

September 28, 2021
Approval: 10/5/21

INTERNATIONAL MONETARY FUND
Minutes of Executive Board Meeting 19/15-2
10:45 a.m., March 6, 2019

2. Greece—First Post-Program Monitoring Discussions

Documents: EBS/19/6 and Correction 1, and Supplement 1

Staff: Dohlman, EUR; Bredenkamp, SPR

Length: 1 hour 16 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors Alternate Executive Directors

D. Mahlinza (AE)

F. Sylla (AF)

D. Vogel (AG), Temporary

G. Johnston (AP)

P. Fachada (BR)

Z. Jin (CC)

P. Moreno (CE)

L. Levonian (CO)

C. Just (CE)

H. de Villeroché (FF)

S. Meyer (GR)

S. Gokarn (IN)

M. Psalidopoulos (IT)

Y. Saito (JA)

M. Dairi (MD)

H. Beblawi (MI)

R. Doornbosch (NE)

J. Sigurgeirsson (NO)

A. Mozhin (RU)

M. Mouminah (SA)

K. Tan (ST)

A. Tola (SZ), Temporary

D. Ronicle (UK)

P. Pollard (US), Temporary

S. Bhatia, Acting Secretary

S. Maxwell, Summing Up Officer

V. Sola, Board Operations Officer

L. Nagy-Baker, Verbatim Reporting Officer

Also Present

European Central Bank: K. Nikolaou, R. Rueffer. European Department: P. Dohlman, D. Kim, M. Mendez Cintron, M. Song, P. Thomsen. Fiscal Affairs Department: S. Mbaye. Finance Department: J. Hukka. Legal Department: C. DeLong. Monetary and Capital Markets Department: T. Bayle, M. Savastano. Strategy, Policy, and Review Department: H. Bredenkamp.

Alternate Executive Director: C. Just (EC), M. Siriwardana (IN). Senior Advisors to Executive Directors: Y.Liu (CC), W. Nakunyada (AE). Advisors to Executive Directors: S. Bah (AF), L. Cerami (IT), M. Coronel (BR), I. Fragin (GR), G. Khurelbaatar (AP), H. Mori (JA), M. Mulas (CE), A. Olhaye (AF), A. Park (AP), P. Snisorenko (RU), N. Vaikla (NO).

2. GREECE—FIRST POST-PROGRAM MONITORING DISCUSSIONS

Mr. Psalidopoulos submitted the following statement:

The Greek authorities welcome the IMF's First Post Program Monitoring report and thank staff for the continuous constructive dialogue and engagement.

Following the successful completion of the ESM Economic Adjustment Program, Greece was integrated into the normal cycle for the coordination of economic policies across the European Union – the European Semester. Economic recovery gains strength and is expected to accelerate in the coming years. Public finances are on track to sustainability, while Greece's successful access to capital markets confirmed that the country has restored its credibility. The reform effort continues with the view to boost growth and address remaining challenges.

Economic recovery is gaining traction and is projected to continue in 2019 and in the medium term. The Greek economy has been growing for seven quarters in a row, at a modest pace in 2017 and an accelerated pace during the last three quarters of 2018 with a forecast for robust growth in 2019 and beyond. Real GDP growth is expected to reach 2.1 percent in 2018 and 2.5 percent in 2019. The drivers of growth have been both domestic and external. Household consumption has rebounded strongly after several years of negative growth with the annual growth rate exceeding 1 percent in 2018 and over the medium term, supported by increased employment and higher disposable income. Exports of goods have increased at double-digit rates in the last two years reflecting both a more benign external environment and significant improvements both in cost and non-cost competitiveness. Unemployment has been falling steadily from a peak of 27 percent in 2013 to nearly 18 percent supporting household consumption and social security revenue, although the level of unemployment and the quality of job creation still remain a challenge that needs to be addressed going forward.

Greece continues to deliver sustainable public finances while also improving the fiscal policy mix to support growth and social inclusion. Building on the strong fiscal track record of the previous years, the general government primary surplus will exceed the fiscal target of 3.5 percent of GDP in 2018 also making Greece one of seven euro-area countries with a positive fiscal balance in the period 2016-2018. Furthermore, Greece is on track to meet its fiscal target for 2019-2022, while fiscal space is expected to emerge, as economic recovery gains traction and the output gap closes,

allowing a shift in the fiscal mix. To this extent and in the context of the 2019 Budget, the Government introduced a fiscal package of 0.5 percent of GDP including reductions in taxes and social security contributions, as well as an increase in targeted social spending. Fiscal risks might possibly arise from court rulings on past wage and pension reforms, but any potential impact could be covered from contingency buffers in the budget.

Significant progress has been achieved on the state of the financial system and the liquidity of Greek banks, while vulnerabilities still persist and will be addressed. Private non-financial sector deposits increased at an accelerating pace for the second straight year in 2018 on improved depositor sentiment and reduction of uncertainty. At the same time, the ELA funding, which soared during the crisis years as the key funding source for Greek banks, was almost eliminated at the end of 2018. Greek banks are adequately capitalized with their Common Equity Tier 1 (CET1) ratio at 15.6 percent (September 2018), while the stress tests conducted by the EBA in May 2018 did not identify any capital shortfall for the four significant Greek banks. Thus, the authorities disagree with the assessment of staff that “the Greek banking system remains highly vulnerable” (on p.14) However, despite its steady decline in the previous years, the NPE stock remains high and a comprehensive approach is needed to clean up bank balance sheets. Key elements are already in place, including a continuous increase in e-auctions and further improvements in the legal framework of out-of-court workouts. At the same time, the Government has already presented to DG COMP an Asset Protection Scheme and has also designed and intends to move ahead with a comprehensive and well-targeted household insolvency law to replace the existing framework. The authorities disagree with staff’s assessment of a still weak payment culture as it steadily improving, and, in any case, a poor payment culture should not be confused with genuine payment problems in time of still existing liquidity constraints.

Since the successful completion of the ESM program, the Greek authorities have carried the reform momentum forward with the view to address existing vulnerabilities and support growth-enhancing policies. Notable reforms have been implemented in several areas including public financial management, health care, justice, public administration and product markets, while the successful completion of privatization projects has led to proceeds of €1.8 billion. The recent increase in the minimum wage is expected to boost labor productivity via higher demand and the elimination of economic slack. The Greek authorities are closely monitoring developments in the labor market and are ready to undertake any necessary action. In any case, on the issue of labor markets, Greek authorities will work towards convincing

staff to rely in the future more on opinions of seawater economists, rather than exclusively relying on those of freshwater economists.

Following the debt relief measures adopted by the Eurogroup of 22 June 2018, the public debt is on a sustainable path. Greece is expected to meet the agreed benchmarks for gross financing needs i.e. below 15 percent of GDP in the medium term and below 20 percent of GDP thereafter. At the same time, state liquidity is sufficient to cover the financing needs for at least two years even without new issuances while the sovereign financing profile remains favorable in the medium term benefiting from extremely low average maturity and favorable interest rates. The Greek authorities are considering further actions to improve the debt profile including an early repayment to the IMF as part of their broader liability management strategy and in consultation with their European partners.

The Greek economic recovery has led to a significant improvement in market sentiment. The rating agencies have proceeded to multiple upgrades of Greece's rating with three rating agencies currently having a positive outlook implying potential further upgrades. The improved confidence in the prospects of the Greek economy has led the 10-year Greek government bond yield to pre-crisis levels at 3.7 percent. This was also reflected in the successful completion of a 5-year, €2.5 billion bond issuance in January, which was four times oversubscribed by high quality foreign investors.

Mr. Mahlinza and Mr. Nakunyada submitted the following statement:

The Greek authorities have made commendable progress in implementing reforms, which have helped eliminate macroeconomic imbalances, reduce unemployment, and attain broad-based growth. This notwithstanding, growth prospects remain vulnerable to reform fatigue, impairment of bank assets, materialization of fiscal risks, and policy reversals. Against this backdrop, additional efforts are required to reinvigorate the reform momentum through rebalancing the fiscal policy mix, enhancing labor market flexibility, repairing bank balance sheets, and completing outstanding structural reforms. We broadly share staff's assessment and provide the following comments for emphasis.

Rebalancing the fiscal policy mix is important to promoting sustained and inclusive growth. In this connection, we agree on the need to boost public investment, better target social expenditures, and broaden the tax base. Considering the numerous fiscal risks, the authorities should closely assess the cost-effectiveness of any new exposures to non-government entities and

financial institutions. We note that staff proposes exploring with European partners, the possibility of a smoothing mechanism to accommodate potential fiscal shocks. Could staff elaborate on how this mechanism operates? Further, we support the acceleration of other fiscal structural reforms to improve efficiency and build additional fiscal space. At the same time, we underscore the need for measures to moderate the liquidity implications of transferring fiscal revenues from banks into the Treasury Single Account (TSA). That said, we commend the authorities for their prudent fiscal policy efforts that have culminated in the accumulation of sufficient buffers that are expected to offset the materialization of fiscal risks as highlighted in the helpful buff Statement by Mr. Psalidopoulos.

An active policy stance on the repair of banks' balance sheets remains important to support a faster reduction in non-performing exposures (NPEs). In this regard, a system-wide NPE resolution strategy remains essential to restoring bank lending as well as improving the payment culture. Further, rebuilding liquidity and capital buffers, as well as strengthening internal bank governance practices should be prioritized. To this end, we urge the authorities to work in collaboration with European stakeholders to develop a comprehensive and well-phased strategy to restore bank profitability. That said, the creation of new NPEs remains a concern as it seems to exceed curing. We see merit in continued relaxation of capital flow management measures (CFMs) in line with the conditions-based milestones, while taking account of banks' liquidity needs. We note the divergence of views on the adequacy of the authorities' NPE strategy and would appreciate staff's comments.

Implementation of outstanding structural reform measures is critical to lock-in competitiveness gains, enhance productivity, and promote sustained growth. To this end, we urge the authorities to continue with efforts to improve labor market flexibility and boost labor force participation, while aligning wage adjustments with productivity. Additional structural reform efforts are required to strengthen the business environment and promote competition in the product and service markets to sustain the pace of employment creation. Could staff comment on the authorities' divergent view that stronger wage growth is expected to boost labor productivity via higher labor utilization?

Mr. Mouminah and Mr. Rouai submitted the following statement:

We thank staff for a focused report on the first Post-Program Monitoring (PPM) and Mr. Psalidopoulos for his informative buff statement.

We are in broad agreement with staff's analysis and policy recommendations and would limit our remarks to a few issues.

We are comforted by recent positive developments in Greece following years of difficult macroeconomic and social adjustment. The authorities should be commended for their efforts, in particular in the area of fiscal adjustment, which were critical in restoring growth, reducing unemployment, and improving debt sustainability. We also welcome staff assessment that Greece's capacity to repay the Fund is adequate as well as the authorities' intention to prepay IMF lending subject to surcharge. This assessment is reinforced by recent upgrades by ratings agencies and by the successful, albeit costly, re-access to markets. However, we take note of staff concern about the slowdown of the reform momentum, in an environment still characterized by high vulnerabilities associated with the legacy of the crisis. In this connection, we encourage the authorities to remain committed to implementing the necessary structural reforms to strengthen financial stability and, more importantly, generate the much-needed growth to improve inclusiveness and social indicators.

The focus of the policy discussions on further reforms to promote growth and improve the economy's resilience is appropriate. In this regard, we share staff's emphasis on the importance of enhancing productivity and competitiveness, particularly after the authorities' recent decisions to increase the minimum wage and reverse the 2012 collective bargaining agreement. Staff also points to the current legal challenges to past wage and pension reforms and we would appreciate some clarifications on the timing of the court rulings.

The authorities should be commended for their continuous fiscal consolidation efforts. We note that the target for the 2018 primary fiscal balance of 3.5 percent of GDP was exceeded, even after excluding the "social dividend" of taxes and social security contributions reductions and increases in targeted social spending. We also take note of the authorities' confidence to reach the fiscal targets for the period 2019-22. We are concerned, however, about the still high level of government arrears and, while we appreciate the authorities' recognition of the need to identify and address their structural roots, we would appreciate staff elaborations on any concrete action plan and timetable to resolve this issue.

Despite the significant progress, the banking system remains exposed to high crisis legacy vulnerabilities. As long as non-performing exposures (NPEs) remain elevated (the highest in Europe, with 47 percent of total loans

at end-September 2018), banks will remain constrained to lend to the private sector and support the economic recovery. We encourage the authorities to give due consideration to staff recommendations for a comprehensive, well-coordinated actions to strengthen banks' balance sheets, improve the payment culture, and revive bank lending. On a related issue, we would appreciate if staff could elaborate on the authorities' strategy to provide protection to distressed mortgage holders.

With these comments, we wish the authorities all the success.

Mr. de Villeroché, Mr. Meyer, Mr. Doornbosch, Mr. Just and Mr. Sigurgeirsson submitted the following statement:

We thank staff for their positive assessment in the context of Greece's Post Program Monitoring. We also appreciate the informative buff statement of Mr. Psalidopoulos.

We broadly share staff's macro and fiscal forecasts and their broad assessment of risks. We welcome staff's positive assessment of Greece's repayment capacity. We commend the authorities for achieving past fiscal targets and we share the staff's view that the fiscal policy targets are likely to be met. We also broadly agree with the staff's fiscal policy recommendations. Adopting an ambitious growth-friendly tax reform will indeed be a main priority for 2020. Furthermore, improving budgeting practices to overcome the recurrent underspending, especially on the investment budget, will be instrumental to enhancing the predictability of fiscal policy. In the same vein, continuing labor and product market reforms are critical in boosting productivity and potential growth.

Macroeconomic developments

Growth has returned to Greece in a more durable manner, lowering unemployment further. After almost a decade of negative growth, the economic recovery is progressing and broadening with the help of higher exports, especially tourism, and higher private consumption. These welcome developments along with an improved cost competitiveness can serve as the basis for sustaining growth in the future. The unemployment rate has continued decreasing but remains still high at 18.5 percent in November 2018. This underscores the need to maintain and further strengthen reforms increasing cost competitiveness. We agree with staff that risks to the forecast point to the downside and we also share their belief that past and planned

structural reforms are crucial in ensuring that Greece can continue to grow in the future.

Fiscal policies

The staff's emphasis on fiscal risks is helpful and we share their view that, in the event of Court rulings overturning key structural elements of reforms agreed under the program, the recurrent fiscal implications of such rulings should be largely addressed by reforms/actions within the same policy field. The authorities are well advised to continue monitoring the high number of ongoing court cases.

Staff's message in stressing the importance of tax compliance and emphasizing a cautious approach to tax debt settlement schemes is fully aligned with the message of the European Institutions (EI) second enhanced surveillance report.

Staff present a debt sustainability analysis for the medium term, up to 2028. We take note of the slight improvement of the Fund's debt sustainability analysis since the last publication. This now makes the staff's baseline scenario slightly more favorable than the EI's adverse scenario. While the two baselines are still apart, staff's general assessment of the medium-term debt outlook, including the potential risks considered, seems reasonable.

Financial market policies

While Greek banks' liquidity position has improved significantly during program engagement, they continue to face important challenges, such as the high levels of non-performing exposures (NPEs). It is therefore crucial to further strengthen the legal toolkit for NPE reduction, while avoiding measures that could have a negative effect on the payment culture. We concur with the staff's view that the authorities could usefully consider additional State-support schemes to accelerate NPL resolution, which should be based on a careful assessment of their relative merits, other implications and limitations, including implications for debt sustainability, conducted by the government in cooperation with the Bank of Greece and other stakeholders as needed. While vulnerabilities in the Greek banking sector certainly exist, we would caution staff against communicating it in a way that could trigger negative market reaction (paragraph 26). As regards the indication of the banks' exposure to the sovereign that equals to 180 percent of their CET1 capital it would be useful to add a footnote to provide the underlying

calculation, given that deferred tax assets are normally not included in definitions of sovereign exposure.

Structural policies

The Greek authorities have delivered on a number of agreed reform initiatives. However, we share staff's assessment that Greece needs to do more in terms of sustained implementation of structural reforms so as to improve the business climate. This is key to attracting investment in Greece and to improving the ease of doing business. We also agree that a slowdown in reform momentum could hamper the country's path towards sustainable and socially inclusive growth in the medium term.

We also share staff's concerns on labor market issues, including the risks of competitiveness losses due to wage settlements that are not in line with economic fundamentals. In 2019 the minimum wage increased and the favorability and extension principles – that in agreement with European partners had been suspended in 2012 until the end of the programs – have been reinstated. However, going forward, it is important that the Greek authorities closely monitor labor market developments so as to assess the impact of changes to collective bargaining and the increase in the minimum wage. We also agree that labor market flexibility and structural reforms in other areas including product markets remain essential and are even more critical to mitigate the risks to employment and competitiveness given the recent increase to the minimum wage and the abolition of the youth sub-minimum wage.

Mr. Lopetegui and Mr. Vogel submitted the following statement:

We thank staff for the informative report and Mr. Psalidopoulos for his comprehensive buff statement.

We are encouraged by the growth rate observed in Greece in 2008, which is projected to accelerate further this year. It is important to consider that since 2008, Greece has shown only three years of positive growth rates, the one in 2018 being the highest. Meanwhile, although still at high levels, Greece's sovereign spread (vs. Germany) has been recording a considerable decrease over the past months, reflecting other positive developments. The big question for Greece's case looking forward would be whether this welcome recovery serves as a platform to consolidate sound policies and propel the remaining structural transformations, which are so importantly needed to successfully face the substantial risks and challenges lying ahead. We are

encouraged by the authorities' commitment to reform and policies aimed at addressing existing vulnerabilities, as underlined in Mr. Psalidopoulos' buff statement.

Unemployment rates are still high but have declined from the levels observed about five years ago, when they surpassed 27 percent. Clearly, much remains to be done in this area and, in this regard, staff provides appropriate comments and recommendations, for example, emphasizing the need to boost productivity and lower non-wage costs. Staff covers the usual risks to employment and competitiveness posed by the recent minimum wage hike, the abolition of the sub-minimum wage, and the extension of collective bargaining. We would have welcomed further elaboration on the impact of these measures on domestic demand, inequality, and the ability to increase consensus in society to support further structural reform. Annex IV on labor market policies brings about interesting facts and comments; for example, that minimum wage had been frozen since the 2012-13 reforms, and that at least 15-20 percent of the workers are receiving the minimum wage; how does this percentage compare with the situation in peer countries? Figure 1 of Annex IV underscores that there is "a raising share of workers receiving the minimum wage since 2015..." is the explanation of this trend related to a reduction of the level of wages towards the minimum?

Greece's public debt-to-GDP ratio, in the range of 180 percent, eloquently reflects the need to keep extreme prudence in fiscal policies. These policies should aim at attaining debt sustainability, reducing the likelihood and impact (by developing a contingency strategy, as recommended by staff) of an eventual contingent liability shock, helping to boost inclusive growth in a sustainable way, and reducing inequality. We recognize the significant efforts and progress made by the authorities and people of Greece in the fiscal area and agree with staff that the policy mix should be improved. We take note of the staff's positive assessment in Annex III related to medium-term debt; in any case, it is necessary to consider that beyond the dynamic of the debt, in Greece's case its high level constitutes a risk by itself. We understand the authorities' consideration that the risks assumed under the downside scenario are unlikely to materialize simultaneously, although the materialization of one risk may trigger others. We welcome the authorities' indication that in this case there would be space for a policy adjustment to ensure achievement of fiscal targets and to preserve market access in the medium term. We are encouraged by the increase of total revenues, while noting the staff's comments that tax compliance remains well below advanced country standards. We recently read in the news that the Independent Authority for Public Revenue has some problems in attracting

highly-qualified staff, which could exacerbate the above-referred issue. Could staff elaborate further on the expected steps to address the tax compliance gap?

The banking system entails substantial risks for the country, starting with the high level of non-performing exposures that reach almost to half of outstanding loans. Staff provides, in Annex V of the report, a valuable framework to analyze eventual state support for NPE reductions, including quantitative and qualitative aspects. Meanwhile, as previously noted on interrelated risks, fiscal and financial risks are deeply connected through the Greek banks' exposure to domestic sovereign risk, as explained in Box 1 of the report.

We note that the authorities are considering an early repayment to the IMF as part of its broader liability management strategy. We would like to have a further elaboration from staff on the benefits and costs that this decision would have from the financial point of view.

Among the risks underlined in the staff report, there is one linked to pre-election policy pledges. We would appreciate an update from staff on the basic platform of the different parties that could have a greater chance of winning the election.

With these comments, we wish Greece and its people every success in their future endeavors.

Mr. Fachada and Mr. Coronel submitted the following statement:

We welcome the first Post-Program Monitoring (PPM) with Greece and thank staff for the report. We also thank Mr. Psalidopoulos for his statement.

We are pleased with staff's assessment that Greece's capacity to repay the Fund remains broadly adequate under the baseline scenario, supported by above-target fiscal outturns, comfortable cash buffers, and low gross financing needs. We take note that the Greek authorities are exploring the possibility to prepay the Fund their debt subject to surcharges. Nonetheless, we agree with staff that the Greek economy remains vulnerable to mounting domestic and external risks, which can affect the country's capacity to repay its obligations.

Increasing potential growth should remain Greece's main strategic objective. In 2018, real GDP growth continued to accelerate and, although

prospects for 2019 are promising with GDP projected by staff to expand by 2.4 percent, a gradual slowdown is expected thereafter, as economic activity is constrained by structural factors and crisis legacies. Increasing the growth potential of the economy requires long-term reforms, a challenging task given reform fatigue and the lack of social and political cohesion. In our view, the priorities outlined by staff to support faster and sustainable growth and strengthen economic resilience are appropriate. Boosting productivity, competitiveness and private investment, promoting labor market reforms, pursuing a more growth-friendly fiscal policy, increasing public investment in energy, infrastructure and transportation, and accelerating efforts to clean up bank balance sheets would make growth more robust and inclusive going forward.

Greece's public debt overhang remains a concern, although fiscal results have been above target and gross financing needs are manageable over the medium-term. In 2018, the primary surplus exceeded the 3.5 percent of GDP target, and the 'social dividend' enabled the distribution of part of the excess surplus without creating a recurrent spending. Given the current fiscal policy mix and increasing fiscal risks, we agree with staff about the need to further improve tax compliance and accelerate some public financial management initiatives. We take note of the exercise in Annex VI that considers the impact of a downside scenario on Greece's capacity to repay its debt. Although useful, the exercise does not seem very realistic as it assumes the materialization of contingent liabilities, legal shocks and curtailed market access combined with a permanent reduction of VAT and no offsetting policy response.

Weak bank balance sheets continue to hamper the economy. Despite some progress in the reduction of non-performing exposures, much remains to be done to recover the capacity of Greek banks to expand private credit and contribute to economic growth. Tackling the still poor payment culture through proper legislation and a speedier judiciary remains key.

Ms. Pollard and Ms. Crane submitted the following statement:

We thank staff for the report and Mr. Psalidopoulos for the helpful buff statement. We welcome recent positive trends in the Greek economy, including the acceleration and broadening of GDP growth, rising employment and disposable income, and further building of the cash reserve through the January bond offering. The staff report highlights potential risks to Greece's hard-won progress on competitiveness. We encourage the authorities to persist with reforms to improve labor and product markets, strengthen the

growth-orientation of fiscal policy, and address the overhang of non-performing exposures. We welcome the detailed analysis of Greece's capacity to repay, an important element of Post Program Monitoring, and concur with staff's conclusions. We'd like to focus our comments in a few key areas.

Fiscal Policy. Greece has taken important steps to meet the challenging fiscal targets agreed with European partner institutions. We commend the authorities for this discipline but stress the importance of improving the growth orientation of fiscal measures. It is disappointing that the authorities cancelled the pre-legislated pension reform based on perceived fiscal space resulting from budget under-execution. Considering that well-targeted capital spending is sorely needed to boost weak investment and sustain the recovery, under-execution of capital spending is particularly worrying. Taken as a whole, the revised package of measures adopted by the authorities does not fully make up for cancellation of the pre-legislated package in either quantity or quality. Going forward, we encourage a policy mix that lowers taxes to boost growth while broadening the tax base, building on recent progress on tax compliance, and that improves the growth-orientation of spending.

Financial Sector. Banks remain weighed down by non-performing exposures (NPEs) and further efforts are needed to restore banks to their role in supporting growth. We concur with staff that a more comprehensive, well-sequenced strategy for repairing bank balance sheets is necessary. We strongly encourage the authorities to expedite the assessment of the proposed NPE reduction solutions. While the staff report suggests that removing obstacles to the existing private sector-led strategies could be effective, and we agree that work to make private disposal more attractive and efficient should continue, we believe that it is becoming increasingly clear that a public solution is also needed. Banks are unwilling or unable to sell NPEs, and absorb associated losses, at prices that private sector actors are willing to pay. We appreciate the annex outlining criteria the authorities could use to assess the costs and benefits of different forms of state support for NPE reduction. But we believe that at this juncture the competition policy objectives of the state aid rules should be subsumed to the interest of restoring financial intermediation necessary for a resumption of economic growth. Could staff elaborate on the pros and cons of a system-wide NPE reduction solution centered on state guarantees versus deferred tax credits (assuming state aid rules are not triggered)? We encourage continued progress in the gradual lifting of capital flow management measures as economic conditions permit.

Capacity to Repay. We welcome staff's analysis showing that near-term financing needs are manageable, particularly with the large cash buffer, the use of hedging to manage interest rate risks, and current prospects for periodic market borrowings. We welcome the possibility of Greece repaying the IMF early and the authorities' stated commitment to undertake additional policy adjustment, if needed, in the event of a downside scenario.

Labor Markets. We share staff's concerns that changes to the collective bargaining framework and the sizeable increase in the minimum wage (notably for the young) risks undermining progress on competitiveness and constraining employment. We urge the authorities to consider anchoring further minimum wage developments to objective productivity-related indicators, as recommended by staff. Can staff elaborate on successful examples from peer countries? On the positive side, we welcome active labor market policies such as the pilot retraining program for the long-term unemployed and efforts to incentivize hiring of youth.

Mr. Beblawi and Ms. Abdelati submitted the following statement:

The continued expansion of economic activity in 2018 is welcome, together with the recovery in employment, consumer confidence, and economic sentiment, as reflected in the upgrades by rating agencies. Productivity gains and improvements in competitiveness are noteworthy. The outlook is promising with near-term growth and job creation expected to accelerate in 2019. An improved fiscal position has helped reduce the public sector financing needs, and the authorities successfully tapped international markets. However, credit continues to contract in most categories, which constrains growth. We share the concerns that the hard-earned gains could be eroded, if the unfinished reform agenda is not pursued or if key reforms were reversed in some cases.

We welcome the overachievement of the fiscal target in 2018 and continued commitment to sustainable fiscal finances. We agree with staff that achieving higher and more inclusive growth, while meeting the fiscal targets agreed with the European partners, is challenging. Substantial fiscal risks from ongoing court challenges to core pension and wage reforms call for fiscal contingency planning. We take note of the authorities' assurance that fiscal risks that might possibly arise from court ruling on past wage and pension reforms would be covered from contingency buffers in the budget. However, we support staff's suggestion to explore with European partners the possibility of accommodating such shocks through a smoothing mechanism, in order to preserve growth friendly and socially inclusive expenditure. We also take note

of the authorities' view that fiscal space is expected to emerge, as the economic recovery gains traction, and that would allow for a shift in the fiscal mix.

Care is needed to avoid or mitigate the negative effects on competitiveness and employment from rising wage pressures. The report provides useful analysis of the impact of the recent minimum wage hike and abolition of the sub-minimum wage. Enhancing labor market flexibility remains a key priority, and this could be helped by reconsidering the recent changes in collective bargaining policies. The authorities argue that the adverse impact of the wage hike would be minimal and expect it to boost labor productivity via higher labor utilization. Could staff comment on the potential for this outcome to materialize?

While agreeing that restoring bank profitability is critical to resume productive bank lending, the authorities object to staff's assessment that the Greek banking system remains highly vulnerable. While recognizing the significant progress that has been achieved on the state of the financial system, the level of nonperforming loans is extremely high at 44 percent of total gross loans in September 2018, and only one half of it is provisioned. This raises the risks of a sharp deterioration of sentiment towards banks. We see a need to accelerate clean-up of banks' balance sheets and to communicate a credible and ambitious strategy to restore bank sustainability. The authorities believe that key elements of a comprehensive approach to clean bank balance sheets are already in, and we look forward to staff's further elaboration of this in the Article IV report.

We very much appreciate staff's careful and clear analysis of debt sustainability. We are encouraged that staff finds Greece's capacity to repay the Fund adequate, and project debt- to-GDP to decline over the medium-term following the debt relief measures adopted by the Eurogroup in June 2018. The very strong cash buffer would allow the government to service its debt through end-2022, without any further market financing, and we note the authorities' readiness to consider early repayment to the Fund. However, additional actions would be required to maintain repayment capacity if some of the identified fiscal and other risks materialize.

Mr. Saito and Ms. Mori submitted the following statement:

We thank staff for comprehensive report and Mr. Psalidopoulos for his informative statement. We welcome that the economic recovery in Greece is accelerating and broadening. We also commend the continued high primary

surplus, low debt servicing costs, large cash buffer and successful market access. However, vulnerabilities stemming from crisis legacy including high public debt and impaired private balance sheet remain and downside risks such as global financial tightening and court rulings on past measures are rising. Against this background, continuous reform efforts are needed while taking into account reform fatigue and political pressure ahead of 2019 elections. We encourage the authorities to continue taking close communication with the Fund and European partners. As we broadly concur with the thrust of the staff's appraisal, we will limit our comments to the following points:

Structural Reform

While acknowledging the significant gains in competitiveness and in growth during the program era, further efforts are needed to enhance labor market flexibility and boost productivity and competitiveness. We share staff's concern on reduced labor market flexibility and rising wage pressure by recent reversal of the 2012 collective bargaining agreement reforms and statutory minimum wage hike far in excess of productivity growth. We support the staff's recommendation to pursue more flexible labor market policies. In addition, minimum wage consultation processes should be more firmly guided by productivity increases and economic considerations to foster durable, inclusive growth. Non-wage measures to boost investment, productivity and competitiveness should be pursued as well. In this regard, we note that the authorities insist that minimum wage increase is expected to boost labor productivity via higher labor utilization while the staff point out a risk of undermining the job recovery, an impact on the budget and an erosion of external competitiveness gains. staff's elaboration on this difference of view is welcome.

Fiscal Policy

Pursuing growth-friendly and socially inclusive fiscal policy mix and preparing a fiscal risk contingency plan are priorities. We welcome that the government overachieved 2018 primary fiscal balance target. However, given the series of fiscal risks such as legal challenges to past wage and pension reforms and pre-election policy pledges, the authorities need to develop fiscal contingent plan and build fiscal space while preserving targeting social spending and efficient investment to boost inclusive growth. In this point, we note that the authorities cancelled the pre-legislated 2019 pension reform and scaled back the accompanying expansionary measures such as targeted housing benefit and planned hike in investment. We would like to ask staff's

view regarding the impact of cancelled pension reform on fiscal balance on a longer horizon.

Financial Policy

Addressing high non-performing exposures (NPE) and restoring lending are indispensable for the country's growth. Swift approach to reduce NPE is crucial as a delay in disposal of NPE will increase the cost, and the government plays vital role in this process in addition to private solution. In this context, we agree with staff that the government should take a more forceful lead in bringing together key Greek and European stakeholders to assess the combined impact of various policies, proposals, prudential regulatory changes, and other developments on bank balance sheets, and a comparative cost-benefit analysis of the various proposals is warranted before moving ahead a public financial support. In this context, we support the very useful Guidelines for a Cost-Benefit Analysis. On the weak payment culture which staff repeatedly point out in the paper but the authorities disagree, could staff elaborate more on the background of evaluating as weak payment culture? Since changing culture is usually associated with difficulty and takes long time, what policy measures do staff recommend to change it?

Repayment Capacity

While we positively take note that Greece's repayment capacity is broadly adequate supported by a sizable cash buffer and low medium-term gross financing needs, the authorities should remain vigilant to downside risks. As the impact of downside scenarios such as the court ruling and VAT rate cut are significant, we agree with staff that a strong policy response and/or other measures would be required if significant downside risks were to materialize.

Mr. Moreno and Ms. Mulas submitted the following statement:

We thank staff for its positive assessment in the context of Greece's Post-Program monitoring and Mr. Psalidopoulos for his informative buff statement. We associate ourselves to the joint statement by Mr. de Villeroché, Mr. Meyer, Mr. Doornbosch, Mr. Just, and Mr. Sigurgeirsson and would like to add the following remarks.

We agree with staff's assessment that the economic recovery in Greece is accelerating and broadening; however, the social consequences of the crisis are still visible. After almost a decade of contraction and stagnation, Greece's

economy started to grow again in 2017 and accelerated in 2018 supported by exports. Indeed, authorities consider that Greece has become more export-oriented. Staff's views are welcome. Greece has substantially improved its budget and current account balances in recent years. Besides, the social situation started to improve from 2017, thanks to the gradual labor market recovery and the reforms which strengthened the Greek social welfare system. Despite recent improvements, Greece still faces challenges for most indicators of the Social Scoreboard supporting the European Pillar of Social Rights. To keep momentum, we encourage authorities to safeguard and foster the reforms needed to enhance an inclusive and sustainable growth in Greece.

We welcome staff's assessment that Greece's repayment capacity is broadly adequate under staff's baseline scenario. As noted in the buff statement, following the debt relief measures adopted by the Eurogroup, public debt is on a sustainable path. In June 2018, the Eurogroup agreed that certain policy-contingent debt measures were made available to Greece on a semi-annual basis up to mid-2022, subject to compliance with its commitments on reform continuity and completion, based on positive reports under enhanced surveillance. Therefore, it is highly important that authorities advance in its commitments to ensure the activation of policy-contingent debt measures agreed in the Eurogroup statement.

We commend authorities as Greece has successfully restored its budget balance and we urge them to maintain it over the next years. The headline balance has been in surplus since 2016 and the primary balance target was exceeded for the fourth consecutive year in 2018. The 2019 budget adopted in December 2018 is expected to ensure the achievement of the primary surplus target of 3.5 percent of GDP. However, several measures with an impact on the 2019 public finances have been adopted or announced after the 2019 budget was voted. Besides, some risks may come from the potential fiscal impact of some court rulings reverting past cuts in public wages and pensions. Against this background, we agree with staff on the need to develop a contingency strategy to offset the fiscal impact of these court decisions. Additionally, we consider that the implementation of the growth-friendly tax reform for 2020 is needed to ensure that the primary surplus target is met. From 2023, Greece's commitment is to maintain a fiscal trajectory that is consistent with its commitments under the European fiscal framework, which would be achieved, according to the analysis of the European Commission, with a primary surplus of 2.2 percent of GDP on average in the period from 2023-60. According to Greece' Public Sector Debt Sustainability Analysis (DSA), staff foresees a primary surplus target of 1.5 percent of GDP in 2026-28. Staff's comments are welcome.

Despite the progress made, the financial system in Greece faces several challenges. Wide-ranging policy measures to ensure financial stability and strengthen the viability of the banking system have helped to stabilize the financial sector. However, the Greek banking system remains vulnerable. Non-Performing Loans (NPL) resolution remains the most important challenge for the banking sector in Greece. NPL reduction is essential to allow Greek banks to fulfill their mission of providing credit to the real economy more promptly and to attract equity investors. A more ambitious pace of NPL reduction and a better design of the Household insolvency law that prevents across-the-board solutions that create problems of moral hazard, strategic defaulters and undermines the payment culture are needed. Recent proposals from the authorities on new systemic instruments to achieve a faster pace of NPL reduction are welcomed but will need to be assessed from an antitrust perspective to avoid protecting strategic defaulters.

Strengthening investment will be instrumental in underpinning longer-term growth based on progress in key reforms such as privatization. Several years of underinvestment have led to major investment gaps in Greece. Investment as a share of GDP bottomed out in 2015 and is slowly increasing but it is still the lowest in the EU. In addition, the rate of foreign direct investments is the lowest in the EU, although it has slowly picked up in recent years mostly thanks to the ongoing privatization program. However, there are still blockages delays in some privatizations. The on-going process of privatization aims at making the economy more efficient and providing financial resources to the State. Therefore, we consider important a full and smooth implementation of the privatization plan. Could staff elaborate on the importance of privatization to attract investors and new foreign direct investment to support the economic recovery in Greece?

Mr. Jin and Ms. Liu submitted the following statement:

We thank staff for the comprehensive report and Mr. Psalidopoulos for the helpful buff statement. It is encouraging to note that economic activities in Greece are accelerating and the recovery is broad-based. The market sentiment is also improving as Greece successfully taps capital markets. We commend the authorities' reform in reducing macroeconomic imbalances in recent years. Nevertheless, some vulnerabilities remain, including high public debt and weak bank balance sheet. Sustained efforts therefore are needed to address vulnerabilities and enhance resilience. We broadly share staff's appraisal and offer the following comments.

Implementing a more growth-friendly and socially inclusive fiscal policy mix is needed. The authorities have made significant progress in eliminating the chronic fiscal deficits in recent years. However, some fiscal risks, including the possible legal challenges from the past wage and pension reforms are the sources of concern. To meet the fiscal target of 3.5 percent of GDP, a high GDP growth rate is needed, we therefore concur with staff's recommendation to have a better fiscal policy mix to support inclusive growth, focusing on lowering taxes and increasing targeted social spending. Taking into account potential fiscal implications from the pension and wage reforms, as well as contingent liabilities such as the guaranteed bank loans, we see a need to prepare a fiscal risk contingency plan to mitigate future fiscal risks.

Continued efforts are needed to clean up bank balance sheets and restore lending capacity to support the economy. We welcome the progress made in bank liquidity management. Nevertheless, the Greek banking system remains vulnerable with high levels of non-performing exposures (NPE), constraining banks' lending capacity. Meanwhile, other challenges such as state exposures to the banking system through direct ownership and contingent liabilities remain to be resolved. In this regard, we agree that a more comprehensive and well-coordinated approach is needed to improve bank profitability and capital buffer. We take note of the three proposals put forward by various stakeholders aimed at addressing the NPE issue and encourage the authorities to further assess the proposals, with a focus on the implications of the banking sector, and to find out a more pragmatic solution.

Steadfast implementation of the structural reforms is crucial to maintaining its hard-earned competitiveness and strengthened growth prospects. We welcome the progress in increasing competitiveness in recent years, but more is needed to address the crisis legacies. It is not clear what implications the recent double-digit minimum wage hike and the abolishment of the youth sub-minimum could have. The changes to the collective bargaining framework aimed at strengthening workers' bargaining power could also trigger more broad-based wage increases which may undermine the job recovery, hurt competitiveness and ultimately dampen growth. Staff comments are welcome. We encourage the authorities to continue to push ahead structural reforms to boost productivity and maintain competitiveness. We encourage staff to closely monitor the adverse impact of the minimum wage increases on competitiveness.

It is encouraging to note that public debt is on a downward trajectory, and the medium-term refinancing risks remain manageable. As staff analyzed,

contingent liability shock, if fiscal and financial risks materialize, could lower real GDP growth and increase debt-to-GDP ratio. In addition, as the official sector debt matures and is replaced by more expensive market debt, Greece's debt service capacity may become more challenging. Considering its high level of public debt and more challenging debt service environment, we encourage the authorities to make every effort to keep debt on a downward path in a forward-looking manner.

Mr. Tan and Ms. Rauquege submitted the following statement:

We thank staff for the informative report and Mr. Psalidopoulos for his insightful buff statement. Stronger growth and job prospects account for the broadening economic recovery, as low debt servicing costs and a large cash buffer underpin Greece's adequate capacity to repay the Fund. Given existent crisis legacies and structural vulnerabilities including a fragile banking system and still-high public debt and unemployment, additional efforts are required to entrench the recovery, transform the economy and avoid reform fatigue. Since we share the thrust of staff's assessment, the following comments are made for emphasis.

Deeper structural reforms are needed to raise productivity and safeguard competitiveness. While we recognize the authorities' views on the potential for the recent wage hike to boost demand and not affect broader wage setting dynamics, we caution against further wage increases that run ahead of productivity gains as they may erode past competitiveness improvements and impede social inclusion. Given the difference in views between staff and the authorities on labor market policies, can staff elaborate on how the authorities can track and assess wage dynamics in order to make timely adjustments as needed? Addressing product market rigidities to improve product choice and competition and facilitating diversified investment should help lift Greece's growth potential and support much-needed investment.

Rebalancing the fiscal policy mix to support growth and mitigate fiscal risks needs to be prioritized. Removing tax distortions, broadening the PIT base and better targeting of social spending are important elements for achieving higher and more inclusive growth. We acknowledge the steps already taken in this vein by the authorities and note their position that successful legal challenges to past wage and pension reforms could be managed from existing contingency buffers. Structural fiscal reforms including strengthening public investment management and addressing arrears will also be key in promoting efficiency and building fiscal space. Could staff

elaborate on the actual factors that are holding back the identification of structural causes of arrears, and if staff engagement would be helpful?

Improved financial sector resilience must be anchored in more steadfast clean-up of banks' balance sheets. We welcome the positive outcome of the EBA's health check of the four largest Greek banks. Nevertheless, the state's significant exposure to the banking system makes improving banks' internal governance and building up the capital base and buffers even more important for enhancing the overall banking sector health. Furthermore, NPEs remain a critical concern, as new NPE creation has exceeded the reduction in NPEs, which was mainly achieved through write-offs. Therefore, durably addressing the still-high NPEs would also help with revamping weak credit growth and restoring confidence in the financial sector and its supportive role to the real economy.

Mr. Daïri submitted the following statement:

We thank staff for the concise report and Mr. Psalidopoulos for his helpful buff statement.

Greece is making significant strides in reducing imbalances and achieving stronger and broad-based growth. Unemployment is declining, the fiscal balances are strong along with a large cash buffer, the debt situation is manageable with lower servicing costs, and access to the capital markets has been restored. We are pleased that the trend improvement is expected to continue into 2019 and beyond, albeit subject to downside risks. Building on these achievements, it will be important to complete the reform agenda in critical areas in order to bolster competitiveness, improve the fiscal policy mix in support of social inclusion and investment, and restore bank balance sheets to support credit growth. We are in broad agreement with the staff appraisal and offer the following comments.

Preserving the hard-won improvement in the fiscal situation is critical. We commend the authorities for exceeding the 2018 primary fiscal balance target and welcome the indication that projected surpluses will be in line with the targets agreed with the European partners. Nonetheless, it will be essential to rebalance the policy mix in favor of growth-enhancing (and fiscally neutral) measures while creating space to address the fiscal risks highlighted in the report. Those risks from ongoing legal challenges of past wage and pension reforms could be covered from contingency buffers under the budget, as indicated by Mr. Psalidopoulos. Could staff clarify if additional fiscal space is needed to this effect? That said, we underscore the importance of

strengthening tax compliance, further advancing structural fiscal reforms, improving public investment execution, and addressing the structural factors behind the large payment arrears. We welcome the authorities' commitment to move forward in these areas.

Strengthening the financial sector is work in progress. Banks' liquidity has improved and private sector deposits have increased, but the still-high non-performing exposures (NPEs) continue to weigh on banks' balance sheets and impede their capacity to lend. While we welcome the steps taken to enhance the financial sector's legislative and regulatory environment, like staff, we call for a more ambitious and coordinated strategy to reduce NPEs. A range of options seems to be available to that effect, as detailed in the report, including market-based solutions and possible public-sector support which, according to staff, is becoming increasingly unavoidable. We encourage the authorities to work with key Greek and European stakeholders to identify workable solutions while avoiding moral hazard, improving internal bank governance, and enhancing the payment culture.

Further advances in structural reforms would put Greece on a trajectory of high and inclusive growth. As shown in the staff report for the 2018 Article IV consultation (page 16 of EBS/18/71), Greece has achieved a remarkable reduction in unit labor costs over the last decade, which has boosted competitiveness. The authorities' approach in supporting income and private consumption by increasing the minimum wage at this particular juncture is sensible and could help strengthen growth in the short run, but further increases should be assessed against the risk of eroding past gains in competitiveness. We note the authorities' intention to closely monitor developments in the labor market and take the necessary action, as indicated by Mr. Psalidopoulos. We also see merit in putting emphasis on non-wage cost reductions to boost productivity and investment, and call for stepped up reform of product and service markets, which together with streamlining of regulations, would improve the business environment.

We take a positive note of the staff assessment that Greece's capacity to repay the Fund is adequate. The staff medium-term DSA shows a declining public debt over the next 10 years along with manageable gross financing needs. Reflecting the recent debt relief from the Eurogroup, and the large cash buffer equivalent to 16 percent of GDP at end-2018, Greece is in a position to service its debt obligations, and possibly repay the Fund after consultation with its European partners (for *pari passu* considerations). We welcome the successive upgrades of Greece' sovereign risk rating, and look forward to

further downward movement in its sovereign spread in line with the improved medium-term outlook.

Mr. Johnston, Mr. Khurelbaatar and Ms. Park submitted the following statement:

We thank staff for their informative report and Mr. Psalidopoulos for his buff statement. The broadening of the recovery in Greece is welcome, and we commend the authorities for the progress that has been made in reducing macroeconomic imbalances through significant fiscal adjustment and implementation of important reforms. We note staff's assessment that Greece's capacity to repay the Fund is broadly adequate in the baseline scenario and medium term gross financing needs are manageable. However, we remain concerned about the risks to debt sustainability, particularly in the context of significant remaining vulnerabilities and staff's assessment of downside risks. Further efforts to mitigate these risks and vulnerabilities are needed, including reforms supportive of productivity and competitiveness.

Rebalancing the fiscal policy mix to be more growth-friendly is a priority, alongside the development of a fiscal contingency strategy. We welcome the medium term fiscal balance projections which are in line with the targets agreed with the European Union. However, the mix of policy measures could be improved, and we would recommend aiming for higher public investment, broadening of the tax base and targeted social spending. Contingency planning is necessary considering material fiscal risks arising from court rulings, contingent liabilities and pre-election policy pledges. In particular, an increase in permanent fiscal obligations could adversely affect fiscal prospects and debt sustainability without offsetting measures. The introduction of a single treasury account and improved PFM could also improve fiscal planning and execution and help prevent further accumulation of arears.

Caution is needed to ensure that gains to labor market flexibility and competitiveness made during the program period are not eroded. The authorities' intention to closely monitor conditions in the labor market is welcome and, as staff suggest, this could include assessing the impact of collective bargaining agreement mechanisms to address any unintended consequences of recent changes in this area. Staff's suggestions on possible measures to reduce non-wage costs are also valuable.

Finally, continued efforts are needed to address bank balance sheet weaknesses and restore the financial sector's capacity to support the economy. High non-performing loans leave the banking system vulnerable to a materialization of risks and could add to fiscal risks. Progress in improving

legal frameworks to support private resolution is welcome. If private solutions fail to speed up sustainable reductions on non-performing loans there may be a case to consider state-supported system-wide schemes, though, as usefully outlined in Annex V, such a scheme would need to be carefully designed.

Mr. Raghani, Mr. N'Sonde and Mr. Bah submitted the following statement:

We would like to thank staff for their well-balanced report and Mr. Psalidopoulos for his helpful buff Statement.

The Greek authorities should be commended for the recovery of the economy following the implementation of far-reaching reforms over the past years. Their sustained efforts to address macroeconomic imbalances have resulted in the resumption of growth, more viable public finances, a reversal of unemployment trends and the return of this country to capital markets, thus reflecting the credibility of ongoing policies. We also note that Greece's capacity to repay the Fund is adequate and its public debt-to-GDP ratio is expected to decline over the medium-term.

Looking forward, significant downside risks remain on the domestic and external fronts, which calls for continuous vigilance to preserve hard-won macro stability and increase resilience. Despite the authorities' good performance, the Greek economy is facing noticeable challenges related to the legacies of the past crisis and external risks stemming from the global slowdown and the tightening of financial conditions. To address these challenges and further strengthen the economic recovery, we invite the authorities to press ahead the implementation of their policy and reform agenda. In this regard, we are heartened to note from Mr. Psalidopoulos' buff statement that the authorities' reform effort will remain steadfast towards boosting growth while addressing remaining vulnerabilities.

We encourage the authorities to continue implementing their fiscal structural reforms while pursuing growth-friendly consolidation. The fiscal outcomes achieved in 2018, including the primary surplus are commendable. The necessary fiscal reforms to improve efficiency and build policy space include enhancing tax administration, overhauling the pension system and strengthening public investment management. As regards the composition of fiscal adjustment, we see merit in rebalancing the policy mix with the view to better support growth while enforcing tax compliance. At the same time, the authorities should develop a contingency strategy to mitigate potential fiscal shocks. We expect the Fund to continue providing technical assistance to help

the authorities identify and address the structural roots of payment arrears, including by strengthening cash flow management if needed.

In order to further enhance the prospects of declining public debt over the 10-year horizon, implementation of strong fiscal and debt policies should be pursued to mitigate potential macroeconomic shocks and avoid slippages. We encourage the authorities to tackle debt management weaknesses and promote good relations with creditors. We welcome the authorities' intention to repay the Fund early and agree on the need to consult with their European creditors given the *pari passu* considerations.

Further efforts are required to address vulnerabilities affecting the banking sector and improve its lending capacity with a view to support growth. In this regard, a more comprehensive and well-coordinated approach involving Greek and European stakeholders of banks is warranted to reinforce banks' capital, liquidity buffers and profitability. There is also a need for the authorities to further strengthen the legal toolkit used in reducing the non-performing exposure (NPE). In the same vein, banks' collaboration with the SSM on NPE reduction strategies is a welcome step. Moreover, improving banks' viability and governance will be helpful to restore their capacity for organic capital generation and boost the sector's resilience.

On structural reforms, we share the view that the authorities' National Growth Strategy, if well implemented, should help achieve a more robust and broad-based economic growth. Their efforts aimed at promoting higher growth should be focused on fostering labor market flexibility and raising investment, productivity and competitiveness. Given the still high unemployment, market flexibility should balance bargaining dynamics and boosting domestic demand. Noting the disagreement between authorities and staff on labor market policies, especially on the effects of the statutory minimum wage hike, we call on pursuing close dialogue in order to strike the right balance between raising competitiveness and sustaining domestic demand. We also call on the authorities to make further progress in improving the business environment to attract higher and more diversified investments. Moreover, it is essential to speed up efforts in implementing needed reforms in product and service markets to bolster competition.

With these remarks, we wish the Greek authorities further success in their endeavors.

Ms. Levonian, Ms. McKiernan and Mr. Hart submitted the following statement:

We thank staff for their report and Mr. Psalidopoulos for his buff.

We acknowledge the important progress made by the Greek authorities over a difficult period. However, we remain concerned that Greece's economy still suffers from structural weaknesses in the areas of productivity, competitiveness, governance and in the financial sector. Adding to the fragility are very high levels of public debt, impaired private sector balance sheets, and a strong sovereign-bank nexus.

We welcome staff's assessment that Greece's capacity to repay is adequate. This assessment is grounded in Greece's fiscal restraint, low gross financing needs, a significant cash buffer, and the commitment of additional debt relief from European partners.

However, the downside risks outlined in the Review are significant and call for ongoing vigilance and contingencies, should risks materialize. We share staff's main recommended policy priorities and would like to emphasize a few additional points. We also note staff's ongoing concerns over the long-run sustainability of Greece's public debt.

We encourage the authorities to adopt a more growth-friendly and socially-inclusive fiscal policy mix. The authorities' fiscal performance potentially comes with social and economic costs, particularly through the continued under-execution of the capital budget. Broadening the tax base and lowering tax rates would further support growth and inclusivity. This should be complemented by reinvigorating structural fiscal reforms and raising tax compliance to mitigate various fiscal risks.

The authorities should prioritize investments in productivity and competitiveness. We broadly share the view that wage policies should be linked with productivity gains, but note the authorities' preference for large minimum wage increases and tighter collective bargaining rules. With higher labor costs expected, addressing other barriers to Greece's competitiveness takes on a greater urgency. Priorities in this regard include strengthening the business climate, liberalizing restrictive product and services markets, and investing in quality infrastructure.

Repairing bank balance sheets to kickstart domestic lending remains a top priority. We encourage Greece's partners to continue to assist in the effort to address banks' non-performing exposures (NPEs). Like staff, we see the

need for a comprehensive and well-coordinated NPE strategy that favors private sector solutions. However, we note that there are multiple proposals for how to proceed and staff's expectation that some form of state aid may be inevitable. Can staff elaborate on how they expect this to move forward?

Finally, what are the implications for the Fund if Greece pursues the option of early repayment?

Mr. Trabinski and Mr. Tola submitted the following statement:

We thank staff for the insightful paper and Mr. Psalidopoulos for his helpful buff statement.

We are encouraged by the authorities' progress in putting the economy back on the recovery path, not least thanks to the adjustments implemented during the program era. In addition, strong export growth has been particularly important, reflecting improvements in competitiveness as well as a more benign external environment. That said, domestic and external risks are tilted to the downside. Hence, further measures are needed to bolster investments and business climate, and to revive lending. Moreover, in light of the upcoming elections, it is essential that all parties display full commitment to preserving the progress achieved in the program era.

The significant spending compression calls for additional measures to support higher and more inclusive growth. In light of continued subdued public investment, it is key to address structural bottlenecks in budget execution. Efforts to strengthen tax compliance and its infrastructure are important to further improve the payment culture. Furthermore, we regret that the pension reform, scheduled for this year, was cancelled; and we encourage the authorities to stick to the plan to broaden the CIT in 2020.

More efforts are needed to advance the banking sector's balance sheet healing and to improve its governance and operational efficiency. Slow NPE absorption continues to weigh on the banking sector. Moreover, write-offs remain among the key drivers of NPE- reduction, and new NPE-creation outpaces their reduction. Thus, institutional, legal, and other structural bottlenecks prevent a swift resolution of insolvency cases needing to be addressed. Private sector solutions should be preferred, given the already existing strong state-bank nexus and the sizeable risks to the budget from existing contingent liabilities. Any additional state support should be well targeted, temporary, and designed in a way to avoid further weakening of the payment culture.

Recent reversals of labor market reforms risk adding to structural growth impediments. We concur with staff that the recent labor market reform presents a source of concern. In our view a more prudent approach to a minimum wage change would have been warranted. In the short-term, this reform might lead to an increase in disposable income, with a positive effect on consumption. However, in the long-term, the disconnect between the reform and productivity growth suggests a negative impact on formal employment and competitiveness. Furthermore, slow progress in privatizations, persistent market rigidities, and low business climate attractiveness should be addressed more rigorously to attract foreign investment. This is particularly important in an environment of subdued public investment and negative credit growth.

We share staff's view that Greece's repayment capacity is broadly adequate under the baseline scenario. However, the materialization of the downward scenario described in Annex VI of the staff report could impair this capacity. Staff assesses the likelihood that some risks listed in this scenario materialize as high. We also note that the authorities are planning a gradual depletion of their cash buffer. Considering the above, would a more cautious approach with regard to cash buffer be preferable? Does the current approach pose any liquidity risk in case of a further tightening of global financial conditions?

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the first Post-Program Monitoring (PPM) Discussions Report on Greece, and Mr. Psalidopoulos for his informative buff statement. Greece has made significant strides in addressing macroeconomic imbalances, benefiting from the reform measures implemented under the recently concluded adjustment programs, and we commend the authorities for their efforts in a difficult social and political environment. Growth has become positive while inflation remains subdued. The fiscal performance has improved with a significant primary surplus, but the current account deficit has increased slightly. Unemployment has declined, though it still remains high, particularly among youth. The government's large cash buffer is sufficient to cover many months of funding needs. These developments suggest that the country has gradually come out from the crisis a decade ago. The repayment capacity to the Fund has been assessed as broadly adequate under staff's baseline scenario.

However, the PPM report reveals that significant vulnerabilities remain, particularly in the context of structurally weak productivity and competitiveness, legacies of high public debt, weak bank balance sheets and high unemployment. Hence, Greece will have to adhere to a path of strict fiscal discipline and other policy commitments, and complete the unfinished reform agenda, particularly with respect to labor and product market reforms, to unleash productivity and strengthen competitiveness to ensure a sustainable recovery in growth with increased employment. This, in turn, will reinforce the fiscal consolidation process. In doing so, we encourage the authorities to give due consideration to the reform fatigue and political pressures in the run up to elections to avoid policy reversals that could weaken the progress so far achieved and continue sound economic and fiscal policies, and safeguard macroeconomic stability. Could staff elaborate on how this PPM report will feed into the enhanced surveillance process with European Institutions (EIs) and meeting preconditions for additional debt relief going forward?

A growth friendly and more inclusive fiscal policy is important in efforts to strengthen fiscal and debt sustainability. We welcome the over performance of the primary fiscal balance in 2018. However, it has partly been achieved by under-execution of investment spending which could affect the growth recovery. We noted the provision of social dividend (of about 0.5 percent of GDP) in 2018. While we are encouraged by this measure, staff's comments are welcome on any risks associated with this type of relaxation of fiscal adjustments. Fighting tax evasion, strengthening tax administration and compliance, simplifying and widening the tax base and further strengthening PFM remain key areas to complement fiscal consolidation efforts. We support the fiscal contingency plan proposed by staff in the context of monitoring and insuring against possible fiscal risks, including the impending court rulings related to past wage and pension reforms.

On the DSA, we noted that the past macro assumptions have been optimistic. We would welcome staff's further elaboration on the potential implications of forecast errors in the key macroeconomic variables on the debt sustainability path which would also guide the potential future debt relief.

We noted the authorities' disagreement on the extent of the financial system vulnerability, highlighted in the buff statement. Staff comments are welcome. The non-performing exposure (NPE) at 47 percent, which is the highest in the Europe, weighing on banks' profitability and capital adequacy, remains as a significant impediment to future growth. Moreover, despite the ongoing efforts, staff has indicated that 'new NPE creation exceeds curing'. Hence, we agree with the need for a comprehensive approach to clean up bank

balance sheets to improve their capacity to provide credit to enhance growth, and encourage the authorities to consider staff's recommendations outlined in ¶29 to repair private sector balance sheets and revive bank lending. Staff comments are welcome on the adequacy of the current targets for NPE reduction in view of the EIs and the potential for massive write-downs and capital shortfalls. Staff has recommended that CFM liberalization should continue in line with the conditions-based roadmap. We would welcome major details of this roadmap.

Deeper reforms are needed to raise productivity and competitiveness, enhance growth and ensure a durable recovery. With respect to labor market reforms, improving productivity through prudent wage formation, consistent with productivity gains, is essential to safeguard competitiveness and provide gainful employment. Hence, we support staff's call for more flexible labor market policies and are encouraged by the authorities' readiness to undertake any necessary action, indicated in the buff statement. In this context, staff comments are welcome on the impact of the recent increase in minimum wage and changes to the collective bargaining policies in particular and the reversing of labor reforms in general on the recovery of private sector investment and job creation. The continued product market reforms are also critical to restore Greece's competitiveness as well as to promote competition, investment, and entrepreneurship. These should be supported with structural reforms in the business institutional framework and environment to boost higher and more diversified investments.

With these remarks, we wish Greek authorities all the very best in their future endeavors.

Mr. Mozhin and Mr. Tolstikov submitted the following statement:

We thank staff for the well-written report and Mr. Psalidopoulos for his insightful buff statement. We welcome progress achieved by the authorities over the recent years in reducing macroeconomic imbalances and implementing structural reforms. Supported by sound macroeconomic policies, economic recovery is gaining traction and unemployment is falling steadily. In certain aspects, including real GDP growth in excess of 2 percent, substantial primary fiscal surplus, and solid fiscal buffers Greece even compares favorably with the average euro area performance. However, high public debt and unemployment, the fragile financial system and weak productivity performance remain the key vulnerabilities. In order to address them, the authorities need to carry forward reforms in fiscal, financial, and labor and product market areas.

Following debt relief provided by the European partners, Greece's debt sustainability has improved significantly, and the medium-term debt repayment capacity remains solid. It is reflected in the recent upgrades by several rating agencies, as well as in staff's conclusion about adequate capacity to repay the Fund. At the same time, long-term debt sustainability remains uncertain, and substantial downside risks require further actions to strengthen the economy.

A growth-friendly rebalancing of fiscal policy mix is needed to support inclusive growth, while maintaining fiscal targets agreed with the European partners. Strong fiscal performance allowed the authorities to reduce some taxes and social security contributions and increase targeted social spending. That should be supported by measures to further improve tax compliance and tax debt collection. We note substantial risks from legal challenges to past wage and pension reforms, which may result in significant one-off retroactive payments and additional fiscal obligations. These risks require developing a contingency strategy, which may include the use of fiscal buffers and/or adjustment of fiscal targets in coordination with Greece's European partners.

We take positive note of the signs of improvements of Greece's financial sector performance, including the ongoing recovery in private and public deposits, near-elimination of the Emergency Liquidity Assistance, and stronger banks' capitalization. However, the NPE level at 47 percent of loans remains the highest in the euro area, and private credit growth is still negative. We welcome recent changes in the legal framework for resolving NPEs, which may facilitate their reduction. At the same time, we see merit in staff advice on further strengthening of the NPE reduction toolkit. As the financial system is strengthening, the gradual relaxation of the exchange restrictions would proceed in accordance with the CFM roadmap.

The risks to employment and competitiveness stemming from the recent increase in minimum wages and reversal of reform of collective bargaining process should be carefully considered and monitored. Transmission of the minimum wage increase into broader wage pressures depends on the slack in the Greek labor market, which is still substantial, given the level of unemployment above 18 percent. Therefore, positive effects on domestic demand may compensate for potential decline of competitiveness. We, however, agree with staff that reducing non-wage costs through reforms in fiscal and financial sectors is essential to mitigating downside risks from the authorities' labor policies. Implementation of reforms

envisaged under the National Growth Strategy should also boost investment and competitiveness.

Mr. Ronicle and Miss Chen submitted the following statement:

We thank staff for the first post program monitoring report for Greece and Mr Psalidopoulos for his informative buff statement. We associate ourselves with the statement of Messrs de Villeroché, Meyer, Doornbosch, Just, and Sigurgeirsson.

Greece's economic recovery continues, after a near decade of contracting output through to 2016. The Greek authorities have achieved a substantial real adjustment and net trade has made a substantial contribution to growth to date in 2018. Unemployment is falling, and employment and confidence are rising. We welcome staff's assessment that Greece's capacity to repay continues to be adequate. Nevertheless, we agree with staff that vulnerabilities remain high and whilst the macroeconomic data in Greece has held up well, the softening data for major trading partners underscores the need for Greece to continue building resilience.

Greece's 2018 primary surplus came in above target and public debt is projected to fall relative to GDP. While higher than expected receipts are to be welcomed, we support staff's call to tackle persistent under-execution of investment spending. We commend the authorities' work on short-term debt management; over the last 5-10 years significant reprofiling of the debt has taken place, smoothing out financing requirements and providing the authorities with a large degree of flexibility around the timing of future market access. And while public debt remains high, the large liquidity buffer provides comfort. Mr. Psalidopoulos note that his authorities are considering further action to improve the debt profile, which we view positively.

Credit growth to the Greek economy remains negative and NPEs high; tackling the latter and restarting growth in the former should remain priorities. We welcome the Greek authorities' effort in raising the pace of addressing NPEs; In the past year the central bank has driven an accelerated program of sales into the secondary market of distressed debt, and the banks themselves have started to look at new solutions to aid the process. However, further acceleration would be helpful, as new lending remains too low to support a significant recovery and, as staff note, the banking system remains a key vulnerability.

The Acting Chair (Mr. Zhang) made the following statement:

We all recognize the significance of today's discussion because this is the first time since 2010 that we have met to discuss Greece outside the program area, including the European Stability Mechanism program, which ended last August, so we are talking about post-program issues here.

Our surveillance work now shifts into a more normal period of surveillance, and given the large size of the exposure of Greece, which is SDR 7.7 billion, which I believe is the third-largest among the membership, this carries quite a large significance in our surveillance work.

Finally, I want to share that the recent post-program monitoring mission (PPM) was successfully conducted together with the second review mission under the European enhanced surveillance framework. In that respect, management and the staff would like to send our appreciation to our counterparts in the European institutions for their collaborative work, and we will continue to build this collaborative, constructive relationship down the road.

Mr. Psalidopoulos made the following statement:

I would like to inform the Board about some current developments. Greece successfully tapped markets once in the near past and has done so for a second time as of yesterday. This was the first 10-year benchmark bond after 2010. Greece raised EUR 3.5 billion at 3.9 percent, and the move came following a double credit rating upgrade by Moody's at the end of last week by two notches to B1. Moody's also upgraded the deposit rating of three out of the four systemic banks.

Finally, the Bank of Greece is currently in the process of submitting to the European Central Bank (ECB) a revised estimate on the effects of the draft household insolvency law on banks' balance sheets. Once this is done and cleared and the Directorate General for Competition in Brussels clears the bill, the new house insolvency law will be submitted to parliament and voted on under an urgent procedure. It is hoped that this will take place before March 11.

Mr. Meyer made the following statement:

Greece after many years of efforts has completed the adjustment programs also within the European context, and the staff indicates that Greece

exited with reduced imbalances and that in the baseline, Greece's repayment capacity is broadly adequate. I commend the Greek authorities for the immense efforts and the Greek people for their patience in waiting for the efforts to bear fruit. I have issued a gray statement with my euro area colleagues and therefore would like to raise just a few points for emphasis.

We welcome the accelerating and broadening economic recovery of Greece, supported by solid export growth, including through record-high tourist arrivals and private consumption. We also commend the authorities for upholding their commitment to prudent fiscal policies, with the agreed primary surplus of 3.5 percent of GDP once again projected to be met. But the path ahead remains extremely challenging. One key challenge will be to improve the composition of the budget and to overcome the recurrent underspending, especially on public investment, and to have a socially inclusive fiscal policy with better targeted social spending.

In addition, continued labor and product market reforms are critical to safeguard the achieved competitiveness gains and foster productivity. This appears particularly important in light of the still-high, although decreasing, unemployment rate of 18.5 percent, according to data from November 2018. More broadly, a persistent momentum for structural reforms will remain essential to sustain growth in the face of downside risks to the outlook.

As for the financial sector, significant progress has been achieved in improving liquidity in the banking system, and the reduction of nonperforming exposures (NPEs) has continued, but their high level still poses an important challenge and weighs on private credit growth. It is therefore crucial to further strengthen the legal toolkit for NPE reduction. We further agree with the staff that consideration could be given to additional state support schemes based on a careful assessment of inter alia cost efficiency and implications for debt sustainability and conducted in a coordinated way in cooperation with relevant stakeholders.

Greece is at an important juncture. The economic recovery is bearing fruit, and market sentiment is improving. Mr. Psalidopoulos alluded to that. Greece is in a position to place bond issuance with still-high but much-improved yields. It is crucial to build on this, to not backpedal on reforms, in close coordination with European partners and the Fund. With this, I wish the authorities continued success in their future endeavors.

Mr. Sylla made the following statement:

The Greek authorities should be commended for the recovery of the economy following the implementation of far-reaching reforms over the past year. We issued a gray statement, so I will limit my comments to the following.

Noting the disagreement between the authorities and the staff on labor market policies, especially on the effect of statutory minimum wage hike, we call on pursuing close dialogue in order to strike the right balance between raising competitiveness and sustaining domestic demand. But more fundamentally, in reading the staff report, the question that could be asked is how to reconcile the fatigue of the reform highlighted in paragraph with the need to continue and accelerate reforms advocated throughout the paper. The staff's comments are welcome on this issue.

Mr. Doornbosch made the following statement:

We issued a gray statement together with Mr. Meyer and other European Directors, and we fully associate ourselves with his remarks this morning. I would like to make two points.

First, as recalled over the past years, Greece has implemented an impressive set of reforms on a wide range of issues, and this has probably contributed to the current recovery of the Greek economy and the upgrade by the rating agencies.

Still, we share the staff's concerns on the external competitiveness. As the staff highlights, to maintain competitiveness and mitigate some of the risks from recent changes in labor market policies, it is recommended to reduce non-wage costs and address remaining rigidities in product markets to improve product choice, quality, and competition. It is most important that wage developments remain in line with economic fundamentals, and we therefore appreciate the commitment of the Greek authorities to closely monitor developments in the labor market and undertake action if necessary, as highlighted in Mr. Psalidopoulos' buff statement.

Second, we noticed in the report a strong emphasis on the weak payment culture in Greece, and we wonder whether such a general statement is the best way to address the issue. In the end, payment cultures are driven by economic institutions and effective governance. If the problem of strategic defaults increases, it is worth assessing whether the measures put in place by

the Greek authorities—such as an increase in e-auctions and the introduction of an asset protection scheme—are effective. If the problem relates to tax compliance, it should be assessed whether the current tax administration reforms are adequate. We appreciate the assessment but feel that generalizations are not always the best way to tackle a problem.

Mr. de Villeroché made the following statement:

I published a joint gray statement with my European colleagues. I would like to make the following remarks.

The staff's report strikes the right balance between acknowledging the progress made to improve macroeconomic fundamentals over the past years while stressing the importance of pursuing growth-friendly, sustainable, and inclusive reforms, including to protect the hard-won fruits of fiscal consolidation.

Mitigating the risks to growth prospects will be challenging in the context of the upcoming elections, and we strongly encourage the authorities to maintain the current path of reforms and keep improving the policy mix to achieve stronger and more inclusive growth.

On the outlook, Greece has performed well in 2018, but reform fatigue and even a reversal of past reforms could put the recent good performance in jeopardy. The economic recovery is projected to continue this year, sustained by private consumption, favorable labor market orientations, strong exports, and a positive contribution of the foreign balance to growth. Nonetheless, given the still-high level of public debt and unemployment, the hard-won reforms and the adjustment that has been achieved must be preserved.

We call on the authorities to be cautious when taking any measure that might hinder the country's past efforts to restore cost competitiveness. Ensuring a better alignment of wage growth to productivity gains is key, as well as the introduction of firm labor flexibility along with structural reforms to foster investment and improve competitiveness.

On fiscal policy, the update of public sector debt sustainability analysis is welcome. Under this baseline scenario, public debt is projected to keep decreasing over the medium term, while public gross financing needs should be contained below the 15 percent threshold. We encourage the authorities to remain strongly committed to these fiscal targets, which were agreed with our European partners. Moreover, rebalancing of the fiscal policy

mix appears warranted to achieve stronger and more inclusive growth. Budget-neutral measures on taxation would contribute to build up fiscal space and to remove distortions on the most vulnerable groups. We therefore encourage the authorities to promote greater tax fairness and to increase tax administration efficiency in order to be in a position to reallocate spending toward investment while ensuring a larger execution of investment spending.

Mr. Beblawi made the following statement:

The outlook of the economy is promising, with near-term growth and job creation expected to accelerate in 2019. An improved fiscal position has helped reduce the public sector financing needs, and the authorities successfully tapped the international market, as confirmed by today's announcement by the Greek chair. We congratulate the Greek authorities for these outcomes. However, credit continues to contract in most categories, which constrains growth. We share the concerns that the hard-earned gains could be eroded if the unfinished reform agenda is not pursued or if key reforms were reversed.

We welcome the overachievement of the fiscal target in 2018 and the continued commitment to sustainable fiscal finance. We agree with the staff that achieving higher and more inclusive growth while meeting the fiscal targets agreed with the European partners is challenging. We support the staff's suggestion to explore with the European partners the possibility of accommodating such shocks through a smoothing mechanism in order to preserve growth-friendly and socially inclusive expenditure.

We also take note of the authorities' view that fiscal space is expected to emerge as the economic recovery gains traction and that this would allow for a shift in the fiscal mix. We consider closing the tax compliance gap to be very important. Enhancing labor market flexibility remains a key priority, and this could be helped by reconsidering the recent changes in collective bargaining policies. Care is needed to avoid or mitigate the negative effects on competitiveness and employment from rising wage pressures.

We see a need to accelerate clearing up banks' balance sheets and communicate a credible and ambitious strategy to restore bank sustainability. We look forward to the staff's further elaboration of the authorities' comprehensive approach to clean bank balance sheets. We appreciate the staff's careful and clear analysis of debt sustainability. We are encouraged by the results of this assessment, which has improved following the debt relief measures adopted by the Europeans in June 2018.

Mr. Saito made the following statement:

As we issued a gray statement, I would like to offer two comments.

First, on the labor market. The key policy priorities for Greece are to enhance competitiveness and strengthen growth prospects and increase resilience. To this end, labor market reform is inevitable. We share the staff's concern that if the minimum wage increases higher than productivity, it would erode past competitiveness improvements and undermine social inclusion in the longer-term. Therefore, like Mr. Doornbosch and others, we encourage the authorities to carefully monitor the impact of recent labor market policy changes and take necessary actions. At the same time, given the difference of views between the authorities and the staff, we encourage the staff to conduct deeper analysis on this issue and strengthen dialogue with the authorities based on the analysis in the upcoming Article IV discussion.

Second, on the financial sector, as high NPEs hamper lending to the private sector and economic growth, reduction of NPEs should be a priority. We agree with Ms. Pollard that it is becoming increasingly clear that a public solution is needed. Therefore, comparative cost-benefit analysis is warranted before introducing any specific strategies. We appreciate the Annex 5, the guidelines for the cost-benefit analysis, which would be beneficial for the authorities to analyze the cost effectiveness of the various options.

We note that it is difficult for the staff to compare various proposals at this stage due to the uncertainty about key parameters. We would like to ask the staff whether they have a plan to conduct their own cost-benefit analysis when the key parameters become clearer.

Ms. Pollard made the following statement:

I want to highlight a few points. First, on arrears, we appreciated the answer to the question in Mr. Mouminah's gray statement about the timeline and strategy to address government arrears. We welcome the steps the authorities have taken so far to streamline the payment process and encourage them to work with Fund staff to identify and address other drivers of arrears. The persistence of arrears at the same time that the government has a significant cash buffer is an unfortunate and seemingly unnecessary drag on the economy. Perhaps even more importantly, we believe that the authorities need to set an example in promoting a stronger payment culture.

Second, on the financial sector, we found the answers to the technical questions helpful to understand the pros and cons of different public sector approaches to resolving the NPEs. We encourage the authorities to press forward with a coordinated approach that can achieve a meaningful reduction in NPEs. We hope that the Greek authorities will have maximum flexibility to pursue an effective approach and would underscore a point in our gray statement that state aid competition policy objectives should take a backseat to more immediate economic growth and stability objectives. I also want to echo Mr. Saito's comments on the minimum wage and agree with him that this is an issue that is worth exploring in the next Article IV consultation.

On fiscal overperformance, the quality of fiscal measures is paramount, and here we see room for improvement. We urge the authorities to carry out a robust public investment plan in support of growth and to look for ways to broaden the tax base and boost compliance to provide room for lower tax rates.

Mr. Gokarn made the following statement:

We join other Directors in thanking the staff for the excellent report and Mr. Psalidopoulos for his buff statement and his opening remarks.

We issued a gray statement, but I would like to focus on a point about the growth outlook. Table 1 suggests that while the growth performance as of now is reasonable, the outlook is, if not bleak, certainly not very optimistic, when growth slows over the next few years to 1 percent or thereabouts from the 2 percent plus that we are seeing now. I want to understand this in two contexts. One is the recommendation, which is a reasonable recommendation, that the reform momentum has to persist, and the report cautions against the onset of reform fatigue. But this argument needs to be bolstered by the payoffs or the cost of not carrying out these reforms. In that context, I am wondering what this outlook reflects. Does it reflect the status quo, the end of reforms, the loss of momentum? Or does it reflect an outcome which takes into consideration persistence with reforms? If that is the case, then this growth outcome does not make a strong case for persistent reform. What are the costs of not doing it? If one is growing at 1 percent during those reforms, it is not a compelling case.

The second context concerns the fiscal space that Ms. Pollard and others have referred to. We see a significant improvement in the fiscal situation with the achievement of the primary balance objective, and that is likely to persist to about 2½ percent plus of primary balance over the next five

years. The question is whether this is constraining the use of potential fiscal space to stimulate growth, and whether that growth outlook to be more positive if the fiscal space that is implied by these numbers is used in a growth-inducing way.

The second point I want to make is that we share Mr. Doornbosch's views on the characterization of the financial problem as reflecting a weak payment culture. This would imply that a set of incentives that is put in place to change behavior—and that is really the basis of the financial sector reform—will not work effectively because there are intrinsic constraints. That statement needs to be supported by evidence. We do not know yet whether the change in incentives is inducing the right kind of behavior and will generate desirable outcomes, and from my reading of the financial sector assessment, there are signs that this is happening. The generalization about the culture is not something that we need to see in this type of analysis. It is ultimately a question of whether the right incentives are in place, and that behavior is being influenced by those incentives in a desirable direction.

Mr. Moreno made the following statement:

I would like to acknowledge the Greek authorities' efforts. After years of programs, the country has achieved an exit from the program. The process has required tremendous effort by the Greek authorities and society to erase economic imbalance, and I will also highlight the importance of the support of the international community of the European Union (EU) and also the Fund. It has also been a bumpy road for these institutions, but we have learned from this process, and the support of the Fund has been important.

As stressed by Mr. Psalidopoulos, Greece has returned to regular surveillance of the EU and the European semester and is also under post-program surveillance monitoring by the European authorities. Naturally, significant challenges remain. Even though the situation has started to improve from 2017, unemployment remains very high at 18.5 percent, and the social consequences of the crisis are still visible in most social indicators.

We have issued a gray statement, and we share the comments made by Mr. Meyer, so I will only highlight a few issues. On the fiscal front, we commend the authorities for achieving past fiscal targets, and we believe it will be particularly important to pursue a more growth-friendly and socially inclusive policy mix. Here we consider it key to implement the tax reform for 2020.

We are also concerned about the potential impact of some court rulings regarding past fiscal reforms, and we share the staff's view on the need to develop a contingency strategy to offset the fiscal impact of these court decisions.

On the financial sector, we believe it is also important to continue to foster reforms to allow Greek banks to fulfill their mission of providing credit to the real economy and attract equity investors. We share the staff's recommendation to pursue a more ambitious pace of NPE reduction. On the debate on NPE reduction, we take note of the authorities' concerns, and like Mr. Gokarn, we note that the reference to payment culture might not be appropriate in this case, and we would rather place the emphasis on the incentives of the authorities' policies. In particular, it is important to have a better designed household insolvency law and a law that prevents across-the-board solutions and might create problems of moral hazard or strategic behavior. But the words are not irrelevant, they are important, and the emphasis should be placed on incentives.

Finally, we would also stress the importance of the authorities stepping up their efforts in terms of sustained implementation of the structural reforms and the commitment to safeguard the wage competitiveness and create a business- and investment-friendly environment.

Mr. Sigurgeirsson made the following statement:

We issued a joint statement with other Directors, and I associate myself with the remarks made by Mr. Meyer, but I would like to add emphasis on a few issues.

Given the difficult circumstances in the first years of the crisis, the authorities managed to roll out an impressive list of measures, and lately we have seen several developments confirming that the policies that have been implemented are starting to bear fruit. Last week's credit rating upgrade by Moody's of two notches was very positive and further confirmation that Greece is on the right track, as is the printing in the market of long-term bonds in the past few days.

I would also commend the Greek authorities for performing well on the fiscal side, resulting in the substantial cash buffer and overperformance of fiscal targets. Having said that, many crisis legacies remain. The key for preserving resilience and enhancing sustainable long-term growth lies in maintaining the hard-earned competitiveness achieved during the program

years. With this in mind, the recent raise in the minimum wage may have been premature. Youth unemployment stands at 35 percent, and this measure will probably not help reduce that figure.

Second, I would like to emphasize that continued implementation of fiscal sector reforms remains critical. In the past years, the management of the big four banks have been changed, and new management teams were selected with an emphasis on long-term international experience. At the same time, the authorities undertook measures toward removing impediments to nonperforming loans (NPL) reduction. Despite all these efforts, NPLs remain elevated, even in sectors such as the tourism industry, which has shown a strong rebound. While the banks have passed the EU stress test and targets for reductions have been met, the quality of the banks' balance sheets needs to be restored if the banks are to support a further rebound. While an asset protection scheme and associated asset management company may be viewed as necessary to take on the NPL problem, I would be very concerned about governance issues, moral hazard, and an overall exit strategy for such an undertaking.

Like Mr. Doornbosch and Mr. Gokarn, I agree that it can be argued that it is too much of a generalization to characterize the country as having a weak payment culture. It is probably more a symptom that reform efforts in the financial sector have fallen short, and if the authorities want to see an efficient improvement in the banking sector, that is where further efforts are needed, especially regarding legal aspects concerning debt resolution.

Mr. Tan made the following statement:

We welcome the assessment that Greece's repayment capacity remains broadly adequate. Much credit is due to the authorities for their commendable reform efforts and achievement of strong macroeconomic outcomes.

Given the remaining vulnerabilities facing the country, we join others on the need to keep the reform momentum going toward sustainable and more inclusive growth. We particularly focus on policies that promote economic resilience, including specifically the labor market reforms as well as other comments on fiscal policy.

Given the potential to undermine the recovery and overall growth, appropriately assessing and managing the recent rich dynamics will be a key priority for its impact on competitiveness and potential for an inflation spiral, as well as its influence on the collective bargaining process.

On the banking system, I have two comments to add to our gray statement. First, we note the joint statement by the French, German, Dutch, Austrian, and Icelandic chairs on the caution needed in communicating the vulnerabilities so as not to achieve a negative market reaction. Few argue against transparency, and we are not doing so, and the staff should be encouraged to evaluate these areas. That being said, experience has shown that financial markets can be less-than-discerning at times and quite susceptible to self-fulfilling panics. Hence, we thought it was a useful reminder in general on what the Fund may put out into the public domain.

Second, many chairs are weighing on the NPE concerns, and rightly so as credit quality can be a barometer of financial system health. Much of the discussion centered around the comprehensive strategy on private and public sector involvement, and the authorities do need to act on this front. We emphasize that this is not just a stock issue but also a flow issue, as evident in the staff's observation on new NPE creation. Hence, looking ahead, it will be equally important for the authorities to drill down deeper into the credit underwriting and monitoring standards of the banks and address the underlying root causes before expectations of further credit deterioration do become a self-fulfilling prophesy.

Mr. Mouminah made the following statement:

We commend the Greek authorities for their efforts, which were critical in restoring growth, reducing unemployment, and improving debt sustainability. We also commend the Greek people for their patience and perseverance, which made them get through a tough time, and now they are on the right path for recovery.

We also welcome the staff's assessment that Greece's capacity to repay the Fund is adequate and note with satisfaction the authorities' intention to repay the Fund's lending subject to surcharge.

Greece's prospects remain fragile, and we note the staff's concerns about the slowdown of the reform momentum in an environment still characterized by high vulnerabilities associated with the legacy of crisis including a very high level of NPEs.

We join other Directors in encouraging the authorities to remain committed to a growth-friendly fiscal policy, strengthen bank balance sheets, improve the payment culture, and revive bank lending to the private sector,

something that was already highlighted by other Directors such as, Mr. Doornbosch, Ms. Pollard, and others.

The implementation of the necessary structural reform is also critical to generate the much-needed growth to improve the inclusiveness and social indicators. We had another question about bond issuance, but it was addressed earlier by Mr. Psalidopoulos. With these comments, we wish the authorities all the success.

Mr. Jin made the following statement:

We thank the staff for the comprehensive report and Mr. Psalidopoulos for the informative statement. It is encouraging to note that economic activity is accelerating and that the recovery is broad-based. The market sentiment is also improving, as Greece is successfully tapping capital markets. We commend the authorities' reforms for reducing macroeconomic imbalances in recent years. At the same time, some vulnerabilities remain. It is necessary to implement a more growth-friendly and socially inclusive fiscal policy mix, and continued efforts are also needed to clean up bank balance sheets and restore lending capacity.

It is not clear what implications the recent double-digit minimum wage hike and the abolishment of the youth sub-minimum could have. We encourage the staff and the authorities to closely monitor the impact of the new policy on competitiveness.

It is encouraging to note that public debt is on a downward trajectory in general, while the public debt level is still high. We encourage the authorities to make every effort to keep debt on a continuous downward path, and we wish the authorities every success in their future policy endeavors.

Ms. Levonian made the following statement:

We have issued a gray statement, so I will keep my remarks brief, and colleagues have made many of the points.

We believe this is an important juncture. We wish to acknowledge the scale of the adjustment that has been taken by Greece throughout this very difficult period and the progress that has been made. The economic recovery is welcome, but vulnerabilities remain. We share the staff's main recommended policy priorities. We wanted to emphasize the need to keep up public financial management (PFM) reforms, which are essential to move to a

more growth-friendly and socially inclusive fiscal policy mix. The need for higher quality government spending focused on investment that will help future growth will be essential in improving long-term debt dynamics. We are also interested in the hearing staff's perspective on Mr. Sylla's reform fatigue point; and Mr. Doornbosch, Mr. Gokarn, and others have made the point about the weak payment culture. We would be interested in hearing the staff's perspective on that as well. With that, we wish the authorities well.

Mr. Dairi made the following statement:

We congratulate the Greek authorities for the successful exit from EU programs. This owes much to the authorities' continued commitment to sound policy implementation, as well as the strong support from the Fund and the EU partners. We are pleased to note that growth has moved decisively to positive territory over the past two years and that there is significantly more green and yellow in the DSA heatmap.

We agree with other Directors on the importance of continuing with sound policies and reforms, and we are confident that the authorities will listen carefully to Directors' comments and suggestions. Nevertheless, it will be crucial for the authorities to do their utmost to maintain public support to their reform program and to avoid adjustment fatigue.

We call on the authorities to continue working together with the Fund and the EU partners to reach a common understanding on the way forward to ensure higher and more inclusive growth while maintaining social stability. There is significant convergence of view between them, as indicated by Mr. Psalidopoulos, and it will be important to agree on the remaining points of this agreement.

Mr. Meyer made the following statement:

I have two issues to raise. First, I just wanted to make a comment on state aid rules, as Ms. Pollard made that point. I wanted to indicate that state aid rules in the EU hold true for the EU overall, and they are a cornerstone of the level playing field within the EU single market in general, and the banking and capital markets union in specific. In general, we always highlight the importance of making progress on those fronts. Against that background, when finding solutions on the NPE reduction, one has to take those state aid rules into account, which are also enshrined in the EU treaties.

Second, we had an exchange with the mission chief on the press statement, and I understand it got a reply. I wanted to make the comment that the two paragraphs before the Board's view, the summing up, should be as factual as possible, and we felt that those two paragraphs went over and above that. Maybe the staff can have another look. Basically, the first sentence could be closer aligned to how it is presented in the staff report. It says the economy's recovery is accelerating, and we are proposing to broaden that. But more importantly, the last sentence of the first paragraph and the last sentence of the second paragraph go very much into the normative, and we thought it should be more descriptive.

The staff representative from the European Department (Mr. Dohlman), in response to questions and comments from Executive Directors, made the following statement:¹

I thank Directors for the compelling comments and questions, and I will try to address them.

I want to begin by reiterating a few of the positive developments. We should not forget that the Greek authorities and the Greeks as a whole have come a long way since 2009-2010, with a very large and sustained fiscal adjustment. Greece is now entering a growth period, and Greece recently tapped sovereign bond markets, which is encouraging.

I would like to start by addressing some comments that were in the gray statements related to the financial sector. Specifically, there were some questions regarding possible differences of view between the staff and the authorities on the extent of financial sector vulnerabilities and on what is needed.

On the first issue, we see significant vulnerabilities and risks surrounding the financial sector, and we have provided a deeper analysis in the staff report, including on the bank-sovereign nexus. We can also see evidence of this in many of the financial soundness indicators, as noted in one of the written responses to technical questions.

Banks remain a missing engine of growth. Greece has now experienced nearly 9 years of negative credit growth, and it still has the highest NPE ratio in the euro area, and this is in spite of eight rounds of bank assessments and four rounds of bank recapitalizations over the last 10 years. So we do see significant risks and vulnerabilities.

¹ Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

Banks are now facing regulatory pressure to speed up NPE reduction and resolution, and this is rightfully so. This reduction is key to restart lending, but as we highlighted in our staff report, achieving these more ambitious targets will require more capital from banks that currently lack sufficient internal income and access to capital markets. Moreover, banks are facing fundamental changes to the regulatory environment that are raising the bar, and therefore Greek banks are still in a critical phase.

As to what needs to be done, it is important to highlight that Fund staff are no longer in negotiating mode, but rather providing advice in a surveillance context. That being said, we have advised the government to take a more proactive role, to bring stakeholders together, including some of the entities mentioned by Directors—such as DG COMP, to consider state aid issues, the Single Supervisory Mechanism (SSM) at the European Central Bank (ECB), but also the Greek institutions—to bring them together into a more comprehensive, well-coordinated approach, and I would be happy to go through some of the specifics of what we mean by that. But to conclude, I believe there is a systemic problem in the Greek banking system that requires a comprehensive solution.

Turning to some of the issues that were raised in the Board, payment culture is one that was raised in the discussion. Mr. Sigurgeirsson, Mr. Psalidopoulos, and Mr. Moreno, and Mr. Gokarn, and Mr. Doornbosch have all raised this issue about ‘what do we mean’; are we going too far in characterizing the Greek issue as a cultural problem. I would like to give a few examples to set the stage for what we see in terms of payment culture issues in Greece. In this case, we mean payment culture issues on the revenue, the tax payment side, and also on the banking side—strategic defaulters. I will throw out a few examples and then I would come back to address more directly the questions that were raised.

A study just last year by some central bank employees conservatively estimated that about 28 percent of defaults in the primary residence mortgage market are strategic. This is about EUR 5 billion in NPLs for the Greek banking system.

On the tax side, tax and social security data indicate that the vast majority of workers report incomes that are below per capita GDP. It is implausible to have the incomes reported below what the economy is producing. There are studies that go back to the pre-crisis period as well.

A second example in the tax area: the tax compliance gap indicators are very high. The VAT compliance gap for Greece is three times higher relative to the median EU country. Yet another example: just last year there was a voluntary disclosure of income. About 500,000 applications were submitted corresponding to approximately EUR 10 billion in previously undisclosed income and about EUR 800 million in taxes that will be paid over some time.

We believe there is a payment problem. Maybe the culture is the wrong word, but there is an issue. Coming back more directly to the comments that were raised, this term – payment culture – is a term of art. It has been used in past discussions, including for Greece but also for other countries. In the context of Greece, it has been used to reflect the tendency for weak payment discipline to become embedded in the country and where there have been longstanding weaknesses in policies and in institutions, as has been the case in Greece.

Related to this and related to the relevant and important point about incentives, which we strongly agree with – that there has been and is an incentive issue—, we are concerned that there are currently a number of government policies that are being considered that we believe would create adverse incentives, negative incentives, to payment discipline. These include the household primary residence protection. There is a scheme or policy that is being formulated, which we believe goes beyond what would be prudent. In addition, there are also several tax installment schemes that are being considered that we may hear about in the next few weeks, but we do not have any details at this time.

There was a question from Mr. Saito about whether the staff will do its own analysis of the banking schemes once the data become available. We are certainly capable of doing that, and if it makes sense for us to do it, we would, but our point has been that this should be a government-led exercise, that in the context of their plan, their strategic thinking about the banking sector, it is important for them to take this on board and do a dynamic analysis of how these things might relate. But nonetheless, as we are looking at issues like the impact on balance sheets, credit growth, and ultimately on economic growth and how it relates to the long-term Debt Sustainability Analysis (DSA), which we will update at the time of the Article IV consultation. These are all relevant issues, and we will certainly explore them.

Mr. Tan raised a question about the financial sector, and it was also raised by Mr. Psalidopoulos. The question is – are we going too far and being

too negative? Do we have a messaging issue? This is an issue that we have to be sensitive to, but I think we also need to be balanced. We need to be careful but be balanced in these messages, and the problems in the sector are obvious, and they are public. The financial soundness indicators are published on a quarterly basis, and there we see a prominent one—the 47 percent NPE ratio. Bank stocks fell 50 percent last year. That is a very public message about some of the problems. I could give some other examples, but it is important that we maintain our credibility in putting these messages out.

There were two comments or questions related to reform fatigue, the labor market, the minimum wage, and Mr. Gokarn asked how we convince the population to move forward with reforms when the growth prospects are perhaps muted. It is a good suggestion to take it up in the context of the Article IV consultation, to look both at the micro—how the minimum wage and the labor market adjustments might be affecting employment and wage structure and competitiveness—and also at more of a macro level, thinking about the competitiveness but also what kind of mitigating policies might be put in place. This is where we can help. Even if the authorities were to hold their ground on the labor market policies, there are a number of things that the authorities can do to mitigate the negative implications of these wage pressures. They need to closely monitor it. They need to consider some of the active labor market policies and some of the other non-wage cost factors, such as in product markets, and think about how they might push forward some of these very difficult product market reforms, where relatively speaking, Greece has lagged.

There was a comment about the press release, and we would certainly be willing to consider some changes.

Mr. Psalidopoulos made the following statement:

On behalf of my authorities, I thank the staff for their hard work and the productive and frank exchange of views during the first PPM discussions. I also thank Directors for their gray statements and their comments. Their messages will be conveyed to Athens and will receive due consideration.

Since August 2018, Greece has exited the European Stability Mechanism (ESM) program, and it became a part of the European semester. Economic recovery has gained momentum. The GDP growth rate is above 2 percent. It is projected to remain on that level for the medium term. The goal of achieving a 3.5 primary balance surplus in line with commitments made by

Greece to its EU partners is secured. The external deficit, the current account is almost balanced. Policy uncertainty has receded.

Finally, in terms of maturity and average interest costs, Greece has currently one of the most advantageous debt profiles. An early repayment of obligations to the Fund in accordance with these developments and in consultation with EU partners is in sight.

The growth strategy for the future adopted by the Greek authorities is being implemented, and this will lead to broadening the tax base to reduce high corporate and personal income tax rates and to benefit private investment and employment. That being said, the authorities understand that risks to the downside are a possibility and are therefore firm in their resolve to proceed with the reforms which need to be kept up and strengthened.

In foreign policy, the authorities recently undertook a bold move and resolved a 20-year-old issue with their northern neighbor. They have demonstrated their readiness to tackle any issue that demands attention and action. As they did in foreign policy, they will do so in economic policy as well, in accordance with agreements and obligations they reached with their European partners.

A major new development is the new household insolvency law. As I said in my opening remarks, this is under discussion. We will know in a week's time or further down the road how this new law will look and how it tackles NPEs. Therefore, when we discuss the Article IV consultation on Greece after the summer, we will know more and will assess this whole situation.

At this sensitive juncture, the country needs all the support and advice it can get and is keen to hear the Fund's advice. The Fund can be seen in a twofold manner, as a trusted advisor and as a straightforward truth-teller.

On the financial vulnerabilities issue, to the Greek government, the most important thing is that they are on track with the EU institutions. They are working together to clear problems. The Greek authorities note that the Greek banks' past European stress tests and have concrete targets to meet by the end of 2019. Therefore, the expression "highly vulnerable" might be going too far.

Last but not least, on the issue of the weak payment culture, this is not helpful to my authorities. The Greek taxpayer has contributed revenue to

fulfill the ambitious fiscal targets and the 3.5 percent primary surplus in the past three years. Obviously, there is no weak payment culture there. The new household insolvency law will be submitted in parliament, and will ensure that strategic defaulters will be held accountable. Therefore, it would be a great communications error on the part of the Fund to adopt this wording in the forthcoming press release.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the commendable progress in implementing reforms which have helped restore stability and growth, reduce unemployment, improve debt sustainability and re-access markets. Building on Greece's growth momentum, they encouraged the authorities to address still-significant vulnerabilities and strengthen the economy's resilience and inclusion by enhancing labor market flexibility, rebalancing the fiscal policy mix, and strengthening bank balance sheets to support sustainable and more inclusive growth. Directors recognized that Greece's medium-term repayment capacity remains adequate, but noted rising downside risks that require further actions to strengthen the economy.

Directors noted that further efforts are needed to lock in competitiveness gains, enhance productivity, and ensure labor market flexibility. They expressed concern about the risks to employment and competitiveness from the combination of the recent reversal of the 2012 collective bargaining agreement reform and the increase in the statutory minimum wage, which was well above productivity growth. Looking ahead, Directors encouraged the authorities to accelerate reforms that could both mitigate these downside risks and help boost productivity and lower non-wage costs. They recommended further steps to improve the business climate and facilitate higher and more diversified investment, including long-needed deeper product market reforms aimed at improving product choice, quality, and competition.

Directors emphasized the importance of adopting a more growth-friendly and socially inclusive fiscal policy mix. They called for a further fiscal rebalancing, while meeting medium-term fiscal targets agreed with European partners. Directors supported the planned tax cuts in 2020, prioritizing lower direct tax rates while broadening the personal income tax base. They also recommended allocating more fiscal space to public investment and better targeted social spending. To support these objectives, Directors also called for accelerating public financial management reforms

and tax compliance efforts and addressing the structural causes of arrears. They also recommended deeper contingency planning for the possible realization of rising fiscal risks.

Directors encouraged the authorities to take a more comprehensive, well-coordinated approach to strengthening bank balance sheets and reviving growth-enhancing lending. Noting the high level of non-performing exposures (NPEs), they encouraged the authorities to bring together key stakeholders and base policy measures on cost-efficiency assessments of various NPE reduction options, while considering the impact of forthcoming regulatory changes and related fiscal implications. Directors encouraged further strengthening of the legal toolkit to facilitate private-sector based NPE reduction before considering state support, and to avoid measures that could further erode payment discipline, while improving bank internal governance. Liberalization of capital flow management measures should continue in line with the conditions-based roadmap.

APPROVAL: October 5, 2021

CEDA OGADA
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***Please comment on the authorities' consideration that Greece has become more export-oriented.***
 - Greek exports of goods and services have experienced sustained, real year-on-year growth above 5 percent every quarter since mid-2016 and (excluding shipping) have increased about 50 percent in real terms since the crisis, outperforming Euro area export growth. The share of total exports in GDP increased from 20 percent of GDP in 2009 to 32 percent in 2017. The structure of exports continues to be dominated by services (notably tourism, which is more sensitive to labor costs and trading partner growth). Goods exports, while experiencing some diversification and higher market access, are still dominated by refined petroleum. However, recent labor market developments and external factors pose risks to competitiveness and medium-term export prospects. Staff will take a closer look at these issues in the 2019 AIV Consultations.

2. ***We would appreciate an update from staff on the basic platform of the different parties that could have a greater chance of winning the election.***
 - The main opposition party (center-right New Democracy) has stated that it supports 'more growth-friendly policies', including by lowering corporate and property taxes, accelerating structural reforms, and unlocking privatization. Fiscal space to finance new initiatives is expected to come from faster growth, tighter control over public spending (attrition rule), and possibly a renegotiation in due course of the high primary surplus targets agreed with European member states once credibility has been established on growth-friendly reforms. Both the government and the opposition have made pledges for tax reductions, increases in social benefits and favor labor market protection.

3. ***Given that the authorities plan a gradual depletion of their cash buffer, would a more cautious approach with regard to cash buffer be preferable? Does the current approach pose any liquidity risk in case of a further tightening of global financial conditions?***
 - There is a trade-off between the confidence-enhancing effects of a large liquidity buffer and the cost of carrying cash while issuing new sovereign bonds to service

debt. Under the baseline scenario, the cash buffer declines gradually but would be a still sizeable €10 billion at end-2024 (six months of next year's GFN). However, as discussed in the staff report, the buffer would not be sufficient to cover a combination of risks materializing, absent a strong policy response. Therefore, ongoing assessments of risks (and policy options) are important for, among other things, guiding the use of the buffer.

Fiscal Policy and Social Welfare

4. ***Staff proposes exploring with European partners the possibility of a smoothing mechanism to accommodate potential shocks. Could staff elaborate on how this mechanism operates?***
 - If fiscal shocks create permanent costs, staff suggests that targeted policy measures should be introduced in the affected area, unless fiscal measures that are less detrimental to growth can be identified. However, if the fiscal shocks are temporary, the impact could be accommodated by allowing a temporary deviation from the annual primary balance target to be compensated in the following years to ensure public debt remains on the same path. Staff also sees merit in flexibility to help smooth business cycle fluctuations.
5. ***Could staff clarify if additional fiscal space is needed to cover the potential cost from on-going legal challenges of past wage and pension reforms?***
 - Staff projects the primary balance target to be met under the baseline over the medium term. However, if selected negative fiscal shocks emerge that exceed contingency reserves in the budget, additional fiscal policy actions would be needed to achieve the fiscal target. Annex VI provides a discussion of the implications of the realization of selected risks and related quantifications.
6. ***Could staff clarify the timing of the court rulings on legal challenges to past wage and pension reforms?***
 - While there have already been a number of lower-level court rulings on legal challenges, it is difficult to predict the exact timing of the final (supreme court) rulings. Nonetheless, staff consider that the court rulings discussed in Annex VI have higher chances of being finalized in the near term. In contrast, a final ruling on the challenges to the 2016 pension reform may take longer.
7. ***How does staff assess the impact of cancelled pension reform on fiscal balance on a longer horizon?***

- The pension expenditure paths with and without the pre-legislated pension reform would converge eventually after about 20 years, meaning that the 2017 reform will have little impact on long-run pension spending. However, the reform would have eliminated the negative differences upfront, which would have freed up fiscal space of about 10 percent of GDP over 20 years during the transition period. This additional fiscal space would have allowed a rebalancing of the fiscal mix toward growth and social inclusion, through direct tax reductions and more targeted social spending within the fiscal target committed to European partners. Moreover, even with the reform, the pension system would remain in deficit, of about 4½ to 5 percent of GDP, reflecting the unfunded pay-as-you-go ‘national’ pension.

8. *Could staff elaborate on the authorities’ action plan and timetable to address the high level of government arrears?*

- The agenda on reducing the structural roots of arrears involves actions in several areas. First, since the January mission, the authorities have identified a series of additional reforms to streamline payment processes, and discussion is ongoing as to whether there is room for further streamlining. Second, an updated audit of the government arrears is expected to take place in June, which should lay the groundwork for strengthened action plans in this area. Third, staff is discussing with the authorities possible further technical assistance to identify and address remaining PFM drivers of the arrears (which are not likely to be addressed by the June audit).

9. *Could staff elaborate further on the expected steps to address the tax compliance gap?*

- The authorities’ agenda on tax compliance is progressing gradually, as one would expect given its structural roots. One strand of important ongoing work involves the mapping of compliance risks and corresponding mitigation measures. The authorities have completed a working draft of a compliance risk matrix for domestic taxes and initiated a similar exercise for customs. As mentioned in the staff report, the outcome of this exercise will need to be institutionalized and used as an integral part of the IAPR (revenue agency) compliance management strategy. In addition, the IAPR is about to officially launch its comprehensive “Blueprint” to set in motion a large agenda of operational reforms to improve tax compliance.

10. *Could staff comment on any risks associated with one-off social dividends?*

- The most recent dividend was targeted in a similar way as the one in 2017 and did not pose a risk to meeting the 2018 primary fiscal target. To some extent, these dividends are a by-product of the hard floor on the primary balance agreed with member states. However, one risk of this policy is that their repeated use creates expectations of

ongoing dividends. Furthermore, staff considers such year-end social dividends as sub-optimal and would advocate for well specified policies (e.g. tax reductions to the extent overperformance is assessed to be permanent) and full budget execution (e.g. investment spending) in order to have a higher growth return for a given fiscal stance.

Debt Sustainability Analysis and Debt Relief

11. *Could staff elaborate further on the benefits and costs that early repayment to the Fund would have from the financial point of view? What are the implications for the Fund if Greece pursues the options of early repayment?*
 - Currently, SDR3 billion is subject to a surcharge rate (3 percent) on top of the standard interest rate (2.1 percent), which, in total, is higher than recent market borrowing rates (the recent issuance of 5-year bonds amounting to €2.5 billion yielded 3.6 percent). Therefore, an early repayment to the Fund of the portion of the loan subject to a surcharge rate (either utilizing the current cash buffer or issuing new bonds at current yields) would lower interest expenses and improve GFN and debt ratios.

12. *While the DSA by the EC assumes a primary surplus of 2.2 percent of GDP on average in the period from 2023-2060, staff foresees a primary surplus of 1.5 percent of GDP in 2026-28. Could staff comment on this difference?*
 - Fund staff's assessment of the maximum sustainable primary balance over the longer term has not changed since the 2018 Art IV. A full update will be available with the publication of the next Art IV.

13. *Could staff elaborate on how this PPM report will feed into the enhanced surveillance process with European Institutions (EIs) and meeting preconditions for additional debt relief going forward?*
 - The IMF's PPM process, including the staff report, is a stand-alone exercise taken under Fund policies and procedures. The report has been distributed to member state representatives, including for the Euro Area, and selected institutions (including the ECB and European Commission) using the normal channels. Staff joined to the EIs for the enhanced surveillance (ES) missions (the second ES review was conducted in parallel with the Fund's first PPM review) and the teams have generally been in close contact regarding policy areas of common focus. When asked, staff also provides its views and assessment directly to Euro Area member states.

14. *Given the past macro assumptions for the DSA have been optimistic, could staff elaborate further on the potential implications of forecast errors in the key*

macroeconomic variables on the debt sustainability path which would also guide the potential future debt relief?

- If macro outturns were to fall short of assumptions, the implication is that debt and GFN indicators would be worse. Therefore, optimistic assumptions could lead to an overly optimistic view of debt sustainability. Staff considers its long-term projections on growth and primary balance to be realistic. These projections are described in more detail in the 2018 AIV staff report, and will be revisited in the context of the 2019 AIV Consultation.

Financial Sector

15. *Could staff elaborate on the authorities' strategy to provide protection to distressed mortgage holders?*

- The authorities are currently working on new legislation to provide protection to debtors with debts secured by a primary residence. This work is being done in the context of the recent expiration, at end-February 2019, of the “Katseli law” which has provided near blanket protection of primary residences since 2010. Staff has seen preliminary proposals of the replacement scheme, which includes a limited state subsidy for eligible borrowers. Staff has raised a number of concerns with the preliminary proposals, including the wide eligibility criteria, mandatory nature of restructurings, significant opportunities to remain under court protection and delay repayment, as well as potentially significant negative impact on banks' balance sheets.

16. *Could staff elaborate more on the background of evaluating as weak payment culture? What policy measures do staff recommend to change the payment culture?*

- The weak payment culture in Greece, particularly with respect to tax evasion and strategic defaulting on mortgage loans, has been documented in conversations with key stakeholders, including the authorities and financial sector representatives, in past staff reports, and in academic literature. Regarding mortgage loans, the legislative framework and the significant backlog of household insolvency cases in the court system has created a system where there is near blanket protection for primary residences, which has furthered moral hazard. To address this, staff has recommended that the authorities significantly reduce the scope of primary residence protection, in addition to strengthening NPL resolution mechanisms such as e-auctions, to gradually normalize the system and provide the proper incentives for those who can repay to do so—while at the same time pushing for stronger social safety net protection more broadly. On the tax side, staff has supported the strengthening of the revenue

administration, and reduction of tax expenditures and arrears (and urged caution regarding repeated use of installment schemes).

17. *It would be useful to add a footnote on the banks' exposure to the sovereign, given the deferred tax assets are normally not included in definitions of sovereign exposure.*

- The list of banks' exposures included in staff's estimate are provided in Box 1 (see reference in ¶27). In particular, the first paragraph of the box clarifies that DTAs are a contingent exposure to the State. DTAs are claims against the government on the asset side of banks' balance sheets, arising on account of taxes paid or tax losses carried forward that may entail a refund from the government in the future.

18. *Could staff elaborate on the pros and cons of a system-wide NPE reduction solution centered on state guarantees versus deferred tax credits (assuming state aid rules are not triggered)?*

- Given the current uncertainty about key parameters of the proposals (including due to potential changes to design required to ensure compliance with State aid/BRRD rules), a comparison of alternative proposals at this stage has to be limited to the general features of such NPE reduction schemes. At a high level, a solution based on guarantees (APS) seems to imply lower immediate costs for the State, though banks' willingness to participate in such a scheme and thus its impact on NPE reduction could be low if the 'market-based' price of the guaranty proves to be too high. The creation of an AMC and transfer of DTCs from the banks' balance sheets could imply a prompt and significant reduction of the NPE stock on banks' books. However, it may prove to be costly for both banks (their capital being reduced by the transfer of DTCs, and governance issues surrounding collection) and the State (the DTCs being transformed into an irrevocable liability for the State).

19. *Could staff comment on the divergence of views on the adequacy of the authorities' NPE strategy? Could staff comment on the authorities' disagreement on the staff's assessment on the extent of the financial system vulnerability?*

- Bank vulnerabilities are evident when looking at commonly used financial soundness indicators. For example: (i) capital adequacy which, assessed on a fully-loaded basis, is the fourth lowest in the EU and is based on the weakest quality of capital, given the share of DTCs, (ii) asset quality, the lowest in the EU (the highest NPE rate), (iii) profitability, the lowest and still negative, (iv) liquidity, with most banks failing to meet their regulatory requirements, and (v) resolvability, with no MREL buffer built up so far. Regarding the broader NPE strategy, staff's views are outlined in paragraph 29 of the staff report.

20. *Given that there are multiple proposals for NPE reductions and staff expects that some form of state aid may be inevitable, can staff elaborate on how the effort to address NPEs is expected to move forward?*

- This remains uncertain, with the timing and order dependent on the authorities and key stakeholders. The authorities appear to be prioritizing an enhanced primary residence protection scheme (see question #15). The authorities have also told us that they prefer to move forward initially with an asset protection scheme (whereby the state guarantees tranches of NPE securitizations), rather than an asset management company proposed by the Bank of Greece. These schemes will require European Commission approval as a no-state aid scheme, and ECB-SSM review to check the regulatory capital treatment of the securitization.

21. *Could staff comment on the adequacy of the current targets for NPE reduction in view of the EIs and the potential for massive write-downs and capital shortfalls?*

- The banks are finalizing updates of their NPE reduction targets for the period up to 2021. Preliminary announcements by selected banks indicate they are targeting single digit NPE ratios in a few years. If this is successfully achieved, this would support a revival of banking lending.

Labor Market and Structural Reforms

22. *Could staff comment on the authorities' divergent view that stronger wage growth is expected to boost labor productivity via higher labor utilization, and the potential for this outcome to materialize, compared to the risks to job recovery and external competitiveness that staff pointed out?*

- The authorities consider a boost to aggregate demand from a higher minimum wage would increase work intensity and increase average production per worker in smaller, service-oriented firms (that tend to pay minimum wage). Staff has not conducted an analysis of productivity at the sectoral level, but existing evidence indicates the binding impact of the minimum wage is large for such firms, many of which are already facing limited financing and other cost constraints, thus risking a reduction or non-expansion of employment. Also, a spillover of higher wages to the tradable sectors would put pressures on unit labor cost and external competitiveness. Staff plans to analyze the labor market in more detail in the upcoming Article IV.

23. *How does the share of minimum wage workers in Greece compare with the situation in peer countries? Is the growing share of minimum wage workers in Greece related to a reduction of the level of wages towards the minimum?*

- Compared to the EU level for 2014, Greece was ranked at the mid-point in the share of employees earning less than 105 percent of the minimum wage (Eurostat). It is likely that the share in Greece relative to peers is currently higher since this estimate excludes part-time workers and those who work for small firms (less than 10 employees), which constitute the majority of firms in Greece. Also, the percentage of workers earning the minimum wage in Greece has increased since then (see SR Annex IV Figure1), likely bumping Greece above peers, all else equal. Based on the national registry for private sector employment, the share of minimum wage earners was 21 percent in 2017. Staff has yet to determine causality, but the reduction in the average wage level was driven by the lower statutory minimum wage established in 2012 (see SR Figure 2).

24. *Can staff elaborate on successful examples of anchoring minimum wage developments to objective productivity-related indicators in peer countries?*

- Examples of cases in the past where minimum wages have been linked to objective indicators include expected inflation (Slovenia, Italy), retail prices (Malta), or other wages (Luxembourg and the Netherlands).

25. *Could staff clarify what implications the recent double-digit minimum wage hike and the abolishment of the youth sub-minimum could have? Could staff comment on that the changes to the collective bargaining framework aimed at strengthening workers' bargaining power could trigger more broad-based wage increases which may undermine the job recovery, hurt competitiveness and ultimately dampen growth? Could staff comment on the impact of the recent increase in minimum wage and changes to the collective bargaining policies in particular and the reversing of labor reforms in general on the recovery of private sector investment and job creation.*

- Firm-level data for the fourth quarter are not yet available to assess the impact of the CBAs signed after August 2018. The impact of the minimum wage will only be evident later in the year as employment statistics after the February 2019 increase become available. As mentioned in the staff report, staff sees risks to employment, particularly for the youth given the substantial wage increase, and the potential of spillovers to the average wage level given the re-instatement of collective bargaining agreements, which in the past followed minimum wage developments closely. In addition, employers cite workers' recourse to unilateral arbitration as an amplifier of collective bargaining. Staff will assess the impact of the minimum wage increase, including for private sector investment and employment, in more detail in the 2019 Article IV Consultation.

- 26. *Given the difference in views between staff and the authorities on labor market policies, can staff elaborate on how the authorities can track and assess wage dynamics in order to make timely adjustments as needed?***
- As mentioned in the staff report, staff has strongly encouraged periodic assessment of the market representativeness mechanism in CBAs (and their impact), particularly through dialogue with the smaller firms bound by the agreements put in place since August 2018. Staff also recommends closely tracking employment data in general, but in particular for vulnerable populations (youth, women) and advancing progress in incorporating informal sector statistics in the labor survey.
- 27. *Could staff elaborate on the importance of privatization to attract investors and new foreign direct investment to support the economic recovery in Greece?***
- Advances in privatization, notably in key sectors such as transport and energy, would present new investment opportunities and encourage productivity gains. Completing the well-identified agenda (which includes large projects such as the Hellenikon complex) would foster foreign direct investment (FDI) and support the private-sector led recovery in Greece.