Theodore Mitrakos: Overview of the Greek economy and financial sector

Speech by Mr Theodore Mitrakos, Deputy Governor of the Bank of Greece, at the 37th meeting of the Central Banks Governors' Club, Session III "Country Presentations - Recent Economic and Financial Developments", Belek - Antalya, Turkey, 3 April 2017.

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It is a great pleasure for me to be here with you today and have the opportunity to update you on economic and financial developments, and more importantly to share my thoughts on the growth prospects of the Greek economy.

Allow me first to give you a brief overview of the performance of the Greek economy and financial sector over the last few years. Following the global financial crisis of 2007–2008, the Greek economy has entered a deep and prolonged recession. The sovereign debt crisis in Greece turned soon into a banking crisis: banks were gradually excluded from the interbank market, suffered significant deposit outflows and losses to the value of their assets as the sovereign debt was downgraded by rating agencies. What started as a liquidity crisis for banks, turned into a solvency crisis following the Greek debt restructuring (the so-called Private Sector Involvement – PSI) and debt buyback in 2012. Greek banks suffered losses in the order of €38 billion, which wiped out their entire capital base.

Furthermore, the cumulative decline in real GDP by more than a quarter from its pre-crisis level and the surge in unemployment impacted negatively the financial condition of households and businesses and therefore the ability of borrowers to service their debt obligations. As a result, non-performing loans increased by around eight times from 5.5% in 2008 to 45.1% in June 2016.

Against this backdrop, Greece has implemented a brave programme of economic adjustment that has eliminated fiscal and external deficits and improved competitiveness that, between 2009 and 2016, resulted in the shrinkage of the general government deficit by approximately 14 percentage points of GDP and to the improvement of the primary balance, adjusted for the effect of the business cycle, by about 17 percentage points of potential GDP. This achievement represents one of the largest fiscal adjustments ever undertaken worldwide. Significant improvement was also recorded on external adjustment, where the current account improved by about 15 percentage points of GDP compared to 2008, being in balance in the last two years. In addition, bold reforms in the labour and product markets helped towards the restoration of competitiveness, helping the share of exports in GDP to increase from 19% in 2009 to 30% in 2016, while the exports of goods in real terms have increased by 43% since 2009, compared to 42% for the euro area.

The aforementioned developments helped the economy to show signs of stabilization, with real GDP remaining almost flat despite bouts of uncertainty surrounding the negotiations with our European partners, the imposition of capital controls (including limits in deposits withdrawals and cross-border transfers) and the implementation of further austerity measures.

As far as the banking sector is concerned, the management of non-performing loans represents the most significant challenge as their stock has reached unprecedented levels, with the deterioration in asset quality being widespread. The Bank of Greece and the State have implemented a number of measures to address impediments in efficient NPL management. Following a troubled asset review, the Bank of Greece enhanced the supervisory and regulatory framework helping banks to enrich their policies and practices to deal with the large-scale resolution of troubled assets. The banks have to follow specific guidelines regarding NPL management, starting with the establishment of a well-defined and fully operational internal independent NPL workout unit and implement the Code of Conduct regarding the interaction of credit and other financial institutions with borrowers in arrears.

Recently, the Bank of Greece, in close cooperation with the Banking Supervision arm of the European Central Bank ECB has designed an NPL operational targets framework, supported by several Key Performance Indicators (KPIs). The selected targets and KPIs are both action-oriented and results-oriented and provide a granular view on the key asset quality metrics of the bank, on the management actions to reduce NPLs and on the effectiveness of these actions. In addition, following an extensive consultation with authorities and the industry, the reporting framework of the Bank of Greece has been upgraded accordingly. Banks agreed on ambitious but achievable targets, which were submitted at the end of September 2016, with a 3-year time horizon. According to these targets, banks will aim at reducing their NPLs by 49% by the end of 2019. The reduction is mainly driven by curing of loans and write-offs and to a lesser extent by liquidations, collections and sales of loans. The largest part of the reduction will be effective in 2018 and 2019, since inflows of new NPEs will remain significant in the second half of 2016 and 2017. Banks managed to achieve the NPE targets for Q3 and Q4 2016, despite the headwinds in real GDP growth in the last quarter.

The State, for its part, updated the law on over indebted households, amended the Code of Civil Procedure, enhanced the efficiency of the judicial system and developed a framework for a secondary market for bad loans and non-bank credit servicing firms.

Turning to the most recent developments, following the Eurogroup of 20th March, the Greek authorities and the institutions have intensified talks on outstanding issues to reach a staff level agreement as quickly as possible. In the fiscal front, the state budget recorded a surplus of 0.2% of GDP in the first two months of 2017, while available data for 2016 indicate that the surplus will reach 2.0% of GDP, outperforming the Programme’s target by a large margin. It should also be noted that the European Stability Mechanism adopted a set of short-term debt relief measures for Greece on 23.1.2017. These measures, which were endorsed by the Eurogroup in December, are designed to reduce interest rate risk for Greece and to ease the country’s repayment profile.

Looking forward, the Bank of Greece expects GDP to grow by around 2.5% in 2017, although a downward revision of the December 2016 forecasts is likely due to the negative carry-over effect of the sharp decline in output in Q4 2016 (attributed mainly to the decline in gross fixed capital formation and government consumption). Downside risks to the economic outlook exist related to delays in the conclusion of the second review of the Programme, the impact of increased taxation on economic activity and reform implementation. Downside risks connected with the international environment include increased uncertainty associated with forthcoming elections in several EU countries, the rise in protectionism worldwide and a slowdown in global trade and a possible resurgence of the refugee crisis. Upside risks are related to the inclusion of Greek sovereign debt in the ECB’s quantitative easing programme (QE) and an increase in tourist arrivals and travel receipts, as indicated in the bookings trend.

Regarding the banking sector outlook, the out-of-court mechanism will focus on standardizing procedures for small business professionals and small and medium enterprises to ensure a rapid, effective and transparent resolution of arrears. On the remaining steps, it is important that bank managers and employees acting in good faith in managing non-performing loans should be protected from criminal prosecution, while the platforms for electronic auctions and the out-of-court mechanism are expected to become operational soon.

Addressing the problem of non-performing loans in an efficient manner is important from both a micro and a macro-prudential perspective, since it would not only improve the financial soundness of banks, but also free-up funds to be directed to other more productive sectors of the economy, resulting in an increase of productivity and growth. The resolution of private debt is of utmost significance for the rebalancing of the Greek economy towards export-oriented sectors and the efficient allocation of resources. The identification of viable businesses, for which sustainable long-term restructuring solutions should be implemented, will preserve the productive fabric of the economy and lay the foundations for resumption in investment and growth. In a similar vein, restoring affordability of household debt can render many households once again bankable and reinforce social cohesion.

In conclusion, Greece is about to return to economic and financial normality and to shift to a new, outward-looking and sustainable growth model, based on tradable goods and services. To this end, allow me to highlight the following pre-conditions: the prompt completion of the second review and a more realistic approach by all parties to the fiscal mix and government debt burden.

Thank you for your attention.