GREECE

Highlights

- **The economy is stabilising but investment and confidence levels remain weak.** After another decline in output in 2015, quarterly growth has resumed in the second quarter of 2016 and fiscal performance is on track, but there are no signs yet of a rapid turnaround.
- **Important reforms have advanced.** Progress has been made on all four areas of the agreement with international creditors, namely: enhancing fiscal sustainability; safeguarding financial stability; enhancing growth, competitiveness and investment; and building a modern state and public administration.
- **The banking sector has been successfully recapitalised.** The country's four systemic banks all completed their recapitalisation in late 2015 and are currently undergoing restructuring programmes to divest their non-core assets and enhance their operational efficiency.

Key priorities for 2017

- **Macroeconomic stability must be retained.** The government has made commendable progress in meeting fiscal targets and improving the fiscal policy mix. It will be important for macroeconomic credibility to stick to agreed targets and effectively implement new tax and spending measures.
- **Energy sector reforms should be advanced.** This is an area where Greece has major potential but where wide-ranging reforms are acknowledged to be necessary. A key step would be the full unbundling of the electricity transmission system operator, ADMIE, from the incumbent state-owned power operator Public Power Corporation (PPC) by early 2017.
- **Further progress is needed on privatisation.** The setting-up of a new privatisation fund, currently under way, will be an important step forward, but the new body's effectiveness in delivering results, once it is fully established, is yet to be tested.

Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	-7.3	-3.2	0.4	-0.2	0.0
Inflation (average)	3.1	0.4	-0.3	-1.5	-1.0
Government balance/GDP	-5.8	-4.4	-0.2	-1.4	-0.5
Current account balance/GDP	-5.6	-4.5	-4.6	-3.6	-0.9
Net FDI/GDP [neg. sign = inflows]	-0.4	-1.5	-0.3	0.3	-1.1
External debt/GDP	241.8	245.2	221.8	246.5	n.a.
Gross reserves/GDP*	n.a.	n.a.	n.a.	n.a.	n.a.
Credit to private sector/GDP	116.0	117.7	116.5	112.6	n.a.

*Greece is a member of the Euro area

CONTINUES

Macroeconomic performance

The economic situation remains very difficult, but signs of stabilisation are apparent. The year 2015 was another difficult one for the Greek economy. The escalation of the crisis in July 2015, with the introduction of a three-week bank holiday and the imposition of capital controls, led to a drop in economic activity in the second half of the year. On the positive side, tourism numbers held up well, reaching record levels in 2015. Overall growth in 2015 is estimated at -0.2 per cent, much better than expected given all the mid-year uncertainties. The economy continued to decline on a year-on-year basis in the first half of 2016, influenced by high base effects from the equivalent period in 2015, but quarterly growth resumed in the second quarter, with output rising 0.3 per cent quarter-on-quarter. In December 2015, the economy finally emerged from 33 months of deflation, with the inflation rate positive at 0.4 per cent year-on-year, and it stood at 0.4 per cent year-on-year in August 2016. Unemployment remains a major problem at around 23 per cent of the labour force, with youth unemployment close to 50 per cent.

New fiscal targets have been set. Greece experienced a primary surplus in 2015, of 0.7 per cent of GDP (excluding the one-off cost of bank recapitalisation), exceeding the Memorandum of Understanding (MoU) target of -0.25 per cent. The government has agreed with international creditors to target primary surpluses of 0.50, 1.75 and 3.50 per cent of GDP in 2016, 2017 and 2018, respectively, with the 3.50 per cent surplus being maintained over the medium term. These targets should be achieved by a combination of new measures to raise revenues and others to contain spending (that is, personal income tax reform, changes in the VAT rate, public sector wage adjustments, motor vehicle taxation and additional consumption taxes), along with a comprehensive programme to strengthen tax compliance and fight tax evasion, as well as the introduction of pension reform. Overall public debt is around 180 per cent of GDP and is judged by the International Monetary Fund (IMF) to be unsustainable. At the same time, much of this debt is on lengthy repayment schedules (in excess of 30 years) and with significant grace periods; hence, the debt repayment profile in the short term is correspondingly moderate. Subject to further progress with reforms and political consensus among Greece's creditors, it is envisaged that further restructuring (for example, maturity lengthening and possibly interest rate reductions) of this debt may be granted in the future.

Significant short-term uncertainties remain. Prospects for a quick recovery are weak, given the lack of investment in recent years and the need for further short-term austerity measures to put the debt profile on a sustainable path. For 2016, growth will likely be around 0 per cent; however, quarterly growth has already turned positive again in the second quarter. GDP growth is expected to pick up in 2017 to 2.0 per cent. Potential growth drivers in the short term include disbursement of EU structural funds (up to €7 billion), the clearance of public arrears to the private sector, progress in non-performing loan (NPL) resolution, and some resumption of private sector investment. The fiscal tightening is a headwind to growth in the short term because of the need to aim for primary surpluses. Downside risks to the forecast could arise from delays in implementing the MoU and completing reviews on time, which would be damaging to confidence.

Major structural reform developments

Significant reforms have been introduced in the past year, albeit with some delays. An MoU was agreed between Greece and the European Commission (the latter acting on behalf of the European Stability Mechanism) in August 2015 on a Third Economic Adjustment programme. Under the MoU, the then-government committed to an ambitious reform agenda focused on four areas: restoring fiscal sustainability; safeguarding financial stability; enhancing growth, competitiveness and investment; and building a modern state and public administration. Progress has been made on all fronts and, after some delays, an agreement was reached at staff level on the first review of the programme in May 2016. As a result, a second tranche of European Stability Mechanism (ESM) assistance (€10.3 billion) was authorised in June 2016. Part of this tranche (€7.5 billion) was disbursed in June and a further tranche of €2.8 billion (in two parts) in October.

CONTINUES

A new privatisation fund is being established and important sales have progressed. While the privatisation process was effectively stalled for most of 2015, some progress occurred in the latter part of the year and in 2016. A flagship deal to award a 40-year concession worth €1.2 billion to the German company Fraport, to run 14 regional airports was ratified by parliament in May 2016, and the transfer of operations is expected to be completed by November 2016. Another important deal was the sale of a 67 per cent stake in Piraeus port to the Chinese consortium Cosco Shipping Group, which was completed in August 2016. The train company Trainose was privatised in July 2016. A number of other sales are in the pipeline. From late 2016, all privatisations will be managed by a new privatisation and investment fund, the Hellenic Corporation of Assets and Participations (HCAP). The Board of HCAP consists of five members: three chosen by the Greek government and two chosen by the European Stability Mechanism.

Product markets are being reformed. The extent of regulation and restrictive practices in the economy remains high in comparison to other EU countries, but efforts have been made in recent years to improve the situation. Among other measures introduced in the past year, the authorities have adopted a variety of recommendations from the OECD's Competition Assessment Toolkit. These measures have led to the opening up of previously highly regulated and closed professions. Nevertheless, Greece's business environment is still weak, as evident in the country's latest ranking in the World Bank's *Doing Business 2017* report: at 61st out of 190 economies, the country's ranking is among the lowest in the European Union, with registering property and enforcing contracts particularly challenging areas.

Energy sector reforms are advancing. The government has acknowledged that energy markets in Greece need wide-ranging reforms to bring them in line with EU standards. As part of these reforms, the government has committed to fully unbundle the electricity transmission system operator, ADMIE, from the incumbent state-owned power operator Public Power Corporation (PPC). On 12 July 2016, the PPC launched an international public tender for the acquisition of 24 per cent of shares of ADMIE by a preferred strategic investor, to be selected through a tender process. This process is part of the complete ownership unbundling of ADMIE. Gas market liberalisation has also advanced, with complete liberalisation envisaged by 1 January 2018.

Financial stability is being restored in the banking sector. An asset quality review (AQR) by the European Central Bank in summer 2015 identified a capital shortfall of €14.4 billion in the four main banks, which collectively have an asset share of more than 90 per cent of the Greek banking market. In November 2015, the four banks successfully completed their recapitalisation, raising €9.0 billion from new sources and the remaining €5.4 billion (for two of the banks) from the Hellenic Financial Stability Fund. The banking system as a whole turned profitable in the first quarter of 2016 for the first time since 2011. The banks are currently undergoing restructuring programmes and are addressing the overhang of NPLs, which accounted for 35.4 per cent of total loans as of the first quarter of 2016. Deposits in the banking system have stabilised in 2016 but remain at low levels, partly because of ongoing capital controls. In July 2016, capital controls were further relaxed; among other measures, cash withdrawal limits for funds transferred from abroad have been increased; and restrictions on early loan repayments have been removed.

The social security system is being overhauled. The economic crisis of the past eight years has put an enormous strain on social welfare and cohesion and has intensified the need for a major overhaul of the system to ensure fairness, sustainability and protection for vulnerable groups. The pension system is undergoing a comprehensive reform. Measures introduced in the past year include a significant reduction in early retirement rights, an increase in healthcare contributions and the move to a unified system for all new retirees.