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Enhanced Surveillance update - Greece, September 2021

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BACKGROUND

Economic developments and policies in Greece are monitored under the European Semester for economic policy co-ordination and under the enhanced surveillance framework according to Articles 2 and 3 of Regulation (EU) No 472/2013 ([1]). The implementation of enhanced surveillance for Greece ([2]) acknowledges the fact that Greece needs to continue implementing measures to address the sources or potential sources of economic and financial difficulties, while implementing structural reforms to support a robust and sustainable economic growth.

Enhanced surveillance provides a comprehensive framework for monitoring economic developments and the pursuit of policies needed to ensure a sustainable economic recovery. It allows for a regular assessment of recent economic and financial developments in Greece, as well as for monitoring sovereign financing conditions and updates of the debt sustainability analysis. Enhanced surveillance also provides the framework for assessing the general commitment given by Greece to the Eurogroup of 22 June 2018, to continue and complete reforms adopted under the European Stability Mechanism programme and to ensure that the objectives of the important reforms adopted under the financial assistance programmes are safeguarded. In that context, enhanced surveillance monitors the implementation of specific commitments to complete key structural reforms started under the programme, in six key areas by agreed deadlines up to mid-2022, namely: (i) fiscal and fiscal-structural policies, (ii) social welfare, (iii) financial stability, (iv) labour and product markets, (v) Hellenic Corporation of Assets and Participations and privatisation, and (vi) the modernisation of public administration ([3]).

This is the eleventh enhanced surveillance report for Greece. The report is based on the findings of a mission held remotely on 15 July 2021 and regular dialogue with the authorities. The mission was conducted by the European Commission in liaison with the European Central Bank ([4]); the International Monetary Fund participated in the context of its Post-Programme Monitoring framework, while the European Stability Mechanism participated in the context of its Early Warning System and in line with the Memorandum of Understanding of 27 April 2018, on working relations between the European Commission and European Stability Mechanism. The current report assesses the implementation of Greece's commitments to the Eurogroup regarding reform completion due up to mid-2021. This report is not linked to a release of the next set of policy-contingent debt measures, which – in line

([1]) Regulation (EU) No 472/2013 of the European Parliament and the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, OJ L140, 27.5.2013, p. 1.

([2]) Commission Implementing Decision (EU) 2021/1279 of 28 July 2021 on the prolongation of enhanced surveillance for Greece.

([3]) https://www.consilium.europa.eu/media/35749/z-councils-council-configurations-ecofin-eurogroup-2018-180621-specific-commitments-to-ensure-the-continuity-and-completion-of-reforms-adopted-under-the-esm-programme_2.pdf.

([4]) ECB staff participated in the review mission 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. The review mission was preceded by a technical mission, also held remotely, from 1 to 7 July 2021.

with the agreed biannual schedule – could take place on the basis of the twelfth report. The twelfth report is expected to be published in November.

The commitments given by Greece to Eurogroup partners in June 2018, which are the basis for the release of additional debt relief measures, were established up to mid-2022 and thus Greece has entered the final year of this arrangement. Whilst many commitments have been completed, the mission sought to clarify the scope and timeline for completion of the outstanding reform commitments.

OVERALL ASSESSMENT

The economy shows signs of an earlier-than-expected recovery, in spite of the later-than-planned opening. Following the large downturn of 8.2% in 2020, real GDP increased by 4.5% and 3.4% on a quarter-on-quarter basis in the first and second quarter of 2021 respectively, driven by investments and accumulation of inventories. According to the Commission 2021 Summer interim forecast, GDP is forecast to increase by 4.3% in 2021 and by 6.0% in 2022, taking into account the investment impetus from the recovery and resilience plan, as well as the fiscal stimulus from the government support measures. Fiscal policy remains accommodative as the authorities continue to provide targeted and temporary support to the economy, including in response to the catastrophic fires that affected the country in August. Employment support measures, supported notably through the EU instrument to 'Support to mitigate Unemployment Risks in an Emergency (SURE), continued propping up the labour market and, along with the relaxation of the healthcare restrictions and the restart of the tourist season, supported a further decrease in the unemployment rate to 15.9% in the second quarter of 2021 compared to 17.1% in the second quarter of 2020. The vaccination campaign continues to progress; however, the uncertainty surrounding the outlook remains high in particular in relation to the recent upsurge of COVID-19 cases over the summer due to the spread of new variants of the coronavirus.

The recently adopted recovery and resilience plan will play a key role in helping Greece emerge stronger from the COVID-19 pandemic. Greece's recovery and resilience plan was among the first plans that were formally approved by the Council, on 13 July, following a positive assessment by the European Commission on 17 June. Greece received a disbursement of €3.96 billion in pre-financing on 9 August. The plan, which presents measures to mobilise €17.8 billion in grants and €12.7 billion in loans, represents a significant effort by Greece to address the challenges it faces. It includes many climate-relevant investments and will provide a boost to digitalisation and a large number of reforms building on past and ongoing efforts. Greece was also the first Member State to finalise its Partnership Agreement for the 2021-2027 programming period. The Partnership Agreement, adopted by the Commission on 29 July 2021, sets out the strategic orientation for deploying of more than €21 billion worth of investments to support Greece's economic, social and territorial cohesion.

Reform implementation continued at a good pace across a number of policy areas, with a number of specific policy commitments completed in the current reporting period. Notably:

- Important and material progress has been achieved as regards **privatisations**, notably by closing the transaction on the iconic Hellinikon project and by selecting a preferred investor on the Egnatia concession and the Public Gas Corporation (DEPA) Infrastructure transaction. The work of the **Hellenic**

Corporation of Assets and Participations is progressing as regards the preparation of the update of its strategic plan and the performance contract for the Athens Urban Transport Organisation.

- The supplementary wage grid for the **Independent Authority of Public Revenue**, adopted in the context of the 10th report, has been successfully rolled-out to a significant number of its staff, thus completing the specific commitment in the area of tax administration.

- Despite long delays in the tendering procedure, the contract regarding the full deployment of the relevant IT system to support the **investment licensing framework** was recently signed, thus fulfilling this specific commitment.

- The contract for the development of the **National Gateway for Codification and Reform of Greek Legislation** has been awarded, effectively closing this specific commitment. The contract has a long implementation phase of 36 months and is EU-funded through the National Strategic Reference Framework.

Progress continued well also in other areas covered by specific commitments and the authorities committed to ensure their implementation according to agreed timelines. More specifically:

- The end-to-end IT collection system for the **tax administration**, a mid-2021 specific commitment, is in a testing phase and the final system is expected to be in place by end-2021, broadly in line with what was expected in the 10th report.

- As regards health and social care, the collection of **clawback**, i.e. spending over and above the legislated ceiling for public spending on pharmaceuticals and other healthcare services that is due to be collected back from healthcare providers, is now progressing broadly according to schedule, following delays due to the pandemic. The authorities are advancing with the adoption of the primary legislation establishing a Personal Assistance scheme for persons with **disabilities** based on a new functionality-based disability assessment approach, with secondary legislation to follow by the end of the year.

- As regards the business and investment environment and following the set of legislations adopted in April 2021, the authorities adopted further primary legislation in June 2021 to reform the **licensing of economic activities** in all agreed sectors. This is a welcome step. Nonetheless, the authorities are encouraged to strengthen the pace of the adoption of ministerial decrees necessary to implement the April and June laws, which is necessary to make the new provisions fully operational. The implementation of the road map for the completion of the **cadastre** project progresses satisfactorily, with moderate delays on the ratification of forest maps. The European institutions welcome that the authorities adopted a new cadastral law, which aims to accelerate cadastral mapping and property transfer procedures. Following the recent labour reform, the authorities are expected to present an initial draft of a new Labour Code by early 2022, with a view to enhancing legal certainty and access to law through **legal codification**.

- In the area of **justice**, the authorities have made good progress on the specific commitment on electronic e-filing in the current reporting period. Greece's recovery and resilience plan includes a number of welcome follow-up measures that will further pursue and broaden the objectives of this reform.

- Regarding **the fight against corruption**, the authorities have put forward measures to address the remaining recommendations by the Group of States against Corruption (GRECO), a specific commitment, progressively by April 2022.

- The authorities progressed with the master plan for the development of the **Olympic Athletic Centre** (OAKA). Further work will be needed to ensure that the plans for the site guarantee its long-term financial sustainability.

The authorities advanced on a number of broader structural reforms initiated in the context of enhanced surveillance. Notably:

- A new comprehensive law on **school education** was adopted in Parliament in August 2021 and will be applied in the current academic year 2021-22. This reform brings a number of important innovations as regards schools' autonomy, organisational changes and teachers' evaluation.

- The authorities prepared a detailed action plan, through technical support provided by the European Commission, to strengthen the **hiring process for civil servants**. The implementation of the plan will be monitored under Greece's recovery and resilience plan.

- The authorities adopted a new national **public procurement strategy** for 2021-2025, with key initiatives including the digitalisation of public procurement processes, introduction of modern tools and e-services and improvements in governance and control framework.

- Last but not least, the authorities continue making steady progress on **e-governance**, notably as regards the ongoing development of the gov.gr portal and securing the robustness of public sector systems. The actions in this area will be also supported under Greece's recovery and resilience fund.

In some areas, progress has been slower than expected in the 10th report. Notably, the pace of **arrears clearance** has not picked up. The total stock of arrears stood at around €900 million, exceeding the end-July overall target (around €500 million) by nearly 80%. This significant deviation raises concerns, especially given the extensive reassessment of clearance targets undertaken in the context of the 10th report. The current delay makes the target to materially clear the stock of non-pension arrears, which was due in June 2021, challenging to be met even by end-September. The authorities are invited to accelerate the implementation of all actions that facilitate the arrears clearance and prevent the accumulation of new ones, in order to avoid any future slippages from the agreed targets. It is nevertheless encouraging that the implementation of the recommendations of the Hellenic Court of Auditors on arrears clearance continues as planned and that the authorities identified proposals for the simplification of certain fiscal procedures, the majority of them to be adopted by October and December 2021. The authorities have overall made significant progress on the **reform of the inspection framework** but the last remaining element from

the priority areas followed under enhanced surveillance, namely primary legislation and implementing decrees on inspections in the area of environmental protection, has suffered delays on account of ongoing wider environmental reform with respect to the May 2021 timeline that was expected in the 10th report. The authorities committed to completing the inspection reform by the end of October 2021. In the area of **justice**, the work on the establishment of JustStat units is progressing slower than expected and the call for tenders for the integrated case management system for civil and criminal cases remains yet to be launched. Following the adoption of a number of major education laws in 2021, the law on **higher education**, is now expected to be adopted by the end of 2021, somewhat later than envisaged. In the area of **health care**, centralised health procurements are ongoing but the adoption of the new legislative framework for the National Centralised Health Procurement Authority (EKAPY) has slipped to the next review. The revision of the law on primary healthcare is progressing, although key elements such as gatekeeping and compulsory patient registration are still being defined, and progress was also made on hiring new general practitioners. The authorities committed to completing the draft and putting it to public consultation by mid-October.

The impact of the pandemic on the financial sector has been moderate so far, thanks to the measures put in place by the Greek authorities and at the euro area level. Implementation of agreed policy actions has resumed but progress is overall slower than expected. The non-performing loan ratio in the first quarter of 2021 remained at 30%, similar to the end of 2020 level, but the trend of a continuous improvement is expected to restart in the next quarters on the back of further sizable securitisations under the Hercules scheme. The initial signs from the use of the new **insolvency framework** implemented in the context of the 10th report are encouraging but it is too early to assess the effectiveness of the new framework. The concessionary process for the setup of the sale and lease-back entity for vulnerable debtors has been further delayed, with its establishment not expected before mid-2022, without affecting, however, other parts of the insolvency framework. The processing of the **backlog of household insolvency cases**, an end-2021 specific commitment, has resumed but is likely to take longer than initially expected on account of several months of court suspensions related to the pandemic and a low case-processing capacity in a number of courts. Regarding the conduct of **e-auctions** and other enforcement proceedings, the welcome and significant steps included in the revised (draft) Code of Civil Procedure will come into force later than expected, on 1 January 2022, which is unfortunate considering the earlier assurances that the Code would enter into force by mid-September 2021. The authorities have launched additional steps to increase the efficiency of certain procedural aspects of e-auctions in 2022. Delays in the clearance of the **backlog of called state guarantees** have continued in the second quarter of 2021, leading to a downward revision of the 2021 clearance target. While recent data provided encouraging signs of an acceleration, meeting the revised targets remains challenging. The European institutions welcome the adoption of the necessary secondary legislation to ensure full operationalisation of the **deferred tax credits framework** in July 2021, to enable the use of deferred tax credits in case of bank losses, and that the relevant primary law will be amended shortly to further facilitate securitisations and sales of non-performing loans.

The authorities indicated that completion of a number of specific commitments and other important reforms is in reach in time for the 12th report. More specifically:

- As regards fiscal structural reforms, the implementation of the 1st level of the functional classification, which constitutes a mid-2021 specific commitment in the

area of the **Chart of Accounts**, is on track for completion in time for the adoption of the 2022 budget. The end-to-end IT collection system, a mid-2021 specific commitment in the area of **tax administration**, is in a testing phase with a view to becoming fully operational by end-October 2021. Legislation is expected in November 2021 to implement a major reform for 2022 of the ENFIA property tax with the wider base provided by the new market-related property tax values, a specific commitment.

- In the area of **energy**, an anti-trust remedy has been agreed with the authorities. The successful implementation thereof, through adopting the relevant regulatory and corporate measures, will complete this specific commitment.

- The specific commitment to complete the integrated human resources management system for the **public administration** is expected to be closed also by October 2021, following the recent completion of interconnections between records on each jobholder collected by the census of public officials, the Single Payment Authority and the human resources department. The authorities have also completed the assessment of existing temporary staff categories and committed to set an annual ceiling for temporary staff by October 2021, to be applied as of 2022. The European institutions encouraged the authorities to complete the process for the appointment of the permanent secretary for education the soonest possible.

- Despite minor delays, the authorities are progressing well to operationalise the **Strategic Projects Pipeline** and the **Project Preparation Facility**, both of which will play a critical role in the implementation of Greece's recovery and resilience plan. The entities are expected to be fully operational by the time of the 12th report, including the first Development Programme of Contracts of Strategic Importance and a launch of the tender process for framework contracts for consultants for projects assigned for maturation through the Project Preparation Facility. The authorities are also expected to complete the adoption of the remaining secondary legislation identified as critical for the operationalisation of the new law on **public procurement**, following steady progress over the past months.

- Discussions have started on the future of the **Hellenic Financial Stability Fund**, a specific commitment. A legal amendment, touching upon the duration, governance, divestment strategy and special rights of the Fund, is expected to be adopted by October 2021. It is noted that the nomination process for the post of the Fund's Deputy Chief Executive Officer has encountered delays. Preserving the Fund's independence and respecting the selection process as set out in the law remains essential.

Overall, this report concludes that Greece has taken the necessary actions to achieve its due specific commitments, despite the challenging circumstances caused by the pandemic. The authorities delivered on specific commitments across various areas, including privatisations, improving the business environment and tax administration, while advancing on wider structural reforms including in the area of school education and public administration. The European institutions welcome the close and constructive engagement in all areas and encourage the authorities to keep up the momentum and, where necessary, reinforce the efforts to remedy the delays partly caused by the pandemic, in particular as concerns financial sector reforms and arrears clearance.

MACROECONOMIC DEVELOPMENTS

Following the large downturn of 8.2% in 2020, the Greek economy started to recover in the first half of the year. Real GDP increased by 4.5% and 3.4% on a quarter-on-quarter basis (seasonally adjusted) in the first and second quarter of 2021 respectively, driven by investments and accumulation of inventories. Consumer price growth picked up in the summer reaching 1.2% in August, after several months of a decline. The developments in the first part of the year, although somewhat detached from the global inflationary pressures observed in other Member States, are primarily attributed to the impact of VAT reductions on prices of services. Employment support measures continued propping up the labour market, despite the large economic disruption brought about by the pandemic. It is estimated that in 2020, around 1.5 million workers in more than 200 000 businesses were supported by employment-support measures financed by the EU instrument to 'Support to mitigate Unemployment Risks in an Emergency (SURE), while more than 600 000 workers may benefit from the instrument in 2021. Following the relaxation of the healthcare restrictions and the restart of the tourist season, which have helped accelerate job creation, the unemployment rate in the second quarter of 2021 decreased to 15.9%, i.e. 0.4 percentage points below its level in the first quarter and more than 1 percentage point compared with a year ago. Yet, youth unemployment increased from 32.8% in the first quarter of 2020 to 41.7% in the first quarter of 2021 (latest available data). Leading indicators from 'Ergani' information system point to a further increase in employment during the summer months, signalling a potential reduction of the unemployment rate for the subsequent quarter. In parallel, the vaccination campaign continues to progress; however, the recent upsurge of cases over the summer period due to the emergence of the new delta variant has raised concerns.

According to the Commission 2021 Summer interim forecast, GDP is forecast to increase by 4.3% in 2021 and by 6.0% in 2022. Growth is expected to be domestically driven in 2021, on the back of the investment impetus from the recovery and resilience plan, as well as the fiscal stimulus from the government support measures. While international tourist arrivals recovered a considerable part of their losses with respect to 2019 levels over the summer season, notably in August, tourist receipts are forecast to remain below their 2019 levels. Goods exports are expected to keep their positive momentum, fuelled from their notable resilience during the period of the pandemic. Headline inflation is forecast at -0.4% in 2021 and 0.5% in 2022.

Greece's recently adopted recovery and resilience plan is set to strengthen private and public investment going forward. Through implementing strategic investments in the fields of green transformation, digital transition, sustainable and inclusive growth as well as other growth-enhancing actions, the plan is expected to support the economic recovery. According to the latest simulations by the Commission services, the GDP level is expected to increase by 2.1-3.3% by 2026, from the combined effect of the grants and loans component. Such simulations do not include the possible positive impact from the structural reforms envisaged under the plan, which could be substantial. Growth will also be supported by the new EU funding cycle.

The uncertainty surrounding the outlook remains high. Particularly as regards the recovery of the tourism industry, the progress with the fight against the pandemic, both at a domestic but also international level, will be a key factor. The reopening of tourism in early-May, provided a boost to the sector; however, the impact of this was partly offset by the late relaxation of travel restrictions from key source countries. Uncertainty also concerns the speed of recovery of the private sector after the expiry of the support measures. For that reason, the phasing-out of these measures will need to be carefully timed to avoid cliff effects and prohibit a surge of new bankruptcies. This also concerns the labour market and the withdrawal of the respective labour

market support schemes, which will need to be designed with an objective to keep an upsurge of lay-offs under control. The recent pick-up in input costs and the presence of supply chain bottlenecks are adding to the uncertainty regarding the inflation outlook. External geopolitical factors and a potential resurgence of migration flows remain an additional source of uncertainty. On the upside, the realisation of part of the purchases delayed from the previous year could provide an additional boost to private consumption, as suggested by high-frequency indicators of the economy.

FISCAL DEVELOPMENTS

The authorities continue to provide timely, targeted and temporary support to the economy, the re-opening of which has been more gradual than assumed in April. According to the Council opinion on the Greece's 2021 Stability Programme, the measures taken by Greece in 2020 and 2021 have been in line with the Council Recommendation of 20 July 2020 ([5]). The measures adopted by August 2021 remain currently in place and are expected to be gradually lifted in the coming period. The fiscal cost of these measures is now expected to reach 5.9% of GDP, i.e. 0.2% of GDP higher in 2021 than previously estimated. This includes a new measure that incentivises young adults to get vaccinated. The government plans to continue its support next year but on a lower scale. Apart from the already announced measures of the reduced rate of social security contributions and the reduction of the social solidarity tax for the private sector, which are included in Commission 2021 spring forecast, the authorities also decided to extend the application of lower value added tax rates in 2022 for specific goods and services in certain vulnerable sectors. In June 2021, the Council recommended that Greece, in 2022, should use the Recovery and Resilience Facility to finance additional investments in support of the recovery while pursuing prudent fiscal policy and preserving nationally-financed investment ([6]).

In response to the extensive forest fires in August, the authorities adopted a set of relief and support measures. At the end of August 2021, the authorities issued a supplementary budget, which increases the ordinary budget expenditure by 0.1% of GDP and the public investment budget expenditure by 0.2% of GDP, in order to finance the measures that provide assistance to affected households, businesses and regions. The introduced support is estimated to increase public spending by 0.3% of GDP in 2021 and 0.1% of GDP in 2022 and consists of a wide range of measures such as grants and loans, exemptions from repayment of the refundable advance provided during the pandemic, waiver of the real estate tax (ENFIA) for 2021-2023, temporary suspensions of taxes and debts obligations and support to affected local governments to help the reconstruction of their regions.

On 11 September 2021, the authorities announced a package of additional measures. Most of the measures prolong or adjust the existing support measures. More specifically, the

([5]) Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Greece, OJ C 304, 29.7.2021, p. 33–37.

([6]) Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Greece, OJ C 304, 29.7.2021, p. 33–37. Note that the general escape clause, which remains active in 2022, allows for a temporary departure from the budgetary requirements, provided that this does not endanger fiscal sustainability in the medium term. It was initially activated in March 2020 for 2020 and extended to 2021 as indicated in the Annual Sustainable Growth Strategy 2021. On the basis of the Commission's 2021 spring forecast, on 2 June the Commission considered that the conditions for the continued application of the general escape clause in 2022 and its deactivation as of 2023 are met. Country specific situations will continue to be taken into account after the deactivation of the general escape clause.

repayment rate of all 'repayable advance payments' (public support to companies affected by the pandemic, distributed in the form of loans with a conditional subsidy component) will be decreased further from the current 50-100% to 25-50%, depending on the rate of loss in turnover for each company; the short-time work scheme ('SYNERGASIA') will be extended until the end of 2021; and the temporary instalment subsidy scheme for coronavirus-affected debtors with primary residence loans (the 'Gefyra' scheme) will be extended for three additional months ([7]). In response to the recent increase in electricity prices a new subsidy scheme was announced, which will offer a discount of 30€/MWh for the first 300 kWh per month consumed until the end of the year. This measure is temporary and will benefit all households and low voltage businesses. The cost of these measures are yet to be fully specified and will be included in the Commission 2021 autumn forecast. The package also includes measures that have a fiscal impact in 2022 and will be assessed in the context of the 2022 Draft Budgetary Plan ([8]).

A new settlement scheme has been adopted for the overdue tax and social security obligations that occurred during the period of the pandemic and until end-June 2021. This new scheme amends the already adopted settlement scheme that concerns the repayment of the deferred liabilities for the period between March and June 2020. According to the previous scheme, businesses and households that were directly affected by lockdowns and labour contract suspensions, could choose to pay their deferred obligations in 24 instalments without any interest, or in 48 monthly instalments in which case an annual interest of 2.5% is charged. Given that the pandemic has lasted longer than expected at the time of the design of this scheme and that the accumulation of new overdue tax and social security debt has increased, the authorities decided to allow a longer period for the repayment of these liabilities under the new scheme. Following this modification, the eligible natural and legal persons may repay their overdue debt in a maximum of 36 or 72 instalments. Similar to the previous scheme, those who choose the shorter repayment period will not be charged any interest. In order to reduce the average number of paid instalments, the minimum monthly payments for debts over €1 000 has been increased to €50.

A reform of the auxiliary pension system was adopted by the Parliament in September 2021 and it will enter into force in 2022, at limited fiscal costs in the medium run but a sizeable fiscal impact in the long run. The authorities will create a new fully funded public pension fund that will operate as a defined contribution pension scheme for the auxiliary pensions. The new entrants to the labour market ([9]) will be automatically enrolled in this new fund, while employees who are already in the notional defined contributions system and are below 35 years of age will be allowed to choose whether they want to participate in the new fund or remain in the existing scheme. The fiscal costs of the reform in the short term reflect the diversion of future contributions of new employees towards capital accumulation in the new fund, hence the creation of a revenue gap that will need to be covered by public funds. These costs are expected to be manageable (0.1-0.2% of GDP per year) over the next decade,

([7]) The scheme's extension is subject to the Commission's approval of the amendment to the decision SA.58555.

([8]) According to the Commission 2021 spring forecast, the primary deficit monitored under enhanced surveillance is expected to reach 7.3% of GDP in 2021 and 0.5% of GDP in 2022, which is closely aligned with the projection of the authorities. The Greek Parliament also adopted the Medium Term Fiscal Strategy in July 2021, which is consistent with the Stability Programme submitted in April 2021.

([9]) New entrants hired in sectors that are already under the current notional defined contributions auxiliary system.

and can be covered by existing buffers in the social budget. However, the cost of the reform is expected to increase over time and peak at about 1% of GDP in 2070s in annual terms. The cost depends on the share of current employees insured in the existing supplementary funds who decide to move to the new fund, while the impact on the general government debt level will depend also on the investment strategy of this fund and on its sector classification ([10]).

The fiscal risks remain substantial and relate mainly to the evolution of the pandemic and to the pending court rulings. Additional fiscal costs might arise from the further prolongation of the containment measures and related fiscal support, in case the pandemic continues to evolve. Other risks stem from to the possibility of the guarantees issued as part of the support measures to be called in the coming years. Further risks relate to the pending court ruling on the retroactive pensions. Following the 2020 July Council of State ruling, the Greek State paid €1.4 billion in retroactive pension payments, but declined to recognise any remaining claims that relate to seasonal bonuses and supplementary pensions. The pending ruling of the Council of State on the retroactive compensation for cuts in the supplementary pensions and seasonal bonuses could lead to further substantial payments in case the court rules in favour of the pensioners. In addition, the pending litigation cases against the Public Real Estate Company (ETAD) continue to pose fiscal risks. Finally, the classification of the sale and lease-back entity for properties owned by vulnerable debtors is still pending. In case it is classified as a general government entity, it would result in substantial fiscal costs during the run-up phase of the entity.

SOVEREIGN FINANCING

The cash buffer remains large as the government successfully continues its bond issuance programme. The sovereign yield spreads over the German Bund have decreased further and have been hovering around 100 basis points on the 10-year tenure since end-May 2021. The favourable financing conditions continue to be supported also by the European Central Bank's accommodative monetary policy stance, including its Pandemic Emergency Purchase Programme. Greece tapped the capital markets multiple times since April 2021. In May, it raised €3 billion through the issuance of a new 5-year benchmark government bond. The achieved yield was 0.17%, with a coupon of 0%. Both are the lowest values ever achieved by a Greek bond on this maturity. In June, the books of the 10-year bond issuance of January 2021 were reopened, and €2.5 billion were raised with a yield of 0.89%. Issuance activity continued in September with the reopening of the books for the 5-year and 30-year bonds. The Public Debt Management Agency raised €1.5 billion (0.02% yield) and €1 billion (1.675% yield) respectively from those issuances. The Greek state has already exceeded its original issuance plan for 2021, raising €14 billion on the open market. In addition, approximately €2.5 billion loans were disbursed to Greece in May under the European instrument for temporary 'Support to mitigate Unemployment Risks in an Emergency' programme. The general government's cash reserves stood at around €34 billion in early July 2021 ([11]). Furthermore, in August 2021 Greece received €4 billion in pre-financing under the Recovery and Resilience Facility.

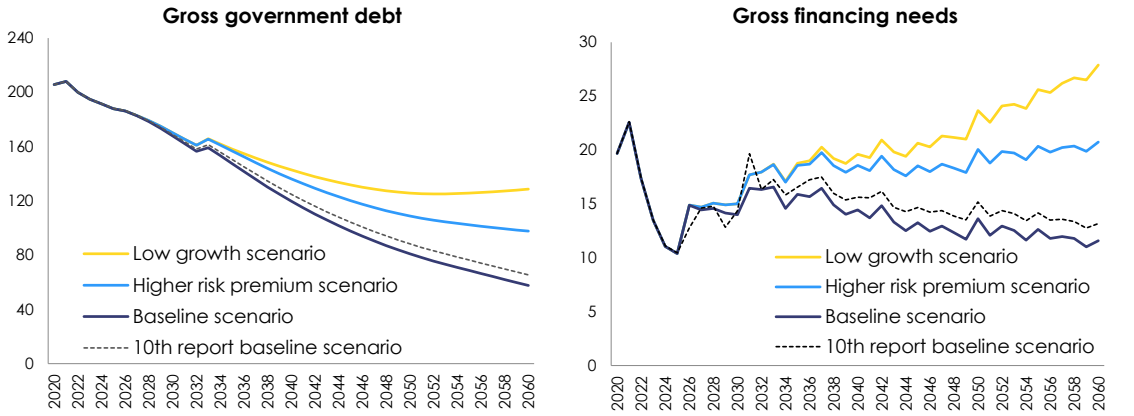
([10]) If classified within general government, the impact on public debt would be lower as the fund's holdings of Greek sovereign bonds would be consolidated within general government.

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

DEBT SUSTAINABILITY ANALYSIS

The update of the analysis indicates that debt sustainability risks remained broadly unchanged compared to the 10th report. Similarly to the assessment in the 10th report, the current update of the analysis indicates that short-term risks to debt sustainability remain contained. Risks are more significant over the longer run in the 'low growth' and 'higher risk premium scenarios'. The debt sustainability analysis continues to build on the Commission's spring forecast and has been updated with new information on forward rates and the issuances that took place since the last report. The baseline scenario has marginally improved compared to the 10th report due to the further decrease in the Greek forward rates as of mid-August, while the alternative scenarios remained broadly unchanged, as the risk free rate projections changed only marginally. In the baseline scenario, debt decreases to 57.6% of GDP by 2060, while gross financing needs remain below 15% of GDP in the long run. In the higher risk premium scenario, debt decreases to 97.6% of GDP by 2060, while gross financing needs hover around 20% of GDP from the late-2050's. In the low growth scenario, the debt level does not stabilise, and gross financing needs permanently surpass 20% of GDP from the late 2040's.

Graph 1.1: **Results of the debt sustainability analysis**



Source: Commission services

FINANCIAL SECTOR DEVELOPMENTS

The provisioning needs linked to the securitization transactions of non-performing loans have dampened bank profitability. As a result, banks have continued to record losses in the first quarter of 2021. On the positive side, net revenues increased. In particular, one-off trading revenues linked to the government bond portfolio helped, while net interest income has been resilient as a result of the lower cost of funding due to the abundant liquidity on the back of growing deposits and ample Eurosystem funding. In the case of two systemic banks, results were also bolstered by a lower cost-of-risk, as they start to reap the benefits of their non-performing loan deleveraging. At the same time, operating costs increased due to some non-recurring restructuring costs. Excluding those, operating costs declined, reflecting banks' efforts to reduce their staff and branches. Net interest margins are expected to remain under pressure by the low interest rates and the expected balance sheet clean up. The profitability prospects for the second half of 2021 will therefore be influenced by the (i) ability of banks to further reduce their provisioning needs, (ii) economic activity, which will affect the demand for new loans, and (iii) the ability of banks to find alternative sources of income. Further

reducing costs and taking advantage of the digital transition will be other key challenges in the near term.

The capital position of Greek banks at the end of the first quarter of 2021 remained broadly adequate despite the losses registered due to the pandemic, the clean-up of banks' balance sheets and the partial phase-out of transitional prudential adjustments. Banks' average Common Equity Tier 1 and Total Capital ratios stood, on a consolidated basis, at 13.6% and 15.6% of risk-weighted assets, respectively. This implies a decline with respect to the previous quarter and in comparison to end-2019 (16.2% and 17.3% respectively), as banks have frontloaded provisioning linked to the impact of the pandemic and the upcoming securitisations. The phasing out of transitional prudential adjustments ([12]) and the yearly amortisation of mostly guaranteed deferred tax assets, has also temporarily put pressure on the banks' overall capital ratio in the first quarter of 2021. Nonetheless, the recent, successful share capital increases by two systemic banks in the second quarter of 2021 ([13]), coupled with other capital enhancing actions, enable the Greek systemic banks to move forward with their ambitious non-performing loan reduction strategies. At the same time, the capital position of some less significant institutions may require close monitoring in the near term, as they also address their high level of non-performing loans. With respect to the minimum requirement for own funds and eligible liabilities (MREL), the four systemic banks have adjusted their issuance policy so as to meet the binding interim target set for 1 January 2022, as evidenced by successful issuances in the first half of 2021 ([14]).

The sovereign-bank nexus has become stronger over the last year and will require close monitoring going forward. The already high share of deferred tax credits in banks' capital is on a rising trend, reaching 65% of Common Equity Tier 1 capital in the first quarter of 2021, as banks' capital positions comes under pressure by the cost of completed and upcoming loan securitisations and the subdued profitability levels. Moreover, Greek systemic banks have gradually increased their exposure to domestic government bond holdings, from 6.4% of their total assets as of end 2018 to 10.1% as of end-2020 ([15]), although the associated risk remains contained for the time being due to the share of government bond holdings classified at amortised cost ([16]) and the low volatility of sovereign bond yields on the back of the accommodative European Central Bank monetary policy stance. In addition, the exposure of Greek banks to their sovereign is increased further through state guarantees provided in the context of the Hercules scheme and Covid-19 state support measures, while the State also maintains equity stakes in the sector, as a result of its participation in past bank recapitalisations.

The marginal deterioration in the non-performing loan ratio in the first quarter of 2021 is expected to be reversed in the next quarters on the back of further non-performing

([12]) These transitional arrangements refer to the phasing in of the new accounting standards on impairments of financial assets and the implementation of new rules leading banks to more quickly write down non-performing exposures, according to Regulation (EU) 2019/630 amending Regulation (EU) No 575/2013 and relevant supervisory guidance.

([13]) The first one in April 2021, raising €1.38 billion, and the second one in June 2021, raising €800 million. These were the first share capital increases of Greek banks since 2015.

([14]) Greek banks successfully issued in the first half of 2021 a €500 million Tier-II note in March 2021, a €500 million preferred senior unsecured note in May 2021 and a €600 million Additional Tier I note in June 2021.

([15]) Source: Bank of Greece, Financial Stability Review June 2021

([16]) By classifying government bond holdings as held to maturity (i.e. at amortised cost), banks insulate their capital base from any potential rise in the volatility of government bond yields.

loan securitisations under the Hercules scheme. After a continuous improvement in 2020, the non-performing loan ratio has edged upwards in March 2021, to 30.3% on a solo basis, and remains the highest in the euro area. The reason for this slight increase is a pick-up in new defaults in the 1st quarter of the year, especially in the corporate and consumer loan book, with three of the four systemic banks recording net inflows of non-performing loans in the quarter. However, the decrease in the stock of non-performing loans is expected to resume from the 2nd quarter of the year, as three more transactions were formally concluded by the end of June 2021 under the Hercules scheme, reaching an aggregate portfolio of securitised non-performing loans of approximately €17 billion. The four systemic Greek banks plan to dispose an additional €24 billion of non-performing loans by the end of 2021, making use of the recent extension of the scheme. Their aim is to reach single digit non-performing loan ratios in 2022 at the latest. The success of these ambitious reduction plans is contingent on a number of factors, such as the scale of new non-performing loan inflows, future economic growth and overall market conditions. In this respect, in an effort to adapt the Hercules framework to the post-pandemic environment and reflect the adverse impact of the health crisis on loan recoveries ([17]), the authorities have adopted in July 2021 additional amendments to the relevant implementing law.

Following the expiry of the moratoria, an initial assessment shows a moderate adverse impact on asset quality, in line with banks' expectations, but downside risks remain. The vast majority of moratoria expired at the end of 2020, with some limited exceptions, particularly linked to the hospitality sector. The initial results suggest that the number of potential defaults are unlikely to exceed the original estimate incorporated in the banks' business plans for 2021. Currently, about half of the borrowers exiting moratoria have returned to a normal payment pattern while the smooth transition of the remaining borrowers to a normal payment pattern is supported by a) a series of step-up products offered by the banks to viable customers facing temporary difficulties and b) the two temporary instalment subsidy schemes set up by the authorities for performing or restructured coronavirus-affected debtors (the "Gefyra" and "Gefyra II" schemes). The deadline for applications for the most recent of these two schemes, targeting business loans of small and medium-sized firms and professionals, was the end of May, with a total of 40 314 submitted applications, of which 18 077 eligible applications were processed by the end of July, corresponding to €6.5 billion of loans, predominantly (84%) performing. The authorities have also announced a limited 3-month extension of the first scheme, related to loans secured by a primary residence, to allow for a more gradual phase-out for Covid-stricken debtors. Nonetheless, downside risks with regards to the banks' provisioning levels persist, as the full impact of the pandemic on non-performing loan inflows may become evident with a lag only in 2022. This is due to the expiry of the majority of step-up products and the two "Gefyra" schemes towards the end of this year, as well as the expected lifting of various other state support programmes. As a result, there is a need for appropriate and homogeneous classification and provisioning of the loans under step-up solutions as well as further improvements in the internal capacity by banks to provide viable long-term loan restructurings, in order to proactively manage such risks and ensure that the ambitious non-performing loan reduction targets are met.

The credit-support programmes have continued to bolster the flow of credit to the economy. Over the period from January to June 2021, 28% of new loans with defined

([17]) The suspension of enforcement measures during the pandemic has affected the ability of servicers to recover on their credits and has created the need for some flexibility, given that the legislative framework foresees measures in case recoveries fall short of the business plans' projections.

maturity to non-financial corporations were supported by instruments offered by the Hellenic Development Bank and 48% in the case of small and medium-sized enterprises. The Covid-19 enterprise guarantee fund has helped providing €5.7 billion in loans since the start of the pandemic until the end of June. The fund will remain available until the end of 2021, expecting to channel €0.8 billion of additional loans. Under 'Tepix II' €2.1 billion loans have been disbursed until the end of June. Credit to non-financial corporations continued growing but at a slower pace. In July 2021, the annual rate of growth of net credit to non-financial corporations fell to 4.1% from 6.7% in April and 10.0% in December 2020, with a deceleration in the case of large companies fully offsetting an acceleration for small and medium-term enterprises, as two large corporate loan repayments in April affected the overall trend. The cost of credit to non-financial corporations remained historically low during the first half of 2021, unlike the cost of credit for unincorporated businesses, which is substantially higher. In addition, favourable market conditions have allowed the largest Greek non-financial corporations to resort to the financial markets to look for additional funds through the issuance of corporate bonds. With respect to households, the annual rate of growth of credit remained negative and broadly unchanged at -2.5% in July 2021 compared to end-2020 and comes at a steadily higher cost.

The Hellenic Financial Stability Fund has participated in the successful share capital increases of two systemic banks. The Fund has participated in the second quarter of 2021 to the capital raising exercises of two credit institutions to avoid an excessive dilution of its existing stake in them. At the same time, the Fund has continued supporting banks in their long-term strategic plans to meet the challenges of innovation and sustainability. The statistical treatment of the fiscal impact of capital injections will be assessed by the statistical authorities in the coming period. The nomination process for the post of the Fund's Deputy Chief Executive Officer has encountered delays. Preserving the Fund's independence and respecting the selection process as set out in the law remains essential.