bank financing) and on capital (as banks absorb losses on non-performing loans), and a cautious projected lending policy (gradually reducing the loan-to-deposit ratio to the long-term average of 80 percent). But it is important to ensure that credit conditions do not remain so tight, nor deleveraging so persistent, as to derail recovery.

22. Although challenging, flat or even shrinking credit stocks can be consistent with growth, if allocated efficiently. Cross-country experience reveals that up to 25 percent of all recoveries do not depend on credit growth: it takes time for lenders and borrowers to repair their balance sheets (see SIP).

- Aggregate credit conditions often hide sectoral variations: in Greece, the 15 percent reduction in the overall credit since mid-2010 has masked a positive credit growth to some sectors (public utilities and tourism), offset by contractions in others (manufacturing, shipping, and wholesale and retail trade).

- To support activity, firms would need to use internal sources of capital or access non-bank external financing, such as FDI or direct access to capital markets. But the scope for the latter may be more limited in Greece because of the very large share of small enterprises.

- Going forward, to ensure efficient allocation and given that the state is set to assume ownership of much of the banking system, it will be critical for regulators to keep banks free of political

influence in their lending practices. The authorities have put in place governance safeguards for all banks, to ensure arm's length involvement by the state while protecting the state against fraud. These include the HFSF as owner (with a sufficient number of independent directors), monitoring trustees, and relationship frameworks. While these safeguards are welcome, staff is concerned that they are not yet fully effective, given Greece's poor record with state-run banks. Therefore, an urgent priority is to rapidly re-privatize banks under the control of the HFSF.

- Moreover, in a situation where funding is likely to be a constraint, it is particularly important that scarce funding not be trapped into continuously refinancing the same loan, but rather be directed to the most productive uses. Thus, regulatory practices discouraging such evergreening will be key to ensuring sufficient credit to new and dynamic enterprises, not least SMEs.

23. At the same time, targeted and well-designed restructuring programs to deal with the loans of viable but over-indebted borrowers can facilitate investment and consumption. Successful examples of government-sponsored restructuring programs in the aftermath of the financial crisis include the US (2008), the UK (2008), and Iceland (2010). Key lessons that have emerged are: (i) restructuring should occur when there is a systemic risk to the economy; (ii) targeted relief should be provided to the most distressed borrowers; (iii) if borrowers are insolvent, an NPV negative restructuring is usually needed; and (iv) proposals should be designed in conjunction with the banks. Furthermore, the eligibility criteria for each program should differentiate between borrowers temporarily in difficulty (and thus in need of forbearance) and those in need of more long-term solutions. In Greece, the authorities are putting in place a household debt restructuring framework aimed at providing standardized forbearance solutions which will significantly speed banks' procedures compared to a case-by-case approach (see the accompanying third review staff report). They also intend to introduce a legislative framework to provide long-term solutions for over-indebted borrowers. A concern in this regard is that these restructuring schemes might be overly generous and amenable to political pressures, which could damage the payment culture and the ability of the banking system to extend credit. The authorities are conducting a distressed credit operations review of banks' NPL resolution practices, and will set-up and monitor targets for NPL resolutions for banks to ensure timely progress.

24. The authorities need to guard against potential bank capital constraints. Ensuring banks are sufficiently capitalized has been the focus of the financial sector strategy, and at the moment the banks are fully capitalized. Going forward, the capital needs and financial sector program envelope may change due to a number of factors: (i) the macroeconomic environment has deteriorated beyond that envisaged in the last stress test, which will likely reduce earnings capacity and increase loan losses; (ii) the banking system structure has changed significantly due to on-going consolidation in the sector; (iii) banks and the authorities have taken steps to reduce the reliance on public funds (e.g., private sector participation, liability management exercises, foreign subsidiary recapitalizations, and a relaxation of caps on deferred tax assets); and (iv) the authorities are introducing policies to tackle NPLs. Once banking sector consolidation is complete, a further detailed stress test in late 2013 will help clarify future capital needs. While capital losses need to be minimized and paths to raising additional capital established, staff believes on balance and based on

current information that the €50 billion recapitalization envelope, which includes a €5 billion conservatism buffer, will suffice to meet any potential shortfall:

- **Reducing capital consumption (beyond loan restructuring).** Greek banks need to maximize their recoveries from loans in default. The authorities' focus has rightly been on revising the regulatory framework to remove operational restrictions facing liquidators in charge of running down the bad assets of resolved banks, and to align their roles and functions closer with those of an asset manager. By doing so, the legal framework could allow for borrowing firms to potentially continue operating as going concerns rather than face liquidation. An alternative approach, to deal more generally with bad assets of resolved banks as well as distressed portfolios of the operating banks, would be to set up a centralized asset management company (e.g., as in Spain). This approach is less likely to be advantageous for Greece where distressed assets are distributed across asset classes. Purchasing of impaired assets of banks in operation by an AMC may also require funding beyond the financial sector support envelope.

- **Raising additional capital.** A priority is to bring banks to the point where they can re-access capital from markets. For the two banks that are controlled by private shareholders, a three-year lock-out period prevents the HFSF from attracting new investors, and existing shareholders have the right to use any resources to buy back HFSF shares rather than contribute fresh capital. The authorities should make efforts to attract new private capital to state-controlled core banks, bringing in strategic investors and preparing the banks for re-privatization as soon as possible.

25. Another key consideration going forward will be how to improve funding availability. International experience has shown that sovereign re-access is generally necessary before financial sector re-access to wholesale markets. In Greece, the sovereign-bank link has been attenuated substantially—Greek banks after PSI have very little exposure to the Greek sovereign—which should facilitate market access. Meanwhile, longer-term funding could be sought through multilateral agencies, in addition to a return of deposits to the Greek banking system:

- **EIB and EBRD funding.** Greek banks could use low-cost EIB funding to on-lend to SMEs, similar to Portugal. Greek subsidiaries in the EU Accession countries could replace funding from their parent banks with the EBRD SME Finance Facility (subject to coordination with host countries, e.g., in providing guarantees for the EBRD). In both cases, the credit risk would remain on the banks' balance sheet. The authorities engaged the EIB by establishing a joint dedicated guarantee fund supporting lending to SMEs in March 2012. With a start-up capital of €500mn from unabsorbed Structural Funds for Greece, the fund will guarantee EIB loans to SMEs via partner banks in Greece totaling up to €1 billion (these guarantees help ease capital constraints).

- **Attracting deposits.** Staff estimates that as much as €58 billion of the total €71 billion that left the Greek banking system between 2010 and end 2012 was flight capital (either leaving the country or stored as cash outside the banking system), although about €17 billion has since returned. A further return of deposits would help improve banks' funding base. The authorities' strategy relies on successful program implementation and decisive bank recapitalization as pull factors, and on cracking down on evaded taxes from amounts outside the country (to reduce the

incentive to keep funds outside). This strategy should be accompanied by the effective implementation of AML measures to prevent tax evaders from misusing Greek financial institutions, and to facilitate access to information on accounts held abroad through all available international cooperation channels.

26. Complementary measures to strengthen non-bank intermediation are being considered. As noted, the authorities' proposals include the establishment of a development fund that would guarantee bank lending, or a small cooperative bank for lending to SMEs. International experience suggests caution with such approaches: these institutions often increase their lending with the election cycle, tend to finance the government to a greater degree than the private banks, are lacking in their managerial practices, and are subject to government intervention in credit decisions. Where there has been success abroad, key factors have included: i) a clear mandate to target only those sectors underserved by commercial banks, and not competing with them; ii) independence from political influence; iii) professional management; iv) while not deposit taking, should be subject to the same supervisory and prudential regulations as commercial banks; and v) clearly defined performance measures, such as a minimum return on capital. In light of the poor track record of such institutions in Greece in the past (the state-owned Agricultural Bank of Greece had a history of weak controls and public recapitalizations triggered by large NPLs that were eventually written off), however, there remain concerns about the risk of political interference in these schemes.

Authorities' views

27. The authorities concurred with staff's general assessment of the constraints faced by the banking sector in credit provision. They agreed that successful program implementation and return of confidence following recapitalization are by far the most important factors in attracting deposits and improving funding constraints. On NPL resolution, the authorities cautioned against pushing banks to clear NPLs too aggressively, since losses are likely to be highest at the bottom of business cycle. They were more favorably inclined to establish an Asset Management Company to deal with banks' bad assets as well as those under liquidation, suggesting that such a scheme might improve investors' interest in the Greek banking sector and could minimize losses for the state. They also agreed that it would be essential to prevent political interference in the management of banks with public capital, but were confident that the safeguards put in place were effective.

C. Advancing Fiscal Adjustment

28. While Greece has made very significant progress, completing the fiscal adjustment through 2016 will require: (i) delivering gains in tax administration over this period of 1½ percent of GDP; and (ii) identifying further measures equivalent to about 2 percent of GDP in 2015–16. The baseline projection assumes that the above-stated gains from tax administration reform materialize. With respect to the remaining 2 percent gap, there is some scope for the authorities to further adjust spending programs and taxation:

- **Spending cuts.** Public administration reform, which has not yet started in earnest and requires closing inefficient entities and programs and reducing staff in a targeted manner through exits, could generate ½ percent of GDP in savings. Savings of 1–1½ percent of GDP might be possible from rationalizing education and social spending, which should also be better targeted. But room for other cuts appears limited. After shrinking by 3½ percentage points since 2009, the primary expenditure ratio is now below the EU median. Health spending, public sector wages, and intermediate consumption have all been reduced sharply.

- **Tax increases.** There is scope for further base broadening, in particular to further increase revenue from sectors that have not contributed fully to the adjustment so far. For instance, raising direct taxes on the self-employed and removing some of the special reduced VAT rates could generate gains of up to ¼ percent of GDP. Room for tax rate hikes is limited: direct labor taxes already constitute a very large share of income (above 43 percent compared to an average of 30 percent in the EU).

Beyond the 1½ percent of GDP revenue gains above, further gains from revenue administration are critically important to improve the composition of fiscal policy including needed tax rate reductions, a stronger safety net, and a more modern public administration.

29. However, Greece also faces social safety net spending needs and a need to in fact reduce its high tax rates, but these will require identifying additional high-quality measures. Some elements of the social safety net are inadequate, particularly in light of the large and unequal distribution of adjustment costs. For instance, the net replacement rate of unemployment benefits is just below the 20th EU percentile (but is in part compensated by higher severance), and social benefits target only half of the poorest 30 percent of the population. The program commits Greece to identify and fill social safety net needs. Meanwhile, tax rate reductions are needed to boost competitiveness. The program targets a reduction in the labor tax wedge (to deliver a fiscal devaluation, in light of earlier VAT increases), while Greece's high corporate tax rate relative to its regional competitors is also an issue. These safety net and tax reductions will consume a good part of the gains from spending and tax base broadening measures.

30. The key to realizing Greece's medium-term adjustment remains improvements in revenue collection efficiency (Figure 6). This reform is critical to achieving the medium-term primary surplus target, upgrading and modernizing the public sector to be able to provide high-quality services, and over time to making room for needed tax rate reductions, while avoiding new spending cuts. Potential gains are large, estimated as high as 5 percent of GDP (see SIP). Taking this route would also help improve equity in sharing the adjustment costs: despite the overall progressivity of the adjustment so far (including through the recent income tax reform), there has been a growing sense of unfairness stemming from the failure to reduce tax evasion.

31. Gains through revenue collection are, however, highly uncertain in terms of their size and timing. Country experience shows that, while targeted reforms can deliver benefits in even less than one year, comprehensive reorganizations of the type Greece is undertaking can sometimes take close to 10 years to fully deliver (text table). Greece's program anticipates gains in the range of

¼ to ½ percent of GDP in the first year, cumulating to about ¾ percent in 2015 and 1½ percent of GDP by 2016. This is consistent with experience in other countries: Bulgaria increased tax and SSC collection by 5 percent of GDP, and VAT collection by 3 percent of GDP, over a 6-year period. The revenue gains are conservative compared to some more successful cases, such as Georgia, where tax revenues to GDP rose by 6 percentage points in 2005–07. But they could also be lower than targeted, as they have to date under the program. The crucial issue for Greece will be how quickly it can successfully implement reforms going forward.

Country Experiences with Institutional Reforms

Country	Type of Revenue Administration Reform	Period
Bulgaria	New unified revenue administration; consolidating 340 offices into 29; upgrading functions; merging SSC collection into tax administration; IT platform (2000-2009). Further reduction of offices from 29 to 7 (2009). (Tax and SSC collection increased by 5 percent of GDP, and VAT collection by 3 percent of GDP, during 2002–2008.)	2000–2009
Georgia	Reorganized tax headquarters and field units; new tax code and simplified administrative procedures; abolishing compulsory audit of all annual filings and adopting a risk-based approach to tax audits; compulsory electronic filing; new two stage administrative dispute resolution mechanism. (Tax revenues rose by 6 percent of GDP in this period.)	2005–2007
FYROM	New tax procedures law; restructuring of headquarters and field offices; creating large taxpayer office; flexibility in hiring, firing, rewarding staff; integrating collection of social insurance contributions to tax agency. (Income tax revenues rose by ½ percent of GDP in 2005–08.)	2005–2009
Peru	Creating an independent revenue administration agency directly reporting to the president with full budget flexibility. (Tax revenues rose by 2½ percent of GDP in this period.)	1991–1995
Hungary	Comprehensive: reorganizing the HQ office; creating an LTU; Improving VAT and PIT procedures: new arrears management approach; IT upgrade; Improving audit selection. (VAT revenues rose by ½ percent of GDP between 1994 and 1997.)	1993–1998

Sources: World Bank 2009; Durand, 1996; IOTA Tax Tribune Issue 28, 2011.

32. Evidence from other cases suggests that a number of elements are critical to the success of tax administration reform efforts, each of which features in Greece's program (see also the third review staff report). Above all, unwavering political commitment is the most critical element to the success (or failure) of such efforts.

- **Insulation from political interference, while maintaining checks and balances.** The head of the revenue administration should have sufficient powers and flexibility to drive the reforms forward, and then be held accountable (e.g., Latvia, Hungary). In Greece, important strides have been made to establish a legal framework that provides greater autonomy and flexibility to the head of the revenue administration. The key now is to overcome inertia and demonstrate unequivocal support for the process by implementing the legislation in the next 6 months and

showing through action that sufficient autonomy has been achieved and that the problem of political interference and patronage has been tackled.

- **Increasing efficiency.** The organizational structure needs to be transformed and refocused to better utilize resources and improve efficiency in units that have the greatest revenue potential (e.g., large taxpayer unit and high-wealth individuals unit). In Greece, the authorities must operationalize overdue reforms: (i) by providing new management and staff support to the units for large debt collection and audit of large taxpayers and high-wealth individuals; (ii) via staff training, improving grade and promotion incentives, and implementing performance assessments; and (iii) by implementing newly adopted legislation to streamline write-offs of uncollectable debt, risk-based selection of audit cases, indirect audit methods, and dispute resolution.

- **Strengthened collection enforcement.** Discretionary tax administration practices that provide for discounts, including amnesties, must be replaced with stronger enforcement (e.g., placing lien and seizure of assets). Repeated amnesties have been a serious problem, and contributed substantially to weakening the payment culture. In this regard, the authorities have made important—albeit still modest—improvements to the collection enforcement toolkit, such as new powers under the AML legislation and streamlined judicial procedures. Long overdue steps have been taken to reform the previous culture of automatic installments: new tax and SSC debt installment plans were adopted, in line with best international practice. Full implementation of these reforms would put to rest concerns about actual commitment in this area.

- **Greater transparency, improved performance measurement, and simplification of tax and procedural legislation.** Simpler tax policy and tax procedures rules provide greater incentives for taxpayers to comply with their tax obligations and are easier to administer (e.g., Latvia recently reformed its tax and customs code to reduce discretion of tax officials and simplify procedures). The authorities have simplified the income tax regime, and are working to overhaul the income tax legislation by removing provisions that do not belong in it and consolidating income tax policy provisions contained in other pieces of legislation. Similarly, an overhaul of tax procedures is expected to result in a simpler and more transparent code by mid-2013. Implementation will be key.

Authorities' views

33. The authorities concurred with these conclusions, and expressed moderate optimism about the direction of the institutional reforms. They saw little social support for further deep cuts in wages and pensions and tax increases, and agreed that policy options are becoming more limited. They agreed that it is critical to the success of fiscal adjustment and for broader political support of the program that tax administration reforms begin to deliver results. They acknowledged that the administration would face a huge challenge to implement the necessary wide-ranging reforms quickly, and emphasized their political commitment to see the process through.

D. Strategy to Reduce Public Debt

34. Greece's debt is projected to remain high well into the next decade (Appendix I). The debt reduction strategy relies on four pillars:

- **The resumption of growth.** Under program projections, the resumption of real growth will contribute 30 percentage points to the reduction in the debt ratio by 2020.
- **Fiscal adjustment.** Achievement of the primary surplus target of 4½ percent in 2016 (reduced to 4¼ percent by 2020) will improve medium-term debt dynamics in a long-lasting way.
- **Privatization** is projected to make a contribution to debt reduction equivalent to roughly 10 percentage points of GDP by 2020.
- **Conditional debt relief.** Debt sustainability going forward is underpinned by the euro area Member States' commitment in December 2012 to provide any further relief necessary—conditional on Greece fully implementing the program—to ensure that Greece's debt reaches 124 percent of GDP in 2020; and significantly below 110 percent of GDP by 2022. Under staff's current DSA, this will require yet unspecified additional relief of 4 percent of GDP by 2020 as well as at least a further 3 percent of GDP by 2022.

35. As high debt implies Greece will remain accident prone, the conditional relief framework must credibly bring down debt. This framework for tackling the debt overhang has sought to balance the need for firm commitment to debt relief (to protect investor confidence) with an incentive structure that avoids moral hazard (see Box 1 in the Staff Report on the Request for an EFF arrangement, and Box 4 in the Staff Report on the First/Second Review under the EFF arrangement). With the projected debt path contingent on both considerable and sustained fiscal adjustment as well as extended financing support from euro area member states, the core risks stemming from high debt have not been eliminated. There is a risk that investors will not consider the framework to be sufficient to restore debt sustainability. Debt therefore may continue to weigh on investment, and the assumed recovery may not take hold. The macroeconomic and debt outlook must remain under close review.

Authorities' views

36. The authorities broadly agreed with this assessment. They highlighted, in particular, the negative effects of the debt level on sovereign spreads, market confidence, and investment. In that regard, they welcomed Europe's commitment to provide further debt relief and understood the importance in this regard of their meeting the required fiscal balance targets.

STATISTICS

37. Greece has made significant progress in addressing statistical shortcomings from the past, but the gains must be preserved in the face of ongoing political pressures. The new Statistical Law established ELSTAT as an independent statistical agency, which is an important accomplishment. Professional independence supported by law, and giving freedom from political interference, is in line with the Fund's Data Quality Assessment Framework. The Greek statistical authorities have recently benefited from technical assistance in GFS from the Fund and Eurostat. The actions foreseen in the Joint Overall Statistical Greek Action Plan have been implemented on a consistent basis and there has been improvement in the process of GFS compilation by ELSTAT, including coverage, timeliness, and consistency with international statistical standards. These significant gains have been hard-won and should be protected by defending the statistical agency against any efforts to undermine its credibility, guaranteeing its professional independence, and securing its adequate and stable resources. These principles have been endorsed by the Greek government in February 2012 in the "Commitment on Confidence in Statistics" and should be firmly respected.

STAFF APPRAISAL

38. Greece has unquestionably made significant strides in overcoming deep-seated problems. Three achievements stand out:

- Progress on fiscal adjustment has been exceptional by any international comparison, with the primary balance now set to swing into a surplus by end-2013, having improved by 16 percent of GDP in structural terms. Greece is well underway to complete its fiscal adjustment.
- The competitiveness gap has narrowed by about one-half, as bold labor market reforms are helping realign wages and productivity, while the current account deficit has dropped by about 10 percent of GDP. The economy is now rebalancing fast.
- Financial sector stability has been preserved, despite large losses associated with the PSI and the recession-induced surge in NPLs. This is a major achievement for an economy undergoing such a dramatic recession and rapid rebalancing.

39. Significantly, Greece has been able to stay within the euro area and the program has thus fulfilled what throughout the crisis has been the overarching concern of Greek society and body polity. In this regard, the program undoubtedly internalized constraints on its policies and options coming from membership of the euro area that do not exist in countries outside. This includes taking into account the impact of policy choices on other members of the currency union. While such constraints have been a matter of much debate and have evolved as the crisis has unfolded, for Greek policymakers taking actions that could jeopardize Greece's membership in the euro area was never an option that they were willing to consider. Staff agrees that euro exit would

have devastating consequences, and that this would not avoid Greece having to undertake the comprehensive and difficult structural reforms needed to modernize its economy.

40. However, the recession was much deeper than expected, and the social cost has been very high. While GDP was on track in 2010, a key assumption of the program—that, after two years, a recovery in investment would begin to more than offset the drag from fiscal tightening, paving the way for a gradual recovery in 2012—failed to materialize. Greece was hit by a series of negative and mutually reinforcing shocks—political turmoil, failure to implement structural reforms, uncertainty about the external financing strategy, and ever rising concerns about debt sustainability (which could, with the benefit of hindsight, partially have been addressed by an earlier restructuring exercise, if such an exercise had been feasible)—that jolted the investment climate from early 2011 and exacerbated the downdrafts from fiscal tightening. These developments fueled the specter of euro exit and sent spreads to default-levels.

41. This suggests that the current program can only succeed if policy makers—in Greece and abroad—address these root causes of the lack of confidence. Like in the original program, the assumed recovery in 2014 still hinges on the assumption that an improved investment climate will by then begin to offset what is set to be a drag on growth from fiscal policy in the next few years. Without an improvement in sentiment, the economy will continue to contract, stretching the already seriously strained social fabric. Steadfast implementation of key reforms thus remains essential, although the pace of reforms in the program has now been calibrated more in line with the constraints evident from the experience of recent years. Similarly, the assumed recovery will not materialize if investors remain concerned about debt sustainability and the credibility of policies to bring down the huge debt burden.

42. As to policy makers in Greece, refocusing the program on key reforms could do much to shore up broader support. Maintaining public support while advancing what is bound to be painful reforms will pose a formidable political challenge. However, much of the sense of social injustice reflects the fact that failure to advance key reforms has caused an unequal burden of adjustment. Reforms need to be refocused on three key areas:

- **Curtailing tax evasion:** Limited progress has been made in tackling Greece’s notorious tax evasion. The rich and self-employed are not paying their fair share, which has forced an excessive reliance on across-the-board expenditure cuts and higher taxes on those earning a salary or a pension. Tackling tax evasion, including by putting in place safeguards against what remains significant political interference in tax administration, is an overarching priority.

- **Opening up the economy:** While labor market reforms are causing a notable decline in wages, this has only to a limited degree been reflected in lower prices, because of the failure to decisively liberalize closed professions and product markets and strengthen the investment framework. High prices and lower wages is another way in which too much of the burden has fallen on those earning wages and pensions. Redoubling efforts to open up the economy to competition is another priority.

- **Accepting mandatory public sector lay-offs.** While the rebalancing of the economy has been associated with a surge in unemployment in the private sector, the over-staffed public sector has been spared. In a country with youth unemployment of over 60 percent, political reluctance to fire even workers who do not show up for work is inexplicable. Recent announcements of planned layoffs are a start. Without progress in this area, staff doubts that Greece can meet its medium-term fiscal targets without further across-the-board cuts in pensions and wages.

43. The accompanying third review staff report presents just such a refocusing of the program. The disappointing track record to date suggests that these reforms will be fiercely contested by a small, but well-entrenched, group of narrow vested interests. Reform efforts that could have a large pay-off in terms of broad political support for the program must not be allowed to falter because of an inability to overcome opposition from what are far more privileged vested interests. Staff takes note of the government's assurances that it is keenly aware of what is riding on such success and that it is determined to push ahead with reforms.

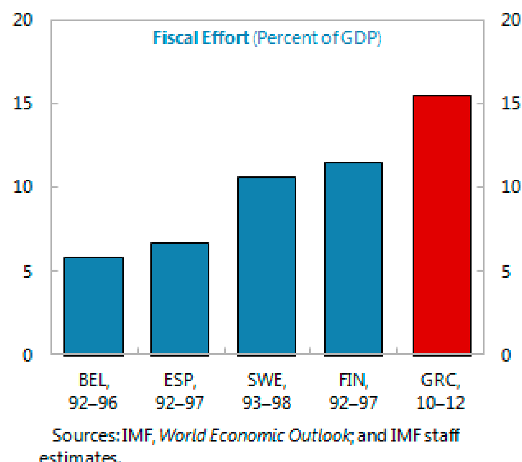
44. As far as European partners are concerned, it is critical that they dispel any doubts about their commitment to ensure debt sustainability. The Eurogroup's promise to provide additional relief to keep debt on the programmed path, if necessary and if primary balance targets are met, provides a welcome framework for restoring debt sustainability. The credibility of this framework is bolstered by the fact that virtually all debt is now on public balance sheets. Still, even under this framework, debt will remain exceptionally high well into the next decade. This could raise concerns on the part of investors about whether the framework is credible, in particular because of the contingency linking debt relief to policy implementation. Should debt sustainability concerns prove to be weighing on investor sentiment going forward, strong program implementation by the Greek authorities notwithstanding, then a more front-loaded approach to debt relief would need to be considered.

45. The next Article IV consultation with Greece is expected to take place on a 24-month cycle.

Box 1. Why Has the Recession In Greece Been So Deep?

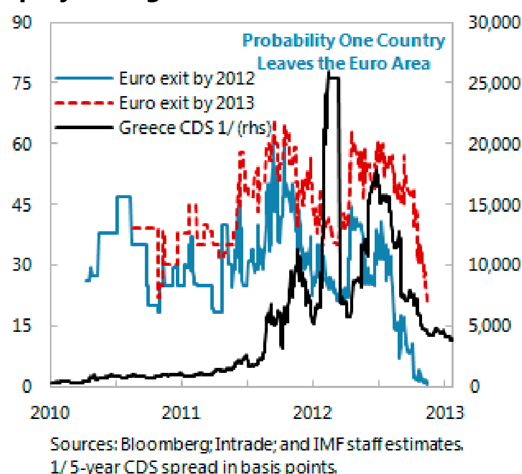
Failure to implement structural reforms and adverse shocks that amplified the negative fiscal impulse contributed to the depth of the recession in Greece.

- **As expected, fiscal adjustment primed the recession at the outset of the program.** To arrest the ballooning public debt and constrained by the scale of official available support, Greece adopted an ambitious fiscal adjustment path. The adjustment under the SBA was projected to be among the largest and most frontloaded ever recorded, with planned measures in 2010-12 amounting to 15½ percent of GDP (including 7½ percent of GDP in 2010 alone). This was projected to have a significant recessionary impact. Using Greece-specific multipliers estimated by OECD (2009), staff projected the impact to be over 3 percent of GDP in 2010, and staff projections were close to actual (4 vs. 5 percent).



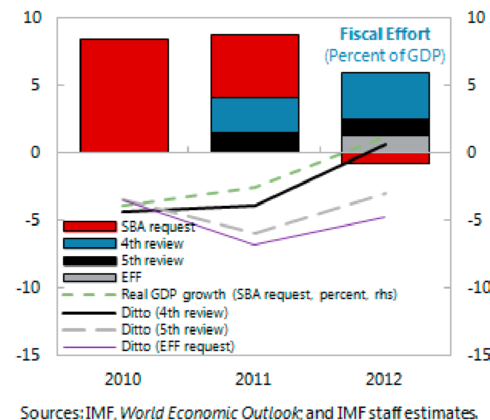
Sources: IMF, *World Economic Outlook*; and IMF staff estimates.

- **Structural reforms were projected to start working their way through the economy relatively fast and offset the impact of further tightening, but projected gains did not materialize.** Deregulation and privatization were expected to turn around expectations, and boost investments to exploit new profit opportunities. Income policies (reductions in public wages and changes to collective bargaining framework) were expected to improve cost competitiveness, which, together with pro-competition structural reforms, would reduce relative prices over time, encouraging strong export response. But these projections failed to materialize, mainly because the critical mass of structural reforms were not achieved, but also because transmission lags to growth proved longer than expected.



Sources: Bloomberg; Intrade; and IMF staff estimates.
1/ 5-year CDS spread in basis points.

- **Moreover, a barrage of powerful adverse shocks hit the economy.** Diminishing support for the program and the domestic political turmoil, combined with a growing impatience with the slow pace reform implementation among European leaders, led to the growing uncertainty surrounding Greece's future in the euro area. The widespread loss of confidence resulted in a large outflow of deposits and seizing up of liquidity in the economy. This hampered the transmission from even the modest structural reform implementation to growth by stifling investments. Externally, recessionary forces in Europe proved stronger than expected, reducing demand for Greece's exports.



Sources: IMF, *World Economic Outlook*; and IMF staff estimates.

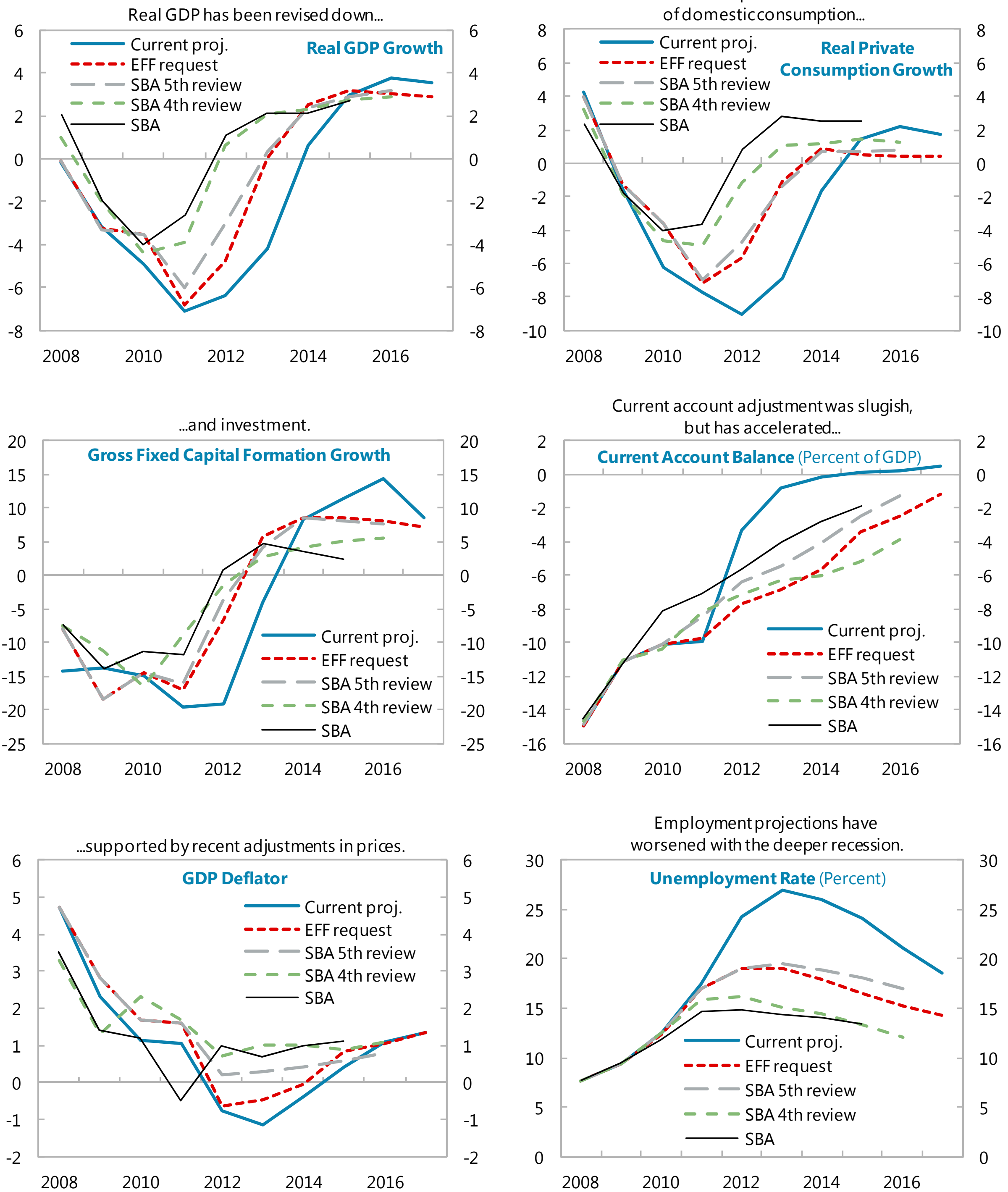
Box 1. Why Has the Recession In Greece Been So Deep? (concluded)

- **With no support to growth from structural reforms, the adverse shocks amplified the impact of the negative fiscal impulse, creating a negative feedback loop.** Fiscal targets were relaxed only marginally in the face of weaker growth, effectively leading to additional, highly pro-cyclical tightening. Consecutive packages of measures amounted to around 7 percent of GDP. Under standard OECD multipliers, this would have reduced GDP growth by additional 4 percentage points (on top of the direct impact of expectations and the liquidity squeeze on the economy), but multipliers have likely increased when liquidity crunch associated with the confidence crisis affected access to credit for households and businesses alike.

Box 2. External Balance Assessment (EBA)

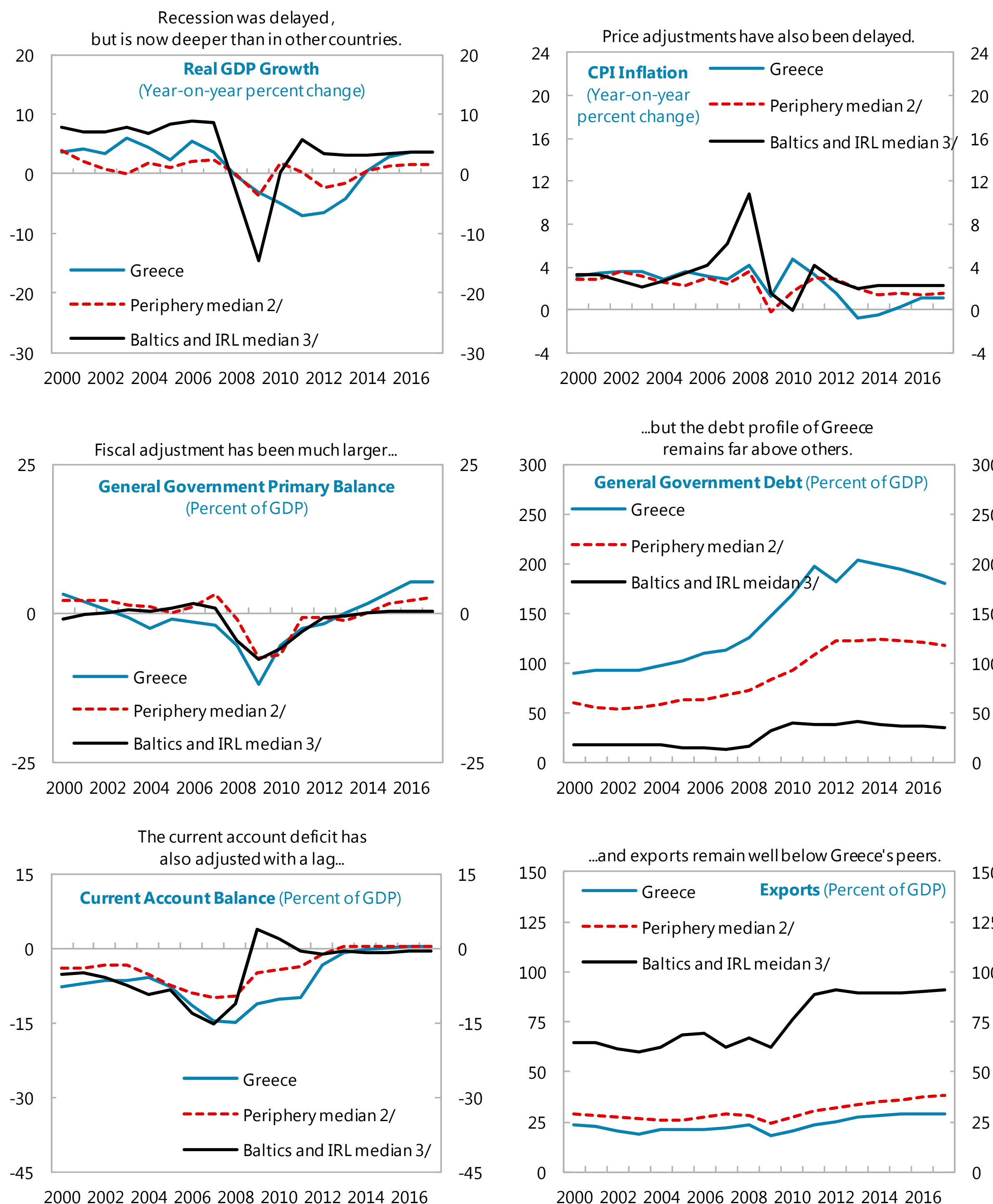
The EBA exercise indicates that the external adjustment is not yet complete:

- The EBA current account exercise suggests that further current account adjustment is needed to restore external sustainability. The EBA estimates a current account norm of -2.5 percent of GDP compared to 2012 cyclically-adjusted current account of around -5½ percent of GDP. The envisaged fiscal adjustment under the program is expected to be one of the key elements to bring the current account closer to the norm (the EBA methodology attributes about -1 percent of GDP to the domestic fiscal balance policy gap, which is expected to close).
- In the medium-term, high net external debt requires an extended period of current account balances above the EBA norm to reduce debt to safer levels. Staff projects that a cyclically-adjusted current account converging to a surplus of about 2 percent of GDP by 2020 would be consistent with net external debt falling to around 70 percent of GDP by the end of the decade. In this scenario, public debt would still be in a range where detrimental effects to growth could occur.
- The EBA REER regression yields a 9 percent overvaluation. CGER results indicate a larger overvaluation of 24 percent (broadly consistent with the 4 percent drop in the REER from the peak in 2009Q4 and an estimated overvaluation of 20-30 percent at the onset of the SBA in 2010), but it does not reflect the narrowing of policy gaps, which are reflected in the EBA methodology. Given the large and ongoing structural changes to the Greek economy, these results should be interpreted with caution.
- On the basis of the envisaged product and labor market reforms and continued domestic demand restraint, staff projects the CPI- and GDP-deflator based REERs to fall by a cumulative 10 percent by 2020. Together with the general business environment improvements that the program's structural reforms will deliver, these projected REER developments are consistent with closing the competitiveness gap around 2020.



Sources: Elstat; Bank of Greece; and IMF staff projections.

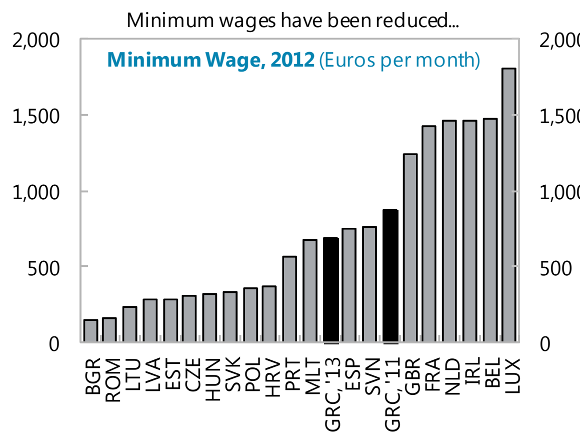
Figure 2. Greece: Performance Among Peers, 2000–17 1/



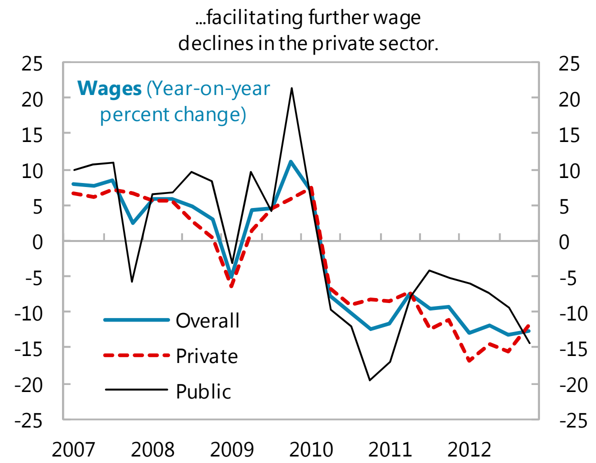
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Aggregates exclude Greece. Max and min for the entire sample excluding Greece.
2/ Includes Italy, Portugal, and Spain.
3/ Includes Estonia, Ireland, Latvia, and Lithuania.

Figure 3. Greece: Labor Market Developments, 2007–12

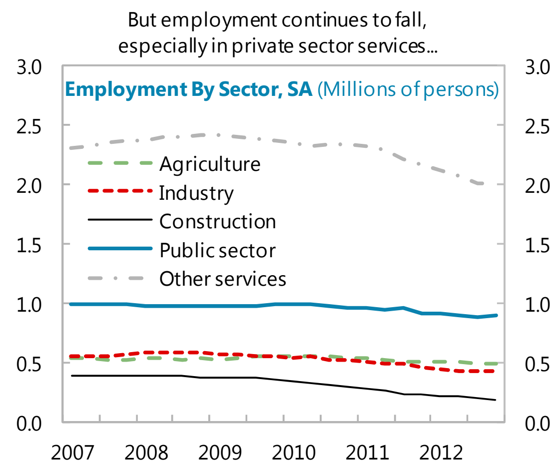
Minimum wages have been reduced...



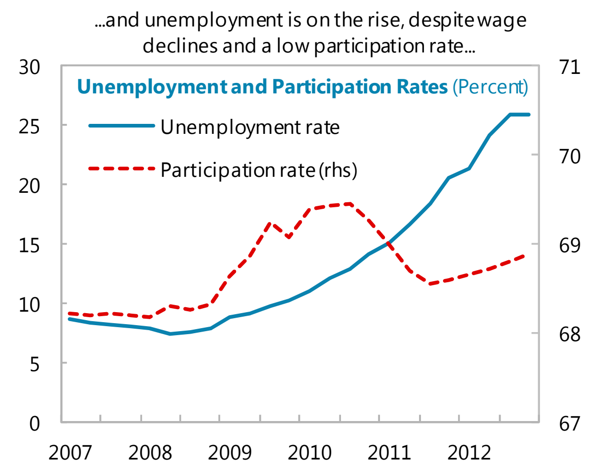
...facilitating further wage declines in the private sector.



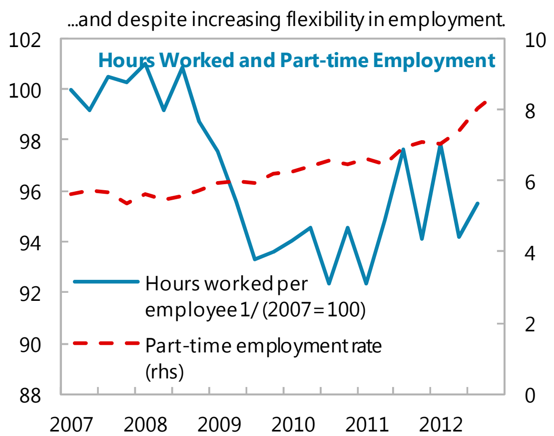
But employment continues to fall, especially in private sector services...



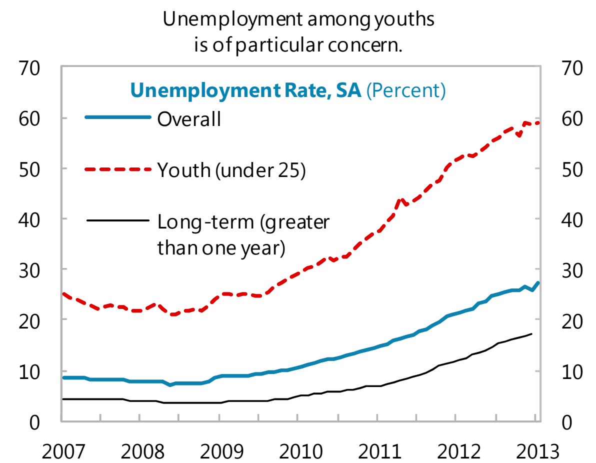
...and unemployment is on the rise, despite wage declines and a low participation rate...



...and despite increasing flexibility in employment.

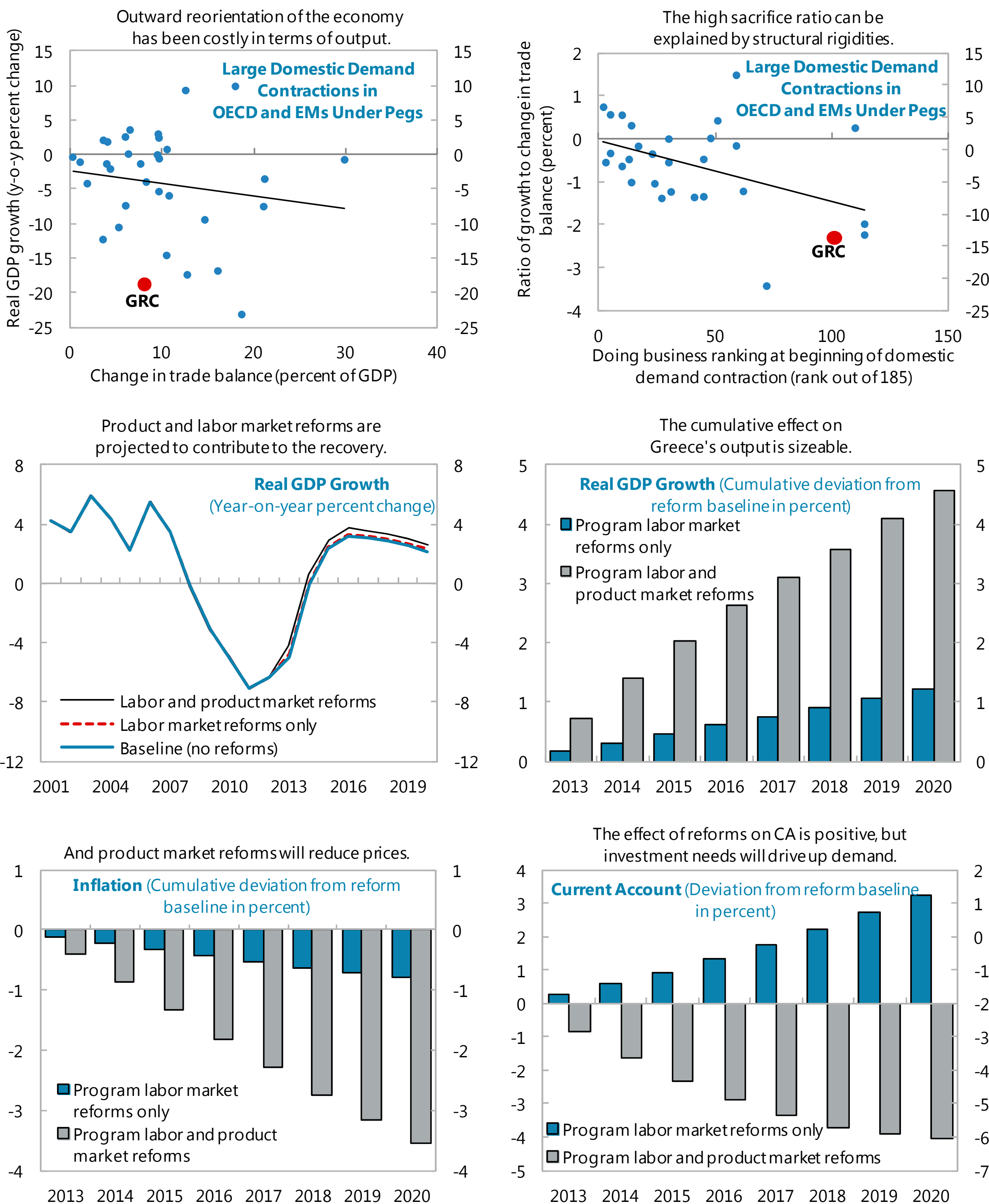


Unemployment among youths is of particular concern.



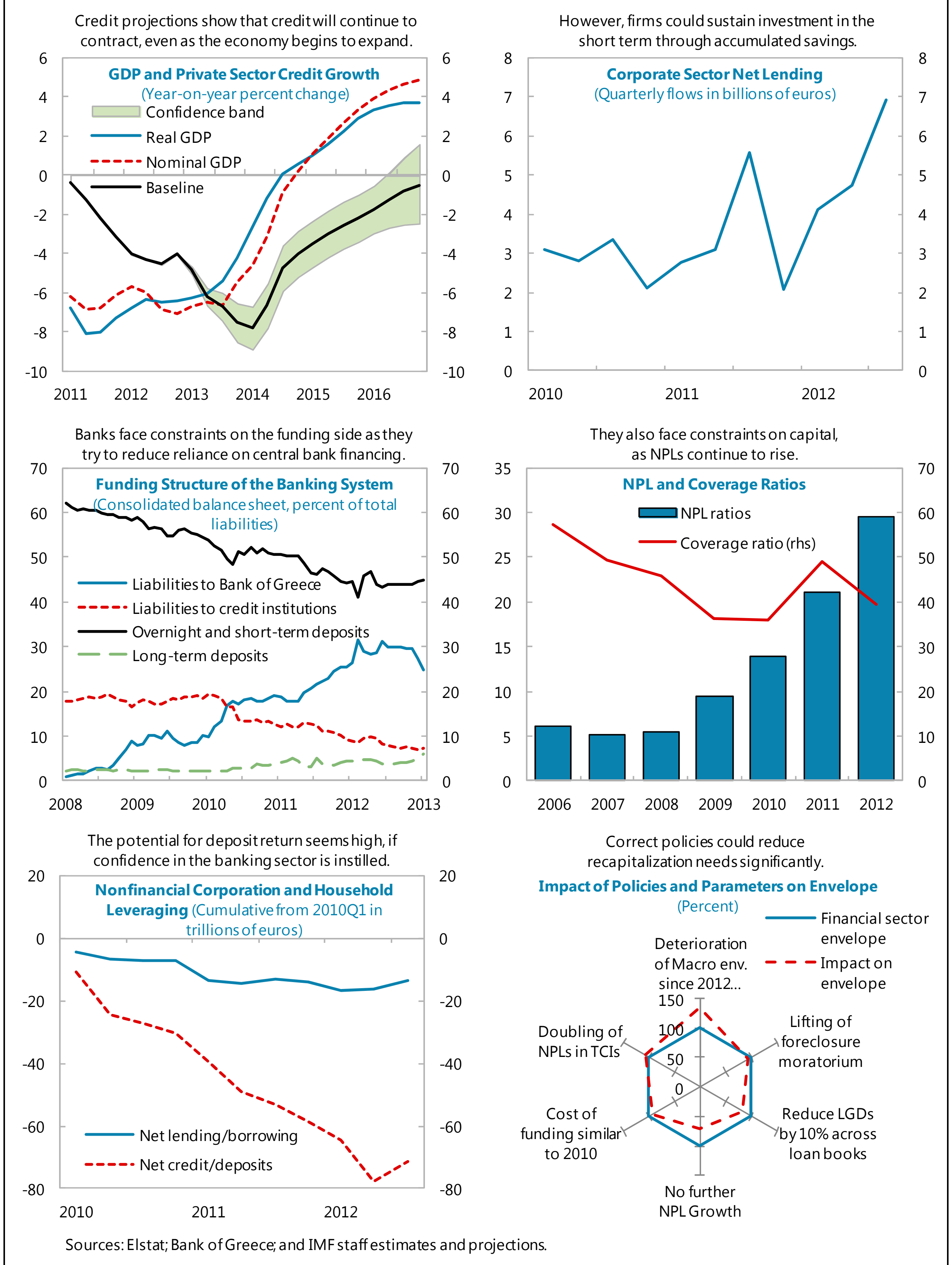
Sources: Elstat; Eurostat; Haver; and IMF staff calculations.

Figure 4. Greece: Restoring Growth

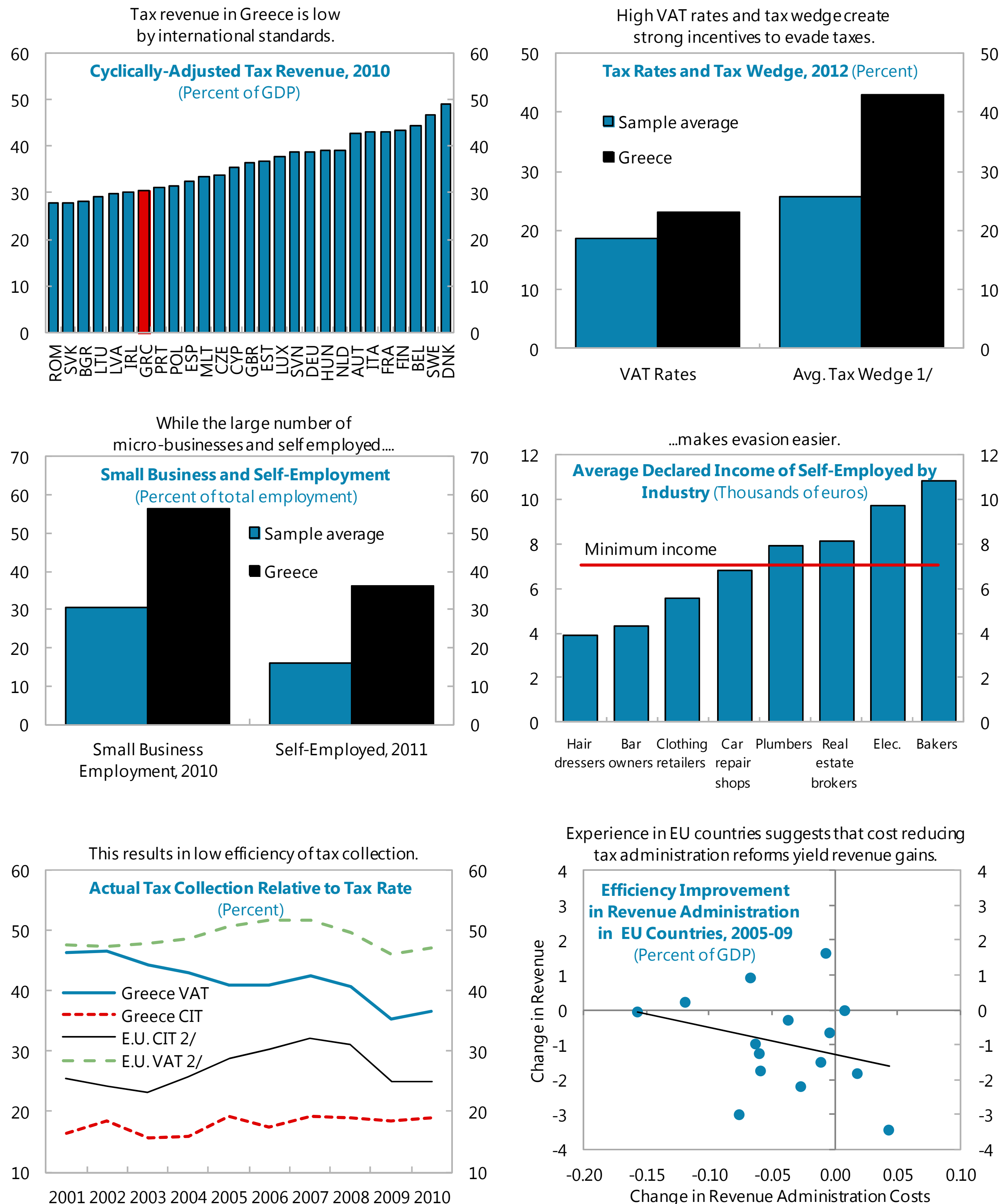


Sources: IMF, *World Economic Outlook;* and IMF staff estimates.

Figure 5. Financial Sector: Supporting the Recovery



Sources: Elstat; Bank of Greece; and IMF staff estimates and projections.



Sources: European Commission; Eurostat; OECD; and IMF staff estimates.
1/ Tax wedge for one family earner with two children.
2/ Unweighted average.

Table 1. Greece: Selected Economic Indicators, 2009–14

	2009	2010	2011	2012		2013	2014
				Prog.	Est.	Proj.	
	(Percentage change, unless otherwise indicated)						
Domestic economy							
Real GDP	-3.1	-4.9	-7.1	-6.0	-6.4	-4.2	0.6
Output gap (percent of pot. output)	7.3	3.3	-2.6	-7.3	-7.7	-10.6	-9.5
Total domestic demand	-5.5	-7.0	-8.7	-8.7	-10.4	-5.6	-1.1
Private consumption	-1.6	-6.2	-7.7	-7.7	-9.1	-6.9	-1.6
Public consumption	4.9	-8.7	-5.2	-6.2	-4.2	-4.0	-6.2
Gross fixed capital formation	-13.7	-15.0	-19.6	-14.4	-19.2	-4.0	8.4
Change in stocks (contribution)	-1.2	0.7	-0.4	0.4	0.0	0.4	0.0
Foreign balance (contribution)	3.0	3.0	2.4	3.3	3.7	2.6	1.7
Exports of goods and services	-19.4	5.2	0.3	-1.2	-2.4	3.0	4.6
Imports of goods and services	-20.2	-6.2	-7.3	-11.5	-13.8	-6.4	-1.9
Unemployment rate (percent) 1/	9.4	12.5	17.5	24.4	24.2	27.0	26.0
Employment 1/	-1.0	-2.7	-6.6	-9.2	-8.2	-3.7	0.6
Unit labor costs	4.2	-1.1	-3.9	-8.1	-6.1	-6.5	-1.5
Consumer prices (national definition), period averag	1.2	4.7	3.3	1.2	1.5	-0.8	-0.4
Consumer prices (HICP), period average	1.3	4.7	3.1	...	1.0	...	...
Core prices, period average 2/	2.3	2.6	1.1	...	-0.3	...	...
GDP deflator	2.3	1.1	1.0	-0.5	-0.8	-1.1	-0.4
	(Percent of GDP, unless otherwise indicated)						
Balance of payments							
Current account	-11.2	-10.1	-9.9	-4.2	-3.4	-0.8	-0.2
Structural current account balance	-7.0	-8.3	-10.9	...	-5.4	-4.9	-3.6
Trade balance	-7.8	-6.8	-6.0	-2.5	-2.5	-0.2	1.4
Export of goods and services	18.3	20.5	23.4	25.3	25.4	27.4	28.3
Imports of goods and services	-26.2	-27.3	-29.5	-27.8	-27.9	-27.6	-26.9
Total transfers	0.6	0.1	0.3	0.3	0.7	1.8	1.5
Net income receipts	-3.9	-3.5	-4.1	-2.0	-1.6	-2.5	-3.1
Net international investment position	-86.4	-98.4	-86.1	-94.2	-114.1	-118.9	-117
Public finances (general government)							
Total revenues	38.3	40.6	42.4	43.6	44.1	44.3	43.7
Total expenditures	54.0	51.4	52.0	50.3	50.4	48.4	46.9
Primary expenditures	48.8	45.5	44.8	45.1	45.4	44.3	42.2
Overall balance	-15.6	-10.8	-9.6	-6.7	-6.3	-4.1	-3.2
Primary balance	-10.5	-4.9	-2.4	-1.5	-1.3	0.0	1.5
Cyclically-adjusted primary balance	-13.0	-6.1	-1.3	...	2.2	5.0	5.9
Gross debt	130	148	170	158	157	176	174
Interest rates and credit							
Lending interest rate (percent)3/	5.1	6.1	6.8	...	5.8	6.4	...
Private credit growth (percent change) 4/	4.2	0.0	-3.1	-7.2	-4.0	-6.5	-4.0
Exchange rates, end-period (percent change) 3/							
Nominal effective exchange rate	0.4	-3.7	0.0	...	-0.5	0.1	...
Real effective exchange rate (CPI-based)	1.7	-1.2	-0.7	...	-1.9	-2.1	...
Real effective exchange rate (man. ULC-based)	1.1	0.8	-6.1	...	-8.4	-8.4	...
Memorandum items:							
Nominal GDP (billions of euros)	231	222	209	195	194	183	184
Nominal GDP (percent change)	-0.9	-3.9	-6.1	-6.5	-7.1	-5.3	0.2

Sources: National Statistical Service; Ministry of Economy and Finance; Bank of Greece; and IMF staff projections.

1/ Based on Labor Force Survey.
2/ Core prices exclude energy, food, alcohol, and tobacco.
3/ Data for 2013 as of March.
4/ Includes securitized or otherwise transferred loans from 2010 onward.

Table 2. Greece: Medium-Term Macro Framework, 2012–18

	2012	2013	2014	2015	2016	2017	2018
	Est.	Proj.					
	(Percentage change, unless otherwise indicated)						
Domestic economy							
Real GDP	-6.4	-4.2	0.6	2.9	3.7	3.5	3.3
Output gap (percent of pot. output)	-7.7	-10.6	-9.5	-6.9	-4.5	-2.7	-1.0
Total domestic demand	-10.4	-5.6	-1.1	1.7	3.2	3.2	3.0
Private consumption	-9.1	-6.9	-1.6	1.4	2.2	1.8	1.5
Public consumption	-4.2	-4.0	-6.2	-4.8	-4.0	3.2	3.7
Gross fixed capital formation	-19.2	-4.0	8.4	11.3	14.4	8.5	7.4
Change in stocks (contribution)	0.0	0.4	0.0	0.0	0.0	0.0	0.0
Foreign balance (contribution)	3.7	2.6	1.7	1.2	0.6	0.4	0.4
Exports of goods and services	-2.4	3.0	4.6	5.5	4.7	4.1	4.3
Imports of goods and services	-13.8	-6.4	-1.9	1.2	2.7	3.1	3.2
Unemployment rate (percent) 1/	24.2	27.0	26.0	24.0	21.0	18.6	16.3
Employment	-8.2	-3.7	0.6	2.6	4.0	3.0	2.7
Unit labor costs	-6.1	-6.5	-1.5	-0.3	1.7	1.4	1.6
Consumer prices (national defintion), period average	1.5	-0.8	-0.4	0.3	1.1	1.2	1.3
Consumer prices (HICP), period average	1.0	...	...	...	...	...	...
GDP deflator	-0.8	-1.1	-0.4	0.4	1.1	1.3	1.4
Monetary survey							
Private credit growth (percent change) 2/	-4.0	-6.5	-4.0	-2.2	-0.6	5.3	n.a.
Private sector deposit growth (percent change)	-7.0	1.3	1.0	3.4	5.0	5.0	n.a.
Liabilities to the Bank of Greece (billions of Euro)	121.2	81.5	66.9	51.0	35.0	27.7	n.a.
	(Percent of GDP, unless otherwise indicated)						
Balance of payments							
Current account	-3.4	-0.8	-0.2	0.1	0.2	0.5	0.9
Structural current account balance	-5.4	-4.9	-3.6	-2.1	-0.8	0.1	1.0
Trade balance	-2.5	-0.2	1.4	2.4	3.0	3.5	3.9
Export of goods and services	25.4	27.4	28.3	28.6	28.7	28.9	29.1
Export of goods	11.4	12.1	12.4	12.4	12.2	12.2	12.3
Exports of services	14.0	15.3	15.9	16.3	16.4	16.6	16.9
Imports of goods and services	-27.9	-27.6	-26.9	-26.2	-25.7	-25.4	-25.2
Imports of goods	-21.5	-21.3	-20.8	-20.2	-19.7	-19.5	-19.3
Imports of services	-6.4	-6.3	-6.1	-6.0	-6.0	-5.9	-5.9
Total transfers	0.7	1.8	1.5	1.2	0.9	0.7	0.4
Net income receipts	-1.6	-2.5	-3.1	-3.5	-3.7	-3.7	-3.4
Net international investment position	-114.1	-118.9	-116.9	-111.3	-104.3	-96.9	-89.1
Gross external debt	232.8	247.0	238.1	222.2	204.7	190.6	176.6
Private sector capital flows (net)	-21.5	-14.2	5.1	5.1	4.5	0.7	0.8
Public finances (general government)							
Total revenues	44.1	44.3	43.7	42.7	42.0	42.0	42.0
Total expenditures 3/	50.4	48.4	46.9	44.8	42.7	42.6	42.8
Primary expenditures 3/	45.4	44.3	42.2	39.7	37.5	37.5	37.7
Overall balance	-6.3	-4.1	-3.2	-2.1	-0.7	-0.6	-0.8
Primary balance	-1.3	0.0	1.5	3.0	4.5	4.5	4.3
Cyclically-adjusted primary balance	2.2	5.0	5.9	6.0	6.4	5.6	4.7
Privatization receipts	0.1	1.4	1.0	1.1	1.1	1.1	1.5
Gross debt	156.9	175.8	174.2	168.2	159.5	149.7	140.9

Sources: National Statistical Service; Ministry of Economy and Finance; Bank of Greece; and IMF staff projections.

1/ Based on Labor Force Survey.

2/ Projections do not take into account write-offs, valuation changes, or reclassifications.

3/ Includes unidentified measures.

Table 3. Greece: General Government: Statement of Operations (GFSM 2001, flows), 2010–16 1/

(Millions of euros)

	2010	2011	2012	2013	2014	2015	2016
Revenue	90,232	88,383	85,458	81,243	80,265	81,205	83,675
Taxes	45,109	44,917	43,644	42,264	41,714	42,259	43,802
Social contributions	29,764	27,435	26,508	24,666	25,220	25,127	25,790
Grants and other revenue	15,359	16,031	15,306	14,313	13,331	13,819	14,082
Expenditure	114,289	108,346	97,655	88,807	86,313	88,484	89,403
Expense	114,472	111,332	100,264	....	....	....	....
Compensation of employees	27,773	25,852	24,215	21,184	20,365	20,175	19,895
Use of goods and services	13,429	9,789	9,456	7,583	6,919	7,069	6,999
Consumption of fixed capital	5,386	5,782	6,263	....	....	....	....
Interest	13,193	15,016	9,723	7,527	8,745	9,786	10,524
Subsidies	129	982	977	1,090	478	212	375
Social benefits	47,476	47,450	44,383	39,957	38,513	39,251	40,010
Grants and other expense	7,086	6,461	5,247	3,130	2,772	2,725	2,652
Net acquisition of nonfinancial assets	-183	-2,986	-2,609	....	....	....	....
Gross capital formation 2/	5,203	2,796	3,654	8,337	8,520	9,265	8,948
(-) Consumption of fixed capital	5,386	5,782	6,263	....	....	....	....
Unidentified Measures (Cumulative)	0	0	0	37	60	3,195	4,173
Gross operating balance 3/	-18,854	-17,167	-8,543	810	2,532	5,181	7,392
Net operating balance 4/	-24,240	-22,949	-14,806	....	....	....	....
Net lending (+)/borrowing (–) 5/	-24,057	-19,963	-12,197	-7,527	-5,988	-4,084	-1,556
Primary Net lending (+)/borrowing (–)	-10,864	-4,947	-2,474	0	2,758	5,702	8,969
Net acquisition of financial assets	4,798	356	52,061	....	....	....	....
Monetary gold and SDRs	0	0	0	....	....	....	....
Currency and deposits	5,097	-2,012	4,979	....	....	....	....
Debt securities	0	-48	13,535	....	....	....	....
Loans	144	832	-4,995	....	....	....	....
Equity and investment fund shares	380	652	38,036	....	....	....	....
Insurance, pensions, and standardized guarantee schemes	4	1	1	....	....	....	....
Financial derivatives and employee stock options	0	0	0	....	....	....	....
Other accounts receivable	-827	931	505	....	....	....	....
Net incurrence of liabilities	28,695	20,057	64,525	....	....	....	....
SDRs	0	0	0	....	....	....	....
Currency and deposits	-503	-184	-46	....	....	....	....
Debt securities	-311	-2,981	-44,744	....	....	....	....
Loans	30,216	26,907	107,811	....	....	....	....
Equity and investment fund shares	0	0	0	....	....	....	....
Insurance, pensions, and standardized guarantee schemes	0	0	0	....	....	....	....
Financial derivatives and employee stock options	951	166	-1,499	....	....	....	....
Other accounts payable	-1,658	-3,851	3,003	....	....	....	....

Sources: Ministry of Finance; and IMF staff projections

1/ Calculations based on program definitions as outlined in the TMU.
2/ Acquisition less disposals of nonfinancial assets.
3/ Revenue minus expense (excluding consumption of fixed capital).
4/ Revenue minus expense (including consumption of fixed capital).
5/ Revenue minus expenditure.

Table 4. Greece: Financial Balance Sheet (GFSM 2001, stocks), 2008–12 1/

(Millions of euros)

	2008	2009	2010	2011	2012
Stock positions					
Net worth	....	....	....	....	....
Nonfinancial assets	....	....	....	....	....
Net financial worth	-221,099	-242,350	-211,112	-153,297	-198,700
Financial assets	64,412	77,232	79,471	75,756	121,573
Monetary gold and SDRs	0	0	0	0	0
Currency and deposits	13,213	11,764	16,901	14,732	20,707
Debt securities	702	741	741	693	14,196
Loans	1,591	5,261	5,407	6,238	1,243
Equity and investment fund shares	29,256	39,757	37,533	34,270	65,097
Insurance, pensions, and standardized guarantee schemes	38	42	47	48	49
Financial derivatives and employee stock options	0	0	0	0	0
Other accounts receivable	19,612	19,667	18,842	19,775	20,281
Liabilities	285,511	319,582	290,583	229,053	320,273
Monetary gold and SDRs	0	0	0	0	0
Currency and deposits	728	1,508	1,005	820	774
Debt securities	213,617	248,184	190,632	104,586	78,128
Loans	45,912	44,811	75,193	102,921	216,240
Equity and investment fund shares	0	0	0	0	0
Insurance, pensions, and standardized guarantee schemes	0	0	0	0	0
Financial derivatives and employee stock options	2,736	980	1,311	2,134	3,536
Other accounts payable	22,518	24,099	22,442	18,592	21,595
Memorandum items:					
Debt (at market value)	282,775	318,602	289,272	226,919	316,737
Debt at face value	285,802	323,784	351,957	373,764	325,513
Maastricht debt	263,284	299,685	329,515	355,172	303,918
Other economic flows					
Change in net worth from other economic flows	....	....	....	....	....
Nonfinancial assets	....	....	....	....	....
Change in net financial worth from other economic flows	-5,405	15,093	55,135	77,516	-25,729
Financial assets	-13,417	10,552	-2,559	-4,071	966
Monetary gold and SDRs	0	0	0	0	0
Currency and deposits	48	-67	40	-157	-223
Debt securities	0	0	0	0	-32
Loans	-2	0	2	-1	0
Equity and investment fund shares	-13,461	10,619	-2,604	-3,915	1,220
Insurance, pensions, and standardized guarantee schemes	-1	-1	1	0	0
Financial derivatives and employee stock options	0	0	0	0	0
Other accounts receivable	-1	1	2	2	1
Liabilities	-8,012	-4,541	-57,694	-81,587	26,695
Monetary gold and SDRs	0	0	0	0	0
Currency and deposits	0	57	0	-1	0
Debt securities	-7,067	-3,353	-57,241	-83,065	18,286
Loans	6	-11	166	821	5,508
Equity and investment fund shares	0	0	0	0	0
Insurance, pensions, and standardized guarantee schemes	0	0	0	0	0
Financial derivatives and employee stock options	-950	-1,234	-620	657	2,901
Other accounts payable	-1	0	1	1	0

Sources: Ministry of Finance; and IMF staff projections.

1/ Calculations based on program definitions as outlined in the TMU.

Table 5: Greece: General Government Operations, 2010–17 1/

	2010	2011	2012	2013	2014	2015	2016	2017
					Proj.			
	(Billions of euros)							
Revenue	90.2	88.4	85.5	81.2	80.3	81.2	83.7	87.8
Indirect taxes	27.3	26.6	24.3	23.5	23.2	23.7	25.0	26.2
Direct taxes	17.5	18.0	19.1	18.7	18.5	18.6	18.8	19.7
Social contributions	29.8	27.4	26.5	24.7	25.2	25.1	25.8	27.1
Other current revenue	4.9	5.7	4.7	5.3	5.1	5.3	5.5	5.8
Sales	6.1	5.6	5.8	4.6	4.4	4.6	4.8	5.0
Capital revenue	4.6	5.0	4.9	4.4	3.8	3.9	3.8	4.0
Primary expenditure	101.1	93.3	87.9	81.3	77.6	78.7	78.9	82.7
Social benefits	47.5	47.5	44.4	40.0	38.5	39.3	40.0	42.0
Subsidies	0.1	1.0	1.0	1.1	0.5	0.2	0.4	0.4
Other current expenditure	3.4	2.6	2.3	2.5	2.4	2.4	2.4	2.5
Compensation of employees	27.8	25.9	24.2	21.2	20.4	20.2	19.9	20.9
Intermediate consumption	13.4	9.8	9.5	7.6	6.9	7.1	7.0	7.3
Investment	8.9	6.7	6.6	8.9	8.9	9.6	9.2	9.7
Unidentified measures (cumulative)	0.0	0.0	0.0	0.0	0.0	3.2	4.2	4.4
Primary balance	-10.9	-4.9	-2.5	0.0	2.8	5.7	9.0	9.4
Interest	13.2	15.0	9.7	7.5	8.7	9.8	10.5	11.0
Overall balance	-24.1	-20.0	-12.2	-7.5	-6.0	-4.1	-1.6	-1.6
Gross debt (Maastricht)	329.5	355.2	303.9	322.5	320.3	319.8	317.9	312.9
	(Percent of GDP)							
Total primary revenue	40.6	42.4	44.1	44.3	43.7	42.7	42.0	42.0
Indirect taxes	12.3	12.8	12.6	12.8	12.6	12.5	12.5	12.5
Direct taxes	7.9	8.6	9.9	10.2	10.1	9.8	9.4	9.4
Social contributions	13.4	13.2	13.7	13.4	13.7	13.2	12.9	12.9
Other current revenue	2.2	2.7	2.4	2.9	2.8	2.8	2.8	2.8
Sales	2.7	2.7	3.0	2.5	2.4	2.4	2.4	2.4
Capital revenue	2.1	2.4	2.5	2.4	2.1	2.1	1.9	1.9
Total primary expenditure	45.5	44.8	45.4	44.3	42.2	41.4	39.6	39.6
Social benefits	21.4	22.8	22.9	21.8	20.9	20.7	20.1	20.1
Subsidies	0.1	0.5	0.5	0.6	0.3	0.1	0.2	0.2
Other current expenditure	1.5	1.2	1.2	1.4	1.3	1.2	1.2	1.2
Compensation of employees	12.5	12.4	12.5	11.5	11.1	10.6	10.0	10.0
Intermediate consumption	6.0	4.7	4.9	4.1	3.8	3.7	3.5	3.5
Investment	4.0	3.2	3.4	4.9	4.8	5.1	4.6	4.6
Unidentified measures (cumulative)	0.0	0.0	0.0	0.0	0.0	1.7	2.1	2.1
Primary balance	-4.89	-2.37	-1.28	0.00	1.50	3.00	4.50	4.50
Interest	5.9	7.2	5.0	4.1	4.8	5.1	5.3	5.3
Overall balance	-10.8	-9.6	-6.3	-4.1	-3.3	-2.1	-0.8	-0.8
Gross debt (Maastricht)	148.3	170.3	156.9	175.8	174.2	168.2	159.5	149.7
Nominal GDP (billions of euros)	222.2	208.5	193.8	183.5	183.9	190.1	199.3	209.1

Sources: Ministry of Finance; and IMF staff projections.

1/ Calculations based on program definitions as outlined in the TMU.

Table 6. Greece: Summary of Balance of Payments, 2010–18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
				Proj.					
				(Billions of euro)					
Current account balance	-22.5	-20.6	-6.5	-1.6	-0.4	0.2	0.4	0.9	1.9
Balance of goods and services	-15.0	-12.6	-4.9	-0.3	2.6	4.6	5.9	7.2	8.6
Goods balance	-28.3	-27.2	-19.6	-16.9	-15.4	-14.9	-15.0	-15.1	-15.4
Exports	17.1	20.2	22.0	22.2	22.8	23.5	24.4	25.6	26.9
Imports	45.4	47.5	41.6	39.1	38.2	38.4	39.4	40.7	42.3
Services balance	13.2	14.6	14.7	16.6	18.0	19.5	20.9	22.4	24.0
Credit	28.5	28.6	27.1	28.1	29.3	30.9	32.7	34.8	37.0
Debit	15.2	14.0	12.4	11.5	11.2	11.4	11.9	12.4	13.0
Income balance	-7.7	-8.6	-3.1	-4.7	-5.7	-6.6	-7.3	-7.7	-7.5
Credit	4.0	3.3	3.3	3.8	4.2	4.6	5.1	5.7	6.1
Debit	11.7	11.9	6.3	8.5	9.9	11.2	12.3	13.4	13.6
Current transfers (net)	0.2	0.6	1.4	3.4	2.7	2.2	1.8	1.5	0.8
Capital and financial account balance	-8.6	-21.0	-103.4	-33.2	-15.2	-7.0	-3.0	-4.9	-5.0
Capital account balance	2.1	2.7	2.3	4.6	3.5	3.2	3.3	3.3	2.8
Financial account	-10.6	-23.7	-105.7	-37.9	-18.7	-10.3	-6.3	-8.2	-7.8
Direct investment	-0.9	-0.5	2.3	2.3	1.8	1.9	1.8	2.2	3.0
Portfolio investment	-20.9	-19.8	-99.9	-2.8	-9.0	-5.4	-2.1	-3.5	0.2
Of which: government	-26.8	-23.3	-57.0	6.2	-9.1	-6.1	-2.7	-4.7	-0.9
Other investment (excl. program financing)	11.0	-3.4	-8.1	-37.3	-11.4	-6.8	-6.0	-6.8	-11.0
Reserve assets (increase = -)	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Program financing, net	31.5	41.5	109.9	34.8	11.0	0.3	2.6	3.9	3.1
Unidentified financing	0.0	0.0	0.0	0.0	4.6	6.5	0.0	0.0	0.0
				(Percent of GDP)					
Current account balance	-10.1	-9.9	-3.4	-0.8	-0.2	0.1	0.2	0.5	0.9
Balance on goods and services	-6.8	-6.0	-2.5	-0.2	1.4	2.4	3.0	3.5	3.9
Goods balance	-12.7	-13.1	-10.1	-9.2	-8.4	-7.8	-7.5	-7.2	-7.0
Services balance	6.0	7.0	7.6	9.0	9.8	10.2	10.5	10.7	11.0
Income balance	-3.5	-4.1	-1.6	-2.5	-3.1	-3.5	-3.7	-3.7	-3.4
Current transfers	0.1	0.3	0.7	1.8	1.5	1.2	0.9	0.7	0.4
Capital and financial account balance	-3.9	-10.1	-53.4	-18.1	-8.3	-3.7	-1.5	-2.3	-2.3
Capital account balance	0.9	1.3	1.2	2.5	1.9	1.7	1.7	1.6	1.3
Financial account	-4.8	-11.3	-54.6	-20.6	-10.1	-5.4	-3.2	-3.9	-3.6
Direct investment	-0.4	-0.2	1.2	1.2	1.0	1.0	0.9	1.0	1.4
Portfolio investment	-9.4	-9.5	-51.6	-1.5	-4.9	-2.8	-1.1	-1.7	0.1
Of which: government	-12.1	-11.2	-29.4	3.4	-4.9	-3.2	-1.4	-2.2	-0.4
Other investment	5.0	-1.7	-4.2	-20.4	-6.2	-3.6	-3.0	-3.3	-5.0
Reserve assets (increase = -)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Program financing	14.2	19.9	56.7	19.0	6.0	0.2	1.3	1.9	1.4
Unidentified official financing / market access	0.0	0.0	0.0	0.0	2.5	3.4	0.0	0.0	0.0
Gross external debt	213.1	225.4	232.8	247.0	238.1	222.2	204.7	190.6	176.6
Public sector	150.9	173.5	183.3	196.0	187.9	173.8	158.5	146.8	134.7
Private sector	62.2	51.9	49.5	51.0	50.2	48.4	46.2	43.8	42.0
Memorandum item:									
Current account balance in cash terms	-10.1	-9.9	-3.4	-0.4	0.8	2.1	2.5	3.0	3.5
Structural current account balance	-8.3	-10.9	-5.4	-4.9	-3.6	-2.1	-0.8	0.1	1.0

Sources: Bank of Greece; and IMF staff estimates.

Table 7. Greece: Monetary Survey, 2010–14

	2010	2011	2012	2013				2014			
				Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
								Proj.			
	(Billions of Euros)										
Aggregated balance sheet of Monetary Financial Institutions (MFIs)											
Total assets	654.6	646.1	602.5	558.5	541.4	526.7	520.9	512.4	505.6	499.5	494.4
Cash (held by credit institutions)	2.1	2.4	2.5	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.9
Claims on Bank of Greece	10.6	5.1	3.1	4.2	3.5	3.4	3.4	3.4	3.4	3.4	3.4
Claims on other MFIs	186.0	146.8	170.7	130.9	129.0	124.2	122.0	117.6	113.8	109.8	106.1
Claims (Loans) on non MFIs	289.0	275.9	250.1	249.3	240.2	232.8	229.6	226.6	224.3	222.5	221.2
Domestic	282.5	269.5	244.8	243.6	235.1	227.7	224.5	221.6	219.3	217.4	216.1
General government	26.3	22.3	17.4	15.3	14.6	14.0	13.9	13.8	13.8	13.9	13.9
Other sectors 1/	256.2	247.2	227.5	228.2	220.5	213.7	210.6	207.7	205.4	203.6	202.2
Other countries	6.5	6.4	5.2	5.7	5.2	5.2	5.1	5.1	5.1	5.1	5.1
Securities 2/	101.2	93.0	100.4	99.8	96.9	95.5	95.3	94.5	93.9	93.5	93.2
Other assets	60.7	117.9	70.6	67.4	65.2	64.3	64.2	63.9	63.9	64.0	64.2
Fixed assets	5.0	5.0	5.0	4.9	4.6	4.5	4.5	4.5	4.5	4.5	4.5
Total Liabilities	654.6	646.1	602.5	558.5	541.4	526.7	520.9	512.4	505.6	499.5	494.4
Liabilities to Bank of Greece	97.8	76.9	121.2	92.0	88.8	83.9	81.5	77.6	74.1	70.5	66.9
Liabilities to other MFIs	164.7	155.4	133.2	109.3	108.7	103.9	101.6	97.6	94.1	90.4	86.9
Deposits and repos of non MFIs	282.5	237.5	225.2	227.2	223.7	221.1	220.9	220.2	220.1	220.7	221.8
Domestic	225.1	187.7	179.1	186.0	182.1	180.2	180.4	179.7	179.6	180.2	181.2
Other countries	57.4	49.8	46.1	41.2	41.6	40.8	40.6	40.5	40.5	40.5	40.7
Capital and reserves	46.7	54.8	56.0	59.8	58.2	57.0	56.6	56.9	57.3	57.8	58.4
Banknotes and coins in circulation	22.5	23.7	24.3	23.9	23.3	22.8	22.6	22.5	22.5	22.5	22.6
Other liabilities	40.3	97.8	42.6	46.3	38.8	38.0	37.7	37.6	37.6	37.6	37.7
Money and credit											
Broad money	232.9	199.2	188.4	193.7	191.4	189.5	189.6	189.3	189.6	190.5	191.9
Credit to the private sector 3/ 4/	257.5	248.1	227.3	228.0	220.5	213.7	210.6	207.7	205.4	203.6	202.2
Credit to government 3/	63.0	59.1	28.2	22.5	22.8	22.3	22.4	22.3	22.3	22.3	22.3
	(Annual percentage change) 5/										
Broad money	-11.2	-14.6	-5.3	1.5	8.6	4.9	0.6	-2.2	-1.0	0.5	1.2
Domestic private sector deposits	-12.4	-17.0	-7.0	0.9	9.8	6.0	1.3	-2.0	-1.1	0.3	1.0
Credit to the private sector 3/ 4/	0.0	-3.1	-4.0	-3.5	-5.0	-5.6	-6.5	-8.8	-6.8	-4.8	-4.0
Credit to government 3/	28.3	2.0	-7.9	-17.0	-15.0	-24.6	-20.8	-0.9	-2.3	-0.1	-0.1
	(Percent of GDP)										
Broad money	101.8	89.5	89.1	97.8	101.0	102.7	103.5	103.6	103.8	104.2	104.6
Domestic deposits	98.4	84.3	84.7	93.9	96.1	97.7	98.4	98.4	98.4	98.5	98.7
Credit to the private sector 4/	112.6	111.4	107.5	115.1	116.3	115.9	115.0	113.7	112.5	111.3	110.1
Credit to government	27.6	26.6	13.4	11.4	12.0	12.1	12.2	12.2	12.2	12.2	12.2
Memorandum items:	(Percent)										
Capital to assets	5.8	6.9	5.7	5.8	5.7	5.7	5.6	5.9	6.1	6.3	6.5
Loans to customer deposits	103.5	117.0	111.6	110.3	107.1	104.9	103.5	102.5	101.4	100.3	99.2
Velocity	1.0	1.1	1.1	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0

Sources: Bank of Greece; and IMF staff estimates and projections.

1/ As of June 2010, securitised assets are no longer derecognised from the balance sheet of banks that have adopted the International Accounting Standards. The counterpart of these assets is recorded on the liabilities side as deposit liabilities to non-euro area residents.

2/ Holdings of securities other than shares and derivatives.

3/ Projected growth rates are calculated from differences in outstanding amounts and do not take into account write-offs, valuation changes, or reclassifications.

4/ Credit to domestic non-MFI residents by domestic MFIs excluding the Bank of Greece, including securitized loans and corporate bonds.

Table 8. Greece: Monetary Financial Institutions (excl. BoG)—Uses and Sources of Funds, 2010–16

	2010	2011	2012	2013	2014	2015	2016
					Proj.		
				(Billions of euros)			
Assets	515.0	476.9	442.2	408.6	396.6	394.4	398.7
Cash	2.1	2.4	2.5	1.9	1.9	2.0	2.1
Claims on other MFIs	88.9	68.7	48.3	40.5	39.1	39.0	39.4
Claims on non-MFIs	354.8	338.4	321.3	299.9	289.3	284.9	285.4
General government	63.0	59.1	28.2	22.4	22.3	23.1	24.2
Private sector 1/	255.8	246.8	227.1	210.6	202.2	197.7	196.6
Corporate	116.5	113.0	100.8	97.1	95.3	95.3	96.8
Households	139.3	133.8	126.3	113.5	106.8	102.4	99.8
Other countries	36.0	32.4	66.0	66.9	64.8	64.1	64.5
Other assets	69.1	67.4	70.0	66.4	66.3	68.5	71.8
Liabilities	515.0	476.9	442.2	408.6	396.6	394.4	398.7
Liabilities to other MFIs	66.3	44.5	31.7	34.6	34.5	35.5	37.0
Deposits of non-MFIs	280.2	232.3	218.9	215.7	216.6	225.0	237.9
Central government	9.0	4.1	7.1	7.2	6.4	6.4	7.2
Private sector	213.9	178.7	166.2	168.4	170.0	175.8	184.5
Other countries 2/	57.4	49.5	45.6	40.1	40.2	42.8	46.2
Other liabilities	26.3	18.1	17.2	24.3	24.3	25.1	26.3
Capital and reserves	44.4	53.1	53.2	52.5	54.3	57.8	62.5
Eurosystem liquidity support	97.8	128.9	121.2	81.5	66.9	51.0	35.0
				(Percent of GDP)			
Assets	231.8	228.7	228.2	223.0	216.1	207.9	200.4
Cash	1.0	1.1	1.3	1.0	1.0	1.0	1.0
Claims on other MFIs	40.0	33.0	24.9	22.1	21.3	20.6	19.8
Claims on non-MFIs	159.7	162.3	165.8	163.7	157.6	150.2	143.5
General government	28.4	28.4	14.6	12.2	12.2	12.2	12.2
Private sector 1/	115.2	118.4	117.2	115.0	110.1	104.3	98.9
Corporate	52.4	54.2	52.0	53.0	51.9	50.3	48.7
Households	62.7	64.2	65.2	62.0	58.2	54.0	50.2
Other countries	16.2	15.6	34.1	36.5	35.3	33.8	32.4
Other assets	31.1	32.3	36.2	36.2	36.1	36.1	36.1
Liabilities	231.8	228.7	228.2	223.0	216.1	207.9	200.4
Liabilities to other MFIs	29.8	21.4	16.4	18.9	18.8	18.7	18.6
Deposits of non-MFIs	126.1	111.4	113.0	117.7	118.0	118.6	119.6
Central government	4.0	2.0	3.7	3.9	3.5	3.4	3.6
Private sector	96.3	85.7	85.8	91.9	92.6	92.7	92.8
Other countries 2/	25.8	23.7	23.5	21.9	21.9	22.6	23.2
Other liabilities	11.8	8.7	8.9	13.2	13.2	13.2	13.2
Capital and reserves	20.0	25.4	27.5	28.7	29.6	30.5	31.4
Eurosystem liquidity support	44.0	61.8	62.5	44.5	36.5	26.9	17.6
Memorandum items:							
Domestic private sector deposit growth (percent)	-12.4	-17.0	-7.0	1.3	1.0	3.4	5.0
Private credit growth (percent change) 3/	0.0	-3.1	-4.0	-6.5	-4.0	-2.2	-0.6
Eurosystem liquidity support (percent of total assets)	19.0	27.0	27.4	20.0	16.9	12.9	8.8

Sources: Bank of Greece; and IMF staff estimates and projections.

1/ As of June 2010, securitised assets are no longer derecognised from the balance sheet of banks that have adopted the International Accounting Standards. The counterpart of these assets is recorded on the liabilities side as deposit liabilities to non-euro area residents.

2/ June 2010 reclassification related to liabilities associated with assets disposed of in a securitisation but still recognised on the statistical balance sheet.

3/ Projections do not take into account write-offs, valuation changes, or reclassifications.

Table 9. Greece: Core Set of Financial Soundness Indicators for Deposit Taking Institutions, 2009–12

(Percent, unless otherwise indicated)

	2009	2010	2011				2012			
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Core set										
Regulatory capital to risk-weighted assets 1/	11.9	12.3	12.3	10.6	10.1	7.0	5.7	8.9	10.2	10.2
Regulatory tier I capital to risk-weighted assets 1/	10.9	11.2	11.1	9.6	9.2	5.8	4.7	8.1	9.4	9.5
Nonperforming loans net of provisions to capital	37.9	46.9	51.2	66.3	78.6	...	...	...	...	...
Nonperforming loans to total gross loans	7.8	10.5	11.5	12.8	14.7	16.0	18.7	21.6	22.5	24.6
Bank provisions to nonperforming loans	42.0	46.2	...	...	...	62.9	57.1	49.5	50.1	48.1
Return on assets (after taxes) 2/	-0.1	-0.6	-0.3	-1.7	-2.1	...	...	...	...	...
Return on equity (after taxes) 2/	-1.7	-8.8	-3.9	-27.3	-34.2	...	...	...	...	...
Interest margin to gross income 2/	75.8	91.0	82.5	87.4	91.7	93.7	100.1	106.5	123.1	103.1
Non-interest expenses to gross income 2/	57.4	62.2	54.1	56.9	58.6	66.1	72.0	89.2	106.0	94.0
Liquid assets to total assets 3/	45.2	35.2	34.5	35.2	33.2	32.3	27.3	29.3	30.8	32.1
Liquid assets to short-term liabilities 3/	56.9	46.9	46.4	48.2	50.2	43.1	34.0	37.5	39.7	41.9
Net open position in foreign exchange to capital 1/ 4/	11.6	11.3	12.0	15.4	14.5	...	...	...	...	...
Encouraged set										
Spread between reference lending and deposit rates (end-of-period, basis points) 5/	5.2	6.4	...	...	...	7.5	7.4	7.3	7.1	7.1
Customer deposits to total (noninterbank) loans 3/	125.7	96.6	...	...	...	85.5	84.2	80.5	85.0	89.6
Foreign currency-denominated liabilities to total liabilities 3/	10.8	9.0	...	...	...	7.7	7.1	6.7	6.5	6.5
Market liquidity										
Average bid-ask spread in the securities market (basis points)	60.6	126.0	...	...	...	87.2	177.0	185.0	155.0	193.0
Households										
Household debt to GDP	52.1	60.0	...	...	...	61.3	63.8	66.2	64.1	63.7
Real estate markets										
Residential real estate loans to total loans 3/	20.3	21.1	...	...	...	22.8	24.2	25.0	25.5	25.5
Memorandum items:										
Assets (billions of euros)										
Banks	440.3	465.5	...	...	...	412.7	376.0	383.5	383.3	389.7
Branches of foreign banks	38.3	36.9	...	...	...	52.0	47.6	42.6	40.9	39.1
General insurance companies 6/	15.6	15.7	...	...	...	14.9	14.3	14.1	15.1	15.4
Other credit institutions	11.6	11.4	...	...	...	11.5	10.6	10.9	12.1	12.6
Deposits (billions of euros)										
Banks	248.6	220.3	...	...	...	172.4	163.3	152.0	155.0	164.0
Branches of foreign banks	21.9	18.7	...	...	...	20.9	20.1	16.0	16.7	18.1

Source: Bank of Greece.

1/ Data on a consolidated basis. For end-2011 and 2012Q1, C.A.R. ratios are affected by the PSI and include only the first tranche of €18 billion HFSF recapitalization. In addittion, C.A.R. ratios are affected by the negative supervisory own funds of two banks (ATEbank and TT Hellenic Post Bank).

2/ From 2004 in accordance with IFRS.

3/ On an aggregate resident-based approach (i.e. commercial banks, cooperative banks, and foreign branches).

4/ Based on revised figures from 2002 onwards.

5/ Spread between rate on credit lines and savings deposit rate.

6/ There are no specialised life insurance companies in Greece. General insurance companies offer general insurance and life insurance products.

Table 10. Greece: Risk Assessment Matrix 1/
(Scale—High, Medium, or Low)

Source of risk	Relative Likelihood	Impact if Realized
Reform fatigue	**High** Unemployment is high, recovery still some distance ahead, and recent fiscal adjustment reforms have increased public discontent.	**High** Rejection of program policies could trigger debt default and/or euro exit.
Delayed or weak recovery of domestic demand	**High** Debt overhang could be a bigger-than-expected drag on investments, and fiscal impulse from fiscal measures is uncertain (fiscal multipliers higher than assumed).	**High** Lower growth would undermine achievement of fiscal targets, putting at risk the conditional debt relief, and leave Greece in a high-debt low-growth trap.
Re-emergence of financial stress in the euro area	**Medium** Heightened financial stress from incomplete delivery of policy commitments could lead to large negative shocks to Euro area growth.	**High** Direct effects via lower exports, and indirect effects via a possibly vicious spiral of weaker confidence and renewed capital flight.
Delayed pay-off from structural reform	**Medium** It could take longer for wage adjustments to translate to lower prices, and for stronger competitiveness to lead to higher export growth.	**Medium** Debt sustainability could be called into question, and consensus for continued reforms eroded.
Protracted period of slow European growth	**Medium** Ongoing public and private deleveraging in Europe could create adverse debt-deflation dynamics.	**Medium** Adverse impact from lower exports to Europe and weaker confidence would be gradually offset by trade diversification.
Financial crisis in Cyprus	**High** Problems with financial sector solvency and public sector sustainability.	**Low** Adverse effects limited mainly to financial links (from two Cypriot banks branches in Greece).

1/ The risk assessment matrix shows events that could materially alter the baseline path discussed in this report (which is the most likely to materialize in the view of the staff). The matrix reflects staff's subjective assessment of the sources of risks around this baseline, their relative likelihood, and overall level of concerns as of the time of the discussions with the authorities.

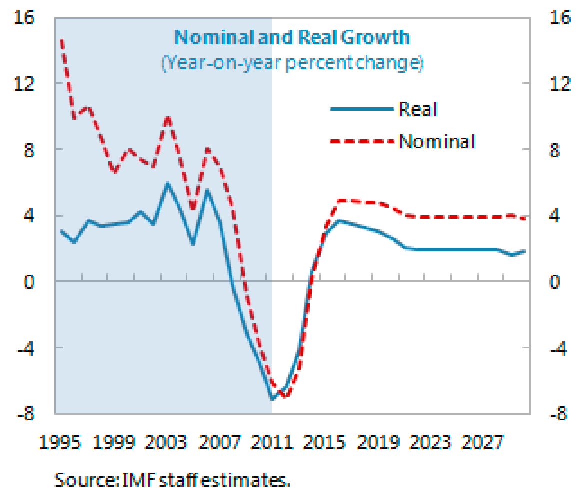
Appendix I: Debt Sustainability Analysis

1. **This appendix considers the sustainability of Greece's public and external debt**. Section A provides an overview of the macro, policy and financing inputs. Sections B and C consider, respectively, public and external debt sustainability, examining the debt trajectory under the program baseline and under a variety of stress scenarios. The results suggest that the current program can place Greece on a sustainable trajectory, but the size and duration of adjustment still required of Greece poses significant risks. Such risks cannot be credibly eliminated without a more conclusive reduction in Greece's debt burden.

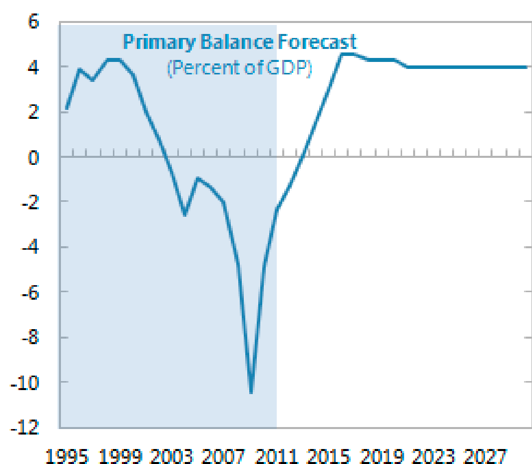
A. Key Inputs for the DSA

2. **The macro and policy framework underpinning the DSA reflects both the significant headwinds facing the Greek economy and the limits on currently available financing**.

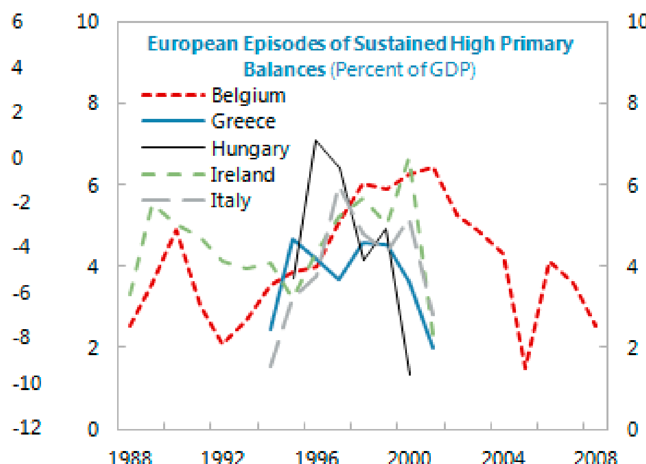
- **Output Path.** The economy is expected to continue to contract in 2013 before a modest recovery takes hold in 2014. Tight liquidity, low confidence, and significant fiscal drag will be negative for growth in the near term. But steady implementation of the authorities' program should help turn around expectations, improve liquidity conditions, and lead to a recovery beginning in 2014 and accelerating to peak at 3¾ percent in 2016. In the long-term, growth in Greece is projected to gradually taper off to around 1¾ percent per annum.



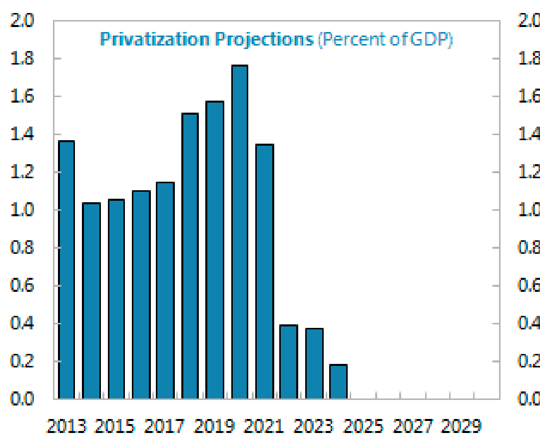
- **Fiscal Adjustment.** The program fiscal path targets headline primary adjustment of 1.5 percent of GDP per year, terminating in a surplus of 4.5 percent in 2016. It is further assumed that Greece can maintain a long-term primary surplus of 4 percent of GDP. This fiscal path is ambitious, but, in terms of dynamics, almost all of the adjustment will be behind Greece at the end of this year. Maintaining a 4 percent primary surplus will remain a challenge: while there were episodes of large sustained primary surpluses in the past, they were rare and often occurred in extraordinary circumstances (e.g., before the euro accession).



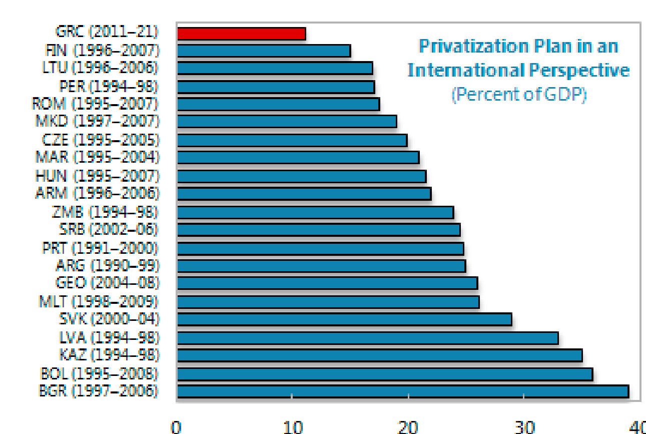
Source: IMF staff estimates.



Sources IMF staff estimates.



Sources: IMF staff estimates.



Source: IMF, 2011 Fiscal Monitor; and IMF staff estimates.

- **Privatization** – Expected proceeds for privatization are EUR 22 billion. This target is at the low end of international experience. However, the slow progress in recent months point to risks to achieve even the conservative goals, although mainly concerning the timing of proceeds rather than the total yield.

- **Other** – The DSA also incorporates key assumptions regarding Greece's liquidity needs: i) financing for clearance of arrears is EUR8 billion in the 5 quarters between end Q3-12 and end-2013; ii) the program targets net deposit accumulation of 1.5 billion by end 2014 before

returning to the original program path thereafter; and iii) the path for the stock of T-bills remains elevated at 15 billion for the duration of the program.

3. The program financing framework reflects the significant relief committed by the official sector in 2012. At the time of the EFF arrangement in March of 2012, euro area member countries made an explicit commitment to provide adequate support to Greece during the program period and beyond, provided that Greece fully complies with the requirements and objectives of the program. This broad-based show of support was repeated at the Eurogroup in December 2012 but the euro area member states also made a series of further, more specific commitments which are now modeled explicitly in the DSA.

- A reduced interest rate on the Greek loan facility from a margin of 150 basis points to 50bps over Euribor.
- Cancellation of a 10 bps administrative fee on EFSF loans .
- Deferral (and capitalization) of interest payments on EFSF (excluding PSI related loans) between 2013 and 2022 and on PSI related loans (roughly 34 billion) between 2015 and 2024.
- Transfer of profits on the ECB's SMP portfolio back to Greece (a projected flow of 9.3 billion through 2020).
- An additional 4 percent of GDP in debt reduction measures after 2014, conditional on Greece achieving a primary surplus, to ensure Greece reaches a debt level of 124 percent of GDP in 2020.

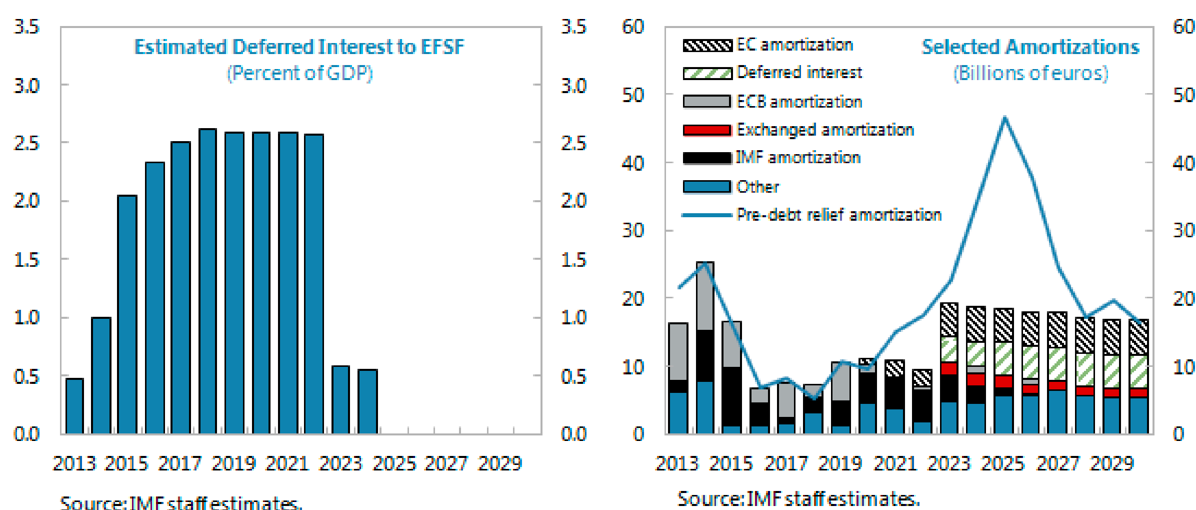
Additionally, there is a key commitment that is not modeled in the DSA but remains critical to the assessment of sustainability in Greece. Euro area member states promised further relief to ensure Greece reaches a debt level substantially below 110 percent of GDP in 2022, once Greece reaches an annual primary surplus. Without such relief, the baseline debt projection currently reaches 113 percent of GDP in 2022 and is in the mid 80s by 2030.

4. The DSA assumes no market access over the life of the program. Given Greece's high debt levels (largely to official sector creditors) and the significant haircut to private sector debt implemented in March 2012, it is assumed that market access at affordable rates will not be feasible until late in the decade and even then at modest amounts. Full reliance on market financing begins after 2020 with initially short maturities of 3 years. For modeling purposes, it is assumed that the terms of borrowing are directly linked to the level of Greece's debt. At a debt level of roughly 115 percent of GDP, Greece is assumed to be able to borrow at a spreads of 450-600 bps depending on the maturity with spreads rising by 10 bps for every 1 percentage point increase in debt.

B. Public Sector DSA

5. Baseline projections show that debt would decline to 124 percent of GDP in 2020 and to 113 percent by 2022 (Table A1 and Figure A1). Debt is projected to peak at above 175 percent of GDP in the near term. Steady reductions in the debt ratio begin in 2015, and the debt ratio is projected to drop below 100 percent of GDP in 2026. The downward revisions at the time of the first and second review—growth, speed of primary adjustment, and privatization—resulted in a higher debt path than envisioned at the time of the approval of the EFF arrangement, when 2020 debt was expected to reach 120 percent of GDP. However, once Greece reaches an annual primary surplus, the additional relief promised by the European member states to reduce debt substantially below 110 percent by 2022 will significantly improve debt dynamics.

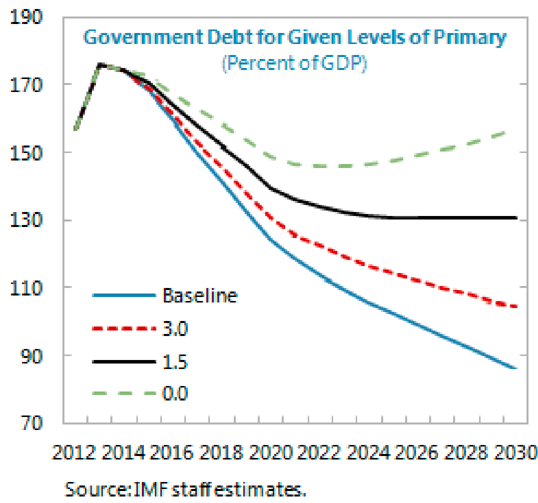
6. Despite the high level, the structure of Greece's debt mitigates risks: near term financing needs have been substantially reduced via interest deferral on loans from European member states; maturity extensions by the EFSF have considerably reduced the amount of debt that matures in the immediate period after 2020 (facilitating the return to market access); and almost 80 percent of all debt is now to the official sector, substantially reducing rollover risks.



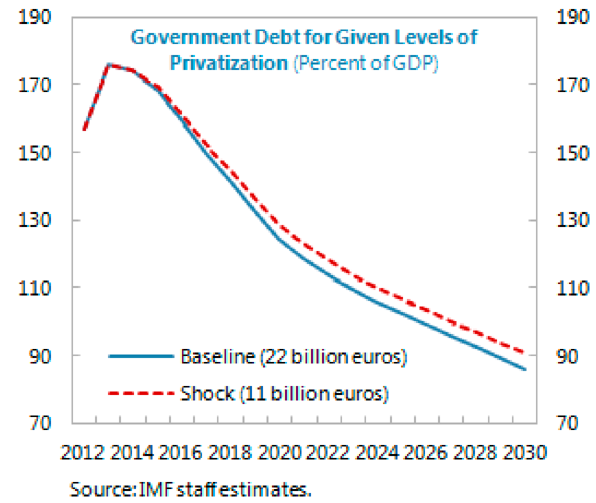
7. Nonetheless, stress tests suggest that risks to the debt path remain considerable, particularly from lower primary surpluses and weaker nominal growth (Table A2 and Figure A2).

- **Policies**. If fiscal adjustment ceased when the primary balance reaches the 1.5 percent of GDP surplus expected next year, debt to GDP would flatten out just below 130 percent of GDP. A lower primary balance would put debt on an ever increasing trajectory. The cost of a lower primary effort for the debt path is greater in the post 2020 period when Greece is expected to meet its financing needs in the market rather than at concessional official sector interest rates. Meanwhile, the debt path is less sensitive to lower privatization proceeds. Indeed, if total receipts are only half of projected levels at 11 billion, debt to GDP in 2020 and 2030 is only 4 percentage points higher in 2020 and it does not widen further over time. This

reflects the now relatively conservative assumptions that privatization will generate roughly 1 percent of GDP per year.

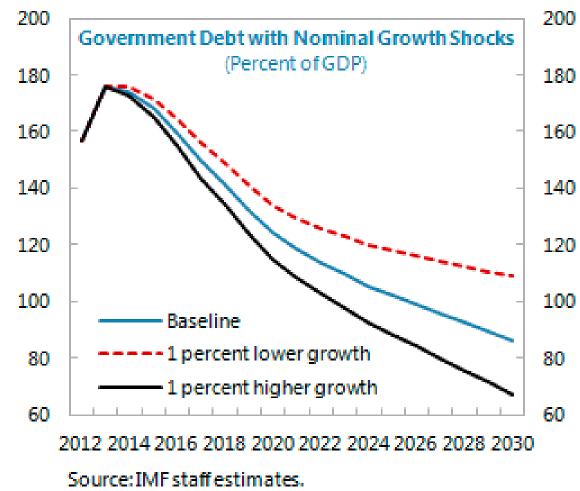


Source: IMF staff estimates.



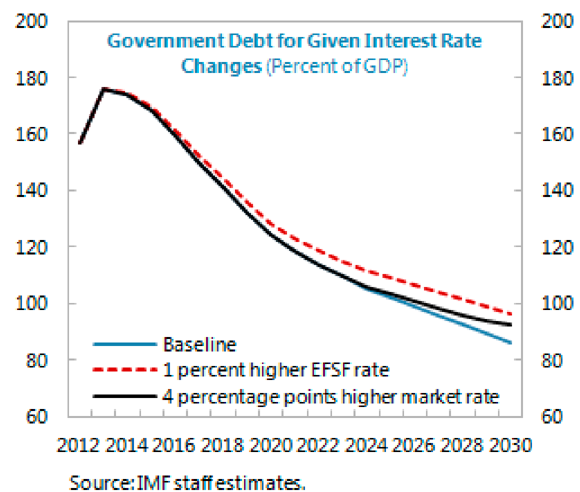
Source: IMF staff estimates.

- **Nominal Growth**. The debt ratio is also sensitive to lower growth in nominal output. Beyond the indirect challenge that weaker growth would have on the primary effort, a sustained lower rate of growth by 1 percentage point increases public debt in 2020 by 10 percentage points of GDP.



Source: IMF staff estimates.

- **Financing Assumptions.** The sensitivity of the debt path to changes in interest rates could arise either from a change in the rate charged by the EFSF or, after 2020, by the cost of new market borrowing. In practice, the risks from this channel over the next decade appear modest as no market access is assumed and the cost of borrowing from the EFSF/ESM is a function of the latter's own borrowing costs (which is the weighted cost of borrowing of the Euro area, largely anchored by low interest economies).

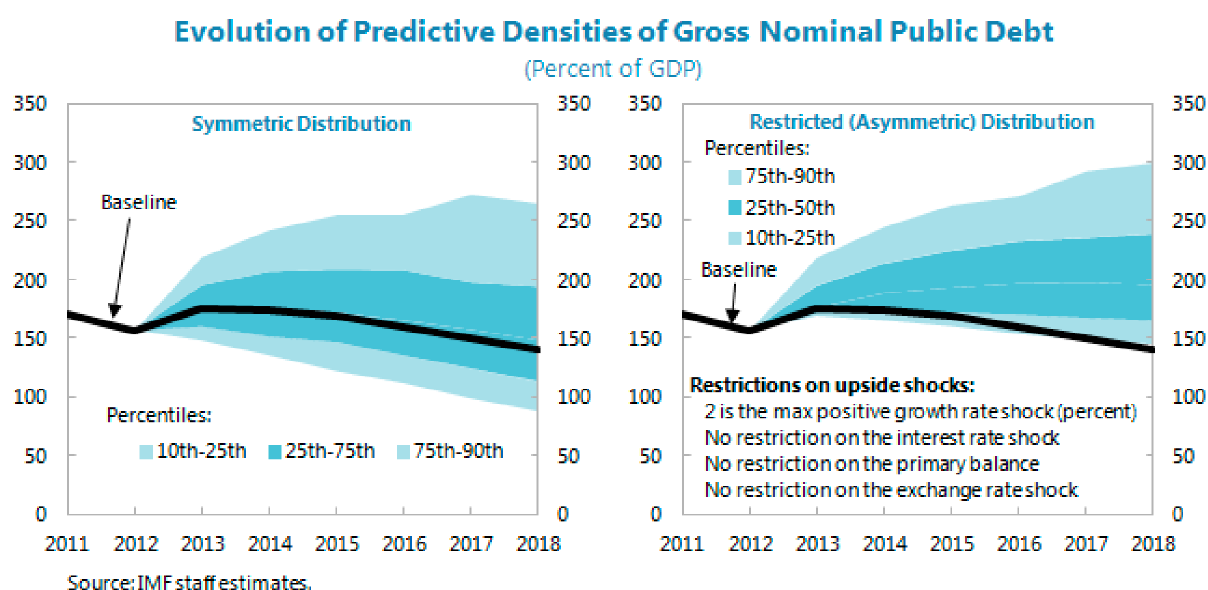


Source: IMF staff estimates.

- **Joint Shocks.** The debt trajectory remains extremely sensitive to program delays. This "tailored downside" scenario assumes that a recovery in confidence and investment is delayed, structural reforms take longer to implement, and the economy continues to adjust

through recessionary channels—resulting in a lower output path than in the baseline. On the policy side, primary adjustment is assumed to take two years longer to reach the end target, and privatization delivers €10 billion less than targeted. In this scenario, debt would peak near 180 percent of GDP but would remain higher for longer, falling to around 147 percent by 2020, roughly 23 percentage points above the baseline. The underlying point is that, with debt levels remaining so high in this scenario, even small further shocks could produce unsustainable dynamics (See Table A2).

- **Further sensitivity tests.** The fan charts below illustrate the impact on the debt-to-GDP ratio of a large number of shocks to key macroeconomic variables, including (i) real GDP growth; (ii) the effective real interest rate on government debt; (iii) the variation in the real exchange rate; and (iv) the primary balance in percent of GDP. Country-specific historical data are used to generate the sample means and the variance-covariance matrix that define the joint normal distribution for these variables. By construction, a joint normal distribution of shocks would generate a broadly symmetrical fan chart, with upside risks matching downside risks (left panel). To better reflect the likely asymmetry of risks to the Greek debt profile and to give an indication of sensitivity of the debt path to individual macroeconomic variables, an asymmetric fan chart is also presented in which positive growth is constrained to be no greater than 2 percent in any given year.



Source: IMF staff estimates.

C. External Sector DSA

8. External debt is expected to decline gradually (Table A3 and Figure A3). Gross debt, currently at 233 percent of GDP, would peak at around 245 percent of GDP in 2013 and then decline to about 155 percent in 2020. Net debt would fall from about 130 percent of GDP in 2012 to around 75 percent in 2020. Several factors lie behind the projected improvement in external debt. Most importantly, the current account is projected to improve quickly as competitiveness is restored and Greece continues to rely on official loans at relatively low interest

rates. The agreed reduction in the GLF interest rate and EFSF fees, and the return of SMP profits will also contribute to the sharp improvement in the current account. FDI inflows related to privatization also remain an important non-debt-creating source of financing.

9. **Macroeconomic shocks and policy slippages could result in adverse dynamics**.

- **Larger current account deficits.** Slow competitiveness improvements resulting from delayed structural reforms or a terms-of-trade shock could affect exports negatively and worsen the baseline current account projections by around 1.5 percent of GDP. The debt ratio would remain on a downward path, but would be 10 percentage points higher than in the baseline by 2020.

- **Interest rate shock.** The effects of higher Greek sovereign spreads would be dampened by the almost exclusive reliance of Greece on official financing. Changes in the risk free rate would nevertheless impact Greece through the cost of official financing. A 100 bps shock to Bund rates would worsen the income account and result in a 2020 debt ratio 8 percentage points above the baseline.

- **Slippages in privatization.** Privatization delays that result in only about half of the projected privatization proceeds over the projection period would affect external debt dynamics by reducing non-debt-creating flows. The impact on the debt path would be modest since baseline privatization related inflows are small relative to the overall financial account balance. The debt ratio in 2020 would be around 3 percentage points higher than in the baseline.

10. **Debt dynamics would be significantly worse under a combined shock involving lagged program implementation, weak competitiveness, and higher interest rates**. The shocks above would likely be individually manageable, but would have a more substantial impact in an adverse scenario where they occur simultaneously. The net debt ratio would reach about 100 percent of GDP in 2020, 23 percent of GDP higher than in the baseline.

Table A1. Greece: Public Debt Sustainability Framework: Baseline, 2007–30

(Percent of GDP, unless otherwise indicated)

	Actual					Projections							Debt-stabilizing primary balance 9/
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2020	2025	2030	
Baseline: public sector debt 1/	112.9	129.7	148.3	170.3	156.9	175.8	174.2	168.2	159.5	124.2	102.2	86.2	1.1
Of which: foreign-currency denominated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in public sector debt	5.7	16.8	18.6	22.0	-13.5	18.9	-1.6	-6.0	-8.7	-8.1	-3.4	-3.1	
Identified debt-creating flows (4+7+12)	5.5	16.5	16.6	20.1	65.3	17.7	0.2	-7.6	-8.0	-8.6	-3.6	-2.9	
Primary deficit	4.8	10.5	4.9	2.4	1.3	0.0	-1.5	-3.0	-4.5	-4.3	-4.0	-4.0	
Revenue and grants	40.7	38.3	40.6	42.4	44.1	44.3	43.7	42.7	42.0	42.0	42.0	42.0	
Primary (noninterest) expenditure	45.5	48.8	45.5	44.8	45.4	44.3	42.2	39.7	37.5	37.7	38.0	38.0	
Automatic debt dynamics 2/	0.5	6.2	11.2	16.9	18.0	12.9	4.4	-0.6	-2.6	-1.2	0.1	0.9	
Contribution from interest rate/growth differential 3/	0.5	6.2	11.2	16.9	18.0	12.9	4.4	-0.6	-2.6	-1.2	0.1	0.9	
Of which contribution from real interest rate	0.3	2.6	4.5	5.7	6.3	5.9	5.4	4.3	3.4	2.2	2.0	2.4	
Of which contribution from real GDP growth	0.2	3.6	6.7	11.2	11.7	7.0	-1.0	-5.0	-6.0	-3.3	-1.9	-1.6	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.2	-0.1	0.6	0.8	46.0	4.8	-2.6	-4.0	-0.9	-3.2	0.3	0.2	
Privatization receipts (negative)	0.0	0.0	0.0	-0.5	-0.1	-1.4	-1.0	-1.1	-1.1	-1.8	0.0	0.0	
Recognition of implicit or contingent liabilities	0.2	-0.1	0.6	1.3	7.1	2.3	-1.6	-3.0	0.2	-1.4	0.3	0.2	
Other (Includes bank recap, PSI sweetener)	0.0	0.0	0.0	0.0	39.0	3.9	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including debt relief (2-3) 5/	0.1	0.3	2.0	1.9	-78.7	1.2	-1.8	1.7	-0.7	0.5	0.3	-0.2	
Public sector debt-to-revenue ratio	277.6	338.2	365.2	401.9	355.6	397.0	399.0	393.8	379.9	295.7	243.5	205.3	
Gross financing need 6/	9.9	15.6	19.6	27.5	18.9	21.1	25.1	18.6	11.7	8.7	5.4	4.0	
Billions of U.S. dollars	34.1	50.2	57.9	79.7	47.1	51.4	60.8	46.3	30.2	26.8	20.0	18.2	
Key macroeconomic and fiscal assumptions underlying baseline													
Real GDP growth (percent)	-0.2	-3.1	-4.9	-7.1	-6.4	-4.2	0.6	2.9	3.7	2.6	1.9	1.8	
Average nominal interest rate on public debt (percent) 7/	5.0	4.5	4.4	4.6	2.7	2.5	2.7	3.0	3.2	3.5	4.1	4.9	
Average real interest rate (nominal rate minus change in GDP deflator, percent)	0.3	2.2	3.3	3.5	3.5	3.6	3.1	2.6	2.2	1.8	2.1	2.9	
Inflation rate (GDP deflator, percent)	4.7	2.3	1.1	1.0	-0.8	-1.1	-0.4	0.4	1.1	1.7	2.0	2.0	
Growth of real primary spending (deflated by GDP deflator, percent)	6.3	3.9	-11.3	-8.6	-5.1	-6.5	-4.2	-3.0	-2.1	2.6	1.9	1.8	

1/ General government gross debt. Only intra-government holdings are netted out.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

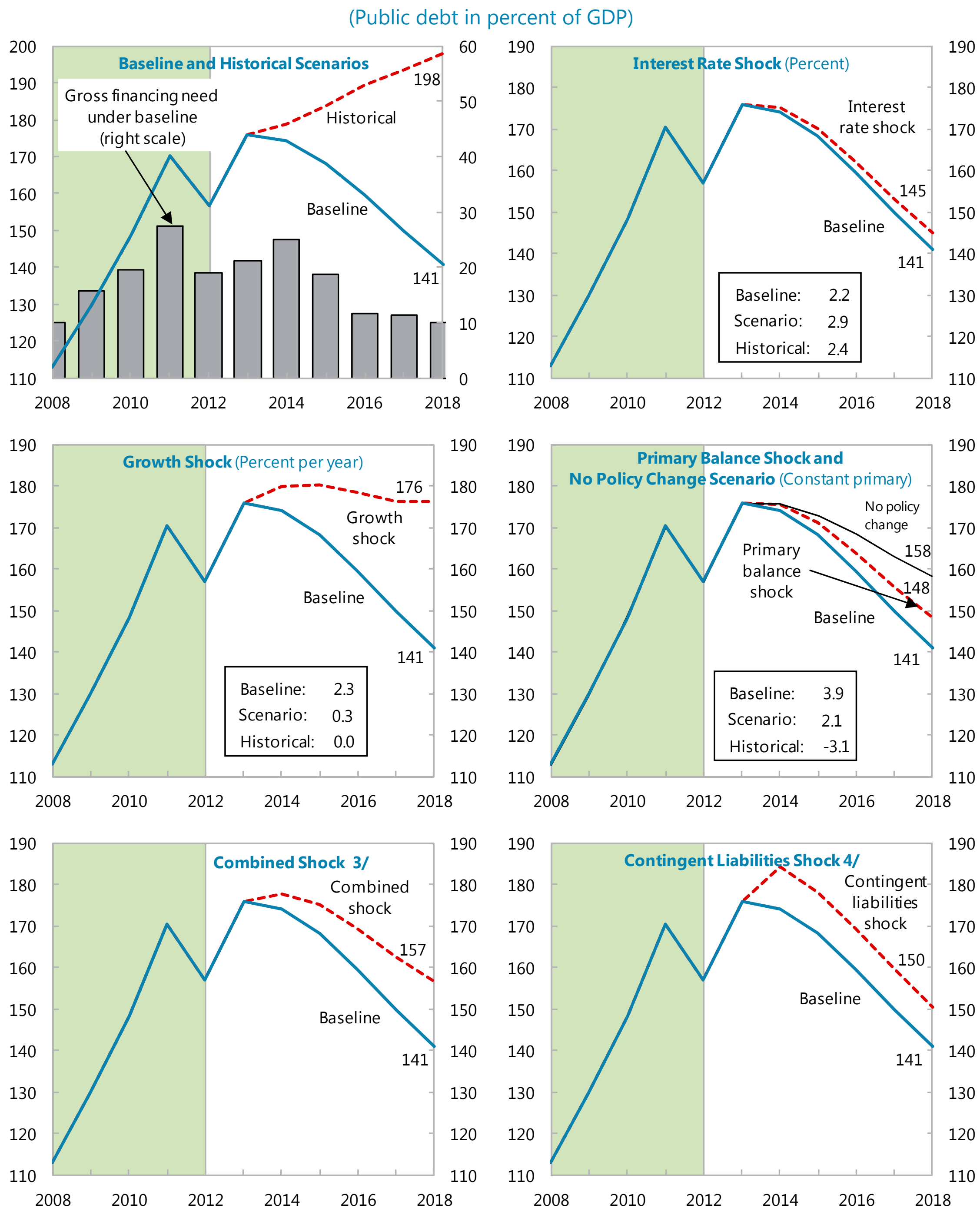
5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ Derived as nominal interest expenditure divided by previous period debt stock.

Figure A1. Greece: Public Debt Sustainability: Baseline Bound Tests, 2008–18 1/ 2/

(Public debt in percent of GDP)



Sources: IMF staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

4/ 10 percent of GDP shock to contingent liabilities occur in 2010.

Table A2. Greece: Public Sector Debt Sustainability Framework: Alternative Scenario, 2007–30

(Percent of GDP, unless otherwise indicated)

	Actual					Projections									Debt-stabilizing primary balance 9/
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2020	2025	2030	
Baseline: public sector debt 1/	112.9	129.7	148.3	170.3	156.9	180.5	182.1	181.7	176.4	169.7	161.6	147.2	126.0	111.3	1.4
Of which: foreign-currency denominated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in public sector debt	5.7	16.8	18.6	22.0	-13.5	23.7	1.6	-0.5	-5.3	-6.7	-8.1	-6.6	-3.2	-2.8	
Identified debt-creating flows (4+7+12)	5.5	16.5	16.6	20.1	65.3	22.1	1.7	-6.3	-7.0	-9.9	-9.8	-9.2	-3.6	-2.6	
Primary deficit	4.8	10.5	4.9	2.4	1.3	0.0	-1.6	-2.0	-3.0	-3.5	-4.5	-4.3	-4.0	-4.0	
Revenue and grants	40.7	38.3	40.6	42.4	44.1	45.5	45.7	45.5	45.3	45.8	45.9	46.0	45.9	45.9	
Primary (noninterest) expenditure	45.5	48.8	45.5	44.8	45.4	45.5	44.1	43.5	42.3	42.3	41.4	41.8	41.9	41.9	
Automatic debt dynamics 2/	0.5	6.2	11.2	16.9	18.0	17.1	6.0	0.0	-3.0	-2.4	-2.1	-1.5	0.1	1.1	
Contribution from interest rate/growth differential 3/	0.5	6.2	11.2	16.9	18.0	17.1	6.0	0.0	-3.0	-2.4	-2.1	-1.5	0.1	1.1	
Of which contribution from real interest rate	0.3	2.6	4.5	5.7	6.3	10.0	7.1	5.2	3.5	3.5	3.3	2.4	2.5	3.1	
Of which contribution from real GDP growth	0.2	3.6	6.7	11.2	11.7	7.2	-1.1	-5.2	-6.5	-5.9	-5.3	-3.9	-2.4	-2.0	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.2	-0.1	0.6	0.8	46.0	5.0	-2.8	-4.3	-1.0	-4.0	-3.3	-3.5	0.3	0.3	
Privatization receipts (negative)	0.0	0.0	0.0	-0.5	-0.1	-1.4	-1.1	-1.1	-1.2	-1.2	-1.6	-1.9	0.0	0.0	
Recognition of implicit or contingent liabilities	0.2	-0.1	0.6	1.3	7.1	2.3	-1.7	-3.2	0.2	-2.8	-1.6	-1.5	0.3	0.3	
Other (Includes bank recap, PSI sweetener)	0.0	0.0	0.0	0.0	39.0	4.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including debt relief (2-3) 5/	0.1	0.3	2.0	1.9	-78.7	2.7	-0.1	5.8	1.7	3.2	1.7	2.6	0.4	-0.2	
Public sector debt-to-revenue ratio	277.6	338.2	365.2	401.9	355.6	396.9	399.0	399.0	389.3	370.9	352.2	320.0	274.4	242.5	
Gross financing need 6/	9.9	15.6	19.6	27.5	18.9	21.7	26.2	19.8	12.6	12.4	10.9	9.6	5.9	4.4	
Billions of U.S. dollars	34.1	50.2	57.9	79.7	47.1	51.4	60.8	46.3	30.2	30.8	27.9	26.8	20.0	18.2	
Key macroeconomic and fiscal assumptions underlying baseline															
Real GDP growth (percent)	-0.2	-3.1	-4.9	-7.1	-6.4	-4.2	0.6	2.9	3.7	3.5	3.3	2.6	1.9	1.8	
Average nominal interest rate on public debt (percent) 7/	5.0	4.5	4.4	4.6	2.7	2.5	2.7	3.0	3.2	3.4	3.5	3.5	4.1	4.9	
Average real interest rate (nominal rate minus change in GDP deflator, percent)	0.3	2.2	3.3	3.5	3.5	6.0	3.9	2.9	2.1	2.1	2.1	1.7	2.0	2.9	
Inflation rate (GDP deflator, percent)	4.7	2.3	1.1	1.0	-0.8	-3.5	-1.2	0.1	1.2	1.2	1.5	1.8	2.1	2.1	
Growth of real primary spending (deflated by GDP deflator, percent)	6.3	3.9	-11.3	-8.6	-5.1	-4.2	-3.4	0.1	-0.5	2.5	0.9	2.6	1.8	1.7	

1/ General government gross debt. Only intra-government holdings are netted out.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

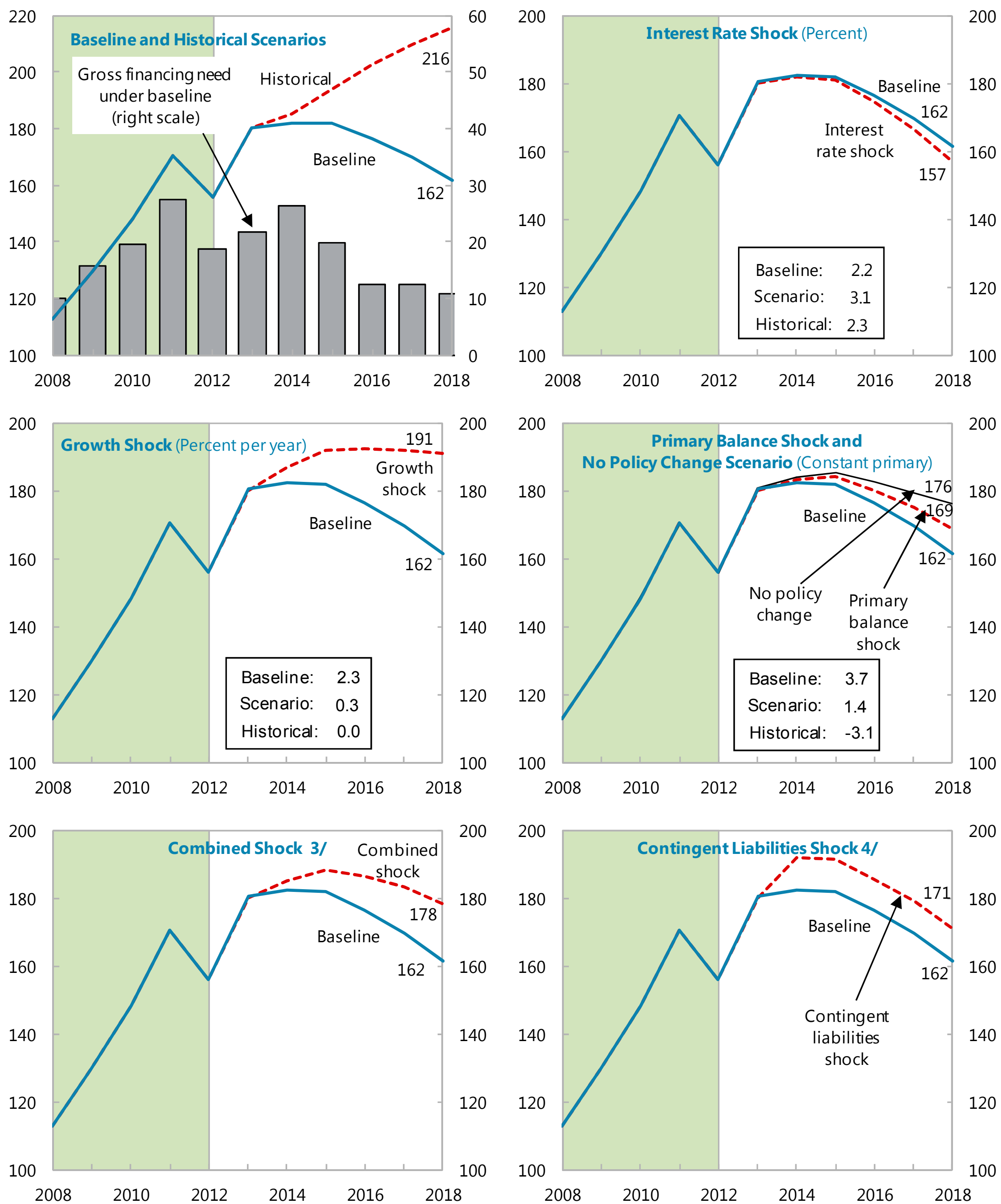
5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ Derived as nominal interest expenditure divided by previous period debt stock.

Figure A2. Greece: Public Debt Sustainability: Alternative Scenario, Bound Tests, 2008–18 1/ 2/

(Public debt in percent of GDP)



Sources: IMF staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

4/ 10 percent of GDP shock to contingent liabilities occur in 2010.

Table A3. Greece: External Debt Sustainability Framework, 2007–21

(Percent of GDP, unless otherwise indicated)

	Actual						Projections									Debt-stabilizing non-interest current account 7/
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	
Baseline: external debt	70.5	76.8	90.5	134.4	148.3	130.6	135.0	132.0	124.5	115.4	105.9	95.8	86.1	77.0	70.7	-5.1
Change in external debt	6.7	6.4	13.7	43.9	13.9	-17.7	4.4	-3.0	-7.4	-9.1	-9.5	-10.1	-9.6	-9.2	-6.3	
Identified external debt-creating flows (4+8+9)	6.1	-1.9	9.2	12.6	16.7	12.2	4.9	-3.4	-8.2	-10.0	-10.1	-8.7	-8.5	-8.3	-7.0	
Current account deficit, excluding interest payments	9.8	9.1	6.0	4.9	3.7	-0.6	-3.8	-4.9	-5.5	-5.9	-6.3	-6.5	-6.6	-6.4	-6.0	
Deficit in balance of goods and services	11.2	11.5	7.8	6.8	6.0	2.5	0.2	-1.4	-2.4	-3.0	-3.5	-3.9	-4.3	-4.6	-4.5	
Exports	21.9	23.1	18.3	20.5	23.4	25.4	27.4	28.3	28.6	28.7	28.9	29.1	29.4	29.6	29.6	
Imports	33.1	34.6	26.2	27.3	29.5	27.9	27.6	26.9	26.2	25.7	25.4	25.2	25.1	25.0	25.2	
Net non-debt creating capital inflows (negative)	-2.4	-0.3	0.0	1.4	0.3	-1.1	-1.2	-1.0	-1.3	-1.5	-1.6	-2.0	-2.1	-2.3	-2.0	
Automatic debt dynamics 1/	-1.3	-10.7	3.2	6.3	12.7	13.9	9.9	2.5	-1.3	-2.6	-2.2	-0.3	0.1	0.4	0.9	
Contribution from nominal interest rate	2.6	2.5	2.5	2.6	3.9	2.6	2.6	2.8	3.0	3.1	3.2	3.0	2.8	2.6	2.4	
Contribution from real GDP growth	-1.8	-10.0	2.4	4.7	10.2	10.2	5.8	-0.8	-3.8	-4.4	-3.9	-3.3	-2.8	-2.2	-1.5	
Contribution from price and exchange rate changes 2/	-2.0	-3.2	-1.7	-1.0	-1.4	1.1	1.5	0.5	-0.6	-1.3	-1.5	-1.5	-1.6	-1.5	-1.4	
Residual, incl. change in gross foreign assets (2-3) 3/	0.6	8.2	4.5	31.2	-2.8	-29.9	-0.5	0.4	0.7	0.9	0.6	-1.4	-1.1	-0.9	0.7	
External debt-to-exports ratio (in percent)	321.8	332.6	494.5	655.3	633.2	515.2	492.3	466.2	435.3	402.6	366.8	328.6	293.3	259.9	238.6	
Gross external financing need (billions of euros) 4/	93.3	122.9	194.4	216.2	239.0	205.6	178.8	158.5	139.2	119.5	105.7	95.6	88.1	78.4	72.1	
Percent of GDP	41.9	52.7	84.1	97.3	114.6	106.1	97.5	86.2	73.2	60.0	50.6	43.6	38.4	32.7	28.9	
Scenario with key variables at their historical averages 5/	...	...	...	...	...	...	131.1	131.1	131.3	131.6	131.6	131.3	131.3	131.3	132.3	-6.7
Key macroeconomic assumptions underlying baseline																
Real GDP growth (percent)	3.0	17.5	-3.1	-4.9	-7.1	-6.4	-4.2	0.6	2.9	3.7	3.5	3.3	3.0	2.6	2.0	
GDP deflator (change in percent)	3.3	4.7	2.3	1.1	1.0	-0.8	-1.1	-0.4	0.4	1.1	1.3	1.4	1.7	1.7	1.9	
Nominal external interest rate (percent) 6/	4.3	4.4	3.3	2.8	2.7	1.6	1.9	2.1	2.4	2.6	2.9	3.0	3.1	3.1	3.3	
Growth of exports (euro terms, percent)	9.6	10.4	-21.5	7.7	7.2	0.6	2.4	3.5	4.5	5.1	5.6	5.8	5.6	5.3	4.0	
Growth of imports (euro terms, percent)	14.3	9.6	-25.2	0.3	1.4	-12.1	-6.4	-2.3	0.7	2.9	3.7	3.9	4.2	4.1	4.6	
Current account balance	-14.6	-14.9	-11.2	-10.1	-9.9	-3.4	-0.8	-0.2	0.1	0.2	0.5	0.9	1.2	1.4	1.1	
Net non-debt creating capital inflows	2.4	0.3	0.0	-1.4	-0.3	1.1	1.2	1.0	1.3	1.5	1.6	2.0	2.1	2.3	2.0	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in euro terms, g=real GDP growth , e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

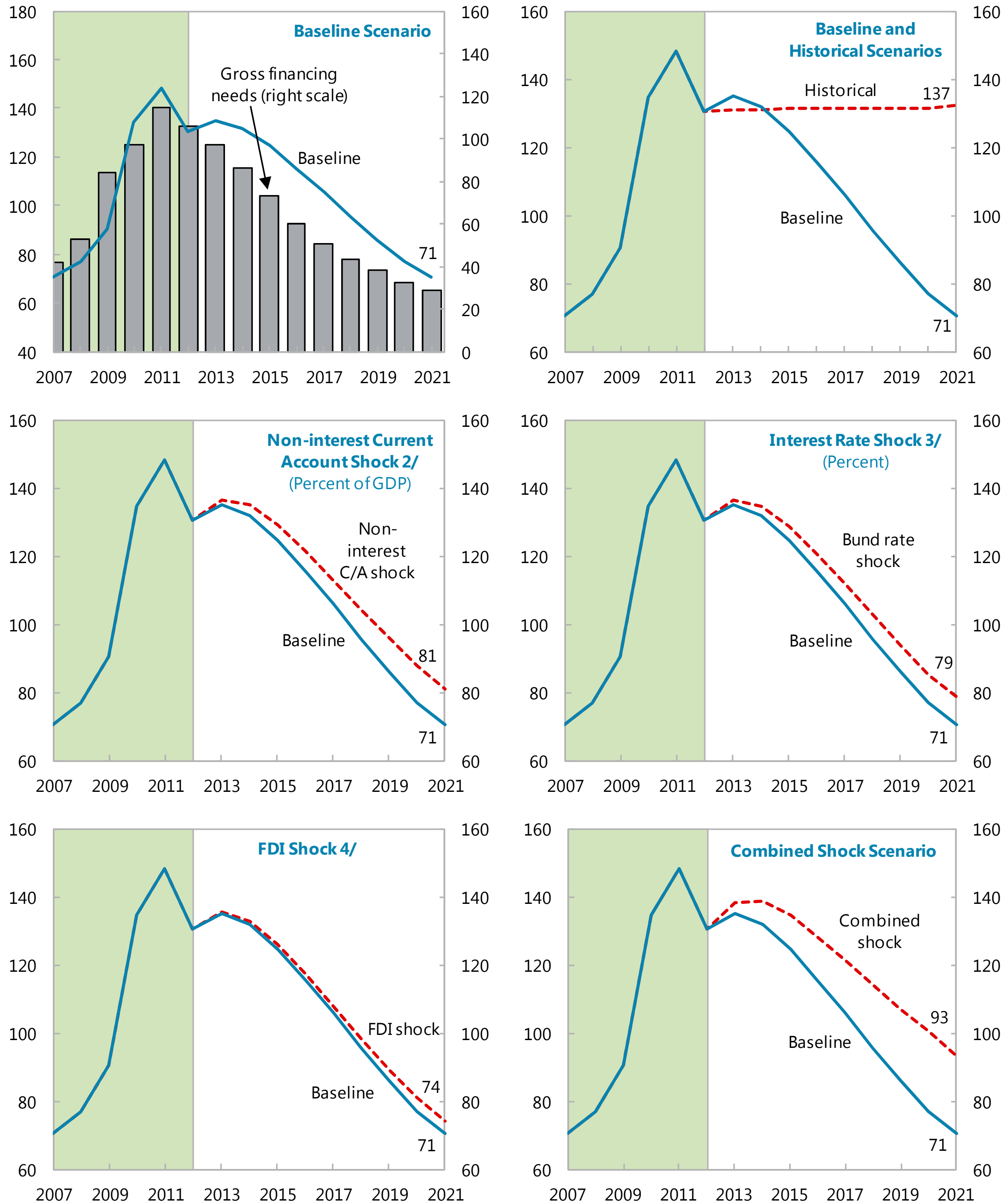
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ The external DSA is based on net external debt while the interest rates in the public sector DSA are based on gross debt. Nevertheless, average interest rates generally follow a rising trend, and are more closely correlated at the end of the projection period, as more new debt is contracted at higher interest rates.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table A3. Greece: External Debt Sustainability: Baseline Bound Tests, 2007–21

(Net external debt in percent of GDP)



Sources: Greek authorities; and IMF staff estimates.

1/ Shaded areas represent actual/preliminary data. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year (pre-crisis) historical average for the variable is also shown.

2/ Current account balance lower by 1.5 percent of GDP due to delayed program implementation and terms-of-trade shock.

3/ Impact of100bps shock to Bund rates on Greece's official interest rates and income balance.

4/ Decline in FDI due to reduced privatization receipts.

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FOR IMMEDIATE RELEASE
June 5, 2013

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation, Completes Third Review of the Extended Fund Facility (EFF), and Discusses Ex Post Evaluation of 2010 Stand-By Arrangement (SBA) with Greece

On May 31, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the 2013 Article IV Consultation with Greece[1] and completed the Third Review of the country's performance under an economic program supported by an Extended Fund Facility (EFF) arrangement (see Press Release No. 13/195). The Executive Board also discussed the Ex Post Evaluation of Exceptional Access Under the 2010 Stand-By Arrangement for Greece[2].

Background

Since the last Article IV consultation in mid-2009, Greece has been in a deep economic crisis. This crisis followed from the buildup by 2009 of extraordinary fiscal and external imbalances—the result of fiscal expansion after euro accession, financed by low-cost external borrowing. The

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

[2] The requirement for ex post evaluations (EPEs) was agreed by the IMF Executive Board in September 2002 for members using exceptional access in capital account crises, and extended to any use of exceptional access in February 2003. The aim of an EPE is to determine whether justifications presented at the outset of the individual program were consistent with IMF policies and to review performance under the program. To do this, EPEs seek to provide a critical and frank consideration of two key questions: (i) were the macroeconomic strategy, program design, and financing appropriate to address the challenges the member faced in line with IMF policy, including exceptional access policy?; and (ii) did outcomes under the program meet program objectives?

re-pricing of risk associated with the global financial crisis, large government deficit and debt data revisions, and the deterioration in the fiscal balance triggered the crisis in Greece. The government lost access to capital markets in 2010, and an ambitious multi-year adjustment program was put in place with the support of the European Commission, European Central Bank, and IMF. The program aimed to make the fiscal position sustainable through significant front-loaded consolidation, and to improve competitiveness through comprehensive structural reforms, while safeguarding the financial system. Unprecedented international support was provided—first through a 3-year, €110-billion financing package jointly with euro area members under a Stand-By Arrangement in May 2010, and then through a €173-billion package jointly with euro area members under the Extended Fund Facility in March 2012 (of which about €136 billion was financing over and above the undisbursed portion from the first package).

Important progress has been achieved in stabilizing the Greek economy. The cyclically-adjusted primary balance improved cumulatively by about 15 percent of GDP during 2010–12, and the headline primary deficit is expected to be eliminated in 2013. Far-reaching labor market reforms put in place in early 2012 have contributed to wage corrections and a significant reduction of the competitiveness gap. The external current account deficit improved from about 15 percent of GDP in 2008 to 3.4 percent in 2012. Financial stability has been preserved, including through a large recapitalization of the system. Greece remained in the euro area, its key objective, and associated spillovers that may have had a severe effect on a fragile global economy were relatively well-contained.

But Greece has adjusted mainly through recession, rather than through productivity-enhancing reforms. Several adverse and mutually reinforcing factors contributed to worsening investor sentiment, large deposit outflows, and underperformance of growth in 2011–12; bouts of political turmoil left doubts about domestic support for the program; structural reforms fell well short of expectations; and concerns about the external financing strategy, debt sustainability and Greece’s future in the euro area undermined confidence. These factors amplified the negative output effect of the front-loaded fiscal consolidation and deepened the recession. As a result, Greece experienced one of the deepest peacetime recessions to afflict an advanced economy. Output contracted by 22 percent during 2008–12, unemployment has increased to about 27 percent, and youth unemployment now exceeds 60 percent.

The underperformance of growth made restructuring of the high level of sovereign debt inevitable. By involving both private and official creditors in such a restructuring in 2012, the debt burden was reduced markedly. But public debt still stood at 157 percent of GDP at end-2012. Thus, the commitment by Greece’s European partners to provide further conditional relief, if needed, to bring the projected debt-to-GDP ratio to 124 percent by 2020 and to substantially below 110 percent of GDP by 2022, is critical for ensuring sustainability.

Greece’s recovery is expected to be gradual. Although fiscal adjustment will remain a drag on growth, the lion’s share of structural fiscal adjustment is now behind Greece, and steadfast program implementation can help to turn around expectations, improve liquidity conditions, and

lead to a recovery of investment and net exports. On that basis, growth is projected to contract by 4.2 percent in 2013, but to expand by 0.6 percent in 2014.

Executive Board Assessment

The Executive Directors commended the Greek authorities for the progress thus far in addressing deep-seated vulnerabilities amidst a sharp and socially painful recession. Fiscal adjustment has been exceptional by any international comparison, wage adjustment has facilitated a significant decline in the competitiveness gap, and financial sector stability has been safeguarded. Directors noted nevertheless that the recovery path remains very difficult, on the back of still high levels of unemployment, public debt, and non-performing loans. They urged the authorities to redouble their reform efforts to improve tax and public administration and enhance productivity, noting that these reforms would promote the efficient allocation of resources and boost output, facilitate remaining fiscal adjustment, and make the burden of adjustment more equitable.

Directors noted that Greece is well underway to complete its needed fiscal adjustment. They underscored that a priority now is to tackle tax evasion by reforming the revenue administration to improve collection efficiency and enhance its operational independence, and if necessary, consideration could be given to creating an independent tax agency. Directors encouraged the authorities to save any gains from better tax collection, continue to broaden the tax base, and press ahead with public administration reform, particularly the targeted reduction in staff and replacement of under-performing workers with better qualified staff.

Directors stressed that a critical mass of structural reforms is necessary to raise productivity, lower consumer prices, boost investment, and create much-needed employment opportunities. They observed that progress on labor market reforms has increased wage flexibility. Directors encouraged further steps to facilitate price adjustments commensurate with wage declines through the liberalization of regulated professions and other product and service markets, and to improve the business environment more broadly.

Directors welcomed a significant achievement in bank recapitalization and resolution. Noting that this process will leave the banking system largely under state ownership, they called on the authorities to reinforce the governance framework in the financial sector and, as soon as conditions permit, to re-privatize banks that are under state control. Further efforts are needed to repair balance sheets and restore credit growth, and in this regard, Directors looked forward to the completion of the reform of the insolvency and non-performing loan resolution frameworks.

Directors expressed concern that public debt is projected to remain high well into the next decade and concurred with the assessment that macroeconomic risks are on the downside. In this context, Directors welcomed the assurances from Greece’s European partners that they will consider further measures and assistance, if necessary, to reduce debt to substantially below 110 percent of GDP by 2022, conditional on Greece’s full implementation of all commitments

contained in the program. Directors also welcomed the continued commitment of Greece's European partners to provide adequate support to Greece during the life of the program and beyond until the country has regained market access, provided that Greece fully complies with the requirements and objectives of the adjustment program. Most Directors considered that, should debt sustainability concerns weigh on investor sentiment, even with the framework for debt relief now in place, and strong program implementation by the Greek authorities notwithstanding, consideration of a more front-loaded approach to debt relief would be needed. The macroeconomic and debt outlook must remain under close review.

Directors welcomed the candid assessment of the ex post evaluation of exceptional access under the 2010 Stand-By Arrangement (SBA), and agreed that it provides a good basis for all parties to draw valuable lessons. Directors emphasized in particular the importance of adequate financing, strong program ownership, and implementation capacity in the design of programs. They noted the finding that the SBA-supported program had made overly optimistic assumptions, including about growth, although some considered that to be the case only with the benefit of hindsight. Directors saw merit in better risk-sharing arrangements within the euro area, and noted the benefits of a timely restructuring of sovereign debt with the necessary safeguards to contain spillover risks and moral hazard. Mindful of the need to ensure equal treatment across the Fund's membership, Directors generally saw scope for tailoring the Fund's lending policies to the particular circumstances of monetary unions, including appropriate modalities for collaboration with the union-level institutions.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report(use the free Adobe Acrobat Reader to view this pdf file) for the 2013 Article IV Consultation with Greece is also available.

Greece: Selected Economic Indicators, 2009–13

	2009	2010	2011	2012		2013
				Prog.	Est.	Proj.
	(Percentage change, unless otherwise indicated)					
Domestic economy						
Real GDP	-3.1	-4.9	-7.1	-6.0	-6.4	-4.2
Output gap (percent of pot. output)	7.3	3.3	-2.6	-7.3	-7.7	-10.6
Total domestic demand	-5.5	-7.0	-8.7	-8.7	-10.4	-5.6
Private consumption	-1.6	-6.2	-7.7	-7.7	-9.1	-6.9
Public consumption	4.9	-8.7	-5.2	-6.2	-4.2	-4.0
Gross fixed capital formation	-13.7	-15.0	-19.6	-14.4	-19.2	-4.0
Change in stocks (contribution)	-1.2	0.7	-0.4	0.4	0.0	0.4
Foreign balance (contribution)	3.0	3.0	2.4	3.3	3.7	2.6
Exports of goods and services	-19.4	5.2	0.3	-1.2	-2.4	3.0
Imports of goods and services	-20.2	-6.2	-7.3	-11.5	-13.8	-6.4
Unemployment rate (percent) 1/	9.4	12.5	17.5	24.4	24.2	27.0
Employment 1/	-1.0	-2.7	-6.6	-9.2	-8.2	-3.7
Unit labor costs	4.2	-1.1	-3.9	-8.1	-6.1	-6.5
Consumer prices (national definition), period avg.	1.2	4.7	3.3	1.2	1.5	-0.8
Consumer prices (HICP), period average	1.3	4.7	3.1	...	1.0	...
Core prices, period average 2/	2.3	2.6	1.1	...	-0.3	...
GDP deflator	2.3	1.1	1.0	-0.5	-0.8	-1.1
	(Percent of GDP, unless otherwise indicated)					
Balance of payments						
Current account	-11.2	-10.1	-9.9	-4.2	-3.4	-0.8
Structural current account balance	-7.0	-8.3	-10.9	...	-5.4	-4.9
Trade balance	-7.8	-6.8	-6.0	-2.5	-2.5	-0.2
Export of goods and services	18.3	20.5	23.4	25.3	25.4	27.4
Imports of goods and services	-26.2	-27.3	-29.5	-27.8	-27.9	-27.6
Total transfers	0.6	0.1	0.3	0.3	0.7	1.8
Net income receipts	-3.9	-3.5	-4.1	-2.0	-1.6	-2.5
Net international investment position	-86.4	-98.4	-86.1	-94.2	-114.1	-118.9
Public finances (general government)						
Total revenues	38.3	40.6	42.4	43.6	44.1	44.3
Total expenditures	54.0	51.4	52.0	50.3	50.4	48.4
Primary expenditures	48.8	45.5	44.8	45.1	45.4	44.3
Overall balance	-15.6	-10.8	-9.6	-6.7	-6.3	-4.1
Primary balance	-10.5	-4.9	-2.4	-1.5	-1.3	0.0
Cyclically-adjusted primary balance	-13.0	-6.1	-1.3	...	2.2	5.0
Gross debt	130	148	170	158	157	176
Interest rates and credit						
Lending interest rate (percent)3/	5.1	6.1	6.8	...	5.8	6.4
Private credit growth (percent change) 4/	4.2	0.0	-3.1	-7.2	-4.0	-6.5
Exchange rates, end-period (percent change) 3/						
Nominal effective exchange rate	0.4	-3.7	0.0	...	-0.5	0.1
Real effective exchange rate (CPI-based)	1.7	-1.2	-0.7	...	-1.9	-2.1
Real effective exchange rate (man. ULC-based)	1.1	0.8	-6.1	...	-8.4	-8.4
Memorandum items:						
Nominal GDP (billions of euros)	231	222	209	195	194	183
Nominal GDP (percent change)	-0.9	-3.9	-6.1	-6.5	-7.1	-5.3

1/ Based on Labor Force Survey.
2/ Core prices exclude energy, food, alcohol, and tobacco.
3/ Data for 2013 as of March.
4/ Includes securitized or otherwise transferred loans from 2010 onward.

Statement by Thanos Catsambas, Alternate Executive Director for Greece
May 28, 2013

THE THIRD REVIEW OF THE EFF-SUPPORTED PROGRAM

Economic Developments and Prospects. Greece is currently in its sixth year of recession: GDP declined by 6.4 percent in 2012 for a cumulative contraction of 22 percent between 2008 and 2012; it is forecast to decline further by 4.2 percent in 2013. The unemployment rate is close to 27 percent and youth unemployment now exceeds 60 percent. Inflation is anticipated to be steadily lower than the euro area average for both 2013 and 2014. The current-account deficit has declined from 11.2 percent of GDP in 2009 to 3.4 percent in 2012, and is expected to decline further to 0.8 percent in 2013.

These outcomes are the result of an unprecedented adjustment effort, which began strongly in 2010, continued at a slower pace in 2011, was bolstered with the PSI in early 2012, and was reinvigorated under the government of Prime Minister Samaras that has been in power since last June. Thanks to the determined efforts by the authorities, the economic outlook during the last review remained largely unchanged from the previous review, with continued prospects for a gradual return to growth in 2014, supported by inflation well below the euro area average and improved wage flexibility, both of which are helping to restore the competitiveness of the Greek economy.

Fiscal Policy and Management. Fiscal performance is on track to meet the program targets, and the government is committed to fully implement all agreed fiscal measures for 2013-14 that are not yet in place; recent legislation extended the collection of the real estate tax through 2013 via the Public Power Company to ensure an uninterrupted stream of good revenue performance. A very important step towards enhancing the revenue collection mechanism, which the authorities recognized as a weak link in the adjustment effort, was a major reform of the revenue administration to provide it with significantly more autonomy, powers and resources, and the adoption of more effective and enforceable installment schemes. The authorities share the staff views that improved tax collections and minimization of tax evasion and corruption are essential ingredients for a more balanced and fair distribution of adjustment, which would generally enhance the ownership of the adjustment program.

The Banking Sector. Most systemic banks completed the basic steps of the recapitalization process at the end of April; the subscription process is expected to be finalized in the coming weeks. The recapitalization included the purchase of branches of three Cypriot banks that had come under distress in recent months by one Greek bank. The funds provided by the Hellenic Financial Stability Fund should provide adequate capital, even under a significantly adverse scenario, and will thus ensure the safety and soundness of the banking system and its deposits. More generally, the authorities have undertaken to develop a comprehensive strategy for the banking sector following recapitalization by July 15, 2013; the strategy will address, *inter alia*, the issue of possible further mergers among the four systemic banks and

the timetable for disposing the shares held by the Hellenic Financial Stability Fund to the private sector.

Structural Reforms. With the macroeconomic adjustment under control, the authorities are turning their attention to deeper structural reforms, which have been under consideration since the beginning of the program, and which required rigorous analysis and extensive consultations with social partners. One important commitment that had lagged behind is well under way: the administrative reform to improve the quality of the public service and to strengthen accountability by streamlining its structures, removing positions, and reallocating staff. This major reform includes dismissals that are targeted at disciplinary cases and cases of demonstrated incapacity, absenteeism, and poor performance, or that result from closure or mergers of government entities. Other areas of continued structural reforms are (a) continued liberalization of product and service markets, including transport and retail trade, private education, fuel distribution; and (b) electricity sector reforms to ensure financial sustainability and promote competition and efficiency.

Safety Net. The government is committed to protect the most vulnerable segments of the population during these turbulent times. The government is making progress in strengthening the social safety net, including through targeted employment and training programs supported by the EU, pilot programs to extend unemployment benefits and provide minimum income support, a program to provide access to primary health care for the uninsured, and a scheme to reduce the financial burden on indebted low-income households which have been severely affected by the crisis.

In sum, this review succeeded in shifting the focus from further macroeconomic adjustment through recessionary channels to the prospect of viable growth through extensive structural reforms, which will help achieve an annual primary surplus at an early time. When this is realized, the authorities look forward to earlier commitments by Euro Area Member States to consider further initiatives and assistance, if necessary, for achieving an additional and credible reduction of the Greek debt-to-GDP ratio, which should help ensure the long-term sustainability of Greece's public debt.

THE 2013 ARTICLE IV CONSULTATION

Areas of Agreement. My authorities are grateful to the staff for the comprehensive and rigorous Article IV consultation report. They consider it a useful and important supplement to the program discussions. They also appreciate the analytical chapters in the Selected Issues paper, which they consider important contributions to the debate about the development model of Greece "the day after".

My authorities agree with most conclusions in the staff appraisal, and appreciate the emphasis on three major achievements accomplished by Greece: exceptional fiscal adjustment in a short period of time, fundamental changes in the labor market, and preservation of banking sector stability. Combined, progress in these areas has improved Greece's competitiveness and has contained the runaway increase in public debt. With the help of the Fund and its European partners, Greece has begun the process of (re)gaining

sustainability within the Euro zone and is now looking forward to reaching a sustainable growth path based on an economically viable model.

Some Amplification to Staff Conclusions. While the authorities agree with the thrust of the staff remarks and recognize that major challenges remain ahead, they wish to qualify some of the conclusions that are presented in the staff analysis regarding structural reforms.

First, as a matter of general principle, structural reforms are more difficult to implement than macroeconomic adjustment measures, not only because of political considerations but also due to severe capacity constraints. The latter, which should not be underestimated during the early phases of the program, are gradually being overcome thanks to massive technical assistance from Fund staff, the European Task Force, and several bilateral donors. As a result, progress under the coalition government that came to power one year ago has been steadfast: the Spring 2013 Update of the Euro Plus Monitor, produced by Berenberg Bank and the Lisbon Council, *placed Greece on the top spot of its Adjustment Progress Indicator*. In addition, Greece has been ranked as the country with *the highest responsiveness to OECD recommendations between 2010-12.*

Second, the authorities would qualify the characterization that "limited progress has been made in tackling Greece's notorious tax evasion" as follows: while tax compliance and collections remain a formidable challenge, in the past six months there are weekly reports about individuals who have been arrested for major tax evasion offenses. More generally, tax compliance is expected to be strengthened considerably with the January appointment of an independent General Secretary of public revenues, who, as noted earlier, was vested with more autonomy, power and resources to carry out effectively the tax collection process. However, resolution of tax offenses lies with the tax courts, which are beyond the reach of the executive branch, and the government has identified this as an area for further improvement. As staff acknowledges in the Article IV report (para. 33), the authorities, while mindful of the huge task of reforming tax administration within a short time horizon, have "emphasized their political commitment to see the process through".

Third, the authorities recognize the considerable delays in the implementation of employment reforms in the public sector. However, with the April 29 passage of the Omnibus Law, which included quarterly plans for 4,000 mandatory exits in 2013 and 15,000 cumulative through end-2014, the taboo against dismissals in the public sector has in principle been lifted, and the door has been opened for mandatory redundancies. The government sees this new avenue as a long-overdue opportunity to revamp the quality of public services through the replacing of laid-off public servants with qualified staff in key areas such as bank supervision and tax administration.

Doing Business, Privatizations, and the Banking Sector. Beyond tax administration and public sector reforms, the government intends to focus on invigorating Greece's export and import competing industries. The government is committed to reduce barriers to entry into various markets, including opaque and lengthy licensing procedures, and, more generally, to improve the business environment. *The World Bank Group Doing Business Report has raised the rank of Greece to 78 in 2013 from 89 in 2012*.

The privatization process has picked up. The Hellenic Republic Asset Development Fund recently approved the sale of a 33 percent stake in the Football Betting Organization to a private concern for over €700 million. Other privatizations recently completed are State Lotteries (€190 million), Mobile Telephony Licenses (€381 million) and the International Broadcasting center (€81 million). There are also 14 privatizations in the final stages of completion, including the National Gas Utility Corporation, for which established foreign companies have tendered bids. In sum, since the beginning of the program the authorities expect cumulatively €4.2 billion privatization receipts by end-2013, €6.5 billion by end-2014, €7.7 billion by end-2015 and €11.1 billion by end-2016.

The authorities recognize the importance of effective financial intermediation in achieving a strong recovery and a viable growth path**.** The large injection of public capital to the systemic banks is understood as a temporary measure and the government intends to implement re-privatization at the earliest possible stage. More generally, the authorities are working on a reinforced governance framework, supporting strong oversight and supervision, which would also eliminate undue Government interference and attendant problems of directed credit. Moreover, a key priority for the banking system will be to contain and reverse the mounting tide of non-performing loans. The authorities are committed to put in place a framework for dealing with distressed household borrowers. In addition, deposits are replenished through cash that had been removed from the banking system: Greek private-sector bank deposits are 9 percent up from last June's lows and stabilized in May after some outflows in April on Cyprus fears.

Green shoots. While in several areas the picture is mixed, the government believes that 2013 will be the last year of retrenchment and the recession will bottom out in the next few months. Several recent developments point to hopeful signs for economic recovery. First, the real economy is set to acquire much needed liquidity: the government has paid off €2.2 billion of an outstanding €9 billion in arrears to suppliers and the stock of T-bills held by the banking sector declined, thus releasing resources for the financing of private sector activities. Second, work on some major infrastructure projects is restarting, potentially creating thousands of jobs. Third, tourist spending during the upcoming summer season may rise, as the Association of Greek Tourism Enterprises are anticipating 17 million tourist arrivals in 2013, one million more than in 2012. Fourth, two weeks ago the rating company FITCH upgraded both the sovereign rating and the rating of Greece’s four systemic banks by one notch (with a stable outlook), stating that “ clear progress has been made towards eliminating the twin fiscal and current account deficits and that ‘internal devaluation’ has at last begun to take hold”.

Growth and the Role of Confidence. The authorities fully share the staff’s view that restoring growth remains the overarching precondition for the success of the three-year old adjustment effort**.** In turn, growth cannot be achieved without improvement in sentiment. The authorities’ top priority is to continue to enhance confidence in the government’s resolve to forge ahead with the required reforms, so as to secure broad political stability and thus elicit domestic and foreign investments. The April 29 Omnibus Law mentioned earlier is a testimonial to the support that the government now enjoys among large strata of the

population. The passage of the bill in parliament, despite its far reaching implications for civil servants, has been received only with muted protests, and certainly without vocal street confrontations.

Confidence is rising. The latest euro-zone Economic Sentiment Indicator for Greece rose to 89.2, above the euro-zone average, and the Purchase Managers' Index showed considerable improvement in April (45, up from 42.1 in March), which was the highest level since July 2011. Such improvement in sentiment, coupled with the European partners' commitment to deal effectively with Greece's debt overhang, is the best assurance to dispel Euro exit fears and set the stage for a new page in the country's growth path.

THE EX-POST EVALUATION (EPE) OF THE 2010 STAND-BY ARRANGEMENT

The authorities have found the analysis in the paper insightful and balanced; essentially, following initial resistance by European partners, who had considered the Greece problem an "internal affair" of the Euro zone, the SBA was put together in a very short period of time, without adequate political dialogue and, more importantly, with insufficient contributions by the authorities to tailor conditionality to the peculiarities of the economy and the Greek public administration. Moreover, an ex-ante (or, at least, early) debt restructuring that would have helped mitigate the depth of adjustment and the severity of the recession, was ruled out by Greece in agreement with Euro zone partners. In a nutshell, as the EPE report aptly remarks, the SBA-supported program turned out to be a holding operation until the PSI became inevitable and an EFF-supported program replaced the original arrangement.

The authorities' official and detailed comments appear in Appendix I. They found the concluding section "Possible Lessons" reasonable and constructive, and would like to emphasize the following two areas for future consideration by staff and management:

- Although fiscal adjustment was necessary and structural reforms were essential, especially in the absence of monetary and exchange rate policies, the detailed conditionality in many program areas was at times overwhelming. Going forward, it would be helpful always to ensure that prior actions, not only in fiscal policy and management but in all areas with structural conditionality, are macro-critical for the achievement of the program objectives. At the same time, the authorities acknowledge that the TA provided by Fund staff, especially in fiscal management, has been tailored to the needs of a system that required hands-on assistance and has been important to help them improve much needed capacity for implementation; they hope to continue the strong TA engagement with the Fund.

- Relations with Troika members have generally been smooth, and the authorities acknowledge both the synergies in areas of shared expertise and the respective comparative advantage in structural issues. Based on these considerations, the authorities fully endorse the recommendation for streamlining procedures and documents among the Fund staff and EC and ECB officials.