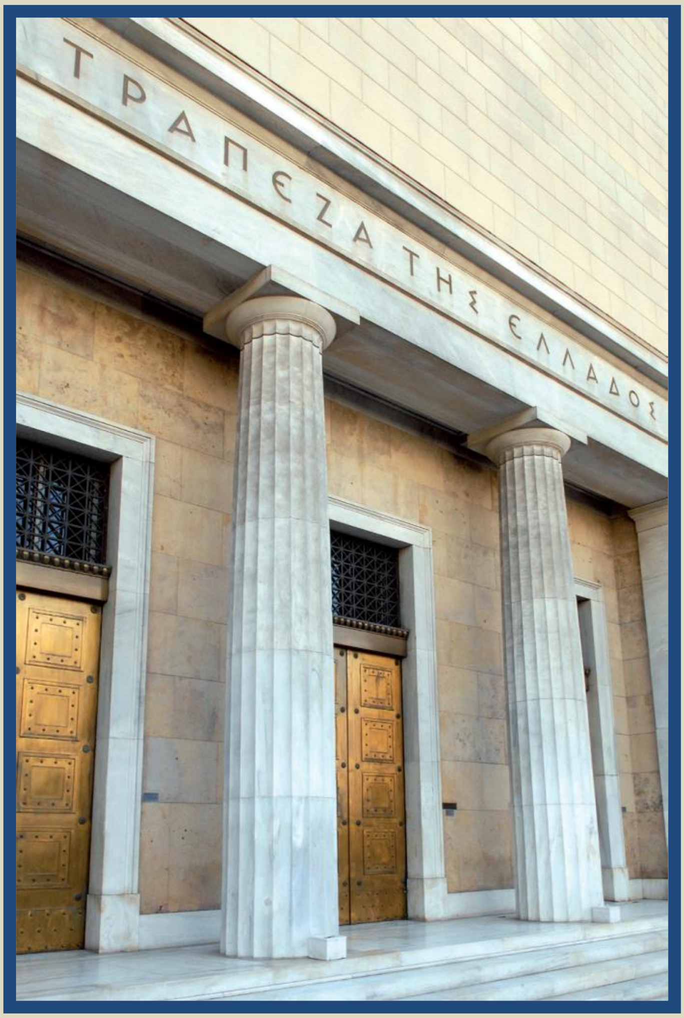
# FINANCIAL STABILITY REVIEW

## EXECUTIVE SUMMARY




April
2024

BANK OF GREECE
EUROSYSTEM

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**BANK OF GREECE**

21, E. Venizelos Street

GR - 102 50 Athens

www.bankofgreece.gr

Financial Stability Department

Tel. +30 210 320 5103

Fax +30 210 320 5419

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# I. EXECUTIVE SUMMARY

**Risks to financial stability declined in the second half of 2023, but remain elevated.** Monetary policy tightening was instrumental to achieving a sustained disinflationary path. Having peaked at 10.6% in October 2022, the inflation rate in the euro area stood at 2.4% in March 2024. In 2023, economic activity in the euro area slowed down significantly. Uncertainty remains extremely high at the global level, driven by adverse geopolitical developments and political uncertainty due to the upcoming elections in Europe and the US. Moreover, high interest rates have a dampening effect on economic activity, increasing the risk of persistently weak economic growth in the near future. They also affect the capacity of firms and households to repay existing loans, as well as the demand for new loans. At the same time, high valuations in money and capital markets accentuate the risk of a sharp repricing of assets, while concerns about the continued downward path of commercial real estate prices globally linger on.

**In 2023, the Greek economy recorded a satisfactory growth rate.** Real gross domestic product (GDP) growth stood at 2.0% in 2023, with a positive contribution from both domestic demand and net exports. The overachievement of the fiscal targets and the management of public debt reduction helped enhance the overall state of the Greek economy and, therefore, financial stability. Continued economic growth was conducive to a further – albeit milder – improvement in the labour market in 2023, with the unemployment rate declining to 11.1%, from 12.4% in 2022. Inflation, as measured by the Harmonised Index of Consumer Prices (HICP), fell markedly in 2023 to 4.2%, mainly on the back of substantial energy price drops (13.4%). However, HICP excluding energy grew at a fast rate, reflecting upward pressures on food prices, as well as on the prices of non-energy industrial goods and services, thus affecting business operating costs and household disposable income.

**Greek banks are in a better position than in the past to withstand potential shocks.** In 2023, liquidity, asset quality, profitability and capital adequacy of the banking sector improved. The improvement in the banking sector's fundamentals and prudential indicators, coupled with Greece's upgrade to investment grade,[1] have created favourable conditions for the implementation of the Hellenic Financial Stability Fund's (HFSF)[2] strategy to divest its stakes in significant Greek banks. More specifically, in the fourth quarter of 2023 and the first quarter of 2024, the HFSF carried out four consecutive transactions[3] involving the sale of its stakes in the share capital

[1] On 19 April 2024, Standard & Poor's upgraded the outlook of the Greek economy to positive from stable, paving the way for a further upgrade in Greece's credit rating within the next 24 months.

[2] It should be noted that, under the legal framework governing the HFSF, its term is set to expire at the end of 2025. Therefore, the divestment target has been upgraded and considered to be of equal importance to the HFSF's role in maintaining the stability of the Greek banking sector to the benefit of the public interest.

[3] In more detail, in the fourth quarter of 2023 the HFSF carried out three divestment transactions, selling its entire stakes in Eurobank Ergasias Services and Holdings S.A. and Alpha Services and Holdings S.A., as well as a 22% stake in the capital of National Bank of Greece S.A. In the first quarter of 2024, it also sold its entire 27% stake in Piraeus Bank, closing the current divestment cycle. It should be noted that the HFSF maintains an 18.39% stake in National Bank of Greece S.A. and a 72.54% stake in Attica Bank.

of significant institutions (Sis), thus signaling the recovery of investor confidence in the banking sector and the latter's return to normality.

**The liquidity and funding conditions of the Greek banking sector improved further.** The balance of residents' deposits in Greece rose by 3.8% year-on-year and stood at EUR 201.6 billion in December 2023. This development greatly contributed to maintaining high levels of liquidity in Greek banking groups, despite the repayment part of the liquidity they had raised through targeted longer-term refinancing operations (TLTRO III). At the same time, despite the high interest rate environment, the return to investment grade in the second half of 2023 contributed to a further decline in sovereign and bank bond yields and facilitated the access of Greek banks to capital markets.

**In 2023, the process of cleaning up credit institutions' balance sheets continued.** The total stock of non-performing loans (NPLs) stood at EUR 9.9 billion, down by 25% or EUR 3.3 billion compared to December 2022. The ratio of NPLs to total loans for the banking sector declined further to 6.6% in 2023, from 8.7% in 2022. The corresponding indicator for SIs fell below 5%,[4] thus shortening its distance from the European average. However, the net inflow of new NPLs in 2023, despite significant reclassifications of NPLs as performing, is a source of concern. For less significant institutions (LSIs), the NPL ratio remained particularly high, standing at 37.6% in 2023, down by 8 percentage points from December 2022, mainly due to some of these banks' credit growth.

**Greek banking groups' core profitability improved significantly.** In 2023, Greek banking groups posted profits, after tax and discontinued operations, amounting to EUR 3.8 billion, compared with profits of EUR 3.4 billion in 2022. Higher net interest income contributed positively, as a result of the key ECB interest rate hikes, while a negative impact came from a large decline in income from financial operations and other revenue. In more detail, in 2023 the operating income of Greek banks increased by 9.1% compared to 2022. In particular, income from core banking activities (i.e. net interest and commission income) grew substantially by 41.7%. The significant fall in income from financial operations in 2023 is due to the fact that such income in 2022 included non-recurring gains from transactions in Greek government bonds and profits from derivatives and hedging instruments. Moreover, the decline in other revenue is explained by the fact that the 2022 results included non-recurring income from the carve-out and sale of the payment-acquiring business by all four significant institutions. At the same time, operating and credit risk costs remained unchanged. As a result, banking groups posted solid profits after tax and discontinued operations, and their Return on Assets (RoA) and Return on Equity (RoE) ratios stood at 1.2% and 12.0%, respectively.

[4] It should be noted that this ratio is below 5% in three of the four significant institutions.

**The capital adequacy of Greek banking groups strengthened considerably.** The increase in prudential own funds, mainly as a result of internal capital generation on the back of core profitability, but also through the issuance of capital instruments, more than offset a rise in risk-weighted assets. In particular, the Common Equity Tier 1 ratio (CET1 ratio) on a consolidated basis rose to 15.5% in December 2023, from 14.5% in December 2022, and the Total Capital Ratio (TCR) to 18.7%, from 17.5%, respectively, bringing the CET1 ratio closer to the European average (15.7% in September 2023), while the TCR (19.7% in December 2023) still falls short of the European average.[5] However, the quality of Greek banks' prudential own capital remains low, as in December 2023 deferred tax credits (DTCs) amounted to EUR 12.9 billion, representing 44% of total prudential own funds (down from 52% in December 2022). Moreover, deferred tax assets (DTAs) of EUR 2.6 billion are included in Greek banking groups' prudential own funds, accounting for around 9% of their total prudential own funds.

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**In the current macroeconomic and financial environment, gradually implementing an appropriate macroprudential policy to avoid the build-up of systemic risks is all the more important.** In this context, the Bank of Greece enacted macroprudential borrower-based measures (BBMs) for loans and other credit to natural persons secured by residential real estate located in Greece, effective as of January 2025. In more detail, Executive Committee Act No. 227/1/8.3.2024 introduced a cap on the loan-to-value ratio at origination (LTV-O) of 90% for first-time buyers and 80% for second and subsequent borrowers, as well as a cap on the debt-service-to-income ratio at origination (DSTI-O) of 50% for first-time buyers and 40% for second and subsequent borrowers. In addition, up to 10% of the total number of new loans and other credit can be exempted from the above LTV-O and DSTI-O caps. In parallel, the Bank of Greece conducts a quarterly assessment of the intensity of cyclical systemic risks and the appropriateness of the Countercyclical Capital Buffer (CCyB) rate for Greece and sets or adjusts it, if necessary. In 2023 and in the first two quarters of 2024, this was maintained at 0%, i.e. the lowest possible level. The analysis of the additional indicators examined by the Bank of Greece points to emerging cyclical systemic risks in certain areas, such as residential real estate prices and the current account. Overall, however, it confirms that there is no excessive credit growth and leverage. Finally, the Bank of Greece identified Other Systemically Important Institutions (O-SIIs) in Greece for the year 2023, applying the relevant European Banking Authority (EBA) guidelines, and set the O-SII buffer rate for 2024 at 1.25% for Eurobank Ergasias Services and Holdings S.A. on a consolidated basis and at 1.00% for other O-SIIs.[6] In the medium term, the implementation of appropriate macroprudential policy measures helps create adequate macroprudential space that ensures the stability of the financial system.

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[5] Source: Single Supervisory Mechanism (SSM), SSM Supervisory Banking Statistics, Publication of supervisory data (europa.eu).

[6] More specifically, for National Bank of Greece S.A. (on a solo and a consolidated basis), Piraeus Financial Holdings S.A. (on a consolidated basis) and Piraeus Bank S.A. (on a solo basis), Eurobank S.A. (on a solo basis), Alpha Services and Holdings S.A. (on a consolidated basis) and Alpha Bank S.A. (on a solo basis).

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**In 2023, insurance undertakings maintained their capital adequacy at a high level.** Their profitability was affected by increased payments of insurance claims in the aftermath of storm 'Daniel' and the impact from the implementation of International Financial Reporting Standard 17 Insurance Contracts (IFRS 17).Total gross written premiums grew, both in life and in non-life insurance. Finally, the process of mergers between insurance undertakings continued, increasing the already high concentration in the insurance sector.

**The smooth operation of financial market infrastructures, i.e. payment, clearing and settlement systems, contributed positively to the stability of the domestic financial system through the efficient processing of transactions.** As regards the electronic means of payment used, 2023 saw a significant increase in the number and value of transactions, as well as a rise in the fraud-to-transaction ratio in terms of number and value of fraud incidents.

**In 2023, the total value of exposures managed by credit servicing firms (CSFs)[7] amounted to EUR 88 billion,** of which 79% relates to exposures managed by CSFs on behalf of credit acquiring firms[8] and the remaining 21% concerns the management of exposures on behalf of credit institutions. Most of the exposures managed by CSFs on behalf of credit acquiring firms have been assigned to them over the past three years in the context of credit institutions' strategic decisions to reduce their non-performing exposures (NPEs). In light of the performance so far and its importance for an effective management of non-performing private debt, while at the same time putting into use idle productive resources, the management of these exposures by CSFs needs to improve further.

**The revised framework on credit servicers and credit purchasers (Law 5072/2023) transposes into Greek law the relevant provisions of Directive (EU) 2021/2167[9] on the authorisation and supervision of CSFs, as well as provisions on the supervision of credit purchasers**, by introducing: (a) additional requirements for the establishment and operation of CSFs; (b) communication requirements regarding the transfer of assets by credit and financial institutions and credit purchasers; and (c) a framework for cross-border activities by credit servicers. At the same time, CSFs authorised under Article 1 of Law 4354/2015 (Government Gazette A 176) and carrying out credit servicing activities are subject to reauthorisation by the Bank of Greece (to be

[7] Exposures include all debt instruments (loans and advances and debt securities), excluding off-balance-sheet exposures and write-offs. It should be noted that Bank of Greece Executive Committee Act 206/1/03.06.2022 modified, inter alia, supervisory data and information to be submitted by CSFs to the Bank of Greece.

[8] Prudential data analysed in the present section may differ from data regularly posted on the Bank of Greece website because of the different perimeter of each data release.

[9] Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU.

concluded by end-June 2024), in order to verify their compliance with the provisions of the new legislative framework.[10]

**The activities of Payment Institutions (PIs) and Electronic Money Institutions (EMIs) grew considerably in 2023.** The total value of payment transactions carried out by PIs in 2023 stood at EUR 58.2 billion, up by 92% compared to 2022 (EUR 30.3 billion) and about 32 times higher compared to 2021 (EUR 1.8 billion). The total annual value of payment transactions carried out by EMIs stood at EUR 13.7 billion, up by 33% compared to 2022 (EUR 10.3 billion). These developments had a positive impact on the own funds and profitability of PIs and EMIs.

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**The outlook for the Greek banking sector is positive, although significant challenges still lie ahead.** Greece's upgrade to investment grade undoubtedly had a positive impact on banks, while the overall improvement in banking fundamentals is undeniable. However, the outlook for the Greek banking sector is inevitably linked to European developments and progress towards a single banking market. If the necessary political will to reach a consensus is mustered, the EU will be able to take the necessary initiatives to complete the Banking Union,[11] as well as the Capital Markets Union (CMU), thus laying the foundations for stronger growth and increasing resilience in the face of new common challenges and uncertainties. In addition, boosting competition in the domestic banking sector by continuing to work towards a "fifth pillar" is important, as it will benefit consumers and businesses, also increasing the financing of the real economy. Despite the significant progress made to buttress the banking sector, challenges still lie ahead. In a more uncertain international environment, there is no room for complacency.

**The macroeconomic environment may affect banks' asset quality.** The maintenance of the European Central Bank's (ECB) key interest rates at restrictive levels – in order to bring inflation closer to its 2% medium-term target –puts strain on the resilience of households and businesses, as the bulk of their loans carry variable rates.[12] As a result, if debt-servicing costs are anchored at high levels, this can have a negative impact on the quality of banks' assets. Therefore, improving banks' asset quality and ensuring the convergence of Greece's NPL ratio to the European average

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[10] Following the publication of Law 5072/2023, the Bank of Greece issued Executive Committee Act 225/1/30.1.2024, which lays down terms and conditions for authorisation of CSFs.

[11] The European Deposit Insurance Scheme (EDIS) and, more broadly, the review of the crisis management and deposit insurance (CMDI) and the Capital Markets Union (CMU) framework.

[12] According to Bank of Greece data, the share of outstanding long-term variable-rate loans stood at 92% in December 2023.

(December 2023: 1.9%)[13] is a priority. In this context, extending the "Hercules III" asset protection scheme[14] is expected to help banks focus on their main function, which is to finance the Greek economy.

**Maintaining banks' profitability and strengthening their capital base is also challenging.** Banks' core profitability improved considerably in 2023, underpinned by net interest income, and their profitability ratios stood at high levels. When the ECB starts to cut its key interest rates, banks' core profitability may be negatively affected, especially if banks fail to meet their credit growth targets. Reduced profitability will affect banks' internal capital generation capacity and hence their ability to improve, in the medium term, the quality of their prudential own funds. In this context, banks' dividend policy must take into account the heightened uncertainty and the challenges associated with the international environment. Building up adequate capital buffers is important for the robustness of the banking sector.

**The current economic environment poses risks mainly linked to external factors**. The sharp rise in geopolitical risks with the expansion of armed conflicts, as well as the increasing trade tensions between the US and China, is leading to higher overall costs. Therefore, a possible further rise in inflation and a decline in global growth may cause stagflationary pressures. The international environment poses the biggest challenge, with potentially significant negative economic repercussions on national economies and, thus, also on financial stability. An abrupt deterioration in international financial conditions could have adverse effects both on the global financial system and on the financial situation of firms and households at the domestic level, causing shocks.

**In order for Greek credit institutions to fulfil their role as drivers of growth, they must continue their efforts to further enhance their resilience.** Priorities include the continued cleaning up of their balance sheets, as well as a quantitative and qualitative strengthening of their capital base, while maintaining adequate profitability. Banks have restarted financing the real economy, while credit growth rates will also be boosted by disbursements of business loans related to the Recovery and Resilience Facility. However, banks should continue to invest in the digitalisation of their operations in order to improve the services provided to their clients, but also to reduce operating costs. Emerging new risks, including the climate crisis and cyberattacks, need to be taken seriously, as they are difficult to identify and quantify. Therefore, vigilance from all stakeholders is needed in order to keep the domestic banking sector on a growth path.

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[13] Source: European Banking Authority, EBA Dashboard – Q4 2023.pdf (europa.eu). It should be noted that EBA data are calculated on a consolidated basis and include loans to credit institutions and central banks; therefore, they are not directly comparable with Bank of Greece data. For instance, the NPL ratio for domestic significant credit institutions on a consolidated basis and taking into account loans to credit institutions and central banks stands at 4.7%.

[14] Under this extension, the "Hercules III" scheme has a guarantee ceiling of EUR 2 billion and a term that ends on 31.12.2024. It should be noted that this scheme is expected to be used by Attica Bank and Pancreta Bank, so that they may clean up their balance sheets of NPLs ahead of their merger.

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