

Achieving an inclusive and sustainable recovery in Greece

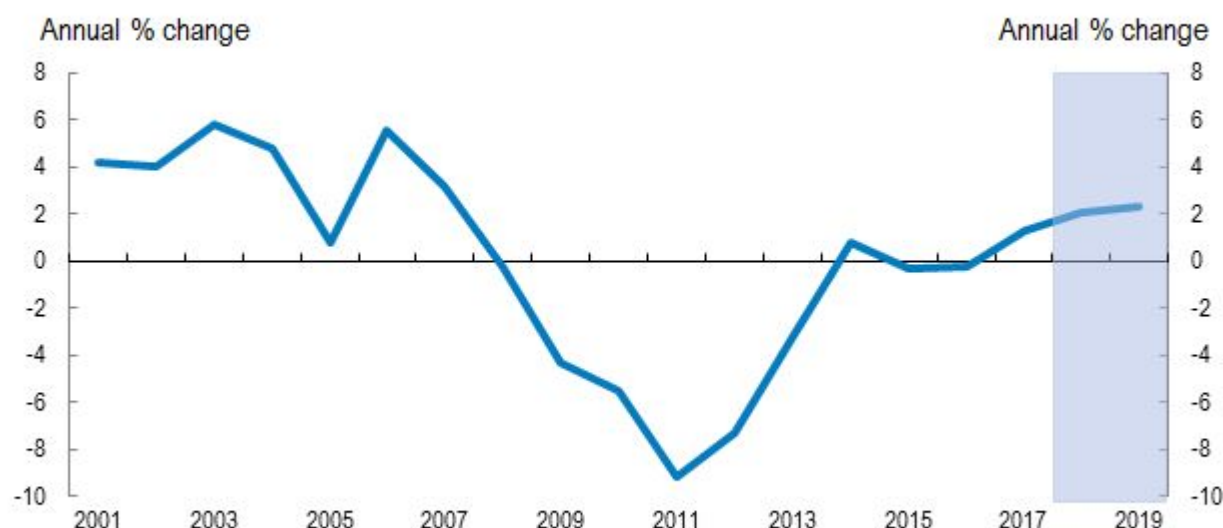
Category: Greece, Labour markets, Uncategorized

written by oecdecoscope | April 30, 2018

by Mauro Pisu and Tim Bulman, Greece Desk, Economics Department

Greece is finally recovering from a deep depression. In 2017 GDP expanded by 1.3%, according to initial estimates, and is projected to accelerate to 2% in 2018 and 2.3% in 2019 (Figure 1). Labour market reforms have improved competitiveness and exports are leading the expansion. Overall the economy is becoming more open. Exports rose from 24% of GDP in 2008 to 34% in 2017. Employment is rising strongly while the external and fiscal imbalances are being addressed. Public finances are outperforming European Stability Mechanism (ESM) Stability Support programme's targets, helping to restore fiscal credibility. Financial markets are taking notice, with bond spreads falling and agencies upgrading their ratings of Greece's public debt.

Figure 1. The economy is recovering



Source: OECD (2018), OECD Economic Outlook: Statistics and Projections (database).

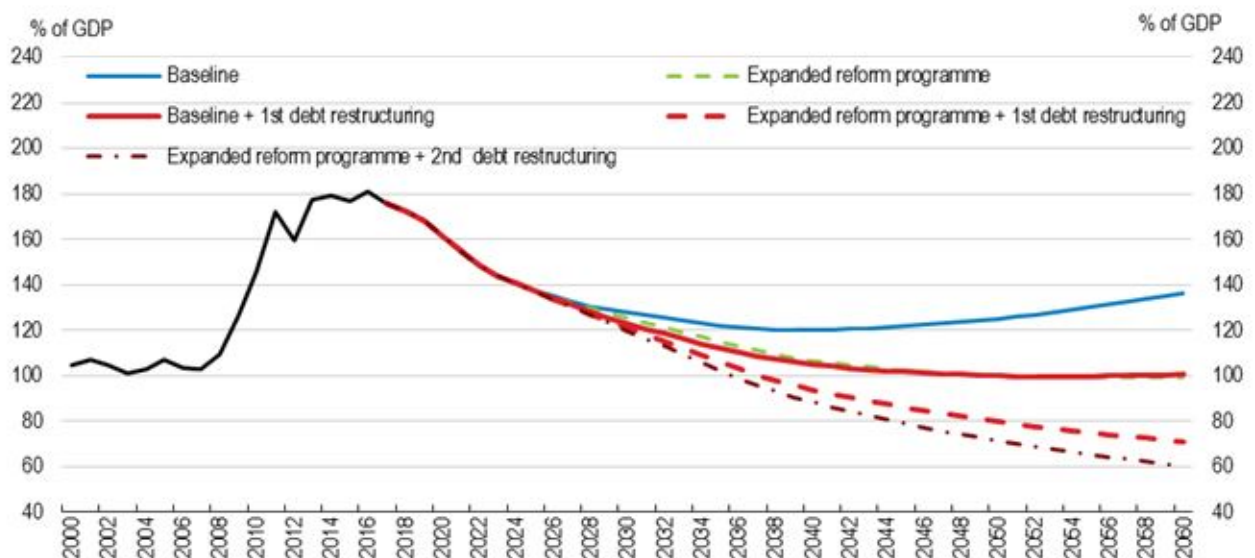
Despite these positive developments, the long crisis has left deep scars in the society that have yet to heal. GDP per capita is still 25% below its pre-crisis level. The public debt is still high. Wages are low. Though poverty has stabilised, it remains near a record high, especially among the young and families.

The OECD's 2018 Economic Survey of Greece suggests that maintaining the reform momentum and strengthening reform ownership will be essential to sustaining the recovery and moving towards a more inclusive and prosperous society. Keeping the reform momentum is crucial to tackle the three key challenges highlighted in the 2018 Survey: Improving debt sustainability, sustaining job growth and reducing poverty, boosting investment.

The public debt has stabilised but at about 175% of GDP is still one of the largest in the world. A three-pronged strategy would place this on a downward path for the long-term (Figure 2). This includes: additional pro-growth reforms; large but realistic primary surpluses; and additional debt restructuring, as needed:

- Pro-growth reforms, focusing on improving the functioning of public administration and product markets as well as boosting labour force participation, will do most to bolster long term GDP growth.
- Maintaining the primary surplus above 2% of GDP into the long-term will be challenging but can be achieved through further broadening the tax base – by improving tax collection and reducing the informal economy – and improving spending effectiveness – by using spending reviews regularly and continuing the ambitious public administration reform.
- As concerns debt restructuring, locking-in the currently low interest rates on concessional loans would reduce public debt below 80% of GDP by the 2050s, under prudent assumptions, if combined with additional pro-growth reforms.

Figure 2. Pro-growth reforms, high but realistic primary surplus and appropriate debt restructuring will reduce the debt ratio



Note: The historical data and projections to 2019 follow the Economic Outlook No. 102 and updates (for the forecast). In all scenarios, the primary budget surplus is projected to be 3.5% of GDP until 2022, then decrease to 2.2% of GDP by 2025 and remain at that level. The GDP deflator growth is expected to gradually rise to 2% by 2023. The effective market interest rate is projected to gradually rise to 5.3% by 2029. The effective interest rate of official creditors' loans (EFSF, ESM and GLF) is projected to rise to 4.2% by 2029. The baseline assumes the near-complete implementation of the current reform programme (Table 6); this raises annual real GDP growth to average 1.7% from 2020 to 2029, slowing to 1.3% over 2030 to 2039, then to 1% over the subsequent period, largely due to demographic factors. The 'Expanded reform programme' assumes implementation of the current and additional reforms (Table 6). This raises average growth rates to 2.2% by 2027, before gradually slowing after 2031 to 1.4% by 2043. In the 1st debt restructuring scenario the effective interest rates of official creditors' loans is fixed at 2% from 2020 onwards. In the 2nd debt restructuring scenario the effective interest rates of official creditors' loans is fixed at 2% from 2020 onwards and the EFSF repayments are postponed until 2031. The projections consider the short-term relief measures described in the May 2016 and June 2017 Eurogroup statements. These include: smoothening the EFSF repayment profile under the current maximum weighted average maturity; waiving the step-up interest rate margin on the EFSF debt-buyback tranche for 2017; diversifying the ESM funding strategy to reduce interest rate risk (the ESM has started implementing this measure through interest rate swaps; these projections assume that this measure will set the interest rate of EUR 50 billion in EFSF loans to 1.6% for 34 years). All scenarios include privatisation receipts of EUR 10 billion in total from 2020 to 2040.

Source: Calculations based on OECD (2017), OECD Economic Outlook: Statistics and Projections (database).

For Greece's recovery to be inclusive, it must be rich in jobs. Greece's recent labour market reforms have improved flexibility and supported job creation. However, over 1 million people are still unemployed, three-quarters for over a year. New jobs often pay the minimum wage, and are part-time or temporary. Reintroducing sectoral collective wage agreements should aim at maintaining the flexibility of the current system, ensuring wages align with productivity and better protecting individuals from labour market risks. They should cover broad working conditions and have no automatic extensions. Since small firms employ most workers, wage agreements need also to be flexible enough to take into account their specific circumstances.

The number of Greeks suffering from poverty doubled between 2010 and 2016, to almost 2.4 million on some measures, harming families with children the most. Recent reforms have already started to address this problem by better targeting social programmes. However, the many small and poorly targeted programmes and cumbersome administrative processes lower the effectiveness of and access to the welfare system. Progress towards better targeting social programmes and simplifying administrative processes should continue so as to create a fairer and more effective welfare system.

Investment has dropped by 60% since the onset of the crisis and has yet to recover, because of a mixture of weak demand, tight financial conditions and structural problems. The productive stock capital is now falling, dragging down GDP growth.

Recent reforms have already improved important areas of the investment climate, but Greece's business environment still lags other countries. Further addressing product market restrictions, improving regulatory quality and transparency through Regulatory Impact Assessments, completing the land registry, and fully implementing the legislated insolvency reforms are priorities the OECD survey highlights.

Greece also needs to continue tackling the challenges facing its banking sector. Governance standards have improved drastically but these still need to become entrenched practices. Addressing the large stock of non-performing loans will require fully implementing out-of-court workout procedures and e-auctions, and strengthening temporary tax incentives to encourage the disposal of banks' non-performing loans. Carefully phasing out capital controls, while preserving financial stability, will also be needed to restore access to finance.

References:

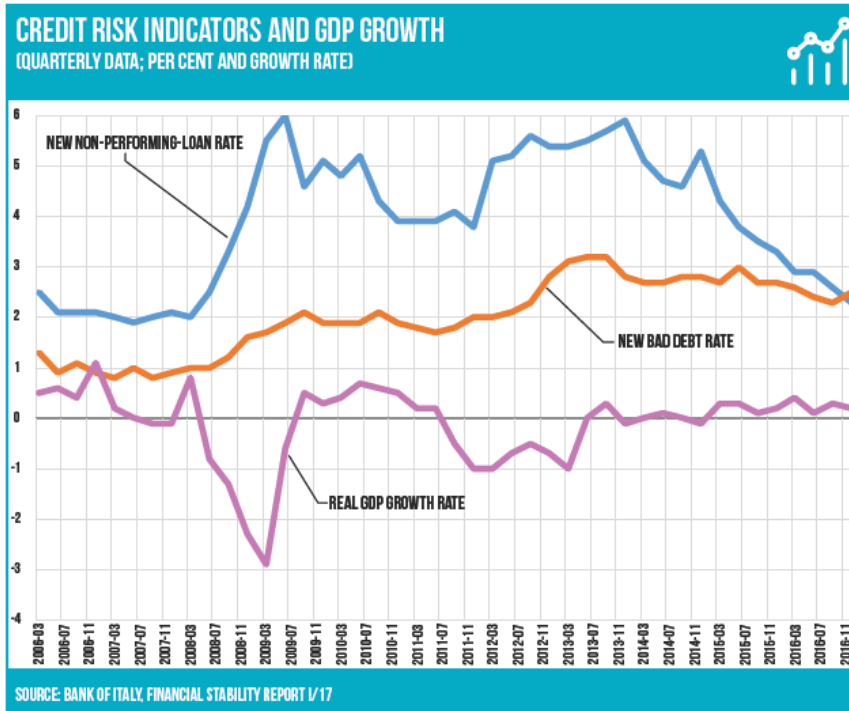
The Italian banking system at a turning point – The Italian View

Category: Italy, The Italian View, Uncategorized

written by oecdecoscope | April 30, 2018

by the Italian Ministry of Economy and Finance, Pier Carlo Padoan, Italy's Minister of finance, was OECD Deputy Secretary-General and Chief Economist from 2009-2014).

The Italian banking system has long since been waiting for a comprehensive reform addressing structural inefficiencies and structural rigidities. As of 2014, the Government has defined a comprehensive reform plan while also tackling the crisis affecting several banks.



To begin with this latter topic, three interventions involved seven banks that were experiencing major strains. The first intervention required the resolution of four small and medium-sized regional banks that led to the formation of “bridge banks” in charge of continuing operations, thus rescuing 12 billion euros in savings for about 1 million customers.

The resolution procedures ended in April 2017 with the sale of three “bridge banks” to a larger bank (UBI). BPER acquired the fourth in June 2017. Buyers were selected through a fair, open and transparent procedure. This resolution did not imply any State aid, thus requiring a major effort by the banking sector. The private sector provided 4.7 billion euros to avoid bankruptcy and its social and entrepreneurial consequences, preserving the issue of loans to over 200,000 small and medium-sized businesses, small retailers and craftsmen.

More recently, the Government intervention was addressed to the liquidation of Banca Popolare di Vicenza and Veneto Banca. After the ECB recognized the two banks as “failing or likely to fail”, the Single Resolution Board stated – under the EU Banking Recovery and Resolution Directive – that the crisis

had to be dealt with according to national insolvency rules, since a resolution was not applicable. Consequently, the Italian Government started a liquidation procedure assisted by public resources combined with the sale of some assets and liabilities of the two banks to Intesa Sanpaolo. The Government, after having shared the burden of the intervention with shareholders and junior bondholders, committed around 4.8 billion euros in cash and around 12 billion euros in guarantees for that purpose. As in previous cases, the procedure preserved the flow of credit to clients of the insolvent banks (families, businesses, craftsmen), and limited the impact on the social and business environments of one of the best performing regions in the Country.

Eventually, the precautionary recapitalization of Monte dei Paschi di Siena was approved at the beginning of July by the European Commission, as part of the restructuring plan 2017-2021, including the disposal of 28.6 billion euros of gross bad loans. The recapitalization was needed to put the bank in conditions to successfully face the adverse scenario of the stress tests that the ECB ran in 2016. The precautionary recapitalization includes 3.9 billion euros of direct capital injection and up to 1.5 billion euros of compensation in favor of retail subordinated bondholders, meeting certain conditions, whose bonds are mandatorily converted into equity.

By facing each case with a suitable solution, according to the specific nature and magnitude, both European and Italian rules could be implemented offering the best possible solutions. Improvements in the banking industry are a different matter altogether, they require a deeper and more thorough approach, to be pursued through structural reforms designed to reduce inefficiencies and address the issue of non-performing loans (NPLs).

The reform of large cooperative banks (the so-called "Popolari"), introduced as early as January 2015, aims at consolidating and bolstering the Italian banking system. Banks

included in the cluster were forced to transform into joint stock companies, and as a result, two of them merged, creating the third largest group in Italy. The reform of smaller cooperative banks promotes consolidation in the industry, as well as the adoption of more efficient business models reducing the exposure to market risks. Finally, the self-reform of banking foundations is meant to put greater emphasis on the community-based initiatives of the foundations in place of interfering with the management of participated banks.

Alongside such structural reforms of the banking sector, the Government has adopted measures to encourage the creation of a market for non-performing loans, which helps to reduce the burden of those assets and restore an adequate flow of lending to the real economy.

These provisions include the institution of a guarantee on the Securitization of Bad Loans (GACS), which is a State guarantee on ABS' senior tranches granted upon request by the banks. Changes to Italian insolvency rules and to foreclosures procedures also may help in creating a market for NPLs, as they improve the efficiency of insolvency proceedings and streamline the enforcements of creditors' rights. The legislation now includes a series of measures to reduce lead-time for foreclosures such as: competition in pre-bankruptcy agreements with creditors; acceleration of sale transactions to ensure higher NPLs value; new rules for debt restructuring; easier access to credit for troubled companies; amendment of the regulations governing the deductibility of credit losses; and agreements secured by real estate assets, where parties may agree that transfer of the assets will become effective upon default by the borrower.

Even after facing a long recession, the Italian banking sector has proven to be sound and resilient. The stock of NPLs is shrinking at an increasing pace, while the origination rate of new exposure is approaching pre-crisis level. Those comprehensive interventions on specific banks and on the

industry as a whole reduced and in some cases excluded major sources of risk. Overall, after years of adjustments, the Italian banking industry is returning to positive, effective and promising levels of performance.

Further reading:

The Narrow Path | Issue #2 | August 2017 | www.mef.gov.it | Italian Ministry of Economy and Finance

Central bank negative deposit rates and the banking sector

Category: Economic outlook, Uncategorized

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By Kei-Ichiro Inaba and Lukasz Rawdanowicz, Macroeconomic Policy Division, OECD Economics Department

The ECB, the Bank of Japan and five other central banks in Europe have applied negative interest rates on commercial banks' reserves. This additional monetary policy stimulus, following large asset purchases by central banks in some of these areas, should boost the economy and thus raise inflation closer to target. However, its effectiveness may be reduced if negative interest rates undercut banks' profits. As discussed in Box 1.2 in the latest *Economic Outlook*, so far these negative effects have been small but will increase in the euro area.

Negative interest rates applied to central bank reserves should lower short and longer-term market interest rates by signalling an easier monetary policy stance and encouraging banks and investors to rebalance their portfolios towards

riskier assets. With unchanged monetary policy abroad, they should also weaken the domestic currency. All these effects should bolster the economy and thus banks.

However, negative interest rates may also imply direct losses for banks. The feasibility for banks to compensate these losses depends on their business models. It can be high when banks liabilities are largely in the form of inter-bank loans or bonds and stimulative monetary policy is effective in lowering market interest rates. In contrast, the feasibility will be particularly limited for banks with a large share of retail deposits. Passing negative interest rates to depositors risks widespread withdrawals when storing cash is not very costly. Thus, banks could be forced to compensate losses by raising fees and increasing, or not lowering, interest rates on loans. The chance of such an outcome, and an associated perverse impact on loan demand and growth, increases with the level and duration of negative interest rates.

So far, interest costs on banks' funds at central banks have been limited and tiny compared to banks' profits and the average interest rates on funds placed with the central banks are less negative than the central banks' deposit rates (table below). This stems from various forms of exemptions (tiered reserve systems in Denmark, Japan, Norway and Switzerland; exemption for required reserves in the euro area and Japan). In Sweden, the costs are reduced as banks effectively do not use the deposit facility given that they can purchase Riksbank's certificates or use overnight fine-tuning operations that are remunerated at less negative interest rates than the deposit rate. In Japan, banks as a whole continue to earn net positive interest income from excess reserves.

In the euro area, the cost of negative interest rates for banks is going to increase with the expansion of ECB total assets and the concomitant increase in reserves for banking sector as a whole. This will not be the case for Japan.

Although the Bank of Japan intends to sustain asset purchases, the negative-interest tier has been capped at around 30 trillion yen.

Characteristics of negative interest rate frameworks				
	Effective interest rate on funds at central bank, per cent	Policy interest rate, per cent	Annual net interest income on funds at central bank, % of banks' profits	Characteristics of exemptions
Denmark	-0.47	-0.65	-2.04	Individual current account limits (on aggregate 32 billion krone)
Euro area	-0.35	-0.40	-1.91 / -2.18	Required reserves exempted from negative interest rates
Japan	0.07	-0.10	3.13	Three-tiered system; the BoJ maintains the balance of negative-interest tier between 10 and 30 trillion yen
Sweden	-0.54	-1.25	-0.35 / -0.36	Negative costs mitigated by the use of term claims remunerated at less negative interest rates
Switzerland	-0.23	-0.75	-4.58	Individual exemption thresholds (20 times reserve requirements in October-November 2014)

Note: Calculations for Hungary and Norway are not presented as central bank negative interest rates effectively do not apply in these two countries. For further details see Box 1.2 in June 2016 Economic Outlook.
Source: National central banks; Statistics Denmark; Japanese Bankers Association; and OECD calculations.

References

OECD (2016), *OECD Economic Outlook*, Volume 2016, Issue 1, OECD Publishing, Paris.

DOI: http://dx.doi.org/10.1787/eco_outlook-v2016-1-en

Yes, finance fuels income inequality

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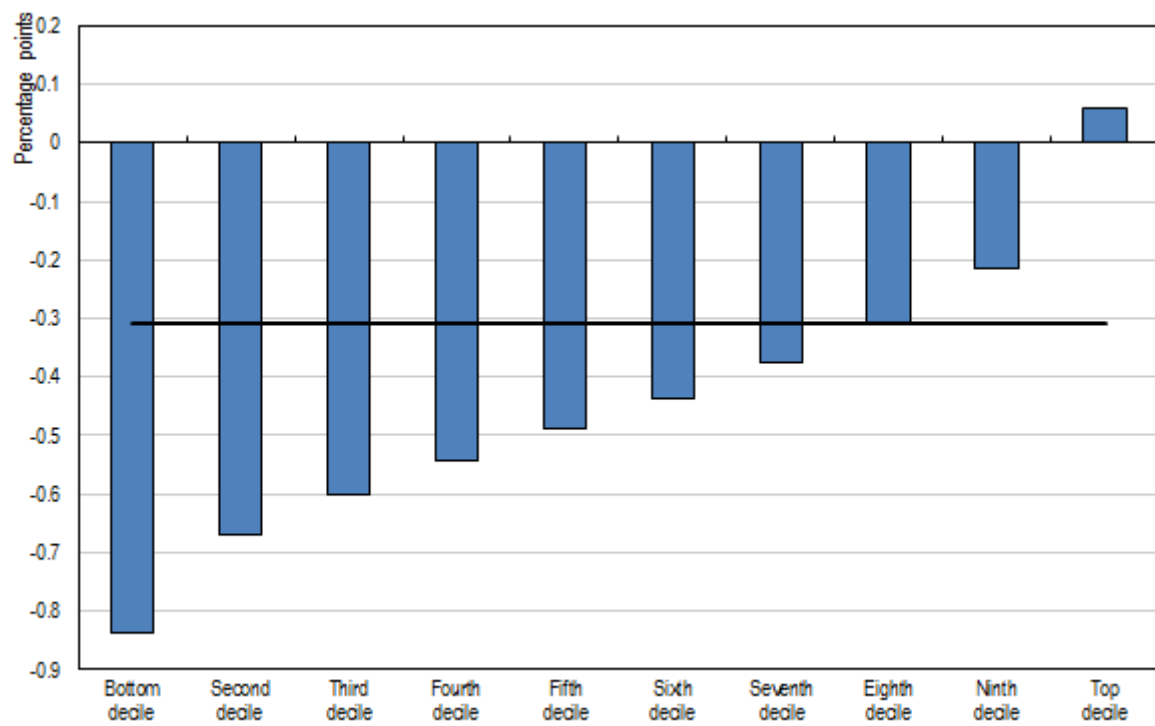
The Great Financial Crisis has prompted a lively debate, where the financial sector has been accused of not only triggering crises but also concentrating income in the hands of a few.

The Occupy Wall Street movement in New York coined the slogan “we are the 99%”, that is to say the bottom 99% in the income distribution. The OECD in Paris has extensively probed the data to examine how finance influences the distribution of income.

The main conclusion is that, indeed, financial expansion exacerbates income inequality. Econometric investigations uncover that more finance, in the form of more bank credit or larger stock markets, goes hand in hand with higher income inequality across OECD economies (see Chart). Further expansion in bank credit from the levels observed in OECD countries is associated with slower household income growth, but the negative effects are particularly acute at the bottom of the distribution, while simulations suggest that the top 10% benefit. Stock market expansion is linked with stronger household income growth, but the benefits are concentrated at the top and the very bottom of the income distribution is simulated to lose out. These effects, which have been identified on average across OECD countries, might not apply at lower levels of development.

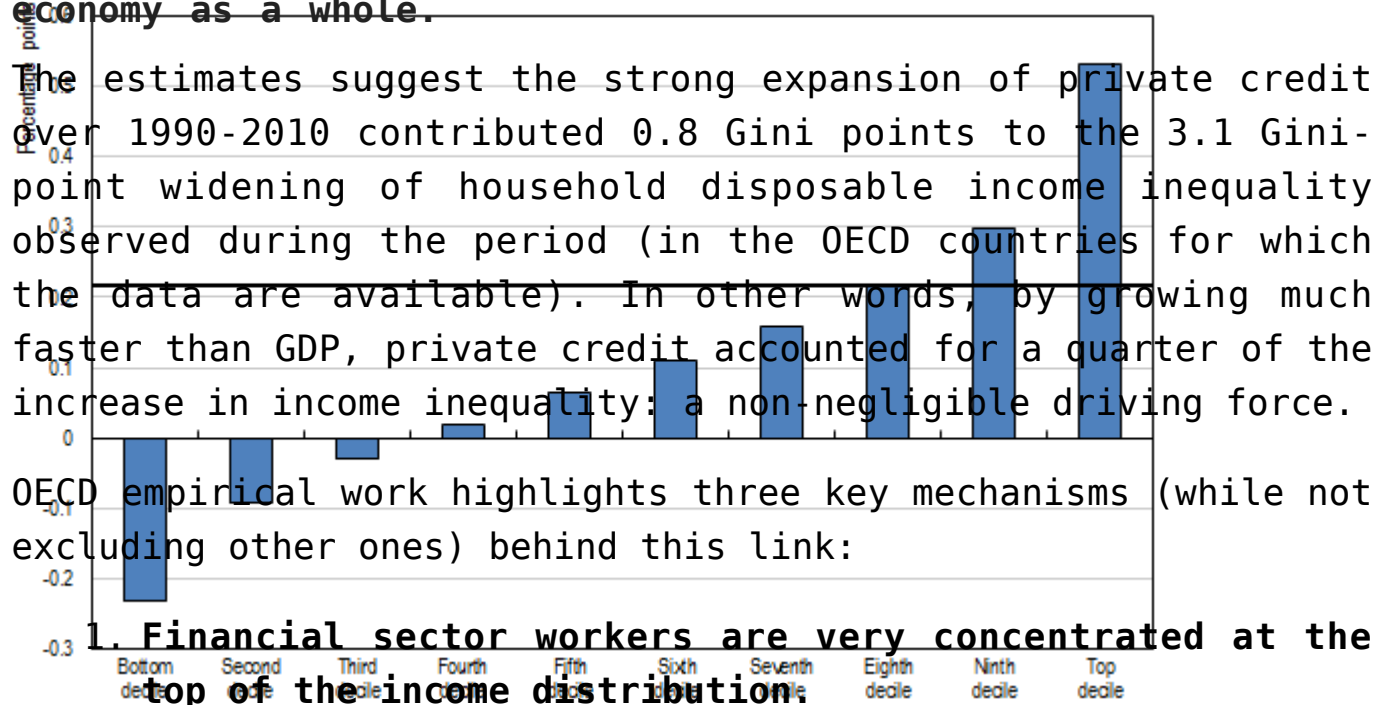
The effects of credit and stock market expansion vary a lot across income levels

A. Simulated effect of a 10% of GDP expansion of financial sector credit on household income growth



B. Simulated effect of a 10% of GDP expansion of stock market capitalisation on household income growth

Note: Household income growth is household disposable income growth per capita. Stock market capitalisation is the value of all shares listed in a stock market. The horizontal line indicates the change in household income growth for the economy as a whole.



Financial sector employees are concentrated high up in the income distribution. In Europe, financial sector employees make up only 4% of the workforce but 20% of the top 1% earners. In Luxembourg and the United Kingdom, more than 30% of employees in the top 1% work for financial firms. The high

number of financial sector workers among top earners is justified as long as very high productivity underpins their earnings. However, detailed econometric investigations find that financial firms pay wages well above what employees with similar profiles earn in other sectors. Even worse, the premium is especially large for top earners.

2. High income earners can and do borrow more.

The distribution of credit is twice as unequal as the distribution of household income in euro area countries (where detailed, internationally comparable data are available). More than 45% of total household credit goes to the top 20% of the income distribution in Austria, Finland, France, Germany and Italy. Credit expansion fuels income inequality, because the well-off gain more than others from the investment opportunities that they can identify.

3. Much of the benefits of stock market expansion go to affluent households.

Stock holdings are disproportionately concentrated in the hands of high-income people. In the euro area, stock market wealth is four times more unequally distributed than household income. As a consequence, larger stock markets, which generate more dividends and capital gains, widen the income distribution.

As a result, more finance means more income inequality.

Find out more:

Cournède, B., O. Denk and P. Hoeller (2015), "Finance and Inclusive Growth", OECD Economic Policy Papers, No. 14, OECD Publishing, Paris.

Denk, O. (2015), "Financial Sector Pay and Labour Income Inequality: Evidence from Europe", OECD Economics Department Working Papers, No. 1225, OECD Publishing, Paris.

Denk, O. and A. Cazenave-Lacroutz (2015), "Household Finance and Income Inequality in the Euro Area", OECD Economics Department Working Papers, No. 1226, OECD Publishing, Paris.

Denk, O. and B. Cournède (2015), "Finance and Income Inequality in OECD Countries", OECD Economics Department Working Papers, No. 1224, OECD Publishing, Paris.