Benoît Cœuré: Greece - progress achieved and challenges ahead

Keynote speech by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the American-Hellenic Chamber of Commerce conference on "Greece and the global disruptive environment: A look into the future", Athens, 28 November 2016.

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Ladies and gentlemen,

Thank you for inviting me to this conference.

I am grateful for this opportunity to share with you the ECB's perspective on the third economic adjustment programme for Greece.

This conference aims to be "a look into the future", and I will indeed try to provide that by considering the challenges and prospects ahead. Before doing so, let me briefly recall the circumstances in which the third European Stability Mechanism programme for Greece was negotiated, as this remains key to understanding where we are now. Against this backdrop, I will review the progress made in the third programme and discuss the way forward.

I will mainly focus on financial issues, as I believe this is where the ECB's perspective is of particular relevance.

Challenges for Greece at the start of the third programme

What were the challenges facing Greece in summer 2015 when the programme was negotiated?

After a severe and long recession, which started back in 2009, the long-awaited rebound of the Greek economy finally got under way in the second half of 2014. But renewed uncertainty and the lack of any prospect of continued financial assistance led to a worsening of the economic environment and of sovereign creditworthiness in early 2015. This in turn had a severe impact on an already severely weakened financial sector.

Between December 2014 and June 2015, deposit outflows amounted to more than a quarter of total deposits. Lack of adherence to the second programme barred the ECB, under its rules, from waiving its minimum credit requirements and accepting Greek government-linked securities as collateral in its monetary policy operations. Nevertheless, the Eurosystem provided 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.

Amid mounting uncertainty, bank holidays and capital controls were introduced in late June 2015, which eased immediate liquidity pressures in the banking sector. In August 2015 an agreement was reached on a third programme. One of the immediate priorities at that time was to regain depositor and market confidence in the Greek banking system.

To this end, ECB Banking Supervision conducted a comprehensive assessment of the four significant Greek banks between August and October 2015. It was followed by a successful recapitalisation exercise. The identified capital shortfall of the banks, which amounted to €14.4 billion, was largely covered by private funds, while 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 in the second half of 2015. Benefiting from the macroeconomic stabilisation, the situation in the Greek banking sector also gradually improved during the first year of the programme, although it is far from having regained the ground lost in the first half of 2015.

Since the bank recapitalisation in late 2015, the focus has been on resolving 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. Reducing it 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 debtors make payments in line with their ability to pay. The authorities also adopted legislation that liberalises NPL servicing for all loan categories, and provided a framework for the sale of loans. In addition, banks have set up comprehensive strategies, including detailed operational measures and actions. The supervisory arm of the ECB in cooperation with the Bank of Greece recently agreed with banks on operational and financial targets to significantly reduce their NPE stocks over the coming years.

These policy actions and the gradual macroeconomic stabilisation have already started to work. And the liquidity position of Greek banks has improved, albeit at a slow pace.

The way forward

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

The reshaping of banks' governance structures in compliance with new requirements is one key element. Considerable progress has been made this year in the review and reconstitution of the boards of directors of Greek banks. This process needs to be finalised in the near future. The banks will face difficult and complex decisions, particularly when resolving the large stock of non-performing loans. Thus, bank boards have to have strong and independent directors with a robust track record who can ensure arm's length decisions in the best interests of their stakeholders and of the Greek economy.

Bank management needs to be free of political interference and vested interests. With this aim in mind, we encourage the Hellenic Financial Stability Fund to make every reasonable effort to finalise the review and reconstitution process within the next few weeks.

On financial sector policy, there are other important elements of the ongoing second review which seek to further reduce structural impediments to swift and effective NPL resolution. Let me highlight the reform of the out-of-court workout framework, with its main goal being to provide sufficient incentives for creditors and debtors to agree on mutually beneficial debt restructuring arrangements. The framework is intended for viable but distressed firms whose profitability has been severely hit by the prolonged economic crisis. To be effective, it needs to take into account the fact that Greek firms have both significant non-performing loans vis-à-vis banks and significant arrears to the state. Let me add that as of end-2015 total arrears to the state in respect of taxes and social security contributions were around €110 billion, of which about €79 billion was due from corporations, small and medium-sized enterprises as well as professionals – the categories eligible for out-of-court frameworks. The stock of non-performing exposures in Greek banks relative to these same categories amounted to another €55 billion.

Apart from developing effective out-of-court frameworks, the Greek authorities also need to fully implement the agreed measures to strengthen the judicial system, thereby substantially shortening legal proceedings and enhancing the competence of the courts. These requirements are not specific to Greece; experience has shown that NPL resolution requires strong legal frameworks throughout the euro area. In any case, creditors in Greece have to wait longer to obtain a court ruling after an insolvency than in any other EU country except the Slovak Republic. It takes on average about three and a half years, compared with less than six months in Ireland, the EU's best performer.

Swift progress on NPL resolution will also help banks to support the economic recovery through credit provision, eventually ending the prolonged period of negative credit growth. So far, credit developments remain subdued, with credit from monetary financial institutions to the domestic non-financial sector continuing its downward trend that started in early 2011.

The success of the adjustment programme, however, ultimately rests on its capacity to re-establish conditions for a path of economic growth that is sustained and sustainable over time. The success of the out-of-court workouts will provide an input to support the recovery by contributing to restore the viability of non-financial corporations. Bear in mind that the indebtedness of Greek non-financial corporations, when measured by debt-to-GDP ratio, rose from about 52% to approximately 64% between end-2008 and end-2015. Non-residential investment by the private sector declined by about 50% in the same period.

In this respect, financial sector policy is only one element, but a crucial one, of a much broader strategy. The strategy is based on decisive action to strengthen competitiveness and investment, and to restore fiscal sustainability.

Boosting competitiveness and attracting investment are two formidable challenges for the Greek economy. A lot has been done to improve competitiveness and the gains should not be unwound. More needs to be done, however, to restore the conditions for a pick-up in investment, both domestic and from abroad. A business environment more conducive to growth needs to be established through further structural and product market reforms and a full implementation of the privatisation programme.

All these efforts need to go hand in hand with policies to alleviate the costs for the most vulnerable members of society and to help the economy escape the trap of high and long-term unemployment and increased inequality. The improved targeting and tailoring of the active labour market policy framework and the rollover of the guaranteed minimum income scheme go exactly in this direction.

Regarding fiscal sustainability, 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 sustainability of public debt in an uncertain macroeconomic environment allow the full involvement of the IMF in the programme – which would enhance the programme's credibility – and ultimately restore market access for Greece before the programme ends in July 2018, while not undermining the reform effort.

As regards the potential inclusion of Greek bonds in the Public Sector Purchase Programme (PSPP), a topic much debated by politicians and the media in Greece in recent weeks, let me be clear that the Governing Council of the ECB takes decisions on the PSPP in full independence. Programme developments and, in particular, the debt sustainability assessment of the institutions are an important input, but they are not the only ones. The Governing Council will base its assessments also on internal analysis and will take into account other risk management considerations before making its final decision.

To bring the programme to a successful conclusion and to restore market access for the sovereign 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 under the programme. Only if this happens can all stakeholders be confident that reforms will not be reversed and in fact be strengthened after the programme, therefore further supporting the potential for growth of the Greek economy.

Conclusions

Let me conclude. I have outlined the progress achieved so far and mapped out the challenges ahead for the third Greek adjustment programme. In the summer of 2015, European leaders agreed on a series of measures that will secure Greece's future in the euro. If everyone plays their part, I am firmly convinced that, by the end, 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.

Thank you for your attention.