INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/248

GREECE

July 2018

2018 ARTICLE IV CONSULTATION AND PROPOSAL FOR POST-PROGRAM MONITORING —PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GREECE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with Greece, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 27, 2018 consideration of the staff report that concluded the Article IV consultation with Greece.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 27, 2018, following discussions that ended on June 29, 2018, with the officials of Greece on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 13, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Greece.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 18/322
FOR IMMEDIATE RELEASE
July 31, 2018

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2018 Article IV Consultation with Greece

On July 27, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Greece.

Following a deep and protracted contraction, growth has finally returned to Greece. The large macroeconomic stabilization effort, structural reforms, and a better external environment contributed to an increase in real GDP of 1.4 percent in 2017, helped also by substantial support from European partners, which secured medium-term sustainability and restored market access. However, stock legacy issues persist, as unemployment remains high and public and private balance sheets remain impaired.

The recovery is projected to strengthen in the near-term, with growth expected to reach 2 percent this year and 2.4 percent in 2019, and with unemployment declining as the output gap closes. However, external and domestic risks are tilted to the downside, including from slower trading partner growth, tighter global financial conditions, regional instability, the domestic political calendar, and risks of reform fatigue. Moreover, in the long term, population aging is expected to weigh down on potential growth, increasing the need to foster productivity.

Executive Board Assessment[2]

Executive Directors commended the authorities for important reforms and policy choices in recent years that have largely eliminated fiscal and current account imbalances, stabilized the financial sector, reduced unemployment, and restored growth. These substantial efforts, along with welcome debt relief by European partners, have put Greece on a path to successfully exit the European Stability Mechanism-supported program in August 2018.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

While a recovery is underway, Directors stressed that significant crisis legacies and social pressures remain, and the risks to the outlook remain on the downside. To address these issues, they encouraged further efforts to rebalance fiscal policy, strengthen bank balance sheets, and reform product and labor markets to boost sustainable and inclusive growth.

Directors agreed that, given the significant adjustment to date, Greece does not require further fiscal consolidation, while also noting that achieving the high primary balance targets comes at a cost to growth, including through high taxes and constrained social and investment spending. They supported a shift to a more growth-friendly and inclusive fiscal policy mix, and welcomed the authorities' commitment to fully implement the pre-legislated fiscal package in 2019 and 2020. Directors called for further fiscal rebalancing to reduce direct taxes and increase targeted social spending to support growth and reduce still-high poverty.

Directors urged the authorities to accelerate efforts to address high non-performing loands (NPLs) and restore lending. In this regard, they encouraged banks to step up use of the strengthened financial sector legislative and regulatory frameworks that have created a better environment for addressing high non-performing exposures, including through the development of a secondary market for non-performing loans. A number of Directors also encouraged the authorities to set more ambitious NPL targets. Directors called for building-up of capital buffers, further steps to mitigate liquidity and funding risks, and stronger bank internal governance. They supported gradual relaxation of exchange restrictions in line with the milestone-based roadmap and taking due account of banks' liquidity.

Directors noted that in the context of limited macroeconomic policy space, further structural reform efforts are needed to boost productivity, competitiveness, and social inclusion. Despite important progress, Greece continues to score lower than peers in competitiveness indicators and lags its peers in liberalizing most service sector professions. Directors urged the authorities to further improve the business environment, aiming to foster competition in product markets and preserving labor market flexibility—through a prudent minimum wage policy and preserving reforms to collective bargaining. These reforms would help ensure competitiveness and preserve the momentum of employment recovery.

Directors underscored the importance of further public sector efficiency improvements and strengthened governance, noting, in particular, the shortcomings in tax enforcement. In addition to efforts in public revenue administration, Directors encouraged the authorities to provide adequate protection from liability of public officials, to implement the Anti-Corruption Action Plan with a focus on improving data collection and transparency, and to take measures to modernize the judiciary. They also emphasized the need to protect achieved gains in the quality of official statistics by defending the statistical agency against any efforts to undermine its credibility, guaranteeing its professional independence, and addressing remaining shortcomings in reporting.

Directors welcomed the debt relief measures granted by European partners and the improvement in debt sustainability over the medium term. They concurred that this relief, combined with a large cash buffer, will facilitate medium-term market access. A number of Directors considered that, over the longer term, these measures will significantly reduce gross financing needs. Many others, however, cautioned that long-term sustainability remains uncertain and emphasized the need for realistic assumptions for primary balance targets and growth projections. Directors welcomed the continued commitment of Greece’s European partners to support the country in the future, including through further debt relief, if needed.

Directors looked forward to close engagement between the authorities and the Fund under the post-program monitoring framework.

Greece: Selected Economic Indicators

Population (millions of people)	10.8	Per capita GDP (€'000)	16.5
IMF quota (millions of SDRs)	2,428.9	Literacy rate (percent)	97.1
(Percent of total)	0.51	Poverty rate (percent)	35.7

Main products and exports: tourism services; shipping services; food and beverages; industrial products; petroleum products; chemical products.

Key export markets: E.U. (Italy, Germany, Bulgaria, Cyprus, U. K.), Turkey, U.S.

	2016	2017	2018	2019	2020	2021	2022	2023
			(proj.)					
Output								
Real GDP growth (percent)	-0.2	1.4	2.0	2.4	2.2	1.6	1.2	1.2
Employment								
Unemployment rate (percent)	23.6	21.5	19.9	18.1	16.3	15.2	14.4	14.1
Prices								
CPI inflation (period avg., percent)	0.0	1.1	0.7	1.2	1.5	1.7	1.7	1.7
General government finances (percent of GDP) 1/								
Revenue	50.2	49.0	48.7	47.1	46.4	45.8	45.0	45.0
Expenditure	49.5	48.0	48.1	47.2	46.2	45.5	44.9	45.4
Overall balance	0.7	1.1	0.5	-0.1	0.2	0.3	0.1	-0.4
Overall balance (excl. program adjustors)	0.6	0.8	…	…	…	…	…	…
Primary balance	3.9	4.2	3.5	3.5	3.5	3.5	3.5	3.0
Public debt	183.5	181.8	188.1	177.1	169.6	162.9	155.3	151.3
Money and credit								
Broad money (percent change)	2.2	5.7	…	…	…	…	…	…
Credit to private sector (percent change)	-4.5	-5.8	…	…	…	…	…	…
3-month T-bill rate (percent)	3.1	2.3	…	…	…	…	…	…
Balance of payments								
Current account (percent of GDP)	-1.1	-0.8	-0.7	-0.4	-0.3	-0.2	-0.1	0.0

FDI (percent of GDP)	-2.4	-1.7	-1.7	-1.7	-1.6	-1.6	-1.6	-1.5
External debt (percent of GDP)	247.8	227.9	221.3	209.7	199.7	190.2	182.5	177.6
Exchange rate								
REER (percent change)	0.6	1.0	0.6	-0.3	-0.2	-0.1	-0.2	-0.4

Sources: Elstat; Ministry of Finance; Bank of Greece; World Bank, World Development Indicators; IMF, International Finance Statistics; IMF, Direction of Trade Statistics; and IMF staff projections.

1/ Based on program definitions outlined in the Technical Memorandum of Understanding of the Third Economic Adjustment Program.

GREECE

July 13, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION AND PROPOSAL FOR POST-PROGRAM MONITORING

KEY ISSUES

Context. Greece has stabilized its economy and begun to grow. The authorities deserve credit for largely eliminating macroeconomic imbalances, including via a significant fiscal adjustment, and for many other reforms undertaken in recent years. Reflecting these efforts, European partners have provided significant support, most recently agreeing to a final loan disbursement under the ESM program and additional debt relief. However, as the country exits the program era in August, crisis legacies and an unfinished policy reform agenda in most areas weigh on Greece's prospects. High public debt, weak bank balance sheets, reliance on capital controls and emergency liquidity assistance, and worrisome social indicators, including still-high unemployment, all weigh on growth and social cohesion. Fiscal adjustment has been sizable, but has relied on distortionary high tax rates on still-narrow bases and growth-detrimental discretionary spending cuts, and efforts to bring down tax and spending arrears have been met with limited success. Social spending is better targeted, but many social needs remain unmet and the risk of poverty remains high. Bank credit continues to shrink. Structural reform efforts to address obstacles to growth and competitiveness—while significant—have fallen well-short of what is needed, and competitiveness indicators remain below the Euro Area average. Notably, the planned reversal of reforms to the collective bargaining framework risks undoing previous gains in competitiveness.

Policy recommendations. With macroeconomic policy options constrained by membership in the currency union and commitments with European partners to maintain very high primary surpluses, and with elections approaching, well-focused policies will be essential to generate sustainable growth and improved social outcomes:

- **Fiscal policy**. The emphasis should be on rebalancing the fiscal policy mix to support growth and address pressing social needs, beginning with implementation of the pre-legislated package of fiscal reforms for 2019–20. In 2019, these reforms will expand social safety net and investment spending, offset by reducing reliance on old-age benefits. In 2020, tax rates will be lowered, funded by a broadening of the personal income tax base. Implementation of the 2019–20 package along the agreed lines is essential not only in its own right but also because of the clear message it will send about Greece's commitment to stay on the reform path in the post-program era. Beyond this, there remains scope to further improve the fiscal policy mix and to strengthen public financial management, including through better cash management and efforts to strengthen tax compliance and reduce the large tax debt owed to the state.

- **Financial sector**. To restore growth-enhancing lending, the focus should be on healing banks' balance sheets. With the improved legal framework now largely in place, banks and borrowers have the tools to reduce bad loans, and more ambitious targets and enhanced supervisory incentives to reduce non-performing exposures are called for. Capital and liquidity buffers need to be built-up, and banks' internal governance improved.

- **Productivity and jobs**. A more ambitious reform agenda is needed to accelerate the pace of productivity growth and increase employment. Labor market flexibility should be enhanced to foster job creation, and the minimum wage policy should be prudent, to ensure competitiveness within the Euro Area.

- **Public sector efficiency and governance**. Implementation of the envisaged judicial reform and the anti-corruption plan is key, with a focus on specific results and improving data collection and transparency.

- **Debt relief**. The envisaged levels of debt relief will mitigate refinancing risks over the medium-term, but longer-term prospects remain uncertain.

Approved By
Philip Gerson (EUR) and Hugh Bredenkamp (SPR)

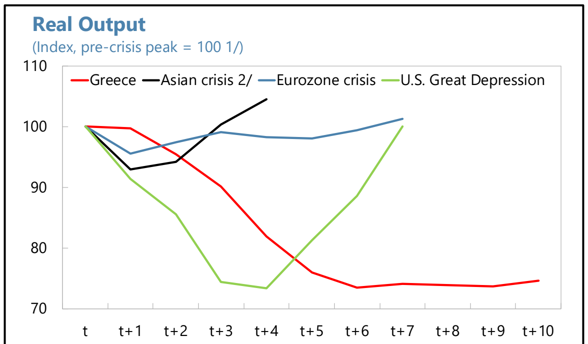
Discussions for the Article IV consultations were held during June 23–29, 2018. The mission met with Minister of Finance, E. Tsakalotos, Governor of the Central Bank, Y. Stournaras, other Cabinet Ministers, and staff of their ministries. Mission members included: P. Dohlman (head), D. Kim, E. Flores, N. Novikova, S. Saksonovs, S. Weber, and S. Chen (all EUR), S. Mazraani (FAD), T. Bayle (MCM), B. Shukurov (SPR), J. Garrido (LEG). D. Botman, E. Argyropoulos, N. Kalavrezou, M. Kalimeri (IMF, Resident Representative Office) assisted the mission. M. Psalidopoulos (OED) participated in key meetings. V. Bezerra de Menezes assisted from headquarters.

CONTENTS

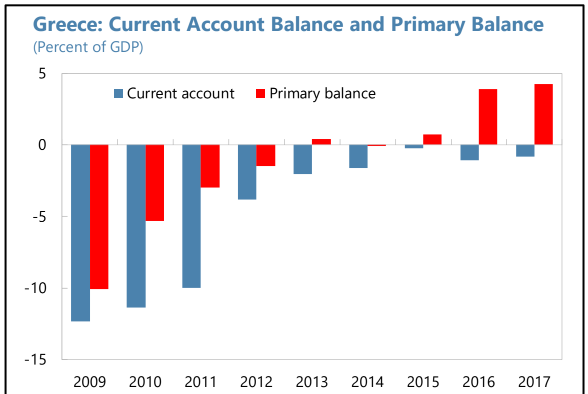
ANNEXES

CONTEXT

1. **Greece has stabilized its economy and largely closed imbalances, but at considerable cost.** The current account deficit was reduced significantly and primary fiscal deficits were closed under the first two adjustment programs, with the 2012 debt restructuring and exceptional official financing proving critical to meeting payment obligations and keeping Greece in the Eurozone. Greece's European Stability Mechanism (ESM) program, launched in 2015, envisaged a strong recovery starting in 2017, but growth has been well below expectations, in part because the fiscal stance was more restrictive than needed to achieve fiscal targets. Real output is only about 75 percent of its (overheated) pre-crisis peak. The share of population at risk of poverty or social exclusion increased by 8 percentage points to 36 percent by 2013, and has remained broadly unchanged since then.



Sources: Eurostat; Haver Analytics; and IMF staff calculations.
1/ Pre-crisis peaks are 2007 for Greece, 1997 for Asian crisis, 2008 for Eurozone crisis, and 1929 for Great Depression.
2/ Including Indonesia, Republic of Korea, and Thailand.



Sources: Elstat; and Haver Analytics.

2. **Greece will exit the program era having accomplished much, but facing significant challenges to secure higher growth.** There has been important progress under the programs and policies have been largely in line with past staff recommendations, but there have also been many delays in implementation and some backtracking (Annex I).[1] As it exits the 2015–18 ESM adjustment program this August, Greece lags comparator countries in competitiveness, and has much to do to achieve higher productivity, growth, and job creation (Figure 1).

3. **Greece needs to overcome several interrelated challenges.**

- First, fiscal policy will need to be substantially rebalanced to better support growth, including by reducing tax rates and strengthening social safety nets, while still maintaining the high primary surpluses agreed with the European Institutions (EIs).
- Second, substantial work is needed to repair weak bank balance sheets, restore full confidence in the financial system, and revive growth-enhancing bank intermediation.

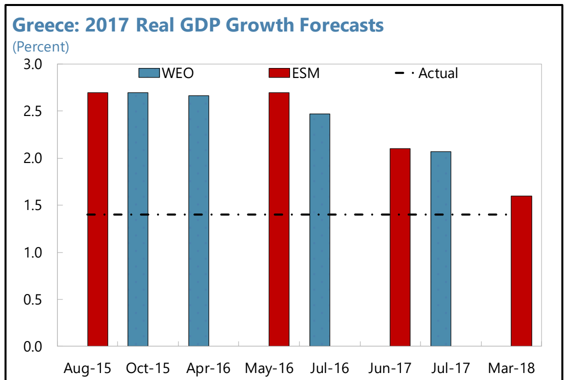
[1] The IMF's July 2017 SBA approved in principle ('SBA-AIP'), which aimed to provide breathing space to mobilize broad political support for deeper long-term structural reforms needed for Greece to prosper within the Euro Area, was not activated for a number of reasons, most significantly because a debt relief agreement did not materialize in time.

- Third, significant additional labor and product market reforms are needed to boost productivity and overcome competitiveness gaps.

- Fourth, Greece needs further reforms to enhance efficiency and governance of still-ineffective public sector institutions.

- Relatedly, Greece will need to meet strict policy commitments to secure promised European debt relief over 2019–22, and will need to maintain policies consistent with ensuring market access.

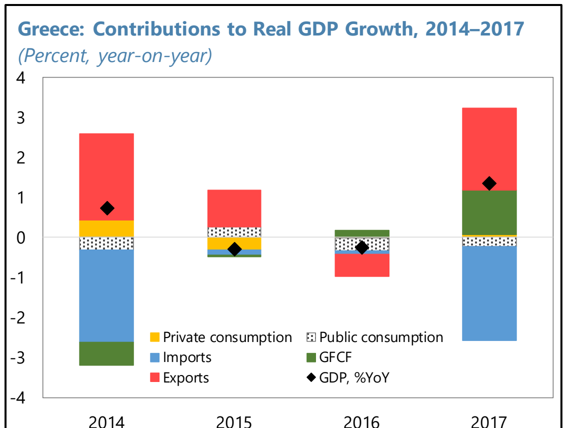
4. However, with elections approaching, the direction of reform is uncertain. To lower refinancing risks, the Greek authorities favored building a precautionary cash buffer rather than a follow-up program. Nonetheless, given the high European official sector exposure to Greece (close to €260 billion), Greece will engage in 'enhanced' post-program monitoring (PPM) with the EIs, which entails higher frequency (quarterly) engagement and monitoring of specific policies than in the other Euro Area post-program countries. These efforts will be coordinated with the expected IMF PPM. This framework could support sound economic and fiscal policies and continued reform efforts, but securing political consensus within Greece could be difficult amid signs of reform fatigue, a shrinking coalition majority in parliament, and the approaching 2019 parliamentary elections. The growth strategy recently produced by the authorities (Annex II) was quickly rejected by the main political opposition party (which leads in the polls) as insufficiently business friendly.



Sources: European Commission Compliance Reports; and IMF WEO database.

RECENT DEVELOPMENTS

5. Growth resumed in 2017, but was weaker than expected by staff and the EIs. Growth was largely driven by goods and services exports (including a continued boom in the tourism sector) and supported by a positive surprise in investment in 2017: Q4 (reflecting spending on equipment and transportation), but reached only 1.4 percent, well below both expectations and the Eurozone average). (Table 1). Private consumption remained weak amid sluggish productivity and wage growth, and a high tax burden. The labor market continued its gradual recovery, with the unemployment rate declining to 21.2 percent. Growth accelerated in 2018: Q1 to 0.8 percent Q-o-Q (seasonally adjusted) as private consumption growth turned marginally positive on the back of an end-2017 social dividend payment, and import contraction. Economic sentiment



Sources: ELSTAT; Haver Analytics; and IMF staff calculations.

stabilized (Figure 2), helped by new orders and external demand. HICP inflation stood at around 1.1 percent on average in 2017, but decelerated to close to zero in early 2018.

6. **The fiscal primary balance overperformed last year, largely due to significant spending compression (Figure 3; Table 3).** The general government primary surplus reached 4.2 percent of GDP, against the SBA-AIP target of 1¾ percent. Revenue was broadly in line with staff projections, but spending was almost 3 percent of GDP lower. Pension spending declined due to delayed processing of claims and fewer eligible retirees. Investment spending was 1 percent of GDP lower than projected due to delays in EU funding and administrative bottlenecks. With the help of ESM funds, the stock of government arrears declined to €4.2 billion as of end-April (compared to €7.3 billion in April 2017).

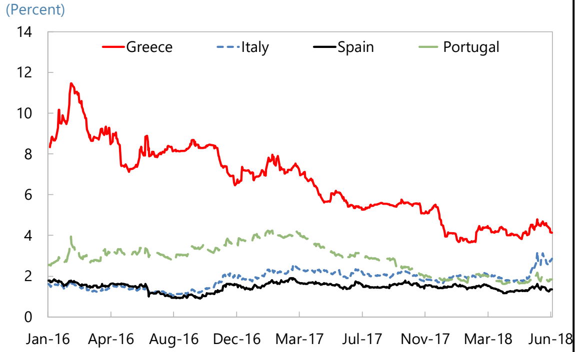
2017 Budget: EDP Outturn vs SBA-AIP
(Percent GDP)

	Outturn	SBA-AIP /1	Difference
Revenue	**49.0**	**49.4**	**-0.4**
Indirect Taxes	17.3	17.5	-0.2
Social Contributions	14.6	14.0	0.6
Direct Taxes	10.2	10.4	-0.2
Other	7.0	7.5	-0.6
Primary Expenditure	**44.8**	**47.7**	**-2.9**
Social Benefits	21.6	22.4	-0.8
Compensation of Employees	12.1	12.5	-0.4
Other	11.2	12.8	-1.6
Primary Balance	**4.2**	**1.7**	**2.5**

Source: IMF staff estimates.
1/ SBA-AIP projections expressed as a ratio to the latest estimate of 2017 GDP and include balance neutral reclassifications between line items since the SBA request.

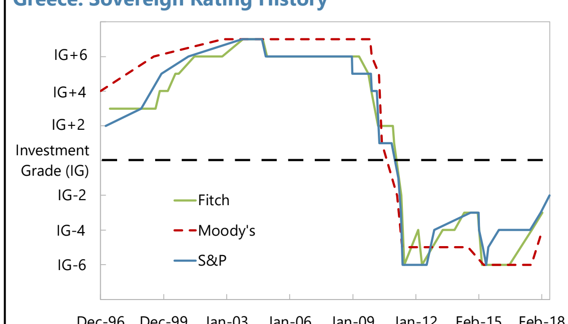
7. **The government has re-accessed capital markets, largely for liability management operations**. In July 2017, the government issued a €3 billion five-year bond with a 4.4 percent coupon (sold mainly to foreign investors), half of which was used for liability management. In November, the authorities conducted a voluntary off-market €25.5 billion exchange of existing PSI bonds for five new benchmark issues; around 60 percent of the participants were domestic. The operation was broadly neutral in nominal and NPV terms, but improved liquidity and extended the yield curve. In mid-February, following completion of the third review of the ESM program, yields declined and the authorities issued a €3 billion, seven-year government bond yielding 3.5 percent. Since then, yields have been volatile, with 10-year bond yields peaking at 4.8 percent in May (reflecting mainly higher external risks), before easing slightly. After the June 21 debt agreement, S&P upgraded Greek sovereign debt (but ratings remain well-below investment grade) and the 10- year yield declined around 50 bps to just under 4 percent.

General Government 10-Year Bond Yields
(Percent)



Sources: Reuters; and Haver Analytics.

Greece: Sovereign Rating History



Sources: S&P; Moody's; and Fitch.
Notes: Investment grade corresponds to BBB-(S&P and Fitch), and Baa3 (Moody's).

8. Bank balance sheets are weak, and credit continues to contract (Figure 4; Tables 4 and 5). As of end-March 2018, Greek banks' non-performing exposures (NPEs) were among the highest in the EU at 49 percent of total loans, with a coverage ratio of 49 percent. Banks have so far met the NPE reduction targets submitted to the Single Supervisory Mechanism (SSM), but in large part because the targets are backloaded. Moreover, banks have mostly relied on write-offs to reduce NPEs rather than on sustainable restructurings. Nevertheless, there has been some more recent progress in NPE reduction, helped by a better legal enabling environment (see ¶18). NPE sales have commenced, with several projects currently underway, and the number of e-auctions of foreclosed properties is rising. Banks have re-accessed markets (issuing new covered bonds amounting to €2 billion in the end of 2017—early 2018). Private deposits have been trending up over the past year, though they are still slightly below their early 2015 levels. Some capital flow management measures (CFMs) remain in place (Annex III). These factors, together with increased usage of repo transactions, higher government deposits, and further deleveraging, have allowed banks to reduce Emergency Liquidity Assistance (ELA) to just under €10 billion (a €30 billion reduction y-o-y). In early July, S&P upgraded the ratings of all four major banks.

9. The 2017 external position was moderately weaker than that suggested by medium-term fundamentals and desirable policies (Annex IV). Staff assesses the current account (CA) gap to be in the range of -2.4 to -1.4 percent, corresponding to a REER gap of between 5 and 9 percent. The REER index and level regression models indicate overvaluations of 13 and 19 percent and the CA model indicates a gap of 8 percent (corresponding to a CA gap of -2.2 percent of GDP). The external sustainability approach suggests that the CA balance gap was consistent with a gradual improvement in the large negative net international investment position (NIIP) over the long term, but such an improvement is predicated on continued reforms to enhance competitiveness and on sufficient public debt relief to safeguard Greece's debt sustainability.

10. Greece's European partners have agreed to provide further debt relief (Annex V). At the June 21 Eurogroup meeting, European member states agreed on additional debt relief, noted the successful conclusion of the final ESM review, and agreed on an enhanced post-program surveillance framework. The IMF and the EIs agree that this relief will significantly mitigate refinancing risks and improve debt prospects in the medium term. However, there are differences of views over the likelihood that the relief package will ensure long-run sustainability, reflecting in large part different assumptions about the baseline nominal growth and fiscal paths (see Annexes V and VI).

OUTLOOK AND RISKS

11. Modest growth is expected over the medium term. Real GDP growth this year has been revised down to 2.0 percent (from 2.6 percent expected in the SBA-AIP), reflecting weaker consumption and a slightly lower contribution from net exports. Growth is projected to accelerate modestly in 2019, with the output gap closing by 2023, but with structural unemployment still in double-digits[2]. Private investment will accelerate (from a low base), financed by foreign capital inflows including FDI, private debt issuances, and privatization deals, while public investment will continue to be supported by EU investment funds. Private consumption growth will be more muted, in part due to the net effect of adjustments to the fiscal policy mix over 2019–20. Fiscal policy is expected to target a constant primary balance, implying some stimulus as the output gap narrows; a further positive stimulus is likely in 2023 when the primary balance target is lowered. Long-term potential real GDP growth is projected at around 1 percent, slowed by unfavorable demographic trends (Annex VI).

Greece: Medium-Term Macro Framework, 2016–22
(Contribution unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022
			Proj.				
Real GDP (% YoY)	-0.2	1.4	2.0	2.4	2.2	1.6	1.2
Private consumption	0.0	0.1	0.4	0.4	0.5	0.5	0.5
Public consumption	-0.3	-0.2	0.2	0.1	0.1	0.1	0.1
Gross fixed capital formation	0.2	1.1	1.3	1.6	1.4	0.9	0.5
Foreign balance (contribution)	-0.6	-0.3	0.2	0.1	0.1	0.0	0.0
Exports of goods and services	-0.6	2.1	1.5	1.4	1.4	1.1	1.1
Imports of goods and services	0.1	2.4	1.3	1.3	1.3	1.1	1.1

Sources: ELSTAT; Bank of Greece; and IMF staff estimates.

12. There are significant downside risks to these projections (Annex VII):

- **Domestic policy and financial sector risks**. Reform fatigue could put a dent in the pace of structural reforms or result in rollbacks. Sustaining the targeted high primary fiscal surpluses entails significant political and judicial risks. A negative ruling on a pending constitutional court challenge to pension reform could undermine fiscal consolidation and the medium-term viability of the pension system. Political pressures to roll back reforms may intensify ahead of the 2019 elections. Even with full policy implementation, growth may prove to be lower than staff's medium and long-term forecasts, including due to a more-adverse-than-expected impact of high primary surpluses on growth, a lower-than-expected output gap, and weaker recovery of investment. Finally, banks remain vulnerable to shifts in depositor confidence—especially as CFM measures are relaxed further—and ongoing assessments of balance sheets, combined with phasing in of new accounting standards, could result in the need for additional buffers. However, with their legacy portfolios weighing on profitability, banks have limited prospects for internal capital generation.

- **External risks.** Tighter global financial conditions, increased regional risk aversion (e.g. Italy-related) and the potential for market skepticism about Greece's commitment to post-program reforms could entail refinancing risks for vulnerable firms, banks, and the Greek state.[3] Weaker growth in the Euro Area, and other risks discussed in Annex VII, could lower exports and hurt confidence.

[2] Structural unemployment is estimated to have been about 15 percent in 2017, with only gradual improvement expected over the next two decades (Greece 2016 Article IV).

[3] While the projected general government cash buffer is sufficient to withstand several years of market stress relating to long-term funding, a shock that leads to a drying up of short-term debt markets would affect debt service repayment capacity by end-2019.

13. The debt relief measures announced at the June Eurogroup meeting substantially strengthen medium-term debt sustainability, but improvements may prove difficult to maintain. The debt relief measures mitigate medium-term refinancing risks, improve medium-term debt trends, and reopen access to medium-term financing. However, this improvement in debt indicators will be hard to sustain over the long-run under what staff considers realistic assumptions on average nominal growth (around 2.8 percent) and fiscal primary balances (at most 1.5 percent of GDP), suggesting that it could be difficult to sustain market access over the longer run without further debt relief (see Annexes V and VI for a discussion of contrasting views on long-run projections). In this regard, the commitment of European partners to undertake an assessment of whether additional debt relief will be needed helps mitigate risks (but should be contingent on realistic assumptions).

General Government Operations, 2017-23 (ESA 2010), percent of GDP

	2017	2018	2019	2020	2021	2022	2023
Revenue	**49.0**	**48.7**	**47.1**	**46.4**	**45.8**	**45.0**	**45.0**
Indirect Taxes	17.3	16.9	16.5	16.1	15.8	15.7	15.5
Social Contributions	14.6	14.3	14.0	14.0	13.9	13.7	13.6
Direct Taxes	10.2	10.0	9.5	9.5	9.5	9.6	9.6
Other	7.0	7.4	7.1	6.8	6.5	6.1	6.2
Primary Expenditure	**44.8**	**45.1**	**43.7**	**42.9**	**42.2**	**41.5**	**41.9**
Social Benefits	21.6	21.1	19.7	19.3	18.9	18.7	18.8
Compensation of Employees	12.1	12.8	12.1	12.1	12.0	11.8	11.8
Intermediate Consumption	5.0	4.7	4.8	4.7	4.8	4.8	4.9
Other	6.1	6.5	7.0	6.8	6.5	6.3	6.4
Primary Balance	**4.2**	**3.5**	**3.5**	**3.5**	**3.5**	**3.5**	**3.0**

Sources: Ministry of Finance, and IMF staff estimates.

14. The authorities broadly agreed with the staff's medium-term outlook but had a more sanguine view on long-term growth prospects, and emphasized external risks. The authorities consider that their growth strategy, the implementation of structural reforms, and more optimistic views on demographic projections will deliver higher real GDP growth rates (in the range of 1.3 to 1.5 percent) through TFP improvements (particularly as the output gap closes), in turn reducing risks to long-term debt sustainability. The authorities agreed that sustaining primary balances of 2.2 percent over the long run is not free of risks but they were fully committed to meeting them and were confident that the recently announced debt relief measures will fully unlock market access going forward. The authorities broadly agreed with staff's external sector assessment. While acknowledging the external risks highlighted by staff, they were less concerned about domestic risks to the economy. They stand ready to make policy adjustments in response to materialization of such risks, and pointed to fiscal space in their medium-term fiscal strategy, should it be needed.

POLICY DISCUSSIONS

15. While much has been accomplished, most notably in strengthening the fiscal position, more is needed for Greece to be successful within the Euro Area. Discussions focused on the need to accelerate reforms, in a context of limited macroeconomic policy space, to foster productivity and growth.

A. Pursuing Pro-Growth Fiscal Policy

16. Greece has achieved an impressive fiscal adjustment, but at a significant cost to growth. To achieve the high primary surpluses agreed with European partners, Greece has relied on a severe compression of capital and other discretionary spending, and increases in already high tax rates. Nonetheless, Greece has now reached its targeted 3.5 percent of GDP primary surplus, and is projected to maintain it through 2022. The authorities' MTFS projects additional fiscal policy space that, if affirmed as permanent, will be used to lower tax rates.

17. Discussions centered on improving the fiscal policy mix. Staff repeated its view that the high primary surplus commitments are detrimental to growth, but welcomed the authorities' commitment to fully implement the 2019–20 pre-legislated (fiscal rebalancing) package, recognizing that this is a politically challenging decision. In 2019, spending on well-targeted social safety nets and investment will increase by 1 percent of GDP, funded by a fiscally neutral reduction in spending on pensions (via a pension recalibration) (Annex VIII). In 2020, income tax rates will be reduced by an equivalent of 1 percent of GDP, funded through a broadening of the personal income tax base—specifically a lowering of the income tax credit (see text Table). These reforms will allow the authorities to improve the inter-and intra-generational fairness of the pension system and increase the efficiency of social spending—historically, pension payments in Greece have served as an imperfect substitute for spending that is typically accomplished via more targeted payments in other countries—and reduce distortions in the tax system, supporting growth without compromising the achievement of budget targets.[4]

Greece: Income Tax Credit

Number of children	Tax credit (€) Current	Tax credit (€) Reform	Tax-free income (€) Current	Tax-free income (€) Reform
0	1,900	1,250	8,636	5,682
1	1,950	1,300	8,864	5,909
2	2,000	1,350	9,091	6,136
3 or more	2,100	1,450	9,545	6,591

Sources: Ministry of Finance; and IMF staff calculations.

18. Staff urged caution in adopting permanent expansionary measures beyond the pre-legislated package, and for further improvements in the fiscal policy mix. The mission urged reliance on more conservative underlying revenue assumptions for the MTFS, and stressed that current staff projections

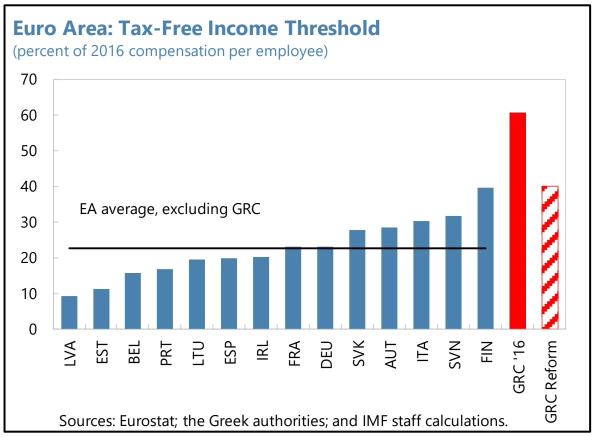
Greece: Growth Measures
(percent GDP)

Spending Measures	Cost	Tax Measures	Cost
(Taking effect in 2019)		*(Taking effect in 2020)*	
Housing allowance	0.3	Reduction of PIT bottom rate	0.5
Child benefit	0.1	Reduction in solidarity contribution	0.2
School meals program	0.1	Reduction of CIT rate	0.2
Reducing prescription co-payments	0.1	Reduction of ENFIA	0.1
Pre-schooling and nursery units	0.1		
ALMP /1	0.1		
Public investment /1	0.1		
Total	**1.0**	**Total**	**1.0**

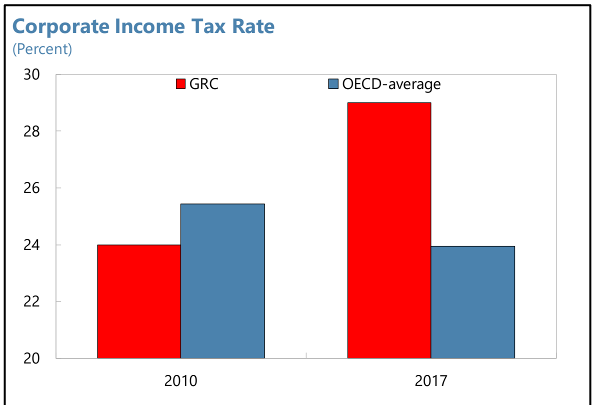
Sources: Ministry of Finance; and IMF staff estimates.
1/ The introduction of these measures may have to be delayed if sufficient fiscal space cannot be found in 2019.

[4] Prior to the 2016 reform, the Greek pension system was fragmented across occupations, types of pensions and benefit rules, resulting in large differences in the contribution-benefit link within the same generation. See also the 2017 Article IV (IMF Country Report 17/40) arguing that lowering the tax credit, while lowering bottom PIT rate, would ensure that the tax burden is borne by relatively better-off groups. Spending on safety nets will not affect tax free thresholds.

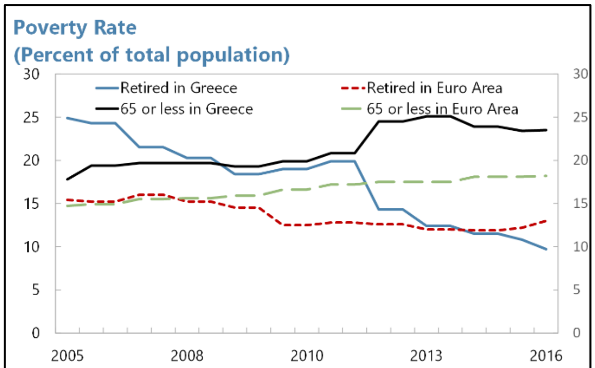
suggest there is no additional fiscal space for deficit-increasing measures given Greece's high primary surplus commitments (tied to debt relief). The mission urged the authorities to adopt more sustainable expenditure control measures to replace reliance on blunt ceilings on healthcare spending (which are currently indexed to real GDP growth) and the civil servant attrition rule that limits new hiring. Moreover, staff urged the authorities to identify additional space for further growth-enhancing (fiscally neutral) rebalancing that would reduce distortions or improve the targeting of the social safety net. This could include measures to further reduce distortionary taxes, while broadening the base (e.g., lowering the high labor tax wedge, unifying VAT rates under a lower statutory rate) and better targeting of social safety nets (e.g., the residential electricity tariff discount for lower income households and revamping other parts of the welfare system, such as disability benefits and other targeted programs). Such rebalancing could support long-term growth through increased labor supply and human capital accumulation.[5] Staff also highlighted the need for measures that could be employed in case fiscal risks materialize (including delaying expansionary measures), and to explore ways to build buffers to allow counter-cyclical fiscal policies in the longer term, while remaining consistent with the expectation by European partners to maintain a 2.2 percent of GDP average primary surplus target over 2023–60.[6]



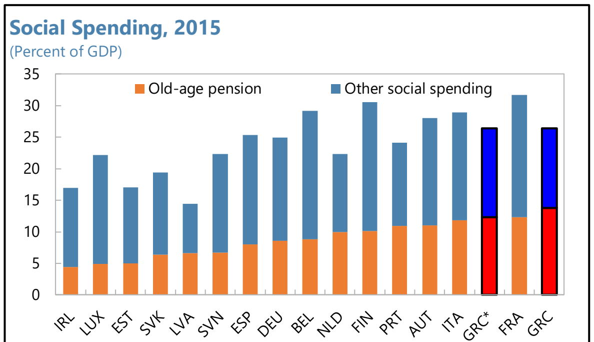
Sources: Eurostat; the Greek authorities; and IMF staff calculations.



Source: OECD.



Source: Eurostat.
Note: share of population below 60 percent of median equivalized income after social transfers.



Sources: Eurostat; OECD; and IMF staff estimates.
Note: GRC* applies the rebalancing between pension spending that will be implemented in 2019 and other social spending (SSI and other spending measures) to the 2015 data.

[5] See for instance IMF (2015) "Fiscal policy and long-term growth".

[6] Staff has consistently argued that Greece can reasonably be expected to sustain a long-run primary surplus of no more than 1.5 percent GDP. (See Annexes V and VI).

19. The mission welcomed the authorities' commitment to further strengthen tax administration and implement deep multi-year public financial management reforms. The authorities have made important progress over the past two years, including: (i) the creation of a new revenue agency with considerable autonomy; (ii) improvements to the automated risk analysis and audit case selection system; (iii) legislating a new out-of-court debt restructuring scheme which includes debts to the public sector; and (iv) legislative reforms in accounting and cash management, including a move towards a streamlined treasury system for the general government. In this context, staff highlighted the importance of:

- **Finalization of measures to strengthen the revenue administration**, including completion of a new HR regime (replacing a seniority-based system with a position and performance based grading and promotion system), an upgrade of major IT systems, stronger debt collection enforcement, reduction of the excessive portfolio of uncollectible debts, further development of compliance risk management, and further modernization of audit practices.
- **Implementation of the planned public financial management measures**, including multi-year sequenced reforms in cash management, the chart of accounts, and accounting, measures to clear and prevent arrears, upgrading of budgeting practices, and execution of plans to improve procurement procedures.

20. The authorities affirmed they will fully implement the pre-legislated growth-friendly fiscal package in 2019 and 2020, but the exact composition of the expansionary measures is still under evaluation. They also conveyed their view that there will be further fiscal space for expansionary measures in the medium-term. They project additional fiscal space of around 0.4 percent of GDP in 2019 (rising to 1.7 percent of GDP in 2022), but will revisit this estimate when preparing the 2019 budget later this year. Should space be available, the authorities will prioritize reducing the tax burden in 2019 and 2020, while in subsequent years fiscal space would be allocated equally between further reducing the tax burden and increasing social spending. The authorities agreed that structural measures should reduce reliance on the spending ceiling to contain healthcare outlays, but expected the transition to be gradual. The authorities agreed that a review of spending priorities should be undertaken, taking into consideration implementation capacity, and they will continue to work on improving the efficiency of government spending. They saw a long-term average primary surplus target of 2.2 percent as ambitious but feasible, benefitting from a more favorable macro environment and fiscal structural reforms undertaken during the adjustment programs.

B. Restoring Bank Health to Support Growth

21. The authorities have strengthened financial sector legislative and regulatory frameworks, but banks' capacity to provide credit remains constrained. Recent reforms have significantly improved the legal environment for credit and have facilitated NPE resolution, including through: (i) improvements in the household and corporate insolvency frameworks, the regime of insolvency administrators, and the position of secured creditors; and (ii) introduction of a new out-of-court workout scheme (OCW) and a new system of electronic auctions (fully replacing traditional auctions). However, their effect on banks' portfolios will take time to materialize and the large NPE overhang will continue to weigh on banks' profitability and capital adequacy for some time. Banks also face significant challenges regarding asset-liability management, as highlighted by systematic ongoing breaches of liquidity requirements. CFMs continue to be lifted in steps, most recently in June, but remaining limits are unlikely to be removed before 2019. Bank governance has improved (boards and senior management have been strengthened), but more is needed to ensure compliance with best practice standards. These factors continue to constrain banks' ability to meet credit demand.

22. Discussions focused on the steps needed to hasten the recovery of the financial sector and restore its capacity to support the economy:

- **More ambitious NPE reduction targets and supervisory incentives.** Banks should aim for restructuring solutions seeking the return of borrowers to long-term viability, and should strive to accelerate NPE write-offs and sales under more ambitious and broader NPE reduction targets. Staff cautioned against NPE resolution initiatives that create new fiscal risks, such as developing an asset protection scheme (APS) involving public guarantees.

- **Proactive build-up of capital buffers, as needed**. While the results of the recent SSM stress tests did not require any immediate actions, banks still appear to be vulnerable to adverse shocks and incoming supervisory decisions (Box 1). There is a need to reduce the relative importance of deferred tax assets eligible under the Greek deferred tax credit (DTC) scheme (which are more than half of banks' CET1), which provide limited loss absorption, deter private equity investors[7], and pose a potential budgetary cost. Given banks' limited organic capital generation, capital raises (e.g. through the issuance of non-dilutive instruments in the private markets, in line with the objective of further curtailing state ownership) should be considered in the near-to-medium term. Over a medium-term horizon, banks will need to absorb the phasing-in of the new IFRS 9 rules[8] and build up Minimum Requirements for own funds and Eligible Liabilities (MREL).

- **Steps to address liquidity and funding risks**. Banks need to narrow maturity gaps and reduce asset encumbrance. Given the anticipated termination (when Greece exits its program) of the

[7] Investors may fear dilution if subsequent losses trigger the conversion of DTCs into shares subscribed by the state.

[8] Greek banks booked substantial provisions upfront, but consistent with the EU directive, will reflect this gradually equity through 2023 (in a backload fashion).

ECB waiver, banks will need to secure liquidity at a sustainable cost and continue deleveraging. Given uncertainty about the evolution of deposits and access to wholesale funding, banks may need to tap more expensive ELA, and the higher costs may impact bank profitability and trigger DTC conversion. The authorities should regularly update a comprehensive assessment of downside risks related to potential spillovers from any increase in sovereign financing costs.

- **Measures to further strengthen bank governance.** The Bank of Greece and the SSM should increase their follow-up of progress in bank internal governance and related supervisory action, aiming to address important operational deficiencies and loopholes in: (i) the internal control environment; (ii) the risk management framework; and (iii) the governance of NPL management and performance practices.

- **Effective implementation of legal reforms.** The authorities should continue to adjust legislative frameworks as needed to facilitate NPE resolution.

- **Continued liberalization of CFMs in a prudent, conditions-based manner**. Gradual relaxation should continue as planned, with priority given to restrictions that create impediments to normal business activity.[9] Ensuring sufficient bank liquidity while CFMs are relaxed will be critical to preserve financial stability.

23. The authorities assessed that banks are on track to return to long-term sustainability and noted a new momentum to the clean-up of balance sheets, facilitated by improved governance. They pointed to stress test results that demonstrated banks' resilience against adverse shocks. Moreover, they noted that recent significant additional provisioning will allow banks to speed up NPE write-offs, sales and securitizations. Together with the benefits expected from upgraded workout and insolvency frameworks, they argued that these more aggressive strategies will allow banks to meet their current NPE reduction targets, and allow banks to contribute again to credit growth. Profitability prospects should sustain internal capital generation, and garner the interest of private investors. On the funding side, they expect the improved confidence underlying the gradual lifting of CFMs, the return of deposits, and access to wholesale funding to help further curb and then eliminate ELA refinancing by end-2019. They stressed that further efforts to strengthen governance aim at implementing the HFSF recommendations for improving risk culture and the control environment. They agreed that conditions-based relaxation of CFMs (following the roadmap) should continue, taking into account liquidity considerations and avoiding unnecessary delays that could be detrimental to confidence. The government conveyed the view that credit market failures in the SME sector could be overcome through the creation of a development bank, drawing on non-deposit funding (e.g., EIB).

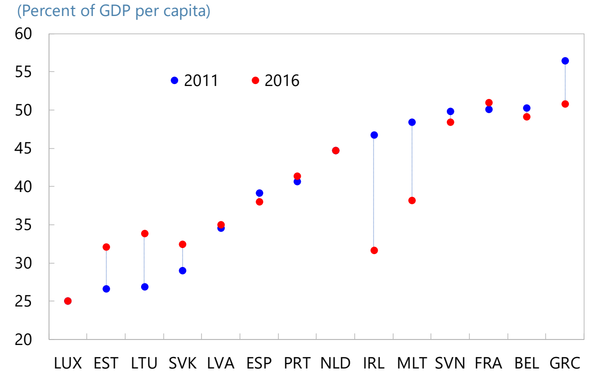
[9] Greece continues to maintain measures that give rise to three exchange restrictions subject to Fund approval under Article VIII, Section 2(a) (for a detailed description see the 2018 Informational Annex). The Executive Board previously approved the temporary retention of these three exchange restrictions until February 5, 2018.

C. Fostering Employment

24. Greece needs further labor market flexibility to help bring down unemployment and enhance competitiveness. In the initial reform program period (2010-14), labor market flexibility and cost competitiveness improved significantly. More recent reforms have been modest, but have moved broadly in the right direction. Nonetheless, while the unemployment rate has declined (Figure 5), it remains the highest in Europe. This reflects slack in the economy, but also structural issues such as the shift away from non-tradables (e.g., construction) and the large public-sector wage premia. In this context, the discussions focused on:

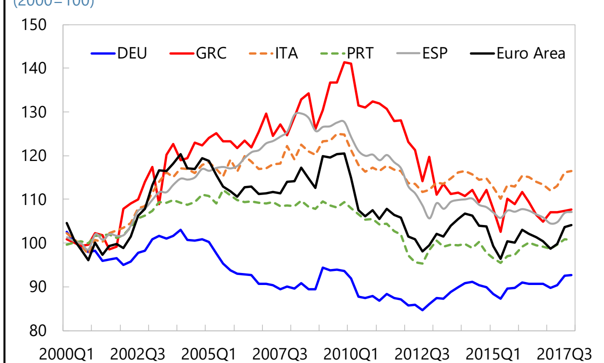
- **Means to avoid the negative consequences of the reversal of two key labor market reforms**. In September, the authorities will reverse reforms relating to 'extensions'—allowing the government to apply the conditions of a collective labor agreement (CLA) negotiated by one subgroup of workers to all workers in the sector or occupation—and 'favorability'—which allows workers potentially subject to multiple CLAs to select the most favorable one. Staff continued to urge reconsideration of this decision, which will reduce labor market flexibility and risk disconnecting wages from productivity at the firm level (thus hurting job creation). Staff noted that the authorities' planned introduction of a new mechanism to measure representativeness, aiming to extend only representative agreements, could ameliorate the negative impact somewhat, depending on its implementation.

Minimum Wages: Euro Area
(Percent of GDP per capita)



Sources: Eurostat; and IMF staff calculations.

Relative unit labour costs, 2000–17
(2000=100)



Source: OECD.

- **Implementing the new minimum wage framework in a prudent manner.** A new minimum wage framework (legislated in 2013) will go into effect this September. It envisages a statutory minimum wage level set by the government, following annual consultations with partners and experts (with the consultation starting in February 2019). Some social partners fear that increases could quickly spread to the full wage spectrum, threatening competitiveness, while others consider that increases are needed to address losses in minimum wage purchasing power. Staff stressed that prudent outcomes (strongly connecting wages to labor productivity) are key to preserving competitiveness gains. Further simplification of the framework by discontinuing seniority premiums, which create multiple minimum wages, is also recommended.

- **The need for further progress in active labor market policies (ALMP) and measures to boost labor force participation, aiming to reduce high structural unemployment.** The authorities are working to revamp their policies to address constraints for new entrants and the long term unemployed, and to increase female and older age cohort participation (given envisaged demographic trends).

25. The authorities argued that restoration of collective bargaining is critical to achieve shared prosperity and support aggregate demand, and in line with their commitments. They assessed that a good part of unemployment is cyclical in nature, and will dissipate if the economy strengthens. They saw higher wages resulting from collective agreements as a way to drive a shift of resources to more productive activities—which would in turn generate jobs. They considered that the reinstatement of extension and favorability will lead to a stronger dialogue among social partners which will then drive productivity increases that would fully compensate for the impact of higher wages on employment. Regarding the minimum wage, they indicated that they will implement the legislated framework, and stressed that workers should share in the benefits from future increases in productivity.

D. Product Market Reforms to Accelerate Productivity

26. While product market reforms have advanced, Greece still lags its peers in many respects, and significant productivity gains have not yet been realized. Productivity growth is well below the Eurozone average and FDI is low. The authorities have continued their efforts to reduce barriers to competition, including liberalization of some closed professions and reforming investment licensing, but the implementation of approved measures has been mixed and the authorities' new growth strategy does not include any significant further changes (Annex II). Greece's business environment and product market restrictiveness continue to compare poorly to the OECD average, Greece ranks well below the least restrictive country in most categories (Figure 1). Privatization efforts remain, overall, underwhelming, with some success in securing the regional airport concession in 2017, but delays in the Hellenikon airport project, the sale of Hellenic Petroleum shares, and the gas distributor (DEPA).

Service Trade Restrictions Can Be Lowered Further

(OECD Services Trade Restrictiveness Index, scale from 0 to 1 (most restrictive), 2017)

Source: OECD (2018), "Service Trade Restrictions Index by services sector" in OECD Industry and Services Statistics (database).

27. Discussions focused on accelerating product market liberalization and facilitating further privatization. Staff emphasized that fostering competition is essential to increase the pace of productivity growth, and competitiveness within the Eurozone. The mission suggested that efforts should center on already identified and well-understood reform, including further reducing barriers to competition for professional services and the remaining sectors of the investment licensing reform. In addition, further privatization efforts, particularly completion of those already in the pipeline, are crucial to foster FDI.

28. The authorities agreed with these priorities, but stressed the need to balance the streamlining of regulations with the need to protect the public interest. They remain committed to finalizing the investment licensing reform as expressed in their growth strategy. Regarding closed professions, they will complete the reforms that are currently in the pipeline, and will review whether there is room for further improvements. They plan to implement their current privatization plans, and will assess prospects for monetizing remaining participation in state-owned enterprises.

E. Addressing Public Sector Efficiency and Governance Issues

29. The authorities are undertaking efforts to improve governance and the rule of law. They are implementing a strategic plan to strengthen the judicial system by enhancing efficiency, speeding up proceedings, and addressing functional shortcomings in the courts. Priorities include further efforts to introduce modern technology at the courts, and increasing the specialization of the judiciary. Moreover, an Anti-Corruption Action plan is being implemented with EC and OECD support. This plan seeks to promote integrity within the government's overall reform program, enhance public-private cooperation on tackling fraud and corruption, and raise awareness of the negative impact of corruption.

30. However, further efficiency and governance-related improvements are needed in the public sector. Staff noted the broadly shared sentiment that still-weak tax enforcement, inadequate internal audit/control, and corruption in Greece have facilitated tax evasion and contributed to weak public finances. Initial efforts on tax administration, public procurement, cash management, electronic payment systems, anti-money laundering (see ¶19), and public-sector staffing more broadly have helped ameliorate vulnerabilities, but these reforms need to be completed and fully implemented. In addition, the authorities should implement the planned and adopted reforms to increase the protection from liability of public officials engaged in the normal exercise of their official duties. The several reported cases of public officials facing criminal charges for actions in their official capacity could undermine data integrity and the independence of public institutions (or perceptions thereof). The Anti-Corruption Action plan should be implemented with a focus on specific results and improving data collection and transparency.

31. The quality of official statistics has continued to improve, and data provision is broadly adequate for surveillance. Considerable progress has been made in the quality of Greek statistics since the establishment of the independent Hellenic Statistical Authority, ELSTAT, in 2010. The coverage and timeliness of data compilation processes have improved, making them consistent with international statistical standards. Technical assistance from the IMF, Eurostat, and EU member states has been important in this regard. Nonetheless, there remain important weaknesses, which include significant gaps in the fiscal source data, and continuing discrepancies in the fiscal reports of the Bank of Greece. The authorities should protect the gains achieved so far by defending the statistical agency against any efforts to undermine its credibility, guaranteeing its professional independence, and addressing remaining shortcomings in reporting, while firmly respecting the "Commitment on Confidence in Statistics" that was endorsed by the government in 2012.

32. The authorities agreed on the importance of good governance and the rule of law and their growth strategy envisages significant reforms. The Ministry of Justice will continue to implement plans to modernize and increase the efficiency of the judiciary, and is open to initiatives to improve the implementation of the legislated reforms. The Anti-Corruption authorities are implementing the new National Anti-Corruption Action Plan that aims to address the identified gaps in the existing framework, and are receptive to the recommendations of international organizations. The authorities intend to continue implementing reforms to strengthen tax enforcement tools, preserve the independence of the newly formed tax authority, and strengthen cash management through closure of bank accounts towards a streamlined Treasury Single Account. The authorities continue to stand by the accuracy of the national statistical data, and remain committed to preserve the independence of institutions.

F. Future Fund Engagement

33. Greece meets the criteria for initiating post-program monitoring (PPM). Its outstanding obligations to the Fund are expected to remain above the SDR 1.5 billion threshold until late 2022. Moreover, there are no exceptional circumstances that would indicate that PPM is not warranted.

STAFF APPRAISAL

34. Growth has returned to Greece, helped by an impressive macroeconomic stabilization effort, structural reforms, and a better external environment. Greece deserves credit for substantial fiscal and current account adjustments and for implementing some key structural reforms in recent years. These efforts, combined with substantial European support and a more favorable external environment, have allowed a return to growth and falling unemployment. However, external and domestic risks are significant, including from slower trading partner growth, tighter global financial conditions, regional instability, the domestic political calendar, and reform fatigue. Staff assesses that 2017 external position was still moderately weaker than that suggested by medium-term fundamentals and desirable policies.

35. The debt relief recently agreed with Greece's European partners has significantly improved debt sustainability over the medium term, but longer-term prospects remain uncertain. The extension of maturities by 10 years and other debt relief measures, combined with a large cash buffer, should secure a steady reduction in debt and gross financing needs as a percent of GDP over the medium term and thereby improve the prospects for Greece to sustain access to market financing over this period. Staff is concerned, however, that this improvement in debt indicators can only be sustained over the long run under what appear to be very ambitious assumptions about GDP growth and Greece's ability to run large primary fiscal surpluses, suggesting that it could be difficult to sustain market access over the longer run without further debt relief. In this regard, staff welcomes the undertaking of European partners to provide additional relief if needed, but believe that it is critically important that any such additional relief be contingent on realistic assumptions, in particular about Greece's ability to sustain the real GDP growth rates envisaged by the EIs while also achieving exceptionally high primary surpluses.

36. Further efforts are needed to overcome crisis legacies and to boost productivity, competitiveness, and social inclusion. Macroeconomic imbalances have been largely eliminated, but high public debt, weak bank and other private sector balance sheets, CFMs, government arrears, and the large at-risk population weigh on growth prospects. Progress with key fiscal and market reforms has lagged. Greece needs to continue its reform efforts if it is to achieve sustained high growth and secure competitiveness within the Euro Area, while also supporting those in greatest need. The authorities' growth strategy contains promising elements in this respect, and further assessment of gaps, continuity with current reforms, and implementation will be crucial.

37. A growth-friendly rebalancing of the fiscal policy mix is a priority. Achieving the high 2018–22 primary surplus targets agreed with the EIs will require high tax revenues and will constrain social spending and investment. To support inclusive growth while meeting fiscal targets, the authorities should aim for budget-neutral improvements in the fiscal policy mix, starting with the already legislated fiscal package for 2019–20. These measures, backed by fiscal structural reforms to strengthen efficiency and implementation, will help reduce the poverty rate and economic distortions, and support growth. Any delay in these reforms would seriously undermine the credibility of the assumptions underlying the debt relief measures agreed with European partners. In addition, the authorities should be cautious in adopting permanent expansionary measures beyond those already legislated, to avoid jeopardizing their fiscal targets.

38. Reviving banks' lending capacity, including by tackling very high non-performing exposures (NPEs), is critical for supporting the economy. Important legal reforms aimed at reducing NPEs have been adopted, and steps taken to develop a NPE secondary market, but further implementation efforts are needed for them to take root. To accelerate banks' balance sheet clean-up, more ambitious NPE reduction targets, proactive build-up of capital buffers, further steps to mitigate liquidity and funding risks, and stronger bank internal governance are needed. Remaining CFMs need to be lifted in a prudent manner following the agreed roadmap, with the pace dictated by economic and banking sector conditions and the level of depositor confidence. Staff supports the authorities' request for Executive Board approval for the temporary retention of exchange restrictions under Article VIII, Section 2(a) since they are imposed temporarily, for balance of payments reasons, and non-discriminatory.

39. Further product and labor market reforms would boost productivity and labor force participation. Progress with product market reform has been uneven and slow in some areas, and Greece is still lagging other European countries in several competitiveness indicators. Earlier labor market reforms contributed to the recovery of employment and competitiveness, but legislation that will reintroduce extensions and favorability of collective agreements beginning later this year risks unwinding these gains. Fund staff strongly urges the authorities not to reverse these reforms. Any minimum wage adjustment should be prudent and in line with productivity gains, aiming to preserve the momentum of employment recovery and avoid any erosion of competitiveness. Improved delivery and better targeting of active labor market policies would help reintegrate the long-term unemployed to the labor market.

40. Public sector efficiency and governance need to be strengthened further, and the independence of the statistical authority should be protected. Despite some important (but uneven) progress, efforts are needed to modernize public institutions, strengthen tax compliance and the payment culture, and improve licensing procedures, cash management, procurement, and reporting practices. A more effective judiciary is necessary for the success of legal reforms in all areas. Improving governance and the independence of public institutions, including by ensuring adequate protection for officials--such as those in charge of statistical reports--is essential to increase confidence in public finances and ensure data integrity.

41. As it exits the program era, Greece must maintain its forward momentum and continue to pursue policies that support prosperity and inclusion. Greece has reached this point thanks to enormous efforts during its adjustment programs. European partners have demonstrated their support by providing further lending and additional debt relief. Greece should now consolidate and extend its success by addressing, with determination, its remaining challenges.

42. The Managing Director recommends the initiation of post-program monitoring. The first PPM Board discussion would be envisaged by early 2019. The next Article IV consultation with Greece is expected to be conducted on the standard 12-month cycle.

Box 1. Stress Test Results for Greek Banks

Stress tests results published by the ECB in May point to the resilience of the Greek banks in the baseline scenario but significant capital depletions in the adverse scenario. Under the baseline banks' CET1 ratios remain in the range of 15–21 percent in 2020. The adverse scenario leads to severe CET1 depletions of about 9 percentage points. The stress test methodology did not include any pass or fail threshold (or 'hurdle rate') for capital adequacy ratio, and no automatic supervisory decision on the need for further recapitalizations was triggered by the stress test results at this stage. The SSM plans to incorporate these results as well as other inputs and qualitative information when determining its comprehensive assessment of Greek banks around end-2018—early 2019. Therefore, both the size of shortfalls, if any, and the timeline for addressing such shortfalls will remain uncertain until then. Staff estimates that if the three banks with lower CET1 were asked to maintain capital ratios under adverse conditions in line with a capital requirement of 7.5–8.0 percent, the related capital shortfall could be in the range of €1.3–1.9 billion.

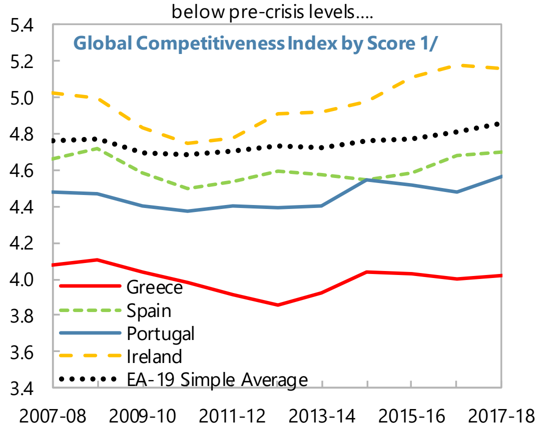
CET 1
(Percent)

	Starting point end-2017 (A)	Baseline scenario end-2020 (B)	Adverse scenario end-2020 (C)	Depletion (C) - (A)
Alpha Bank	18.3	20.4	9.7	-8.6
Eurobank	15.4	16.6	6.8	-8.7
NBG	16.5	16	6.9	-9.6
Piraeus Bank	14.9	14.5	5.9	-9

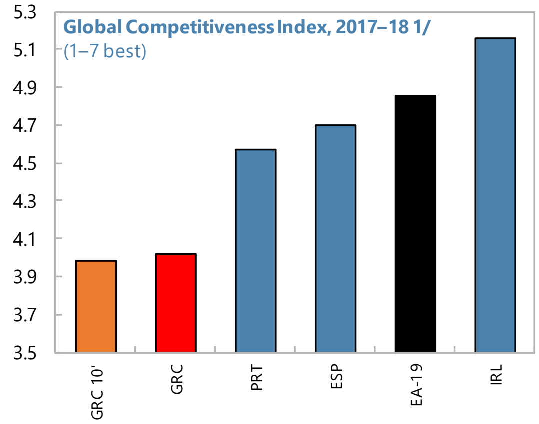
Source: European Central Bank.

Figure 1. Greece: Competitiveness Indicators

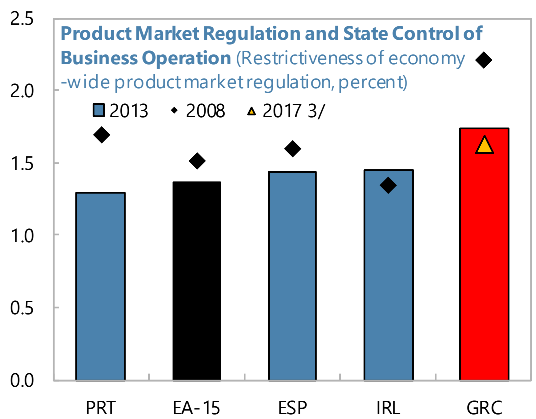
Greece competitiveness scores have improved, but remain well below pre-crisis levels....



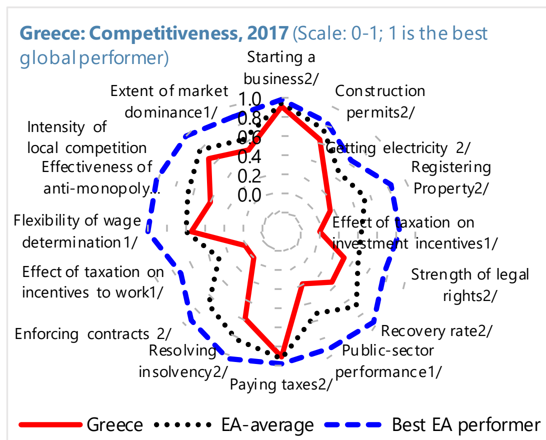
...and Greece's score remained low among Euro Area countries.



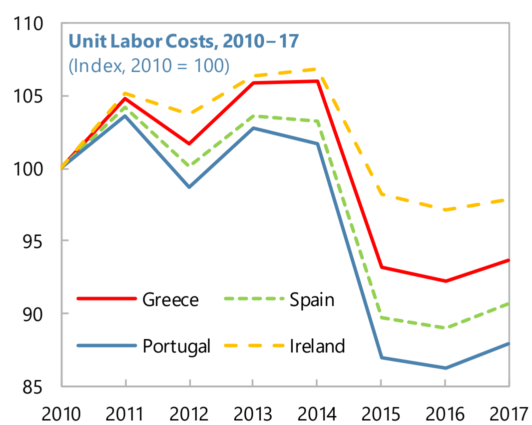
Regulatory restrictions have been reduced, but remain high...



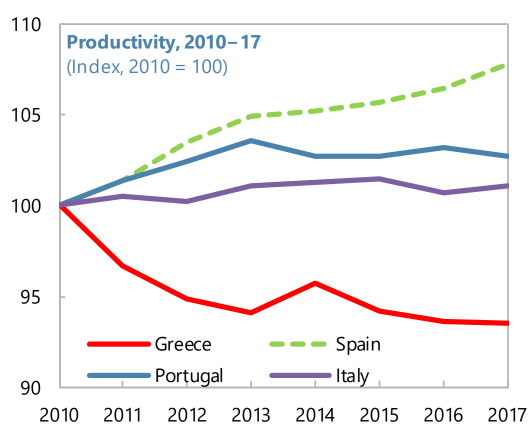
...and Greece's doing business environment remains below the European average



Lower unit labor costs have helped regain competitiveness...

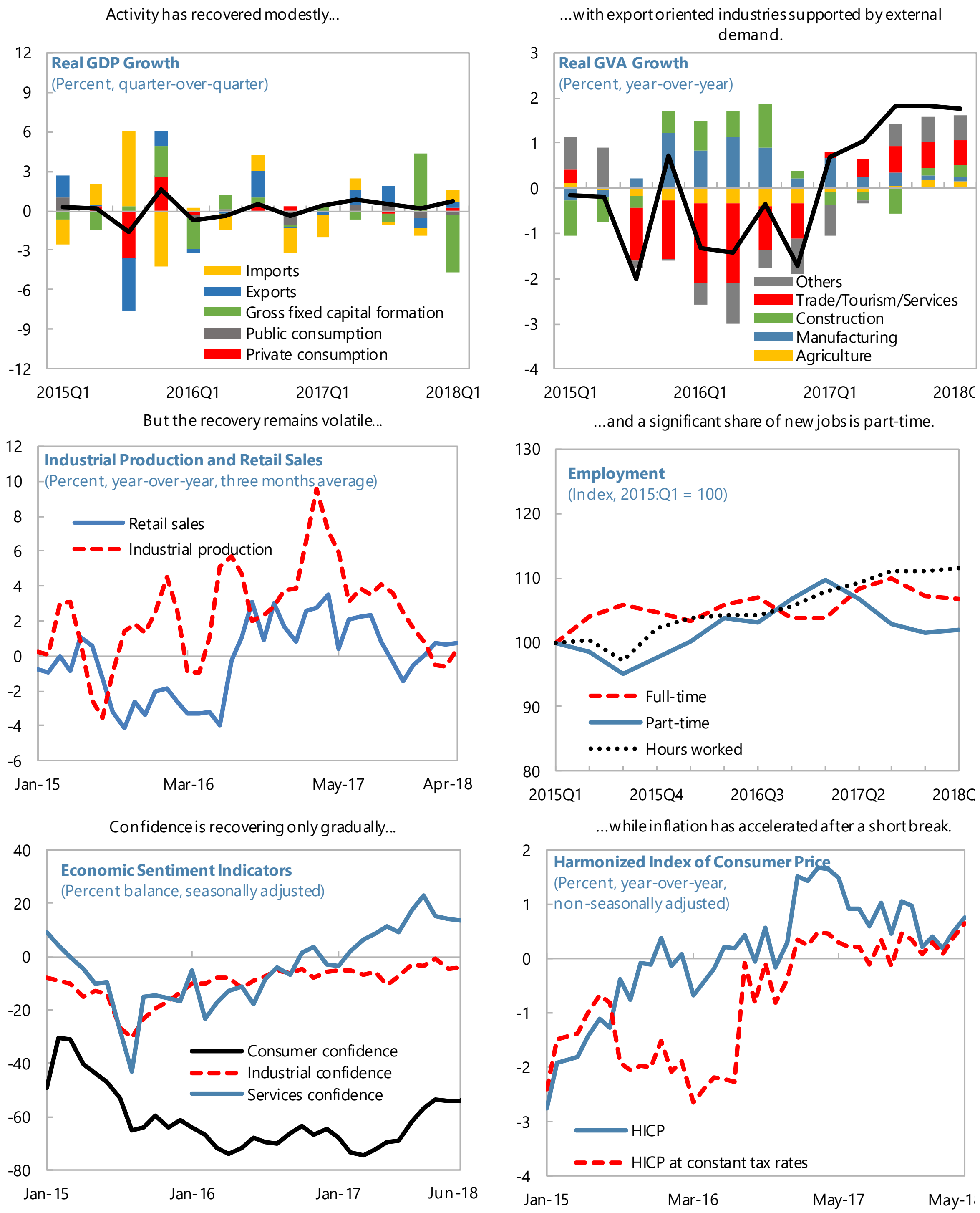


...but the decline was based on lower wages rather than productivity gains.



Sources: Bank of Greece; ECB; Elstat; Eurostat; OECD; WEF; World bank Doing business; and IMF staff estimates.
1/ Data is from World Economic Forum, The Global Competitiveness Index Historical Dataset.
2/ Data is from World bank Doing business 2018.
3/ Data in 2017 is only available for Greece.

Figure 2. Greece: Macroeconomic Developments



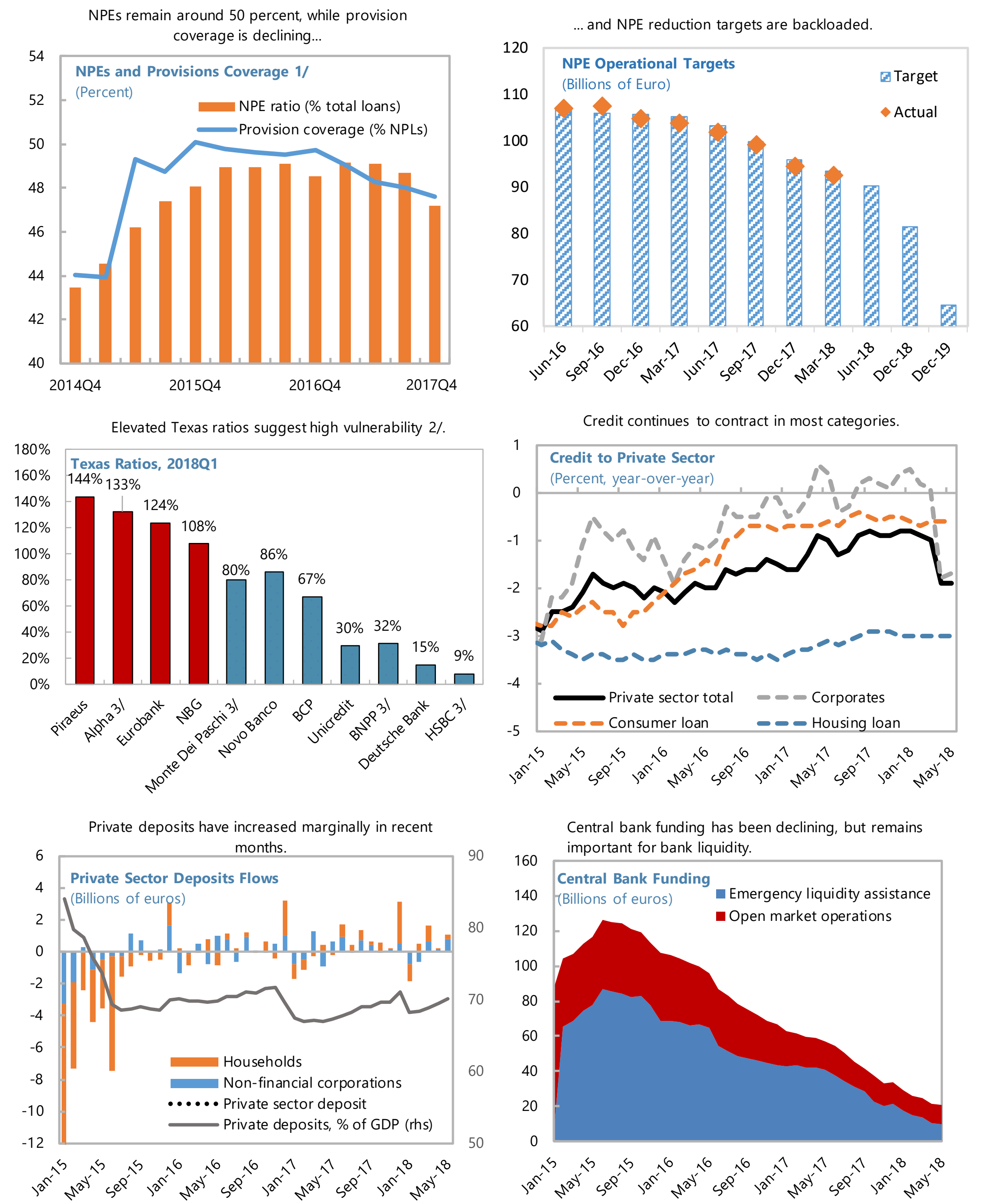
Sources: Bank of Greece; Eurostat; ELSTAT; Haver Analytics; and IMF staff calculations.

Figure 3. Greece Fiscal Developments—General Government

(Percent of GDP)

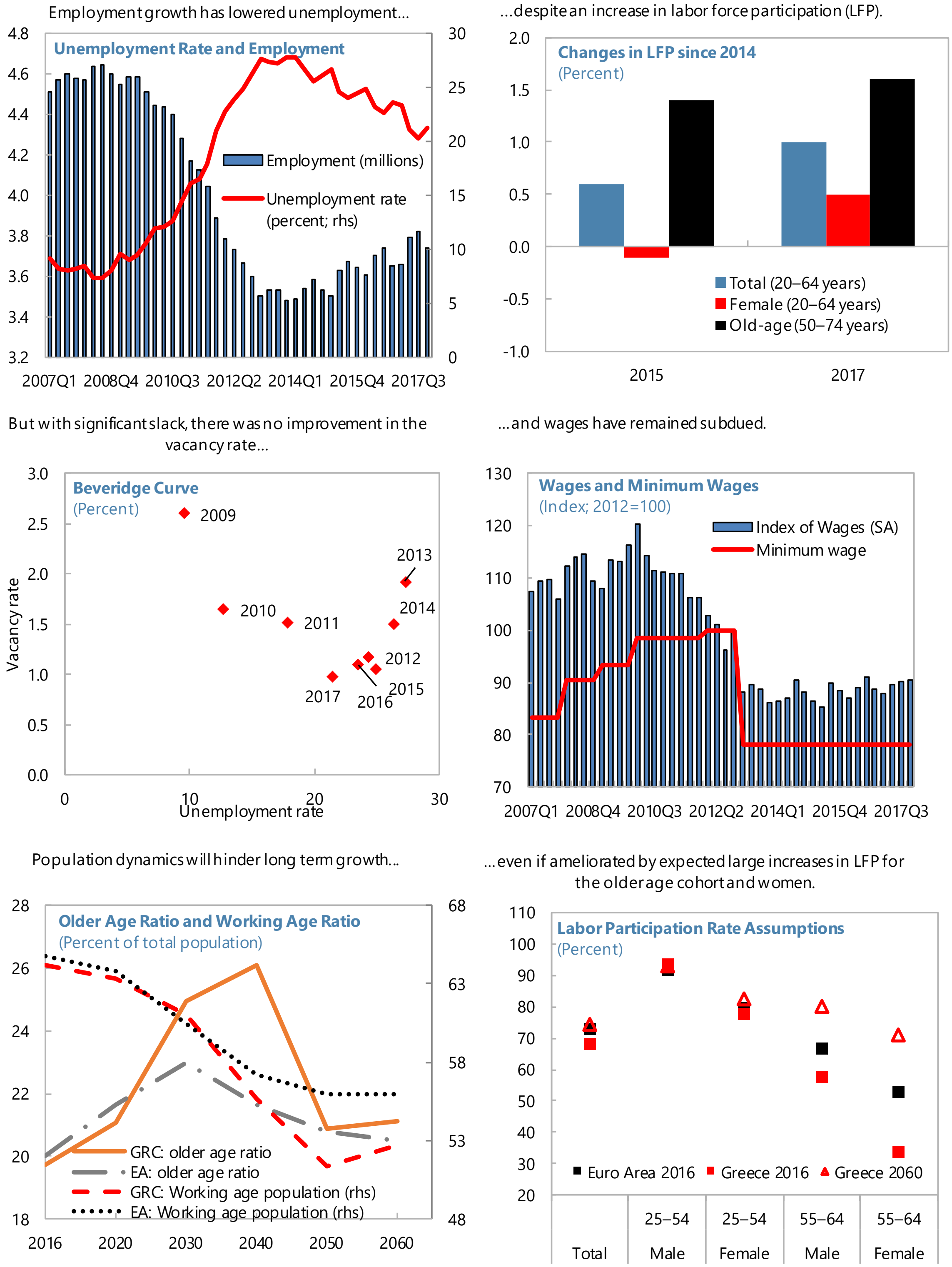
Sources: Elstat; Eurostat; OECD; and IMF staff estimates.
1/ Euro area 16 countries.

Figure 4. Greece: Financial Sector Developments



Sources: Bank of Greece; ELSTAT; Haver Analytics; S&P Market Global Intelligence; and IMF staff calculations.
1/Non-performing Exposures are defined as loans that are 90 days or more past due, unlikely to be repaid in full without realizing collateral, and impaired according to accounting rules, as well as loans that have been restructured for less than a year.
2/ Impaired customer loans before the reserve for losses as a percent of tangible equity plus the reserve for loan losses.
3/ Only 2017Q4 data is available.

Figure 5. Greece: Labor Market and Employment Developments, 2013–2017



Sources: Bank of Greece; EC Aging report; Elstat; Eurostat; and IMF staff estimates.

Table 1. Greece: Medium-Term Macro Framework, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
					Proj.			
			(Percentage change, unless otherwise indicated)					
Domestic economy								
Real GDP	-0.2	1.4	2.0	2.4	2.2	1.6	1.2	1.2
Total domestic demand	0.6	1.2	1.7	2.1	2.0	1.6	1.1	1.2
Private consumption	0.0	0.1	0.6	0.5	0.7	0.8	0.8	0.8
Public consumption	-1.5	-1.1	0.9	0.4	0.5	0.5	0.5	0.7
Gross fixed capital formation	1.6	9.6	10.0	12.2	9.6	5.9	3.0	2.8
Exports of goods and services	-1.8	6.8	4.8	4.4	4.1	3.3	3.3	3.1
Imports of goods and services	0.3	7.2	3.7	3.7	3.6	3.0	3.0	2.9
Final Consumption (contribution)	-0.3	-0.2	0.6	0.5	0.6	0.7	0.6	0.7
Gross fixed capital formation (contribution)	0.2	1.1	1.3	1.6	1.4	0.9	0.5	0.5
Change in stocks (contribution)	0.6	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance (contribution)	-0.6	-0.3	0.2	0.1	0.1	0.0	0.0	0.0
Unemployment rate (percent) 1/	23.6	21.5	19.9	18.1	16.3	15.2	14.4	14.1
Employment	1.7	2.2	2.1	2.1	1.5	0.9	0.5	0.0
Unit labor costs	0.8	0.9	0.9	0.9	1.4	1.6	1.7	1.7
Consumer prices (HICP), period average	0.0	1.1	0.7	1.2	1.5	1.7	1.7	1.7
GDP deflator	-1.0	0.7	0.9	1.0	1.4	1.7	1.7	1.7
			(Percent of GDP, unless otherwise indicated)					
Balance of payments								
Current account	-1.1	-0.8	-0.7	-0.4	-0.3	-0.2	-0.1	0.0
Trade balance	-0.7	-0.5	-0.2	0.0	0.2	0.3	0.4	0.4
Export of goods and services	28.4	31.6	34.6	35.3	35.8	36.1	36.6	36.9
Export of goods	14.1	15.7	17.7	17.8	18.1	18.2	18.5	18.6
Exports of services	14.4	15.9	17.0	17.4	17.7	17.9	18.1	18.3
Imports of goods and services	29.1	32.2	34.8	35.3	35.6	35.9	36.2	36.5
Imports of goods	23.6	26.0	28.4	28.8	29.0	29.2	29.5	29.7
Imports of services	5.6	6.1	6.4	6.5	6.6	6.6	6.7	6.8
Primary income	0.0	0.1	-0.1	-0.1	-0.2	-0.3	-0.4	-0.3
Secondary income	-0.3	-0.3	-0.4	-0.2	-0.2	-0.2	-0.1	0.0
Net international investment position	-139.3	-140.9	-119.9	-115.8	-111.3	-107.1	-103.4	-103.7
Gross external debt	247.8	227.9	221.3	209.7	199.7	190.2	182.5	177.6
Private sector capital flows (net)	21.6	20.4	2.5	7.4	4.6	5.1	6.3	2.7
Public finances (general government) 2/								
Total revenues	50.2	49.0	48.7	47.1	46.4	45.8	45.0	45.0
Total expenditures	49.5	48.0	48.1	47.2	46.2	45.5	44.9	45.4
Primary expenditures	46.3	44.8	45.1	43.7	42.9	42.2	41.5	41.9
Primary balance	3.9	4.2	3.5	3.5	3.5	3.5	3.5	3.0
Cyclically-adjusted primary balance	9.1	8.0	6.2	5.2	4.3	3.9	3.6	3.0
Overall balance	0.7	1.1	0.5	-0.1	0.2	0.3	0.1	-0.4
Overall balance (excl. program adjustors)	0.6	0.8	...	...	...	...	...	...
Privatization receipts	0.2	0.7	0.6	0.6	0.2	0.0	0.1	0.0
Gross debt 3/	183.5	181.8	188.1	177.1	169.6	162.9	155.3	151.3

Sources: ELSTAT; Ministry of Finance; Bank of Greece; and IMF staff estimates.

1/ Based on Labor Force Survey.

2/ Based on program definitions outlined in the Technical Memorandum of Understanding of the Third Economic Adjustment Program.

3/ General government debt includes the stock of deferred interest.

Table 2. Greece: Summary of Balance of Payments, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
			Proj.					
				(Billions of euros)				
Current account balance	-1.9	-1.5	-1.2	-0.7	-0.5	-0.4	-0.2	0.0
Balance of goods and services	-1.3	-1.0	-0.3	-0.1	0.4	0.6	0.9	0.8
Goods balance	-16.6	-18.4	-19.7	-20.7	-21.4	-22.2	-23.0	-23.9
Exports	24.5	27.9	32.3	33.8	35.4	36.9	38.5	39.9
Imports	41.1	46.3	52.0	54.4	56.8	59.2	61.5	63.8
Services balance	15.3	17.4	19.3	20.6	21.7	22.8	23.9	24.7
Credit	25.0	28.3	31.1	33.0	34.8	36.3	37.8	39.3
Debit	9.7	10.9	11.7	12.4	13.0	13.5	14.0	14.5
Primary income balance	0.0	0.1	-0.2	-0.2	-0.4	-0.7	-0.9	-0.7
Credit	5.9	6.1	6.2	6.3	6.3	6.4	6.5	6.7
Debit	5.9	6.0	6.4	6.5	6.8	7.1	7.4	7.4
Secondary income balance	-0.6	-0.6	-0.7	-0.5	-0.5	-0.3	-0.2	-0.1
Capital account balance	1.0	0.9	1.4	1.1	1.3	1.6	1.6	1.5
Financial account balance	6.8	8.4	21.4	0.9	1.5	2.1	2.6	3.3
Direct investment	-4.2	-3.0	-3.1	-3.2	-3.2	-3.3	-3.4	-3.3
Portfolio investment	9.6	-18.6	-2.8	-2.9	-1.5	-1.7	-2.7	-1.5
Other investment	1.3	30.1	27.4	7.0	6.3	7.1	8.7	8.1
Net errors and omissions	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Reserves and related items	-7.7	-9.0	-21.3	-0.5	-0.7	-0.9	-1.3	-1.8
Reserve assets	0.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0
IMF credit and loans	-3.2	-0.7	-1.8	-2.1	-2.1	-2.1	-1.9	-1.3
Exceptional financing	11.4	9.9	23.0	2.6	2.7	2.9	3.2	3.2
				(Percent of GDP)				
Current account balance	-1.1	-0.8	-0.7	-0.4	-0.3	-0.2	-0.1	0.0
Balance on goods and services	-0.7	-0.5	-0.2	0.0	0.2	0.3	0.4	0.4
Goods balance	-9.5	-10.3	-10.7	-10.9	-10.9	-11.0	-11.0	-11.1
Services balance	8.8	9.8	10.6	10.9	11.1	11.3	11.4	11.5
Primary income balance	0.0	0.1	-0.1	-0.1	-0.2	-0.3	-0.4	-0.3
Secondary income balance	-0.3	-0.3	-0.4	-0.2	-0.2	-0.2	-0.1	0.0
Capital account balance	0.6	0.5	0.8	0.6	0.7	0.8	0.7	0.7
Financial account balance	3.9	4.7	11.7	0.5	0.8	1.0	1.3	1.5
Direct investment	-2.4	-1.7	-1.7	-1.7	-1.6	-1.6	-1.6	-1.5
Portfolio investment	5.5	-10.5	-1.5	-1.5	-0.8	-0.8	-1.3	-0.7
Other investment	0.7	16.9	14.9	3.7	3.2	3.5	4.2	3.8
Net errors and omissions	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Reserves and related items	-4.4	-5.1	-11.6	-0.3	-0.3	-0.4	-0.6	-0.8
Reserve assets	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
IMF credit and loans	-1.8	-0.4	-1.0	-1.1	-1.1	-1.0	-0.9	-0.6
Exceptional financing	6.5	5.6	12.6	1.4	1.4	1.4	1.5	1.5
Gross external debt	247.8	227.9	221.3	209.7	199.7	190.2	182.5	177.6
Public sector 1/	204.2	192.7	185.9	174.5	166.0	157.9	149.4	144.8
Private sector	43.7	35.2	35.4	35.2	33.7	32.3	33.1	32.8
Memorandum item:								
Current account balance in cash terms	-0.4	-0.2	-0.1	0.2	0.4	0.5	0.7	0.9

Sources: Bank of Greece; and IMF staff estimates.

1/ Includes debt of the monetary authority.

Table 3. Greece: General Government Operations, 2016–23 1/

	2016	2017	2018	2019	2020	2021	2022	2023
			Proj.					
	(Billions of euros)							
Revenue	87.5	87.2	89.1	89.2	90.9	92.7	93.9	96.5
Indirect taxes	30.4	30.7	31.0	31.2	31.6	32.1	32.6	33.4
Direct taxes	18.1	18.1	18.3	17.9	18.6	19.3	19.9	20.6
Social contributions	24.9	25.9	26.2	26.5	27.4	28.1	28.7	29.3
Other current revenue	5.5	4.4	3.9	3.3	3.4	3.5	3.4	3.5
Sales	5.5	5.5	5.8	6.0	6.0	5.9	5.9	6.1
Capital revenue	3.1	2.5	3.9	4.2	3.9	3.9	3.3	3.7
Primary expenditure	80.6	79.6	82.6	82.6	84.1	85.5	86.6	90.0
Social benefits	38.8	38.3	38.7	37.3	37.9	38.3	38.9	40.4
Subsidies	1.8	1.7	2.0	1.9	1.9	1.9	1.9	2.0
Other current expenditure	2.8	2.7	3.3	3.1	3.1	3.0	3.1	3.2
Compensation of employees	21.4	21.5	23.4	23.0	23.8	24.3	24.6	25.2
Intermediate consumption	9.0	8.9	8.6	9.1	9.2	9.7	9.9	10.5
Investment	6.0	5.2	5.9	7.3	7.3	7.2	7.2	7.7
Capital Transfers Payable	0.8	1.3	0.8	0.9	0.9	0.9	0.9	1.0
Primary balance	6.8	7.5	6.5	6.6	6.8	7.2	7.3	6.5
Interest	5.6	5.6	5.5	6.7	6.4	6.6	7.1	7.4
Overall balance	1.2	1.9	1.0	-0.1	0.4	0.6	0.2	-0.9
Overall balance (excl. program adjustors)	1.1	1.5	...	...	...	...	...	...
Gross debt (Maastricht) 2/	319.6	323.1	344.4	335.0	332.5	330.0	324.0	324.7
	(Percent of GDP)							
Total primary revenue	50.2	49.0	48.7	47.1	46.4	45.8	45.0	45.0
Indirect taxes	17.5	17.3	16.9	16.5	16.1	15.8	15.7	15.5
Direct taxes	10.4	10.2	10.0	9.5	9.5	9.5	9.6	9.6
Social contributions	14.3	14.6	14.3	14.0	14.0	13.9	13.7	13.6
Other current revenue	3.1	2.5	2.1	1.8	1.7	1.7	1.7	1.6
Sales	3.1	3.1	3.2	3.2	3.0	2.9	2.9	2.8
Capital revenue	1.8	1.4	2.1	2.2	2.0	1.9	1.6	1.7
Total primary expenditure	46.3	44.8	45.1	43.7	42.9	42.2	41.5	41.9
Social benefits	22.3	21.6	21.1	19.7	19.3	18.9	18.7	18.8
Subsidies	1.0	0.9	1.1	1.0	1.0	1.0	0.9	0.9
Other current expenditure	1.6	1.5	1.8	1.6	1.6	1.5	1.5	1.5
Compensation of employees	12.3	12.1	12.8	12.1	12.1	12.0	11.8	11.8
Intermediate consumption	5.1	5.0	4.7	4.8	4.7	4.8	4.8	4.9
Investment	3.5	3.0	3.2	3.8	3.7	3.6	3.5	3.6
Capital Transfers Payable	0.4	0.7	0.4	0.5	0.5	0.5	0.4	0.4
Primary balance	3.9	4.2	3.5	3.5	3.5	3.5	3.5	3.0
Interest	3.2	3.2	3.0	3.5	3.3	3.3	3.4	3.5
Overall balance	0.7	1.1	0.5	-0.1	0.2	0.3	0.1	-0.4
Overall balance (excl. program adjustors)	0.6	0.8	...	...	...	...	...	...
Gross debt (Maastricht) 2/	183.5	181.8	188.1	177.1	169.6	162.9	155.3	151.3
Nominal GDP (billions of euros)	174.2	177.7	183.1	189.2	196.0	202.6	208.6	214.6

Sources: Elstat; Ministry of Finance; and IMF staff estimates.
1/ Based on program definitions outlined in the Technical Memorandum of Understanding of the Third Economic Adjustment Program.
2/ General government debt includes the stock of deferred interest.

Table 4. Greece: Monetary Survey, 2012–17

	2012	2013	2014	2015	2016	2017
			(Billions of euros)			
Aggregated balance sheet of Monetary Financial Institutions (MFIs)						
Total assets	602.5	517.6	501.5	544.4	469.2	386.8
Cash (held by credit institutions)	2.5	2.0	1.9	1.7	1.8	1.8
Claims on Bank of Greece	3.1	4.0	3.5	1.7	0.9	2.0
Claims on other MFIs	170.7	107.3	86.2	134.1	86.1	50.4
Claims (Loans) on non MFIs	250.1	238.9	234.2	225.6	213.7	201.0
Domestic	244.8	233.8	229.7	221.0	209.2	197.6
General government	17.4	15.9	17.7	16.7	14.1	13.8
Other sectors	227.5	217.9	212.0	204.3	195.1	183.8
Other countries	5.2	5.2	4.5	4.6	4.5	3.4
Securities 1/	100.4	94.3	102.0	107.7	97.2	63.4
Other assets	70.6	66.0	69.1	68.9	64.9	63.4
Fixed assets	5.0	5.1	4.7	4.7	4.7	4.7
Total Liabilities	574.8	495.2	501.5	544.4	469.2	386.8
Liabilities to Bank of Greece	121.2	73.0	56.0	107.6	66.6	33.7
Liabilities to other MFIs	133.2	93.0	92.6	107.5	97.6	34.9
Deposits and repos of non MFIs	197.5	196.5	191.0	145.8	150.6	153.6
Domestic	179.1	182.6	177.2	139.2	142.4	147.0
Other countries	18.3	13.9	13.8	6.6	8.2	6.5
Capital and reserves	45.6	67.0	75.0	91.2	89.1	83.6
Banknotes and coins in circulation	24.3	25.4	27.9	29.6	30.7	30.9
Other liabilities	53.0	40.3	59.0	62.7	34.6	50.1
Money and credit						
Broad money	188.4	193.2	192.6	158.4	161.9	171.0
Credit to the private sector 2/	227.3	217.5	211.6	203.9	194.7	183.4
Credit to government	28.2	21.8	23.6	23.7	19.1	18.9
			(Annual percentage change)			
Broad money	-5.3	2.7	-0.3	-17.8	2.2	5.7
Domestic private sector deposits	-7.3	1.4	-2.4	-23.5	3.4	4.2
Credit to the private sector 2/	-4.0	-3.9	-3.9	-3.6	-4.5	-5.8
Credit to government	-7.9	-18.1	8.0	0.7	-19.7	-0.7
			(Percent of GDP)			
Broad money	98.5	107.0	108.0	90.0	93.0	96.5
Domestic deposits	93.6	101.1	99.3	79.1	81.9	83.0
Credit to the private sector 2/	118.8	120.5	118.6	115.9	112.0	103.5
Credit to government	14.8	12.1	13.2	13.5	11.0	10.7
Memorandum items:			(Percent)			
Capital to assets	3.3	6.9	7.7	9.2	9.2	11.2
Loans to customer deposits	110.5	108.9	109.3	138.3	131.2	127.1
Velocity	1.0	0.9	0.9	1.1	1.1	1.0

Sources: Bank of Greece; and IMF staff calculations.

1/ Holdings of securities other than shares and derivatives.

2/ Credit to domestic non-MFI residents by domestic MFIs excluding the Bank of Greece, including securitized loans and corporate bonds.

Table 5. Greece: Core Set of Financial Soundness Indicators (Deposit Taking Institutions), 2012–17 (Percent, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017			
						Mar.	June	Sep.	Dec
Core set									
Regulatory capital to risk-weighted assets 1/	10.0	13.6	14.1	16.4	17.0	16.8	17.2	17.2	17.0
Regulatory tier I capital to risk-weighted assets 1/	9.3	13.2	13.9	16.3	16.9	16.7	17.1	17.1	17.0
Nonperforming loans net of provisions to capital 2/	152.0	138.5	120.3	79.5	81.2	82.2	80.0	175.0	172.4
Nonperforming loans to total gross loans 2/	24.5	31.9	33.8	36.8	36.3	36.6	36.4	47.2	45.6
Bank provisions to nonperforming loans	49.1	49.3	55.8	67.6	68.9	68.6	68.4	49.1	48.6
Return on assets (after taxes)	...	...	-1.3	-2.5	0.1	0.0	0.0	0.0	-0.2
Return on equity (after taxes)	...	...	-14.1	-24.3	0.9	0.3	0.0	-0.3	-1.3
Interest margin to gross income	103.1	76.7	88.0	81.9	74.2	82.6	84.1	75.8	78.4
Non-interest expenses to gross income	93.9	76.3	64.8	56.0	45.3	48.8	49.4	55.7	59.5
Liquid assets to total assets 3/	32.1	29.9	28.9	29.7	27.0	26.0	24.6	21.5	17.7
Liquid assets to short-term liabilities 3/	41.9	40.0	40.1	40.4	36.3	34.9	33.5	29.7	24.3
Net open position in foreign exchange to capital 1/	15.7	5.3	5.4	5.6	0.8	-0.2	3.2	3.0	1.3
Encouraged set									
Spread between reference lending and deposit rates (end-of-period, basis points) 4/	7.1	7.0	6.2	5.9	5.6	5.5	5.4	5.3	5.3
Customer deposits to total (noninterbank) loans 3/	89.6	90.4	90.3	71.8	76.0	76.4	77.9	65.1	68.1
Foreign currency-denominated liabilities to total liabilities 3/	6.5	5.9	5.5	3.1	3.5	3.7	3.8	4.0	4.3
Market liquidity									
Average bid-ask spread in the securities market (basis points)	193.0	185.0	157.0	173.0	149.0	115.0	107.0	103.0	100.0
Households									
Household debt to GDP	63.7	64.5	63.0	62.3	60.2	57.6	58.7	58.1	57.0
Real estate markets									
Residential real estate loans to total loans 3/	25.5	26.4	26.8	27.6	27.2	27.7	27.8	29.0	29.1
Memorandum items:									
Assets (billions of euros)									
Banks	389.7	383.0	375.0	367.8	342.2	332.3	323.8	306.3	292.2
Branches of foreign banks	39.1	10.8	9.1	5.8	5.9	5.4	5.5	5.5	5.3
General insurance companies 5/	15.6	16.2	16.3	16.6	15.9	16.1	16.4	16.4	16.9
Other credit institutions	12.6	12.9	13.0	12.0	3.2	3.2	3.2	3.2	3.3
Deposits (billions of euros)									
Banks	164.0	177.2	174.3	128.7	134.6	133.0	134.1	135.9	138.7
Branches of foreign banks	18.1	3.5	2.5	2.8	3.6	3.5	3.5	3.5	3.4

Source: Bank of Greece.

1/ Data on a consolidated basis. For 2012 CAR ratios are affected by the PSI and include only the first tranche of €18 billion HFSF recapitalization. In addittion, CAR ratios are affected by the negative supervisory own funds of two banks (ATEbank and TT Hellenic Post Bank).
2/ Until June 2017 loans were classified as nonperforming when (1) payments of principal and interest are past due by 90 days or more, or (2) interest payments equal to 90 days or more have been capitalized (reinvested in to the principal amount, refinanced, or rolled over), or (3) payments less than 90 days past due that are recognized as nonperforming under the national supervisory guidance. Since September 2017 and onwards, nonperforming loans are calculated on consolidated basis and, in line with the EBA Guidance Note, also include restructured NPLs or exposures that are unlikely to be repaid on the basis of qualitative criteria.
3/ On an aggregate resident-based approach (i.e. commercial banks, cooperative banks, and foreign branches).
4/ Spread between rate on credit lines and savings deposit rate.
5/ There are no specialised life insurance companies in Greece. General insurance companies offer general insurance and life insurance products.

Table 6. Greece: General Government Financing Requirements and Sources, 2017–23

(Billions of euros)

	2017	2018	2019	2020	2021	2022	2023
	Act.			Proj.			
Gross borrowing need	25.8	39.0	15.7	15.6	15.7	16.4	24.8
Overall balance	-2.0	-2.1	-1.0	-1.7	-2.0	-1.9	-1.1
Primary deficit	-7.5	-6.5	-6.6	-6.8	-7.2	-7.3	-6.5
Interest payments (cash)	5.5	4.4	5.5	5.1	5.1	5.4	5.4
Amortization	28.5	18.9	26.1	19.4	19.7	24.2	26.1
Short-term (T-bills)	14.3	14.3	14.3	14.3	14.3	14.3	14.3
Medium and long-term (non-official)	11.4	2.8	9.7	2.3	1.0	5.3	5.9
ECB holdings	5.3	1.9	5.8	1.4	0.0	1.3	0.0
Official creditors	2.7	1.8	2.1	2.8	4.4	4.6	5.8
IMF	0.7	1.8	2.1	2.1	2.1	1.9	1.3
GLF/EFSF/ESM	2.0	0.0	0.0	0.7	2.3	2.6	4.5
Other	-0.6	22.2	-9.4	-2.1	-1.9	-5.9	-0.1
Arrears clearance	3.0	4.0	0.0	0.0	0.0	0.0	0.0
Privatization	-3.3	-1.2	-1.1	-0.5	-0.1	-0.1	-0.1
o/w CoCo repayment	-2.0	0.0	0.0	0.0	0.0	0.0	0.0
ECB related income (SMP/ANFA)	-0.3	-0.3	-1.5	-1.4	-1.4	-1.3	-0.1
Cash buffer: replenishment (+) / drawdown (-)	2.1	19.7	-6.9	-0.3	-0.5	-4.5	0.0
Gross financing sources	25.8	39.0	15.7	15.6	15.7	16.4	24.8
Market access	17.3	17.3	15.7	15.5	15.7	16.4	24.8
Short-term (T-bills)	14.3	14.3	14.3	14.3	14.3	14.3	14.3
Medium and long-term	3.0	3.0	1.3	1.2	1.4	2.1	10.5
Official financing	8.5	21.7	0.0	0.0	0.0	0.0	0.0
ESM 1/	8.5	21.7	0.0	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo item:							
Deposit stock 2/	21.4	41.1	34.2	33.9	33.4	28.9	28.9

Sources: Ministry of Finance; and IMF staff projections.

1/ Includes committed disbursements of €15 billion in Q3 2018.

2/ The total stock of general government deposits consists of the stock of state government deposits (€16.4 billion) and general government entities' deposits (€14.2 billion) in the BOG and commercial banks as of end-May 2018.

Table 7. Greece: External Financing Requirements and Sources, 2017–23
(Billions of euros, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023
				Proj.			
Gross financing requirements	158.1	114.3	100.0	92.1	90.3	91.6	91.2
Current account deficit	1.5	1.2	0.7	0.5	0.4	0.2	0.0
Medium and long-term debt amortization	16.6	7.7	15.1	8.3	8.6	13.1	15.0
Public sector	13.4	4.6	11.8	5.1	5.4	9.9	11.7
Of which: GLF/EFSF/ESM/IMF	2.7	1.8	2.1	2.8	4.4	4.6	5.8
Banks	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Other	1.6	1.6	1.7	1.7	1.7	1.7	1.7
Short-term debt amortization	140.0	105.4	84.2	83.3	81.3	78.2	76.2
Public sector and Bank of Greece	87.3	70.6	48.2	47.3	45.1	41.9	39.8
Bank of Greece 1/	85.7	64.4	40.6	38.2	35.3	31.4	28.6
Public sector	1.6	6.2	7.6	9.1	9.8	10.5	11.2
Banks 2/	45.5	27.6	29.1	29.6	30.0	30.4	30.8
Other	7.2	7.2	6.9	6.5	6.2	5.9	5.6
Source of financing	148.2	91.3	97.4	89.4	87.4	88.4	88.1
Capital account (net)	0.9	1.4	1.1	1.3	1.6	1.6	1.5
Foreign direct investment (net)	3.0	3.1	3.2	3.2	3.3	3.4	3.3
Equities (net)	-4.3	-3.0	-1.5	-1.5	-1.5	-1.5	-1.5
Assets drawdown (- increase)	40.0	-1.8	6.1	0.4	2.9	3.2	-4.2
Bank of Greece	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Banks	3.9	0.0	-0.6	11.4	11.3	19.3	20.0
Other sector	-43.6	2.0	-5.3	-11.5	-14.0	-22.3	-15.5
New borrowing and debt rollover	108.5	91.6	88.5	86.0	81.1	81.8	89.0
Medium and long-term borrowing	6.2	7.4	5.2	4.7	2.9	5.6	14.2
Public sector	2.8	2.8	-0.1	-0.2	0.0	0.6	9.4
Banks	2.7	3.1	3.2	3.3	3.2	3.3	3.2
Other	0.7	1.6	2.1	1.6	-0.3	1.7	1.7
Short-term borrowing	102.3	84.2	83.3	81.3	78.2	76.2	74.7
Public sector and Bank of Greece	54.3	48.2	47.3	45.1	41.9	39.8	38.2
Bank of Greece 1/	52.7	40.6	38.2	35.3	31.4	28.6	26.3
Public sector 3/	1.6	7.6	9.1	9.8	10.5	11.2	11.9
Banks 2/	41.2	29.1	29.6	30.0	30.4	30.8	31.2
Other	6.8	6.9	6.5	6.2	5.9	5.6	5.3
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	9.9	23.0	2.6	2.7	2.9	3.2	3.2
Of which: interest deferral	1.1	1.1	1.1	1.3	1.5	1.7	2.0

Sources: Bank of Greece; and IMF staff estimates.

1/ Includes liabilities to Eurosystem related to TARGET.

2/ Includes currency and deposits and securitized loans.

3/ Includes government deposits' build-up (regardless of currency denomination for presentational purposes).

Annex I. Implementation of Past IMF Recommendations

During the 2016 Article IV consultation (concluded in February 2017), staff urged a fiscally neutral rebalancing of the policy mix and comprehensive reforms in financial, labor, and product markets to achieve sustainable and more equitable growth, while regaining competitiveness within the currency union. In the context of the July 2017 SBA-AIP, the authorities set out reform measures to be implemented through August 2018—broadly in line with staff's earlier recommendations—and approved legislation (the 'pre-legislated package') with fiscal rebalancing measures to be implemented in 2019 and 2020. The full implementation of these measures would help create the conditions for investment and more inclusive growth. However, key labor market reforms are legislated to be reversed in 2H2018, which will weigh on the recovery of private sector investment and job creation.

Annex I. Box 1. Implementation of Policies under the July 2017 SBA–AIP

The SBA-AIP reform goals were modest: stabilize the economy and provide room to build consensus for a more ambitious reform agenda. The economic adjustment program included 21 Structural Benchmarks (SB) to help improve fiscal sustainability, financial stability, and competitiveness of the Greek economy. These policy commitments were closely aligned with the conditionality of the 2015–2018 ESM program.

Implementation of structural reforms was mixed. Following approval of the SBA-AIP, satisfactory progress was made in the financial sector, but implementation delays were encountered in the fiscal structural and labor/product market reform areas. Some reforms that were implemented were subsequently weakened (e.g., closed professions and public administration). Over the past year, the timelines for SB implementation were updated in discussions with the authorities (while remaining consistent with the SBA-AIP objectives), along with some technical modifications to reflect additional information on implementation capacity (based on TA findings), while preserving the SBA-AIP objectives. As of end-May, 12 structural measures under the SBA-AIP remained outstanding, in various stages of implementation.

While a Fund arrangement is no longer expected, staff anticipates that many of the SBA-AIP benchmarks will be completed before end-August. Most are closely intertwined with the ESM program objectives (and reflected in the Supplemental MoU with the European Institutions). However, in a few areas, notably liberalization of closed professions and enabling the legal environment for HR reforms to the revenue administration agency, staff could not reach understandings with the authorities on modified measures, and therefore are not expected to be completed.

Quantitative performance was broadly on track. The Quantitative Performance Criteria (QPC) set under the SBA-AIP were mostly met, frequently with a comfortable margin, except that the QPC floors on intermediate spending at end-September and end-December 2017 were missed by a small margin (0.1–0.2 percent of GDP). The QPCs for 2018 were subsequently revised to reflect stronger fiscal projections than anticipated, and fiscal developments in the first quarter of 2018 were broadly in line with the revised QPCs.

Annex I. Box 2. Implementation of 2016 Article IV Recommendations

Recommendations	Policy Actions
Fiscal Policy	
Maintain a neutral fiscal stance over the medium term with the primary balance at 1.5 percent of GDP.	The authorities significantly overperformed their 2017 target of 1.75 percent of GDP in large part due to lower than expected expenditure on investment and social benefits, which weighed on growth. The authorities expect to meet their 2018 target, and are committed to a primary balance target of 3.5 percent of GDP during 2019–2022.
Rebalance the fiscal policy mix, by broadening tax the base and rationalizing pension spending. This will create room for tax rate cuts and more targeted social assistance, and in turn create the conditions for investment and more inclusive growth.	The authorities approved legislation to cut pensions and reduce the personal income tax credit threshold, to be implemented in 2019 and 2020, respectively. Each of these measures is expected to generate net fiscal savings of 1 percent of GDP, which will be used to lower corporate, personal, and property tax rates and finance new investment, ALMPs, and social protection programs to the extent that they are consistent with achieving the medium-term primary balance targets.
Continue fiscal structural reforms to address tax evasion and the large tax debt owed to the State.	The authorities established a new independent revenue agency in January 2017. Policy actions have been taken to improve the automated risk analysis and audit case selection system. An out-of-court debt restructuring scheme was legislated (but has yet to be fully implemented) for restructuring of tax and social contribution debt for viable taxpayers.
Financial Sector Policies	
Reduce NPLs, strengthen and implement fully the debt restructuring legal framework, and enhance supervisory tools.	NPE targets have been broadly met, but they have been unambitious and banks have relied on write-offs. Important legal reforms (including launch of e-auctions and OCW) were implemented, but the direct impact in terms of absolute NPE reduction has so far has been modest.
Strengthen bank governance and eliminate CFMs as soon as prudently possible.	Governance improvement roadmaps were developed in 2017, and some important changes were implemented. In May 2017, the authorities have adopted a roadmap for relaxation of the CFMs. Several liberalization steps have been implemented since the imposition of CFMs in June 2015. However, cash withdrawals and transfers abroad continue to be subject to some limits, which may impede normal business activities.

Structural Reforms	
Preserve earlier labor market reforms that improved market flexibility.	The authorities have reversed the policy by legislating the reinstatement of extension and favorability (and will take effect at the end of the ESM program).
Complement reforms already in place with additional measures to bring Greece's collective dismissals and industrial relations frameworks in line with international best practice.	The authorities undertook some reforms, including removal of the requirement for pre-approval for collective dismissals. However, important restrictions remain, such as low thresholds for collective dismissal and prohibition of defensive lockouts.
Accelerate the implementation of product and service market reforms and privatizations.	In general, the product market reform is progressing, though some measures (e.g. on Sunday trade and building materials) have been diluted or remain to be implemented. Progress on liberalizing closed professions is uneven, and despite increasing privatization revenues, key projects (e.g., Hellenikon) face significant challenges.

Annex II. The Greek Authorities' Growth Strategy

1. The Greek authorities recently produced a new growth strategy. It aims to balance domestic social pressures with creditor expectations and the need to remain competitive inside the Euro Area. The strategy represents an important effort at planning and consultation, and correctly puts focus on moving towards a more productive outward-oriented economy and providing essential social safety nets.

2. The strategy's objectives include higher R&D, more infrastructure investment supportive of the tradable goods sector, and a more efficient and targeted social welfare system. While the strategy is a high-level description of the government's agenda and vision, more detail would be needed to fully develop its potential in providing a roadmap to achieve higher sustainable growth. In particular, the strategy:

- *Would benefit from better diagnostics and assessment of current policies and ongoing reforms*, as well as further efforts to identify remaining policy gaps. For example, further steps to liberalize closed professions and foster competition are vague or absent.

- *Envisages a less flexible labor market by rolling back the 2011 suspension of labor contract extensions and favorability principles*. This will reduce labor market flexibility, risk disconnect between productivity and wages, and endanger jobs. The strategy also proposes an unspecified increase in the minimum wage.

- *Outlines several objectives that are laudable, but needs concrete reform proposals that are feasible and take due account of relevant interlinkages*. For instance, it is unclear how the important objective to increase youth employment is consistent with the call to increase the minimum wage, when unemployment is still very high. Similarly, a more detailed discussion on the funding plans for an expanded social welfare system is recommended.

- *Could be used as an opportunity to discuss a much-needed shift to a more growth friendly fiscal policy mix*. High marginal tax rates and expenditure compression on social and growth-supporting measures finance still high pension expenditures and make up for tax arrears. While a reduction of tax rates would be important for employment and investment, no details are given beyond a commitment to fight tax evasion on how to move to a growth friendly policy mix whilst adhering to the post-program primary balance targets.

- *Should focus its proposals in the financial sector more on further bank balance sheet repair.* The strategy instead hints at a national asset management company, using cooperative banks "to contribute to the real economy by financing SMEs," and using public funds (possibly through a new development bank) to support SMEs, cooperative and social enterprises, business start-ups and local communities. There are financial and fiscal risks in these proposals, and little evidence presented of any productivity benefits.

Annex III. Progress on Relaxation of Capital Flow Management Measures

1. In May 2017, the authorities published a conditions-based roadmap for the liberalization of capital flow management measures (CFMs). Restrictions to prevent the rapid decline of bank assets and liabilities (such as a ban on early loan repayment and on early redemption of time deposits) were abandoned in 2015–16 following bank recapitalization and completion of the 1st review of the ESM program. Therefore, the roadmap focused on the CFMs that were still in place; including provisions related to cash withdrawals and opening of new accounts (Pilar II), and to capital transfers abroad (Pillar III). The document describes milestones (including progress in the normalization of the banking sector, economic conditions, and implementation of the adjustment program) that set conditions for the implementation of relaxation steps. Liberalization steps, even within the same stage, may be implemented gradually, taking into account developments in the economic environment, and depending on the potential impact of the relaxation steps on banks' liquidity and depositor confidence. The roadmap envisages that CFMs related to the outflow of funds abroad would be the last part of the controls to be abolished, given that their relaxation is closely connected to the reopening of the financial markets for the country.

2. Recovery of economic activity and progress under the ESM program allowed for further relaxation steps but the pace of liberalization was slower than expected by the staff. Since July 2017, economic performance has improved in a number of sectors and GDP growth returned to positive territory the 3rd and 4th reviews under the ESM program were completed, and agreement on further debt relief was reached. More broadly, confidence continued to improve, and the banks and the government were able to access (repeatedly) international capital markets. Banknotes in circulation continued their declining trend, while use of electronic payments increased substantially. However, banks' liquidity positions remained tight despite stabilization of deposit flows and reduced use of ELA. Deposits and capital flows remained sensitive to any deterioration of confidence and risks of capital flight remained elevated. In this context, only minor changes to the CFM framework were made in the second half of 2017, but more aggressive actions were implemented in the last few months. Limits on cash withdrawals were increased substantially, restrictions on opening of new accounts were eliminated, and restrictions on transfers abroad were relaxed.

Greece: Evolution of Capital Flow Management (CFM) Measures in 2015–18 1/

	Type of restrictions	CFM introduced June - July 2015	Roadmap published May-17	Current status Jul-18
Pillar I	**Early loan repayment**	Allowed only if made through transfer from abroad or in cash.	Early repayment of loans allowed.	
	Early redemption of time deposits	Allowed only under specific circumstances.	Early redemption of time deposits allowed.	
Pillar II	**Cash withdrawals**	€60 daily limit and a cumulative €420 weekly limit per depositor 2/.	€840 bi-weekly limit per depositor.	€5,000 monthly limit per depositor.
			30% of funds credited from abroad.	100% of funds credited from abroad.
			100% of funds credited in cash.	
	New accounts/ Customer IDs 2/	Permitted in certain cases for selected groups of individuals and companies.	Permitted for a wider set of cases /groups; new Customer ID allowed if no other accounts available.	Permitted for everyone (companies / individuals).
Pillar III	**Transfers abroad for general purposes**	Not permitted (some exceptions applied).	€1,000 monthly limit per customer, up to an aggregate monthly ceiling for all banks and sub-allocated by bank.	€4,000 over two months per customer, up to an aggregate monthly ceiling for all banks and sub-allocated by bank.
	Individuals' physical transfer of funds abroad	Not permitted (some exceptions applied). 3/	€2,000 per person per travel abroad.	€3,000 per person per travel abroad.
	Business transfer for normal business activity of funds abroad subject to:			
	-BTAC's approval 4/	€100K per working day.	Over €350K per customer per day.	Over €700K per customer per day.
	-bank subcommitees' approval	Not applicable.	Up to €350K per customer per day; weekly limit per bank.	Up to €700K per customer per day; weekly limit per bank.
	-bank branches' approval	Not applicable.	Up to €10K per customer per day; weekly limit per bank.	Up to €40K per customer per day; weekly limit per bank.

1/ The table covers main elements of the framework only and does not include all applicable exceptions. Color of the cells schematically indicates the degree of CFMs tightness from 'dark orange' (reflecting the status when such measures were introduced) to 'light orange (partial liberalization compared to initiation) and 'green' (full relaxation).
2/ Restrictions set per depositor /customer are based the definition on of a *Customer ID* , which is a unique identification number given to every customer holding an account with a bank, and is used across all branches of the same bank.
3/ Transfers limited to €2,000 per person per travel abroad were allowed already in July 2015.
4/ BTAC stands for Bank Transactions Approval Committee.

Annex IV. External Sector Assessment

A. Overall Assessment

The external position of Greece in 2017 was moderately weaker than consistent with medium-term fundamentals and desirable policies. Despite a significant output gap, the current account (CA) balance remains negative. The CA deficit narrowed marginally in 2017 due to strong performance of exports (including a continued boom in the tourism sector). It is expected to remain close to balance over the medium term provided the envisaged reforms to further improve competitiveness in the long-run materialize. This will allow a gradual improvement in the net international investment position (NIIP), though it will remain large and negative for many years, reflecting a large stock of external public-sector debt.

B. Potential Policy Responses

Greece requires sustained increases in productivity to remain competitive within the Euro Area. To this end, structural reform efforts need to continue. Gradual liberalization of capital flow management measures should continue in a prudent, conditions-based manner.

Foreign asset and liability position and trajectory	**Background.** Greece's NIIP has been deteriorating steadily since 2001, reaching a historical low of minus 141 percent of GDP in 2017. The official sector accounts for around three quarters of external liabilities (with about 15 percent due to the central bank and the rest due to the general government). Given marginal CA deficits over the medium term, the IIP is projected to recover due to normalization of TARGET2 imbalances. **Assessment.** The large negative NIIP is due to official sector liabilities to official creditors, which, although extended at concessional terms, constitute an external vulnerability due to significant gross financing needs that will arise as this debt is expected to be refinanced by the private sector.
Current account	**Background.** The CA deficit in 2017 stood at 0.8 percent of GDP, improving marginally due strong exports (including a continued boom in the tourism sector). The deficit is projected to narrow in the medium-term with the CA returning to balance by 2023, supported by improvements in both trade and income balances. **Assessment.** The cyclically-adjusted CA balance is estimated at -3.7 percent of GDP, compared to the EBA norm of -1.6 percent. Staff assesses the CA gap in the range of (-2.4; -1.4) percent with a mid-point estimate of -1.9 percent. This is 0.3 percent of GDP lower than the implied EBA CA gap, and reflects adjustments to the underlying CA given large uncertainty around the output gap estimates (particularly the significant risk of that the output gap is narrower). The assessment is consistent with that of the external sustainability approach, which implies a CA norm of -2.2 percent of GDP, and would allow a gradual reduction of NIIP over the medium term (from -141 to about -100 percent of GDP over a six-year period). Staff assesses Greece's external position in 2017 as moderately weaker than one consistent with medium-term fundamentals and desirable policies.
Real exchange rate	**Background.** HICP-deflated real exchange rate (REER) came down from its peak in 2009 by around 18.1 percent. It has trended up since 2015 (by 3.8 percent), on the back of rising, though still weak, inflation. ULC-deflated REER [/1] fell by 36 percent from its peak in 2009 and 21 percent since the labor market reform aiming to make wage bargaining more

	flexible took effect in 2012. Since 2015 it has remained broadly stable. Marginal REER appreciation in 2017 reflected a spike in Greek inflation driven by tax hike and oil prices. **Assessment.** The REER index and level regression models indicate substantial overvaluation of 12.6 and 18.8 percent respectively, EBA CA model indicates a gap of 8 percent. However, the results are driven primarily by a large residual, and the standard error of norm is large (for the index model). Given the significant adjustment in unit labor costs, and the fact that marginal appreciation of CPI-based REER was affected by consumption tax increased in 2016 and 2017, staff believes that the REER models are overestimating the overvaluation. On balance, consistent with the staff-assessed CA gap and a semi-elasticity of 0.28, the REER gap is assessed to lie between 5 and 9 percent, with a mid-point overvaluation of 7 percent.
Capital and financial accounts: flows and policy measures	**Background.** Greece's financial account has been dominated by official financing flows. Net FDI inflows increased in last couple of years driven by privatization deals and M&A activity in the financial sector. Greece continues to maintain CFMs and payment restrictions, although they have been gradually relaxed. Financing conditions have eased somewhat with the Greek government successfully accessing the markets three times since July 2017. Following successful Greek government's issuances, Greek banks and corporates also issued bonds in 2017 and early 2018 after a three-year hiatus. **Assessment.** CFMs should be removed based on the milestone-based roadmap and gradual normalization of financial conditions (e.g. continuing return of deposits and progress in reducing non-performing loans). A steady improvement in the business climate, not least due to continued effort on structural reforms, and reduction in uncertainty, is needed to bring in more FDI and expand access to external funding markets.
FX intervention and reserves level	**Background.** The euro has the status of a global reserve currency. **Assessment.** Reserves held by the Euro Area are typically low relative to the standard metrics, but the currency is free floating.
1/ This rate is what the ECB refers to as "harmonized competitiveness indicators", which also considers the intra-Euro Area trade.	

Annex V. Debt Sustainability Analysis (DSA)

The debt relief recently agreed with Greece's European partners[1] (Box AV-1) has significantly improved debt sustainability over the medium term, but longer-term prospects remain uncertain. The extension of EFSF maturities by 10 years and other debt relief measures, combined with a large cash buffer, should secure a steady reduction in debt and gross financing needs as a percent of GDP over the medium term and thereby improve the prospects for Greece to sustain access to market financing over this period, although risks remain. Staff is concerned, however, that this improvement in debt indicators can only be sustained over the long run under what appear to be very ambitious assumptions about GDP growth and Greece's ability to run large primary fiscal surpluses, suggesting that it could be difficult to sustain market access over the longer run without further debt relief. In this regard, staff welcomes the undertaking of European partners to provide additional relief if needed, but believe that it is critically important that any such additional relief be contingent on realistic assumptions, in particular about Greece's ability to sustain exceptionally high primary surpluses.[2]

A. Public Sector DSA

Annex V. Box 1. 2018 Debt Relief Package for Greece

- A 10-year deferral and 10-year weighted average maturity (WAM) extension of non-PSI EFSF loans, entailing zero payments of non-PSI EFSF through 2032 (the WAM has increased to 42.5 years).
- A €3.3 billion additional disbursement, aimed at mitigating refinancing risks. These funds would be used to increase the state government cash buffer to about €24 billion (and come on top of the final disbursement in the context of the ESM program of €11.7 billion—for a total of €15 billion).
- Abolishing the step-up interest rate margin on the EFSF debt buy-back tranche for 2018 onwards
- Returning ANFA/SMP profits over 2019–2022 (around €5 billion). However, these profits may also be used to finance investments rather than reducing financing needs, in which case this measure will not be considered debt relief.
- A general commitment by European partners to a future review (in 2032) of Greece's debt sustainability and provide additional debt relief measures if needed, but only if policies stay on track.

1. **The public sector DSA is based on a Gross Financing Needs (GFN) framework.** The rationale for this approach (rather than debt-to-GDP) is that most Greek public-sector debt consists of lower interest, longer term official sector obligations (see IMF Country Report 17/229 for further discussion). This debt mix also calls for examining sustainability over a longer period (beyond the usual 5- to 10-year DSA horizon). A key question is whether long-term debt dynamics are sustainable, specifically whether the debt-reducing effects of growth and primary surpluses can overcome the expected rise in average interest rates, given the transition towards higher cost market

[1] For the debt relief to become effective, required amendments of the underlying debt contracts need to be executed by various parties, including Greece and the EFSF/ESM.

[2] External debt, discussed below, is high and expected to decline only gradually over the medium term; macroeconomic shocks and policy slippages could result in adverse dynamics.

financing. The discussion below assesses sustainability under the debt relief package under different macroeconomic assumptions, and discusses risks.

2. **With the agreed debt relief package, medium-term refinancing risks and debt trends under the IMF's baseline scenario appear manageable.** While the IMF's 10-year DSA assessment signals significant risks to sustainability, including from weaker growth, lower primary balances or the materialization of contingent liabilities[3] (see DSA tables and figures including stress scenarios), in the baseline scenario debt-to-GDP nonetheless trends down and GFN remains below 15 percent of GDP in all years except for 2018 (due to a larger ESM disbursement for cash buffer purposes). If markets share this assessment, and other risks do not materialize (see Greece's RAM, Annex VII), the debt relief package should allow Greece to successfully tap markets over the medium-term. The state government's financing needs will also be lowered over the next four years given agreement with the ESM to draw down a €24 billion cash buffer (reaching €12 billion as of end-2022).[4] This assessment assumes that a €14 billion short-term debt (T-bills) will continue to be rolled over smoothly, and no further state-funded recapitalization or other funding needs tied to banks.

3. **However, staff has reservations about whether the specific components of the package will be sufficient to safeguard long-run market access.** A central concern in this regard is that Greece's impressive fiscal adjustment to date has been achieved via a growth unfriendly policy mix and that a significant change in this mix is required for Greece to achieve sustained and robust economic growth over the long-run. Specifically, the severe compression of capital and other discretionary spending and the increase in already high tax rates need to be at least partially reversed, which will require Greece to cut unsustainably high pension expenditures significantly and substantially broaden its very narrow tax base. In view of Greece's very large structural unemployment and weak policy-making institutions, staff believes that it will be difficult to undertake such politically difficult changes while at the same time maintaining exceptionally high primary surpluses for a very extended period. Although developments in recent years have shown that Greece is able to run large surpluses if required to do so, they have also shown that this takes a heavy toll on growth.[5]

4. **The contrasting long-term assessments of the staff and the European Institutions can be summarized as follows** (see Annex VI for further explanation of staff's views on long-run primary balance and growth):

[3] For example, liabilities could stem from a conversion of banks' DTCs, with such risk higher under the weaker growth scenario.

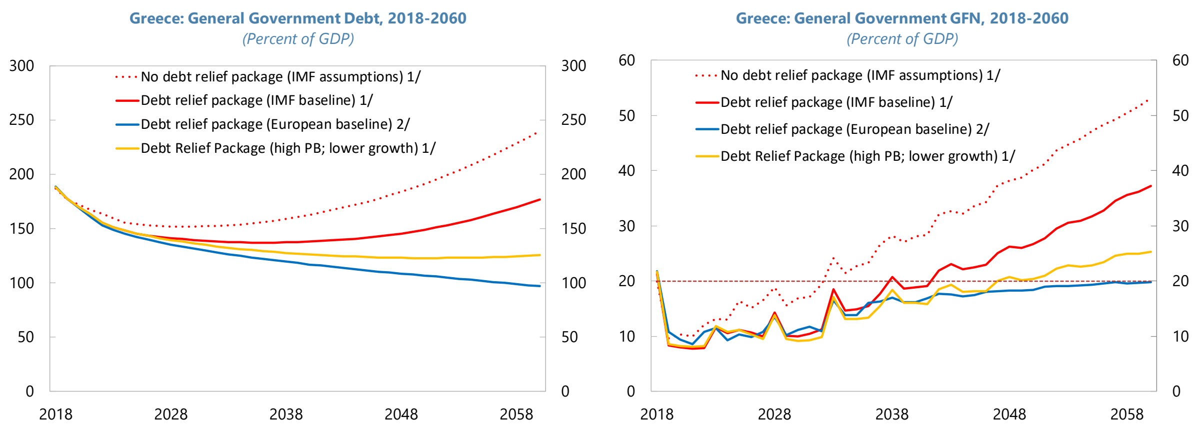
[4] The €12 billion cash buffer of the state government in 2022 would cover only six months of next year's GFN. Financing needs of the state government could be manageable for a longer period once deposits of general government entities are fully integrated into the Treasury Single Account.

[5] To illustrate this concern, staff presents an illustrative 'high primary surplus, lower growth' scenario, in which Greece achieves a higher long-term primary balance (2.2 percent of GDP) than under staff's long-term assumptions, but at the cost of lower nominal growth (2.7 percent). Under these assumptions, debt and GFN would initially fall in relation to GDP, but then follow an explosive path over the longer term.

- **IMF baseline.** Staff has long argued that Greece can reasonably be expected to sustain a long-run primary surplus of no more than 1.5 percent of GDP and annual real GDP growth of around 1 percent, and that even achieving these outcomes will require Greece to undertake profound structural reform over time.[6] Under these and other assumptions (Table AV-1 and Box AV-2), staff assesses that the specific components of the debt relief package are not sufficient to secure long-run debt sustainability (Figures AV-1 and AV-2). Debt-to-GDP would initially fall, but then begin an uninterrupted rise from around 2038. GFN would breach the 20 percent of GDP threshold by 2038 and continue rising thereafter.[7] Therefore, additional relief would be needed to secure debt sustainability.

- **European Institutions' baseline.** In contrast, the European Institutions believe that Greece can and should maintain a long-run primary surplus of 2.2 percent of GDP (on average), while at the same time achieving long-run nominal annual GDP growth of 3 percent. Under such assumptions, the agreed debt relief package will indeed secure a long-run downward debt path, with GFN within the 20 percent threshold, and additional relief would not be necessary.

Annex V. Figure 1. Greece Debt Sustainability



1/ IMF staff estimates.

2/ ESM staff estimates.

5. While staff acknowledges that long-term assumptions are subject to high uncertainty, concerns remain that the commitment to provide additional relief if needed may not be sufficient to safeguard long-term sustainability. Given high uncertainty about the long-term assumptions, the commitment to provide additional relief, contingent on a future reassessment of the outlook, could act as a safeguard against the risks identified above. Indeed, the unprecedented financing and debt relief provided by Greece's European partners to date lends considerable credibility to such a future commitment on the part of Member States. At the same time, however,

[6] Together with staff's 1.8 percent projection of the GDP deflator growth, the nominal GDP annual long-term growth projection is 2.8 percent.

[7] Figure AV-1 also shows a 'no debt relief (IMF assumptions) scenario, for purposes of assessing the impact of the debt relief package. It also shows that debt-to-GDP would start rising from 2033 with GFN breaching the 20 percent threshold in the same year.

past implementation problems by successive Greek Governments, and the possibility of political changes in Member States that could reduce the commitment to support Greece in the future, could weigh on investor sentiment, especially as the time when the GFN is set to increase draws closer. In this context, staff is particularly concerned that the commitment to provide additional relief is contingent on Greece's adherence to a very ambitious primary surplus path. This in turn suggests that the commitment to provide additional relief if needed may be insufficient to mitigate the long-term risks, and that Greece, therefore, could struggle to maintain market access over the long run.

Annex V. Table 1. Greece Debt Sustainability Analysis: Macroeconomic Assumptions

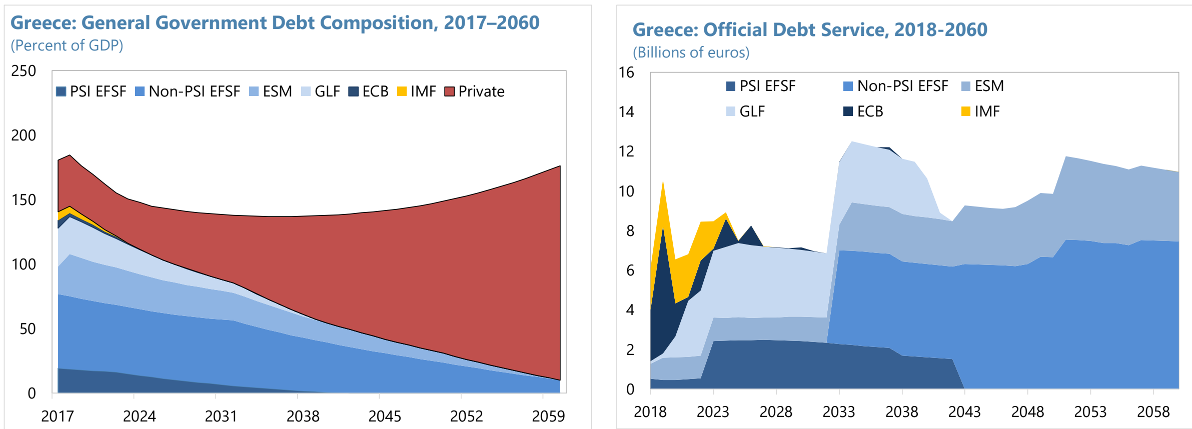
	2018	2019	2020	2023	2027	2030	2040	2050	2060	Average 2018-2060	Average 2023-2060
Nominal growth											
IMF baseline 1/	3.0	3.3	3.6	2.9	2.8	2.8	2.8	2.8	2.8	2.9	2.8
European baseline 2/	2.8	3.6	3.9	3.0	3.0	3.0	3.0	3.0	3.0	3.1	3.0
High PB; lower growth 1/	3.0	3.3	3.6	2.9	2.7	2.7	2.7	2.7	2.7	2.8	2.7
Primary balance											
IMF baseline 1/	3.5	3.5	3.5	3.0	1.5	1.5	1.5	1.5	1.5	1.8	1.6
European baseline 2/	3.5	3.5	3.5	3.0	2.2	2.2	2.2	2.2	2.2	2.4	2.2
High PB; lower growth 1/	3.5	3.5	3.5	3.0	2.2	2.2	2.2	2.2	2.2	2.4	2.2
Privatization (below the line) under all scenarios (total: €5.7bn) 3/	1.2	1.1	0.5	0.1	0.3	0.3	0.0	0.0	0.0		
EFSF interest rate											
IMF baseline 1/	1.4	1.4	1.3	1.8	2.7	3.1	3.3	3.3	3.3	2.9	3.1
European baseline 2/	1.4	1.4	1.3	1.8	2.7	3.1	3.1	3.1	3.1	2.8	3.0
High PB; lower growth 1/	1.4	1.4	1.3	1.8	2.7	3.1	3.3	3.3	3.3	2.9	3.1
Market interest rates											
IMF baseline 1/	4.5	5.3	5.5	5.8	5.7	5.6	5.6	5.9	6.0	5.7	5.7
European baseline 2/	3.2	4.1	4.3	5.0	5.2	5.2	4.8	4.5	4.2	4.7	4.8
High PB; lower growth 1/	4.5	5.3	5.5	5.8	5.7	5.5	5.3	5.1	5.2	5.3	5.3

1/ IMF staff estimates.

2/ ESM staff estimates.

3/ Privatization path is slightly more frontloaded in the European baseline (the total amount is same as in the staff's baseline).

Annex V. Figure 2. Greece Debt Components and Debt Service, 2017–60 (under IMF baseline)



Source: IMF staff estimates.

Annex V. Box 2. DSA Interest Rate Assumptions

- **Official interest rates**: Official interest rates (currently around 1 percent) are projected to revert to their historical averages over the long run as financing conditions normalize. Relative to the July 2017 SBA-AIP staff report, staff has revised (following consultation with the ESM) the long-run ESM/EFSF rates down from 3.8 percent in the 2017 DSA to 3.3 percent, given that risk spread of ESM/EFSF over Germany has come down and recognizing the capacity of the ESM/EFSF to use its diversified funding strategy to optimize issuances and maturity structure. Staff has not adopted a recent additional downward revision by the ESM (to 3.1 percent), due to differences of views over the justification.

- **Market interest rates**: Greece is assumed to access markets by end-program at an initial rate of 4.5 percent (versus 6 percent in the 2017 DSA). This rate is consistent with a risk-free rate of less than 1 percent in 2018 and a risk premium of around 380 basis points. Over time, the market rate is assumed to evolve according to changes in the risk-free rate, which is expected to reach 3.3 percent in the long term, and Greece's risk premium, which is projected to fall/rise by three basis points for each 1 percentage point decrease/increase in debt-to-GDP ratio (the mechanism ceases to operate when debt reaches the Maastricht limit). The market rate is assumed to fluctuate between a cap of 6 percent (to avoid non-linearities and reflect the likelihood of loss of market access at high levels of debt/interest rate) and a floor of 4 percent, consistent with a small long-run risk premium of 75 basis points (in the 2017 DSA, the market rate was projected to fall/rise by four basis points for every one percentage point decline/increase in the debt-to-GDP ratio, with no adjustment for the risk-free rate). The EIs also apply this method, but recently modified it through ad-hoc downward adjustments to the risk premium for the first decade and by lowering the steady-state risk free rate to 3.1 percent.

B. External Sector DSA

6. **At 228 percent of GDP, Greece's external debt is higher than in most European economies.** At minus 141 percent of GDP, Greece's net international investment position is the second weakest in Europe after Ireland. The weak international investment position will continue to

represent a drag on the recovery as the availability of external savings remains limited and domestic savings have to be mobilized to make room for investment.

7. External debt is projected to decline gradually to 178 percent of GDP in 2023. This improvement would be supported by the projected recovery in growth and inflation, a positive non-interest current account, higher FDI inflows, debt relief, and the usage of the government's cash buffer to reduce the need to tap market financing.

8. Macroeconomic shocks and policy slippages could result in adverse dynamics.

- *Interest rate shock*. A 90-bps interest rate shock would worsen the income account and result in an increase in the debt ratio by 7 percentage points above the baseline by 2023.
- *Growth shock*. A decline in average growth by 2 percentage points would continue to see debt decline, but the ratio would end in 2023 some 17 percent higher than in the baseline.
- *Larger current account deficits***.** Deterioration in the baseline current account projections by half standard deviation in 2019–23 would raise the debt ratio by 16 percentage compared to the baseline by 2023.
- *Debt dynamics* would also be worse under a combined shock involving higher interest rates, lower growth and a smaller current account, with the debt ratio reaching 198 percent of GDP in 2023, 20 percent of GDP higher than in the baseline.

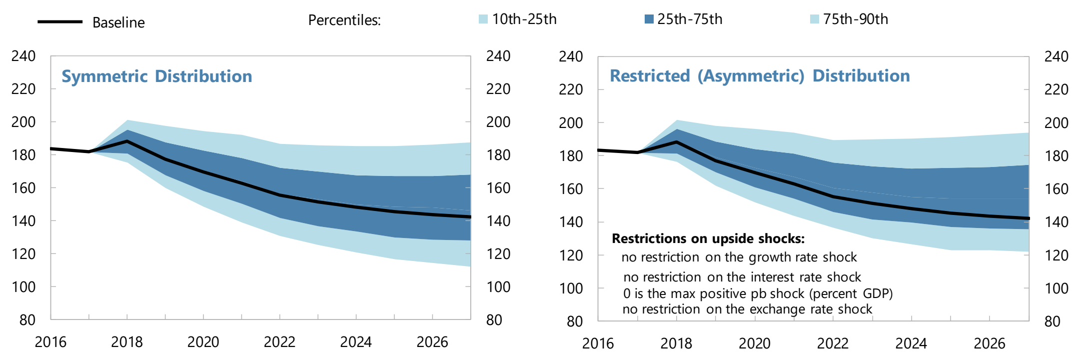
Annex V. Figure 3. Greece Public DSA Risk Assessment (Baseline Scenario)

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

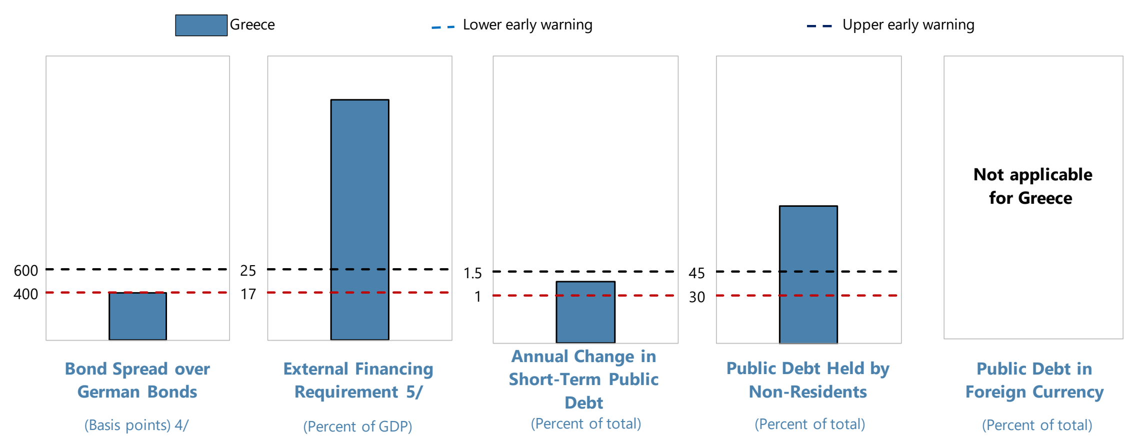
Evolution of Predictive Densities of Gross Nominal Public Debt

(Percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ An average over the last 9 months, 28-Sep-17 through 27-Jun-18.

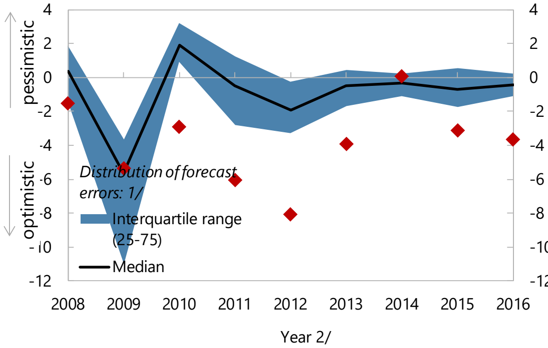
5/ Includes liabilities to the Eurosystem related to TARGET.

Annex V. Figure 4. Greece Public DSA - Realism of Assumptions (Baseline Scenario)

Forecast Track Record, versus program countries

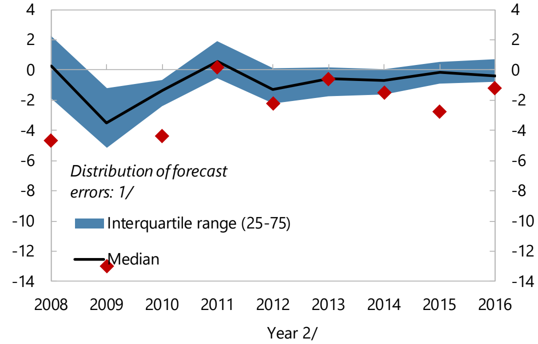
Real GDP Growth
(Percent, actual-projection)

Greece median forecast error, 2008-2016: **-3.67**
Has a percentile rank of: **1%**



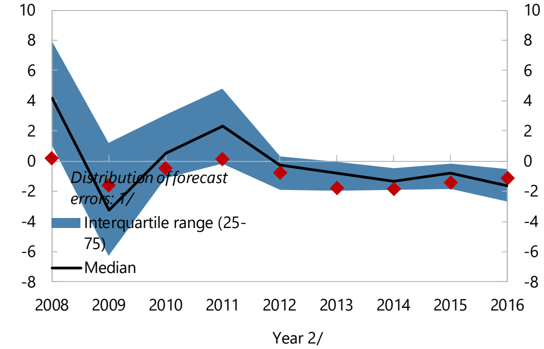
Primary Balance
(Percent of GDP, actual-projection)

Greece median forecast error, 2008-2016: **-2.21**
Has a percentile rank of: **11%**



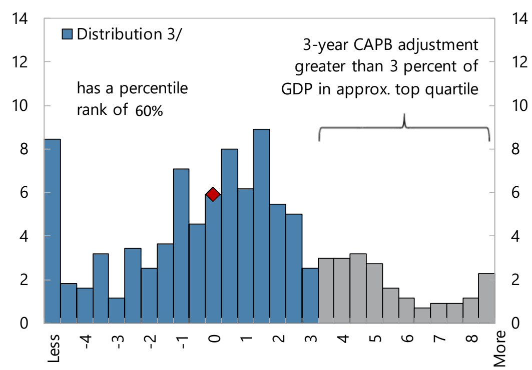
Inflation (Deflator)
(Percent, actual-projection)

Greece median forecast error, 2008-2016: **-1.13**
Has a percentile rank of: **18%**

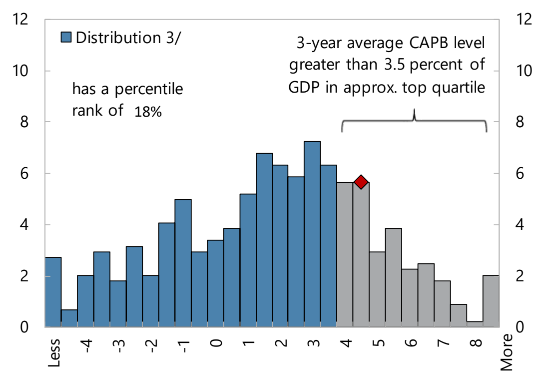


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Source : IMF Staff.
1/ Plotted distribution includes program countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex V. Table 2. Greece: Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(Percent of GDP, unless otherwise indicated)

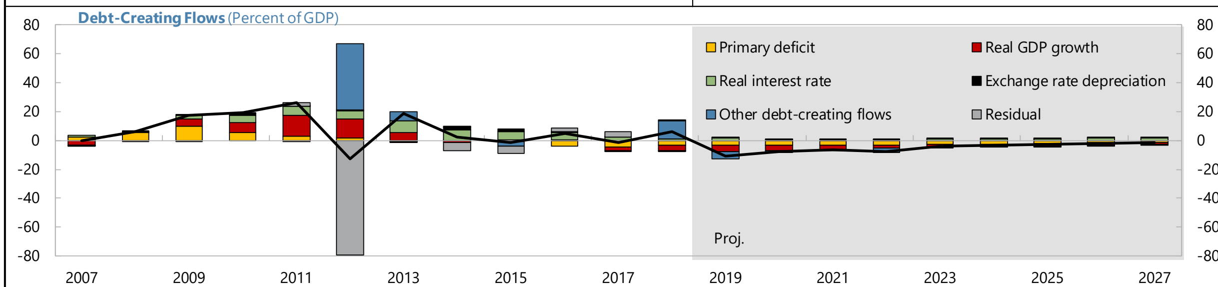
Debt, Economic and Market Indicators 1/

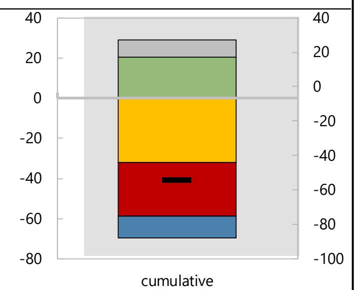
	Actual			Projections										As of June 27, 2018		
	2007–2015 2/	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	Sovereign Spreads		
Nominal gross public debt 3/	150.5	183.5	181.8	188.1	177.1	169.6	162.9	155.3	151.3	148.1	145.5	143.6	142.3	Spread (bp) 4/		377
Public gross financing needs	22.7	12.4	12.0	21.3	8.3	7.9	7.8	7.9	11.6	10.5	11.1	10.7	10.0	CDS (bp)		363
Real GDP growth (percent)	-2.9	-0.2	1.4	2.0	2.4	2.2	1.6	1.2	1.2	1.2	1.2	1.2	1.0	Ratings	Foreign	Local
Inflation (GDP deflator, percent)	0.7	-1.0	0.7	0.9	1.0	1.4	1.7	1.7	1.7	1.8	1.8	1.8	1.8	Moody's	B3	B3
Nominal GDP growth (percent)	-2.2	-1.2	2.0	3.0	3.3	3.6	3.3	3.0	2.9	3.0	3.0	3.0	2.8	S&Ps	B+	B+
Effective interest rate (percent) 5/	3.6	1.8	2.1	1.7	1.9	1.9	2.0	2.1	2.3	2.5	2.7	2.8	2.9	Fitch	B	B

Contribution to Changes in Public Debt

	Actual			Projections											
	2007–2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	Cumulative	Debt-stabilizing primary balance 10/
Change in gross public sector debt	8.4	4.7	-1.7	6.3	-11.0	-7.5	-6.7	-7.6	-4.0	-3.2	-2.7	-1.9	-1.3	-39.5	0.1
Identified debt-creating flows	18.1	1.9	-5.1	6.3	-11.2	-7.6	-6.7	-7.7	-4.0	-3.2	-2.7	-1.9	-1.4	-40.3	
Primary deficit	2.9	-3.9	-4.4	-3.5	-3.5	-3.5	-3.5	-3.5	-3.0	-2.5	-2.0	-1.5	-1.5	-28.0	
Primary (noninterest) revenue and grants	43.7	50.2	49.0	48.7	47.1	46.4	45.8	45.0	44.9	44.8	46.2	46.1	46.1	461.0	
Primary (noninterest) expenditure	46.7	46.3	44.6	45.2	43.6	42.9	42.3	41.5	41.9	42.3	44.2	44.6	44.6	433.0	
Automatic debt dynamics 6/	9.6	5.7	-0.7	-2.3	-2.7	-3.0	-2.3	-1.4	-1.0	-0.7	-0.5	-0.3	0.2	-14.0	
Interest rate/growth differential 7/	9.3	5.4	0.1	-2.3	-2.6	-3.0	-2.2	-1.3	-1.0	-0.7	-0.5	-0.3	0.2	-13.6	
Of which: real interest rate	4.6	5.0	2.5	1.3	1.7	0.7	0.5	0.6	0.8	1.1	1.2	1.4	1.6	10.9	
Of which: real GDP growth	4.7	0.4	-2.4	-3.6	-4.3	-3.7	-2.7	-1.9	-1.8	-1.8	-1.7	-1.7	-1.4	-24.5	
Exchange rate depreciation 8/	0.4	0.3	-0.8	…	…	…	…	…	…	…	…	…	…	…	
Other identified debt-creating flows	5.5	0.2	0.0	12.1	-5.0	-1.1	-0.9	-2.8	-0.1	0.0	-0.2	-0.1	-0.1	1.7	
Net privatization proceeds	-0.1	-0.2	-0.7	-0.6	-0.6	-0.2	0.0	-0.1	0.0	0.0	-0.2	-0.1	-0.1	-2.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other liabilities (arrears clearance and cash buffer flows)	5.6	0.4	0.7	12.8	-4.4	-0.9	-0.9	-2.8	0.0	0.0	0.0	0.0	0.0	3.7	
Residual, including asset changes 9/	-9.7	2.7	3.4	0.0	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.7	

Debt-Creating Flows (Percent of GDP)

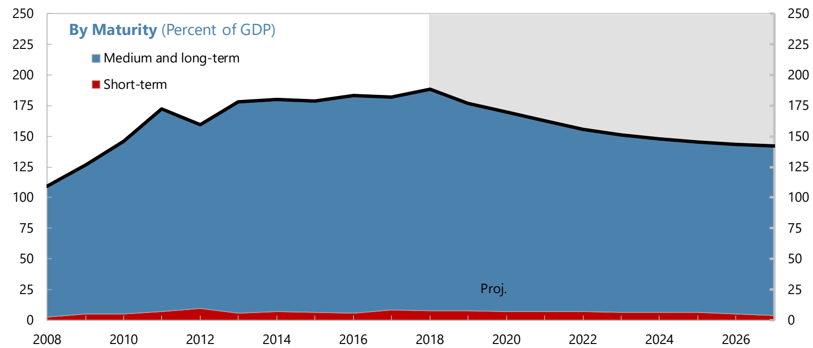


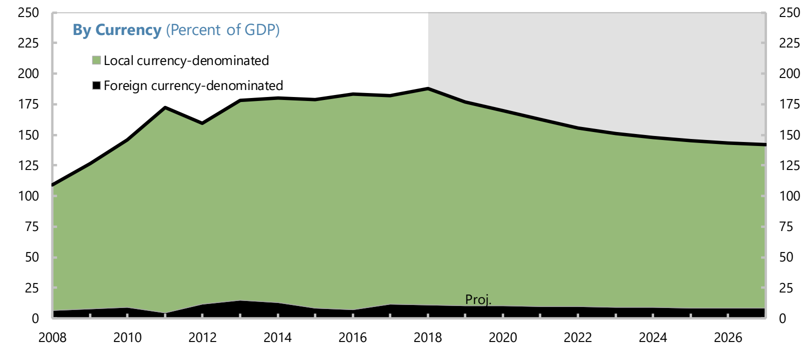


Source: IMF staff projections.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ Public debt includes the stock of deferred interest.
4/ Bond Spread over German Bonds.
5/ Defined as interest payments divided by debt stock at the end of previous year.
6/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
7/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.
8/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
9/ For projections, this line includes exchange rate changes during the projection period.
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

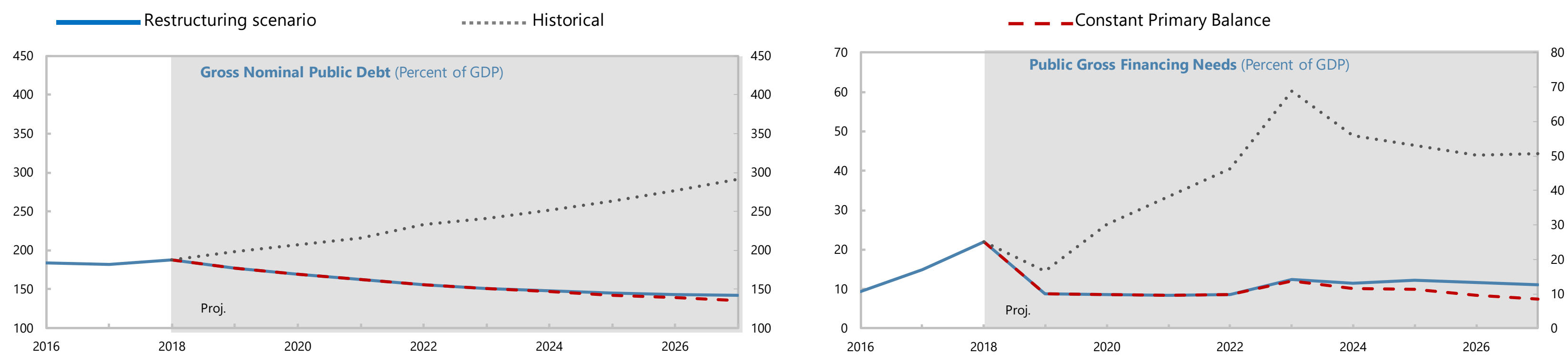
Annex V. Figure 5. Greece Public DSA - Composition of Public Debt and Alternative Scenarios (Baseline Scenario)

Composition of Public Debt





Alternative Scenarios



Underlying Assumptions

(Percent)

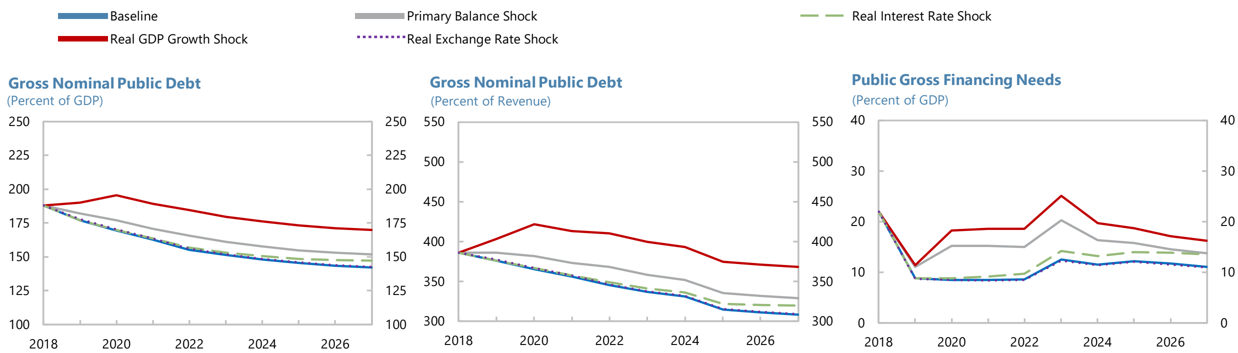
Restructuring scenario	2018	2019	2020	2021	2022	2023	2024	2027
Real GDP growth	2.0	2.4	2.2	1.6	1.2	1.2	1.2	1.0
Inflation	0.9	1.0	1.4	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	3.5	3.5	3.5	3.5	3.0	2.5	1.5
Effective interest rate	1.7	1.9	1.9	2.0	2.1	2.3	2.5	2.9
Constant primary balance scenario								
Real GDP growth	2.0	2.4	2.2	1.6	1.2	1.2	1.2	1.0
Inflation	0.9	1.0	1.4	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Effective interest rate	1.7	1.9	1.9	2.0	2.1	2.3	2.5	2.9

Historical scenario	2018	2019	2020	2021	2022	2023	2024	2027
Real GDP growth	2.0	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8
Inflation	0.9	1.0	1.4	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	-1.6	-1.6	-1.6	-1.6	-1.6	-1.6	-1.6
Effective interest rate	1.7	1.9	2.2	2.4	2.7	3.1	3.6	4.4

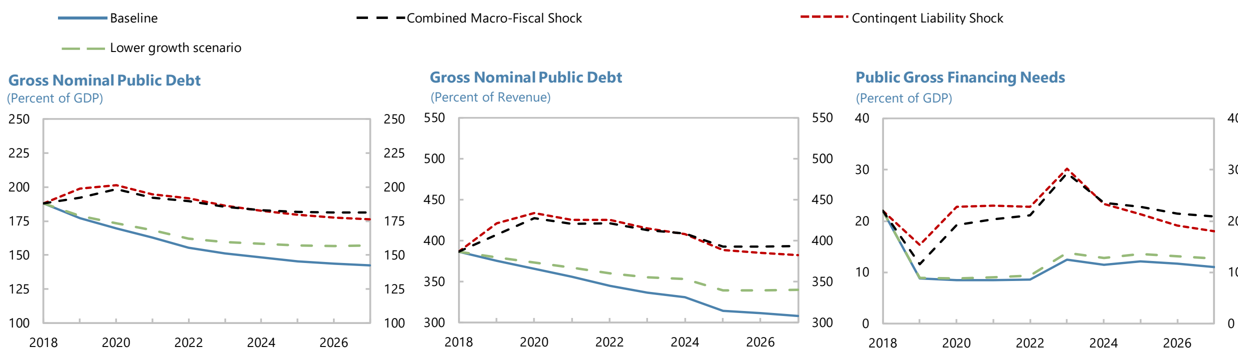
Source: IMF staff.

Annex V. Figure 6. Greece Public DSA - Stress Tests (Baseline Scenario)

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(Percent)

	2018	2019	2020	2021	2022	2023	2024	2027
Primary Balance Shock								
Real GDP growth	2.0	2.4	2.2	1.6	1.2	1.2	1.2	1.0
Inflation	0.9	1.0	1.4	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	1.3	1.3	3.5	3.5	3.0	2.5	1.5
Effective interest rate	1.7	1.9	2.0	2.1	2.2	2.3	2.6	3.1
Real Interest Rate Shock								
Real GDP growth	2.0	2.4	2.2	1.6	1.2	1.2	1.2	1.0
Inflation	0.9	1.0	1.4	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	3.5	3.5	3.5	3.5	3.0	2.5	1.5
Effective interest rate	1.7	1.9	2.1	2.2	2.4	2.6	3.0	3.8
Combined Shock								
Real GDP growth	2.0	-1.3	-1.5	1.6	1.2	1.2	1.2	1.0
Inflation	0.9	0.1	0.5	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	1.3	-0.6	3.5	3.5	3.0	2.5	1.5
Effective interest rate	1.7	1.9	2.2	2.5	2.7	3.0	3.5	4.3
Lower Growth Scenario								
Real GDP growth	2.0	1.4	1.2	0.6	0.2	0.2	0.2	0.0
Inflation	0.9	1.0	1.4	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	3.5	3.5	3.5	3.5	3.0	2.5	1.5
Effective interest rate	1.7	1.9	1.9	2.0	2.1	2.3	2.5	3.0

	2018	2019	2020	2021	2022	2023	2024	2027
Real GDP Growth Shock								
Real GDP growth	2.0	-1.3	-1.5	1.6	1.2	1.2	1.2	1.0
Inflation	0.9	0.1	0.5	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	1.5	-0.6	3.5	3.5	3.0	2.5	1.5
Effective interest rate	1.7	1.9	2.0	2.1	2.2	2.4	2.7	3.1
Real Exchange Rate Shock								
Real GDP growth	2.0	2.4	2.2	1.6	1.2	1.2	1.2	1.0
Inflation	0.9	1.4	1.4	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	3.5	3.5	3.5	3.5	3.0	2.5	1.5
Effective interest rate	1.7	1.9	1.9	1.9	2.1	2.2	2.5	2.9
Contingent Liability Shock								
Real GDP growth	2.0	-1.3	-1.5	1.6	1.2	1.2	1.2	1.0
Inflation	0.9	0.1	0.5	1.7	1.7	1.7	1.8	1.8
Primary balance	3.5	-2.4	3.5	3.5	3.5	3.0	2.5	1.5
Effective interest rate	1.7	2.0	2.1	2.1	2.2	2.4	2.7	3.2

Source: IMF staff.

Annex V. Table 3. Greece: External Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
Baseline: External debt	237.3	237.5	250.4	247.8	227.9			**221.3**	**209.7**	**199.7**	**190.2**	**182.5**	**177.6**	**-4.2**
Change in external debt	0.3	0.2	12.9	-2.6	-20.0			-6.5	-11.6	-10.0	-9.5	-7.7	-4.9	
Identified external debt-creating flows (4+8+9)	13.2	-0.2	-0.5	1.7	-8.6			-5.3	-6.3	-5.7	-4.6	-3.7	-3.7	
Current account deficit, excluding interest payments	-3.1	-2.6	-2.5	-1.3	-1.7			-1.9	-2.2	-2.3	-2.4	-2.5	-2.5	
Deficit in balance of goods and services	2.8	2.2	0.2	0.7	0.5			0.2	0.0	-0.2	-0.3	-0.4	-0.4	
Exports	30.4	32.4	29.9	28.4	31.6			34.6	35.3	35.8	36.1	36.6	36.9	
Imports	33.2	34.6	30.1	29.1	32.2			34.8	35.3	35.6	35.9	36.2	36.5	
Net non-debt creating capital inflows (negative)	-2.8	-4.5	-3.4	-2.4	-4.5			-1.7	-1.7	-1.6	-1.6	-1.6	-1.5	
Automatic debt dynamics 1/	19.1	6.9	5.4	5.4	-2.4			-1.7	-2.5	-1.8	-0.6	0.4	0.3	
Contribution from nominal interest rate	5.1	4.3	2.7	2.4	2.5			2.6	2.6	2.5	2.5	2.6	2.4	
Contribution from real GDP growth	7.9	-1.8	0.8	0.6	-3.2			-4.3	-5.1	-4.3	-3.2	-2.2	-2.1	
Contribution from price and exchange rate changes 2/	6.1	4.4	1.9	2.4	-1.7			-2.2	-2.1	-3.0	-3.3	-3.2	-3.0	
Residual, incl. change in gross foreign assets (2-3) 3/	-12.9	0.4	13.4	-4.3	-11.4			1.0	-3.2	-1.3	-1.6	-0.7	1.8	
External debt-to-exports ratio (in percent)	780.4	733.7	837.6	872.2	720.6			639.0	594.5	557.7	526.2	498.7	481.6	
Gross external financing need (in billions of US dollars) 4/	256.4	214.0	180.9	176.1	168.9			135.4	119.0	110.8	109.3	111.6	111.6	
in percent of GDP	106.9	90.1	92.5	91.4	84.2	10-Year	10-Year	61.7	52.6	46.8	44.5	43.8	42.6	
Scenario with key variables at their historical averages 5/								**221.3**	**231.1**	**246.9**	**261.7**	**279.2**	**299.6**	**17.0**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	-3.2	0.7	-0.3	-0.2	1.4	-2.8	3.6	2.0	2.4	2.2	1.6	1.2	1.2	
GDP deflator in US dollars (change in percent)	0.9	-1.8	-17.4	-1.2	2.7	-1.4	7.9	7.2	0.6	2.6	2.1	2.4	1.7	
Nominal external interest rate (in percent)	2.1	1.8	0.9	0.9	1.0	1.8	1.6	1.2	1.2	1.3	1.3	1.4	1.4	
Growth of exports (US dollar terms, in percent)	3.8	5.3	-23.9	-6.3	15.9	-0.1	14.6	19.8	4.8	6.4	4.8	4.9	3.7	
Growth of imports (US dollar terms, in percent)	0.1	3.1	-28.4	-4.5	14.9	-4.1	14.6	18.5	4.4	5.7	4.5	4.6	3.8	
Current account balance, excluding interest payments	3.1	2.6	2.5	1.3	1.7	-1.9	6.5	1.9	2.2	2.3	2.4	2.5	2.5	
Net non-debt creating capital inflows	2.8	4.5	3.4	2.4	4.5	1.7	2.1	1.7	1.7	1.6	1.6	1.6	1.5	

1/ Derived as [i - g - r(1+g) + ea(1+i)]/(1+g+r+gr) times previous period debt stock, with i = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

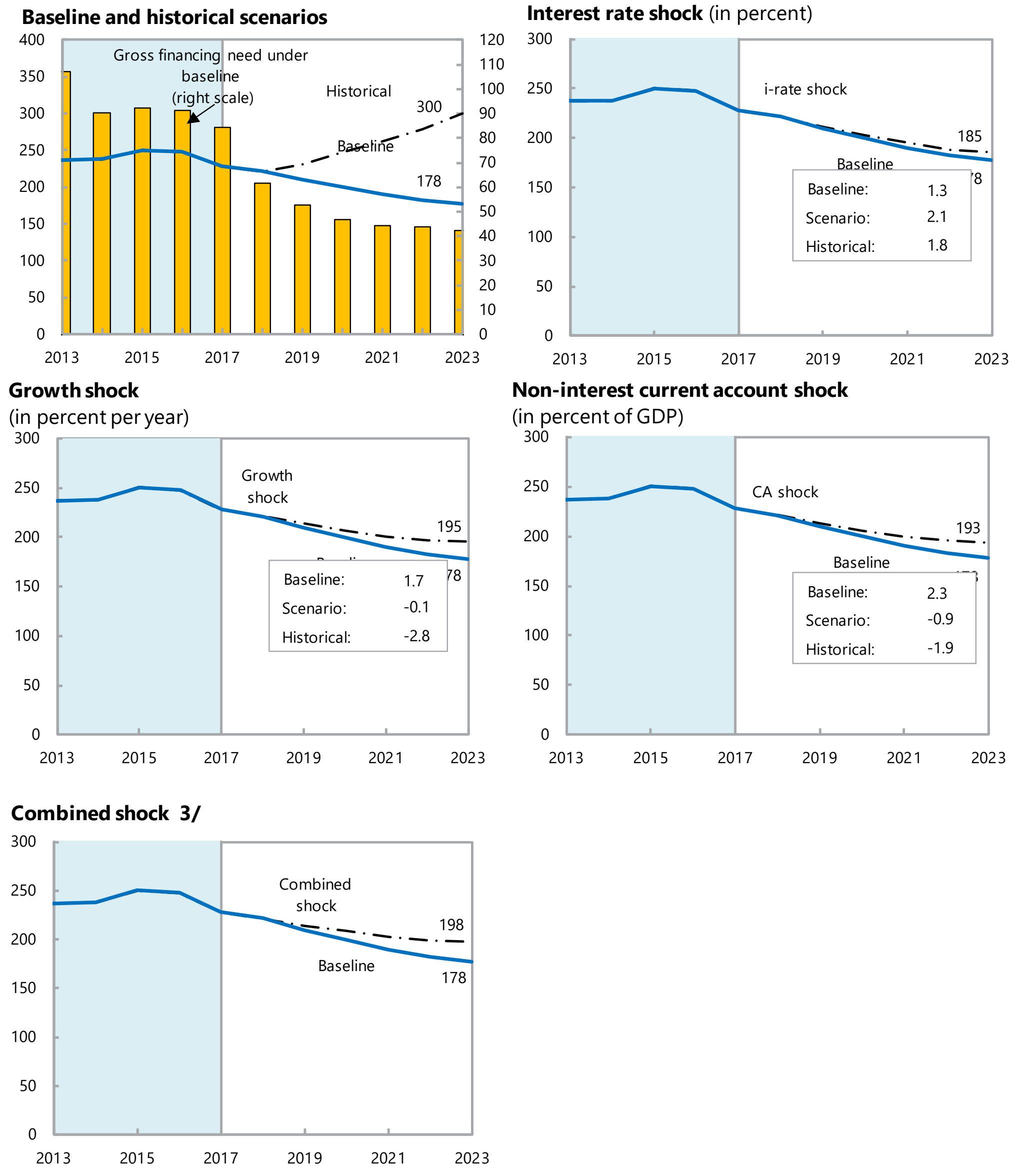
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex V. Figure 7. Greece: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)

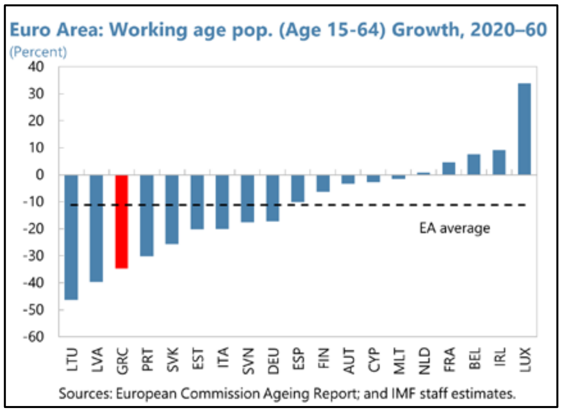


Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

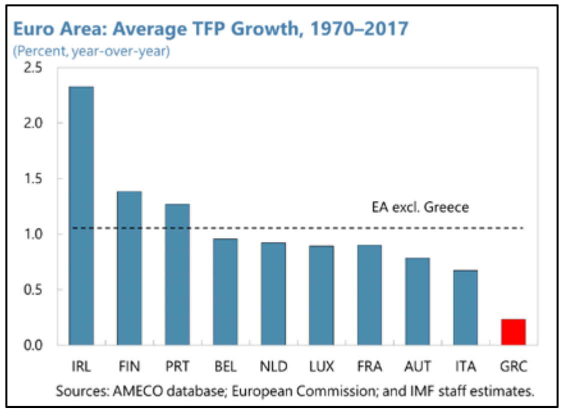
Annex VI. Long-Run Growth and Primary Balance Projections

A. Greece's Long-Term Growth Potential

Adverse demographics and a history of poor productivity performance suggest boosting long-run output growth will be an uphill battle. Achieving annual growth rates of 1 percent over the next half century—as assumed in staff's DSA—will require that structural reforms in Greece deliver payoffs on employment, labor force participation, and productivity growth that exceed the experience elsewhere. It will also demand a reform effort whose pace and scope exceed what Greece has achieved in the past.



Sources: European Commission Ageing Report; and IMF staff estimates.



Sources: AMECO database; European Commission; and IMF staff estimates.

1. **Greece is set to experience dramatic population aging over the next several decades.** In its 2018 Aging Report[1], the EC projects Greece's working age population to fall by about 35 percent between 2020 and 2060 due to a shrinking and rapidly aging population.[2] This is among the largest such declines in the Euro Area, and three times the average fall for the Euro Area. Ceteris paribus, aging would imply an average yearly decline of 1.1 percentage points in Greece's labor force during the next four decades.

2. **Greece's productivity growth has historically been poor**. Greece's underperformance relative to peers is often associated with relatively low openness of the economy and a high share of labor allocated to non-tradable sectors. Total factor productivity (TFP) growth over the last 47 years averaged just ¼ percent annually, by far the lowest in the Euro Area. Assuming this historical average TFP growth rate going forward, labor productivity (output per worker) would grow only at about 0.4 percent in the steady state (the rate of TFP growth adjusted for the labor share in output).

3. **A pickup in investment could provide a short-run boost to growth, but productivity and demographics will dominate in the longer run.** Investment is bound to recover from its

[1] Population and labor force projections were revised down compared to the July 2017 SBA-AIP (which relied on the 2015 Aging Report).

[2] Outward migration, especially of the working age population, may further exacerbate this trend if it continues at its current pace.

highly depressed level once Greece emerges from the crisis, but the growth effect of this will wane once the capital stock returns to its long-run level. Staff's medium-term projections already assume a temporary boost to GDP growth from higher investment (with real GDP growth rates averaging close to 2 percent during the investment recovery).[3] Once the transition to the new, higher capital ratio is completed, however, the impact of increased investment will fade and growth dynamics will be determined by the evolution of output per worker and of the number of workers.[4]

4. Long-run GDP growth prospects are thus poor, absent a major change in policies. As a starting point, combining the historical growth in output per worker of 0.4 percent with expected growth in the number of workers of -1.1 percent would imply long-term annual growth of -0.7 percent.[5] This simple result is broadly similar to other recent findings in the literature, which estimate Greece's baseline growth rate (before the effect of reforms) at -0.4 percent during 2024–2043.[6]

5. Structural reforms to raise TFP growth and employment are therefore the only option to achieve higher long-term output growth. Estimating the gains from structural reforms is technically difficult, and results are necessarily imprecise. The empirical evidence suggests that the GDP growth gains from reforms are somewhat modest and transitory: while studies have documented an impact on output *levels* of 3 to 13 percent over the initial decade, the impact of reforms on *growth* tends to fizzle out afterwards.[7]

- The 2016 WEO estimates the GDP level gain from past episodes of product market deregulation in 26 advanced economies over 1970–2013 at about 3 percent on average, with gains accruing over a period of eight years, suggesting a GDP growth gain of about 0.4 percentage points per year during the eight-year period.

- Adhikari et al. (2016) looks at case studies of major past reformers in both labor and product markets—Australia, Denmark, Ireland, Netherlands, and New Zealand in the 1990s, Germany in the 2000s—and finds that the GDP effect of reforms ranged between 0 and 34 percent over a period of 5 years. Excluding Ireland, which is a clear outlier, the average impact was

[3] Specifically, as the economy recovers and the output gap closes, and increase in investment at double-digit rates is expected, especially as Greece is the beneficiary of large EU Funds. These funds, together with other investment related support from international institutions (EIB, EBRD), sum up to about 4 percent of GDP per year during 2018-2020.

[4] Staff projections assume a level of investment that is sufficient to stabilize the capital-to-output ratio at its historical average of about 3.5. Under the neoclassical model, a higher or lower ratio would affect the level of GDP but—once that steady-state ratio is achieved—not its growth rate.

[5] In the neoclassical Solow growth model, the production of output (Y) uses labor (L), capital (K) and total factor productivity (A), where α is the share of capital and (1-α) is the share of labor: $Y=AK^{\alpha}L^{1-\alpha}$. In steady-state, output (and capital) grow at the rate of labor force growth (l) and total factor productivity adjusted by the share of labor: $A/(1-\alpha)$.

[6] See McQuinn and Whelan (2015).

[7] There are, however, theoretical endogenous growth models that predict permanent effects on growth from innovation, testing these in practice over long periods of time has been more challenging, including due to the availability and difficulty to isolate innovation shocks from other effects.

0.6 percentage points per year over the five-year period, and in two out of six cases, there were no significant gains.

6. Permanently raising growth would require a period of reform implementation that exceeds in both ambition and duration what Greece has achieved so far. While Greece has initiated numerous structural reforms in the context of its adjustment programs—from labor markets to energy, judicial reforms, closed professions, and others—implementation has sometimes lagged. The country's key accomplishment has been a cornerstone labor market reform adopted in 2011, but this is set to be partially reversed after the current program. Other legislated reforms have faltered at the implementation stage. For example, numerous attempts at privatizing state monopolies in the energy sector are yet to reduce significantly the state's share in this sector; judicial reforms have been slow moving, with continued high court backlogs; reforms to liberalize close professions have fall short from expectations in terms of both pace and scope; and; the investment licensing reform, which started in 2011, is still not fully completed.

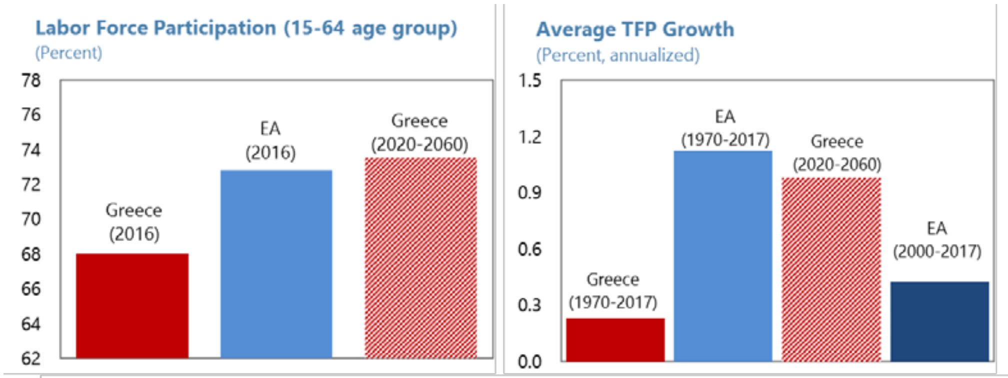
7. Given demographics, the impact of structural reforms will need to be substantial to achieve an overall long-term GDP growth rate of 1 percent over the next half century. Lifting long-term growth from its baseline of –0.7 percent to 1 percent requires reforms to add 1.7 percentage points to growth per year for the next decades. The OECD (2016) estimates that full implementation of a broad menu of structural reforms could raise Greece's output by about 7.8 percent over a 10-year horizon, which translates into an increase in annual growth of some 0.8 percentage points for about a decade.[8] Bourles et al. (2013) estimate this gain to be slightly higher, at about 0.9 percentage points per year, while Daude (2016) finds that reforms focused on product markets and improving the business environment in Greece could boost growth by about 1.3 percentage points per year for a decade.

9. In conclusion, achieving staff's assumption of 1 percent growth in the face of adverse demographics and historically weak productivity growth will require that the Greek authorities and people commit to an extended period of profound structural reform. Implicitly, the 1 percent growth projection presumes that Greece would manage to increase labor force participation to levels that exceed the Euro Area average (to offset the significant projected decline in Greece's working age population)[9] and that would generate TFP growth rates permanently far above Greece's historical average. This underscores the importance of rapid and decisive action on the part of the authorities to tackle the many bottlenecks that constrain growth and limit the country's ability to prosper in the Euro Area.

[8] These reforms include: (i) labor, pension and employment protection reforms; (ii) product market reforms to reduce administrative burden, open professions, and liberalize investment licensing; (iii) tax reform; (iv) bankruptcy reforms; and (v) reforms of network industries (electricity, gas, rail road and transport). The latest OECD report provides comparable estimates in a range of 0.5–1 percent increase in annual growth depending on future reform efforts.

[9] Labor force participation in Greece over the long-run is also affected by pension system reforms, including increase in the effective retirement age and limiting early retirement options.

Annex VI. Figure 1. Key Assumptions Underlying Staff's Long-Run Growth Projections



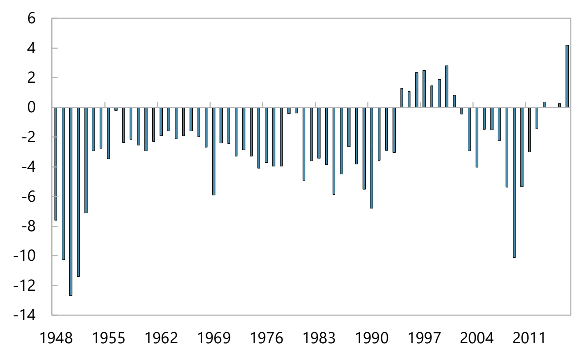
Sources: AMECO database; European Commission 2018 Aging Report, and IMF staff estimates.

B. A Sustainable Primary Surplus for Greece

It is difficult to sustain high primary balances over prolonged periods. Few countries have managed to do so, and usually accomplished it under peculiar circumstances. Greece's conditions and outlook do not suggest that a primary balance above 1.5 percent of GDP could be sustained for a prolonged period.

10. Historically, Greece has been unable to sustain primary surpluses for prolonged periods. During 1945–2015, the average primary balance in Greece is a deficit of about 3 percent of GDP, although a brief period of near-zero primary balance took place at the time of Greece's EU accession. The high water-mark for Greece was a primary surplus exceeding 1 percent of GDP during eight consecutive years (1994–2001), which allowed Greece to reach the 3-percent overall balance threshold prior to euro adoption. The average primary balance during this period was 1¾ percent of GDP. But the primary balance reversed to a deficit of 2 percent of GDP immediately following euro adoption (2002–07), and widened to a deficit of 5–10 percent in 2008–09. From 2010 to 2015, the primary deficit averaged 1½ percent of GDP[10], with small surpluses of less than 1 percent of GDP recorded only in 2013 and 2015. The situation improved in 2016, with a large surplus of 3.9 percent, however, the drivers of this surplus were temporary, such as one-off revenues and/or under-execution of the budget expenditures. Similarly, the surplus of 4.2 percent in 2017 was driven by lower than expected spending rather than a more sustainable mix of measures.

Greece: Primary Balance, 1948–2016
(Percent of GDP)



Sources: IMF World Economic Outlook database; and Mauro et al. (2013).

[10] According to the SBA-AIP program definition, which, notably excludes bank recapitalization costs.

11. Cross-country evidence suggests that large primary fiscal surpluses have been difficult to achieve and sustain in post-war history. In a sample covering 90 countries during the period 1945–2015, there have been only 13 cases where a primary fiscal surplus above 1.5 percent of GDP could be reached and maintained for a period of ten or more consecutive years.[11] Only three cases can be identified if the primary surplus threshold is increased to 3.5 percent of GDP; and only one case if resource-rich countries are also excluded. Cross-country experience also shows that ten-year averages above 3.5 percent of GDP are very rare (7.5 percent of the cases for the full sample and 4.3 percent of the cases for developed economies in the Euro Area that are not oil or resource rich). Even ten-year averages above 1.5 percent are relatively rare, corresponding to 12.8 percent of the cases in the latter group.

Probability of a 10-year Average Primary Balance to Exceed a Threshold *(percent)*

	Primary Balance Threshold (percent of GDP)				
	1.5	**2**	**2.5**	**3**	**3.5**
Full sample	23.8	17.3	12.6	9.8	7.5
Non-oil and non-resource rich countries, *among these*	21.6	14.9	10.4	7.7	5.6
Advanced economies	23.5	15.8	11.2	8.3	5.7
Euro area advanced economies	12.8	10.4	7.7	6.7	4.3

Sources: IMF World Economic Outlook database; and Mauro et al. (2013).

Episodes of Sustainable Primary Surpluses

Threshold (percent of GDP)	Country	Period
4	Congo, Rep.	2003-2012
	Norway	1964-2014
3.5	Mexico	1983-1992
3	Belgium	1994-2004
	Finland	1975-1990
2.5	Chile	1987-1997
2	Brazil	1975-1985
	Canada	1964-1974
	Finland	1998-2008
1.5	Brazil	2001-2013
	Canada	1996-2007
	Denmark	1997-2008
	Russia	1999-2008

Sources: IMF World Economic Outlook database; and Mauro et al. (2013).

Note: Sustainable primary fiscal surpluses are defined as a primary surplus larger than the threshold for longer than 10 consecutive years.

Economic Conditions around Episodes of High Primary Fiscal Balances in European Countries, 1980-2015 1/

(percent of GDP unless indicated otherwise)

Country	Period	Number of years with average PB > 3.5 percent of GDP	PB		Prior to high PB episode					During high PB episode				
			Min	Max	Real GDP growth 2/ (percent)	CPI inflation 2/ (percent)	Unemployment (percent)	Gross public debt	Net foreign assets	Real GDP growth (percent)	CPI inflation (percent)	Unemployment (percent)	Change in gross public debt	Change in net foreign assets
Belgium	1986-2008	23	-0.2	6.1	1.5	6.3	10.1	118.7	-13.3	2.3	2.1	8.2	-26.2	61.1
Denmark	1997-2008	12	1.5	6.0	3.7	2.1	6.3	68.3	-22.8	1.9	2.2	4.6	-34.9	17.4
Finland	1997-2008	12	0.4	7.6	3.9	1.0	14.6	55.3	-40.9	3.7	1.7	9.2	-22.7	37.9
Ireland	1995-2002	8	0.8	6.5	3.9	2.3	15.1	78.6	-34.3	8.7	3.1	7.7	-48.0	15.0
Italy	1994-2002	9	1.5	5.7	0.5	5.2	9.8	120.3	-12.0	1.8	2.9	10.5	-18.3	-5.0
Sweden	1984-1991	8	0.9	6.6	2.7	9.8	4.8	-	-19.8	2.2	6.1	3.1	-	-5.7
Average			0.8	6.4	2.7	4.5	10.1	88.2	-23.8	3.4	3.0	7.2	-30.0	20.1
Greece (2016)					0.0	-0.8	23.6	181.6	-134.5					

Sources: IMF WEO databases; and IMF staff calculations. (Samples: European Union Countries: period: 1980-2015).

1/ Episodes of high primary fiscal balances (PB) are defined as cases with average PB above 3.5 percent of GDP sustained for more than 5 years.

2/ Three years prior to a high PB episode.

[11] Database constructed from the World Economic Outlook, International Financial Statistics, World Development Indicators, and Mauro et al. (2013).

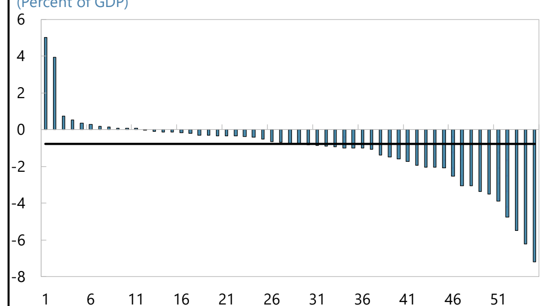
12. Economic conditions matter. Among EU countries, before entering a period of high average primary balances, countries tend to have strong real GDP growth (2.7 percent) and modestly high inflation (4 percent). They also have moderate unemployment (10 percent) and low net foreign debt (24 percent of GDP), conditions that do not conform to those now applying in Greece. Moreover, during the high primary balance periods, growth has been rapid (about 3.4 percent), inflation slightly elevated (3 percent), and unemployment contained (at about 7.2 percent). This suggests that sustained periods of high primary surpluses are driven by strong economic growth rather than by sizeable fiscal consolidation.

13. Large primary surpluses achieved mostly through very strong consolidation are often reversed. Countries that carried out large fiscal adjustments to achieve large primary surpluses were not able to sustain such performance for a long period, as strong spending pressures had accumulated during the adjustment period:

- *Sustained consolidation is challenging*. Among 55 consolidation episodes with an improvement of the primary balance of more than 10 percentage points of GDP during a five-year period (as in Greece since 2009), the primary balance improved further for the following five years in only 20 percent of the cases. In the large majority of episodes, the primary balance deteriorated after such a strong consolidation. This finding is in line with other evidence that following substantial consolidation efforts, countries tend to ease primary balances.[12]

Annual Change in Primary Balance Post-Adjustment

(Percent of GDP)



Sources: IMF World Economic Outlook database; and Mauro et al. (2013).
Note: Annual average change of the primary balance following an adjustment of more than 10 percentage points of GDP.

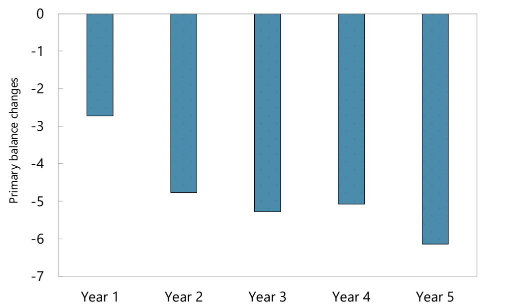
- *Reversal is rapid*. The average annual change of the primary balance during the five-year period following the end of the adjustment for all 55 episodes is about -¾ percentage points of GDP. Stronger consolidations are reversed even faster; for countries that reached a primary balance of more than 3.5 percent of GDP at the end of the consolidation, the subsequent deterioration of the primary balance is about 1¼ percentage points of GDP.

- *Reversal is also rapid following a strong adjustment under IMF-supported programs.*[13] Programs that ended with very high primary balances tightened policy significantly during the program period (quartile 4 in the figure to the right). Primary balances typically deteriorated rapidly the year after the program, much more so than in other programs (quartiles 1–3). Following a strong improvement during the program, the primary surplus falls on average by half in about five years after the program, with the bulk of that deterioration within the first two years.

[12] Escolano et al., 2014.

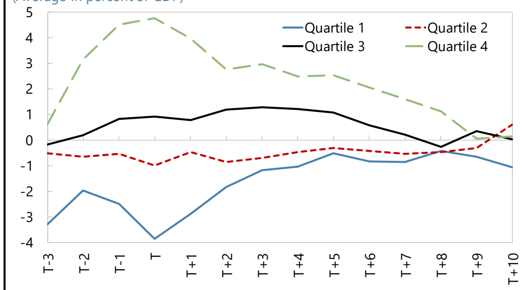
[13] This analysis refers to programs financed with the General Resources Account, such as Stand-By Arrangements and the Extended Fund Facility.

Reversal after 10% Consolidation Reaching 3.5% Surplus
(Percent of GDP)



Sources: IMF World Economic Outlook database; and Mauro et al. (2013).

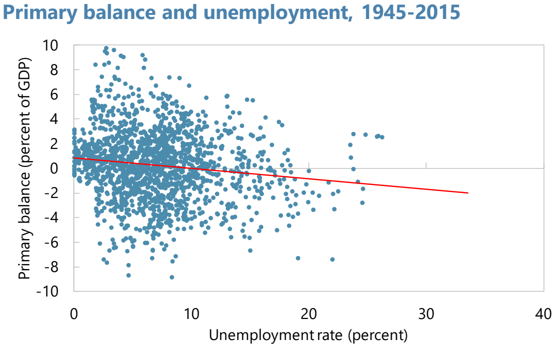
Average Primary Balances after GRA Programs
(Average in percent of GDP)



Source: IMF staff calculations.
Note: The quartiles are based on the primary balance at the last program year.

14. High unemployment is associated with lower primary fiscal balances. Unemployment weighs on the budget through higher social expenditures—such as for unemployment benefits and social safety nets—as well as lower income-related revenue. Greece's unemployment rate is exceptionally high—only 10 countries have had unemployment higher than 20 percent in the post-war period. Within the above sample, the average primary balance corresponding to countries suffering double-digit unemployment rates is about zero percent of GDP (*i.e.* balance). For double digit unemployment lasting for 10 years or longer, the average primary balance is about -½ percent of GDP. With long-term unemployment likely to remain high for some time, pressures on social assistance spending in Greece—such as the guaranteed minimum income—are likely to mount.

Primary balance and unemployment, 1945-2015



Sources: Mauro et al. (2013); World Development Indicators database, World Bank; and IMF World Economic Outlook database.
Note: The chart shows five-year averages. Outliers were excluded.

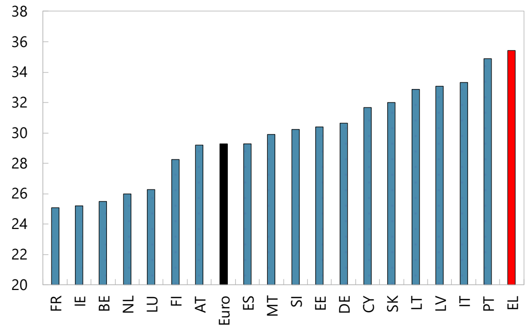
Unemployment and Primary Balance

Country	Period	Primary Balance (percent of GDP)	Unemployment Rate (percent)
Argentina	1993-2006	0.3	16.4
Chile	1975-1987	2.0	13.4
Colombia	1999-2012	1.3	12.0
Georgia	1998-2013	0.6	13.4
Jordan	1990-2013	0.2	14.4
Morroco	1995-2005	2.3	13.4
Nigeria	2000-2011	2.9	13.5
Poland	1995-2006	-0.8	15.0
Slovakia	1995-2007	-2.9	16.4
South Africa	2000-2013	2.0	24.8
Spain	1980-2004	-1.0	17.2
Sudan	1990-2013	-0.6	15.2

Sources: IMF World Economic Outlook database; and Mauro et al. (2013).

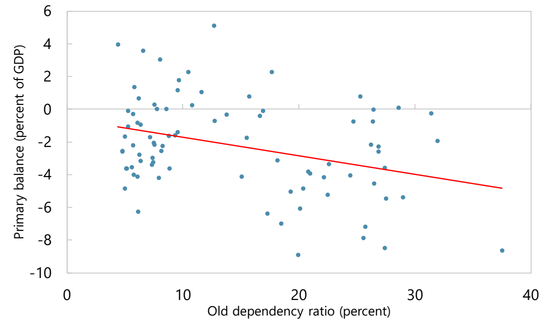
15. Demographic pressures also constrain primary balance performance. Countries with aging populations are not generally able to sustain large fiscal surpluses for long periods, as the share of taxpayers in the population declines while the share of the population receiving health, pension and other social benefits rises. Greece's old-age dependency ratio is high compared to those in peer countries; and according to the latest EC's Aging report is projected to be the highest in the Euro Area by 2060.

Elderly population 65 and over (2060 projections)
(Percent of total population)



Source: European Commission, Aging Report 2018.

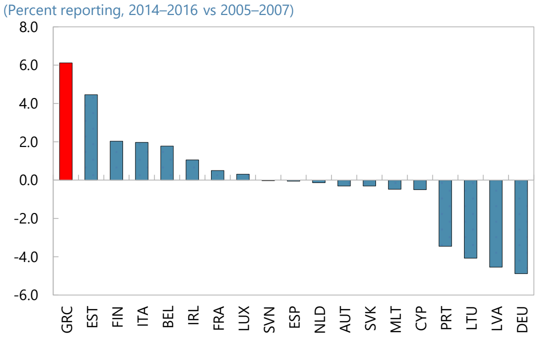
Primary Balance and Old Dependency, 2010



Sources: Mauro et al. (2013); World Development Indicators database, World Bank; and IMF World Economic Outlook database.

16. **Health spending has been compressed to one of the lowest levels in the Eurozone**, which is unsustainable. During 2010–15, social health spending declined by 1 percent of GDP, which disproportionally affected the poor, as evidenced by the rising share of out-of-pocket spending among the poorest quintile (from 22 percent of household income in 2010 to 44 percent in 2015). During this period, intermediate consumption in health declined by half relative to the average level in Europe. This large adjustment has taken a toll on the quality of health services, as evidenced by a significant increase in the share of people reporting unmet healthcare needs, especially among the poor. The large reduction of health expenditure in recent years widened the gap from the average level of health expenditure among European peers. In 2015, Greece's general government health expenditure stood at 4½ percent of GDP, about 1¾ percent of GDP lower than the average of EU15 countries. As European countries face similar demographic challenges, the European average provides a good benchmark for the adequate level of public resources to ensure a provision of quality health service to the population.

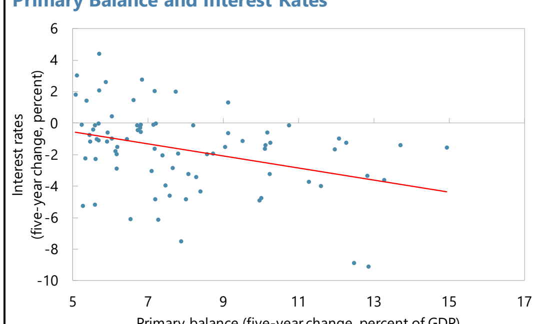
Increase in Unmet Healthcare Needs
(Percent reporting, 2014–2016 vs 2005–2007)



Sources: Eurostat; and IMF staff calculations.

17. **Finally, the inability to fully use monetary and exchange rate policies for counter-cyclical purposes also limits the primary balance performance**. Countries without an independent monetary policy will find it more challenging to sustain large primary fiscal surpluses as monetary and exchange rate policy tools are not available to country authorities for aggregate demand management. Based on the above sample, changes in primary balance larger than 10 percentage points of GDP during a period of five years are associated only with periods of monetary easing. This relationship is in line with Escolano et al. (2014). Interest rates in Greece are not expected to ease over the projection horizon.

Primary Balance and Interest Rates



Sources: IMF World Economic Outlook database; and Mauro et al. (2013).

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Annex VII. Risk Assessment Matrix[1]

Source of Risk	Relative Likelihood and Transmission	Expected Impact if Realized	Recommended Policy Response
Reform fatigue	**High** It could dent the pace of structural reforms or result in back-tracking. Political pressures might intensify ahead of the 2019 elections.	**High** Policy reversals may trigger loss of confidence and renewed liquidity and fiscal pressures.	Stay on track with implementation of policies agreed under the ESM-supported program and the SBA-AIP.
Tighter global financial conditions	**High** Against the backdrop of continued monetary policy normalization and increasingly stretched valuations across asset classes, an abrupt change in global risk appetite (e.g. due to higher-than-expected inflation in the U.S.) could lead to sudden sharp increases in interest rates and associated tightening of financial conditions. Higher debt service and refinancing risks could stress leveraged firms, households and vulnerable sovereigns, including through capital account pressures in some cases.	**High** Lower growth, liquidity pressures, and higher debt service costs for banks, non-financial corporates, and the sovereign.	Accelerate clean-up of banks' and private sector balance sheets. Continue with gradual conditions-based relaxation of capital flow management measures.
Structurally weak growth in key advanced economies	**High** Low productivity growth (U.S., euro area and Japan), high debt, and failure to fully address crisis legacies by undertaking structural reforms amidst persistently low inflation (euro area and Japan) undermine medium-term growth.	**Medium** Adverse impact from lower exports to the rest of Europe and weaker confidence.	Diversify export destinations, and accelerate reforms to improve competitiveness. Rebalance spending towards vulnerable groups, health and investment—also making better use of EU funds.
Weaker recovery of domestic demand	**Medium** More-adverse-than-expected impact of high primary surpluses on growth, a lower-than-expected output gap, smaller gains from fiscal and structural reforms.	**High** Lower growth could undermine fiscal performance and perpetuate debt problems.	Stay on track with implementation of agreed policies; pursue a more growth friendly consolidation by tackling structural challenges on the expenditure side, lowering tax rates and broadening tax bases.

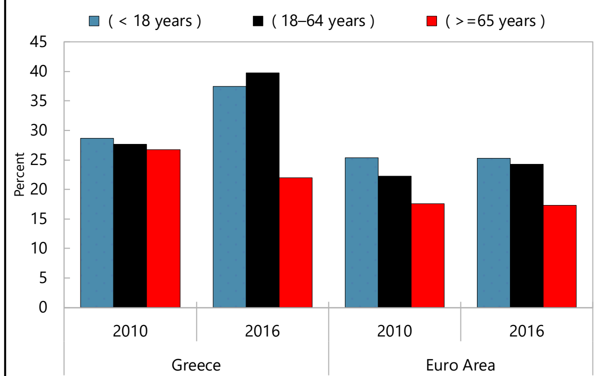
Policy uncertainty	**Medium** Two-sided risks to U.S. growth with uncertainties about the positive short-term impact of the tax bill on growth and the extent of potential medium-term adjustments to offset its fiscal costs; uncertainty associated with negotiating post-Brexit arrangements and NAFTA and associated market fragmentation risks; and evolving political processes, including elections in several large economies, weigh on the whole on global growth.	**Medium** Negative consequences for trade, and capital flows, sentiment, and growth.	Diversify export destinations, and accelerate reforms to improve competitiveness.
Intensification of the risks of fragmentation/security dislocation	**High** In parts of the Middle East, Africa, Asia, and Europe, leading to socio-economic disruptions.	**Medium** Fiscal pressures related to military spending, and to migrants' flows.	Keep sufficient fiscal buffers.

[1]The risk assessment matrix shows events that could materially alter the baseline path discussed in this report (the scenario most likely to materialize in the view of staff). The relative likelihood is the staff's subjective assessment of the risk surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risk and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex VIII. Social Welfare Reforms in Greece

1. Greece's social support system was inefficient and poorly targeted leading up to the crisis. It was heavily centered around a highly generous old-age pension system, with limited direct support in place for lower income households and the unemployed. When the crisis hit, those with pensions or work income supported others, but it was not sufficient. Consequently, poverty rates increased disproportionately for the working age population and the youth.

At Risk of Poverty by Age

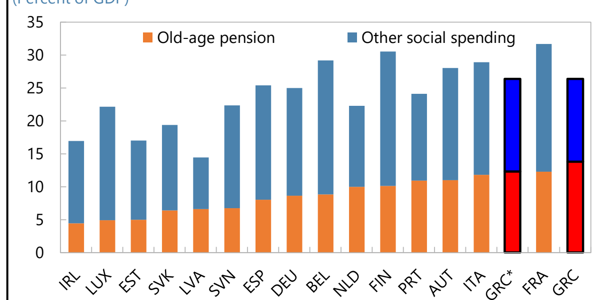


Source: Eurostat.

2. Despite reforms taken under the programs, the social welfare system remains inordinately reliant on old-age benefits. At 27 percent of GDP (in 2017), Greece's overall social spending is higher than the average Euro Area country. But much of this is still for pensions, while other social safety nets remain underdeveloped, underfunded, or both.

Social Spending, 2015

(Percent of GDP)



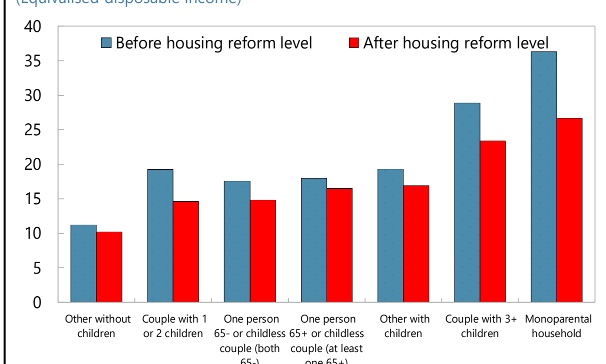
Sources: Eurostat; OECD; and IMF staff estimates.

Note: GRC* applies the rebalancing between pension spending that will be implemented in 2019 and other social spending (SSI and other spending measures) to the 2015 data.

3. The authorities are deploying a new means-tested system which aims to improve the effectiveness of the social safety net. The authorities have already implemented two of four planned components: (i) the minimum income scheme (SSI) activated in 2017 which provides support to households with equivalized imputed income below €2,400 per year (thus directly addressing extreme poverty and reducing inequality); and (ii) a new child benefit scheme activated in 2018 that provides higher support for those with lower income. In addition, a housing benefit for renters and households with mortgages aiming to address the severe housing cost overburden in the first two income quintiles will take effect in 2019; and a new ALMP system will be implemented. Some other smaller targeted programs are also forthcoming.

At-Risk-of-Poverty Headcount by Household Type

(Equivalised disposable income)

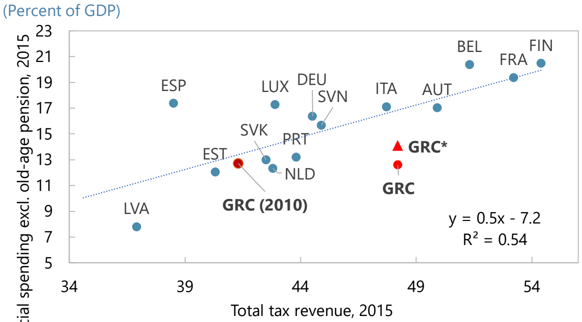


Sources: Based on Greek authorities' simulation; and IMF staff calculations.

4. Even after the new system is fully implemented, non-old age benefits will remain low compared to peer countries. Once fully implemented, the combined budget for the new (non-old age benefit) schemes will be about 1½ percent of GDP. While this is a welcome improvement, overall spending on non-old age benefits would remain low. Staff estimates that up to an additional 2½ percent of GDP in non-pension social spending would be more in line with peers. However, scope to further increase these benefits is hindered by the still high pension spending (despite substantial reforms), and the high envisaged primary balance targets agreed with the Greece's European partners.

Social Spending versus Tax Revenue

(Percent of GDP)



Sources: Eurostat; OECD; and IMF staff calculations.

Note: GRC* applies the rebalancing between pension spending that will be implemented in 2019 and other social spending (SSI and other spending measures) to the 2015 data.

5. In addition, the authorities will need to guard against various pitfalls as they implement the new system. The newly designed system promises to help better cushion future shocks but also creates risks, such as a proliferation of untargeted benefits (e.g., a new transportation benefit), and a risk of creating poverty traps.

INTERNATIONAL MONETARY FUND

GREECE

July 13, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION AND PROPOSAL FOR POST-PROGRAM MONITORING—INFORMATIONAL ANNEX

Prepared By

European Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(as of May 31, 2018)

Membership Status: Joined December 27, 1945.

Exchange Rate Arrangements: Greece's currency is the euro, which floats freely and independently against other currencies. Greece has accepted the obligations of Article VIII, Sections 2, 3, and 4, but maintains three exchange restrictions subject to Fund approval under Article VIII, Section 2(a) arising from the following measures: (i) absolute limits and discretionary Bank Transactions Approval Committee (BTAC) approval of the availability of foreign exchange for certain payments and transfers for (a) current international transactions related to normal business activities and (b) invisible transactions and remittances (such as travel, except for tuition fee and medical expenses). (ii) discretionary BTAC approval of transfers abroad of moderate amounts for the amortization of loans and of income from investments including dividends and interest payments of non-financial entities to non-residents; and (iii) absolute limits on withdrawal of cash from bank accounts in Greece in the absence of an unrestricted channel for payments due to discretionary BTAC approval and absolute limits. Greece also maintains exchange restrictions for the reasons of national or international security, set at the EU level, and notified to the Fund under Executive Board Decision No. 144.

General Resources Account:

	SDR Million	Percent Quota
Quota	2,428.90	100.00
IMF's Holdings of Currency	10,896.63	488.62
Reserve Tranche Position	572.97	23.59

SDR Department:

	SDR Million	Percent Allocation
Net Cumulative Allocation	782.36	100.00
Holdings	5.22	0.67

Outstanding Purchases and Loans:

	SDR Million	Percent Quota
Extended Arrangements	9,040.63	372.21

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
EFF	Mar 15, 2012	Jan 15, 2016	23,785,30	10,224.50
Stand-by	May 09, 2010	Mar 14, 2012	26,432.90	17,541.80

Projected Payments to the Fund:
(SDR Million, based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2018	2019	2020	2021	2022
Principal	977.61	1,704.08	1,704.08	1,704.08	1,587.49
Charges/Interest	151.88	240.67	156.39	88.12	53.62
Total	1,129.49	1,944.75	1,860.48	1,792.21	1,641.12

Article IV Consultations:
The last Article IV was concluded on February 6, 2017, following consultation discussions that ended on September 22, 2016. Greece is on the standard 12-month consultation cycle.

Resident Representative:
Mr. Dennis Botman (Senior Resident Representative) assumed his position in September 2016.

Technical Assistance:

Department	Purpose	Date
STA	Government Finance Statistics	November 2016
FAD	IT Strategy Development in Tax Administration	December 2016
FAD	Institutional Reforms in Tax Administration	January 2017
FAD	IT Strategy Development in Tax Administration	February 2017
STA	Government Finance Statistics	February 2017
FAD	Chart of Accounts, Cash Management and Reconciliation	March 2017
STA	Government Finance Statistics	May 2017
FAD	Roadmap for IT Strategy Implementation in Tax Administration	August 2017
FAD	Restructuring Tax Debt	September 2017
FAD	Strategic Planning in Tax Administration	October 2017
FAD	Implementing a Treasury Single Account	November 2017
FAD	Roadmap for IT Strategy Implementation in Tax Administration	January 2018
FAD	Assessment of Tax Administration	February 2018
FAD	Follow-up on Tax Administration Reforms	February 2018
FAD	Chart of Accounts, Accounting and Treasury Single Account Reforms	February 2018
STA	Government Finance Statistics	February 2018
FAD	Developing Communication Procedures in Tax Administration	March 2018
FAD	Performance Targets in Tax Administration	March 2018
FAD	Roadmap for IT Strategy Implementation in Tax Administration	April 2018
FAD	Cash Management Legislation and Regulation	June 2018

STATISTICAL ISSUES

As of June 20, 2018

I. Assessment of Data Adequacy for Surveillance	
General. Data provision has some shortcomings but is broadly adequate for surveillance. The quality of Greek statistics has improved since the establishment of the independent Hellenic Statistical Authority, ELSTAT, in 2010.	
Real sector. Quarterly and annual national accounts are compiled in accordance with the *ESA 2010* standard. The CPI is chained annually, and weights are being renewed every year on the basis of the most recent available data from the Household Budget Survey.	
Fiscal sector. General government accounts are compiled in accordance with *ESA 2010*. Eurostat has not validated and published Greece's general government financial accounts reported by the Bank of Greece (BoG). The financial accounts data reported by the BoG do not follow Eurostat standards (Reg. 479/2009 and Reg. 549/2013 interpreting ESA 2010) in several areas. In addition, compilation issues result in flows that appear implausible and have also not been validated by Eurostat. Therefore, reported data are not comparable to non-financial accounts data and data reported in the context of EDP. Shortcomings in source data, such as the absence of accounting records on operations not passing through the state budget (e.g. Single Treasury Account), also present risks to fiscal data quality. Greece reports high frequency and annual GFS data for general government to STA through the Eurostat GFS convergence project with the IMF.	
Trade and balance of payments. Since January 2015, data are provided according to the IMF's sixth edition of the *Balance of Payments Manual*. Historical data based on the new methodology are available from January 2002. Since July 2015, the BoG has been using ELSTAT's trade statistics instead of the settlements data used until June 2015 inclusive. Therefore, the goods trade balance statistics reflect customs-based or other administrative data, as collected or estimated by ELSTAT. Historical data based on the methodology is available from January 2013.	
Monetary sector. Data on the central bank (BoG) balance sheet and on the aggregated balance sheets of other depository corporations are available from BoG's website. The data are also reported to the IMF through the ECB using standardized report forms: 1SR for the central bank (1SR) and 2SR for other depository corporations (ODCs). Data on other financial corporations (OFCs) is not compiled.	
Financial sector surveillance. Data on financial soundness indicators (FSIs) are compiled and reported to IMF on a quarterly basis and covers deposit takers, other financial corporations, nonfinancial corporations and households.	
II. Data Standards and Quality	
Greece has been a subscriber to the Fund's Special Data Dissemination Standard (SDDS) since November 8, 2002.	A data module of the Report on the Observance of Standards and Codes (ROSC) was published in 2003, and it was updated in 2004 and 2005 in the context of the Article IV staff report.

Greece: Table of Common Indicators Required for Surveillance (As of June 20, 2018)					
	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	5/31/18	6/1/18	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	5/18	6/7/18	M	M	M
Reserve/Base Money	5/18	6/7/18	M	M	M
Broad Money	4/18	5/30/18	M	M	M
Central Bank Balance Sheet	5/18	6/12/18	M	M	M
Consolidated Balance Sheet of the Banking System	5/18	6/12/18	M	M	M
Interest Rates[2]	6/18	7/02/18	M	M	M
Consumer Price Index	5/18	6/08/18	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2017	4/23/18	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	4/18	6/4/18	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2018/Q1	5/18/18	Q	Q	Q
External Current Account Balance	4/18	6/20/18	M	M	M
Exports and Imports of Goods and Services	4/18	6/20/18	M	M	M
GDP/GNP	2018/Q1	6/4/18	Q	Q	Q

Greece: Table of Common Indicators Required for Surveillance
(As of June 20, 2018) (concluded)

Gross External Debt	2017/Q4	5/30/18	Q	Q	Q
International Investment Position[6]	2018/Q1	6/29/18	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security fun and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

Statement by Michalis Psalidopoulos, Executive Director for Greece
July 27, 2018

In recent years, the Greek economy has moved from a state of prolonged economic crisis to a state of solid economic recovery. Following years of protracted recession, eight years of economic adjustment programs and numerous structural reforms, Greece, in a few weeks, will successfully complete the ESM 2015–18 Economic Adjustment Programme.
The program has enabled the country to redress the significant fiscal and external imbalances that led to the crisis of 2010, thus, paving the way for the economic recovery and the sustained market access witnessed currently. The authorities thank the IMF for first, providing technical support to this program, and second, for approving in principle an SBA for Greece (July, 2017), which was not activated due to time constraints.

In this context, the Greek authorities welcome the Article IV report on Greece. The report is useful as a basis for IMF involvement and for providing an overall assessment of the economic situation. My authorities welcome the acknowledgement that macroeconomic imbalances have largely been eliminated and that numerous reforms have taken place. However, the report understates the impact of several fiscal and structural reforms, focusing more on delays, weaknesses and what has not been implemented, rather than on the economic potential of 450 legislated and implemented actions during the past three years, accompanied by the return to conditions of macroeconomic and fiscal stability.

My authorities also welcome staff's progress in revising the macro-fiscal outlook for the immediate post-program period. During the past years, the successful fiscal consolidation has strengthened credibility, dispelled economic uncertainty and improved the overall macroeconomic environment. The general government deficit of -15.1 percent of GDP in 2009, due to a large structural fiscal adjustment, has turned into a surplus of 0.6 percent in 2016 and 0.8 percent in 2017, the best fiscal outcome in at least the past 20 years. Greece has also been overshooting its primary fiscal targets by a wide margin for three consecutive years, signifying the ability of the economy to produce sustainable primary surpluses. The authorities call on IMF to recognize the significant fiscal effort and the ability of the economy to produce sizable surpluses within the enabling environment of the EU Stability and Growth Pact, which determines the targets for fiscal policy and the commitments of euro area countries.

My authorities and European Institutions repeatedly indicated to staff the significant fiscal impact of legislated reforms, both during all program reviews and during the last 2017 Article IV report, where the primary surplus for 2018 at the time was projected by staff merely at 1.5 percent of GDP. Without adopting any structural fiscal measures since 2017 and with a lower GDP growth outcome than the IMF projected at the time, my authorities welcome the primary surplus revision by staff at 3.5 percent for the 2018–2022 period, thus, indicating that past staff fiscal projections were significantly more pessimistic, by a margin of at least 2 percent of GDP in structural terms. Despite the revision, my authorities regret to observe that no additional space is projected from 2019 to 2022 while the underlying baseline includes the one-sided implementation of the pre-legislated package. In light of previous more pessimistic projections by staff and the significant *ex post* revisions that took place, specifically for 2016, 2017 and 2018, a clearer, transparent and credible explanation of the methodology and assumptions followed by staff is warranted. The Article IV report would benefit from an elaboration of the sources of these revisions, as well as a detailed analysis of the growth and distributional impact and transmission channels of the pre-legislated fiscal package, without which the projections and the staff's proposals which are based on these projections, lack credibility.

The reform effort, especially in the areas of product markets, business environment, justice and public administration, has been intense and has started bearing fruit, while the banking sector has undergone significant restructuring of its governance framework and it is now working with a wide and effective set of tools for the cleaning up of their balance sheets. Numerous structural reforms have been implemented in almost all sectors of economic activity and public administration, creating the conditions for long-term growth. The program reforms that stand out include the following:

- On the fiscal side, pension and income tax reform; indirect taxation; the enhancement of electronic payments; and the creation of an independent tax authority.

- In the banking sector, the NPL resolution strategy involving insolvency legislation; an out-of-court workout scheme; and an electronic auctions platform.

- Regarding privatizations: the new privatization and investment fund, HCAP, for the management of Greek state assets.

- On labor and product markets covering, *inter alia*, collective bargaining and dismissals, as well as dealing with the issue of unreported and underpaid work and the adoption of OECD recommendations on product market organization and competition.

In addition to more than 450 actions legislated during the past three years, the reform effort is set to continue in years to come through the Greek Growth Strategy and the post-program framework. The Greek Growth Strategy provides a concise overview of the medium-term objectives set by the authorities, supported by specific actions. Specifically, it highlights the necessity to continue growth friendly reforms that also foster social cohesion and inclusion. In this context, three areas have been identified that will be of outmost priority given their significant impact: public administration, business environment and the judicial system.

The Article IV report would benefit from a more balanced tone regarding the achievements and the potential impact of these reforms on long-term growth. Instead of emphasizing what has been done and in analyzing the impact of the implemented reforms, the report paints an overly-negative picture of reform implementation, emphasizing delays without giving credit to achievements. On competition, the report focuses on Sunday trade, itself being one of hundreds of recommendations under OECD Toolkits I, II and III, without mentioning neither other recommendations implemented, nor their long-term impact on growth. On privatizations, the report fails to acknowledge the completed tenders, such as the Pireaus Port, the Thessaloniki Port, the financial closing of Astir, the privatization of the Greek train operating company, the regional airports and the significant progress on Hellinikon, to name a few. My authorities regret that the report fails to fully acknowledge the progress made and to reflect the impact of the wide-raging reforms on the long-term growth potential of the economy.

On labor markets, unemployment has been falling steadily over the past years but wages remain subdued, undermining the recovery and exacerbating inequality. In the post-program period, growth must be inclusive and opportunities must be available for everyone. Thus, prudent wage formation is essential as economic growth gains momentum which requires collaboration between authorities and social partners when setting minimum wages. My authorities take note of the IMF's view on collective bargaining and minimum wages, but cannot subscribe to that view and remain unconvinced of the analysis they have provided so far. The authorities recall that the extension and favorability principles were suspended temporarily in 2012 with a defined time horizon for reinstatement. Moreover, in the context of the 3rd review of the ESM program, an independent group of experts was established with the consent of all interlocutors, tasked with assessing these principles. The experts were in favor of the reinstatement of both principles: unanimously in favor of lifting the suspension of the extension principle and by majority in favor of the lifting of the suspension of the favorability principle. Since these arrangements were temporarily suspended with an exact date of reinstatement, the authorities disagree with the view that reinstatement constitutes policy reversal.

Lastly, my authorities welcome that the IMF recognizes the sustainability of Greece's debt over the medium term. However, staff's assumptions used in the DSA remain overly pessimistic on nominal growth, fiscal path and market refinancing rates, especially given the large output gap, the low participation rates in the labor market and the numerous reforms implemented in recent years. Compared to the assumptions used by all other institutions, the baseline scenario of the IMF is in line with their and our adverse scenario, thus failing to incorporate the possibility of better than expected outcomes. These asymmetric assumptions stem from a lower primary surplus scenario, an insufficient assessment of the impact of reforms on long-term growth and significantly more pessimistic refinancing rates compared to the most recent market data. The effect of the Stability and Growth Pact on the sustainability of public finances and the production of surpluses for euro area countries, including Greece, is also not accounted for in the analysis. The rationale behind these assumptions needs a detailed explanation. Lastly, although my authorities acknowledge the need for a prudent public financial management going forward, they do not share the staff's view that democratic processes should be considered a risk factor.