Overcoming the crisis in Greece

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I. A BIRD'S EYE VIEW ON GREECE

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2012	Greece	EA17	World
Population (mil.)	11.4	332.1	7,052.1
Geographical Area (thousand km^2)	132.0	2,624.0	148,940
GDP per capita (€)	17,161	28,463	7,219
Human Development Index (2012 UN ranking among 186 countries)	29		
Life expectancy (years)	80.0	81.0	70.1
Motor vehicles per 1000 inhabitants (2010)	624	593	175
Suicides / 100 thousand inhabitants (2009)	3.2	12.9 (OECD)	
Primary Sector (% GDP)	3.4	1.8	4.3
Secondary Sector (% GDP)	16.4	25.1	29.3
Tertiary Sector (% GDP)	80.2	73.1	66.4
Tourism (Total contribution, % GDP)	16.4	8.3 (EU-27)	9.2
Construction (% GDP)	2.1	5.9	
Public Sector (Prim. Gen. Gov. Exp. % GDP)	49.7	46.8	
Exports (% GDP)	27.0	45.7	
Imports (% GDP)	32.0	43.0	
Private Consumption (% GDP)	73.7	57.5	
Gen. Gov. Debt (% GDP)	156.9	92.7	

I. HIGH GREEK GROWTH RATES .... UNTIL 2007 ...

Eurobank

- An increase in Greek world-wide relative living standards from 1960 to 2008
- Within Europe, consistently larger annual growth rates relative to EE-15 average from 1996 through 2007, bringing convergence in living standards with the rich EE-15

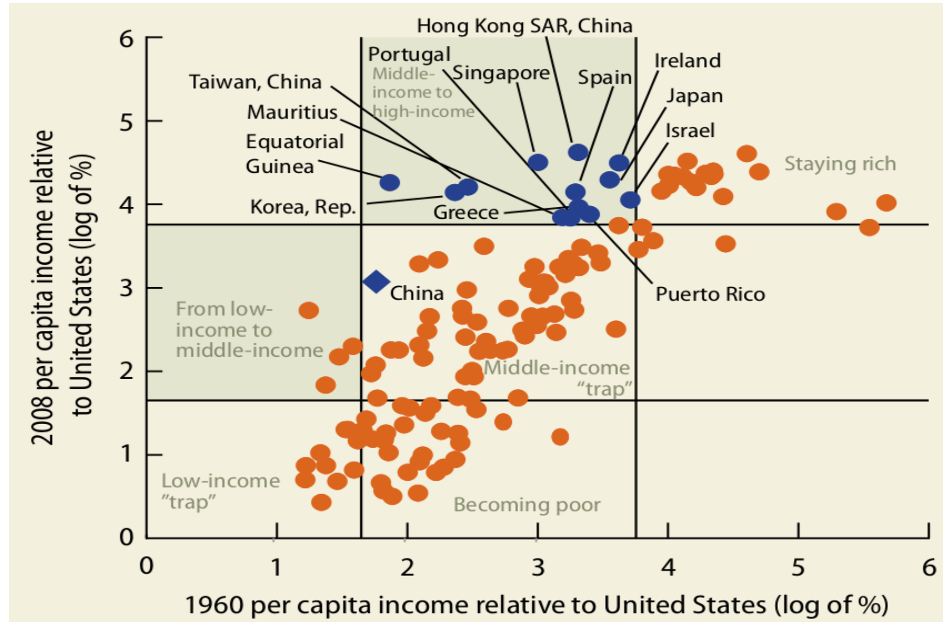
Relative Living Standards

EE-15=100 in PPS

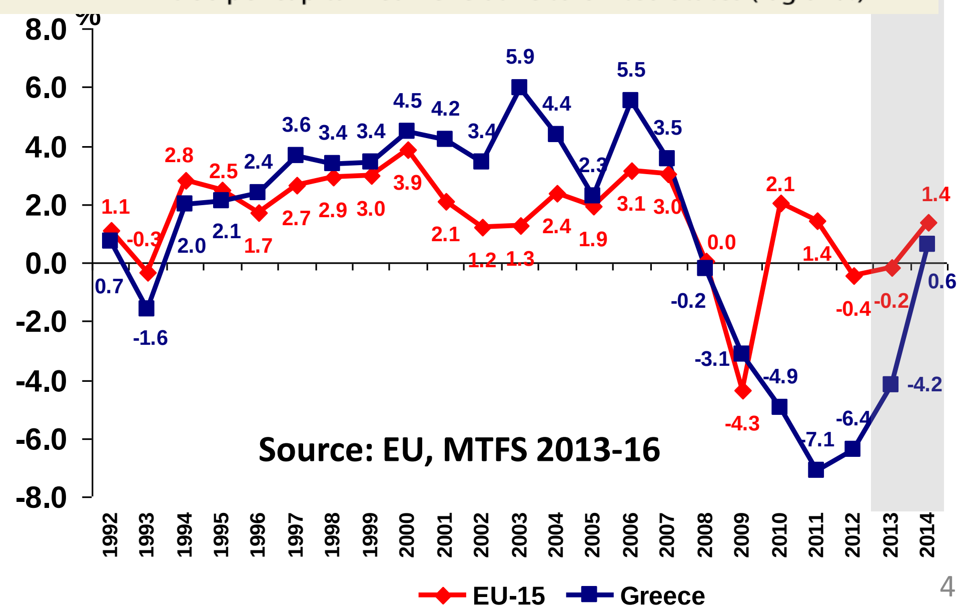
1992 74.7

2009 85.3

2014 65.4



- HUGE DIVERGENCE today with a recession that has lasted 6 years
- From boom to bust, how come? Answer: Major imbalances in the economy, i.e. not an equilibrium growth, driven by external borrowing



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I. FUNDAMENTAL IMBALANCES: OVER-CONSUMPTION & UNDER-PRODUCTION

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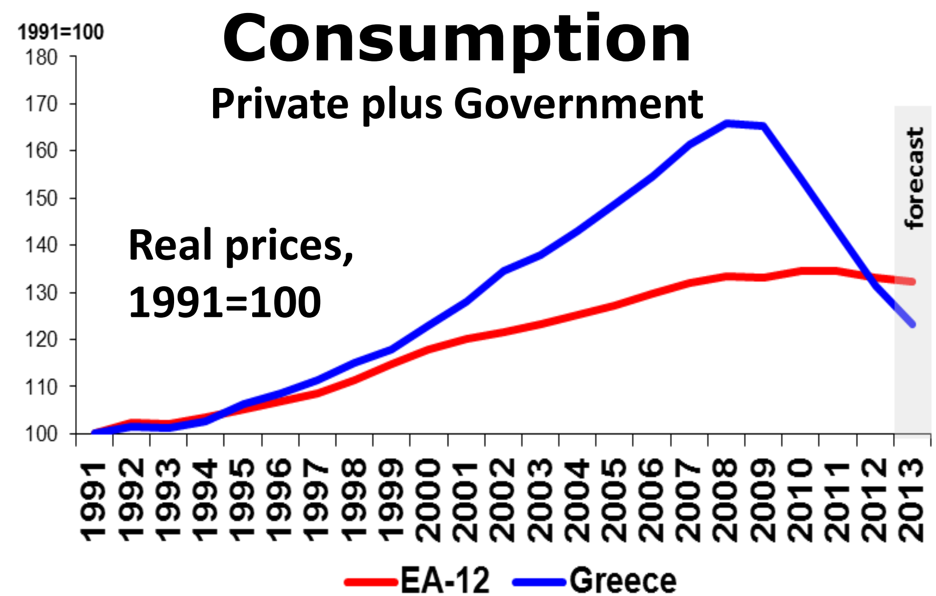
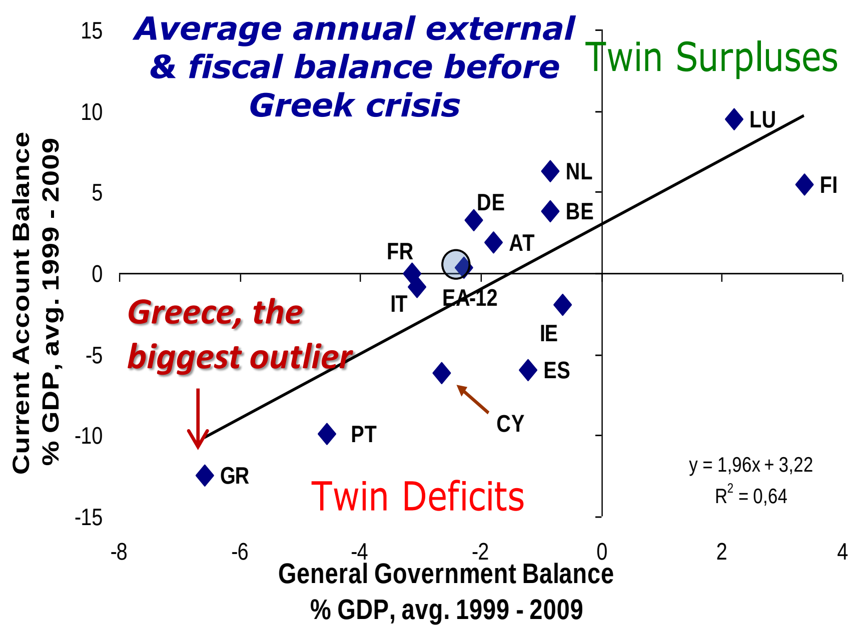
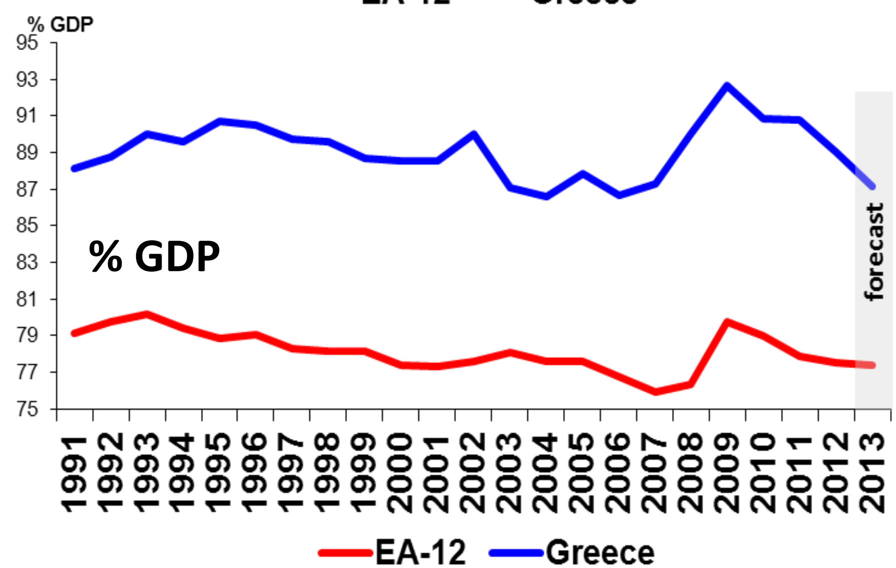
2012 SHARE in real GDP	Greece	EA17
Private consumption	69.8%	56.1%
Public consumption	19.4%	21.4%
Total investment	13.7%	18.2%
Exports	25.1%	45.3%
Imports	28.6%	41.0%

Oil Exports in 2012 were € 10.4bn or 5.4% GDP
Oil Imports in 2012 were € 17.9bn or 7.2% GDP







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Source: European Commission

Source: European Commission

I. A NEW GROWTH MODEL REQUIRED

- Equilibrium growth implies that the share of consumption in GDP has to decline
  - **Puzzle**: But if consumption is such a huge percentage of GDP and, therefore, its momentum drives GDP growth, how can this be done without a long recession/stagnation?
  - **Answer**: By ensuring the other components of GDP rise a lot faster, namely exports and investment.
  - This way consumption can still increase, yet at a lower rate than GDP, with a declining share in GDP and simultaneously without dragging down aggregate demand
- Hence, the **new growth model should place an emphasis on exports and investment.** This points to the importance of competitiveness and a friendly business environment.
- This balance between consumption and investment & exports is also present in the Troika projections over the next decade
- Thus far only exports have picked up. Investment has shrank and there is no help form public investment either

I. TWO CONSECUTIVE MoUs, 5/2010 & 3/2012, DESCRIBE RESPONSE TO THE CRISIS

- ✓ Drastic pension reform in the Law
- ✓ 1st MoU design flaw, as the negative effects of fiscal consolidation on real economy were expected to be partly mitigated by positive effects of internal devaluation and other structural reforms
- ✓ Troika proved over-optimistic :

POLICIES		SUCCESS
1.	Pension reform	+
2.	Fiscal consolidation	+
3.	Internal devaluation	+
4.	Structural reforms	~
5.	Privatizations	-
6.	Debt restructuring	~

1. **Size of exports a lot less than size of consumption**, thus cost-competitiveness gains translate into higher export shares with delay
2. **Fiscal multipliers proved much higher than assumed**: Hardliners over-relied on (a) the benefits of fiscal contraction on expectations, disregarding history & Keynesian Theory, and on (b) the benefits of structural reforms, which come with a substantial delay
3. **Early on, Greeks pushed structural reforms only half-heartedly and often under the threat of not receiving the promised cash from the lenders**
   - Greeks kept destroying credibility, infuriating the lenders on a constant basis, as they refused to reform the deep State, the entrenched tax system, the interest groups, the oligarchic structure
   - Of course, democratic societies cannot change attitudes overnight plus the inflow of European money (1st MoU) prevented a "**sudden stop**" or an economic hard-landing, which would have awaken the population a lot faster to the reality of the budget and State mess

I. MAJOR ACHIEVENTS WITH CONCRETE RESULTS

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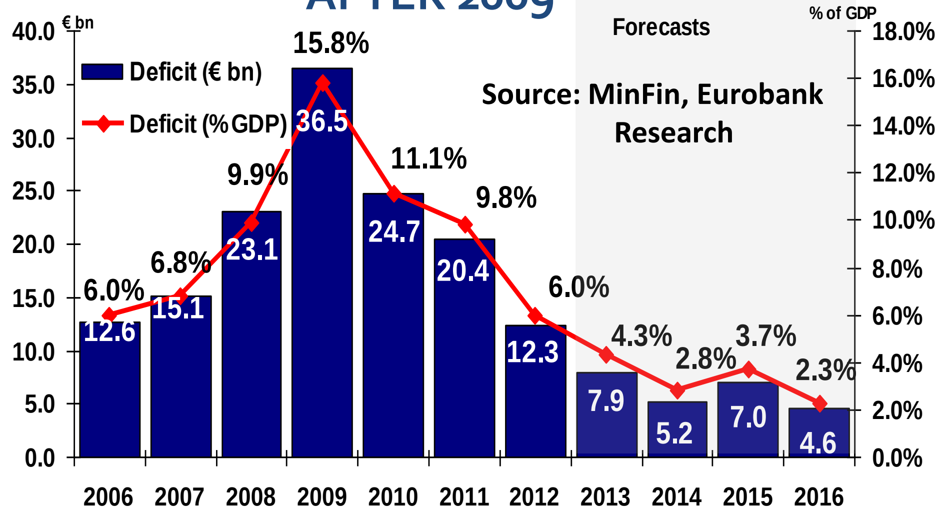
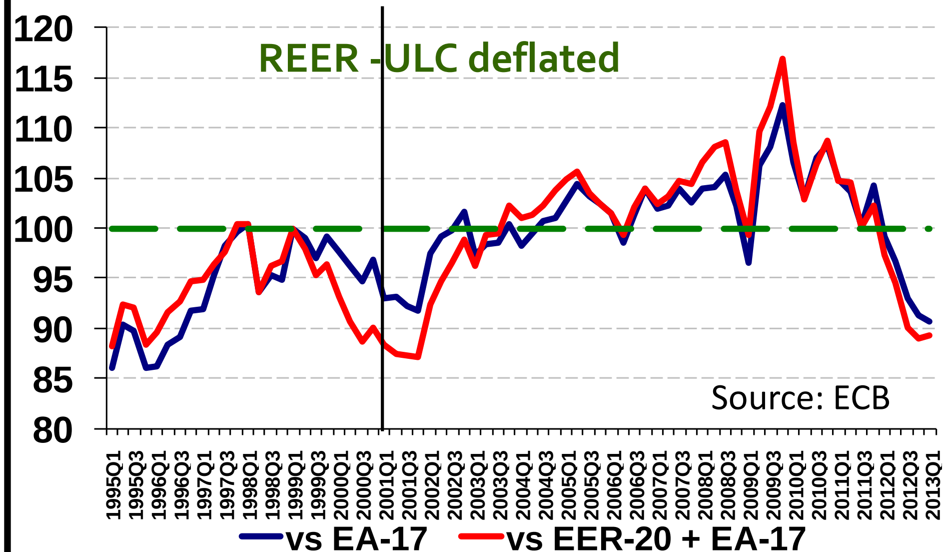
DRASTIC FISCAL CONSOLIDATION AFTER 2009



- <u>Wage & pension cuts</u> & other public expenses
- Pensions, Health Care, Public Sector & Structural Fiscal Reforms <u>also contributed</u> despite the serious delays in implementation

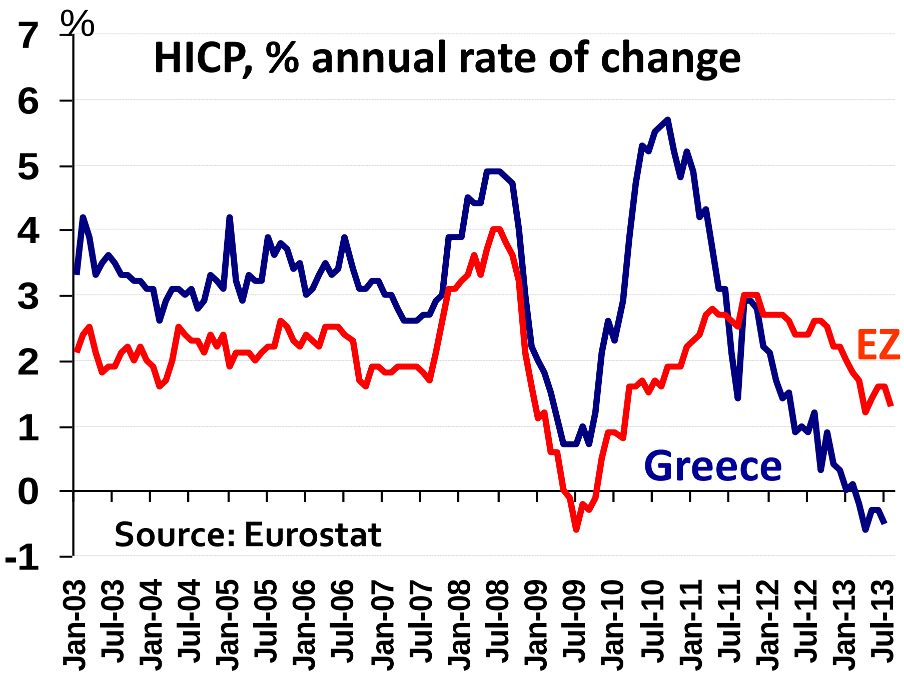
COMPETITIVENESS IMPROVED

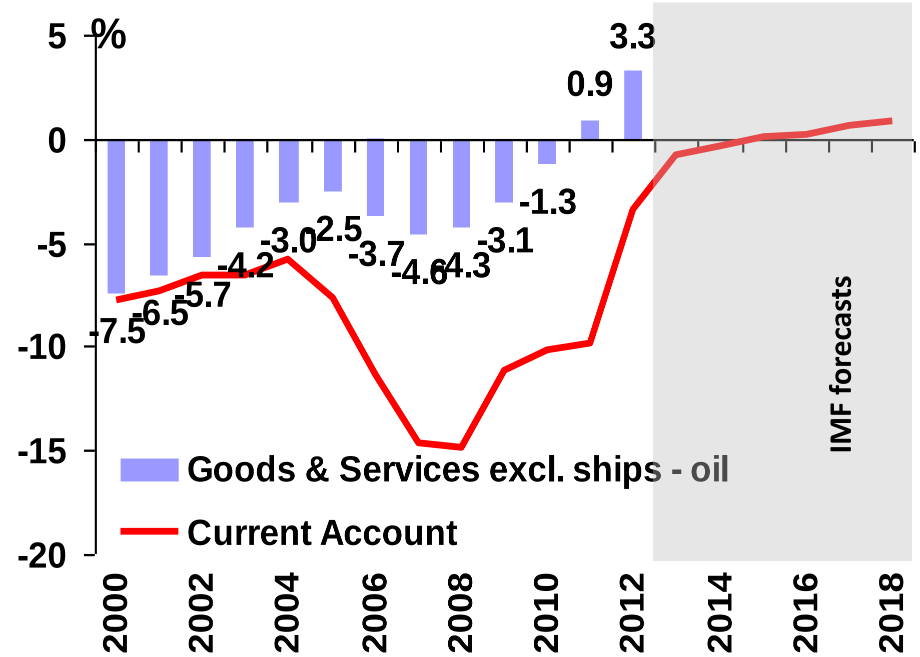


- Gains of over 25 points in <u>cost</u> competitiveness from the peak in 2009 because <u>Labor Market reforms took priority</u> over product & service market reforms
- Institutional reforms lag behind

CUMULATIVE (%Δ) IN NOMINAL UNIT LABOR COSTS

% Δ	GR	CY	DE	FR	IT	ES	IE	PT	US	EA17	EU27
2000 - 2009	33.2	31.2	5.6	22.4	31.4	33.8	34.2	26.8	18.2	21.0	23.2
2009 - 2012	-8.1	4.2	3.1	4.0	3.4	-6.6	-9.4	-5.8	2.7	1.6	2.3





Source: BoG, IMF

2012	€ mn	% GDP
Curr. Account	-6,527.9	-3.4
Goods	-19,619.0	-10.1
Services	14,721.4	7.6
Income	-3,061.7	-1.6
Transfers	1,431.5	0.7

Overcoming the Crisis in Greece

I. THE RECENT PAST: A serious effort to correct earlier imbalances

II. THE PRESENT: The depression is way too long & deep. How can it be stopped?

III. THE FUTURE: How can the country pick up momentum on a new equilibrium growth path?

II. CLUES THAT OPTIMISM IS COMING BACK

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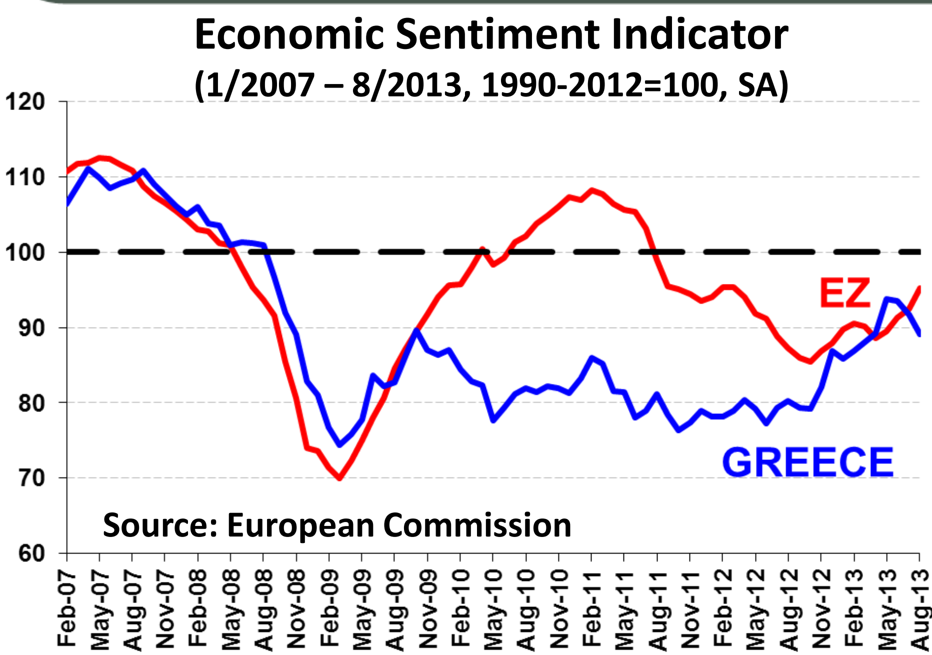
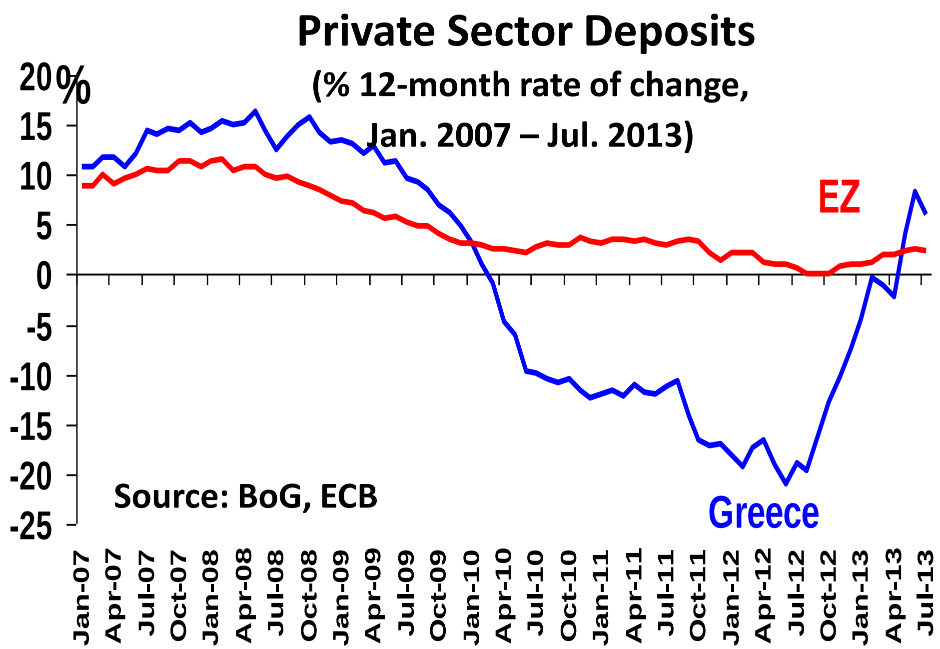
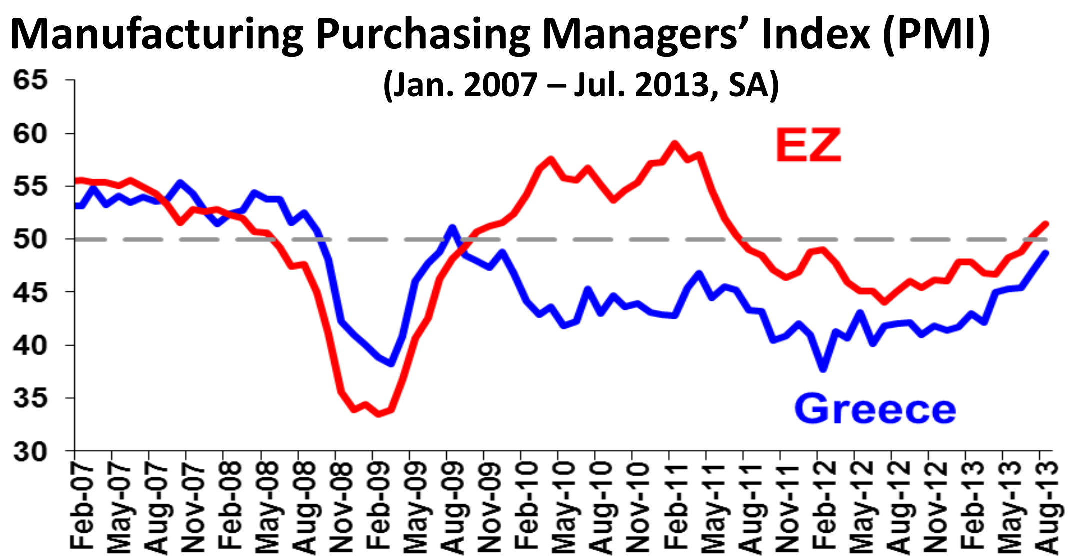




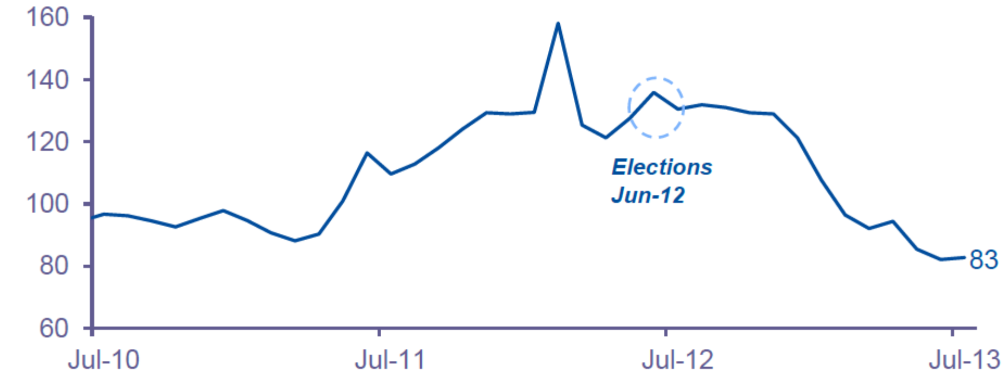


Source: Markit, Bloomberg, BoG

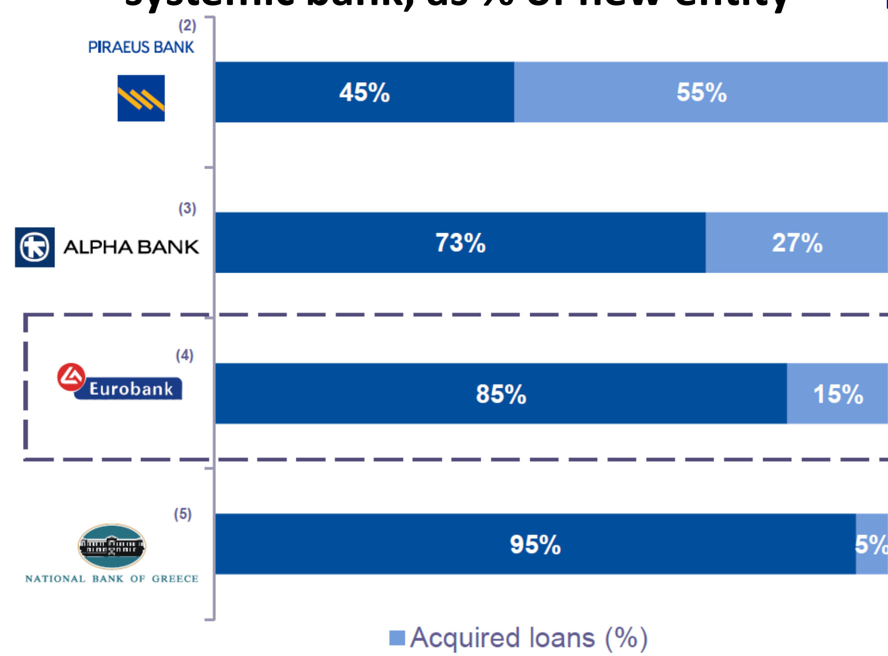
II. RETURN OF CONFIDENCE IN THE BANKING SYSTEM

- Deposits flow back after June 2012 elections & there is room for more inflows
- Eurosystem funding declines, and so does the costly ELA funding
- Cost of deposits begins declining from unusually high levels
- Deceleration in new NPLs
- Provisions (i.e. cost of risk) are reaching their maximum in 2013
- Consolidation in the sector, as four systemic banks now own 91% of total gross loans
- Banks are fully capitalized: €42 bn of new capital injected via HFSF (€38.9) and private investors (€3.1)
- Pre-provision income improves

Eurosystem funding (€bn)



Loan portfolio expansion per systemic bank, as % of new entity



New size of Loans €

68.5

53.4

46.3

43.2

II. LIQUIDITY EXPECTED TO COME BACK TO THE MARKET

- **Liquidity to the private sector expected to be boosted by**:
  - ✓ Expected improved absorption of EU Structural Funds: €8.75bn in 6/2013 – 12/2015
  - ✓ Planned elimination of government arrears by the end of 2013 from €8.9bn or 4.6% of GDP at the end of 2012
    - Already €2.5bn disbursed by end-of-June 2013
  - ✓ EIB funding of €1bn agreed for 2013 for SMEs (this will probably be larger due to leveraging/co-financing of projects by banks)
  - ✓ Recapitalization of Greek banks (€23.5bn in 2013 alone) – already completed - and its impact on banks' available funding & cost of funding
  - ✓ Uncertainty regarding Euro participation remains low or declines further, leading to a gradual return of deposits

II. THE ECONOMY SHOWS SIGNS OF IMPROVEMENT

- **A recession deceleration** in 2013-Q2 higher than expected
- **Balance of Payments Deficit improves** faster than expected, from -7.3% of GDP in 1H2012 to -3.3% in 1H 2013
- **Tourism revenues increased** by 17.1% yoy in 2013 H1
- The **TAP pipeline** is a strategic success that can also bring 10,000 jobs in the future
- **Highway projects** can bring 25,000 expected **new jobs**
- Measures to **reduce unemployment** through projects funded by **EU structural funds**
- **Privatizations** as a subsequent potential source of FDI in the medium term
  - Privatization revenues go directly to the reduction of debt, yet their fulfillment subsequently brings new FDI
  - Cumulative privatization revenues of €1.6 bn at the end-2012
  - Privatizations of OPAP and DESFA soon to be completed (expected revenue by the end-September 2013 at €0.9 bn).
  - Target for 2013 at €1.6 bn, revised downwards because of lack of interest for DEPA
  - Targets for 2014, 2015 and 2016 are €3.5bn, €2.0bn & €2.2bn respectively

II. MACROECONOMIC PROJECTIONS POINT TOWARDS AN END OF THE RECESSION

	2012 Nominal €bn	2012 growth Real	Shares in 2012 Nom. GDP	2013 growth Real	2014 growth Real
Private Consumption	142.756	-9.1%	73.7%	-7.1%	0.5%
Government Consumption	34.398	-4.2%	17.8%	-7.2%	-3.1%
Tot. Consumption	177.154	-8.1%	91.4%	-7.1%	-0.2%
GFCF	26.339	-17.6%	13.6%	-9.9%	1.5%
Domestic Demand	203.493	-9.4%	105.0%	-7.5%	0.0%
Imports	62.053	-13.8%	32.0%	-9.8%	0.6%
Exports	52.309	-2.4%	27.0%	2.9%	2.1%
GDP (nominal)	193.748				
Real GDP		-6.4%		-3.9%	0.4%
GDP deflator		-0.9%		-1.5%	-0.5%
Unemployment (avg)		24.7%		27.0%	27.5%

Source: Eurobank Research

II. WHY SUCH MACROECONOMIC PROJECTIONS?

- **What is so different in 2014, which was not present in previous years that can justify the optimism?**
- **Answer: Besides the positive clues already mentioned earlier, no additional anticipated restrictive measures, hence stability in disposable income and improvement in sentiment**

1. **Consumption stops declining as fast as before**
   - **Tax rates do not rise further, hence do not decrease disposable income**
   - **Level of permanent income stops declining, as exports & investment-driven growth generates a recovery**
2. **Exports continue expanding with the help of the freshly capitalized banking system and with the enforcement of structural reforms that minimize bureaucracy and help improve price & quality competitiveness**
3. **Gross investment stabilizes and takes off soon, that is,**
   - **Sentiment improves and Greeks begin believing in future stability**
   - **Privatizations continue as planned and bring in additional fresh capital & jobs**
   - **A solution to the sustainability of the Debt-to-GDP ratio is brokered with the official lenders, minimizing the threat for possible future over-taxation**
   - **The banking system stabilizes and regains some of its deposits back**
   - **Interest rates on bank loans decline**
   - **Political stability prevails**

II. DOWNSIDE RISKS IN THE SHORT RUN

1. **Disposable income does not stabilize in 2014 because of**
   - possible new cuts in primary and secondary pensions in order to address expected shortfalls in revenue and overruns in expenditure
   - Continued decline in private sector wages and further rise in unemployment
2. **Liquidity does not improve**
3. **Political instability prevails before European Parliament May 2014 elections**
   - Population does not see the greenshoots, hence climate can turn sour for investment and consumption, plus reforms can stall; the "lost period for reform" of April-September 2012 in such an example
4. **Non achievement of the 2013 primary surplus target because of:**
   - lower than expected tax revenue, lower social security funds revenue, higher than expected social security funds expenditure
   - Yet, less of a risk than currently perceived
5. **Other risks:**
   - Political pressures to loosen the program, Structural reform fatigue, Delays in the privatizations programme

II. THE LIQUIDITY RISK

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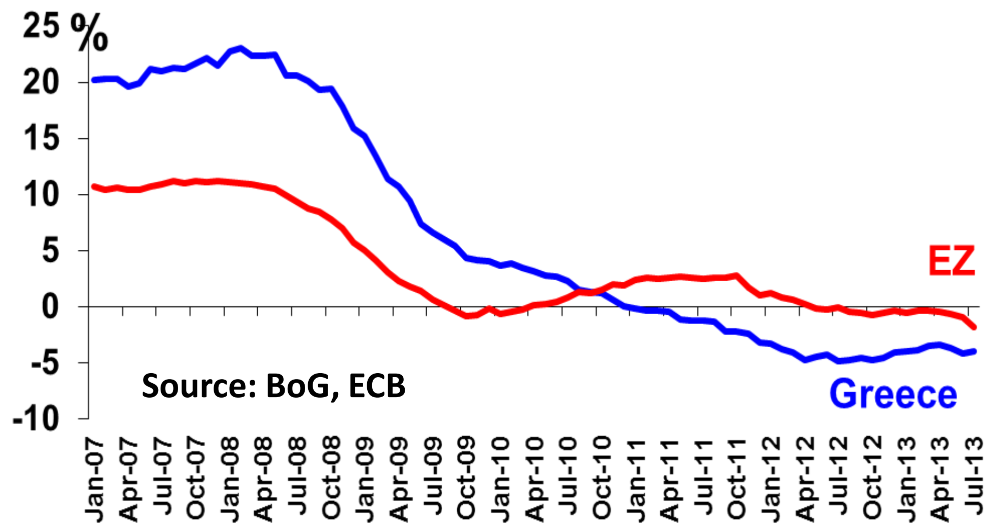
Pessimistic scenarios point to a lack of liquidity:

- If private sector **liquidity squeeze persists**, it could lead to a **non-linear** increase in the number of –otherwise healthy- firms closing down with severe repercussions on unemployment and GDP ⇨ social unrest ⇨ possibility of economic collapse
- **Liquidity constraints** for households which consume > 100% of their disposable incomes and a **negative wealth effect** (falling house prices and stock prices, bond haircuts) could increase pass through to consumption
- The **over-taxation of real estate** worsens the liquidity picture & the risk of a downward cycle

Bank credit to the domestic private sector

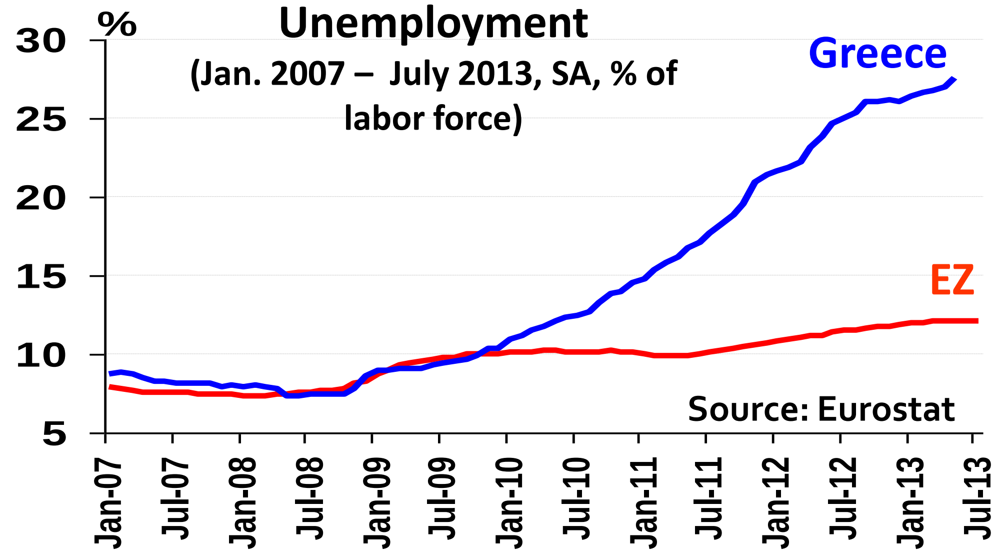
(% 12-month rate of change, Jan. 2007 – July 2013)

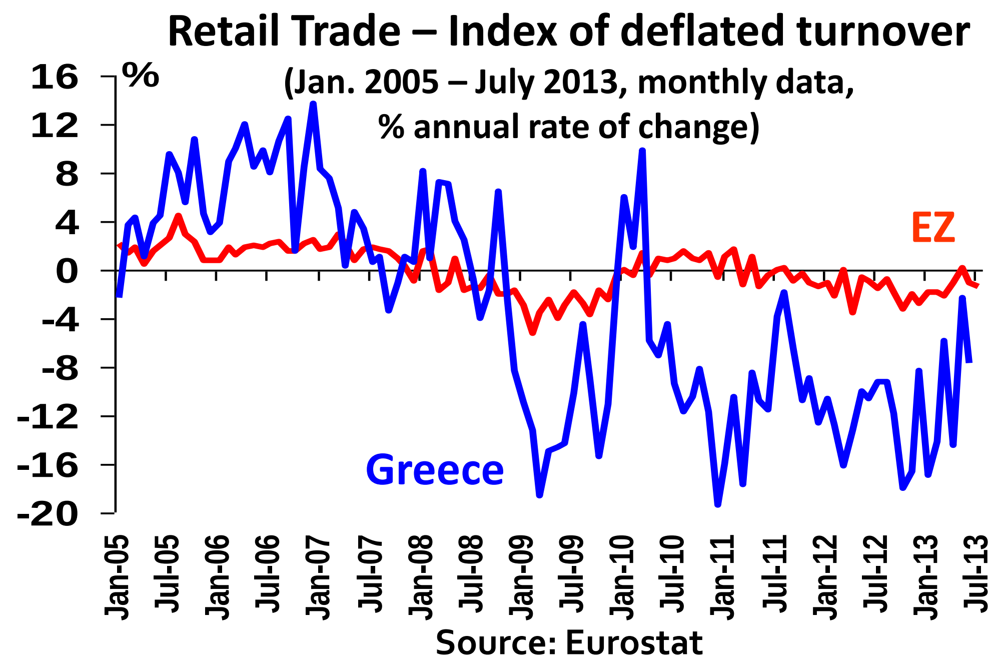


- **Yet,**
  - **the observed deceleration of Bank NPLs in 2013 partially refutes the pessimistic scenarios**

II. MORE ON THE ECONOMIC RISKS

1. The economy is not out of the woods yet; disposable income threatened by more **pension & wage cuts** & an increase in unemployment
   - Yet, the overwhelming taxation of real estate may decline in 2014
3. Unemployment can fire up political instability





II. THE FISCAL FUNDING GAP: IT IS LESS OF A RISK

- The inability to access long bond markets implies a **funding gap** for **2014** and **2015,** currently estimated at **€4.4 bn** and **€6.5 bn** respectively
- For the economy to stabilize in 2014, it is important that this **gap does not trigger additional restrictive fiscal measures**
- Absent any positive surprises on the revenue side, either **a new loan** would be provided or an **expansion of short-term borrowing** would be allowed

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- Yet, **willingness for a new loan exists** despite the perception of hardliners that Greece no longer presents a contagion threat
  - The financing gap originates from Eurogroup's December 2012 decision to relax the future fiscal requirements for Greece, without securing the corresponding required financing
  - Yet, Eurogroup simultaneously promised to provide monetary help, assuming the Greek side delivers on generating a small primary surplus in 2013
  - Europeans have invested a lot of reputational capital to let the Greek recovery project fail plus the issue was aired in the German pre-election campaign
  - Greeks have learned to deliver on their earlier promises
- Moreover, once the Greek population sees an end to the recession tunnel, **optimism can recover** quickly and the **vicious cycle can become virtuous**

II. THE DEBT BURDEN AS A BACKGROUND DOWNSIDE RISK

Eurobank

IMF (implied) forecasts:

- The debt discourages investors who fear **future taxation** or property/profits confiscation
- History shows that the **nominal debt rarely declines**; rather, it is the economy expanding that diminishes the debt burden
- In the case of Greece, the **face value** of Gov. debt is a **huge percentage of GDP** and will decline only if the economy resumes high growth rates
- Given a high discount rate, postponing the debt maturities **decreases its present value**

	Real GDP % growth	Nom. GDP % growth	Nom. GDP €bn	Debt €bn	Debt % GDP
2008	-0.2	4.5	233.2	263.3	112.9
2009	-3.1	-0.8	231.3	300.0	129.7
2010	-4.9	-3.8	222.5	330.0	148.3
2011	-7.1	-6.1	209.0	355.9	170.3
2012	-6.4	-7.1	194.1	304.6	156.9
2013	-4.2	-5.3	183.8	323.0	175.7
2014	0.6	0.2	184.2	320.5	174.0
2015	2.9	3.3	190.3	319.9	168.1
2016	3.7	4.8	199.4	317.9	159.4
2020	2.6	4.3	238.0	295.1	124.0
2021	2.0	3.9	247.3	292.3	118.2
2022	1.9	3.9	257.0	291.9	113.6
2023	1.9	3.9	267.0	292.1	109.4
2024	1.9	3.9	277.4	293.2	105.7
2025	1.9	3.9	288.2	294.9	102.3
2030	1.8	3.8	348.3	301.3	86.5

Source: IMF fourth review of Greek program July 2013, Eurobank calculations

II. DSA SENSITIVE TO GROWTH

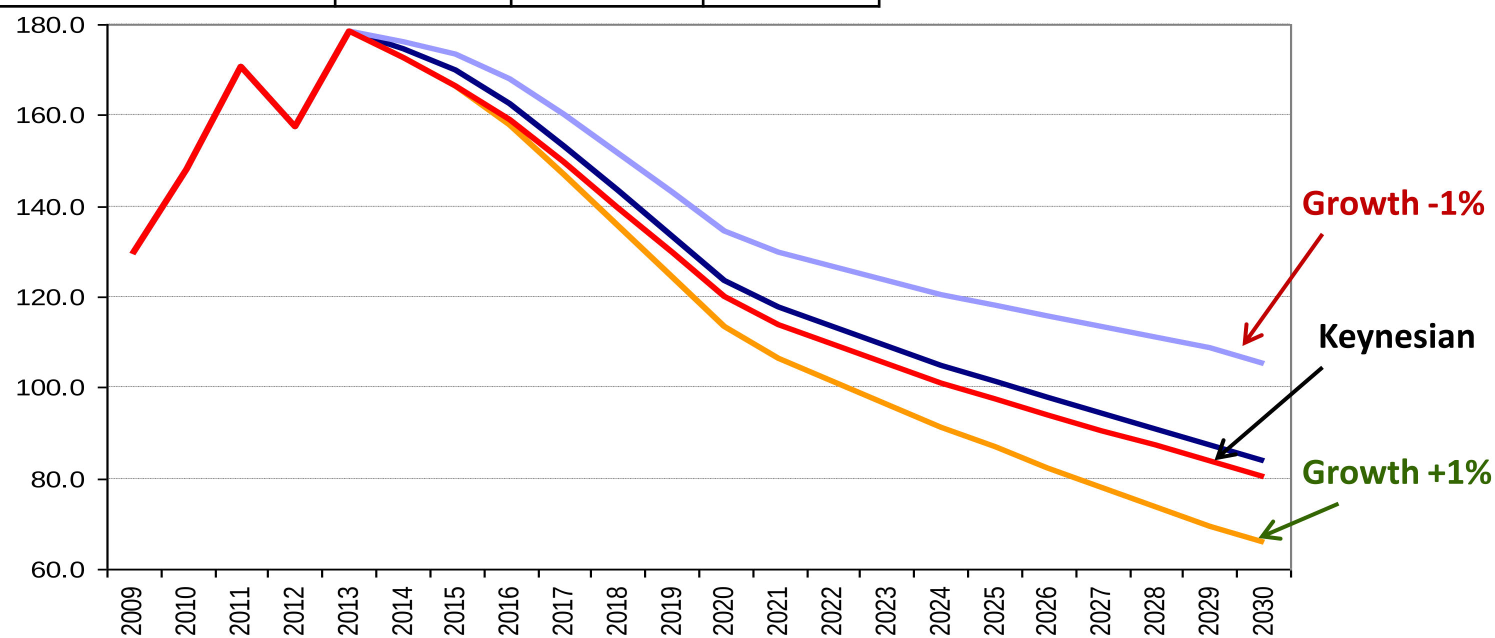
Eurobank

DSA – Sensitivity to growth			
	2012	2021	2030
Debt - Baseline (€ bn)	304.6	292.3	301.3
Nominal GDP - Baseline (€ bn)	194.1	247.3	348.3
Debt - Baseline (%GDP)	156.9	118.2	86.5
Growth +1%	157.5	105.9	65.4
Growth -1%	157.5	129.1	104.4
Growth +1% & PS 3.0% GDP*	157.5	113.2	79.8

BASELINE ASSUMPTIONS

- **Positive Growth from 2014 onwards with average growth at 2.3% of GDP for 2014-2030**
- **Primary Balance at 0.0% in 2013, 1.5% at 2014, 3.0% at 2015 and on average 4.1% of GDP for 2016-2030**

***PS After 2015, i.e. Keynesian scenario, effects resemble base-line scenario**



Source: Eurobank Research, ELSTAT

II. DSA - PRIMARY SURPLUS MATTERS AS WELL

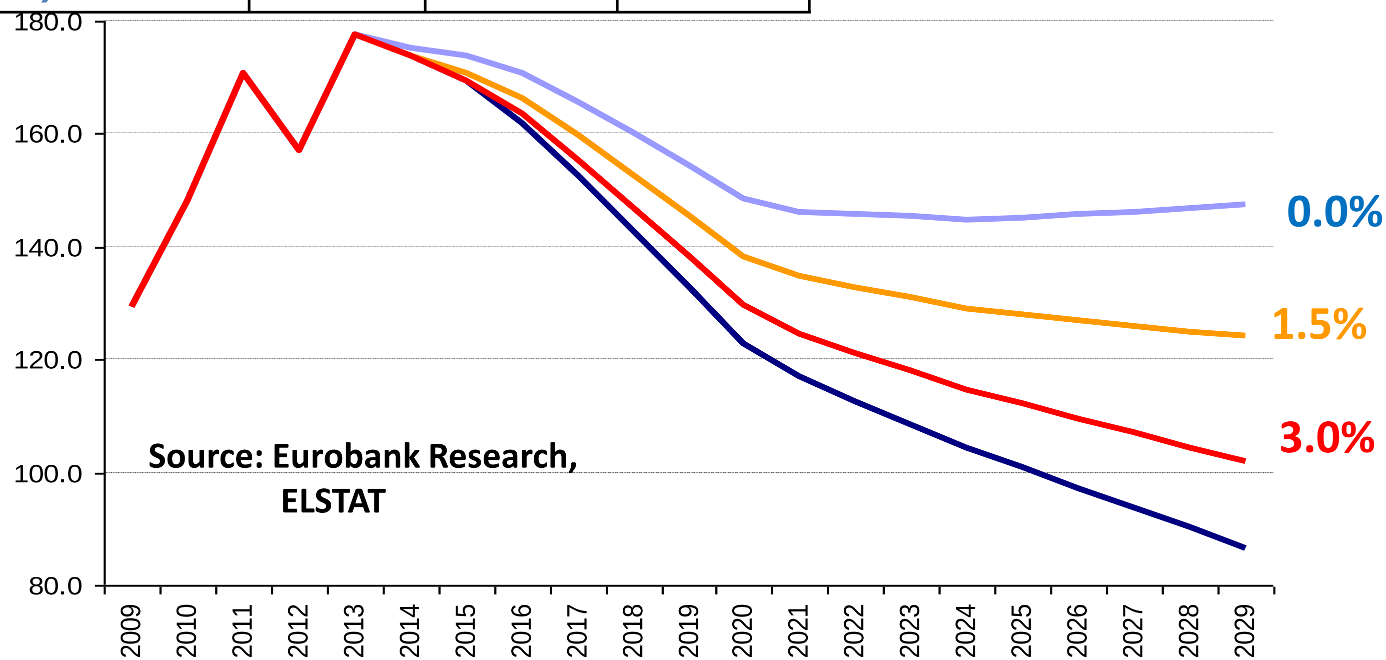
DSA – Sensitivity to primary surplus	2012	2021	2030
Debt Baseline (€ bn)	304.6	292.3	301.3
Nominal GDP - Baseline (€ bn)	194.1	247.3	348.3
Debt Baseline (%GDP)	156.9	118.2	86.5
PS at 3% after 2015 (%GDP)	157.5	124.4	98.5
PS at 1.5% after 2014 (%GDP)	157.5	134.6	120.5
PS at 0% after 2013 (%GDP)	157.5	146.2	143.9

BASELINE ASSUMPTIONS

- **Positive Growth from 2013 onwards with average growth at 2.3% of GDP for 2014-2030**
- **Primary Balance at 0.0% in 2013, 1.5% at 2014 3.0% at 2015 and on average 4.1% of GDP for 2016-2030**

✓ **Attaining a large primary surplus is critical to sustainability**

✓ **Its lack of, gobbles up even the boost of economic growth**



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I. THE RECENT PAST: A serious effort to correct earlier imbalances

II. THE PRESENT: The depression is way too long & deep. How can it be stopped ?

III. THE FUTURE: How can the country pick up momentum on a new equilibrium growth path?

III. DETERMINANTS OF LONG-TERM ECONOMIC GROWTH

Eurobank

Greece has to address the factors that contribute to long-term growth

- According to the traditional model, during 1990-2008, in Greece average growth was 3%, caused by three determinants: **Capital (1.10 pp.), Labor hours (0.90 pp.), Total Factor Productivity (1.00 pp.)**
- In the 1990s economists emphasized investment in technology
- Then in the 2000s, institutional characteristics like corruption, rule of law, efficient organization of the State sector, etc. were thought to be the deeper causes of growth
- The empirical literature makes cross-country comparisons over decade-long time intervals. Variables found important:

I. (+) Investment as a % of GDP (affecting size of physical capital)
II. (+) Rate of human capital increase, ~ by % population in sec. education
III. (-) Initial income, capturing convergence
IV. (-) Government consumption, thought not to be productive (e.g. military exp.)
V. (-) Inflation, which destroys the price mechanism
VI. (-) Real effective exchange rate, showing the competitiveness effect
VII. (+) Openness
VIII. (+) Quality of institutions

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IX. (-) FX risk premium in countries that have flexible exchange rates

III. PROGRESS IN CERTAIN SOURCES OF GROWTH

Eurobank

- The country is addressing some of those factors with success, see Table in RHS:
- A more specific growth path is hard to pin point with precision as it depends on the evolution of both demand and supply factors (potential GDP). Nevertheless, we know:
  - **The procrastination of recession destroys labor skills and capital** and constrains growth over the next decade
  - **Lack of population growth or immigration abroad also reduces growth**

1. **Competitiveness improving**
2. **Openness is improving: (Exports + Imports)/GDP from the 57.7% average over 2001-2009 is 59.0% in 2012**
3. **Inflation is improving: From 3.3% in 2001-2009 to 1.0% in 2012**
4. **The size of government consumption is declining, from 18.4% in 2001-2009 to 17.8% in 2012**
5. **The initial condition will be lower at the end of 2014, which makes convergence easier**

Relative Living Standards

EE-15=100 in PPS

1991	75.5	2003	80.7
1995	71.7	2007	80.9
1999	71.0	2014	65.4

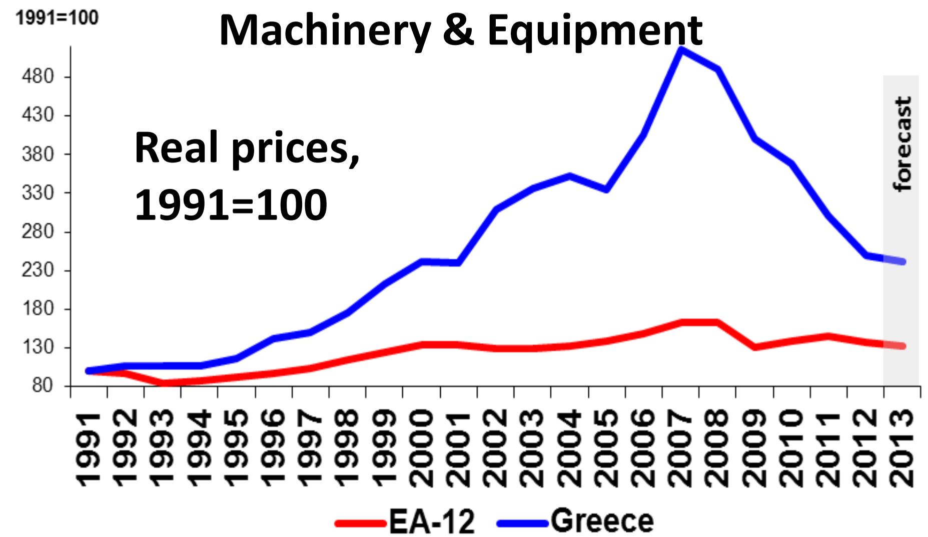
III. LAGGING BEHIND IN OTHER SOURCES OF GROWTH

	Greece	EA-12
1. Investment (% GDP)		
2001-2009	**22.8**	**20.6**
2012	**13.1**	**18.4**
2. Corruption Perceptions Index 2012 (0-100)	**36.0**	**70.6**
3. Rule of Law 2011 (score -2,5 to 2,5)	**0.57**	**1.41**
4. Government Effectiveness 2011 (score -2,5 to 2,5)	**0.48**	**1.36**

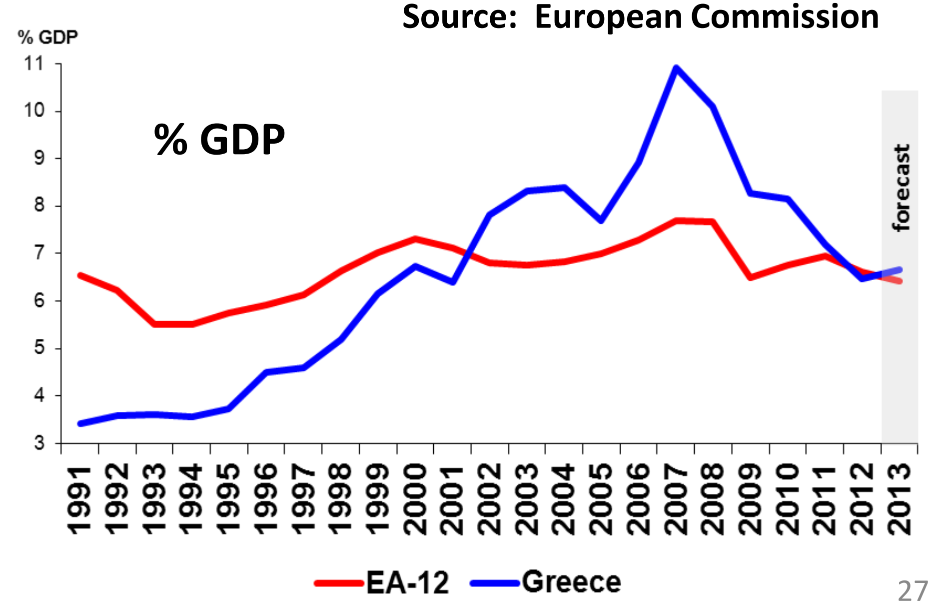
Source: EUROSTAT, Transparency International, World Bank

5. Labor force participation and quality of education are also factors that lag behind

Investment



Source: European Commission



III. REMAINING REFORMS AIMING TO ADRESS THE FISCAL DISEQUILIBRIUM & IMPROVE EFFICIENCY OF PUBLIC SECTOR

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ON-GOING REFORMS to be completed soon

- **Complete Restructuring of tax system**: Increase number of inspectors to 1.000 from 235, IT system that interconnects tax offices
- **Anti–corruption plan**: Penalties for tax evasion, protection of whistle blowers, empower the internal audit of tax offices
- **Speed-up the public procurement** framework: Remains in a pilot stage at public hospitals, where it is not finished yet
- **Double entry accrual** accounting in all hospitals
- Additional **pharmaceutical spending reduction** with generics to reach 40% use from current ~ 18%
- **Legal clearance** of real estate for future privatizations

CHALLENGING REFORMS

- **Reorganize public sector entities** and transfer or lay-off redundant employees (12,500 public sector employees in the mobility scheme by end-September 2013 plus 12,500 in 2014)
- Restructure of **defence industry** and LARKO (nickel)
- **Privatizations** at a delicate balance: Revenues of only €0.9bn thus far in 2013, relative to an updated target of € 1.6bn), encountering problems on the demand side

III. REMAINING REFORMS AIMING TO ADDRESS THE INSTITUTIONAL & BUSINESS ENVIRONMENT

ON-GOING REFORMS to be completed soon

- **New Code of Lawyers** by the end of September: Elimination of unjustified restrictions on legal services
- **Facilitate trade**: Reduce red tape, increase working hours of customs, etc.
- **Energy sector** liberalization: Restructure PPC (DEH), liberalize the electricity market
- **Labour reforms** in order to fight unemployment (differentiating benefits, etc.)

CHALLENGING REFORMS

- **Speed-up the judicial reform**
  - Update plan for reduction of backlog of tax and nontax cases; past targets missed
  - Prepare a draft Code of Civil Procedure
  - Open access to mediation services to non-lawyers
- **Land registry and spatial planning**
  - Simplify legislation for town planning processes
  - Update legislation on forests, lands and parks

III. REFROM IMPLEMENTATION: SIGNIFICANT RISKS REMAIN

REFORM IMPLEMENTATION COULD LOSE STEAM

- **Limited ownership** of Reform Program ⇨ Reforms may stall after primary balances achieved or after troika leaves
- Yet, **reforms need time** to work through the economy and its structure, so that the population ends up realizing their significance for their lives
- **Troika** prescriptions are driven mainly by the IMF recipes on reforms, some of which may be too quick or intrusive and risk never to be accepted by the uninformed public
- There are **coordination** problems within the Troika itself, and between the Troika and the Task Force
- **Cohesion of government** is at possible risk as reforms now touch the **deep state**; it is difficult to reorganize and shrink the public sector through lay-offs of redundant staff, etc. without the modern tools of management and the ability to reward effort
- **Consensus** for the reforms among all major political parties is a must if they are to continue over the next 10 years and to affect expectations positively today

SUMMARY: OVERCOMING THE CRISIS IN GREECE

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- ✓ The neglected imbalances of past decades brought the prolonged crisis today
- ✓ Yet, the crisis presents an opportunity for change: Over the last four years, a lot was accomplished in fiscal consolidation, internal devaluation and structural reforms
- ✓ THE NEW GROWTH MODEL requires a delicate balance between (i) a strong emphasis on exports & investment, and (ii) the requirement that consumption increases more modestly, i.e. at a lower rate than GDP, so that its share declines gradually to more normal levels without being a drag on domestic aggregate demand
- ✓ Policy-wise, there is still a lot to be done, nevertheless two are the critical questions:

  1. WHEN will the economy stop shrinking? This is the highest risk
     - ❖ When aggregate demand stabilizes; we are almost there as long as no additional restrictive fiscal measures are imposed; Greeks are over-taxed and their savings have dwindled; the fiscal gap needs external financing
     - ❖ Sentiment has to continue improving, so that Greeks and foreigners believe in the growth scenario, which can reverse the vicious cycle into a virtuous one
     - ❖ Pro-growth policies and public investment have to be re-ignited
     - ❖ Liquidity has to gradually come back to the economy

SUMMARY: OVERCOMING THE CRISIS IN GREECE

2. <u>HOW</u> will long-term equilibrium growth come back?
   - By addressing the factors which drive long-term growth: (i) Investment/GDP, (ii) quantity plus quality of human capital (iii) reduction in the size of government, (iv) inflation (v) cost competitiveness, (vi) openness, (vii) quality of institutions like Government functioning & effectiveness, rule of law and corruption
   - The MoUs addresses all 7 factors, and we can already claim success in improving a number of factors
   - Reforms have now touched the DEEP STATE and test government's willingness to proceed: <u>OWNERSHIP OF REFOMRS NEEDED</u>
   - The sooner the recession/depression is over, the better the long-term prospects become as we need to reverse the on going destruction of the factors of production: Today capital becomes obsolete and labor skills are destroyed, the youth immigrates abroad and childbearing diminishes

<u>Last but not least</u>:

✓ The reform recipe ought to go ahead even if the recession continues, which requires political consensus

✓ Let us not forget: Fixing our country is our problem and no one else's

Thank you
for your attention

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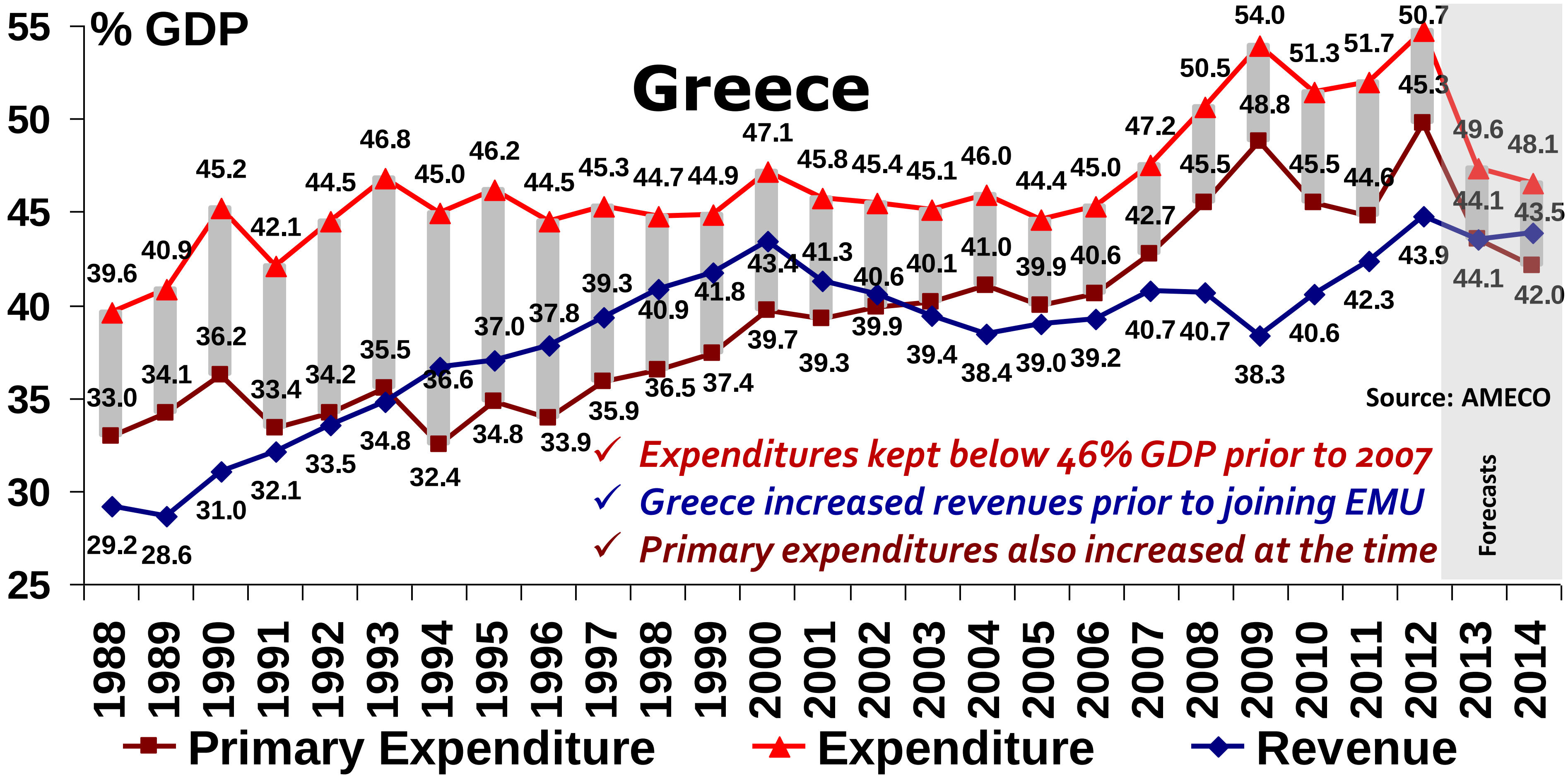
APPENDIX: FISCAL PROFLIGACY THROUGHOUT RECENT HISTORY



- ✓ The period of primary surpluses was from 1993 to 2003 and, hopefully, from 2013 on
- ✓ Greece was almost always in fiscal trouble, i.e. always in deficit, with primary expenditures on a rising trend since 1994
- ✓ Recent huge fiscal mess began in 2006, way prior to the onset of the 2008 recession

APPENDIX: EARLY RESPONSE , CONTROL RUNNAWAY PENSION IMBALANCES

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The hidden imbalance of the pension system was the first to be tackled

- Fix system's parameters ⇨ reduce increase in future annual state pension liabilities (by 2060) from 12.5% of GDP to 2.5% of GDP
- Retirement age for everyone at 67, increasing in line with life expectancy after 2020 with minimum contributory period of 40 years by 2015

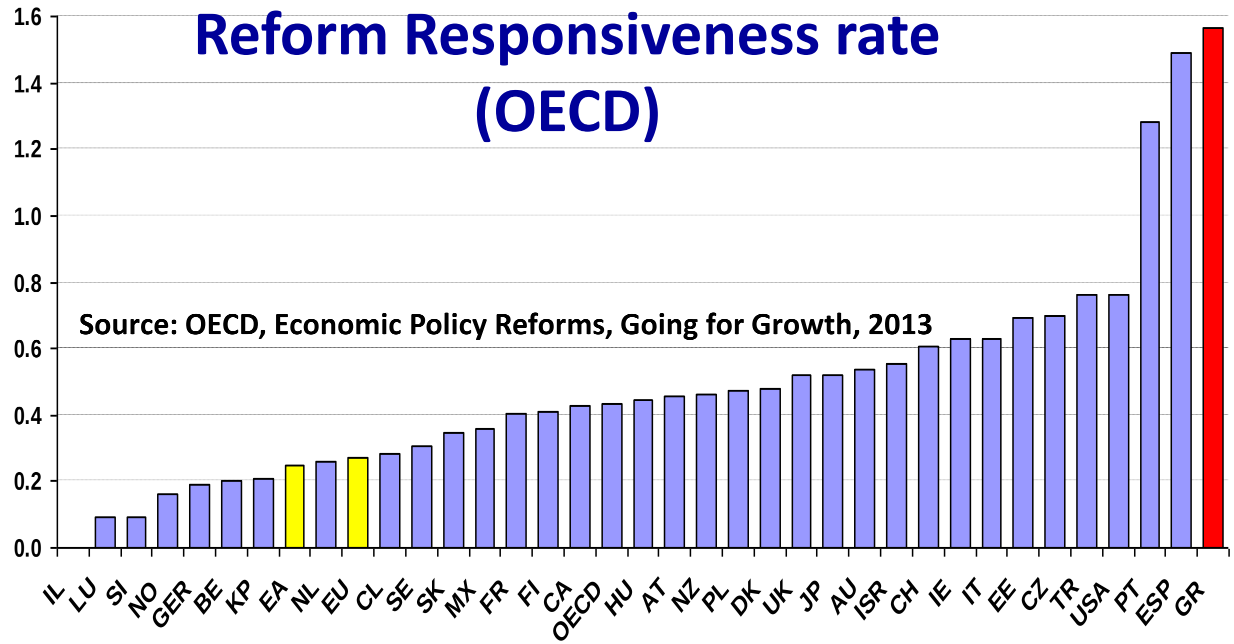
REFORM IN URGENT NEED

Old Regime	2010	2020	2035	2060
Pension Exp. (% GDP) GR	11.6	13.2	19.4	24.1
Dependency*	56	59	78	102
Pension Exp. (% GDP) EA	11.2	11.6	13.2	13.9

- Early retirement restricted to the age of 60 by 2015, will be penalized more than before (6% loss per year, including those insured prior to 1993)
- Size of pension linked to life-time contributions
- List of heavy and arduous professions reduced drastically, ceiling of 10% of labor force

APPENDIX: SPEEDY REFORMS COMPARED TO OECD COUNTRIES

- Greek governments came under severe criticism for being sluggish in carrying the necessary reforms
- Yet, a cross country comparison by the OECD on the speed of reforms shows a resurrected Greece! i.e. the best performer in 2012
- Obviously, the reform speed is partly due to the imposition of the will of the lenders and their threats of not delivering the cash on time



Note: The index is the ratio of the total number of years in which some action is taken to address policy priorities recommended by the OECD to the total number of years in which policy priorities have been identified. To account for the fact that some policy areas appear to be more difficult to reform than others, responsiveness on each individual priority is weighed by the average responsiveness to priorities in this area across the OECD countries.

- Nevertheless, by the Fall of 2013, the majority of reforms (say 70%) is complete and their benefits are expected to arrive over the next decade, assuming no reversals in the political environment
- Recent WEF 2014 rankings, which show an improvement of 5 positions (currently 91st out of 148 countries) reveal the need to continue pushing reforms

APPENDIX: DEBT COMPOSITION BEFORE & AFTER PSI & BUYBACK

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Notes to the Table:

- End-2011 is before PSI
- End-2012 is after PSI & Debt Buyback
- Debt breakdown refers to Central Gov., hence numbers do not add-up exactly
- ECB/NCBs included in private sector for convenience
- Post-PSI bonds of €64.8 bn were reduced to €33.8 bn after successful debt buyback of €31.0 bn (of which €14 bn from Greek banks)
- Remaining funds to receive from EFSF/IMF:
  - € 6.7 bn until end-2013
  - €17.5 bn until end-2014
- Nominal GDP
  - 2011: €208.5 bn
  - 2012: €193.7 bn
  - 2013: €183.5 bn

Debt Composition 2011-2013 (€ bn)

	End-2011	End-2012	End-2013
Gen. Gov. Debt	355.2	304.6	323.0
(% of GDP)	170.3	156.9	175.7
Restructured bonds	205.6	33.8	33.8
Hold-outs	0.0	5.3	2.6
T-Bills	15.1	18.4	15.0
ECB/NCBs holdings	56.5	45.1	37.8
Private sector	277.2	102.6	89.2
(% GDP)	132.9	53.0	48.6
IMF loans	20.7	21.7	28.7
Bilateral EU loans	52.1	52.1	52.1
EFSF loans (PSI Notes & Accrued Interest)	0.0	34.5	34.5
EFSF loans (2nd Progr)	0.0	73.8	101.7
Official Sector	72.8	182.7	217.0
(% GDP)	34.9	94.3	118.3

APPENDIX: OFFICIAL SECTOR FINANCING

Official sector financing (IMF, EFSF) & bond redemptions (2012-2014, €bn)

	2012				2013				2014				Total
IMF	1.6	0.0	0.0	0.0	3.3	1.8	1.8	1.8	3.5	1.8	1.8	1.8	19.1
EFSF	40.4	33.6	0.0	34.3	4.8	17.5	2.5	3.1	5.7	2.9	0.0	0.0	144.7
Total	42.0	33.6	0.0	34.3	8.1	19.3	4.3	4.9	9.2	4.7	1.8	1.8	163.9
ANFA& SMP	0.0	0.0	0.0	0.3	0.0	0.6	1.6	0.5	0.0	0.5	1.9	0.0	5.5
Maturing Debt	4.9	4.0	0.0	0.3	4.4	6.8	3.8	1.3	3.5	11.7	7.5	2.6	50.8

Source: 2º Economic Adjustment Programme for Greece (July 2013)

- Up to July 10, 2013, total financing from IMF/EFSF amounts to €139.8 bn plus € 2.2 bn from the SMP program
- Remaining financing from EFSF/IMF until the end of 2013 amounts to €6.7 bn plus €0.5 bn from the SMP program
- Total funding from EFSF/IMF for 2014 stands at €17.5 bn plus €2.4bn from SMP&ANFA holdings ’ profits