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In-Depth Review for Greece

in accordance with Article 5 of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances

Accompanying the

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF THE REGIONS AND THE EUROPEAN INVESTMENT BANK

Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy

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The 2021 Alert Mechanism Report concluded that an in-depth review should be undertaken for Greece to examine further the persistence of imbalances or their unwinding. In February 2020, under the previous annual cycle of surveillance under the Macroeconomic Imbalances Procedure, the Commission identified "excessive macroeconomic imbalances" in Greece. These imbalances related to high government indebtedness, the high share of non-performing loans and incomplete external rebalancing, in a context of still high –although declining - unemployment and low potential growth. The analysis shows that these vulnerabilities remain. It should be noted that the context of the assessment of vulnerabilities in this year's in-depth review (IDR) for Greece is markedly different from last year. Also, the evolution of the COVID-19 pandemic, the strength of the recovery, and possible structural implications of the crisis are all still surrounded by high uncertainty, requiring caution in the assessment. In general, policy action over the past year focused on cushioning the impact of the COVID-19 shock and facilitating the recovery. This has added to indebtedness but should support adjustment in the medium-term. Looking forward, the Recovery and Resilience Plan provides an opportunity to address imbalances, investment and reforms needs.

Main observations and findings of this IDR analysis are:

- **This IDR is informed by the 2021 spring forecast, which expects a recovery in economic activity in Greece with the easing of the COVID-19 crisis.** After the steep drop of 8.2% in 2020, real GDP is projected to increase by 4.1% this year and 6% next year, allowing the economy to recover to its pre-pandemic level by the end of 2022.

- **Greece has a high public debt to GDP ratio.** Its level increased by more than 25 percentage points in 2020, due to the decline in GDP and the fiscal response to the COVID-19 pandemic. Even though public debt is high, a large share of it has been extended by official creditors at concessional rates, which, together with the large cash buffer, insulates Greece from short-term fluctuations. The debt ratio is expected to resume a downward path from 2021.

- **The banking sector is burdened by a high stock of non-performing loans and provisions impact weigh on the banks' profitability.** The still high NPL ratio in the banking sector has been on a marked declining trend, mostly due to sales of loans supported by the 'Hercules' asset protection scheme. However, there is a risk that NPLs will increase again, once policies to protect borrowers from the COVID-19 shock are phased out. In addition, the debt repayment capacity of both households and non-financial corporations remain particularly low, while the underdeveloped capital market limits firms' access to non-debt financing. The new insolvency code, which will come into effect from June 2021, is a key step to resolve and prevent unviable debt.

- **The external position remains weak and the current account balance deficit appears high compared to prudent benchmarks.** Greece's external liabilities increased as a result of the COVID-19 pandemic, reflecting the impact of the travel restrictions and the cycle. The current account is forecast to remain below what is required to reach a more prudent net international investment position. However, external liabilities consist to a large extent of debt instruments held by official creditors, which mitigate Greece's exposure to external shocks or to shifts in market sentiment.

- **Potential growth in Greece has been negative since 2010.** Potential growth fell to -0.8% in 2020 and is forecast to turn slightly positive in 2022. Efforts to strengthen growth prospects face headwinds from the depleted capital stock, population ageing and outward migration of skilled labour. The reforms included in the Greek Recovery and Resilience Plan build on the very large reform effort undertaken under the economic adjustment programmes and are complementary to reforms monitored under enhanced surveillance.

- **The labour market remains a serious concern.** The weak labour market performance reduces Greece's social and economic resilience and increases risks of poverty and social exclusion. The unemployment rate has been steadily declining since 2013, reflecting improvements in the functioning of the labour market and reached 16.3% in 2020, with youth unemployment at 35% in 2020. Yet, unemployment, both total and youth, still remains the highest in the EU, while the activity rate stood almost 5 percentage points below the EU average in 2020. The timely response of the Greek authorities to the COVID-19 crisis has limited dismissals, thanks to the effective implementation of a set of employment retention measures supported by European instruments.

1. ASSESSMENT OF MACROECONOMIC IMBALANCES

Introduction

In February 2020, over the previous annual cycle of surveillance under the Macroeconomic Imbalances Procedure, the Commission identified "excessive macroeconomic imbalances" in Greece. These excessive imbalances related to high government indebtedness, incomplete external rebalancing and the high share of non-performing loans, in a context of still high unemployment and low potential growth. The 2021 Alert Mechanism Report published in November 2020 concluded that a new in-depth review (IDR) should be undertaken for Greece with a view to assess the persistence or unwinding of imbalances.

The context of the assessment of vulnerabilities this year is markedly different from last year's IDRs, which took place before the COVID-19 pandemic. The evolution of the pandemic, the strength of the recovery, and possible structural implications of the crisis are still surrounded by high uncertainty requiring caution in the assessment. Policy action over the past year focused on cushioning the impact of the COVID-19 shock and on facilitating the recovery. While this supports adjustment in the medium-term through stronger fundamentals, it also has added to indebtedness. Follow-up to country-specific recommendations from 2019 and 2020, including those that are MIP-relevant, is taking place in the context of the assessment of the Recovery and Resilience Plans (RRPs). The analysis of policies in the present report was finalised before the formal submission of RRPs and does not draw on information included in RRPs. It is therefore without prejudice to the Commission's assessment of RRPs, which is ongoing at the time of publication of this report.

The assessment follows a similar structure as the IDRs that were included in Country Reports in recent annual cycles. This chapter presents the main findings for the assessment of imbalances, also summarised in the MIP assessment matrix. The assessment is backed by selected thematic chapters that look more at length at productivity (section 2), external sector (section 3), financial sector (section 4) and labour market (section 5). Spillovers and systemic cross-border implications of imbalances are also taken into account. In addition, also assessments of structural issues made in previous IDRs and in the context of fiscal assessments are considered if relevant.

Macroeconomic context

Real GDP growth is forecast to rebound in 2021, with GDP expected to reach its pre-crisis level by the end of the forecast horizon. Growth in Greece rebounded during the last two quarters of 2020, following an unprecedented contraction in the first half of the year. Overall GDP fell by -8.2% in 2020 and is forecast to grow by 4.1% in 2021 and 6.0% in 2022, levelling the real GDP volume in 2022 with the pre-pandemic figure in 2019. Potential growth is forecast to recover from the sharp drop in 2020 and reach 0.1% in 2022. The output gap is set to improve but will likely remain negative, at -2.1% in 2022. The current account balance is forecast to only gradually recover, remaining in deficit (-4.3%) in 2022, still below the levels registered in 2019 (-1.5%). The negative gross saving rate of households increased markedly to positive territory as a result of the COVID-19 crisis. It is forecast to reduce in 2022, but remain positive, even though well below EU average rates. The unemployment rate is expected to remain high, at 16.3% in 2021, and slowly decline to 16.1% in 2022, as the slack in the labour market gradually diminishes. HICP inflation would gradually increase to 0.6% in 2022, as the economic activity returns to its pre-pandemic levels and tourism activity gradually recovers.

The economic recovery in 2021 and 2022 is expected to be driven by domestic demand. The ongoing rollout of the vaccination campaign should allow Greece to gradually start reducing the stringency of its containment measures, thus improving economic sentiment and lowering uncertainty. Private consumption will benefit from the realisation of consumption deferred from the previous year, while the launch of the Recovery and Resilience Plan is likely to boost investments going forward. The gradual reopening of the tourism sector is also likely to contribute modestly to the recovery in 2021 and more significantly in the following years. Fiscal policy will remain accommodative, while support measures to protect jobs and provide liquidity to firms are expected to remain in place. Despite the progressing vaccination campaign, the evolution of the COVID-19 pandemic at both domestic and international level remains subject to substantial uncertainty. This has repercussions for the upcoming tourism season, which could be weaker than expected if the vaccination process is delayed or the healthcare repercussions of the COVID-19 pandemic deteriorates. An additional uncertainty concerns the speed of recovery of the corporate and the banking after the phasing out of support measures, which could create pressure for firms' liquidity and possibly solvency. The cliff effects are expected to be mitigated by a recent subsidy scheme supporting business loans. Impediments to access to finance in particular for small and medium-sized enterprises persist but are expected to be eased through measures presented in the Recovery and Resilience Plan. Similarly, the developments on the labour market in the short run will crucially depend on the phasing out of the labour market support measures, which will need to be carefully managed. The external geopolitical factors and the potential resurgence of the migration crisis once the pandemic subsides also remain a source of uncertainty. On the upside, the savings accumulated during the pandemic could boost spending going forward.

Imbalances and their gravity

Greece faces a high public debt to GDP ratio, amounting to 205.6% of GDP in 2020. The debt is largely external and extended by official creditors at long maturities and low interest rates, effectively insulating Greece from short-term fluctuations. Moreover, financing conditions remain favourable at present and the government continues holding a large cash buffer, which reduces the rollover risks. However, the high stock of debt represents a constraint to fiscal policy as it implies a relatively high interest rate burden in the long run. It also increases Greece's vulnerability to higher refinancing rates in the long run.

The ratio of non-performing loans is still the highest in the euro area. According to the European Central Bank data, the ratio of non-performing loans came down from 35.5% at end-2019 to 29.4% in September 2020 ([1]). High non-performing loans require banks to increase provisioning, mitigating financial stability risks but limiting their ability to provide credit to companies and consumers. Since capital markets are not well developed and offer few alternative sources of finance, they may not be able to compensate for the constraints in bank finance (see section 4). The strong sovereign-bank nexus coupled with the high stock of non-performing loans creates non-negligible contingent liability risks for the public sector.

The stock of external liabilities is among the highest in the euro area and while it primarily consists of public debt held by official creditors, the current account balance falls short of the level needed to stabilize the net international investment position to sustainable levels. In 2020, the net international investment position stood at -176.4% of GDP. This stock is mainly composed of debt instruments issued by the public sector, and held by official creditors, which mitigates Greece's exposure to external shocks and market sentiment shifts. Reducing Greece´s external liabilities would require maintaining current account surpluses for a sustained period of time. However, the current account balance was -6.7% of GDP in 2020 and -11.8% of GDP in cyclically adjusted terms ([2]), which points to a structural imbalance. The current account surplus that is necessary to stabilise the net international investment position below the macroeconomic imbalance procedure threshold of -35% of GDP in 2030 was estimated at around 1.5% of GDP in the medium term (see also section 3).

The labour market suffers from high unemployment, including among the youth, and low activity and employment rates. At 16.3% in 2020, unemployment was still the highest in the EU as was youth unemployment (35% compared to 16.8% in the EU). The activity rate was almost 5 percentage points lower than the EU average (73.1% compared to 77.8%) and the employment rate stood at 61.1% in 2020, 11 percentage points below the EU average and 5 percentage points below its level of 2008. The weak

([1]) Non-performing loans as a share of total gross loans and advances on a consolidated basis (i.e. including cash balances at central banks and other demand deposits in the denominator). This figure is different than the one reported under enhanced surveillance, which follows non-performing loans as a share of total gross customer loans on a solo basis, as reported by the Bank of Greece.

([2]) The cyclically adjusted or underlying current account balance is the current account balance that would prevail if all economies were at potential output. The difference between this indicator and the current account norm establishes the current account gap.

labour market performance reduces Greece's social and economic resilience and increases risks of poverty and social exclusion (see section 5).

Greece's low growth potential weighs on the adjustment of the accumulated stock imbalances. Potential growth is held back by the ageing population, migration outflows of high-skilled workers and a depleted capital stock, in the context of low productivity growth, which signals a need to complete and deepen the structural reforms agenda initiated in the previous decade.

Evolution, prospects and policy responses

Greece's public debt-to-GDP ratio increased markedly in 2020 on account of the COVID-19 pandemic but is expected to revert to its downward trend in the short run. The pandemic has had a sizeable impact on the Greek government debt, which is estimated to have increased from 180.5% of GDP in 2019 to over 205.6% of GDP in 2020. The updated debt sustainability analysis presented in the 10th enhanced surveillance report confirms that the pandemic increased fiscal sustainability risks in the medium term. However, according to the baseline projection, the general government debt ratio would decline over the forecast period, although remaining at a high level, with increased sustainability risks under the alternative scenarios. ([3]).

The stock of non-performing loans has continued to decrease through December 2020 but this trend could be interrupted by the economic effects of the COVID-19 pandemic. The stock of non-performing loans has steadily decreased since its peak in 2016. At the end of December 2020, it amounted to €47.5 billion, down by €21.1 billion from December 2019 ([4]). However, the economic impact of the pandemic, the expiry of the moratoria and the gradual phase-out of state support measures may result in a further increase in non-performing loans (section 4). The authorities continue to take measures to address deficiencies in the financial sector, including by putting in place and subsequently extending the 'Hercules' asset protection scheme, adopting a new Insolvency Code, and introducing two temporary instalment subsidy schemes for coronavirus-affected debtors, one for with primary residence loans and one for business loans of small and medium-sized firms and professionals (the 'Gefyra' schemes).

The size of Greece's external liabilities increased as a result of the COVID-19 pandemic, while the current account deficit is forecast to remain considerable in 2021. The pandemic has further weakened the country's net international investment position by around 18 percentage points in 2020, while causing a marked deterioration in the current account balance. While part of the deterioration is due to the travel restrictions and the contraction in external demand, it also shows that part of the previous improvements were due to favourable cyclical factors (section 3). The balance is expected to gradually improve along with the economic recovery. More precisely, the current account deficit is forecast to shrink only marginally in 2021 (-7.6%) but more markedly in 2022 (-5.3%). The authorities have taken a number of measures to ease doing business and facilitate productivity enhancing investments, including foreign ([5]), but the public sector processes still remain relatively cumbersome, inter alia as interoperability of public sector systems and registries is still limited. Additional challenges include stringent and complex regulation in certain sectors, including high entry barriers. Further, the framework for fast-tracking strategic investments has not yielded the expected results, whilst the new strategy to facilitate trade and foreign direct investment has not been adopted yet and its draft lacks a concrete strategic vision to develop high productivity sectors and provide incentives for firms to grow, innovate and export.

Wage growth had been moderate during the three years before the COVID-19 pandemic, remaining broadly aligned with developments in productivity, inflation and unemployment. Unit labour costs grew slower than the euro area average, improving cost competitiveness for Greek exports. This resulted in strong export market share gains during 2017-2019. Wages stagnated in 2020, as labour

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([3]) European Commission (2021), 10th Enhanced Surveillance Report, June 2021.
([4]) Source: Bank of Greece, data on a solo basis.
([5]) Advances in e-governance and the digitalisation of public services are recorded, especially since the outbreak of the COVID-19 pandemic. Other key steps include the recent introduction of a new impact assessment framework, the simplification of licensing legislation in a number of sectors, and the easing of doing business, mainly through interoperability initiatives and the streamlining of documentation requirements. Further, Greece adopted primary legislation to overhaul the public procurement framework and also made tangible progress in establishing a pipeline of major investment projects, including public-private partnerships.

demand was curtailed by the COVID-19 pandemic and the revision of the minimum wage was postponed to 2021. Moreover, the employment retention measures allowed companies to reduce labour costs while preserving existing contracts. Going ahead, labour costs will be adjusted to the annual revision of the statutory minimum wage expected to be completed by July 2021.

While the pandemic has had a relatively limited impact on the labour market thanks to the effective policy response, unemployment remains high but is expected to decrease in the next years. Since 2013 and until the outbreak of the health crisis in the first quarter of 2020, unemployment had been steadily falling reflecting improvements in the functioning of the labour market and the gradual economic upturn (section 5). So far, this positive trend has not been reversed by the COVID-19 pandemic thanks to a range of public support measures, which have also been instrumental in maintaining the employment rate at 61.1% in 2020, the same level as the year before. Unemployment is expected to decrease further in the next years along with the economic recovery. The pandemic has nevertheless caused a 'freeze' in economic activities, leading to a large decline in job vacancies (-61% year-on-year in the second quarter of 2020). The authorities have adopted an ambitious Labour Code reform to modernise key aspects of the labour market and have advanced on completing the General Minimum Income scheme with a labour-market integration pillar.

The impact of the temporary economic shock due to the COVID-19 pandemic on potential output in the longer run is subject to uncertainty. While private investments have halted as a consequence of the lockdown measures, they are expected to recover relatively quickly along with the reopening of the economy thanks to the effective support measures. Similarly, job separations have been largely contained. Productivity growth in recent years benefitted from a series of structural reforms implemented in the context of the economic adjustment programme and the current enhance surveillance framework (section 2). While the pace of reforms has been slowed down by the COVID-19 pandemic, it has also helped to bring forward some reforms, most notably those linked to the ambitious digital agenda of the government.

The authorities have adopted a number of key measures to strengthen growth prospects going forward but the outlook faces headwinds from the depleted capital stock, population ageing and outward migration of skilled labour. In addition to the above-mentioned reforms of the financial sector and the labour market, the government has, notably, adopted ambitious reforms for both the vocational education and training and university education, maintained consistent progress on investment licensing reforms and public administration reforms, strengthened the capacity of the tax administration, reformed the electricity market by the introduction of the 'Target Model' and advanced on a number of flagship privatisation projects and corporate governance reforms of state-owned enterprises. These reforms, monitored under enhanced surveillance are relevant steps towards improving Greece's growth potential, which can then give a major contribution to the reduction of the high debt burdens. Nevertheless, there remains substantial scope to advance on further institutional and structural reforms ([6]) to support productivity growth and offset the burden of years of limited investment, outward migration of skilled labour and the prospects of falling labour supply due to population ageing ([7]).

Overall assessment

The COVID-19 pandemic has interrupted – and partly erased – the gains of the adjustment process initiated in the previous years. It has lead to a large increase in public debt and a deterioration of the net international investment position. The impact on unemployment and on the stock of non-performing loans has been limited so far, through the timely policy response by the authorities, but the withdrawal of the emergency measures will need to be carefully managed. The COVID-19 pandemic has also brought to the fore the importance of bolstering the country's growth prospects in correcting the legacy imbalances and strengthening its economic and social resilience.

The Greek authorities have continued their reform agenda despite the difficult circumstances posed by the COVID-19 pandemic but the accumulated imbalances will require further efforts in the coming years. During the previous years, the authorities adopted a range of measures to improve the business environment and the growth prospects of the country, strengthen the financial sector, facilitate

([6]) Commission (2020), Country Report – Greece, February 2020.
([7]) Commission (2020), The 2021 Ageing Report, "Underlying assumptions & projections methodologies", November 2020.

the functioning of the labour and product markets, and promote exports, building on reforms initiated under the programme. Given the high, and partly increased ‘stock’ imbalances on account of the recession, restoring and sustaining positive ‘flow’ developments in the following years will be necessary in order for the country to resume the correction of stock imbalances. Completing the initiated reform agenda will take many years of sustained implementation, while the country faces headwinds to growth from the depleted capital stock, population ageing and outward migration of skilled labour, but can also further contribute to the reduction of the high debt burdens. The reforms and investments to be implemented under the Recovery and Resilience Facility, along with other EU support, represent a major opportunity to boost growth and modernise the Greek economy.

Table 1.1: **Assessment of Macroeconomic Imbalances Matrix - Greece**

	Gravity of the challenge	Evolution and prospects	Policy response
	Imbalances (unsustainable trends, vulnerabilities and associated risks)		
Public debt	Greece has a high level of public debt, amounting to 205.6% of GDP in 2020. A large stock of public debt constrains fiscal policy and increases Greece's vulnerability to higher refinancing rates in future. However, the debt is largely extended by official creditors at long maturities and concessional rates, which – together with the large cash buffer – insulates Greece from short-term fluctuations.	The public debt ratio increased by 25 percentage points in 2020, on account of the measures to limit the economic and social cost of the pandemic as well as of the sharp decline in GDP. The debt ratio is expected to reach 208.8% in 2021 before declining to 201.5% in 2022.	Greece reached high primary surpluses in the years before the outbreak of the pandemic and the 2021 Stability Programme presented by the authorities in April 2021 envisages that primary surpluses will be restored as of 2023. Investments financed through the RRF will be instrumental to improve growth potential. It would be equally important to preserve nationally-financed investment.
Financial sector	The banking sector is burdened by a high stock of non-performing loans 29.4% in September 2020 (on a consolidated basis, source: European Central Bank) and provisions impact the banks' profitability. The capital position of the banking system is broadly adequate (total capital ratio at 16.3% as of September 2020) but the quality of capital remains weak. This is due to the high share of deferred tax credits, which are the most prominent element in a persistently strong link to the Greek sovereign. The debt repayment capacity of both households and non-financial corporations remains particularly low, while the underdeveloped capital market limits firms' access to non-bank financing.	The non-performing loan ratios continued to decline despite the economic impact of the pandemic but the expiry of loan moratoria and the gradual phase-out of state support may create new non-performing loans. Favourably, the secondary market for non-performing loans is growing rapidly. The profit outlook will remain challenging, and thus limiting the internal capital generation capacity. The phasing out of transitional prudential arrangements may pose additional challenges for the banks' capital position. Reliance on state-related assets is set to increase. Despite recent improvement in liquidity, the cost of long-term unsecured funding remains high (see Section 4).	The Hercules asset protection scheme to securitise banks' non-performing loans is expected to have a positive impact on the banks' cost-of-risk and free up space in banks' balance sheets for new lending, but it also entails an initial one-off capital loss. State support measures and the banks' loan payment moratoria have slowed the inflow of new non-performing loans, while bolstering credit growth to firms. The authorities adopted the new Insolvency Code at the end of 2020. It is expected to enter into force on 1 June 2021. The authorities adopted provisions to accelerate the processing of the backlog of household insolvency cases and enhanced the functionality of the e-auctions platform.
External sustainability and competiveness	Greece has a high stock of net external liabilities (its net international investment position was -176.4% of GDP in 2020), mainly composed of debt instruments held by official creditors, which mitigates Greece's exposure to external shocks or shifts in market sentiment. The current account balance was -10.7% of GDP in 2020 in cyclically adjusted terms, well below what would be needed to ensure a lasting improvement in the net international investment position (section 3).	The size of Greece's external liabilities increased as a result of the pandemic, while the current account deficit widened as a result of the travel restrictions and subsequent losses in incoming cross-border tourism flows. The current account balance is forecast to reduce only marginally in 2021 (-6.6%) until it subsides in 2022 (-4.3%). Despite a temporary loss due to the pandemic, Greece is expected to continue strengthening its export market share, also building on the recent policy measures taken to ease doing business and facilitate investments. However its trade openness is still among the lowest in the EU (see Section 3.2.2).	The authorities have embarked on simplification of processes, expediting licensing procedures, in particular environmental and construction permits, reducing entry barriers in certain sectors, and fast-tracking strategic investments. A new strategy to facilitate trade and foreign direct investment is under preparation but faces delays. Relatively limited focus on high productivity sectors and incentives for firms to grow, innovate and export.

(Continued on the next page)

Table (continued)

Potential growth and productivity	Potential GDP growth in Greece has been negative since 2010, on account of weak total factor productivity growth and a large drop of investments during the global financial crisis, which has led to an erosion of the capital stock (section 2). The large share of micro and small businesses is an aggravating factor as most small and medium-sized enterprises struggle with access to finance and regulatory barriers. Those potential growth weaknesses slow down the deleveraging from the high debts and hamper adjustment and resilience in general.	The impact of the temporary economic shock due to the pandemic on potential output in the longer run is subject to uncertainty. In 2020, investment contracted by 0.6% but is expected to recover along with the reopening of the economy. Similarly, job separations have been largely contained. Efforts to strengthen growth prospects faces headwinds from the depleted capital stock, population ageing and outward migration of skilled labour (see Section 5).	The authorities adopted ambitious education reforms, made progress on simplifying investment licensing and public administration reforms including the tax administration, reformed the electricity market and advanced on a number of flagship privatisation projects and corporate governance of state-owned enterprises. In addition, the authorities adopted the 'Development Plan for the Greek Economy' and the 'Digital Bible', which outlines ambitious growth and digitalisation agendas.
	Adjustment issues		
Labour market and unemployment	At 16.3% in 2020, unemployment remains the highest in the EU as does youth unemployment (at 35% compared to 16.8% in the EU). The employment rate stood at 61.1% in 2020, 11 percentage points below the EU average and 5 percentage points below 2008. The weak labour market performance reduces Greece's social and economic resilience and increases risks of poverty and social inclusion.	Following the steady downward trend in the past six years prior to the pandemic, unemployment has remained broadly stable since the outbreak of the pandemic, as net job losses have been largely contained trough employment support measures. The pandemic has nevertheless led to a large decline in job vacancies (section 5). Unemployment is expected to subside to 16.1% and employment to expand by 0.7% in 2022.	Since the outbreak of the pandemic, the authorities have put forward a wide range of measures to maintain jobs and prevent a sharp increase in unemployment. These have helped contain net job losses and have supported household incomes. The authorities have adopted an ambitious Labour Code reform to modernise key aspects of the labour market and advanced on completing the General Minimum Income scheme with a labour-market integration pillar.

Main takeaways

- Greece entered the pandemic with vulnerabilities linked to high public debt, a high stock of non-performing loans and incomplete external rebalancing, in a context of low potential growth and high unemployment. Despite that short-run risks remain limited, these intertwined challenges impose a constraint on fiscal policy, reduce the amount of credit that can be channelled to the economy and weaken Greece's social and economic resilience.
- The pandemic has interrupted the adjustment process initiated in the previous years and has led to a large increase in public debt and deterioration of the net international investment position. The impact on unemployment and on non-performing loans has been limited so far through the timely policy response by the authorities, but the withdrawal of the emergency measures will need to be carefully managed. Unwinding of the identified vulnerabilities is expected to restart along with economic recovery.
- While the policy priorities have necessarily shifted to tackling the social and economic impacts of the pandemic, the authorities continued to take relevant measures to facilitate economic adjustment, building on wide-ranging measures introduced in the past decade. The growth and digital agendas outlined in the 'Development Plan of the Greek Economy' and the 'Digital Bible' represent ambitious steps. Their timely implementation, along with completing the reforms monitored under enhanced surveillance, will be key. The revamped Multi-annual Financial Framework and the Next-Generation EU represents a major opportunity to boost growth and modernise the Greek economy.

Source: European Commission Services

Table 1.2: **Selected economic and financial indicators, Greece**

	2004-07	2008-12	2013-18	2019	2020	forecast 2021	forecast 2022
Real GDP (y-o-y)	3.6	-5.5	0.1	1.9	-8.2	4.1	6.0
Potential growth (y-o-y)	2.8	-1.1	-1.1	-0.4	-0.8	-0.2	0.1
Private consumption (y-o-y)	3.4	-4.3	0.0	1.9	-5.2	2.5	3.3
Public consumption (y-o-y)	5.1	-3.4	-2.0	1.2	2.7	2.2	-2.3
Gross fixed capital formation (y-o-y)	5.8	-17.7	-1.1	-4.6	-0.6	12.9	15.1
Exports of goods and services (y-o-y)	9.3	-1.9	5.3	4.8	-21.7	9.1	14.8
Imports of goods and services (y-o-y)	8.3	-7.8	4.7	3.0	-6.8	6.3	6.8
Contribution to GDP growth:							
Domestic demand (y-o-y)	4.6	-7.0	-0.5	1.0	-3.1	3.7	3.7
Inventories (y-o-y)	-0.3	-0.7	0.2	0.1	0.7	0.0	0.0
Net exports (y-o-y)	-0.8	2.1	0.4	0.7	-5.8	0.4	2.3
Contribution to potential GDP growth:							
Total Labour (hours) (y-o-y)	0.5	0.0	-0.2	-0.4	-0.4	-0.2	0.0
Capital accumulation (y-o-y)	1.0	0.1	-0.3	-0.3	-0.6	-0.4	-0.3
Total factor productivity (y-o-y)	1.3	-1.2	-0.6	0.3	0.2	0.3	0.4
Output gap	3.8	-5.8	-10.8	-3.7	-10.8	-6.9	-2.1
Unemployment rate	9.5	14.5	23.7	17.3	16.3	16.3	16.1
GDP deflator (y-o-y)	3.1	1.5	-0.8	0.2	-1.5	-0.3	0.7
Harmonised index of consumer prices (HICP, y-o-y)	3.2	2.9	-0.1	0.5	-1.3	-0.2	0.6
Nominal compensation per employee (y-o-y)	5.1	-0.9	-1.7	1.0	0.0	1.3	2.0
Labour productivity (real, person employed, y-o-y)	2.0	-3.6	-0.5	0.6	-7.0	.	.
Unit labour costs (ULC, whole economy, y-o-y)	3.1	2.8	-1.7	0.4	7.6	-2.3	-3.0
Real unit labour costs (y-o-y)	0.0	1.3	-0.9	0.2	9.2	-2.0	-3.8
Real effective exchange rate (ULC, y-o-y)	1.6	0.3	-2.0	-3.1	.	.	.
Real effective exchange rate (HICP, y-o-y)	0.2	-0.2	-0.3	-2.0	0.4	-0.8	-1.7
Net savings rate of households (net saving as percentage of net disposable income)	-0.7	-6.8	-14.6	-11.6	.	.	.
Private credit flow, consolidated (% of GDP)	14.4	1.8	-2.3	0.8	.	.	.
Private sector debt, consolidated (% of GDP)	88.3	125.2	125.8	109.9	.	.	.
of which household debt, consolidated (% of GDP)	37.8	58.9	61.4	55.5	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	50.5	66.3	64.4	54.5	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (2)	.	9.1	34.2	31.3	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	5.1	7.2	8.0	1.8	1.6	3.3	1.0
Corporations, gross operating surplus (% of GDP)	19.0	18.0	17.1	15.7	14.4	15.2	14.5
Households, net lending (+) or net borrowing (-) (% of GDP)	-7.9	-4.7	-4.7	-4.2	1.9	0.8	-1.3
Deflated house price index (y-o-y)	4.6	-6.5	-4.4	7.0	5.6	.	.
Residential investment (% of GDP)	9.9	5.6	1.2	0.7	0.9	.	.
Current account balance (% of GDP), balance of payments	-10.8	-10.0	-1.8	-1.5	-6.7	-6.5	-4.3
Trade balance (% of GDP), balance of payments	-9.1	-7.2	-1.6	-0.9	-6.8	.	.
Terms of trade of goods and services (y-o-y)	-0.1	-0.3	0.1	-0.6	0.2	-1.1	-0.4
Capital account balance (% of GDP)	1.4	1.2	1.0	0.4	1.6	.	.
Net international investment position (% of GDP)	-79.7	-94.2	-138.9	-155.8	-176.4	.	.
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (1)	.	-96.2	-131.0	-135.3	-155.4	.	.
IIP liabilities excluding non-defaultable instruments (% of GDP) (1)	.	189.9	234.9	246.2	300.7	.	.
Export performance vs. advanced countries (% change over 5 years)	13.6	-5.2	-9.3	1.8	-5.6	.	.
Export market share, goods and services (y-o-y)	0.9	-5.9	2.7	0.7	-19.1	1.1	9.0
Net FDI flows (% of GDP)	0.1	-0.1	-1.2	-2.1	-1.5	.	.
General government balance (% of GDP)	-6.9	-11.2	-3.9	1.1	-9.7	-10.0	-3.2
Structural budget balance (% of GDP)	.	.	4.0	2.0	-4.7	-6.6	-2.2
General government gross debt (% of GDP)	104.2	144.2	181.0	180.5	205.6	208.8	201.5
Tax-to-GDP ratio (%) (3)	32.9	35.5	40.8	41.9	40.7	40.1	39.9
Tax rate for a single person earning the average wage (%) (4)	25.2	25.2	25.4	26.2	25.4	.	.
Tax rate for a single person earning 50% of the average wage (%) (4)	16.0	17.8	16.3	16.8	15.8	.	.

(1) NIIP excluding direct investment and portfolio equity shares
(2) domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.
(3) The tax-to-GDP indicator includes imputed social contributions and hence differs from the tax-to-GDP indicator used in the section on taxation
(4) Defined as the income tax on gross wage earnings plus the employee's social security contributions less universal cash benefits, expressed as a percentage of gross wage earnings
Source: Eurostat and ECB as of 2021-05-05, where available; European Commission for forecast figures (Spring forecast 2021).

2. THEMATIC ISSUE: PRODUCTIVITY, INVESTMENTS AND POTENTIAL GROWTH

Greece's weak potential growth and the high investment gap slow down its rebalancing and correction of accumulated imbalances. Potential growth remains burdened by a persistent capital stock depletion and a steady contraction in the labour input (Graph 2.1(e)). These factors emerged after the global financial crisis and are having a strong impact on potential growth in Greece. While between 2000 and 2008, potential output growth was hovering around 3.2% per year, much higher compared to the euro area (1.9%), it has turned negative since 2010, with some signs of recovery after 2016. The positive trends in productivity and competitiveness gains that had started to materialise as a result of the reforms implemented under the macroeconomic adjustment programmes were largely interrupted by the outbreak of the pandemic. Persistency of low growth represents a risk for the sustainability of public debt.

Total factor productivity improved during the years prior to the pandemic but remains well below the levels reached prior to the global financial crisis. Total factor productivity in Greece in 2019 was at 81% of the 2007 level, and the gap against the euro area average remains large. Starting from 2017, total factor productivity was slowly gaining momentum, with growth rates above the euro area averages, however the pandemic is expected to slow the adjustment. Total factor productivity in 2020 fell by 7.1%.

Total factor productivity growth remains curtailed by ongoing erosion of human capital and a complex regulatory framework. Persistent emigration of high-skilled labour (see section 4) that was exacerbated with the financial crisis has for long held back total factor productivity. Restoring the human capital stock and addressing skills mismatches will be key for improving labour productivity, in particular in an increasingly digitalised economy. There remain substantial weaknesses and inefficiencies in the regulatory, administrative and judicial framework that work as barriers to the much-needed productive investment, including from abroad. The recent digital leap through improved digital services of the public administration as a response to the pandemic, in addition to a number of ongoing initiatives to ease the administrative burden and facilitate investment projects, provide a good starting point to further improve framework conditions for private investments. Progress in modernising the public administration is being made ([8]), while the recently launched national simplification programme should result in reduced administrative burden in parallel to the roll out of new digital services. Nonetheless, the public administration is still facing challenges in policy planning and coordination resulting in administrative complexity, while the civil servants have comparatively low digital skills and access to modern digital tools.

Additional challenges include low technological adoption and relatively high contribution to the economy of low-productivity sectors and small firms. Ongoing challenges to accessing credit, including seed, start-up and growth venture capital, make it difficult for firms to break the size ceiling and finance innovation activities. The productivity of small and medium-sized enterprises, which are predominant in Greece, was less than a third of the EU average in 2020. Further, the share of high-growth enterprises ([9]) in Greece remains well-below EU average in almost all economic sectors, with the biggest split observed amongst high-tech to medium high-tech, and knowledge intensive sectors.

The share of workers aged 55+ in the labour force is expected to increase substantially over the next decades, which is projected to reduce labour supply and weigh on potential growth ([10]). Apart from the direct impact on the number of workers in productive age, an ageing workforce (reflecting the shift in the composition of the workforce from relatively young to relatively old workers) also reduces

([8]) For example the law-making process has become more predictable through the more systematic use of public consultation and a reduced number of unrelated or last-minute amendments.
([9]) Defined as the proportion of high-growth enterprises in the total number of active enterprises with at least 10 employees. High growth firms are firms with at least 10 employees in the beginning of their growth and average annualised growth in number of employees greater than 10% per annum over a 3-year period.
([10]) Commission (2020), The 2021 Ageing Report, "Underlying assumptions & projections methodologies", November 2020.

productivity, through its negative effect on total factor productivity and may lead to low potential growth in the absence of structural reforms.

Several years of underinvestment during the protracted economic crisis have generated a significant investment gap (Graph 2.1(a)). Investments in Greece exceeded the euro area average for a long period before the global financial crisis (averaging to 24.2% of GDP in 2000-2007 compared to 22.2% in the euro area). However, the majority of investments in Greece during this period were public and largely financed by external debt. Credit-financed construction investment (mainly residential) also boomed prior to the crisis as in several other euro area economies. Once domestic and external funding sources dried up in the aftermath of the global financial crisis, both public and private investment collapsed and the much-needed deleveraging process of the whole economy has affected their recovery. Despite having somewhat narrowed since, the investment gap against the euro area average corresponded to €21.7 billion in nominal terms in 2019. As corporate credit still comes at a high cost, in particular for small and medium-sized firms, addressing the investment gap through domestic savings remains challenging (see also section 5). The recurrent under-execution of the public investment budget has slightly diminished in 2019 (Graph 2.1(b)) and the authorities have taken several actions ([11]) to remedy the issue. Public investment is likely to increase going forward on the back of the implementation of the EU-finance investment as the 2014-2020 programming period reaches maturity.

A number of factors hamper greater investment activity, both domestic and foreign direct investments. As analysed in the 2020 Country Report, Greece still performs relatively unfavourably in terms of its business environment and the efficiency of public administration. Moreover, swift implementation of investments, including from the private sector, is conditional on the effectiveness of the justice system, which remains relatively low in Greece ([12]). However, the pandemic has encouraged the use of ICT in justice, including greater electronic filing of documents and issuance and delivery of court documents and certificates. A series of bottlenecks affecting firm creation, expansion and exit hinder business dynamics in the economy. The share of capital accounted for by insolvent companies in Greece was 28% ([13]) in 2013, which may suggest limited efficiency of insolvency proceedings, soft enforcement of overdue taxes, high tax and labour burdens and financing costs, and regulatory constraints. The ongoing insolvency reform, as well as the revamped out-of-court workout framework, are expected to facilitate the resolution of key challenges in the financial sector. Reforms to facilitate market entry and remove barriers to investments have started but are yet to be fully completed (see section 5).

Labour productivity has been gaining traction in recent years and, going forward, it is expected to resume its upward trend following the temporary adverse shock it suffered in 2020. Labour productivity growth has been negative for most of 2008-2016 and has subsequently entered into positive territory. In 2020, labour productivity was severely hit by the suspension of economic activity in many economic sectors and the underlying adjustment in remuneration and/or working hours. It decreased by 7% in real terms in 2020 but is projected to gradually recover in 2021 and 2022 along with the economic upturn. In addition to the cyclical factors, ongoing and past labour market reforms are expected to support productivity growth going forward (see also section 5).

Improved productivity and reforms undertaken in the past decade have been reflected also in improving exports of goods and services. Since 2016, Greece has been showing a marked increase in its export market shares. This trend was interrupted by the pandemic. Mainly as a result of the steep fall in tourism receipts, export market shares dropped by 19.1% in 2020, fully offsetting the previous gains (Graph 2.1(g)). The low openness of the economy is linked also to the small average firm size, as small firms find it more difficult to overcome administrative impediments to trade, enter international markets and integrate into global value chains. The authorities are preparing a revamped economic diplomacy strategy to reduce reliance on tourism and reallocate resources towards higher-productivity sectors,

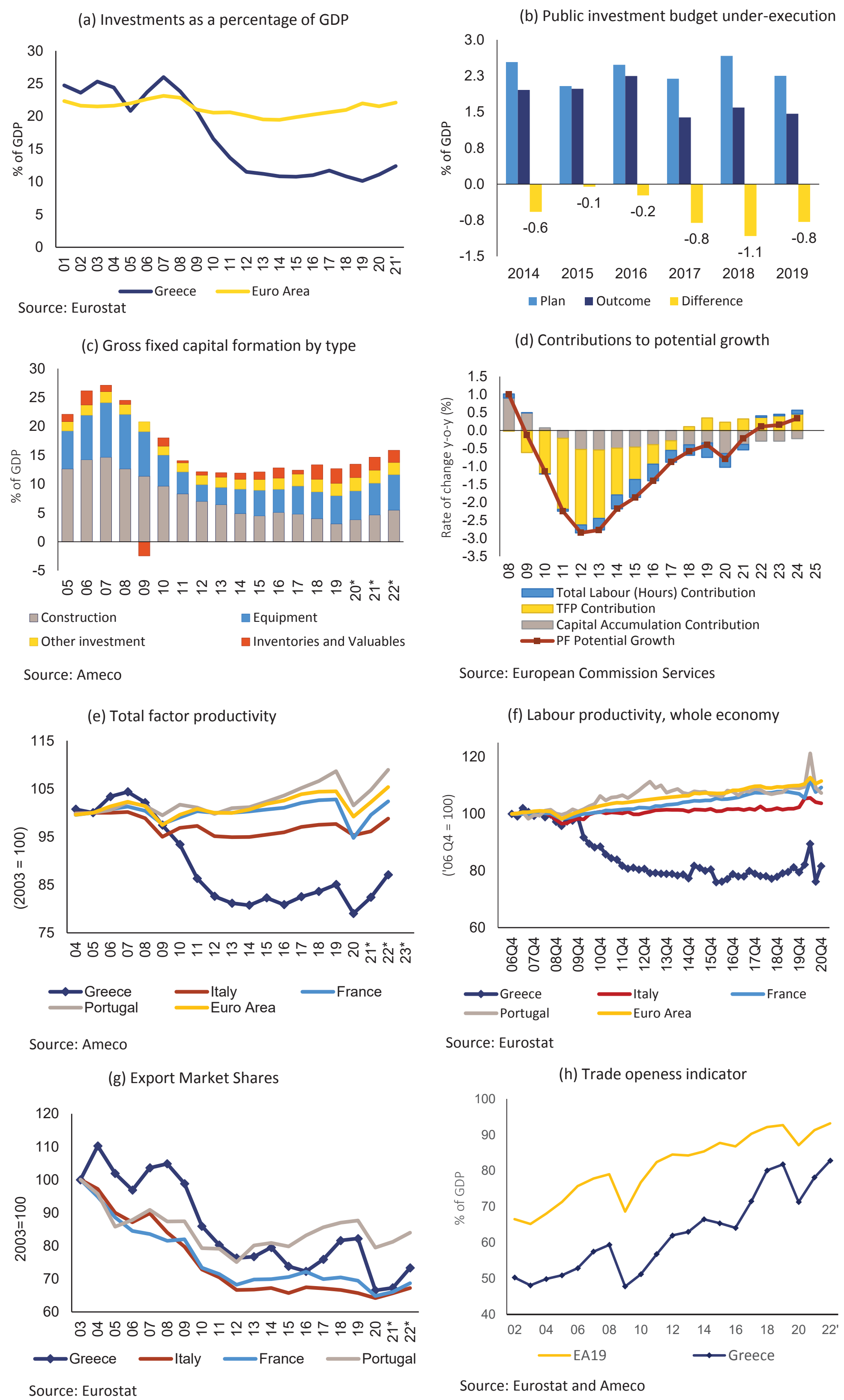
([11]) These actions include the implementation of a detailed action plan to enhance the monitoring and forecasting of the public investment budget, the creation of a Project Preparation Facility and the development of a Strategic Project Pipeline which will make the best possible use of available resources, accelerate the drawing of EU funds and support the sustainable recovery from the pandemic

([12]) According to the 2020 EU Justice Scoreboard, despite improvements, courts of all jurisdictions are slow in processing cases; the time needed to resolve civil and commercial disputes at first instance remains high or has even increased compared to pre-crisis levels.

([13]) OECD (2017), “Insolvency regimes, zombie firms and capital reallocation”, June 2017.

increase physical and human capital intensity and diversification, and expedite technological adoption. Modernising the legislative framework for exports in line with EU best practices, simplifying/digitalising customs procedures, and swiftly operationalising the recently re-established government structures to promote trade would further help unlock Greece's export potential.

Graph 2.1: **Thematic Graphs: Productivity, investments and potential growth imbalances**



Source: AMECO, Eurostat, ECFIN calculations

3. THEMATIC ISSUE: EXTERNAL SECTOR

The outbreak of the pandemic has worsened Greece's net international investment position. Partly as a result of the economic downturn, the net international investment position reached -176.4% of GDP at the end of 2020, having widened by almost 20 percentage points compared to 2019 (Table 3.1). Nevertheless, a gradual correction is expected in 2021 and 2022 as the economy starts growing again. The net international investment position is largely composed of external government debt extended by official creditors at concessional terms and with long maturities, which mitigates Greece's exposure to external shocks or shifts in market sentiment.

Inflows of foreign direct investments continued despite the COVID-19 pandemic. Since 2016, net inflows of foreign direct investments in Greece followed an increasing trajectory (Graph 3.1 (d)) until 2019, and remained broadly stable in 2020 at 1.5% of GDP ([14]). However, the composition of foreign direct investments is tilted to sectors with limited productivity growth potential. Data for 2019 show that more than half of the net inflows of foreign direct investments were directly into the real estate sector, while manufacturing and information and communication activities attracted only 7.5% and 2.1% of the total inflows, respectively.

Net borrowing increased markedly in 2020 which deteriorated the net international investment position (Graph 3.1(b))**.** The increased financing needs due to the fiscal measures addressing the pandemic, have led to a considerable government deficit in 2020. At the same time, the corporate sector increased its savings by postponing investments, which cushioned the fall in aggregate net lending. The government's balance is forecast to hover around its previous year levels in 2021, and should remain negative at least until 2022. Overall, net borrowing of the total economy is expected to slowly decrease, starting from 2021. However, the forecast improvement would not be sufficient to reverse the increase in net international investment position.

Greece has significantly narrowed its current account deficit since 2012, but it remains large (Graph 3.1(c))**.** Greece's current account deficit reached -2.2% of GDP in 2019 (national accounts definition), down from 10.4% of GDP between 2008 and 2021. While this is a considerable improvement compared to the past, partly reflecting the competitiveness gains during the economic adjustment process, the current account balance falls short of the level (estimated at a surplus of around 1.5% of GDP over the medium term) needed to stabilise the net international investment position to sustainable levels (above -35% of GDP). Achieving this level is conditional on further efforts to improve competitiveness and productivity growth and attract strong investments over the medium term (see also section 2).The current account deficit widened to -7.8% of GDP in 2020 (national accounts definition), mainly reflecting a deterioration in the trade balance due to the pandemic and the GDP denominator effect. The trade balance in energy improved during 2020, reflecting a better and more efficient use of the country's domestic sources. The deficit is forecast to narrow along with the recovery in international travel. In cyclically adjusted terms, the current account is projected to follow a similar pattern.

Greece records persistent trade deficits, mirroring chronic structural weaknesses. During the four years prior to the pandemic, the economy showed signs of improving export performance (see section 2). The recent pandemic has reversed the trend and after a substantial narrowing of the trade deficit (balance of payments definition) in 2019 (to 0.9% of GDP), the economy recorded a deficit of 6.8% GDP in its trade balance in 2020, as shown in Table 1.2. A gradual correction of the trade deficit is projected in 2021-2022, following the gradual lift of travel restrictions. Export market shares contracted sharply by 19.1% in 2020, fully offsetting the gains accumulated since 2017, primarily reflecting the impact of the steep fall in tourism receipts.

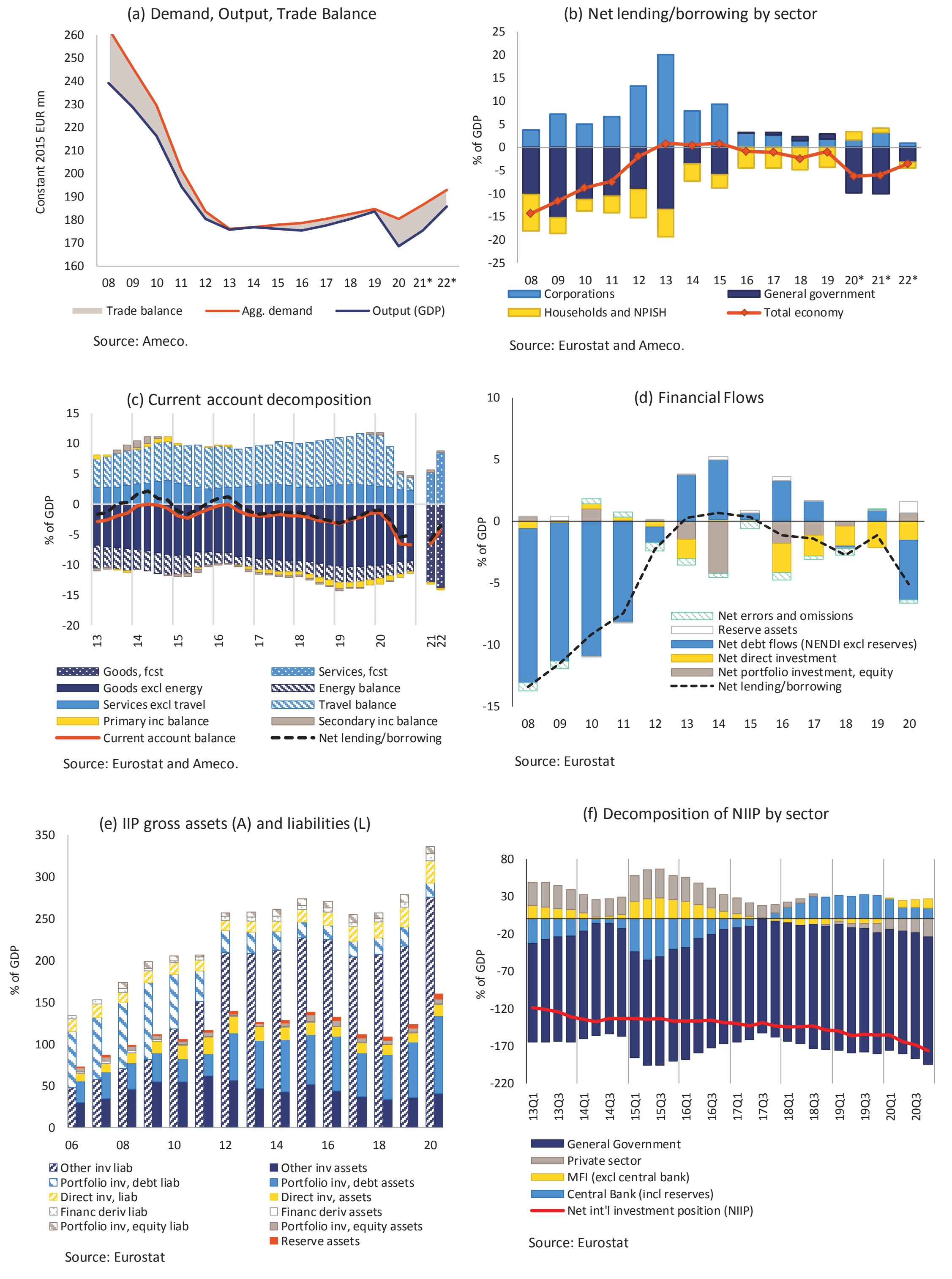
([14]) Note that 1.5% of GDP refers to the balance between 1.9% of GDP direct investment inflows and 0.4% of GDP direct investment outflows. Data source: Eurostat/International Monetary Fund, International Financial Statistics and Balance of Payments databases, World Bank, International Debt Statistics.

Table 3.1: **Selected external indicators, Greece**

	Source:	2008-12	2013-17	2018	2019	2020	2021f	2022f
Flows [(1)]								
Current Account balance as % of GDP, national accounts	(b)	**-10.4**	**-1.8**	**-3.6**	**-2.2**	**-7.8**	**-7.6**	**-5.3**
Current Account balance as % of GDP, Balance of Payments	(a)	-10.0	-1.3	-2.9	-1.5	-6.7	-6.6	-4.3
Cyclically adjusted Current Account balance as % of GDP [(2)]	(c)	-12.9	-7.5	-8.1	-5.3	-11.8	-10.8	-6.5
Current Account required to stabilize NIIP above -35% [(3)]	(c)	3.6	3.1	3.0	2.6	2.7	1.6	1.7
Current Account explained by fundamentals (norm) [(4)]	(c)	-1.8	-1.4	-1.1	-1.1	-0.9	-0.9	-0.8
Required Current Account for specific NIIP target [(5)]	(c)	5.0	6.8	7.5	7.4	7.9	8.3	8.4
Trade bal. G&S, % of GDP, NA	(b)	-8.1	-1.6	-2.1	-1.7	-7.6	-7.7	-5.3
Required TB for specific NIIP target [(5)]	(c)	6.4	6.3	7.3	7.1	8.0	8.2	8.4
Capital account bal. as % of GDP, NA	(b)	**1.7**	**1.9**	**1.3**	**1.3**	**1.6**	**1.8**	**1.9**
Stocks								
NIIP as % of GDP	(a)	**-94**	**-137**	**-148**	**-156**	**-176**	**-176**	**-169**

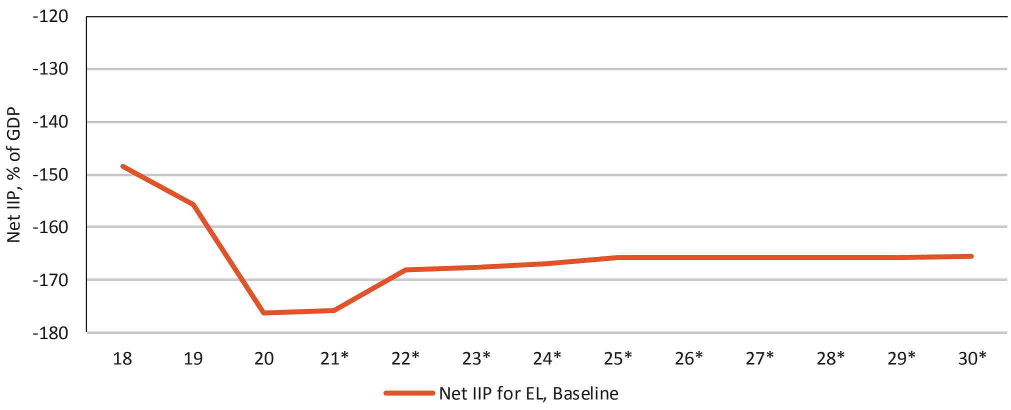
Abbreviations: NIIP = Net International Investment Position
(1) Flow data refer to national account concept, unless indicated otherwise.
(2) Cyclically adjusted Current Account is the Current Account adjusted for the domestic and foreign output gaps, taking into account trade openness.
(3) The average Current Account needed in order to stabilise the NIIP is based on T+10 ECFIN projections.
(4) The Current Account explained by fundamentals refers to the expected Current Account given the level of its fundamentals with respect to world average.
(5) The Current Account or Trade Balance needed either to halve the distance to fundamental NIIP benchmark, or to reach the prudential NIIP benchmark in 10Y, whichever is higher. Based on T+10 ECFIN projections.
Source: (a) Eurostat, (b) AMECO, (c) European Commission calculations, (d) WIOD database

Graph 3.1: **Thematic Graphs: External position**



(1) Forecast period uses the NA-based figures adjusted for statistical discrepancies (between NA and BoP data) observed in the last available year of data. Services balance includes travel for the forecast period.
Source: Eurostat, AMECO, ECFIN calculations

Graph 3.2: **NIIP projection**



Source: ECFIN staff calculations.

4. THEMATIC ISSUE: FINANCIAL SECTOR

The Greek banking sector suffers from low profitability, low quality of capital and a high level of non-performing loans. The economic effects of the pandemic are expected to continue to put pressure on banks' already low profitability through lower net interest income and high loan loss provisions. Low or in some cases even negative profitability, coupled with the cost of upcoming non-performing loan securitisations and the gradual phasing out of transitional prudential arrangements, may pose challenges for the banks' capital position. At the same time, quality of capital remains weak and reliance on state-related assets is set to increase.

The extension of the Hercules scheme is expected to facilitate a further reduction of non-performing loans. Non-performing loans stood at 29.4% of total loans in September 2020 ([15]). The decrease was supported by the 'Hercules' asset protection scheme and more recently by bank moratoria on debt repayments. Loans under moratoria at solo level amounted to €20.8 billion as of November 2020, with 34% of them belonging to the category of loans of increased credit risk ('Stage 2'). Most moratoria expired at the end of 2020, with some limited exceptions, particularly linked to the hospitality sector. Bank of Greece estimates an additional flow of €8-10 billion of non-performing loans resulting from the pandemic. The initial results from the first two months of 2021 suggest that the number of potential defaults may not exceed the original estimate incorporated in the banks' business plans or the lower end of Bank of Greece's current projections.. In order to mitigate these effects, banks are offering to their clients intermediate products to pave the way towards a gradual return to full payment. The authorities adopted two temporary instalment subsidy schemes for the pandemic-stricken debtors, one for primary residence loans and one for business loans of small and medium-sized firms and professionals. In addition, the recent extension of the Hercules asset protection scheme is expected to allow Greek banks to further reduce their non-performing loans and support their effort to reach single digit non-performing loan ratios in 2022.

Corporate credit increased in 2020 but still comes at a higher cost than the euro area average, in particular for small and medium-sized enterprises. As a result of the measures adopted by the authorities during the pandemic, credit to companies increased at a pace last observed in mid-2009, led by a strong performance in the energy, tourism, storage and transport sectors. Although most of the increase in bank lending was directed to large corporates, the flow of new loans to small and medium-sized enterprises was also up by 84% in 2020. The nominal cost of lending for businesses at the end of 2020 was near historical lows but remained twice as high as the Euro area average, reflecting differences in credit risk. For small and medium-sized firms the relative cost of credit increased, as reflected in the widening spread between the interest rate on new loans to these firms compared to the overall average lending rate for corporates.

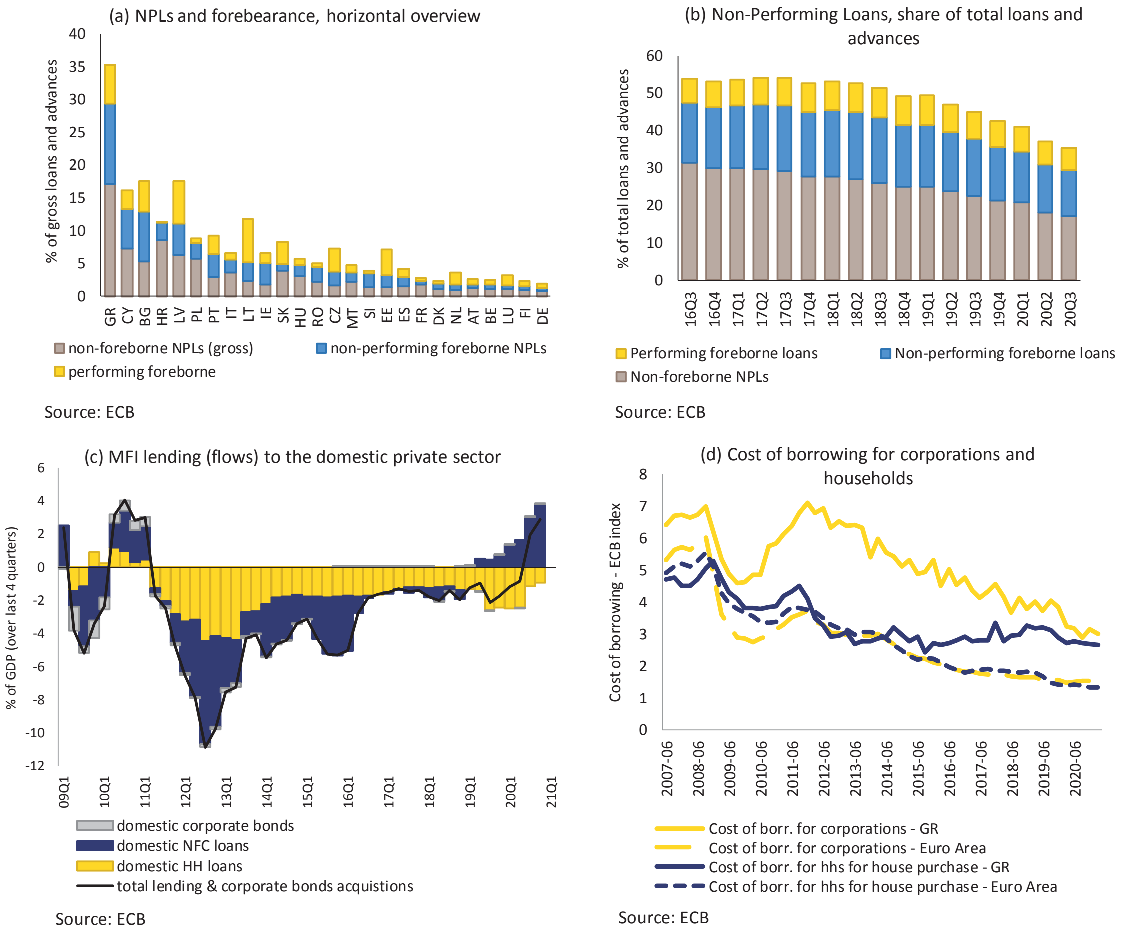
Banks will be called to maintain an adequate level of lending to support the recovery despite the gradual phase-out of state support and renewed pressures on asset quality. Credit expansion is expected to come mainly in the corporate loans' segment, where banks will need to counterbalance the gradual phase-out of state support schemes. These support schemes accounted for close to 40% of new loans to corporates in 2020, particularly those to small and medium-sized enterprises. Liquidity is likely to continue benefiting in the near term from to Eurosystem funding provided at favourable terms. However, a potential increase in non-performing loan inflows may impose further capital constraints on new lending. The recent extension of the Hercules asset protection scheme will facilitate banks in this respect.

The constraints on access to finance for small and medium enterprises are exacerbated by the limited alternative sources of financing. The Greek capital markets are underdeveloped and still

([15]) Non-performing loans as a share of total gross loans and advances on a consolidated basis (i.e. including cash balances at central banks and other demand deposits in the denominator). This figure is different than the one reported under enhanced surveillance, which follows non-performing loans as a share of total gross customer loans on a solo basis, as reported by the Bank of Greece.

affected by the prior deep and prolonged recession, with listed shares and debt securities of non-financial corporations in Greece accounting for 19.7% of GDP compared to 72.9% of GDP in the euro area in December 2020. This is highlighted by poor initial public offering activity over the last decade. For an average Greek company, raising capital on the equity and bond markets remains difficult due to country risk, low profitability and a shallow domestic investor base. Recent efforts to improve transparency and foster company listings, while facilitating the set-up of investment funds domiciled in Greece, aim to act as a catalyst to reverse this trend. At the same time, the Hellenic Development Bank is trying to leverage private investments through venture capital and private equity funds, directed to small and medium-sized firms, including those that are active in environmentally friendly activities.

Graph 4.1: **Thematic Graphs: Financial sector**



Source: ECB, National central banks and banking groups, FINREP

5. THEMATIC ISSUE: LABOUR MARKET

The outbreak of the pandemic has interrupted the ongoing recovery of the Greek labour market from a previous decade-long economic crisis. Employment has been gradually recovering in recent years, on the back of rising economic growth and sustained labour demand. Nevertheless, the employment rate stood at 61.1% in 2020, 11 percentage points lower than the EU average and 5 percentage points below its level of 2008. Similarly, while the unemployment rate had been on a steadily downward trend since 2013, reflecting improvements in the functioning of the labour market, at 16.3% in 2020, it was still the highest in the EU. Youth unemployment was also the highest in the EU (35% compared to 16.8% for the EU in 2020) while the activity rate was more than 5 percentage points below the EU average (73.1% compared to 77.8%).

While the pandemic had a sizable impact on the economy, its effects on the labour market have been mitigated thanks to the effective implementation of a set of employment retention measures supported by the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE). In March 2020, a first public support scheme was adopted, allowing companies affected by the pandemic to suspend the labour contract of their employees, and granting a special compensation to the latter (of EUR 534 per month) for the days not worked. Companies benefiting from this measure were obliged not to dismiss any worker, and to maintain the same number of staff after the end of the suspension of activities, for the same number of days that the scheme had been used. More than 800,000 workers were covered by the scheme in its first period of application (from mid-March to end-April), i.e. about 21% of total employment. In June 2020, another short-time work scheme was introduced to help companies able to operate but at a reduced capacity. The scheme (named '*Syn-ergasia'*) allowed employers to reduce the weekly working hours of their full-time employees by up to 50%, under the condition that the employment relationship was retained. Eligible companies have been those having recorded a drop in their turnover of at least 20% during the previous months, new companies that operate for the first time, as well as companies that operate on a seasonal basis. In early November 2020 with the resurge of the pandemic, the economy entered a new lockdown phase and the government made use of both employment-supporting measures for a longer period of time.

As a result of these emergency support measures, net job losses have been largely contained and unemployment has not increased significantly. In the third quarter of 2020 the employment rate stood at 61.3%, broadly the same level as the year before. After a relatively small increase between the first and second quarter of the year (to 16.7%), the unemployment rate reverted to 16.2% at the end of 2020, below the level observed at the end of 2019.

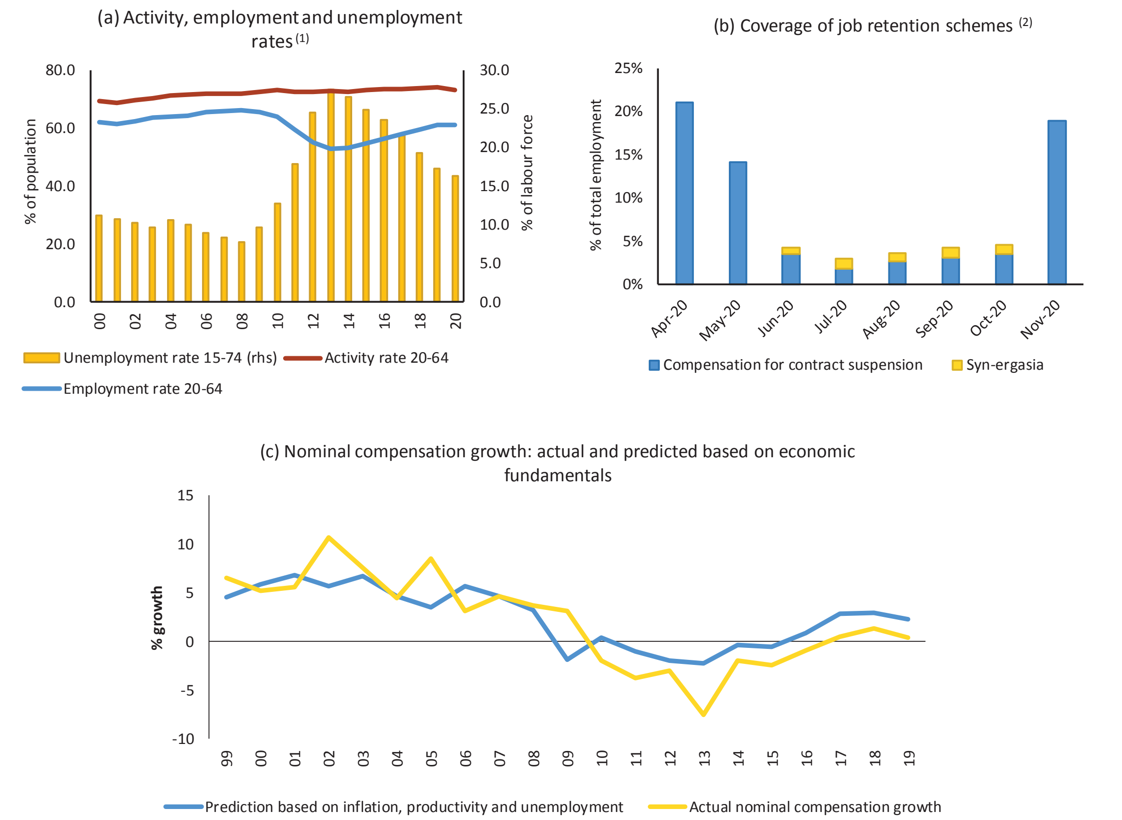
Aside from the negative impact of the pandemic, the Greek labour market faces a number of structural challenges, including brain drain and high youth unemployment. At 20.7% in 2019, the share of young people aged 15-34 not in employment, education or training was 10 percentage points lower than in 2013, but is still among the highest in the EU. This is coupled with significant 'brain drain'. Although comprehensive data on the skills profile of migrants are not available, several sample studies conducted in Greece have confirmed that the emigration wave during the crisis primarily concerned young people with a high level of education (often in medicine or engineering) and previous work experience (Lazaretou, 2016).

Furthermore, there are significant differences between men and women in terms of their labour market attachment. In 2020 the employment rate of men stood at 70.7%, almost 19 percentage points higher than the one of women (51.8%); while the unemployment rate of men stood at 13.6%, compared to 19.8% for women. To support women's employment Greece has expanded subsidised childcare, although there are still significant unmet needs, especially for children below the age of 2.5 years. There are also challenges concerning the provision of targeted activation support. About 70% of the unemployed have been out of the labour market for more than one year. The limited counselling capacity of the Public Employment Service and the current model for delivering active labour market policies, which relies on ad-hoc open calls to potential participants, do not allow for timely, tailor-made and effective support to jobseekers on a broad basis.

Skills mismatch represent another major structural problem of the labour market in Greece. Greece ranks at the bottom of the European Skills Index (CEDEFOP): it has one of the lowest score for skills matching and skills activation among EU skills systems ([16]). Under a new National Strategy for Lifelong Learning (to be developed by the end of 2021) Greece aims to overhaul its training system, consolidating various funding streams, establishing Individual Learning Accounts, and putting in place a new framework to ensure the quality of trainings. This is expected to be a far-reaching reform that comes with new governance bodies. Adopting the Strategy by the end of the year would be critical to address the issues of skills mismatches and youth unemployment.

Wages stagnated in 2020, as labour demand was curtailed by the pandemic, employment retention measures allowed companies to reduce labour costs, and the revision of the minimum wage was postponed to 2021. Wage growth had been moderate during the three years before the pandemic, remaining broadly aligned with developments in productivity, inflation and unemployment. The pandemic caused a ‘freeze’ in economic activities, leading to a drastic decline in job vacancies (-61% year-on-year in the second quarter of 2020). The emergency support measures put in place by the government have allowed companies to reduce labour costs preserving existing contracts at the same time. The annual revision of the statutory minimum wage, originally foreseen for June 2020, was postponed repeatedly in agreement with the social partners, determining a freeze in its level.

Graph 5.1: **Thematic Graphs: Labour Market**



(1) Preliminary data for 2020 – average of first 3 quarters for employment and activity rate, average over Jan-Nov for the unemployment rate.
(2) Data for the first month (April) corresponds to the share of workers benefiting from the measure during the 45-day period from mid-March to end-April. Data from Syn-ergasia for November 2020 not available
Source: Eurostat, DG EMPL calculations

([16]) https://www.cedefop.europa.eu/en/publications-and-resources/data-visualisations/european-skills-index