Greece (/gws/en/esp/issr/80442212)

FitchRatings

Fitch Affirms Greece at 'CCC'

Fitch Ratings-London-24 February 2017: Fitch Ratings has affirmed Greece's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'CCC'. The issue ratings on Greece's long-term senior unsecured foreign- and local-currency bonds are also affirmed at 'CCC. The Short-term Foreign and Local Currency IDRs and the rating on Greece's short-term debt have all been affirmed at 'C', and the Country Ceiling at 'B-'.

KEY RATING DRIVERS
Greece's 'CCC' IDRs reflect the following key rating drivers:

The Greek government is broadly complying with the terms of the EUR86bn European Stability Mechanism (ESM) programme. The second review of the programme remains incomplete and there are disagreements among the country's European creditors and the IMF around the long-term sustainability of Greek public debt. The delay in the completion of the second review increases the risk that the recent economic recovery will be undermined by a hit to confidence or by the Greek government building up arrears with the private sector to preserve liquidity.

The Greek government agrees with the IMF that further debt relief is needed, but has objected to the fund's position that the government should pre-legislate for specific automatic fiscal correction measures in case it misses future primary surplus targets. Even so, the current stand-off appears to be driven more by the inter-creditor disagreement. Relations between the Greek government and official creditors have stayed on a fairly firm footing since the current ESM programme was agreed.

The government's compliance with the ESM programme conditions is one reason that Fitch believes Greece's European creditors would be prepared to proceed and disburse funds without IMF involvement. Another reason is the desire to avoid a Greek political crisis during an already congested European election year. However, downside risks remain and a negative shock with respect to the completion of the second review and the payment of the next bailout tranche cannot be excluded.

Fitch's baseline is that an agreement will be reached. This implies that the Greek government may have to adopt additional fiscal measures, which increases the risk of early elections as Syriza's slim parliamentary majority (153 out of 300 seats) makes it harder for the government to maintain sufficient support for unpopular measures. The extent to which Prime Minister Alexis Tsipras will continue to be able to rely on votes from centrist parties is unclear.

Early elections are not our baseline. In our view, Prime Minister Tsipras will try to avoid elections: based on recent polls, Syriza trails by more than 10pp the centre-right New Democracy party, which has less ideological opposition to a number of the programme measures but has been arguing for its renegotiation in particular on the fiscal targets. Early elections would provide an additional source of uncertainty that would likely undermine the recent economic recovery.

Real GDP grew 0.3% in 2016 amid improved business and consumer confidence and progress in clearing government arrears with the private sector. Fitch has revised upwards its real GDP growth forecasts to 2.5% and 3% in 2017 and 2018, from 1.8% and 2.2% respectively. Pent-up investment demand, a declining unemployment rate and continued clearance of government arrears are set to support domestic demand. Resilient eurozone growth recovery should support export performance.

Fitch estimates that Greece recorded a primary surplus of 2.5% of GDP in 2016, well above the ESM programme target of 0.5%, owing to higher-than-budgeted revenues. Revenue outperformance stems mainly from stronger growth in indirect and corporate income tax receipts. The 2016 outturn should make the 2017 target of 1.75% easier to achieve. However, the 2018 target of 3.5% in 2018 remains challenging. The European creditors estimate the 2018 fiscal gap at EUR700m (0.4% of GDP).

The government has already legislated "prior actions" measures, which are projected to yield 3% of GDP through 2018, of which just above two-thirds come from pension and income tax reform. Fairly weak domestic ownership of programme measures makes full implementation of these measures more difficult and the 2018 target harder to achieve. There is, however, a contingent fiscal mechanism to retrospectively trigger further measures if a target is missed, and tax efficiency reform on which the follow-through is more uncertain.

Confidence in the banking sector remains fragile. The customer deposit base is prone to volatility. After falling by 27% between September 2014 and July 2015, private sector deposits have barely recovered. Since the relaxation of capital controls in July 2016, the inflow of deposits has been weak. Delays to the programme review are likely to put additional pressure on investor confidence, although capital controls should limit deterioration in banks' liquidity position.

A key challenge for the banking sector is tackling non-performing exposures (NPEs), which remain stubbornly high at 45.2% of gross loans. Improvement has been made to the legal and institutional framework for resolving loans and banks have stepped up their restructuring efforts but with limited effect on the stock of NPEs so far.

SOVEREIGN RATING MODEL (SRM) and QUALITATIVE OVERLAY (QO)
Fitch's proprietary SRM assigns Greece a score equivalent to a rating of 'BB' on the Long-Term Foreign Currency IDR scale.

In accordance with its rating criteria, Fitch's sovereign rating committee decided to adjust the rating indicated by the SRM by more than the usual maximum range of +/- 3 notches because of Greece's experience of financial crisis.

Consequently, the overall adjustment of five notches reflects the following adjustments:-
-Macro: -1 notch, to reflect a history of weak macroeconomic management that

contributed to financial crises and steep declines in GDP;
-Public Finances: -1 notch, to reflect public debt at close to 180% of GDP; the SRM does not capture "non-linear" vulnerabilities at such a high level;
-External finances: -2 notches, to reflect: a) Greece's high net external debt which is not captured in the SRM, and lack of market access which reduces financing flexibility a) and b) the +2 notch SRM enhancement for "reserve currency flexibility" has been adjusted to +1 notch given Greece's financial crisis experience;
-Structural Features: -1 notch, to reflect political risks to the programme, and a weak banking sector reliant on official sector funding and with capital controls still largely in place.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a Long-Term Foreign Currency IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable or not fully reflected in the SRM.

RATING SENSITIVITIES
Future developments that could, individually or collectively, result in positive rating action include:
-Evidence that the recent economic recovery is sustained and a track record of achieving primary surpluses. Official sector debt relief would also provide upward momentum for the ratings over the medium-term;
-Further track record of successful implementation of the ESM programme, underpinned by an orderly working relationship between Greece and its official sector creditors and a fairly stable political environment.

Future developments that could, individually or collectively, result in negative rating action include:
- A breakdown in relations between Greece and its creditors or domestic political instability disrupting economic and fiscal policies and out-turns;
-Non-payment, redenomination or distressed debt exchange of government debt

securities issued in the market or a government-declared moratorium on all debt service.

KEY ASSUMPTIONS
-Our base case assumes the second programme review is completed ahead of the July debt maturities.
-Any debt relief given to Greece under the ESM programme will apply to official sector debt only, and would not therefore constitute an event or default under the agency's criteria.

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Applicable Criteria
Country Ceilings (pub. 16 Aug 2016) (https://www.fitchratings.com/site/re/885997)
Sovereign Rating Criteria (pub. 18 Jul 2016)
(https://www.fitchratings.com/site/re/885219)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
(https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?
pr_id=1019555&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJzZXNzaW9uS2V5Ij
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