# Yannis Stournaras: The world economy and Greece - prospects and challenges with a focus on the role of shipping

Speech by Mr Yannis Stournaras, Governor of the Bank of Greece, at the Union of Greek Shipowners, Athens, 4 December 2017.

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Ladies and Gentlemen,

It is a great pleasure for me to be with you today, especially since this year has been proclaimed "Year of Shipping" for the EU and marks the entry of the Union of Greek Shipowners into its second century, after it celebrated its centennial last year.

I will start my speech with an overview of international economic developments. Then I will give an account of recent developments and describe the prospects of the Greek economy. I will go on to discuss the importance of Greek shipping and the challenges facing it. I will conclude by highlighting the preconditions for sustainable recovery of the economy.

## 1. The international environment

**The world economy is on a stable upward trajectory**. Business and consumer confidence indicators suggest that sentiment remains positive, while financial conditions in advanced economies remain supportive, assisted by accommodative monetary policies. In emerging market economies, financial markets remain resilient and capital inflows are strong. Economic recovery is broadly based both across developed and emerging economies and in terms of GDP composition. 2017 is expected to be the first year since 2010 to see all large economies grow in synch. There are also growing signs of a recovery in investment worldwide.

Looking forward, world economic activity is expected to pick up moderately. The improvement in activity in **advanced economies** is supported by the monetary and fiscal policies pursued. Among **emerging economies**, growth is expected to remain robust in commodity-importers, such as China, while in commodity-exporting economies the downturn will bottom out after the deep recessions observed in the last two years. **World trade is recovering** and over the medium term is expected to expand as world economic activity gathers pace. A significant boost to world trade could come from the recent multilateral or bilateral trade agreements, such as the WTO Trade Facilitation Agreement and the EU-Canada Trade Agreement.

However, there are several **risks** surrounding the short-term outlook for the world economy, trade and – therefore – sea transport. Specifically, in addition to geopolitical risks, there also downside risks related to rising protectionism, the impact of gradual monetary policy normalisation on international financial conditions, a possible sharp correction of asset (especially equity) prices, the sustainability of growth in emerging markets (most notably China), and the implications of Brexit for trade.

**In the euro area, economic growth is increasingly gaining traction**. The euro area economy has been posting positive growth rates for 18 quarters in a row and the latest data suggest that this momentum will be maintained in the period ahead. The accommodative stance of monetary policy bolsters domestic demand. Employment growth and some pick-up in wage growth support households' disposable income. Combined with a progressive increase in household wealth, these have a benign effect on private consumption. Investment recovery is assisted by improved corporate profitability and very favourable financing conditions. Robust external demand supports euro area exports, although the recent appreciation of the euro is a source of uncertainty regarding the overall contribution of net trade to economic growth.

Inflation is expected to decline in the short term, mainly reflecting base effects in the energy component. Over the next two years, inflation is expected to remain well below a level compatible with the ECB's inflation target. Moreover, developments in core inflation have yet to show convincing signs of a sustained upward trend. Against this background, the ECB Governing Council, with the recent recalibration and extension of its asset purchase programme until September 2018 or beyond, if necessary, confirmed that a substantial degree of monetary accommodation is still needed to ensure a sustained return of inflation to rates of below but close to 2%.

## 2. Developments and prospects of the Greek economy

Since the onset of the sovereign debt crisis in 2010, Greece has implemented an **economic adjustment programme** that has eliminated the fiscal and external deficits and has improved international (especially labour cost) competitiveness.

At the same time, a bold **reform programme** has been implemented in the pension system, the health system, labour and product markets, the business environment, public administration, the tax system and the budgetary framework. Its implementation, alongside a privatisation and a public asset development programme, is ongoing. According to a recent Lisbon Council report (EuroPlus Monitor, September 2017 Update), **Greece ranks first** in the EU-28 on the basis of the **Adjustment Progress Indicator**. Moreover, on the basis of **the World Bank's "ease of doing business" index** ("Starting a business" subindex), Greece's ranking has improved considerably between 2011 and 2017 (from 148th in 2011 to 37th in 2017), although there is still significant room for improvement.

As a result of these efforts, openness has improved substantially and the economy has started to **rebalance towards tradable, export-oriented sectors**.

Specifically, the share of total exports in GDP increased from 19.0% in 2009 to 30.2% in 2016, while between 2010 and 2016 the relative prices of tradables versus non-tradables rose by about 9%. As a consequence, the size of the tradables sector relative to that of the non-tradables, measured by gross value added, grew by approximately 11% at constant prices and by about 21% at current prices, while in terms of employment it increased by around 7%.

Despite any missteps and conflicting signals, there are encouraging signs also regarding **foreign direct investment (FDI)**. FDI inflows reached a post-2010 record of almost €2.8 billion in 2016 (1.6% of GDP), and were mainly targeted at services sectors (i.e. hotels and restaurants, transportation, financial intermediation and real estate activities). In the first nine months of 2017 the cumulative inflow already reached €3.0 billion, and as was the case in 2016, continued to target the services sectors. **Increased FDI inflows indicate the positive assessment of major foreign investors about the prospects of the Greek economy**.

Turning to the banking system, significant **recapitalisation**, following stringent stress tests along with in-depth asset quality reviews, now ensures that **Greek banks are among the best capitalised in Europe**. This fact, along with an NPE coverage ratio of 47% and good collateral, will play a catalytic role in allowing banks to address the pressing issue of reducing the high stock of non-performing loans. In addition, significant institutional reforms have been initiated aiming at providing banks with a variety of means of reducing non-performing loans, such as the creation of a secondary market for distressed assets, an out-of-court settlement mechanism and e-auctions. According to incoming data, there has been progress since the beginning of the year in the area of banks' non-performing exposures (NPE). At end-June 2017, the stock of NPEs (including off-balance-sheet items) was 3.2% lower than at end-December 2016.

### *2.1 Prospects of the Greek economy*

The economic recovery continues and growth is gathering pace following the completion of the second review and the positive impact it had on confidence and liquidity. Further positive effects are expected from the staff-level agreement on the third review that was reached last Saturday. The consolidation of growth dynamics is reflected not only in GDP figures, but also in the performance of several short-term indicators of economic activity, such as industrial production, retail sales, dependent employment flows in the private sector, exports of goods and services, as well as soft data such as the manufacturing PMI and the economic sentiment indicator. With particular regard to exports, over the first nine months of 2017:

- real exports of goods rose by 3.5% year-on-year; and
- tourist and shipping receipts grew, in nominal terms, by 10.3% and 22.1%, respectively.

The improved outlook for the economy boosted economic sentiment, increased bank deposits, led to a slowdown in the negative rate of change in bank credit to non-financial corporations, improved Greece's credit rating and led to successive declines in banks' dependence on central bank financing: for example, the ceiling of Emergency Liquidity Assistance (ELA) for Greek banks now stands at €25.8 billion, down from its peak of €90 billion in July 2015. In addition, yields of Greek government bonds declined to late-2009 levels, which allowed the Greek government to return to international markets, after a period of three years, on 25 July 2017.

More recently, the Public Debt Management Agency conducted an exchange operation of twenty PSI bonds maturing from 2023 to 2042, with a total face value of €29.7 billion, for five new fixed-coupon bonds maturing in 5 to 25 years, in order to enhance the liquidity of the market for Greek debt and normalise the yield curve of sovereign bonds, thus facilitating Greece's next bond issuance programme on international markets.

At the same time, the slope of the yield curve steepened, implying improved investor perceptions about the outlook of the Greek economy. Corporate bond yields have also fallen to historically low levels. Meanwhile, Greek banks have made their way back to international financial markets by selling covered bonds.

The above data support the assessment that recovery will gain momentum in the coming months. **For 2017 as a whole, the economy is expected to return to positive, albeit relatively low growth rates**. The recovery will be supported by higher exports of goods and services, and the continued, foreign-demand-driven increase in industrial production, which contributes to job creation.

- Exports of goods have been on a strong upward trend since 2014, as a result of improvements in the international competitiveness of the economy.
- Regarding exports of services, their rise in 2017 is attributable to buoyant travel receipts as well as higher shipping receipts, as a result of both a recovery in global trade and sea transport and the fact that the impact of capital controls has weakened.

**Growth is expected to pick up in 2018 and 2019, with private consumption and investment as its key drivers**.

- Consumption is expected to recover, mainly on the back of higher household real disposable income as a result of increased employment.
- The contribution of investment is expected to be positive, chiefly due to stronger business investment, reflecting the gradual restoration of confidence and liquidity in the financial system, as well as the acceleration of privatisations.
- **Exports are expected to remain robust**, reflecting higher foreign demand and the restoration of the international competiveness of the economy.
- **Employment** is expected to rise in line with the upturn of economic activity. The benign

outlook for employment, in particular dependent employment, is supported mainly by the positive performance of manufacturing and tourism, low labour costs, and labour flexibility ensured by the institutional framework.

These forecasts are based on the assumption that the reform and privatisation programme will be implemented smoothly and according to the agreed time schedule.

### *2.2. Risks and challenges*

However, despite the positive forecasts, there are still **downside risks** that need to be addressed. The most important **domestic risks** are:

- any delays in the implementation of the recently agreed measures under the third review;
- any delays in the fourth (and last) review signalling the end of the programme;
- a higher than expected negative impact from high tax rates on economic activity; and
- uncertainty about the Greek government's financing conditions after the end of the programme.

In addition, there are **external risks** associated with developments in international financial markets and geopolitical factors, such as the refugee crisis.

At the same time, the protracted economic crisis has left a number of stock imbalances that must be addressed over the medium term if the Greek economy is to return to sustainable growth, most notably:

- **high and persistent long-term unemployment;**
- **the high stock of non-performing loans;**
- **the investment gap;**
- **the public debt overhang.**

These challenges need to be tackled in order to safeguard social cohesion, preserve Greece's high-quality human capital, facilitate the financing of the Greek economy, entrepreneurship and FDI inflows, and strengthen the medium- to long-term potential growth of the Greek economy.

## 3. The importance of shipping for the Greek economy

Greek shipping, an **extrovert activity by definition**, has traditionally been a key driving force of the Greek economy, despite the challenges it has faced at both the international and the national level.

Shipping receipts have always been essential for covering a large part of the country's external financing needs. Over the 2002–2014 period, inflows from shipping accounted, on average, for roughly 44% of total receipts from services and offset about 43% of Greece's goods deficit.

However, according to Bank of Greece balance-of-payments data on shipping inflows on the basis of bank transactions data, a considerable drop in inflows has been recorded since the second half of 2015. This drop is primarily due to the imposition of the capital controls and may therefore be reversed once the controls are fully removed. In 2016 in particular, as a result of the capital controls and low freight rates, receipts from sea transport services accounted for a mere 23% of total receipts in the services balance and financed 35% of the goods deficit, while net receipts (receipts less payments) accounted for 29% of the surplus of the services balance. As I have already pointed out, available data for the January-September period suggest **a partial return, during 2017, to the pre-2015 situation**. This upturn may improve further in view of the anticipated relaxation of the capital controls, as well as on the back of higher freight rates in international markets, mainly in the dry bulk sector.

It should be noted that the Greek shipping industry and maritime cluster can play a pivotal role in the effort of the Greek economy to recover, contributing to GDP growth both directly and indirectly. According to a study conducted by IOBE (2013), the (direct and indirect) contribution of the Greek shipping industry to the economy's total value added was estimated at more than 6% of GDP in 2009, while its contribution to total employment came to about 200,000 jobs. In 2016 shipping receipts declined to 3.3% of GDP, from 6.4% of GDP in 2014, i.e. one year prior to the imposition of the capital controls.

In any event, the expected relaxation and the ultimate abolition of the capital controls, coupled with the pick-up in global economy and trade, should increase the shipping industry's share in GDP and enhance the openness of the Greek economy.

### 4. Challenges facing the shipping industry

It is indeed a remarkable achievement for a small country like Greece to be a leader in global shipping. On the basis of recently published data by the United Nations (UNCTAD), **Greece remains the largest ship-owning nation in terms of cargo carrying capacity** (dead weight tonnage – dwt), even though only 22% of the merchant fleet under Greek control and/or management is Greek-flagged.

Greek shipping has good track record in overcoming challenges. Today, it is confronted with a **number of new challenges**:

1. **World trade and shipping**: The expansion of the global economy is a key factor behind **the increase in demand for seaborne trade**. Nevertheless, this increase – although it is expected to accelerate in the years ahead – is not always sufficient to match the **increased supply of transportation services on account of rapid fleet growth**. Overall, freight rates, as captured by the ClarkSea Index, have risen by about 15% so far in 2017. However, this development was driven by a sharp rise in dry bulk freight rates from their 2016 historic lows, while tanker freight rates have declined markedly, despite a short-lived – as it turned out – recovery in late 2016. In the **near future**, **the balance between new ship deliveries and demolitions**, given the upward trend of world trade, will determine the path of freight rates. Over the **medium term**, the **development of infrastructure projects** in the context of the Chinese One Belt One Road Initiative should also play an important role in strengthening demand, mainly for the dry bulk and container sectors.

2. **Tax regime**: It is now generally accepted that one of the key factors contributing to the success of Greek shipping has invariably been the stable tax regime for shipping. In December 2015 the European Commission invited Greece to better target its tonnage tax and related support measures in the maritime sector, as the Commission found that certain current provisions on the taxation of ships (for instance, Law 27/1975) may breach EU state aid rules, as specified in the Maritime Guidelines. Today, two years on and after many efforts, a mutu ally accepted and workable solution has been found for the vast majority of the identified issues, while there is good progress in addressing the remaining ones.

At this point, let me say a few words about the **voluntary contribution** of the Greek shipping community in support of the Greek economy during the crisis, as provided for in Article 42 of Law 4301/2014, ratifying a relevant Memorandum of Understanding signed between the Greek government and the Union of Greek Shipowners in summer 2013. The initial duration of the MoU was three years (2014–2016). **Subsequently, it has been extended twice, in summer 2014 and 2017, to ultimately cover a total period of five years (2014–2018), with the additional revenue for 2018 estimated at €107 millio**n.

3 . **The capital controls**: As I mentioned earlier, the imposition of the capital controls was followed by a significant fall in shipping receipts, partly due to a loss of confidence in the domestic banking sector, which led to a shift of shipping receipts towards foreign banks. However, **today, two years later, the Greek banking system is fully recapitalised, measures for the relaxation of capital controls have been taken, some of which are targeted to the shipping industry, while a roadmap on the full removal of the capital controls has been published.** Against this background, trust in the Greek banking system is being restored rapidly and financial normalcy is gradually returning.

4. **Domestic bank financing**: In recent years, **the financing of oceangoing shipping by the Greek banking system has dropped sharply,** with outstanding loans to shipping now standing at €8.2 billion, against over €18 billion in mid-2010. This trend is not specific to Greece, since sizeable reductions in the portfolios of traditional shipping lenders have also been observed in the rest of Europe as well. **Part of this gap was covered, through various types of financing, by Asian financial institutions.**

Besides, Greek shipping should adapt to the new **environmental requirements** of the international regulatory framework for shipping (e.g. management of ballast water, use of low-sulfur-content fuels, participation of the shipping industry in the greenhouse gas emissions trading system, etc.).

### 5. Conclusions

Over the past seven years, Greece has gone a long way in adjusting its major macroeconomic imbalances, reforming its economy and restoring competitiveness. The Greek economy now has the potential and the prospect to return to a sustainable growth path, by embracing a new, extrovert growth model.

Still, as I have already mentioned, risks and challenges remain for the Greek economy and the Greek maritime sector and must be addressed, in order to ensure that the economy remains on a sustainable growth track and to increase the contribution of shipping to GDP. To this end, economic policy must from now on focus on the following areas:

1 . **Speed up the implementation of reforms and privatisations.** Such actions foster competitiveness in goods and services markets, improve the business environment and help to attract domestic and foreign investment.

2 . **Improve the quality of institutions and ensure their proper functioning and independence**. With regard to independent authorities, it is important to strengthen their administrative and financial autonomy, ensure respect for their independence and increase their accountability towards Parliament. Well-functioning institutions improve structural competitiveness and promote economic growth, as they affect incentives for individuals and businesses to invest in physical and human capital, technology and the organisation of production.

3. **Tackle the problem of non-performing loans** (and **strategic defaulters**), which prevents the banking system from financing economic growth. Banks should utilise all the available toolbox to reduce troubled assets, and in particular speed up the sale of NPLs. Particular emphasis should also be placed on the restructuring of viable companies and the liquidation of non-viable ones. This will release resources to support new and existing sound investment and business initiatives, thereby supporting the economic recovery.

4. **Adopt a growth-friendly fiscal policy mix**.

5. **Gradual relaxation of the capital controls** in tandem with the return of confidence.

6. **Address the public debt overhang.** Decisive and concrete actions are needed to **ensure the sustainability of Greek public debt in line with the Eurogroup decisions of June 2017.** The Bank of Greece has put forward a specific mild debt reprofiling proposal, which involves only a negligible cost for Greece's partners and consists in extending the weighted average maturity of interest payments on EFSF loans by at least 8.5 years.

Last but not least, in order for Greece to tap the financial markets on sustainable terms after the end of the current programme in August 2018, t**he Greek authorities must close the 4th (and last) review on time**, with a view to significantly improving the credit rating of the country. At the same time, our **European partners**, apart from specifying in more detail the medium-term debt reprofiling measures, which would enable the refinancing of public debt from the markets on sustainable terms, should, in close cooperation with the Greek authorities, **provide more clarity on the post-programme support for the Greek economy**.

These actions will improve the investment climate, attract domestic and foreign direct investment and facilitate the return to financial normality and positive GDP growth rates after seven years of sacrifices, recession and stagnancy, which have taken a toll on economic and social cohesion.

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