Greece 2020 – Factsheet on Financing the real economy

Greece's protracted economic crisis has resulted in major investment gaps in several sectors. Total fixed investments in Greece were at 11.4% of GDP in 2019, lagging all EU peers and standing 10 ppts of GDP below EU average. Smooth financing of the economy is key for Greece's swift recovery following the pandemic crisis as well as for its resilient and sustainable growth in the long-term. The current juncture presents a challenging opportunity whereby the Covid-19 severe economic hit is partially offset by unprecedent liquidity provision measures both from a monetary and fiscal perspective at the national and European level.

Figure 1: Main pillars of financing the real economy

- Private sector (banks, capital markets)
- Public sector (public investment budget)
- International sector (EU funds and programmes)
- Crisis response (fiscal stimulus and liquidity relief measures)

Private sector

- Banks have traditionally been the main pillar of funding for productive investments in Greece. Despite their strong capital and liquidity base, they continue to face significant challenges, not least of which relates to their fragile asset quality, inter alia reflected by the highest stock of NPLs in Europe. While the "new" crisis sets further challenges on their credit capacity towards the real economy, unprecedent liquidity measures tend to simultaneously raise significant opportunities for a resilient recovery.
- Capital markets have systematically been under-exploited in Greece compared to other EU peers. The size of Greek investments in securities through institutional investors is among the lowest in the EU. In the current juncture, it is crucial to enhance households participation in targeted, growth enhancing capital market investments. Reform directions following good practice in other countries would relate to introducing a fully funded pension pillar, and tax incentives for retail investments through capital markets on start-ups and firms focusing on innovation, green investments or infrastructure networks.

Public sector

- The public investment programme has been continuously under-executed in recent years. Unlocking the full potential of exploitation of public assets and public investment is a prerequisite for durable growth.

EU funds

- Greece benefits from European Structural and Investment Funds (ESIF) of €21.4 billion during 2014-2020, through 20 national programmes. Their absorption rate by end-2019 was only 35%, hence there is prospect for better exploitation and synergies with public investments.

Pandemic crisis response

- Following the coronavirus crisis outbreak, unprecedent emergency liquidity measures have been taken both at the EU and national level. They offer a unique window of opportunity for a resilient recovery, as long as they are used effectively, and policy makers advance further on complementary structural reforms implementation.

Factsheet on financing channels in Greece, prepared by the Foundation for Economic and Industrial Research – IOBE, in the context of the European Semester e-Conference on Greece 2020, organized jointly with the European Commission

1. FACTS & FIGURES

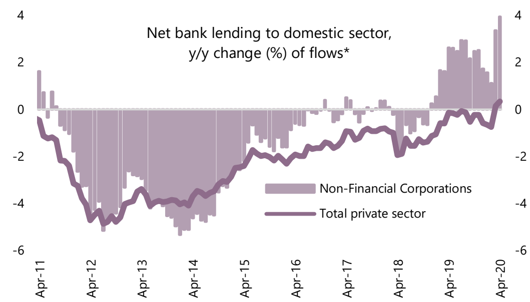
Banking system

The banking system has traditionally been the main pillar of funding for productive investments in Greece. Banks' lending channel was inevitably significantly affected by the sovereign debt crisis. As a result, banks' credit to the domestic private sector contracted during eight consecutive years since 2011, by an average rate of 2.3% per annum, following 10 years of accelerated credit growth of circa 16.9% per annum (2001-2010).

During 2020, the world economy was hit by the global pandemic crisis. The unprecedented containment measures implemented at a local, national and international level, combined with high uncertainty, have severe implications for economic activity, affecting both the demand and supply side. The real economy hit spills over to the financial sector, including through an impact on banks' profitability and assets' quality. At the same time, a series of significant monetary and fiscal policy measures have been taken at the national and European level, which inter alia curtail the pressure on NPL formation, allow Greek banks to access wholesale funding at significantly lower cost and aim to maintain the momentum of credit recovery despite the weakening real economy.

Bank credit to non-financial corporations has been growing since 2019, after seven years of contraction, while credit growth to households remains negative for a tenth consecutive year. Net lending to businesses accelerated markedly during March-April 2020, reaching the highest growth rate since September 2009, reflecting (i) firms' high liquidity needs in the context of the Coronavirus outbreak, which inter alia triggered the activation of existing credit lines and (ii) the positive impact of policies by both the Greek government and the European Central Bank to support the provision of emergency liquidity by banks.

*Figure 2 Bank lending in Greece during 2011-2020**

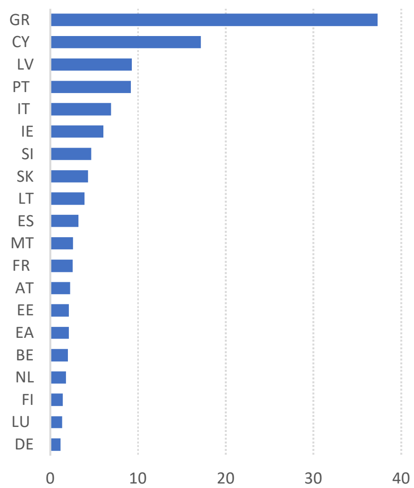


Source: Bank of Greece
**Flows after correcting for write-offs, exchange rates and statistical reclassifications.*

Nominal lending rates to non-financial corporations have continued their downward trend, reaching a historical low in March 2020, albeit remain higher than the respective for Euro Area peers; those to households have also declined since the summer 2018 but remain somewhat above the minimum reached in 2015. Like in other euro area countries, the decline in lending rates to non-financial corporations in 2020 largely reflects the very accommodative monetary policy, as well as the various targeted measures geared to support the flow of credit to households and firms across the euro area.

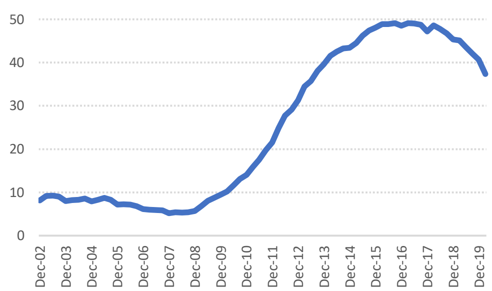
Following the sovereign debt crisis, banks' asset quality continues to be a major challenge, which in turn affects banks ability to finance the economy. The pace of reduction of Non-Performing Loans (NPLs) accelerated in 2019 but their share (37.4% in March 2020) remains by far the highest in the Euro Area. The stock of NPLs at end-2019 reached €68.5 billion, down by €13.3 billion relative to one year before and €38.7 billion below the March 2016 peak. The main drivers of its decrease in 2019 were sales of NPLs worth €8.1 billion and €4.3 billion of write-offs.

Figure 3 NPL ratio (%) across the EA, end-2018



Source: ECB (consolidated bank group data)

Figure 4 NPL ratio (%) in Greece during 2002-2020



Source: Bank of Greece (individual bank level data)

The current economic shock (coronavirus) is affecting banks' NPL reduction strategies. Greek systemic banks have made use of the flexibility awarded to them by the supervisory authority and will submit their 2020 revised strategies to reduce non-performing loans six months later, i.e. in September 2020. The 'Hercules' asset protection scheme will be impacted too, as the risk profile of Greek NPLs may be impacted leading to repricing of costs for the participating banks.

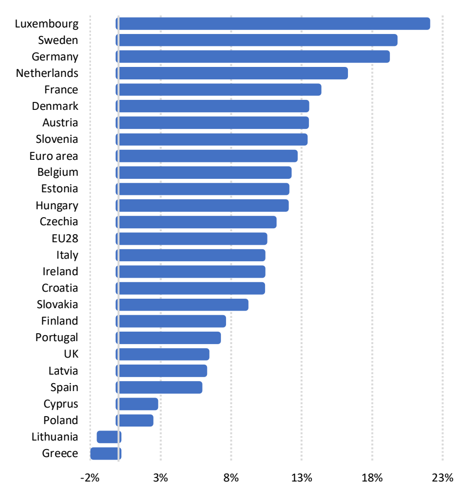
In response to the coronavirus hit, the Hellenic Bank Association announced a 6-month moratorium, on the capital instalments of performing loans by affected companies. Besides, a 3-month moratorium was extended to loan instalments by affected natural persons, while servicers of NPLs announced a similar 3-month suspension of any loan instalments.

Capital markets

In the context of a quick and durable recovery from the pandemic crisis it is crucial to prioritize productive investments. However, Greece continues to be an outlier in household savings and fixed investments compared to all EU peers.

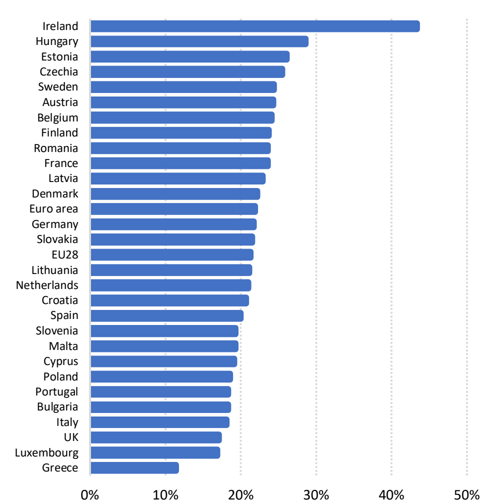
- Greek households have been recording negative savings for the last few years (-1.8% in 2018).
- Total fixed investments in Greece reached only 11.4% of GDP in 2019, compared to 21.3% for the EU average.

Figure 5 Household savings in 2018 (% of disposable income)



Source: Eurostat

Figure 6 Gross Fixed Investments in 2019 (% of GDP)



Source: Eurostat

The current juncture calls for the need, while offers an opportunity to further exploit financing opportunities provided by capital market instruments.

- Financing the economy in Greece has traditionally been bank-centric, but the high rate of NPLs puts restrictions on new lending.
- The size of Greek investments in securities through institutional investors is among the lowest in the EU, which inter alia relates to the absence of a fully funded pension pillar.
- The reserves of insurance funds invested in the capital market account for only 8% of GDP, the second lowest in the EU.

Figure 7 Institutional Investors Total Assets, 2018 (% of GDP)

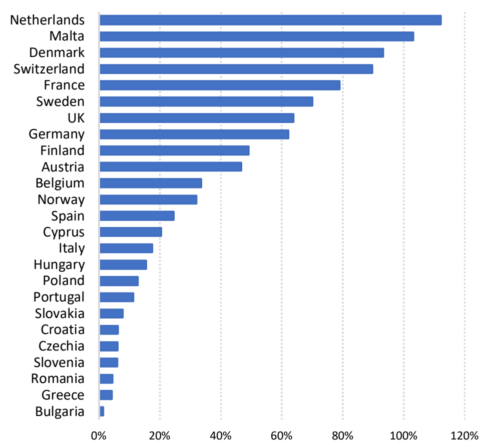
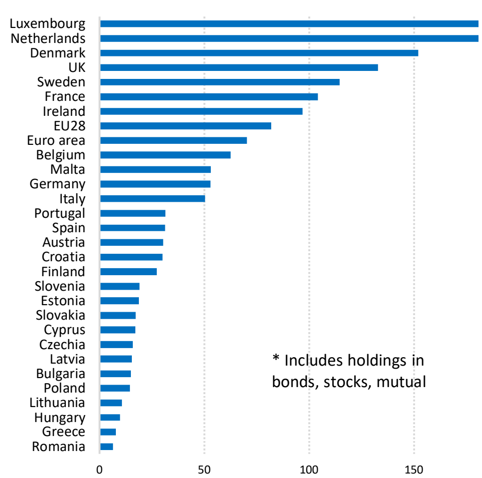


Figure 8 Pension Funds and Insurance Companies, total assets invested in capital markets in 2018 (% of GDP)*



Source: Eurostat

At the European level, the envisaged Capital Markets Union is considered a critical factor in mobilizing savings and investments to create jobs. In addition, the EU General Exemption Regulation 651/2014 enables Member States to introduce incentives for household financial investments in targeted domestic small and medium-sized enterprises (SMEs), without violating the state aid ban within the EU single market. Several Member States (e.g. France, Italy) have already exploited such opportunities through tax incentives to strengthen their capital markets. In particular, tax exemptions are granted to individuals who invest, either directly or indirectly (through collective investment schemes) in shares or bonds of domestic SMEs, start-ups, and firms focusing on innovation, green investments or infrastructure networks.

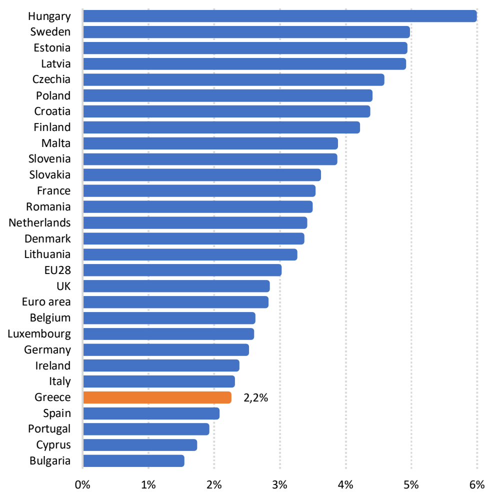
Public Investment Programme

Greece's protracted economic crisis has resulted in major investment gaps in several sectors. Once both domestic and foreign funding dried up in the aftermath of the global financial crisis, private investment plummeted, notably residential investment. Public investment also dropped sharply. Investment slowly started to recover since 2015, albeit remains the lowest in the EU.

The Public Investment Programme recorded an annual decline of around €1.5bn on average during 2010-2016 compared to 2000-2008. The public investment programme has been continuously under-executed in recent years. Only in 2019, general government investment was lower by 1.2% of GDP or €2.3 billion compared to the initial plans, to reach 2.2% of GDP, the fifth lowest rate in the EU. At the same time, the pandemic affects the implementation of the privatization program, inter alia through difficulties in engaging with potential investors, impact on asset valuations, reduced administrative capacity to implement necessary actions, and the delay of construction works.

Unlocking the full potential of exploitation of public assets and increasing the effectiveness of public investment remains a priority and also a key requirement for a speedy recovery after the Coronavirus outbreak. To this direction, Greece is currently designing for the first time a 5-year horizon public investment programme, i.e. a multi-year allocation of funds based on macroeconomic and social criteria.

Figure 9 ***Public investments across the EU, 2019 (% of GDP)***

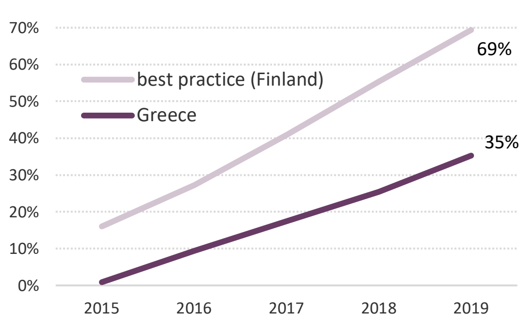


Source: Eurostat

EU funds

EU funds supporting growth and convergence among member-state economies have been providing significant liquidity to the Greek economy during the past four decades. During the period 2014-2020, Greece benefits from European Structural and Investment Funds (ESIF) of €21.4 billion, through 20 national programmes. However, Greece lags EU best practice in terms of the absorption of EU funds, with 35% of the total 2014 – 2020 ESPA budget being effectively spent by end-2019, compared to 69% in Finland.

Figure 10 Implementation progress in absorption of 2014-2020 ESIF (spending, in % of total budget)



Source: https://cohesiondata.ec.europa.eu/countries

Crisis response: Fiscal stimulus through liquidity relief measures

A. National level

Following the coronavirus crisis outbreak and in line with the coordinated response agreed by the Eurogroup, the Greek authorities adopted an extensive set of fiscal measures. The adopted measures aimed to support around 2 million persons and 800,000 companies during March-May. Among those, a sub-set aimed to provide emergency liquidity to the productive sectors and households mostly hit. Indicatively, such initiatives included:

- Moratorium on payments for tax and social security obligations including the tax instalment schemes for at least 3 months for affected companies and workforce.
- Public guarantees offered by the Hellenic Development Bank via the commercial bank network. The total envelope for guarantees is €2 billion in the form of cash collateral together with an additional €250 million of guarantees and loans towards the small and medium-sized enterprises through the current 'TEPIX II' scheme.
- Direct grants offered by the government for the provision of credit, and particularly working capital, to viable, primarily small and medium sized enterprises. These schemes will complement initiatives backed by the European Investment Bank. The total envelope is up to €0.8 billion in the form of interest subsidies to existing performing loans

According to estimates by the European institutions, the overall size of the government measures announced during March-May has been around 10.5% of GDP, of which 5.0% of GDP are budgetary measures. Moreover, the net impact on the budget balance of these measures was estimated at 3.7% of GDP, as part of the measures are fiscally neutral and part will be financed by the EU level Coronavirus Response Investment Initiative or through a re-allocation of expenditure from the public investment budget.

B. EU level

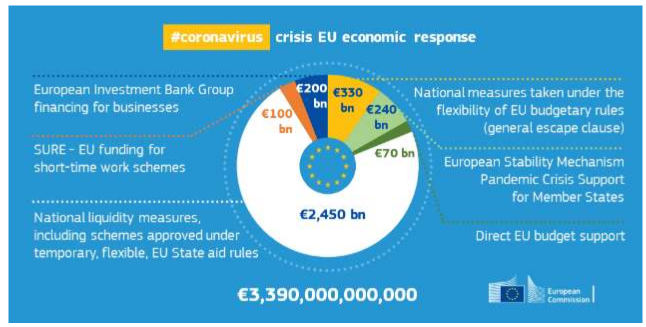
The Coronavirus Response Investment Initiative Plus (CRII Plus) – approved by the EU Parliament since 17 April – introduced the necessary flexibility to allow a full mobilization of all non-utilized support from the ESIF, of around €37 billion. These funds will come from the European Social Fund (ESF) and the European Regional Development Fund (ERDF) and will be available for the needs of the health system, as well as for issuing guarantees on SME loans for working capital.

Greece is further benefitting from a number of European Commission initiatives to counteract the economic impact of the pandemic and the guarantee fund set up by the European Investment Bank (EIB). Indicatively:

- Financial support for affected workforce to be available through the program 'Support to mitigate Unemployment Risks in an Emergency' (SURE)
- Financial support for affected Greek firms to be available via the pan-European guarantee fund set up by the EIB which is aiming at mobilizing €200 billion in loans to EU SMEs.
- The EIB group is also increasing funding under the already existing support schemes, aiming to support SMEs.
- The European Commission launched 'ESCALAR', a new investment instrument developed together with the European Investment Fund (EIF) that will support venture capital and growth financing.

On 23 April, 2020, the European Council approved the €540 billion package of safety nets for workers, businesses and sovereigns. Besides, it agreed to establish a Recovery Fund to further support economies in the aftermath of the protective measures. On 27 May, the European Commission presented its Recovery Plan and the new financial instrument 'Next Generation EU', that will be embedded within a long-term EU budget. 'Next Generation EU' will raise money by temporarily lifting the EU own resources ceiling to 2% of EU Gross National Income, allowing the Commission to use its strong credit rating to borrow €750 billion from the financial markets. A key pillar of the plan is the new 'Recovery and Resilience Facility', which will be embedded in the European Semester and will offer up to €560 billion of financial support (up to €310 billion in grants and up to €250 billion in loans) for investments and reforms, linking these to the EU priorities. The European Council is expected to decide on the final modalities of the scheme to be implemented.

Figure 11 EU economic response to the pandemic crisis



SURE / ESM Pandemic Crisis Support / EIB Guarantee Fund for Workers and Businesses	€540 billion
Next Generation EU	Temporary reinforcement €750 billion
Multiannual Financial Framework	€1 100 billion

Source: European Commission

Note: The presentation excludes emergency monetary stimulus implemented by the European Central Bank

In parallel to the aforementioned measures put in place by the European Commission and the EIB, the European Central Bank (ECB) expanded its already unprecedentedly large quantitative easing programme by another €750 billion in order to boost liquidity and curtail the effects of the crisis. (Pandemic Emergency Purchase Programme)

2. Open Discussion Questions

- What are the main challenges faced by Greek banks in financing productive investments? What other policies need to be introduced to restart bank financing?

- How is NPL formation affected by the pandemic crisis? What should be the key priorities in relation to banks' revised NPL reduction strategies? How will the new Insolvency Code impact financing and NPL reductions? What is the role of solutions such as asset protection schemes, or the debate over the creation of a 'bad bank' in order to accelerate the improvement of banks' asset quality? Which are the main risks?

- What are the prospects for banks' credit growth in the medium run?
- How can Greece enhance households' investments in domestic capital market instruments (scope for tax incentives, reforms in the pension system)? How can Greece develop a capital market for smaller firms?
- How will the envisaged 'Capital Markets Union' affect the Greek economy's funding prospects? Does the coronavirus pandemic affect its implementation timeline?
- How can Greece's EU Structural Funds programme contribute to growth and jobs for 2021-27? How can Greece improve the absorption rates of its EU funds?
- How important are both the size as well as the allocation of Greece's public investment programme?
- How can the HCAP's public sector real estate holdings be leveraged to supply financing for the economy?
- How do international markets and rating agencies assess the impact of the pandemic on Greece's credit rating? How do they assess Greece's longer-term access to capital markets?
- The Coronavirus Response Investment Initiative as well as the contemplated 'Next Generation EU' provide precious liquidity resources to member states, including Greece. Can this facilitate the ownership and timing for further structural reforms?
- What precedent/legacy does the current crisis set for Europe's preparedness to tackle future crises?
- How will the 'Recovery and Resilience Facility', be aligned with the European Semester procedures?

3. Sources

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