



Brussels, 10 July 2015

***Greece - request for stability support in the form of an ESM loan***

***Assessment of:***

- a) the existence of a risk to the financial stability of the euro area;*
- b) whether public debt is sustainable.*
- c) the actual or potential financing needs.*

***(in compliance with Art 13 of ESM Treaty)***

\* In compliance with Article 13 of the ESM Treaty, this assessment has been prepared by the European Commission, in liaison with the ECB. The assessment has been conducted with input of IMF staff for parts b) and c).

***Greece - Assessment of the Commission, in liaison with the ECB, of the request for stability support in the form of an ESM loan, in compliance with Art 13 of ESM Treaty***

10 July 2015

**1. Introduction**

On 8 July 2015 the Hellenic Republic made a request to the Chairperson of the Board of Governors of the European Stability Mechanism (ESM) for stability support in the form of a loan,<sup>1</sup> with an availability period for three years, in the context of a macro-economic adjustment programme comprising strict conditionality, with a comprehensive set of reforms and measures in the areas of fiscal sustainability, financial stability and long term growth.

Pursuant to Article 13(1) the ESM Treaty in conjunction with Article 2 of the ESM Guidelines on Loans<sup>2</sup>, and to form the basis for a decision of the ESM Board of Governors in line with Article 13(2) whether to grant, in principle, stability support to the Hellenic Republic in the form of a loan, on 8 July the Chairperson of the Board of Governors has entrusted the European Commission, in liaison with the ECB, with the following tasks:

- a) to assess the existence of a risk to the financial stability of the euro area as a whole or its Member States;
- b) to assess, together with the International Monetary Fund, whether public debt is sustainable;<sup>3</sup>
- c) to assess the actual or potential financing needs of Greece.

This document provides the three assessments pursuant to article 13 of the ESM Treaty.

**2. Assessment of the existence of a risk to the financial stability of the euro area as a whole or its Member States<sup>4</sup>**

**2.1 Risks to the financial stability of Greece**

***Since May 2010, over the course of the two Economic Adjustment Programmes for Greece, the Greek banking sector has been restructured, consolidated and undergone a series of significant reforms.*** The banking sector was recapitalised twice between 2013 and 2014, respectively, while being subject to three Asset Quality Reviews (AQRs) and stress tests. The results of the ECB Comprehensive Assessment in 2014 confirmed that the four core Greek banks would not require additional capital under the dynamic balance sheet assumption, based on their restructuring plans

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<sup>1</sup> According to Article 13§ of the Treaty establishing the ESM ('ESM Treaty'), "An ESM Member may address a request for stability support to the Chairperson of the Board of Governors. Such a request shall indicate the financial assistance instrument(s) to be considered." [http://www.esm.europa.eu/pdf/esm\\_treaty\\_en.pdf](http://www.esm.europa.eu/pdf/esm_treaty_en.pdf).

<sup>2</sup> <http://www.esm.europa.eu/about/legal-documents/index.htm>

<sup>3</sup> Article 13(1)b, stipulates that the task is "b) to assess whether public debt is sustainable. Wherever appropriate and possible, such an assessment is expected to be conducted together with the IMF".

<sup>4</sup> According to Article 12§1 of the ESM Treaty, "If indispensable to safeguard the financial stability of the euro area as a whole and of its Member States, the ESM may provide stability support to an ESM Member subject to strict conditionality, appropriate to the financial assistance instrument chosen".

approved by the EC, taking the capital increases in the first three quarters of 2014 into account. At the end of 2014, the banking sector had adequate solvency levels with Core Equity Tier 1 (CET1) ratios of 13.8% at consolidated level and 16% at solo level, while the coverage of non-performing loans (NPLs) (excluding restructured loans) by provisions was further increased to 55.8% (from 49.3% at end-2013).

**However, since end-2014, the situation of the banking sector has deteriorated dramatically** amid increased State financing risks, strong deposit outflows, a worsened macroeconomic development and more recently due to the implementation of administrative measures designed to stabilise the funding situation of banks and preserve financial stability. On this basis, the current prospects for the sector are even more negative than those assumed in the adverse scenario of the Comprehensive Assessment.

**The liquidity of banks seriously deteriorated in 2015 and is now in a very critical state.** In 2015 until end May, deposits of €30bn or 19% left the banking sector. The sector's reliance on central bank funding dramatically increased to above €116.4bn amid loss of market access, deposit outflows and a series of additional factors negatively affecting the liquidity situation of banks. The use of Emergency Liquidity Assistance (ELA) by Greek commercial banks increased from zero in December 2014 to €78bn by end May 2015.

**Since 29 June 2015, a bank holiday was imposed on Greek banks with strict restrictions on deposit access.** The Governing Council of the ECB decided to non-object to the maintenance of the ELA ceiling for the Greek banking sector at an unchanged level (since 26 June 2015). On 6 July 2015, the Governing Council of the ECB also decided to increase the haircuts on the Greek government related assets used as ELA collateral, which have reduced the remaining ELA collateral buffers of banks. Consequently, banks are currently operating under very tight liquidity conditions, and have almost exhausted their eligible collateral.

**In addition to high liquidity risks, the capital situation of Greek banks is coming under increasing pressure since end-2014 due to expectations of significant further deterioration in asset quality.** While Greek banks already face unprecedentedly high NPL levels, these are expected to materially increase due to the adverse impact of political uncertainty since end-2014 on economic activity and payment culture, the significant delay in the NPL resolution process, and most importantly significant adverse impact of bank holidays and capital controls on economic activity and payment culture. Since end 2014, the ratio of NPLs has resumed a sharp upward trend, as the ability and propensity of borrowers to service their loans has declined owing to the uncertain economic conditions. By the end of Q1 2015, 36% of total loans were classified as non-performing and 8% were classified as restructured.<sup>5</sup> In these circumstances, bank capital has been eroded and by end-Q1 2015, the CET1 ratio for the sector was at 12.5% at consolidated level and 14.4% at solo level. The capital controls, which are expected to remain in place for an extended period of time until depositors' confidence is restored, will seriously constrain economic activity, further eroding the ability and willingness of borrowers to repay their loans and so are expected to lead to a further strong increase in NPL ratios.

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<sup>5</sup> By end-2014, 7% of performing loans were in the 0-90 day delinquency category (i.e. in arrears but not yet non-performing), which are soon expected to partly or fully transition into the non-performing category while the number of loans in arrears is expected to increase substantially further.

***A very significant risk to financial stability from the bank-sovereign nexus remains in Greece.*** The banks hold a notable amount of government papers and significant part of the collateral used for ELA purposes includes Greek Government related assets. These government papers, guarantees and capital elements might be deemed unacceptable from a prudential perspective or their collateral eligibility be revisited, in particular if the Greek state defaults on its debt service obligations. Furthermore, significant part of Greek banks capital are DTAs.

***Against this background, banks will face additional capital needs.*** It is also uncertain whether banks would be able to implement envisaged divestments of foreign subsidiaries and other non-core assets as envisaged under the CA dynamic balance sheet projections thus further aggravating the capital shortage. Consequently, the capital needs of banks needs to be reassessed in light of these new developments as soon as there is more clarity on the outlook and past developments are mostly reflected in banks' financials. It is expected that banks will need to raise a substantial amount of capital over a short period of time so as to remain compliant with regulatory requirements. Given that it is unlikely that banks will be able to secure private funds in the continued absence of market access, capital injections from Programme financing remain as the only option.

***In view of this, it is necessary to agree on an adequate capital backstop to restore the confidence of depositors and markets in Greek banks and safeguard financial stability in Greece.***

***In the absence of support by the ESM, financial stability risks for Greece will not be manageable and the banking sector will inevitably collapse.*** Without provision of funding to the State, a sovereign default would be almost certain, given the shortage of available liquidity and upcoming obligations, as already highlighted by the build-up of significant internal arrears, and outstanding arrears with the IMF and the Bank of Greece. In absence of support, the ability of Greek banks to access central bank refinancing would need to be reassessed while at the same time the solvency of banks would be adversely affected.. The Greek banks would need to remain closed with depositors having no access to their deposits. In this scenario, the banking sector would collapse and the economy would experience a further very sharp contraction. Greek citizens would suffer significant reductions in wealth and income and could face a shortage of basic goods.

***The effect of financial instability in Greece would be very significant beyond the financial sector.*** The imposition of capital controls and of a bank holiday is already taking a very significant toll on the real economy, through a number of channels, such as investment, trade and tourism, with strong impact on growth and employment prospects. These effects would be amplified if the stability of the Greek financial system could not be secured, and the majority of Greek companies would be in default.

## **2.2 Risks to the financial stability of the euro area and other Member States**

***Greece is a relatively small economy compared to the size of the Euro area (representing only 1.77% of total GDP).*** However, the collapse of the Greek banking system would still have negative consequences for the Euro Area as a whole, and potentially serious repercussions for a number of Euro Area Member States.

***The direct risk of contagion to the Euro Area through the banking system has been reduced during the two Economic Adjustment Programmes.*** Risks were mitigated via the consolidation of the sector

and the reduction of foreign exposures; specifically the exit of foreign banks from the Greek market as well as the absorption of Cypriot bank branches operating in Greece during 2013.

***In addition, the euro area's institutional framework has been improved significantly in recent years and thus made more resilient.*** In particular, the euro area and EU has strengthening the fiscal and macroeconomic surveillance, establishing a permanent crisis resolution framework (the ESM) and setting up important steps towards a banking union (such as establishment of the SSM and SRB). These improvements have helped limit apparent spill-over effects from the renewed Greek crisis in 2015 thus far. In addition, the accommodative monetary policy of the Eurosystem including non-standard measures such as the currently ongoing expanded asset purchase programme (EAPP) has a broadly supporting effect on the prices of sovereign bonds and other financial assets in other euro area member states and may thus contribute to limiting financial contagion. Moreover, in September 2012, the ECB introduced the Outright Monetary Transactions (OMT) programme which is a scheme designed to safeguard an appropriate monetary policy transmission and the singleness of the monetary policy. OMT is a potential backstop if funding conditions in some euro-area government bond markets deteriorate substantially and the conditions of its application are met. Further steps to complete the Banking Union could further safeguard financial stability in other euro area countries.

***Greek banks still have a number of branches and subsidiaries in other countries which could cause spillover effects.*** The foreign subsidiaries of Greek banks are located in Cyprus, Bulgaria, Romania, the UK, FYROM, Albania, Serbia and Turkey. In some of the EU member states Greek banks' subsidiaries account for 15-25% of the local banking sector which make them systemically important. Adverse development in the Greek banking sector has the potential to create financial instability in these countries which would prompt host authorities to act and set intrusive ring-fencing measures on the Greek operations in their jurisdictions. Furthermore, it cannot be excluded that the banking turmoil in Greece, the potential spill-overs to host countries and the reaction by host authorities might indirectly influence depositors' behaviour in other Euro Area and EU Member States due to confidence effects.

***Besides the specific impact on other countries through the banking/financial sector, banks throughout the euro area might also see their ability to raise unsecured funding deteriorate; and there might be a negative impact on the funding outlook of other sovereigns.*** All this could have a negative impact on the credit supply and on its costs, with potential important repercussions on growth and employment.

***Finally, an uncontrolled collapse of the Greek banking system and of Greece as a sovereign borrower would create significant doubts on the integrity of the euro area as a whole,*** currently and in the future, which would exacerbate the effects highlighted above.

## **2.3 Conclusion**

***There are substantial financial stability risks in Greece, which are caused by the uncertainty on the economic and financial policies of the Greek authorities over the last half year.*** The provision of stability support by the ESM to Greece that includes an adequate capital backstop for Greek banks is critical to restore confidence of depositors and markets in Greek banks and safeguard financial stability in Greece, but also to avoid risks for other EU member states and the euro area as a whole. A default of Greece and its banks could have direct stability consequences for countries where the market share of branches and subsidiaries of Greek banks are of systemic importance, even with

strong mitigating action due to confidence effects. Even though reforms in recent years should enable the euro area to better manage such spillovers, the long-term consequences resulting from developments which affect the integrity of the euro area are likely to be significant, yet difficult to assess due to the lack of a historical precedent.

***However, support can only be granted on the basis of a far-reaching and credible reform programme which has a high level of ownership of the Greek authorities and the general public.***

The granting of a third programme thus has to be made on the basis of the same level of stringency applied in previous country programmes. Otherwise, the credibility of the Eurogroup, Euro Area institutions and the governance framework could be undermined, which could pose risks to financial stability looking forward.

### **3. Assessment of whether public debt is sustainable**

**This is a preliminary estimate of the sustainability of Greece's public debt, which will need to be reviewed in light of the outcome of the MoU negotiations and hence precise commitments of the Greek authorities as well as the timing of their implementation.**

***The economic and financial situation in Greece has strongly deteriorated*** following policy uncertainty, shortfall in government revenues, the authorities' decisions that made the bank holidays and the imposition of capital controls necessary, and the missed payments to the IMF and Bank of Greece.

***Hence, the sustainability of Greece's public debt has significantly deteriorated compared to the DSA published in the April 2014 Compliance Report prepared by the Commission in liaison with the ECB.***

At the time, the debt-to-GDP ratio was projected to reach 125% in 2020 and 112% in 2022. During the second part of 2014 Greece's debt sustainability improved further due to lower interest rates and the replacement of part of external funding sources by internal sources through repo operations with general government entities. These factors together with full programme implementation by the Greek authorities would have reduced the debt-to-GDP ratio well below the 2012 targets of 124% in 2020 and significantly below 110% in 2022. Under these circumstances, debt was deemed sustainable.

***Since end of last year, a very significant weakening of commitment to reforms and backtracking on previous reforms have led to a significant deterioration of debt sustainability.*** Prior to the announcement of the referendum and the imposition of capital controls, a preliminary DSA was run and three scenarios were presented to the Eurogroup. The first assumed the full implementation of the reforms in the aide memoire and the corresponding growth effects. The second scenario assumed partial compliance with the aide memoire, among others regarding privatisation, resulting in a 0.5% lower growth path and a higher risk premium (0.6%). The third scenario reflected the IMF baseline as published on 2 July 2015. In all three scenarios, the debt-to-GDP ratios were on a declining path, but remained substantially above the Eurogroup November 2012 targets of 124% in 2020 and significantly below 110% in 2022 (the debt-to-GDP range under the three scenarios was 138% to 150% in 2020 and 124% to 142% in 2022).

***The parameters that led to the deterioration*** were: (i) lower macroeconomic growth due to the weaker implementation of structural reforms by the authorities; (ii) a lowering of the fiscal targets

compared to the original programme; (iii) a lowering of privatisation receipts compared to the original programme targets; (iv) higher arrears clearance as protracted negotiations led to an acute liquidity shortage for the sovereign.

***The failure to complete the review, the missed debt service payments, the expiration of the EFSF programme and the introduction of capital controls have created new circumstances which have led to a further strong deterioration in debt sustainability.*** The following paragraphs present the different assumptions according to a baseline and an adverse scenario and give the respective numbers in these two scenarios:

- **Growth estimates have been further revised downwards:** preliminary revised projections point to a strong decline in economic activity in 2015. Real GDP growth expectations now range from -2% to -4.0% in 2015, compared with 0.5% in the Spring forecast. 2016 should also see negative growth -0.5% to -1.75% with growth picking up only in the course of 2017, assuming that political stability is restored soon and a gradual relaxation of the administrative measures on the banking sector. Long-term growth is assumed at 1.8% in the base line and at 1.5% in the adverse scenario.
- **The expected primary surplus outcomes have been revised downwards.** The fiscal programme, which had been on track until the third quarter of 2014, was de-railed in the last quarter of 2014. The weaker implementation of reforms in the second half of 2014 and the turn of the economic cycle led to a primary balance rather than a primary surplus. Moreover, the political uncertainties and the severe policy slippages of the first half of 2015 have led to a strong deterioration of economic growth and hence to weaker primary balance outcomes. Furthermore, the imposition of capital controls and the severe liquidity shortage in the Greek economy now require a further downward revision of the fiscal targets at least for 2015-2017. It is now expected that primary balance outcomes would decrease substantially. A primary deficit of 0% to 1% is expected in 2015, a primary balance of 1% to 0.5% in 2016 and a primary surplus of 2.25 to 2% in 2017, before moving to 3.5% from 2018 onwards. The expected outcomes have been lowered in view of the developments of the Greek economy.
- **Privatisation receipts are likely to be lower than envisage when the last review was completed.** The strong deterioration in the banking sector outlook, heightened economic and political uncertainty, more challenging financing conditions for potential investors together with reduced prospects for the privatisation programme result in lower expected privatisation proceeds, though the government intends to proceed with privatisation projects. We could expect until 2022 EUR 10 bn would materialise in the baseline scenario going down to EUR 4 bn in the adverse scenario (compared to EUR 22 bn before).
- **Financing needs for the banking sector have increased considerably.** The capital situation of Greek banks is coming under increasing pressure due to worsening asset quality that is related to the significantly weaker macro-economic development, high political uncertainty, the delayed NPL resolution process and the significant adverse impact of capital controls on economic activity and payment culture. In view of this banks will face substantial capital needs. As they will likely have no market access in the near future, an adequate capital backstop as part of a next financial assistance programme is needed. The estimated size of the required capital backstop amounts on a preliminary basis to EUR 25 bn. Further work on

the calibration and terms of such capital backstop is currently ongoing among the different institutions.

**Based on the developments above, the debt-to-GDP ratio is expected to reach 165% in 2020, 150% in 2022 and 111% in 2030 in the baseline scenario.** The respective debt/GDP ratios in the adverse scenario are: 187% in 2020, 176% in 2022 and 142% in 2030..

**However, focusing exclusively on the debt-to-GDP level does not allow capturing the structure of debt and is not accounting entirely for the measures taken by the European financial support to make Greek debt sustainable.** This aspect can be better assessed by the gross financing needs of a country, which captures its payment structure over time. Lower gross financing needs reduce rollover and financial stability risks. Greece currently benefits from very low debt servicing in the period up to 2020 due to low interest rates, interest deferral and a long grace period on both GLF and EFSF loans. As in the case of the debt-to-GDP ratio it is also difficult to determine concrete thresholds for this alternative metric above which public debt should be considered as no longer being sustainable. Based on cross country evidence, an IMF guidance note to staff suggests that gross financing needs-to-GDP would need to remain below the 15% to ensure debt sustainability.

**Given the further strong deterioration that followed the imposition of capital controls and the grinding to a halt of the Greek economy, gross financing needs-to-GDP over the 2015-30 period are and on average 10.4% and above the 15% threshold in a number of years.** In the adverse scenario, the average gross financing needs-to-GDP ratio stands at 13.1% over the 2015-30 period.

## **Conclusion**

**The high debt to GDP and the gross financing needs resulting from this analysis point to serious concerns regarding the sustainability of Greece's public debt.** The concerns could be addressed through a far reaching and credible reform programme, very strong ownership of the Greek authorities for such a programme and, after full restoration of the loans agreements, debt-mitigating measures that would be granted only once the commitments to reform from the Greek authorities has been demonstrated. A very substantial re-profiling, such as a long extension of maturities of existing and new loans, interest deferral, and financing at AAA rates would allow to cater for these concerns from a gross financing requirements perspective, though they would still leave Greece with very high debt-to-GDP levels for an extended period.

## **4. Assessment of the actual or potential financing needs of Greece**

**This preliminary estimate of the financing envelope would also need to be reviewed in light of the outcome of the MOU negotiations and the agreed targets.**

Greece is projected to have the following financing needs over the July 2015-July 2018 period.

### *a. Financial sector:*

As explained in detail in *section 2.1 'Risks to the financial stability of Greece'*, following the uncertainty over the financing of the State and over the economic and financial policies by the Greek government in the last months, and the introduction of bank holidays, restrictions on deposit withdrawals and capital controls, the situation for the banks has dramatically worsened.



Hence, it is expected that banks will need to raise a substantial amount of capital over a relatively short period of time so as to remain compliant with regulatory requirements and to mitigate the loss of confidence resulting from the imposition of payment restrictions. Given that it is unlikely that banks will be able to secure private investment, capital injections will likely need to come from programme financing.

Current preliminary calculations estimate financing needs in the banking sector to total EUR 25 bn. These would need to be validated by a due diligence exercise by the various institutions at a later stage.

#### *b. Medium and long-term debt redemption*

Over the three years, Greece has to cover EUR 53.7 bn in debt amortisation and interest payments (EUR 35.9 bn in amortisation and EUR 17.8 bn in interest payments). This includes the EUR 2.1 bn in debt redemptions to the IMF and Bank of Greece (BoG) that were due on 30 June 2015 and which Greece has not yet paid. This assumes that no creditors will accelerate their claims due to default of repayments and that the authorities and other creditors will respect the IMF's preferred creditor status. The Greek authorities' arrears to the Fund as of July 10 are EUR 1.6 billion.

Of the total amortisation due over the July 2015-July 2018 period, EUR 8.3 bn represents IMF debt redemption, EUR 12.7 bn is amortisation on the Eurosystem ANFA and SMP bonds, EUR 1.9 bn is for the BoG and EUR 6.8 bn is on other debt mainly to the private sector.

In terms of interest payments over this period, EUR 3.6 bn is due on the Eurosystem ANFA and SMP bonds, EUR 2.7 bn on the new Greek government bonds issued after the PSI exchange and mostly held by the private sector, EUR 1.6 bn on the EFSF PSI and bond interest facilities (which is not deferred), EUR 1.3 bn on the IMF loan and EUR 1.2 bn on the GLF loan.

#### *c. Fiscal needs*

Compliance with the primary fiscal targets of the second programme, would have allowed the primary balance surpluses to contribute to lower financing needs. The second programme fiscal primary target path were a surplus of 1.5% of GDP in 2014, 3% in 2015, 4.5% in 2016-17, 4.3% in 2018-20 and 4% in 2021-22. This would have resulted in internal financing of some EUR 24 bn over the programme period. Maintaining those targets would be highly pro-cyclical. Every percentage point change in the targets will cost about EUR 1.8bn per year. In this respect, guidance from the Eurogroup would be appreciated, in light of the implications for programme financing.

The primary fiscal deficits which are in accrual terms need to be adjusted to cash to calculate the overall financing needs. The cash-accrual adjustment depends on the final measures agreed with the Greek authorities and is estimated at EUR 2 bn for the period July 2015 to July 2018. Overall, assuming implementation of fiscal measures to reach a primary surplus of 3.5% by 2018, it is expected that the fiscal primary balance will lower financing needs by EUR 6 bn during this period.

The authorities also need to clear arrears given the tight financing conditions. Arrears clearance based on latest data available is estimated at EUR 7 bn over the programme period.

#### *d. Cash buffer for deposit build-up*

The absence of programme disbursements since August 2014 and the complete lack of market access since October 2014 have forced the authorities to use internal resources to honour internal and

external debt service payments. As a result, the liquidity situation has become very tight and total State deposits had decreased to below EUR 1 bn by end-May 2015. The programme should allow re-building deposits to the EUR 5 bn level at the end of 2015 which had been agreed during the second adjustment programme. The total State deposit level is projected to remain constant at EUR 5 bn over the medium to long term. The build-up of State deposits would require an additional EUR 4.5 bn. The IMF is of the view that given the accumulation of external arrears, it is necessary to build an additional amount of EUR 3 bn to build a buffer for State deposits of EUR 8 bn.

#### *e. Privatisation proceeds*

Since the imposition of capital controls, it is no longer realistic to assume a re-privatisation of banks. This together with a weak track record so far and uncertainty on the commitment on the part of the authorities to privatise non-bank assets have led to a strong downward revision of the privatisation receipts expected over the programme period. The latter currently amount to EUR 2.5 bn until July 2018 while the IMF estimate is EUR 1.5 bn.

#### *f. Unwinding of repo operations*

The Greek fiscal framework did not allow inter-governmental borrowing amongst the various general government entities. As a result more expensive external borrowing was used to cover part of the State financing needs. Since Spring 2014 the Greek authorities implemented legislation that allowed general government entities to conduct repo operations with the State thereby covering part of its financing needs, while crowding out liquidity available to the private sector. This was meant as a temporary tool until the authorities implemented an in-depth cash management reform that would allow using part of the repo operations as a permanent source of funding.

Since the liquidity shortage the authorities have had to increasingly rely on repo operations to meet internal and external financing needs. The total stock of repo operations increased to EUR 10.5 bn by end-June 2015. Of this total stock we estimate that EUR 7 bn can be considered a permanent source of funding, while the remaining EUR 3.5 bn would have to be unwound and replaced with other sources of funding.

Based on all the elements above total gross financing needs for the programme period are estimated at the current juncture around EUR 82 bn. The IMF staff estimates are some EUR 4 bn higher, mostly due to higher state deposit build up.

### **Total financing sources**

#### *a. SMP/ANFA profits*

Total SMP and ANFA profits until July 2018 amount to EUR 7.7 bn. If agreed by Member States, the SMP profits of 2014 and 2015 (totalling EUR 3.3 bn), although insufficient, could be used in July to July to repay arrears to the IMF and other upcoming payments. SMP profits of 2016, 2017 and 2018 could also be used for subsequent programme financing.

Over the July 2015-July 2018 period, Greece is expected to receive EUR 2.7 bn in SMP profits (excluding the 2014 and 2015 profits used for urgent debt payments) and EUR 1.7 bn in ANFA profits from the other Member States and the BoG, reducing financing needs accordingly.

**Table. Greece financing envelope for new programme**

	<b>New 3-year ESM programme from the beginning</b>
	Aug 15-end Jul 18
<b>Gross financing needs</b>	<b>81.7</b>
Amortisation	33.8
Repayment IMF and BoG loans	2.1
Interest payments	17.8
Arrears clearance	7.0
Cash buffer for deposit build-up	4.5
Privatisation (-)	-2.5
Cash general government primary surplus* (-)	-6.0
Bank recapitalisation	25.0
<b>Potential Financing sources</b>	<b>7.7</b>
SMP/ANFA profits	7.7
<b>Financing gap</b>	<b>74.0</b>

*Note:* The cash primary balance is calculated based on the accrual fiscal targets and adjusted to cash. Although the programme is expected to start only at the beginning of August, the programme financing envelope also covers the clearance of the external arrears and the financing gap of July.

*b. IMF*

At this stage, in light of the arrears to the IMF it is impossible to predict how much the IMF could contribute to the programme. Under the current EFF, the IMF has an amount of around EUR 16 bn undisbursed. At this stage, in light of the arrears to the IMF, the IMF is not in a position to contribute to the programme. The preferred creditor status of the IMF needs to be acknowledged. Arrears to the IMF need to be cleared before the IMF is able to disburse. Furthermore, the IMF staff indicated that it would need sufficient assurances--through much stronger prior actions or or by waiting for an extended period to allow the authorities to build a track record of strong policy implementation--that arrears will not reoccur before new financing is disbursed.

*c. Access to market financing*

The main purpose of ESM financial assistance accompanied by a macroeconomic adjustment programme is to allow the beneficiary member to gradually regain market access at affordable costs. While it is difficult to forecast when and to which extent market access is regained, it is consistent with past experience (including Greece itself) assuming that from the second half of the programme horizon, a beneficiary member state is able progressively to tap the markets. The amount raised in the markets will obviously reduce the amount of resources to be provided by the official sector.

Provided overall current market conditions and the search for yield, market access of Greece could even start earlier provided that a credible reform path is pursued by the government.

## **Conclusion**

***Given the projected financing needs and sources above, Greece is expected to have a financing gap in the range of EUR 74 bn plus over the July 2015–July 2018 period that would need to be covered by new external financing. The IMF considers that this estimate should be EUR 4 bn higher. Given the profile of the needs, the disbursement will have to be frontloaded.***