August 2018: Is the Greek Crisis coming to an End?

Gikas A. Hardouvelis

Professor of Finance & Economics

University of Piraeus

ΕΑΣΕ

ΕΤΑΙΡΙΑ ΑΝΩΤΑΤΩΝ ΣΤΕΛΕΧΩΝ ΕΠΙΧΕΙΡΗΣΕΩΝ

ASSOCIATION OF CHIEF EXECUTIVE OFFICERS

November 8, 2017

Table of Contents

I. 2017: A cyclical Recovery begins

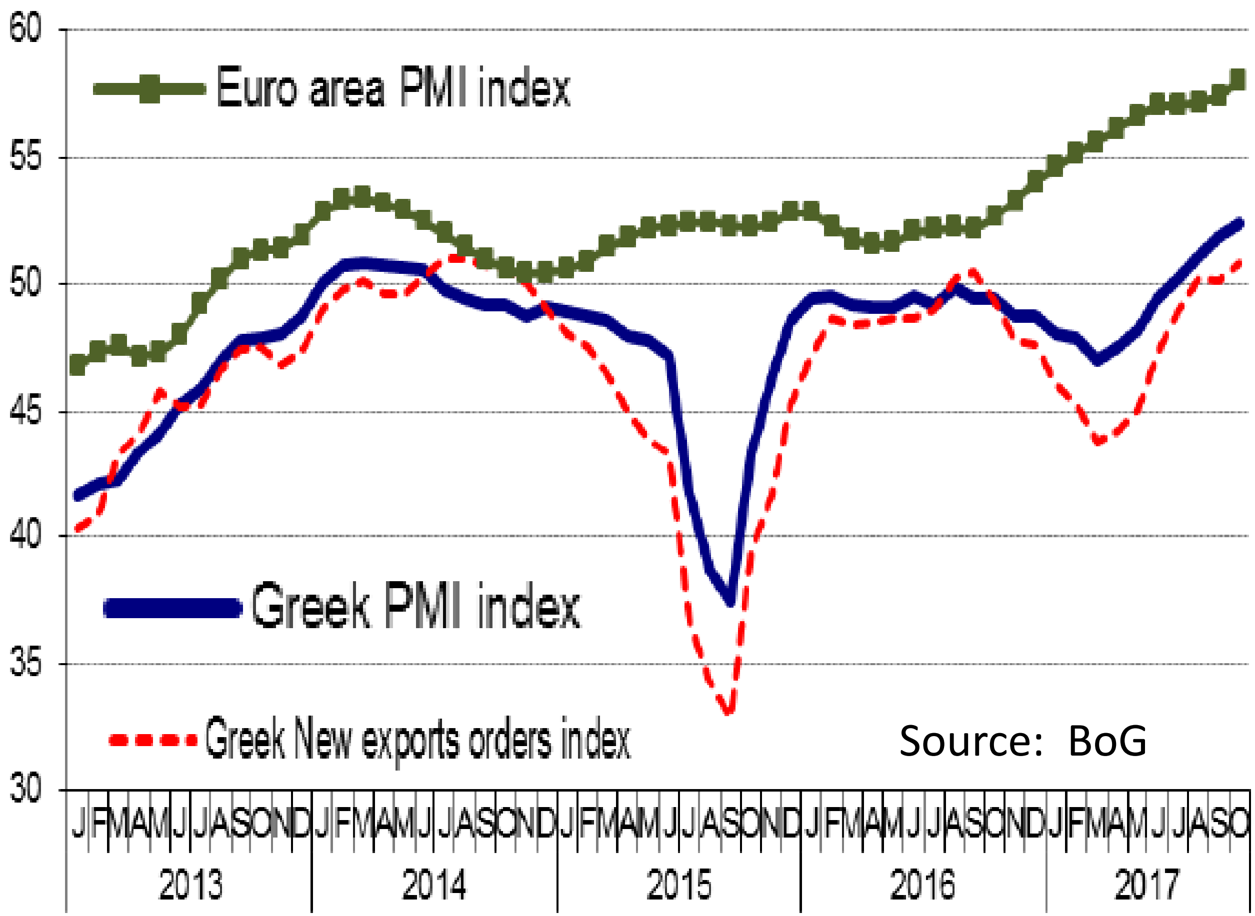
Downside Risks:
- Increased taxation
- Slow reform implementation

Upside Risks:
- Inclusion of Greece in ECB's QE
- Stronger fiscal stimulus in 2017

2018 Challenges:
- Complete Program on time
- Re-enter markets at low interest rates
- Get Debt relief without giving up flexibility in future economic policy

Greek GDP growth

2014	2015	2016	2017	2018
+ 0,7%	- 0,3%	-0,2%	+ 1,4%	+2,0%



I. Stagnation or Growth over the Long Term?

- August 2018 marks the end of the 3rd Economic Adjustment Program 2015-2018, **supported by fresh borrowing of up to €86bn**
- **What follows next? Stagnation or Growth?**

The Optimistic View:

- **Since 2014 the country has returned to balanced budgets and balanced current accounts**
- **Privatizations were not stalled even under the present hostile government**
- **Labor markets are flexible and unit labor costs have declined**
- **Energy markets are in the process of liberalization**
- **Excluding oil and ships, exports of goods have risen**
- **The politically hard reforms are behind us**
- **Grexit is no longer on the table by the Europeans**
- **Political maturity: Even the hostile left has made a U-turn on how it perceives the economy**
- **A new consensus on a growth recipe can easily form**

I. Stagnation or Growth over the Long Term?

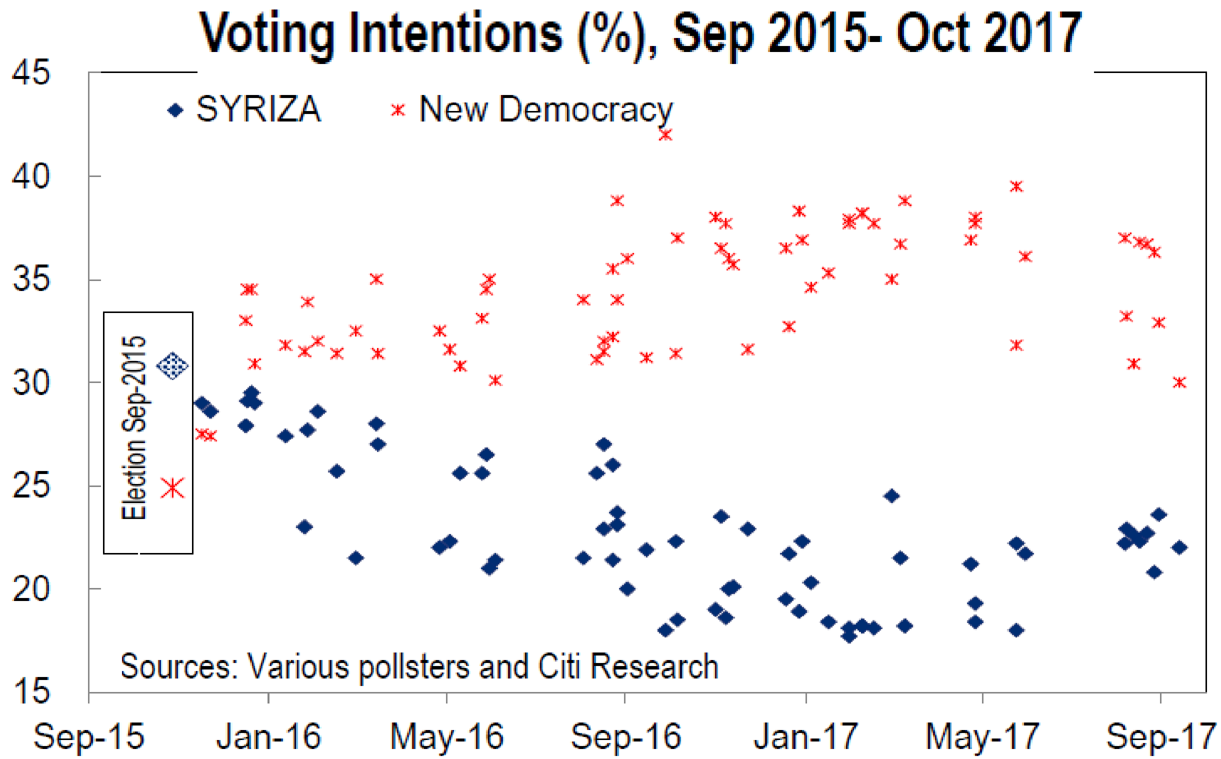
The Pessimistic View:

Many, including the IMF, have concluded growth cannot exceed 1% over the long term and they point to:

- **Negative population growth**
- **Low productivity due to:**
  - **Low levels of investment and national savings, coupled with lack of FDI**
  - **Low technological content of production**
  - **Debt overhang in both public and private sectors**
  - **Fragile financial sector with an overwhelming level of NPLs**
  - **Over-taxation of the same group of citizens, leading to low work effort, low innovation, huge tax avoidance plus immigration abroad**
- **Huge Debt-to-GDP ratio constrains future fiscal policy**
- **No ownership of reforms, hence incomplete and delayed implementation or even a reversal of reforms once the Troika is gone**
- **Many Greeks have yet to understand the causes of the crisis and their politicians are partly to blame for it. Greek society has not come to terms with the globalized world and its demands on competitiveness**

I. Which View will prevail?

- ❑ Which view has the higher probability of materializing? The optimistic or the pessimistic one?
- ❑ The growth scenario lost its chance in 2015
- ❑ <u>Today pessimists win hands down</u>
- ❑ In the future what may increase the possibility of the Growth scenario?



<u>Take small steps at a time in the right direction</u>, hence over the next year:

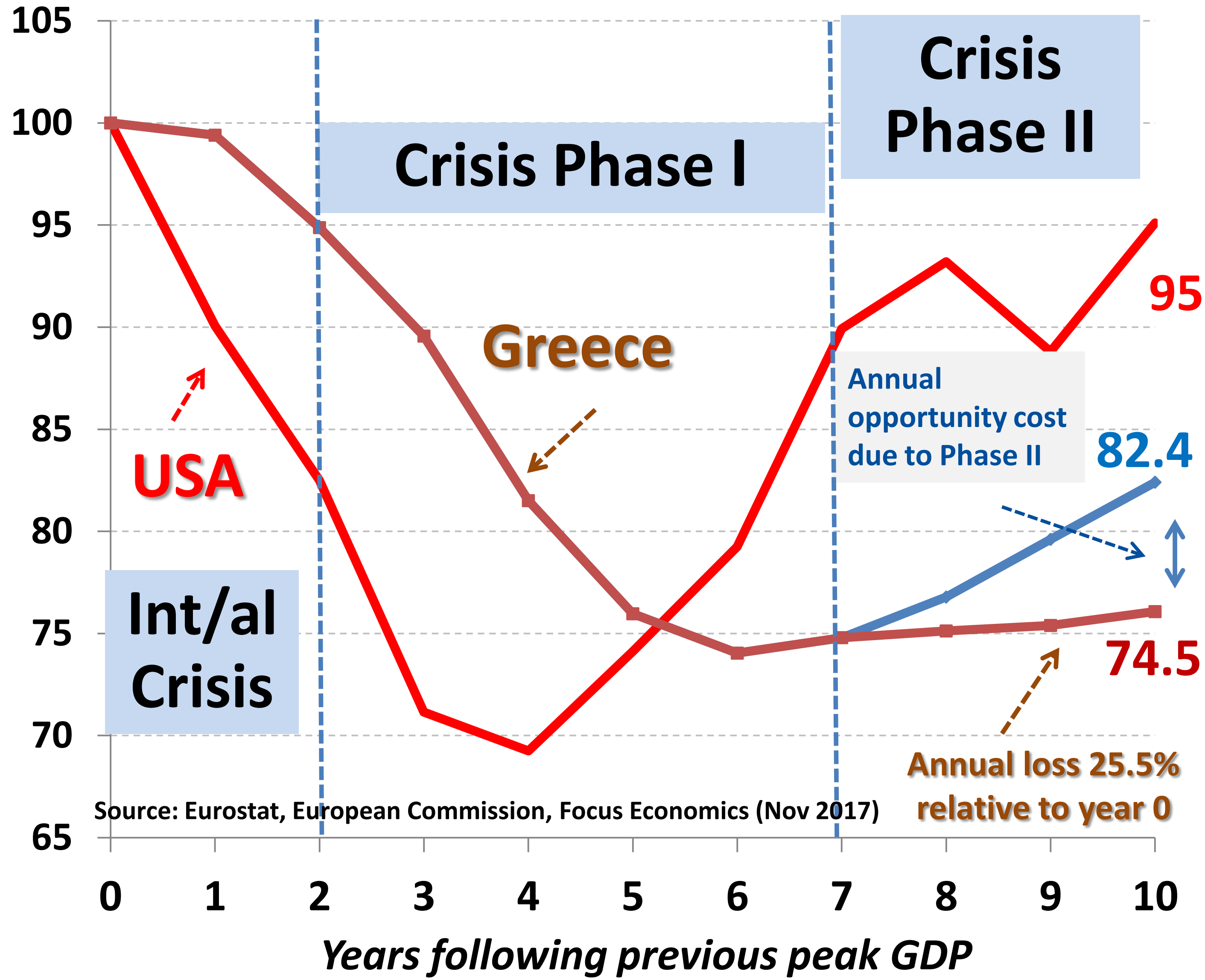
- ❖ Program closure on time, including a 4^{th} review in 2018
- ❖ Tap the markets at low interest rates
- ❖ Design own growth model and follow it (Reversal of current tax policy, link pensions to contributions through third pillar, rationalize public sector, …)

II. More detailed analysis of the Greek Economy

- Comparing the current Greek Depression to the US Great Depression of the 1930s
- The unexpected and politically motivated Phase II of the Greek crisis
- The triple problem of the financial sector: Assets, liabilities, capital
- Today’s other main challenges
- Conclusion

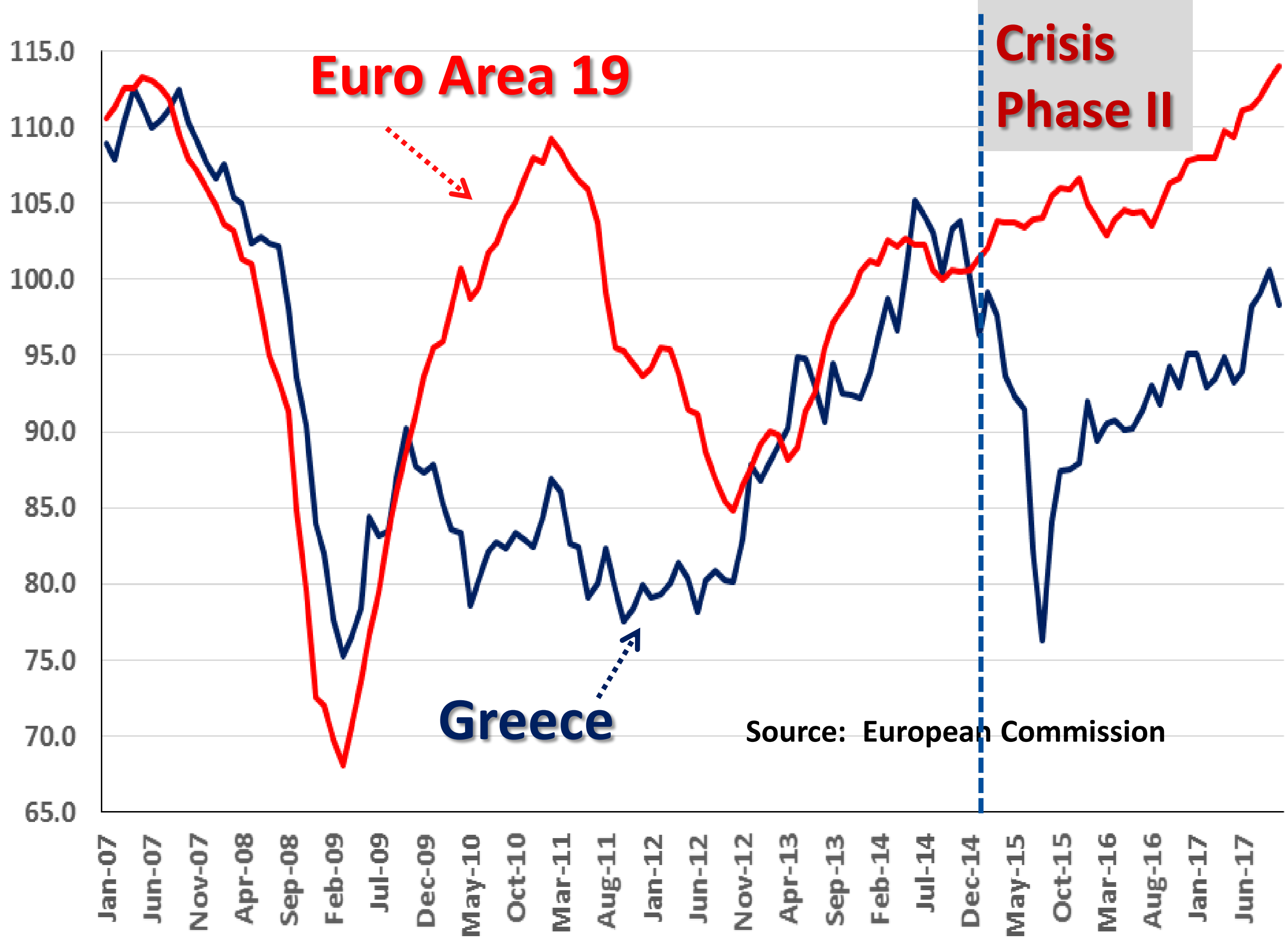
Unusual length of Greek crisis due to its Phase II plus the earlier international crisis

- Date 0 is 1929 for the US and 2007 for Greece: Real GDP is set at 100
- The Greek recovery of year 10, 2017, is a forecast
- After 10 years, the US was at 95 in 1939 but Greece at 74.5 in 2017
- Fall 2014: Greece was forecasted to be around 82.4
- At minimum, Phase II costs <u>annually</u> 7.9 ppts or ca. €18bn



Crisis Phase II shows up clearly in Economic Sentiment

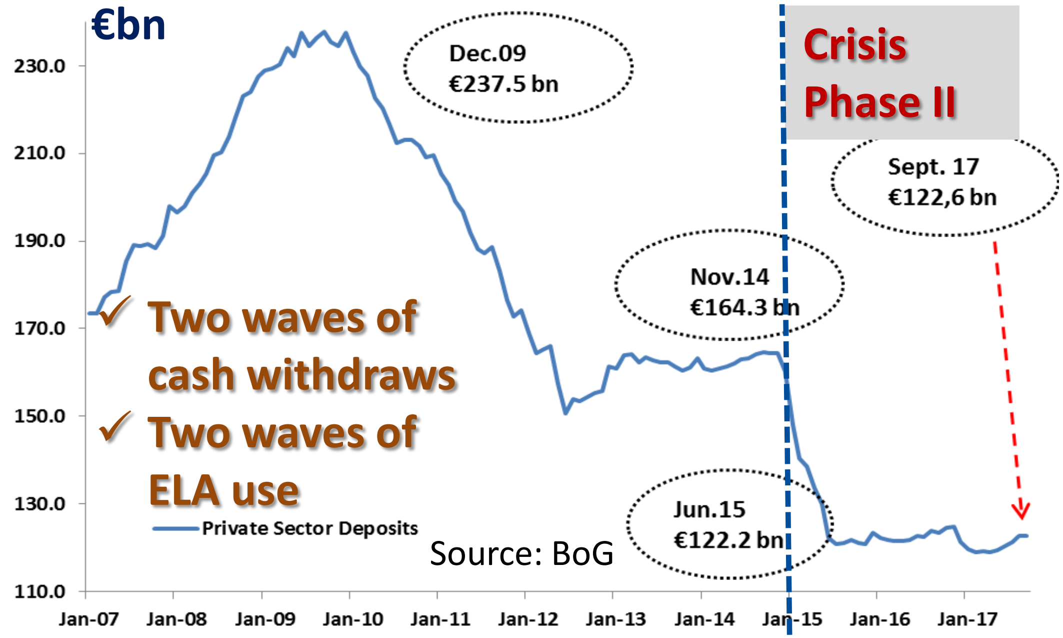
- ❑ The sentiment index in Greece was moving together with sentiment in EA until late 2009, both declining
- ❑ **Decoupling during the Greek crisis until November 2012**
- ❑ From late 2012 until late 2014, **re-coupling**: Greek sentiment moved upward and in line with EA sentiment

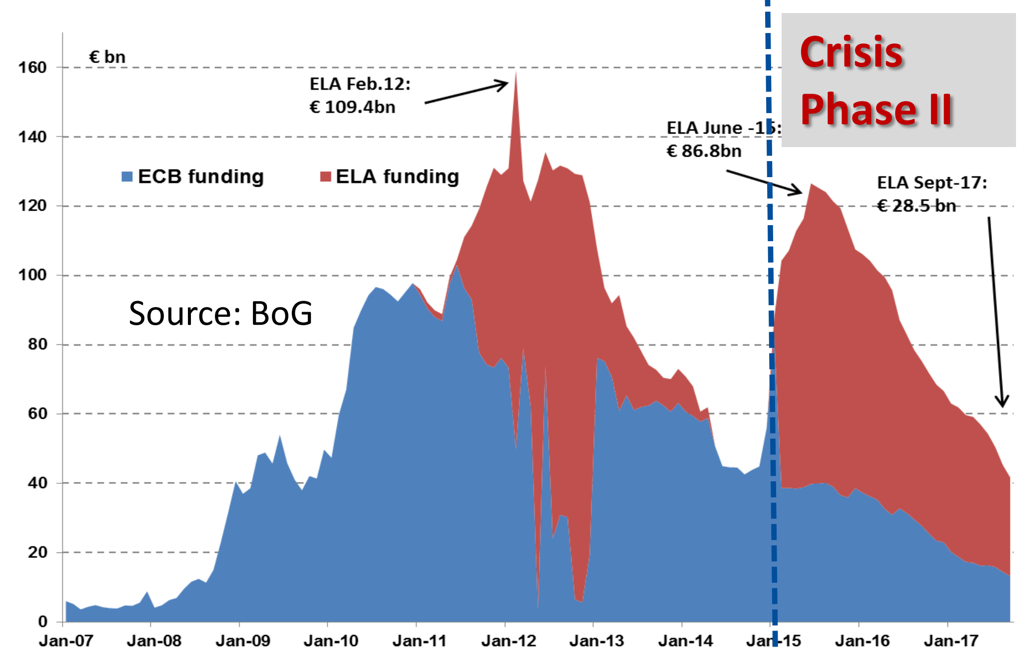


- ❑ Greek sentiment peaked in the period June 2014 - November 2014, but subsequently began a fast downward slide as the political landscape deteriorated and generated new uncertainty, thus <u>decoupling a second time</u> **from the rest of EA. Phase II of the crisis was creating anxiety in sentiment.**

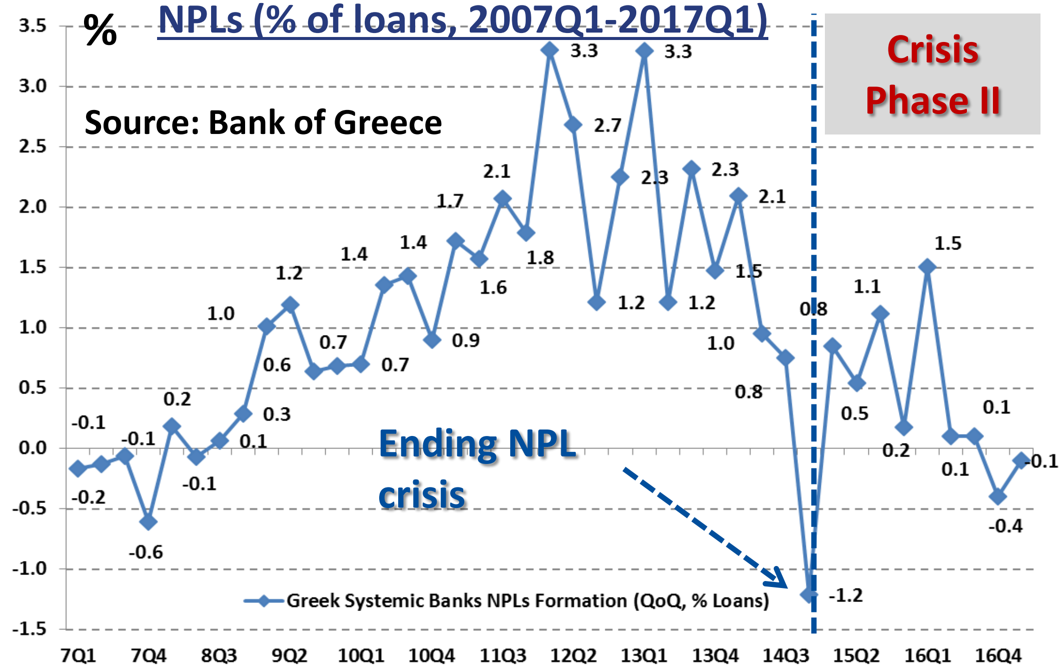
Crisis Phase II shows up in the Financial Sector

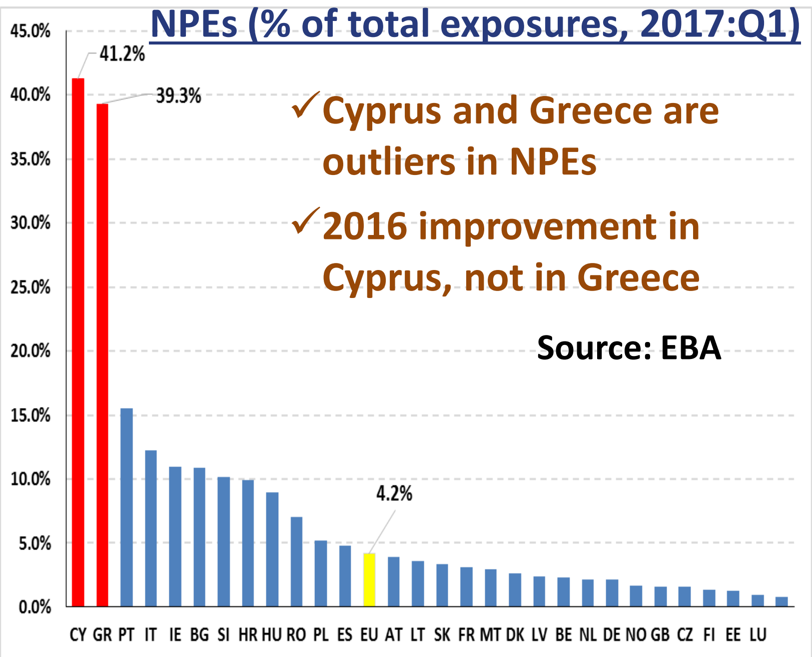
- A second wave of cash withdrawals in 2015 plus a disappearing inter-bank market leads banks to ELA:
  - ELA was zero at the end of 2014, yet it peaked again in 2015
  - It remains at €41bn today
  - Capital controls still imposed
  - Unless credibility returns, cash will stay outside the banks
  - After re-introduction of ECB waiver in July 2016, gradual improvement in ELA dependence
- Bank stock prices collapsed in 2015H1, State lost over €25bn in value, and a necessary 3rd recapitalization in Nov 2015
- State owner-ship of systemic banks shrank: NBG (40.4%), Piraeus (26.4%), Alpha (11.0%), Eurobank (2.4%)
- **Capital** (excl. CoCos & Prefs) **strong,** yet **depends on DTA,** 49% of €8.92bn in Alpha, 64% of €7.89bn in Piraeus 66% of €7.74bn in NBG, 78% of €6.25bn in Eurobank





Banks remain vulnerable on the Asset side of their balance sheet as well



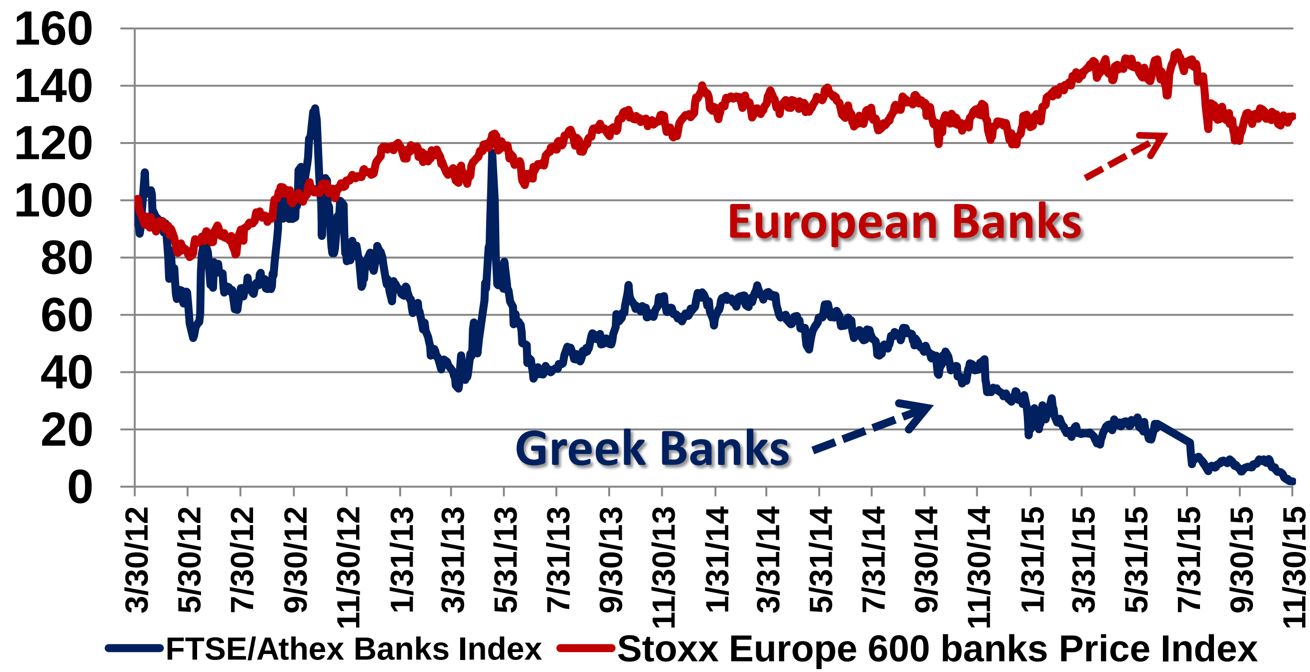


- ❑ Greek banking sector NPEs second only to Cyprus in 2017:Q1. Target reduction of 38% by end of 2019
- ❑ The NPL improvement of late 2014 was reversed due to Phase-II of the crisis
- ❑ Unless economy picks up and NPL problem is gradually resolved, banks
  - Would stay zombies, unable to provide new credit to healthy companies
  - May need additional capital infusion, with no foreigners willing to come in this time
- ❑ The Athens Stock Exchange FTSE Banks Index increased by ca 21% YTD (62.1% since end of Sept.2016) on expectations regarding the conclusion of the 2nd review (realized in mid-June 2017). The FTSE is still below its end of 2015 level (last recap. took place in Nov.-Dec. 2015) by ca 13.5%

How the Stock Market views the Banks

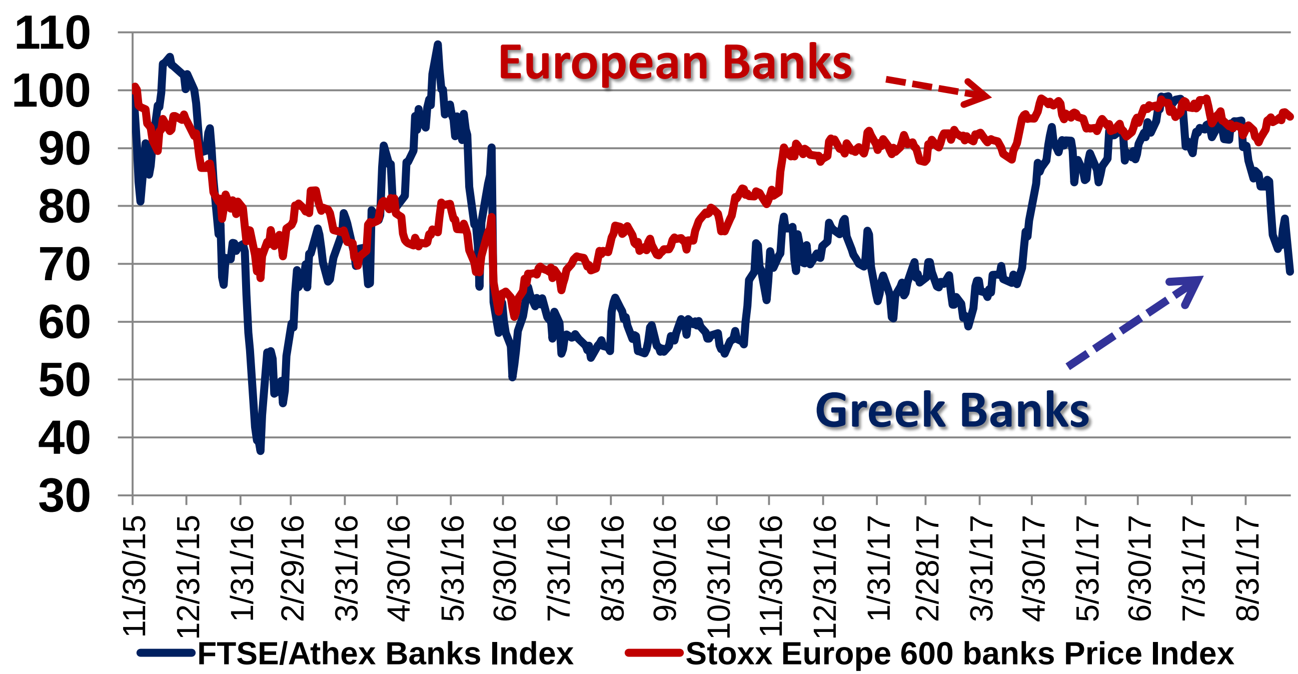
BANK INDICES = 100 at 30/3/2012

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



BANK INDICES = 100 at 30/11/2015

- After the third recapitalization, the Greek bank index fluctuated and now is 30% lower, due to the fears of additional capital needs in 2018



The Health of Greek Systemic Banks as of June 2017

Group level , 6/2017	Piraeus	NBG	Eurobank	Alpha	Total
1. Total Loans (€mn)	62.000	43.750	50.200	59.100	215.050
2. Non-Performing Exposures (€mn)	34.900	19.700	22.100	31.700	108.400
3. NPE ratio	52,3%	45,0%	44,1%	53,7%	50,4%
4. Non-Performing Loans (€mn)	23.000	14.800	17.300	22.200	77.300
5. NPL ratio	37,1%	34,0%	34,6%	37,6%	36,0%
6. Provisions (€mn)	7.564	10.968	11.304	12.322	42.158
7. Regulatory Capital CET1 (€ mn)	8.829	6.451	6.772	8.800	30.852
8. Texas Ratio 1 = 4/(6+7)	1,40	0,85	0,96	1,05	1,06
9. Tangible Equity	7.464	6.600	5.753	9.024	28.841
10. Texas Ratio 2 = 4/(6+9)	1,53	0,84	1,01	1,04	1,09

Notes:

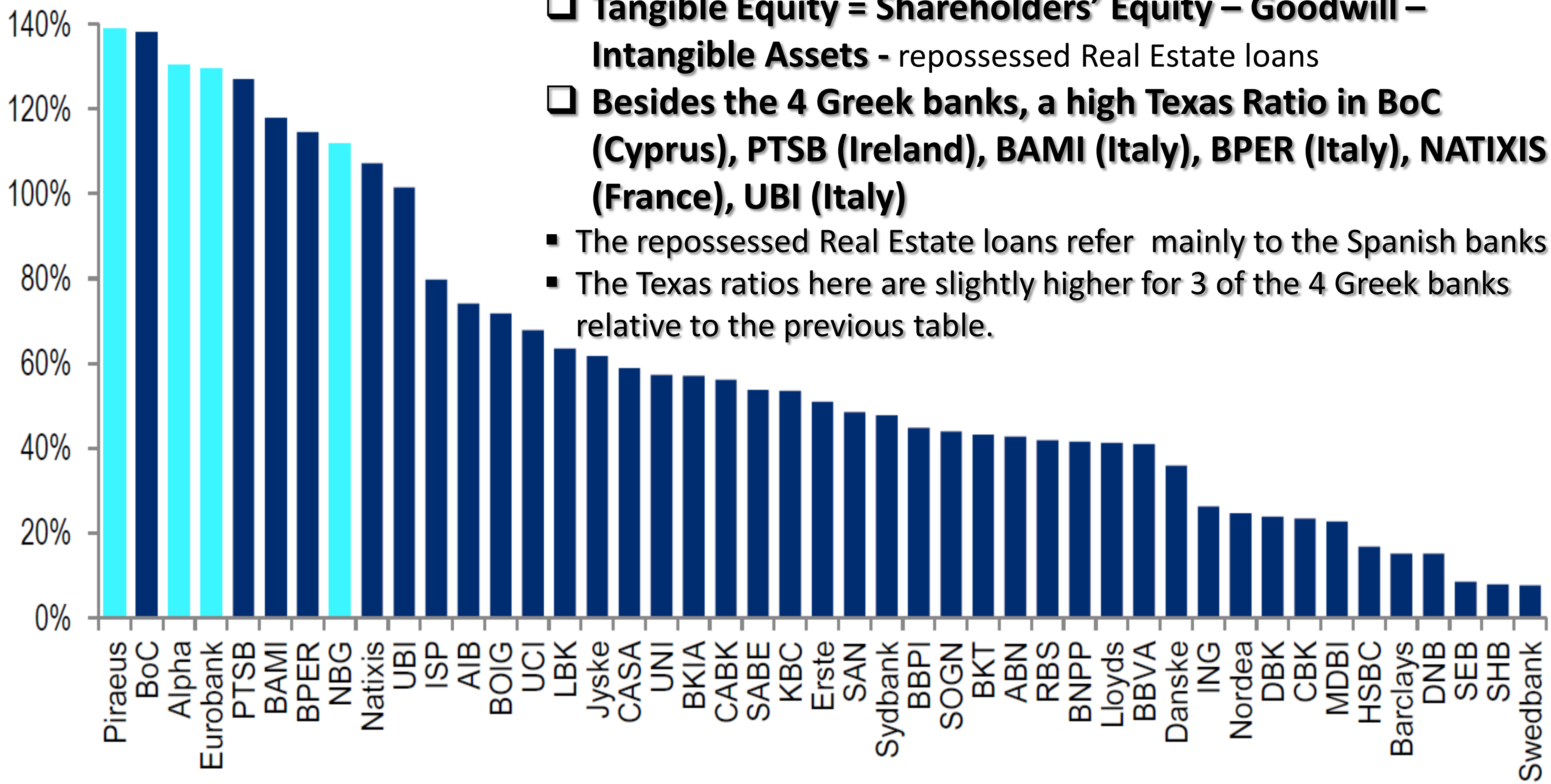
1. In the worst possible scenario, **when all NPL value is lost**, two of the four systemic banks survive (they have a **Texas Ratio less than unity**), a third barely survives and a fourth one needs capital. Yet, if all NPE value is lost, no bank survives.
2. About **2/3 of regulatory capital is DTA. Without it, no bank survives even today.**
3. In January 2018, new IFRS-9 rules impose additional capital needs over the following five years, perhaps more than €4-6 bn.
4. New Stress Tests is 2018 before the end of the Program will add more capital needs

Source: *Author calculations based on banks' published statistics*

Comparison to other European Banks in June 2017

European Banks Texas Ratio (excl Foreclosed Assets), 1H17

- **Tangible Equity = Shareholders' Equity – Goodwill – Intangible Assets -** repossessed Real Estate loans
- **Besides the 4 Greek banks, a high Texas Ratio in BoC (Cyprus), PTSB (Ireland), BAMI (Italy), BPER (Italy), NATIXIS (France), UBI (Italy)**
  - The repossessed Real Estate loans refer mainly to the Spanish banks
  - The Texas ratios here are slightly higher for 3 of the 4 Greek banks relative to the previous table.



Texas ratio defined as: Gross NPLs / (Tangible Equity + B/S Loan Loss Reserves)

Source: Company data and Citi Research.

Greek Banks 10 Oct 2017

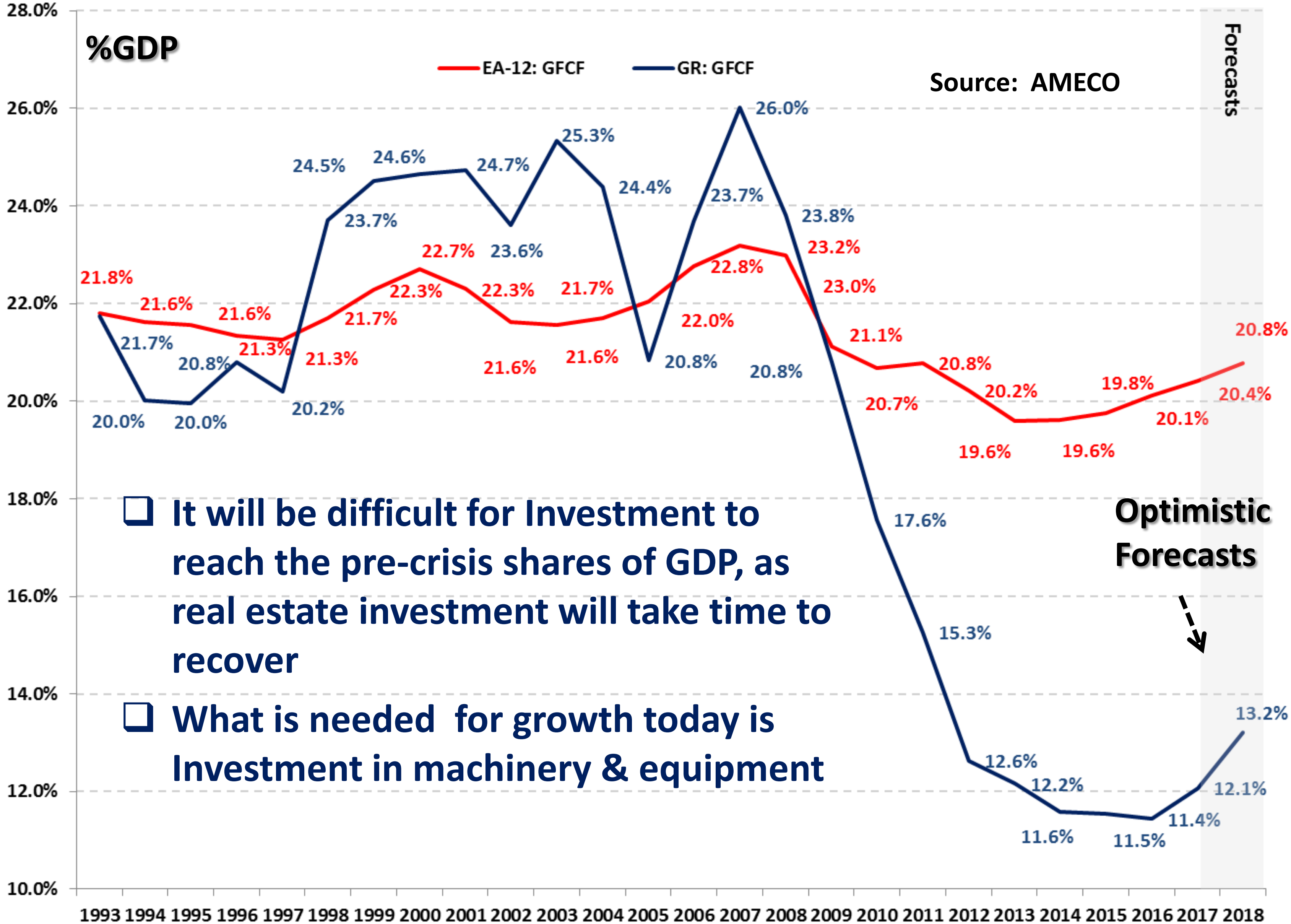
Major long-term challenges today

During the Greek-crisis Phase-I years of 2010-2013, Greece brought its fiscal and current account deficits back in balance plus improved its cost competitiveness

Yet major challenges remain:

- **Reversing the decline in investment and raising exports, both needed in order to rebalance aggregate demand away from consumption. This means:**
  - **Improving credibility**
  - **Providing incentives for work and doing business, e.g. reversing the over-taxation policy, minimizing obstacles to investment, improving the efficiency of the State sector, etc.**
- **Repairing the financial sector** *(already mentioned)*
- **Solving the Pension problem via reciprocity, i.e. by connecting contributions to benefits**

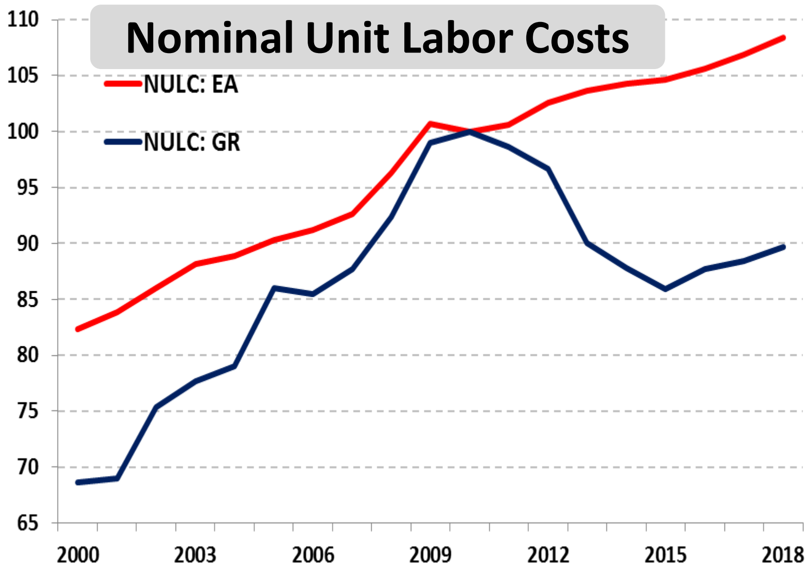
Investment: A binding constraint on growth



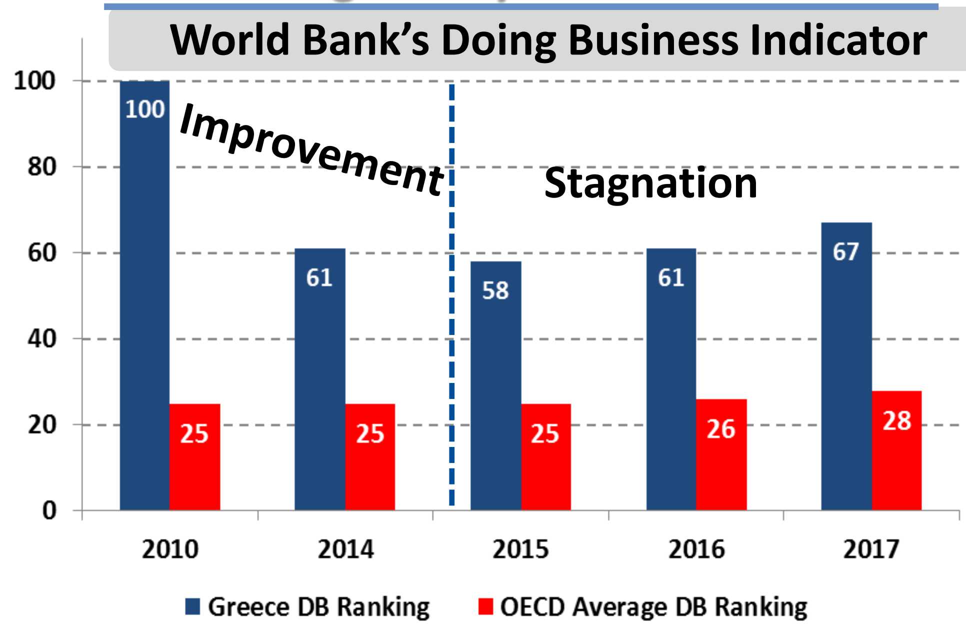
- It will be difficult for Investment to reach the pre-crisis shares of GDP, as real estate investment will take time to recover
- What is needed for growth today is Investment in machinery & equipment

Cost competitiveness improvement, yet exports do less well

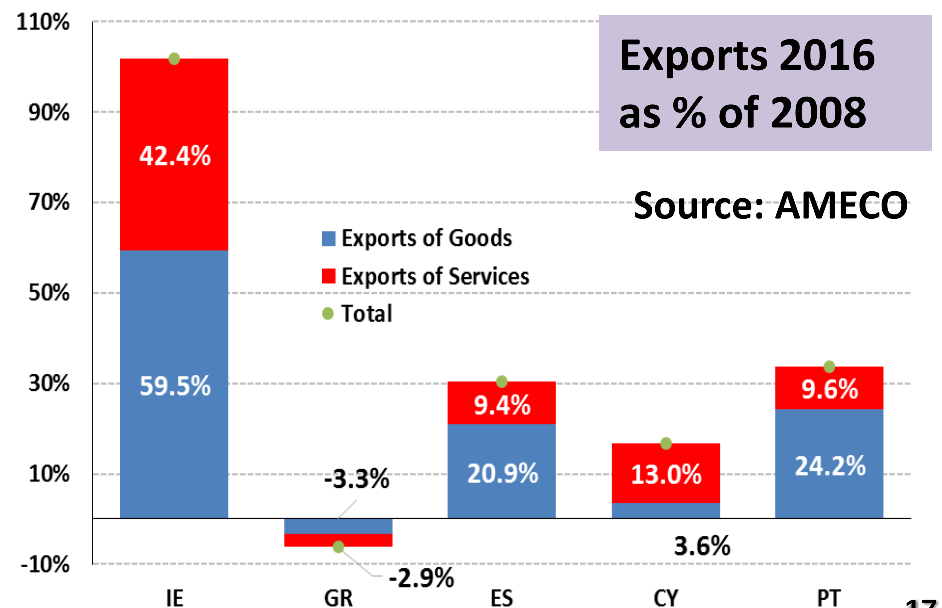
Near-Elimination of Post Euro-entry Wage Competitiveness Losses



Regulatory Environment



- ❑ Non wage competitiveness improvement stops in 2014.
- ❑ Greece is the only Program country showing lower value of exports in 2016 relative to 2008. Underperformance may be due to:
    1. The poor institutional quality (EC, 2014, The Puzzle of the Missing Greek Exports).
    2. The price of oil, which represents about 30% of Greek exports. Ships are also affecting the value of services, which were affected by capital controls. Both constitute signs of low diversification of Greek exports.



Long list of reforms remaining

- Continuation of **liberalization of product markets - ** implementation of **OECD toolkits** aiming to increase competition in **internal markets** (opening-up of remaining closed professions, removal of barriers to competition & investment, shift of focus from non-tradables to the tradables sector)
- Continuation of the **energy market's liberalization**
- Implementation of reforms to address **red tape on businesses licensing / operation** (improve Doing Business rankings)
- Legislation on the **use of land / forests** etc., progress on creating the **Cadastre**
- Reform of the **justice system**
- Continuation of **labor reform** (legislation to increase the quorum for first-degree unions to vote on a strike to 50 percent, etc.)
- Implementation of the **privatization agenda** (total revenues of €17.0bn between 2017 and 2060 of which €13.0bn from non-bank assets).
- Improvement of the **effectiveness of the public sector**
- **Undoing** the **"reform"** on the **education sector**
- Formation of framework for a new **extrovert growth model** of the country (choice of promising sectors, focus on further reforms on these sectors, etc)
- Vigilance on **preventing** the **back tracking of reforms,** e.g. labor, which essentially requires **ownership of the reform agenda** by the Greek authorities**.**

Conclusion:
Is August 2018 marking the End of the Greek Crisis?

- **STRONG DOUBTS on the ability of the economy to materially take off unless ...**
  - **credibility comes back**
  - **incentives for work and innovation reappear**
  - **the tax and pension contribution structure is cured**
  - **Reforms continue (privatizations, bureaucracy reduction, rationalization of the public sector, liberalization of energy markets, etc.)**

Thank you for your attention!

Gikas A. Hardouvelis
Professor of Finance & Economics
University of Piraeus

ΕΑΣΕ
ΕΤΑΙΡΙΑ ΑΝΩΤΑΤΩΝ ΣΤΕΛΕΧΩΝ ΕΠΙΧΕΙΡΗΣΕΩΝ
ASSOCIATION OF CHIEF EXECUTIVE OFFICERS

November 8, 2017