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Greece's Financial Policies From 2009 Till Now

A Linguistic Approach To It

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1. Introduction

1.1 The international dimension

The financial crisis, which originally broke out in the US in August 2007, and then rapidly deteriorated in autumn 2008 with the collapse of the Lehman Brothers investment bank, evolved into a global economic crisis within the environment of closely interlinked economies, causing the greatest recession since the 1930s and a serious deterioration of public finances in most countries. There was an adverse impact on all the economies of the world.

In 2009 the world economy recorded negative growth for the first time in the postwar period, as most advanced economies went into deep recession and economic activity in emerging economies slowed down considerably. All euro area countries recorded negative rates of change in GDP, while the recession was greater in the more open economies, which suffered particularly due to the rapid decline of world trade (by 10.7%) that year. Of course, these more open economies were also the first to benefit from the recovery of the world economy and international trade that started in 2010. By contrast, countries with serious external and domestic macroeconomic imbalances and structural weaknesses lacked the resilience and flexibility required to independently cope with the impact of the financial and economic crisis and to benefit from the recovery of world economy and trade that followed the great recession of 2009.

Thus, although countries with sound key economic aggregates managed to get back on a growth track within a relatively short time, countries with large macroeconomic imbalances and structural weaknesses faced great difficulties and in some cases had to resort to external financial assistance. Equally large was the divergence in the area of employment as well, since economies with sound fundamentals and a satisfactory degree of flexibility were able to maintain low unemployment rates, whereas unemployment in economies with serious structural weaknesses rose rapidly.

1.2 Policies for coping with the world financial crisis

The crisis demonstrated the need to improve the institutional regulatory and supervisory framework of the global financial system and led to the support of the financial sector and to its restructuring in many countries. In Europe, the financial crisis and —later on— the sovereign debt crisis expedited the implementation of extensive reforms in the governance of EMU.
In October 2008 the euro area countries agreed on taking coordinated action to stabilise the banking system. The Paris Declaration, signed by the euro area country leaders on 12 October 2008 and then adopted by the European Council on 15-16 October, provided for coordinated measures to restore confidence and improve financing conditions. These measures included granting government guarantees for bank-issued debt securities as well as bank recapitalisation.
In December 2008 the European Council approved the European Economic Recovery Plan, which aimed at supporting economic activity by stimulating aggregate demand and at intensifying efforts for the implementation of structural reforms.

2. 2008-2009: The crisis in Greece

Especially since its dramatic deterioration in October 2008, the global financial crisis started to negatively affect the Greek economy as well, leading to a considerable weakening of expectations.

As regards public finances, in 2008 the (then recorded) general government deficit exceeded 4% of GDP, resulting in the initiation of an Excessive Deficit Procedure (EDP) against Greece in April 2009, while public debt as a percentage of GDP rose to almost 97%. Developments in 2008 already, clearly indicated that the condition of the economy was bound to deteriorate, a fact confirmed dramatically the following year. Besides, throughout 2008, there had been constant "warnings" from abroad. The previous long period of strong growth supported the "naive forecast" that this would continue in the coming years as well, while there were also specific reasons which delayed a full manifestation of the impact of the global crisis (discussed further below).
The overall tone of the estimates regarding the Greek economy's state in late 2008 and early 2009 is reflected in the Updated Stability and Growth Programme 2008-2011, submitted to the European Commission on 30.1.2009 with forecasts that —against that background— were extremely optimistic.

The conclusion drawn from the above has to be that in that period there was no realisation of the severity of the situation and the risk of the global banking crisis turning into a sovereign debt crisis for countries with high deficits and debts such as Greece. On the contrary, the international crisis, galloping at rapid rates all over the world, was treated as a distant phenomenon, irrelevant for Greece. 2009 was a particularly crucial year as it saw the aggressive emergence of problems that, albeit pre-existing, had been ignored within the generalised climate of complacency that had been fuelled by growth in the previous period. But, with the onset of the global crisis, these problems were no longer controllable; addressing them required taking immediate extraordinary measures and making long-term coordinated efforts. However, it seems that it was hard, politically and socially, to exert such efforts. A second decisive fact was the heavy impact of the political cycle on the efforts to address these problems in a timely manner. Two elections were held in the course of 2009, for the European Parliament in spring and for the Greek Parliament in October.

This not only led to the typical fiscal result of the political cycle, namely higher public expenditure and relaxation of the tax collection mechanism, but also prevented the political system as a whole from converging on a minimum base of mutual understanding in order to cope with the extraordinary conditions that were patently in the offing.

2.1 The climate deteriorates, confidence is shaken

Adverse developments in 2009 were characterised by a derailing of fiscal aggregates, with the deficit reaching 15.7% of GDP and public debt 129.7% of GDP.
After fifteen years (1994-2008) of continuous growth, GDP fell in 2009 by 3.2%, despite the vast fiscal stimulus. Specifically, the general government deficit came to 15.7% and the primary deficit to 10.5% of GDP. Compared with 2008, the deficit widened by 5.8 percentage points and the primary deficit by 5.5 percentage points of GDP. This widening was due to poor revenue performance (2008: 40.7% of GDP, 2009: 38.3% of GDP) and increased general government expenditure (2008: 50.6% of GDP, 2009: 54.0% of GDP). Nevertheless, affected by lower investment and private consumption, GDP fell and the economy officially entered into recession. Moreover, in the 2001-2008 period the cumulative loss of international competitiveness reached 16.9% based on relative consumer prices and 27.7% based on relative labour costs.

These developments dramatically heightened uncertainty about the economy's future, strongly affected expectations, and brought about a confidence deficit, which in turn led to a downgrading of the economy's credit rating and a considerable widening of the yield spreads between Greek and German bonds.
The banking system started facing serious liquidity problems, as the country's lower credit ratings restricted the banks' access to the international interbank market and later on to other funding sources as well.
Already in January 2009, Standard & Poor's downgraded the country's credit rating from A to A-, due to the "Greek economy's deteriorating loss of competitiveness", keeping it nevertheless in the investment grade category. On account of this downgrading, the spreads between Greek and German government bonds rose to 300 basis points in January and remained at this level until March 2009. Over the next months the spreads stood somewhat lower, between 150 and 200 basis points, but moved further upwards in the last months of 2009.

A turning point concerning the further deterioration in confidence was the announcement by the Greek authorities on 22 October 2009 that the government deficit in 2009 was more than double the projection and that the 2008 deficit was also considerably higher than estimates up to that time.
This large official revision of the deficit confirmed market, rating agency and international media estimates that the fiscal problem of Greece was much graver than what was suggested by the data available by then. This fact was drawing the markets' attention to two crucial questions: First, whether the Greek authorities had the will and the determination to implement a consolidation programme able to address deficits of this magnitude and, second, whether the statistical data reliably recorded the country's fiscal situation.

At the end of 2009, the markets' answer to both questions was negative, corroborated by the December ECOFIN decision, according to which Greece had failed to sufficiently respond to the Council's recommendation of April 2009, when the EDP had been initiated. Specifically, by 27 October when the deadline expired, no measures had been taken. In addition, the decision stated that "new measures of the 2009 budget consist mainly of revenue-enhancing measures, partly temporary, and not

permanent measures on the expenditure side, as called for by the Council". It is characteristic that the largest downgradings of Greece's credit rating in the course of 2009, by all three major rating agencies, took place in December,13 following the aforementioned ECOFIN decision.

Various reports in the international media, questioning Greece's ability to achieve the required fiscal consolidation and align itself with the other euro area countries, aggravated the adverse climate. In the first months of 2010 such reports multiplied, focusing on the country's public debt and possible bankruptcy and exit from the euro area. Furthermore, as both the implementation of effective fiscal consolidation measures in Greece and the adoption of EU decisions for a support framework conditional on the implementation of an economic adjustment policy were taking time,15 media reports about a risk of contagion of the crisis to other euro area countries, or even of a breakup of the euro area itself, proliferated. The Greek crisis had thus become the potential catalyst of developments in the world economy.

2.2 Questioning of the statistical data

The doubts cast on the reliability of Greek statistical data turned out to be one of the major factors that contributed to the loss of confidence. This questioning had a long history, which was reflected in Eurostat reports. But, by the end of 2009, the issue had grown out of proportion, both in Greece and, mainly, abroad.
In 2009, the persistence with relatively optimistic deficit forecasts, although the data during most of the year pointed to the opposite direction along with successive revisions within a short period of time, dealt a decisive blow to the reliability of Greek statistical data and contributed to the overall questioning of the country's credibility.

In October 2009, Eurostat explicitly expressed reservations regarding the reliability of the fiscal data and did not confirm the deficit of 12.5% of GDP as revised by Greece. Moreover, in January 2010, the European Commission reprimanded and publicly criticized Greece for providing unreliable fiscal data. This referred both to data reported in the past (in the 1997-2003 period, examined in a Eurostat report of 2004, as well as reservations expressed by Eurostat on five occasions after 2004), and, mainly, to the data reported in April and October 2009. Indicatively, the Commission report ascertains that: "Even if the existing governance framework for fiscal statistics at EU level functions satisfactorily and enables improvements of a statistical and methodological nature, it cannot prevent deliberate misreporting of data".

It was only in April 2010 that Eurostat announced revised data on the fiscal deficit of Greece in 2009, which was now estimated at 13.6% of GDP, a percentage further revised upwards (to 15.4%) later. Thus, for several months and in a particularly crucial period, uncertainty regarding the final level of the deficit persisted, a fact that kept fuelling all sorts of conjectures about the country's future and worsening its relationship with its European partners.

2.3 The deterioration of the situation is not dealt with adequately

The economic policy pursued, both before the elections held on 4 October 2009 and for a few months afterwards, was timid and the measures taken proved inadequate to halt the downward course of the economy. Indicatively, the new government, although it released its estimate of the 2009 deficit (12.5% of GDP, against an initial forecast of 3.7%) a few days after the elections, at the same time stated they meant to implement the measures announced before the elections, which were clearly expansionary in nature.

In early 2009, economic policy planning had relied on the forecasts included in the Updated Stability and Growth Programme, about a government deficit in the order of 3.7% of GDP in 2009. Soon enough, however, it became clear that this initial forecast was not compatible with the actual facts, and that the deficit would finally stand much higher. As mentioned earlier, the forecast regarding the 2009 deficit was then (22.10.2009) set at 12.5%, and subsequently at 12.7%, while the estimate for 2008 was 7.7%. Despite the drastic revision of the 2010 Budget, passed in December 2009, the impression continued to prevail that the crisis could be overcome by means of a relatively mild —compared to the size of the problem— fiscal adjustment programme.

Thus, in late 2009 and early 2010, the economy’s fundamentals were out of track, with vast public revenue shortfalls and increases in public expenditure, deficit and debt, whereas the balance of payments deficit remained at historically high levels, although the economy was now already in recession.

<u>Late 2009 timeline</u>

- 4 October 2009 – The centre-left PASOK wins the Greek legislative elections. The party received 43.92% of the popular vote and 160 of 300 parliamentary seats.
- 20 October 2009 – Greece's budget deficit is expected to reach ~12.5% of GDP, according to disclosure by George Papakonstantinou, finance minister in Greece's new socialist government. This deficit exceeds a threshold of 3% of GDP which was set in the Stability and Growth Pact for all eurozone member states.
- 22 October 2009 – Greece's credit rating is downgraded by Fitch, one of the Big Three credit ratings agencies, from A to A−.
- 8 December 2009 – Greece's credit rating is downgraded by Fitch from A− to BBB+.
- 16 December 2009 – Greece's credit rating is downgraded by Standard and Poor's, another of the Big Three credit ratings agencies.

- 23 December 2009 – Greece's credit rating is downgraded by Moody's, the third of the Big Three credit ratings agencies, from A1 to A2.

3. A new European environment is being built from 2010 onwards

In 2010 the financial crisis evolved into a sovereign debt crisis in some euro area countries, posing a direct threat to the stability of the economic and monetary union. Greece found itself at the epicenter of the crisis, as the weakest euro area economy with large (fiscal and current account) deficits and serious structural problems.
By early May 2010, it had become clear that one country's problem had turned into a problem for the euro area as a whole. The European leaders came to important decisions for coping with the crisis and averting its future re-emergence; these decisions represent the beginning of the most significant effort to reform the EMU since its inception.

At this time, the European Union was looking into the experience of the crisis, in search of new governance orientations, ones that would define a new operational framework for EMU and the Member States' economies, a new institutional setup. For the countries of the euro area, the environment thus shaped required greater consistency in abiding by fiscal obligations and introducing new rules for all economic policies, in addition to fiscal policy. The crisis appeared to set the EU and the euro area on a new course, having as a main objective the convergence of the Member States' economic policies. This entailed long-term commitments to achieve fiscal balance, improve competitiveness, and harmonise rules on the operation of markets and the banking system.

The crisis resulted not only in the adoption of longer-term objectives for changing the existing structures, but also in a key decision – the one regarding financial support of countries facing problems. This choice was neither easy, nor self-evident; this is why it met with some serious resistance. In the end, however, the choice prevailed, as it was based on European criteria – i.e. the view that the default of one Member State would have very serious side-effects for the entire euro area.

All of the above delineated the objective reality within which the Greek economy had to function in the years of the crisis, and will be required to function in the future:
- In the medium term, meeting the terms of the support programmes was, and still is, a primary condition for European solidarity to continue.
- In the long term, the Greek economy must work towards a new growth model, one that will be in line with the new reality as it is being shaped at European level.

3.1 2010: Decisions for supporting the Member States − in search of systemic solutions

On 11 February 2010, the euro area Heads of State or Government declared that they support the efforts of the Greek government and its commitment to take any action required in order to ensure the achievement of the ambitious targets set in the stability programme for 2010 and the following years, and called upon the Greek government to promote with determination all the necessary measures so as to reduce the fiscal deficit by 4% of GDP in 2010. Their statement emphasised that euro area countries would take decisive and coordinated action, if necessary, to safeguard financial stability in the entire euro area, and also clarified that the Greek government had not requested any financial assistance.

On 25 March, the Heads of State or Government of the euro area countries, after reconfirming their statement made on 11 February, reached an agreement which specified that "as part of a package involving substantial International Monetary Fund financing and a majority of European financing, euro area member states, are ready to contribute to coordinated bilateral loans". They also agreed on the need to improve and complement the framework for ensuring sustainable public finances in the euro area, and to enhance its ability to act in crisis periods.
On the basis of the aforementioned decision, a mechanism for the support of the Greek economy by the euro area countries and the IMF was activated in early May 2010, after the Greek authorities had drawn up an economic policy programme that was accepted —as a condition for the provision of financial support— by the Commission in cooperation with the ECB and by the IMF.

In parallel (on 8-9.5.2010), the euro area summit and the euro area Finance Ministers decided to establish a provisional European Financial Stability Facility (EFSF), accessible only to euro area countries. This Facility was provided with guarantees amounting to €440 billion following a decision on June 17 (in addition to the amounts granted for the support of Greece and a further amount of €60 billion available at EU level),2 in order to prevent the recurrence of similar debt and confidence crises in the future, and to protect stability in the euro area.
The ECB's monetary policy stance remained accommodative in 2010, while the Eurosystem kept resorting to the use of non-standard monetary policy measures, with a view to improving the financing conditions and boosting the flow of bank credit to the real economy. The ECB activated an additional non-standard measure, the Securities Markets Programme, and intervened in the secondary market by purchasing government bonds issued by some countries, in order to address disfunctioning in financial markets that jeopardised the smooth operation of the mechanism for the transmission of monetary policy effects to the real economy.
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These decisions, combined with the better-than-anticipated results of the EU wide stress tests of banks in July 2010 and the positive performance of adjustment programmes in the first months of their implementation, led to a partial restoration of investor confidence, but only in the short run. Markets continued to treat the provisional support mechanism with skepticism, deeming the size of its available funds insufficient to cope with a broader debt crisis in Europe. The yield spreads of government bonds issued by relatively weaker countries to corresponding

German bonds remained at high levels, while new reports in the international media were discussing an increased probability of euro area breakup, at the same time questioning the future effectiveness of the bailout mechanisms and the European leaders' determination to jointly resolve the debt crisis in Europe.

Thus, a few months later, in October 2010, the European leaders decided to alleviate pressures by creating a permanent crisis-resolution mechanism, the European Stability Mechanism, thereby confirming their will to take all necessary actions in order to safeguard the stability of the financial sector and of the euro area in general. Developments were now making obvious the strong interdependence of EU Member States and the need for closer coordination of their fiscal and economic policies. So, for the first time in 2010, the issue of a "European economic governance in the EU-27" was raised, with a view to developing a common economic agenda and a strong, comprehensive monitoring framework at EU level. The new framework would require all Member States to make long-term commitments, particularly as regards fiscal discipline and the focus of their economic policy on improving competitiveness – i.e. precisely the two major challenges Greece had to face, one way or another.

In combination with the decisions to strengthen economic governance and safeguard stability in the euro area, the European leaders and the EU institutions implemented in the course of 2010 a series of decisions that had been taken in 2009 for the reform of the financial sector. Specifically, the European Systemic Risk Board (ESRB) was set up, with the active involvement of the ECB. Its responsibilities include monitoring and assessing the risks to the stability of the financial system as a whole ("macro prudential supervision") and providing early warnings and recommendations to the Member States. This Board was complemented by the European System of Financial Supervisors (ESFS) for the supervision of the individual financial institutions ("micro prudential supervision"), composed of three new European Supervisory Authorities. Also, in June 2010, it was agreed to introduce a system of taxes and levies on financial institutions, in order to ensure fair participation in the systemic risk limitation costs of the financial sector. Finally, in order to increase transparency, it was decided that banks' stress test results would be published.

With Greece returning as a main item of discussion in the G7 meeting (in October 2010), the issue of restructuring the debts of euro area countries was voiced for the first time during the German chancellor's meeting with the French President in Deauville, resulting in an upward surge in the interest rates on government bonds of the euro area periphery, and primarily on those of Greece. Proposals for the issuance of euro bonds were rejected, on the grounds that a mutualisation of the debt would weaken the fiscal and reform efforts of the countries with deficits, whilst creating at the same time moral hazard problems in the rest of the countries.

3.2 The Memorandum of Economic and Financial Policies

The negative developments of 2009 continued and intensified in the first months of 2010. The period was mainly characterised by escalating pressures in the bond market and a dramatic increase in the cost of borrowing. To prevent a further decline in confidence, the Greek government proceeded to considerable fiscal target revisions, and the new targets were included in the Updated Stability and Growth Programme 2010-2013 of January 2010. Compared with the already adopted Budget, this was a more drastic and frontloaded fiscal consolidation.

Nevertheless, despite positive statements by heads of EU bodies and institutions, the markets and the international media continued to maintain a strongly negative stance to Greece. By 28 January, the spread of the Greek 10-year bonds over the corresponding German bonds had reached 369 basis. Markets were reacting intensely to a multitude of unfavourable reports in the international media. Despite the announcement of additional measures in February and March (also welcomed by heads of EU bodies and institutions), the cost of borrowing for Greece continued to rise. In April 2010, the yield spread on 10-year bonds climbed to 430 basis points. This continuing rise in the cost of borrowing did not permit any new bond issues, while increased uncertainty surrounding fiscal and macroeconomic developments led to successive downgradings of the country's credit rating. In April alone, all three major credit rating agencies (Fitch, Standard & Poor's, and Moody's) announced considerable downgradings.

Thus, on 23 April 2010 the Greek government submitted to the euro area countries and the IMF a request for financial assistance (based on the framework decision made by the European Council of March 25 and on the elaboration of its terms by the Eurogroup on 11 April). The Memorandum of Economic and Financial Policies and its accompanying provisions were incorporated in Law 3845/2010 ("Measures for the implementation of the support mechanism for the Greek economy by the euro area Member States and the International Monetary Fund"), and provided the guidelines for the economic policy that had to be followed throughout the duration of the loan agreement.

3.3 Provisions and directions of the Memorandum

In essence the Memorandum provided for a loan of €110 billion to be extended by the euro area Member States and the IMF to Greece, intended to cover the economy's financing needs and support the banking system. Moreover, the measures, which constituted an integral part of the Memorandum, reoriented economic policy to three main directions:
First, towards a frontloaded fiscal consolidation, effected mainly through a cross the board measures that would bring the deficit below 3% by 2014 and achieve a balanced primary budget in two years. In the immediately next phase, from2011 onwards, the Memorandum provided for structural reforms in the functioning of the State, aimed at the long-term sustainability of the adjustment effort and the generation of large primary surpluses to reduce the debt.
Second, towards structural reforms in the functioning of markets, aimed at improving

competitiveness and creating a business environment able to attract investment. Third, towards safeguarding the stability of the financial sector.

3.4 The implementation of the Programme

In the first months of the programme's implementation, developments were encouraging. According to the first review by the Commission, the ECB and the IMF, published in August 2010, the programme had got off to an impressive start: on the one hand, all (but one) fiscal targets ("performance criteria") set for end-June had been met, and on the other hand, the implementation of some reforms was progressing ahead of the programme's schedule.

Still, despite this generally positive account, the second review, carried out on the basis of data for the first nine months of the year and published on 6 December 2010, fully confirmed the chronic weaknesses of the Greek public sector. At the same time, it pointed out that structural issues had to be addressed for the adjustment to be sustainable. At the macroeconomic level it mentioned that the recession was deeper than initially anticipated, while inflation in October (5.2%) had only slightly declined compared to July (5.5%). Finally, unemployment had reached 12.2% in August.

In contrast to the first review, it was now recognised that liquidity in the economy (and the banking system) was tight, non-performing loans were increasing, and the profitability of the banking system remained weak.
The overall assessment during that period was that, although the programme's implementation remained broadly on track, it had reached a critical crossroads. At that particular point in time, economic recovery relied heavily on dynamically promoting the structural reforms, mainly by opening up closed professions, liberalizing retail trade, and strengthening the tourism industry. This would require a clash with vested interests, putting the government's resolve to carry out these reforms to the test.

These remarks reflected concerns caused by the relaxation in the programme's implementation and the discrepancies already apparent since the autumn of 2010. Particularly as regards structural reforms, such as the opening up of closed professions or the deregulation of product and services markets, etc., right from the start there had been hesitation, doubts, cop-outs and procrastination.

3.5 Results and consequences

Assessing in brief the results of the implementation of the Memorandum in 2010, the following should be noted:

- The implementation of the financial support agreement allowed the country's financing by its euro area partners and the IMF to continue, averting the eventuality of default that had emerged in April.
- The general government deficit (on a national accounts basis) for 2010 stood

at 10.6% of GDP. The deficit fell by almost 5 percentage points compared to 2009 − roughly in line with the programme's projections. This was a very big adjustment, all the more so in a period of recession, even if account is taken of the fact that —due to considerable overruns in 2009— some expenditure cuts were relatively easy. Nevertheless, the revision of the 2009 deficit from 13.6% to 15.4% of GDP negated any possibility of meeting the target set for a reduction of the deficit to 8.1% of GDP in 2010.

- The recession deepened: GDP declined (4.5%) for a third consecutive year, affected mainly by lower domestic demand.
- As 180,000 jobs were lost, unemployment exceeded 12% of the labour force.
- Average nominal earnings of employees in the economy as a whole fell by 5%.
- Despite the recession, high inflation persisted (4.7%), partly due to increased indirect taxes.
- The current account deficit narrowed slightly (from 11% of GDP in 2009 to 10.4%).
- The annual rate of credit expansion to the domestic private sector, which had been decelerating considerably since 2008, was nil at end-2010.
- A major characteristic of the way the crisis was handled is that since the beginning, before the programme's preparation, fiscal adjustment policy had focused clearly on increasing taxes rather than on curtailing unnecessary expenditure and the squandering of public funds. This was a missed opportunity to learn from international experience and studies showing that fiscal consolidation is sustainable and leads to faster economic recovery when based mainly on expenditure cuts. The continuous increase of tax burdens generated right from the start negative expectations that led to disproportionately large declines in private consumption and investment, resulting in a deeper and more prolonged recession.

In summary, although the programme's implementation produced a visible fiscal consolidation result, the means to its implementation amplified the contractionary impact of the reduction of expenditure. One should not overlook, however, that the negative outcomes as regards economic activity and employment would have been much worse in the absence of the adjustment programme and the financial support of the country's EU partners and the IMF.

2010 timeline

- 21 January 2010 – The Greek/German 10-year debt yield spread surpasses 300 basis points.
- 9 February 2010 – The First austerity package is passed by the Greek parliament. Measures include: a freeze in the salaries of all government employees, a 10% cut in bonuses, and cuts in overtime workers.
- 3 March 2010 – The Second austerity package is passed by the Greek parliament. Measures include: a freeze in pensions; an increase in VAT from 19% to 21%; rises in taxes on fuel, cigarettes, and alcohol; rises in taxes on luxury goods; and cuts in public sector pay.
- 9 April 2010 – Greece's credit rating is downgraded by Fitch from BBB+ to BBB−.

- 22 April 2010 – Greece's credit rating is downgraded by Moody's from A2 to A3.
- 23 April 2010 – Prime Minister George Papandreou formally requests an international bailout for Greece. The European Union (EU), European Central Bank (ECB) and International Monetary Fund (IMF) agree to participate in the bailout.
- 27 April 2010 – Greece's credit rating is downgraded by Standard & Poor's below investment grade to junk bond status. Standard & Poor's is the last of the Big Three credit ratings agencies to downgrade Greece's credit rating in April 2010.
- 28 April 2010 – The Greek/German 10-year debt yield spread surpasses 1000 basis points.
- 2 May 2010 – The IMF, Greek Prime Minister Papandreou, and other eurozone leaders agree to the First bailout package for €110 billion ($143 billion) over 3 years. The Third austerity package is announced by the Greek government.
- 5 May 2010 – Greece-wide riots and popular revolt break out as Greece turns violent. There is a 48-hour nationwide strike and demonstrations in two major cities. Three people are killed when a group of masked people throw petrol bombs in a Marfin Egnatia Bank branch on Stadiou street
- 6 May 2010 – The Third austerity package is passed by the Greek parliament.
- 14 June 2010 – Greece's credit rating is downgraded by Moody's from A3 to Ba1. The downgrade follows a previous downgrade on 27 April 2010.
- 7 July 2010 – The Greek parliament passes pension reform, a key requirement of the EU and IMF. Measures include: increasing retirement age from 60 to 65 for women. The reforms cut prospective payments from 25% of GDP by 2050. Additional pension reforms come in November 2012.
- 15 December 2010 – The Greek parliament passes a new law regarding public companies. The law sets a cap on monthly wages and introduces 10% cuts on salaries above €1,800.
- 23 December 2010 – The Greek parliament approves the 2011 austerity budget.

4. 2011: Developments in Greece heighten uncertainty about the future of the euro

In 2011, the public debt crisis in the euro area intensified. In April 2011, Portugal became the third country to request financial assistance; its economic adjustment programme was adopted by the Eurogroup on 17May 2011. At the same time, in the second half of the year there were heightened fears of a possible exit of Greece from the euro, which worsened confidence both at home and abroad.
In the first half of 2011 the situation remained under control. In January, the new economic and fiscal coordination framework, the European Semester, started being implemented, while the new financial sector supervision system was launched. Moreover, in March 2011 the provisional financial stability mechanism was further improved, as the European Financial Stability Facility was granted the possibility to intervene in exceptional circumstances in the primary market for government bonds, and the terms of the permanent European Stability Mechanism were agreed, with a real lending capacity of up to €500 billion and a nominal capital of €700 billion. In addition, it was decided to change the terms of the bilateral loans extended to Greece, by lengthening their maturity to 7.5 years and lowering their interest rate by 100 basis points, thus allowing some relief as regards the servicing of the debt.

However, economic and financial conditions deteriorated in the second half of 2011, mainly in the more exposed and vulnerable economies, such as Greece. The international community, particularly the US, expressed deep concern that a possible default of Greece would produce chain reactions in the euro area, thereby negatively affecting the global economy. From every direction, euro area leaders were increasingly urged to take determined and coordinated action, so as to avoid a transmission of the peripheral countries' problems to the core of the euro area. The challenge for the European leaders was dual: on the one hand, direct and urgent action had to be immediately taken to protect financial stability in the euro area and prevent any defaults of Member States; on the other hand, the credibility of the euro had to be restored. Thus, the European leaders deemed it necessary to arrive at even bolder and substantial decisions, in order to avert the likelihood of a systemic collapse.

In July 2011, under strong market pressures, discussions began on a second support package for Greece, while controversy peaked concerning the way to handle the Greek fiscal crisis – particularly as regards "private sector involvement" (PSI) in a possible haircut of the Greek public debt. Germany insisted in a cut involving the private sector, to which France was opposed, deeming that such a haircut would contribute to a contagion of other euro area countries with the Greek problem. The ECB as well, was not in favour of the idea of cutting the Greek debt, due to its potential significant impact on the financial stability of the euro area. The ECB had repeatedly expressed its opposition to any debt-haircutting forms that would not be purely voluntary but would involve elements of compulsion, while it also wanted to prevent any "credit event", "default" or "selective default".
In the end, an agreement was reached to grant a new, second assistance package to Greece, amounting to €109 billion, as well as to proceed with a cut of the debt on the basis of a voluntary involvement of the private sector. Although it was made

clear that Greece constituted a special / unique case, markets and investors deemed that the new agreement was setting a precedent for the involvement of the private sector in the haircuts of the public debts of other countries experiencing difficulties as well.

The results of the annual EU-wide bank stress testing exercise conducted in July 2011 confirmed the feeling that the banking sector of the EU was still facing serious challenges. In August and in the fall of 2011, the interest rates on the government securities of some of the larger euro area countries rose dramatically.
The governments of the euro area countries now had to deal with the markets' strong doubts regarding the sustainability of EMU in its existing institutional form. The euro, this "material and symbolic heart of the Union" (in the words of Herman Van Rompuy), was facing the greatest confidence crisis since its introduction, in an environment of increasing financial uncertainty, economic recession and unemployment.

With respect to Greece, on 26 October 2011, the EU Summit approved the new financing package, as well as the debt reduction (PSI). The new agreement revised a previous one reached on 21 July 2011, mainly as regards the part referring to the voluntary involvement of the private sector in the bond exchange, with a 50% nominal discount on the notional Greek debt held by private investors.
Based on the agreement's provisions at the time, the debt would fall to 120% of GDP by 2020. Despite the positive effects of the PSI on public debt reduction, growing political and social reactions in Greece —which led to a proposal by the Prime Minister, George A. Papandreou, to carry out a referendum on the new loan agreement (which, in the eyes of the European leaders, would be equivalent to a referendum on whether to exit the euro area or not)—sharply increased uncertainty in the country, leading to a massive outflow of deposits, acute liquidity and private-sector financing problems, and a major deviation of the adjustment programme from its implementation course. Developments in Greece were now largely driving international economic sentiment, especially in Europe. Twice in the period 2008-2012, measurements of uncertainty regarding economic policies in Europe recorded peaks attributed to developments in Greece. The first time, in 2010, coincided with the country's recourse to the support mechanism. The second time, at end-2011, coincided with the announcement of plans for a referendum. It is worth mentioning that in the second case the relevant European Policy Uncertainty Indicator reached its highest level recorded throughout the entire global crisis period (2007-2012).

4.1 Missed targets or delays bring the country to the verge of default

After a brief initial period in which the programme was implemented rather consistently and produced visible results, signs of fatigue and relaxation started to appear. Fiscal adjustment slowed down considerably, while structural reforms fell behind in practically all areas.
Already since February 2011, the review report by the EU, the ECB and the IMF had identified revenue shortfalls and expenditure overruns in entities outside central government and had pointed out the need for additional cuts in central government

outlays in order for the "performance criteria" to be met.
The Troika's joint statement following completion of the third review stressed that major reforms need to be planned and implemented, so as to build up the necessary critical mass that would ensure the sustainability of public finances and economic recovery.

Nevertheless, fiscal adjustment, remained problematic, with large revenue shortfalls and expenditure overruns. Already bymid-2011 it was obvious that with-out additional interventions the programme was heading to a derailment. The Troika's joint statement (on 3.6.2011) declared that the mission had reached an understanding with the Greek authorities on a package of economic and financial policy measures required to meet the programme's targets. These interventions were included in the Medium-Term Fiscal Strategy Framework (MTFS), having as main objectives the achievement of primary surpluses, an acceleration of privatisations and the development of the state's assets, to control debt dynamics.

The measures, covering the period 2011-2015, were passed by the Greek Parliament in June (Law 3985/1.7.2011) along with the first "implementation" legislation (Law 3986/1.7.2011). It is worth recalling that the governing majority voted in favour of the MTFS as a whole, but the opposition also voted in favour of 22 out of its 55 articles. This probably represents the first indication that the severity of the situation had started to reorient the political forces towards the notion of convergence, which materialised in the form of a coalition government a few months later.
Yet the adoption of the MTFS, despite the big package of fiscal measures it included, failed to convince the markets, which – making the assessment that a debt restructuring was imminent – reacted negatively: the spreads of Greek government bonds over the corresponding German bonds soared to new all-time highs and the three credit rating agencies downgraded the country's credit rating almost to the level of bankruptcy.

4.2 October 2011: a new EU/ECB/IMF support programme

From mid-2011 onwards, and despite the adoption of the MTFS, economic developments deteriorated considerably. Fiscal consolidation was already obviously reversing (on the basis of data for the first seven months), with both the total state budget deficit and the primary deficit widening. Moreover, a considerable increase was also recorded in public debt, which had already exceeded 150% of GDP in March. The sizeable increase of the debt, the large primary deficit and the deepening of the recession (from -3.8% to -5.5% or more) largely offset the positive effects on debt dynamics attributable to the decisions made during the Summit of 21 July 2011, which included a commitment to support —with the involvement of the private sector— a new programme for covering the Greek financing gap and provided for lowering the interest rate and lengthening the maturity of the loans.
On 11 October 2011, the Troika stated that an understanding had been reached with the Greek authorities (at the level of representatives) on the policies required "in order to get the government's adjustment programme back on track".The EU came to realise that a more generalised approach was required for the entire euro area. Thus, the Summit of 26 October 2011 arrived at decisions regarding both a further assistance to Greece and a broader arrangement to support the euro.

The new assistance programme for Greece provided for a new package of support measures amounting to €130 billion,12 as well as for a voluntary exchange of privately held Greek bonds with new ones, the nominal value of which was discounted by roughly 50%.13 According to estimates of the time, this was expected to lower the Greek debt by approximately €100 billion. In parallel with developments in the EU, in Greece it became imperative to take new measures in addition to those of June 2011, in order to limit deviations from the MTFS targets as much as possible. So, in October 2011, Law 4021/2011 imposed an extraordinary special levy on all power-supplied buildings.
In the end, despite all these measures, the general government deficit (on a national accounts basis) in 2011 fell only by 1.3 percentage points of GDP and stood at 9.4%, a level well above the target set (7.4% of GDP). The primary deficit declined more (by 2.6 percentage points), coming down to 2.3% of GDP.

4.3 Soaring uncertainty – formation of a coalition government

Perhaps the most important development in 2011 was the large decline in economic activity, much larger than what was originally projected, and the explosion of unemployment.
The deep recession was predominantly due to the decline in domestic demand, although it appears that uncertainty about the outcome of the stabilisation attempt also played an important part.

Such high uncertainty originated to a considerable extent in the way stabilisation was sought after, at least during the second year of the original programme's implementation. Instead of continuing the frontloaded policy decided, a more hesitant approach was favoured, in the hope that perhaps part of the costs could be avoided after all, or, in a worst-case scenario, be paid later on. Postponements and delays each time led to revised agreements with the lending partners and to new measures, resulting in adjustment costs higher than those that would have been incurred by prompt adoption of the measures at the time originally agreed, and in a further forward shift of the expected emergence of positive results. This entrenched a perception that the adjustment programme had failed, and that what was going on was merely a series of painful measures with no visible result. This fact had very grave consequences:

- It strengthened expectations of increasingly adverse future developments, resulting in a constant postponement of consumer and – principally – investment decisions. This resulted in a recession deeper than that warranted by the restrictive policies, a fact that undermined fiscal adjustment and intensified the vicious circle.
- It undermined the credibility of the financial support agreement, which a large part of the population viewed negatively, considering it to be the main cause of all evils, thereby obfuscating the real reasons that had led to the crisis. • It intensified social unrest for a long period of time, with public debate focusing

again and again on the cost of the discussed measures, while their implementation was continuously postponed.

- It threatened the cohesion of the government and undermined political stability. All of the above widened the credibility gap; as a result, in the negotiations with the country's lending partners increasingly stronger assurances were required that Greece would abide by what it agreed upon. This loss of trust stemmed from the assessment that the political will for the implementation of the programme was subsiding, given that the minimum of consensus necessary to carry out the changes that Greece had committed to implement had not been achieved by the political forces. This assessment led to doubting the country's ability to ensure continuity of the programme's implementation and fuelled all sorts of conjectures and forecasts on possible scenarios.

Uncertainty rose after September 2011 and references to the country's possible exit from the euro area proliferated, a fact that paralysed the economy, causing deposit outflows and further instability in the political system. On 31 October, the then Prime Minister, G.A. Papandreou, announced his intention to hold a referendum on the new loan agreement. This led to a peaking of political turmoil and eventually to the government's resignation. During that period, as already mentioned, the international sentiment on Greece had reached its lowest point and projections about the country's exit from the euro area and its default held sway across all media and experts' analyses.

On 11 November, a new coalition government was formed, headed by Lucas Papademos, with the participation of the New Democracy, PASOK and LAOS parties and with the mandate to ensure the conditions for the implementation of the decisions made on 26 October and then to hold parliamentary elections. The cooperation of political forces, as regards both voting in favour of the new loan agreement and taking part in the Papademos government, represented a first encouraging element that started to have a positive effect on sentiment. Yet, at the end of 2011 uncertainty remained high and the country's future in the euro area was questioned more than ever.

An interesting measure of uncertainty is the evolution of sales of gold sovereigns by the BoG (i.e. of private demand for gold sovereigns), as well as the evolution of the relevant purchases/sales ratio. It is indicative that, in the course of the crisis, sales (after a previous high in October 2008) peaked in May and June 2010 when the country resorted to its euro area partners and the IMF and climbed again to a very high level in December 2011, i.e. the period of negotiations on the second adjustment programme. A similar path is observed for the purchases/sales ratio, which implies excess private demand for gold sovereigns when it takes values lower than one.

2011 timeline

- 14 January 2011 – Greece's credit rating is downgraded by Fitch from BBB− to BB+.

- 7 March 2011 – Greece's credit rating is downgraded by Moody's from Ba1 to B1.
- 29 March 2011 – Greece's credit rating is downgraded by Standard and Poor's to BB−.
- 9 May 2011 – Greece's credit rating is downgraded by Standard and Poor's from BB− to B.
- 20 May 2011 – Greece's credit rating is downgraded by Fitch from BB+ to B+.
- 25 May 2011 – The Greek Indignant Citizens Movement (also known as the Square Movement) starts daily protests. It is inspired by a similar movement in Spain.
- 1 June 2011 – Greece's credit rating is downgraded by Moody's from B1 to Caa1.
- 13 June 2011 – Greece's credit rating is downgraded by Standard and Poor's to its lowest rating.
- 17 June 2011 – The prime minister makes a broad cabinet reshuffle and Evangelos Venizelos assumes the position of finance minister.
- 29 June 2011 – The Fourth austerity package is passed by the Greek parliament despite protests outside the parliament building. The two-day demonstrations against the bill turn violent as protesters clash with police in front of the Greek parliament and other areas of central Athens. The measures in the austerity package include new taxes and new cuts of workers' wages.
- 13 July 2011 – Greece's credit rating is downgraded by Fitch from B+ to CCC.
- 25 July 2011 – Greece's credit rating is downgraded by Moody's to Ca−.
- 27 July 2011 – Greece's credit rating is downgraded by Standard and Poor's from CCC to CC.
- 8 August 2011 – The Athens Stock Exchange general index falls below 1000 points, its lowest level since January 1997.
- 11 September 2011 – The Greek parliament imposes a new property tax to be collected through the electricity bill.
- 20 October 2011 – The Fifth austerity package is passed by the Greek parliament, amid protests and violent rioting outside the parliament building.
- 27 October 2011 – The investors agree to a "haircut" of 50% in converting their existing bonds into new loans.

- 28 October 2011 – An anti-austerity protest in Thessaloniki forces the cancellation a commemoration parade for a national holiday. Similar incidents occur in several other Greek cities.
- 31 October 2011 – Greek Prime Minister Papandreou calls for a confidence vote and a referendum to approve the EU summit deal from the previous week regarding the Greek debt haircut.
- 4 November 2011 – Papandreou wins the confidence vote 153–145.
- 6 November 2011 – Prime Minister Papandreou resigns.
- 10 November 2011 – Lucas Papademos becomes the new Greek Prime Minister, as the leader of a coalition government consisting of the PASOK, New Democracy, and LAOS parties.
- December 2011 – Greece's private TV channel Alter stops broadcasting due to financial difficulties.

5. 2012: Speeding up the efforts to institutionally restructure the EU − sentiment gradually improves

The year 2012 was a turning point for the EU and a resilience test for the euro area. In June 2012, Cyprus became the fourth euro area country to submit a request for assistance. Fears of a euro area breakup, heightened in the first half of the year, gradually subsided, while efforts towards a genuine completion of EMU intensified.
Restoring confidence in fiscal prospects and the banking sector, boosting liquidity and getting back on a growth track became cornerstones of the European endeavor. The decisions made resulted in an institutional and legislative reinforcement of the principles of responsibility and reciprocity between euro area countries.
However, recession and rising unemployment, particularly in the economies of the European South, rendered the achievement of these targets difficult.

In parallel, the euro area came by a more credible and clear proposition regarding its long-term outlook and strategy, through the publication on 26 June 2012 of a report by the four Presidents (of the European Council, the Eurogroup, the Commission, and the ECB) titled "Towards a genuine EMU", along with a commitment to prepare a specific roadmap by the end of the year. The final report, presented at the European Council of December 2012, along with the Commission's "Blueprint for a deep and genuine Economic and Monetary Union", describe in detail the next steps to be taken for the creation of a robust and stable structural design in the financial, fiscal, economic, and political sectors, in order to support the stability of the euro and of the EU as a whole. All key choices related to the Member States' economic and fiscal policies would be subject to coordination, endorsement and surveillance at EU level.

These decisions made it even clearer that participation in the monetary union entailed close interdependence and shared responsibility. Crisis prevention, management and resolution tools improved and, on 3 October 2012, the Treaty for the establishment of the European Stability Mechanism (ESM) came into effect, following its ratification by the national parliaments of all the euro area countries. Enabling in principle the recapitalisation of financial institutions directly by the mechanism, this Treaty made the ESM "the world's most capitalised international financial institution and the world's biggest regional firewall".

The markets' confidence in the euro area was further improved thanks to series of other events, such as the new Greek government's reaffirmation of its commitment (in June 2012) to meet the targets of the economic adjustment programme, the election of a new government in the Netherlands (in September 2012), the positive ruling of the Federal Court of Justice of Germany (Bundesgerichtshof) regarding the permanent European Support Mechanism (in September 2012), Ireland's "partial" return to the markets (in July 2012), and the new agreement on the sustainability of the Greek debt (in November 2012). Another fact that acted as a catalyst in regaining much of the confidence lost and in diminishing the risk of a euro area breakup was the ECB's decision to activate a new programme for the purchase of government bonds

(on 6 September 2012), i.e. to undertake Outright Monetary Transactions (OMTs) which allow for unlimited purchases of government bonds under strict conditionality,

5.1 Greece faces historic choices

The first two months of 2012 saw the completion of negotiations on the restructuring of public debt, according to which the private sector's involvement was greater than what was originally envisaged.
It is estimated that the level of old loans to private investors was reduced in February by approximately €106 billion. Also, with the debt buyback in December 2012, the debt was further reduced by €31.9 billion, i.e. by €137.9 billion in total. But the net gain from the debt restructuring was considerably smaller, mainly due to: (i) the need to recapitalise the Greek banks by issuing new debt (amounting to €41 billion during 2012); (ii) borrowing amounting to €11.3 billion required for the debt buyback operation (in December); (iii) the fact that the reduction of the value of bonds held by Greek insurance funds or other entities (amounting to €16.2 billion) led to no debt reduction since it involved intra-government debt; (iv) borrowing amounting to €4.5 billion in order to provide EFSF bonds to insurance funds as an offset for the reduction in their assets; (v) the need to borrow €11.9 billion to cover the 2012 deficit (including the payment of accrued interest in February but not the effect of supporting credit institutions); and (vi) other government liabilities (payments to the ESM, payment of old debts, etc.) totalling €1.9 billion. The final net result of all transactions was a debt reduction of only €51.2 billion. A precondition for the completion of the debt restructuring was a new agreement on the necessary interventions in the economy. The new arrangements were reflected in the Memorandum of Economic and Financial Policies and the Memorandum of Understanding on Specific Economic Policy Conditionality, adopted by Parliament on 12 February 2012 (Law 4046/2012).

The new agreement was accompanied by a new financial support package amounting to €130 billion. Together with the remainder of the first programme, total undisbursed assistance at the time was close to €167 billion. The debt restructuring and the new financial support agreement put a halt to the course towards collapse that the Greek economy was on in late 2011. But a condition for the completion of these first positive steps was to proceed without delay to the implementation of everything that had been agreed so far.
This did not happen, however. The elections announced on 11 April were held on 6 May and then repeated on 17 June, creating new long delays and once more heightening uncertainty both in Greece and abroad.
In Greece, the Economic Sentiment Indicator recorded in June one of its lowest levels in the three years up to that time (comparable to those observed in May 2010 and November 2011), standing at 77.3, against an average of 78.5 in the first quarter of 2012 and an annual average of 80.6 points in 2011.

The loss of confidence and uncertainty about future developments weighed heavily on banks, which faced considerable deposit outflows: between end-December 2011 and end-June 2012 private sector deposits with the Greek banking system fell by €26.3 billion. Indicatively, in May alone this reduction reached €9 billion. It is clear that this large decline was directly associated with political uncertainty, given

that after the formation of the new government (from end-June onwards) and until the end of the year this downward course came to a stop and part of these deposits (€12.2 billion) returned. Of course, lower deposits were not due exclusively to outflows abroad or to hoarding, but they also partly reflected debt repayments by depositors, including debts to banks. Such behaviour led to lower levels of money in circulation.

Abroad, the loss of confidence was reflected in media reports, most of which argued that the Greek programme had derailed and considered that the country's exit from the euro area was now very likely. Similar views were also voiced by research institutes, while the likelihood of a Greek default had started to also find its way into statements by European politicians.

It can safely be argued that this upsurge in uncertainty was due to the long delays observed in the implementation of the programme, but the effect of the large increase in political risk was also strong. Indicatively, the Political Risk Index compiled by the Economist Intelligence Unit rose to its historical peak at end-May 2012 and thereafter declined.
In a similar fashion, this upsurge in uncertainty was also reflected in the BoG gold sovereign purchases/sales ratio, which indicated excess private demand for gold sovereigns, as it fell to 0.48 in June 2012 (its lowest level since February of the same year).

2012 timeline

- 12 February 2012 – The Fifth austerity package is passed by the Greek parliament amid violent protests. Many buildings in the centre of Athens are burned during the riots.
- 21 February 2012 – The Second bailout package is finalized. It brings the total amount of eurozone and IMF bailouts to €246 billion by 2016, which is 135% of Greece's GDP in 2013.
- 9 March 2012 – Greek 10-year bond yields[60] reach a peak of 44.21% on the eve of debt restructuring. 83.5% of Greek bondholders are in the private sector.
- 4 April 2012 – A retired pharmacist commits suicide a short distance from Greece's parliament as an act of protest against austerity. He becomes a symbol for groups opposing the austerity measures, and violent clashes between police and demonstrators erupt in Athens.
- 6 May 2012 – Elections are held. The New Democracy party wins, but with a smaller share of the popular vote and fewer seats than it had in the previous election. The governing PASOK party collapses, while more votes go to the left wing parties (Syriza, KKE, and DIMAR) and right wing parties (ANEL, XA). No party wins the majority of the parliament seats.

- 16 May 2012 – No coalition government is able to be formed, so Panagiotis Pikramenos assumes the position of caretaker Prime Minister. An early election is called for the 17th of June.
- 25 May 2012 – The Athens Stock Exchange general index falls below 500 points.
- 17 June 2012 – Early elections are held. The New Democracy party leads, winning 29.7% of the popular vote, but doesn't win a majority of seats in parliament. Four days later, a coalition government is formed between New Democracy, PASOK and DIMAR. Antonis Samaras, the president of New Democracy, becomes the new Prime Minister.
- 7 November 2012 – The Sixth austerity package is adopted by the Greek parliament. The austerity measures are required for Greece to receive the next installment, the second economic bailout, worth €31.5 billion. Protests occurs outside the parliament. Austerity measures include: public pension cuts on average between 5% and 15% through the removal of two seasonal bonuses; an increase of the retirement age from 65 to 67; additional wage cuts for civil servants up to 20%; and public salary wage cuts up to 30%.
- 11 November 2012 – The Greek parliament passes the 2013 austerity budget.

6. 2013: The economy on a track of stabilisation
6.1 The year 2013 is a landmark for fiscal consolidation

The year 2013 was a landmark for fiscal consolidation in Greece, as, for the first time since 2002, a primary surplus was achieved at general government level. According to the Eurogroup decisions of 27 November and 13 December 2012, the achievement of a primary surplus in 2013 was a precondition for the country's euro area partners to take action that will ensure sustainability of its public debt.
Even more important is the fact that the structural primary balance is estimated by the BoG to have improved by 19 percentage points of potential GDP over the period 2010-2013, yielding a surplus of around 4.4% of potential GDP by end-2013. This improvement is not only a major accomplishment, but also represents one of the biggest fiscal consolidations ever achieved worldwide, although it should be noted that it has relied more than it should have on tax increases; this put a considerable burden on taxpayers and squeezed disposable income.
In the course of 2013, several measures aimed at increasing tax revenue have been adopted, such as the tax system reform and the new Unified Property Tax. In addition, better expenditure control was ensured through a strengthening of fiscal rules and mechanisms for monitoring the proper execution of the approved budgets across all levels of general government (including public utilities and enterprises).

Also, efforts to restructure public entities and enterprises —such as the Hellenic Broadcasting Corporation (ERT), the Hellenic Vehicle Industry (ELVO), Hellenic Defence Systems (EAS), the Mining and Metallurgical Company (LARCO)— progressed, whereas considerable delays were recorded in the course of the year with respect to the implementation of a number of actions necessary for reforming the central government as required by the Economic Adjustment Programme, concerning, for instance, the preparation of updated organisation charts in public administration, the placing of employees in a labour reserve/mobility scheme and an assessment of staff qualifications and performance.

The progress made as regards meeting the fiscal targets of the adjustment programme, as well as the need to speed up public administration reforms, are also pointed out in the joint statement by the European Commission, the ECB and the IMF published in the course of 2013, while on 17 December the President of the Eurogroup confirmed that Greece had met the four preconditions ("milestones") agreed with the Troika during the third review.

6.2 Easing of the recession – marked weakening of macroeconomic imbalances

In early 2014, there were clearer indications that the situation in 2013 had improved compared with 2012 − mainly that the economy had entered a track of stabilisation and that the preconditions were in place for the recession to end and recovery to start in 2014. There was indeed an improvement in 2013, although early in the year the crisis in Cyprus rekindled concerns and uncertainties about the Greek

banking system and the Greek economy in general. The risks, which were indeed extremely high, were finally averted, following the swift, coordinated and effective intervention by the government and the BoG.

The more favourable conditions in late 2013 can be summarised as follows:

- Fiscal consolidation made impressive progress and a primary surplus was recorded in 2013 after a long period of sizeable deficits.
- For the first time, the current account balance showed a surplus in 2013. This development was largely due to a decline in imports, but the buoyant recovery of tourism receipts and higher receipts from exports of goods also played a role.
- The pace of recession was estimated to drop to roughly 4% in 2013; the final outturn was slightly lower (-3.85%), i.e. the recession was milder compared with both 2012 and the initial projection for 2013.
- Expectations improved both in Greece and abroad, and confidence was gradually taking hold again. Indicatively, the BoG gold sovereign purchases/sales ratio stood considerably higher than one —indicating excess private supply of gold sovereigns— throughout the period from July 2012 to December 2013, with a single exception in April 2013 when it briefly fell to 0.57 (indicating excess demand), evidently due to the uncertainty caused at the time by the banking crisis in Cyprus and the way it was addressed. Favourable developments started to appear in the real economy as well, in certain production and labour market indicators. In parallel, the spreads of Greek government bonds to the corresponding German bonds fell back to 2010 levels, while on 30 November 2013 a rating agency (Moody's) proceeded to the first upgrading of the Greek government's credit rating after the onset of the crisis, by two notches (from C to Caa3).
- For the first time in over 45 years, the inflation rate turned negative in 2013. This development indicates that prices have started to respond to lower demand and labour costs and to support real disposable income. However, a prolonged continuation of this phenomenon at the same pace would be undesirable, as negative inflation intensifies uncertainty in the economy and in business expectations and worsens public debt dynamics.
- The restructuring of the economy on the supply side moved ahead, albeit slowly. Nevertheless, developments in relative prices provided an incentive for a shift of resources from the sector of internationally non-tradable goods to the tradable sector, in which productivity is much higher. The assessment was made that the continuation and strengthening of this trend would lead to higher total productivity, improve competitiveness and support job creation, over the medium term.
- The recapitalisation of credit institutions was promoted and the structure of the banking sector changed radically, with the creation of more resilient banks that are better positioned to exploit economies of scale. The restructuring and consolidation of the banking system has been smooth, without a single repository having incurred a loss on their savings; in other words, without any disruption of financial stability.

2013 timeline

- 28 April 2013 – The Greek parliament approves a reform bill: it abolishes 15,000 state jobs by the end of 2014, including 4,000 in 2013; makes it easier to fire civil servants; increases the working hours of teachers; and cuts a property tax by 15%.
- 11 June 2013 – The Greek parliament shuts down the country's Public Broadcasting Service ERT.
- 21 June 2013 – The Democratic Left party withdraws from the Greek coalition government, which retains a razor-thin majority in parliament.
- 24 June 2013 – Prime Minister Samaras reshuffles his cabinet.
- 17 July 2013 – The Seventh austerity package is passed by the Greek parliament. Measures include a contentious plan for thousands of layoffs and wage cuts for civil service workers.
- 21 December 2013 – A bill on the Single Property Tax and the auction of houses is approved by a majority of 152 deputies in the 300-seat chamber.

7. 2014: Greek economy back on track after 5 years of recession

7.1 First signs of economy's recovery

In 2014, private consumption and net exports drove economic activity, prompting a long-awaited return to growth, which measured 0.8% in terms of real GDP. Backed by falling prices and the adjustment of the labour market, private consumption increased for the first time after five years of continuous contraction. Exports of services improved strongly thanks to the tourism and shipping sectors, goods exports also improved, although stronger domestic demand meant that imports also rose. Investment increased for the first time since 2008, mainly due to the increase in equipment investment.
The positive momentum has, however, been hurt by uncertainty since the announcement of snap elections in December. The current lack of clarity on the policy stance of the government to the country's policy commitments in the context of the EU/IMF support arrangements worsens uncertainty further. Greece's economic sentiment indicator (ESI) deteriorated in March due to falling confidence in all business sectors, although consumer confidence remained at relatively high levels. Greece's purchasing managers index (PMI), recorded a further deterioration in business conditions for manufacturing in March, suggesting that the sector is still in depression, with new export orders and output falling.

7.2 Uncertainty draws back and expectations on GDP growth are rising.

Conditional on agreement with the EU/IMF by June and assuming that business confidence returns along with the liquidity of the government and banking sector, the economy is now forecast to grow by around ½% in 2015, considerably lower than in the previous forecast. Private consumption should benefit slightly from the drop in oil prices and the return of 'under-the-mattress' deposits to the economy. Export growth is expected to continue in 2015 as tourism and shipping should benefit from the weaker euro.
Uncertainty, however, is taking a heavy toll on investment, which is also suffering from limited credit supply from the financial sector and a build-up of arrears from the public sector. In 2016, real GDP growth is projected to strengthen to 2.9%, as investment rebounds on the back of structural reforms.
Greece's current account balance is expected to improve further in the forecast horizon supported by past and ongoing structural and institutional reforms, as well as by the weaker euro. The current account deficit is forecast to shrink to 1.6% of GDP in 2015 and to 1.3% in 2016.
The unemployment rate fell to 26.5% in 2014 reflecting the creation of about 100 000 new jobs. When growth picks up in 2016, the unemployment rate should fall further to 23.2%. Prices fell by 1.4% in 2014 and inflation is expected to remain below zero this year, due to weak domestic demand, before turning positive in 2016 as the recovery gains pace.

7.3 Winter of 2014 the era of unstabilisation of Greek government and economy

The rise in uncertainty since the autumn of 2014 and the slowdown in the recovery have had a significant impact on Greece's public finances, In 2014, the real GDP of Greece grew for the first time since 2007, expanding by 0.8%. The conditions to support growth are in place but uncertainty and tighter financing conditions are holding back the recovery and weighing on public finances. The poor revenue collection around the turn of the year resulted in a significantly weaker-than expected fiscal outcome for 2014. The general government balance at -3.5% of GDP in 2014, is substantially worse than expected in the winter forecast. The headline balance in 2014 is, nevertheless, much better than in previous years, as it is no longer affected by the large one-off effects of bank recapitalisations recorded in 2012 and especially 2013. Given the existing uncertainty about the timely implementation of necessary reforms and budget commitments, projections for 2015 and 2016 are based on a no-policy-change assumption. Accordingly, the forecasts for the headline balance in 2015 and 2016 have been lowered to -2.1% of GDP and -2.2% respectively. This reflects weaker than-expected revenues due to lower growth prospects offsetting a rebound in collection after the first quarter of the year. The projection assumes that profits from Eurosystem securities transactions (the SMP and ANFA programmes) are transferred, which in turn presumes that new fiscal measures will be taken. Expenditure ceilings were binding in 2014 and are expected to remain so in the future as well.
The government's debt-to-GDP ratio is expected to peak in 2015 before declining in 2016. Favourable interest rates, better cash management together with the back-loaded payment schedule for loans from the European Financial Stability Facility (EFSF) will help to keep interest expenditure low for a long period, despite the high stock of debt.

<u>2014 timeline</u>

- 14 Jan 2014 – Greece posts a primary budget surplus of 1.5% of GDP for the 2013 financial year (€691 million).
- 30 March 2014 – The Greek parliament passes a new multi-bill which is needed for Greece to receive its next bailout payment. Nikitas Kaklamanis, a member of parliament, is expelled from the government for abstaining from the vote on one of the bill's two articles, leaving the government with an even smaller majority.
- 10 April 2014 – Greece returns to financial markets with the issue of €3 billion Eurobonds at a yield below 6%.
- 18 May 2014 – Local elections are held.

- 23 May 2014 – Greece's credit rating is downgraded by Fitch from B− to B.
- 25 May 2014 – Syriza wins the European Parliament election.
- 9 June 2014 – The cabinet is reshuffled. Gikas Hardouvelis assumes the position of finance minister.
- 8 December 2014 – Parliament begins attempts to elect a new president to replace outgoing Karolos Papoulias, whose five-year presidential term was due to end in February. The next day the Athens Stock Exchange falls 12.78%, its largest single-day decline since 1989.
- 29 December 2014 – The government's candidate for the president (a largely ceremonial role), Stavros Dimas, fails to win majority support from parliament, and the government falls. This leads to snap parliamentary elections, which are set to be held on 25 January 2015.

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