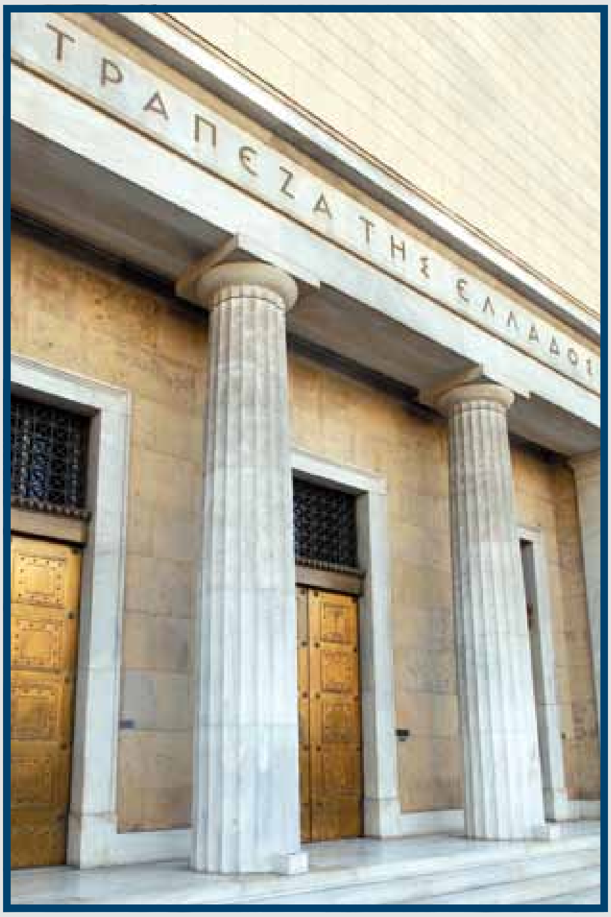
ANNUAL REPORT
2010

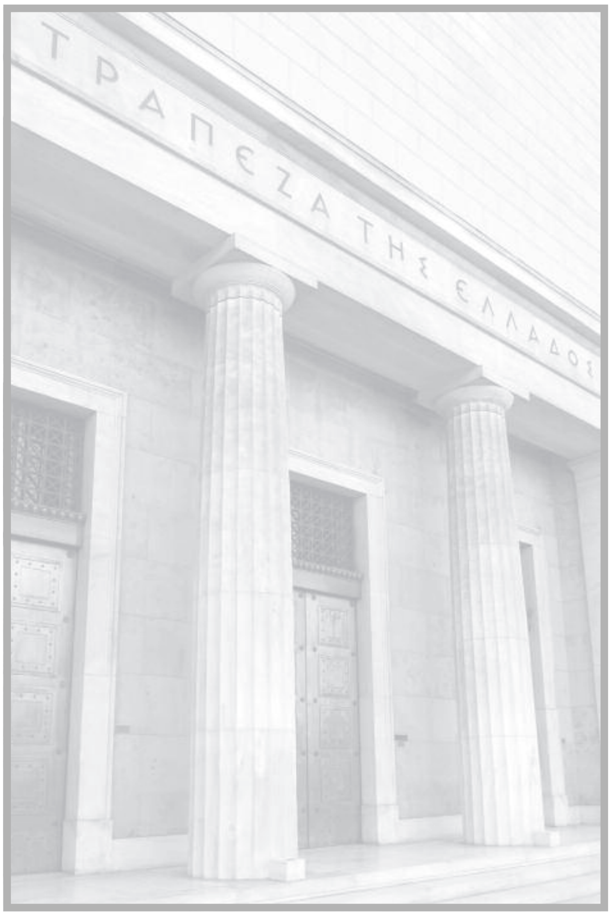


APRIL 2011

BANK OF GREECE
EUROSYSTEM

ANNUAL REPORT
2010

Presented to the 78th General Meeting of Shareholders
on 18 April 2011 by Governor George Provopoulos



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GENERAL COUNCIL

George Provopoulos	**Chairman – Governor**	
Helen Dendrinou – Louri	**Deputy Governor**	
Ioannis Papadakis	**Deputy Governor**	
George Demopoulos	Member of the MPC and Member	
George Oikonomou	»	
Ioannis Gozadinos	Member	
Georgios Kassimatis	»	
Odysseas Kyriacopoulos	»	*Expiry of term of office: 2011**
Georgios Mylonas	»	*Expiry of term of office: 2011**
Christos Polyzogopoulos	»	
Michael Chandris	»	*Expiry of term of office: 2011**
Panagiotis Karakousis	Government Commissioner	

* The term of office of General Council Members Messrs Odysseas Kyriacopoulos, Georgios Mylonas and Michael Chandris, elected by the Annual General Meeting of 24 April 2008, expires at the current Annual General Meeting, in accordance with Article 21 of the Bank's Statute.

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GEORGE PROVOPOULOS

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BY ORDER OF THE GENERAL COUNCIL

I FINANCIAL RESULTS FOR 2010

The Bank's Profit and Loss Account for 2010 shows total net revenue of €1,044.5 million and total operating expenses (including depreciation and provisions) of €854.1 million. Net profit thus reached €190.4 million, against €228.2 million in 2009.

In accordance with Article 71 of the Bank's Statute, the General Council has decided to propose to the Meeting of Shareholders to allocate the profits of 2010 as follows (also taking into account the provisions of the new tax law 3943/2011): to distribute €13.3 million or 12% of the Bank's capital as first dividend and €25.9 million as additional dividend, thus bringing the total dividend to €39.2 million. Income tax on distributed dividends comes to €12.4 million. From the balance of net profits – after the allocation of €12 million to an increase in the extraordinary reserve – an amount of €126.8 million shall be transferred to the State.

In greater detail, the Bank's revenue and expenses in financial year 2010 can be broken down as follows:

Revenue

The Bank's total net revenue from monetary policy operations, interest and fee income and other revenue from domestic and foreign activities declined by 8.3% to €1,044.5 million, from €1,139.5 million in 2009.

Specifically:

Net income from interest and financial operations came to €831.0 million, declining by 0.3% from €833.3 million in 2009, as the European Central Bank (ECB) key interest rate came to 1% in 2010, compared with an average of 1.279% in 2009.

Net income from fees and commissions dropped by 19% to €141.5 million, from €174.8 million in 2009. It mainly relates to fees and commissions received for transactions conducted by the Bank on behalf of the Greek State, as well as commissions for the management of the Common Fund of Legal Persons in Public Law and Social Security Funds and other operations conducted by the Bank. The drop is due to a decline in fees received by the Bank for the management of Greek government securities, as a result of the decreased volume of new issues in 2010.

Income from equity shares and participating interests fell by €54.7 million to €12.3 million, compared with €67 million in 2009. It relates to dividends received from various participating interests of the Bank and income from the ECB. This decline was due to a decrease in profits distributed by the ECB. Out of its profits in 2010 (€1,334 million), the ECB used €1,163 million to increase provision against portfolio risks. Out of the remaining €171 million that was allocated to the Eurosystem's national central banks, the Bank of Greece received €4.8 million, corresponding to the Bank's key for subscription to the ECB's capital (2.81539%), compared with €63.4 million in 2009.

Income from the release of provisions came to €47 million, from €45 million in 2009. An additional amount of €47 million was released from the €149.5 million provision that was established in 2008 against counterparty risk from Eurosystem's monetary policy operations, in line with a decision of the Governing Council of the ECB following the reassessment of collateral used by Eurosystem counterparties in monetary policy operations, with a view to mitigating such risks.

Finally, other income declined by €6.8 million to €12.6 million, compared with €19.4 million in 2009. The bulk of this amount concerns income from activities carried out by the Banknote Printing Works (IETA) on behalf of the Greek State and various other revenues.

Expenses

Total expenses in 2010 declined by €57.2 million (i.e. 6.3%) to €854.1 million, compared with €911.3 million in 2009.

Specifically:

- The Bank's general operating expenses excluding provisions (staff costs and pensions, depreciation, other costs) decreased by €57.9 million (i.e.13.2%) to €381.2 million, from €439.1 million in 2009. As part of a general effort to rationalise the Bank's operating expenses, staff costs and pensions were reduced by 5.8% in the past two years, while the cost of overtime employment was cut down by 22% while, in the first months of 2011, the decrease came close to 40%, compared with the corresponding period of 2009. The number of cash transports to the regional branches and outlets fell by 35% in the past year. Moreover, since late 2009 the members of the Administration and the Monetary Policy Council have waived 20% of their earnings.

- Increased provisioning for future risks and liabilities of the Bank continued in 2010 (€472.9 million were allocated) reaching a cumulative €2,385.4 million.

The practice of establishing high provisions and reserves is associated with the principle of prudence, also applied by the ECB and the other central banks of the Eurosystem. It aims at consolidating the financial position of the Bank of Greece, thereby enabling it to fulfill in the best possible manner its assigned duties and respond to the risks assumed.

Organisational restructuring

The Bank's staff decreased by 83 people in the course of 2010 to 2,251 at year-end, despite the fact that the Bank was entrusted with new responsibilities that call for additional human resources. The Bank's staff has decreased by a total of 512 members over the past three years. Furthermore, the Bank went ahead with the reorganisation of its branch network, adapting it to the new conditions within the Eurosystem.

Specifically, the Corfu and Rethymno branches were successfully downsized into outlets as from 15 January 2010 and 1 March 2010, respectively, while the Pyrgos branch will be downsized into an outlet by 30 June 2011. The Bank's branch network has been curtailed by 1/3 since 2007. Moreover, the operation of 27 of the Bank's Cash Reserves in branches of the National Bank of Greece has been discontinued since February 2011 and a procedure was established for serving the Greek State through a special account with the corresponding branches of the National Bank of Greece.

At the same time, organisational restructuring continued in order to better meet present-day needs. In this context, the Bank of Greece took note, inter alia, of the requirements concerning the application of optimal operating practices, especially as regards corporate governance and its internal audit system, and set up an Audit Committee and two special units, namely the Compliance Unit and the Risk Management Unit.

Furthermore, in order to more efficiently support the transfer of the duties of the Private Insurance Supervisory Committee to the Bank of Greece, a new Department (Department of Private Insurance Supervision) and a new Section within the Legal Department (Private Insurance Legal Issues Section) were set up as from 1 December 2010.

In order to ensure appropriate support to the Bank's new tasks relating to its personnel social security funds, as from 1 January 2011 by virtue of Law 3863/2010, the units responsible for the operation of the two main and auxiliary pension funds were abolished and two new Sections were established within the Administration Department: the Pension Award Section and the Pension Payment Section.

Finally, in order to streamline the regulatory framework for the operation of the Bank's services, revised draft Operating Regulations were submitted for all units. The new Operating Regulations are expected to facilitate the smooth operation, as well as the more effective supervision and control of units.

At the same time, the conditions for an integrated electronic communication system were created to improve and upgrade the services provided to the Greek State, and systems and procedures were properly adjusted to support the relevant operations more effectively, as part of the operations of the Special Central Account of Structural Funds and the Cohesion Fund (NSRF), as well as of the Single Payment Authority.

Buildings and technical projects

As regards the Bank's premises, in 2010 the Technical Services Department carried out maintenance and remodelling work in the Bank's premises in Attica and other regions of the country, as part of a programme to improve working conditions, enhance the physical security of facilities and operations and switch over to more eco-friendly solutions.

At the same time, in the course of 2010, extended remodelling of premises was required at the Head Office, the IETA building and the building on Amerikis Street, in order to accommodate newly established units, specifically the Department of Private Insurance Supervision, the Compliance Unit and the Risk Management Unit. Moreover, in the context of organisational restructuring of the Bank's units and the downsizing of branches into outlets, proper arrangements were made in the premises leased to house the Bank's outlets in Florina and Rethymno.

According to the Bank's Statute and the decisions of the General Council, the building that used to house the Agrinio branch was sold in 2010 to the municipality of Agrinio. This property sale is in conformity with the Bank's standard policy of safeguarding the integrity of its assets, while screening prospective buyers to ensure that their profile and the use intended for the property best serve the public interest.

Other activities

In 2010, the Bank of Greece pursued its mandate with efficiency and commitment in all areas of responsibility, within the scope of its participation in the Eurosystem and in accordance with its Statute. Indeed, during the year, the Bank was entrusted with new duties as regards the supervision of private insurance companies (as from 1 December 2010) and the management of the financial assets of social security funds. In addition, the Bank's staff successfully participated in committees and working groups of the Eurosystem and international organisations, as well as in consultations with representatives from the European Central Bank, the International Monetary Fund and the European Commission in the context of the Economic Adjustment Programme. Above all, the Bank of Greece has decisively contributed to safeguarding the stability of the financial system, by exercising strict prudential supervision, overseeing the conduct of EU-wide stress tests for banks in Greece and providing liquidity to the Greek credit system in the context of the Eurosystem, as well as by its participation in institutions and bodies responsible for financial stability both at the domestic (e.g. the newly established Systemic Stability Board) and the European levels (e.g. the European Systemic Risk Board).

Moreover, continuing a long-standing tradition, the Bank of Greece took further initiatives in the field of economic research on issues mainly concerning the Greek economy, as well as South-East European economies. In 2010, 13 working papers and two new issues of the Economic Bulletin of the Bank of Greece were published. Joint research projects were also carried out, bringing together experts from the Bank of Greece and the academic community, as well as postgraduate students from Greek universities, while the Bank hosted 29 lectures by Greek and foreign researchers.

A conference on the Greek labour market was held in March 2010. The papers presented in the conference ("The Greek labour market: features, developments and prospects") were published on the Bank's website.

In September 2010, the Bank published a collective volume entitled "Greece's current account: causes of imbalances and policy recommendations" (in Greek) comprising 16 papers, which were the outcome of an extensive two-year research. This publication is also available on the Bank's website.

In 2010, the Climate Change Impacts Study Committee continued its work, which is nearing its completion. In the first half of 2011, the Committee will present its Report, comprising the results of the research conducted on the initiative of the Bank of Greece with the participation of a large pool of scientists.

Given its interest in South-East European and Mediterranean economies, the Bank of Greece organised the first conference on the economies of these countries in May 2010, while in March 2010 it had also hosted the meeting of the "Vienna Initiative" about the mitigation of the effects of the global financial crisis on Emerging Europe. In February 2011, the Bank of Greece and the University of Oxford (SEESOX – South-East European Studies at Oxford) jointly organised a conference on achieving sustainable growth in South-East Europe; the fruitful cooperation between the Bank of Greece and SEESOX resulted in the publication of a collection of papers entitled "From Crisis to Recovery – Sustainable Growth in South-East Europe" in the same month.

Moreover, in October 2010, the Bank of Greece and ELIAMEP (the Hellenic Foundation for European and Foreign Policy) co-organised two workshops on the medium-term prospects of the Greek economy's financing from the EU budget (the first workshop concerned the prospects of the Common Agricultural Policy, while the second related to the Policy of Economic and Social Cohesion).

Finally, the Museum of the Bank of Greece, which has started operating on a pilot basis since early 2010, attracts a steady stream of visitors interested in the numismatic and economic history of modern Greece. The number of visitors, including many pupils and students, has reached 2,500, while according to group visit requests the Museum's schedule is fully booked up to May 2011.

End of term of office of General Council members

In October 2010, Mr. Panayotis-Aristidis Thomopoulos submitted his resignation to the Monetary Policy Council and, consequently, to the Bank of Greece's General Council, as he was appointed Chairman of the Board of Directors of the Hellenic Financial Stability Fund. Mr. Thomopoulos was Deputy Governor of the Bank of Greece from October 1994 to February 2009 and a member of the Monetary Policy Council from February 2009 until his resignation.

Today's Annual General Meeting marks the end of tenure of General Council Members Ulysses Kyriacopoulos, Georgios Mylonas and Michael Chandris, elected by the Annual General Meeting of 22 April 2008, in accordance with Article 21 of the Bank's Statute. The General Meeting will therefore be called upon to elect three new General Council members for a three-year term. The outgoing General Council members are eligible for re-election.

II THE ADJUSTMENT PROCESS OF THE GREEK ECONOMY AT A DECISIVE JUNCTURE – CRITICAL CHALLENGES FOR ECONOMIC POLICY

1 INTRODUCTION

One year after Greece had recourse to the support mechanism is a good time to take stock of the course of the Greek economy and assess the achievements and delays in implementing the Economic Adjustment Programme; the current outlook – against the backdrop of changes in the international environment, in particular the EU and the euro area; and, finally, the policies required in the immediate future.

1.1 MAIN ECONOMIC DEVELOPMENTS OVER THE LAST TWELVE MONTHS

• **The Memorandum of Economic and Financial Policies averted Greece's default.** The first and foremost development in the year under review has been the ongoing implementation of the support agreement. The European Commission and the IMF, in three successive reviews, acknowledged the progress made, rendering possible the smooth inflow of funding. This averted the disastrous developments that seemed inevitable back in April 2010, and the economy was given a window of opportunity to carry out the major changes required.

• **The real economy performed worse than expected.** The **drop in domestic demand**, which was to be expected due to the necessary fiscal adjustment, was the key factor behind the recession. GDP contracted by 4.5% in 2010, exclusively weighed down by domestic demand, in particular declines of 4.5% in private consumption, 6.5% in public consumption and 16.5% in gross fixed capital formation.

• **The recession would, however, have been milder if faster progress had been made with the measures and policies that, in the face of fiscal constraints, can foster recovery and create the conditions for a transition to a new, export- and investment-led growth model.** Such measures and policies include increasing the efficiency of public spending, maximising the use of Community funding available under the National Strategic Reference Framework (NSRF) and promoting reforms to improve the business environment.

• **Developments in the external sector of the economy somewhat softened the recession, despite the limited outward-orientedness of the Greek economy.** Indeed, changes in the real external balance made a positive contribution to GDP growth in 2010 (just as in 2009, compared with a negative contribution in the 2006-2008 period). As imports fell and exports rose, the positive contribution of the external sector partly offset the negative impact of domestic demand.

The decline in imports came as a result of lower consumption and investment. However, to the extent that the observed drop in consumer goods imports is attributable to adjustments in consumption behaviour, it could become a more durable feature in future trade deficit developments.

• **Competitiveness has improved, but there are still substantial accumulated losses to be recovered.** The rise in exports was primarily driven by the recovery of world trade and, to a lesser extent, by improved competitiveness. However, two points should be made in this respect: First, the improvement in competitiveness in terms of relative unit labour costs (taking into account the evolution of the effective exchange rate of the euro) came to roughly 6% in the total economy and to 5% in the business sector in 2010, which must be weighed against cumulative losses of 28% over the 2001-2009 period, implying that there is still a long way to go. Second, exports of goods and services account for only 21% of GDP (compared with 40.5% in the euro area as a whole). This low share, in the short term, constrains the ability of exports to visibly mitigate the recession and foster recovery, even if they rise due to improved cost competitiveness; in the medium term, however, it implies that there is considerable room for an increase in exports, provided that structural competitiveness also improves. A positive contribution to GDP growth could also come from import substitution *in those categories of products where this would be feasible, taking into account the comparative advantages that Greece could gain once the structural changes and reforms have been made.*

• **The recession has led to job losses across all sectors of the economy and to a rise in unemployment.** In the last quarter of 2010, employment fell by 4% year-on-year, which translates into 180,000 jobs lost, while the rate of unemployment reached 14.2% of the workforce. The average annual decrease in employment (-2.7%) was smaller than the decline in GDP, causing **productivity to fall** by 1.8%.

1.2 THE ECONOMIC CRISIS REFLECTS THE COLLAPSE OF A GROWTH MODEL NO LONGER SUSTAINABLE

The characteristics of the current recession — in particular the decisive role played by the drop in consumer demand (alongside the decrease in gross fixed capital formation) — underscore the main weaknesses of the Greek economy that have left their negative mark on the distorted growth model that prevailed for decades. This growth model relied on domestic consumption, both public and private, and was fuelled by public and household borrowing. The business sector did not manage to sufficiently tap into the opportunities opened up by Greece's participation in the euro area, while the boost in households' expectations generated by this participation and the swelling of the public sector encouraged consumerism. This led to negative net national saving from 2002 to the present and to a continuous transfer of resources from the business sector to the oversized, low-productivity public sector. This model favoured present consumption at the expense of the future and was underpinned by the illusion that growth could be driven by the public sector *ad infinitum*. The rise in consumption, characterised by a high propensity to consume imported goods, encouraged and supported a "shallow" domestic entrepreneurship, focused on the distribution sector and the end consumer. However, as the factors that previously underpinned consumption have now been eliminated, this type of business activity has inevitably suffered a serious blow. Meanwhile, as already mentioned the necessary conditions to foster a new type of entrepreneurship, geared towards a new growth model, have not yet been created.

In this sense, the current economic crisis is the crisis of a growth model that could no longer be sustained. The cost that society is summoned to pay today is — to a considerable extent — due to the delay in moving on to the new model.

1.3 THE REORIENTATION OF ECONOMIC POLICY WAS A NECESSITY, NOT AN OPTION

Since May 2010, economic policy has been reoriented in two main directions: rapid fiscal consolidation and structural reforms in the public sector and markets. The Bank of Greece has repeatedly stressed that this shift was long overdue and that implementing the announced plans was the only way for the economy to get back on a track of sustainable growth.

• **The effort to drive down the fiscal deficit delivered tangible results.** This policy produced tangible results mainly on the fiscal front, as the general government deficit was reduced by approximately five percentage points of GDP in 2010 compared to 2009. It should, of course, be noted that deficit reduction during this first phase of adjustment was mainly achieved through cuts across the board in wages and pensions, a freeze in public sector hiring, the slashing of operating costs and grants, increases in indirect taxes, the imposition of extraordinary levies on businesses and individuals, and revenue from back tax settlements.

• **Progress with reforms has been made, but has been slow.** On the other hand, despite the important reforms to the public sector announced, there has yet to be any substantial improvement in the deficit-generating sectors — public administration, government-controlled organisations and local authorities — or in the tax collection mechanism. In the area of structural changes, significant legislation has been passed in such crucial sectors as social security, healthcare, closed-shop professions and the labour market and in certain cases considerable progress has been made (see also Chapter V.3, Box VI.1, Chapter IX.5). In some other cases, however, the reforms do not go deep enough and their implementation is often delayed, either because of administrative inefficiency or because of reluctance to push ahead, in the face of opposition.

1.4 SOCIETY AND THE REFORM EFFORT

• **The causes of the crisis and the effort required have not been adequately explained to the public.** The policy launched in May 2010 called into question certainties long considered unchallengeable and came up against entrenched attitudes. Nevertheless, there are still a number of questions that call for convincing answers: How did we get to where we stand today? Why did the growth model of the last 30 years collapse and what is the meaning of a "new growth model"? What is the real situation today? What rights, obligations, opportunities, possibilities, responsibilities and constraints does our participation in the EU and the euro area give rise to? What are the alternatives and what would they cost? What risks lie ahead and how can we address them? What will the final outcome of this effort be and, more importantly, how is it connected to the changes being promoted?

• **A part of the public remains perplexed and reserved in the face of the unfolding changes, while there are even calls from certain circles with vested interests for a return to practices of the past.** Owing to a significant lack of information, the public, though aware of the critical turning point we have reached, has yet to fully grasp the causes of the crisis, or the scope, duration and absolute necessity of the effort required. Some of the reactions observed can therefore be attributed to the uncertainty caused by inadequate information, while there are also reactions that aim to obstruct change and revert to the practices of the past. Meanwhile, much of the public debate tends to overstate the direct impact of the reforms, without mentioning why these changes are so imperative and, above all, what the positive outcome will be. Moreover, in several cases the backing of reforms has proved timid.

1.5 THE CHANGES IN THE EU HERALD A NEW ENVIRONMENT

Over the past twelve months, important changes have taken place in the rest of the world, particularly in the EU and the euro area.

• The **ECB monetary policy stance remained accommodative**. At the same time, the Eurosystem continued to use non-standard monetary policy measures, which improved the liquidity position of banks and supported the flow of credit to the economy. In 2010, the ECB Governing Council reactivated some of the non-standard monetary policy measures that it had planned to phase out and launched another one, the Securities Markets Programme. As far as Greece is concerned, the Governing Council took the important decision that debt securities issued or guaranteed by the Greek government shall constitute eligible collateral for the purposes of Eurosystem monetary policy operations, irrespective of their external credit rating.

• **Work continued towards a reinforced framework of economic governance and policies to prevent a recurrence of the crisis – positive implications for the conduct of economic policy in Greece.** The European Stability Mechanism and the "Euro Plus Pact" that were recently agreed upon will shape a new economic environment imposing stricter fiscal discipline and introducing new rules in other areas of economic policy. The "Euro Plus Pact" marks the beginning of a path leading to stronger economic policy convergence among Member States. **The new framework will require all Member States to make long-term commitments, especially in terms of fiscal discipline and in focusing their economic policies on improving competitiveness, – which are**

actually the two major challenges to which Greece must rise anyway.

1.6 ECONOMIC POLICY CHALLENGES REMAIN SERIOUS, DUE TO FACTORS THAT DAMPEN THE ECONOMIC OUTLOOK

The year 2010 marked a shift in economic policy, in response to the need to address the impasses caused by a long period of bad choices. This shift had broadly positive results, as it averted the worst and gave Greece some extra time to implement necessary far-reaching adjustment.

However, the challenges facing economic policy remain serious, given a number of key factors dampening the economic outlook.

• **The domestic resources that could finance growth are extremely limited**, both because net national saving is negative and because banks are facing serious challenges. Tapping into international savings, in the form of foreign direct investment (FDI), or bank funding from the international money and capital markets is difficult, given the negative climate abroad concerning Greece and the prevailing high uncertainties.

• **The debt dynamics is unfavourable.** Despite the progress with fiscal adjustment, the debt dynamics are extremely adverse and keep market cautiousness high. The fact that fiscal adjustment is more difficult in times of recession adds to this.

• **There have been delays in implementing reforms to create a business-friendly environment, an "entrepreneurial ecosystem" that would encourage domestic investment initiatives and attract FDI.**[1] The undertaking of major private investment projects —which would dramatically change the economic climate— presupposes, among other things, fast-track **site planning** and **licensing** procedures, a stable **taxation** and market regulation regime, as well as a radical upgrade of the **legal system** to ensure faster delivery of justice. Admittedly, certain positive steps have been made, but they are not enough to boost the economy's **structural competitiveness**. As repeatedly stressed, **the sooner and more efficiently structural reforms are implemented, the sooner growth is likely to resume**.

2. THE MAIN CHARACTERISTICS OF DEVELOPMENTS IN 2010 – THE CURRENT PICTURE OF THE ECONOMY

2.1 THE ECONOMY AT A CRITICAL JUNCTURE

In 2010, the general government deficit fell by a substantial 5 percentage points of GDP, but real GDP contracted by 4.5%, total employment dropped by 2.7% and salaried employment by 3%, while the average unemployment rate reached 12.5%. Meanwhile, the current account deficit receded only slightly to 10.4% of GDP (from 11% in 2009), inflation rose to 4.7%, the average *nominal* earnings of employees in total economy decreased by 5.0% (according to Bank of Greece estimates) and the annual rate of credit expansion to the private sector was nil in December (slightly negative for households, slightly positive for businesses).

At the same time, there were two worrying developments:

• First, according to rough estimates, the potential growth rate, which averaged close to 3.5% from 2000 to 2008 before dropping to below 1.5% in 2009, is currently at 0.5% or lower.

• Second, gross national saving came to merely 2.1% of GDP in 2009 and 2.8% in 2010. *Net* national saving (excluding depreciation) was negative in 2009 (-12.1% of GDP) and in 2010 (-13.9% of GDP), and has been so since 2002 (it was positive in 2001, but at a mere 0.2% of GDP).

1 See also Bank of Greece, *Monetary Policy – Interim Report 2010*, October 2010, p.31-33; *Monetary Policy 2010-2011*, February 2011, p.22-24.

2.2 POSITIVE ASPECTS OF DEVELOPMENTS

The main positive development in 2010, apart from the large decrease in the fiscal deficit, was the recovery in goods exports, which became visible from the second half of the year onwards and is confirmed by all indicators, even though exports have yet to recoup the sharp declines of 2009 and return to their 2008 level. The recovery of goods exports is no coincidence and can, of course, be attributed to the recovery of the world economy and, therefore, of demand by Greece's trading partners, as well as to the increasing shift of Greek firms to foreign markets, as a means of compensating for the drop in domestic demand. However, this recovery in exports also reflects an incipient reversal of past competitiveness losses. According to Bank of Greece estimates, over the 2001-2009 period Greece's international competitiveness *vis-à-vis 28 trading partners* fell by a cumulative 19% in terms of relative consumer prices (CPI) and by some 28% in terms of relative unit labour costs (ULC) in total economy. In 2010, however, CPI-based competitiveness improved slightly (by 0.5%, despite high inflation and exclusively owing to the lower effective exchange rate of the euro), whereas ULC-based competitiveness is estimated to have improved markedly, by some 6% in total economy and 5% in the business sector, largely reflecting the considerable drop in wages and unit labour costs in both the public and the private sector, as well as the evolution of the effective exchange rate of the euro.

There are two more developments that could, under certain circumstances, be seen as positive.

- **Core inflation (i.e. excluding energy and unprocessed food) was 3.0% in December, but without the impact from indirect tax increases would have been just 0.3%.** This reflects a reversal of demand- and labour cost-driven inflationary pressures and supports the forecast that CPI-inflation will gradually recede as the impact from higher indirect taxes wanes. In any case a risk of deflation seems unlikely, with inflationary pressures expected to build up, at first on account of external factors, such as increases in the prices of oil, food and other commodities (due to both structural and cyclical reasons); upward price trends in countries from which Greece imports manufactured products; and, later on, a gradual recovery of domestic activity.

- The **sharp drop in goods imports** continued in 2010, bringing the cumulative decline over the two years 2009 and 2010 to 25.4% at constant prices, according to national accounts data. This development is a direct reflection of the cumulative declines of private consumption by 6.6% and of gross fixed capital formation by 25.9% over the same period, meaning that it came as a result of the recession. This however can be seen in a positive light, to the extent that lower *consumer* goods imports also reflect an adjustment in the consumption pattern of Greek households, capable of leading to a more permanent reduction in the trade deficit. In other words, it would appear that the crisis has made us realise that, for no less than 13 years (1996-2008), we consumed more than we could afford, having become over-confident about the future (in part due to the liberalisation of credit), while rejecting the structural changes that would have helped those optimistic expectations to materialise.

3 THE MACROECONOMIC PROSPECTS FOR 2011

3.1 A RAPIDLY CHANGING ENVIRONMENT THAT CALLS FOR NEW CHOICES IN KEY AREAS

The macroeconomic prospects for 2011 are unfolding in an international environment characterised by the growing importance of the economy of China, as well as those of India, Russia, Brazil and neighbouring Turkey. At the same time, **geopolitical uncertainty** has escalated sharply in recent months, with regime overthrows and unrest across North Africa and the Middle East. These developments are not unrelated to the increases in the prices of food and other commodities.

Meanwhile, it has become increasingly evident in recent years how vulnerable the global economy and the modern way of living can be to **extreme weather conditions, natural disasters and epidemics**. Last month's disaster in Japan showed how dependence on nuclear energy coupled with insufficient safety measures can amplify —just how much remains to be seen— the initial impact of the earthquake and the tsunami. These considerations, as well as the need to start addressing climate change before it is too late, imply **that new policy choices, on a global scale, will be required in such areas as construction, town planning and zoning, transportation, as well as energy production and consumption**.

At the **European level**, as already mentioned, Greece is taking part in the intensive efforts to enhance the economic governance framework and ensure financial stability in the European Union and the euro area.

3.2 PROJECTIONS FOR KEY AGGREGATES OF THE GREEK ECONOMY: CONTINUED RECESSION, FURTHER RISE IN THE RATE OF UNEMPLOYMENT, SIGNIFICANT DECLINE IN INFLATION, NEGATIVE ANNUAL RATE OF CREDIT EXPANSION TO THE PRIVATE SECTOR

The present report provides projections regarding Greece's main macroeconomic aggregates.

• With regard to **economic activity**, the projection of a 3% decline in GDP for 2011 included in the report *Monetary Policy 2010-2011* (February 2011) still holds, while a slightly bigger drop cannot be ruled out.

• The **unemployment rate** should continue to rise and may exceed 15%. In fact, if the year-on-year rates of change in the labour force and employment recorded in the fourth quarter of 2010 persist throughout 2011, the average rate of unemployment could rise as high as 16.5% in 2011. This could be averted through the effective implementation of the active employment policies already announced and of the legislation enacted in May, July and December 2010 enabling a more flexible use of labour inputs. As rising unemployment reflects not only the recession, but also the ongoing restructuring of production and employment in the context of the crisis, the available policy options and arrangements (see Chapter VI and Box VI.1) must be geared towards increasing labour mobility across sectors and jobs, reducing the duration of unemployment and supporting the income of the unemployed while in search of a job or in retraining.

• *According to recently revised projections*, the average annual rate of HICP **inflation** should decline substantially, despite the continued increase in oil prices, but could approach 3¼%. Average core inflation is expected to fall much lower, to less than 1.5%. Excluding the impact from increases in indirect taxes, core inflation should drop even lower, to below 1% on average, following negative rates in January and February 2011. Underlying these developments are the gradual unwinding of the impact from indirect tax increases and the continued fall in both demand and unit labour costs, especially in the business sector. A dampening effect on inflation should also arise from increased competition in the goods and services markets as the implementation of structural reforms progresses. **Average *nominal* earnings of employees** in total economy are expected to fall by 2.7%.

• The **annual rate of credit expansion to the domestic private sector**, already slightly negative in January and February this year (at -0.2% and -0.3%, respectively), is expected to remain negative throughout 2011, due to both loan supply and loan demand related factors. On the demand side, access to credit, as well as willingness to incur debt, continue to be constrained by the weakened financial condition of households and enterprises. On the supply side, Greek banks are gradually regaining limited access to the international money and capital markets, after being virtually excluded from them, while the considerable drop in deposits recorded in 2010 (partly as a result of heightened uncertainty, but to a large extent also because of the need of depositors —enterprises and households— to meet current liabilities) continued into early 2011. At the same time, banks have seen the quality of their loan portfolios to households and enterprises deteriorate due to the recession. These pressures are counterbalanced, first, by the liquidity support package introduced by Law 3723 in autumn 2008, later complemented and recently extended in duration and expanded in size and, second, the provision of substantial amounts of liquidity by the Eurosystem, while encouraging was the fact that banks' capital adequacy remained relatively high. An upward, yet limited effect on credit to businesses can be expected from the further improvement in the absorption of EU funds through co-financed programmes under the National Strategic Reference Framework, while other positive contributions should arise from the implementation of the new Development Law and the establishment and activation of the Hellenic Fund for Entrepreneurship and Development (ETEAN).

3.3 THE MAIN POSITIVE ASPECTS OF THE PROSPECTS FOR 2011

Apart from the targeted and projected **further reduction of the fiscal deficit** and the anticipated **decline in inflation**, the main positive development in 2011 is expected to come from exports.

• Indeed, the recovery of goods exports will continue, driven both by the rise in foreign demand and by the continued improvement of competitiveness as a result of a further drop in unit labour costs. The declining trends of labour costs in the business sector from 2009 onwards initially reflected the response of businesses to the economic downturn (through reductions in average working hours, temporary lay-offs and wage cuts). Today, the lowering of labour costs is also facilitated by changes in the legal framework aimed at increasing labour market flexibility as a means of saving jobs, including the hiring of youth at below the minimum wage, the *de facto* reduction in dismissal indemnities, lower pay for overtime work and the introduction of enterprise-specific collective agreements. Export prospects may also be boosted by other factors affecting the international competitiveness of Greek products, such as:

– **(a)** Foreign direct investment, which can be considered likely subject to the aforementioned conditions. Foreign direct investment is typically associated with know-how transfers and thereby higher productivity.

– **(b)** A more efficient organisation of production and labour, provided that the aforementioned changes to the legal framework governing the labour market are put to use and the reforms to the product markets are duly promoted.

– **(c)** The implementation of the specific measures included in the National Export Strategy launched by the Ministry of Regional Development and Competitiveness in December.

With tourism receipts also expected to recover and consumer goods imports expected to continue to decline, the current account deficit should further decrease in 2011, perhaps to below 9% of GDP, despite higher oil prices and interest payments.

• The forecasts for **tourism receipts** are positive, especially given both the reduction in the VAT rate charged on accommodation and the recent turmoil in countries of North Africa, which used to be competitor tourist destinations.

• Finally, demand for imported consumer goods will continue to be weighed down by the correction of household consumption patterns, although this cannot translate into steadily high rates of decline, given that a significant reduction in demand has already taken place. By contrast, demand for imported capital goods should be affected upwards once investment starts to recover (probably towards year-end), and also due to special factors – e.g. the launching of major wind farm investment projects which have a high import content (see Chapter XI.3). Moreover, it should be noted that —with the current production capacity profile— sustained strong exports in the future would also entail higher imports of raw materials and intermediate goods used as inputs in the production of some (not all) exportable Greek products. This further compounds the need to speed up reforms in the product and labour markets and to intensify the effort to attract foreign direct investment, so as to not only boost exports, but also —as just mentioned— to substitute for imports in as many product categories as realistically feasible, taking into account the comparative advantages that Greece could gain once the structural changes and reforms have been made.

4 FISCAL POLICY AND FISCAL REFORMS

4.1 SHARP DEFICIT REDUCTION IN 2010

According to data on an administrative basis, the deficit of the State budget fell to 8.4% of GDP in 2010, from 13.1% of GDP in 2009 and compared with a target of 8.1% of GDP in the Economic Adjustment Programme. Despite the sharp reduction in the deficit, down by 37.0% relative to 2009, the deficit target was not met, due to a revenue shortfall that was only partly offset by a higher than targeted cutback in expenditure.

Furthermore, according to cash data from the Bank of Greece, the borrowing requirement (cash deficit) of the State budget[2] fell by 28.3% in 2010 to 10.2% of GDP, compared with 13.9% of GDP in 2009. This decline came mainly from the reduction in the ordinary budget cash deficit and, to a lesser extent, from the lower deficit of the public investment budget.

The final data on the general government deficit for 2010 (on a national accounts basis), for Greece as well as for the other EU countries, will be released by Eurostat on 26 April. It should be reminded that the recent EU/IMF reviews expected Greece's general government deficit for 2010 to be close to 9½% of GDP. The deficit may, however, turn out higher, due to the revision of individual components to be finalised between Eurostat and ELSTAT by the release date.

4.2 MAIN GUIDELINES IN THE 2011 BUDGET FOR FURTHER REDUCING THE DEFICIT

The 2011 budget marks a continuation of the significant effort, since the spring of 2010, to achieve fiscal consolidation and rein in the debt-to-GDP ratio and anticipates a reduction in the general government deficit to 7.4% of GDP (i.e. 2.2 percentage points lower than the 2010 deficit estimated in the Introductory Report on the 2011 Budget).

In 2011, contrary to 2010, the reduction in the general government deficit is expected to come mostly (by about three fourths) from entities outside central government. The deficit of the state budget will improve by only 0.5% of GDP. This low figure, despite the important measures taken on both the revenue and the expenditure sides, partly reflects how difficult it is to achieve fiscal consolidation when an economy is in recession. However, the primary deficit of the state budget is expected to decline significantly more (by 1.8% of GDP) than the overall deficit.

The reduction in the state budget deficit is expected to stem mainly from a significant increase in revenues of the ordinary budget (by 8.5%), while the revenues of the public investment budget are also expected to increase substantially (by 27.7%). On the other hand, ordinary budget expenditure in 2011 is expected to increase by 5.8%, mainly on account of interest payments, while primary expenditure under the ordinary budget is expected to rise by only 1.9% and investment expenditure by 0.6%.

2 Not including movements in OPEKEPE account.

According to the Introductory Report on the 2011 Budget, the government has aimed to ensure that budgetary targets will be met by adopting additional measures (apart from the ones envisaged in the Economic Adjustment Programme) corresponding to a total 2.7% of GDP (1% of GDP from higher revenue and 1.7% from lower expenditure), which mostly involve expenditure cuts in public enterprises and organisations (DEKO), public hospitals, social security organisations and local government authorities – i.e. entities with substantial spending overruns in the past. Moreover, the latest (third) review of the Economic Adjustment Programme, taking into account the evolution of fiscal aggregates and the yield of certain measures, concluded that further measures of structural fiscal consolidation amounting to 3/4% of GDP will be required to ensure that the general government deficit falls to 7.4% in 2011. In any case, achieving the 2011 budget targets will require action on three fronts:

- better revenue performance by combating tax evasion and enhancing the efficiency of the tax collection mechanism;

- implementation of structural fiscal reforms to reduce the expenditure of general government entities; and

- stronger and more effective fiscal institutions.

4.3 KEY STRUCTURAL FISCAL REFORMS: SIGNIFICANT CHANGES HAVE BEEN ENACTED, BUT THE REAL CHALLENGE LIES IN THEIR IMPLEMENTATION

Important structural reforms were enacted in 2010 and are expected to further underpin fiscal adjustment. Several of these reforms focused on crucial sectors of the economy, such as the pension system, healthcare, public enterprises and local government. At the same time, the fiscal policy framework was radically reorganised, fiscal institutions were enhanced to ensure greater transparency and tighter expenditure control, while emphasis was also placed on the operation of tax administration and on combating tax evasion (see Chapter IX.5). In greater detail:

- The Kallikratis Programme, among other objectives, aims to save resources by reducing the number of local government authorities and associated entities and through economies of scale. To this end, the government has taken measures to limit borrowing by local authorities and has imposed a no-deficit rule on them until at least 2014.

- The social security reform (Law 3863/2010 and Law 3865/2010 applying to workers in the private and the public sector, respectively) aims to ensure the long-term sustainability of the pension system and is considered highly ambitious in the light of international experience. The next step will consist in evaluating the viability of the larger auxiliary pension funds, so that relevant legislation can be adopted by September 2011.

- The social security reform of July 2010 brought about changes in the field of healthcare as well, although these had to be supplemented by additional measures, designed to reduce expenditure, increase cost effectiveness and improve the service level, such as the introduction of electronic prescribing and cutting back on pharmaceutical expenditure, rationalising the procurement system and establishing the National Healthcare Organisation. Carrying through these reforms represents a major challenge.

- Important institutional changes have also been made to public enterprises, which are now subject to stricter financial supervision coordinated by the Ministry of Finance. With a view to ensuring the economic viability of public utilities, new legislation was passed to restructure transport entities, namely the Hellenic Railways (OSE-TRAINOSE) and Athens Urban Transport Organisation (OASA) groups of companies. A common aim of the reforms is to consolidate the finances of these groups through wage and operating cost cuts and tariff increases; the assumption of their accumulated debts by the State; the setting of ceilings on government subsidies; the transfer of surplus personnel in line with the "one recruitment for every five retirements or dismissals" rule that applies to the entire public sector; the requirement to submit business plans; and permanent accountability of managements.

• Additional cost saving can be expected from the implementation of legislation providing for the closing or merger of services, organisations and entities of the public sector. However, implementation of this measure has stalled.

• The new fiscal management and responsibility framework, the aims of which are, among others, to increase expenditure control, has introduced stringent transparency and disclosure requirements, enlarged the scope of financial supervision by the Ministry of Finance to include, apart from central government, all the entities of general government, as it requires the submission to Parliament of consolidated annual budgets. Law 3871/2010 establishing this new fiscal management and responsibility framework also provides for a rolling three-year Medium-Term Fiscal Strategy Plan. However, progress in strengthening fiscal institutions has been slow, because of continued delays in such matters as budgeting practices and procedures, expenditure control and the regular reporting of fiscal data by general government entities. As a result, nearly a year after the launching of the Economic Adjustment Programme, there is still no full or clear picture of Greece's fiscal position on a monthly basis.

• Apart from the fiscal measures directly aimed at increasing tax revenue, numerous structural measures have been adopted to streamline tax administration, reform the tax system by broadening the tax base, curb tax evasion and enhance tax compliance, thereby making the tax system more equitable. The latest tax law contains a number of provisions that will help improve tax administration and fight tax evasion. It should be noted that, according to the 2011 budget, the fight against tax evasion should yield €1.6 billion in revenue this year, which underscores the importance of implementing the relevant provisions swiftly and rigorously. Any deviation from the 2011 budget target will need to be compensated for by additional measures.

4.4 THE SIGNIFICANCE OF RECENT EU DECISIONS AND OF THE MEDIUM-TERM FISCAL STRATEGY FRAMEWORK CURRENTLY IN PREPARATION

• The recent informal Eurogroup meeting of heads of state or government of the euro area on 11 March 2011 took the **favourable —for Greece— decisions** (endorsed by the European Council on 24-25 March) to lower the interest rate and lengthen the maturity of loans extended to Greece under the Support Mechanism and enable the European Financial Stability Facility (EFSF) and the future European Stability Mechanism (ESM) to purchase government securities in the primary market in exceptional circumstances and in the context of a programme with strict conditionality. By virtue of the same decisions, Greece is called upon to rigorously continue structural reforms, fully and speedily complete the €50 billion privatisation and real estate development programme that the government has drawn up and to introduce a strict and stable fiscal framework with the strongest possible legal basis (to be decided by the Greek government). Against this background, **the implementation of an ambitious medium-term fiscal strategy framework clearly outlining the fiscal consolidation path and encompassing —as a crucial component— the privatisation and real estate development programme could substantially reduce the public debt, help restore confidence and optimism in the prospects of the Greek economy and, thus, facilitate Greece's return to the bond markets**.

• The government is expected to release **the Medium-Term Fiscal Strategy Framework** by mid-April,[3] as also provided for by Law

3 This Framework is to be released after the present report went to press.

3871/2010, specifying the fiscal measures of a permanent nature and a binding time schedule for the period 2012-15, in order to reduce the general government deficit to below 3% by 2014 and to 1% of GDP by 2015.

5 THE CHALLENGES FOR BANKS AND THE NECESSITY OF THE LIQUIDITY SUPPORT PROGRAMME

5.1 THE GROWTH CONTRIBUTION OF THE FINANCIAL SECTOR PUT TO THE TEST

Generalised economic crises, irrespective of their causes and origins, put the ability of banks to contribute to the growth process to a severe test, by impeding their access to key sources of funding (e.g. deposits, markets) and impairing the quality of their assets (e.g. loans and securities holdings).

Banks as intermediaries play a pivotal role in the set-up and growth of an economy by ensuring the safe and efficient channelling of available savings towards investments and other uses. The unhindered fulfilment of this role is of paramount importance, especially in economies with a bank-based financial system, where business activity and households are financed primarily by banks, rather than directly by the markets. The Greek economy is a case in point, with the domestic banking system providing most of the private sector debt financing.

5.2 DUE TO THE CRISIS, BANKS' LIQUIDITY NEEDS ARE SIGNIFICANTLY HIGHER

Throughout 2010 and the first months of 2011, the liquidity of Greek banks came under strong pressure, due to the fiscal crisis and the economic downturn.

- The successive downgrades of Greece's sovereign credit rating inevitably affected the ratings of domestic banks too, virtually cutting them off from **international money and capital markets**. This occurred at a time when Greek banks were faced with: (i) the need, within 2010, to repay maturing debt amounting to about €8 billion; and (ii) a significant contraction of their deposit base; relative to the beginning of 2010, this contraction had slightly exceeded €40 billion by the end of February 2011.

- During that same time, banks were also required to provide the Eurosystem with additional assets totalling some €26 billion, to replenish their collateral (consisting mostly of government securities, but also of bank bonds, covered bonds, etc.).[4] This need arose because, after the downgrades, a significant part of that collateral became ineligible. Meanwhile, the assets that remained eligible lost part of their collateral value, given the downward mark-to-market valuations and higher haircuts.

5.3 THE GOVERNMENT GUARANTEE SCHEME STILL NECESSARY FOR THE TIME BEING

The conditions described above called for a prolongation and expansion of the liquidity support measures introduced by Law 3723/2008; similar measures had been adopted by all EU countries in 2008, following the intensification of the global financial crisis.

It should be recalled that **under this scheme *the government, for a fee, guarantees bank-issued debt securities;* it does not provide banks with cash**. These guarantees enable the banks to obtain liquidity from the Eurosystem against eligible collateral. It should also be noted that, given the valuation haircuts involved, the liquidity that can be obtained against such government-guaranteed securities is considerably less than their nominal value.

4 According to the statutory provisions governing the Eurosystem, liquidity from the national central banks to credit institutions can only be provided against adequate collateral, in the form of eligible assets, i.e. securities and other assets that satisfy the Eurosystem's eligibility criteria. The liquidity provided by the Eurosystem is lower than the market value of the underlying collateral, to an extent that depends on the haircut applicable to the respective type of asset. A haircut is the percentage which the Eurosystem subtracts from the market value of an asset, when calculating how much to lend to a credit institution against such collateral.

Overall, between January 2010 and the end of February 2011, banks used guarantees for a nominal value of €50 billion, which, following market valuation and haircuts, secured them some €35 billion in Eurosystem liquidity. The recent expansion of the guarantee scheme became necessary, for the following reasons:

- Greek banks remain virtually shut out of wholesale funding markets;

- the funds obtained so far using the guarantee scheme are not sufficient to meet the liquidity needs in the face of shrinking deposit bases, collateral devaluations and maturing interbank liabilities;

- the ECB's non-standard measures to enhance liquidity in the euro area will be gradually phased out; and

- it is necessary to prevent recession from becoming deeper as a result of insufficient financing of the economy or of a sudden deleveraging by banks.

In view of these reasons, Article 19 of the draft law submitted to Parliament on 31 March 2011 ("Reform of the operational framework of the Deposits and Loans Fund") increases by €30 billion the amount of support available under the government guarantee scheme introduced by Article 2 of Law 3723/2008. *One difference between Article 19 and the provisions of Law 3723/2008 is that the support shall be conditional upon the preparation and implementation by each applicant credit institution of a detailed medium-term liquidity plan, to be approved by the Bank of Greece and the ECB, in cooperation with the European Commission and the IMF.*

The option that credit institutions had of raising liquidity from the Eurosystem by making use of government guarantees prevented credit growth rates from turning negative in 2010. Although nominal GDP fell by 2.1% in 2010, the outstanding amount of bank credit to the private sector in December 2010 remained unchanged year-on-year. Given the overall financial environment, without the extraordinary provision of liquidity by the Eurosystem the banks would have been forced to expedite the collection of their claims, cut back on loan rescheduling and reject applications for new loans even from creditworthy customers. **The extraordinary monetary policy measures of the ECB and the government's liquidity support measures averted a credit crunch.**

However, the extraordinary liquidity support measures taken by the ECB and the government are temporary in nature. They aim to give banks time to adjust their assets and cost structure, according to the circumstances. This adjustment must be orderly, so as not to further aggravate the current economic downturn or dampen recovery, once it begins. In other words, **banks must, as soon as possible, be in a position to intermediate between savers and investors and rely on their own resources, without the need for extraordinary support from the ECB or the government**.

5.4 CREDIT RISK, PROFITABILITY, CAPITAL ADEQUACY: TRENDS AND PROSPECTS

Pressure on the domestic banking system in 2010 was also exerted by the rise in credit risk on bank lending. The significant deterioration of the financial condition of businesses and households, owing to the adverse macroeconomic environment, was accompanied by a considerable increase in the non-performing loans ratio (NPL ratio) (December 2010: 10.4%, December 2009: 7.7%). The upward trend of non-performing loans is expected to continue in 2011.

The adverse macroeconomic conditions also affected the profitability of banks, which registered losses both on a solo and on a consolidated basis in 2010, due to lower operating income and higher impairment charges. The impact on profitability was only partially offset by a decline in operating expenses in 2010, which became more pronounced in the second half of the year.

By contrast, a positive contribution to financial stability in 2010 came from the increase in the capital adequacy of banks and banking groups. Compared with end-2009, regulatory own funds rose, while risk-weighted assets declined slightly. At end-December 2010, the Capital Adequacy Ratio (CAR) and the Tier I ratio for banks as a whole stood at 13.8% and 12.2%, respectively, and for banking groups as a whole at 12.2% and 10.9%, respectively.

Despite their satisfactory capital adequacy ratios, banks need to be very cautious, at the current juncture, in formulating their medium-term strategies for their capital bases and the uses of funds. In this respect, which is crucial for financial stability, banks must, with realism, caution and a forward-looking perspective, weigh not only the challenges posed by the fiscal and macroeconomic conditions but also the upcoming major changes in banking regulation and supervision. The relevant work undertaken by European and international institutions and bodies is well under way.

5.5 THE FACTORS THAT WILL ENABLE BANKS TO DEAL WITH THE CHALLENGES OF 2011

The most important factors driving the performance of the domestic banking system in 2010 continue to be in play this year, while the medium-term outlook for profitability, the quality of loan and securities portfolios and bank liquidity are surrounded by high uncertainty. Even though this situation, in the case of Greece, was not the outcome of weaknesses, inadequacies or mistakes on behalf of the banking sector, as was the case in many other countries, there is still need for an active demonstration of increased vigilance and resolve. Banks, in particular, are called upon to flexibly adjust their business strategies, restructure their activities and review their objectives, cut operating costs and shift to market-based funding sources that would help them to wean themselves off liquidity support from the Eurosystem and the government.

Today's reality is a given; as for the future, the signals are clear as to the basic parameters of the economic environment and the regulatory framework. **Banks will therefore have to adjust their business models accordingly, and muster all their forces. Reorganisation and alliances are more successful when they are carried out with foresight and are the outcome of informed decisions and friendly negotiation.**

The reorganisation of the banking sector will considerably enhance its contribution to the growth process, once the economy begins to recover. It will also support domestic financial stability, on condition of course that the primary factor for stability is in place, i.e. that the confidence of economic agents, markets and the international community is restored and consolidated. No reorganisation of the financial system can substitute for the need to pursue fiscal adjustment and speed up structural reforms in the public sector and the economy at large.

6 PRIORITIES OF ECONOMIC POLICY

Last year's developments and the outlook for the near future strictly set the objectives and map out the course for the next few years.

6.1 A DYNAMIC RE-LAUNCH OF OUR EFFORTS IS NEEDED TO GIVE NEW IMPETUS TO REFORM POLICIES

Today, the Greek economy is at a watershed. Progress with adjustment has been made, but is still too slow considering the debt dynamics. What is now needed is a strong re-launch of our efforts, to make up for the delays and give fresh impetus to reform policies. The key prerequisites for this to happen are the following:

- The government must actively demonstrate its firm commitment to moving forward, without ambivalence or hesitation, on the difficult path that it has mapped out.

• The public must be regularly informed about where the economy stands, which policy goals are being pursued, what difficulties and risks are present, how much ground still needs to be covered, what the ultimate goal is and what the consequences of failure would be.

• The benefits of the reforms, which are not only necessary, but also morally right, must be clearly highlighted as they abolish privileges and aim for equal and better opportunities for all.

• A minimum of consensus must be reached among the political and social forces so as to ensure continued adjustment, the duration of which will extend well beyond any one government's term.

6.2 FISCAL CONSOLIDATION AND THE RECOUPING OF LOST COMPETITIVENESS: TWO PREREQUISITES FOR GROWTH

There is absolutely no doubt today that growth remains the main challenge.

• As shown by international experience, large public deficits and high public debt cannot possibly foster sustainable growth. Therefore **the first step towards economic growth is to stabilise the economy**.

• **Growth means launching new productive businesses that are competitive and export-oriented. This hinges upon a radical change in the business climate, by creating a business- and investment-friendly environment.** Therefore, a much faster pace is needed for the structural reforms in the markets and especially the public sector; these reforms should focus, apart from recouping the losses in international cost competitiveness, on improving structural competitiveness.

6.3 KEY PRIORITIES

First, speeding up reforms in the public sector

The stabilisation process has entered its second and more difficult phase. Following the wage cuts across-the-board and the tax increases, it must now focus with determination on structural reforms in the public sector, so as to permanently reduce wasteful spending stemming from operational inefficiency.

There is actually ample room for such changes. Two crucial opportunities present today must however be seized: first, the Medium-Term Fiscal Adjustment Framework 2012-2015 and, second, the Privatisation and Public Property Development Programme. These could act as a catalyst for re-launching the reform effort.

• The **Medium-Term Fiscal Strategy Framework,** soon to be made public, provides the chance to design a fiscal policy with clear objectives, well-specified actions and concrete timetables, rather than piecemeal interventions and stop-gap measures. If the objectives of this Framework are to be achieved, the factors generating the deficit must be eliminated – most importantly, spending must be cut.

• The **Privatisation and Public Property Development Programme**, if boldly and rapidly implemented, could contribute to substantial debt reduction in the years immediately ahead.

Second, mitigating the impact of the recession

The —absolutely necessary— restrictive fiscal policy currently conducted is exacerbating the recession, which in turn makes improving the debt-to-GDP ratio even more difficult. Economic policy, without making any concessions in terms of fiscal adjustment, must aim simultaneously to mitigate the effects of the recession and to bring GDP growth back to positive territory as soon as possible.

• **For the time being, any further increase in the tax burden of those businesses, workers and pensioners who pay their taxes regularly must be avoided; instead, tangible progress must be made in the fight against tax and social-security contribution evasion. This is also crucial for bolstering a sense of equity and increasing consensus on the adjustment programme.**

• Moreover, since there is no room for an increase in public expenditure, all possibilities must be exhausted to:

– cut spending by eliminating the squandering of public funds and merging or eliminating public sector entities that are unproductive;

– re-allocate total expenditure towards growth-enhancing and socially beneficial uses; and

– increase the efficiency of public spending.

These actions will make it possible to support the more vulnerable groups of society, improve the effectiveness of social expenditure, facilitate labour mobility across sectors and jobs and increase the share of public funds allocated to investment.

• The EU funds at the country's disposal under the National Strategic Reference Framework (NSRF) need to be absorbed at a quicker pace, by using the instruments introduced by the new development law and by fully activating the Hellenic Fund for Entrepreneurship and Development (ETEAN).

• Finally, the implementation of structural reforms that entail zero or low budgetary costs but which can yield quick results must begin immediately; such reforms include those that reduce red-tape, tackle corruption and remove product and labour market rigidities. This should encourage domestic firms to take up new investment, and could attract foreign direct investment, with the favourable side-effect of technology transfer.

Third, attracting foreign investment

Given that domestic resources for the financing of growth are currently very limited, FDI inflows must be attracted, so as to drastically increase imported resources. True, the conditions are unfavourable, with the prevailing negative climate and large uncertainties. However, some positive side effects can be expected from the Privatisation Programme and the creation of attractive opportunities for capital inflows, and of course from all the urgently-needed measures to upgrade the business environment.

Fourth, a new growth model

The constant invocation of growth as a remedy to the crisis would remain mere rhetoric, unless it is well understood that the new growth model that Greece needs means shifting from the present to the future, from consumption to saving, investment and exports, from statism and the perpetuation of privileges to competition and business initiative. In other words, it means new patterns of consumption, entrepreneurship and public administration. In particular, **the new model means increasing the share of investment and exports in GDP; reducing the share of private and public consumption; giving a substantial boost to saving (so that net national saving becomes positive); shifting entrepreneurial initiative to the competitive sector of production and orienting it towards the international markets; ensuring that public administration functions in a way that does not discourage investment and does not tolerate tax evasion**.

Fifth, an Action Plan for Growth: main lines of reform and sources of growth

Changing the current growth model will obviously be a long process. As proposed by the Bank of Greece last October, the first step in this direction should be a **coherent Action Plan for Growth**, capable of leading away from the distorted old model to a new one, and characterised by an outward-looking growth dynamics based primarily on enhancing the productive base through investment and structural reforms. The new model should also encompass environmental protection and the strengthening of social cohesion. This means that structural reforms will have to be designed on the basis of a multi-faceted, "holistic" approach. Policies that facilitate fiscal consolidation also help to reduce the current account deficit. The same can also be said for policies that aim to rein in consumer borrowing and encourage private sector saving, as they contribute to reducing the shortfall in private saving against private investment.

• **The main lines of reform** – several of which are already in progress – should include:

– **Consolidating the public sector and improving its efficiency**, by streamlining public administration through cutting red tape and increasing transparency.

– **Enhancing labour market flexibility and mobility**, including by policies for vocational and on-the-job training and life-long learning, in order to increase the employment rate and ensure a continuous upgrading of human capital and higher productivity.

– **Strengthening competition** in the markets for goods and services.

– **Improving the absorption of Community funds through the National Strategic Reference Framework, promoting and facilitating investment and an enhancing the export orientation of the economy.**

– **Increasing the efficiency of education at all levels and encouraging innovation and research.**

– **Changing the current energy production and consumption patterns.** The Greek economy is particularly energy-consuming and has a high oil dependency, despite the use of renewable energy sources (hydroelectric, solar and wind energy) and lignite. Moreover, current estimates suggest that Greece, as a Mediterranean country, will be more affected by climate change. In order to implement the European policy on energy and climate change, Greece would, inter alia, have to upgrade its production processes by introducing less energy-consuming technology, as well as energy-efficient land use planning, and improve life in the cities. The latter can be achieved by streamlining public transportation, so as to reduce the use of more energy-consuming means of transportation, and by promoting new energy technologies and alternative energy sources for the insulation and heating of homes and other buildings. Significant steps are already being taken in this direction, which is crucial for Greece, not only because of climate change and life quality considerations but also because it can lead to large-scale investments, stronger competition in the energy sector and the creation of new businesses and jobs, while contributing to reducing the country's energy dependency and thereby the current account deficit.

• Apart from the **large-scale investments to change the current energy production and consumption patterns, other main sources** of growth could be:

– The **upgrading of tourism**, by attracting higher-income visitors, encouraging well-off pensioners and active professionals from other countries to take up permanent or seasonal residence in Greece, promoting convention tourism, facilitating cruises and attracting foreign visitors to Greece's mainland and mountain areas. The limited public resources will have to be allocated more efficiently and, among other changes, will need to be channelled towards protecting and highlighting traditional villages, promoting mountain tourism, upgrading services at museums and other sites, conserving areas of outstanding natural beauty, and reinforcing our infrastructure in transportation, communication and health services, if we want Greece's tourism to evolve in the directions set above. Special care will be needed to transform Athens, Greece's main gateway, while land planning for tourism will obviously need to be completed. Options worth considering are the co-financing of infrastructure projects through public-private partnerships, the collective financing by businesses of activities needed to prolong the tourist season and to boost tourist arrivals, improving the vocational training provided by Schools of Tourism Professions and the possible introduction of tourism studies in Universities (not only at post-graduate level), so as to make Greece a centre for tourism education for the wider region.

– **The further growth of overseas transport**, a sector where the Greek-owned merchant fleet has a strong presence and the receipts of which could prove crucial to reducing the current account deficit.

– In manufacturing, the **pharmaceuticals and petroleum products sectors**, which have shown noteworthy export dynamism, and the growth opportunities of certain **metal** and **mineral** sectors.[5] Dynamic export-oriented businesses can be found in all sectors.

– The **exploitation of Greece's agricultural produce, drawing on the processing of crops and livestock products**, deserves special attention. Apart from the potential for cotton (due to rising prices on the world markets), the beverages, juices and dairy products sectors have been quite successful.

– **Turning Greece into a major transit hub** by exploiting the potential of the country's ports, as well as into a **provider of high quality healthcare and education** to consumers from the wider Balkan and Eastern Mediterranean region. Greece has highly qualified human resources for the development of these sectors, which in turn could avert and even reverse the brain drain.

* * *

As a **general condition for the success** of the efforts undertaken, the policies already conducted, as well as those proposed here, rather than being a simple sum of individual measures, must be balanced, internally coherent, well-synchronised or well-sequenced, as well as swiftly implemented. A partial or piecemeal implementation of the policies already legislated, announced or proposed could indeed entail the risk of a vicious circle of adjustment and recession. By contrast, a synchronised and balanced implementation can ensure that a virtuous circle for the economy is set in motion.

5 As pointed out in a recent report by the European Commission (*The Economic Adjustment Programme for Greece – Third Review*, Occasional Papers 77, February 2011).

III THE INTERNATIONAL AND EUROPEAN ENVIRONMENT

1 INTERNATIONAL AND EURO AREA DEVELOPMENTS AND PROSPECTS, AND POLICY RESPONSES[1]

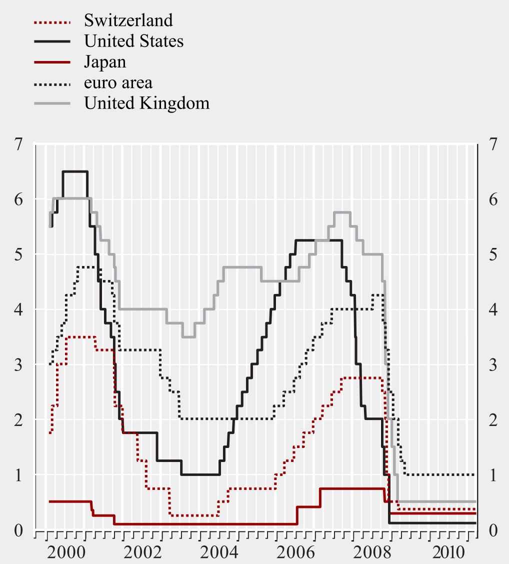
1.1 THE GLOBAL ECONOMY: DEVELOPMENTS AND PROSPECTS

Following the downturn caused by the financial crisis in 2009, the recovery of the global economy in 2010 turned out stronger than expected, as the favourable effects of expansionary fiscal and monetary policies (see Chart III.1) and the marked rebound of world trade more than offset the impact of uncertainty that was generated by high unemployment rates and international market concerns about sovereign debt crisis in Europe. Global economic growth is expected to continue in 2011 at a slightly slower pace than in 2010. However, there are significant downside risks, associated with the possibility of further rises in oil and food commodity prices and the impact of high and growing government debt in several advanced economies, compounded more recently by the economic implications —as yet of unknown extent— of the Japanese natural and nuclear disaster and the serious political turmoil in North Africa and the Middle East.

After its first contraction since 1946, world GDP declined by 0.5% in 2009 and grew by 5.0% in 2010 (see Table III.1). In advanced economies, which were more severely hit by the crisis, the recovery was more pronounced (+3.0%, against -3.4% in 2009) and broadly synchronised. However, unemployment rose further to 8.3%, from 8% in 2009. In the United States, where recovery was driven by domestic demand and inventory rebuilding, GDP grew by 2.9% in 2010 (according to the latest estimates), after contracting by 2.6% in 2009. The Japanese economy experienced a recovery led by external demand, with GDP increasing by 3.9% in 2010 (2009: -6.3%), while the euro area posted a growth of 1.7% (2009: -4.1%, see below). In emerging and developing economies, GDP growth strengthened to 7.3%, from 2.7% in 2009. In China where, unlike what is the case in most advanced economies, monetary policy is being tightened in the face of high inflation, while fiscal policy continues to be expansionary, GDP growth accelerated to 10.3%, from 9.2% in 2009.

Chart III.1 Central bank policy rates (January 2000 - March 2011)

(percentages per annum; daily data)



Sources: Euro area: European Central Bank (ECB), interest rate on main refinancing operations; USA: Federal Reserve, federal funds target rate; Japan: Bank of Japan, official discount rate; United Kingdom: Bank of England, repo rate; Switzerland: Swiss National Bank, operational target range for the three-month Libor.

Despite the significant recovery of GDP, fiscal positions in advanced economies improved only modestly in 2010 (the general government deficit dropped by 1 percentage point to 7.7% of GDP), while the structural deficit as a percentage of potential output continued to rise (to 5.7%, from 5.4% in 2009). The results of the fiscal retrenchment programmes implemented by an increasing number of advanced economies will become visible in 2011. However, government debt-to-GDP

1 The analysis is based on macroeconomic developments until early April 2011and has taken into consideration forecasts by the IMF (*World Economic Outlook*, April 2011), the European Commission (*Autumn forecasts*, November 2010, and *Interim forecast*, February 2011) and the OECD (*Economic Outlook*, November 2010), as well as the ECB staff macroeconomic projections of March 2011.

Table III.1 Key macroeconomic aggregates of the world economy

	Number of coun-tries	Share in GDP[1] (%)	Output (annual percentage changes in real GDP)				Inflation[2] (annual percentage changes)				Fiscal balance (% of GDP)				Current account balance (% of GDP)			
			2009	2010	2011	2012	2009	2010	2011	2012	2009	2010	2011	2012	2009	2010	2011	2012
World total	**185**	**100.0**	**-0.5**	**5.0**	**4.4**	**4.5**	-	-	-	-	-	-	-	-	-	-	-	-
1. Advanced economies	*35*	*52.3*	*-3.4*	*3.0*	*2.4*	*2.6*	*0.1*	*1.6*	*2.2*	*1.7*	*-8.6*	*-7.7*	*-6.9*	*-5.1*	*-0.3*	*-0.2*	*-0.2*	*-0.1*
United States		19.7	-2.6	2.8	2.8	2.9	-0.3	1.6	2.2	1.6	-12.7	-10.6	-10.7	-7.5	-2.7	-3.2	-3.2	-2.8
Japan		5.8	-6.3	3.9	1.4	2.1	-1.4	-0.7	0.2	0.2	-10.2	-9.5	-9.1	-8.0	2.8	3.6	2.2	2.4
United Kingdom		2.9	-4.9	1.3	1.7	2.3	2.1	3.3	4.0	1.8	-10.3	-10.5	-8.2	-6.1	-1.7	-2.4	-2.3	-2.0
Euro area	17	14.6	-4.1	1.7	1.6	1.8	0.3	1.6	2.2	1.7	-6.3	-6.3	-4.6	-3.8	-0.3	-0.6	0.2	0.4
2. Emerging and developing economies	*150*	*47.7*	*2.7*	*7.3*	*6.5*	*6.5*	*5.2*	*6.2*	*6.9*	*5.2*	*-4.1*	*-3.1*	*-1.9*	*-1.5*	*1.8*	*1.7*	*2.2*	*2.1*
China		13.6	9.2	10.3	9.6	9.5	-0.7	3.3	5.0	2.5	-3.1	-3.1	-2.1	-1.5	6.0	5.2	5.7	6.3

Sources: IMF, *World Economic Outlook*, October 2011.
Notes: Estimates for 2011 and projections for 2012. According to IMF classification: *Advanced economies*: Euro area-17, the four *newly industrialised Asian economies* (Korea, Singapore, Taiwan Province of China and Hong Kong SAR), United States, Japan, Australia, Denmark, Switzerland, United Kingdom, Iceland, Israel, Canada, Norway, New Zealand, Sweden and the Czech Republic. *Emerging and developing economies*: Africa (44), Central and Eastern Europe (15), Commonwealth of Independent States (13 incl. Mongolia), Developing Asia (26), Middle East (20) and Western Hemisphere (32).
1 Percentage share in world GDP in 2010, on the basis of purchasing power parities (PPPs).
2 HICP for the euro area and the United Kingdom, CPI for the other countries. Year averages.

ratios are projected to rise in 2011 across major advanced economies with the exception of Germany.

Inflation in advanced economies picked up to 1.6% in 2010, from 0.1% in 2009, mainly as a result of higher commodity prices, but remained generally low in the context of a slack in the economy despite the recovery, while in 2011 it is expected to rise to 1.9%. In emerging and developing economies, robust economic activity and higher food commodity prices led to a pick-up in inflation, which came to 6.2% and is estimated to accelerate further in 2011 to 6.9%.

World trade, which had been badly hit in 2009 and was the main channel of contagion of the recession across regions, rebounded markedly in 2010. The volume of world trade in goods and services returned to its pre-crisis levels in 2010, growing by 12.4% after contracting by 10.8% in 2009, and is expected to increase by 7.4% in 2011. Commodity prices (in US dollar terms), after a sharp fall in the second half of 2008, resumed an upward path in 2009-2010 (see Section 1.3 below). International oil prices (the average of three types of crude oil, in US dollars) rose at an average annual rate of 27.9% in 2010, and are projected by the IMF to rise more strongly (by 35.6%) in 2011. The prices of non-oil commodities increased by 26.3% in 2010 and are expected to rise significantly also in 2011 (by 25.1%).

In 2011, the global economy is projected to continue growing, albeit at a slower pace. In advanced economies, the risk of a double-dip recession or stagflation seems to have been warded off and the financial condition of business firms is improving. The most important risks to the economic outlook for 2011 are related to the possibility of a renewed hike in commodity prices, rising sovereign debts, as well as weak labour and housing markets in a number of advanced economies. World GDP growth is expected to moderate to 4.4% and to stand at 2.4% in advanced economies and 6.5% in emerging economies.

1.2 DEVELOPMENTS IN THE EURO AREA

The economic recovery recorded for the euro area as a whole in 2010 masked diverging growth performances across individual countries. Specifically, Germany experienced a strong growth of 3.5%, as its economy benefited the most from the rebound of global trade, while the economies at the centre of the debt crisis (Greece, Ireland and Spain) posted nil or negative growth rates and most of the other euro area economies recorded moderate growth. Portugal maintained a positive GDP growth rate, as the effect of fiscal adjustment will be felt during the current year and in 2012.

For 2011, the IMF projects a slightly weaker growth of euro area GDP (1.6%), affected by an overall tighter fiscal policy and the completion of the rebuilding of inventories, which had been a key driver of growth in 2010. By contrast, fixed capital formation is expected to increase, as the economic outlook and corporate profitability are improving. GDP growth differentials across the euro area will persist in 2011, although they are expected to narrow. The German economy is projected to return to more "normal" rates (2.5%), Greece will continue to be in recession, albeit at a smaller scale than in 2010 (declining by around 3.0%), followed by Portugal (-1.3%), while Ireland and Spain are expected to register positive, but moderate, growth rates. The rate of unemployment is expected to remain virtually unchanged, at around 10% of the labour force, with wide variations across countries. The strongest performers are expected to be Austria (4.3%) and the Netherlands (4.4%) and, among the larger economies, Germany (6.6%), while Spain will continue to record the highest rate of unemployment (19.4%).

Inflation in the euro area rose to 1.6% in 2010, from 0.3% in 2009, and according to the ECB staff projections will be between 2.2% and 2.7% in 2011, mainly as a result of higher fuel and food prices. The general government deficit is anticipated to decline from 6.3% in

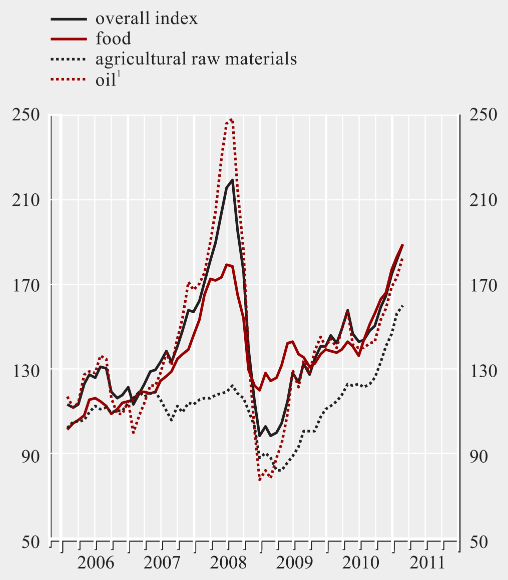
2010 to 4.6% of GDP in 2011 (corresponding to a decrease of about one percentage point in the structural deficit), as most euro area countries return to fiscal adjustment policies in parallel with economic recovery. However, public debt is projected to rise further to 88.4% of GDP in 2011, from 86.2% of GDP in 2010.

1.3 TRENDS, DETERMINANTS AND CONSEQUENCES OF HIGHER INTERNATIONAL OIL AND FOOD PRICES

In recent years, international commodity prices have shown sharp swings and high volatility. After surging in 2007 and plummeting in the second half of 2008, commodity prices resumed their upward trend in 2009 and 2010. This trend continued at a strong pace into early 2011. The commodity price index compiled by the IMF rose by 32% between June 2010 and February 2011, recovering more than half of its 2008 losses. The increase was broadly based across the energy and the food components (see Chart III.2). The price of the Brent blend exceeded USD 100 per barrel in the first three months of 2011, compared with USD 80 per barrel in the second half of 2010 (period averages). Similarly, the IMF food price index has risen by 41% since mid-2010 and grain prices reached again the high levels of the first half of 2008.[2]

Chart III.2 Commodity price index (January 2006-February 2011)

(market price index, 2000=100)



Source: IMF.
1 Average of three types of crude oil.

The increase in international oil and food prices stemmed from structural, cyclical and special factors. Structural factors refer to changes over time in key supply and demand aggregates in energy and food markets, while cyclical factors are associated with developments in global economic activity. Furthermore, special factors such as geopolitical developments, weather conditions, financial activity, monetary policy and the evolution of the US dollar exchange rate have influenced current prices and the prices of commodity futures.

Key drivers of rising oil prices in recent months were the strong and increasing demand by energy-consuming developing economies, mainly in Asia, and the swift recovery of oil demand by advanced economies amid conditions of rising world GDP growth. In addition, political and social unrest in oil-exporting countries of the Middle East and North Africa in February 2011 caused disruptions to supply and, most importantly, rekindled concerns about the ability to meet future demand. The weakening of the US dollar and the transactions on commodity derivative markets[3] contributed further to a hike in oil prices. International oil prices are anticipated to fall slightly over the short term, but remain high over the medium term, due to increasing global demand, geopolitical risks and high marginal oil production costs.[4]

Although the main factors behind the surge in food prices are more difficult to identify, supply disruptions on account of adverse weather

2 See IMF, *World Economic Outlook*, April 2011, Appendix 1.2 "Commodity market developments and prospects".
3 For further details, see the communication by the European Commission entitled "Tackling the challenges in commodity markets and on raw materials", COM(2011) 25 final, February.
4 See footnote 2.

conditions seem to have played a central part. Drought and wildfires in Russia, Ukraine and Kazakhstan, as well as a hot summer in the United States, took their toll on wheat and maize production, respectively. This, coupled with stronger global demand and low stocks, has lead to sharp increases in prices. Although disruptions associated with such phenomena tend to normalise rapidly, increasing or further developing farmland represents a major challenge in the long run, if agricultural production is to meet growing demand for food and biofuel. Food prices are expected to remain high during the current year,[5] affected by uncertainty about weather conditions, the impact from high prices of energy raw materials and the risk of new constraints on world trade due to lower production.

The so far remarkable increase in oil and food prices, as well as their anticipated persistence at relatively high levels, have serious economic and social implications worldwide, in particular for developing economies, including, most importantly, (i) a pick-up in CPI and cost-push inflation due to first- and second-round effects on price setting; (ii) a worsening of the terms of trade and the trade balance for countries which are net importers of food and energy; and, generally, (iii) a slowdown or halt of global economic activity.[6] Besides, as evidenced by the recent social commotion in several developing economies, constantly rising oil and food prices have redistributive effects at the expense of poorer population strata, implying that food security and social welfare should be top priorities. On the other hand, such hikes boost the income of oil and food exporting countries, which, in part, is recycled in international goods and services markets. Moreover, given the high R&D cost in the energy and innovative crops sector, high oil and food prices may ensure a profit margin of such initiatives by opening new vistas for economic growth and social well-being. The present conjuncture encourages a revisiting of the modern consumption and industrial pattern in the face of population growth, natural resources shortage and climate change.

5 See footnote 2.

6 For the empirical estimates of the impact from rising energy prices on inflation and economic activity, see OECD (2011), "The effects of oil price hikes on economic activity and inflation", OECD Economic Department Policy Notes, No 4; and ECB (2010), "Energy markets and the euro area macroeconomy", ECB Occasional Paper Series, No 113, June 2010.

Box III.1

DECISIONS TAKEN BY THE HEADS OF STATE OR GOVERNMENT OF THE EURO AREA ON 11 MARCH 2011 AND BY THE EUROPEAN COUNCIL ON 24-25 MARCH 2011

At their informal meeting of 11 March 2011, the Heads of State or Government of the euro area assessed progress made on the comprehensive response to the crisis, inviting the Finance Ministers to complete their work on the European Stability Mechanism (ESM) and the European Financial Stability Facility (EFSF) in time for the European Council of 24-25 March 2011, and adopted a Pact for the Euro which establishes a stronger economic policy coordination for competitiveness and convergence.

The European Council of 24-25 March 2011 welcomed the decisions taken by the euro area Heads of State or Government on 11 March 2011 and endorsed the features of the future ESM, noting that the preparation of the ESM treaty and the amendments to the EFSF agreement will be stepped up so as to allow signature of both agreements at the same time before the end of June 2011. The European Council also adopted a comprehensive package of measures to address the crisis, including a Euro Plus Pact.

1 Meeting of Heads of State or Government of 11 March 2011: The EFSF and the ESM – maturity extension and interest rate reduction for loans to Greece

In its conclusions, the European Council stressed that financial support through the ESM and the EFSF should strictly adhere to and fully implement the European Council conclusions of December 2010 and the Eurogroup statement of 28 November 2010. Moreover, it specified the financing capacity and the instruments of these facilities, as well as the financial conditions for the granting of EFSF loans. These can be summarised as follows:

Financing capacity of the ESM

The ESM will have an overall effective lending capacity of €500 billion. The ESM effective lending capacity will be ensured by establishing the appropriate mix between paid-in capital, callable capital and guarantees. Until the entry into force of the ESM, the agreed lending capacity of €440 billion of the EFSF will be made fully effective.

Instruments of the ESM

The ESM will provide financial assistance when requested by a euro area member and when such intervention is deemed indispensable to safeguard the stability of the euro area as a whole. Any decision to that effect will be taken by unanimity on the basis of a debt sustainability analysis of the Member State concerned conducted by the Commission and the IMF, in liaison with the ECB. Financial assistance will be subject to strict conditionality under a macroeconomic adjustment programme.

Financial assistance from the ESM and EFSF will take the form of loans. However, to maximise the cost efficiency of their support, the ESM and the EFSF may also, as an exception, intervene in the debt primary market in the context of a programme with strict conditionality.

Financial conditions for EFSF assistance – Provisions regarding Greece

Pricing of the EFSF should be lowered to better take into account debt sustainability of the recipient countries, while remaining above the funding costs of the facility, with an adequate mark-up for risk, and in line with the IMF pricing principles. The same principles will apply to the ESM.

Against this background and in view of the commitments undertaken by Greece in the context of its adjustment programme, the interest rate on its loans will be lowered by 100 basis points. Moreover, the maturity for all the programme loans to Greece will be increased to 7.5 years, in line with the IMF.

2 The Euro Plus Pact

The Euro Plus Pact, as agreed by the euro area Heads of State or Government on 11 March 2011 and joined by Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania, will further strengthen the economic pillar of EMU and achieve a new quality of economic policy coordination, with the objective of improving competitiveness and thereby leading to a higher degree of convergence.

This renewed effort for stronger economic policy coordination for competitiveness and convergence rests on four guiding rules:

a. It will be consistent with and build on existing EU economic governance institutions.

b. It will be focused on priority policy areas that are essential for fostering competitiveness and convergence.

c. Each year, concrete national commitments will be undertaken by each Head of State or Government; the implementation of such commitments will be monitored politically.

d. Participating Member States are fully committed to the completion of the Single Market which is key to enhancing the competitiveness in the EU and the euro area.

Participating Member States undertake to take all necessary measures to pursue the following objectives:

- **Foster competitiveness.** Progress will be assessed on the basis of wage and productivity developments and competitiveness adjustment needs.

- **Foster employment.** A well functioning labour market is key for the competitiveness of the euro area. Progress will be assessed on the basis of the following indicators: long-term and youth unemployment rates, and labour participation rates.

- **Enhance the sustainability of public finances.** The highest attention will be paid to **sustainability** of pensions, health care and social benefits.

- **Reinforce financial stability.** A strong financial sector is key for the overall stability of the euro area. A comprehensive reform of the EU framework for financial sector supervision and regulation has been launched.

In addition to the issues mentioned above, attention will be paid to **tax policy coordination**.

Progress towards the common objectives above will be politically monitored by the Heads of State or Government on the basis of a series of indicators covering competitiveness, employment, fiscal sustainability and financial stability. Countries facing major challenges in any of these areas will have to commit to addressing these challenges in a given timeframe.

3 European Council of 24-25 March 2011 – Term Sheet on the ESM

Recalling the importance of ensuring financial stability in the euro area, the European Council adopted the decision amending the Treaty on the Functioning of the European Union with regard to the setting up of a future European Stability Mechanism (ESM).

The European Council called for the rapid launch of national approval procedures with a view to its entry into force on 1 January 2013. It welcomed the decisions taken by the euro area Heads of State or Government on 11 March 2011 and endorsed the features of the ESM (attached to its conclusions as Annex II).

The main features of the ESM are the following:

- The ESM will be activated by mutual agreement, if indispensable to safeguarding the financial stability of the euro area as a whole.

- The ESM will assume the role of the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM) in providing external financial assistance to euro area Member States after June 2013.

- Access to ESM financial assistance will be provided on the basis of strict policy conditionality under a macro-economic adjustment programme and a rigorous analysis of public-debt sustainability, which will be conducted by the Commission together with the IMF and in liaison with the ECB. The beneficiary Member State will be required to put in place an appropriate form of private-sector involvement, according to the specific circumstances and in a manner fully consistent with IMF practices.

- The ESM will have an effective lending capacity of €500 billion. The adequacy of the lending capacity will be reviewed on a regular basis and at least every five years. The ESM will seek to supplement its lending capacity through the participation of the IMF in financial assistance operations, while non-euro area Member States may also participate on an ad hoc basis.

Institutional form: The ESM will be established by a treaty among the euro area Member States as an intergovernmental organisation under public international law and will be located in Luxembourg. The statute of the ESM will be set out in an annex to the treaty.

Governance: The ESM will have a Board of Governors consisting of the Ministers of Finance of the euro area Member States. The Board of Governors will be the highest decision-making body of the ESM and will take the following major decisions by mutual agreement: the granting of financial assistance, the terms and conditions of financial assistance, the lending capacity of the ESM, changes to the menu of instruments.

Capital structure: The ESM will aim to obtain and maintain the highest credit rating from the major credit rating agencies. The ESM will have a total subscribed capital of €700 billion. Of this amount, €80 billion will be in the form of paid-in capital provided by the euro area Member States being phased in from July 2013 in five equal annual instalments. In addition, the ESM will also dispose of a combination of committed callable capital and of guarantees from euro area Member States to a total amount of €620 billion. The contribution key of each Member State in the total subscribed capital of the ESM will be based on the paid-in capital key of the ECB.

Instruments: Financial assistance from the ESM will be provided through loans. However, the ESM may intervene, as an exception, in debt primary markets on the basis of a macro-economic adjustment programme with strict conditionality and if agreed by the Board of Governors by mutual agreement.

Pricing: The ESM will be able to lend at a fixed or variable rate. The pricing of the ESM will be in line with IMF pricing principles and, while remaining above the funding costs of ESM, will include an adequate mark-up for risks. The following pricing structure will apply to ESM loans: (i) ESM funding cost, (ii) a charge of 200 basis points applied on the entire loans and (iii) a surcharge of 100 basis points for loan amounts outstanding after 3 years.

Modalities for involving the private sector: An adequate and proportionate form of private-sector involvement will be expected, the nature and extent of which will be determined on a case-by-case basis and will depend on the outcome of a debt sustainability analysis: (a) if, on the basis of a sustainability analysis, it is concluded that a macro-economic adjustment programme can realistically restore the public debt to a sustainable path, the beneficiary Member State will take initiatives aimed at encouraging the main private investors to maintain their exposures; (b) if, on the basis of a sustainability analysis, it is concluded that a macro-economic programme cannot realistically restore the public debt to a sustainable path, the beneficiary Member State will be required to engage in active negotiations in good faith with its creditors to secure their direct involvement in restoring debt sustainability. The granting of the financial assistance will be contingent on the Member State having a credible plan and demonstrating sufficient commitment to ensure adequate and proportionate private sector involvement. The Member State will consult creditors on the design of any rescheduling or restructuring of public debt with a view to reaching negotiated solutions. Measures reducing the net present value of the debt will be considered only when other options are unlikely to deliver the expected results.

Collective Action Clauses: Collective Action Clauses (CACs) will be included in all new euro area government securities, with maturity above one year, from July 2013. The objective of such CACs will be to facilitate agreement between the sovereign and its private-sector creditors in the context of private sector involvement.

Preferred Creditor Status of the ESM: The ESM will enjoy preferred creditor status in a similar fashion to the IMF, while accepting preferred creditor status of IMF over ESM.

2 THE ECONOMIES OF SOUTH-EAST EUROPEAN COUNTRIES[7]

According to data for the last quarter of 2010, the recovery of South-East European economies continues and gathers momentum. More specifically, Romania and Croatia were the only countries to end the year with negative growth rates (-2.0% and -1.9%, respectively).[8] Turkey recorded the highest economic growth rate (about 8.2%), followed by Albania (3.5%). Serbia, FYROM, Montenegro, Bosnia and Herzegovina and Bulgaria posted quite lower rates (1.5%, 1.2%, 1.1%, 0.5% and 0.3%, respectively – see Table III.2.A).

In most countries, the recovery dynamics was primarily based on a rebound of exports, which mainly reflected a rise in world trade volumes after the second half of 2009, and an increase in inventories. By contrast, domestic demand remained weak in almost all countries, due to the fiscal adjustment efforts and the exceptionally low rates of credit expansion. The only exception is Turkey, where domestic demand displayed a spectacular recovery.

In 2011, it is expected that recovery will continue unabated and GDP growth differentials will narrow, on the back of a concerted strengthening of domestic demand in all countries. On the other hand, however, these forecasts are surrounded by considerable uncertainty, which is mainly associated with mounting inflationary pressures, the sovereign debt crisis in peripheral euro area countries and the risk of continued political turmoil in the Middle East and North Africa.

The considerable deceleration of inflation observed during the crisis, which in some cases

7 The analysis on the Southeastern European economies refers to the following countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Former Yugoslav Republic of Macedonia (FYROM), Montenegro, Romania, Serbia and Turkey.

8 It should be noted that Croatia posted positive growth rates in the third and the fourth quarter of 2010, and the same applies to Romania, on a quarterly basis, in the fourth quarter of 2010.

Table III.2 Key macroeconomic indicators in South-East European countries[1]

A. GDP and inflation
(annual percentage changes)

Country	GDP 2007	GDP 2008	GDP 2009	GDP 2010 (estimates)	GDP 2011 (forecasts)	Inflation 2007	Inflation 2008	Inflation 2009	Inflation 2010 (estimates)	Inflation 2011 (forecasts)
Albania	5.9	7.7	3.3	3.5	3.4	2.9	3.4	2.2	3.6	3.3
Bosnia-Herzegovina	6.1	5.7	-3.1	0.5	2.2	1.5	7.4	-0.4	2.1	2.5
Bulgaria	6.4	6.2	-4.9	0.3	2.5	7.6	12.0	2.5	3.0	4.0
Croatia	5.5	2.4	-5.8	-2.0	1.6	2.9	6.1	2.4	1.0	2.4
FYROM	6.1	5.0	-0.9	1.2	3.5	2.3	8.3	-0.8	1.5	2.5
Montenegro	10.7	6.9	-5.7	1.1	2.0	4.2	8.5	3.4	0.5	1.2
Romania	6.3	7.3	-7.1	-1.9	1.5	4.8	7.8	5.6	6.1	5.4
Serbia	6.9	5.5	-3.1	1.5	3.0	6.9	12.4	8.1	6.2	9.1
Turkey	4.7	0.7	-4.7	8.2	4.5	8.8	10.4	6.3	8.6	4.8

B. Current account balance and fiscal balance
(% of GDP)

Country	Current account balance 2007	Current account balance 2008	Current account balance 2009	Current account balance 2010 (estimates)	Current account balance 2011 (forecasts)	Fiscal balance 2007	Fiscal balance 2008	Fiscal balance 2009	Fiscal balance 2010 (estimates)	Fiscal balance 2011 (forecasts)
Albania	-10.4	-15.2	-14.0	-9.5	-10.2	-3.5	-5.9	-7.0	-3.1	-3.5
Bosnia-Herzegovina	-10.7	-14.5	-6.9	-6.1	-5.8	1.2	-2.2	-4.4	-4.1	-4.0
Bulgaria	-30.2	-23.3	-9.9	0.3	0.0	0.1	2.9	-0.8	-4.0	-3.0
Croatia	-7.6	-9.2	-5.4	-2.9	-3.9	-2.5	-1.4	-4.1	-5.7	-6.1
FYROM	-6.5	-13.7	-6.9	-3.6	-4.7	0.6	-1.0	-2.7	-2.5	-2.5
Montenegro	-39.5	-50.6	-30.3	-25.6	-24.5	6.4	-0.4	-4.4	-2.9	-7.0
Romania	-13.4	-11.6	-4.2	-4.6	-4.9	-3.1	-4.8	-7.3	-6.5	-4.4
Serbia	-16.0	-18.5	-6.9	-7.8	-7.7	-1.9	-2.6	-4.3	-4.4	-4.1
Turkey	-5.9	-5.7	-2.3	-6.3	-7.2	-1.0	-1.8	-5.5	-3.4	-3.0

Sources: IMF, *World Economic Outlook*, national central banks and Ministry of Finance of Albania.
1 Estimates for 2010 and forecasts for 2011 are expected to be revised.

was even accompanied by an emergence of deflationary conditions, is apparently coming to an end. Inflationary pressures have, albeit only in part, reappeared in 2010 (see Table III.2.A). This is mainly due to increases in commodity prices, hikes in indirect taxes and administered prices, as well as the weakening trend of certain currencies (especially that of Serbia). In 2011, inflationary pressures are very likely to intensify, mainly as a result of an anticipated acceleration in economic growth rates. Lastly, as long as unrest in the Middle East and North Africa persists, this may turn out to be a serious source of risk to the inflation outlook.

Fiscal adjustment constitutes a top macroeconomic policy priority for the countries of the region. As recession subsides and economic conditions improve, nearly all of the governments have embarked on a concerted effort of fiscal consolidation with a view to ensuring the sustainability of their public finances, which is a *sine qua non* for achieving sustainable economic growth. Most of them managed to drive down their fiscal deficits, while the fiscal adjustment effort is expected to continue into 2011 (see Table III.2.B).

The current account deficit for most of the countries remained at high levels in 2010 and, in a number of them, widened sizeably (in Turkey, Romania and Serbia – see Table III.2.B). The only exception is Bulgaria, which saw an, albeit marginal, surplus in its external sector. Capital inflows for direct investment hovered at low levels, while increased inflows to Turkey mainly concern portfolio investment. In 2011, the external sector will most probably deteriorate further, due to an anticipated gradual recovery in demand for imports, as well as uncertainty surrounding the sovereign debt crisis in the euro area and developments in the Middle East and North Africa.

It is expected that monetary policy for 2011 will hinge upon the level of inflation and the different pace of economic recovery in the economies of the region. Monetary policy relaxation, which was introduced and maintained throughout 2010, was effective, as corroborated by the positive growth rates currently recorded across the region during the fourth quarter of 2010, but apparently tends to be terminated. Serbia has already raised its key interest rate, thus signalling a change in its monetary policy stance, although the other countries are following a wait-and-see approach. The only exception is Turkey, which has tightened its policy by using "non-standard" tools, such as cutting interest rates and increasing banks' reserve requirements. Overall, it is expected that monetary authorities will keep interest rates low for the time being, taking into account the level of inflation, in an effort to foster growth, and any decisions pointing to a policy tightening may be deferred to the second half of 2011.

The region's financial sector shows evident signs of improvement and credit growth rates have become stronger. In 2011, credit growth is expected to accelerate, without nevertheless reaching its pre-crisis levels, and banks' profitability will greatly depend on the evolution of non-performing loans, which are the lagged result of the crisis. In addition, the new economic growth model which is now being forged favours domestic capital flows (over inflows of foreign capital) to ensure the liquidity needed by the banking system, resulting however in higher interest rates and subdued bank profitability. In general, it should be noted that the strong capital base of the South-East European financial sector, which relies on domestic saving, guarantees stability and growth in the region's economies.

IV THE SINGLE MONETARY POLICY AND THE EUROSYSTEM'S RESPONSES[1]

Inflationary pressures in the euro area remained subdued during 2010, allowing monetary policy to maintain its accommodative stance, thus supporting economic recovery. However, from early 2011, the assessment of the Governing Council of the ECB was that higher commodity prices, against the backdrop of rising global economic activity and ample liquidity, as well as the recent geopolitical tensions, generates upside risks to price stability, could trigger a broadly-based increase in prices of goods and services in the euro area, a prospect that should, by all means, be averted. In 2010 and over the first quarter of 2011, the Eurosystem key interest rates remained unchanged at historically low levels, but they were raised by 25 basis points in April 2011 (the first change in almost two years), in order to counter the upside risks to price stability mentioned above (see Table IV.1). At the same time, the Eurosystem continued to resort to non-standard monetary policy measures (see Table IV.2).[2]

It should be recalled that the phasing-out of some of these measures was scheduled in December 2009 and the implementation of the exit strategy started month later. Meanwhile, from the last months of 2009, financial markets were increasingly affected by concerns about the fiscal situation in certain euro area member countries (most notably Greece), resulting in the emergence of growing tensions that peaked in early May 2010. In response to these tensions, the Governing Council of the ECB reintroduced in the same month some of the non-standard monetary policy measures that had been withdrawn and introduced an additional one, the securities markets programme.[3,4] During that same period, the Governing Council made a decision of particular importance for Greece, according to which the Eurosystem would consider debt instruments issued or guaranteed by the Greek government, irrespective of their credit rating, as eligible collateral for refinancing operations.[5]

The monetary policy conducted by the Governing Council of the ECB is geared towards achieving the Eurosystem's primary objective, i.e. to maintain price stability[6] in the euro area over the medium term. In 2010 and the first two months of 2011, the Governing Council repeatedly stressed that the Eurosystem key interest rates were deemed appropriate to achieve the primary objective of the single monetary policy and described the monetary policy stance as accommodative. Indeed, in 2010 and in early 2011, inflation expectations remained at levels consistent with the aim of keeping inflation rates below, but close to, 2% over the medium term, meaning that economic agents expected that the primary objective of the single monetary policy would be achieved. However, in March 2011 the Governing Council noted an ongoing rise in inflation, stressing that it was indispensable to ensure that it would not lead to broadly-based price increases over the medium term. Therefore, "strong vigilance" was warranted and the Governing Council remained prepared to act in a firm and timely manner to ensure that upside risks to price stability over the medium term would not materialise. Thus, as already mentioned, the monetary policy stance was

1 The present chapter draws from the introductory statements of the President of the ECB at the press conferences following the first Governing Council meeting of each month, in which monetary policy is discussed, in 2010 and the first four months of 2011, as well as announcements and other texts published by the ECB.
2 They are described as "non-standard" because they involve significant modifications in the operational framework – i.e. the instruments and procedures used by the Eursosystem – for the implementation of monetary policy. These measures render financing conditions more favourable and support the flow of funds to the economy through the financial system – that is, for the euro area, mainly banks – more than it could be possibly achieved through standard measures alone, i.e. key interest rate cuts with no change in the operational framework.
3 See the ECB Decision of 14 May 2010 establishing a securities markets programme (ECB/2010/5). Under this programme, the Eurosystem purchases securities (denominated in euro) in order to contribute to the elimination of malfunctions in financial markets which, in turn, hamper the monetary policy transmission mechanism and, thereby, the effective conduct of monetary policy oriented towards price stability in the medium term. The purchase of debt instruments by the Eurosystem contributes, first of all, to an increase in the banking system's overall liquidity, which is subsequently being absorbed by means of other non-regular open market operations that are renewed on a weekly basis, so as to avoid the creation of excess liquidity in the interbank market.
4 At the same time, the Ecofin Council and Member States established the European Financial Stability Mechanism and the European Financial Stability Facility that will operate on a temporary basis with the aim of safeguarding financial stability (see also Box III.1 in the previous chapter).
5 A similar decision about Irish government bonds was announced on 31 March 2011.
6 According to the definition that is part of the monetary policy strategy of the Eurosystem, price stability is achieved when inflation rates are maintained below, but close to, 2%.

Table IV.1 Changes in key ECB interest rates

(percentages per annum)

With effect from:[1]		Deposit facility	Main refinancing operations		Marginal lending facility
			Fixed rate tenders (fixed rate)	Variable rate tenders (minimum bid rate)	
2000	6 October	3.75	-	4.75	5.75
2001	11 May	3.50	-	4.50	5.50
	31 August	3.25	-	4.25	5.25
	18 September	2.75	-	3.75	4.75
	9 November	2.25	-	3.25	4.25
2002	6 December	1.75	-	2.75	3.75
2003	7 March	1.50	-	2.50	3.50
	6 June	1.00	-	2.00	3.00
2005	6 December	1.25	-	2.25	3.25
2006	8 March	1.50	-	2.50	3.50
	15 June	1.75	-	2.75	3.75
	9 August	2.00	-	3.00	4.00
	11 October	2.25	-	3.25	4.25
	13 December	2.50	-	3.50	4.50
2007	14 March	2.75	-	3.75	4.75
	13 June	3.00	-	4.00	5.00
2008	9 July	3.25	-	4.25	5.25
	8 October	2.75	-	-	4.75
	9 October	3.25	-	-	4.25
	15 October	3.25	3.75	-	4.25
	12 November	2.75	3.25	-	3.75
	10 December	2.00	2.50	-	3.00
2009	21 January	1.00	2.00	-	3.00
	11 March	0.50	1.50	-	2.50
	8 April	0.25	1.25	-	2.25
	13 May	0.25	1.00	-	1.75
2011	13 April	0.50	1.25	-	2.00

Source: ECB.
1 From 10 March 2004 onwards, with the exception of the interest rate changes of 8 and 9 October 2008, changes in all three key ECB interest rates are effective from the first main refinancing operation following the Governing Council decision, not the date of the Governing Council meeting at which this decision is made.

adjusted in April 2011. The increase in key interest rates will contribute to keeping inflation expectations at levels consistent with price stability over the medium term, which a prerequisite for monetary policy to support economic growth in the euro area. Still, the stance of monetary policy continues to be accommodative even after the recent adjustment of key interest rates – since money and capital market interest rates remain low across the entire maturity spectrum – thereby supporting economic growth and job creation. Moreover, the Governing Council stressed that it would continue to monitor closely all developments with respect to upside risks to price stability.

In formulating the single monetary policy, the Governing Council uses the results of both economic and monetary analyses.

In 2010, the economic analysis confirmed that economic recovery was ongoing in the euro area. During 2010, quarterly GDP growth in the euro area ranged between 1% (in the sec-

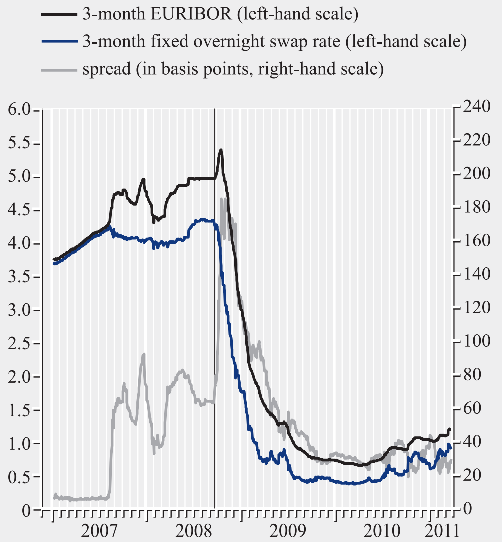
Table IV.2 The Eurosystem's open market operations in 2010 and the first quarter of 2011

1. Main and longer-term refinancing operations:	
1.1 Main refinancing operations (MROs): provision of liquidity with a maturity of one week	**Frequency:** Once a week. **Procedure:** At least until 12 July 2011, fixed rate tender with full allotment.
1.2 Longer-term refinancing operations (LTROs):	
1.2.1 Provision of liquidity with a maturity of one maintenance period	**Frequency:** Once at the beginning of each maintenance period. These special-term refinancing operations will continue to be carried out at least until the end of the second quarter of 2011. **Procedure:** Fixed rate tender (at a rate equal to the MRO rate) with full allotment.
1.2.2 Provision of liquidity with a maturity of three months	**Frequency:** Once a month. **Procedure:** Fixed rate tender (at a rate equal to the MRO rate) with full allotment, from January to September 2010, with the exception of the operation allotted on 28 April, which was conducted as a variable-rate tender. In the period October 2010-March 2011, such operations continued to provide liquidity with full allotment, but the interest rate was/will be set ex post equal to the average value of the fixed rate in the MROs conducted over the life of the respective three-month operations.[1] This procedure will also be used in the operations to be conducted in the course of the three months from April to June 2011.
1.2.3 Provision of liquidity with a maturity of six months	**Frequency:** One operation was conducted on 31 March and one on 12 May 2010. **Procedure:** Fixed rate tender with full allotment, the interest rate being fixed ex post at the average value of the fixed rate in the MROs over the life of the respective LTRO. As the rate on the MROs remained unchanged at 1% over the life of the six-month operations, its average, too, was 1%.
2. Outright purchases of securities:	
2.1 Covered Bond Purchase Programme	The Programme lasted from July 2009 to June 2010. The Eurosystem purchased bonds of a total nominal value of €60 billion.
2.2 Securities Markets Programme	The Governing Council decided on 9 May 2010 to launch the Programme. By end-March 2011, the Eurosystem had purchased securities of a total value of €77.6 billion.
3. Fine-tuning operations:	
3.1 Liquidity absorption on the last day of each maintenance period	**Procedure :** Collection of overnight deposits from credit institutions through variable-rate tenders with a maximum bid rate of 1% until March 2011.
3.2 Liquidity absorption on a weekly basis to sterilise the effect, on the overall liquidity of the banking system, of purchases made under the Securities Markets Programme	**Frequency:** Every week, starting on 18 May 2010. **Procedure:** Collection of weekly deposits from credit institutions, through variable-rate tenders with a maximum bid rate of 1% until March 2011.
3.3 Provision of liquidity for 6 or 13 days to mitigate the effect of maturing 12-month and 6-month LTROs on the overall liquidity of the banking system	Operations with a maturity of six days were conducted on 1 July, 30 September and 11 November 2010. An operation with a maturity of 13 days was conducted on 23 December 2010 to ensure that the additional liquidity would remain available to credit institutions in the period around the year-end. **Procedure:** Fixed rate tender (at a rate equal to the MRO rate) with full allotment.
4. US dollar liquidity-providing operations:	
	These operations were discontinued after 27 January 2010 but were resumed on 11 May 2010 and have continued in 2011. They provide liquidity in US dollars with a maturity of 7 days against collateral eligible for the Eurosystem's credit operations in euro. One 84-day US dollar liquidity-providing operation was conducted on 18 May 2010 and one 14-day operation on 22 December 2010. **Procedure:** Fixed rate tender with full allotment.
5. Swiss franc liquidity-providing swap operations:	
These operations were discontinued after 25 January 2010. They took the form of weekly EUR/CHF foreign exchange swaps, whereby the Eurosystem provided liquidity with a maturity of 7 days in Swiss francs in exchange for euro.	

1 As the rate on the MROs remained unchanged at 1% over the life of the three-month operations maturing until March 2011, its average, too, was 1%.

Chart IV.1 Spread between the 3-month Euribor and the 3-month fixed rate on overnight-indexed swaps (January 2007-March 2011)

(percentages per annum and basis points, daily data)



Sources: ECB and European Banking Federation.
* The vertical line marks the date of the Lehman Brothers bankruptcy on 15 September 2008.

ond quarter) and 0.3% (in the third and fourth quarters), resulting in an average annual GDP growth of 1.7%. On the basis of data and information gathered in early 2011, the Governing Council is of the view that economic recovery is continuing, despite the prevailing relatively high uncertainty.

In the context of economic analysis, the Governing Council also noted a gradual rise in inflation in the course of 2010, to 2.2% by December compared with 0.9% one year earlier. Over the first months of 2011, inflation continued to pick up, reaching 2.6% in March, according to Eurostat's flash estimate.

Since the beginning of 2011, the Governing Council of the ECB has underlined that the rising prices of oil and other commodities are triggering inflationary pressures in the short run, which have started to affect pricing at the early stages of the supply chain. In March and April 2011, the Governing Council stressed that it was of paramount importance to prevent any second-round effects[7] on consumer prices from higher energy and food commodity prices. The emergence of second-round effects would contribute to broad-based increases in the prices of final products over the medium term.

According to the latest ECB staff macroeconomic projections, released in March 2011, average annual inflation is projected to be between 2% and 2.6% in 2011 and between 1% and 2.4% in 2012, assuming continued moderation in wage- and price-setting behaviour. However, there is an increased probability that the average annual inflation rate may exceed these projections.

In 2010, the monetary analysis conducted by the Governing Council together with the economic analysis, as required under the monetary policy strategy adopted by the Eurosystem, confirmed the outcome of the economic analysis, according to which inflationary pressures in the euro area over the medium term would remain contained. The Governing Council's assessment about inflationary pressures over the medium term on the basis of the monetary analysis remained unchanged in January 2011. In February-March 2011, the Governing Council pointed out that, according to its monetary analysis, inflationary pressures should remain contained, though over a medium to long-term horizon.

The abovementioned assessments of the Governing Council during 2010 and in early 2011 reflected the fact that inflationary pressures over the medium to long term are influenced by the underlying pace of monetary expansion,[8] which remained moderate in the euro area in 2010 and in early 2011, as broad money[9] and

7 Second-round effects occur when consumer prices are burdened either because of the widening of profit margins or because of wage increases, in an effort to counterbalance the adverse impact of the rise in commodity prices on the purchasing power of firms and wage earners respectively. See ECB, *Monthly Bulletin*, July 2004, p.p.28-30.

8 Underlying monetary expansion is measured by the ECB using various alternative techniques (see ECB, *Monthly Bulletin*, May 2008, Box 1, p. 15), although the measures thus derived are not published. This concept is seen as more closely correlated to inflation (taking into account the entailed lags) than headline M3 growth.

loan[10] growth was still low. However, in March 2011, the Governing Council noted noted that there was only a partial unwinding of the large amounts of monetary liquidity accumulated in the economy prior to the period of financial tensions and that this liquidity could facilitate the accommodation of price pressures currently emerging in commodity markets, as mentioned earlier. In April 2011, the Governing Council of the ECB reiterated this assessment as regards the risks entailed by accumulated liquidity, further pointing out that the underlying pace of monetary expansion was gradually picking up.

The downward trend followed by the three-month Euribor[11] since the beginning of the fourth quarter of 2008 was reversed at the beginning of the second quarter of 2010. In April-October 2010, this rate showed an almost uninterrupted increase, while from the beginning of November 2010 until mid-January 2011 it declined slightly. Afterwards, it resumed its upward course (see Chart IV.1).

Changes in the three-month Euribor (and other interbank rates) can be associated with the evolution of liquidity in the interbank market. In the first half of 2010 there was an increase in the liquidity that banks obtain from the Eurosystem. However, there has been an almost uninterrupted decrease in the banking system's liquidity since July 2010, as, among other longer-term refinancing operations, three 12-month operations matured (at the beginning of July, the end of September and the end of December respectively) and banks —although they had the possibility— did not receive sufficient new funds (i.e. equal to the repayments to the Eurosystem) through open market operations conducted in the second half of 2010 and the beginning of 2011.

The evolution of interbank loan rates was also influenced by changes in the counterparty risk premium in the interbank market.[12] It is possible to conclude that in certain periods of 2010[13] this premium grew because of concerns about the public finances in some Member States.

In 2010 and early 2011, the reallocation of liquid assets in the euro area interbank market continued to be hampered. Especially in countries where fiscal sustainability was perceived by markets as doubtful, credit institutions with liquidity deficits seemed to be facing difficulties in attracting interbank deposits from credit institutions with liquidity surpluses in other Member States, when no collateral was offered or when domestic government bonds were offered as collateral. As a result, they were obliged to resort mostly to main refinancing operations and longer-term refinancing operations, or even to the Eurosystem's marginal lending facility to raise the necessary funds. In March and April 2011, the Governing Council of the ECB stressed that banks with limited access to interbank market financing urgently needed to increase their efficiency and strengthen their capital base.

The ECB's position on the reform of the economic governance framework and on the European Stability Mechanism (ESM)

Recent legislative proposals and the ongoing planning of economic governance in the European Union and the European Stability Mechanism are considered constructive by the ECB.[14] However, especially as regards the budgetary surveillance framework and the

9 Rate of change in M3: December 2010: 1.7%, December 2009: -0.3%. In January 2011, it stood at 1.5%, but in February it accelerated to 2.0%.
10 Rate of growth of bank loans to the private sector: December 2010: 1.9%, December 2009: -0.2%. In January 2011, it reached 2.4%, while in February it further increased to 2.6%.
11 The three-month interest rate is representative of interbank loan rates (with longer than overnight maturities) in the euro area.
12 It refers to the risk of a borrower defaulting on an interbank loan. The risk associated with investments in the interbank market can be measured by the spread between Euribor and the "fixed rate" on overnight index swaps (of comparable maturity), or the rate on collateralised interbank loans of comparable maturity (EUREPO). See Bank of Greece, *Annual Report 2008*, p.49, footnote 6.
13 For example, from end-October until end-December 2010.
14 Opinion of the ECB of 16 February 2011 on economic governance in the European Union (CON/2011/13) and opinion of the ECB of 17 March 2011 on a draft European Council Decision amending article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro (CON/2011/24). See also "The reform of economic governance in the euro area – essential elements" in the March 2011 issue of the *Monthly Bulletin* of the ECB (available on the website of the Bank of Greece). These views were also summarised in the introductory statement made by the President of the ECB after the Governing Council meeting of 7 April 2011.

macroeconomic surveillance framework, the ECB has repeatedly expressed the view that these proposals fall short of the quantum leap necessary to ensure the conduct of suitable budgetary and other economic policies in the Member States, which will not jeopardise the Monetary Union, but will instead contribute to long-run stability and economic prosperity.

The ECB's main objections focus on the fact that the new budgetary surveillance framework and the macroeconomic surveillance framework both allow substantial scope for discretion on the part of the European Commission and the Council of (Economics and Finance) Ministers: (i) as to whether recommendations will be issued to Member States that do not comply with their obligations, (ii) as to whether sanctions will be imposed on these Member States and (iii) as to the form and the size of such sanctions.

According to the ECB, there is room for a non-consistent implementation of rules, which diminishes credibility in the new frameworks before their actual implementation, given that, among other things, the recent past has demonstrated that the exercise of discretion from EU institutions in the operation of the Stability and Growth Pact did not manage to ensure the sustainability of public finances in all Member States. The ECB considers it necessary to limit the discretion of various decision-making bodies that are involved in the processes provided for in the new frameworks and to introduce more automation to them.[15]

Particularly as regards the proposed macroeconomic surveillance framework, another main objection of the ECB is that it does not provide a clear distinction between the economic policies that will be deemed appropriate for the euro area Member States and those that will be recommended for the other Member States of the European Union. On the contrary, the ECB expressed the view that different economic indicators should be monitored and different thresholds should be set in relation to each indicator for the Member States of the euro area – e.g. thresholds should be tighter in the case of competitiveness indicators. In addition, the proposals of the European Commission do not ensure a clear focus of macroeconomic surveillance on the macroeconomic imbalances that threaten the functioning of the Monetary Union, namely significant losses in competitiveness, persistent current account deficits etc.[16] (By contrast, the proposed macroeconomic surveillance framework aims at preventing both excessive losses and excessive gains in the international competitiveness.)

Other remarks made by the ECB in relation to the proposed new framework of budgetary surveillance include the necessity to incorporate its objectives (e.g. the fiscal deficit-to-GDP ratio) into Member States' domestic law, as well as to establish independent national bodies of budgetary surveillance —e.g. fiscal councils— in euro area member countries. At the European level, the ECB proposes the establishment of an independent advisory body whose task will be to monitor —and publish an annual report— the compliance of the European Commission and of the Council of Min-

15 Regarding budgetary surveillance, the ECB has proposed that the European Commission and the Council of Ministers should have no possibility to reduce or waive financial sanctions on the grounds of "exceptional economic circumstances", or following a request by the Member State concerned. A similar observation has been put forward by the ECB as regards the macroeconomic surveillance framework. Moreover, the Commission or the Council of Ministers should not be allowed to extend the deadline for the correction of an excessive fiscal deficit, or accept significant deviations from the adjustment path towards the medium-term budgetary objective during "a severe economic downturn of a general nature". In the same vein, the ECB considers that it is necessary to limit the scope for taking into consideration any "relevant factors" (whether on the basis of the deficit criterion or on the basis of the debt criterion) when establishing the existence of an excessive fiscal deficit. As regards the macroeconomic surveillance framework, according to the ECB, it is advisable to specify that, in many cases, the Commission's proposals and recommendations should be automatically adopted by the Council of Ministers, if they have not been rejected by a qualified majority vote.

16 Turning to the modalities of the proposed macroeconomic surveillance framework, the ECB has expressed the view that sanctions should be imposed immediately after the first instance of non-compliance or non-cooperation by a Member State and should be applied gradually thereafter, in order to provide Member States with the right incentives to comply with policy recommendations. The ECB also considers that the proposed framework should include provisions on reporting to the European Council in case of non-compliance by a Member State and that the European Commission should be given the possibility to conduct missions of experts in liaison with the ECB. This would exert more political pressure on Member States to comply with their obligations.

isters with their obligations under Articles 121 (economic policies coordination) and 126 (excessive fiscal deficit procedure) of the Treaty and under the new procedures set out in the proposed frameworks of budgetary and macroeconomic surveillance.[17] Finally, the ECB has proposed some modifications in technical aspects of the budgetary surveillance framework.[18]

As regards the European Stability Mechanism, the ECB has emphasised that, in order to avoid moral hazard, there is a need to ensure that the Mechanism does not constitute an attractive option, but rather a last resort for Member States that turn to it requesting assistance. To this end, fiscal discipline should be imposed on euro area member countries that use the Mechanism and any financial assistance must be made subject to strict conditionality and granted on non-concessional terms. In the ECB's opinion, it should be expressly provided that, in case a Member State is proven insolvent, its debt to individuals may not be fully repaid. This provision will contribute to yields in sovereign debt markets adequately reflecting the differentiation of credit risk among Member States according to their fiscal position.

17 The ECB has expressed the broader view that the economic analysis which will be used for the purposes of the budgetary surveillance framework must be independent and subject to accountability. Therefore, the European Commission services that are involved in budgetary or macroeconomic surveillance must enjoy the same degree of independence as the services responsible for the protection of competition. The European Commission's intention to clearly distinguish the analysis and assessment carried out under the authority of the Commissioner for Economic and Monetary Affairs from decision-making by the full College of Commissioners regarding the proposals to be submitted to the Council of Ministers goes in the right direction; however, the ECB believes that further safeguards should be introduced.

18 The ECB maintains that it is necessary to require from Member States faced with a public debt-to-GDP ratio exceeding 60% to make a faster progress towards their medium-term objective with larger annual decreases than the minimum required annual decrease of the cyclically adjusted deficit (excluding any extraordinary public revenue/expenditure) by 0.5% of GDP. In addition, the ECB considers that the benchmark proposed by the European Commission for assessing the pace of public debt reduction does not exert sufficient pressure on Member States with high public debt and robust nominal GDP growth. Finally, the ECB has underlined that the European Statistics Code of Practice should be enshrined in a regulation, to ensure the timeliness of statistical data. Any weaknesses found in statistical data collection and reporting should be addressed immediately. Also, the ECB believes that it is necessary to bring forward the deadlines for the reporting of annual and quarterly fiscal data to the European Commission, so that it is allowed more time to assess these data thoroughly.

V ECONOMIC ACTIVITY IN GREECE

1 ECONOMIC ACTIVITY DEVELOPMENTS AND PROSPECTS

1.1 DEVELOPMENTS IN ACTIVITY IN 2010

According to ELSTAT provisional estimates (18 March 2011), GDP fell by 4.5% in 2010, after a 2% decrease in 2009 (see Table V.1 and Chart V.1). The change in gross value added (at constant factor prices, i.e. less indirect taxes plus subsidies) was -5.2%. The difference between the outturn and the projections of most organisations for 2010 (implying a contraction of close to 4%) is explained by larger than expected decreases in private consumption and investment and a smaller than expected (but still significant) decline in imports.

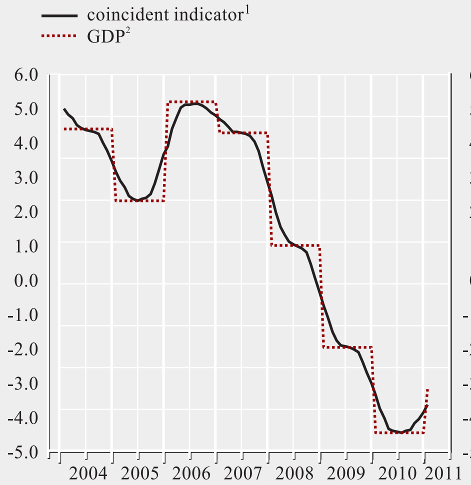
The economic situation deteriorated in 2010, as the measures to reduce the fiscal deficit began to affect all sectors, and credit expansion declined considerably (see Chapter IX). Nevertheless, due to a lack of *seasonally adjusted* quarterly national accounts data, the accurate pattern of GDP in the course of the year (i.e. its quarter-on-quarter changes) is hard to estimate.[1]

It should however be noted that the *annual* rate of decline in GDP reached -6.6% in the fourth quarter of 2010, from -0.7% in the first, -5.0% in the second, and -5.1% in the third quarter of the year.

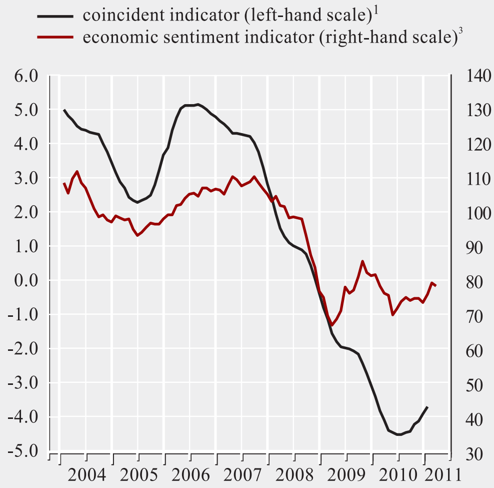
On the **expenditure** side, the key drivers of the drop in GDP were **private consumption** (down by 4.5% at constant prices, with a negative contribution of 3.3 percentage points) and **fixed capital formation** (down by 16.5%, with a negative contribution of 3.1 percentage points). A 6.5% decrease in **public consumption** contributed 1.3 percentage points to the contraction of GDP. These decreases were partly offset by the positive contribution (2.3 percentage points) of the change in the **real external balance** (i.e. net exports of goods and services), mainly due to considerably lower imports of goods (-8.4%) and higher exports of goods (+4.8%) and services (+3.2%).

Chart V.1 Economic activity indicators

A. The coincident indicator of economic activity compiled by the Bank of Greece
(January 2004 - January 2011)



B. The coincident indicator of economic activity compiled by the Bank of Greece and the European Commission's economic sentiment indicator for Greece
(January 2004 - March 2011)



Sources: Bank of Greece (coincident indicator, as well as GDP for 2011), ELSTAT (GDP 2004-2010) and European Commission (economic sentiment indicator).

1 Annualised monthly percentage changes.
2 Annual rate of change.
3 Monthly data.

1 As announced by ELSTAT, seasonally adjusted national accounts data will be compiled and published in cooperation with Eurostat (Press release, 18 March 2011).

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

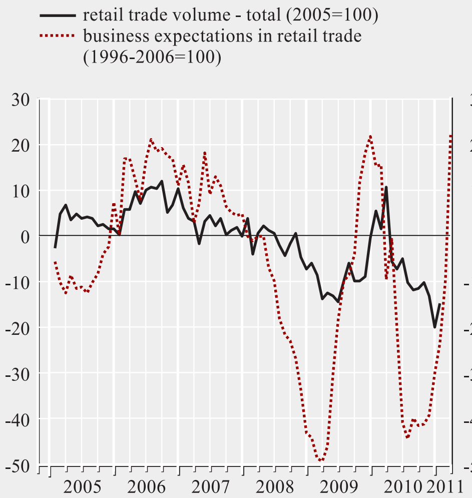
(at constant market prices of 2000)

	Value in million euro	Annual percentage changes						
	2000	2004	2005	2006	2007	2008	2009	2010
1. Private consumption	98,627	3.8	4.5	5.2	2.8	3.2	-2.2	-4.5
2. Public consumption	24,271	3.5	1.1	8.8	8.2	1.5	10.3	-6.5
3. Gross fixed capital formation	29,450	0.4	-6.3	10.6	5.5	-7.5	-11.2	-16.5
3.1 Construction	17,944	-3.0	-7.8	16.4	-4.1	-18.9	-12.3	-12.5
3.2 Equipment	10,415	4.5	-4.8	3.0	22.3	6.6	-11.8	-23.5
3.3 Other investment	1,091	8.6	-1.9	7.1	-12.2	-11.7	13.6	22.0
4. Domestic final demand[1]	152,349	3.0	1.7	6.8	4.2	0.8	-1.8	-6.9
5. Change in inventories and statistical discrepancy (% of GDP)	2,328	0.5	-0.3	-0.6	1.1	1.6	-0.9	0.0
6. Exports of goods and services	33,882	17.3	2.5	5.3	5.8	4.0	-20.1	3.8
6.1 Exports of goods	14,253	9.4	6.3	11.7	1.5	3.8	-18.0	4.8
6.2 Exports of services	19,629	22.8	0.1	1.0	9.0	4.1	-21.5	3.2
7. Final demand	188,558	4.7	1.3	6.3	5.8	1.7	-6.8	-4.6
8. Imports of goods and services	52,277	5.7	-1.5	9.7	9.9	4.0	-18.6	-4.9
8.1 Imports of goods	40,730	4.4	-1.2	10.7	10.2	2.1	-18.5	-8.4
8.2 Imports of services	11,548	11.7	-2.9	4.9	8.1	13.7	-18.9	11.1
GDP at market prices	**136,281**	**4.4**	**2.3**	**5.2**	**4.3**	**1.0**	**-2.0**	**-4.5**
		Contribution to GDP change (percentage points)						
1. Private consumption		2.8	3.2	3.8	2.0	2.3	-1.6	-3.3
2. Public consumption		0.6	0.2	1.4	1.4	0.3	1.8	-1.3
3. Gross fixed capital formation		0.1	-1.5	2.3	1.2	-1.7	-2.3	-3.1
3.1 Construction		-0.4	-1.0	1.9	-0.5	-2.3	-1.2	-1.1
3.2 Equipment		0.4	-0.4	0.3	1.9	0.7	-1.2	-2.2
3.3 Other investment		0.1	0.0	0.1	-0.1	-0.1	0.1	0.2
4. Domestic final demand[1]		3.4	1.9	7.5	4.7	0.9	-2.0	-7.7
5. Inventories and statistical discrepancy		-0.7	-0.7	-0.4	1.7	0.5	-2.5	0.9
6. Exports of goods and services		3.6	0.6	1.2	1.3	0.9	-4.9	0.8
6.1 Exports of goods		0.8	0.6	1.1	0.2	0.4	-1.9	0.4
6.2 Exports of services		2.6	0.0	0.1	1.2	0.6	-3.0	0.4
7. Final demand		6.3	1.7	8.4	7.8	2.3	-9.4	-6.0
8. Imports of goods and services		2.0	-0.5	3.3	3.5	1.5	-7.1	-1.5
8.1 Imports of goods		1.3	-0.3	2.9	3.0	0.6	-5.7	-2.2
8.2 Imports of services		0.7	-0.2	0.3	0.5	0.9	-1.4	0.7
9. External balance of goods and services (net exports)		1.6	1.1	-2.0	-2.1	-0.5	2.2	2.3
GDP at market prices		**4.4**	**2.3**	**5.2**	**4.3**	**1.0**	**-2.0**	**-4.5**

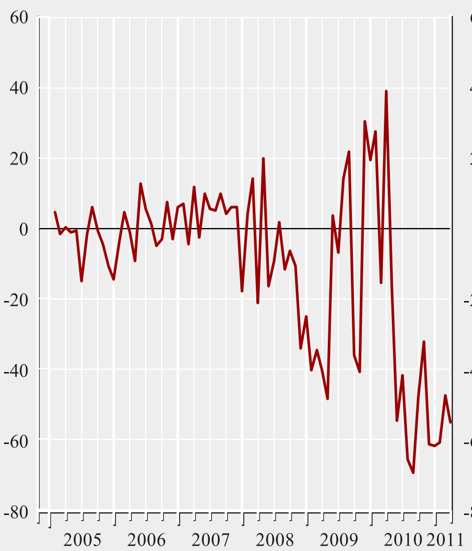
Source: ELSTAT, National Accounts, revised data for 2004-2009 and provisional estimates for 2010, March 2011.
1 Excluding inventories and statistical discrepancy.

Chart V.2 Consumer demand indicators

A. Retail trade volume and business expectations[1]
(January 2005 - March 2011)



B. New private passenger car registrations[1]
(January 2005 - March 2011)



Sources: ELSTAT (retail trade and cars) and IOBE (expectations). The index of business expectations is based on firms' estimates of sales and stocks as well as on their forecasts on business activity over the next three months.

1 Percentage changes over same month of previous year.

Lower private consumption is reflected in a strong decline in the volume of retail sales (excluding cars and fuels) and the number of new passenger car registrations, which dropped by 6.9% and 37.2%, respectively (see Table V.2 and Chart V.2).

Underlying the decline in **private consumption** were mainly a fall in incomes, as a result of job losses (see Chapter VI) and cuts in wages (see Chapter VII), as well as higher prices and heightened concerns about employment prospects.[2] According to national accounts estimates by ELSTAT, total compensation of employees (including employers' social security contributions) decreased by 5.7% in 2010, while compensation per employee dropped by 3.5% at current prices, with the sharpest decline in the latter being recorded in "other" services (public administration, health, education, etc.).

In 2010, total (public and private) **gross fixed capital formation** dropped (at constant prices of 2000) by 16.5%, as mentioned above. This mainly reflected a considerable decline in expenditure for transport equipment and machinery, as well as reduced housing investment (see also Table V.3). These changes, which follow the trends observed in the past few years, have led to a shift in the composition of investment. Thus, while in 2000-2008 one third of investment expenditure was directed to housing, in 2010 the corresponding share was less than one fourth,[3] and roughly one third of investment expenditure was directed to machinery. Factors cited by firms as responsible for the decline in investment in 2010 include the negative effect of economic policy, the higher taxation of profits, as well as shortage of funds and higher costs.[4] Shortage of

2 Indeed, according to the consumer confidence indicator compiled by the European Commission on the basis of IOBE's household survey, Greek consumers are the most pessimistic about employment prospects. Based on seasonally adjusted data for March 2011, the percentage balance between consumers' negative and positive employment expectations was 84.5 in Greece, i.e. much higher than in other countries (Portugal: 59.3, Romania: 56.6, United Kingdom: 53.3, Bulgaria: 47.7, Slovenia: 45.6, Italy: 44.5, Hungary: 40.0), though it should be noted that the responses of Greek consumers in this respect are typically more pessimistic than those of consumers from other countries.

3 This is also confirmed (see Table V.3) by data on housing loans, the outstanding amount of which was 0.4% lower in December 2010 than in December 2009.

4 See IOBE, Industrial Investment Survey Results Bulletin, 2nd survey 2010 – 15 December 2010.

Table V.2 Indicators of consumer demand (2009-2011)

(annual percentage changes)

	2009	2010	2011 (available period)
Volume of retail trade (excl. fuel and lubricants)	-9.3	-6.9	-14.8 (Jan.)
Food-beverages-tobacco[1]	-6.1	-5.5	-11.1 (»)
Clothing-footwear	1.4	-11.4	-25.3 (»)
Furniture-electrical appliances-household equipment	-15.3	-12.7	-20.6 (»)
Books-stationery-other	-24.0	-4.3	-7.2 (»)
Revenue from VAT (at constant prices)	-10.2	0.1	2.3 (Jan.- Feb.)
Retail trade business expectations index	-21.4	-26.4	-6.1 (Jan.- March)
New private passenger car registrations	-17.4	-37.2	-55.9 (» »)
Tax revenue from mobile telephony[2]	13.2	37.1	-22.9 (Jan.- Feb.)
Outstanding balance of consumer credit[3]	2.0 (Dec.)	-4.2 (Dec.)	-4.2 (Feb.)

Sources: ELSTAT (retail trade, cars), Ministry of Finance (VAT revenue, tax revenue from mobile telephony), IOBE (expectations), Bank of Greece (consumer credit).
1 Comprising big food stores and specialised food-beverages-tobacco stores.
2 Monthly service fee per subscription until July 2009. As of August 2009, new progressive rates apply to mobile telephony contracts and different fees to prepaid mobile telephony.
3 Comprising bank loans and securitised loans. The rates of change are adjusted for loan write-offs. foreign exchange valuation differences and a transfer of loans by one bank to a domestic subsidiary finance company in 2009.

Table V.3 Indicators of investment demand (2009-2011)

(annual percentage changes[1])

	2009	2010	2011 (available period)
Capital goods output	-22.5	-25.1	-6.8 (Jan.)
Capacity utilisation rate in the capital goods industry	(73.4)	(66.1)	(66.9) (Jan.-Mar.)
Bank credit to domestic enterprises[2]	5.1 (Dec.)	1.1 (Dec.)	0.9 (Feb.)
Disbursements under the Public Investment Programme	-2.8	-11.3	-41.4 (Jan.-Mar.)
Production index in construction (at constant prices)	-17.5	-31.6	...
Volume of private construction activity (on the basis of permits issued)	-26.5	-23.7	...
Cement production	-21.4	-14.3	-8.1 (Jan.)
Construction business expectations index	-31.4	-27.4	-40.9 (Jan.-Mar.)
Outstanding balance of total bank credit to housing[3]	3.7 (Dec.)	-0.4 (Dec.)	-1.1 (Feb.)

Sources: ELSTAT (capital goods output, volume of private construction activity, cement production), IOBE (capacity utilisation rate, business expectations index), Bank of Greece (bank credit to domestic enterprises and housing, disbursements under the Public Investment Programme).
1 Except for the capacity utilisation rate in the capital goods industry, which is measured in percentages.
2 Comprising loans and corporate bonds, securitised loans and securitised corporate bonds but excluding (as of June 2010) loans to sole proprietors and unincorporated partnerships. The rates of change are adjusted for loan write-offs, foreign exchange valuation differences, as well as loans and corporate bonds transferred by domestic MFIs to their subsidiaries operating abroad and to one domestic subsidiary finance company in 2009.
3 Comprising loans and securitised loans. The rates of change are adjusted for loan write-offs, foreign exchange valuation differences and a transfer of loans by one bank to a domestic subsidiary finance company in 2009.

Table V.4 Activity indicators in the services sector (2009-2011)

(annual percentage changes)

	2009	2010	2011 (available period)
Services turnover indicators			
Motor trade	-15.7	-36.4	...
Wholesale trade	-8.9	-6.2	...
Telecommunications	-8.9	-11.4	...
Land transport	-31.5	-18.1	...
Sea transport	-22.8	-8.4	...
Air transport	-12.6	-3.3	...
Storage and supporting transport activities	-33.3	-10.9	...
Travel agencies and related activities	-9.9	-24.5	...
Tourism (accommodation and food service activities)	-9.1	-8.2	...
Legal, accounting and management consulting services	-12.4	-7.2	...
Architectural and engineering services	-18.6	-21.9	...
Advertising and market research	-18.4	-23.8	...
Passenger traffic			
Athens International Airport	-1.5	-5.0	-15.6 (Jan.-Feb.)
Aegean Airlines[1]	9.9	-5.1	...
Piraeus port (OLP)	-3.8	-6.0	...
Business expectations index in the services sector	**-28.3**	**-9.3**	**-7.9 (Jan.-Mar.)**

Sources: ELSTAT (services turnover), Athens International Airport, Aegean Airlines, Piraeus Port Authority (OLP) and IOBE (expectations).
1 Including charter flights.

funds is also confirmed by a considerable deceleration in the annual rate of credit expansion to enterprises (to almost 1% by December 2010, see Table V.3 and Chapter X). The Bank Lending Survey (which also covers enterprises and is discussed in Chapter X) shows that in the second half of 2010 the tightening of credit standards by banks contributed to this weakening of credit expansion. The decline in investment for the third consecutive year affects both actual and potential output growth. However, what is encouraging is that investment in equipment, which due to its technology content, helps improve total factor productivity, has not decreased as much as housing investment over the past few years.

As a result of subdued consumption, **imports of goods and services** fell by 4.9% in 2010 compared with 2009. This stemmed exclusively from a decline of 8.4% in imports of goods, while imports of services rose by 11.1%.[5] In 2010, imports of goods corresponded to 30.9% of private consumption (at current prices), against 38.9% in 2000-2008.[6] It should be noted, however, that the decline in the ratio of imports to private consumption was smaller in 2010 (down by 2 percentage points) than in 2009 (down by 7.9 percentage points).

National accounts data show a rise in **exports of goods (4.8%) and services (3.2%)** in 2010.

5 The increase in the import of services mainly reflect higher payments for sea transport services, which represent inputs for the provision of such services and are linked to a subsequent increase in relevant receipts.

6 The ratio of imports of goods to private consumption is merely indicative, given that several imported goods represent investment (e.g. machinery, transport equipment) and not consumption. Nevertheless, the ratio of imports of goods to the sum of private consumption and business investment also showed a significant decline, from 35% in 2000-2008 to 28.6% in 2010.

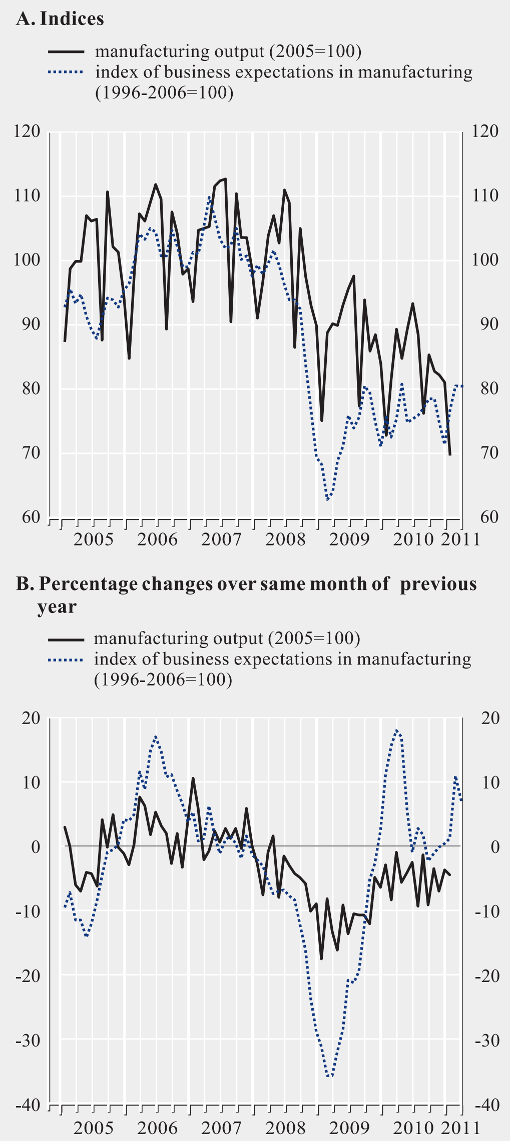
Table V.5 Industrial production

(2005=100)

		Weights 2005	Average annual percentage changes			Level 2010 (2005=100)
			2008	2009	2010	
Industry	**100.0**		**-4.0**	**-9.4**	**-5.8**	**84.5**
1. Mining and quarrying	***6.1***	***100.0***	***-4.5***	***-11.8***	***-6.5***	***76.2***
Mining of coal and lignite		56.6	0.4	-2.3	-13.1	80.7
Extraction of crude petroleum and natural gas		1.9	-17.1	31.2	42.5	117.8
Mining of metal ores		9.1	2.2	-23.3	16.2	74.3
Other mining and quarrying		32.4	-13.1	-27.7	0.0	66.5
2. Manufacturing	***69.8***	***100.0***	***-4.7***	***-11.2***	***-5.0***	***83.8***
Food		18.2	0.5	-2.7	-3.6	97.1
Beverages		6.0	-0.5	-4.8	-7.6	96.3
Tobacco		1.9	-3.3	-2.7	-17.5	74.6
Textiles		3.1	-21.7	-27.8	-20.4	42.0
Wearing apparel		3.4	-16.9	-23.6	-22.9	48.5
Leather and related products		0.6	-4.5	-14.9	-36.7	50.1
Wood and cork		1.2	-9.5	-27.3	9.4	60.4
Paper and paper products		2.3	-4.5	-3.0	-4.6	92.9
Printing and reproduction of recorded media		1.9	-4.9	-11.3	-14.1	75.7
Coke and refined petroleum products		11.3	-4.3	-0.1	5.7	110.8
Chemicals and chemical products		5.3	-4.8	-14.6	1.9	85.0
Basic pharmaceuticals		2.5	2.9	18.3	2.3	153.4
Rubber and plastic products		4.2	-2.8	-13.7	-6.3	86.0
Non-metallic mineral products		10.3	-6.6	-24.2	-14.3	59.4
Basic metals		8.0	-6.4	-17.9	12.0	92.6
Metal products		5.1	-9.8	-17.7	2.9	81.9
Computers. electronics and optical products		1.2	-2.7	-42.2	-19.7	33.5
Electrical equipment		3.0	-1.6	-20.1	4.4	86.1
Machinery and equipment n.e.c.		2.1	-0.5	-27.0	-17.1	68.1
Motor vehicles. trailers and semi-trailers		0.8	-15.4	-13.3	-7.4	67.4
Other transport equipment		1.6	-2.4	-18.6	-56.5	36.7
Furniture		1.5	-2.1	-27.2	-19.0	62.8
Other manufacturing		0.5	-16.4	-12.5	-9.4	65.2
Repair and installation of machinery and equipment		4.1	-9.2	-15.2	-26.7	55.1
3. Electricity	***20.8***	***100.0***	***-2.8***	***-4.2***	***-9.2***	***86.0***
4.Water supply	***3.3***	***100.0***	***2.5***	***-3.1***	***0.7***	***103.7***
Industry	**100.0**		**-4.0**	**-9.4**	**-5.8**	**84.5**
Main industrial groupings						
Energy	36.8		-2.4	-2.9	-4.9	92.7
Intermediate goods	28.0		-6.7	-18.4	-0.1	78.5
Capital goods	8.6		-7.4	-22.5	-25.1	53.6
Consumer durables	2.3		-5.7	-20.7	-13.4	67.2
Consumer non-durables	24.3		-2.0	-4.1	-7.0	91.6

Source: ELSTAT.

Chart V.3 Output and business expectations in manufacturing (January 2005 - March 2011)



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

However, exports of goods and services as a percentage of GDP (at current prices) still remain very low (21.0% in 2010, compared with 18.8% in 2009 and 23.4% in 2008) relative to the euro area average (40.5% in 2010, 36.3% in 2009 and 41.9% in 2008[7]).

Turning to developments in the **supply side**, output decreased in **all sectors except the primary**, and was mainly driven by the services sector, on account of a marked decline in the value added, given its weight in total economy.

Specifically, the **gross value added of the services sector** at constant prices fell by 5.1% in 2010, compared with a 1.7% decrease in 2009 (following a continuous rise at an average annual rate of 4.9% in 2001-2008). Considerable declines were recorded in trade, hotels-restaurants, and transport and communications (-6.4%), the combined share of which in gross value added at current prices was 33.3% in 2010. Besides, all branches of the services sector saw their turnover drop (see Table V.4). The business expectations index in the services sector (excluding retail trade and banking) in 2010 remained at historically low levels (averaging 64 points, compared with 70 points in 2009).

The sharpest decline as a percentage of value added at constant prices was registered in the **secondary sector** (manufacturing, energy, construction), reaching 8.8% in 2010, after a decrease of 4.6% in 2009, mainly due to a sharper drop in industrial activity including energy (-11.6%), as well as to the continued fall in construction activity (-3.2%, compared with -13.1% in 2009 and -13.8% in 2008, i.e. a cumulative decrease of 27.6% in 2008-2010).

The downturn in **industrial output** resulted mainly from a sharp decline in the production of capital goods and consumer durables; at the same time, consumer non-durables and energy showed stronger declines than in 2009 (see Table V.5).[8] It should be noted, however,

7 See *Statistical Annex of European Economy – Autumn 2010*, Table 36.
8 According to data from the Hellenic Transmission System Operator (HTSO/DESMHE), total net electricity generation from the country's interconnected system fell by 3.7% in 2010 (mainly due to poorer output of oil-fired and lignite-fired power plants). A weakening, though at a milder pace (-0.9%), was also observed in total demand for electricity (net demand plus net imports) in the country's interconnected system, as a result of subdued demand by households, commercial and small industrial enterprises (-1.4%). Conversely, high voltage electricity consumption by eligible customers (metallurgical and large industrial enterprises) rose by 5.9%. However, in January-February 2011, both electricity generation and total demand rose slightly (by 0.3% and 0.6%, relative to the corresponding two-month period of 2010).

Table V.6 Other indicators of industrial activity (2009-2011)

(annual percentage changes[1])

	2009	2010	2011 (available period)
1. Industrial turnover index[2]	**-23.1**	**5.6**	**13.9 (Jan.)**
Domestic market	-22.1	-3.1	5.0 (»)
External market	-25.6	28.7	39.3 (»)
2. Industrial new orders index[3]	**-27.7**	**3.9**	**9.1 (»)**
Domestic market	-23.0	-12.6	-6.6 (»)
External market	-34.4	29.6	32.7 (»)
3. Index of business expectations in industry	**-21.5**	**5.1**	**6.3 (Jan.-March)**
4. Industrial capacity utilisation rate	**70.5**	**68.5**	**68.3 (» »)**
5. Purchasing Managers' Index (PMI)[4]	**45.3**	**43.8**	**45.4 (March)**

Sources: ELSTAT (industrial turnover and new orders), IOBE (expectations, industrial capacity utilisation rate), Markit Economics and Hellenic Purchasing Institute (PMI).
1 Except for the industrial capacity utilisation rate, which is measured in percentages, and the PMI index.
2 The index refers to the sales of industrial goods and services in value terms.
3 The index reflects developments in demand for industrial goods in value terms.
4 Seasonally adjusted index; values over 50 indicate expansion.

that business expectations in industry improved considerably against 2009, while orders (at current prices) from the external market grew at double-digit rates in 2010 (see Table V.6 and Chart V.3).

Finally, gross value added of the primary sector rose by 12.3% in 2010 (having increased by 9.3% in 2009 and 10.1% in 2008), on the basis of the ELSTAT national accounts estimates. However, according to the index of real agricultural income per worker compiled by Eurostat, net value added at constant factor prices[9] per full-time worker dropped by 3.5% in 2010 (having increased by 1.6% in 2009, after a 10.9% fall in 2008),[10] possibly reflecting lower subsidies on production. It should be noted that the revision of the Common Agricultural Policy after 2013 is expected to bring about changes (such as cuts in direct aid and subsidies), which would call for a more efficient utilisation of the Greek agricultural sector's comparative advantages and a drastic enhancement of its export orientation.[11]

As the contraction of output outpaced the associated drop in employment, labour productivity (GDP per employee) remained in negative territory (-1.8%) in 2010 for the second consecutive year (2009: -0.9%).

1.2 ACTIVITY PROSPECTS FOR 2011

Available short-term indicators for the first months of 2011 suggest that recession will continue this year. The Bank of Greece projects that GDP will decrease by approximately 3%, although a somewhat larger decline cannot be ruled out. Economic activity is expected to benefit from the ongoing global recovery and the implementation of policies geared towards the targets of the Economic Adjustment Programme. According to the first responses of business firms to a survey conducted by the Bank of Greece, the overall sentiment could be reversed by adopting a time-bound action plan for growth, pushing ahead with the privatisation agenda, attracting foreign investment and supporting market liquidity. Moreover, firms stress

9 Calculated as gross value added net of depreciated capital and production taxes plus subsidies.
10 "Indicator A", revised estimates published on the Eurostat website on 28.3.2011.
11 The initiatives of the Greek Ministry of Rural Development and Food (inter alia for the so-called "basket of products") relate to a series of regionally planned measures aimed at promoting local agricultural goods by also utilising manufacturing and export industries.

the importance of institutional changes in the labour market as key to a reversal of the climate.

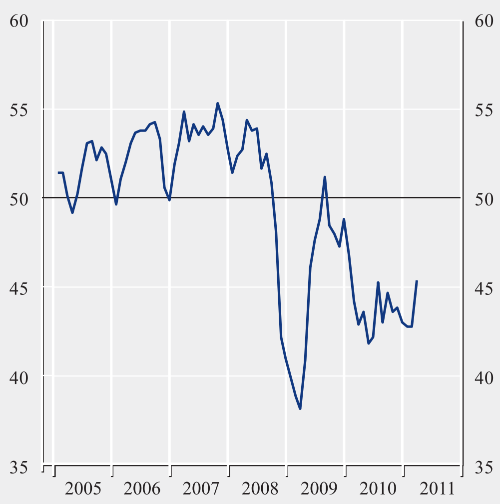
As evidenced by recent short-term indicators of economic activity (industrial output, new passenger car registrations, bank credit), the economic downturn has yet to come full circle. However, the Purchasing Managers' Index (PMI) in manufacturing, although still implying a drop in production, stood in March 2011 at its highest level since January 2010 (see Chart V.4). Furthermore, external demand is giving positive signs: the recovery of exports of goods is expected to continue, supported by the economy's improved competitiveness. The outlook for tourism receipts is also positive, especially after the reduction in VAT on accommodation services and the recent turmoil in North African countries (which, until recently, constituted competitive tourist destinations – see also Chapter VIII). Further encouraging indications are provided by the economic sentiment indicator, which edged slightly up in the first quarter of 2011 (standing on average at 78.0, compared with 74.5 in the last quarter of 2010 – see Chart V.1), as well as by the fact that the very low consumer confidence indicator seems to have bottomed out after its all-time low in December 2010.

For 2011, the major source of uncertainty is the evolution of investment. The new growth-boosting measures (development law, Entrepreneurship Fund, new financing tools) have not been effectively put to use yet, and their success will also depend on banks' ability to provide liquidity. Reforms that are currently implemented are essential to restoring business and household confidence and strengthening investment (see Section 1.3 below).

Over the medium term, the economic outlook will hinge upon an improvement of both individual and total factor productivity. The size of the effort required is indicated by the fact that higher unemployment and reduced investment have caused the annual potential growth rate to decline from almost 3.5% in 2000-2008, to 0.5%, or even less, in 2010.

Chart V.4 Purchasing Managers' Index (PMI) in manufacturing (January 2005 - March 2011)

(seasonally adjusted; values over 50 indicate expansion)



Sources: Markit Economics and Hellenic Purchasing Institute.

Looking further ahead, a transition into a new, sustainable growth model would imply a further shrinking of consumption and its share in GDP in favour of saving (see also Chapter II).[12]

1.3 POLICY OPTIONS OF ZERO OR LOW FISCAL COST, WHICH CAN FAVOUR RECOVERY

Restoring confidence in the Greek economy relies on creating conditions that foster sustainable growth. Infrastructure that enhances the economy's productive capacity and the establishment of an environment that encourages healthy and innovative business activity would help in this direction. Of particular importance are reforms to remove bureaucratic obstacles to business activity, strengthen competition in product markets and enhance flexibility in the labour market. Furthermore, in the current circumstances of fiscal retrenchment and tight credit supply, other financing tools have a more prominent role to play.

12 As private consumption declined in 2010 at the same rate as GDP, its share in total output (at constant prices) remained unchanged.

Speeding up the implementation of NSRF, implementing the new development law, thus avoiding mistakes that were made with earlier laws aimed at fostering investment, the operation of the General Commercial Registry, opening-up closed professions and creating healthy competition conditions are some of the measures to this direction.

1.3.1 SPEEDING UP NSRF IMPLEMENTATION

The National Strategic Reference Framework (NSRF) provides **a very useful tool for achieving economic recovery at low fiscal cost**. Between 2007 and 2013, Greece stands to receive EU funds of €24.3 billion (at current prices of each year of the period) to finance the implementation of the NSRF (including €3.9 billion for rural development). In the first three years of NSRF implementation, disbursements were low due to delays —also observed in other European countries— which were partly associated with the new, stricter management and control framework.

As discussed in more detail in Chapter VIII.3, the efficient utilisation of the NSRF is among the priorities of the Economic Adjustment Programme, and specific targets have been set for the absorption of EU funds. At end-2010, the rate of absorption exceeded 18% of available EU funding for 2007-2013, while a rate of over 35% is targeted by end-2011. At the same time, action has been taken to enhance the efficiency of the regulatory and organisational framework for the implementation of the NSRF.

According to the current orientations, funds available under the Public Investment Programme are channelled by priority to projects co-financed by EU funds. It is obvious that EU financing becomes increasingly important, as fiscal tightening has put pressure on national resources.[13] In 2011, 73% of the Public Investment Programme will be co-financed by EU funds, thus saving national resources, while part of the national share can be financed through loans from the European Investment Bank.[14]

The absorption and optimal use of EU resources to promote growth are facilitated by: Law 3840 (March 2010), which aims at decentralising, streamlining and enhancing the efficiency of NSRF procedures; the activation of an earlier law on public private partnerships (PPP); new investment legislation (Law 3908/2011); the utilisation of the JEREMIE and JESSICA initiatives; the operation of the National Hellenic Fund for Entrepreneurship and Growth (ETEAN); devolution to the regional level, and other regulatory and organisational reforms. In addition, the absorption of community funds will be facilitated by EU legislation for the management of Structural Funds, adopted in June 2010.[15]

The revision of the NSRF, which is currently under way, places emphasis on the need to change the country's growth model geared towards a greener economy, balanced regional development, and well-functioning and efficient public administration.[16] As regards balanced regional development, particular importance has been attached to formulating a new regional strategy. This will entail the preparation of Regional Development Pacts, i.e. specific action plans based on the comparative advantages and natural, human and financial resources available in each region. The content of the pacts will be based on proposals submitted by Regional Governors regarding: investment plans promoting regional cohesion, outward-looking business networks, institutional measures to improve local entrepreneurship, education and training programmes.[17]

13 Compared to 2010, projects financed by national resources are reduced by €500 million in 2011 (see Introductory Report on the 2011 Budget, p.68, and European Commission, *The Economic Adjustment Programme for Greece – Second review – Autumn 2010*, European Economy, Occasional Papers, No. 72, December 2010, p. 42).
14 See Chapter VIII.3, footnote 23.
15 Regulation (EU) No 539/2010 of the European Parliament and of the Council of 16 June 2010 amending Council Regulation (EC) No 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund as regards simplification of certain requirements and as regards certain provisions relating to financial management.
16 Statement by the Greek Minister of Regional Development and Competitiveness following a meeting with the Commissioner for Regional Policy, 16 February 2011.
17 Press Release by the Greek Ministry of Regional Development and Competitiveness, 25 January 2011.

Another factor that is expected to play a significant role in speeding up absorption of NSRF funds is the launch of the new operational programme "National Contingency Reserve".[18] This programme, co-financed by the European Social Fund with a total budget of €211.7 million, aims at supporting employment and social cohesion in areas affected by unforeseen local or sectoral crises linked to economic and social restructuring, including cases of restructuring as a result of natural disasters or the opening-up of global trade. The above actions create favourable conditions for tackling persisting regional development deficits.

As stressed in earlier reports, the NSRF represents the last occasion that *amounts of this size* will be transferred to Greece from EU structural funds. Greece should therefore use these resources as efficiently as possible. The European Commission will review all expenditure under the Community Budget in the context of negotiations about the 2014-2020 financial perspectives in the context the Europe 2020 strategy.[19]

1.3.2 IMPLEMENTING THE DEVELOPMENT LAW AND USING NEW FINANCING TOOLS

Law 3908/2011, passed on 20 January, provides for more tax allowances and loan facilities than direct financing of business investment. Support to fixed capital formation may not exceed 40% of total eligible expenditure, thereby limiting the scope for overinvoicing. Businesses eligible for support are required to submit business plans and may receive support up to a percentage of their total budget. Percentages vary according to firm size, location, type of activity and age of the entrepreneur, within a ceiling of 50% of the total budget.

The investment law provides for defined annual budgets and clear time schedules (applications are to be submitted twice a year). Project evaluation and selection criteria will be measurable and objective, depending on the solvency and experience of the investor, viability and profitability of the investment plan, its contribution to regional development, and the innovative character of the investment.

The distorted business-support framework that prevailed during the previous decades (targeted to small, not export-oriented or innovative businesses) indicates a need for a shift of focus towards a better evaluation and monitoring of investment projects. As the activation of Law 3908 was due in April, the deadline for the submission of the first investment plans was extended.

Law 3912/2011 established the Hellenic Fund for Entrepreneurship and Growth (ETEAN), which introduces various "smart" financial products to fill a gap in the Greek market (e.g. revolving loans, co-investment, hybrid finance to SMEs, start-up financing through business angels), and also provide information and consultancy to businesses.

1.3.3 OPENING UP CLOSED PROFESSIONS

Although considerable legislative measures for the opening-up of closed professions have been taken, in many cases administrative decisions for their actual implementation have not been issued yet. Once completed, this liberalisation can lead to lower prices, enhanced competitiveness and stronger activity. Using inflow-outflow tables, the IMF estimates that a 10% reduction in the cost of professional services can lower the general level of prices by 0.5%.[20]

1.3.4 FACILITATING ENTREPRENEURSHIP

The General Commercial Registry (GCR), launched in early April, was a prerequisite for

18 Press Release by the Greek Ministry of Regional Development and Competitiveness, 22 December 2010.

19 See the European Commission's announcement, "Europe 2020, a strategy for a smart, sustainable and inclusive growth", COM (2010)2020 final, 3.3.2010, and the "Conclusions of the European Council", EUCO 13/10, Brussels, 17.6.2010.

20 IMF, *Greece: Third Review under the Stand-By Arrangement – Staff Report*, March 2011, p.18-19 .

the activation of one-stop shop procedures for starting up a business (as specified in Law 3853/2010) and is expected to act as a catalyst in facilitating business activity.

1.3.5 ENSURING EFFECTIVE COMPETITION

Ensuring conditions of effective competition will lead to higher business productivity and encourage innovation and export-orientation. In this respect, a draft law on the protection of competition was due to be passed in mid-April. The objective of this new law is to upgrade the institutional framework of the Hellenic Competition Commission (HCC) and enhance its independence (among other things, by a longer term of office for all members of the HCC's Board, stricter rules to avoid conflict of interest and accountability). With a view to increasing the effectiveness of the HCC, the law enhances its ability to set strategic goals, prioritise important cases, and undertake intervention in order to remove regulatory obstacles.

Furthermore, the updated Memorandum includes the Greek government's commitment to take measures for the liberalisation of the retail trade and tourism sectors; all relevant proposals will be announced by end-April. As regards retail trade, restrictions that distort competition and lead to higher prices are expected to be lifted, while any market regulations causing market distortions will be abolished or simplified.

For the reforms in the labour market, see Box VI.1.

2 THE REAL ESTATE MARKET: DEVELOPMENTS AND PROSPECTS

2.1 RESIDENTIAL PROPERTY PRICES

Since early 2009, residential property prices in Greece have been showing negative rates of change. Based on data collected by the Bank of Greece from credit institutions,[21] prices for all apartments (in nominal terms) are estimated to have fallen in 2010 at an average annual rate of 4.0% (by -1.8%, -4.7%, -4.1% and -5.7% year-on-year in the first, second, third and fourth quarter, respectively), compared with a decrease of 3.7% in 2009. During the first period of the current crisis and up to the first quarter of 2010, the decline in prices was stronger for old apartments (over 5 years) than for new apartments (up to 5 years) (2009: old -4.8%; new -2.0%). This seems to reflect the relatively higher resilience initially displayed by the prices of newly-builts available for sale by construction firms. However, the prices of new apartments may have remained resilient through the first quarter of 2010, but have been falling at a faster pace thereafter (-5.3%, -5.0% and -8.1% in the second, third and fourth quarter of 2010, respectively) than the prices of old apartments (-4.3%, -3.4% and -4.0% in the second, third and fourth quarter, respectively).

A breakdown by geographical area shows that the decrease in apartment prices in 2010 as a whole was more pronounced in Thessaloniki (average annual change: -6.9%) as well as in the other semi-urban or rural areas of Greece (-4.8%), where secondary residences or holiday homes are located, compared with Athens (-2.8%) and other large cities (-4.5%, see Table V.7).

The relative resilience of Greek house prices may be associated with specific features of the Greek housing market, such as the very high rate of owner-occupancy (well above 80%), low residential mobility and real estate resale frequency, the high costs of transactions, the limited number of transactions relative to the

21 Detailed data on appraisals of residential property compiled since early 2009 by the Real Estate Market Analysis Section of the Bank of Greece pursuant to the Bank of Greece Governor's Act 2610/31.10.2008 on "Reporting by credit institutions of data on residential property which is financed or used as collateral for loans granted by credit institutions". Among other things, these data include credit institutions' appraisals on the current market value of residential property, as well as information on qualitative characteristics. The number of appraisals already reported to the Bank of Greece (until end-March 2011) reached around 528.000 (68.6% concerns apartments, 19% houses, 5.5% maisonettes, 5.1% building plots, 1.8% other types of property).

Table V.7 Summary table of key short-term indicators for the real estate market

Indicators	Average annual percentage changes						
	2005	2006	2007	2008	2009	2010	2011
1. Indices of prices of dwellings (BoG) and rents (ELSTAT)							
1.1 Indices of apartment prices (new series)							
a. All apartments (Greece)	-	-	5.9	1.7	-3.7	-4.0	...
a1 By age							
a. New (up to 5 years old)	-	-	7.2	2.3	-2.0	-4.4	...
b. Old (over 5 years)	-	-	5.2	1.3	-4.8	-3.8	...
a2 By geographical area: Total							
a. Athens	-	-	6.2	0.9	-4.6	-2.8	...
b. Thessaloniki	-	-	7.0	1.5	-6.0	-6.9	...
c. Other cities	-	-	6.3	1.8	-2.7	-4.5	...
d. Other areas	-	-	4.6	3.3	-1.9	-4.8	...
a2.1 By geographical area: New (up to 5 years)							
a. Athens	-	-	9.6	0.0	-3.5	-2.9	...
b. Thessaloniki	-	-	3.7	3.5	-5.3	-7.1	...
c. Other cities	-	-	7.8	2.4	-2.1	-4.4	...
d. Other areas	-	-	4.1	5.4	1.0	-5.7	...
a2.2 By geographical area: Old (over 5 years)							
a. Athens	-	-	4.5	1.4	-5.2	-2.8	...
b. Thessaloniki	-	-	8.4	0.6	-6.3	-6.8	...
c. Other cities	-	-	5.3	1.4	-3.2	-4.6	...
d. Other areas	-	-	5.0	1.4	-4.4	-4.0	...
1.2 Indices of prices of dwellings (historical series)							
a. Urban areas	10.9	12.4	5.1	1.7	-4.3	-3.9	...
a1. Athens	8.6	11.7	6.2	0.9	-4.6	-2.8	...
b1. Other urban areas[1]	13.4	13.0	3.8	2.6	-2.9	-6.0	...
1.3 Price index of rents	4.2	4.4	4.5	3.9	3.6	2.4	1.6 (2 months)
1.4 House price-to-rent ratio (2007=100)[2]	90.9	98.7	100.0	97.9	91.0	85.2	...
2. Indices of residential property transactions							
2.1 Indices of residential property transactions with MFI intermediation (BoG)[3]							
a. Number of transactions	-	-	36.8	-21.7	-35.7	-1.0	...
b. Volume of transactions (in square metres)	-	-	36.6	-23.5	-38.9	-0.8	...
c. Value of transactions	-	-	41.1	-20.0	-40.0	-6.9	...
2.2 Indices of contracts of real estate transactions signed in the presence of a lawyer: Athens (DSA)							
a. Number of contracts	-	-22.3	1.4	-10.0	-18.0	-16.3	...
b. Value of contracts	-	-2.9	12.5	-2.3	-28.3	-20.8	...
2.3 Number of notarial acts of real estate transactions[4] (ELSTAT)							
a. Greece, total	29.6	-19.6	-3.0	-5.8	-13.9	...	...
b. Athens	49.5	-22.0	-8.2	-9.2	-14.0	...	...
2.4 Number of real estate transactions[4] (Ktimatologio SA)							
a. Greece, total	-	-	-	-	-16.3	-9.8	...
b. Athens	-	-	-	-	-15.2	-12.5	...
2.5 Number of properties sold[4] (Ktimatologio SA)							
a. Greece, total	-	-	-	-	-14.0	-13.0	...
b. Athens	-	-	-	-	-8.0	-19.2	...

Sources: BoG: Bank of Greece, ELSTAT: Hellenic Statistical Authority, DSA: Athens Bar Association, TEE: Technical Chamber of Greece, IOBE: Foundation for Economic & Industrial Research, Ktimatologio SA (Hellenic Cadastre).
1 Data collected by Bank of Greece branches, mainly from real estate agencies.
2 In absolute terms.
3 The indices of residential property transactions are based on appraisal reports by banks' engineers regarding the value and qualitative characteristics of the residential properties underlying loan agreements. It cannot be excluded that part of such appraisals are not connected with transactions in residential property, but concern a renegotiation of existing loans, registration of a mortgage to back non-housing loans, debt transfers from one bank to another, etc.
4 Including all real estate categories of residential and commercial properties (dwellings, general stores, offices, building plots, rural plots of land, etc.).

Table V.7 Summary table of key short-term indicators for the real estate market *(continued)*

Indicators	Average annual percentage changes						
	2005	2006	2007	2008	2009	2010	2011
3. Construction cost indices of (new) residential buildings (ELSTAT)							
3.1 Total cost	3.4	4.3	4.6	5.1	-0.3	1.8	...
3.2 Price index of work categories	2.6	2.9	2.8	4.2	-0.2	0.3	...
3.3 Labour cost	3.1	2.6	2.4	3.3	0.3	0.0	...
3.4 Material cost	3.6	5.6	6.3	6.4	-0.7	3.0	4.0 (2 months)
4. Private building activity (ELSTAT)							
4.1 Greece, total							
a. Number of building permits	22.0	-14.9	-7.2	-17.6	-16.1	-10.9	...
b. Floor space (in square metres)	43.0	-23.9	-7.8	-19.0	-24.4	-19.8	...
c. Volume (in cubic metres)	36.9	-19.2	-5.8	-17.3	-26.5	-23.7	...
4.2 Athens							
a. Number of building permits	35.9	-15.3	-13.8	-28.7	-15.3	-13.8	...
b. Floor space (in square metres)	58.2	-24.6	-14.0	-26.1	-18.6	-33.6	...
c. Volume (in cubic metres)	51.9	-20.6	-13.3	-25.2	-19.4	-35.5	...
5. Construction activity							
5.1 Cement production volume (ELSTAT)	2.4	3.1	-9.2	-3.1	-21.4	-14.3	-8.1 (Jan./Jan.)
5.2 Public investment programme disbursements (BoG)	-21.0	8.9	7.6	9.3	-2.8	-11.3	-41.4 (3 months)
5.3 Production indices in construction (ELSTAT)							
a. General index	-38.8	3.7	14.3	7.8	-17.5	-31.6	...
b. Building construction	-15.3	-9.9	6.7	-0.5	-24.1	-38.1	...
c. Civil engineering construction	-49.9	18.3	20.5	13.8	-13.4	-28.0	...
5.4 Civil engineer fees (TCG)							
a. Total fees	-	-5.3	23.5	6.2	-16.2	-2.1	4.7 (2 months)
b. Building permit issuance fees	-	-8.4	19.0	11.0	-14.5	1.6	31.0 (2 months)
c. Construction supervision fees	-	1.5	32.5	-2.4	-19.6	-10.0	-47.6 (2 months)
6. Business expectations (IOBE)							
6.1 Business confidence in the construction sector (private activity)	-22.7	44.6	1.5	3.0	-31.4	-27.4	-40.9 (3 months)
a. Total private construction	-11.7	12.8	1.9	-8.4	-43.2	9.3	-28.7 (3 months)
b. Residential	-3.2	-9.0	27.6	-14.0	-28.4	-32.4	-47.2 (3 months)
c. Non-residential	-12.5	2.9	13.4	0.9	-46.8	20.2	-25.2 (3 months)
d. Public works	-30.2	68.4	0.8	9.5	-24.6	-41.0	-47.4 (3 months)
6.2 Months of assured production in construction[2]							
a. Total construction	13.9	15.7	16.8	17.3	15.9	12.9	13.9 (March)
b. Residential	11.3	14.7	15.4	11.7	11.0	8.3	5.2 (March)
c. Non-residential	8.7	9.3	10.1	9.8	8.4	7.8	5.8 (March)
d. Public works	15.9	18.4	19.5	21.1	19.8	15.2	17.7 (March)
6.3 Activity relative to previous quarter[5]							
a. Total construction	-27.3	11.8	10.2	10.0	-16.1	-39.0	-69.1 (March)
b. Residential	-2.0	24.0	-11.0	-22.0	-30.7	-58.1	-74.2 (March)
c. Non-residential	-13.5	13.2	16.4	25.6	-28.8	-27.9	-64.1 (March)
d. Public works	-35.9	9.0	11.3	8.1	-8.2	-41.0	-70.4 (March)
6.4 Planned future activity[5]							
a. Total construction	-57.8	-44.9	-33.2	-28.8	-42.8	-63.2	-82.9 (March)
b. Residential	-40.6	-22.3	-22.1	-38.9	-52.3	-84.6	-94.7 (March)
c. Non-residential	-41.9	-45.6	-30.3	-22.7	-56.3	-45.5	-62.7 (March)
d. Public works	-65.9	-49.9	-36.5	-30.0	-36.5	-67.6	-88.9 (March)
6.5 Prospects of employment over the next 3-4 months[5]							
a. Total construction	-22.1	18.7	9.6	10.4	-32.1	-46.4	-67.0 (March)
b. Residential	4.3	31.0	1.5	-32.6	-60.9	-60.3	-73.4 (March)
c. Non-residential	-1.7	6.6	12.8	6.9	-45.8	-36.7	-32.5 (March)
d. Public works	-32.4	21.0	9.0	18.8	-21.2	-48.3	-78.6 (March)

Sources: BoG: Bank of Greece, ELSTAT: Hellenic Statistical Authority, DSA: Athens Bar Association, TEE: Technical Chamber of Greece, IOBE: Foundation for Economic & Industrial Research, Ktimatologio SA (Hellenic Cadastre).
2 In absolute terms.
5 Weighted percentage balances of positive and negative answers.

Table V.7 Summary table of key short-term indicators for the real estate market *(continued)*

Indicators	Average annual percentage changes						
	2005	2006	2007	2008	2009	2010	2011
7. Investment in construction (ELSTAT) and capital inflows (BoG)							
7.1 Investment in construction[6]							
a. Total construction	-7.8	16.4	-4.1	-18.9	-12.3	-12.5	...
b. Residential construction	-0.5	29.8	-8.6	-29.1	-21.7	-18.6	...
7.2 Investment in construction as a percentage of GDP[2,6]							
a. Total construction	11.8	13.0	12.0	9.6	8.6	7.9	...
b. Residential construction	7.4	9.2	8.1	5.7	4.5	3.8	...
7.3 Net capital inflows from abroad for the purchase of real estate property in Greece	48.0	55.4	66.5	-58.2	-24.4	-35.4	-64.2 (Jan./Jan.)
8. Domestic MFI credit to households (BoG)[7]							
8.1 Total (stock)	31.0	25.7	22.4	12.8	3.1	-1.3	-1.6 (Feb.)
8.2 Housing loans (stock)	33.0	26.3	21.9	11.5	3.7	-0.4	-1.1 (Feb.)
9. Housing loan rates (BoG)[2]							
9.1 Interest rates on new housing loans[8]	4.3	4.7	4.9	5.3	4.1	3.8	4.5 (Feb.)
9.2 Interest rates on outstanding housing loans with an initial maturity of over 5 years	4.8	4.9	5.1	5.1	4.3	3.7	3.7 (Feb.)
10. Financial stress indicators							
10.1 Non-performing loan ratio (BoG)[2]							
a. Total loans	6.3	5.4	4.5	5.0	7.7	10.4	...
b. Housing loans	3.6	3.4	3.6	5.3	7.4	10.0	...
c. Corporate loans	7.1	6.0	4.6	4.3	6.7	8.7	...
d. Consumer loans	7.8	6.9	6.0	8.2	13.4	20.5	...
10.2 Credit to households as a percentage of GDP[2, 7]							
a. Total loans	35.4	40.6	45.9	49.5	50.9	51.3	...
b. Housing loans	23.3	27.0	30.5	32.8	34.3	34.9	...

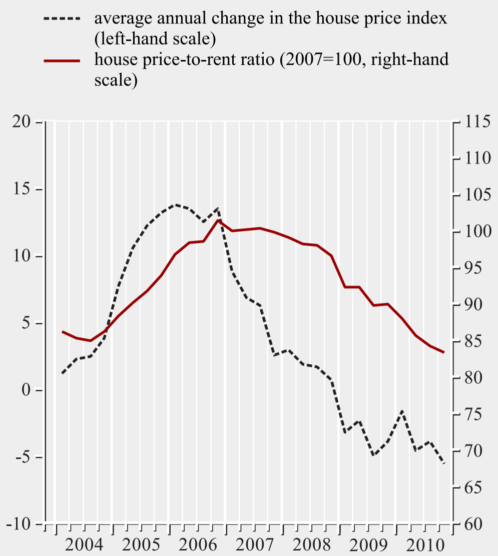
Sources: BoG: Bank of Greece, ELSTAT: Hellenic Statistical Authority, DSA: Athens Bar Association, TEE: Technical Chamber of Greece, IOBE: Foundation for Economic & Industrial Research, Ktimatologio SA (Hellenic Cadastre).
2 In absolute terms.
6 At constant prices.
7 End-of-period balances. Comprising loans and securitised loans.
8 Including non-interest charges (handling fees, mortgage registration fees, etc.).

available stock, etc.),[22] as well as to increased uncertainty and lack of investment alternatives amid the current crisis.[23] On the other hand, the total construction cost of new buildings and mainly material cost were rising faster than inflation in 2004-2008 (average annual change in total cost: 4.1%; in material cost: 5.1%). Despite the recession, residential construction costs still remained high in 2010 (total cost rose by 1.8%; materials by 3.0%), thus hindering any further decline in residential property prices.

Despite this stickiness, there does not seem to be major overvaluation in the Greek real estate market, also considering that the house price-to-rent ratio has been declining over the past three years (see Chart V.5).[24] The house price-to-rent ratio is expected to keep falling at a moderate pace in the following quarters, as a

22 For a comparison of the characteristics of housing markets in OECD countries, see "Housing markets and structural policies in OECD countries", OECD Economic Department, Working Paper No 836, January 2011.
23 The relative resilience of prices in the Greek housing market may also be associated with the social attitudes of Greek households, which see houses as means of intergenerational transfer (by parental donation or inheritance) rather than investment instruments. It also reflects the structure of the construction industry – and mainly residential construction – which is dominated by a large number of small, family businesses, with a limited entrepreneurial scope or experience. Given their high profitability in the decade prior to the crisis, when the real estate market was buoyant, these businesses did not have to resort to increased bank borrowing, which also partly explains their current resilience.
24 The house price-to-rent ratio is typically used in combination with other indicators (e.g. interest rates, return on alternative types of investment, cyclical position) to determine whether there might be a bubble in current real estate prices.

Chart V.5 House price-to-rent ratio



Source: Bank of Greece.

result of a further decline in house prices and the persistence of a positive, albeit slightly lower, rate of change in the price index of rents (annual rate of change: 3.6% in 2009, 2.4% in 2010, and 1.6% in the first two months of 2011, see Table V.7).

2.2 DEMAND FOR HOUSE PURCHASES

Demand for house purchases is characterised by relative cautiousness in the current juncture.[25] It is estimated that the cautionary stance of households is mainly associated with increased uncertainty about employment and future incomes, which has been exacerbated in the last few months by soaring unemployment, as well as by uncertainty regarding the overall economic outlook and the remedy of fiscal and structural problems. Furthermore, households' expectations of lower house prices in the future could have made them postpone a purchase decision.

Moreover, banks are more cautious and have tightened credit standards for new housing loans, on account of the crisis, which is estimated to have also contributed to a weakening of household demand for house purchase.[26] Likewise, the slight increase in the interest rates on new housing loans since March 2010 and their emerging upward trends in the next few months might have further discouraged households from purchasing a house. It should also be noted that, during the crisis, households' interest has shifted towards smaller, older and, above all, less costly houses.[27] Finally, the relative shortage in bank lending has led to an increase in the share of transactions paid for in cash, as well as in the share of cash in the total financing of real estate purchases.

2.3 REAL ESTATE SUPPLY AND NUMBER OF TRANSACTIONS

In the past two years the Greek real estate market has been marked by excess supply and a considerable stock of unused (unsold) property. On the supply side, the excess stock that had accumulated by end-2008 is estimated to have remained roughly unchanged in 2009-2010, because of the relative cautiousness on the demand side. The slowdown in private construction activity over the past two years (see Chart V.6) was broadly in line with a corresponding drop in the number of real estate transactions. Indeed, the number of new building permits fell by 16.1% in 2009 and 10.9% in 2010, while the total number of notarial acts for real estate transactions dropped by 13.9% in 2009, for which data are available.[28] A sim-

25 According to a survey by the Athens University of Economics and Business, which was presented in "Property 2011: 4th International Exhibition and Conference on Real Estate" organised by HELEXPO (18-21 March 2011), 79.3% of the respondents stated that they were unlikely to buy a house within the next two years, 13.9% that they might or might not make a purchase, 4.1% that they were most likely to buy, and only 2.2% reported that they would definitely purchase a house.

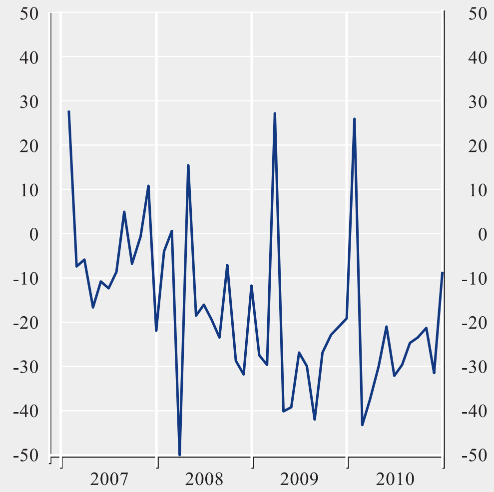
26 Weakened demand is also evident in declining growth rates of housing loans, especially in the wake of the recent financial crisis. More specifically, despite lower interest rates on housing loans since November 2008, the annual rate of change in the outstanding balance of bank loans to households for house purchases was -0.4% at end-2010 (February 2011: -1.1%), i.e. down from 3.7% at end-2009 and 11.5% at end-2008.

27 This is evidenced by the quarterly survey on the country's major real estate agencies conducted by the Real Estate Market Analysis Section of the Bank of Greece. See http://www.bankofgreece.gr/BoGDocuments/TE_EREVNA_KTIMATOMESITON.pdf.

28 Specifically, based on ELSTAT data collected from notaries nationwide, the number of notarial acts for real estate transactions fell from 167,700 in 2007 to 158,000 in 2008 and 136,000 in 2009.

Chart V.6 Volume of new buildings and extensions on the basis of permits issued (January 2007 - December 2010)

(percentage change over same month of previous year)



Source: ELSTAT.

ilar decline was observed in the number of real estate transactions, on the basis of contracts recorded in the Hellenic National Cadastre by “Ktimatologio S.A.” (down by 16.3% in 2009 and 9.8% in 2010) and real estate transaction contracts signed in the presence of a lawyer according to the Athens Bar Association (-18.0% and -16.3%, respectively) for the area of Athens.

It should also be noted that private building activity in terms of floor space and volume, as well as the value of real property transferred in the past two years, decreased at considerably higher rates than the number of new building permits and of real estate transactions. This development is in line with the previous observation regarding a shift towards smaller, more affordable houses (see Table V.7).[29]

2.4 COMMERCIAL PROPERTY MARKET

The above developments in the residential property market also concern —more or less— the commercial property market (offices, stores, industrial buildings, storage spaces, etc.). In more detail, subdued demand by enterprises coupled with a shift towards less expensive commercial property, a considerable supply of mostly old property, lower prices and lending shortage have been the main features of the commercial property market in the past few years. In addition, an increase in vacant stores and offices, a sharp decline in rents with the elimination of the component corresponding to the intangible value of the property (goodwill) and a renegotiation of leasing contracts mainly in the secondary or regional markets are observed. Finally, cautiousness is also evident in the development of new investment plans, despite a considerable increase in the total floor space occupied by large shopping malls and department stores mainly in the Attica region over the past two years.

2.5 EXPECTATIONS AND PROSPECTS

There is no doubt that the negative medium-term expectations for the real estate market and the Greek economy in general strongly affect the Greek real estate market’s ability to recover. IOBE’s business confidence indicator for construction dropped by 40.9% in the first quarter of 2011, compared with -27.4% in 2010 and -31.4% in 2009. In March 2011, business expectations in construction stood at particularly negative levels, in terms of activity relative to the previous quarter, planned future activity and prospects for employment over the next 3-4 months (weighted percentage balances of positive and negative answers: -69, -83 and -67, respectively).

In the upcoming quarters, a further slight correction is expected in real property prices, while it is estimated that emerging conditions may keep any risks of price shocks at bay. It should be noted, however, that the recovery of the real estate market is now directly linked with the improvement of household and busi-

29 Similar observations are also made based on the number, total square metres and value of residential property transactions with MFI intermediation in 2009-2010 (data collected from credit institutions). In this period, the average annual rate of decline in the number of transactions was 18.4%, while that in square metres reached 19.9% and 23.5% in terms of total value.

ness expectations, the easing of uncertainty and the availability of bank credit, as well as with the overall prospects of tackling Greece's economic problems. A clear message on the ability to effectively address Greece's fiscal and structural problems is expected, among other things, to contribute to a rapid unfreezing of the Greek real estate market.

VI LABOUR MARKET DEVELOPMENTS AND PROSPECTS

According to ELSTAT Labour Force Survey (LFS) data, the average number of employed persons fell by 120 thousand or 2.7% in 2010 compared with 2009. Increasingly sharp **declines** were seen **in the course of the year** (Q1: 60.2 thousand or -1.3%, Q2: 104.9 thousand or -2.3%, Q3: 137.2 thousand or -3.0%, Q4: 177.8 thousand or -4.0% year-on-year), reflecting the prolonged recession (see Chart VI.1).

The number of employed persons in the last quarter of 2010 was 5.6% lower than in the last quarter of 2008, when economic activity began to decline.

The fall in employment (see Chart VI.1) reflected a decrease in the number of employees (annual average change: -3.0%, annual rate in the fourth quarter: -4.3%), as well as the exit of non-employees (self-employed with or without personnel, and contributing family workers) from the labour force (annual average change: -2.0%, annual rate in the fourth quarter: -3.3%).

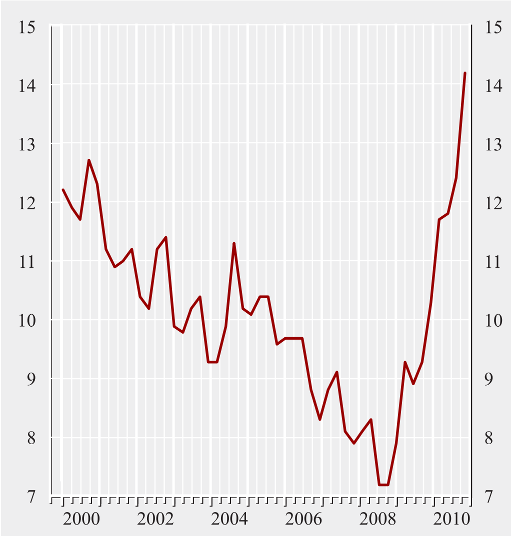
Chart VI.1 Employment (1999-2010)

(percentage changes year-on-year)

Source: ELSTAT, Labour Force Survey.
Note: New revised data for 1998-2003, published in January 2005. No changes are shown for 2004, as data are not fully comparable due to a change in the survey sample.
* Other employed persons = self- employed with staff (employers) + self- employed without staff + contributing family workers.

Chart VI.2 Total unemployment rate (1999-2010)

(percentage of labour force)



Source: ELSTAT, Labour Force Survey.

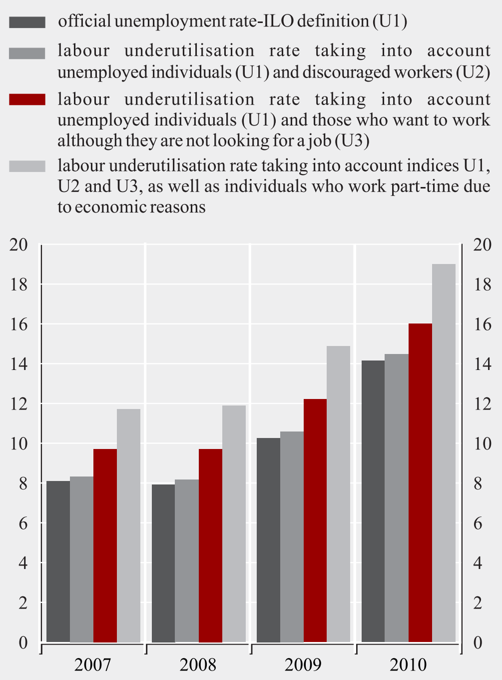
The year-on-year decline in the number of the unemployed by almost 180 thousand in the fourth quarter of 2010 mainly stemmed from **construction** (65.5 thousand), **manufacturing** (45.5 thousand), **accommodation and catering services** (19.1 thousand) and the primary sector (17.4 thousand). **Health services** were virtually the only sector to show some increase in the number of the employed.

In March 2011, firms' assessments about the **short-term prospects** of the number of employees, as reflected in IOBE business surveys (see Chart VI.4), suggested a further decline in employment in construction, manufacturing, and accommodation and catering.[1] As regards the trade sector, although Labour Force Survey data do not point to a further drop in employment for the *last quarter of 2010* (following an annual decline of 3.4% between January and September 2010), the ELSTAT's sectoral survey on retail trade indicates a sharp decrease.[2]

1 Accommodation and catering services are included in the services aggregate shown in Chart VI.4.
2 Indeed, the ELSTAT's sectoral survey on retail trade shows a strong annual rate of decline (-9.9%) in the number of employed persons of all categories in the fourth quarter of 2010.

Chart VI.3 Alternative measures of underemployment (2007 - 2010)

(percentages-Q4 data)



Source: ELSTAT, Labour Force Survey.

Moreover, in March 2011 retail trade firms expected a contraction in employment in the months ahead.

The **number of unemployed persons** increased significantly in 2010, reflecting both the lower number of employed persons and higher participation in the labour force (see Table VI.1).[3] The labour force increased, despite a rise in the number of retirements including early pensioners.[4] Specifically, the number of new job seekers came to around 170.8 thousand in the fourth quarter of 2010, compared with 136 thousand and 137 thousand in the fourth quarter of 2009 and 2008, respectively.

At the end of the first quarter of 2010, the **number of the unemployed** stood at 586.8 thousand, but by the end of the fourth quarter it had reached 712.1 thousand. The unemployment rate came to 14.2% in the fourth quar-

3 More specifically, the labour force participation rate of persons aged 15-64 rose from 67.8% in 2009 to 68.2% in 2010. The increase was stronger for women, from 56.4% to 57.5%.

4 The number of persons reporting in the fourth quarter of 2010 that they had retired during the year, including cases of early retirement, came to 54.2 thousand, up from 35.6 thousand in 2009.

Table VI.1 Population, labour force and employment

	Q2 2010 (thousands of persons)	Annual percentage changes				
		Q2[4]				
		2006	2007	2008	2009	2010
Population aged 15+[1]	9,302	0.5	0.6	0.2	0.3	0.4
Population aged 15-64[1]	7,231	0.3	0.8	0.3	-0.1	0.2
Labour force[1]	5,021	0.6	0.8	0.4	0.7	0.9
Employment[1]	4,427	1.6	1.5	1.4	-1.1	-2.3
– Primary sector[1]	552	-1.7	-2.6	-0.6	2.1	4.2
– Secondary sector[1]	886	-0.2	3.1	1.1	-6.4	-7.4
– Tertiary sector	2,989	2.9	1.7	1.9	0.1	-3.8
Labour force participation rate[2]		67.0	67.0	67.2	67.7	68.3
Employment rate[3]		61.0	61.5	62.2	61.6	60.1
Unemployment as a percentage of the labour force		8.8	8.1	7.2	8.9	11.8

Source: ELSTAT, Labour Force Survey.
1 Second quarter-on-second quarter.
2 Labour force participation rate of population aged 15-64.
3 Employed persons aged 15-64 as a percentage of population aged 15-64.
4 Average annual changes and average year levels are reported in the main text.

ter of 2010, from 10.3% in the corresponding quarter of 2009 (December 2010: 14.8%, December 2009: 10.2%). The rise in the unemployment rate accelerated during the year – from 2.4 percentage points in the first quarter of 2010 to 3.9 percentage points in the fourth quarter.

Job losses and the difficulty to find a job are also evidenced by changes in **the probability of remaining employed or unemployed and the probability of transition from unemployment to employment**. Between the fourth quarter of 2009 and the fourth quarter of 2010, the probability of remaining employed fell from 0.94 to 0.92, the probability of remaining unemployed rose from 0.7 to 0.8 and the probability for an unemployed person to find a job declined from 0.2 to 0.1.

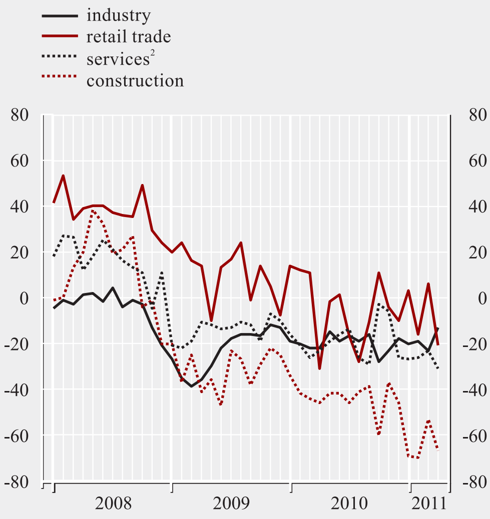
The rise in the overall unemployment rate was accompanied by **changes in the composition of unemployed population** by gender, age, skills, work experience and nationality (see Table VI.2). In particular, while in the 2000-2008 period 60% of the unemployed were female, this share fell close to 50% in 2010.

In addition to the unemployed according to the ILO definition, there are also persons who would like to work but are *not* looking for a job, because they believe they will not find one or for other reasons and those who work part-time because they cannot find a full-time job. Taking both groups into account, the **underemployment rate** comes to 19.0% in the fourth quarter of 2010, from 14.9% in the corresponding period of 2009 (see Chart VI.3).[5]

Against this background, the number of **persons aged 18-59 living in workless households** increased significantly from 8.5% in 2009 to 10.3% in 2010. Moreover, labour income losses led to an increase (from 22.8% in the last quarter of 2009 to 24.1% in the last quarter of 2010) in the percentage of persons aged 18-59 reporting that their main source of subsistence during 2010 was income from other household members or non-household members.

Chart VI.4 Employment expectations[1] (December 2007 - March 2011)

(net percentage balances)



Source: IOBE, Business Surveys.
1 Firms were asked to assess the prospect of an increase in the number of their employees over the coming period.
2 Excluding banks and retail trade.

A source of concern is also the **increase in the share of the long-term unemployed**, i.e. those who remain out of job for more than 12 months, in the total number of the unemployed (2009: 42.8%, 2010: 47.2%). Concerns are caused by the fact that the likelihood of finding a job decreases with the duration of unemployment, and there is a risk that temporary unemployment may turn into structural unemployment. It should be noted that, according to OECD estimates regarding the Greek labour market, a rise in the aggregate unemployment rate by one percentage point would lead to a 0.7 percentage point increase in the "long-term unemployment rate" (i.e. the number of the long-term unemployed as a percentage of the labour force) in three to four years. In the fourth quarter of 2010, the rate of long-term unemployment in Greece was 6.8%.[6] Furthermore, the fact that the long-term

5 In the fourth quarter of 2009, the gap between the two indicators was similar (4.5 percentage points: unemployment rate 10.3%, underemployment rate - broader definition: 14.9%).
6 See Guichard, S. and E. Rusticelli (2010), "Assessing the impact of the financial crisis on structural unemployment in OECD countries", OECD Economics Department Working Paper no. 767.

Table VI.2 Population, labour force, employment and unemployment: Q2

(thousand persons)

	Population					Labour force					Employed persons					Unemployed persons					Unemployment rate				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
Men and women																									
– total (aged 15+)	9,150	9,207	9,230	9,262	9,302	4,880	4,918	4,939	4,974	5,021	4,453	4,520	4,582	4,532	4,427	427	398	357	443	594	8.8	8.1	7.2	8.9	11.8
– 15-64 years	7,152	7,208	7,228	7,220	7,231	4,792	4,827	4,854	4,887	4,940	4,366	4,431	4,497	4,445	4,347	426	397	357	442	593	8.9	8.2	7.3	9.0	12.0
– 15-24 years	1,216	1,172	1,151	1,123	1,103	395	364	349	343	333	298	284	277	259	229	97	80	72	84	105	24.5	22.0	20.6	24.5	31.4
– aged 25+	7,935	8,034	8,079	8,140	8,198	4,485	4,554	4,591	4,632	4,688	4,155	4,236	4,305	4,273	4,199	331	318	285	358	490	7.4	7.0	6.2	7.7	10.4
Men																									
– total (aged 15+)	4,454	4,490	4,503	4,518	4,539	2,887	2,906	2,925	2,915	2,918	2,726	2,762	2,789	2,730	2,645	161	144	137	185	273	5.6	5.0	4.7	6.3	9.4
– 15-64 years	3,567	3,602	3,615	3,613	3,622	2,821	2,841	2,862	2,854	2,862	2,661	2,698	2,726	2,670	2,589	160	143	136	184	272	5.7	5.0	4.8	6.5	9.5
– 15-24 years	611	590	579	564	554	223	203	197	192	186	184	174	167	157	140	38	29	30	34	46	17.3	14.1	15.1	18.0	24.8
– aged 25+	3,842	3,900	3,924	3,954	3,985	2,664	2,703	2,728	2,723	2,732	2,542	2,587	2,622	2,573	2,505	122	115	107	150	227	4.6	4.3	3.9	5.5	8.3
Women																									
– total (aged 15+)	4,696	4,717	4,728	4,744	4,762	1,994	2,012	2,014	2,059	2,103	1,727	1,758	1,794	1,802	1,782	267	254	221	258	321	13.4	12.6	10.9	12.5	15.3
– 15-64 years	3,586	3,605	3,613	3,607	3,608	1,971	1,986	1,991	2,033	2,078	1,705	1,733	1,771	1,776	1,757	266	254	221	258	321	13.5	12.8	11.1	12.7	15.4
– 15-24 years	604	583	572	559	549	172	161	152	151	147	114	109	110	101	89	58	52	42	50	59	33.9	32.1	27.7	32.9	39.7
– aged 25+	4,092	4,134	4,155	4,186	4,213	1,821	1,851	1,862	1,908	1,956	1,613	1,649	1,684	1,700	1,693	208	202	178	208	263	11.4	10.9	9.6	10.9	13.4

Source: ELSTAT, Labour Force Survey.

unemployed are typically low-skilled highlights the importance of government intervention with active employment policies.

According to Manpower Employment Organisation (OAED) data on **wage/salaried employment flows in the private sector**, in 2010 layoffs (including the expiry of fixed-term contracts) and voluntary retirements exceeded recruitment by 96,200 persons, which implies a net decline in salaried jobs (the corresponding decline in 2009 was 86,200, i.e. smaller by 10,000). OAED data show that during 2010 recruitments fell by 44,500, while layoffs (57% of which concerned the expiry of fixed-term contracts) increased by 7,200. Voluntary quits decreased by 41,700, which can be expected in times of crisis; nevertheless, this figure should be interpreted with caution, as quits are not fully recorded. In January-February 2011, 39,600 jobs were lost according to OAED data, i.e. more than double the figure one year earlier (17,600). Overall, OAED data show continuous declines in jobs every month since August 2010, exceeding the corresponding declines twelve months earlier.

Interestingly, **data collected by the Labour Inspectorate**[7] reveal a shift towards more flexible forms of employment. Indeed, in the January-December 2010 period, 66.9% of recruitments concerned full-time employment, 26.2% part-time employment and 6.9% job rotation schemes, while in the February-December 2009 period[8] the respective shares were 79.0%, 16.7% and 4.3%. Moreover, during 2010, 26,253 contracts were converted from full-time into part-time or job rotation schemes (against 16,977 conversions in February-December 2009). In 2010, 71% of these conversions concerned part-time employment, 25% job rotation schemes by mutual agreement between the employer and the employee, and 4% by unilateral decision on the part of the employer.

In **2011**, the **unemployment rate** should continue to rise and may exceed 15%. In fact, if the year-on-year annual rates of change in the labour force and employment recorded in the fourth quarter of 2010 persist throughout 2011 (+0.4% and -4.0%, respectively), the average rate of unemployment could rise to as high as 16.5% in 2011 and 18% in the fourth quarter. This could be averted through the effective implementation of the active employment policies already announced and of the legislation enacted in May, July and December 2010 enabling a more flexible use of labour inputs (see also Box VI.1). As rising unemployment reflects not only the recession, but also the ongoing restructuring of production and employment in the context of the crisis, the available policy options and arrangements must be geared towards increasing labour mobility across sectors and jobs, reducing the duration of unemployment and supporting the income of the unemployed while in search of a job or in retraining.

Firms' response to the crisis regarding employment and recent reforms in labour legislation

As early as April 2009, at the outbreak of the crisis,[9] it was pointed out that amid weakening external and domestic demand, enterprises would seek to increase their competitiveness (by reducing operating costs, prices and profit margins and by improving productivity), in order to expand their shares in a shrinking market and prevent a decline in output. Alternatively, if these efforts did not deliver the necessary results, firms would have to cut output. In either case, an adjustment in employment could be expected.

These expectations came true. As regards the downward adjustment of employment, many Greek firms initially made use of the leeway provided by the Greek labour market legislation, including cutbacks in overtime work, working time arrangements, non-renewal of fixed-term employment contracts on expiry, job rotation schemes, shift from full-time to part-time employment, temporary layoffs and,

7 Labour Inspectorate (SEPE), press release of 1 February 2011.
8 Data collection began in February 2009.
9 See *Annual Report 2008*, Box V.1, p. 74-77.

as a last resort, individual or mass layoffs. If firms resort to layoffs, legislation provides for unemployment benefits. In addition to unemployment benefits (passive employment policies), active labour market policies are also in place, aimed to facilitate the reintegration of the unemployed into the labour market by subsidies on salaries (or employers' social security contributions) for hiring unemployed workers, support of unemployed persons starting a business and training programmes.

In 2010, significant changes were introduced in the legal framework governing the labour market (by Laws 3845 and 3846 in May, 3863 in July and 3899 in December), including the hiring of youth at sub-minimum wages, the *de facto* reduction in layoff compensation, lower premia for overtime work, longer probationary employment periods, making it easier for firms to use part-time employment or job rotation, as well as introducing special firm-level collective agreements and reforming the mediation and arbitration procedures in collective disputes (see Chart VI.1). Furthermore, OAED places an emphasis on targeted active labour market policies (subsidisation of employers' social security contributions as an incentive to hire or retain employees, training programmes, etc.).

Box VI.1

RECENT REFORMS IN LABOUR LEGISLATION: OBJECTIVES AND IMPLEMENTATION

1 THE NEED FOR STRUCTURAL REFORMS IN THE LABOUR MARKET

The need for structural reforms in the Greek labour market is clearly demonstrated by the sluggishness of job creation in the private sector.[1] Factors behind this sluggishness include high recruitment and layoff costs, as well as the fact that wage developments do not properly reflect developments at firm level. This latter mismatch is partly associated with the fact that not all firms are represented in collective bargaining at sector level, whereas sectoral collective agreements are becoming less and less meaningful in an economy characterised by heterogeneity across individual activities and businesses.

Structural reforms in the labour market would lead to substantial productivity and competitiveness gains for the Greek economy, especially if they are accompanied by a comprehensive growth strategy – which would e.g. include an action plan for growth, as well as by structural reforms in product markets etc. (see also Chapter II.6).

2 RECENT LEGISLATIVE CHANGES

Further to the changes legislated in spring and summer 2010,[2] a second wave of labour market reforms was passed by Parliament in December. These recent reforms (Law 3899/2010) complemented previous legislation (Laws 3845, 3846 and 3863) and are aimed to ensure that wage developments better reflect developments at firm level and create conditions fostering job creation. To this end, they focus on three areas:

(i) **Collective bargaining.** Law 3845 overturned the hierarchy of collective agreements as established by Law 1876/1990. Specifically, it repealed the prohibition of Law 1876/1990, whereby agree-

1 For a more extensive discussion of the structural problems of the Greek labour market, see Bank of Greece, Monetary Policy - Interim Report, October 2010, Box IV.1, p.73-76.
2 Laws 3845, 3846 and 3863. Ibid, for a presentation and discussion of the relevant provisions.

ments at occupational, sector and firm level could not envisage less favourable arrangements than those stipulated in the National General Collective Labour Agreement. Nevertheless, some months after the new law was passed, legal circles continued to argue that further clarifications were required as to whether or not this relationship had indeed been overturned.[3]

Later on, Law 3899 explicitly amended Law 1876/1990 and introduced a new type of collective agreement, the "special firm-level collective agreement" (SFLCA), enabling employers and employees to agree on wages and other working conditions that could be less favourable than those stipulated in sectoral agreements, although not less favourable than those stipulated in the National General Collective Labour Agreement. Law 3899 explicitly states that special firm-level agreements take precedence over sectoral agreements. Furthermore, under the new law, SFLCAs may be signed also by firms with less than 50 employees, with the employee side being represented by the firm-level union where available, otherwise by the respective sectoral union or federation. SFLCAs are notified in advance to the Social Inspection Council of the Labour Inspectorate (SICLI) along with an explanation of motives, and SICLI issues a non-binding opinion within 20 days.

Although employers have reportedly shown a keen interest, actual agreements of this type have yet to be signed, with the exception of one in Northern Greece in January. This particular agreement originally provided for a pay cut, but, after SICLI's skeptical stance and adverse publicity at national and —most importantly— local level, it was amended to provide instead for a pay freeze.

In any case, it should be stressed that the lack of wage flexibility takes a toll on jobs, as suggested by the surge in unemployment. Moreover, if wage adjustment cannot be done in an orderly manner, e.g. through SFLCAs, this could potentially lead to the prevalence of informal or disorderly flexibility, which would be the worst-case scenario for employees.

In this respect, it should be noted that Law 3899/2010 did not eliminate the administrative extension of sectoral agreements to firms that were not party to negotiations, although the Memorandum of Understanding stipulated otherwise.[4]

(ii) **Mediation and arbitration procedures.** Although Law 1876/1990 was innovative at the time it was introduced, endeavouring to promote the idea of negotiations, it comes as no surprise that two decades of practice have revealed its deficiencies and weaknesses. One of these weaknesses relates to unions' privileged access to arbitration. Specifically, Law 1876/1990 provided that unilateral recourse to arbitration could take place (i) on the initiative of trade unions, if they accept the proposals of the mediator that the employer had rejected and (ii) regarding in particular firm-level collective agreements and public-utility agreements, on the initiative of the party that accepted the proposal of the mediator that had been rejected by the other party. (As a result, in cases of sectoral or occupational disputes, employers were unable to have recourse to arbitration if employees rejected the proposal put forward by the mediator). Furthermore, all in all, the system of arbi-

3 See e.g. K. Bakopoulos, "Reforms to labour legislation introduced by Law 3845/2010" and S. Goudrololos, "Collective agreements after Law 3845", Labour Legislation Bulletin 1561/2010 (in Greek). Both authors argue that Law 3845 has not altered the regime that was established under the previous law, since it does not directly repeal the relevant provisions.

4 According to legal circles (see, for instance, Picoulas I. "Reflections about whether or not it is possible after the adoption of Article 13 of Law 3899/2010 to declare sector collective agreements generally mandatory", Labour Legislation Bulletin 1575/2011), it remains unclear whether the new law has established that sector-level collective agreements may not be extended to cover non-signatory parties. However, during the discussion of the law in question in Parliament, the Minister of Labour and Social Insurance assured that the ministerial right to extend sector collective agreements had not been affected.

tration seems to have effectively favoured employees, since there have been several decisions in favour of employees that were not adequately justified.[5]

While Law 3863 provided for a Presidential Decree to be issued until the end of 2010 to address these weaknesses, the changes required were ultimately enacted in Law 3899/2010. As far as changes to the system of arbitration access are concerned, there is now an explicit reference to the principles of good judgement, objectivity and impartiality, all three of which should guide the decisions of the Organisation for Mediation and Arbitration (OMED), whereas employers, too, can submit sectoral and occupational disputes to arbitration. Moreover, arbitration is now limited to basic pay disputes, whereas the representative of the Ministry of Labour and Social Insurance participates as an observer with no voting right in the meetings of the OMED Board.[6] These amendments represent a clear improvement on the previous arbitration system, but are far from generally eliminating any mandatory elements that hamper negotiations from the institution.

(iii) **Increasing labour market flexibility.** The probationary period for the newly-employed has been extended to one year (previously 2 months) by virtue of Law 3899. In the same vein, the maximum possible period of employment under temporary working agencies before a fixed-term contract is converted into an open-ended contract/indefinite-term contract is extended from 18 months to 36 months (in the case of continuous employment) and from 6 months to 9 months (for occasional employment). Moreover, with a view to encouraging part-time employment, the 7.5% premium to the hourly remuneration of part-time workers working less than four hours a day (established under Law 2874/2000), as well as the 10% premium for part-time workers working overtime (established under Law 3846/2010), have been abolished.

5 See, in this respect, the positions expressed by the National Confederation of Hellenic Commerce (ESEE) on a draft Presidential Decree on OMED sent in early October 2010 by the Minister of Labour and Social Insurance to social partners for consultation. Available at http://www.esee.gr/page.asp?id=3233

6 The number of the OMED Board members has also been reduced to 9 (down from 11) and their term of office to 3 years (from 4 years).

VII INFLATION, WAGES AND BUSINESS PROFITS: DEVELOPMENTS AND PROSPECTS – INCOME INEQUALITY AND POVERTY

1 OVERVIEW OF DEVELOPMENTS IN 2010 AND PROSPECTS FOR 2011

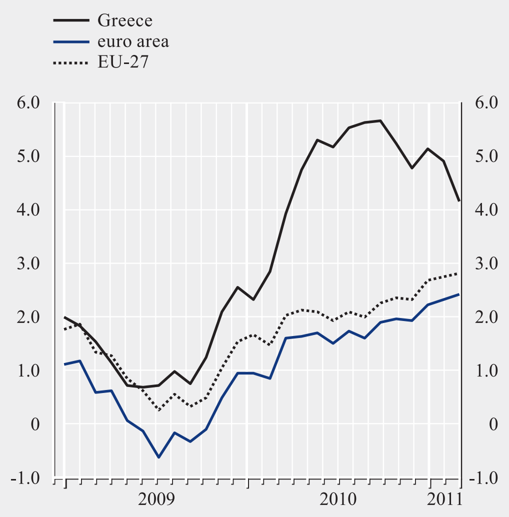
In 2010, despite declining demand and lower unit labour costs, inflation picked up, mostly reflecting the strong increases in indirect taxes and the surge in oil prices. The annual rate of increase in the Harmonised Index of Consumer Prices (HICP) rose sharply from 2.3% in January 2010 to 5.7% in September (see Chart VII.1), the highest level seen since August 1997, before declining slightly to 5.2% by December. Core inflation (which excludes energy and unprocessed food prices) also rose to high levels, from 1.4% in January 2010 to 3.9% in August, falling thereafter to 3.0% by December (see Chart VII.2). For 2010 as a whole, the average annual rate of HICP inflation reached 4.7%, from 1.3% in 2009, while core inflation averaged 3.0%, up from 2.2% in 2009 (see Table VII.1).

In the course of 2011, the impact of higher indirect taxes on the annual rate of increase in prices is expected to gradually fade out, while the continued decrease both in demand and in unit labour costs, mainly in the business sector, will have a strong disinflationary effect. A dampening effect on inflation should also arise from increased competition in the goods and services markets as the implementation of structural reforms progresses. Thus, according to recently revised projections, the average annual rate of HICP inflation should decline significantly, despite the continued increase in oil prices; yet, it is likely to exceed 2.5% and could even approach 3¼%. Average core inflation is expected to be much lower than headline inflation, at a level below 1.5%.

It should be recalled that average annual inflation in the euro area rose to 1.6% in 2010 from 0.3% in 2009, while in 2011 it is anticipated to be between 2.0% and 2.6% according to ECB staff macroeconomic projections (see Tables VII.2, VII.3 and VII.4, as well as Chart VII.3). Therefore, the **inflation differential** between Greece and the euro area, after a temporary widening in 2010, is expected to fall in 2011 below the 2001-2009 average. In terms of core inflation, the euro area figure averaged 1.0% in 2010, down from 1.3% in 2009.

Chart VII.1 Harmonised index of consumer prices in Greece, the euro area and the European Union (January 2009 - February 2011)

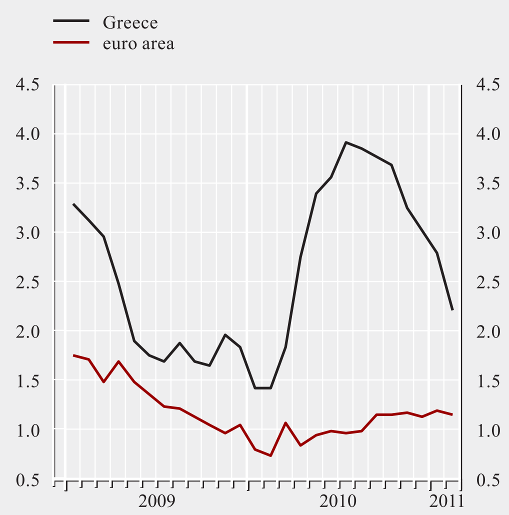
(year-on-year percentage changes)



Sources: ELSTAT and Eurostat.

Chart VII.2 Core inflation in Greece and the euro area on the basis of the HICP excluding energy and unprocessed food prices (January 2009 - February 2011)

(year-on-year percentage changes)



Sources: ELSTAT and Eurostat.

Table VII.1 Price 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	Interme-diate goods	Consumer goods	General index	General index	General index excl. energy
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	7.3	6.5	7.3	6.2	4.8	4.2	2.7
2007	2.9	2.5	3.5	2.9	3.0	3.2	5.6	1.3	4.1	2.7	6.1	-0.3	3.0	2.6	3.0
2008	4.2	4.3	3.9	3.4	3.0	5.4	4.6	14.7	10.0	6.4	8.4	4.5	6.4	7.1	2.5
2009	1.2	-0.5	3.6	2.4	2.6	1.9	5.3	-15.7	-5.8	-0.1	-1.2	0.9	-6.0	-1.8	0.5
2010	4.7	5.6	3.6	3.0	3.4	0.1	-4.3	36.2	6.1	0.9	2.3	-0.3	8.8	6.6	1.4
2007 Q1	2.7	2.1	3.4	3.2	3.3	3.1	4.9	-4.9	1.5	1.9	6.4	-1.7	0.4	-0.7	3.4
Q2	2.6	1.9	3.6	2.9	3.1	2.0	2.9	-1.5	2.7	1.9	5.8	-1.5	2.1	0.9	3.2
Q3	2.7	2.0	3.6	2.8	3.0	3.3	11.8	-3.1	3.4	2.3	5.7	-0.7	2.5	3.0	3.0
Q4	3.6	3.9	3.2	2.8	2.5	4.5	3.7	15.8	8.9	4.7	6.6	2.9	7.1	7.4	2.6
2008 Q1	4.3	5.0	3.3	2.9	2.3	6.1	7.1	24.0	11.5	6.9	9.3	4.9	8.5	8.1	2.5
Q2	4.8	5.6	3.6	3.6	3.0	6.4	5.3	21.5	13.5	7.2	9.4	5.3	10.0	10.1	2.3
Q3	4.7	5.1	4.2	3.7	3.2	4.5	-3.1	22.9	14.2	7.2	9.7	4.9	9.8	10.1	2.8
Q4	2.9	1.7	4.5	3.5	3.4	4.5	8.9	-7.4	1.3	4.2	5.4	3.0	-2.4	0.4	2.3
2009 Q1	1.5	-0.5	4.3	3.2	3.3	3.6	8.2	-22.6	-5.2	1.1	0.5	1.5	-7.8	-2.4	1.4
Q2	0.7	-1.5	3.7	2.3	2.5	2.7	11.0	-23.0	-8.8	-0.7	-2.2	0.5	-9.5	-4.4	0.5
Q3	0.7	-1.2	3.3	2.1	2.3	2.1	8.3	-18.5	-9.1	-1.0	-2.9	0.8	-8.2	-3.7	-0.2
Q4	2.0	1.0	3.2	2.0	2.4	-0.7	-5.8	4.8	0.4	0.4	0.1	0.7	2.0	3.7	0.1
2010 Q1	3.0	2.8	3.3	1.7	2.1	-1.7	-9.4	33.0	6.4	1.1	1.5	0.8	9.4	8.3	0.8
Q2	5.2	6.2	3.8	3.3	3.8	-0.9	-9.3	42.9	7.5	1.1	2.3	0.0	10.2	8.0	1.4
Q3	5.5	6.7	4.0	3.7	4.1	1.4	1.2	35.3	4.9	0.6	2.3	-0.9	7.5	5.2	1.4
Q4	5.1	6.6	3.1	3.3	3.6	1.6	2.1	33.5	5.6	1.0	3.2	-0.9	8.3	5.1	1.9

Source: ELSTAT.

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

(annual percentage changes)

	2009	2010	2010 May	2010 June	2010 July	2010 Aug.	2010 Sept.	2010 Oct.	2010 Nov.	2010 Dec.	2011 Jan.	2011 Feb.
A. Euro area												
Harmonised Index of Consumer Prices (HICP) and its components												
Overall index	**0.3**	**1.6**	**1.7**	**1.5**	**1.7**	**1.6**	**1.9**	**1.9**	**1.9**	**2.2**	**2.3**	**2.4**
Goods	-0.9	1.8	2.0	1.6	2.0	1.7	2.2	2.4	2.3	2.9	2.9	3.0
Food	0.7	1.1	0.8	0.9	1.3	1.6	1.5	1.6	1.8	2.1	1.9	2.3
Processed food[1]	1.1	0.9	0.9	0.9	0.9	1.0	1.0	1.2	1.3	1.5	1.8	2.0
Unprocessed food	0.2	1.3	0.7	1.1	2.1	2.5	2.3	2.3	2.6	3.2	2.2	2.7
Industrial goods	-1.7	2.2	2.6	2.0	2.3	1.7	2.6	2.7	2.6	3.2	3.4	3.4
Non-energy industrial goods	0.6	0.5	0.5	0.6	0.4	0.3	0.9	0.8	0.9	0.7	0.5	0.1
Energy	-8.1	7.4	9.2	6.2	8.1	6.1	7.7	8.5	7.9	11.0	12.0	13.1
Services	2.0	1.4	1.3	1.3	1.4	1.4	1.4	1.4	1.3	1.3	1.5	1.6
Industrial producer prices	*-5.1*	*2.9*	*3.1*	*3.1*	*4.0*	*3.6*	*4.3*	*4.3*	*4.5*	*5.4*	*5.9*	*6.6*
B. Greece												
Harmonised Index of Consumer Prices (HICP) and its components												
Overall index	**1.3**	**4.7**	**5.3**	**5.2**	**5.5**	**5.6**	**5.7**	**5.2**	**4.8**	**5.2**	**4.9**	**4.2**
Goods	-0.1	5.9	6.9	6.7	6.8	7.1	7.4	6.8	6.4	7.4	6.6	5.1
Food	2.5	3.1	2.6	3.3	4.0	5.7	5.4	5.0	4.9	5.5	5.9	5.9
Processed food[1]	1.6	5.0	5.8	6.6	7.0	7.0	6.8	6.8	6.9	7.1	8.0	8.0
Unprocessed food	3.9	0.2	-2.4	-2.0	-0.7	3.6	3.1	2.3	1.7	2.8	2.7	2.6
Industrial goods	-1.7	7.7	9.7	8.8	8.6	8.0	8.7	8.0	7.3	8.6	7.1	4.6
Non-energy industrial goods	0.8	1.9	2.7	2.6	2.6	2.6	3.1	3.1	2.3	2.3	0.4	-1.9
Energy	-12.1	30.4	38.0	33.1	31.8	28.5	30.5	26.5	26.2	32.6	31.0	25.9
Services	3.2	3.1	3.1	3.2	3.8	3.6	3.3	3.1	2.7	2.2	2.6	2.9
Industrial producer prices	*-5.8*	*6.1*	*7.3*	*6.1*	*5.5*	*4.0*	*5.3*	*4.4*	*5.4*	*6.9*	*6.8*	*8.0*

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

Table VII.3 Harmonised index of consumer prices: Greece and the EU (2009-2011)

(annual percentage changes)

Country	2009 (year average)	February 2010	2010 (year average)	February 2011
Austria	0.4	0.9	1.7	3.1
Belgium	0.0	0.8	2.3	3.5
Bulgaria	2.5	1.7	3.0	4.6
Cyprus	0.2	2.8	2.6	3.1
Czech Republic	0.6	0.4	1.2	1.9
Denmark	1.1	1.8	2.2	2.6
Estonia	0.2	-0.3	2.7	5.5
Finland	1.6	1.3	1.7	3.5
France	0.1	1.4	1.7	1.8
Germany	0.2	0.5	1.2	2.2
Greece	**1.3**	**2.9**	**4.7**	**4.2**
Hungary	4.0	5.6	4.7	4.2
Ireland	-1.7	-2.4	-1.6	0.9
Italy	0.8	1.1	1.6	2.1
Latvia	3.3	-4.3	-1.2	3.8
Lithuania	4.2	-0.6	1.2	3.0
Luxembourg	0.0	2.3	2.8	3.9
Malta	1.8	0.7	2.0	2.7
Netherlands	1.0	0.3	0.9	2.0
Poland	4.0	3.4	2.7	3.3
Portugal	-0.9	0.2	1.4	3.5
Romania	5.6	4.5	6.1	7.6
Slovakia	0.9	-0.2	0.7	3.5
Slovenia	0.9	1.6	2.1	2.0
Spain	-0.2	0.4	2.0	3.4
Sweden	1.9	2.8	1.9	1.2
United Kingdom	2.2	3.0	3.3	4.4
European Union - 27	1.0	1.5	2.1	2.8
Euro area	**0.3**	**0.8**	**1.6**	**2.4**

Source: Eurostat.

Table VII.4 Contributions to the inflation differential between Greece and the euro area (2005-2010)

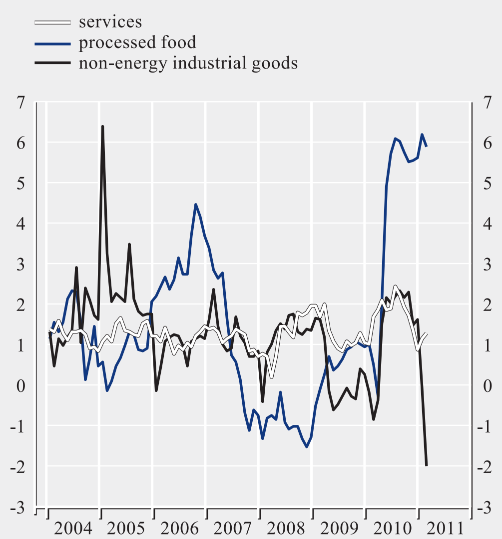
(percentage points)

	2005	2006	2007	2008	2009	2010
HICP inflation differential	**1.3**	**1.1**	**0.9**	**1.0**	**1.1**	**3.1**
Contributions:						
Core inflation	1.40	1.15	1.00	0.77	0.91	1.60
of which						
Services	0.51	0.43	0.50	0.56	0.64	0.71
Processed food	0.10	0.44	0.13	-0.14	0.14	0.52
Non-energy industrial goods	0.79	0.28	0.35	0.35	0.13	0.37
Unprocessed food	-0.30	-0.12	-0.06	0.03	0.39	-0.12
Energy	0.20	0.11	-0.03	0.24	-0.25	1.66

Source: Calculations based on Eurostat and ECB data.

Chart VII.3 Annual inflation differentials between Greece and the euro area (2004 - 2011)

(selected price indicators; differentials in percentage points)



Source: Calculations based on Eurostat and ECB data.

2 KEY DETERMINANTS OF INFLATION

The strong **increase in indirect taxes** was the key driver of the rise in inflation in **2010**, even though it was not fully passed on to consumer prices, as firms absorbed part of the increase by reducing their profit margins in response to subdued demand. The increases in VAT, however, are estimated to have been passed on to consumer prices by a percentage that increased from about 50% in March 2010 to about 90% in December, and by an estimated 65% in average annual terms in 2010.[1] This average would have been even lower, in the context of falling demand due to the economic crisis, if competition in the domestic market had worked more effectively. According to revised estimates, the contribution of higher indirect taxes to the annual rate of HICP inflation peaked in August 2010 (4.6 percentage points out of an overall inflation rate of 5.6%). For 2010 as a whole, the average annual level of this contribution reached 3.3 percentage points (out of an overall inflation rate of 4.7%). Factoring in the contribution of administered prices, the total contribution of tax increases came to 3.7 percentage points on average in 2010 (or 78% of inflation). In terms of core inflation, the average annual contribution of indirect tax increases reached 2.0 percentage points (average core inflation: 3.0%), while when taking into account the increases in administered prices, the total average contribution reached 2.35 percentage points (or 79% of core inflation). For **2011**, the contribution of higher indirect taxes to average annual inflation is expected to drop dramatically after February and, according to some estimates, could average as low as 0.9 percentage points, while the contribution of increases in administered prices should drop to 0.3 percentage points.

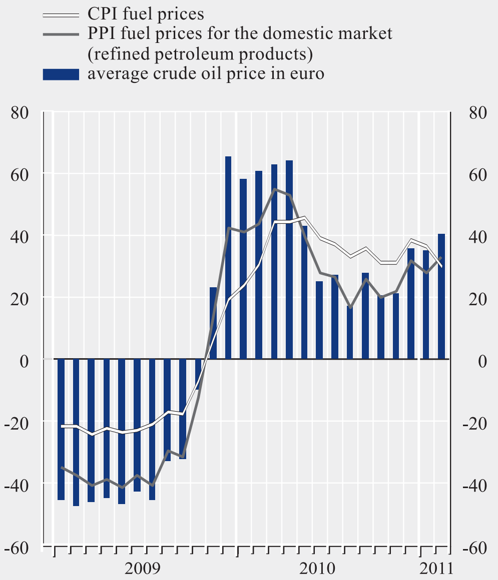
It is worth noting that core inflation, at 3.0% in December 2010, would in fact have come to only 0.3% *without the impact of indirect taxes and it is estimated that it was negative in January and February 2011* (-0.2% and -0.8%, respectively). This reflects a reversal of demand- and labour cost-side pressures on prices and supports the forecast of a moderation in HICP inflation this year, as mentioned above. The question however arises as to whether there might be a risk of deflation. The answer is a definite no, given the external price pressures anticipated, initially, from the rising prices of oil, food and other commodities (owing to structural as well as cyclical factors – see Chapter III.1.3) as well as the upward trend of prices in countries from which Greece imports manufactured products and, later on, due to a gradual recovery of domestic economic activity.

The **increase in the price of crude oil** in the global market, which, expressed as an annual average, reached 36.1% in euro terms in **2010**, compared with a decrease of 32.3% in 2009 (UK Brent – see also Charts VII.4 and VII.5), is expected to continue in **2011** at a faster pace. According to the latest IMF projections, the

1 In the case of fuels, the increase in special consumption tax and VAT rates was almost entirely passed on to consumers, while VAT increases were fully passed through to main utility rates.

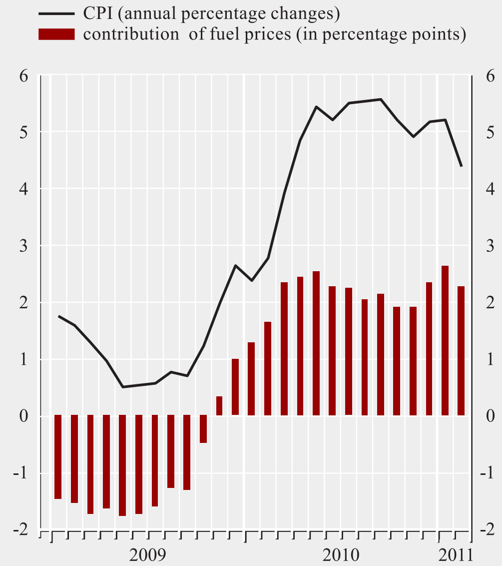
Chart VII.4 Evolution of CPI/PPI fuel prices and of the Brent crude oil price (in euro) (January 2009 - February 2011)

(percentage changes over same month of previous year)



Source: Calculations based on ELSTAT data and, for crude oil prices (UK Brent), on ECB data.

Chart VII.5 Contribution of fuel prices to inflation (January 2009 - February 2011)



Source: Calculations based on ELSTAT data.

price of oil in US dollars (average for three types of crude oil) should rise by 35.6% this year, compared with 27.9% in 2010.[2] Another, though less important, factor behind the surge in inflation in 2010 was the **recovery in the prices of non-energy industrial imports** (see Chart VII.6),[3] which are expected to remain on a steep upward path in **2011**.[4] In euro terms this recovery also partly reflected developments in the average annual effective **exchange rate of the euro**, as calculated in respect of the currencies of Greece's trading partners, which had depreciated by 2.8% in 2010.

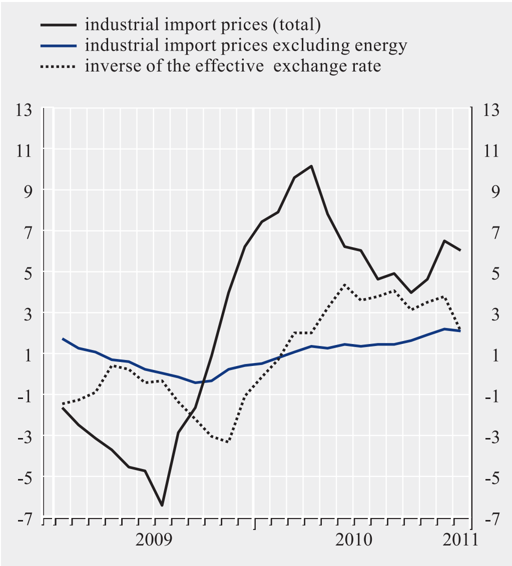
By contrast, a dampening effect on inflation in **2010** came from **subdued demand**, which was also reflected in lower profit margins. Indeed, profit margins declined, as implied by available data on the 2010 annual results for 193 Athex-listed non-financial firms[5] pointing to falls of 16.0% in gross profits and of 66.4% in net pre-tax profits, relative to 2009. Sales may have grown at the same time by 6.3% in nominal terms, but this stemmed solely from the higher sales of two refineries (up by about 30%). Excluding these two refineries, the remaining 191 firms in the sample reported a drop of 3.4% in sales and a much stronger fall in profits (gross profits: -20.0%, net pre-tax profits: -81.1%), implying a narrowing of some 3.5 percentage points in the gross profit margin.

A decelerating effect on inflation in **2010** also came from the estimated fall in **unit labour costs** by 3.0% in total economy (after an increase of 5.4% in 2009) and by 1.8% in the business sector (2009: +3.4%). At the total economy level, this development reflected a decline of 5.0% in nominal average gross earnings, compared with an increase of 4.6% in

2 See IMF, World Economic Outlook, April 2011.
3 The prices of non-energy industrial goods imports increased by 2.2% in December 2010, compared with 0.5% in December 2009. In January 2011 the annual rate was 2.1%.
4 In US dollars, the IMF projects an increase of 25.1% this year, compared with 26.3% in 2010.
5 Both the Public Power Corporation (DEH) and the Hellenic Telecommunications Organisation (OTE) are not part of the sample. Also excluded, as an outlier, was a large chemicals/plastics company, given the huge net losses it posted in 2010.

Chart VII.6 Industrial import price index and the inverse of the effective exchange rate of the euro, weighted on the basis of Greece's external trade (January 2009 - January 2011)

(percentage changes over same month of previous year)



Sources: ELSTAT and Bank of Greece.

2009 (see Table VII.5). Compensation per employee[6] fell by 4.5%, while productivity (GDP per employee) fell by 1.5%. In 2011, unit labour costs are expected to continue to decrease, though at the somewhat more moderate pace of about 2% in total economy but more strongly (by about 2¾%) in the business sector. In total economy, nominal average gross earnings are projected to fall by 2.7% in 2011, or 5-5¾% in real terms (see Table VII.5). It is worth noting that, in the euro area, unit labour costs for the total economy fell by 0.7% in 2010, while they are expected to rise in 2011 by 0.6% (see Table VII.6), implying that 2010 marked the start of a reversal of past competitiveness losses. According to Bank of Greece estimates, between 2001 and 2009 Greece's international competitiveness vis-à-vis 28 trading partners fell by a cumulative 19% on the basis of relative consumer prices and by some 28% on the basis of the relative unit labour costs. In 2010, however, the CPI-based competitiveness index improved slightly by 0.5%, (despite high inflation and exclusively due to the depreciation of the effective exchange rate of the euro), while the ULC-based index (taking into account developments in the effective exchange rate of the euro with regard to non-euro area trading partners) is estimated to have improved markedly, by some 6% for the total economy and 5% for the business sector (see Table VIII.2, Chapter VIII).

The above estimates of unit labour costs take into account: (a) the provisions of Laws 3833/2010 and 3845/2010 on the freeze of minimum wages and the cut in allowances to civil servants and employees of the broader public sector; (b) similar provisions of Law 3847/2010 on civil servants' pensions; (c) the three-year National Collective Labour Agreement signed on 15 July 2010 and Article 51 of Law 3871/2010;[7] (d) the provisions of Article 74 of Law 3863/2010;[8] and (e) the provisions of Law 3899/2010.[9] As estimated, in 2010 these measures led to decreases of 9.5% in the average gross earnings of civil servants, 7.3% in average central government pensions and 5.5% in the average earnings of employees in public utilities. In 2010, the decrease in gross (pre-tax) earnings in real terms was about 13.5% for civil servants and 9.3% for the whole economy, suggesting that the purchasing power of earnings in 2010 fell below the 2003 level for civil servants and below the 2006 level for the economy as a whole.

6 Including employer social security contributions and government expenditure on pensions.

7 The National General Collective Labour Agreement provided for zero increases in minimum earnings during 2010, and for the next two years inflation-linked increases as follows: as of 1 July 2011 in line on the basis of average annual inflation in the euro area for 2010 (i.e. 1.6%) and as of 1 July 2012 on the basis of average annual inflation in the euro area for 2011 (projected at about 2.3%). As a result, the average annual rise in minimum earnings stood at 1.7% in 2010 (solely due to the carryover effect from the 2009 increases), while the average annual rise will be about 0.9% in 2011 and 2.0% in 2012. Moreover, Article 51 of Law 3871/2010 states that until the end of 2012 any wage increases following appeals to the Organisation for Mediation and Arbitration cannot deviate from the percentage increases laid down in the National General Collective Labour Agreement.

8 These provisions refer to cuts in layoff compensation, the hiring of youth at sub-minimum wages and lower premia for overtime work.

9 These concern wage cuts in public enterprises and organisations and in the Agricultural Bank of Greece (ATE) in 2011, as well as new rules on mediation, arbitration and increased flexibility in collective bargaining, inter alia through the introduction of special firm-level collective agreements.

Table VII.5 Earnings and labour costs (2004-2011)

(annual percentage changes)

	2004	2005	2006	2007	2008	2009	2010 (estim.)	2011 (forecasts)
Greece								
Average gross earnings (nominal):								
– whole economy	7.2	4.4	5.7	5.2	6.2	4.6	-5.0	-2.7
– central government[1]	9.7	2.3	3.1	3.8	7.1	5.2	-9.5	-3.0
– public utilities	9.9	7.6	7.0	7.1	8.2	7.7	-5.5	-6.2
– banks	8.0	1.5[2]	10.8	8.9	0.0	3.7	-1.8	-3.3
– non-bank private sector	5.8	5.6	6.8	6.1	6.5	2.8	-2.9	-1.7
Minimum earnings	**4.8**	**4.9**	**6.2**	**5.4**	**6.2**	**5.7**	**1.7**	**0.9**
Average gross earnings (real)	**4.2**	**0.9**	**2.4**	**2.2**	**1.9**	**3.3**	**-9.3**	**-5.0 to -5.8**
Total compensation of employees	**8.9**	**5.8**	**7.8**	**8.2**	**8.5**	**3.2**	**-7.3**	**-5.1**
Compensation per employee	**7.6**	**3.9**	**5.9**	**5.6**	**6.8**	**4.9**	**-4.5**	**-2.2**
Unit labour costs[3]								
– whole economy	4.3	3.4	3.2	3.8	7.4	5.4	-3.0	-2.0
– business sector[4]	3.0	3.8	3.8	4.5	6.7	3.4	-1.8	-2.7

Sources: ELSTAT (GDP 2004-2010), Bank of Greece estimates/forecasts (for the 2011 GDP and the other annual aggregates in 2004-2011).
1 Outlays for salaries per employee.
2 The relatively low growth rate of bank employees' average earnings mainly reflects changes in staff structure.
3 ULC calculations based on revised GDP data (March 2011).
4 The business sector includes private and public enterprises and banks.

Table VII.6 Average earnings and unit labour costs in total economy: Greece and the euro area (2001-2011)

(annual percentage changes)

	Average earnings		Unit labour costs	
Year	**Greece**	**Euro area**	**Greece**	**Euro area**
2001	4.7	2.8	3.9	2.4
2002	6.6	2.7	5.5	2.5
2003	5.6	2.9	2.3	2.2
2004	7.2	2.6	4.3	1.0
2005	4.4	2.2	3.4	1.3
2006	5.7	2.5	3.2	1.1
2007	5.2	2.6	3.8	1.5
2008	6.2	3.3	7.1	3.6
2009	4.6	1.8	5.6	4.0
2010	-5.0	1.5	-3.0	-0.7
2011 (forecast)	-2.7	1.8	-2.0	0.6

Sources: For Greece, Bank of Greece estimates. For the euro area: European Commission, *Economic Forecasts, Autumn 2010*; ECB, *Monthly Bulletin*.

It should also be pointed out that the estimates of the changes in the earnings of private sector employees in 2010 take into account that, although average annual *contractual* earnings increased —solely as a result of the carryover effect from the 2009 increases— by 1.7% in the non-bank private sector and by 1.9% in banks, *actual* earnings dropped. In particular, according to rough estimates, in the non-bank private sector 40-50% of employees experienced wage cuts in the order of 10%, while the newly introduced option of hiring youth at sub-minimum wages and the cuts in overtime pay (see also Chapter VI) may have contributed to a fall in labour costs per employee by 0.5% – ultimately leading to a drop of 2.9% in *average actual* earnings. Besides, as suggested by the financial results of major domestic banks and of the Bank of Greece for 2010, staff costs were reduced by 4.6%, while average annual employment dropped by 2.9%, thereby causing compensation per employee to decrease by 1.8%.

3 INCOME INEQUALITY, POVERTY AND KEY INDICATORS OF LIVING CONDITIONS IN GREECE

On the basis of the latest official data,[10] 19.7% of the population of Greece or 840,000 households with their members (2,147,000 people in total) live below the *relative* at-risk-poverty threshold (based on 2008 incomes).[11] Greece has the highest at-risk-of-poverty rate in the EU-15 (based on data from the EU-SILC 2009 survey, the average at-risk-of-poverty rate in the EU-15 was 16.1%) and one of the highest in the EU-27 (EU-27 average: 16.3%).[12] Greece's ranking is also roughly the same in terms of the relative at-risk-of-poverty gap, which measures the difference between the median income of those at-risk-of poverty and the at-risk-of poverty threshold, as a percentage of the income at-risk-of poverty threshold (Greece: 24.1%, the second widest gap in the EU-15 behind Spain; EU-15: 21.7%, EU-27: 22.4%).

Greece has a similar ranking in terms of inequality: its Gini coefficient, at 33.1, is the highest among the EU-15 (30.3) with the exception of Portugal (35.4), and higher than in most countries of the EU-27 (30.4). In addition, as measured by the S80/S20 ratio, the total income of the richest 20% of the population was 5.8 times higher than that of the poorest 20%. The respective ratio for the EU-15 and the EU-27 was 4.9.[13]

These relative at-risk-of-poverty and inequality indicators, calculated using the same methodology, have shown remarkable stability over the past fifteen years or more, both in Greece and in the EU as a whole,[14] in spite of the focus of EU policies on strengthening social cohesion and the recognised need to reduce, by 2010, the number of people at risk of poverty and social exclusion. It is of particular significance in the case of Greece that the increase in social expenditure (as a percentage of GDP) over the last fifteen years has not been accompanied by a drop in inequality and poverty, as the redistributive effect of social transfers proved lower than in the rest of the EU due to Greece's over-fragmented welfare state. Indeed, the poverty reduction achieved in Greece via total social expenditure came to only 22.3 percentage points (with 19.3 achieved through pensions and only 3.0 achieved through social transfers), compared

10 Data from the Survey on Income and Living Conditions of Households (EU-SILC) 2009, as announced by the Hellenic Statistical Authority (ELSTAT, press release of 9 December 2010) and published by Eurostat (Statistics Database). The EU-SILC is the main reference source for comparative statistics on income distribution, the risk of poverty and social inclusion in EU countries.

11 According to the concept of relative poverty, a person is considered poor when his/her income is not sufficient to ensure a standard of living compatible with the habits and standards of the given society he/she lives in. This approach implies that the poverty line changes with the average standard of living of the population, while under the concept of absolute poverty it remains stable over time in terms of purchasing power. In the 2009 survey, the relative poverty threshold was set at €6,897 for a single-member household and at €14,484 for a four-member household with two adults and two children.

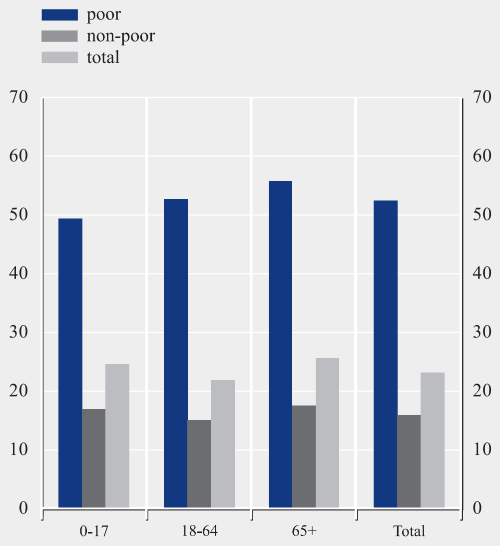
12 According to the 2009 survey, among the 12 new EU Member States (EU-12), at-risk-of-poverty rates higher than Greece's were recorded in Latvia (25.7%), Romania (22.4%), Bulgaria (21.8%) and Lithuania (20.6%). The EU-12 average was 17.1%.

13 See Bank of Greece, Monetary Policy 2010-2011, Table IV.7 p. 53, February 2011.

14 It should be recalled that during this period Greece saw a mass inflow of economic migrants. Although the migrant population was found to have poverty rates more than twice as high as those of Greek households, and this across all of the different dimensions of poverty, the poverty rates for the entire population remained stable.

Chart VII.7 Percentage of population with an enforced lack of at least three out of nine material deprivation items in the economic strain and durables dimension

(%)



Sources: ELSTAT and EU-SILC 2009.

with an EU average of 26.0 percentage points (with 17.2 attributable to pensions and 8.8 to social transfers). It should however be noted that the effectiveness of social expenditure in Greece has improved considerably in the last few years (from 16.6 in 2005 to 19.3 in 2009).

Despite the stability of relative at-risk-of-poverty rate in Greece, in absolute terms the standard of living and the living conditions of the population, especially the poor, have improved over time.[15] In the ten years leading up to the current crisis, this improvement came almost exclusively from Greece's strong growth performance and probably did not translate into significantly lower inequality in income distribution. An analysis of living condition measures shows that material deprivation and difficulties in meeting basic needs can be found not only among the poor, but also among part of the non-poor population.[16] More specifically, 52.5% of the poor and an estimated 15.7% of the non-poor experienced three or more of the total nine aspects of material deprivation listed in the EU-SILC 2009.[17] Material deprivation was found to be highest among the elderly (65 years plus), for whom the above rates were 55.7% and 17.3% respectively, while for children up to 17 years the respective rates, though lower, were still quite high (49.2% and 16.7%, see Chart VII.7).

Another finding of the survey was that 60.3% of the poor and 21.4% of the non-poor reported that they would not afford an unexpected but necessary expense of about €500, while 77.7% and 40.0% respectively stated that they could not afford one week of holiday away from home. Housing costs represent a significant burden for households, with 30.3% of the total population stating that they constitute a heavy burden (44.4% of the poor and 26.6% of the non-poor), while 63.1% considered them to be somewhat of a burden (53.9% of the poor and 65.5% of the non-poor).

Despite the stability of poverty indicators at the national level, there have been wide variations in relative poverty across certain groups of the population over the past few years. The relative-at-risk-of poverty rate in Greece has shifted from the elderly to younger couples with children and to young workers. In this respect, the recent developments described below are particularly important and should become the focus of social policy in the years to come:

- Child poverty, i.e. the percentage of children living below the relative poverty threshold, has risen dramatically in the last five years. Specifically, according to the latest available data for 2009, 23.4% of children aged up to 15 (EU-27:

15 The at-risk-of-poverty rate reported in the EU-SILC survey for 2009 (19.7%), recalculated using the poverty threshold for 2005 (adjusted for HICP inflation), would have been limited to 16.2%.
16 See Press release of 9 December 2010, ELSTAT, EU-SILC 2009, Living conditions indicators.
17 The nine indicators of material deprivation used in the survey are: the reporting of arrears in relation to routine living expenses (mortgage, rent, and credit card instalments, utility bills, etc.); the inability to afford a one week's annual holiday away from home; to afford a meal with meat/chicken/fish or a vegetarian equivalent every second day; to meet unexpected but necessary expenses of about €500; to afford a telephone (incl. mobile phone); a colour TV; a washing machine; a personal car; and the inability to keep home adequately warm.

19.6%) live in poor households, compared with 19.3% in 2005.[18] This seems to be partly attributable to the job-finding difficulties that young people face, as well as to the new flexible types of employment (part-time work, independent contract jobs, piecework, etc.), which, though facilitating access to employment, fail to prevent poverty.

- The past few years have seen a significant decrease in the poverty rate among the elderly (aged 65 plus) from 27.9% in 2005 to 21.4% in 2009 (EE-27: 17.8%). The drop in the relative poverty gap among the elderly was even more pronounced, falling from 23.7% (total population: 23.9%) in 2005 to 14.7% in 2009, i.e. 7 percentage points lower than for the total population (21.7%). This improvement can be attributed almost entirely to the poverty-mitigating effect of pensions, given the significant increases in minimum pensions and the Social Solidarity Pension Supplement (EKAS). It seems that a large number of pensioners had been just below the poverty line in previous years and that many of them, as soon as the minimum pensions were significantly increased, found themselves above the relative poverty threshold.

- Over the period extending back to 1974, poverty appears to have shifted from rural to urban areas and from the low-skilled (e.g. who have not completed primary schooling) to middle- and higher-skilled groups (e.g. with lower/upper secondary schooling). While the share of farmers in total poverty used to be very high, it has fallen significantly in recent years, reflecting the shrinking agricultural sector, population ageing and the introduction of a contribution-based pension system for farmers. As for the skills-related shift in poverty, this probably reflects rising educational attainment over time (i.e. an improvement in the overall education level of the population) rather than a lesser probability for the low-skilled to find themselves below the poverty line.[19]

- Finally, it is estimated that the current economic crisis has made low-wage workers considerably more at-risk-of-poverty. The latest data from the EU-SILC 2009 survey show that the at-risk-of-poverty rate among individuals in work reached 13.8% in Greece, much higher than anywhere else in the EU (EU-15: 7.9%, EU-27: 8.4%) except Romania (17.9%). Low earnings, combined with underemployment (particularly in certain industries and family businesses), are factors that can at least partly explain the higher rates of poverty among certain categories of workers in Greece (farmers, manual workers in the construction industry, etc.). The low rate of female employment is seen as an additional key factor behind the higher poverty rates among working households.[20] On the other hand, the size of this phenomenon is closely related to the level of social expenditure (as a percentage of GDP), its allocation and financing sources, while in the EU there is a very strong correlation between poverty rates for the total population and those for the working population. The decrease in real earnings in 2010, the minimum wage freeze in effect till mid-2011, as well as the option of hiring young employees at sub-minimum wages (Law 3863/2010) are likely to lead to even higher relative poverty levels among those in work. However, it should be pointed

18 It should be noted that the relative deprivation of children living in poverty does not refer to insufficient income alone (see Bank of Greece, Economic Bulletin, No. 30, May 2008). There are a number of dimensions of child well-being, such as access to specific goods, housing, health, exposure to risk and risk behaviours, social participation and family environment, education, local environment, etc. The material deprivation of families and children in particular was the focus of a specific survey (ad hoc module), conducted by ELSTAT in parallel with the EU-SILC 2009. This survey showed that in a large majority of Greek households (86,7%), children aged under 16 were able to possess outdoor leisure equipment (bicycle, roller skates, etc.) and indoor toys and games (94.4% of households), participate in regular leisure activities (64.6%), organise celebrations on special occasions such as birthday and other parties (84.4%), invite occasionally other children over to play and/or eat (83.4%), participate in school trips/events costing money (87,4%), have a suitable place to study (87,9%), have an outdoor space in the neighbourhood where they can play safely (60,1%), go on holiday at least one week per year (52.7%).

19 Nevertheless, the results of studies for Greece have shown that the probability of poverty is dramatically reduced as the educational level of the household's head rises, while policies geared towards reducing educational disparities are bound to help limit economic inequalities and poverty in the long run. See Bank of Greece, Annual Report 2008, Box VI.I.

20 Given that poverty is defined at the household level, it is obvious that the presence of only one job holder within the household, especially when combined with part-time or temporary employment and low earnings, cannot prevent poverty.

out that the above measures, to the extent that they help reduce unemployment and/or increase employment (particularly among the young and the unskilled) could in fact lead to a reduction in the poverty risk for the entire population and improve other social indicators, including the poverty gap, extreme poverty, etc.

VIII EXTERNAL BALANCE AND COMPETITIVENESS

I. OVERVIEW OF DEVELOPMENTS IN 2010 – FACTORS AFFECTING THE OUTLOOK FOR GOODS EXPORTS AND IMPORTS

During the last two years, the current account deficit has been narrowing continuously, mainly as a result of lower consumption and investment demand. This decline was marked in 2009 (to 11.0% of GDP, from 14.7% in 2008), but much less pronounced in 2010 (to 10.4% of GDP) (see Table VIII.1).

Underlying the contraction in the deficit was, in both 2009 and 2010, a considerable reduction in the import bill excluding oil and ships, as well as (in 2010) a large increase in oil export and transport receipts. The steep fall in goods imports in 2009-2010 reflects directly a strong decline in private consumption and fixed capital formation during this period as a result of the recession, as well as an estimated adjustment or correction of Greek households' consumption pattern, which may contribute to a more permanent drop in the trade deficit in the future.

Goods exports fell considerably in 2009 due to the global recession; by contrast, in 2010 total goods exports (including oil) rose (at current prices), while goods exports excluding oil and ships shrank by a mere 1.3% (compared with 17.8% in 2009), according to Bank of Greece data. At the same time, in 2010 the net oil import bill grew considerably, while net current transfers contracted in the period 2009-2010.

Although the current account deficit fell only slightly in 2010 as a percentage of GDP, it should be pointed out that the rebound in *goods exports excluding oil and ships* was a positive development that has been visible since the second half of the year and is confirmed by all indicators.[1] However, exports, having dropped steeply in 2009, continue to fall short of the 2008 figure. Positive developments in exports are mainly attributable to the recovery in the world economy and, therefore, external demand, as well as the fact that Greek firms increased their business in foreign markets in order to offset the decline in domestic demand for their products. It also partly reflects the lagged effect of an incipient recovery of past competitiveness losses, which will become stronger in the future. According to Bank of Greece estimates, in the 2001-2009 period Greece's competitiveness vis-à-vis 28 trade partners had dropped by a cumulative 19% based on relative consumer prices and some 28% based on relative unit labour costs in the total economy. In 2010, however, competitiveness based on relative consumer prices improved slightly (by 0.5%, despite high inflation and exclusively due to a drop in the effective exchange rate of the euro), and rose visibly on the basis of relative unit labour costs (*account being taken of the change in the effective exchange rate of the euro vis-à-vis non-euro area trade partners*) (see Table VIII.2), by around 6%, taking into account relative labour costs in the total economy, and by about 5%, taking into account relative labour costs in the business sector. This reflects, to a considerable extent, a substantial drop in wages and labour costs in the public and the private sector (see also Chapter VII.2).

Regarding the outlook for 2011, goods *exports will continue to recover*,[2] as external demand is forecast to increase and competitiveness will continue to improve, reflecting a further decrease in unit labour costs (see Chapter VII.2). The outlook for exports may also benefit from other factors that affect the international competitiveness of Greek products, namely: first, a possible increase in foreign

1 The improvement in export performance is reflected in both the Bank of Greece data and the ELSTAT data. This recovery is accompanied by a considerable increase in foreign new orders, mainly from non-euro area countries and Southeastern Europe, which are traditional destinations of EU imports. The product categories recording the largest increases in export receipts are metal products (partly as a result of a rise in the international prices of metals and raw materials), chemicals and pharmaceuticals (exported to foreign markets, which offer higher prices), as well as foods and beverages. See European Commission, *The Economic Adjustment Programme for Greece, Third Review*, Occasional Paper no. 77, February 2011, which identifies the pharmaceutical industry as the best performer in terms of market share and international demand.

2 In January 2011, goods export receipts excluding oil and ships rose by 14.1% year-on-year, according to Bank of Greece data, while non-oil export values increased by 24.6%, according to ELSTAT.

Table VIII.1 Balance of payments

(million euro)

	January – December		
	2008	**2009**	**2010***
I CURRENT ACCOUNT BALANCE (I.A+I.B+I.C+I.D)	**-34,797.6**	**-25,818.7**	**-24,060.5**
I.A Trade balance (I.A.1 – I.A.2)	**-44,048.8**	**-30,767.3**	**-28,279.6**
Oil trade balance	-12,154.6	-7,596.5	-8,627.2
Non-oil trade balance	-31,894.3	-23,170.8	-19,652.4
Ships balance	-4,705.0	-3,356.9	-3,621.3
Trade balance excl. oil and ships	-27,189.3	-19,813.9	-16,031.1
I.A.1 Exports of goods	*19,812.9*	*15,318.0*	*17,081.5*
Oil	4,254.5	3,063.2	4,950.0
Ships (receipts)	1,582.0	771.7	798.6
Other goods	13,976.5	11,483.1	11,332.9
I.A.2 Imports of goods	*63,861.7*	*46,085.3*	*45,361.0*
Oil	16,409.0	10,659.8	13,577.1
Ships (payments)	6,286.9	4,128.6	4,419.9
Other goods	41,165.8	31,296.9	27,364.0
I.B Services balance (I.B.1 – I.B.2)	**17,135.6**	**12,640.2**	**13,248.5**
I.B.1 Receipts	*34,066.2*	*26,983.3*	*28,477.8*
Travel	11,635.9	10,400.3	9,611.3
Transport	19,188.3	13,552.2	15,418.4
Other services	3,242.0	3,030.9	3,448.1
I.B.2 Payments	*16,930.6*	*14,343.2*	*15,229.4*
Travel	2,679.1	2,424.6	2,156.0
Transport	9,316.0	7,073.4	8,155.4
Other services	4,935.5	4,845.1	4,917.9
I.C Income balance (I.C.1 – I.C.2)	**-10,643.0**	**-8,984.3**	**-9,228.3**
I.C.1 Receipts	*5,573.2*	*4,282.9*	*3,791.5*
Wages, salaries	344.7	294.6	199.7
Interest, dividends, profits	5,228.5	3,988.3	3,591.8
I.C.2 Payments	*16,216.2*	*13,267.2*	*13,019.8*
Wages, salaries	410.1	411.9	377.6
Interest, dividends, profits	15,806.1	12,855.2	12,642.2
I.D Current transfers balance (I.D.1–I.D.2)	**2,758.6**	**1,292.6**	**198.9**
I.D.1 Receipts	*6,882.7*	*5,380.7*	*4,654.3*
General government (mainly transfers from the EU)	4,678.8	3,527.9	3,188.5
Other sectors (emigrants' remittances, etc.)	2,203.9	1,852.8	1,465.8
I.D.2 Payments	*4,124.1*	*4,088.1*	*4,455.4*
General government (mainly payments to the EU)	2,717.6	2,679.6	2,860.4
Other sectors	1,406.4	1,408.5	1,595.0
II CAPITAL TRANSFERS BALANCE (II.1–II.2)	**4,090.8**	**2,017.4**	**2,071.5**
II.1 Receipts	**4,637.8**	**2,328.1**	**2,356.2**
General government (mainly receipts from the EU)	4,241.9	2,133.2	2,239.3
Other sectors	395.9	194.9	116.9
II.2 Payments	**547.0**	**310.7**	**284.7**
General government (mainly payments to the EU)	192.0	14.4	15.8
Other sectors	354.9	296.3	268.9
III CURRENT ACCOUNT AND CAPITAL TRANSFERS BALANCE (I+II)	**-30,706.8**	**-23,801.3**	**-21,989.0**
IV FINANCIAL ACCOUNT BALANCE (IV.A+IV.B+IV.C+IV.D)	**29,914.2**	**24,395.4**	**22,068.4**
IV.A Direct investment[1]	**1,420.7**	**274.5**	**693.5**
By residents abroad	-1,650.4	-1,479.3	-958.4
By non-residents in Greece	3,071.1	1,753.8	1,651.9
IV.B Portfolio investment[1]	**16,428.0**	**27,863.8**	**-20,855.0**
Assets	-268.9	-3,773.0	13,278.7
Liabilities	16,696.9	31,636.8	-34,133.6
IV.C Other investment[1]	**12,094.6**	**-3,636.9**	**42,132.9**
Assets	-27,823.3	-23,875.7	7,639.4
Liabilities	39,917.8	20,238.8	34,493.6
(General government borrowing)	-572.7	-2,335.0	29,978.2
IV.D Change in reserve assets[2]	**-29.0**	**-106.0**	**97.0**
V ERRORS AND OMISSIONS	**792.6**	**-594.1**	**-79.4**
RESERVE ASSETS	**2,521.0**	**3,857.0**	**4,777.0**

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

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

(annual percentage changes in year averages)

	Nominal EER	Real EER: On the basis of relative consumer prices	Real EER: On the basis of relative unit labour costs in total economy
2000	-6.3	-6.9	-5.0
2001	1.7	1.3	0.7
2002	2.3	2.6	4.1
2003	5.0	5.4	3.8
2004	1.7	1.9	4.1
2005	-1.0	-0.1	0.4
2006	0.0	0.8	1.7
2007	1.3	1.6	2.4
2008	2.4	2.5	5.4
2009	1.2	1.6	2.2
2010*	-2.8	-0.5	-6.1
Cumulative percentage change between 2001 and 2010	12.2	18.4	20.1

Sources: Exchange rates: ECB, euro reference exchange rates. CPI: ECB, HICP where available. Unit labour costs in total economy: Bank of Greece estimates for Greece, ECB for the other countries.
* Provisional data and estimates.
1 These indices are compiled by the Bank of Greece and include Greece's 28 main trading partners. Weights have been revised on the basis of imports and exports of manufacturing goods (SITC 5-8) in the years 1998-2000 for the period 1993-2000 and in the years 2004-2006 for the period 2001-2010. Weights take account of third-market effects.

direct investment (FDI), which involves technology transfers and leads to improvements in productivity; second, a more efficient organisation of production and labour, if recent labour market reforms are tapped and product market reforms are implemented in time; and third, implementation of measures included in the export promotion strategy announced by the Ministry of Regional Development and Competitiveness in December. If these materialise, further declines in the deficit will be substantial and it will become sustainable.[3]

If tourist receipts (see Section 2 of this chapter) recover in line with forecasts and consumer goods imports continue to fall, it is estimated that the current account deficit will further shrink in 2011, perhaps below 9% of GDP, despite higher oil prices and interest payments.

Certainly, demand for *imported consumer goods* will continue to be adversely affected by the estimated correction in households' consumption pattern, but this cannot be reflected continuously in *high* rates of decrease in imports, which have already fallen steeply. Moreover, demand for *imported capital goods* will be *boosted* once investment starts to rebound (possibly towards the end of the year) and, most importantly, when large investment projects in wind energy start to be implemented, entailing considerable equipment imports (see also Chapter XI.3). It should also be pointed out that *—by current output standards—* sustained strong export growth in the future will also result in a higher import bill for raw materials and intermediate products, which are used as inputs for some Greek export prod-

3 See also OECD (2011), "The Impact of Structural Reforms on Current Account Imbalances", Economics Department Policy Notes, No. 3. Also, IMF (2011), *Greece: Third Review Under the Stand-By Arrangement – Staff Report*, and European Commission, *The Economic Adjustment Programme for Greece, Third Review*, Occasional Paper no. 77.

ucts (not all). This probability is another reason why labour and product market reform should be sped up and efforts to attract FDI should be stepped up,[4] in order to achieve not only higher exports, but also import substitution *in those product categories where this is realistic, in the light of Greece's comparative advantages, as they will emerge after the implementation of structural changes and reforms.*

2. CURRENT ACCOUNT

In 2010, the current account deficit fell by €1.8 billion or 6.8% in comparison with 2009 to €24.1 billion. The decrease, on an annual basis, was first recorded in July 2010. This development for the whole of 2010 reflects mainly a fall in the trade deficit and a rise in the surplus of the services balance. By contrast, the surplus of the current transfers balance narrowed considerably, while the income account deficit rose slightly.

2.1 TRADE BALANCE

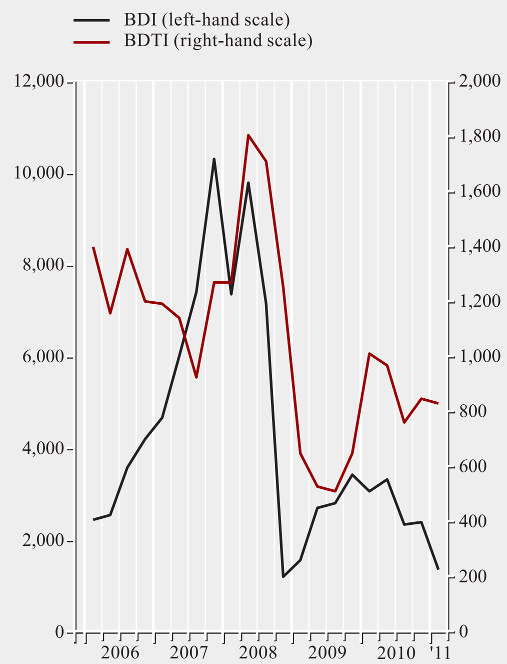
The €2.5 billion drop in the overall trade deficit mainly stemmed from a decrease of €3.8 billion in the trade deficit excluding oil and ships.[5] By contrast, the net oil import bill rose by €1.0 billion or 13.6%, while net payments for purchases of ships grew by €0.3 billion or 7.9%.

2.2 SERVICES BALANCE: FACTORS AFFECTING ITS OUTLOOK

The €0.6 billion increase in the surplus of the services balance mainly reflects higher net transport receipts and, secondarily, lower net payments for "other" services. Gross transport receipts (chiefly from merchant shipping) showed an increase of 13.8% and – despite a 15.3% rise in the corresponding payments – net transport receipts grew by €0.8 billion, as a result of both a 30% average annual increase in freight rates (see also Chart VIII.1) and a rebound in world trade.[6] It is not possible to make safe estimates and forecasts for the current and the next years following the natural disasters in Australia and Japan, which are expected to have a different impact across types of ships (dry cargo, oil, liquefied gas and container) over the short term.[7] By contrast, net travel receipts fell by €0.5 billion, as travel spending by non-residents in Greece dropped by €0.8 billion or 7.6%, while travel spending by residents abroad declined by €0.27 billion or 11.1%. Net payments for "other" services decreased by €0.35 billion. Lower net travel

Chart VIII.1 Developments in sea freight indices

(quarterly data)



Source: Clarkson Research Services.

4 See also OECD, op. cit.
5 According to Bank of Greece data, the import bill excluding oil and ships, which exceeds export receipts by a factor of three, fell by 12.6% in 2010, while the corresponding export receipts only dropped by 1.3%. The decline in imports affects all product categories with the exception of metal products (due to higher international prices). Moreover, according to available provisional ELSTAT data for 2010, non-oil export values rose by 8.5%, while the corresponding import bill shrank by 10.7%. The rise in exports mainly stems from non-euro area markets, while the largest share of imports comes from EU countries.
6 Specifically, the BDI (Baltic Dry Index) and the BDTI (Baltic Dirty Tanker Index) rose by 5.7% and 54.2% per annum in 2010, respectively. For world economic growth and the rate of increase in world trade volumes (goods and services), see Chapter III.
7 In the first quarter of 2011, freight rates fell by some 22% year-on-year, most prominently for dry cargo vessels.

receipts in 2010 largely reflect a decrease in average daily spending and, secondarily, in tourists' average duration of stay in Greece, while arrivals showed a small increase (up by 0.6%).

Regarding the *outlook of the services balance*, the following points should be made:

With respect to *transport receipts*, it is well-known that *merchant shipping* is one of the most dynamic sectors of the Greek economy and enjoys high growth rates,[8] chiefly connected with world trade. The renewal of the Greek-owned fleet, a procedure well under way since 2006, has contributed to its qualitative upgrading and a reduction in average age.[9] Although world trade volumes are expected to rise by some 7% in 2011,[10] the large number of new ships due to be delivered in the coming years will dampen freight rate growth.[11]

Regarding travel receipts, it is worth examining Greece's performance in the world cruise market, which has been growing at over 10% per year in the last decade in terms of passengers (this rate is expected to be maintained in 2011). Although Greek destinations attract the majority of European cruise passengers,[12] Greek ports as homeports rank fourth. An increase in the share of tourists starting their cruise from Greece could boost revenue considerably, as average spending per cruise passenger is estimated at €271 at the embarkation port and at €61 at the port-of-call.[13] At the same time, an improvement in the cruise support infrastructure (e.g. airports, harbour facilities) would further help attract cruise companies to Greek ports.

However, 2010 was a difficult year for Greek tourism, with considerable losses of revenue. The small rise in arrivals was more than offset, as already mentioned, by a decline in the average duration of stay and, above all, average per capita spending, which partly reflected a worsening of the *overall* competitiveness of the Greek tourist product, among other things because a large number of arrivals were diverted to alternative destinations due to the frequent riots and rallies in the greater Athens region, which were widely reported by world mass media.[14]

The outlook for 2011 is quite benign, thanks to the continued recovery in the world economy, the cuts in VAT rates on tourist accommodation services with a view to boosting competitiveness, and the developments in Northern African countries, so far rival tourist destinations.[15] Over the medium term, certainly, *the*

8 European Commission, *The Economic Adjustment Programme for Greece, Third Review*, Occasional Paper no. 77, pp. 10-12. According to Lloyd's Register-Fairplay data compiled by the Greek Shipping Co-operation Committee of London, at the beginning of 2011 the Greek-owned fleet accounted for some 15% of the world fleet, while the fleet under construction accounted for 13.5% of the corresponding world fleet (in dwt terms).

9 Average age is 7.9 years (down by around ten years in comparison with 2000), i.e. equal to that of the world fleet.

10 IMF, *World Economic Outlook*, April 2011.

11 Specifically, following the disastrous tsunami, Japan will increase the use of liquefied gas and thermal coal in power generation, which will push up demand for vessels carrying such goods. The partial destruction of iron ore reserves will boost imports, after damages in Japan's steelworks are restored. However, the anticipated drop in industrial output in Japan will decrease its export volumes and, as a result, demand for container vessels. At the same time, Germany's decision to temporarily shut down its nuclear plants will require using alternative energy sources (coal, natural gas etc.). On the side of demand for marine transport services, although a considerable number of new (mainly dry bulk cargo) vessels are expected to be delivered in 2011, the recent reactivation of ship breaking yards in Bangladesh (March 2011) will dampen the world fleet growth rate.

12 European Cruise Council (2010), *Contribution of Cruise Tourism to the Economies of Europe*. The classification of countries and their shares are as follows: (a) on the basis of ports-of-call: Greece (20.9%), Italy (20.9%) and Spain (17.3%); and (b) on the basis of home ports: Italy (35.3%), Spain (20.5%), United Kingdom (15.2%) and Greece (10.4%).

13 Under the regime previously in force, non-EU flag ships were excluded from cruises using Greek home ports. Law 3872/2010 on cruises by non-EU flag ships departing from Greek ports and the Joint Ministerial Decision of 14 December 2010 laying down the required documentation lifted the limitations on cruises by non-EU flag ships starting from Greek ports. However, *the first tangible results of this institutional change will not become visible before 2012*, as most companies in the cruise industry had already completed their schedules for 2011 by the time of publication of the law and the relevant ministerial decision. Moreover, representatives of the tourist and cruise industries have expressed reservations about the degree of liberalisation and the bureaucratic burdens imposed under the new institutional framework as e.g. the companies concerned are required to sign a contract with the Greek State.

14 Characteristically, in the World Economic Forum classification on the basis of the Indicator of Travel and Tourist Competitiveness 2011, Greece fell to the 29th from the 24th position.

15 The VAT rate on tourist accommodation services was adjusted from 11% to 6.5%. While the World Tourism Organisation (WTO) forecasts a rise of 4%-5% in arrivals internationally (World Tourism Barometer, vol. 9, no. 1, February 2011), there are clear indications of a further increase in tourist traffic to Greece due to the events in Northern Africa (early bookings from Germany, France, Italy, the UK and Russia are up, while notices of arrival of cruise ships in the port of Piraeus for 2011 have risen by 19%, according to the Piraeus Port Authority).

tourist product should be upgraded by being realigned[16] towards attracting high-income tourists; encouraging seasonal or permanent stay of wealthy foreign pensioners and self-employed; fostering conference tourism; and attracting foreign visitors to continental Greece and the Greek highlands. In this direction, it is essential to protect and promote traditional settlements; strengthen mountain tourism; upgrade the services provided in museums and most frequented sites; protect sites of natural beauty; enhance modern transport, communication and health infrastructures; and upgrade Athens, which is the main point of entry into Greece. Proposals include cofinancing infrastructure projects through PPPs; pooling business financing of activities required for prolonging the tourist season and increasing arrivals; improving the education provided by Schools of Tourism Professions; and considering introducing undergraduate courses in tourism studies (currently there are only offered at postgraduate level), with a view to making Greece a tourist education hub for the broader region.

2.3 INCOME ACCOUNT BALANCE

Higher net interest, dividend and profit payments in 2010 contributed to a small €0.2 billion increase in the income account deficit, which is expected to grow further in 2011, as interest payments on Greek government loans are bound to rise.[17]

2.4 CURRENT TRANSFERS BALANCE

Finally, the surplus of the current transfers balance fell by €1.1 billion in comparison with 2009 to €0.2 billion. This decline reflects the fact that the "other" sectors (emigrants' remittances etc.) showed net transfer *payments* of €129 million, against net *receipts* of €444 million in 2009, while general government net transfer receipts (mainly from the EU) dropped by €520 million (about 2/3 of this decrease was attributable to lower receipts and 1/3 to higher payments).[18]

3. CAPITAL TRANSFERS BALANCE: THE NATIONAL STRATEGIC REFERENCE FRAMEWORK (NSRF) AS A RECOVERY TOOL

In 2010, the surplus of the capital transfers balance remained unchanged over 2009 and came to €2.1 billion.[19] Increasing the absorption of EU structural and cohesion funds and utilising them more efficiently are now among the tools of the Economic Adjustment Programme. The government's targets are reflected in the Memorandum of Understanding, as updated on a quarterly basis.[20]

In 2010, disbursements for projects and programmes under the NSRF rose considerably to €2.3 billion, from €1.1 billion in 2009; as a result, the absorption rate exceeded 18% of overall Community financing for the 2007-2013 period (actually overshooting, *on the basis of payment claims*, the annual target set in the Memorandum). By the end of 2011, it is expected to exceed 35%.[21] According to the

16 See e.g. the speech by the Bank of Greece Governor at the conference of the Association of Greek Tourism Enterprises (SETE) on "Tourism and the Greek Economy" on 18 October 2010, as well as the recent study by SETE and Eurobank *Greek Tourism 2020 – Proposal for a new development model*, 12 January 2011.

17 See Introductory Report to the 2011 Budget, Table 8.9, p.166.

18 Current transfers from the EU mainly include direct aid and subsidies under the Common Agricultural Policy (CAP), as well as receipts from the European Social Fund, while current transfers to the EU include Greece's contributions (payments) to the Community Budget. The decline in net EU transfers partly stems from the payment of €258 million contribution to the JESSICA Fund (Joint European Support for Sustainable Investment in City Areas), while the fall in the net receipts of the "other" sectors is mainly receipts-driven. According to provisional balance of payments data of the Bank of Greece, net EU current transfers came to €1,421 million *in the first two months of 2011*, compared with a deficit of €685 million over the same period in 2010. However, it is estimated that, due to the quick implementation of the relevant procedures, the bulk of direct aid and subsidies under the CAP for the whole of 2011 has already been absorbed.

19 Capital transfers from the EU mainly include receipts from the Structural Funds – except for the European Social Fund – and the Cohesion Fund under the Community Support Frameworks (CSF) and the National Strategic Reference Framework (NSRF). It should be pointed out that in 2009 funds of some €1.1 billion plus €1.1 billion had been received under CSF III and the NSRF, respectively, while in 2010 the relevant funds concerned almost exclusively receipts under the NSRF.

20 According to the Memorandum of Understanding (3 May 2010 – Law 3845) and its updates of 6 August 2010, 22 November 2010 and 11 February 2011, the annual targets for absorption of EU structural and cohesion funds (based on payment claims) are as follows: 2010: €2,750 million, 2011: €3,350 million, 2012: €3,730 million and 2013: €3,890 million. These amounts do not include Agricultural Development.

21 On the basis of provisional balance of payments data of the Bank of Greece, at end-February 2011 the NSRF absorption rate reached 21% of total financing. The acceleration of the NSRF implementation is also confirmed by the recent document of the European Commission *State of execution of interim payments*, 1 February 2011.

European Commission's third review, not only the absorbability target has been achieved, but there has also been progress in the specific measures and the overall regulatory and organisational framework relating to the NSRF implementation under the Memorandum.[22]

Under the current fiscal constraints, the NSRF is a very useful tool for economic recovery at little fiscal cost. According to the Memorandum, Public Investment Budget (PIB) funds are applied on a priority basis towards projects cofinanced by EU structural and cohesion funds[23] (see also Chapter V.1.3.1).

It should also be noted that until 2013 direct aid and subsidies under the CAP will remain broadly unchanged at around €2.5 billion per year.[24] As a result, overall net fund transfers from the EU in 2011 (current plus capital transfers less payments to the Community Budget) will be around €4 billion on a cash basis, compared with €2.6 billion in 2010.

4. FINANCIAL ACCOUNT

In 2010, the financial account showed a net inflow of €22.1 billion, compared with €24.4 billion in 2009. Specifically, net inflows were recorded under direct investment (€0.7 billion) and "other" investment (€42.1 billion), against a net outflow of €20.9 billion under portfolio investment.

22 See, in more detail, Bank of Greece, *Monetary Policy – Interim Report*, October 2010, p.85. In accordance with the implementation time schedule, on 3 January 2011 the new NSRF payment procedure, through a special central account kept with the Bank of Greece, became fully operational. Applications for 12 major infrastructure projects have already been submitted to the European Commission. Moreover, a report was presented on the activities of the task force assessing progress in ensuring the rapid implementation of projects. See European Commission, *The Economic Adjustment Programme for Greece – Third Review – Winter 2011*, Occasional Paper no.77; and IMF (2011), *Greece: Third Review Under the Stand-By Arrangement*, March 2011. By the end of 2011, a fully-operational web-based open-access monitoring tool of procedures for approval of project proposals and for implementation of public projects should be introduced and the managerial capacity of all the managing authorities and intermediate bodies of operational programmes under the NSRF must be certified according to the standards of the International Standardisation Organisation.

23 In 2011, 73% of the PIB will be cofinanced by EU structural and cohesion funds, leading to national fund savings. Part of the national participation may be financed with loans granted by the European Investment Bank (EIB). A €2 billion loan agreement was signed with the EIB on favourable terms in July 2010, and the extension of new loans is being discussed. Moreover, as regards the part of the PIB that is financed exclusively by national funds, the selection of projects will be based on the criteria of complementarity, synergies and feasibility of implementing projects cofinanced by the EU (see Introductory Report to the 2011 Budget).

24 After 2013, new CAP implementation measures will apply, affecting the amount, breakdown and allocation of the relevant funds. For the future of the CAP until 2020, see *Communication from the Commission, The CAP towards 2020: Meeting the food, natural resources and territorial challenges of the future,* COM (2010)672/5, *and Conclusions of the Council of Ministers of Agriculture and Fisheries*, 17 March 2011. The proposals for the relevant legislative framework will be presented in mid-2011. The Community Budget total expenditure for 2014-2020 will be reviewed under the "Europe 2020" strategy, which was adopted by the European Council of 17 June 2010.

Table VIII.3 Geographical breakdown of inward foreign direct investment

(million euro)

	2008	2009	2010*
EU-27	2,908	1,561	1,565
Euro area	3,043	1,601	1,764
Other OECD countries[1]	131	87	82
Balkan countries[2]	1	0	3
Middle East, Mediterranean and former USSR[3]	-5	6	9
Other countries	37	100	-7
Total direct investment by non-residents	**3,071**	**1,754**	**1,652**

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

Table VIII.4 Geographical breakdown of outward foreign direct investment

(million euro)

	2008	2009	2010*
EU-27	685	1,142	638
Euro area	1,028	1,118	493
Other OECD countries[1]	620	18	24
Balkan countries[2]	164	143	111
Middle East, Mediterranean and former USSR[3]	64	21	28
Other countries	116	155	157
Total direct investment by residents	**1,650**	**1,479**	**958**

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

Net inflows of non-residents' funds for direct investment in Greece reached €1.7 billion in 2010 (see Table VIII.3), compared with a net inflow of €1.8 billion in 2009,[25] while a net outflow of €1.0 billion (2009: €1.5 billion) was recorded under residents' direct investment abroad, in particular the Balkan countries and Poland (see Table VIII.4). Under portfolio investment, a net outflow of €20.9 billion was observed (against a net inflow of €27.9 billion in 2009), mainly reflecting a decrease of €33.0 billion in non-residents' holdings of Greek bonds and Treasury bills. This outflow was partly offset by an inflow of €14.1 billion owing to a decline in resident credit institutions' and institutional investors' holdings of foreign bonds and financial derivatives. Finally, under "other" investment, a net inflow of €42.0 billion (against a net outflow of €3.6 billion in 2009) is mainly attributable to general government net borrowing of €30.0 billion under the Support Mechanism for the Greek economy; a decrease of €7.7 billion in resident credit institutions' and institutional investors' deposit and repo holdings abroad; and a €3.9 billion increase in non-residents' deposit and repo holdings in Greece.

At end-December 2010, Greece's reserve assets stood at €4.8 billion.

5. INTERNATIONAL INVESTMENT POSITION AND GROSS EXTERNAL DEBT

The *negative* net International Investment Position of Greece represents the difference between residents' assets and liabilities vis-à-vis non-residents, marked-to-market, including both direct investment and reserve assets (see Table VIII.5).

On the basis of latest data, at end-2010 Greece's negative International Investment Position (IIP) reached €225.9 billion, from €199.6 billion at end-2009, i.e. the country's net liabilities rose by €26.3 billion or 13.2%. The IIP corresponded to 98.2% of GDP in 2010, compared with 84.9% of GDP in 2009.

Turning to the IIP breakdown by investment category, the overall outcome for direct investment was positive, €3.2 billion, for the first time in the last ten years (for which data are available). This suggests that direct investment assets (€28.3 billion) exceeded direct investment liabilities (€25.1 billion). This develop-

25 The most important inflow of non-residents' funds for direct investment in Greece concerned a €939 million inflow for the participation of Crédit Agricole in the capital increase of Emporiki Bank S.A. An inflow of €410 million was also recorded for the participation of Société Générale in the capital increase of Geniki Bank.

Table VIII.5 Greece's international investment position

(million euro)

	2008	2009[1]	2010*
1. Direct investment	-637	-1,835	3,231
Abroad by residents	26,753	27,387	28,346
In Greece by non-residents	27,390	29,222	25,115
2. Portfolio investment	-120,763	-146,350	-94,410
Assets	88,216	92,215	73,350
Liabilities	208,979	238,565	167,760
3. Financial derivatives	970	1,771	1,395
4. Other investment	-61,273	-57,049	-140,932
Assets	106,695	129,561	112,576
Liabilities	167,968	186,610	253,508
5. Reserve assets	2,521	3,857	4,777
Net international investment position (IIP) (1+2+3+4+5)	-179,182	-199,606	-225,939
GDP	236,917	235,017	230,173
Net IIP as % of GDP	-75.6	-84.9	-98.2

Source: Bank of Greece.
* Provisional data.
1 Revised data.

ment *does not reflect a real decrease in non-residents' investment in Greece (disinvestment), but is attributable to valuation losses* on such investment due to the steep fall in share prices on the Athens Exchange. It should be noted that, on the basis of balance of payments data, net inflows for direct investment in Greece came to €1.7 billion in 2010.

Under portfolio investment, the negative net position improved from -€146.4 billion to -€94.4 billion, mainly owing to a €70.8 billion decline in liabilities. The latter reflects chiefly a fall in the prices of Greek government bonds and, secondarily, a decrease in non-residents' holdings of Greek bonds, valued at par (representing the bond issuer's obligation on maturity). To a certain extent, lower net liabilities also reflect the decrease in share prices on the Athens Exchange (with respect to non-residents' investment in shares of Greek firms).

Finally, under other investment (mainly loans and deposits), the €83.9 billion rise in the negative position is mainly attributable to an increase in *liabilities* as a result of (a) €38.1 billion transactions on the TARGET account; and (b) general government borrowing of €32.8 billion under the Support Programme, as well as a €26 billion decline in credit institutions' external *assets* (in the form of deposits abroad and loans to non-residents). The developments that led to a rise in the negative position were only partly offset by the fact that the "other" sectors (non-financial corporations and households) showed net assets of €14.6 billion at end-2010, compared with net liabilities of €2.4 billion at end-2009 – i.e. these net assets of the "other" sectors rose by €17 billion during 2010, reflecting an increase in their deposits abroad (of some €9 billion) and a decline in the outstanding balance of loans received from non-residents (to the tune of €8 billion), due to the reclassification of this item in the credit institutions sector.

26 It should be noted that the gross external debt figures only refer to external liabilities by sector of the economy, gross of external assets. Net external liabilities by sector of the economy, including reserve assets, are presented in the International Investment Position, which was discussed earlier.

Table VIII.6 Gross external debt position

(million euro)

	2005	2006	2007	2008	2009[1]	2010*
A. General government	**145,230**	**154,660**	**177,106**	**191,985**	**219,546**	**190,168**
B. Bank of Greece	**7,217**	**8,183**	**10,797**	**35,348**	**49,036**	**87,088**
C. Other Monetary Financial Institutions	**52,499**	**68,624**	**97,424**	**111,194**	**112,861**	**115,219**
D. Other sectors	**17,412**	**18,637**	**19,501**	**21,252**	**24,216**	**15,991**
E. Direct investment	**541**	**2,803**	**3,712**	**2,808**	**2,200**	**1,843**
Debt liabilities to affiliated enterprises	169	620	826	537	266	155
Debt liabilities to direct investors	372	2,183	2,886	2,271	1,934	1,688
Gross external debt (A+B+C+D+E)	**222,899**	**252,906**	**308,539**	**362,587**	**407,859**	**410,309**
% of GDP	**114.4%**	**119.7%**	**135.9%**	**153.0%**	**173.5%**	**178.3%**

Source: Bank of Greece.
* Provisional data.
1 Revised data.

On the basis of latest data compiled by the Bank of Greece Statistics Department, **the gross external debt**[26] of Greece at market prices rose to €410.3 billion at end-2010 (178.3% of GDP), from €407.9 billion at end-2009 (173.5% of GDP – see Table VIII.6).

In more detail, the general government external debt dropped by €29.4 billion during 2010 (end-2010: €190.1 billion, end-2009: €219.5 billion). This decline is accounted for by, mainly, a fall in the prices of Greek bonds and, secondarily, a decrease in foreign investors' holdings of Greek bonds. Specifically, while non-residents' holdings of Greek bonds declined by €31 billion, the corresponding decrease at market prices was €65 billion. This fall was offset, as already mentioned, by general government new borrowing (€32.8 billion) under the Support Mechanism.

The liabilities corresponding to the Bank of Greece are reflected in the balance of the TARGET account, which rose from €49 billion at end-2009 to €87 billion at end-2010, mainly reflecting the funding of Greek banks by the ECB.

The outstanding balance of credit institutions' external liabilities rose marginally, to €115 billion at end-2010, from €113 billion at end-2009, as a result of divergent changes in the distribution of short-term and long-term liabilities.

The liabilities of the "other" sectors were by €8 billion lower in 2010 than in 2009, as a result of a net decrease in public enterprises' and non-financial corporations' external borrowing.

IX FISCAL DEVELOPMENTS AND PROSPECTS*

1 OVERVIEW OF DEVELOPMENTS AND PROSPECTS

In response to escalating tensions in the bond market and a dramatic increase in borrowing costs,[1] despite the successive measures taken up to March 2010, on 23 April 2010 the Greek authorities officially requested the activation of the EU/IMF financial support package. On 2 May 2010, in the context of the Memorandum of Economic and Financial Policies agreed with the European Commission, the ECB and the IMF and under the Economic Adjustment Programme (EAP) that was adopted,[2] it was decided that fiscal adjustment would become more frontloaded. Thus, the general government deficit target for 2010 was set at 8.1% of GDP (instead of 8.7% according to the Stability and Growth Programme of January 2010), compared with a deficit of 13.6% of GDP for 2009, as revised on the basis of then available data. At the same time, the duration of the fiscal consolidation effort and the deadline for reducing the deficit below 3% was extended until 2014 rather than 2013, as originally planned. Under the EAP, financial assistance to Greece would reach €110 billion, of which €80 billion would come from euro area countries and €30 billion from the IMF.

The implementation of the EAP in 2010 made significant progress. This was also acknowledged in reports by the European Commission and the IMF following the first three assessments of EAP's implementation. The fiscal adjustment and consolidation programme included a number of measures for 2010 aimed at reducing expenditure and increasing revenue – in particular, wage and pension cuts, a freeze on public sector hiring, cuts in operating expenses and subsidies to entities within the broader public sector, indirect tax increases, tax system reform and imposition of extraordinary levies on businesses and individuals, as well as settlement of tax cases.

At the same time, considerable effort has been devoted to improving budgeting processes, strengthening control over expenditure, ensuring better information on the financial condition of all entities within the general government and, more generally, enhancing the credibility and transparency of fiscal data. This has been accompanied by ongoing efforts to increase the efficiency of the tax-collection mechanism and combat tax evasion.

The past year also saw important structural reforms in the field of public finances. The "Kallikratis" programme started being implemented and is expected to help consolidate the finances of local authorities and support the overall fiscal adjustment effort through cost savings. The pension reform is considered to be very successful and should contribute to long-term fiscal sustainability. The health reform has made considerable headway, with interventions expected to improve the financial position of public hospitals, ensure better control on expenditure, reduce pharmaceutical expenditure, rationalise hospital procurement and improve the quality of services provided. Significant progress has also been made in restructuring public enterprises, with the aim to reducing wage and operating costs and increase revenue. The restructuring plans for OSE, TRAINOSE and OASA are steps to the right direction, but will have to be implemented with resolve.

On the negative side, general government deficit and debt figures for the years 2006-2009 were revised upwards and were validated by Eurostat in November 2010. In particular, the general government deficit for 2009 (on a national accounts basis) was revised from 13.6% of GDP to 15.4% of GDP, thereby affecting the achievement of a deficit of 8.1% of GDP in 2010 as targeted by the EAP.[3] More-

* This chapter takes into account data and information that had been published by 4 April 2011.

1 On 8 April 2010, the spread of two-year bonds reached 652 basis points and that of ten-year bonds 430 basis points (against the corresponding German bonds).

2 The EAP was ratified by the Greek Parliament through the adoption of Law 3845/2010 ("Measures for the implementation of the mechanism for the support of the Greek economy by euro area Member States and the International Monetary Fund").

3 The principal reason behind the last review of the general government deficit in 2009 was the reclassification of public enterprises into the general government sector (for more information, see Bank of Greece, *Monetary Policy 2010-2011*, February 2011, p. 69-70).

Table IX.1 General government and state budget deficits

(percentages of GDP)

	2006	2007	2008	2009	2010*
General government deficit[1] *(national accounts data – convergence criterion)*	**-5.7**	**-6.4**	**-9.4**	**-15.4**	**-9.5**
– Central government	-6.1	-6.4	-9.8	-15.1	-
– Social security organisations, local authorities, legal entities in public law	0.4	0.1	0.4	-0.3	-
State budget deficit[2] *(administrative data)*	**-3.9**	**-4.4**	**-5.9**	**-13.1**	**-8.4**
State budget deficit[3] *(cash data)*	**-5.4**	**-5.5**	**-7.3**	**-13.9**	**-10.2**

Sources: Bank of Greece, Ministry of Finance and ELSTAT.
* Provisional data.
1 ELSTAT data, as notified to the European Commission (Excessive Deficit Procedure). Data on the general government deficit for 2010 are estimates from the February 2011 update of the Economic Adjustment Programme for Greece. Figures may not add up due to rounding.
2 State General Accounting Office data, as shown in the state budget.
3 Bank of Greece data referring to the state budget deficit on a cash basis excluding movements in the OPEKEPE account.

over, the stronger than expected economic downturn in 2010 weighed heavily on the fiscal adjustment effort, which nevertheless did bring about tangible results in 2010, with the general government deficit ratio expected to fall by about 5 percentage points of GDP relative to 2009.

Eurostat will release final data on general government deficit in 2010 (on a national accounts basis) for Greece and the other EU countries on 26 April. According to recent assessments by the European Commission and the IMF, the general government deficit for 2010 (on a national accounts basis according to the European system of accounts ESA 1995) will stand at about 9½% of GDP or about €22 billion, i.e. the same as the revised target set for 2010 in the Introductory Report on the 2011 Budget (€21.9 billion, see Table IX.1). In addition, the reports stated that almost all quantitative targets had been met, under the quantitative performance criteria on a cash basis, by the end of 2010. However, the deficit may reach a higher level as a result of the revision of some data to be finalised by Eurostat and ELSTAT by the date of publication.

It should be noted that, while applauding the progress made up to now, the EU and IMF reports also point out that the upcoming period will be critical for the achievement of targets set in the EAP. Moreover, both organisations consider that further fiscal adjustment measures of a structural nature amounting to 3/4% of GDP should be taken to ensure the achievement of the target set in the 2011 Budget to reduce the general government deficit to 7.4% of GDP in 2011.

According to the decisions taken by the recent informal meeting of Heads of State or Government of the euro area on 11 March 2011 and confirmed by the European Council on 24-25 March, which are favourable for Greece, it is of decisive importance to adopt an ambitious medium-term fiscal strategy framework for 2012-2015, aiming at speeding up fiscal adjustment, as repeatedly suggested by the Bank of Greece. Key to achieving sustainable fiscal adjustment is to reduce public expenditure on a permanent basis, effectively combat tax evasion and upgrade tax administration.

Overall, the implementation of an ambitious medium-term fiscal strategy framework for 2012-2015 that will clearly describe the fiscal consolidation and will include —as a crucial component— a public property utilisation and privatisation programme, could considerably reduce public debt, contribute to economic growth, help restoring confidence and optimism for the future prospects of the Greek economy and therefore facilitate the return of Greece to the bond markets.

2 FISCAL DEVELOPMENTS IN 2010 ON THE BASIS OF FISCAL DATA

The institutional framework for the long-needed structural fiscal reforms was established in 2010. However, these reforms will not yield results to the required extent if their implementation is not completed.

As regards 2010, the impact of these reforms cannot be easily quantified, as such changes yield results over the long run. For this reason, and in order to immediately reduce deficit, restrictive policies were adopted in 2010; these policies aimed at increasing revenue and containing expenditure and their impact can be seen in individual items of the government budget.

In particular, the government budget deficit fell to €19,448 million or 8.4% of GDP in 2010, from €30.872 million or 13.1% of GDP in 2009, against a targeted decrease to 8.1% of GDP in the EAP (see Table IX.10). Despite the large reduction in the deficit (by 37.0% compared to 2009), the deficit target set in the EAP has not been achieved due to a shortfall in revenue, which was only partly compensated by the fact that the reduction in expenses exceeded the target. In particular, government budget revenue rose by 7.4% (against a targeted increase of 15.5%), while primary expenditure was reduced by 12.5% (against a targeted decrease of 7.3%, as envisaged in the EAP). Finally, interest payments rose by 7.3% (against a targeted 5.6% in the EAP). The reduction in primary deficit, from 7.9% of GDP in 2009 to 2.7% of GDP in 2010, is very important, as the primary deficit directly influences the dynamics of the debt to GDP ratio.

2.1 ORDINARY BUDGET REVENUE

Ordinary budget revenue (before tax refunds) rose by 5.1% in 2010, compared with a revised annual target of 5.7% under the Introductory Report on the 2011 Budget, and came to €56,156 million (see Table IX.2). This suggests a shortfall of €380 million compared with the revised target. It should be noted that the initial target in the 2010 Budget was 9.1%; it was later revised to 12.7% in the EAP, to be lowered to 5.7% as a result of the decline in economic activity and delays in tax collection. The increase in VAT revenue, especially after August 2010, helped reduce the shortfall in revenues (against the revised target). At the same time, an important contribution also came from the tax amnesty (receipts in the last two months of the year amounted to about €1 billion) and from the full collection of road duties for 2011 in 2010.

Revenue from direct taxes fell considerably, by 5.6%. All categories of direct taxes yielded lower revenue, with the exception of receipts from tax arrears due to the tax amnesty and from other direct taxes, which rose due to the extraordinary levy on the profits of large undertakings for the fiscal year 2008. In more detail:

• Revenue from personal income tax fell by 13.3%, as a result of lower earnings of public sector employees and pensioners and lower employment. Tax withheld on personal income registered a negative rate of growth for the first time in recent years (-14.3%).

• Revenue from corporate income tax fell by 16.9%, mostly as a result of lower corporate profitability in 2009.

• Revenue from tax on inheritance, gifts, parental donation and real property also decreased, due to the delay in dispatching the (large) real estate property tax payment notifications for 2010.

• Revenue from tax arrears for the whole year improved considerably, mostly in the last

Table IX.2 Ordinary budget revenue[1]

(million euro)

	2007	2008	2009	2010*	Percentage changes 2008/2007	2009/2008	2010*/2009
I. Direct taxes	**19,832**	**20,864**	**21,432**	**20,224**	**5.2**	**2.7**	**-5.6**
1. Income tax	16,092	16,670	16,590	14,287	3.6	-0.5	-13.9
– Personal	10,160	10,816	10,841	9,398	6.5	0.2	-13.3
– Corporate	4,659	4,191	3,790	3,149	-10.0	-9.6	-16.9
– Special categories of income tax	1,272	1,583	1,880	1,670	24.4	18.8	-11.2
(tax on shipping)	12	11	13	14	-13.0	21.2	7.7
(tax on interest income from bonds, deposits, etc.)	492	635	504	567	29.0	-20.6	12.5
2. Property taxes	434	486	526	487	11.8	8.3	-7.4
3. Direct taxes collected on behalf of third parties	5	1	2	1	-79.2	92.5	-70.0
4. Tax arrears	1,742	2,077	2,446	2,874	19.2	17.8	17.5
5. Extraordinary and other direct taxes	1,559	1,631	1,868	2,575	4.6	14.5	37.8
II. Indirect taxes	**28,572**	**30,221**	**28,291**	**31,042**	**5.8**	**-6.4**	**9.7**
1. Customs duties and special contributions on imports-exports	326	320	254	217	-1.9	-20.6	-14.6
2. Consumption taxes on imports	3,233	3,246	2,229	2,046	0.4	-31.3	-8.2
– VAT	2,236	2,403	1,756	1,796	7.5	-26.9	2.3
– Cars	936	783	441	226	-16.3	-43.7	-48.8
– Special consumption tax	61	59	32	24	-2.6	-46.1	-25.0
3. Consumption taxes on domestic products	22,190	23,798	23,758	27,150	7.2	-0.2	14.3
– Turnover tax	17	1	1	1	-96.6	72.1	0.0
– VAT	15,145	15,840	14,826	15,578	4.6	-6.4	5.1
– Fuel	2,867	3,689	4,374	5,698	28.7	18.6	30.3
– Tobacco	2,582	2,516	2,566	2,913	-2.5	2.0	13.5
– Road duties	820	997	1,046	1,591	21.6	4.9	52.1
– Special levies and contributions on cars	76	73	63	52	-3.3	-14.0	-17.5
– Other[2]	684	683	882	1,317	-0.1	29.1	49.3
4. Transaction taxes	2,242	2,063	1,453	1,120	-8.0	-29.6	-22.9
– Capital transfers	1,323	1,130	831	702	-14.6	-26.5	-15.5
– Stamp duties	684	685	459	414	0.2	-33.0	-9.8
– Licence fees for gambling	236	247	163	4	4.8	-34.1	-97.5
5. Other indirect taxes	581	794	597	509	36.7	-24.8	-14.7
III. Total tax revenue	**48,404**	**51,085**	**49,723**	**51,266**	**5.5**	**-2.7**	**3.1**
IV. Non-tax revenue	**3,372**	**4,249**	**3,720**	**4,890**	**26.0**	**-12.4**	**31.5**
V. Total ordinary budget revenue	**51,777[3]**	**55,334**	**53,443**	**56,156**	**6.9**	**-3.4**	**5,1**

Source: State General Accounting Office.
* Provisional data.
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 Air.

months of the year, due to the receipts (of more than €1 billion) from the tax amnesty.[4] This category also includes the collection of the

4 Tax amnesty for unaudited fiscal years was introduced as a revenue enhancing mechanism in 1978. Since then, it has been used by many governments to boost tax revenue. This is the tenth time it is being used and concerns pending tax cases of the previous ten-year period.

single tax on real property (ETAK) for 2009, which, contrary to what was initially expected, was not completed in 2010.

- Revenue from other direct taxes was 37.8% higher, due to the extraordinary levy on the profits of large enterprises (€910 million), the one-off extraordinary tax on natural persons whose annual income in 2009 exceeded €100,000 euro (€65 million) and the extraordinary tax on natural persons with large real estate property (€73 million).

The considerable increase in revenue from indirect taxes (9.7%) reflects to a large extent the impact of tax measures taken in 2010. However, there was still a shortfall compared with the revised targets in the Budget (increase by 11.2%). In more detail:

- Revenue from VAT rose by 4.8%, as a result of increased VAT rates and the introduction of the receipt-based system of tax allowances.[5] It should be noted that after two successive increases in VAT rates and the extension of VAT scope, the targeted increase in annual VAT revenue had been revised to 6.6% (in the Introductory Report to the 2011 Budget).

- Revenue from indirect taxes was considerably boosted by increases in excise duties on tobacco, alcohol and fuel. The significant increase in revenue from the taxation on tobacco (13.5%) and alcohol (31.0%) reflects the successive increases in the respective excise duties in the months of January, March and May 2010.[6] Revenue from taxes on liquid fuels rose by 30.3%, a development related to the three increases in excise duties on fuels in 2010.[7]

- Furthermore, an important contribution came from road duties for 2011, which were paid in their entirety in 2010 (the deadline for paying road duties was not extended, as has been the case in previous years). Thus, receipts from this item in December were particularly increased.

Finally, non-tax revenue was considerably boosted by receipts of €635 million (up by 31.5%), as a result of the programme to support the liquidity of banks.

2.2 ORDINARY BUDGET EXPENDITURE

Ordinary budget expenditure (which excludes tax refunds) fell by 9.1% in 2010, compared with a targeted decrease of 5.5% under the EAP. This development is attributable to lower primary expenditure in the ordinary budget, which fell by 10.9% in 2010, against an initially targeted reduction of 5.8%. It should be noted that primary expenditure had risen by 16.5% in 2009. Interest payments rose by 7.3% in 2010, compared with a forecast increase of 5.6% under the EAP (see Table IX.10).

The large decrease in primary expenditure results from successive measures[8] taken in 2010 in the context of intensive efforts to reduce deficit, as dictated by the EAP. On the basis of available detailed data, this decrease derives mostly from:

- Personnel outlays, which fell by 9.3% in 2010, against an increase of 7.4% in 2009 (see Table IX.3). This is attributable to measures mostly related to a freeze in hiring, non-renewal of fixed-term contracts, freeze in wages and pensions, a 20% cut in the allowances of civil servants, a 30% cut in the Easter bonus for 2010 and the abolition of the holiday allowance and the Christmas bonus for civil servants and central government pensioners, a reduction in the highest pensions, cuts in overtime pay, reduction in remuneration for participation in committees

5 See Appendix.
6 For the increases in excise duties, see the Appendix.
7 See Appendix.
8 Law 3833/2010: "Protection of the national economy – Urgent measures to address the fiscal crisis", Law 3845/2010: "Measures for the implementation of the mechanism for the support of the Greek economy by euro area Member States and the International Monetary Fund", Law 3847/2010: "Redetermination of Christmas and Easter bonuses and holiday allowance for central government pensioners and recipients of aid", Law 3863/2010: "The new social security system and relevant provisions. Regulation of labour relations", Law 3865/2010: "Reform of the state pension system and relevant provisions".

Table IX.3 Outlays under the ordinary budget and the public investment budget

(million euro)

	Annual data					Percentage changes			
	2007	2008	2009	Execu-tion 2010*	Budget 2011	2008/07	2009/08	2010*/09	2011/10*
I. Outlays under the ordinary budget	**55,137**	**60,980**	**71,817**	**65,247**	**69,003**	**10.6**	**17.8**	**-9.1**	**5.8**
1. Personnel outlays	21,909	24,082	25,870	23,452	22,905	9.9	7.4	-9.3	-2.3
of which: pensions	5,052	5,904	6,487	6,250	6,258	16.9	9.9	-3.7	0.1
2. Interest payments[1]	9,796	11,207	12,325	13,223	15,920	14.4	10.0	7.3	20.4
3. Payments to the European Union	3,265	2,649	2,484	2,363	2,487	-18.9	-6.2	-4.9	5.2
of which: for retroactive contributions	1,108	-	-	-	-	-	-	-	-
4. Transfer of revenue collected on behalf of third parties	4,313	4,624	6,452	5,656	5,978	7.2	39.5	-12.3	5.7
5. Subsidies to farmers	734	758	665	516	735	3.3	-12.3	-22.4	42.4
6. Grants	11,488	14,890	19,015	16,933	17,554	29.6	27.7	-10.9	3.7
– to social security organisations[2]	8,744	12,128	15,266	13,656	14,415	38.7	25.9	-10.5	5.6
– to the Intergenerational Solidarity Fund	-	-	522	560	606				
– extraordinary social solidarity aid	-	-	489	113	0				
– other grants	2,481	2,762	2,738	2,604	2,533	11.3	-0.9	-4.9	-2.7
– to the fire-stricken	263	-	-	-	-	-	-	-	-
7. Other	3,632	2,770	3,508	2,729	2,974	-23.7	26.6	-22.2	9.0
of which:									
– Olympic Air	839	-	294	-	-	-	-	-	-
– conduct of elections	134	-	293	120	20	-	-	-	-
– reserve	-	-	-	-	580	-	-	-	-
8. Grants for the repayment of public hospitals' arrears	-	-	1,498	375	450				
II. Outlays under the public investment budget	**8,803**	**9,624**	**9,588**	**8,447**	**8,500**	**9.3**	**-0.4**	**-11.9**	**0.6**
1. Project execution	2,149	2,819	3,421	...	...	31.2	21.4	...	...
2. Grants	6,569	6,689	6,135	...	...	1.8	-8.3	...	...
3. Administrative costs	85	116	32	...	...	36.5	-72.4	...	...
III. Outlays under the state budget (I+II)	**63,940**	**70,604**	**81,405**	**73,694**	**77,503**	**10.4**	**15.3**	**-9.5**	**5.2**
Primary expenditure under the state budget	54,144	59,397	69,080	60,471	61,583	9.7	16.3	-12.5	1.8
Primary expenditure under the ordinary budget[3]	45,341	49,773	57,994	51,649	52,633	9.8	16.5	-10.9	1.9
Amortisation payments	23,543	26,246	29,135	19,549	28,130	11.5	11.0	-32.9	43.9
Procurement of defence equipment	2,380	2,597	2,175	1,017	1,600	9.1	-16.2	-53.2	57.3
NATO expenditure			51	23	40				
Guarantees called in (entities outside the general government)			100	145	145				

Source: State General Accounting Office.
* Provisional data.
1 Including "other expenditure" for public debt servicing.
2 Including expenditure for the implementation of social welfare measures (e.g. Social Solidarity Pension Supplement for Pensioners – EKAS, allowance to families with many children, etc.)
3 Excluding grants for the repayment of public hospitals' arrears.

and the establishment of a ceiling for public sector wages.

- Expenditure for subsidies (mostly to social security funds), which were reduced by 10.9%, against an increase of 27.7% in 2009. This reduction resulted, inter alia, from the 10% cuts in subsidies to the social security funds of the Hellenic Telecommunications Organisation (OTE) and the Public Power Corporation (DEH), as well as the cancellation of the largest part (€400 million) of the second instalment of the extraordinary social solidarity aid.

- Consumption and other expenditure, which was reduced by 22.2% in 2010, compared with an increase of 26.6% in 2009. This reflected cuts in commissions and travel expenses and the reduction by €100 million of the initial budget item for new projects by the Ministry of Education.

2.3 PUBLIC INVESTMENT BUDGET

A number of decisions were taken in 2010 on cutting back expenditure under the Public Investment Budget; as a result, investment expenditure was reduced by 11.9%, compared with a targeted decrease of 4.0% under the EAP, and came to €8,447 million or 3.7% of GDP (see Table IX.10). Revenue of the Public Investment Budget rose by 50.6% in 2010, against a targeted increase of 59.7%. As a result of the above, the investment budget deficit came to €5,375 million or 2.3% of GDP, compared with a deficit target of 2.6% of GDP under the EAP.

2.4 SOCIAL SECURITY AND WELFARE ORGANISATIONS

Under Law 3871/2010 on financial management and accountability, starting from 2010 the budget submitted to the Parliament each year will include an annual social budget for the integrated social security system. The relevant ex post data for 2009, estimates for 2010 and forecasts for 2011 are presented in Table IX.4.[9]

As can be seen in Table IX.4, the consolidated debt (excluding State budget subsidies) of social security organisations (SSOs) for 2010 is estimated at €9,180 million (4.0% of GDP), a drop of 22.3% compared with 2009. This favourable development is due to both higher revenue (by 4.3%) and lower expenditure (by a cumulative 3.5% for the operating and capital accounts).

In particular, with regard to revenues, despite the significant rise in unemployment and the squeeze in earnings in 2010, the contributions received by social security organisations appear to be slightly higher (€22,618 million, against €22,070 million in 2009), which is possibly related to the effort to combat contribution evasion. At the same time, the collection of arrears boosted other revenue of SSOs.

Lower expenditure is attributable, on the one hand, to decreased wage and pension outlays of SSOs (by 8.4% and 2.5%, respectively) under the strict incomes policy of 2010 and, on the other hand, to savings from a more efficient control of health expenditure, mostly pharmaceutical expenditure,[10] reflected in the drop of other SSO expenses from €12,652 million in 2009 to €11,960 million in 2010.

As a result of the above, State subsidies, which counterbalance the consolidated deficit of SSOs, were significantly reduced in 2010 and came to €10,741 million (or 4.7% of GDP), against €13,186 million (or 5.6% of GDP) in 2009.

2.5 PUBLIC ENTERPRISES

According to the data in Table IX.5, the total deficit (operating and capital accounts) of pub-

9 It should be noted that up to 2009 the budget included data for only six social security and welfare organisations, namely the Social Insurance Institute (IKA), the Farmers' Insurance Fund (OGA), the Seamen's Pension Fund (NAT-KAAN), the Manpower Employment Organisation (OAED), the Workers' Housing Organisation (OEK) and the Workers' Welfare Organisation (OEE). For this reason, data on Social Security Organisations included in Table IX.4 are not comparable with those included in previous Annual Reports.

10 See Section 5 below.

Table IX.4 Results of social security organisations[1] and their financing

(million euro)

	2009	2010*	Budget 2011	Percentage changes 2010/2009	2011/2010*
A. Management account					
1. Revenue	28,250	29,463	31,076	4.3	5.5
of which:					
Social security contributions	22,070	22,618	23,817	2.5	5.3
Other revenue	6,180	6,845	7,259	10.8	6.0
2. Expenditure	39,976	38,542	38,763	-3.6	0.6
of which:					
Salaries and wages	1,153	1,056	1,026	-8.4	-2.8
Pensions	26,168	25,520	27,169	-2.5	6.5
Other expenditure	12,652	11,960	10,553	-5.5	-11.8
3. Balance (1 - 2)	-11,726	-9,079	-7,687	-22.6	-15.3
B. Capital account					
4. Revenue	-	-	-	-	-
5. Expenditure	83	100	165	20.3	64.3
(Investment)	83	100	165	20.3	64.3
(Other expenditure)	-	-	-		
6. Balance (4 - 5)	-83	-100	-165	20.3	64.3
Total result (3+6)	***-11,809***	***-9,180***	***-7,852***	***-22.3***	***-14.5***
Percentage of GDP	***5.0***	***4.0***	***3.4***	***-20.6***	***-13.8***
Financing					
7. Subsidies	13,186	10,741	9,998	-18.5	-6.9
(Ordinary budget)	13,185	10,741	9,998	-18.5	-6.9
(Public investment budget, EU, etc.)	1	0	0	-83.3	300.0
8. Net result (3+6+7)	1,377	1,562	2,146	13.4	37.5
(-) deficit, (+) surplus					
9. Amortisation	11	12	11	2.7	-1.7
10. Gross result (8+9)	1,365	1,550	2,135	13.5	37.7

Source: Ministry of Finance, Introductory Report on the 2011 Budget.
* State General Accounting Office estimates.
1 Including 32 main and supplementary social security funds as listed in the Introductory Report on the 2011 Budget. Excluding social welfare organisations (Manpower Employment Organisation – OAED, Workers' Housing Organisation – OEK and Workers' Fund – EE) and public hospitals.

lic enterprises[11] came to €588 million in 2010, i.e. much lower than in 2009 (€1,472 million). The improvement in the financial results of public enterprises is consistent with government policies implemented in 2010 with a view to increasing the profitability of public enterprises and containing their losses. These policies include, inter alia, introducing standardised control procedures based on regular and timely reporting, improving transparency by publishing timely information on the Internet regarding the financial position of large pub-

11 According to Law 3899/2010, public undertakings are defined – with no exceptions from now on – as either societes anonymes (SA) which are under the direct or indirect control of central government, or public entities in private law in which central government holds a majority stake and which are managed and administered by central government. Compared with the law previously in force (Law 3429/2005), this definition extends the scope of the supervision by the Special Secretariat for Public Enterprises and Organisations of the Ministry of Finance. The Introductory Report on the 2011 Budget, which includes the financial results of 52 Public Enterprises and Organisations shown in Table IX.7, had been drafted before the adoption of Law 3899/2010. Therefore, the scope of supervision by the Special Secretariat for Public Enterprises and Organisation is expected to be extended in 2011. Furthermore, it should be noted that these 52 Public Enterprises and Organisations include six enterprises (Thermal Bus Company – ETHEL, Athens-Piraeus Electric Railway – HSAP, Trolley-bus Company of Athens and Piraeus – HLPAP, Hellenic Railways Organisation – OSE, TRAINOSE and Hellenic Defence Systems - EAS) which now come under the general government sector (after the revision of deficit data by ELSTAT and Eurostat in November 2010).

Table IX.5 Results of public enterprises and their financing

(million euro)

						Percentage changes			
	2007[2]	2008	2009	2010*	Budget 2011	2008/2007	2009/2008	2010*/2009	2011/2010*
A. Operating account									
1. Revenue	1,814	1,806	1,853	1,557	1,718	-0.5	2.6	-16.0	10.4
2. Expenditure	3,278	3,676	3,820	3,209	2,460	12.1	3.9	-16.0	-23.4
3. Balance (1 - 2)	-1,464	-1,870	-1,967	-1,653	-742				
B. Capital account									
4. Revenue	0	0	0	0	0				
5. Expenditure	1,950	1,330	755	595	-356	-31.8	-43.3	-21.2	-159.8
Investment	1,322	1,112	1,244	1,061	507	-15.9	11.9	-14.7	-52.2
Working capital	380	-10	-645	-546	-921	-	-	-	-
Other expenditure	248	228	155	79	58	-7.9	-31.9	-49.1	-26.4
6. Balance (4 - 5)	-1,950	-1,330	-755	-595	356				
7. Special funds and provisions[1]	1,079	1,136	1,249	1,660	12,572[3]	5.3	10.0	32.8	657.5
Total result (3+6+7)	***-2,335***	***-2,065***	***-1,472***	***-588***	***12,186[3]***				
Percentage of GDP	***1.0***	***0.9***	***0.6***	***0.3***	***5.3***				
Financing									
8. Ordinary budget subsidies[4]	185	191	232	210	589	3.6	21.2	-9.6	180.9
9. Depreciation	256	255	276	267	155	-0.6	8.5	-3.5	-41.8
10. Net borrowing requirements	1,894	1,619	964	111	-12,931[3]	-14.5	-40.5	-88.4	-
Total financing	***2,335***	***2,065***	***1,472***	***588***	***-12,186***	***-11.6***	***-28.7***	***-60.1***	***-***
11. Amortisation[5]	134	520	403	961	12,816	288.1	-22.6	138.8	-
12. Credit repayments[5]	5	14	12	30	396	180.0	-11.1	138.8	-
13. New commercial credit	132	38	3	3	0	-71.1	-90.9	-27.2	-100.0
14. Gross borrowing requirements (10+11+12-13)	1,901	2,115	1,376	1,100	282	11.3	-35.0	-20.0	-74.4

Source: Ministry of Economy and Finance.
* Estimates.
1 Advance payments and participations by DEH consumers, one-off contribution by OTE subscribers, private participations in EYDAP projects and own reserves (from surpluses) of certain public enterprises. Since 1997, subsidies through the public investment budget and the EU have gradually taken the form of share capital increases, thus have gradually stopped appearing under "subsidies" and are now recorded as "special funds".
2 According to Law 3429/2005 (Gov. Gazette 31 4A/27 December 2005), 20 new public enterprises replaced 19 older ones in the list of Public Enterprises and Entities (DEKO) included in the Introductory Report on the 2007 Budget, bringing their number to 49 in 2008, before increasing to 52 in 2009.
3 The large improvement in the total result and the net borrowing requirements has stemmed from the assumption of OSE's debt by the Greek government.
4 Ordinary budget subsidies to public enterprises with deficits, minus revenue payments by enterprises with surpluses.
5 Estimated breakdown of amortisation and repayments, due to the lack of relevant data.

lic enterprises, introducing strategic planning for these enterprises, ensuring a more rational management of their real estate property, enhancing mechanisms to control management as regards compliance with laws and regulations relevant to them, etc.

The lower deficit of public enterprises came exclusively from lower expenditure. By contrast, revenue fell compared with 2009. In the operating account, expenditure was reduced by 16.0% (or €611 million) compared with 2009, which reflected the strict control over the wage bill and compliance with the guidelines of the Special Secretariat for Public Enterprises and Organisations of the Ministry of Finance on cutting down operating costs. In this respect, according to the data published by the Special Secretariat for Public Enterprises and Organisations, cost savings from wages in the nine-month period from January to September 2010 compared with the corresponding period in 2009 amounted to €143 million. Expenses in the capital account have been reduced by €160 million compared with 2009 (-21.2%); this was mainly due to the drop in investment by €183 million. It should be noted that revenues of the 52 Public Enterprises and Organisations came down to €1,557 million in 2010, compared with €1,853 million in 2009.

Finally, in 2010 legislation was adopted on the restructuring, financial consolidation and development of OSE group and TRAINOSE (Law 3891/2010), while the restructuring of OASA group was also planned.[12] These interventions are expected to considerably improve the financial aggregates of public enterprises as a whole, as these transport entities account for the bulk of public enterprises' total deficit.[13]

2.6 PUBLIC DEBT

The evolution of public debt over time, with rates above 99% of GDP in the past fifteen years, and structural rigidities represent the most important sources of macroeconomic imbalances that led the Greek economy to a deep crisis (see Table IX.6). Although the fast-paced economic growth from 2000 up until the onset of the crisis was combined with low interest rates up to 2005, primary surpluses up to 2002 and privatisation proceeds mostly from 1996 onwards, it has not been possible to halt the upward trend of public debt. By contrast, the significant shortfall in tax income and the increase in expenditure in recent years up to 2009 have led to a strong rise in borrowing requirements, thereby strengthening Greece's dependence on developments in capital markets, while at the same time highlighting the structural weaknesses in both the tax-collection and the expenditure control mechanisms.

According to the Introductory Report on the 2011 Budget, the general government debt is estimated at €330.4 billion in 2010. This figure represents 143.5% of the revised GDP for 2010.

As pointed out[14] by the Bank of Greece, the strong increase in the general government debt reflects an upward revision[15] of the general government fiscal aggregates (deficit and debt on a national accounts basis) for 2006-2009 (see Table IX.7).

The most important factors behind the increase in public debt from 99.2% of GDP in 2008 to 115.1% and then to 126.8% of GDP in 2009 include the reclassification of public enterprises of the broader public sector into the general government sector (7.7% of GDP), the inclusion of swap agreements into public debt (2.3% of GDP), the downward revision of GDP for 2009 at current prices (1.3% of GDP), other adjustments (0.4% of GDP) and the recording of the external debt of local authorities (0.04% of GDP). In 2010, public debt was burdened with the estimated deficit for 2010

12 The restructuring of the Athens Urban Transport Organisation (OASA) was legislated in February 2011 with the adoption of Law 3920/2011, whose basic provisions are outlined in Section 5 below.
13 In 2009 the cumulative deficit of OSE, TRAINOSE and OASA corresponded to 79% of the total deficit of all 52 public enterprises and organisations.
14 Bank of Greece, *Monetary Policy Report 2010-2011*, February 2011, p. 69.
15 According to Eurostat's press release of 15.11.2010.

Table IX.6 Decomposition of changes in the general government debt-to-GDP ratio[1]

(percentages of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009	2010*
General government debt-to-GDP ratio	101.7	97.4	98.9	109.0	106.1	105.1	110.3	126.8	143.5
Changes in the general government debt-to-GDP ratio	-2.1	-4.2	1.4	10.2	-2.9	-1.0	5.3	16.5	16.7
– Primary balance	-0.7	0.7	2.6	0.7	1.4	1.9	4.5	10.1	3.8
– Change in GDP and change in interest rates	-1.2	-4.4	-1.8	-0.4	-4.2	-2.9	0.5	6.2	8.4
– Deficit-debt adjustment[2]	-0.1	-0.5	0.7	9.8	-0.2	0.0	0.2	0.2	4.5

Source: Ministry of Finance, General Directorate of Economic Policy, "Hellas: Macroeconomic Aggregates".
* Provisional data from the Introductory Report on the 2011 Budget.
1 Changes in the debt ratio have been decomposed using the following formula:

$$\left(\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}}\right) = \frac{PB_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - g_t}{1+g}\right) + \frac{SF_t}{Y_t}$$

where D_t = general government debt
PB_t = primary balance (deficit or surplus)
Y_t = GDP at current prices
g_t = nominal GDP growth rate
i_t = average nominal rates on government debt
SF_t = deficit-debt adjustment

2 The deficit-debt adjustment includes expenditure or liabilities assumed by the general government which do not affect the deficit but increase debt, as well as proceeds (e.g. from privatisation) which do not affect the deficit but reduce debt.

Table IX.7 Consolidated debt of general government[1]

(million euro)

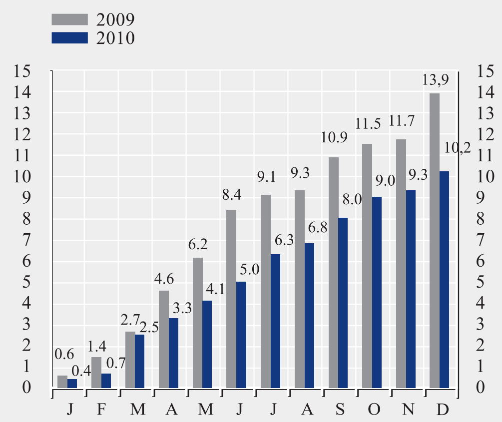
	2004	2005	2006	2007	2008	2009	2010*
Short-term	2,839	1,337	2,347	1,940	5,551	12,065	-
– securities	2,568	1,156	943	1,625	5,496	10,820	-
– loans	271	181	1,404	315	55	1,245	-
Medium- and long-term	179,342	209,846	220,869	235,948	255,117	284,490	-
– securities	156,969	168,336	178,600	192,712	210,643	241,901	-
– loans	22,373	41,510	42,269	43,236	44,474	42,589	-
Coin and deposits	1,006	1,235	988	693	728	1,477	-
Total	**183,187**	**212,418**	**224,204**	**238,581**	**261,396**	**298,032**	**330,400**
% of GDP	*98.9*	*109.0*	*106.1*	*105.1*	*110.3*	*126.8*	*143.5*
– euro-denominated debt	180,684	209,671	222,148	236,665	259,764	296,772	324,387
of which:							
(to the Bank of Greece)	*(8,488)*	*(7,988)*	*(7,991)*	*(7,521)*	*(7,051)*	*(6,581)*	*(6,154)*
(to the IMF/EU/ECB)							*(27,121)*
– non-euro denominated debt	2,503	2,747	2,056	1,916	1,632	1,260	6,013[2]
(of which: to the IMF/EU/ECB)							*(4,704)*

Sources: State General Accounting Office and Bank of Greece.
* Provisional data.
1 According to the definition in the Maastricht Treaty.
2 Valuation using exchange rates as at 31.12.2010.

(about 9½% of GDP, according to the Introductory Report on the Budget), the assumption of the debt of hospitals (2.3% of GDP),[16] the financing of the Hellenic Financial Stability Fund (about 1.1% of GDP),[17] the fall in nominal GDP and the cash balance of 2010. It should be reminded that the upward revision of the debt for 2009 (which also affected the level of debt for 2010) for the most part did not derive from new liabilities of the central government, but from existing state-guaranteed loans granted in the past to public enterprises. As a result of the inclusion of significant public enterprises in the general government sector, relevant state-guaranteed loans were automatically taken into account in the public debt, while the state-guaranteed loans were reduced accordingly.

Chart IX.1 State budget deficit on a cash basis (January 2009-December 2010)

(percentages of GDP)



Source: Bank of Greece.
Note: The "monthly" data reported here are cumulative percentages as of the start of the respective year.

3 FISCAL DEVELOPMENTS IN 2010 ON THE BASIS OF CASH DATA

According to available data, the cash deficit of the State budget[18] fell by 28.3% in 2010 to €23,396 million or 10.2% of GDP, against 13.9% of GDP in 2009 (see Table IX.8 and Chart IX.1). The decline in the deficit would have been larger (by about 0.2% of GDP) if nominal GDP in 2010 had not been lower than that in 2009. The decline in the deficit came mainly from the reduction in the ordinary budget cash deficit from €25,318 to €18,333 million and, to a lesser extent, from the drop in the deficit of the public investment budget to 2.2% of GDP in 2010 from 3.1% in 2009.

The reduction in the State budget deficit in 2010 is attributable both to the increase in revenue and the decrease in expenditure. In particular, State budget revenue on a cash basis rose by 9.7%, against an 11.2% decrease in 2009. Ordinary budget revenue rose by 7.7%, while revenue in the public investment budget rose by 57.8%. A considerable reduction in the primary expenditure of the ordinary budget by 11.3% was achieved in 2010, against a 16.9% increase in 2009. Moreover, public investment budget expenditure was also reduced by 11.3%, against a reduction of 2.8% in 2009.

In the first three months of 2010, the central government borrowing requirement was financed through the issuance of syndicated bonds (for an amount of €18 million), Treasury bills and foreign short-term securities. However, due to the fiscal crisis and the particularly high rates on government loans and Greek debt refinancing in international markets, the Financial Support Mechanism was set up. Thus, from May 2010 onwards, Greece's access to markets has been limited to Treasury bill auctions (conducted on a monthly basis rather than on a three-month basis and for lower amounts since September 2010) and borrowing takes place mostly through the Support Mechanism on a quarterly basis. In 2010, €31.7 billion was received through this mechanism;

16 With regard to hospital liabilities, it should be noted that, in October 2009 although these had been recorded in the deficits of the years 2005-2009, they had not been recorded in the debt for the respective years, as the issuance of the relevant bonds started only in December 2010. Up to end-2010, the bonds issued to pay hospital liabilities totalled €849.2 million (0.4% of GDP). Therefore, the debt for 2010 includes also this amount, while the remainder will affect the debt for 2011.
17 However, from the foreseen €2.5 billion, which corresponds to 1.1% of GDP, €1.5 billion was paid in 2010, i.e. 0.6% of GDP.
18 Not including movements in the OPEKEPE account.

Table IX.8 State budget deficit on a cash basis[1,2]

(million euro)

	2007	2008	2009	2010*
State budget	**12,432**	**17,361**	**32,622**	**23,396**
% of GDP	5.5	7.3	13.9	10.2
– Ordinary budget[3]	8,512[4]	12,585[5]	25,318[6]	18,333[7]
– Public investment budget	3,920	4,776	7,304	5,063

Source: Bank of Greece.
* Provisional data.
1 As shown by the respective accounts with the Bank of Greece and other credit institutions.
2 Excluding movements in the OPEKEPE (Payment and Control Agency for Guidance and Guarantee Community Aids) account.
3 Including movements in public debt management accounts.
4 Including privatisation proceeds of €1,107.5 million from the sale of Hellenic Telecommunications Organisation (OTE) shares and €502.8 million from the sale of Postal Savings Bank shares. Also including expenditure of €264.9 million paid as emergency relief to the fire stricken population and a grant of €465.7 million to the Agricultural Insurance Organisation (OGA).
5 Including proceeds of €430.8 million from the sale of OTE shares and expenditure of €570.8 million for a grant to OGA but excluding the payment of Greek government debt to the Social Insurance Institute (IKA) by the issuance of bonds of €1,172 million. It should be noted that during the strike of the Bank of Greece personnel in March 2008, public debt service payments of €1,537 million were effected through commercial banks, of which €359 million in interest payments were not reflected in the cash data of the Bank of Greece. If this latter amount is included in interest payments, then the state budget deficit rises from 7.3% of GDP to 7.5% of GDP.
6 Excluding expenditure of €3,769 million for the acquisition of preference shares of Greek banks under Law 3723/2008 and of €1,500 million for the issuance of bonds to cover the capital increase of the Credit Guarantee Fund for Small and Very Small Enterprises (TEMPME SA), but including proceeds of €673.6 million from the sale of OTE shares and €72.3 million from the privatisation of Olympic Airlines, as well as the payment of Greek government debt to OGA by the issuance of bonds of €531 million.
7 Including expenditure of: (i) €297.9 million (bond issue reopening) for the payment of past government debt to the Social Insurance Institute (IKA); and (ii) €714.7 million (bond issuance) for the payment of past government debt to the Hellenic Petroleum SA (ELPE), Egnatia Motorway SA and the Agricultural Bank of Greece, but excluding expenditure of: (i) €849.2 million (bond issue reopening) for the repayment of public hospitals' arrears pursuant to Article 27 of Law 3867/2010, which burdens the 2010 debt; and (ii) €424.3 million (bond issuance) for the settlement of financial obligations of the Hellenic Agricultural Insurance Organisation (ELGA), a replacement of previous loan with the same terms. Also excluding expenditure of €1,500 million for the paying-up of the capital of the Hellenic Financial Stability Fund.

Table IX.9 Financing of the state budget deficit

(million euro)

	2007		2008		2009		2010*	
	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
Greek Treasury bills and government bonds[1]	15,310	123.1	17,283[4]	99.6	39,953[5]	122.5	1,155[6]	4.9
Change in the balances of central government accounts with the banking system[2]	-742	-6.0	-3,596	-20.7	-4,612[5]	-14.1	-8,148	-34.8
External borrowing[3]	-2,136	-17.2	3,674	21.2	-2,719	-8.3	-1,314	-5.6
Borrowing from the IMF/EU/ECB							31,703	135.5
– from the EU							21,000	
– from the IMF							10,703	
Total	**12,432**	**100.0**	**17,361**	**100.0**	**32,622**	**100.0**	**23,396**	**100.0**

Source: Bank of Greece.
* Provisional data.
1 Comprising Treasury bills, short-term securities and government bonds issued in Greece, as well as bonds convertible into shares.
2 Comprising changes in the central government accounts held with the Bank of Greece and other credit institutions. Excluding changes in the OPEKEPE account.
3 Comprising borrowing abroad and securities issuance abroad (all currencies). Excluding non-residents' holdings of bonds issued in Greece.
4 Excluding bonds issued by the Greek government for debt repayment to the Social Insurance Institute – IKA. See also footnote 5 in Table IX.8.
5 Including the issuance of bonds of €3,769 million for the acquisition of preference shares of Greek banks to help strengthen their liquidity position, as well as the issuance of bonds of €1,500 million for covering the capital increase of the Credit Guarantee Fund for Small and Very Small Enterprises (TEMPME SA).
6 Excluding bonds issued by the Greek government for the repayment of debts of public hospitals and of the Hellenic Agricultural Insurance Organisation (ELGA). See also footnote 7 in Table IX.8.

in particular, €21 billion came from euro area countries and €10.7 billion from the International Monetary Fund (see Table IX.9).

4 THE BUDGET FOR 2011: KEY FISCAL ADJUSTMENT MEASURES AND INSTITUTIONAL FISCAL REFORMS

4.1 THE STATE BUDGET FOR 2011

The 2011 budget marks a continuation of the major effort launched in spring 2010 to achieve fiscal adjustment and stabilise the debt-to-GDP ratio. The 2011 budget is in line with the updated Economic Adjustment Programme and anticipates a decline in the general government debt by 2.2 percentage points, to 7.4% of GDP (see Table IX.10). At the same time, the Updated Memorandum (February 2011) projects a reduction of the deficit to below 3.0% of GDP in 2014.

Contrary to 2010, the reduction in the general government deficit in 2011 is expected to come by about 3/4 from entities outside the central government. For this reason, the projected reduction in the deficit of the state budget for 2011 is only 0.5% of GDP (from 8.4% of GDP in 2010 to 7.9% of GDP – see Table IX.10). This low figure, despite the important measures taken on both the revenue and expenditure sides, partly reflects how difficult it is to achieve fiscal adjustment amid recession.

It should be stressed, however, that the primary deficit of the state budget for 2011 is expected to show a much higher improvement than the overall deficit (primary deficit: reduction by 1.8 percentage points, overall deficit: reduction by 0.5 percentage points of GDP). Thus, the primary deficit target for 2011 has been set at 0.9% of GDP, compared with 2.7% in 2010 and 7.9% in 2009 (see Table IX.10). Provided there are no deviations in the implementation of the 2011 budget, this steep drop in the primary deficit within a period of two years would lay the foundations for achieving a primary surplus in 2012 and a stabilisation of the debt-to-GDP ratio in 2012-2013.

The reduction in the state budget deficit is expected to come mainly from a significant increase in revenues of the ordinary budget (by 8.5%), while revenues of the public investment budget are also expected to increase substantially (by 27.7%). On the other hand, ordinary budget expenditure in 2011 is expected to increase by 5.8% against 2010. As analysed below, this increase is mainly due to interest payments, while primary expenditure under the ordinary budget is expected to record a smaller increase (of only 1.9%). Furthermore, investment expenditure is expected to rise by only 0.6% compared with 2010.

4.1.1 Ordinary budget

The considerable increase in the ordinary budget revenue (before tax refunds), which is estimated at €59,320 million (or 26.0% of GDP, compared with 22.7% in 2009 and 23.4% in 2008), is expected to stem from the full (annual) yield of a multitude of tax and structural measures that have already been taken in 2010, as well as from new measures (many of which have already been launched). The most important of these measures are as follows:

- Annual return of all tax measures taken in 2010, in particular of the two increases in VAT rates, the broadening of the VAT base to include activities that were exempt from VAT up to June 2010 (e.g. legal services of all types, taxi fares, writers, artists, etc.), the increases in excise taxes (on fuel, tobacco and alcoholic beverages), the changes in the taxation of inheritance, gifts and parental donations, etc.

- Increase in the lower VAT rate from 11% to 13% as of 1 January 2011.

- Collection of the proceeds of tax amnesty measures and of tax arrears, which started in October 2010.

Table IX.10 State budget balance

(million euro)

	Annual data						Percentage changes				
				2010		2011			2010/2009		2011/10
	2007 (1)	2008 (2)	2009 (3)	Economic Adjustment Programme (4)	Execution* (5)	Budget (6)	2008/07 (7=2:1)	2009/08 (8=3:2)	Economic Adjustment Programme (9=4:3)	Execution* (10=5:3)	Budget/ Execution* (11=6:5)
I. Revenue[1]	**54,026**	**56,698**	**50,531**	**58,382**	**54,246**	**59,442**	**4.9**	**-10.9**	**15.5**	**7.4**	**9.6**
1. Ordinary budget[2]	49,154	51,680	48,491	55,124	51,174	55,520	5.1	-6.2	13.7	5.5	8.5
Revenue before tax refunds	51,777	55,334	53,443	60,224	56,156	59,320	6.9	-3.4	12.7	5.1	5.6
Tax refunds	2,623	3,654	4,952	5,100	4,982	3,800	39.3	35.5	3.0	0.6	-23.7
2. Public investment budget	4,872	5,018	2,040	3,258	3,072	3,922	3.0	-59.3	59.7	50.6	27.7
– Own revenue	61	350	183	149	271	200	473.8	-47.7	-18.6	48.1	-26.2
– Revenue from the EU	4,811	4,668	1,857	3,109	2,801	3,722	-3.0	-60.2	67.4	50.8	32.9
II. Expenditure[1]	**63,940**	**70,604**	**81,403**	**77,073**	**73,694**	**77,503**	**10.4**	**15.3**	**-5.3**	**-9.5**	**5.2**
State budget primary expenditure	54,144	59,397	69,078	64,056	60,471	61,583	9.7	16.3	-7.3	-12.5	1.8
1. Ordinary budget	55,137	60,980	71,815	67,873	65,247	69,003	10.6	17.8	-5.5	-9.1	5.8
– Interest payments	9,796	11,207	12,325	13,017	13,223	15,920	14.4	10.0	5.6	7.3	20.4
– Ordinary budget primary expenditure[3]	45,341	49,773	57,992	54,611	51,649	52,633	9.8	16.5	-5.8	-10.9	1.9
– Grants for the repayment of public hospitals' arrears			1,498	245	375	450					
2. Public investment budget	8,803	9,624	9,588	9,200	8,447	8,500	9.3	-0.4	-4.0	-11.9	0.6
III. State budget balance	**-9,914**	**-13,906**	**-30,872**	**-18,691**	**-19,448**	**-18,061**	**40.3**	**122.0**	**-39.5**	**-37.0**	**-7.1**
% of GDP	-4.4	-5.9	-13.1	-8.1	-8.4	-7.9					
1. Ordinary budget	-5,983	-9,300	-23,324	-12,749	-14,073	-13,483					
2. Public investment budget	-3,931	-4,606	-7,548	-5,942	-5,375	-4,578					
IV. State budget primary balance	**-118**	**-2,699**	**-18,547**	**-5,674**	**-6,225**	**-2,141**					
% of GDP	-0.1	-1.1	-7.9	-2.5	-2.7	-0.9					
V. General government balance											
% of GDP (on a national accounts basis)	-6.4	-9.4	-15.4	-8.1		-7.4					
Amortisation payments	22,544	26,246	29,135	22,375	19,549	28,130	16.4	11.0	-23.2	-32.9	43.9
Procurement of defence equipment	2,129	2,597	2,175	1,800	1,017	1,600	22.0	-16.2	-17.2	-53.2	57.3
GDP (at current prices)	227,074	236,917	235,017	231,000	230,173	228,408	4.3	-0.8	-1.7	-0.8	-0.8

Source: State General Accounting Office.
* Provisional data.
1 For comparability purposes, tax refunds are not included in expenditure and have been deducted from revenue, a practice followed by the Ministry of Finance in the past few years.
2 Including: for **2007**: "notional" revenue of €437 million from the settlement of positions vis-à-vis Olympic Air; for **2009**: revenue from special accounts (now abolished), amounting to €1,088 million, as well as revenue from the liquidity support package, amounting to €47 million; for **2010**: revenue from the liquidity support package, amounting to €485 million.
3 Including: for **2007**: "notional" expenditure of €840 million from the settlement of positions vis-à-vis Olympic Airlines, as well as additional contributions to the Community Budget (€1,108 million) due to the upward revision of past GDP figures; for **2008**: payment of €710 million to the Insurance Funds of DEH's personnel in exchange for property; for **2009**: payments out of special accounts (now abolished) amounting to €827 million, expenditure of €522 million for the Intergenerational Solidarity Fund, an amount of €350 million paid to the National Fund for Social Cohesion (home heating subsidies to pensioners entitled to the Social Solidarity Pension Supplement (EKAS), unemployed and disabled persons), extraordinary social solidarity aid amounting to €489 million, payments of €294 million to Olympic Airlines following an arbitration decision, expenditure of €1,498 for the repayment of public hospitals' arrears, as well as election expenditure amounting to €293 million; for **2010**: extraordinary social solidarity aid amounting to €113 million.

• Collection of the Single Tax on Real Estate Property (ETAK) from 2009 and of the tax on (large) real estate property for 2010 and 2011.

• Updating "objective real estate values" within 2011.

• Introduction of new criteria to determine the taxpayers' presumptive income and extension of the book specification of income for tax purposes.

• New extraordinary levy on businesses (largely to be paid in May-June 2011).

• Possible equalisation of excise tax on motor fuel and heating fuel as of autumn 2011, thus curbing fuel smuggling.

• Drastic reduction of pending court cases through institutional changes in the proceedings before administrative courts in tax cases.

• Sale of gaming licenses and collection of royalties.

• Renewal of telecommunications licenses, fees for licenses to use radio frequencies, etc.

It should be noted that a new tax bill is under preparation that will provide for new measures and will set a limit on existing tax exemptions in income taxation.

It should be noted that, in addition to new tax measures, a radical reorganisation and improvement of the tax collection mechanism is indispensable. The need to improve tax collection has become urgent, as the increased tax burden makes tax evasion more "attractive"; thus, insincere taxpayers intensify their efforts to evade tax. Therefore, tax measures should be combined with measures aimed at improving the tax collection mechanism. In the absence of a modern, sound and efficient tax-collection mechanism, no tax measure could yield the anticipated revenues.

Regrettably, the reduction in budget expenditure achieved in 2010 is rather impossible to continue in 2011. Thus, as mentioned above, ordinary budget expenditure in the 2011 budget is projected to increase by 5.8% reaching €69,003 million, compared with €65,247 million in 2010. Ordinary budget primary expenditure is expected to rise to a lesser extent, by 1.9% compared with 2010, reaching €52,633 million.

The increase in ordinary budget expenditure by €3,756 million compared with 2010 is attributable mainly to the following (see Table IX.3):

• increase in interest payments by 20.4% (or €2,697 million), due to higher interest rates on Greek borrowing (mostly on short-term loans),

• increase in grants to welfare organisations (Labour Force Employment Organisation-OAED, Workers' Housing Organisation-OEK, etc.) and public hospitals by €759 million,

• increase in the restitution of revenue to third parties (mostly first and second-level local authorities) by €322 million, and

• increase in other expenditure by €245 million. This development is entirely due to the establishment of a €580 million reserve that did not exist in previous years.

By contrast, the wage bill in 2011 is expected to decrease by a further 3.2% and stand at €16,647 million, compared with €17,202 million in 2010. These savings are expected to come from measures taken in 2010 that would yield results on an annual basis in 2011 (e.g. abolition of the Easter bonus and cuts in allowances), as well as from the retirement of a large number of civil servants (less increased expenses from pay advancement and limited new recruitment).

Finally, despite the measures taken in 2010, expenditure on civil servants' pensions will remain virtually unchanged (2011: €6,258 million, 2010: €6,250 million), due to the large number of civil servants who retired in 2010.

4.1.2 Public investment budget

In 2011, payments under the public investment budget are expected to remain virtually unchanged at €8,500 million, compared with €8,447 million in 2010 (see Table IX.10). By contrast, public investment budget revenue is expected to rise by 27.7% reaching €3,922 million. In particular, inflows from EU Structural Funds are expected to rise by 32.9% against 2010 and reach €3,722 million. Compared with 2009 (€1,857 million), they are expected to double. Thus, in 2011 the public investment budget deficit would be limited to €4,578 million, or 2.0% of GDP, compared with a deficit of €7,548 million in 2009 (see Table IX.10).

4.2 FINANCIAL TRANSACTION WITH THE EUROPEAN UNION

Following a sharp decline in 2009, net receipts from the EU rose by 54.6% in 2010 reaching €3,113 million, up from €2,014 million in 2009 (see Table IX.11). This improvement mainly stems from the increase in inflows by 21.7%, as well as from the decline in payments to the EU by 4.9% compared with 2009. Higher inflows mostly came from the European Social Fund, the European Regional Development Fund, the European Rural Development Fund and the Cohesion Fund.

For 2011, a further increase of 39.1% is expected in net receipts, which would thus reach a targeted €4,331 million. This development is expected to stem from a 24.5% increase in inflows, while payments to the EU will also rise slightly, by 5.2% (see Table IX.11).

4.3 BUDGETS OF SOCIAL SECURITY AND WELFARE ORGANISATIONS AND PUBLIC ENTERPRISES

Social Security Organisations

According to data[19] in the Introductory Report on the 2011 Budget, the deficit of social security organisations (without taking into account grants under the ordinary budget) is expected to decrease compared with the two previous years and stand at €7,851.5 million or 3.4% of GDP, compared with 4.0% in 2010 and 5.0% in 2009 (see Table IX.4). This projection is based both on the expected considerable rise in revenue (5.5%) and on the slower growth of expenditure (rise by only 0.6%).

According to the Introductory Report, the increase in revenue will be achieved through higher receipts from social security contributions (5.3%), which account for 76.6% of total revenue. The anticipated considerable rise in contributions is based on the extensive efforts to combat contribution evasion, reduce uninsured labour and collect contribution arrears. However, recent data pointing to a decline in economic activity and a fall in employment in the last quarter of 2010 (which had not been available when the budget was drafted) may imply that it would be difficult to achieve the targeted increase in social security contributions by 5.3% in 2011.

With regard to expenditure of social security organisations, diverging developments are expected in the two main expenditure categories. Pension outlays, which account for 70.1% of total current expenditure, is expected to rise considerably (6.5%), because of the increased number of pensioners in 2010 and 2011. By contrast, health expenditure (mostly on medicines), which accounts for about 25.0% of total expenditure, is expected to fall by 11.8%. This decline is expected to result from control over pharmaceutical expenditure through (a) the electronic monitoring of funds' prescriptions, (b) the decrease in the prices of pharmaceuticals, (c) the establishment of a mandatory list of reimbursable medicines for all funds (d) the setting of a ceiling for the prices of materials used in surgical operations. Finally, savings are also anticipated in the staff costs of social security organisations, which are expected to fall by about 2.8% in 2011.

19 As already mentioned in Section 2.4, it is the first time that the Introductory Report includes data for almost all social security organisations in Greece (see footnote 9).

Table IX.11 Greece's financial account with the European Union

(million euro)

						Percentage changes			
	2007	2008	2009	2010*	Budget 2011	2008/2007	2009/2008	2010*/2009	Budget 2011/2010*
A. Receipts from the EU budget	**7,274**	**7,481**	**4,498**	**5,476**	**6,818**	**2.8**	**-39.9**	**21.7**	**24.5**
1. 10% refund on own resources collection costs	77	77	64	64	52	0.0	-16.9	0.0	-18.8
2. European Social Fund	783	992	118	295	666	26.7	-88.1	150.0	125.8
3. EAFRD – Agricultural Fund	589	504	261	408	539	-14.4	-48.2	56.3	32.1
4. ERDF – Regional Fund	3,065	2,858	1,338	1,735	2,082	-6.8	-53.2	29.7	20.0
5. EAGF – Agricultural Guarantee Fund	2,374	2,718	2,398	2,351	2,764	14.5	-11.8	-2.0	17.6
6. Framework programme on solidarity and management of migration flows	-	-	6	37	34	-	-	516.7	-8.1
7. Other receipts	19	102	13	16	11	436.8	-87.3	23.1	-31.3
8. Cohesion Fund	334	200	274	570	640	-40.1	37.0	108.0	12.3
9. EFF – Fisheries Fund	33	30	26	0	30	-9.1	-13.3	-100.0	-
B. Payments to the EU budget	**3,265**	**2,649**	**2,484**	**2,363**	**2,487**	**-18.9**	**-6.2**	**-4.9**	**5.2**
1. Agricultural levies and duties	11	7	4	0	0	-36.4	-42.9	-100.0	-
2. Sugar levies	0	2	2	2	2	-	-	-	-
3. Customs duties under the Common External Tariffs and anti-dumping duties	297	298	248	277	208	0.3	-16.8	11.7	-24.9
4. Contribution according to the VAT base	473	577	512	462	414	22.0	-11.3	-9.8	-10.4
5. Contribution on the basis of GDP	1,184	1,415	1,522	1,561	1,768	19.5	7.6	2.6	13.3
6. Additional extraordinary contributions	1,108	136	150	12	30	-	-	-92.0	150.0
7. Contribution to the European Development Fund	36	40	43	47	55	11.1	7.5	9.3	17.0
8. Payments owing to unrealised projects	156	174	3	2	10	11.5	-98.3	-33.3	400.0
Net receipts from the EU budget (A-B)	**4,009**	**4,832**	**2,014**	**3,113**	**4,331**	**20.5**	**-58.3**	**54.6**	**39.1**

Source: State General Accounting Office.
* Provisional data.

The projected reduction in the deficit of social security organisations, for the second year in a row, implies lower grants from the ordinary budget (-6.9%). Despite lower grants, the financial result for 2011 (a large part of which will be added to the funds' reserves) is expected to be a surplus of €2,146 million, against a surplus of €1,562 million in 2010.

Public enterprises

As mentioned above, in 2011 the effort to reduce the general government deficit has shifted to entities not falling under the State budget and in particular to public enterprises. Already in 2010, through a series of measures,[20] a reduction was achieved in the overall deficit of the consolidated operating and capital account to €588 million (see Table IX.5). An even stronger moderation of the deficit is expected in 2011, when the consolidated deficit of the operating and capital account should turn into a surplus of €387 million.[21]

This improvement is expected to derive mainly from the decline in operating expenditure by 23.4% to €2,460 million. This projection is based on the planned reduction in the wage and operating costs of public enterprises and, in particular, on the restructuring of the OSE and OASA groups[22] (Laws 3891/2010 and 3920/2011). At the same time, the revenue of public enterprises is expected to rise in 2011 by 10.4%, thus contributing to better financial results.

These projections are based on efforts and measures that were launched in 2010 and were intensified in 2011 in order to improve the operation of public enterprises. These measures, in addition to reducing wage costs, include: checking whether a type of expenditure is necessary; achieving economies of scale; ensuring strict control on budgets; putting to better use the real property of public enterprises; assuming the loans of OSE/TRAINOSE and a part of OASA's liabilities; increasing ticket prices and ensuring that tickets are actually paid; assessing results on a monthly basis; strengthening internal auditing; improving the procurement procedure; and merging administrative services, particularly for small enterprises.

In order to boost consolidation in public enterprises, the grant under the ordinary budget for 2011 (in addition to assuming the liabilities of OSE and OASA) will rise to €589 million, compared with €210 million in 2010. Thus, their gross borrowing requirement for 2011 is expected to decrease considerably, to €282 million, from €1,100 million in 2010.

5 KEY INSTITUTIONAL CHANGES AND STRUCTURAL REFORMS IN THE FISCAL SECTOR

In 2010, significant structural reforms were enacted and are expected to further underpin fiscal adjustment. A multitude of legislative measures focused on crucial sectors of the economy, such as the social security system, healthcare, public enterprises and local government. At the same time, the fiscal policy framework was radically overhauled and fiscal institutions were strengthened in order to ensure greater transparency and tighter control of expenditure.

In June 2010, the Kallikratis Programme was passed by Parliament.[23] Kallikratis aims at saving resources by reducing the number of local government authorities and associated entities[24] and achieving economies of scale. For the 2011-2013 period, annual savings of €500 mil-

20 See Section 2.5.
21 This amount results from the surplus of €12,186 million indicated in Table IX.5 less €11,799 million (settlement of OSE's debt).
22 The Bank of Greece has repeatedly stressed in the past that containing deficits particularly of public transports formed a necessary condition for controlling deficits and borrowing of public enterprises. See, for example, Bank of Greece, *Annual Report 2009*, p. 98-99 and 109.
23 Law 3852/2010 "New architecture of local government and decentralised administration – Kallikratis Programme".
24 In particular, the number of first-level local government authorities (municipalities) are reduced to 325 (from 1,034), second-level local government authorities are structured into 13 regions by bringing together the former 57 prefectural divisions that have now been abolished, while legal entities in public law within municipalities and regions are merged into 2,000 entities, down from 6,000.

lion are expected. To this end, the government has taken measures to limit borrowing by local authorities and has imposed a no-deficit rule on them until at least 2014.

In July 2010, the social security reform was legislated (Law 3863/2010 and Law 3865/2010 applying to workers in the private and the public sector, respectively), with the aim to ensuring the long-term sustainability of the pension system,[25] which can be quantified as limiting pension expenditure growth to 2.5% of GDP in the 2009-2060 period, against 12.5% of GDP under the no-change scenario. According to the latest assessments of the European Commission and the IMF, the reform is considered highly ambitious in the light of international experience.[26] The next step will consist in evaluating the viability of the larger supplementary pension funds. New legislation focusing on supplementary pension and welfare funds are expected to be adopted by September 2011.[27]

The social security reform of July 2010 also brought about changes in the field of healthcare,[28] although these had to be supplemented by additional legislative measures[29] designed to reduce expenditure, increase cost efficiency and improve the provision of services. Reforms mostly aim at reducing pharmaceutical expenditure and rationalising hospital procurement.[30] According to the Introductory Report on the 2011 Budget, cost savings in the field of healthcare for 2011 are estimated at €2.1 billion.[31] With regard to structural reforms, provision has been made for the establishment of the National Healthcare Organisation (EOPYY) in August 2011, whose authority will extend to the National Health System hospitals, the healthcare arms of the Social Security Institute (IKA), of the Agricultural Insurance Organisation (OGA) and of the Social Security Organisaton for the Self-Employed (OAEE), the Healthcare Organisation for the Insured of the Public Sector (OPAD) and the Seamen's Home (Law 3918/2011). Measures of administrative nature have also been enacted concerning the operation of hospitals aimed at boosting hospital revenue, such as the introduction of the all-day operation of hospitals (Law 3868/2010). At the same time, admission fees for regular outpatient clinics in public hospitals and healthcare

25 The principal changes in the social security reform are as follows: (a) introducing — as from 1 January 2015 — a contributory pension that will be calculated on the basis of contributions paid throughout working life and a basic pension that will not be contribution-based but rather of a welfare nature; (b) adjusting key parameters of the pension system in order to include future pension expenditure, e.g. setting the minimum retirement age at 60 years provided 40 years of working life have been completed. For a more detailed presentation of the social security reform, see Bank of Greece, *Monetary Policy – Interim Report 2010*, October 2010, Box V.2, p. 109-111.

26 In a recent preliminary study concerning three social security funds (Social Security Institution - IKA, Social Security Organisation for the Self-Employed – OAEE and Agricultural Insurance Organisation - OGA), the projections of the National Actuarial Authority (EAA) for the 2010-2060 period suggest that the 2010 social security reform has made a considerable contribution to stabilising pension expenditure (as a percentage of GDP) at 2009 levels.

27 Further changes in the larger pension funds cannot be ruled out if the financial target of the social security reform (putting a 2.5% of GDP cap on pension expenditure in the 2009-2060 period) is deemed unattainable.

28 In particular, the financial and accounting independence of the healthcare arm of IKA-ETAM has been established, the primary and secondary healthcare units of the National Health System and the Social Security Organisations (FKA) have been pooled and now operate within a single framework and, finally, provision has been made for a partnership between social security organisations with regard to health benefits through the Coordinating Board for Health Services that is going to operate within the General Secretariat for Social Security.

29 In particular, the relevant reforms are included in: (a) Law 3840/2010 "Decentralisation, simplification and improvement of the efficiency of procedures pertaining to the National Strategic Reference Framework (ESPA) 2007-2013 and other provisions" (24 March 2010), (b) Law 3868/2010 "Upgrading of the National Health System and other provisions falling within the jurisdiction of the Health and Social Solidarity Ministry" (27 July 2010), and (c) Law 3918/2011 "Structural changes in the health system and other provisions" (15 February 2011).

30 New legislation designed to reduce pharmaceutical expenditure and reform the hospital procurement system can be summarized as follows: *Pharmaceutical expenditure*: Law 3840/2010 stipulates that (a) the prices of brand-name medicines, upon expiry of the patent, are reduced by at least 20%, (b) the prices of pharmaceutical products with a similar active substance and pharmacotechnical form are set to a maximum of 90% of the sale price of the respective off-patent brand-name medicine, (c) the price of each pharmaceutical product produced or packaged or imported in Greece is determined as the average of the three lowest prices of the medicine in EU Member States. Furthermore, Law 3918/2011 provides for the following: (a) introduction of a reimbursement from private pharmacies and pharmaceutical companies in favour of the healthcare arms of social security organisations, (b) reducing the gross profit margin of pharmaceutical product wholesalers, (c) transferring to the Ministry of Health the responsibility to price medicines. *Procurement procedures*: Law 3918/2011 (a) aims at rationalising supplies, by ensuring that each organisation drafts an annual list of products and services to be procured for the next year, (b) gives the possibility to awarding authorities to assign the responsibility to carry out procurement to other entities (including private ones), (c) provides for a realignment of medical equipment prices with those of the Price Observatory.

31 The containment of pharmaceutical expenditure is expected to be further enhanced by the universal implementation of the electronic prescription system (which, for the time being, is implemented only by the Social Security Organisation for the Self-Employed – OAEE) the extension of the list of medicines and a wider use of generic medicines.

centres of the National Health System have risen (from €3 to €5). Hospital computerisation and the introduction of the double-entry accounting system in public hospitals, as well as the universal application of the electronic prescription system are ongoing.

Progress is at present a major challenge, as controlling and evaluating the performance of the measures intended to reduce health expenditure can only be achieved if the central administration has access to reliable, timely and regularly available financial data for all entities within the National Health System. For example, according to a recent report by the European Commission, electronic prescribing has not been extended to all hospitals (it is used in only 60 out of 134 hospitals), while the creation of a similar uniform and integrated system for all social security organisations (except OAEE) has yet to be completed.[32]

Important institutional changes have also been introduced to public enterprises, which are now subject to a stricter financial supervision framework coordinated by the Special Secretariat for Public Enterprises and Organisations within the Ministry of Finance (EGDEKO).[33] This Special Secretariat closely monitors the evolution of the wage bill and the compliance with legislation on incomes policy in Public Enterprises and Organisations,[34] as well as the progress made in the effort to reduce their operating expenses. With a view to ensuring the economic viability of Public Enterprises and Organisations, new legislation was passed to restructure transport entities, namely the groups of the Hellenic Railways (OSE-TRAINOSE) and the Athens Urban Transport Organisation (OASA).[35] A common aim of the reforms is to consolidate the finances of these groups through wage and operating cost cuts and tariff increases,[36] the assumption of accumulated debts by the State, the setting of ceilings on government subsidies, the transfer of surplus personnel in line with the rule of not more than one recruitment for five exits in the entire public sector, drafting business plans and permanent accountability of managements. Overall, cost savings resulting from measures applicable to Public Enterprises and Organisations are estimated at €500 million for 2011 according to the revised Economic Adjustment Programme (February 2011). Additional cost saving can be expected from the implementation of legislation providing for the closing or merger of services, organisations and entities of the public sector,[37] where 18 public entities are closing and 13 are merging into 5. Overall, with regard to the reforms in the Public Enterprises and Organisations and the planned closing or merger of other legal entities under public law, a lot will depend on the fast and efficient implementation of surplus human resources management schemes and a rearrangement of activities.

The overall fiscal consolidation effort takes place within a new fiscal management and responsibility framework,[38] which aims inter alia to enhance expenditure control. It has introduced stringent transparency and disclosure requirements and has widened the scope of financial supervision by the Ministry of

32 It should be noted that a special task force has been set up and has undertaken to produce a comprehensive mapping of the health system and to propose policies and quantitative criteria in individual sectors. The task force is expected to deliver its report, which will form the basis to draw up a concrete action plan, in May 2011.

33 For example, pursuant to Law 3871/2010 Public Enterprises and Organisations are required to submit monthly cash data, while Law 3899/2010 introduces the requirement to submit quarterly financial statements audited by chartered auditors/accountants.

34 Laws 3833/2010, 3845/2010 and 3899/2010. Law 3899/2010 concerns 2011 and provides for (a) cuts in earnings by 10% (for total earnings above €1,800), (b) a ceiling of 10% on the total wage bill for overtime pay, travel expenses, overwork pay, subsistence allowance, and work during public holidays, (c) a ceiling of €4,000 (on a twelve-month basis) on gross monthly earnings, and (d) prohibition of any rise in the earnings of civil servants for the year 2011.

35 Law 3891/2010 "Restructuring, consolidation and development of the OSE group and TRAINOSE and other provisions applicable in the railway sector" and Law 3920/2011 "Consolidation, restructuring and development of urban transports in the Region of Attiki and other provisions".

36 With regard to OSE-TRAINOSE, the financial and operational independence of TRAINOSE has been established, the National Manager of Railway Infrastructure (EDISY) will merge with OSE and the responsibilities of ERGOSE and GAIOSE will be redefined. With regard to OASA, the reform envisages the merger of the companies ensuring the provision and performance of transport services into two entities, one for track-based transports (STASY) and one for road transports (OSY), to be wholly-owned by OASA.

37 Law 3895/2010 "Closing and merger of services, organisations and entities of the public sector".

38 Law 3871/2010 "Fiscal management and responsibility". For more information, see Bank of Greece, *Monetary Policy – Interim Report 2010*, October 2010, Box V.1, pp. 108-109.

Finance to include, apart from central government, all general government entities, as it requires the submission to Parliament of consolidated annual budgets. The new fiscal management and responsibility framework also introduced a rolling three-year Medium-Term Fiscal Strategy Plan.

However, as pointed out in the latest European Commission and IMF reports in the context of the third Economic Adjustment Programme review, progress in strengthening fiscal institutions has been slow. For example, delays continue to exist in such matters as budgeting practices and procedures, expenditure control and the regular reporting of fiscal data by general government entities. As a result, nearly a year after the launching of the Economic Adjustment Programme, there is still no full or clear picture of Greece's fiscal position on a monthly basis, which is also reflected in the accumulation of debts falling due.

In order to meet extraordinary fiscal needs, measures have been taken to immediately increase tax revenues. These measures included successive increases in VAT rates and excise taxes on fuel, tobacco and alcoholic beverages and an extraordinary levy on enterprises. At the same time, numerous measures of a structural nature have been adopted to reform the tax system by broadening the tax base, curbing tax evasion and enhancing tax compliance, thereby making the tax system more equitable and, finally, strengthen tax administration. In particular, the latest tax bill contains a number of provisions that will help improve tax administration and fight tax evasion.[39] It should be noted that according to the 2011 budget, the fight against tax evasion is expected to yield €1.6 billion in revenue this year, which underscores the importance of implementing the relevant provisions swiftly and rigorously. Otherwise, any deviation from the 2011 budget will need to be compensated for by additional measures that could undesirably affect economic activity. However, the larger than expected decline in domestic demand in 2010 and the continued rise in unemployment may affect the achievement of the targeted increase in revenue in 2011.

According to the updated Memorandum of February 2011, the government was expected to release an action plan for the reduction of the deficit in the medium-term, by mid-April 2011, which would then be submitted for approval by the Cabinet. The Medium-Term Fiscal Strategy Framework will specify the fiscal measures of a permanent nature and a binding time schedule amounting to €22 billion for the period 2012-15, in order to reduce the general government deficit to €2.6 billion or 1% of GDP in 2015. It should be stressed again that the key to sustainable fiscal consolidation is reducing government expenditure on a permanent basis, combating tax evasion and upgrading the tax administration. Reducing expenditure should be achieved by restructuring loss-making public enterprises and organisations and closing government entities, rationalising the pay-system and the human resources management system, reforming public administration and social expenditure (on the basis of information from the assessment currently carried out by the OECD), as well as by cutting back on defence expenditure.

6 THE DYNAMICS OF PUBLIC DEBT

Public debt dynamics and issues related to the stabilisation of public debt have been the focus of public debate. In theoretical and empirical literature, public debt as a percentage of GDP represents a key economic variable, whose limits, evolution over time and consequences are of particular economic interest. The evolution of public debt has an impact on the allocation of available economic resources, as well as on the distribution of income and wealth. Thus, it is related to present, as well as past decisions that often set limitations for the future. In addition, the economic crisis has shown in practice that the evolution of public debt over time and the relevant fiscal stability issues are

39 See Appendix.

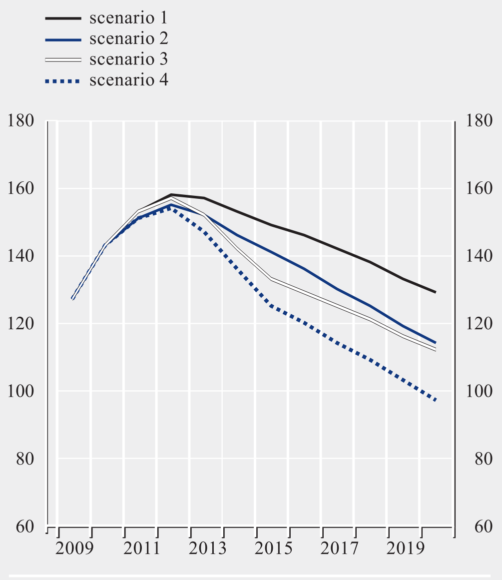
related to the short-term liquidity in the economy and the ability of governments to access capital markets in order to finance their borrowing requirements. A non-sustainable public debt and, in general, a non-credible fiscal policy give rise to solvency problems and are related with a reluctance of investors to grant credit to a country, which makes it difficult for governments to access markets in order to obtain financing. The above result in an urgent need for fiscal adjustment, which is the main subject of discussion in Greece.

Chart IX.2 illustrates four projections/simulations of Greek public debt as a percentage of GDP for 2010-2020. The main assumptions used in the projections regarding the macroeconomic environment, the main fiscal variables and the divestment of state assets are in line with those used in the third report of the European Commission and the IMF on the assessment of the implementation of the Economic Adjustment Programme (March 2011), as well as with the basic guidelines in the Medium-Term Fiscal Strategy Framework for 2012-2015 presented by the Ministry of Finance in March 2011. Namely, these assumptions include a primary surplus above 5.5% of GDP in 2014-2020 and a rate of nominal GDP growth above 2% for the period beyond 2013. In addition, the already decided reduction in the interest rate (by 100 basis points) on the entire loan from the euro area countries has been taken into account.[40]

Under the above scenario, i.e. the baseline scenario (Scenario 1), public debt as a percentage of GDP (126.8% in 2009) will be rising up to 2012 and will start to decrease at a slow but gradually accelerating rate thereafter, reaching 129.1% of GDP in 2020. Higher growth rates (+1%) under Scenario 2 would help to achieve a larger reduction in the public debt, which would drop to 113.8% of GDP by 2020. The reduction in public debt will be even higher if, instead of the above improvement in growth, the programme of divestment of state assets and privatisations that is being drafted by the government is fully complied with until 2020

Chart IX.2 Government debt scenarios

(percentages of GDP)



(Scenario 3). In this case, public debt would fall to 111.7% of GDP by 2020. Of course, if privatisations and the divestment of state assets are combined with increasing growth rates (Scenario 4), after increasing up to 2012, public debt would then fall sharply, to stand at a level below 100% of GDP by 2020.

Although these are sensitive to different assumptions regarding nominal GDP growth and interest rates on borrowing, it clearly follows that the implementation of fiscal adjustment, structural changes, privatisations and divestment of state assets, combined with an increasing growth rate, is crucial to lowering the public debt. Given that the achievement of these targets is set at a long-term horizon, fiscal management should proceed in a sys-

40 In the informal meeting of the euro area heads of state and government on 11 March 2011 it was decided that the interest rate on the entire loan from the EU (€80 billion) would be reduced by 100 basis points, the grace period would be extended from 3 to 4 years and the maturity of each loan instalment would be extended from 2 to 7 years (this decision was confirmed by the European Council of 24-25 March). This would lead to annual savings of about €800 million during the 7.5-year maturity of loans amounting €80 billion. Overall, savings in interest payments are estimated at €6 billion.

tematic and methodical way. In this regard, the contribution of the appropriate institutional framework, as this has been established through the legislative measures adopted in 2010 and those that are currently underway, will be critical. The strict implementation of the fiscal adjustment programme is of decisive importance, as it can put in place the necessary conditions to ensure the access of Greece to capital markets and the financing of its borrowing requirements under satisfactory terms.

APPENDIX TO CHAPTER IX
TAX POLICY MEASURES

In 2010, a number of measures were adopted, aimed to ensure a reduction in the fiscal deficit and the achievement of the objectives set in the Economic Adjustment Programme. Some of these measures, such as the successive increases in VAT rates and in excise taxes on fuel, tobacco and alcoholic beverages and the extraordinary levy on businesses, were intended to directly boost tax revenue. Numerous other measures, included in the two major tax packages passed in 2010, introduced structural reforms to the tax system by widening the tax base, combating tax evasion and enhancing tax compliance, in order to ensure a more equitable tax system and more efficient tax administration.

Law 3842/2010,[1] passed in March 2010,[2] brought about major changes to personal and corporate income taxation and property taxation.

Regarding income taxation, the law established a single tax scale for all incomes and drastically reduced the cases where income is taxed separately rather than being added to the taxpayer's other income. Income tax became more progressive (with emphasis on higher incomes), a top tax rate of 45% was introduced for incomes of over €100,000, and the tax-free allowance – applicable to all taxpayers[3] – was set at €12,000.[4] For the first time, entitlement to this tax-free allowance became conditional upon the submission of receipts for the purchase of goods and services in an amount depending on income and up to €12,000. Any additional receipts for up to €3,000 in excess of this amount are eligible for a tax relief.

The same law reintroduced the tax deduction of 1.5% for natural and legal persons paying the entire tax amount by the due date of the first tax instalment.

Other provisions of this law reduced the mortgage interest tax deduction for housing loans concluded after 1 January 2009 and abolished a number of other tax deductions (such as for expenditure on wedding and baptism receptions, etc.), replacing them by the new receipt-based system of tax allowances. The law also introduced income imputation based on the taxpayer's cash expenditures.[5] As from 1 January 2010, first-time homebuyers are no longer exempt from the requirement to disclose the origin of funds (later, however, Law 3899/2010

1 "Restoring tax equity, addressing tax evasion, and other provisions".
2 The measures adopted before March 2010, including the first increase in VAT rates, are described in the *Annual Report 2009*.
3 Increased by €1,500 for taxpayers with one child, €3,000 for two children, €11,500 for three children and €2,000 for each child over three children.
4 Under the previously applicable tax scale, the tax-exempt amount was €12,000 for employees and pensioners and €10,500 for all other taxpayers.
5 Relevant expenditure items include rental value of owner-occupied or rented principal residence and/or secondary residence, private passenger cars owned by natural and legal persons, tuition fees of private schools, wages paid to domestic employees, ownership of pleasure boats, airplanes, etc.

Personal income tax scale for all taxpayers

Income bracket	Tax rate (%)	Bracket tax	Total income	Total tax
12,000	0	0	12,000	0
4,000	18	720	16,000	720
6,000	24	1,440	22,000	2,160
4,000	26	1,040	26,000	3,200
6,000	32	1,920	32,000	5,120
8,000	36	2,880	40,000	8,000
20,000	38	7,600	60,000	15,600
40,000	40	16,000	100,000	31,600
Excess	45			

partly suspended the implementation of this provision – see below).

Under the same law, income from taxi and kiosk business and the income of street market vendors and providers of holiday accommodation services (other than hotels) will be subject to accounts-based taxation; in addition, the obligatory use of cash registers was extended to more occupations and activities. Important changes were also made in the VAT regime, by broadening the VAT base to include formerly exempt activities such as legal services of any nature and medical services provided by private healthcare institutions.

Changes were also made in the taxation of corporate earnings. The tax rate on retained earnings was lowered to 24% for income accrued in 2010. For distributed profits (for financial year 2010), separate taxation was abolished and withholding tax at a rate of 21% was introduced. Dividends will now be added to the taxpayer's other income and taxed according to the general provisions.

The tax law also brought about changes to the taxation of property, transfers of second-hand houses, gifts to legal entities in public law and lottery winnings. The tax exemption for first-time homebuyers, which applied to homes of up to 200 square metres irrespective of value, was abolished and replaced by an exemption based on value, with the exempt amount increasing with family size.[6]

With respect to taxation of real estate wealth, the Single Tax on Real Estate (ETAK)[7] was abolished, and a progressive Large Real Estate Tax was imposed on natural persons owning any property of over €400,000 in value. Real estate owned by legal persons is subject to an ad valorem tax of 0.1% to 0.6%, depending on the type and use of the property and the legal person's non-profit status or otherwise.

Other provisions of this law concerned: encouraging the repatriation of funds;[8] establishing self-assessment criteria for small businesses, as an incentive for voluntary tax compliance; introducing a tax evasion point system and risk analysis to determine, in a centralised manner, any cases warranting a tax inspection and/or audit.

Law 3843 of April 2010[9] specified the conditions and procedures for remedying town planning irregularities (the so-called "semi-outdoor spaces") at a cost equal to 10% of the objective value of the space concerned, thereby discharging the taxpayer from the liability to pay any additional taxes and social security contributions in this respect. The deadline for making use of this arrangement was set at 30 June 2011.[10]

Law 3845 of May 2010[11] introduced a new tax package to boost revenue and reduce the fiscal deficit. To this end, VAT rates were adjusted for a second time in 2010[12] from 21% to 23%, from 10% to 11% and from 5% to 5.5%, effective from 1 July 2010; effective from 3 April 2010, the overall excise tax levied on the cigarette price category most in demand was raised from 65% to 67% and its unit-based component was raised from 7.5% to 10%, while the excise tax on alcohol was increased by 30%;[13] and the excise taxes on petrol and diesel oil were increased by 7.9% and 9.8% per litre, respectively.[14]

6 The tax-exempt amount was set at €200,000 for a single and €250,000 for a married taxpayer respectively, to be increased according to the number of children.
7 It should be recalled that the Single Tax on Real Estate had been levied as from 1 January 2008 under Law 3634/2008.
8 The law envisages an exemption from the requirement to disclose the origin of funds and a tax of 5% for any funds deposited with banks abroad and transferred into time deposits in Greece within six months; the same exemption and a tax of 8% will apply to any funds declared as being held abroad but not repatriated.
9 "Digital ID for buildings, violations of building regulations and changes of use, metropolitan planning, and other provisions".
10 It should be noted that the revenue to be collected had not been included in the budgeted revenue under the State Budget.
11 "Measures for the implementation of the support mechanism for the Greek economy by the euro area Member States and the International Monetary Fund".
12 The first adjustment of VAT rates in 2010 was introduced by Law 3833/2010 and took effect as from 15 March 2010. See *Annual Report 2009*, April 2010.
13 The first increase in taxes on tobacco and alcohol in 2010 was introduced by Law 3815/2010 and took effect as from 18 January 2010. The second increase was introduced by Law 3833/2010 and took effect as from 4 March 2010. See *Annual Report 2009*, April 2010.
14 The first increase in taxes on fuel in 2010 was introduced by Law 3828/2010 and took effect as from 9 February 2010. The second increase was introduced by Law 3833/2010 and took effect as from 4 March 2010. See *Annual Report 2009*, April 2010.

A provision of the said law adjusted the tax brackets and rates of the luxury tax introduced in March 2010, while expanding its scope to less expensive goods such as cars,[15] and raising the top tax rate by 30%.

Finally, a new extraordinary levy was imposed on businesses with profits of over €100,000, for the next three years, at progressive rates ranging from 4% to 10%.[16]

In early September, **Law 3888/2010**[17] launched a new tax amnesty, targeting some 2 million unaudited tax cases and cases of verified overdue debts to the State and offering favourable terms to taxpayers. It should be noted that the last three decades have seen another nine tax amnesties as an emergency revenue-raising measure and in order to reduce backlogs in tax processing. The same law introduced a new system of road excise duties for 2011, which is based on a vehicle's engine capacity rather than age and is more progressive. For new cars, road taxes are scaled according to pollutant emissions.

Law 3899/2010 of December 2010[18] mainly included a number of provisions on the implementation of the 2011 budget. In more detail, effective from 1 January 2011, VAT rates were adjusted for a third time (the "low" rate was increased from 11% to 13% and the "very low" rate from 5.5% to 6.5%). Effective from 1 January 2011, pharmaceutical products, hotels and holiday accommodation services were transferred from the 11% rate to the adjusted "very low" rate of 6.5%. The taxation of heating oil was simplified by abolishing the high excise tax payable by heating oil suppliers at customs clearance. Regarding tax on cigarettes, as from 1 January 2011, the overall excise tax levied on the price category most in demand was cut to 65%, but the unit-based component of tax was raised from 10% to 15%. The excise tax on electric power for domestic use[19] was lowered, business electricity bills (other than high voltage) were increased, and electricity for agricultural use was exempt from tax. In order to revive the real estate market, first-time home buyers acquiring a property of an objective value of up to €200,000 are exempt from the requirement to disclose the origin of funds. Another provision introduces incentives to replace older cars, in the form of lower registration fees for newer, less polluting cars until the end of 2011, while the luxury tax on cars in the medium (ex-works) price category was reduced (cf. the previous regime under Law 3845/2010).

Finally, a new tax law (**3943/2011**[20]) was passed in March, with a number of measures mainly aimed at combating tax evasion and widening the tax base.

In more detail, measures to ensure faster resolution of tax disputes and stricter enforcement include the announcement of a three-year anti-tax evasion action plan , the appointment of a Financial Crime Prosecutor and the application of *in flagrante delicto* procedures, ex *officio* prosecution and strict penalties for tax evasion.

The law also addresses the need to restructure the tax audit and collection mechanisms by overhauling the tax audit system and improving the staff and overall performance evaluation system in tax administration. Specifically, the law envisages the appointment of Tax Enforcement Officers at the Ministry of Finance; the establishment of an Internal Affairs Directorate to investigate allegations of corruption cases involving Ministry of Finance staff; the establishment of a Department for International Administrative Cooperation in the field of direct taxation; and the reorganisation of the General Directorate of Tax

15 The threshold for the luxury tax was set as an ex-works price of over €15,000, rather than €17,000 applying previously under Law 3833/2010.
16 It should be noted that an extraordinary levy was first imposed on large businesses under Law 3803/2009 (on 2008 pre-tax profits).
17 "Voluntary closure of tax disputes, settlement of overdue debts, provisions on effective punishment of tax evasion, and other provisions".
18 "Urgent measures to implement the support programme for the Greek economy".
19 Originally levied by Law 3833/2010.
20 "Combating of tax evasion, staffing of tax audit services, and other provisions within the field of responsibility of the Ministry of Finance".

Audits. Tax secrecy is lifted, and public disclosure of names is possible, for taxpayers with overdue debts exceeding €150,000. Finally, overdue debts to the State are distinguished into collectable and non-collectable.

The same law introduced measures to improve the business tax environment and provide incentives to encourage entrepreneurship. In this context, the corporate income tax rate was reduced from 24% to 20% and the withholding tax rate on distributed profits was raised from 21% to 25%, effective from 1 April 2011; the tax rate on sales of shares on the Athens Exchange was increased from 1.5‰ to 2‰; shares acquired from 1 January 2012 onwards are exempt from transaction tax and are subject instead to a capital gains tax;[21] the effect of the provisions of Law 3842/2010 on the repatriation of funds is extended until 30 September 2011; the percentage of a fine that must be paid before an appeal can be filed was raised from 25% to 50%, and a similar increase applies to VAT cases; against the background of the current economic downturn, the previously discontinued arrangements to facilitate VAT collection came back into effect; the optional use of an electronic receipt card is introduced; and, finally, the law provides for the establishment of a Body of Tax Arbitrators, which will dealing exclusively with tax cases involving amounts of over €150,000, thereby ensuring faster resolution of tax disputes and at a lower cost to the taxpayer.

21 Law 3842/2010 (Article 16).

X MONEY, CREDIT AND CAPITAL MARKETS IN GREECE

1 MONETARY DEVELOPMENTS

The monetary aggregate M3[1] (excluding currency in circulation) decreased markedly in 2010 and its average annual rate of change came to -7.5%. The decline of M3 accelerated during the year, particularly in the first half, to reach -11.8% in the fourth quarter, whereas it decelerated in the first two months of 2011 (see Table X.1). Conversely, in the euro area the growth rate of M3 was positive in the second half of 2010 and the first two months of 2011. As a result, the differential between these two rates widened considerably during the period under review, apparently reflecting the different cyclical position between Greece and the other euro area countries.[2]

In Greece the decline in M3, which consists almost entirely of deposits,[3] is mainly associated with the serious worsening of the macroeconomic environment. The economic downturn and, subsequently, the decreasing incomes of business firms and households brought about a deterioration in their liquidity positions and pushed them to use their deposits in order to cover operating costs or consumer expenditure. To a lesser extent, the drop in deposits is also linked with an observed decline in household indebtedness[4] and a change in the commercial behaviour of corporations.[5] In certain periods, especially in the first half of 2010, the decline in M3 was aggravated by heightened uncertainty among savers, which led to shifts from instruments within M3 (mostly time deposits) to assets outside M3.[6]

More specifically, deposits of the private sector with domestic credit institutions declined by 12%[7] in 2010. According to Bank of Greece data, it is estimated that more than 1/3 of the total decline in deposits was channelled to credit institutions abroad, while a considerable part of the decline concerned the substitution of deposits with high-value banknotes.[8] However, in the course of the year, uncertainty became less important in explaining the evolution of deposits, while economic activity became more important. This conclusion is also confirmed by the fact that the drop in overnight deposits became more pronounced in the second half of 2010 relative to the first half.[9]

The adverse macroeconomic environment is expected to continue to have a significant effect on the monetary aggregate, as it has been observed that the annual growth rate of real deposits lags behind that of real GDP.[10] Conversely, the drop in M3 in Greece does not appear to be justified by developments in the opportunity cost of holding money, since the impact of the steep yield curve on the monetary aggregate waned, as was also the case for

1 This aggregate, which constitutes the Greek contribution to the euro area M3, comprises overnight deposits, deposits with an agreed maturity of up to 2 years and deposits redeemable at notice of up to 3 months, repurchase agreements, money market fund units/shares and debt securities with a maturity of up to 2 years. It should be reminded that the Greek M3 does not take into account currency in circulation (M0) as, with the introduction of euro banknotes in January 2002, currency in circulation can be estimated only for the euro area as a whole and not separately for each country.
2 This conclusion stems both from M3 releases and from the more directly comparable M3 excluding currency in circulation.
3 In 2010, deposits included in M3 accounted for 99.5% of the monetary aggregate, on average.
4 In the course of the year, households repaid only part of their outstanding debt, which is also corroborated by the negative flow of MFI financing (see Section 3 below).
5 In 2010, non-financial corporations seem to have limited their transactions in credit and increased the share of their transactions in cash. However, this aggregate is not taken into account in the calculation of M3 in Greece (see footnote 1).
6 Among other things, deposits or financial investment abroad, gold sovereigns or banknotes of high nominal value.
7 This figure concerns proportional changes in outstanding total deposits of the domestic private sector for which a sectoral breakdown is available, and not deposits with a maturity of up to two years which are included in M3. However, it should be noted that in December 2010 M3 deposits of the private sector accounted for 98.7% of total private sector deposits.
8 It is estimated that the bulk of net outflows of high-value banknotes (over €100) from the Bank of Greece was held for hoarding purposes, given the income elasticity of demand for currency in circulation and the negative growth rate of nominal GDP, as well as the limited use of high-value banknotes in transactions.
9 It should be noted that the decline in total private deposits in the first half of 2010 concerned mainly time deposits (by 2/3); in the second half of the year, approximately 80% of the outflow stemmed from overnight deposits (savings accounts, current accounts and sight deposits). According to an ECB survey concerning the permanent and temporary factors influencing the evolution of M3, the contribution of shocks from overnight deposits (and currency in circulation) is highly correlated with the respective contribution of the economic cycle. See Box 2 "Permanent and temporary factors in broad money growth", ECB, *Monthly Bulletin*, March 2011, p. 25.
10 In a sample of historical data concerning the period from the first quarter of 2000 to the fourth quarter of 2010, it has been observed that the correlation ratio between the annual growth rates of real deposits of the domestic private sector and real GDP is maximised when the annual growth rate of real deposits lags the GDP growth rate by 6 quarters.

Table X.1 Greek contribution to the key monetary aggregates of the euro area

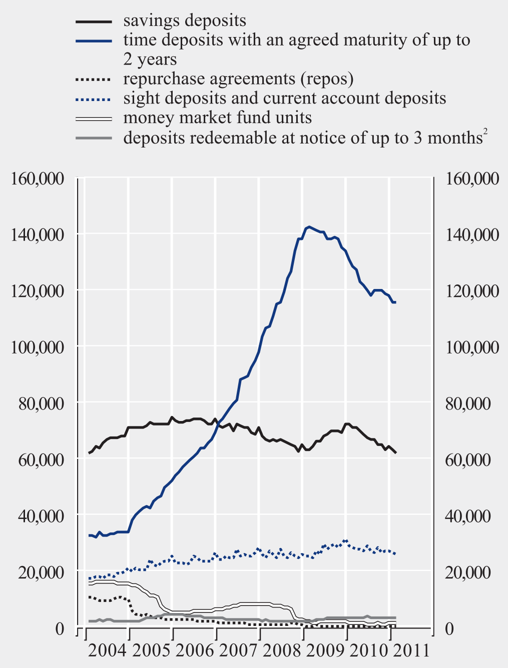
(non-seasonally adjusted data)

	Outstanding balances on 28.02.11 (million euro)	Annual percentage changes[1]											
		2005	2006	2007	2008	2009		2010					2010
		Q4[2]	Q4[2]	Q4[2]	Q4[2]	Q4[2]	Dec.[3]	Q1[2]	Q2[2]	Q3[2]	Q4[2]	Dec.[3]	Feb.[3]
1. Overnight deposits	87,488	9.3	0.7	-0.9	-7.0	11.4	13.9	13.4	4.2	-4.1	-8.0	-11.9	-11.5
1.1 Sight deposits and current account deposits	25,770	20.2	1.8	10.3	-3.6	15.7	19.8	14.4	3.7	-4.7	-7.6	-13.1	-7.9
1.2 Savings deposits	61,718	6.3	0.2	-4.6	-7.9	9.5	11.5	12.8	4.5	-3.7	-8.1	-11.4	-13.2
2. Time deposits with an agreed maturity of up to 2 years	115,197	45.2	37.5	42.2	39.1	2.7	-2.4	-7.3	-13.6	-15.0	-13.8	-12.8	-9.8
3. Deposits redeemable at notice of up to 3 months[4]	2,887	105.2	-24.4	-20.3	-24.1	64.2	69.9	56.9	14.9	5.3	-7.0	-9.6	-8.3
4. Total deposits (1+2+3)	**205,572**	**20.7**	**12.1**	**15.9**	**15.3**	**6.6**	**4.6**	**1.2**	**-6.3**	**-10.3**	**-11.3**	**-12.4**	**-10.5**
5. Repurchase agreements	102	-72.8	-35.7	-54.3	-11.4	-67.1	-50.0	-39.6	-51.4	-50.1	-48.9	-54.3	-31.8
6. Money market fund shares/units	995	-51.8	-2.5	40.5	-58.8	-44.8	-32.1	-27.7	-33.8	-46.3	-45.8	-39.2	-23.8
7. Debt securities issued with a maturity of up to 2 years[5]	5	-42.2	24.2	-	-	-	-	-	-	-		-	-
8. M3 excluding currency in circulation (4+5+6+7)	**206,674**	**6.9**	**10.6**	**14.7**	**14.4**	**4.8**	**3.2**	**0.1**	**-7.3**	**-11.1**	**-11.8**	**-12.5**	**-10.6**

Sources: Bank of Greece and ECB.
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 the 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-of-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.

Chart X.1 Deposits, repurchase agreements and money market fund units in Greece[1] (January 2004 - February 2011)

(end-of-period balances, million euro)



Source: Bank of Greece.
1 These aggregates are included in M3 according to the ECB definition and therefore constitute the Greek contribution to the corresponding euro area aggregates.
2 Including savings deposits in currencies other than the euro.

the euro area.[11] Lastly, the decline in M3, as long as it is attributed to the aforementioned substitution of M3 components with other assets, overestimates the underlying rate of monetary contraction.

The evolution of M3 components showed similar trends in 2010 and the first two months of 2011. In addition, a shift (within M3) towards less liquid assets cannot be ruled out, due to widening spreads between overnight and time deposit interest rates. More specifically, overnight deposits declined at an accelerating annual rate, which was -8.0% in the fourth quarter of 2010 (February 2011: -11.5%, see Table X.1).[12] Time deposits also recorded a decline,[13] but their rate of change has decelerated since mid-2010 (February 2011: -9.8%, fourth quarter of 2010: -13.8%, see Table X.1). Among the other components of M3, the already shrinking holdings of repurchase agreements and money market fund units/shares decreased further over the reviewed period (see Table X.1 and Chart X.1).

2 BANK DEPOSIT RATES

In 2010 interest rates on new bank deposits in Greece recorded a sizeable increase as regards deposits with an agreed maturity of up to one year and remained almost unchanged in overnight deposits (see Table X.2A and Chart X.2). The interest rate on time deposits rose mainly during the first half of the year and remained broadly stable (with some fluctuations) in the second half, while it increased between January and February 2011. As a result, the average deposit rate stood at 2.18% in February 2011, against 1.32% in December 2009. The evolution of bank deposit rates over the reviewed period is only partly attributable to a rise in interest rates in the interbank market,[14] and mainly reflects the limited liquidity of Greek banks.[15] This led credit institutions to offer depositors higher interest rates in an effort to attract savings. Money market rates and the ECB key monetary policy interest rate are expected to influence bank deposit rates in the coming months, given their anticipated increase.[16]

11 See ECB, *Annual Report 2010*.
12 It should be noted that this category recorded a net outflow of €-12.3 billion in 2010 (2009: inflow of €12.6 billion). Thus, the contribution of time deposits in total M3 increased marginally to 42.7% in December 2010 (December 2009: 42.6%) – slightly higher than in February 2011 (42.3%).
13 By €16.4 billion in 2010 and a further €2.4 billion in the first two months of 2011. However, their contribution to M3 (excluding currency in circulation) came to 55.7% in February 2011 (December 2009: 55.4%).
14 It should be noted that from December 2009 to February 2011 the rate on time deposits with an agreed maturity of up to one year (which represent the most important deposit category) rose by 165 basis points, while the three-month Euribor rose by 38 basis points.
15 It should be recalled that Greek banks resorted to the ECB for liquidity, as a result of shrinking bank deposits and difficulties in accessing international money and capital markets. For further details on Greek banks' liquidity, see Section 8 below.
16 As a matter of fact, the speed and degree of the pass-through of changes in money market rates to bank deposit rates are different across deposit categories. According to a survey conducted by the ECB, the pass-through of money market rate changes to retail bank rates is stronger for time deposit rates and weaker for overnight deposit rates. See the Article entitled "Recent developments in the retail bank interest rate pass-through in the euro area" (Box 1, Results of the pass-through to euro area retail bank interest rates using an error correction modelling approach), ECB, *Monthly Bulletin*, August 2009.

Table X.2A Bank interest rates on new deposits by households in the euro area and Greece

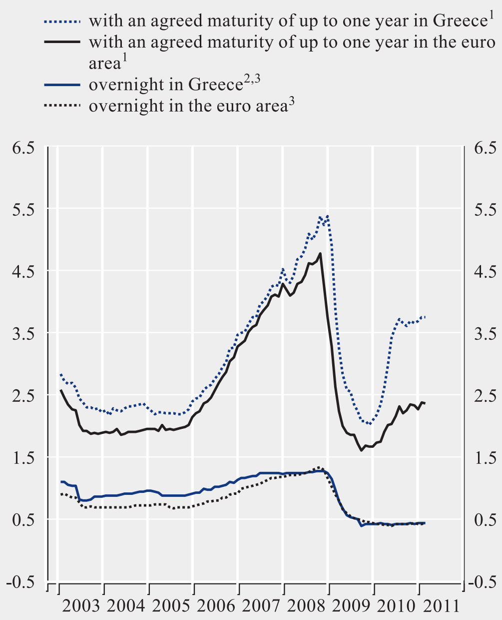
(percentages per annum)

	December 2009	February 2011	Change Feb. 2011/ Dec. 2009 (percentage points)
Overnight[1]			
Weighted average interest rate in the euro area	0.45	0.44	-0.01
Maximum interest rate	1.21	1.09	-0.12
Minimum interest rate	0.05	0.08	0.03
Interest rate in Greece	0.43	0.44	0.01
Interest rate differential between Greece and the euro area	-0.02	0.00	0.02
With an agreed maturity of up to one year[2]			
Weighted average interest rate in the euro area	1.67	2.36	0.69
Maximum interest rate	4.13	4.02	-0.11
Minimum interest rate	0.50	0.82	0.32
Interest rate in Greece	2.10	3.75	1.65
Interest rate differential between Greece and the euro area	0.43	1.39	0.96

Sources: ECB and euro area NCBs.
1 End-of-month rates.
2 Monthly averages.

Chart X.2 Bank interest rates on new deposits by households in Greece and the euro area (January 2003 - February 2011)

(percentages per annum)



Sources: Bank of Greece and ECB.
1 Monthly average rate.
2 Represented by the interest rate on savings deposits, which make up the bulk of overnight deposits.
3 End-of-month rate.

Real rates[17] on deposits were determined in 2010 mainly by developments in inflation and stood at negative levels throughout the year. On average, the real rate on overnight deposits by households fell to -4.27% in 2010, from -0.59% in 2009, whereas the rate on deposits with an agreed maturity of up to one year declined to -1.44% (2009: 1.52%). In February 2011, the real rate on overnight deposits was -3.95% (December 2009: -2.21%), while that of deposits with an agreed maturity of up to one year stood at -0.64% (December 2009: -0.54%).

Deposit rates in the euro area as a whole increased in most deposit categories, although less markedly than in Greece. Thus, the spread of Greek interest rates over euro area rates widened in most categories, implying that Greek banks are facing even higher funding costs on the domestic market, compared with euro area banks. As a matter of fact, for the largest deposit category, i.e. time deposits with an agreed maturity of up to one year by house-

17 The average real rate of a period is calculated as the average nominal rate less average inflation rate over the same period.

Table X.2B Bank interest rates on new deposits by households in euro area countries[1]

	Overnight[2]		With an agreed maturity of up to 1 year[3]	
	December 2009	February 2011	December 2009	February 2011
Austria	0.64	0.62	1.21	1.29
Belgium	0.37	0.35	0.73	0.87
Cyprus	1.21	1.09	4.13	4.02
Estonia	0.23	0.12	1.14	1.17
Finland	0.39	0.43	1.32	1.83
France	0.11	0.09	1.43	2.00
Germany	0.75	0.74	0.87	1.24
Greece	**0.43**	**0.44**	**2.10**	**3.75**
Ireland	0.64	0.63	1.62[4]	1.81[4]
Italy	0.26	0.29	1.01	1.61
Luxembourg	0.85	0.71	0.50	0.82
Malta	0.30	0.28	1.97	1.94
Netherlands	0.44	0.44	2.51	2.47
Portugal	0.05	0.08	1.52	2.82
Slovakia	0.34	0.38	1.88	2.33
Slovenia	0.23	0.21	2.00	1.98
Spain	0.36	0.29	2.15	2.47

Sources: ECB and euro area NCBs.
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 in regulatory and fiscal arrangements.
2 End-of-month rates.
3 Monthly averages.
4 The interest rate applies to all time deposits irrespective of maturity. The latest available data refer to January 2011.

holds, this spread stood at 139 basis points in February 2011 (December 2010: 141 basis points; December 2009: 43 basis points) and the Greek rate on this deposit category is the second highest in the euro area (see Tables X.2A and X.2B).

3 FINANCING OF THE ECONOMY

The annual growth rate of the outstanding amount of total financing to the economy by domestic monetary financial institutions (MFIs)[18] decelerated in 2010 to 5.7% in December 2010, from 6.6% one year earlier.[19] This slowdown is a result of the opposing trends that were recorded in the annual growth rates of financing to the private sector (which registered a continuous decline) and to general government, which accelerated overall with some fluctuations (see Chart X.3 and Table X.3). Thus, on the one hand, the annual growth rate of financing to the domestic private sector was zero for the first time in December 2010 (December 2009: 4.1%) and, on the other

18 The outstanding balance of bank financing to general government and the domestic private sector is calculated as the sum of outstanding loans to general government and the domestic private sector, banks' holdings of government debt securities and corporate bonds, plus the balance of securitised loans and corporate bonds. The growth rates of credit are calculated as the difference between the outstanding amounts of credit at the beginning and at the end of the reference period, adding banks' total write-offs/write-downs during the reference period and adjusting for changes in Greek government bond prices (incorporated in the outstanding amount of credit to general government) and for foreign exchange valuation differences in respect of foreign currency-denominated loans, thus obtaining the net flow of credit. In calculating credit expansion, net transfers of loans by domestic credit institutions to affiliated banks or branches abroad were not taken into account. Although these transactions led to changes in the outstanding amount of credit, they were not taken into account either in the net flow or the annual rate of change, as they do not affect the flow of credit to the domestic private sector.

19 It should be noted that data on financing have been revised after the publication of the report on *Monetary Policy 2010-2011* in February 2011.

Table X.3 Credit[1] to the economy by domestic MFIs

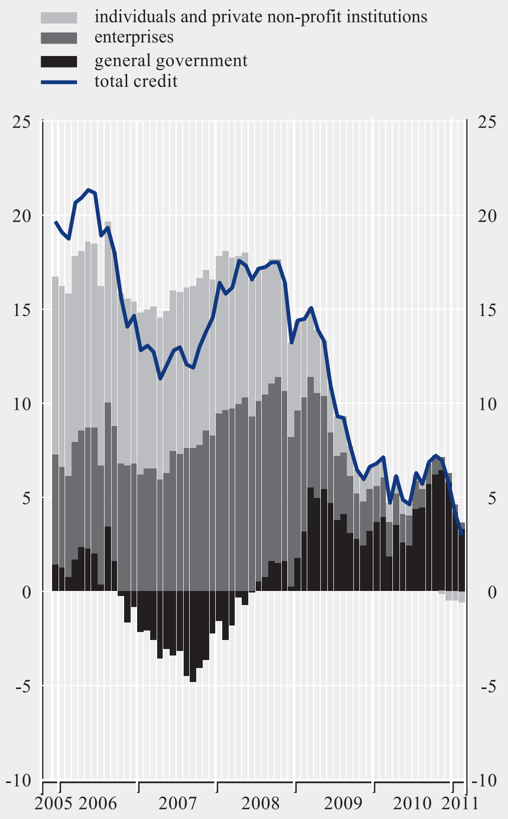
(annual percentage changes, non-seasonally adjusted data)

	2007	2008	2009		2010					2011	
	Q4[2]	Q4[2]	Q4[2]	December[3]	Q1[2]	Q2[2]	Q3[2]	Q4[2]	December[3]	January[3]	February[3]
1. Total MFI credit	13.3	16.3	6.5	6.6	6.5	5.2	5.9	6.8	5.7	4.1	3.0
2. Credit to general government	-14.6	7.3	17.2	19.4	19.8	14.0	22.5	32.9	28.6	20.4	15.4
3. Credit to the private sector	21.7	18.3	4.4	4.1	3.8	3.0	2.0	0.8	0.0	-0.2	-0.3
3.1 Enterprises[4]	20.1	21.8	5.5	5.1	4.7	3.8	2.9	1.9	1.1	1.0	0.9
3.2 Sole proprietors and unincorporated partnerships[4]	-	-	-	-	-	-	2.4	1.3	0.3	0.2	0.0
3.3 Individuals and private non-profit institutions	23.6	14.8	3.3	3.1	2.8	2.2	0.9	-0.4	-1.3	-1.4	-1.6
of which:											
3.3.1 Lending for house purchase	23.3	13.4	3.9	3.7	3.6	3.1	1.7	0.4	-0.4	-0.7	-1.1
3.3.2 Consumer credit	22.6	18.4	2.4	2.0	1.4	0.3	-1.2	-2.9	-4.2	-4.1	-4.2

Source: Bank of Greece.
1 Including MFI loans and holdings of corporate bonds and government securities, as well as the outstanding amounts of securitised loans and securitised corporate bonds. The rates of change are adjusted for loan write-offs, reclassifications and exchange rate variations in respect of loans denominated in foreign currency. The rate of change in credit to enterprises is also adjusted for loans and corporate bonds transferred in 2009 by MFIs to subsidiaries abroad and to a domestic finance company. In February and March 2010, one bank repurchased bonds amounting to €686 million and, although this transaction led to an increase in the outstanding stock of credit, it does not represent a flow of new credit to the private sector in February and thus was not taken into account in the annual rate of change for that month.
2 The quarterly average is derived from monthly averages (which are calculated as the 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-of-month levels.
4 As of June 2010, loans to sole proprietors and unincorporated partnerships are presented separately and are no longer included under "credit to enterprises". This change, of a purely statistical nature, does not affect the rates of credit expansion.

Chart X.3 Sectoral contributions to total domestic MFI credit (December 2005 - February 2011)

(annual percentage changes; contributions in percentage points)



Source: Bank of Greece.
Note: Total MFI credit comprises MFI credit (stock) to the domestic private sector and general government, as well as MFI holdings of government debt securities, corporate bonds, securitised loans and securitised corporate bonds. The rates of change are adjusted for exchange rate variations and loan write-offs carried out by banks during the reference period.

hand, the annual growth rate of credit expansion to general government came to 28.6% (December 2009: 19.4%).[20] Moreover, the cumulative net flow of financing to the economy for 2010 came to €17,891 million and corresponds to a positive flow of financing to general government (€17,929 million), as the flow of financing to the private sector was overall negative (€-38 million), although the flow of financing to non-financial corporations was positive (see further below).

The considerable decline in the annual rate of change in the outstanding amount of **financing to the private sector** in 2010, which turned negative for the first time in January 2011 (-0.2%) and thereafter in February 2011 (-0.3%), reflects a continuous weakening of credit expansion to non-financial corporations and individual household groups, i.e. sole proprietors and unincorporated partnerships, private individuals and private non-profit institutions.[21] The cumulatively negative net annual flow of financing to the private sector in 2010 (€-38 million in 2010, against a positive flow of €10,337 million in 2009 – see Chart X.4) stemmed from the negative flow of financing to individuals and private non-profit institutions (€-1,519 million in 2010, against a positive flow of €3,598 million in 2009), and especially from the considerably negative flow of consumer loans (€-1,522 million in 2010, against a positive flow of €745 million in 2009), which counterbalanced the respective positive flow of financing to non-financial corporations (€1,483 million in 2010, against €6,739 million in 2009). More specifically, **financing to corporations** (see Table X.4 and Chart X.4) was marked by slower and negative growth rates of financing to those sectors that registered a decline in output or a worsening of prospects, e.g. industry, trade, construction[22] and tourism. As regards financing to households, the growth rate of **financing to the self-employed-farmers-personal enterprises** had decelerated since June 2010 to stand at a marginally positive level in December 2010. The growth rate of **financing to individuals and private non-profit institutions** weakened significantly to enter negative territory in November 2010, reflecting a sharp decline for housing loans, as well as an even sharper decline for consumer loans.[23]

20 The high rate of credit expansion to general government is due to an annual change of 33.3% (in December 2010) in the value of government bonds (€44.8 billion) held by MFIs excluding the Bank of Greece in their portfolios.
21 Since June 2010 loans to the self-employed, farmers and personal enterprises ("loans to sole proprietors and unincorporated partnerships") constitute a separate category and are no longer included in corporate loans.
22 In an IOBE survey (February 2011) concerning business expectations in construction, 1 out of 3 private construction firms have reported that insufficient credit hampers their operation, whereas for public construction this ratio was 3 out of 5 firms.
23 The highest negative rates of change were recorded in loans through credit cards (which accounted for 24% of the total outstanding amount of consumer loans in December 2010).

Table X.4 Credit[1] to the domestic private sector by domestic MFIs

(annual percentage changes, non-seasonally adjusted data)

	Outstanding balances on 28.02.11 (million euro)	2007	2008	2009		2010						
		Q4[2]	Q4[2]	Q4[2]	December[3]	Q1[2]	Q2[2]	Q3[2]	Q4[2]	December[3]	January[3]	February[3]
A. Enterprises [4,5]	**122,871**	**20.1**	**21.8**	**5.5**	**5.1**	**4.7**	**3.8**	**2.9**	**1.9**	**1.1**	**1.0**	**0.9**
1. Trade	25,134	17.9	22.2	5.0	4.2	2.4	-0.7	-1.1	-2.1	-3.5	-3.9	-3.0
2. Industry[6]	24,698	11.0	17.4	-2.8	-3.5	-2.8	-1.3	-1.5	-1.3	-2.0	-1.0	-0.9
3. Shipping	17,356	25.7	24.6	3.9	4.1	2.5	3.0	6.2	7.1	5.7	7.2	6.9
4. Construction	11,093	28.6	37.4	2.2	2.7	3.4	2.9	2.0	2.3	1.9	0.7	-0.9
5. Tourism	7,283	21.1	24.4	6.4	7.8	8.0	6.6	4.4	4.0	2.9	1.3	0.5
6. Other financial institutions (non-MFI)	6,387	14.6	-2.4	7.2	5.4	10.1	10.1	3.2	2.6	7.9	6.7	-1.5
7. Electricity - gas - water supply	5,322	40.2	36.5	14.8	14.7	20.2	23.4	27.4	23.1	21.6	19.6	20.0
8. Agriculture	2,057	10.8	20.5	3.7	3.8	5.1	2.6	1.3	0.6	1.1	-1.7	-1.6
9. Transport (excluding shipping)	1,938	39.6	35.7	19.5	25.2	27.0	25.9	8.0	-3.8	-8.7	-9.7	-10.0
10. Other sectors	21,603	27.4	23.8	12.3	10.3	7.6	6.4	7.0	5.1	3.6	3.9	4.8
B. Sole proprietors and unincorporated partnerships [5]	**16,540**	**-**	**-**	**-**	**-**	**-**	**-**	**2.4**	**1.3**	**0.3**	**0.2**	**0.0**
C. Individuals and private non-profit institutions	**117,198**	**23.6**	**14.8**	**3.3**	**3.1**	**2.8**	**2.2**	**0.9**	**-0.3**	**-1.3**	**-1.4**	**-1.6**
1. Housing loans	79,950	23.3	13.4	3.9	3.7	3.6	3.1	1.7	0.4	-0.4	-0.7	-1.1
2. Consumer loans	34,691	22.6	18.4	2.4	2.0	1.4	0.3	-1.2	-2.9	-4.2	-4.1	-4.2
– Credit cards	8,290	6.3	12.4	-0.4	-0.6	-1.4	-2.0	-2.4	-4.6	-5.4	-5.7	-6.0
– Other consumer loans[7]	26,401	30.9	20.9	3.5	3.1	2.5	1.2	-0.8	-2.2	-3.8	-3.5	-3.6
3. Other loans	2,558	42.2	7.5	-2.3	-1.1	0.0	2.5	3.9	9.6	10.7	11.1	13.5
TOTAL	**256,609**	**21.7**	**18.3**	**4.4**	**4.1**	**3.8**	**3.0**	**2.0**	**0.8**	**0.0**	**-0.2**	**-0.3**

Source: Bank of Greece.

1 Including MFI loans and holdings of corporate bonds, as well as the outstanding amounts of securitised loans and securitised corporate bonds. The rates of change are adjusted for loan write-offs, reclassifications and exchange rate variations in respect of loans denominated in foreign currency. The rate of change in credit to enterprises is also adjusted for loans and corporate bonds transferred in 2009 by domestic MFIs to subsidiaries abroad and to a domestic finance company. In February and March 2010, one bank repurchased bonds amounting to €686 million and, although this transaction led to an increase in the outstanding stock of credit, it does not represent a flow of new credit to the private sector in February and thus was not taken into account in the annual rate of change for that month.

2 The quarterly average is derived from monthly averages (which are calculated as the 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-of-month levels.

4 Sectors are listed in descending order of their share in total credit, with the exception of "other sectors". Growth rates are adjusted for loan write-offs.

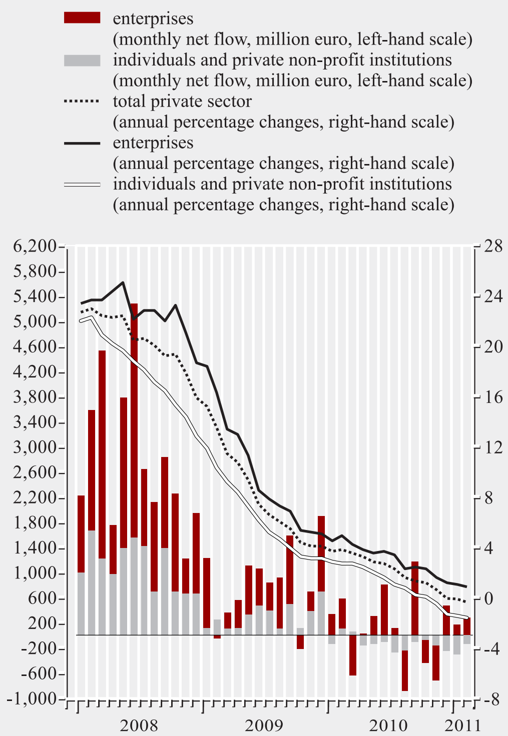
5 As of June 2010, loans to sole proprietors and unincorporated partnerships are presented separately and are no longer included under “credit to enterprises”. This change, of a purely statistical nature, does not affect the rates of credit expansion.

6 Comprising manufacturing and mining/quarrying.

7 Comprising personal loans and loans against supporting documents.

Chart X.4 Credit[1] to the domestic private sector by domestic MFIs (January 2008- February 2011)

(monthly net flow[2]; annual percentage changes)



Source: Bank of Greece.
1 Including MFI loans and holdings of corporate bonds, as well as the outstanding amounts of securitised loans and securitised corporate bonds. The annual rates of change are adjusted for loan write-offs and foreign exchange valuation differences on loans denominated in foreign currency.
2 The monthly net flow of credit is defined as the difference in the outstanding stock of credit between the beginning and the end of a given month, adjusted for exchange rate variations in respect of loans denominated in foreign currency and loan write-offs during that month.

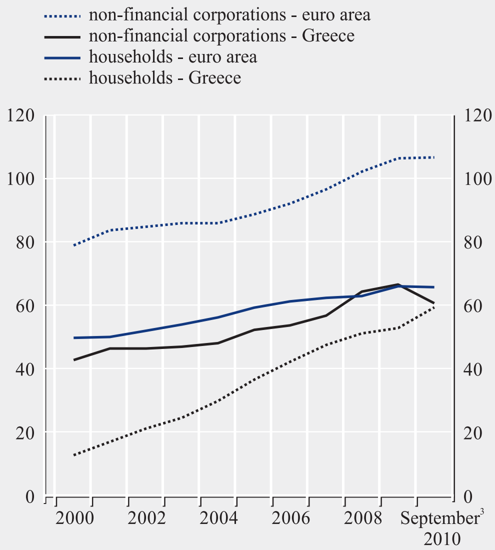
On the back of credit developments and the evolution of GDP, total indebtedness of the non-financial private sector as a percentage of GDP was slightly higher in September 2010 (119.5%), against December 2009 (118.2%), according to financial accounts data. The debt-to-GDP ratio of households[24] rose to 59.3% (December 2009: 52.4%), while the debt ratio of non-financial corporations declined to 60.2% in September 2010 (December 2009: 65.8%), as since June 2010 credit to the self-employed has been included in households and not in non-financial corporations (see Chart X.5).

The weaker growth of financing to the private sector is still attributable to factors that have restrained both demand for and supply of new loans. Subdued supply is evidenced in the tightening of banks' credit standards and lending conditions, as recorded by the Bank Lending Surveys,[25] as well as in higher interest rates across all main loan categories[26] (especially for new loans to non-financial corporations). This moderation is due, on the one hand, to a deterioration in the quality of banks' loan portfolios (i.e. a rise in non-performing loans) and its anticipated continuation in the context of the economic downturn and, on the other hand, to the constraints which affect banks' external funding, such as a sizeable decrease in deposits (see Section 1 of this chapter) and, initially, the closing of international money and capital markets for Greek banks (see Section 8 below), which today enjoy only a limited access.[27] Naturally, as a counterpoise to the abovementioned strains, liquidity support measures were introduced under Law 3723/2008, which were later expanded or extended, and a considerable amount of liquidity was provided by the Eurosystem. On the demand side, deteriorating macroeconomic conditions, in particular higher unemployment and lower disposable income of households and corporate sales, led to a worsening of the financial condition of households and non-financial corporations, thus limiting both their ability and willingness to take on further debt.[28] The uncertainty of households and businesses is reflected in the low level of the consumer/household confidence indicator (as captured by IOBE), as well

24 Including individuals and private non-profit institutions, self-employed, farmers and personal enterprises ("sole proprietors and unincorporated partnerships").
25 The Bank Lending Survey is conducted by the Bank of Greece on a quarterly basis, as part of a Eurosystem-wide survey. Banks tightened their credit standards and conditions on corporate loans in the fourth quarter of 2010, as was also the case in the first three quarters of the year. As regards households, banks tightened their credit standards only slightly in the fourth quarter, as they had already adopted considerably tighter criteria earlier that year.
26 See Section 4 of this chapter concerning the evolution of bank lending rates.
27 In the latest Bank Lending Survey (January 2011), strains on liquidity are mentioned as one of the factors underlying the tightening of credit standards in the fourth quarter of 2010.
28 A negative effect on demand for loans was also exerted by the decrease in households' total wealth.

Chart X.5 Debt of households[1] and non-financial corporations[2] in the euro area and Greece (2000-September 2010)

(percentages of GDP)



Sources: Bank of Greece and ECB (outstanding debt), Eurostat and ELSTAT (GDP). GDP figures for 2010 are calculated as the sum of four quarters up to Q3 2010.
1 Household debt comprises the overall stock of household loans and securitised loans. Debt data are derived from the financial accounts of the household sector, which record the sector's total financial assets and liabilities.
2 The debt of non-financial corporations comprises loans, debt securities issued, as well as pension fund reserves.
3 Due to a reclassification (from June 2010), loans to sole proprietors and unincorporated partnerships, previously included under "credit to enterprises", are now classified as "credit to households". This change increases the debt stock of households (compared with December 2009), and decreases it for non-financial corporations.

as in the suspension of business investment plans. These constraints were also recorded in the Bank Lending Surveys.[29] In addition, expectations about a correction of prices in the real estate market in 2011 contributed to the subdued demand for housing loans.

The recent short-term trends of financing to individual categories of the private sector are expected to continue and, in the case of non-financial corporations, to worsen. More specifically, at end-2010 the flow of financing to non-financial corporations deteriorated on a quarterly basis, whereas the flow of financing to households remained negative.[30] (This deterioration would have been greater without the upward effect of seasonality on December's flow.[31]) However, between January and February 2011, the flow of financing to non-financial corporations exhibited a relative "resilience" and turned positive, while the flow of financing to households remained negative. Financing to the domestic private sector is projected to register negative annual growth rates and negative flows for all individual categories in 2011. This outlook hinges upon the contraction of GDP in 2010 and its projected further decline in 2011, while similar developments in financing had already been observed one year earlier in other countries and in the euro area as a whole, which is currently witnessing an economic upturn.[32] Besides, constraints which, as mentioned above, affect the external funding of banks continue to exist this year. These factors, coupled with the prospective phasing-out of the non-standard measures adopted by the ECB, call for a deleveraging of the banking system over the medium term,[33] in other words a gradual reduction of total assets, possibly through a decrease in claims on the private sector.[34] In view of this necessity, it should also be taken into account that the private sector debt-to-GDP ratio is lower than in the rest of the euro area, which may imply a comparatively narrower downward adjustment in private sector debt as soon as the economic

29 According to the Bank Lending Surveys, demand for credit by non-financial corporations remained almost unchanged in the third and fourth quarters of 2010, as the aforementioned adverse factors were counterpoised by the upward effect of the need to restructure their borrowing, while in the first two quarters of the year demand for credit had declined. As regards households, demand for loans decreased in the fourth quarter, as was also the case in the previous three quarters.
30 In the fourth quarter of 2010 the net flow of financing to non-financial corporations was €-445 million, accounting for 45% of the total negative flow of financing to the private sector, against a positive flow of €630 million in the third quarter of 2010.
31 Financing is typically higher in December (or the fourth quarter in general).
32 It is estimated that the growth rate of financing to the domestic private sector in Greece lags behind the GDP growth rate by about 4 quarters.
33 For a discussion on the key aggregates of the Greek banking system, see Section 8 below.
34 For instance, a further reduction in the outstanding amount of such claims, against a background of recession, could also come from loan write-offs, which however would not have an adverse effect on the supply of new loans (and the flow or the growth rates of financing). See the discussion on that matter in the latest IMF report, *Greece – Third Review under the Stand-By Arrangement – Staff Report*, March 2011, Box 2, "Greece: Banking System Deleveraging", p. 25.

downturn ends.[35] Thus a key desideratum is that the progressive deleveraging of the banking system should not have a deeper impact on financing flows than the present juncture would justify, with a view to averting the creation of a financial environment which could intensify or prolong recession. Once the economy starts to rebound and as a result, loan demand returns to higher levels, it is crucial for banks to be able to meet higher demand. The improved economic outlook is likely to bring about a recovery first in housing loans, due to the ensuing improvement of prospects for the real estate market (as well as to their better collateralisation) and subsequently in consumer loans.[36,37] As regards non-financial corporations, their ability to meet their needs through internal funding during upturns partly explains a renewed time lag that bank credit may display against credit to individuals and private non-profit institutions.

On the policy side, the government guarantee scheme is expected to continue through 2011 in order for banks to continue raising funds from the Eurosystem. Thus, since the enhanced liquidity support measures (as provided for in Articles 1, 2 and 3 of Law 3723/2008) have recently been extended (by virtue of Ministerial Decision 59181/B.2585, Government Gazette B 2015/2010) until end-June 2011 regarding the provision of additional government guarantees totalling €25 billion, a draft law reforming the operational framework of the Deposits and Loans Fund, which was submitted to the Greek Parliament on 31.3.2011, stipulates (in Article 19) that the government guarantee pillar under Law 3723/2008, Article 2, is expanded by a further €30 billion and the ensuing support shall only be supplied, provided that each credit institution draws and implements a plan for its medium-term financing needs, following an approval by the Bank of Greece and the ECB, in conjunction with the European Commission and the IMF. As regards non-financial corporations, the implementation of actions to encourage investment and facilitate credit to small and medium-sized enterprises (SMEs) is expected to be further sped up. Since 2010 a significantly better absorption of Community funds has been recorded on the back of the co-financed programmes included in the National Strategic Reference Framework (NSRF), as provided for by the Public Investment Programme. Furthermore, the National Hellenic Fund for Entrepreneurship and Development (ETEAN) was recently founded (under Law 3912/2011) succeeding to the Greek Credit Guarantee Fund for Small and Very Small Enterprises (TEMPME) for SME financing. The new Fund is expected to act as a mediator for channelling funds (including projects under NSRF) totalling €1 billion, which, if account is also taken of bank credit, could reach €2.5 billion in 2011-2012 (see also Chapters V.1.3 and VII.3).[38]

4 BANK LENDING RATES, THE INTEREST RATE MARGIN AND DIFFERENTIALS BETWEEN GREECE AND THE EURO AREA

In February 2011, interest rates in most new bank loan categories in Greece stood at levels higher than in December 2009 (see Table X.5A and Chart X.6). The observed rise in bank lending rates was due to important liquidity strains facing Greek banks, as a result of their inability to raise funds in international markets, the worsening of their borrowing standards from the internal market[39] and the

35 The extent of decline in financing following a recession is associated with those factors that actually induced the recession. The particularly high growth rates of credit prior to a recession or the association of recession with disruptions in the functioning of the financial system inevitably reduce financing during return to growth, as discussed in the interesting paper by A. Abiad, G. Dell'Ariccia and B. Li, "Creditless recoveries", IMF Working Paper 11/58, March 2011.

36 This development in financing to households was observed in the euro area as a whole; see ECB, *Monthly Bulletin*, March 2011, Box 4, "Explaining the recent decoupling between growth in MFI loans for house purchase and consumer credit", p. 54. As regards the recovery of housing loan demand, this analysis notes that households' urge to invest in dwellings plays an important part.

37 As regards consumer credit, its decline so far may be in line with a prospective smaller share of private consumption in GDP after the recovery. If account is taken of the fact that the share of consumer credit in total financing to the private sector is high by European standards (13.6% in Greece at end-2010, against 4.8% in the euro area as a whole), it is natural that this share remains at a lower level even after the rebound in financing.

38 See http://www.opengov.gr/ypoian/wp-content/uploads/downloads/2010/11/faq_etean.pdf.

39 See Section 2 of this chapter.

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

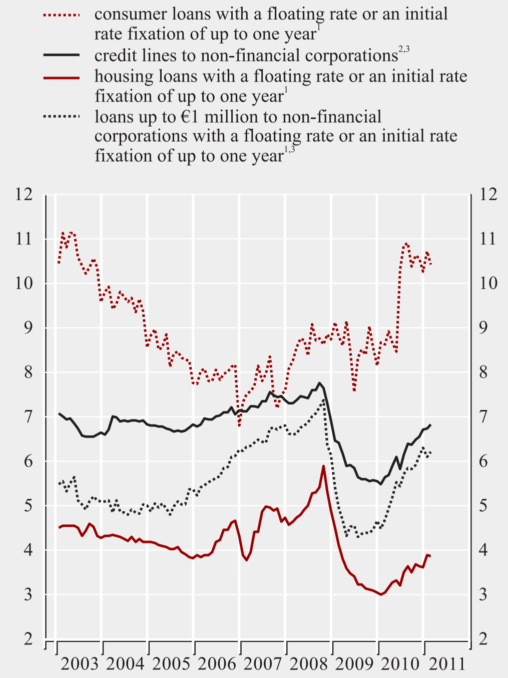
(percentages per annum)

	December 2009	February 2011	Change Feb. 2011/ Dec. 2009 (percentage points)
A. Loans with a floating rate or an initial rate fixation of up to one year[1]			
A.1. Loans up to €1 million to non-financial corporations			
Weighted average interest rate in the euro area	3.28	3.59	0.31
Maximum interest rate	6.00	6.48	0.48
Minimum interest rate	2.42	2.61	0.19
Interest rate in Greece[2]	4.70	6.23	1.96
Interest rate differential between Greece and the euro area	1.42	2.64	1.22
A.2. Loans of more than €1 million to non-financial corporations			
Weighted average interest rate in the euro area	2.19	2.61	0.42
Maximum interest rate	5.47	5.76	0.29
Minimum interest rate	1.63	2.01	0.38
Interest rate in Greece	3.24	5.37	2.13
Interest rate differential between Greece and the euro area	1.05	2.76	1.71
A.3. Housing loans			
Weighted average interest rate in the euro area	2.71	2.96	0.25
Maximum interest rate	5.26	4.98	-0.28
Minimum interest rate	1.92	1.81	-0.11
Interest rate in Greece	3.08	3.91	0.83
Interest rate differential between Greece and the euro area	0.37	0.95	0.58
A.4. Consumer loans			
Weighted average interest rate in the euro area	6.43	5.37	-1.06
Maximum interest rate	9.85	20.35	10.50
Minimum interest rate	3.04	3.30	0.26
Interest rate in Greece	8.18	10.44	2.26
Interest rate differential between Greece and the euro area	1.75	5.07	3.32
B. Loans with an initial rate fixation of over one and up to 5 years[1]			
B.1. Housing loans			
Weighted average interest rate in the euro area	3.96	3.83	-0.13
Maximum interest rate	5.57	4.89	-0.68
Minimum interest rate	2.94	2.30	-0.64
Interest rate in Greece	4.60	3.57	-1.03
Interest rate differential between Greece and the euro area	0.64	-0.26	-0.90
B.2. Consumer loans			
Weighted average interest rate in the euro area	6.26	6.13	-0.13
Maximum interest rate	22.83	21.98	-0.85
Minimum interest rate	4.44	3.60	-0.84
Interest rate in Greece	8.95	8.73	-0.22
Interest rate differential between Greece and the euro area	2.69	2.60	-0.09

Sources: ECB and euro area NCBs.
1 Monthly average rates.
2 As of June 2010, loans to sole proprietors and unincorporated partnerships are presented separately and are no longer included under "credit to enterprises". Changes in interest rates on loans to enterprises have been adjusted to reflect this reclassification.

Chart X.6 Bank interest rates on new loans in Greece (January 2003- February 2011)

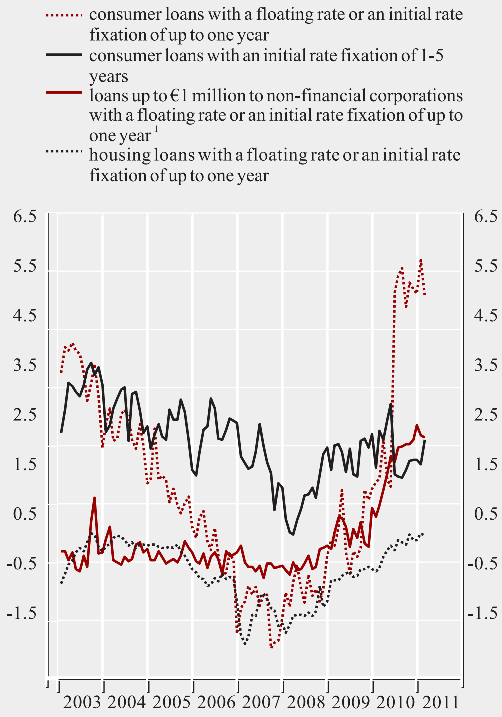
(percentages per annum)



Source: Bank of Greece.
1 Monthly average rate.
2 End-of-month rate.
3 See footnote 2 in Table X.5A.

Chart X.7 Bank interest rates on new loans: differential between Greece and the euro area (January 2003 - February 2011)

(percentage points)



Sources: Bank of Greece and ECB.
1 See footnote 2 in Table X.5A.

tightening of terms and conditions for liquidity supply by the Eurosystem (haircut on collateral).[40] Besides, the increase in lending rates reflects a rise in incorporated risk premia, due to the heightened credit risk faced by Greek banks.[41] As a result, a larger increase in interest rates was observed on average in both consumer and corporate loans, which are typically less collateralised compared with housing loans. The same loan categories witnessed the most significant widening of interest rate differentials between Greece and the euro area (see Chart X.7).

In more detail, the average lending rate (on both housing and consumer loans) to individuals and private non-profit institutions in Greece was 6.53% in February 2011, up by 83 basis points relative to end-2009. This development was mainly driven by a sharp increase (of 226 basis points) in the interest rate of the most important consumer credit category, i.e. loans with a floating rate or an initial rate fixation of up to one year, which in 2010 accounted, on average, for about 1/6 of the total flow of loans with an agreed maturity to individuals and private non-profit institutions. The most important category of housing loans also made a sizeable contribution,[42] with its interest rate rising by 83 basis points in the

40 See ECB's decisions about haircuts on the valuation of collateral with credit ratings BBB+ and BBB-, "Monetary policy measures of the Eurosystem", Bank of Greece, *Monetary Policy 2010-2011*, February 2011. For further details on liquidity conditions of credit institutions in Greece, see Section 8 below.

41 For instance, it should be noted that in 2010 a rise in non-performing loans was observed across all loan categories (see Section 8 below).

42 Namely housing loans with a floating rate or an initial rate fixation of up to one year, which accounted for approximately 40% of the total flow of new loans with a fixed maturity to individuals and private non-profit institutions and nearly 3/4 of new housing loans during the period between December 2009 and February 2011.

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

(percentages per annum)

	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				Housing loans		Consumer loans		Consumer loans	
	Loans up to €1 million		Loans over €1 million							
	Dec. 2009	Feb. 2011	Dec. 2009	Feb. 2011	Dec. 2009	Feb. 2011	Dec. 2009	Feb. 2011	Dec. 2009	Feb. 2011
Austria	2.48	2.61	2.04	2.24	2.91	2.71	4.28	5.00	4.44	4.66
Belgium	2.42	2.72	1.63	2.01	2.92	3.27	5.27	5.22	6.50	5.78
Cyprus	6.00	6.48	5.47	5.76	5.01	4.98	7.00	6.78	-[3]	-[3]
Estonia	4.02	4.97	3.94	3.81	3.25	3.18	7.44	20.35	22.83	21.98
Finland	2.53	2.61	2.08	2.64	1.92	2.19	3.04	3.62	4.76	4.67
France	2.71	2.63	1.94	2.26	3.38	3.21	6.91	6.28	6.15	5.91
Germany	3.36	3.59	2.57	2.69	3.36	3.56	4.04	3.30	4.83	5.43
Greece	**4.70**	**6.23**	**3.24**	**5.37**	**3.08**	**3.91**	**8.18**	**10.44**	**8.95**	**8.73**
Ireland	3.32	4.32	2.50	3.09	2.61	2.99	3.63	7.26	-[3]	-[3]
Italy	2.95	3.28	1.78	2.50	2.24	2.59	9.85	7.32	8.28	7.31
Luxembourg	2.42	2.70	2.03	2.42	2.03	1.81	-[3]	-[3]	5.17	3.60
Malta	5.29	5.38	4.19	4.94	3.48	3.38	-[3]	-[3]	-[3]	-[3]
Netherlands	3.18	3.47	1.96	2.23	3.84	3.62	8.76	n.a.[4]	-[3]	-[3]
Portugal	4.95	6.28	3.27	4.46	2.22	3.03	5.53	7.41	12.17	11.46
Slovakia	3.70	4.16	2.57	2.76	5.26	4.62	7.11	13.40	15.47	14.71
Slovenia	5.65	5.69	4.63	4.75	3.36	3.41	4.99	4.83	7.35	7.01
Spain	3.63	4.16	2.16	2.90	2.45	2.84	9.72	5.88	8.08	8.70

Sources: ECB and euro area NCBs.
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 in regulatory and fiscal arrangements.
2 Monthly average rates.
3 These countries do not publish data on the respective interest rates.
4 Not published for reasons of confidentiality.

Table X.6 Interest rate margin in Greece and the euro area

(percentage points)

	Average interest rate on new loans in Greece[1] (percentages per annum)	Average interest rate on new deposits in Greece[1] (percentages per annum)	Interest rate margin in Greece	Interest rate margin in Greece with euro area weighting	Interest rate margin in the euro area
December 1998	16.21	8.12	8.09	...	...
December 1999	14.02	6.98	7.04	...	...
December 2000	9.68	4.00	5.68	...	...
December 2001	7.26	1.96	5.30	...	...
December 2002	6.29	1.67	4.62	...	...
December 2003	5.92	1.2	4.72	4.45	2.77
December 2004	5.94	1.22	4.72	4.18	2.54
December 2005	5.79	1.27	4.52	3.59	2.56
December 2006	6.38	1.87	4.51	3.63	2.88
December 2007	6.67	2.53	4.14	3.48	3.09
December 2008	6.72	3.27	3.45	3.27	2.63
December 2009	5.09	1.32	3.77	3.40	2.29
December 2010	6.08	2.15	3.93	4.02	2.25
February 2011	6.43	2.18	4.25	4.39	2.38

Sources: Bank of Greece and ECB.
1 The average interest rate depends on the level of interest rates of individual categories of deposits/loans as well as on the weight of each type of deposit/loan in the corresponding total. Therefore, changes in the average interest rate reflect changes in the actual interest rates and/or changes in the weights of the instrument categories concerned. In order to smooth out the impact of abrupt changes in weights, the calculation of the average interest rate is based on the average of the weights over the past twelve months.

period under review (see Table X.5A). Nevertheless, it should be noted that the average interest rate of housing loans was particularly low in the previous years, while —especially in 2007 and 2008, as well as in the period from June 2009 to February 2010— it was lower than the corresponding weighted average interest rate in the euro area.

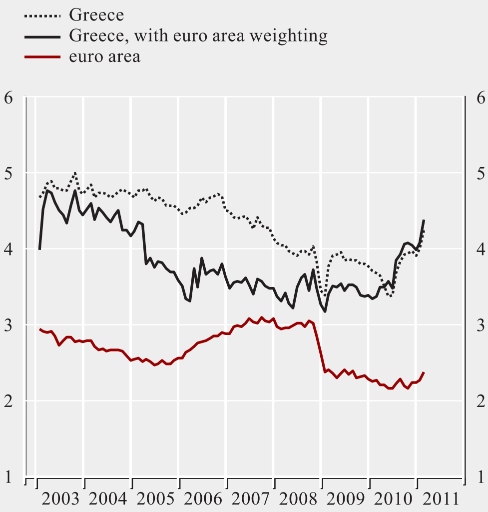
Turning to non-financial corporations, the interest rate of all loan categories recorded a remarkable rise and, as a result, they averaged 5.93% in February 2011, up by 194 basis points relative to December 2009.[43] A considerable rise in borrowing costs was observed in almost all new corporate loans during this period as, with regard to the three key categories,[44] which accounted for about the total flow of new corporate loans, interest rate increases exceeded 150 basis points.

Most new bank lending rates in the euro area decreased or registered a smaller increase compared with the corresponding Greek rates; as a result, their differential widened further in most categories in 2010 (see Tables X.5A and X.5B and Chart X.7). The highest increase was observed in loans with an agreed maturity and a floating rate or with an initial rate fixation of up to one year, while the increase in the interest rate differential was remarkable almost across all categories of corporate loans. In January 2011 this development was sustained in the most important categories of housing and consumer loans, but came to a halt as regards credit lines and corporate loans of up to €1 million, regardless of their interest rate category. In February 2011, developments exhibited mixed trends.

43 It should be noted that as from June 2011 loans to the self-employed, farmers and personal enterprises represent a separate category ("sole proprietors and unincorporated partnerships") and are not included in credit to non-financial corporations. Changes in the lending rate of this category are calculated after taking into account the effect of the above-mentioned reclassification.
44 That is credit lines and loans with an agreed maturity and a floating rate or with an initial rate fixation of up to one year.

Chart X.8 Average interest rate margin between new loans and new deposits in Greece and the euro area (January 2003 - February 2011)

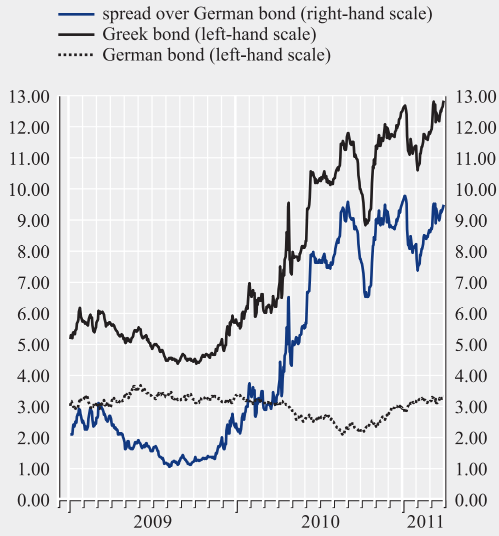
(percentage points)



Sources: Bank of Greece and ECB.

Chart X.9 10-year government bond yields: Greece and Germany (January 2009-March 2011)

(daily data, percentages per annum, spread in percentage points)



Source: Bank of Greece.

The interest rate margin in Greece rose during the third quarter of 2010 but this rise came to a stop in the fourth quarter of 2010, whereas a further increase was recorded in January-February 2011 (February 2011: 4.25%, see Table X.6 and Chart X.8). However, it should be noted that the interest rate margin in Greece remained throughout the year at a lower level than the respective average (4.33%) of the January 2003-February 2011 period. As the euro area interest rate margin remained almost unchanged in the period under review, its differential vis-à-vis the corresponding Greek one came to 187 basis points in February 2011, up by 39 basis points relative to end-2009.

5 THE GOVERNMENT BOND MARKET

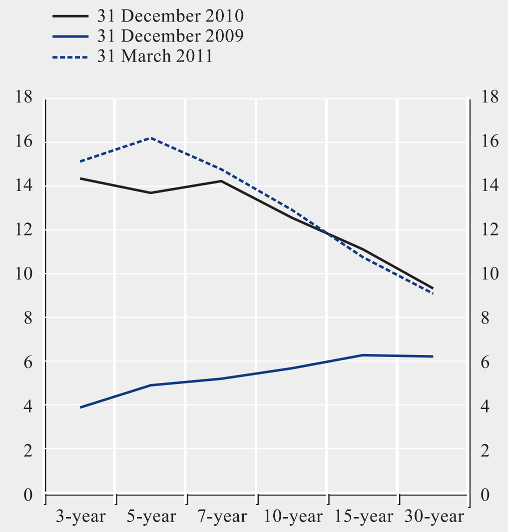
A surge in yields in the secondary market and a subsequent rise of the cost of borrowing to prohibitive levels for new government bond issues were the most notable features of the Greek government bond market in 2010. These developments were associated with heightened uncertainty about Greece's fiscal and economic outlook, on the back of which credit rating agencies successively downgraded Greek sovereign debt.[45] In the first half of 2011, there were signs that investment uncertainty had subsided, but they proved to be short-lived and, as a result, yields remained elevated.

In more detail, Greek government bond yields across all maturities were substantially higher in 2010 compared with end-2009 levels, and their volatility was high. There was a temporary, slight drop in yields in May 2010, following recourse to the support mechanism for the Greek economy, and, once again, at the beginning of the fourth quarter of 2010 (see Chart X.9). In the former case, the drop in yields was reversed by a further downgrade of Greek sovereign debt in June; in the latter, the debt crisis and fiscal imbalances in other euro area

45 Fitch downgraded Greek sovereign debt from BBB+ to BBB- on 9 April 2010 and from BBB- to BB+ on 14 January 2011, while Standard and Poor's cut Greece's rating from BBB+ to BB+ on 27 April 2010 and from BB+ to BB- on 29 March 2011. Finally, Moody's proceeded with credit rating downgrades on 22 April 2010 (from A2 to A3), on 14 June 2010 (from A3 to Ba1) and on 7 March 2011 (from Ba1 to B1).

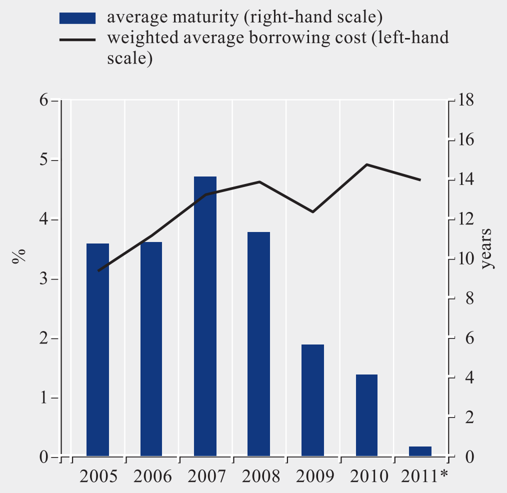
Chart X.10 Greek government paper yield curves

(yields in percentages per annum)



Source: Bank of Greece.

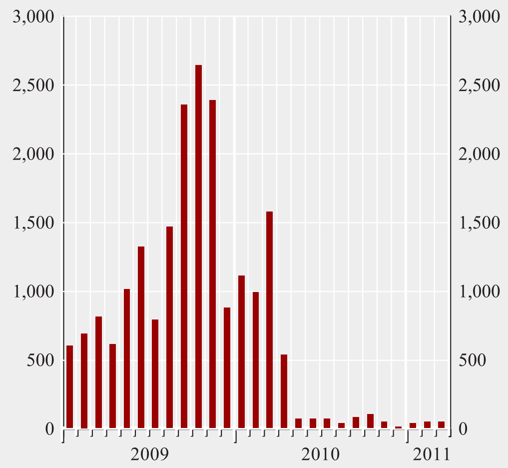
Chart X.12 Greek government securities characteristics of new issues (per year)



Sources: Public Debt Management Agency and Bank of Greece.
* Note: The figure exclusively refers to Treasury bills issued in the first three months of the year.

Chart X.11 Average daily trading value in the Electronic Secondary Securities Market (HDAT) (January 2009 - March 2011)

(million euro)



Source: Bank of Greece.

countries put renewed upward pressure on Greek bond yields.

By way of illustration, between end-2009 and end-2010 the yield spread of the ten-year Greek bond vis-à-vis its German counterpart increased by 731 basis points (31 December 2009: 229 b.p., 31 December 2010: 960 b.p.). This spread and its volatility remained high in the first quarter of 2011 compared with the last quarter of 2010, but their upward trend moderated.

Against this background, the Greek government bond yield curve shifted considerably upwards in the course of 2010. At the same time, its slope turned negative, as the rise in yields was stronger at the shorter end of the maturity spectrum. The yield spread between the ten-year and the three-year bond became negative as from mid-April 2010 and on 31 December 2010 stood at -178 basis points (see Chart X.10). From the beginning of 2011 to end-March the slope of the yield curve became more negative, despite a slight drop following the euro area summit on 11 March 2011.

Trading of Greek government bonds in the Electronic Secondary Securities Market (HDAT) decreased considerably, as the average daily value of transactions fell by 70% against 2009, to €390.3 million (see Chart X.11), which occured mainly after the first quarter of 2010. In the first three months of 2011, the average daily value of HDAT transactions was €41.4 million, compared with €1,225.2 million in the corresponding period of 2010.

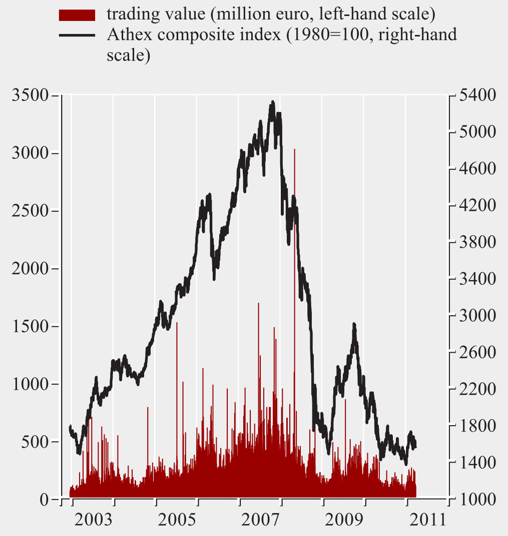
As a result of the above-mentioned developments, the Greek government did not issue any medium- and long-term bonds after the first quarter of 2010. Consequently, from April 2010 onwards, new issues exclusively concerned Treasury bills with a maturity of 13, 26 and 52 weeks. Against this background, the interest rate on new issues came close to the high levels recorded during the intensification of the global financial crisis in 2008 (see Chart X.12). Adding to the cost of Treasury bills the cost of borrowing through bonds issued by the Greek government in the first quarter of 2010, the average weighted cost of government securities in 2010 (4.9%) exceeded that of 2009 (4.1%). Finally, the issuance of Treasury bills in 2010 led to a significant shortening of the average maturity of public debt.

6 STOCK MARKET DEVELOPMENTS

In 2010 the fall in share prices on the Athens Exchange (Athex) was strong (see Chart X.13), compared with the relatively small decline in

Chart X.13 Athens Exchange: composite share price index and trading value (January 2003 -March 2011)

(daily data)



Source: Athens Exchange.

share prices on average in the euro area. Similarly, trading activity was also significantly reduced and also fund raising on the stock market registered a drop (see Table X.7). Share prices recovered slightly amid high volatility in the first quarter of 2011.

In more detail, between end-2009 and end-2010 the Athex composite share price index

Table X.7 Fund-raising through the Athens Exchange

(million euro)

Business sector	Number of firms January-December 2009	 2010*	Funds raised[1] January-December 2009	 2010*
Listed companies	18	12	4,253.1	3,472.2
Newly listed companies	3	-	2.1	0.0
Total	**21**	**12**	**4,255.2**	**3,472.2**
Financial sector–Banks	6	4	3,823.6	3,192.5
Non-financial sector	15	8	431.6	279.7

Sources: Athens Exchange and Bank of Greece.
* Provisional data.
1 Capital increases through public offerings and private placements. Subscriptions to the capital increase are entered on the last day of the public offering period.

dropped by 35.6%,[46] a development which is directly associated with investor uncertainty concerning the development of Greece's fiscal aggregates as well as its economic outlook.[47] As already mentioned, in the course of 2010 the Athex composite index fell more than the Dow Jones Euro Stoxx, which remained virtually unchanged (-0.01%). This picture was reversed in the first three months of 2011, when the Athex index rose by 8.6%, compared with a 3.6% rise in the Dow Jones Euro Stoxx.

Turning to the remaining key aggregates in the Athens Exchange, the average daily value of transactions came to €140 million in 2010, down by about 32% compared with 2009, and to €130 million in the first three months of 2011. The total amount of funds raised through the stock market fell to €3,472 million in 2010, compared with €4,253 million in 2009 (see Table X.7). Just as in 2009, almost the total of funds raised in 2010 related to financial corporations.

In 2010, the rate of decline in the banking sub-index (-52.4%) was stronger than the decline in the Athex composite share price index and double the corresponding rate of the euro area banking sub-index (-26.8%). This negative development was due to continuing pressures on Greek banks' liquidity and to the impact of economic contraction on their profitability and the quality of their loan portfolios.[48] These factors explain why by end-March 2011 bank share prices had returned to their December 2010 levels, unlike the upward trend of the Athex composite index.

7 THE MUTUAL FUNDS MARKET

Developments in the mutual funds market remained negative in the course of 2010. Between end-2009 and end-2010, total mutual fund assets declined by 23.3% to €6.2 billion, while the number of mutual funds dropped slightly compared to 2009 (2010: 230, 2009: 236 – see Table X.8). In the first two months of 2011, mutual fund assets increased slightly by 3.2%.

46 In average annual terms the drop came to 22.2% compared with 2009.
47 As a result of these developments, there was an outflow of non-residents' investment in 2010 which came to €1.1 billion.
48 For more details on developments in the banking sector, see section 8 of this chapter.

Table X.8 Total number and value of mutual funds' assets[1]

Year	Number	Value of mutual funds' assets In million euro
2000	269	30,978.7
2001	272	26,826.1
2002	263	25,429.2
2003	265	30,384.0
2004	262	31,628.5
2005	258	27,089.9
2006	269	22,971
2007	260	20,701
2008	269	8,385
2009	236	8,070
2010	230	6,189

Source: Bank of Greece.
1 End-of-period levels.

Among different types of mutual funds, only funds of funds recorded an increase in assets (5.3%). Out of the other mutual fund types, money market fund assets recorded the most marked decline (-33.3%) followed by other mutual fund types, which also registered a considerable decline (equity funds: -27.6%, mixed-type funds: -26.6%, bond funds: -27.2%).

Looking at the structure of the mutual fund market by investment policy, at end-December 2010 bond funds remained the most important category, accounting for 33.2% of total assets, compared with 28.4% for equity funds, 19.1% for money market funds, 9.8% for mixed-type funds and 9.5% for funds of funds. Finally, the investment behaviour of mutual funds was marked by lower domestic and foreign investment.

8 OVERVIEW OF DEVELOPMENTS IN THE BANKING SECTOR

The adverse macroeconomic and fiscal conditions in Greece were the main causes of the problems faced by the domestic banking sector in 2010 and the first months of 2011. These factors had a multi-faceted effect. First of all, they had an adverse impact on the loan repayment ability of households and enterprises, resulting in a rise in the non-performing loans ratio. Second, they fomented pessimism and uncertainty among economic agents, thus contributing to a shrinking of deposits. Third, they led to credit rating downgrades for credit institutions and, subsequently, to the decrease in the value of assets used as collateral for obtaining liquidity from the Eurosystem. Against this adverse background, the banking system posted losses on both an individual and consolidated basis, in a period during which liquidity was under multiple pressures. These pressures were contained by the ECB's non-standard liquidity-providing measures, the prolonged and expanded liquidity support measures under Law 3723/2008[49] and, in an indirect manner, the support mechanism for the Greek economy from the euro area Member States and the IMF. On the positive side, amidst multiple adverse conditions the banking system managed to improve its capital base.

In more detail, in 2010 and the first months of 2011, the liquidity of Greek banks came under strong pressure, as the successive downgrades of Greece's sovereign debt since late 2009 inevitably affected the ratings of domestic banks too, virtually cutting them off from international money and capital markets. As a result, banks had difficulties in tapping into funding from the interbank market and refinancing their liabilities, thereby restricting the financing of the economy. Over the same period, banks were faced with continuously shrinking deposit bases, which slightly exceeded €40 billion (from the beginning of 2010 to February 2011).[50] Pressure on bank liquidity was also exerted by the abovementioned downgrades, which also affected the credit ratings of banks and led to a devaluation of assets they have been using as collateral for refinancing from the Eurosystem. Banks were therefore required to provide the Eurosystem with additional assets (bank bonds, covered bonds, etc.) totalling some €26 billion, to make up for the shortfall of collateral value.

Consequently, the effect of shrinking deposit bases and adverse collateral valuations alone implied a need for bank funding of about €66 billion in order to safeguard the stability of the banking sector and the economy at large. Taking also into account banks' liabilities of €8 billion maturing within 2010, their total funding requirements between January 2010 and February 2011 came to €74 billion. These severe liquidity constraints were to some extent alleviated by the Eurosystem and by the Greek

49 In accordance with Ministerial Decision 59181/B-25 of 24 December 2010, the deadlines set for the participation of Greek banks in Articles 1, 2 and 3 of Law 3723/2008, as amended, were extended until 30 June 2011. Furthermore, Article 4 of Law 3845/2010 expanded the bank bond guarantee scheme by €15 billion (in addition to the €15 billion initially provided for by Law 3723/2008), Article 7 of Law 3872/2010 by another €25 billion, and a further expansion of guarantees by €30 billion is envisaged by Article 19 of the draft law on the reform of the operation for the Deposits and Loans Fund tabled to Parliament on 31 March.

50 Deposits by the private sector, general government and non-residents.

Table X.9 Financial results of Greek commercial banks and banking groups (2009-2010)

(amounts in million euro)

	Banks			Banking groups		
	2009	2010	Change (%)	2009	2010	Change (%)
Operating income	**10,627**	**9,486**	**-10.7**	**15,714**	**14,532**	**-7.5**
Net interest income	8,000	8,580	7.2	11,617	12,272	5.6
– Interest income	19,235	17,884	-7.0	24,203	22,780	-5.9
– Interest expenses	11,235	9,304	-17.2	12,586	10,508	-16.5
Net non-interest income	2,627	906	-65.5	4,096	2,260	-44.8
– Net fee income	1,316	1,245	-5.4	2,140	2,003	-6.4
– Income from financial operations	926	-552	-	1,360	-180	-
– Other income	386	214	-44.6	596	438	-26.6
Operating costs	**6,133**	**5,914**	**-3.6**	**8,631**	**8,451**	**-2.1**
Staff costs	3,598	3,465	-3.7	4,890	4,787	-2.1
Administrative costs	2,111	2,047	-3.1	3,000	2,924	-2.5
Depreciation	384	367	-4.3	696	701	0.8
Other costs	40	36	-11.2	46	39	-13.8
Net income (operating income less costs)	**4,494**	**3,571**	**-20.5**	**7,082**	**6,081**	**-14.1**
Provisions for credit and other risks	4,492	5,764	28.3	5,786	6,875	18.8
Share of profit (loss) of associates				10	-20	-
Pre-tax profits	**2**	**-2,193**	**-**	**1,306**	**-814**	**-**
Taxes	406	217	-46.5	659	537	-18.4
After tax profits	**-404**	**-2,410**	**-**	**648**	**-1,351**	**-**

Source: Financial statements of Greek commercial banks and banking groups.

government's liquidity-support measures which were absolutely necessary to enable banks to obtain sufficient liquidity from the Eurosystem.

It should be noted, however, that this manner of funding, which was necessary – for the reasons already mentioned – in order to safeguard the stability of the banking system, is only a temporary solution to banks' liquidity strains. It should also be clarified that *the bond guarantee scheme being part of the liquidity support plan implies that the government guarantees, for a fee, debt securities issued by banks and does not involve any cash injections to banks*. Given the sovereign debt downgrades involved, the liquidity that can be obtained against such government-guaranteed securities is much less than their nominal value. This is why, until the end of March 2011, banks used guarantees for a nominal value of €50 billion, which secured them some €35 billion in Eurosystem liquidity.

Against this background, the expansion of the guarantee scheme is deemed necessary in order to ensure that banks can meet liquidity requirements without a rapid deleveraging which would risk deepening the recession due to a lack of credit to the economy. At the same time, however, it is necessary for banks to find alternative sources of funding. Encouraging signs in this direction are provided by the fact that two banks obtained funding from international markets in September 2010 and January 2011. It should also be noted that, unlike other countries that have experienced a sharp contraction in bank credit to the private sector during recessions – in fact milder than the

Table X.10 Key vulnerability and shock-absorption capacity indicators of Greek commercial banks and banking groups

(percentages)

	Banks		Banking groups	
	2009	2010	2009	2010
Asset quality[1]				
Non-performing loans (NPLs) - total	7.7	10.4		
– Housing loans	7.4	10.0		
– Consumer loans	13.4	20.5		
– Business loans	6.7	8.7		
Accumulated provisions over NPLs	41.5	44.7		
Ratio of net NPLs to regulatory own funds	38.2	47.8		
Liquidity				
Loan-to-deposit ratio	106.6	119.1	113.3	122.8
Liquid asset ratio	24.2	25.5		25.6
Asset/liability maturity mismatch ratio	-4.2	-6.9		-3.9
Capital adequacy				
Capital adequacy ratio (CAR)	13.2	13.8	11.7	12.2
Tier 1 ratio	12.0	12.2	10.7	10.9
Profitability				
Net interest margin	1.87	1.97	2.65	2.68
Cost-to-income ratio	57.7	62.3	54.9	58.2
Return on assets - ROA (after tax)	-0.09	-0.55	0.15	-0.30
Return on equity - ROE (after tax)	-1.66	-8.64	2.26	-4.16

Sources: Bank of Greece and financial statements of commercial banks and banking groups.
1 NPL data on international activities are not comparable and therefore the NPL ratio on a consolidated basis is not reported.

one currently faced by Greece– the annual rate of credit expansion in Greece remained positive, albeit marginally, in 2010 (and was zero in December). Furthermore, both the level and terms of credit would have been far worse without the abovementioned measures and guarantees.

Pressure on the domestic banking system was also exerted by the rise in credit risk on bank lending. The significant deterioration of the financial condition of businesses and households, owing to the adverse macroeconomic environment, was accompanied by a considerable increase in the non-performing loans ratio (NPL ratio) in Greece (December 2010: 10.4%, December 2009: 7.7% – see Table X.9); this upward trend is expected to continue in 2011.[51] On the positive side, the coverage ratio improved (December 2010: 44.7%, December 2009: 41.5%), as a result of a significant increase in the stock of provisions during 2010. This ratio still remains low and needs to be further improved, particularly in view of an increase (i.e. deterioration) of 10 percentage points in the ratio of net NPLs (measured as accumulated provisions for credit risk over NPLs) to total regulatory own funds, and the possibility of a further deterioration in the economic climate and the financial condition of

51 The ongoing slowdown of credit expansion has caused this ratio to increase, as its denominator has been rising at a weaker pace against previous years and against the numerator.

households and businesses. It is therefore imperative that banks further increase their stock of provisions for credit risk.

The adverse macroeconomic conditions also affected the profitability of banks, which registered losses both on a solo and a consolidated basis in 2010 (see Table X.10). These losses were due to lower operating income, which fell by 10.7% and 7.5% relative to 2009 for banks and banking groups, respectively, over 2009, as well as higher impairment charges (up by 28.3% and 18.8% for banks and banking groups, respectively).[52] Looking at individual income components, net interest income rose (by 7.2% and 5.6% for banks and banking groups, respectively) in contrast with a significant fall in net non-interest income (by 65.5% and 44.8% for banks and banking groups, respectively), mainly due to losses from financial operations in the first half of 2010. The small decline in operating expenses[53] did not offset the decline in operating income; as a result, net income fell considerably both at the level of banks (-20.5%) and at the level of banking groups (-14.1%). Increased provisioning for credit risk contributed to the negative financial results posted by banks and banking groups, as well as negative ROE and ROA values (see Table X.10).

By contrast, a positive contribution (to financial stability) in 2010 came from the increase in the capital adequacy of banks and banking groups compared with end-2009 (see Table X.9), as a result of a rise in their regulatory own funds and a small decline in risk-weighted assets. At end-December 2010, the Capital Adequacy Ratio (CAR) and the Tier I ratio for banks as a whole stood at 13.8% and 12,2%, respectively, and for banking groups as a whole at 12.2% and 10.9%, respectively.[54] Despite their satisfactory capital adequacy ratios, banks need to be very cautious at the current juncture in formulating their medium-term strategies for their capital base and uses of funds, weighing not only the adverse macroeconomic conditions in Greece but also the upcoming major changes in international banking regulation.

The factors driving the performance of the domestic banking system in 2010 continue to be in play this year and are expected to continue to have the same effect for some months in 2011. Looking further ahead, the medium-term outlook for profitability, the loan portfolio and liquidity is surrounded by high uncertainty. This is why banks are called upon to demonstrate constant vigilance, flexibly adjust their business strategies, cut operating costs and shift to alternative funding sources other than those temporarily available from the Eurosystem. In this context, the internal reorganisation of banks through the adjustment of their business models as well as the overall restructuring of the banking system by a joining of forces are imperative and inevitable. However, these cannot by themselves provide a solution to the difficult situation currently faced by banks. Developments in the banking system and thereby the overall financial system will crucially depend on the ability to restore the confidence of markets and the international community in the country's financial and economic prospects. This would require a stronger impetus for reforms and structural changes.

52 The level of total losses was dampened by improved results from foreign business.
53 It should be noted that operating costs fell at a faster pace in the second half of the year, mainly those from domestic activities.
54 In the first months of 2011, one more bank completed its capital increase through payment in cash, another bank announced a deal to sell 70% of its business in Poland, while a third bank announced its intention to proceed with a significant capital increase.

XI ENERGY POLICY DEVELOPMENTS IN THE EU AND IN GREECE, GREENHOUSE GAS EMISSION PERFORMANCE, AND RENEWABLE ENERGY SOURCES

1 CLIMATE CHANGE, ENERGY POLICY OPTIONS AND THE CURRENT CONJUNCTURE

The Bank of Greece has repeatedly stressed that changing the current energy production and consumption pattern is an essential aspect of reforms aimed to relaunch economic growth in Greece. The Greek economy is very energy-consuming, and its oil dependence remains high, despite the use of renewable energy sources (hydropower and wind power) and lignite. Moreover, available estimates indicate that Greece, as a Mediterranean country, will be more strongly affected by the impact of climate change. Also, in order to comply with the EU energy and climate change policies, Greece is required to adjust its production processes, by introducing less energy-consuming technologies, and improve life in the cities. The latter involves overhauling public transport to phase out energy-consuming vehicles, as well as promoting new technologies and alternative energy sources for the insulation and heating of homes and other buildings. Significant steps are being taken in this direction, which is of paramount importance for Greece, not only because of climate change and life quality considerations, but also given its potential to lead to major investments, stronger competition in the energy sector and the creation of new businesses and jobs, and can help reduce the country's energy dependence and the associated current account deficit.

The **recent disaster in Japan**, where the severe earthquake and the tsunami were followed by a large-scale nuclear accident, showed how technological progress can compound the fallout of natural disasters. Nuclear dependence coupled with safety measures that, in hindsight, are judged insufficient, amplified —just how much remains to be seen— the initial impact of the earthquake and the subsequent tsunami. These considerations, as well as the need to start addressing climate change before it is too late imply that new policy choices will be required on a global scale in such areas as construction, town-planning and zoning, transportation, as well as energy production and consumption.

At the EU level, it is worth noting that the **European Council of 24-25 March** stressed the need to fully draw the lessons from the events in Japan and to provide all necessary information to the public. Recalling that the energy mix is the competency of Member States, the European Council called for work to be taken forward as a matter of priority on the following aspects:

- the safety of all EU nuclear plants should be reviewed, on the basis of a comprehensive and transparent risk and safety assessment ("stress tests"). The European Nuclear Safety Regulators Group (ENSREG) and the European Commission are invited to develop as soon as possible the scope and modalities of these tests in a coordinated framework in the light of lessons learned from the accident in Japan and with the full involvement of Member States. Assessments will be conducted by independent national authorities and through peer reviews. Their outcome and any necessary subsequent measures that will be taken should be shared with the European Commission and with the ENSREG and should be made public; The European Council will assess initial findings by the end of 2011, on the basis of a report from the Commission;

- the priority of ensuring the safety of nuclear plants *obviously cannot stop at EU borders. The EU will request that similar stress tests be conducted in the neighbouring countries* and worldwide, regarding both existing and planned plants;

- the highest standards for nuclear safety should be implemented and continuously improved in the EU and promoted internationally;

- the Commission will review the existing legal and regulatory framework for the safety of nuclear installations and will propose by the end of 2011 any improvements considered necessary. Member States should ensure the full implementation of the Directive on the safety of nuclear installations. The proposed Directive on the management of spent nuclear fuel and radioactive waste will have to be adopted as soon as possible. *The Commission is invited to reflect on how to promote nuclear safety in neighbouring countries;*

- consequences for the world and for the EU need to be closely monitored, paying particular attention to the volatility of energy and commodity prices, in particular in the context of the G20.

2 GREENHOUSE GAS EMISSIONS UPDATE – GREECE'S PERFORMANCE AGAINST THE KYOTO TARGET

According to the latest available data, in 2008 total greenhouse gas emissions in the EU-27, excluding the sector "land uses, land use change and forestry" and emissions from international aviation and maritime transport, amounted to 4,940 million tonnes of carbon dioxide (CO_2) equivalents, i.e. 11% less than in 1990. In the EU-15 (the older EU Member States), 2008 gas emissions amounted to 3,970 million tonnes (down by 6% from 1990 levels), accounting for 80% of total emissions in the EU-27 (compared with a share of 76% in 1990). Among the older Member States, Germany and the United Kingdom were jointly responsible for the largest part of the total EU greenhouse gas emissions in 2008 (32% of total EU-27 emissions and 40% of total EU-15 emissions), making, however, considerable progress relative to 1990, as their emissions decreased by 22% and 19% respectively. The smallest gas emission contributors were Luxembourg (0.2%), Sweden, Denmark and Finland (1%), which all had similar shares in total EU-15 emissions.

As regards Greece, although its contribution in total EU emissions is very small, its level of greenhouse gas emissions in 2008 increased by 23% relative to 1990, highlighting the need to promote green economy and renewable energy sources (see Table XI.1).

The data of Table XI.1 also indicate that countries which, due to their size, are among the largest contributors of total greenhouse gas (GHG) emissions tend to perform better in terms of GHG emissions per capita or per unit of gross domestic product (GDP).[1] Conversely, Luxembourg and Ireland, although having very small shares in total emissions, rank among the higher scorers in terms of emissions per capita (25 and 15 tonnes of CO_2 equivalent/person, respectively). Looking at the evolution of this index over time, almost all of the older Member States (with the exception of Greece, Portugal and Spain) have shown an improvement. Greenhouse gas emissions per unit of GDP, on the other hand, dropped in all EU-15 Member States in 2008, relative to 1990, with Sweden being the best performer (0.02 kg of CO_2 equivalent/ unit of GDP) and **Greece the worst (0.69 kg of CO_2 equivalent/ unit of GDP). However, Greece, along with Ireland and the United Kingdom, is one of the countries with the largest improvement in terms of this index**.

Regarding the breakdown by each of the six main gases in the EU-27 in 2008, carbon dioxide (CO_2) had the far largest share (83%), followed by methane (CH_4) and nitrous oxide (N_20) with shares of 8% and 7%, respectively. Looking at changes in individual gas emissions, CO_2 emissions fell by 7%, while CH_4 and N_2O emissions fell by 31% and 30%, respectively, between 1990 and 2008.

In Greece, CO_2 emissions in 2008 stood at 110 million tonnes, corresponding to 2.7% of CO_2 emissions in EU-27 and 87% of total GHG emissions in Greece and representing an increase of 32% compared with 1990.

As far as the sources of GHG emissions are concerned (see Table XI.2), energy was the largest contributor with a share of 79% in the EU-27 for 2008 (3,907 million tonnes of CO_2 equivalent). The second largest source of GHG emissions was agriculture, with a share of 10% (472 million tonnes of CO_2 equivalent), followed by industrial processes and waste, with

1 This may be due to differences in the energy efficiency of power production and other plants, the energy savings of households and enterprises, energy market deregulation, etc.

Table XI.1 Greenhouse gas emissions[1] in EU-15 and EU-27 Member States

	Greenhouse gas emissions (in million tonnes of CO_2 equivalents)			Shares in EU-15 total (%)			Greenhouse gas emissions per capita (in tonnes of CO_2 equivalents)			Greenhouse gas emissions per unit of GDP (in kg of CO_2 equivalents)		
	1990	**2000**	**2008**	**1990**	**2000**	**2008**	**1990**	**2000**	**2008**	**1990**	**2000**	**2008**
Austria	78	80	87	1.8	1.9	2.2	10.2	10.0	10.4	0.48	0.39	0.35
Belgium	143	145	133	3.4	3.5	3.4	14.4	14.2	12.5	0.71	0.57	0.46
Denmark	69	68	64	1.6	1.7	1.6	13.4	12.8	11.7	0.07	0.05	0.04
Finland	70	69	70	1.7	1.7	1.8	14.2	13.3	13.2	0.65	0.52	0.42
France	563	557	527	13.3	13.5	13.3	10.0	9.2	8.2	0.48	0.39	0.32
Germany	1,232	1,025	958	29.0	24.9	24.1	15.6	12.5	11.7	0.70	0.50	0.42
Greece	*103*	*125*	*127*	*2.4*	*3.0*	*3.2*	*10.2*	*11.5*	*11.3*	*0.96*	*0.92*	*0.69*
Ireland	55	68	67	1.3	1.7	1.7	15.6	18.0	15.3	1.04	0.65	0.46
Italy	517	550	541	12.2	13.4	13.6	9.1	9.7	9.1	0.51	0.46	0.43
Luxembourg	13	10	12	0.3	0.2	0.3	34.3	23.0	24.8	0.97	0.45	0.40
Netherlands	212	215	207	5.0	5.2	5.2	14.2	13.6	12.6	0.69	0.51	0.42
Portugal	59	81	78	1.4	2.0	2.0	5.9	7.9	7.4	0.63	0.64	0.57
Spain	285	381	406	6.7	9.3	10.2	7.3	9.5	9.0	0.60	0.60	0.50
Sweden	72	69	64	1.7	1.7	1.6	8.5	7.8	7.0	0.04	0.03	0.02
United Kingdom	772	673	628	18.2	16.4	15.8	13.5	11.4	10.3	1.02	0.69	0.54
EU-15	**4,245**	**4,114**	**3,970**	**100.0**	**100.0**	**100.0**	**14.4**	**13.4**	**12.3**	**0.59**	**0.47**	**0.39**
EU-27	**5,567**	**5,062**	**4,940**				**11.8**	**10.5**	**9.9**	**0.74**	**0.55**	**0,46**

Source: European Environment Agency, *Annual European Union greenhouse gas inventory 1990-2008 and inventory report 2010*, 27 May 2010.
1 Excluding international aviation and maritime transport as well as the "land use, land-use change and forestry" sector.

Table XI.2 Greenhouse gas emissions by source: EU-27, EU-15 and Greece

(in million tonnes of CO_2 equivalents)

	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
EU-27															
Energy	4,267	4,024	4,136	4,030	4,018	3,957	3,962	4,046	4,013	4,096	4,088	4,062	4,050	3,978	3,907
Industrial processes	484	463	458	467	439	401	413	400	397	405	416	420	421	434	410
Solvents and other product use	17	14	14	14	14	14	14	13	13	13	13	13	13	13	12
Agriculture	592	513	515	515	513	509	501	492	487	481	481	475	472	472	472
Waste	207	201	198	190	185	179	173	165	161	155	150	146	145	142	139
Total [1]	*5,567*	*5,215*	*5,321*	*5,217*	*5,169*	*5,060*	*5,062*	*5,117*	*5,072*	*5,149*	*5,148*	*5,117*	*5,100*	*5,039*	*4,940*
EU-15															
Energy	3,254	3,176	3,261	3,194	3,238	3,212	3,226	3,297	3,281	3,338	3,335	3,316	3,291	3,223	3,168
Industrial processes	375	374	371	379	359	327	331	322	320	323	329	327	322	330	313
Solvents and other product use	14	12	12	12	12	12	12	11	11	11	11	11	11	10	10
Agriculture	431	410	415	415	415	414	410	401	395	390	389	383	378	379	378
Waste	171	165	161	153	148	141	136	129	123	116	111	108	106	104	102
Total [1]	*4,245*	*4,137*	*4,220*	*4,154*	*4,171*	*4,106*	*4,114*	*4,159*	*4,131*	*4,178*	*4,174*	*4,145*	*4,108*	*4,046*	*3,970*
Greece															
Energy	78	81	83	88	93	92	97	100	99	103	104	107	105	108	104
Industrial processes	10	12	13	13	14	14	13	13	13	13	13	13	11	11	11
Solvents and other product use	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Agriculture	11	10	10	10	10	10	10	10	10	10	10	9	9	10	9
Waste	4	4	4	4	4	4	4	3	3	3	3	3	3	3	3
Total [1]	*103*	*108*	*111*	*116*	*121*	*121*	*125*	*126*	*126*	*130*	*130*	*133*	*129*	*132*	*127*

Sources: European Environment Agency, *Annual European Community greenhouse gas inventory 1990-2008 and inventory report 2010*, 27 May 2010; Ministry of Environment, Energy and Climate change, *Annual inventory submission under the convention and the Kyoto Protocol for greenhouse and other gases for the years 1990-2008*, April 2010.

1 Excluding “land use, land use change and forestry” sector.

shares of 8% and 3% (410 and 139 million tonnes of CO_2 equivalent, respectively).

In Greece, gas emissions from the energy sector reached 104 million tonnes of CO_2 equivalent in 2008, up by 34% from 1990, while in the EU-27 the corresponding emissions dropped by 8% over the same period.

Finally, with regard to the evolution of GHG emissions **against the Kyoto Protocol targets**, it is worth noting that most of the EU-15 Member States are still short of the country-specific targets under the Protocol (see Table XI.3). Spain and Austria are the countries farthest off-track, although they have made progress compared with 2007. By contrast, Sweden, the United Kingdom and France have already overshot their Kyoto targets.

It should be recalled that the target set under the Kyoto Protocol for Greece is to contain the increase in its greenhouse gas emissions to 25% relative to the base year 1990, by 2008-2012. In 2008, Greece's GHG emissions were 18.6% higher relative to the base year, i.e. within the target. It should also be noted that a considerable improvement was recorded in comparison with 2007, when the increase against the base year had been 23.2%.

3 THE DEVELOPMENT OF RENEWABLE ENERGY SOURCES IN GREECE

The considerable increase in Greece's GHG emissions from 1990 to date, both in aggregate terms and per capita, as shown by the above data, points out to an urgent need for environmentally friendly methods of generating electricity. Renewable energy sources (RES) are considered to play a decisive role in this respect, with their total capacity coming to 1,736 MW at end-2010, from 1,446 MW in 2009. Photovoltaic (PV) systems increased their penetration and their capacity, growing from 53 MW in 2009 to 198 MW in 2010; adding wind power capacity of 131 MW, this makes a total of 1,298 MW. Furthermore, the capacity of small hydroelectric power plants increased to 196.3 MW in 2010, from 182.6 MW in 2009. According to the Greek Ministry of Environment, Energy and Climate Change (YPEKA) and based on data from the licencing procedures, the capacity of wind and PV power plants is expected to increase by 300 MW and 200 MW, respectively, in 2009.[2]

The selection, however, of the specific RES energy mix should at all times take account not only of technological parameters, but also of administrative and economic considerations. For instance, the experience with PV subsidisation programmes has revealed a number of administrative and economic distortions, the removal of which is not administratively or fiscally neutral. Regarding these distortions, the following points can be made:

- *First*, the administrative or technical services (system stability) were not, at least initially, adequately prepared to accommodate the large interest of households and professionals (businessmen and farmers as investors) in PV. It should be noted that the bulk of investment plans submitted under the previous legislation on investment incentives and are still under examination refers to PV systems. Furthermore, it is worth mentioning that more than 30,000 applications which were submitted to the Public Power Corporation (DEH) concerned solely PV systems that are exempted from an energy production license.

- *Second*, from an economic perspective, factors to be considered are the following: (a) the opportunity cost implied by the use of high-productivity farmland for the installation of PV systems by farmers; (b) the market distortions entailed, as the application of a special RES tax leads to a wide subsidy gap between PV and windfarms; and (c) a common misconception among farmers that PV systems can be a substitute for sound agricultural business activity.

2 RES Investor Report for 2010, Ministry of Environment, Energy and Climate Change (YPEKA).

Table XI.3 Greenhouse gas emissions[1] and the Kyoto Protocol targets

	1990	Kyoto Protocol (base year)[2]	2008	Change 2008 over 2007	Change 2008 over 1990	Change 2008 over base year	Kyoto targets 2008-2012
	(in million tonnes of CO_2 equivalents)			(percentage changes)			
Austria	78.2	79.0	86.6	-0.4	10.8	9.6	-13.0
Belgium	143.4	145.7	133.3	2.3	-7.1	-8.6	-7.5
Denmark	68.9	69.3	63.8	-4.5	-7.4	-7.9	-21.0
Finland	70.4	71.0	70.1	-10.2	-0.3	-1.2	0.0
France	563.2	563.9	527.0	-0.6	-6.4	-6.5	0.0
Germany	1,231.8	1,232.4	958.1	0.1	-22.2	-22.3	-21.0
Greece	*103.3*	*107.0*	*126.9*	*-3.8*	*22.8*	*18.6*	*25.0*
Ireland	54.8	55.6	67.4	-0.3	23.0	21.3	13.0
Italy	517.0	516.9	541.5	-2.0	4.7	4.8	-6.5
Luxembourg	13.1	13.2	12.5	-2.3	-4.8	-5.1	-28.0
Netherlands	212.0	213.0	206.9	0.0	-2.4	-2.9	-6.0
Portugal	59.3	60.1	78.4	-1.9	32.2	30.3	27.0
Spain	285.1	289.8	405.7	-7.5	42.3	40.0	15.0
Sweden	72.4	72.2	64.0	-3.3	-11.7	-11.3	4.0
United Kingdom	771.7	776.3	628.2	-1.8	-18.6	-19.1	-12.5
EU-15	**4,244.7**	**4,265.5**	**3,970.5**	**-1.9**	**-6.5**	**-6.9**	**-8.0**

Source: European Environment Agency, *Annual European Community greenhouse gas inventory 1990-2008 and inventory report 2010*, 27 May 2010.
1 Total emissions excluding the "land use, land use change and forestry" sector.
2 For the gases CO_2, CH_4 and N_2O, all the Member States chose 1990 as their base year. For the gases HFC, PFC and SF_6, 12 Member States chose 1995 as their base year, while Austria, France and Italy chose 1990.

Furthermore, the unquestionable environmental and growth benefits[3] of investing in RES should be part of the b*roader medium- to long-term planning of the economy*, in order to ensure that the resulting demand will not lead to lower than expected job creation and that the following are duly taken into account:

– (i) the long-term benefits in terms of GHG emission reduction, as well as oil import substitution (implying an improvement in the current account); and

– (ii) the one-off deterioration in the current account associated with the non-existence or insufficiency of domestic production of photovoltaic panels and wind generators.

Nevertheless, the electricity market is affected both by RES subsidisation and the purchase of extra emission permits (from 2013 onwards). This impact should be mitigated through reforms to further streamline the energy market and make it more competitive (energy market reforms are discussed in the following section of this chapter).

4 REFORMS IN THE GREEK ENERGY MARKET – IMPLEMENTATION OF THE THIRD EU ENERGY PACKAGE

An important step towards ensuring effective competition in the domestic electricity and gas markets was taken by the draft law harmonising Greek legislation with the provisions of

3 According to YPEKA, the total level of investment in RES for the 2010-2020 period is estimated to amount to €16.4 billion, plus an additional €4-5 billion for connection and network projects.

Directives 2009/72/EC and 2009/73/EC of the European Parliament and of the Council (Third Internal Energy Market Package"),[4] which was unveiled by the Minister of Environment, Energy and Climate Change at a Cabinet meeting on 9 March 2011.

The provisions of the draft law focus on the following:

- enhancing the independence and scope of the Regulatory Authority for Energy;

- reforming the electricity and natural gas markets, with a view to strengthening competition; and

- increasing consumer protection and safeguarding the rights of consumers.

In this context, the **Regulatory Authority for Energy (RAE)** assumes broader responsibilities and an expanded role, including the power to adopt *all administrative acts and measures* regarding the regulation of energy markets and the implementation of the current legal framework, excluding those relating to the formulation of the overall national policy in the energy sector, which will remain with the Ministry of Environment, Energy and Climate Change (YPEKA).[5]

In the field of the **deregulation of electricity and natural gas markets**, the draft law provides for the separation of the generation function from the transmission and distribution functions in the respective markets.[6]

In the **electricity market**, the draft law envisages the establishment of three new companies:

– A company which will be a wholly owned subsidiary of DEH (the Public Power Corporation), according to the Independent Transmission Operator (ITO) model, under the name of "ADESMHE S.A.",[7] which will take up *the transmission activities of DEH* (as well as its fixed assets) and the transmission activities currently carried out by DESMHE. The new company will be entrusted with the ownership, maintenance, management, exploitation and development of the Transmission System.[8] Furthermore, the draft law envisages a *Supervisory Body* of ADESMHE, responsible for decisions having a significant bearing on the value of fixed assets, as well as the appointment of a *Compliance Officer*, also involved in ADESMHE's daily operations.

The draft law also enables the transfer of minority interests in ADESMHE S.A. to third parties (other than stakeholders in the production and supply of electricity or natural gas), with a view to strengthening the company's capital base and securing the resources required for the projects envisaged in the company's ten-year development plan.

– A company responsible for the operation of the electricity market, under the name of "LAGHE S.A.", which will be the successor of the present DESMHE. The Greek State will initially have a 100% holding in the new com-

4 As well as with Regulations (EC) 713/2009, 714/2009 and 715/2009 of 13 July 2009.

5 Specifically, the RAE is entrusted with *decision-making* powers (which have up to now been solely advisory) regarding (a) the security of energy supply, (b) the licensing procedure, i.e. *all electricity generation and supply licences*, as well as the *licences for the exercise of natural gas activities*, will be granted by the RAE, which until now had been granting only RES licences, (c) the development and monitoring of a network and infrastructure development project, (d) the tariffs for non-competitive business (operation of networks and infrastructures), (e) the supervision and certification of independent electricity and natural gas operators (*granting certification is a new task of the RAE*) and (f) consumer protection.

6 According to the EU directives, Member States may choose among three alternative options with regard to the separation of the electricity and natural gas generation procedure from the transmission procedure. These are: (a) the "*full ownership unbundling*" model, under which the same person or persons are not entitled to exercise control over a generation or supply undertaking and, at the same time, exercise direct or indirect control over a transmission system operator, (b) the "*independent system operator – ISO*", according to which undertakings are entitled to maintain the supply and transmission activities whilst ensuring "effective separation of interests", and (c) the "*independent transmission operator – ITO*, on the basis of which a vertically integrated undertaking shall maintain its network of activities whilst ensuring "effective separation of interests" by establishing rules concerning individual activities, equipment, staff, identity and compliance control.

7 Under the Independent System Operator (ISO), ADESMHE must have been certified by the RAE as an Electricity System Operator by March 2012.

8 The new subsidiary will take over the entire staff of the Transmission branch of DEH S.A., as well as the staff of DESMHE S.A. responsible for the maintenance, management, exploitation and development of the Transmission System.

pany,[9] with a possibility to transfer part of its stake to third parties.

– *A company which will be a totally owned subsidiary of DEH* under the name of "ADDHE S.A.", responsible for the operation, maintenance and development of the *distribution network*, including the network of non-interconnected islands. The ownership of the fixed assets of the distribution network will however remain with DEH, which will be required to finance the network's development according to the applicable network development plans.

In the **natural gas market**, the draft law provides for the unbundling of DEPA from DESFA, once again opting for the Independent Transmission Operator (ITO) model.

In this context, DESFA S.A. will take up the operation, maintenance and development of the National Natural Gas System (ESFA), after having been authorised by RAE. Furthermore, the draft law envisages the creation of a Supervisory Body, responsible for making decisions with a significant bearing on the value of the company's fixed assets. Three out of its seven members must not have entered into any kind of business relations with DEPA in the last three years. Futhermore, the draft law provides for the appointment of a Compliance Officer, also involved in DESFA's daily operations. In addition the draft law transposes into national law Article 9 of Directive 2009/73/EC regarding the ownership unbundling of undertakings performing any of the functions of natural gas production or supply from new (i.e. after 3 September 2009) transmission system operators.

Finally, the draft law addresses key issues regarding consumer protection in electricity and natural gas supply, with a view to ensure:

– maximum benefits to consumers from energy market deregulation, access to affordable and high-quality energy products and services;

– the effective protection of consumer rights; this involves, among other things, protection against market abuse on the part of suppliers, the introduction of smart meters, enabling consumers' active participation in the energy market and uninterrupted electricity supply even in the event of supplier failure. Furthermore, all suppliers are subject to public service obligations (social tariffs for household customers), and the concept of energy poverty is introduced, while a Universal Service Provider is designated (acting as a default or last resort supplier) and vulnerable consumers are defined (who can benefit from favourable payment options or the prohibition of disconnection in critical times).

9 The 100% participation of the Greek State will result from the transfer of 49% of DESMHE shares, which are currently owned by DEH.

ANNEX

ANNUAL ACCOUNTS FOR THE YEAR 2010

AUDITOR'S REPORT
REPORT OF THE GENERAL COUNCIL

CONTENTS

BALANCE SHEET AS AT 31 DECEMBER 2010

EIGHTY THIRD YEAR

(in euro)

ASSETS	31.12.2010	31.12.2009
1. Gold and gold receivables	**5,005,114,533**	**3,633,315,395**
2. Claims on non-euro area residents denominated in foreign currency	**1,009,983,571**	**1,108,075,094**
2.1 Receivables from the International Monetary Fund (IMF)	908,925,790	947,530,824
2.2 Balances with banks and security investments, external loans and other external assets	101,057,781	160,544,270
3. Claims on euro area residents denominated in foreign currency	**283,797,006**	**281,553,987**
3.1 General government	200,915,553	270,390,666
3.2 Other claims	82,881,453	11,163,321
4. Claims on non-euro area residents denominated in euro	**165,813**	**177,285**
4.1 Balances with banks, security investments and loans	165,813	177,285
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	**97,668,800,000**	**49,655,100,000**
5.1 Main refinancing operations	18,023,000,000	2,355,000,000
5.2 Longer-term refinancing operations	78,382,800,000	47,300,100,000
5.3 Fine-tuning reverse operations	1,263,000,000	0
6. Other claims on euro area credit institutions denominated in euro	**71,609,150**	**72,760,162**
7. Securities of euro area residents denominated in euro	**23,860,877,515**	**20,668,018,576**
7.1 Securities held for monetary policy purposes	4,898,275,295	674,147,384
7.2 Other securities of euro area residents denominated in euro	18,962,602,220	19,993,871,192
8. General government long-term debt denominated in euro	**6,867,002,312**	**7,294,205,864**
9. Intra-Eurosystem claims	**1,600,050,638**	**1,597,874,267**
9.1 Participating interest in the ECB	468,140,047	435,391,713
9.2 Claims equivalent to the transfer of foreign reserves to the ECB	1,131,910,591	1,131,910,591
9.3 Claims related to the allocation of euro banknotes within the Eurosystem (net)	0	0
9.4 Net claims arising from balances of TARGET2 accounts	0	0
9.5 Other claims within the Eurosystem (net)	0	30,571,963
10. Items in course of settlement	**415,701**	**2,369,833**
11. Other assets	**2,272,489,005**	**2,280,203,801**
11.1 Coins	69,322,438	58,087,539
11.2 Tangible and intangible fixed assets	755,550,905	763,695,749
11.3 Other financial assets	29,172,193	29,260,593
11.4 Off-balance-sheet instruments revaluation differences	1,653,134	0
11.5 Accruals and prepaid expenses	988,458,366	1,009,094,586
11.6 Sundry	428,331,969	420,065,334
TOTAL ASSETS	**138,640,305,244**	**86,593,654,264**

OFF-BALANCE-SHEET ITEMS	31.12.2010	31.12.2009
1. Greek government securities relating to the management of the "Common capital of legal entities in public law and social security funds" according to Law 2469/97	22,599,433,438	20,167,881,047
2. Greek government securities and other securities relating to the management and custody of funds of public entities, social security funds and private agents	9,408,108,799	9,624,298,900
3. Assets eligible as collateral for Eurosystem monetary policy operations and intra-day credit	162,000,732,695	77,190,735,706
4. Other off-balance-sheet items	10,870,038,657	282,506,757
TOTAL OFF-BALANCE-SHEET ITEMS	**204,878,313,589**	**107,265,422,410**

Notes:

1 Under Article 54A of the Bank's Statute, the financial statements of the Bank of Greece are drawn up in accordance with the accounting principles and rules established by the European Central Bank (ECB) and applying to all the members of the European System of Central Banks (ESCB).

2 The Bank's key for subscription to the ECB's capital fully paid up by the 16 National Central Banks of the Eurosystem is 2.81539%.

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	31.12.2010	31.12.2009
1. Banknotes in circulation	**21,748,281,800**	**20,886,044,900**
2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	**10,528,376,123**	**8,008,073,640**
2.1 Current accounts (covering the minimum reserve system)	3,303,376,123	4,616,073,640
2.2 Deposit facility	7,165,000,000	3,392,000,000
2.3 Fixed-term deposits	60,000,000	0
3. Other liabilities to euro area credit institutions denominated in euro	**0**	**0**
4. Liabilities to other euro area residents denominated in euro	**2,339,465,608**	**1,381,108,771**
4.1 General government	781,941,428	1,333,377,502
4.2 Other liabilities	1,557,524,180	47,731,269
5. Liabilities to non-euro area residents denominated in euro	**766,281,837**	**719,806,349**
6. Liabilities to euro area residents denominated in foreign currency	**22,321,537**	**73,079,424**
7. Liabilities to non-euro area residents denominated in foreign currency	**56,827**	**84,505,484**
7.1 Deposits and other liabilities	56,827	84,505,484
7.2 Liabilities arising from the credit facility under ERM II	0	0
8. Counterpart of special drawing rights allocated by the IMF	**905,349,233**	**851,675,401**
9. Intra-Eurosystem liabilities	**95,054,832,880**	**49,122,200,115**
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)	7,921,552,125	86,137,460
9.3 Net liabilities arising from balances of TARGET2 accounts	87,088,090,137	49,036,062,655
9.4 Other liabilities within the Eurosystem (net)	45,190,618	0
10. Items in course of settlement	**23,305,724**	**26,358,624**
11. Other liabilities	**787,477,099**	**764,807,737**
11.1 Off-balance-sheet instruments revaluation differences	1,719	191,109
11.2 Accruals and income collected in advance	114,941,633	68,547,768
11.3 Sundry	672,533,747	696,068,860
12. Provisions	**2,385,419,686**	**1,953,462,075**
13. Revaluation accounts	**3,263,692,564**	**1,917,223,958**
14. Capital and reserves	**815,444,326**	**805,307,786**
14.1 Capital	111,243,362	111,243,362
14.2 Ordinary reserve	111,243,362	111,243,362
14.3 Extraordinary reserve	84,500,000	72,500,000
14.4 Special reserve from the revaluation of land and buildings	507,247,856	509,257,925
14.5 Other special reserves	1,209,746	1,063,137
TOTAL LIABILITIES	**138,640,305,244**	**86,593,654,264**

4 Account balances related to monetary policy operations are shown under distinct items.
5 Gold has been valued at the price provided by the ECB as at 31 December 2010: €1,055.418 per fine oz, compared with €766.347 as at 31 December 2009.
6 Claims/liabilities denominated in foreign currency have been converted into euro using the euro foreign exchange reference rates of the ECB as at 31 December 2010.
7 Marketable securities (other than held-to-maturity) are valued at the mid-market prices of 31 December 2010. Marketable securities classified as held-to-maturity and non-marketable securities are valued at amortised cost subject to impairment. In financial year 2010 no impairment losses incurred.
8 Fixed assets are valued at cost, with the exception of land and buildings which are valued at market prices determined by independent appraisers, less depreciation.
9 From 2005 onwards, depreciation of buildings is calculated at a rate of 2.5%, over their expected life (40 years).
10 In 2010 an amount of €47 million (2009: €45 million) was released from the provision of €149.5 million against counterparty risks related to the monetary policy operations of the Eurosystem, initially established in 2008. This amount of €47 million was transferred to income from unused provisions.
11 From the profit of financial year 2010, an amount of €12 million was transferred to the extraordinary reserve.
12 Certain items of the balance sheet and the profit and loss account for the year 2009 have been reclassified to ensure comparability with the respective items of the year 2010.
13 "Other off-balance-sheet items" include a promissory note of €10.6 billion (SDR 9.1 billion) issued by the Greek government for the total amount of the loan received from the IMF until 31 December 2010.

PROFIT AND LOSS ACCOUNT FOR THE YEAR 2010

(in euro)

	2010	2009
1. Net interest income	**825,890,005**	**766,668,842**
1.1 Interest income	1,741,334,930	1,432,540,058
1.2 Interest expense	-915,444,925	-665,871,216
2. Net result of financial operations, write-downs and risk provisions	**50,321,799**	**58,209,232**
2.1 Realised gains arising from financial operations	50,321,799	58,209,232
2.2 Write-downs on financial assets and positions	-21,326,568	-5,170,554
2.3 Transfer from provisions for foreign exchange rate interest rate, credit and gold price risks	21,326,568	5,170,554
3. Net income from fees and commissions	**141,548,446**	**174,827,731**
3.1 Fees and commissions income	143,186,356	176,416,753
3.2 Fees and commissions expense	-1,637,910	-1,589,022
4. Income from equity shares and participating interests	**12,288,700**	**66,983,496**
5. Net result of pooling of monetary income	**1,834,971**	**53,376,709**
6. Other income	**12,630,271**	**19,410,623**
Total net income	**1,044,514,192**	**1,139,476,633**
7. Staff costs and pensions	**-319,516,458**	**-332,781,100**
8. Administrative and other expenses	**-48,198,051**	**-46,498,739**
9. Depreciation of tangible and intangible fixed assets	**-13,481,729**	**-59,807,274**
10. Provisions	**-472,865,662**	**-472,228,907**
Total expenses	**-854,061,900**	**-911,316,020**
PROFIT FOR THE YEAR	**190,452,292**	**228,160,613**

Note: *Item 5 "Net result of pooling of monetary income" includes amounts regarding the partial release of the provision of €149,522,606 against counterparty risks related to the monetary policy operations of the Eurosystem, first established in 2008 (2010: €47,025,589, 2009: €44,966,265).*

DISTRIBUTION OF NET PROFIT

(Article 71 of the Statute)

(in euro)

	2010	2009
Dividend €0.67 per share on 19,864,886 shares	13,309,473	13,309,473
Extraordinary reserve	12,000,000	17,500,000
Additional dividend €0.89 per share*	17,679,749	34,366,253
Tax payment on dividends**	20,659,482	15,891,909
To the Government	126,803,588	147,092,978
	190,452,292	**228,160,613**

* *The total dividend for financial year 2010 amounts to €2.60 per share compared to €3.20 in the previous year.*
** *Dividends are subject to withholding tax of 40%, in accordance with Article 13 of Law 3842/23.4.2010. In case of the amendment of the above Law, before the dividend payment, the tax and the dividend amounts will be adjusted appropriately.*

Athens, 14 March 2011

THE GOVERNOR

GEORGE A. PROVOPOULOS

THE DIRECTOR OF THE ACCOUNTS DEPARTMENT

CHRISTOS K. PAPAKONSTANTINOU

To the Shareholders of the BANK OF GREECE S.A.

Report on the Financial Statements

We have audited the accompanying financial statements of the BANK OF GREECE S.A. ("the Bank"), which comprise the Balance Sheet as at December 31, 2010, and the income statement, and the statement of profit distribution for the year then ended, and a summary of significant accounting policies and other explanatory information.

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 prescribed by the European Central Bank (ECB) as adopted by the Bank in article 54A of its Statute, and note 12 in the financial statements as concerns the method used to provide for general risks and the Accounting Standards prescribed by Greek legislation, and for such internal controls as Management determines are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility: Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards of Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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.

The balance sheet item "Provisions" includes provision for pensions, other liabilities to employee funds amounting to €1,465 million (December 31, 2009: €1,275 million) for which we were unable to obtain audit evidence concerning their calculation and, consequently, we are unable to satisfy ourselves as to the adequacy of such provision.

Opinion: In our opinion, except for the possible effects of the matter described in the paragraph above, the financial statements present fairly, in all material respects, the financial position of the BANK OF GREECE S.A. as at December 31, 2010, and of its financial performance for the year then ended in accordance with the accounting principles prescribed by the European Central Bank as adopted by the Bank in article 54A of its Statute and note 12 in the financial statements as concerns the method used to provide for general risks and the Accounting Standards prescribed by the Greek legislation.

Report on Other Legal Requirements: We confirm the reconciliation and correspondence of the information given in the Report of the Governor with regard to the income statement for the year ended 2010 with the attached financial statements, according to articles 43a and 37 of the Law 2190/1920.

Athens, 14 March 2011

The Certified Auditors - Accountants

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REPORT OF THE GENERAL COUNCIL TO THE GENERAL MEETING OF SHAREHOLDERS

NOTES ON THE ANNUAL ACCOUNTS

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 from time to time 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, as amended by Guidelines ECB/2007/20 of 17 December 2007, ECB/2008/21 of 11 December 2008, ECB/2009/18 of 17 July 2009, ECB/2009/28 of 14 December 2009 and ECB/2010/20 of 11 November 2010.

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.

Main 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 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. 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 value date in accordance with the cash 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/value 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 and the foreign currency position is affected commensurately.

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 on 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, other than held to maturity, are valued at the average market prices prevailing at the Balance Sheet date on the basis of their ISIN code; for the financial year ending on 31 December 2010, the average market prices of 31 December 2010 were used.

• Marketable debt securities held to maturity and various holdings are valued at amortised cost and are subject to impairment tests.

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/payments and are amortised over the remaining life of the assets.

• Impairment losses are taken to the Profit and Loss Account and are not netted in subsequent years, unless impairment is reduced and this change can be related to an observable event that occurred after the impairment was first registered.

Off-balance sheet instruments

Foreign exchange forward transactions, the forward legs of currency swaps and other currency transactions that involve exchanging a currency for another on a future date are included in the net foreign currency positions for the purpose of calculating average purchase cost and foreign exchange gains and losses.

Banknotes in circulation

The ECB and the 16 euro area NCBs, which together comprise the Eurosystem, issue euro banknotes.[1] 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 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 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 circulation 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.

The small further adjustments of balances made henceforth reflect changes in the balances of NCBs joining the Eurosystem, which affect those of the participating NCBs.

1 ECB Decision of 13 December 2010 on the issue of euro banknotes (recast) (ECB/2010/29), OJ L35, 9.2.2011, p. 26.
2 “Banknote allocation key” means the percentages that result from taking into account ECB’s share (8%) in the total euro banknote issue and applying the subsequent capital key to the NCB’s share in this total.
3 ECB decision of 25 November 2010 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (recast) (ECB/2010/23), OJ L35, 9.2.2011, p. 17.

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 of the Eurosystem under "Net interest income".

Interim distribution of the ECB's income from seigniorage and from securities purchased under the Securities Markets Programme (SMP)

The Governing Council of the ECB has decided that the income from its share (8%) of the total euro banknote issue (the ECB's seigniorage) and the net income from securities purchased under the Securities Markets Programme (SMP) is due to the NCBs and will be paid to them in full in the financial year it accrues. The ECB will distribute both amounts to the NCBs in January of the following year in the form of an interim distribution.[4] The income on euro banknotes in circulation will be paid in full, unless the Governing Council decides to reduce such income on account of expenses incurred by the ECB in connection with the issue and handling of euro banknotes. The Governing Council shall decide before the end of the financial year whether all or part of the ECB's income arising from SMP securities and, if necessary, all or part of the ECB's seigniorage income should be retained to the extent necessary to ensure that the amount of the distributed income does not exceed the ECB's net profit for that year.

Furthermore, the Governing Council may decide before the end of the financial year to transfer part or all of the ECB's income arising from securities purchased under the SMP and, if necessary, part or all of the ECB's seigniorage income to the provision for foreign exchange rate, interest rate, credit and gold price risk.

For the year 2010, pursuant to the decision of the Governing Council of the ECB of 16 December 2010 and decision ECB/2010/24, the ECB will allocate the whole of its seigniorage income, of €654 million, and the whole of its income from the SMP portfolio, of €438 million, to increase this provision.

Intra-ESCB balances/intra-Eurosystem balances

Intra-ESCB transactions refer to cross-border payments between two EU central banks. They are mostly effected through the TARGET2 system[5] and give rise to bilateral balances in the TARGET2 accounts of EU central banks. These bilateral balances are netted out with the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis the ECB only. This position in the books of the ECB represents the net claim or liability of each NCB against the rest of the ESCB.

Intra-Eurosystem euro-denominated balances of euro area NCBs vis-à-vis the ECB (excluding the ECB capital and the positions arising from the transfer of foreign reserve assets to the ECB) are presented on the Balance Sheet of the ECB as a single net asset or liability position and disclosed under "Other claims within the Eurosystem (net)"or "Other liabilities within the Eurosystem (net)".

4 Decision of the ECB of 25 November 2010 on the interim distribution of the income of the ECB on euro banknotes in circulation and arising from securities purchased under the securities markets programme (ECB/2010/24), OJ L6, 11.1.2011, p. 35.
5 TARGET2: Trans-European Automated Real-time Gross settlement Express Transfer system.

Intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are included as a single net asset (liability) under "Net claims related to the allocation of euro banknotes within the Eurosystem" ("Net liabilities related to the allocation of euro banknotes within the Eurosystem").

Cash flow statement

Taking account of the special role of the central bank in the context of the single monetary policy of the Eurosystem, the Bank of Greece, regards the publication of a cash flow statement unnecessary, on the grounds that it would not provide the readers of financial statements with additional information.

NOTES ON THE BALANCE SHEET

ASSETS

1. Gold and gold receivables

Holdings and receivables in standard gold	31.12.2010	31.12.2009	Change
Volume in fine troy ounces (thousands)	4,742	4,741	1
Volume in tonnes	147.5	147.5	0
Value (€ million)	5,005.1	3,633.3	1,371.8

The amounts reported above comprise the Bank's gold holdings (3,587 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), as well as scrap gold and gold coins for melting (140 thousand ounces). The largest part of gold holdings is kept in banks abroad.

The small increase by one thousand ounces in the volume of gold holdings and receivables reflects purchases of gold from private individuals, while the significant €1,371.8 million increase in the value of gold in euro is due to the appreciation of the euro in 2010.

The total amount arising from the increase in the price of gold (value as at 31 December 2010 compared with the average acquisition cost – unrealised profit) came to €3,259.1 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. €1,055.418 on 31 December 2010, compared with €766.347 on 31 December 2009. This price was derived from the USD price of gold quoted on the London market on 31 December 2010 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 with banks abroad; time deposits; 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 €756.2 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 *(in millions)*	31.12.2010 *SDRs*	*€*	31.12.2009 *SDRs*	*€*	Change *SDRs*	*€*
SDR holdings	609.1	704.8	694.2	755.7	-85.1	-50.9
Greece's SDR quota	170.9	197.8	170.8	185.9	0.1	11.9
Special non-interest-bearing deposit in SDRs	5.4	6.3	5.4	5.9	0.0	0.4
Total	**785.4**	**908.9**	**870.4**	**947.5**	**-85.0**	**-38.6**

- **SDR holdings**

The decline in SDR holdings is the result of the payment of commissions, interest, various expenses and other liabilities arising from IMF loan payments to Greece in the course of 2010 in the context of the IMF and EU financial support to the country. These expenses were paid out of the aforementioned holdings, in debit of the euro account of the Greek State with the IMF. Most of these holdings were replaced by SDR purchases made by the Bank of Greece.

It should be noted that the largest part of Greece's SDR holdings with the IMF comes from SDR allocations to Greece in 2009 in the context of IMF's general SDR allocation, equivalent to USD 250 billion, to all its member countries, which was approved by the IMF Board of Governors on 7 August 2009 and entered into force on 28 August 2009.

This allocation aimed to provide liquidity to the global economic system by boosting the foreign reserve assets of the IMF member countries according to their quotas.

- **Greece's SDR quota in the IMF**

The amount of this quota increased due to the depreciation of the euro vis-à-vis the SDR in 2010.

The above receivables from the IMF were valued at the SDR/euro exchange rate as at 30 December 2010, based on ECB's reference exchange rates, i.e. 1 SDR = €1.1572, compared with €1.0886 as at 31 December 2009.

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. time deposits, current account balances with foreign correspondents, debt securities and non-euro banknotes in the Bank's vaults.

Asset category	31.12.2010 *(in € millions)*	31.12.2009	Change
Time deposits with foreign banks	4.2	80.0	-75.8
Current account balances with foreign correspondents	22.7	13.2	9.5
Marketable debt securities (bonds)	58.0	45.8	12.2
Cash holdings of foreign currency	16.2	21.5	-5.3
Total	**101.1**	**160.5**	**-59.4**

The largest part of these assets as at 31 December 2010 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 claims arising from the Bank's reverse transactions with domestic credit institutions.

3.1 Claims on general government

These claims include:

– 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 €200.9 million on 31 December 2010, against €270.4 million on 31 December 2009. The decrease is attributable to the repayment on 6 September 2010 of a long-term loan of GBP 75 million concluded with foreign banks on behalf of and assigned to the Greek State on 6 September 1985. The Bank's liabilities decreased commensurately (liabilities item 7 "Liabilities to non-euro area residents denominated in foreign currency").

3.2 Other claims

The balance as at 31 December 2010 concerns foreign currency-denominated time deposits with euro area correspondents and reverse transactions in US dollars with domestic credit institutions.

Categories of claims	**31.12.2010** *(in € millions)*	**31.12.2009**	**Change**
Time deposits	26.8	11.2	15.6
Reverse transactions with domestic credit institutions	56.1	0.0	56.1
Total	**82.9**	**11.2**	**71.7**

The considerable increase observed is attributable to the reactivation of the US dollar liquidity-providing operations for euro area credit institutions in May 2010 in the form of reverse operations against Eurosystem-eligible collateral. These operations are carried out under the temporary liquidity swap lines between the European Central Bank (ECB) and the Federal Reserve to provide short-term US dollar liquidity to financial markets.

Under this agreement, the Federal Reserve System made US dollars 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 this context, the Bank of Greece provided US dollar liquidity to domestic credit institutions amounting to €56.1 million as at 31 December 2010.

4. Claims on non-euro area residents denominated in euro

4.1 Balances with banks, security investments and loans

This comprises interest-bearing current account balances with banks abroad (outstanding balance as at 31 December 2010: €166 thousand).

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, in the context of the single monetary policy.

Liquidity is chiefly provided through main refinancing operations (with a maturity of 7 days) and longer-term refinancing operations (with a maturity of one or three months) against eligible collateral (marketable debt securities and other assets).

Categories of operations	31.12.2010 (in € millions)	31.12.2009	Change
MROs (maturity of 7 days)	18,023.0	2,355.0	15,668.0
LTROs (maturity of 1 or 3 months)	78,382.8	47,300.1	31,082.7
Fine-tuning reverse operations	1,263.0	0	1,263.0
Total	**97,668.8**	**49,655.1**	**48,013.7**

It should be noted that, according to Article 32 of the Statute of the ESCB and the ECB, the NCBs that conduct monetary policy operations on behalf of the Eurosystem participate in income and provisions in accordance with the ECB's capital key.

6. Other claims on euro area credit institutions denominated in euro

This item mainly includes current account balances with correspondent banks, as well as other claims.

These claims came to €71.6 million on 31 December 2010, down from €72.8 million on 31 December 2009.

7. Securities of euro area residents denominated in euro

7.1 Securities held for monetary policy purposes

This comprises two categories:

A) Securities purchased under the Covered Bonds Purchase Programme (CBPP1)[6]

The total value of these securities purchased by the Bank under the Covered Bonds Purchase Programme stood at €1.6 billion. This item consists of covered bonds in euro issued by euro area banks and credit institutions with maturities of up to 12 years.

It should be noted that this programme was concluded on 30 June 2010 and the total value of covered bonds held by the Eurosystem as at 31 December 2010 was €60.8 billion (acquisition cost).

6 Decision of the European Central Bank of 2 July 2009 on the implementation of the covered bond purchase programme (CBPP1) (ECB/2009/16), OJ L175, 4.7.2009, p. 18.

B) Securities purchased under the Eurosystem Securities Markets Programme (SMP)[7]

The Governing Council of the ECB has decided to put into effect a purchase programme for securities issued in the euro area in order to restore the smooth functioning of the monetary policy transmission mechanism in euro area countries (Securities Markets Programme – SMP)

Under this programme, Eurosystem NCBs and the ECB purchased bonds, amounting on 31 December 2010 to €73.4 billion (acquisition cost).

In this context, the Bank of Greece purchased bonds amounting to €3.3 billion (acquisition cost).

According to Article 32.4 of the Statute of the ECB, any losses on such securities will be allocated to the NCBs of the Eurosystem, in accordance with their ECB capital key.

Securities from both these programmes are held to maturity and valued at amortised cost subject to impairment tests. The test carried out at end-2010 showed that there is no evidence of impairment.

7.2 Other securities of euro area residents denominated in euro

This item includes euro-denominated bonds, Treasury bills and commercial paper issued by euro area governments, including the Greek State. They make up the Bank's investment book.

Type of securities	31.12.2010	31.12.2009	Change
	(in € millions)		
Marketable debt securities issued by euro area governments other than held to maturity			
Euro area securities, other than Greek government securities			
Bonds	2,984.9	5,612.4	-2,627.5
Treasury bills	2,383.5	6,146.5	-3,763.0
Commercial paper	67.4	248.2	-180.8
Zero-coupon bonds	19.9	0	19.9
Greek government securities			
Bonds	877.9	0	877.9
Treasury bills	214	0	214
Commercial paper	0	49.5	-49.5
Total	**6,547.6**	**12,056.6**	**-5,509.0**
Held to maturity marketable debt securities			
Greek government bonds	4,389.4	3,529.1	860.3
Greek Treasury bills	0	49.6	-49.6
Bonds issued by other euro area governments	8,025.6	4,358.5	3,667.1
Total	**12,415.0**	**7,937.2**	**4,477.8**
Grand total	**18,962.6**	**19,993.8**	**-1,031.2**

7 Decision of the European Central Bank of 14 May 2010 establishing a Securities Markets Programme (SMP) (ECB/2010/5), OJ L124, 20.5.2010, page 8.

As shown in the table, a predominant part of the Bank's portfolios comprises securities held to maturity.

These are valued at amortised cost and the impairment tests carried out at end-2010 showed that there is no evidence of impairments.

The remaining debt securities were valued at the average market prices prevailing on 31 December 2010. Gains were taken to revaluation accounts, and losses were covered by the provision that was formed for this purpose.

8. General government long-term 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 December 1993.

Specifically, it consists of:

– interest-bearing loans extended to the Greek State up to 31 December 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	€6,867.0 million
Outstanding balance as at	€7,294.2 million
Decrease	€427.2 million

The decrease stems from the gradual repayment of interest-bearing loans.

9. Intra-Eurosystem claims

9.1 Participation in the capital, reserve assets and provisions of the ECB

The table below shows the items related to the ECB capital, reserve assets and provisions and the Bank's participation therein.

As at 31.12.2010	(%)	(in € millions)
ECB's subscribed capital (applying to all 27 EU Member States)		**10,760.7**
Bank of Greece's key for subscription to the ECB's capital (capital key)	1.9649	
ECB capital paid up by the 16 Eurosystem NCBs		**5,183.6**
Weighting of the Bank of Greece in the subscribed capital key	2.81539	

As at 31.12.2010	(%)	(in € millions)
Bank of Greece's share in the subscribed capital		145.9
Bank of Greece's contribution to the ECB's reserves and provisions		322.2
Bank of Greece's total contribution to ECB's capital, reserves and provisions as at 31.12.2010		**468.1**

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).

According to Article 28.1 of the Statute of the ESCB, Council Regulation 1009/2000 of 8 May 2000, and following a relevant decision of the Governing Council on 13 December 2010, the ECB increased its subscribed capital by €5 billion, from €5,760.7 million to €10,760.7 million, effective from 29 December 2010. The NCBs of the euro area countries pay the amounts corresponding to the increase in their share in the ECB capital (a total of €3.5 billion) in three equal annual instalments. The first instalment was paid on 29 December 2010, and the other two will be paid at end-2011 and end-2012, respectively.

The increase in the capital of the ECB was deemed appropriate in view of increased volatility in foreign exchange rates, interest rates and gold prices, as well as credit risk. As the maximum size of the ECB's provisions and reserves is equal to the level of its paid-up capital, this decision allows the Governing Council to augment the provision by an amount equivalent to the capital increase, starting with the allocation of part of year 2010 profits. From a longer-term perspective, the capital increase —the first one after 12 years— is also motivated by the need to provide an adequate capital base in a financial system that has grown considerably.

In this context, on 29 December 2010, the Bank of Greece paid the amount of €32.7 million which corresponds to the first instalment of its share in the ECB capital increase.

Following the above payment, the participation of the Bank of Greece in the capital, together with its contribution to the reserves and equivalent provisions of the ECB, amounted to €468.1 million, on 31 December 2010.

The share of the Bank of Greece in the ECB capital is €145.9 million and has been paid up in full. It corresponds to 2.81539% (capital key weighting) of the ECB capital paid up by the 16 NCBs of the Eurosystem, which after the adjustments of 2010, amounts to €5,183.6 million.

The remaining amount (€322.2 million) relates to the Bank's contribution to the ECB's reserves and provisions. This amount has been paid in full to the ECB.

Pursuant to Article 29.3 of the Statute of the ESCB, the weighting of NCBs' keys for subscription to the ECB capital is 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 whenever a new country joins the EU and its NCB joins the ESCB.

9.2 Claims equivalent to the transfer of foreign reserves to the ECB

As at 31.12.2010	*(%)*	*(in € millions)*
Total foreign reserve assets transferred to the ECB by the 16 NCBs of the Eurosystem		40,204.5
Bank of Greece's subscribed capital key	2.81539	
Claims of the Bank of Greece on 31.12.2010 arising from the transfer of foreign reserve assets to the ECB		**1,131.9**

These claims stem from the transfer of foreign reserve assets to the ECB, in accordance with the provisions of the Treaty on European Union (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 85% of the latest available marginal rate for the Eurosystem's MROs (the 15% difference corresponds to a zero return on the gold component).

9.5 Other claims within the Eurosystem (net)

On 31 December 2010, the net balance of Bank of Greece's other transactions with the Eurosystem represented a liability of the Bank and is therefore disclosed under liability item 9.4 "Other liabilities within the Eurosystem (net)".

10. Items in course of settlement

The outstanding balance of €416 thousand concerning items in the course of settlement on 31 December 2010 includes receivable cheques issued by banks abroad.

11. Other assets

11.1 Coins

This item represents the value of coins issued by the 16 euro area countries and held by the Bank of Greece on the Balance Sheet date.

Coins put into circulation by the Bank of Greece are recorded in a special account of the Greek State, included in liability item 4.1 "General government".

Value of coins as at 31.12.2010	€69.3 million
Value of coins as at 31.12.2009	€58.1 million
Increase	€11.2 million

11.2 Tangible and intangible fixed assets

Fixed assets comprise real estate (land, buildings and fixtures, buildings under construction), furniture, machinery, hardware and software. Fixed assets other than real estate, which is valued at market prices determined by independent assessors, are valued at acquisition cost.

The value of fixed assets as at 31 December 2010, less accumulated depreciation, is reported.

Depreciation is calculated on a straight-line basis over the expected lifetime of the asset.

Undepreciated value of fixed assets				
Asset category	**31.12.2010** *(in € millions)*	**31.12.2009**	**Change**	**Depreciation rate *(%)***
Land	493.8	496.2	-2.4	0
Buildings and fixtures	225.6	205.6	20	2.5
Buildings under construction and advance payments of asset acquisitions	3.7	32.4	-28.7	0
Other equipment	31	28.7	2.3	8-24
Capitalised expenses (software costs, etc.)	1.4	0.8	0.6	20-24
Total	**755.5**	**763.7**	**-8.2**	

11.3 Other financial assets

This item includes the Bank's holdings in DIAS Interbanking Systems SA, the Hellenic Deposit and Investment Guarantee Fund (TEKE), the Hellenic Exchanges SA Holding, Clearing, Settlement and Registry, SWIFT, as well as in the Bank for International Settlements (BIS), denominated in SDRs.

The value of the above assets at amortised cost was €29.2 million on 31 December 2010, down by €88 thousand against 31 December 2009 due to an equal return of funds from the Hellenic Exchanges SA Holding, Clearing, Settlement and Registry (its share capital decreased).

11.4 Off-balance-sheet instruments revaluation differences

Outstanding balance as at 31.12.2010 . . . . €1.7 million

This item shows the result of the end-of-year revaluation of unsettled operations in foreign currency recorded in off-balance-sheet accounts.

In comprises unrealised gains amounting to €1.7 million, mainly stemming from currency swaps and forward transactions, and recorded on revaluation accounts

11.5 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 31 December 2010. The latter are to be collected in the current financial year and relate mainly to interest income on loans granted in the context of the Eurosystem's monetary policy, 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 €240.9 million, which had not been exchanged for euro banknotes by 31 December 2010 and are treated as accruals.

Outstanding balance as at 31.12.2010	€988.5 million
Outstanding balance as at 31.12.2009	€1,009.1 million
Decrease	€20.6 million

11.6 Sundry

This item primarily consists of reserves of the Banknote Printing Works (IETA), balances on the Bank's suspense debit accounts, as well as the outstanding balances of loans to the Bank's staff.

Outstanding balance as at	€428.3 million
Outstanding balance as at	€420.1 million
Increase	€8.2 million

LIABILITIES

1. Banknotes in circulation

Outstanding balance as at 31.12.2010	€21,748.3 million
Outstanding balance as at 31.12.2009	€20,886.0 million
Increase	€862.3 million

This item consists of the Bank's share of total euro banknotes in circulation, calculated on the basis of the banknote allocation key (2.590%). The change resulted from the rise in total euro banknotes in circulation both inside and outside the euro area, to €839.7 billion as at 31 December 2010, compared with €806.4 billion as at 31 December 2009

(see "Banknotes in circulation" under "Accounting policies").

The average value of euro banknotes in circulation that corresponds to the Bank of Greece on the basis of the banknote allocation key rose to €21.1 billion over 2010, from €19.8 billion in 2009.

	31.12.2010	31.12.2009	Change
	(in € millions)		
Value of euro banknotes put into circulation by the Bank	29,669.8	20,972.2	8,697.6
Less: Liability resulting from the ECB's share in the total euro banknote issue (8% of the total value of euro banknotes in circulation)	-1,891.2[8]	-1,816.3[8]	-74.9
Less: Liability resulting from the allocation of euro banknotes within the Eurosystem	-6,030.3[8]	1,730.1[8]	-7,760.4
Value of euro banknotes in circulation based on the banknote allocation key of the Bank of Greece	**21,748.3**	**20,886.0**	**862.3**

8 Recorded under liability item 9.2 "Net liabilities related to the allocation of euro banknotes within the Eurosystem".

2. Liabilities to euro area credit institutions related to monetary policy operations in euro

2.1 Current accounts (including minimum reserve holdings)

These accounts include credit institutions' reserve holdings with the Bank of Greece, which can also be used for maintaining minimum reserves with the Eurosystem and as settlement accounts for transactions between them.

Outstanding balance as at 31.12.2010	€3,303.4 million
Outstanding balance as at 31.12.2009	€4,616.1 million
Decrease	€1,312.7 million

The average balance on these accounts in 2010 amounted to €5.1 billion, compared with €5.3 billion in 2009.

2.2 Deposit facility

This relates to the deposit facility offered by the Eurosystem to credit institutions, in the context of the implementation of the single monetary policy in the euro area.

In more detail, it consists of overnight deposits placed by credit institutions with the Bank of Greece at a pre-specified interest rate.

Outstanding balance as at 31.12.2010	€7,165.0 million
Outstanding balance as at 31.12.2009	€3,392.0 million
Increase	€3,773.0 million

2.3 Fixed-term deposits

Outstanding balance as at 31.12.2010	€60.0 million

Collection of fixed-term deposits from credit institutions for liquidity absorption purposes owing to fine-tuning operations.

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 31.12.2010	€781.9 million
Outstanding balance as at 31.12.2009	€1,333.4 million
Decrease	€551.5 million

The average balance of these deposits decreased considerably in the course of 2010 to €3.8 billion, compared with €9.6 billion in 2009.

4.2 Other liabilities

This item records the balances of deposits held by various entities.

Outstanding balance as at 31.12.2010	€1,557.5 million
Outstanding balance as at 31.12.2009	€47.7 million
Increase	€1,509.8 million

The considerable increase observed relates to a €1.5 billion deposit by the Hellenic Financial Stability Fund.

The HFSF deposit is interest-bearing and was financed by the EU/IMF support mechanism for Greece. According to Law 3864/2010 establishing the HFSF, the Fund's capital will amount to €10 billion. The objective of the Fund is to maintain the stability of the Greek banking system by strengthening, where necessary, the capital adequacy of credit institutions.

5. Liabilities to non-euro area residents denominated in euro

This item includes deposits by various entities.

Outstanding balance as at 31.12.2010	€766.3 million
Outstanding balance as at 31.12.2009	€719.8 million
Increase	€46.5 million

The bulk of these liabilities (€756.3 million) consist of a deposit account in euro held by the IMF with the Bank and corresponding to Greece's euro-denominated participation (quota) in the IMF. Through this account, the Bank effects financial transactions with third countries, according to IMF instructions.

The observed increase reflects the (upward) valuation adjustment of the IMF's account balance as a result of the depreciation of the euro vis-à-vis the SDR in 2010 (see 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 31.12.2010	€22.3 million
Outstanding balance as at 31.12.2009	€73.1 million
Decrease	€50.8 million

7. Liabilities to non-euro area residents denominated in foreign currency

7.1 Deposits and other liabilities

This item consists of interest-bearing and non-interest deposits of various entities. The considerable change observed is due to the repayment of the long-term loan of GBP 75 million raised on behalf of and assigned to the Greek State on 6 September 1985.

Outstanding balance as at 31.12.2010	€57 thousand
Outstanding balance as at 31.12.2009	€84,505 thousand
Decrease	€84,448 thousand

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 782.2 million) to Greece. This amount was allocated by the IMF to Greece gradually. An amount of SDR 103.5 million was allocated between 1970 and 1981 and the remaining SDR 678.7 million in 2009. The latter allocation was effected in the context of IMF's general SDR allocation, equivalent to USD 250 billion, to all its member countries, which was approved by the IMF Board of Governors on 7 August 2009 and entered into force on 28 August 2009.

This allocation was aimed to provide liquidity to the world economy by boosting the foreign reserve assets of the IMF member countries according to their quotas.

Outstanding balance as at 31.12.2010	€905.3 million
Outstanding balance as at 31.12.2009	€851.7 million
Increase	€53.6 million

The increase reflects adjustments for exchange rate variations due to the depreciation of the euro against the SDR in 2010.

9. Intra-Eurosystem liabilities

9.2 Net liabilities related to the allocation of euro banknotes within the Eurosystem

This item shows liabilities that stem from the allocation of euro banknotes within the Eurosystem (see "Banknotes in circulation" under "Accounting Policies").

Outstanding balance as at 31.12.2010	€7,921.5 million
Outstanding balance as at 31.12.2009	€ 86.1 million
Increase	€7,835.4 million

The balance as at 31 December 2010 is made up of the following:

– 1,891.2 million; these 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 €74.9 million higher than on 31.12.2009 (€1,816.3 million) due to the general increase in euro banknotes in circulation.

– 6,030.3 million; these represent an adjustment (reduction) in the amount of euro banknotes that the Bank has actually put into circulation, after deducting 8% in favour of the ECB. 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 significant change seen in this item (from a claim of €1,730.1 million as at 31.12.2009 to a liability of €6,030.3 million as at 31.12.2010) reflects the large increase in the value of euro banknotes that the Bank has actually put into circulation over 2010 (see table on p. A27).

9.3 Net liabilities arising from transactions with the ESCB (TARGET2)

These are net liabilities to the ESCB stemming from the Bank's cross-border transactions with the other national central banks of the Eurosystem, the ECB and the non-Eurosystem EU central banks that participate in the TARGET2 system.

TARGET2 account, year-end balances

31.12.2004	31.12.2005	31.12.2006	31.12.2007 *(in € millions)*	31.12.2008	31.12.2009	31.12.2010
6,545.9	7,216.8	8,183.5	10,796.6	35,348.3	49,036.1	87,088.1

TARGET2 account, average annual balances

2004	2005	2006	2007 *(in € millions)*	2008	2009	2010
13,363.3	12,019.0	11,762.0	9,298.0	14,650.0	37,647.0	77,022.0

These liabilities were originally created on 1 January 2001, the date on which the Bank of Greece joined the Eurosystem.

From the onset of the financial crisis in 2008, and especially during 2009-2010, there was a significant gradual increase in the balance of this account, as a result of the weak financial conditions that prevailed and their impact on cross-border payments.

This did not affect the Bank's financial results, as the increased amount of interest payments to the Eurosystem was offset by an equal amount of interest income from the Bank's provision of liquidity to credit institutions.

9.4 Other liabilities within the Eurosystem (net)

Balance as at 31.12.2010	€45.2 million

The above liability stems from the negative result from the reallocation of the monetary income of the Eurosystem for 2010, given that the monetary income that actually accrued to the Bank was higher than the one that would have been allocated to it according to the weighting of its key for subscription to the ECB capital, i.e:

Monetary income actually accruing to the Bank	€337.5 million
Monetary income as per the Bank's weighting of its key for subscription to the ECB capital	€292.3 million
Balance	€45.2 million

This was due to the fact that the value of Greek government securities (whose yields are higher than those of other euro area government securities) held by the Bank under the Securities Markets Programme (SMP) was more than the share corresponding to it.

10. Items in course of settlement

This item mainly consists of the float of cheques and payment orders whose settlement is pending, as well as balances, in course of settlement, of various intermediate accounts, totalling €23.3 million.

11. Other liabilities

11.1 Off-balance sheet instruments revaluation differences

Balance as at 31.12.2010	€1,719

This item represents the outcome of the end-year revaluation of outstanding currency instruments recorded in off-balance sheet (memorandum) accounts.

It relates to €1,719 of unrealised losses from spot operations, which were transferred to the profit and loss account and covered by the provision formed for this purpose.

11.2 Accruals and income collected in advance

This item represents interest expenses accrued up to 31 December 2010 and other expenses. Such expenses shall be paid within the new financial year and mainly involve various categories of interest payable (on the outstanding balance of the TARGET2 account, on credit institutions' reserve holdings and on other liabilities).

Balance as at 31.12.2010	€114.9 million
Balance as at 31.12.2009	€68.5 million
Increase	€46.4 million

11.3 Sundry

This 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 liabilities	**31.12.2010**	**31.12.2009**	**Change**
	(in € millions)		
Dividends to be distributed	31.0	47.7	-16.7
Tax on dividends	20.7	15.9	4.8
Profit to be transferred to the Greek State	126.8	147.1	-20.3
Value of drachma banknotes in circulation	240.9	244.0	-3.1
Liability to the Greek State (Greece's SDR-denominated participation in the IMF)	197.8	185.9	11.9
Other liabilities	55.3	55.5	-0.2
Total	**672.5**	**696.1**	**-23.6**

12. Provisions

Category of provisions	**31.12.2010**	**31.12.2009**	**Change**
	(in € millions)		
1. Special provisions against operational risk, unexpected losses and doubtful claims	150.6	149.2	1.4
2. Provision covering the Bank's obligation to provide social insurance to its staff	1,464.7	1,275.4	189.3
3. Provision against foreign exchange, interest rate, credit and gold price risks	215.4	200.0	15.4
4. Provision against counterparty risks from Eurosystem monetary policy operations	57.5	104.6	-47.1
5. Provision against general risks under Article 71 of the Statute	497.2	224.3	272.9
Total	**2,385.4**	**1,953.5**	**431.9**

The Bank increased considerably its provisions in 2010 to €2,385.4 million.

High provisioning aims to strengthen the financial position of the Bank of Greece and enable it to best fulfil its tasks and is in line with the principle of prudence followed by the ECB and the other NCBs of the Eurosystem.

In greater detail:

1. Special provisions against operational risk, unexpected losses and doubtful claims

These are special provisions directly associated with the Bank's operation, that include:

- cash deficits;
- the value of drachma banknotes exchanged for euros;
- compensation to employees paid upon retirement; and
- doubtful claims.

These provisions were formed in response to real needs and liabilities and their level was determined using estimates of the amounts likely to be required for covering risks and losses and of the amounts of doubtful claims that will not be collected.

2. Provision covering the Bank's obligation to provide social insurance to its staff

As of 1 January 2011, the Bank has undertaken and provides social insurance for its staff in the main and supplementary pension sectors, in accordance with Article 64 of Law 3863/2010.

This provision has been formed to cover this liability and to meet the staff's social insurance needs in general.

3. Provision against foreign exchange, interest rate, credit and gold price risks

This provision has been formed to cover possible future losses from the securities and foreign exchange portfolios managed by the Bank.

The amount of the provisions has been determined on the basis of the stress tests carried out taking into account the amount of the securities portfolio at year-end and the amount of the foreign exchange portfolio that could be acquired. Moreover, changes in interest and foreign exchange rates under extreme conditions were also taken into account.

4. Provision against counterparty risks from Eurosystem monetary policy operations

The provision, the purpose of which is to provide a buffer against counterparty risks arising from Eurosystem monetary policy operations, was first established in the financial year 2008, following a decision by the Governing Council of the ECB.

The initial amount of this provision was €149.5 million for the Bank, against €5,736 million at Eurosystem level.

In the financial years 2009 and 2010, after an upward revaluation of the collateral that the Eurosystem accepted in order to conduct monetary policy operations and a downward reassessment of risk exposures, an amount of €3,529 million was released from the provision, reducing its balance to €2,207 million as at 31 December 2010. The respective amounts released for the Bank were €45 million in 2009 and €47 million in 2010 and were transferred to income from unused provisions.

It should be noted that the NCBs, including the Bank of Greece, that conduct monetary policy operations on behalf of the Eurosystem participate in monetary income and, hence, in risk provisions according to their shares in the ECB capital.

The current collateral and risk control framework is adequate.

However, the large-scale Eurosystem intervention in the money markets, mainly in the 2008-2011 period, with a view to maintaining financial stability, resulted in higher risk exposure, as well as, of course, in the generation of satisfactory income.

Against this background and in order to cover possible risks, the necessary provisions are formed on the basis of the principle of prudence.

The extent to which these provisions will be used depends on future developments in money markets.

5. Provision against general risks under Article 71 of the Statute

In keeping with its standard practice, which is in line with the practice of the ECB and the other central banks of the euro area, and in the light of both its current reserve assets and provisions and overall conditions in money and capital markets as well as potential risks, the Bank of Greece formed provisions for general risks also in 2010.

This provision is intended to cover:

- risks at Eurosystem level potentially arising from the Eurosystem's key task, which is to formulate and conduct monetary policy in the euro area;

- future credit risks;

- any other risks and liabilities potentially arising from the Bank's business as the country's central bank; and

- any additional liabilities of the Bank arising from the provision of social insurance to its staff.

The Bank reviews these provisions on an annual basis and adjusts them taking into account:

– the amount of assets involving risks;

– risk exposure;

– risk assessment studies;

– money market developments and general economic conditions in the euro area and Greece;

– its current reserve assets and provisions.

– the balances of revaluation accounts.

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 (see "Income recognition" under "Accounting policies").

Valuation at end-2010 produced unrealised gains of €3,263.7 million (largely stemming from gold), which were transferred to the corresponding revaluation accounts (see breakdown in the table below).

Unrealised valuation gains	**31.12.2010**	**31.12.2009**	**Change**
	(in € millions)		
– on foreign currency instruments	0.1	1.2	-1.1
– on securities	4.5	21.1	-16.6
– on gold	3,259.1	1,894.9	1,364.2
Total	**3,263.7**	**1,917.2**	**1,346.5**

Unrealised losses of €21.3 million, as a result of the valuation of securities made on 31 December 2010, were taken to the Profit and Loss Account and were covered by the provision established for this purpose.

14. Capital and reserves

Balance as at 31.12.2010	€815.4 million
Balance as at 31.12.2009	€805.3 million
Increase	€10.1 million

The €10.1 million increase in the Bank's own funds stemmed from:

• A €12 million rise in the extraordinary reserve out of the profits for 2010.

• A €147 thousand increase in other special reserves (in 2010, the value of various artworks was accounted for).

• The above increases were partly offset by a €2 million decrease in the special reserve formed out of revaluation gains on land and buildings at fair (market) value. This decrease is attributable to settlements and the transfer to results of part of the gains, stemming from the sale of the buildings of branches that were converted into outlets in the context of the Bank's organisational restructuring undertaken in recent years.

The capital and the ordinary reserve, which are equal and amount to €111.2 million each, remained unchanged.

In detail, the capital and reserves are 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, 17/4.7.2005 and 8/10.6.2008, **has reached €111,243,362, divided into 19,864,886 shares of a par value of €5.60 each.**

14.2 Ordinary reserve

The Bank's ordinary reserve amounts to €111,243,362 and is equal to the share capital.

14.3 Extraordinary reserve

The extraordinary reserve was increased by €12 million out of the profits for the year 2010 and reached €84.5 million.

14.4 Special reserve from the revaluation of land and buildings

This special reserve was established during financial years 2004 and 2007 with the capital gains from the restatement of land and buildings at fair (market) value (as determined by an independent assessor).

In 2005 and 2008, part of these gains were capitalised through the allotment of bonus shares to shareholders, while a small part, stemming from land and buildings of the Bank that were sold, was transferred to profit in 2008, 2009 and 2010.

14.5 Other special reserves

They amount to €1.2 million and represent artworks and fixed assets (mostly buildings) transferred gratis to the Bank.

Post-balance sheet events.

As of 1 January 2011, the Bank has undertaken and provides social insurance for its staff in the main and supplementary pension sectors, in accordance with Article 64 of Law 3863/2010.

OFF-BALANCE SHEET (MEMORANDUM) ITEMS

	31.12.2010	31.12.2009	Change
	(in € millions)		
– Greek government securities management of the "Common fund" (surpluses of public entities and social security organisations) under Law 2469/97	22,599.5	20,167.9	2,431.6
– Greek government securities and other debt securities (management and safe custody on behalf of public entities, social security organisations and private-sector agents)	9,408.1	9,624.3	-216.2
– Assets eligible as collateral for participation in the Eurosystem's monetary policy operations and in the provision of intraday liquidity[1]	162,000.7	77,190.7	84,810.0
– Other off-balance sheet accounts[2]	10,870.0	282.5	10,587.5
Total	**204,878.3**	**107,265.4**	**97.612.9**

Notes on off-balance sheet items:

1 The considerable increase observed in the value of assets deposited with the Bank by domestic credit institutions as collateral against credit in the context of the conduct of the Eurosystem's monetary policy reflects the considerable interventions of the Eurosystem in the money market to ensure the stability of the financial sector.

2 These reflect:

– a non-interest bearing, non-negotiable promissory note of €10.6 billion (SDR 9.1 billion) issued by the Greek government of respect of IMF loans received up until 31.12.2010. The note is kept at the Bank of Greece, which acts as fiscal agent for Greece vis-à-vis the IMF.

– forward and swap operations related to the Bank's portfolios.

– documentary credits to be executed, third-party guarantees for good performance, coins in storage at the Bank, etc.

– forward liabilities to the ECB and forward claims on domestic credit institutions, which arose in connection with the provision of US dollar liquidity to Eurosystem counterparties. Through temporary reciprocal currency arrangements (swap lines), the US Federal Reserve (FED) provided the ECB with US dollars. The ECB simultaneously entered into back-to-back swap transactions with euro area NCBs, which used the resulting funds to conduct US dollar liquidity-providing operations with Eurosystem counterparties in the form of swap transactions.

GENERAL NOTES ON THE PROFIT AND LOSS ACCOUNT FOR 2010

The Bank's profits in 2010 amounted to €190.4 million, compared with €228.2 million in 2009, having fallen by 16.5%.

ANALYSIS OF THE PROFIT AND LOSS ACCOUNT FOR 2010

INCOME

The Bank's net income from the conduct of the single monetary policy of the Eurosystem and its net income from interest, commission fees and other revenue from domestic and foreign activities totalled €1,044.5 million, compared with €1,139.5 million in 2009, down by 8.3%.

In greater detail:

• ***Net income from interest and financial operations*** reached €831.0 million, against €833.3 million in the previous financial year (-0.3%).

• ***Net income from fees and commissions*** fell by 19% to €141.5 million, from €174.8 million in 2009

• ***Income from equity shares and participating interests*** decreased by €54.7 million to €12.3 million, from €67 million in 2009, on account of a decrease in the profit distributed by the European Central Bank.

• Finally, income rose by €47 million, compared to €45 in 2009, due to the ***release of provisions***.

EXPENSES

Total expenses fell by €57.2 million (or 6.3%) to €854.1 million in 2010, from €911.3 million in 2009.

Specifically:

• ***The Bank's general operating expenses excluding provisions*** (staff costs, pensions, depreciation and other expenses) dropped by €57.9 million (or 13.2%) to €381.2 million, from €439.1 million in the previous financial year.

• ***Provisions*** grew considerably in 2010 as well, by €472.9 million to €2,385.4 million (see notes on liability item 12).

DETAILED INCOME AND EXPENSE STATEMENT

NET OPERATING INCOME (*in euro*)

	2010	2009
1. NET INTEREST INCOME	**825,890,005**	**766,668,842**
1.1 Interest income	**1,741,334,930**	**1,432,540,058**
a. Interest on loans to credit institutions related to monetary policy operations	848,005,150	610,227,511
b. Interest on securities held for monetary policy purposes	166,354,434	4,654,440
c. Interest on investment portfolios (excluding Greek government debt securities)	331,392,453	412,355,371
d. Interest on Greek government debt securities	269,324,437	144,932,342
e. Remuneration of long-term euro-denominated claims arising from the transfer of foreign reserve assets to the ECB	9,754,870	12,474,205
f. Interest on long-term claims against the Greek State	109,633,787	237,250,087
g. Interest on net claims related to the allocation of euro banknotes in circulation within the Eurosystem	0	5,242,040
h. Interest on the IMF reserve tranche position, deposits with the IMF and SDR holdings	2,586,032	1,118,118
i. Interest on loans to the personnel of the Bank of Greece	4,049,137	3,795,650
j. Other interest income	234,630	490,294
1.2 Interest expense	**-915,444,925**	**-665,871,216**
a. Interest and expenses on intra-ESCB balances (TARGET2)	-779,813,684	-477,111,940
b. Interest on net liabilities related to the allocation of euro banknotes within the Eurosystem	-38,989,998	0
c. Interest on banks' current accounts in the context of monetary policy operations (including minimum reserves)	-58,387,363	-74,935,187
d. Interest on deposits by the Greek State	-34,896,357	-112,290,847
e. Interest on foreign exchange deposits by public entities	-134,254	-277,380
f. Interest on the allocations of SDRs	-2,624,273	-1,094,025
g. Other interest expense	-598,996	-161,837
2. NET RESULT OF FINANCIAL OPERATIONS WRITE-DOWNS AND RISK PROVISIONS	**50,321,799**	**58,209,232**
3. NET INCOME FROM FEES AND COMMISSIONS	**141,548,446**	**174,827,731**
4. INCOME FROM EQUITY SHARES AND PARTICIPATING INTERESTS	**12,288,700**	**66,983,496**
5. NET RESULT OF POOLING OF MONETARY INCOME	**1,834,971**	**53,376,709**
6. OTHER INCOME	**12,630,271**	**19,410,623**
TOTAL NET INCOME	**1,044,514,192**	**1,139,476,633**

NOTES ON NET OPERATING INCOME ACCOUNTS

The Bank's net operating income in 2010 from the conduct of the single monetary policy of the Eurosystem and its net operating income from interest, commission fees and other revenue from domestic and foreign activities totalled €1,044.5 million, compared with €1,139.5 million in 2009, down by 8.3%.

In greater detail:

1. Net interest income

Net interest income (interest income less interest expense) increased by 7.7% to €825.9 million, from €766.7 million in the previous financial year.

The individual categories of interest are as follows:

1.1 Interest income

Interest income increased by 21.6% to stand at €1.7 billion, from €1.4 billion in 2009.

In particular:

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 of the euro area.

In 2010, this income increased to €848 million, from €610.2 million in 2009, mainly owing to an increase in the liquidity provided to credit institutions in response to their heightened liquidity needs due to the financial crisis.

Lending in 2010 averaged €83.4 billion, compared with €43.9 billion in 2009.

By contrast, the interest rate on Eurosystem main refinancing operations averaged 1% in 2010, compared with 1.279% in 2009.

Interest on lending to credit institutions	**2010** *(in € millions)*	**2009**	**Change**
– main refinancing operations (MROs)	171.8	202.6	-30.8
– longer-term refinancing operations (LTROs)	672.3	407.5	264.8
– fine-tuning reverse operations	3.2	0.0	3.2
– marginal lending facility	0.7	0.1	0.6
Total	**848.0**	**610.2**	**237.8**

b) Interest on securities held for monetary policy purposes

This amounted to €166.4 million (2009: €4.7 million) and refers to interest on securities purchased by the Bank under the Eurosystem's covered bond purchase programme (CBPP) and Securities Markets Programme (SMP). These programmes were launched in the context of Eurosystem interventions conducted in euro area debt securities markets with a view to ensuring liquidity, addressing the malfunctioning of certain market segments and restoring the smooth functioning of the monetary policy transmission mechanism. The value of the Bank's holding of CBPP and SMP securities as at 31 December 2010 was €4.9 billion, against 674.1 million as at 31.12.2009.

c) Interest on investment portfolios (excluding Greek government debt securities)

Interest on investment portfolios (excluding Greek government debt securities)

Interest by type of asset	**2010**	**2009**	**Change**
	(in € millions)		
– on debt securities	331.2	412.0	-80.8
– on time deposits and current accounts	0.2	0.4	-0.2
Total	**331.4**	**412.4**	**-81.0**

The decrease in the above interest was offset by the increase in interest on Greek government debt securities.

d) Interest on Greek government debt securities

Interest on the Bank's holdings of Greek government securities rose strongly, by €124.4 million in comparison with the previous financial year (2010: €269.3 million, 2009: €144.9 million).

e) 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 latter, 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 fell by €2.7 million in 2010 to €9.8 million (2009: €12.5 million), exclusively on account of the decrease in the MRO rate (the average level of this rate was 1% in 2010, compared to 1.279% in 2009).

f) Interest on long-term claims against the Greek State

This represents interest on long-term loans granted by the Bank of Greece to the Greek State up to 31 December 1993.

This interest income fell by €127.6 million to €109.6 million in 2010, from €237.3 million in 2009, mostly owing to the decrease in the 12-month euro LIBOR and LIBID rates applicable 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" and, to a lesser degree, to a reduction in principal as a result of gradual debt repayment.

g) Interest on net claims related to the allocation of euro banknotes in circulation within the Eurosystem

In 2010, the balance on the accounts through which euro banknotes in circulation are allocated within the Eurosystem represented a liability of the Bank to the ECB. As a result, interest amounting to €39 million was paid to the Eurosystem (item "b" under interest payments), compared with interest income of €5.2 million in 2009.

h) Interest on the IMF reserve tranche position, deposits with the IMF and SDR holdings

This item stood at a considerably higher level than in the previous financial year (2010: €2.6 million, 2009: €1.1 million). It chiefly comprises interest on Greece's participation (quota) in the IMF and on SDR holdings with the Fund, which derive from the IMF's SDR allocation that took place in 2009 in the context of the general SDR allocation to all IMF member countries. The increase is attributable to the considerable increase in SDR holdings.

i) 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 amounted to €4 million, compared with €3.8 million in 2009.

j) Other interest income

This item stood at €235 thousand, compared with €490 thousand in 2009.

1.2 Interest expense

Interest expense increased by 37.5% to €915.4 million, from €665.9 million in 2009.

In greater detail:

a) Interest and expenses on intra-ESCB balances (TARGET2)

Interest expense on the TARGET2 account (in € millions)

2004	2005	2006	2007	2008	2009	2010
273.4	252.1	333.5	369.7	545.2	477.1	779.8

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 TARGET2 system.

The substantial rise in 2010 is the result of the enhanced liquidity provided to domestic credit institutions in the context of the conduct of the Eurosystem monetary policy in euro area countries. In its largest part, this liquidity was transferred by credit institutions to other EU countries through the TARGET2 account. However, TARGET2-related expense was fully offset by an equal amount of interest income from the Bank's liquidity-providing operations, therefore there was no impact on the Bank's financial results (the applicable remuneration rate is the ECB's key interest rate, i.e. 1% for 2010).

b) Interest on net liabilities related to the allocation of euro banknotes in circulation within the Eurosystem

This item rose to €39 million, compared to interest income of €5.2 million in 2009, owing to the fact that the value of euro banknotes actually put into circulation by the Bank in 2010 was higher than the value of euro banknotes that would have been allocated to it in accordance with the banknote allocation key. Interest calculated on the basis of the key ECB interest rate and amounting to €39 million was paid on the resulting difference, which represents a liability of the Bank to the Eurosystem.

This interest expense is calculated on the basis of:

– 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 Bank's liability from the issue of euro banknotes on behalf of the ECB (a share of 8% of the total value of euro banknotes in circulation has been allocated to the ECB);

– 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 and, to a lesser extent, interest paid on time deposits and overnight deposits by domestic credit institutions with the Bank of Greece, in the context of monetary policy conduct in the euro area countries.

This item decreased by €16.5 million in 2010 (2010: €58.4 million, 2009: €74.9 million), exclusively due to the lower ECB key interest rate (the average annual level of this rate was 1%, against 1.279% in 2009). By contrast, deposits rose (in 2010 deposits averaged €7.6 billion, compared with €6.7 billion in 2009).

d) Interest on deposits by the Greek State

Interest on deposits by the Greek State fell by 68.9% to €34.9 million, from €112.3 million in 2009, as a result of the lower applicable interest rate.

The average daily level of the Greek State's total deposits with the Bank was €3.5 billion in 2010, compared with €9.6 billion in 2009, remunerated at an average interest rate of 0.99%, compared with 1.27% in 2009.

The bulk of this item refers to interest paid on time deposits held by the Greek State with the Bank following the revision of the relevant agreement between the Bank and the Greek State, whereby it was agreed that, as from 29 January 2008, daily balances of more than €2 billion in government deposit accounts with the Bank of Greece are converted to time deposits.

It should be noted that the interest paid on the Greek State's time deposits is offset by a corresponding decline in the interest paid on the balance of the TARGET2 account. This is so because the funds placed by the Greek State in time deposits with the Bank derive from funds held with commercial banks; in order to compensate for the withdrawal of these funds, the latter transfer equal amounts from their holdings abroad via TARGET2.

e) Interest on foreign exchange deposits by public entities

This item decreased substantially to €134 thousand, from €277 thousand in 2009, due to a significant fall in deposits.

f) Interest on SDR allocations

Interest on the Bank's liabilities from the allocation of IMF special drawing rights (SDRs) increased by €1.5 million (2010: €2.6 million, 2009: €1.1 million) due to a considerable rise in the allocations of SDRs amounting to €678.7 million by the IMF to Greece in September and October 2009 in the context of liquidity provision to the global economic system with a view to boosting the reserve assets of its member countries.

g) Other interest expense

This item rose to €599 thousand, from €162 thousand in the previous financial year.

2. Net result of financial operations, write-downs and risk provisions

The net result from financial operations in 2010 declined by €7.9 million to €50.3 million, from €58.2 million in 2009.

A detailed breakdown is provided below.

2.1 Realised gains from financial operations	**2010**	**2009**	**Change**
	(in € millions)		
– foreign exchange operations	11.0	8.4	2.6
– transactions in securities	20.8	44.5	-23.7
– foreign exchange valuation differences due to changes in the €/SDR parity	-1.7	0.3	-2
– purchases and sales of gold coins	20.2	5.0	15.2
Total	**50.3**	**58.2**	**-7.9**
2.2 Write-downs of financial assets and positions (unrealised losses)			
– from the valuation of foreign exchange	0.0	-0.4	-0.4
– from the valuation of securities	-21.3	-4.8	16.5
Total	**-21.3**	**-5.2**	**16.1**

2.3 Transfer from provisions for foreign exchange, interest rate, credit and price risks	**21.3**	**5.2**	**16.1**
Grand total	**50.3**	**58.2**	**-7.9**

As shown in the table, the €7.9 million decline in the net result from financial transactions was mainly due to a €23.7 million drop in gains, offset by interest income. Gains from foreign exchange operations rose by €2.6 million, while gains from the sale of gold coins (British sovereigns) amounted to €20.2 million, up from €5 million in 2009.

Finally, the results for 2010 include unrealised losses of €21.3 million (2009: €5.2 million) from the year-end valuation of securities. These losses were fully covered by the special provision established for this purpose.

3. Net income from fees and commissions

Net income from fees and commissions fell by 19% to €141.5 million in 2010, from €174.8 million in the previous year, mainly as a result of lower commissions for the management of Greek government securities (lower volume of new issues).

A breakdown is provided below.

Net income from fees and commissions	**2010** *(in € millions)*	**2009**	**Change**
3.1 Income from fees and commissions			
– management of Greek government securities	26.1	56.4	-30.3
– payments and receipts on behalf of the Greek State	75.9	80.4	-4.5
– management of the “Common Fund” (surpluses of public entities and social security organisations) under Law 2469/1997	31.8	30.9	0.9
– other	9.3	8.7	0.6
Total	**143.1**	**176.4**	**-33.3**
3.2 Fees and commissions expense	**-1.6**	**-1.6**	**0.0**
Total net income from fees and commissions	**141.5**	**174.8**	**-33.3**

4. Income from equity shares and participating interests

Income from equity shares and participating interests decreased considerably to €12.3 million in 2010, from €67 million in 2009.

Income from equity shares and participating interests	2010	2009	Change
	(in € millions)		
• income from the ECB			
– from the distribution of part of the ECB's seignorage income	0.0	22.2	-22.2
– from the distribution of the ECB's net profits	4.8	41.3	-36.5
• other income from equity shares and participating interests	7.5	3.5	4.0
Total	**12.3**	**67.0**	**-54.7**

• Income from the ECB

In 2010, the full income earned on the ECB's share of total euro banknotes in circulation and securities purchased under the Securities Markets Programme (SMP), amounting to €654 million and €438 million respectively, was transferred to the provision for foreign exchange rate, interest rate, credit and gold price risks. Another amount of €71 million from its other income was also transferred to this provision. The remaining €171 million of net profit was distributed to the National Central Banks of the Eurosystem. Thus, the Bank of Greece received an amount of €4.8 million based on its key for subscription to the ECB's capital.

• Other income from equity shares and participating interests

This income, amounting to €7.5 million, corresponds to deferred payments of dividends for the financial year 2009 and returns of capital (Hellenic Exchanges SA) in respect of the Bank's participating interests in the Bank of International Settlements (BIS), DIAS Interbank Systems SA and Hellenic Exchanges SA.

5. Net result of pooling of monetary income

	2010	2009	Change
	(in € millions)		
– Income from the reallocation of the Eurosystem monetary income	-45.2	8.4	-53.6
– Transfer to income from the provision against counterparty risks from Eurosystem monetary policy operations	47	45	2
Total	**1.8**	**53.4**	**-51.6**

The net result from the pooling and reallocation of Eurosystem monetary income decreased considerably to €1.8 million, compared with €53.4 million in the previous financial year.

In greater detail:

Net result of pooling and reallocation of the Eurosystem 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 equal to its annual income (actual and imputed) derived from its assets held against the "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 arising from balances of TARGET2 accounts;

– net liabilities related to the allocation of euro banknotes within the Eurosystem.

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;

– securities held for monetary policy purposes. These include covered bonds issued by euro area credit institutions and securities involved in the Securities Markets Programme (SMP). The yields on the former are calculated daily on the basis of the latest available marginal rate of the Eurosystem main refinancing operations, while those on the latter are calculated in real terms;

– intra-Eurosystem claims equivalent to the transfer of foreign reserve assets other than gold to the ECB;

- net intra-Eurosystem claims arising from balances on TARGET2 accounts;

- net claims related to the allocation of euro banknotes within the Eurosystem;

- gold, including claims in respect of gold transferred to the ECB, in an amount permitting each NCB to earmark a proportion of its gold that corresponds to the application of its share in the subscribed capital key to the total amount of gold earmarked by all NCBs. Gold is deemed to generate no income.

Where the value of an NCB's earmarkable asset exceeds or falls short of the value of its liability base, the return on the difference (gap) is calculated daily on the basis of the latest available marginal rate for the Eurosystem's main refinancing operations.

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 negative result (€45,190,618) recorded in 2010 is due to the fact that the monetary income that accrued to the Bank (€337,550,327), according to the ECB's calculation method, was higher than the €292,359,709 estimated according to the Bank's share in the capital of the ECB (see note on liability item 9.4).

The above method for allocating monetary income was established by Decision 2010/23 of the Governing Council of the ECB.

Transfer to income from the provision against counterparty risks from the Eurosystem's monetary policy operations

The Bank's income in 2010 includes a transfer of a further €47 million (in addition to the €45 million transferred in 2009) from the €149.5 million provision against counterparty risks from monetary policy operations.

This provision was initially established in 2008, following a decision by the Governing Council of the ECB on 18.12.2008, in view of the exceptionally adverse conditions that prevailed in the money market in 2008 and affected the liquidity-providing monetary policy operations conducted that.

In this context, the Governing Council of the ECB decided, in line with the principle of prudence, that the NCBs should form respective provisions totalling €5.7 billion in their annual accounts for 2008 as a buffer against counterparty risks arising from the monetary policy operations conducted in 2008.

In accordance with the Statute of the European System of Central Banks (ESCB) and of the ECB, this provision was funded by all the national central banks of the Member States according to their subscribed shares in the capital of the ECB.

In accordance with the above-mentioned decision of the Governing Council of the ECB, the amount of the provision will be adjusted annually after the revaluation of collateral received from defaulted counterparties.

The favourable outcome of the revaluation of collateral in 2009 and 2010, which is attributable to improved conditions in financial markets, combined with the reduced balance of collateral due to the sale of part of the portfolio and the proceeds of coupons, resulted in a reduction in the relevant risk and, therefore, a decrease in the relevant provision from €5.7 billion to €2.2 billion; also, in the transfer to income of a total amount of €3.5 billion from the unused provisions of Eurosystem NCBs for 2009 and 2010 (the share of the Bank is €92 million).

6. Other income

Other income decreased by €6.8 million to €12.6 million, compared with €19.4 million in the previous financial year.

Other income includes revenue of €8.7 million from the activities of the Banknote Printing Works (IETA) of the Bank of Greece, derived from the production of items on behalf of the Greek State (coins, lottery tickets, passports, forms), profits of €1.7 million from the sale of the building housing the Agrinio branch, which was converted into an outlet in the context of the organisational restructuring undertaken by the Bank in the past few years, as well as other revenue, amounting to €2.2 million, from accreditation fees, unused provisions, tax discounts, etc.

OPERATING COSTS, DEPRECIATION AND PROVISIONS

	2010	2009
	(in euro)	
STAFF COSTS AND PENSIONS	319,516,458	332,781,100
ADMINISTRATIVE AND OTHER EXPENSES	48,198,051	46,498,739
DEPRECIATION OF TANGIBLE AND INTANGIBLE FIXED ASSETS	13,481,729	59,807,274
PROVISIONS	472,865,662	472,228,907
TOTAL EXPENSES	854,061,900	911,316,020

NOTES ON THE EXPENDITURE ACCOUNTS

Expenditure in 2010 fell by €57.2 million (6.3%) to €854.1 million, from €911.3 million in 2009.

In greater detail:

- ***Outlays for staff costs (wages, social security contributions, etc.) and pensions*** decreased by €13.3 million (4%) to €319.5 million, from €332.8 million in 2009.

- ***Depreciation*** fell to €13.5 million, from €59.8 in the previous financial year, due to the total depreciation of previous years' banknote production costs amounting to €46.4 million in the financial year 2009.

- ***Administrative and other expenses*** increased by 3.7%, to €48.2 million, from €46.5 million in 2009. These expenses mainly include the expenditure of the Banknote Printing Works (IETA) for raw materials for the production of banknotes and other items on behalf of the Greek State (coins, lottery tickets, passports, forms), the repair and maintenance costs of premises, the procurement of computer hardware and other equipment, insurance premiums, other overhead costs, etc.

- ***Provisions*** increased considerably ***in 2010 as well*** (+€472.9 million), in order to cover operational risks and other liabilities of the Bank (see notes on liability item 12 "Provisions").

DISTRIBUTION OF NET PROFIT

(Article 71 of the Statute)

Profit amounted to €190.4 million in 2010, compared with €228.2 million in 2009, having decreased by 16.5%.

The General Council proposes to the General Meeting of Shareholders that the profit be distributed as follows:

	2010	2009
	(in euro)	
Dividend of €0.67 per share (number of shares 19,864,886)	13,309,473	13,309,473
Extraordinary reserve	12,000,000	17,500,000
Additional dividend, €0,89 per share*	17,679,749	34,366,253
Tax on dividends**	20,659,482	15,891,909
To the government	126,803,588	147,092,978
	190,452,292	**228,160,613**

* Total gross dividend in 2010 is €2.60 per share, compared with €3.20 in 2009.
** Tax on dividends was calculated at a rate of 40% pursuant to Article 13 of the applicable tax law, 3842/23.4.2010. In case of amendment to the legislation applicable to the taxation of distributed dividends prior to their actual payment, the tax and dividend amounts will be adjusted accordingly.

Athens, 14 March 2011

For the General Council
THE CHAIRMAN

GEORGE A. PROVOPOULOS
GOVERNOR OF THE BANK OF GREECE

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