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Enhanced Surveillance Update - Greece, February 2022

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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 thirteenth enhanced surveillance report for Greece. The report is based on the findings of a mission held virtually on 25 January 2022 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 Financing Assessment 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-2021. This report is not linked to a release of the next set of policy-contingent debt measures, which – in line with the agreed biannual schedule – could take place on the basis of the fourteenth report. The fourteenth report is expected to be published in May 2022.

([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) 2022/216 of 15 February 2022 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, held remotely, from 12 to 17 January 2022.

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. The authorities expressed an intention to focus their efforts on delivering on outstanding commitments by mid-2022. The decisions on the release of the remaining debt relief measures as well as the ending of enhanced surveillance will need to take account of the progress towards completion of commitments as well as the wider economic policy environment.

OVERALL ASSESSMENT

Greece recovered swiftly from the pandemic and the outlook remains strong, albeit subject to high uncertainty. The economy is currently expected to have reached a high GDP growth rate of 8.5% in 2021, driven by domestic demand and the better-than-expected tourist season. The pre-pandemic level of economic activity was reached already in the third quarter of 2021. The outlook for 2022 remains strong, supported by the accommodative fiscal and monetary policy and the strong boost from the recovery and resilience plan. The spread of the new omicron variant of the coronavirus is nevertheless likely to have weighed on growth in the last quarter of 2021, but this impact is expected to largely fade out during the first quarter of 2022. Greece introduced mandatory vaccination for residents over age 60 from January 2022. Risks of additional disruptions exist, although that impact is currently expected to be rather short-lived. The recent world market price developments in energy and, in particular, electricity prices have led to a surge in consumer prices and is an additional source of uncertainty for the economy at large. While most of the emergency support measures were phased out in 2021 as planned, the government responded swiftly to the outbreak of the new coronavirus variant and the higher-than-expected inflation with new targeted support. The general government deficit is expected to substantially narrow in 2022 compared to the previous year ([5]). Labour market developments remain favourable and unemployment, which stood at 14.1% in the third quarter of 2021 (down from 17.2% in the third quarter of 2020), is set to decrease further in 2022. The at-risk-of poverty rate stood at 17.7% in 2020, down from 17.9% in 2019.

The authorities have successfully completed a further set of specific commitments:

- In the area of **public administration**, the authorities have effectively completed the preparation of job descriptions for public officials. Together with the digital organisation charts, which were put in place earlier in 2021, the job descriptions constitute a key element in the establishment of an integrated human resources management system for the Greek public administration.

- The authorities have completed the **simplification of investment licensing in the agreed sectors** by adopting the last piece of legislation for education activities. These efforts build on and complement a major reform that was initiated during the financial assistance programme by extending simplified investment licencing procedures to a number of additional economic activities ([6]).

([5]) The Commission's autumn forecast projected that the primary deficit monitored under enhanced surveillance would reach 7.6% of GDP in 2021 and 1.2% of GDP in 2022.

([6]) These were: transport-related services, social welfare, tourism, physical well-being, personal and health services, leasing of maritime leisure equipment, lifeguard training, livestock installations, aquaculture, veterinary clinics and pet breeding and trading, in addition to education activities mentioned above.

- In the area of **social welfare** reforms, the authorities have completed the administrative reorganisation of the Single Pension Fund, following the setting up and operationalisation of all required local offices, while making steady progress on the improving its IT infrastructure. The reform completes the efforts to consolidate the previously fragmented pension system, while moving towards a full digitalisation of pension system data: it thus constitutes an important step for enhancing the efficiency of the Greek pension system.

In addition, reform implementation has progressed well across a broad range of specific commitments. In particular:

- In the area of **public financial management**, the work on further refinements of the functional budgetary classification (part of the **chart of accounts** reform) is progressing according to plan and is expected to be completed by April 2022 and published in the annual update of the Medium Term Fiscal Strategy in May 2022.

- The authorities have made progress as regards the **clearance of arrears** of the general government towards the private sector. The stock of pension arrears has been reduced in line with what was envisaged in the action plan adopted in autumn 2021 and the authorities confirmed that it would be fully cleared by June 2022. After several months of stagnation, the stock of non-pensions arrears decreased markedly on the back of actions adopted by the government to bring clearance back on track. While the stock currently remains somewhat above the target set in March 2021, the authorities expect the stock of non-pension arrears to be materially cleared by February 2022. The implementation of the recommendations made by the Hellenic Court of Auditors and the simplification of fiscal procedures proceed according to plan.

- The **ENFIA property tax reform** has reached a final stage of preparation. An agreement has been reached on the detailed tax rate structure and fiscal cost of the reform based on the new market-related property tax values, which will widen the tax base and improve the fairness and economic efficiency of the property tax. This will be legislated in February 2022 to allow for the tax assessment and first payments to take place, with a minor delay, in April 2022.

- As regards **health care**, collection of clawbacks (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 pharmaceutical suppliers and healthcare providers), is progressing according to schedule for both pharmaceuticals and other services, which is welcome. Procurement activities are on track to reach the mid-2022 target of a 40% share of centralised procurement in total hospital expenditure for which the Centralised Health Procurement Authority is mandated to issue tenders.

- The authorities are advancing on the preparation of the **disability reform**, with the secondary legislation for disability determination based on both medical and functional assessment being prepared and expected to be adopted by the end of March 2022. The new assessment framework will inform in-kind benefit decisions for the provision of personal assistance to persons with disabilities.

- The General Assembly of the **Hellenic Corporation of Assets and Participations** has approved the updated Strategic Plan prepared by the Corporation, which sets out the top-level key performance indicators by which the Corporation will track its

performance, as well as detailed actions for the Corporation to act as an investor and a reformer in the state-owned enterprises in its portfolio. Work has progressed well on the implementation of the Coordination Mechanism, including the approval of the first-ever performance contract for the Athens Urban Transport Organisation. The authorities are preparing a first draft of a law for the modernisation of the institutional framework for state-owned enterprises, covering indirect subsidiaries of the Corporation and other public companies outside of the Corporation's portfolio. The Council of State ruled in February 2022 the transfer of the stakes in the water utilities of Athens and Thessaloniki to the Corporation in 2018 unconstitutional. The implications of this decision are under examination.

- There has been overall good progress with **privatisation transactions** over the past months. The tender process for the Public Gas Corporation (DEPA) Infrastructure has progressed towards a final stage, and its financial closure is expected shortly. The tenders for a number of important regional ports and 'Gournes Heraklion' (development of part of the former American military base on Crete) are in progress, and the tender process for the award of a concession agreement for the Athens Ring Road (Attiki Odos) has been launched. The authorities have progressed further with the construction works on the Egnatia motorway, paving the way to the activation of the concession agreement expected by end-2022.

- The **cadastral mapping** and the transition to the full establishment of the new Hellenic Cadastre have continued to progress in the past three months. The ratification of the **forest maps**, which is currently suspended in view of the prolongation of the period for raising objections, is set to restart in May 2022. The period for raising objections was prolonged due to the impact of the wild fires of summer 2021. The authorities expect it to be substantially completed by July 2022, broadly in line with what was noted in the previous report.

- Work on the **codification of labour legislation** continues in close collaboration with the Central Codification Committee, with a first draft of the revised legislation to be presented in March 2022. The authorities committed to adopting the codified laws in May 2022.

- Implementation of **mandatory e-filing** in administrative courts is advancing and is expected to be concluded by April 2022. An e-docket platform, used to allow stakeholders to register and monitor the progress of cases through the courts, has been launched in Athens and its functionality will gradually extend across the territory of Greece, and the e-divorce procedure is now fully functional.

- The authorities continued working towards implementation of the remaining recommendations for the **fight against corruption** from the fourth evaluation round of the Group of States against Corruption (GRECO). A large part of these recommendations is conditional on the adoption of the Code for the Organisation of Justice and the Status of Officers of the Courts, which is delayed (see below). The recommendations concerning bribery of public officials were successfully implemented at the end of 2021.

Nevertheless, some specific commitments and other key policies have seen delays compared with the timelines agreed in the context of the 12th report. Notably:

- The new **IT collection system for the Independent Authority for Public Revenue** has encountered delays. This is due to delays in submitting the final complete version of the end-to-end IT collection system by the contractor, which is now scheduled for June 2022. As a result, the full operationalisation of this new IT system, which was planned for end-April 2022, is now expected by end-September 2022. However, the Independent Authority still plans that its central and decentralised services, including the directorate of collection and refund and the collection operation unit, will start using some functionalities of this system by April 2022.

- The **reform of primary health care** has seen limited progress. Alongside a final draft of the primary legislation, the authorities have now prepared draft secondary legislation, which spells out the main features of patient registration and of the gatekeeping function of general practitioners, although some key parameters of the system are still under definition. The authorities are encouraged to put in place in a timely manner sufficient incentives to contain self-referrals, while ensuring equal access to healthcare, and implementing compulsory patient registration as provided for in the existing legal framework. The authorities committed to launch public consultation on the legislation at the end of February or the beginning of March 2022, with adoption to follow shortly thereafter by the time of the 14th report. Implementation of the reform will start thereafter and will continue to be closely monitored.

- Completion of the **reform of the inspections framework** for the supervision of economic activities and product markets remains pending. Secondary legislation in the last remaining area of environmental protection has not been finalised in time for this review due to the necessary consultations to ensure constitutional conformity of the reform. The consultations have now been completed and the legislation is expected to be adopted shortly. This legislation will elaborate on the enforcement management model to facilitate a harmonised approach in the application of the enforcement system.

- The authorities adopted two pieces of secondary legislation critical for the implementation the new **public procurement law**, while the final one remains pending. The two adopted joint ministerial decisions concern the establishment of a certification framework for private-sector engineers for public works and studies. However, the adoption of the third pending joint ministerial decision, which concerns the set-up of a new legal entity to develop and maintain a new integrated IT system, has been delayed and is now expected shortly.

- The launch of the call for bids for the **integrated case management system for civil and criminal court cases** has been further delayed and is due to be launched in March 2022. The European institutions reiterated their concern about the delay and encouraged the authorities to ensure the efficient and unhindered conduct of the process going forward.

- Adoption of the new **Code for the Organisation of Justice and the Status of Officers of the Courts** has accumulated a considerable delay. The Code was initially due to enter into force by September 2021 but was then delayed to January 2022. Currently, the authorities plan to table the Code to Parliament by the end of April 2022. The authorities attribute the additional delay to redrafting and consultation constraints. Among other things, the Code is expected to contribute to alleviating the challenges faced with dealing with personal insolvency backlogs monitored under the financial

policy commitment, in the sense that its revised disciplinary and promotion rules will foster a culture of stricter adherence to high professional standards amongst the members of the judiciary. Its adoption is also a precondition for addressing a significant part of the commitment to fight corruption. The authorities are strongly encouraged to proceed swiftly with the finalisation of the Code, given its fundamental importance for the efficient functioning of the justice system.

- The requisite secondary legislation for the operationalisation of the **JustStat unit of the Ministry of Justice** is expected to be adopted with a nine-month delay, by end-March 2022. The mandate of this specialised department is to collect and process data with a view to measuring and improving the performance of the judicial system.

In addition to the progress with specific commitments, the report welcomes that the authorities advanced on a number of broader structural reforms initiated in the context of enhanced surveillance. Notably:

- A list identifying deviations from the unified wage grid has been finalised as part of the authorities' efforts to strengthen central control of hiring and salary provisions in the **public administration.** Legal provisions addressing the identified weaknesses are planned to be adopted by April 2022. A needs assessment of permanent and temporary teachers in the medium- to long-term will also be completed by April 2022.

- The authorities have successfully completed the set-up of the **single digital (Gov.gr) portal** backed by relevant initiatives to ensure system interoperability and robustness, in line with the guidelines and priorities set out in the National Digital Transformation Strategy and the urgent needs arising from the evolution of the pandemic.

- The authorities are continuing the preparatory work on the **Higher Education Act**, following previous welcome reforms of the education sector, but its adoption is being delayed due to the challenges presented by the pandemic. The authorities have committed to launching the public consultation in March 2022 and the adoption is currently expected in May 2022.

The reduction of non-performing loans by the banking sector – mainly through the Hercules scheme – has continued but vulnerabilities remain as net inflows ([7]) of non-performing loans continue, albeit so far at a limited rate. The non-performing loans ratio stood at 15% on a solo basis in September 2021, having declined strongly from 30.1% at end-2020 and 40.6% at end-2019 ([8]), but remains the highest in the euro area. Net inflows of non-performing loans continued but remain below initial expectations. The securitisations under the Hercules scheme will allow banks to reduce their cost-of-risk going forward and free up space in their balance sheets for new lending. While recent securitisation transactions under the Hercules scheme result in increased provisioning needs, their impact on banks' capital

([7]) The term 'net inflows' refers to the difference between the volume of new non-performing loans and the volume of previously generated non-performing loans that have been cured or whose collateral has been liquidated in a given period of time. The overall stock of non-performing loans can decrease even if net inflows are positive, if for instance some non-performing loans are removed from the stock due to securitisation transactions or outright sales.

([8]) Source: Bank of Greece.

positions was partly offset by successful capital enhancing actions. Still, banks' capital position remains one of the lowest in the euro area and entails a high share of deferred tax credits.

The implementation of agreed policy actions in the financial sector has advanced, however several policy actions remain behind schedule. Regarding the insolvency code implementation, all procedures (OCW, rehabilitation, regular and simplified insolvency proceedings and early warning mechanism) are operational, along with the corresponding e-platforms. The assignment of new hearing dates for pending household insolvency cases is picking up, according to the updates provided by the authorities, but clearance of the backlog still falls short of expectations and is not envisaged before end-2023. The authorities have taken steps to increase the processing capacity at courts and expect the provisions of the Code for the Organisation of Justice/Judges to further enhance the process. The conduct of electronic auctions continues to increase since its resumption in September 2021, while work is ongoing regarding the introduction of further enhancements. The authorities remain committed to meet the agreed final targets concerning the processing and clearance of the entire backlog of called state guarantees by mid-2023 and mid-2024, respectively. The processing of claims has accelerated but this is only partially reflected in payments. Meeting the targets set for 2022 will require a further significant increase in the processing of claims and payments. The call for the expression of interest for the sale-and-lease-back entity is expected to be launched in February 2022. An interim support scheme for vulnerable debtors with primary residences is considered by the authorities to ensure a smooth transition until the sale-and-lease-back entity commences operations, which is currently not expected before end-March 2023. The authorities are encouraged to put in place strong safeguards to counter unintended use of the scheme and mitigate legal risks and proceed swiftly with establishing the sale-and-lease-back entity so as to ensure a timely phase-out of the interim scheme. Discussions on the future of the Hellenic Financial Stability Fund have progressed well and the relevant amendment is expected to be adopted by April 2022.

The authorities announced their intention to implement on 1 May 2022 an increase in the statutory minimum wage, in consultation with social partners, with a view to alleviating the negative impact of the price increases on low-income workers. This increase would follow a modest increase of 2%, decided in July 2021 and implemented in January 2022 following a two-year freeze of the minimum wage (as a result of the pandemic), which reflected developments in wages and productivity, as well as other indicators based on data up to the first half of 2021. While accelerating the regular procedure of updating the minimum wage to mitigate the impact of the high inflation on low-income workers, the authorities committed to follow the process established in law 4172/13 for determining the minimum wage. The authorities also indicated that the potential minimum wage adjustment in May will safeguard competitiveness and have a limited fiscal cost, including as regards the public sector wage bill. The minimum wage increase resulting from these consultations is expected to be announced in April 2022 and implemented from the following month.

Overall, this report concludes that Greece has taken the necessary actions to achieve its specific commitments, despite the challenging circumstances that continue to be posed by the pandemic. The Greek authorities have also outlined a credible path leading to further substantial progress on its commitments by the time of the 14th enhanced surveillance report to be published in May 2022. The authorities delivered on specific commitments across various areas, notably as regards enhancing the efficiency of public administration,

completing the administrative reorganisation of the Single Pension Fund and the simplification of investment licensing in the agreed sectors. Greece also advanced on wider structural reforms, including in particular in the area of digitalisation, and embarked on the implementation of its recovery and resilience plan ([9]). The European institutions welcome the authorities' 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 reforms in the area of financial sector policy, primary health care, the business environment and justice, and reach the agreed targets for the clearance of arrears.

MACROECONOMIC DEVELOPMENTS

The economy sustained its growth momentum in the third quarter of 2021 on account of strong export performance and private consumption. Growth in the third quarter of 2021 (2.7% quarter-on-quarter) was also supported by a quick recovery in tourist receipts and the goods exports remained resilient, despite the bottlenecks in the value chains. Investment also contributed positively, although from a relatively low base. The recent emergence of omicron variant and the related sharpening of the containment measures in December 2021, are expected to have weighed on growth in the last quarter of 2021, but this impact is expected to largely fade out during the first quarter of 2022. Overall, real GDP is projected to have rebounded by 8.5% in 2021, with the economy reaching its pre-pandemic level of activity already in the third quarter of 2021.

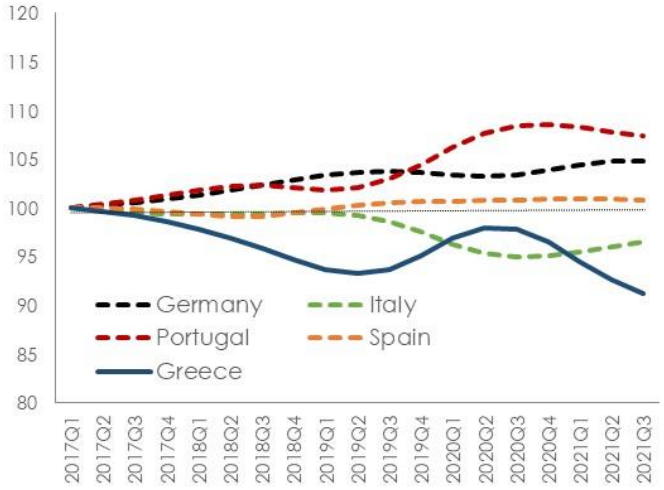
Growth in 2022 is forecast to be domestically driven, supported by the stimulus from the implementation of the investments and reforms under the Recovery and Resilience Facility. The external environment is forecast to remain supportive, as tourism is expected to recover a significant part of its losses during the pandemic, while goods exports are to extend their strong performance from last year. For the year as a whole, real GDP growth is estimated to reach 4.9% in 2022. In the third quarter of 2021, employment increased by 4.9%, up from 1.9% in the second quarter. While employment has almost reached its pre-pandemic levels, the losses in active labour force endured during the pandemic have not been fully recovered yet. Households' real disposable income is expected to rebound strongly in 2021 and continue growing in 2022. Rising oil and gas prices drove the noticeable increase in inflation over the second half of 2021, but these pressures are expected to ease later in 2022 as international prices moderate. The Commission's winter interim forecast expects inflation to peak in 2022, reaching 3.1%.

The above-mentioned announcement to increase the minimum wage in May 2022 comes in this context of rising inflation and strong recovery. According to law 4172/13, which sets out the minimum wage revision process, the level of the statutory minimum wage should be determined by taking into account the state of the economy and the evolution of growth prospects, notably developments in productivity, inflation, competitiveness, employment,

([9]) The plan was adopted by the Council on 13 July 2021 and includes reforms and investments worth EUR 17.8 billion in grants and EUR 12.7 billion in loans. The European Commission disbursed EUR 4 billion to Greece on 9 August 2021 in pre-financing, equivalent to 13% of the country's grant and loan allocation under the Recovery and Resilience Facility. On 29 December 2021, Greece submitted a request to the Commission for a disbursement of EUR 4.1 billion in financial support, assessment of which is ongoing. Greece was among the first countries to submit such a request.

unemployment, incomes and wages. Competitiveness, as measured by unit labour cost ([10]), had improved since 2018, largely on the back of a decrease in real compensation per employee, as real wages remained in check while employment increased. The temporary shock due to the pandemic in 2020 triggered a strong increase in unit labour cost as compensation per employees remained broadly unaffected due to the emergency support measures put in place by the authorities. In 2021, productivity is expected to have nearly fully recovered and its growth rate is expected to remain high, also supported by the investments implemented under Greece's Recovery and Resilience Plan. As shown in Graph 1, Greece has overall recorded significant gains in competitiveness since 2018. Despite these improvements, Greece's export base remains focused on products with a low level of technological sophistication and the exports-to-GDP ratio is low, despite recent improvements. Furthermore, its current account in cyclically adjusted terms ([11]) was in deep deficit in 2020 (-11.8% of GDP in national accounts terms) and remains well below the required level to reach a prudent net international investment position. The nominal minimum wage increased in a majority of euro area Member States (11 out of 15 Member States that have established a collective bargaining process) in 2021, ranging from 0.3% in the Netherlands to 16.3% in Latvia.

Graph 1: Real effective exchange rate based on unit labour cost (19 trading partners – euro area) (2017Q1 = 100)



Source: *European Commission*

Note: *The real effective exchange rate based on unit labour cost is defined as the ratio of the real effective exchange rate (value of currency against the weighted average of the euro area trade partners) divided by the unit labour cost. This indicator captures the drivers of persistent changes in cost competitiveness of each Member State relative to its major trading partners.*

The risks to the forecast remain elevated. Despite the better-than-expected economic outturn in the first three quarters of 2021, the evolution of the pandemic at both domestic and international levels represents a continuous source of uncertainty, for both tourist arrivals and potential further prolongation of the supply-side bottlenecks, and vulnerabilities remain. In addition, the projection expects only a limited negative impact on production from the notable pick-up in input costs, in line with the current reading of forward-looking indicators of

([10]) The unit labour cost (ULC) is defined as the ratio of the nominal compensation per employee to the real GDP per person employed.

([11]) The cyclically adjusted current account balance is defined as the current account balance adjusted for the level of the output gap in the domestic economy and its most important trade partners.

producers' sentiment. On the upside, the stock of savings accumulated by households during the pandemic could facilitate a stronger realisation of part of the purchases delayed from the previous periods, as spending opportunities for households improve. The strong performance of goods exports since the third quarter of 2020, could be indicative of structural improvements in the export base, as also evidenced by the continuous gains in export market shares. This could be a source of additional upside risks.

Table 1: Summary of main macroeconomic variables (%)

	2020	2021	2022	2023
Real GDP growth	-9.0	8.5	4.9	3.5
HICP growth	-1.3	0.6	3.1	1.1

Source: *European Commission*

FISCAL DEVELOPMENTS

The early reading of the fiscal and economic data augurs well for the fiscal outturn for 2021 as a whole. To recall, the Commission autumn forecast projected a primary deficit (as monitored under enhanced surveillance) of 7.6% of GDP for 2021 and 1.2% of GDP for 2022, and a primary surplus of 1.5% of GDP in 2023. Regarding the developments on the expenditure side in 2021, the implementation of some of the emergency support measures have been more gradual than assumed in the autumn forecast and thus payments worth around 0.1% of GDP have been shifted from 2021 to 2022. Furthermore, some measures had lower fiscal cost than anticipated, reducing the total cost for the measures in 2021 by another 0.1% of GDP. At the same time, state revenues in 2021 were higher than expected in the Commission autumn forecast by close to 1.2% of GDP. This was mostly due to high corporate income tax receipts, as the decline in corporate profitability in 2020, which determines the clearance of the 2020 tax liability due in 2021, was less severe than initially expected. Also other income taxes and VAT revenues had a higher yield than expected, mostly reflecting of the better-than-forecast macroeconomic growth. These factors were partly offset by the cost of a subsidy of EUR 250 per person to low income elderly and those receiving disability benefits provided by the government to counter the impact of increased inflation.

The vast majority of the emergency measures have been phased out by the end of 2021. In line with previous plans, only a limited set of temporary and targeted pandemic-related emergency measures will continue to support households and businesses in 2022, with a fiscal cost of about 1.7% of GDP. However, in view of the recent emergence of omicron variant some measures have been prolonged, such as labour contract suspensions, short term works scheme and hiring subsidy scheme. The health care system will also continue to receive increased support, which increases the fiscal costs for 2022 by an additional 0.15% of GDP. The repayment of the refundable advance was to start in January 2022, but due to delays in setting up the IT system repayments are expected only from the middle of 2022. This delay has a very limited fiscal impact for 2022 of about EUR 40 million. Finally, the authorities also plan to adopt a reform of the ENFIA property income tax, with a permanent fiscal cost of about 0.1% of GDP.

In response to the increased electricity prices the authorities have designed a new automatic support mechanism to alleviate cost increases to households and businesses. The scheme replaces a temporary subsidy scheme introduced in 2021 and provides a subsidy

linked to the excess of current electricity prices over a given threshold. Households are eligible for this subsidy only for their first residence. The subsidy will cover 80% of the increase above the threshold for the first 150 KWh consumed monthly and 60% of the increase for the next 150 KWh. Vulnerable households will benefit from a larger subsidy covering 90% of the increase for the first 300 KWh. For enterprises, a single subsidy is planned for all categories covering 50% and 30% of the price increase in the first and the second quarter of 2022, respectively. Based on the projection of wholesale electricity prices of the Renewable Energy Sources Operator, the total volume of the subsidies might reach EUR 1 billion until July 2022 (0.5% of GDP). The subsidy scheme was calibrated to be fiscally neutral as its cost will be covered by the estimated increased revenues from the emissions trading system. The additional revenues from the emission trading system are also expected to cover the cost of a heating subsidy to alleviate the impact of the sharp increase in natural gas prices. The subsidies appear in line with the guidance provided in the Commission Communication on Tackling Rising Energy Prices ([12]), as they are temporary and will be re-assessed every month.

Fiscal risks remain high. Uncertainty about the evolution of the pandemic remains the main short-term risk factor, notably, as regards the need for further support measures and the possible activation of the state guarantees provided during the pandemic. The new electricity subsidy scheme will require close monitoring in view of its large size, in particular as regards the adequacy of the assigned revenue flows expected to cover these subsidies, while at the same time ensuring that the account of renewable energy sources will not turn into deficit. Further risks remain unchanged compared to the previous report, in particular the recent or planned financial policy arrangements, including the sale and lease-back scheme for properties owned by vulnerable debtors, may entail a deficit- and debt-increasing impact depending on their final statistical classification. Additional uncertainty is related to pending legal cases including on retroactive compensation for pension cuts and litigation cases against the Public Real Estate Company (ETAD). On the upside, the better than expected state revenues are likely to carry over for 2022 as they possibly reflect that the tax base was less affected by the crisis than initially assumed.

SOVEREIGN FINANCING

Yield spreads have increased but remain below the average levels reached in 2019 before the pandemic. In December 2021, the Governing Council of the European Central Bank decided ([13]) to discontinue net asset purchases under its pandemic emergency purchase programme at the end of March 2022 and to reinvest the principal payments from maturing securities purchased under this programme until at least the end of 2024. In this context, the Governing Council clarified that in the event of renewed market fragmentation related to the pandemic, reinvestments can be adjusted flexibly across time, asset classes and jurisdictions at any time and could include purchasing bonds issued by Greece over and above rollovers of redemptions. Despite the ongoing asset purchases of Greek government bonds by the European Central Bank, and reflecting increased risk aversion in financial markets against the backdrop of increasing uncertainty about the economic and inflation outlook, yield spreads over the

([12]) Commission Communication on Tackling rising energy prices: a toolbox for action and support, COM(2021) 660.

([13]) Combined monetary policy decisions and statement, 16 December 2021. https://www.ecb.europa.eu/press/pressconf/shared/pdf/ecb.ds211216.en.pdf

German Bund have been increasing, moving above 200 basis points on the 10-year maturity in early February 2022.

Greece conducted a successful liquidity management exercise in 2021. After the previous bond exchange concerning the so-called 'step-bonds' conducted in 2017, Greece now managed to exchange EUR 3 billion of the remaining EUR 4 billion worth of step-bonds. With this exchange the weighted average maturity of these liabilities increased from eight years to thirteen years. As some of the bond holders received cash in return for their bonds, the general government debt has been reduced by around EUR 1 billion.

New bond issuances contribute to high cash reserves. In line with the expectations based on the seasonality of budgetary revenues and expenditure and the debt amortisation schedule, cash reserves declined in the last quarter of 2021 and stood at EUR 31.6 billion in December ([14]). This is slightly higher than the level observed a year earlier. The Public Debt Management agency published its funding strategy for 2022. Based on the plan, Greece expects to raise EUR 12 billion on the open market in 2022, which is slightly lower than the amount raised in 2021. In January 2022 the implementation of this plan started by the successful issuance of a 10-year bond with the amount of EUR 3 billion, reaching a yield of 1.8%.

DEBT SUSTAINABILITY ANALYSIS

The update of the debt sustainability analysis indicates that risks remained unchanged compared to the 12th report but uncertainty remains high. The current analysis is a partial update of the one published in the 12th report. The update includes the data on the recent liquidity management exercise and the latest bond issuance while the macroeconomic, financial and fiscal variables continue to be based on the Commission 2021 autumn forecast. Short-term risks to debt sustainability remain contained, whereas risks are more significant over the longer run in the alternative scenarios. In the baseline scenario, debt decreases from 203% of GDP in 2021 to around 55% of GDP in 2060, while gross financing needs remain below 15% of GDP in the long run. In the higher risk premium scenario, debt decreases to 90% of GDP by 2060, and gross financing needs hover around 18% of GDP from the 2030s. In the low growth scenario, the debt level does not stabilise, and gross financing needs permanently surpass 20% of GDP as of 2050. The alternative scenarios show that potential increases in the interest rates over the medium-term and weaker economic growth could negatively affect debt sustainability. A full update, including macroeconomic, financial and fiscal assumptions will be presented in the next enhanced surveillance report.

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

Table 2: Main assumptions of the baseline scenario

		2021	2022	2023	2024	2030	2040	2050	2060	average 2021-2029	average 2030-2060
Assumptions	Primary balance (% of GDP)	-7.6	-1.2	1.5	2.2	2.2	2.2	2.2	2.2	0.7	2.2
	Real GDP growth	7.1	5.2	3.6	2.7	1.2	1.7	1.6	1.5	2.5	1.5
	Nominal GDP growth	7.0	6.1	4.0	3.4	3.0	3.8	3.6	3.6	3.4	3.6
	Re-financing rate (10 year maturity)	0.8	0.9	0.9	1.0	1.4	2.6	3.9	4.0	1.1	3.1
Results	Gross financing needs (% of GDP)	23.7	17.1	14.9	9.6	12.9	13.7	13.1	11.1		
	Gross goverment debt (% of GDP)	202.5	195.9	191.1	185.2	162.9	116.1	78.2	55.2		

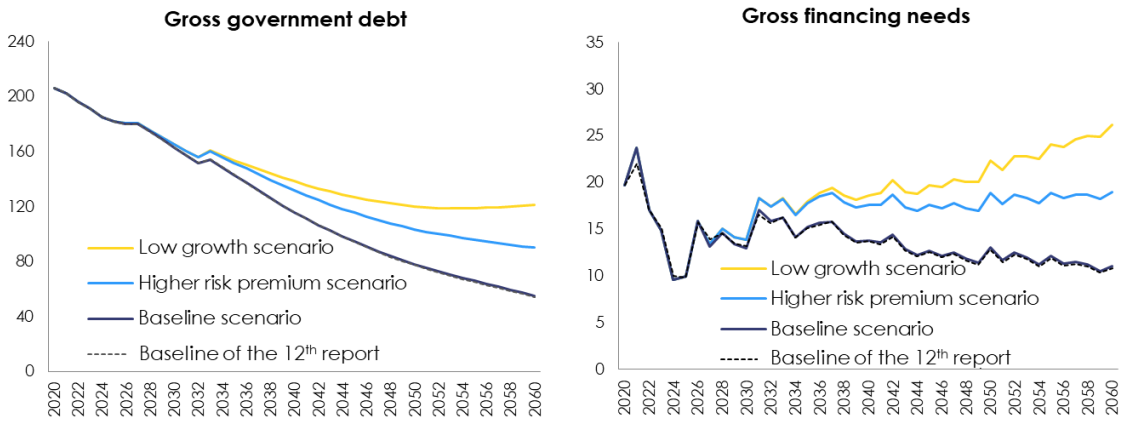
Source: *Commission services*

Table 3: Main assumptions of the scenarios

		2021	2022	2023	2024	2030	2040	2050	2060	average 2021-2029	average 2030-2060
Nominal GDP growth (%)	Baseline scenario	7.0	6.1	4.0	3.4	3.0	3.8	3.6	3.6	3.4	3.6
	Higher risk premium scenario	7.0	6.1	4.0	3.4	3.0	3.8	3.6	3.6	3.4	3.6
	Low growth scenario	7.0	6.1	4.0	3.4	3.0	3.0	3.0	3.0	3.4	3.0
Re-financing rate (%)	Baseline scenario	0.8	0.9	0.9	1.0	1.4	2.6	3.9	4.0	1.1	3.1
	Higher risk premium scenario	0.8	0.9	0.9	1.0	4.0	4.4	5.2	5.3	2.2	4.7
	Low growth scenario	0.8	0.9	0.9	1.0	4.0	4.6	5.7	6.0	2.2	5.1

Source: *Commission services*

Graph 2: Results of the debt sustainability analysis (% of GDP)



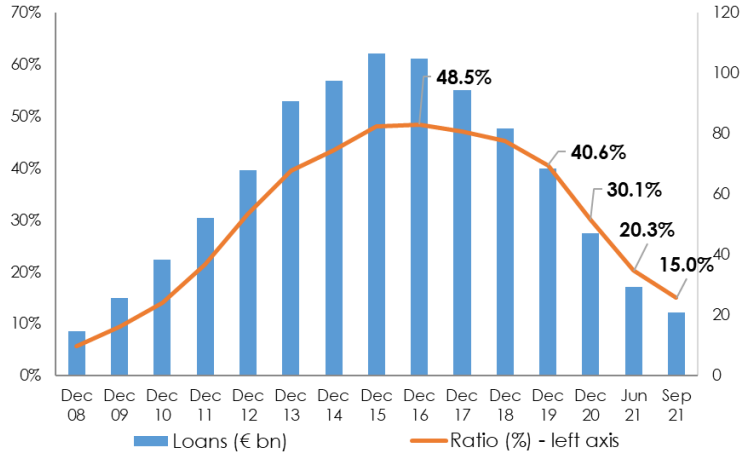
Source: *European Commission*

FINANCIAL SECTOR DEVELOPMENTS

The reduction of non-performing loans in the banking sector has continued but vulnerabilities remain and a large amount of this debt remains in the economy, burdening the private sector. The non-performing loans ratio stood at 15% on a solo basis in September 2021, having declined strongly from 30.1% at end-2020 and 40.6% at end-2019, mainly thanks to securitisation transactions under the Hercules scheme. Nonetheless, it remains the highest in the euro area. This corresponds to a reduction in the stock of non-performing loans on a solo

basis from EUR 68.5 billion at end-2019 and EUR 47.2 billion at end-2020 to EUR 20.9 billion in September 2021 ([15]). It amounts to an 80.5% reduction compared to its peak level in end-March 2016 (EUR 107.2 billion). All four systemic banks are so far on track to meet the target of single-digit non-performing loans ratios at the latest by the end of 2022, with three non-performing loan securitisations of circa EUR 9.3 billion already concluded in the fourth quarter of 2021 ([16]). Further, more limited securitisation transactions and outright non-performing loan sales are anticipated in 2022 to support these efforts. As a result of this unprecedented transaction activity, a large amount of non-performing debt has exited the banks' balance sheets but remains in the hands of specialised non-bank financial institutions, which owned EUR 72.2 billion of predominantly non-performing loans as of end-September 2021. These institutions will try to maximize recoveries from these loans through a combination of restructurings and liquidations, using their previous experience with managing non-performing loans.

Graph 3: Evolution of the stock of gross non-performing loans and the non-performing loan ratio of Greek banks



Source: *Bank of Greece*
Note*: Gross non-performing loans as a share of total customer loans, for on-balance-sheet loans in accordance with European Banking Authority's definitions.*

Net inflows of non-performing loans continued albeit so far at a limited rate but risks persist. Banks are currently reporting a limited increase in the re-default rate for loans after exiting moratoria, below initial expectations. However, net inflows ([17]) of non-performing loans continued in the third quarter of 2021, at similar levels as in the first half of the year. There is a material part of the banks' loan book that still benefits from some form of support, mainly via two temporary instalment subsidy schemes set up by the authorities for performing or restructured coronavirus-affected debtors (the "Gefyra" and "Gefyra II" schemes) ([18]) and, to a lesser degree, via banks' 'step up' products offered to viable customers facing temporary

([15]) Source: Bank of Greece.
([16]) Gross book values of the underlying loan portfolios.
([17]) The term 'net inflows' refers to the difference between the amount of new non-performing loans and the volume of previously generated non-performing loans that have been cured or whose collateral has been liquidated in a given period of time. It does not take into account the much larger reductions of non-performing loans due to other means, such as the securitisations under the Hercules scheme, which explains the overall decrease in the stock.
([18]) As of end-December 2021, the Gefyra I scheme covers 101 562 eligible debtors, corresponding to EUR 8.5 billion of loans, predominantly performing (83.1%). For Gefyra 2, the equivalent figures are 13 888 eligible debtors, corresponding to EUR 6.8 billion of loans, mostly (81.4%) performing.

difficulties and the remaining payment moratoria granted to the hospitality sector. As a result, the full impact of the pandemic on the banks' asset quality is expected to materialise only in 2022.

Going forward, banks' management of loans in or at risk of default and their ability to offer viable long-term solutions is expected to gain importance, as the potential for securitisations and sales is gradually being exhausted. The swift deleveraging of denounced loans by Greek banks is changing the structure of their non-performing loan portfolios, with unlikely-to-pay loans representing an increasing share of the portfolio (33.7% as of end-June 2021 as opposed to 29.4% at end-December 2020). As a result, banks' internal credit risk management and their capacity to offer viable long-term restructurings, tailored to the specific needs of this type of loans, are expected to become a crucial element to sustain an adequate pace of non-performing loan curings ([19]). At the same time, effective collateral recovery will be crucial when successful restructuring is not feasible. The challenge for banks to rely more on viable restructuring solutions is illustrated by the fact that, out of the total amount of EUR 22.8 billion of restructured (i.e. forborne) loans in the banks' loan book at end-June 2021, 17.7% had re-defaulted and were in arrears for more than 90 days ([20]), while the percentage of re-defaulted long-term modifications within a 1-year horizon stood at relatively high levels.

The continued efforts to clean up banks' balance sheets negatively impact their profitability in the short term but open the way for profitable new lending. Higher provisioning needs due to securitisations of non-performing loans have adversely affected two significant banks. As a result, the banking sector has continued to show aggregate losses in the first nine months of 2021 with only two of the four systemic banks achieving positive results. Nevertheless, according to banks' own calculations, all recurring operations have been profitable, which indicates a gradual return to profitability, when excluding the one-off effects of efforts to move non-performing loans off the banks' balance sheets. Interest revenues will be affected by the completion of further non-performing loans securitisations ([21]) coupled with the low interest rate environment. On the cost side, the need for further debt issuances in order to meet the minimum requirement for own funds and eligible liabilities (MREL) ([22]) as per the EU legislation will put further pressure on the banks' cost of funding. The banks plan to counterbalance these costs by the implementation of business plans, which take into account the expected increased financing needs of the economy and the prospects for new lending, the reduced impairments following recent efforts to reduce non-performing loans, and the development of alternative sources of revenue by accelerating the banks' digital transformation.

The impact of the clean-up of the banks' balance sheets on their capital position was partly offset by certain successful capital enhancing actions. Banks' average Common

([19]) I.e. the return of previously defaulted loan balances back to performing loan status.

([20]) Source: Bank of Greece, Financial Stability Report, December 2021.

([21]) Securitisations of non-performing loans lead to a recurrent loss of net interest income, as they result in the loss of the accrued interest income from the transferred non-performing loan portfolios. However, as accrued interest income is interest income earned but yet to be received, the average quality of the bank's recurrent net interest income will improve once the offloaded non-performing loans are replaced with profitable new lending.

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

Equity Tier 1 and Total Capital ratios stood at the end of the third quarter of 2021 at 12.5% and 15% of risk-weighted assets on a consolidated basis, respectively ([23]), virtually unchanged compared to the previous quarter (12.5% and 15% respectively). However, their capital position was still lower than a year ago (14.6% and 16.3% respectively in September 2020), reflecting the cost of non-performing loan deleveraging and the phasing out of transitional prudential adjustments ([24]). The quality of the regulatory capital continues to be a concern, as deferred tax credits account for EUR 14.4 billion or 62% of total regulatory own funds in September 2021, which is an increase from 53% in December 2020. The capital position of the banks has been strengthened by two banks' successful share capital increases, which were concluded in 2021 ([25]). Further upcoming capital enhancing actions took place in the last quarter of 2021 and are expected to materialize in 2022, in order to provide support for the capital position of the four systemic banks, enabling them to continue with their ambitious non-performing loan reduction plans. While the outlook of increasing capital buffers and cleaning balance sheets seems positive, the capital position remains one of the lowest in the EU.

Provision of credit to the non-financial corporate sector has registered a mild recovery in recent months. In net terms, it has reached 3.8% in December 2021 compared to a year ago. This is a positive turn after continuous net credit growth deceleration which fell to 2.8% year-on-year in September 2021 from 6.7% in April and 10.0% in December 2020. The earlier decreasing trend was mainly driven by less net credit to large corporates mainly on the back of muted credit demand, as companies make use of precautionary liquidity buffers built up over previous quarters. Moreover, the largest non-financial corporations are partially substituting bank lending with cheaper funding through corporate bond issuances. At the same time, credit growth to small and medium enterprises continues to decelerate. Growth of credit to households remained negative but the decline was marginally smaller in December 2021 (-2.4%) due to a milder contraction in consumer loans. The weighted cost of credit to non-financial corporations decreased to 2.9% in December 2021 from 3.3% a year earlier and remains at historically low levels, substantially less than the cost of credit for unincorporated businesses or households (4.6% and 4.7% respectively). The Hellenic Development Bank launched five new financing schemes in 2021, mainly targeted to support small and medium-sized enterprises but they are significantly smaller in size compared to COVID-19 enterprise guarantee fund and TEPIX II schemes, which are almost exhausted. In 2022 and beyond, a large support for credit expansion to non-financial corporations is expected to come from projects financed by Greece's recovery and resilience plan.

Discussions progressed well on the future of the Hellenic Financial Stability Fund. The reform of the Fund's legal framework is expected to focus on the duration, governance, divestment strategy and special rights of the Fund. Adoption of the legal amendment is now expected to take place in the coming months and will be reported on in the 14th report. The Hellenic Financial Stability Fund has also participated in the share capital increase of a less-significant institution where it already had a majority stake, which was a result of the

([23]) Source: European Central Bank Consolidated Banking Data

([24]) 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.

([25]) Share capital increases were concluded by two systemic banks in early May and early July. Third quarter figures do not reflect yet a share capital increase undertaken by a less-significant bank in December 2021.

implementation of the Greek legislation for deferred tax assets. The bank has successfully performed a share capital increase, which aims to be the first step in the bank's transformation and development. The Fund has reduced its previous shareholding to allow the participation of private investors and has entered, for the first time, into a shareholder agreement with private investors on the terms concerning the operations and the business plan of the bank as well as its implementation.