Rating Action: Moody's upgrades Greece's sovereign bond rating to Caa2 and changes the outlook to positive

Global Credit Research - 23 Jun 2017

London, 23 June 2017 -- Moody's Investors Service ("Moody's") has today upgraded Greece's long-term issuer rating as well as all senior unsecured bond and programme ratings to Caa2 and (P)Caa2 from Caa3 and (P)Caa3, respectively. The outlook has been changed to positive from stable.

Greece's short-term ratings have been affirmed, at Not Prime (NP) and (P)NP.

The key drivers for today's rating action are as follows:

1. Successful conclusion of the second review under Greece's adjustment programme and release of a tranche of €8.5 billion in the coming days. Beyond the near-term impact of allowing Greece to repay upcoming maturities, we consider the conclusion of the review to be a positive signal regarding the future path of the programme, as it required the Greek government to legislate a number of important reform measures.

2. Improved fiscal prospects on the back of 2016 fiscal outperformance, expected to lead soon to a reversal in the country's public debt ratio trend. The government posted a 2016 primary surplus of over 4% of GDP versus a target of 0.5% of GDP. Moody's expects the public debt ratio to stabilize this year at 179% of GDP, and to decline from 2018 onwards, on the back of continued substantial primary surpluses.

3. Tentative signs of the economy stabilizing. While it is too early to conclude that economic growth will be sustained, Moody's expects to see growth this year and next, after three years of stagnation and a cumulative loss in output of more than 27% since the onset of Greece's crisis.

The decision to assign a positive outlook to the Caa2 rating reflects Moody's view that the prospects for a successful conclusion of Greece's third adjustment programme have improved, which in turn raises the likelihood of further debt relief. The euro area creditors have committed to further extend Greece's repayment terms to the EFSF (European Financial Stability Facility; senior unsecured Aa1 stable) if needed after August 2018 when the programme ends. Later repayment to official creditors would improve Greece's capacity to service debt held by private sector investors, to which Moody's ratings speak.

The long-term country ceilings for foreign-currency and local-currency bonds have been raised to B3 from Caa2, to reflect the reduced risk of Greece exiting the euro area, and the long-term ceiling for foreign-currency and local-currency deposits has been raised to Caa2 from Caa3. Moody's maintains a two-notch gap between the bond and the deposit ceilings to reflect the ongoing capital controls. The short-term foreign-currency bond and bank deposit ceilings remain unchanged at Not Prime (NP).

A full list of affected ratings is provided towards the end of this press release.

RATINGS RATIONALE

RATIONALE FOR THE UPGRADE TO THE RATING TO Caa2

FIRST DRIVER: SUCCESSFUL CONCLUSION OF THE SECOND REVIEW

The successful conclusion of the second review under Greece's current programme and the release of an €8.5 billion tranche in the coming days will allow the Greek government to repay upcoming maturities of €6.6 billion in July, including to the ECB (€3.9 billion) and private-sector bondholders (€2.3 billion). It will also allow for the clearance of some of the government's arrears, thereby injecting much needed liquidity into the economy.

Moody's considers the importance of the second review to go beyond the short-term financial support it will yield. It required the Greek government to legislate a number of measures, some of them politically difficult (such as further tax increases and pension cuts, changes to employment legislation and some with the potential to improve Greece's growth prospects over the coming years (such as those aimed at strengthening the banking sector).

Moody's also considers that the progress made on the Programme illustrates how the risk of an exit from the euro area has diminished somewhat. While the events of 2015 illustrate the volatility of Greek politics, the current political situation is calmer, and opinion polls indicate a broad-based shift of support towards parties that are in favour of continued euro area membership.

SECOND DRIVER: IMPROVED FISCAL PROSPECTS FOR THE COMING YEARS AND REVERSAL IN THE DEBT TREND

The government managed to exceed the fiscal targets for 2016, posting a primary surplus of 4.2% of GDP versus a target of 0.5% of GDP. Part of the stronger-than-expected performance was due to temporary factors, but it also reflected improvements in tax collection that Moody's considers to be more permanent in nature. Moody's expects primary surpluses this year and next to be smaller, but still large enough to ensure that the public debt ratio starts to decline from next year onwards.

The government also legislated additional fiscal measures totaling 2% of GDP for 2019 and 2020, which go beyond the end of the current programme and would be activated if needed. These provide some assurance that the fiscal stance will remain appropriately tight in the coming years. Moody's expects the debt ratio to stand at around 176% of GDP by end-2018, compared to the peak of 179.7% in 2014. That said, the debt trend remains highly vulnerable to growth and fiscal shocks and the decline will likely be slow.

THIRD DRIVER: TENTATIVE SIGNS OF A STABILISATION OF THE ECONOMY

While it is too early to conclude that the economy has definitely turned the corner, Moody's expects to see positive growth this year, after three years of stagnation and a cumulative loss in output of more than 27% since the onset of Greece's crisis. Employment has been rising for more than a year, thereby supporting private consumption. Investment is expected to get a boost from an acceleration of EU structural funds that amount to €15.2 billion (8.4% of 2017 GDP) for the 2014-2020 period. On top of the EU structural funds, significant funding is available from the European Investment Bank (EIB, Aaa stable) and the European Bank for Reconstruction and Development (EBRD, Aaa stable). Importantly, fiscal policy will be significantly less of a drag on growth than in 2016.

RATIONALE FOR ASSIGNING A POSITIVE OUTLOOK

The positive outlook reflects Moody's view that the prospects for a successful conclusion of Greece's third adjustment programme have improved. While significant implementation risks remain, the 'heavy lifting' in terms of legislating structural reform measures has been achieved now, which in turn reduces political risks related to the stability of the government. Successful completion would be credit positive for Greece, inter alia because of the further debt relief which it would likely bring.

Greece's euro area creditors have already committed to considering a further extension of the weighted average maturities of the EFSF loans and a further deferral of interest and amortization on those loans, by up to 15 years. The IMF's intention to remain involved via a new stand-by agreement and to continue to press for additional debt relief also supports Moody's view that steps will be taken to make Greece's debt burden sustainable. The principle of linking debt relief to economic growth outcomes -- which the Eurogroup will consider -- would be a further positive step for the country.

RATIONALE FOR THE Caa2 RATING

That said, Greece's economic, fiscal and political risks remain very elevated. Negative scenarios -- in particular linked to political events and delays in implementing the agreed measures -- are entirely plausible. They are the key reason why Moody's considers that a Caa2 rating remains appropriate, at least until the means and extent of the promised medium-term debt relief has been fully clarified, the conditions for any such debt relief are clear, and a longer and stronger track record of parliamentary and electoral acquiescence in reform implementation has been established.

WHAT COULD CHANGE THE RATING UP

Greece's ratings could be upgraded further if there was clear evidence that the economy was on a sustained and reasonably strong growth path, associated with solid implementation of agreed reforms, including measures to address asset quality problems in the banking sector. Agreement by Greece's official-sector creditors to implement material further debt relief which rendered Greece's debt burden more sustainable over the medium to long-term would also place upward pressure on the rating, provided there remained broad support for the fiscal and other conditions associated with such relief.

WHAT COULD CHANGE THE RATING DOWN

Downward pressure on the ratings would emerge if there are signs that the willingness of the Greek authorities to implement the agreed measures wanes or a renewed lengthy period of political uncertainty hampers the economic recovery and leads to a material deviation from the fiscal targets.

GDP per capita (PPP basis, US$): 26,669 (2016 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 0% (2016 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 0% (2016 Actual)

Gen. Gov. Financial Balance/GDP: 0.7% (2016 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -0.6% (2016 Actual) (also known as External Balance)

External debt/GDP: [not available]

Level of economic development: Low level of economic resilience

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 20 June 2017, a rating committee was called to discuss the rating of the Greece, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutional strength/framework, have materially increased. The issuer's fiscal or financial strength, including its debt profile, has materially increased. The issuer's susceptibility to event risks has not materially changed.

The principal methodology used in these ratings was Sovereign Bond Ratings published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

LIST OF AFFECTED RATINGS

Upgrades:

..Issuer: Greece, Government of

....LT Issuer Rating, Upgraded to Caa2 from Caa3

....Senior Unsecured Regular Bond/Debenture, Upgraded to Caa2 from Caa3

....Senior Unsecured Medium-Term Note Program, Upgraded to (P)Caa2 from (P)Caa3

....Senior Unsecured Shelf, Upgraded to (P)Caa2 from (P)Caa3

Affirmations:

..Issuer: Greece, Government of

....Commercial Paper, Affirmed at NP

....Other Short Term , Affirmed at (P)NP

Raises:

..Issuer: Greece, Government of

....LT Country Ceiling Bank Deposit Rating, Raised to Caa2 from Caa3

....LT Country Ceiling Bond Rating, Raised to B3 from Caa2

Unaffected:

..Issuer: Greece, Government of

....ST Country Ceiling Bond Rating, Remains at NP

....ST Country Ceiling Bank Deposit Rating, Remains at NP

Outlook Actions:

..Issuer: Greece, Government of

...Outlook, Changed to Positive from Stable

REGULATORY DISCLOSURES

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