MOODY'S
INVESTORS SERVICE

ISSUER IN-DEPTH
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Government of Greece

FAQ on growth, debt, banks and politics

Greece (Ba3 stable) has recorded one of the strongest recoveries from the pandemic in Europe, which has supported an improvement in its core credit metrics. In this FAQ, we answer questions about the sustainability of these improvements and the key risks Greece faces in the near future.

» **Is Greece likely to sustain one of the highest growth rates in Europe?** A strong tourism sector, domestic consumption and investment will drive healthy real GDP growth of 5.3% in 2022. However, growth will slow sharply to 1.8% in 2023, as high energy prices feed through to broader price pressures and weaken household purchasing power and rising interest rates will weigh on investment. Beyond next year, structural factors like Greece's rapidly ageing population will continue to impede the economy's long-term growth potential at around 1.2%.

» **Is Greece's debt pile still its primary credit challenge, and what are the key risks to look out for?** Government debt has declined to 193.3% of GDP at the end of 2021 from 206.3% in 2020 and we project nominal GDP growth and primary surpluses from 2023 on will support further declines to 154% by 2026. However, Greece will still have one of the highest debt burdens globally by then. The government's cash buffer and an average time to maturity of more than 18 years reduce immediate liquidity risks, but maintaining the confidence of its official-sector creditors is crucial to ensuring Greece's debt sustainability.

» **Have conditions in the banking sector improved?** Despite inflationary pressures and signs of an economic slowdown, our outlook on the Greek banking sector remains positive, predominantly because of the progress banks have made in reducing their non-performing loans from almost 50% during the euro debt crisis to 9.5% now. The improvement in asset quality will support banks' organic profitability, and in turn will support economic growth and limit the government's contingent-liability risks.

» **How big a risk do elections next year pose to Greece's credit profile?** A changed election law that scraps bonus seats and introduces a purer system of proportional representation makes two rounds of elections likely, which we expect in spring 2023. It could take a number of weeks or more to form a coalition government. We see a low risk of reforms being rolled back or a material change in fiscal and economic policies.

This publication provides an update on the sovereign credit profile and may also discuss the likely credit implications of a new development or trend for the sovereign. It does not announce a credit rating action.

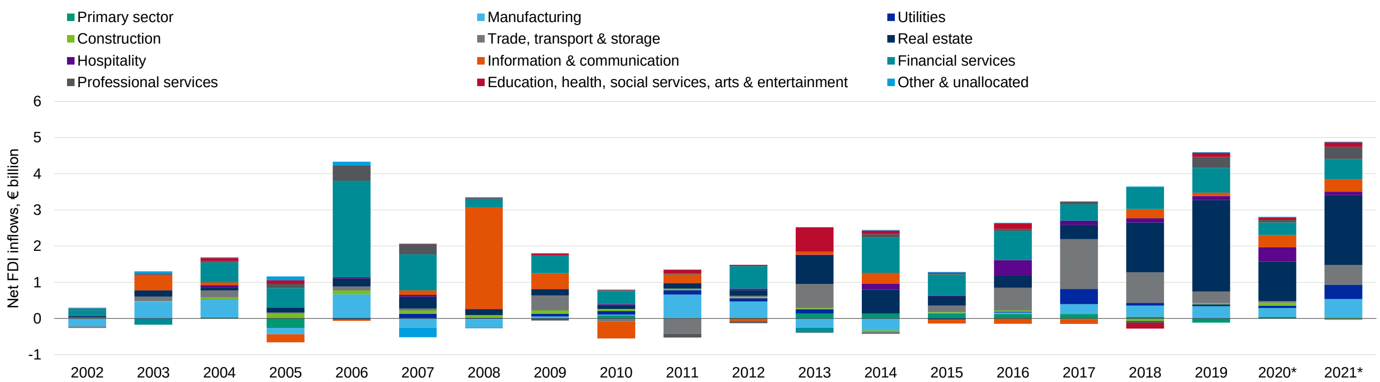
Is Greece likely to sustain one of the highest growth rates in Europe?

The Greek economy has rebounded strongly from the pandemic and is actually 5% larger in real terms than it was in the fourth quarter of 2019, which exceeds the average recovery in Europe. We also expect a strong tourism sector, domestic consumption and investment, as well as goods exports will drive healthy real GDP growth of 5.3% in 2022, compared to the EU-27 average of 3.3%.

Foreign direct investment (FDI) inflows are at record levels, having increased 74.3% in 2021 and up 60% year-on-year in the first half of this year, reflecting Greece's attractiveness for investment also as a result of structural reforms and privatization efforts over the past years (see Exhibit 1). FDI has broadened into sectors like IT and green entrepreneurship which will support long-term growth potential. Greece's direct trade, tourism or financial exposures to the Russia-Ukraine crisis are limited.

Exhibit 1

Foreign direct investment has hit record highs and will support future growth
Net FDI inflows, € billion

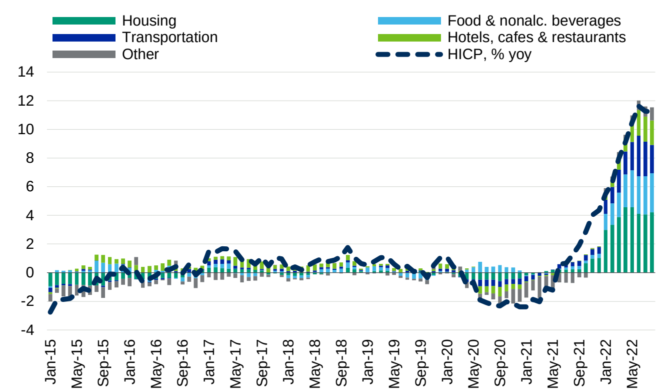


*provisional
Source: Bank of Greece, Moody's Investors Service

However, we forecast growth will slow sharply to 1.8% in 2023, as high energy prices feed through to broader price pressures and weaken the purchasing power of households (see Exhibit 2). Rising interest rates will also start to weigh on investment. Given the strong recovery in tourism in 2022 (see Exhibit 3), there is also limited further upside in the sector. A deeper-than-expected recession in key source countries like Germany (Aaa stable) is also a key risk to growth.

Exhibit 2

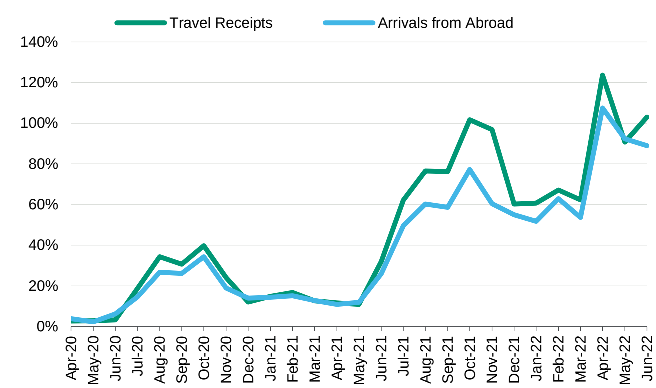
High energy prices are driving a rise in consumer price inflation, but core inflation is also rising
Contribution to headline inflation, percentage points



Source: Elstat, Moody's Investors Service

Exhibit 3

Tourist arrivals and revenues have increased
% of the respective month in 2019

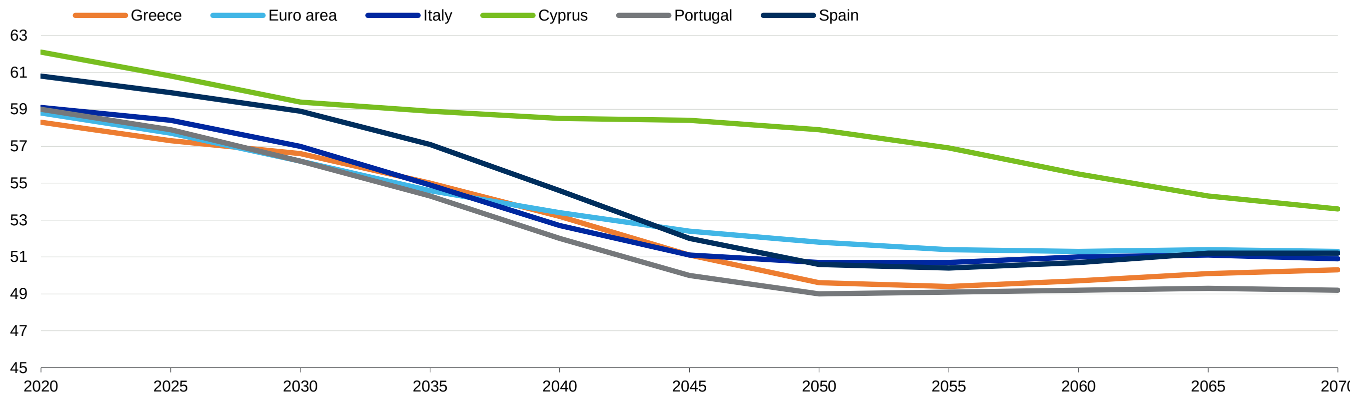


Sources: Bank of Greece, Moody's Investors Service

Beyond next year, structural factors will continue to impede the Greek economy's growth potential at around 1.2%. The government has started to address low savings and investment rates by reducing tax rates, easing regulations, improving the investment licensing framework and pushing ahead with privatisations. However, Greece's population is ageing rapidly and experienced significant brain drain during the financial and euro debt crises. According to Eurostat's baseline projections, the share of people aged 20 to 64 years in Greece will shrink almost nine percentage points (pp) by 2050 (see Exhibit 4).

Exhibit 4

Greece and Portugal will experience some of the most rapid population ageing in Europe
Working age people (20-64), % of total population



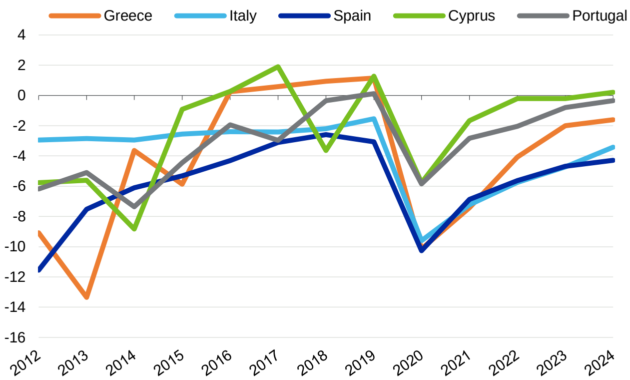
Source: Eurostat, Moody's Investors Service

As a result, any sustained acceleration in Greece's future growth potential beyond 2025 will hinge on a boost in investment and productivity increases. In this regard, money from the European Union (EU, Aaa stable) recovery funds and associated reforms disbursement is tied to is a positive. Assuming Greece realizes 90% of the loans and all grants allocated to it, the IMF estimated that NGEU would add 0.6 percentage points to real GDP growth annually between 2022-26. The government received €4 billion in pre-financing in August 2021 and another €3.6 billion in April 2022. Greece is also on track to meet the reform milestones needed to unlock the next disbursement and we expect a payment request to be made before the end of the year.

Is Greece's debt pile still its primary credit challenge and what are the key risks to look out for?

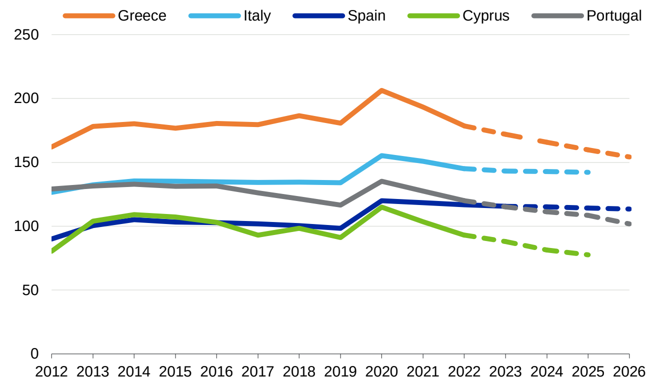
Greece's government debt burden has declined to 193.3% of GDP at the end of 2021 from 206.3% in 2020 and we project nominal GDP growth and a return to primary surpluses from 2023 will support further declines to 154% by 2026. However, Greece will still have one of the highest debt burdens globally by then, below only Japan (A1 stable). The impact from adverse demographics on government finances is cushioned by the effects of past pension reforms: in the latest Ageing Report the European Commission (EC) projects Greece's ageing costs to decline by 3.7 pp between 2019 and 2070, which is the largest projected decline in the euro area and the EU.

Exhibit 5
Greece will make rapid improvements in its fiscal balances
General government fiscal balance, % of GDP



Sources: Eurostat, Moody's Investors Service

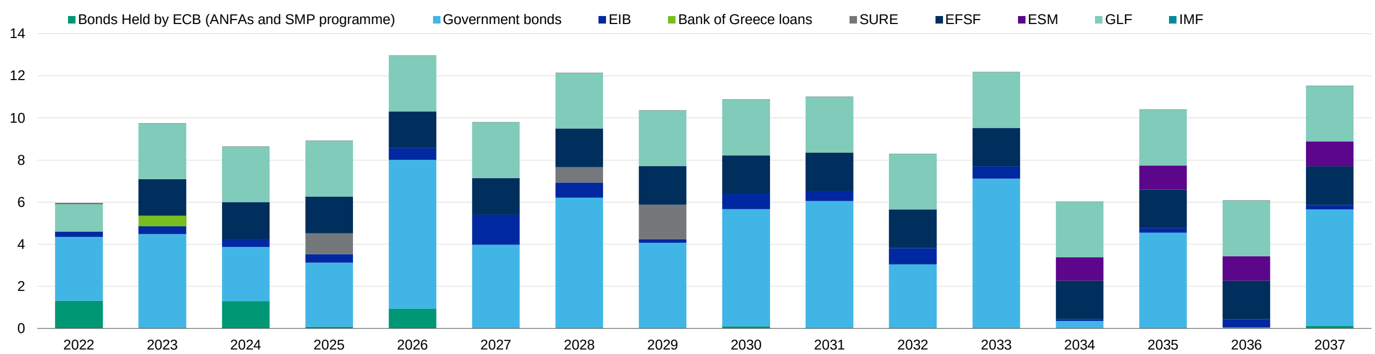
Exhibit 6
Growth and primary surpluses will drive a steady reduction in Greece's debt burden
General government debt, % of GDP



Sources: Eurostat, Moody's Investors Service

The government's cash buffer which covers funding needs worth around 2-3 years and an average time to maturity of more than 18 years reduce immediate liquidity risks and largely shields Greece from rising government bond yields. In addition, around 80% of central government debt is held by official creditors like for instance the European Stability Mechanism (ESM, Aaa stable) and other euro area institutions, which have agreed to a spread out Greece's repayment profile (see Exhibit 7).

Exhibit 7
The government's debt repayments are evenly spread out
€ billion



Excluding T-bills
Source: PDMA, Moody's Investors Service

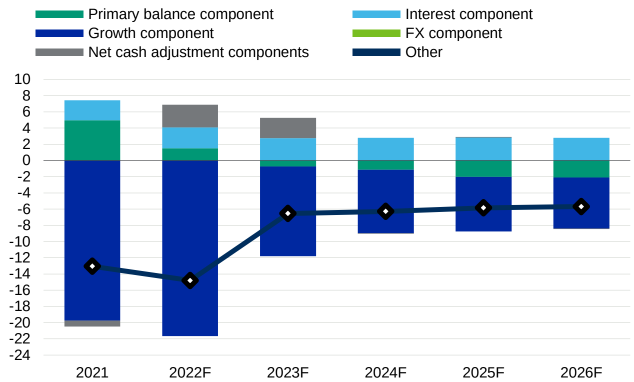
However, the sustainability of Greece's debt burden remains contingent on support from euro-area creditors, including ad hoc support from the ECB. The Greek government has also sizable contingent liabilities to public-sector entities in financial services, to a large part because of guarantees issued to securitize nonperforming loans (NPLs) under the Hercules scheme. According to IMF estimates, the crystallization of contingent liabilities related to the Hercules scheme alone could lift Greece's debt burden by around 14 pp of GDP. Improvements in bank profitability alongside higher interest rates and solid economic growth limit the risks however (see Question 3).

Instead, a significant slowdown in the economy is the key risk to the government's debt trajectory, rather than rising interest rates or fiscal loosening. A fall in nominal growth of 2.3 pp over the next five years compared to our baseline forecasts would add 17.8 pp to Greece's debt/GDP ratio. However, even in this scenario, debt would still be 21.3 pp lower than it was in 2021 (see Exhibits 8 & 9).

Exhibit 8

Growth is crucial to Greece's debt trajectory

Contribution to changes in government debt, pp

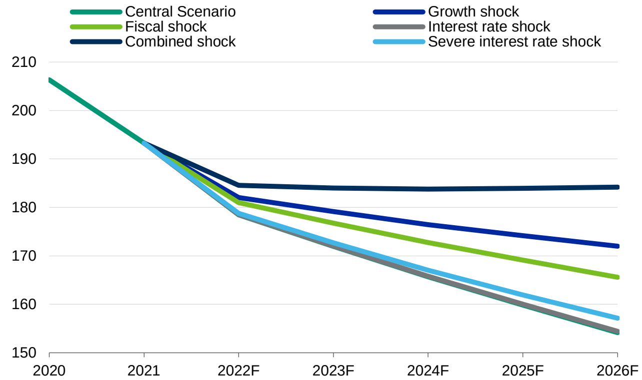


Source: Moody's Investors Service

Exhibit 9

Government debt reduction would slow if the economy did as well

General Government Debt, % of GDP



Shocks are based on 10 year historical standard deviation

Sources: Moody's Investors Service

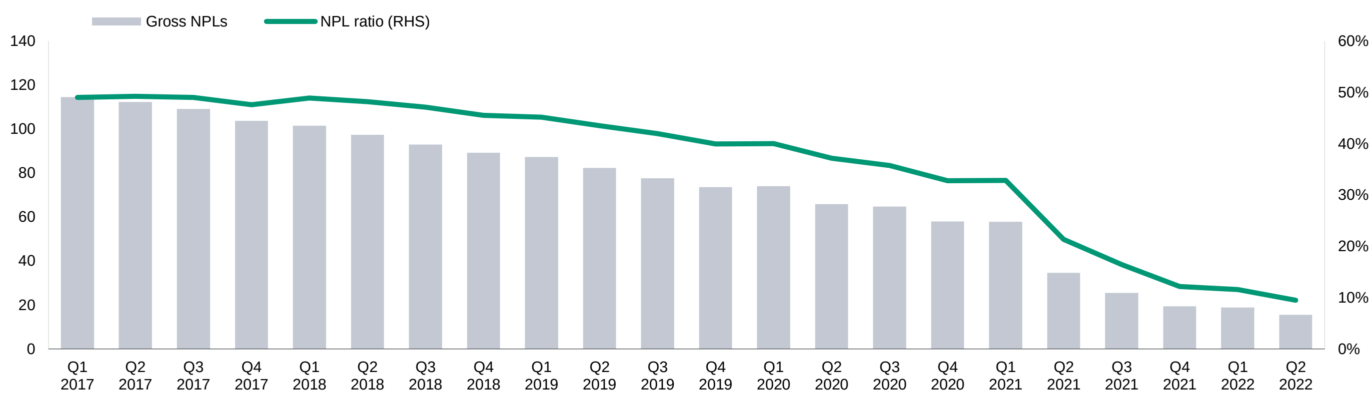
Have conditions in the banking sector improved?

Despite inflationary pressures and signs of an economic slowdown, our outlook on the Greek banking sector remains positive, predominantly because of the good progress banks have made in reducing the sector's NPLs (see Exhibit 10). Moreover, problem loans should continue to fall as banks offload NPLs and provide loans to companies who have survived the crisis years and are more resilient as a result. Nevertheless, both the IMF and EC have stressed the need to be vigilant on pandemic-related lending, as well as the effects of rising residential real estate prices and interest rates on borrowers, although provisioning is sufficient to limit risks to banks' solvency.

Exhibit 10

Non-performing loans in the banking sector have fallen steadily in recent years

€ billion (left) and % of total loans (right)



Source: Bank of Greece, Moody's Investors Service

Capital levels will stabilise because banks took the bulk of NPL securitisation losses upfront in 2020-21. Funding and liquidity will remain sound as customer deposits increase (deposits increased €36 billion during 2020 and 2021 because of lockdowns, lack of consumption opportunities). As such, Greece has one of the lowest loan-to-deposit ratios (around 65%) in the euro area.

Higher interest rates and good loan demand will lead to an improvement in banks' profitability. Consequently, we expect banks to start gradually to pay some modest dividends to shareholders, while ensuring that they remain comfortably above capital requirements.

Collectively, these conditions will enable the banking sector to support the economy. However, a healthier banking system also reduces contingent liability risks to the government balance sheet.

How big a risk do elections next year pose to Greece's credit profile?

The domestic political environment in Greece has been relatively stable since general elections in July 2019 gave the country its first single-party parliamentary majority since 2009. However, this government's term is up next year and changes introduced by the previous Syriza-led government in 2016 that scrap bonus seats and introduce a purer system of proportional representation make it highly unlikely that any single party will gain an absolute majority, or enough seats to form a stable coalition. A second round of voting is therefore our base case, and it will take a number of weeks or longer for a government to be in place.

Based on recent opinion polls (see Exhibit 11), support for Prime Minister Mitsotakis' New Democracy (ND) party has been in steady decline from a peak of around 48% in mid-2020 to around 36% currently. The biggest gains have been made by KINAL/PASOK, support for whom has grown from less than 10% up until late 2021 to close to 13% currently. Alexis Tsipras' Syriza party has been hovering around 27% for most of the time since the 2019 elections.

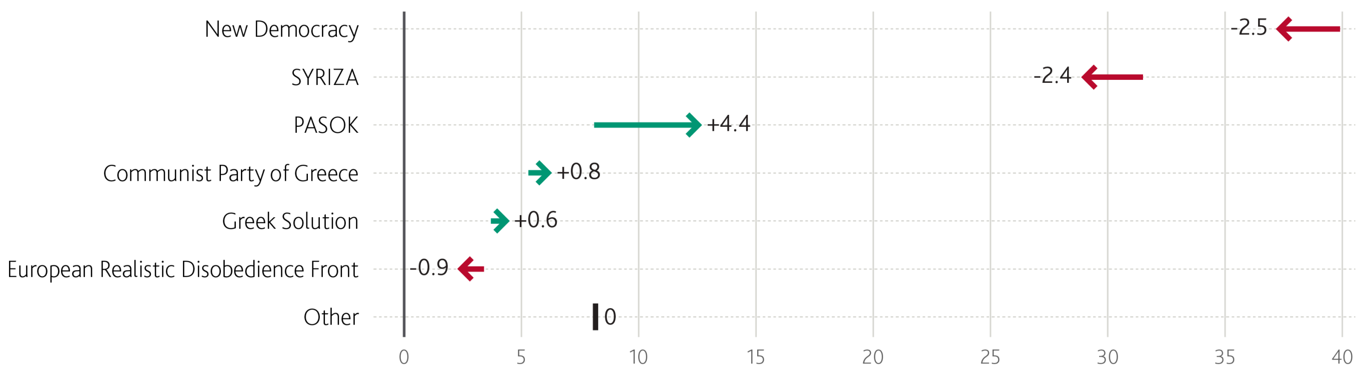
Based on these numbers and the changes to bonus seats, no party is likely be able to obtain a majority and any coalition arithmetic would be very difficult, especially because a recent wiretapping scandal involving KINAL/PASOK leader Nikos Androulakis and a few journalists through Greece's National Intelligence Service presents an obstacle to a coalition between ND and KINAL. A second election is therefore highly likely, under which bonus seats would be reintroduced following ND legislation in 2020 (20 extra seats for the winning party list, plus extra seats for parties receiving between 20% and 40% of the popular vote).

While we expect it will take longer to form a government, the risk of reforms being rolled back on or a material change in fiscal and economic policy course is low. Nevertheless, political risks remain elevated because its creditors demand Greece continue to pursue prudent fiscal policies and implement further institutional and structural economic reforms.

Exhibit 11

New Democracy and Syriza poll below their 2019 results

Results from polling carried out between 19-21 September 2022 compared to 2019 election outcome, % and pp



Red arrows signal a weaker, green arrows a stronger polling result than in the 2019 election.
Source: Alco/Open, Moody's Investors Service

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