George A Provopoulos: Where is the Greek economy heading?

Presentation by Mr George A Provopoulos, Governor of the Bank of Greece, at the 7th Hellenic Albanian Business Forum, Tirana, 13 November 2013.

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Introduction

It's a pleasure to speak to you here today. This forum is an excellent example of the close ties that exist between our two nations. Greek-Albanian trade relations, as we all know, are strong and expanding. Greek entrepreneurial presence in Albania continues to be important. Greece's share in Albania's FDI stock is more than 15%. Importantly, Greek banks have a considerable presence here and have contributed to Albania's smooth transition to a market economy. Because of the important economic presence of Greece here, I will focus my remarks on developments in the Greek economy, especially with regard to the banking system. I will also provide a few remarks on the role of Greek banks in Albania. Let me first provide an overview of the impact of the Greek sovereign crisis on the banking system. Prior to the outbreak of the sovereign crisis, the banking sector had sound fundamentals – with high capital positions, low loan-to-deposit ratios, and essentially no toxic assets of the kind that set-off the 2007 global financial crisis. However, the sovereign crisis spilled over to the banking system, generating a general crisis of confidence, which intensified the contraction of GDP and worsened the debt dynamics. Yet, I believe that the future now looks brighter. Why do I believe this? Because, for one thing, during the past few years, throughout the contraction, Greece has made important progress in addressing its fiscal and external imbalances. In addition, the country's banking system has been recapitalized and consolidated. Allow me to consider each of these areas – fiscal and external adjustment, and the restructuring of the banking system.

Fiscal adjustment

First, fiscal adjustment. Greece's fiscal consolidation is one of the largest ever achieved by any country at any time under an IMF programme. From 2009 to 2012 the fiscal deficit was reduced by 10 percentage points of GDP. In 2013 we expect it to be reduced by a further 3 (2.9) percentage points of GDP. The structural fiscal deficit – that is, the deficit corrected for the business cycle – will have shrunk by almost 20 percentage points of GDP by end-2013. A few years ago the primary fiscal deficit exceeded 10 per cent of GDP. This year the primary balance is in surplus. What makes these achievements especially impressive is that they have taken place despite a contracting economy, which creates moving targets for fiscal consolidation.

External adjustment

Let me now turn to external adjustment. In the 9 years, 2001 through 2009, Greece lost about 30 per cent in terms of cost competitiveness against its major trading partners. In just 4 years, 2010 through 2013, the entire loss has been recovered. Competitiveness is also being promoted through structural reforms. As a result of these improvements in competitiveness, a rebalancing of the Greek economy is taking place. The share of exports of goods and services in GDP rose from 19 per cent in 2009 to 27 per cent in 2012. The share of Greek exports of goods in world trade has risen by 30 per cent since 2010. The current account, which reached a deficit of 15 per cent of GDP in 2008, has moved into surplus in the first eight months of 2013, and we expect a surplus for the year as a whole.

The banking sector strategy

With the deepening of the crisis a few years ago, the Bank of Greece stepped-in to preserve banking system stability. Our efforts focused on two fronts:

- Preserving banking system liquidity, and
- Restoring capital adequacy.

The Bank of Greece, as part of the Eurosystem, provided ample liquidity to banks at low interest rates using standard and non-standard monetary policy measures. Moreover, when banks came under intense liquidity pressures, the Bank of Greece provided them with emergency liquidity assistance. In terms of capital, a national backstop of €50 billion was established in the form of the Hellenic Financial Stability Fund. In addition, the Bank of Greece conducted a viability study of the banking system. Based on this study, viable banks have been fully recapitalized using a combination of state and private funds. Non-viable banks that were not able to raise private capital have been resolved, using state of the art resolution tools – tools that are now being introduced in many other countries. In total, 9 banks have been successfully resolved.

As a result, today we have four well-capitalized viable pillar banks; one of them under state control – but soon to be privatized (Eurobank) – and three privately managed (NBG, Alpha and Piraeus). We also have a few smaller banks, that are also well-capitalized. This situation, with four large banks and a few smaller ones, should be seen in the context of a banking system comprising almost 20 banks a few years ago. I believe that the consolidation, and the elimination of excess capacity to be achieved over the next few years, are impressive. Moreover, there is a significant backstop facility (the "buffer"), in excess of €10 billion, to provide additional capital support to banks, should that be necessary.

I am extremely satisfied that, having survived such an enormous economic and financial storm, the Greek banking system is becoming more competitive and well-capitalized. This result didn't just happen – it was the result of enormous work, difficult decisions, and careful organization. However, this is not the end of the story for the transformation of the banking system. The second stage of our strategy is just beginning. This stage will be characterized by efforts to implement a new banking model.

This model will allow banks to exploit synergies and economies of scale, and will, therefore, entail a further elimination of excess capacity. In this way, banks will become more efficient, gradually reducing their reliance on state aid and central-bank funding. Banks also need to refocus their business on their core activities. This step implies selling non-core assets and rationalizing their network and activities abroad. Rationalization does not mean outright sale. The banks will consider disposing operations that absorb disproportional amounts of capital and (scarce) liquidity. However they do not intend to proceed to fire sales of self-funded, efficient business units, a situation that characterizes most subsidiaries of Greek banks in Albania.

But I will come back to this issue. As you may know, we have recently engaged BlackRock – for a second time – to update credit loss projections for banks' loan portfolios up to 2016, and to study the efficiency of banks' procedures in managing non-performing loans. As I mentioned, due to the efficient use of resources, a buffer of €10 billion is available [at the Hellenic Financial Stability Fund] as a public backstop, should additional capital needs arise. Moreover, we estimate that the sale of non-core assets and the exploitation of synergies arising from mergers will provide a further buffer of an estimated €5-€6 billion. Banks also need to manage their loan portfolios in a more efficient way. This involves primarily efficient resolution of non-performing loans. Improvements in the NPL management will lead to lower capital requirements. The reduced capital requirements are expected to free up resources that can be used to finance the new business model of the Greek economy. Thus, banks will play a key role in shifting funds from non-productive to productive businesses. Finally, low deposit rates are allowing banks to reduce funding costs and, thus, to ease the cost of financing for both retail and corporate clients. These developments should have a positive impact upon operating efficiency and, eventually, the ability of borrowers to service their obligations.

Greek banks in Albania

Now, let me say a few words about the Greek banks in Albania. Greek banks comprise an important part of the Albanian banking system as evidenced by the fact that they hold about 20% of total banking sector assets. They are well-capitalized, mainly self-funded, and play a vital role in the Albanian economy. However, individually their operations are rather small compared to those of other foreign banks in Albania. Therefore, some mergers may need to take place. In recent years, Greek banks have spread widely in South Eastern Europe. However, few banks managed to obtain, on an individual basis, a substantial market share and size, which are critical factors for efficiency and profitability. This shortcoming has to be addressed. A stronger presence of fewer banks would be better not only for individual banks, but also for the market and the domestic economy. The benefits of consolidation can be seen in the Greek banking market.

A major challenge not only for subsidiaries of Greek banks, but for the Albanian banking system as a whole, is the rising level of non-performing loans. The rise in NPLs is a problem for most countries in the region, including Greece. Dealing with this situation is important for not only the robustness of the banks but, more importantly, for ensuring adequate credit supply to the real economy. It is for these reasons that the matter of effective management of NPLs is a top priority for the Bank of Greece. We have set up a plan to increase banks' efficiency in dealing with troubled borrowers. The frameworks that the banks will develop will, of course, be disseminated throughout their groups and will contribute to the efforts by all supervisory authorities in Southeastern Europe to address the common concern of non-performing loans.

Finally, I would like to reassure you that Greek banking groups have not engaged in excessive deleveraging and they are not going to do so in the future. In fact, there has been no "home"-bias in the loan deleveraging process, rather the opposite. The need of strategic restructuring does not mean a weaker commitment by Greek banks. After all, their presence here and in other countries is a strategic choice as they see substantial long-term growth and earnings potential in both Albania and the region more generally.

The future: the cost has been borne; we are now expecting to bear the fruits

Dear friends

We are now seeing the results of the changes that have been taking place in the Greek economy. Over the past year or so there has been positive news with respect to financial indicators and soft data; recently, there has been positive news in the hard data. The policy reforms – including fiscal adjustment and structural reforms – that Greece has been implementing during the past several years follow an established recipe. That recipe worked for the U.K. in the 1980s, Sweden and Finland in the early 1990s, Asia in the late 1990s, Germany in the early 2000s, and in many other countries. This recipe includes fixing social security, strengthening employment incentives, raising consumption taxes, and streamlining the public sector. Some of these measures – especially structural reforms – take some time to work. They require patience, perseverance, and the ability to ignore the siren calls of those who offer quick fixes. That recipe is now working in Greece. The benefits of the country's adjustments extend beyond the credibility and competitiveness effects of decreasing macroeconomic imbalances. In light of these developments, I expect economic growth to return, starting in 2014. If Greece achieves a primary surplus in 2013, which seems very likely to happen, the euro area will be discussing further debt reducing measures in spring 2014. Indeed, financial markets apparently share my view about a positive future for the Greek economy.

Recently, the FT ran an article that reported that both hedge and long funds are investing heavily in Greek banks. I can confirm that this is indeed the case. The markets have introduced a new term GRECOVERY – that is, a recovery of the Greek economy, to replace the earlier term, GREXIT. As my remarks today make clear, I believe that the markets' reassessment is well-founded.

Thank you for your attention.