Yannis Stournaras: Prospects of the Greek economy after six years of adjustment

Speech by Mr Yannis Stournaras, Governor of the Bank of Greece, at the EU-Arab World Summit "Partners for Growth and Development", Athens, 3 November 2016.

* * *

It is a great pleasure for me to be here with you today and have the opportunity to share my thoughts on the prospects of the Greek economy after six years of economic adjustment. I will focus on four issues: **First**, the achievements made so far during the difficult years of economic adjustment. **Second**, the missteps and delays in the adjustment process. **Third**, recent developments and future challenges and prospects. And **fourth**, I will highlight the main reasons why Greek assets constitute a prime investment opportunity.

1. Economic adjustment over the past six years

Since the beginning of the sovereign debt crisis, six years ago, Greece has come a long way in adjusting its fiscal and external imbalances and has implemented a bold programme of structural reforms.

- **First, there has been unprecedented fiscal consolidation**. The fiscal consolidation effort contributed to an improvement in the general government primary balance as a percentage of GDP by more than 11 percentage points over the period 2009–2015, despite the deepening recession. In fact, in the period 2013–2015 Greece managed to maintain small primary surpluses (as defined in the programme) in the general government budget for the first time since 2001. Adjusting for the effect of the recession, the improvement in the "structural" primary balance over the period 2009–2015 reached 17 percentage points of potential GDP; twice as much as the adjustment in other Member States that were under EU-IMF programmes.
- **Second, competitiveness has been restored**. The cumulative loss in labour cost competitiveness vis-à-vis our trading partners recorded between 2000 and 2009 has been fully recovered.

  This development reflects the effect of structural reforms in the labour market, which allow for greater flexibility in the wage bargaining process, as well as the impact of the sharp rise in unemployment on labour costs.

- **Third, the external adjustment has been significant**. The current account posed a small surplus in 2015 (0.1% of GDP). This marks a significant turnaround of the current account balance by about 15 percentage points of GDP since 2008. Adjustment has come primarily from a decline in imports of goods, particularly in 2009, when world trade collapsed due to the global recession. However, since 2010, exports, excluding shipping, have contributed significantly to the improvement.

Exports of goods in real terms have actually rebounded in line with those of our euro area peers and the shares of goods exports have increased significantly vis-à-vis non-EU countries. On the other hand, exports of services in real terms have underperformed primarily due to the weakness of the shipping sector. This was driven by domestic economic uncertainty and the imposition of capital controls, as well as global factors, such as the weaker growth of global trade, lower commodity prices and a supply overhang in the global shipping sector.

In more detail, the share of exports in GDP increased from about 19% in 2009 to close to 30% in 2015, with about 2/3 of this increase stemming from goods exports and 1/3 from services exports and, in particular, receipts from tourism. It should be noted that goods exports stood at about 14% of GDP in 2015 compared with 7.5% of GDP in 2009.

- **Fourth, the policy agenda has included bold structural reforms**. A series of structural reforms have been implemented in the labour and product markets, as well as in public administration. These reforms are expected to boost the growth potential of the Greek economy in the long-term through higher productivity and employment growth. According to the OECD, the reforms implemented in the period 2010–2014 are expected to raise real GDP over a 10-year-horizon by about 5.6%. Adding the reforms currently being implemented or planned under the ESM programme, the overall increase in real GDP comes to about 13.4% over a 10-year-period. However, this estimate is a lower bound in the sense that additional reforms, for example improving the judiciary system, strengthening bankruptcy regulations, modernising the public administration and resolving the issue of non-performing exposures (NPEs) cannot easily be quantified. In-house work by the Bank of Greece points to similar estimates with the main effect coming from higher total factor productivity (TFP) growth.
- **Fifth, the rebalancing of the economy has been remarkable**. The restructuring of the Greek economy towards a new, extrovert, growth model based on tradable goods and services and a higher share of exports in GDP is already underway. In more detail, the relative prices of tradable goods and services rose by about 10% in the period 2010–2015, making their production more profitable. As a result, the share of tradable goods and services in the private economy has risen in recent years. For example, in gross value added terms, the relative size of the tradable sectors grew by approximately 12% in the period 2010–2015 in volume terms and by about 24% in nominal terms, while in employment terms it grew by around 8%. This development is attributed both to the structural reforms implemented so far and to the fact that tradable export-oriented sectors have gone through a milder recession and have thereby gradually gained some ground in terms of volume and employment shares.

An additional aspect worth highlighting is that on account of the decline in domestic demand and the scaling back of construction in Greece, a great number of dynamic construction companies expanded their businesses abroad (Middle East, Balkans) transforming a previously thought to be a non-tradable activity into an internationally tradable one.

Going forward, structural reforms and improved financing and liquidity in the economy are expected to speed up the restructuring of the economy in favour of tradable goods and services.

- **Sixth, bank recapitalization and considerable consolidation have taken place**. Over the past few years, the landscape of the banking system has changed significantly with the number of banks having been reduced through mergers, takeovers and resolutions. Today the system comprises four core banks and a number of smaller ones. The banking system, following successive rounds of recapitalization involving significant private sector involvement and the implementation of restructuring plans, is now well-placed to address the major challenge posed by the high stock of non-performing exposures (NPEs). Effectively managing NPEs is key to the recovery of credit growth and to the restructuring of businesses and sectors in the real economy.

2. Missteps and delays in the adjustment process

However, despite the huge efforts to avert default and address imbalances, Greece remains under an adjustment programme, unlike Cyprus, Ireland and Portugal, which have already completed their respective programmes, even though they entered these programmes later than Greece did.

This lagging behind can be attributed to several factors, including: lack of ownership of the necessary reforms and lack of commitment, by part of the political system, to correct past errors, the anti-bailout rhetoric, rivalry and failure to reach an understanding among political parties, and the various – small and large – vested interests that have resisted reform.

Meanwhile, the fact that our European partners have yet to deliver on their commitment to provide further debt relief, as stated in the Eurogroup decisions made as far back as in November 2012 (and iterated most recently in May 2016), and the threat of default and euro area exit brandished against Greece by some of our partners whenever negotiations seemed to stall, even on just technical matters, has weighed heavily on market sentiment, further fueling uncertainty and negatively affecting the economic climate in Greece.

Certain miscalculations in the design of the economic adjustment programmes could also explain Greece's lagging behind vis – a – vis the other countries, previously under programmes. Given the size of the fiscal imbalances back in May 2010, when the first economic adjustment programme was initiated, more emphasis was placed on fiscal consolidation, pension reform, streamlining budgetary procedures, increasing fiscal transparency, as well as financial sector restructuring. Less emphasis was given on growth-enhancing labour market reforms and, most notably, on product and services market reforms and reorganizing the public sector. In addition, growth forecasts were too optimistic and fiscal multipliers turned out to be higher than initially anticipated. As a result, the economy was trapped in a vicious circle of austerity, recession, rising unemployment and private debt overhang.

Despite the recouping of losses in international competitiveness, exports have underperformed relative to what could have been anticipated based on historical correlations. This can in part be explained by the lack of financing, higher long-term borrowing costs, increased uncertainty, as well as the higher tax burden, which slows or even halts progress towards restoring overall competitiveness. In addition, this can also be attributed to a number of inherent structural weaknesses that hamper the international market penetration of Greek products and involve non-cost aspects such as product quality, protected designation of origin and branding, red tape, etc. Hence, despite the improvement in structural competitiveness over the period 2013–2014 (according to a number of indices compiled by the OECD, the World Bank, and the World Economic Forum), Greece still ranks at the lower end of the advanced economies, and progress has stalled or even reversed slightly in recent years.

3. Recent developments and prospects

In spite of the delays and missteps, progress in correcting past mistakes has been remarkable. For example, the new ESM programme in place since August 2015 builds on the successes of the first two programmes (i.e. the correction of fiscal and external imbalances and the improvement of labour cost competitiveness) and aims at prioritizing reforms that will increase potential growth in the medium-to-long term, i.e. reforms in product markets, public administration, institutions and the business environment, bank recapitalization and resolution of NPEs.

Building on the progress achieved so far, the completion of the first review of the ESM programme had a positive effect on confidence and liquidity and is expected to boost economic activity in the second half of 2016.

Most importantly, the reinstatement of the waiver for Greek government bonds enabled Greek banks to obtain low-cost financing from the European Central Bank (ECB). This, along with the gradual dissipation of uncertainty, the stabilization of private sector deposits and the progress achieved in restructuring and recapitalizing Greek banks, has contributed to the lowering of the emergency liquidity assistance (ELA) ceiling for Greek banks by about €40 billion since July 2015, bringing it down to €51.1 billion as of today.

These developments are expected over the medium term to encourage a return of deposits to the Greek banking system, which will allow an easing and, ultimately, the lifting of capital controls. Coupled with a more effective management of non-performing loans, this will contribute to reducing borrowing costs and will gradually increase the lending capacity of Greek banks, with positive effects on the financing, hence the growth performance, of the Greek economy.

The gradual economic recovery is already reflected in the performance of several key indicators of economic activity, such as: industrial production, retail sales, dependent employment flows in the private sector, and real exports of goods.

The **current forecasts of the Bank of Greece** point to a recovery starting from the second half of 2016 and continuing through 2017 and 2018. Specifically, GDP is projected to post a small decline of 0.3% in 2016, but then to grow by 2.5% and 3% in 2017 and 2018 respectively. These projections assume that the programme implementation will remain on track, the relevant loan tranches will be disbursed on time, and that the monetary policy of the ECB will continue to be accommodative.

Nevertheless, **risks to the outlook** of the Greek economy remain. **Delays in the implementation of reforms and privatizations** envisaged in the programme would dampen economic growth, thereby refueling uncertainty, undermining confidence and weakening the prospects of a definitive exit from the crisis.

Meanwhile, there also are **risks and uncertainties regarding the course of the global economy**, stemming, among other things, from protectionist voices and actions around the world, the implementation of a hard Brexit, and a likely exacerbation of the refugee crisis. These risks could slow down the recovery of the Greek economy, both through negative effects on tourism and trade and through a slower-than-expected decline in yields on Greek government bonds due to the risk aversion from global investors.

The **containment of the abovementioned risks and the realization of the positive prospects** of the Greek economy **require a number of tangible and concerted actions**. These actions, which will ensure the successful conclusion of the ESM programme and the return to financial markets, comprise the following:

1st Stepping up the pace of reforms and privatizations. The government should remain committed to the timely implementation of the structural reforms and privatizations that have been agreed upon with the Institutions. Particular emphasis should be placed on:

- simplifying investment licensing procedures, reducing administrative burden on businesses and facilitating competition,
- opening up the remaining regulated professions and network industries,
- scaling up the privatization and public real estate programme, and improving its governance,
- modernizing and strengthening public administration,
- enhancing judicial efficiency and speeding up court proceedings.

In this context, the on-going second review should be completed without undue delays, so as to solidify the recovery prospects and the return to robust positive growth in 2017.

2nd Tackling the high stock of non-performing exposures (NPEs). Alongside the structural reforms, using idle public property to attract foreign direct investment through appropriate land use legislation and speeding up privatization, there is an urgent need to **address the private debt overhang problem,** in order to facilitate the recovery through a stronger pick-up in lending. On the one hand, the high stock of NPEs reduces bank profitability and thus constrains the supply of credit, which primarily affects bank-dependent SMEs. On the other hand, high NPEs delay corporate restructuring and thus thwart the ability of viable firms to finance new investment projects.

Tackling the high stock of non-performing loans is currently the greatest challenge facing the Greek banking system and the Greek economy. Greece has the second highest NPE ratio in Europe (after Cyprus), with non-performing exposures at the end of the first half of 2016 reaching 45.1% of total exposures or €108.7 billion.

A number of initiatives are underway with the goal of setting up an accelerated and efficient framework for private debt resolution. These initiatives, amongst others, include:

- the development of a secondary market for both performing and non-performing loans;
- the establishment of an enhanced framework for out-of-court workouts and pre-bankruptcy procedures, as well as the overhaul of bankruptcy legislation;
- the recently revised Code of Conduct for banks for the transparent, effective and, where appropriate, flexible treatment of cooperating borrowers facing difficulties in servicing their debt obligations;
- amendments to legislation to ensure the cooperation of old shareholders in the restructuring of the underlying businesses;
- the launch of a comprehensive monitoring framework in relation to banks' non-performing exposure resolution activities, and, finally,
- a series of targets and key performance indicators that aim at reducing overall non-performing exposures by 40% by the end of 2019.

On their part, banks need to pursue a more active policy for NPE management, by promoting long-term solutions and multi-creditor workouts, as well as focusing on the restructuring of viable businesses. These lines of action, coupled with the economy's path out of the recession and back to growth, should bring about a stabilization and, subsequently, a decline in the NPE ratio.

3rd Addressing the large public debt overhang The commitment of our European partners in May 2016 to take action in order to **ensure the sustainability of public debt in the short and medium-to-long term**, reaffirmed their November 2012 Eurogroup decision and is a positive step forward. However, the envisaged long-term public debt management measures have not been specified yet. Urgent action is warranted on the specification and quantification of the foreseen debt relief measures. This will enhance the credibility and acceptance of the policies pursued, thereby helping to further consolidate confidence, strengthen economic recovery, lower the tax burden and **facilitate the return to financial markets after the end of the programme**.

4th Easing and eventually lifting remaining capital controls. The gradual relaxation of capital controls, along with improvements in confidence and liquidity, are expected to contribute to the normalization of economic conditions by facilitating both enterprises and individuals in their transactions.

4. Final remarks: investment needs and opportunities in Greece

Greece is poised to return to economic and financial normality and to shift to a new, extrovert and sustainable growth model, based on tradable goods and services. To this end, the improvements in cost competitiveness of recent years provide considerable room for higher exports in goods and services in the near future.

However, new investment will be needed in order to strengthen the export base of extrovert firms. The further opening-up to international trade, the participation in global value chains and the closer trade links with countries and businesses with cutting-edge technology internationally will enable the adoption of new technologies by export firms and their diffusion across the Greek economy, strengthening its long-term growth prospects.

New investment, by facilitating innovation and the introduction of new technologies, will both broaden the export base and improve the quality of Greek exports, raising total factor productivity of the Greek economy. In turn, this will make the reduction in the external deficit sustainable and increase potential output over the medium-to-long term.

Therefore, Greece needs a substantial amount of foreign direct investment (FDI). **The policy changes made in recent years are conducive to growth, thus creating profitable investment opportunities**. For example, the implementation of reforms in the labour, product and services markets and in public administration, the enhancement of financial stability, the utilization of public real estate, the stepping-up of the privatization programme, and efforts to tackle the private and public debt overhang problem improve confidence and rebuild financial markets' trust. Hence, they generate positive growth prospects and help attract foreign direct investment.

In this context, prospective investors will also benefit from the presence of **high-skilled human capital** by OECD standards and a vast pool of idle labour resources. According to the Global Competitiveness Report 2016–2017 of the World Economic Forum, Greece ranks quite high in terms of workforce education and skills (38th out of 138), in higher education and training (45th), in the availability of scientists and engineers (10th), in technological readiness (42nd). Although, a large number of high-skilled youth have moved to other EU countries since the outbreak of the crisis, the opening-up of new jobs in Greece as growth returns and investment picks up will contribute to the repatriation of many of them, further improving the skill and knowledge content of the labour force.

Furthermore, **the new investment incentives law** (L.4399/2016) provides a clear framework and a stable business environment for the commencement of a variety of individual investment projects. The new law envisages several aid schemes, for example: tax exemption, subsidies for the acquisition of new machinery and other equipment, subsidy of the cost of created employment, a stable corporate income tax rate for a period of 12 years from the completion of the investment project. In order to qualify for the aid schemes, the investment projects should entail initial investment, for example, investment in buildings, machinery, intangible assets, and should meet certain conditions (i.e. creation of new production units, expansion of existing production units' capacity, etc.).

On top of the above, the recent conclusion of a number of major privatization projects — such as the privatization of the port of Piraeus, which will upgrade its role as a shipping hub, the sale of 14 regional airports in key tourist destination islands and cities, the sale and real estate development of the old Athens Airport facilities at Hellinikon, as well as the participation of private investors in the recapitalization of Greek banks — constitute an important vote of confidence from major foreign investors, who decided to position themselves early on the Greek market, in anticipation of even better future prospects for the Greek economy.

Going beyond recent policy changes, Greece provides significant investment opportunities on account of its **geographical location** in Southeast Europe and its close proximity to the Middle East and the Arab world. There are potential gains in the **trade, logistics, transport and energy sectors** as Greece aspires to become a transport and energy hub in future years, which implies significant infrastructure, networks and other investment needs.

Moreover, significant investment opportunities exist in **tourism** as Greece is a major tourist destination, and at the same time it has a sizeable public real estate property that is available for utilization by private investors in order to expand capacity and quality of tourism infrastructure.

Last but not least, Greece is both a member of the **European Union and the euro area**. Currency redenomination issues are off the table for good. Consequently, prospective non-EU investors will benefit from gaining access to the **EU Single Market** and will enjoy a stable institutional environment, investor protection, as well as access to **a sound banking and financial system**.

Therefore, Greek assets in general can be regarded as undervalued, which, on account of all the recent policy changes, the improvement of labour cost competitiveness and the country's competitive advantages, have great potential to perform much better in the future, generating substantial profits for new investors.

* * *

In conclusion, I would like to emphasize once again that economic adjustment and structural improvements over the past six years have rendered Greece more business-friendly and have opened up significant investment opportunities, in particular for those who will position themselves early in the Greek economy. At the same time, foreign direct investment is also essential for Greece, because it will set in motion a virtuous circle signaling investor confidence in Greece's future prospects, a definite exit from the crisis and a return to sustainable and extrovert economic growth.

Sources:

Bank of Greece (2016), Annual Report 2015, February.

Bank of Greece (2016), Monetary Policy 2015–2016, June.

OECD (2016), Greece, OECD Economic Surveys, March.

Stournaras, Y. (2016), "The Greek Economy: Developments, Opportunities and Prospects". Speech at the Federation of Industries of Northern Greece, Thessaloniki, 13 May 2016.

Stournaras, Y. (2016), "Greece and the Eurozone at a crossroads". Speech at an event organised by the Young Presidents' Organization in Athens, 23 September 2016.