BANK OF GREECE

EUROSYSTEM

ANNUAL REPORT
2007

ATHENS 2008

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2007

PRESENTED TO THE 75th GENERAL MEETING
OF SHAREHOLDERS ON 22 APRIL 2008
BY GOVERNOR NICHOLAS C. GARGANAS

ATHENS 2008

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GENERAL COUNCIL

Nicholas C. Garganas	***Chairman – Governor***	
Panayiotis A. Thomopoulos	***Deputy Governor***	
Nicholas D. Paleocrassas	***Deputy Governor***	
Georgios Akkas	*Member*	*expiry of term of office* 2008*
Ioannis Gozadinos	»	
Georgios Dimopoulos	»	
Georgios Kassimatis	»	
Ulysses Kyriacopoulos	»	*expiry of term of office* 2008*
George Economou	»	*expiry of term of office** 10.04.08*
Ioannis Papadakis	»	
Christos Polyzogopoulos	»	
Michael Chandris	»	*expiry of term of office* 2008*
Eleftherios Foukas	*Government Commissioner*	

* The term of office of General Council members Messrs Georgios Akkas, Ulysses Kyriacopoulos and Michael Chandris, elected by the Annual General Meeting of 25 April 2005, expires at the current Annual General Meeting, in accordance with Article 21 of the Bank's Statute.

** The term of office of Mr. George Economou, who was appointed Member of the Monetary Policy Council by the Presidential Decree of 20 March 2001 (Government Gazette – Legal Persons in Public Law – No. 238/22 October 2002) to replace Mr. Nikolaos Paleocrassas for the remaining part of his term in accordance with Article 35A of the Bank's Statute, expired on 10 April 2008. The renewal of Mr. Economou's term has been decided and the issuance of a Presidential Decree to this effect is pending.

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REPORT
OF GOVERNOR
NICHOLAS C. GARGANAS

TO THE ANNUAL GENERAL MEETING OF SHAREHOLDERS
BY ORDER OF THE GENERAL COUNCIL

I FINANCIAL RESULTS FOR 2007

The Bank's Profit and Loss Account for 2007 shows total net revenue of 825.5 million and total operating expenses (including depreciation and provisions) of 540.8 million. Net profit thus reached 284.7 million, compared with 244.6 million in 2006.

In accordance with Article 71 of the Bank's Statute regarding profit appropriation, the General Council, following a relevant decision, proposes to the Meeting of Shareholders that 10.6 million or 12% of the Bank's capital be distributed as first dividend and that an amount of 40.2 million be distributed as additional dividend, bringing the total dividend proposed for distribution to 50.8 million, up from 46.1 million in 2006. The total dividend per share would thus come to 3.2, i.e. 10.3% more than in 2006. From the balance of net profits —after the allocation of 36.0 million to an extraordinary reserve and the deduction of income tax on distributed profits— an amount of 180.9 million shall be paid to the State in accordance with Article 71 of the Bank's Statute, compared with 160.7 million in 2006.

The General Council, at its meeting of 17 March 2008, approved the book value adjustment of the Bank's real estate, in accordance with Law 2065/92. This adjustment led to revaluation gains of 71.5 million, recorded under item "Special reserve from the revaluation of land and buildings". By the same decision, the General Council approved the increase of the Bank's share capital by 22.2 million, by capitalising part of these revaluation gains. This increase will be achieved though the issuance of 3,972,977 new bonus shares of a par value of 5.6 each, to be allotted to current shareholders in a proportion of 1:4 (one new share for every four shares held). The share capital of the Bank of Greece will thus come to 111.2 million, consisting of 19,864,886 shares of a par value of 5.6 each. In accordance with the Statute of the Bank of Greece, the share capital increase is subject to the Government's approval.

Total net income from interest, commission fees and other revenue from domestic and foreign activities, including transactions with the European Central Bank (ECB) and the other members of the European System of Central Banks (ESCB), totalled 825.5 million in 2007, compared with 830.9 million in 2006, decreasing by 5.4 million or 0.6%. Underlying this decrease in net income are the changes in the following items:

Net interest income from claims on the Greek State and domestic or foreign credit institutions rose by 114.2 million or 27.0%, relative to 2006. This was mainly due to higher interest income from securities and balances in euro and foreign currency with credit institutions abroad, as well as to increased interest income from long-term loans extended by the Bank of Greece to the Greek State.

More specifically, net interest income from transactions with the Greek State increased by 26.2 million in 2007 (+ 9.9 million in 2006), reflecting developments in interest income from long-term loans extended by the Bank of Greece to the Greek State. The latter increased by 61.0 million over the previous financial year on account of the substantial rise in euro interest rates at which these loans are remunerated. The increase in interest on long-term loans was partly offset by a 11.1 million decline in interest income from the Bank's holdings of government securities, due to a decrease in the average balance of the above-mentioned holdings, and by a 25.1 million increase in interest paid by the Bank of Greece to the Greek State, as a result of the significant rise in interest rates and of the higher average balance of these deposits.

The Bank's interest income from lending to credit institutions through liquidity-providing refinancing operations increased by 49.7 million over the previous financial year, owing to the rise in the relevant interest rate. However, the interest paid by the Bank on credit institutions' required reserves also increased (+ 63.1 million), reflecting the higher main refinancing rate at which these reserves are remunerated, as well as the higher, relative to 2006, average reserve holdings. As mentioned above, a substantial increase of 156.2 million was recorded in interest income from securities and balances in euro and foreign currency with credit institutions abroad.

Interest paid on net liabilities arising from intra-ESCB transactions rose by 36.2 million to 369.7 million in 2007, from 333.5 million in 2006, exclusively as a result of the higher remuneration rate (the minimum bid rate on the main refinancing operations), while the Bank's net average liability vis-à-vis the rest of the ESCB fell further in 2007.

The Bank's financial transactions once again resulted in a net credit balance in 2007, which, however, at 104.0 million, was a substantial 137.7 million less than the level of 241.7 million reached in 2006. The main reasons for this was a 111.0 million decrease in profits from swap transactions, as well as a 20.4 million increase in unrealised losses from the year-end valuation of foreign exchange positions and securities as a result of the appreciation of the euro against other major currencies and of asset price movements.

Commission fees, income from participations and other non-interest income rose to 180.6 million in 2007, from 163.1 million in 2006, thus registering an increase of 17.5 million, on account of higher commissions, mainly on transactions with the State.

The Bank's total operating expenses —excluding provisions— rose by 34.0 million to 392.7 million in 2007. More specifically, personnel outlays, excluding employer contributions, increased by 9.4 million or 6.7% relative to 2006. This was due to the pay rises given in compliance with the enterprise-level wage agreements, to the grade and pay advancement of the personnel, and to costs associated with the implementation of the organisational restructuring agreement in 2007. Administrative costs and other general expenses increased by 7.9 million in 2007 (+ 10.7 million in 2006), reflecting expenditure for the maintenance and repair of premises and office furniture, the outsourcing of cleaning and other office services, as well as the donation of emergency relief to last year's fire victims. Depreciation increased by 4.3 million in 2007, owing to increased depreciation of euro banknote printing costs of previous years.

Finally, provisions for asset valuation loss and for future liabilities from the exchange of drachma banknotes for euro banknotes were raised to 54.7 million, from 23.2 million in 2006, while provisions for future obligations to personnel insurance funds came to 93.4 million (down from 204.4 million in 2006).

In the course of 2007, the Bank recruited 155 employees (63 with post-graduate degrees in economics and finance, 7 lawyers, 3 technicians and 82 secondary school or university graduates to be employed in accounting and teller operations). Meanwhile, 158 employees retired. The Bank's staff therefore decreased slightly, by three members, to 2,763 at the end of 2007.

The year 2007 saw the Bank of Greece adopt further measures to improve its internal organisation and administration, and respond more effectively to the obligations arising from Eurosystem membership. Towards this end, the Departments for (i) Supervision of Credit and Financial Institutions, (ii) Financial Operations, (iii) Government Financial Operations and Accounts, (iv) Accounts and (v) Administration all underwent extensive restructuring, in line with present-day requirements. Furthermore, in the context of a broader restructuring plan designed to modernise the Bank's unit network, the Bank closed its local branches in Argostoli, Drama, Agrinion, Xanthi and Piraeus. These branches (with the exception of the Piraeus branch, whose operations have been transferred to the Head Office in Athens), have been replaced by smaller units ("outlets") which mainly carry out certain transactions with the State and with public organisations. Twenty agencies also ceased operating, and their activities are now assumed by the nearest Bank of Greece units. In this respect, care has been taken to ensure that all staff from the closing units are transferred to other Bank of Greece units without suffering any reduction in salary and integrate smoothly into their new environment.

In the field of personnel training, the Bank organised programmes designed to improve the staff's professional skills and knowledge in areas including the TARGET2 payment system, detection and prevention of e-fraud and money laundering, as well as banking supervision methodologies and practices. Relevant personnel of other banks were also offered training in the recognition and handling of counterfeit euro and other currency banknotes. As part of its intensive foreign language courses, the Bank inaugurated a distance learning programme on written communication in English and in Greek to ensure the widest possible participation. Finally, the security personnel took part in training programmes focused on bank premise and cash transport security.

Throughout 2007, construction, maintenance and remodelling works continued on several of the Bank's premises, with a view to enhancing both working conditions and the security of premises and transactions. More specifically, in the area of Pylaia outside Thessaloniki, work began for the construction of the Bank's second Cash Processing and Distribution Centre on land belonging to the Bank: this state-of-the-art facility, which meets high operating and security standards, will decongest the Bank's Thessaloniki branch as well as other branches in Northern Greece, and enhance the security of cash transports within the wider area and the Balkans. At the Head Office in Athens, the necessary remodelling was made to accommodate the Historical Archives Service and the Disaster Recovery Site. Outlets were set up in rented offices in Argostoli and Drama, where two branches recently ceased operating in accordance with the Bank's restructuring plan. The refurbishing of the listed neoclassical building that houses the Bank's Thessaloniki branch is nearing completion.

In the field of information technology, the necessary infrastructure was created to support the Disaster Recovery Site. The Securities Management Application Realtime Technology (SMART) for the Central Securities Depository of Athens, as well as the sub-systems for the application of Human Resource Management were installed and put into operation.

The Bank of Greece pursued initiatives aimed at furthering relations with central banks and banking supervision authorities in countries of South-Eastern Europe where many Greek banks have set up operations. More specifically, on the initiative of the Governor of the Bank of Greece, the Governors of the national central banks of Albania, Bulgaria, Cyprus, FYROM, Greece, Romania and Serbia met in Athens in July 2007 and signed a Memorandum of Understanding on high-level principles of cooperation and coordination among the banking supervisors of South-Eastern Europe, with a view to strengthening financial stability in the region.

Wishing to reach out to the victims of last year's devastating forest fires in Western Peloponnese, the Bank of Greece deposited the sum of 5 million in a special relief account opened at the Bank's Head Office.

Finally, Greece was chosen to be the featured country in 2007 in the "Cultural Days of the European Central Bank", which have taken place every year in Frankfurt since 2004, dedicated each time to a different EU Member State. In this context, the Bank of Greece and the ECB jointly organised a series of events under the umbrella title "Cultural Days – Greece 2007", which included concerts, theatre performances and film screenings, modern dance, but also literary soirées, archaeology lectures, a photo exhibition and events for children. Their purpose is to bring the cultural diversity and wealth of the EU Member States to the people of the Rhine-Main region, the ECB staff, and visitors from Europe and the rest of the world.

2007 saw the Bank of Greece expand its capacity in all its fields of competence. As a full member of the Eurosystem, as the supervisory authority of credit institutions and other entities in the financial sector, and as the operator and overseer of payment systems, the Bank once again fulfilled its mandate. It played an active and effective part in implementing the single monetary policy conducted by the ECB, and contributed to further strengthening financial stability and banking transparency. It goes without saying that this would not have been possible without its staff's great zeal and commitment, but also adaptability to new conditions and demands. I would therefore invite the General Meeting to join me in expressing our commendation to the entire staff.

George Economou was reappointed member of the Monetary Policy Council for another six-year term, after his first term ended on 10 April 2008. At today's Annual General Meeting and in accordance with Article 21 of the Bank's Statute, the term of office of General Council members Messrs Georgios Akkas, Ulysses Kyriacopoulos and Michael Chandris expires. The General Meeting will therefore be called upon to elect three new General Council members for a three-year term, i.e. until the Annual General Meeting of 2011.

The outgoing General Council members are eligible for re-election.

II THE GREEK ECONOMY: DEVELOPMENTS, PROSPECTS AND ECONOMIC POLICY CHALLENGES

1 INTRODUCTION

The main features of economic developments in 2007 were the international financial turmoil and the rise in oil and food prices in world markets. These phenomena began in the second half of the year and led to mounting inflationary pressures and a slowdown in global economic growth, in particular in the last months of 2007 and the first months of the current year. These international developments have had an adverse impact on inflation and on the growth rate of the Greek economy.

The annual growth rate of gross domestic product (GDP) decelerated markedly, from 4.2% in the first half of 2007 to 3.7% in the second half. This year, the slowdown in the growth rate of global economic activity and external demand, the rise in international oil and food prices and the increase in financing costs imply that GDP growth will fall below 3.7% (compared with 4.0% in 2007), remaining, however, well above the growth rate of the euro area as a whole. In general, due to increased uncertainty, the balance of risks to this projection is on the downside.

Inflation accelerated significantly in the last months of 2007 and the early months of 2008 (in March it reached 4.4%), chiefly reflecting an increase in imported inflation (in particular, of international oil and food prices, partly for conjunctural reasons and partly for more permanent, structural reasons) and, to a lesser extent, an increase in production costs. It is projected that these factors will result in average annual inflation reaching around 4% this year, compared with 3.0% in 2007.

The impact of the international financial turmoil on the Greek banking system during 2007 was limited and mainly indirect. The profitability and capital adequacy of banks remained satisfactory in 2007, contributing to the stability of the banking system and its resilience to external shocks. However, adverse conditions in international financial markets, continued strong credit growth in Greece and the increasing penetration of Greek banks into new markets in Southeastern Europe heighten the risks facing banks. This calls for adaptation and further development of banks' risk measurement and management mechanisms, including further improvements in the quality of banks' loan portfolios.

The current account deficit, which has reached very high levels in recent years, widened further to 14.1% of GDP in 2007. This growth of the deficit of the external balance, caused, *inter alia,* by the decline in the Greek economy's international competitiveness, reflects the significant shortfall of domestic savings, which are relatively low, with respect to domestic investment, which is relatively high. Chiefly as a result of the expected slowdown in world trade growth and of high oil prices, it is estimated that in 2008 the deficit will remain roughly stable as a percentage of GDP, and there is a possibility that it will even increase.

As for fiscal developments in 2007, the general government deficit as a percentage of GDP was below 3% for the second consecutive year, while public debt declined further as a percentage of GDP, though the pace of decline is slow. Despite the fiscal adjustment achieved in the last three years, fiscal imbalances remain serious. It should be noted in particular that Greece's public debt as a percentage of GDP, which is the second highest in the euro area, came to around 95% at the end of 2007.

In order to minimise the negative impact from the continuing crisis in international financial markets, external inflationary pressures and the now evident considerable decline in global economic growth, it is necessary to enhance the Greek economy's resilience to external shocks. The best way to achieve this is to maintain the efforts to improve the fundamentals of the economy. This implies continuing fiscal consolidation on the basis of the updated Stability and Growth Programme 2007-2010 in order to bring the general government deficit as a percentage of GDP down to zero by 2010 and to reduce public debt considerably. Additionally, it is necessary to step up the efforts for raising productivity growth and containing production costs, in order to eliminate the inflation differential between Greece and the euro area as a whole and to restore the economy's international price competitiveness. Strengthening competitiveness and increasing national savings are essential if the current account deficit is to be reduced. Improving productivity and the structural competitiveness of the economy will require continuing reform in a wide range of areas.

These policies will make it possible to sustain satisfactory growth rates in the future and ensure that the benefits from increasing prosperity will be shared more widely among the population.

2 THE INTERNATIONAL AND EUROPEAN ECONOMIC ENVIRONMENT

World economic growth remained strong in 2007, despite the fact that the second half saw a turmoil in international financial markets and large rises in international oil and food prices.

In 2008, however, the growth rate is expected to decline markedly and to be lower than forecast at the beginning of the year, both in the euro area and in the world economy, chiefly due to the impact from the international financial turmoil. In particular, the International Monetary Fund forecasts that global GDP growth will drop to 3.7% this year, from 4.9% in 2007. In the euro area, according to the latest ECB staff macroeconomic projections released in early March 2008, annual real GDP growth should be between 1.3% and 2.1% this year, down from 2.6% in 2007.

It should be noted that the international financial turmoil began in mid-2007, triggered by increasing defaults on sub-prime mortgage loans in the United States, which led to liquidity shortage and disruptions in various segments of money markets. In particular, in the interbank asset-backed commercial paper market, financial institutions had significant exposures to complex structured credit products, whose valuation became increasingly uncertain as liquidity dried up. This led to large losses and asset write-downs in several financial institutions. At a global level, banks are now reducing their loan portfolios and exposures to other companies in the financial sector, and the outlook for financial markets is highly uncertain. The ongoing process of market correction has given rise to an in-depth review of practices and rules in all areas that have a bearing on the functioning of international financial markets and the conduct of market participants.

The spread of the original turmoil to other markets and the continued uncertainty concerning developments in the financial markets have further increased the risk of a lower growth rate. The financial turmoil is marked, among other things, by volatile and falling share prices internationally, amidst growing signs of economic weakness in certain countries. Foreign exchange markets have also been affected by the turmoil. In the US financial market, conditions are likely to remain very volatile and it is now highly probable that the US economy will slip into recession, as the (quarterly) GDP growth rate may reach zero or turn negative in the first two quarters of 2008. For the time being, the economic slowdown in the United States has had only a limited negative effect on the euro area economy, the impact being more visible in economies with large trade flows with the United States.

At the same time, the world economy faces major inflationary risks this year. There were further sharp increases in international oil and food prices in the first quarter of 2008. This development is expected to lead to high inflation for some time. In addition, there is uncertainty as to the future path of oil and food prices and their impact on inflation expectations.

Inflation is on the rise everywhere. In February of this year, it reached 8.7% in China, 4% in the United States and 3.3% in the euro area (rising further to 3.6% in March) – chiefly due to higher oil and food prices. In the euro area, the annual inflation rate will probably remain elevated in the coming months before falling only gradually later, and is not expected to approach 2% this year.

3 MACROECONOMIC DEVELOPMENTS IN GREECE IN 2007 AND THE OUTLOOK FOR 2008

3.1 ECONOMIC ACTIVITY

According to the most recent NSSG estimates, GDP grew by 4.0% in 2007, compared with 4.2% in 2006. Thus, the GDP growth rate once again exceeded the corresponding rate in the euro area (2.6%) and the Greek economy remained one of the fastest growing economies in the EU. As in previous years, strong economic growth in 2007 is attributable to the positive contribution of domestic demand (both private consumption and investment, although the rate of increase for both was lower than in 2006), while the change in the real external balance (i.e. the difference between exports and imports of goods and services at constant prices) had a dampening effect on GDP growth.

The turmoil in global financial markets and developments in the international economic environment had a limited impact on the Greek economy in 2007. In 2008, however, there is the risk that the impact on macroeconomic aggregates will be stronger. A slowdown can already be observed in Greece's annual GDP growth, from 4.2% in the first half of 2007 to 3.7% in the second half. According to projections made by the Bank of Greece at the beginning of the current year and published in February, average annual GDP growth was expected to remain satisfactory this year, reaching 3.7% (2007: 4.0%), as it was estimated that the majority of factors that had driven positive economic developments in recent years, such as strong business investment growth, continue to have a favourable effect on economic growth in Greece. However, as there appears to be a deterioration in the international environment, it is obvious that the Greek economy will be adversely affected, and it is probable that its growth rate will be lower, as the slowdown of the rate of increase in global economic activity and external demand will be stronger than previously assumed, the increase in international oil and food prices will be sharper and financing costs will be higher. Still, the growth rate of the Greek economy will remain higher than the euro area average.

3.2 EMPLOYMENT AND UNEMPLOYMENT

Economic growth in 2007 was accompanied by a rise of 1.3% in employment and a fall in the unemployment rate to 8.3% (from 8.9% in 2006). The increased level of employment primarily stemmed from the private non-agricultural sector and, secondarily, from the public sector, while employment in the agricultural sector continued to decline.

Despite positive developments in 2007 as far as employment and unemployment are concerned, it appears that the Greek economy is still characterised by a smaller capacity to create jobs than other countries in the euro area. This can be attributed to the continued restructuring of the Greek economy, chiefly evidenced by the considerable shrinkage of the agricultural economy and the ensuing heavy job losses, by labour market rigidities (e.g. the relatively less widespread use of part-time employment) and by certain mismatches between supply and demand in the labour market.

Because of the smaller capacity to create jobs, the employment rate in the Greek labour market remains considerably lower than the EU-15 average (61.4% in Greece in 2007, compared with 66.2% in the EU-15 in 2006). This differential mainly reflects the much lower employment rate among women in Greece.

3.3 INFLATION (DEVELOPMENTS AND PROSPECTS) AND INTERNATIONAL PRICE COMPETITIVENESS

In 2007, average annual inflation on the basis of the Harmonised Index of Consumer Prices (HICP) fell to 3.0%, from 3.3% in 2006. The drop in average annual inflation is chiefly attributable to temporary favourable factors (in particular oil price developments), which were later reversed. Underlying the drop in average annual inflation was also a slowdown in the annual rate of increase in processed food prices up to September (this rate accelerated, however, in the final quarter). As a result of these developments, average annual inflation in the fourth quarter of 2007 stood at a higher level than one year earlier (3.6%, compared with 3.2%).

In addition, core inflation (HICP excluding energy and unprocessed food prices) rose to 3.2% on an average annual basis, from 2.9% in 2006, reflecting inflationary pressures from both total demand, which continued to grow strongly, and domestic supply, as unit labour costs in the whole economy continued to increase at a high rate.

The differential of Greek inflation over the corresponding figure in the euro area as a whole remained wide in 2007, despite narrowing slightly (to 0.9 percentage point, from 1.1 percentage points in 2006). The core inflation differential also remained large, but did shrink slightly (to 1.2 percentage points, from 1.4 percentage points in 2006). Persistently higher core inflation than in the euro area as a whole is explained by both macroeconomic factors associated with demand and production costs and market operating conditions. There is an interaction between inflationary pressures arising from excess demand in Greece and unit labour cost growth, which is significantly stronger in Greece than in the euro area. In addition, certain markets do not operate efficiently due to inadequate competition, and as a result profit margins are relatively high.

Due to the inflation differential, the decline in the international price competitiveness of the economy continued. Specifically, it is estimated that the real effective exchange rate (vis-à-vis Greece's 28 major trading partners) based on consumer prices (i.e. consumer prices expressed in a common currency) increased by a cumulative 15% between 2000 and 2007, while relative unit labour costs, expressed in a common currency, rose cumulatively by almost 20% in the whole economy and by 41% in manufacturing. These increases correspond to losses in competitiveness. In the 2001-2007 period, the euro's nominal exchange rate (also weighted against the currencies of Greece's 28 trading partners) rose by a cumulative 10% (appreciation of the euro).

HICP inflation, which had already reached 3.9% in November and December 2007 and in January 2008, stood at 4.5% in February and 4.4% in March. It is estimated that – as in the euro area – average annual inflation will remain high in the next few months, chiefly as a result of a sharp increase in imported inflation (which is associated with historically high oil prices and a large increase in food prices in the world market). Thereafter it is expected that inflation will fall gradually and, in the final quarter of 2008, it is likely to be slightly lower than in the final quarter of 2007. However, due to its overall evolution throughout the year, average annual HICP inflation will be higher in 2008 than in the previous year. Specifically, according to Bank of Greece projections made at the beginning of the year and published in February, average inflation was expected to reach 3.4% this year, compared with 3.0% in 2007. However, certain risks which were highlighted back in February (mainly concerning developments in international oil prices, as well as unit labour costs) now seem to have materialised. Thus, inflation will turn out to be higher than forecast and is expected to stand around 4%.

Core inflation (which does not include energy and unprocessed food prices) is expected to show a gradual increase during the year, with its average annual level rising slightly in comparison with 2007 (when it reached 3.2%).

These forecasts are surrounded by considerable uncertainty concerning developments in international prices of oil and other commodities, as well as in exchange rates. Of particular importance will be the final outturn of unit labour cost growth, which will depend on the outcome of collective wage bargaining at sectoral, occupational and enterprise levels in the business sector, as well as on the productivity growth rate. The new two-year National General Collective Labour Agreement of the social partners provides for average annual increases in minimum wages of 6.2% in 2008 and 5.7% in 2009. These increases are the same as or slightly higher than those agreed upon for the previous two-year period 2006-2007 (6.2% in 2006 and 5.4% in 2007). For the current year, however, the agreed rise is higher than for 2007. As expected, unit labour cost growth in 2008 will accelerate markedly in the economy as a whole, remaining particularly high in the business sector.

3.4 EXTERNAL BALANCE

The current account deficit grew considerably to reach 14.1% of GDP, from 11.1% in 2006. However, if the surplus of the capital transfers balance is also taken into account, the total deficit for 2007 is reduced to 12.2% of GDP, compared with 9.6% of GDP in 2006.

The high levels reached by the deficit of the external balance in recent years, which are partly the result of a decline in the international competitiveness of the Greek economy, reflect the significant shortfall in domestic savings, which are relatively low with respect to domestic investment, which is relatively high. More specifically, savings are significantly lower as a percentage of GDP than in the euro area, while investment is markedly higher. Underlying the large increase in investment as a percentage of GDP in the last seven years were the improved macroeconomic environment and prospects (as a result of the country's EMU entry and lower interest rates) and the availability of funding for the construction of infrastructure projects (due to inflows from the EU Structural Funds). In addition, the relatively low level of total savings as a percentage of GDP reflects, on the one hand, fiscal deficits (which imply that savings in the general government sector are negative) and, on the other hand, an increase in the private sector's propensity to consume, as a result of improved households' expectations concerning their future income and of consumer credit growth. These factors are associated with excess domestic demand in the Greek economy during the last seven years, in contrast to the situation in the euro area as a whole. Due to the increase in private consumption and investment activity, imports of consumer and investment goods are rising rapidly, while export growth is not strong enough to prevent the trade deficit from continuously widening. These developments in imports and exports are attributable to the Greek economy's low structural competitiveness, one aspect of which is the fact that the composition of domestic output does not adequately match the composition of domestic and external demand. They also reflect the continuous erosion of the international price competitiveness of the Greek economy, chiefly because of the inflation differential, as well as —to a lesser extent— of the appreciation of the euro. As a result of the large trade deficits, the Greek economy's foreign debt has ballooned, leading to sharp rises in net interest payments. The large increase in the deficit between 2005 and 2007 is also attributable to higher net payments for the purchase of ships and a higher oil import bill.

Specifically in 2007, the widening of the current account deficit chiefly reflected increases in the trade deficit excluding oil and ships, the deficit of the ships' balance and the income account deficit, as well as a decline in the surplus of the current transfers balance. To a very small extent, it also reflects an increase in the oil deficit. These developments were only partly offset by the rising surplus of the services balance.

Underlying the growth of the trade deficit excluding oil and ships in 2007 were, as in previous years, mainly the high rate of increase in private consumption and the continued decline in the economy's international price competitiveness. High international oil prices in the last months of 2007 and increased spending for the renewal of the country's merchant shipping fleet contributed to increases in the oil deficit and the deficit of the ships' balance respectively. In 2007, the growth of the income account deficit was chiefly due to higher net interest payments, while increased payments of the general government sector to the EU (largely because of the upward revision of the country's GDP) are the main reason behind the decline in the surplus of the current transfers balance. Finally, the rise in the surplus of the services balance in 2007 was entirely the result of higher net sea transport receipts.

Prospects of reducing the current account deficit in the next few years are not especially favourable. It is estimated that the deficit will remain more or less stable as a percentage of GDP in 2008, although it may actually increase. This estimate takes account of the low structural competitiveness and continued decline in the international price competitiveness of the Greek economy as well as certain special factors. Specifically, goods and services export growth will slow in 2008 as a result of an expected drop in the growth rate of world trade, while the high level of oil prices and spending for the purchase of ships will continue to put considerable stress on the trade balance. Of course, spending to purchase ships is an investment expenditure and is expected to lead to higher transport receipts in the coming years (provided that international freight rates generally remain at the high levels observed in recent years) and, as a result, to a reduction in the current account deficit over the medium term. However, as non-residents' public debt holdings grow, the income account will be increasingly burdened by interest payments.

4 FISCAL DEVELOPMENTS AND PROSPECTS

4.1 THE GENERAL GOVERNMENT DEFICIT

According to the latest NSSG estimates communicated to Eurostat at the end of March, the general government deficit on a national accounts basis reached 2.8% of GDP in 2007, compared with 2.6% in 2006 and a target of 2.2%. Underlying this increase were, *inter alia*, certain extraordinary factors, including the payment of additional contributions to the Community Budget following the revision of past GDP figures, costs associated with last summer's fires, the cost of holding snap elections and the settlement of the State's claims on and liabilities to Olympic Airways.[1] At the same time, however, extraordinary receipts from the EU Structural Funds had a beneficial effect on the deficit. It has been calculated that the widening of the deficit mainly results from an increase of

1 Claims and liabilities vis-à-vis Olympic Airways were settled by offsetting, thereby the general government balance was not essentially affected. However, the ordinary budget deficit and the rate of change in its revenue and expenditure were affected. In addition, the payment of an extraordinary contribution of €1,108 million as a result of the GDP revision was effectively offset by the receipt of extraordinary additional revenue of €982 million from the EU Structural Funds.

almost 0.4 percentage point of GDP[2] in the central government deficit in comparison with 2006, as well as from a shortfall of €576 million, or 0.25% of GDP, in the social security funds' and local authorities' surplus compared with the budget target.

Due to these developments, the primary surplus was reduced from 1.4% of GDP in 2006 to 1.2% in 2007. It is estimated that there has also been a decline in the cyclically adjusted primary surplus, the annual change of which is used as an indicator of the fiscal policy stance.

4.2 THE EVOLUTION OF PUBLIC DEBT

The consolidated general government debt as a percentage of the (revised) GDP reached 94.5% at the end of 2007. Compared with the end of 2006, the reduction in debt was limited to 0.8 percentage point of GDP. Greece's public debt remains the second highest in the EU-27 and continues to be well above the reference value (60% of GDP) provided for in the Maastricht Treaty.

4.3 THE UPDATED STABILITY AND GROWTH PROGRAMME 2007-2010

According to the 2008 Budget and the updated Stability and Growth Programme (SGP) 2007-2010, fiscal policy in 2008 will be contractionary. The general government deficit (on a national accounts basis) is forecast to fall to 1.6% of GDP and the public debt to 91.0% (at the end of the year). The deficit is forecast to decline further to 0.8% of GDP in 2009 and to be eliminated in 2010. Fiscal consolidation will require continued efforts for a number of years in order to achieve a considerable primary surplus, ensuring a reduction in public debt (which, according to the updated SGP, will fall to 82.9% of GDP in 2010). It should be noted that the fiscal adjustment required to reduce the debt will be even greater if the expected long-term increase in public spending on pensions and healthcare owing to population ageing is taken into account.

5 THE ECB MONETARY POLICY AND MONETARY AND CREDIT DEVELOPMENTS IN THE EURO AREA

The monetary policy of the Eurosystem has been gradually tightened since late 2005: after raising its key rates by 1.5 percentage points by end-2006, the Governing Council of the ECB took two further decisions in 2007, on 8 March and 6 June respectively, to raise them by another cumulative 50 basis points, judging that the risks to price stability were on the upside. Since then, the minimum bid rate on the main refinancing operations has remained at 4%.

In August 2007, the financial turmoil began to exert upward pressure on interbank rates in the money markets of developed economies, amid growing indications that the crisis in the US sub-prime mortgage market would affect credit institutions worldwide. In addition, the rate of increase in oil and food commodity prices picked up considerably, while monetary and credit aggregates continued their strong growth. Against this background, during the period

2 Half of the increase in the central government deficit is due to extraordinary factors (specifically, the cost of fighting last summer's fires and providing emergency relief to fire victims, as well as the cost of holding snap parliamentary elections). The other half is attributable to an overrun in payments for tax refunds.

September-December 2007, the Governing Council of the ECB repeatedly recognised that the impact from the financial turmoil on economic activity and financial developments (and, ultimately, on inflationary pressures) is surrounded by uncertainty. Thus, even though the assessment of developments showed the risks to price stability to be on the upside, particularly because of the strong price increases for commodities, the Governing Council of the ECB maintained its key rates unchanged, but stressed that it would closely monitor all relevant developments.

So far this year, the euro area has been marked by (i) increased upside risks to price stability in the short term, (ii) continued, albeit decelerating GDP growth, as indicated by the latest macroeconomic data, and (iii) a persistence of the uncertainty caused by the turmoil in the financial markets. After weighing these factors, the ECB has chosen to maintain its rates unchanged. At its meeting on 10 April 2008, the Governing Council of the ECB confirmed that, as indicated by the latest information, upside risks to price stability prevail over the medium term. Given that maintaining price stability is the primary objective of the ECB, in accordance with its mandate, the Governing Council stressed that anchoring medium- to longer-term inflation expectations remains its highest priority and that there would be no room for complacency in this regard. The Governing Council also underlined that the current monetary policy stance will contribute to achieving this objective and that it remains strongly committed to preventing second-round effects and the materialisation of upside risks to price stability over the medium term. Last, the Governing Council stated that it will continue to monitor all developments very closely.

The financial turmoil caused liquidity constraints and upward pressure on interbank rates. In order to restore normal conditions in the interbank market, the Eurosystem differentiated and expanded its instruments for providing liquidity to credit institutions, thus managing to contain the volatility of the very short-term market interest rates around the minimum bid rate of the main refinancing operations.

In 2007, euro area MFI interest rates on new deposits and loans continued to rise, owing to the hikes in money market rates and government bond yields (although there were fluctuations in the course of the year). In the second half of the year, bank interest rates were affected by the turmoil, but the MFI short-term interest rates for the majority of loan categories increased less than the three-month money market rate. On the other hand, long-term interest rates generally did not follow the downward course of the yields of government debt securities of corresponding maturities, observed after the outbreak of the financial turmoil.

The rise in bank lending rates was in part responsible for the deceleration in household loan growth in the euro area. However, corporate loan growth (to both financial and non-financial corporations) accelerated and the ensuing increase in M3 at a rate higher than in 2006 mainly reflects faster credit expansion to corporations.

Long-term government bond yields in the euro area generally followed an upward path from the beginning of 2007 to early July. The outbreak of the financial turmoil caused important portfolio shifts towards government securities in the euro area, the

United States, Japan and other (mostly developed) economies, reflecting a flight to safety. Due to these shifts, long-term interest rates followed a downward, yet highly volatile, trend after early July 2007. In the first quarter of 2008, long-term interest rates declined further (despite some small fluctuations) in the euro area, the United States and Japan.

Share prices in the euro area, the United States and Japan followed an upward course from early 2007 to mid-July, but from then until the end of 2007, in the context of the financial turmoil, recorded strong fluctuations, though generally falling worldwide. All in all, however, from December 2006 to December 2007, share prices increased in Europe and the United States, while falling in Japan.

6 MONEY AND CREDIT

In Greece, the annual growth rate of the total financing of the economy by domestic Monetary Financial Institutions (MFIs) remained at a relatively high level in 2007 (fourth quarter 2007: 13.1%, fourth quarter 2006: 15.3%). This continued strong growth reflects the contribution of private sector financing, while the financing of general government showed negative rates of change throughout 2007, despite some fluctuations. The annual rate of increase in private sector financing reached 21.2% in the fourth quarter of 2007 (fourth quarter of 2006: 21.3%). This development indicates that the tensions in international financial markets in the third quarter of 2007 did not affect the supply of bank credit to the domestic private sector until the end of the year. In particular, the annual growth rate of corporate finance by domestic MFIs (loans, corporate bonds and securitisation) showed a remarkable acceleration (fourth quarter of 2007: 19.3%, fourth quarter of 2006: 16.8%). The annual rate of increase in bank financing to households by MFIs slowed down considerably during 2007, maintaining its downward trend, but nevertheless remained at a high level (fourth quarter of 2007: 23.2%, fourth quarter of 2006: 26.7%). This slowdown chiefly reflects a deceleration in the annual growth rate of housing loans (fourth quarter 2007: 22.8%, fourth quarter 2006: 28.0%). However, a small slowdown was also observed in the rate of increase in consumer loans in 2007 (fourth quarter 2007: 22.6%, fourth quarter 2006: 23.7%). Thus, household indebtedness reached 41.0% of GDP by December 2007 and its difference from the euro area average narrowed to 13.3 percentage points, from 16.5 percentage points at the end of 2006. If securitised loans are included, household indebtedness reached 45.5% of GDP in December 2007.

Further increases in key ECB rates (during the first half of 2007) and the rise in money market rates (also because of the turbulence in financial markets in the second half) pushed up deposit and lending rates in Greece. However, the rise was, in general, smaller than in the euro area, resulting in most cases in further convergence of Greek rates with corresponding rates in the euro area. Moreover, due to the increasing competition among banks, 2007 saw rates in the two major categories of housing loans in Greece remain lower than the corresponding euro area rates.

In Greece, the differential between the average weighted interest rate on total new bank loans and the corresponding rate on new bank deposits, i.e. the interest rate spread, was further reduced in 2007, reaching 4.06% in December. Underlying this decline were increased productivity of Greek banks as well as enhanced competition among banks in recent years. However, the interest rate spread remained 0.97 percentage point higher than in the euro area (December 2007: 3.09%), although in recent years a considerable degree of convergence has been achieved. The higher interest rate spread in Greece reflects the effect of several factors, not least of which is the different composition of deposits and, above all, loans, in Greece in comparison with the euro area. If this composition were the same in Greece as in the euro area, the interest rate spread in Greece would be smaller and the interest rate spread differential between Greece and the euro area would have been 0.39 percentage point in December.

7 BANKING SYSTEM STABILITY

7.1 THE CONSEQUENCES OF THE TURMOIL

The Greek banking system shows a high degree of stability, despite the continued international financial turmoil. Banks' profitability and capital adequacy remained satisfactory in 2007, contributing to the stability of the banking system. Moreover, the quality of banks' portfolios showed a small further improvement. However, the international financial turmoil, continued strong credit growth in Greece and Greek banks' increasing penetration into new markets in Southeastern Europe increase risks. Hence, continuous adjustment and further development of banks' risk measurement and management systems are warranted, including further improvements in the quality of their loan portfolios.

The adverse conditions that emerged in the international financial markets in the second half of 2007 and continued into the first months of 2008 have affected the determinants of the stability of each country's financial system. The impact of these conditions on the Greek banking system was limited and mostly indirect in 2007, as Greek banks had very little exposure to both investment products associated with US subprime mortgage loans and other products, the valuation of which was affected by uncertainty in international markets.

Nonetheless, one should not lose sight of the fact that the current turmoil in the international financial system has gathered momentum and is fuelled by self-feeding and interacting risks. Therefore, its impact does not regard only the degree of individual banks' direct exposure, but also the possibility that these risks may take on a more systemic character. Uncertainty about counterparties' creditworthiness (credit risk) and the valuation of securities has led to considerable liquidity shortage in the interbank market. Coupled with the interdependence of various risk categories, it also has implications for credit institutions, as it affects the evaluation of the results and the manner of application of stress tests by supervisory authorities. Actually, under the circumstances, supervisory authorities require proper adjustment of risk management policies, taking into account investors' reduced risk appetite and preference for safer and more liquid assets at the cost of lower yields.

7.2 PROFITABILITY AND EFFICIENCY

Under these conditions, it is particularly noteworthy that the Greek banks' resilience to the international turmoil is supported by sustained robust profitability, especially for banks that are increasingly active abroad. Higher profitability ratios were recorded by banks with strong activity in Southeastern Europe; however, these ratios did not exceed those for similar banks in the EU. Credit growth continued to be the main determinant of bank profitability, another determinant being a considerable decrease in provisioning. At the same time, however, strong credit growth may entail increased risks, in particular credit risk and, for certain banks, country risk. On the other hand, mounting competition in the Greek banking market (also evidenced by developments in banks' market shares) and banks' increased funding costs led to a small narrowing in 2007 of the net interest rate margin in comparison with 2006 (at bank level).

In any case, it should be pointed out that banks should not try to make up for their increased funding costs through further credit expansion, especially to borrowers of low credit standing, who are charged with higher lending rates (as the risk assumed by banks increases). Such a policy might maintain bank profitability at high levels, at least in the short run, but would increase considerably the risk of a sharp decline in profitability in the future.

7.3 CAPITAL ADEQUACY

The evolution of profitability contributed to a further increase in banks' own funds; however, own funds growth falls short of the increase in risk-weighted assets at bank and (mainly) banking group level. The Capital Adequacy Ratio (CAR) of Greek banks declined in 2007, standing at 11.2%, in comparison with 12.2% at end-2006. Although the CAR dropped for the second year in a row, this level continues to provide a satisfactory margin for ensuring banking system stability and is still close to the level recorded for large banks in the EU (11.1%, according to data for the first half of 2007). Banking groups' Tier I ratio fell less, reaching 9.2% (December 2006: 9.9%).

7.4 BANKING RISKS

Regarding banking risks, according to December 2007 data, the non-performing loans to total loans ratio (NPL ratio) declined further (to 4.5% at end-2007, from 5.4% at end-2006), but is still well above the EU average. This, in conjunction with the fact that the NPL ratio hinges critically on the quality of each bank's risk management, because of both the new supervisory framework "Basel II" and the avowed need for international credit risk repricing, warrants a reduction in the NPL ratio below the target set by the Bank of Greece before the turmoil (3.5% for end-2008).

Market risk remained relatively low, while liquidity risk increased. The liquidity ratios showed considerable volatility, but stood at satisfactory levels at end-2007.

This finding was also confirmed by two liquidity stress tests with scenarios of turmoil continuing until end-March and end-June 2008, respectively. In the light of prevailing market conditions, liquidity must be monitored continuously; therefore, the Bank of Greece has asked banks to report relevant data more frequently than required by the applicable general provisions.

The violent international financial market turmoil, coupled with strong credit growth and

Greek banks' penetration into new markets that involve higher risk, confirm the need for continuously adjusting risk (especially credit and liquidity risk) measurement and management mechanisms, as well as the correlation between these two risk categories.

These developments make the Bank of Greece's recommendations to both banks and households all the more relevant.

Specifically, banks have been requested to further improve the quality of their loan portfolios, by tightening their credit standards. The implementation of the specific provisions under the second pillar of the supervisory framework "Basel II" will help in this direction. In particular, in addition to the capital requirement provisions currently in force, *ad hoc* supervisory measures shall be taken in the case of banks which, without due justification from a risk management perspective, lend to households in excess of the recommended debt-to-income ratio of 30% or up to 40% (depending on income levels). Moreover, under the second pillar of Basel II, the Bank of Greece also examines loan-to-value ratios in the light of current, bank-specific circumstances and risk profiles. It should be pointed out that this ratio increased for new housing loans once again in 2007.

Households, for their part, should consider more carefully their debt-servicing capacity. To this end, they should take into account their future disposable income, as well as any impact on their debt obligations and credit standing by such factors as high volatility and uncertainty in international money and capital markets, banks' credit risk repricing, widening of the interest rate margin, the possibility of a hike in benchmark rates as well as the inevitable tightening of credit standards by banks.

8 MEDIUM- AND LONG-TERM ECONOMIC PROSPECTS AND POLICY CHALLENGES

8.1 GROWTH PROSPECTS, STRUCTURAL WEAKNESSES AND MACROECONOMIC IMBALANCES

The strong performance of the Greek economy over the last twelve years has led to considerable progress towards real convergence with the more advanced economies of the European Union. Still, Greece lags behind in terms of economic development and social welfare levels and its growth prospects are undermined by serious macroeconomic imbalances and structural weaknesses, reflected, among other things, in a persistent inflation differential vis-à-vis the euro area and in the high levels of the current account deficit, unemployment and public debt. The expected ageing of the population should have negative fiscal and economic implications, while globalisation not only provides opportunities, but also represents a challenge for the Greek economy. Moreover, the ongoing international financial turmoil that started in mid-2007 is expected to hamper world growth and therefore dampen international demand for Greek exports. Against this background, maintaining high growth rates in Greece will require stepping up economic policy efforts, as well as social consensus, so as to achieve further fiscal consolidation, contain wage increases to levels compatible with price stability and improve productivity. It also calls for structural reforms in a wide range of areas.

Strong economic growth over the last twelve years (at an average annual rate of 3.9% during 1996-2007) was primarily driven by buoyant domestic demand, while improvements in productivity and domestic supply conditions have been mediocre. Private sector consumption and investment have benefited from a substantial decrease in financing costs following Greece's entry into the euro area and from strong credit expansion as a result of financial liberalisation. Household indebtedness has risen rapidly, but as a percentage of GDP still remains lower than in the euro area. Sizeable fiscal deficits, although generally declining in recent years, have also helped boost domestic demand, but at the same time contributed to continuous accumulation of public debt. Thanks to robust public and business investment, a rise in employment – partly reflecting migrant inflows – and structural reforms, productive capacity has responded to the sharp increase in demand, but not sufficiently, thus resulting in excess domestic demand, which has led to a build-up of inflationary pressures and a very large current account deficit. Moreover, strong unit labour cost growth (at an average annual rate of 3.6% during 2001-2007, compared with 1.6% in the euro area) has been conducive to inflation levels persistently higher than in the euro area and, through the deterioration in international competitiveness, a widening of the external deficit. Besides, a number of structural weaknesses have prevented stronger productivity growth and have kept unemployment and poverty levels relatively high.

Reflecting these developments and structural weaknesses of the economy:

– Average annual inflation remained high (3.4%) during 2001-2007, exceeding that of the euro area as a whole by 1.2 percentage points.

– The current account deficit has risen sharply in recent years, standing at 14.1% of GDP in 2007. This has led to a considerable deterioration in Greece's negative international investment position (i.e. net external financial liabilities of the public and the private sectors), from 43.4% of GDP at end-2000 to 93.7% of GDP at end-2007.

– Per capita GDP (in purchasing power standards – PPS) falls short of the EU-15 average by 11.6% (2007 data). This is attributable to a 27.9% shortfall in productivity per hour worked in Greece (again in PPSs, 2006 data) compared with the EU-15 average and to the relatively low employment rate (61.0%, EU-15: 66.2% in 2006). Moreover, unemployment and poverty levels remain high and exceed the EU-15 averages. The unemployment rate was 8.3% in 2007, compared with 7.0% in the EU-15, and the poverty rate was 21% in 2006, compared with 16% in the EU-15.[3]

– Despite the fiscal adjustment achieved in the 2005-2007 period, fiscal imbalances remain serious, as reflected in the general government deficit and debt levels (2.8% and 94.5% of GDP in 2007, respectively), which are among the highest in the euro area.[4]

3 Source: Eurostat data on the "structural indicators". It should be pointed out that productivity per person employed (not per hour worked) only fell short by 4% of the EU-15 average in 2007. This difference reflects the fact that hours worked per person employed are much higher in Greece than in the EU-15, on the one hand because part-time employment is less common and on the other because the average working hours for those employed on a full-time basis are longer.

4 The general government deficit and debt in the euro area stood at 0.6% and 66.3% of GDP respectively in 2007 (Eurostat news release, 18 April 2008).

Maintaining high economic growth rates over the long term will require radical changes to the growth pattern of the last twelve years, when buoyant domestic demand (in particular consumption) was the key driver. The large current account deficit – which, rather than productive investment, mostly reflects high private consumption and residential investment – leads to higher external debt without expanding the productive and export potential or improving the economy's debt-servicing capacity.[5] Thus, an increasing share of GDP will have to be devoted to net spending to service the external financial liabilities of the private and the public sector (in the form of interest, dividends etc.), with negative implications for investment, growth prospects and, ultimately, consumption and living standards. Driving down the very large current account deficit should therefore be a top priority for economic policy. Economic policy should encourage private saving through appropriate incentives, while continued fiscal adjustment should help general government saving (which was negative up to 2007) to become positive in the future. Regarding household borrowing, banks should adhere to strict credit standards, while households should carefully consider their debt-servicing capacity before undertaking loan obligations.

In any case, domestic demand growth will tend to weaken in coming years, when the strong credit expansion supporting private consumption and housing investment will inevitably decline as households' overall indebtedness – which as a percentage of GDP is still well below the euro area average – will tend to level off. This highlights how important it is to transform the economy into an outward-looking one, in which growth will rely on productive investment and exports, if high growth rates are to be sustained in the long run. Such a transformation will require correcting macroeconomic imbalances and improving the Greek economy's productivity and international competitiveness. Moreover, effective fiscal adjustment and structural reforms will require broad social consensus.

The correction of macroeconomic imbalances should be pursued primarily through continued fiscal consolidation, but also through wage increases in line with productivity growth and consistent with price stability, proper pricing policies and structural reforms that improve productivity and the supply side of the economy and strengthen competition.

8.2 CORRECTING FISCAL IMBALANCES

As already mentioned, fiscal imbalances remain serious, despite the consolidation achieved in recent years, and the size of the fiscal effort required for their correction is in fact larger than what the current levels of deficit and debt would imply. Against a backdrop of worsening demographics, public spending associated with population ageing (including pension and healthcare expenditure but excluding long-term treatment/care spending) will rise dramatically as a percentage of GDP, especially after 2015 – by a total of 11.5 percentage points between

5 Greece's current account deficit as a percentage of GDP grew to 14.1% in 2007, while the corresponding figure for the euro area was almost zero. This is associated with the fact that domestic saving as a percentage of GDP is lower than in the euro area, while investment as a percentage of GDP is higher.

2005 and 2050 – according to available projections.[6] These projections, compiled and released in 2002-2005, obviously take no account of the recently passed social security law, the budgetary impact of which remains to be estimated in detail.[7] The new legislation (Law 3655/2008 re: "Administrative and organisational reform of the social security system, and other social security provisions") attempts to address the excessive segmentation of the social security system and amend certain aspects of the pension system with a view to ensuring its sustainability (e.g. by providing incentives for staying at work and discouraging early retirement).

Given the adverse demographic projections, there is urgent need for drastic fiscal adjustment that will lead to sizeable primary surpluses and a decrease of public debt to 60% of GDP by 2015, while further reforms will be warranted in the future.[8] It is self-evident that the impact of population ageing on government finances cannot be addressed by fiscal policy measures alone – i.e. tax increases and/or cuts in other expenditure – as this would undermine economic growth and jeopardise the adequate provision of vital public services.

According to Greece's updated Stability and Growth Programme 2007-2010, the general government deficit is projected to fall to zero by 2010, from 2.8% of GDP in 2007, leading to a primary surplus of 3.8% of GDP by 2010, i.e. improved by 2.6 percentage points). The structural deficit (i.e. the cyclically adjusted deficit net of the effect of one-off measures) is projected to fall to 0.5% of GDP by 2010. This implies that the medium-term objective of reaching structural fiscal balance can be achieved in 2011. At the same time, rising primary surpluses coupled with high growth rates and privatisation revenue are expected to enable a steady decline in public debt to 82.9% of GDP by 2010.

However, the envisaged fiscal consolidation is not sufficient for public debt to drop to 60% of GDP by 2015. In this connection, the following points should be made:

(a) During the last eight years, although strong growth performance, historically low interest rates, substantial privatisation proceeds and high primary surpluses have created very favourable conditions for fast debt reduction, the decline in the debt-to-GDP ratio was slow, about 1.1% of GDP per annum on average. At this pace, it would take roughly three decades to reach the reference rate of 60% of GDP.

(b) Even if public debt develops as projected in the updated Stability and Growth Programme 2007-2010 (dropping by 3.5% of GDP per annum on average), it will still be at 66.5% of GDP by the end of 2015, rather than 60%. It should also be noted that in 2006 and 2007 the average interest rate on government (new) borrowing rose by 0.6 percentage point (each year), and this trend has continued into 2008, while growth is weakening. These developments exacerbate

6 See Bank of Greece, *Monetary Policy 2007-2008*, February 2008.

7 The only estimates available so far refer to the amount of expenditure and the "expenditure savings" under the new law, and are included in the report by the State General Accounting Office that in accordance with Article 75 (1) of the Constitution was submitted to Parliament along with the draft law.

8 See also Opinion No. 194/18 March 2008 of the Economic and Social Committee (www.oke.gr) on the recent social security draft law.

the dynamics of public debt and further complicate its reduction.

Achieving primary surpluses calls for action on both the revenue and the expenditure side. Given strong tax competition among the EU Member States and the low competitiveness of the Greek economy, there is little room for improving revenue by levying new taxes or increasing the existing ones (the real estate tax reform introduced by Law 3634/2008 is very recent). Corporate tax rates have been lowered and a similar reform for personal tax is under way. Instead, tax revenue could be raised by more effectively combatting tax evasion. The reduction of income tax rates and the efforts made to cross-check tax data are positive steps in this direction. Such measures should be combined with a stable tax system. In recent decades, repeated tax amnesties have far from helped to build a taxpaying culture.

On the expenditure side, the effective control of general government primary expenditure is crucial for achieving sizeable and sustainable primary surpluses. (It should be pointed out that, according to the updated Stability and Growth Programme 2007-2010, fiscal consolidation relies mainly on increases in revenue.) Priority should be given to containing those expenditure categories (such as personnel outlays, grants or State guarantees on behalf of public enterprises) that represent high shares of total government expenditure or grow rapidly. Thus, reducing the hiring-to-retirement ratio and utilising the existing human resources more efficiently through transfers and reassignments can help contain personnel outlays. Besides, rationalisation of the public enterprises' functioning would reduce their deficits and the relevant State grants and guarantees.

8.3 WAGE INCREASES, PRICING POLICIES AND COMPETITION

The need to ensure macroeconomic stability highlights the importance of wage moderation and firms' pricing policies.

Specifically, collective wage bargaining should take into account productivity developments, price competitiveness, as well as the level of unemployment. In particular in this year's ongoing bargaining (at sectoral, occupational or enterprise level), account should be taken of the fact that the expected rise in average annual inflation in 2008 relative to 2007 mainly reflects the hike in international oil prices. The latter inevitably implies a transfer of income from oil-importing to oil-exporting countries, and the impact of this process on purchasing power cannot be sustainably offset by nominal wage increases, which would instead lead to even higher inflation eroding the purchasing power of domestic incomes, especially among the economically weaker social groups. Another factor to be considered is that unit labour cost growth in Greece in 2008 is projected to outpace that in the euro area, implying a further loss of price competitiveness.

More generally, there is need to increase competition in those markets that do not operate efficiently. This will enable firms to adopt a price-setting behaviour in line with cost developments and keep their profit margins at levels that do not undermine price stability and competitiveness.

8.4 STRUCTURAL POLICIES TO RAISE EMPLOYMENT AND PRODUCTIVITY

Although considerable progress with structural reforms has been made since the beginning of the 1990s, reform should continue in order to improve productivity and the economy's structural competitiveness. This will in particular require a further drastic reduction of labour and product market rigidities; an improvement in the business environment, the tax system and public sector efficiency; and cutting down on red tape. It will also require a further upgrading of human capital.

It is worth noting that, according to the Country-Specific Integrated Recommendations adopted by the European Council on 13-14 March 2008 for the current year, "Policy areas ... where challenges need to be tackled with the highest priority" include (in addition to "long-term fiscal sustainability") "implementation of the public administration reform agenda, consolidation of active labour market policies, tackling high youth unemployment, tackling undeclared work, and acceleration of education and life-long learning reforms".[9]

8.4.1 Raising employment

As already mentioned, Greece has a lower employment rate and a higher unemployment rate in comparison with the EU-15 averages. Raising employment rates will require policies aimed at: (a) increasing labour market flexibility by encouraging new forms of labour organisation and providing a wider range of contractual arrangements for workers; (b) bringing into the labour market sections of the population with relatively low participation rates (especially women and older workers) by improving childcare systems, promoting equal opportunities for men and women and eliminating tax disincentives; and (c) continuously upgrading the skills of the labour force by improving education and training systems and making them more responsive to economic and technological changes. These goals are all the more important as demographic projections suggest that Greece will experience a decline in working-age population in coming years. This implies that long-term economic growth will have to rely exclusively on boosting labour productivity – through an increased ratio of capital to labour input and a more efficient use of resources – and on raising the employment rate (in particular of women and older workers, as already mentioned, and young people).

8.4.2 Raising productivity

Raising productivity requires, among other things, a modern business environment and the development of dynamic firms. This, in turn, requires policies aimed at: (a) pro-

9 Specifically, it is recommended that Greece
— "implement the reform of its public administration, by building up effective regulatory, control and enforcement capabilities, by modernising its human resources policy; and through effective use of the Structural Funds;
— in line with an integrated flexicurity approach, modernise employment protection including legislation in order to cover all forms of contractual arrangements, reduce further tax burden on labour, strengthen active labour market policies and transform undeclared work into formal employment;
— accelerate the implementation of reforms on education and lifelong learning, in order to improve quality and responsiveness to labour market needs, increase participation, and allow for a smooth transition into employment, particular for the young".
Besides, over the medium term, it is recommended that Greece "accelerate efforts to set up a research and innovation strategy and increase investment in R&D; improve further the transposition of internal market legislation; speed up progress towards meeting the SME policy targets set by the 2006 Spring European Council; strengthen competition in the area of professional services; protect the environment by prioritising effective solid and water waste management and curb greenhouse gas emissions; encourage further female participation in employment; reduce early school leaving and put in place a coherent active ageing strategy''. See Council of the European Union, doc. 7275/08, 4 March 2008, and Brussels European Council 13/14 March 2008, Presidency Conclusions, doc. 7652/08.

moting competition, enhancing public administration efficiency, simplifying the regulatory and tax environment and creating conditions that will enable economies of scale to be reaped; (b) supporting investment in public infrastructure and physical capital; (c) upgrading the human capital by improving education and training; and (d) allocating resources to research and innovation.

Stronger competition in product markets can directly contribute to higher total factor productivity, as it encourages innovation and cost-saving. Inadequate competitive conditions in the Greek economy are largely associated with the existence of administrative barriers to business start-ups and the complex regulatory framework (which encourages concerted practices among existing firms). Despite the progress achieved so far (e.g. in the financial sector, telecommunications, goods and services distribution and retail trade), there is considerable room for further strengthening competition in the economy.

The productivity of the business sector would benefit greatly from a more efficient public administration. Admittedly, current staff allocation and the operational framework of the public administration fail to meet the immediate or long-term requirements of the Greek society and economy effectively. Modernisation in this area has been advancing at a relatively slow pace, while tasks and procedures have been less than adequately subjected to regular review based on cost-benefit criteria. It is worth noting in this respect that an estimated 40,000 civil servants (i.e. about 15% of the tenured personnel) are still assigned to issuing all kinds of permits, documents or certificates, although these are normally obtainable from electronic databases to which the administration has access (following the launch of the new "Syzefxis" system by the Ministry of the Interior). Of course the public administration can only reap the full benefits of using immediate data processing technologies once the institutional framework has been adapted and the personnel has been properly trained. Among other things, it is necessary to overhaul and streamline administrative procedures, many of which have become redundant after the introduction of information technologies. Without such streamlining, both the public administration and the citizens will miss the many advantages of technology.

Regarding the creation of conditions for exploiting economies of scale, it should be stressed that the average size of Greek firms across the economic activity spectrum is smaller than in most of the other EU-15 countries. In the past, the small size of Greek firms was attributed, among other things, to the fact that the market for them was small. However, in today's globalised market and in view of the fast growth of several neighbouring economies this constraint is gradually fading.[10] Greek firms' information about possibilities of access to large foreign markets, and availability of support in their first steps from Greek diplomatic services in foreign countries can materially change the parameters based on which several business

10 A recent study conducted by the National Bank of Greece ("Inter-linkages between SE Europe and Greece provide significant positive growth synergies", *Economic and Market Analysis*, March 2008) stresses that in the last ten years the strength of Greek exports to SE European countries, imports of low-cost intermediate goods and migrant inflows to Greece from these countries have contributed 0.6 percentage point to annual GDP growth.

decisions are made (e.g. investment in physical capital, product diversification etc.) and allow Greek enterprises to exploit economies of scale. Economies of scale can also be achieved by forming clusters, i.e. geographical concentrations of firms with similar activities, which would enable them to share some costs (e.g. transport, R&D), exchange know-how and specialise the products and services they offer, while creating externalities also for smaller firms. For consumers, benefits would mainly include lower prices (due to the firms' reduced average operating costs) and enhanced diversification and quality of products and services.

The availability of modern and functional infrastructure can increase productivity and bolster economic activity both directly and indirectly. Infrastructure improvements are obviously needed in the area of (land, sea and air) transport as well as in network industries (energy, water supply and communications). Regarding transport, Greece lags considerably behind the other EU-15 countries, even though it ranks higher than Ireland and Italy in terms of the infrastructure sub-index[11] of the World Economic Forum's Global Competitiveness Index, which measures mainly the adequacy of transport infrastructure.[12] Regarding improvements in network industries, which are also essential for boosting productivity, progress has been made in recent years in communications infrastructure, as broadband penetration has overshot the target set (7% by the end of 2008) to stand at 9% in January 2008,[13] while prices for broadband access in euro per Mbit/s have declined considerably. However, despite this progress, Greece's broadband penetration gap vis-à-vis the EU is around 11 percentage points.[14]

Productivity will also benefit from investment in physical capital other than infrastructure, as it leads to capital deepening. Firms' capital investment decisions are influenced, among other things, by the size of target markets. Thus, access to new, larger markets offers firms, in addition to the benefits described above, opportunities of modernisation.

Education and training foster growth insofar as, among other things, they improve career opportunities and enable the labour force to adapt more flexibly to new technologies. In 2005, the percentage of 20-24 year olds with upper secondary education was higher in Greece than in the EU-15 (84.1%, compared with 76.4%). However, according to the OECD's PISA[15] results that measure reading, mathematical and scientific literacy, Greek students performed worse than their peers from the other EU-15 countries in two successive cycles of the assessment, i.e. in 2003 and 2006. This implies that curricula are not sufficiently tailored to the requirements of society and the economy.

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11 The sub-index takes into account: (1) overall infrastructure quality; (2) railroad network development; (3) quality of port infrastructure; (4) quality of air transport infrastructure; (5) quality of the road network; and (6) number of telephone lines.

12 Moreover, the need to further improve the road network is suggested by Eurostat data for 2001, indicating a road network density of 6 kilometres per 1,000 square kilometres of land, compared with 16 kilometres in the EU-15 (while the ratio of the number of trucks to the population far exceeds the EU-15 average). The inadequacy of the road network is also reflected in Greece's high road death rate relative to the size of the vehicle fleet.

13 Annex to the "Progress report on the single European electronic communications market 2007", Brussels, 19 March 2008 – COM (2008) 153.

14 In Greece, the ratio of the number of broadband connections relative to the population rose from 1.45% in January 2006 to 9.11% in January 2008. The corresponding figure for the EU-27 was 20% in January 2008. Moreover, optical fibre technology, which has considerable advantages and will be the basis for the next generation of broadband access, has a very low penetration rate in Greece.

15 Programme for International Student Assessment.

At the same time, as technology is evolving rapidly, people should continue to acquire knowledge and skills even after the end of formal education, through lifelong learning and on-the-job training programmes. However, the percentage of companies in Greece offering on-the-job training to their employees is the smallest in the EU-15, and participation in lifelong learning programmes is low.

The above discussion points to a need for closer cooperation between the education system and the market, as regards both preparation of curricula and engagement in research. Synergies among research centres, universities and firms (or clusters of firms) would allow major research projects to be undertaken, otherwise infeasible for relatively small-sized firms. Research also creates externalities and, as a result, benefits diffuse throughout society.

Several of the interventions mentioned above are or can be financed by the Community Support Frameworks, the resources of which have contributed to the strong growth seen in the last twelve years. In order to maintain high growth rates after these inflows are scaled down, the resources currently available have to be utilised now to upgrade the economy's productive structure in a manner favouring long-term sustainable growth, while at the same time meeting the demographic challenges ahead and the need to protect the environment.

9 CONCLUSIONS

The foregoing analysis highlights the need to minimise the negative consequences for the Greek economy of the continued crisis in international financial markets, external inflationary pressures, the expected considerable slowdown of the global economy and the high likelihood of the US economy entering a recession in the first half of this year.

The safest way to enhance the resilience of the Greek economy to external shocks is to keep up efforts to improve its fundamentals. This implies that fiscal consolidation should continue, as envisaged in the updated Stability and Growth Programme 2007-2010, in order to bring the general government deficit-to-GDP ratio down to zero by 2010 and reduce public debt considerably. Stronger efforts will be needed for raising productivity growth and containing production costs, so as to restore the international competitiveness of the economy. It is also necessary to increase national saving. In addition to reducing fiscal deficits, which will contribute to higher national saving, measures should be taken to encourage and increase private saving, thereby leading to a decline in the current account deficit.

Certainly, eliminating the inflation differential between Greece and the euro area as a whole is essential. Apart from the support of appropriate fiscal policies and wage agreements, this would also benefit from market supervision measures to prevent excessive profit-seeking, such as those taken by the Ministry of Development. However, these measures address the symptoms of the problem rather than its causes, which are associated with the structure of markets. Indeed, in the far from few markets where certain firms have a dominant position, inflation has risen faster than in those with sound competitive conditions. This is a long-standing problem that cannot be resolved by the government overnight. Rather, it calls for a systematic and far-reaching policy based on a thorough study of market structures, for strengthening competition through market restructuring, so as to achieve competitive conditions similar to those prevailing in the more advanced European countries.

Policies of this type can help sustain the progress achieved in recent years in terms of higher living standards. In the last twelve years (1996-2007), real per capita GDP has risen by a cumulative 51%, or at an average annual rate of 3.5%. During the same period, according to Bank of Greece estimates, average real pre-tax earnings rose by 34.5% overall, or by 2.5% on average annually, broadly in line with productivity growth. However, despite the strong performance of the Greek economy, income inequality and poverty can be observed and would be further exacerbated in the event of a significant decline in the growth rate.

As already mentioned, about one-fifth of Greek households are below the poverty line, according to NSSG surveys over a number of years. The most recent survey suggests that 13% of workers, 25% of pensioners and 33% of unemployed persons are below the poverty line, as are 41% of single-parent families with at least one dependent child.

This situation can be tackled with a comprehensive anti-poverty strategy. While the establishment of the National Fund for Social Cohesion (Law 3631/2008) was indeed a step in the right direction, it is in itself insufficient to drastically reduce the poverty rate. A number of reforms are also necessary in this respect, to help reduce unemployment further, raise the percentage of skilled labour and facilitate labour market entry, so that higher prosperity can be shared more widely among the population.

Moreover, between the households that have already benefited from growth and enjoy increasingly high incomes and the poor households, lies a large number of households living on the verge of economic and social insecurity. Preventing further exacerbation of these social problems is another important reason why we absolutely must reduce inflation and ensure continued satisfactory growth. Generally, if living standards are to keep rising, it is necessary to place much greater emphasis on productivity-led growth. Demand-led growth not accompanied by higher productivity has its own natural limits and cannot be expected to shelter the Greek economy from the impact of a possible slowdown in world growth and a rise in world inflation. By contrast, policies that improve productivity can better insulate the economy from external shocks and lay more solid foundations for higher living standards in the future.

III ECONOMIC ACTIVITY AND EMPLOYMENT

1 ECONOMIC ACTIVITY

1.1 DEVELOPMENTS IN KEY DEMAND COMPONENTS IN 2007

According to the latest NSSG estimates (March 2008), GDP rose by 4.0% in 2007 (4.2% in 2006). However, its annual growth rate slowed down in the course of the year and fell to 3.7% in the second half, from 4.2% in the first half. Despite this slowdown, the GDP growth rate in 2007 exceeded that of the euro area, and the Greek economy continues to be one of the fastest growing in the EU.

Strong economic growth in 2007 was due, as in previous years, to the positive contribution made by domestic demand, while the change in the real external balance (i.e. the difference between imports and exports of goods and services at constant prices) had a negative contribution to GDP growth, although to a lesser extent than in 2006.

The international financial turmoil and the developments in the external economic environment had a limited impact on the Greek economy in 2007. However, the significant effective appreciation of the euro vis-à-vis the major currencies and the weakening of international trade flows had a dampening effect on the growth of exports of goods. Furthermore, the rise in oil prices in the second half of 2007 eroded the purchasing power of households' incomes, while business confidence indicators remained at relatively high levels, although they declined somewhat in the last quarter of 2007.[1] Moreover, the extensive losses of physical capital and agricultural production caused by the disastrous forest fires of last summer do not seem to have had any major impact on total activity, as they were to some extent offset by the increase in demand-boosting effects of social transfers to fire victims.

Turning to individual key demand components (see Table III.1), the rate of increase in private consumption slowed significantly to 3.2% in 2007, from 4.2% in 2006. The volume of retail sales (excluding car and fuel sales) grew at a rate of 2.3% in 2007, compared with 8.0% in 2006,[2] while the number of passenger car registrations rose by 4.3% (2006: +0.5%).

The growth of private consumption (see Table III.2) continued to be supported chiefly by households' higher real disposable income, as well as by consumer credit expansion.

The rise in households' disposable income mainly reflected improvements in real average earnings (by 2.4% – see Chapter IV) and in employment (see Section 2 of this chapter), as well as the measures taken to assist low-income earners, such as increases in the Social Solidarity Pension Supplement (EKAS), Agricultural Insurance Fund (OGA) pensions and unemployment benefits. (The

1 Indeed, the Economic Sentiment Indicator for Greece remained at satisfactory levels in 2007 (108.0 on average, according to revised data) and, in any case, higher than in 2006 (102.3 on average). In the last quarter of 2007, the indicator dropped to 100.6, primarily due to a deterioration in consumer confidence, while the fall in business confidence was very limited.

2 The retail trade business confidence indicator compiled by the IOBE rose considerably in 2007, at an average rate of 9.0% (2006: +14.5%, 2005: –7.7%). The corresponding indicator for services excluding retail trade and banking rose at an average annual rate of 2.8% in 2007 (2006: +10.7%, 2005: –1.0%).

impact of measures to reduce the tax burden on individuals will become evident mainly from 2008 onwards.) According to estimates by the NSSG and the Ministry of Economy and Finance, households' real disposable income increased in 2007 at a rate of 4.0%, which was higher than that of consumer spending at constant prices. This

Table III.1 Gross expenditure of the economy and gross domestic product

(constant market prices of 2000)

	Value in million euro	Annual percentage changes						
	2000	2001	2002	2003	2004	2005	2006	2007
1. Private consumption	98,628	4.5	4.2	5.0	4.7	4.2	4.2	3.2
2. Public consumption	24,271	0.4	7.3	–1.0	3.0	1.2	0.3	7.4
3. Gross fixed capital formation	29,450	4.1	10.7	15.4	6.0	0.7	14.8	4.4
3.1a By investor: general government	4,957	3.1	–1.8	15.1	6.6	–16.0	7.7	1.7
3.1b other sectors	24,493	4.3	13.2	15.5	5.9	3.6	15.9	4.7
3.2a By type: construction	17,945	4.3	3.6	11.0	3.7	–1.0	21.6	1.9
3.2b equipment	10,416	0.2	22.0	22.9	8.0	1.7	6.5	7.7
3.2c other investment	1,089	36.9	20.3	10.3	15.1	9.7	12.2	5.3
4. Change in inventories and statistical discrepancy (% of GDP)	2,327	0.4	–0.5	0.0	0.2	0.2	–0.4	0.2
5. Domestic final demand	154,676	2.6	5.0	6.6	5.0	3.0	5.4	4.6
6. Exports of goods and services	33,882	–2.7	–7.7	2.5	12.6	2.7	5.1	5.9
6.1 Exports of goods	14,253	0.2	–7.8	7.8	0.5	7.5	12.4	1.6
6.2 Exports of services	19,629	–4.8	–7.6	–1.6	22.8	–0.6	–0.2	9.4
7. Final demand	188,558	1.7	2.9	5.9	6.1	2.9	5.4	4.8
8. Imports of goods and services	52,277	–5.8	–0.2	8.7	10.7	0.5	8.7	7.0
8.1 Imports of goods	40,730	–6.0	4.2	13.2	10.8	1.0	8.7	6.2
8.2 Imports of services	11,547	–4.9	–15.4	–10.7	10.4	–2.3	8.4	11.0
GDP at market prices	**136,281**	**4.5**	**3.9**	**5.0**	**4.6**	**3.8**	**4.2**	**4.0**
		Contribution to GDP change (percentage points)						
1. Private consumption		3.3	3.0	3.6	3.4	3.0	3.1	2.4
2. Public consumption		0.1	1.2	–0.2	0.5	0.2	0.0	1.1
3. Gross fixed capital formation		0.9	2.3	3.5	1.5	0.2	3.7	1.2
3.1a By investor: general government		0.1	–0.1	0.5	0.2	–0.6	0.2	0.1
3.1b other sectors		0.8	2.4	3.0	1.3	0.8	3.5	1.1
3.2a By type: construction		0.6	0.5	1.4	0.5	–0.1	2.8	0.3
3.2b equipment		0.0	1.6	2.0	0.8	0.2	0.7	0.8
3.2c other investment		0.3	0.2	0.1	0.2	0.1	0.2	0.1
4. Change in inventories and statistical discrepancy		–1.3	–0.9	0.4	0.3	0.0	–0.7	0.6
5. Domestic final demand (excluding the change in inventories)		4.2	6.6	7.0	5.4	3.4	6.8	4.7
6. Exports of goods and services		–0.7	–1.8	0.5	2.5	0.6	1.1	1.3
6.1 Exports of goods		0.0	–0.8	0.7	0.0	0.7	1.1	0.2
6.2 Exports of services		–0.7	–1.0	–0.2	2.5	–0.1	0.0	1.1
7. Final demand		2.3	3.8	7.9	8.3	4.0	7.3	6.6
8. Imports of goods and services		2.2	0.1	–2.9	–3.7	–0.2	–3.1	–2.6
8.1 Imports of goods		1.8	–1.1	–3.6	–3.1	–0.3	–2.6	–2.0
8.2 Imports of services		0.4	1.2	0.7	–0.6	0.1	–0.5	–0.6
9. External balance of goods and services		1.5	–1.7	–2.4	–1.1	0.4	–2.0	–1.3
GDP at market prices		**4.5**	**3.9**	**5.0**	**4.6**	**3.8**	**4.2**	**4.0**

Sources: NSSG, National Accounts, and Ministry of Economy and Finance, March-April 2008.

Table III.2 Indicators of consumer demand (2006-2008)

(annual percentage changes)

	2006	2007	2008 (available period)
Volume of retail sales	8.0	2.3	3.4 (Jan.)
Food-beverages-tobacco[1]	9.0	0.9	0.1 (")
Clothing-footwear	0.8	1.1	8.4 (")
Furniture-electrical appliances-household equipment	17.7	6.7	5.5 (")
Books-stationery-other	3.7	6.7	9.3 (")
Revenue from VAT (constant prices)	8.5	6.8	. . .
Retail trade business expectations index	14.5	9.0	–0.4 (Jan.-March)
New passenger car registrations	0.5	4.3	–2.2 (Jan.-March)
Piraeus Port Authority (OLP) passengers	3.7	2.0	. . .
Tax revenue from mobile telephony (monthly flat fees)[2]	11.8	114.2	5.8 (Jan.-Feb.)
Outstanding balance of total consumer credit extended by banks[3]	23.9 (Dec.)	22.4 (Dec.)	22.6 (Jan.)

1 Including big food stores and specialised food-beverages-tobacco stores.
2 Adjusted rates apply as from 1 November 2006.
3 Taking into account securitised loans and loan write-offs.
Sources: NSSG (retail sales, cars), Bank of Greece (VAT revenue and consumer credit), IOBE (expectations), OLP, Ministry of Economy and Finance (tax revenue from mobile telephony).

development resulted in an increase in the very low household saving rate (from 1.2% to 1.9%).

As regards consumer credit expansion (which, in recent years, is associated with financial deregulation and households' positive expectations concerning their future incomes), the average annual growth rate of the outstanding balance of consumer loans slowed to 22.4% in December 2007, from 23.9% in December 2006, but remained high, despite higher interest rates.

Other factors have also played a part in maintaining strong private consumption growth in recent years, such as the increase in population as a result of the continued immigration flows.

Government consumption (on a national accounts basis and at constant prices) rose by 7.4% in 2007, having increased by a mere 0.3% in 2006. The substantial increase in 2007 reflects spending associated with the disastrous fires of last summer and the cost of holding snap parliamentary elections in September 2007.

Total *gross fixed capital formation* (see also Table III.3) grew by 4.4% in 2007, compared with 14.8% in 2006. This marked deceleration is due to a decline in residential investment and, to a lesser extent, to a slowdown in the growth rate of public investment. By contrast, business investment continued to show robust growth, despite some moderation, and made a significant contribution to GDP growth.

Specifically, the 6.8% drop in *residential investment* in 2007 (2006: +21.5%) is mainly associated with a large increase in the stock of available dwellings and the fact that

Table III.3 Indicators of investment demand (2006-2008)

(annual percentage changes)[1]

	2006	2007	2008 (available period)
Capital goods output	1.3	–2.4	–5.1 (Jan.-Feb.)
Capacity utilisation rate in the capital goods industry	(76.7)	(80.4)	(78.0) (Jan.-March)
Outstanding balance of loans to non-financial corporations with a maturity of over one year[2]	12.1 (Dec.)	25.7 (Dec.)	. . .
Disbursements out of the Public Investment Programme	8.9	7.6	–34.9 (Jan.-March)
Volume of private construction activity (on the basis of permits issued)	–19.5	–5.0	–5.4 (Jan.)
Cement production	3.1	–9.2	–8.9 (Jan.-Feb.)
Construction business expectations index	44.6	1.5	–1.8 (Jan.-March)
Outstanding balance of total bank credit to housing[3]	25.8 (Dec.)	21.4 (Dec.)	20.9 (Jan.)

1 Except for the capacity utilisation rate.
2 Adjusted for the amount of loan write-offs.
3 Taking into account securitised loans and loan write-offs.
Sources: NSSG (capital goods output, volume of private construction activity, cement production), IOBE (capacity utilisation rate, business expectations index), Bank of Greece (loans to non-financial corporations, disbursements out of the public investment programme, housing loans).

the population's housing needs have been largely covered following a long period of strong construction activity. However, the average annual growth rate of the outstanding balance of housing loans remained high, although it slowed down to 21.4% in December 2007, from 25.8% in December 2006.[3] It should be noted that non-residential construction investment rose by 11.4%, thereby contributing to a 1.9% increase in total construction investment.

Business investment rose by 10.3% in 2007 (2006: 13.3%) and made a significant contribution of 1.7 percentage points to GDP growth. Sustained investment demand benefited from a favourable business climate, evidenced, among other things, by the response of the private sector to the opportunities offered by the Developmental Law. According to data from the Ministry of Economy and Finance, 3,807 investment projects totalling €8.78 billion were approved between March 2005, when the Developmental Law 3299/2004 came into effect, and the end of 2007. These are expected to create more than 21,000 new jobs directly (and many more indirectly). Furthermore, following the new amendments to the institutional framework, mainly concerning regional support, 667 investment proposals with a total value of €1.7 billion have already been submitted. Overall satisfactory profitability, the acceleration of the annual growth rate of the outstanding balance of bank loans to enterprises and corporate bonds (to 19.9% in December 2007, from 16.6% in December 2006) and the large increase in funds raised

3 The volume of private construction activity on the basis of residential and other building permits, which is a leading indicator, fell at an average annual rate of 5.0% in 2007 (compared with a 19.5% decline in 2006 and a 35.2% increase in 2005). Cement production dropped by 9.2% (2006: +3.1%).

through the Athens Exchange (see Chapter VII) all played a part in financing business investment in 2007.

The growth rate of *public investment* (at constant prices) slowed down markedly to 1.7% in 2007, from 7.7% in 2006. A relatively smaller decline was observed in disbursements under the Public Investment Programme, which rose by 7.6% (at current prices) in 2007, compared with 8.9% in 2006.

Developments in the real external balance (on a national accounts basis) had a negative impact on GDP growth once again in 2007. However, as the slowdown in growth of exports of goods and services was accompanied by a slowdown also in the growth of imports, the negative effect was contained to –1.3 percentage point in 2007, from –2.0 percentage points in 2006.

On a national accounts basis, the rate of increase in *exports of goods and services* at constant prices rose to 5.9% in 2007 (2006: 5.1%), mainly driven by the strong performance of exports of services. The growth rate of goods exports dropped sharply to 1.6%, from a peak of 12.4% in 2006. This certainly reflected the weakness in global trade and hence in Greek export demand.[4] The slowdown in the growth of goods exports (at constant prices) was, however, markedly stronger than would have been justified by the evolution of external demand, suggesting that this adverse development should rather be attributed to the cumulative decline in the international competitiveness of the Greek economy over several years. By contrast, exports of services at constant prices grew significantly (by 9.4% in 2007, after a virtual stagnation (–0.2%) in 2006). Specifically, receipts from shipping grew sharply (by 18% at current prices), while there was a very small rise in tourist receipts (0.4% at current prices – see Chapter IX).

The growth of *goods and services imports* in 2007 once again outpaced that of domestic demand. This implies that the structure of the domestic production of goods does not fully meet domestic demand, while it also reflects the cumulative loss of international price competitiveness in recent years. As private consumption and gross fixed capital formation both weakened, the growth rate of imports of goods and services at constant prices and on a national accounts basis declined markedly to 7.0% (2006: 8.7%).

1.2 SECTORAL DEVELOPMENTS IN ACTIVITY IN 2007

In 2007 GDP grew by 4.0% and gross value added (GVA)[5] by 3.7% at basic prices, mainly reflecting the increased output of the services sector, while the output of the secondary sector recorded a limited rise and that of the primary sector declined, according to NSSG national accounts data (March 2008).

Specifically, in 2007 the value added of the primary sector (agriculture, livestock breeding, hunting, forestry and fishing) dropped by 4.6% at constant prices (2006: –5.6%).

4 According to some estimates, external demand for Greek exports rose by 6.5% in 2007, compared with approximately 9% in 2006. (This demand is measured on the basis of the increase in total import volumes of Greece's export markets, weighted on the basis of each trading partner country's share in total Greek exports).

5 GVA is derived if "taxes on products plus subsidies on products", which in 2007 increased by 6.4% at constant prices, are deducted from GDP at market prices.

The rate of increase in agricultural output prices (excluding subsidies) accelerated to 7.1% in 2007, from 6.6% in 2006. Agricultural input prices also increased to 6.3% in 2007, from 4.0% in 2006. Thus, the "terms of trade" for producers improved by 0.7% in 2007, i.e. markedly less than in 2006 (+2.5%). In any event, according to Eurostat estimates (on the basis of data reported by Member States in January 2008), the real agricultural income per full-time worker declined in Greece by 0.3% in 2007 (2006: 1.1%, 2001-2007: 16.9%), while in the EU-27it increased by 5.4%.[6]

The share of the primary sector in total GVA has gradually declined from 6.6% in 2000 to 3.6% in 2007.[7] This development, against the background of intense international competition, underlines the need to raise productivity in agriculture. Thus requires a change in the structure of production, to bring it more in line with the current price structure in the international market (e.g. the very large increase in the international price of wheat lately —it has more than doubled in the past twelve months— may imply that wheat crops are becoming more profitable).

The value added of the secondary sector (industry, energy, constructions) increased in 2007 by 0.4% at constant prices (2006: 10.6%).[8] In addition, according to available NSSG short-term indicators, total industrial production and manufacturing output (see Table III.4) continued to grow in 2007 (following a limited upturn in 2006). Specifically, the production of industry as a whole increased by 2.2% (2006: 0.5%) and manufacturing output grew by 1.8% (2006: 0.8%), chiefly due to a rebound in consumer non-durables (+4.1%), as well as to the continuing growth of energy production (+3.7%) and consumer durables (+1.2%). By contrast, the production of capital goods dropped by 2.4%, while the production of intermediate goods remained virtually unchanged (+0.2%).

A similarly positive picture of manufacturing activity is provided by the IOBE business survey: IOBE's industrial confidence indicator rose in 2007 by 1.3%, following a 9.7% increase in 2006, reflecting a further improvement in the business climate, chiefly during the first months of 2007, while from May onwards firms' expectations were more reserved. Capacity utilisation in industry as a whole was higher than in 2006 and than the averages recorded in recent years (77.0% on average in 2007, compared with 76.2% in 2006). In addition, since the beginning of 2007, the Purchasing Managers' Index (PMI) has hovered above the threshold of 50 points, following a several-year high of 53.7 in annual average terms in 2007.

The value added of the tertiary sector (services) increased in 2007 by 5.2% at constant prices, i.e. much more than in 2006 (1.7%). Most sub-sectors (telecommunications, transport, financial services, real estate management, trade) showed satisfactory levels of activity. Section 1.1 of this chapter has already referred to retail trade (excluding cars and fuel). According to IOBE sectoral surveys, in 2007

6 See Eurostat, Statistics in focus, No. 24/2008. The figures reported refer to the net value added of agricultural activity (i.e. minus taxes plus subsidies) per worker (in full-time equivalents).

7 At current prices, according to NSSG national accounts estimates (March 2008).

8 The large increase in 2006 mainly stemmed from construction.

Table III.4 Industrial production (2000=100)

	Weights 2000		Average annual percentage changes 2004	2005	2006	2007*	Level 2007* (2000=100)
Industry	**100.0**		**1.2**	**–0.9**	**0.5**	**2.2**	**102.2**
1. Mining and quarrying	**5.9**	**100.0**	**0.3**	**–6.2**	**–2.2**	**–0.9**	**97.1**
Coal and lignite extraction		48.3	1.6	–3.7	–6.0	0.6	99.4
Oil wells and extraction of natural gas		5.2	3.0	–29.7	–7.1	–18.2	28.5
Ore extraction		11.5	–2.5	4.6	–16.6	–3.4	86.7
Other extraction and quarrying activities		35.1	–0.7	–11.0	8.6	–1.2	107.6
2. Manufacturing	**77.5**	**100.0**	**1.2**	**–0.8**	**0.8**	**1.8**	**99.9**
3. Electricity - natural gas - water supply	**16.6**	**100.0**	**1.4**	**0.6**	**0.1**	**4.7**	**115.1**
Electricity		80.9	0.8	0.6	–1.7	3.5	110.7
Natural gas		5.3	9.9	6.1	16.9	22.6	199.0
Water		13.8	1.6	–1.7	2.6	1.1	108.0
Industry	**100.0**		**1.2**	**–0.9**	**0.5**	**2.2**	**102.2**
Main industrial groupings							
Energy	28.5		0.3	0.6	1.3	3.7	111.3
Intermediate goods	31.1		1.0	–1.7	0.7	0.2	100.9
Capital goods	10.6		–0.5	–5.1	1.3	–2.4	75.9
Consumer durables	2.5		1.8	11.4	2.0	1.2	81.7
Consumer non-durables	27.3		2.7	–0.9	–1.0	4.1	106.5

* Final data.
Source: NSSG.

turnover (at current prices) grew by 9.9% in information technology services, 1.1% in post and telecommunications and 17.6% in other business activities (chiefly architecture-engineering, legal and advertising services). In addition, turnover (at current prices) grew by 18.2% in land transport, 8.1% in shipping–ferry services, 7.0% in air transport, 11.5 in wholesale trade, 6.9 in trade-maintenance-repair of cars and motorcycles and fuel and lubricants retail trade and 6.5% in tourism (hotels-restaurants). For the banking sector, see Chapter X.

1.3 THE OUTLOOK OF ECONOMIC ACTIVITY FOR 2008

As already mentioned, the turmoil in international financial markets and the developments in international economy have had limited effects so far on the Greek economy. For the Greek banking sector in particular, the impact is small and mostly refers to higher borrowing costs. As regards macroeconomic aggregates, however, there is a risk that effects could be more significant, since the slowdown in global growth and international inflationary pressures are stronger than expected earlier this year. The annual growth rate of the Greek economy has already declined, from 4.2% in the first half of 2007 to 3.7% in the second half. According to forecasts made by the Bank of Greece in early 2008 and published in February, the average GDP growth rate was expected to remain satisfactory and stand at 3.7% in 2008 (2007: 4.0%). However, as the international economic environment is deteriorating, it is self-evident that the growth rate of the Greek economy will be adversely affected, given the sharper than expected slowdown in the growth of domestic demand, further increases in international oil and food prices and higher financing costs. By way of illustration, at the beginning of the year it was assumed —on the basis of information available at the time — that the average annual Brent oil price would stand at $85.5-88.5 per barrel this year. However, in the first quarter of 2008 the average price of Brent was $96.5, while more recently it exceeded $100 and its average annual level is now expected —on the basis of futures prices— to stand slightly above $100. Developments in the broader economic environment have already weighed on business and household confidence indicators in Greece. It is worth noting that the Economic Sentiment Indicator dropped to 100.7 on average in the first quarter of 2008 (from 106.6 in the last quarter of 2007); in March it stood at 98.9, its lowest level since April 2006.

Still, the growth rate of the Greek economy will continue to exceed the euro area average, since most of the factors that have supported Greece's positive growth performance in recent years, such as robust business investment, are expected to continue to be at play, although a further deceleration in private consumption growth is forecast. Risks and uncertainties mainly stem from the possibility of a stronger slowdown in external demand, steeper rises in the international prices of oil and other commodities and weaker domestic credit expansion than was initially expected.

According to the initial forecast, the growth rate of domestic demand will decelerate slightly in 2008, but will remain high and be the main driver of economic growth, while the external sector will continue to have a negative contribution, although marginally less so than in 2007.

Specifically, the growth rate of private consumption is projected to decline slightly in 2008 to stand at almost 3%. The increase in households' real disposable income and the rise in employment, two factors which fostered private consumption in 2007, are expected to continue to exert a beneficial effect in 2008. (As mentioned in Chapter IV, the growth rate of average nominal earnings should accelerate in 2008 broadly in line with inflation.) Private consumption should also be supported by consumer credit that will remain at relatively high levels, despite an anticipated further decline in the growth rate of consumer loans to households.

In 2008, according to projections contained in the updated Stability and Growth Programme 2007-2010 (December 2007), the growth rate of government consumption (at constant prices) is expected to decline to 0.7%.

The growth rate of total gross fixed capital formation is forecast to edge up in 2008, mainly due to the projected favourable developments in business investment, the halting of the decline in residential investment and the higher than in 2007 increase in public investment.

Specifically, it is expected that the decline in residential investment will come to an end, as the excess supply of housing will gradually be absorbed and the market will tend to reach a new equilibrium. (The growth rate of housing credit will slow down further.) Public investment (at constant prices) will increase by 4.7% – according to the updated Stability and Growth Programme (December 2007), while, according to the Introductory Report on the 2008 Budget, expenditure of the Public Investment Budget (at current prices) will rise by 6.9%.

In 2008 the growth rate of business investment is expected to remain close to the high level of 2007. The robustness of business investment is associated with the implementation of investment plans falling within the scope of the developmental law or of the law on public-private partnerships. Certainly, as mentioned above, the business climate in the first quarter of 2008 was clouded by uncertainties relating to the recent developments in the international environment and the financial turmoil. It is estimated that domestic and external demand for the products of several branches will continue to rise, albeit at declining rates. At the same time, while business profitability and access to financing remain overall favourable, the cost of financing is increasing and the risk of a significant slowdown is likely to be realised in credit expansion to enterprises.

For 2008, the contribution of the real external balance to GDP growth is forecast to remain negative. In particular, the growth rate of the export volume of goods and services (on a national accounts basis) is expected to decline slightly compared with 2007. This decline is associated with the projected slowdown in the growth of world trade, which will affect both the exports of goods and demand for shipping transport services, as well as with the continuing drop in the international price competitiveness of the Greek economy.

The expected minor slowdown in private consumption growth in 2008 may exert a dampening effect on the growth of imports of goods and services. On the other hand, the implementation of investment plans by private firms in import-intensive sectors (such as energy) will contribute to sustaining imports at relatively high levels.

2 EMPLOYMENT AND UNEMPLOYMENT

2.1 OVERVIEW

Economic growth in 2007 was accompanied by a 1.3% increase in employment and a 0.6 percentage point decline in the unemployment rate. The rise in employment mainly stemmed from the private non-agricultural sector, where employment grew at a rate of 2.0%, thus contributing 1.3 percentage points to the rise in total employment, while public sector employment, with a growth of 1.3%, contributed 0.3 percentage point.[9] By contrast, in the agricultural sector, employment continued its downward trend observed since the early 1990s and declined by 2.5%, thus contributing –0.3 percentage point to the change in total employment. Increased labour demand seems to have come mainly from enterprises

9 The distinction between private and public sector is based on Labour Force Survey (LFS) data on the ownership status of the business where the worker is employed. In this context, the public sector comprises administration (central government), legal persons in public law, legal persons in private law owned by the State, public organisations, local authorities and enterprises run by local authorities, public utility companies and State-controlled enterprises.

employing 10 or less workers, while demand from larger enterprises was weaker.[10]

According to Labour Force Survey (LFS) data, the increase in employment in the private non-agricultural sector mainly stemmed from the 3.2% rise in salaried employment in this sector,[11] while the number of self-employed and assistants in family businesses rose only marginally (0.1%).

The *average weekly hours worked* by salaried employees in the private non-agricultural sector and the public sector declined by 1% and 1.8% respectively. A decline was also observed in the average weekly hours worked by self-employed.

As regards the types of employment, the share of persons employed in non-agricultural economy (private and public sector) under unlimited contracts remained virtually unchanged (2006: 89.7%, 2007: 89.4%). However, among young people (aged 15-29), this share declined slightly to 80.8% in 2007, from 81.9% in 2006, and a commensurate increase was seen in the prevalence of fixed-term contracts.

2.2 SECTORAL DEVELOPMENTS

The medium-term sectoral developments in employment are in line with developments in economic activity. Thus, employment growth in 2007 (see Table III.5) stemmed from services and the secondary sector, while in the primary sector the number of employed persons continued to drop, as has been the case since the early 1990s.[12] The share of the tertiary sector in total employment rose to 66% in 2007, from 65% in 2004 (the earliest year for which comparable LFS data are available enabling intertemporal comparisons of sectoral developments).[13] Conversely, the share of primary sector employment fell to 11.5% in 2007 from 12.6% in 2004, while the share of secondary sector employment remained virtually unchanged.

Specifically, in the primary sector the average annual number of workers in 2007 was 2.5% lower than in 2006 (520 thousand, compared with 533 thousand). This decline is higher than that recorded in previous years.[14]

Declining employment in the primary sector over time seems to be associated with (i) the high average age of respective workers, and (ii) the dwindling activity in the sector. Specifically, the average age of agricultural workers is much higher than in the rest of the economy (47 years, compared with 40.1 years), implying a large number of

10 The number of persons working in private non-agricultural firms employing 10 or less workers is estimated to have increased by 3.6%, thus contributing about 2 percentage points to the rise in salaried employment. For enterprises employing more than 10 workers, the corresponding rate was 2.6%, thus contributing 1.2 percentage point to the rise of salaried employment in this sector.

11 In the total economy, the number of wage earners increased by 2.5% in 2007.

12 The primary sector comprises agriculture, livestock breeding, hunting, forestry and fisheries; the secondary sector comprises mining and quarrying, manufacturing, electricity-gas-water supply and construction; the tertiary sector comprises all services (i.e. trade, hotels and restaurants, transports and communications, financial services, business activities, real estate management, public administration, education, healthcare).

13 The corresponding figure in the EU-15 was about 70% in 2007.

14 The weekly hours worked in the primary sector decreased marginally by 0.2% and averaged 36.5 in 2007 (compared with 39.7 in the rest of the economy). For a significant percentage (25.7%) of employed persons, the hours worked per week are 20 or less.

Table III.5 Population, labour force and employment

	2007 (thousands of persons)	Annual percentage changes (second quarter-on-second quarter)[5]				
		2003	2004[4]	2005	2006	2007
Population aged 15 and over[1]	9,207	0.6	. . .	0.5	0.5	0.6
Population aged 15-64[1]	7,208	0.1	. . .	0.1	0.3	0.8
Labour force[1]	4,918	1.6	. . .	0.5	0.6	0.8
Employment[1]	4,520	2.3	. . .	1.2	1.6	1.5
– Primary sector[1]	522	1.1	. . .	-0.1	–1.7	–2.6
– Secondary sector[1]	1,011	1.2	. . .	1.0	-0.2	3.1
– Tertiary sector	2,986	3.0	. . .	1.5	2.9	1.7
Labour force participation rate[1,2]	. . .	65.1	66.5	66.8	67.0	67.0
Employment rate[1,3]	. . .	58.9	59.6	60.3	61.0	61.5
Unemployment as a percentage of the labour force[1]	. . .	9.3	10.2	9.6	8.8	8.1

1 NSSG, Labour Force Surveys. New revised data 1998-2003, published in January 2005. New sample as from 2004.
2 Labour force participation rate of population aged 15-64.
3 Employed persons aged 15-64 as a percentage of the population aged 15-64.
4 Labour Force Survey data for 2004 are not fully comparable with those for the previous years.
5 For average annual changes and average year levels, see the main text.

retirements. In addition, the small number of hours worked per week and the high percentage of agricultural workers with a second job (6.7% in 2007, compared with 2.7% in the rest of the economy) indicate the shrinking economic activity in the sector.

In the *secondary sector*, a 3.3% rise in the number of workers is mainly accounted for by higher employment in construction (+8.9%). Much smaller increases were seen in electricity, gas and water supply (+1.6%) and in mining and quarrying (+2.0%), while employment in manufacturing increased by a marginal –0.2%.[15] The average weekly hours worked in the secondary sector decreased by 0.6%, because of declines in the weekly hours worked in manufacturing (–1.4%) and electricity-gas-water supply (–1.9%). It should be noted that the percentage of immigrants employed in construction increased to 28.6% in 2007, from 26.1% in 2006.

Higher employment in the *services sector* stemmed from trade, hotels-restaurants, healthcare and public administration.

Specifically, in *trade* the LFS data show a 1.5% rise in the number of workers in 2007 and a 1.3% decline in the average weekly hours worked. This development mainly reflects an increase (3.2%) in the number of wage earners, who account for approximately 53% of the persons employed

15 In manufacturing, this marginal decrease in the average number of workers in 2007 is estimated to reflect a decline in the number of persons working in firms employing 10 or less workers, which has offset an increase in the number of persons working in firms employing more than 10 workers.

in the sector. The rise in the retail trade employment is confirmed by a more specific survey conducted by the NSSG among retailers, which however suggests a smaller increase in the number of workers (0.7%).[16] It should be noted that the share of part-time employment in trade is about 4.7% (compared with about 5.8% in the rest of the economy).

In *hotels and restaurants* the number of workers increased by 4.2%, while the average weekly hours worked decreased by 1.5%. In *financial intermediaries*, the number of workers, according to LFS data, declined by 1.4% in 2007. This decline is estimated not to stem from banks, but rather from other financial organisations (e.g. insurance companies). In *education*, the number of workers fell by 2.1% (mainly reflecting employment developments in private education), while the average weekly hours worked also declined by 5.2%. In *healthcare*, the number of workers increased by 6% in 2007 (both in private and public healthcare), while the average weekly hours worked declined by 2.3%. In *public administration*, the number of workers increased by 1.3%, while the average weekly hours worked decreased by 1.3%.[17]

2.3 UNEMPLOYMENT AND THE EMPLOYMENT RATE

According to data from both the LFS and OAED (the Greek Manpower Employment Organisation), the number of jobless fell significantly in 2007. According to the LFS definition and data, the average number of jobless in 2007 was 406.9 thousand (unemployment rate: 8.3%), i.e. 27.5 thousand fewer than in 2006 (unemployment rate: 8.9%). The drop in the unemployment rate in 2007 reflects a decrease in the number of jobless with and without previous employment (5.1% and 8.5%, respectively). Moreover, in the past few years there has been a larger reduction in the unemployment rate of young tertiary-education graduates.

The fall in the number of jobless was broadly based across age groups, with the exception of the 25-29 group, where a marginal rise was noted. The slowdown in the unemployment rate was accompanied by a shortening of the duration of unemployment. Specifically, the share of long-term unemployment (more than one year), although still very high, declined to 51.7% in 2007, from 56.0% (as a percentage of the total number of unemployed persons) in 2006.

Despite the positive developments in 2007 as far as employment and unemployment are concerned, it appears that the Greek economy still shows a lower job creation capacity than other countries in the euro area. Possible explanations for this include: the ongoing restructuring of the Greek economy, which is chiefly characterised by a significant contraction of the agricultural sector and the ensuing loss of a large number of jobs; labour market rigidities, including the relatively less widespread use of part-time employment; and supply-demand mismatches in the labour market. Specifically, population

16 As the NSSG survey on retail trade enterprises is conducted on the basis of a non-updated register of enterprises, it could underestimate the increase in employment.

17 Among persons who were recruited in public administration in 2007 as first-time employment (about 9,000 in 2007), a large proportion holds fixed-term contracts (67.3%, compared with 8% for the total employees of public administration in 2007; 2006: 63.6% and 8% respectively).

census data[18] show that in 1991-2001, the average annual rate of decrease in the number of persons employed in the primary sector was 0.8%, while in 2005-2007 this figure was even higher (around 1.5%) according to LFS data. Moreover, the percentage of part-time employment in Greece was 5.7% in 2006, compared with 18.1% in the EU-15. Finally, despite the relatively high unemployment rate, there are still job vacancies (3% of salaried jobs in the business sector), while, at the same time, a growing percentage of firms report skill shortages as a drag to their activities (in services, this percentage stood at 7% in 2007, compared with 3% in 2004-2006).

Reflecting lower creation capacity, the employment rate in the Greek labour market remains well below the EU-15 average (61.4% in Greece in 2007, compared with 66.2% in the EU-15 in 2006). This divergence mainly reflects the much lower employment rate of women in Greece, which —despite a significant rise in the past few years— remains very low (47.9% in Greece in 2007, compared with 58.7% in the EU-15 in 2006). The low employment rate of women is attributed both to weak demand by firms and to their lower participation in the labour market. As reported by women themselves in the relevant LFS questionnaire, scarce availability of child care (as well as care for other dependent family members) makes it harder for them to participate in the labour market and —in addition— possibly discourage demand for them by employers.

It should also be noted that the average age of workers has increased remarkably in the past few years (to 40.7 years in 2006 and 40.9 years in 2007, from 40.0 years in 2000).[19] This highlights further the need to ensure that workers receive continuous training in order for the labour market and the economy to grow in the long run. Specifically, as the higher average age means de facto that the know-how diffusion associated with the entry of young persons in the labour market becomes slower, this should be addressed through lifelong learning and on-the-job training programmes.

2.4 SHORT-TERM PROSPECTS OF EMPLOYMENT

According to firms' employment expectations in the coming months (as recorded in March), employment prospects continue to be positive in services[20] and retail trade, while they are marginally positive in industry. In construction, prospects from September 2007 to January 2008 were marginally negative, but have been more optimistic ever since, as firms expecting a rise in employment in the coming months are more than those expecting a decline.

18 Due to the breaks in LFS data series, it is difficult to measure the annual rate of change in employment in the primary sector over large periods of time.
19 Both the average age and its increase are higher if account is not taken of immigrants, who are typically younger (41.2 years in 2007, 40.2 in 2000).
20 In the relevant survey conducted by IOBE, services do not include banks or retail trade (a separate indicator is compiled for each of these two sectors).

IV INFLATION, WAGES AND BUSINESS PROFITS

1 INFLATION

1.1 DEVELOPMENTS AND DETERMINANTS IN 2007

In 2007, average annual inflation on the basis of the Harmonised Index of Consumer Prices (HICP) fell to 3.0%, from 3.3% in 2006. In particular, energy prices rose at an average annual rate of 2.1%, compared with 9.4% in 2006, while the rate of increase in processed food prices was 3.7% (2006: 5.2%). By contrast, annual inflation accelerated in the components of unprocessed food (2.2%, from 1.9% in 2006), non-energy industrial goods excluding food (to 2.2%, from 1.6%) and services (to 3.7%, from 3.1% – see Tables IV.1 and IV.2).

The drop in average annual inflation is chiefly attributable to temporary favourable factors, in particular oil price developments, which were reversed later in the year. It also reflects the fact that the annual rate of increase in processed food prices declined up to September (before accelerating in the fourth quarter). As a result of these developments, the annual inflation rate in the fourth quarter of 2007 stood at 3.6%, higher than one year earlier (3.2%).

Core inflation (as measured on the basis of the HICP excluding energy and unprocessed food prices) rose to 3.2% in average annual terms, from 2.9% in 2006, reflecting inflationary pressures from both the side of aggregate demand, which remained buoyant, and the domestic supply side, as unit labour costs in the total economy continued to grow rapidly and faster than in 2006. On the other hand, the successive increases in ECB interest rates from December 2005 to June 2007 and the policy of fiscal consolidation both had a dampening effect on inflation expectations. The continued rise in competition in retail trade, along with imports of final consumer goods from low-cost countries, also helped rein in inflation.

More specifically, lower imported inflation played an important part in the drop in average annual inflation in 2007. The international price of Brent crude oil (in euro), after a sharp fall in the period August 2006-January 2007, began to rise again in February, but remained lower until the end of August than in the corresponding period in 2006. Overall during 2007, the average annual price of Brent crude oil dropped by just 0.2% in euro terms, compared with an increase of 18.6% in 2006.[1] Reflecting these developments, the prices of imported energy raw materials (crude oil and natural gas) in Greece rose at an average annual rate of 2.5% in 2007, compared with 10.8% in 2006, while the prices of imported final fuel products (gasoline, heating oil, diesel and heavy oil) increased at an average annual rate of just 0.3%, (compared with 9.2% in 2006), according to the NSSG's Import Price Index in Industry. At the wholesale level, fuel prices (final products) included in the Industrial Producer Price Index for the domestic market, increased at an average annual rate of 5.3% in 2007 (compared with an increase of 12.9% in 2006). Finally, retail prices of fuel included in the CPI rose in 2007 at an average annual rate of 1.3%, compared with 10.9% in 2006.

1 According to data concerning the price of Brent crude oil. See ECB, *Monthly Bulletin*, Euro Area Statistics, Tables 5.1.2 and 8.2.

Table IV.1 Inflation indicators

(annual percentage changes)

	Consumer Price Index								Industrial producer price index					Import price index in industry	
		Sub-indices							Domestic market				External market		
										Sub-indices					
Year or quarter	General index	Goods	Services	CPI excl. fuel & fresh fruit and vegetables	CPI excluding food & fuel	Food and non-alcoholic beverages	Fresh fruit and vegetables	Fuel	General index	General index excl. energy	Intermediate goods	Consumer goods	General index	General index	General index excl. energy
2001	3.4	3.2	3.7	3.8	3.7	5.1	9.2	–4.8	3.6	5.1	5.5	5.0	0.7	3.1	3.4
2002	3.6	3.2	4.3	3.6	3.6	5.3	13.8	–1.7	2.3	2.3	1.3	3.2	1.1	0.3	0.4
2003	3.5	3.1	4.2	3.2	3.1	5.0	10.7	3.9	2.3	2.5	2.3	2.7	–0.3	0.7	0.6
2004	2.9	2.3	3.8	3.3	3.2	0.5	–11.9	7.5	3.5	4.7	3.2	6.0	5.0	3.1	0.8
2005	3.5	3.4	3.7	3.1	3.2	0.6	–8.1	18.0	5.9	3.0	3.8	2.5	3.7	8.8	1.2
2006	3.2	3.4	3.0	2.7	2.5	3.7	3.3	10.9	6.9	6.3	7.5	5.9	4.2	4.4	2.8
2007	2.9	2.5	3.5	2.9	3.0	3.2	5.6	1.3	3.3	2.4	6.6	–0.7	1.8	3.0	3.2
2004 Q1	2.7	1.8	4.0	3.3	3.2	3.3	2.6	–5.7	1.3	4.3	1.6	6.5	2.3	–0.1	0.1
Q2	2.9	2.3	3.9	3.3	3.2	–0.7	–16.3	11.6	4.4	5.3	3.3	6.9	7.4	2.3	1.0
Q3	2.8	2.1	3.9	3.4	3.4	–1.3	–22.8	9.6	4.4	5.0	3.6	6.1	6.0	4.3	1.0
Q4	3.2	2.9	3.5	3.0	2.9	0.8	–11.3	15.5	4.1	4.3	4.1	4.5	4.4	5.8	1.2
2005 Q1	3.3	3.1	3.6	3.3	3.5	–0.6	–11.5	15.1	4.6	2.6	4.9	0.8	2.7	8.2	1.4
Q2	3.3	3.0	3.8	3.0	3.1	–0.3	–12.4	18.1	4.9	2.3	3.6	1.4	2.3	8.4	1.1
Q3	3.9	4.0	3.6	3.0	3.1	1.4	–4.1	21.6	6.3	2.6	3.3	2.2	4.5	9.8	1.1
Q4	3.7	3.6	3.7	3.0	3.0	2.1	–2.2	17.1	7.7	4.7	3.5	5.7	5.4	8.9	1.4
2006 Q1	3.3	3.3	3.2	2.5	2.3	1.9	–5.8	19.6	9.2	6.8	4.7	8.8	7.0	7.7	1.8
Q2	3.2	3.6	2.7	2.5	2.3	3.4	1.3	14.8	8.6	7.2	7.6	7.4	5.9	6.8	2.7
Q3	3.4	3.9	2.8	2.7	2.4	5.1	10.8	11.8	6.8	7.2	9.2	6.2	3.2	2.7	3.1
Q4	2.9	2.7	3.1	3.0	2.8	4.6	9.4	–1.2	3.0	4.3	8.6	1.6	0.8	0.7	3.4
2007 Q1	2.7	2.1	3.4	3.2	3.3	3.1	4.9	–4.9	0.7	1.6	6.8	–2.2	–0.8	–0.4	3.5
Q2	2.6	1.9	3.6	2.9	3.1	2.0	2.9	–1.5	1.9	1.6	6.2	–2.0	0.9	1.2	3.3
Q3	2.7	2.0	3.6	2.8	3.0	3.3	11.8	–3.1	2.6	2.0	6.1	–1.2	1.3	3.3	3.1
Q4	3.6	3.9	3.2	2.8	2.5	4.5	3.7	15.8	8.0	4.4	7.0	2.4	5.9	7.8	2.7
2008 Q1	4.3	5.0	3.3	2.9	2.3	6.1	7.1	24.0	. . .	. . .	. . .	. . .	. . .	. . .	. . .

Source: NSSG.

The average annual rate of increase in the international prices (in euro) of other raw materials, although it remained high, declined to 9.2% in 2007 from 24.8% in 2006.[2] However, the prices of consumer goods imports rose at an average annual rate of 1.9% in 2007, i.e. roughly the same as in 2006 (2.0%).[3]

The strengthening of the euro against the dollar and other currencies throughout 2007 played an important role in bringing down imported inflation. The euro appreciated by 10.3% against the dollar between December 2006 and December 2007 and by 9.15% in annual average terms. The nominal effective exchange rate of the euro, weighted on the basis of Greece's external trade, rose by 1.9% between December 2006 and December 2007, while the average annual appreciation was 1.4%.

By contrast, inflationary pressures from the demand side, coupled with unit labour cost growth at a markedly higher rate than in 2006, contributed to a rise in core inflation in 2007.

Specifically, the growth rate of unit labour costs in the total economy (as calculated by the Bank of Greece – see Section 2 of this chapter) rose to 4.2% in 2007, from 3.5% in 2006. In the business sector, which has a more direct impact on inflation, unit labour costs are estimated to have increased by 4.8%, compared with 4.1% in 2006.

As far as profit margins are concerned, the available data are chiefly derived from the annual profit and loss accounts of companies listed on the Athens Exchange, while the profits reported partly reflect income from foreign activities and unexpected earnings (which were substantial in certain cases). Therefore, the data are not sufficient for reliable general conclusions to be drawn. It appears, however, that profit margins narrowed in the economy as a whole (see Section 3 of this chapter).

Inflationary pressures from the demand side remained strong in 2007. Specifically, the growth rates of consumption and investment demand remained high in 2007, though there was a slowdown in both (see Chapter III). In addition, the "output gap"[4] of the Greek economy, which has been positive in recent years (i.e. the level of actual output has exceeded the "potential" level), is estimated to have remained broadly unchanged in 2007. According to the European Commission,[5] the output gap widened in 2007 to 1.3, from 1.1 in 2006, while OECD[6] estimates suggest a decline to 1.3, from 1.4 in 2006. According to estimates from the Bank of Greece (Economic Research Department), which take into account more recent data, the output gap remained more or less stable in 2007. There are, however, two indications of an increase in the positive output gap: (a) in industry, accounting for 12-13% of GDP, capacity

2 See ECB, *Monthly Bulletin*, Euro Area Statistics, Tables 5.1.2 and 8.2.
3 According to the NSSG's Import Price Index in Industry.
4 It should be recalled that 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. It is an aggregate not directly measurable but estimated by various alternative methods. Estimates of potential output and of the "output gap" are surrounded by a high degree of uncertainty. This caveat should be kept in mind when interpreting the results of relevant analyses. The change in the "output gap", which is measured in percentage points of GDP, is perhaps a more reliable indicator.
5 *Autumn Economic Forecasts*, November 2007.
6 *Economic Outlook*, December 2007.

utilisation increased to 77.0 in 2007, from 76.2 in 2006; and (b) the unemployment rate dropped while the employment rate rose in 2007, suggesting higher labour force utilisation (see Section 2 of Chapter III). As a result, excess demand continued to contribute —to approximately the same degree as in 2006— to the maintenance of inflation at a relatively high level.

1.2 THE INFLATION DIFFERENTIAL BETWEEN GREECE AND THE EURO AREA AND MEASURES OF INTERNATIONAL PRICE COMPETITIVENESS

In the euro area, average annual HICP inflation fell slightly to 2.1% in 2007, from 2.2% in 2006 (see Table IV.2), while the average annual level of core inflation rose from 1.5% to 2.0%. Therefore, Greece's inflation differential vis-à-vis the euro area as a whole remained large in 2007, despite dropping slightly to 0.9 percentage point, from 1.1 percentage points in 2006. The core inflation differential remained large, although it showed a small decline to 1.2 percentage points, from 1.4 percentage points in 2006. Among the individual components of core inflation, the inflation differential for processed food narrowed in 2007, while higher inflation differentials were recorded for industrial goods excluding food and energy and —to a much smaller degree— for services.

As has repeatedly been pointed out, persistently higher inflation in Greece than in the euro area as a whole is explained by macroeconomic factors (developments in demand and costs), as well as by the functioning of markets. There is an interaction between inflationary pressures arising from excess demand in Greece and unit labour cost growth, which is significantly stronger in Greece than in the euro area (see Section 2 of this chapter). In addition, certain markets do not operate efficiently due to inadequate competition, leading to relatively high profit margins.

Reflecting the persistent inflation differential, the international price competitiveness of the economy has been declining. The loss of competitiveness is significant when measured in terms of the real effective exchange rate of the euro, an indicator that captures developments in consumer prices or unit labour costs in Greece and in its major trading partners, in conjunction with the evolution of the nominal effective exchange rate of the euro weighted on the basis of Greece's external trade with these partner countries. Specifically, as shown in Table IX.2, the real effective exchange rate of the euro calculated against Greece's 28 major trading partners and deflated by consumer prices (i.e. relative consumer prices expressed in a common currency) increased cumulatively by 15% between 2000 and 2007, while relative unit labour costs expressed in a common currency rose cumulatively by almost 20% in the total economy and by 41% in manufacturing. These increases represent losses in competitiveness. In the seven years from 2001 to 2007, the nominal effective exchange rate of the euro, weighted on the basis of Greece's external trade, rose by a cumulative 9.9% (appreciation of the euro).

1.3 THE OUTLOOK FOR INFLATION IN 2008

HICP inflation, which had already reached 3.9% in January this year, was 4.5% in

Table IV.2 Price developments in Greece and the euro area

(annual percentage changes)

	2006	2007	2007 July	2007 Aug.	2007 Sept.	2007 Oct.	2007 Nov.	2007 Dec.	2008 Jan.	2008 Feb.	2008 March
A. Euro area											
Harmonised Index of Consumer Prices (HICP) and its components											
Overall index	**2.2**	**2.1**	**1.8**	**1.7**	**2.1**	**2.6**	**3.1**	**3.1**	**3.2**	**3.3**	**3.6**
Goods	2.3	1.9	1.2	1.2	1.9	2.6	3.4	3.4	3.7	3.8	4.1
Food	2.4	2.8	2.3	2.5	2.7	3.5	4.0	4.3	4.8	5.2	5.6
Processed food[1]	2.1	2.8	1.9	2.5	3.1	3.8	4.6	5.1	5.8	6.5	6.8
Unprocessed food	2.8	3.0	2.8	2.4	2.1	3.1	3.0	3.1	3.3	3.2	3.8
Industrial goods	2.3	1.4	0.7	0.6	1.5	2.1	3.2	3.0	3.1	3.1	3.4
Non-energy industrial goods	0.6	1.0	0.9	1.0	1.0	1.1	1.1	1.0	0.7	0.8	0.9
Energy	7.7	2.6	0.0	-0.9	3.0	5.5	9.7	9.2	10.6	10.4	11.2
Services	2.0	2.5	2.6	2.6	2.5	2.5	2.5	2.5	2.5	2.4	2.8
HICP excluding energy and unprocessed food	*1.5*	*2.0*	*1.9*	*2.0*	*2.0*	*2.1*	*2.3*	*2.3*	*2.3*	*2.4*	*2.7*
Producer prices in industry	**5.1**	**2.8**	**1.8**	**1.8**	**2.7**	**3.3**	**4.3**	**4.4**	**5.0**	**5.3**	**. . .**
B. Greece											
Harmonised Index of Consumer Prices (HICP) and its components											
Overall index	**3.3**	**3.0**	**2.7**	**2.7**	**2.9**	**3.0**	**3.9**	**3.9**	**3.9**	**4.5**	**4.4**
Goods	3.5	2.5	1.8	1.8	2.5	2.8	4.4	4.3	4.4	5.6	5.4
Food	4.0	3.1	2.8	3.4	3.3	2.6	3.5	3.5	4.3	5.4	5.1
Processed food[1]	5.2	3.7	2.5	2.7	2.4	2.7	4.0	4.3	4.5	5.7	6.0
Unprocessed food	1.9	2.2	3.4	4.6	4.9	2.6	2.8	2.2	3.8	4.8	3.7
Industrial goods	3.1	2.2	1.2	0.8	2.0	2.9	4.9	4.8	4.4	5.6	5.6
Non-energy industrial goods	1.6	2.2	2.6	2.2	2.0	1.8	1.8	1.8	0.3	1.6	1.9
Energy	9.4	2.1	-3.2	-3.7	1.7	7.7	17.6	16.8	21.4	21.6	20.7
Services	3.1	3.7	4.0	3.9	3.7	3.3	3.4	3.2	3.3	3.2	3.0
HICP excluding energy and unprocessed food	*2.9*	*3.2*	*3.3*	*3.3*	*2.9*	*2.6*	*2.9*	*2.9*	*2.5*	*3.1*	*3.1*
Industrial producer prices	**6.9**	**3.3**	**1.7**	**1.7**	**4.4**	**6.4**	**8.7**	**9.0**	**10.2**	**10.8**	**. . .**

1 Including alcoholic beverages and tobacco.
Source: Calculations based on ECB and NSSG data.

February and 4.4% in March. Inflation is projected to remain at high levels in the coming months, as will also be the case with the euro area, chiefly as a result of the sharp rise in imported inflation, in the context of oil prices reaching new historic highs and the hike in the prices of food commodities in world markets. Later in the course of the year, it should moderate gradually, to reach a slightly lower level in the fourth quarter of 2008 than in the corresponding period of 2007. Developments in inflation during the year are expected to bring the average annual rate of HICP inflation in 2008 to a higher level than in 2007. Specifically, according to Bank of Greece forecasts made at the beginning of the year and released in February, average annual inflation was expected to reach 3.4% this year, compared with 3.0% in 2007. However, certain upside risks which were highlighted back in February (mainly relating to developments in international oil prices, as well as unit labour costs) now seem to be materialising, therefore average annual inflation will turn out to be higher than forecast and stand around 4%.

Core inflation (which does not include energy and unprocessed food prices) is expected to show a gradual increase in the course of the year, and its average annual level should be slightly higher than the 2007 figure of 3.2%.

These forecasts take into account the current price trends, the economic policy being pursued, certain technical assumptions or projections concerning exogenous factors (international prices of oil and other commodities and the euro exchange rate), forecasts and assumptions relating to unit labour costs, as well as estimates of profit margins and GDP growth in conjunction with the productive capacity of the economy.[7] The inflation forecast is, of course, surrounded by considerable uncertainty concerning developments in international prices of oil and other commodities and in exchange rates. An important factor in inflation developments will be the final outcome of unit labour cost growth, which will depend on the outcome of collective wage bargaining at a sectoral, occupational and enterprise level in the business sector, as well as on the productivity growth rate.

The expected path of HICP inflation in 2008 largely reflects the evolution of fuel prices. Moreover, the expected path of core inflation incorporates the lagged indirect impact on the general level of prices from the sharp increases in crude oil and other commodities in world markets; it also associated with the expectation that the growth rate of unit labour costs in the total economy will accelerate appreciably further, while remaining particularly high in the business sector and significantly higher than in the euro area. By contrast, inflationary pressures associated with total demand are expected to decline somewhat in 2008.

More specifically, the international price of crude oil is expected to record a large increase on an average annual basis, both in US dollar and in euro terms. In this respect, the average annual price of Brent crude oil was $96.5 in the first quarter of 2008, while more recently it has exceeded $100. Based on the latest available prices of oil futures, it is assumed that the average annual price level of crude oil in the world market will be slightly above 100 US dollars per barrel in 2008 (up from $72.5 in 2007), i.e. it will increase by 39%, compared with an increase of 9% in 2007. Despite the significant

7 As regards the short-term forecasts of firms themselves concerning the prices of their goods or services, the surveys conducted by the IOBE in the first quarter of 2008 indicate that there was an increase, in comparison with the final quarter of 2007, in the percentage of firms in the sectors of manufacturing, retail trade, services (other than retail trade and banks) and residential construction which expect that, *during the coming 3-4 months*, the prices of the goods or services they offer will increase (to be precise: there was an increase in the positive balance between the percentage of firms that expect an increase in their prices and the percentage of those that expect a reduction). By contrast, the corresponding percentage declined among construction firms as a whole. Regarding consumers' inflation expectations, the development of the percentage who expect inflation to rise *in the coming twelve months* (as recorded in a survey conducted on behalf of the European Commission) also indicates an increase in inflation expectations in the first quarter of 2008.

appreciation of the euro,[8] the increase in the average annual price of crude oil will remain large also in euro terms (23% in 2008, compared with a decrease of 0.2% in 2007).[9]

Turning to non-energy commodities (including food), the annual rates of increase in their prices in euro decelerated during 2007, from 15.7% in the first quarter to 1.6% in the fourth quarter), before picking up again in early 2008, to 10.4% in January and 15.0% in February.[10] It should be noted that the international price of wheat has more than doubled in the last twelve months and that of rice doubled between January and March 2008.

The nominal effective exchange rate of the euro weighted on the basis of Greece's external trade is projected to rise further by 2.7%, compared with 1.4% in 2007, based on the technical assumption of the exchange rates of the euro remaining unchanged from the levels of the second half of March 2008.

Unit labour cost growth in the total economy is expected to strengthen by 0.7 percentage point to 4.9% in 2008, from 4.2% in 2007. The rate of increase in unit labour costs in the business sector is expected to remain very high, at around last year's level of 4.8% (see Section 2 of this chapter).

Finally, inflationary pressures arising from excess demand are expected to decline somewhat in 2008, in view of the fiscal consolidation policy being pursued, the expected moderation of credit expansion and the expected weakening of both foreign demand for Greek exports and domestic demand (see Chapter III). It should be noted that the positive output gap is expected to narrow slightly.[11]

2 WAGES AND SALARIES

2.1 WAGE DEVELOPMENTS IN 2007

The growth rate of unit labour costs in the total economy (which, as calculated by the Bank of Greece, offers a satisfactory approximation of the rate of increase in unit labour costs in the non-agricultural sector of the economy)[12] is estimated to have accelerated to 4.2% in 2007, from 3.5% in

8 On the *technical* assumption that the euro-dollar exchange rate remains stable at its average level prevailing in the second half of March 2008, the average annual appreciation of the euro against the dollar should be about 13%.

9 As far as domestic retail fuel prices are concerned, the 5.8% increase in the Special Consumption Tax as from 1 January 2008 has also been taken into account. It should be recalled that Article 10 of Law 3483/2006 provided for a gradual rise during the four years up to 2009 in the Special Consumption Tax on fuels. The Special Consumption Tax rates in Greece until June 2006 were on average 20% lower than the lowest rates of tax on fuels that will apply in the European Union as from 2010. The higher rates will be phased in gradually until 2009 (so as to minimise the effect on inflation), in view of the country's obligation to adjust its fuel tax rates to the minimum level applicable in the European Union from 2010 onwards. The first increase in the Special Consumption Tax took effect on 1 July 2006.

10 See ECB, *Monthly Bulletin*, Euro Area Statistics, Table 5.1.2.

11 According to the European Commission, the output gap will narrow to 1.2 (from 1.3 in 2007), while the OECD forecasts a fall to 0.9 (again from 1.3 in 2007). The Economic Research Department of the Bank of Greece projects a slight decline in the output gap. See also footnotes 5 and 6.

12 It should be recalled that, for these estimates, the *rate of change* in (nominal) unit labour costs is calculated by comparing the change in total compensation of employees with the change in real GDP or, equivalently, by comparing the change in compensation per employee with the change in productivity (measured by comparing the change in GDP with the change in the number of employees). In the national accounts, the change in productivity is calculated differently, namely on the basis of GDP per employed person in general, including the self-employed. This methodological issue is discussed in detail in the *Annual Report 2006*, April 2007, Box IV.1, pp. 132-135). It should also be noted that, since 1977, the Bank of Greece has been publishing 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 Service of the NSSG.

2006. Unit labour costs in the business sector,[13] which have a more direct impact on inflation, are estimated to have risen by 4.8%, compared with 4.1% in 2006. It is calculated that average nominal pre-tax earnings grew by 5.4% (compared with 5.7% in 2006), while productivity grew by an estimated 1.5%, compared with 2.4% in 2006.[14] (Compensation per employee including employers' social security contributions increased by 5.7% in 2007. For more details on wage developments, see Table IV.3).

It should be noted that in the euro area as a whole, according to the available national accounts data, compensation per employee in 2007 (including employers' social security contributions) increased by 2.3% (compared with 2.2% in 2006), productivity by 0.8% (2006: 1.3%) and unit labour costs by 1.5% (2006: 0.9% – see Table IV.4).[15] As unit labour costs are a key element of nominal production costs, their stronger growth for a number of years in Greece than in the euro area (in the 2001-2007 period, the average annual rates were 3.6% and 1.6% respectively) is one of the reasons behind higher inflation and loss in competitiveness.

In particular, in central government, average compensation of employees is estimated to have increased by 4.5% in 2007. The total increase in compensation excluding pensions in 2007 was 5.9% (6.9% including pensions), according to data from the State General Accounting Office, while the number of civil servants is estimated to have increased by 1.3%. In the non-bank private sector, it is estimated that the average annual increase in contractual earnings at branch level (based on the two-year agreements signed in 2006) was 5.6%, while the average gross increase is put at 6.1%. In public utility companies it is estimated that the average annual contractual increase was 5.6% (approximately the same as in 2006) and that average gross earnings increased by 7.1% (taking account of the two-year agreements signed in 2006). In banks, the average annual contractual increase was 5.3%, but due to the effects of seniority and agreements at enterprise level average gross wages rose by 8.9%.

2.2 WAGE PROSPECTS FOR 2008

The growth rate of unit labour costs in the total economy is expected to accelerate by 0.7 percentage point to 4.9% in 2008, from 4.2% in 2007. In the business sector, the rate will remain high, at 4.7%, compared with 4.8% in 2007. Underlying this projection are a set of data and assumptions concerning the evolution of average earnings and the projected broadly stable growth of productivity (measured as GDP per employee).

As far as the growth rate of average earnings in 2008 is concerned, it is expected that in central government —on the basis of projections contained in the 2008 Budget— gross compensation per employee should increase by 8.8%, compared with 4.5% in 2007. According to the 2008 Budget, the total increase in wage outlays excluding pensions will be 8.9% (compared with 5.9%

13 The business sector comprises public and private enterprises and banks and excludes central government.
14 The change in productivity is calculated as explained in footnote 13.
15 See ECB, *Monthly Bulletin*, Euro Area Statistics, Table 5.1.4. Also, European Commission, *Autumn Economic Forecasts*, 9 November 2007, and *Statistical Annex of European Economy*, Autumn 2007, Table 33.

Table IV.3 Earnings, productivity and labour costs (2001-2008)

(annual percentage changes)

	2001	2002	2003	2004	2005	2006	2007	2008 (proj.)
Average gross earnings (nominal):								
– *whole economy*	*4.7*	*6.6*	*5.6*	*7.2*	*4.4*	*5.7*	*5.4*	*6.6*
– central government[1]	5.5	7.3	5.9	9.7	2.3	3.1	4.5	8.8
– public utilities	7.0	10.6	10.9	9.9	7.6	7.0	7.1	. . .
– banks	6.4	2.9[4]	3.1[4]	8.0	1.5[4]	10.8	8.9	. . .
– non-bank private sector	5.3	6.5	5.8	5.8	5.6	6.8	6.1	. . .
Minimum earnings	3.5	5.4	5.1	4.8	4.9	6.2	5.4	6.2
Average gross earnings (real)	**1.3**	**2.9**	**2.0**	**4.2**	**0.9**	**2.4**	**2.4**	**2.5**
Net[2] income of an employee with average earnings								
nominal	3.4	6.3[5]	6.3[7]	5.3	3.6	4.3	5.7	. . .
real	0.0	2.6[5]	2.7[7]	2.3	0.1	1.1	2.7	. .
Total compensation of employees	**8.3**	**9.1[6]**	**8.3[7]**	**8.9**	**5.8**	**7.8**	**8.4**	**. . .**
Compensation per employee	**4.8**	**5.9**	**5.5**	**7.6**	**3.9**	**5.9**	**5.7**	**6.6**
GDP[8]	**4.5**	**3.9**	**5.0**	**4.6**	**3.8**	**4.2**	**4.0**	**. . .**
Output per hour worked in manufacturing	–0.6	0.6	1.2	1.2	–0.4	2.9	1.9	. . .
Unit labour costs:								
– whole economy	3.6	5.0[6]	3.1[7]	4.2	1.9	3.5	4.2	4.9
– business sector[3]	4.5	4.4[6]	3.5[7]	2.8	2.2	4.1	4.8	4.7
– manufacturing	6.1	5.3[6]	4.7[7]	4.5	6.0	3.8	4.1	. . .

1 Compensation per employee.
2 Gross earnings less employees' social security contributions and income tax.
3 The business sector comprises private and public enterprises and banks.
4 The relatively low growth rate of bank employees' average earnings mainly reflects changes in staff structure.
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 (0.1% of gross earnings) in employees' and employers' contributions to the Workers' Fund.
8 NSSG/Ministry of Economy and Finance for the years 2001-2007 (revised GDP).
Sources: NSSG/Ministry of Economy and Finance (GDP 2001-2007), Bank of Greece estimates (for the other annual aggregates in 2007-2008).

in 2007); *including pensions* it will also increase by 8.9% (compared with 6.9% in 2007). In addition, the assumption has been made that the increase in the number of civil servants will be restrained (about 0.1%). The relatively large increase in central government wage outlays includes —in addition to the general salary increases paid to civil servants[16]— the special benefit awarded to judges (without which the increase in wage outlays would have been limited to 7.7%), the pay rises for the police, coast guard and armed forces staff due to the implementation of new pay scales as from 1 January 2008, the increase in the special benefit awarded to the above categories of employees, to teachers and hospital staff, as

16 These increases were announced on 3 April 2008, specifically an across-the-board increase in the basic salaries of tenured civil servants by 2.5% as from 1 January 2008 and 2.0% as from 1 October 2008.

Table IV.4 Average earnings and unit labour costs in the whole economy: Greece and the euro area (2001-2008)

(annual percentage changes)

	Average earnings		Unit labour costs	
	Greece	Euro area	Greece	Euro area
2001	4.7	2.7	3.6	2.2
2002	6.6	2.7	5.0	2.3
2003	5.6	2.8	3.1	2.0
2004	7.2	2.5	4.2	1.0
2005	4.4	2.0	1.9	1.1
2006	5.7	2.2	3.5	0.9
2007	5.4	2.3	4.2	1.5
2008 (forecast)	6.6	3.1	4.9	1.8

Sources: For Greece, Bank of Greece estimates. For the euro area: (i) European Commission, *Autumn Economic Forecasts 2007*, and *Statistical Annex of European Economy*, Autumn 2007, and (ii) ECB, *Monthly Bulletin*, (for 2006-2007).

well as the wage bill for employees granted tenured status by Presidential Decree 164/2004 (see Chapter VIII).[17]

In the non-bank private sector, in *banks* and in *public enterprises*, collective bargaining is still in progress. Thus an initial working assumption was made that the average annual increase in *contractual* earnings in 2008 will be no higher than in 2007. However, this assumption is surrounded by considerable uncertainty. The two-year accord reached by the social partners (26 March 2008) in the context of the National General Collective Labour Agreement, provides for an average annual increase in minimum wages of 6.2% in 2008 and 5.7% in 2009.[18] These increases are similar to or slightly higher than provided for by the agreement covering the *previous two years 2006-2007* (6.2% for 2006 and 5.4% for 2007); It is worth noting however that the increase envisaged for 2008 is greater than that of 2007. Of course, the final outcome of unit labour cost growth and inflation will depend on the outcome of collective bargaining at sectoral, occupational and enterprise level in the business sector. On the other hand, *for the euro area as a whole*, compensation per employee (including employers' social security contributions) will increase this year by 3.1% (compared with 2.3% in 2007) and unit labour costs by 1.8% (compared with 1.5% in 2007).[19] Thus, unit labour cost growth in Greece will continue to outpace that of the euro area, contributing to a further decline in the Greek economy's price competitiveness.

Based on the above data and assumptions, average earnings in the whole economy should increase by 6.6% in 2008, while compensation per employee including employers' social security contributions and

17 The increased pension expenditure is also due to the new pension arrangements as of 1 January 2008 and, more importantly, to the increase in pensions for military staff. The general increase in central government pensions announced on 3 April 2008 is 3% as from 1 January 2008 and 2% as from 1 October 2008.

18 These average annual increases stem from the increase in the minimum wage of 3.45% as from 1 January 2008, 3.0% as from 1 September 2008 and 5.5% as from 1 May 2009.

19 See European Commission, *Autumn Economic Forecasts 2007*, and ECB, *Monthly Bulletin* (for revised 2007 data).

civil servant pensions) should also increase by 6.6% and GDP per employee by approximately 1.5%.

2.3 THE SHARE OF WAGES IN TOTAL OUTPUT

During the last seven years (i.e. since Greece joined the euro area), total compensation of employees (more accurately, total outlays for wages and employers' social security contributions) have increased more than the gross domestic product at current prices. This has resulted in an increase in the share of wages in total output. Specifically, between 2000 and 2007, GDP at current market prices grew by a cumulative 68% (according to revised national accounts data from the NSSG). In the same period, total compensation of employees including employers' social security contributions rose more: by 84% according to the revised national accounts data and by 71.5% according to Bank of Greece estimates published in this report (see Table IV.3). The share of wages in GDP at current market prices increased from 33.2%[20] in 2000 to 36.4% in 2007, according to revised national accounts data from the NSSG.

The increased share of wages mainly reflects the higher share of salaried employees in total employment, as their number increased at a higher rate than that of total employment in the same seven-year period (18.2%, compared with 10.6%). To a lesser extent, it also reflects an increase in average wages (over the same period) at a slightly higher rate than that of GDP or the gross value added (GVA) at current prices per employed person in general (55.6%, compared with 51.9% or 52.2%). This suggests that during the seven-year period in question the increase in nominal wages was greater than inflation and the rise in productivity.

The share of wages in total output can also be assessed by alternative measures. One such measure is the share of total compensation of employees (including employers' social security contributions) in gross value added at current basic prices,[21] which rose from 37.6% in 2000[22] to 41.1% in 2007, according to revised NSSG national accounts data.[23] If total compensation of employees (including employers' social security contributions) is deducted from gross value added, what remains is the "net operating surplus", which increased by 62% between 2000 and 2007 and includes the gross income of private and public enterprises (irrespective of size), agricultural income and income earned by the self-employed.

3 BUSINESS PROFITS

The data available for 2007 concerning profits are chiefly derived from the annual profit and loss accounts of companies listed on the Athens Exchange. In addition, the reported profits also reflect income from Greek firms'

20 The share of wages in GDP at current market prices was 32.3% in 1995, according to the unrevised national accounts data.

21 Adding net indirect taxes to gross value added, we derive GDP at market prices.

22 The share of total compensation of employees including employers' social security contributions in gross value added at current basic prices was 36.1% in 1995, according to the unrevised national accounts data.

23 In addition, given that salaried employment is very limited in the agricultural sector, it should be noted that the share of wages (in all sectors) in the gross value added of the non-agricultural sector (i.e. excluding farming, livestock production, hunting, forestry and fishing) increased from 40.3% in 2000 to 42.7% in 2007.

activity abroad, as well as unexpected income (often substantial, as in the case of the Public Power Corporation – DEH). As a result, the data are insufficient to allow any reliable general conclusions to be drawn.

However, from a macroeconomic perspective, GDP deflator in 2007 increased by 2.9%, i.e. less than unit labour costs (4.2%). This implies a reduction in operating profit margins in the whole economy.

V MONETARY POLICY AND MONETARY AND CREDIT DEVELOPMENTS IN THE EURO AREA

1 THE SINGLE MONETARY POLICY OF THE ECB

Starting from late 2005 the monetary policy of the Eurosystem was gradually tightened and by end-2006 the ECB had raised its key interest rates by 1.5 percentage points. In 2007 the Governing Council of the ECB decided to further raise the key interest rates on 8 March and on 6 June, by a total of 50 basis points. Since then the minimum bid rate on the main refinancing operations has remained at 4% (see Table V.1).

Table V.1 Changes in key ECB interest rates

(percentages per annum)

Date of interest rate change[1]	Deposit facility	Main refinancing operations	Marginal lending facility
6 Oct. 2000	3.75	4.75	5.75
11 May 2001	3.50	4.50	5.50
31 Aug. 2001	3.25	4.25	5.25
18 Sept. 2001	2.75	3.75	4.75
9 Nov. 2001	2.25	3.25	4.25
6 Dec. 2002	1.75	2.75	3.75
7 March 2003	1.50	2.50	3.50
6 June 2003	1.00	2.00	3.00
6 Dec. 2005	1.25	2.25	3.25
8 March 2006	1.50	2.50	3.50
15 June 2006	1.75	2.75	3.75
9 Aug. 2006	2.00	3.00	4.00
11 Oct. 2006	2.25	3.25	4.25
13 Dec. 2006	2.50	3.50	4.50
14 March 2007	2.75	3.75	4.75
13 June 2007	3.00	4.00	5.00

1 As from 10 March 2004, the effective date of changes in all three key ECB interest rates is the date of the first main refinancing operation following the relevant decision of the Governing Council.
Source: ECB.

The above increases in the key interest rates in the first half of 2007 were deemed necessary, as the economic and monetary analysis, underlying the decisions of the Governing Council of the ECB, increasingly identified upside risks to price stability. These risks were associated, on the one hand, with the favourable developments and prospects for economic activity in the euro area, as well as the upward course of oil prices (from mid-January 2007 onwards), and on the other, with the strong rates of money and credit growth, particularly in a context of increased liquidity.

In spite of the increases in key interest rates, the Eurosystem's monetary policy stance −given that GDP continued to grow at high rates− remained on the accommodative side in the period January-July 2007, as financing conditions were generally favourable and supportive to economic growth, the monetary and credit expansion remained very strong and liquidity was ample.

As from August 2007 the financial turmoil, which had already adversely affected international corporate bond and stock markets, began to exert upward pressure on interbank rates in the money markets of advanced economies, amid growing signs that defaults in housing loans to the US sub-prime mortgage market would weigh heavily on the operating results of credit institutions globally. At the same time, the rate of increase in oil and food commodity prices accelerated significantly, and money and credit growth remained vigourous.

Against this background, in the period from September to December 2007 the Governing Council of the ECB repeatedly recognised that, although robust corporate profitability, the increase in employment and the decline in the unemployment rate to a 25-year low in the euro area implied that the evolution and the prospects of output and total demand were satisfactory, the impact of the financial turmoil on total demand and supply and on money and credit developments, (and, ultimately, on inflationary pressures), was surrounded by exceptionally high uncertainty. The Governing Council therefore pointed out that it was appropriate to gather additional information and to examine new data on the effects of the financial turmoil before drawing further conclusions for monetary policy. Accordingly, notwithstanding the assessment about the existence of upside risks to price stability largely as a result of the hikes in commodity prices, the Governing Council did not change the key interest rates, but stressed that it will monitor closely all relevant developments. At the same time, the Governing Council confirmed that by acting in a firm and timely manner it would seek to prevent particularly second-round effects[1] from the increase in oil and food commodity prices. This was necessary for ensuring that the pick-up of inflation since September 2007 would remain temporary and for anchoring of medium-to-long term inflation expectations at levels consistent with price stability.

More specifically, economic analysis pointed to satisfactory real GDP growth (Q1: 0.8%, Q2: 0.3%, Q3:0.7%, Q4: 0.4%),[2] while in the context of successive rounds of macroeconomic projections,[3] the range of the growth rate of GDP for 2007 was revised upwards between end-2006 and the first half of 2007, but subsequently it was revised considerably downwards in December 2007. In the period January-August 2007, the inflation rate in the euro area turned out to be between 1.7% and 1.9%. The Governing Council of the ECB repeatedly warned that this moderation of inflation, which was largely reflected on the drop in oil prices after August 2006,[4] did not allow any room for complacency and should be construed as a short-term development that would be reversed in the last months of 2007 (as the annual rate of change in oil prices would again become positive and high, owing to a base effect from the low levels seen a year earlier). For this reason, the Governing Council forecast a considerable acceleration of inflation and it kept pointing to upside risks to price stability over the medium term. Indeed, as from September 2007 the inflation rate picked up to well above 2%, reaching 3,1% in the last two months of 2007, a level that had not been observed since May 2001. Underlying this development were the simultaneous large increases in the prices of oil and food commodities. At the same time, assumptions concerning the future path of the prices of these commodities were revised considerably upwards; as a result, in the Eurosystem staff macroeconomic projections of December 2007 the projected range for inflation in 2008 was also revised upwards. According to the same projections, inflation should fall significantly in 2009 but, as the

1 Such as adjustments of wages and/or profit margins in order to offset the loss of purchasing power resulting from the recent sharp increases in commodity prices. In turn, wage adjustments would bloat production cost and could be passed on to a large extent −given the strong total demand and competition inadequacy in many euro area markets− on retail prices.

2 Quarter-on-quarter rates.

3 Macroeconomic projections for the euro area are produced in March and September of each year by ECB staff, and in June and December by Eurosystem staff. These are, in principle, not adopted by the Governing Council of the ECB but are drawn up on the responsibility of ECB or Eurosystem experts. Also they do not prejudge Governing Council decisions but are assessed together with many other data.

4 Oil prices continued to fall until mid-January 2007.

Governing Council of the ECB underlined on several occasions from late 2007 onwards, this mainly reflected the projected drop in the prices of oil and food commodities on the basis of the prices of respective futures contracts, and the assumption that the past and current increases in oil and food commodity prices will not have *large-scale* second-round effects.

Throughout 2007, the Governing Council of the ECB pointed out the possibility that the prices of raw materials, administered prices, indirect taxes and wages would increase more than it had assumed in the economic analysis. This possibility implied upside risks to price stability over the medium term. Although in 2007 wage increases remained moderate, there were certain incipient risks of stronger wage developments, associated with robust growth for a number of quarters and positive developments in the labour market and capacity constraints, while towards the end of the year the risk of second-round effects became higher. Inflationary risks were also posed by a potential increase in firms' pricing power, particularly in markets with low competition, which would enable them to fully pass higher commodity prices on their own prices or even to widen their profit margins. Accordingly, during 2007 the Governing Council of the ECB repeatedly underlined the need for social partners to maintain their responsible stance with respect to wage and price setting negotiations and the pricing policy. Finally, in certain meetings of the Governing Council of the ECB it was stressed that fiscal policies in certain Member States could boost demand in a procyclical manner, thus leading to additional inflationary pressures.

The monetary analysis confirmed that risks to price stability in the medium and long term remained on the upside. Broad money (M3) (December 2006: 9.9%, December 2007: 11.6%)[5] and loans to the private sector (December 2006: 10.8%, December 2007: 11.1%)[6] continued to increase rapidly. Repeatedly during 2007, the Governing Council pointed out that the annual growth rate of M3 was understandably affected by temporary factors such as the flattening of the yield curve (see further below). However, even excluding the effect of temporary factors, the long-term trend of money growth was still strongly upward in 2007. This trend is related in the long run with inflationary pressures in the economy and therefore (in contrast to short-term fluctuations in monetary aggregates) it must be taken into account in the formulation of monetary policy.

In the euro area, risks for the short-term outlook of inflation have increased, the latest data suggest that GDP growth continues but at a slower pace, while uncertainty due to the financial turmoil remains high. Against this background, the ECB has kept its key interest rates unchanged so far in 2008. In its meeting of 10 April 2008, the Governing Council of the ECB confirmed that, as shown by the analysis of the most recent data, there are upside risks to price stability in the medium term. In view of the ECB's primary responsibility to maintain price stability, according to its mandate, the Governing Council judged that it is of the utmost importance to ensure the anchoring of medium-to-long-term inflation expectations

5 January 2008: 11.5%, February 2008: 11.3%.
6 January 2008: 11.1%, February 2008: 10.9%.

and for this reason kept its key interest rates unchanged. Also, the Governing Council underscored that the current stance of monetary policy will contribute to the attainment of this objective and reiterated its strong commitment to prevent second-round effects on inflation and deter risks to price stability over the medium term. Finally, it stressed that it will continue to monitor closely all developments.

2 THE EVOLUTION OF M3

The acceleration of M3 growth (see Table V.2) is associated −as mentioned above− with the flattening of the yield curve in 2007. The relative flat yield curve has made it more attractive to hold M3 components that are remunerated at close to market rates than to hold medium and long-term securities or longer-term bank deposits. As the higher liquidity and the lower risk of these M3 assets in relation to longer-maturity instruments were not offset by substantially lower yields, there were portfolio shifts out of investment in medium- and long-term bonds and deposits towards M3. On the other hand, returns on M1 assets did not follow money market rates and thus the increase in key interest rates contributed to a slowdown in M1 growth. Furthermore, the increase in bank lending rates, which is linked with the tightening of the Eurosystem's monetary policy, exerted, along with the weakness in the real estate markets of several countries in the euro area, a dampening effect on the growth of (housing and consumer) loans to households (see Table V.3). However, the growth of loans to enterprises (financial and non-financial) accelerated, implying that the strengthening of M3 dynamics in 2007 relative to 2006 reflected mainly faster credit expansion to enterprises. Capital inflows in the first quarter and in July 2007 also contributed to the creation of liquidity.

The financial turmoil initially led to capital outflows, which subsequently were partly reversed. However, generally the financial turmoil does not seem to have had a negative effect in 2007 on M3 growth or the flow of credit to non-financial enterprises and

Table V.2 Main components of M3 in the euro area

(annual percentage changes, derived from data adjusted for seasonal and calendar effects; for 2007: quarterly averages)

	2007				2008	
	Q1	Q2	Q3	Q4	January	February
M1	**7.0**	**6.2**	**6.6**	**5.9**	**4.3**	**3.7**
Currency in circulation	10.5	10.0	8.8	8.0	7.8	7.6
Overnight deposits	6.3	5.5	6.2	5.5	3.6	2.9
Other short-term deposits (=M2–M1)	**11.9**	**13.1**	**15.0**	**16.8**	**17.9**	**19.4**
Deposits with an agreed maturity of up to two years	29.5	33.0	37.6	40.7	41.1	43.1
Deposits redeemable at notice of up to three months	−0.8	−2.1	−3.2	−4.0	−3.6	−3.2
M2	**9.1**	**9.2**	**10.3**	**10.7**	**10.4**	**10.7**
Marketable instruments (=M3–M2)	**16.9**	**19.3**	**18.7**	**19.6**	**18.2**	**14.6**
M3	**10.2**	**10.6**	**11.5**	**12.0**	**11.5**	**11.3**

Source: ECB.

Table V.3 Main counterparts of M3 in the euro area

(annual percentage changes, derived from data adjusted for seasonal and calendar effects; for 2007: quarterly averages)

	2007				2008	
	Q1	Q2	Q3	Q4	January	February
Longer-term financial liabilities[1]	**8.6**	**9.0**	**9.2**	**8.9**	**9.2**	**8.0**
Credit to general government	**–4.5**	**–4.4**	**–4.0**	**–3.8**	**–2.2**	**–2.5**
Loans to general government	–1.3	–1.2	–0.9	–1.8	–0.5	–1.0
Credit to the private sector	**11.1**	**11.0**	**11.7**	**12.3**	**12.7**	**12.5**
Loans to the private sector	10.6	10.5	11.0	11.1	11.1	10.9
– to non-financial corporations[2]	13.0	12.7	13.8	14.0	14.5	14.8
– to households[2]	8.1	7.5	7.0	6.6	6.0	5.8

1 Including capital and reserves.
2 Data not adjusted for seasonal and calendar effects.
Source: ECB.

households, but mostly affected money market mutual fund shares units and MFI loans to non-banking financial enterprises.

3 THE FINANCIAL TURMOIL, LIQUIDITY-PROVIDING OPERATIONS AND MONEY MARKET INTEREST RATES

The financial turmoil gave rise to liquidity shortage and upward pressures on interbank interest rates. In order to restore normal conditions in the money market, the Eurosystem differentiated and broadened its instruments for the provision of liquidity to credit institutions. This policy continued into the first quarter of 2008. As it has been repeatedly underscored, *this* is considered to be the appropriate method for dealing with tensions, rather than changes in key interest rates, which are defined by the Governing Council of the ECB with a view to maintaining price stability in the euro area as a whole. Indeed, with the differentiation and broadening of liquidity supply instruments, the Eurosystem managed to limit the fluctuations of the EONIA rate to levels close to the minimum bid rate on the main refinancing operations (4%). However, the three-month interbank rate, which is representative of EURIBOR rates, remained at very high levels until the end of the year. In the first quarter of this year the EONIA continued to hover around 4% with small fluctuations. The three-, six- and twelve-month EURIBOR rates continued to decline in January and February, before increasing again considerably in March by 23-24 basis points. The evolution of interbank rates in March, as well as the persistence of interbank rates in both the uncollateralized (EURIBOR) segment and the repo segment at much higher levels than before the turmoil, imply that tensions in the money market have not been abated yet.

4 MFI INTEREST RATES, LONG-TERM BOND YIELDS AND THE FINANCIAL TURMOIL

In 2007 the deposit and lending rates applied by MFIs continued to increase, following the generalised rise in interest rates in money markets and government bond yields (despite some fluctuations during the year). In the second half of 2007 bank rates were affected by the financial turmoil, although short-term MFI interest rates for most categories of loans increased less than the three-month money market rate. On the other hand, long-term bank rates did not follow the decline of long-term government securities yields observed after the onset of the financial turmoil (see further below), probably because banks incorporated in their lending rates the sharp increase in long- and medium-term funding costs through the issuance of bank bonds and the upward re-assessment of risk premia.

Long-term government bond yields in the euro area followed a broadly upward path from the beginning of 2007 until early July. Following the onset of the financial turmoil, investors realised that risks of losses entailed by investment in most financial instruments had considerably increased and their risk appetite was limited. This resulted in large portfolio shifts towards government securities of the euro area, the United States, Japan and other (mostly advanced) economies, which are seen as relatively safer investment. Owing to these shifts, long-term interest rates followed a downward course with strong fluctuations after early July 2007 (ten-year government securities[7] in the euro area, on average monthly levels, December 2006: 3.91%, June 2007: 4.53%, December 2007: 4.31%).

The financial turmoil was also associated with a considerable increase in corporate bond spreads, both in the euro area and the United States. This can be seen as a correction of underestimation of risk during earlier years. Between January and March 2008, long-term interest rates fell considerably (amid some small fluctuations) in the euro area,[8] the United States and Japan, while corporate bond spreads continued to increase.

5 STOCK MARKET DEVELOPMENTS

Stock prices in the euro area, the United States and Japan followed an upward course between the beginning of 2007 and-mid July. Thereafter and until year-end, mainly because of the financial turmoil, these prices were very volatile, but broadly declined. Overall, however, by December 2007 the broad index Dow Jones EURO STOXX had increased by 6.4% compared with December 2006 (average monthly levels), while the US Standard & Poor's 500 index had increased by 4.5%. By contrast, in Japan the Nikei 225 index dropped by about 7.6% in the same period. Equity prices were negatively affected mainly by investors' limited risk appetite and the associated increase in equity risk premia and the flight to safety, as mentioned above. Stock prices were also affected in the same direction by the observed decline in the volume of mergers and acquisitions, which is attributable to the turmoil. The drop in equity prices was also the direct result of the defaults that caused the turmoil, given that they led to a decline in the value of the assets of listed companies – mainly banks and other enterprises of the financial sector. In the first quarter of 2008 there was a sharp drop in stock prices

7 With an AAA rating (based on the credit standing of the issuing government).
8 The yields on ten-year government securities with an AAA rating averaged 4.04% in March 2008.

internationally: by March 2008 the broad index Dow Jones EURO STOXX had fallen by 17.3% in comparison with December 2007 (average monthly levels), the Standard & Poor's 500 index by 11.0% and the Nikkei 225 index by 18.9%.

VI MONETARY AND CREDIT DEVELOPMENTS IN GREECE

1 MONETARY DEVELOPMENTS

The annual growth rate of the Greek contribution to the euro area M3 (excluding currency in circulation) accelerated further in 2007 and stood at 14.7% in the fourth quarter, up from 10.6% in the fourth quarter of 2006 (the acceleration continued into January 2008, see Table VI.1). The higher money market interest rates (owing to the increase in key ECB interest rates during the first half of 2007 as well as the financial market turmoil in the second half) had an upward effect on bank rates (particularly for certain deposit categories). This further strengthened the shifts from assets outside M3 (e.g. units of certain types of mutual funds) towards M3 components (such as deposits with an agreed maturity of up to two years and money market fund shares/units) that offered an increasingly attractive combination of yields, liquidity and safety. The annual growth rate of the Greek M3 (excluding currency in circulation) remained higher than the corresponding euro area figure.

However, during 2007 there were also shifts within M3, as savers seemed to prefer time deposits (the interest rates of which increased much more markedly), causing the growth rate of this deposit category to rise strongly. On the other hand, savings deposits and repo holdings showed negative change, while holdings of money market fund shares/units rose at a high rate.

The growth rate of total M3 deposits accelerated to 15.9% in the fourth quarter of 2007 (fourth quarter of 2006: 12.1 %), remaining at broadly the same level in January 2008 (16%). Driving this development were the interest rates on time deposits with a maturity of up to two years (now the most important category of household deposits), which rose relatively more than the rates of other deposit categories, thus inducing shifts towards time deposits from assets outside M3 as well as other M3 components (such as savings deposits and repos). The growth rate of time deposits thus reached a very high level in the fourth quarter of 2007 (42.2%, fourth quarter 2006: 37.5%), while it moderated slightly in January 2008 (41.0%). Time deposits with a maturity of up to two years now make up the most important category of household deposits, with their share in M3 (excluding currency in circulation) growing to 47.4% at end-2007, e.g. up by 9 percentage points year-on-year. By contrast, savings deposits fell in 2007 (fourth quarter 2007: –4.6%, fourth quarter 2006: 0.2%) and throughout the year (and in January 2008) lagged behind time deposits, reflecting their negative real returns and their remuneration at one fourth of the interest rate of time deposits with a maturity of up to one year. At end-2007, the share of savings deposits in M3 excluding currency in circulation stood at 34.3%, 6.8 percentage points lower than at the end of 2006.

Among the other M3 components, repo holdings declined further in 2007 (fourth quarter 2007: –54.3%, fourth quarter 2006: –35.7%), while in January 2008 the negative annual rate of change strengthened further (–55.8%). In addition to the relatively lower yields on repos compared with time deposits, another factor behind this decline was the fact that, during the previous year, MFI holdings of Greek government securities, which serve as underlying assets

Table VI.1 Greek contribution to the main monetary aggregates of the euro area

(not seasonally adjusted data)

	Outstanding balances on 31.12.07 (million euro)	Annual percentage changes[1]										
		2002	2003	2004	2005	2006	2007					2008
		Q4[2]	Q4[2]	Q4[2]	Q4[2]	Q4[2]	Q1[2]	Q2[2]	Q3[2]	Q4[2]	Dec.[3]	Jan.[3]
1. Overnight deposits	98,836.5	8.9	6.8	16.8	9.3	0.7	0.2	0.1	–0.6	–0.9	–1.2	–1.9
1.1 Sight deposits and current account deposits	28,210.0	5.7	17.7	19.1	20.2	1.8	6.4	9.3	7.3	10.3	8.4	7.5
1.2 Savings deposits	70,626.5	9.8	4.1	16.1	6.3	0.2	-1.9	-2.9	-3.2	-4.6	-4.7	-5.0
2. Time deposits with agreed maturity of												
up to 2 years	97,547.2	10.1	29.3	5.3	45.2	37.5	37.7	36.5	42.1	42.2	41.0	41.0
3. Deposits redeemable at notice up to 3 months[4]	2,261.6	8.1	1.5	2.8	105.2	–24.4	–31.4	–28.1	–21.6	–20.3	–20.1	–24.1
4. Total deposits (1+2+3)	**198,645.3**	**9.2**	**12.6**	**13.1**	**20.7**	**12.1**	**12.4**	**12.8**	**15.2**	**15.9**	**15.4**	**16.0**
5. Repurchase agreements	704.3	–19.0	–47.7	–12.6	–72.8	–35.7	–44.2	–49.6	–53.3	–54.3	–55.0	–55.8
6. Money market fund shares/units	7,917.9	–3.7	68.0	–1.9	–51.8	–2.5	30.0	43.9	43.4	40.5	36.3	30.4
7. Debt securities issued with maturity of up to 2 years[5]	–1,587.3	–26.2	268.6	–0.3	–42.2	24.2	–14.1	–	–	–	–	–
8. M3 excluding currency in circulation (4+5+6+7)	**205,680.2**	**2.2**	**6.4**	**9.2**	**6.9**	**10.6**	**12.0**	**12.2**	**13.9**	**14.7**	**14.3**	**15.0**

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 "Euro area statistics" section of the ECB *Monthly Bulletin*).
3 Based on end-month levels.
4 Including savings deposits in currencies other than the euro.
5 This aggregate is calculated on a consolidated basis with the other euro area countries and thus does not include domestic MFIs' holdings of debt securities with a maturity of up to two years issued by euro area MFIs.
Sources: Bank of Greece and ECB.

in repo agreements, declined further as a percentage of the MFIs' assets.[1] Thus, the share of repos in M3 (excluding currency in circulation) fell to 0.3% at end-2007, from 0.9% at end-2006 (and 6.3% at end-2004). Finally, holdings of money market fund shares/units, which are generally less risky, rose substantially in 2007 (fourth quarter 2007: 40.5%, fourth quarter 2006: –2.5%), reflecting their relatively higher yields. In January 2008 their growth rate declined somewhat. As a percentage of M3 (excluding currency in circulation), money market fund shares/units stood at a slightly higher level at the end of 2007 (3.8%), compared with one year earlier (3.2%).

2 CREDIT DEVELOPMENTS

2.1 TOTAL CREDIT EXPANSION AND BANK CREDIT TO GENERAL GOVERNMENT

The total financing[2] of the economy by domestic Monetary Financial Institutions (MFIs) continued to rise strongly in 2007 (fourth quarter 2007: 13.1%, fourth quarter 2006: 15.3%, see Table VI.2), and its growth rate, having weakened during the second half of 2006 and the first months of 2007, stabilised at a high level thereafter. This development was largely driven by the financing to the private sector (enterprises and households), which gained momentum from the second quarter of 2007 onwards, as credit expansion to enterprises strengthened. This pattern continued into January 2008, thus contributing to a rise in the growth rate of the total financing of the economy, which reached 16.3%.

In contrast with financing to the private sector, financing to general government had a negative contribution to total credit expansion throughout 2007, recording negative rates of change (fourth quarter 2007: –16.1%, fourth quarter 2006: –1,8%). Moreover, the rate of change in financing to general government fluctuated, causing the growth of the total financing of the economy to slow during the first months of 2007. The rate of change in financing to general government, albeit slower, remained negative during January this year (January 2008: –7,3%). The continued decline in MFI claims on general government reflects substantial decrease in MFI holdings of government securities. This development had already started to unfold before the turmoil in international financial markets in the third quarter of 2007 and is associated with structural adjustments in MFI assets, which are driven by both developments in government securities yields, as compared with alternative investments, and MFIs' expectations concerning the evolution of those yields. Moreover, increased demand for government securities by the other sectors of the economy, in the context of a general "flight to quality" triggered by the turmoil in international markets, may have provided credit institutions with an opportunity to realise capital gains by selling part of their portfolio. Characteristically, a substantial decline in credit institutions'

1 In recent years, credit institutions have substituted higher-yield instruments for Greek government securities, the share of which in total credit institutions' assets fell to around one third between December 2002 and December 2007.

2 The financing of the economy by domestic MFIs comprises the outstanding balance of MFI loans to non-financial corporations, households and general government, as well as total government securities and corporate bonds held by MFIs. The calculation of the rate of change in total financing also includes the balances of securitised loans, as well as total loan write-offs by banks during the reference period.

Table VI.2 Total financing of the economy by domestic MFIs

(annual percentage changes)

	2003	2004	2005	2006	2007					2008
	Q4[1]	Q4[1]	Q4[1]	Q4[1]	Q1[1]	Q2[1]	Q3[1]	Q4[1]	December[2]	January[2]
1. Total financing by MFIs[3,4]	4.4	11.0	14.0	15.3	13.2	12.0	12.4	13.1	14.4	16.3
2. Financing of general government	–15.9	–5.6	–0.7	–1.8	–7.5	–12.6	–16.1	–16.1	–9.7	–7.3
3. Financing of enterprises and households[3,4]	19.1	19.6	20.1	21.3	20.0	19.7	20.8	21.2	20.9	22.3
3.1 Enterprises[3]	13.7	13.0	12.7	16.8	15.9	15.6	18.1	19.3	19.9	22.7
3.2 Households[4]	28.8	30.2	30.6	26.7	24.7	24.5	23.8	23.2	22.1	21.8
of which:										
3.2.1 Housing loans[4]	27.8	26.9	31.5	28.0	25.5	25.2	23.7	22.8	21.4	20.9
3.2.2 Consumer loans[4]	25.0	38.4	30.4	23.7	23.0	22.6	22.4	22.6	22.4	22.6

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 "Euro area statistics" section of the ECB *Monthly Bulletin*).
2 Based on end-month levels.
3 Including corporate bonds held in MFI portfolios, as well as securitised loans. Loan write-offs are also taken into account since the fourth quarter of 2003, when the relevant statistical data became available.
4 Including securitised loans. Loan write-offs are also taken into account since the fourth quarter of 2003, when the relevant statistical data became available.
Source: Bank of Greece.

holdings of government securities during 2007 was recorded also in the euro area as a whole. However, the supply of government securities did not have a dampening effect on the relevant MFI holdings, as the net borrowing requirements of central government, on a cash basis, increased significantly during 2007 (to €13,592 million) in comparison with 2006 (€10,467 million). Thus, net government securities issuance in 2007 was higher than in 2006 (see Chapter VII).

2.2 BANK FINANCING OF ENTERPRISES AND HOUSEHOLDS

The rate of credit expansion to enterprises and households remained high during 2007 (fourth quarter 2007: 21.2%, fourth quarter 2006: 21.3%) as a result of offsetting developments in both sectors. In particular, the annual growth rate of credit to enterprises continued the upward trend observed since mid-2005 and recorded a further strong acceleration (fourth quarter 2007: 19.3%, fourth quarter 2006: 16.8%), reaching a particularly high level. By contrast, credit expansion to households slowed substantially during 2007 (fourth quarter 2007: 23.2%, fourth quarter 2006: 26,7%), again in line with a trend seen since early 2006, while credit expansion to households, despite decelerating, has remained robust. Thus, available data show no evidence that the international financial turmoil in the third quarter of 2007 has had a significant impact on the ability of the domestic banking system to meet credit demand by the private sector. This is corroborated by the results of the October 2007 and January 2008 rounds of the Bank Lending Survey,[3] which show that Greek banks have not made any significant change in financing conditions or credit standards in the face of tensions in international financial markets. However, if these tensions were to persist and limit the access of the banking system to funding sources, such as the interbank market and loan securitisation,[4] some impact on the availability of bank credit to the private sector could not be precluded.

As credit expansion to enterprises and households remained strong, their total debt to MFIs rose to 94.1% of GDP at end-2007, compared with 83.9% at end-2006. In the first month of 2008, developments in the financing of the private sector continued the trends observed during the previous year, with the growth of financing to enterprises rising to 22.7% and credit expansion to households reaching 21.8%.

A noteworthy acceleration was seen in the growth rate of foreign-currency denominated loans to enterprises and households, which reached 74.5% in the fourth quarter of 2007 (fourth quarter 2006: 17.0%). A large part (over 60%) of this strengthening stemmed from housing loans denominated in Swiss francs, given their lower interest rates. Moreover, developments in the outstanding balance of loans in foreign currency, expressed in euro terms, also include the effect of exchange rate valuation. During

3 The Bank Lending Survey is conducted by the Bank of Greece on a quarterly basis, as part of a wider survey at the Eurosystem level. The October 2007 and January 2008 rounds of the Survey also included specific questions on the impact of tensions in international financial markets on credit standards and financing conditions.

4 It should be noted, however, that the importance of these two sources of funding is still relatively limited for the domestic banking system as a whole. Naturally, the relative importance of the two sources varies across credit institutions.

2007, the euro appreciated against the major currencies; relative to the US dollar in particular, which is the currency of denomination for more than half of non-euro loans, the appreciation of the euro was 11.8% between end-2006 and end-December 2007. Adjusted for foreign exchange valuation effects, the growth rate of loans in foreign currency is even higher (December 2007: 81.5%, December 2006: 31.8%). In any event, the rate of increase in loans in foreign currency at end-2007 far exceeded that of euro-denominated loans (fourth quarter 2007: 14.4%), and their share in total loans to enterprises and households, though still limited, rose to 7.6% in December 2007 (December 2006: 5.2%).

As regards the breakdown of loans to enterprises and households on the basis of their initial maturity, a small prolongation of the average maturity was recorded during 2007. In particular, the growth rate of medium- and long-term loans (i.e. with an initial maturity of over one year) remained higher than the corresponding rate of short-term loans.[5] As a result, the share of the former in total loans expanded further to 67.5% in December 2007 (December 2006: 64,9%).

The higher average maturity of loans largely reflects the contribution of housing loans, the bulk of which (December 2007: 98.5%) have an initial maturity of over five years. However, average maturities turned out to be longer also for loans to enterprises, although short-term credit continues to represent a large part of total loans (December 2007: 50.9%), reflecting the fact that almost one third of that total takes the form of credit lines that are short-term by nature.

2.2.1 Bank financing of enterprises

The annual growth rate of financing to enterprises maintained its upward trend, as mentioned before, showing a significant acceleration in 2007. This development reflects enterprises' higher needs for external financing, although their improved profitability also implies increased availability of internal financing. Credit demand was mostly motivated by the need for working capital to support rapidly growing sales; it is also partly associated with the need to finance investment plans, as business investment growth is estimated to have remained strong in 2007 (see Chapter III). The relevance of this factor is confirmed by the aforementioned prolongation of the average maturity of business loans. Moreover, enterprises' demand for bank loans remained strong, as lending rates are still relatively low, despite their increase, while financing conditions and/or credit standards have not tightened as yet, according to the results of recent rounds of the Bank Lending Survey. However, it is possible that business firms have sped up their borrowing or use of existing credit lines, anticipating less favourable financing conditions and credit standards in the future as a result of the turmoil.

Financing through the issuance of corporate bonds held by banks has become increasingly popular among enterprises in view of, among other things, the tax advantages it offers.[6] This type of financing thus came to represent 28% of total net bank

5 The growth rate of medium- and long-term loans in the fourth quarter of 2007 stood at 22.7% (fourth quarter 2006: 20.7%), while the corresponding rate for short-term loans fell to 8.0% (fourth quarter 2006: 8.5%).

financing flows to enterprises in 2007, compared with 34% in 2006 and a share of 17.0% in enterprises' total debt liabilities to the banking system in December 2007 (December 2006: 15.0%).

Looking at developments in bank loans to enterprises (a sectoral breakdown is also available for this aggregate),[7] their annual growth rate accelerated in 2007 and stood at 16.0% in the fourth quarter of the year (fourth quarter 2006: 11.1%, see Table VI.3). This reflected the strength of lending to "other sectors", to retail sales firms and, to a lesser extent, shipping and tourism.

In more detail, the annual growth rate of loans to enterprises of the "other sectors" accelerated further in 2007 and rose to 28.3% in the fourth quarter (fourth quarter 2006: 21.5%). In line with its relatively higher concentration of bank loans, this category had the largest contribution to the dynamics of loans to enterprises as a whole. Moreover, enterprises in the "other sectors" were very active in the issuance of corporate bonds, accounting for 24.6% of the amount of corporate bonds held by MFIs in December 2007. Thus, total bank financing to enterprises of the "other sectors", through loans, securitised loans and corporate bonds, also grew very strongly (fourth quarter 2007: 28.4%, fourth quarter 2006: 27.8%), with construction companies playing a major part in this development, although the role of firms in the communications and transport industries (excluding shipping, which is considered separately) has also been increasing in recent years.

A marked strengthening was also seen in the growth rate of bank loans to retail trade firms (fourth quarter 2007: 14.1%, fourth quarter 2006: 5.4%), the second most important corporate borrower among the sectors of economic activity. Moreover, retail trade firms continued to make extensive use of corporate bond issues as a source of financing. As a result, the annual rate of change in their total bank financing (loans, securitised loans and corporate bonds) came to 16.9% in the fourth quarter of 2007 from 9.1% in the fourth quarter of 2006, as the total net funds they raised from the banking system during the year reached €3,960 million. In the conjunctural surveys conducted by the Foundation for Economic and Industrial Research (IOBE), retail trade firms reported a positive assessment of their sales in 2007 and favourable expectations for the near future, which explains, at least partly, their increased demand for bank financing. Judging from its typically short maturity, the bulk of this financing is used to meet working capital needs generated by the growth of sales.[8]

6 According to the legal framework governing corporate bond issues (Law 3156/2003), these securities are exempt from the contribution under Law 128/1975 (0.6% on the outstanding balance of the loan). Corporate bond issues are almost exclusively held by banks and are not traded on a regulated secondary market.

7 The discussion of sectoral developments in credit expansion is limited to bank loans, given that a sectoral breakdown of corporate bonds is only available since March 2005. The calculation of rates of change in loans to enterprises by sector of economic activity excludes loan write-offs, for which a sectoral breakdown is not available. However, the outstanding balances of securitised loans are included in this calculation. For the agricultural sector in particular, the impact of write-offs on the rates of change is quite sizeable, reflecting the extensive loan write-offs effected by the Agricultural Bank of Greece (ATE) mostly during 2005 and 2006, either in implementation of Law 3259/2004 on the settlement of overdue debts to banks (which included specific provisions on the agricultural sector) or for portfolio restructuring purposes.

8 In December 2007, 68% of loans to retail trade firms had an initial maturity of one year.

Table VI.3 Loans to domestic firms and households from domestic MFIs

	Outstanding balances on 31.12.07 (million euro)	Annual percentage changes									
		2003	2004	2005	2006	2007					2008
		Q4[1]	Q4[1]	Q4[1]	Q4[1]	Q1[1]	Q2[1]	Q3[1]	Q4[1]	December[2]	January[2]
A. Enterprises[3,4]	**92,361**	**11.0**	**8.6**	**6.4**	**11.1**	**11.5**	**11.7**	**14.7**	**16.0**	**16.1**	**18.4**
1. Agriculture	3,242	3.3	7.8	–12.7	9.0	2.6	–1.4	1.6	4.1	5.7	9.1
2. Industry[5]	17,611	10.4	1.1	–0.6	5.7	4.6	2.3	3.3	5.5	5.7	8.1
3. Trade	24,555	4.0	12.7	6.6	5.4	9.5	11.0	13.1	14.1	13.6	16.8
4. Tourism	4,774	24.4	17.6	4.6	5.3	4.3	3.5	4.3	5.8	9.8	10.0
5. Shipping	8,147	2.3	3.0	34.4	12.0	9.0	9.5	14.5	16.6	21.3	17.7
6. Non-monetary financial institutions	3,174	–3.2	9.5	–29.7	23.4	28.6	23.3	15.4	17.2	9.1	12.8
7. Other sectors	30,858	26.5	11.7	15.7	21.5	20.8	22.6	28.4	28.3	27.5	30.3
B. Households[3]	**104,116**	**28.6**	**30.0**	**30.3**	**26.2**	**24.1**	**23.7**	**23.0**	**22.3**	**21.2**	**20.9**
1. Housing loans	69,363	27.7	26.9	31.3	28.0	25.4	25.1	23.7	22.7	21.4	20.9
2. Consumer loans	31,942	24.8	37.9	29.9	22.4	20.9	20.4	20.2	20.3	20.1	20.2
– Credit cards	9,275	27.8	23.4	12.4	4.6	3.5	3.7	3.7	4.4	6.4	8.4
– Other consumer loans[6]	22,667	21.8	53.1	44.5	33.9	31.4	29.5	28.9	28.5	26.8	25.9
3. Other loans	2,811	135.7	18.8	11.5	29.9	28.0	28.4	39.8	38.3	31.7	29.9
Total	**196,477**	**17.3**	**17.0**	**16.8**	**18.4**	**17.8**	**17.7**	**18.9**	**19.3**	**18.8**	**19.7**

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 "Euro area statistics" section of the ECB *Monthly Bulletin*).
2 Based on end-month levels.
3 Excluding loan write-offs (taken into account *since the fourth quarter of 2003* in Table VI.2) but including the outstanding balances of securitised loans.
4 Excluding corporate bonds held in MFI portfolios. Rates of change including these bonds are reported in Table VI.2.
5 Including manufacturing and mining/quarrying.
6 Comprising personal loans and loans against supporting documents.
Source: Bank of Greece.

In contrast to the above sectors of activity, the growth rates of bank loans to industry, i.e. the other large recipient of bank lending, fell marginally, remaining low (fourth quarter 2007: 5.5%, fourth quarter 2006: 5.7%). However, total bank financing to that sector (loans, securitised loans and corporate bonds) recorded a small acceleration (fourth quarter 2007: 10.0%, fourth quarter 2006: 8.7%), which underlines the importance of corporate bonds as a source of financing for this sector.[9] By any standard, developments in the bank financing of industrial firms were weaker than in the case of "other sectors" and retail trade.

The annual growth rate of bank lending to shipping, after declining in 2006, resumed its upward course in 2007 (fourth quarter 2007: 16.6%, fourth quarter 2006: 12.0%). In fact, this outcome does not reflect the actual size of the acceleration, as it also includes the effects of the euro appreciation against the US dollar, in which more than 80% of loans to this sector is denominated. Adjusted for this valuation effect, the growth rate of loans to shipping is significantly higher (fourth quarter 2007: 27.4%, fourth quarter 2006: 18.9%). Increased bank lending to shipping is associated with shipping firms' higher need for investment financing, in the context of the renewal and expansion of their fleets. At the same time, it also reflects, to a certain extent, the increased share of the domestic banking system in financing to shipping, which until recently was provided almost exclusively by major financial centres abroad.

The growth rate of bank loans to tourism accelerated slightly (fourth quarter 2007: 5.8%, fourth quarter 2006: 5.3%). However, as in the case of industrial firms, a large part (around 60%) of the funds that the tourist industry raised through the banking system in 2007 was in the form of corporate bonds; thus the growth rate of total bank financing to this sector picked up considerably (fourth quarter 2007: 19.9%, fourth quarter 2006: 10.1%), possibly reflecting heavy investment in capacity expansion and infrastructure improvement in response to rising tourist arrivals in the last few years.[10] By contrast, credit expansion to non-bank financial corporations weakened in 2007, although it should be noted that such credit flows occur mostly from banks to their subsidiaries (in particular leasing companies) and are thus also affected by intra-group acquisitions.[11]

2.2.2 Bank financing of households

In 2007, credit expansion to households continued its downward path observed since early 2006, decelerating significantly further, as already mentioned. Underlying this development were three main factors: (i) a slowdown in the growth of households' investment and consumer spending; (ii) an increase – although limited – in interest rates from their historical low levels;[12] and (iii) a gradual maturing of the household loan market, as household indebtedness is rising. As regards the third factor in particular, the growth rate of financing to households,

9 In 2007, 52% of net financing of industrial firms by the banking system was in the form of corporate bond issues.
10 However, the growing number of tourist arrivals has not been accompanied by a proportionate rise in tourist receipts.
11 For example, following the enactment of Law 3483/2006 that allowed banks to engage in financial leasing activities themselves, some banks absorbed their leasing subsidiaries, with a view to exploiting economies of scale and reducing operating costs.
12 However, it is estimated that the effect of rising interest rates on household demand for loans has beens limited, given that these rates remain at relatively low levels.

despite a moderation, has remained very high and in the context of the euro area is second only to that of Slovenia. Also, given that it far exceeds nominal GDP growth, total household indebtedness (total MFI lending, including securitised loans) rose to 45.5% of GDP in December 2007, up from 40.1% in December 2006. Thus, household indebtedness is gradually approaching levels comparable with those recorded in the euro area as a whole. In particular, net of securitised loans, household borrowing stood at 41.0% of GDP in December 2007 (December 2006: 37.5%) and its difference vis-à-vis the euro area figure fell to 13.3 percentage points, from 16.5 percentage points at end-2006.[13]

Developments in the growth rate of total financing to households in 2007 mostly reflect the deceleration of the annual rate of housing loans to 22.8% in the fourth quarter, from 28.0% in the corresponding quarter of 2006, as well as a further decline in January 2008 (20.9%). This slowdown is primarily attributable to lower activity in the housing market, as evidenced, among other things, by a drop in the rate of increase in house prices during 2007. It is worth noting, in this respect, that private construction activity also declined, as reflected in the evolution of building permits. This cooling of the housing market followed a surge in activity, partly as a result of the announcement that VAT would be levied on new residential buildings and that the objective values of real estate would be adjusted as from January 2006. Important developments in the housing loan market in 2007 include a strong increase in housing loans denominated in foreign currency[14] (Swiss francs) and a shift by borrowers towards loans with an initial rate fixation of over one year.[15]

The growth rate of consumer loans also fell slightly in 2007 (fourth quarter 2007: 22.6%, fourth quarter 2006: 23,7%), but still remains very high and one of the highest in the euro area; in January 2008 it was unchanged from the fourth quarter of 2007. Among individual consumer loan categories, the increase in "other" consumer loans (comprising personal loans and loans against supporting documents) remained high, at 28.5% in the fourth quarter of 2007 compared with 33.9% in the fourth quarter of 2006. These loans now make up more than 70% of total consumer loans. By contrast, loans through credit cards, which used to be the main form of consumer credit in the past, rose only slightly (fourth quarter 2007: 4.4%, fourth quarter 2006: 4.6%). The divergent trends observed in different consumer loan categories reflect the higher interest rates on loans through credit cards, resulting in credit cards being used primarily as a means of payment, rather than a credit instrument.

Finally, the growth rate of other loans to households also accelerated further in 2007 (fourth quarter 2007: 42.2%, fourth quarter 2006: 30.5%), a trend that was only partly reversed in January 2008 (34.1%). This

13 However, as mentioned in previous Reports, the difference should be interpreted with some caution, since securitised loans correspond to a different percentage of GDP in Greece compared with the euro area.

14 32% of housing loans granted in 2007 are denominated in foreign currency.

15 In 2007, an average of 73% of new housing loans had an initial rate fixation of over one year (euro area: 57%), while the corresponding rate in 2006 was only 37%.

category includes loans extended for a number of often quite dissimilar purposes.[16] Therefore, it is not always easy to identify the determinants of their development. However, these loans continue to represent a very small part of total household borrowing (December 2007: 2.7%).

3 BANK INTEREST RATES

Bank interest rates on all types of deposits and on most loan categories continued their upward course throughout 2007, reflecting in the first half of the year the increases in the key ECB rates and in the second half the higher money market rates as a result of the financial turmoil.

Starting with new deposits by households, the largest interest rate rise (105 basis points) was seen in deposits with an agreed maturity of up to one year[17] (December 2007: 4.52%), as banks, in order to increase their liquidity, particularly in the second half of the year, offered even higher rates on these deposits, which have now become the most important category of household deposits. Actually, the interest rate increase exceeded not only the cumulative rise in the key ECB interest rates (50 basis points), but also the increase in interest rates on individual loan categories. By contrast, much smaller interest rate increases were recorded for overnight deposits (9 basis points), as well as savings deposits[18] (7 basis points); the interest rate on the latter category stood at 1.16% in December 2007. In January 2008, the rate on deposits with an agreed maturity of up to one year fell slightly, while the rate on savings deposits remained unchanged. The real interest rate on savings deposits (deflated by the annual inflation rate), although it declined somewhat, remained negative throughout 2007 (–1.7%, compared with –2.2% in 2006), in contrast with the real rate on time deposits with a maturity of up to one year, which has turned positive since September 2006 (2007: 1.1%). Moreover, the repo rate also increased significantly (by 46 basis points), standing at 3.76% in December 2007 and increasing slightly further in January 2008.

The corresponding euro area rates followed an upward course during 2007, generally remaining at levels lower than the Greek rates. The interest rate on overnight deposits in the euro area rose more strongly than the Greek rate, causing the positive differential between Greek interest rates and the corresponding euro area rates to narrow further to 5 basis points in 2007 (from 22 basis points in December 2006), at which level it broadly remained in January 2008 (see Tables VI.4A and VI.4B). However, the increase in the interest rate on deposits with an agreed maturity of up to one year was slightly smaller in the euro area; as a result, the positive differential between the Greek and the corresponding euro area rate widened slightly (December 2007: 24 basis points, December 2006: 20 basis points). In January 2008, this differential narrowed to 16 basis points. By contrast, the interest rate on new repos in the euro area rose further during 2007 and in December it was higher (by 19 basis points) than the corresponding Greek rate.

16 This category includes, e.g., loans to private non-profit institutions, loans for the purchase of stocks, loans to pay taxes and social security contributions, overdrafts from current accounts, etc.
17 This is the largest category of deposits with an agreed maturity.
18 These deposits account for 88% of households' overnight deposits.

Table VI.4A Bank interest rates on new deposits by households in the euro area and Greece

(percentages per annum)

	December 2006	January 2008	Change Jan. 2008/ Dec. 2006 (in percentage points)
Overnight[1]			
Weighted average interest rate in the euro area	0.92	1.20	0.28
Maximum interest rate	2.16	2.67	0.51
Minimum interest rate	0.18	0.16	–0.02
Interest rate in Greece	1.14	1.24	0.10
Interest rate differential between Greece and the euro area	0.22	0.04	–0.18
With an agreed maturity of up to one year[2]			
Weighted average interest rate in the euro area	3.27	4.19	0.92
Maximum interest rate	3.56	4.55	0.99
Minimum interest rate	2.26	2.89	0.63
Interest rate in Greece	3.47	4.35	0.88
Interest rate differential between Greece and the euro area	0.20	0.16	–0.04

1 End-of-month rate.
2 Monthly average rate.
Sources: ECB and euro area NCBs.

Table VI.4B Bank interest rates on new deposits by households in euro area countries[1]

	Overnight[2]		With agreed maturity of up to one year[3]	
	December 2006	January 2008	December 2006	January 2008
Austria	1.46	2.01	3.27	4.19
Belgium	1.20	1.12	3.36	4.07
France	0.18	0.16	3.36	4.01
Germany	1.49	1.89	3.23	4.08
Greece	**1.14**	**1.24**	**3.47**	**4.35**
Ireland	0.97	1.41	3.25[4]	3.97[4]
Spain	0.52	0.72	3.22	4.55
Italy	0.94	1.29	2.26	2.89
Luxembourg	2.16	2.67	3.19	3.92
Netherlands	0.63	0.78	3.50	4.16
Portugal	0.18	0.22	3.27	4.00
Slovenia	. . .[5]	0.44	. . .[5]	4.08
Finland	0.63	1.11	3.56	4.37

1 Despite the efforts to harmonise statistical methodologies across the euro area, considerable heterogeneity remains in the classification of banking products, which is partly due to differences in national conventions and practices as well as regulatory and fiscal arrangements (see ECB, "*Differences in MFI interest rates across euro area countries*", September 2006).
2 End-of-month rate.
3 Monthly average rate.
4 The interest rate applies to all time deposits irrespective of maturity.
5 No data available before January 2007.
Sources: ECB and euro area NCBs.

As already noted, lending rates rose for most loan categories in 2007, in line with the increase in the key ECB interest rates (by a cumulative 50 basis points in the first half of 2007) and higher money market rates. However, as the rise in lending rates in the euro area was generally stronger, the positive differential between Greek rates and the average euro area rates decreased. The increase in the average rate on loans to enterprises was double that recorded for loans to households, as growing competition among banks in Greece contributed to a moderation in interest rate increases or even a decline in interest rates on certain categories of consumer and housing loans.

Although interest rates on consumer loans with an agreed maturity showed divergent trends, leading to a net result (which caused the average rate to rise by 58 basis points and stand at 8.40% in December 2007), their positive differential vis-à-vis the corresponding area rates narrowed in most consumer loan categories. The only exception was the category of loans without a defined maturity, including loans through credit cards, where the differential widened and still remains high (401 basis points at end-2007, unchanged in January 2008). As already mentioned, loans through credit cards carry relatively higher interest rates (December 2007: 15.31%), mainly because of the high credit risk they involve and their high administrative costs.

Interest rates on housing loans also showed mixed trends. In the context of keen competition among Greek banks in the field of loans, the interest rate on the most important loan category (i.e. loans with an initial rate fixation of over one year and up to five years) fell by 16 basis points,[19] while the corresponding euro area rate increased. Although the interest rate on the second most important category of housing loans (those with a floating rate or an initial rate fixation of up to one year) rose (by 40 basis points), the increase was smaller than in the euro area. Thus, interest rates on the two most important categories of housing loans in December 2007 were not only lower (by 82 and 56 basis points, respectively) than the euro area average, but also the lowest among all euro area countries. The negative differential in the above categories widened somewhat in January 2008 (see Tables VI.5A and VI.5B). Owing to the above developments in individual housing loan categories, the average interest rate on total housing loans remained almost unchanged in 2007 (December 2007: 4.45%, December 2006: 4.41%) and fell slightly in January 2008 (4.39%).

Interest rates on all categories of loans to non-financial corporations rose less in Greece than in the euro area; as a result, these interest rates converged further towards the corresponding euro area rates. The interest rate on loans without a defined maturity[20] recorded the smallest increase in Greece and, as the corresponding rise in the euro area was stronger, the positive differential between the two rates shrank to 94 basis points in December 2007 (from 155 basis points in December 2006). By contrast, the interest rate on loans of over €1 million (with a floating rate or an initial rate fixation of up to one year) recorded the strongest increase (63 basis points), while the rate on loans of up to €1 million rose less (by 53 basis points). As the corresponding euro area rates showed stronger increases, the differentials between Greek rates vis-à-vis the euro area rates narrowed during 2007. This development also continued into 2008 and suggests that Greek interest rates keep on converging gradually towards the corresponding euro area rates. During the

19 This loan category has increased its share in total new housing loans to 58% in 2007 from 25% in 2006, thus accounting for the bulk of housing loans, as borrowers increasingly prefer such arrangements in anticipation of further interest rate increases in the future.
20 It should be noted that loans without a defined maturity predominantly refer to credit lines.

Table VI.5A Bank interest rates on new loans in the euro area and Greece

(percentages per annum)

	December 2006	January 2008	Change Jan. 2008/ Dec. 2006 (in percentage points)
A. Loans with a floating rate or an initial rate fixation of up to one year			
A.1 Loans up to €1 million to non-financial corporations			
Weighted average interest rate in the euro area	5.08	5.93	0.85
Maximum interest rate	6.52	7.56	1.04
Minimum interest rate	4.57	5.37	0.80
Interest rate in Greece	6.30	6.66	0.36
Interest rate differential between Greece and the euro area	1.22	0.73	–0.49
A.2 Loans of more than €1 million to non-financial corporations			
Weighted average interest rate in the euro area	4.50	5.12	0.62
Maximum interest rate	5.50	6.12	0.62
Minimum interest rate	4.24	4.72	0.48
Interest rate in Greece	5.16	5.48	0.32
Interest rate differential between Greece and the euro area	0.66	0.36	–0.30
A.3 Housing loans			
Weighted average interest rate in the euro area	4.56	5.32	0.76
Maximum interest rate	5.23	6.49	1.26
Minimum interest rate	4.15	4.61	0.46
Interest rate in Greece	4.36	4.61	0.25
Interest rate differential between Greece and the euro area	–0.20	–0.71	–0.51
A.4 Consumer loans			
Weighted average interest rate in the euro area	7.55	8.11	0.56
Maximum interest rate	10.62	11.29	0.67
Minimum interest rate	4.28	5.69	1.41
Interest rate in Greece	6.82[1]	8.15	1.33
Interest rate differential between Greece and the euro area	–0.73	0.04	0.77
B. Loans with an initial rate fixation of over one and up to 5 years[2]			
B.1 Housing loans			
Weighted average interest rate in the euro area	4.58	5.02	0.44
Maximum interest rate	7.00	6.61	–0.39
Minimum interest rate	3.47	4.14	0.67
Interest rate in Greece	4.37	4.14	–0.23
Interest rate differential between Greece and the euro area	–0.21	–0.88	–0.67
B.2 Consumer loans			
Weighted average interest rate in the euro area	6.05	7.00	0.95
Maximum interest rate	10.29	12.00	1.71
Minimum interest rate	4.85	5.73	0.88
Interest rate in Greece	8.93	8.26	–0.67[3]
Interest rate differential between Greece and the euro area	2.88	1.26	–1.62

1 It is noted that the average interest rate on this loan category in Greece declined considerably in December 2006, when certain banks decided to offer exceptionally low interest rates for that type of loans.
2 Monthly average rates.
3 This reduction partly reflects the fact that (as was the case with certain categories of housing loans) certain banks restructured loan servicing costs by charging lower interest rates for an initial period and higher interest rates for the remaining maturity of the loan.
Sources: ECB and euro area NCBs.

Table VI.5B Bank interest rates on new loans in euro area countries[1]

	New loans with a floating rate or an initial rate fixation of up to one year[2]								New loans with an initial rate fixation of over one and up to five years[2]			
	To non-financial corporations											
	Loans up to €1 million		Loans over €1 million		Housing loans		Consumer loans		Housing loans		Consumer loans	
	Dec. 2006	Jan. 2008	Dec. 2006	Jan. 2008	Dec. 2006	Jan. 2008	Dec. 2006	Jan. 2008	Dec. 2006	Jan. 2008	Dec. 2006	Jan. 2008
Austria	4.57	5.37	4.24	4.89	4.79	5.62	5.89	6.59	3.47	4.59	5.57	6.36
Belgium	5.02	5.67	4.39	5.00	4.47	5.25	6.49	6.98	4.44	5.09	7.49	7.35
France	4.93	5.66	4.33	4.72	4.22	5.01	7.02	7.90	4.04	4.75	6.40	7.00
Germany	5.67	6.31	4.58	5.21	5.23	5.99	5.31	5.99	4.86	5.17	4.85	5.73
Greece	**6.30**	**6.66**	**5.16**	**5.48**	**4.36**	**4.61**	**6.82**	**8.15**	**4.37**	**4.14**	**8.93**	**8.26**
Ireland	5.68	6.37	5.50	6.12	4.57	5.02	5.89	6.52	. . .[4]	. . .[4]	. . .[4]	. . .[4]
Spain	4.83	5.84	4.43	5.08	4.53	5.39	9.48	10.83	4.78	5.70	8.40	9.34
Italy	5.03	5.82	4.47	5.08	4.71	5.36	10.62	11.29	4.09	5.47	8.65	7.98
Luxembourg	...[3]	5.69	...[3]	5.10	4.51	4.89	. . .[3]	. . .[3]	. . .[3]	. . .[3]	5.82	6.22
Netherlands	4.69	5.38	4.34	4.95	4.51	5.46	8.64	8.89	4.65	5.09	. . .[3]	. . .[3]
Portugal	6.52	7.56	5.03	5.80	4.40	5.25	7.29	8.21	...[4]	...[4]	10.29	12.00
Slovenia	...[5]	6.22	...[5]	5.62	. . .[5]	6.49	. . .[5]	7.21	. . .[5]	6.61	. . .[5]	7.73
Finland	4.91	5.49	4.42	4.98	4.15	4.83	4.90	5.69	4.53	4.72	5.26	6.00

1 Despite the efforts to harmonise statistical methodologies across the euro area, a considerable product heterogeneity remains in terms of instrument characteristics and volumes; this partly reflects differences in national conventions and practices, as well as regulatory and fiscal arrangements (e.g. see ECB, *"Differences in MFI interest rates across euro area countries"*, September 2006, Table 2, showing that consumer loans without agreed maturity, which include credit cards, represent a much higher share – 53% in Greece compared with the euro area average of 15%).
2 Monthly average rate.
3 In these interest rate categories, the volume of loans is very small.
4 No data on the respective interest rates are published in these countries.
5 No data available before January 2007.
Sources: ECB and euro area NCBs.

Table VI.6 Interest rate spread in Greece and the euro area[1]

(percentages per annum)

	Average interest rate on new loans in Greece	Average interest rate on new deposits in Greece	Interest rate spread in Greece (percentage points)	Interest rate spread in Greece with euro area weighting (percentage points)	Interest rate spread in the euro area (percentage points)
Dec. 1998	16.21	8.12	8.09	...	...
Dec. 1999	14.02	6.98	7.04	...	...
Dec. 2000	9.68	4.00	5.68	...	...
Dec. 2001	7.26	1.96	5.30	...	...
Dec. 2002	6.38	1.67	4.71	...	...
Dec. 2003	5.95	1.17	4.78	4.45	2.77
Dec. 2004	5.98	1.21	4.77	4.18	2.53
Dec. 2005	5.73	1.30	4.43	3.59	2.56
Dec. 2006	6.36	1.91	4.45	3.63	2.89
Dec. 2007	6.68	2.62	4.06	3.48	3.09
Jan. 2008	6.63	2.65	3.98	3.41	2.98

1 Since September 2002 banks submit new, more detailed interest rate series on the basis of the single methodology followed by all euro area countries. Interest rate data for the pre-2002 period have been adjusted and re-assessed in order to be comparable with the new data. It should also be noted that the average interest rate on deposits underestimates the cost of money, as it does not fully reflect banks' increased cost of funding through the interbank market at relatively high interest rates.
Sources: Bank of Greece and ECB.

previous year, the differential between the rate on loans to small enterprises and that on loans to large enterprises narrowed in Greece (while it grew in the euro area) and stood at 104 basis points in December (73 basis points in the euro area). This differential is wider in Greece, as small enterprises face higher risks and, thus, tighter bank credit standards, given that the average size of enterprises in Greece is significantly smaller than in the euro area.

The interest rate spread, i.e. the difference between the weighted average rate on new bank loans and the corresponding rate on new deposits, contracted further by 39 basis points in 2007 and stood at 4.06% in December (see Table VI.6), as the average rate on loans increased less than the average rate on deposits. This spread, despite a cumulative decline of 403 basis points from December 1998 to December 2007, remains higher than in the euro area[21] (where the spread widened by 20 basis points in 2007[22] and stood at 3.09% in December 2007). Factors contributing to the decline in the spread in Greece (which narrowed further by 8 basis points in January 2008) include the improved productivity of Greek banks, as well as the increased competition triggered by their growing integration into the banking system of the euro area. The reasons why the Greek interest rate spread is wider than in the euro area have already been discussed in detail in previous Bank of Greece reports[23] and relate to inherent characteristics of the domestic banking system, such as the higher operating costs of Greek banks (partly attributable to the relatively large number of

21 As calculated by the Bank of Greece.
22 This is attributable to the fact that in the euro area, opposite to what was the case in Greece, the average lending rate rose more strongly than the average deposit rate.
23 See *Annual Report 2006*, p. 188-190.

small depositors and borrowers); the higher borrowing costs of Greek banks in the interbank market; the higher non-performing loans to total loans ratio than in the euro area (which leads to a higher risk premium embodied in the corresponding interest rates); the longer time needed in Greece for the liquidation of collateral; and differences in national practices, the legal and institutional framework and the language, which give Greek banks a competitive advantage, particularly in retail banking, where "customer proximity" plays a significant role. Another factor contributing to higher interest rate spreads in Greece is the different composition of deposits and, even more so, of loans. Had the composition of loans and deposits in Greece been the same as in the euro area, the interest rate spread in Greece would have been 3.48% in December (i.e. 58 basis points lower) and its differential over the corresponding spread in the euro area would have been reduced to 39 basis points.

VII CAPITAL MARKETS

1 THE MARKET FOR GOVERNMENT PAPER

1.1 THE PRIMARY MARKET

The main developments in the primary market for government paper in 2007 were a considerable increase in funds raised through that market and an upward trend in interest rates,[1] in line with rising yields in the secondary market.

The nominal value of securities issued in 2007 rose to €36.5 billion, from €29.0 billion in 2006 (see Table VII.1). This resulted from increased government net borrowing requirements and higher redemptions of past issues.[2] Issuance was effected mainly through syndication (as in the case of the 10-year, 15-year, 23-year and 30-year benchmark bonds) and, to a lesser degree, through auction procedures (as in the case of the new 5-year benchmark bond and the reopening of past issues).[3]

The securities issued in 2007 were predominantly bonds (96% of the total), while Treasury bills covered only a small fraction (4% of the total), as is typically observed in recent years[4] (see Table VII.1). Among bond issues, the largest share was accounted for by bonds with a maturity of 10 years or more (2007: 73%, 2006: 55%), bringing the weighted average maturity of new Greek government securities issued in 2007 up to 13.3 years,[5] from 10.5 years in 2006.

Finally, demand for Greek government paper in the primary market remained buoyant in 2007. Specifically, auctioned Greek government bond issues were oversubscribed almost four times.[6]

Table VII.1 Percentage breakdown of Greek government paper issues

Type of securities	2005	2006	2007
Treasury bills	**5.7**	**6.9**	**4.3**
Bonds	**94.3**	**93.1**	**95.7**
3-year	19.4	19.1	4.3
5-year	23.9	25.4	22.3
10-year	26.8	29.1	32.3
12-year	9.7	1.9	–
15-year	–	–	19.8
23-year	6.2	8.8	9.9
32-year	14.0	15.7	11.4
Total	**100.0 100.0**	**100.0 100.0**	**100.0 100.0**
Total funds raised (million euro)	**38,117**	**28,955**	**36,532**

Note: Reopened past issues are classified according to initial (rather than residual) maturity.
Source: Ministry of Economy and Finance.

1.2 THE SECONDARY MARKET

In line with developments in comparable euro area securities,[7] Greek government bond yields increased considerably between

1 The weighted average cost of new borrowing rose to 4.42% in 2007 from 3.72% in 2006.
2 Redemptions of Greek government paper stood at €21.1 billion in 2007, compared with €18.7 billion in 2006.
3 Moreover, the first Greek 50-year bond was issued through private placement in early 2007. The bond is indexed to the euro area HICP excluding tobacco, and the issue amount is €1 billion. Similar bonds with a maturity of more than 30 years were issued in other countries (e.g. France, United Kingdom) as well, given the marked flattening of the yield curve in the last three years.
4 In addition, the Greek government established a Euro Commercial Paper, in order to cover extraordinary cash needs between the above scheduled issues. This programme enables the issuer to directly issue short-term securities denominated in euro or other currencies, with a fixed or floating interest rate and maturities of 1 to 365 days, on money market terms.
5 Provisional data.
6 According to balance of payments data, net inflows for investment in Greek government bonds and Treasury bills came to €25.7 billion in 2007, compared with €9.0 billion in 2006.
7 For developments in euro area bond markets see Chapter V.4.

December 2006 and early July 2007, when they reached a 5-year peak. This development reflected the positive outlook for economic activity and perceptions of inflationary risks in the euro area.[8] From mid-July onwards however, bond yields decreased, with wide fluctuations, affected by the turmoil in the US subprime mortgage market. The uncertainty prevailing during that period in international money and capital markets led to an upward reassessment of risks and increased demand for relatively safe instruments, such as government bonds, while at the same time euro area growth figures were revised downwards. The decline in yields continued into the first quarter of 2008, save for those of the 15-year and 30-year bonds that rose slightly.

The yield curve of Greek government paper shifted upwards overall between end-2007 and end-2006, as the increase in yields in the first half of 2007 was greater than the decline that followed. Also, the slope of the yield curve steepened,[9] with the yield differential between the 10-year and the 3-year bond widening by 45 basis points compared with end-2006. It should be recalled that in the three years from 2004 to 2006 the yield curve had been flattening as long-term yields remained at very low levels.

The yield on the 10-year Greek government bond stood at 4.66% at end-December 2007, up from 4.19% one year earlier. Furthermore, its spread over the yield on the comparable German bond widened to 29 basis points at end-December 2007, from 27 basis points at end-December 2006. The spread peaked during the financial market turmoil (in the second half of 2007), as was also the case in Italy and other euro area countries, since the uncertainty that prevailed induced investors to prefer German government bonds, the market for which is the largest and most liquid in the euro area. The yield spread of the Greek 10-year bond against Germany increased considerably further in the first quarter of 2008.[10]

The average daily value of transactions in HDAT and the Book-Entry Securities System[11] of the Bank of Greece stood at €2.3 billion (see Table VII.2) and €19.7 billion respectively in 2007, from €2.6 billion and €15.6 billion in 2006. As in previous years, the bulk of transactions in HDAT concerned long-term securities (with maturities of 10 years or more); specifically, 10-year bonds accounted for 64% of total value (2006: 73%, see Table VII.2). The bid-ask spread rose to 9.7 basis points in December 2007, from 7.4 basis points in December 2006, and this rise occurred mostly from August onwards, when the financial turmoil led to weak secondary market activity and generalised risk aversion.

2 THE STOCK MARKET

The Greek stock market continued to perform well in 2007. Share prices followed an upward trend, while increases were recorded in both the average daily value of

8 In this respect, during that period the European Central Bank raised its key interest rates twice (in March and June) by 25 basis points each time.
9 The increase in yields was more pronounced for long-term bonds than for those with short and medium maturities.
10 Reaching 70 basis points in mid-March 2008, on account of the reasons mentioned above.
11 The Book-Entry Securities System of the Bank of Greece processes, apart from HDAT transactions, over-the-counter transactions between banks and their customers.

Table VII.2 Value and structure of transactions in government securities in HDAT

Period		Average daily value of total transactions (million euro)	Percentage share in total value of transactions[1]								
			Treasury bills	Government bonds							
				3-year	5-year	10-year	12-year	15-year	20-year	23-year	32-year
2007	Jan.	2,923.3	0.1	4.2	7.7	72.4	0.8	1.0	4.8	0.0 [3]	9.0
	Feb.	2,383.7	0.0 [2]	4.4	8.1	72.6	0.3	1.5	4.1	0.1	8.9
	March	2,841.1	–	3.4	16.1	65.6	0.4	1.6	5.0	0.1	7.8
	April	3,104.3	0.0 [2]	1.9	12.2	73.2	0.1	2.5	3.9	0.1	6.1
	May	2,694.1	0.0 [2]	1.9	14.3	67.5	0.4	5.5	3.0	0.2	7.2
	June	2,802.3	0.0 [2]	2.9	16.6	63.3	0.1	5.2	3.0	0.2	8.7
	July	2,533.6	1.6	2.0	17.5	64.2	0.1	4.0	2.6	0.2	7.8
	Aug.	1,292.5	–	3.5	11.1	60.7	0.1	6.9	5.2	0.2	12.3
	Sept.	1,717.5	–	3.1	17.1	57.3	0.2	7.1	3.5	0.1	11.6
	Oct.	1,771.7	–	2.7	14.7	64.9	0.3	5.8	2.0	0.1	9.5
	Nov.	1,834.2	–	3.8	15.4	57.8	0.5	8.6	2.8	0.3	10.8
	Dec.	1,124.4	–	3.0	17.0	53.2	0.2	7.4	6.6	0.0 [3]	12.6
	Jan.-Dec.	2,251.9	0.2	3.1	14.0	64.4	0.3	4.8	3.9	0.1	9.4
2008	Jan.	1,987.9	–	2.1	14.9	59.3	0.3	7.8	4.8	0.3	10.8
	Feb.	1,967.1	–	4.0	11.7	56.7	0.4	10.4	5.2	0.3	11.3

1 Based on initial maturity.
2 The average daily value of transactions in Treasury bills amounted to €0.26 million in February 2007, €1.37 million in April 2007, €0.24 million in May 2007 and €1.19 million in June.
3 The average daily value of transactions in the 23-year bond amounted to €0.5 million in January 2007 and €0.3 million in December 2007.
Source: Bank of Greece.

transactions and the value of funds raised through the stock market (see Table VII.3). Driving these positive developments in the Athens Exchange (Athex) were domestic factors such as the Greek economy's relatively strong growth, the satisfactory profitability of listed firms, the favourable prospects created by business initiatives in several branches, and the ongoing structural reforms in companies owned or co-owned by the public sector.

However, despite the overall increase in share prices in the Athex in 2007, there were periods of strong declines and heightened volatility, mainly in the second half of the year, reflecting investors' concerns about the impact of the international financial turmoil. Concerns were intensified by the downgrading of the credit rating of several products linked to housing loans (of the US market), the write-off of a considerable part of such loans by foreign banks, as well as structured investment product valuation losses and fears that the turmoil could spill over to the non-financial sector. Although the Greek stock market was affected similarly to foreign stock markets during price falling periods, it then recovered at a stronger pace. Particularly important was

Table VII.3 Stock market aggregates

Year	Share price indices[1] Composite (1980 =100)	Banks (30.12.05 =5,000)	Average daily value of transactions[2] (million euro)	Market capitalisation (million euro) Shares	Bonds[3]	Total	Market capitalisation (percentage of GDP) Shares	Bonds[3]	Total	Funds raised through the Athens Exchange (ATHEX)[4] (million euro) Listed companies	New companies	Total
2003	2,263.6	4,246.9	141.1	84,547	135,219	219,766	49	79	128	317	61	378
2004	2,786.2	6,129.0	140.8	92,140	157,905	250,045	50	85	135	397	79	476
2005	3,663.9	7,904.2	209.3	123,033	178,925	301,958	62	90	152	2,906	61	2,967
2006	4,394.1	6,194.5	343.3	157,928	191,549	349,477	74	90	164	3,396	86	3,482
2007	5,178.8	7,296.4	480.0	195,503	195,322	390,825	85	85	170	9,988	146	10,134

1 At year-end.
2 In shares; not including transactions in existing shares.
3 Comprising Greek Treasury bills and government bonds, bank bonds and corporate bonds.
4 Through capital increase and issuance of new shares. Subscriptions to new capital are entered on the last day of the subscription period.
Sources: ATHEX, Bank of Greece calculations and (for GDP) Ministry of Economy and Finance.

the fact that Greek firms and especially banks had very limited exposure to high-risk complex investment instruments associated mostly with the aforementioned housing loans in the US subprime mortgage market.

Investors' worries due to the turmoil continued into the first quarter of 2008, leading to stock price declines both in the Athens Exchange and globally.

In more detail, between end-December 2006 and end-December 2007 the Athex composite index rose by 17.9%, while its average annual level in 2007 was 22.3% higher than in 2006. Its trough was recorded on 5 March 2007 (at 4,344.79 points), and its peak on 31 October 2007 (5,334.50 points). Compared with the composite index, higher rises were seen in the subindices of small capitalisation (20.1%) and medium capitalisation (19.4%), while the big capitalisation subindex lagged behind (15.8%).[12]

Compared with share prices in the euro area, the Athex composite index outperformed the Dow Jones Euro Stoxx Broad index (4.9%).[13] Also, with share prices rising faster than corporate earnings, the Athex P/E ratio stood higher (21) than both its level at end-2006 and the corresponding ratio for the Dow Jones Euro Stoxx Broad index (13), which decreased slightly compared with end-2006. The dividend yield of the composite index remained almost at the levels of 2006 (3%), i.e. similar to that of the Dow Jones Euro Stoxx Broad index.[14] Moreover, the correlation between these two indices was high,[15] mainly during the periods in which share prices declined.

12 Regarding sectoral indices, increases were seen in utilities (78.9%), healthcare (33.8%), industrial products and services (20.6%), banks (17.8%) and telecommunications (11.8%), while the subindices of technology (–18.3%), constructions (–10.1%) and oil-gas (–2.7%) dropped.
13 For stock market developments in the euro area see Chapter V.5. The Athex composite index also performed better than the Standard & Poor's 500 index in the United States, which changed by 3.5% (or –6.6% in euro terms).
14 For the P/E ratio and dividend yields, the source of data is the Bloomberg database.
15 Using daily percentage changes, the correlation coefficient between the Athex composite index and the Dow Jones Euro Stoxx Broad index rose to 0.75 in 2007, from 0.59 in 2006 and an average of 0.55 for the past five years.

The average daily value of transactions in shares increased considerably (by 40%) in 2007[16] compared with 2006 (see Chart VII.3). Transactions in the big capitalisation segment and in banking shares respectively accounted for about 75% and 50% of total transactions. The share marketability index[17] also developed similarly, rising to an average of 5.8% in 2007 from 5.5% in 2006, although it reached a year low at end-December.

Once more, foreign investors were the key drivers of the strength of the Athex in 2007, accounting for more than 55% of the value of total transactions (or even 60% in big capitalisation shares). Their growing activity in the domestic stock market is also reflected in their share in the overall market capitalisation of the Athens Exchange. According to Central Securities Depository data, at end-December 2007 foreign investors[18] held 51.8% of the capitalisation of the Athex, compared with 47% at end-December 2006. Reflecting these developments, net inflows for investment in Athex-listed shares have been increasing in the past few years; according to balance of payments data, net inflows came to €8.1 billion in 2007, i.e. 35% higher than in 2006.[19]

The positive performance of the Greek stock market contributed to a considerable increase in the total market capitalisation of Athex-listed shares, which exceeded the capitalisation of Athex-quoted bond issues and at the end of 2007 came to €195 billion or 85% of GDP (see Table VII.3). This reflected mainly higher prices, but also – in contrast with previous years – increased volumes of IPOs and secondary offerings.

In more detail, total funds raised through the stock market almost tripled in 2007 and reached €10,134 billion (see Table VII.3). Although this increase stemmed mainly from the banking sector, accounting for about 80% of total funds, the funds raised by the non-bank sectors practically quadrupled compared with 2006 and concerned twice as many firms (2007: 29 firms, 2006: 14 firms). Of these, four firms (2006: 1 firm) were new entrants, raising €470 million (2006: €86 million).

The banking sector, the most important sector of the Athex, performed quite well, accounting for 41.6% of total market capitalisation at end-2007, against 40.7% at end-2006. In more detail, the Athex banking sector index rose by 17.8%, i.e. more than the composite index, while the average daily value of transactions in bank shares rose by 45.1% compared with 2006, i.e. faster than the value of transactions for the entire market, and reached €215 million. However, the average marketability of bank shares in 2007 (5.2%) fell short of both the level of 2006 (5.4%) and the corresponding index for the market as a whole. Positive developments in the banking sector were mainly driven by the buoyant profitability of banking groups (up 40.4%)[20] due to the expansion of their activities in the domestic and foreign markets, mainly in South Eastern Europe, Turkey and Egypt, as well as by Greek banks' limited exposure to high-risk complex investment in-

16 The value of transactions in Greek government bonds and corporate bonds remained very subdued.
17 Number of shares traded to total number of shares listed.
18 61.6% of foreign investors come from EU countries, mainly Luxembourg (17.5%) and the United Kingdom (14.7%), while 19.8% are investors from the United States.
19 However, the first quarter of 2008 saw net outflows of investment in Athex-listed shares.
20 Refers to Greek banking groups' pre-tax profits. See Chapter XI for a detailed discussion of the profitability and efficiency of Greek commercial banks.

struments. On account of the above, the P/E ratio decreased to 18 at end-December 2007, from 19 at end-December 2006, while banks' dividend yield increased and stood at approximately 3.4% at end-2007 (2006: 2.5%).

In parallel, 2007 saw a further enhancement of the Greek capital market's regulatory framework. More specifically, Law 3556/2007 came into effect, aimed to ensure improved transaction transparency and investor protection, mainly by requiring securities issuers (through their main shareholders, board members or other competent persons) to regularly inform investors about corporate actions and developments, as well as by establishing reporting requirements, including quarterly financial statements and semi-annual reports.

Moreover, Law 3606/2007 transposed into Greek legislation Directive 2004/39/EC on markets in financial instruments (MiFID), which seeks to ensure higher investor protection by setting specific transparency and disclosure rules, and allows banks and investment firms to carry out transactions in financial instruments even outside regulated stock markets. In implementation of the MiFID, the Hellenic Capital Market Commission issued several Decisions regarding rules of conduct, organisational requirements, as well as disclosure obligations for investment firms, while the Bank of Greece issued Governor's Act 2597/2007, which amended and supplemented Governor's Act 2577/2006 on internal audit systems.

At the same time, the MiFID provisions ensure that market participants meet high professional standards, by requiring authorisation from the Bank of Greece and the Hellenic Capital Market Commission. In addition, in line with international standards, the Bank of Greece Governor's Act 2599/2 November 2007, issued following a recommendation by the Hellenic Capital Market Commission, abolished the ceiling of €1 million per customer regarding financing by credit institutions and Athex members for the purchase of shares.[21]

Other institutional developments in 2007 included the launch of the "Alternative Market",[22] which expands the range of available investment tools, and the authorisation and listing of the first Exchange Traded Fund (ETF) on the Athex as of January 2008.[23] Finally, Decision 3/403/8 November 2006 of the Hellenic Capital Market Commission introduced Joint Investor Shares, held by more than one beneficiary under a single investor identification code and functioning similarly to the joint bank accounts of Law 5638/1932.

3 THE MUTUAL FUNDS MARKET

Activity in the mutual funds market decreased for a third consecutive year, with total assets standing at €20.7 billion at end-2007, 15.2% lower than at end-2006 (see Table VII.4). This development reflected net

21 This abolition is in line with the new regulatory environment following Law 3601/2007 on the capital adequacy of credit institutions and investment firms implementing "Basel II", and Law 3606/2007 implementing the MiFID.
22 This market is addressed to small- and medium-sized enterprises and involves less strict criteria than those applicable to the other Athex markets.
23 The assets of ETFs reproduce the composition of stock exchange indices and their units are traded on regulated stock markets. The ETF traded on the Athex as of 24 January 2008 tracks the FTSE/Athex 20 index.

Table VII.4 Mutual funds: number and assets[1]

(million euro)

Type of mutual fund	2006		2007		Percentage change in value compared with previous year	Percentage of total assets	
	Number	Assets value	Number	Assets value		2006	2007
Money market funds	**30**	**5,894**	**26**	**7,969**	**35.2**	**25.7**	**38.5**
Domestic	25	1,408	21	1,012	–28.1	6.1	4.9
Foreign	5	4,486	5	6,957	55.1	19.6	33.6
Bond funds	**66**	**5,881**	**62**	**3,996**	**–32.1**	**25.6**	**19.3**
Domestic	31	2,045	24	1,084	–47.0	8.9	5.2
Foreign	35	3,836	38	2,912	–24.1	16.7	14.1
Equity funds	**105**	**6,327**	**93**	**5,198**	**–17.8**	**27.5**	**25.1**
Domestic	63	5,143	58	4,445	–13.6	22.3	21.5
Foreign	42	1,184	35	753	–36.4	5.2	3.6
Balanced type funds	**46**	**1,918**	**49**	**2,099**	**9.4**	**8.4**	**10.1**
Domestic	27	881	28	955	8.4	3.8	4.6
Foreign	19	1,037	21	1,144	10.3	4.6	5.5
Funds of Funds	**22**	**2,950**	**30**	**1,439**	**–51.2**	**12.9**	**7.0**
Equity type	10	593	10	464	–21.8	2.6	2.2
Balanced type	9	1,928	17	770	–60.1	8.4	3.7
Bond type	3	429	3	205	–52.2	1.9	1.1
Total	**269**	**22,970**	**260**	**20,701**	**–9.9**	**100.0**	**100.0**

1 At year-end. Excluding the two mutual funds managed by "Pension Mutual Fund Management S.A.".
Source: Bank of Greece.

outflows[24] that more than offset the rise in unit prices.[25]

Among individual categories of mutual funds, strong asset declines were observed in bond funds and equity funds (–€1.9 billion and –€1.2 billion, respectively), while the assets of funds of funds decreased for the first time since they were launched in mid-2005, by €1.5 billion (see Table VII.4). By contrast, the assets of money market funds increased (by a considerable €2.1 billion) as did those of balanced funds, although to a lesser degree (by €0.2 billion). This development reflected investors' preference for safer investments and more liquid assets, in the context of the ongoing financial turmoil and the rising money market interest rates that sustained returns on money market funds at satisfactory levels.

Owing to the above developments, in 2007 money market funds were the most important category of mutual funds (based on their assets), as their share in the total value of the assets of mutual funds grew considerably (2007: 38.5%, 2006: 25.7% – see Table VII.4). A small increase was recorded in the respective share of balanced funds, which however remains at just 10%. In all other categories asset market shares declined, with equity and bond funds accounting for about 20% and 25% respectively. A stronger decline was seen in funds of funds, the asset share of which fell to almost half (see Table VII.4).

24 Cumulative capital outflows of €3.3 billion were recorded in 2007, mostly concentrated in the fourth quarter of the year.
25 It should be noted that in 2007 the weighted average yields by category of mutual funds were as follows: equity funds: 15.3%; balanced funds: 5.0%; funds of funds: 2.7%; money market funds: 3.2%; and bond funds: 0.4%.

In 2007, as in previous years, demand for mutual funds was mostly covered by sales of shares of mutual funds already operating at end-2006. In the course of the year, 18 new entrants (6 funds of funds, 5 balanced funds, 4 bond funds and 3 equity funds) joined the market, while scale economy considerations led to mergers between existing mutual funds of a similar type. Thus, the total number of mutual funds at end-2007 dropped to 260, from 269 at end-2006.

The investment behaviour of mutual funds in the course of 2007 was mainly characterised by a shift away from domestic and foreign equity, government bonds and units of other mutual funds, towards foreign corporate bonds, as well as deposits and cash.

Unlike the Greek mutual funds market, the European market enjoyed strong growth once again in 2007.[26] The total assets of European mutual funds rose by 4.2% compared with end-2006 and stood at €6.2 trillion, while net inflows came to €170 billion. However, despite the increase recorded at the aggregate level, in roughly half the countries the assets of mutual funds decreased. Moreover, inflows took place in the first half of the year, while the second half saw outflows.

At end-2007, the Greek mutual funds market ranked 18th among 25 European countries, with a share of 0.3% in total assets.

26 According to European Fund and Asset Management Association (EFAMA) data, which cover 25 countries.

VIII PUBLIC FINANCE

1 THE PUBLIC SECTOR BORROWING REQUIREMENT AND ITS FINANCING

1.1 SUMMARY OF DEVELOPMENTS

According to the latest available data,[1] the general government deficit on a national accounts basis increased to 2.8% of GDP in 2007, compared with 2.6% in 2006 and a targeted[2] 2.2% of GDP (see Table VIII.1). The evolution of the deficit was affected, among other things, by a series of extraordinary events, which are detailed further below.

The widening of the deficit stemmed mainly from central government, the deficit of which increased by almost 0.4 percentage point of GDP in comparison with 2006 to 4.3% of GDP. By contrast, the consolidated surplus of social security organisations, local government and other public entities increased from 1.3% of GDP in 2006 to 1.4% in 2007 (see Table VIII.1); however, this surplus fell short of the budget target by almost 0.3 percentage point of GDP.

Specifically, the central government deficit on an administrative basis[3] rose from 3.8% of GDP in 2006 to 4.6% in 2007 (see Table VIII.1). State budget developments are discussed in Section 2 of this chapter.

The cash deficit (borrowing requirement) of the central government, as shown by movements in central government's and OPEKEPE's accounts, also rose from 4.9% of GDP in 2006 to 5.9% in 2007 (see Table VIII.1). It should be pointed out that central government data on an administrative or a cash basis are only comparable with central government aggregates on a national accounts basis and not to general government data which, as is known, include

1 These data were notified by Greece to Eurostat at end-March 2008, in the context of the Excessive Deficit Procedure.
2 The initial target for the general government deficit in 2007 was 2.4% of GDP, but following the revision of GDP it corresponded to 2.2% of GDP.
3 State Budget data compiled by the State General Accounting Office on an administrative basis.

Table VIII.1 General and central government deficits

(percentage of the revised GDP)

	2002	2003	2004	2005	2006	2007*
General government deficit[1,2] (national accounts data – convergence criterion)	**–4.7**	**–5.6**	**–7.4**	**–5.1**	**–2.6**	**–2.8**
– Central government	–7.2	-8.1	–9.4	–6.1	–3.9	–4.3
– Social security organisations and local government	2.4	2.5	2.1	0.9	1.3	1.4
Central government deficit[3] (administrative data)	**–3.4**	**–5.7**	**–6.9**	**–5.7**	**–3.8**	**–4.6**
Central government deficit[4] (cash basis)	**–4.5**	**–6.1**	**–8.4**	**–7.3**	**–4.9**	**–5.9**

1 Ministry of Economy and Finance data, as submitted to the European Commission (Excessive Deficit Procedure).
2 Figures may not add up due to rounding.
3 State General Accounting Office data, as contained in the state budget.
4 Bank of Greece data, reffering to the borrowing requirement of central government on a cash basis. The borrowing requirements of public entities are now calculated by the NSSG on the basis of a quarterly survey among these entities regarding their financial results (revenue-expenditure) and financial situation (borrowing, investment in securities, deposits, etc.), a method considered more reliable than the bank statistics used previously.
* Provisional data.
Sources: Bank of Greece, Ministry of Economy and Finance and NSSG.

also social security organisations, local government and other public entities.

1.2 THE CENTRAL GOVERNMENT BORROWING REQUIREMENT

The aforementioned increase in the cash deficit (to 5.9% from 4.9% of GDP) is attributable to the ordinary budget and the Payment and Control Agency for Guidance and Guarantee Community Aid (OPEKEPE). The higher deficit of the ordinary budget was mainly due to the overrun of primary expenditure, while that of OPEKEPE reflected the payment of the total amount (about €1,600 million) of the "single aid" to the farmers at the beginning of the subsidies period[4] (December 2007). By contrast, the public investment budget deficit fell considerably, owing to non-budgeted revenue of €982 million from the EU Structural Funds (see Table VIII.2).

The central government borrowing requirement was financed in an environment which, especially in the second half of the year, was characterised by the international financial turmoil and pressures on interest rates. The weighted average interest rate on Greek government loans concluded in 2007 rose to 4.4% from 3.8% in 2006 and 3.2% in 2005. Furthermore, the international turmoil led to a repricing of risks even for euro area countries. For this reason, government bond yield spreads against Germany increased considerably in

4 The subsidies period starts in December and continues up to May of the following year.

Table VIII.2 Net borrowing requirement of central government on a cash basis[1, 2, 3]

(million euro)

	2004	2005	2006	2007*
Central government	**15,605**	**14,424**	**10,467**	**13,592**
% of GDP	***8.4***	***7.3***	***4.9***	***5.9***
– State budget	15,377	14,793[6]	11,500[7]	12,432[9]
(Ordinary budget)[4]	8,841	10,033	7,020	8,512
(Public investment budget)	6,536	4,760	4,480	3,920
– OPEKEPE[5]	228	–369	–1,033[8]	1,160[10]

1 This table shows the borrowing requirement of central government on a cash basis. For the borrowing requirements of public entities see footnote 4 in Table VIII.1.
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) from 3 September 2001.
6 Including a grant of about €2,586 million to hospitals, expenditure (of €1,055.2 million) for the capital increase of the Agricultural Bank of Greece, as well as proceeds of €1,239.3 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.
7 Including €149.7 million from EETT revenue settlement, €299.3 million from the decrease in the capital of the Postal Savings Bank, €34 million from the decrease in the capital of the Agricultural Bank, €290 million from additional dividends of the Deposits and Loans Fund, €323 million from the sale of Agricultural Bank shares, €597.4 million from the sale of Postal Savings Bank shares and €364.4 million from the sale of Emporiki Bank shares.
8 The OPEKEPE balance for 2006 is high, because the Ministry of Rural Development concluded a loan of approximately €600 million in December and made advance payments to farmers. This amount would be offset within 2007 by OPEKEPE, once final payment orders to beneficiaries were prepared.
9 Including privatisation proceeds of €1,107.5 million and €502.8 million from the sale, respectively, of OTE and Postal Savings Bank shares, as well as an expenditure of €264.9 million and €465.7 million for aid to the fire-stricken and a grant to OGA, respectively.
10 In December 2007 farmers received the "single aid", which totalled €1,600 million.
* Provisional data and estimates.
Source: Bank of Greece.

Table VIII.3 Financing of the borrowing requirement of central government

(million euro)

	2004		2005		2006		2007*	
	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
Greek Treasury bills and government bonds[1,2]	16,829	107.8	15,325	106.2	11,342	108.4	15,310	112.6
Change in the balances of central government accounts with the banking system[3]	–901	–5.8	–1,224	–8.5	–1,145	–10.9	418	3.1
External borrowing[4]	–323	–2.1	323	2.2	270	2.6	–2,136	–15.7
Total	**15,605**	**100.0**	**14,424**	**100.0**	**10,467**	**100.0**	**13,592**	**100.0**

1 Comprising Treasury bills and government bonds issued in Greece, as well as bonds convertible into shares.
2 Not including bonds issued by the Greek government for debt repayment to the Social Insurance Institute – IKA (Law 2972/2001, article 51). See also footnote 3 in Table VIII.2.
3 Central government's accounts with the Bank of Greece and credit institutions, as well as OPEKEPE's account.
4 Comprising borrowing abroad and securities issuance abroad, as well as the change in government deposits with foreign banks. Excluding non-residents' holdings of bonds issued in Greece.
* Provisional data.
Source: Bank of Greece.

several European countries. In this context, the yield spread of the Greek ten-year government bond against the German bond rose to 29 basis points at end-2007 from 27 basis points at end-2006 (see also Chapter VII.1.2).

For the most part, the central government borrowing requirement was financed through the issuance of long- and medium-term bonds in the domestic market; and to a lesser extent through domestic financial institutions. By contrast, central government liabilities to foreign investors dropped substantially (see Table VIII.3). *It should be pointed out that "external borrowing" excludes non-residents' holdings of euro-denominated bonds issued in Greece (these holdings continued to increase – see Chapter IX.3.2).*

2 THE STATE BUDGET

The state budget deficit (on an administrative basis) increased from €8,232 million or 3.8% of GDP in 2006 to €10,521 million or 4.6% in 2007 (see Table VIII.7). The increase in the deficit was, inter alia, attributable to extraordinary factors, such as the payment of additional contributions to the Community Budget following the upward revision of past GDP figures; the costs of fighting last summer's fires; the cost of holding snap parliamentary elections; and the settlement of claims and liabilities of the State vis-à-vis Olympic Airways. At the same time, however, extraordinary receipts from the EU Structural Funds had a beneficial effect on the deficit.

The payment of additional contributions (€1,108 million) to the Community Budget, following GDP revision, was practically offset by extraordinary revenue of €982 million from the EU Structural Funds and as a result the net burden on the state budget was limited to €126 million. The settlement of claims and liabilities between the State and Olympic Airways implied extra ordinary expenditure of €403 million, but the balance at the general government level was not essentially affected[5]. The cost of fighting the fires and providing emergency relief to fire victims as well as the cost of holding snap parliamentary elections implied extraordinary expenditure of €457 million. If the total of these extraordinary items is not taken into account, the overrun of ordinary budget expenditure is limited to €400 million.

2.1 ORDINARY BUDGET REVENUE

Ordinary budget revenue rose by 6.3% in 2007 to €51,775 million (see Table VIII.4). Excluding the ("notional") revenue from Olympic Airways (OA), revenue comes to €51,338 million, which is close to the budget target, and the rate of change comes to 5.5%, showing no significant shortfall in 2007.

As in 2006, the positive performance of revenue (without taking OA related revenue into account) stemmed mainly from indirect taxes, which grew by 8.6%.[6] Receipts from direct taxes also increased, by 5.0%, while non-tax revenue declined by 13.7%.

The strong rise in indirect tax revenue is partly attributable to the measures taken in 2006,[7] the impact of which became visible in annual figures in 2007. Specifically:

- Receipts from the special consumption tax on liquid fuel rose by 9.9%, compared with an increase of 5.2% in 2006, and reached €2,867 million.

- Revenue from tobacco taxation increased by 6.9% to €2,581 million. This, apart from the aforementioned increase in the tax rate, also reflected an across-the-board increase in retail prices (effected by tobacco industries)[8] in September 2006. Furthermore, receipts from mobile telephony duties rose by 112.5%.

Other factors that played a role in favourable indirect tax developments were the following:

- Revenue from VAT (on domestic and imported goods) rose by 9.8%, reflecting an increase in the nominal value of retail sales (by 5.7%), the intensification of tax controls and the increase in the special consumption tax rates on fuel and tobacco.[9]

- Receipts from car registration fees increased by 11.6%, owing to a rise of 4.3% in the number of new passenger car registrations in 2007, as well as an increase in average engine capacity.

5 Specifically, the State paid €840 million to Olympic Airways, by offsetting them against payments by OA of tax arrears (€437 million), contributions to IKA, amounts arising from guarantees called in and paid by the State, airport duties and a small amount (€6.5 million) to the Olympic Tourist Company. In total, Olympic Airways paid €840 million too, of which €833 million to general government.
6 It should be noted that the "revenue" from Olympic Airways (€437 million) has been allocated to various categories of revenue of Table VIII.4 and the rates of change reported (in that table) take this revenue into account. The main text reports the rates of change without the "revenue" from Olympic Airways.
7 The special consumption tax on liquid fuel rose by 5.8% on 1st July 2006 and by another 5.8% on 1 January 2007. Also, on 27 July 2006 the minimum special consumption tax on cigarettes rose from 65% to 75% of the amount of tax which corresponds on the most demanded price category. Finally, as from 1 October 2006 the mobile telephony duty was increased by 36% to 127%.
8 The rise in the minimum special consumption tax in July had affected the price of cheap brands only.
9 As VAT is imposed on the sum of the factory price and the special consumption tax, an increase in the special consumption taxes of tobacco, alcohol and fuel led to the automatic increase in the receipts from VAT.

Table VIII.4 Ordinary budget revenue[1]

(million euro)

	2004	2005	2006	2007*	Percentage changes 2005/2004	2006/2005	2007*/2006
I. Direct taxes	**16,484**	**18,371**	**18,704**	**19,831**	**11.4**	**1.8**	**6.0**
1. Income tax	**13,307**	**14,166**	**15,006**	**16,091**	**6.5**	**5.9**	**7.2**
– Personal	7,785	8,292	9,275	10,160	6.5	11.9	9.5
– Corporate	4,724	4,731	4,438	4,660	0.1	–6.2	5.0
– Special categories of income tax	798	1,143	1,293	1,271	43.2	13.1	–1.7
(tax on shipping)	9	9	9	12	0.0	0.0	33.3
(tax on interest income from bonds, deposits, etc.)	436	439	441	492	0.7	0.5	11.6
2. Wealth taxes	**422**	**548**	**464**	**434**	**29.9**	**–15.3**	**–6.5**
3. Direct taxes collected on behalf of third parties	**1**	**2**	**2**	**5**	**100.0**	**0.0**	**150.0**
4. Tax arrears	**1,569**	**2,410**	**1,848**	**1,742**	**53.6**	**–23.3**	**–5.7**
5. Extraordinary and other direct taxes	**1,185**	**1,245**	**1,384**	**1,559**	**5.1**	**11.2**	**12.6**
II. Indirect taxes	**23,000**	**23,722**	**26,287**	**28,572**	**3.1**	**10.8**	**8.7**
1. Customs duties and special contributions on imports-exports	**277**	**260**	**276**	**326**	**–6.1**	**6.2**	**18.1**
2. Consumption taxes on imports	**2,624**	**2,661**	**2,922**	**3,233**	**1.4**	**9.8**	**10.6**
– VAT	1,716	1,771	2,026	2,236	3.2	14.4	10.4
– Cars	852	833	839	936	–2.2	0.7	11.6
– Special consumption tax	56	58	57	61	2.9	–1.0	7.0
3. Consumption taxes on domestic products	**18,168**	**18,547**	**20,372**	**22,189**	**2.1**	**9.8**	**8.9**
– Turnover tax	269	270	296	17	0.3	9.7	–94.3
– VAT	12,025	12,360	13,799	15,145	2.8	11.6	9.8
– Fuel	2,462	2,478	2,608	2,867	0.6	5.2	9.9
– Tobacco	2,242	2,257	2,415	2,581	0.7	7.0	6.9
– Road duties	693	706	794	820	1.8	12.5	3.3
– Special levies and contributions on cars	82	60	72	75	–27.0	20.2	4.2
– Other[2]	395	417	388	684	5.6	–7.0	76.3
4. Transaction taxes	**1,514**	**1,687**	**1,867**	**2,243**	**11.4**	**10.7**	**20.1**
– Capital transfers	799	905	1,045	1,323	13.3	15.5	26.6
– Stamp duties	624	681	710	684	9.1	4.3	–3.7
– Licence fees for gambling	91	101	112	236	11.0	10.9	110.7
5. Other indirect taxes	**417**	**567**	**850**	**581**	**36.0**	**49.9**	**–31.6**
III. Total tax revenue	**39,484**	**42,093**	**44,991**	**48,403**	**6.6**	**6.9**	**7.6**
IV. Non-tax revenue	**2,571**	**2,667**	**3,694**	**3,372**	**3.7**	**38.5**	**–8.7**
V. Total ordinary budget revenue	**42,055**	**44,760**	**48,685**	**51,775[3]**	**6.4**	**8.8**	**6.3**

1 For comparability purposes, tax refunds have not been deducted from revenue.
2 Including the special consumption tax on domestic products.
3 Including "notional" revenue of €437 million arising from the settlement of positions vis-à-vis the Olympic Airways.
* Provisional data.
Source: State General Accounting Office.

- Revenue from real estate transfer tax (included in "capital transfers" in Table VIII.4), grew by 24.1%, compared with 12.2% in 2006, and reached €1,147 million. This large rise is attributable to deferred payments (until end-February 2007) of tax on real estate transfers effected in December 2006. Moreover, the strong demand for real estate observed in 2005 and 2006 continued into the first months of 2007, most probably in anticipation of a raise in objective prices,[10] expectations of an increase in housing loan rates and in a rush interest in the purchase of VAT-exempt newly-built residences.

- Revenue from tax on stock exchange transactions (which are aggregated with real

10 The increase had been pre-announced and eventually took place on 1 March 2007.

estate transfer tax and are reported under "capital transfers" in Table VIII.4), rose by 45.5%, compared with a rise of 48.8% in 2006, to €176 million. This reflected a considerable rise both in share prices and in the volume of transactions in the Athens Exchange in 2007.

Direct tax revenue increased (without revenue from OA) by 5.0%, in spite of the still under way reduction in corporate and personal income tax rates. Specifically:

- Receipts from personal income tax rose by 9.5% to €10,160 million, despite the slight decrease in tax rates and the widening of tax brackets as of 1 january 2007. It should be noted that in 2007 these arrangements affected only receipts from tax withholding (increase of 8.6%, compared with 13.4% in 2006), while in 2008, with the review of personal returns (for 2007 incomes) the effect on receipts will be greater. This considerable rise in receipts is partly associated with the increase in nominal earnings and employment, as well as with the abolition of the 15% tax rate and the merging of the relevant bracket with the next higher on the scale (which is subject to a rate of 29%). Thanks to the streamlining of the taxation framework and intensified efforts to curb tax evasion, personal income tax accounted for 51.2% of total direct tax receipts in 2007, compared with 39.6% in 2000.

- Receipts from corporate income tax rose by 5.0%, although the relevant tax rate[11] was cut from 32% to 29%. This positive development is attributable to an increase in the tax advance payment, a large increase in profits[12] in 2006, as well as the abolition as from 2007 of the discount (1.5% on the tax amount) for one-off payment of the tax.

In contrast, revenue from the remaining categories of direct taxes (tax on parental donations, gifts and inheritances, tax arrears etc.) declined (see Table VIII.4).

Finally, non-tax revenue (excluding "revenue" from Olympic Airways) fell by 13.7% in 2007, against a budgeted increase of 11.0%, mainly reflecting a base effect from a non-concurrent extraordinary non-tax revenue of €773 million in 2006.

2.2 ORDINARY BUDGET EXPENDITURE

Ordinary budget expenditure increased by 11.2% to €58,365 million in 2007 (see Table VIII.5). This amount includes extraordinary expenditure totalling €2,405 million,[13] without which the growth rate comes to 6.6%, against a budgeted 5.8%. That is, excluding extraordinary payments, the expenditure overrun is limited to €400 million.

Primary expenditure[14] under the ordinary budget, excluding the aforementioned extraordinary payments, increased by 7.6%,

11 As is known, the tax rate was reduced from 35% to 32% in 2005, to 29% in 2006 and to 25% in 2007. The 29% rate was imposed on profits of 2006 which were taxed in 2007 and the 25% rate applies to the profits of 2007 that will be taxed in 2008.

12 The net pre-tax profits of a sample of 472 businesses of the non-financial sector increased by 15.9%, while the increase in the profits of the financial sector was even larger (see *Annual Report 2006*, p. 146).

13 This amount is broken down as follows: Additional contributions owing to the revision of the GDP: €1,108 million; settlement of liabilities to Olympic Airways: €840 million; cost associated with the fires and emergency relief to fire victims: €303 million; holding parliamentary elections: €154 million.

14 Including payments for tax refunds.

Table VIII.5 Outlays under the ordinary budget and the public investment budget

(million euro)

	2004	2005	2006	2007*	Percentage changes 2005/2004	2006/2005	2007*/2006
I. Outlays under the ordinary budget	**48,288**	**51,239**	**52,508**	**58,365**	**6.1**	**2.5**	**11.2**
1. Personnel outlays	18,425	19,325	20,427	22,141	4.9	5.7	8.4
of which: pensions	(4,065)	(4,211)	(4,576)	(5,052)	(3.6)	(8.7)	(10.4)
2. Interest payments[1]	9,464	9,774	9,589	9,791	3.3	–1.9	2.1
3. Payments to the European Union	2,030	2,224	2,172	3,265	9.6	–2.3	50.3
of which: for retroactive contributions	–	–	–	(1,108)			
4. Transfer of revenue collected on behalf of third parties	3,736	4,056	4,087	4,289	8.6	0.8	4.9
5. Tax refunds	2,799	2,554	2,392	2,623	–8.8	–6.3	9.7
6. Subsidies to farmers	555	634	694	730	14.2	9.5	5.2
7. Grants	8,721	9,960	10,600	11,967	14.2	6.4	12.9
– to social security organisations[2]	(6,454)	(7,593)	(7,784)	(8,632)	(17.6)	(2.5)	(10.9)
– to public enterprices	(2,267)	(2,367)	(2,835)	(3,073)	(4.4)	(19.8)	(8.4)
– to fire-stricken	–		–	(262)			
8. Other	2,558[3]	2,712[4]	2,547	3,559	6.0	–6.1	39.7
of which:							
– Olympic Airways	–	–	–	(840)			
– conduct of snap elections	–	–	–	(154)			
II. Outlays under the public investment budget	**9,522**	**7,524**	**8,184**	**8,803**	**–21.0**	**8.8**	**7.6**
1. Project implementation	3,633	2,260	2,060	. . .	–37.8	–8.8	. . .
2. Grants	5,821	5,206	6,058	. . .	–10.6	16.4	. . .
3. Administrative costs	68	58	66	. . .	–14.7	13.8	. . .
III. Total (I+II)	**57,810**	**58,763**	**60,692**	**67,168**	**1.6**	**3.3**	**10.7**
Primary expenditure under the state budget	48,346	48,989	51,103	57,377	1.3	4.3	12.3
Primary expenditure under the ordinary budget	38,824	41,465	42,919	48,574	6.8	3.5	13.2
Amortisation payments	**20,356**	**21,752**	**16,954**	**22,544**	**6.9**	**–22.1**	**33.0**
Ministry of National Defence programmes for the procurement of military equipment	**1,792**	**1,394**	**2,075**	**2,129**	**–22.2**	**48.9**	**2.6**

1 Including: "other expenditure" for public debt servicing.
2 Including expenditure for the implementation of social welfare measures (e.g. Social Solidarity Allouance for Pensioners —EKAS, allowance to families with many children, etc.).
3 Including €148 million for the preparation of the Olympic Games and €333 million for extraordinary allowances related to the conduct of the Olympic Games.
4 Including extraordinary expenditure of €345 million for the repayment a debt of the Greek State to ATE and expenditure of €39 million for an allowance to forest guards, granted retroactively following a court decision.
* Provisional data.
Source: State General Accounting Office.

compared with 3.5% in 2006, and reached €46,169 million. In relation to the initial target, this represented an overrun of €359 million. The remaining amount (€41 million) of the total overrun is attributable to interest payments.

Personnel outlays (which include healthcare and pensions) increased by 8.4% to €22,141 million (37.9% of total ordinary budget expenditure). This amount includes an extraordinary allowance to firemen of €41 million, as well as a grant to local government[15] of €115 million for part-time municipality employees, the staff of the Citizen Service Centres (KEP) and people with special needs. Without these amounts, the rate of change compared with 2006 is limited to 7.6%. In comparison with the

15 Until 2006 this grant was included in outlays for grants.

budget forecast personnel outlays (net of these extraordinary payments) recorded a small overrun of €134 million, which mainly stemmed from pension expenditure (€240 million) owing to the large number of retirements in 2007, as well as from health care expenditure for public servants (€148 million). By contrast, owing to the retirement of many employees, which was only partly offset by new recruitments, there were staff cost savings of €222 billion.

Interest payments increased by 2.1% to €9,791 million in 2007, about as much as the budget forecast (€9,750 million). Interest payments were only to a small degree affected by the rise in interest rates on new government borrowing in 2006 (by 0.6 percentage point), while the increase in interest rates in 2007, also by 0.6 percentage point, will affect interest payments from 2008 onwards.

Payments to the EU (excluding additional contributions due to GDP revision) fell by 0.7% to €2,157 million, against a budgeted €2,337 million. This reflected the lower contribution to the Community Budget on the basis of the GDP (–3.1% compared with the previous year), in spite of a 9.6% revision of GDP during 2007 (see also Table VIII.8).

Restitution of revenue to third parties (mainly municipalities and prefectures) rose by 4.9%, compared with a rise of 0.8% in 2006, and came to €4,289 million. Tax refunds rose by 9.7% to €2,623 million, exceeding the relevant budgeted amount by €423 million or 0.2% of GDP.

Outlays for government grants (to social security organisations, transport organisations and other entities), the second largest item of ordinary budget expenditure (20.5% of the total), increased by 12.9% to €11,967 million. This amount, however, includes extraordinary expenditure of €262 million for the emergency relief to fire victims. Excluding this amount, the rate of change is limited to 10.4%. This considerable increase is attributable to grants to social security organisations (+10.9%) owing to the large increase in OGA and EKAS pensions as from 1 January 2007.

Finally, "other outlays" increased by 39.7% and reached €3,559 million in 2007. This considerable rise mainly stemmed from extraordinary (notional) expenditure of €840 million for the settlement of government's debt to Olympic Airways. Excluding this item, the increase comes to 6.8%.

2.3 THE PUBLIC INVESTMENT BUDGET

In 2007 investment spending increased by 7.6% to €8,803 million, exceeding the budgeted amount (€8,750 million) by €53 million (see Tables VIII.5 and VIII.7).

Revenue under the public investment budget (mainly inflows from the EU Structural Funds) rose by 29.1% to €4,872 million, overshooting the budgeted amount (€3,890 million) by €982 million. This extraordinary revenue is attributable to the increased percentage of EU financing for projects, facing the risk of becoming ineligible for assistance under the 3rd Community Support Framework.

Following the particularly favourable developments in revenue, the public investment budget deficit fell to €3,391

Table VIII.6 Consolidated debt of general government[1]

(million euro)

	2002	2003	2004	2005	2006	2007*
Short-term	1,398	3,409	2,839	1,346	1,108	100
– securities	982	3,084	2,568	1,156	943	57
– loans	416	325	271	190	165	43
Medium- and long-term	156,974	163,860	179,342	192,757	202,298	215,588
– securities	134,040	140,922	156,969	170,863	180,968	196,226
– loans	22,934	22,938	22,373	21,894	21,330	19,362
Coin and deposits	515	454	521	563	612	674
Total	**158,887**	**167,723**	**182,702**	**194,666**	**204,018**	**216,362**
% of GDP	***100.8***	***97.9***	***98.6***	***98.0***	***95.3***	***94.5***
– domestic debt	154,190	164,341	180,199	191,919	201,962	214,404
(of which: debt to the Bank of Greece)[2]	*(9,561)*	*(9,018)*	*(8,488)*	*(7,988)*	*(7,991)*	*(7,520)*
– external debt[3]	4,697	3,382	2,503	2,747	2,056	1,916

1 According to the definition in the Maastricht Treaty.
2 The small increase recorded in this item for 2006 is due to the redenomination in euro of debt denominated in foreign currency, previously included in external debt. This is also reflected in the significant decrease in external debt.
3 Also see footnote 4 in Table VIII.3.
*Provisional data.
Sources: State General Accounting Office and Bank of Greece.

million, and being lower than the budget forecast (by €929 million or 0.4% of GDP) and last year's figure (by €478 million). As a percentage of GDP, the public investment budget deficit fell to 1.7% in 2007, from 2.1% in 2006 and 2.4% in 2005, contributing to the containment of the general government deficit.

3 PUBLIC DEBT

Following the revision of GDP, the consolidated debt of general government was reduced at end-2007 to 94.5% of GDP (9 percentage points of GDP smaller than before the revision),[16] from 95.3% of GDP in 2006. In comparison with 2006, the reduction of 2007 was 0.8 percentage point of GDP, while in 2006 the debt had declined by 2.7 percentage points of GDP (see Table VIII.6). This development reflects, inter alia, the reduction of general government primary surplus from 1.4% of GDP in 2006 to 1.2% in 2007.

Despite its considerable decrease due to the revision of GDP, the debt ratio remains at high levels (it is the second highest in the EU) and constitutes one of the most important sources of macroeconomic imbalance, particularly if account is taken of: (i) the anticipated heavy burden on the budget coming from ageing-related expenditure from 2015 onwards, (ii) the considerable increase in interest rates in the recent period; and (iii) the objective of reducing the debt-to-GDP ratio to below 60%.

The structural nature of the problem is also shown by the evolution of debt to date, which in the past 15 years has on average[17] remained at 109% of unrevised GDP (or at about 99% of revised GDP), in spite of the particularly

16 Based on the unrevised GDP, the debt-to-GDP ratio for 2007 would reach 103.4%.
17 The average level for the period 1993-2007 is 108.9% of the unrevised GDP or about 99.4% of the revised GDP.

Table VIII.7 Key fiscal aggregates

(million euro)

	2004	2005	2006	2007*	2008 budget	Percentage changes 2005/04	2006/05	2007*/06	budget* 2008/07
I. State budget									
Revenue[1]	**44,949**	**47,446**	**52,460**	**56,647[4]**	**62,602**	**5.6**	**10.6**	**8.0**	**10.5**
1. Ordinary budget	42,055	44,760	48,685	51,775[4]	58,070	6.4	8.8	6.3	12.2
Direct taxes	(16,484)	(18,371)	(18,704)	(19,831)	(22,040)	11.4	1.8	6.0	11.1
Indirect taxes	(23,000)	(23,722)	(26,287)	(28,572)	(32,605)	3.1	10.8	8.7	14.1
Other revenue	(2,571)	(2,667)	(3,694)	(3,372)	(3,425)	3.7	38.5	–8.7	1.6
2. Public investment budget	2,894	2,686	3,775	4,872	4,532	–7.2	40.5	29.1	–7.0
Expenditure[1]	**57,810**	**58,763**	**60,692**	**67,168[5]**	**70,908**	**1.6**	**3.3**	**10.7**	**5.6**
1. Ordinary budget	48,288	51,239[3]	52,508	58,365[5]	61,608	6.1	2.5	11.2	5.6
(Interest payments)[2]	(9,464)	(9,774)	(9,589)	(9,791)	(10,500)	3.3	–1.9	2.1	7.2
(Ordinary budget primary expenditure)	(38,824)	(41,465)[3]	(42,919)	(48,574)	(51,108)	6.8	3.5	13.2	5.2
2. Public investment budget	9,522	7,524	8,184	8,803	9,300	–21.0	8.8	7.6	5.6
Net deficit (–)/surplus (+)	**–12,861**	**–11,318**	**–8,232**	**–10,521**	**–8,306**				
% of GDP	**–6.9**	**–5.7**	**–3.8**	**–4.6**	**–3.4**				
1. Ordinary budget	–6,233	–6,479	–3,823	–6,590	–3,538				
2. Public investment budget	–6,628	–4,838	–4,409	–3,931	–4,768				
Primary deficit (–)/surplus (+)	**–3,397**	**–1,544**	**1,357**	**–730**	**2,194**				
% of GDP	**–1.8**	**–0.8**	**0.6**	**–0.3**	**0.9**				
Amortisation payments[2]	20,356	21,752	16,954	22,544	26,211	6.9	–22.1	33.0	16.3
Ministry of National Defence programmes for the procurement of military equipment[2]	1,792	1,394	2,075	2,129	1,800	–22.2	48.9	2.6	–15.5
GDP (at current prices)	185,225	198,609	213,985	228,949	245,374	7.2	7.7	7.0	7.2
II. General government (on a national accounts basis)									
Deficit ratio (% of GDP)	**–7.4**	**–5.1**	**–2.6**	**–2.8**	**–1.6**				
Primary deficit (–)/surplus (+) ratio[6] (% of GDP)	**–2.4**	**–0.8**	**1.4**	**1.2**	**2.4**				

1 For comparability purposes, tax refunds are included in expenditure rather than deducted from revenue, in line with the practice followed by the Ministry of Economy and Finance in recent years.
2 From 2003 onwards, interest and amortisation payments effected by the Ministry of National Defence are recorded in the off-budget item "Ministry of National Defence programmes for the procurement of military equipment".
3 Including a grant of €330 million to OTE's personnel insurance fund (TAP-OTE) and repayment of debt (€345 million) to the Agricultural Bank of Greece. These expenditure amounts were not included in the estimates of the Ministry of Economy and Finance for 2005, as published in the Introductory Report on the 2006 budget.
4 Including "notional" revenue of €437 million arising from the settlement of positions vis-à-vis the Olympic Airways.
5 Including "notional" expenditure of €840 million arising from the settlement of positions vis-à-vis the Olympic Airways, as well as additional contributions to the Community Budget (€1,108 million) due to the upward revision of past GDP figures.
6 Deficit and primary deficit according to the EDP notification of March 2008.
* Provisional data.
Source: State General Accounting Office.

favourable conditions for its decrease that prevailed between the mid-90s and 2007 (i.e. strong economic growth, falling interest rates up to 2005, sizeable privatisation proceeds, as well as high primary surpluses up to 2001). More recently, the conditions favouring debt reduction have weakened. Specifically, the rise in the average rate on new government borrowing (from 3.2% in 2005 to 3.8% in 2006 and 4.4% in 2007), coupled with the rise in the average rate on new government borrowing (from 3.2% in 2005 to 3.8% in 2006 and 4.4% in 2007), coupled with the anticipated slowdown of economic growth, strengthens the debt ratio dynamics and makes it more difficult to achieve fast debt reduction.

4 THE BUDGET FOR 2008

According to the budget for 2008, the fiscal policy stance will be restrictive. The general government deficit (on an administrative basis) is forecast to fall considerably, from 2.8% of GDP in 2007 to 1.6% in 2008. This reduction will mainly come from the state budget: its deficit is forecast to decrease from 4.6% of GDP in 2007 to 3.4% in 2008 and its primary surplus to increase to 0.9% in 2008 (see Table VIII.7).

The reduction of the state budget deficit is anticipated to stem from a considerable increase[18] in the ordinary budget revenue (13.1%), while expenditure should grow by 10.1%,[19] against a projected increase in GDP at current prices by 7.2%.

The large increase in ordinary budget revenue, which is forecast to reach €58,070 million, is partly associated with the introduction of a single tax on real estate, the equalisation of the special consumption tax on heating oil with that on diesel, as well as with the curbing of tax evasion. Besides, after the new budget was tabled in Parliament further provisions were adopted that will increase 2008 revenue; these provisions are included in the law on real estate taxation.

Specifically, in addition to the two main tax changes mentioned above, ordinary budget revenue in 2008 is expected to be boosted by the following:

- the third increase in the special consumption tax on liquid fuel by 5.8% as from 1 January 2008;

- the taxation of formerly tax-exempt special reserves of sociétés anonymes in specific branches of activity, created under Law 3220/2004, to finance investment in facilities and mechanical equipment;

- an increase in the percentage of the advance payment of corporate income tax, especially for credit institutions, from 80% to 100% of the tax amount;

- the adjustment (as from 8 April 2008) of the objective prices of land in areas outside town plan; and

- the implementation of the recent law on combating and curbing tax-evasion (Law 3610/2007), in conjunction with a further intensification of tax controls.

Under the 2008 budget, expenditure (including tax refunds) is forecast to increase by 10.1% to €61,608 million, from €55,960[20] million in 2007. Primary expenditure is expected to grow by 10.7%, while interest payments will rise by 7.2%.

18 The growth rate was calculated after the deduction, from the revenue of 2007, of the Olympic Airways "revenue".
19 The growth rate was calculated after all extraordinary expenditure, amounting to €2,405 million, was deducted from 2007 expenditure.
20 As mentioned above, for reasons of comparability, all extraordinary expenditure (€2,405 million) has been deducted from 2007 expenditure.

Table VIII.8 Greece's financial account with the European Union

(million euro)

	2004	2005	2006	2007*	Budget for 2008	Percentage changes 2005/04	2006/05	2007*/06	2008 budget/07*
A. Receipts from the EU budget	**5,650**	**5,455**	**6,733**	**7,274**	**7,574**	**–3.5**	**23.4**	**8.0**	**4.1**
1. Own resources collection costs	65	67	68	77	80	3.1	1.5	13.2	3.9
2. Social Fund	640	576	552	783	858	–10.0	–4.2	41.8	9.6
3. EAGGF – Guidance Section	296	376	382	589	402	27.0	1.6	54.2	–31.7
4. Regional Fund	1,523	1,341	2,146	3,065	2,561	–12.0	60.0	42.8	–16.4
5. EAGGF – Guarantee Section	2,737	2,754	3,072	2,374	3,185	0.6	11.5	–22.7	34.2
6. Other receipts	8	5	10	17	31	–37.5	–	70.0	82.4
7. Cohesion Fund	348	311	482	334	310	–10.6	55.0	–30.7	–7.2
8. Receipts from EFTA countries	4	3	3	2	6	–25.0	0.0	–33.3	200.0
9. Fisheries Fund	29	22	18	33	41	–24.1	–18.2	83.3	24.2
10. EU Solidarity Fund					100				
B. Payments to the EU budget	**2,030**	**2,224**	**2,172**	**3,265**	**2,682**	**9.6**	**–2.3**	**50.3**	**–17.9**
1. Agricultural levies and duties	18	12	12	11	10	–33.3	0.0	–8.3	–9.1
2. Sugar levies	7	4	3	0	2	–42.9	–25.0	–100.0	–
3. Customs duties under the Common External Tariffs	259	250	258	297	307	–3.5	3.2	15.1	3.4
4. Contribution according to the VAT base	441	424	467	473	579	–3.9	10.1	1.3	22.4
5. Contribution on the basis of GDP	1,129	1,211	1,222	1,184	1,514	7.3	0.9	–3.1	27.9
6. Additional extraordinary contributions	15	41	2	1,108	10	–	–95.1	–	–99.1
7. Contribution to the European Development Fund	35	33	33	36	40	–5.7	0.0	9.1	11.1
8. Payments owing to unrealised projects	126	249	175	156	220	97.6	–29.7	–10.9	41.0
Net receipts from the EU budget (A – B)	**3,620**	**3,231**	**4,561**	**4,009**	**4,892**	**–10.7**	**41.2**	**–12.1**	**22.0**

* Provisional data.
Source: State General Accounting Office.

The considerable rise in primary expenditure stems mainly from higher social and wage expenditure. As from 1 January 2008 the OGA pension increases by €52.25 on a monthly basis, EKAS (the Social Solidarity Benefit for Pensioners) by €35 per month, the unemployment benefit by €36.50 per month, while the allowance to families with many children is extended to families with three children. Furthermore, the salaries of the military and the personnel of law enforcement agencies are increased by 8% to 9%, while the first installment (€180 million) of back payments is paid to the judiciary. The basic salaries of regular public servants are increased by 2.5% as from 1 January 2008 and by 2% as from 1 October 2008. Moreover, the special allowance and the pensions for certain categories of pensioners are adjusted, while an appropriation of €100 million is forecast for the newly established National Social Cohesion Fund. Payments to the EU will also increase by 20.9%, owing to the revision of the GDP.

In contrast with the above categories of expenditure, budget appropriations for the remaining categories have been squeezed.

Grants, for instance, to transport and other organisations, which in 2007 increased by 8.9%, are forecast to rise by only 0.8% in 2008. A reduction of 2.6% can be seen in outlays for tax refunds which for the first time in 2008 include also refunds of fuel tax for the consumption of heating oil. The relevant budget appropriations for 2008 amount to €2,550 million, compared with payments of €2,623 million in 2007.

Interest payments are forecast to grow by 7.2% in 2008 to €10,500 million, compared with an increase of 2.1% in 2007 and a decline of 1.9% in 2006. This development reflects the aforementioned rise in interest rates.

Turning to the investment budget for 2008, investment expenditure is forecast to increase by 5.6%. Revenue will decrease by 7.0%, exclusively reflecting a base effect from extraordinary revenue of €982 million realized in 2007. Thus, the deficit of the Public Investment Budget, after a drop to 1.7% of GDP in 2007, will return to almost the level of 2006 (2008: 1.9%, 2006: 2% of GDP).

As regards Greece's financial transactions with the EU, net receipts declined by 12.1% in 2007, compared with an increase of 41.2% in 2006, and came to €4,009 million (see Table VIII.8). This development resulted from higher payments to the EU, which rose by 50.3% (after falling by 2.3% in 2006), associated with the payment of the additional contribution owing to the revision of GDP. Receipts from the various EU Structural Funds increased by 8.0%. A considerable increase was observed in receipts from the Regional Fund and the Social Fund, as well as from the Guidance Section of the EAGGF. By contrast, receipts from the Cohesion Fund and inflows for farmer subsidies under the CAP (EAGGF, Guarantee Section) declined.

For 2008, net inflows of EU resources are expected to increase by 22%, being the net result of lower payments to the EU (–17.9%) and a marked increase, (+34.2%), in inflows for agricultural support (see Table VIII.8).

IX BALANCE OF PAYMENTS

1 CURRENT ACCOUNT DEFICIT

1.1 SUMMARY OF DEVELOPMENTS AND OUTLOOK

The current account deficit stood at €32.3 billion in 2007, showing a significant increase (of €8.6 billion) compared with 2006 (see Table IX.1). As a result, the current account deficit rose to 14,1% of GDP, from 11.1% in 2006. Besides, taking into account the surplus of the capital transfers balance, the overall deficit in 2007 is limited to €27.9 billion (or 12.2% of GDP), compared with €20.6 billion (or 9.6% of GDP) in 2006.

The high level of the external balance in recent years, which is partly a result of a decline in the international competitiveness of the Greek economy, reflects the substantial shortfall of domestic savings, which are relatively low, compared to domestic investment, which is relatively high. In particular, as a percentage of GDP, savings are significantly lower than in the euro area, while investment is considerably higher. The significant rise in investment as a percentage of GDP over the last seven years is attributable to an improvement in the macroeconomic environment and outlook (as a result of EMU entry and the fall in interest rates), as well as in the ability to finance the construction of infrastructure projects (thanks to the inflows from the EU Structural Funds). At the same time, the relatively low level of overall savings as a percentage of GDP reflects on the one hand fiscal deficits (which imply that general government savings are negative) and, on the other hand, a rise in the private propensity to consume, as a result of an improvement in households' expectations regarding their future income and consumer credit growth. These factors are connected with the excess domestic demand in the Greek economy over the last seven years, as opposed to the euro area as a whole. Due to private consumption growth and the rise in investment activity, imports of consumer and investment goods are increasing rapidly, while exports growth is not strong enough to prevent the ongoing widening of the trade deficit. These import and export developments are explained by the low structural competitiveness of the economy, as a result of which the composition of domestic output does not sufficiently match the composition of domestic and external demand, as well as the ongoing decline in international price competitiveness of the Greek economy (see Table IX.2), mainly due to the inflation differential and, to a lesser extent, the appreciation of the euro.[1] High trade deficits have led to a significant increase in the external debt of the Greek economy, which implies a substantial rise in net interest payments. The significant widening of the deficit in 2005-2007 is also due to the increase in net payments for purchases of ships and in the oil import bill.

In 2007, in particular, the increases in the trade deficit excluding oil and ships, the deficit of the ships' balance and the income

1 The international price competitiveness of the Greek economy declined considerably in recent years, as the real effective exchange rate based on consumer prices rose by a cumulative 15% between 2000 and 2007, while in 2007 this worsening came to 1.9%. Furthermore, relative unit labour costs expressed in a common currency recorded a cumulative increase of almost 20% in the whole economy (3.2% in 2007) and 41% in manufacturing (4.4% in 2007). These increases are equal to corresponding price competitiveness losses. In 2001-2007, the nominal exchange rate of the euro (weighted by Greece's external trade) rose cumulatively by 9.9% (appreciation of the euro), while in 2007 this appreciation was 1.4%.

Table IX.1 Balance of payments

(million euro)

	January – December		
	2005	**2006**	**2007***
I Current account balance (I.A+I.B+I.C+I.D)	**–14,743.5**	**–23,668.1**	**–32,261.2**
I.A Trade balance (I.A.1 – I.A.2)	**–27,558.9**	**–35,286.3**	**–41,499.2**
Oil trade balance	–6,629.2	–8,761.3	–9,219.6
Non-oil trade balance	–20,929.7	–26,525.0	–32,279.6
Ships balance	–723.0	–3,390.5	–5,520.3
Trade balance excl. fuel and ships	–20,206.7	–23,134.5	–26,759.3
I.A.1 Exports of goods	**14,200.9**	**16,154.3**	**17,445.5**
Fuel	2,257.7	2,939.8	3,037.3
Ships (receipts)	1,602.2	1,631.8	2,275.4
Other goods	10,341.0	11,582.7	12,132.8
I.A.2 Imports of goods	**41,759.8**	**51,440.6**	**58,944.8**
Fuel	8,886.9	11,701.1	12,256.9
Ships (receipts)	2,325.2	5,022.3	7,795.7
Other goods	30,547.7	34,717.2	38,892.2
I.B Services balance (I.B.1 – I.B.2)	**15,391.1**	**15,337.1**	**16,723.9**
I.B.1 Receipts	**27,253.5**	**28,364.1**	**31,425.3**
Travel	10,729.5	11,356.7	11,407.2
Transport	13,871.4	14,324.7	16,939.3
Other services	2,652.6	2,682.7	3,078.9
I.B.2 Payments	**11,862.4**	**13,027.0**	**14,701.4**
Travel	2,445.7	2,382,8	2,441.5
Transport	6,237.7	6,991.3	7,771.3
Other services	3,179.0	3,652.9	4,488.6
I.C Income balance (I.C.1 – I.C.2)	**–5,676.1**	**–7,118.8**	**–9,077.0**
I.C.1 Receipts	**3,273.5**	**3,626.1**	**4,625.7**
Wages, salaries	287.1	318.1	366.9
Interest, dividends, profits	2,986.4	3,308.0	4,258.9
I.C.2 Payments	**8,949.6**	**10,744.9**	**13,702.7**
Wages, salaries	219.8	280.7	332.6
Interest, dividends, profits	8,729.8	10,464.2	13,370.1
I.D Current transfers balance (I.D.1–I.D.2)	**3,100.4**	**3,399.9**	**1,591.1**
I.D.1 Receipts	**6,876.4**	**6,847.4**	**6,608.1**
General government (mainly receipts from the EU)	4,615.5	4,462.4	4,461.2
Other sectors (emigrants' remittances, etc.)	2,261.0	2,385.0	2,246.9
I.D.2 Payments	**3,776.0**	**3,477.5**	**5,017.0**
General government (mainly payments to the EU)	2,921.4	2,472.7	3,825.4
Other sectors	854.6	974.8	1,191.6
II Capital transfers balance (II.1–II.2)	**2,048.6**	**3,041.3**	**4,332.3**
II.1 Receipts	**2,324.9**	**3,310.7**	**4,673.9**
General government (mainly receipts from the EU)	2,137.1	3,116.5	4,401.4
Other sectors	187.8	194.2	272.4
II.2 Payments	**276.3**	**269.5**	**341.6**
General government (mainly payments to the EU)	22.9	32.2	27.1
Other sectors	253.4	237.3	314.5
III Current account and capital transfers balance (I+II)	**–12,694.9**	**–20,626.8**	**–27,928.9**
IV Financial account balance (IV.A+IV.B+IV.C+IV.D)	**12,606.6**	**20,363.7**	**27,361.4**
IV.A Direct investment[1]	**–679.0**	**953.8**	**–2,499.0**
By residents abroad	–1,180.4	–3,321.6	–3,900.1
By non-residents in Greece	501.3	4,275.4	1,401.1
IV.B Portfolio investment[1]	**7,322.6**	**8,115.4**	**17,441.7**
Assets	–18,459.7	–6,961.2	–16,351.1
Liabilities	25,782.3	15,076.6	33,792.8
IV.C Other investment[1]	**5,914.0**	**11,518.5**	**12,740.6**
Assets	–6,301.5	–5,851.0	–16,266.1
Liabilities	12,215.5	17,369.5	29,006.8
(General government loans)	–447.0	–447.7	–2,341.7
IV.D Change in reserve assets[2]	**49.0**	**224.0**	**–322.0**
V Errors and omissions	**88.3**	**263.1**	**567.5**
Reserve assets	**1,945.0**	**2,169.0**	**2,491.0**

1 (+) net inflow, (–) net outflow.
2 (+) decrease, (–) increase.
* Provisional data.
Source: Bank of Greece.

Table IX.2 Greece: revised nominal and real effective exchange rate (EER) indices[1]

(average annual levels, percentage changes)

	Nominal EER	Real EER: On the basis of relative consumer prices	Real EER: On the basis of relative unit labour costs in manufacturing	Real EER: On the basis of relative unit labour costs in total economy
2001	1.1	1.0	3.4	0.6
2002	1.9	2.8	4.5	3.7
2003	4.5	5.3	7.9	4.9
2004	1.4	1.9	6.0	4.2
2005	–0.7	0.3	4.9	–0.5
2006	0.1	1.0	4.3	2.1
2007[2]	1.4	1.9	4.4	3.2
Cumulative percentage change between 2001 and 2007	**9.9**	**15.0**	**41.1**	**19.7**

1 Revised indices (compiled by the Bank of Greece) comprise Greece's 28 main trading partners (including the other euro area countries, with the exception of Malta). The weights used reflect the share of each partner country in Greece's manufacturing trade (SITC 5-8) during 1999-2001 and account for competition in third markets.
2 Provisional data and estimates.
Sources: – Exchange rates: ECB, euro reference exchange rates.
– CPI: ECB, harmonised CPI where available.
– Unit labour costs in manufacturing and unit labour costs in total economy: Bank of Greece estimates for Greece; ECB for the other countries.

account deficit, the decline in the current transfers surplus and the rise in the deficit of the oil balance contributed by 42.2%, 24.8%, 22.8%, 21.0% and 5.3% respectively to the growth of the current account deficit. These developments were only partly offset by an increase in the surplus of the services balance, which contributed by 16.1% to the *decrease* in the current account deficit.

The main factors behind the widening of the trade deficit excluding oil and ships in 2007 were, as in previous years, strong private consumption growth and the continued worsening of the international price competitiveness of the Greek economy. High crude oil prices in the last months of 2007 and increased expenditure for the renewal of Greece's commercial fleet have contributed to a widening of the deficits of the oil and the ships' balance respectively. In 2007, underlying the growth of the income account deficit was mainly a rise in net interest payments, while the narrowing of the current transfers surplus is mainly accounted for by an increase in general government payments to the EU (due to the upward revision of GDP by 9.6%). Finally, the widening of the services surplus in 2007 was exclusively a result of a rise in net sea transport receipts.

The outlook for the current account deficit in the coming years is not particularly favourable and it is estimated that it will remain virtually unchanged as a percentage of GDP in 2008 and may even increase further. This estimate takes into account the low structural competitiveness and the continued worsening of the international price competitiveness of the Greek economy, as well as certain more specific factors. In particular, goods and services export growth will slow in 2008 due to an anticipated decline in world trade growth, while high oil prices and expenditure for purchases of ships will put a considerable strain on the trade deficit. Certainly, expenditure for purchases of ships constitutes investment spending and is expected to lead to higher transport receipts in the coming years (provided that international freight rates remain at relatively high levels) and hence reduce the current account deficit over the medium term. At the same time, however, the income account balance will be increasingly burdened by interest payments, owing to the ongoing growth of non-residents' public debt holdings.

1.2 TRADE BALANCE

The overall trade deficit widened by €6.2 billion due to an increase in, mainly, the trade deficit excluding oil and ships and, secondarily, net payments for purchases of ships, while the net oil import bill rose minimally.

With respect to the trade balance excluding oil and ships, the strong decline in the rate of increase in export receipts excluding oil and ships to 4.7% (from 12.0% in 2006) is attributable to the continuous worsening of the competitiveness of Greek products and to the ensuing loss of shares in major international markets, as Greek products have failed to benefit from strong overall external demand growth. Given that the rate of increase in the corresponding import bill remained high (12.0%, from 13.6% in 2006) and that the value of imports is much higher than that of exports, the widening of the trade deficit continued unabated. It should be pointed out that, although the growth of the import bill overall declined, the "machinery and appliances" category, which includes both consumer durables and capital goods, recorded a rise. This development is related to strong business investment growth (see Chapter III).

According to NSSG data on the geographical breakdown of external trade (including oil products), receipts from exports to the EU increased (mainly on account of the entry of Bulgaria and Romania into the EU), while receipts from exports to third countries declined considerably. No significant changes are observed in the geographical breakdown of the import bill (including oil products), with the exception of a rise in imports from the EU (mainly on account of the entry of Bulgaria and Romania into the EU). The exports and imports share of the EU now stands at 65.0% and 60.5% respectively.

1.3 SERVICES BALANCE

The surplus of the services balance came to €16.7 billion, up by 9.0% compared with 2006. This is exclusively due to a rise in net transport receipts, which was partly offset by a further widening of the deficit of the "other services" balance, given that net travel receipts remained almost unchanged.

Specifically, gross transport receipts stood at €16.9 billion, up by €2.6 billion or 18.3% compared with 2006. This is mainly due to a rise in gross shipping receipts as a result of the further expansion of the Greek-owned fleet and the high level of dry-cargo freight rates[2] in comparison with 2006. At the same time, gross transport payments rose by €780

2 The Baltic Dry Index (BDI) for dry bulk freight rates rose by 122%, while the Baltic Dirty Tanker Index (BDTI) for oil tanker freight rates dropped by 13% compared with the average annual levels in 2006.

million, €402 million of which are related to increased shipping payments.[3] Consequently, net transport – mainly shipping – receipts rose by €1.8 billion and covered more than 20% of the trade deficit.

Travel receipts remained virtually unchanged (up by 0.4%), despite a notable increase in tourist arrivals.[4] The stagnancy in travel receipts is connected with (i) a change in the population of foreign tourists (arrivals from high-income countries decreased, while arrivals from relatively low-income countries −the Balkans and Eastern Europe− increased); (ii) the squeezing of tourist product prices due to "all-inclusive" packages[5] and (iii) the appreciation of the euro, which makes other destinations (outside the euro area) more competitive.

Lastly, net payments for other services rose by €440 million, mainly on account of increased net payments for royalties and financial services fees.

Looking at sea transport in more detail, strong performance is attributable to a rise in dry-cargo freight rates, which is associated with increased iron, ore and coal transport requirements, mainly of China and, to a lesser extent, India, and the expansion of the fleet under Greek management (following the orders of previous years). The rise in freight rates is also due to the congestion observed mainly in Australian ports, as part of the fleet remains inactive waiting for the loading process to start, which reduces the number of available ships. However, oil tanker freight rates have shown a declining trend since August, which is due to, on the one hand, the increased supply of transport services (as a result of new ship deliveries which were not matched by decommissioning of old ships) and, on the other hand, lower demand due to mild weather in the winter of 2007 and higher crude oil prices. Strong performance in the transport sector is also attributable to an increase in the volume of the demand for transport services, which exceeded the rise in the transport capacity of the dry-cargo fleet. The outlook for dry-cargo freight rates remains positive for the next two years, on account of the continued demand for iron ore and coal by developing countries and the moderate rise in the capacity of the world dry-cargo fleet. By contrast, oil tanker freight rates are expected to adjust slightly further, as the anticipated increase in oil consumption falls short of the increase in the capacity of the world fleet. In any case, the phase-out of single-hull ships by 2010 will push up freight rates.

The process of renewing the Greek-owned fleet is ongoing (now focused on dry-cargo ships) and is expected to bear significant benefits. According to the latest available data, Greek shipping companies have ordered 556 ships −mainly dry-cargo− worth 31.9 billion US dollars in whole. Most ships ordered in 2007 are expected to be delivered in 2010 and 2011.[6] Thus, the import bill for purchases of ships, which accounts for around 1/3 of the

3 Most payments for shipping services are associated with ancillary and supplementary shipping services, such as ship agency, anchorage dues, towage etc.
4 According to data for January-December 2007, foreign tourist arrivals increased by 6.2%, but the number of overnight stays per arrival fell by 6.3%, while expenditure per overnight stay increased by a mere 1.0%. These data result from the sample border survey concluded on behalf of the Bank of Greece.
5 See Institute of Tourism Research and Forecasting (ITEP), *Greek Economy and Tourism*, Issue 24, November 2007.
6 Data from G. Moundreas Shipbrokers for January-December 2007. The corresponding data for 2006 indicate a contract value of 16.7 billion US dollars for the building of 322 ships.

increase in the trade deficit, can be logically considered as investment spending and creates the conditions for a further rise in transport receipts in the years to come (provided that, as already mentioned, international freight rates remain at relatively high levels).

1.4 INCOME ACCOUNT

The income account deficit widened by €2.0 billion as a result of increased net interest, dividend and profit payments. This development is mainly connected with an increase in non- residents' public debt holdings.

1.5 CURRENT TRANSFERS BALANCE

The current transfers surplus decreased by €1.8 billion, mainly due to a €1.5 billion decline in net EU transfers to general government. Following the recent revision of Greece's GDP by 9.6%, payments were burdened with a €1.1 billion retroactive contribution to the Community Budget, which was paid at the start of December. At the same time, other sectors' net receipts (mainly emigrants' remittances) dropped by €355 million.[7]

2 CAPITAL TRANSFERS BALANCE

The capital transfers balance recorded a surplus of €4.3 billion (or 1.9% of GDP) in 2007, up by €1.3 billion in comparison with 2006, reflecting a rise in capital transfers from the EU to general government.[8] This rise is attributable to the higher absorption rate of Structural Fund resources under CSF III and is related to a number of measures taken during its successive revisions. From the start of CSF III implementation in 2001 to end-December 2007, €17 billion had been disbursed by the Structural Funds, namely 75% of the envisaged total Community financing for the period 2000-2006 (€22.7 billion),[9] compared with 54% of the total Community contribution until end-December 2006. In the coming months the absorption rate is expected to edge up further. According to provisional data, disbursements by the Structural Funds under CSF III reached around €1.6 billion in the first quarter of 2008, with the absorption rate reaching 81% of total Community financing.

Total net transfers from the EU (current and capital transfers minus contributions to the Community Budget) came, on a cash basis, to €4.9 billion in 2007, including advance payments under the National Strategic Reference Framework – NSRF (CSF IV) 2007-2013,[10] and they are expected to exceed €5

7 Current transfers from the EU mainly include receipts from the Guarantee Section of the European Agricultural Guidance and Guarantee Fund – EAGGF – in the context of the Common Agricultural Policy, and receipts from the European Social Fund, while current transfers to the EU mainly include Greece's contributions to the Community Budget. Current transfers on a monthly and an annual basis do not always correspond to direct CAP subsidies and regular contributions to the Community Budget, as they include other funds as well, such as extraordinary contributions and return of funds to the EU budget.

8 EU capital transfers mainly include receipts from the Structural Funds – other than the European Social Fund – and the Cohesion Fund under the Community Support Frameworks.

9 At end-December 2007, the absorption rates on a cash basis by Structural Fund were as follows: European Regional Development Fund (ERDF) 73%, European Social Fund (ESF) 76%, Guidance Section of the European Agricultural Guidance and Guarantee Fund (EAGGF) 79%, European Fisheries Fund (EFF) – Financial Instrument for Fisheries Guidance (FIFG) 70%.

10 In November and December 2007, Greece received 2007-2013 NSRF advance payments of €401 million. It should be recalled that, according to the relevant regulations, the European Commission will pay to Greece and the other EU Member States, as an advance under the 2007-2013 NSRF, 5% advance of Structural Funds' total financing during the 2007-2008 period and 7.5% of the Cohesion Fund total financing during the 2007-2009 period.

billion in 2008, since –in addition to other CSF III disbursements– further advance payments and first payments for projects under the 2007-2013 NSRF are bound to flow. This amount corresponds to about 2.0% of GDP.

Turning to the fiscal period 2007-2013, Greece has ensured Community funding of €24.3 billion[11] for the implementation of the NSRF, including resources for agricultural development.[12] At the same time, it seems that direct support and subsidies under the CAP[13] will remain virtually unchanged until 2013, unless new CAP implementation measures take effect in the meantime, given that the CAP is to be reviewed in 2008 in the context of the negotiations for the EU Budget for the 2014-2020 programming period.[14] The recent revision of Greece's GDP entails a minor increase in the annual contribution to the Community Budget as from 2007, but will not affect the amounts of EU transfers already agreed upon for the period 2007-2013.[15] Community fund transfers in 2007-2013 remain substantial, albeit lower that those under CSF III. As the NSRF is the last transfer of considerable Community funds to Greece, the 2007-2013 period is a transitional stage during which Greece's development will be gradually weaned of such funds. Their full absorption and effective use will contribute essentially to achieving Greece's development objectives, in the context of the priorities jointly set at EU level for the new programming period.

3 FINANCIAL ACCOUNT

In 2007, net financial inflows came to €27.4 billion or 12.0% of GDP and, together with the surplus of the capital transfers balance (1.9% of GDP), are enough to finance the

11 This amount is calculated at current prices of the period covered by CSF IV and corresponds to €20.1 billion at 2004 constant prices, compared with €26 billion of CSF III (also at 2004 constant prices). In particular, under the 2007-2013 NSRF, Greece will have at its disposal, together with the national contribution, resources amounting to €32.2 billion. Including the additional resources for agricultural development and fisheries, total resources reach almost €37.3 billion, and the participation of private funds will bring the sum to around €40 billion (see the Minister and Deputy Minister of Economy and Finance speeches in Thessaloniki on the 2007-2013 NSRF, 22 February 2008).

12 The NSRF, which includes the national plan and priorities for the 2007-2013 programming period, as well as the National Strategic Plan for Agricultural Development and the National Strategic Plan for Fishery Development, was approved at end-November 2007. Eighty per cent of Community funding is earmarked for the regions. In the context of the NSRF, 13 operational programmes have been designed, of which 8 are sectoral and 5 are regional. The basic management principles and implementation mechanisms of the NSRF can be found in Law 3614/2007. The private sector, in partnership with the public sector, will also contribute to the implementation of part of the NSRF projects (in accordance with law 3389/2005). The amount of €24.3 billion is allocated as follows: (1) €20.4 billion for Structural Actions, which are financed by the ERDF, the ESF and the Cohesion Fund; (2) €3.9 billion for Agricultural Development, which is funded by two new funds – (a) the European Agricultural Fund for Rural Development (EAFRD), which replaces the Guidance Section of the former European Agricultural Guidance and Guarantee Fund, and also includes the amounts for the accompanying measures that were financed by the Guarantee Section of the former EAGGF, and (b) the European Fisheries Fund (EFF), which replaces the former Financial Instrument for Fisheries Guidance (FIFG). According to the "ν + 2" rule, the maximum delay allowed for the absorption of Community funds is two years. For 2007-2010 in particular, the "ν + 3" rule applies. (See Deputy Minister of Economy and Finance speech in Thessaloniki on the 2007-2013 NSRF, 22 February 2008)

13 Direct aid and subsidies will now be funded by the European Agricultural Guarantee Fund (EAGF), which replaces the Guarantee Section of the former European Agricultural Guidance and Guarantee Fund (EAGGF).

14 See Commission of the European Communities, Communication from the Commission, "Preparing for the 'Health Check' of the CAP reform", COM (2007) 722, 20 November 2007.

15 With regard to inflows from the Cohesion Fund, it should be recalled that Member States with a per capita GDP of less than 90% of the EU average remain eligible. The eligibility of all Member States will be re-examined in 2010 on the basis of economic data regarding the EU-27, and Greece may lose part of its total allocation for the whole seven-year period (currently amounting to €3.7 billion at current prices).

Table IX.3 Geographical breakdown of Greek direct investment outflows

(million euro)

	2005	2006	2007*
EU-27	761	375	1,371
Euro area	394	461	864
Other OECD countries[1]	34	2,342	2,125
Balkan countries[2]	192	510	121
Middle East, Mediterranean and former USSR[3]	60	15	47
Other countries	133	80	236
Total direct investment outflows	**1,180**	**3,322**	**3,900**

1 Australia, Canada, Iceland, Japan, Korea, Mexico, New Zealand, Norway, Switzerland, Turkey and United States.
2 Albania and former Yugoslavia countries (Bosnia-Herzegovina, Croatia, FYROM, Serbia and Montenegro).
3 Greece's main trading partners in the Middle East, the Mediterranean and former USSR countries.
* Provisional data.
Source: Bank of Greece.

current account deficit. Certainly, it should be noted that, under direct investment, outflows for residents' investment abroad were almost three times the respective inflows for non-residents' investment in Greece, resulting in a significant net outflow under direct investment. Thus, the financing of the current account deficit was covered by net inflows under the other two categories (portfolio and "other" investment), which however mostly represent external financing.

In more detail, in 2007 financial investment, i.e. the sum of direct, portfolio and "other" investment (including mainly interbank investment in deposits and repos), showed a net inflow of €27.7 billion, compared with a net inflow of €20.6 billion in 2006 (see Table IX.1). This development is attributable to a net inflow of €17.4 billion for portfolio investment (compared with €8.1 billion in 2006) and a net inflow of €12.7 billion for "other" investment (€11.5 billion in 2006). Direct investment recorded a net outflow of €2.5 billion, compared with a net inflow of €954 million in 2006.

3.1 DIRECT INVESTMENT

Residents' direct investment abroad increased from the already high level in 2006. Conversely, non-residents' investment in Greece recorded a significant decline, resulting in a high net outflow under this category.

Specifically, net outflows of residents' funds for direct investment abroad stood at €3.9 billion (compared with €3.3 billion in 2006). This development is mainly due to the completion of the acquisition (worth €1.7 billion) of Finansbank (Turkey) by the National Bank of Greece. By contrast, non-residents' investment in Greece showed a considerable decline to €1.4 billion, from €4.3 billion in 2006).

Table IX.3 shows the geographical breakdown of residents' direct investment abroad. This investment was absorbed mostly by "other OECD countries" (including Turkey), mainly on account of the completion of the acquisition of Finansbank,

Table IX.4 Geographical breakdown of Greek foreign direct investment inflows

(million euro)

	2005	2006	2007*
EU-27	232	3,994	1,196
Euro area	–22	3,253	1,435
Other OECD countries[1]	140	203	108
Balkan countries[2]	1	0	0
Middle East, Mediterranean and former USSR[3]	13	13	19
Other countries	115	65	78
Total direct investment by non-residents	**501**	**4,275**	**1,401**

1 Australia, Canada, Iceland, Japan, Korea, Mexico, New Zealand, Norway, Switzerland, Turkey and United States.
2 Albania and former Yugoslavia countries (Bosnia-Herzegovina, Croatia, FYROM and Serbia-Montenegro).
3 Greece's main trading partners in the Middle East, the Mediterranean and former USSR countries.
* Provisional data.
Source: Bank of Greece.

while a large share was directed to EU countries. Greek investment in Balkan countries remains substantial, even though Greek investment in Bulgaria and Romania is now considered as investment in EU countries. The most significant investments by residents abroad concerned (a) a €278 million capital injection by EFG Eurobank-Ergasias S.A. to its branches in Poland; (b) a €142 million increase in the participation of the same bank (from 30% to 70%) in the capital of Tekfenbank AS (Turkey); (c) a €90 million increase in the participation of Alapis S.A. in the capital of Microprism Services Ltd (Cyprus); (d) a €87 million outflow for the partial acquisition of Ocean Ring (Norway) by the shipping company Dryships Inc; (e) a €85 million outflow by the National Bank of Greece for both covering the capital increase of its subsidiary in Serbia Vojvodjanska Banka (€53 million) and injecting capital to its NBG Beograd branch (€32 million); and (f) an outflow of €50 million for the participation of private investors in the capital increase of Ladisk Ltd (Switzerland). Other significant investments by Greek banks include outflows of €50 million, €38 million and €26 million for the participation of Piraeus Bank in the capital increase of its subsidiaries Piraeus Bank Romania (Romania), Piraeus Bank in Serbia and Tirana Bank in Albania respectively, as well as a €55 million outflow for the acquisition of International Commerce Bank (Ukraine) by the same bank.

In terms of geographical breakdown, non-residents' direct investment in Greece originated almost exclusively from EU countries, in particular euro area countries, and to a much lesser extent from the other OECD countries (see Table IX.4). The two most significant investments by non-residents in Greece concerned an inflow of €322 million for the acquisition of the participation of the National Bank of Greece in the capital of AGET Heracles S.A. by Lafarge S.A., and a €300 million inflow for the acquisition of INFOTE by Rhone Capital

Table IX.5 Greece's nternational investment position

(million euro)

	2005	2006[1]	2007*
1. Direct investment	–13,213	–14,328	–14,971
Abroad by residents	11,530	17,022	20,922
In Greece by non-residents	24,743	31,350	35,893
2. Portfolio investment	–112,007	–127,172	–150,724
Assets	59,319	67,195	86,848
Liabilities	171,326	194,367	237,572
3. Financial derivatives	559	10	503
4. Other investment	–26,471	–38,842	–51,907
Assets	56,741	62,640	79,539
Liabilities	83,212	101,482	131,446
5. Reserve assets	1,945	2,169	2,491
Net international investment position (1+2+3+4+5)	–149,187	–178,163	–214,608
GDP	198,609	213,985	228,949
% of GDP	–75.1	–83.3	–93.7

1 Data for 2006 have been revised.
* Provisional estimates.
Source: Bank of Greece.

Plc and Zarkona Trading Ltd. Other investments by non-residents in Greece included (a) an inflow of €169 million for the participation of Endesa Europe (Spain) in the increase of the share capital of Endesa Hellas; (b) a €110 million inflow for the coverage of the capital increase of Geniki Bank by Société Générale (France); (c) an inflow of €88 million for the completion of the acquisition of Wind Hellas by the Wind group; (d) a €40 million inflow for the coverage of the capital increase of ING Greece Life Insurance by its parent company ING Continental (Netherlands); and (e) an inflow of €30 million for the participation in the capital increase of Dionysus Leisure S.A. by TBU International (Luxembourg). A negative development was an outflow of €104 million due to the withdrawal of General Biscuit S.A. from the capital of Papadopoulou Biscuits S.A.

3.2 PORTFOLIO INVESTMENT

Non-residents' portfolio investment inflows came to €33.8 billion, recording a significant increase (of €15.1 billion) compared with 2006. This is due to a substantial rise in non-residents' investment in mainly Greek government bonds and Treasury bills, which reached €25.7 billion, compared with €9.0 billion in 2006, and, secondarily, in shares of Greek firms, worth €8.1 billion, from €6.0 billion in 2006.

Residents' portfolio investment abroad also increased significantly and came to €16.4 billion (€7.0 billion in 2006). Also in this case, the rise stemmed mainly from an increase in residents' investment in foreign bonds and Treasury bills, which reached €15.4 billion, compared with €5.3 billion in 2006. By contrast, residents' investment in foreign shares fell to €0.5 billion, from €2.3 billion in 2006.

3.3 OTHER INVESTMENT

"Other" investment recorded a significant net inflow, which mainly reflects the fact that the inflow of non-residents' funds for investment in deposits and repos in Greece was almost double the outflow of residents' funds for corresponding investment abroad. In more detail, non-residents' investment in deposits and repos in Greece came to €31.7 billion, compared with €17.0 billion in 2006, while residents' corresponding investment abroad came to €15.8 billion (€5.5 billion in 2006). The inflow of funds into Greece was offset to a small extent by the repayment of loans granted by non-residents to residents (€2.6 billion).

Lastly, Greece's reserve assets, as defined by the European Central Bank, increased by €322 million to €2.5 billion at the end of 2007.

4 INTERNATIONAL INVESTMENT POSITION

In 2007, Greece's negative international investment position deteriorated to €214.6 billion at the end of the year (93.7% of GDP), from €178.2 billion at the end of 2006 (88.3% of GDP – see Table IX.5).

The deterioration of the country's international investment position mainly reflects the developments in portfolio and "other" investment. In these categories, the increase in liabilities is much greater than the increase in assets, which affects significantly the volume of Greece's external borrowing.

X BANKING SYSTEM AND SUPERVISION

1 GENERAL OVERVIEW

The stability of the Greek banking system remained very high also in 2007. Greek commercial banks, which continue to hold a substantial market share in the Greek banking system, improved their fundamentals in comparison with 2006. Underlying this development were continued strong credit growth in Greece, the accelerating expansion of certain Greek banks into foreign markets and their minimal exposure to structured products. Greek commercial banks' profitability and capital adequacy remained high. Moreover, in line with the goals set by the Bank of Greece, the quality of their loan portfolios improved, although the non-performing loans to total loans ratio (NPL ratio) in Greece remained above the corresponding ratio in the EU. Market risk remained low, while liquidity risk increased.

However, the ongoing turmoil in international markets, rapid credit growth and the increasing presence of Greek banks in foreign markets involve heightened risks; hence, banks should continuously adapt their risk measurement and management systems to the evolving economic and credit environment.

2 PROFITABILITY

The profitability of Greek commercial banks and their groups[1] remained very high also in 2007 (see Table X.1). Banking groups' business and in particular profitability benefited from the upward phase of the business cycle in both Greece and most Southeastern European countries, where certain banks expanded their business through branches and subsidiaries. Moreover, in addition to credit growth, Greek banks' minimal exposure to high-risk structured products also had a beneficial effect.[2]

In more detail, pre-tax profits rose by 23.6% for banks and 36.6% for banking groups in comparison with 2006, reaching €3,650 million and €5,529 million respectively.[3] A positive contribution was made by increases in net interest income (banks: 10.4%, groups: 20.9%) and net commission income (banks: 11.9%, groups: 21.5%). These two income categories continued to account for almost 86% of banks' (and banking groups') income. The faster rise in banking groups' income is attributable to the fact that the rate of credit growth in Southeastern European countries was more than double the corresponding rate in Greece. All other income categories[4] also showed an increase (banks: 12.9%, groups: 10.6%); as a result, operating income rose by 10.9% at bank level and 19.5% at group level.

Operating costs also grew (banks: 11.8%, groups: 18.5%), as they were affected by a considerable increase in activities abroad. Personnel outlays, which make up 3/5 of total operating costs, rose by 11.4% for banks

1 Profitability analysis does not include data on Emporiki Credicom, Panhellenic Bank and First Business Bank, which were not available until the cut-off date.

2 Contrary to Greek banks, euro area banks' comparatively higher exposure to structured products, the valuation of which was affected by the turmoil in financial markets, had a considerable impact on their profitability.

3 It should be noted that about 10% of banking groups' profits, in both 2006 and 2007, was accounted for by windfall profits.

4 They include income from dividends and financial operations, as well as other income.

Table X.1 Financial results of Greek commercial banks and banking groups in 2007

(percentage changes over 2006)

	Banks	Banking groups
Operating income	**10.9**	**19.5**
– Net interest income	10.4	20.9
– Net non-interest income	12.4	16.5
– Net commision income	*11.9*	*21.5*
– Income from financial operations	*5.1*	*35.2*
– Dividends and other operating income	*26.9*	*–9.5*
Operating expenses	**11.8**	**18.5**
– Personnel outlays	11.4	17.9
– Depreciation and amortisation	7.2	9.8
– Other operating expenses	13.3	21.5
Net income	**10.0**	**22.4**
Provisions for doubtful loans	–15.6	–10.7
Pre-tax profits	**23.6**	**36.6**
Taxes	–26.8	–10.5
After-tax profits	**46.1**	**55.0**

Source: Individual institutions' income statements.

and 17.9% for groups, and other costs and depreciation expenses grew by 13.3% and 7.2% respectively for banks and by 21.5% and 9.8% respectively for groups.

These developments in operating income and costs led to small changes in the efficiency ratio (operating costs to operating income), which rose (i.e. deteriorated) for banks (2007: 52.6%, 2006: 52.2%), but declined (i.e. improved) for banking groups, reaching 52.6% at the end of the reviewed period (2006: 53.1%), which compares favourably with the figure for large banking groups in the euro area (first half of 2007: 60%).

Provisions for credit risk showed a considerable 15.6% decline for banks and dropped by 10.7% for banking groups, reaching 0.47% (2006: 0.63%) of average assets. Although this percentage remains higher than that for medium-sized banking groups in the EU,[5] the comparison should take into account the relevant level of risks. Greece's higher ratio reflects the higher level of potential loss. Hence, it is necessary to further reduce the NPL ratio by tightening credit standards and linking more effectively provisions with risks. Moreover, in 2007 provisions as a percentage of operating income (banks: 12.6%, groups: 10.6%) declined by around 4 percentage points in comparison with 2006.

Regarding the profitability ratios, the net interest rate margin[6] narrowed slightly at bank level (2007: 2.5%, 2006: 2.7%) and remained stable at 3% at group level. This development reflects (a) for banks, stronger competition in the domestic market,[7] customers' increased use of time deposits[8]

5 According to end-2006 data, in the EU the corresponding ratio is about 0.25%.
6 Net interest income as a percentage of average assets.
7 It should be noted that, although the degree of concentration of the Greek banking system remained almost at the level of 2006, changes were observed in certain banks' market shares, which are explained by consumers' "mobility" in an effort to take advantage of increased competition among banks.
8 During the reviewed period, these accounts carried a considerably higher interest rate than simple saving accounts (see Chapter VI).

Table X.2 Frequency distribution of return on equity of Greek listed commercial banking groups

	Number of groups		
	2005	2006	2007
ROE<0%	2	2	1
0%≤ROE<5%	0	1	1
5%≤ROE<10%	2	1	4
10%≤ROE<15%	2	3	0
15%≤ROE<20%	5	4	4
ROE≥20%	1	1	2
Total	**12**	**12**	**12**

Sources: Individual institutions' balance sheets and Bank of Greece calculations.

and higher funding costs; and (b) for groups, their activities abroad, which feature wider profit margins, but are generally also considered to involve higher risks.

After-tax return on assets (ROA) and return on equity (ROE) rose, both at bank and banking group level. In 2007, banks' ROA and ROE reached 1% and 14.8% respectively (2006: 0.8% and 12.8% respectively), while the corresponding ratios for banking groups were 1.4% and 17.6% respectively (2006: 1.1% and 14.1% respectively).[9] However, ROE figures varied across banking groups. Moreover, the number of groups with ROEs below 10% increased (see Table X.2). Most of these groups do not have any material foreign operations. In terms of financial stability, this variance should be underlined, as the level and volatility of ROE are elements used in the evaluation of banks' capital adequacy over the medium-term.

3 BANKING RISKS

Credit risk and —due to the continued international turbulence— liquidity risk are the most important risks facing the Greek banking system.

3.1 CREDIT RISK

Due to the relatively high NPL ratio, continued rapid credit growth in Greece and Greek banks' increased activity in foreign developing markets, credit risk is the main form of risk for the Greek banking system over time. This is also attributable to the fact that, contrary to large banks in the EU and the United States, which draw almost half of their total income from investment banking and other non-interest income operations, Greek banks focus on retail banking.

For this reason, banks should seek to further improve the quality of their loan portfolios and continuously adapt their risk management mechanisms and credit policies to the conditions of the economic environment. At the same time, the Bank of Greece assesses the use of innovative products involving credit risk transfer as a source of funding of banks' operational programmes.

The quality of Greek banks' loan portfolios improved during 2007, as the NPL ratio

9 Underlying this development was also the profitability of a banking group that had recorded losses in 2006.

Table X.3 Evolution of non-performing loans by type of Greek commercial bank loans

(% of total loans of the relevant type)

	2003	2004	2005	2006	2007
Consumer loans	8.0	7.2	7.8	6.9	6.0
Housing loans	4.8	4.6	3.6	3.4	3.6
Corporate loans	7.4	7.8	7.1	6.0	4.6
Total	**7.0**	**7.0**	**6.3**	**5.4**	**4.5**

Source: Bank of Greece.

dropped to 4.5% at end-2007, from 5.4% at end-2006, despite a small increase in the NPL ratio for housing loans (see Table X.3). By contrast, the coverage ratio of provisions to NPLs declined (December 2007: 53.4%, December 2006: 61.8% – see Table X.4) and the ratio of net NPLs[10] to supervisory capital rose (December 2007: 16.8%, December 2006: 15.4%). Underlying these developments were considerable write-offs of €1,819 million (up 25.3% in comparison with 2006), in line with the Bank of Greece's goal of reducing the NPL ratio to 3.5% by the end of 2008. However, it should be pointed out that the NPL ratio at system level is affected by a small number of banks whose NPL ratios are still relatively high, despite their downward path. Therefore, certain banks should further adapt the quality of their risk management to the new framework "Basel II", taking into account international credit risk repricing. In the same vein, banks ought to monitor borrowers' debt-to-income ratio and, in particular with respect to housing loans, the loan-to-value ratio.

3.1.1 Household loans' credit risk

Developments in the quality of the household loan portfolio provided a mixed picture.

The NPL ratio for consumer loans declined (December 2007: 6.0%, December 2006: 6.9%). This is attributable to considerable write-offs during the year and a gradual tightening of credit standards (see Table X.3).[11]

By contrast, there have been indications of a slight deterioration in the quality of the housing loan portfolio, the outstanding balance of which exceeds that of the consumer loan portfolio by a factor of two. The NPL ratio for housing loans increased (December 2007: 3.6%, December 2006: 3.4%), as non-performing housing loans rose faster than total housing loans. In addition, it should be noted that the fast increase in the outstanding balance of housing loans in recent years is expected to have a lagged impact on the NPL ratio, as well as on the estimated potential loss from the housing loan portfolio.[12]

10 Net NPLs are defined as total NPLs overdue by more than 90 days minus cumulative provisions.

11 The tightening of credit standards was helped by the enrichment of the Tiresias S.A. database (which resulted in banks having a better picture of borrowers' financial behaviour) and banks' response to the Bank of Greece's recommendations.

12 This impact will be more serious to the extent that less tight credit standards have been applied and household indebtedness has increased, especially for households on the lower income brackets.

Table X.4 Non-performing loans provision coverage to total loans

	2003	2004	2005	2006	2007
NPL provision coverage ratio	49.9	51.4	61.9	61.8	53.4
Provision coverage of loans in arrears of over one year, lost loans and doubtful loans	70.3	77.3	90.3	96.3	92.4
Ratio of net non-performing loans to total loans	3.5	3.4	2.4	2.1	2.1

Source: Bank of Greece.

Moreover, the loan-to-value ratio for new housing loans remained high. Specifically, this ratio exceeded 80% for 21% of new mortgage loans, which made up 25.7% of disbursements in 2007, and 100% for 5.8% of new mortgage loans, which accounted for 6% of new disbursements (up in comparison with 2006). It is evident that the continued increase in household indebtedness as a result of the upward path of interest rates, coupled with a rise in households' debt-to-net-income ratio, the cooling of the housing market and the evolution of the business cycle in Greece, warrant further improvement in the quality of banks' loan portfolios, not only through loan write-offs or provisioning, but also mainly through timely factoring of the aforementioned parameters into their credit policies.

Finally, the rate of increase in foreign-currency- (mainly Swiss-franc-) denominated housing loans edged up and their percentage in total housing loans quadrupled during 2007 (December 2007: 6.9%, December 2006: 1.7%). Regarding these loans, banks should, according to the Bank of Greece's instructions, in addition to managing risks (at bank and, mainly group level), also inform their customers in detail about the foreign exchange risk inherent in borrowing in foreign currency.

3.1.2 Corporate loans' credit risk

The NPL ratio for corporate loans improved in 2007 (December 2007: 4.6%, December 2006: 6%), as NPLs declined slightly in absolute terms, while the outstanding balance of corporate loans grew strongly. This was also helped by non-MFIs' sustained satisfactory profitability.[13] Positive developments in banks' credit risk are also implied by credit registry data of the Greek credit bureau "Tiresias S.A.".[14] In 2007, the value of unpaid cheques, the number of bankruptcy petitions and the value of court payment orders declined by 23.2%, 21.7% and 10% respectively, while the value of unpaid bills of exchange remained unchanged.

Despite these positive data, banks should reconsider their credit standards, as the rise in the cost of borrowing due to credit risk repricing, the revaluation of the euro vis-à-vis the US dollar and persistently high oil prices may have an adverse impact on corporate profitability and credit-worthiness.

13 In 2007, Athens Exchange-listed non-MFIs' net (after-tax) profits improved by around 15% in comparison with 2006.
14 However, it should be noted that these data are typically very volatile and should be interpreted with caution.

3.2 MARKET AND LIQUIDITY RISK

The turmoil in international money and capital markets, in conditions of increasing exposure to structured products and mounting internationalisation, has highlighted the importance of market and, in particular, liquidity risk. Specifically, the turbulence in the US subprime mortgage market first spread to credit markets and then to the interbank market; as a result, the increased credit risk of subprime mortgage loan portfolios finally turned into market risk, heavily affecting the valuations of investment products underlying which were not only subprime loans, but also other securities (e.g. collateralised debt obligations). These developments in turn led to higher liquidity risk for banks. While demand in the interbank market grew, money markets showed a liquidity shortage, as many categories of investment products sustained heavy losses and banks reduced their lending to counterparty financial institutions (also because of increased counterparty risk). Hence, a large number of banks resorted to central bank liquidity provided through fine-tuning operations and other interventions. At the same time, other banks were forced into substantial asset write-offs and impairment losses, as well as capital increases in order to restore their capital adequacy ratios.

Greek banks' low exposure to structured products resulted in maintaining low market risk, despite the above unfavourable developments in the international economic environment.

By contrast, due to international developments, liquidity risk appears heightened, although Greek banks' liquidity ratios remained at satisfactory levels. Sustained strong credit growth pushed up the loan-to-deposit ratio by around 7 percentage points (December 2007: 112%, December 2006: 105%)[15], although this ratio is still lower than for banking groups in the EU-25 (2006: 130%). It should be pointed out that this ratio exceeds 120% for certain banks that account for 52% of the banking systems' assets. At the same time, slight declines were recorded in the liquid asset ratio (December 2007: 23.2%, December 2006: 24%)[16] and the asset/liability maturity mismatch ratio (December 2007: –2.8%, December 2006: 0.7%),[17] which, however, remained well above the regulatory minimums (20% and –20% respectively).[18]

In the light of these developments in international markets, the policy concerning unexpected risks should be reviewed. At the same time, both banks and regulatory and supervisory authorities should adapt liquidity risk management parameters to the new situation, as the international turmoil showed that markets that were so far considered independent are actually closely correlated. This adaptation involves controlling and improving the risk management models they

15 This ratio varies considerably across banks and depends on each bank's focus on retail banking and the size of its branch network.

16 Defined as the ratio of liquid assets with a maturity of up to 30 days to total borrowed funds with a maturity of up to one year.

17 Defined as the ratio of assets net of liabilities with a maturity of up to 30 days to total borrowed funds with a maturity of up to one year.

18 In the overall assessment of liquidity, one should take into account banks' alternative funding sources, such as securitisation or covered bonds (for the supervisory framework of covered bonds issued by credit institutions, see Bank of Greece Governor's Act 2598/2 November 2007).

apply and taking measures (by preparing relevant plans, safeguarding contingency liquidity sources etc.) to address even conditions of extreme liquidity shortage which are not bank-specific, but systemic (so far, smooth conditions in financial markets used to be taken for granted). This systemic risk is enhanced by the interaction of various segments of money and capital markets.

Furthermore, the policy of financing credit growth through loan securitisation should be reconsidered for two reasons. Sale of loans to investors on the one hand reduces banks' motives to adhere to tight credit standards and monitor closely borrowers' creditworthiness and, on the other hand, increases banks' dependence on the smooth operation of international credit and money markets, which —as it became evident— should not be taken for granted.

In addition, banks, as they ought to, and investors should examine more carefully the risks assumed than in the past and not make their choices exclusively on the basis of published recommendations and credit ratings. This holds all the more true for investments in structured products, i.e. products with structured cash flows which are associated with other debt securities, price indicators (e.g. of equity, bond and commodity prices) or derivatives (forwards, options). In structured products, return for investors and the issuer's obligations depend on changes in the value of the underlying instruments and are very sensitive to changes in risk factors (e.g. interest rates, prices etc.). Moreover, there is no regulated market for trading such products, which makes the derivation of credible market prices difficult.

Finally, the implementation of the new supervisory framework "Basel II" is expected to be beneficial. Specifically, the first pillar of the new framework contains explicit provisions on the calculation of capital requirements for exposures relating to securitisation, including exposures to special purpose vehicles. These provisions are very strict in regard to the criteria that any funding agreements should meet in order to qualify as cash facilities. The second pillar introduces the assessment of internal control systems by supervisory authorities, in particular with respect to liquidity risk management procedures. This will boost financial market participants' confidence, in particular once convergence with best practices has been achieved.

Stress tests are important risk management tools. These are simulations of highly unlikely, but plausible shocks. They are very useful for banks and supervisory authorities, because they lead to vigilance, constant readiness and capacity-building to manage unforeseeable situations, including those that are most improbable to materialise. The importance of such tests has grown in the current conjuncture, where the international financial turmoil has triggered a chain reaction of varying intensity and duration across international markets or regions and, as a result, it will take a long time to fully estimate its systemic impact and consequences on the activity and performance of the real sector of various economies.

Stress tests enhance banks' ability not only to identify accurately, classify methodically and assess in detail the specific categories of risk they would face in the event of adverse external shocks, but also to make a quantitative and comparative evaluation of such unexpected events' impact on their financial condition. Valuations and other information gleaned from stress tests are valuable for soberly outlining in advance the general strategy and specific measures and policies that banks would apply if they ever had to face emergencies that could impair —to an unknown extent and for an unknown time— the financial robustness and stability of banks themselves and, hence, the banking system as a whole and, through this, all the other sectors and subsectors of the economy.

In any case, the Eurosystem, where it deems it appropriate (as it did so repeatedly after August 2007), is expected to take proper action in order to smoothen liquidity conditions across the banking system. In such emergencies, the role of the institutional "lender of last resort" is essential. However, it will actually promote banking stability and safety only if credit institutions, for their part, are prepared in a sufficient and timely manner to adapt to emergencies. To help in this direction, the Bank of Greece designed common scenarios for a stress test conducted by Greek credit institutions, in order to examine the adaptiveness of their liquidity management strategy and policies in "extreme conditions" (see Box X.1).

Box X.1

LIQUIDITY STRESS TESTS

The liquidity stress test for Greek commercial banks, using data as at 31 December 2007 and the 30th of June 2008 as time horizon, was designed to collect data on the impact of the continued turmoil on the financial condition of banks and to examine the adaptation of banks' policies if extreme funding difficulties were to arise.

As even initially limited shocks deteriorate rapidly when there is a liquidity shortage and can intensify into solvency shocks, the stress test was based on scenarios of very extreme liquidity conditions.

It should also be noted that these scenarios do not take into account that in extreme conditions central banks intervene, in particular by providing liquidity, so as to deter systemic risks.

1. Cost increase – valuations

According to data on the increase in funding costs and on profits/losses from valuation of securities in banks' portfolios, the impact from the turmoil on the Greek banking system until 31 December 2007 was small, as:

— The total net loss (losses less profits) was 0.69%[1] of own funds as at 30 September 2007 and is mainly accounted for by a rise in funding costs (0.40% of own funds).

—Net loss from securities closely associated with the turmoil (collateralised debt obligations – CDOs, asset/mortgage-backed securities, other structured products and investments in hedge funds

1 If profits from securities valuation are not taken into account, this loss amounts to 1.12% of own funds, and total loss to 1.52% of own funds.

and private equity funds) came to 0.30% of own funds.[2]

– Net profits from other securities (government and corporate bonds, Treasury bills, shares, mutual funds and other debt securities) came to 0.01% of own funds.[3]

2. Examination of contingency policy

In the context of the stress test, three escalating scenarios were designed and 18 banks were invited to calculate the resulting financial exposure, as well as the Liquid Asset Ratio (LAR) as at 31 March 2008 and 30 June 2008, with reference data of 31 December 2007, if these scenarios were to materialise. If the LAR fell below 20%, banks were asked to determine an optimal mix of reduced credit growth and further borrowing, in order for the LAR to revert to the 20% supervisory minimum.

The following scenarios were used:

–1st Scenario: Inability to renew 50% of market funding (wholesale funding) maturing until 30 June 2008.

– 2nd Scenario: 1st Scenario + inability to renew 20% of time deposits maturing within the scenario's time horizon.

– 3rd Scenario: 2nd Scenario + withdrawal of 10% of sight and saving deposits, cumulatively until 31 March 2008, without renewal until 30 June 2008.

As it transpired from these simulations, the average LAR for all banks falls below the 20% supervisory minimum under all three scenarios. However, for 7 banks under the first scenario and 3 banks under the second and third scenarios the LAR remains below 20%, while under the first two scenarios the LAR remains above 10% for most banks.

It should be noted that the object of conducting stress tests is not to impose administrative measures, but to enable banks to determine themselves the required corrective action to adapt their strategies and policies, which are assessed by supervisory authorities according to each bank's risk profile, including the loan-to-deposit ratio, which has exceeded 120% for certain banks. Although this level suggests medium reliance on money market funding, in conditions of protracted liquidity shortage this would force banks to seek an appropriate mix of reduced credit growth and market borrowing at higher cost and/or resorting temporarily to the Eurosystem's marginal lending facility for a certain (in any case short) time period.

	Number of Banks (30.6.2008)		
LAR ratio	1st scenario	2nd scenario	3rd scenario
>20%	7	3	3
10% - 20%	4	5	1
<10%	7	10	14

Sources: Bank of Greece and bank balance sheets.

2 If valuation profits are not taken into account, loss from securities closely associated with the turmoil amounts to 0.40% of own funds and loss from other securities to 0.72% (total: 1.12%).
3 See previous footnote.

4 CAPITAL ADEQUACY

The capital adequacy ratios (CARs) of all Greek commercial banks and their groups declined during 2007, but continue to suggest that their funds still provide a satisfactory margin for ensuring the stability of the banking system. Strong credit growth in Greece and abroad led to a considerable increase in risk-weighted assets for credit risk. This development was not fully offset by the capital increases completed during 2007 and banks' retained earnings.

In more detail, at banking group level, the CAR and the Tier I ratio dropped for the second consecutive year and stood at 11.2% (compared with a supervisory minimum of 8%) and 9.2% respectively in 2007 (see Table X.5), but remained close to the levels of large internationalised banks in the EU (11.1%, according to data for the first half of 2007). This decline came as a result of a larger increase (of 27.8% in 2007 over 2006) in banking groups' risk-weighted assets for credit risk than in their supervisory own funds (up 16.7%). At the same time, risk-weighted assets for market risk recorded a small decrease of 4% in comparison with 2006 and make up only 3.8% of total weighted assets. The ratio of weighted assets to total assets of banking groups rose further to 65.2% (2006: 62.9%).

Banks' CAR also dropped, reaching 12.7% (December 2006: 13.7%). The Tier I ratio showed a smaller decline (to 9.3%, December 2006: 9.5%). As was also the case for banking groups, underlying this was a considerable increase (of 28.2%) in risk-weighted assets for credit risk due to continued rapid credit growth. Moreover, risk-weighted assets for market risk rose by 13.5% in comparison with 2006, reflecting heightened volatility in financial markets.

5 ON-SITE EXAMINATIONS, SANCTIONS AND CORRECTIVE MEASURES

5.1 ON-SITE EXAMINATIONS

According to the legislation in force and the decisions of the Bank of Greece, credit and financial institutions' supervision aims at ensuring in a timely manner that their managements comply with their obligations concerning the stability of the financial system. The Bank of Greece exercises supervision by analysing all kinds of reports, data and information submitted to banks (off-site supervision), by carrying out on-site examinations (on-site supervision) and by holding regular discussions with the managements and competent officers of banks in order to:

– ensure their compliance with supervisory requirements;

– assess their internal control systems in order to verify both their adequacy in terms of strategy and policy, and their implementation in supervised institutions' day-to-day business;

– verify the implementation of any corrective measures that the Bank of Greece imposed following earlier examinations or banks themselves undertook to implement.

On-site examinations focus on assessing the efficiency of risk management, in particular under "Basel II", and the incorporation of the

Table X.5 Capital adequacy of Greek commercial banks and composition of regulatory capital on a non-consolidated basis

	2003	2004	2005	2006	2007
Tier I (million euro)	10,849	11,311	11,911	16,410	20,647
Tier II (million euro)	3,074	4,654	6,622	7,760	7,260
Deductions from total own funds (million euro)	–181	–147	–286	–573	–1,240
CAR at bank level (%)	12.8	13.5	13.3	13.7	12.7
CAR at group level (%))	12.0	12.9	13.2	12.2	11.2

Source: Bank of Greece.

results of stress tests into banks' business decisions. The objects of these examinations also include ensuring that the anti-money laundering (AML) framework is implemented and suspicious transactions are reported to the National Authority; verifying compliance with transaction transparency rules; credentialing credit institutions' employees and officers etc. On-site examinations are carried out by the staff of the Supervision of Credit and Related Financial Institutions Department and specialised employees of the Bank of Greece branches.

The Bank of Greece's supervision of institutions cannot be judged only on the basis of the number of on-site examinations. As already mentioned, discussions with banks' competent officers and daily monitoring of bank-specific developments are also crucial, as they help the Bank of Greece form a picture in a timely manner, taking into account each bank's risk profile, and verifying compliance with instructions. (For the number of on-site examinations conducted by the Bank of Greece in the last three years, see Table X.6).

5.2 SANCTIONS

Regarding sanctions, two issues should be discussed: (a) their form (non-remunerated deposit or pecuniary penalty); and (b) their role in the correction of weaknesses and the prevention of new violations.

Since the 1950s, according to the legislation in force, the Monetary Committee and later the Bank of Greece, as monetary and supervisory authorities, have always imposed sanctions in the form of non-remunerated deposits on banks that hold reserve accounts with the Bank of Greece, instead of fines in favour of the State.

As a rule, fines in favour of the State are imposed on companies that do not hold accounts with the Bank of Greece (e.g. bureaux de change, financial leasing companies etc.). Moreover, non-pecuniary penalties are imposed, such as suspension or withdrawal of authorisation, non-approval of expansion of activities (e.g. establishment of branches).

The amount of the non-remunerated deposit is calculated after determining the amount of the sanction, using as presumed interest rate the Eurosystem's marginal lending facility rate against collateral. As a result, the loss of profits due to the sanction typically exceeds the marginal lending rate,

Table X.6 Number of on-site examinations by the Bank of Greece

	2005	2006	2007
At credit institutions	**240**	**200**	**201**
regarding:			
– internal control system/risk management	56	55	32
– anti-money laundering	152	97	129
– transparency of transactions	32	48	40
At financial institutions	**20**	**23**	**8**
Other examinations	**136**	**101**	**131**
Total	**396**	**324**	**340**
of which at:			
– branches outside Attica	152	164	106
– branches and subsidiaries abroad	6	6	13

Source: Bank of Greece.

as the marginal cost of funds is much higher and differs across banks. (For the pecuniary penalties imposed in 2006 and 2007 by category, see Table X.7.)

5.3 CORRECTIVE MEASURES

Fines imposed according to the gravity of the violation instead of profitability are not the only and, often, not the most effective sanction imposed on banks.

The managements of supervised institutions are aware that non-compliance with supervisory requirements does not bring about only the aforementioned sanctions.

The 23rd of the 26 Core Principles for Effective Banking Supervision of the Basel Committee on Banking Supervision expressly provides that a range of measures should be available to supervisory authorities, including recommendations to credit institutions. Moreover, Directive 2006/48 and Law 3601/2007 provide that, where a bank does not have an adequate risk management system, sanctions may include increasing the capital requirements of the bank concerned.

Against this background, the Bank of Greece:

– Has slashed the expansion plans of banks that had inadequate internal control systems. Non-approval of establishment of branches has proved to be a very effective sanction.

– Has made use of the possibility (existing already since 1997, i.e. before Law 3601/2007 was passed) to increase banks' minimum capital requirements. Today, seven commercial banks are obliged to have CARs above the 8% supervisory minimum.

6 DOMESTIC INSTITUTIONAL DEVELOPMENTS

6.1 DECISIONS OF THE BANK OF GREECE AND LEGISLATIVE ARRANGEMENTS

Table X.7 Sanctions imposed by the Bank of Greece

(amounts in euro)

A. Transparency of transactions

	2006 (14 banks)	2007 (8 banks)	2006-2007 total (16 banks)
Amount of non-interest-bearing deposit	34,373,200	14,400,000	48,773,200
Total costs[1]	859,330	360,000	1,219,330
Average costs	42,603	45,000	43,801
Minimum costs[2]	3,000	10,000	–
Maximum costs	77,778	160,000	–

B. Anti-money laundering framework

	2006 (14 banks)	2007 (12 banks)	2006-2007 total (18 banks)
Amount of non-interest-bearing deposit	13,413,200	20,200,000	33,613,200
Total costs[1]	335,330	505,000	840,330
Average costs	14,436	42,083	28,260
Minimum costs[2]	6,108	20,000	–
Maximum costs	20,804	75,000	–

1 Calculated on the basis of the marginal lending rate (5%). Calculated on the basis of the cost of capital (7%), the total costs of sanctions in 2006-2007 with respect to transaction transparency amounts to €1,707,062, while regarding the anti-money laundering framework, total sanction costs amount to €1,176,462.
2 Under the principle of proportionality, certain categories of sanctions may not exceed the maximum amount for the corresponding category provided for by Law 2912/2001 on compound interest (e.g. for a delayed reply to customers, the range of sanctions is set at €2,934,70–€14,673,51).
Source: Bank of Greece.

During 2007 and in early 2008, the Bank of Greece made considerable modifications to the supervisory framework, mainly by transposing provisions of Community Directives and adopting guidelines issued by the Committee of European Banking Supervisors (CEBS) and other provisions by authority of the new banking law (3601/2007). Specifically:

(a) Law 3601/2007 transposed to Greek law the general principles of Directives 2006/48/EC and 2006/49/EC on the capital adequacy of investment firms and credit institutions, replacing and supplementing the pre-existing provisions of banking legislation (Law 5076/1931, Law 1665/1951 etc.), which were included in the new law. Most notably:

– The provisions on credit institutions' capital increases have been modernised, allowing credit institutions to cover increases also by contributions in kind, provided that the supervisory conditions set by the Bank of Greece are fulfilled.

– To ensure a level playing field, the interest rate and compounding of interest on the credits of all supervised financial institutions are governed by the legislation on credit institutions.

– The Bank of Greece may request information also about shareholders with voting rights over 1% (i.e. the minimum is lowered), with a view to enhancing transparency and controlling the eligibility of shareholders that can be very influential in case of wide dispersion of shares.

– The role of the competent authority supervising banking groups on a consolidated basis is strengthened, in particular in periods of crisis when the stability of the financial sector of an EU Member State is at risk.

– The Bank of Greece may publicise its decisions imposing sanctions, provided that the sanctions do not concern the supervisory requirements of the relevant law and publicisation will not cause serious disturbances to financial markets or a disproportionate damage to the parties concerned.

– The new provisions describe the criteria taken into account by the Bank of Greece in calculating the fines and sanctions imposed on supervised institutions and introduce immunities for the Bank of Greece, as supervisory authority, and its competent statutory organs according to the core principles of the Basel Committee.

– The costs of examinations carried out by the Bank of Greece may be borne by supervised institutions.

(b) Bank of Greece Governor's Acts 2587-2596/20 August 2007 completed, by authority of Law 3601/2007, the transposition to Greek law of the provisions of the aforementioned Directives. Most importantly:

– The current framework was modified in regard to the assets and composition of credit institutions' own funds taken into account for the calculation of their capital adequacy.

– The method of calculating capital requirements for credit risk with the "standardised approach" was specified and the "internal ratings-based approach" was introduced. Thus, a totally new methodology for calculating capital requirements on the basis of risk parameters was launched, allowing credit institutions to use their internal management systems and assessment models for these parameters.

– Capital requirements for operational risk were established, which can be calculated by banks either with standardised or sophisticated approaches.

– The method of calculating capital requirements for market risk was modified.

– Credit institutions were required to disclose data mainly on (1) the companies of the group of a credit institution; (2) its own funds and the method of calculating its capital adequacy; and (3) its exposure to risks of all kinds.

– Alternative methods for calculating banks' capital requirements for their exposures connected with securitisation were determined.

– (1) Qualitative criteria for calculating each credit institution's capital adequacy according to its risk profile were established, for covering all kinds of risks (internal capital), as well as (2) a procedure for assessment by the Bank of Greece of each credit institution's compliance with its supervisory obligations.

– The applicable provisions on the control of large financial exposures were amended and codified.

(c) The Bank of Greece further adapted the applicable framework to current conditions. The relevant Bank of Greece Governor's Acts:

– Set the conditions on which asset-backed securities issued by a credit institution are recognised by the Bank of Greece as covered bonds coming under a special supervisory framework (Bank of Greece Governor's Act 2598/21 November 2007).

– Abolished the 1 million ceiling per customer for the extension of credit by credit institutions and members of the Athens Exchange for carrying out transactions on the stock exchange (Bank of Greece Governor's Act 2599/2 November 2007).

– Raised the maximum administrative sanctions that can be imposed by the Bank of Greece on banks and other supervised firms (Bank of Greece Governor's Act 2602/4 February 2008).

– Simplified the procedure for the Bank of Greece's assessment of banks' applications for (1) establishment of new branches; and (2) participation in the capital of financial corporations (Bank of Greece Governor's Acts 2603/4 February 2008 and 2604/4 February 2008).

– Codified the provisions on credit institutions' supervisory reporting obligations to the Bank of Greece and determined the persons that are considered to have a "special relation" with the credit institution and hence their transactions therewith come under specific supervisory provisions (Bank of Greece Governor's Act 2606/21 February 2008).

6.2 PROVISIONS ON THE RENDERING OF INVESTMENT SERVICES BY CREDIT INSTITUTIONS

Law 3606/2007 transposed to Greek law Directive 2004/39/EC on markets in financial instruments (MiFID). This law sets out, inter alia, detailed rules on the organisation and behaviour of both investment firms and credit institutions in providing investment services to their clients, with a view to ensuring higher protection and efficiency. By authority of this law, Bank of Greece Governor's Acts were issued:

– amending the provisions that govern credit institutions' outsourcing of any activities (banking, investment or ancillary) and specifying the core principles on the identification and management of conflicts of interests, customers' asset custody and record-keeping in relation to the provision of investment services (Bank of Greece Governor's Act 2597/31 October 2007); and

– laying down the terms and conditions of registration of persons providing services as brokers or associated representatives on behalf of credit institutions in a register kept by the Bank of Greece (Bank of Greece Governor's Act 2600/28 November 2007).

7 EUROPEAN AND INTERNATIONAL DEVELOPMENTS

7.1 INSTITUTIONAL DEVELOPMENTS IN THE EU

In September 2007, the European Parliament and the Council adopted Directive 2007/44/EC amending previous provisions as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector. The object of this Directive is to enhance transparency and promote harmonisation among Member States of the procedures followed in financial sector mergers and acquisitions, without prejudice to each authority's supervisory powers.

Moreover, in November 2007, the European Parliament and the Council adopted Directive 2007/64/EC, which provides the legal background for the creation of a single market for payment services in the EU. The object of this Directive is to ensure free and uniform access to such markets and strengthen competition, consumer protection and service efficiency, as well as reduce costs.

7.2 COMMITTEE OF EUROPEAN BANKING SUPERVISORS (CEBS)

In 2007, CEBS focused on promoting convergence among European supervisors' practices during the implementation of the new capital adequacy framework. In particular, in addition to providing technical advice on the revision of the Community framework on large financial exposures and liquidity risk management, CEBS published:

– (a) amendments to its Guidelines on credit institutions' financial reporting;

– (b) a protocol and methodology for peer review of the implementation of the Guidelines; and

– (c) a protocol on mediation for the resolution of specific issues of supervision of groups active in different Member States.

7.3 PREVENTION OF THE USE OF THE FINANCIAL SYSTEM FOR MONEY LAUNDERING AND TERRORIST FINANCING

In 2007, the Financial Action Task Force (FATF) completed Greece's assessment in this respect. FATF's observations are set out in the Assessment Report adopted by its Plenary Session in June 2007. The said report identifies the weaknesses of the Greek financial system as a whole and recommends improvements in the supervisory framework. The main points concern areas that do not affect the Bank of Greece.

Regarding the Bank of Greece, the assessment identifies certain weaknesses in the area of human resources, as well as in issues connected with the implementation of the forthcoming law. However, although it was judged that the Bank of Greece has responded satisfactorily to the relevant recommendations, this is not reflected in the final grade, due to weaknesses in the system as a whole.

In this area, measures have already been planned for addressing the relevant general or specific weaknesses. They include the introduction by the Capital Market Committee of new provisions as from 1 March 2007 and the commencement of operation of the Private Insurance Supervisory Authority on 1 January 2008.

To fully respond to FATF's recommendations, the Bank of Greece:

– Carried out an administrative restructuring of the AML sector in order to further enhance its efficiency and modified the institutional framework, by introducing two amendments to Annex 4 to Bank of Greece Governor's Act 2577/2006 (decisions 242/6/4 May 2007 and 257/4/22 February 2008 of the Banking and Credit Matters Committee).

– Hired and will continue to hire more staff, also placing great emphasis on its training, by organising seminars under distinguished foreign lecturers.

– Reviewed controls according to the risk-based approach, deciding that the assessment of the adequacy of supervised institutions' AML/CTF systems will be a part of the overall assessment of their internal control systems. To this end, in addition to examining transactions at branch level, assessment focuses on the efficiency of systems at central level, which ensure branches' compliance.

– Carried out specific examinations of the implementation of the regulatory framework at 13 subsidiaries of Greek banks in Balkan countries, in addition to examinations in Greece (see Table X.6).

– The sanctions framework was modified extensively by Law 3601/2007 and Bank of Greece Governor's Act 2602/4 February 2008 (as already mentioned in Section 6.1 of this chapter).

The institutional framework is expected to improve further by the adoption of the new law on the suppression and prevention of money laundering, which will transpose to Greek law the third Community Directive (2005/60/EC), and by the adaptation of the Bank of Greece's instructions to credit institutions. This law, as well as the development of the required attitude on the part of supervised institutions in this area, are top priorities in the effort to address the aforementioned weaknesses in the financial system as a whole.

8. PAYMENT SYSTEMS

8.1 THE HERMES PAYMENT SYSTEM

The HERMES real time gross settlement system operated satisfactorily in 2007, contributing to the safe and effective conduct of payments and to financial stability.

Payment traffic in the HERMES system rose by 6.5% to 1.6 million in volume terms and by 22.6% to €8,423 billion in value terms in comparison with 2006 (see Table X.8). The increase in volume terms stemmed mainly from cross-border (especially interbank) payments, which, however, rose proportionally less in value terms. The largest increase in value terms was recorded in domestic payments (most notably among them, customers' payment orders). As domestic payments rose more in value than

Table X.8 Transactions through the HERMES system

Payment orders	Number of transactions			Value of transactions (million euro)		
	2006	2007	% change	2006	2007	% change
1. Domestic	**1,194,058**	**1,253,986**	**5.0**	**4,384,690**	**5,616,243**	**28.1**
– Customer payments	645,586	677,867	5.0	214,638	281,496	31.1
– Interbank payments	548,472	576,119	5.0	4,170,052	5,334,747	27.9
2. Cross-border	**324,083**	**362,190**	**11.8**	**2,488,131**	**2,806,471**	**12.8**
– Customer payments	195,983	213,359	8.9	15,581	19,904	27.7
– Interbank payments	128,100	148,831	16.2	2,472,550	2,786,567	12.7
HERMES total	**1,518,141**	**1,616,176**	**6.5**	**6,872,821**	**8,422,714**	**22.6**
TARGET total	**83,179,993**	**93,262,844**	**12.1**	**533,541,100**	**614,252,407**	**15.1**

Sources: Bank of Greece and ECB.

in volume terms, their average value per transaction increased from €3.7 million in 2006 to €4.5 million in 2007.

TARGET transactions grew by 12.1% in volume terms and by 15.1% in value terms in 2007. As the rate of increase in the HERMES transactions in volume terms was lower than that for TARGET transactions, while their growth rate in value terms was higher, the share of the HERMES system in the TARGET system fell to 1.73% (2006: 1.83%) in volume terms and increased slightly in value terms (2007: 1.37%, 2006: 1.29%).

The smooth flow of payments was supported by sufficient intraday liquidity provided by the Bank of Greece also in 2007. The value of posted collateral was well in excess of the collateral actually used throughout 2007. Specifically, the average daily amount of posted collateral was €2,644.1 million, while the average value of intraday credit was €719.2 million, providing an adequate buffer against any credit institutions' increased liquidity requirements.

The availability of the HERMES system remained high in 2007, with the average annual availability rate standing at 99.84% (owing to three failures due to technical reasons, which were addressed successfully), close to the average annual figure for the TARGET system (99.89%).

8.2 TARGET2 PAYMENT SYSTEM

The new trans-European payment system TARGET2 is used for real-time settlement of payment orders in central bank money. With its advanced potential, it constitutes an integrated payment system for Europe. The completion of the migration to TARGET2 signals the end of the operation of the real-time gross settlement systems of the Eurosystem's national central banks that made up the original TARGET system, including the HERMES system.

In 2007, the Eurosystem focused on tests covering the entire range of the TARGET2 operations and settled certain institutional issues. TARGET2 went live successfully on 19 November 2007, when the first group of countries joined following the schedule set by the Eurosystem, according to which migration to the new system will be completed in three waves. The second group of countries joined equally successfully on 18 February 2008, and the third group (including Greece) will join on 19 May 2008.

The Bank of Greece has completed both its preparation for connecting to the new system and the coordination and promotion of the migration of credit institutions and ancillary systems. The testing period for Greece, which started in July 2007 and was completed in April 2008, enabled the TARGET2 members to control the readiness of their systems, so as to ensure their uneventful connection with the new payment system.

8.3 SINGLE EURO PAYMENTS AREA

The creation of a Single Euro Payments Area (SEPA) is one of the priorities of the Eurosystem and the European Commission. With the euro cash turnover in the euro area countries in 2002, a single cash payments area was created, excluding, however, other means of payment, i.e. credit transfers (remittances), direct debits and credit/debit cards. Differences across countries in standards, techniques and procedures for using these means of payment led the Eurosystem and the European Commission to undertake an initiative for the creation of a single payment area also for means of payment other than cash. The object of SEPA is to create a single market for payment services without discriminating between cross-border and domestic payments and enabling all euro area payments to be carried out as safely and rapidly as are domestic payments today. Effectively, this means that consumers, companies and other economic agents will be able, by using a single bank account, to carry out and accept payments on the same main conditions and with the same rights and obligations, regardless of their geographical location.

SEPA poses an important challenge to the banking sector, which established to this end the European Payments Council (EPC) in 2002, encouraged and actively supported by the Eurosystem and the European Council. The EPC has focused its efforts on developing the SEPA means of payments (credit transfer orders, direct debits and credit/debit cards), which will eventually replace the corresponding domestic means of payment. To this end, the EPC prepared rules of operation for two new payment schemes, which concern credit transfers and direct debits, and processed a framework of general principles to govern payments through cards.

The creation of SEPA required harmonisation of the payments legal framework, which is achieved by Directive 2007/64 of the European Parliament and the Council on payment services. The transposition of this Directive to countries' domestic law is expected to be completed by November 2009. This Directive harmonises the requirements for market access and introduces a "single passport" for payment services providers other than banks, thus strengthening competition in domestic markets. It also establishes a set of harmonised information requirements that should be met by all payment services providers, whether they offer SEPA or domestic products. This will ensure greater transparency for customers and full harmonisation of domestic rules, which vary considerably today. The provisions of the Directive clearly set out the rights and obligations of both users and payment services providers, thus consolidating legal certainty, which is necessary for means of payment, especially SEPA direct debits.

The migration to SEPA for credit transfers started on 28 January this year. "Old" domestic means of payment and the corresponding "new", SEPA-compliant instruments will coexist for the coming period. The plan is to achieve gradual increase in the use of SEPA means of payment, so that by the end of 2010 the bulk of payments will be carried out through them. It should be noted that the possibility of using SEPA direct debits across the euro area will not materialise before the transposition of the Payment Services Directive into Member States' domestic law. Until then, SEPA direct debits and domestic direct debits will coexist in domestic markets.

In Greece, the Hellenic Bank Association, which is represented in the European Payments Council,[19] is responsible for the development of the SEPA means of payment. The Bank of Greece, within the context of its powers to oversee and promote the smooth operation of systems and means of payment, actively supports the development and completion of SEPA and coordinates the SEPA Forum[20] set up to this end.

19 As already mentioned, the European Payments Council was established by the banking industry and its purpose is to establish rules and procedures for payments in euro, in particular those carried out through SEPA means of payment, for the provision of information to all parties involved and the coordination of efforts for the establishment of a single market for payment services.

20 The SEPA Forum is chaired by a Deputy Governor of the Bank of Greece, and participants include the Hellenic Bank Association, the Ministry of Economy and Finance, the company "DIAS Interbank Systems", representatives of chambers of commerce and utilities, and consumer associations. The Forum's purpose is to monitor progress with SEPA in Greece, inform end-users and facilitate the use of SEPA products and the promotion of the migration plan.

APPENDIX TO CHAPTER X

BANK OF GREECE DECISIONS CONCERNING THE ESTABLISHMENT AND OPERATION OF CREDIT INSTITUTIONS AND THE SUPERVISION OF THE FINANCIAL SYSTEM

1 January 2006

The Paris-based Bank Société Générale discontinues the operation of its branch in Greece.

2 January 2006

A branch of the Belgium-based Fortis Bank SA/NV commences its operation in Greece.

4 January 2006

The merger between the National Bank of Greece and the company "Ethniki Axiopiiseos Akiniton kai Ekmetallefseos Genikon Apothikon S.A." is approved.

"Pireaus Leasing S.A." is authorised to operate as a leasing company.

24 January 2006

Alpha Bank is authorised to establish and operate 30 new branches in Bulgaria and 4 in Albania.

The National Bank of Greece is authorised to establish and operate 7 new branches in Albania.

The Bank of Greece withdraws its authorisation for the establishment and operation of a bureau de change by Change Star S.A.

24 February 2006

The maximum amount that the Agricultural Bank is authorised to invest in shares and mutual fund units is harmonised with that of other credit institutions and raised to 25% from 15% of the bank's own funds.

The merger between EFG Eurobank Ergasias and Intertrust Mutual Funds Management S.A. is approved.

9 March 2006

With a view to adapting the principles and criteria that govern credit and financial institutions' internal control systems to supervisory developments, as well as taking into account the need to further specify individual issues, notably relating to risk management and compliance with the institutional and supervisory framework in force, the basic general principles and criteria all credit and financial institutions supervised by the Bank of Greece must comply with are established in order to ensure that these institutions have, on both an individual and a group basis, an effective organisation structure and an adequate Internal Control System, including risk management, internal audit and regulatory compliance.

10 March 2006

Marquis International S.A. is authorised to operate as a money transfer intermediary.

EFG Eurobank Ergasias is authorised to acquire 100% of the share capital of "Nacionalna Stedionica Banka", based in Serbia-Montenegro.

27 March 2006

"Geniki Cards and Financial Services S.A." is authorised to become a credit company under the name "SFS Hellasfinance S.A.".

4 April 2006

The absorption of "Ivision – Advanced Systems and Information Services S.A." by Pireaus Bank is approved.

13 April 2006

Proton Investment Bank S.A. is authorised to acquire a qualifying holding of 20% in the share capital of "Aeoliki Portfolio Investment S.A.".

19 April 2006

"Greek Postal Savings Bank S.A." is authorised to operate in Greece.

EFG Eurobank Ergasias is authorised to increase its qualifying holding in the share capital of "Dias Portfolio Investment S.A.".

EFG Eurobank Ergasias is authorised to acquire 100% of the share capital of the Bucharest-based life insurance company under establishment "SC EFG Eurolife Asigurari de Viata S.A.".

8 May 2006

Hellenic Post S.A. is authorised to acquire 10% of the share capital of "Greek Postal Savings Bank S.A."

11 May 2006

The National Bank of Greece is authorised to acquire the majority of the share capital of the Turkey-based Finansbank AS.

"Manig Money Services S.A." is authorised to operate in Greece.

30 May 2006

Pireaus Bank is authorised to acquire the majority of the share capital of its Bucharest-based subsidiary "Pireaus Bank Romania S.A.".

Laiki Bank (Hellas) S.A. is authorised to acquire 100% of the share capital of "Laiki Leasing S.A.".

15 June 2006

The financing of natural or legal persons who are among the 10 largest shareholders or stake holders in a company, in order to acquire shares or stakes, is allowed provided that with this acquisition the borrower's share in the company's capital is either maintained or increased.

21 June 2006

The National Bank of Greece is authorised to operate 5 new branches in Serbia-Montenegro.

10 July 2006

IRF European Finance Investment Ltd. is authorised to acquire a qualifying holding of 30% in the share capital of Proton Investment Bank S.A.

The ceiling on credit institutions' investment in equity and mutual fund units (25% of their own funds) will be calculated on the basis of their net positive position in equity, derivatives on equity and equity-indexed derivatives of their trading portfolios.

JP Morgan Chase Bank N.A. is authorised to establish and operate a representative office in Greece.

26 July 2006

The Paris-based Crédit Agricole S.A. is authorised to acquire 100% of the share capital of the Commercial Bank of Greece.

The Agricultural Bank of Greece is authorised to acquire a qualifying holding up to 57.12% (85% by a later decision) in the share capital of the Romania-based Mindbank S.A.

Marfin Financial Group S.A. is authorised to acquire a qualifying holding up to 49% of voting rights in Egnatia Bank.

Société Générale Consumer Finance Holding Hellas S.A. is authorised to acquire 100% of the share capital of “Cofidis Hellas Finance S.A.”.

EFG Eurobank Ergasias is authorised to acquire the majority of the share capital of the Turkey-based “Tekfenbank A.Ş.”.

6 September 2006

The absorption of Omega Bank and of Proton Stock Brokers by Proton Investment Bank is approved. Proton Investment Bank is also authorised to become a member of the Athens Exchange.

Dubai Financial LLC is authorised to acquire a qualifying holding up to 34% in the share capital of Marfin Financial Group S.A. and, through it, in the share capital of Marfin Bank, Investment Bank of Greece and Egnatia Bank.

“EFG Factors S.A.” is authorised to operate a branch in Bulgaria.

EFG Eurobank Ergasias is authorised to acquire the majority of the share capital of the Ukraine-based Bank Universal.

The Zurich-based I.B.I. Bank AG is authorised to establish and operate a representative office in Greece.

21 September 2006

The Agricultural Bank of Greece is authorised to acquire a qualifying holding in the share capital of the Serbia-based Agroindustrijka Komercijalna Banka-AIK Banka AD.

26 September 2006

Marfin Bank S.A. is authorised to acquire the majority of the share capital of the Investment Bank of Greece.

2 October 2006

A branch of the Austria-based BMW Austria Bank GmbH commences its operation in Greece.

13 October 2006

The National Bank of Greece is authorised to convert its branch network in Serbia into a subsidiary.

The operational principles and the evaluation criteria for the structure of credit and financing institutions’ internal control systems are specified, with a view to preventing the use of the financial system for money-laundering and terrorism financing.

The authorisation for the establishment and operation of bureaux de change by “Dias Bureaux de Change S.A.” is withdrawn.

Novabank S.A. is authorised to amend its Statute and its registered name. The latter becomes “Millenium Bank S.A.”.

8 November 2006

The National Bank of Greece is authorised to acquire 100% of the share capital of the Serbia-based “Vojvodjanska Banka AD Novi Sad”.

28 November 2006

EFG Eurobank Ergasias is authorised to acquire 100% of the share capital of the Bulgaria-based “DZI Bank AD”.

Piraeus Bank is authorised to acquire a qualifying holding up to 27% in the share capital of "Trieris Real Estate Ltd.".

The authorisation for the establishment and operation of bureaux de change by "Karlos Enterprises Bureaux de Change S.A." is withdrawn.

By virtue of Law 3483/2006, "Pancretan Cooperative Bank" is authorised to conduct transactions with non-members as well.

11 December 2006
The Cyprus-based Marfin Popular Bank Public Co. Ltd. is authorised to acquire a qualifying holding up to 100% in the share capital of Egnatia Bank S.A., of Marfin Financial Group S.A. and, through the latter, up to 100% of the share capital of Marfin Bank ATE and 91% of the share capital of Investment Bank of Greece S.A.

The National Bank of Greece is authorised to acquire 100% of the share capital of P&K Investment Services S.A.

Except for the cases where the manner of application of contractual terms is clearly determined, whenever the contractual terms agreed upon between customers and credit institutions are unilaterally amended by the credit institution, the latter is obliged to inform the counterparty individually. Besides, fees for the lack of transactions will not be applied to savings deposits, to the extent that such fees exceed interest amounts and reduce the outstanding balance of the deposited amount.

The authorisation for the establishment and operation of bureaux de change by "Eurocambio Bureaux de Change and Tourist Enterprises S.A." is withdrawn.

"Intel Express Bureaux de Change S.A." is authorised to operate in Greece.

The terms for keeping sight deposit accounts and for the circulation of cheques through the banking system are amended and codified so as to respond to market conditions and also to allow for their better application by credit institutions and customers.

1 January 2007
The Greek branch of the Italy-based bank "Sanpaolo IMI S.p.A." changes its registered name to "Intesa Sanpaolo S.p.A.".

24 January 2007
"Proton Bank S.A." is authorised to increase its qualifying holding in the share capital of the Cyprus-based Interfund Investments Ltd.

1 February 2007
The branch of the Poland-based DaimlerChrysler Bank Polska S.A. commences its operation in Greece.

13 February 2007
The Greek branch of Société Générale, which is under liquidation, is authorised to prolong its administrative, accounting and tax-related operations.

20 February 2007
The framework for the processing and recirculation of euro banknotes by credit institutions and professional cash handlers is determined.

1 March 2007

Alpha Bank is authorised to acquire: (i) a direct qualifying holding in the share capital of a holding company under establishment and (ii) an indirect qualifying holding in the share capital of the Turkey-based Alternatif Bank A.Ş., Alternatif Financial Kiralama A.Ş., Alternatif Yatirim A.Ş. and Alternatif Yatirim Ortakliği A.Ş.

The Russia-based Kedr Close Joint Stock Company Commercial Bank is authorised to establish and operate a branch in Greece.

9 March 2007

Piraeus Bank is authorised to acquire a qualifying holding in the share capital of the insurance company "Europaiki Pisti AEGA".

ANNEX

ANNUAL ACCOUNTS FOR THE YEAR 2007

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BALANCE SHEET AS AT 31 DECEMBER 2007
EIGHTIETH YEAR

(in euro)

ASSETS	31.12.2007	31.12.2006
1. Gold and gold receivables	**2,616,818,200**	**2,210,725,255**
2. Claims on non-euro area residents denominated in foreign currency	**438,938,791**	**486,131,282**
2.1 Receivables from the IMF	82,587,355	125,814,163
2.2 Balances with banks and security investments, external loans and other external assets	356,351,436	360,317,119
3. Claims on euro area residents denominated in foreign currency	**700,340,293**	**553,330,050**
3.1 General government	283,313,841	302,662,973
3.2 Other claims	417,026,452	250,667,077
4. Claims on non-euro area residents denominated in euro	**1,002,041,543**	**649,303,017**
4.1 Balances with banks, security investments and loans	1,002,041,543	649,303,017
4.2 Claims arising from the credit facility under ERM II	0	0
5. Lending to euro area credit institutions related to monetary policy operations denominated in euro	**8,727,274,500**	**4,795,146,004**
5.1 Main refinancing operations	6,759,000,000	3,083,000,000
5.2 Longer-term refinancing operations	1,968,274,500	1,712,146,004
6. Other claims on euro area credit institutions denominated in euro	**232,122,255**	**942,132,861**
7. Securities of euro area residents denominated in euro	**10,518,594,994**	**6,298,382,914**
8. General government debt denominated in euro	**8,231,573,922**	**8,744,528,645**
9. Intra-Eurosystem claims	**1,443,521,602**	**1,453,912,102**
9.1 Participating interest in the ECB	390,235,477	393,403,998
9.2 Claims equivalent to the transfer of foreign reserves to the ECB	1,046,595,328	1,055,840,343
9.3 Claims related to promissory notes backing the issuance of ECB debt certificates	0	0
9.4 Claims related to the allocation of euro banknotes within the Eurosystem (net)	0	0
9.5 Net claims related to transactions with the ESCB (TARGET)	0	0
9.6 Other claims within the Eurosystem (net)	6,690,797	4,667,761
10. Items in course of settlement	**3,352,187**	**2,039,130**
11. Other assets	**8,746,291,885**	**8,789,731,911**
11.1 Coins	50,594,774	41,305,892
11.2 Tangible and intangible fixed assets	822,814,486	755,690,484
11.3 Other financial assets	6,500,144,114	6,813,977,432
11.4 Accruals and prepaid expenses	808,539,286	705,669,379
11.5 Sundry	564,199,225	473,088,724
TOTAL ASSETS	**42,660,870,172**	**34,925,363,171**

OFF-BALANCE-SHEET ITEMS	31.12.2007	31.12.2006
1. Investments in Greek government securities relating to the management of the "Common capital of legal persons in public law and social security funds" according to Law 2469/97	19,361,048,419	18,034,147,613
2. Investments in Greek government securities and other securities relating to the management and custody of funds of public entities, social security funds and private agents	13,474,822,865	10,753,664,510
3. Other off-balance-sheet items	13,461,812,780	7,035,832,577
TOTAL OFF-BALANCE-SHEET ITEMS	**46,297,684,064**	**35,823,644,700**

Notes:

1. *Under Article 54A of the Bank's Statute, the balance sheet was drawn up in compliance with the accounting rules and techniques determined by the European Central Bank (ECB) and applying to the members of the European System of Central Banks (ESCB).*
2. *The weighted key for subscription of the Bank of Greece to the ECB's capital fully paid up by the 13 national central banks of the Eurosystem is 2.61375%.*
3. *Claims/liabilities denominated in euro or foreign currency are broken down into claims on/liabilities to euro area residents and non-euro area residents.*

(in euro)

LIABILITIES	31.12.2007	31.12.2006
1. Banknotes in circulation	**16,269,736,665**	**15,338,479,600**
2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	**7,107,978,508**	**4,529,984,822**
2.1 Current accounts (covering the minimum reserve system)	6,602,978,508	4,526,984,822
2.2 Deposit facility	5,000,000	3,000,000
2.3 Fixed-term deposits	500,000,000	0
3. Other liabilities to euro area credit institutions denominated in euro	**33,400,000**	**22,195,000**
4. Liabilities to other euro area residents denominated in euro	**1,215,526,026**	**912,830,809**
4.1 General government	1,159,332,273	893,567,625
4.2 Other liabilities	56,193,753	19,263,184
5. Liabilities to non-euro area residents denominated in euro	**838,556,609**	**851,539,789**
6. Liabilities to euro area residents denominated in foreign currency	**81,162,206**	**83,723,120**
7. Liabilities to non-euro area residents denominated in foreign currency	**102,325,450**	**111,747,203**
7.1 Deposits and other liabilities	102,325,450	111,747,203
7.2 Liabilities arising from the credit facility under ERM II	0	0
8. Counterpart of special drawing rights allocated by the IMF	**111,207,295**	**118,206,311**
9. Intra-Eurosystem liabilities	**13,195,830,237**	**9,752,092,960**
9.1 Liabilities related to promissory notes backing the issuance of ECB debt certificates	0	0
9.2 Liabilities related to the allocation of euro banknotes within the Eurosystem (net)	2,399,261,590	1,568,551,555
9.3 Net liabilities related to transactions with the ESCB (TARGET)	10,796,568,647	8,183,541,405
9.4 Other liabilities within the Eurosystem (net)	0	0
10. Items in course of settlement	**43,934,772**	**55,474,879**
11. Other liabilities	**747,352,247**	**778,947,772**
11.1 Accruals and income collected in advance	151,550,812	170,041,389
11.2 Sundry	595,801,435	608,906,383
12. Provisions	**1,173,625,858**	**1,052,296,846**
13. Revaluation accounts	**965,418,437**	**650,634,500**
14. Capital and reserves	**774,815,862**	**667,209,560**
14.1 Capital	88,994,690	88,994,690
14.2 Ordinary reserve	88,994,690	88,994,690
14.3 Extraordinary reserve	55,000,000	19,000,000
14.4 Special reserve from the revaluation of land and buildings	541,550,688	470,018,863
14.5 Special reserve from the acquisition (free) of fixed assets	275,794	201,317
TOTAL LIABILITIES	**42,660,870,172**	**34,925,363,171**

4. *Account balances related to monetary policy operations are shown under separate items.*
5. *The value of gold has been calculated on the basis of the price in euro per fine ounce as derived from the ECB's reference exchange rates of 31 December 2007 (€568.236 per ounce, compared with €482.688 per ounce on 29 December 2006).*
6. *Claims and liabilities in foreign currency are converted into euro on the basis of the ECB's euro foreign exchange reference rates of 31 December 2007.*
7. *The value of securities has been calculated on the basis of average market prices applying on 31 December 2007, except for the securities included in asset item 11.3 "Other financial assets", which have been valued at cost. This item reflects the investment portfolio of the Bank of Greece, which comprises Greek government securities and government securities issued by other euro area countries; these securities constitute fixed investment to be held to maturity.*
8. *Fixed assets are valued at cost, except land and buildings, which are valued at market prices, determined by independent appraisers, less depreciation. In financial year 2007, the book value of the Bank's real estate was adjusted to fair (market) value, as determined by independent appraisers. The resulting surplus value (€71,5 million) was transferred to the "special reserve from the revaluation of land and buildings".*
9. *The depreciation of buildings and banknote production costs is calculated, as of financial year 2005, at a rate of 2,5% and 20% respectively, according to the estimated useful life of buildings (40 years) and the lifetime of banknotes (5 years on average).*
10. *Out of the profit for financial year 2007, €36 million were allocated to an extraordinary reserve.*
11. *Some items of the balance sheet and the profit and loss account for financial year 2006 have been reclassified to ensure comparability with 2007 figures.*

PROFIT AND LOSS ACCOUNT FOR THE YEAR 2007

(in euro)

	2007	2006
1. Net interest income	**540,922,539**	**426,049,483**
1.1 Interest income	1,195,082,817	929,862,887
1.2 Interest expense	-654,160,278	-503,813,404
2. Net result of financial operations, write-downs and risk provisions	**104,002,889**	**241,705,184**
2.1 Realised gains arising from financial operations	119,336,142	241,705,184
2.2 Write-downs on financial assets and positions	-43,333,253	-22,939,084
2.3 Transfer from provisions for foreign exchange rate and price risks	28,000,000	22,939,084
3. Net income from fees and commissions	**131,739,075**	**121,812,074**
3.1 Fees and commissions income	132,948,968	122,842,921
3.2 Fees and commissions expense	-1,209,893	-1,030,847
4. Income from equity shares and participating interests	**3,383,702**	**3,472,030**
5. Net result of pooling of monetary income	**6,690,797**	**4,667,120**
6. Other income	**38,758,703**	**33,147,655**
Total net income	**825,497,705**	**830,853,546**
7. Staff costs	**-230,209,907**	**-214,591,454**
7.1 Wages and salaries	-149,801,715	-140,353,929
7.2 Employer's contributions and other levies	-80,408,192	-74,237,525
8. Pensions	**-61,544,339**	**-55,381,266**
9. Administrative and other expenses	**-58,143,853**	**-50,203,499**
10. Depreciation of tangible and intangible fixed assets	**-42,786,390**	**-38,436,988**
11. Provisions	**-148,129,355**	**-227,604,875**
Total expenses	**-540,813,844**	**-586,218,082**
PROFIT FOR THE YEAR	**284,683,861**	**244,635,464**

DISTRIBUTION OF NET PROFIT

(Article 71 of the Statute)

(in euro)

	2007	2006
Dividend €0.67 per share on 15,891,909 shares	10,647,579	10,647,579
Extraordinary reserve	36,000,000	19,000,000
Additional dividend €2.53 per share on 15,891,909 shares*	40,206,530	35,438,957
Tax payment on dividends (Law 3296/2004, Article 6)	16,951,370	18,824,078
To the Government	180,878,382	160,724,850
	284,683,861	**244,635,464**

** The dividend for the year 2007 totals €3.20 per share, against €2.90 for the year 2006.*

Athens, 17 March 2008

THE GOVERNOR

NICHOLAS C. GARGANAS

THE DIRECTOR OF THE ACCOUNTS DEPARTMENT

DIMITRIOS E. MATSIMANIS

INDEPENDENT AUDITOR'S REPORT

This is a translation from the original "INDEPENDENT AUDITOR'S REPORT" issued in the Greek Language

To the Shareholders of BANK OF GREECE S.A.

Report on the Financial Statements

We have audited the accompanying financial statements of BANK OF GREECE S.A. (the Bank), which comprise the balance sheet as at December 31, 2007, the income statement, and the statement of profit distribution.

Management's Responsibility for the Financial Statements: Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting principles determined by the European Central Bank (ECB) as they have been adopted by the Bank in Article 54A of its Articles of Association and the Greek Company Law. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility: Our responsibility is to express an opinion on these financial statements based on our audit. Except as discussed in the following paragraph, we conducted our audit in accordance with the Greek Auditing Standards which are based on International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion: The recorded provision for pension and other liabilities to Employee Funds amounts to €1,003 million, which is not supported by an analysis of the calculation method and, consequently, we could not assess its adequacy. In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to adequacy of the provision for pension and other liabilities to Employee Funds, the financial statements give a true and fair view of the financial position of BANK OF GREECE S.A. as of December 31, 2007, and of its financial performance for the year then ended in accordance with the accounting principles determined by the European Central Bank as they have been adopted by the Bank in Article 54A of its Articles of Association and the Greek Company Law.

Report on Other Legal and Regulatory Requirements: The General Council report is consistent with the information required by the Directives of the European Central Bank and the aforementioned financial statements.

Athens, 17 March 2008

The Certified Auditors-Accountants

Christos Glavanis
(Registration no 10 371)

Despina Xenaki
(Registration no 14 161)

11 klm National Road Athens Lamia
144 51 Metamorphosi Attiki

Ernst & Young (Hellas) S.A.
Certified Auditors Accountants
(Registration no. 107)

ERNST & YOUNG

REPORT OF THE GENERAL COUNCIL TO THE GENERAL MEETING OF SHAREHOLDERS

ANNUAL ACCOUNTS OF THE BANK OF GREECE FOR THE YEAR 2007

ACCOUNTING POLICIES

General principles regarding the preparation of the Bank's accounts

The annual accounts of the Bank of Greece, under Article 54A of its Statute, are prepared in accordance with the accounting rules and principles applicable to the European System of Central Banks, as set out by the European Central Bank (ECB) in its Guideline ECB/2006/16 of 10 November 2006.

These rules and practices, although based on internationally accepted accounting standards, have been adjusted to reflect the specific status of the national central banks (NCBs) of the Eurosystem.

Any issues that are not covered by the aforementioned rules or ECB guidelines or are governed by non-mandatory provisions are to be treated either in accordance with the ECB recommendations or in accordance with the Bank's Statute and Law 2190/1920 on sociétés anonymes.

Basic accounting principles

The main accounting principles that apply to the Eurosystem (i.e. the ECB and the euro area NCBs, including the Bank of Greece), are the following:

- ***Transparency:*** accounting and financial reporting must reflect the Bank's real financial situation.

- ***Prudence:*** Unrealised valuation gains on financial instruments in foreign currency and securities are not recognised as income in the Profit and Loss Account, but are transferred directly to revaluation accounts. By contrast, unrealised valuation losses at the year-end in excess of previous unrealised valuation gains are recognised as expenses and are taken to the Profit and Loss account.

- ***Post-balance-sheet events:*** Assets and liabilities are adjusted for events that occurred between the annual balance sheet date and the date on which the financial statements were approved, if such events affect the condition of assets or liabilities on the balance sheet date.

- ***Materiality and non-deviation from accounting rules.***

- ***Going concern basis:*** Accounts are prepared on a going concern basis.

- ***The accruals principle:*** Income and expenses are recognised in the accounting period in which they were earned or incurred and not in the period in which they were received or paid.

- ***Consistency and comparability:*** The criteria for balance sheet valuation and income recognition are applied consistently to ensure comparability of data in financial statements.

Accounting approaches

- Financial transactions denominated in euro are recorded on settlement date in accordance with the cash/settlement approach.

- Foreign exchange transactions, financial instruments denominated in foreign currency and related accruals are recorded using the economic approach, according to which:

- Transactions are recorded on off-balance sheet accounts on trade date.

- On settlement date, the off-balance sheet booking entries are reversed, and the transactions are booked on balance sheet accounts.

- Using the economic approach, the foreign currency positions, realised gains and losses arising from net sales and the calculation of average cost are affected on trade date.

- Interest, premium or discount accrued related to financial instruments denominated in foreign currency is calculated and booked on a daily basis.

Balance sheet valuation rules

- Assets and liabilities in foreign currency and gold are converted into euro at the exchange rate prevailing on the balance sheet date, as derived from the ECB's daily quotation of reference exchange rates.

- Income and expenses are converted into euro at the exchange rate prevailing at the trade date.

- No distinction is made between the price and currency revaluation differences for gold. Instead, a single gold valuation is accounted for on the basis of the price in euro per fine ounce of gold, which is derived from the exchange rate of the euro against the US dollar on the balance sheet date.

- The revaluation of foreign exchange assets and liabilities, including on-balance-sheet and off-balance-sheet instruments, is performed on a currency-by-currency basis.

- Marketable debt securities recorded under asset items 2.2, 3.2, 4.1 and 7 are valued at the average market prices prevailing at the Balance Sheet date on the basis of their ISIN code.

- Debt securities and holdings recorded under asset item 11.3 "Other financial assets" are valued at acquisition cost.

Income recognition

- Realised gains and losses arising from the sale of foreign exchange, gold and securities are taken to the Profit and Loss Account. Such realised gains and losses are calculated using the average cost of the respective asset at the date when they are realised.

- Unrealised gains (revaluation gains) are not recognised as income, but are transferred directly to revaluation accounts.

- Unrealised losses (revaluation losses), when in excess of previous revaluation gains registered in the corresponding revaluation account, are taken at year-end to the Profit and Loss Account and are not netted against new revaluation gains in subsequent years. Unrealised losses in any one security, in any one currency or in gold holdings are not netted against unrealised gains in other securities, currencies or gold. The average cost of a financial asset giving rise to unrealised loss at year-end shall be valuated at the end-year foreign exchange rate or market price.

- Premiums or discounts arising on purchased securities are calculated and presented as part of interest income and are amortised over the remaining life of the assets.

Off-balance sheet instruments

Foreign exchange forward transactions are included in the net foreign currency position for the purpose of calculating foreign exchange gains and losses.

Banknotes in circulation

The ECB and the 13 euro area NCBs, which together comprise the Eurosystem, issue euro banknotes.[1]

The ECB has been allocated a share of 8% in the total value of euro banknotes in circulation, while the remaining 92% is allocated to the NCBs. The total value of euro banknotes in circulation is allocated to the Eurosystem central banks on the last working day of each month according to their banknote allocation keys.[2]

The share of banknotes in circulation that has been allocated to the Bank of Greece is disclosed under the Balance Sheet liability item 1 "Banknotes in circulation".

The difference between the value of euro banknotes allocated to each NCB according to its banknote allocation key and the value of euro banknotes that the NCB actually puts into cir-

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1 ECB Decisions of 6 December 2001, 18 December 2003 and 22 April 2004 on the issue of euro banknotes.
2 "Banknote allocation key" means the percentages that result from taking into account the ECB's share (8%) in the total euro banknote issue and applying the subsequent capital key to the NCB's share in the total.

culation produces "Intra-Eurosystem claims/liabilities". These interest-bearing claims or liabilities[3] are disclosed under the sub-item "Net claims/liabilities related to the allocation of euro banknotes within the Eurosystem".

For financial years 2002 to 2007, "intra-Eurosystem claims" and "intra-Eurosystem liabilities" arising from the allocation of euro banknotes are adjusted in order to avoid sharp fluctuations in the monetary income of NCBs relative to previous years.

The amounts of these adjustments were calculated taking into account the differences between the average value of banknotes in circulation of each NCB during the period from 1 July 1999 to 30 June 2001 and the average value of banknotes that would have been allocated to them during the same period in accordance with the ECB's capital key.

Interest income and interest expenses on these claims/liabilities, are netted in the ECB accounts and are disclosed in the Profit and Loss Account of each NCB under "Net interest income".

The Governing Council of the ECB has decided that the income from the ECB's share (8%) of the total value of euro banknotes in circulation issued on its behalf (seignorage) will be recognised on the NCBs' balance sheets in the same financial year it accrues and will be distributed to the NCBs on the second working day of the following year, in the form of an interim distribution.[4] This income shall be due in full, unless the ECB's net profit for the year is less that its income earned on euro banknotes in circulation and also subject to any decision of the Governing Council in respect of expenses incurred by the ECB in connection with the issue and handling of euro banknotes.

For the year 2007, the Governing Council of the ECB decided that the full amount of income earned from the ECB's share of total banknotes in circulation would be retained and set aside in the provision against foreign exchange rate, interest rate and gold price risks.

3 ECB Decision of 6 December 2001 on the allocation of monetary income of the national central banks of participating Member States from the financial year 2002 (ECB/2001/16, amended by ECB Decision ECB/2003/22 of 18 December 2003).
4 ECB Decision of 17 November 2005 (ECB/2005/11) on the distribution of the income of the European Central Bank on euro banknotes in circulation to the national central banks of the participating Member States.

NOTES ON THE BALANCE SHEET

ASSETS

1. Gold and gold receivables

Holdings and receivables in standard gold	31.12.2007	31.12.2006	Change
volume in fine troy ounces (thousands)	*4,605.0*	*4,580.0*	*25.0*
volume in tonnes	*143.2*	*142.5*	*0.7*
value (€ million)	2,616.8	2,210.7	406.1

The amounts reported above comprise the Bank's gold holdings (3,619 thousand ounces) and gold receivables from the Greek State (986 thousand ounces) corresponding to Greece's participation in the IMF (the gold component of Greece's quota has been paid by the Bank of Greece on behalf of the Greek State). The largest part of gold holdings is kept in banks abroad.

The increase by 25 thousand ounces in the volume of gold holdings and receivables reflects purchases of gold from private individuals, while the significant €406.1 million increase in the value of gold in euro is mainly due to the appreciation of the euro in 2007.

The total amount arising from the increase in the price of gold came to €961.3 million and is disclosed under liability item 13 "Revaluation accounts". This sum will serve as a buffer against any losses from gold price movements in the future.

Gold has been valued at its euro price per fine troy ounce as at year-end according to the ECB's reference exchange rate, i.e. €568.236 on 31 December 2007 compared with €482.688 on 29 December 2006. This price was derived from the USD price of gold quoted on the London market on 31 December 2007 and the euro/USD exchange rate on that same date.

2. Claims on non-euro area residents denominated in foreign currency

This item consists of: receivables from the IMF (in SDRs); balances on correspondent accounts; time deposits with banks abroad; securities holdings; and the value of non-euro banknotes held in the Bank's vaults.

2.1 Receivables from the IMF

These arise from Greece's participation in the IMF and include the following:

– the Bank's holdings of special drawing rights (SDRs);

– the SDR component of Greece's quota in the IMF. This has been financed by the Bank, which is entrusted with the management of the relevant assets. The euro component of Greece's quota in the IMF, amounting to €828.4 million, is disclosed under liability item 5 "Liabilities to non-euro area residents denominated in euro". Greece's overall quota amounts to SDR 823 million and must remain unchanged (i.e. the euro component and the SDR component must always add up to SDR 823 million).

Receivables from the IMF	**31.12.2007**		**31.12.2006**		**Change**	
(in million)	***SDRs***	***€***	***SDRs***	***€***	***SDRs***	***€***
Greece's SDR quota	54.0	58.1	85.2	97.2	–31.2	–39.1
SDR holdings	17.4	18.7	19.6	22.4	–2.2	–3.7
Special non-interest-bearing SDR deposit	5.4	5.8	5.4	6.2	0	–0.4
Total	**76.8**	**82.6**	**110.2**	**125.8**	**–33.4**	**–43.2**

The decrease in SDRs reported above was due to a shift in the composition of the quota, following a decrease in the SDR component that reflected amounts collected by the Bank from third countries in line with IMF instructions. This necessitated a commensurate increase in the euro component, in order to restore the overall Greek quota to the stable level of SDR 823 million. The decrease in the amount in euro was, apart from the reason mentioned above, also due to the appreciation of the euro against the SDR.

The above receivables from the IMF were valued at the SDR/euro exchange rate as at 31 December 2007, based on the ECB's reference exchange rates, i.e. 1 SDR = €1.074, compared with €1.1416 as at 29 December 2006.

2.2 Balances with banks and security investments, external loans and other external assets

This item consists of claims on non-euro area residents denominated in foreign currency, e.g. deposits (mainly time deposits), debt securities and non-euro banknotes.

Asset category	**31.12.2007**	**31.12.2006**	**Change**
	(in € million)		
Deposits with foreign banks (mostly time deposits)	127.8	229.3	–101.5
Marketable debt securities (bonds - Treasury bills)	196.0	92.3	103.7
Cash holdings of foreign currency	32.6	38.7	–6.1
Total	**356.4**	**360.3**	**–3.9**

The largest part of these assets as at 31 December 2007 is denominated in US dollars.

3. Claims on euro area residents denominated in foreign currency

This item consists of claims on general government that stem from long-term loans, time deposits with correspondent banks in other euro area countries and holdings of marketable securities (bonds, commercial paper).

3.1 Claims on general government

These claims include:

a long-term loan of GBP 75 million, concluded on 6 September 1985 with foreign banks on behalf of the Greek State. The corresponding liability of the Bank on foreign banks is disclosed under liability item 7.1 “Deposits and other liabilities”;

loans in SDRs granted to the Greek State to finance its participation in the IMF, relating to the SDR component of Greece’s quota;

loans in USD and gold-linked loans to the Greek State to finance its participation in international organisations.

These claims amounted to €283.3 million on 31 December 2007, down from €302.7 million on 31 December 2006. The €19.4 million decrease stems from the appreciation in 2007 of the euro against the currencies in which these loans are denominated, apart from the gold-linked loan, the outstanding amount of which increased as a result of the appreciation of gold.

3.2 Other claims

This sub-item consists primarily of time deposits in foreign currency held with euro area correspondent banks and holdings of marketable debt securities denominated in foreign currency, issued by euro area residents.

It also consists of a €96.3 million claim on a domestic credit institution, arising from a US dollar liquidity-providing reverse operation conducted in the context of the Term Auction Facility, following an agreement between the ECB and the Federal Reserve.

Under this agreement, the Federal Reserve System made USD 20 billion available to the ECB through a temporary reciprocal currency arrangement (swap line) in order to provide short-term liquidity, in US dollars, to Eurosystem counterparties.

In turn, the ECB conducted swap operations with the Eurosystem NCBs, which used these funds to conduct liquidity-providing operations with Eurosystem counterparties (credit institutions).

These operations generated non-interest bearing balances within the Eurosystem between the ECB and the NCBs. For the Bank of Greece, the corresponding balance is included in the overall balance of the TARGET account (liability item 9.3 "Net liabilities related to transactions with the ESCB (TARGET)".

Claims	31.12.2007	31.12.2006	Change
	(in € million)		
Time deposits	216.5	243.4	–26.9
Marketable debt securities (bonds, commercial paper)	104.2	7.3	96.9
Swap operations	96.3	0	96.3
Total	**417.0**	**250.7**	**166.3**

The bulk of these claims as at 31 December 2007 is denominated in US dollars.

4. Claims on non-euro area residents denominated in euro

4.1 Balances with banks, security investments and loans

This item mainly includes time deposits in euro with non-euro area correspondent banks, as well as holdings of euro-denominated bonds and Treasury bills issued by non-euro area residents.

Categories of claims	31.12.2007	31.12.2006	Change
	(in € million)		
Time deposits	104.7	445.6	–340.9
Bonds	459.3	203.7	255.6
Treasury bills	438.0	0	438.0
Total	**1,002.2**	**649.3**	**352.7**

The purchases of marketable debt securities (bonds, Treasury bills) in 2007 were partly financed by funds formerly held in euro-denominated time deposits with euro area credit institutions (asset item 6).

5. Lending to euro area credit institutions related to monetary policy operations, denominated in euro

This item consists of outstanding balances of lending to credit institutions in Greece mainly against collateral of Greek government securities and securities issued by other euro area countries, in the context of the single monetary policy.

Liquidity is chiefly provided through main refinancing operations (with a maturity of one week) and to a lesser extent through longer-term refinancing operations (with a maturity of three months).

Main refinancing operations (MROs) are liquidity-providing open market operations conducted by the Eurosystem in the form of reverse operations executed through weekly standard tenders with a maturity of one week.

Longer-term refinancing operations (LTROs) are liquidity-providing open market operations conducted by the Eurosystem in the form of reverse operations executed through monthly standard tenders with a maturity of three months

Operations	31.12.2007	31.12.2006	Change
	(in € million)		
MROs	6,759.0	3,083.0	3,676.0
LTROs	1,968.3	1,712.1	256.2
Total	**8,727.3**	**4,795.1**	**3,932.2**

The average amount of these operations during 2007 was €4,653 million compared with €4,774 million during 2006.

6. Other claims on euro area credit institutions denominated in euro

These claims mainly relate to time deposits in euro held by the Bank of Greece with correspondent banks in the euro area. They are not connected with monetary policy operations and serve purely investment purposes.

Categories of claims	31.12.2007	31.12.2006	Change
	(in € million)		
Time deposits	155.3	857.2	–701.9
Other claims	76.8	84.9	–8.1
Total	**232.1**	**942.1**	**–710.0**

A significant part of the above time deposits was substituted for by euro-denominated marketable debt securities (asset items 4 and 7).

7. Securities of euro area residents denominated in euro

This item represents the Bank's trading portfolio of euro-denominated bonds, Treasury bills and commercial paper issued by euro area residents other than the Greek government. Greek government securities and part of euro-denominated debt securities issued by other euro area residents, held in the Bank's investment portfolio until maturity, are disclosed under asset item 11.3 "Other financial assets".

Type of securities	31.12.2007	31.12.2006	Change
	(in € million)		
Bonds	4,738.3	1,242.2	3,496.1
Treasury bills	5,067.0	4,677.3	389.7
Commercial paper	658.5	378.9	279.6
Zero-coupon bonds	54.8	0	54.8
Total	**10,518.6**	**6,298.4**	**4,220.2**

Of the €4.2 billion increase in the Bank's trading portfolio as at 31.12.2007, compared with 31.12.2006, €3.2 billion was financed from the TARGET account and €1 billion was financed from time deposits and from the investment portfolio.

In 2007, the value of the Bank's total asset management portfolio of securities, deposits and loans averaged some €25.5 billion, up from €25 billion in 2006.

8. General government debt denominated in euro

This item consists of the long-term loans in euro extended by the Bank to the Greek State up to 31.12.1993 and, more specifically:

– interest-bearing loans extended to the Greek State up to 31.12.1993;

– interest-bearing loans extended by the Bank of Greece to the Greek State on 31 December 1993, in settlement of the balance of the account "Exchange rate valuation differences – Law 1083/80";

– interest-free loans in euro extended by the Bank to the Greek State for the purpose of financing its euro-denominated participation in the IMF. The amount of this participation, which is deposited by the IMF with the Bank, is disclosed under liability item 5 "Liabilities to non-euro area residents denominated in euro".

Outstanding balance as at 31.12.2007	€ 8,231.6 million
Outstanding balance as at 31.12.2006	€ 8,744.5 million
Decrease	€ 512.9 million

The decrease stems from the gradual repayment of interest-bearing loans.

9. Intra-Eurosystem claims

9.1 Participation in the capital and reserve assets of the ECB

The table below shows the items related to the ECB capital and the Bank's participation therein, after the changes that took place in 2007.

As at 31.12.2007	(%)	(in € million)	
ECB's subscribed capital (applying to all 27 EU Member States)		**5,760.7**	
Bank of Greece's key for subscription of the ECB's capital	1.8168		
ECB capital paid up by the 13 Eurosystem NCBs		**4,004.2**	
Weighting of the Bank of Greece in the subscribed capital key	2.61375		
Bank of Greece's subscribed share of capital			104.7
Bank of Greece's contribution to the ECB's reserves			285.5
Bank of Greece's total contribution to ECB's capital and reserves as at 31.12.2007			**390.2**

According to Article 28 of the Statute of the European System of Central Banks (ESCB), the national central banks of the ESCB are the sole subscribers to and holders of the capital of the ECB.

The subscription to the ECB's capital is based on a key assigned to each NCB and is equal to the sum of 50% of the share of its respective Member State in the gross domestic product of the European Union and 50% of the share of its respective Member State in the population of the European Union (Article 29.1 of the ESCB Statute). On 31.12.2007, the participation of the Bank of Greece in the capital, together with its contribution to the reserves and the equivalent provisions of the ECB, amounted to €390.2 million.

The share of the Bank of Greece in the ECB's capital is €104.7 million and has been paid up in full. It corresponds to 1.8168% (capital key) of the ECB's total subscribed capital (27 NCBs of the ESCB), which after the adjustments of 2007 amounts to €5,760.7 million and to 2.61375% (capital key weighting) of the ECB capital paid up by the 13 NCBs of the Eurosystem, which after the adjustments of 2007 amounts to €4,004.2 million.

The remaining amount (€285.5 million) relates to the Bank's contribution to the reserves and provisions of the ECB. This contribution was paid up upon the entry of the Bank of Greece into the ESCB on 1 January 2001.

Under Article 29.3 of the Statute of the ESCB, the NCBs' keys for subscription to the ECB capital are adjusted every five years after the establishment of the ESCB. Also, according to Article 49.3 of the ESCB Statute, the ECB's subscribed capital is automatically increased when a new Member State joins the EU and its NCB joins the ESCB.

On 1 January 2007, the Bank of Greece's key for subscription to the ECB's capital was lowered from 1.8974% to 1.8168% after Bulgaria and Romania joined the EU and their respective NCBs became part of the ESCB.

Also on 1 January 2007, Slovenia adopted the euro as its national currency and Banka Slovenije joined the Eurosystem. The weighting of the Bank of Greece in the ECB's capital key was therefore adjusted from 2.65405% to 2.61375%.

As a result of these adjustments, the Bank's share in the capital and the reserves of the ECB decreased from €393.4 million to €390.2 million. The difference/balance was paid to the Bank on 12 March 2007.

9.2 Claims equivalent to the transfer of foreign reserves to the ECB

As at 31.12.2007	**(%)**	**(in € million)**
Total foreign reserve assets transferred to the ECB by the 13 NCBs of the Eurosystem		40,041.8
Weighting of the Bank of Greece in the subscribed capital key		2.61375
Claims of the Bank of Greece on 31.12.2007 arising from the transfer of foreign reserve assets to the ECB		**1,046.6**

These claims stem from the transfer of foreign reserve assets to the ECB, in accordance with the provision of the Accession Agreement (Article 30 of the Statute of the ESCB).

Out of the said foreign reserve assets, determined on the basis of the Bank's share in the paid-up capital of the ECB, 85% were transferred in the form of assets denominated in USD and JPY and 15% in the form of gold.

These claims are expressed in euro, taking into account the exchange rates prevailing at the time of transfer, and are remunerated at the latest available marginal rate for the Eurosystem's MROs (adjusted to reflect a zero return on the gold component).

9.3 Other claims within the Eurosystem (net)

This item, amounting to €6.7 million as at 31 December 2007, corresponds to the balance between the monetary income of €598.6 million accrued to the Bank during 2007 and the monetary income of €605.3 million allocated to the Bank according to its share in the paid-up capital of the ECB.

This claim was recorded as prepaid expense in financial year 2007 and was collected in January 2008.

10. Items in course of settlement

These include balances, in the course of settlement, of various intermediate accounts, which serve to monitor: receivable cheques issued by banks abroad, cheques settled through clearing offices and transactions between Bank of Greece branches.

Outstanding balance as at 31.12.2007	€3.4 million
Outstanding amount as at 31.12.2006	€2.0 million
Increase	€1.4 million

11. Other assets

11.1 Coins

This item represents the value of coins issued by the 13 euro area countries and held by the Bank of Greece on the Balance Sheet date.

Coins put in circulation by the Bank of Greece are recorded in a special account of the Greek State, included in liability item 4.1 "General government".

Outstanding balance as at 31.12.2007	€50.6 million
Outstanding balance as at 31.12.2006	€41.3 million
Increase	€9.3 million

11.2 Tangible and intangible fixed assets

Fixed assets comprise: real estate (land, buildings and fixtures, buildings under construction), furniture, machinery, hardware andsoftware and the production cost of euro banknotes. Fixed assets other than real estate, which is valued at market prices determined by independent assessors, are valued at acquisition cost. Depreciation is calculated on a straight-line basis over the expected lifetime of the asset.

The value of fixed assets as at 31 December 2007 is reported less accumulated depreciation.

Depreciation is calculated on a straight-line basis over the expected lifetime of the asset.

Undepreciated value of fixed assets

Asset category:	31.12.2007	31.12.2006	Change	Depreciation rate (%)
	(in €million)			
Land	506.4	432.1	74.3	0
Buildings and fixtures	207.6	209.6	2.0	2.5
Buildings under construction	7.1	3.2	3.9	0
Other equipment	39.5	40.3	–0.8	8-24
Capitalised expenses (R&D, software, etc. costs)	3.7	6.4	–2.7	20-24
Banknote production costs	58.5	64.1	–5.6	20
Total	**822.8**	**755.7**	**67.1**	

11.3 Other financial assets

The largest part of this item represents the Bank's investment portfolio (to be held up to maturity) of Greek government bonds and euro-denominated bonds issued by other euro area governments.

Asset category	31.12.2007	31.12.2006	Change
	(in € million)		
Greek government bonds	3,099.2	3,611.7	–512.5
Government bonds of other euro area countries	3,372.1	3.168.3	203.8
Treasury bills of other euro area countries	0	5.0	–5.0
Other participating interests	28.8	29.0	–0.2
Total	**6,500.1**	**6,814.0**	**-313.9**

It also includes the Bank's holdings in DIAS Interbanking Systems SA, the Hellenic Deposit Guarantee Fund (TEK), the Hellenic Exchanges Holding SA as well as in the Bank for International Settlements (BIS), denominated in SDRs.

These assets are valued at acquisition cost.

11.4 Accruals and prepaid expenses

This item includes accrued interest on securities, written-off premia on securities and also interest and other income accrued but not collected up to by 31 December 2007. The latter are to be collected in the current financial year and relate mainly to interest income on lending, securities holdings and deposits with banks, as well as to interest income on the claim corresponding to the transfer of foreign reserve assets to the ECB. Also included is the value of drachma banknotes, estimated at €251.4 million, which had not been exchanged for euro banknotes by 31 December 2007 and are treated as prepaid expenses for the Bank.

Outstanding balance as at 31.12.2007	€808.5 million
Outstanding balance as at 31.12.2006	€705.7 million
Increase	€102.8 million

11.5 Sundry

This item consists primarily of balances on the Bank's suspense debit accounts, its remaining holding of non-standard gold, as well as the outstanding balances of loans to the Bank's personnel.

Outstanding balance as at 31.12.2007	€564.2 million
Outstanding balance as at 31.12.2006	€473.1 million
Increase	€91.1 million

This change is due to an increase in the balances of suspense debit accounts and of loans to the Bank's personnel, as well as to an increase in the value of non-marketable gold, as a result of the non-standard gold purchased by the Bank from the private sector.

LIABILITIES

1. Banknotes in circulation

Outstanding balance as at 31.12.2007	€16,269.7 million
Outstanding balance as at 31.12.2006	€15,338.5 million
Increase	€931.2 million

This item consists of the Bank's share of total euro banknotes in circulation, calculated on the basis of the banknote allocation key (2.4045%) (see "Banknotes in circulation" under "Accounting policies").

The average value of euro banknotes put into circulation by the Bank of Greece during 2007 rose to €15.1 billion, from €14.1 billion in 2006.

	31.12.2007	31.12.2006	Change
	(in € million)		
Value of euro banknotes put into circulation by the Bank	18,669.0	16,907.1	1,761.9
Less:			
– Liability resulting from the ECB's share in the total euro banknote issue (8% of the total value of euro banknote into circulation)	-1,414.9[5]	-1,333.9	-81.0
– Liability resulting from the allocation of euro banknotes within the Eurosystem	-984.4[5]	-234.7	-749.7
Value of euro banknotes in circulation based on the banknote allocation key of the Bank of Greece	**16,269.7**	**15,338.5**	**931.2**

5 Recorded under liability item 9.2 "Net liabilities related to the allocation of euro banknotes within the Eurosystem".

2. Liabilities in euro to euro area credit institutions related to monetary policy operations

2.1 Current accounts (covering the minimum reserve system)

These accounts include credit institutions' reserve holdings with the Bank of Greece, which can also be used as settlement accounts for transactions with the central bank.

Outstanding balance as at 31.12.2007	....	€6,603.0 million
Outstanding balance as at 31.12.2006	....	€4,527.0 million
	Increase	€2,076,0 million

2.2 Deposit facility

This relates to the deposit facility offered by the Eurosystem to credit institutions.

In more detail, it consists of overnight deposits placed by credit institutions with the Bank of Greece at a pre-specified interest rate, in the context of the implementation of the single monetary policy in the euro area.

Outstanding balance as at 31.12.2007	....	€5.0 million
Outstanding balance as at 31.12.2006	....	€3.0 million
	Decrease	€2.0 million

2.3 Fixed-term deposits

The collection of fixed-term deposits are one type of open market operations conducted by the Eurosystem through fixed rate tenders for fine-tuning purposes in order to absorb liquidity in the market.

Outstanding balance as at 31.12.2007	....	€500.0 million
Outstanding balance as at 31.12.2006	....	€0.0 million
	Increase	€500.0 million

The average balance of all three sub-items under item 2 in 2007 came to €4.2 billion, compared with €3.6 billion in 2006.

3. Other liabilities to euro area credit institutions denominated in euro

These are non-interest-bearing, fixed-term deposits by credit institutions as a result of sanctions for infringements of credit rules. On 31 December 2007 these deposits amounted to €33.4 million.

4. Liabilities to other euro area residents denominated in euro

4.1 General government

This item comprises deposits by the Greek State (central government), public entities and the Deposits and Loans Fund.

Outstanding balance as at 31.12.2007	€1,159.3 million
Outstanding balance as at 31.12.2006	€893.6 million
Increase	€265.7 million

The average balance of these deposits in 2007 amounted to €1.5 billion, compared with €1.1 billion in 2006.

4.2 Other liabilities

This sub-item records the balances of non-interest bearing deposits held by various entities.

Outstanding balance as at 31.12.2007	€56.2 million
Outstanding balance as at 31.12.2006	€19.3 million
Decrease	€36.9 million

5. Liabilities to non-euro area residents denominated in euro

Outstanding balance as at 31.12.2007	€838.6 million
Outstanding balance as at 31.12.2006	€851.5 million
Decrease	€12.9 million

The bulk of these liabilities (€828.4 million) consists of deposits in euro held by the IMF with the Bank and corresponds to Greece's euro-denominated participation (quota) in the IMF.

The €12.9 million decrease stems largely from these specific deposits and reflects a valuation effect due to the appreciation of the euro vis-à-vis the SDR.

This decrease more than offset the increased amounts collected by the Bank from third countries according to IMF instructions (see relevant note to asset item 2.1).

6. Liabilities to euro area residents denominated in foreign currency

These liabilities mainly stem from interest-bearing deposits by public entities, denominated in foreign currency.

Outstanding balance as at 31.12.2007	€81.2 million
Outstanding balance as at 31.12.2006	€83.7 million
Decrease	€2.5 million

The decrease is mainly due to the adjustment of these deposits as a result of the appreciation of the euro, the most common currency of denomination for these deposits, against the USD.

7. Liabilities to non-euro area residents denominated in foreign currency

7.1 Deposits and other liabilities

The largest component of this sub-item is the long-term loan of GBP 75 million raised on behalf of and assigned to the Greek State on 6 September 1985. The corresponding claim on the Greek State is disclosed under asset sub-item 3.1 "General government".

Outstanding balance as at 31.12.2007	€102.3 million
Outstanding balance as at 31.12.2006	€111.7 million
Decrease	€9.4 million

The decrease is due to a valuation adjustment as a result of the appreciation of the euro against the GBP.

8. Counterpart of special drawing rights allocated by the IMF

This item comprises the Bank's liabilities to the IMF stemming from the cumulative allocation of special drawing rights (SDR 103.5 million) to Greece between 1970 and 1981.

Outstanding balance as at 31.12.2007	€111.2 million
Outstanding balance as at 31.12.2006	€118.2 million
Decrease	€7.0 million

The decrease in the amount of these interest-bearing liabilities, when expressed in euro terms, is solely due to valuation effects, i.e. the appreciation of the euro against the SDR.

9. Intra-Eurosystem liabilities

9.2 Net liabilities related to the allocation of euro banknotes within the Eurosystem

This account shows liabilities that stem from the allocation of euro banknotes within the Eurosystem (see "Banknotes in circulation" under "Accounting Policies").

Outstanding balance as at 31.12.2007	€2,399.3 million
Outstanding balance as at 31.12.2006	€1,568.6 million
Increase	€830.7 million

The balance as at 31 December 2007 is broken down as follows:

– €1,414.9 million refer to the value of euro banknotes issued by the Bank of Greece on behalf of the ECB (8% of the total value of banknotes in circulation are issued on behalf of the ECB). The Bank's share in this amount is calculated in proportion to its share in the subscribed capital of the ECB. This amount was €81 million higher than on 31.12.2006 (€1,333.9 million), due to the general increase in euro banknotes in circulation.

– €984.4 million represent an adjustment (reduction) in the amount of euro banknotes that the Bank has actually put in circulation. The purpose of this adjustment is to equalise the bank's share in total euro banknotes in circulation (liability item 1) with its banknote allocation key.

The average balance of these liabilities during 2007 came to €1,235 million, from €534 million in 2006.

This decrease was due to the fact that the value of the euro banknotes actually put into circulation by the Bank in 2007 increased, roughly coming to the same level as the Bank's share based on its allocation key.

9.3 Net liabilities related to transactions with the ESCB (TARGET)

These are net liabilities to the ECB, stemming from the Bank's cross-border transactions with the other national central banks of the Eurosystem, the ECB and the non-euro area EU NCBs that participate in the TARGET system.

TARGET account, year-end balances

31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006	31.12.2007
		(in € million)			
17,411.2	15,353.1	6,545.9	7,216.8	8,183.5	10,796.6

The €2.6 billion increase observed year-on-year as at 31 December 2007 was due to the funds that the Bank drew from the TARGET account at the end of 2007 for the purpose of financing purchases of short-term euro-denominated bonds issued by euro area countries.

TARGET account, year averages

2002	2003	2004	2005	2006	2007
		(in € million)			
13,872.0	16,331.9	13,363.3	12,019.0	11,762,0	9,298.0

The creation of these liabilities in 2001 and their continuous increase through to 2003 reflect outflows of excess liquidity from domestic credit institutions to other EU countries. This excess liquidity resulted from the gradual release of credit institutions' reserve holdings (in euro and foreign currency) with the Bank of Greece when Greece joined EMU on 1 January 2001 and became subject to the single monetary policy of the Eurosystem.

This change has had no effect on the Bank's financial results, since the amount of interest paid by the Bank to the ECB in respect of these liabilities has replaced the interest paid until 2001 to domestic credit institutions as remuneration of their reserve holdings.

In the years 2004-2007 these liabilities gradually decreased, while banknotes in circulation increased, reflecting capital inflows aimed at meeting credit institutions' increased funding needs in the face of strong demand for credit by households (housing and consumer loans) and non-financial corporations.

10. Items in course of settlement

This item mainly consists of the float of cheques and payment orders whose settlement is pending, totalling €43.9 million as at 31 December 2007 (31 December 2006: €55.5 million).

11. Other liabilities

11.1 Accruals and income collected in advance

This sub-item represents write offs/write downs of premiums on securities, interest expenses accrued up to 31 December 2007 and other expenses. Such expenses shall be paid within the new financial year and mainly involve tax on interest income from Greek State bonds and various categories of interest payable (on the outstanding balance of the TARGET account, on credit institutions' reserve holdings and on other liabilities).

Outstanding balance as at 31.12.2007	€151.5 million
Outstanding balance as at 31.12.2006	€170.0 million
Increase	€18.5 million

11.2 Sundry

This sub-item comprises: the distributable profit for the year; tax on dividends; other taxes to be paid; the Bank's liability towards the Greek State regarding Greece's SDR-denominated participation in the IMF (the corresponding claim of the Bank on the IMF is recorded under asset item 2.1 "Receivables from the IMF"); and the balances of credit suspense accounts and other accounts on behalf of third parties (suppliers, etc.).

Also included, as from 2 January 2003, is the equivalent of drachma banknotes not withdrawn from circulation (ultimate deadline for exchanging drachma for euro banknotes: 1 March 2012).

Sundry	**31.12.2007**	**31.12.2006**	**Change**
	(in € million)		
Dividends to be distributed	50.9	46.1	4.8
Tax on dividends	17.0	18.8	–1.8
Profit to be transferred to the Greek State	180.9	160.7	20.2
Value of drachma banknotes in circulation	251.4	256.6	–5.2
Liability to the Greek State (Greece's SDR-denominated participation in the IMF)	58.0	97.2	–39.2
Other liabilities	37.6	29.5	8.1
Total	**595.8**	**608.9**	**–13.1**

12. Provisions

Category of provisions	**31.12.2007**	**31.12.2006**	**Change**
	(in € million)		
Provision for future obligations of the Bank to its personnel insurance funds	1,002.9	909.5	93.4
Provision for general risks under Article 71 of the Statute	50.3	25.5	24.8
Other provisions for doubtful claims	120.4	117.3	3.1
Total	**1,173.6**	**1,052.3**	**121.3**

– In the financial year 2007 the Bank added an amount of €93.4 million to the provision for future obligations to its personnel insurance funds. This amount represents net profit from swap operations carried out during 2007, following ECB approval.

– The provision of €50.3 million under Article 71 of the Statute is aimed at covering credit risk associated with non-performing loans and the risk of asset depreciation (foreign exchange rate, interest rate and gold price risks).

– The category "Other provisions for doubtful claims" is aimed at covering special cases of doubtful claims.

13. Revaluation accounts

In accordance with the accounting principles set out by the European Central Bank for the NCBs of the European System of Central Banks, especially the principle of prudence, unrealised valuation gains on gold, financial instruments in foreign currency and securities are not recognised as income in the Profit and Loss Account but are transferred directly to revaluation accounts (functioning as reserves for these particular assets only). By contrast, unrealised valuation losses at year-end are recognised as expenditure and are taken to the Profit and Loss Account.

Valuation at end-2007 produced unrealised gains of €965.4 million (almost exclusively stemming from gold, see breakdown below), which were transferred to the corresponding revaluation accounts.

Unrealised valuation gains	**31.12.2007**	**31.12.2006**	**Change**
	(in € million)		
– on foreign currency instruments	0	0.2	–0.2
– on securities	4.1	0.2	3.9
– on gold	961.3	650.2	311.1
Total	**965.4**	**650.6**	**314.8**

Unrealised losses of €43.3 million were taken to the Profit and Loss Account.

14. Capital and reserves

On 31 December 2007 the Bank's own funds amounted to €774.8 million, against €667.2 million on 31 December 2006.

In more detail, the composition of the Bank's own funds as at 31 December 2007 is as follows:

14.1 Capital

The Bank's capital, following the increases effected by virtue of Legislative Decrees 413/1970 and 889/1971, Laws 542/1977 and 1249/1982, Ministerial Decision E.2665/1988, Law 2065/1992, Ministerial Decision 1281/30.10.1996 and Cabinet Acts No. 8/4.2.2000, 32/23.5.2002 and 17/4.7.2005, **has reached €88,994,690 divided into €15,891,909 shares of a par value of €5.60 each.**

14.2 Ordinary reserve

The Bank's ordinary reserve is now equal to its share capital, and amounts to €88,994,690.

14.3 Extraordinary reserve

An extraordinary reserve of €55,000,000 was created out of the profits for the years 2006 and 2007.

14.4 Special reserve from the revaluation of land and buildings

This special reserve was established during financial year 2004 with the capital gains from the restatement of land and buildings at fair (market) value (as determined by an independent real estate assessor). At that time, it amounted to €492,267,534.

In 2005, part of the above amount (more specifically, €22,248,671) was converted into share capital with the issue of 3,972,977 new shares of a nominal value of €5.60 each, which were distributed to shareholders, for free, at a ratio of one new share for each three shares held.

In 2007, the Bank's land and buildings were revalued at fair value by independent assessors. The resulting revaluation increment of €71,531,825 was transferred to the above special reserve, which came to €541,550,688.

14.5 Special reserves

This special reserve amounts to €275,794 and represents the value of fixed assets (mostly buildings) transferred gratis to the Bank.

OFF-BALANCE SHEET (MEMORANDUM) ITEMS

	31.12.2007	31.12.2006	Change
	(in € million)		
– Greek government securities (management of the "Common fund of public entities and social security organisations" under Law 2469/97	19,361.1	18,034.1	1,327.0
– Greek government securities and other debt securities (management and safe custody of public entities', social security organisations' and private-sector agents' funds	13,474.8	10,753.7	2,721.1
– Other*	13,461.8	7,035.8	6,426.0
Total	**46,297.7**	**35,823.6**	**10,474.1**

* These include:

– securities issued by the Greek government and governments of other euro area countries, and provided to the Bank as collateral by counterparties in Eurosystem credit operations in the context of the single monetary policy of the euro area;

– forward purchases/sales of foreign exchange against euro;

– documentary credits to be executed, third-party guarantees of good performance, coins in storage at the Bank, etc.

Also included in the "other" memorandum items is a liability to the ECB from the fixed-term operation, to be settled after 31 December 2007, conducted under the agreement between the ECB and the Federal Reserve System for the short-term funding, in US dollars, of Eurosystem credit institutions (see the relevant note to asset item 3.2 "Other claims").

GENERAL NOTES ON THE PROFIT AND LOSS ACCOUNT FOR 2007

The Bank's net profits in 2007 amounted to €284.7 million, compared with €244.6 million in 2006, thus increasing by 16.4%.

More specifically:

INCOME

• ***The Bank's total net income*** was slightly lower than in the previous financial year (dropping by 0.6% to €825.5 million, from €830.9 million in 2006).

This result was primarily due to lower gains from swap transactions that, as in the previous financial year, were carried out following a prior approval by the ECB in order to increase the special provision for the Bank's future liabilities to its personnel social security funds. This decrease in profit from swap transactions (€93.4 million in 2007, compared with €204.4 million in 2006) can mainly be attributed to the drop in total net income from financial operations (€104 million in 2007, compared with €241.7 million in 2006).

In contrast, net income from interest, which is the Bank's main source of income, was significantly higher in 2007, increasing by 27%. Net income from commissions increased by 8.1%, while other income rose by 18.4%.

In greater detail:

• ***Net interest income*** amounted to €540.9 million, compared with €426.0 million in 2006, as a result of higher yields on the Bank's portfolios.

• ***Net income from commissions*** amounted to €131.7 million, compared with €121.8 million in 2006, and consisted mainly of commissions paid by the Greek State for operations that the Bank carries out on its behalf, as well as fees for managing the "Common Fund of Public Entities and Social Security Organisations".

• ***Other income*** amounted to €48.9 million, down from €41.3 million in 2006. Included under this heading are: income from operations by the Banknote Printing Works (IETA), participating interests, and the amount received from the allocation of the monetary income of the Eurosystem.

This item does not include any amount arising from the Bank's allotted share in the ECB's income on euro banknotes in circulation and in the ECB's net profits, since the ECB, in 2007 as in previous financial years, retained the full amount of its profits, including income from its share (8%) in the total value of euro banknotes in circulation issued on its behalf. This surplus was set aside in a provision against foreign exchange rate, interest rate and gold price risks.

EXPENSES

Total expenses were 7.7% lower in 2007 (€540.8 million) than in 2006 (€586.2 million).

This was mainly due to lower provisioning.

More specifically:

- ***Total provisions*** made during 2007 came to €148.1 million, down from €227.6 million in 2006. This decrease stemmed from the provision for future liabilities to personnel social security funds, which fell to €93.4 million in 2007, from €204.4 million in 2006. This provision was financed by gains from swap operations, conducted following the approval of the ECB.

- ***The Bank's operating expenses excluding provisions*** (staff costs, pensions, administrative and other expenses, depreciation) increased in 2007 by 9.5% to €392.7 million (after increasing by 11% to €358.6 million in 2006).

Operating expenses were substantially affected by:

– increased compensation payments for staff retirement, given that a large number of employees, as in 2006, became eligible for retirement (158 in 2007);

– the increased depreciation of euro banknote printing costs;

– the increase in other expenses, including the emergency relief donated by the Bank to the fire victims of 2007.

It should be noted that the increase in expenditure for wages and other personnel benefits was contained to 6.7%, compared with 6.1% in 2006, in spite of the extraordinary expenditure arising from the Bank's restructuring.

DETAILED INCOME AND EXPENSE STATEMENT

NET OPERATING INCOME *(in euro)*

	2007	2006
1. NET INTEREST INCOME	**540,922,539**	**426,049,483**
1.1 Interest income	**1,195,082,817**	**929,862,887**
a. Interest on lending to credit institutions in relation to monetary policy operations	188,544,374	138,824,569
b. Interest on securities and deposits with non-resident credit institutions	517,870,472	361,686,000
c. Interest on Greek government debt securities	145,621,771	156,683,378
d. Remuneration of long-term euro-denominated claims arising from the transfer of foreign exchange reserves to the ECB	35,456,978	25,620,362
e. Interest on long-term claims against the Greek State	302,331,036	241,327,469
I. Interest on long-term loans to the Greek State granted before 31.12.1993	*246,605*	*3,229,033*
II Interest on long-term loans to the Greek State (conversion of debit balances on 31.12.1993)	*46,620,394*	*49,212,015*
III Interest on a long-term bond issue in euro on 31.12.1993 (in settlement of the balance of the account "Exchange rate valuation differences")	*78,947,743*	*58,595,610*
IV. Interest on the long-term euro-denominated loan (conversion of debit balances of accounts of exchange rate valuation differences on 31.12.1993)	*176,414,235*	*130,180,741*
V. Interest on a long-term USD-denominated loan (31.12.1993)	*102,059*	*110,070*
f. Interest on deposits and SDR holdings with the IMF	2,090,874	3,012,924
g. Interest on loans to the personnel of the Bank of Greece	3,126,747	2,678,221
h. Other interest income	40,565	29,964
1.2 Interest expense	**–654,160,278**	**–503,813,404**
a. Interest and expenses on intra-ESCB balances (TARGET)	–369,671,588	–333,457,592
b. Interest on net liabilities related to the allocation of euro banknotes within the Eurosystem	–62,396,937	–35,148,573
c. Interest on banks' deposit accounts in the context of monetary policy operations (including minimum reserves)	–166,076,828	–103,044,349
d. Interest on deposits by the Greek State	–47,383,741	–22,263,731
e. Interest on foreign exchange deposits by public entities	–3,916,693	–5,373,361
f. Interest on the allocation of SDRs	–4,701,903	–4,459,584
g. Other interest expense	–12,588	–66,214
2. NET RESULT OF FINANCIAL OPERATIONS, WRITE-DOWNS AND RISK PROVISIONS	**104,002,889**	**241,705,184**
3. NET INCOME FROM FEES AND COMMISSIONS	**131,739,075**	**121,812,074**
4. INCOME FROM EQUITY SHARES AND PARTICIPATING INTERESTS	**3,383,702**	**3,472,030**
5. NET RESULT FROM THE POOLING AND REALLOCATION OF MONETARY INCOME	**6,690,797**	**4,667,120**
6. OTHER INCOME	**38,758,703**	**33,147,655**
TOTAL NET INCOME	**825,497,705**	**830,853,546**

NOTES ON NET OPERATING INCOME ACCOUNTS

The Bank's net operating income was slightly lower in 2007, falling by 0.6% to €825.5 million, from €830.9 million in 2006.

In greater detail:

1. Net interest income

Net interest income (interest income less interest expense) increased by 27% to €540.9 million, from €426 million in the previous financial year. This change was due to the high yields on the Bank's portfolios.

The individual categories of interest are as follows:

1.1 Interest income

Interest income 2007: €1,195.1 million, 2006: €929.9 million.

a) Interest on lending to credit institutions related to monetary policy operations

This refers to the financing of domestic credit institutions through the liquidity-providing open market operations conducted by the Eurosystem in the context of the single monetary policy within the euro area.

In 2007, this category showed a significant increase of €49.7 million, exclusively on account of higher interest rates. The minimum bid rate of the main refinancing operations (MROs) rate was raised further in 2007, coming to 4% in June 2007, from 3.5% in December 2006 and 2.25% in December 2005. In contrast, the average volume of credit extended in 2007 was slightly lower than in 2006 (2007: €4,653 million, 2006: €4,774 million).

Interest on lending to credit institutions	2007	2006	Change
	(in €million)		
– main refinancing operations	100.6	106.5	–5.9
– longer-term refinancing operations	87.7	32.3	55.4
– fine-tuning reverse operations	0.2	0	0.2
Total	**188.5**	**138.8**	**49.7**

b) Interest on securities and deposits with non-resident credit institutions

This includes interest on securities and deposits in euro and in foreign currency with credit institutions both in the euro area and outside the euro area.

Interest by type of asset	2007 (in € million)	2006	Change
– on securities	462.0	291.3	170.7
– on time deposit accounts and current accounts	55.9	70.4	-14.5
Total	**517.9**	**361.7**	**156.2**

c) Interest on Greek government debt securities

Interest on the Bank's holdings of Greek government securities dropped by €10.9 million against the previous financial year (2007: €145.8 million, 2006: €156.7 million). The total value of holdings came to €3.1 billion as at 31 December 2007, from €3.6 billion as at 31 December 2006.

d) Remuneration of long-term euro-denominated claims arising from the transfer of foreign reserve assets to the ECB

This refers to interest on the Bank's euro-denominated claim against the ECB with respect to the foreign reserve assets transferred to the ECB, in accordance with Article 30 of the Statute of the ESCB. This claim is remunerated at 85% of the latest marginal MRO rate. This item rose by a significant €9.9 million in 2007 to €35.5 million (2006: €25.6 million), exclusively on account of the increase in the MRO rate.

e) Interest on long-term claims against the Greek State

This refers to interest on loans granted by the Bank of Greece to the Greek State up to 31 December 1993.

This interest income rose to €302.3 million in 2007, from €241.3 million in 2006 (+€61million), owing to the considerable increase in the Libor and Libid rates that apply to all loans granted to the Greek State and resulting from the conversion of the debit balances of the account "Foreign exchange rate valuation differences under Law 1083/80" (12-month Libor and Libid rates). The increase in this category of interest more than offset the decline in overall interest payments by the Greek State caused by gradual debt repayment.

f) Interest on deposits and SDR holdings with the IMF

Comprised in this item is interest on Greece's participation in the IMF and on the Bank's SDR holdings with the IMF. This category of interest income decreased by €0.9 million to €2.1 million (2006: €3.0 million).

g) Interest on loans granted to the personnel of the Bank of Greece

This change was due to the significant decrease in Greece's participation in the IMF (in SDRs) and the commensurate increase in Greece's euro-denominated component, and to a lesser extent to the lower interest rate.

h) Interest on loans to the personnel of the Bank of Greece

Interest on loans (for house purchase or personal loans) granted by the Bank of Greece to members of its staff increased by €0.4 million (2007: €3.1 million, 2006: €2.7 million).

i) Other interest income

Other interest income totalled €40,565, against €29,964 in 2006.

1.2 Interest expense

Interest expense 2007: €654.2 million, 2006: €503.8 million.

a) Interest and expenses on intra-ESCB balances (TARGET)

Interest and expenses on the TARGET account (in € million)

2001	2002	2003	2004	2005	2006	2007
320.9	458.9	384.8	273.4	252.1	333.5	369.7

The above interest and expenses are calculated on the basis of the daily balances of the account dedicated to the transactions of the Bank of Greece with the ECB and other ESCB NCBs within the TARGET system.

In the first two years after the Bank joined the ESCB (2001 and 2002), this interest rose significantly, due to the transfer of excess liquidity from domestic credit institutions to other EU countries, while gradual declines were observed from 2003 to 2005. In 2003 the decline was exclusively due to the lower interest rate (marginal MRO rate), as the average annual balance of the account increased.

The continuing declines of 2004 and 2005 reflected lower balances on the TARGET account, in the absence of significant changes in the interest rate over the same period (the interest rate increase of 6 December 2005, from 2% to 2.25%, had a negligible impact).

The considerable rise in 2006 and 2007 is due exclusively to the higher MRO rate, as the average balance on the account stood at lower levels (2005: €12.0 billion, 2006: €11.8 billion, 2007: €9.3 billion).

It should be noted that this interest expense replaced the interest paid by the Bank until 2001 to domestic credit institutions on their required reserve holdings.

b) Interest on net liabilities related to the allocation of euro banknotes within the Eurosystem

This interest expense registered a significant rise of €27.3 million (2007: €62.4 million, 2006: €35.1 million), as a result of both higher key ECB interest rates and an increase in the average level of these liabilities, relative to the previous financial year (2007: €1.6 billion, 2006: €1.3 billion).

This interest expense is calculated on the basis of:

– the Bank's liability corresponding to the ECB's share in the euro banknote issue (a share of 8% of the total value of euro banknotes in circulation is allocated to the ECB);

– the intra-Eurosystem claim/liability corresponding to the value of euro banknotes put into circulation by the Bank of Greece, adjusted to ensure that the Bank's share in total euro banknotes in circulation (after the deduction of the 8% share allocated to the ECB) is equal to its banknote allocation key;

– the amount of adjustment. Since 2002, intra-Eurosystem balances related to the allocation of euro banknotes have been adjusted in order to avoid sharp fluctuations in the monetary income of Eurosystem NCBs (see section "Banknotes in circulation" under "Accounting Policies", as well as the note on Liability item 9.2).

c) Interest on banks' current accounts in the context of monetary policy operations (including minimum reserves)

This mainly concerns interest paid on banks' minimum reserves, in the context of monetary policy conduct in the euro area countries.

This item rose by €63.1 million in 2007 compared with the previous year (2007: €166.1 million, 2006: €103.0 million), a development which is attributed both to the rise in key ECB interest rates (average MRO rate during the reserve maintenance period) and to the increase in the level of reserve holdings (2007: €4.2 billion, 2006: €3,6 billion).

d) Interest on deposits by the Greek State

Interest on deposits by the Greek State rose by a considerable €25.1 million, to €47.4 million (2006: €22.3 million). This was due both to higher interest rates (average rate 2007: 3.95%, 2006: 2.83%) and to the increase in these deposits, the average level of which rose to €1.2 billion in 2007, from €794 million in 2006.

e) Interest on foreign exchange deposits by public entities

This category of interest expense decreased by €1.5 million (2007: €3.9 million, 2006: €5.4 million), mainly due to a decrease in these deposits.

f) Interest on the allocations of SDRs

Interest on the Bank's liabilities from the allocation of IMF special drawing rights (SDRs) increased slightly by €0.2 million (2007: €4.7 million, 2006: €4.5 million), due to a rise in SDR interest rates.

g) Other interest expense

This category of interest expense came to €12,588, compared with €66,214 in 2006.

2. Net result of financial operations, write-downs and risk provisions

The net result from financial operations in 2007 decreased by €137.7 million to €104.0 million, compared with €241.7 million in 2006.

A detailed breakdown is provided below.

2.1 Realised gains from financial operations	**2007** *(in € million)*	**2006**	**Change**
– transactions in foreign exchange	9.0	26.4	–17.4
– transactions in securities	7.6	3.2	4.4
– transactions in swaps	93.4	204.4	–111.0
– transactions in SDRs	9.3	7.7	1.6
Total	**119.3**	**241.7**	**–122.4**
2.2 Write-downs of financial assets and positions (unrealised losses)			
– from the valuation of foreign exchange	–30.9	–17.1	–13.8
– from the valuation of securities	–12.4	–5.8	–6.6
Total	**–43.3**	**–22.9**	**–20.4**
2.3 Transfer from provisions for exchange rate and price fluctuation risks	**28.0**	**22.9**	**5.1**
Grand total	**104.0**	**241.7**	**–137.7**

The significant €137.7 million decrease in the net result from financial transactions shown in the above table stems mainly from a decrease in profits on swap transactions, owing to a drop in the volume of conducted transactions.

Gains from foreign exchange transactions decreased by €17.4 million, whereas gains from transactions in securities increased by €4.4 million, and gains from transactions in SDRs rose by €1.6 million.

Finally, the 2007 results include unrealised losses of €43.3 million, compared with €22.9 million in 2006, which stemmed from the year-end valuation of foreign exchange and securities and are attributed to the revaluation of the euro against the main foreign currencies and to changes in securities prices. These losses were largely covered by the special provision made for this purpose.

3. Net income from fees and commissions

Net income from fees and commissions increased by €9.9 million in 2007 to €131.7 million, against €121.8 million in 2006. A breakdown is provided below.

Net income from fees and commissions	2007	2006	Change
	(in € million)		
3.1 Income from fees and commissions			
– from the management of Greek government securities	32.8	25.1	7.7
– from payments and receipts on behalf of the Greek State	63.3	60.9	2.4
– from the management of the "Common Fund" (surpluses of public entities and social security organisations) under Law 2469/1997	29.1	29.6	–0.5
– other	7.7	7.2	0.5
Total	**132.9**	**122.8**	**10.1**
3.2 Expenditure for fees and commissions	**–1.2**	**–1.0**	**–0.2**
Total net income from fees and commissions	**131.7**	**121.8**	**9.9**

4. Income from equity shares and participating interests

Income from equity shares and participating interests in 2007 remained roughly unchanged from the level of 2006 (€3.4 million).

This income corresponds to dividends collected in 2006 from the Bank's participating interests in the Bank of International Settlements-BIS (€2.5 million), DIAS Interbank Systems

SA (€254 thousand) and Hellenic Exchanges SA (€660 thousand, of which €160 thousand was refund of capital).

No income distribution took place, since the ECB, in 2007, as in previous years, retained the full amount of its net profits, including the income from its share (8%) of total euro banknotes in circulation, and set it aside in a provision for foreign exchange rate, interest rate and gold price risks.

5. Net result of pooling of monetary income

Monetary income is the income accruing to the euro area NCBs in the performance of the Eurosystem's monetary policy function.

The amount of each NCB's monetary income is determined by measuring its actual income derived from its assets held against a "liability base".

The liability base consists of the following liability items:

- banknotes in circulation;

- deposit liabilities to euro area credit institutions in euro, related to monetary policy operations;

- net intra-Eurosystem liabilities related to transactions with the ESCB (TARGET); and

- net intra-Eurosystem liabilities related to the allocation of euro banknotes.

Any interest paid by an NCB on items included in the liability base is deducted from the monetary income of that NCB..

The assets that are held against the liability base ("earmarkable assets") are the following:

- loans to euro area credit institutions related to monetary policy operations denominated in euro

- intra-Eurosystem claims equivalent to the transfer of foreign reserves to the ECB

- net intra-ESCB claims resulting from TARGET transactions;

- net claims related to the allocation of euro banknotes within the Eurosystem; and

- a minimum amount of gold reserves for each NCB, according to its allocation key. Gold is considered to generate no income.

Where the value of an NCB's earmarkable assets exceeds or falls short of the value of its liability base, the difference is offset by applying to the value of the difference the average rate of return on the earmarkable assets of all NCBs taken together.

At the end of each financial year, the monetary income pooled by the Eurosystem is reallocated to the NCBs in proportion to their paid-up shares in the capital of the ECB.

The positive difference (€6.7 million) between the monetary income accrued to the Bank of Greece in 2007 (€598.7 million) and the amount to be allocated to it (€605.4 million) in proportion to its paid-up share in the ECB's capital is the Bank's net monetary income. This difference was also positive in 2006 (€4.7 million).

The above method for allocating monetary income was established by decision of the Governing Council of the ECB (ECB/2001/16).

6. Other income

Other income increased by €5.7 million to €38.8 million, compared with €33.1 in 2006.

The most important category under this heading is income from the activities of the Banknote Printing Works (IETA) of the Bank of Greece (€34 million), accreditation fees (€1.3 million). A much smaller category comprises income from: the sale of obsolete items and equipment (including vehicles), cashier surpluses, the provision of training services, etc.

The observed increase is mainly attributed to higher IETA revenue from the production of banknotes and a number of products on behalf of the Greek State (passports, coins, lottery tickets, legal stationery).

OPERATING COSTS, DEPRECIATION AND PROVISIONS

	2007	2006
	(in euro)	
STAFF COSTS	**230,209,907**	**214,591,454**
Wages, salaries and other benefits	149,801,715	140,353,929
Employer's social security contributions and other levies	80,408,192	74,237,525
PENSIONS	**61,544,339**	**55,381,266**
ADMINISTRATIVE AND OTHER EXPENSES	**58,143,853**	**50,203,499**
DEPRECIATION OF TANGIBLE AND INTANGIBLE FIXED ASSETS	**42,786,390**	**38,436,988**
TOTAL EXPENSES BEFORE PROVISIONS	**392,684,489**	**358,613,207**
PROVISIONS	**148,129,355**	**227,604,875**
TOTAL EXPENSES	**540,813,844**	**586,218,082**

NOTES ON EXPENSES ACCOUNTS

Outlays for wages, salaries and other benefits increased by 6.7%, compared with 6.1% in 2006, reflecting the restructuring of the Bank in 2007, apart from the implementation of the Collective Labour Agreements. This restructuring consisted in merging several of the Head Office's service units and downsizing the Bank's network. It should be noted that all of the other Eurosystem NCBs have already undergone similar organisational restructuring.

Employer's social security contributions and other levies rose by 8.3%, i.e. by roughly as much as in 2006).

Outlays for pensions rose by 11.1%, i.e. by less than in 2006 (12.9%). These increases were due to the higher number of retirements in 2006 and 2007 than in previous years.

Administrative and other expenses increased by 15.8%. These expenses include the expenditure of the Banknote Printing Works (IETA) for raw materials, the cost of building repair and maintenance, the procurement of computer hardware and other equipment, insurance premiums, charitable donations, overhead costs, etc.).

This increase, which was significantly lower than the one of 2006 (+27.2%), was largely due to the Bank's contribution to the fire victim relief effort.

Depreciation increased by €4.4 million, mainly due to the increased outlays for the depreciation of previous years' banknote production costs.

It should be noted that the annual depreciation of the Bank's buildings is calculated at a rate of 2.5% on the basis of the buildings' estimated lifetime (40 years), while the annual depreciation of the banknote production costs is calculated at a rate of 20% over the average lifetime of banknotes (5 years).

Breakdown of provisions made in 2007 and 2006	**2007**	**2006**
	(in euro)	
– Provision under Article 71 of the Statute	50,000,000	23,000,000
– Provision against future liabilities of the Bank to personnel social security funds	93,400,448	204,375.968
– Provision against future liabilities from the exchange of drachma banknotes for euro banknotes	4,500,000	0
–Other provisions according to decisions of the General Council	228,907	228,907
Total provisions	***148,129,355***	***227,604,875***

Total provisions made in 2007 amounted to €148.1 million, compared with €227.6 million in the previous year. This substantial decrease was due to the Bank's lower provisions for future liabilities to personnel social security funds (€93.4 million in 2007, compared with €204.4 million in 2006). It should be noted that this provision was funded by gains from swap operations, carried out in 2006 and 2007, following an approval by the ECB.

NET PROFITS

Net profit after provisions amounted to €284.7 million in 2007, compared with €244.6 million in 2006, increasing by €40.1 million (or 16.4%).

DISTRIBUTION OF NET PROFIT

(Article 71 of the Statute)

The General Council proposes to the General Meeting of Shareholders that the net profit be distributed as follows:

	(in euro)
Dividend on capital, €0.67 per share on 15,891,909 shares, corresponding in total to 12% of the share capital	10,647,579
To the extraordinary reserve	36,000,000
Additional dividend, €2.53 per share on 15,891,909 shares	40,206,530
Tax payment on dividends (Article 6 of Law 3296/2004)	16,951,370
To the Greek State	180,878,382
Total	**284,683,861**

The General Council proposes to the General Meeting of Shareholders that a total dividend of €3.20 per share be distributed to shareholders. This would correspond to an increase of 10.3% over the total dividend of €2.90 distributed per share in 2006.

Athens, 17 March 2008

For the General Council
THE CHAIRMAN

NICHOLAS C. GARGANAS
GOVERNOR OF THE BANK OF GREECE