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# COMMUNICATION FROM THE COMMISSION

## Enhanced Surveillance update - Greece, June 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 tenth enhanced surveillance report for Greece.** It is issued alongside the in-depth review of macroeconomic imbalances and country-specific recommendations assessing Greece's 2021 Stability Programme under the European Semester. The report is based on the findings of a mission held remotely on 20-21 April 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 end-2020 and provides information on the commitments due by mid-2021. The report was prepared taking into account information available up to the cut-off date 27 May 2021.

([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) 2021/998 of 17 February 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 6 to 14 April 2021.

**This report could serve as a basis for the Eurogroup to decide on the release of the next set of policy-contingent debt measures worth €748 million.** These measures were agreed with the Eurogroup on 22 June 2018 and include the transfer 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 and a waiver for the step-up interest margin for certain loans provided by the European Financial Stability Facility. The fourth tranche of policy-contingent debt measures was released following the Eurogroup on 30 November 2020, inter alia based on the assessment of the implementation of Greece's commitments for mid-2020 included in the enhanced surveillance report adopted by the Commission on 18 November 2020 ([5]) and considering the extraordinary circumstances posed by the coronavirus outbreak.

## OVERALL ASSESSMENT

**The report was prepared against the backdrop of the continuing pandemic and containment measures but also expectations for a gradual reopening of the economy thanks to the vaccination campaign.** The Greek economy contracted by 8.2% in 2020, somewhat less than expected, but still considerably more than the EU as a whole, mainly on account of the weight of the tourism sector in the economy. The increase in new coronavirus cases has led the authorities to maintain the personal mobility restrictions and containment measures introduced at the end of 2020 and earlier this year, while starting – more recently – to cautiously reopen the tourism sector to foreign tourists. The government presented additional fiscal policy measures for 2021 and 2022 to buttress economic recovery and private investment. The fiscal policy stance is therefore expected to remain supportive and continue mitigating the impact of the crisis on the labour market and the social situation. The employment protection measures are being supported by the EU notably through the new financing instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) and the European Social Fund. Employment is forecast to grow marginally in 2021, due to a gradual restart of hiring along with the reopening of the economy. The expected launch of the implementation of the reforms and investments presented in the Recovery and Resilience Plan is set to provide an additional growth impulse and momentum to efforts to modernise the economy and reduce unemployment, poverty and social exclusion ([6]).

**The authorities progressed well with reform implementation across a broad range of policy areas, including those that will help manage the socio-economic impact of the pandemic and facilitate the implementation of new public investments.** Notably:

- **The insolvency reform is expected to come into effect as agreed on 1 June,** following the entry into force of the framework on the rehabilitation of companies and corporate bankruptcy on 1 March. This code represents a major reform of the insolvency framework and its entry into force is a result of very substantial implementation work related to its detailed specification as well as to the setting up of an IT platform interconnected with those of the banks. The process for the set-up of the sale and lease-back entity is expected to take significantly longer than initially

([5]) https://ec.europa.eu/info/publications/enhanced-surveillance-report-greece-november-2020_en.

([6]) References in this report to the Recovery and Resilience Facility do not constitute any assessment of the Greek Recovery and Resilience Plan and cannot in any way serve to pre-judge the Commission assessment of the Plan.

expected, but it will not require amendments of the relevant legal provisions and will not affect the implementation of the other aspects of the framework nor the recently adopted lifting of the suspension of enforcement measures. The scheme may entail a substantial fiscal cost in case it is classified within general government and the authorities are therefore urged to implement it in a way that avoids this risk.

- **The authorities extended the Hercules scheme to facilitate a further reduction of non-performing loans.** The scheme was the main driver behind a substantial decrease in the non-performing loans ratio to 30.2% at end-2020, from above 40% at end-2019 ([7]). The extension of the scheme is expected to allow Greek banks to further reduce their non-performing loans and support their effort to reach single-digit non-performing loan ratios in 2022 in line with their recently revised non-performing loan reduction strategies submitted to the supervisor. The success of these ambitious plans is contingent on a number of factors, such as the scale of inflows of new non-performing loans and economic and market conditions.

- **A comprehensive human resources reform of the Independent Authority of Public Revenue is expected to come into effect on 1 June**. The reform is expected to help the Independent Authority to deliver on the specific commitment on ensuring appropriate staffing going forward.

- **The authorities completed the reform of the system of subsidies for local public transport**, a specific commitment, and the nationwide rollout of the **third and last pillar of the Guaranteed Minimum Income (GMI)**, also a specific commitment, allowing the provision of social support and tailor-made employment services to GMI recipients as of 1 June. The GMI reform has had a visible impact in terms of poverty reduction, although the share of people at risk of poverty or social exclusion is still among the highest in the EU (30% in 2019). The authorities will legislate in September to use the **functionality-based disability assessment system** to assess benefit eligibility in their new trial programme of personal assistance to disabled people. This means the new assessment scheme will be used directly for in-kind benefit decisions from the first quarter of next year, rather than a further pilot of the functionality assessment system being needed.

- **The authorities adopted a major overhaul of the public procurement framework**, a new conceptual framework regarding the **internal control in the public administration**, and legislation to establish a **Strategic Project Pipeline.** The legislation on the setting up of a **Project Preparation Facility** for large investment projects is expected to be adopted in early June. While full implementation of these measures will need to continue in the future, these steps are crucial for a successful start of the Recovery and Resilience Facility. The reforms and investments included in the Recovery and Resilience Plan are complementary to reforms monitored under enhanced surveillance but have a longer-term horizon and, where appropriate, further develop reforms initiated under enhanced surveillance.

([7]) Source: Bank of Greece, non-performing loans as a share of total gross customer loans on a solo basis. This figure is different than the one reported under the In Depth Review, as the latter is the figure reported by the European Central Bank and represents non-performing loans as a share of total gross loans and advances on a consolidated basis (i.e. including cash balances at central banks and other demand deposits in the denominator).

- **The authorities reached the 30% target on centralised procurement of healthcare expenditure**, a specific commitment, while taking steps to speed up the collection of clawback and relaunching work on the primary healthcare reform.

- **The capacity of the Supreme Council for Civil Personnel Selection has been strengthened** and good progress has been made towards an integrated human resources management system for the public administration. A limit to the recruitment of temporary staff, the work on which continues, will be implemented only as of 2022 but the authorities committed to implementing an agreed reduction in temporary posts in October 2021.

**Reforms continued also in other important areas.** The authorities are progressing well with the development of the 1st level of the **functional classification for public accounts** due in October 2021 and prepared a road map for implementing its 2nd level by April 2022. The functional classification is an essential element in budget and policy formulation. Important steps, including new primary and secondary legislation, were taken to **simplify the investment licensing** requirements and reform the **inspection framework**. Despite the broad sectoral coverage of the reforms, areas related to the licensing of business in educational activities were left out from the present package but the authorities will address these by September 2021. The tender for the deployment of the IT system for licensing and inspections, the execution of which had faced difficulties, was finally unblocked and the final decision for awarding the contract has recently been published. The **cadastral reform** is on track according to the revised road map, with good progress on the completion of cadastral surveys, setting up of the cadastral offices and preparation of **forest maps.** The ratification of 95% of all maps will be achieved in the first quarter of 2022 following the extension of the period for filing objections on account of the pandemic and to address administrative and legislative hitches. The **Hellenic Corporation of Assets and Participations** is preparing an updated Strategic Plan, following the issuance of the authorities' updated Ministerial Guidance, which includes a new focus on market based asset management, and welcome steps are being taken to strengthen the role of the Corporation as an active shareholder. Good progress was made with several of the ongoing **privatisation transactions**, including Hellinikon, a number of regional ports, real estate and the underground natural gas storage in South Kavala. Progress made on the remaining pending actions on the Egnatia concession has been limited and works are behind schedule. Last but not least, the authorities adopted relevant measures to address the remaining **recommendations of the Group of States against Corruption** and established a timeline to complete the specific commitment, while completing the long-awaited improvements to the implementation of the asset declaration procedure.

**The authorities are taking steps to remedy the delays caused by the pandemic.** First, contrary to initial plan, the **stock of arrears** increased by €96 million between December 2020 and February 2021, largely on account of liquidity shortages in certain entities. The authorities took measures to remedy the situation and provided an updated clearance plan, which confirms the previously agreed targets, while taking into account a new comprehensive analysis of factors out of the direct control of the government. The analysis, which was agreed with the European institutions, is expected to support the credibility and attainability of the targets. In parallel, the authorities are progressing with the implementation of structural measures to address the recommendations of the Hellenic Court of Auditors mainly focused on IT improvements, establishing efficient internal control systems, staffing and improvements in payment procedures with the majority of them to be addressed by mid-2021.

Secondly, the authorities successfully completed the revaluation exercise for the **ENFIA property** tax and agreed to bring forward the August 2022 tax declarations to the first quarter of 2022, as implementing the reform still in 2021 is no longer feasible. Thirdly, the procedure for updating the **statutory minimum wage** resumed and is expected to be completed by end-July and the long-awaited **Labour Code reform** has been put into public consultation and is planned to be submitted to Parliament during the first week of June, bringing in a significant modernisation of labour legislation and opening the way to its codification, which is a specific commitment. Finally, **judiciary reforms** saw some welcome progress with the adoption of the Code of Judicial Staff and the secondary legislation for the 'JustStat' unit, while work on other important laws and the setting up of special chambers will continue. There is good momentum on the digitalisation of judiciary but the much delayed introduction of mandatory e-filing is progressing only in administrative courts, as its implementation in civil and criminal courts is linked to the development of the second phase of the case management system, the tender for which will be relaunched – with a broadened scope – in July 2021. The European institutions encouraged the authorities to support e-filing in civil and criminal courts on an optional basis.

**Despite the substantial progress on the insolvency legislation, the pandemic-related disruptions to court proceedings continued to weigh on the implementation of other reforms in the financial sector in the first quarter of 2021 but the processes are gradually restarting.** This is in particular the case for the processing of the backlog of earlier household insolvency cases. While a specific roadmap is being implemented for the processing to accelerate, the full clearance is now likely to be delayed beyond the end-2021 target. The horizontal suspension of enforcement proceedings, including auctions, which had been in place since November 2020 and was assessed as having a potential adverse effect on the reduction of non-performing loans, was lifted at the beginning of April 2021, allowing for a gradual restart of all enforcement steps. Most auctions will be rescheduled for after the summer, thus limiting the total number of auctions to be conducted in 2021 to below pre-pandemic levels. The authorities are also preparing further steps to facilitate compliance with the measures passed in December 2020 to improve the conduct of auctions and confirmed that the revised Code of Civil Procedure, which will among others complete the auctions reform, will be adopted in July 2021 and enter into force before the start of the next judicial year after the summer. The pandemic has continued to hamper progress on the clearance of called state guarantees but the measures that have already been put in place are expected to allow for an acceleration in the second quarter of the year.

**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 a number of fundamental reforms, including in the areas that will be key to managing the long-run repercussions from the current economic crisis and strengthening the capacity of the public administration to successfully implement the Recovery and Resilience Plan. 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 the financial sector reforms.

## MACROECONOMIC DEVELOPMENTS

**The impact of the coronavirus pandemic marked the course for the Greek economy in 2020.** Greece's gross domestic product contracted by 8.2% on an annual basis in 2020, reflecting the impact of the containment measures on economic activity and especially on the

tourism sector. Despite the tightening of restrictions to limit the spread of the pandemic during the last quarter of the year, the Greek economy recorded a marked growth of 2.7% on a quarterly basis, reflecting higher government expenditure and a strong upswing in net exports. Consumer prices fell, mostly on account of the strong deflationary pressures from energy prices and the slack in the economy.

**Employment support measures managed to protect the labour market by keeping the unemployment rate at 16.3% in 2020 despite the large economic disruption brought about by the pandemic.** At the same time, employment decreased compared to a year ago on the back of a lower number of newly hired workers primarily in the tourism sector. The main scheme protecting the labour market was put in place already in early 2020 and supports workers whose labour contracts have been temporarily suspended, while protecting their positions. In March 2021, the number of employees under labour contract suspension reached 547 000 (in 128 400 enterprises), which is more than three times as much as in October 2020, when the second wave of the pandemic started in Greece. Similarly, the employment subsidy programme that was launched in October 2020 has so far provided employment to nearly 30 000 persons, of which 4 600 were previously long-term unemployed. The short-time work scheme ('Synergasia'), supported by the financing instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE), continued to provide support to about 17 000 employees in 1 600 enterprises in February 2021.

**The pace of recovery in the short run is likely to be somewhat slower than previously forecast, due to the prolongation of the containment measures, but the expected launch of the implementation of the Recovery and Resilience Plan is set to boost growth going forward.** The tightened containment measures are expected to weigh on the pace of recovery in the first quarter of 2021. However, the steady progress in vaccinations and the gradual reopening of the tourism sector are likely to accelerate economic activity in the second half of the year. According to the Commission 2021 spring forecast, real GDP in Greece is forecast to grow by 4.1% in 2021 and 6.0% in 2022, driven mainly by investments from the second half of 2021 onwards. Net exports are also expected to provide a positive contribution, supported by the gradual reopening of the tourism sector. Private consumption is likely to be supported by the realisation of part of the purchases delayed from the previous year. The expected increase in household spending, and the ensuing recovery in the more labour-intensive services sector, should also facilitate the return of workers currently under employment support schemes to regular employment, allowing for a gradual easing of the support measures. Inflation is forecast to remain mildly negative in 2021, on account of negative price pressure from the services sector and weak demand for industrial goods. For 2022, consumer prices are expected to slowly recover as the economic activity returns to its pre-pandemic levels and tourism activity gradually recovers.

**The Commission 2021 spring forecast factors in the reforms and investments included in the Recovery and Resilience Plan.** The Plan includes a number of mature investment projects, notably in the areas of green transformation, digital transition, sustainable and inclusive growth as well as other growth-enhancing expenditures, the implementation of which is expected to get quickly underway in the second half of 2021. By fostering the green and digital transformation of Greece, these investments are likely to provide a strong impetus to recovery, and lift growth by around 1.3 percentage points on average in 2021 and 2022. As well as improving competitiveness and productivity, the Plan also aims to promote employment and an inclusive recovery.

**Uncertainty regarding the outlook remains high**. Despite the progressing vaccination campaign, the evolution of the pandemic at both domestic and international level remains subject to substantial uncertainty. This has repercussions for tourism and tourism-related sectors such as the hospitality sector and the provision of food and services, which represent a relatively large share of the Greek economy. Uncertainty also concerns the speed of recovery of the corporate and the banking sector after the phasing out of support measures, which could create pressure for firms' liquidity and possibly solvency. The cliff effects are expected to be mitigated by a recent subsidy scheme supporting business loans. Impediments to access to finance in particular for small and medium-sized enterprises persist but are expected to be eased through measures presented in the Recovery and Resilience Plan. The developments on the labour market in the short run will crucially depend on the phasing out of the labour market support measures, which will need to be carefully managed. The external geopolitical factors and the potential resurgence of the migration crisis once the pandemic subsides remain a source of uncertainty. On the upside, the savings accumulated during the pandemic could boost spending going forward. Turning to inflation, the uncertainty surrounding the economic outlook implies downside risks to the projected path.

Table .1: **Summary of main macroeconomic variables (%)**

| | 2020 | 2021 | 2022 |
|---|---|---|---|
| Real GDP growth | -8.2 | 4.1 | 6.0 |
| Employment growth | -1.3 | 0.4 | 0.7 |
| Unemployment rate | 16.3 | 16.3 | 16.1 |
| Harmonized index of consumer prices growth | -1.3 | -0.2 | 0.6 |

***Source:*** European Commission

## FISCAL DEVELOPMENTS

**Greece's primary deficit monitored under enhanced surveillance reached 7.5% of GDP in 2020.** The deterioration compared to the Commission's 2020 autumn forecast is explained by the additional measures taken by the government to address the second wave of the pandemic in the last months of 2020. Furthermore, several statistical issues have been clarified by Eurostat, which contributed to the lower fiscal balance. The most notable statistical revision is the decision to accrue all the expected clearance cost of the backlog of state guarantees to 2020. This revision added 1.2% of GDP to the 2020 deficit, while having no impact on the debt level of the general government. Another important decision taken by the statistical authorities concerned the fiscal recording of the claw-back mechanism. Due to the constantly accumulating stock of uncollected claw-backs, the statistical authorities decided to abandon the previous practice of recording, whereby the accrual expenditure was defined by the claw-back ceilings, and to record all claw-backs and rebates when they would actually be collected or offset. For 2020, this change is estimated to have had a balance-deteriorating impact of 0.3% of GDP, while the past fiscal balances between 2012 and 2019 have deteriorated by 0.2% of GDP on average, with no impact on the level of general government debt.

**Fiscal policy will remain accommodative in 2021 and most of the fiscal measures adopted to mitigate the social and economic costs of the crisis are expected to be phased out in 2022.** The authorities sustain the support to address the pandemic in 2021 by prolonging earlier measures in response to the third wave of the infections. This includes a

further increase in the envelope of the 'repayable advance payments' (public support to companies affected by the pandemic, distributed in the form of loans with a conditional subsidy component), increased fiscal support related to employees whose labour contract has been suspended, increased health care expenditures and prolonged tax deferrals. Under the current assumption of the gradual easing of the lock-down, most measures targeted to companies and households who have been directly hit by the pandemic are expected to be discontinued from 2022.

**Further measures are envisaged to continue to provide support to the recovery in 2022, including a much needed relief to the tax burden of corporates.** The reduced rate of social security contributions and the reduction of the social solidarity tax in the private sector will remain in place also in 2022. The authorities also decided to reduce the rate of advance payment of corporate income tax from 100% to 70% in 2021 and to maintain it at 80% from 2022 onwards. This measure aims to safeguard liquidity and private investments as firms would otherwise face a nearly 50% effective tax rate when turning profitable ([8]), which would pose a major risk for private investments. Furthermore, the corporate income tax will be reduced by two percentage points to 22% from the 2021 tax year onwards. This measure has a minor negative permanent impact on public finances of about 0.1% of GDP, but it is a step in the right direction in addressing the high tax burden on corporates, which has been a long standing concern ([9]). The impact of this measure will be offset by a permanent increase in the revenues of the Renewable Energy Source account applied from 2021 onwards, most notably from greenhouse gas emission allowances and the introduction of a green fee on the consumption of diesel.

**The Commission 2021 spring forecast expects that the primary deficit monitored under enhanced surveillance will reach 7.3% of GDP in 2021 and 0.5% of GDP in 2022, which is closely aligned with the projection of the authorities ([10]).** This projection factors in the gradual expiry of the fiscal support measures and the expected economic recovery. It also includes the cost of the 'repayable advance payments' (public support to companies affected by the pandemic distributed in the form of loans with a conditional subsidy component). Provisions for the guarantees provided in the context of the pandemic have been recorded in

([8]) In Greece, firms pay advances on the corporate income tax based on their profits of the previous year, with clearance made in the following year, once profits have become known. This means that if a company makes a profit in year T-1 for the first time, then in year T it will be liable to pay a 24% advance on the tax that will be due for year T and a 24% corporate income tax on the profit made in T-1 through the clearance mechanism as no advances have been paid in the previous year. This adds up to an effective tax rate of 48% in year T.

([9]) See the 2nd enhanced surveillance report (February 2019) for an analysis of the tax burden.

([10]) The General Escape Clause was activated in agreement between the European Commission and the European Council in March 2020 and remains active in 2021 as indicated in the Annual Sustainable Growth Strategy 2021. The General Escape Clause allows for a temporary departure from the budgetary requirements, including Greece's fiscal targets monitored under enhanced surveillance, provided that this does not endanger fiscal sustainability in the medium term. In March 2021, the Commission adopted a Communication suggesting that Member States with high debt levels as Greece should pursue prudent fiscal policies in 2022, while preserving nationally-financed investment and making use of grants under the Recovery and Resilience Facility to fund additional high-quality investment projects and structural reforms. 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. See 'Communication from the Commission on Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy', Brussels, 2.6.2021, COM(2021)500 final.

2020. By contrast, the guarantees provided in the context of the Hercules scheme may affect the fiscal balance only in the future, if and when they are called. The Commission spring forecast takes into account the large-scale financial support from growth-enhancing reforms and investments included in Greece's Recovery and Resilience Plan, which are expected to provide a substantial support to the economy and boost potential growth. This will in turn facilitate achieving prudent fiscal positions. The authorities' 2021 Stability Programme projects the primary deficit to reach 7.2% of GDP in 2021 and 0.3% of GDP in 2022.

Table .2: **Main drivers of the fiscal projection**

| | 2020 Act. | 2021 Proj. | 2022 Proj. |
|---|---|---|---|
| **Total revenues, bn EUR** | **82.9** | **84.6** | **90.0** |
| **% of GDP** | **50.0** | **49.2** | **48.9** |
| | *level* | *y-o-y change (bn EUR)* | |
| **Total revenues, bn EUR** | **82.9** | **1.7** | **5.5** |
| Macro | | 1.0 | 3.0 |
| Revenue measures | | -2.1 | 1.2 |
| Non-tax revenues and claims on EU funds | | 0.5 | 0.9 |
| Other adjustments | | 2.2 | 0.4 |
| **Total primary expenditures, bn EUR** | **95.3** | **97.1** | **90.9** |
| **% of GDP** | **57.5** | **56.5** | **49.4** |
| | *level* | *y-o-y change (bn EUR)* | |
| **Total primary expenditures, bn EUR** | **95.3** | **1.8** | **-6.2** |
| Compensation of employees | 22.3 | 0.4 | 0.2 |
| Social transfers | 39.5 | 0.9 | -0.3 |
| Investments | 5.2 | 3.8 | 2.0 |
| Intermediate consumption | 8.7 | 1.3 | -0.5 |
| Other expenditure and reserve | 19.8 | -4.6 | -7.5 |
| **Primary balance in enhanced surveillance terms, bn EUR** | **-12.4** | **-12.6** | **-0.9** |
| **% of GDP** | **-7.5** | **-7.3** | **-0.5** |

***Source:*** European Commission

**The authorities adopted secondary legislation that sets out the criteria for the re-entry to the tax settlement scheme for tax liabilities which were interrupted before the pandemic.** This legislation is part of arrangements agreed in the context of the 8th enhanced surveillance report and operationalises a 'second chance' for those who had dropped out from earlier settlement schemes after the November 2019 revision of the framework. It introduces wealth, income loss and strict compliance criteria, which is a welcome novelty to the framework.

**Fiscal risks remain substantial.** For the large part, they continue to be driven by the uncertainty surrounding the evolution of the pandemic and further fiscal support that might become necessary to mitigate the social and economic cost of the health crisis. Further risks are related to the actual cost of the state guarantees and repayable advances extended during the pandemic. The planned sale and lease-back scheme for properties owned by vulnerable debtors may carry substantial fiscal costs if it is classified into the general government sector ([11]). The risks stemming from the litigation cases against the Public Real Estate

([11]) Depending on the degree of economic freedom and ownership under which such an organisation operates, it can be considered to be part of the general government or not. If an overwhelming majority of its operating conditions is defined by the state in a way that limits its discretion over important parameters, it may be

Company (ETAD) and the ongoing legal challenges against earlier reforms, as described in previous reports, remain considerable. A resurgence in migration flows would deteriorate the fiscal balance going forward. Finally, the forecast assumes a full execution of budget ceilings, which, if not achieved, would improve the fiscal outturn at the cost of reducing the contribution of public expenditures to growth.

## SOVEREIGN FINANCING

**The sovereign yield spreads have been stable since February 2021, at around 60 basis points on the five year tenure.** 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 maintained its presence on the bond markets and carried on with implementing its funding plan. In March, €2.5 billion were raised through the issuance of a 30-year government bond with a yield just below 2%. The auction was more than 10-times oversubscribed, and it was the first 30-year Greek sovereign bond issued since 2007. Also in March, Greece carried out the partial early-repayment of the International Monetary Fund loans, which is a welcome step that helps to reduce the foreign exchange risk and sends the right signal to the markets. The remaining amount of loans outstanding towards the International Monetary Fund is €1.8 billion. The general government's cash reserves stood at around €28 billion at the end of March 2021, which would be sufficient to cover the financing needs of the general government for more than a year under the current fiscal projections. In April 2021, Standard & Poor's upgraded Greece's sovereign credit rating by one notch from BB- to BB while maintaining a positive outlook. With this update, Greece's sovereign rating is only two notches below investment grade at two rating agencies.

## DEBT SUSTAINABILITY ANALYSIS

**An update of the debt sustainability analysis has been carried out following the updated macroeconomic and fiscal outlook in the Commission 2021 spring forecast.** The methodology was published in the 8th enhanced surveillance report. The framework closely follows the Commission Debt Sustainability Monitor's framework and considers additional alternative scenarios. The forward rates used for the interest rate assumptions are as of end-March 2021.

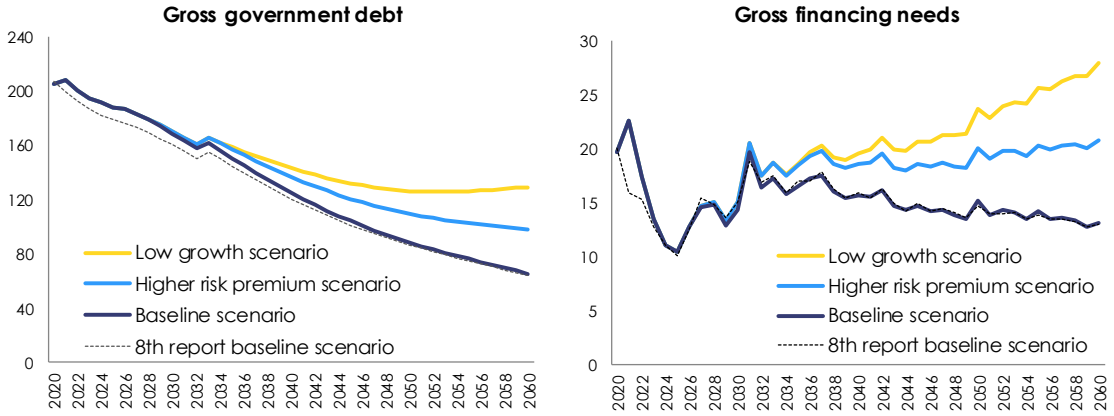
**The protracted pandemic increased fiscal sustainability risks, which are partly offset by the expected economic recovery.** The results of the analysis show that in the baseline scenario, the debt-to-GDP ratio remains on a downward path from 2021 onwards. Debt is projected to reach 169% by the end of the decade, and to decline below 100% of GDP by 2047 in the baseline scenario.

**The assessment takes into account the expected positive impact of the Recovery and Resilience Facility on growth in the coming six years**. It is based on the information provided in the Recovery and Resilience Plan and reflected in the assumptions used in the Commission's spring forecast, and is without prejudice to the formal assessment of the Recovery and Resilience Plan being conducted by the Commission. The measures presented in the Recovery and Resilience Facility are expected to have a multiplier effect of 0.8 on real

classified to be part of the general government. In this case the purchases made by this organisation would be considered government expenditure.

GDP on average between 2021 and 2026. While this has a long-term impact on GDP levels, this debt sustainability analysis does not factor in for any potential long-term impact of the Recovery and Resilience Facility on potential GDP growth beyond 2026. In terms of financing, 13% of the total envelope is expected to be disbursed in 2021 as pre-financing. For the loans, the calculations are based on the government's plan to on-lend the whole amount to the private sector, in the form of co-financing, with maturities matching that of the Recovery and Resilience Facility loans. This leads to an increase in gross financing needs in the short term, but has no impact on the nominal debt levels in the long term, as the repayment of loans by the private sector to the government is assumed to provide the necessary financing for the repayment of the government's loan to the EU. The current simulations do not take into account any possible impacts on the fiscal balance from the loan element of the Facility (save for second round effects).

Graph .1: **Results of the debt sustainability analysis**




***Source:*** Commission services

Table .3: **Main assumptions and results**

| | | 2021 | 2022 | 2023 | 2024 | 2030 | 2040 | 2050 | 2060 | average 2021-2029 | average 2030-2060 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Assumptions | Primary balance (% of GDP) | -7.3 | -0.5 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 0.8 | 2.2 |
| | Real GDP growth | 4.1 | 6.0 | 2.4 | 1.7 | 0.7 | 1.7 | 1.6 | 1.5 | 2.0 | 1.5 |
| | Nominal GDP growth | 3.8 | 6.7 | 3.2 | 2.5 | 2.8 | 3.8 | 3.6 | 3.5 | 2.9 | 3.5 |
| | Re-financing rate (10 year maturity) | 0.8 | 1.0 | 1.1 | 1.3 | 2.3 | 3.1 | 4.0 | 4.0 | 1.5 | 3.4 |
| Results | Gross financing needs (% of GDP) | 22.6 | 17.4 | 13.5 | 11.1 | 14.3 | 15.6 | 15.2 | 13.2 | | |
| | Gross goverment debt (% of GDP) | 208.1 | 200.1 | 194.9 | 191.6 | 168.8 | 124.8 | 88.3 | 65.4 | | |

***Source:*** Commission services

**Gross financing needs remain elevated in the short term mainly due to the high primary deficit**. The implementation of the Loan Facility presented in the Recovery and Resilience Plan is expected to contribute to the higher gross financing needs in 2021-2022, although this additional financing need is covered by the assumed disbursement of the Recovery and Resilience Facility loan. In the following years, financing needs are expected to be moderate and remain below 15% of GDP until 2030. Following a period of elevated gross financing needs in 2030s, linked to the start of repayments of loans extended under the European Stability Mechanism programme and to the expiry of the interest deferral period of the European Financial Stability Facility loans, they are expected to remain on a declining path and reach 13% of GDP by 2060.

Table .4: **Main assumptions of the scenarios**

| | | 2021 | 2022 | 2023 | 2024 | 2030 | 2040 | 2050 | 2060 | average 2021-2029 | average 2030-2060 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Nominal GDP growth (%) | Baseline scenario | 3.8 | 6.7 | 3.2 | 2.5 | 2.8 | 3.8 | 3.6 | 3.5 | 2.9 | 3.5 |
| | Higher risk premium scenario | 3.8 | 6.7 | 3.2 | 2.5 | 2.8 | 3.8 | 3.6 | 3.5 | 2.9 | 3.5 |
| | Low growth scenario | 3.8 | 6.7 | 3.2 | 2.5 | 2.8 | 3.0 | 3.0 | 3.0 | 2.9 | 3.0 |
| Re-financing rate (%) | Baseline scenario | 0.8 | 1.0 | 1.1 | 1.3 | 2.3 | 3.1 | 4.0 | 4.0 | 1.5 | 3.4 |
| | Higher risk premium scenario | 0.8 | 1.0 | 1.1 | 1.3 | 4.0 | 4.7 | 5.9 | 6.0 | 2.3 | 5.2 |
| | Low growth scenario | 0.8 | 1.0 | 1.1 | 1.3 | 4.0 | 4.7 | 5.9 | 6.0 | 2.3 | 5.2 |

***Source:*** Commission services

**The alternative scenarios indicate slightly increased sustainability risks.** The two alternative scenarios developed in the 8th enhanced surveillance report have also been updated. Under the 'higher risk premium' scenario, the debt trajectory is overall higher but remains decreasing throughout the period under assessment. Gross financing needs are higher in the long run and marginally exceed 20% of GDP in the final years of the projection. In the 'low growth' scenario, debt levels remain high in the long run and gross financing needs are rising throughout the horizon, permanently surpassing 20% of GDP from the mid-2040s.

**The composition and maturity profile of government debt mitigates debt vulnerabilities, while additional risks could emerge from contingent liabilities.** A large share of debt is financed at low rates with long maturities, which, along with the high cash reserves of the Greek general government, effectively cushions the impact of short-term fluctuations in financing costs. The debt sustainability analysis presented in this report does not take into account the long-term growth impact of the reforms and investments presented in the Recovery and Resilience Plan, which may further mitigate sustainability risks. By contrast, there are risks stemming from the uncertainty related to contingent liabilities vis-à-vis the private sector, including the state guarantees granted to firms and self-employed during the pandemic or in the context of the Hercules scheme. Finally, a reversal in the currently prevailing low-interest environment over the medium-term would also increase sustainability risks, if it materialises.

## FINANCIAL SECTOR DEVELOPMENTS

**Bank profitability in 2020 benefitted from extraordinary trading gains and low financing costs. At the same time, some banks have frontloaded provisioning linked to the impact of the pandemic and upcoming securitisations.** The banks registered positive trading gains in their government bond portfolios and a lower cost of funding, thanks to ample Eurosystem liquidity and the shrinking costs of retail deposits. At the same time, impairments were increased to cater for higher provisioning needs due to the pandemic and to anticipate the planned securitization transactions of non-performing loans in 2021. In addition, one systemic bank had to account for the incurred losses within a securitisation transaction implemented by the end of 2020. On the positive side, banks have contained operating costs thanks to the implementation of voluntary staff exit schemes. Overall, the banking system as a whole posted losses after taxes in 2020, while avoiding the triggering of deferred tax credits following earlier corporate transformations (the 'hive-downs'). The low-interest-rate environment and uncertainty about the economic outlook weigh on the prospects for 2021. Low interest rates should continue to support economic activity but will also put further pressure on net interest margins, especially after the expected clean up of balance sheets. This could be counterbalanced through new loan activity, increased fees from digital services, wealth management and bank insurance business and initiatives to reduce costs. Impairments could normalise due to stronger balance sheets, subject to the success of non-performing loan reduction efforts.

**The capital position of the banking system as a whole is broadly adequate but it remains challenged by low profitability and poor asset quality, while the sovereign bank nexus has become stronger.** Banks' average Common Equity Tier 1 and Total Capital ratios stood, on a consolidated basis, at 14.6% and 16.3% of risk-weighted assets, respectively, at the end of September 2020. Although banks are taking a series of capital enhancing actions to cover the cost of upcoming non-performing loan securitisations and the gradual phasing out of transitional prudential arrangements, the subdued profitability levels may pose challenges for the banks' capital position going forward. Moreover, this may lead to a rise in the already high share of deferred tax credits in banks' capital (59% of Common Equity Tier 1 capital as of end-2020). The large share of deferred tax credits, the banks' increasing domestic government bond holdings, the equity stakes held by the state in the sector and the state guarantees under the Hercules scheme imply a stronger sovereign-bank nexus that will need to be monitored closely going forward. On the positive side, the first share capital increase by a systemic bank since 2015 was successfully concluded in April 2021, raising €1.38 billion. In the medium-term, in line with the EU banking regulatory framework, Greek banks, like all EU banks, will also have to issue substantial amounts of bail-in-able debt in the following years in order to meet the minimum requirement for own funds and eligible liabilities (MREL), which could put upward pressure on their cost of long-term unsecured funding.

**The extension of the Hercules scheme is expected to facilitate an acceleration in the reduction of non-performing loans in 2021, mainly through inorganic actions ([12]), building on the strong performance of the previous year.** Sales and securitisations of non-performing loan portfolios under the Hercules scheme were the main driver behind a substantial fall by €21.1 billion in the stock of non-performing loans in 2020, reaching €47.5 billion on a solo basis, following a strong fourth quarter performance. As a result, the non-performing loans ratio came down significantly to 30.2% ([13]), remaining however the highest in the euro area. The continuous improvement in 2020, despite the pandemic and the resulting drop in the number of cured loans, has been supported by historically low default rates thanks to the moratoria and the state support measures in place. The recent prolongation of the Hercules asset protection scheme for an additional 18 months, coupled with additional €12 billion bringing the schemes' overall envelope of state guarantees to €24 billion, is expected to allow Greek banks to further implement their non-performing loan reduction strategies, in an effort to reach single digit non-performing loan ratios in 2022 ([14]). 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. The authorities are assessing whether an additional amendment in the relevant implementing law of the Hercules scheme is required to reflect the adverse impact of the

([12]) Inorganic actions refer to sales and securitisations of non-performing loans. Organic actions refer to the internal restructuring or collateral liquidation of non-performing loans.

([13]) Source: Bank of Greece.

([14]) Three transactions under the original Hercules scheme involving a total of €17.6 billion of non-performing loans, have been signed and will be concluded within the first half of 2021, with one more close to completion for a loan portfolio of €6 billion. In addition, an additional four transactions, corresponding to €16.3 billion worth of securitisations have been announced and are expected to be concluded between the fourth quarter of 2021 and the second quarter of 2022, taking advantage of the recent extension.

pandemic on recoveries ([15]). The Commission has approved the measure as being free of any State aid.

**Initial signs of payment behaviour following the expiry of the moratoria suggest that the adverse impact on asset quality may be broadly in line with banks' original expectations but downside risks remain.** Most moratoria expired at the end of 2020, with some limited exceptions, particularly linked to the hospitality sector. The initial results from the first two months of 2021 suggest that the number of potential defaults may not exceed the original estimate incorporated in the banks' business plans or the lower end of Bank of Greece's current projections. The smooth transition to a normal payment pattern for borrowers is also supported by a) the temporary instalment subsidy scheme set up by the authorities for coronavirus-affected debtors with primary residence loans (the "Gefyra" scheme) and b) a series of step-up products offered by the banks to viable customers facing temporary difficulties. A similar scheme to Gefyra, targeting business loans of small and medium-sized firms and professionals, has also been adopted recently and will contribute to mitigating any cliff effect from the expiry of the moratoria. However, downside risks persist as part of the adverse impact on asset quality may spill-over to the second half of 2021 or early 2022, in particular following the lifting of various state support programmes. This could imply higher provisioning needs than those booked so far to fully capture the eventual impact of the pandemic on the loan book. Moreover, the material flow of new bad loans, under any scenario, still points to the need for an improved internal capacity by banks for viable long-term loan restructurings to meet the ambitious non-performing loan reduction targets.

**The Hellenic Development Bank continues to support credit, not only with measures related to the pandemic but also with new initiatives planned for 2021.** The Covid-19 enterprise guarantee fund has managed to provide €5.4 billion in loans by the end of March, while the launch of a new call towards small business and professionals is expected to leverage additional €0.4 billion in new loans. Under TEPIX II almost €2.6 billion loans have been granted until the end of March. Moreover, discussions are under way to implement additional schemes during the course of the year with a focus on small and medium sized enterprises. The positive impact of these support programs has bolstered net credit to non-financial corporations, which continued to show record 12-month growth rates, reaching 10.3% in February 2021, with higher rates for large corporates than for small and medium-sized enterprises. However, the future phase-out of state support measures may affect banks' capacity to maintain such levels of credit growth in the future. The cost of credit to non-financial corporations remained stable at historically low levels as regards large corporates while small rises were observed for smaller firms, reflecting increased credit risk. Net credit to households continues to show a stable negative 12-month growth rate (-2.5% in February 2021), despite a decline in bank lending rates for this type of credit.

**The Hellenic Financial Stability Fund has completed its 3rd corporate governance evaluation of the boards of the four systemic banks.** This will be followed by a list of recommendations towards the banks. At the same time, a recently adopted amendment of its governing law allows the Fund to participate as a private investor in future share capital increases of the banks where it maintains a shareholding, starting with the recently concluded share capital increase in one of the systemic banks. Other key aspects, including the lifetime

([15]) The suspension of enforcement measures during the pandemic has affected the ability of servicers to recover on their credits. The authorities are assessing if some flexibility could be provided, given that the legislative framework foresees measures in case recoveries fall short of the business plans' projections.

of the Fund, governance, special rights, the divestment strategy and board eligibility criteria for banks, are expected to be addressed jointly by October 2021.