Greece: Staff Concluding Statement of the 2018 Article IV Mission

June 29, 2018

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

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

Greece has come a long way, but still faces many challenges. Greece will exit the program era having largely eliminated macroeconomic imbalances. Some important reforms have been implemented, growth has returned, unemployment is declining (though still very high), and the recently agreed debt relief package will secure medium-term sustainability. But significant crisis legacies and an unfinished reform agenda still hamper faster growth, while membership in the currency union and high primary surplus targets limit policy options. Boosting growth and living standards will therefore depend on improving the fiscal policy mix, repairing financial sector balance sheets, further liberalizing product and labor markets, and strengthening public sector efficiency and governance.

Growth has returned to Greece, helped by an impressive macroeconomic stabilization effort, structural reforms, and a better external environment. Greece deserves credit for substantial fiscal and current account adjustments and for implementing some key structural reforms in recent years. These efforts, combined with substantial European support and a more favorable external environment, allowed a return to growth, with real GDP rising 1.4 percent in 2017 and expected to reach 2 percent this year and 2.4 percent in 2019. As the output gap closes, unemployment is expected to drop from about 20 percent this year to around 14 percent by 2023. External and domestic risks are significant, including from slower trading partner growth, tighter global financial conditions, regional instability, the domestic political calendar, and reform fatigue.

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

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

A growth-friendly rebalancing of the fiscal policy mix is a priority. Achieving the high 3.5 percent of GDP primary surplus target for 2018-2022 agreed with the European Institutions will require high taxation and will constrain social spending and investment. To support inclusive growth while meeting fiscal targets, the authorities should aim for budget-neutral improvements in the fiscal policy mix, starting with the already legislated fiscal package for 2019-2020. In 2019, the government should proceed with planned increases in targeted social support and investment spending, funded by savings in the pension system. In 2020, it should reduce high tax rates, while broadening the personal income tax base in a fiscally neutral way. These measures, backed by fiscal structural reforms to strengthen efficiency and implementation, will help reduce the poverty rate and economic distortions, and support growth. Any delay in these reforms would seriously undermine the credibility of the assumptions underlying the debt relief measures agreed with European partners. The authorities should be cautious in adopting permanent expansionary measures beyond those already legislated, to avoid jeopardizing their fiscal targets.

Reviving banks' lending capacity, including by tackling very high non-performing exposures (NPE)s, is critical for supporting the economy . Important legal reforms aimed at reducing NPEs have been adopted, and steps taken to develop a NPE secondary market, but further implementation efforts are needed for them to take root. To accelerate banks' balance sheet clean-up, more ambitious NPE reduction targets, proactive build-up of capital buffers, further steps to mitigate liquidity and funding risks, and stronger bank internal governance are needed. Remaining capital controls need to be lifted in a prudent manner following the agreed roadmap, with the pace dictated by economic and banking sector conditions and the level of depositor confidence.

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

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

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

The mission is grateful to the authorities for the hospitality and the constructive discussions.

IMF Communications Department

MEDIA RELATIONS

PRESS OFFICER: Andreas Adriano

Phone: +1 202 623-7100**Email:** MEDIA@IMF.org