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Greece Economy briefing:

Are Greek banks in danger?

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Are Greek banks in danger?

The economic crisis has seriously affected Greece. One of the sectors that has undergone and is currently undergoing changes is the banking one. As long as Greek banks do not provide loans to healthy enterprises, sustainable growth cannot be achieved. For this to happen the banks have, inter alia, to reduce the rate of non-performing exposures. The mission has already started during the bailout years and more needs to be done in the future. But the ability and determination of the banks to fulfil this obligation is being currently questioned by the markets. As a result the banking index is tumbling. The government attempts to respond by proposing an asset protection scheme. Similar plans helped the banking sector in other eurozone countries indeed. The reaction of the EU for the Greek case has not been particularly warm though.

The month of October 2018 is disastrous for Greek bank shares in the stock market. The crumbling of the banking index is raising serious questions about the reasons for this fall as well as about the sustainability of the Greek banking sector. On the whole, the number of domestic credit institutions was drastically reduced since 2009 from 35 to 17, of which eight are commercial and nine cooperative. Of the eight commercial banks only four are deemed 'systemically significant' and these control approximately 96% of the banking assets. Over the last years and following three phases of recapitalization in 2012, 2013 and 2015, Greek banks have been under regulatory pressure to tackle the bad debt problem. This has been a significant bailout obligation that has been only partly fulfilled. Concerns about the conclusion of the mission are fueling an atmosphere of uncertainty.

The compliance report of the European Stability Mechanism (ESM) Stability Program for Greece (July 2018) places attention to non-performing exposures (NPEs) on banks' balance sheets. Under the fourth review of the bailout, the authorities have made selective amendments to several legislations that are of significance for the reduction of non-performing loans (NPLs). But as the supplemental memorandum of understanding suggests, further efforts are needed to tackle the large stock of NPLs. This requires, inter alia, the effective implementation of the strengthened framework to support NPLs resolution such as the out-of-court workout and e-auctions. Banks and the public sector have to speed up the restructuring of debts and the liquidation of nonviable businesses to support the recovery of the economy. To this end, the Bank of Greece, in cooperation with the European Central Bank and the Single Supervisory Mechanism should ensure NPEs targets remain both realistic and ambitious and that banks' NPEs strategies are adequately designed and executed to reach the targets.

Key future operational targets and metrics for the total portfolio of banks are 43.1 percent (€81.5 billion) for NPEs ratio and 21.1 percent (€52 billion) for NPLs ratio for December 2018 and 35.2 percent (€64.6 billion) and 21.1 percent (€38.6 billion) for 2019 respectively. According to the analysis of the Bank of Greece banks outperformed their 2017 NPEs target that was set in last year's submission by €1.6 billion. Consequently, the opening balance for NPEs of Greek banks for the new targets setting period (June 2017-2019) was €101.8 billion. Banks are now targeting for a 37 percent reduction of their NPEs within this period reaching €64.6 billion in 2019. This is a more ambitious target compared to the previous submission by €2.2 billion. The timing of the NPEs reduction has not changed and the largest part will be back loaded and will take effect in 2018 and 2019.

In the second quarter of 2018, as data from the Bank of Greece exhibit, Greek banks managed to meet the targets for the reduction in the stock of NPEs. More specifically, the stock of NPEs stood at €88.65 billion or €1.6 billion lower than the targeted amount. Nonetheless, banks did not meet the target for the stock of NPLs, which amounted to €61.0 billion or €0.3 billion higher than the targeted amount. The actual NPEs ratio stood at 47.6 percent, higher than the foreseen level of 46.9 percent and the NPLs ratio at 32.8 percent, also higher than the foreseen level of 31.5 percent. According to the Bank of Greece, the NPEs ratio still remains high across most asset classes. For end-June 2018, the NPEs ratio is 44.3 percent for residential, 56.9 percent for consumer and 48 percent for the business portfolio. For the business portfolio, specifically, the highest NPEs ratio is noted in the small business and professionals segment (NPEs ratio at 68.8 percent) and the small and medium size enterprises segment (NPEs ratio at 62.3 percent). Better performance is noted in the large corporate (NPEs ratio at 28.3 percent) and shipping (NPEs ratio at 31.6 percent) segments.

Greek banks are currently setting new targets to reduce NPEs by 2021. Targets should be approved by the European Central Bank and the Single Supervisory Mechanism. Bloomberg, for instance, reports Piraeus Bank, which has the highest bad-loan ratio at 54.7 percent, will cut that to 21 percent by the end of 2021. According to Bloomberg, the ratio for the National Bank of Greece stood at 42.1 percent, for Alpha Bank at 51.9 percent and for Eurobank at 40.7 percent. Their targets for 2021 are 19 percent, 20 percent and 15 percent respectively. But as an analysis of Goldman Sachs explains, NPEs are expected to remain at elevated levels for a long period of time. And this constitutes the main problem for the Greek banking sector.

In response to the crumbling of the banking sector, the Greek government started to consider the creation of an asset protection scheme to form part of the overall strategy toward the reduction of NPEs. Although the creation of a so-called bad bank had been considered and rejected by Greece's European creditors in the past, various measures were put in place to protect lenders in Italy, Spain and Cyprus. The proposed scheme involves setting up special purpose vehicles (SPVs) where billions of euros of bad loans would be transferred from banks' balance sheets to help speed up the clean-up process. The SPVs would, among other things, issue bonds, some backed by the state, and sell them to investors. However, the ESM denied any involvement in favor of Greek banks. For its part, the European Commission refused to comment.

In the view of the Governor of the Bank of Greece Yannis Stournaras, the soundness of Greek banks should not be contested. By contrast, recent stock market developments concerning banking sector are due to purely exogenous factors, such as rises in interest rates internationally and in Greece's neighboring countries. In his view, the ongoing improvement of the liquidity situation of Greek banks reflects the improved condition of the Greek financial system. In October, the ECB lowered the ceiling on the emergency liquidity assistance – funds that Greek banks draw from the domestic central bank – by €200 million euros to €5.0 billion. The new ceiling is valid through to 7 November 2018.

With his statement, the Governor of the Bank of Greece has attempted to appease fears. Along with the recent decision of the ECB to lower the ceiling on the emergency liquidity assistance, the Greek banks have successfully passed the 2018 stress tests. The results exhibit that the average capital depletion under the adverse scenario, which covered a three-year period and assumed static balance sheets, was 9 percentage points, equivalent to €15.5 billion. However, some positive developments do not suffice to remove risks. That is why Greece's creditors insist on the need for the country to reduce NPEs and NPEs.

Current economic conditions are not ideal. In parallel with problems in Greece's neighborhood, mainly in Turkey, as Stournaras suggests, disagreements between Italy and the EU does not help Greece's effort to return to the markets. As long as Greece is unable to issue its own sovereign bonds, the operation of banks is significantly influenced. Additionally, real economy stagnation does now allow enterprises and citizens to better serve their debt obligations in order for bad loans to be sustainable. Last but not least, a recent business scandal is increasing suspicion. Folli Follie company overstated the number of its worldwide retail outlets and provided falsified data for its 2017 finances. The institutional weakness of the Greek market capital commission cannot but be noted by international investors.

Conclusion

After necessary restructuring and three rounds of recapitalization Greek banks are again at the epicenter of attention. Although deposits are not in danger and capital controls have been significantly lifted since the beginning of October, the large ratio of NPEs is causing an alarm. The need to reduce this ratio does not constitute news as this has been a bailout obligation for Greece that is naturally affecting the post-bailout strategic planning. But the difficulty of the task becomes higher in a period during which Greece attempts to make economic decisions alone and return to the markets. The Greek government is attempting to respond to the problem by discussing the creation of an asset protection scheme. The nature of this scheme, its financial resources, and the approval by the EU remain open to debate and difficult negotiations.