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Post-Programme Surveillance Report

Greece, Autumn 2023

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European Commission
Directorate-General for Economic and Financial Affairs

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Greece, Autumn 2023

EUROPEAN ECONOMY

Institutional Paper 263

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This Post-Programme Surveillance assessment was prepared in the Directorate General-General for Economic and Financial Affairs of the European Commission under the guidance of Declan Costello, Deputy Director General, Luc Tholoniat, Director and Júlia Lendvai, Head of Unit for Greece ([1]).

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The report was prepared in liaison with staff from the ECB ([2]). Staff from the European Stability Mechanism (ESM) also provided comments.

This report reflects information available and policy developments that have taken place until 31 October 2023. Therefore, the macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission 2023 autumn forecast released on 15 November 2023 (with cut-off date of 31 October 2023).

Comments on the report would be gratefully received and should be sent, by mail or e-mail, to:

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([1]) The executive summary of this report was adopted as Commission Communication C(2023)9803 on 19 December 2023. The rest of the report reflects the findings of the Staff Working Document (SWD(2023)983) accompanying that Communication.

([2]) European Central Bank (ECB) Staff participated in this mission, and in the drafting of this report, in accordance with the ECB's competences and thus provided expertise on financial sector policies and macro-critical issues, such as headline fiscal targets and sustainability and financing needs.

ABBREVIATIONS

DSA: debt sustainability analysis

ECB: European Central Bank

EFSF: European Financial Stability Facility

ELTA: Hellenic Post

ESM: European Stability Mechanism

GDP: gross domestic product

HAPS: Hellenic Asset Protection Scheme, also known as Hercules scheme

HICP: harmonised index of consumer prices

IAS: International Accounting Standards Plus

IMF: International Monetary Fund

IFRS: International Financial Reporting Standards

MFI: monetary and financial institutions

MREL: minimum requirement for own fund and eligible liabilities

NPL: non-performing loan

OASA: Athens Urban Transport Organisation

PPS: post programme surveillance

pp(s).: percentage point(s)

RRF: Recovery and Resilience Facility

RRP: Recovery and Resilience Plan

SLBO: sale-and-lease back organisation

SPB: structural primary balance

EXECUTIVE SUMMARY

The third post-programme surveillance mission to Greece took place from 2 to 5 October 2023. The mission involved European Commission staff in liaison with European Central Bank (ECB) staff. European Stability Mechanism (ESM) staff participate on aspects relating to the ESM's Early Warning System, and staff from the International Monetary Fund also participated.

Following a strong output expansion in 2022, economic activity is expected to moderate, with GDP growth exceeding the long-term growth potential. The Greek economy proved resilient in the face of external shocks and expanded by 5.6% in 2022. Real GDP is expected to grow by 2.4% in 2023, 2.3% in 2024 and 2.2% in 2025, according to the Commission 2023 autumn forecast. Beside consumption, gross fixed capital formation is expected to be a key driver of growth as the implementation of the Recovery and Resilience Plan supports investments. The recent natural disasters are expected to have a relatively small impact on GDP growth in 2023, since the affected areas account for a limited share of total value added. Following the sharp decline in the first half of 2023, inflation is expected to continue decreasing, albeit at a slower pace, due to the waning negative base effect of past energy price shocks and solid wage growth amid tightening labour market conditions. Employment is projected to increase further, although at a more moderate pace in line with economic activity. The current account deficit has narrowed in 2023 and is expected to drop in the next years. Still, the external balance is likely to remain in a sizeable deficit.

The budget balance is forecast to record a solid primary surplus as of 2023. The primary balance is expected to improve further compared to 2022 and to reach a surplus of 1.1% of GDP in 2023, on the back of the considerable decrease in the cost of fiscal support measures addressing the energy crisis. To address the emergencies related to the recent natural disasters, the government provided immediate support to households and businesses, thereby increasing fiscal expenditure. The primary surplus is expected to increase further in 2024-2025 on the back of muted expenditure growth and consistent revenue increase. The stock of arrears has decreased, but the reduction has been uneven: while progress was satisfactory in the pension sector, the persistently high stock of arrears in hospitals and extra budgetary funds calls for structural improvements.

Bank profitability remains strong, but the workout of non-performing loans particularly by servicers continues to face challenges. In 2022 and in the first half of 2023, banks benefitted from the increase in interest margins which enhanced banks' profitability, allowing them to strengthen their capital ratios. However, interest margins are set to narrow due to rising funding costs, including higher deposit rates. The reduction in the stock of non-performing loans (NPLs) has stalled in the first half of 2023, following significant improvement down to single digits in recent years. This indicates banks' possible difficulties to sustain NPL reduction through organic workouts. The planned relaunch of the Hellenic Asset Protection Scheme (HAPS) is expected to contribute to further NPL reduction. A number of portfolios securitised under the original HAPS are still underperforming original business plans, as the workout of non-performing debt by servicers continues to face challenges. These challenges include delays in judicial proceedings, a still high share of barren auctions, and, to a lesser extent, a relatively low – albeit increasing – take-up of the

'out-of-court workout' procedure. The effective debt restructuring by credit servicers and the efficient functioning of debt enforcement, coupled with the functioning of the secondary market for NPLs, will be key to further NPL reduction and thereby to support economic performance.

Pending the introduction of planned improvements, financial sector policies to clear various obstacles in tackling legacy non-performing debt perform steadily despite delays in the implementation of scheduled initiatives. The pace of the clearance of the backlog of household insolvency cases has been steady. By September 2023, 96.5% of the household insolvency court cases are expected to have been heard, and final court decisions issued for 75% of the cases. Out-of-court workout restructurings have gained traction and the authorities intend to introduce new features to the platform. However, there is room to further facilitate the use of the other tools of the new insolvency code, such as the second chance platform. The process for setting up the sale-and-lease back organisation (SLBO) is not expected to be completed before September 2024. The interim support scheme for the protection of primary residences of vulnerable households is therefore set to be extended for another 15 months or until the establishment of the SLBO, even though the take-up of this scheme has been very limited so far. Most claims related to called state guarantees have been processed but payments remain significantly below targets. Depending on court decisions, a significant part of the called state guarantees may be delayed or not be paid at all, particularly in the corporate loans segment.

Public asset management is becoming more efficient thanks to the new law on the governance of state-owned enterprises. In the first half of 2023, the Hellenic Corporation of Assets and Participations achieved the highest-ever income received from its portfolio companies' dividends. Privatisation transactions are progressing broadly according to plan.

By the end of October 2023, Greece has been upgraded to investment grade by two of the four credit rating agencies recognised by the ECB within its monetary policy implementation framework. The main reasons for the upgrades were sustained commitment to fiscal responsibility, a resilient economy, and the implementation of economic reforms. Greece is one notch below investment grade at the other two rating agencies.

Greece retains the capacity to service its debt. Despite several challenges, the Greek economic, fiscal, and financial situation continues to be resilient. According to the debt sustainability analysis, Greece is assessed to face low risks in the short and long term, while medium-term risks appear to be high on the back of the still high debt-to-GDP ratio. Government gross financing needs for the period 2023 to 2025 are low, due to projected significant primary surpluses and moderate debt amortisation. Greece requested to early repay EUR 5.3 billion of the Greek Loan Facility in 2023. Repayments of the principal on EFSF loans started this year, while the repayment of the ESM loans will only start in 2034. Greece has a very large cash buffer and has continued market access and regular successful bond auctions.

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1. INTRODUCTION

Staff from the European Commission, in liaison with staff from the ECB, conducted a mission from 2 to 5 October 2023 in the context of post programme surveillance (PPS). Staff from the European Stability Mechanism (ESM) participated in the meetings on aspects related to the ESM's Early Warning System, and staff from the International Monetary Fund (IMF) also participated. Under PPS, the Commission carries out bi-annual review missions to EU Member States that have had an EU-supported financial assistance programme. The objective of the PPS mission is to assess the economic, fiscal, and financial situation to ensure the Member State maintains its capacity to service its debt to the European Financial Stability Facility (EFSF), the ESM and bilateral lenders ([3]).

Greece has received assistance under three adjustment programmes between 2010 and 2018. Under the first economic adjustment programme, in 2010 and 2011 Greece received a financial assistance of EUR 52.9 billion under the Greek Loan Facility and EUR 20.1 billion from the IMF. Under the second economic adjustment programme Greece received EUR 141.8 billion from the EFSF and EUR 12 billion from the IMF between 2012 and 2014. Between 2015 and 2018, Greece received EUR 61.9 billion from the ESM in the context of the ESM stability and support programme.

This report reflects information available and policy developments that have taken place until 31 October 2023. The macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission 2023 autumn forecast released on 15 November 2023 (with cut-off date of 31 October 2023).

([3]) Under Regulation (EU) No 472/2013, PPS will continue until at least 75% of the financial assistance received under the programme has been repaid. Under the current repayment schedule, PPS will last until 2059.

2. MACROECONOMIC DEVELOPMENTS

The Greek economy proved resilient in the face of external and domestic shocks. Real GDP grew by 2.4% year-on-year in the first half of 2023, primarily driven by private consumption and net exports. Notably, after a contraction in 2022, rising wages and strong employment growth led to a modest uptick in real disposable income in the first half of 2023, thereby supporting consumption. By contrast, investment growth decelerated following the remarkable rise in the second half of 2022. The slowdown in capital spending was accompanied by a decline in corporate credit growth, as interest rates, particularly in real terms have inched upward.

Economic growth is expected to moderate but to exceed Greece's long-term growth potential. Following the strong post-pandemic recovery in 2021-2022 and despite an outstanding tourism season as well as a generally positive sentiment indicated by various soft indicators, economic growth is expected to moderate in 2023, but to remain above the EU and euro area average. Private consumption growth is likely to ease as pent-up demand subsides. Furthermore, natural disasters that struck Greece in the third quarter are expected to affect production and the trade balance in the second half of the year, although their overall impact on GDP and net exports are expected to be limited ([4]). Overall, GDP growth is projected at 2.4% in 2023 and the longer-term outlook remains positive. As the implementation of the Recovery and Resilience Plan (RRP) ([5]) is gradually shifting from reforms towards investment projects, it is expected to encourage private investments as well, thereby providing a more pronounced support to GDP growth in 2024-2025. Effective and timely implementation of the RRP is crucial for economic growth. Furthermore, the gradual recovery in the EU is expected to support exports and in particular tourism over the forecast period until 2025. Still, given the high import content of investments, net exports are expected to have only a small positive impact on 2024 growth and to be broadly growth neutral in 2025. Overall, GDP growth is estimated at 2.3% in 2024 and at 2.2% in 2025.

Following a sharp decline in the first half of 2023, consumer price inflation has stabilised in recent months. The harmonised index of consumer prices (HICP) rose by 3.2% on average in the third quarter of 2023, while core inflation, i.e., HICP excluding food and energy, averaged 5.2%, indicating that underlying price pressures are still strong. Although monetary conditions are expected to

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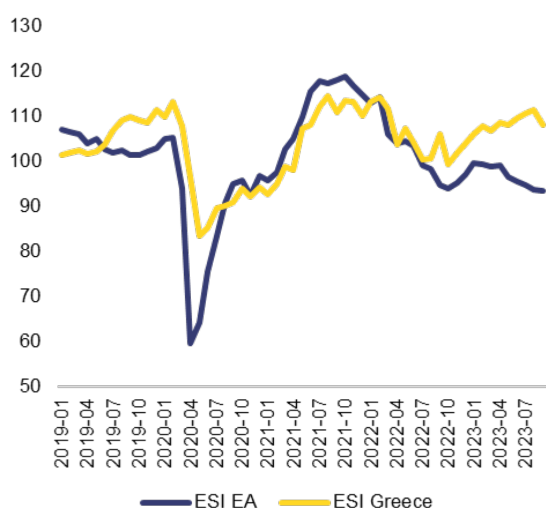
([4]) Agriculture and manufacturing, i.e., the sectors most affected by the floods in Thessaly represent 1.4% of total gross value added in Greece. Hence, despite their detrimental impact on production in the area, the direct impact of the floods on the economy as a whole is expected to be very limited.

([5]) The RRP with an envelope of EUR 30.5 billion, i.e., 16.8% of the 2021 GDP of Greece to be disbursed over the period 2021-2026. For further details see: https://commission.europa.eu/business-economy-euro/economic-recovery/recovery-and-resilience-facility/country-pages/greeces-recovery-and-resilience-plan_en.

remain tight for an extended period, the easing of price pressures is expected to be slowed by the waning negative base effect of past energy price shocks and persistent service and food inflation, the latter being exacerbated by the consequences of recent floods. Further upward pressure to prices may come from wage increases, as compensation per employee grew by 5.7% in the first half of 2023, after remaining stagnant in the previous year. HICP inflation is forecast to average 4.3% in 2023 and gradually decrease to 2.8% and 2.1% in 2024 and 2025, respectively.

Graph 2.1: **Economic sentiment indicator (ESI), Greece vs euro area**



Source: Eurostat

The employment rate has continued to rise, but specific sectors suffer from labour shortages. In the second quarter of 2023, the employment rate reached a new high of 68.3% (age group 20-64). Employment growth has been particularly strong in the agriculture, construction, and transport sectors. By August 2023, unemployment had slightly dipped below 11% in seasonally adjusted terms. The unemployment rate is still among the highest in the EU with women and the youth disproportionately affected. However, some segments of the labour market, especially in the tourism, agriculture and construction sectors have reported labour shortages. Employment is expected to increase further, albeit at a slower pace as economic activity is set to moderate. Overall, employment is forecast to grow by 1.5% in 2023 and at a slower rate of 1.1% in 2024 and 1.0% in 2025. The unemployment rate is projected to average 11.4% in 2023, before falling to 10.7% in 2024 and 9.9% in 2025.

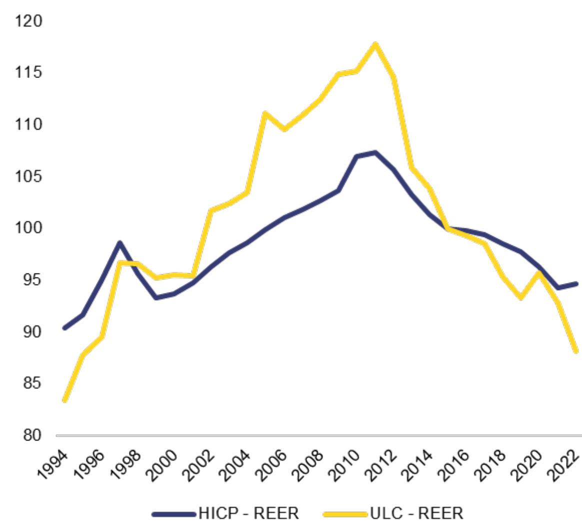
The sizable current account deficit has narrowed in the first half of 2023 and is expected to shrink further over the forecast period. However, the external balance is likely to remain in a sizeable deficit, suggesting persistent vulnerabilities. After reaching a deficit of 10.3% of GDP in 2022, the four-quarter cumulative current account deficit was 7.9% of GDP by mid-2023. The improvement was mainly driven by the fall in energy prices and the decline in non-energy imports. In the first seven months, net foreign direct investment inflows and capital transfers including funds from the Recovery and Resilience Facility (RRF) covered more than 60% of the current account deficit. The external balance is forecast to improve further thanks to the expected moderation in consumption growth and the cost competitiveness gains that Greece has accrued over the last decade. However, the expected robust growth in investment is likely to keep demand for imports elevated, which may limit the improvement in the trade balance over the forecast horizon. Overall, the current account

deficit is projected at 6.7% of GDP in 2023 and to fall to 5.3% of GDP by 2025 ([6]).

Greece's net international investment position stood at -144.2% of GDP in 2022. Net foreign liabilities are the highest in the EU in terms of GDP but are expected to continue falling, driven by nominal GDP growth (denominator effect) and the relatively low and stable financing costs owing to the concessional nature of a significant part of the external debt. However, addressing the underlying weaknesses through structural policies remains crucial to reducing external sustainability risks ([7]).

Greece realised sizeable gains in cost competitiveness over the past decade. Wages and prices have exhibited a considerably slower rate of increase compared to those in the country's trading partners during the last ten years. Consequently, Greek cost competitiveness indicators returned to levels recorded in the late 1990s (see Graph 2.2). Greece has also managed to expand its real export market share in recent years. By contrast, non-cost competitiveness remains a challenge. In 2024 and 2025, wages are expected to exhibit solid growth on the back of tighter labour market conditions. Hence, unit labour costs are projected to increase by 4%, 2.8% and 1.1% in 2023, 2024 and 2025. Nevertheless, the cost competitiveness is not expected to deteriorate since Greece's major trade partners are also expected to record similar or even higher increases in unit labour costs.

Graph 2.2: **Cost competitiveness indicators, 2015=100**



Source: ECFIN database
Note: Displayed indicators are the Unit Labour Cost-based Real Effective Exchange Rate (ULC-REER), and the Inflation-based Real Effect Exchange Rate (HICP-REER).

The economic outlook is subject to downside risks. Russia's war of aggression against Ukraine, and the Middle East conflict are general sources of major risk. Escalations in these conflicts could negatively impact energy prices, exports, and tourism, posing challenges also to Greece's economic prospects.

([6]) The current account balance, both the actual data and the forecast are based on the Balance of Payment statistics.

([7]) For a detailed assessment of imbalances and policy responses see: In-depth review for Greece in accordance with Article 5 of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances, SWD(2023) 631 final.

3. PUBLIC FINANCE DEVELOPMENTS

3.1. FISCAL PERFORMANCE AND OUTLOOK

The Commission 2023 autumn forecast expects the headline deficit to remain broadly unchanged and reach 2.3% of GDP in 2023. This corresponds to an improvement in the primary surplus from 0.1% of GDP in 2022 to 1.1% in 2023 which is counterbalanced by an increase in interest expenditure. The improvement in the primary balance compared to 2022 despite the one-off spending related to natural disasters is due to the strong reduction of the cost of the energy measures and the marked increase of current revenues. A limited set of new discretionary fiscal measures affect the balance of 2023 with a fiscal cost of 0.2% of GDP. These include the two-month extension of the 'market pass' (a social transfer to households in response to the loss in purchasing power following sharp price increases), and the repeated pension bonus to be paid in December 2023 for those pensioners whose pension is not indexed.

Following the devastating floods in September 2023, the authorities adopted measures to address emergencies and to support the reconstruction of the destroyed buildings and infrastructure. The support measures are organised along four axes: (i) measures to support households, (ii) measures to support businesses, (iii) measures to support farmers and (iv) measures to rebuild public infrastructure. The immediate support measures (i-iii) consist mainly of direct financial aid for those hit hard by the disaster and financial assistance to rebuild or restore damaged buildings. The bulk of the costs of the immediate support measures is expected to occur in 2023. The expenses to support the reconstruction of buildings and the physical infrastructure (roads, dams, railways, bridges etc.) are expected to be spread over four years. On a preliminary basis, the related expenditure of all these measures is estimated at EUR 900 million (0.4% of GDP) in 2023, EUR 700 million in 2024 and around EUR 500 million annually between 2025 and 2027. These costs will be financed using funds from the RRF, the European structural funds as well as from the national budget.

The Commission 2023 autumn forecast expects the headline deficit to decrease further to 0.9% of GDP in 2024, implying a primary surplus of 2.5% of GDP. The forecast factors in a set of fiscal measures announced this year, and an updated estimation of the public sector's wage grid reform. New fiscal measures include the increase of the personal income tax allowance for families with children (fiscal cost of 0.1% of GDP), as well as the increase of certain social benefits, such as the guaranteed minimum income and the extension of maternity leave for self-employed and farmers. An additional noteworthy measure is the 10% reduction of the ENFIA property tax for those households who take out insurance against earthquakes and floods ([8]). Whereas the direct short-term fiscal cost of this measure is very limited, it can contribute to a better insurance coverage of private properties thereby reducing the government's intervention costs in the future in case of natural disasters. On the revenue side, the authorities plan to increase the

([8]) Insurance for natural disasters will become compulsory as of 1 January 2024 for companies with annual turnover of more than EUR 2 million.

overnight tax for stays in hotels and other types of accommodation by EUR 1.5 on average and introduce a 13% value added tax for all legal entities and for those private individuals who rent out more than two apartments for short term lease. These measures are expected to yield 0.1% of GDP.

The Commission 2023 autumn forecast expects headline deficit to improve further to 0.8% of GDP in 2025, with the primary balance set to reach a surplus of 2.6%. According to the plans announced by the government, two medium-term tax cuts will commence in 2025. First, following the planned implementation of further measures against tax evasion, the fixed tax of the self-employed will be gradually reduced starting from 2025. Second, social security contributions will be further reduced by 1 percentage point, starting with a 0.5 percentage points reduction in 2025. The fiscal cost of these two measures is estimated at 0.1% of GDP in 2025. The headline balance nevertheless improves as expenditure growth is planned to remain muted.

Fiscal risks decreased since the previous report but remain sizeable. Russia's war of aggression and the conflict in the Middle East are the main sources of risks, through their potential impact on energy prices. Risks continue to stem from pending legal cases, most notably the litigation cases against the Public Properties Company. A further source of fiscal risk is the persistent occurrence and intensification of natural disasters, as shown by this year's devastating floods. On the upside, the government plans to put in place several measures to fight tax evasion, to improve compliance and to increase the digitalisation of payments (see below), which could lead to higher-than-expected fiscal revenues.

3.2. POLICY ISSUES

Energy prices have been lower than expected in the spring, which led to further reductions in spending on energy support. Broad based support to households and companies in the form of electricity price subsidies has been significantly reduced since the first quarter of 2023 and will have come to an end by the end of 2023. Similarly, the price-cap mechanism on electricity producers which has been in place since mid-2022 will expire by the end of 2023. Social tariffs will remain available for the most vulnerable – a system which had been in place already before the energy crisis. According to the authorities' plan, potential further targeted electricity subsidies may be given in case a surge in gas prices occurs.

The (re-)opening of highly concessional tax debt settlement schemes has attracted limited interest. Only 22% and 17% of eligible taxpayers participated in the re-opened '120' and 'Covid' instalment schemes and in the new instalment scheme, respectively. The authorities do not plan to re-open any of the existing schemes or to create new debt settlement schemes.

The authorities plan to implement ambitious measures to fight tax evasion in 2024. Part of these measures aim to increase the share of electronic payments, hence increase the traceability of transactions. Such measures are the interconnection of the point of sale (POS) terminals with the cash registers and the digital submission of this data to the tax administration and the

extension of the mandatory acceptance of direct electronic payments to sectors where this was not obligatory before (e.g., taxis, parking lots, kiosks). Moreover, real estate transactions will be allowed to take place only through electronic means of payment. Another part of these measures aims to directly improve the enforcement of current tax rules. In this context, self-employed may declare business expenses only if the invoices are uploaded in the electronic tax platform by their issuers. Also, the audits done by the Independent Authority for Public Revenues will be digitalised and automated.

The authorities have announced to abolish the 30% reduction in pension for those pensioners who are employed, as of 2024. Instead, they plan to introduce an additional 10% levy on top of the personal income tax on the labour income of pensioners. The current system strongly discourages pensioners from taking up (or declaring) jobs, especially part-time jobs, as the additional revenue might not even compensate the 30% loss of their pensions ([9]). With the new rule, the disincentive to work or declare labour income will be significantly reduced, as only the pensioners' marginal revenue will be taxed.

The stock of arrears has decreased, but progress has been uneven. The total stock of net arrears decreased from EUR 637 million in January 2023 to EUR 541 million in July 2023. However, the deviation from the target remains significant at EUR 376 million.

The stock of pension arrears has further decreased since January 2023. The stock fell to EUR 18 million in July 2023 compared to EUR 30 million in January 2023. The clearance of pension arrears made headway thanks to the implementation of the IT system for the processing of pension claims ('Atlas'), the introduction of automated procedures in the pension processing workflow, and the use of smart business intelligence tools and analytics.

There has been satisfactory progress in the clearance of lump-sum pension arrears but it is unlikely that the target has been met. Between January and July 2023 lump-sum pension arrears decreased from EUR 226 million to EUR 120 million. However, due to the higher-than-expected number of new pension applications (more than double), it is unlikely that the authorities would have achieved the target by September 2023. Hence, the authorities have updated the clearance plan, setting out the target to materially clear lump-sum arrears by March 2024.

Hospitals and extra budgetary funds account for almost half of total arrears. The stock of extra budgetary funds' arrears increased from EUR 81 million in January 2023 to EUR 131 million in July 2023. This is largely due to liquidity shortages caused by the delay in issuing the joint ministerial decision to compensate the public transport companies for lower tariffs linked to the conduct of social policy. Hospitals' arrears remain high (EUR 110 million in July 2023), despite the timely disbursement of grants from both the state and the health fund.

([9]) Currently, around 40 000 pensioners declare income from employment.

The high level of arrears in hospitals raises concerns. The outstanding stock of arrears in hospitals remains high, and there is a considerable risk that the actions undertaken by Ministry of Health to clear them in the short run will not be sufficient. However, the authorities have committed to actions that are expected to help reducing the accumulation of new arrears in 2024. These actions include the full rollout of the reform of the National Centralised Health Procurement Authority and the centralised Digital System for calculation and issuance of hospitals' clawback. In particular, the Authority is set to manage the purchase of an increasing number of pharmaceutical supplies centrally, which could lead to cost savings. In addition, due to the Authority's e-invoicing system, the repayment time is estimated to be reduced from currently 10 months to less than 90 days.

The codification of the labour legislation is underway and is expected to be completed in the coming months. Following the adoption on 26 September of the labour law 5053/2023 that transposed EU Directive 2019/1152 on transparent and predictable working conditions (OJ 158/A/2023), the full labour code (which will also include the above law) is expected to be published in the Official Journal in the coming months. This will mark the fulfilment of the Eurogroup policy commitment that called for the adoption of the Labour Law Code and Code of Labour Regulatory Provisions to enhance legal certainty and access to law.

3.3. PUBLIC ASSET MANAGEMENT

The dividend income of the Hellenic Corporation of Assets and Participations reached a new record. In the first semester of 2023, the Corporation's income from dividends of the state-owned enterprises in its portfolio reached EUR 115.4 million, which is the highest in its history.

The new law on the governance of state-owned enterprises has strengthened the governance of the Corporation's portfolio companies. According to the new law 4972/2022, the Corporation reviews, approves and monitors each company's business plans, budget, and staffing plans. It examines new remuneration policies for the Boards of Directors of the state-owned enterprises in its portfolio. By applying the relevant provisions on procurement of the new law, the Corporation achieved sizeable savings through launching a first group procurement process and has also initiated the process for re-organising substantial and more complex procurement fields. Among others, the flexibility to hire qualified staff need to increase to materially improve the performance of the portfolio of state-owned enterprises.

The Corporation is also progressing in implementing its Strategic Plan 2022-2024.

- The **Public Properties Company** has commenced a large-scale valuation of 36 000 real estate assets, which will provide a critical source of information for properly managing those assets, many of which are currently unidentified. To complete the valuation exercise and properly manage the portfolio, the Company needs to be able to hire experts from the market.

- The restructuring and modernisation of **Hellenic Post (ELTA)** is

progressing through merging 150 stores and streamlining the distribution network, introducing new customer services, and collecting receivables from the ceased energy business.

- The **Athens Urban Transport Organisation (OASA)** reached economic break-even including by reducing freeriding. Restructuring and value creation initiatives should continue at full pace.

A further challenge for the Corporation and the government is to ensure the timely transfer of the public service obligation payments to ELTA and OASA and the consistency of cash flows and associated calculations.

The Corporation is also increasing its internal management capabilities. It is implementing a new annual assessment policy and a strengthened selection process for the boards of its portfolio companies. It is also strengthening the framework for investing its investable reserves and completed a first investment in one of its portfolio companies (Hellenic Saltworks) with a view to creating and capturing increased value.

The ongoing privatisation transactions are broadly on track.

- The Hellenic Republic Asset Development Fund announced the preferred bidder following a EUR 3.27 billion offer for a 25-year concession of the **Attiki Odos**, for which the financial closing is expected in the fourth quarter of 2024.

- The financial closure for the concession of 67% of the **Igoumenitsa Port** till 2062 was signed on 20 October 2023.

- For the **Port of Kavala** the financial closing is expected by the end of 2023, and for the **Ports of Heraklion and Volos** in the first quarter of 2024.

- For **Egnatia Odos**, the tender documents have been submitted to the Court of Audit for the pre-contractual audits needed prior to the conclusion of the concession agreement, in view of a financial closing in the first quarter of 2024. This represents a further delay compared to the timeline envisaged last spring and is mainly due to the complexity of the transaction and the evolution of the financial conditions since the submission of the binding bids.

- As regards the **underground natural gas storage facility of “South Kavala”**, the Fund has not identified any practical way to develop or privatise this asset under the current regulatory and market conditions. Consequently, the Fund has asked to return this asset to the State.

- The Fund, in cooperation with all shareholders, continues the preparatory work for launching an initial public offering of its stake in **Athens International Airport,** in the first quarter of 2024. The fund is thus expected to maximise the sales revenue, whilst increasing the investors’ base and improving the liquidity of the Athens Stock Exchange.

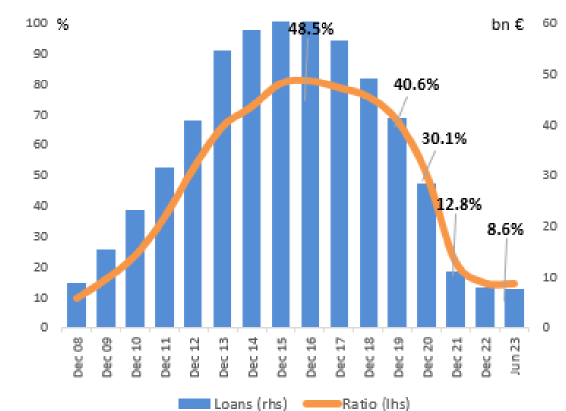
4. FINANCIAL SECTOR

4.1. FINANCIAL SECTOR DEVELOPMENTS

Following significant improvements in recent years, the reduction in the stock of non-performing loans (NPLs) has stalled in the first half of 2023. The level of NPLs remains the highest in the EU, substantially above the EU average ([10]). After the rapid clearing NPLs from the banks' books in previous years, the stock of NPLs only marginally decreased, from 8.7% in December 2022 to 8.6% in June 2023 ([11]). This mainly reflects a denominator effect from the reduction in the performing loan book, as the stock of NPLs decreased from EUR 13.2 billion to EUR 12.7 billion in the same period. The net inflow of NPLs ([12]) was positive in the first half of 2023, strongly affected by one large corporate bankruptcy case in the second quarter. However, this also indicates possible difficulties in the ability of banks to sustain NPL reduction through the organic workout of NPLs, as sale of loans played a significant role in reducing NPLs.

The risks to NPL workout persist. While there are no signs of a material rise in default rates following the expiry of pandemic-related state support schemes (Gefyra I and II), and loans that had exited the COVID-19 payment moratoria, a large share of outstanding loans have variable interest rates, and this may accelerate the inflow of NPLs should the repayment capacity of debtors decrease. The ongoing "freeze" of variable interest rates for 12 months, offered by most Greek banks for all performing mortgage debtors at the interest rate levels of end-March 2023 minus 20 basis points, will expire in the first half of 2024, with the potential risks of faster NPL build-up following the expiry.

Graph 4.1: **Evolution of the stock of gross NPLs and the corresponding NPL ratio for the Greek banks**



Source: Bank of Greece, data on a solo basis

The Government has announced the intention to relaunch the Hercules scheme. The drastic NPLs reduction from 48.5% at the end of 2016 to 8.7% at the end of 2022([13])was mainly driven by the securitisation transactions under the Hellenic Asset Protection Scheme (HAPS, also known as Hercules scheme), which expired in October 2022. NPL securitisations of EUR 49.5 billion

([10]) ECB reports NPLs for Greece and for the EU average as a share of total gross loans and advances (i.e., including cash balances at central banks and other demand deposits in the denominator) on a consolidated basis, which is different than the one reported by the Bank of Greece. The respective ECB figures for the first quarter of 2023 are 6.4% and 1.8% for Greece and the EU average respectively. Second quarter 2023 data are not yet available.

([11]) Source: Bank of Greece. The figures refer to NPLs as a share of total gross customer loans on a solo basis.

([12]) As defined by gross inflows of new NPLs minus loan curing.

([13]) ECB data for NPLs shows reduction from 46.3% at the end of 2016 to 6.2% at the end of 2022.

gross book value have taken place under the scheme, making use of EUR 18.7 billion of state guarantees. The relaunched scheme subject to approval by the European Commission in the context of EU State aid rules would be instrumental in concluding the securitisations which were submitted by the systemic banks before the previous scheme ended in October 2022, but for which the process to benefit from a State guarantee was not completed. The relaunched scheme would also be open to smaller, less-significant institutions to clean up more rapidly their balance sheets. The additional securitisations from the relaunched scheme are expected to provide some push to further NPL reduction, but loan restructuring and internal loan workout are likely to be the main drivers going forward. Moreover, the NPL ratios of less-significant institutions remain on average substantially higher than those of systemic banks, albeit with significant divergence among banks.

The legacy non-performing debt is still in the economy, and its workout remains a difficult task. While the bulk of NPLs exited banks' balance sheets as part of Hercules securitisations and outright NPL sales, credit servicers held EUR 71.2 billion of debt (excluding off-balance sheet claims) in June 2023. Servicers are expected to proceed with the resolution and restructuring of NPLs. A number of these securitised portfolios have been underperforming their initial objectives, mainly due to lower recoveries from collateral liquidations. This is partly the result of the suspension of enforcement proceedings and delays in court procedures during the COVID-19 pandemic, but it also reflects the still high ratio of unsuccessful auctions. The Supreme Court decision of 16 February 2023 has dispelled legal uncertainty that overshadowed enforcement proceedings, but the servicers continue to be challenged in courts on technical aspects, which in turn is slowing down enforcement processes. To meet initial objectives, credit servicers are taking specific actions, including sales of NPL portfolios on the secondary market, which allows them to frontload cash flows. However, such sales come at the potential cost of a worse performance in the future, without necessarily resulting in the effective workout of the sold loans. The effective debt restructuring by credit servicers and the efficient functioning of debt enforcement and the NPL secondary market will be key to future economic performance and would decrease the risk of state guarantees granted under the Hercules scheme being called upon.

All four systemically important banks continued to book solid profits in the first half of 2023, but profitability is not expected to stay high in the medium term. This was mainly driven by net interest income as banks' net interest margin increased further. According to Bank of Greece, the interest rate spread reached 5.86 percentage points in July 2023 for existing loans, mainly because of a rather subdued rise in deposit rates and rapid repricing of loans. Banks' profitability is likely to stay high in the short term but is set to come increasingly under pressure by the rising cost of wholesale funding, a higher pass-through to deposit rates, an increasing share of term accounts in the deposit mix and potentially higher provisioning needs. All four systemic banks are considering small dividend payments in 2024, subject to regulatory approval.

Banks' capital position has improved in 2022, but the quality of capital remains a concern. Profits helped to increase the capital ratios of the four systemic banks, over-compensating the ratio-decreasing impact of

the IFRS9 prudential phase-in ([14]) and allowing them to strengthen their capital ratios. At the end of 2022, banks' average Common Equity Tier 1 and Total Capital ratios stood at 14.4% and 17.4% as opposed to 13.6% and 16.2% at the end of 2021 ([15]). However, further improvements are needed as the capital position of Greek banks remains one of the lowest in the EU and its quality continues to be a concern, due to the high, though declining, share of deferred tax credits (approx. 52% of supervisory capital at end-2022 at consolidated level). The planned repayments of the targeted longer-term refinancing operations, which are already at an advanced stage, are likely to be completed without major effects on liquidity ratios. Banks already experienced an increase in unsecured funding costs, and their plans for further debt issuances to meet the minimum requirement for own funds and eligible liabilities (MREL) might come under pressure due to a steeper yield curve ([16]).

The financial sector has substantial multi-channel interlinkages with the Greek sovereign. Domestic government bond holdings are significant (9.5% of banks' total assets in the second half of 2022, including Treasury bills), but the banks have classified a large part (82% in June 2023) of their sovereign portfolio as held to collect ([17]), and are applying hedging strategies against interest rate risk on the remaining parts. Banks' capital contains a high share of deferred tax credits in their supervisory capital, impacting the quality of regulatory capital. The significant state ownership in the four out of five largest banks as a legacy of past recapitalisations amplifies the sovereign-bank nexus. There are also sizable long-term contingent liabilities, EUR 18.7 billion of state guarantees were given under the Hercules scheme, of which EUR 16.9 billion were still outstanding as of end-June 2023 (i.e., 8.1% of 2022 GDP).

Credit growth continued in 2023 at a slower pace for non-financial corporations but remained negative for households. Net lending in 2022 to non-financial corporations grew 11.8% (December 2022), mainly driven by lending to large corporations. In the first half of 2023, the growth trend continued, albeit at a slower pace compared to the second half of 2022, booking 5.8% annual growth rate in June 2023. Net lending to households continued to fall in 2022 and has maintained this trend in the first half of 2023 (-2.7% in June 2023 compared to year earlier), on the back of persistently negative net mortgage lending. One of the reasons for the supressed demand is increased cost of lending: the weighted average cost of new bank lending has risen significantly, reaching in June 2023 5.7% for businesses, 5.5% for micro firms and individual entrepreneurs and 6.1% for household loans, of which 4.1% for mortgages. The lending margin (i.e., the spread between lending and deposit rates) was consistently widening (see Graph 4.2b) and

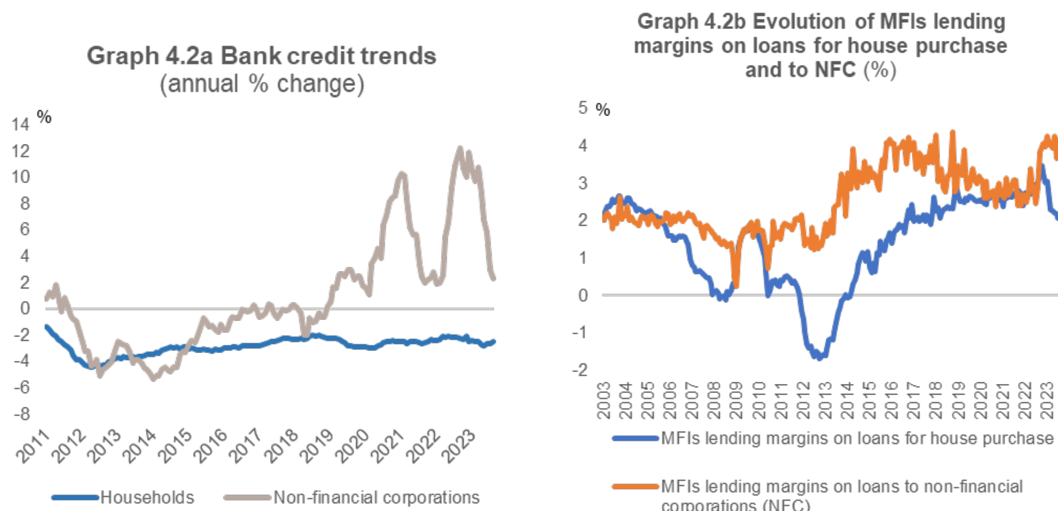
([14]) IFRS9 replaced the previous accounting standard for financial instruments (IAS 39) and was endorsed in the EU in November 2016. It is effective for periods beginning on or after 1 January 2018. IFRS 9 moves from an incurred loss model (under IAS 39) to an expected credit loss model. Given that this change could lead to a significant capital loss, the EU legal framework allows for a five-year transitional arrangement for banks who choose to make use of it.

([15]) Source: ECB – CBD2 Consolidated Banking Data.

([16]) Binding MREL targets are established by the resolution authorities on a bank-by-bank basis on the basis of the provisions of the Bank Recovery and Resolution Directive (2014/59/EU) and the Single Resolution Mechanism Regulation (806/2014/EU) and their subsequent amendments.

([17]) Source: EBA Risk Dashboard, data as of June 2023.

Graph 4.2: **Bank lending and interest rate trends**



Source: Bank of Greece, ECB ([19])

was in July 2023 amongst the highest in the euro area for the non-financial corporations ([18]). Loan disbursements linked to the Loan Facility under the RRF have started in 2022 and are expected to have accelerated by the end of 2023. Lending supported by the RRF has generally lower cost than market lending, which should support credit demand for non-financial corporations, possibly substituting for now more expensive loans which would have otherwise been taken without RRF co-financing.

While the banks are currently benefitting from the high interest rate margins, the current environment of higher interest rates and inflation involves downside risks for the financial sector. Rising interest rates are likely to further decrease credit demand and the repayment capacity of debtors. This in turn might put pressure on asset quality. Banks' profitability, stemming from historically high net interest margins, could come under pressure due to increased cost of funding (given the need of Greek banks to issue a significant amount of MREL-eligible debt in the coming years). However, the steady inflow of funds to the country for projects implemented under Greece's RRP and the restoration of investment-grade rating of the sovereign could prove as powerful counterbalancing factors.

The Hellenic Financial Stability Fund started with its planned divestment process by selling its stake in Eurobank. The 1.4% stake was bought by the bank itself through a share buyback scheme. On 30 October the Fund launched a formal sale process through auction of its entire 8.98% stake in Alpha Services and Holdings, after having received an unsolicited binding offer from Italian Unicredit. The Fund plans to divest by end-2025 from all four systemically important banks.

([18]) See ESRB Risk Dashboard, September 2023.

4.2 FINANCIAL SECTOR POLICIES

Restructurings under the out-of-court workout platform are gaining traction. The submission of applications has gained pace, with circa 23 000 completed and/or finally submitted applications since the start of the operation of the platform (corresponding to EUR 9.98 billion of debt, up from EUR 7.7 billion in the first quarter of 2023). Circa 8 800 requests have led to a successful restructuring, representing EUR 3.26 billion of debt. The approval rate from the side of creditors has increased in 2023 and is steadily around 70%-80%, however the re-default rate stands at around 40%. It will be crucial to monitor closely the viability of these restructurings until such loans turn performing. The authorities intend to adopt legislation by end-2023, introducing potential new features to the platform, as for instance (i) making algorithm-produced restructuring proposals to vulnerable debtors mandatory for creditors, (ii) offering a steady interest rate over a five-year period, (iii) modifying the algorithm to allow for higher haircuts, (iv) providing for electronic updates on debt status pending the processing of applications, etc.

The interest in the other tools of the new insolvency code remains limited. Although debtors' interest is still modest for the second chance platform (i.e., the core insolvency proceedings), there has been a steady increase in court validations of restructuring agreements, with a total of 2 426 applications validated by courts, corresponding to a total debt of around EUR 1.6 billion since its entry into force, (as compared to 1 443 applications for a debt of EUR 1 billion as of spring 2023). However, interest for the rehabilitation procedure (i.e., in-court restructuring) remains very limited. At least to some extent, this could be attributed to a perception of lack of credible threat of foreclosure. Further awareness-raising actions may also be useful to familiarise debtors and their consultants (lawyers, accountants) with these tools. By contrast, interest in the acquisition of the vulnerable debtor's status through submissions to the relevant e-platform remains high, given its link to the vulnerable debtors' supporting scheme for the provision of an interest rate subsidy. However, only 6.4% of all debtors who applied received a vulnerable debtor certificate by end-September 2023.

The interim support scheme for the protection of primary residences of vulnerable households is set to be extended as the process for setting up a sale-and-lease back organisation (SLBO) is expected to be completed in the second half of 2024. The concessionary process for the SLBO is delayed as the authorities were considering introducing some changes to make the scheme more attractive to potential bidders. The entire process, including the ratification of the contract award by the Parliament, is planned to be finalised by end-September 2024 at the earliest. To cover the interim period, the authorities plan to extend the interim support scheme for the protection of primary residences of vulnerable households for another 15 months, or until the SLBO is operational. The take up of the interim scheme has been very limited so far, with

(19) Lending margins are measured as the difference between (1) MFIs' interest rates for new loans to households for house purchase and a weighted average rate of new deposits with agreed maturity from households and non-financial corporations and (2) MFIs' interest rates for new business loans and a weighted average rate of new deposits with agreed maturity from households and non-financial corporations. For euro area countries, rates refer to loans granted to euro area residents.

only 130 debtors entering the scheme as of end-September 2023.

The pace of clearance of the backlog of household insolvency cases has been maintained. Out of circa 47 800 pending applications, 97% had received a hearing date by end-September 2023. In all, cases representing 96.5% of the total backlog were expected to have been heard by end-September 2023. However, despite final court decisions being issued at an increasing rate, their number still lags behind expectations based on the scheduled hearing dates, with only 75% of heard cases showing an issued final court decision on the platform by end-September 2023. The rejection rate of applications remains high (41% of issued decisions up to end-September 2023). Securing the timely upload of issued court decisions by court secretariats remains of the essence, as it is possible that the number of issued final decisions may be appreciably higher than the one registered on the platform, because of data uploading delays. In this respect, the authorities reported that a circular to this effect is expected to be addressed shortly by the Supreme Court to Magistrate's courts throughout the country.

Most auctions fail due to the lack of bidders. Out of 28 372 performed auctions in 2023 (up to end-September), 75% did not result in a transfer of the property, due to a lack of bidding. The same percentage of barren auctions was registered in 2022, slightly down from 78% in 2021, leading to the conclusion that the recently adopted automatic reserve price adjustment mechanism cannot in itself address the problem. Amid the predominant shortcomings identified by the authorities are: (i) the lack of funding, (ii) property-related overdue amounts, such as unpaid public utility bills, claimable against new purchasers, (iii) tenant eviction delays, (iv) lack of information on the state of properties, (v) non-uploading on the e-auctions platform of certificates, permits and plans relevant to the property being auctioned, (vi) excessive delays in the judicial resolution of post-auction disputes and in the registration of transactions in the land registries or cadastral offices, etc. These factors together create disincentives to prospective purchasers.

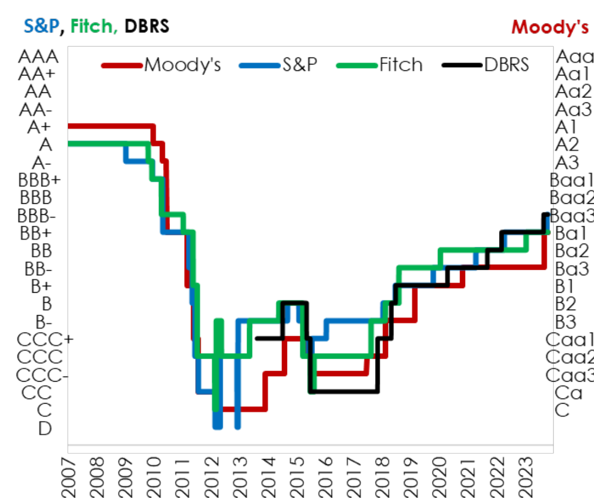
Most of the called state guarantees have been processed but payments are significantly behind targets. According to the Greek authorities, the value of claims processed by September 2023 reached almost EUR 1.7 billion, out of the total backlog estimated at around EUR 2.3 billion. The authorities plan to finish with all processing by end-2024. However, the total payments continue to lag behind, with EUR 521 million paid until September 2023. Progress with payments is picking up for the natural persons segment, with payments having been concluded for about 40% of the called guarantees' amount. However, the payments are particularly lagging in the corporate loans segment, with just EUR 77 million paid out of EUR 978 million processed. There are various legal reasons for non-payments, and it is estimated that about half of the pending cases in the corporate loan segment will be subject to court decisions. Depending on the court decisions, a part of the claimed state guarantees may not be paid. While the main processing work on the authorities' side is expected to be completed by end-2024, the work on payments is likely to extend beyond that date.

5. SOVEREIGN FINANCING AND CAPACITY TO REPAY

5.1. SOVEREIGN FINANCING

Greece's credit rating returned to investment grade. After more than a decade, Greece's credit rating returned to investment grade at two of the four major rating agencies by the cut-off date of this report. First, DBRS upgraded Greece to investment grade in September 2023, quoting the sustained commitment to fiscal responsibility, a resilient economy and the implementation of economic reforms as the key drivers for the upgrade. Next, S&P awarded Greece with investment grade in October 2023. In the meantime, Moody's also lifted Greece's credit rating by two notches from Ba3 to Ba1, one notch below investment grade, referring to profound structural changes in the economy, public finances, institutions and the banking system.

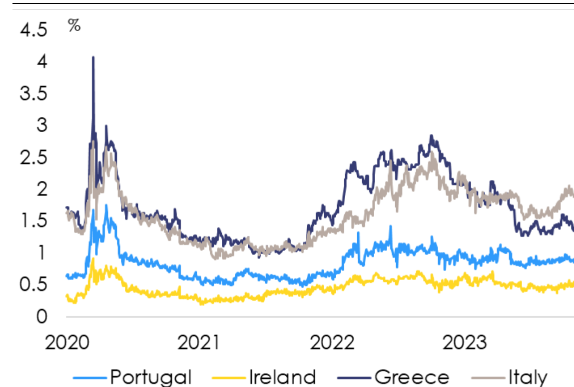
Graph 5.2: Greece's credit ratings



Source: Commission services
Note: For DBRS rating scale, "+" corresponds to "High", "-" corresponds to "Low".

Tightening yield spreads helped offset the impact of globally rising sovereign yields since April 2023. The yield spread between 10-year Greek government bonds and 10-year German Bunds declined by around 40 basis points and has been hovering around 150 basis points in the last six months. In the same period, Greek sovereign yield levels have been hovering around 4%.

Graph 5.1: Sovereign yield spreads (10Y)



Source: IHS Markit

Greece successfully tapped the bond market including an issuance of a new benchmark bond. Since April 2023, Greece raised over EUR 3.4 billion from the market. This included the regular bond auctions according to the published calendar, with two scheduled auctions each quarter in the second half of the year. In addition, Greece issued a new benchmark 15-year bond in July, with a nominal amount of EUR 3.5 billion. However, this transaction included a switch and tender offer of EUR 1.5 billion affecting bonds that are maturing in 2024 and 2025, i.e., only EUR 2 billion constitutes new financing. The achieved yield was 4.46% with an almost fourfold over-subscription. Investors were predominantly banks and funds from the United Kingdom, Ireland, and Greece.

Greece requested to early repay EUR 5.3 billion (2.4% of GDP) of the Greek Loan Facility. The request was made for the lenders to accept the early repayment in December 2023 of the amortisations due

in 2024 and 2025. Lenders raised no objections, and once the formal procedure has been completed, the prepayment is expected to be executed this year. With this prepayment, Greece will increase the weighted average maturity of its outstanding debt and increase the share of fixed-rate debt instruments.

Greece's cash buffer remains large, and risks to state financing are low in the short term. The cash buffer of the general government increased to around EUR 38 billion at the beginning of October ([20]), also supported by the disbursement of RRF grants and loans ([21]).Following the upgrades to investment level, the Public Debt Management Agency is likely to gradually shrink the buffer using it to decrease the outstanding stock of T-bills or other debt instruments with short maturities. Greek public debt continues to be insulated to a great extent from the increase of interest rates due to the still large share of official loans granted at concessional rates.

5.2. CAPACITY TO REPAY

Public debt remains high but is expected to decline in the short term and stay on a downward trajectory in the medium and long term. General government debt is projected to decline to 160.9% of GDP in 2023, and to 151.9% in 2024 on the back of economic growth, primary surpluses, and low interest expenditures. In the baseline scenario, the public debt ratio is expected to fall to 124.1% of GDP in 2034. This downward trajectory is to a very large extent conditional on prudent fiscal policy. According to the debt sustainability analysis (DSA), Greece faces low fiscal sustainability risks in the short term and in the long term, while in the medium term, risks appear to be high ([22]).

Greece retains the capacity to service its debt. In the coming years, Greece's gross financing needs are expected to be low due to the expected primary surpluses, limited debt maturities and low interest expenditure. Greece is expected to early repay EUR 5.3 billion (2.4% of GDP) of the Greek Loan Facility, which is the sum of the amounts which were due in 2024 and 2025. The financing needs in 2024 and 2025 were also reduced in the context of the bond exchange described above. With this, Greece's long-term debt amortisation is lowered to a little above EUR 5 billion (2.2% of GDP) annually in 2024 and 2025, which includes the scheduled repayment of EUR 1.7 billion (0.8% of GDP) for the EFSF in each year, and in 2025 also EUR 1 billion (0.4% of GDP) amortisation of the loans provided under the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency. The after-swap interest payments are also expected to be around EUR 5 billion (2.2% of GDP) in both years. The amortisation of the deferred interests on the EFSF loans is expected to commence in 2033, while the amortisation of the ESM loans will start in 2034.

([20]) The cash buffer account balance remained at EUR 15.7 billion. The cash buffer account was built also through disbursements under the third financial assistance programme and is dedicated to debt service. Greece may use this amount for other purposes as well, following an approval of the ESM's governing bodies.

([21]) Disbursements of grants (including pre-financing) to Greece under the RRF have amounted to EUR 5.7 billion, and disbursements of loans (including pre-financing) under the RRF have amounted to EUR 5.3 billion, by that cut-off date of this report.

([22]) For a more detailed results see Annex 2.

ANNEX 1

Main macroeconomic and financial indicators

Table A.1.1: **Selected economic indicators - Greece**

	2019	2020	2021	2022	2023	2024	2025
Real economy			*(percent change)*				
Real GDP	1.9	-9.3	8.4	5.6	2.4	2.3	2.2
Domestic demand incl. inventories	1.1	-3.7	7.2	6.0	1.2	1.8	2.0
Private consumption expenditure	1.8	-7.4	5.8	7.4	2.8	1.9	1.7
Government consumption expenditure	2.4	3.0	1.8	2.1	4.1	-2.3	0.5
Gross fixed capital formation	-2.2	2.0	19.3	11.7	6.9	7.5	5.7
Exports of goods and services	4.9	-21.5	24.2	6.2	5.7	5.0	3.6
Imports of goods and services	2.9	-7.3	17.9	7.2	3.0	3.8	3.0
Contribution to growth			*(percentage points)*				
Domestic demand (excl. inventories)	1.5	-4.3	6.8	7.1	3.7	1.9	2.1
Foreign trade	0.7	-5.6	0.6	-1.0	1.0	0.3	0.1
Changes in inventories	-0.3	0.6	0.9	-0.6	-2.3	0.0	0.0
Inflation			*(percent change)*				
GDP deflator	0.2	-0.8	1.5	7.8	5.3	2.7	2.1
HICP	0.5	-1.3	0.6	9.3	4.3	2.8	2.1
Labour market			*(percent change, unless otherwise stated)*				
Unemployment rate (% of labour force)	17.9	17.6	14.7	12.5	11.4	10.7	9.9
Employment	2.2	-2.6	1.2	2.5	1.5	1.1	1.0
Compensation per employee	-0.3	-0.4	3.8	2.8	4.9	4.1	2.4
Labour productivity	-0.3	-6.9	7.1	3.0	0.8	1.2	1.3
Unit labour costs	0.0	7.0	-3.1	-0.2	4.0	2.8	1.1
Public finance			*(percent of GDP)*				
General government balance	0.9	-9.7	-7.0	-2.4	-2.3	-0.9	-0.8
Total revenue	49.0	50.5	50.7	50.5	48.1	47.1	46.6
Total expenditure	48.1	60.2	57.7	52.9	50.5	47.9	47.3
General government primary balance	3.9	-6.7	-4.5	0.1	1.1	2.5	2.6
Gross debt	180.6	207.0	195.0	172.6	160.9	151.9	147.9
Balance of payments			*(percent of GDP)*				
Current external balance	-2.3	-8.0	-8.6	-10.6	-7.0	-6.1	-5.6
Ext. bal. of goods and services	-1.7	-7.7	-7.8	-9.7	-6.0	-5.2	-4.6
Exports goods and services	40.1	32.1	40.9	49.1	46.9	48.1	48.4
Imports goods and services	41.8	39.8	48.7	58.9	52.9	53.3	53.0
Memorandum item			*(EUR bn)*				
Nominal GDP	183.3	165.0	181.5	206.6	222.6	233.9	244.2

Source: European Commission, European Economic Forecast Autumn 2023.
Note: The current account balance, both the actual data and the forecast are based on the Balance of Payment statistics.

ANNEX 2
Debt Sustainability Analysis

This annex assesses fiscal sustainability risks for Greece over the short, medium and long term. It follows the same multi-dimensional approach as the European Commission's 2022 Debt Sustainability Monitor, updated based on the Commission 2023 autumn forecast and including a technical change to anchor the fiscal variables to the structural primary balance of the first forecast year (t+1) as opposed to the second forecast year (t+2) in previous publications. This change aims to ensure a higher degree of stability and consistency with the ongoing work on the revision of the economic governance framework. This means that the debt and budget balance projections for t+2 (in this case 2025) can differ from the Commission 2023 autumn forecast. A more detailed description and explanation of this update will be published in the forthcoming Debt Sustainability Monitor 2023.

A.1. SHORT-TERM RISKS

Short-term risks to fiscal sustainability are low. The Commission's early-detection indicator (S0) does not signal major short-term fiscal risks (Table A21.2) ([23]). Government gross financing needs are expected to decrease to around 10% of GDP in the short term (i.e. over 2023-2024) (Table A21.1, Table 1.). Greece's sovereign credit rating has been steadily improving and has returned to investment grade at two of the four major rating agencies by the cut-off date of this report.

([23]) The S0 is a composite indicator of short-term risk of fiscal stress. It is based on a wide range of fiscal and financial-competitiveness indicators that have proven to be a good predictor of emerging fiscal stress in the past.

A.2. MEDIUM-TERM RISKS

Medium-term fiscal sustainability risks for Greece appear high.

The DSA baseline shows that the government debt ratio is expected to decline but remain at a high level in the medium term (at around 124% of GDP in 2034) (Graph 1, Table 1) ([24]). The debt reduction is supported by the assumed structural primary surplus of 2.0% of GDP. Compared to historical data running from 1980, this may appear fairly ambitious. Indeed, less than one fourth of past fiscal positions were more stringent than the one assumed in the baseline. (Table A21.2) ([25]). However, compared with more relevant recent performance, the fiscal room of

([24]) The assumptions underlying the Commission's 'no-fiscal policy change' baseline include in particular: (i) a structural primary surplus, before ageing costs, of 2.0% of GDP from 2024 onwards; (ii) inflation converging linearly towards the 10-year forward inflation-linked swap rate 10 years ahead (which refers to the 10-year inflation expectations 10 years ahead); (iii) the nominal short- and long-term interest rates on new and rolled over debt converging linearly from current values to market-based forward nominal rates by T+10; (iv) real GDP growth rates from the Commission 2023 autumn forecast until 2025, followed by the EPC/OGWG 'T+10 methodology projections between T+3 and T+10 (average of 0.8%); (v) ageing costs in line with the 2021 Ageing Report (European Commission, Institutional Paper 142, November 2020). For information on the methodology, see the 2022 Debt Sustainability Monitor.

([25]) This assessment is based on the consolidation space indicator, which measures the frequency with which a tighter fiscal position than assumed in a given scenario has been observed in the past. Technically, this consists of looking at the percentile rank of the projected SPB within the distribution of SPBs observed in the past in the country, taking into account all available data from 1980 to 2022.

manoeuvre seems reasonable (as the average SPB computed over the last 15 years reaches a surplus of 3.6% of GDP). The debt decline also benefits from a still favourable but declining snowball effect of around -0.6% of GDP annually on average over 2025-2034, which is supported by the impact of Next Generation EU. On the other hand, stock-flow adjustments should slightly mitigate the projected debt reduction over the period 2025-2034, due to the effect of deferred interests in 2033 ([26]).

The baseline projections are stress-tested against four alternative deterministic scenarios to assess the impact of changes in key assumptions relative to the baseline (Graph 1). Under the *historical structural primary balance (SPB) scenario* (i.e. the SPB returns to its historical 15-year average) the debt ratio would be lower than under the baseline by about 13.6 pps. in 2034. However, under the *adverse interest-growth rate differential scenario* (i.e. the *interest-growth rate differential* deteriorates by 1 pp. compared with the baseline), the debt ratio would be higher than under the baseline by around 9.5 pps. in 2034. Under the *financial stress scenario* (i.e. interest rates temporarily increase by 5.3 pps. compared with the baseline) the government debt ratio would be higher by around 3.3 pps. in 2034. Finally, under the *lower structural primary balance scenario* (i.e. the projected cumulative improvement in the SPB over 2023-2024 is halved) the debt ratio would be higher than under the baseline by about 4.4 pps. in 2034.

The stochastic projections indicate medium risk, pointing to the moderate sensitivity of these projections to plausible unforeseen events ([27]). These stochastic simulations indicate a 14% probability that the debt ratio will be higher in 2028 than in 2023, implying medium risks given the high debt level. In addition, the uncertainty surrounding the baseline debt projections (as measured by the difference between the 10th and 90th debt distribution percentiles, reaching around 59 % of GDP in five years' time) is high (Graph 2).

A.3. LONG-TERM RISKS

Long-term fiscal sustainability risks for Greece appear overall low.

This assessment is based on the combination of two fiscal gap indicators, capturing the required fiscal effort to stabilise debt (S2 indicator) and bring to 60% of GDP (S1 indicator) over the long term ([28]). This

([26]) Statistical authorities have started a discussion on the statistical treatment of the deferred interest on the EFSF loan, but this has no impact on Greece's debt sustainability. The deferred interest on the EFSF loan is currently recorded as accrued interest expenditure, but the resulting liability is not recorded as part of the Maastricht debt. The statistical authorities have started to deliberate on whether to include the deferred interest in the Maastricht debt in the year when they are accrued. A final decision is pending. Debt figures could be revised upwards as of 2013, the beginning of the EFSF interest deferral. Importantly, this decision does not affect the assessment of Greece's debt sustainability, as the amounts to be actually repaid are the same.

([27]) The stochastic projections show the joint impact on debt of 2000 different shocks affecting the government's budgetary position, economic growth, interest rates and exchange rates. This covers 80% of all the simulated debt paths and therefore excludes tail events.

([28]) The S2 fiscal sustainability indicator measures the permanent SPB adjustment in 2025 that would be required to stabilise public debt in the long term. It is complemented by the S1 indicator, which

assessment is driven by the favourable initial budgetary position and projected decline in ageing costs. Hence, these results are conditional on the country maintaining a sizeable SPB over the long term, and duly implementing legislated pension reforms.

The S2 indicator points to low fiscal sustainability risks. The indicator shows that, relative to the baseline, the SPB would not need to improve to ensure debt stabilisation over the long term. This result is underpinned by the projected decline in ageing-related costs (contribution of -2.0 pps.) and a favourable initial budgetary position (-1.4 pps.). Ageing costs' developments are primarily driven by a projected decrease in public pension expenditure (-2.1 pps.), which is only partly offset by a projected increase in health-care spending (0.7 pps.) (Table A21.1, Table 2).

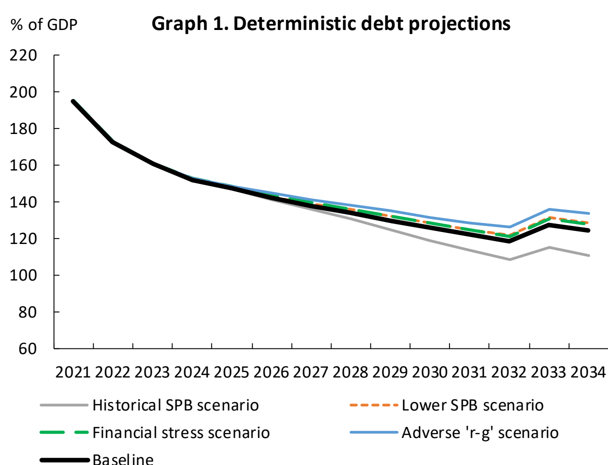
The S1 indicator points to low fiscal sustainability risks. The indicator shows that the country does not need to further improve its fiscal position to reduce its debt to 60% of GDP by 2070. This result is mainly driven by the current favourable initial budgetary position (contribution of -2.1 pps.) and the projected decline in age-related public spending (-1.1 pps.). However, the current distance of the Greek government debt ratio from the 60% reference value partially reduces the fiscal room for manoeuvre (1.9 pps.) (Table A21.1, Table 2).

Finally, several additional risk factors need to be considered in the assessment On the one hand, risk-increasing factors are related to the recent increase in interest rates, in particular the state guarantees granted recently, also in the context of the COVID-19 crisis. Contingent liability risks continue to stem from the non-performing loans in the banking sector (although the share of non-performing loans witnessed a sharp reduction in the previous years), and the costs linked to pending legal cases against the state also pose fiscal risks. A further source of fiscal risk is the persistent occurrence and intensification of natural disasters. On the other hand, risk-mitigating factors are related to the structure of the debt. In particular, the major share of debt is held by official lenders at low interest rates and has a particularly long maturity structure compared with peer countries. The currency denomination of debt also mitigates risks. In addition, the structural reforms under the Next Generation EU/RRF, if fully implemented, could have a further positive impact on GDP growth in the coming years, and therefore help to mitigate debt sustainability risks.

measures the permanent SPB adjustment in 2025 to bring the debt ratio to 60% by 2070. For both the S1 and S2 indicators, the risk assessment depends on the amount of fiscal consolidation needed: 'high risk' if the required effort exceeds 6 % of GDP, 'medium risk' if it is between 2% and 6% of GDP, and 'low risk' if the effort is negative or below 2% of GDP. The overall long-term risk classification combines the risk categories derived from S1 and S2. S1 may notch up the risk category derived from S2 if it signals a higher risk than S2. See the 2022 Debt Sustainability Monitor for further details.

Table A.21.1: **Debt sustainability analysis – Greece**

Table 1. Baseline debt projections	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Gross debt ratio (% of GDP)	**195.0**	**172.6**	**160.9**	**151.9**	**147.2**	**141.9**	**137.8**	**134.1**	**129.9**	**125.9**	**122.0**	**118.3**	**127.3**	**124.1**
Changes in the ratio	-12.0	-22.4	-11.7	-8.9	-4.8	-5.2	-4.2	-3.7	-4.2	-4.0	-3.9	-3.7	9.0	-3.2
of which														
Primary deficit	4.5	-0.1	-1.1	-2.5	-3.1	-3.0	-2.8	-2.6	-2.6	-2.7	-2.6	-2.6	-2.8	-2.8
Snowball effect	-16.3	-21.2	-8.9	-4.4	-3.2	-1.4	-0.4	0.0	-0.4	-0.2	0.0	0.1	0.2	-0.4
Stock-flow adjustments	-0.2	-1.0	-1.7	-2.0	1.6	-0.8	-0.9	-1.1	-1.1	-1.2	-1.2	-1.2	11.6	0.0
Gross financing needs (% of GDP)	19.4	13.7	13.1	7.3	8.9	9.6	9.3	11.5	10.7	11.2	12.5	11.0	15.4	11.7



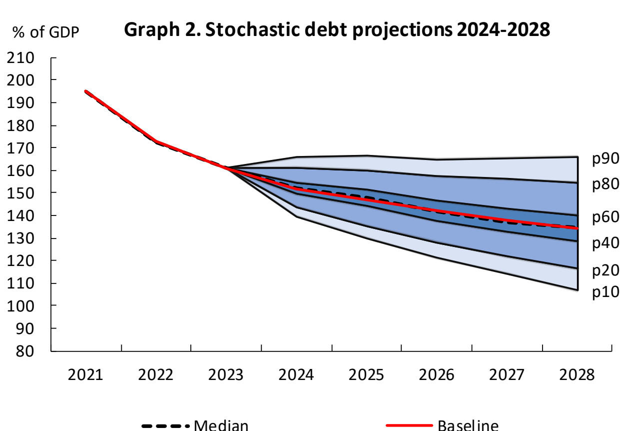


Table 2. Breakdown of the S1 and S2 sustainability gap indicators

		S1	S2
Overall index (pps. of GDP)		**-1.3**	**-3.4**
of which			
Initial budgetary position		-2.1	-1.4
Debt requirement		1.9	
Ageing costs		-1.1	-2.0
of which	*Pensions*	-1.2	-2.1
	Health care	0.5	0.7
	Long-term care	0.0	0.0
	Others	-0.4	-0.5

Source: Commission services

Table A21.2: **Heat map of fiscal sustainability risks - Greece**

Short term	Medium term - Debt sustainability analysis (DSA)								Long term		
			Deterministic scenarios								
Overall (S0)	Overall		Baseline	Historical SPB	Lower SPB	Adverse 'r-g'	Financial stress	Stochastic projections	S2	S1	Overall (S1 + S2)
LOW	HIGH	Overall	HIGH	HIGH	HIGH	HIGH	HIGH	MEDIUM	LOW	LOW	LOW
		Debt level (2034), % GDP	124.1	110.5	128.6	133.6	127.5				
		Debt peak year	2023	2023	2023	2023	2023				
		Fiscal consolidation space	24%	21%	27%	24%	24%				
		Probability of debt ratio exceeding in 2028 its 2023 level						14%			
		Difference between 90th and 10th percentiles (pps. GDP)						59.1			

(1) *Debt level* in 2034. Green: below 60% of GDP. Yellow: between 60% and 90%. Red: above 90%. (2) The *debt peak year* indicates whether debt is projected to increase overall over the next decade. Green: debt peaks early. Yellow: peak towards the middle of the projection period. Red: late peak. (3) *Fiscal consolidtation space* measures the share of past fiscal positions in the country that were more stringent than the one assumed in the baseline. Green: high value, i.e. the assumed fiscal position is plausible by historical standards and leaves room for corrective measures if needed. Yellow: intermediate. Red: low. (4) *Probability of debt ratio exceeding in 2028 its 2023 level*. Green: low probability. Yellow: intermediate. Red: high (also reflecting the initial debt level). (5) the *difference between the 90th and 10th percentiles* measures uncertainty, based on the debt distribution under 2000 different shocks. Green, yellow and red cells indicate increasing uncertainty.

Source: Commission services

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