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Post-Programme Surveillance Report

Greece, Spring 2023

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European Commission
Directorate-General for Economic and Financial Affairs

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Greece, Spring 2023

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Institutional Paper 203

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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 28 April 2023. Therefore, the macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission 2023 spring forecast released on 15 May 2023 (with cut-off date of 28 April 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)4002 on 22 May 2023. The rest of the report reflects the findings of the Staff Working Document (SWD(2023)651) 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.

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ABBREVIATIONS

DSA: debt sustainability analysis

ECB: European Central Bank

EFSF: European Financial Stability Facility

ELTA: Hellenic Post

EKAPY: National Centralised Health Procurement Authority

ESM: European Stability Mechanism

ETAD: Public Properties Company

GDP: gross domestic product

GLF: Greek Loan Facility

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

HCAP: Hellenic Corporation of Assets and Participations

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

NFC: non-financial corporation

NGEU: Next Generation EU

NPL: non-performing loan

OASA: Athens Urban Transport Organisation

PPS: post programme surveillance

RRF: Recovery and Resilience Facility

SME: small and medium-sized enterprise

SOE: state-owned enterprise

SPB: structural primary balance

TLTRO: targeted longer-term refinancing operations

VAT: value-added tax

EXECUTIVE SUMMARY

The second post-programme surveillance mission to Greece took place from 27 to 29 March 2023. This mission involved European Commission staff in liaison with European Central Bank (ECB) staff. European Stability Mechanism (ESM) staff participated on aspects relating to the ESM's Early Warning System and the International Monetary Fund (IMF) staff also participated.

Despite a challenging international environment, the Greek economy grew at a solid pace in 2022, but economic growth is expected to moderate in 2023 and 2024 reflecting tighter monetary and fiscal policy conditions and the still challenging global environment. According to the Commission 2023 spring forecast, real GDP is expected to grow by 2.4% in 2023, 1.9% in 2024. Investment is expected to be a key driver of growth this year, as the implementation of the Recovery and Resilience Plan is expected to boost both public and private investment. Consumer price inflation has eased but price pressures are set to remain persistent and moderate gradually over the coming years. The labour market has proved resilient to external shocks, but employment growth is set to decelerate as the economy slows down. The current account deficit has widened further, and it is expected to decrease only slowly in the coming years.

The budget balance has improved considerably in 2022, and the primary balance is set to be in surplus in the coming years. Despite the large fiscal support provided to households and corporations in the context of the energy crisis, the primary balance reached a surplus of 0.1% of GDP in 2022 on the back of better-than-expected performance of tax revenues. The Commission 2023 spring forecast expects that the primary balance will reach a surplus of 1.9% of GDP in 2023 and 2.5% in 2024.

Strong profitability helps prepare the banking sector for future challenges. The profitability of the banking sector strongly improved in 2022 due to a solid core performance but was partially supported by one-off trading gains. This helped buttress the capital ratios of the four systemic banks, but the quality of capital remains a concern due to the high, though declining, share of deferred tax credits. Non-performing loans in the banking sector continue to shrink, reaching 8.7% of total gross customer loans at end-December 2022 compared to 30.1% at end-2020, as the inflow of new non-performing loans remains contained. Nevertheless, this ratio remains substantially above the EU average, while the economic slowdown, high inflation and rising interest rates warrant vigilance to avoid a renewed deterioration in bank asset quality. The swift completion of pending securitisations under the Hellenic Asset Protection Scheme will be important to keep the ratio of non-performing loans on a decreasing path. Despite the resolution of the legal uncertainties related to the functioning of the secondary market of the non-performing loans, the workout of legacy non-performing debt, mostly held by credit servicers, remains a challenge, as a number of securitised portfolios have been underperforming their initial objectives.

Previously implemented reforms in the financial sector start bearing fruits but further progress is needed. A number of targeted improvements were recently adopted to the out-of-court workout and insolvency frameworks. Restructurings under the out-of-court workout platform are progressing well, even though these still cover only a small though increasing

part of legacy non-performing debt to date. At the same time, there is limited interest in the other tools of the new insolvency code, which points to the need for further awareness-raising actions. The number of auctions is increasing but the high percentage of auctions with no bidder (barren auctions) suggests that further improvements in the functioning of the debt enforcement framework may be required. The concessionary process for the set-up of the sale-and-lease back entity is progressing, although slower than previously expected partly due to process extensions requested by bidders, and the entity is not expected to be operational before the second half of 2024. The clearance of the backlog of household insolvency cases is progressing broadly according to schedule. Called state guarantees are being processed and cleared at a faster pace than in the previous two years, but payments are still significantly lagging behind targets.

Public asset management is progressing with the Hellenic Corporation of Assets and Participations (HCAP) consolidating its efforts to enhance the value of its portfolio companies. The Corporation is taking an increasingly active role as asset manager and shareholder of its subsidiaries aiming to improve their services and returns. By implementing the recently adopted law on the governance of state-owned enterprises and establishing framework agreements with service suppliers for all its subsidiaries, the Corporation has already achieved cost reductions, whilst more substantial improvements are expected through the development of new business and hiring plans. Privatisation transactions are broadly progressing according to plans with noteworthy results in particular in the regional ports sector. The financial closing of the Egnatia motorway concession agreement, however, has been delayed and is now expected in the fourth quarter of 2023.

Progress in some other policy areas remains to be monitored. Following the adoption of the codified individual labour law last December, the authorities are working on the codification of the two remaining parts of the labour legislation.. The cadastral mapping continues to progress, while the swift establishment, staffing and digitalisation of the new cadastral offices remains essential. The government has re-opened concessional tax debt settlement schemes and created a new settlement scheme outside the permanent ‘basic scheme’, which could undermine the credibility of the basic scheme, and is detrimental to payment discipline. Arrears of the main pension scheme have been broadly cleared, but the target for non-pension arrears has been missed.

Greece retains the capacity to service its debt. Despite a number of challenges, the Greek economy, public finances and financial situation have proven resilient. According to the debt sustainability analysis, Greece is assessed to face low risks in the short term, high risks in the medium term and low risks in the long term. Government gross financing needs for 2023 and 2024 are low, on back of projected primary surpluses and moderate debt amortisation. Repayment of the principal on EFSF loans started this year while the repayment of the ESM loans will only start in 2034. Greece has a sizeable cash buffer and has maintained continuous market access amidst improving sovereign debt ratings, albeit remaining below investment grade.

1. INTRODUCTION

Staff from the European Commission, in liaison with staff from the ECB, conducted a mission from 27 to 29 March 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 European Stability Mechanism (ESM) and bilateral lenders ([3]).

This report reflects information available and policy developments that have taken place until 28 April 2023. The macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission 2023 spring forecast released on 15 May 2023 (with cut-off date of 28 April 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.

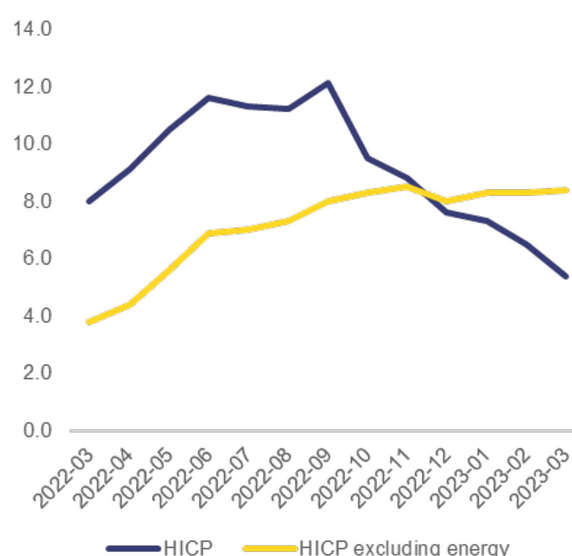
2. MACROECONOMIC DEVELOPMENTS

Against the backdrop of a challenging international environment, the Greek economy grew at a solid pace in 2022. Real GDP increased by 5.9%, largely driven by consumption and buoyant investment as well as a strong tourist season. During the first half of the year, private consumption was growing at a robust rate driven by post-pandemic recovery dynamics as households tapped into their accumulated savings, and was supported by a steady recovery of employment, while in the second half it lost momentum amid the global energy crisis and soaring inflation. Domestic demand was supported by the measures that Greece adopted to address the energy crisis (see also the section on public finance developments).

Economic growth is expected to downshift this year with real GDP growth averaging 2.4% this year and 1.9% in 2024. The return to more moderate growth rates is set to take place amid post-pandemic catching-up effects waning and a continuously challenging international environment. Private consumption is set to grow but at a slower rate, given the gradual phasing-out of fiscal support and lingering price pressures trimming real disposable income growth. By contrast, investment is expected to remain a key driver of growth this year, as the implementation of the Recovery and Resilience Plan is expected to notably buttress both public and private investment.

Consumer price inflation has eased but price pressures are set to remain persistent. Soaring energy prices drove inflation up to 12.1% in September 2022 (see graph 2.1), with price pressures becoming more broad-based. Looking ahead, inflation is forecast to gradually moderate over the coming years. Headline HICP inflation is projected to fall back to an average of 4.2% in 2023 on the back of falling energy prices and associated negative base effects. However, the lagged pass-through of energy costs to other goods, notably food and services is expected to imply a more persistent core inflation.

Graph 2.1: **Energy and non-energy HICP inflation, y-o-y %**



Source: Eurostat.

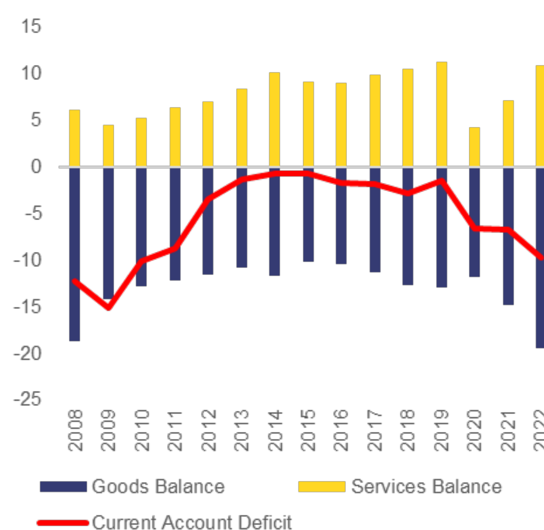
Employment dynamics are expected to weaken amidst a challenging domestic and international environment. The employment rate reached a record high of 67.6% in the third quarter of 2022 (age group 20-64) in the context of post-pandemic dynamics, notably the recovery of tourism, but the projected slowdown of economic activity is set to affect job creation. The domestic services sector, which accounted for 61% of total employment in 2022, was initially more protected from the energy

price shock given its relatively lower energy-intensity, but is set to be affected by inflationary pressures and the projected slowdown in consumption. Overall, employment is expected to grow by 0.8% in 2023 and 0.7% in 2024. The unemployment rate stood at 12.5% in 2022 and is forecast to average 12.2% in 2023 and 11.8% in 2024.

The current account deficit has widened, making the reduction of net foreign liabilities more challenging. The current account deficit increased since 2020 and reached 9.7% of GDP in 2022, mainly due to the deterioration in the goods balance, which was only partially offset by the improvement in the services balance (see graph 2.2). The deterioration of the goods balance in 2022 took place despite the marked improvement in the terms of trade and was driven by a surge in goods imports. The deterioration in the current account is related to higher energy prices but also partly explained by buoyant domestic demand in a post-pandemic recovery. Going forward, the current account deficit is set to decrease to 7.3% of GDP this year and ease further to 6% in 2024. In 2022, the net international investment position of Greece stood at -141.3% of GDP. This implies a marked improvement from 2020 and 2021, -173.8% and -171.9% respectively, albeit largely driven by nominal GDP growth ([4]) and still remains the lowest in the EU. Ongoing and planned policies to address the underlying structural weaknesses are key to contain external deficits and safeguard Greek economy against external shocks in the future ([5]).

Cost competitiveness is forecast to improve. Unit labour costs are forecast to increase at a slower pace than in the euro area on average, as wage growth in Greece is lagging behind the euro area average despite the recent hike in the minimum wage in April 2023. In this regard, the extent of future wage adjustments will be crucial to avoid adverse employment and competitiveness effects as well as the impact on in-work poverty. Unit labour costs are expected to increase by 1.9% and 1.5% in 2023 and 2024.

Graph 2.2: **Trade and current account balance, % of GDP**



Source: AMECO database.

([4]) Sectoral decomposition shows that the largest debtor by far is the general government, whose liabilities are largely held by official lenders at concessional interest rates.

([5]) For a more detailed assessment 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.

Despite the positive growth outlook, a number of risks remain. The unpredictable developments regarding Russia's war of aggression against Ukraine and their impact on global energy markets and supply chains could spur further inflationary pressures and curb economic activity. These downside risks could also affect the growth outlook of Greece's key trade partners, where a potential deterioration of external demand could weigh negatively on the Greek economy, in particular, through a worse-than-expected tourist season.

Table 2.1: **Summary of main macroeconomic variables (%)**

	2021	2022	2023	2024
Real GDP growth	8.4	5.9	2.4	1.9
Employment growth	2.7	3.8	0.8	0.7
Unemployment rate (a)	14.7	12.5	12.2	11.8
Harmonized Index of Consumer Prices growth	0.6	9.3	4.2	2.4

Source: European Commission.

3. PUBLIC FINANCE DEVELOPMENTS

3.1. FISCAL PERFORMANCE AND OUTLOOK

Greece's headline deficit has turned out significantly lower than expected. It reached 2.3% of GDP in 2022, which corresponds to a primary surplus of 0.1%. The result for the primary balance is 1.7 percentage points better than forecast in the Commission 2022 autumn forecast, which is primarily due to better-than-expected tax revenues, particularly from value-added tax and direct taxes. This could partially reflect the authorities' efforts to digitalise tax assessment and collection and suggests that the welcome reduction of the VAT gap has continued in 2022 ([6]). Furthermore, the transfer of the eighth and last tranche of income equivalent amounts stemming from central banks' holdings of Greek government bonds under the Securities Markets Programme and the Agreement on Net Financial Assets, which was decided after the Commission 2022 autumn forecast, improved the balance by 0.3 percentage points. Finally, around 0.2 percentage points improvement comes from underspending in the social budget. By contrast, considerably less revenues from EU structural funds were claimed than previously planned, which had a negative impact on the balance of 2022 by 0.4 percentage points ([7]). The net fiscal cost of the energy-related measures was marginally higher than expected, which worsened the balance by 0.2 percentage points.

The Commission 2023 spring forecast expects the headline deficit to decrease further to 1.3% of GDP in 2023, implying a primary surplus of 1.9% of GDP. The projected improvement of the primary balance compared to 2022 is driven by the phasing out of the remaining COVID support measures and a significant reduction in the cost of the measures taken in response to the energy crisis, while the growth of the wage bill and social benefits is expected to remain muted. The better-than-expected evolution of the tax base in 2022 is expected to carry over to 2023, which improves the forecast compared to the previous projections. Since the Commission 2022 autumn forecast, the authorities introduced a measure labelled as 'market pass' with an estimated fiscal cost of 0.2% of GDP. This is a voucher of EUR 35 per month for the months from February to July 2023 for households fulfilling certain income criteria. The voucher is provided in the form of a pre-paid card that can be used in supermarkets and grocery stores, or if beneficiaries accept a 20% discount on the subsidy amount, the money is transferred directly to the beneficiaries' bank account and can be used for any other purpose. In addition, pensioners whose pension is currently not indexed have received a one-time pension bonus, the budgetary cost of

([6]) See the VAT gap report for the details and assessment of the reduction of the VAT gap until 2021. European Commission, CASE, Poniatowski, G., Bonch-Osmolovskiy, M., Śmietanka, A., Pechcińska, A., *VAT gap in the EU – Report 2022*, Publications Office of the European Union, Luxembourg, 2022

([7]) For Greece, revenues from the EU structural funds are accounted when the authorities send the payment claims to the EU, and not when the expenditure occurs. This means the EU-funded expenditure is not necessarily fiscally neutral each year, but it is so over the course of the particular programming periods.

which is 0.1 % of GDP ([8]). The eligibility and amount of this bonus is income-dependent and ranges from EUR 200 to EUR 300. About 85% of pensioners in the category considered are eligible for this bonus. On the revenue side, the Greek authorities levied a temporary solidarity contribution on oil refineries for 2023. This implements Chapter III of the Council regulation on an emergency intervention to address high energy prices. The expected revenue from this tax is 0.2% of GDP.

The headline deficit is projected to improve further to 0.6% of GDP in 2024, with the primary balance set to reach a surplus of 2.5%. The balance is forecast to improve on account of the phasing out of the remaining energy measures by 2024. In addition, despite the planned reform of the wage bill with an estimated fiscal impact of 0.2% of GDP for 2024, growth of public spending is expected to remain overall muted thereby improving the balance and decline in real terms.

Fiscal risks have decreased but could still have a sizeable impact in case they materialise. The solid economic performance in 2022 and the fall in energy prices contribute to the moderation of the risks. Nevertheless, the uncertainty related to Russia's war against Ukraine remains considerable. Following the increase in price levels, pressure on the government spending continues to build up, and may prompt higher-than-planned increases in public wages and social expenditure. Risks continue to stem from the pending legal cases, most notably the litigation cases against the Public Properties Company (ETAD). On the upside, if the improvement in tax compliance continues, revenues could turn out higher than currently expected.

3.2. POLICY ISSUES

With the rapid fall in energy prices since autumn 2022, the expenditure on energy measures is expected to be considerably lower than previously expected. Whereas in autumn 2022, the gross cost of measures addressing the energy crisis was expected to reach 5.8% in 2023, it is currently projected at 0.9% of GDP following the decline in energy prices. The net cost of the energy measures is now expected to be 0.2% of GDP, revised down from 0.5% of GDP forecast in the autumn mainly due to the new solidarity contribution levied on the refineries as described above. Provided there are no further surges in gas prices, the authorities plan to phase out the measures currently in place still this year ([9]).

([8]) The income of pensioners whose pension is currently not indexed is on average higher than the income of those whose pension is indexed. Therefore, the former has not been eligible for indexation based on the 2016 pension reform.

([9]) The 2023 Country Report for Greece includes a box that provides a comprehensive overview of the measures taken in response to the energy crisis, together with an assessment of whether they are targeted towards the most vulnerable and preserve the price signal, as well as the government's intentions for their withdrawal.

The authorities have again re-opened highly concessional tax and social security contribution debt settlement schemes and created a new settlement scheme outside the permanent 'basic scheme'. In 2019, the basic scheme was redesigned with the purpose to eventually end all extraordinary debt settlement schemes. The authorities have now decided to allow dropouts from some highly concessional settlement schemes to re-enter these schemes without imposing a permanent increase in the interest rate charged on these debts and applying a penalty interest only on the missed instalments. In addition, the authorities have created yet another extraordinary instalment scheme for those, who remained current on their existing debt instalments since November 2021 throughout to December 2022 but created new debt towards the government in the meantime. The repeated creation of extraordinary instalment schemes and the re-opening of previous instalment schemes especially without sufficient safeguards and penalties to filter out and deter strategic defaulters, could undermine the credibility of the basic scheme and is detrimental to payment discipline.

While the main pension arrears have been broadly cleared, the target for non-pension arrears has been missed. According to January 2023 data, the stock of net arrears reached EUR 637 million, an increase of EUR 71 million compared to the August 2022 level and implying a deviation from the target of broadly EUR 500 million. By contrast, most subsectors have performed well as the clearance of their stock of arrears is broadly on target (state and tax refunds arrears) or very close to it (main pension, local government, and extra-budgetary funds' arrears).

Hospitals and the social security fund are responsible for lump-sum pensions account for 90% of the target deviation. Despite providing sufficient liquidity to hospitals, their stock of net arrears remains high, pointing to some structural problems. The full rollout of the reform of the National

Table 3.1: **Energy measures according to type (% of GDP)**

	2022	2023
(A) Spending on energy measures	**4.8**	**0.9**
Energy subsidies	4.1	0.9
Social transfers	0.4	0.0
Fuel subsidies	0.3	0.0
(B) Total revenues from financing measures	**2.3**	**0.7**
Tax on the energy producers via a price cap	2.1	0.5
Levy on windfall revenues to energy producers for the period Oct-21 to Jun-22	0.2	0.0
Solidarity contribution from refineries	0.0	0.2
(A-B) Net fiscal cost	**2.5**	**0.2**

Source: European Commission.

Centralised Health Procurement Authority (EKAPY) could potentially help accelerate the clearance of arrears as the centralised procurement is expected to contain hospitals' expenditure and accelerate payments as they will be made centrally and not by each hospital. As a consequence of the faster processing of main pension requests, the stock of lump-sum pension arrears has increased significantly, from EUR 11 million in August 2022 to EUR 227 million in January 2023. The authorities have updated the clearance plan, including a timeline and actions supporting the clearance of lump-sum pensions to materially clear them by September 2023.

The codification of the labour legislation is advancing. Following the adoption of the codified individual labour law last December, the authorities are working on the codification of the remaining two parts of the labour law (collective labour law, administrative labour law). Once the relevant work is completed, the full codified legislation is expected to be a comprehensive document that would constitute the point of reference for all labour-related issues thereby enhancing legal certainty and access to law.

The cadastral mapping is expected to be completed by the end of this year. So far, 72% of property rights in the country have been mapped. In total, 99.2% of the country's mapping is either completed or contracted and under implementation, with the full mapping planned to be completed by end-2023. The 392 old mortgage offices are progressively being closed and replaced by 17 cadastral offices and 75 branches with digitalised procedures. This transition is expected to be completed by early-2024. The swift establishment, staffing and digitalisation of the new cadastral offices is essential for speeding-up property transaction registrations.

3.3. PUBLIC ASSET MANAGEMENT

The Hellenic Corporation of Assets and Participations (HCAP) is consolidating its efforts to enhance the value of its portfolio companies. The Corporation is taking an increasingly active role as shareholder and asset manager fostering good corporate governance and practices, social responsibility and sustainability, thus providing a good example to other state-owned enterprises.

The new law 4972/2022 has effectively strengthened the governance of state-owned enterprises in the portfolio. The Corporation has already realised cost reductions by establishing framework agreements with service suppliers for all its subsidiaries. The Corporation's strategic guidance to its subsidiaries for the development of business and hiring plans is expected to further improve services and raise returns in the medium- and long term.

The Corporation is strengthening its investment function, completing its investment framework and implementing transformations within the portfolio. A concerted focus on the business and investment planning of all its subsidiaries, while ensuring highly professional and independent boards, is expected to assist with these transformations.

The Corporation is also progressing with the priorities of its strategic plan, albeit at a relatively slow pace for certain subsidiaries. A long due strategy for the Public Properties Company (ETAD) to start delivering a satisfactory performance across its portfolio is under preparation. Upon the

completion of the first phase of a pilot valuation of the Company's assets, the full valuation of its entire asset portfolio should proceed as quickly as possible, to solve the long-standing problems of understanding what the portfolio comprises of, its documentation and data quality, and how to manage it most productively. The Corporation is likewise planning initiatives for the expected restructuring of the Athens Urban Transport Organisation (OASA) and the transformation of Hellenic Post (ELTA) to improve their services and financial performance.

The ongoing privatisation transactions are broadly on track.

- The Hellenic Republic Asset Development Fund signed the share purchase agreement for the sale of 67% of the **Igoumenitsa Port Authority**, for which the financial closing is expected in the third quarter of 2023.
- The privatisation procedures for the **Ports of Heraklion and Volos** are ongoing with strong private sector interest and the financial closing is expected in the first quarter of 2024.
- In the **Port of Alexandroupolis**, whose strategic geopolitical importance has considerably increased following Russia's war of aggression against Ukraine, the Fund has planned investments to upgrade the port's current operational capabilities and explores ways of funding. Identifying suitable sources of funding to invest in critical infrastructure that is needed to bring new users and new businesses in the port of Alexandroupolis or in other small regional ports owned by the Fund, is key to increase the overall value of the Fund's portfolio and its future proceeds and will also have a crucial economic and social impact benefiting the respective port communities.
- For **Egnatia Odos**, the pending financial and construction documents recently submitted by the preferred bidder remain to be agreed with the Fund and forwarded 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 by the fourth quarter of 2023. This represents one year of delay compared to the timeline envisaged last autumn, which is mainly due to the preferred bidder's repeated requests for extending the period of finalisation of tender documents due to the complexity of the transaction and the evolution of the financial conditions since the submission of the binding bids.
- For **Attiki Odos**, the procedure is ongoing with strong private sector interest and the financial closing is expected in the fourth quarter of 2024.
- For the **underground natural gas storage facility of "South Kavala"**, the Fund is assessing the international natural gas market conditions following Russia's war of aggression in Ukraine taking into account the strategic objectives in the context of the REPowerEU plan. Following a previous unsuccessful tender, the Fund is considering to launch a new international tender, this time including the possibility of storing renewable hydrogen.

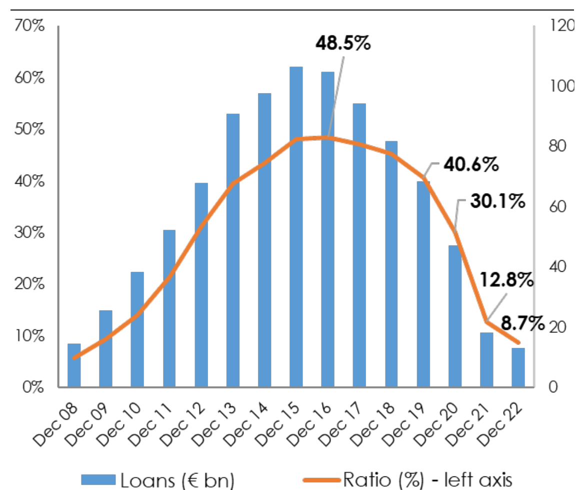
- The Fund is also preparing for an initial public offering of its stake in **Athens International Airport** aiming to maximise the profitability of the sale whilst increasing the investors' base and improving the liquidity of the Athens Stock Exchange.

4. FINANCIAL SECTOR

4.1. FINANCIAL SECTOR DEVELOPMENTS

The stock of non-performing loans (NPLs) in the banking sector continued to fall in the second half of 2022. The stock stood at EUR 13.2 billion as of December 2022, representing an NPL ratio of 8.7% as opposed to 12.8% at end-2021 and 30.1% at end-2020 ([10]). Nevertheless, this ratio remains substantially above the EU average ([11]). Inorganic actions continued to play a role in the fourth quarter, through a major non-performing loan transaction. However, following the expiry of the Hellenic Asset Protection Scheme (also known as Hercules scheme) in October 2022, a gradual shift has started to organic actions as the main driver for non-performing loan reduction, such as loan curing, i.e. loans that returned to performing status, as well as collections, collateral liquidation and write-offs. As a result, the ability of banks to offer viable long-term solutions or to proceed with effective collateral recovery will play an increasing role. Although long-term arrangements represent an increasing share of restructurings in recent years, loan restructurings continue to exhibit relatively high re-default rates. This suggests that further progress may be needed to achieve viable restructurings and a sustainable future NPL reduction. It is also important that the remaining securitisations under the Hercules scheme are swiftly completed to keep the NPL ratio on a decreasing path. Moreover, NPL ratios of less-significant institutions remain on average substantially higher, albeit with significant divergence among banks. This represents a challenge, particularly as the scale of the NPL portfolios of these institutions was too small to make use of the Hercules scheme.

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.

Inflow of new NPLs remains contained but risks persist. Loan curing slightly offset the gross inflows of new NPLs in the second half of 2022 on an aggregated level. However, household loans registered a net inflow of NPLs ([12]). Following the expiry of pandemic-related state support schemes (Gefyra I and II), there is no sign of a

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

([11]) 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 third quarter of 2022 are 6.4% and 1.8% for Greece and the EU average respectively. Fourth quarter 2022 data are not yet available.

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

material rise in the default rates from these schemes. In addition, systemic banks continue to report stable default rates of loans that had exited the COVID-19 payment moratoria, including cases where specific products had been offered to viable customers facing temporary difficulties. Nevertheless, banks are in the process of revising their NPL reduction strategies and their expectations for new NPL inflows and provisioning needs, to reflect a deteriorating macroeconomic outlook and the impact of increasing interest rates. The latter have the potential to erode the repayment capacity of debtors, since a large share of outstanding loans have variable interest rates and may accelerate the inflow of NPLs. To address this risk, the majority of Greek banks recently announced a new reward programme to "freeze" the interest rate of variable-rate mortgage loans for 12 months for all performing debtors at the levels of end-March levels minus 20 basis points. This new programme comes on top of an earlier initiative to provide a 12-month subsidy to economically disadvantaged debtors, covering 50% of the interest rate increases that have taken place since July 2022 in the loan instalments of their primary residence loans.

The workout of legacy non-performing debt remains a challenge. A large amount of legacy non-performing private debt remains in the economy, even after having left the banks' balance sheets as part of NPL securitisations and outright NPL sales. It is held by credit servicers, which are expected to proceed with its resolution and restructuring. 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, despite the increase in the number of auctions conducted in 2022.

A recent Supreme Court decision has dispelled legal uncertainty that overshadowed enforcement proceedings. The decision of 16 February 2023 acknowledged the legal standing of credit servicers to initiate enforcement proceedings also under the 2003 securitization law, as opposed to only under the 2015 law on the licensing and regulation of non-bank service providers and loan transfers. This decision creates a precedent resolving the previous legal uncertainty, thereby averting a standstill in debt enforcement, and facilitating amicable restructuring solutions with debtors. As a result, it is expected to contribute to the faster resolution of non-performing debt in the economy.

Credit servicers are taking actions to gradually meet their initial objectives. These include sales of NPL portfolios on the secondary market, which allows credit servicers 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. To effectively improve performance and improve the sale value of the underlying portfolios, such transactions would need for example to increasingly involve loans that have undergone restructuring and have become performing again. The effective debt restructuring by credit servicers and the efficient functioning of the NPL secondary market will be key to economic performance. As a result, the continuous assessment of the existing workout and enforcement framework,

including the potential need for improvements, will remain crucial in the future.

All four systemically important banks booked large profits in 2022. This high profitability was driven by strong core performance and lower impairments but was partially due to one-off trading gains. Net interest income from the performing loan book increased markedly on the back of credit expansion and higher interest rates. While interest rates on new and existing loans and mortgages were largely repriced, given the high share of variable-rate loans, deposit rates rose only marginally during 2022, implying an increase in the interest rate spread. Banks' net interest margin is expected to continue growing in 2023, albeit at a slower pace, as it is increasingly challenged by rising cost of wholesale funding, higher pass-through to deposit rates, an increasing share of term accounts in the deposit mix and potentially higher provisioning needs. Banks are applying a hedging strategy to reduce the effective duration of their significant sovereign bond portfolio, 84% of which is valued at amortised cost ([13]), and to mitigate any unrealised losses due to the impact of interest rate increases.

Banks' capital position is gradually improving but the quality of capital remains a concern. Profit generation in 2022 helped to buttress the capital ratios of the four systemic banks, offsetting the ratio-decreasing impact of the IFRS9 prudential phase-in ([14]). At the end of September 2022, banks' average Common Equity Tier 1 and Total Capital ratios stood at 13.5% and 16.2% of risk-weighted assets as opposed to 13.2% and 15.9% at the end of June 2022 ([15]). The banks intend to further reinforce their capital position through internal capital generation, as well as capital relief through synthetic securitisations of performing loans and the planned completion of the three remaining NPL securitisations under the Hercules scheme. All four systemic banks have expressed their intention to pay dividends in 2024 for the first time in years, as a sign of confidence in their capital levels, while one of them has asked for the approval of the supervisor to do so already this year and another one intends to proceed to a share buyback. Despite this positive trend, 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 (circa 57% of supervisory capital at end September 2022 at consolidated level).

Banks face challenges ahead, as the economic outlook involves downside risks. Rising interest rates are likely to further squeeze the repayment capacity of debtors and put pressure on asset quality, while also weakening credit demand. The increased cost of funding is expected to hit profitability. 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

([13]) Source: EBA Risk Dashboard, data as of December 2022.

([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.

due to a steeper yield curve [16]. On the positive side, the planned repayments of the targeted longer-term refinancing operations (TLTRO III), which have already started, are likely to be completed without major effects on liquidity ratios. This is mainly due to currently high liquidity buffers and the high share of collateral currently pledged under the TLTRO III that is eligible for Eurosystem funding under the normal refinancing instrument.

Credit growth picked up in 2022 for non-financial corporations but remained negative for households. Net lending to non-financial corporations accelerated in 2022, registering an average annual growth rate of 8.3%, in comparison to 5.7% a year earlier. Growth rates have been especially high since the middle of 2022, mainly driven by lending to large companies and this trend has continued in the first two months of 2023. Net lending to households continued to fall in 2022 and is not expected to turn positive in 2023, on the back of persistently negative net mortgage lending. Although gross new mortgage lending in 2022 has been the highest since 2015, it is still at low levels compared to the pre-2009 period and falls short of repayments of existing mortgages. The weighted average cost of bank lending has risen significantly across the board, reaching in February 2023 5.4% for businesses, 7% for micro firms and individual entrepreneurs and 5.7% for household loans, of which 3.8% for mortgages. This is also reflected in a widening lending margin (i.e. the spread between lending and deposit rates), which has recently risen (see Graph 4.2b), particularly for non-financial corporations, and is amongst the highest in the euro area [17].

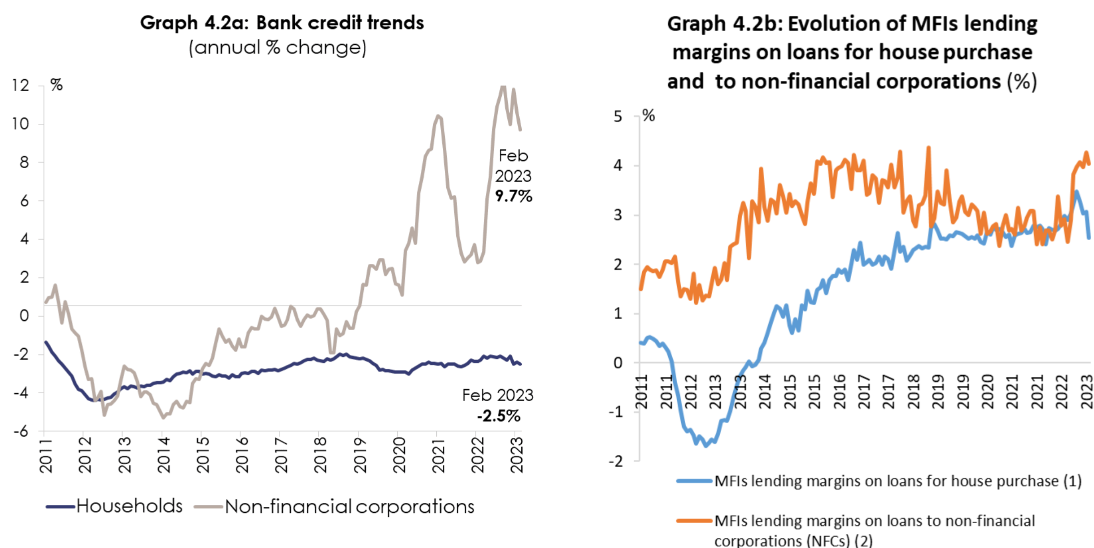
EU and to a lesser extent, Hellenic Development Bank financial instruments, account for a large part of new lending to small and medium-sized enterprises (SMEs). Overall, 19% of total new bank lending in 2022 to non-financial corporations and self-employed, corresponding to 4.2 billion euros, took place through programs managed by the European Investment Bank group and the Hellenic Development Bank. 78% of these loans were granted in the context of the Pan-European Guarantee Fund, while 2.9 billion were related to new loans to SMEs, micro firms and individual entrepreneurs, corresponding to 58% of new bank lending for these categories. Loan disbursements linked to the Loan Facility under the Recovery and Resilience Facility have only just started in 2022 and are expected to accelerate significantly in 2023. All this should support credit demand, which may nevertheless be affected in the short term by the worsening macroeconomic outlook.

The Hellenic Financial Stability Fund (HFSF) aims to divest by end-2025. According to the updated divestment strategy, the Fund has full flexibility in choosing the method to divest from its holdings by the end of 2025. No concrete actions were made public yet, while one commercial bank announced that it intends to bid through a share buyback scheme for the 1.4% stake the Fund owns in its shareholding structure. On the investment activity side, the Fund has recently participated alongside other investors, mostly private, in a new share capital increase of a less significant

(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) See ESRB Risk Dashboard, March 2023.

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



Source: Bank of Greece, ECB ([18])

institution, maintaining its majority stake in the bank.

4.2 FINANCIAL SECTOR POLICIES

Restructurings under the out-of-court workout platform are progressing well. The applications that were submitted to the platform by end-March 2023 correspond to EUR 7.7 billion of debt. Applications representing 54% of the underlying notional debt have been assessed, indicating an acceleration in the processing rate since the previous report, and 18% of notional debt (i.e. EUR 1.4 billion) already restructured. A further 6% (i.e. EUR 0.5 billion) is close to completion, while the significant backlog of submitted applications under negotiation implies that the number of restructurings is likely to increase. However, these restructurings still cover only a small though increasing part of legacy non-performing debt to date. Creditors' average approval rates since the start of the platform stand at 92% for the public sector and 74% for banks and credit servicers ([19]) and have been on the rise since September 2022. Average approval rates by debtors since the start stand at 66% for bilateral restructurings and 54% for multilateral restructurings. It will be crucial to monitor closely the viability of these restructurings until such loans can again be considered performing.

There is limited interest in the other tools of the new insolvency code. Debtors' interest is still modest for the second chance platform (i.e. the core insolvency proceedings) and even more limited for the rehabilitation

([18]) 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 NFCs. For euro area countries, rates refer to loans granted to euro area residents.

([19]) Based on the nominal value of the debt involved.

procedure (i.e. in-court restructuring) and the early warning mechanism. This could be partially 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 new tools. At the same time, it is important to continuously monitor the speed at which pending applications are processed in the context of these tools and particularly the second chance platform. By contrast, there has been a spike in interest for the vulnerable debtors' platform, given its link to the recent vulnerable debtors' support programme announced by the four systemic banks. As a result, 2 950 debtors received a vulnerable debtor certificate by end-March 2023. This is substantially behind initial expectations but based on the high number of pending applications (36 483), the figure is expected to rise significantly.

The authorities have recently adopted a number of amendments to the out-of-court workout and insolvency frameworks. The aim is to make targeted improvements to the relevant processes and widen the scope of out-of-court workout, while at the same time requesting both financial institutions and debtors to justify non-consent with the restructuring proposal provided by the platform's algorithm. The effectiveness of all components of the insolvency framework will be monitored in the context of post-programme surveillance on a continuous basis.

The set-up of the sale-and-lease back entity is not expected to be completed before the second half of 2024. The concessionary process is currently in the stage of the competitive dialogue, which is now expected to take substantially longer than initially planned partly due to process extensions requested by bidders. The entire process, including the ratification of the contract award by the Parliament, is expected to be finalised by end-June 2024 at the earliest, which means that the new entity will be established and become operational only later that year. In the meantime, interest for the interim support scheme for the protection of primary residences of vulnerable households, which aims to ensure a smooth transition until the new entity commences operations, has been very limited so far, with only 64 debtors entering the scheme as of end-March 2023.

The clearance of the backlog of household insolvency cases has continued broadly according to schedule. Out of circa 47 900 pending applications 95.9% had received a hearing date by end-March 2023, despite a deceleration in the pace of assigning new hearing dates. Out of the cases that have received a hearing date, 91% were heard by the end of 2022, while 9% were scheduled for a hearing within 2023. Final court decisions are being issued at an increasing rate, albeit still lagging behind the one expected based on the scheduled hearing dates. Final court decisions have been reported for 26 355 cases (up from 14 895 in end-October 2022). In 39.8% of these cases, the decision was not to grant any protection or stay of enforcement, while in 7.5% of the cases the outcome is still not reported. The timely upload of issued court decisions by court secretariats would be crucial to improve visibility, including on non-final ("interlocutory") decisions.

Called state guarantees have been processed and cleared at a quicker pace in 2022 than in the previous two years, but payments are still significantly lagging behind targets. According to the Greek authorities, the value of claims processed in 2022 out of the total backlog of around EUR 2 billion, reached EUR 941 million,

compared with EUR 279 million in 2021. Payments rose to EUR 240 million, up from EUR 79 million in 2021. Moreover, the processing of all claims linked to corporate loans has been completed. However, total payments have been consistently lagging behind targets and this trend has continued in the first quarter of 2023. Nonetheless, payments in the second and third quarters of 2023 will benefit from the unlocking of roughly up to EUR 270 million of guarantee claims related to loans that were transferred to another legal entity without prior approval by the guarantor, which had previously been put on hold for legal reasons. Moreover, the recently completed recruitment of 35 additional staff by the authorities is expected to accelerate processing. While the work on the authorities' side is expected to be completed by end-2024, the payment of claims will also depend on the timing and outcome of pending court cases and the timely submission of supporting documents by banks.

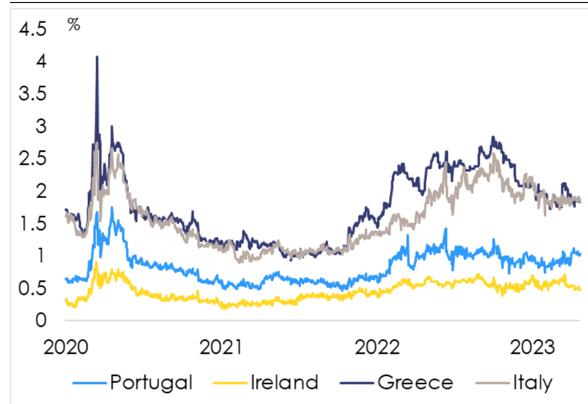
The number of auctions is increasing but a high percentage of auctions has no bidder (barren auctions). In 2022, 51 960 auctions were planned, 75% of which (i.e. 38 869) were conducted, a number substantially higher than previous years. This trend has largely continued in the first quarter of 2023, with 11 012 conducted e-auctions. However, the large percentage of barren auctions remains a concern. In the first quarter of 2023, about 78% of concluded auctions were unsuccessful and there is no improvement so far following the introduction of the automatic reserve price adjustment mechanism. Hence, further improvements in the functioning of the debt enforcement framework may be required to increase the overall ratio of successful auctions, including a more streamlined and effective post-auction process and a speed-up of cadastral rights registration procedures that show extensive delays in some cases and affect negatively property transactions as well as auctions. Additional factors that weigh on the success of auctions are a shortage of available financing for potential interested purchasers and the limited market demand for certain assets, although the increasing share of auctioned properties that are acquired by third parties shows an improvement in this respect.

5. SOVEREIGN FINANCING AND CAPACITY TO REPAY

5.1. SOVEREIGN FINANCING

Yield spreads and yield levels have decreased somewhat from their peak in October 2022. The yield spreads over the 10-year German Bund stood around 190 basis points in April 2023, down by approximately 80 basis points since October 2022. This was reflected in the decrease of the re-financing rates as well, which hovered around 4.2 % on the 10-year maturity in April 2023.

Graph 5.1: Sovereign yield spreads (10Y)

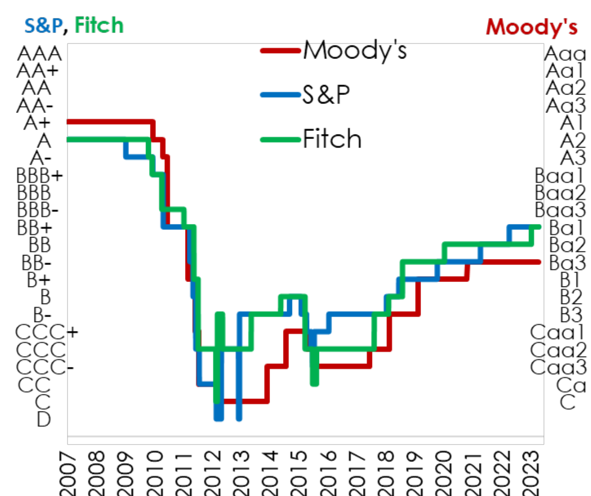


Source: IHS Markit.

By April, Greece has raised EUR 6.3 billion from the market during 2023 and published a bond auction calendar for the first time since 2008. In January, a new 10-year benchmark fixed-coupon bond was issued, raising EUR 3.5 billion at a yield of 4.3%. In March, another EUR 2.5 billion was raised through a new 5-year benchmark bond at a yield of 3.9%, and in April a EUR 300 million was raised through a reopening of a 10-year bond issued in January 2023. All three issuances were heavily oversubscribed and the investor base for both issuances predominantly consisted of banks and fund managers, with a diversified geographical distribution. As a landmark step towards normalisation, the Public Debt Management Agency published a bond auction calendar for the second quarter of 2023 to facilitate the operation of the secondary market of the Greek government bonds. According to the calendar, the Agency will hold one auction each month in the second quarter of this year.

Credit ratings have continued to improve. Fitch has upgraded Greece's credit rating from BB to BB+ at the end of January 2023. The key drivers of the upgrade were the improved fiscal outturns and reduced banking sector risks. With this, Greece is only one notch below investment grade at two major credit rating agencies, Fitch and S&P. In March, Moody's changed the rating outlook from neutral to positive, while keeping the credit rating at Ba3. This is the first change in the assessment of Moody's since 2020. While the rating by Moody's remains three notches below investment grade, the change to positive outlook reflects the good economic performance and the effective economic and banking sector reforms implemented in the past years. In April 2023, S&P improved the rating outlook from stable to positive, while keeping the rating itself unchanged. The major drivers of the revision were progress in structural reforms and surge in investment as well as an improving fiscal position.

Graph 5.2: Greece's credit ratings



Source: Commission services.

Greece's cash buffer remains large, and risks to state financing are low in the short term. The cash buffer of the general government reached around EUR 35 billion at the end of March ([20]). The Public Debt Management Agency plans to maintain this high level of the cash balance as long as Greece's credit rating remains below investment grade. Given the more than 20-year average maturity of the Greek general government debt, the current increase of interest rates does not pose considerable financing risks. The impact of rising interest rates is also mitigated by the hedging operations carried out by the Agency in recent years, whereby the Greek Loan Facility (GLF) debt is fully hedged at a low interest rate.

5.2. CAPACITY TO REPAY

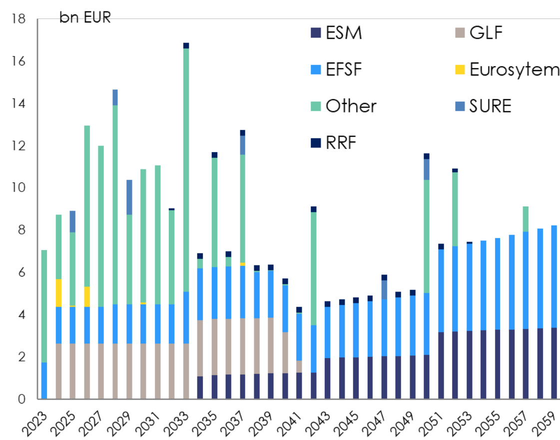
Public debt remains high but is expected to decline in the short term and stay on a downward trajectory in the medium and long term ([21]). General government debt declined sharply from 194.6% of GDP at the end of 2021 to 171.3% at the end of 2022 ([22]). This decline was driven primarily by the increase in nominal GDP, and the primary surplus had a minor contribution too. Government debt is projected to decline further to 160.2% in 2023 and to 154.4% in 2024 on the back of further improving fiscal balances, economic growth and still high inflation. In a baseline scenario, this positive trend is projected to continue in the medium term and the debt ratio is expected to fall to 126.1% of GDP in 2033. The downward trajectory of the debt ratio continues to hinge crucially on prudent fiscal policy.

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

([22]) Senior notes issued so far in the context of the Hellenic Asset Protection Scheme and guaranteed by the Greek government are not to be added to government debt. According to the new statistical rules, the classification of such debt securities as government debt or private debt depends on the overall risk born by each party. However, this methodology will be implemented only for those securitisation operations that materialize after 1 February 2023.

Graph 5.2: Redemption profile of general government debt



Source: Commission services.
Note: Short-term debt (T-bills and repos) are not included in the graph.

Greece retains the capacity to service its debt. Greece's financing needs in the coming years are low. In December 2022, Greece successfully prepaid EUR 2.6 billion of the Greek Loan Facility (GLF), which was originally due in 2023. This contributes to the low financing needs in 2023: Greece has only about EUR 7 billion long-term debt to amortise, which includes a repayment of EUR 1.7 billion to the EFSF. By the end of April 2023, most of the repayments due in 2023 have already been executed. In 2024-2025 debt amortisation remains low, about EUR 9 billion each year. This includes the scheduled repayment of EUR 2.6 billion of the GLF, another EUR 1.7 billion for the EFSF and in 2025 also EUR 1 billion amortisation of the loans provided under the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency. 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.

ANNEX 1
Main macroeconomic and financial indicators

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

	2019	2020	2021	2022	2023	2024
Real economy		*(percentage change)*				
Real GDP	1.9	-9.0	8.4	5.9	2.4	1.9
Domestic demand incl. inventories	1.1	-3.4	7.2	8.2	1.8	1.4
Private consumption expenditure	1.9	-7.7	5.8	7.8	1.6	1.4
Government consumption expenditure	2.1	2.6	2.2	-1.6	-0.2	-1.4
Gross fixed capital formation	-2.2	1.1	20.0	11.7	7.2	6.0
Exports of goods and services	4.9	-21.5	24.1	4.9	6.5	5.2
Imports of goods and services	2.9	-7.3	17.7	10.2	4.7	3.8
Contribution to growth		*(percentage change)*				
Domestic demand excl. inventories	1.5	-4.7	6.9	6.5	2.1	1.6
Foreign trade	0.7	-5.6	0.7	-3.0	0.5	0.4
Changes in inventories	-0.3	1.3	0.8	2.4	-0.1	-0.1
Inflation		*(percentage change)*				
GDP deflator	0.2	-0.9	1.3	8.1	4.7	2.9
HICP	0.5	-1.3	0.6	9.3	4.2	2.4
Labour market		*(percentage change, unless otherwise stated)*				
Unemployment rate (% of labour force)	17.9	17.6	14.7	12.5	12.2	11.8
Employment	2.2	-1.8	2.7	3.8	0.8	0.7
Compensation per employee	-0.3	-0.6	2.3	0.3	3.6	2.8
Labour productivity	-1.2	-7.3	5.0	1.8	0.6	1.3
Unit labour costs	1.0	7.2	-2.6	-1.5	3.0	1.4
Public finance		*(percentage of GDP)*				
General government balance	0.9	-9.7	-7.1	-2.3	-1.3	-0.6
Total revenue	49.0	50.4	50.6	50.2	47.7	46.5
Total expenditure	48.1	60.1	57.7	52.5	49.0	47.2
General government primary balance	3.9	-6.7	-4.7	0.1	1.9	2.5
Gross debt	180.6	206.3	194.6	171.3	160.2	154.4
Balance of payments		*(percentage of GDP)*				
Current external balance	-1.5	-6.6	-6.8	-9.7	-7.3	-6.0
Ext. balance of goods and services	-0.9	-6.8	-7.6	-9.4	-7.6	-6.4
Exports goods and services	39.6	31.2	40.9	48.6	50.4	51.9
Imports goods and services	40.5	38.0	48.6	58.0	58.0	58.3
Memorandum item		*(EUR bn)*				
Nominal GDP	183.4	165.4	181.7	208.0	223.1	233.9

Source: European Commission.

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 spring forecast.

A.1. SHORT-TERM RISKS

Short-term risks to fiscal sustainability are low overall. 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 but remains below investment grade reflecting the financial markets' perceptions of sovereign risk.

A.2. MEDIUM-TERM RISKS

Medium-term fiscal sustainability risks for Greece appear high overall.

The DSA for Greece, under the baseline, shows that the government debt-to-GDP ratio is expected to decline but remain at a high level over the medium term (at 126.1% in 2033) (Graph 1) ([24]) ([25]). The assumed structural primary balance (SPB) (a surplus of 2.1% of GDP) supports these developments, and it appears ambitious compared with past fiscal performance, suggesting limited room for policy action ([26]). At the same time, the baseline projections up to 2033 benefit from a still favourable snowball effect, notably thanks to the impact of Next Generation EU (NGEU), with real GDP growth at around 0.8% of GDP over 2025-2033. Government gross financing needs are expected to remain broadly stable over the projection period; they are projected at around 11.5% on average over the projection period, slightly above the level forecast for 2024.

The baseline projections are stress-tested against four alternative scenarios to assess the impact of changes in key assumptions (Table A21.1, Graph 1). For Greece,

([23]) The S0 is a composite indicator of short-term risk of fiscal stress. It is based on a wide range of macro-financial and fiscal variables that have proven to perform well in the past in detecting situations of upcoming fiscal stress.

([24]) The assumptions underlying the Commission's 'no-fiscal policy change' baseline notably comprise: (i) a structural primary surplus, before ageing costs, of 2.1% of GDP as of 2024; (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 from now); (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 spring forecast until 2024, followed by 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]) Table 1 shows the baseline debt projections and its breakdown into the primary balance, the snowball effect (the combined impact of interest payments and nominal GDP growth on the debt dynamics) and the stock-flow adjustment.

([26]) This assessment is based on the consolidation space indicator, which takes into account all available data from 1980 to 2021. The structural primary balance of +2.1% of GDP would be considered much less ambitious if compared with a shorter time horizon, for instance of the last 15 years.

reverting to historical fiscal trajectories under the 'historical structural primary balance' scenario would support the reduction of the government debt ratio. If the SPB gradually converged to its historical 15-year average (3.3% of GDP), the projected debt-to-GDP ratio would be about 8 pps. lower than in the baseline in 2033. A permanent worsening of the macro-financial conditions, as reflected under the 'adverse interest-growth rate differential' scenario (i.e. 1 pp. higher than the baseline) would result in a persistently higher government debt-to-GDP ratio, by around 10% of GDP by 2033, as compared with the baseline. A temporary worsening of financial conditions, as reflected in the 'financial stress' scenario (i.e. temporarily increase of interest rates by 5.9 pps.), would lead to a slightly higher public debt-to-GDP ratio by 2033 (around +9% of GDP) compared with the baseline. The 'lower structural primary balance' scenario (i.e. the forecast improvement in the SPB over 2023-2024 is reduced by half of the cumulative forecast change) would also lead to a significantly higher government debt-to-GDP ratio by 2033 (about +11% of GDP) compared with the baseline.

Stochastic projections show a medium sensitivity of these projections against plausible unforeseen events ([27]). These stochastic simulations point to a 10% probability of the debt ratio in 2027 being greater than in 2022, entailing medium risk given the initial high level of debt. In addition, such shocks point to significant uncertainty (i.e. the difference between the 10th and 90th debt distribution percentiles) surrounding the government debt baseline projections (Table A21.1, Graph 2).

A.3. LONG-TERM RISKS

Long-term fiscal sustainability risks for Greece appear low overall ([28]).

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 decrease in ageing-related costs (contribution of -1.8% of GDP) and a favourable initial budgetary position (-0.9% of GDP). Ageing costs' developments are primarily driven by the projected decrease of public pension expenditure (contribution of -1.9% of GDP), which is only partly offset by the projected increase health care spending (contribution of +0.6% of GDP) (Table A21.1, Table 2).

When combined with long-term debt vulnerabilities, as highlighted by the S1

([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, therefore excluding tail events.

([28]) The S2 fiscal sustainability indicator measures the permanent SPB adjustment in 2024 that would be required to stabilise public debt over the long term. It is complemented by a revised S1 indicator, which measures the fiscal gap in 2024 to bring the debt-to-GDP ratio to 60% in the long-term. For both S1 and S2 indicators, the risk assessment depends on the amount of fiscal consolidation needed: 'high risk' if the required effort exceeds 6 pps. of GDP, 'medium risk' if it lies between 2 pps. and 6 pps. of GDP, and 'low risk' if the effort is negative or below 2 pps. of GDP. The overall long-term risk classification brings together the risk categories derived from S1 and S2. S1 may notch up the risk category derived from S2 when it signals a higher risk than S2. See the 2022 Debt Sustainability Monitor for further details.

indicator, overall long-term risks are assessed as low. Indeed, the S1 sustainability gap indicator (at -1.5% of GDP) signals 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 very favourable initial budgetary position (contribution of -2.4 pps.) and the projected decline in ageing-related public spending (contribution by -1.1% of GDP). However, the current distance of the Greek government debt ratio from the 60% reference value partially reduces the fiscal space (contribution of +2.0% of GDP) (Table A21.1, Table 2). This assessment is conditional to the country maintaining a high structural primary balance over the long term.

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. Significant contingent liability risks continue to stem from the still relatively high share of 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. 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 NGEU/RRF, if fully implemented, could have a further positive impact on GDP growth in the coming years, and therefore further mitigate the debt sustainability risks.

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

Table 1. Baseline debt projections	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Gross debt ratio (% of GDP)	**206.3**	**194.6**	**171.3**	**160.2**	**154.3**	**149.2**	**144.8**	**140.2**	**135.1**	**130.4**	**126.1**	**122.1**	**118.3**	**126.1**
Changes in the ratio	25.7	-11.7	-23.3	-11.0	-5.9	-5.1	-4.4	-4.6	-5.1	-4.7	-4.3	-4.0	-3.8	7.8
of which														
Primary deficit	6.7	4.7	-0.1	-1.9	-2.5	-2.6	-2.7	-2.7	-2.7	-2.7	-2.8	-2.7	-2.7	-2.9
Snowball effect	22.6	-16.0	-22.2	-8.3	-4.3	-2.9	-2.2	-1.6	-1.3	-0.8	-0.4	0.0	0.2	-0.1
Stock-flow adjustments	-3.6	-0.4	-0.9	-0.8	1.0	0.4	0.3	-0.6	-1.1	-1.2	-1.2	-1.2	-1.3	10.8
Gross financing needs (% of GDP)	17.8	18.9	13.3	9.6	11.0	10.0	11.3	11.5	11.6	11.5	11.8	12.0	11.6	13.8

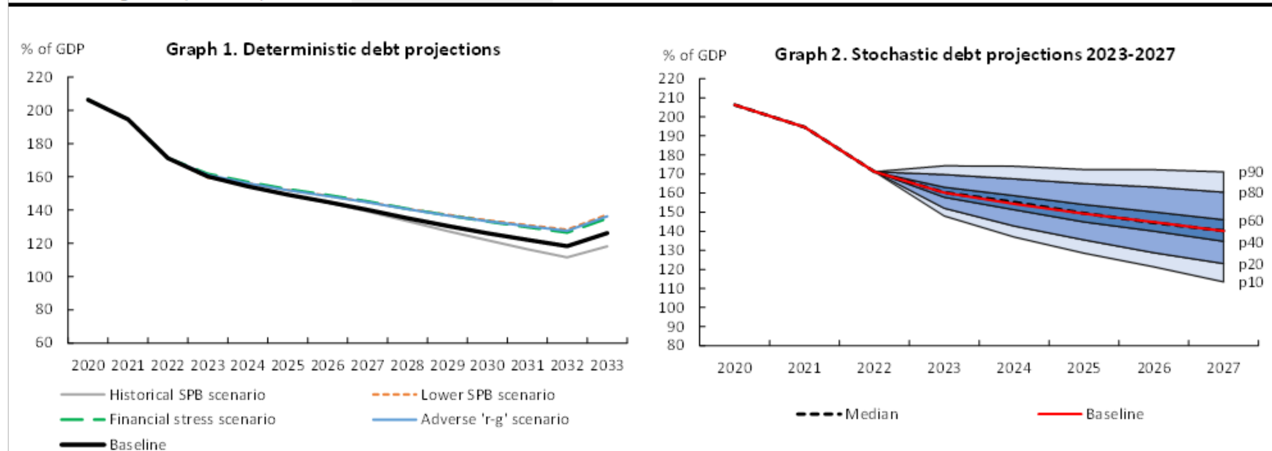


Table 2. Breakdown of the S1 and S2 sustainability gap indicators

		S1	S2
Overall index (pps. of GDP)		**-1.5**	**-2.8**
of which			
Initial budgetary position		-2.4	-0.9
Debt requirement		2.0	
Ageing costs		-1.1	-1.8
of which	*Pensions*	-1.2	-1.9
	Health care	0.5	0.6
	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		
Overall (S0)	Overall		Deterministic scenarios: 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 (2033), % GDP	126.1	118.2	137.2	136.3	135.0				
		Debt peak year	2022	2022	2022	2022	2022				
		Fiscal consolidation space	23%	22%	38%	23%	23%				
		Probabilty of debt ratio exceeding in 2027 its 2022 level						10%			
		Difference between 90th and 10th percentiles (pps. GDP)						57.7			

(1) *Debt level* in 2033. 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 2027 its 2022 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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