Greece: Staff Concluding Statement of the First Post-Program Monitoring Mission

January 25, 2019

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

An International Monetary Fund (IMF) mission visited Athens during January 21-25, 2019 for the first Post-Program Monitoring (PPM) discussions—part of the IMF's regular surveillance of countries with IMF credit outstanding above either SDR 1.5 billion or 200 percent of quota. PPM missions are focused on vulnerabilities and risks to the repayment capacity to the IMF. The IMF mission was coordinated with the European Commission, the European Central Bank, and the European Stability Mechanism

Growth and job creation in Greece are expected to accelerate further in 2019, while public sector financing needs remain manageable. To maintain growth momentum, reform efforts should focus on raising productivity and reducing vulnerabilities. Policy priorities include creating fiscal space to lower direct taxes and raise public investment and targeted social spending, accelerating the clean-up of bank balance sheets, and enhancing labor market flexibility and cost competitiveness. This would also help to mitigate intensifying downside risks.

1. **Economic activity is expected to accelerate in 2019, and then gradually moderate over the medium-term as the output gap closes.** Growth is projected to reach 2.4 percent in 2019, up from an estimated 2.1 percent in 2018. Exports, especially tourism, and consumption (supported by declining unemployment and higher confidence) are leading the way. The recovery in private deposits has allowed a further relaxation of capital flow management (CFM) measures. Investment growth remains tepid, however, due to high base effects and still-weak investor sentiment. Over the medium term, growth is expected to reach just above 1 percent, when economic slack is eliminated, despite the gradual reduction in the high primary surplus targets agreed with European partners. The current account deficit is expected to remain broadly unchanged in the medium term after deteriorating in 2018.

2. **Medium-term public debt repayment capacity remains robust** . This reflects the government's moderate gross financing needs under the baseline and a substantial precautionary cash buffer. Primary surplus targets are expected to be met and debt is projected to decline over the medium term. However, a strong policy response would be required to ensure the sovereign's repayment capacity over the medium-term if significant downside risks materialize.

3. **Downside risks have intensified.** Crisis legacies remain significant, including high public debt, impaired private balance sheets, and a weak payment culture. In this context, external risks (such as a deterioration in trading partner growth, a potential sharp tightening of global financial conditions, and a slowdown in global trade) could dampen exports and growth. Investment and medium-term growth and competitiveness prospects could be weakened by reform fatigue (or reversals) in the context of an election year. Fiscal risks stem from ongoing court cases, while the banks remain sensitive to financing conditions and regulatory changes.

4. **To maintain hard-earned competitiveness gains amid rising wage pressures, Greece should press ahead with its unfinished reform agenda.** The authorities' growth strategy provides laudable high-level objectives, but further measures will be needed to achieve them. In the labor market, greater flexibility would help mitigate any negative effects to competitiveness and employment from wage pressures in excess of productivity growth and the abolition of the youth minimum wage. These mitigating measures should also include structural reforms in other areas (including product markets), aiming to boost productivity and lower non-wage costs.

5. **A growth-friendly rebalancing of the fiscal policy mix, and preparing contingency plans to address fiscal risks, are priorities.** Achieving higher, more inclusive growth while meeting the fiscal targets agreed with European Institutions is challenging but can be facilitated through budget-neutral improvements in the fiscal policy mix. The government should prioritize cuts to wage and profit tax rates, funded by the planned broadening of the personal income tax base next year. A contingency plan should be prepared to deal with potential fiscal shocks from ongoing court cases to core pension and wage reforms, as well as from contingent liabilities such as guaranteed bank loans. Accelerating ongoing IAPR and public financial management reforms will further support spending efficiency, build fiscal space, and mitigate fiscal risks.

6. **Restoring growth-enhancing bank lending will require swift, comprehensive, and well-coordinated actions to help repair balance sheets**. Coordinated steps by key stakeholders are needed to support banks' efforts to achieve a faster reduction of non-performing loans (NPL). The authorities should revisit the design of the household insolvency framework and facilitate the efficient use of electronic auctions and out-of-court workouts. Public funds could support market-based efforts to reduce NPLs, but the cost-effectiveness of such a strategy should be assessed in a comprehensive manner, including its impact on bank and sovereign balance sheets. These steps, combined with other efforts such as improving internal governance, will help restore profitability and build capital and liquidity buffers. CFM liberalization should continue in line with the conditions-based roadmap.