

**Rating Action: Moody's upgrades Greece's government bond rating to Caa1 from Caa3**

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London, 01 August 2014 -- Moody's Investors Service has today upgraded Greece's government bond rating by two notches to Caa1 from Caa3. The outlook on the rating is stable. Greece's short-term debt rating is unaffected and remains Not Prime (NP).

The rating action was triggered by the following key factors:

- The significant improvement in Greece's fiscal position over the past year and the rating agency's view that the government remains committed to fiscal consolidation underpin Moody's forecast of a gradual decline in the public debt to GDP ratio, which Moody's expects to peak this year and then start to fall from 2015.
- The improvement in Greece's economic outlook, based on both a cyclical recovery and the progress made in implementing structural reforms and rebalancing the economy, further supports the downward trajectory of the public debt ratio.
- The government's reduced interest burden and lengthened maturities of the debt, which is predominantly owed to official creditors, adds to fiscal flexibility and reduces refinancing risks.

Concurrently, Moody's has raised the local and foreign-currency country ceilings for long-term debt and deposits to Ba3 from B3. The foreign-currency country ceilings for short-term debt and deposits remains Not Prime (NP).

**RATINGS RATIONALE**

**RATIONALE FOR UPGRADE**

**-- FIRST DRIVER: SIGNIFICANT IMPROVEMENT IN THE GOVERNMENT'S FISCAL POSITION SUPPORTS REDUCTION IN THE DEBT RATIO FROM 2015**

The first factor behind the upgrade of Greece's rating is Moody's strengthened expectation that the general government debt to GDP ratio will start declining in 2015, after peaking this year according to Moody's estimates at around 179% of GDP. The government's progress in fiscal consolidation under its economic adjustment programme underscores the improvement in the debt trajectory. Moody's expects the government will reach its primary surplus Troika target of around 1.6% of GDP this year and that the headline budget deficit will decline to 2.9% in 2014. Last year, the government registered its first primary surplus since 2002, one year before it was scheduled to do so, and was able to deliver it in a decelerating economic growth environment. The budget deficit shrank to 3.2% (under the Troika support programme definition) and 12.7% of GDP according to Eurostat's definition (which includes bank recapitalisation costs, among other items).

Moreover, Moody's notes that there have been improvements in Greece's fiscal institutions and these changes should provide support to the attainment of future budget targets and support a debt reduction, which, according to the rating agency estimates, could fall to around 166% of GDP by 2018.

**-- SECOND DRIVER: IMPROVING ECONOMIC OUTLOOK SUPPORTS THE DOWNWARD DEBT TREND**

The second factor supporting the upgrade is greater certainty regarding the prospect of continued improvements in the fiscal and debt trends offered by Greece's improving economic environment, with the recovery showing signs of broadening from net exports to domestic demand. Though real GDP continued to contract (-0.9% year-on-year) in Q1 2014, the deceleration was much lower than had been expected and significantly below the -6.0% recorded in Q1 2013. Private consumption grew +0.7% in Q1 2014 for the first time in 15 quarters, reflecting a broadening of economic activity. Investment continued to decline, but at a much lower rate (-7.9%), supported by the absorption of EU funds, especially following the restart of large infrastructure projects.

While Greece's ambitious structural reform agenda has had mixed results to date, the Government has made good progress on labour market reforms and in liberalising some areas of the product markets. These reforms

have led to wage and price adjustments, which far outstrip adjustments elsewhere in the euro area periphery. Moreover, the government recently passed legislation that should help the country's medium-term growth outlook, because it will further deregulate the food processing, retail, building materials and tourism sectors. Based on these trends and high frequency data, Moody's forecasts real GDP growth of +0.4% in 2014 and +1.2% in 2015.

#### -- THIRD DRIVER: GREECE'S MORE BENIGN DEBT STRUCTURE REDUCES REFINANCING RISKS AND PROVIDES FISCAL FLEXIBILITY

The predominantly official creditor structure of the Greek government debt has allowed the reduction of the government's interest burden and lengthened maturities following previous private-sector debt restructurings and official sector assistance. The creditor structure, where 82% of Greece's general government debt is held by the official sector (mainly the IMF, EC, ECB and other euro area governments), and the debt profile that has evolved in consequence, adds to the government's fiscal flexibility and reduces refinancing risks.

Moody's considers that Greece's fiscal outlook is more resilient than in the past, given the improvement in the debt affordability (interest expenses-to-revenues) to 10.1% in 2014 from 17.0% in 2011. At 4% of GDP in 2013, interest-to-GDP is also in line with the euro area average. Greece's debt-maturity profile has also been lengthened to around 18 years in 2014, up from around 6.5 years in 2011.

#### --FACTORS CONSTRAINING THE RATING AT THE Caa LEVEL

This rating level incorporates the continuing, high level of political uncertainty in Greece. There is a high probability of early parliamentary elections by Q1 2015, prompted by (1) the eroding majority of the coalition government; and (2) the constitutional rules surrounding the Presidential appointment, which is due by February 2015. Moody's believes that the prospect of early elections, the result of which are highly uncertain, increases the risk of delays in policy implementation at a critical juncture of the economic adjustment programme, and amplifies liquidity and financing risks associated with the near-term financing gap.

This uncertainty is heightened by the ambiguity associated with the end of European Commission and IMF programmes in December 2014 and Q1 2016, respectively. Important decisions will be made over the coming months related to the financing of the government's funding needs for 2015, the shape of the structural adjustment programme post 2016 and the structure of further official-sector debt relief (as was discussed by the Eurogroup in November 2012). Moody's base case is that external support will still be forthcoming in some form; however, the rating agency believes that the primary surplus targets under the current Troika program are ambitious and would prove demanding in the current social and political environment. Consequently, Moody's expects that the forthcoming negotiations with the official creditors will be challenging and the risk that these tensions imply for creditors are incorporated in the current rating level. Thus, the rating continues to incorporate the following credit challenges: (1) an ambitious structural adjustment programme; (2) a very high level of public debt and a banking system that has high levels of non-performing loans (NPLs) and is unsupportive to economic growth; (3) a track record of default; and (4) a challenging political and social environment, which complicates the implementation of structural reforms.

#### --LOCAL AND FOREIGN-CURRENCY CEILING--

Moody's has also today adjusted upwards Greece's local and foreign-currency ceilings to Ba3 from B3. The ceilings reflect a range of un-diversifiable risks to which issuers in any jurisdiction are exposed, including the risk of exit from the euro area and the resulting currency redenomination.

#### WHAT COULD MOVE THE RATING UP/DOWN

Moody's could consider upgrading the rating in the event of (1) an increase in the pace of fiscal consolidation, and structural reforms; (2) continued economic growth and sustained large primary surpluses, both of which would support a continued decline in debt levels; and (3) more certainty and visibility on future external financial support and the political environment.

Conversely, the rating could be downgraded if there is a deceleration in the implementation of the structural adjustment programme due to heightened political risk and reform fatigue, as this would further hinder Greece's growth prospects and its ability to generate large primary surpluses over the coming years.

GDP per capita (PPP basis, US\$): 24,012 (2013 Actual) (also known as Per Capita Income)

Real GDP growth (% change): -3.9% (2013 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): -1.7% (2013 Actual)

Gen. Gov. Financial Balance/GDP: -12.7% (2013 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: 0.7% (2013 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 29 July 2014, 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 improved. The issuer's fiscal or financial strength, including its debt profile, has strengthened. An analysis of this issuer, relative to its peers, indicates that a repositioning of its rating would be appropriate.

The principal methodology used in this rating was Sovereign Bond Ratings published in September 2013. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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

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