

Rating Object	Rating Information	
HELLENIC REPUBLIC (GREECE) Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Assigned Ratings/Outlook: B+ /stable	Type: Monitoring, unsolicited
	Initial Rating Publication Date: Rating Renewal:	23-12-2016 21-12-2018
	Rating Methodologies:	"Sovereign Ratings"

Rating Action

Neuss, 21 December 2018

Creditreform Rating has raised its unsolicited long-term sovereign rating on the Hellenic Republic to "B+" from "B-". Creditreform Rating has also raised Greece's unsolicited ratings for foreign and local currency senior unsecured long-term debt to "B+" from "B-". The outlook is revised to "stable".

Contents

Rating Action.....	1
Key Rating Drivers	1
Reasons for the Rating Decision ..	1
Rating Outlook and Sensitivity.....	10
Economic Data	10
Appendix	12

Key Rating Drivers

1. Greece's economic recovery should continue in 2018/19, but has to be set against vulnerabilities owing to the country's growth model and weak medium-term growth prospects due to demographics, stalling productivity growth, and a cumbersome business environment hampering investment
2. Compliance with program targets led to subsiding political tensions with EU and paved the way for exit from the ESM program in August 2018; political instability has waned, persisting inefficiencies in public administration as well as high levels of perceived corruption continue to impair the institutional set-up
3. While primary surplus surprised on the upside again in 2017, targets for 2018 and 2019 should be met in view of favorable macro outlook, reform progress, and spending discipline; extraordinarily high debt-to-GDP ratio set to decline sharply from 2019 onwards; debt affordability concerns mitigated by a stable investor base and very long tenor of EFSF/ESM program loans
4. Banking sector entails large contingent liability risks; capital and liquidity metrics have stabilized, but poor asset quality remains a significant burden and continues to impair monetary policy transmission
5. Despite highly negative net international investment position, external risks appear limited given that the bulk of external debt is held by official creditors; current account should remain broadly balanced

Reasons for the Rating Decision

Creditreform Rating has raised its ratings on the Hellenic Republic to "B+" from "B-". Our decision is underpinned by (i) resuming GDP growth coupled with improving labor market conditions; (ii) further progress on the implementation of key structural reforms leading to

a successful conclusion of the ESM program; and (iii) repeated outperformance of budgetary targets, and the Eurogroup's approval of additional debt relief measures.

The Greek economy entered into moderate recovery last year. After stagnating in 2016 (-0.2%), real GDP edged up to 1.5%, marking the highest growth rate since 2007 (+3.3%). However, the economic upturn remained comparatively weak given that the economy has contracted by more than 25% between 2007 and 2016. In 2017, Greek GDP growth was the weakest in the euro area (+2.4%) and significantly lagged behind other former program countries such as Portugal (+2.8%), Cyprus (+4.2%) or Ireland (+7.2%).

Last year's economic expansion was mainly driven by strengthening domestic demand. Private consumption, which has heavily weighed on Greece's macroeconomic performance over the last decade, appears to have bottomed in 2016 (+0.0%) and returned to growth last year. On the back of gradually improving labor market conditions and modestly rising nominal wages, household spending increased by 0.9% y-o-y. Furthermore, 2017 witnessed a pick-up in investment activity. Growth in gross fixed capital formation almost doubled from 4.7 to 9.1%, thereby contributing the bulk (1.1 p.p.) to the increase in total output. The latest increase in investment was largely driven by higher spending on machinery and equipment, which expanded by 22.2% on the heels of an 11.4% decline in 2016. Above all, expenditures on transport equipment, including rather cyclical shipping investments, skyrocketed by 50.9%, reaching the highest level since 2011. On the other hand, investment dynamics were curtailed by weak construction activity. Following an extraordinarily strong 2016 (+29.2%), construction investment remained flat (+0.4%), mainly due to base effects. Accelerating growth in domestic demand lifted import volumes, resulting in a slightly negative contribution of net external trade in 2017 (-0.3 p.p.). For the first time since 2014, imports have shown meaningful growth and expanded by 7.1% (2016: +0.3%). To be sure, Greek exports performed exceptionally well last year. In real terms, exports of goods and services increased by 6.8% in 2017 (2016: -1.8%), as tourism and transport services boosted Greek service exports. As revealed by balance of payments data, export receipts from travel were up 10.8%, while the number of foreign visitors rose from 28.1 to 30.2m in 2016-17 (+7.4%). Meanwhile, improving fundamentals for the global shipping industry, reflected by increasing freight rates, boded well for sea transports. In 2017, receipts from sea transports rose from EUR 10.6 to 12.4bn (+17.4%), hitting a six-year high.

Into the first nine months of 2018, Greece has continued on its recovery path, displaying robust quarterly growth rates. The Greek economy was thus off to a strong start in 2018 (Q1: +2.5% y-o-y, seasonally and calendar adjusted), before growth eased somewhat in the second quarter (+1.7%). According to latest national accounts data, growth regained momentum in Q3, with real GDP recording a yearly growth rate of 2.2%. Assuming no significant slowdown in Q4, we project total output to increase by 2.1% in 2018. Private consumption is set to remain on its 2017 growth trajectory, underpinned by improving consumer sentiment. Although the European Commission's Economic Sentiment Index has somewhat weakened in Q3-18, falling from 102.5 (Jun-18) to 101.3 points (Sep-18), consumer sentiment is still consistent with solid growth in private consumption. Further-

more, household spending should be supported by sustained employment growth and modestly rising disposable incomes. Alongside the implementation of some tax relief measures, accelerating nominal wage growth should bolster consumers' purchasing power. Nevertheless, we expect growth in consumer spending to remain muted in 2018/19 against the backdrop of households' highly negative saving rate. During the last decade, the protracted economic downturn was accompanied by a steep fall in disposable income, with households drawing down their savings to smoothen consumption. As a result, the savings ratio entered negative territory in 2012 (-0.1%) and continued to fall in the years thereafter. We note that the ongoing macroeconomic improvement has not yet led to a reversal in private savings. In 2017, the savings rate dropped from -6.9 (2016) to -7.2%, falling to a record-low.

At the same time, investment is likely to remain volatile. Although capital controls were further relaxed and the successful conclusion of the ESM program in Aug-18 has significantly reduced uncertainty over the economy's near term growth prospects, gross fixed capital formation should pull back in 2018 before starting to rise again next year. At present, spare capacity in the Greek manufacturing sector remains sizeable, pointing to limited need for a build-up of additional production capacities. Throughout 2018, capacity utilization in the industry sector has been broadly stable, still running below its long-term average (Q4-18: 70.9% vs. 1982-2017 avg. 73.8%). Against this background, price pressure should increase only gradually. This year, we expect HICP inflation to come in at 0.8% (2017: 1.1%), before higher energy prices should lift inflation to a still moderate 1.2% in 2019. What is more, weaker investment is set to weigh on import demand. As illustrated by quarterly national accounts data, imports were broadly flat in the first half of the year. Concurrently, exports stepped up a gear, expanding at rates of 8.1 and 9.2% y-o-y in Q1 and Q2-18 respectively (Q4-17: +5.9%). Export growth was broad-based, with positive contributions from goods and services. Above all, tourism continued to perform exceptionally well. Over the first six months of the year, tourism receipts grew by 17.2% as compared to the first half of 2017. As a result, net exports are set to take over from domestic demand as the main driver of economic growth in 2018.

Looking ahead into 2019, GDP growth should continue to firm, prospectively reaching 2.2%. With the economic cycle in the EU becoming more mature, export dynamics are likely to slow down somewhat. However, weaker external demand should be more than offset by sustained growth in domestic demand. Aided by an accelerating absorption of ESI funds, growth should be increasingly driven by investment. At the same time, consumption should be bolstered by fiscal stimuli (see below), and sustained job creation. We expect positive labor market dynamics to carry over into 2019. The third quarter of 2018 marked the seventh consecutive quarter with positive employment growth (Q3-18: +1.3% y-o-y). Concurrently, the number of unemployed declined further. Decreasing from 20.9 (Q3-17) to 18.8% in Q3-18, the unemployment rate fell below the 20%-mark for the first time since 2011, but remained significantly above euro area levels (8.1%). Though remaining extraordinary high, long-term and youth unemployment have also receded since our last review. Youth unemployment (<25y), which had peaked at 59.6% in Q1-13, fell from 40.7 to 37.0% between Q3-17 and Q3-18. As regards labor market reforms, the

government's focus seems to have shifted in light of improving macroeconomic conditions. While reforms under the economic adjustment program were designed to restore price competitiveness in the first place, the government now aims to mitigate wage inequality, rolling back some unpopular measures implemented in 2010-12. Since Greece concluded the economic adjustment in Aug-18, mandatory collective bargaining has been reinstated in several sectors (e.g. banking, travel agencies and maritime shipping). In addition, the government announced it would increase minimum wages next year, partly restoring the cuts introduced in 2012. We also expect that the reduced minimum wage for workers aged 15-24 years will be phased out, as the necessary legislation for a prolongation has not been passed.

Although a greater emphasis on labor market inclusiveness is arguably important, the eventual impact of the latest policy measures on labor costs has to be monitored closely. In this context, we note that real unit labor costs were stable 2015-17. Keeping unit labor costs in check appears vital, as the Greek economy remains highly exposed to sectors we consider as cyclical or sensitive to a deterioration in price competitiveness. Trade, transport and accommodation, which includes the important tourism sector, contributed 21.2% to GDP alone (2017). On the other hand, the industrial sector and high value-added services play only a minor role. At the latest count, ICT and professional services accounted for only 3.0 and 4.6% of GDP respectively, both the lowest shares in the EU-28. The implementation of the "Growth strategy for the future" published in July could help achieve a higher degree of economic diversification in the medium term. Among others, the strategy proposes to promote innovative and high value-added tradable sectors.

In our view, diversifying the economy towards industries with a higher value added would not only enhance economic resilience, but also help to spur income convergence. As illustrated by IMF data, Greece exhibited a GDP per capita of USD 27,796 (PPP terms) in 2017, which we regard as rather high for a B-rated sovereign. However, it has to be highlighted that the income gap towards the EU-28 has significantly widened over the recent years. Since Greece requested official financial assistance, GDP per capita has dropped from 85.9 (2010) to 67.2% (2017) of EU-28 levels, and CEE countries such as Poland, the Slovak Republic and Hungary have overtaken Greece in terms of personal wealth.

Despite our expectation of robust growth in 2018-19, medium-term growth prospects are comparatively weak due to a confluence of multiple factors. Firstly, unfavorable demographic trends are here to stay, putting a lid on future employment growth. As Eurostat data illustrates, the Greek population exhibited an average population decline of 0.4% p.a. in 2010-16, largely driven by highly negative net migration. Over this period, net outward migration in the age group 15-64y added up to almost 250,000. Going forward, net migration should recede somewhat but labor supply is set to shrink further in view of a rapidly ageing population. According to the EU's 2018 ageing report, the population share of people at working-age is projected to drop by another 3.2 p.p. by 2030, down from an already low 64.2% in 2016 (EU-28: 65.2%)

Secondly, challenges related to a decreasing working-age population are compounded by anemic productivity growth. In fact, weak productivity appears to be a major weakness of

the Greek economy. Growth in total factor productivity (TFP) has essentially stagnated in the period since 2000, averaging at -0.1% per year. Hence, productivity trends compare unfavorably with the euro area, where TFP growth averaged at 0.4% in 2000-17. According to preliminary OECD data, product market regulation has been lowered only marginally since 2013, as implementation of product market reforms was often sluggish and subject to delays. To unlock productivity growth, Greece continued to adopt competition-enhancing reforms last year. That being said, Greece adopted 365 of 366 recommendations identified in the course of the OECD's competition assessments (Toolkit III) up to Apr-18, aiming to alleviate market access in various industries. Furthermore, the government is pushing ahead with reforms intended to boost competition in network industries. After a national energy exchange was established in Nov-18, state-owned electricity utility Public Power Corp. is expected to spin-off some assets in early 2019 to further unbundle energy supply and distribution. In general, these measures should be conducive to the economy's medium-term growth potential, but their effectiveness remains to be seen.

Thirdly, a protracted period of subdued investment activity stemming from economic uncertainty and deleveraging efforts in the public and private sector has eroded the economy's capital stock. The net capital stock of the Greek economy shrank by 6.7% in 2008-17 (AMECO data), as gross fixed capital formation lagged behind EA-19 levels for almost a decade. Although the investment-to-GDP ratio increased slightly from 12.1 (2016) to 12.9% in 2017, it has almost halved since 2008 (23.8%) and remains the lowest in the euro area by far (20.6%). Low capital spending in the private sector also left its mark on real labor productivity, which decreased by 12.2% in 2008-17. Lifting investment to its pre-crisis levels could be facilitated by stronger FDI inflows, in our view. We acknowledge that foreign direct investment has somewhat recovered over the last two years. FDI inflows thus rose from EUR 1.15 to 2.45bn in 2015-16, before increasing to 3.20bn last year, mainly reflecting foreign investment in the energy and transport sector. Still, Greece exhibited a significantly lower FDI stock as compared with countries at similar income levels. In 2017, total FDI liabilities amounted to 17.6% of GDP, the second-lowest level observed in the EU-28.

We believe that further efforts to improve the business environment are a prerequisite for attracting FDI on a larger scale. According to the World Bank's 2019 Doing Business report, conditions for entrepreneurs remain challenging in Greece. Slipping from rank 67 to 72 out of 190 economies, the country ranked second to last in the EU-28. Thus, the quality of the Greek business environment resembles that of the Ukraine (rank 71) and Indonesia (rank 73). In particular, property registration and contract enforcement stand out as major weaknesses, with Greece ranking 153 and 132 on the respective sub-components. On a positive note, authorities continue to remove obstacles to doing business. In July 2018, investment licensing was facilitated by launching one-stop shops for investors. Meanwhile, the establishment of cadaster with technical support by the World Bank is advancing, as well as the implementation of an integrated judicial case management system. The latter should contribute to a further acceleration of court proceedings. As underscored by the 2018 EU Justice Scoreboard, the time needed to resolve administrative cases has almost halved from 2,003 days in 2010 to 1,086 days in 2016. Notwith-

standing, the length of proceedings still compares unfavorably with most EU peers, as the judicial system struggles with a significant backlog of pending cases.

Greece's poor business environment is mainly a result of entrenched institutional weaknesses, which continues to constrain the sovereign's rating. The recently updated Worldwide Governance Indicators (WGI) for 2017 illustrate that Greece continues to display high levels of perceived corruption and low public governance standards. As compared to its euro area peers, the country scores below average on all WGI's. It is also noteworthy that technical and administrative support by multilateral institutions such as the EU, the IMF, and OECD has not yet translated into improving institutional quality. By contrast, the sovereign has fallen several places as regards the WGIs control of corruption and government effectiveness. Concerning the quality of public administration and the prevalence of corruption, Greece dropped from rank 65 and 92 (out of 209 countries) in 2010 to 71 and 100 respectively in 2017 (EA-19 median: rank 33 and 41).

In our view, institutional quality was adversely affected by weak ownership and a lack of political stability. Since the beginning of its first economic adjustment program in 2010, Greece has seen seven prime ministers and multiple cabinet reshuffles. Political instability culminated in 2015, when PM Tsipras held a referendum on the country's euro area membership. More recently, political uncertainty has receded. As the Greek authorities delivered on the required reforms according to schedule, the third and fourth program reviews were concluded on time, paving the way for Greece's program exit on 20 August 2018. Looking ahead, the EU's enhanced surveillance framework combined with the conditionality of some debt relief measures (see below) agreed by the Eurogroup in June has lowered the risk of significant policy slippages in the aftermath of the 2019 general elections. Currently, the electoral outcome is difficult to predict but conditionality should provide any new government with a strong incentive to avoid backtracking on past reforms. Turning to monetary institutions, we view advantages associated with Greece's euro area membership, namely access to broad and deep capital markets and the euro's reserve currency status, as balanced by limited monetary policy flexibility. In the case of Greece, the latter appears in particular important, as price and wage developments have been not well synchronized with the euro area.

Apart from institutional shortcomings, the sovereign's key credit weakness continues to lie in its exceptionally high debt levels and a weak banking sector, which represents a contingent liability risk for Greece's public finances.

We assess that the government's budgetary position has vastly improved in the recent past. In 2017, Greece outperformed the deficit targets stipulated in the Memorandum of Understanding for the third consecutive year. According to the program definition, which excludes several items such as privatization proceeds and one-offs for bank recapitalization, the primary surplus climbed from to 3.8 (2016) to 4.1% of GDP last year, exceeding the 2017 program target (1.75% of GDP) by a wide margin. The headline balance also improved, increasing from 0.5 to 0.8% of GDP. Last year's budgetary outperformance was mainly driven by the expenditure side of the budget. While revenues essentially stagnated (-0.7%), developing broadly in line with expectations, spending (-1.2%) was significantly lower than anticipated. The bulk of the budgetary improvement can be at-

tributed to under-execution on the government's public investment budget (PIB), reflecting a lackluster absorption of EU funds and administrative bottlenecks. PIB expenditure totaled EUR 5.87bn in 2017, significantly lower than initially budgeted (EUR 6.75bn). In addition, lower outlays on pensions had a positive impact on the budget balance. Partly due to delays in the processing of claims and tighter eligibility criteria introduced by the 2016 pension reform, spending on pensions fell by 4.0% (EUR 1.2bn). We also note that the government continued to contain spending on employee compensation (+0.4%). As measured by GDP, spending on the public wage has been trending downward since 2012 (12.8%), decreasing to 11.9% in 2017.

As indicated by budgetary developments in the first nine months of the year, the state is likely to over-achieve its fiscal targets again in 2018. Up to September, the sovereign has run a primary surplus of EUR 5.19bn, equivalent to 3.8% of GDP. Accordingly, we expect the primary surplus to broadly remain at this level until the end of the year. In this context, it has to be highlighted that growth in tax revenues gained some momentum in the first nine months, exceeding the previous year's level by 4.5%. In particular, VAT and PIT receipts exhibited strong growth, expanding by 6.3 and 11.4% y-o-y. Mirroring a ruling of the Council of State, which provided for the refund of wages to public officials, spending on employee compensation rose by 4.4%. However, this was more than offset by low PIB expenditures, which remained well below the spending ceiling.

With regard to 2019, we expect the Greek government to maintain its prudent fiscal stance. Under a no-policy change scenario, the primary surplus would post at approx. 4% GDP next year – well above the 3.5% program target. Against this backdrop, pre-legislated pension cuts will not enter into force in Jan-19, and Greece has some fiscal leeway to implement a fiscal policy package targeted towards the reduction of social inequality and lowering labor costs. As laid out in the 2019 budget, authorities will introduce a new rent and housing subsidy scheme worth 0.2% of GDP. To improve labor market access for young people, the government also envisages subsidizing social security contributions. The measure will cover workers up to the age of 24y and will consist of a 100% subsidy for employees' contributions and a 50% subsidy for employers' contributions. On the revenue side, the government has budgeted some tax relief measures. Social security contributions will be lowered by 33% for self-employed, independent professionals and farmers and the unified property tax (ENFIA) will be reduced by 10%. Revenue losses associated with the implementation of these measures should add up to 0.2% GDP.

Even though fiscal sustainability risks have moderated, Greece faces some medium-term challenges regarding the stability of public finances. Problems pertaining to tax collection are an impediment to lower statutory tax rates, which would be conducive to growth. Both the low use of non-cash payments and the large VAT-gap (2016: 29.2%) indicate that there is significant scope to improve revenue collection. At the same time, Greek taxpayers' debt to the state totaled at EUR 103.1 EUR (57.2% of 2017 GDP) in Sep-18 – one of the highest figures among OECD members. In order to enhance revenue collection, Greece forged ahead with the implementation of the IAPR Reform Action Plan 2018-20. The plan envisages, among others, increasing human and technical resources at the Independent Authority of Public Revenue (IAPR) and improving tax audit processes. On

the expenditure side, pending court rulings on the abolition of the 13 and 14th monthly salary and pension cuts for public sector employees represent a major downside risk to public finances. If the aforementioned reforms were eventually ruled unconstitutional, this would put pressure on the public wage bill. In the same vein, political pressures to water down welfare reforms could reemerge in light of a rapidly ageing population. The Greek old-age dependency ratio, at 33.6% (2017) already the second highest in the EU-28 (29.9%), could rise by 11.3 p.p., reaching 44.9% in 2030. Currently, Greece is progressing with the implementation of ambitious reforms in the areas of pension and healthcare. Alongside the introduction of centralized healthcare procurement, a new pension formula and the consolidation of various pension funds should help to contain age-related spending.

Driven by favorable fiscal developments and resuming growth, public indebtedness experienced a moderate decline in 2017, with the debt-to-GDP ratio falling from 178.5 (2016) to 176.1% of GDP. This year, government debt is set to increase temporarily owing to sizeable stock-flow adjustments. Over the course of 2018, the ESM disbursed EUR 21.7bn to Greece. These funds were partially allocated towards the clearance of government arrears. Drawing on Ministry of Finance data, the stock of arrears (incl. tax refunds) decreased from EUR 3.3bn at the end of 2017 to EUR 2.6bn in Oct-18. Another EUR 9.5bn was used for building up a cash buffer (see below). As a result, the sovereign's debt-to-GDP ratio should increase to levels in the order of 183% in 2018. From 2019 onwards, sustained and sizeable primary surpluses coupled with robust GDP growth should help to put government debt on a steep downward trajectory. We expect that the debt-to-GDP ratio falls below the 170%-mark by 2020. We do not factor potential early repayments of loans into our debt projection. More recently, authorities expressed their intention to redeem IMF and ECB loans ahead of schedule, but both timing and scope of early repayments are currently subject to uncertainty. The same applies to potential proceeds from privatizations. In 2018, we have seen some progress on the sale of national gas system operator DESFA and the prolongation of concessional agreement with airport operator Athens International Airport S.A in Nov-18, enabling the full privatization of Athens International Airport. However, the privatization process of regional ports and Egnatia motorway is subject to delays.

Although the sovereign's exceptionally high debt levels will continue to limit its fiscal flexibility over the coming years, debt affordability is no imminent reason for concern. As illustrated by our preferred measure, interest expenditure-to-revenues, Greece exhibited moderate interest outlays last year. At 6.5%, the sovereign's interest-to-revenue ratio was the lowest among all former program countries (CY: 6.6%, IE: 7.6%; PT: 8.9%). Having said this, debt affordability is aided by a very favorable composition of government debt, as Greece continues to benefit from a significant share of multilateral loans with low interest rates and long maturities. Official debt, which includes IMF and EFSF/ESM program loans, made up for 75% of the sovereign's debt stock in Q3-18, and the weighted average maturity (WAM) posted at 18.5 years. Taking into account recent debt relief measures agreed on by the Eurogroup in June, the WAM, already the highest in the EU-28, is set to rise further. In November, the EFSF/ESM board approved a deferral of inter-

est and amortization by 10 years on EUR 96.4bn of EFSF loans. Initially, these loans were scheduled to be repaid from 2023 onwards. Further debt relief measures, namely the abolition of the step-up interest rate margin until 2022 and the reimbursement of ECB profits on Greek bond holdings, are conditional on the continued implementation of key reforms under the ESM program. Against this background, the share of marketable debt will increase rather slowly over the coming years.

We note that Greece continues to issue medium-term debt at reasonable rates. After the issuance of a 5y-bond in July 2017, Greece issued a EUR 3.0bn bond due in 2025 with a coupon of 3.375% in February 2018. Still, financing conditions remain susceptible to sudden swings in investor sentiment as underpinned by volatile yield developments in the second half of 2018. Having fallen from 4.5 to 3.8% between June and July, the 10y bond yield trended upwards in the months thereafter, reaching 4.6% in Nov-18. Hence, PDMA's strategy to hold a strong cash position appears reasonable in our view. As of Q3-18, Greece's cash buffer of EUR 26.5bn (14.7% of 2017 GDP) is sufficient to cover gross public financing needs for almost two years. In general, gross financing needs appear manageable. After the implementation of debt relief measures, gross financing needs should average at around 10% of GDP in 2019-22.

We continue to regard contingent liabilities in the banking sector as the most significant risk to fiscal consolidation. Currently, the state is holding stakes in three out of four of the country's largest lenders. As of Q2-18, the government held 11.0% in Alpha Bank, 26.4% in Piraeus Bank and 40.4% in National Bank of Greece via the Hellenic Financial Stability Fund. At the same time, recent developments in the Greek banking sector give a mixed picture. Following three rounds of recapitalization since 2010, Greek banks display solid capital buffers. Although the CET1-ratio fell from 17.2 to 15.8% in the year up to Q2-18, it remained slightly above the EU-28 average (14.5%). An ECB stress test conducted in Feb-18 confirmed that the four systemic banks maintain sufficient buffers to absorb additional credit losses in the event of a severe economic downturn. We also note that banks have markedly improved their liquidity position. At the beginning of the year, banks regained access to the interbank market and the domestic deposit base (excl. government deposits) has grown steadily in 2018, allowing a further loosening of capital controls. While private sector deposits increased by EUR 6.95bn (+5.6%) between January and September, ELA funding declined from EUR 17.4 to 3.58bn over the same period.

Notwithstanding, bank balance sheets are still burdened with a very high portion of non-performing loans, even though NPLs (all banks on a consolidated basis) continued to decline in absolute and relative terms in the year up to Q2-18. The total volume of impaired loans fell by EUR 12.9bn (-12.7% y-o-y) between Q2-17 and Q2-18, with the NPL ratio decreasing from 49.1 to 47.8% (Bank of Greece data). To be sure, the lower NPL ratio was mainly as a result of write-offs (EUR 7.5bn), and to a lesser extent of the sale of impaired loans. In general, we expect write-offs to remain the primary driver of NPL resolution over the coming months, although sales and securitization gained some momentum. In Jul-18, private equity investor KKR struck a deal with a Greek banking syndicate to invest in another portfolio of impaired loans. More recently Eurobank announced plans to securitize EUR 7bn in NPLs.

In our view, a significant reduction of the still sizeable stock of NPLs will be a tedious process going forward. If implemented, a proposal unveiled by the Bank of Greece in Nov-18, could help to accelerate NPL resolution. Under the proposed scheme, which envisages the establishment of a bad bank, banks would transfer a significant part of their NPLs to a special purpose vehicle.

Moreover, NPLs continue to constrain the lending capacity of the Greek banking sector and also has a negative impact on financing costs. As indicated by ECB data, the outstanding credit volume to the private sector has been in decline since mid-2011 and there are no signs of a recovery yet. Credit outstanding to households and NFCs still posted negative y-o-y growth of 6.2% in Oct-18.

The external position of the Greek economy remained fundamentally unchanged in 2017. The current account balance came in at -1.0% of GDP last year, in line with its 3y-average in 2014-16. As compared to 2016 (-1.3% of GDP), the current account deficit narrowed slightly, as a somewhat higher deficit of trade in goods was more than offset by a stronger trade in services balance. Mainly due to record earnings in the tourism sector and an improving business environment for the Greek shipping industry, the trade in services surplus increased by 1 p.p. to 9.8% of GDP in 2016-17. Meanwhile, the trade in goods deficit widened from 9.5 to 10.3% of GDP owing to accelerating import demand in the context of last year's pick-up in investment. The current account should remain broadly balanced, as we expect no excessive use of foreign savings to fund domestic demand as seen in 2000-10. We also believe that the economy's net international investment position, which amounted to -142.5% of GDP last year, will remain among the most negative in the EU-28 in the medium term. Alongside central bank debt, long-term debt securities and loans to the government sector make up the bulk of external liabilities. Usually, a large share of interest-bearing external liabilities renders an economy vulnerable to sudden shifts in investor sentiment. Having said this, the bulk of Greece's external debt is held by official creditors, which are strongly committed to the current economic adjustment program. Hence, we view the extraordinarily high level of net external debt (2017: 136.2% of GDP) as no immediate threat to the stability of the Greek economy.

Rating Outlook and Sensitivity

Our outlook on the long-term sovereign rating is stable, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – is likely to remain fundamentally unchanged over the next twelve months.

We could raise the sovereign rating or the outlook if medium-term growth turns out to be substantially higher than expected. Such a scenario could materialize if broad political consensus on the implementation of structural reforms leads to a significant improvement in the business environment, or if we see notable progress in the resolution of non-performing loans coupled with a termination of remaining capital controls. Upward pressure on the outlook or rating could also arise if we see sustained improvements in key

governance indicators or if general government debt declines faster than anticipated over the next two years.

A negative rating action could be prompted if, contrary to our belief, significant fiscal slippages were observed, leading to a further increase of the sovereign's debt-to-GDP ratio in the years beyond 2018. More generally, we could lower the rating if we perceive that already implemented reforms were watered down or reversed, jeopardizing the reform success achieved over the recent years. That said, GDP growth significantly below our current expectations also represents a downside risk.

Primary Analyst
Johannes Kühner
Sovereign Credit Analyst
j.kuehner@creditreform-rating.de
+49 2131 109 1462

Chair Person
Benjamin Mohr
Head of Sovereign Ratings
b.mohr@creditreform-rating.de
+49 2131 109 5172

Ratings*

Long-term sovereign rating	B+ /stable
Foreign currency senior unsecured long-term debt	B+ /stable
Local currency senior unsecured long-term debt	B+ /stable

*) Unsolicited

Economic Data

	2013	2014	2015	2016	2017	2018e	2019e
Real GDP growth	-3.2	0.7	-0.4	-0.2	1.5	2.1	2.2
GDP per capita (PPP, USD)	25,248	26,098	26,467	26,875	27,796	29,112	30,522
HICP inflation rate, y-o-y change	-0.9	-1.4	-1.1	0.0	1.1	0.8	1.2
Default history (years since default)	1	2	3	4	5	6	n.a.
Life expectancy at birth (years)	81.4	81.5	81.1	81.5	n.a.	n.a.	n.a.
Fiscal balance/GDP	-13.2	-3.6	-5.6	0.5	0.8	0.5	0.6
Current account balance/GDP	-2.0	-1.6	-0.2	-1.3	-1.0	n.a.	n.a.
External debt/GDP	237.3	237.5	249.1	244.4	224.0	n.a.	n.a.

Source: International Monetary Fund, Eurostat, own estimates

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	23.12.2016	B- /stable
Monitoring	22.12.2017	B- /positive
Monitoring	21.12.2018	B+ /stable

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. Neither the rated sovereign nor a related third party participated in the credit rating process. Creditreform Rating AG had no access to the accounts, representatives or other relevant internal documents for the rated entity or a related third party. Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology in conjunction with its basic document "Rating Criteria and Definitions". CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG's rating methodologies and basic document "Rating Criteria and Definitions" is published on the following internet page: www.creditreform-rating.de/en/regulatory-requirements/.

To prepare this credit rating, CRAG has used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, Ministry of Finance, Public Debt Management Agency, Bank of Greece and ELSTAT.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG's "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In

case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated, including any rating outlooks, is indicated clearly and prominently in the rating report; the first release is indicated as “initial rating”; other updates are indicated as an “update”, “upgrade or downgrade”, “not rated”, “affirmed”, “selective default” or “default”.

In accordance to Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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Creditreform Rating AG

Creditreform Rating AG

Hellersbergstrasse 11
D - 41460 Neuss

Phone +49 (0) 2131 / 109-626
Fax +49 (0) 2131 / 109-627
E-Mail info@creditreform-rating.de
Internet www.creditreform-rating.de

CEO: Dr. Michael Munsch
Chairman of the Board: Prof. Dr. Helmut Rödl
HRB 10522, Amtsgericht Neuss