Benoît Cœuré: Strengthening the Greek financial system

Introductory remarks by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at a public hearing at the European Parliament, Brussels, 12 October 2016.

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Thank you for inviting me to this meeting of the Financial Assistance Working Group.

I am grateful for the opportunity to contribute to the dialogue between our institutions on the euro area macroeconomic adjustment programmes. In recent years, this topic has indeed been frequently discussed here by the ECB President and other ECB Executive Board Members, including myself. We have also responded publicly to the many questions you have sent us in writing. Maintaining an open discussion with you as the representatives of the people of Europe is very important, given the advisory role in the field of surveillance and programme assessment conferred upon the ECB by EU legislators[1] and by the ESM Treaty.

You asked me to discuss in particular the third adjustment programme in Greece from the ECB's perspective. Let me therefore base my short introductory remarks on the following three points.

First, I will recall the challenging situation in summer 2015 when the third Greek programme was negotiated. Against this backdrop, and this will be my second point, I will review the progress made in the third programme. Finally, I will discuss the challenges ahead and emphasise the importance of a continued collective commitment for the success of the programme.

In my remarks today, I will mainly focus on financial issues, as I believe this is where the ECB's advice is of particular relevance.

The situation at the start of the third Greek programme

Let me briefly recall the circumstances in which the third ESM programme for Greece was negotiated. This indeed remains key to understanding where we are now.

After the severe and long recession, which started in 2009, the long-awaited rebound of the Greek economy got under way in the second half of 2014.

However, following the announcement of new parliamentary elections at the end of December 2014, economic conditions started to rapidly deteriorate. Increased policy and political uncertainty, partial reversals of previous reforms, the rejection of existing commitments by the new government and the lack of a prospect of continued financial assistance under a programme led to a worsening of the economic environment and of sovereign creditworthiness. This in turn had a strong impact on an already severely weakened financial sector.

In particular, between December 2014 and June 2015, deposit outflows amounted to more than a quarter of total deposits. Lack of adherence to the second programme no longer allowed the ECB, under its rules, to waive its minimum credit requirements and accept Greek government-linked securities as collateral in its monetary policy operations. Nevertheless, the Eurosystem provided all the liquidity necessary for the Greek economy to function, with adequate safeguards against monetary financing of the government. As a result, central bank funding rose from €56 billion to over €125 billion, more than two-thirds of Greece's gross domestic product, demonstrating our commitment to the Greek economy.

By the end of June, uncertainty and concerns about the economic policies of the government were mounting, culminating in the announcement of the referendum on 5 July 2016. The introduction of bank holidays and capital controls in late June had eased immediate liquidity pressures, but further impaired economic activity.

In such an environment, once the third programme had been agreed by the Greek authorities and their euro area partners, one of the immediate priorities was to regain depositor and market confidence in the Greek banking system.

To this end, a comprehensive assessment was conducted of the four significant Greek banks between August and October 2015 by the supervisory arm of the ECB. It was followed by a successful recapitalisation exercise. The identified capital shortfall was largely covered by private funds, while the reliance on public funds was limited to €4.5 billion.

Measuring progress so far

The conclusion of the programme negotiations and the successful recapitalisation of the banking system led to a stabilisation of economic conditions.

Real GDP in 2015 turned out to be only slightly negative, but more than one percentage point better than expected after the imposition of capital controls. The stabilisation of output was supported by the resilience of private consumption, positive net exports and an acceleration of public investment at the end of the year.

The achievement of the primary budget balance target for end-2015 was supported by a series of important policy actions, especially on the revenue side.

Supporting and at the same time benefiting from the macroeconomic stabilisation, the situation in the Greek banking sector has also gradually improved during the first year of the programme, although it has not yet regained the ground lost in the first half of 2015.

Following the recapitalisation in October 2015, the aggregated CET1 ratio for the four significant Greek institutions increased from 11.2% in September 2015 to 17.9% in June 2016. While the ratios may appear high compared with the European banking sector average, they provide the necessary capital buffers to properly address the elevated risk profile of Greek banks.

Nevertheless, restoring the capital position of Greek banks represented only the first step of a more comprehensive reform plan to restore confidence in Greek banks. Over the past months the focus has been on the resolution of non-performing loans (NPLs) and on improving bank governance. The non-performing exposure (NPE) ratio of Greek banks is very high (49% in June 2016), the second highest in the euro area, after Cyprus. Its reduction is a key precondition for gradually restoring an adequate and efficient supply of credit to the Greek economy, and for achieving sustained growth.

Some important legislative reforms in this direction have already been passed. For instance, the household insolvency law was amended to ensure that banks can take legal steps against strategic defaulters and that debtors make payments in line with their ability to pay. And the Code of Conduct of the Bank of Greece provides guidelines on the interaction between banks and debtors in arrears. The authorities have also adopted legislation that liberalises NPL servicing for all loan categories, and provided a framework for the sales of loans. In addition, banks have set up comprehensive strategies, including detailed operational measures and actions, prioritised and scheduled, as well as numerical targets to significantly reduce their NPE stocks over the coming years.

Banks are also reshaping their governance structures in compliance with new Greek regulations and international regulations and guidelines. While the process is still ongoing, considerable progress has already been made in the review of boards of directors. Strict application of the criteria set under Greek law will be key to increase the knowledge, relevant experience and independence of bank directors.

The policy actions I have outlined have already started to show effects. Since the imposition of the capital controls in Greece in June 2015, the liquidity position of Greek banks has improved, albeit at a slow pace. Deposits have increased slightly and banks have regained access to market funding based on high-quality collateral. Dependence on central bank funding has been reduced to about €78 billion.

Working together towards the same goal

While the conclusion of the first review constitutes a first major step in safeguarding financial stability, preparing the ground for a sustainable economic recovery and regaining access to international capital markets, let me be very clear: more is yet to be done. The mere fact that bank deposits linger at about three-quarters of their level of late 2014 shows that the return of confidence is still gradual.

The important challenges Greece still faces can only be addressed by a steady implementation of the agreed policies and strong political support from all stakeholders.

From a financial point of view, let me emphasise two key deliverables of the forthcoming second review which aim to further reduce structural impediments to the swift and effective resolution of the large amount of NPLs I already mentioned.

The first is the overhaul of the out-of-court workout framework, whose main objective is to provide sufficient incentives for creditors and debtors to participate in a mutually advantageous scheme.

The second deliverable is the development of the corporate insolvency code to support the restructuring of the Greek non-financial sector and overcome possible obstructions by uncooperative shareholders.

In addition to these legislative changes, the Greek authorities need to fully implement the agreed measures to strengthen the capacity of the judicial system to substantially shorten legal proceedings and enhance the competence of the courts.

These requirements are not specific to Greece and experience has shown that throughout the euro area, NPL resolution requires strong legal frameworks. While these reforms are essential to support the financial sector, action is also required on the other three pillars which form the foundations of the third programme: first, improving the fiscal position, second, restoring sustained and sustainable growth via a number of reforms, and third, introducing a modern state and public administration and a well-targeted social security system.

All stakeholders in the Greek adjustment programme realise that there are serious concerns about the sustainability of Greek public debt. As you are all well aware, a discussion is currently ongoing in the Eurogroup on the short-term, medium-term and long-term measures needed to secure the sustainability of Greek debt. We are looking forward to a solution that can reassure markets, restore confidence in the dynamics of public debt, allow the full involvement of the IMF in the programme – which would enhance the programme's credibility – and restore market access for Greece ahead of the end of the programme in July 2018, while not undermining the reform effort.

To bring the programme to a successful conclusion and to restore market access on a lasting basis, it is above all essential that the Greek authorities continue to show a serious commitment to the goals and measures taken in the context of the programme. Only if this happens can all stakeholders be confident that reforms will not be reversed and, instead, will be strengthened in the aftermath of the programme, therefore further supporting the potential for growth of the Greek economy.

Conclusions

Let me conclude.

I have traced the progress achieved so far and mapped the challenges ahead for the third Greek adjustment programme. A year ago, European leaders agreed on a set of measures that will secure Greece's future in the euro. If everyone plays their part, I am firmly convinced that at the end of the programme, Greece will be better able to reap the benefits of Economic and Monetary Union – a Union of 340 million people sharing the same currency – and its economy will be stronger and more resilient.

We should not forget, nevertheless, what else we can do to make Greece stronger in a stronger Europe. Let me be clear: Europe will not address matters of pressing concern such as security or migration without a strong and sustainable economy. A lot still needs to be done to make our Economic and Monetary Union stronger.

The ECB is committed to playing its role as the central bank for the euro area, and thus for Greece.

Thank you for your attention. I look forward to your questions.

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1 The ECB's role in surveillance is enshrined in EU secondary legislation ('two-pack' Regulation (Regulation (EU) 472/2013).