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Greece Economy briefing:

Greece's economic program on track and debt issue settled

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When SYRIZA won the national election of September 2015 and re-formed a coalition government with Independent Greeks, the successful completion of the Greek bailout could not be taken for granted. However, on the grounds of a relatively smooth cooperation between the Greek government and its creditors, all four reviews were successfully conducted. Following the last and final one, the Eurozone decided on 21 June to take medium-term measures to reduce the Greek debt (and possibly long-term ones in the future). Greece will be under 'enhanced surveillance' for the years to come and notwithstanding the impressive progress, austerity measures and reforms will remain an obligation for the country.

The Greek government successfully managed to conclude the fourth and final review of the third Greek bailout. Despite usual delays after the third review, this conclusion was confirmed in the Eurogroup of 21 June 2018. As a result Finance Ministers of the Eurozone were entitled to discuss medium and long-term measures to reduce the Greek debt in line with the relevant decision of 25 May 2016. Following difficult negotiations, the Eurogroup of 21 June issued a statement outlining forthcoming steps. In particular, it welcomed the commitment of Greece to maintain a primary surplus of 3.5 percent of GDP until 2022, which – in the view of the European Commission – would imply a surplus of 2.2 percent of GDP on average in the period from 2023 to 2060. It thus expects that gross financial needs for Greece would remain below 15 percent of GDP in the medium term and below 20 percent of GDP thereafter. This analysis has constituted the basis for the agreed medium and long-term measures.

For the medium term, the measures will be: a) The abolition of the step-up interest rate margin related to the debt buy-back tranche of the second Greek program as of 2018. B) The use of 2014 Securities Markets Program (SMP) profits from the European Stability Mechanism (ESM) segregated account and the restoration of the transfer of Agreement on Net Financial Assets (ANFA) and SMP income equivalent amounts to Greece as of budget year 2017. The available income equivalent amounts will be transferred to Greece in equal amounts on a semi-annual basis in December and June, starting in 2018 until June 2022, via the ESM segregated account and will be used to reduce gross financing needs or to finance other agreed investments. And: c) A further deferral of European Financial Stability Facility (EFSF) interest and amortization by 10 years and an extension of the maximum weighted average maturity by 10 years.

The Eurogroup will review at the end of the EFSF grace period in 2032 whether additional debt measures are needed to ensure the meeting of the presented gross financial needs targets. Within this context and as far as long-term measures are concerned, Eurozone member-states are able to make use of the May 2016 agreement on the debt contingency mechanism. This mechanism will be activated in the case of an unexpectedly more adverse scenario entailing a further re-profiling, capping and deferral of interest payments of the EFSF to the extent needed to meet targets.

Post-bailout surveillance and measures

With reference to the post-bailout period to start in August 2018, the continuing implementation of reforms and austerity measures remains an obligation for Greece. The main objective is to ensure market credibility in order for the country to gradually return to the financial markets. Therefore, commitments related to the program will be linked to the abolition of the step-up interest rate margin up to 2022 as well as to the return of SMP-ANFA income equivalent amounts. Overall, Greece will be leaving the program with a sizeable cash buffer of €24.1 billion covering the sovereign financial needs for around 22 months after August. This represents a significant backstop against any risks.

The new type of supervision for Greece will be called ‘enhanced surveillance’. Quarterly reports under this procedure will facilitate closer monitoring of the economic, fiscal and financial situation of the country. The International Monetary Fund (IMF) will be finally involved as in the previous years.

To maintain an annual primary surplus of 3.5 percent of GDP, the Greek government commits to complete the full offsetting and collection of the clawback by June every year for the previous calendar year, to undertake by mid-2019 and mid-2020 nationwide valuation exercises of property tax value based on market values and to update property tax values for ENFIA and other taxes fully in line with market values by mid-2020. The Greek government will also have to act in the field of tax administration and reach the agreed permanent staffing positions at the Independent Authority of Public Revenue of 12.000 by end-2018, 12.500 by end 2019 and 13.322 by mid-2021, by when the end to-end IT collection systems will be fully operational.

Other measures to be applied or reforms to be carried out by the Greek government in the coming years are the avoidance of the accumulation of new arrears, the modernization of the social welfare system, the health care sector and the public administration, the restoring of the health of the banking system and the introduction of an e-justice system. Regarding the labor market, Greece will safeguard competitiveness through an annual update of the minimum wage and will implement an action plan on undeclared work by end-2019. Last but not least the country will continue the policy privatizations. Some regional ports (Alexandroupolis and Kavala) and energy companies (DEPA and DESFA) are expected to attract investors.

A warning signal

The Eurogroup of 21 June sparked enthusiasm among members of the Greek government. Speaking the day after at Zappeion Hall in Athens to SYRIZA and Independent Greeks lawmakers of the ruling coalition, Prime Minister Alexis Tsipras wore – for the first time a tie – to celebrate the debt settlement. He had promised to do so only if Greece was granted debt relief, and he wanted to honor promises. But the main opposition New Democracy party criticized Tsipras for his ‘hypocritical’ stance. As it explained, the Greek government did not get a reduction of the debt from the Eurogroup. By contrast, New Democracy said, the country is accepting an increased surveillance status while the markets have no confidence in the national economy.

Amid political disagreements in Greece, the European Commission adapted on 11 July a decision to activate the enhanced surveillance framework for the country. However, the outcome of the Eurogroup that took place the day after (12 July) was not positive for Greece. Although Eurozone countries were set to disburse a final €15 billion bailout loan to Greece, this will not happen before August. It was Germany which blocked the immediate release of the payment. The main political reason is that the Greek government decided to extend the value-added tax discount on five Greek islands (Lesvos, Chios, Samos, Leros and Kos) without securing the approval of its creditors first. In the view of the Greek Finance Minister Euclid Tsakalotos, the loss of circa €28 million euros will be covered by other sources. The postponement of the payment is generally seen as a warning signal of Berlin to Athens to stick on targets set. Beyond these negative news, Greece is not expected to enter the Quantitative Easing program. ECB Governing Council member Benoit Coeure publicly refuted this scenario on 12 July.

What now?

The Greek government is currently downplaying the Eurozone decision of 12 July considering the issue of postponement of minor significance as it concerns a small-scale fiscal adjustment. Alternatively, it emphasizes the debt settlement of 21 June and is attempting to persuade the public opinion that the country will exit the bailout in August with the magnitude of the fiscal commitments of the previous years.. The economic theme that is critical for the future is also related to reduction of pensions to take place in 2019. The Greek government has already voted for these cuts but will negotiate with its creditors for some flexibility. European Economic and Monetary Affairs Commissioner Pierre Moscovici visited Athens at the beginning of July and left a small window open.

The contentious issue of pension cuts in 2019 led the leader of New Democracy Kyriakos Mitsotakis to announce the submission of an amendment by his party calling for a freeze of the already voted measures. His announcement followed that of Democratic Alliance leader Fofi Gennimata, who submitted a proposal for legislation that would revoke the cuts. As opposed to Moscovici's stance, Eurogroup chief Mario Centeno and European Stability Mechanism Managing Director Klaus Regling stress there should be no change to what has already been agreed. It is therefore not clear whether the Greek government will succeed in its goal. The whole discussion goes beyond the sphere of economics into that of politics. It is widely accepted that Tsipras will be politically damaged by accepting to hold the national election on the same year pension cuts will be applied. The fabrication of the hope that the cuts might be averted along with the success of the exit from the bailout and the debt settlement could be a good justification for a new snap election.