

BANK OF GREECE

MONETARY POLICY

2005 - 2006



FEBRUARY 2006

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REPORT ON
MONETARY
POLICY
2005-2006



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To the Greek Parliament and the Council of Ministers

The present Report on Monetary Policy is submitted to the Greek Parliament and the Council of Ministers in accordance with the Statute of the Bank of Greece. The Report examines the international economic environment and discusses economic developments in the euro area and Greece during 2005, as well as the economic prospects for 2006. The Report is summarised in Chapter I.

Developments in the world economy were overall positive in 2005, despite the substantial rise in world crude oil prices, as mentioned in Chapter II, while the outlook remains favourable for 2006. According to available forecasts, economic activity worldwide and the volume of world trade will grow at approximately the same high rates as in 2005. However, the economic outlook continues to be subject to considerable risks, associated with a possible further rise in oil prices and the large macroeconomic imbalances in the world economy. In the euro area, average GDP growth is estimated to have slowed in 2005 in comparison with 2004, but in the current year is expected to gain momentum and reach a clearly higher level. Inflation in the euro area stood slightly over 2% in 2005, while in 2006 it is expected to be between 1.6% and 2.6%. On 1 December 2005, the ECB raised its key interest rates by 25 basis points. The ECB's Governing Council reached this decision after taking into account the risks to price stability and the medium-term outlook for inflation. The Governing Council has not decided *ex ante* to proceed to successive interest rate increases in the near future. However, it will continue to monitor closely all developments relevant to the medium-term outlook for price stability. In its recent meetings (12 January and 2 February 2006), the Governing Council decided to leave the key ECB interest rates unchanged,

but stressed the need for vigilance in order to ensure the solid anchoring of inflation expectations at levels in line with price stability over the medium term.

Chapter III examines monetary and financial developments in Greece and evaluates the stability of the financial system, with a focus on the banking system. The main conclusion of this evaluation is that the profitability and capital adequacy of the Greek banking system provide a satisfactory safety margin for ensuring its stability. Notwithstanding this finding, the need to monitor and control continuously the risks assumed by banks should not be underestimated, since the level of such risks may rise considerably in the event of adverse developments in the economic environment.

Chapter IV discusses economic developments in Greece in 2005 and the outlook for the current year. Economic growth is expected to slow down slightly in 2006 in comparison with 2005; therefore, the economy will continue to grow considerably faster than in the euro area. Inflation is expected to fall somewhat in 2006 compared to 2005, because the adverse effects of exogenous factors will weaken, but will remain higher than in the euro area.

Despite relatively high growth rates during the last decade, the Greek economy faces crucial challenges, which are examined in the last chapter. Unemployment remains unacceptably high, living standards continue to be lower than the EU-15 average and social inequality is still substantial. At the same time, for the sixth consecutive year since the adoption of the euro, inflation remains persistently higher than in the euro area; as a result, the economy's international price competitiveness is being constantly eroded, while

the economy's overall competitiveness is low owing to structural weaknesses. Fiscal imbalances, as reflected in the very high deficit- and debt-to-GDP ratios (despite their decline in 2005), fuel inflation and jeopardise macroeconomic stability. Moreover, the EU enlargement and globalisation pose serious challenges for Greece, but also create opportunities for our country.

Athens, February 2006

Continuing the efforts to achieve macroeconomic stability, i.e. fiscal consolidation and price stability, and going on with the implementation of structural reforms over a wide range of economic sectors in order to further improve the macroeconomic environment and boost the productivity and international competitiveness of the Greek economy are key conditions for addressing these challenges and generating high and sustainable growth.

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I. Summary

On 1 December 2005, the European Central Bank (ECB) decided to raise by 25 basis points its key rates,¹ which had remained unchanged at historically low levels for two and a half years. The ECB Governing Council reached this decision after taking into account the risks to price stability and the medium-term outlook for inflation. This rate increase is aimed at keeping medium and long-term inflation expectations in line with price stability. Such an anchoring of inflation expectations will enable monetary policy to make an ongoing contribution towards supporting economic growth in the euro area. It should be noted that interest rates across the maturity spectrum in the euro area still remain very low and are supportive of economic activity, which is expected to gain further momentum in the course of 2006.

According to the economic analysis on which the ECB's Governing Council based its decision to raise interest rates, recent price increases, mainly in energy, contributed to pushing HICP inflation above 2%. The annual inflation rate was 2.2% in December, compared with 2.6% in September, while the average inflation rate for 2005 stood at 2.2%. Furthermore, the most recent projections of the Eurosystem staff (December 2005) for annual inflation in 2006 were revised upwards, compared with those made in September 2005, and inflationary risks were identified, which may stem from possible oil price increases and second-round effects on the wage and price-setting policies of enterprises, as well as from possible increases in indirect taxes and administered prices in the euro area. Also, it was confirmed, on the basis of all relevant indicators, that there is excess liquidity in the euro area, which also points upside risks to price stability in the medium and

¹ Specifically, the minimum bid rate on the main refinancing operations was raised to 2.25%, the marginal lending facility rate to 3.25% and the deposit facility rate to 1.25%.

long term. The strengthening of monetary growth, observed since mid-2004, continued until September 2005. A small deceleration was recorded in the fourth quarter of 2005, but the rate remained high, mainly owing to credit expansion to the private sector, associated, *inter alia*, with the low level of interest rates.

As regards the future interest rate policy, the Governing Council has not decided *ex ante* to proceed to successive interest rate increases in the near future. However, it will continue to monitor closely all developments relevant to the medium- and long-term outlook for price stability, the maintenance of which will be the guiding principle of any decisions to be made.

In its recent meetings (12 January and 2 February 2006), the Governing Council decided to leave the key ECB interest rates unchanged, but stressed the need for vigilance in order to keep inflation expectations in line with price stability over the medium term.

Across the short end of the maturity spectrum, euro area money market rates remained stable for the most of 2005 and rose in November 2005, as expectations for an increase in the ECB's rates gradually gained ground. Long-term interest rates, after some fluctuations in the first half of 2005, followed an upward path from the end of July, which continued at the beginning of 2006. Ten-year bond yields were very low, reflecting the stabilisation of inflation expectations, the enhanced credibility of monetary policy, weak expectations (until mid-September) about economic activity, as well as an upward shift in the demand for long-term securities.² In the first 11 months of 2005, bank deposit rates did not change considerably, while lending rates dropped further in most categories. In December 2005, however, deposit and lending rates rose in almost all categories. The

euro area stock market followed an upward course and at end-2005 the broad Dow Jones EURO STOXX index was 23% higher than at end-2004.

In Greece, the annual growth rate of the Greek contribution to the euro area M3 (excluding currency in circulation) slowed considerably during 2005 (fourth quarter of 2005: 6.4%, fourth quarter of 2004: 9.2%) and since mid-2005 has been –for the first time in the 2004-2005 period– lower than the corresponding rate in the euro area. This deceleration is *largely* associated with shifts out of M3 (mainly into foreign bond-type mutual funds) and, secondarily, with a moderation, compared with 2004, in the growth rate of GDP at current prices, which rate is a determinant of transactions demand for money.

The introduction, as from January 2005, of a single tax rate for deposit interest income, repo and government securities yields affected developments in the main components of M3. Specifically, substantially higher annual growth rates were observed in the deposits which, according to the ECB's definition, are included in M3 (fourth quarter of 2005: 19.2%, fourth quarter of 2004: 12.6%). Underlying this was a large rise in time deposits. Since they offer a relatively higher net interest rate, these deposits attracted flows out of repos, which continued to decline at a faster pace, as well as out of savings deposits, the growth of which decelerated substantially. Finally, the rate of decrease in repo holdings and money market fund shares/units accelerated further.

The annual growth rate of the total financing³ of the economy by Monetary Financial Institutions (MFIs,

² The reasons underlying this phenomenon are analysed in Box II.1.
³ The total financing of the economy comprises the outstanding balance of bank loans (including extraordinary write-offs and securitised loans, see Chapter III.2), as well as MFIs' holdings of government securities and corporate bonds.

i.e. banks and money market funds) operating in Greece accelerated appreciably to 16.8% in the fourth quarter of 2005 (fourth quarter of 2004: 10.8%). This was mainly due to the annual rate of change in general government financing, which turned positive in the last quarter of 2005 (9.4%, in comparison with -5.6% in the fourth quarter of 2004) for the first time since January 2002. The growth rate of credit to enterprises and households also accelerated, though less so (last quarter of 2005: 19.9%, last quarter of 2004: 19.3%).

Specifically, the annual growth rate of the total financing of enterprises (loans and bonds) stood at 12.5% in the fourth quarter of 2005, i.e. it remained virtually unchanged year-on-year (fourth quarter of 2004: 12.6%). Underlying the maintenance of this relatively high growth rate were issues of corporate bonds held by MFIs. Issuance activity continued in 2005; as a result, MFIs' holdings of such securities at the year-end represented 12.0% of total corporate financing by banks (December 2004: 8.2%). Among economic sectors, the growth of credit to shipping has accelerated appreciably, reflecting, in addition to foreign exchange valuation differences, increased investment spending by shipping companies for fleet renewal.

The annual rate of increase in total bank credit to households (including securitised loans) remained high, standing at 30.3% in the fourth quarter of 2005 (fourth quarter of 2004: 30.0%). This reflects the combined effect of a substantial acceleration in housing loan growth (fourth quarter of 2005: 31.3%, fourth quarter of 2004: 26.9%) and a large decline in the rate of increase in consumer loans, which, however, remained high (fourth quarter of 2005: 29.9%, fourth quarter of 2004: 37.9%). As a result of these developments, total household indebtedness (loans from MFIs, including securitised loans) rose to 38.3% of GDP in

December 2005 (December 2004: 31.4%). Total MFI loans to households (excluding securitised loans) as a percentage of GDP stood at 36.5% at end-2005, compared with a euro area average of 52.6%.

Bank deposit rates showed little change in Greece during 2005. Specifically, interest rates on deposits by households stood higher than the corresponding euro area rates; as a result, the positive differential of Greek interest rates vis-à-vis the euro area average remained practically unchanged (25 basis points for deposits with a maturity of up to one year in December 2005).

Interest rates on new loans to households fell in Greece during 2005. The decline in Greek lending rates is largely attributable to strong competition between banks operating in Greece and was maintained for some categories in December, i.e. *after* the ECB raised its key interest rates by 25 basis points. By contrast, as already mentioned, during the same month, lending and deposit rates in the euro area rose in almost all categories. It should be pointed out that interest rates on loans to households in the euro area remained at lower levels and in certain loan categories they showed smaller changes; hence, their differential with the corresponding Greek rates narrowed. In Greece, during 2005 the largest decline (110 basis points) was observed in the category of consumer loans with a defined maturity, while the average rate on consumer loans without a defined maturity also fell (by 34 basis points). The average interest rate on the total of housing loans declined commensurately (by 46 basis points).

Interest rates on new corporate loans rose or remained virtually unchanged in 2005. Specifically, the average rate on corporate loans without a defined maturity showed almost no change. By contrast, interest rates on corporate loans of up to

€1 million with a floating rate or an initial rate fixation of up to one year increased significantly (by 37 basis points), while the corresponding rates in the euro area remained virtually unchanged; as a result, the relevant differential widened. Generally, the largest differentials are observed in (consumer and corporate) loans without a defined maturity.

The margin between the average rate on the total of bank loans and the corresponding rate on deposits narrowed by 27 basis points during 2005. This development was mostly due to a drop in the average lending rate and –to a lesser extent– a slight increase in the average deposit rate. The decline in the average lending rate mainly reflects a decrease in the average interest rate on loans to households, while the interest rate on loans to enterprises rose slightly. The narrowing of the margin between lending and deposit rates largely reflects increased competition between banks. The fact that this margin remains wider in Greece than in the euro area as a whole reflects, *inter alia*, differences in banks' operating and loan management costs (which, in turn, may be associated with differences in e.g. the size of borrowing firms or households' loan-to-collateral ratios).

Greek government bond yields fell to historical lows between mid-2004 and end-September 2005, before rebounding considerably in the remainder of the year. This reflects similar developments in the euro area bond markets. Initially, factors underlying the decline in yields, which was stronger for long-term bonds, were uncertainty about the path of the economy in the euro area (owing to the rise in oil prices) and increased liquidity in capital markets worldwide. However, in the last quarter of 2005, a correction was observed in comparison with the September historical lows. Furthermore, an improved outlook for the euro area economy and investor concerns

about a possible pickup in inflation as a result of high oil prices and, therefore, about a rise in euro area interest rates also contributed to the widening of yields. Despite a decline in comparison with the previous year, transactions in government securities on the secondary market were high in 2005. Activity in the primary market for securities was characterised by a drop in funds raised, an increase in long-term securities issuance, as well as sustained strong demand for Greek government securities, notably by foreign institutional investors.

Share prices in the Greek stock market rose appreciably in 2005, influenced favourably by the increased profitability of Athens Exchange-listed firms (notably of the financial sector), higher participation of foreign institutional investors, expected structural changes in companies affiliated with the government sector, as well as the strengthening of the institutional framework of the capital market and the entry into force of the new Athens Exchange Regulation. It should be pointed out that the rise in the Athens Exchange composite share price index was one of the highest in both the euro area stock markets and other developed markets worldwide. Moreover, 2005 saw a substantial increase in stock exchange transactions, while the funds raised grew visibly, despite remaining at relatively low levels.

* * *

World economic developments remained favourable in 2005, marked by a moderate slowdown in economic activity in spite of a steep rise in world crude oil prices. World GDP growth fell to 4.3% in 2005, from 5.1% in 2004, and the volume of world trade in goods and services increased by around 7%. In spite of a sharp rise in oil and other commodity prices, inflation rates stayed low, due to wage moderation and the downward pressure

on prices exerted by the globalisation of the goods and services markets and the ever-growing participation of low-production-cost countries in world trade. Meanwhile, central banks' gain in credibility regarding the achievement of price stability has had a favourable effect on the inflationary expectations of economic agents.

The outlook for 2006 is also favourable. World GDP is projected to continue to grow at the same satisfactory pace as in 2005, while the volume of world trade is forecast to rise by 7.4%. However, the principal risks to the sustainability of strong global economic growth and to keeping inflation in check are oil and other commodity price developments, as well as the significant macroeconomic imbalances (mainly the large current account deficit of the United States). Addressing these risks calls for appropriate policies. According to the IMF, such policies should focus on increasing savings (mainly by reducing fiscal deficits) in countries with large current account deficits and strengthening domestic demand (mainly through investment and structural changes) in countries with current account surpluses. Appropriate policies should be geared both to increasing the oil supply and refining capacity and to reducing oil dependency, while excess volatility and disorderly movements in exchange rates are undesirable; exchange rates should reflect economic fundamentals. Besides, in order to contain inflationary pressures, in addition to an appropriate monetary policy, other policies are also needed, aimed at safeguarding free trade and competition worldwide.

In the *euro area*, macroeconomic developments in 2005 were marked by the gradual recovery of economic activity during the first three quarters (although average annual GDP growth declined to 1.3%, from 2.1% in 2004), the persistence of inflation above 2% throughout most of the year and

the weakening of the euro's effective exchange rate for the first time in four years. In terms of budgetary developments, 2005 did not see any fundamental change in the fiscal position of the euro area as a whole.

Specifically, during the first three quarters of 2005, investment expenditure and exports and – to a lesser extent – private consumption gradually strengthened. The main factors underlying this strengthening in investment growth were firms' satisfactory profitability and favourable financing conditions, in conjunction with a positive outlook for the global economy and international demand. The improvement in private consumption was limited, which is mainly attributable to the small increase in households' real disposable income, on account, *inter alia*, of the dampening effect of oil price increases on households' purchasing power. Economic recovery in the euro area is expected to continue in 2006 and real GDP growth is forecast to be around 2.0%. External demand growth is expected to remain strong, while the maintenance of low interest rates and favourable financing conditions for firms in the euro area should support investment demand. The rebound in business confidence and investment is expected to have a beneficial effect on employment and, in turn, support private consumption.

As already mentioned, in 2005 average annual inflation in the euro area was 2.2%, while in January 2006 annual HICP inflation reached 2.4% (provisional estimates), i.e. it was lower than expected. According to Eurosystem macroeconomic staff projections (December 2005), inflation should be between 1.6% and 2.6% in 2006 as a whole, assuming that oil prices will increase much less (on average) in 2006 than in 2005 and that nominal wage increases will be moderate.

In the *Greek economy*, growth is forecast to slow down slightly this year in comparison with 2005; therefore, the economy will continue to grow considerably faster than the euro area. Inflation is expected to fall somewhat in 2006 compared with 2005, because the adverse effects of exogenous factors will weaken, but will remain higher than in the euro area; as a result, the international price competitiveness of the economy will be further eroded.

Specifically, GDP is forecast to grow by about 3.5% in 2006, compared with 3.7% in 2005. Private consumption is expected to increase at a slightly lower rate than in 2005, but continue to be the main driving force of domestic demand, and to be supported not only by an expected rise in incomes and employment, but also by the increase in consumer loans and the cumulative rise in the market value of households' assets in recent years. Besides, the share of total fixed capital formation in GDP growth will be substantially larger in 2006, as a result of an expected rebound in public investment (following drastic cuts in 2005) and residential investment (after a small decrease in 2005). The rate of business investment growth is expected to be near the 2005 level, since public enterprises plan to increase their investment considerably, while it is estimated that private firms will take advantage of the incentives provided under the development law and of credit conditions, which remain favourable. By contrast, government consumption growth will decline further as a result of fiscal adjustment. Economic growth will be accompanied by a further rise in employment, but, as a result of an increase in the labour force, it is estimated that it will have a limited effect on the unemployment rate, which will therefore remain high.

The contribution to GDP growth of the change in the real external balance of goods and services, which was positive in 2005, is estimated to turn

negative this year. The current account deficit as a percentage of GDP is expected to show a small increase in 2006 over 2005, when it reached 7.8%. (However, it is estimated that the current account deficit excluding ships will remain unchanged or will drop slightly as a percentage of GDP in comparison with 2005, when it was 7.4%. The combined current account and capital transfers deficit as a percentage of GDP is expected to remain virtually unchanged in comparison with 2005 at 6.7%.) Specifically, goods exports will grow faster, boosted by world economic activity, but, owing to further losses in international competitiveness, their increase will continue to fall short of the rise in demand for imports in the markets for Greek exports. At the same time, goods imports, which remained virtually unchanged or declined (at constant prices) in 2005 (after rising to a high level in 2004 owing to the Olympic Games), are expected to show a marked rebound in 2006. The favourable external environment should support demand for shipping services (but receipts may decrease owing to the fall in freight rates), while tourist receipts are expected to rise further. Finally, it is estimated that interest payments will continue to grow, while at the same time the preconditions exist for an increase in the current transfers surplus (and in the capital transfers surplus).

HICP inflation is forecast to fall to 3.2% in 2006, from 3.5% in 2005 (average annual rates), while core inflation (i.e. excluding energy and unprocessed food prices) is expected to drop to 2.9% in 2006, from 3.2% in 2005. These forecasts take into account the waning (from April 2006) of the impact of last year's raise in indirect tax rates on the annual inflation rate, the expected decrease in imported inflation (mainly as a result of weaker crude oil price hikes) and an estimated further easing of inflationary pressures on the demand side. It is estimated that these factors will more

than offset the effect of an expected faster rise in unit labour costs (which, according to certain data and assumptions, are forecast to increase by 3.5-3.8%, compared with 2.5% in 2005, for the whole economy and by 4.0-4.3%, compared with 2.8% in 2005, for the business sector). Naturally, inflation forecasts incorporate an element of uncertainty, to the extent that they hinge on developments in oil prices, exchange rates and the prices of fresh fruits and vegetables during 2006, as well as on unit labour cost growth (which will depend, on the one hand, on the outcome of collective bargaining in the private sector and public enterprises and, on the other hand, on the productivity growth rate).

* * *

Despite relatively high growth rates during the last decade, the Greek economy faces critical challenges. Greece's *per capita* GDP (in purchasing power standards) was still 23% lower than that of the EU-15 in 2005 and unemployment remains unacceptably high (slightly below 10% of the labour force). Moreover, despite the fast improvement in average living standards, the relative financial position of certain social groups has not improved considerably; as a result, social inequality remains significant and the poverty rate remains virtually unchanged. At the same time, the prospects for high economic growth over the longer term are jeopardised by macroeconomic imbalances and structural weaknesses, under conditions of ever stronger competition in the world economy.

Inflation remains higher than in the euro area; as a result, the economy's international price competitiveness is being constantly eroded, while its overall competitiveness is low, owing to structural weaknesses and rigidities in the labour market, the educational system and the business

environment. Fiscal imbalances, as reflected in the very high deficit- and debt-to-GDP ratios (despite their decline in 2005), fuel inflation and jeopardise macroeconomic stability. Furthermore, unless structural measures are taken to address the population ageing problem and unless pension system reform is implemented in a timely manner, fiscal imbalances will deteriorate from 2015, when –*given current trends and the existing institutional framework*– pension expenditure as a percentage of GDP is expected to start rising owing to demographic developments. Moreover, the expansionary stance of fiscal policy in recent years was reversed in 2005, while strong credit expansion, which is also one of the factors that have supported private consumption, domestic demand and GDP growth in recent years, will inevitably slow when households' total borrowing as a percentage of GDP (which is still considerably lower than the euro area average) will tend to stabilise. At the same time, the international environment, despite remaining favourable, may become unfavourable for economies that lag behind in productivity growth and are characterised by rigidities.

In these circumstances, achieving fiscal consolidation, ensuring price stability and continuing to implement structural reforms over a wide range of economic sectors in order to further improve the macroeconomic environment and boost the productivity and international competitiveness of the Greek economy are key conditions for achieving high and sustainable growth.

Fiscal consolidation will require sustained fiscal adjustment for a number of years, so as to achieve fiscal surpluses and substantially reduce public debt over the long term. Moreover, wage increases compatible with achieving and maintaining price stability will halt a further erosion of price competitiveness and help reduce inflation.

Specifically, fiscal adjustment should – as provided for by the Updated Stability and Growth Programme of December 2005 – rely on rigorously controlling current expenditure, broadening the tax base and combatting tax evasion. This will provide leeway to further reduce tax rates, carry out adequate public investment for upgrading infrastructures, face the pressures on the pension and health systems from population ageing and ensure social protection for weak population groups. It should be pointed out, in this connection, that reforming the social security system in a timely manner is vital if ageing-induced demographic pressures are to be addressed in a way that is socially fair and does not have an adverse impact on the economy's long-term prospects. Furthermore, reducing fiscal deficits and public debt substantially will allow the implementation of a redistributive policy through the government budget, so as to support those social groups (like low-pension earners) that are always below the poverty line but cannot benefit from measures to boost employment, as they have retired from the labour market.

However, in addition to efforts to achieve macroeconomic stability, economic policy measures that improve overall competitiveness and encourage exports of skilled-labour-intensive products will be needed if the Greek economy is to cope with the challenges faced in world markets. Such measures should include upgrading the labour force (partly by improving education), reducing labour market rigidities, enhancing competition in product markets and improving the business environment and the operation of public administration and the public sector in general. So far considerable steps have been made (see the Appendix to Chapter IV), but there is still a lot to be done. Unless structural problems are addressed in a timely manner, not only economic stability will be at risk, but also

investors' confidence in the prospects for the economy will weaken.

* * *

The Greek financial system benefited from burgeoning economic activity in recent years, the liberalisation of the financial sector and integration into the EU and the euro area. As pointed out in the previous Bank of Greece report,⁴ the Greek financial sector overall is sound and resilient to possible shocks. The stability of the Greek financial system has been ensured, as the capital adequacy ratios, the profitability and liquidity of Greek banks are most satisfactory. However, the banking sector faces certain medium-term challenges owing to potential risks from strong credit expansion in the event of a slowdown in economic growth or a further increase in euro area interest rates. Moreover, the competitiveness of Greek banks, which are relatively small, is adversely affected by arrangements that limit banks' leeway to reduce operating costs and their interest rate margin.

Ahead of the implementation of the new supervisory framework ("Basel II") in 2007, the Bank of Greece has taken or recommended the relevant necessary measures and is going to take further measures soon with a view to addressing effectively the aforementioned risks and challenges. Among other things, it has urged banks to implement conservative credit standards in evaluating loan applications. According to a Bank of Greece Governor's Act, banks should ensure that the ratio of total loan servicing costs to income for any borrower should not exceed a reasonable ceiling (30% or 40%, depending on the income size). In addition, with respect to real estate col-

⁴ *Monetary Policy, Interim Report 2005*, October 2005.

lateral, banks should ensure that the loan-to-collateral ratio does not exceed the reasonable percentage of 75%.

Furthermore, since the bulk of loans to households are floating-rate loans, the Bank of Greece has recommended to households that they should make realistic assumptions about their income prospects in relation to the amount of their total debt obligations, so as to be able to cope with any increase in the loan servicing costs owing to possible interest rate hikes. If they do not wish to assume such a risk, households should seek to obtain fixed-rate loans. Finally, since 1998, the

Bank of Greece has been establishing general principles and criteria for banks' internal control systems. In 2005 it set out specific principles and criteria for ensuring the effective and safe operation of banks' information technology systems. Moreover, the Bank of Greece decided to update and broaden the institutional framework on internal control systems. To this end, it prepared and transmitted to banks a draft Governor's Act for consultation; the object of this draft Act is to ensure that every credit institution, on both an individual and a consolidated basis, has adequate internal control, risk management and compliance systems.

II. The international economic environment and economic developments and prospects in the euro area

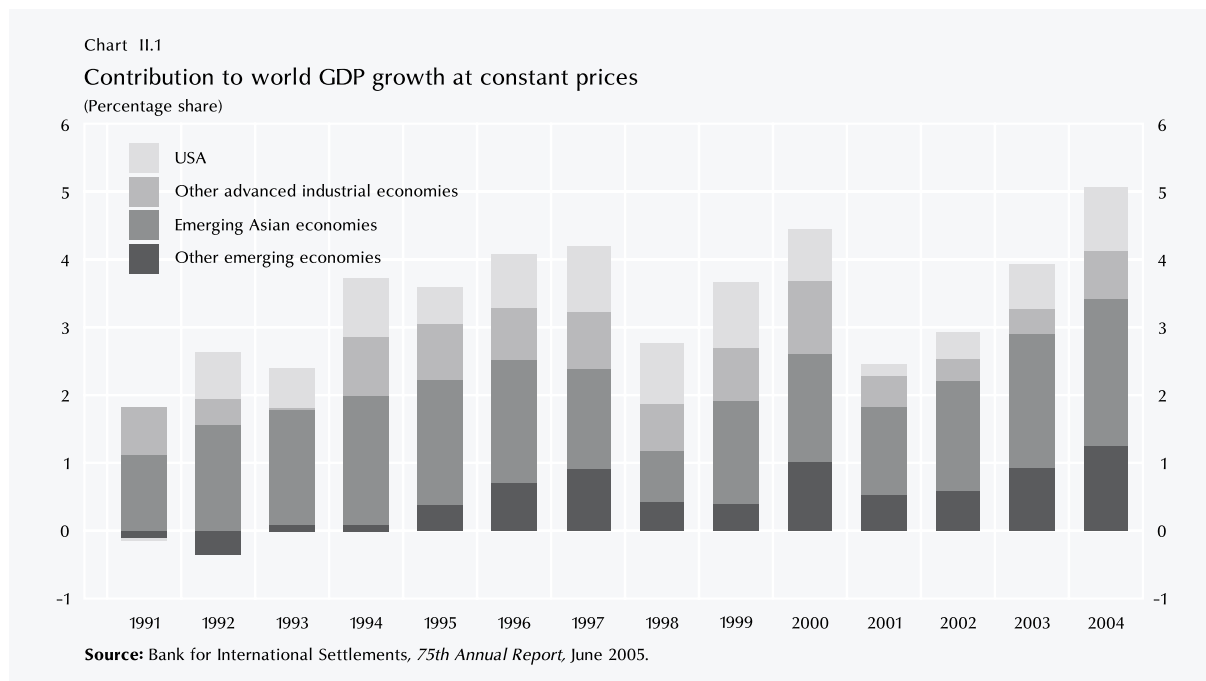
1. The international economic environment¹

1.1. Overview

World economic developments remained favourable in 2005, marked by a moderate slow-down in economic activity in spite of the steep rise in crude oil prices. The outlook for 2006 is equally favourable, though subject to considerable uncertainty associated mainly with a further rise in oil prices and widening global macroeconomic imbalances.

The negative impact on global GDP in 2005 caused by the sharp (about 46%) rise in the already high oil prices was in part offset by the continued –since 2004– positive contributions of such factors as: exceptionally low real interest rates and favourable financing conditions, an improvement in the financial position of businesses and the further increase in household assets spurred by the upward trend in the real estate markets of certain major economies. Favourable employment developments were also recorded in several economies. In addition, the dynamism of the economies of China and India continued to significantly underpin high global economic growth (see Chart II.1). In spite of the sharp rise in oil and other commodity prices, inflation rates stayed low, due to wage moderation and the downward pressure on prices exerted by the globalisation of the goods and services markets and the ever-growing participation of low production cost countries in world trade. Meanwhile, the central banks' gain in credibility

¹ The estimates and forecasts given for 2005-2006 are based on data available in mid-February 2006. Where such information was not available, data were drawn from the following sources: OECD, *Economic Outlook* (November 2005); European Commission, *Economic Forecasts – Autumn 2005* (November 2005) and IMF, *World Economic Outlook* (September 2005).



regarding the achievement of price stability has had a favourable effect on the inflationary expectations of economic agents.

World GDP growth (at constant prices) fell to 4.3% in 2005 from 5.1% in 2004, though still remaining slightly above its long-term trend. The slowdown was to be expected, considering that world GDP growth in 2004 had reached its highest level since 1976. GDP growth in the advanced economies as a whole slowed to 2.5% from 3.3% in 2004, reflecting developments in the US and Japan, as well as in the euro area. GDP growth also slowed in the “emerging market and developing economies”² (to 6.4% in 2005 from 7.3% in 2004).

Among the larger economies, the highest GDP growth rates in 2005 were recorded by China (9.9%), India (7.1%) and Russia (6.1%) in the group of emerging market and developing economies, and by the United States and Canada in the advanced economies. GDP growth in the euro area slowed to 1.3% in 2005 from 2.1% in

2004 (for a more detailed analysis, see Section 2 below), and to 3.5% from 4.2% in the US. The net impact on the US economy of the natural disasters in August and September (once restoration costs are taken into consideration) is estimated at roughly 0.5 percentage point of GDP for the second half of 2005. Private consumption remained strong, while net exports, in spite of their negative contribution to GDP, improved, as a result of the US dollar depreciation over the previous three years. In Japan, the slowdown in GDP growth to 2.0% in 2005 (from 2.7% in 2004) was mainly due to the smaller contribution of net exports to GDP. Nevertheless, domestic demand picked up further, suggesting that recovery will continue in the medium term. In the United Kingdom, GDP growth slowed to 1.8% in 2005, from 3.2% in 2004, mainly on account of weakening domestic

² The term “emerging market and developing economies” was introduced by the IMF in April 2004 to designate the economies that are not part of the group of 29 advanced economies. This term encompasses the “transition economies” (countries of Central and Eastern Europe, countries of the Commonwealth of Independent States – former USSR) and the developing economies (in Africa, Asia, Latin America and the Western Hemisphere).

Table II.1

GDP at constant prices: latest available estimates and forecasts of the IMF, the European Commission, the OECD and Consensus Economics

(Annual percentage changes)

	Percentage share in world GDP(*)	2005 (estimates)*				2006 (forecasts)			
		IMF 21.9.05	EC 28.11.05	OECD 29.11.05	Consensus 16.2.06	IMF 21.9.05	EC 28.11.05	OECD 29.11.05	Consensus 16.2.06
World economy**	100.0	4.3	4.3	–	3.2	4.3	4.3	–	3.3
USA	20.9	3.5	3.5	3.6	3.5	3.3	3.2	3.5	3.2
Japan	6.9	2.0	2.5	2.4	2.5	2.0	2.2	2.0	2.3
China	13.2	9.0	9.3	9.3	–	8.2	8.7	9.4	–
United Kingdom	3.1	1.9	1.6	1.7	1.8	2.2	2.3	2.4	2.1
Euro area	15.3	1.2	1.3	1.4	1.4	1.8	1.9	2.1	2.0

* According to the first available ex post data for 2005 from national sources, GDP increased by 3.5% in the USA, 9.9% in China, 1.8% in the UK and 1.3% in the euro area.

** Calculations based on 2004 purchasing power parities (excluding Consensus Economics' calculations, which are based on exchange rates for 2004).

Sources: IMF, *World Economic Outlook*, September 2005.

European Commission, *Autumn 2005 Economic Forecasts*, November 2005.

OECD, *Economic Outlook*, No. 78, November 2005.

Consensus Economics, *Consensus Forecasts*, February 2006.

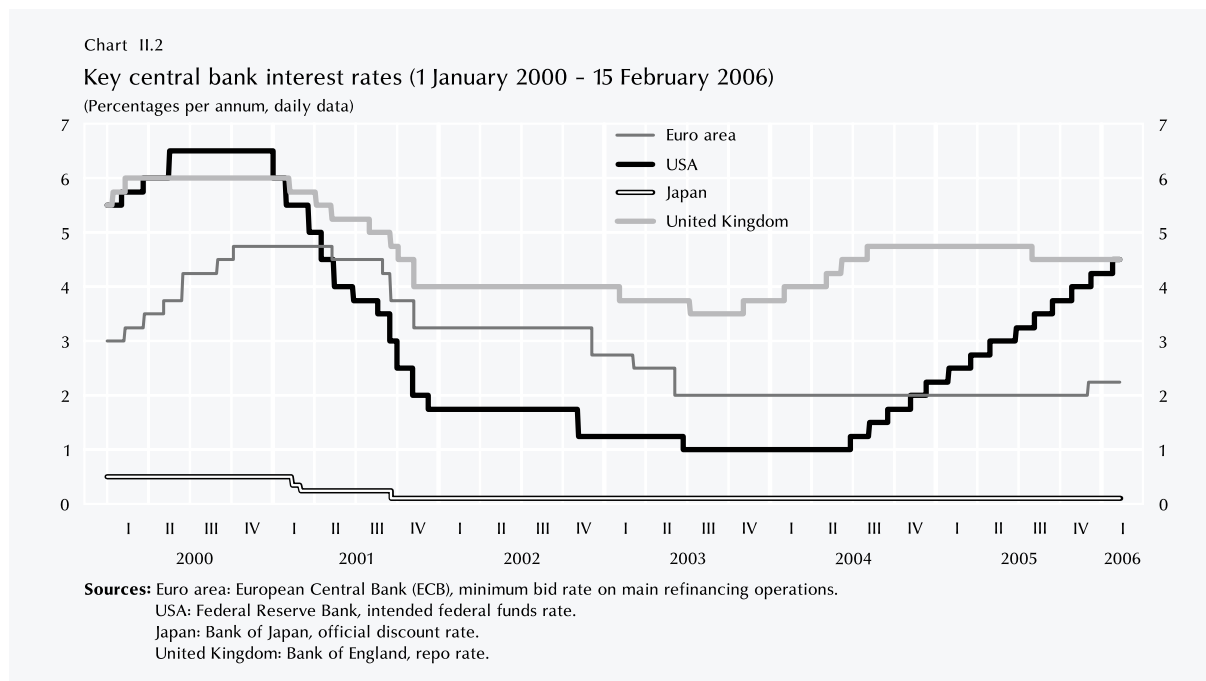
demand. In China, GDP growth eased slightly (9.9%, from 10.1% in 2004)³ due to a drop in investment growth, but remained very high, as a result, *inter alia*, of the robust increase in exports of manufactured goods. Another reason for the boost to Chinese exports was the lifting of the restrictions that various countries had imposed on textiles imports from China.

Global economic growth is projected to continue at the same satisfactory pace in 2006 as in 2005 (4.3% according to the IMF and the European Commission). The advanced economies should, however, see their GDP growth pick up (to 2.7%, from 2.5% in 2005), while in the developing and emerging market economies GDP growth is expected to slow slightly further to 6.1%, from 6.4% in 2005. (The forecasts of international organisations for individual countries are given in Table II.1.) Among the advanced economies, the outlook for 2006 remains favourable for the US, with GDP growth projected to reach 3.2-3.5%. Compared with last year, the prospects are better for the euro area, with GDP growth projected to

reach 2%, and slightly better for Japan, where GDP growth should reach 2.0-2.3%. GDP growth in the United Kingdom is also expected to improve in 2006, rising to between 2.1% and 2.4% from 1.8% in 2005, though clearly falling short of the performance of 2004 (3.2%). Among the emerging market and developing economies, high rates of economic growth – though lower than in 2005 – have been forecast for China (over 9.0%), India (6.3%) and Russia (5.7%).

The stance of monetary policy in the major advanced economies and economic areas was generally restrictive in 2005. In the US, the Federal Reserve raised its targeted interest rate on eight occasions in 2005 (each time by 25 basis points) and by an additional 25 basis points to 4.50% on 31 January 2006. This rate had been increased a total of 5 times in 2004 from a record

³ At the end of December 2005, China's statistical authorities announced a significant (17%) upward revision of the country's GDP level and their intention to gradually revise GDP growth rates from 1993 onwards.



low of 1.0%. The ECB decided on 1 December to raise its key policy rates by 25 basis points to 2.25% (see Section 3 later in this Chapter), after keeping them unchanged from June 2003 through November 2005. Monetary policy remained exceptionally loose in Japan, with the Bank of Japan maintaining near-zero interest rates, on account of the downward trend in the general price level. In the United Kingdom, where the rise in interest rates had already begun in November 2003, the Bank of England increased its key short-term rate (repo rate) another four times in 2004, bringing it to 4.75% on 5 August 2004. It remained unchanged at this level until it was lowered to 4.5% a year later on 4 August 2005 (see Chart II.2).

According to IMF September 2005 estimates, the general government deficit in the seven largest advanced economies (G-7) as a whole should edge up slightly to 4.0% of GDP in 2005 from 3.9% in 2004. The fiscal policy stance in these economies is estimated to have remained essentially neutral in 2005, as the structural deficit⁴ rel-

ative to potential GDP fell only marginally from 3.7% in 2004 to 3.6% in 2005 (see Chart II.3). As far as the fiscal outlook for 2006 is concerned, the IMF projects that the G-7 fiscal deficit will worsen slightly to 4.1%, while the respective structural deficit will remain unchanged at 3.6% of GDP. These projections are nonetheless subject to significant uncertainty, as more recent ones by the European Commission (November 2005) place the US deficit for 2006 at higher levels than initially forecast last September (4.7%, compared with 3.9% of GDP). In contrast, the differences in fiscal projections for the euro area and the rest of the G-7 are small.

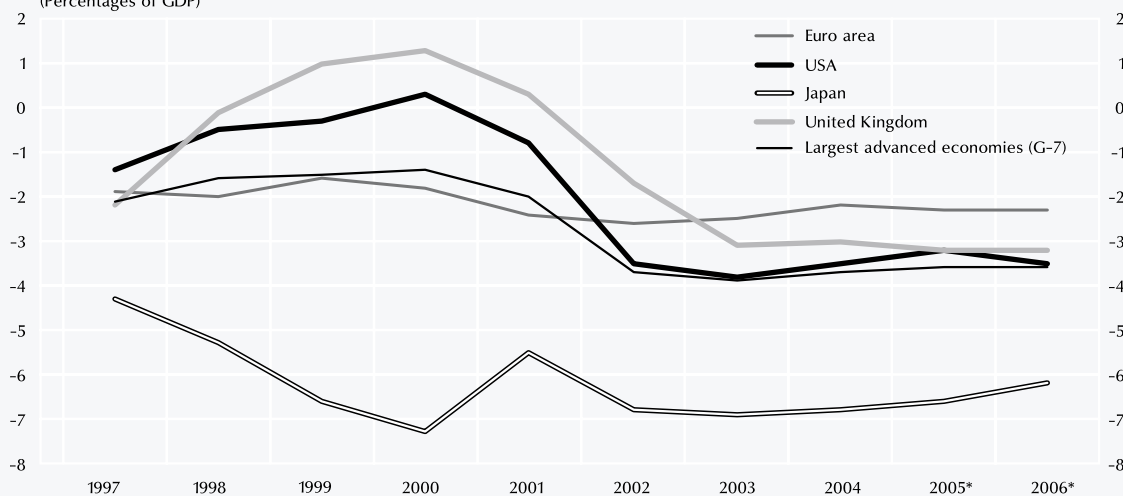
The principal risks to the sustainability of strong global economic growth and to keeping inflation in check are oil and other commodity price volatility, as well as significant macroeconomic imbalances. Global imbalances regarding current

⁴ A structural or cyclically adjusted fiscal balance (deficit or surplus) is defined as a fiscal balance that has been adjusted so as to take account of the effects of the economic cycle.

Chart II.3

Structural fiscal balance (1997-2006)

(Percentages of GDP)



* 2005: estimates, 2006: forecasts.

Source: IMF, *World Economic Outlook*, September 2005.

accounts are not expected to diminish in 2006,⁵ while oil prices remain a constant source of uncertainty.

Addressing these risks calls for appropriate policies. According to the IMF,⁶ policies to reduce global macroeconomic imbalances should focus on: (i) increasing savings – mainly by reducing fiscal deficits – in countries with large current account deficits and (ii) strengthening domestic demand – mainly through investment and structural changes – in countries with a current account surplus. Appropriate policies should be geared both to increasing the oil supply and refining capacity and to reducing oil dependency (as noted in previous Bank of Greece reports, oil dependency, mainly in the advanced economies, has been roughly halved since the 1970s oil crises).⁷ With regard to exchange rates, the G-7 finance ministers and central bank governors, at their meeting in Washington D.C. on 2-3 December 2005, reaffirmed that exchange rates should reflect economic fundamentals and that excess volatility and disorderly movements in

exchange rates are undesirable for economic growth. Finally, in order to contain inflationary pressures, policies must be aimed at safeguarding free trade and competition and at minimising the second-round effects of oil price increases, while monetary policy must be adjusted (see above for changes in central bank rates).

1.2 International trade and commodity prices

The volume of world trade in goods and services increased in 2005 by 7%, i.e. at a rate lower than

⁵ The persistence, over the long run, of global macroeconomic imbalances, in particular the large and widening current account deficit of the US (around 6% of GDP in 2005), is mainly attributed (see, for instance, IMF, *World Economic Outlook*, September 2005) to the following factors: (i) The highly expansionary monetary and fiscal policies conducted by the US over a number of years have spurred an increase in domestic demand. (ii) Investments have remained very low in some of the major economies, e.g. Germany and Japan, while in the emerging Asian economies except China they remain sluggish compared with previous years. (iii) The savings ratio in China and in the oil-exporting countries has increased sharply.

⁶ See, for instance, IMF, *World Economic Outlook*, September 2005.

⁷ Oil dependency is measured as the quantity of oil used per unit of output at constant prices (see, for instance, OECD, *Economic Outlook*, December 2004).

in 2004⁸ (10.3%), but higher than the average for the last two decades (6.6%). An increase of 7.4% has been projected for 2006. Trade growth rates in the emerging market and developing economies were stronger than in the advanced economies, both on the import side (13.5% against 5.4%) and on the export side (10.4% against 5%). In addition, compared with 2004, the export growth rate of these economies was marked by a steeper slowdown than their import growth rate.

Non-fuel commodity prices in US dollars increased less in 2005 (8.6%) than in 2004 (18.5%), mainly on account of the decrease in food prices (by 0.9%, compared with an increase of 14.3% in 2004) and a moderation in price increases for metals (22.6%, against 36.1% in 2004). Turning to 2006, non-fuel commodity prices were initially projected to fall by 2.1% (according to the IMF) or to increase by only 3.8% (according to the ECB), but, according to the latest forward prices, they will probably increase more.

International oil prices, as expressed by the US dollar price of Brent crude, continued their climb at an average year-on-year rate of 46.3% in 2005 (compared with 33.6% in 2004), even though world oil demand remained within expectations.

Robust global demand combined with market expectations of a future shortage in crude oil production and refining (hence also in the supply of oil products)⁹ are the main reasons for the price rise and explain the increased volatility and sensitivity of oil prices to short-term developments, as highlighted by the initial impact of hurricanes Katrina and Rita¹⁰ in August 2005.

2. Macroeconomic developments and prospects in the euro area¹¹

Macroeconomic developments in the euro area in 2005 were marked by the gradual recovery of economic activity during the first three quarters, the persistence of inflation above 2% throughout most of the year and the weakening of the euro's effective exchange rate after four years of appreciation. It should be noted that the ECB's key interest rates, which had remained unchanged since June 2003, were increased in December 2005 (see Section 3 later in this Chapter). In terms of budgetary developments, 2005 did not see any fundamental change in the fiscal position of the euro area as a whole. At an institutional level, the revision of the Stability and Growth Pact marked an important event for the European Union as a whole and for the euro area in particular (see *Monetary Policy – Interim Report 2005*, Box VI.1).

2.1 Inflation

Average annual euro area inflation, measured in HICP terms, edged up to 2.2% in 2005, from 2.1%

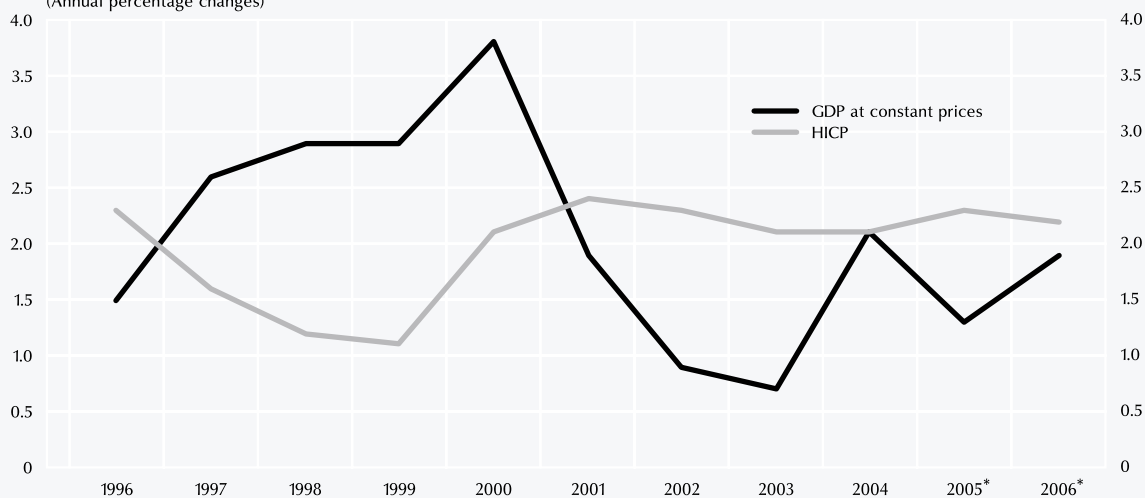
⁸ The increase in the volume of world trade slowed in the first quarter of 2005, in tandem with the global slowdown of manufacturing sector activity.

⁹ One of the main factors shaping expectations about the future oil supply is the markets' estimate that the oil extraction and refining investments carried out so far will not allow production capacity to keep up with the anticipated increase in global demand for oil and processed oil products. Indeed, capital-intensive investments in production facilities, equipment and technology were not profitable in the past because of low oil prices. Other factors accounting for the limited investments in the oil production sector are: the large, private oil companies' downsizing in the 1990s and their decision to distribute high dividends, the unfavourable climate for foreign investment in oil-producing countries (e.g. Saudi Arabia, Mexico, Kuwait, Russia, Venezuela) and the reluctance of the national oil companies to proceed to new investment, as the production capacity of the 1980s had been excessive.

¹⁰ The price of West Texas Intermediate crude came close to \$70 per barrel in early September 2005.

¹¹ The references to the economic outlook for 2006 are based on the Eurosystem Staff Projections (ECB, *Monthly Bulletin*, December 2005) and the European Commission's Autumn Forecasts (November 2005), while more recent data have been taken into account where available.

Chart II.4
Euro area: GDP at constant prices and HICP (1996–2006)
(Annual percentage changes)



* 2005: estimates, 2006: forecasts.

Source: European Commission: Eurostat and DG ECFIN, *Autumn 2005 Economic Forecasts*, November 2005.

in 2004 (see Chart II.4). Annual inflation remained slightly above 2% (between 2.1% and 2.2%) over most of 2005 (through August), but then climbed to 2.6% (its highest level in recent years) in September, mainly on account of the sharp rise in oil prices, before gradually receding to 2.2% in December. Another reason why inflation remained above 2% in 2005 was the increase in indirect taxes and administered prices in some euro area countries. Core inflation (i.e. the HICP excluding energy and unprocessed food prices) fell to 1.5% in 2005, from 2.1% in 2004. According to provisional estimates, euro area HICP inflation came to 2.4% in January 2006, i.e. to a level lower than expected.

According to Eurosystem macroeconomic staff projections (December 2005), inflation is forecast to come to between 1.6% and 2.6% in 2006¹² (2.2% according to the European Commission and 2.1% according to the OECD). These projections are conditional on a number of assumptions:

– First, oil prices, which have contributed signif-

icantly to the rise in inflation in recent years, are projected to increase much less – on average – in 2006 than in 2005.

– Second, the increase in employees' nominal earnings is assumed to remain moderate over the projection horizon. This is supported by the appraisal that the second-round effects from the oil price increases on wages will be limited and that the productivity rise, even if rather small, will contribute to maintaining unit labour cost growth broadly stable.

– Third, the inflation outlook incorporates only those increases in indirect taxes that were known with sufficient certainty at the time when the macroeconomic projections were being prepared. Besides, the projections are based on the expec-

¹² The results of the Eurosystem Staff Projections for each variable are given in range form, because of the degree of underlying uncertainty. The extent of these ranges is based on the difference between realisations and previous projections, tabulated by central banks over a number of years. The width of each range is double the average of each difference, in absolute rates.

tation that inflationary pressures from imports will remain low.

Apart from the oil price developments, liquidity in the euro area is another factor that poses a risk to price stability, as the high rate of increase in monetary aggregates observed since mid-2004 has picked up recently.

2.2 Economic activity

GDP growth in the euro area gradually gained momentum in the first three quarters of 2005, in spite of the sluggishness of economic activity early in the year, coming to an average annual rate of 1.3% (see Chart II.4). Quarter-on-quarter growth picked up to 0.6% in the third quarter, from 0.4% in the second and 0.3% in the first, as the investment expenditure and exports and, to a lesser extent, private consumption gradually strengthened. According to Eurostat's flash estimates, quarter-on-quarter GDP growth slowed to 0.3% in the fourth quarter. Quarter-on-quarter investment growth sped up to 1.6% in the third quarter from a mere 0.2% in the first and 0.8% in the second.¹³ It is estimated that the main factors underlying last year's strengthening in investment growth were firms' satisfactory profitability, along with favourable financial conditions and a positive outlook for the global economy and international demand. The improvement in private consumption was limited.¹⁴ This is mainly attributed to the restrained increase in households' real disposable income, on account, *inter alia*, of the dampening effect that the oil price increases have had on household purchasing power. According to the very latest estimates (OECD, *Economic Outlook*, November 2005) for the euro area, investment rose by 2.1% and private consumption by 1.3% in 2005.

Based on the European Commission's latest short-

term projection, released on 13 January 2006, euro area quarterly GDP growth should come to between 0.4% and 0.8% in the first quarter and to between 0.4% and 0.9% in the second quarter of this year.

Economic recovery in the euro area is expected to continue in 2006 and, in average annual terms, to approach the potential output growth rate. According to Eurosystem staff projections, euro area GDP growth is expected to be between 1.4% and 2.4% in 2006 (the European Commission and the OECD advance projections of 1.9% and 2.1% respectively). Robust external demand is expected to underpin fixed capital formation, which should rise by between 1.6% and 4.6% in 2006. Meanwhile, according to recent surveys,¹⁵ business expectations in the euro area remain favourable. Private consumption growth is estimated to range between 0.9% and 1.9%, reflecting the anticipated rise in households' disposable income. Export growth is estimated to range between 4.3% and 7.5% in 2006.

According to available projections, the euro area's continued economic recovery in 2006 can be attributed to a series of factors. Based on Eurosystem staff macroeconomic projections, growth in the euro area's external export markets is expected to come to 7.1% in 2006, i.e. roughly the same level as in 2005. Meanwhile, investment demand should benefit from the continuation of

¹³ Quarter-on-quarter investment growth developments are reflected, in part, by the European Commission's Economic Sentiment Indicator, which declined continuously from October 2004 through May 2005, but then improved almost uninterruptedly from June onwards, before rising markedly in January 2006. A similar trend was recorded for the euro area manufacturing sector by the Purchasing Managers' Index (PMI), which has remained steadily above 50 since August 2005 (implying an increase in output) and came to 53.5 in January 2006.

¹⁴ According to the latest data, the volume of retail sales in the euro area increased at an annual rate of 0.8% in December 2005.

¹⁵ As mentioned previously, the economic sentiment indicator improved markedly in January 2006.

low interest rates and favourable business financing conditions in the euro area. The recovery of business confidence and investment is expected to have a favourable impact on employment and, in turn, private consumption.

The risks that GDP growth in 2006 may fall short of projections mainly stem from the possibility of further oil price increases and from the potential adverse impact that a sudden adjustment of the accumulated global economic imbalances could have on the European and the world economy. These downside risks underscore the need for promoting the structural changes laid down in the revised Lisbon strategy, so as to strengthen the euro area economies' adjustability and ability to cope successfully with unexpected developments and shocks.

2.3 Labour market

Labour market conditions in the euro area gradually improved in 2005 from the second quarter onwards. Employment rose by 0.2% in the third quarter, after increasing by 0.1% in the second and remaining broadly unchanged in the first. Recent surveys on employment expectations in the services, retail and construction sectors indicate a continued improvement in the second half of 2005 and a positive outlook for 2006.

According to the European Commission, in spite of the slowdown in GDP growth, euro area employment is estimated to have increased by 1% in 2005 – which translates into 1.4 million new jobs – up from an increase of 0.7% in 2004. The unemployment rate is estimated to have decreased to 8.6% of the labour force in 2005, from 8.9% in 2004.

Generally speaking, the euro area (and the EU) labour markets have been markedly less influ-

enced in recent years by the economic conjuncture, compared with earlier cycles.¹⁶

The slowdown in GDP growth in 2005, combined with the rise in employment by roughly one percentage point, resulted in a cyclical decline in labour productivity growth, from 1.4% in 2004 to 0.3%. Unit labour cost growth is estimated to have risen to 1.5% in 2005 from 0.9% in 2004.

Employment growth is projected to accelerate marginally to 1.2% in 2006. This outlook reflects the GDP growth forecasts of around 2% this year and takes into consideration the usual lagged response of the labour market to the economic conjuncture. The unemployment rate is projected to decrease further to 8.4% of the labour force in 2006, reflecting the concomitant increase in labour supply – as a result of the improved economic outlook and labour market reforms – and employment.

2.4 Fiscal developments

There was no significant change in the fiscal position of the euro area as a whole in 2005, with the average general government deficit set to reach 2.9% of GDP, up from 2.7% in 2004, while the cyclically adjusted deficit¹⁷ is estimated to have been slightly reduced to 2.4% in 2005 from 2.5% in 2004. The average government debt ratio increased to 71.7% of GDP from 70.8% in 2004.

Fiscal developments diverged significantly across the euro area. Most countries saw their general government deficit widen in 2005, headed by

¹⁶ This is attributed by some analysts to the structural improvement in the functioning of the labour market, and mainly to a decline in long-term unemployment rates and to an improvement in the matching process (see European Commission, *Economic Forecasts – Autumn 2005*, November 2005).

¹⁷ See footnote 4.

Portugal whose deficit is estimated to have doubled to 6% of GDP from 3% in 2004, while only Greece, France and the Netherlands are estimated to have reduced their deficits. Only two euro area countries, Finland and Spain, showed a budget surplus of 1.9% and 0.2% of GDP, respectively, in 2005, while Belgium's budget remained balanced.

The fiscal stance is expected to remain broadly neutral in the euro area in 2006, as the cyclically adjusted budgetary deficit is projected (by the European Commission) to stay at 2.4% of GDP, while the nominal (non-adjusted) deficit is expected to diminish only marginally to 2.8% of GDP. The general government debt is expected to remain unchanged at 71.7% of GDP.

Following the ECOFIN's decision in June 2005 to abrogate its previous decision whereby the Netherlands had been subject to an Excessive Deficit Procedure (EDP), five euro area countries, namely France, Germany, Greece, Italy and Portugal were still subject to such a procedure.¹⁸ (This was the second time an EDP was launched against Portugal: the first EDP had been launched in 2002 and abrogated in 2004.)

According to the updated stability programmes of the countries that are currently under an EDP, the fiscal outlook for 2006 seems encouraging, as the general government deficit as a percentage of GDP is projected to decrease as follows: In France to 2.2%, from an estimated 2.9% in 2005, in Greece to 2.6%, from 4.3% in 2005, in Italy to 3.5%, from 4.3% in 2005, and in Portugal to 4.6%, from 6% in 2005. Germany had yet to submit an updated stability programme in mid-February.¹⁹

The updated stability programmes (and convergence programmes for the non-euro area EU Member States) comply with the requirements of the revised Stability and Growth Pact (see

Monetary Policy – Interim Report 2005, Box VI.1) and of the revised Code of Conduct on the content and presentation of stability and convergence programmes that was elaborated by the Economic and Financial Committee and approved by ECOFIN.

2.5 The exchange rate of the euro and Exchange Rate Mechanism II

In December 2004, the euro exchange rate reached its highest level since 1999, before entering an almost uninterrupted downward cycle until December 2005. The broad nominal effective exchange rate of the euro,²⁰ which had risen by 12.4% in 2003 and 4.1% in 2004 (in average annual terms), weakened by a slight 1.4% in 2005. The depreciation of the euro becomes more apparent (6.6%) when one compares the December 2005 exchange rate with the record high exchange rate reached twelve months earlier.

The real effective exchange rate (based on the CPI) followed a similar course to that of the nominal exchange rate. After increasing by 11.9% in 2003 and by 3.7% in 2004, it dropped by 1.7% on average in 2005 to find itself 7.0% lower in December 2005 than twelve months earlier. Last year's developments denote an improvement in the international price competitiveness of the euro area, which is vital to the recovery of economic activity in the euro area, as export performance constitutes a base for economic expansion.²¹ However, the depreciation of the euro ver-

¹⁸ A total of eleven EU Member States are currently subject to the EDP: the above-mentioned five euro area countries plus Cyprus, the Czech Republic, Hungary, Malta, Poland and Slovakia.

¹⁹ As stated in the Coalition Agreement of 11 November 2005, the aim was to reduce the deficit below 3% of GDP by 2007, from an estimated 3.9% in 2005.

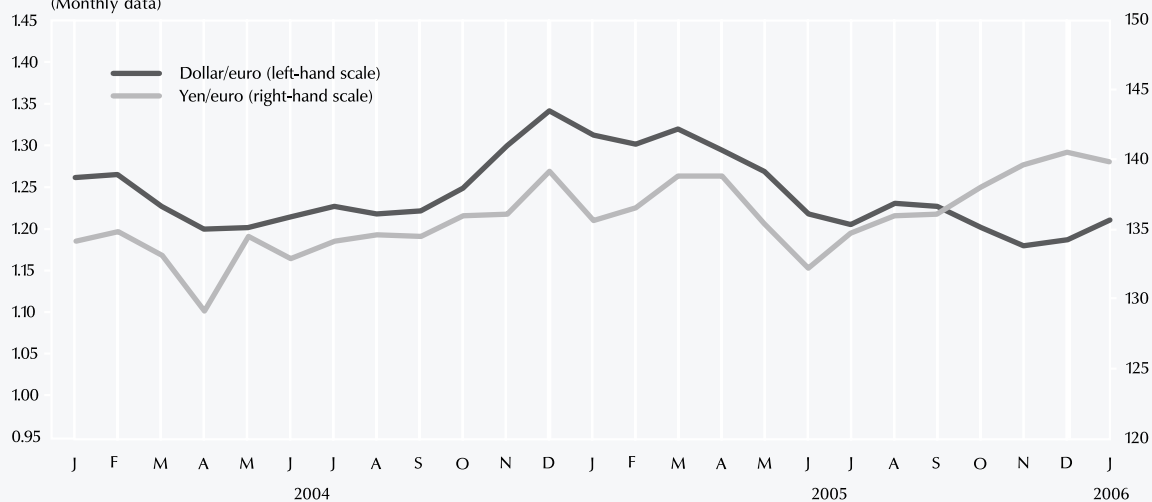
²⁰ Indicator of bilateral exchange rate developments based on the external trade of the euro area with 42 trading partners.

²¹ The euro area is the world's largest exporter, with 31.3% of world exports of goods and services in 2004 (and 15.3% of world GDP, as measured in purchasing power units). The United States rank second, with 10.3% of world exports (and 20.9% of world GDP).

Chart II.5

Exchange rate of the euro against the US dollar and the Japanese yen
(January 2004 - January 2006)

(Monthly data)



Sources: ECB and Bank of Greece.

sus the US dollar during the period in question, in conjunction with the rise in dollar-denominated international oil prices, has made energy costs harder to bear for the euro area economies, cancelling out the advantages that had been gained from the appreciation of the euro over the previous three years.

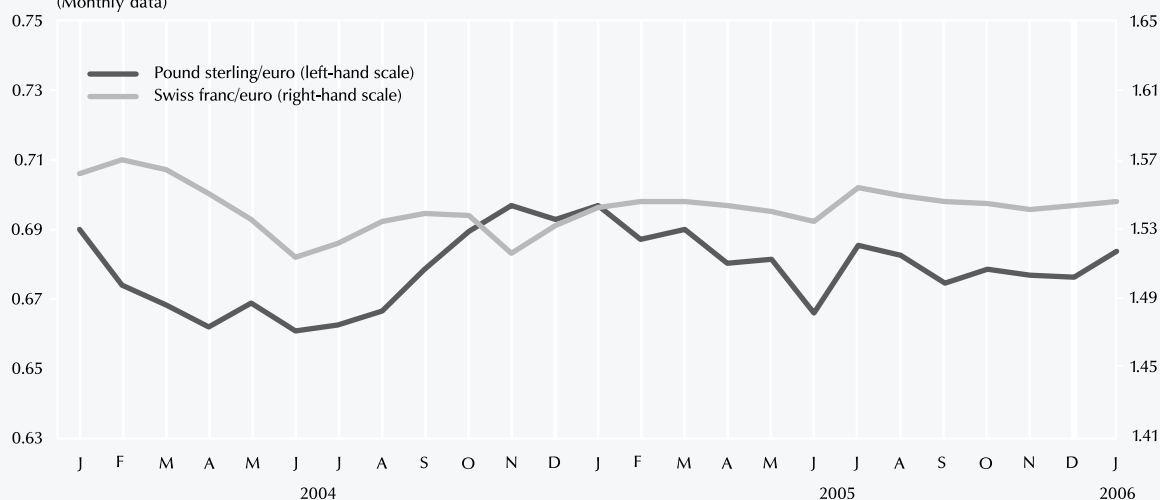
The euro underwent strong bilateral exchange rate movements against the US dollar, which, after depreciating steadily versus the euro over the previous three years and falling to an unprecedented low of \$1.3408 dollars to the euro in December 2004, reversed its losses in 2005. The continued widening of the growth rate gap between the euro area and the US, together with the widening interest rate differential, caused the euro to depreciate slowly but steadily against the dollar from the second quarter onwards. In December 2005, the euro traded for 1.1856 US dollars, compared with an average exchange rate of 1.2439 in 2004. In spite of the appreciation of the dollar against the euro by 13.1% between December 2004 and December 2005, the average

annual bilateral euro/dollar exchange rate remained unchanged in 2005.

The Japanese yen lost further ground against the euro in 2005, particularly in the fourth quarter, reflecting its concomitant depreciation against the US dollar. After strengthening temporarily against the euro in January-February and once again in June-July, the yen then depreciated, trading at a lower rate in December 2005 (140.58 yen to the euro) than on average in 2004 (134.44 yen to the euro). In average annual terms, the yen depreciated against the euro by 1.8% in 2005. The pound sterling also lost some ground against the euro in 2005, trading at 0.68380 to the euro, compared with 0.67866 in 2004. As for the other currencies, an important development in currency markets was the decision by the Chinese authorities in July to revalue the yuan renminbi against the US dollar by 2.05% and to peg it to a basket of currencies. On 23 September 2005 the Chinese authorities announced the doubling of the yuan renminbi's fluctuation band versus all non-dollar currencies to $\pm 3\%$.

Chart II.6

Exchange rate of the euro against the pound sterling and the Swiss franc
(January 2004 – January 2006)
(Monthly data)



Sources: ECB and Bank of Greece.

Following a decision taken on 25 November 2005, the Slovak koruna joined the Exchange Rate Mechanism II (ERM II)²² and observes a standard fluctuation band of $\pm 15\%$ around its central rate vis-à-vis the euro. This decision brings the number of new EU Member State currencies participating in ERM-II (not counting the Danish krone) up to seven.²³ In recent months, most of the currencies traded at close to their respective central parity rates within the ERM. On 11 January 2006, the Slovak koruna, together with other Central and Eastern European currencies, traded above their central parity rates against the euro by as much as 2.8%.

3. Monetary developments and policy in the euro area

3.1 The single monetary policy of the ECB

In the first two years of the single monetary policy, the ECB raised the minimum bid rate on its main refinancing operations from 3% to 4.75%. From

May 2001 on, the rate followed a gradual downward path to reach the historical low of 2% in June 2003 and remained at that level for more than two and a half years. The other two key ECB rates, i.e. the rates on the marginal lending facility and the deposit facility, followed a similar path (see Chart II.7). On 6 December 2005²⁴ however, the key ECB rates were increased by 25 basis points. Specifically, the minimum bid rate on main refinancing operations was raised to 2.25%, the marginal lending facility rate to 3.25% and the deposit facility rate to 1.25% (see Chart II.7 and Table II.2).

Based on the ECB's economic and monetary analysis, the Governing Council, in view of the risks to price stability and the inflation prospects, decided on 1 December 2005 to render the single

²² The central exchange rate of the Slovak koruna was set at 1 euro = 38.4550 Slovak korunas.

²³ Six other currencies joined ERM-II prior to the Slovak koruna: the Cyprus pound, the Estonian kroon, the Latvian lats, the Lithuanian lita, the Maltese lira and the Slovenian tolar.

²⁴ The increase was decided on 1 December but was put in force on 6 December (date of the first main refinancing operation following the Governing Council's decision).

Table II.2

Changes in key ECB interest rates

(Percentages per annum)

Date of interest rate change ¹	Deposit facility	Main refinancing operations	Marginal lending facility
6 June 2003	1.00	2.00	3.00
6 December 2005	1.25	2.25	3.25

¹ From 10 March 2004 onwards, the date refers to the deposit and marginal lending facilities and to the main refinancing operations (changes effective from the first main refinancing operation following the Governing Council discussion).

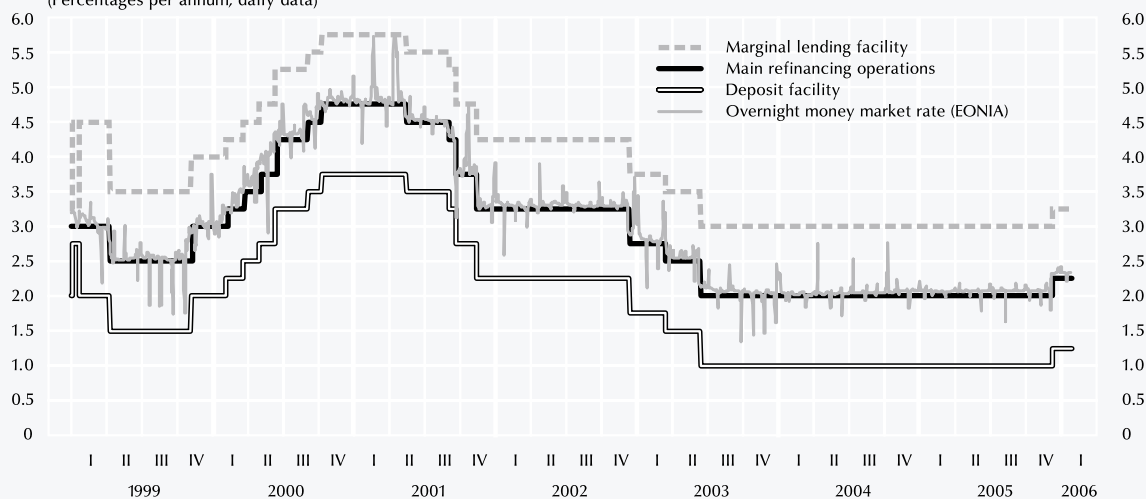
Source: ECB.

Chart II.7

ECB interest rates and the overnight money market rate (EONIA)

(January 1999 - January 2006)

(Percentages per annum, daily data)



Source: ECB.

monetary policy less accommodative. This decision is expected to keep medium and long-term inflation expectations in line with price stability. Such anchoring of inflation expectations will enable monetary policy to make an ongoing contribution towards boosting economic growth in the euro area. It should be noted that interest rates across the maturity spectrum in the euro area still remain very low and support economic activity, which is expected to accelerate further in the course of 2006.

The economic analysis on which the ECB's

Governing Council based its decision to raise interest rates shows that recent increases, mainly in energy prices, have raised HICP inflation above 2%. The annual inflation rate was 2.2% in December, compared with 2.6% in September, while the average inflation rate for 2005 stood at 2.2%.

A factor taken seriously into consideration by the Governing Council in its decision to raise interest rates was that the Eurosystem's staff projections of December 2005 for the annual inflation in 2006 were revised upwards, compared with those made in September 2005. According to these pro-

jections,²⁵ the average annual inflation is expected to lie between 1.6% and 2.6% in 2006 and between 1.4% and 2.6% in 2007. In other words, inflation will probably exceed the ECB target for price stability (i.e. maintaining inflation rates below, but close to 2%).

The Governing Council ascertained the existence of inflationary risks that may stem from potential increases in oil prices and second-round effects on the wage and price-setting policies of enterprises, as well as from a likely rise in indirect taxes and administered prices.

All relevant indicators show that there is excess liquidity in the euro area, which also points towards upside risks to price stability in the medium and long term. The strengthening of monetary expansion, observed since mid-2004, continued until September. A small deceleration was recorded in the fourth quarter of 2005, but the rate remained high, mainly owing to credit expansion to the private sector, associated, *inter alia*, with the low level of interest rates.

Therefore, the decision to raise interest rates was based on a comprehensive and forward-looking analysis of the main underlying developments driving the outlook for price stability in the medium term. As regards the future interest rate policy, the Governing Council has not decided *ex ante* to proceed to successive interest rate increases in the near future. It will continue to monitor closely all developments relevant to the medium- and long-term outlook for price stability, the maintenance of which will be the core of any decisions to be made in the future.

In its recent meetings (12 January and 2 February 2006), the Governing Council, on the basis of its regular economic and monetary analysis, decided to leave the key ECB interest rates unchanged fol-

lowing the increase on 6 December 2005. Available information after this increase underpins the appropriateness of the decision to adjust the very accommodative stance of monetary policy, in order to maintain medium- and long-term inflation expectations at levels consistent with price stability. The Governing Council stressed the need for vigilance in order to stabilise inflation expectations and to ensure that the risks to price stability over the medium term to longer term, as indicated by the economic and monetary analysis, do not materialise.

3.2 The evolution of M3 and its counterparts

Recent monetary developments were characterised by a persistently high M3 annual growth rate, which stood at 7.8% in the fourth quarter of 2005 (Q3: 8%, Q1: 6.7%; see Table II.3). Moreover, the short-term dynamics of M3 is shown to be very strong, as reflected in the annualised quarterly rate of change in M3, which stands close to the historical peak recorded in the second quarter of 2003 (see Chart II.8). This development is mainly due to the low level of interest rates, which is corroborated by strong credit expansion and the pickup in demand for more liquid assets included in M3, particularly M1. From 2001 to mid-2003, the high growth rate of M3 reflected strong investor preference for liquidity amid high uncertainty. Unlike that period, investment behaviour seems to have normalised in the last few months and no longer contributes to the continuing growth of M3.

The pickup in the growth rate of M3 is mainly driven by increased credit expansion to the private sector (see Table II.4), which can be largely attributed to the low level of interest rates, as well as to

²⁵ See ECB, *Monthly Bulletin*, Section 6, December 2005.

Table II.3

Main components of M3 in the euro area

(Annual percentage changes,¹ derived from data adjusted for seasonal and calendar effects, quarterly averages²)

	2004	2005				
	Q4	Q1	Q2	Q3	Q4	December
M1	9.3	9.6	9.8	11.2	10.9	11.3
Other short-term deposits (=M2-M1)	3.5	4.5	5.0	5.5	5.9	5.3
M2	6.4	7.1	7.5	8.4	8.5	8.4
Marketable instruments (=M3-M2)	3.9	4.0	4.4	5.6	3.8	0.9
M3	6.1	6.7	7.0	8.0	7.8	7.3

1 Annual rates of change in the corresponding index, which is compiled on the basis of outstanding stocks for December 2001 and cumulative monthly flows, adjusted for exchange rate variations, reclassifications etc.

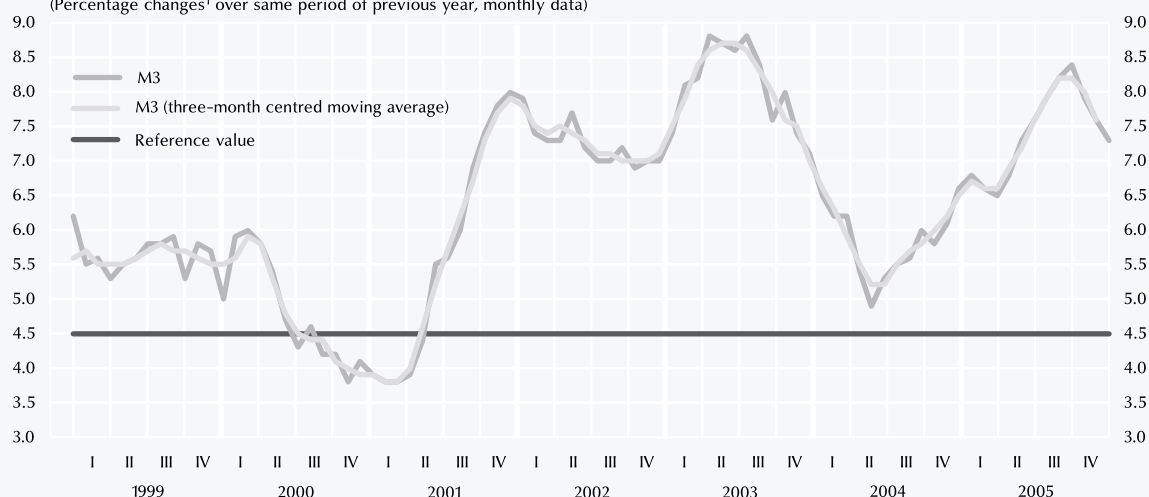
2 The quarterly average is derived from monthly averages (which are calculated as arithmetic means of two successive end-of-month figures) and is not the three-month average of end-of-month annual growth rates (see the Technical Notes in the ECB *Monthly Bulletin*).

Source: ECB.

Chart II.8

M3 in the euro area (January 1999 - December 2005)

(Percentage changes¹ over same period of previous year, monthly data)



¹ Adjusted for seasonal and calendar effects.

Source: ECB.

the easing of banks' credit standards.²⁶ Overall, in 2005 the growth rate of loans to the private sector (which account for the bulk of total credit) accelerated, mainly because of the pickup in the growth rate of loans to households, especially loans for house purchase, the demand for which is affected by the upward trend in the prices of dwellings in some euro area countries. In addition, the growth rate of loans to non-financial cor-

porations accelerated, also reflecting increased demand for investment, while the issuance of debt securities by non-financial corporations fluctuated.

²⁶ According to the results of the quarterly Bank Lending Survey conducted by the Eurosystem (the latest was published in January 2006), in the first three quarters of 2005 there was an overall further easing of banks' credit standards for loans to the private sector, while the standards remained virtually unchanged in the last quarter.

Table II.4

Main counterparts of M3 in the euro area

(Annual percentage changes,¹ derived from data adjusted for seasonal and calendar effects, quarterly averages²)

	2004	2005				
	Q4	Q1	Q2	Q3	Q4	December
Longer-term financial liabilities ³	7.9	8.4	8.6	9.2	8.8	8.8
Credit to general government	3.7	3.4	2.2	1.2	2.7	4.5
Loans to general government	0.4	-0.3	-0.7	-0.9	0.4	2.0
Credit to the private sector	6.7	7.3	7.8	8.6	9.4	9.5
Loans to the private sector	6.9	7.3	7.6	8.4	8.9	9.1
– To non-financial corporations ⁴	5.1	5.7	6.1	7.0	7.5	8.0
– To households ⁴	7.9	8.1	8.2	8.6	9.1	9.4

1 Annual rates of change in the corresponding index, which is compiled on the basis of outstanding stocks for December 2001 and cumulative monthly flows, adjusted for exchange rate variations, reclassifications etc.

2 The quarterly average is derived from monthly averages (which are calculated as arithmetic means of two successive end-of-month figures) and is not the three-month average of end-of-month annual growth rates (see the "Technical Notes" in the *ECB Monthly Bulletin*).

3 Including capital and reserves.

4 Data not adjusted for seasonal and calendar effects.

Source: ECB.

tuated in the course of 2005 (growth rate of the outstanding amount of debt securities: November: 2.9%, Q3: 2.2%, Q2: 4.6%, Q1: 2.8%).

Among the other counterparts of M3, the longer-term financial liabilities of MFIs continued increasing strongly throughout 2005. This development, in conjunction with the low growth rate of money market mutual fund units/shares included in M3, reflects a shift towards longer-term assets, although it has moderated, as indicated above.

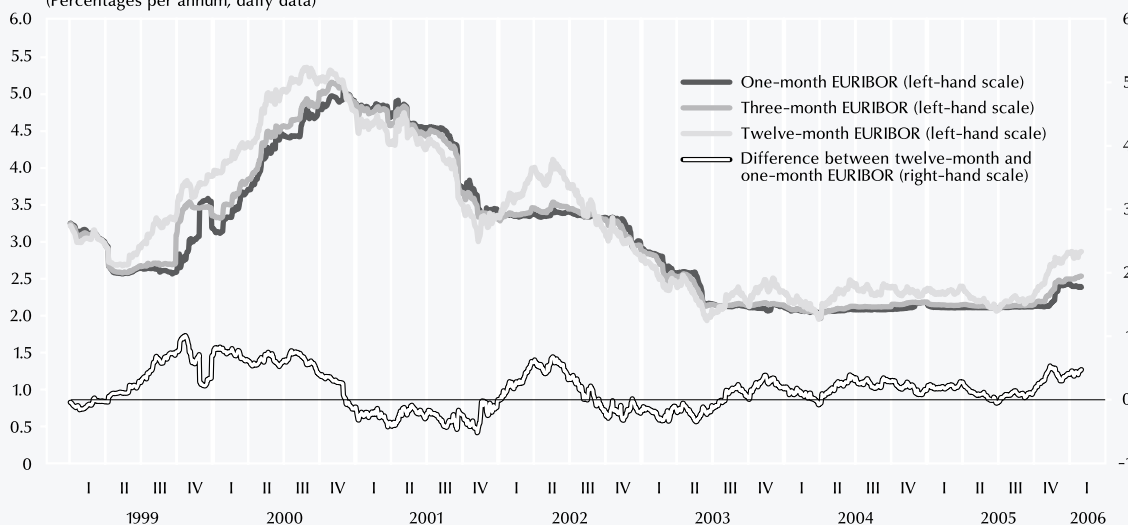
The deceleration in the annual rate of credit expansion to general government by means of debt securities and loans came to a halt in the fourth quarter of 2005, owing to the reversal of the negative rate of change in the outstanding amount of loans to general government that was recorded in the first three quarters. By contrast, debt securities issuance by euro area general government recorded a gradual decline in the course of 2005 (growth rate of the outstanding amount of debt securities: November: 4.5%, Q3: 4.5%, Q2: 4.9%, Q1: 5.5%).

3.3 Money market interest rates, bank rates and long-term government bond yields

Interest rates in the single money market remained stable at low levels in the first half of 2005, reflecting unchanged key ECB interest rates over the same period. They subsequently rose, slightly at first and markedly in the last quarter of the year, as markets progressively consolidated their expectations about interest rate increases. Following the 25 basis points increase in ECB interest rates, the euro overnight index average (EONIA) moved close to the new level (2.25%) of the ECB minimum bid rate on main refinancing operations (see Chart II.7). The three-month EURIBOR stood, already before the decision of 1 December, higher than at end-2004 (November 2005: 2.36%, December 2004: 2.17%) and then rose further (December 2005: 2.47%). Owing to the comparatively higher interest rate increase at longer maturities (see Chart II.9), the slope of the money market yield curve²⁷ became

²⁷ Measured as the difference between the twelve-month and one-month EURIBOR.

Chart II.9
Short-term interest rates in the euro area (January 1999 – January 2006)
(Percentages per annum, daily data)



Source: ECB.

more positive in December 2005, compared with December 2004.

In the first eleven months of 2005, MFI short-term deposit rates remained broadly unchanged at low levels, in line with stable money market interest rates. Short-term lending rates dropped further over the same period, with the exception of consumer loan rates, which remained unchanged. Overall decreases²⁸ were also recorded in MFI long-term lending rates, especially those on loans for house purchase, which in November 2005 were up to 52 basis points lower than in December 2004 (loans with an initial rate fixation of 5-10 years). Five-year government bond yields increased by 17 basis points in the same period. In December 2005 MFI lending and deposit rates increased in almost all categories.

In the first nine months of 2005, long-term government bond yields in the euro area were significantly lower than at end-2004. The 10-year bond yield dropped to the historically low level of 3.16% in September 2005 (see Chart II.10). This

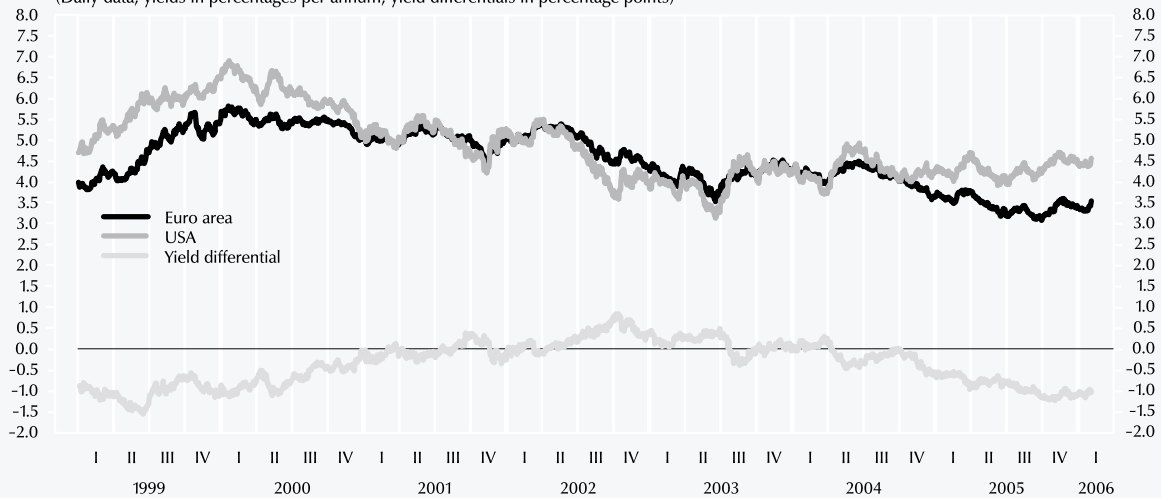
development can be attributed both to macroeconomic factors, specifically pessimism about the outlook for economic activity, and to structural factors, such as institutional investors' increased demand for bonds. From mid-September to mid-November, bond yields followed an upward course, owing to the rise in real interest rates, associated with the favourable outlook for economic activity in the euro area, as well as to expectations of increased inflation. The rise in yields may also be attributed to market expectations that the US Federal Reserve System would further tighten monetary policy and, subsequently, to expectations of a possible increase in ECB interest rates. However, the upward course of the 10-year government bond yield in the euro area was reversed in the second half of November, bringing this yield to 3.41% on average in December 2005, from 3.69% at end-2004. Yields in the United States recorded a higher overall increase in the second half and thus the differential between US

²⁸ In November long-term lending rates presented a mixed picture.

Chart II.10

Ten-year bond yields in the euro area and the United States
(January 1999 - January 2006)

(Daily data, yields in percentages per annum, yield differentials in percentage points)

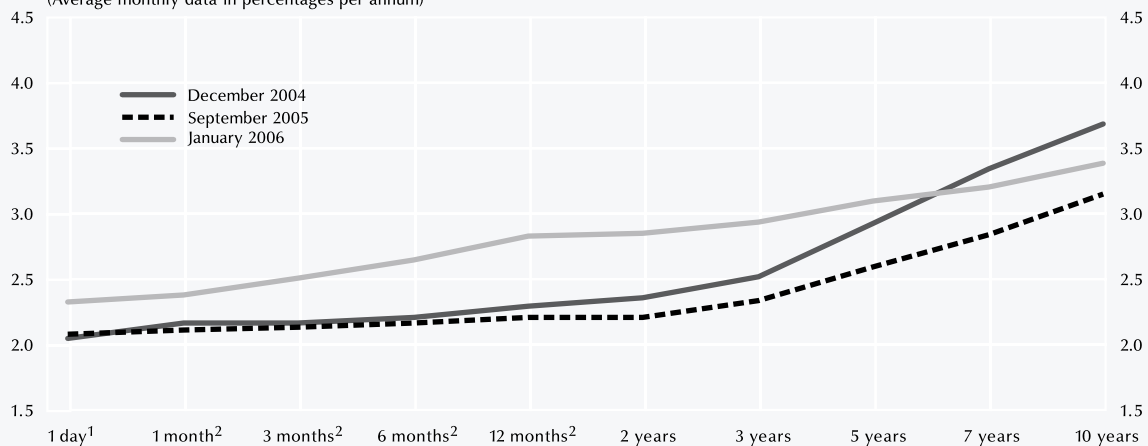


Source: ECB.

Chart II.11

Money market and bond market yield curves in the euro area

(Average monthly data in percentages per annum)



- 1 Overnight money market rate (EONIA).
- 2 Interbank offered rates (EURIBOR).

Source: ECB.

and euro area 10-year government bond yields widened in December 2005, compared with December 2004 (from 54 to 105 basis points). Uncertainty in euro area bond markets²⁹ remained at low levels.

A paradox has been observed in recent months

for the euro area and during a much longer period for the United States: the shift of the central bank

²⁹ Bond market uncertainty is measured by implied volatility, a time series derived from futures data. Volatility in the euro area government bond market is calculated on the basis of implied volatility of the prices of options on ten-year German Bund futures, which is compiled by Bloomberg and monitored by the ECB.

towards a tighter policy (or the expectation that such a shift is imminent) is not accompanied by a corresponding rise in bond yields, as was the case until now. By way of illustration, the euro area bond market yield curve became flatter in recent months (see Chart II.11), despite the consolida-

tion of expectations that ECB interest rates would increase. The determinants of this development in long-term government bond yields are analysed in Box II.1.

BOX II.1

The downward trend in long-term bond yields

Since the early 1990s, the nominal yields of long-term government bonds issued by euro area countries, the United States and other industrial countries have been following a downward path, causing long-term interest rates to fall to historically low levels globally. The same is true of the long-term interest rates that markets expect to prevail in the future (after 5-10 years), as well as of deflated yields.

The downward trend in long-term interest rates can be attributed – for the most part of the period after 1990 – to the global decline in inflation, in conjunction with the containment of its volatility, which also allowed for a decrease in the inflationary risk premium incorporated in bonds. Particularly in the euro area, this development was significantly underpinned by the nominal convergence and the consolidation of the credibility of monetary policy, with the enactment of the independence of the national central banks that were not already independent and the establishment of the Eurosystem. The containment of fiscal imbalances during the 1990s in Europe and the United States has also contributed to the declining trend in long-term interest rates.

However, the fact that long-term interest rates continued to drop (with some fluctuations) in the course of the last two years, despite the increase of 325 basis points¹ in the Federal Reserve's target rate in the same period (which pushed short-term interest rates for the US dollar upwards), is puzzling at first sight. It can of course be explained by the simultaneous effect of many factors, most of which contribute to an upward shift of the demand curve for long-term government bonds; as a result, the prices of such bonds are maintained at high

levels and, accordingly, long-term interest rates stand at low levels. In greater detail, these factors include:

- (i) The global demand for private fixed capital investment is subdued compared with savings; therefore, significant resources are channelled to long-term government bond markets. The ECB has repeatedly underlined that, in the last few years, euro area liquidity exceeds the level needed to support the economic growth rate. Excess liquidity seems to be channelled to asset markets and, therefore, upward pressure is exerted on securities and property prices in the euro area. In their search for yield, investors are forced to resort to increasingly riskier forms of investment. Similar phenomena are observed in the United States.
- (ii) Part of the increase in the revenue of oil-producing countries (owing to the rise in oil prices) is channelled to long-term government bonds in euro area countries and the United States. In addition, demand for long-term US government bonds is supported by extensive interventions by many Asian countries in foreign exchange markets, aiming at containing the appreciation of their currencies against the US dollar.
- (iii) Certain provisions in the regulatory framework governing pension funds and insurance companies in the European Union and the United States →

¹ The Federal Reserve increased its target rate again on 31 January 2006 by 25 basis points.

→ have urged these entities to invest a larger part of their reserves in long-term government bonds. In any event, to deal with the euro area demographic problem, savings must be increased in order to offset the higher expenditure for pensions and health care, thus strengthening demand for long-term financial instruments.

(iv) The drop in euro area real long-term yields also reflects, to a certain extent, the – gradual in the last few years – downward revision of expectations about the future economic growth rate in the euro

area, mainly due to the rise in oil prices. Only recently was there an improvement in the outlook for euro area economic activity. Moreover, bond yield fluctuations (mainly for short-term bonds) and anticipated fluctuations stabilised at low levels globally for a long period of time, mainly due to contained uncertainty about economic developments and interest rate changes by the US Federal Reserve. This made bonds more attractive forms of investment and contributed to an increase in the demand for bonds.

3.4 Stock market developments

At the end of 2005, share prices in euro area stock markets were significantly higher than in December 2004, but had recorded some fluctuations in the course of the year (see Chart II.12). The Dow Jones EURO STOXX index rose by 23% between end-December 2004 and end-December 2005, while the Standard & Poor's 500 index recorded a much smaller increase (3%). By contrast, the Nikkei 225 index recorded an impressive rise (40.2%), owing to expectations of high corporate profitability in Japan. In January 2006, stock market indicators continued to rise in the euro area and the United States, while stabilisation trends were recorded in Japan.

In 2005, euro area stock markets benefited overall from low interest rates and high corporate profits. Moreover, until recently, high oil prices supported the share prices of the energy sector, while the low yields of long-term bonds shifted investors' interest towards shares. From September on, the strong rise in share prices stemmed mainly from the pickup in economic activity owing to subsiding oil prices, as well as estimates about continued high corporate profits, which offset the negative effect of increased bond yields and investors' concerns about the global rise in infla-

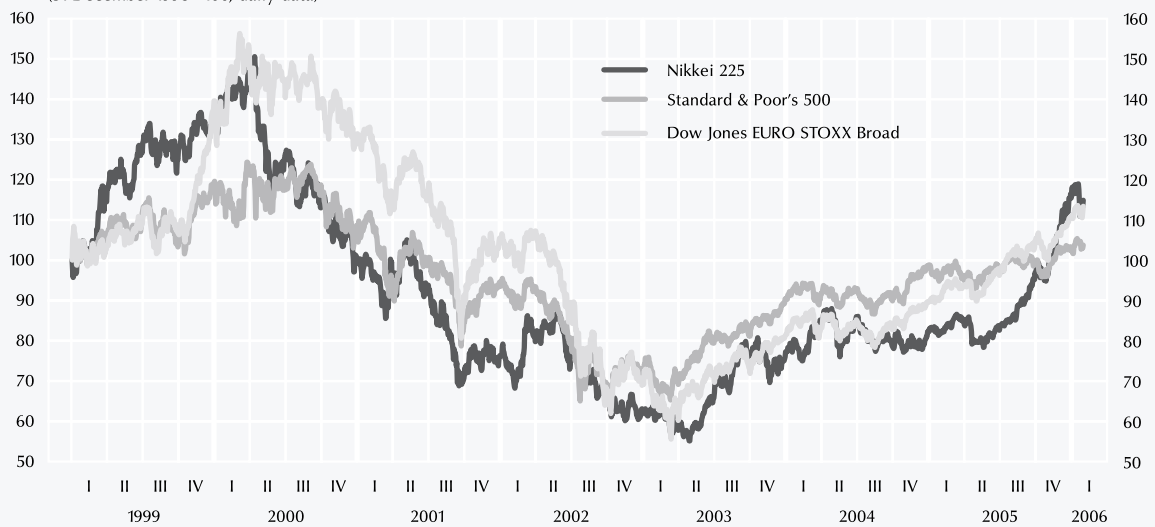
tion. As regards the overall changes in share prices by sector, the largest increase during 2005 was recorded in those of the energy sector (over 30%), while a 7% decrease was recorded in the share prices of the telecommunications sector.

In the United States, the comparatively smaller increase in share prices in 2005 can be partly attributed to sustained investors' interest in US bonds, since their yields dropped less than those of the corresponding euro area bonds. In any event, US share prices are still supported by the favourable outlook for corporate profits. In Japan, the rise in stock market prices is associated with continued investors' optimism about economic growth prospects leading to increased capital inflows, as well as with low interest rates. The marked rise in share prices in Japan is accompanied, however, by a significant increase in uncertainty,³⁰ as measured by implied stock market volatility, mainly in the last quarter of 2005. Increased uncertainty suggests concerns about the sustainability of the high corporate profits that have been recorded in the last few months, as well as about the robustness of the current economic recovery.

³⁰ Stock market uncertainty is measured by an index compiled by Bloomberg following a similar approach to the one described in footnote 29 for bond market uncertainty.

Chart II.12

Stock price indices (January 1999 - January 2006)
(31 December 1998 = 100, daily data)



Source: ECB.

By contrast, uncertainty in the euro area and the United States was kept at low levels in 2005, with the exception of a small increase due to extreme

weather conditions in the United States in the summer of 2005.

III. Monetary and financial developments in Greece and stability of the financial system

1. Monetary developments in Greece

1.1 The evolution of monetary aggregates

The annual growth rate of the Greek contribution to the euro area M3¹ (excluding currency in circulation) slowed considerably in 2005, to stand at 6.4% in the fourth quarter (fourth quarter 2004: 9.2%).² This deceleration is *largely* associated with shifts out of M3 (mainly into foreign bond-type mutual funds) and, to a lesser degree, with a moderation in the growth rate of GDP at current prices (7.7% in 2005, from 8.4% in 2004), which is a determinant of demand for transaction balances. Reflecting these developments, since July 2005 the annual growth rate of the Greek M3 (excluding currency in circulation) has been, for the first time in the 2004-2005 period, lower than the corresponding euro area figure.

Developments in M3 components have been affected by the January 2005 change in the tax rates on deposit interest income and repo yields, i.e. the introduction of a single tax rate for both instruments, equal to that applying to yields³ on government securities. Thus, the annual growth rate of deposits strengthened appreciably due to

1 The Greek M3, as well as that of any other euro area country (see the Glossary for definitions of monetary aggregates), can no longer be calculated accurately, as quantities of euro banknotes and coins put in circulation by one euro area country may be held by residents of other euro area countries (and/or residents of third countries). Owing to these calculation problems, developments are discussed with respect to the Greek M3 excluding currency in circulation and to its key components (excluding currency).

2 These growth rates of the Greek M3 (excluding currency in circulation) have been calculated by the ECB and do not take into account that part of the reduction in money market funds' assets which is attributable to the conversion (in 2005) of some such funds into bond-type mutual funds, the shares/units of which are not included in M3. Corrected for this effect, the deceleration of the Greek M3 growth is even larger.

3 Specifically, the tax rate on interest income from deposits was reduced from 15% to 10%, while that on repo yields was raised from 7% to 10%, i.e. it became equal to the tax rate on interest from government securities.

Table III.1

Greek contribution to the key monetary aggregates of the euro area

(Not seasonally adjusted data)

	Outstanding balances on 31.12.05 (million euro)	Annual percentage changes ¹												
		2002		2003		2004		2005		2005		December ³		
		Q4 ²	Q4 ²	Q4 ²	Q4 ²	Q1 ²	Q1 ²	Q2 ²	Q2 ²	Q3 ²	Q3 ²	Q4 ²	December ³	
1. Overnight deposits	99,207	8.9	6.8	16.8	14.5	11.8	10.6	9.3	8.1					
1.1 Sight deposits and current account deposits	24,768	5.7	17.7	19.1	17.2	18.4	21.2	20.2	19.7					
1.2 Savings deposits	74,439	9.8	4.1	16.1	13.7	9.9	7.7	6.3	4.8					
2. Time deposits with an agreed maturity of up to 2 years	50,623	10.1	29.3	5.3	21.2	31.7	34.6	42.6	47.6					
3. Deposits redeemable at notice of up to 3 months ⁴	4,415	8.1	1.5	2.8	-1.5	30.1	67.0	105.2	111.2					
4. Total deposits (1+2+3)	154,245	9.3	12.2	12.6	15.3	16.8	17.3	19.2	19.8					
5. Repurchase agreements (repos)	2,728	-19.0	-47.7	-12.6	-46.3	-57.2	-64.7	-72.8	-71.4					
6. Money market fund units	4,875	-3.7	68.0	-1.9	-4.1	-19.6	-34.7	-51.8	-60.2					
7. Bank bonds with a maturity of up to 2 years ⁵	419	...	...	...	...	...	...	...	...
8. M3 excluding currency in circulation (4+5+6+7)	162,267	2.2	6.4	9.2	9.1	8.5	6.7	6.4	6.8					

1 Annual rates of change in the corresponding index, which is compiled on the basis of outstanding stocks for December 2001 and cumulative monthly flows, adjusted for exchange rate variations, reclassifications etc.

2 The quarterly average is derived from monthly averages (which are calculated as arithmetic means of two successive end-of-month figures) and is not the three-month average of end-of-month annual growth rates (see the "Technical Notes" in the ECB Monthly Bulletin).

3 Annual rates of change on the basis of the corresponding index at the end of the month.

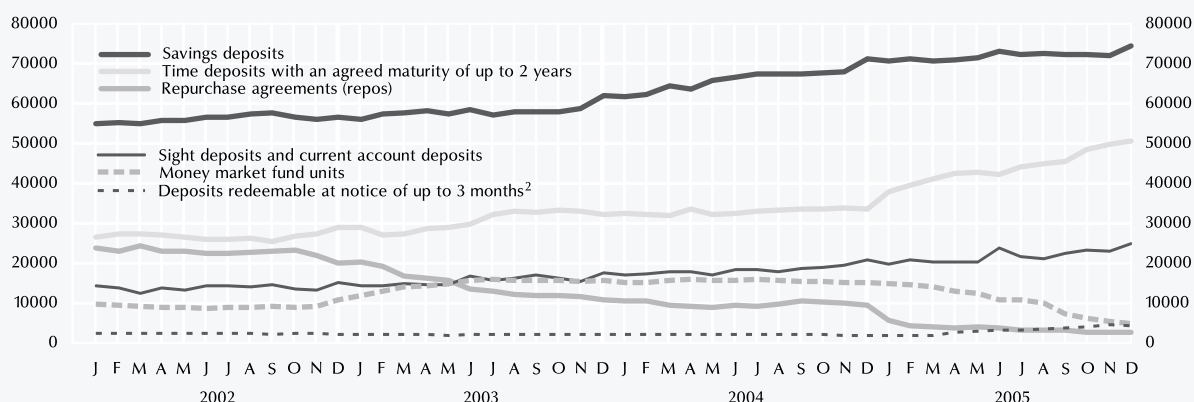
4 Including savings deposits in currencies other than the euro.

5 Rates of change are not shown because, owing to the low calculation base, they are very high.

Sources: Bank of Greece and ECB.

Chart III.1

Deposits, repurchase agreements and money market fund units in Greece¹ (January 2002 - December 2005)
(End-of-period balances, in million euro)



1 These aggregates concern deposits, repos and money market fund units which, according to the ECB definition, are included in M3 and therefore constitute the Greek contribution to the corresponding euro area aggregates.

2 Including savings deposits in currencies other than the euro.

Source: Bank of Greece.

considerable flows into time deposits (mainly out of repos), while the rate of decrease in repo holdings and money market fund shares/units accelerated further.

In more detail, the annual growth rate of deposits included in M3 picked up gradually in 2005 and stood at 19.2% in the fourth quarter of the year (fourth quarter 2004: 12.6%, see Table III.1). A considerable acceleration was observed in the annual rate of increase in time deposits with an agreed maturity of up to two years, which rose to 42.6% in the fourth quarter of 2005 (from 5.3% one year earlier), reflecting shifts from repos and savings deposits as well as the relatively higher net (after tax) remuneration of time deposits. In contrast, the annual rate of increase in savings deposits (the major category of overnight deposits⁴) slowed considerably in the year under review (fourth quarter 2005: 6.3%, fourth quarter 2004: 16.1%).

Among the other components of M3, holdings of repos declined further in 2005 (see Chart III.1)

and their annual rate of decrease picked up considerably (fourth quarter 2005: -72.8%, fourth quarter 2004: -12.6%). Thus, the share of repos in M3 (excluding currency in circulation) fell to 1.7% in December 2005, from 6.7% in December 2004 and 22% in mid-2001, when repo yields were tax free. Aside from the effect of the change in the taxation of repo yields, this development also reflects to some extent the fact that in the previous year credit institutions further reduced their holdings of Greek government securities as a percentage of their assets.⁵ Finally, holdings of money market fund shares/units fell further during the period under review and their annual rate of decline sped up to 51.8% in the

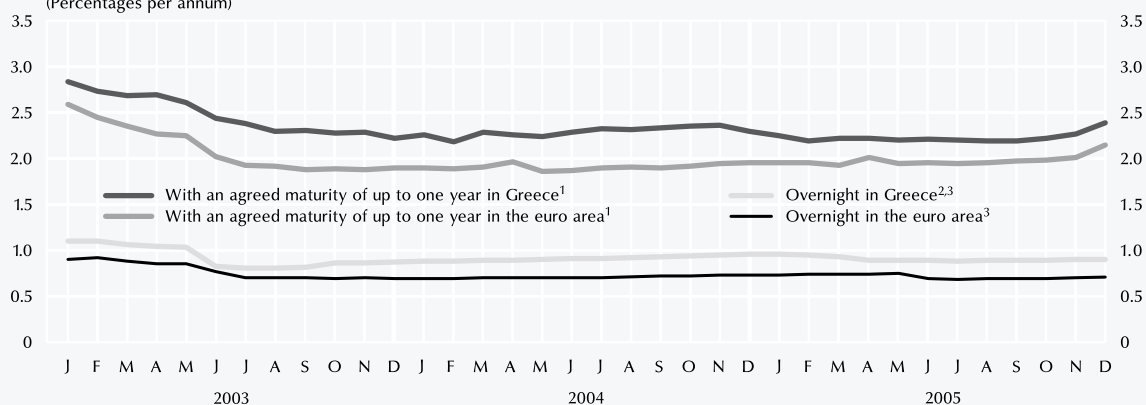
⁴ It should be recalled that, as of 2003, savings deposits are included in overnight deposits along with sight deposits and current account deposits. Savings deposits (as already mentioned in previous Annual Reports and Monetary Policy Reports) are broadly similar to current account deposits, since they are redeemable on demand (without penalty) and enable depositors to effect payments to third parties.

⁵ In this respect, owing to the gradual decline in the yields of Greek government securities during the last few years, in December 2005 the share of such securities in the total assets of credit institutions was almost half compared with December 2000.

Chart III.2

Bank interest rates on new deposits from households in Greece and in the euro area
(January 2003 – December 2005)

(Percentages per annum)



1 Monthly average rate.

2 The interest rate on savings deposits is used, as these deposits represent the bulk of overnight deposits and their interest rate is almost the same as the overnight rate.

3 End-of-month rate.

Sources: Bank of Greece and ECB.

fourth quarter of 2005 (fourth quarter 2004: –1.9%).⁶ This development is associated, on the one hand, with their lower yields due to the historically low level of money market interest rates and a decline in bond yields during the best part of 2005 (as bonds constitute a sizeable part of money market funds' assets)⁷ and, on the other hand, with the normalisation of portfolio allocation behaviour following favourable stock market developments.

1.2 Deposit interest rates

Interest rates on deposits showed small changes in 2005.⁸ Thus, in the case of deposits from households (which constitute the bulk of total deposits), the positive differential of Greek interest rates vis-à-vis the euro area average remained practically unchanged, given that euro area interest rates on the above category did not change considerably.⁹ As for households' overnight deposits and deposits with an agreed maturity of up to one year, in December 2005 this differential was 20 and 25 basis points, respectively (see

Table III.2). In contrast, in the same month the interest rate on new repos in Greece was 4 basis points lower than the corresponding euro area average.

⁶ It should be noted that assets of money market funds as a percentage of total assets of mutual funds fell to 18.2% in December 2005 from 48.8% in December 2004.

⁷ Furthermore, the change in the institutional framework for money market funds (Law 3283/2004) has limited the investment options of such mutual funds.

⁸ Specifically, the average interest rate on new overnight deposits from households – the bulk (91%) of which involves savings deposits – decreased marginally (by 5 basis points) to 0.91% in December 2005, from 0.96% in December 2004 (see Chart III.2). The interest rate on households' new deposits with an agreed maturity of up to one year was slightly higher in December 2005 (2.39%) than in December 2004 (2.30%). The interest rate on repos also stood at a higher level (December 2005: 2.18%, December 2004: 2.01%).

⁹ It should be noted that any disparities in deposit interest rates across the euro area are due to the fact that such rates are not entirely comparable and reflect differences in taxation and in deposit product characteristics (in terms of e.g. liquidity, handling fees/costs associated with services offered through deposit accounts – such as execution of standing payment orders, transfers through cards, etc.).

Table III.2

Bank interest rates on new deposits in the euro area and in Greece

(Percentages per annum)

	December 2004	December 2005	Change Dec. 2005/Dec. 2004 (in percentage points)
Overnight from households¹			
Weighted average interest rate in the euro area	0.73	0.71	-0.02
Maximum interest rate	1.17	1.20	0.03
Minimum interest rate	0.12	0.14	0.02
Interest rate in Greece	0.96	0.91	-0.05
Interest rate differential between Greece and the euro area	0.23	0.20	-0.03
With an agreed maturity of up to one year, from households²			
Weighted average interest rate in the euro area	1.95	2.14	0.19
Maximum interest rate	2.35	2.48	0.13
Minimum interest rate	1.48	1.57	0.09
Interest rate in Greece	2.30	2.39	0.09
Interest rate differential between Greece and the euro area	0.35	0.25	-0.10

1 End-of-month rate.

2 Monthly average rate.

Sources: ECB and euro area NCBs.

2. The financing of the economy

The annual growth rate of the total financing¹⁰ of the economy by Monetary Financial Institutions (MFIs) accelerated appreciably to 16.8% in the fourth quarter of 2005, compared with the last quarter of 2004 (10.8%, see Table III.3). This was mainly due to the annual rate of change in general government financing, which turned positive in September 2005 (for the first time since January 2002) and then accelerated, reaching 9.4% in the last quarter of the year (fourth quarter of 2004: -5.6%). As the net central government borrowing requirement on a cash basis was lower in 2005 (2005: €14,424 million, 2004: €15,605 million), the higher rate of credit expansion to general government reflects MFIs' investment strategy: MFIs increased their holdings of Greek government securities, after a prolonged period of liquidation of these holdings.¹¹ The growth rate of credit to enterprises and households also accelerated, though less so (last quarter of 2005: 19.9%, last quarter of 2004: 19.3%).

2.1 Bank credit to enterprises and households

The annual growth rate of total MFI credit to enterprises (loans¹² and bonds) remained high during 2005. The fact that this rate remains almost unchanged compared with the last quarter of 2004 (fourth quarter of 2005: 12.5%, fourth quarter of 2004: 12.6%) suggests that enterprises still have relatively easy access to bank credit. Total credit includes MFI holdings of corporate bonds, issued as an alternative source of finance.¹³ Specifically, new corporate bonds were issued in 2005 and, as a result, the MFIs' holdings

¹⁰ The financing of the economy by domestic MFIs comprises the outstanding balance of loans to enterprises, households and general government, as well as total government securities and corporate bonds held by the central bank, credit institutions and money market funds. Note, however, that, in order to calculate total financing, account is also taken of extraordinary write-offs and securitisation of loans by banks during the reference period, as well as of the change in the corresponding balances.

¹¹ However, as mentioned earlier (see footnote 5), the share of Greek government securities in total assets held by credit institutions fell in the last few years.

¹² Including borrowing through credit lines.

¹³ The increased use of corporate bond issues is mainly related to the fact that these securities are exempt from contributions under Law 128/1975, which are levied on bank loans.

Table III.3
Financing of the economy by Greek MFIs
(Annual percentage changes)

	2001	2002	2003	2004	2005				
	Q4 ¹	Q4 ¹	Q4 ¹	Q4 ¹	Q1 ¹	Q2 ¹	Q3 ¹	Q4 ¹	December ²
1. Total financing by MFIs ^{3,4}	8.9	7.1	4.3	10.8	11.1	11.4	12.9	16.8	19.6
2. Financing of general government	-2.4	-5.2	-15.9	-5.6	-5.2	-5.7	-2.1	9.4	15.3
3. Financing of enterprises and households ^{3,4}	23.1	18.2	18.7	19.3	18.9	19.0	19.3	19.9	21.3
3.1. Enterprises ³	16.7	11.3	13.4	12.6	11.9	12.1	12.6	12.5	14.2
3.2. Households ⁴	40.0	33.1	28.6	30.0	29.9	29.4	29.2	30.3	31.1
3.2.1 Housing loans ⁴	36.7	35.4	27.7	26.9	27.5	28.0	28.8	31.3	33.4
3.2.2 Consumer loans ⁴	44.3	27.4	24.8	37.9	35.6	33.7	32.1	29.9	28.0

1 The quarterly average is derived from monthly averages (which are calculated as arithmetic means of two successive end-of-month figures) and is not the three-month average of end-of-month annual growth rates (see the "Technical Notes" in the ECB *Monthly Bulletin*).

2 Annual rate of change at the end of the month.

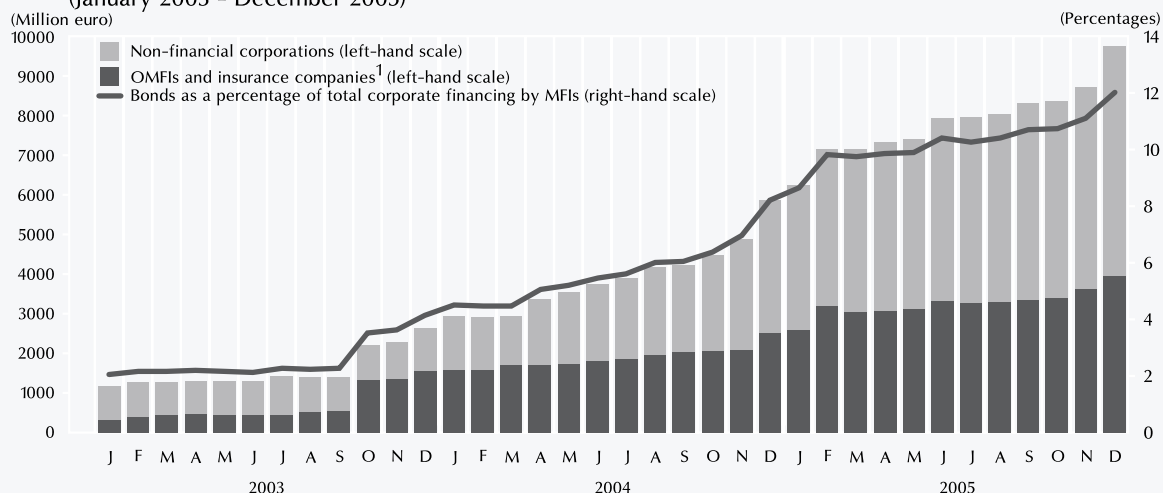
3 Including corporate bonds held in MFI portfolios, as well as extraordinary write-offs of claims.

4 Including securitised loans.

Source: Bank of Greece.

Chart III.3

Corporate bonds in MFI portfolios in Greece
(January 2003 - December 2005)



¹ The share of insurance companies is less than 1%.

Source: Bank of Greece.

of such securities at the year-end represent 12.0% of total corporate financing by MFIs (December 2004: 8.2%, see Chart III.3). Moreover, total credit includes balances concerning one-off write-offs of, mainly, Agricultural Bank of Greece (ATE) receivables that were effected in order either to settle overdue debts pursuant to Law 3259/2004 or to consolidate the bank's portfolio. If these two factors (issuance of corporate bonds and extraordinary write-offs) are not taken into account, the annual growth rate of bank loans to enterprises appears to have decelerated in 2005 (fourth quarter of 2005: 6.4%, fourth quarter of 2004: 8.6%, see Table III.4).

The average monthly amount of new loans¹⁴ to non-financial corporations stood at €2,671 million in 2005, remaining almost unchanged compared with the previous year (€2,713 million), which is consistent with the results of the January 2006 Bank Lending Survey.¹⁵ According to these results, there is no evidence that banks have tightened their credit standards. Lending on floating rate or an initial rate fixation of up to one

year amounts to almost the total of new loans (more than 90%). As regards the amount of new loans granted, large loans (over €1 million) represent more than 60% of the total amount of new loans.

The breakdown of bank lending by sector of economic activity shows that the annual rate of change of the loan balances to agriculture has turned negative since the second quarter of 2005 (fourth quarter of 2005: -12.7%, fourth quarter of 2004: 7.8%, see Table III.4). However, credit expansion to agriculture has been affected by one-off write-offs of ATE receivables from this

¹⁴ New loans include only loans of a specific amount and with a defined maturity and not credit lines or debit balances on current accounts, which, taken together, represent one-third of total loans to non-financial corporations.

¹⁵ The Bank Lending Survey is carried out on a quarterly basis in the context of a wider survey at the Eurosystem level. Its aim is to gain information concerning credit conditions, whether in relation to participating banks' credit policy (credit standards and terms of financing) or demand conditions. The Greek sample includes three banks. For more information concerning the Bank Lending Survey in the euro area see ECB, *Monthly Bulletin*, April 2003.

Table III.4
Breakdown of bank loans to enterprises and households in Greece

	Outstanding balances on 31.12.05 (million euro)	Annual percentage changes											
		2001		2002		2003		2004		2005		Q4 ¹	December ²
		Q4 ¹	Q4 ¹	Q4 ¹	Q4 ¹	Q1 ¹	Q2 ¹	Q3 ¹	Q4 ¹	Q1 ¹	Q2 ¹		
A. Enterprises³	71,283	16.7	11.4	11.0	8.6	6.0	5.6	6.3	6.4	8.7			
1. Agriculture	2,954	-2.6	-14.0	3.3	7.8	4.1	-4.3	-8.2	-12.7	-9.1			
2. Industry ⁴	15,754	10.2	11.5	10.4	1.1	-1.9	0.1	0.5	-0.6	0.5			
3. Trade	19,958	20.3	7.8	4.0	12.7	12.8	12.3	11.1	6.6	6.0			
4. Tourism	4,190	14.2	33.7	24.4	17.6	15.1	13.2	7.8	4.6	3.7			
5. Shipping	6,185	7.8	5.5	2.3	3.0	6.9	21.0	27.2	34.4	37.6			
6. Non-monetary financial institutions	2,236	141.8	72.5	-3.2	9.5	-21.4	-41.2	-37.7	-29.7	-17.0			
7. Other loans	20,006	24.6	14.3	26.5	11.7	9.8	8.6	11.3	15.7	20.6			
B. Households⁵	65,698	40.0	33.1	28.2	28.0	28.4	27.9	25.2	26.2	27.2			
1. Housing loans	43,199	36.7	35.4	27.1	23.8	25.3	25.7	25.2	28.1	30.4			
2. Consumer loans	20,850	44.3	27.4	24.8	37.9	35.6	33.7	26.9 ⁶	24.0 ⁶	22.3 ⁶			
– Credit cards	7,470	62.1	37.1	27.8	23.4	22.0	19.9	5.2 ⁶	-0.7 ⁶	-2.5 ⁶			
– Other consumer ⁷ loans	13,380	31.8	19.2	21.8	53.1	48.9	46.4	45.8	44.5	42.5			
3. Other loans	1,649	165.5	62.6	135.7	18.8	22.0	13.4	7.8	11.5	13.3			
Total	136,981	23.2	18.3	17.1	16.1	15.0	14.7	14.1	14.9	16.9			

1 The quarterly average is derived from monthly averages (which are calculated as arithmetic means of two successive end-of-month figures) and is not the three-month average of end-of-month annual growth rates (see the "Technical Notes" in the ECB *Monthly Bulletin*).

2 Annual rate of change at the end of the month.

3 Excluding corporate bonds held in MFI portfolios and written-off claims. See Table III.3 for the growth rates that the inclusion of these items would entail.

4 Comprising manufacturing and mining/quarrying.

5 Excluding securitised housing loans (€2,220 million) and consumer loans (€975 million). See Table III.3 for the growth rates that the inclusion of these items would entail.

6 The slowdown of consumer loan growth is partly associated with the securitisation of loans effected in July 2005.

7 Including personal loans and loans against supporting documents.

Source: Bank of Greece.

sector, which, as mentioned before, are associated with the implementation of Law 3259/2004¹⁶ and the consolidation of the bank's loan portfolio. If these accumulated write-offs (which reached about €760 million up to December 2005) are taken into account, we see that credit expansion to agriculture decelerated only slightly (fourth quarter of 2005: 8.2%, fourth quarter of 2004: 9.6%).

The annual rate of change in bank loans to industrial firms, after standing at marginally positive levels during the second and the third quarter of 2005, returned to negative levels (fourth quarter of 2005: -0.6%, fourth quarter of 2004: 1.1%). The low or even negative rate of change in bank lending to industrial firms observed since mid-2004 reflects, to a degree, the substitution of bank loans with corporate bonds held by banks. According to available data, this practice is often pursued by industrial firms.¹⁷ For example, during the March-December 2005 period,¹⁸ total MFI credit (loans and bonds) to industrial firms grew by 3.3%.

Credit expansion to trade has shown a tendency to decelerate since the second quarter of 2005, after a period of relatively high growth rates since mid-2004. Thus, the annual growth rate of bank lending to trade firms fell to 6.6% in the fourth quarter of 2005, from 12.7% in the fourth quarter of 2004. However, it should be noted that, as in the case of industrial firms, trade firms substitute part of their bank loans with the issuance of bonds, which are held by banks.¹⁹ During the March-December 2005 period, for which statistical data concerning bonds by sector are available, total MFI claims (loans and bonds) against trade firms rose by 5.7%.

The annual growth rate of credit to shipping has accelerated appreciably since the second quarter of 2005 (fourth quarter of 2005: 34.4%, fourth

quarter of 2004: 3.0%). As mentioned in previous reports, since the bulk of loans to shipping companies are granted in US dollars, balances expressed in euros include the effect of developments in the USD/euro exchange rate.²⁰ However, the acceleration cannot be fully attributed to foreign exchange valuation differences, as it remains quite strong, even if this effect is not taken into account (fourth quarter of 2005: 26.0%, fourth quarter of 2004: 9.9%). This outcome is associated with increased investment spending by shipping companies for fleet renewals, along with the rise in ship prices.

The annual growth rate of total bank credit to households (including securitised loans²¹) remained high throughout 2005. In the fourth quarter, it stood at practically the same level as at the end of the previous year (fourth quarter of 2005: 30.3%, fourth quarter of 2004: 30.0%, see Table III.3). During the year, new securitisations of housing loans (a total of €1.5 billion), as well as the first ever securitisation of consumer loans (a total of €952 million) took place. If securitised loans are not taken into account, the annual growth rate of MFI loans to households, though remaining high, shows a decline in the fourth quarter of 2005 (26.2%, see Table III.4) compared with the last quarter of 2004 (28.0%).

The growth rate of household borrowing remained

¹⁶ It includes specific provisions for agriculture.

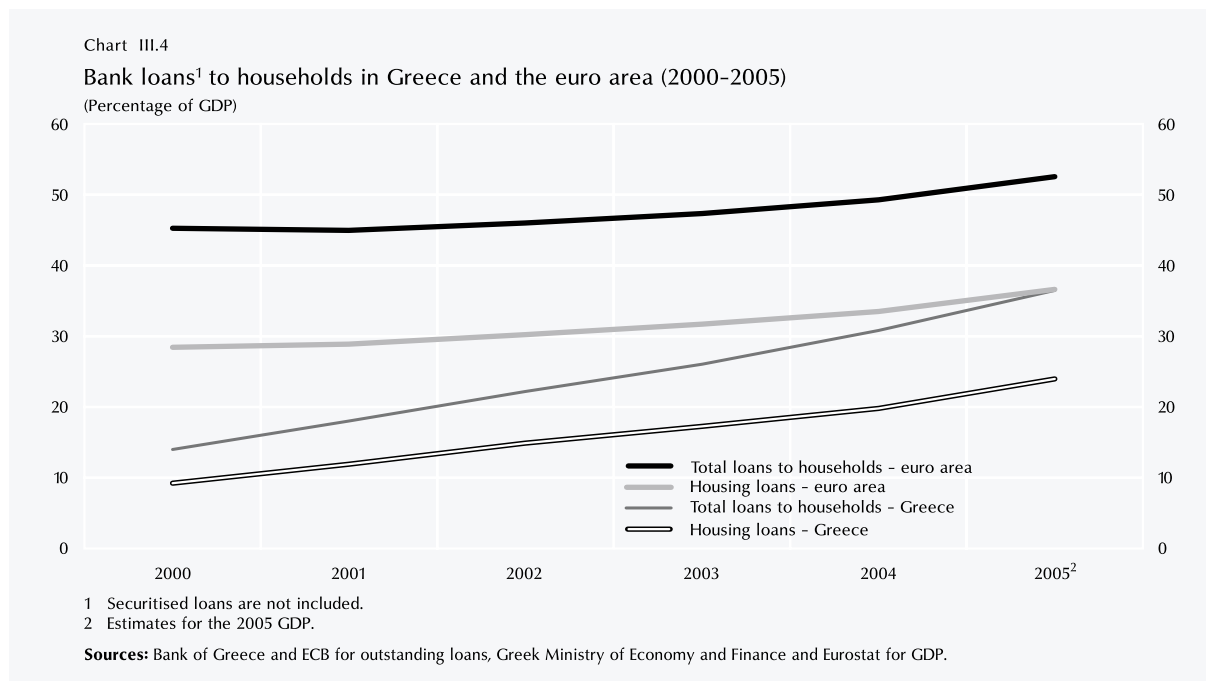
¹⁷ A significant part (December 2005: 22% of the total) of corporate bonds held by MFIs has been issued by industrial firms.

¹⁸ Statistical data concerning corporate bonds held by MFIs by branch of economic activity are available since March 2005.

¹⁹ Trade firms had issued 14% of total corporate bonds held by MFIs in December 2005.

²⁰ From end-December 2004 to end-December 2005, the euro depreciated against the US dollar by 13.4%.

²¹ Securitised loans are removed from the assets of the bank involved (the originating bank) and are transferred to the Special Purpose Vehicle through which the securitisation takes place (see *Monetary Policy 2004-2005*, Appendix to Chapter IV, February 2005).



high, thereby raising total household indebtedness (loans from MFIs, including securitised loans) as a percentage of GDP to 38.3% in December 2005 (December 2004: 31.4%). Total MFI loans to households (excluding securitised loans) as a percentage of GDP stood at 36.5% in December 2005 (December 2004: 30.9%, see Chart III.4), thus gradually bridging the gap with the respective euro area average (December 2005: 52.6%, December 2004: 49.3%). Given that these percentages underestimate, to a different degree, the total indebtedness of households (which also includes securitised loans), conclusions should not be based solely on this comparison.²²

In more detail, the growth rate of housing loans accelerated considerably in 2005 (fourth quarter of 2005: 31.3%, fourth quarter of 2004: 26.9%) and is still high, even if the balances of securitised housing loans are not taken into account (fourth quarter of 2005: 28.1%, fourth quarter of 2004: 23.8%). The evolution of housing credit reflects the increased demand observed in the housing market, which was largely affected by

the announcement that as of 1 January 2006 the objective values of real property would be raised and VAT would be applied on new residential buildings.

Owing to increased demand for housing loans, the average monthly total of new housing loans in 2005 was 68% higher than in the corresponding period of the previous year. In addition, borrowers still preferred floating rate loans or loans with an initial rate fixation of up to one year, as the share of those loans in total new housing loans rose (2005: 89%, 2004: 82%, 2003: 71%). At the same time, owing to the fast expansion of housing credit, household indebtedness as to housing loans (including securitised loans) rose to 25.2% of GDP in December 2005 (December 2004: 20.4%). If the balances of securitised loans are not taken into account, housing loans represented 24.0% of GDP in December 2005 (Decem-

²² Statistical information on the balance of securitised loans in the euro area is not available, see ECB, *Monthly Bulletin*, September 2005, Box 1.

ber 2004: 19.8%), compared with 36.6% for the euro area in the same month (December 2004: 33.5%). However, as mentioned above, caution should be exercised when comparing the two figures.

The growth rate of consumer loans remains high, notwithstanding the significant slowdown observed in 2005 (fourth quarter of 2005: 29.9%, fourth quarter of 2004: 37.9%), which is even stronger when the balances of loans through credit cards securitised in July 2005 are not taken into account (fourth quarter of 2005: 24.0%, fourth quarter of 2004: 37.9%). This reflects the deceleration in the growth rate of other consumer loans (personal loans and loans against supporting documents) as well as loans through credit cards. As regards credit cards, the deceleration was steeper, reducing their share in total consumer loans, after taking into account securitised receivables, to 39% in December 2005 (December 2004: 45%).

2.2 Bank lending rates

Interest rates on new loans to households (both consumer and housing) fell in Greece during the previous year, while interest rates on new corporate loans increased or remained almost unchanged. The decline in Greek lending rates is largely attributable to strong competition between banks operating in Greece and was maintained for some categories in December, after the ECB raised its key interest rates by 25 basis points. During the same month, lending and deposit rates in the euro area rose in almost all categories (see Chapter II.3.3). Interest rates on loans to households in the euro area remained at lower levels, while in most cases they showed smaller changes in 2005; hence, their differential from the corresponding Greek rates narrowed (see Table III.5). By contrast, the differential widened for interest rates on the majority of corporate

loans. It should be noted that, although lending rates in Greece exceed the corresponding rates in the euro area, in certain categories they are not the highest among euro area countries. The differentials of lending rates among individual euro area countries are attributable to factors such as differences concerning the ratio of loan coverage with collateral, the characteristics of lending products, bank size and the relative operating costs, the amount of bad debts, the legal framework governing the realisation of mortgaged assets, as well as the percentage of delays recorded in debt servicing (this percentage is higher in Greece).

In more detail, as regards lending rates in Greece, during 2005 the largest decline (110 basis points) was observed in the category of consumer loans with a defined maturity (December 2005: 8.26%). The average rate on consumer loans without a defined maturity (which represents 52% of the balance of consumer loans) also fell (by 34 basis points) and stood at 13.07% in December.²³ The rate on consumer loans with an initial rate fixation of over one and up to five years²⁴ (which represent 41% of consumer loans with a defined maturity) fell significantly (101 basis points). The decline (of 46 basis points) in the average interest rate on the total of new housing loans was smaller (December 2005: 3.91%).²⁵ The average rate on corporate loans without a defined maturity (which

²³ By contrast, the interest rate on open loans (which represent 1/3 of the balance of consumer loans without a defined maturity) rose by 36 basis points during the previous year (December 2005: 12.01%).

²⁴ The interest rate on consumer loans with a floating rate or an initial rate fixation of up to one year, which represent almost 1/3 of consumer loans with a defined maturity, also fell (by 80 basis points) in 2005.

²⁵ In the previous year, a slightly smaller decline (of 35 basis points) was observed in the interest rate on the major subcategory (90%) of new housing loans, i.e. loans with a floating rate or an initial rate fixation of up to one year (December 2005: 3.86%, see Chart III.5).

Table III.5

Bank interest rates on new loans in the euro area and in Greece

(Percentages per annum)

A. Loans with a floating rate or an initial rate fixation of up to one year¹			
	December 2004	December 2005	Change Dec. 2005/Dec. 2004 (in percentage points)
A.1. Loans up to €1 million to non-financial corporations			
Weighted average interest rate in the euro area	3.97	3.98	0.01
Maximum interest rate	5.52	5.74	0.22
Minimum interest rate	3.48	3.53	0.05
Interest rate in Greece	5.04	5.41	0.37
Interest rate differential between Greece and the euro area	1.07	1.43	0.36
A.2. Loans of more than €1 million to non-financial corporations			
Weighted average interest rate in the euro area	3.05	3.22	0.17
Maximum interest rate	4.09	4.22	0.13
Minimum interest rate	2.67	2.70	0.03
Interest rate in Greece	3.77	3.93	0.16
Interest rate differential between Greece and the euro area	0.72	0.71	-0.01
A.3. Housing loans			
Weighted average interest rate in the euro area	3.43	3.49	0.06
Maximum interest rate	4.37	4.44	0.07
Minimum interest rate	3.10	3.18	0.08
Interest rate in Greece	4.21	3.86	-0.35
Interest rate differential between Greece and the euro area	0.78	0.37	-0.41
A.4. Consumer loans			
Weighted average interest rate in the euro area	6.73	6.75	0.02
Maximum interest rate	10.99	10.19	-0.80
Minimum interest rate	4.73	3.94	-0.79
Interest rate in Greece	8.58	7.78	-0.80
Interest rate differential between Greece and the euro area	1.85	1.03	-0.82
B. Loans with an initial rate fixation of 1-5 years¹			
Consumer loans			
Weighted average interest rate in the euro area	6.60	6.36	-0.24
Maximum interest rate	10.59	8.60	-1.99
Minimum interest rate	4.25	4.22	-0.03
Interest rate in Greece	9.45	8.44	-1.01
Interest rate differential between Greece and the euro area	2.85	2.08	-0.77

¹ Monthly average rate.

Sources: ECB and euro area NCBs.

represent about 33% of the balance of corporate loans) remained almost unchanged and stood at 7% in December.²⁶ As regards interest rates on corporate loans of a specific amount with a floating rate or an initial rate fixation of up to one year, there has been a significant increase (37 basis points) in the interest rates on loans up to €1 million, while the increase was smaller (16 basis

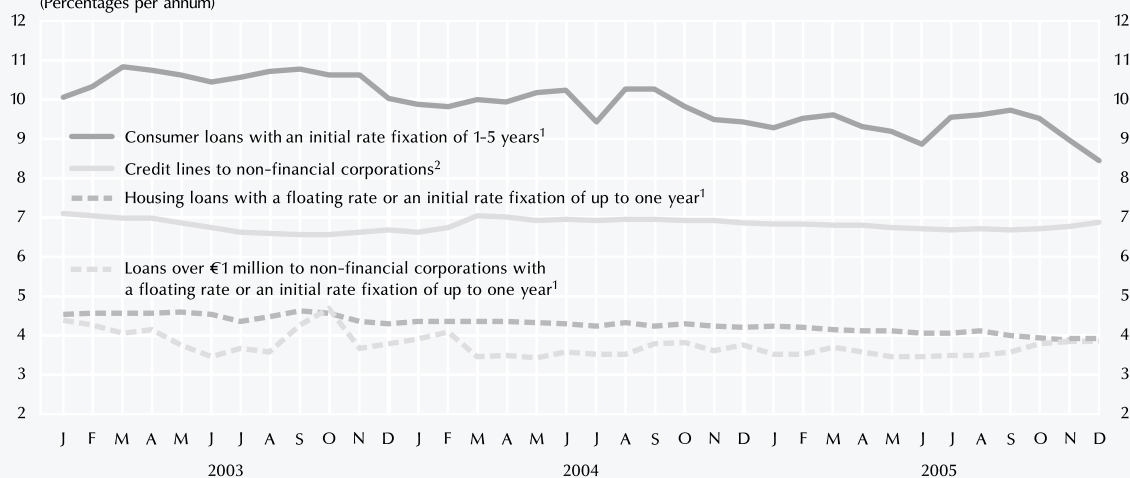
points) in the interest rates on loans over €1 million. In December 2005, these rates reached 5.41% and 3.93%, respectively.

²⁶ These loans are mostly granted through credit lines, whose interest rate remained basically unchanged. Another, less important, category of loans to enterprises without a defined maturity is that of sight account overdrafts.

Chart III.5

Bank interest rates on new loans in Greece (January 2003 - December 2005)

(Percentages per annum)



1 Monthly average rate.

2 End-of-month rate.

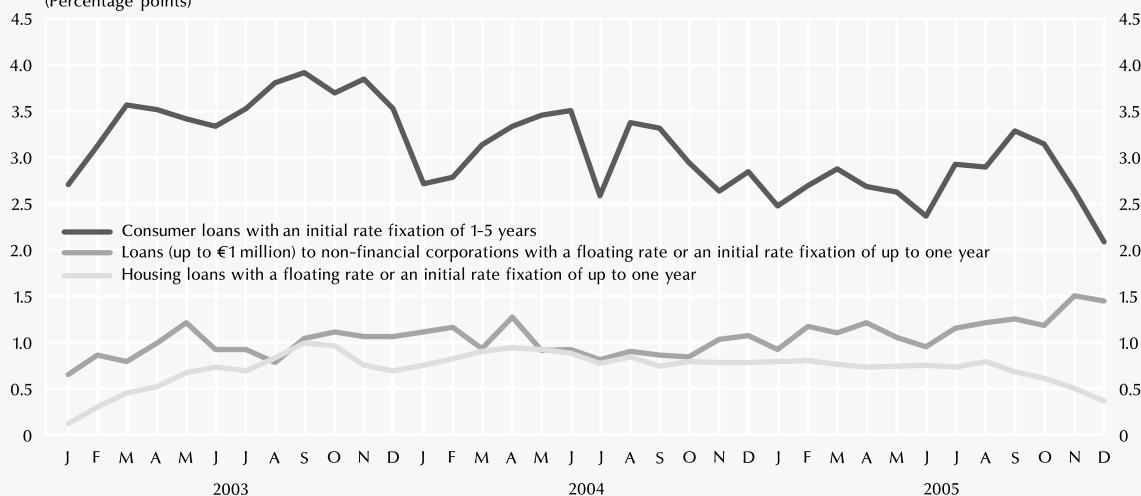
Source: Bank of Greece.

Chart III.6

Bank interest rates on new loans: differentials between Greece and the euro area

(January 2003 - December 2005)

(Percentage points)



Sources: Bank of Greece and ECB.

As regards the euro area, trends in bank lending rates were mixed last year. The interest rate on consumer loans without a defined maturity rose (by 26 basis points), whereas that on almost all other consumer loans fell (by 24 to 27 basis points). The interest rate of the most important

category of housing loans (with a floating rate or an initial rate fixation up to one year) showed a small increase (6 basis points), while those of the other housing loan categories fell (by 11 to 40 basis points). Finally, the interest rate on large corporate loans (over €1 million with a floating

interest rate or an initial rate fixation of up to one year) rose (by 17 basis points), whereas those of the other categories of corporate loans fell (by 13 to 16 basis points).

Although, as mentioned above, differentials between Greek and euro area interest rates on loans to households narrowed during 2005, they are still wide. In particular, the differential between consumer loans without a defined maturity, though falling by 58 basis points, is still wide (December 2005: 3.30 percentage points). The differential is due to the fact that, in contrast to other euro area countries, in Greece loans without a defined maturity are mostly granted through credit cards, whose interest rate is high (December 2005: 13.78%), reflecting the high management costs banks incur for this particular product. However, it should be noted that, in Greece, this interest rate was 51 basis points lower in December 2005 than in December 2004.²⁷

The differential between Greek and euro area interest rates on new consumer loans with an initial rate fixation of over one and up to five years fell to 2.08 percentage points in 2005, from 2.85 percentage points in December 2004 (see Chart III.6). It should be noted that consumer loans with a long maturity involve greater risks, which may be limited if banks obtain collateral or guarantees. High interest rates on these loans indicate their lower ratios of collateral coverage.²⁸ Concerning housing loans with a floating rate or an initial rate fixation of up to one year, the differential fell to 37 basis points in December 2005, from 78 basis points in December 2004 (see Table III.5), as the interest rate on the same category of loans in the euro area rose slightly. As mentioned in a previous report, high interest rates on housing loans²⁹ are associated with the fact that the time required for the liquidation of real property serving as loan collateral is longer in Greece.

As mentioned earlier, however, interest rate differentials between Greece and the euro area regarding corporate loans rose last year. The corresponding differential of loans without a defined maturity rose slightly (to 1.88 percentage points in December 2005, from 1.71 percentage points in December 2004). The collateral coverage ratio of these loans, which depends on the probability of default, differs among individual euro area countries and has an inversely proportional effect on interest rates. An increase was also observed in 2005 in the differential between Greece and the euro area regarding interest rates on corporate loans of a specific amount and with a defined maturity, with a floating rate or an initial rate fixation of up to one year concerning loans of up to €1 million, while the differential remained almost unchanged for loans over €1 million. This differential was 143 and 71 basis points in December 2005, against 107 and 72 in December 2004, respectively. The level of interest rates on corporate loans also depends on the availability of alternative sources of funding, such as corporate bond issues (which mostly major corporations resort to). In contrast to other euro area countries, the market for this type of bonds is not developed in Greece, a fact conducive to higher interest rates. The interest rate differential between loans to companies of small size and those to companies of large size³⁰ did not fluctuate much last year and

²⁷ Loans through credit cards are not the main type of borrowing in other euro area countries (as regards consumer loans without a defined maturity), as the relevant debts are mostly paid in full. Overdrafts on current accounts are an alternative type of borrowing, where interest rates are lower for larger amounts. Thus, this type of borrowing is preferable to consumer loans with a defined maturity.

²⁸ In some euro area countries collateral can be in the form of a mortgage, thus limiting risks and lowering interest rates.

²⁹ Lower interest rates on housing loans in certain euro area countries are attributed to the guarantee that may be provided by the government for such loans.

³⁰ As mentioned in Section 2.1 of this chapter, in Greece new loans to enterprises with a defined maturity and a floating rate or an initial rate fixation of up to one year and up to €1 million account for more than 60% of the total of new corporate loans.

stood at 148 basis points in Greece in December, compared with 76 basis points in the euro area. The higher differential observed in Greece is attributable to the different size structure of companies in Greece compared with other countries. Higher interest rates on corporate loans reflect the relatively smaller size of companies in Greece, combined with the lower negotiating capability of small companies, owing to higher risks, as reflected in the stricter credit standards usually applied by banks in such cases.

The margin between the average rate on the total of bank loans and the corresponding rate on deposits fell by 27 basis points during 2005 (December 2005: 4.57 percentage points, December 2004: 4.85 percentage points). This development was mostly due to the drop in the average lending rate (December 2005: 5.84%, December 2004: 6.03%), while the average deposit rate also increased slightly (December 2005: 1.27%, December 2004: 1.19%). The decline in the average lending rate is associated with a significant drop in the average interest rate on loans to households (to 6.37% in December 2005, from 7.04% in December 2004), which mainly reflects the decline in the interest rate on consumer loans, while the interest rate on loans to enterprises rose slightly. The narrowing of the margin between lending and deposit rates largely reflects increased competition between banks.

Average interest rates on the balance of existing loans offer additional information on the overall evolution of bank rates. The average interest rate on the outstanding amounts of euro-denominated loans (new as well as older loans), which affects the operating income of banks, decreased in 2005. However, there were mixed signs from individual loan categories. In particular, the interest rate on the major consumer loan category (with a maturity of up to one year) fell signifi-

cantly, whereas the interest rate on the second most important category of consumer loans (those with a maturity of over one and up to 5 years) rose. In addition, the interest rate on the most significant category of housing loans (with a maturity of over 5 years) also declined. The average interest rate on short-term corporate loans decreased, while the interest rate on corresponding medium-term loans showed a small increase. The interest rate on long-term loans to non-financial corporations remained almost unchanged.

3. Capital markets

3.1 *The bond market*

Short- and medium-term Greek government bond yields stood at higher levels at the end of 2005 compared with the end of 2004, whereas long-term bond yields declined. Transactions in these securities in the Electronic Secondary Market for Securities (HDAT), although reduced compared with one year before, remained at high levels in 2005.

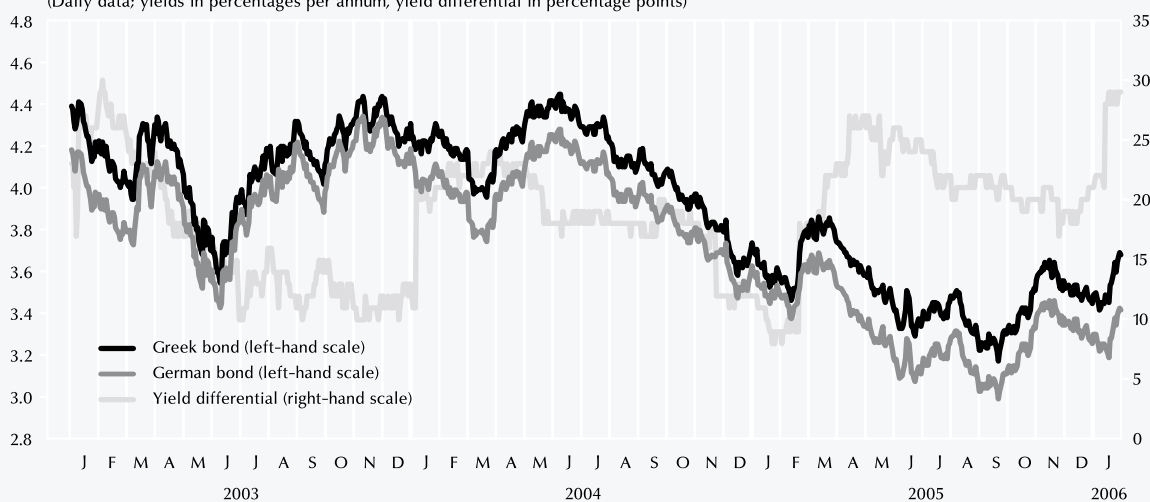
In line with similar developments in the yields of comparable euro area securities,³¹ Greek government bond yields fell to historical lows between mid-2004 and end-September 2005,³² before rebounding considerably in the remainder of the year, especially in the case of short-term and medium-term bonds (see Charts III.7 and III.8). The fall in the yields during the first nine months of the year was associated with (i) the less favourable prospects for the euro area economy in a context of rising oil price and (ii) the conditions

³¹ For a more detailed discussion of developments in US and euro area bond markets, see Chapter II.3.3.

³² Because of the significant drop in nominal long-term interest rates, the real long-term interest rates reached particularly low (even negative occasionally) levels.

Chart III.7

Yields on the 10-year Greek and German government bonds
(January 2003 – January 2006)
(Daily data; yields in percentages per annum, yield differential in percentage points)



Source: Bank of Greece.

of ample liquidity prevailing in international financial markets. In the subsequent months, however, there was some correction relative to the historically low levels of September. Furthermore, an improved outlook of the euro area economy and investor concerns about a possible pickup in inflation as a result of high oil prices fuelled expectations of a rise in euro area interest rates.³³ Against this background, government bond yields increased, and this trend continued into January 2006. Moreover, in 2005 the volatility of government bond yields both in HDAT and in the euro area bond market remained low compared with the average of the last five years.³⁴

The yield on the Greek 10-year government bond in HDAT fell to 3.51% at end-December 2005, i.e. 29 basis points down compared with one year earlier, having ranged between a peak of 3.97% on 10 March and a trough (3.21%) on 22 September. The yield differential between this bond and the comparable German one was 21 basis points at end-December 2005, up from 13 basis points at end-December 2004 (see Chart

III.7). It should be noted that in mid-February 2005 this differential widened to 18 basis points, due to the issuance of a new Greek reference bond maturing 6.5 months later than the corresponding German bond.^{35,36}

Regarding other Greek government bond yields, between end-December 2004 and end-December 2005 yields for maturities of up to 5 years increased, whereas yields for maturities of over 7 years declined, especially at the longer end of the

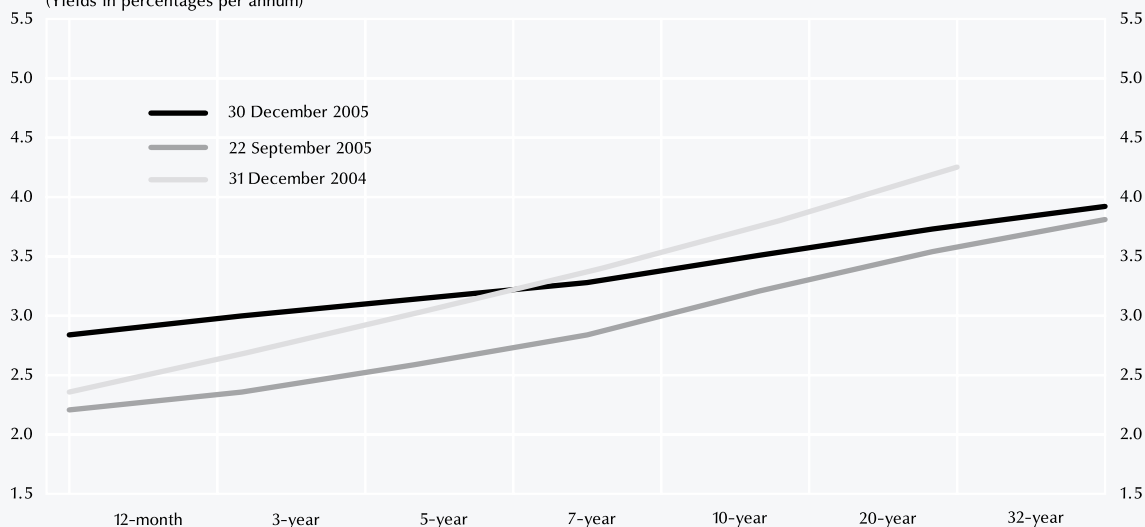
³³ On 1 December 2005 the European Central Bank decided to increase its key interest rates by 25 basis points, after having kept them unchanged since June 2003.

³⁴ Volatility in HDAT has been measured by the standard deviation of the daily yields on the 10-year reference bond. For volatility in the euro area, see Chapter II.3.3, footnote 28.

³⁵ The release of revised Greek government deficit and debt figures by Eurostat on 18 March 2005 is estimated to have had a small and temporary upward effect on the yield differential between the 10-year Greek government bond and the corresponding German bond.

³⁶ On 25 November 2005 a new German reference bond maturing on 4 January 2006 (i.e. 5.5 months later than the corresponding Greek bond) was issued. If these two bonds had the same maturity, their yield differential would have been 25 basis points at end-December 2005 compared with 21 basis points at end-December 2004.

Chart III.8
Greek government paper yield curves
(Yields in percentages per annum)



Source: Bank of Greece.

spectrum (32- and 20-year bonds, see Chart III.8). As a result, the yield curve flattened markedly, as evidenced by the yield spread between the 10-year bond and the 12-month Treasury bill, which fell by 77 basis points in the period under examination. This development reflected investors' assessment that the monetary policy in the euro area would be effective in containing inflation over the medium to long term.

The average daily value of transactions in HDAT was €2.9 billion in 2005, from €3.8 billion in 2004 (see Chart III.9).³⁷ Investor attention remained focused on 10-year bonds, which accounted for about 59% of total transactions in terms of value. The bid-ask spread stood at 7.9 basis points in December 2005, compared with 6.1 basis points in December 2004.³⁸

In the primary market for Greek government securities, the total amount of funds raised in 2005 was €38.1 billion,³⁹ i.e. 12.1% less than in 2004 (see Table III.6). New issuance predominantly took the form of syndicated issues⁴⁰ and, to

a lesser extent, auctioned issues.⁴¹ Moreover, the Greek government re-opened past issues of 3-year, 5-year and 10-year bonds using auction procedures and one past issue of the 23-year bond through syndication.⁴²

³⁷ Moreover, the average daily value of transactions through the Book-Entry Securities System of the Bank of Greece, which, in addition to HDAT transactions, includes OTC transactions between banks and their customers, was €25.8 billion in 2005, compared with €27.1 billion in 2004.

³⁸ The widening of the bid-ask spread was connected with the higher volume of transactions in long-term bonds, including the 32-year bond, which involve wider bid-ask spreads compared with bonds of shorter maturities.

³⁹ It should be noted that redemptions of Greek government securities reached €23.9 billion in 2005, compared with €25.3 billion in 2004.

⁴⁰ These included the first Greek 32-year bond, launched in early March 2005, carrying a coupon of 4.50% and maturing on 20 September 2037. Demand was almost double the amount of the issue (€5 billion) and was for the most part absorbed by foreign institutional investors. It should be noted that in the period under review other countries too issued bonds with maturities of over 30 years, in order to lock in low borrowing costs and in response to a demand from pension funds and insurance companies that wished to cover long-term liabilities. For instance, 50-year bonds were launched by France and the United Kingdom.

⁴¹ Besides, the new 12-year bond was issued by private placement.

⁴² This bond is linked to the Harmonised Index of Consumer Prices (excluding tobacco) of the euro area, with a coupon of 2.90% and maturing on 25 July 2025.

Chart III.9
Average daily value of transactions in the Electronic Secondary Market for Securities (HDAT)
(January 2004 – January 2006)

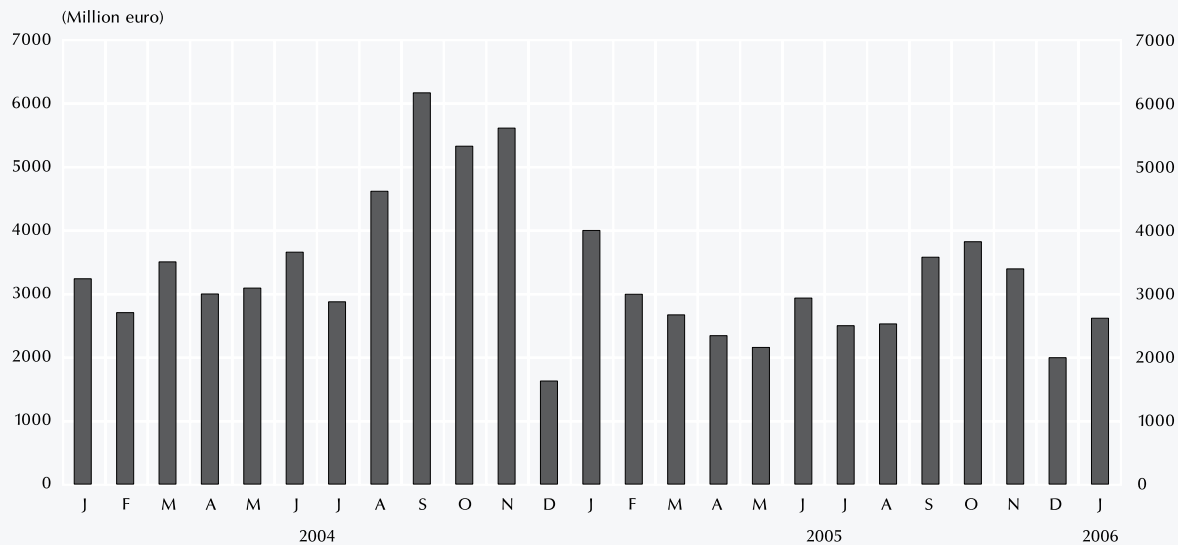


Table III.6
Greek government paper issuance

Type of security	January - December			
	2004		2005	
	Million euro	Percentage of total	Million euro	Percentage of total
Treasury bills	2,493	5.7	2,179	5.7
Bonds ¹	40,868	94.3	35,938	94.3
1-year	7,183	17.5	—	—
3-year	8,663	21.2	6,990	19.4
5-year	12,352	30.3	8,603	23.9
7-year	96	0.2	—	—
10-year	9,692	23.7	9,609	26.7
12-year	384	0.9	3,499	9.7
20-year	242	0.7	—	—
23-year	2,256	5.5	2,213	6.3
32-year	—	—	5,024	14.0
Total	43,361	100.0	38,117	100.0

1 By initial maturity as regards the reopening of past issues.

Source: Ministry of Economy and Finance.

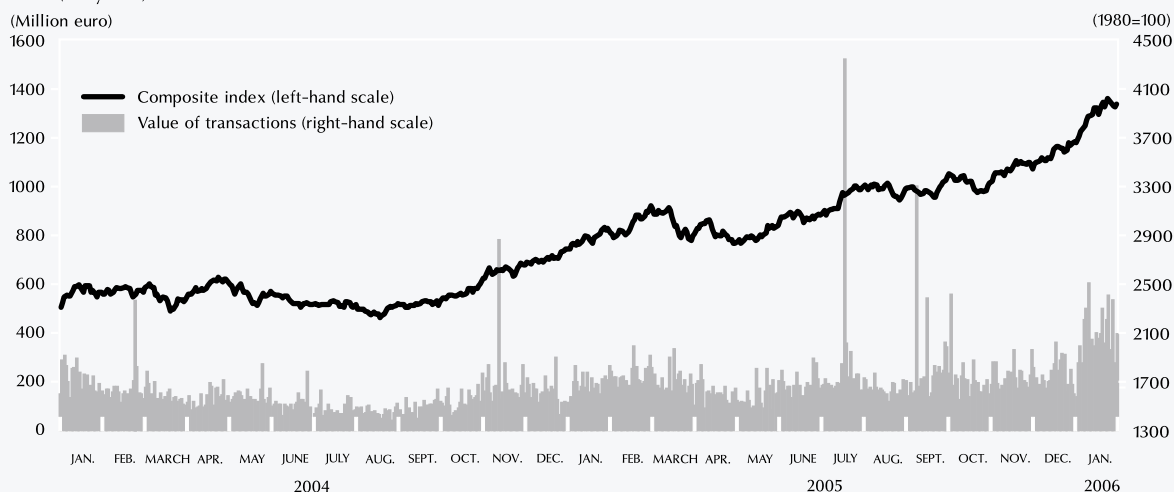
As shown in Table III.6, maturities of up to 7 years accounted for €15.6 billion (43% of total bond issues in terms of value, compared with 69% in 2004) and maturities of 10 years and over (10, 12, 23 and 32 years) for €20.3 billion (57% of total value, compared with 31% in 2004). This points to

a clear shift, on the part of the Greek government, towards long-term securities in 2005, compared with 2004, in the context of very low long-term interest rates and in line with the policy of increasing the average maturity of public debt. Thus, the weighted average maturity of the secu-

Chart III.10

Athens Exchange: composite share price index and value of transactions
(January 2004 - January 2006)

(Daily data)



Source: Athens Exchange.

rities issued in the year under review increased.⁴³ Finally, Treasury bill issues remained once again low in 2005, representing about 6% of total issues.⁴⁴

In 2005, demand outstripped supply in the case of syndicated new issues of 5-year, 10-year and 32-year bonds, as well as in auctioned issues, reflecting the sustained attractiveness of Greek government securities mostly to foreign institutional investors.^{45,46}

3.2 Stock market developments

The upward course of the composite share price index of the Athens Exchange (Athex), which started in late August 2004, continued throughout 2005 (see Chart III.10) at a robust pace, considerably stronger than that of the Dow Jones EURO STOXX index for the euro area.⁴⁷

In more detail, share prices were driven by the low returns on alternative investment types, the positive financial results reported by Athex-listed firms' release for the first half and the first nine

months of 2005,⁴⁸ the announcement of important business initiatives, the expected structural changes in companies affiliated with the govern-

⁴³ According to the latest available data, the weighted average maturity of these securities in the period January-September 2005 was 10.76 years, up from 6.85 years in 2004.

⁴⁴ Moreover, during 2005, various public debt management operations were conducted aimed at reducing the exposures associated with floating interest rates and benefiting from the historically low long-term interest rates.

⁴⁵ According to balance of payments statistics, net flows into Greek government bonds from non-residents amounted to €20.7 billion in 2005, compared with €21.6 billion in 2004.

⁴⁶ For instance, broken down by country of residence, investors in the new 32-year bond were as follows: 18.9% Greek residents, 18.5% based in the United Kingdom, 17.9% in Belgium, Luxembourg and the Netherlands, 13.8% in Germany, 28.3% in other EU countries and 2.6% in the United States. Broken down by sector, 41.8% were banks, 29.9% asset management companies, 12.7% insurance companies, 8.2% pension funds, 5.4% central banks and 2% other investors.

⁴⁷ It should be noted that, compared with the other euro area stock markets, in terms of strength, the Athex index was second only to the Austrian index. For a detailed discussion of stock market developments in the euro area, see Chapter II.3.4.

⁴⁸ Under Law 3301/2004, Athex-listed firms are required, effective from the beginning of 2005, to comply with the international accounting standards in drawing up their financial statements. Financial statements published so far have shown that firms have adjusted smoothly to the new accounting regime and that their profitability has improved. Actually, non-consolidated pre-tax profits of all the Athex-listed firms rose by 8.1% during the first nine months of 2005 relative to the corresponding 2004 period.

ment sector, the increased participation of foreign investors in Athex transactions, and the rigorous supervision on the part of the Hellenic Capital Market Commission.⁴⁹ At the same time, in an attempt to boost further the liquidity and competitiveness of the Greek stock market, the new Athens Exchange Regulation came into effect at end-November 2005.⁵⁰ Share prices continued to rise in January 2006.

Between end-December 2004 and end-December 2005, the Athex composite index rose by 31.5%,⁵¹ having ranged between a trough of 2,818.33 points on 5 January and a peak of 3,663.90 points on 30 December. It thus outperformed the Dow Jones EURO STOXX broad index for the euro area (23%) and the Standard & Poor's 500 index in the United States (3%), but was surmounted by the Japanese Nikkei 225 index (40.2%).⁵² Among individual domestic market indices, the largest gains were recorded by the medium capitalisation index (47.1%), followed by the small capitalisation index (33.3%) and the large capitalisation index (30.5%).

It should also be noted that the Athex composite share price index exhibited low correlation with the Dow Jones EURO STOXX broad index in 2005. Specifically, the correlation coefficient of the two indices was 0.38, compared with 0.50 in 2004. By contrast, the correlation of major stock market indices in the EU (FTSE 100, DAX and CAC 40) with the Dow Jones EURO STOXX broad index was high (over 0.85). The volatility of the Athex composite index, however, which had been higher than that of the Dow Jones EURO STOXX broad index since November 2004, converged to the latter after August 2005.⁵³ Both volatilities remained below their six-year averages throughout 2005, which reflected investors' low uncertainty and positive expectations about stock market and economic developments.

The average daily value of transactions reached €209.3 million in 2005, rising by 48.9% relative to 2004. The bulk of transactions (about three fourths) related to shares that are included in the large capitalisation index. The participation of foreign investors in Athex transactions and market capitalisation was high.⁵⁴

The total amount of funds raised from the stock market increased⁵⁵ from €476.6 million in 2004

⁴⁹ In this context, Law 3340/2005 against insider trading and market manipulation was passed and came into effect. This was followed by Law 3371/2005 on capital market issues, which laid down provisions regarding securities admitted to trading on regulated markets, the minimum disclosure obligations for issuers and the independence of the Hellenic Capital Market Commission.

⁵⁰ Under the new Athens Exchange Regulation, which was approved by the Hellenic Capital Market Commission, the markets operating up to 25 November 2005 (main, parallel, new market and EAGAK) as well as the special liquidity category and the "supervision" category (which includes companies placed under surveillance) were replaced by a new market consisting of three categories: (i) "large capitalisation", (ii) "medium and small capitalisation" and (iii) a residual category of "special stock exchange characteristics", which includes shares not falling under the first two categories and shares of companies already under supervision. Already listed shares were classified under the above three categories, on the basis of their capitalisation. As for sectoral classification, the FTSE Dow Jones Industry Classification Benchmark (ICB) was adopted at the beginning of 2006.

⁵¹ Its average level for 2005 was 29.4% higher compared with 2004.

⁵² Expressed in euro terms, the change in the Standard & Poor's 500 index and the Nikkei 225 index was 18% and 41.2% respectively.

⁵³ Volatility for each index has been measured by applying a GARCH model to the daily returns for the period from 1 January 2000 to 31 December 2005.

⁵⁴ According to data from the Central Depository of Securities, at the end of December 2005 foreign investors accounted for 40.3% (of which 61% was accounted for by investors located in EU countries, mainly Luxembourg, 21%, and the United Kingdom, 17%, and by USA investors, 20%) of the Athex market capitalisation in terms of value, compared with 36% at end-2004. Among foreign investors, institutional investors had a share of 28% compared with 24% at the end of 2004. In the large capitalisation category, foreign investors had a comparatively higher share of, 42.8%, with foreign institutional investors having a share of 30.2%. The share of foreign investors in the total value of transactions was higher (47%) however. This percentage stood at approximately 51% for the large capitalisation category, but was only around 10% in the medium and small capitalisation category.

⁵⁵ This increase largely stemmed from the funds raised by the Agricultural Bank of Greece in June (€1,248.9 million) and Emporiki Bank in November (€397.1 million). If the banking sector is excluded, fund-raising is limited to €564.9 million, still substantially higher (by 105%) than in 2004. It should be pointed out that total funds raised in the period under review were equivalent to about 42.5% of the average figure for the three years 1998-2000.

Table III.7

Fund-raising through the Athens Exchange

(Million euro)

Business sectors	Number of firms			Funds raised ¹		
	2003	2004	2005*	2003	2004	2005*
Listed companies	35	33	17	317.0	397.2	2,906.0
Newly listed companies	13	10	6	61.0	79.4	61.0
Total	48	43	23	378.0	476.6	2,967.0
– Banks	4	4	4	105.8	185.2	1,936.3
– Investment	2	1	3	3.0	13.2	214.6
– Insurance	2	1	3	35.0	3.0	251.1
– Holding	1	2	1	0.3	11.8	400.0
– Industrial	17	12	3	80.4	102.5	50.9
– Construction	1	2	0	7.5	41.0	–
– Commercial	5	5	4	36.3	37.7	31.9
– Telecommunications	3	2	1	3.0	10.0	15.3
– Real estate management	0	0	1	–	–	26.4
– Information technology	12	9	2	38.6	24.3	14.5
– Other	1	2	1	8.1	47.9	26.0

1 Share capital increases through public offerings and private placements. Subscriptions to the share capital increase are entered on the last day of the public offering period.

* Provisional data.

Sources: Athens Exchange and Bank of Greece.

to €2,967 million in 2005⁵⁶ and involved 23 companies (2004: 43 companies), of which 6 were newly listed and raised €61 million (2004: 10 companies, €79.4 million, see Table III.7).

The banking sub-index rose slightly less (28.9%) than the Athex composite index, and the average daily value of transactions in bank stocks (€72.9 million) grew by 66% relative to 2004, i.e. more rapidly than the respective aggregate for the market as a whole. At the same time, the market capitalisation of the banking sector as a percentage of total market capitalisation rose somewhat.⁵⁷ Underlying the strong performance of the banking sub-index was the high profitability of banks. In particular, during the first nine months of 2005, against the corresponding 2004 period, the operating revenue of Greek commercial banks with Athex-listed shares grew year-on-year by 13% and their profits before tax and provisions by 34.7%. This was mainly associated with a rise in various

income categories, as well as a small decrease in operating costs. In more detail, the net interest income of banks rose by 13.8%⁵⁸ and fee income by 11.6% – these two categories account for about 92% of total revenue. Operating costs declined by 0.4% owing to the implementation of personnel voluntary retirement plans and, more generally, to banks' policy of cutting down on their overall expenditure. As a result of these developments, the efficiency ratio⁵⁹ improved significantly to 54.6% from 61.9% in the corresponding 2004 period.

⁵⁶ Another €2,100 million were raised in 2005 through secondary offerings by OPAP and OTE.

⁵⁷ At the end of 2005, the banking sector accounted for 37.3% of total stock market capitalisation in the Athex, compared with 34.5% at end-2004.

⁵⁸ The net interest margin was 2.9% against 2.8% in the corresponding 2004 period.

⁵⁹ Ratio of operating costs to operating revenue.

4. The stability of the financial system

As mentioned in last year's corresponding report,⁶⁰ the stability of the Greek financial system depends crucially on the stability of the banking system, owing to banks' predominant role in the financial sector.⁶¹ Hence, the analysis that follows focuses on the evaluation of the stability of the banking system. This evaluation consists of an examination of, on the one hand, the nature and magnitude of the risks assumed by banks in relation to possible developments in the economic environment and, on the other hand, the profitability and capital adequacy of banks (i.e. the aggregates that determine banks' ability to cope safely with possible adverse, risk-increasing developments). The main conclusion of this evaluation is that the profitability and capital adequacy of the Greek banking system provide a satisfactory safety margin for ensuring its stability. Notwithstanding this finding, the need to monitor continuously and control in a timely manner the risks assumed by banks should not be underestimated, since the level of such risks may rise considerably in the event of adverse developments in the economic environment.

4.1 Credit risk

As for most banks worldwide, credit risk is the major risk facing Greek banks. However, market risks and their potential impact on specific banks should not be underestimated, especially if such banks do not have effective market risk management mechanisms in place. The magnitude of credit risk is affected on the one hand by the asset structure and credit policy of banks and, on the other hand, by borrowers' financial condition, which depends, *inter alia*, on developments in the overall economic environment.

4.1.1 Credit risk arising from loans to households

As a result of continuing strong credit expansion to households, total MFI lending to households

for 2005 (excluding securitised loans – see Section 2 of this chapter) rose to 36.5% of estimated nominal GDP in December 2005; yet this figure is still lower than the corresponding euro area average (52.6%). At end-December 2005, the outstanding balance of bank loans to households made up 48.0% of total bank lending to firms and households, compared with 28.6% at end-2000. Therefore, developments in households' financial condition have significant bearing on banks' credit risk.

Strong credit expansion to households increases banks' credit risk, insofar as it may lead to household overindebtedness, especially if there is an unexpected considerable further slowdown in economic growth in Greece or a further rise in interest rates in the euro area, since in Greece floating-rate loans make up the bulk of loans to households (e.g. 88.8% of new housing loans in the January-November 2005 period were granted at a floating rate or with an initial rate fixation of up to one year, compared with a euro area average of 54.8%). The possibility of a rise in credit risk was also pointed out by the International Monetary Fund (IMF) in its recent evaluation of the Greek financial sector.⁶² To mitigate credit risk, the Bank of Greece has requested banks not to relax their credit standards under the pressure of competition and – when they evaluate loan applications, set terms and conditions (including collateral coverage) and make provisions for bad loans – to take adequately into account the likelihood of adverse developments in the economic environment by conducting appropriate stress tests.

⁶⁰ *Monetary Policy 2004-2005*, February 2005, Chapter V.

⁶¹ The total assets of the Greek financial system (excluding the Bank of Greece) were €349.6 billion on 30 September 2005. Of this amount, about 85% was accounted for by the total assets of credit institutions and the remaining 15% by the sum of the assets of insurance companies, mutual funds and other financial institutions.

⁶² See IMF, *Greece: Financial System Stability Assessment*, January 2006.

The policy of *ex post* provisioning for non-performing loans is not the best practice, as it does not take sufficiently into account the possibility of reduced profitability. Specifically, in order to control credit risk and prevent households' overindebtedness, banks should, when they evaluate loan applications, ensure that the ratio of total debt servicing costs to income for any given borrower does not exceed a reasonable ceiling (30% or 40%, depending on the income size). The Bank of Greece has already carried out audits and verified that banks apply this criterion quite satisfactorily, taking into account the time required for adjustment by certain banks that had previously been using considerably more relaxed criteria.

Credit risk is also directly influenced by developments in residential property prices, as the value of the relevant collaterals changes. Although a future fall in residential property prices in certain segments of the market cannot be ruled out, the possibility of a substantial overall correction in the market is limited. In any case, in order to limit credit risk, the market value of the real estate used as collateral should exceed total lending to each borrower by a sufficient margin. However, it has been observed that, under the pressure of competition, banks grant loans whereby the loan-to-collateral ratio exceeds considerably a reasonable percentage of 75%. Hence, the Bank of Greece has decided that the reduced capital requirement ratio for credit risk (4%) shall henceforth apply only to loan segments up to the said percentage, while a ratio of 8% shall apply to any amount in excess thereof.

4.1.2 Credit risk arising from loans to enterprises

The rate of credit expansion to enterprises falls considerably short of that to households and overall appears to be relatively stable, albeit with marked differences across sectors. Thus, for the

business sector as a whole, the rate of credit expansion does not seem to be in itself a potential credit-risk-enhancing factor for banks. However, there are cases of considerable concentration of exposures to certain firms that face problems. Aggregated data on the evolution of firms' profitability and financial condition during 2005 are not currently available. On the basis of the financial statements of 317 firms (excluding public and financial corporations) collected by the Bank of Greece, it is estimated that their total pre-tax profits grew by only 2.8% in the first half of 2005 over the same period in 2004, although domestic sales and notably exports showed considerably higher rates of increase (10% and 21.4% respectively). As the sample includes a limited number of (typically large by Greek standards) firms, it is not possible to draw safe conclusions on the evolution of the profitability of firms as a whole during 2005. In any case, the relative slowdown in economic growth, rising imports from low-cost countries and the decline in the growth rate of incomes must inevitably have had an impact on the financial condition of firms primarily active in the domestic market, especially small and medium-sized enterprises. Adverse developments in firms' financial condition are also implied by the bad credit record data compiled by "Tiresias S.A.". Specifically, in 2005 the value of unpaid cheques and unpaid bills of exchange rose by 42.9% and 6.8% respectively.

4.1.3 Credit risk measurement and management

According to *ex post* data, the evolution of non-performing loans and the 12.4% rise in banks' credit-risk-weighted assets between 31 December 2004 and 30 September 2005 are clear indications of increased credit risk. In the reviewed period, the non-performing loans to total loans ratio increased across the three main categories of loans (consumer, housing and business loans). Although provisioning grew, the non-performing loans (net of

provisions) to total loans ratio of Greek commercial banks as a whole (excluding the Agricultural Bank of Greece – ATE) rose to 2.7% on 30 September 2005, from 2.2% on 31 December 2004. Likewise, the non-performing loans (net of provisions) to own funds ratio jumped from 16.3% to 21.7%. Besides, the provisions to non-performing loans ratio dropped from 58.9% to 55.6%. It should be pointed out that the encouraging developments in the consolidation of ATE's loan portfolio have led to a gradual convergence of the relevant ratios for the banking system as a whole with those for the banking system excluding ATE. Despite data comparability problems, it should be noted that all the aforementioned ratios are worse than the corresponding averages for euro area banks of comparable size as a whole. Greek banks continued their efforts to improve their credit risk measurement and management systems ahead of the implementation in 2007 of the new supervisory framework ("Basel II"). However, the Bank of Greece considers that banks should take further measures to upgrade both credit and other risk management systems.⁶³ The scope of adaptation clearly differs across banks. The Bank of Greece, in addition to sending relevant consultation documents to provide clarifications and guidelines on the implementation of the new framework, has already started to evaluate the adaptation of the banks' systems on an individual basis and expects, especially from large internationalised banks, faster progress in the adoption of the more sophisticated capital requirement calculation methods provided for by the new framework. A separate issue is that, although the implementation of the International Financial Reporting Standards by banks helped increase provisioning, banks typically continue to make provisions without taking adequately into account possible future swings in the business/credit cycle, which strongly affect expected loan loss, as defined in the new supervisory framework. The degree of convergence of

banks' provisioning policy with the requirements of the International Financial Reporting Standards and the new supervisory framework ("Basel II"), as well as any deviations, are subject to evaluation by the Bank of Greece and consultation with banks, in line with international practice. Specifically with respect to business loans, the Bank of Greece has requested banks to continuously adjust provisioning levels in order to comply with the relevant supervisory requirements (Bank of Greece Governor's Act 2442/1999, as currently in force).

4.2 Market risks

On the basis of Greek commercial banks' data on a consolidated basis, capital requirements for overall market risks declined by 19.5% during the reviewed nine-month period; as a result, on 30 September 2005 they corresponded to only 3.84% of total capital requirements for credit and market risks, compared with 5.29% on 31 December 2004. Therefore, under present conditions, Greek banks' exposure to market risks is overall limited.

However, it should be taken into account that interest rate risk influences, in addition to banks' trading portfolio on which the calculation of capital requirements for the relevant market risk is based, banks' own funds through changes in the fair values at which their positions in available-for-sale instruments are valued. Furthermore, interest rate changes affect net interest income from banks' overall investment portfolio, to the extent that the time of interest repricing for banks' placements does not coincide with the time of interest repricing for the borrowed funds used to finance such placements. In particular, as regards net inter-

⁶³ The same point was also made in the aforementioned evaluation of the Greek financial sector by the IMF (see previous footnote).

est income from loans, interest rate risk may increase in the future because certain banks, pressed by the inadequate growth of their customers' deposits, have already been forced to finance their strong credit expansion with borrowed funds raised through the markets, which are more sensitive to interest rate changes.

4.3 Banks' profitability and capital adequacy

As already mentioned, banks' ability to weather adverse developments hinges on their profitability and capital adequacy. Specifically, in periods of high profitability, banks are better placed, by allocating profits to reserves, to boost their own funds in order to cover the depreciation of their loans and other placements in the event of future adverse developments. As regards the evolution of the profitability of the Greek commercial banks listed on the Athens Exchange as a whole, net pre-tax profits on a consolidated basis and according to the International Financial Reporting Standards grew by 50.9% in the January-September 2005 period over the same period in 2004. This rate of increase was clearly affected by base effects from certain extraordinary expenditures (provisions, cost of employees' voluntary retirement plans etc.) that weighed on the results of 2004. Total operating income grew by 15.2%, mainly reflecting a hike in net interest and commission income (of 17.3% and 13.3% respectively), while net income from financial operations and from dividends declined (by 18.4% and 17.8% respectively). Underlying the rise in net interest income (which increased its share in total income from 68.4% to 69.7%) was mainly strong credit expansion, while the interest rate margin as a percentage of average assets remained virtually unchanged. Higher profitability of banking groups was also helped by the containment of total operating costs, which grew marginally (by 1%); as a result, operating efficiency (measured by the operating costs to operating income

ratio) improved from 62.9% to 55.1%, compared with an average of 58.5% for euro area banks of a similar size in 2004. The annualised after-tax return on assets (ROA) and return on equity (ROE) ratios reached 1% and 15.7% respectively in the January-September 2005 period (compared with 0.7% and 12.5% in the same period of 2004 and 0.5% and 9.5% for euro area banks of a similar size in 2004).⁶⁴

Broadly speaking, the rebound in Greek commercial banks' profitability observed since 2003, stemming mainly from the growth of net interest and commission income, enhances the stability of the banking system, provided that banks decide to allocate a considerable part of their profits to reserves. Euro area banks as a whole also showed increased profitability. Specifically, in 2004 underlying the improvement in the profitability of European banks were notably a rise in net interest income as a result of stronger credit expansion (mainly to households) and a decrease in loan-loss provisions.

The total capital adequacy ratio (CAR) of Greek banks on a consolidated basis came to 13.1% on 30 September 2005, slightly higher than on 31 December 2004 (12.8%). As a result of increased loan-loss provisioning in January-September 2005, the shortfall of actual provisioning against the provisioning requirements under Bank of Greece Governor's Act 2442/1999, as currently in force, was reduced. Hence, the decline in the CAR, taking into account the shortfall of actual provisioning, narrowed from 0.44 percentage point on 31 December 2004 to 0.27 percentage point on 30 September 2005. The composition of supervisory own funds was characterised by an increase in the

⁶⁴ However, it should be taken into account that, in the current phase of the business cycle, economic growth in Greece by far exceeds the corresponding average for the euro area as a whole.

share of core capital (Tier I capital, which comprises the higher-quality elements of own funds) to 79.3% on 30 September 2005, from 77.1% on 31 December 2004; as a result, the decline observed in 2001-2004 came to a halt. Owing to the growth of the percentage share of core capital, the CAR including only core capital rose slightly to 10.6% on 30 September 2005, from 10% on 31 December 2004, compared with an average of 8.5% for EU banks as a whole in 2004.

The Bank of Greece considers it essential that banks carry out regular stress tests of credit and market risks to verify on the one hand the resilience of their profits and, on the other hand, whether their own funds, in addition to meeting the supervisory minimum capital requirements, provide adequate buffers for absorbing shocks. To this end, during the overall assessment of the stability of the financial sector by the IMF, the Bank of Greece requested banks to simulate extreme but plausible worst-case scenarios of adverse changes in credit and market risk factors (rating of their loan portfolios, interest rates, equity prices and the euro exchange rate) and calculate the impact on their capital base. The aggregated results for the banks that participated in the exercise, covering about 74% of the total assets of commercial banks, showed that credit risk and equity-price risk had the largest impact on banks' CAR. Specifically with respect to equity price changes, account was taken not only of the impact on banks' open positions in equities of the trading portfolio on which capital requirements for market risk are calculated, but also of the impact on open positions in equities of their investment portfolio, which mainly concern strategic investments in associated and affiliated firms. In any case, both for credit risk and equity-price risk, the impact on the CAR of the sample banks as a whole was around one percentage point; as a result, the CAR remains well above the regulatory minimum (8%), which testifies to the resilience of the banking system.

In conclusion, under present conditions, Greek banks' CAR provides an adequate cushion for safeguarding the stability of the banking system and exceeds the average for EU banks as a whole (11.87% in 2004). In its recent evaluation of the Greek financial sector, the IMF reached positive conclusions on the profitability and capital adequacy of Greek banks, as well as on their supervision exercised by the Bank of Greece, and urged the competent Greek authorities to adopt the recommendations in the assessment report, which are aimed at further enhancing supervision. Besides, the implementation of the International Financial Reporting Standards does not seem to have affected materially the overall capital adequacy of the Greek banking sector. Two banks whose capital base was affected considerably by the implementation of the said Standards, notably of Standard 19, which requires the recognition of liabilities arising from employee defined benefit plans on banks' balance sheets, responded by increasing their own funds to restore their capital adequacy. The implementation of the new capital adequacy framework ("Basel II") within 2007 will have repercussions on banks' CAR, the overall magnitude of which will depend on the alternative methods for calculating capital requirements to be adopted by banks, as well as on the composition and quality of their loan portfolios, in conjunction with the future evolution of the business cycle. Given the uncertainty surrounding these factors, as well as the general uncertainty about economic developments, the Bank of Greece, with a view to ensuring the capital adequacy of Greek banks over time, has recommended that they continue to increase their own funds, notably by allocating profits to reserves in periods of increased profitability, such as the year 2005 (according to estimates), and, above all, by detecting and pricing risks in a timely manner.

Besides, the Bank of Greece, considering that the improvement of the internal operation of banks,

also taking into account the principles of corporate governance, enhances the effectiveness and robustness of the banking system, has initiated a consultation by transmitting to banks a draft Governor's Act on the basic general principles and minimum criteria for ensuring that a credit institution, on both an individual and a group basis, has adequate internal control, risk management and compliance systems. The provisions of this draft are in line with the best international practices in the above areas.

4.4 Insurance sector

Any serious problems facing insurance companies may have wider implications, to the extent that they limit the scope of insurance coverage or lead to excessive increases in insurance premiums. Therefore, there may be some implications for the smooth conduct of certain transactions, notably the supply or cost of bank loans where borrowers are required to obtain insurance coverage for themselves or for the collaterals they provide. Furthermore, for banks and capital markets, there is a risk of contagion by insurance companies' problems through banks' financial exposures to insurance companies and the latter ones' activities in capital markets; this might lead to systemic risk for the financial sector. However, taking into account that in Greece both the amount of insurance companies' investment in negotiable instruments in relation to the size of the capital market and the amount of banks' financial exposures to insurance companies in relation to banks' own funds are small, such risk is low.

According to aggregated data on Greek insurance companies, 2004 saw a deterioration over 2003 in the gross operating results of both the life insurance sector (by 61.5%) and the casualty sector (by 5.4%). This development in both sectors is mainly accounted for by a substantial decline in income

from investments, while income from accrued premiums showed a notable increase. As a result of the unfavourable outturn of gross operating results, insurance companies as a whole recorded pre-tax losses of €84.2 million in 2004, compared with pre-tax profits of €92.2 million in 2003. As regards the evolution of profitability in 2005, there are currently no aggregated data on insurance companies as a whole. However, according to published data of five insurance companies listed on the Athens Exchange for the January-September 2005 period, aggregate pre-tax profits of €40.6 million were recorded, compared with losses of €21.2 million in the same period of 2004. The ratio of own funds to total insurance provisions, which is a measure of the economic robustness of insurance companies, improved marginally to 27.06% in 2004, from 26.95% in 2003, but is still low. Finally, the implementation of the International Financial Reporting Standards as from 2005 affected considerably the own funds of the Athens Exchange-listed insurance companies, which have increased these funds recently to enhance their capital adequacy.

Generally, in Greece there is considerable scope for further growth of the insurance industry, notably the life insurance sector, since (i) the total amount of premiums amounted to only 2.2% of nominal GDP in 2004 (compared with an average of 8.3% for the EU as a whole in 2003); and (ii) demand for insurance products for supplementary pension coverage is expected to rise in the coming years. Cooperation between banks and insurance companies for the promotion of bankassurance products helps considerably the further growth of insurance business in Greece. Besides, the enhancement of the supervision of insurance companies will contribute to the consolidation of public trust in the institution of private insurance. To this end, the activation and operational independence of the new supervisory authority for the insurance sector estab-

lished by Law 3229/2004 is essential. This was pointed out recently by the IMF in the context of the evaluation of the Greek financial sector. Specifically, the IMF identified weaknesses in the current financial condition and supervision of the insurance sector, which may have implications for Greek banks that own insurance subsidiaries. Furthermore, if cooperation between this authority on the one hand and the Bank of Greece and the Capital Market Commission on the other is legally established, this will help considerably the coordination of action between the supervisory authorities, with a view to ensuring the stability of the financial sector and increasing the effectiveness of the supervisory treatment of bankassurance products offered by banks in cooperation with insurance companies.

4.5 Securities companies sector

The rebound in the activity and profitability of securities companies observed in 2003 did not continue in 2004. Specifically, the turnover and pre-tax profits of securities companies as a whole declined by 13.7% and 53.5% respectively in 2004 over 2003, despite considerable differences across this sector. Of a total of 67 companies, 35 showed losses in 2004, while nine recorded pre-tax profits below €50 thousand each. Besides, the own funds to total assets ratio dropped to 32% in 2004, from 36% in 2003 and 37% in 2002. Data on the evolution of the financial condition of securities companies in 2005 are not currently available, but the increase in both the Athens Exchange general index and the value of transactions that year is estimated to have influenced favourably the results of the sector's companies. In any case, growing competition in the context of European capital market integration and the fact that the number of companies active in the Greek financial intermediation services market is large – in comparison with other European markets – are expected to lead to a decline in the number of

securities companies, taking into account the fact that several companies, notably the smaller ones, face serious problems. It should be noted that, despite the relatively large number of securities companies, the five largest ones, four of which are banks' subsidiaries, controlled almost 50% of the total assets of the sector in 2004.

The total outstanding debit balance of credit extended by securities companies to their customers for purchases of equities grew to €160 million on 30 November 2005, compared with €156.9 million on 31 December 2004. However, the value of the collaterals that back those credits also rose commensurately; as a result, the coverage ratio of credit granted by these companies remained virtually unchanged (at around 350%) between end-2004 and 30 November 2005.

Securities companies' debts to banks grew by 46.4% in 2004, but the total financial exposure of banks to the sector remains low in relation to banks' own funds. Since banks' financial exposures (direct participations, loans, letters of guarantee) of over €1.5 million in each case to securities companies on 30 June 2005 corresponded as a whole to a mere 4.4% of banks' own funds, it is estimated that overall such exposures do not represent a potential risk to the banking system. However, it should be noted that certain banks, in determining the credit rating of certain securities companies on 30 June 2005, do not seem to have taken into account the losses and the overall bad financial condition of these companies, as reflected in their balance sheets and results for 2004.

4.6 Payment systems

Payment and securities settlement systems are basic infrastructures the effectiveness of which contributes to financial stability.

The HERMES real-time gross settlement system⁶⁵ operated effectively in 2005. Its average monthly availability ratio was 99.80%, reaching 100% in eight out of twelve months and dropping only marginally in the other months, as it was influenced by four short failures owing to technical reasons. The smooth flow of payments was helped by the adequacy of intraday liquidity provided by the Bank of Greece to the members of the HERMES system, through which payments with an average daily value of €20.5 billion were settled in 2005. The average value of intraday credit rose to €622.9 million in 2005, from €411.6 million in 2004. The value of collaterals provided to the Bank of Greece for the extension of credit rose commensurately. The average daily value of collaterals rose to €1,980 million in 2005, from €1,547.6 million in 2004, providing an adequate margin for covering any increased liquidity requirements of the system's members.

The DIAS S.A. systems and the Athens Clearing Office, which make up the main infrastructure for retail payment clearing and settlement, also continued to operate smoothly in 2005. The Bank of Greece evaluates these systems according to the Eurosystem's standards on retail payment systems in order to examine their systemic importance and ensure maximum business continuity, safety and effectiveness.

A positive development was the settlement in real time through the HERMES system, as from mid-2005, of all debt securities transactions via the Book-Entry Securities Monitoring System operated by the Bank of Greece. The introduction of this set-

tlement method⁶⁶ allows the immediate finalisation of a payment; thus, debt securities may be used in the same working day for different purposes.

Another positive development with respect to the settlement of the cash leg of securities transactions was the decision to settle through the Bank of Greece all transactions on the Athens Exchange. It is considered, according to international standards, that the use of central bank money limits the risk from the settlement of such transactions and is therefore expected to enhance their safety.

At the European level, preparations for the development of the new payment system (TARGET2) that will replace TARGET continued. During 2005, the specifications of the new system, which is expected to become operational in November 2007, were finalised and the time schedule for the connection of national central banks and credit institutions with TARGET2 was laid down. Furthermore, in a number of contacts credit institutions were informed about the services offered by the new system and the Bank of Greece, as well as the migration procedure. Like every large payment system, TARGET2 should meet the relevant oversight standards established by the Eurosystem.

⁶⁵ The HERMES system is the Greek component of the Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET), which comprises the national real-time gross settlement systems of the EU Member States and the ECB Payment Mechanism (EPM). The availability of the TARGET system, measured as the average of the availability ratios of the component systems, was 99.81% in 2005.

⁶⁶ "Delivery versus Payment – Model 1", according to the terminology of the BIS Committee on Payment and Settlement Systems, which provides for simultaneous real-time settlement of the cash leg and the securities leg of each transaction.

IV. Macroeconomic developments and prospects in Greece

1. Inflation: developments and determinants in 2005

1.1 Summary of developments

Inflation increased in 2005 in Greece, chiefly due to exogenous factors. More specifically, the increase in the price of crude oil in 2005 was greater than in 2004. The same is true of the increase in the prices of other imported products, which in part reflects the small average annual depreciation of the euro against other currencies, in contrast to the appreciation noted in 2004. In addition, from April onwards, indirect taxation increased (as a result of the package of measures introduced on 29 March 2005).

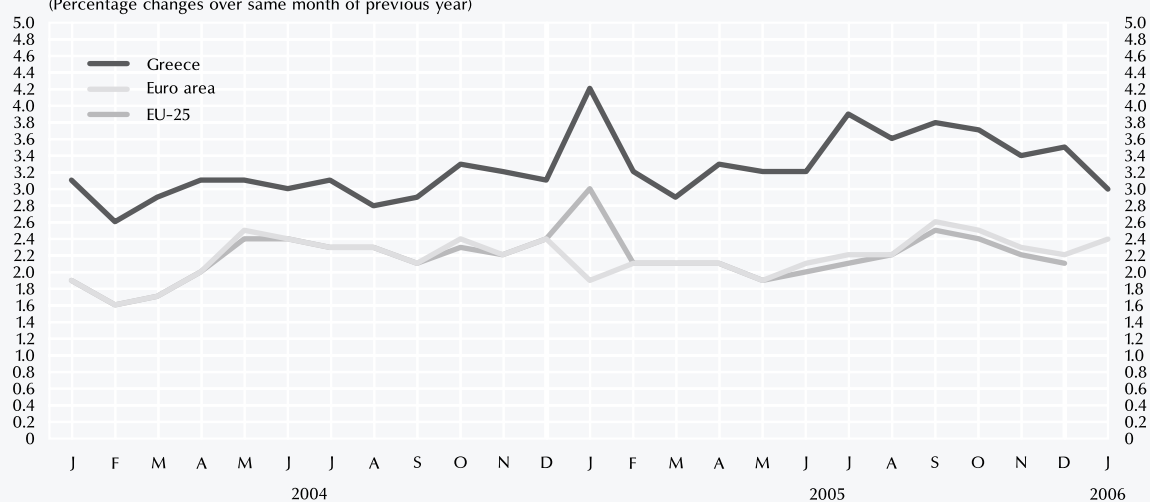
The annual inflation rate in Greece based on the Harmonised Index of Consumer Prices (HICP – see Chart IV.1) accelerated to 3.5% in the final quarter of 2005, from 3.2% in the fourth quarter of 2004. In addition, the average annual inflation rate based on the HICP rose to 3.5% in 2005, from 3.0% in 2004 (see Table IV.1). By contrast, core inflation, as measured on the basis of the HICP excluding energy and unprocessed food, fell slightly (to 3.0% in the final quarter of 2005, from 3.2% in the last quarter of 2004 – see Chart IV.2). Average annual core inflation dropped to 3.2% in 2005, compared with 3.4% in 2004.¹ Still, inflation remained relatively high. As in the euro area average annual inflation was almost unchanged at 2.2% (2004: 2.1%) and core inflation fell to 1.5% (2004: 2.1%), the headline inflation differential between Greece and the euro area as a whole increased to 1.3 percent-

¹ If the impact of increased indirect taxation on core inflation is excluded, core inflation fell even more sharply in 2005. The average annual inflation rate based on the Consumer Price Index (CPI) accelerated to 3.5% in 2005, from 2.9% in 2004. By contrast, core inflation, as measured in this case on the basis of the annual rate of change in the CPI excluding fuel and fresh fruit and vegetables, fell to 3.1%, from 3.3% in 2004 (see Chart IV.3).

Chart IV.1

Harmonised index of consumer prices in Greece, the euro area and the European Union
(January 2004 - January 2006)

(Percentage changes over same month of previous year)



Sources: NSSG and Eurostat.

Table IV.1

Harmonised index of consumer prices: Greece and the EU (2004-2005)

(Annual percentage changes)

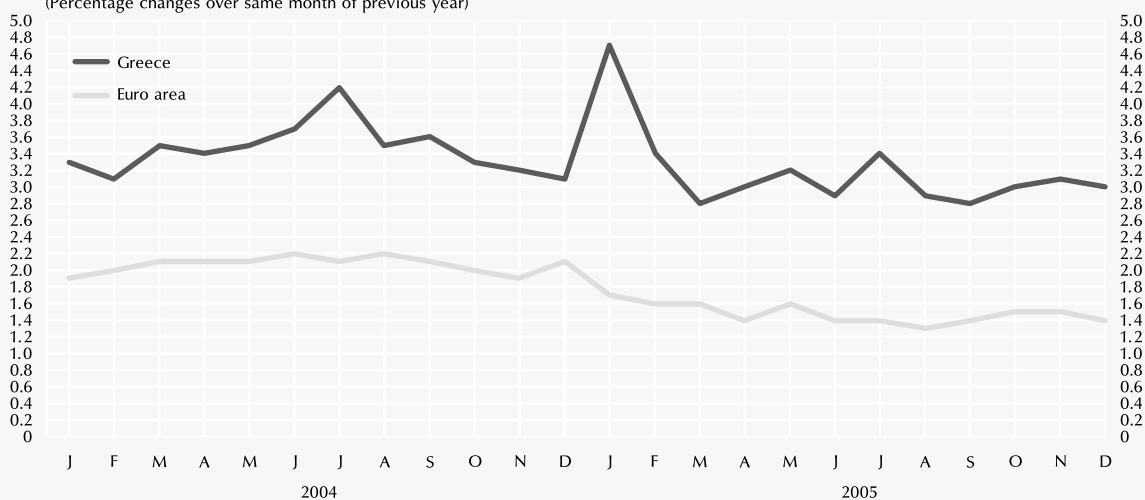
Country	2004 (year average)	Dec. 2004	2005 (year average)	Dec. 2005
Austria	2.0	2.5	2.1	1.6
Belgium	1.9	1.9	2.5	2.8
Cyprus	1.9	3.9	2.0	1.4
Czech Republic	2.6	2.5	1.6	1.9
Denmark	0.9	1.0	1.7	2.2
Estonia	3.0	4.8	4.1	3.6
Finland	0.1	0.1	0.8	1.1
France	2.3	2.3	1.9	1.8
Germany	1.8	2.2	1.9	2.1
Greece	3.0	3.1	3.5	3.5
Hungary	6.8	5.5	3.5	3.3
Ireland	2.3	2.4	2.2	1.9
Italy	2.3	2.4	2.2	2.1
Latvia	6.2	7.4	6.9	7.1
Lithuania	1.2	2.8	2.7	3.0
Luxembourg	3.2	3.5	3.8	3.4
Malta	2.7	1.9	2.5	3.4
Netherlands	1.4	1.2	1.5	2.1
Poland	3.6	4.4	2.2	0.8
Portugal	2.5	2.6	2.1	2.5
Slovakia	7.5	5.8	2.8	3.9
Slovenia	3.6	3.3	2.5	2.4
Spain	3.1	3.3	3.4	3.7
Sweden	1.0	0.9	0.8	1.3
United Kingdom	1.3	1.6	2.1	2.0
EU-15	2.0	2.2	2.1	2.2
EU-25	2.1	2.4	2.2	2.1
Euro area	2.1	2.4	2.2	2.2

Source: Eurostat.

Chart IV.2

Core inflation in Greece and the euro area on the basis of the HICP excluding energy and unprocessed food
(January 2004 – December 2005)

(Percentage changes over same month of previous year)

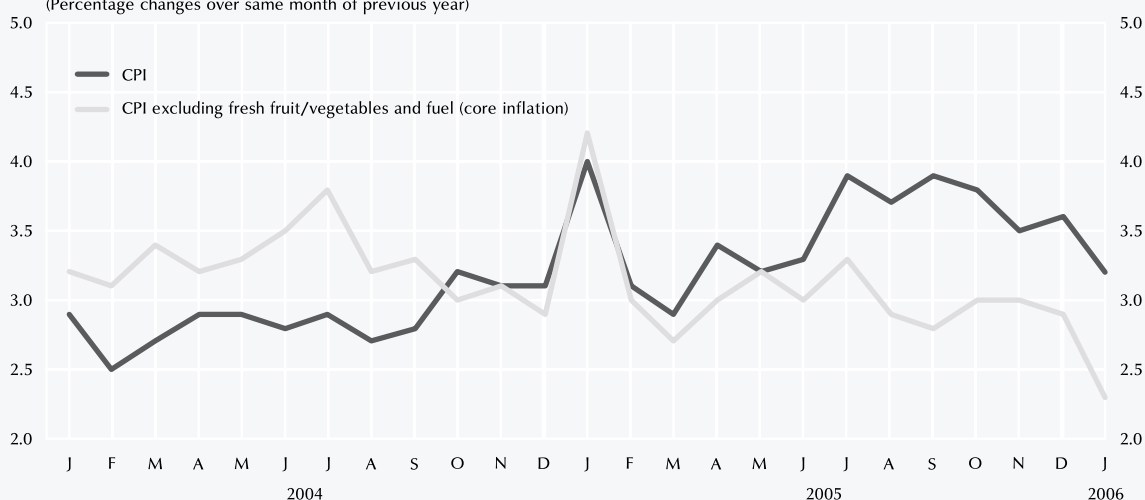


Sources: NSSG and Eurostat.

Chart IV.3

Consumer price index and core inflation in Greece
(January 2004 – January 2006)

(Percentage changes over same month of previous year)



Source: Calculations based on NSSG data.

age points (from 0.9 percentage point) and the core inflation differential increased to 1.7 percentage points (from 1.3 percentage points).²

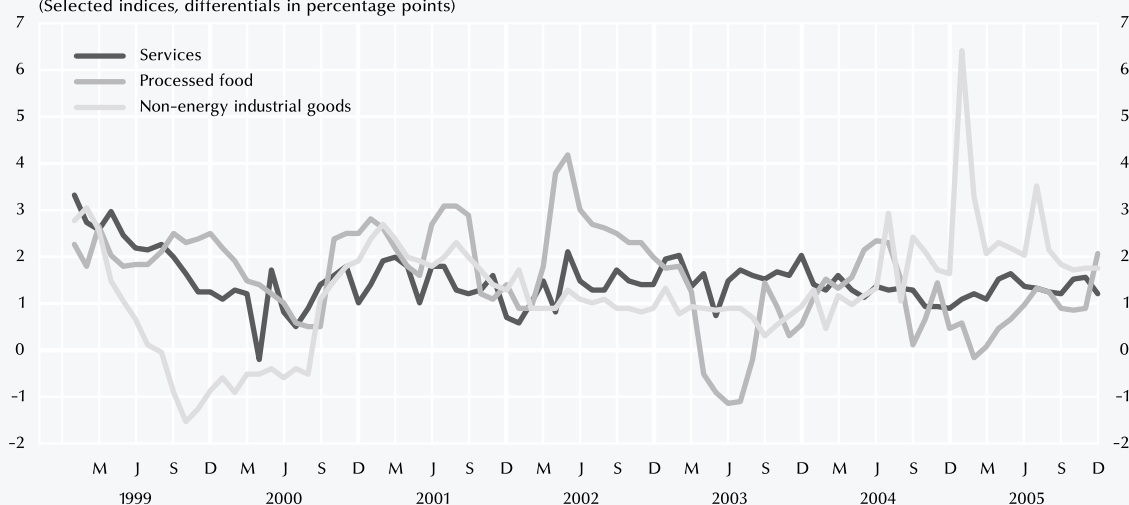
The fact that the increase in headline inflation was relatively limited and that core inflation fell slightly is due to a series of factors. First, the increase in

² If the prices of the individual groups of goods and services included in the core inflation “basket” are examined, it can be seen that in 2005 (compared with 2004) the positive inflation differential narrowed for processed food, while it widened for services and for industrial goods excluding food and energy. As far as the two groups of goods which are not included in the core inflation “basket” are concerned, the positive inflation differential widened for energy prices, while a significant *negative* differential remained with regard to the rate of change in unprocessed food prices – as these fell in Greece but rose in the euro area. See Table IV.2 and Chart IV.4.

Chart IV.4

Annual inflation differentials between Greece and the euro area
(January 1999 – December 2005)

(Selected indices, differentials in percentage points)



Source: Calculations based on Eurostat and ECB data.

Table IV.2

Contribution to the inflation differential between Greece and the euro area (2002-2005)

(Percentage points)

	2002	2003	2004	2005
Differential of average annual rates of HICP change	1.6	1.3	0.9	1.3
Contribution to the HICP inflation differential stemming from the difference in the average annual rates of change in:				
Core inflation	1.2	0.9	1.2	1.4
<i>Services prices</i>	0.5	0.6	0.5	0.5
<i>Processed food prices</i>	0.4	0.0	0.2	0.1
<i>Non-energy industrial goods prices</i>	0.3	0.3	0.5	0.8
Unprocessed food prices	0.4	0.4	-0.4	-0.3
Energy prices	0.0	0.0	0.1	0.2

Source: Calculations based on Eurostat and ECB data.

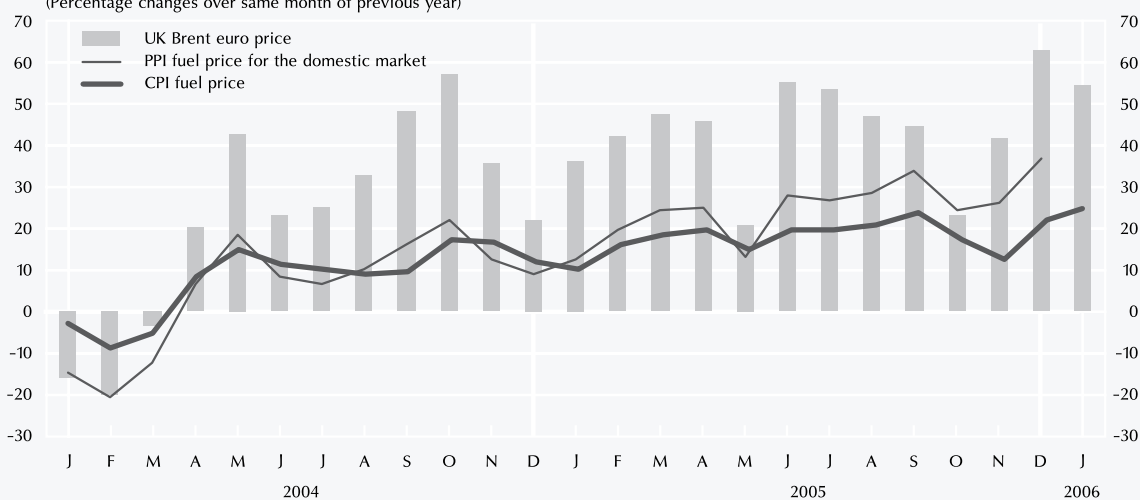
indirect taxation was not passed on fully to consumer prices (see Section 1.2 of this chapter). Second, the substantial fall in the prices of fresh fruit and vegetables observed in 2004 continued in 2005, though it was somewhat lower. Third, the rate of increase in the prices of imported goods (excluding fuel) accelerated but nevertheless

remained very low – this is associated with the fact that imports of low-cost goods (chiefly clothing-footwear and consumer durables) from Asian countries are increasing. Fourth, although public utility rates (and certain fees and duties set by the State) increased more –on average– than in 2004, the increase was relatively restrained in compari-

Chart IV.5

Evolution of CPI/PPI fuel prices and of the euro price of Brent crude oil
(January 2004 - January 2006)

(Percentage changes over same month of previous year)



Source: Calculations based on NSSG data and, for crude oil prices (UK Brent), on US Department of Energy data.

son with, for example, the price increases which some public enterprises had requested in order to cover cost increases. Fifth, there was closer market surveillance by the Ministry of Development and the Competition Commission. Sixth, inflationary pressures on the demand side were lower in 2005 than in 2004 and profit margins narrowed. These factors more than offset the inflationary impact of the faster –in comparison with 2004– increase in the prices of crude oil and other imported products, higher indirect taxation and the fact that the rate of increase in unit labour costs in the business sector did not slow down but instead remained relatively high. The fall in core inflation probably also reflects the fact that certain firms –as part of their efforts to remain or become competitive– do not fully pass on increases in unit labour costs and raw materials to the prices of their products. However, to the extent that such firms do not manage to increase their productivity, bring down their production costs and increase their competitiveness to a satisfactory level, they suffer losses and bear a higher risk of going out of business.

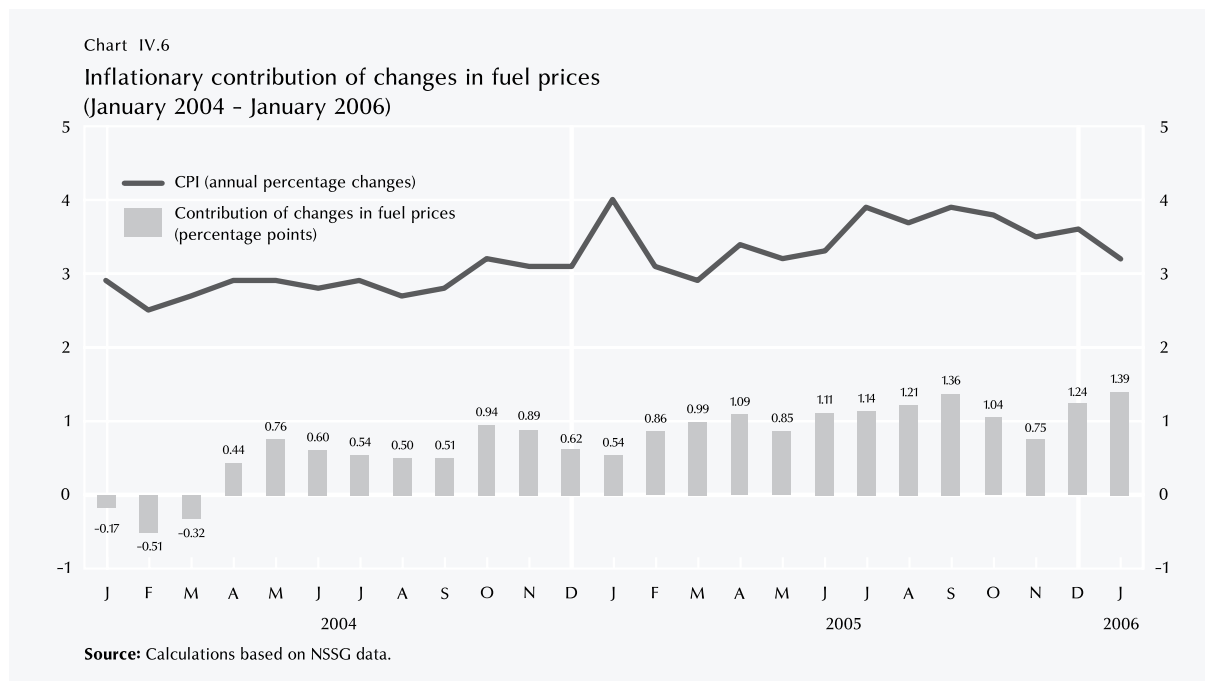
1.2 Determinants of inflation in 2005

As already noted, the acceleration of the average annual rate of increase in the HICP and the CPI in 2005 was to a significant degree due to the exogenous impact of developments in the price of crude oil. Specifically, as the dollar price of Brent crude oil rose at a far higher annual rate than in 2004³ and the average annual appreciation of the euro against the dollar came to a halt,⁴ the acceleration of the increase in the euro price of oil was even greater (46.2%, from 21.5% in 2004).⁵ Thus, in the

³ The Brent crude oil price in dollar terms rose at an average annual rate of 46.3% in 2005 (compared with 33.6% in 2004). See ECB, *Monthly Bulletin*, Euro area statistics, Tables 5.1.2 and 8.2.

⁴ The appreciation was less than 0.1% in 2005, compared with 10.0% in 2004. In addition, between December 2004 and December 2005, the exchange rate of the euro against the dollar fell by 11.6%.

⁵ Price rises in euro for other raw materials slowed down slightly to 9.4% in 2005, i.e. they were almost the same as in 2004 (10.8%) – see ECB, *Monthly Bulletin*, Euro area statistics, Table 5.1.2. In addition, it should be noted that the new Import Price Index in Industry, compiled by the NSSG, covers not only final products but also raw materials and intermediate products, which were not included in the old Wholesale Price Index. Thus, according to the new index, the prices of imported raw materials for energy production (crude oil and natural gas) rose at an average annual rate of 55.5% in 2005, while prices for imported fuels-final products (i.e. petrol, heating oil, diesel and heavy oil) increased at an average annual rate of 22.0%.



domestic market, retail fuel prices included in the CPI rose at an average annual rate of 18.0% in 2005, compared with 7.5% in 2004 (see Charts IV.5 and IV.6).⁶

Furthermore, while the prices of fresh fruit and vegetables continued to fall, the average rate of the fall in 2005 was lower than in 2004 (-8.1%, compared with -11.9%, see Chart IV.7).⁷

As for *core inflation*, its slight decline is the result of a number of countervailing developments.⁸ The factors which contributed both to the fall in core inflation and the relatively limited increase in headline inflation are detailed below.

First, core inflation was pushed up – albeit to a *limited extent* – by the increase in indirect taxation,⁹ which was not fully passed on to prices, as firms themselves absorbed part of the increase, either as a result of a slowdown in demand growth or because of tax evasion, as shown by the marginal rise in public revenue from VAT.¹⁰ More specifically, based on the December 2005 data, it

⁶ Moreover, at a wholesale level, fuel prices (final products only) included in the Industrial Producer Price Index for the domestic market rose at an average annual rate of 25.1% in 2005 (compared with an increase of 4.3% in the whole of 2004). It should be noted that domestic fuel prices for consumers change less than international crude oil prices, chiefly because a large part of the retail prices of fuels in Greece is accounted for by “Special Consumption Taxes”, which are fixed and are defined per unit of volume and not of value and so do not change in line with the price of the product. It is estimated that, during the winter period, a 10% increase in the euro price of crude oil leads directly to (a) an increase of just 3.8% in the retail price of fuels (petrol and heating oil) for consumers and (b) an increase of just 0.19% in the general CPI (see Bank of Greece, *Monetary Policy 2004-2005*, February 2005, Box III.1, pp. 48-50).

⁷ It should be pointed out that, during the two previous years, prices of fresh fruit and vegetables rose significantly: 13.8% in 2002 and 10.7% in 2003.

⁸ For example, there was a marked slowdown in the rate of increase in the prices of food excluding fresh fruit and vegetables (2.5%, from 3.6%), rents (4.2%, from 5.3%), household repair and maintenance services (2.9%, from 5.2%), medical services (6.0%, from 7.9%), recreation services (2.0%, from 4.9%) and hotels-café-restaurants (3.2%, from 4.3%). By contrast, an acceleration was observed in price increases for transport services (4.7%, from 2.2%), hospital care (4.1%, from 2.0%), consumer durables (1.8%, from 0.9%), electricity (2.9%, from 2.1%), and clothing and footwear (4.7%, from 4.1%). In addition, the prices of telephone services fell at a much lower rate (-0.4%, from -4.4%). It should also be noted that the decline in inflationary pressures was more perceptible at the level of industrial producer prices for the domestic market. Indeed, these prices (excluding energy) rose at an average annual rate of 3.0% in 2005 (compared with an increase of 4.7% in the whole of 2004 – see Table 3 of the Statistical Appendix).

⁹ For more details about these changes, see Section 5 of this chapter, footnote 75.

¹⁰ This revenue increased by just 2.8% in 2005 (see also Section 5 of this chapter).

Chart IV.7
Core inflation, prices of fresh fruit/vegetables and fuel prices
(January 2004 - January 2006)



Source: Calculations based on NSSG data.

is estimated that increases in indirect taxation contributed a mere 0.75 percentage point to the annual CPI inflation rate.¹¹ Given that indirect taxation increases came into force gradually after 1 April 2005, their impact on *average annual* inflation in 2005 was even smaller (in the order of 0.6 percentage point).

Second, the average annual increase in the new Import Price Index in Industry (compiled by the NSSG) accelerated to 8.9% in 2005 (from 3.1% in 2004 – see Chart IV.8). This major acceleration is

due to the fact that the new index does not only cover final products (as was the case with the previous index used), but also intermediate goods and raw materials in the industry sector, *including crude oil*, imported by domestic firms in all branches of economic activity.¹² However, the rate

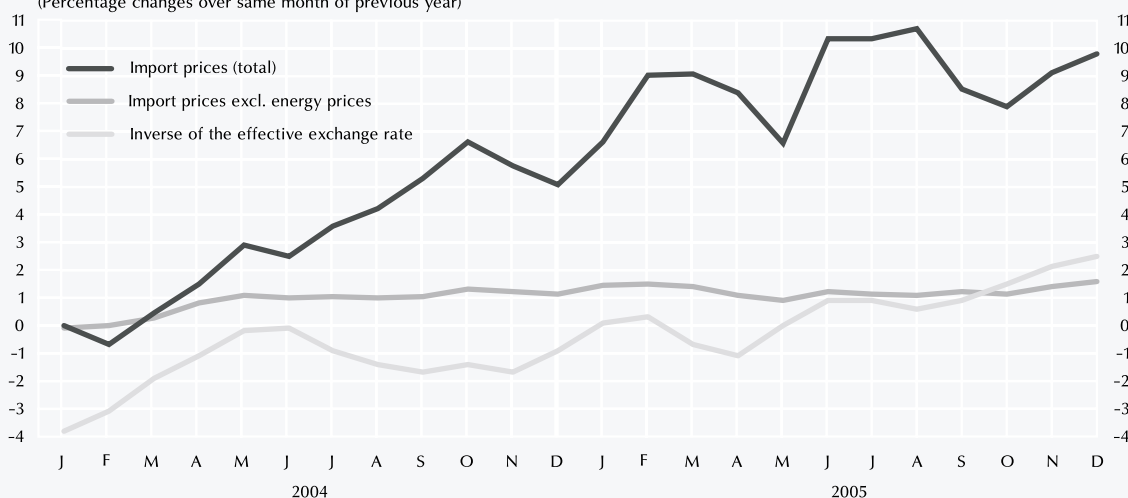
¹¹ The effect that the increase in Special Consumption Taxes (SCT) payable on alcoholic beverages and certain categories of cigarettes had on inflation was almost negligible (less than 0.1 percentage point). The detailed CPI data show that the increase in VAT rates chiefly affected the prices of food, services provided by hotels-café-restaurants, clothing and footwear, and consumer durables.

¹² See also footnote 5 above.

Chart IV.8

Import price index in industry and the inverse of the effective exchange rate of the euro, weighted on the basis of Greece's external trade (January 2004 - December 2005)

(Percentage changes over same month of previous year)

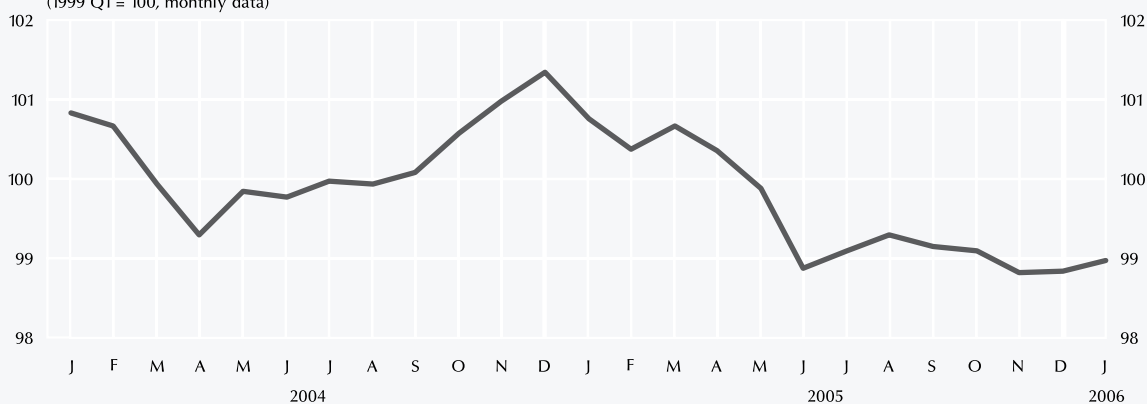


Sources: NSSG and Bank of Greece.

Chart IV.9

Revised effective exchange rate index, weighted on the basis of Greece's external trade (January 2004 - January 2006)

(1999 Q1 = 100, monthly data)



Note: The revised effective exchange rate index includes Greece's 27 main trading partners (among them, the other 11 countries of the euro area) and the weights are calculated on the basis of manufacturing imports and exports (categories 5-8) during 1999-2001, taking into account competition in third markets.

Source: Bank of Greece.

of increase in this index *excluding energy prices* did indeed accelerate, but nevertheless remained low (1.2% in 2005, compared with 0.8% in 2004). This small acceleration reflects in part the small average annual weighted depreciation of the euro against other currencies¹³ of 0.7% in 2005 (following a

¹³ Revised index of the nominal effective exchange rate for Greece. In the new index, the weighting is based on Greece's external trade with 27 countries/trading partners, including the other 11 countries of the euro area (with these countries, the exchange rate obviously does not change, as the countries all share the same currency). In the previous index, the weighting was based on Greece's external trade with 15 countries/trading partners. See also Box IV.3.

1.5% appreciation in 2004 – see Chart IV.9), which pushed up the prices (in euro terms) of products imported from non-euro area countries. However, the rate of increase in these prices remained very low; this, as already noted, is associated with the fact that there was a rise in the volume of low-cost imported products (chiefly clothing and footwear¹⁴ and consumer durables) from Asian countries. Moreover, the rate of increase in the prices of consumer goods imported from euro area countries decelerated (as indirectly indicated by the slowdown in core inflation in the euro area to 1.5% from 2.1% in 2004); this helped keep the rate of increase in the prices of imported consumer goods at a relatively low level (1.4% in 2005, compared with 0.6% in 2004, according to the new Import Price Index in Industry compiled by the NSSG) and certainly lower than domestic inflation.

Third, the rates of public utility services (which are provided both by public and private enterprises) and certain fees and duties set by the State¹⁵ are estimated to have increased more than inflation in 2005 and at a higher annual average rate than in 2004 (4.6%, compared with 3.0%), *when rates for telecommunications services are excluded*. (Telecommunications rates continue to fall due to the competitive conditions in this particular market, although the fall almost stopped in 2005.¹⁶) Thus, it is estimated that these increases pushed up the general CPI by 0.27 percentage point, compared with 0.16 percentage point in 2004. It must, however, be stressed that, due to efforts to restrain as far as possible the rate of increase in public utility rates, the increase in these rates remained lower than the corresponding cost increases faced by public enterprises, as inferred from the unfavourable effects on their financial results. Therefore, if public utility rates had increased in line with underlying economic factors, their inflationary impact would have been greater.

Fourth, as already noted, closer market surveillance by the Ministry of Development and the Competition Commission also played a part in restraining price increases.

Fifth, the drop in core inflation is estimated to be accounted for by, *inter alia*, the reduction in inflationary pressures exerted by aggregate domestic demand, which is also reflected in the narrowing of profit margins. Indeed, both the national accounts estimates currently available and short-term indicators of private consumption imply that the rate of increase in private consumption remained high but decelerated (see Section 3 of this chapter for a more detailed examination). In addition, according to available estimates (see Chart IV.10),¹⁷ the Greek economy's "output gap"¹⁸ has remained positive in recent years (i.e.

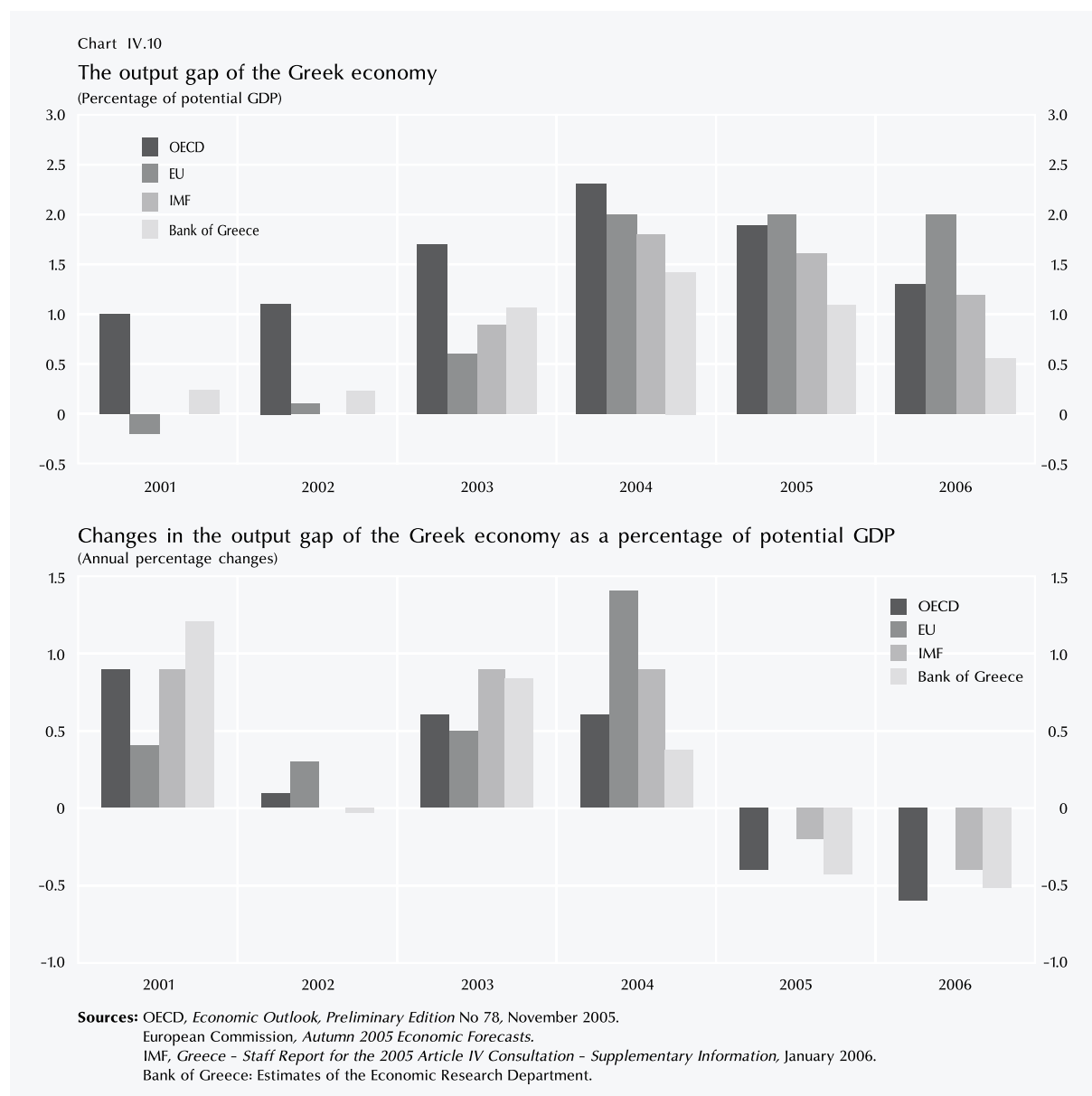
14 The effect of these low-cost imports on the development of consumer prices appears to be much greater in the euro area as a whole (where the prices of clothing-footwear included in the HICP rose by 0.7% in 2004 and just 0.1% in 2005) than in Greece (where, as already reported, these prices rose by 4.1% in 2004 and 4.7% in 2005, possibly indicating increased profit margins).

15 Comprising the rates applied by the Public Power Corporation (DEH), the Hellenic Post Office (ELTA), the Hellenic Railways Organisation (OSE), the Water Supply and Sewerage Company (EYDAP) and other water supply companies, Olympic Airlines and other private airlines, urban public transport fares, hospital and private clinic rates, National Radio and Television Network (ERT) fees, municipal fees, tolls and road tax, which formed 5.9% of the "consumer basket" in 2005. The rates applied by the Hellenic Telecommunications Organisation (OTE) and by private mobile telephony companies (2.3% of the "basket" in 2005) are excluded.

16 The rates of these services fell at an average annual rate of just 0.4%, whereas in 2004 they fell by 4.4%.

17 That is, recent estimates by the IMF (*Greece-Staff Report for the 2005 Article IV Consultation*, January 2006), the European Commission (*Autumn 2005 Economic Forecasts*, November 2005), the OECD (*Economic Outlook*, November 2005) and estimates by the staff of the Bank of Greece.

18 The "output gap" is defined as the difference between the *level* of actual output (GDP) and the country's production potential (level of potential GDP) as a percentage of the *level* of potential GDP. The "output gap" is not measurable directly, but is estimated by using various alternative methods. Estimates of potential output and the "output gap" are surrounded by a high degree of uncertainty, which must be taken into consideration when conclusions are drawn. The *change* in the "output gap", which is measured in percentage points of GDP, is perhaps a more reliable indicator.



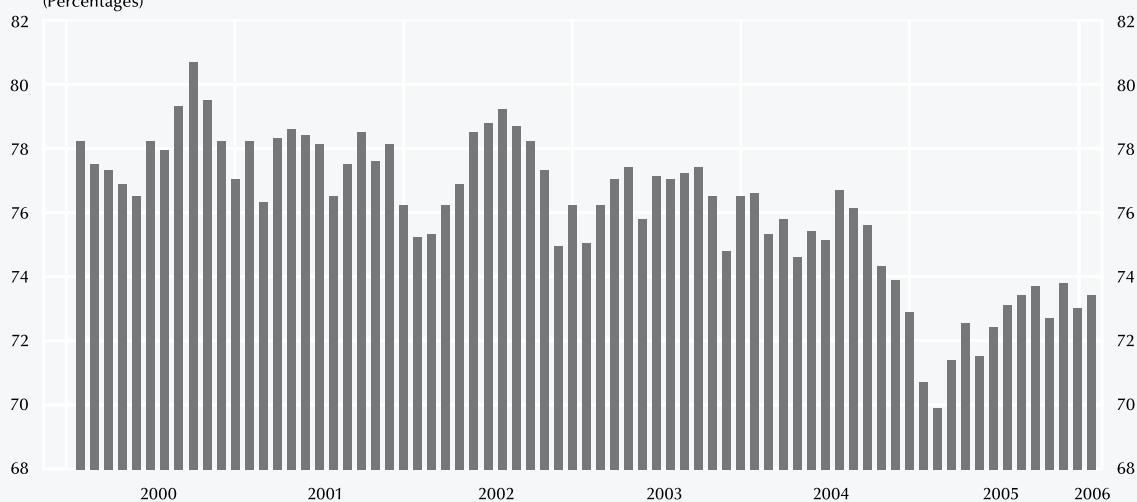
the level of current output exceeds that of “potential” output), but narrowed in 2005.¹⁹ However, excess demand continued to contribute to keeping inflation at a persistently high level, albeit lower than in 2004. More generally it should be recalled that the persistent relatively high level of core inflation is attributable, in principle, to macroeconomic factors associated with demand and with production costs, as well as to the interaction between the two.²⁰ It is also a result of inadequate competitive conditions (see also Box IV.1) in certain markets which do not operate effi-

ciently. Depending on the particular case, excess demand, price inelasticity of demand (for some articles), the fact that a number of companies take advantage of their dominant market position and

¹⁹ Estimates that the Greek economy’s positive “output gap” narrowed in 2005 are in line with the fact that in industry (which, however, accounts for just 11% of GDP) the capacity utilisation rate fell to 72.3 on average in 2005, from 75.2 in 2004 (see Chart IV.11).

²⁰ For example, it is obvious that the evolution of unit labour costs in the business sector is not simply an “autonomous” cost factor. It also reflects the impact of changes in demand, as excess demand affects businesses’ wage policies and workers’ bargaining power.

Chart IV.11
 Industrial capacity utilisation rate (manufacturing)
 (January 2000 - January 2006)
 (Percentages)



Source: Foundation for Economic and Industrial Research (IOBE).

that certain enterprises collude all have an undesirable effect on prices.

As already noted, the reduction of inflationary pressures on the demand side is also reflected in

the evolution of profits. According to available data concerning the period January-September 2005 (summary financial statements published by companies listed on the Athens Exchange and by unlisted companies), profit margins for non-fin-

BOX IV.1

Market structure and regulatory provisions in individual sectors of the Greek economy

The importance of competition in maximising economic potential, through its positive effect on productivity and its dampening impact on price levels, has been stressed repeatedly by the Bank of Greece and international organisations. A number of factors such as the extent of regulations in the economy, inadequate competition in certain sectors of economic activity, limited liberalisation of network industries and the existence of agreements and harmonised practices between companies are evidence of insufficient competition in the Greek economy. A previous report (*Monetary Policy 2004-2005*, Appendix to Chapter III, February 2005) included a presentation of evidence on the lack of competition. Along these lines, this box contains a more detailed presentation of the market struc-

ture of certain sectors. More specifically, a number of indicators (e.g. number of companies active in a sector, sales concentration in individual sectors and barriers to entry) are used to determine the degree of competition in these sectors.

The Herfindahl (H) index of concentration in terms of sales is used here as an indicator of the concentration in a sector.¹ The H index varies between 0 and 1, takes the value 1 in the case of a monopoly and approaches →

¹ More specifically, the H index for a sector is defined as the sum of the squared shares of sales of each firm in the sector i.e. $H = \sum(X_i)^2$, where X_i is the share of firm i in the total sales of the sector.

Secondary sector composition (%) (average values for the period 2000-2003)

	Share in the gross value added of the secondary sector (%) ¹	Share in the gross value added of the whole economy (%) ¹
Electricity, gas and water supply	8.3	1.8
Construction	38.1	8.2
Manufacturing	53.6	11.5
Total	100.0	21.5

1 Calculations based on values in current prices.

Source: NSSG, *National Accounts*, 2005 (provisional data).

→ 0 in perfectly competitive sectors with a large number of enterprises. In general, a value of the index below 0.1 signals that concentration is low, a value of H between 0.1 and 0.18 suggests that concentration is moderate, while a value of H over 0.18 indicates a high degree of concentration.²

The index has been computed at the 4-digit level of industry disaggregation³ (according to the NACE classification of economic activity) for 2002 and 2003 using company level data from the ICAP Greek company database⁴ and covers the non-financial business sector.

The H index is not without shortcomings, however, and *it should not be used as the sole indicator of the oligopolistic power of companies* for two main reasons. Firstly, the observed concentration of a sector might be the result of the efficient operation of some companies and, secondly, the existence of economies of scale in certain sectors (e.g. in capital intensive sectors and sectors with large expenditures in R&D) might call for the establishment of large companies. In fact, the existence of economies of scale and the need to compete internationally requires that some companies, especially in a small country like Greece, have a much larger size than the rest of the companies in the domestic market. As a result, the exploitation by some companies of their power should be evaluated not only on the basis of the H index but combined with, on the one hand, other structural and efficiency indicators (e.g. import penetration,⁵ price-cost mark ups, comparisons of prices with those in similar albeit more competitive markets, profit margins etc.) and, on the other hand, evidence on regulatory provisions that

may act as barriers to entry into the sector. It should also be noted that a low value of H does not necessarily imply the absence from the sector of a firm with a large market share.

The presentation which follows is organised by sector of economic activity starting from the secondary sector.

Secondary sector

The secondary sector is defined here to include the following three sub-sectors: electricity, gas and water supply; construction; and manufacturing. The significance of each of these sub-sectors in terms of their average share, for the period 2000-2003, in the gross value added of the secondary sector and of the economy is presented in the first table of this box.

Turning now to each of these sub-sectors, the situation in terms of market structure is as follows: →

² See, *inter alia*, European Commission (http://europa.eu.int/comm/competition/general_info/h_en.html) and the websites of the Department of Justice and the Board of Trade in the US.

³ The use of data at this level of disaggregation improves the precision with which concentration is measured. It should be noted, however, that even at this level of disaggregation a sector does not tally with the market since a lot of firms are active in more than one sector, while firms here are classified on the basis of their *main* activity.

⁴ The ICAP database contains 36,240 firms for 2002 and 38,595 firms for 2003. Due to the relatively large size of these firms, the database covers a significant part of total domestic economic activity.

⁵ It should be noted at this point that if domestic producers of certain goods are also active in importing such goods (i.e. industrial and commercial companies), then these imports cannot be considered as substitutes of the goods domestically produced.

Regulatory provisions¹ in electricity and natural gas, 1998 and 2003

	Electricity		Natural gas	
	1998	2003	1998	2003
Austria	5.5	1.5	4.5	2.7
Belgium	4.2	1.3	3.7	2.6
Denmark	4.8	1.0	4.5	3.2
Finland	2.0	1.5	4.5	4.5
France	6.0	3.6	6.0	4.0
Germany	3.0	1.8	1.8	1.5
Greece	6.0	3.3	6.0	5.2
Ireland	5.5	3.3	5.4	4.1
Italy	6.0	1.1	4.7	2.4
Netherlands	5.5	0.6	4.5	2.9
Portugal	4.3	2.3	5.5	4.1
Spain	2.1	0.5	3.4	2.5
Sweden	1.5	1.0	3.7	2.7
United Kingdom	0.0	0.0	2.2	1.7

1 All indices vary between 0 and 6. The lower the value of the index, the fewer the regulatory provisions.

Source: Conway, P. and G. Nicoletti (2006), "Product market regulation in non-manufacturing sectors in OECD countries: measurement and highlights", OECD Economics Department Working Paper, forthcoming.

→ Electricity, gas and water supply

The liberalisation of the energy sector (as discussed in the Appendix to this Chapter) is very recent in Greece. Hence, the sector is still dominated by public enterprises (PEs), which face only limited competition in certain facets of their activity. Given the absence of competition, the values of the H index in 2002 and 2003 stood very close to one. The current situation in the energy sector is also reflected in the 1998 and 2003 OECD indices of regulatory provisions presented in the second table of this box. These indices have been constructed on the basis of a number of criteria such as third party access to the sector, the liberalisation of the market for consumers, ownership status, price controls and the degree of vertical integration. The table shows that, despite the regulatory reforms that took place in both the electricity and the natural gas market between 1998 and 2003, Greece in 2003 was still lagging behind most EU-15 countries regarding the electricity market and behind all EU-15 countries regarding the natural gas market. The recent adoption, however, by Greece of the relevant European

Union directives (see the Appendix to this Chapter for more information) which call for the liberalisation of electricity and natural gas supply is expected to enhance competition.

Construction

In 2002, approximately 100,000 companies, most of which were small, were active in construction. The H indices for the sixteen 4-digit industries of the sector confirm the absence of concentration.⁶ In fact, the presence of a large number of firms which were not exploiting economies of scale prompted Parliament to pass a law (2940/2001 "Development, tax and institutional incentives for firms in the construction sector and other provisions") establishing incentives for mergers and acquisitions in the sector.⁷ →

⁶ As an indication, note that sector 4521 "General construction of buildings and civil engineering works", which accounted for around 6% of the secondary sector's sales in 2003, had a Herfindahl concentration index of 0.01.

⁷ See Bank of Greece, *Annual Report 2001*, Box III.3.

Manufacturing¹: share in sales, Herfindahl indices, share of largest firm and number of firms, 2003

NACE class	Industry description	Share in sales (%) ²	Index H	Sales share of the largest firm within each industry ³	Number of firms
3220	Manufacture of television and radio transmitters and apparatus for line telephony and line telegraphy	1.5	0.59	0.74	14
1598	Manufacture of mineral waters and soft drinks	2.0	0.53	0.72	47
2320	Manufacture of refined petroleum products	12.5	0.52	0.66	44
1600	Manufacture of tobacco products	1.4	0.46	0.63	5
2651	Manufacture of ready-made concrete	2.3	0.44	0.51	3
2451	Manufacture of soap and detergents, cleaning and polishing preparations	1.4	0.25	0.45	43
2710	Manufacture of basic iron, steel and ferro-alloys	2.4	0.20	0.35	10
2742	Aluminium production	2.8	0.17	0.30	39
2452	Manufacture of perfumes and toilet preparations	1.2	0.15	0.23	40
1542	Manufacture of refined oils and fats	2.3	0.12	0.21	94

1 Industries with the highest Herfindahl indices amongst the 20 largest (in terms of sales) manufacturing industries.

2 As a percentage of total manufacturing sales.

3 The share varies between 0 and 1.

Source: Calculations based on ICAP data.

→ Manufacturing

The 10 manufacturing industries with the highest Herfindahl indices in 2003 are presented in the third table of this box. Half of the industries presented therein belong to sectors producing energy, capital and intermediate goods (oil refining, production of basic iron, steel and ferro-alloys, production of aluminium, production of ready-mixed concrete, manufacture of television and radio transmitters) for which the minimum efficient scale is large. Thus, the high value of the H index is thought to reflect this rather than the existence of institutional entry barriers.

In oil refining, which shows one of the highest H indices, *Hellenic Petroleum Group SA* (in the share capital of which the state has a holding of 27.4%) has a leading position.⁸ Actually, the three Hellenic Petroleum refineries account for around 80% of the refining capacity of the country.⁹ Despite this large share, however, the Hellenic Competition Commission (HCC), in its opinion

in 2001¹⁰ on the functioning of the oil market as a whole and not just of refining, had concluded that there was no evidence of agreements, harmonised practices or abuse of dominant position which led to unjustifiably high prices. The HCC, however, had identified structural shortcomings that were deemed to some extent to prevent the intensification of competition. Laws 3054/2002 and 3335/2005 contribute to dealing with some of these issues.

A study on competition conditions in manufacturing carried out by the Athens University of Economics and Business, commissioned by the HCC,¹¹ identifies 41 manufacturing industries as markets with insufficient →

⁸ Introductory Report on the 2006 Budget, Table 4.12.

⁹ Data from Hellenic Petroleum Group SA.

¹⁰ Opinion 5/III/2001 published in the Government Gazette (B739/13 June 2001).

¹¹ "Charting of the Greek industry", under the supervision of Professors N. Vettas and I. Katsoulakos, October 2004.

Herfindahl indices and share of sales of the largest firm in each of the services industries with the highest sales in 2002 and 2003

NACE Class	Industry description	Share of sales (%) ¹	H index	Share of sales of the largest firm in each industry ²	Number of firms
2002					
5010	Sale of motor vehicles	8.1	0.022	0.07	619
5151	Wholesale of solid, liquid and gaseous fuels and related products	8.0	0.12	0.21	152
6420	Telecommunications	7.1	0.38	0.55	88
5211	Retail sale in non-specialised stores with food, beverages and tobacco predominating	6.0	0.068	0.14	233
5146	Wholesale of pharmaceutical goods	5.2	0.012	0.04	536
2003					
5010	Sale of motor vehicles	8.2	0.019	0.07	691
5151	Wholesale of solid, liquid and gaseous fuels and related products	7.5	0.12	0.20	160
5211	Retail sale in non-specialised stores with food, beverages and tobacco predominating	7.4	0.082	0.20	238
6420	Telecommunications	6.6	0.31	0.48	96
5146	Wholesale of pharmaceutical goods	5.3	0.011	0.03	578

1 As a percentage of total sales of the service sector.

2 The share varies between 0 and 1.

Source: Calculations based on ICAP data.

→ competition. This verdict was based on the basis of a composite index which takes into account the degree of concentration in the industry, barriers to entry, and technological competitiveness (measured in terms of R&D expenditures). These 41 industries, however, represent only 7.1% of the manufacturing sector's total sales.

Services

H indices for the 5 largest (in terms of sales) service industries in 2002 and 2003 are presented in the fourth table of this box. The sectors are ranked in terms of their share in sales of the service sector.

From the table it appears that, for these industries, neither the H index takes high values nor do we find firms with a large share in terms of sales. *Telecommunica-*

tions show the highest degree of concentration, which, however, appears to gradually decline as the telecoms market is being further liberalised.

In *retail trade* (the value added of which represents 7% of the economy's value added) there appear to be no 4-digit industries that are characterised by both a large share of sales and high concentration ratios. The OECD summary indicator of regulatory restrictions in the sector, however, as presented in the fifth table of this Box, suggests that in 2003 regulations in Greece were more restrictive relative to those in other EU-15 countries. The indicator is based on information regarding the number of days required to get a licence, the existence or otherwise of special regulations for large-scale retail outlets, restrictions on shop-opening hours and price controls on certain products. The deterioration of the index between 1998 and 2003 is probably due to →

Regulatory provisions¹ in retail trade and professional services, 1998 and 2003

	Retail trade		Professional services
	1998	2003	2003
Austria	4.1	3.2	2.0
Belgium	3.7	4.5	2.1
Denmark	2.7	2.5	0.8
Finland	3.4	2.6	1.0
France	4.7	3.1	2.0
Germany	2.2	3.1	3.1
Greece	4.0	4.2	2.9
Ireland	1.3	1.1	1.3
Italy	2.9	2.4	3.6
Netherlands	1.9	1.6	1.6
Portugal	3.1	2.2	2.4
Spain	3.6	3.4	2.4
Sweden	1.3	0.5	0.9
United Kingdom	3.4	2.0	1.1

1 All indices vary between 0 and 6. The lower the value of the index, the fewer the regulatory provisions.

Source: Conway, P. and G. Nicoletti (2006), "Product market regulation in non-manufacturing sectors in OECD countries: measurement and highlights", OECD Economics Department Working Paper, forthcoming.

→ the "Gentlemen agreements" that started in 1999 in the face of the then imminent entry of Greece into the euro area.

The OECD has also proceeded to evaluate the regulatory provisions in certain *professional services*. More specifically, the OECD looks at the existence or otherwise of (i) barriers to entry into certain liberal professions (e.g. licensing, the exclusive exercise of certain functions by certain professions, the existence of quotas on the number of foreign firms that are allowed to practice the profession etc.), (ii) price regulations and (iii) mandatory membership in professional associations. For Greece, the OECD looks at the legal, accounting, architectural and engineering professional services. The data presented in the fifth table suggest that the environment in Greece is characterised by more regulations than most other EU-15 countries, with the exception of Italy and Germany, and although this does not necessarily imply that competition is lacking in these professions, it suggests that the conditions exist that could lead to the curtailment of competition.¹²

From the above it appears that in certain sectors of economic activity the degree of concentration is high. The HCC is already studying in detail specific markets selected on the basis of a number of criteria such as their structure and the fact that the products of some of these industries (e.g. soft drinks, oil etc.) are widely consumed. High concentration is also observed in certain network industries (e.g. electricity supply, telecommunications) in which the presence of the state is still significant. The gradual liberalisation of these markets and the supervision of their operation under specific regulatory authorities are thought to lead to benefits for the consumers in terms of, on the one hand, lower prices and, on the other hand, higher productivity and quality improvement. In fact, the correlation between structure, productivity and prices should be investigated in greater detail in order to clearly demonstrate the benefits from competition.

¹² An example of a profession that the HCC found to restrict competition by setting minimum payment tariffs is mentioned in the Appendix to this chapter.

Table IV.3

Employees' earnings, productivity and labour costs (2001-2006)

(Annual percentage changes)

	2001	2002	2003	2004	2005	2006 (forecast)
Average gross earnings (nominal):						
– whole economy	4.7	6.6	5.6	7.3	4.9	...
– central government ¹	5.5	7.3	5.9	9.9	4.2	6.1
– public enterprises	7.0	10.6	10.9	9.9	7.4	...
– banks	6.4	2.9 ⁴	3.1 ⁴	8.0	3.3 ⁴	...
– non-bank private sector	5.3	6.5	5.8	5.8	5.6	...
Minimum earnings	3.5	5.4	5.1	4.8	4.9	...
Net² income of an employee with average earnings						
(nominal)	3.4	6.3 ⁵	6.3 ⁷	5.4	4.1	...
(real)	0.0	2.6 ⁵	2.7 ⁷	2.4	0.6	...
Total compensation of employees (including employers' social security and other contributions)	8.3	9.1⁶	8.3⁷	8.9	6.3	...
Compensation per employee	4.8	5.9⁶	5.5⁷	7.6	4.7	...
GDP⁸	4.6	3.8	4.6	4.7	3.7	3.5
Output per person-hour in manufacturing	-0.6	0.6	1.2	1.2	1.0	...
Unit labour costs:						
– whole economy	3.5	5.1 ⁶	3.6 ⁷	4.0	2.5	3.5–3.8
– business sector ³	4.4	4.5 ⁶	4.0 ⁷	2.7	2.8	4.0–4.3
– manufacturing	6.1	5.3 ⁶	4.7 ⁷	4.5	4.6	...

1 Compensation per employee.

2 Gross earnings less employees' social security contributions less income tax.

3 It comprises private and public enterprises and banks.

4 The relatively high growth rate of average earnings in banks mainly reflects changes stemming from the restructuring of their staff.

5 Including the abolition (as from 1 January 2002) of stamp duties (0.6% of gross earnings) paid by employees.

6 Including the abolition (as from 1 January 2002) of stamp duties (0.6% of earnings) paid by business sector employers.

7 Taking into account the increase (of 0.1% of gross earnings) in both employees' and employers' contribution to the Workers' Fund.

8 NSSG for the years 2001-2005 (February 2006). Bank of Greece estimates for 2006.

Sources: NSSG (GDP 2001-2005), Bank of Greece estimates-forecasts (for GDP in 2006 and for the other annual aggregates in 2001-2006).

cial corporations fell, as both gross profits and net pre-tax profits increased less than sales did.²¹ This development is also in line with the restraint in pricing policy exhibited by businesses in connection with the increase in indirect taxation. Nevertheless, the data are not necessarily indicative of the overall situation regarding profits.²²

On the other hand, it is estimated that the annual rate of increase in unit labour costs in the *business sector*,²³ which has a more direct effect on

price levels, did not slow down, remaining instead at a relatively high level in 2005 (2.8%,

²¹ For details about the development of profits during the first six months of 2005 (based on a sample group of companies), see Chapter III.4.1.2.

²² For instance, according to a sample survey carried out by the Federation of Greek Industries and ICAP in March and April, industrial firms forecast increases of 6.3% in sales, 6.8% in gross profits and 16.8% in pre-tax profits for 2005. See Federation of Greek Industries and ICAP, *Greek Manufacturing: estimates for 2004 and prospects for 2005*, June 2005. The survey involved a sample group of 300 companies (263 of which responded).

²³ It comprises public and private enterprises and banks.

compared with 2.7% in 2004).²⁴ In the whole economy, however, unit labour costs are estimated to have increased by 2.5% in 2005, i.e. less than they did in 2004 (4.0%),²⁵ as a result of the slowdown in the growth of average earnings of central government employees (see Table IV.3). This reflects the fact that the increase in average pre-tax earnings in the whole economy slowed to 4.9%, from 7.3% in 2004,²⁶ i.e. its slowdown was more rapid than that of the increase in productivity (GDP per employee), which is estimated to have reached 2.1% in 2005, from 3.4% in 2004. It should be noted, however, that, despite these developments, the rate of increase in unit labour costs in Greece remained noticeably higher than the corresponding rate in the euro area (0.9% on average in the first nine months of 2005) and continued to exceed the level which is, in principle, consistent with price stability, i.e. inflation below but close to 2%. It should also be noted that, while the growth of average earnings of central government employees slowed down significantly, average earnings in the private sector increased at almost the same rate in 2004 and 2005.

More specifically, in *central government*, if account is taken of (i) the *ex post* estimates in the Introductory Report on the State Budget for 2006, (ii) Law 3336/2005 on incomes policy in 2005 and (iii) the estimated change in employment, it is calculated that the average annual increase in *regular salaries* reached 3.2% and that –if account is also taken of other allowances and of seniority benefits– compensation per employee rose by 4.2%, compared with 9.9% in 2004.²⁷

The development of unit labour costs in the *business sector* in 2005 reflects the estimated development of average earnings in the non-bank private sector, public utilities and banks, which has in the main been determined by the two-year col-

lective labour agreements signed in 2004 and is presented in Table IV.3.

2. Inflation prospects for 2006

The average annual inflation rate based on the HICP is forecast to decelerate to 3.2% in 2006, while the corresponding CPI inflation rate is projected to drop to 3.3%, from 3.5% (for both

²⁴ The reduction in overtime costs provided for by the recent Law 3385/2005, which came into force on 1 October 2005, may have reduced the increase in unit labour costs in the business sector, but it is not possible to accurately estimate how much.

²⁵ For these estimates, (*nominal*) *unit labour costs* are defined as the ratio of total compensation of employees to real GDP or –expressed in a mathematically equivalent form– as the ratio of compensation per employee to productivity (measured as GDP *per salaried employee*). In the National Accounts they are defined differently, namely as the ratio of compensation per employee to productivity (measured as GDP *per employed person in general*, including the self-employed). The reasons for which the Bank of Greece –in its calculation of the change in unit labour costs– prefers to take into account the change in productivity on the basis of the change in the ratio of GDP to the number of employees have been presented in previous reports (see Bank of Greece, *Monetary Policy 2002-2003*, Box 2, March 2003, pp. 47-48, and Bank of Greece *Annual Report 2002*, Box IV.2, April 2003, pp. 151-153). It should also be noted that, since 1977, the Bank of Greece has published its own estimates concerning the increase in average earnings in the economy as a whole, which are not always the same as those produced by the National Accounts Department of the NSSG.

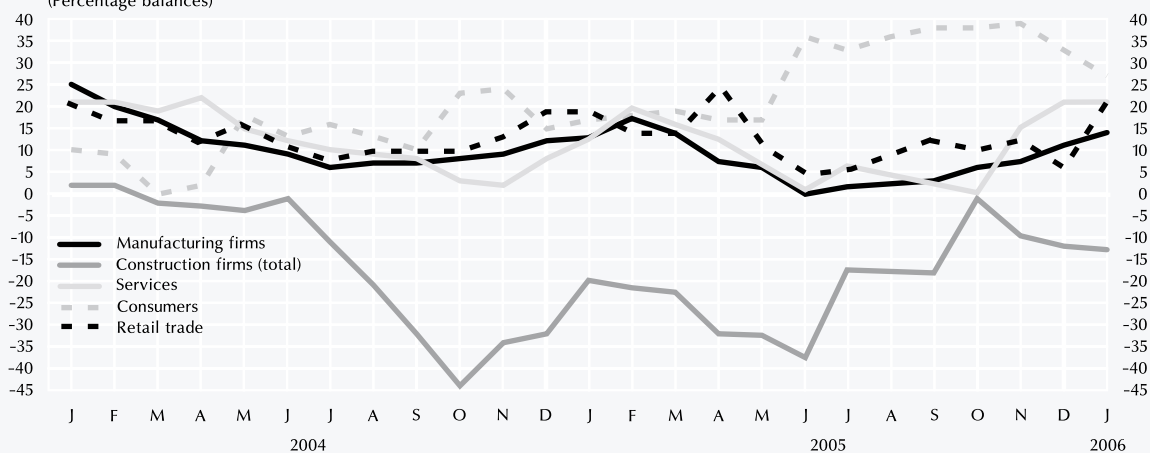
²⁶ Compensation per employee, which includes employers' (social security and other) contributions to social security organisations and central government outlays for pensions, is estimated to have increased by 4.7% in 2005, against 7.6% in 2004.

²⁷ According to *ex post* estimates in the Draft State Budget for 2006 (21 November 2005), the *total* increase in compensation per civil servant excluding pensions was 6.7% (compared with 11.2% in 2004), or 5.8% including pensions (compared with 12.1% in 2004). The annual rate of increase in the number of civil servants (according to data for the first six months of 2005) was 2.5%. The significant slowdown in the rate of increase in compensation per civil servant in 2005 reflects both the fact that the 2004 increase was high due to special factors and the fact that increases in 2005 were more restrained as part of an effort to reduce the public deficit. It should be noted that the slowdown in the rate of increase in central government personnel outlays may ultimately have been even greater. Indeed, according to data on an administrative basis released after the publication of the Introductory Report on the State Budget for 2006, during the twelve months January-December 2005 the increase in the wage bill excluding pensions was kept to 3.4%. However, such data are not absolutely comparable *in terms of coverage* with the estimates contained in the Introductory Report (see also Section 5 of this chapter).

Chart IV.12

Inflation expectations¹ of consumers and business firms (January 2004 - January 2006)

(Percentage balances)



¹ The responses of business firms concern the prospect, in the next 3-4 months, of price increases for the goods they produce, while consumers' responses concern the prospect of a faster increase in consumer prices in the next 12 months. The data for consumers are seasonally adjusted.

Sources: IOBE and European Commission, *Business and consumer survey results*.

indices) in 2005. Core inflation (based on the HICP excluding energy and unprocessed food) will fall to 2.9%, from 3.2% in 2005.²⁸

These forecasts are based on certain estimates and assumptions concerning, on the one hand, world market prices for oil and other raw materials, the euro exchange rate and the prices of fresh fruit and vegetables and, on the other hand, unit labour costs, profit margins and demand (in conjunction with the production potential of the economy). At the same time, account is taken of the impact of the macroeconomic policy being pursued and the structural reform policy, together with the continuing more active involvement of the Competition Commission.²⁹ More specifically, the current forecasts (of a fall both in HICP and CPI inflation and in core inflation) reflect, to begin with, the assessment that the factors which contributed to a drop in core inflation and a limited acceleration of the inflation rate in 2005 will continue to have an effect. Moreover, account has also been taken of the gradual elimination (from April 2006 onwards) of the impact of last year's

change in indirect taxation on the annual inflation rate, as well as of the expected *reduction* of the effect of "imported" inflation (particularly the smaller expected increase in the price of crude oil). It is estimated that these factors will more than offset the impact of the expected faster rise in unit labour costs.

²⁸ Core inflation based on the CPI excluding fuel and fresh fruit and vegetables is forecast to fall to 2.8%, from 3.1% in 2005.

²⁹ In addition, as far as business firms' own short-term forecasts on the prices of their goods or services are concerned, surveys carried out by the IOBE in recent months indicate that in the fourth quarter of 2005 and in January 2006 there was an increase, compared with the third quarter of 2005, in the percentage of firms in the manufacturing, retail trade, services (excluding retail trade and banking) and residential construction sectors which expected that *during the coming 3-4 months* the prices of the products or services they offer would increase (to be precise: the above increase regards the positive balance between the percentage of the firms which expected an increase in their prices and that of those which expected a reduction, see Chart IV.12). As for manufacturing, a similar image was given by the PMI (Purchasing Managers' Index, sub-index "output prices") survey. Concerning inflation expectations among consumers, the percentage of those who expect inflation to increase *in the coming twelve months* (as recorded in a survey carried out on behalf of the European Commission) indicates clearly higher inflationary expectations on the part of consumers in the third and fourth quarters of 2005, although these expectations weakened somewhat in January 2006 (see Chart IV.12).

Of course, these forecasts involve an element of uncertainty connected to the evolution of oil prices, exchange rates and the prices of fresh fruit and vegetables during 2006, as well as to the final size of unit labour cost growth (which will depend on the outcome of collective bargaining in the private sector and in public enterprises and on the rate of productivity increase).

As for individual factors, it is expected, to begin with, that 2006 will see a reduction in the impact of "imported" inflation. In more detail:

— It is expected that increasing oil prices will continue to push up the *level* of prices, both directly (via higher fuel prices which are included in the consumer's "basket") and indirectly, by influencing, with a time lag, production costs.³⁰ However, the total impact of rising oil prices on inflation will be less marked than in 2005. More specifically, it can be assumed that, based on recent forward prices, the average annual level of Brent crude oil prices on the world market will rise to approximately \$66 per barrel in 2006 (from \$55 in 2005), i.e. by approximately 20%, compared with 46.3% in 2005. However, based on the technical assumption that exchange rates will remain stable at the level which, on average, they reached during the last two weeks of January 2006 (1 euro = \$1.215), the euro will show an average annual depreciation of 2.3% against the dollar in 2006. Thus, the expected increase in the average annual price of crude oil *in euro terms* will be around 23%, which is markedly less than in 2005 (46.2%), but nevertheless significant. This forecast is characterised by a large degree of uncertainty concerning oil prices in dollar terms and the euro/dollar exchange rate.

— *Non-oil* commodity prices (raw materials and other products) in US dollars are expected to rise by 3.8% in 2006 (compared with 5.8% in 2005).³¹

So, based on the already mentioned technical assumption concerning the euro/dollar exchange rate, the euro price of commodities will increase by 6.2%, i.e. slightly more than in 2005 (5.7%). (It should be pointed out, however, that the most recent forward prices imply that the increase may well be markedly greater.)

— The relatively low rate of increase in the prices of imported consumer goods and services from euro area countries will probably not change substantially, as inflation in the euro area is expected to remain at approximately the same levels as in 2005 (see Chapter II.2.1).

Furthermore, the rate of increase in unit labour costs in 2006 is expected to accelerate significantly, both in the economy as a whole (to 3.5%-3.8%, from 2.5% in 2005) and in the business sector (to 4.0%-4.3%, from 2.8%) and its positive differential vis-à-vis the euro area should widen.³² This forecast takes into account the data available concerning the budgeted rise in the central government wage bill, certain purely technical assumptions concerning the outcome of collective bargaining in the business sector, as well as the expectation that the rate of increase in productivity (GDP per employee) will remain virtually unchanged. In particular, as far as the rate of increase in average earnings in the whole economy in 2006 is concerned, for *central government* it is expected that —based on State Budget provisions— gross compensation per employee will increase by 6.1% (compared with 4.2% in 2005, according to revised estimates — see Table

³⁰ The size of the "second-round" effects that rising oil prices may have on inflation due to wage increases will depend on the outcome of collective bargaining procedures.

³¹ See the macroeconomic projections produced by the Eurosystem staff (ECB, *Monthly Bulletin*, December 2005).

³² According to the European Commission (*Autumn Forecasts*, November 2005), the rate of increase in unit labour costs in the euro area is forecast to decelerate to 1.3% in 2006, from 1.5% in 2005.

IV.3).³³ In the *non-bank private sector*,³⁴ banks and public enterprises, however, the collective bargaining round is still at an early stage. Accordingly, certain purely *technical assumptions* have been made which are marked by a high degree of uncertainty. So, the final rate of increase in unit labour costs and in inflation will depend on the outcome of collective bargaining. It should be noted, however, that in the *euro area as a whole*, average earnings (to be precise: compensation per employee including employers' social security contributions) are forecast to increase by 2.0%³⁵ (compared with 1.5% on average during the first nine months of 2005).

Inflationary pressures on the demand side are expected to continue to decline in 2006. Indeed, private consumption growth is forecast to decelerate slightly but remain relatively high, while the "output gap" – according to available forecasts³⁶ – will remain positive, but will *narrow further* in 2006 (see Chart IV.10).³⁷ The fiscal policy pursued, which is aimed at bringing about a major reduction in the general government deficit – to 2.6% of GDP, from 4.3% of GDP in 2005 – will also contribute to a reduction in inflationary pressures. Moreover, monetary conditions in Greece remain relaxed overall, with no considerable change at present, as the real exchange rate in recent months has begun to fall on an annual basis, while real interest rates on the money market remain negative, though less so than was the case previously³⁸ (see the Monetary Conditions Index in Chart IV.13).

Forecasts of a drop in HICP and CPI inflation, as well as in core inflation, take into account not just the *net* final impact of the factors discussed above, but also the anti-inflationary impact which certain other factors are assessed to have.

– The rate of increase in unit labour costs in the business sector will, *in practice*, be somewhat

lower than forecast, as it will be influenced by the provisions of Law 3385/2005, which reduce overtime costs and facilitate working time flexibility.

– Increased imports of relatively low-cost goods (chiefly clothing-footwear and consumer durables-

33 According to the State Budget for 2006, the *total* increase in central government personnel outlays excluding pensions will reach 6.3% (compared with 6.7% in 2005), while, including *pensions*, it will come to 6.1% (compared with 5.8% in 2005). It is expected that the increase in the number of civil servants will be limited (in the order of 0.2%). As usual, the expected percentage increase in compensation per employee (6.1%) includes all kinds of increase in compensation of central government employees in addition to the increase in their *regular salaries*. According to government announcements (1 February 2006), the basic salary payable to government functionaries and civil servants, to employees of other legal persons in public law as well as to officers of the Armed Forces and the Security Forces will increase by 3%. However, total regular salaries (including benefits which will remain unchanged) will increase by 2.1-2.4%. In addition to these percentages, in calculating wage increases for central government personnel account should also be taken of changes in seniority benefits (due to advancement, etc.) and of the award, from September 2006, of the second instalment of the new "special conditions allowance" payable to the uniformed members of the Armed Forces and the Security Forces (payment of the first instalment began in September 2005). Moreover, pensions paid by central government and those paid by social security organisations under the pension system applied for central government pensioners will rise by 4.0%. According to government announcements, the auxiliary pension payable to central government pensioners who are also members of the Civil Servants' Pension Fund (MTPY) will rise by an average of 5.0%. In addition, pensions of retirees from the Armed Forces will rise by 6.5%, due either to the award of the fourth instalment of the "position of responsibility" allowance or the payment of a special allowance of €176 (depending on the individual case), plus the payments of the "special conditions allowance" and pay advancement. Finally, EKAS (Pensioners' Social Solidarity Allowance) payments and OGA (Farmers' Insurance Fund) pensions will rise by 7.0% (the income threshold used for the granting of EKAS will also be adjusted in line with the inflation levels recorded in 2005). On 24 June 2006, central government pensioners will receive the first instalment of the retroactive refunding of contributions paid to LAFKA (Social Security Organisations Solidarity Account).

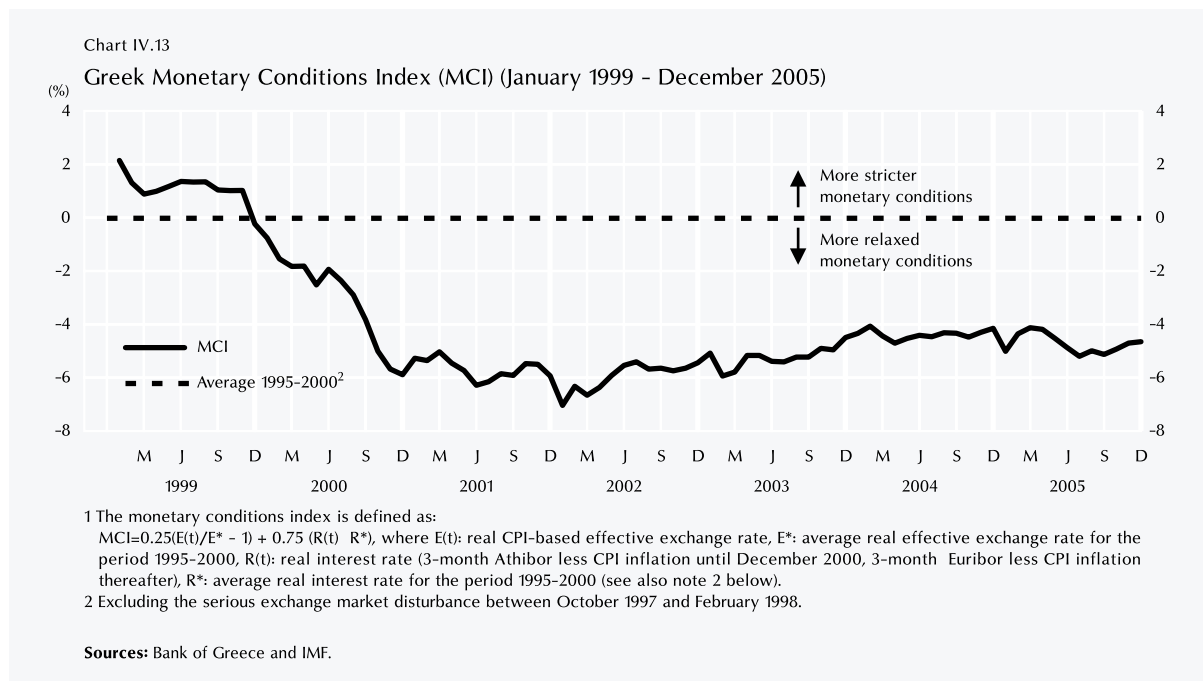
34 In the non-bank private sector, as contractually agreed pay rises in 2005 were paid as of 1 January 2005 and as of 1 September 2005, the "carry-over effect" for 2006 – i.e. the percentage increase in average annual contractual earnings in 2006 even if no increases at all are awarded *during* this particular year – is relatively high (2.1%).

35 See European Commission, *Autumn Forecasts*, November 2005.

36 See also footnote 17 above.

37 To +1.2 from +1.6 according to the IMF and to +1.3 from +1.9 according to the OECD.

38 The Euribor nominal three-month money market rate has increased in recent months, while the rate of increase in the CPI in Greece (used to calculate the real interest rate) is expected to fall during 2006.



household goods from China and other Asian economies) and structural changes in the retail trade sector, with the entry of new department store chains and an increased presence of discount stores in the supermarket sector, will enhance competition. This will lead to a fall in the prices of certain goods and, ultimately, restrain the rise in the general level of consumer prices.

3. Economic activity: developments in 2005 and prospects for 2006

3.1 Developments in 2005

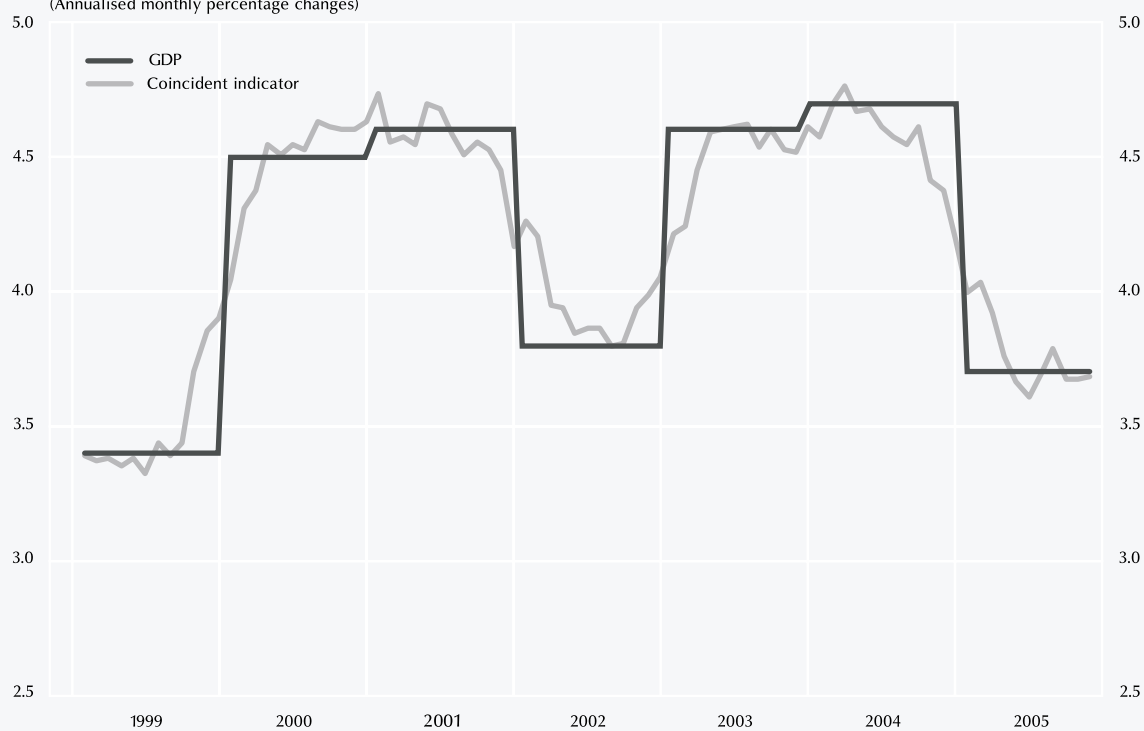
In 2005 economic activity grew less than initially expected. From mid-2004 onwards and after the completion of projects related to the Olympic Games, the rate of growth showed signs of decelerating and gradually fell to lower levels, which however ensure a better balance between aggregate demand and the medium-term productive capacity of the economy (as calculated on the basis of currently available data). From early 2005

onwards, the deceleration became stronger, mainly owing to the surge in oil prices globally, which has adversely affected households' real income and the energy cost of production and also, to some extent, the economic sentiment and the expectations of consumers and firms. Moreover, the substantial containment of the increase in public expenditure, especially public investment cuts, in the context of the fiscal consolidation policy implemented by the government, contributed to the further slowdown in economic growth. The same effect was produced by the drastic fall in the growth rate of exports of services, due to the substantially lower growth rate of shipping receipts compared with 2004. According to the latest quarterly national accounts flash estimates by the NSSG, the annual GDP growth rate was 3.7% in the last quarter of 2005, compared with 4.8% in the fourth quarter of 2004, while the average annual GDP growth rate for 2005 as a whole was also 3.7%, compared with 4.7% in 2004.

In addition, the coincident indicator of economic activity, which is compiled by the Bank of

Chart IV.14

The coincident indicator of economic activity compiled by the Bank of Greece
(January 1999 - November 2005)
(Annualised monthly percentage changes)



Sources: Bank of Greece (coincident indicator) and NSSG (GDP for 1999-2005).

Greece³⁹ and summarises information contained in a set of key short-term indicators of economic activity (see Chart IV.14), has been gradually declining since April 2004. Having accelerated marginally in August, activity stabilised from September onwards and, in the latest available three-month period up to November 2005, the annualised growth rate of the indicator coincided with the estimated average annual GDP growth rate for 2005. Moreover, another set of indicators that the Bank of Greece has recently begun to compile on the basis of different techniques corroborates the deceleration of economic growth in 2005,⁴⁰ though it seems to have stabilised towards the end of the year. It should be noted, however, that the economic sentiment indicator for Greece (compiled by the European Commission based on business survey results) declined almost continuously from

May 2004 to July 2005, but recovered between August 2005 and January 2006. In addition, the OECD's leading indicator of economic activity for the last quarter of 2005 foreshadows a slight improvement in industrial activity in Greece.

It should be recalled that the Ministry of Economy and Finance, in the updated Stability and Growth Programme of December 2005, had estimated that economic activity grew by 3.6% in 2005. In

³⁹ For the coincident indicator see Bank of Greece, *Monetary Policy 2002-2003*, March 2003, Box 3. Also see S. G. Hall and N. G. Zonzilos, "An indicator measuring underlying economic activity in Greece", Bank of Greece *Working Papers*, No. 4, August 2003.

⁴⁰ They are derived from a representative set of short-term indicators of the Greek economy through the Generalised Dynamic Factor Model. For a comprehensive and concise description of the method, see L. Reichlin, "Factor Models in Large Cross Sections of Time Series" in *Advances in Economics and Econometrics*, M. Dewatripont and S. Turnovsky (eds), Econometric Society Monographs, Cambridge University Press, 2003.

their autumn forecasts, international organisations estimated a slightly lower growth rate for the Greek economy, but these estimates are gradually being revised upwards.⁴¹ Moreover, the Bank of Greece had forecast first an increase of 3.3% (*Monetary Policy 2004-2005*, February 2005), then 3% (*Annual Report 2004*, April 2005) and recently 3.5% (*Monetary Policy, Interim Report 2005*, October 2005). The initial forecasts had been based on previous NSSG estimates of a 4.2% GDP growth in 2004 (rather than 4.7%, as is presently estimated); also, they had overestimated the volume of imports and underestimated tourism activity in 2005.

Despite the slowdown in 2005, economic activity remains at relatively high levels and retains elements of resilience to external shocks. The GDP growth rate in Greece continues to exceed that in the euro area and the EU-25, as well as the OECD average. It should be noted that the contribution of domestic demand to GDP growth fell drastically to 2.6 percentage points in 2005, from 5.1 percentage points in 2004, mainly because of public investment cuts and the slower growth of private consumption. The decline in the growth rate of domestic expenditure was partially offset by developments in the external sector of the economy, where for the first time since 2001 net exports of goods and services made a positive contribution of roughly one percentage point to GDP growth. However, this positive turn-around of the real external balance mainly reflects the fact that imports of goods, which had grown at a very high rate in 2004 (due to the preparations for the Olympic Games), remained unchanged; to a lesser extent, it reflects the recovery in exports of goods, which occurred despite the small further decrease in price competitiveness (see Box IV.3). These developments have more than offset the significant deceleration in the growth rate of exports of services, which reflected the very small increase in receipts from transport services (mainly

shipping) after the substantial rise recorded in 2004. In any event, the growth rate of exports of goods and services slowed markedly in 2005 (to 2.7%, according to NSSG provisional estimates, from 11.5% in 2004 – see Table IV.4).

When assessing the performance of the Greek economy in the last few years, it is useful to take into consideration the effect of a series of very favourable factors (such as the fall in interest rates owing to Greece's accession to EMU in conjunction with financial deregulation, investment in view of the Olympic Games and inflows of CSF funds) that contributed to more relaxed monetary conditions and to the expansionary stance of fiscal policy and helped maintain high growth rates of economic activity for a long period of time. Moreover, especially in 2004, the substantial increase in sea transport receipts also contributed to the high GDP growth rate, as mentioned above. The potential growth rate of the economy could have been even higher if full advantage had been taken of beneficial factors and protracted favourable conditions, by the promotion of appropriate structural interventions for a more lasting strengthening of the economy's productive capacity. A less favourable picture appears when the performance of the Greek economy within the European Union is compared with that of some new EU Member States that are closer to Greece as regards the stage of economic growth and *per capita* GDP than certain mature euro area economies.

On the supply side, services have boosted the GDP growth rate. More specifically, activity has been satisfactory in parts of the tertiary sector,

⁴¹ More recently, the OECD estimated a 3.5% increase in GDP (*Economic Outlook*, December 2005), i.e. higher than its June estimate (2.8% – *Economic Outlook*, June 2005). The IMF estimated a 3.2% increase (*World Economic Outlook*, September 2005), which was revised to 3.5% in its report on the Greek economy (*Greece-Staff Report*, January 2006). The European Commission estimated a 3.5% rise in GDP (*Autumn Forecasts*, November 2005).

Table IV.4

Demand and gross domestic product (2003-2005)

(At constant market prices of year 1995, annual percentage changes)

	2003	2004	2005–estimate ¹
Private consumption	4.5	4.4	3.2 (3.7)
Government consumption	-2.1	3.9	2.5 (3.0)
Gross fixed capital formation	13.7	5.7	1.0 (-1.2)
Housing	7.3	-0.6	-1.5
Other constructions	13.2	6.1	2.2
Equipment	18.3	8.0	1.1
Other	3.4	6.9	1.1
Stocks and statistical discrepancy (<i>percentage of GDP</i>)	0.1	0.1	0.0
Domestic final demand	5.5	4.7	2.4
Exports of goods and services	1.0	11.5	5.0 (2.7)
Exports of goods	4.2	-2.5	4.7
Exports of services	-1.3	21.8	5.2
Imports of goods and services	5.1	9.3	0.7 (-1.4)
Imports of goods	7.1	9.0	0.2
Imports of services	-6.1	10.9	3.9
Gross domestic product at market prices	4.6	4.7	3.6 (3.7)

¹ For 2005, the NSSG flash estimates published on 14 February 2006 (where available) are quoted in parentheses.

Sources: NSSG/National Accounts Directorate (September 2005) for 2003 and 2004. For 2005: Ministry of Economy and Finance, Updated Stability and Growth Programme 2005-2008 (December 2005). For 2006, see the main text for Bank of Greece estimates.

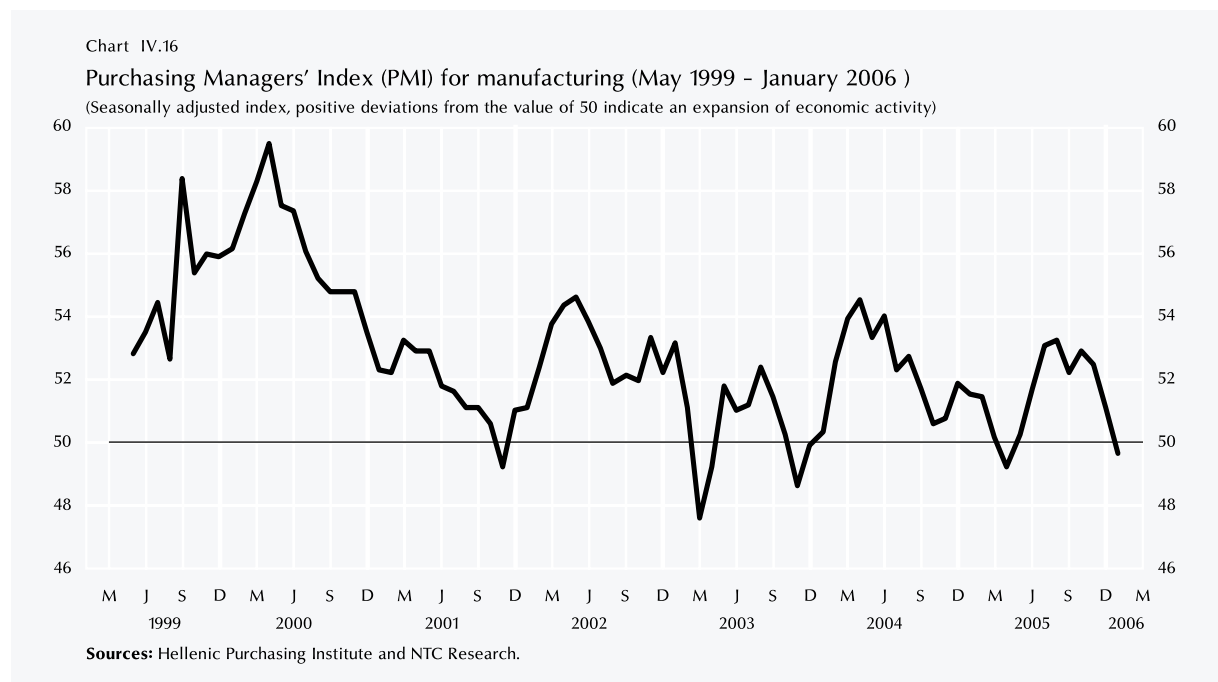
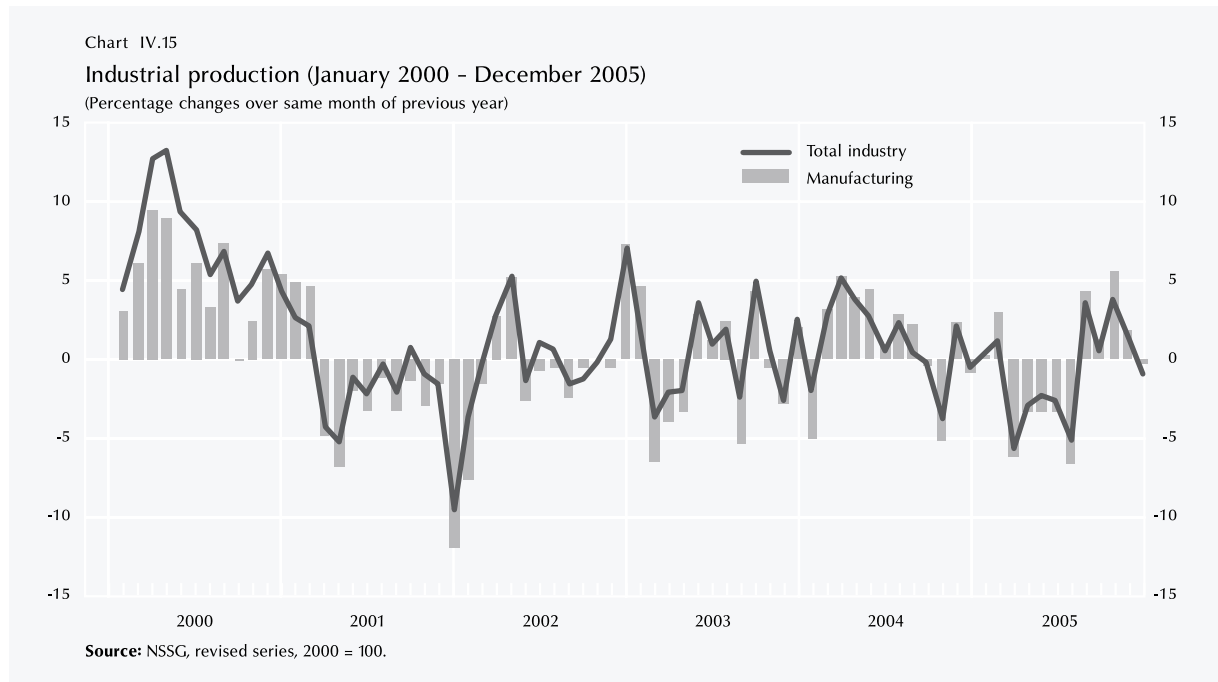
such as telecommunications, financial services, real estate services and trade. Positive developments in the services sector, which accounts for over 70% of GDP, can partly explain the fact that the picture of economic developments based on national accounts is more favourable than the one based on various short-term indicators, which do not cover the services sector adequately.

By contrast to services, total industrial and manufacturing output decreased in 2005 at an average annual rate of 0.9% and 0.8%, respectively (see Chart IV.15). Within industry as a whole, mine and quarry output and capital goods production recorded the biggest drop (6.2% and 4.2% respectively), while production of consumer durables and electricity-natural gas-water supply increased by 11.7% and 0.6% respectively. The PMI offers a

brighter picture of manufacturing, indicating an increase in production for the best part of 2005 (see Chart IV.16). Moreover, the industrial confidence indicator in manufacturing (derived from the IOBE business survey – see Chart IV.17) was falling until July, but started picking up again from August 2005 onwards.

In agriculture, gross value added at constant basic prices is estimated to have decreased by 4.9%. Moreover, according to Eurostat estimates, real agricultural income per worker fell by 3.6% (after a 2.8% rise in 2004).⁴²

⁴² See Eurostat, press release 162/2005 (19 December 2005) “First estimates for 2005 – EU-25 real agricultural income per worker down by 6.3%”, and *Statistics in Focus* 2/2006 (January 2006) “EU Agricultural income: -6.6% (real terms) in 2005”.



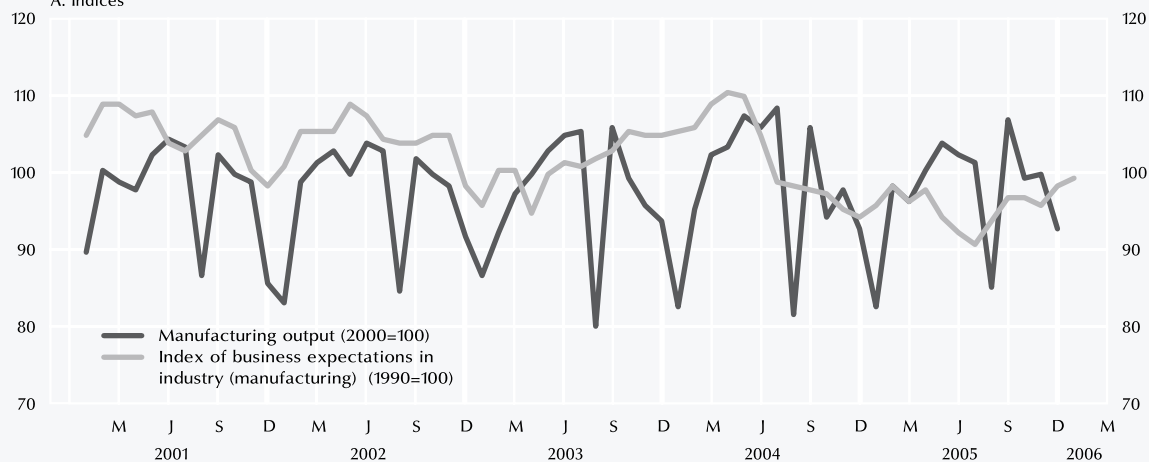
On the demand side, the growth rate of private consumption decelerated in 2005, but remained at high levels and continues to support domestic demand, as shown by available short-term indicators (see Table IV.5), survey results and available national accounts estimates. According to provi-

sional NSSG estimates, the annual growth rate of private consumption, on a national accounts basis, fell to 3.4% in the last quarter of 2005, from 4.3% in the last quarter of 2004, while the average annual growth rate for 2005 as a whole was 3.7% (compared with 4.4% in 2004). The retail trade

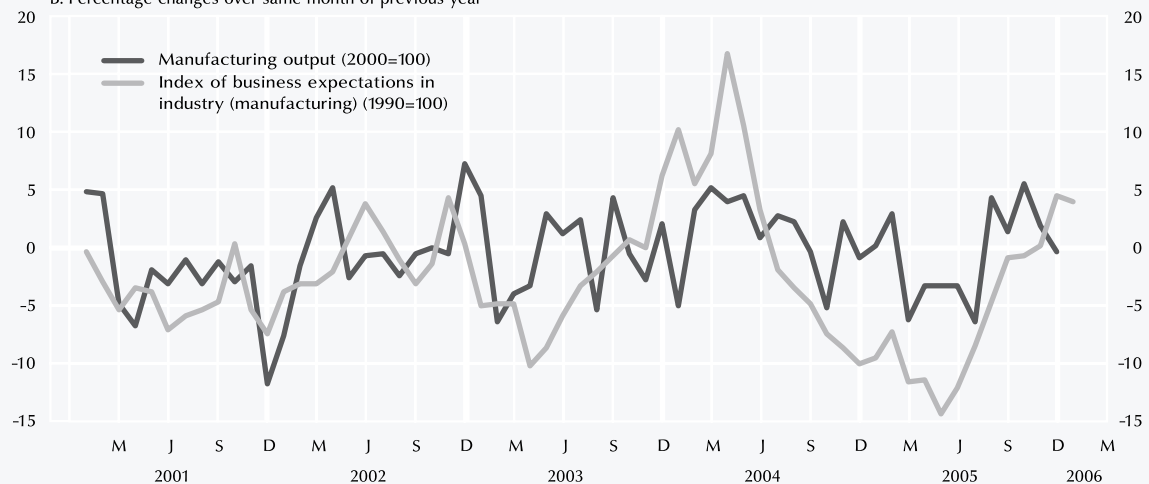
Chart IV.17

Output and business expectations in manufacturing (January 2001 - January 2006)

A. Indices



B. Percentage changes over same month of previous year



Sources: NSSG (output) and IOBE (expectations). The index of business expectations is based on business firms' estimates of total demand and stocks, and on output forecasts for the next 3-4 months.

volume index (which only comprises sales of consumer goods⁴³ excluding cars and covers roughly one-third of total consumption expenditure) rose at an average annual rate of 3.1% in the first eleven months of 2005, compared with 4.8% over the same period of 2004 (see Chart IV.18 and Table IV.6). The number of new passenger car registrations fell by 3.0% in 2005, compared with a 15.7% rise in 2004 (it should be recalled that the 2004 figure partly reflects the exceptional increase in passenger car imports for the needs of the Olympic Games).

The growth rate of the outstanding balance of consumer loans decreased, but remained at high levels during 2005 (December 2005: 28.0%, December 2004: 37.4%).⁴⁴ Moreover, throughout 2005 consumer confidence remained lower than in 2004 and below the average for the last few years.⁴⁵

⁴³ Of course, retail trade in goods belongs to the services sector.
⁴⁴ Adjusted to include loan securitisations. Also see Chapter III.2.
⁴⁵ As shown by a survey conducted on behalf of the European Commission. See European Commission, "Business and consumer survey results", monthly survey.

Table IV.5
Indicators of consumer demand (2004-2006)
(Annual percentage changes)

	2004	2005	2006 (available period)
Volume of retail sales ¹	4.5	3.1 (Jan.-Nov.)	
Food-beverages-tobacco	7.1	5.9	
Clothing-footwear	1.4	1.0	
Furniture-electrical appliances-household equipment	3.9	0.7	
Books-stationery-other	4.7	-1.7	
Revenue from VAT (constant prices)	8.3	-0.7	
Retail trade business expectations indicator	2.8	-7.7	0.1 (Jan.)
New passenger car registrations	15.7	-3.0	-4.1 (Jan.)
Piraeus Port Authority (OLP) passengers	-4.9	4.0 (Jan.-Sept.)	
Tax revenue from mobile telephony (monthly flat fees)	13.0	10.8	
Outstanding balance of total consumer credit extended by banks ²	34.7 (Dec.)	28.0 (Dec.)	

1 Revised retail sales volume index (new NSSG sample, 2000=100).

2 Including the outstanding balance of securitised consumer loans.

Sources: NSSG (retail sales), Bank of Greece (VAT revenue and consumer credit), IOBE (expectations), NSSG (cars), OLP, Ministry of Economy and Finance (tax revenue from mobile telephony).

The growth rate of real disposable income in the private sector⁴⁶ fell to 4.6% in 2005,⁴⁷ from 6.1% in 2004. However, it outpaced the growth rate of private consumption; thus the saving rate of the private sector increased further. The drop in disposable income in 2005 was due to the significant slowdown in the growth rate of both gross average earnings of employees (to 4.9%, from 7.3% in 2004) and net average take-home pay of employees (to 4.1% from 5.4% in 2004, according to estimates – also see Table IV.3). By contrast, expenditures of a social character (social transfers from the general government sector excluding payments in kind) are estimated to have increased by 10.0% in 2005, i.e. much more than in 2004 (5.1%), while net non-labour income (including income of the self-employed) is estimated to have increased by 7.9%, i.e. at a rate close to the 2004 level (7.6%).⁴⁸

Previous Bank of Greece reports provided an explanatory framework concerning the relative sta-

bility of the growth rate of private consumption and its partial independence from current fluctuations in disposable income. The influx of immigrants has led to a significant increase in the country's population. Immigrants have relatively low income; thus, *prima facie*, they have a high propensity to consume. This has helped accelerate the potential growth rate of private consumption.⁴⁹ The deregulation of the banking system and especially the fall in interest rates have made it possible for more households to

⁴⁶ The disposable income of the private sector, as defined in the National Accounts, includes households' income and savings (undistributed profits) of private and public enterprises.

⁴⁷ Estimates of the Updated Stability and Growth Programme, December 2005.

⁴⁸ See footnote 47.

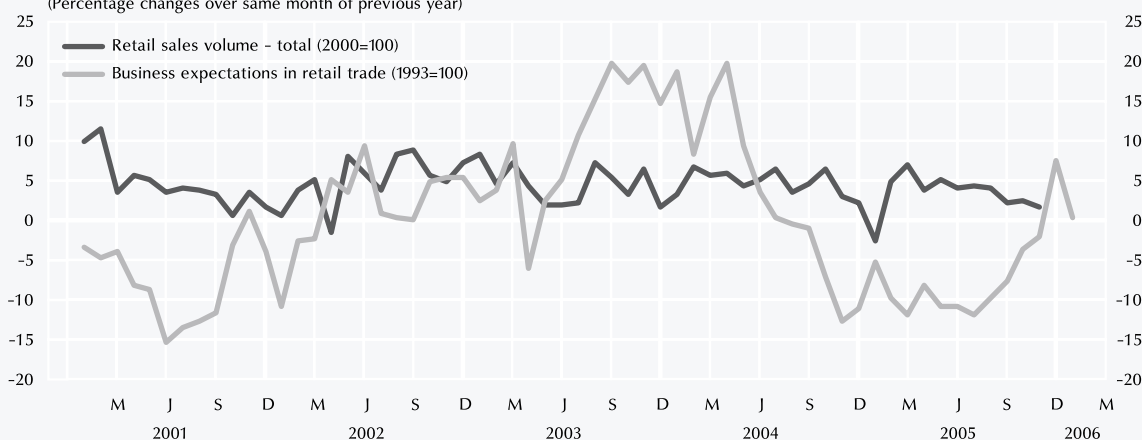
⁴⁹ Of course, outflows of immigrants' remittances restrict – to some extent – the economic immigrants' propensity to consume. However, according to a paper under publication (Th. P. Lianos and J. Kavounidi, "Migrants' propensity to remit in Greece", December 2005, in Greek), the remittances-to-income ratio drops when immigrants live in Greece with their families (as is the case with most immigrants, especially Albanians), as well as when their period of stay in Greece increases.

Chart IV.18

Consumer demand (January 2001 - January 2006)

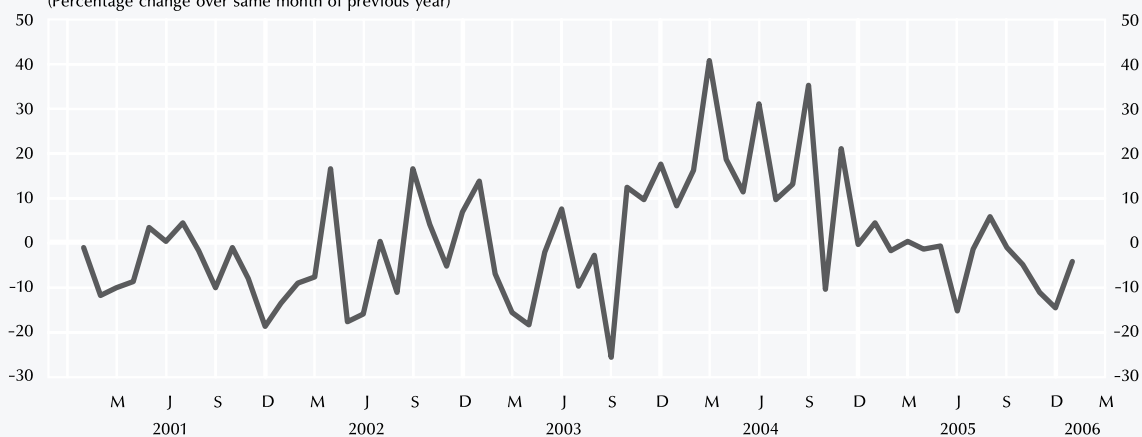
A. Retail sales volume and retail trade business expectations

(Percentage changes over same month of previous year)



B. New passenger car registrations

(Percentage change over same month of previous year)



Sources: NSSG - Eurostat (retail sales and cars), IOBE (expectations). The revised retail sales index (turnover of retail trade at constant prices) is based on the NSSG's new sample for the year 2000. The business expectations index is based on firms' estimates of sales and stocks as well as on their forecasts of business activity over the next six months.

gain access to consumer credit. This has enabled them to plan their consumption over a longer time horizon, basing their decisions more on current and expected disposable funds than on their rather variable disposable income. These changes in consumer behaviour have contributed to total consumption becoming less dependent on short-term fluctuations in real income and thus recording stable growth rates in the medium term. Of course, low-income households with a high propensity to consume still depend directly and almost exclusively on their current income.

These points are consistent with the results of the Household Budget Survey conducted by the NSSG between February 2004 and January 2005. This survey recorded relatively small changes in consumption patterns in Greece over the more recent five-year period (1999-2004), compared with the previous one (1994-1999).⁵⁰ It is esti-

⁵⁰ For instance, the share of food fell to just 17.1% in 2004 from 17.4% in 1999, while similarly small were the changes in other categories of expenditure, such as housing (from 10.1% to 10.7%), transport (from 12.2% to 12.6%), clothing-footwear (from 9.3% to 8.4%) etc.

Table IV.6

Retail trade turnover index (2005)

(Percentage changes over corresponding period of previous year)

Components	Jan.-Nov.
1. Big food stores	6.6
2. Department stores	5.3
3. Food-beverages-tobacco	3.3
4. Pharmaceuticals-cosmetics	6.8
5. Clothing-footwear	5.6
6. Furniture-electrical appliances-household equipment	5.4
7. Books-stationery-other	5.1
8. Retail sales not in stores	1.1
Retail trade turnover index	6.2

Source: NSSG. Revised retail trade turnover index (based on the NSSG's new sample for the year 2000).

mated that the relative stability of the consumption pattern was due to the fact that the survey

included a significant number of economic immigrants' households.⁵¹ Moreover, the percentage of households below the poverty threshold has remained relatively stable in the last few years (see Box IV.2).

In addition, private consumption continues to be positively affected by the cumulative increase in household wealth over the last few years. Specifically, according to available evidence, household wealth has been gradually increasing

⁵¹ The results of the latest Household Budget Survey for 2004/2005 were recently published by the NSSG. The survey was conducted in a sample of 6,555 private households throughout Greece and collected detailed information about the value of households' purchases and receipts in kind, as well as their demographic and social features. These data are fully harmonised with those of the household budget surveys conducted in other EU countries and will be used mainly for the revision of the Consumer Price Index compiled by the NSSG.

BOX IV.2

Latest data/indicators on inequality and risk of poverty in Greece

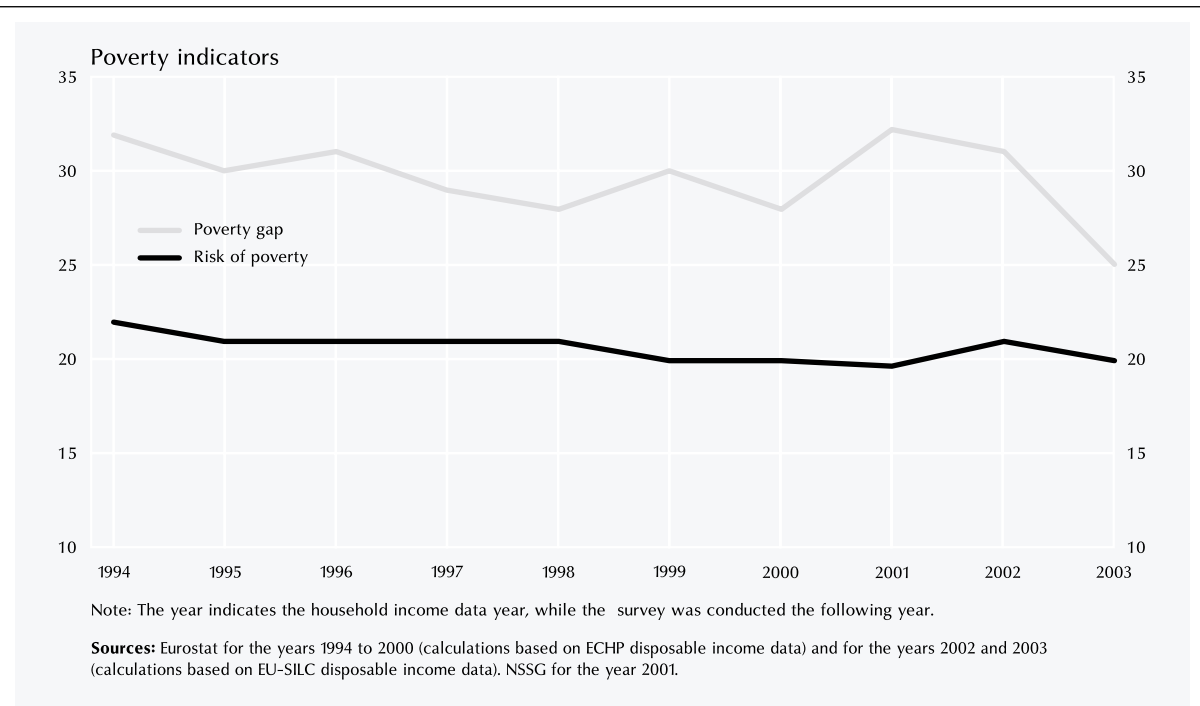
In the last decade, considerable efforts have been made both at EU level and in Greece for the collection and utilisation of the primary statistical data required to analyse inequality and poverty. In the EU, until very recently, the main source of such information was the European Community Household Panel (ECHP), a sampling survey supervised by Eurostat that covered all EU countries for the years 1994-2001.¹ For various reasons,² since 2003 Eurostat has introduced a new survey in place of the ECHP, the European Union – Statistics on Income and Living Conditions (EU-SILC) of households.³ The results of its waves regarding Greece for 2003 and 2004 (covering income statistics for 2002 and 2003, respectively) were recently published by the NSSG. These two surveys include data on each household member's *monetary* income (irrespective of its source), employment status and work conditions, type of residence, level of education and professional training, health status, in addition to other social indicators that pertain to household living conditions, access to social services, social cohesion, etc.

It should be noted, however, that, as far as Greece is concerned, the *most reliable* source of information available for the study of inequality and poverty is →

¹ The ECHP was a recurrent sampling survey, collecting information at different points in time (waves) from the same households (approximately 60,000) and individuals of the original sample, regardless of whether such individuals moved to different households in the meantime. In our country, the ECHP was conducted by the NSSG, and, in addition to the 1994-2001 period, included the year 2002 (covering income data for up to 2001 inclusive). The results of the 2002 wave for Greece have been published only by the NSSG (see NSSG Press Release dated 16 July 2003).

² Mainly because households withdrawing from the survey were not being replaced, and so the sample gradually shrank.

³ The EU-SILC of households is conducted according to the methodological framework and the harmonised definitions of Council Regulation 1177/2003/EC. It surveys a sample of all private households in a cross-sectional and longitudinal way, providing for the replacement of a quarter of these households each year. The similarity in the design and questionnaire compilation of both the ECHP and the EU-SILC, achieved thanks to the instructions and under the supervision of Eurostat, seems to have ensured a high degree of comparability between country-specific data across the EU.



→ the Household Budget Survey (HBS) conducted every five years or so by the NSSG (in order to revise the Consumer Price Index). These surveys collect data on the (monetary and imputed) consumption, income, housing amenities, durable consumer goods and socio-economic characteristics of households and their members. The initial results of the latest HBS, a sampling survey of all of the country's households conducted between February 2004 and January 2005,⁴ were recently made available. The main reason for which the HBSs are the most reliable source of information regarding Greece is that they collect data on the households' imputed expenditure as well (mainly imputed rent and own consumption of agricultural products). In contrast to what is the case in other countries, in Greece owner-occupied houses and own consumption are more common among the poorer households than among the richer. Therefore, leaving out these components of total actually received income (or of total consumption) would lead to an overestimation of the overall level of inequality and poverty in Greece, as well as to an incorrect analysis of the structure of such phenomena, thus encumbering the formulation of an effective policy against them. It is calculated that when these data are not taken into account the poverty rate is overestimated by about three percentage points.

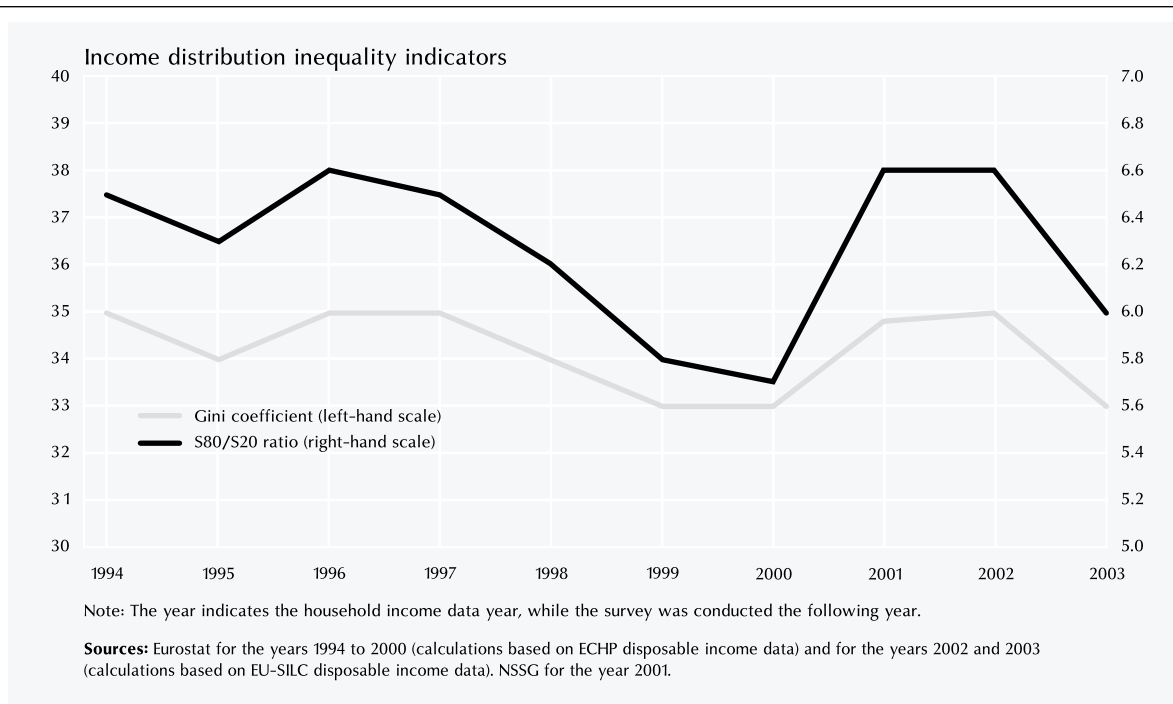
The first chart in this box presents the estimates regarding the risk of poverty in our country based on the aforementioned statistical information. It shows that during the last decade "poverty risk" in Greece has remained fairly unchanged, ranging between 20% and 22%. In 2003, it stood at 20%. When income or consumption estimates take into account owner-occupied houses, self-produced goods and goods and services provided to households by third parties for free, "poverty risk" falls to 17%.

In other words, almost a fifth of the country's population (or approximately two million people) find themselves below the risk-of-poverty threshold, i.e. their available income is less than 60% of the median⁵ of the income distribution of the total population (Eurostat definition).⁶ A similar conclusion is drawn on the basis of the "relative poverty gap" (or "relative poverty depth") indicator, which shows the income status →

⁴ Previously, such sampling surveys covering all Greek households were conducted in 1974, 1981/82, 1987/88, 1993/94 and 1998/99.

⁵ The median of the income distribution is the income level that is higher than the income of half of the households and lower than that of the other half.

⁶ On the basis of the 2004 wave (covering 2003 income data), the risk-of-poverty threshold was an annual income of €5,300 for single-member households and €11,130 for households with two adults and two dependent children.



→ of individuals below the risk-of-poverty threshold. Specifically, it measures the gap between the median of the income of the poor and the risk-of-poverty threshold, as a percentage of the risk-of-poverty threshold. For the income data collected in the 1994-2002 period, this indicator ranged between 28% and 32%, without any evidence of a clear trend over time. However, in 2003 it recorded a considerable drop to 24.5% (from 30.5% in 2002).⁷ In simpler terms, the median of the income of the poor was 24.5% lower than (or equal to 75.5% of) the risk-of-poverty threshold – which in turn is equal to 60% of the median of total income. Therefore, in 2003, the median of the income of the poor was equal to 45% of the median of total household income.

It is of particular importance that 28% of the population aged 65 or over, or else 26% of all pensioners, are below the risk-of-poverty threshold. Moreover, the composition of the poor population is the following: only 32% of the poor are employed, 8% are unemployed seeking work, 27% are pensioners, while the remaining 33% are inactive (i.e. neither employed, nor pensioners, nor unemployed seeking work) and three out of four of the inactive ones are women.

The magnitude of inequality is usually estimated using statistical inequality indicators, such as the Gini coefficient,

the Atkinson index, the S80/S20 ratio, etc. These indicators encapsulate the differences observed in individual income or expenditure among the members of a population. The second chart in this box presents two widely used indicators of income distribution inequality for the 1994-2003 period. According to these data, the inequality in the distribution of *monetary* disposable income among households decreased in Greece – as well as in most EU countries – between 1994 and 2000. Especially in Greece, the S80/S20 ratio (i.e. the income share held by the richer 20% of the population to the corresponding share held by the poorer 20%) decreased from 6.5 in 1994 to 5.7 in 2000. Over the same period, a similar decline from 35 to 33 was seen in the Gini coefficient. However, on the basis of the initial results of the EU-SILC, the above indicators stood higher in 2002 (S80/S20: 6.6 and Gini: 35), to decline again in 2003, the last year for which data are available (S80/S20: 6.0 and Gini: 33). It is also worth noting that, based on data regarding consumption for purchases recorded during the last two HBSs (for the years 1999 and 2004), the levels of overall inequality and poverty remain fairly unchanged.

⁷ Based on the data obtained from the surveys conducted in 2003 and in 2004. See NSSG Press Releases dated 24 June 2005 and 26 January 2006.

since mid-2004 and it is estimated that the change in its market value has made a slightly positive contribution to the growth of consumption in 2005.

Houses are the main asset of Greek households and their prices rose substantially in 2005, both in the region of Athens and the other urban areas (see Table IV.7). However, the direct effect of the increase in house value on consumption is rather limited, considering that in Greece houses are characterised by a low degree of liquidity as assets, while the possession of a house directly provides utility to the owner. Moreover, since the rise in prices of dwellings in 2005 was mainly conjunctural, to the extent it was associated with pre-announced changes in the tax regime (VAT on newly-built houses, increases in “objective values” of real estate), it appears to have had a limited effect on consumption.⁵² As regards prices of shares listed on the Athens Exchange (ATHEX), the composite ATHEX index recorded an average annual rise of 29.4% (27.3% in 2004), while its level at end-2005 was higher than at end-2004. However, since this rise involved certain large capitalisation stocks held by major institutional investors, mainly foreign, it is estimated that it had only a limited effect on domestic consumption.

Greek government bond yields, having decreased from mid-2004 to end-September 2005, when they stood at historically low levels, recorded a significant recovery in October and November 2005, especially in short and medium maturities, while they fell slightly in December. It is estimated that the value of bonds held by the public through mutual fund shares/units rose marginally.

According to NSSG quarterly national accounts flash estimates, government consumption fell to 3.0%, from 3.9% in 2004.

Owing to the favourable macroeconomic environment in the last few years, as well as the projects associated with the preparation for the Olympic Games, gross fixed capital formation remained at particularly high levels for a long period of time, thereby boosting the economy’s production potential. However, it started decreasing in 2004 and, according to quarterly national accounts flash estimates by the NSSG, total fixed capital formation fell by 1.2% in 2005, compared with a 5.7% rise in 2004. These developments were expected, following the marked investment activity recorded in the last few years. It is estimated, however, that the halt in the growth of total investment in 2005 is a temporary phenomenon, to the extent that it is due to the decrease in public investment (owing both to the completion of projects associated with the Olympic Games and to fiscal consolidation). According to Bank of Greece data, Public Investment Programme disbursements, at current prices, dropped by 21.0% in 2005, compared with an 11.7% increase in 2004. Fiscal data draw a similar picture (see Section 5 of this chapter).

Private investment did not bridge the gap created in 2005 by the drastic cuts in the public investment programme. The abovementioned worsening of the Economic Sentiment Index (i.e. firms’ and consumers’ confidence) from May 2004 through July 2005, which, *inter alia*, reflected the rise in oil prices, contributed to subdued expectations concerning the evolution of demand. However, according to the estimates of the Updated Stability and

⁵² It should be noted that the rise in prices of dwellings also influences consumption expenditure indirectly, to the extent that real estate is used as collateral for loans and, therefore, makes bigger loans possible. Moreover, increased real estate prices is one of the factors causing increases in rents, the share of which in GDP (in the value added of the real estate services sector) is significant. According to CPI data, average rents increased by 4.2% in 2005, compared with 5.3% in 2004 and 5.2% in 2003 (i.e. more than inflation).

Table IV.7
Dwelling price index

Period	Urban areas-total			Athens			Other urban areas		
	Index	Percentage changes		Index	Percentage changes		Index	Percentage changes	
	1997=100	Over previous period	Over corresponding period of previous year	1997=100	Over previous period	Over corresponding period of previous year	1993 Q4=100	Over previous period	Over corresponding period of previous year
1994	76.1	...	...	73.4	9.5	9.5	106.0	...	...
1995	82.6	8.5	8.5	80.1	9.2	9.2	114.3	7.8	7.8
1996	91.2	10.5	10.5	88.9	11.0	11.0	125.7	10.0	10.0
1997	100.0	9.7	9.7	100.0	12.5	12.5	134.7	7.1	7.1
1998	114.4	14.4	14.4	115.5	15.5	15.5	152.6	13.3	13.3
1999	124.5	8.9	8.9	129.6	12.2	12.2	161.5	5.8	5.8
2000	137.6	10.5	10.5	149.1	15.1	15.1	171.2	6.0	6.0
2001	157.7	14.6	14.6	175.4	17.6	17.6	190.6	11.3	11.3
2002	178.2	13.0	13.0	203.8	16.2	16.2	208.8	9.5	9.5
2003	188.4	5.7	5.7	211.9	4.0	4.0	225.2	7.9	7.9
2004	193.3	2.6	2.6	212.4	0.3	0.3	237.3	5.4	5.4
2005	...	...	...	...	...	...	265.4	11.8	11.8
2002 I	171.5	4.4	13.9	193.6	5.8	16.8	203.9	3.0	10.7
2002 II	178.9	4.3	14.4	208.0	7.4	19.4	205.3	0.7	8.8
2002 III	179.4	0.3	12.4	205.4	-1.3	14.9	209.9	2.3	9.7
2002 IV	183.1	2.0	11.5	208.2	1.4	13.8	215.9	2.8	9.0
2003 I	187.2	2.3	9.2	214.6	3.1	10.8	219.0	1.4	7.4
2003 II	186.9	-0.2	4.5	210.6	-1.8	1.3	223.0	1.8	8.6
2003 III	188.6	0.9	5.1	210.6	0.0	2.6	227.1	1.9	8.2
2003 IV	190.8	1.2	4.2	211.5	0.4	1.6	231.7	2.0	7.3
2004 I	190.7	0.0	1.8	209.7	-0.9	-2.3	233.8	0.9	6.8
2004 II	191.1	0.2	2.2	209.4	-0.2	-0.6	235.3	0.6	5.5
2004 III	193.4	1.2	2.6	211.1	0.8	0.2	239.1	1.6	5.3
2004 IV	198.1	2.4	3.8	219.4	3.9	3.7	241.1	0.8	4.0
2005 I	204.7	3.3	7.3	223.7	2.0	6.6	252.8	4.9	8.1
2005 II	210.9	3.0	10.4	228.9	2.3	9.3	262.4	3.8	11.5
2005 III	...	...	...	...	...	...	269.0	2.5	12.5
2005 IV	...	...	...	...	...	...	277.5	3.2	15.1
2004 Jan.	...	...	...	212.7	0.0	0.2	...	...	...
2004 Feb.	...	...	...	207.1	-2.6	-2.4	...	...	...
2004 March	...	...	...	209.5	1.1	-4.5	...	...	...
2004 Apr.	...	...	...	208.0	-0.7	-2.6	...	...	...
2004 May	...	...	...	211.5	1.7	0.3	...	...	...
2004 June	...	...	...	208.5	-1.4	0.4	...	...	...
2004 July	...	...	...	208.8	0.1	0.1	...	...	...
2004 Aug.	...	...	...	212.4	1.7	0.3	...	...	...
2004 Sept.	...	...	...	212.1	-0.1	0.3	...	...	...
2004 Oct.	...	...	...	217.9	2.7	3.4	...	...	...
2004 Nov.	...	...	...	219.1	0.5	3.7	...	...	...
2004 Dec.	...	...	...	221.2	1.0	4.0	...	...	...
2005 Jan.	...	...	...	223.6	1.1	5.1	...	...	...
2005 Feb.	...	...	...	223.5	-0.1	7.9	...	...	...
2005 March	...	...	...	224.0	0.2	6.9	...	...	...
2005 Apr.	...	...	...	226.4	1.1	8.8	...	...	...
2005 May	...	...	...	229.1	1.2	8.3	...	...	...
2005 June	...	...	...	231.3	1.0	10.9	...	...	...

Sources: For the other urban areas: Bank of Greece (quarterly data). For Athens: calculations based on data from "Danos and Associates" (1993-97) and "Property Ltd" (monthly data for 1997-05). For the total of urban areas: weighted index based on the housing stock in Athens and other urban areas.

Table IV.8

Indicators of investment demand (2004-2006)

(Annual percentage changes)¹

	2004	2005	2006 (available period)
Capital goods output	-0.5	-4.2	
Investment expenditure (at current prices) of private industrial firms ²	-20.9 ³	-18.2 ⁴	10.7 ⁴
Capacity utilisation rate in the capital goods industry	(78.6)	(71.7)	67.3 (Jan.)
Outstanding amount of loans to non-financial corporations with a maturity of over one year ⁵	18.9 (Dec.)	18.0 (Dec.)	
Disbursements out of the Public Investment Programme	11.7	-21.0	-68.3 (Jan.)
Volume of private construction activity (on the basis of permits issued)	-3.4	12.4 (Jan.-Nov.)	
Cement production	-2.3	2.4	
Construction business expectations indicator	-28.9	-22.9	26.8 (Jan.)
Outstanding balance of total bank credit to housing ⁶	27.2 (Dec.)	33.4 (Dec.)	

1 Excluding the capacity utilisation rate.

2 Estimates of firms participating in the IOBE investment survey.

3 Estimate of the March-April 2005 survey.

4 Estimate or forecast of the October-November 2005 survey.

5 Adjusted for the amount of interest write-offs.

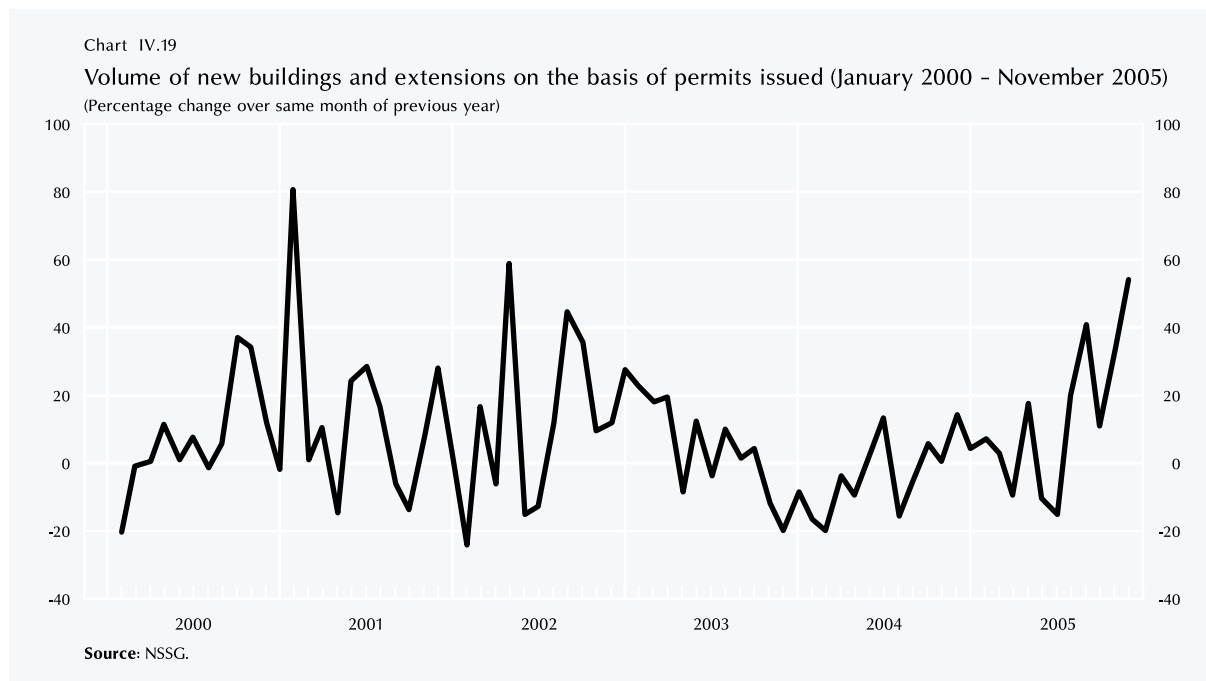
6 Including the outstanding balance of securitised housing loans.

Sources: NSSG (capital goods output, volume of private construction activity, cement production), IOBE (investment expenditure, capacity utilisation rate, business expectations indicator), Bank of Greece (loans to non-financial corporations, disbursements out of the public investment budget, housing loans).

Growth Programme of December 2005, the growth rate of business investment (including public enterprises' investment) remained virtually unchanged (2005: 7.0%, 2004: 6.8%). It should be noted, however, that, according to provisional estimates included in the Introductory Report on the 2006 Budget, investment by public enterprises at current prices declined by 21.4% in 2005. Moreover, according to the latest IOBE investment survey conducted in the second half of 2005, *private industrial* enterprises (which account for part only of the business sector) estimate that their investment expenditure at current prices fell by 18.2% in 2005 (see Table IV.8). In addition, account should be taken of the (so far) limited phenomenon of a number of Greek companies relocating to neighbouring coun-

tries characterised by lower labour costs and more favourable tax regimes. Nevertheless, it is estimated that business investment increased in other sectors and that there are factors supporting the private sector's investment activity. These include the new development (investment) law,⁵³ the framework-law 3389/2005 on public-private partnerships, as well as the effort to restrict time-consuming bureau-

⁵³ Up to 3 February 2006, over 1,256 applications had been submitted for inclusion under the investment law (3299/2004), with a total value of investment projects equalling €2.5 billion. Of these, 601 investment plans (with a value of €959 million) have already been approved; these are expected to lead directly to the creation of 3,376 new jobs, as well as many more indirectly (Speech by the Minister of Economy and Finance, 6 February 2006). To understand the significance of these figures, it should be noted that – according to NSSG national accounts estimates – total business investment (at current prices) reached €27.5 billion in 2004.



cratic procedures. In any event, taking up new investment initiatives requires, in principle, a favourable outlook as well as support to entrepreneurship. The improvement in the outlook is evidenced by the recovery of the Economic Sentiment Indicator since August 2005. The outlook is also good in manufacturing, as shown by the latest outturn of the IOBE industrial confidence indicator and the PMI (until December), on the one hand, and by the recovery of the capacity utilisation rate in the second half of 2005, on the other (although this rate remains below the last few years' averages).

Residential investment recorded a slight decrease.⁵⁴ However, the volume of construction activity on the basis of permits issued, which is the main *leading* indicator of private construction activity, having recorded a significant fall (on an annual basis) until the end of June 2005, subsequently made an impressive recovery, owing to the pre-announcement of changes in the tax regime on dwellings. As a result, it grew at an average annual rate of 12.4% in the eleven-month period from January through November 2005 (see Chart IV.19). The annual

growth rate of the outstanding balance of housing loans remained high in the course of 2005 (33.4% in December⁵⁵). It should be noted, however, that housing loans are also used for the purchase of houses that are not new, as well as for repairs.

The real external balance made a positive contribution (1.1 percentage point) to the growth of GDP in 2005 and, as mentioned above, partially offset the decrease in the positive contribution of domestic demand.

The growth rates of world trade in goods and services and of global demand recorded a limited decline in 2005 compared with 2004, but remained high.⁵⁶ However, the growth rate of

⁵⁴ According to the updated Stability and Growth Programme of December 2005, residential investment fell by 1.5% in 2005, following a drop of 0.6% in 2004.

⁵⁵ Adjusted to include securitised loans. Also see Chapter III.2.

⁵⁶ According to IMF estimates (*World Economic Outlook*, September 2005), the volume of world trade in goods and services increased by 7% in 2005, compared with 10.3% in 2004. The relatively more recent (November 2005) estimates by the OECD and the European Commission are in a similar vein.

Greek exports of goods, although it recovered in 2005 (to 4.7%⁵⁷ on a national accounts basis, compared with a 2.5% drop in 2004), is lower than that of external demand for Greek exports, reflecting cumulative losses in competitiveness over the last few years (see Box IV.3), as manifested by the fall in market shares of Greek products. Moreover, the growth rate of exports of services fell in 2005 (to 5.2%, from 21.8% in 2004). Specifically, transport receipts decreased drastically, mainly owing to the sharp drop in shipping receipts. By contrast, the fact that the growth rate of travel receipts remained relatively satisfactory is associated with the positive publicity Greece enjoyed during the 2004 Olympic Games as a tourist destination.

Overall, the volume of imports of *goods and services* decreased by 1.4% in 2005 (according to the NSSG quarterly national accounts flash estimates), after recording a very substantial increase in 2004 (9.3%).⁵⁸ The stagnation (or decrease, according to certain data) in the volume of goods imports is partly due to the conjunctural (owing to the Olympic Games) large increase in imports of goods in 2004 (the large increase in imports of passenger cars in 2004 has already been mentioned). To some extent, it was also due to the slowdown in the growth rate of total domestic demand.

3.2 Prospects for 2006

As regards prospects for economic activity in 2006, the GDP growth rate is expected to stand around 3.5%, i.e. at a level slightly lower than in 2005.

The Bank of Greece estimates that the factors that contributed to the significant resilience and flexibility of the Greek economy in 2005, which returned smoothly to a sustainable growth path after the completion of the Olympic Games, will

continue to influence and support the economy's course throughout 2006.

Specifically, the international environment seems more favourable in 2006 than in 2005, as world GDP is expected to rise as much as in 2005, while the growth rates of world trade volume and of external demand for Greek goods and services are expected to accelerate slightly (also see Chapter II.1). Moreover, the expected evolution of income and employment and the continuing increase in consumer loans are estimated to support private consumption, which is expected to be once again the main force driving demand in 2006. Monetary policy of course moved towards a restrictive stance in late 2005. Still, monetary conditions in Greece remain generally relaxed and the effects of the latest interest rate increase on output and prices are expected to appear mainly from mid-2006 onwards and be rather marginal.⁵⁹ Financial conditions will remain very favourable, especially for enterprises. Also, the development law and the framework law on public-private partnerships are expected to activate investment initiatives in the course of 2006. However, some reduction in profitability is expected in 2006, especially in the manufacturing sector. Fiscal policy will tighten, but this will have a relatively limited effect on economic activity. According to the Introductory Report on the 2006 Budget, certain non-ordinary revenues of €1,100

⁵⁷ Estimates about the increase in exports of goods and services in 2005 are taken from the Updated Stability and Growth Programme of December 2005, but they may be revised downwards, given that – according to the latest preliminary NSSG estimates – exports of *goods and services* increased by 2.7% only.

⁵⁸ Overall, there is no stable relationship between the rate of change of imports and the rate of change of GDP in the last few years.

⁵⁹ For a quantitative assessment of the effects of interest rate changes on activity and prices and on the monetary policy transmission mechanism in general, see, for the euro area, P. Van Els, A. Locarno, J. Morgan and J. P. Villette (2001), "Monetary Policy Transmission in the Euro Area: What do Aggregate and National Structural Models Tell Us", ECB Working Paper 94, December 2004, and, for Greece, N. Zonzilos, "Monetary policy transmission mechanism: results of the ECB's experiment for Greece", Bank of Greece, *Economic Bulletin*, No. 18, December 2001.

million, which by their nature do not directly affect economic activity,⁶⁰ are expected to help reduce public debt by 0.6% of GDP. Public investment is expected to pick up in 2006, but public investment expenditure will remain lower than the last few years' average, while certain categories of consumption expenditure are kept in check. In addition, according to the Introductory Report on the 2006 Budget, total government expenditure for salaries and pensions is expected to increase at about the same rate as in 2005, while the growth rate of expenditure of a social character will remain at the rather high levels of 2005. In any event, the effect of fiscal policy will also depend on how the implementation of the budget proceeds.

Oil prices are expected to remain at levels clearly exceeding the last few years' average. Certainly, the smaller rise in oil prices forecast for 2006 will contribute to the deceleration of inflation compared with 2005. However, the view prevailing in the market, which is also supported by international organisations (that the "normal" price of crude oil stands at levels exceeding by more than \$20 per barrel the prices that were considered "normal" in previous years⁶¹) is expected to lead in the medium and the long term to factor substitutions in the production process.⁶²

As regards the components of demand, the growth rate of private consumption is expected to fall slightly, but to remain above 3% in 2006. The real disposable income of the private sector will be boosted by the increase in pre-tax incomes, the significant deceleration of inflation (see Section 2 of this chapter) and the stable growth rate of public transfers to less well-off population groups. On the other hand, it is estimated that the average tax burden on households will increase.⁶³ It is therefore expected that the real disposable

income of the private sector will increase by about 4%, compared with 4.6% in 2005, and that the saving rate will rise. Moreover, the increasing market value of household assets is expected to have a rather positive effect. These factors, in conjunction with the prevailing favourable financial conditions, should sustain the rise in private consumption at a rate slightly lower than in 2005, while enabling residential investment to increase by about 4% (compared with an estimated drop of 1.5% in 2005).

Public investment, after drastic cuts in 2005, is expected to pick up in 2006, growing by roughly 6% at constant prices. Business investment, which also includes investment by public enterprises, is expected to rise in 2006 at a rate of 5-7%, almost the same as in 2005. According to the Introductory Report on the 2006 Budget, public enterprises' investment at current prices is forecast to increase by 26.4%. As regards private business investment, the aforesaid IOBE investment survey (conducted in the second half of 2005) shows that private *industrial enterprises* (which account for part only of the business sector) forecast a 10.7% increase in their investment expen-

⁶⁰ Dividend yields, concessions of government rights and revenue settlements, as stated in the Updated Stability and Growth Programme of December 2005.

⁶¹ What is considered as a more permanent rise in oil prices is due, to some extent, to short-term deficiencies in supply (refineries) and the distribution system, but should mainly be attributed to the predicted stable growth of the global economy and the accelerated growth rate of world trade, in conjunction with the subdued (for a long period of time) investment activity in new deposits. Specifically, while nominal Brent oil prices in the second half of the 1990s were no higher than \$20 per barrel on average, they ranged between \$25 and \$28 per barrel in the early 2000s and shot to \$38 in 2004 and close to \$60 in 2005.

⁶² It is difficult to estimate the effects of these substitutions on investment and employment at the current conjuncture, but the extent of the change in oil prices, in conjunction with the high oil-dependency of the Greek economy, may lead to certain short-term reductions in production, as well as to significant structural changes in supply conditions in the medium term.

⁶³ According to the 2006 Budget, revenues from natural persons' income tax will increase more than the nominal disposable income of households (see Section 5 of this chapter).

diture at current prices for 2006.⁶⁴ In addition, the response of enterprises to the provisions of the development (investment) law is expected to become stronger. At the same time, investment behaviour is positively affected by the sound financial position of most firms, the satisfactory credit conditions prevailing in the market, the extremely low long-term real interest rates and, mainly, the favourable outlook for the domestic and the global economy. Moreover, the continuous effort to improve the business sentiment and entrepreneurship, the institutional framework for public-private partnerships and the better utilisation of EU funds may exert a significant favourable influence, the extent of which cannot be assessed *a priori*.

According to Bank of Greece estimates, the change in the real external balance is expected to make, once again (as before 2005), a further negative, though limited, contribution to GDP growth in 2006. The growth in imports of goods and services, which will, *inter alia*, reflect the effects of rising domestic demand, is expected to come close to 5% (following the decrease recorded in 2005); this is the main reason for the negative contribution of the external sector to GDP growth. The growth rate of exports of goods and services, according to Bank of Greece estimates, is expected to come to 5.5%.

The growth rate of exports of goods will rise owing to the expected increase in external demand.⁶⁵ However, a decrease in the shares in global markets is expected in 2006 as well, since the growth rate of exports of goods will be lower than that of external demand, reflecting losses in competitiveness. The growth rate of exports of services is expected to fall slightly, mainly owing to the projected further deceleration in the growth rate of transport receipts. Following the efforts to promote the Greek tourist product in global mar-

kets, travel receipts are expected to continue their upward course in 2006, although they will not offset the slowdown in the growth rate of exports of services in other categories.⁶⁶

4. Employment: developments in 2005 and prospects for 2006

It was to be expected that the substantial growth of GDP in 2005 would be combined with an increase in employment. On the basis of currently available data, it is estimated that the annual growth rate of total employment in 2005 was in the order of 1.0-1.5% (see Chart IV.20). This rise mainly stemmed from increased employment of salaried employees,⁶⁷ chiefly observed in branches associated with consumption (e.g. trade, hotels and restaurants etc.) and in the region of Central Greece, in particular Attica.

According to available indications, the annual growth rate of total employment in 2005 is estimated to have been lower than in 2004.⁶⁸ This is also supported by available Manpower Employment Organisation (OAED) data on employment flows in the private sector. During 2005, the number of jobs fell by 6,664, compared with an increase of 24,119 during 2004. This develop-

⁶⁴ It should be noted, however, that the initial optimistic forecasts of industrial enterprises are usually revised downwards in subsequent surveys.

⁶⁵ The rise in external demand is due to the increased growth rate of world trade and the expected increase in imports by CIS and Balkan countries.

⁶⁶ The improvement in competitiveness of tourism services is significantly affected by the upgrading of hotels, which is included in the "Competitiveness" operational programme of the Ministry of Tourism and the Hellenic Tourism Organisation (EOT).

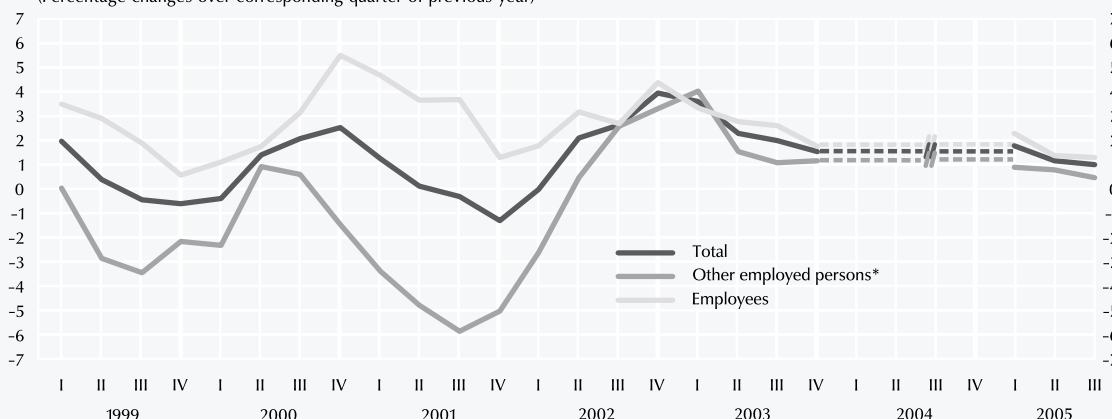
⁶⁷ According to data from the Labour Force Survey (LFS), employment of salaried employees rose by 1.7% in the first nine months of 2005 against the same period in 2004.

⁶⁸ The Labour Force Survey (LFS) data cannot be used to estimate the annual rate of change in 2004, as changes in the sampling methodology (since the first quarter of 2004) make comparisons between 2003 and 2004 unreliable. See also Eurostat, *Statistics in focus: Population and Social Conditions*, 3/2005.

Chart IV.20

Employment (1999 - 2005)

(Percentage changes over corresponding quarter of previous year)



Other employed persons= Self-employed with staff (employers) + self-employed without staff + assistants in family businesses.

Source: NSSG, Labour Force Surveys. New revised data for 1998-2003, published in January 2005. No changes are shown for 2004, since data are not fully comparable, due to a change in the survey sample.

ment mainly reflects a decrease in the number of recruitments.⁶⁹

As regards developments by branch of economic activity, during the first nine months of 2005 the number of employees in the *primary sector* is estimated to have remained almost unchanged against the same period in 2004.

With respect to *retail trade* (which covers almost 12% of total employment), the special NSSG survey indicated a rise (2.6%) in the number of employees in the first nine months of 2005, compared with the same period in 2004.

In *manufacturing*, despite the decline in the manufacturing production index, it seems that the average number of employees and the average number of weekly working hours remained unchanged in 2005, according to data from the Labour Force Survey (LFS) of the NSSG.⁷⁰ The employment sub-index of the Purchasing Managers' Index (PMI) is also consistent with these results. The decline in production seems to have initially affected the cap-

ital equipment utilisation rate, which fell compared with 2004.

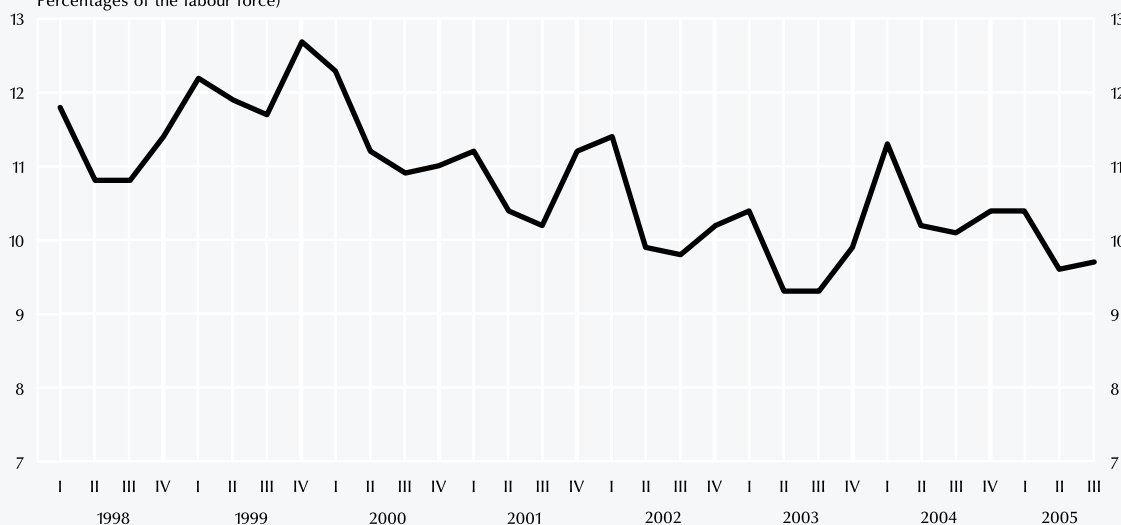
LFS data on *construction* show a rise in the number of employees in the first nine months of 2005, compared with the corresponding period in 2004 (+4.0%). The rise in the number of employees in Central Macedonia and Western Greece, as well as in Attica, contributed to this development. It is estimated that this change reflects developments in private building activity (e.g. construction of offices and dwellings) rather than in infrastructure activity, which declined after the end of the Olympic Games.

After the implementation of voluntary early retirement programmes in certain major banks in 2004,

⁶⁹ OIAD data should be treated with caution, since they do not provide a comprehensive picture of employment, as they neither cover the self-employed nor fully record voluntary quits.

⁷⁰ The average number of employees in manufacturing during the first nine months of 2005 was 563.2 thousand, against 563.6 thousand in the corresponding period of 2004. The average working hours per week in manufacturing during the first nine months of 2005 were 41.6, compared with 41.7 in the corresponding period of 2004.

Chart IV.21
Total unemployment rate (1998 - 2005)
Percentages of the labour force)



Source: NSSG, Labour Force Surveys. New revised data for 1998-2004, published in January 2005.

which led to a drop in the number of employees at the end of 2004 compared with the end of 2003, it is estimated that average employment in *banks* during the first nine months of 2005 was higher than at the end of 2004.⁷¹

In *services* (excluding retail trade and banks), an increase in employment was recorded during the first nine months of 2005, compared with the corresponding period in 2004; this was particularly high in branches such as hotels and restaurants (+9.1%).

Employment in *central government*⁷² grew by an average annual 2.5% in the first half of 2005 (1.2% for the whole of 2004). According to available evidence, employment in *public enterprises* decreased.

As regards *unemployment*, LFS data for the first nine months of 2005, as well as OAED data on registered unemployment for the whole year, show a decline in the number of unemployed, compared with the corresponding periods in 2004. According to the LFS definition and data,

the average number of unemployed persons during the January-September period was about 480 thousand, i.e. it fell by around 28 thousand against the corresponding period in 2004. The average unemployment rate fell from 10.5% in the first nine months of 2004 to 9.9% in the corresponding period of 2005 (see Chart IV.21). It should be pointed out that almost 55% of the unemployed have remained so for more than one year (long-term unemployed). Developments in unemployment vary across age groups and geographical areas. Thus, the decline in the total number of jobless people was chiefly due to the drop in the number of unemployed aged 20-24. In this age group, however, it was not employment that increased, but the number of people who are not economically active (probably due to greater participation in education). As regards other age

⁷¹ Average employment in banks during the first nine months of 2005 is certainly lower compared with the same period in 2004, since the quits under the voluntary early retirement programmes were recorded at the end of 2004.

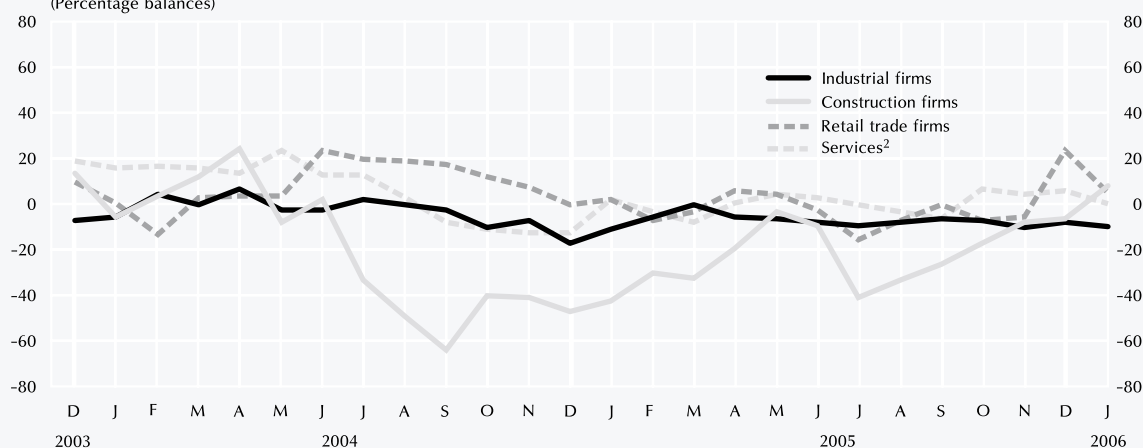
⁷² Comprising personnel of ministries, regional authorities, prefectures, hospitals and security forces.

Table IV.9
Business expectations for employment
(Weighted percentage balances)

	January 2006	Average (Jan. 1998–Jan. 2006)	Maximum (Jan. 1998–Jan. 2006)	Minimum (Jan. 1998–Jan. 2006)
Industry	-10	-2	14 (May 2002)	-17 (Dec. 2004)
Construction	8	20	60 (March 2000)	-64 (Sept. 2004)
Services	0	3	38 (Q1 2000)	-37 (Q2 2001)
Retail trade	5	12	56 (Nov. 1998)	-15 (July 2005)

Source: IOBE business surveys.

Chart IV.22
Business and consumer expectations¹ for employment
(December 2003 – January 2006)
(Percentage balances)



¹ Firms were asked to assess the prospect of an increase in their number of employees over the coming period.

² Excluding banks and retail trade firms.

Source: IOBE, Business Surveys.

groups, an increase in the number of people not economically active was only recorded in the age group over 65. Moreover, the largest decline in the number of unemployed was recorded in the Ionian Islands (-20.9%), in Central Greece and Euboea (-13.5%) and in Western Greece (-13.1%), while in other regions the number of unemployed rose. The largest increase was recorded in Western Macedonia (+11.5%), North Aegean (+9.6%) and Southern Aegean (+6.6%).

Apart from the rise in the number of people not economically active aged 20-24, the decline in the

number of unemployed was possibly supported by the implementation of "active employment policies" (such as the personalised approach and personal action plans for the unemployed who register with OAED, as well as the training programmes for the unemployed and the programmes which subsidise companies for hiring unemployed persons). It should be noted that, in December 2005, more than 60% of the unemployed registered with OAED and wishing to work were under the personalised supervision of employment advisors, compared with around 30% at the beginning of 2005.

As regards the short-term prospects for employment, the latest available data from the IOBE surveys (January 2006, see Table IV.9 and Chart IV.22) show that, while industrial firms are not optimistic, the percentage of retail trade and construction firms expecting a rise in employment is larger than that of firms forecasting a drop in employment. In addition, firms in services (excluding retail trade and banks) seem to expect that employment will remain unchanged. The outlook for employment is associated with the competitiveness prospects of the Greek economy, which will be affected by, *inter alia*, the outcome of the wage bargaining round.

5. Fiscal developments

5.1 Fiscal developments in 2005 based on administrative data

According to provisional data from the General Accounting Office of the State, the state budget deficit narrowed in 2005 to €10,600 million, from €12,861 million in 2004. As a percentage of GDP, the deficit fell to 5.9% in 2005, from 7.7% in 2004. This positive development is also reflected in the primary budget deficit, which fell to 0.5% of GDP in 2005, from 2.0% in 2004 (see Table IV.10).

This reduction in the budget deficit mainly resulted from a curtailment of investment expenditure by €2,004 million or 21.0% compared with 2004. As a result, the public investment budget deficit shrank to 2.6% of GDP in 2005, from 4.0% in 2004. There was also a limited reduction in the ordinary budget deficit, which narrowed from 3.7% of GDP in 2004 to 3.3% in 2005.

The main feature of fiscal developments in 2005 is the shortfall in ordinary budget revenue,⁷³ which rose by about 6.4% against a forecast increase of 10.1%. According to provisional data, this short-

fall in revenue stemmed from indirect taxation, which, despite the positive impact of the measures introduced on 29 March 2005,⁷⁴ increased by 4.1%, compared with a budgeted increase of 11.3%.⁷⁵ By contrast, revenue from direct taxation rose by 10.3%, slightly exceeding the 2005 budget forecast (10.1%).

A significant shortfall in revenue was observed chiefly in the following categories:

- (a) Receipts from VAT (on both domestic and imported products) showed a slight rise of 2.8% compared with 2004. The fact that this revenue has been favourably affected by the increase in the corresponding tax rates⁷⁶ in March 2005, higher international oil prices⁷⁷ and a rise of 6.3%⁷⁸ in the value of retail sales implies that the limited increase in VAT receipts is probably due to increased tax evasion.
- (b) There was a small increase of 0.7% in receipts from the special consumption tax on liquid fuels compared with the corresponding receipts in 2004. This development reflects the relatively small rise in consumption⁷⁹ of liquid fuels (1.6%).⁸⁰ Most importantly, how-

⁷³ Before deduction of tax refunds.

⁷⁴ The tax measures introduced on 29 March were as follows: (a) the standard VAT rate was raised from 18% to 19%, the reduced rate from 8% to 9% and the special reduced rate from 4% to 4.5%, (b) the special consumption tax on alcoholic beverages (other than wine and beer) was increased by 20% and (c) a "minimum excise duty" was imposed on cigarettes whose retail price was lower than the price category most in demand for 2004.

⁷⁵ These percentages have been calculated on the basis of the final data concerning revenue in 2004.

⁷⁶ See footnote 74.

⁷⁷ In contrast with other VAT revenue, receipts from the VAT imposed on fuel rose by 27.2% in the eleven months January-November, for which detailed data are available.

⁷⁸ In the eleven-month period January-November 2005.

⁷⁹ It should be recalled that the special consumption taxes on fuels are set per unit of volume and not on the basis of their value. As a result, the associated receipts are not affected by the increase in fuel prices.

⁸⁰ Data concerning consumption refer to the eleven-month period January-November 2005.

Table IV.10
Fiscal deficits¹
(Million euro)

	Annual data						Percentage changes				
	2002	2003	2004	Budget for 2005	2005*	Budget for 2006	2003/02	2004/03	Budget for 2005/04	2005*/04	Budget for 2006/05*
A. Central government (on an administrative basis)											
I. Revenue²	41,051	41,704	44,949	49,710	47,523	52,240⁴	1.6	7.8	10.6	5.7	9.9
1. Ordinary budget	39,048	39,881	42,055	46,310	44,758	48,750 ⁴	2.1	5.5	10.1	6.4	8.9
2. Public investment budget	2,003	1,823	2,894	3,400	2,765	3,490	-9.0	58.7	17.5	-4.5	26.2
— Own revenue	14	77	83	100	...	90	450.0	7.8	20.5	-	-
— Revenue from the EU	1,989	1,746	2,811	3,300	...	3,400	-12.2	61.0	17.4	-	-
II. Expenditure²	46,412	51,551	57,810	58,227	58,123	60,790	11.1	12.1	0.7	0.5	4.6
1. Ordinary budget	39,398	43,116	48,288	50,177	50,605	52,390	9.4	12.0	3.9	4.8	3.5
— Interest payments	9,134	9,416	9,464	9,800	9,774	9,600	3.1	0.5	3.6	3.3	-1.8
— Ordinary budget primary expenditure	30,264	33,700	38,824	40,377	40,831	42,790	11.4	15.2	4.0	5.2	4.8
2. Public investment budget	7,014	8,435	9,522	8,050	7,518	8,400	20.3	12.9	-15.5	-21.0	11.7
III. Deficit % of GDP	-5,361	-9,847	-12,861³	-8,517	-10,600	-8,550⁴	-	-	-	-	-
1. Ordinary budget	-3.8	-6.4	-7.7	-4.8	-5.9	-4.4	-	-	-	-	-
2. Public investment budget	-350	-3,235	-6,233	-3,867	-5,847	-3,640	-	-	-	-	-
IV. Primary deficit (-)/surplus (+) % of GDP	3,773	-431	-3,397	1,283	-826	1,050	-	-	-	-	-
1. Ordinary budget	2.7	-0.3	-2.0	0.7	-0.5	0.5	-	-	-	-	-
B. General government (on a national accounts basis)											
V. Deficit (% of GDP)	-4.9	-5.7	-6.6	-2.8	-4.3	-2.6	-	-	-	-	-

1 It should be noted that by the "fiscal audit" the general government deficit on a national accounts basis was revised, whereas the central government deficit on an administrative basis was not revised.

2 For comparability purposes, tax refunds are included in expenditure and have not been deducted from revenue.

3 Including the subsidisation of OTE's personnel insurance fund (TAP-OTE) with €220 million.

4 Including extraordinary revenue of €1,100 million from dividends, the sale of concession rights and the clearance of revenue from fines and licences.

* Provisional data.

Sources: Ministry of Economy and Finance/General Accounting Office and NSSG.

ever, it also implies that heating oil (1.0% increase in consumption) was substituted for diesel (1.0% decrease in consumption) in order to evade tax. It should be recalled that the special consumption tax levied on heating oil (€0.021 per litre) is approximately eleven times lower than the corresponding tax on diesel (€0.245 per litre).

- (c) Revenue from tobacco tax also rose by a mere 0.7%, despite the increase in the corresponding tax rates in March 2005. This outturn is probably due to a 2.0% decline in cigarette consumption.⁸¹
- (d) Revenue from car registration fees contracted by 2.2% due to a 3.0% drop in sales of new passenger cars in 2005.
- (e) Finally, receipts from all other indirect taxes declined, with the exception of revenue from real estate transfer tax, which rose by 48.3% as relevant transactions were expedited in anticipation of an increase in “objective” (i.e. set for tax purposes) prices and the imposition of VAT on newly built real estate from 1 January 2006.

While there was only a limited increase in receipts from indirect taxes, revenue from direct taxation exceeded budget forecasts and rose, as already noted, by 10.3% in 2005. This positive development is chiefly the result of the following factors:

- (a) The high yield from the July 2004 measures concerning the settlement of pending tax cases (for tax returns submitted in the period 1998-2003), the collection of tax arrears and the possibility given to taxpayers to submit overdue tax returns without incurring any fine. Relevant revenue increased by 41.6% compared with 2004.

- (b) The 8.4% increase in receipts from personal income tax withheld at source. This development was partly the result of the provisions of Law 3296/2004 on direct taxation. More specifically, the combined effect of, on the one hand, the new tax schedule, the abolition of the tax deduction for family expenditure and the lowering of the tax discount granted for timely payment of tax, and, on the other hand, the 2005 wage increases, caused the tax burden on wage earners and pensioners with a spouse without income and two children to fall for those on a low income (up to €13,072), while it increased for those with a taxable income in excess of this figure.⁸²
- (c) Finally, the receipts from the one-off taxation of the adjusted value of fixed corporate assets (land and buildings) and the taxation, at a rate of 25%, of the accumulated balance of business provisions for doubtful debts (Article 9 of Law 3296/2004) were further factors behind the increase in revenue from direct taxation.

Ordinary budget expenditure⁸³ in 2005 increased by 4.8% compared with 2004, reaching €50,605 million and exceeding the budget forecast by €428 million. Ordinary budget primary expenditure rose by 5.2% and reached €40,831 million, against a budgeted increase of 4.0%. Interest payments, which had been rising rapidly⁸⁴ up until and including August due to a concentration of payments in the two months April-May 2005

⁸¹ See footnote 80.

⁸² See Bank of Greece, *Annual Report 2004*, April 2005, Appendix to Chapter VIII, pp. 232-234.

⁸³ Including expenditure of €2.6 billion for tax refunds, but excluding grants of approximately €2.6 billion from the ordinary budget to hospitals for the settlement of overdue liabilities to their suppliers. Also excluding payments of about €1.0 billion for the capital increase of the Agricultural Bank of Greece.

⁸⁴ In the eight months January-August 2005 the rate of increase in these expenses was 16.4%. See *Monetary Policy, Interim Report 2005*, p. 109.

(while the corresponding increased payments had been made in September 2004), levelled out, as expected, and their annual growth rate was limited to 3.3%. This development was a result of, *inter alia*, certain interest rate swaps (from a fixed rate to a variable rate) carried out in the second half of 2005 for public debt management purposes.

Regarding the breakdown of primary expenditure, provisional data for 2005 suggest the following:

- (a) The increase in total personnel outlays (including pensions) was contained to 3.5%, compared with an increase of 14.1% in 2004,⁸⁵ owing to a moderation in average wage and pension growth in central government. In particular, central government payroll outlays rose by 3.4% (compared with 13.8% in 2004), while costs for civil servants' pensions increased by 3.6% (compared with 15.4% in 2004).
- b) Outlays for government grants (primarily to social security organisations) rose by 13.4%, (national) subsidies to agriculture by 14.8% and restitution of revenue to third parties (chiefly to local authorities) by 8.1%.
- c) Finally, payments relating to Greece's contribution to the EU budget rose by 9.4%.

By contrast, all other primary expenditure components recorded a decline in 2005 compared with the previous year, as their respective "cash limits", which are set by ministerial decisions, were drastically squeezed.

Turning to the public investment budget, the most significant development in 2005 is the €2,004 million or 21.0% decline in expenditure in relation to the previous year, when the corresponding expenditure had been much larger due to the

Olympic Games. Public investment budget revenue (in effect, receipts from the various EU funds) fell by 4.5%. The evolution of public investment budget expenditure and revenue led, as previously mentioned, to a narrowing of the public investment budget deficit by 1.4 percentage points of GDP and was the major factor⁸⁶ behind the reduction of the state budget deficit.

The Introductory Report on the 2006 Budget also includes estimates concerning the development (on an annual basis) of fiscal aggregates in 2005. According to these estimates, ordinary budget revenue was expected to show a significant shortfall,⁸⁷ which, however, was contained due to an upturn at the end of the year.⁸⁸

The restructuring of the Ministry of Economy and Finance's inspection mechanisms (Special Investigations Service – formerly Body for the Prosecution of Economic Crime – SDOE) and the close surveillance from summer onwards resulted, as previously reported, in the inflow of significant revenue from VAT in the last two months of 2005. This development, together with the especially large increase in receipts from the property transfer tax during approximately the same period, significantly increased tax revenue, which on an annual basis exceeded the estimates contained in

⁸⁵ The provisional data relating to personnel outlays for the twelve-month period are not absolutely comparable in terms of coverage with the estimates for the whole of 2005 contained in the Introductory Report on the 2006 Budget. See also Section 1 of this chapter. It should also be remembered that extraordinary factors were in force in 2004 (back-pays, benefits, etc.), which contributed to the increase in personnel outlays. These factors were absent in 2005.

⁸⁶ 82.9% of the narrowing of the state budget deficit in 2005 is due to the reduction in the public investment budget deficit.

⁸⁷ Action was to be taken to reduce the shortfall in ordinary budget revenue by securitisation of revenue of €1,800 million (Draft Budget 2006, October 2005). The securitisation did not, however, materialise, resulting in an increase in the forecast deficit in 2005.

⁸⁸ According to provisional data on an administrative basis, there was a significant improvement in revenue in November and December 2005.

Table IV.11

Net borrowing requirement of central government on a cash basis^{1,2}

(Million euro)

	Years			
	2002	2003	2004	2005*
Central government	7,102	10,526	15,605	14,424
– State budget	6,674	10,833	15,377	14,793
(Ordinary budget) ⁴	2,128	4,106	8,841	10,033 ⁶
(Public investment budget)	4,546	6,727	6,536	4,760
– OPEKEPE ⁵	428	–307	228	–369
Percentage of GDP	5.0	6.8	9.3	8.0

1 This table includes the borrowing requirement of central government on a cash basis. The borrowing requirements of public entities are calculated by the NSSG on the basis of detailed data collected directly from these entities through a special quarterly survey regarding their financial results (revenue-expenditure) and their financial position (borrowing, investment in securities, deposits etc.), since the banking system's data are inadequate for reliable estimates.

2 As shown by the respective accounts with the Bank of Greece and other credit institutions.

3 Excluding the repayment of government debt to the Social Insurance Institute (IKA) through bond issuance (Law 2972/2001, Article 51). The debt, totalling €3,927.9 million, was repaid in three instalments (2002: €1,467.4 million, 2003: €1,549.5 million and 2004: €911 million).

4 Including movements in public debt management accounts.

5 Payment and Control Agency for Guidance and Guarantee Community Aid. It replaced DIDAGEP (Agricultural Markets Management Service) as from 3 September 2001.

6 Including the subsidisation of hospitals with about €2,586 million and expenditure (of €1,055.2 million) for the capital increase of the Agricultural Bank of Greece. Also including proceeds of €1,090 million from the sale of 16.4% of OPAP (the Greek soccer pools organisation) shares and €826 million from the sale of 10% of OTE (Hellenic Telecommunications Organisation) shares.

* Provisional data.

Source: Bank of Greece.

the Introductory Report on the 2006 Budget by €588 million. It is expected that this high degree of supervision will be maintained in 2006.

Following the abandonment of the revenue securitisation plans, the general government deficit for 2005, on a national accounts basis, is estimated to have risen from 3.6% to 4.3% of GDP.

5.2 Fiscal developments in 2005 based on cash data

The narrowing of the state budget deficit is also reflected in the cash data for 2005, which also showed a fall in the central government net cash deficit compared with 2004. According to the available data, the cash deficit fell in 2005 to €14,424 million or 8.0% of GDP, compared with a deficit of €15,605 million or 9.3% in 2004 (see Table IV.11). This drop was smaller than the fall in the budget deficit, because the cash deficit is

affected by a series of transactions which are not counted in with regard to data on an administrative basis.

Specifically, the 2005 cash deficit was affected upwards by the payment of a sum of €2,586 million for the settlement of public hospital liabilities and by the disbursement of €1,055 million as government participation in the share capital increase of the Agricultural Bank of Greece. By contrast, the proceeds (€1,916 million) from the sale of 16.4% of OPAP (the Greek soccer pools organisation) shares and of approximately 10% of OTE (Hellenic Telecommunications Organisation) shares contributed to the narrowing of the deficit. These extraordinary transactions increased the cash deficit by a net amount of €1,725 million, the deduction of which would limit the 2005 cash deficit by a further one percentage point to 7.1% of GDP. It should be noted that the deduction of extraordinary payments and receipts in 2004 (pri-

atisation proceeds and extraordinary expenses related to the Olympic Games) would limit the 2004 cash deficit by just 0.1% of GDP.

The reduction of the cash deficit is to a large degree attributable to the public investment budget, the deficit of which narrowed from 3.9% of GDP in 2004 to 2.6% in 2005. Specifically, public investment budget expenditure fell significantly, by 21.0% in comparison with 2004, more than offsetting the similarly downward course of public investment budget revenue (-7.4%).

The ordinary budget cash deficit⁸⁹ reached 5.6% of GDP, compared with 5.3% in 2004. However, when the necessary adjustments are made to take account of the extraordinary payments and receipts mentioned previously, the ordinary budget deficit in 2005 is limited to 4.6% of GDP. Given the restrictive incomes policy pursued in 2005 and the intense efforts made to contain spending, the fact that the ordinary budget cash deficit reached 4.6% of GDP, compared with 5.3% in 2004 (which included extraordinary payments of €579 million or 0.3% of GDP associated with the Olympic Games) is an indication of the scale of the difficulties faced in reducing the deficit and achieving fiscal consolidation.

5.3 The budget for 2006

The new budget aims to reduce the general government deficit (on a national accounts basis) below 3% of GDP in order for Greece to meet its EU-related obligations and to bring to an end the Excessive Deficit Procedure, to which the country is at present subject. In the Introductory Report on the Budget it is forecast that the general government deficit in 2006 will fall to 2.6% of GDP, from 4.3% in 2005.

To achieve this target, the new budget provides for a reduction in the central government deficit

(on an administrative basis) from 5.9% of GDP in 2005 to 4.4% of GDP in 2006 (see Table IV.10). This narrowing of the deficit is based chiefly on increased revenue and, to a lesser degree, on the containment of expenditure.

Ordinary budget revenue is expected to rise by 8.9% in 2006 to reach €48,750 million. This increase indicates an income elasticity⁹⁰ of revenue of 1.2, which exceeds the elasticities observed in the past five years. It should be noted that, as the revenue collected in 2005 exceeded by €588 million the amount forecast in the Introductory Report on the 2006 Budget, the rates of change given here are lower in comparison with those in the Introductory Report.

This increased elasticity of revenue may stem from:

- (a) the significant forecast increase in VAT receipts (7.2%)⁹¹ due to the increase in tax rates and the curtailment of tax evasion;⁹²
- (b) the increase in receipts from personal income tax (6.9%),⁹³ as no adjustment was made to the tax scale, tax-exempt amounts or other elements of income tax; and

⁸⁹ It includes, *inter alia*, the change in the central government accounts which are held at the Bank of Greece but are not included in the data on an administrative basis.

⁹⁰ Taxation is subject to changes each year. As it is not possible to ascertain the individual impact of each of these changes on tax revenue, the above index does not refer to the "income elasticity" of tax revenue but to the changes in this revenue in general ("buoyancy") for any given change in GDP.

⁹¹ This increase is greater than that of 2005 (2.8%), but is approximately in line with the increase in GDP at current prices (7.4%) forecast in the Updated Stability and Growth Programme of December 2005.

⁹² The imposition of VAT on newly constructed buildings is not expected to yield revenue within 2006, given that there will be no buildings for sale for which the construction permits will have been granted after 1 January 2006. It is, however, expected that the more intense surveillance will contribute to an increase in VAT revenue (excluding that from real estate).

⁹³ The Updated December 2005 Stability and Growth Programme forecasts an increase of 6.6% in pre-tax income for the private sector, and a 6.0% rise in private sector disposable income.

(c) the growth in revenue from taxation on liquid fuels (15.1%), due to the planned rise of approximately 5%⁹⁴ in tax rates in order to gradually bring them by 2009 to the levels provided for in the relevant EU Directive.

For the first time, the budget provides for extraordinary non-tax revenue of €1,100 million, which partly replaces the revenue from the abandoned securitisation.⁹⁵ Half of this revenue stems from the receipt of extraordinary dividends from the Agricultural Bank, the Deposits and Loans Fund and the Postal Savings Bank, while the rest will derive from the issue or renewal of airport and casino operating licences and from toll receipts, as well as from the settlement of revenue collected by the National Telecommunications and Post Commission.

It should be noted that, following the approval of the new budget, additional measures were announced to further improve budget revenue in 2006. More specifically, on 13 January 2006, it was announced that the budget would be strengthened in 2006 by revenue of €400 million to be derived from the reduction of the Postal Savings Bank's share capital, as had been the case at the end of 2003. In addition, there was a rise in the "net profit coefficients",⁹⁶ which are used to calculate on an off-balance-sheet basis the taxable income of important categories of taxpayers. The new rates apply to income earned in 2005. Finally, tax prepayment by legal entities (sociétés anonymes and limited companies, co-operatives, etc.) against next year's tax obligations was increased. The prepayable sum was raised from 55% to 65% of the current year's tax. For financial institutions, in particular, the amount prepayable was set at 80% of the respective tax obligation, compared with the previous figure of 60%. This reform brings the prepayable percentage close to the upper levels of tax prepayment by legal enti-

ties in most countries of the European Union. The new percentages will apply to profits earned in 2005 and it is expected that they will yield revenue of €450 million.

The new budget reflects the intention of the Ministry of Economy and Finance to continue to keep public expenditure under strict control in 2006, as ordinary budget expenditure, including credits for tax refunds, is restrained, with a forecast rate of increase of 3.5% compared with 2005 (see Table IV.10).

Primary budget expenditure is forecast to rise by 4.8% in 2006. In the individual categories of primary expenditure, significant increases are expected in personnel outlays (6.1%), operating costs (10.4%) and spending on grants (8.4%).⁹⁷ By contrast, appropriations for tax refunds are lower than in 2005.

The budgeted interest payments appear 1.8% lower than in 2005 because old loans with a high interest rate are being replaced by new loans, which bear a lower interest rate, but also on account of the interest rate swaps which were carried out during 2005 for public debt management purposes and have a downward effect on interest

94 The increase in the special consumption tax on liquid fuels will contribute to increased VAT revenue as VAT is imposed on the total price, i.e. the price charged by the refinery plus the special consumption tax.

95 According to the 2005-2008 Updated Stability and Growth Programme, the abandonment of the securitisation of revenue of €2,000 million for the year 2006 led to a corresponding widening of the state budget deficit, which was covered by the incorporation into the budget of extraordinary non-tax revenue of €1,100 million and additional tax revenue of €400 million, as well as by a €600 million reduction in spending on tax refunds.

96 Decision of the Deputy Minister of Economy and Finance 1004/19 January 2006.

97 Expenditure for 2006 includes €144 million for the refunding of contributions to LAFKA (Social Security Organisations Solidarity Account), €70 million to extend pay advancement of Armed Forces personnel to the respective pensioners, €50 million for the benefit granted in September 2005 to the staff of the Security Forces and €60 million to hold municipal elections.

Table IV.12
Decomposition of changes in the general government debt-to-GDP ratio¹
(In percentage points of GDP)

	1990	1991	1992	1993	1994	1995	1996	1997 ³	1998 ³	1999 ³	2000	2001	2002	2003	2004	2005*
General government debt ratio	79.6	82.2	87.8	110.1	107.9	108.7	111.3	114.0	112.4	112.3	114.0	114.4	111.6	108.8	109.3	107.9
Changes in the debt ratio	10.6	2.6	5.6	22.3	-2.2	0.8	2.6	2.7	-1.6	-0.1	1.7	0.3	-2.8	-2.8	0.5	-1.4
– Effect of primary balance	6.5	3.0	2.1	2.2	-2.7	-2.6	-4.6	-4.0	-5.0	-4.9	-4.0	-1.2	-1.3	0.0	0.9	-0.9
– Effect of GDP changes and interest rate changes	-4.0	-7.8	-1.7	-0.4	-1.1	0.3	1.5	-0.8	-0.3	1.2	-0.5	-1.8	-2.4	-3.0	-3.0	-2.8
– Stock-flow adjustment ²	8.1	7.4	5.2	20.5	1.6	3.0	5.7	7.5	3.7	3.6	6.3	3.3	1.0	0.2	2.6	2.3

1 The formula used for the decomposition of changes in the debt-to-GDP ratio is the following:

$$\left[\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} \right] = \frac{PB_t}{Y_t} + \left[\frac{D_{t-1}}{Y_{t-1}} \cdot \frac{i_t - g_t}{1 + g_t} \right] + \frac{SF_t}{Y_t}$$

where D_t = general government debt
 PB_t = primary balance
 Y_t = GDP at current prices
 g_t = nominal GDP growth rate
 i_t = average nominal interest rate on government debt
 SF_t = stock-flow adjustment

2 The "stock-flow adjustment" includes expenditure or assumption of liabilities which do not affect the deficit but increase debt, as well as revenue (e.g. privatisation proceeds) which does not affect the deficit but reduces debt.

3 Data on debt and the primary surplus are Eurostat estimates.

* Provisional data.

Sources: Ministry of Economy and Finance, Eurostat and estimates of the Bank of Greece.

payments for 2006 as well. The small increase, at the beginning of last December, in the interest rate on main refinancing operations conducted by the European Central Bank appears for the present to have affected short-term yields. It is indicative that, while the interest rate on the 10-year bond issued on 11 January 2006 remained virtually unchanged, for the Treasury bills auctioned on 3 January 2006 the interest rate increased by 24-40 basis points.⁹⁸

As far as the public investment budget is concerned, the 2006 budget forecasts an increase in both revenue and expenditure in comparison with 2005, but the deficit will remain essentially unchanged, at 2.5% of GDP (2.6% in 2005).

5.4 Public debt and the sustainability of fiscal policy

During the 2000-2005 period, the country's fiscal condition, as reflected in the debt-to-GDP ratio, showed a marginal improvement,⁹⁹ as a result of the combination of a high GDP growth rate and low interest rates. Such a combination can, under certain circumstances (i.e. zero primary surplus and zero deficit-debt adjustment), ensure a fall in the debt-to-GDP ratio in the order of 2.25% annually (see Table IV.12). However, the existence of primary deficits and deficit-debt adjustments during the above period limited the reduction in the above ratio to about one percentage point annually on average (see Table IV.12). This development is worrying if account is taken, first, of the fact that public debt in Greece is the second highest in the EU-25, exceeding by a significant margin the reference value set by the Maastricht Treaty (60% of GDP) and, second, of the fact that, during this period, revenue from privatisation reached an average of 1.47% of GDP per annum, while the reduction in debt was, on average, 1% of GDP per annum.

Under the present circumstances, a possible minor decline in economic growth and a slight increase in interest rates could lead to an interruption of the downward trend in the debt-to-GDP ratio.¹⁰⁰ It is, therefore, essential that efforts towards fiscal consolidation be continued and that significant primary surpluses be created so that, within a reasonable period of time, the debt-to-GDP ratio can be brought down to 60%, as provided for in the Stability and Growth Pact. Achieving this target will help ensure a sustainable fiscal position, in view of the expected medium-term burdening of the budget with increased expenditure associated with population ageing.

6. Balance of payments

6.1 Current account

6.1.1 Summary of developments

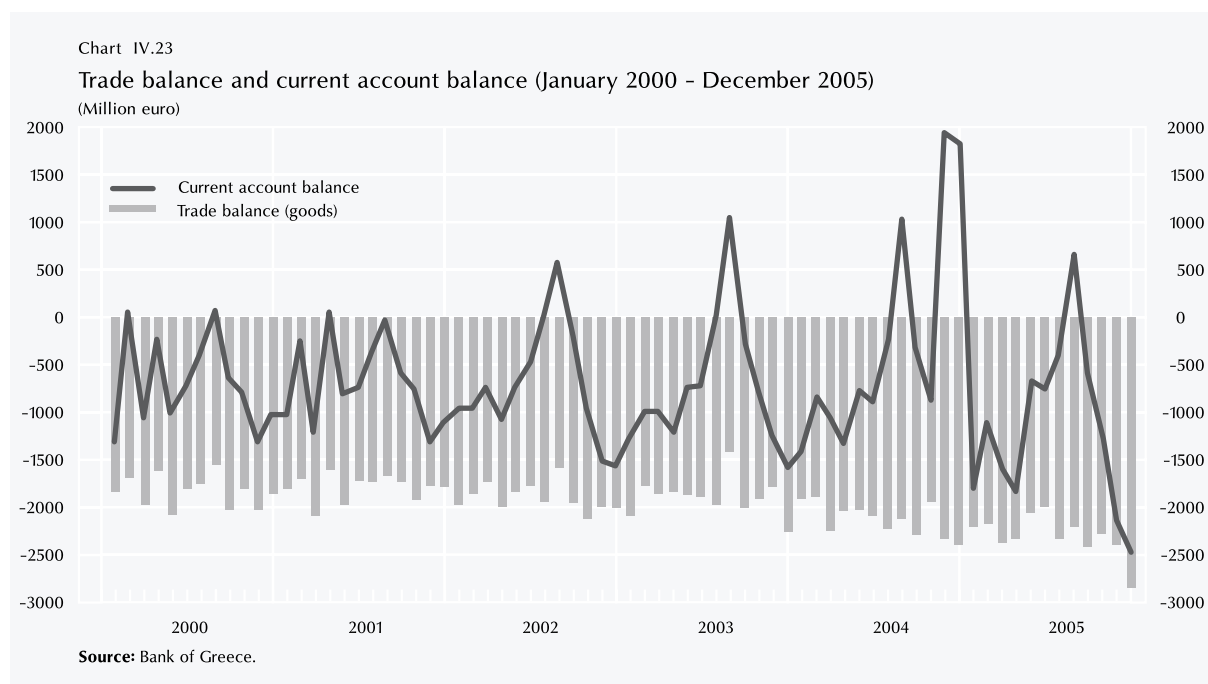
In 2005, the current account deficit (according to the new presentation¹⁰¹) increased considerably

98 The interest rate on the 3-month bills rose by 24 basis points, that on the 6-month ones by 37 basis points and that on the one-year Treasury bills by 40 basis points, from 2.28% to 2.68%.

99 The debt fell to 107.9% of GDP in 2005, from 114.0% of GDP in 2000.

100 Assuming that there is a zero primary surplus and zero "deficit-debt adjustment", the narrowing of the debt-to-GDP ratio will stop if interest rates rise by one percentage point and, at the same time, the GDP growth rate also falls by approximately one percentage point. The same will be true if the rate of economic growth falls by two percentage points and interest rates remain unchanged.

101 It should be recalled that, according to the new presentation of the balance of payments, the transfers balance is now divided into two parts: the current transfers balance, which is classified under the current account, and the capital transfers balance, which is a separate section. The new current account balance now includes the trade balance, the services balance, the income account balance and the current transfers balance, while the capital transfers balance is an independent part of the balance of payments. In this new presentation of the balance of payments, the algebraic sum of the current account balance and the capital transfers balance corresponds to the current account balance as presented up to the data release for June 2005. See Bank of Greece Press Release, 16 September 2005, and *Monetary Policy, Interim Report 2005*, October 2005, pp. 112 ff.



(by €3,594 million over 2004) and reached €14,047 million (see Chart IV.23). However, if imports and exports of ships are not taken into account, the current account deficit increased by €2,736 million over 2004 and amounted to €13,325 million. Furthermore, the combined current account and capital transfers balances (on the basis of the old method of presentation) showed a deficit of €11,999 million, compared with €8,067 million in 2004.

The increase in the current account deficit was a result of, mainly, a widening of the trade deficit and of the income account deficit and, secondarily, a narrowing of the current transfers surplus. By contrast, the services surplus showed a slight increase, which, however, offset only partially the above changes. In 2005¹⁰² the current account deficit rose to 7.8% of GDP, from 6.3% in 2004 and 7.2% in 2003. If the ships' balance is not taken into account, the current account deficit came to 7.4% of GDP in 2005, compared with 6.3% in 2004 and 7.3% in 2003. Moreover, the combined current account and capital transfers balances

showed a deficit of 6.7% of GDP in 2005, compared with 4.8% in 2004 and 6.4% in 2003.

The widening of the current account deficit (including oil and ships) is mainly attributable to the increase in the net oil import bill due to the rise in the price of crude oil on the world markets, to the increase in net interest payments and to the fact that the ships' balance showed a deficit (in contrast to the surplus recorded in 2004), particularly due to the considerable increase in payments for the purchase of new sea-going vessels. It is also attributable, though to a lesser extent, to the fall in the current transfers surplus on account of both the increase in general government gross payments to the EU and the decline in net receipts of other sectors (mainly emigrants' remittances). These developments more than offset the favourable development of the trade balance *excluding oil and ships* (the deficit of which narrowed, because exports

¹⁰² Balance of payments statistical data for December 2005 were released on 20 February 2006, but certain detailed data (imports-exports by product category) are still unavailable.

excluding oil and ships increased, while the corresponding import bill recorded a slight decline from its particularly high level in 2004) and the relatively small increase in the services surplus (mainly due to the marginal rise in net transport receipts, which largely reflected the considerable drop in freight rates, as well as to the increase in net payments for “other” services).

The fact that the current account deficit as a percentage of GDP has reached high levels in the last few years is related to the low *level* of competitiveness and the *decrease* in price competitiveness. In particular, the low level of competitiveness reflects the structural inefficiencies of production. The decrease in competitiveness in recent years stems largely from the fact that inflation in Greece remains higher than in the euro area as a

whole and in other countries against which Greece competes in international trade. Low competitiveness also reflects the increasing importance in the world market of the emerging economies in Asia, as well as Eastern and Central Europe.

The fall in price competitiveness is corroborated by some new calculations (see Box IV.3),¹⁰³ which take into account developments in consumer prices and unit labour costs in manufacturing (ULCM) in Greece and in its 27 main trading partners, in conjunction with *changes in exchange rates*. Specifically, over the last five years the real effective exchange rate based on consumer prices (i.e. Greek relative consumer prices expressed in a

103 See also footnote 13 to Section 1 of the present chapter.

BOX IV.3

Revision of the nominal and real effective exchange rate indices of Greece

A country's nominal effective exchange rate (EER) is commonly defined as a weighted average of the bilateral exchange rates of its currency vis-à-vis the currencies of its major trading partners. The weights used reflect the share of each trading partner in the particular country's exports and imports of goods. The real EER is the nominal EER deflated by a weighted average of appropriate foreign, relative to domestic, price or cost indices – and thus, a measure of a country's competitiveness.

Since the introduction of the single currency on 1 January 1999, the European Central Bank (ECB) has been compiling a set of indices of the nominal and real EER of the euro vis-à-vis the main trading partners of the euro area as a whole.

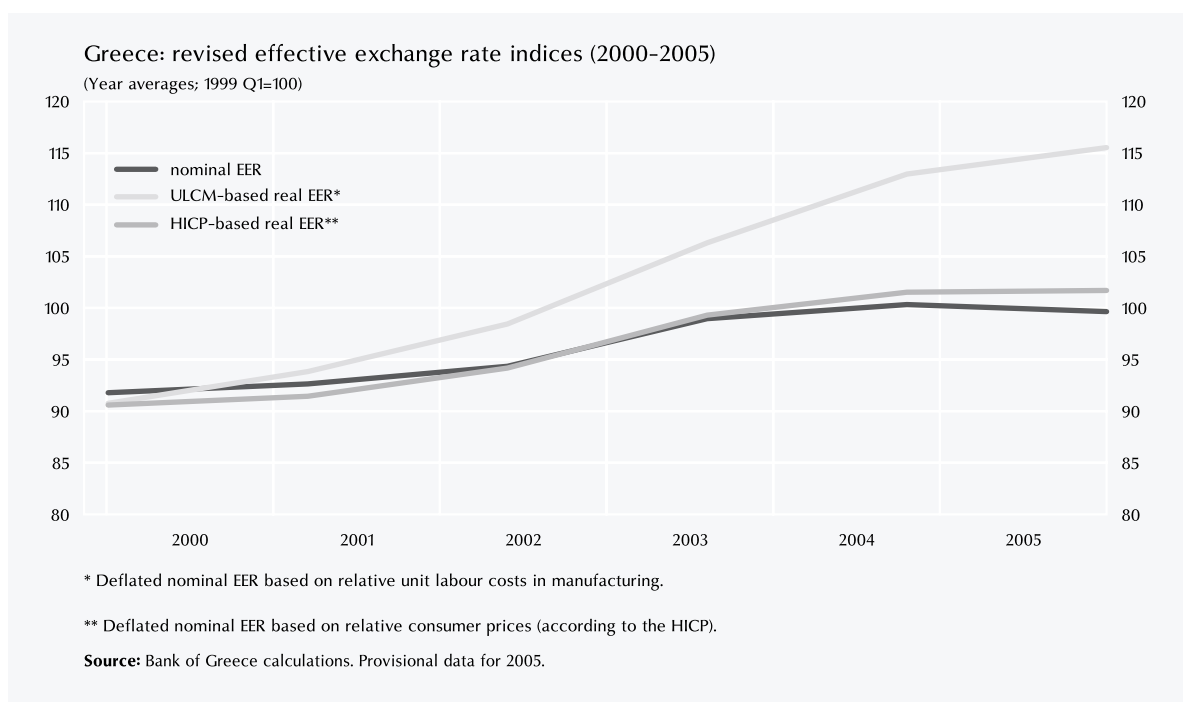
Following ECB's general methodological approach, several central banks of the Eurosystem – including the Bank of Greece – have revised the nominal and real EER indices they compile with respect to the main

trading partners of *their country* and not of the euro area as a whole. These indices are called “National Competitiveness Indicators” (NCIs), so as to avoid confusion with those corresponding to the euro area as a whole.

Technical aspects of the new indices

The new Greek indices of nominal and real EERs are computed on the basis of our country's *trade in manufacturing goods* (Sections 5 to 8 of the Standard International Trade Classification – SITC 5-8) with 27 major trading partners, comprising all the EU-15 countries, four out of the ten new Member States of the EU (Cyprus, Poland, the Czech Republic and Hungary) and nine non-EU countries (United States, Japan, South Korea, China, Switzerland, Turkey, Bulgaria, Russia and Romania).

It was recognised that an extended group of trading partners (e.g. 45) would not materially improve →



→ trade coverage or affect the evolution of the indicators for that matter. The availability and reliability of data were additional considerations in the selection of the particular 27 countries.

Manufacturing is seen as the most appropriate trade basis for computing the EER indicators, as manufacturing goods account for a large share in our country's total external trade of goods. Agricultural prices on the other hand are largely determined within the context of Common Agricultural Policy (CAP) and also subject to sharp fluctuations due to the seasonality of agricultural output and weather conditions. Although it would have been desirable to also include trade in services, there are problems with the availability, comparability and reliability of the relevant data.

The weights used for the new indices are based on manufacturing trade data for the 1999-2001 period and capture "third market effects". In more detail, the import weights are the simple shares of each partner country in total Greek imports, while exports are double-weighted in order to account for the competition faced by Greek exporters in foreign markets, from both domestic producers and exporters from third countries.

On the basis of NSSG data for the 1999-2001 period, the 27 countries included in the indices covered around 88% of Greece's trade in manufacturing and 80% of its total external trade.¹ The weights of individual partner countries or groups of countries are: 59.0% for the rest of the euro area as a whole; 10.2% for the three non-euro area Member States taken together; 7.4% for the United States; 5.3% for Japan; and a total of 18.1% for the remaining 11 partner countries.

In line with the ECB's practice, the base period for all NCIs is the first quarter of 1999 (1999 Q1=100). The base period was selected simply on institutional grounds, as it coincides with the introduction of the single currency, and does not relate to any notion of an "equilibrium" value of the euro. The new NCIs cover the period from 1995 onwards, while data for previous years are chain-linked to the new base period.

The revised index of nominal EER on the basis of Greece's trade with 27 countries is available at a daily, monthly and annual frequency. →

¹ The old EER index included only 15 countries. Its weights were based on total trade excluding fuel and not only on the trade in manufacturing goods. In the three years from 1999 to 2001, these 15 countries represented about 70% of Greece's manufacturing trade and 63% of its total trade.

Greece: revised indices¹ of nominal and real effective exchange rates (EER)

(Year averages)

	Nominal EER		Real EER deflated by relative consumer prices		Real EER deflated by relative unit labour costs in manufacturing	
	1999 Q1=100	Percentage change	1999 Q1=100	Percentage change	1999 Q1=100	Percentage change
2000	91.6	–	90.5	–	90.6	–
2001	92.6	1.0	91.4	1.0	93.8	3.5
2002	94.3	1.9	94.0	2.9	98.3	4.8
2003	98.8	4.7	99.3	5.6	106.2	8.0
2004	100.3	1.5	101.4	2.1	112.9	6.3
2005 ²	99.6	–0.7	101.7	0.4	115.6	2.4
Cumulative percentage change between 2001 and 2005		8.7		12.4		27.6

1 Based on Greece's trade in manufacturing goods (SITC Sections 5-8) with its 27 major trading partners in the 1999-2001 period.

2 Estimates.

Sources: Exchange rates: ECB, euro reference rates.

Relative consumer prices: HICP where available, ECB.

Relative unit labour costs in manufacturing: Bank of Greece estimates for Greece, ECB for other countries.

→ Real EER indices

The revised real EER indices on the basis of Greece's trade with 27 partner countries are calculated quarterly and annually, using as deflators (i) the relative Harmonised Indices of Consumer Prices (HICPs) in the case of EU countries and the CPIs in all other cases, and (ii) the relative indices of unit labour costs in manufacturing.

An additional set of real EER indices is also computed against a narrow group of trading partners, comprising the other 11 euro area countries only. In general, alternative EER indices can be computed using different groups of partner countries (e.g. the EU-15 or the EU-25), or, in the case of real EERs, different deflators.

The real EER indices provide insights into the competitiveness of Greek products in the domestic and the international market. It is obvious that they measure competitiveness exclusively in terms of prices or costs, without taking into account any other factors that affect competitiveness, such as product quality and/or innova-

tion. It should be noted that these indices underestimate the loss in price competitiveness stemming from the huge supply of exports from emerging economies at highly competitive prices these last five years. This is so because (i) the weights of individual trading partners are based on import/export data for the 1999-2001 period, and (ii) the indices merely reflect the effect of changes in relative prices, failing to capture the effect of the low level of prices of imports from emerging economies.

General conclusions

An overview of developments in the revised nominal and real EER indices in the five years from 2001 to 2005 (i.e. since Greece adopted the euro) leads to the following general conclusions (see the table and the chart in this box):

– The nominal EER index gained a cumulative 8.7% in the 2001-2005 period, reflecting the appreciation of the euro and the inclusion of new partner countries which experienced a considerable depreciation of their currencies over the same period (mainly Turkey, →

→ Romania, Bulgaria, Russia, Poland, Hungary and South Korea). The upward trend moderated in 2004, and then reversed in 2005, thus the index of nominal EER declined slightly.

—The real EER indices have been rising² since 2001. In 2005, the real EER index based on relative consumer prices was 12.4% higher compared with 2000, while in the same period the ULCM-based real EER index showed even greater cumulative gains (27.6%). On the basis of the former index, two thirds of the loss in competitiveness in five years are due to the nominal appreciation of the euro and one third to the positive consumer price inflation differential of Greece vis-à-vis its trading partners.³ As measured by the latter index, the loss in competitiveness is much greater —more than double— and due by two thirds to the stronger growth of unit labour cost in manufacturing in Greece compared with its trading partners⁴ and by one third to the nominal appreciation of the euro.

— The loss in international competitiveness in 2004-2005 was less than in the previous two years (2002-2003), mainly because of the developments in the exchange rate of the euro.

It should be noted that, given its decline in the three years from 1998 to 2000, the nominal EER index remained overall unchanged between 1998 and 2005. In the same eight-year period, each of the real EER indices cumulatively gained less than in the last five years (the CPI-based index only 2.1%, while the ULCM-based one 19.7%).

² An appreciation of the real EER index implies a loss in competitiveness.

³ Relative consumer prices rose by 3.5% in these five years (compared with the 27 partner countries).

⁴ Relative unit labour costs in manufacturing rose by 17.5% in these five years (compared with the 27 partner countries).

common currency) recorded a cumulative increase of 12.4% (0.4% in 2005). Moreover, the real effective exchange rate based on labour cost (i.e. relative ULCM expressed in a common currency) increased cumulatively by 27.6% (2.4% in 2005). These increases in the real effective exchange rate imply a corresponding significant *drop* in price competitiveness. According to the latest report of the World Economic Forum, which includes certain competitiveness indicators,¹⁰⁴ in 2005 Greece ranked 46th out of 117 countries (in 2004 it had ranked 37th out of 104 countries) on the basis of the Growth Competitiveness Index (GCI), with a weaker economic performance than the entire EU-25, except Italy and Poland. Furthermore, based on the Business Competitiveness Index (BCI), Greece's position improved only marginally, as it ranked 40th out of 116 countries (in 2004 it had ranked 41st out of 103 countries).

As regards the external transactions outlook for 2006, developments expected in the trade and services balances were examined in Section 3

of this chapter, where it was pointed out that: (i) exports of goods and tourist services will grow at a relatively high rate, (ii) exports of transport services will probably decline and (iii) imports of goods will increase markedly, after remaining unchanged or decreasing in 2005. Additionally, the increase in interest payments will most likely continue, resulting in the further widening of the income account deficit. At the same time, the conditions exist for an increase in the current transfers surplus. Accordingly, the current account deficit as a percentage of GDP is expected to increase slightly compared with last year's levels, while, *excluding ships*, the current account deficit is expected to remain stable or narrow slightly as a percentage of GDP. The deficit in the combined current account and capital transfers balances as a percentage of GDP is anticipated to remain unchanged at the level reached in 2005.

¹⁰⁴ World Economic Forum, *Global Competitiveness Report 2005-2006*, September 2005.

6.1.2 Trade balance

The deterioration in the overall trade balance in 2005 is more than offset by a rise of €2,118 million in the net oil import bill, which reached 24% of the overall trade deficit. This was a result of the steep rise in the price of crude oil on the world markets.¹⁰⁵

Moreover, the trade balance has been considerably affected by purchases and sales of “second-hand” sea-going vessels and purchases of new vessels abroad. In recent years, the increase in such transactions by shipping companies resident in Greece has both boosted the transport capacity and lowered the average age of the Greek-owned merchant fleet.¹⁰⁶ It should be pointed out that sales of “second-hand” ships accounted for 11.6% of non-oil export receipts in 2004 (compared with a mere 2.6% in 2003), while in 2005 this share rose to 13.4%. Furthermore, in 2005, purchases of ships rose to 7.1% of the total non-oil import bill, compared with 3.6% in 2004. Overall, in 2005 the ships’ balance showed a deficit of €722 million (in contrast to the surplus of €136 million recorded in 2004), thus raising the overall trade deficit by €858 million. Increased purchases of ships largely reflect the positive assessment of Greek-based shipping firms about the medium-term prospects of sea transport worldwide, owing to continued strong world trade growth. These prospects, in turn, create favourable conditions for higher sea transport receipts and thus an improvement in the current account balance over the medium term.

By contrast, the trade deficit excluding oil and ships contracted by €865 million owing to an increase of €524 million (or 5.3%) in export receipts excluding oil and ships, while the corresponding import bill decreased by €341 million (–1.1%).¹⁰⁷ According to detailed Bank of Greece data on the breakdown of exports and imports *excluding oil and ships* by product category (see

Table IV.13), in the *January–November 2005 period* export receipts recorded an increase in most product categories, with the exception of “other branches of manufacturing”, where export receipts fell, mainly on account of the decline in textiles exports. A decline was also recorded in receipts from exports of products that cannot be classified,¹⁰⁸ which have an appreciable share of the total (approximately 25%). As regards imports excluding oil and ships, there was a decrease in payments for capital goods, computers, passenger cars, agricultural products and consumer durables. The decline in imports of machinery and passenger cars was expected, since these categories had increased markedly in the same period of 2004, owing to the completion of the Olympic projects and to high car import volumes to cover requirements during the Olympic Games. By contrast, payments for imports of telephony equipment and other manufactures picked up.

Regarding the geographical breakdown of exports (including oil and ships), detailed NSSG

105 The gross oil import bill grew by 46.7%, while the average crude oil price in euro terms rose by around 46.2% year-on-year in 2005. These data imply stagnation in oil import volumes.

106 See Bank of Greece, *Annual Report 2004*, April 2005, Box IX.2. Furthermore, according to recent data from Intertanko, the Greek-controlled tanker fleet grew considerably in the last ten years, reaching 21% of the world fleet in March 2005 (in terms of deadweight tonnage).

107 According to provisional NSSG data, in the first eleven months of 2005, the value of overall exports increased by 13.6%, the value of exports excluding ships rose by 12.6% and the value of exports excluding oil products and ships increased by 9.2%, while the value of overall imports grew by 2.4%, the value of imports excluding ships increased by 3.9% and the value of imports excluding oil products and ships declined by 1.9%. It should be recalled that the differences between Bank of Greece and NSSG trade statistics are due to several reasons, the chief one being that the former relate to receipts and payments mainly through the domestic banking system, while the latter are based on customs data (for transactions with non-EU countries) and tax data (INTRASTAT) (for intra-EU transactions) and remain provisional for a long time.

108 This is so because commercial banks, in submitting data to the Bank of Greece for the compilation of balance of payments statistics, do not give a code number for these products. Since unclassifiable products have an appreciable share in total exports, growth rates for the other categories may not accurately reflect developments in those categories.

Table IV.13

Breakdown of Greece's external trade by product category (excluding oil and ships)

(January – November)

A. Export receipts

	Percentage share of each product category in total export receipts			Percentage change in export receipts	
	2003	2004	2005*	2004/2003	2005/2004
Agricultural products	22.7	19.5	20.7	-13.1	11.1
Chemicals, plastics	12.8	13.5	13.8	6.7	6.4
Metallurgy ¹	8.0	10.9	14.6	38.4	39.5
Machinery, appliances	7.6	6.0	6.5	-19.7	12.4
Means of transport excl. ships	0.6	1.3	1.8	113.8	47.2
Other manufacturing branches ¹	20.5	20.1	18.7	-0.7	-2.5
Unclassified goods ²	27.7	28.7	23.9	5.1	-13.2
Total (excl. oil and ships)	100.0	100.0	100.0	1.5	4.4

B. Import bill

	Percentage share of each product category in total import bill			Percentage change in import bill	
	2003	2004	2005*	2004/2003	2005/2004
Agricultural products	14.4	14.6	14.2	11.4	-4.3
Chemicals, plastics	16.0	15.2	17.0	4.9	10.2
Metallurgy ¹	8.9	9.5	10.5	17.1	8.7
Machinery, appliances	21.2	20.7	19.1	7.3	-8.6
Consumer durables	3.7	3.2	3.2	-3.4	-2.3
Capital goods	13.3	13.0	11.5	7.5	-12.3
Computers	1.9	2.4	2.1	39.2	-11.8
Fixed-voice and mobile telephony	2.4	2.1	2.3	-2.5	8.2
Means of transport excl. ships	14.2	14.7	14.9	14.6	-0.2
Passenger cars	7.2	7.9	7.6	21.0	-5.8
Other manufacturing branches ¹	22.2	21.6	23.3	7.4	6.5
Other goods	0.3	0.4	0.2	42.0	-53.6
Unclassified goods ²	2.8	3.2	0.9	28.9	-73.8
Total (excl. oil and ships)	100.0	100.0	100.0	10.1	-1.2

1 Including raw materials used.

2 Products for which no code number has been reported.

* Provisional data.

Source: Bank of Greece.

data for the *January-November 2005* period (see Table IV.14) point to a slight drop in the share of exports to the euro area and the EU-25 as a whole, as well as to the Balkans, which is a major destination of Greek products. With respect to imports, the share of imports from

the euro area and the EU-25 dropped, while the share of imports from non-EU countries (particularly from the Commonwealth of Independent States and the Middle East) grew, mainly because of higher crude oil prices in the world market.

Table IV.14

Breakdown of Greece's external trade by geographical area*

(January – November)

A. Exports

	Percentage share in the value of total exports			Percentage change in export value	
	2003	2004	2005	2004/2003	2005/2004
European Union (15)	48.9	47.5	45.4	-1.7	8.4
Euro area	39.4	37.8	36.6	-2.9	10.0
New Member States ¹	7.7	7.5	7.6	-1.8	14.3
OECD countries ²	13.5	13.4	13.7	0.4	16.5
USA	5.7	5.3	5.3	-6.0	13.4
Balkan countries ³	16.1	17.1	15.3	7.5	2.1
Commonwealth of Independent States	3.2	3.0	2.8	-6.0	5.5
Northern Africa & Middle East countries ⁴	5.3	6.5	7.5	24.7	30.7
China & Southeastern Asia ⁵	1.5	1.7	2.4	10.8	64.2
Other countries	3.8	3.3	5.3	-11.7	83.3
Total	100.0	100.0	100.0	1.1	13.6

B. Imports

	Percentage share in the value of total imports			Percentage change in import value	
	2003	2004	2005	2004/2003	2005/2004
European Union (15)	54.9	55.6	53.5	7.4	-1.5
Euro area	48.5	49.0	47.5	7.2	-0.8
New Member States ¹	1.8	2.0	2.4	15.2	21.4
OECD countries ²	18.5	16.0	12.8	-8.5	-17.7
USA	5.2	4.7	3.6	-4.9	-21.1
Balkan countries ³	2.7	3.2	3.4	24.5	8.7
Commonwealth of Independent States	7.0	6.2	9.1	-5.7	51.4
Northern Africa & Middle East countries ⁴	7.3	8.1	9.9	16.8	25.4
China & Southeastern Asia ⁵	4.7	5.2	5.6	17.5	9.6
Other countries	3.0	3.8	3.4	32.4	-7.6
Total	100.0	100.0	100.0	6.1	2.5

1 Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Cyprus, Malta.

2 The OECD Member States not included in any other category.

3 Albania, Bulgaria, Romania and former Yugoslavia countries (Bosnia, Croatia, FYROM and Serbia-Montenegro).

4 Greece's major trading partners in Northern Africa and the Middle East.

5 Greece's major trading partners in Southeastern Asia.

* All the data are provisional.

Source: NSSG.

6.1.3 Services balance

The services surplus rose by €231 million, reflecting an increase in net travel and transport receipts. Gross travel receipts, i.e. travel spending by non-residents in Greece, rose by €689 million or 6.7%,

while gross payments, i.e. travel spending abroad by residents of Greece, increased by a mere €135 million or 5.9%; as a result, net travel receipts grew by €553 million relative to 2004. Gross transport (mainly shipping) receipts rose by €564 million or 4.2%, compared with particularly large receipts in

2004 (increase of about 40%), while gross transport payments increased by €509 million or 8.9%; as a result, net transport receipts grew by €54 million. Therefore, contrary to developments in 2004, the largest contribution to the rise in net services receipts came from the travel market, while the contribution of transport services was reduced. The contribution of travel receipts in raising the services surplus mostly reflects the higher number of arrivals, given that service prices in this category recorded only a small increase. By contrast, the decrease in freight charges in 2005 kept down the increase in gross transport receipts.

6.1.4 Income account

The income account deficit grew by €1,263 million in 2005, as a result of increased net interest,¹⁰⁹ dividend and profit payments. The widening of the deficit was mainly due to a continued increase in non-residents' holdings of old and new government bonds and, to a lesser extent, to stronger investment in Athens Exchange equities by foreign, mainly institutional, investors, thereby resulting in larger dividend payments to non-residents.

6.1.5 Current transfers balance

In 2005, the current transfers surplus decreased by €452 million year-on-year to €3,177 million. Underlying this was principally a drop in net current transfers to the "other" (excluding general government) sectors by €282 million, while net current transfers from the EU to general government fell by €169 million. More specifically, gross current transfers from the EU to general government¹¹⁰ rose year-on-year by €535 million or 13.1%, but general government gross current payments to the EU grew by €705 million or 31.8%. It should be noted that, in addition to regular payments to the Community budget (which are distributed almost evenly in the course of the

calendar year), general government payments to the EU include other amounts, such as extraordinary contributions and refunds.

6.2 Capital transfers balance

In 2005, the capital transfers surplus decreased by €337 million year-on-year to €2,049 million. This mainly reflects a drop in capital transfers¹¹¹ from the EU to €2,137 million, compared with €2,464 million in 2004. The rate of absorption of resources from the Structural Funds is expected to pick up,¹¹² as in June 2005 negotiations with the European Commission on the final settlement of pending issues connected with CSF III were completed. At the same time, new arrangements were put in place for the control and management of projects and programmes, with a view to utilising more efficiently Community resources and preventing any further loss¹¹³ of funds.

Considering that inflows from the EAGGF Guarantee Section to Greece in the context of

109 It should be recalled that, as from April 2005, the methodology of recording interest on bonds in the balance of payments statistics has changed, so that interest payments are recorded on an *accruals* basis, rather than on a cash basis, as they had been up to and including March 2005. Thus, data are now recorded more accurately. For comparability purposes, the monthly data going back to January 2003 have also been revised.

110 Current EU transfers mainly include receipts from the Guarantee Section of the European Agricultural Guidance and Guarantee Fund – EAGGF – in the context of the Common Agricultural Policy, receipts from the European Social Fund and Greece's payments to the Community Budget.

111 EU capital transfers mainly include receipts from the Structural Funds – except for the European Social Fund – and the Cohesion Fund under the Community Support Framework.

112 In 2005, the rate of absorption of resources from the Structural Funds exceeded – on a cash basis – 40% of the overall Community contribution under CSF III.

113 It should be recalled that in early June 2005 the European Commission decided to lift its threat to suspend payments to Greece following the audits conducted by the EU services for the past three years. At the same time, it imposed a fiscal correction, which was limited to €518 million. This amount (which concerns funds already paid by the Community) will be refunded through a withholding from future inflows in four annual instalments (€100 million in 2005, €100 million in 2006, €150 million in 2007 and €168 million in 2008).

the CAP remain at almost the same levels each year, net EU transfers to general government (current transfers plus capital transfers) amounted to €3.8 billion in 2005, compared with €4.3 billion in 2004.

According to the EU budget for the years 2007-2013, which was adopted by the European Council on 17 December 2005, Greece is expected to receive €20.1 billion from the Structural Funds and the Cohesion Fund. This means that the Greek economy will continue to absorb considerable EU funds for the implementation of the National Strategic Reference Framework (CSF IV, 2007-2013). At the same time, the CAP is expected to remain more or less unchanged until 2013.

6.3 Financial account

In 2005, financial investment, i.e. the sum of direct, portfolio and "other" investment, showed a net inflow of €12,258 million, compared with €5,225 million in 2004. This is accounted for by the net inflow of €7,323 million for portfolio investment (2004: €13,727 million) and of €5,914 million for "other" investment (2004: net outflow of €9,104 million). By contrast, direct investment showed a net outflow of €979 million (2004: net inflow of €600 million).

Underlying the net outflow of funds for direct investment is primarily residents' investment abroad (€767 million in 2005, €489 million in 2004) and, secondarily, the net outflow of €212 million of non-residents' investment in Greece (2004: net inflow of €1,088 million).

Although the net outflow of non-residents' direct investment in Greece reflects the economy's low level of appeal to foreign investors, it does not imply a total lack of foreign investment. On the

contrary, significant foreign investments have been recorded. The most important investments concern a €60 million inflow for the acquisition of Elliniki Technodomiki by a Luxembourg-based company, the participation, worth €57 million, of Société Générale in Geniki Bank's capital increase, Credit Agricole's participation, worth €69 million, in Emporiki Bank's capital increase, and the €40 million inflow in the context of the acquisition of Interamerican's participation in Nova Bank's capital by the Portuguese bank BCP. The net outflow under non-residents' direct investment in Greece is accounted for by the fact that the Dutch company Aramco withdrew from the share capital of Motor Oil Hellas S.A. (outflow of €275 million), while the Luxembourg company Motor Oil Holding S.A. sold its stake in the share capital of the said company. However, the shares sold by Motor Oil Holding S.A., worth €318 million, were purchased by other non-residents (mainly institutional investors); as a result, this transaction is recorded as an inflow under portfolio investment and the overall financial account balance is not affected thereby.

Direct investment abroad by residents reflects the expansion of Greek enterprises, mainly banks, in the Balkans. The largest direct investments abroad by residents were the acquisition, worth €152 million, of Jubanka bank in Serbia by Alpha Bank, Cosmote's participation, worth €120 million, in Cosmorom's capital increase in Romania, Alpha Bank's participation, worth €66 million, in the capital increase of its subsidiary Alpha Bank Romania, and the acquisition, worth €41 million, of Nationalna Stedionica Banka in Serbia by Eurobank.

With respect to portfolio investment, the significant net inflow is mainly accounted for by considerable purchases of Greek government bonds by non-resident investors. Specifically, the inflow of €25,782 million (2004: €25,217) mainly con-

cerns purchases of Greek bonds (€20,682 million) and, to a lesser extent, shares (€5,118 million). At the same time, resident investors' holdings of foreign bonds were considerable (€14,339 million), while purchases of Treasury bills and shares by residents amounted to €2,384 million and €1,782 million, respectively.

"Other" investment showed a net inflow, because residents' external liabilities rose by €12,215 million; this rise was partly offset by the increase in residents' external assets (by €6,301 million). The

rise in residents' liabilities is exclusively accounted for by non-residents' investment in deposits and repos in Greece (€14.2 billion), which more than offset loan pay-offs (€2.0 billion), while the increase in residents' assets was a result of similar investment in deposits and repos abroad (€6.3 billion).

Finally, Greece's reserve assets dropped by €49 million in 2005, to stand at €1.9 billion at the end of the year.

Recent structural reforms to enhance the economy's competitiveness

Since the end of 2005 the government has announced a series of measures to enhance the economy's competitiveness. These include the introduction of a new institutional framework for the operation of public enterprises and public organisations (DEKOs); the adoption of measures to reduce tax evasion and curtail public spending; the continuation of the privatisation process; decisions on the procedures necessary for the implementation of the provisions of the recently enacted framework law regarding Public-Private Partnerships (PPPs). At the same time, steps have been taken to further liberalise the energy market, create a more favourable business climate, increase competition, promote the economy's export orientation and advance the diffusion of new technology.

1. Rationalisation of the operation of DEKOs

The Ministry of Economy and Finance estimates that in 2005 *non-listed public enterprises (PEs)* suffered losses of around €1 billion (0.5% of GDP).¹ PEs burden the budget not only through the need to finance these deficits, but also through requirements for capital injection and the provision of government guarantees for loans received. Given that these companies have been consistently showing losses and that they account for a significant part of economic activity,² there is need for measures to rationalise their operation. Law 3429/2005 ("Public enterprises and organisations") sets out a new institutional framework within which these companies will operate in order to reduce their deficits, improve their competitiveness and profitability and eventually

reduce government budget financing as well as government-guaranteed loans for these PEs. This law establishes the close supervision of these PEs by central government (specifically by the Ministry of Economy and Finance), together with measures to rationalise their operating costs.

In particular, for the purposes of the above law, *public enterprises (PEs)* are those *sociétés anonymes (SA)* on which the Greek state has a direct or indirect influence either owing to share capital participation or other form of financial involvement, or because of the specific rules governing their operation. *Public organisations*³ are defined as those legal entities in private law the annual budget of which is financed by at least 50% by the state or by legal entities in public law. Most provisions of this law (contained in the first chapter thereof) concern *non-listed PEs*, while for a *public organisation* to fall under the provisions of the law a ministerial decision is required. According to the second chapter of the law, listed enterprises are no longer considered as belonging to the broader public sector and are, like private SAs, governed by Laws 2190/1920 and 3016/2002. Certain provisions of the new law, however, concerning existing or newly hired personnel, also hold for those PEs in which either the public sector continues to have a *majority stake* or which are under restructuring financed by the public sector or which recorded losses during the financial year in which the law was enacted.

*Non-listed PEs*⁴ are active in a number of sectors of

1 Introductory Report on the 2006 Budget (Table 5.2).

2 ICAP estimates that in 2004 sales of 43 DEKOs accounted for 9.1% of business sector sales (http://www.icap.gr/news/index_gr_7419.asp).

3 This use of the term differs from the standard one, where only Social Security Funds and Local Authorities are classified as public organisations.

4 The Introductory Report on the 2006 Budget includes 42 non-listed PEs. The Minister of Economy and Finance, however, at a press conference following the first meeting of the inter-ministerial committee established by this law, announced that there will be stock-taking of all public enterprises; so this number is likely to increase.

economic activity, e.g. transport, infrastructure works, public sector real estate, port management, energy, communications and manufacturing.⁵

State monitoring and supervision of PEs is the responsibility of the inter-ministerial committee for Public Enterprises and Organisations (DEDEKO) established by the new law. The Minister of Economy and Finance chairs the Committee, while the Minister of Development, the Minister of Employment and Social Protection and that of Transport and Communications participate in the Committee, together with other ministers that supervise the PE under consideration. DEDEKO has wide-ranging responsibilities regarding the operation and activities of *non-listed PEs*. More specifically, it controls and approves their strategic and business plans and annual budgets and their borrowing, incomes, hiring and pricing policies. If the provisions of this law are violated, DEDEKO has the right to impose sanctions (e.g. to cut up to 50% of the funds earmarked for the specific PE in the annual budget or in the public investment programme; to cease to provide state guarantees on PE borrowing; to replace the Chairman, CEO or members of the Board etc.). DEDEKO is supported in the release of its tasks by the Special Secretariat of Public Enterprises and Organisations (EGDEKO), also established through Law 3429/2005.

The reform of PEs will be based on four pillars:

- (i) *Improved design and monitoring of company strategy and planning.* More specifically, PEs must develop strategic and business plans compatible both with the action plan of the ministries which supervise them and with the incomes, pricing and borrowing policy specified by DEDEKO. The latter will also specify the time of submission and the time horizon of these plans and is responsible for approving
- (ii) *Improved service to the citizens.* PEs supplying goods or services to consumers are obliged to draw up, by the end of June 2006, a Citizens' Charter (XYK) setting out their commitments towards customers. The XYK will specify the obligations of the company, the conditions under which the company provides goods and services to customers, and the refund policy if these commitments and conditions are not met. The XYK must be submitted to DEDEKO for approval. Observance of the XYK is one of the criteria for the evaluation of PEs' management.
- (iii) *Transparent and accountable corporate governance.* The law requires the implementation by PEs of corporate governance principles outlined in Law 3016/2002 (e.g. designation of

⁵ The companies active in each of these sectors are the following: *in transport*: Attiko Metro Operations Company SA (AMEL), Thermal Bus Company (ETHEL), Electric Buses of Athens and Piraeus (HLPAP), Electric Railway Company (HSAP), Athens Urban Transport Organisation (OASA), Hellenic Railways Organisation (OSE), Urban Railway (PROASTIAKOS SA), Tram; *in the energy sector*: ASPROFOS, Public Gas Corporation SA (DEPA), EKO-ELDA, DIAXON, Institute of Geology and Mineral Exploration (IGME); *in port management*: the port authorities of Alexandroupolis, Corfu, Elefsina, Igoumenitsa, Iraklion, Kavala, Lavrio, Patras, Rafina, Volos; *in postal communications*: ELTA; *in infrastructure and real estate*: Public Enterprise of Urban Planning and Housing (DEPOS), National Roads Fund (TEO), School Buildings Organisation (OSK), Public Sector Real Estate Company (KED); *in manufacturing*: Hellenic Aerospace Industry SA (EAB) and Hellenic Arms Industry & Greek Power and Cartridge Company (EBO-PYRKAL); *in the operation of central markets*: Organisation of Central Athens Market (OKAA) and Thessaloniki Central Market (KATH); the remaining entities are the Thessaloniki International Trade Fair (DETH), Greek National Tourism Organisation (EOT), National Drugs Organisation (EOF), Hellenic Organisation of Small and Medium-Sized Enterprises (EOMMEX), Hellenic Organisation for Standardisation (ELOT), School Books Publishing Organisation (OEDB), Hellenic Broadcasting Corporation (ERT), Hellenic Horseracing Organisation (ODIE), Organisation of Public Materials Management (ODDY), Hellenic Organisation for External Trade (OPE).

members of the Board as executive, non-executive, and independent non-executive,⁶ the drawing up of an internal organisation charter, the establishment of an internal audit committee etc.), the separation of the role of the Chairman of the Board from that of the Chief Executive Officer, and the filing of financial statements according to the International Financial Reporting Standards (IFRS). A major “innovation” of the new law (Article 4, paragraph 3) is the obligation of each PE to establish an internal audit service with wide-ranging responsibilities and independence. Specifically, the internal auditor is appointed by the General Shareholders’ Meeting (i.e. the State), is not an employee of the PE and does not fit into the company’s hierarchy.⁷

(iv) *Abolition of the distortions that disproportionately burden the cost of operation of PEs.* The law calls for the adaptation of industrial relations in PEs to those prevailing in the private sector. Hiring in these companies will follow advertising of the posts. The company must specify the requirements for the job, without prejudice, however, to the powers of the Supreme Council for Civil Personnel Selection (ASEP), which will monitor the procedure. PE personnel will be hired, following a probationary period which can last up to 7 months, with indefinite length contracts under the provisions of the prevailing labour law. Listed PEs in which the state continues to have a majority stake must also follow these rules. PEs that show losses or receive government financing, whether listed or not, must take steps to take full advantage of currently employed personnel by drawing up, wherever necessary, new employment regulation and organisational structure charters as well as educational and training programmes. These changes will be introduced following

negotiations of company management with employees, to be concluded by the end of April 2006. If this deadline is not met, then personnel issues will be dealt with by law. Listed companies in which the state does not have a majority stake and which neither show losses nor receive government financing can hire personnel at all levels with fixed-term or indefinite-length contracts, either following a trial period or not. These contracts will be governed by the provisions of existing labour law which regulate the relationship between employers and employees in the private sector. Furthermore, the law includes measures to curtail management expenses in PEs (e.g. by restricting the number of Board members, by setting ceilings on the compensation of Board members including the Chairman and the CEO etc).⁸

The first inter-ministerial meeting (18 January 2006) decided to ask PEs to adjust their charters to the provisions of the law by the end of June 2006 and to draw up and send to EGDEKO the new internal regulations by the end of September. Furthermore, PEs without approved strategic and business plans or citizens’ charters were asked to draw up these plans and send them for approval to DEDEKO.

2. Measures to prevent tax evasion and contain public spending

Together with the introduction of measures to increase public revenue and contain public expen-

⁶ Executive members are charged with daily management issues, while non-executive members are charged with the promotion of all company issues. Independent non-executive members cannot be shareholders or employees of the company.

⁷ The internal audit service is, *inter alia*, responsible for the provision and accuracy of any information and data asked for by EGDEKO.

⁸ These restrictions on compensation (Article 3, paragraph 3) refer only to non-listed public enterprises and to public organisations.

diture, with the aim of successfully implementing the new budget (see Section 5 of Chapter IV), fiscal policy includes additional important measures of a structural nature to improve the fiscal prospects of the economy on a lasting basis.

An important part of fiscal consolidation will result from measures to combat tax evasion. A number of measures have been introduced to this effect, the most important ones being the following:

- (i) A new service for Special Audits has been established since the summer of 2005 (YPEE, former SDOE), the action of which has already started bearing fruit as evidenced by the course of public revenue in the final quarter of 2005. YPEE is planning 70,000 company audits in 2006 and 11,500 controls on goods trade.
- (ii) Furthermore, the General Secretariat of Information Systems (GSIS), by making use of the data and information included in tax returns, is intensifying electronic cross-checking. More specifically, the GSIS is introducing eight different kinds of cross-checking of invoices issued by enterprises.
- (iii) The imposition of Value Added Tax (VAT) on new building works is expected to curb tax evasion in the construction sector, which, according to all indications, is extensive.
- (iv) The new system for monitoring tax evasion in fuel, through cross-checking of heating oil consumption against invoices for heating oil supply, is expected to reduce tax evasion.

Furthermore, in order to monitor and contain public expenditure, a body of Fiscal Inspectors (SDE) is being set up with wide-ranging responsibilities. SDE will monitor central government as well as local authorities (OTA), social security

funds, PEs and other entities in public law. SDE will investigate not only the lawfulness or otherwise of the expenditures of these bodies but also the management of their assets, the receipt and correct accounting of their revenues etc. In case of serious offences, fiscal inspectors will have the right, following a reasoned decision, to suspend the employee liable for the offence.

3. Privatisation programme

The withdrawal of the state from economic activity and the liberalisation of product markets are amongst the government's priorities. In 2005, privatisation revenues – from the sale of 16.4% of the Football Prognostics Association (OPAP) shares and around 10% of the Hellenic Telecommunications Organisation (OTE) shares to private and institutional investors – amounted to approximately €2.1 billion. For 2006,⁹ the government plans to sell shares of banks in which the state still retains an interest, to restructure the Postal Savings Bank and list it on the Athens Exchange (AE) and to list on the AE the Athens International Airport. Furthermore, there are plans to utilise the state's real estate either through long-term leasing (for hotels, marinas, casinos etc.) or through the *sale and lease-back* of state assets, a method used in, *inter alia*, Austria, Belgium, Italy. This method provides for the sale of state real estate with its simultaneous long-term leasing. Revenues from this process can be used to reduce public debt. The submission to Parliament of the draft bill on sale and lease-back is expected to take place later this year. According to government estimates, privatisation revenues in 2006 will amount to approximately €1.6 billion.

⁹ See, *inter alia*, the press conference held by the Minister of Economy and Finance on 9 January 2006 regarding government policy priorities.

4. Public-Private Partnerships

Following the enactment of Law 3389/2005, which constitutes the framework for the implementation of Public-Private Partnerships (PPPs), the inter-ministerial committee, which according to the law is charged with designing government policy in this area, met for the first time on 25 January 2006.¹⁰ The inter-ministerial committee made decisions on the necessary procedures for the inclusion of works and projects in this framework and was informed about the parties that have expressed an interest and the specific projects proposed. The suggested projects – for which decisions have not yet been made – come under the jurisdiction of ministries, local authorities, the Public Sector Real Estate Company (KED) and Helexpo. These projects concern new schools, student accommodation, the modernisation of port infrastructure, the housing of public sector services, the conversion of a sports facility into a conference centre, a heritage park, the building of an Opera House in Athens, the construction of waste management plants and the renovation of part of the grounds of the Thessaloniki International Trade Fair and Congress Exhibition Centre.¹¹

5. Improving the business climate

The adoption, at the end of 2005, of two legislative initiatives to simplify regulations regarding entrepreneurial activity is expected to lead to its enhancement. In particular, Law 3427/2005, which amends Law 89/1967 on the establishment in Greece of foreign industrial and commercial companies with economic activity outside Greek borders, provides for a concrete framework, compatible with European Union law, for the operation of these companies.¹² In addition, Law 3412/2005 on European Companies transposes into national law Council Regulation 2157/2001,

entered into force on 8 October 2004, and Directive 2001/1986/EC, which provides for the right to establish and manage companies with a European dimension (*Societas Europaea*), thus protecting minority shareholders and creditors.

6. Modernisation of the energy market

The enactment of two laws to liberalise the electricity and natural gas markets and to enhance competition in these areas (Law 3426/2005 “Acceleration of the process for the liberalisation of the electricity market” and Law 3428/2005 “Liberalisation of the natural gas market”), together with the establishment of the legal framework for the use of biofuels (Law 3423/2005 “Introduction of biofuels and other renewable fuels in the Greek market”), have been important developments in the energy sector.

Electricity market

Law 3426/2005, passed by Parliament at the end of November 2005, harmonises Greek legislation with EU Directive 2003/54/EC and continues the reforms initiated by Law 2773/1999 and supple-

10 The Minister of Economy and Finance, the Minister of Development and that of Environment, Physical Planning & Public Works are the regular members of the inter-ministerial committee. Depending on the specific project under consideration, the ministers supervising the entities which are to enter the partnership for each project also participate in the Committee.

11 Furthermore, on 3 February 2006 the Minister of Transport and Communications and the Minister of Shipping announced their plans to construct a new international airport in Kastelli (Iraklion, Crete) through a Public-Private Partnership (Press Release of the Ministry of Transport and Communications).

12 The adjustment was necessary given that the European Commission in 2001 had judged that the incentives provided through Law 89/1967 regarding foreign industrial and commercial companies with economic activity outside Greek borders were akin to state aid and Greece had been called upon to take measures to put an end to this treatment by 31 December 2005. While Law 2992/2002 (“Measures on capital market enhancement and other provisions”) provided for the termination of these incentives for foreign companies to be established in Greece after 1 January 2002, it did not specify the regime to prevail after 31 December 2005 for those companies that had already been established in Greece.

mented by Laws 2837/2000, 2491/2001 and 3175/2003.

The new institutional framework provides for the complete liberalisation of the electricity market, from 1 July 2007, by providing to *all* customers (eligible customers) the right of choice of electricity supplier,¹³ which until then will be provided only to non-residential customers.

The law allows other companies, in addition to Public Power Corporation (DEH), to construct and manage *direct lines for supplying* their own premises, subsidiaries and eligible customers. Furthermore, suppliers must fulfil public service obligations and protect consumers.

All companies active in the transmission, distribution and supply of electricity must keep *separate accounts* for each activity, to avoid discrimination, cross-subsidisation and distortion of competition. Furthermore, from 1 July 2007 onwards they will have to keep separate accounts for the supply of electricity to eligible and non-eligible customers.

The role of the regulatory authorities is enhanced as further responsibilities are conferred upon the Regulatory Authority for Energy (RAE), while the Hellenic Transmission System Operator (HTSO/DESMHE) is designated as the *sole responsible* party for the development and maintenance of the transmission system (i.e. the high voltage system)¹⁴ and the operation of the electricity market. In addition, a new company to manage the transmission system (medium and low voltage), the Manager of the Transmission System, wholly owned by DEH, must be established by 1 July 2007. Under the previous law, the management of this system belonged to DEH.¹⁵

Regarding the tenders conducted by HTSO/DESMHE for independent producers of electricity

(900 MW), the new law extends to 2010 the deadline for introducing this power into the system.¹⁶ The first tender (that should have taken place in 2003 when the first law was enacted) is expected to be announced soon. This tender concerns the construction, in the south of the country, of a natural gas plant (without excluding the possibility of constructing a second one) with power at least equal to 360 MW and is addressed to companies with permission to generate electricity.¹⁷

These tenders¹⁸ are expected to lead to the incorporation in the system, by 2011, of 3-4 private power plants (400 MW each) and will contribute to meeting the increasing needs for electricity. Furthermore, in January 2006 the first independent power plant, belonging to Hellenic Petroleum SA, with a capacity of 390 MW, started its operation.¹⁹

Natural gas market

Law 3248/2005 ("Liberalisation of the natural gas market"), adopted in mid-December, harmonises

13 Customers in micro-isolated systems (with a consumption of less than 500 MWh) in the non-interconnected islands are excluded from the provisions of the law.

14 DEH is the exclusive owner of the fixed assets of the system.

15 This will result in legal and operational separation of the parties in charge of the management of the system from those in charge of generation and supply, as provided for by Directive 2003/54/EC. HTSO/DESMHE will manage the transmission system together with the management of the distribution network until the new company is established.

16 It should be noted that the tendering procedure for 900MW was expected, according to Law 3175/2003, to be concluded by 2007, but, due to the delay in the licensing of private generation plants, the time limit has been extended to 2010.

17 According to RAE, from February 2001 (commencement of the market's formal deregulation) and up to January 2006, 782 licences for electricity generation were granted (total capacity 11,322.5 MW). Twelve of these licences relate to major thermal plants with a total capacity of 4,507 MW. In addition, 14 electricity supply licences (total capacity 2,800 MW) have been granted.

18 The next tender is expected to be held six months after the successful completion of the first tender.

19 In addition to the plant owned by Hellenic Petroleum, a gas-turbine plant with a capacity of 160 MW is already in operation to ensure spare capacity generation.

the rules and regulations in the natural gas market with the European Union Directive 2003/55/EC. The Directive asks Member States to (i) ensure third party access to the natural gas network and other infrastructure with natural monopoly features in order to promote competition, (ii) designate the parties responsible for managing the transportation and distribution of natural gas and ensure their independence from vertically integrated natural gas firms, (iii) gradually liberalise the market by specifying customers eligible to choose their supplier (eligible customers), (iv) enhance the role of the independent regulatory authorities, (v) observe specific pricing principles and (vi) demand that natural gas undertakings keep separate accounts for each of their activities.

The new market, established with the adoption of Law 3428/2005, will be liberalised gradually when eligible customers, in addition to those specified in Law 3175/2003, will have been specified.²⁰ In particular, *all undertakings licensed to produce electricity and heating*²¹ have the right to purchase gas from the supplier they choose. Furthermore, with effect from November 2008, non-residential customers residing outside the remit of Gas Supply Companies (EPAs)²² will also have this right, while *residential customers* will become eligible customers as from November 2009.

The new institutional framework provides for dividing the Public Gas Corporation SA (DEPA) into two companies; the parent company with commercial activities and a new company, a totally owned subsidiary of DEPA, the Manager of the Natural Gas Grid SA (DESFA),²³ which will own the Natural Gas Grid (ESFA) together with all the rights in the exploitation, operation, development and maintenance of the grid.²⁴ Furthermore, DEPA will no longer be the only supplier of natural gas in the domestic market, while the con-

struction, operation, management and exploitation of independent systems of natural gas is also being opened to other companies, which have, however, to obtain licences based on objective and transparent criteria.²⁵ The pricing policy for the access of third parties to the grid will be decided by the Ministry of Development.²⁶

Biofuels market

Law 3423/2005 ("Introduction of biofuels and other renewable fuels in the Greek market"), enacted by Parliament at the end of October 2005, aims to gradually reduce the country's dependence on oil and to guarantee the supply of energy from alternative sources. The new law harmonises national legislation with EU Directive 2003/30/EC,²⁷ according to which Member States have to set national targets regarding the use of these types of fuel in transport.

The new law sets a target to use biofuels for 5.75% of the energy content of all petrol and

20 According to Law 3175/2003, electricity generators who consume over 25 million cubic metres of natural gas and those with a licence for electricity production have the right to choose their supplier as from 1 July 2005.

21 If their annual consumption exceeds 100,000 MWh.

22 The EPAs of Attica, Thessaly and Thessaloniki will also have this right, for amounts of natural gas exceeding those they have signed contracts for with DEPA.

23 The new company will remain under state control for a period of at least 10 years and is expected to begin to operate in November 2006.

24 The National Grid includes the existing central pipeline, its branches and installations as well as the Revithousa Liquefied Natural Gas station.

25 This will guarantee the independence between (i) the parties involved in the management of transmission and distribution of natural gas and (ii) the vertically integrated natural gas companies.

26 The Ministry of Development gave the draft of the decision for public consultation on 23 December 2005.

27 Directive 2003/30/EC aims to meet Kyoto protocol requirements regarding environmental changes, greenhouse gas emissions and the security of supply in an environmentally friendly way, while promoting the use of renewable sources of energy in transport. To this effect, it promotes the use of biofuels especially in transport, which accounts for around 30% of final energy consumption in the European Union.

diesel consumed for transport purposes by 2010. It also provides the institutional framework for companies intending to get involved in the production and trade of biofuels and sets out the requirements for participation of companies in the "Schedule for Biofuel Distribution". Participants in this programme have the right and, at the same time, the obligation to provide the market with a specific amount of biofuels which will be exempt from excise consumption tax for the period up to the end of 2010.²⁸ Furthermore, the law settles issues relating to the blending of biofuels with other compatible diesel products as well as to the quality of biofuels and to relevant transactions. The promotion of the use of biofuels creates new opportunities for sustainable agricultural development, within the framework of the Common Agricultural Policy, and opens up a new market for innovative agricultural products (which can be used in the form of biomass as a source for the production of biofuels).

The modernisation of the legal framework which governs the energy market is expected to be completed within 2006 with the enactment by Parliament of two further laws: one on the establishment of a National Energy Council, which will be the formal advisory body on designing national energy policy,²⁹ and the other on the promotion of electricity generation from renewable sources of energy and from highly efficient plants that combine the generation of heat and power. To this effect, the Ministry of Development unveiled (on 16 January 2006) a draft of the law for public consultation, which provides for the simplification and speeding up of the procedure for the licensing of power plants using renewable energy sources. Furthermore, this law will align Greek legislation with Directive 2001/77/EC and with the Kyoto Protocol targets (ratified by Law 3017/2002) on the use of renewable sources of energy in electricity generation.³⁰

7. *Enhancing competition*

Law 3373/2005, which enhanced the role of the Hellenic Competition Commission (HCC), also provided for an increase in the number of members of the Commission from 9 to 11. The names of all 11 HCC members were announced on 2 February 2006. HCC members have a three-year tenure, which is renewable once.³¹ Further changes in the operating regulations of the HCC, also provided for by Law 3373/2005, are forthcoming.

In the context of monitoring adherence to competition principles, the Secretariat of the HCC initiated an investigation in the provision of dental services to find out whether the Greek Dental Federation and certain Dental Associations had set minimum payments for the services provided by their members. The establishment of minimum payments is contrary to Article 1 of Law 703/1977, as it now stands, since it aims at restricting competition. Following the suggestion of its Secretariat, the HCC in plenary session decided that³² the actions of the above associations aimed at, and succeeded in, dampening competition in dental services provision. The HCC demanded from the associations to stop this violation and not repeat it, to cease making decisions on the pricing policies of their members and to inform them accordingly in writing, within 30

28 It should be noted that, according to Law 3340/2005, the tax-exempt biodiesel quantities for 2005 amounted to 51,000 cubic metres, while for 2006 and 2007 these have been set at 91,000 and 114,000 cubic metres, respectively.

29 The relevant draft law was submitted to Parliament on 9 January 2006.

30 The indicative target for Greece for the consumption of electricity produced from renewable sources is 20.1% of total electricity production by 2010. In this direction, the new institutional framework aims to reach total power of 1,000 MW in established systems of renewable energy by 2010 (Ministry of Development Press Release, 16 January 2006).

31 Prior to the revision of the law there was no limit on the number of times for which tenure was renewable.

32 Decision 292/IV/2005 published in the Government Gazette (B1359/30 September 2005).

Indices of penetration of new technologies in Greece and the EU-15,¹ 2005

(Percentages)

	Greece	EU-15
Broadband penetration rate (number of broadband access lines over number of inhabitants)	0.8	12.0
Large enterprises with internet access, 2005 ²	100.0	100.0
Large enterprises with broadband access, 2005 ²	77.0	93.0
Households with internet access, 2005 ³	22.0	53.0
Households with broadband access, 2005 ³	1.0	25.0

1 Figures are based on a survey, co-ordinated by Eurostat, in Member States.

2 Number of large enterprises (in the non-financial sector) with internet access with any type of connection or with broadband connection, respectively, as a percentage of all large enterprises. Large enterprises are those with over 250 employees.

3 Number of households with internet access with any type of connection or with broadband connection, respectively, as a percentage of all households.

Source: Eurostat, New Cronos Database.

days from the receipt of HCC's decision. The HCC warned that a fine of €3,000 would be imposed to each association for each day it does not comply with this decision.

Furthermore, the plenary session of the Council of State decided that the population criteria set by law (Law 1963/1991) regarding the establishment of pharmacies are incompatible with the Greek Constitution.³³ Following this decision, granting of operation licences to pharmacies will not depend on the size of the population of the respective municipalities or communities.

8. Increasing the economy's extroversion

In order to enhance the economy's extroversion, the government proceeded to upgrade the National Export Council, which co-ordinates all institutions involved in designing export policy, and to radically restructure the Hellenic Organisation for External Trade (OPE). OPE's action plan for 2006 was outlined at the beginning of January and has three main priorities: (i) to access big foreign markets, (ii) to coordinate the actions of the parties involved in exports and (iii) to advertise Greek products and services abroad. The modernisation of the legal framework for the

Export Credit Insurance Organisation (OAEP) (Article 42 of Law 3427/2005), through, *inter alia*, the introduction of new insurance instruments, is also expected to increase exports.

9. Technology diffusion

The need to promote the use of Information and Communication Technologies (ICT) is evident from the data presented in the table above, which show that Greece lags behind the EU-15 average in terms of (i) the broadband penetration rate of large enterprises and (ii) internet access, through any type of connection, of households.

A committee (Informatics Committee)³⁴ has been set up to design the country's digital strategy for the period 2006-2013. The "Digital Strategy 2006-2013", which replaces the "White Paper for the Information Society", is compatible both with the revised Lisbon strategy ("Integrated guidelines for growth and jobs") and with the new European strategic framework for the information society

³³ Decision 3665/2005 of the Council of State.

³⁴ It was set up by the Cabinet in July 2004 with a mandate to formulate the general guidelines of government policy in this area and to develop measures for the use of ICT in areas such as education and R&D.

("i2010"). The Committee unveiled its proposal in July 2005 for public consultation and, on the basis of the comments received, will submit its final proposal for approval by the Cabinet Office.

In designing the strategy, the Committee started by identifying the main reasons behind the little use of ICT and the limited development of this sector in Greece. Reasons that have been proposed to explain these shortcomings include restricted product market competition, the high start-up costs for businesses, the absence of the necessary framework for electronic transactions, the lack of infrastructure for broadband connections, the imperfect co-operation between firms and universities, the limited competition in telecommunications, the restricted opportunities for life-long learning and the public sector's reserved attitude towards ICT. The Committee proceeded to study the digital strategies followed by 20 countries in order to draw on their experience. Evidence suggests that electronic governance should be integrated within a wider context to facilitate the transition to an Information Society. The main requirements for the success of the strategy are the creation of a framework supporting electronic transactions as well as the restructuring of the procedures and services supplied before automating them. For the successful diffusion of new technologies, it is necessary that both actions to this effect and their results, which should be constantly monitored, be widely disseminated. In the development of its proposal, the Committee cooperated, *inter alia*, with non-governmental organisations, representatives from the information and communication technology sector and other professional bodies.

The two main aims of the strategy are to increase productivity and improve the quality of living. For

the achievement of these aims, a large number of actions, organised along 6 pillars, is proposed: (i) encouragement of the use of ICT in enterprises (e.g. by increasing the availability of broadband connections and supporting electronic transactions), (ii) provision of digital services to enterprises and restructuring of the public sector (e.g. electronic procurement, digital certificates), (iii) support to the ICT Sector (e.g. by simplifying the framework regarding ICT projects) (iv) promotion of entrepreneurship in sectors that use ICT (e.g. by simplifying business start-up procedures), (v) improvement of day-to-day life through ICT (e.g. by encouraging broadband penetration, familiarising the public with ICT) and (vi) development of digital services for citizens (e.g. by converting to electronic form the 20 most popular services: submission of applications to universities, transactions with tax offices and customs etc.). All of these actions demand, as well as encourage, the development of human capital through training and the acquisition of new skills.

The implementation of these actions extends over two phases: the short-term actions are scheduled to be completed by 2008, while medium-term actions are expected to be completed by 2013. A key for the implementation of the strategy is the increase of the broadband penetration rate to 7% by 2008.³⁵ The tools to be used for the implementation of the digital strategy include: the operational programmes "Information Society" and "Improvement of the public sector" as well as public-private partnerships, especially in the field of provision of electronic governance.

³⁵ Press Conference held by the Minister of Economy and Finance on 25 October 2005.

V. The prospects of the Greek economy and the stance of economic policy

1. The economic outlook

As mentioned in Chapter IV, economic growth in Greece is expected to slow down slightly this year in comparison with 2005; therefore, the economy will continue to grow considerably faster than the euro area. Inflation is expected to fall somewhat in 2006 compared with 2005, because the adverse effects of external factors will weaken, but it will remain higher than in the euro area; as a result, the international price competitiveness of the economy will be further eroded. Underlying these forecasts is an estimate that the international environment will be relatively favourable in 2006, i.e. that world economic growth will remain strong and a further substantial rise in world oil prices will be avoided.

Over the longer term, the Greek economy faces serious challenges. On the one hand, adverse demographic changes will add to fiscal imbalances. On the other hand, the EU enlargement and globalisation – which lead to stronger competition in world markets and to an increase in their size – are serious challenges for Greece, but also offer opportunities. In these conditions, achieving fiscal consolidation, ensuring price stability and continuing to implement structural reforms over a wide range of economic sectors in order to further improve the macroeconomic environment and boost the productivity and international competitiveness of the Greek economy are key conditions for generating high and sustainable growth.

GDP (at constant prices) is forecast to grow by about 3.5% in 2006, compared with 3.7% in 2005 and an annual average of 4.4% in the previous five-year period (2000-2004). This forecast is based, *inter alia*, on the assumptions that monetary conditions will remain favourable in 2006,

while fiscal policy will continue to be tight, with the fiscal deficit being further reduced. Private consumption is forecast to increase at a slightly lower rate than in 2005, yet over 3%, and continue to be the main driving force of domestic demand. Private consumption will be supported not only by the expected rise in nominal incomes and employment, in conjunction with lower inflation, but also by the increase in consumer loans and the cumulative rise in the market value of households' assets in recent years. Besides, the share of total fixed capital formation in GDP growth is expected to be substantially larger in 2006, as a result of an expected rebound in public investment (following drastic cuts in 2005) and residential investment (after a small decrease in 2005). The growth rate of business investment is expected to be near the 2005 level, since public enterprises plan to increase their investment considerably, while it is estimated that private firms will benefit from the incentives provided by the development law, as well as from credit conditions, which remain favourable. By contrast, government consumption growth will decline further as a result of fiscal adjustment. The contribution to GDP growth of the change in the real external balance on goods and services, which was positive in 2005, is estimated to turn negative this year, since, according to forecasts, export growth will speed up but at the same time imports will rebound markedly (see below).

Economic growth will be accompanied by a further rise in employment, but, as a result of an increase in the labour force, it is estimated that it will have a limited effect on the unemployment rate, which will therefore remain high. In the non-bank private sector, firms' outlook for employment is favourable in retail trade and services other than banking, as well as in construction, but unfavourable in manufacturing. In central government, employment will rise little as a result of a

tight hiring policy (in the context of fiscal adjustment), while the voluntary early retirement plans implemented by several banks and major public enterprises are expected to lead to staff reductions.

The current account deficit as a percentage of GDP is forecast to show a small increase in 2006 over 2005, when it reached 7.8%. (However, it is estimated that the current account deficit excluding ships will remain unchanged or will drop slightly as a percentage of GDP in comparison with 2005, when it was 7.4%.¹) The outlook for the current account aggregates is associated with strong domestic demand, a continued drop in price competitiveness, as well as the structural weaknesses of the Greek economy. Goods exports will continue to grow, boosted by world economic activity, but, owing to further losses in international competitiveness, their increase will continue to fall short of the rise in demand for imports in the markets for Greek exports. At the same time, goods imports, which remained virtually unchanged or declined (at constant prices) in 2005 (after rising to a high level in 2004 owing to the Olympic Games), are expected to show a marked rebound in 2006. The favourable external environment is expected to support demand for shipping services, but receipts may decrease owing to the fall in freight rates, while travel receipts are expected to rise further. Finally, it is estimated that interest payments will continue to grow owing to a further increase in the public debt held by non-residents, while at the same time the preconditions exist for a higher current transfers surplus.²

HICP inflation is forecast to fall to 3.2% in 2006,

¹ The combined current account and capital transfers deficit as a percentage of GDP is estimated to remain virtually unchanged in comparison with 2005 (6.7%).

² It is also estimated that the capital transfers surplus will increase.

from 3.5% in 2005 (average annual rates), while core inflation (i.e. excluding energy and unprocessed food prices) is expected to drop to 2.9% in 2006, from 3.2% in 2005. These forecasts take into account the waning (from April 2006) of the impact of last year's raise in indirect tax rates on the annual inflation rate, a projected decrease in imported inflation (mainly as a result of a slowdown in oil price rises) and an estimated further easing of inflationary pressures on the demand side (since private consumption growth is forecast to slow down slightly and the positive "output gap" should narrow³). It is estimated that these factors will more than offset the effect of an expected faster rise in unit labour costs.

2 The challenges facing the Greek economy and the stance of economic policy

The Greek economy faces critical challenges. Despite relatively high growth rates during the last decade (average annual GDP growth in the 1996-2005 period: 3.9%, compared with 2.2% in the EU-15), Greece's *per capita* GDP (in purchasing power standards) was still 23% lower than that of the EU-15 in 2005. Besides, unemployment remains unacceptably high (slightly below 10% of the labour force), affecting mainly the young and women, as well as certain regions of the country. Moreover, despite the fast improvement in average living standards, the relative financial position of certain social groups has not improved considerably; as a result, social inequality remains significant and the poverty rate is virtually unchanged (see also Box IV.2). At the same time, the prospects for high economic growth over the longer-term are put at risk by macroeconomic imbalances and structural weaknesses, under conditions of ever stronger competition in the world economy. Specifically:

- Inflation remains higher than in the euro area;

as a result, the economy's international price competitiveness is being constantly eroded.

- Fiscal imbalances, as reflected in the very high deficit- and debt-to-GDP ratios (despite their decline in 2005), fuel inflation and jeopardise macroeconomic stability. Furthermore, unless structural measures are taken to address the population ageing problem and pension system reform is implemented in a timely manner, fiscal imbalances will deteriorate from 2015, when – given current trends and the existing institutional framework – pension expenditure as a percentage of GDP will start to rise owing to demographic developments.

- In recent years, economic growth has relied on domestic demand, which has also kept current account deficits high. However, the expansionary stance of fiscal policy in recent years was reversed in 2005. Moreover, strong credit expansion, which is also one of the factors that have supported private consumption, will inevitably slow when households' total borrowing as a percentage of GDP (which is still considerably lower than the euro area average) will tend to stabilise. Besides, the limited growth of goods and services exports (with the notable exception of shipping services exports) in recent years may be attributable to both the erosion of price competitiveness (see below, as well as Box IV.3) and the economy's low overall competitiveness, underlying which are structural weaknesses and rigidities in the labour market, education, the business environment etc.

- At the same time, the international environment – despite remaining favourable, as sug-

³ It should be recalled, however, that estimates of the "output gap" are surrounded by high uncertainty (see footnote 18 to Chapter IV).

gested by the strong growth of world economic activity and world trade volume— becomes unfavourable for economies that lag behind in productivity growth and are characterised by rigidities. The entry of the emerging economies of Asia and Eastern Europe into the world economy leads to the expansion of world markets and stiffer competition. Actually, competition will become even stronger in export markets if the rise in world trade volume decelerates.

In this environment, ensuring conditions for constantly high growth rates will require stepping up the efforts to achieve macroeconomic stability and transform the economy into one where growth relies more on increasing investment that boosts productive capacity and on expanding goods and services exports.

A key condition is the continuation of fiscal adjustment, so that the fiscal deficit and public debt will drop to sustainable levels on a lasting basis. Besides, wage increases compatible with achieving and maintaining price stability will halt a further erosion of price competitiveness and help reduce inflation.

However, for the Greek economy to cope with the challenges faced in world markets — where, as already mentioned, competition, mainly from low-labour-cost countries, becomes increasingly stronger— economic policy measures that promote the transformation of the economy, improve overall competitiveness and encourage exports of skilled-labour-intensive products will be needed. Such measures should include upgrading the labour force (partly by improving education), reducing labour market rigidities, enhancing competition in product markets (see also Box IV.1) and improving the business environment. Unless these problems are addressed in a timely manner, not only economic stability will be jeopardised,

but also investors' confidence in the prospects of the economy will weaken.

2.1 Fiscal policy

As mentioned earlier, fiscal imbalances remain very large, despite the fiscal adjustment achieved in 2005. Specifically, the general government deficit (on a national accounts basis) was reduced by 2.3 percentage points to 4.3% of GDP in 2005, but was the second highest in the euro area. Moreover, public debt declined by only 1.4 percentage points to 107.9% of GDP, but was also the second highest in the euro area.⁴ Indeed, the fiscal adjustment required to correct imbalances is much greater than implied by the current levels of the deficit and the debt. As already mentioned, unless structural measures are taken to address the population ageing problem and unless pension system reform is implemented in a timely manner, government spending on pensions and healthcare as a percentage of GDP is expected to start increasing from 2015 owing to demographic developments. According to available projections, overall ageing-related expenditure will rise by 11.5 percentage points of GDP between 2005 and 2050.⁵ (To give an idea of the magnitude of this increase, it should be noted that combined expen-

⁴ The average general government deficit and debt in the euro area were 2.9% and 71.1% of GDP, respectively, in 2005.

⁵ Between 2005 and 2050, spending on pensions and healthcare will grow from 12.4% to 22.6% and from 5.0% to 6.6% respectively, while spending on education and unemployment benefits will drop slightly from 3.7% to 3.4% (owing to the change in the population's age structure). See *Annual Report 2004*, April 2005, p. 67. These projections are based on data for 2002. The EU Economic Policy Committee (EPC) and the National Actuarial Authority of Greece are currently preparing revised projections taking into account updated data on population and demographic trends (see Section 6 of the revised Updated Stability and Growth Programme of Greece, March 2005, as well as "The 2005 EPC projections of age-related expenditure (2004-2050) for the EU-25 member states: underlying assumptions and projection methodologies", in *European Economy Special Report 4/2005*, 8 November 2005). It should be noted that, according to available projections, fiscal pressures from population ageing in Greece will be the strongest in the euro area.

ditures for education, health/social solidarity and social security under the government budget for 2006 are slightly lower than 11.5% of GDP.⁶)

Addressing fiscal imbalances in a timely manner is crucial for creating a stable macroeconomic environment, which is instrumental to achieving high growth rates and ensuring social security and social protection benefits, as well as the provision of quality services by the public sector. Fiscal adjustment is also warranted if Greece is to meet its obligations under the Stability and Growth Pact and the Excessive Deficit Procedure that was initiated against Greece under Article 104 of the Maastricht Treaty.

The reduction of the fiscal deficit in 2005 was an important first step. However, it should be pointed out that deficit reduction was based on cutting public investment and –to a lesser extent– curbing current expenditure growth, while the deficit remained higher than the initial target, mainly as a result of a shortfall in revenue from indirect taxes, which may be attributed to higher tax evasion. Moreover, various financial transactions –which affect public debt, but are not taken into account directly in the calculation of the deficit– limited considerably the decrease in the debt-to-GDP ratio in 2005.⁷

If confidence is to be safeguarded, fiscal adjustment must be continued this year and the targets of the budget and the Updated Stability and Growth Programme of Greece of December 2005 must be achieved. The fiscal policy target for 2006 is to further reduce the general government deficit (on a national accounts basis) to 2.6% of GDP. Deficit reduction will mainly rely on a considerable increase in government budget revenue, which partly reflects “one-off” measures, as well as on a moderate rise in the ordinary budget primary expenditure and a decline in interest pay-

ments.⁸ Achieving this target will largely depend on successfully combatting tax evasion.⁹ The recent outturn of tax revenue is encouraging in this respect.

Fiscal consolidation will require sustained fiscal adjustment for a number of years, so that fiscal surpluses will be achieved and public debt will be substantially reduced over the long term. Fiscal consolidation should rely on measures that improve the fiscal position on a lasting basis and also contribute to improving overall productivity and enhancing economic growth prospects. Specifically, fiscal adjustment should –as provided for by the Updated Stability and Growth Programme of December 2005– rely on drastically cutting current expenditure, broadening the tax base and combatting tax evasion. This will provide leeway to further reduce tax rates, carry out adequate public investment for upgrading infrastructures, face the pressures on the pension and healthcare systems from population ageing and ensure social protection for weak population groups. With respect to the last two objectives, the following should be pointed out: first, reforming the social security system is vital if ageing-induced demographic pressures are to be addressed in a way that is socially fair and does not have an adverse impact on the economy’s long-term prospects; second, reducing fiscal deficits and public debt substantially will allow the implementation of a redistributive policy through the government budget, so as to support those social groups (like low-pension earners)

⁶ Certainly, this government expenditure is only a part of overall spending on these sectors.

⁷ The “stock-flow adjustment” remained high, at 2.3% of GDP in 2005, compared with 2.6% in 2004 (see Table IV.12).

⁸ According to forecasts, public investment will recover, but, since revenue under the public investment budget (PIB) is also expected to rebound, the PIB deficit will remain virtually unchanged as a percentage of GDP.

⁹ See Appendix to Chapter IV on the recent measures against tax evasion.

that are always below the poverty line but cannot benefit from measures to boost employment, as they have retired from the labour market.

2.2 Wage policy

Persistent high inflation in Greece in recent years and its positive differential with inflation in Greece's trading partners have led to a worsening of the international price competitiveness of the economy and added to the high current account deficit as a percentage of GDP, also impacting unfavourably on economic activity and employment. Hence, firms' wage rises and pricing policies are very important. As mentioned in Chapter IV (Box IV.3), Greece's international price competitiveness vis-à-vis its main trading partners – as measured by the real effective exchange rate indices – deteriorated considerably in the 2001-2005 period: the cumulative rise in the real effective exchange rate amounted to 12.4% (CPI-based index) and 27.6% (unit-labour-cost-in-manufacturing-based index). It should be pointed out that this took place in a period of major structural changes in the world economy, including the entry into world markets of certain emerging economies with a huge low-cost labour supply and very fast growing exports. These changes have led to stronger competition in world markets.¹⁰ This highlights the need to agree, in the ongoing collective wage bargaining round, on wage raises compatible with eliminating the inflation differential and ensuring price stability (i.e. an inflation rate below but close to 2%). However, to address effectively the challenge of increasing international competition – i.e. without an adverse impact on the growth rates of economic activity, employment and real wages – serious structural reforms will also be needed to transform the economy into one exporting skill-intensive goods and services.

2.3 Structural reforms

Despite progress in reforms, the Greek economy continues to exhibit serious structural weaknesses in labour and product markets, as well as in the business environment and public administration. These must be addressed decisively in order to improve productivity and international competitiveness.

Persistent high unemployment, which mainly affects the young and women, implies that there are serious rigidities in the labour market. In fact, it is widely recognised that – despite the measures taken in the last 15 years – the operation of the labour market continues to be hampered by certain aspects of the labour, tax and social security legislative framework, as well as by certain weaknesses of the educational system. These act as disincentives for both labour demand and supply and create mismatches. The recently adopted legal provision according to which new employees of public enterprises and entities will henceforth be hired under indefinite-term labour contracts governed by the labour law in force for the private sector helps increase labour mobility and generally improve the operation of public enterprises. However, further measures will be required in order for the economy to reap the benefits from improved labour force utilisation – i.e. to raise potential output and employment growth and reduce unemployment.

Competitive conditions in the markets for goods and services lead to productivity growth and, through it, to lower production costs and lower

¹⁰ It should be noted that these real effective exchange rate indices underestimate that part of the decline in the international price competitiveness of the Greek economy which is attributable to the fact that in recent years emerging economies, which offer their products at very low prices, have increased their share in world trade (see Box IV.3).

product prices. However, the Greek economy continues to be burdened by regulatory provisions (e.g. barriers to entry into various sectors, exceptions to the anti-trust law, provisions on administered prices) that hamper competition in many sectors of the economy. Certainly, there has been considerable progress in some sectors. The benefits from competition are evident in the mobile telephony market, where enhanced competition has led to lower prices and improved quality of services. More recently, important steps were made towards liberalising the energy market, while company start-up procedures were simplified by laws passed in 2005. (See Appendix to Chapter IV and Box IV.1 of this report, as well as Appendix to Chapter III, *Monetary Policy 2004-2005*, February 2005).

Moreover, a more business-friendly environment – which can be created by simplifying the tax system, establishing a stable tax framework, cutting red tape and generally improving the operation of the public sector – is vital for nurturing economic activity and investment. Recent measures to improve the business environment and enhance transparency in the public sector include the adoption of a new institutional framework on the operation of public enterprises and entities, the establishment of an audit agency for the broader public sector and the implementation of the law on public-private partnerships (see Appendix to Chapter IV).

3. The stability of the financial system

The Greek financial system has matured considerably during the last 15 years¹¹ and has contributed to both the transformation of the Greek economy and the achievement of high GDP growth rates. At the same time, the financial system benefited from burgeoning economic activity, the liberalisa-

tion of the financial sector and integration into the EU and the euro area. As pointed out in a previous Bank of Greece report,¹² as well as in the report on the evaluation of the Greek financial system prepared by the IMF and published in January 2006,¹³ the Greek financial sector overall is sound and resilient to possible shocks. The stability of the Greek banking system has been ensured, as the capital adequacy ratios, the profitability and liquidity of Greek banks are very satisfactory.

However, the banking sector faces certain medium-term challenges. Specifically, there are risks from strong credit expansion, as, even in the current phase of the business cycle, the non-performing loans to total loans ratio is high in comparison with the euro area average and may rise even further in the event of a slowdown in economic activity or a further increase in euro area interest rates. Moreover, the competitiveness of Greek banks, which are relatively small, is adversely affected by arrangements that limit banks' leeway to reduce operating costs and their interest rate margins. As regards banking supervision, the IMF *too* has verified that the Bank of Greece exercises effective supervision and generally responds to the new challenges by enhancing the supervisory framework, although there is scope for further improvement in certain sectors.

Ahead of the implementation of the new supervisory framework ("Basel II") in 2007, the Bank of Greece has taken or has recommended the relevant necessary measures and is going to take further measures soon with a view to addressing effectively the aforementioned risks and challenges.

¹¹ See *Monetary Policy, Interim Report 2003*, October 2003, Annex to Chapter IV.

¹² *Monetary Policy, Interim Report 2005*, October 2005, pp. 19-20 and 140-146.

¹³ See Chapter III.4, as well as IMF, *Greece: Financial System Stability Assessment*, January 2006.

Among other things, it has urged banks to implement conservative credit standards in evaluating loan applications. Specifically, according to a Bank of Greece Governor's Act, banks should ensure that the ratio of total loan servicing costs to income for any borrower should not exceed a reasonable ceiling (30% or 40%, depending on the income size). In addition, with respect to real estate collateral, banks should ensure that the loan-to-collateral ratio does not exceed the reasonable percentage of 75%.

Furthermore, since the bulk of loans to households are floating-rate loans, the Bank of Greece has recommended to households that they should make realistic assumptions about their income prospects in relation to the amount of their total debt obligations, so as to be able to cope with any increase in the loan servicing costs owing to possible interest rate hikes. If they do not wish to assume such a risk, households should seek to obtain fixed-rate loans.

Finally, improving the internal operation of banks on the basis, *inter alia*, of the principles of corporate governance enhances the effectiveness and robustness of the banking system. Hence, since 1998 the Bank of Greece has been establishing general principles and criteria for banks' internal control systems. Moreover, in 2005 it set out specific principles and criteria for ensuring the effective and safe operation of banks' information technology systems. Taking international developments in issues concerning banks' internal operation into account and in order to ensure that Greek banks adapt to best practice, the Bank decided to update and broaden the relevant institutional framework. To this end, it prepared and transmitted a draft Governor's Act to banks for consultation. The object of the draft Act is to ensure that every credit institution, on both an individual and

a consolidated basis, has adequate internal control, risk management and compliance systems.

* * *

The outlook for the Greek economy in 2006 is favourable in terms of economic growth, which is expected to slow down slightly in comparison with 2005, but to remain strong. Inflation is expected to decline somewhat this year, because the influence of external factors that had weighed on prices in 2005 (i.e. the indirect tax rise and the increase in oil prices) will weaken. However, in 2006 inflation will remain well above the euro area average; as a result, the international competitiveness of the economy will be further eroded and thus the current account deficit will remain relatively high. At the same time, high unemployment persists, implying that the problem is structural. As regards long-term prospects, the Greek economy faces serious challenges. Despite a considerable decrease in the fiscal deficit in 2005, fiscal imbalances remain sizeable. In the future, government expenditure will come under further pressure from unfavourable demographic developments, unless the ageing problem is addressed and pension system reform is implemented in a timely manner. At the same time, globalisation and EU enlargement are leading to stronger competition and set serious challenges. However, the growth of world markets also creates opportunities that Greece should take advantage of. In these circumstances, achieving fiscal consolidation, ensuring price stability and continuing to implement structural reforms over a wide range of economic sectors so as to further improve the macroeconomic environment and boost the productivity and international competitiveness of the Greek economy are key conditions for achieving high and sustainable growth rates, raising employment and reducing unemployment.

Monetary policy measures of the Eurosystem

13 January 2005

The Governing Council of the ECB decides that the minimum bid rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 2.0%, 3.0% and 1.0%, respectively.

14 January 2005

The Governing Council of the ECB decides to increase the allotment amount for each of the longer-term refinancing operations to be conducted in the year 2005 from €25 billion to €30 billion. This increased amount takes into consideration the higher liquidity needs of the euro area banking system anticipated for the year 2005. The Eurosystem will, however, continue to provide the bulk of liquidity through its main refinancing operations.

3 February, 3 March, 7 April, 4 May, 2 June, 7 July, 4 August, 1 September, 6 October and 3 November 2005

The Governing Council of the ECB decides that the minimum bid rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 2.0%, 3.0% and 1.0%, respectively.

1 December 2005

The Governing Council of the ECB decides to increase the minimum bid rate on the main refinancing operations by 0.25 percentage point to 2.25%, starting from the operation to be settled on 6 December 2005. In addition, it decides to increase the interest rates on both the marginal lending facility and the deposit facility by 0.25 percentage point, to 3.25% and 1.25% respectively, both with effect from 6 December 2005.

16 December 2005

The Governing Council of the ECB decides to increase the allotment amount for each of the

longer-term refinancing operations to be conducted in the year 2006 from €30 billion to €40 billion. This increased amount takes two aspects into consideration. First, the liquidity needs of the euro area banking system are expected to increase further in the year 2006. Second, the Eurosystem has decided to increase slightly the share of the liquidity needs satisfied by the longer-term refinancing operations. The Eurosystem will, however, continue to provide the bulk of liquidity through its main refinancing operations. The

Governing Council may decide to adjust the allotment amount again at the beginning of 2007.

12 January and 2 February 2006

The Governing Council of the ECB decides that the minimum bid rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 2.25%, 3.25% and 1.25% respectively.

Glossary

Community Support Framework (CSF): compiled by the Commission of the European Communities in co-operation with the Member State and approved by the Commission. It includes the country's growth strategy, activity priorities and financing resources (participation of the Community, national public expenditure, participation of the private sector).

Deposit facility: a *standing facility* of the *Eurosystem* which counterparties may use to make overnight deposits, remunerated at a pre-specified interest rate, at a national central bank.

Deposits redeemable at notice: this instrument comprises savings deposits which the depositor may withdraw once he has given notification thereof within a predetermined time period. At some instances, it is possible to withdraw part of the amount deposited at notice or before, subject to penalty.

Deposits with an agreed maturity (time deposits): deposits with a fixed maturity, which, according to the national practice, are either not convertible into cash before their maturity or are convertible into cash subject to penalty. They include some non-negotiable instruments, such as non-negotiable certificates of (private) deposit.

Effective (nominal/real) exchange rates: nominal effective exchange rates are weighted averages of bilateral exchange rates. Real effective exchange rates are nominal effective exchange rates deflated by a weighted average of foreign, relative to domestic, prices or costs. They are, thus, measures of price and cost competitiveness.

EONIA (euro overnight index average): a measure of the interest rate prevailing in the euro interbank overnight market, based on transactions.

EURIBOR (euro interbank offered rate): the rate at which a prime bank is willing to lend funds in euro to another prime bank, computed daily for interbank deposits with different maturities of up to 12 months.

Euro area: the area encompassing those Member States in which the euro has been adopted as the single currency in accordance with the Treaty and in which a single monetary policy is conducted under the responsibility of the *Governing Council* of the *ECB*. The euro area currently comprises 12 countries: Austria, Belgium, Germany, Greece, Finland, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.

European Central Bank (ECB): the ECB lies at the centre of the *European System of Central Banks* (ESCB) and the *Eurosystem* and has legal personality under Community law. It ensures that the tasks conferred upon the Eurosystem and the ESCB are implemented either through its own activities or through those of the national central banks, pursuant to the Statute of the ESCB and of the ECB. The ECB is governed by the *Governing Council* and the *Executive Board*, and, as a third decision-making body, by the *General Council*.

European System of Central Banks (ESCB): composed of the *ECB* and the national central banks of all 25 EU Member States, i.e. it includes, in addition to the members of the *Eurosystem*, the national central banks of those Member States that have not yet adopted the euro. The ESCB is governed by the *Governing Council* and the *Executive Board*, and, as a third decision-making body, by the *General Council*.

Eurosystem: comprises the *ECB* and the national central banks of those Member States that have adopted the euro. There are currently 12 national central banks in the Eurosystem. The Eurosystem is governed by the *Governing Council* and the *Executive Board* of the *ECB*.

Executive Board: one of the decision-making bodies of the *ECB*. It comprises the President and the Vice-President of the *ECB* and four other members appointed by common accord by the Heads of State or Government of the countries that have adopted the euro.

General Council: one of the decision-making bodies of the *ECB*. It comprises the President and the Vice-President of the *ECB* and the governors of the 25 EU national central banks.

General government: as defined in the European System of Accounts 1995 (ESA 95), comprises central, state and local government and social security organisations.

Governing Council: one of the decision-making bodies of the *ECB*. It comprises all the members of the *Executive Board* and the governors of the national central banks of the countries that have adopted the euro.

Harmonised Index of Consumer Prices (HICP): a measure of consumer prices which is compiled by Eurostat and harmonised for all EU Member States.

Key ECB interest rates: the interest rates, set by the *ECB*, which reflect the monetary policy stance of the *ECB*. Currently, key ECB interest rates are the minimum bid rate on the *main refinancing operations*, the interest rate on the *marginal lending facility* and the interest rate on the *deposit facility*.

Main refinancing operation: a weekly open market operation conducted by the *Eurosystem*. The operations are conducted as variable rate tenders with a pre-announced minimum bid rate and have a maturity of one week.

Marginal lending facility: a *standing facility* of the *Eurosystem*, which counterparties may use to receive overnight credit from a national central bank at a pre-specified interest rate against eligible assets.

Monetary aggregates: a monetary aggregate is the sum total of currency in circulation plus the overdue amounts of certain liabilities of MFIs and central governments which have a high degree of “moneyness” (or liquidity in a broad sense). The narrow monetary aggregate M1, as defined by the *Eurosystem*, comprises currency in circulation plus *overnight deposits* which non-MFI *euro area* residents (other than cen-

tral government) keep with *euro area* institutions that issue money. The monetary aggregate M2 comprises M1 plus *deposits with an agreed maturity* of up to two years plus *deposits redeemable at a period of notice* of up to three months. The broad monetary aggregate M3 comprises M2 and repurchase agreements (repos), money market fund shares/units, money market paper and debt securities with a maturity of up to two years.

Overnight deposits: deposits due on the next working day. This instrument comprises both fully transferable (through cheques etc.) and non-transferable deposits convertible into cash upon request or until the end of the next working day. Particularly for Greece, this instrument includes sight deposits, deposits in current accounts and savings deposits.

Standing facility: a national central bank facility available to counterparties on their own initiative. The *Eurosystem* offers two overnight standing facilities: the *marginal lending facility* and the *deposit facility*.

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Table 1
Consumer price index: general index and basic sub-indices

Period	General index		Goods		Services		CPI excluding fresh fruit/vegetables and fuel		CPI excluding food and fuel	
	(1999=100)	Percentage change over previous year	(1999=100)	Percentage change over previous year	(1999=100)	Percentage change over previous year	(1999=100)	Percentage change over previous year	(1999=100)	Percentage change over previous year
2002	110.2	3.6	110.1	3.2	110.4	4.3	109.0	3.6	108.7	3.6
2003	114.1	3.5	113.5	3.1	115.1	4.2	112.6	3.2	112.2	3.1
2004	117.4	2.9	116.0	2.3	119.5	3.8	116.2	3.3	115.7	3.2
2005	121.6	3.5	120.0	3.4	123.9	3.7	119.8	3.1	119.4	3.2
2004 I	115.8	2.7	114.4	1.8	118.0	4.0	114.3	3.3	113.7	3.2
II	118.2	2.9	117.5	2.3	119.1	3.9	116.6	3.3	116.1	3.2
III	116.5	2.8	114.3	2.1	119.9	3.9	116.0	3.4	115.3	3.4
IV	119.1	3.2	117.9	2.9	121.0	3.5	118.0	3.0	117.8	2.9
2005 I	119.7	3.3	118.0	3.1	122.3	3.6	118.1	3.3	117.7	3.5
II	122.1	3.3	121.0	3.0	123.7	3.8	120.1	3.0	119.8	3.1
III	121.1	3.9	118.9	4.0	124.3	3.6	119.5	3.0	119.0	3.1
IV	123.5	3.7	122.2	3.6	125.4	3.7	121.6	3.0	121.3	3.0
2003 Jan.	111.8	3.1	110.8	2.1	113.4	4.7	110.4	3.7	109.9	3.6
Feb.	112.0	4.3	111.1	4.1	113.3	4.7	109.7	3.8	108.9	3.5
March ..	114.5	4.1	115.2	4.1	113.4	4.1	112.0	3.4	111.6	3.1
Apr.	114.6	3.4	114.6	2.6	114.6	4.5	112.6	3.4	112.3	3.1
May	115.1	3.8	115.4	3.9	114.7	3.7	112.8	2.9	112.6	2.8
June	114.9	3.8	114.9	3.6	114.9	4.2	113.0	3.0	112.7	3.0
July	112.7	3.6	111.1	3.2	115.0	4.1	111.2	2.9	110.5	2.9
Aug.	112.6	3.3	110.9	2.8	115.2	4.0	111.4	3.0	110.7	2.9
Sept.	114.8	3.3	113.9	2.8	116.1	4.2	113.8	3.2	113.5	3.1
Oct.	115.2	3.2	114.4	2.5	116.4	4.2	114.3	3.2	114.1	3.2
Nov.	115.4	3.3	114.7	2.9	116.5	4.1	114.4	3.1	114.3	3.2
Dec.	115.9	3.1	114.7	2.2	117.7	4.5	115.2	3.3	115.0	3.4
2004 Jan.	115.1	2.9	113.3	2.3	117.9	3.9	114.0	3.2	113.4	3.2
Feb.	114.8	2.5	112.7	1.5	117.9	4.0	113.2	3.1	112.2	3.1
March ..	117.6	2.7	117.2	1.8	118.2	4.2	115.9	3.4	115.3	3.3
Apr.	117.9	2.9	117.2	2.3	119.0	3.9	116.3	3.2	115.9	3.2
May	118.5	2.9	118.1	2.4	119.0	3.8	116.6	3.3	116.1	3.2
June	118.1	2.8	117.3	2.1	119.4	3.9	116.9	3.5	116.5	3.3
July	116.0	2.9	113.6	2.2	119.6	4.0	115.5	3.8	114.8	3.8
Aug.	115.7	2.7	113.0	1.9	119.8	4.0	115.0	3.2	114.1	3.1
Sept.	118.0	2.8	116.4	2.2	120.5	3.7	117.5	3.3	117.1	3.2
Oct.	118.9	3.2	117.9	3.1	120.4	3.5	117.7	3.0	117.5	3.0
Nov.	119.0	3.1	117.9	2.8	120.7	3.6	117.9	3.1	117.6	2.9
Dec.	119.5	3.1	117.9	2.8	121.8	3.5	118.5	2.9	118.2	2.8
2005 Jan.	119.8	4.0	118.1	4.3	122.3	3.7	118.7	4.2	118.5	4.5
Feb.	118.3	3.1	115.8	2.8	122.1	3.6	116.6	3.0	115.8	3.2
March ..	121.0	2.9	120.1	2.4	122.5	3.6	119.0	2.7	118.7	2.9
Apr.	121.9	3.4	120.9	3.1	123.5	3.8	119.8	3.0	119.4	3.1
May	122.3	3.2	121.3	2.7	123.8	4.0	120.2	3.2	119.9	3.3
June	122.0	3.3	120.8	3.1	123.8	3.7	120.3	3.0	120.0	3.0
July	120.5	3.9	118.3	4.1	124.0	3.7	119.3	3.3	118.8	3.5
Aug.	120.0	3.7	117.3	3.8	124.1	3.6	118.3	2.9	117.5	3.0
Sept.	122.6	3.9	121.2	4.2	124.8	3.6	120.9	2.8	120.5	2.9
Oct.	123.5	3.8	122.4	3.8	125.1	3.9	121.3	3.0	121.1	3.1
Nov.	123.2	3.5	121.9	3.4	125.2	3.7	121.4	3.0	121.2	3.0
Dec.	123.8	3.6	122.3	3.7	126.0	3.5	121.9	2.9	121.7	2.9
2006 Jan.	123.6	3.2	122.0	3.3	126.2	3.2	121.4	2.3	120.9	2.0

Source: Calculations based on NSSG data.

Table 2
Harmonised index of consumer prices: general index and basic sub-indices

Period	HICP (general index)		Unprocessed food		Processed food		Non-energy industrial goods	
	(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year
2002	124.8	3.9	133.5	6.9	127.0	5.5	118.0	2.5
2003	129.0	3.4	142.0	6.4	131.7	3.6	119.8	1.6
2004	133.0	3.0	137.8	-2.9	138.0	4.8	122.6	2.3
2005	137.6	3.5	135.7	-1.5	141.9	2.8	126.1	2.8
2004 I	130.9	2.9	146.2	3.7	135.9	4.9	118.9	1.7
II	133.9	3.1	142.8	-5.1	138.2	5.9	124.5	2.1
III	132.0	3.0	128.9	-7.2	138.9	4.9	120.8	3.0
IV	135.0	3.2	133.3	-3.1	139.0	3.6	126.4	2.6
2005 I	135.4	3.4	140.4	-4.0	139.3	2.5	123.9	4.2
II	138.2	3.2	138.9	-2.7	141.4	2.3	127.6	2.5
III	136.9	3.8	129.1	0.1	143.0	3.0	123.9	2.5
IV	139.8	3.5	134.6	1.0	143.9	3.5	129.0	2.1
2003 Jan.	126.4	3.3	136.6	-4.7	128.9	4.5	116.1	1.9
Feb.	126.1	4.2	141.6	3.0	129.7	5.0	113.1	1.5
March ..	129.3	3.9	144.8	4.4	130.2	4.5	121.3	1.7
Apr.	129.6	3.3	147.7	6.8	130.5	2.8	121.5	1.7
May	130.2	3.5	153.8	16.1	130.6	2.3	122.2	1.8
June ...	130.0	3.6	149.8	14.2	130.7	2.1	122.2	1.7
July	127.3	3.5	141.2	11.6	130.8	2.1	115.5	1.6
Aug. ...	127.3	3.3	137.8	8.3	132.0	2.9	115.2	1.3
Sept. ...	129.9	3.3	137.6	7.2	134.3	4.6	121.4	1.1
Oct.	130.4	3.2	136.3	4.2	134.2	4.5	122.8	1.4
Nov. ...	130.6	3.2	137.4	3.8	134.1	4.3	123.2	1.5
Dec. ...	131.4	3.1	138.9	3.3	134.2	4.4	123.4	1.7
2004 Jan.	130.3	3.1	142.3	4.1	134.7	4.5	118.4	1.9
Feb.	129.4	2.6	148.1	4.5	135.8	4.7	114.6	1.3
March ..	133.1	2.9	148.3	2.4	137.2	5.4	123.6	1.9
Apr.	133.6	3.1	144.6	-2.1	137.5	5.4	123.8	2.0
May	134.2	3.1	144.8	-5.8	138.5	6.1	124.7	2.0
June ...	133.9	3.0	138.9	-7.3	138.7	6.2	125.0	2.3
July	131.3	3.1	127.9	-9.5	138.8	6.1	119.7	3.6
Aug. ...	130.9	2.8	129.4	-6.1	138.9	5.2	117.5	2.0
Sept. ...	133.7	2.9	129.5	-5.9	138.9	3.5	125.4	3.3
Oct.	134.7	3.3	130.9	-4.0	138.9	3.5	126.4	2.9
Nov. ...	134.8	3.2	131.4	-4.4	139.1	3.7	126.3	2.6
Dec. ...	135.5	3.1	137.6	-1.0	139.1	3.7	126.4	2.4
2005 Jan.	135.8	4.2	138.0	-3.0	139.2	3.4	126.5	6.9
Feb.	133.5	3.2	141.3	-4.6	139.2	2.5	118.5	3.5
March ..	136.9	2.9	141.8	-4.4	139.5	1.7	126.6	2.4
Apr.	138.0	3.3	140.9	-2.6	140.4	2.1	127.1	2.6
May	138.5	3.2	141.2	-2.5	141.5	2.1	127.8	2.5
June ...	138.2	3.2	134.6	-3.1	142.2	2.5	127.9	2.3
July	136.4	3.9	126.4	-1.2	142.8	2.9	123.9	3.5
Aug. ...	135.6	3.6	129.7	0.2	142.9	2.9	120.0	2.1
Sept. ...	138.8	3.8	131.1	1.3	143.3	3.2	127.9	2.0
Oct.	139.7	3.7	134.0	2.4	143.4	3.2	128.9	2.0
Nov. ...	139.4	3.4	134.2	2.1	143.9	3.5	129.0	2.1
Dec. ...	140.2	3.5	135.6	-1.5	144.5	3.8	129.1	2.1

Source: Calculations based on NSSG data.

Table 2 (continued)

Harmonised index of consumer prices: general index and basic sub-indices

Period	Energy		Services		ΕνΔΤΚ χωρίς μη επεξεργασμένα είδη διατροφής & ενέργεια	
	(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year	(1996=100)	Percentage change over previous year
2002	106.1	-0.3	133.8	4.5	125.8	3.9
2003	110.0	3.7	139.4	4.1	129.7	3.1
2004	117.0	6.4	144.7	3.8	134.2	3.4
2005	132.9	13.6	149.9	3.6	138.4	3.2
2004 I	110.4	-3.3	142.8	4.0	131.5	3.3
II	117.2	9.7	144.3	3.8	134.8	3.5
III	118.2	7.9	145.3	3.9	133.8	3.7
IV	122.4	11.6	146.5	3.6	136.6	3.2
2005 I	122.7	11.2	147.9	3.6	136.3	3.6
II	132.9	13.5	149.8	3.8	138.9	3.1
III	137.7	16.5	150.4	3.5	137.9	3.1
IV	138.5	13.1	151.7	3.6	140.7	3.0
2003 Jan.	111.0	11.2	137.7	4.8	127.0	3.7
Feb.	115.2	14.5	137.2	4.7	125.7	3.6
March	116.1	12.0	137.3	4.0	129.1	3.2
Apr.	107.9	-0.6	139.0	4.5	130.0	3.2
May	105.9	-2.0	138.8	3.2	130.2	2.5
June	106.5	-0.3	139.1	4.0	130.4	2.8
July	108.4	1.3	139.3	4.0	127.8	2.8
Aug.	110.1	1.7	139.6	4.1	128.0	2.9
Sept.	110.1	1.3	140.4	4.0	131.2	3.0
Oct.	110.5	1.4	140.8	4.1	131.9	3.1
Nov.	110.6	5.2	140.8	4.0	132.1	3.1
Dec.	107.9	-0.2	142.7	4.3	133.0	3.3
2004 Jan.	109.5	-1.4	143.0	3.9	131.2	3.3
Feb.	108.9	-5.5	142.5	3.9	129.6	3.1
March	112.8	-2.9	143.0	4.1	133.7	3.5
Apr.	115.6	7.0	144.3	3.8	134.4	3.4
May	119.0	12.4	143.9	3.7	134.7	3.5
June	116.9	9.8	144.6	4.0	135.2	3.7
July	117.5	8.4	144.9	4.0	133.2	4.2
Aug.	118.6	7.8	145.2	4.0	132.4	3.5
Sept.	118.3	7.5	145.8	3.8	135.9	3.6
Oct.	125.1	13.3	145.7	3.5	136.3	3.3
Nov.	124.6	12.7	145.9	3.6	136.3	3.2
Dec.	117.5	8.9	147.8	3.6	137.2	3.1
2005 Jan.	118.1	7.9	148.0	3.5	137.4	4.7
Feb.	122.1	12.1	147.6	3.6	134.0	3.4
March	127.9	13.4	148.1	3.6	137.5	2.8
Apr.	132.6	14.7	149.6	3.7	138.4	3.0
May	131.9	10.8	149.9	4.1	139.0	3.2
June	134.3	14.9	149.8	3.6	139.2	2.9
July	135.1	15.0	150.1	3.6	137.8	3.4
Aug.	137.3	15.8	150.2	3.5	136.3	2.9
Sept.	140.5	18.8	150.8	3.4	139.7	2.8
Oct.	142.1	13.6	151.1	3.7	140.3	3.0
Nov.	136.3	9.3	151.2	3.7	140.5	3.1
Dec.	137.1	16.6	152.7	3.3	141.3	3.0

Source: Calculations based on NSSG data.

Table 3

Industrial producer price index (PPI) for the domestic market: general index and basic sub-indices

Period	PPI – domestic market (General index)		Energy (total)		Fuels		General index excl. energy	
	(2000=100)	Percentage change over previous year	(2000=100)	Percentage change over previous year	Δείκτης (2000=100)	Percentage change over previous year	Δείκτης (2000=100)	Percentage change over previous year
2002	106.0	2.3	99.2	2.1	93.3	-0.4	107.6	2.3
2003	108.5	2.3	101.0	1.8	91.6	-1.8	110.2	2.5
2004	112.3	3.5	105.0	4.0	95.6	4.3	115.4	4.7
2005	118.9	5.9	118.9	13.2	119.5	25.1	118.9	3.0
2004 I	109.8	1.3	100.2	-3.6	86.6	-15.9	114.0	4.3
II	112.3	4.4	104.6	6.0	95.3	11.0	115.6	5.3
III	113.3	4.4	107.1	6.5	99.9	10.8	116.0	5.0
IV	113.8	4.1	108.2	7.4	100.5	14.7	116.3	4.3
2005 I	114.8	4.6	110.1	9.9	103.0	19.0	116.9	2.6
II	117.8	4.9	116.8	11.6	116.1	21.9	118.2	2.3
III	120.5	6.3	124.0	15.8	129.6	29.8	118.9	2.6
IV	122.6	7.7	124.7	15.3	129.4	28.7	121.7	4.7
2003 Jan.	108.0	3.5	103.0	7.2	100.7	15.6	109.0	2.5
Feb.	108.8	4.3	105.1	9.6	106.4	22.6	109.3	2.8
March ..	108.6	3.1	103.6	5.8	101.7	10.2	109.6	2.3
Apr.	107.7	1.6	99.1	-0.3	87.2	-9.5	109.8	2.2
May	107.4	1.4	97.9	-1.0	83.5	-11.9	109.8	2.1
June ...	107.7	2.0	99.1	1.3	86.7	-5.2	109.8	2.2
July	108.2	2.2	100.6	2.4	91.6	0.6	109.9	2.2
Aug. ...	108.5	2.0	100.6	0.2	91.5	-2.2	110.4	2.5
Sept. ...	108.9	1.7	100.6	-1.6	87.3	-12.1	110.9	2.6
Oct.	109.2	1.8	101.3	-1.1	89.5	-10.2	111.1	2.7
Nov. ...	109.5	2.5	101.1	1.2	88.6	-3.1	111.6	2.9
Dec. ...	109.3	2.0	99.9	-1.4	84.7	-11.6	111.7	2.9
2004 Jan.	109.3	1.2	99.9	-3.0	86.2	-14.4	113.3	4.0
Feb.	109.5	0.7	99.2	-5.6	84.5	-20.6	114.0	4.3
March ..	110.6	1.8	101.4	-2.1	89.1	-12.4	114.6	4.5
Apr.	111.9	3.9	103.4	4.3	92.9	6.4	115.5	5.2
May	112.9	5.1	106.4	8.7	99.0	18.5	115.7	5.3
June ...	112.2	4.2	104.1	5.1	93.9	8.3	115.6	5.4
July	112.8	4.3	105.9	5.3	97.5	6.5	115.7	5.3
Aug. ...	113.4	4.5	107.5	6.9	100.7	10.0	116.0	5.1
Sept. ...	113.7	4.4	107.9	7.3	101.5	16.3	116.2	4.8
Oct.	114.9	5.2	111.8	10.3	109.5	22.3	116.3	4.7
Nov. ...	114.0	4.1	108.2	7.1	99.7	12.5	116.5	4.4
Dec. ...	112.6	3.0	104.5	4.6	92.2	9.0	116.0	3.9
2005 Jan.	113.6	3.9	107.0	7.1	96.9	12.5	116.4	2.7
Feb.	114.5	4.6	109.1	10.0	101.2	19.8	116.9	2.5
March ..	116.4	5.3	114.2	12.6	110.9	24.6	117.4	2.5
Apr.	117.6	5.1	116.6	12.8	115.9	24.9	118.1	2.2
May	117.1	3.7	114.7	7.8	112.0	13.2	118.1	2.1
June ...	118.6	5.7	118.9	14.3	120.3	28.0	118.5	2.4
July	119.2	5.6	120.6	13.9	123.8	26.9	118.5	2.4
Aug. ...	120.2	6.0	123.5	14.9	129.2	28.3	118.8	2.5
Sept. ...	122.0	7.3	127.9	18.6	136.0	34.0	119.5	2.8
Oct.	123.0	7.0	128.0	14.5	136.1	24.3	120.9	4.0
Nov. ...	122.0	7.0	122.9	13.6	125.7	26.1	121.6	4.3
Dec. ...	122.8	9.1	123.2	17.9	126.3	36.9	122.6	5.7

Source: Calculations based on NSSG data.

Table 4
Industrial producer price index (PPI) for the external market and wholesale price index (imported products)

Period	PPI – external market				Import price index		Import price index excl. energy	
	General index		General index excl. energy					
	(2000=100)	Percentage change over previous year	(2000=100)	Percentage change over previous year	(2000=100)	Percentage change over previous year	(2000=100)	Percentage change over previous year
2002	101.8	1.1	105.1	1.6	103.4	0.3	103.8	0.4
2003	101.5	-0.3	104.4	-0.6	104.1	0.7	104.4	0.6
2004	106.6	5.0	106.3	1.8	107.4	3.1	105.2	0.8
2005	110.6	3.7	106.6	0.3	116.9	8.8	106.5	1.2
2004 I	104.4	2.3	105.9	2.5	104.2	-0.1	104.5	0.1
II	107.0	7.4	106.9	3.4	106.3	2.3	105.2	1.0
III	107.7	6.0	106.5	1.8	108.6	4.3	105.5	1.0
IV	107.3	4.4	106.0	-0.4	110.3	5.8	105.7	1.2
2005 I	107.2	2.7	105.9	0.0	112.8	8.2	106.0	1.4
II	109.4	2.3	106.3	-0.6	115.2	8.4	106.3	1.1
III	112.6	4.5	106.9	0.4	119.3	9.8	106.7	1.1
IV	113.1	5.4	107.4	1.3	120.1	8.9	107.2	1.4
2003 Jan.	101.7	0.8	103.3	-2.1	104.2	0.9	104.4	0.7
Feb.	102.5	1.5	103.2	-2.4	104.5	1.2	104.6	0.9
March	102.1	0.1	103.5	-1.8	104.4	1.0	104.4	0.7
Apr.	99.8	-2.9	103.5	-1.9	104.0	0.6	104.3	0.5
May	99.0	-3.1	103.2	-2.0	103.9	0.4	104.2	0.4
June	99.9	-1.4	103.4	-1.3	103.8	0.5	104.2	0.4
July	101.2	0.3	104.2	-0.3	104.0	0.7	104.3	0.6
Aug.	102.0	0.2	104.4	-0.6	104.1	0.6	104.4	0.5
Sept.	101.6	-1.4	105.2	0.1	104.2	0.6	104.5	0.5
Oct.	102.9	0.0	106.3	1.2	104.2	0.6	104.5	0.6
Nov.	103.1	1.9	106.7	1.9	104.3	0.7	104.5	0.6
Dec.	102.5	0.8	106.6	2.1	104.1	0.4	104.4	0.4
2004 Jan.	104.2	2.4	105.6	2.3	104.1	0.0	104.3	-0.1
Feb.	103.9	1.3	105.8	2.5	103.7	-0.7	104.5	0.0
March	105.2	3.0	106.3	2.6	104.8	0.4	104.7	0.3
Apr.	106.6	6.8	107.0	3.4	105.6	1.5	105.1	0.8
May	107.8	8.9	107.0	3.7	106.9	2.9	105.3	1.1
June	106.6	6.7	106.7	3.2	106.4	2.5	105.2	1.0
July	107.3	6.0	106.6	2.3	107.7	3.6	105.3	1.0
Aug.	107.8	5.7	106.4	2.0	108.5	4.2	105.4	1.0
Sept.	108.1	6.4	106.5	1.2	109.7	5.3	105.6	1.0
Oct.	108.8	5.8	106.3	0.0	111.1	6.6	105.8	1.3
Nov.	107.4	4.1	106.1	-0.5	110.3	5.8	105.8	1.2
Dec.	105.7	3.1	105.7	-0.8	109.4	5.1	105.6	1.1
2005 Jan.	106.2	2.0	105.7	0.1	111.0	6.6	105.8	1.4
Feb.	106.9	2.9	106.0	0.2	113.1	9.0	106.1	1.5
March	108.5	3.1	105.9	-0.3	114.3	9.1	106.1	1.4
Apr.	109.1	2.4	106.0	-0.9	114.4	8.4	106.2	1.1
May	109.1	1.2	106.3	-0.6	113.9	6.5	106.3	0.9
June	110.1	3.3	106.5	-0.2	117.4	10.3	106.5	1.2
July	111.5	3.9	106.8	0.2	118.8	10.3	106.5	1.1
Aug.	112.5	4.4	106.9	0.5	120.1	10.7	106.6	1.1
Sept.	113.8	5.2	107.1	0.6	119.0	8.5	106.9	1.2
Oct.	113.6	4.4	107.1	0.8	119.9	7.9	107.0	1.1
Nov.	113.1	5.3	107.5	1.3	120.3	9.1	107.2	1.4
Dec.	112.6	6.5	107.7	1.9	120.1	9.8	107.2	1.6

Source: Calculations based on NSSG data.

Table 5

Gross value added at basic prices and gross domestic product at market prices

	Million euro	Annual percentage changes (at constant prices of year 1995)					
	1995	2000	2001	2002	2003	2004	2005
Primary sector (agriculture)	7,277	-4.2	-4.1	-1.6	-4.0	0.6	...
Secondary sector	16,550	5.4	6.6	2.1	6.1	0.5	...
Mining and quarrying	476	23.2	2.2	8.4	-4.8	0.6	...
Manufacturing	9,572	4.6	3.3	2.5	3.5	-1.5	...
Electricity - natural gas - water supply	1,751	4.8	1.3	1.8	7.8	4.1	...
Construction	4,751	5.7	15.1	0.9	10.8	2.4	...
Tertiary sector	50,031	5.1	6.1	3.8	6.7	6.5	...
Trade	10,018	3.1	13.9	2.1	9.4	0.5	...
Hotels - restaurants	4,821	5.4	6.3	6.1	7.5	9.3	...
Transport - communications	4,978	16.2	1.3	5.9	6.3	20.8	...
Financial intermediaries	3,112	10.0	7.6	-8.9	21.9	9.4	...
Real estate management and other activities	12,577	3.5	4.4	2.1	2.8	0.2	...
Public administration - security	5,308	-2.8	1.0	8.4	-4.3	14.0	...
Education	3,298	1.6	-1.0	12.0	12.3	1.6	...
Health	3,855	3.0	2.5	5.8	5.4	0.4	...
Miscellaneous services	2,064	7.6	15.2	9.5	4.9	11.8	...
Gross value added at basic prices	73,858	4.4	5.4	3.1	5.8	4.7	...
Financial services indirectly measured (FISIM)	-2,175	13.8	18.8	-12.7	31.6	11.3	...
Gross value added (excluding FISIM)	71,683	4.1	4.9	3.8	4.8	4.4	...
Private consumption	58,405	2.0	3.1	3.3	4.5	4.4	3.2
Public consumption	12,250	14.8	-1.5	7.3	-2.1	3.9	2.5
Gross fixed capital formation	14,867	8.0	6.5	5.7	13.7	5.7	1.0
Housing	4,031	-4.3	4.8	8.8	7.3	-0.6	-1.5
Other constructions	5,391	8.9	8.2	0.7	13.2	6.1	2.2
Equipment	4,680	14.1	4.9	6.9	18.3	8.0	1.1
Other	765	7.6	20.1	21.0	3.4	6.9	1.1
Change in stocks and statistical discrepancy (as a percentage of GDP)	251	0.7	0.2	0.3	0.1	0.1	0.0
Domestic final demand	85,774	5.7	2.7	4.4	5.5	4.7	2.4
Exports of goods and services	14,087	14.0	-1.0	-7.7	1.0	11.5	5.0
Exports of goods	8,344	8.7	-1.6	-7.1	4.2	-2.5	4.7
Exports of services	5,743	18.0	-0.7	-8.1	-1.3	21.8	5.2
Final demand	99,861	7.2	2.0	2.2	4.7	5.8	2.9
Imports of goods and services	19,934	15.1	-5.1	-2.7	5.1	9.3	0.7
Imports of goods	18,084	15.2	-6.3	3.7	7.1	9.0	0.2
Imports of services	1,849	14.3	-0.1	-28.0	-6.1	10.9	3.9
GDP at market prices	79,927	4.5	4.6	3.8	4.6	4.7	3.6

Sources: NSSG/National Accounts, September 2005: final data for 2000 and revised data for 2001-2004. For 2005, Ministry of Economy and Finance (Stability and Growth Programme 2005-2008).

Table 6
Employed persons (in thousands) of 15 years and over, by branch of economic activity

	2005 Q3	
	Total employed persons	Salaried employees
Total	4,385.6	2,796.5
Agriculture, animal breeding, hunting and forestry	531.4	34.8
Fishing	13.5	2.1
Mining and quarrying	20.0	19.1
Manufacturing	558.3	415.6
Electricity, gas, steam and water supply	37.9	37.9
Construction	361.0	242.9
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	779.2	405.9
Hotels and restaurants	319.2	190.0
Transport, storage and communication	273.2	206.6
Financial intermediation	113.7	101.2
Real estate, renting and business activities	284.5	154.4
Public administration and defence, compulsory social security	351.0	350.3
Education	304.0	276.1
Health and social work	217.8	184.7
Other community, social and personal service activities	149.7	107.1
Private households with employed persons	70.2	66.8
Extra-territorial organisations and bodies	0.7	0.7

Source: NSSG, Labour Force Survey.

Table 7
Balance of payments
(Million euro)

	January – December			December		
	2003	2004	2005	2003	2004	2005
I CURRENT ACCOUNT BALANCE (I.A+I.B+I.C+I.D)	-11,044.1	-10,453.1	-14,047.5	-1,955.8	-1,820.4	-2,496.0
I.A TRADE BALANCE (I.A.1-I.A.2)	-22,643.5	-25,435.8	-27,546.9	-2,260.7	-2,389.0	-2,841.3
Oil trade balance	-4,035.8	-4,511.1	-6,629.2	-389.8	-339.7	-976.7
Non-oil trade balance	-18,607.7	-20,924.7	-20,917.7	-1,870.9	-2,049.3	-1,864.6
Ship balance	136.3	135.6	-722.3	72.0	-253.7	-194.1
Trade balance excl. oil and ships	-18,744.0	-21,060.3	-20,195.4	-1,942.9	-1,795.6	-1,670.5
I.A.1 Exports of goods	11,113.6	12,653.3	14,200.9	1,025.6	1,237.0	1,328.8
Fuel	1,280.7	1,544.7	2,257.7	94.5	143.6	162.6
Ships (receipts)	260.5	1,291.4	1,602.2	81.7	122.8	61.3
Other goods	9,572.4	9,817.2	10,341.0	849.4	970.6	1,104.9
I.A.2 Imports of goods	33,757.1	38,089.0	41,747.8	3,286.3	3,626.0	4,170.1
Fuel	5,316.5	6,055.8	8,886.9	484.3	483.3	1,139.3
Ships (receipts)	124.2	1,155.8	2,324.4	9.7	376.5	255.4
Other goods	28,316.4	30,877.4	30,536.4	2,792.3	2,766.2	2,775.4
I.B SERVICES BALANCE (I.B.1-I.B.2)	11,506.5	15,467.0	15,698.1	406.7	655.6	602.8
I.B.1 Receipts	21,430.3	26,742.5	27,560.5	1,437.3	1,726.8	1,763.7
Travel	9,495.3	10,347.8	11,036.5	221.5	228.8	230.0
Transport	9,569.8	13,307.0	13,871.4	970.2	1,212.3	1,279.6
Other services	2,365.3	3,087.7	2,652.6	245.5	285.7	254.1
I.B.2 Payments	9,923.9	11,275.5	11,862.4	1,030.6	1,071.2	1,160.9
Travel	2,136.0	2,310.4	2,445.7	190.4	231.9	240.0
Transport	4,923.6	5,728.2	6,237.7	527.0	497.6	637.0
Other services	2,864.3	3,236.9	3,179.0	313.1	341.8	283.9
I.C INCOME BALANCE (I.C.1-I.C.2)	-3,755.8	-4,113.4	-5,376.1	-412.7	-388.2	-604.7
I.C.1 Receipts	2,256.8	2,470.6	2,873.5	207.3	212.4	258.7
Wages, salaries	337.2	280.0	287.1	27.3	26.7	29.4
Interest, dividends, profits	1,919.6	2,190.6	2,586.4	179.9	185.7	229.2
I.C.2 Payments	6,012.6	6,584.0	8,249.6	620.0	600.6	863.4
Wages, salaries	1,079.9	188.9	219.8	16.7	16.7	27.4
Interest, dividends, profits	5,842.7	6,395.1	8,029.8	603.3	583.8	836.0
I.D CURRENT TRANSFERS BALANCE (I.D.1-I.D.2)	3,848.7	3,629.0	3,177.4	310.9	301.3	347.3
I.D.1 Receipts	6,424.9	6,356.0	6,876.4	665.0	601.2	599.8
General government (mainly transfers from the EU)	4,147.6	4,080.3	4,615.5	467.7	418.0	376.6
Other sectors (emigrants' remittances etc.)	2,277.3	2,275.7	2,261.0	197.3	183.2	223.2
I.D.2 Payments	2,576.2	2,727.0	3,699.0	354.1	299.9	252.6
General government (mainly payments to the EU)	2,153.8	2,216.8	2,921.4	310.2	247.6	196.6
Other sectors	422.4	510.3	777.6	43.9	52.3	55.9
II CAPITAL TRANSFERS BALANCE (II.1-II.2)	1,239.4	2,386.1	2,048.6	174.1	274.5	361.9
II.1 Receipts	1,392.5	2,618.3	2,324.9	189.8	291.2	386.9
General government (mainly transfers from the EU)	1,227.4	2,463.9	2,137.1	177.5	275.9	369.8
Other sectors (emigrants' remittances etc.)	165.1	154.4	187.8	12.2	15.2	17.0
II.2 Payments	153.1	232.2	276.3	15.7	16.7	25.0
General government (mainly payments to the EU)	15.5	69.8	22.9	1.5	1.3	3.7
Other sectors	137.6	162.4	253.4	14.2	15.3	21.3
III CURRENT ACCOUNT AND CAPITAL TRANSFERS BALANCE (I+II)	-9,804.7	-8,067.0	-11,998.9	-1,781.7	-1,545.9	-2,134.1
IV FINANCIAL ACCOUNT BALANCE (IV.A+IV.B+IV.C+IV.D)	9,663.7	7,834.0	12,306.6	1,932.7	1,616.1	1,967.7
IV.A DIRECT INVESTMENT¹	544.7	599.6	-979.0	1,143.8	35.7	22.7
By residents abroad	-41.2	-488.8	-766.7	425.3	-38.2	-57.9
By non-residents in Greece	585.9	1,088.4	-212.3	718.5	73.9	80.6
IV.B PORTFOLIO INVESTMENT¹	12,334.0	13,727.5	7,322.6	1,693.5	3,243.3	-212.4
Assets	-8,737.9	-11,489.4	-18,459.7	-793.2	-1,266.1	-1,176.7
Liabilities	21,071.8	25,216.9	25,782.3	2,486.7	4,509.5	964.3
IV.C OTHER INVESTMENT¹	-7,623.9	-9,104.1	5,914.0	-1,443.6	-2,368.9	2,124.4
Assets	-4,034.5	-6,215.7	-6,301.5	984.8	5,140.5	6,807.0
Liabilities	-3,589.4	-2,888.4	12,215.5	-2,428.4	-7,509.4	-4,682.6
(General government loans)	-2,618.4	-1,027.4	-447.0	-158.9	-222.7	-330.0
IV.D CHANGE IN RESERVE ASSETS²	4,409.0	2,611.0	49.0	539.0	706.0	33.0
V ERRORS AND OMISSIONS	141.0	233.0	-307.7	-151.0	-70.3	166.4
RESERVE ASSETS³				4,605.0	1,994.0	1,945.0

1 (+) net inflow, (-) net outflow.

2 (+) decrease, (-) increase.

3 Since Greece joined the euro area in January 2001, reserve assets, as defined by the European Central Bank, include only monetary gold, the "reserve position" at the IMF, "Special Drawing Rights", and Bank of Greece's claims in foreign currency on residents of non-euro area countries. Conversely, reserve assets do not include claims in euro on residents of non-euro area countries, claims in foreign currency and in euro on residents of euro area countries, and the Bank of Greece participation in the capital and the reserve assets of the ECB.

Source: Bank of Greece.

Table 8
Monetary aggregates of the euro area^{1,2}
(Outstanding balances in billion euro, not seasonally adjusted)

End of period	Currency in circulation (1)	Overnight deposits (2)	M1 (3)=(1)+(2)	Deposits with agreed maturity up to two years (4)	Deposits redeemable at notice up to three months (5)	M2 (6)=(3)+(4)+ +(5)	Repurchase agreements (7)	Money market fund shares/units (8)	Money market paper and debt securities up to two years (9)	M3 ³ (10)=(6)+(7)+ +(8)+(9)
2001	239.7	2,039.2	2,279.0	1,088.8	1,316.6	4,684.4	218.5	398.0	145.9	5,446.8
2002	341.2	2,158.3	2,499.4	1,075.7	1,406.3	4,981.4	226.9	470.5	127.6	5,806.4
2003	397.9	2,329.2	2,727.1	1,039.2	1,529.6	5,295.8	208.7	581.5	92.7	6,178.7
2004	468.4	2,480.5	2,948.9	1,040.5	1,642.9	5,632.2	228.8	604.9	102.3	6,568.2
2005	532.9	2,935.2	3,468.1	1,123.2	1,548.2	6,139.4	221.2	614.3	130.9	7,105.8
2003 Jan.	312.1	2,128.7	2,440.8	1,077.2	1,405.5	4,923.8	233.0	534.9	109.2	5,800.5
Feb.	319.3	2,131.9	2,451.2	1,079.6	1,420.7	4,950.8	233.3	547.2	109.0	5,841.1
March ..	327.2	2,170.3	2,497.5	1,072.9	1,435.8	5,003.6	224.0	550.8	99.4	5,880.3
Apr.	336.3	2,190.9	2,527.2	1,082.1	1,443.1	5,052.4	230.5	565.5	122.6	5,970.9
May	343.8	2,217.7	2,561.5	1,097.4	1,450.5	5,109.4	231.7	571.5	103.7	6,016.3
June	351.0	2,254.4	2,605.4	1,060.6	1,464.0	5,130.1	215.0	570.5	99.9	6,015.5
July	361.5	2,223.3	2,584.8	1,064.1	1,475.3	5,124.3	219.9	585.0	94.1	6,023.3
Aug.	362.7	2,210.5	2,573.2	1,070.1	1,482.7	5,126.0	217.1	587.3	92.5	6,022.8
Sept.	364.8	2,250.7	2,615.6	1,038.6	1,482.8	5,136.9	211.5	576.9	87.6	6,013.0
Oct.	371.2	2,249.1	2,620.4	1,049.6	1,487.9	5,157.9	224.7	582.3	104.1	6,069.0
Nov.	379.1	2,288.6	2,667.8	1,043.5	1,494.8	5,206.0	224.7	585.2	103.6	6,119.7
Dec.	397.9	2,329.2	2,727.1	1,039.2	1,529.6	5,295.8	208.7	581.5	92.7	6,178.7
2004 Jan.	389.1	2,313.8	2,702.9	1,021.7	1,547.2	5,271.7	213.4	591.7	95.6	6,172.4
Feb.	393.5	2,309.8	2,703.3	1,016.4	1,553.8	5,273.5	227.7	599.2	97.0	6,197.5
March ..	399.6	2,345.9	2,745.5	1,005.6	1,559.1	5,310.2	218.6	602.6	94.5	6,225.9
Apr.	409.4	2,361.3	2,770.7	1,006.3	1,567.5	5,344.5	224.8	611.0	99.5	6,279.8
May	416.6	2,372.0	2,788.7	1,015.4	1,573.4	5,377.4	221.2	609.0	96.2	6,303.8
June	423.0	2,410.4	2,833.4	989.0	1,585.6	5,408.0	216.9	609.2	100.1	6,334.2
July	436.2	2,398.6	2,834.8	1,000.4	1,593.3	5,428.5	223.0	613.0	97.8	6,362.3
Aug.	433.4	2,362.3	2,795.7	1,003.5	1,598.9	5,398.0	224.3	624.1	99.3	6,345.6
Sept.	438.0	2,419.1	2,857.1	993.1	1,600.9	5,451.1	215.9	609.5	100.1	6,376.7
Oct.	444.4	2,421.6	2,866.0	1,019.4	1,605.0	5,490.4	229.7	617.1	99.0	6,436.1
Nov.	448.7	2,465.0	2,913.7	1,003.7	1,611.5	5,528.9	223.9	613.4	103.6	6,469.7
Dec.	468.4	2,480.5	2,948.9	1,040.5	1,642.9	5,632.2	228.8	604.9	102.3	6,568.2
2005 Jan.	459.9	2,506.1	2,966.0	1,015.4	1,655.9	5,637.3	228.7	616.4	99.2	6,581.7
Feb.	463.6	2,506.6	2,970.1	1,013.0	1,660.3	5,643.4	227.0	615.4	114.1	6,599.9
March ..	471.8	2,525.8	2,997.6	1,017.7	1,665.2	5,680.4	227.0	614.5	106.1	6,628.0
Apr.	481.1	2,550.0	3,031.1	1,034.8	1,672.5	5,738.4	226.3	627.8	121.0	6,713.4
May	485.8	2,578.3	3,064.1	1,035.7	1,678.7	5,778.4	239.2	634.8	113.5	6,766.0
June	496.6	2,808.0	3,304.5	1,027.4	1,520.2	5,852.1	238.9	621.3	118.5	6,830.9
July	506.4	2,814.7	3,321.1	1,042.1	1,525.7	5,888.9	238.6	635.1	119.2	6,881.8
Aug.	500.9	2,767.7	3,268.7	1,053.7	1,530.0	5,852.4	249.2	639.7	120.7	6,862.0
Sept.	507.1	2,815.4	3,322.5	1,077.7	1,532.0	5,932.3	234.4	631.5	120.0	6,918.2
Oct.	510.5	2,838.8	3,349.3	1,087.8	1,532.2	5,969.4	241.4	629.0	121.5	6,961.3
Nov.	514.5	2,864.0	3,378.5	1,085.6	1,531.3	6,995.4	239.3	629.7	130.0	6,994.4
Dec.* ...	532.9	2,935.2	3,468.1	1,123.2	1,548.2	6,139.4	221.2	614.3	130.9	7,105.8

1 Monetary aggregates comprise monetary liabilities of MFIs and central government (Post Office, Treasury) vis-à-vis non-MFI euro area residents excluding central government.

2 Data for the euro area until the end of 2000 concern the Euro-11. As from 1 January 2001, they concern the Euro-12.

3 M3 and its components exclude non-residents' holdings of money market fund shares/units and debt securities up to two years.

* Provisional data.

Source: ECB.

Table 9

The Greek contribution to the main monetary aggregates of the euro area¹*(Outstanding balances in billion euro, not seasonally adjusted)*

End of period	Overnight deposits		Deposits with an agreed maturity up to two years	Deposits redeemable at notice up to three months ²	Repurchase agreements (repos)	Money market fund shares/units	Debt securities up to two years	Total ³ (M3 excluding currency in circulation)	
	Sight deposits and current accounts	Savings deposits							
	(1)	(1.1)	(1.2)	(2)	(3)	(4)	(5)	(6)	(7)=(1)+(2)+ +(3)+(4)+ +(5)+(6)
2001	70.8	16.1	54.7	29.4	2.4	24.2	9.7	0.1	136.7
2002	71.7	15.2	56.5	28.9	2.3	20.0	10.7	0.2	133.8
2003	79.5	17.6	61.9	32.3	2.0	10.8	15.7	0.5	140.8
2004	91.7	20.7	71.0	33.4	1.9	9.5	15.2	0.5	152.3
2005	99.2	24.8	74.4	50.6	4.4	2.7	4.9	0.4	162.3
2003 Jan.	70.3	14.2	56.1	28.9	2.2	20.2	12.0	0.2	133.7
Feb.	71.8	14.4	57.4	27.1	2.2	19.2	12.9	0.2	133.5
March ...	72.5	14.9	57.6	27.3	2.2	16.8	14.1	0.2	133.2
Apr.	72.7	14.6	58.1	28.7	2.2	16.3	14.4	0.3	134.7
May	71.9	14.5	57.4	28.8	2.0	15.7	14.7	0.3	133.4
June	74.9	16.7	58.2	29.7	2.1	13.5	15.7	0.4	136.3
July	72.9	15.8	57.1	32.0	2.1	13.0	15.8	0.4	136.3
Aug.	74.0	16.1	57.9	33.0	2.2	12.2	15.7	0.4	137.5
Sept.	74.9	17.1	57.8	32.7	2.1	12.0	15.6	0.4	137.7
Oct.	74.0	16.2	57.8	33.3	2.1	11.8	15.6	0.5	137.3
Nov.	74.1	15.4	58.7	32.9	2.1	11.6	15.5	0.5	136.7
Dec.	79.5	17.6	61.9	32.3	2.0	10.8	15.7	0.5	140.8
2004 Jan.	79.5	17.2	61.6	32.5	2.1	10.6	15.2	0.5	139.7
Feb.	79.6	17.3	62.3	32.1	2.1	10.5	15.2	0.5	139.9
March ...	82.1	17.8	64.3	31.8	2.1	9.5	15.8	0.4	141.6
Apr.	81.4	17.8	63.6	33.5	2.2	9.1	15.9	0.4	142.5
May	82.5	17.0	65.5	32.2	2.1	8.9	15.6	0.4	141.8
June	84.9	18.3	66.6	32.4	2.1	9.4	15.8	0.4	145.0
July	85.5	18.3	67.2	33.0	2.1	9.3	15.9	0.4	146.2
Aug.	84.9	17.7	67.2	33.2	2.1	9.6	15.8	0.4	146.1
Sept.	86.0	18.7	67.3	33.4	2.1	10.5	15.3	0.5	147.8
Oct.	86.4	18.9	67.5	33.6	2.0	10.4	15.4	0.5	148.2
Nov.	87.5	19.6	67.9	33.8	2.0	10.1	15.3	0.5	149.1
Dec.	91.7	20.7	71.0	33.4	1.9	9.5	15.2	0.5	152.3
2005 Jan.	90.4	19.8	70.6	37.8	2.0	5.6	14.9	0.5	151.2
Feb.	91.9	20.8	71.1	39.4	2.0	4.4	14.6	0.5	152.8
March ...	90.9	20.4	70.6	41.0	2.0	4.2	14.2	0.4	152.6
Apr.	91.1	20.2	70.9	42.3	2.6	3.8	13.0	0.5	153.4
May	91.5	20.2	71.2	42.6	2.8	4.1	12.5	0.5	153.9
June	96.8	23.9	72.9	42.2	3.1	3.7	10.9	0.4	157.2
July	93.8	21.8	72.0	43.9	3.3	3.3	10.7	0.4	155.4
Aug.	93.5	21.2	72.3	45.0	3.6	3.3	10.1	0.3	155.8
Sept.	94.8	22.5	72.3	45.5	3.9	3.3	7.3	0.4	155.2
Oct.	95.5	23.2	72.3	48.4	4.1	2.6	6.2	0.4	157.2
Nov.	94.9	23.1	71.8	49.7	4.5	2.7	5.5	0.4	157.7
Dec.	99.2	24.8	74.4	50.6	4.4	2.7	4.9	0.4	162.3

1 The Greek contribution begins upon Greece's entry into the euro area (1 January 2001). For statistical reasons, however, the data on monetary aggregates were extended to cover previous years as well.

2 Including savings deposits in currencies other than the euro.

3 As in all other euro area countries, Greece's M3 can no longer be calculated accurately, since part of the quantity of euro banknotes and coins in circulation in each country is held by residents of other euro area countries (as well as non-euro area residents). Owing to these technical problems, the compilation of the Greek M0, M1, M2 and M3 was discontinued in January 2003.

Source: Bank of Greece.

Table 10

Greece: deposits of domestic firms and households with OMFIs,¹ by currency and type*(Outstanding balances in million euro, not seasonally adjusted)*

End of period	Total deposits	Breakdown by currency		Breakdown by type		
		Deposits in euro ²	Deposits in other currencies	Sight deposits	Savings deposits	Time deposits ³
2001	101,809.5	79,566.0	22,243.5	13,385.2	58,323.1	30,101.1
2002	104,761.1	87,732.3	17,028.8	13,367.3	60,406.1	30,987.7
2003	115,750.1	98,119.3	17,630.8	15,395.8	65,141.1	35,213.2
2004	128,424.6	110,206.7	18,217.9	18,274.2	73,954.2	36,196.1
2005	155,698.1	134,637.7	21,060.4	22,180.2	79,800.8	53,717.1
2003 Jan.	102,687.7	85,423.3	17,264.4	11,703.0	59,707.7	31,277.0
Feb.	102,455.9	85,527.5	16,928.4	12,419.8	60,981.4	29,054.7
March	103,684.4	86,637.5	17,046.9	12,996.7	61,203.6	29,484.0
Apr.	105,407.4	87,642.8	17,764.6	12,664.5	61,690.6	31,052.2
May	104,593.8	86,997.3	17,596.5	12,586.4	60,809.6	31,197.8
June	108,637.5	90,199.0	18,438.5	14,702.7	61,700.5	32,234.3
July	108,694.9	89,934.1	18,760.8	13,670.6	60,471.2	34,553.1
Aug.	110,793.2	91,498.3	19,294.9	14,035.9	61,242.3	35,515.0
Sept.	111,384.5	92,881.7	18,502.8	14,958.4	61,151.5	35,274.5
Oct.	111,068.9	92,207.8	18,861.1	14,024.4	61,020.5	36,024.0
Nov.	110,668.9	92,383.7	18,285.2	13,157.4	61,846.9	35,664.6
Dec.	115,750.1	98,119.3	17,630.8	15,395.8	65,141.1	35,213.2
2004 Jan.	114,996.0	96,977.6	18,018.4	14,874.7	64,645.4	35,476.0
Feb.	115,491.9	97,036.0	18,455.9	15,089.7	66,332.2	34,070.0
March	117,571.4	98,647.3	18,924.1	15,479.0	67,322.0	34,770.4
Apr.	118,835.4	99,526.4	19,309.0	15,687.6	66,697.8	36,450.0
May	118,645.4	99,905.7	18,739.7	14,995.6	68,548.9	35,100.9
June	120,997.2	102,774.4	18,222.8	16,078.1	69,641.4	35,277.7
July	122,396.3	103,778.5	18,617.8	16,368.9	70,186.6	35,840.9
Aug.	122,065.6	103,347.9	18,717.7	15,579.5	70,397.0	36,089.1
Sept.	123,471.3	104,687.8	18,783.6	16,727.8	70,396.8	36,346.7
Oct.	123,971.8	105,394.3	18,577.5	16,840.4	70,593.6	36,537.8
Nov.	124,875.8	106,408.6	18,467.2	17,304.0	70,903.5	36,668.3
Dec.	128,424.6	110,206.7	18,217.9	18,274.2	73,954.2	36,196.1
2005 Jan.	131,749.7	114,232.0	17,517.7	17,586.6	73,515.5	40,647.6
Feb.	134,088.9	116,771.1	17,317.8	17,866.2	74,096.0	42,126.7
March	134,801.8	116,303.2	18,498.7	17,521.9	73,527.1	43,752.9
Apr.	136,854.8	118,087.9	18,766.9	17,333.7	74,453.1	45,068.0
May	137,472.3	118,223.8	19,248.5	17,189.9	75,046.6	45,235.8
June	142,951.8	123,548.2	19,403.6	20,868.4	77,036.6	45,046.9
July	142,253.9	122,248.8	20,005.1	19,144.9	76,318.4	46,790.5
Aug.	143,123.5	122,629.8	20,493.7	18,436.6	76,764.9	47,922.0
Sept.	145,473.2	124,504.3	20,968.9	19,789.0	77,143.1	48,541.1
Oct.	149,303.2	128,222.6	21,080.6	20,542.2	77,351.8	51,409.2
Nov.	150,251.5	128,846.7	21,404.8	20,228.8	77,297.6	52,725.1
Dec.	155,698.1	134,637.7	21,060.4	22,180.2	79,800.8	53,717.1

¹ Other Monetary Financial Institutions (OMFIs) comprise credit institutions other than the Bank of Greece and money market funds.

² Including (until 31 December 2001) deposits in drachmas and the other euro legacy currencies.

³ Including blocked deposits.

Source: Bank of Greece.

Table 11
ECB and Bank of Greece interest rates
(Percentages per annum)

1. ECB interest rates				2. Bank of Greece interest rates				
With effect from: ¹	Deposit facility	Main refinancing operations ³	Marginal lending facility	With effect from:	Overnight deposit facility – first tier ⁴	Overnight deposit facility – second tier ⁴	14-day intervention rate	Lombard rate
1999 1 Jan.	2.00	3.00	4.50	1999 14 Jan.	11.50	9.75	12.00	13.50
4 Jan. ²	2.75	3.00	3.25	21 Oct.	11.00	9.75	11.50	13.00
22 Jan.	2.00	3.00	4.50	16 Dec.	10.25	9.25	10.75	12.25
9 Apr.	1.50	2.50	3.50	27 Dec.	10.25	9.00	10.75	11.50
5 Nov.	2.00	3.00	4.00					
2000 4 Feb.	2.25	3.25	4.25	2000 27 Jan.	9.50	8.50	9.75	11.00
17 March	2.50	3.50	4.50	9 March	8.75	8.00	9.25	10.25
28 Apr.	2.75	3.75	4.75	20 Apr.	8.00	7.50	8.75	9.50
9 June	3.25	4.25	5.25	29 June	7.25	–	8.25	9.00
28 June ³	3.25	4.25	5.25	6 Sept.	6.50	–	7.50	8.25
1 Sept.	3.50	4.50	5.50	15 Nov.	6.00	–	7.00	7.75
6 Oct.	3.75	4.75	5.75	29 Nov.	5.50	–	6.50	7.25
				13 Dec.	4.75	–	5.75	6.50
				27 Dec.	3.75	–	4.75	5.75
2001 11 May	3.50	4.50	5.50					
31 Aug.	3.25	4.25	5.25					
18 Sept.	2.75	3.75	4.75					
9 Nov.	2.25	3.25	4.25					
2002 6 Dec.	1.75	2.75	3.75					
2003 7 March	1.50	2.50	3.50					
6 June	1.00	2.00	3.00					
2005 6 Dec.	1.25	2.25	3.25					

1 The date refers to the deposit and marginal lending facilities. For main refinancing operations, unless otherwise indicated, changes in the rate are effective from the first operation following the date indicated. The change on 18 September 2001 was effective on that same day.

2 On 22 December 1998 the ECB announced that, as an exception measure between 4 and 21 January 1999, a narrow corridor of 50 basis points would be applied between the interest rates for the marginal lending facility and the deposit facility, aimed at facilitating the transition to the new regime by market participants.

3 Until 21 June 2000: fixed rate tenders, from 28 June 2000: minimum bid rate in variable rate tenders.

4 On 29 June 2000 the second tier of the deposit facility was abolished; the interest rate thereafter applies to the unified deposit acceptance account.

Sources: ECB and Bank of Greece.

Table 12
Money market interest rates
(Percentages per annum, period averages)

Period	Overnight deposits ¹	1-month deposits ²	3-month deposits ²	6-month deposits ²	9-month deposits ²	12-month deposits ²
2001	4.39	4.33	4.26	4.15	4.10	4.08
2002	3.29	3.30	3.32	3.35	3.41	3.49
2003	2.32	2.35	2.33	2.31	2.31	2.34
2004	2.05	2.08	2.11	2.15	2.20	2.27
2005	2.09	2.14	2.19	2.23	2.28	2.33
2003 Jan.	2.79	2.86	2.83	2.76	2.72	2.71
Feb.	2.76	2.77	2.69	2.58	2.53	2.50
March	2.75	2.60	2.53	2.45	2.42	2.41
Apr.	2.56	2.58	2.53	2.47	2.45	2.45
May	2.56	2.52	2.40	2.32	2.27	2.26
June	2.21	2.18	2.15	2.08	2.04	2.01
July	2.08	2.13	2.13	2.09	2.07	2.08
Aug.	2.10	2.12	2.14	2.17	2.21	2.28
Sept.	2.02	2.13	2.15	2.18	2.21	2.26
Oct.	2.01	2.10	2.14	2.17	2.23	2.30
Nov.	1.97	2.09	2.16	2.22	2.31	2.41
Dec.	2.06	2.13	2.15	2.20	2.28	2.38
2004 Jan.	2.02	2.08	2.09	2.12	2.15	2.22
Feb.	2.03	2.06	2.07	2.09	2.11	2.16
March	2.01	2.04	2.03	2.02	2.02	2.06
Apr.	2.08	2.05	2.05	2.06	2.11	2.16
May	2.02	2.06	2.09	2.14	2.21	2.30
June	2.03	2.08	2.11	2.19	2.29	2.40
July	2.07	2.08	2.12	2.19	2.26	2.36
Aug.	2.04	2.08	2.11	2.17	2.22	2.30
Sept.	2.05	2.08	2.12	2.20	2.28	2.38
Oct.	2.11	2.09	2.15	2.19	2.25	2.32
Nov.	2.09	2.11	2.17	2.22	2.27	2.33
Dec.	2.05	2.17	2.17	2.21	2.25	2.30
2005 Jan.	2.08	2.11	2.15	2.19	2.25	2.31
Feb.	2.06	2.10	2.14	2.18	2.24	2.31
March	2.06	2.10	2.14	2.18	2.25	2.33
Apr.	2.08	2.10	2.14	2.17	2.21	2.27
May	2.07	2.10	2.13	2.14	2.16	2.19
June	2.06	2.10	2.11	2.11	2.10	2.10
July	2.07	2.11	2.12	2.13	2.15	2.17
Aug.	2.06	2.11	2.13	2.16	2.19	2.22
Sept.	2.09	2.12	2.14	2.17	2.19	2.22
Oct.	2.07	2.12	2.20	2.27	2.34	2.41
Nov.	2.09	2.22	2.36	2.50	2.60	2.68
Dec.	2.28	2.41	2.47	2.60	2.70	2.78
2006 Jan.	2.33	2.39	2.51	2.65	2.75	2.83

1 Euro overnight index average (EONIA).

2 Euro interbank offered rates (EURIBOR).

Source: Bloomberg.

Table 13
Greek government paper yields
(Percentages per annum, period averages)

Period	Yield on one-year Treasury bills	Bond yields						
		3-year	5-year	7-year	10-year	15-year	20-year	32-year
2001	4.08	4.28	4.58	4.82	5.30	5.51	5.76	...
2002	3.50	4.06	4.45	4.78	5.12	5.24	5.52	...
2003	2.34	2.82	3.37	3.83	4.27	4.32	4.91	...
2004	2.27	2.87	3.37	3.81	4.25	4.53	4.77	...
2005	2.33	2.65	2.92	3.22	3.59	3.80	3.92	4.14
2003 Jan.	2.70	2.91	3.36	3.81	4.43	4.51	4.97	...
Feb.	2.50	2.65	3.31	3.89	4.24	4.27	4.83	...
March	2.41	2.82	3.38	3.83	4.26	4.33	4.90	...
Apr.	2.46	2.99	3.50	3.96	4.38	4.45	5.02	...
May	2.25	2.64	3.12	3.57	4.02	4.09	4.73	...
June	2.02	2.38	2.88	3.33	3.81	3.86	4.57	...
July	2.08	2.62	3.18	3.65	4.12	4.16	4.83	...
Aug.	2.28	2.98	3.51	3.91	4.29	4.34	4.90	...
Sept.	2.26	2.91	3.47	3.91	4.32	4.37	4.96	...
Oct.	2.30	2.94	3.52	3.95	4.38	4.43	5.02	...
Nov.	2.41	3.06	3.67	4.09	4.51	4.55	5.10	...
Dec.	2.38	2.97	3.58	4.02	4.45	4.49	5.04	...
2004 Jan.	2.21	2.71	3.34	3.81	4.37	4.33	4.94	...
Feb.	2.17	2.91	3.28	3.90	4.35	4.28	4.91	...
March	2.06	2.71	3.26	3.71	4.17	4.43	4.75	...
Apr.	2.16	2.90	3.45	3.90	4.35	4.72	4.88	...
May	2.30	3.08	3.63	4.07	4.49	4.86	5.01	...
June	2.41	3.19	3.73	4.15	4.55	4.89	5.03	...
July	2.36	3.07	3.61	4.03	4.44	4.79	4.93	...
Aug.	2.30	2.91	3.43	3.85	4.28	4.63	4.78	...
Sept.	2.37	2.91	3.40	3.79	4.22	4.56	4.70	...
Oct.	2.32	2.76	3.25	3.65	4.11	4.47	4.61	...
Nov.	2.33	2.66	3.12	3.53	3.97	4.33	4.47	...
Dec.	2.30	2.59	2.98	3.36	3.77	4.10	4.24	...
2005 Jan.	2.31	2.72	2.96	3.29	3.69	3.99	4.12	...
Feb.	2.31	2.80	2.97	3.34	3.69	3.94	4.04	...
March	2.34	2.88	3.06	3.56	3.92	4.12	4.24	4.49
Apr.	2.27	2.70	3.06	3.37	3.76	3.98	4.11	4.38
May	2.19	2.55	2.89	3.21	3.60	3.82	3.95	4.21
June	2.10	2.35	2.70	3.02	3.44	3.66	3.79	4.05
July	2.17	2.42	2.75	3.06	3.46	3.71	3.84	4.10
Aug.	2.22	2.49	2.79	3.07	3.47	3.69	3.82	4.08
Sept.	2.22	2.42	2.66	2.92	3.30	3.52	3.64	3.91
Oct.	2.41	2.66	2.88	3.11	3.45	3.64	3.75	4.00
Nov.	2.69	2.91	3.15	3.36	3.67	3.84	3.94	4.14
Dec.	2.78	2.95	3.14	3.31	3.57	3.73	3.82	4.02
2006 Jan.	2.84	2.99	3.17	3.32	3.60	3.71	3.79	3.98

Source: Bank of Greece.

Table 14

Greece: domestic MFI loans to domestic firms and households, by branch of economic activity

(Balances in million euro)

End of period	Grand total	Firms						Households			
		Total	Agriculture	Industry ¹	Trade	Tourism	Other	Total	Housing	Consumer credit	Other
2000	59,330.0	42,360.3	3,884.9	11,823.7	12,374.2	1,814.3	12,463.2	16,969.7	11,271.9	5,511.3	186.5
2001	74,027.4	50,198.7	3,724.2	12,614.9	15,524.3	2,171.3	16,164.0	23,828.7	15,652.2	7,852.0	324.5
2002	86,510.5	55,012.2	3,224.7	14,364.0	15,670.8	2,903.2	18,849.5	31,498.3	21,224.7	9,755.4	518.2
2003	101,178.1	60,979.3	3,082.7	15,865.1	16,514.4	3,488.2	22,028.9	40,198.8	26,534.2	12,409.6	1,255.0
2004	117,201.7	65,566.3	3,248.0	15,675.6	18,821.6	4,040.0	23,781.1	51,635.4	33,126.8	17,053.8	1,454.8
2005	136,981.1	71,282.9	2,954.0	15,753.8	19,958.4	4,189.8	28,426.9	65,698.2	43,199.4	20,850.0	1,648.8
2003 Jan.	88,241.8	56,165.2	2,964.2	14,529.2	16,321.5	2,978.4	19,371.9	32,076.6	21,599.4	9,884.9	592.3
Feb.	88,787.7	56,164.7	2,980.5	14,485.6	16,310.3	3,049.0	19,339.3	32,623.0	22,062.6	10,023.3	537.1
March	89,363.0	56,195.0	2,994.0	14,422.3	16,053.5	3,095.5	19,629.7	33,168.0	22,366.8	10,247.3	553.9
Apr.	90,770.3	57,050.2	3,043.0	14,565.0	16,113.4	3,149.2	20,179.6	33,720.1	22,747.1	10,344.7	628.3
May	92,497.1	58,049.7	3,027.6	14,866.7	16,488.6	3,085.8	20,581.0	34,447.4	23,183.1	10,432.6	831.7
June	94,344.1	59,171.9	3,062.3	15,165.2	16,139.3	3,201.0	21,604.1	35,172.2	23,705.7	10,600.9	865.6
July	96,253.7	60,223.4	3,062.9	15,674.1	16,307.5	3,207.5	21,971.4	36,030.3	24,267.2	10,871.8	891.3
Aug.	97,350.8	60,781.5	3,102.1	15,681.4	16,700.8	3,255.1	22,042.1	36,569.3	24,573.2	11,075.2	920.9
Sept.	97,747.2	60,221.6	3,103.0	15,544.4	16,612.9	3,278.1	21,683.2	37,525.6	25,043.9	11,301.1	1,180.6
Oct.	98,403.4	59,992.6	3,117.3	15,481.2	16,393.0	3,321.0	21,680.1	38,410.8	25,559.5	11,670.4	1,180.9
Nov.	99,829.3	60,765.5	3,093.6	15,780.9	16,633.3	3,392.4	21,865.3	39,063.8	25,808.6	12,063.2	1,192.0
Dec.	101,178.1	60,979.3	3,082.7	15,865.1	16,514.4	3,488.2	22,028.9	40,198.8	26,534.2	12,409.6	1,255.0
2004 Jan.	102,748.9	61,939.3	3,055.4	16,005.1	16,822.7	3,536.8	22,519.3	40,809.6	26,902.8	12,690.8	1,216.0
Feb.	103,899.7	62,373.0	3,042.0	15,948.2	17,060.8	3,587.7	22,734.3	41,526.7	27,334.5	13,041.9	1,150.3
March	105,263.2	62,632.0	3,095.5	15,831.8	17,012.4	3,661.6	23,030.7	42,631.2	27,894.2	13,442.3	1,294.7
Apr.	106,447.1	62,865.3	3,150.5	15,734.1	17,134.7	3,703.2	23,142.8	43,581.8	28,465.8	13,798.6	1,317.4
May	108,835.0	64,279.3	3,242.6	15,950.4	17,773.5	3,766.9	23,545.9	44,555.7	29,080.6	14,169.3	1,305.8
June	109,806.8	64,817.5	3,324.8	15,831.1	17,952.6	3,801.5	23,907.5	44,989.3	29,035.7	14,585.6	1,368.0
July	111,624.2	65,449.6	3,348.0	15,997.2	18,214.6	3,862.7	24,027.1	46,174.6	29,822.1	14,985.2	1,367.3
Aug.	111,905.0	64,948.0	3,376.4	15,740.2	18,062.7	3,841.8	23,926.9	46,957.0	30,244.2	15,327.8	1,385.0
Sept.	113,392.1	65,419.2	3,402.8	15,743.6	18,335.8	3,865.3	24,071.7	47,972.9	30,832.5	15,722.9	1,417.5
Oct.	114,868.1	65,943.5	3,397.8	15,988.2	18,687.8	3,987.5	23,882.2	48,924.6	31,404.7	16,114.1	1,405.8
Nov.	115,636.5	65,492.4	3,303.2	15,755.2	18,612.8	3,930.4	23,890.8	50,144.1	32,138.9	16,580.3	1,424.9
Dec.	117,201.7	65,566.3	3,248.0	15,675.6	18,821.6	4,040.0	23,781.1	51,635.4	33,126.8	17,053.8	1,454.8
2005 Jan.	118,387.3	65,985.6	3,237.8	15,645.2	18,921.1	4,079.3	24,102.2	52,401.7	33,672.4	17,275.8	1,453.5
Feb.	118,906.4	65,521.9	3,161.6	15,623.8	19,104.7	4,129.9	23,501.9	53,384.5	34,281.6	17,610.7	1,492.2
March	120,704.9	66,096.9	3,079.3	15,565.9	19,309.8	4,180.8	23,961.1	54,608.0	35,091.5	17,995.6	1,520.9
Apr.	123,037.2	67,097.9	3,059.3	15,926.1	19,565.9	4,211.2	24,335.4	55,939.3	35,878.7	18,550.0	1,510.6
May	124,228.8	67,257.5	3,038.1	15,872.9	19,520.5	4,225.7	24,600.3	56,971.3	36,610.2	18,896.4	1,464.7
June	125,452.3	68,474.1	3,096.1	15,918.8	20,142.8	4,293.7	25,022.7	56,978.2	36,102.8	19,386.6	1,488.8
July	127,215.3	69,613.6	3,119.2	16,123.2	20,352.3	4,135.7	25,883.2	57,601.7	37,238.6	18,897.0	1,466.1
Aug.	127,788.5	69,212.3	3,123.3	15,838.2	20,027.5	4,110.4	26,112.9	58,576.2	37,850.0	19,245.1	1,481.1
Sept.	129,507.9	69,305.5	2,939.4	15,674.2	19,985.6	4,073.7	26,632.6	60,202.4	39,022.1	19,628.5	1,551.8
Oct.	131,111.7	69,462.4	2,884.1	15,757.2	19,905.6	4,089.4	26,826.1	61,649.3	40,000.4	20,080.7	1,568.2
Nov.	133,136.0	69,791.5	2,919.6	15,712.5	19,717.1	4,184.2	27,258.1	63,344.5	41,244.2	20,511.7	1,588.6
Dec.	136,981.1	71,282.9	2,954.0	15,753.8	19,958.4	4,189.8	28,426.9	65,698.2	43,199.4	20,850.0	1,648.8

1 Comprising manufacturing and mining.

Source: Bank of Greece.

Table 15

Greece: bank rates on new euro-denominated deposits of euro area residents

(Percentages per annum, period averages unless otherwise noted)

Period	Deposits by households			Deposits by non-financial corporations		Repurchase agreements (repos)
	Overnight deposits ^{1,2}	Savings deposits ²	Deposits with agreed maturity up to one year	Overnight deposits ²	Deposits with agreed maturity up to one year	
2003	0.93	0.92	2.48	0.63	2.49	2.24
2004	0.91	0.90	2.29	0.55	2.17	1.98
2005	0.91	0.88	2.23	0.60	2.09	2.00
2003 Jan.	1.10	1.09	2.83	0.74	2.88	2.75
Feb.	1.10	1.10	2.73	0.75	2.79	2.71
March	1.06	1.05	2.68	0.69	2.40	2.54
Apr.	1.05	1.04	2.70	0.73	2.67	2.46
May	1.04	1.03	2.61	0.70	2.66	2.45
June	0.82	0.81	2.44	0.55	2.41	2.10
July	0.80	0.79	2.38	0.60	2.36	2.04
Aug.	0.81	0.79	2.29	0.52	2.31	2.00
Sept.	0.81	0.80	2.30	0.55	2.30	1.98
Oct.	0.87	0.85	2.27	0.62	2.37	1.98
Nov.	0.87	0.85	2.29	0.54	2.33	1.94
Dec.	0.87	0.86	2.22	0.59	2.35	1.98
2004 Jan.	0.88	0.86	2.26	0.55	2.18	1.99
Feb.	0.88	0.87	2.18	0.57	2.17	1.98
March	0.89	0.87	2.29	0.54	2.13	1.95
Apr.	0.89	0.88	2.26	0.56	2.13	1.97
May	0.90	0.89	2.24	0.56	2.23	1.95
June	0.91	0.90	2.29	0.54	2.16	1.97
July	0.91	0.91	2.32	0.56	2.18	1.97
Aug.	0.92	0.91	2.31	0.60	2.19	1.96
Sept.	0.93	0.92	2.33	0.53	2.12	1.97
Oct.	0.94	0.93	2.35	0.53	2.17	1.98
Nov.	0.95	0.94	2.36	0.51	2.18	2.00
Dec.	0.96	0.94	2.30	0.55	2.20	2.01
2005 Jan.	0.96	0.95	2.25	0.56	2.08	1.97
Feb.	0.95	0.94	2.19	0.55	2.07	1.97
March	0.93	0.91	2.22	0.55	2.02	1.97
Apr.	0.89	0.86	2.22	0.55	2.07	1.98
May	0.89	0.87	2.20	0.56	2.04	1.99
June	0.89	0.86	2.21	0.58	2.07	1.99
July	0.88	0.86	2.20	0.60	2.07	1.98
Aug.	0.89	0.86	2.19	0.59	2.08	1.98
Sept.	0.89	0.87	2.19	0.70	2.09	1.98
Oct.	0.89	0.87	2.22	0.65	2.10	1.97
Nov.	0.90	0.87	2.27	0.65	2.11	1.99
Dec.	0.91	0.88	2.39	0.71	2.32	2.18

1 Weighted average of the current account rate and the savings deposit rate.

2 End-of-month interest rate.

Source: Bank of Greece.

Table 16

Greece: bank rates on new euro-denominated loans to euro area residents

(Percentages per annum, period averages unless otherwise noted)

Period	Loans to households ¹					Loans to non-financial corporations ¹		
	Loans without defined maturity ^{2,3}	Consumer loans		Housing loans		Loans without defined maturity ^{3,4}	With a floating rate or an initial rate fixation of up to one year	
		With a floating rate or an initial rate fixation of up to one year	Total consumer loans average rate	With a floating rate or an initial rate fixation of up to one year	Average rate on total housing loans		Up to €1 million	Over €1 million
2003	14.41	10.57	10.47	4.51	4.78	6.86	5.29	3.98
2004	13.81	9.55	9.86	4.30	4.51	7.01	4.98	3.67
2005	13.36	8.47	9.06	4.06	4.15	6.90	5.08	3.62
2003 Jan.	14.71	10.46	10.17	4.53	4.77	7.15	5.53	4.39
Feb.	14.68	11.13	10.60	4.58	4.81	7.09	5.59	4.27
March	14.66	10.82	10.76	4.58	4.87	7.04	5.37	4.06
Apr.	14.76	11.15	10.82	4.58	4.93	7.07	5.55	4.14
May	14.58	11.13	10.70	4.59	4.93	6.95	5.68	3.76
June	14.54	10.61	10.44	4.53	4.86	6.84	5.15	3.47
July	14.24	10.41	10.33	4.37	4.66	6.70	5.06	3.68
Aug.	14.05	10.24	10.37	4.48	4.76	6.67	4.95	3.60
Sept.	14.14	10.37	10.60	4.62	4.81	6.67	5.14	4.27
Oct.	14.22	10.57	10.58	4.57	4.81	6.68	5.24	4.68
Nov.	14.27	10.36	10.46	4.35	4.63	6.72	5.14	3.66
Dec.	14.08	9.60	9.86	4.31	4.53	6.78	5.13	3.78
2004 Jan.	13.92	9.82	9.94	4.36	4.68	6.74	5.12	3.92
Feb.	13.97	9.94	9.99	4.35	4.63	6.85	5.16	4.09
March	14.00	9.44	9.87	4.37	4.63	7.13	4.88	3.45
Apr.	14.06	9.56	9.85	4.36	4.55	7.11	5.15	3.49
May	13.79	9.82	10.07	4.33	4.54	7.02	4.91	3.45
June	13.89	9.71	10.05	4.30	4.54	7.06	4.89	3.58
July	13.84	9.60	9.67	4.24	4.43	7.03	4.84	3.53
Aug.	13.77	9.70	10.05	4.34	4.53	7.06	4.95	3.52
Sept.	13.62	9.37	9.91	4.23	4.43	7.05	4.87	3.80
Oct.	13.72	9.68	9.87	4.29	4.45	7.02	4.86	3.83
Nov.	13.75	9.40	9.72	4.23	4.36	7.05	5.06	3.61
Dec.	13.41	8.58	9.36	4.21	4.37	6.97	5.04	3.77
2005 Jan.	13.42	8.85	9.39	4.23	4.39	6.95	4.89	3.54
Feb.	13.72	8.99	9.62	4.20	4.34	6.95	5.08	3.53
March	13.51	8.53	9.43	4.15	4.27	6.94	5.00	3.70
Apr.	13.74	8.58	9.37	4.13	4.23	6.94	5.09	3.58
May	13.63	8.88	9.13	4.12	4.21	6.89	4.96	3.47
June	13.48	8.16	8.78	4.07	4.18	6.87	4.82	3.46
July	13.14	8.45	9.35	4.06	4.14	6.82	5.01	3.50
Aug.	13.16	8.48	9.39	4.11	4.18	6.84	5.12	3.50
Sept.	13.23	8.36	8.79	3.99	4.05	6.82	5.06	3.57
Oct.	13.07	8.32	8.68	3.94	4.01	6.85	5.06	3.79
Nov.	13.09	8.28	8.56	3.88	3.93	6.93	5.41	3.84
Dec.	13.07	7.78	8.26	3.86	3.91	7.00	5.41	3.93

1 Associated costs are not included.

2 Weighted average of the rates on loans to households through credit cards, on open account loans and on overdrafts from current accounts.

3 End-of-month interest rate.

4 Weighted average of the rates on corporate loans via credit lines and on overdrafts from sight deposit accounts.

Source: Bank of Greece.