

**REPORT TO CONGRESS ON
THE INTERNATIONAL MONETARY FUND'S
LOAN TO GREECE**



United States Department of the Treasury
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Introduction

This report provides an assessment of the likelihood that a precautionary International Monetary Fund (IMF) loan to Greece, approved in principle in July 2017, will be repaid in full. For the program to become effective – and thus for any potential disbursement of IMF financing to occur – the IMF Executive Board must take a second decision confirming that Greece remains on track with policy reforms under the program, and that there are credible and specific commitments from Greece’s European partners to provide requisite debt relief so that public debt becomes sustainable under the IMF’s analysis.

Consistent with the longstanding practice of the Office of the United States Executive Director (OUSED) at the IMF with respect to all loans, the OUSED and the Treasury Department conducted a careful and thorough evaluation of the proposal for the Greece program submitted to the IMF Executive Board. The OUSED and Treasury staff continue to monitor developments and remain engaged with the Greek authorities, European institutions, and the IMF on Greece’s path towards economic recovery and sustainability.

Overview

On July 20, 2017, the IMF Executive Board approved in principle (AIP) a precautionary Stand-By Arrangement (SBA) which, if approved in full, could provide up to SDR 1.3 billion (around U.S. \$1.8 billion) for Greece. The IMF program is intended to complement Greece’s European Stability Mechanism (ESM) program of \$86 billion. At 55 percent of quota, the IMF program is limited in size, well below the normal access limits of 145 percent of quota annually and 435 percent of quota cumulatively. Furthermore, the Greek authorities have stated that they intend to treat the IMF program as precautionary, meaning that they do not intend to draw on the funding, but would have the option to do so (if the program is approved in full) should external shocks generate a balance of payments need. Regardless of whether the program is fully approved, IMF staff will assess Greece’s progress on quarterly program targets and benchmarks with semiannual IMF Executive Board reviews. The program is set to expire on August 31, 2018.

The IMF’s AIP of the program facilitated the ESM’s approval of a disbursement of €7.7 billion in European program funds on July 7 (with an additional €0.8 billion held back until the fall pending continued reform implementation by Greece), enabling Greece to make large external payments due in July.

Requisite European debt relief will need to be in line with debt sustainability under the IMF program’s assumptions of 1 percent real GDP growth over the medium term and a 1.5 percent of GDP primary fiscal surplus over the longer term after a near-term interval (5 years) at 3.5 percent. Treasury views these assumptions as appropriately conservative. IMF Management will bring the program back to the IMF Executive Board for full approval once the IMF receives specific and credible assurances from Greece’s European partners to restore debt sustainability and assuming Greece remains on track with policy reforms under the program.

The program focuses on three key areas of reforms to help restore macroeconomic stability and improve Greece’s long-term growth prospects: 1) a more growth-friendly fiscal policy mix; 2) a

strengthening of the financial sector with a focus on reducing non-performing loans; and 3) targeted growth-oriented structural reforms to liberalize product and services markets, as well as commitments to not roll back past labor market reforms.

Debt Status

Greece's gross public debt rose to 181 percent of GDP in 2016, up from 176 percent in 2015. The IMF projects that Greece's debt will decline gradually to 150 percent of GDP by 2030, before rising again to 195 percent of GDP by 2060 as Greece replaces highly-concessional official sector financing with more expensive market financing. European institutions have already implemented a package of short-term debt relief measures to lower interest rates and extend maturities and agreed to several medium-term debt relief measures conditional on completion of the ESM program. However, the IMF's analysis shows that these measures alone are insufficient to fully restore Greece's debt sustainability. Additional European debt relief measures are needed to maintain Greece's gross financing needs below the thresholds of 15 percent of GDP in the near term and 20 percent of GDP over the longer run to restore sustainability.

Debt Management Strategy

A key objective of the Greek government is to bring its debt back to sustainable levels. In order to meet this objective, Greece is committed to implement policies that will restore macroeconomic stability in the medium run. Under the IMF program, Greece has committed to a number of growth-friendly fiscal and structural reforms that will boost Greece's primary surplus – a key factor for achieving debt sustainability – and create breathing room to implement long-term structural reforms to restore Greece's competitiveness. In particular, Greece has committed to reduce pensions, broaden the tax base, improve the efficiency of Greece's new revenue agency, and liberalize product markets. The authorities also aim to restore market access and remove capital controls before the end of the IMF program. In addition to the reforms, the Greek authorities, the IMF, and Greece's European creditors have acknowledged the need for additional debt relief from European official creditors. The IMF program will provide a framework and impetus for debt relief discussions between Greece and these official creditors.

Vulnerabilities

Greece has made significant progress in addressing its macroeconomic imbalances. However, a number of economic challenges remain that hinder the country's ability to strengthen economic growth and improve public finances.

The Greek authorities will need to undertake significant reforms to restore debt sustainability. The key variables that will influence Greece's public debt trajectory are the rate of GDP growth, the fiscal balance, and the cost of its financing. Greece's current structure of public finances is unsustainable and growth-unfriendly – partly due to unaffordable pension spending financed by high tax rates on narrow bases. The authorities will need to rebalance the budget to be more growth-friendly and socially-inclusive, including reducing generous pensions and tax exemptions for the middle class. The budget will need to be complemented by decisive fiscal structural

reforms to combat tax evasion and strengthen public administration. Greece's banks continue to hold a substantial amount of non-performing loans (NPL) and stronger efforts are needed to strengthen supervisory actions to incentivize NPL reductions. The country's long-term growth trajectory will also depend on the ability of authorities to preserve previous labor market reforms, in addition to implementing new measures to open and liberalize the economy.

Previous reforms have caused social and political tensions which have slowed reform momentum, and additional reforms to address Greece's vulnerabilities could face significant social and political hurdles to implementation. To mitigate this risk the IMF required several prior actions for the program, including the adoption of legislation on tax collection and audits and measures to strengthen the legal framework for reducing non-performing loans. The IMF and other institutions will also provide technical assistance in support of key reforms.

A key outstanding risk remains the need for significant additional debt relief based on the IMF's assumptions from Greece's European creditors so as to restore debt sustainability.

Overall assessment

Greece remains heavily indebted and vulnerable. However, its economic reform program, supported by the Europeans and the IMF, provides the best opportunity for the country to return to a sustainable debt trajectory and address significant vulnerabilities to improve growth prospects.

Risks to the IMF are mitigated by the limited program size, the precautionary nature of the program, and by linking full approval and any possible disbursements to sufficient commitments on debt relief from European partners. As of end-June 2017, Greece's total exposure to the IMF has declined to SDR 10 billion (around \$14 billion) or roughly 414 percent of Greece's quota and 6.8 percent of GDP, down from a peak of SDR 24 billion (or around \$34 billion) in July 2013. Even in the unexpected case of Greece drawing fully on this arrangement, Greece's total credit outstanding to the IMF would decline to around SDR 9 billion (\$13 billion) by 2018. The IMF program also contains strong policy measures, and the IMF will rigorously review program performance even in the absence of full program approval. The IMF's de facto preferred creditor status will also promote repayment of the IMF ahead of all other creditors. While Greece was delayed in making about \$2.2 billion in payments to the IMF in June 2015, Greece cleared these arrears within three weeks while under severe financial stress and has since continued to make its IMF payments in full and on time.

Based on these factors, the Treasury Department assesses that the IMF's loan to Greece, if approved, is likely to be repaid in full.