George A Provopoulos: “The Chronicle of the great crisis – The Bank of Greece 2008–2013”

Speech by Mr George A Provopoulos, Governor of the Bank of Greece, on the publication of “The Chronicle of the great crisis – The Bank of Greece 2008–2013”, Athens, 11 June 2014.

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The Chronicle of the great crisis is the result of a joint effort by Bank of Greece staff. First of all, I would like to thank all those who contributed to the writing of this book. But far beyond the preparation of this text, a joint effort par excellence was required in order to successfully address the crisis itself.

The purpose of the book is to record the intense and multifaceted activities of the Bank of Greece in the years from 2008 to 2013. This period will certainly mark a watershed in the history of modern Greece. In times which are critical and characterised by high risks, such as the ones in question, decision and policy making are also critical and characterised by high risk. The Bank of Greece was actively involved in such decision making, sometimes directly and other times indirectly, playing an important role both domestically and internationally, as a member of the Eurosystem.

The Chronicle does not purport of course to compete with books of economic history that will be written in the future in order to recount and explain the great crisis of the Greek economy. Besides, the events discussed are too recent to allow an objective historical inquiry. For this reason, the account provided here is only limited to the Bank’s decisions, actions and other public interventions, which reflect our own, institutional, interpretation of what led to the crisis; which crucial decisions had to be made to address it; and what the Bank’s contribution was to the exit from it.

The Bank’s role has mainly two aspects: first, its participation in the Eurosystem and in ECB decision-making, with a responsibility for monetary policy implementation in Greece; and second, the supervision of the banking system with a view to safeguarding financial stability. With specific regard to this second aspect – on which a large part of this book is focused – the Bank of Greece had faced enormous challenges during the crisis. In response, on many occasions it had to act rapidly and decisively, under extremely pressing conditions.

During the crisis the Bank also sought to strengthen its role as an advisor to society, which at the time was inundated with conflicting information originating both in Greece and abroad, which resulted in confusion and higher uncertainty. Through our reports, speeches and interviews we tried to present the true facts in a simple, easily understood manner; to dispel misconceptions, and inform the public on the available options and their implications.

The book presents an extensive discussion of the Bank’s public interventions and positions in the crisis period and describes the actions it took to safeguard financial stability. It provides detailed information on the enhanced banking supervision carried out in this very challenging period; on cash management and liquidity provision to the banking system; on the implementation of resolution and liquidation measures for credit institutions; and on the strategy for restructuring the banking system.

In such a brief speech I could not cover the full spectrum of our actions during the crisis. Nevertheless, I would like to discuss three topics: first, the view of the Bank of Greece as to what caused the crisis; second, the Bank’s key positions regarding the policy orientations for exiting the crisis; third, the steps we took for safeguarding financial stability.

1. What caused the crisis

In addressing the crisis, the Bank of Greece first assessed its root causes. Of course these causes were there before the crisis, but came to the forefront with particular intensity after

2008. Back in 2001 it was expected that Greece's inclusion in the core of European economies would act as a catalyst to accelerate its real convergence with the advanced European countries. Unfortunately, these expectations did not materialise. In the years that followed, economic growth relied mainly on consumption rather than on saving and investment, while any attempts to change long-established structures met with strong reactions. Public spending kept increasing, while revenue could not possibly keep pace, leading to large deficits and historically high levels of public debt, despite the unprecedented low interest rates. The political system hesitated to take decisive reform initiatives. The country enjoyed the benefits of the single currency, but failed to show that it respected the obligations arising from participation in the monetary union.

The distortions in the growth model the country was following had been repeatedly highlighted by the Bank of Greece. Its warnings however were not heeded. The country continued on its carefree path, borrowing and accumulating debts in order to consume increasingly more goods and services that it did not itself produce. With the onset of the global financial crisis the international environment drastically deteriorated, and countries with large structural imbalances were hit the most severely. As early as in late 2008, the Bank was warning that the crisis, which was about to hit Greece as well, would be deep and of a structural nature, adding that overcoming that crisis would require a long, methodical and painstaking effort, given that imbalances and structural rigidities accumulated over several years had to be urgently addressed.

By late 2008, it had become evident that the implementation of a multiannual programme was needed in order to reduce the fiscal deficit, control debt dynamics and carry out extensive structural reforms which would boost the economy's weak competitiveness. However, the policies adopted were timid, even though markets had started moving towards an overall reassessment of credit risk that did not preclude a Greek default, therefore imposing new, more onerous lending conditions.

By early 2010 it was no longer possible to cover the deficits with financing from the markets. In Greece, the international financial crisis was evolving into a sovereign debt crisis. In April 2010 the Greek government submitted to the euro area countries and the IMF a request for financial support, and in May the first Memorandum of Economic and Financial Policies was signed. This triggered a process of sharp economic adjustment in order to avoid default and lay the groundwork for rebalancing the economy.

This process, currently at an advanced stage, has not been linear or painless. For one, it had not been clear from the outset that the country could indeed achieve an orderly adjustment. This is why an exit from the euro area was often presented as looming or unavoidable. Moreover, the conduct of economic policy during that period was subject to critical swings between the consistent implementation of the adjustment programme and hesitation due to political cost considerations. In such a climate, significant modifications had to be made to the original agreements with our partners, in order to make up for implementation delays or errors in initial forecasts.

Fortunately, collapse and exit from the euro area were prevented, thanks to the society's choice in favour of the country's future within the euro area, the assistance provided by our partners, and the efforts of successive governments. Thus, today we can look forward to the future with greater confidence, as we can expect that the economy will recover and, under certain conditions, will enter into a new, virtuous circle.

The economic and social costs of the adjustment have been and remain heavy. The citizens' sacrifices have been very painful. However, losses in terms of output, employment and incomes have been the price that had to be paid to prevent a collapse of the economy. Had this collapse not been averted, losses would have been much greater. An exit from the euro area, as I had put in an interview, would have opened the gates of hell.

2. Policy orientations to overcome the crisis

Against today's more favourable background for the country, recovery appears to be ante portas. The year 2014 marks a halt to a deep and protracted recession. Of course, the economy's adjustment has not been completed. But as the first, difficult cycle seems to be coming to a positive end, it would be helpful to evaluate actions and omissions and, most importantly, draw lessons for the future.

The Bank's positions concerning the exit from the crisis have been expressed based on a number of policy orientations, reflected in its publications and described in detail in the Chronicle. These policy orientations can be summarised as follows:

- First, Greece should make every effort to remain in the euro area and steer clear of default, which would have incalculable economic and social consequences.
- Second, the adjustment programme and the agreements with our partners ensure the financing of the Greek economy. Without them, default would have been inevitable. This is why they must be implemented consistently. Moreover, to a very large extent the programme's terms relate to changes that should have been implemented long ago.
- Third, in order to return to growth, securing its European perspective, the country should eliminate its fiscal imbalances, improve its competitiveness and enhance the export orientation of its economy, modernise the state, restore competitive conditions in markets and reduce the burden of public debt. Greece also needs a new, outward-oriented growth model.
- Fourth, fiscal adjustment should rely primarily on a rationalisation of expenditure. Revenue must be increased by reducing tax evasion and broadening the tax base to make possible the necessary lowering of tax rates and the tax burden in the future.
- Fifth, the historical challenge that the country is facing necessitates the greatest possible alignment of political and social forces, an understanding at the national level and the widest possible convergence of views.
- Finally, the adjustment programmes are a necessary but not sufficient condition for exiting the crisis. A radical reorientation of the economy towards a new model requires a comprehensive National Plan for Growth, which will have far-reaching goals and will be implemented consistently.

Adhering to these policy orientations, the Bank of Greece has performed its institutional functions, informed the citizens and advised the government.

3. Safeguarding financial stability

In addition, however, to its advisory role in economic policy making, the Bank of Greece also had decisive powers and responsibilities for shaping a strategy for the banking sector, constantly geared to safeguarding financial stability.

Although the crisis in Greece started in the public sector, contagion to the banking system was inevitable. The banking system was hit by the successive downgrades of the Greek government's credit rating that led to corresponding downgrades of the banks' credit ratings. This fact, on the one hand decreased the value of collateral available to banks for borrowing from the Eurosystem, and on the other hand made their access to the interbank market particularly hard and expensive, gradually leading to their exclusion. With the debt restructuring in 2012 the value of the bonds held by Greek credit institutions was severely impaired. Thus their capital position was eroded or even turned negative. At the same time, the recession was leading to a continuous increase in non-performing loans, while the surrounding uncertainty was encouraging deposit withdrawals.

To safeguard financial stability, the Bank of Greece intervened by taking several targeted steps. I shall only briefly refer to the most important among them.

First, the Bank of Greece ensured the uninterrupted supply of liquidity to the banking system, including by emergency assistance to the extent required. The provision of emergency liquidity assistance was reviewed every two weeks and the ECB Governing Council could put a stop to it for a variety of reasons (lack of collateral, low capital adequacy ratios of the banks, incomplete implementation of the programme, etc.). We therefore had to thoroughly prepare our positions and persistently intervene to prevent any negative developments.

Second, to avoid a further shaking of the confidence of depositors we constantly had to supply the banking network with banknotes, so as to prevent cash shortages at bank branches or ATMs. In Chapter 8 of the book we release for the first time data on the increased demand for cash and the Bank's cash management during the crisis, which I believe you will find very interesting.

Third, we had to map out a strategy for the recapitalisation, restoration of soundness and restructuring of the banking system. The point of departure for this strategy was the first diagnostic assessment of Greek banks conducted with the help of BlackRock in 2011, and the viability study that followed in 2012.

The Bank of Greece engaged foreign agencies to assist it in these efforts, having as a primary objective to consolidate international confidence in the objectivity and impartiality of the assessment of banks' capital needs. The four credit institutions that were assessed to be viable were recapitalised through a combination of private and public funds. Non-sustainable banks that failed to raise private funds were resolved without any depositor suffering the slightest loss. Overall, there have been twelve bank resolutions, carried out according to the provisions of a new legal framework established in 2011, to the formulation of which the Bank of Greece had crucially contributed.

The restructuring of the banking system continued with the absorption of subsidiaries and/or branches of foreign banks by large Greek banks. This way, we have reached 2014 having four large banks, plus a few smaller ones, instead of the approximately 20 banks that existed at the onset of the crisis.

In 2013 we asked BlackRock to conduct a new diagnostic assessment. Based on the results of this new exercise, the Bank of Greece updated the banks' capital needs.

The credibility of the exercise and the markets' confidence are evidenced by the successful capital increases recently carried out by the four core banks in a span of only two months, attracting the interest of foreign investors. In fact two of the core banks managed to not only cover their capital needs, as assessed by the stress test, but to also raise the funds needed to repurchase their preference shares.

The contribution of the Bank of Greece in the fields of safeguarding financial stability and restructuring the banking sector will of course be judged by results. Thanks to the action taken by the Bank and the support provided by the Eurosystem through some critically important decisions, banks have continued to operate smoothly, even in periods of widespread uncertainty. This prevented an open banking crisis – which would also have had a direct impact on the country's future within (or outside) the euro area. At the same time, the banking system, despite the heavy losses it has suffered, has managed to effectively deal with its problems and has been restructured on solid foundations through the guidance provided by the Bank of Greece as supervisory authority.

To sum up, The Chronicle of the great crisis tells the story of the country's efforts – at times successful, at times not – setbacks, risks, achievements and delays that marked these turbulent and eventful times between 2008 and 2013. It is my hope that this narrative will be of use to the historians of the future who will focus on this period.

I would like to close by recalling that during these last few years the Bank of Greece had to cope with historically unprecedented conditions that required swift decision-making and difficult and delicate handling. The Bank responded to these heavy challenges outstretching its capacities, thanks to the hard work, ethos and dedication of its staff. It is to you therefore – members of the family of the Bank of Greece, who have successfully shouldered a heavy load – that I would like to say a big “thank you” and dedicate this book.