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

Contents

Rating Action

Neuss, 23 December 2016

Creditreform Rating has published the unsolicited long-term sovereign rating of "B-" for the Hellenic Republic. Creditreform Rating has also published Greece's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "B-". The outlook is stable.

Key Rating Drivers

1. Despite considerable progress in terms of budget consolidation since 2010 and limited refinancing risk, public debt levels appear unsustainable; timeline and scale of potential debt relief measures clouded with uncertainty
2. Pronounced institutional weaknesses; unfavorable business environment and political uncertainty impeding implementation of reforms and thus a stronger recovery of investment and GDP
3. Greek economy has stabilized in 2014-16 and growth set to strengthen in 2017 but forecast is subject to significant downside risks; weak prospects for medium- to long-term potential growth
4. Improving external position on the back of sharply decreasing imports and partially regained cost competitiveness via adjustment of unit labor costs, while trade openness remains low and export volumes sluggish

Reasons for the Rating Decision

Our assessment of the Hellenic Republic's moderate creditworthiness is mainly based on the sovereign's impaired debt sustainability, comparatively weak institutions and considerable uncertainty pertaining to the country's macroeconomic perspectives.

Most importantly, the sovereign's exceptionally high debt burden is weighing heavily on growth. Standing at 107.1% of GDP, public debt was already at an elevated level when Greece entered the European Monetary Union (EMU) in 2001. In nominal terms, government expenditure growth (+56.5%) significantly outpaced GDP growth

(+26.8%) in 2001-07, driven by rampant public consumption, in particular by compensation of government employees (+62.1%). Although Greece was running high deficits (2001-07 avg.: 6.7% of GDP) to finance additional expenditure, the sovereign's interest burden as measured by GDP dropped from 6.3 to 4.5%, as decreasing funding costs more than compensated new borrowing requirements. In the wake of the financial crisis, macroeconomic metrics deteriorated and, accordingly, public finances continued to worsen significantly. After Greece had announced that its headline deficit would come in at 12-13% of GDP in Oct-09 – substantially above the 3.7% targeted in its Stability Program 2009, capital markets began to lose confidence in the sustainability of Greece's public finances. Subsequently, sovereign bond yields soared to unsustainable levels, crossing the 6%-mark in Jan-10. Amid financial distress, the Greek government requested the assistance of the EU, which was finally approved in May-10 and resulted in a joint EU/IMF economic adjustment program amounting to EUR 110bn. A second and third program were launched in Mar-12 (EUR 130.9bn) and Aug-15 (EUR 86.0bn), respectively. To be sure, financial assistance was conditional upon the adoption of a broad set of fiscal, institutional and financial market reforms, which were specified in a Memorandum of Understanding (MoU) between Greece and its creditors.

Notwithstanding a 50% haircut on Greek sovereign debt held by private investors in 2012, Greece's public debt burden continued to increase as budget consolidation was hampered by a deeper-than-projected recession and political instability. Thus, the Greek debt-to-GDP ratio reached 177.4% of GDP in 2015 and is set to exceed the 180%-mark this year. Although this is by far the highest debt burden in the euro area, short-term refinancing risks appear to be contained given that 77.8% of Greek debt is non-marketable (mainly ESM, EFSF, IMF loans), with a weighted average maturity of 16.7 years (end Q3-16). That said, 2017 will see large-scale repayments of bonds in April (EUR 1.402bn) and July (EUR 6.212bn). We expect that the sovereign will service the debt held by private investors, maturing on 20 July (EUR 2.334bn).

Despite the continuing increase in sovereign debt, fiscal consolidation under the economic adjustment programs has been characterized by strong efforts. Between 2010 and 2015 Greece achieved a primary balance adjustment of 6.1 p.p. of GDP, which was larger than in Spain (5.5 p.p.) or Cyprus (4.1 p.p.). Last year, Greece's primary surplus surprised on the upside at 0.7% of GDP, well above the target of -0.25% of GDP specified in the current MoU.

However, despite the consolidation progress that has been achieved so far, we view reaching a primary surplus of 3.5% of GDP from 2018 onwards to be very ambitious. While we are not too optimistic with regard to medium-term potential growth (see below), it remains to be seen whether such large primary surpluses can be sustained over an extended period of time. Historical cross-country evidence casts doubts on the feasibility of maintaining large primary surpluses in the long run. Moreover, past consolidation was achieved mainly by means of large investment cuts, whereby the potential for further cuts appears exhausted. At the same time, the authorities have shied away from structural fiscal reforms, as longstanding weaknesses in the tax system as well as an unsustainable pension system still persist.

Problems pertaining to revenue collection are an impediment to lower tax rates, which would be conducive to growth. With 28%, Greece exhibited one of the largest VAT gaps in 2014 as compared to 14.0% in the EU-28. As of July 2016, Greek taxpayers' debt to the state totaled at EUR 91.5 EUR (52.1% of 2015 GDP) – one of the highest figures among OECD members. What is more, Greece offers a generous tax-free income threshold, narrowing the revenue base.

Concerning the expenditure side of the budget, the Greek pension system is disproportionately expensive. As indicated by the EU Commission's Ageing Report 2015, Greece spends 16.2% of GDP on pensions – the highest level in the EU-28. In order to strengthen the sustainability of the pension system, multiple reforms have been adopted since the launch of the first economic adjustment program in 2010. The retirement age has been increased twice (2010/12) to 67 years, while the latest reform passed in Aug-16 consolidated various pension funds, abolished incentives for early retirement, and introduced a new method of pension calculation. Savings resulting from the implementation of these measures are expected to amount to 1.0% of GDP by 2018. Nevertheless, the pension system still requires large state subsidies (about 10% of GDP), putting pressure on public finances.

The Greek banking sector has stabilized since recapitalization of the country's four largest banks was successfully completed in Dec-15. While two banks (Alpha Bank, Eurobank) were able to cover their capital needs entirely from private sources, National Bank of Greece (EUR 2.7bn) and Bank of Piraeus (EUR 2.7bn) received additional funds from the Hellenic Financial Stability Fund (HFSF). As a result, the CET Tier I ratio of Greek banks significantly increased to 17.9% in Q2-16 (EA-19 avg.: 17.0%). Furthermore, the domestic deposit base (excl. government) of Greek banks has stabilized at about EUR 130.0bn in Q3-16 despite the gradual loosening of capital controls in Jul-16. Still, the high and further rising stock of non-performing loans remains a key challenge for domestic banks. Asset quality has significantly deteriorated; since Q1-10 (7.4%) the NPL-ratio has increased by a factor of five to 37.0% (Q1-16) – with only Cyprus reporting a higher ratio in the euro area (47.0%).

As regards macroeconomic performance, Greece is progressing slowly after the economy experienced a period of unsustainable, credit-driven growth in the aftermath of EMU accession. In 2001-07 GDP growth averaged at 4.1%, mainly fueled by vivid consumption which came on the back of strong credit growth. According to Bank of Greece data, the outstanding volume of loans to the domestic private sector more than tripled (206.4%) between 2001 and 2007. When the crisis hit, the Greek economy was severely affected, as GDP contracted for five consecutive years between

2008 and 2013. The deterioration of the country's macroeconomic performance was aggravated by the loss of investor confidence in the sovereign's capability to ensure fiscal sustainability. Thus, Greece did not experience a dynamic recovery in the following years, unlike the Baltic countries or Ireland, which also experienced severe recessions in 2008-09. However, the Greek economy stabilized in 2014-15, posting GDP growth rates of 0.4 and -0.2% respectively, but total output is still 26.4% below the levels seen in 2007.

With regard to 2016, GDP growth slowed at the beginning of the year (Q1-16: -0.6% q-o-q), before resuming in Q2 (0.4%). Following the first review of Greece's third economic adjustment program which stated that the Greek government was broadly on track regarding the reforms included in the MoU, business and consumer sentiment improved notably. As EU commission data reveals, the business climate index of the Greek industry increased from -9.0 (Jun-16) to -5.0 points (Oct-16), while at the same time the consumer confidence index improved from -68.0 to a still very low -63.6 points. Declining uncertainty was mirrored by accelerating GDP growth in Q3-16. According to provisional data published by the Hellenic Statistical Authority (ELSTAT), total output expanded by 0.8% q-o-q. Nevertheless, we forecast the Greek economy to stagnate for a further year in 2016 (-0.1%), as very high unemployment (Aug-16: 23.4%) continues to put pressure on wage growth, which in turn dampens consumer spending. What is more, we project net exports to contribute negatively to growth this year. Going forward, GDP expansion should benefit from a pick-up in domestic demand in 2017. While consumer spending should benefit from accelerating wage growth and improving labor market conditions, we expect investment to be boosted by a gradual relaxation of capital controls and the absorption of ESIF funds. As a result, we project that Greek GDP will grow by 2.5% next year.

Although we expect the recovery of the Greek economy to gather momentum in 2017, medium- to long-term growth prospects remain weak. According to estimates by the EU Commission, Greece exhibits the lowest potential growth rates in the euro area. In 2016-18, the country's potential growth rate should average at around -0.6% as compared to 1.7% in the EA-19. Greece's subdued potential growth and severe shortcomings pertaining to the country's institutional framework are closely interlinked. The poor quality of Greece's institutional framework is impairing the business environment and undermining investor confidence.

As indicated by the World Bank's World Governance Indicators (WGI), weaknesses relate, in particular, to the prevalence of corruption and the efficiency of the public service sector. As compared to its euro area peers, the country scores below average on all WGI indicators. Greece currently ranks 97th out of 209 countries (2015) in terms of perceived corruption, and 76th regarding the WGI government effectiveness index – well below the respective median ranks of the euro area (rank 42 and 31). Moreover, Greek WGI indicators have seen a marked deterioration from their peaks in the early 2000s without exception. Thus, ongoing economic adjustment programs since 2010 have not yielded considerable improvements of the country's institutional set-up so far. To the contrary, there appears to be a large gap between policy formulation and adoption of reforms on the one hand and implementation of legislated reforms on the other. Hence, we expect the unfavorable business environment to remain a major impediment to a significant acceleration of domestic private and foreign direct investment.

The World Bank's Doing Business Report 2017 ranked Greece 61st out of 190 economies; among OECD high-income countries Greece was listed 32/32. Contract enforcement (rank 32nd of 32 high-income countries), property registration (32) as well as the insolvency resolution framework (29), were identified as major weaknesses. With 1,580 days, the enforcement of contracts in Greece takes three times longer than in other OECD high-income countries (553 days), while the quality of property registration is lower than in other program countries. With 4.5 points, Greece scored well below Cyprus (23.0), Ireland (21.0) and Portugal (21.0) on the corresponding index. In addition, growth is held back by limited competition and thus high markups in many branches of the economy. According to OECD data from 2013, network industries as well as professional services were among the most regulated in the EU-28.

Notwithstanding, some progress has been achieved towards enhancing Greek's growth potential by improving the business environment and strengthening competition. Since August 2015, product market regulation has been eased based on the OECDs Toolkit I/II recommendations. Furthermore, the liberalization of the gas and electricity market is progressing. Also, legislation has been passed aimed at an unbundling of electricity supply (PPC) and transmission (ADMIE). To address the problems associated with land registration, the implementation of a new legal framework for nationwide cadastral offices is planned.

Turning to its external balance, Greece's integration in global trade is comparatively low. Trade accounts for only 60.4% of Greek GDP (EA-19: 138.9% of GDP) and the country attracts low FDI inflows (2015: 10.9% of GDP) as compared to economies of similar size such as Portugal (69.4% of GDP) or the Czech Republic (73.5% of GDP). In the years before its EMU accession, Greece was running a persistent current account deficit (1995-2000 avg.: 3.6% of GDP), which subsequently widened to 12.3% of GDP in 2009 due to a gradual loss of cost competitiveness on the back of diverging wage dynamics in Greece and the euro area. With an average annual growth rate of 2.4% (2001-09), real wages significantly outpaced growth in compensation per employee in the euro area (0.5%), whereas real labor productivity growth in Greece (0.8%) was only marginally higher than in the euro area (0.6%). However, Greece has partially regained its cost competitiveness since 2010, as indicated by a 9.8% decrease of unit labor costs (EA-19: -1.0%) and a balanced current account (+0.1% of GDP) in 2015. Current account rebalancing was primarily driven by an improving balance of trade. Receding imports explain the bulk of the narrowing trade deficit since 2010 (82.6% of the reduction), whereas exports grew only by 6.0%, mirroring weak service export performance (-2.2%). Together, tourism and shipping services account for almost half of the country's total exports (2015: 42.2%). Improving cost-competitiveness has benefitted tourism receipts, which increased by 47.0% over 2010-15, whereas weak global trade weighed on the export performance of shipping services (-41.9%).

Rating Outlook and Sensitivity

Our Rating outlook on the long-term sovereign rating of "B-" 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 – will remain fundamentally unchanged in the near term.

We could lower our rating if we see significant delays or a reversion of reforms specified in the MoU. To be sure, Greece has been attested to be broadly on track with the adoption of the reform agenda specified in the MoU of the third program in Jun-16. However, the government of MP Tsipras only relies on a narrow majority, controlling 155 of 300 seats in the Greek parliament. Thus, a repeated failure to enact essential structural reforms could lead to the resignation of the government so that political uncertainty resumes, undermining confidence with negative repercussions on investment and growth. What is more, substantial implementation risks remain in place, particularly in view of the implementation of reforms formalized in past adjustment programs, which have suffered from weak ownership on the part of the Greek government as well as from administrative capacity constraints.

Further downside risks relate to Greece's export market exposure. As revealed by 2015 data, the euro area accounts for 37.2% of Greek exports, with Italy (11.3%), Germany (7.2%) and Cyprus (5.6%) being the most important export markets. Thus, a period of prolonged stagnation in the euro area would adversely affect Greek export performance. In the same vein, the recovery of the Greek economy could be weakened by a further depreciation of the Turkish Lira and in turn a sharp decrease of demand from Turkey, which is the country's largest export market (2015: 6.7%) outside the euro area.

By contrast, we could raise our rating if Greece can reach an agreement with its euro area creditors to alleviate the sovereign's debt burden. The IMF has linked its participation in the ongoing economic adjustment program to a deal on a significant cut in Greek debt, following an updated debt sustainability analysis in May-16. The analysis concluded that without reprofiling, sustainability of Greek sovereign debt cannot be assumed. On 5 December 2016, the Eurogroup decided to extend the average weighted maturity of EFSF loans from 28 to 32.5 years, swapping floating-rate for fixed-rate bonds and waiving an interest rate step-up for a specific EFSF tranche in 2017. However, on 14 December 2016 the Eurogroup put the previously agreed measures on hold, after the Greek government had unilaterally declared that it will grant one-off benefits for low-income pensioners in the amount of 0.4% of GDP and maintain the VAT discount on some Greek islands. In principle, we believe that an IMF participation in the ongoing program would require more significant debt relief. In our view, IMF participation would increase the probability of a successful accession of capital markets after the conclusion of the 3rd economic adjustment program in 2018.

Furthermore, we could raise our ratings if we observe higher-than-expected and stable medium-term growth or if the reform efforts result in a marked improvement in the business environment, or a significant reduction of NPLs within the Greek banking sector.

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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

[in %, otherwise indicated]	2011	2012	2013	2014	2015	2016e	2017e
Real GDP growth	-9.1	-7.3	-3.2	0.4	-0.2	-0.1	2.5
GDP per capita (PPP, USD)	26,850	25,433	25,206	26,006	26,391	26,809	28,201
Inflation rate, y-o-y change	3.1	1.0	-0.9	-1.4	-1.1	0.0	1.0
Default history (years since default)	n.a.	SD	1	2	3	4	5
Life expectancy at birth (years)	80.7	80.6	81.3	81.3	n.a.	n.a.	n.a.
Fiscal balance/GDP	-10.3	-8.8	-13.2	-3.6	-7.5	-2.7	-1.2
Current account balance/GDP	-10.0	-3.8	-2.0	-1.6	0.1	n.a.	n.a.
External debt/GDP	166.6	235.3	240.2	218.4	245.9	n.a.	n.a.

Appendix

Regulatory Requirements

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.

The rating was conducted on the basis of Creditreform Rating´s "Sovereign Ratings" methodology. Creditreform Rating AG 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 Creditreform Rating´s rating methodologies is published on the following internet page: www.creditreform-rating.de.

A Rating Committee was called consisting of highly qualified analysts of Creditreform Rating AG. The quality 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 and that the rating action was and is free of any existing or potential conflicts of interest. 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 Creditreform Rating´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

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