Overview of the Greek crisis

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Crisis Overview

I. The Greek crisis is characterized by two phases

- Economic disequilibria bring Crisis Phase-I in 2009
- Then economy adjusts & disequilibria are cured after two economic adjustment programs, a major public debt restructuring and two bank recapitalizations
- Then bad politics brings Crisis Phase–II in 2015: The country risks GREXIT; capital controls, a 3rd unnecessary economic adjustment program & a 3rd bank recapitalization arrive

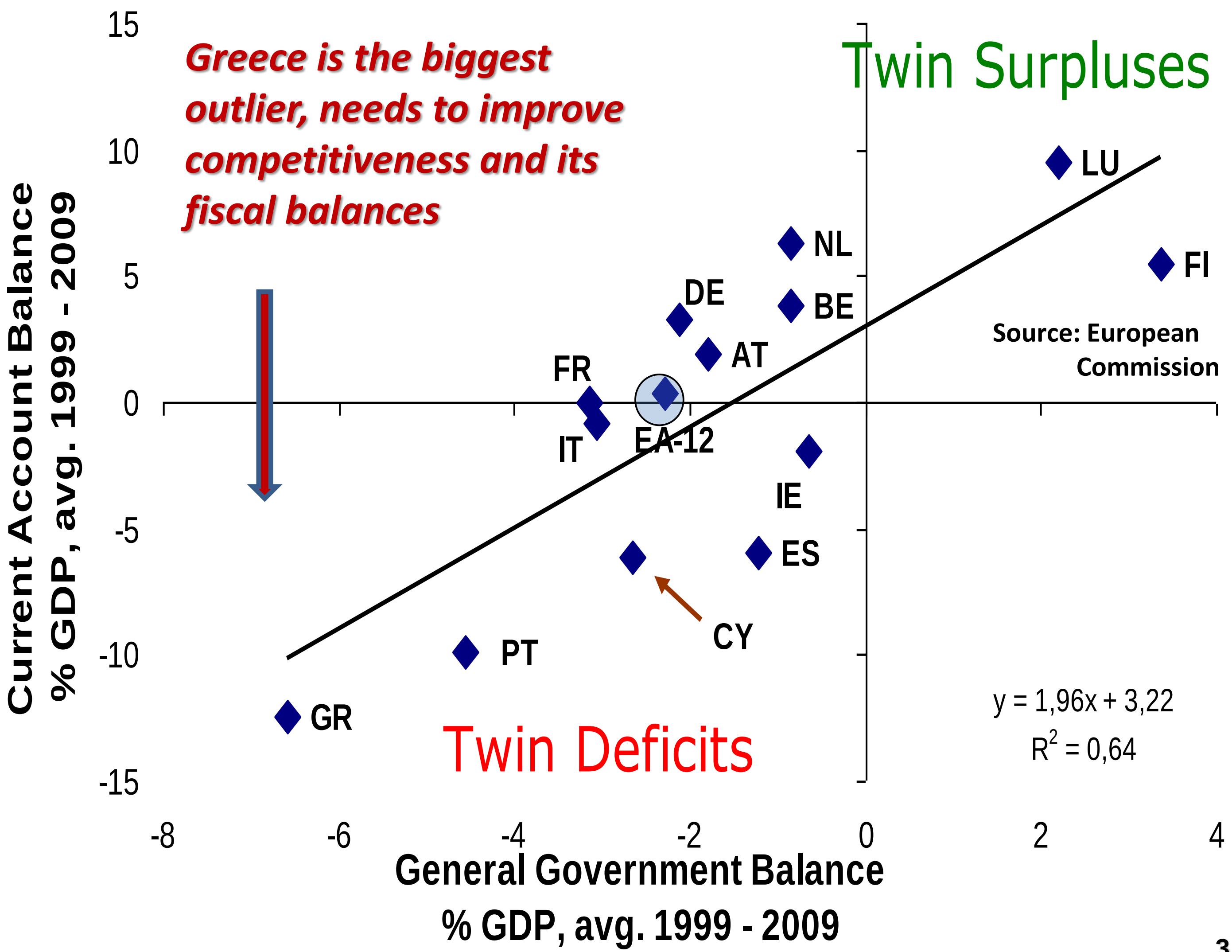
II. The crisis is over but no quick recovery in sight

- Capital controls were lifted on Sept 1, 2019
- Can we jump start the economy?
- What are the key challenges?

I. Severe macroeconomic imbalances bring Greek Crisis Phase I

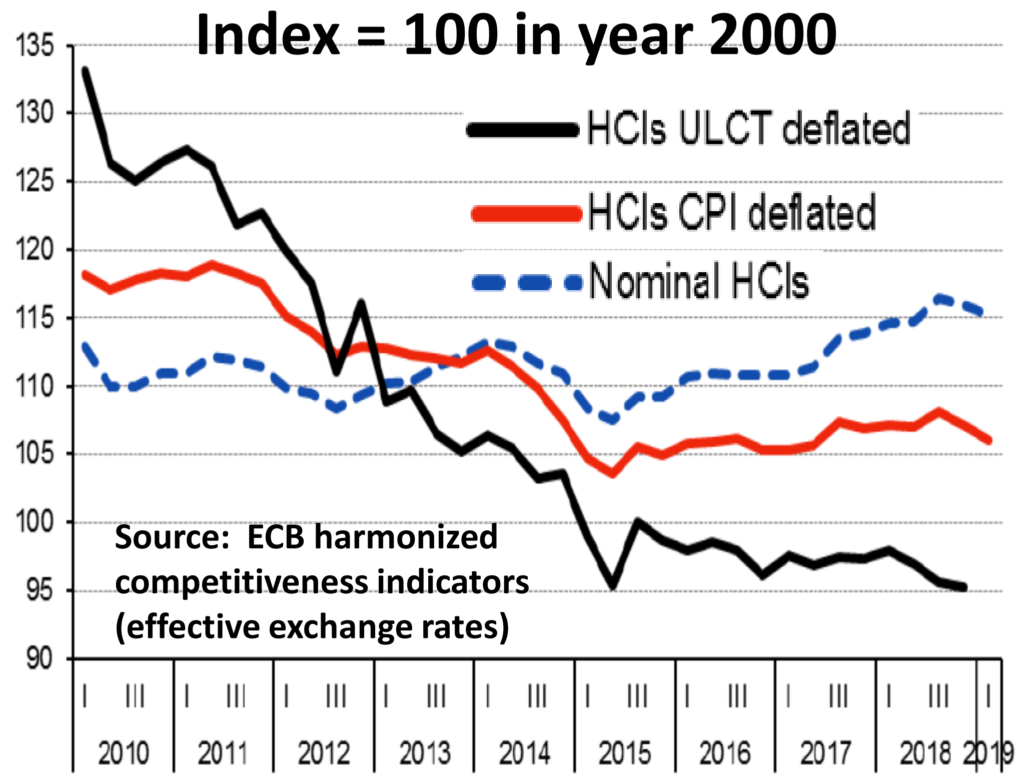
- Greece suffered from **lack of fiscal discipline and lack of competitiveness** as shown in the Figure
- Private sector leverage <u>was not</u> the problem
- Post-EMU, a **competitive North** and an **uncompetitive South** emerged

Average annual external and fiscal balance in EA-12 before the Greek/EMU crisis hit in early 2010



I. Drastic post 2009 adjustment

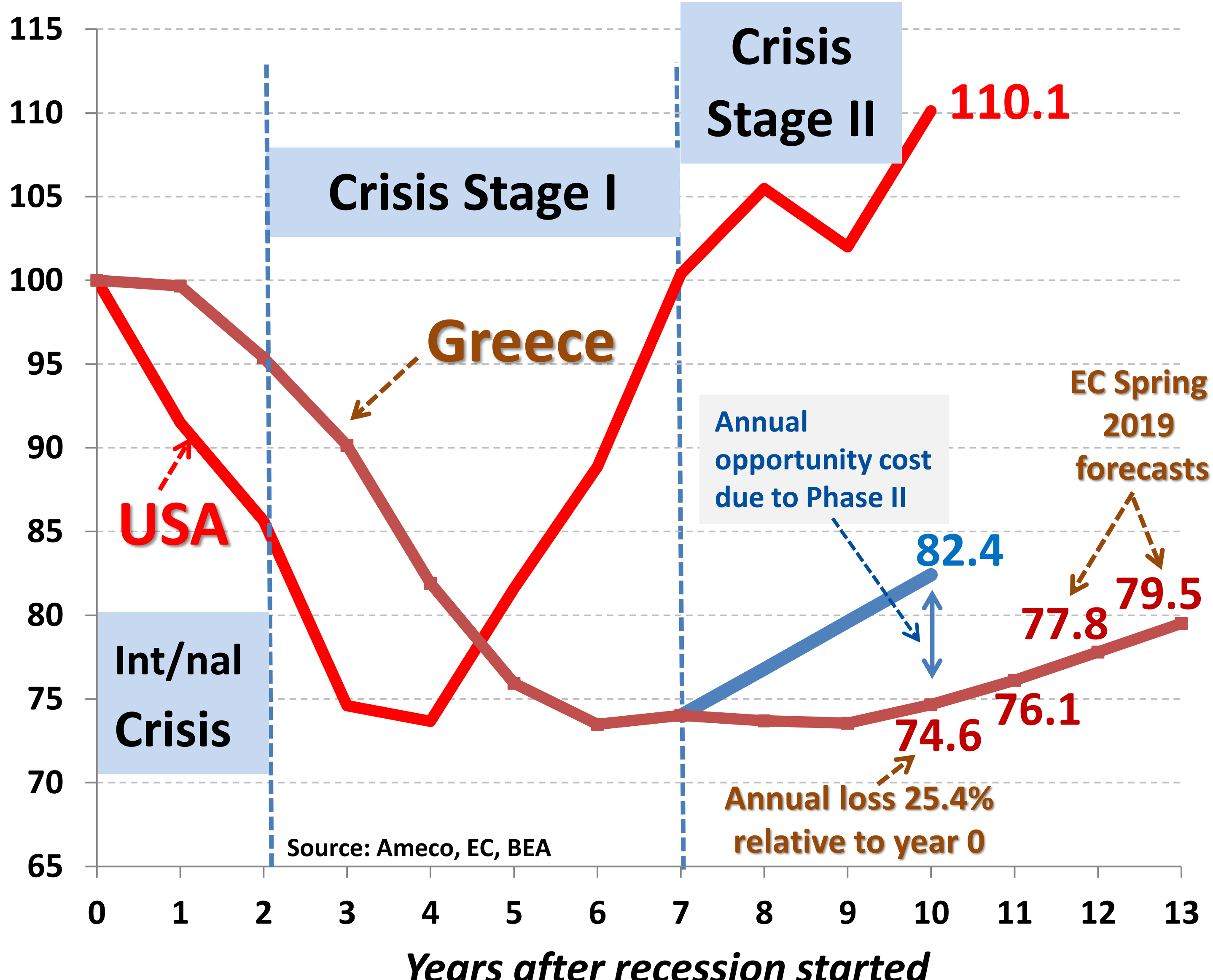
- From a primary deficit of 10.4%GDP in 2009 to 0.0% of GDP in 2014 and 4.3% in 2018 (6th consecutive year with a non-negative primary balance)
- Labor cost competitiveness improves until 2014
- Bold program of structural reforms in Pensions, Health Care, Tax System, Budgetary Framework, Public sector transparency, Business environment, goods & service markets



- WB Ease of Business rank from 109 in 2009 to 60 in 2014, yet to 67 in 2018
- From a current account balance of -15.8% in 2008 to +0.3% in 2015 and +1.4%GDP in 2018
- Share of exports to GDP rose from 19% in 2009 to 32% in 2014 and 36% in 2018; Share of tradables in domestic value added increased

I. Two stages prolong the Greek crisis:
Economic imbalances drive the first – Politics the second

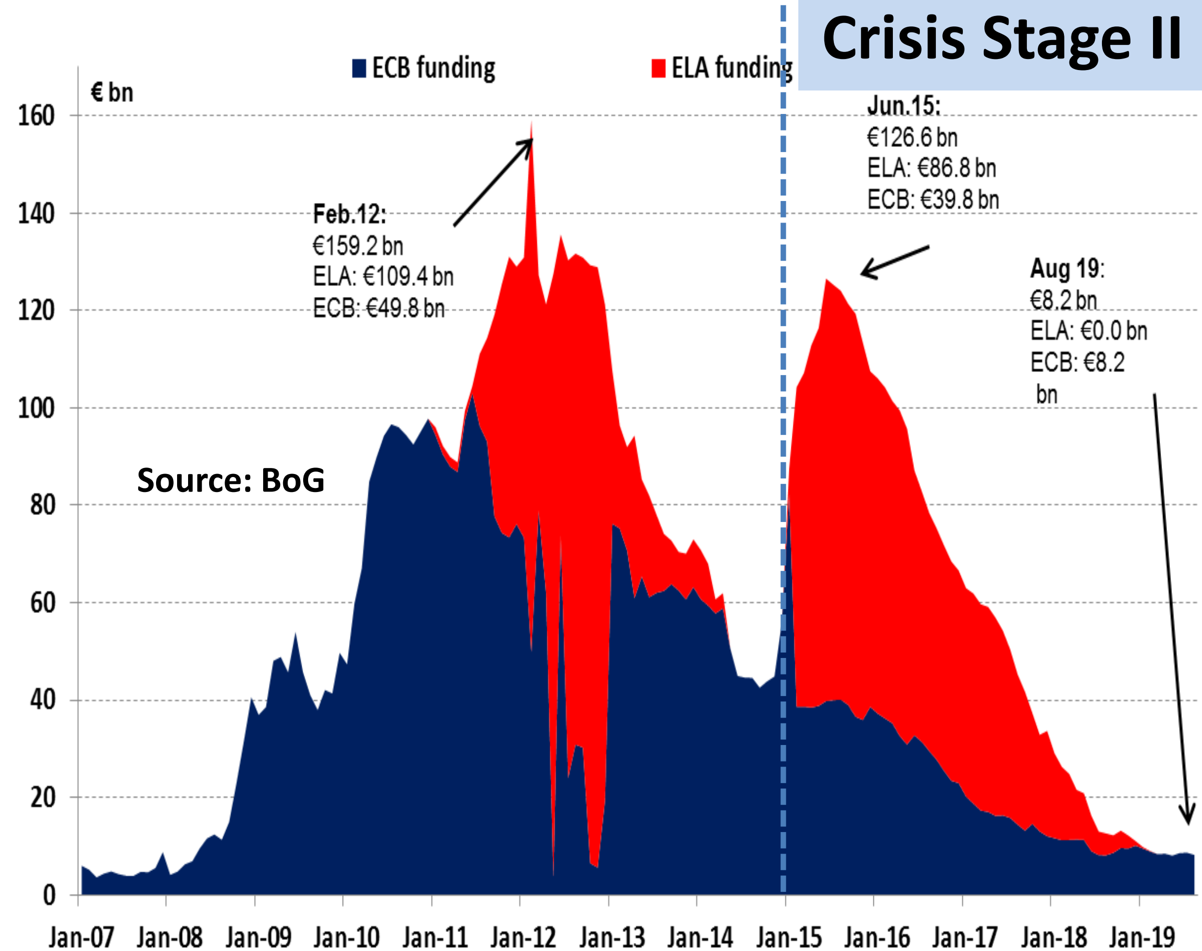
- Phase II costs annually 7.8 ppts or €18bn
- Was unnecessary
- Real GDP at 100 in 1929 for USA 2007 for Greece
- After 10 years, USA at 110.1 in 1939, but Greece at 74.6 in 2017
- Forecast as of Fall 2014: Greece at 82.4 in 2017



I. The two stages of the Greek crisis are revealed in the Eurosystem dependence of domestic banks

- ❑ Prior to the Int/nal crisis little use of ECB borrowing
- ❑ Lehman episode froze the interbank market, raising borrowing to €55bn.
- ❑ Greek crisis raised dependence to above €100bn.
- ❑ Since July 2011 Emergency Liquidity Assistance (ELA)
  - Max value in 11/2012
  - Down to ZERO in 11/2014
  - Back up to €86.8bn in 6/2015
  - August 2019: ELA zero (8th consecutive month) plus €8.2bn in ECB funding

Crisis Stage II



- ❑ ELA borrowing costs 1.5% more due to low quality collateral
- ❑ April 2019: interbank market funding at €25.0bn (Aug.-15: €6.3 bn)

II. The challenges ahead

- The financial sector was a prime victim of the crisis
  - First the State defaulted on its bonds and banks' capital was wiped out, which led to an essential nationalization and two recapitalizations
  - Then the over-burdened private sector began defaulting on its bank debt with NPEs currently at 42% of total loans
  - A credit-less recovery cannot last long
- In the real economy, the capital stock is depleted as investment expenditure shrank
  - Need for 15% rates of investment growth in the next few years
  - FDI will be needed & continued privatizations will help
  - New Greek government understands the problem and has focused on it
- Debt sustainability is a major constraint on fiscal policy
- The nagging question: Will structural reforms continue?
- Ageing population, a major long-term challenge

II. The crisis depresses bank stocks everywhere

- Non-financial stocks in Europe perform a lot better
- Europe went through a second crisis with lower profitability than the US, hence its bank stocks lagged behind US stocks
- Greek bank stock prices close to zero in early 2012 due to the PSI

II. Greek banks pass the Europe-wide AQR and Stress tests of October 2014 … but fail the November 2015 ones

- In November 2014, SSM takes over supervision having conducted an Asset Quality Review and Stress Tests on 130 large European banks
- Thanks to DTC , Greek banks avoid a new (third) recapitalization
- Yet a year later, under a new erratic government, economic growth stalls and SSM refreshes its AQR and Stress Tests with … adverse consequences

BANK INDICES = 100 at 30/3/2012

- Bank stocks reached zero value for a second time in November 2015

Stock prices at zero for a 2nd time in Nov 2015

II. Private investors take over the banks in Nov 2015

- The Nov 2015 AQR depleted the banks' equity capital base
- Stricter stress tests relative to 2014 ones, as target CET1 ratio ⬆
- Plus banks were required to find private investors to cover the capital shortfall of the baseline stress scenario – one bank barely failed
- Hedge funds, which had entered in April 2014 and lost their money, decided to re-enter and acquire control of the banks
- HFSF ownership shrank to: Eurobank 2.4% , Alpha 11%, Piraeus 26.4%, NBG 40.4%

BANK INDICES = 100 at 30/11/2015

- After the third recapitalization, the Greek bank index fluctuated, declining even to 30%!
- After the May 2019 European elections prices are up to 70%

II. The great challenge of non-performing loans & exposures

Group level, Dec-2018	Eurobank	NBG	Alpha	Piraeus	Total
1. Total Loans - gross (€bn)	45.0	39.6	52.5	53.1	190.2
2. Non-Performing Exposures (€bn)	16.7	16.2	25.7	27.3	85.9
3. NPE ratio (%)	37.0%	40.9%	49.0%	51.5%	45.2%
4. Non-Performing Loans (€bn)	13.2	11.8	17.6	17.4	60.0
5. NPL ratio (%)	29.3%	29.9%	33.5%	32.8%	31.6%
6. Provisions (€bn)	8.8	9.5	12.3	13.3	44.0
7. Regulatory Capital CET1 (€bn)	6.5	5.6	8.3	6.5	26.8
8. **Texas Ratio 1** **= 4/(6+7)**	86.5%	78.3%	85.5%	87.7%	84.8%
9. **Texas Ratio 2** **= 2/(6+7)**	109%	101%	125%	138%	121%
10. CET1/RWAs	16.2%	16.0%	17.4%	13.7%	15.8%

Notes:

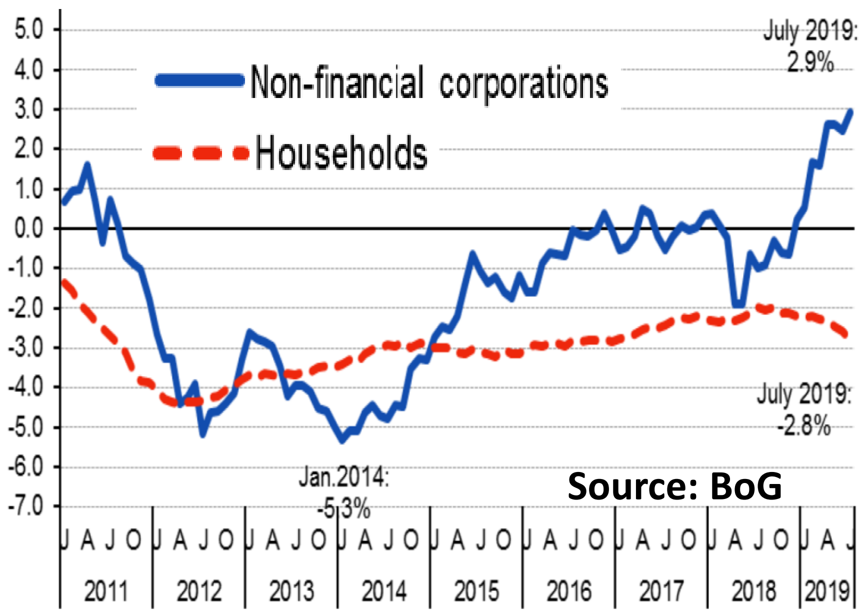
1. In the theoretical stress situation in which all NPL value is lost, all of four systemic banks survive because they all have a **Texas Ratio less than unity**. For NPEs, those ratios are larger than unity.
2. About **70% of regulatory capital is DTC** and without it, no bank survives.
3. In January 2018, new IFRS-9 rules impose additional capital needs over the following five years, to the tune of €5.9bn. However this is gradually phased in over 5 years
4. 2018 stress tests did not result in recapitalization of the Greek banks

Source: *Calculations based on banks' published data*

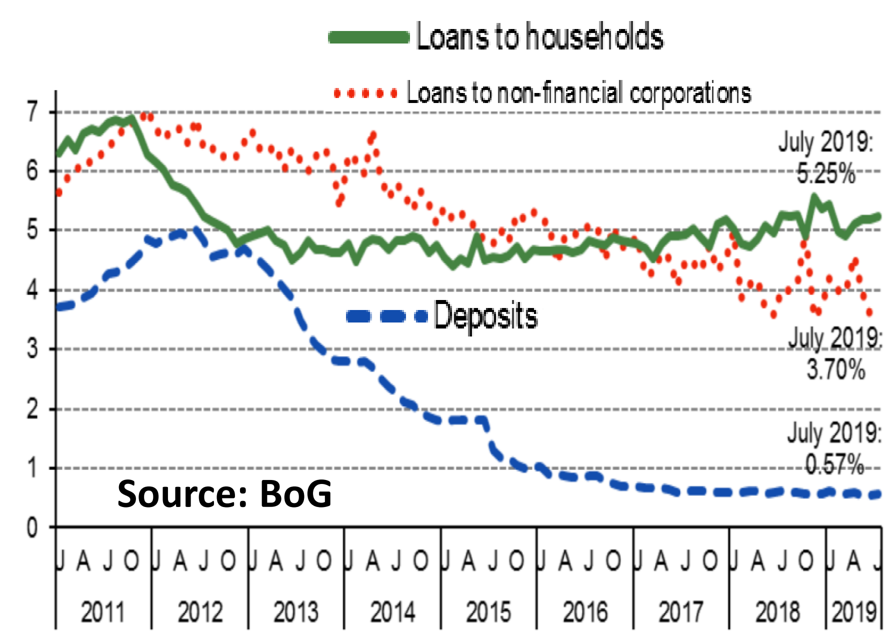
II. Signs of improvement in corporate credit conditions

- Credit growth for non-financial corporations turns positive in 2019, following 8 years of continuous decline
- Loan rates to non-financial corporations on a downward trend since 2012
- Yet household credit continues to shrink and loan rates remain steady
- Bank profitability is squeezed due to NPLs, regulation, IT competition in retail services

Credit growth (yoy)

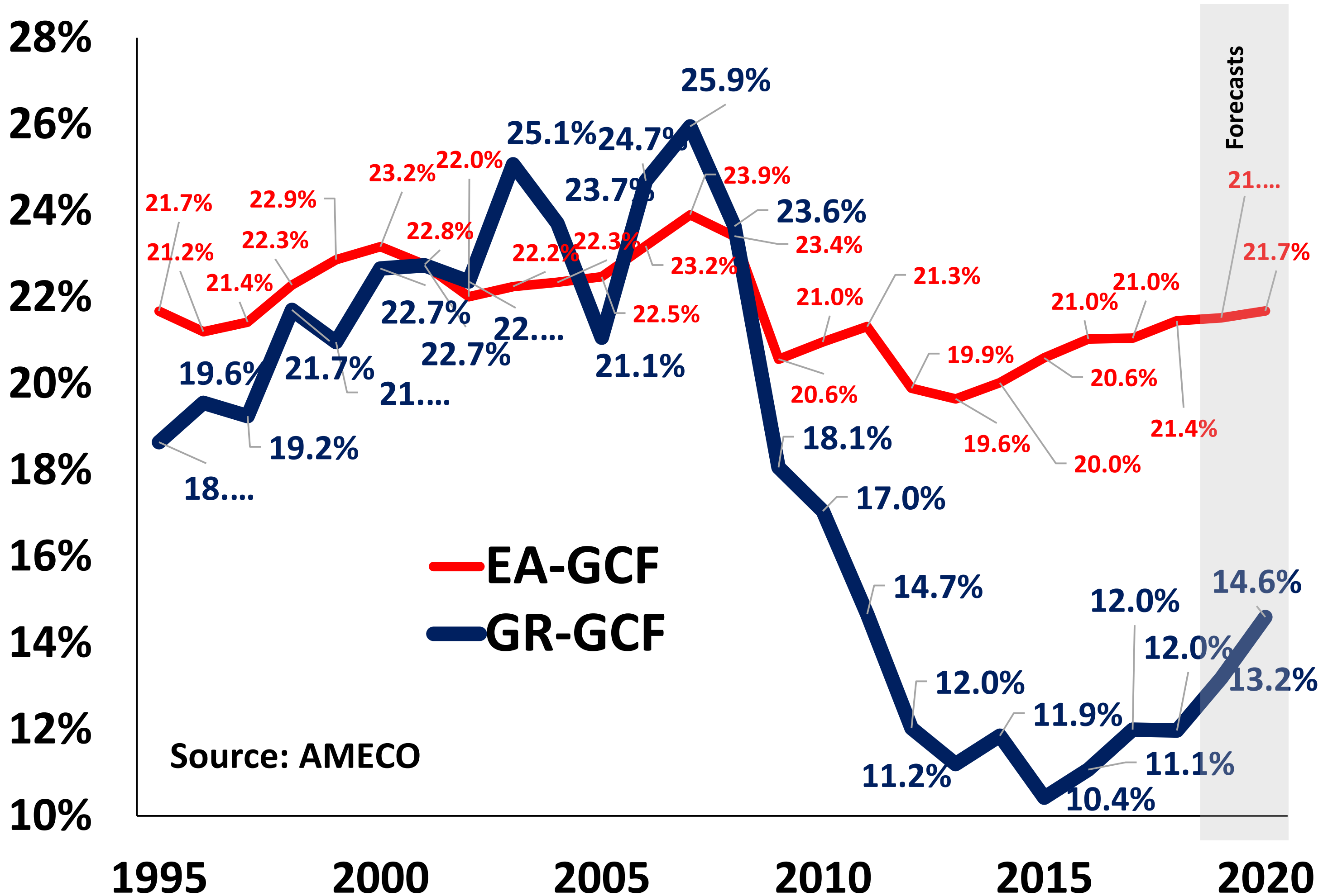


Interest rates



II. On the real economy, investment needs a major boost

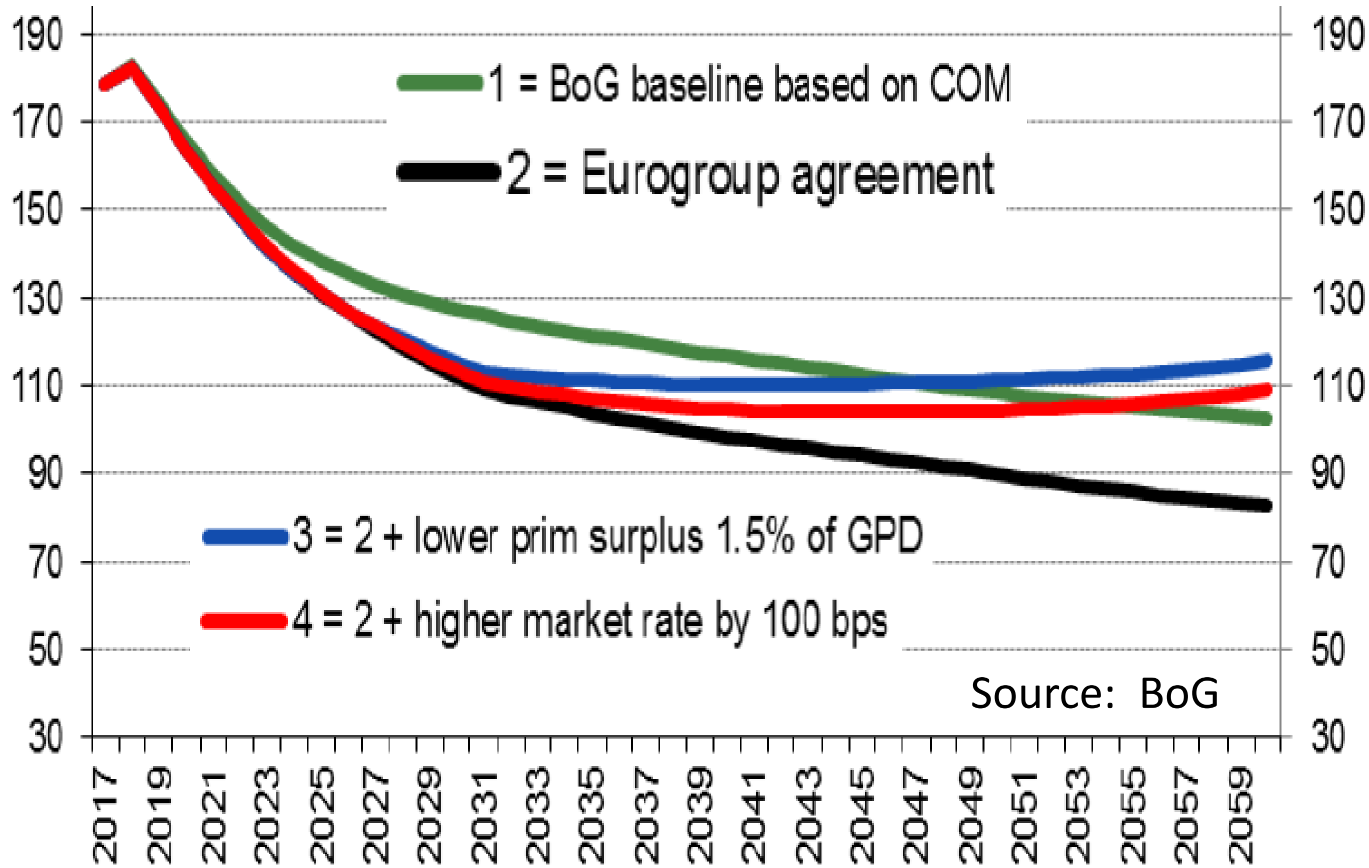
- From €65bn in 2007 (25.9% of GDP) to €22.8bn in 2018 (12.0%)
- Expected increase in 2019 at 13.2% of GDP
- Yet 10 of the 14 ppts reduction due to real estate
- Public investment at 3.0% GDP in 2018 relative to 4.9% in 2007



- Future seems brighter: OECD claims 80 projects are in the pipeline until 2023 with a budget of €20bn

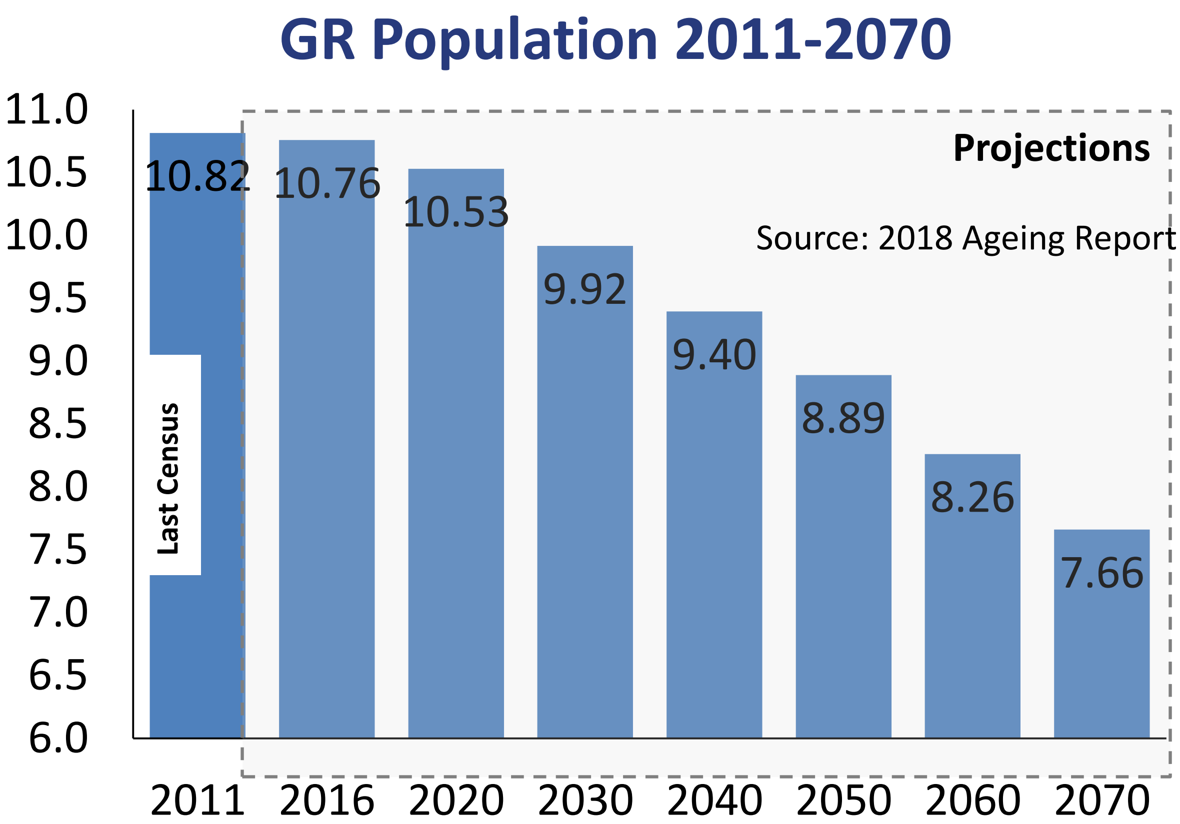
II. Debt sustainability & the fiscal mix

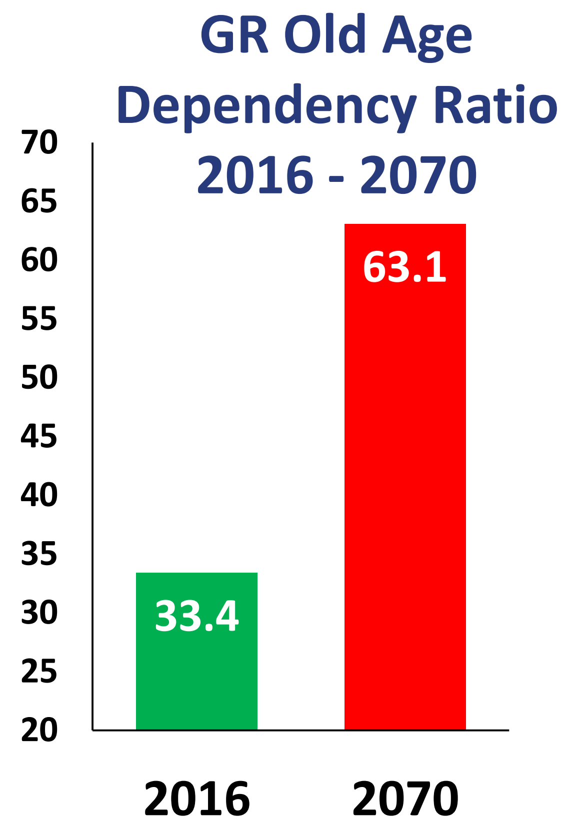
- Public debt is a major constraint
- 2018 Eurogroup agreement is for an average 2023-2060 Primary Surplus target of 2.2% GDP
- Primary Surplus 3.5% GDP for 2019, 2020, 2021 & 2022



- IMF argues for lower targets and greater debt relief
- Fiscal mix is up to Greece to adjust. In 2015-2019 over-reliance on taxes has suppressed incentives to invest and work

II. Adverse Demographics: Population and Pensions





- According to the EC's 2018 Ageing Report the Greek population is expected to decrease at 7.7 mn in 2070 from 10.8 in the 2011 population census
- The Greek old age dependency ratio (the ratio between inactive population above 64 y.o. and the employed aged 22-64) is expected to increase to 63.1% in 2070 from 33.1% in 2016 (Eurostat forecasts).

Summary: A new beginning for the Greek economy

- **The Greek crisis had two phases, the necessary Phase- I and the unnecessary Phase – II**
  - Many imbalances were cured in Phase I (Fiscal deficits eliminated, current account deficits shrank, ULC competitiveness restored)
  - Yet Phase II prolonged the stagnation, with democratic institutions and the financial sector under threat and the population over-levered and in despair for the future
- **A jump–start is now required: What are the major challenges ahead?**
  - Reverse the current disinvestment, which destroys potential growth
  - Correct the fiscal mix with incentives for work and creativity
  - Restore quality competitiveness with privatizations, public sector reforms, investment in IT & innovation, educational reform
  - Help cure the financial sector with a drastic NPE reduction
  - Address the population growth & improve social cohesiveness

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Thank you for your attention!

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