FRIDAY, 12/07/2024 - Scope Ratings GmbH

Scope affirms Greece's BBB- ratings and revises Outlook to Positive

Declining public debt, improved banking-system resilience and favourable structural-reform momentum drive Outlook revision. Very elevated government debt and sustained structural economic weaknesses remain credit constraints.

Rating action

Scope Ratings GmbH (Scope) has today affirmed the Hellenic Republic (Greece)'s long-term issuer and senior unsecured debt-category ratings at BBB-, in both local- and in foreign-currency, and revised the Outlooks to Positive, from Stable. The short-term issuer ratings are affirmed at S-2 in local and in foreign currency, with Outlook Stable.

The revision of the Outlooks to Positive for Greece's long-term credit ratings reflects Scope's expectation of a continued reduction in Greece's general government debt ratio over the coming years. Greece's anticipated public-debt decline, which was one of the drivers of Scope's announcement of the upgrade of Greece to investment grade last August, is driven by favourable debt dynamics and a further decline of the headline budget deficit, including stronger primary surpluses than previously foreseen. In addition, the clean-up of the banking system, the reduction of non-performing loans (NPLs), alongside privatisations of systemic banks, support financial-system resilience. Finally, the adoption of structural reform and investments, facilitated by European recovery and multi-annual funding programmes, bolster the economy's resilience and growth potential.

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Key rating drivers

Continued decline of government debt and achievement of material primary surpluses. The first driver of the revision of the long-term credit Outlook to Positive reflects declining public debt. This is primarily driven by favourable public-debt dynamics driven by a strengthened medium-run nominal-growth outlook and comparatively low average interest costs of outstanding debt, alongside a strong commitment to fiscal prudence.

The aggregate general government debt stock of Greece has declined from peaks of 207% of GDP as of 2020, reaching an estimated 161.9% by end-2023, representing a meaningful 45pp decline and falling already well under the pre Covid-19 levels of 180.6% from end-2019. The robust recovery since Q2-2020, alongside elevated recent inflation, have driven the marked decline in the public-debt ratio and appear sustainable enough to maintain continued debt decline even if at a gradually moderating pace.

The debt ratio is seen easing to 151.9% by end-2024, before further easing to 130.7% by 2029. If realised, this would represent the lowest debt ratio of the sovereign since the start of the Greek crisis (Q1 2010) and under the debt ratio of BBB+ rated Italy by 2026. The agency's debt projections for Greece have strengthened due to continued budgetary outperformance, as the government may meet if not exceed a 2024 primary-surplus objective of 2.1% of GDP. Scope has furthermore updated its medium-run primary-balance assumptions and now expects the government to achieve a 2.5% of GDP surplus over 2025-27 over the remainder of the (Kyriakos)

Mitsotakis government, an increase from the earlier conservative assumption of only a 1% surplus.

The continued focus of authorities on maintaining budgetary prudence provides greater confidence in the achievement and sustenance of elevated primary-surplus objectives ahead of next elections barring unforeseen shocks. This is despite reduced conditionalities and enhanced independence of policy making after Greece's exit from the economic adjustment programmes and post-bailout enhanced surveillance. Primary surpluses align with moderate headline fiscal deficits averaging 0.8% of GDP over 2024-29.

Scope's debt projections currently assume output growth of 2.0% this year, 1.8% next and 1.4% on average from 2026 to 2029. This projection is nevertheless comparatively optimistic, currently reflecting no recession medium run. In addition, Scope assumes GDP-deflator inflation of 2.2% over 2024-29, up from just -0.4% from 2012-21.

Downside risks for this economic scenario include: i) any sharp economic downturn; ii) an unexpected return to low inflation; iii) a renewed severe rise in borrowing rates; and/or iv) an unexpected and material weakening of the budgetary position. As an example, under an adverse economic scenario of two consecutive years of recession during 2024-25, Greek debt might reach 172% of GDP by 2025.

Improvements of banking-system resilience. The second driver of the Outlook revision to Positive is the ongoing reduction of non-performing loans and enhanced banking-system stability.

Greek banks have made considerable progress concerning NPL reduction. System-wide NPLs on a consolidated basis declined significantly from 49.2% as of June 2017, reaching 7.0% by March 2024[1]. This reduction has been supported by NPL securitisations as guaranteed under the Hercules Asset Protection Scheme (HAPS) – which was re-introduced last November and runs until at least December of this year. Scope expects the NPL ratio to continue declining as banks remain committed to further balance sheet clean-up. Still, NPLs remain at this stage above EU averages (of 1.9% in Q1 2024), and moreover remain in the system even if not reported by official statistics.

At the same time, profitability has improved since end-2021 on the back of declining loan loss provisioning, increased non-recurrent income from financial operations and hedging instruments, as well as an increase of interest income benefitting from currently higher lending rates. System-wide tier 1 capital is strengthening due to retained earnings and asset de-risking. As of Q1 2024, it was 16.2% of risk-weighted assets, as compared against 13.0% at 2021 lows.

Nevertheless, banks' domestic government bond holdings, the remaining equity stakes held by the State in the banks and State guarantees under HAPS underscore an outstanding sovereign-bank nexus, reflecting an ongoing credit concern. Greece sold a 22% stake of National Bank of Greece (NBG) last November and more recently sold its final 27% stake in Piraeus Bank. At this stage, the State, via the Hellenic Financial Stability Fund (HFSF), has fully divested from three of the four systemic banks and holds only a remaining 18% stake of NBG and 72.5% of smaller Attica Bank. The government plans to sell remaining shares and sunset the HFSF by end-2024[2], ahead of a deadline of end-2025. The privatisations of the banks, alongside declining deferred tax credits, reduce the legacy of the Greek crisis and cut to an extent sovereign-bank interlinkages – supporting the Outlook change.

Structural reforms and enhanced macroeconomic stability. The final driver of the Outlook revision is an enhanced macroeconomic stability following the crises of the past 15 years, sustained structural reforms and investment, which have supported the economic outlook.

Progress has been maintained on reforms and investments of "Greece 2.0", the Greek Recovery and Resilience Plan and the EU Cohesion Policy. The European Commission recently endorsed a positive preliminary assessment concerning the fourth payment request of EUR 2.3bn of loans under the Recovery and Resilience Facility.[3] The revised Greek recovery and resilience programme after reflecting the REPowerEU sleeve totals EUR 35.95bn, including EUR 18.2bn in grant money and EUR 17.7bn of loans. Investment in the Greek economy remains low – 14% of output as of the year to Q1 2024 – but this is nevertheless stronger than the below 11% as of 2019.

Continued reforms may raise over time Greece's economic growth potential currently estimated at 1.0% a year, which currently recognises the modern economic history of Greece alongside demographic bottlenecks (-0.9% a year working-age population changes forecast by the United Nations over 2024-29). Stronger nominal economic growth is expected over the forthcoming years partially given harmonised inflation of 2.7% in 2024 and 2.8% in 2025, after 4.2% last year.

Unemployment has decreased to 10.6% of the active labour force by May of this year – from June 2020 peaks of 20.2% – its lowest levels since 2009 but still well above EU averages of 6.0% as of May 2024. Scope sees unemployment moderating to 10.6% on average for this year before 10.2% by 2025, supported by continued above-potential economic growth.

Rating challenges: high government debt and gradual weakening of very-strong structure of government debt; sustained structural economic weaknesses.

Greece's BBB- credit ratings remain constrained by:

Firstly, Greece's government debt remains very elevated – second highest of Scope's publicly-rated sovereign universe of 40 nations, after only that of Japan (rated A/ Stable Outlook). The high stock of debt exposes Greece to market reappraisals of risk associated with the long-run sustainability of sovereign debt. Furthermore, as Greece finances itself on markets and repays bailout loans early and the ECB moreover starts quantitative tightening of pandemic purchases, the structure of Greek debt gradually weakens. Interest payments are seen picking up gradually – as Greek refinances via higher interest cost market issuance. The very-long weighted-average debt maturity (of 19.2 years)[4] – the longest of the agency's rated sovereign universe – is gradually normalising lower. Finally, as sovereign ratings are assigned on debt due to be repaid to the private sector, the increasing share of debt held on the private-sector balance sheet is a moderate credit concern.

Political and policy-related risks are modest over forthcoming years but may rise after elections longer run. In addition, structural economic weaknesses and demographic challenges, such as net emigration, limit longer-run economic-growth potential and wealth levels. Elevated structural unemployment and still-moderate participation rates are a credit constraint, even if unemployment is moderating. The GDP per capita of USD 41,188 on purchasing-power-parity bases as of 2024 remains under the averages of the European Union (USD 58,838). Next, low disposable income of households compared with final consumption reflects a social constraint, even as comparative prevalence of low-income jobs and of small and medium-sized enterprises weigh on productivity, the tax base and raise poverty and social exclusion among vulnerable groups. Finally, environmental challenges may adversely affect Greece's economic and budgetary outlooks if left un-addressed given the economy's dependence on tourism and agriculture sectors.

Outlook and rating sensitivities

The **Positive Outlook** reflects Scope's view that risks for the ratings are tilted to the upside over the forthcoming 12 to 18 months.

Upside scenarios for the long-term ratings are if (individually or collectively):

1. Nominal growth and fiscal consolidation drive strong and sustained downward public-debt trajectory medium run;
2. Banking-sector risks are further curtailed, via strengthening banking capitalisation, further reducing non-performing loans and/or curtailing sovereign-bank linkages; and/or
3. Structural-economic and external imbalances are reduced, elevating medium-run growth potential and strengthening macroeconomic sustainability.

Downside scenarios for the rating and/or Outlooks are if (individually or collectively):

1. Eurosystem support for Greek debt were reduced significantly, triggering crystallisation of more severe market scenarios;
2. Fiscal policies remain loose for longer or a more severe economic downturn materialises, impeding or reversing the current trajectory of reductions of the sovereign-debt ratio;
3. Banking-sector risks re-intensify, raising risk of the crystallisation of contingent liabilities affecting the sovereign balance sheet; and/or
4. The sustainability of macroeconomic growth weakens and/or macroeconomic and external-sector imbalances rise.

Sovereign Quantitative Model (SQM) and Qualitative Scorecard (QS)

Scope's Sovereign Quantitative Model (SQM) provides a first indicative credit rating of 'bb+' for Greece. This 'bb+' first indicative rating receives a further one-notch uplift from the SQM's reserve-currency adjustment and no negative adjustment from the political-risk adjustment. This sees a final SQM indicative credit rating of 'bbb-' for Greece. On this basis, the final SQM quantitative rating of 'bbb-' is next reviewed by the Qualitative Scorecard (QS) and can be changed by up to three notches by the primary analyst depending on the size of Greece's qualitative credit strengths or weaknesses compared against a peer group of sovereign states identified by the SQM.

Scope identified the following QS relative credit strengths for Greece: i) fiscal policy framework;

ii) debt profile and market access; iii) external debt structure; iv) financial sector oversight and governance; and v) governance factors. Conversely, Scope identified the following QS relative credit weaknesses of Greece: i) growth potential and outlook; ii) macro-economic stability & sustainability; iii) environmental factors; and iv) social factors. On the aggregate, the QS generates no net adjustment affecting Greece's credit rating, resulting in the final BBB- long-term ratings. A rating committee has discussed and confirmed these results.

Environment, social and governance (ESG) factors

Scope explicitly factors in ESG issues within its ratings process via the sovereign-rating methodology's stand-alone ESG sovereign-risk pillar, which holds a significant 25% weighting under the quantitative model (SQM) and 20% weight under the methodology's qualitative overlay (QS).

In the sovereign ESG pillar's environmental risk sub-category, Greece scores moderately on the SQM on carbon emissions per unit of GDP but, like other advanced economies, comparatively weakly on greenhouse gas emissions per capita. Greece's vulnerability to natural-disaster risk, as measured by the ND-GAIN index, is higher than that of euro-area peers although slightly below-average under a global comparison. Greece's marks are, moreover, weak on the SQM on the economy's comparatively high ecological footprint of consumption compared with available biocapacity. On aggregate, Greece performs about at the global median on the environmental ESG sub-category of the SQM but nevertheless fourth worst of the euro area. Droughts and wildfires are becoming more frequent and intense. A separate Ministry of Climate Crisis and Civil Protection was designed following the wildfires of 2021, but adaptation has been hampered by required preparations at regional administrations. Greece experiences the most significant climate-related economic losses of any EU nation, according to Eurostat.[5] Greece holds an ambitious climate policy vis-à-vis its revised National Energy and Climate Plan[6], aiming for 23% reductions from 2005 greenhouse gas emissions levels by 2030 (under the Effort Sharing Regulation), before a zero-carbon economy by 2050, alongside penetration of renewable energy sources for 44% of energy consumption by the end of this decade. Alongside via the SQM, Greece's environmental objectives and moves towards more sustainable economic growth are furthermore considered by Scope's QS by an assessment of 'weak' on 'environmental factors' as compared against the sovereign peer group.

Socially related credit factors are likewise captured both by Scope's SQM and QS qualitative overlay. In the quantitative model, Greece receives comparatively strong scores on income inequality (as captured by the income share of the bottom 50% of the population), moderate marks on labour-force participation, and weak scores on the old-age dependency ratio. In the QS assessment of Greece's 'social factors', Scope evaluates this qualitative analytical category as 'weak' compared against the credit's sovereign peers.

Finally, under governance-related factors included within the SQM, Greece displays average scores on the World Bank's Worldwide Governance Indicators (WGIs). Despite lagging peers of the euro area on governance, the reform agenda since 2017 has resulted in some improvement on the WGIs. Ongoing reform has anchored an improvement of institutional strengths and has brought progress on areas such as tax administration and compliance, the judicial system, public administration, and anti-corruption. Since 2019 elections, Greece has experienced comparative political stability, due to an absolute parliamentary majority since then of New Democracy. In the QS assessment of Greece's 'governance factors', Scope evaluates this qualitative analytical category as 'strong' against Greece's 'bbb-' sovereign peer group.

Rating committee

The main points discussed by the rating committee were: i) debt and budgetary outlook; ii) banking system; iii) structural reform and growth potential; iv) institutional support; v) SQM and Qualitative Scorecard; vi) history of debt relief; and vii) sovereign peers considerations.

Rating driver references

1. Bank of Greece: Evolution of loans and non-performing loans
2. Reuters: 20 March 2024
3. European Commission: Commission endorses positive preliminary assessment of Greece's fourth payment request for €2.3 billion in loans under the Recovery and Resilience Facility
4. Public Debt Management Agency (Greece): Weighted Average Maturity
5. Eurostat: Losses from climate change: €145 billion in a decade
6. Hellenic Republic Ministry of the Environment and Energy: National Energy and Climate Plan, October 2023

Methodology

The methodology used for these Credit Ratings and/or Outlooks, (Sovereign Rating Methodology, 29 January 2024), is available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The model used for these Credit Ratings and/or Outlooks is (Sovereign Quantitative Model Version 3.0), available in Scope Ratings' list of models, published under https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

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Regulatory disclosures

These Credit Ratings and/or Outlooks are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlooks are UK-endorsed.
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