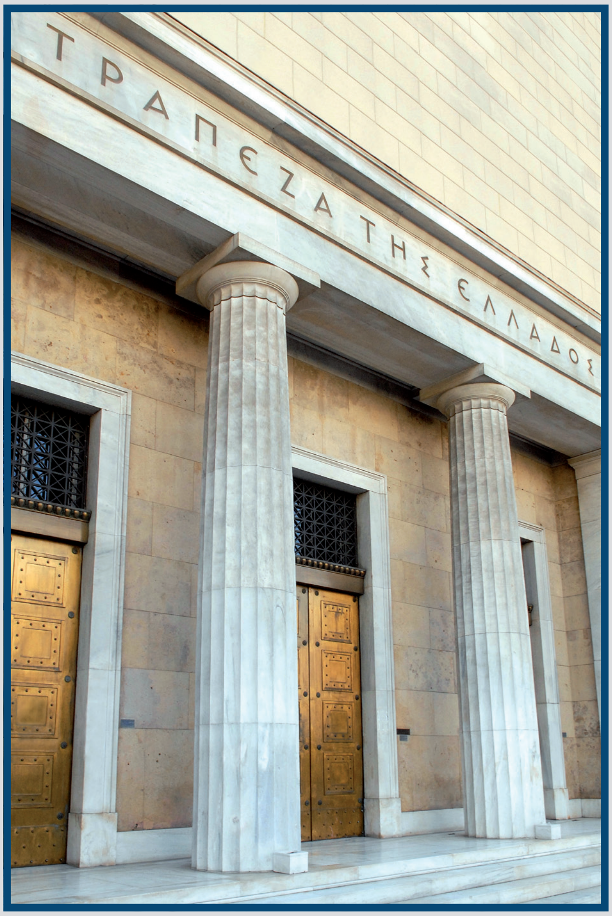
ANNUAL REPORT
2013



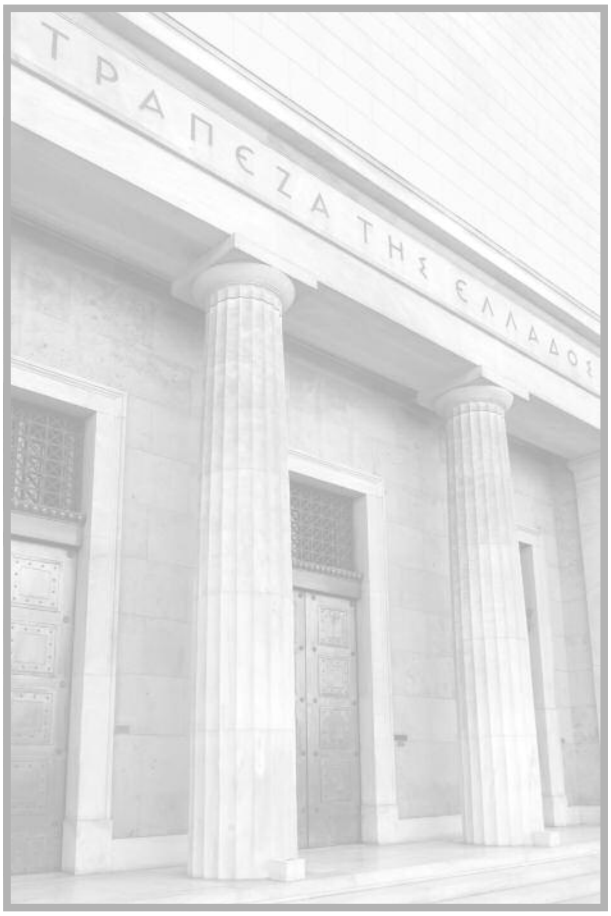
FEBRUARY 2014

BANK OF GREECE

EUROSYSTEM

ANNUAL REPORT
2013

Presented to the 81st General Meeting of Shareholders
on 27 February 2014 by Governor George Provopoulos



FEBRUARY 2014

BANK OF GREECE
EUROSYSTEM

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GENERAL COUNCIL

George Provopoulos	**Chairman – Governor**	
Helen Dendrinou – Louri	**Deputy Governor**	
Ioannis Papadakis	**Deputy Governor**	
Ilias Plaskovitis	Member of the Monetary Policy Council and Member	
Charalampos Stamatopoulos	»	
Georgios-Spyros Tavlas*	»	
Andreas Andreadis	Member	*Term of office expires in 2014***
Dimitrios Asimakopoulos	»	*Term of office expires in 2014****
Evaggelos Geraniotakis	»	
Georgios Mylonas	»	*Term of office expires in 2014****
Christos Polyzogopoulos	»	
Michael Chandris	»	*Term of office expires in 2014****

Attending

Panagiotis Karakousis Government Commissioner

* By the Presidential Decree of 13 June 2013 published in the Government Gazette, Mr Georgios-Spyros Tavlas was appointed Member of the Monetary Policy Council, and consequently Member of the General Council, with a term of office that expires on 10 April 2020, in accordance with Article 35A of the Bank's Statute.

** The term of office of Mr Andreas Andreadis who, by decision of the General Council on 26 April 2013 (Meeting no. 5), was elected Alternate Member of the General Council to fill the vacancy left by the death of Georgios Kassimatis until the current General Meeting, in accordance with Article 22 of the Bank's Statute, expires at the current Annual General Meeting.

*** The terms of office of Mr Dimitrios Asimakopoulos, Mr Georgios Mylonas and Mr Michael Chandris, elected by the Annual Ordinary General Meeting of Shareholders of 18 April 2011, expire at the current Annual Ordinary General Meeting, in accordance with Article 21 of the Bank's Statute.

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REPORT OF GOVERNOR GEORGE PROVOPOULOS

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

I FINANCIAL RESULTS FOR 2013

1 FINANCIAL RESULTS FOR 2013

The Bank's profits in 2013 came to €831.1 million, up from €318.6 million in 2012.

The Bank's total net income for 2013 decreased by 46.6%, while operating costs excluding provisions continued to decline for yet another year, by 10.1%. Staff costs, down by 7.1%, were a major factor in cutting operating costs.

Provisions amounted to €468.8 million, down from €2,342.7 million in 2012.

In accordance with Article 71 of the Bank's Statute, the General Council has decided to propose to the General Meeting of Shareholders that the profits of 2013 be allocated as follows: €13.3 million, or 12% of the Bank's capital, to be distributed as dividend, with the balance (€817.8 million) to be transferred to the State.

In greater detail, the Bank's income and expenses in financial year 2013 were as follows:

Income

The Bank's total net income from Eurosystem monetary policy operations, interest and commission fees, and other revenue from domestic and foreign operations decreased by 46.6% to €1,600.3 million, from €2,995.4 million in 2012. This decrease is mainly due to banks' reduced recourse to Emergency Liquidity Assistance from the Bank of Greece, owing to the improved economic sentiment and the recapitalisation of banks.

Specifically:

Net interest income and income from financial operations and the reallocation of Eurosystem monetary income totalled €1,465.8 million, down by 49.3% from €2,888.9 million in 2012.

The net result on financial operations came to €26.8 million, down by €39.5 million from €66.3 million in 2012. Net income from fees and commissions declined marginally to €70.2 million from €71.8 million in 2012.

Income from equity shares and participating interests rose by €34.1 million to €54.2 million, from €20.1 million in 2012. Most of this increase came from higher income from the interim profit distribution of the European Central Bank for 2013.

The European Central Bank (ECB), by decision of the Governing Council, made an interim profit distribution, amounting to €1,370 million, to the national central banks (NCBs) of the Eurosystem on 31 January 2014. The Bank of Greece received €38.4 million, in proportion to its share in the capital of the ECB. The remaining profit of the ECB was distributed to the NCBs on 21 February 2014, and the amount allocated to the Bank of Greece will benefit its results for 2014.

Finally, other income decreased by 30.8% to €10.1 million, compared with €14.6 million in 2012. The bulk of this amount is income from operations carried out by the Printing Works Department (IETA) on behalf of the Greek State.

Expenses

Total expenses decreased by €1,907.6 million to €769.2 million in 2013, compared with €2,676.8 million in 2012, mainly on account of reduced provisioning (€468.8 million in 2013, compared with €2,342.7 million in 2012). The decrease in total expenses was also the result of a further containment of expenditure for compensation of employees and pension benefits.

Specifically:

The Bank's operating costs excluding provisions (staff costs, pensions, depreciation, other costs) decreased by €33.7 million (-10.1%) to €300.4 million, from €334.1 million in 2012, despite a €4.3 million extraordinary expenditure on consultancy fees for the auditing of the banking system. The reduction in operating costs is primarily due to a €11.2 million decrease in staff costs (-7.1%, i.e. €146.7 million in 2013, compared with €157.9 million in 2012). In addition, expenses for pension benefits were reduced by a significant €13.8 million (-12.3%) to €98.4 million, from €112.2 million in 2012.

This reflects the sustained efforts of the Bank and its staff to curtail expenses by implementing targeted measures and initiatives, such as the three-year firm-level collective agreement currently in force (2012-2015), signed in April 2012 with the Bank of Greece Employees' Union (SYTE).

As a result of the general effort to rationalise the Bank's expenses, operating costs excluding provisions have been reduced by €138.7 million (-31.6%) over the past four years. A significant contribution to this effect came from a reduction of €60.3 million (-29.1%) in staff costs.

This year, consultancy fees for the auditing of the banking system were reduced to €4.3 million, compared with €10.3 million in 2012.

Operating costs were cut despite the Bank's increased obligations in ensuring financial stability (audits, work on banks' recapitalisation, etc.) and supervising private insurance, as well as its obligations arising from the economic support programme for Greece.

Other administrative expenses fell to €37 million, from €40.1 million in 2012, down by 7.7%.

Provisioning remained high in 2013, with the setting aside of €468.8 million, bringing cumulative provisions to €6,651.8 million on 31.13.2013.

High provisioning is in line with the principle of prudence followed by the ECB and NCBs of the Eurosystem. This practice aims both to strengthen the financial position of the Bank of Greece thereby enabling it to fulfil its duties in the best way possible, and to enhance its ability to address risks.

2 BANK OF GREECE ORGANISATION AND OPERATION

Organisational restructuring

The merger or elimination of certain units within the Bank and the reassignment of their tasks continued in 2013, with a view to achieving greater synergies, a more effective use of existing staff (reduced by 865 over the past six years), better financial supervision and monetary policy implementation, avoiding possible overlaps, as well as lower operating costs and operational risk.

In particular, the Financial Operations Department, the Human Resources and Organisation Department, the Accounting Department, the Technical and Administrative Support Department and the Cash Department underwent considerable restructuring, while certain sections within the Internal Audit Department, the Department of Private Insurance Supervision and the Supervision of Credit and Related Financial Institutions Department also saw some organisational adjustments. Given the Bank's macroprudential responsibilities, it was considered necessary to assign new tasks to the Macro-prudential Policy Section of the Financial Stability Department. Furthermore, the tasks of the Credit Institution Resolution Unit – which is chiefly responsible for recommending to the Resolution Measures Committee the adoption of resolution measures or the appointment of a Commissioner to credit institutions – have been expanded.

Finally, the role of the Bank as supervisory authority in the special liquidation proceedings of credit and supervised financial institutions led the Bank to define the scope of supervision and control and to set up a Special Liquidations Advisory Committee.

Ethics Officer

On 1 March 2013, the Bank's Administration appointed an Ethics Officer in compliance with a relevant requirement of the Bank's Code of Conduct, introduced by decision of the General Council on 1 June 2012. The Ethics Officer provides guidance to all staff on matters of business practices and professional ethics, conduct, rights and obligations.

Operation of the Bank's network of regional branches

Organisational restructuring aimed at streamlining the regional branch network continued in 2013, with a view to further cutting down on operating and cash distribution costs. In the year under review, the Thessaloniki Branch underwent organisational changes. Also, the operation of the Bank's Agencies in Lavrio, Siteia, Limnos and Poros was discontinued and the respective NHTO ("notes held to order") stocks with National Bank of Greece Branches serving them were abolished. The operations of these Agencies were taken over by adjacent Bank of Greece Units.

Development of Operating Regulations for the Bank's Units

The regulatory framework governing the operation of the Bank's Units is updated and adapted to new requirements through the formulation of Operating Regulations, submitted for final approval to the Bank's General Council, with a view to facilitating the Units' seamless operation and more efficient supervision and control. In the course of 2013, the General Council approved a total of 30 section-level Operating Regulations.

Coordination of Eurosystem/ESCB-related matters and management of sensitive information

In order to effectively manage the increasing Eurosystem/ESCB-related workload, new procedures were defined to coordinate the necessary actions that the Bank must take when participating in Eurosystem/ESCB tasks. An internal portal for the direct exchange of information and the cooperation among the Bank's representatives in the Eurosystem/ESCB was launched on a pilot basis.

In addition, the Bank held staff training courses on the safe handling of sensitive information, with an emphasis on the relevant rules and procedures established by the Bank and the Eurosystem/ESCB and an analysis of practical guidelines for risk prevention and management.

Buildings and technical works

In 2013 the Technical and Administrative Support Department continued its maintenance and remodelling of the Bank's buildings and premises in Attica and other regions (branches and outlets), as part of a broader effort to improve working conditions, adapt the premises to new organisational structures, enhance the physical security of facilities and transactions, and introduce more eco-friendly solutions.

In order to enhance the physical security of the Bank's buildings, the Bank's Administration decided to install a centralised, integrated, modern, reliable and expandable security system for the Bank's premises in Halandri, to be managed via an envisaged unified signal receiving centre, with state-of-the-art and upgradable software. The security of cash transfers was also enhanced in 2013, with the addition to the Bank's fleet of five new armoured vehicles.

Research activities

The Bank of Greece continued to take active part in ongoing research on issues pertaining to the Greek and European economy, in the context of the Eurosystem's research activities. Researchers from the Bank of Greece participated in the Household Finance and Consumption Survey, the Macroprudential Research Network and the Wage Dynamics Network, which plans to conduct a survey of firms to assess the labour market response to the crisis (more information on these research networks is available at http://www.ecb.europa.eu/home/html/researcher.en.html).

Bank of Greece publications in 2013 included twenty Working Papers and one issue of the Economic Bulletin. Research collaboration programmes continued, leading to the release of jointly conducted studies by experts from the Bank of Greece and from domestic and foreign academic institutions with the participation of post-graduate students from Greek universities, in areas such as product market competition, wages and labour, banking sector uncertainty models, corruption and tax evasion in Greece, macro-sector model simulation for an analysis of the crisis impact in Greece and, finally, immigration and crime.

On 23-24 May 2013, the Bank of Greece held a conference on "The crisis in the euro area", at which Vitor Constâncio, Vice-President of the European Central Bank, was the keynote speaker. The papers presented at the conference are available on the Bank of Greece website under "Special Conference Papers" and will be published in a special issue of the *Journal of Macroeconomics* in April 2014.

On 13 December 2013, the Bank of Greece, in collaboration with the European Bank for Reconstruction and Development (EBRD), organised an international symposium entitled "Growth challenges and economic integration in South-Eastern Europe". The symposium focused on how economic integration can provide new drivers for sustainable growth in the region. Key speakers included Greece's Minister of Development and Competitiveness, the EBRD President, central bank governors from the region, academics and former government officials from countries of South-Eastern Europe.

Other events included a conference on Greek tourism and climate change (see details below), as well as twelve seminars, lectures and research workshops with speakers from Greece and abroad, to ensure that economists from the Bank of Greece and the broader academic community remain abreast of current research developments.

Centre for Culture, Research and Documentation

In March 2013, a Centre for Culture, Research and Documentation, consisting of four Units (Museum and Collections; Library; Historical Archive; Research, Publications and Administrative Support), was established within the Bank. The mandate of the Centre is to serve as a hub for advancing and highlighting the role of the Bank of Greece in the country's economic, social and cultural development; its responsibilities include running the Museum and the Library, managing and curating the Bank's historical archives, managing and expanding the Bank's collections, overseeing relevant publications and research, holding exhibitions and organising cultural events, educational programmes, scientific and cultural conferences.

The Museum continued to provide financial education to the public. Since opening at end-2010, the Museum has had over 12,000 visitors, mostly from secondary schools and universities. In January 2013, the Museum inaugurated its second temporary exhibition, entitled "Production^2" (*Production Squared*), a dual tribute to banknote and coin production and to actual forms of production, agricultural and other, depicted on banknotes and coins.

Climate Change Impacts Study Committee (CCISC)

In 2013, the Climate Change Impacts Study Committee (CCISC) continued its work on the development of adaptation policy proposals for addressing the impacts of climate change, with a focus on tourism, a key sector of the Greek economy with a substantial contribution to national GDP and an even greater contribution to employment. To this end, the Committee held a conference in July 2013 that brought together renowned scientists from the relevant disciplines, the heads of tourism bodies and organisations, as well as the Secretary-General of the Ministry of Tourism and the Secretary-General for the Aegean and Island Policy. Material from the conference is available on the Bank's website, while the detailed conclusions of the conference and the CCISC's research will be published in a forthcoming report entitled "Greek tourism and climate change: adaptation policies and a new growth strategy".

3 EXPIRY OF GENERAL COUNCIL MEMBERS' TERM OF OFFICE

By the Presidential Decree of 13 June 2013 published in the Government Gazette, Mr Georgios-Spyros D. Tavlas was appointed Member of the Monetary Policy Council, and consequently Member of the General Council, with a term of office that expires on 10 April 2020, in accordance with Article 35A of the Bank's Statute.

The terms of office of Mr Dimitrios Asimakopoulos, Mr Georgios Mylonas and Mr Michael Chandris, elected by the Annual Ordinary General Meeting of Shareholders of 18 April 2011, expire at the current Annual Ordinary General Meeting, in accordance with Article 21 of the Bank's Statute. For this reason, the General Meeting will be called upon to elect new General Council Members for a three-year term in their place.

In addition, the General Meeting will be called upon to elect one more General Council Member for a three-year term in the place of Mr Andreas Andreadis who, by decision of the General Council on 26 April 2013 (Meeting no. 5), was elected Alternate Member of the General Council to fill the vacancy left by the death of Georgios Kassimatis until the current General Meeting, in accordance with Article 22 of the Bank's Statute. The outgoing General Council Members are eligible for re-election.

II CHRONIC IMBALANCES CORRECTED IN 2013 – AN EXIT FROM THE CRISIS IN 2014 POSSIBLE UNDER CERTAIN CONDITIONS

1 INDICATIONS ARE THAT 2013 WAS THE LAST YEAR OF RECESSION

At the previous General Meeting of Shareholders of the Bank of Greece in February 2013, the assessment presented was that the Greek economy would soon stabilise. At the time, our forecasts indicated that the recession would gradually ease in the course of 2013 and that positive GDP growth rates would be observed in 2014. The developments in the past year have confirmed this assessment and strengthen the forecast of recovery in 2014.

More specifically, in the past twelve months:

First, economic policy remained committed to the stabilisation programme. Consistent implementation of the programme boosted confidence both domestically and in the international markets:

• The Economic Climate Indicator rose considerably, compared with 2012 and the three previous years.

• The Athex Composite Share Price index was markedly higher than in 2012, reflecting enhanced confidence in the prospects of the economy and the banking system.

• The spread between Greek and German 10-year government bonds fell to 655 basis points at end-2013 (nearing the levels of June 2010), from 1,000 basis points at end-2012.

Second, the improvement in confidence is gradually feeding through into the real economy:

• The Purchasing Managers' Index (PMI) for industry reached a four-year high in the last months of 2013 and recently rose above the growth/contraction threshold;

• Net job creation improved significantly in the course of the year, as the hiring rate picked up and the layoff rate decelerated.

• The fall in GDP in 2013 is expected to have been considerably weaker compared both with 2012 and with projections in early 2013. Specifically, first estimates point to an annual GDP contraction of 3.7% in 2013, mainly on account of the robust performance of exports, especially tourism, and smaller declines in consumption and investment.

Third, in the course of the year the risks to gradual stabilisation did not materialise. The most serious of these risks was the Cypriot crisis, which was dealt with promptly and effectively, without repercussions for confidence in the domestic banking system.

Fourth, the recapitalisation of Greece's four core banks was completed successfully, and major steps were taken towards restructuring and consolidating the banking system. These changes were carried out smoothly, without impact on the safety of deposits and financial stability. This proved to be key to gradually restoring confidence and improving the overall climate.

2 THE YEAR 2013 MARKS A TURNING POINT, WITH THE ELIMINATION OF THE TWIN DEFICITS AND THE RESTORATION OF THE ECONOMY'S COST COMPETITIVENESS

The increasingly brighter outlook during the course of 2013 gradually led to stabilisation and permitted noticeable improvements in fiscal and macroeconomic aggregates:

The *first* noteworthy development is the estimated achievement of a primary surplus for the first time since 2002. After a fiscal adjustment that was unprecedented by international standards, the primary balance of general government is expected to have turned into a surplus of around 0.4% of GDP in 2013, improving by roughly 11 GDP percentage points from 2009. This is a remarkable achievement, considering the severity of the recession.

Second, according to provisional estimates from the Bank of Greece, the current account posted a small surplus in 2013 for the first time in Greece's post-war history. The substantial improvement in the current account balance by roughly 16% of GDP over the last five years was due to lower imports, as a result of the recession, and to increased exports, as the economy regained its cost competitiveness. Specifically, between 2010 and 2013, while imports of goods and services in nominal terms contracted by 15%, exports rose by 21%.

Third, after more than two decades of almost continuous losses in international competitiveness up to 2009, by 2013 Greece had recovered all of the cost competitiveness it had lost relative to its trading partners. This was due mainly to a decline in unit labour costs throughout the economy in the context of a deep recession with a surge in unemployment, and greater labour market flexibility. Price competitiveness, by contrast, has not yet fully recovered, as inflation only started to respond to weak demand and lower labour costs during 2013. Negative inflation of -0.9% in 2013 has contributed to improving the economy's price competitiveness and supports real incomes.

3 STRUCTURAL REFORMS WERE IMPLEMENTED BETWEEN 2010 AND 2013 THAT HAD BEEN OVERDUE FOR DECADES

Apart from the elimination of the economy's domestic and external macroeconomic imbalances, the period 2010-2013 saw the launching and implementation of a number of structural reforms in labour and product markets and in public administration.

Structural changes in labour and product markets

In the labour market, significant structural changes were adopted, aimed at better aligning wage developments with firm performance and at enhancing labour mobility across sectors. Progress with structural reforms in goods and services markets, by contrast, was not as fast as in the labour market. Nevertheless, according to OECD estimates, Greece ranked first in responsiveness to structural reform recommendations made by the Organisation.

Institutional changes to public administration

The fiscal measures taken during the period 2010-2013, aimed for the most part at improving the budgetary balance as quickly as possible, consisted mainly of increases in direct and indirect taxes and, on the expenditure side, of cuts in wages, pensions and social benefits.

Nonetheless, this period also witnessed significant institutional changes geared towards streamlining the public administration and downsizing the public sector, such as:

- the introduction of a single salary grid to the whole civil service and centralised wage management through a Single Payment Authority;

- the partial replacement through attrition of exiting or retiring civil servants;

- the preparation of updated organisation charts in public administration;

- the activation of a labour reserve mobility scheme for civil servants;

- the activation of a National Electronic Public Procurement System;

- the local government reform through the Kallikratis programme;

- the restructuring of state-owned enterprises and organisations;

- the reduction of public expenditure on health and pharmaceuticals and the rationalisation of the operation of hospitals;

- the merging of all health insurance funds into a single healthcare provider and the pension reform of July 2010, which have rationalised the health insurance system and will significantly reduce future pension expenditure as a percentage of GDP.

At the same time, important new institutional reforms were implemented that lay the foundations for improved budget procedures, better control of public spending with the possibility of adjusting expenditure ceilings in line with revenue performance, the adoption of corrective measures and the preparation of medium-term fiscal plans.

Despite the above-mentioned measures, several necessary reforms, such as the administrative reform and the restructuring of public entities through mergers or closure, did not progress quickly enough, thereby delaying an effective restructuring of the State and an improvement of public services.

Significant efforts have also been made to upgrade the tax collection mechanism. However, despite the definite improvements, notable progress in curbing tax and contribution evasion has yet to be made. Hence, the imposition, at times, of tax increases and additional tax measures, which as a rule increase the tax burden on law-abiding taxpayers.

4 FINANCIAL STABILITY WAS SAFEGUARDED BY THE BANK OF GREECE WITH THE SUPPORT OF THE GOVERNMENT

As a result of the global financial crisis of 2008 and its development into a fiscal crisis in 2009, Greek banks were cut off from international markets and, until June 2012, experienced an unprecedented outflow of deposits, both in magnitude and duration, amounting to roughly €90 billion or one third of the deposit base. In response, they resorted increasingly to short-term financing from the Eurosystem. At the height of the crisis in June 2012, total central bank financing to credit institutions came close to €140 billion.

In addition, although Greek banks entered the crisis with satisfactory capital adequacy ratios, the heavy losses they suffered from 2010 onwards and especially the impact of the Private Sector Involvement (PSI) resulted in nearly all banks being faced with a capital shortage at end-2011. The recapitalisation of Greek banks thus became imperative, in order to fully protect depositors.

Under these adverse circumstances, the government and the Bank of Greece took a number of decisive actions aimed at safeguarding financial stability and protecting depositors. The most important of the measures taken involved:

- the uninterrupted coverage of banks' short-term liquidity needs and the public's demand for cash;

- the securing of adequate public funds for the recapitalisation and restructuring of the Greek banking sector;

- the resolution of weak banks under a new legal framework; and

- the recapitalisation of core banks.

The establishment of an appropriate resolution framework allowed for a smooth restructuring of the banking sector. By end-2013, six commercial and six cooperative banks had been resolved, either via the transfer of their healthy assets to another bank or via the setting-up of an interim credit institution. Also, following a bidding process, the assets and liabilities of Cypriot bank branches were transferred smoothly to a Greek bank.

With the completion of the recapitalisation process by mid-2013, Greek banks' capital adequacy ratios had been restored. The Hellenic Financial Stability Fund (HFSF) is now the largest shareholder in each of Greece's four core banks and has a buffer of over €8 billion to meet any further capital needs. Another positive development is the improvement in the quality of capital, which now consists almost exclusively of Tier 1 capital, whereas in 2008 one fifth of banks' total capital was Tier 2 capital.

The banking landscape today is different from that prevailing at the start of the crisis. Excess capacity has largely been eliminated, fewer but stronger banks are in operation, and the first benefits from the exploitation of synergies are already visible.

The Bank of Greece, as the supervisory authority, has repeatedly argued that the size of the Greek economy and the current economic conjuncture call for fewer, but stronger banks with greater resilience to economic shocks.

5 DURING THE SAME PERIOD, MAJOR INSTITUTIONAL CHANGES WERE LAUNCHED THAT REINFORCE EU ECONOMIC GOVERNANCE

The sovereign debt crisis served as a catalyst for strengthening economic governance in the EU, in general, and the euro area, in particular. Support mechanisms were created. Economic policy coordination and budgetary surveillance have been reinforced through the newly introduced European Semester, as well as with the six-pack and two-pack regulations for strengthening the Stability and Growth Pact and the Fiscal Compact that came into force in January 2013.

The new fiscal framework, laid down the Fiscal Compact, requires contracting Member States to adopt national fiscal rules to ensure that the annual structural government deficit does not exceed 0.5% of GDP, as well as a correction mechanism to be triggered automatically in the event of deviation from either the Medium-Term Objective (MTO) itself or the adjustment path towards it. According to the Fiscal Compact, the task of monitoring compliance with the national fiscal rules including the medium-term objective and the activation of the correction mechanism are to be assigned to independent fiscal councils.

Furthermore, important decisions were taken at the EU level towards enhancing the institutional framework for financial supervision and safeguarding financial stability in the euro area. Top priority was given to the establishment of a banking union. The approval of the Single Supervisory Mechanism, scheduled to become fully operational by November 2014, as well as the European Council's agreement on a general approach to a Single Resolution Mechanism are important steps towards the completion of the banking union. In 2013, agreement was also reached on directives on deposit guarantee schemes and a framework for the recovery and resolution of credit institutions.

Overall, the reinforcement of economic governance in EMU is expected to bolster stability in the euro area by enabling the early identification and correction of macroeconomic imbalances and the activation of effective crisis management mechanisms. As far as Greece is concerned, the institutional improvements to the EMU architecture will ensure that past mistakes in fiscal management are not repeated and will contribute in the long run to economic stability, while the banking union is expected to boost confidence in the banking system.

6 PREREQUISITES FOR THE MATERIALISATION OF THE FORECASTED RECOVERY IN 2014

Based on all the available data, it is reasonable to forecast that 2013 was the last year of recession. However, if this forecast is to become a reality, not only must the conditions contributing to the improved outlook remain unchanged, but they also have to be taken further. The prerequisites for this to happen are:

- Resolve and consistency in implementing the stabilisation programme. The positive outcomes so far leave no room for complacency or relaxation of fiscal policy. On the contrary, they call for a continuation of fiscal adjustment for maintaining and increasing primary surplus so as to ensure debt sustainability and consolidate the climate of confidence.

- Elimination or at least minimisation of the risks and uncertainties that might be triggered by a deterioration in the social and political climate, as a result of growing confrontation in the run-up to the European and local government elections.

Today, as we are near the end of a protracted recession, a national policy that will lead us safely out of the crisis and onto a path of sustainable growth is required. To be effective, such a policy calls for consensus building and compromise. Both, however, are difficult to achieve in a polarised climate, which acts only to amplify differences and thwarts the convergence of views.

A prerequisite for growth is the continuation of fiscal adjustment and public sector restructuring. In this regard, top priority must be given to:

- ensuring consistency in the execution of the 2014 budget, thereby providing a strong signal that the fiscal adjustment is sustainable and that, combined with a return to growth, it can lead to a definitive exit from the crisis.

- upgrading the tax administration and the tax collection mechanism;

- speeding up the resolution of tax cases pending before the courts, in order to effectively combat tax evasion;

- enhancing the quality of public services; and

- evaluating the performance of public services and civil servants according to transparent and objective criteria.

In the field of social security, a tighter monitoring and control of expenditure as well the curbing of contribution evasion to boost revenue are needed, so as to avoid the accumulation of arrears, especially those owed by the social security funds and the National Organisation for Health Care (EOPYY). The accumulation of arrears at the general government level and the shortfalls from target in privatisation proceeds pose downside risks to the liquidity of the economy, growth and the State's ability to meet its future financial obligations. The further enhancement of the institutional framework for the preparation, execution and monitoring of the budget with the establishment of an independent fiscal council will further ensure the sustainability of fiscal balance improvement in the post-Memorandum era.

7 FINANCING THE ECONOMIC RECOVERY

The shortage of financing is one of the major constraints on the economy today. This shortage, however, does not stem exclusively from the decline in bank credit. Rather, it is due to a combination of factors, many of which, predating the crisis, had shaped a growth model excessively dependent on bank lending. The banking system essentially went with the flow and responded to rising demand for credit from businesses and households.

Greek businesses, on the other hand, failed to take advantage of the conditions of recurring profitability and improve their financing structure, thereby reducing their dependence on bank lending. In fact, for as long as they had access to relatively cheap money, they had no real incentive to do so.

With the start of the fiscal crisis in 2009 and the deep recession that followed, both the supply and demand for credit contracted sharply. Against this backdrop, banks' lending capacity was inevitably constrained, as the fiscal crisis strongly affected the credit ratings of the country and by extension of the domestic banking system. Thus, bank credit to the private sector and to businesses in particular gradually declined, causing a large number of businesses to have difficulty financing their production activities.

Subsequently, the banking landscape in Greece has changed. Recapitalisation and restructuring of the banking system are gradually restoring confidence and are creating the conditions necessary for the supply of bank credit to the economy to increase over the medium term. However, several factors continue to limit new lending in the short term.

The most important are the following:

First, net deposit inflows, a critical determinant of banks' capacity to supply credit to the economy, remain low.

Second, the loan-to-deposit ratio needs to be kept at a conservative level. This ratio has risen largely because of the loss of deposits during the crisis.

Third, the reliance of Greek banks on short-term financing from the Eurosystem remains high, in contrast to other euro area countries, and must be gradually brought down to more reasonable levels.

Fourth, despite the boost in confidence achieved after the recapitalisation, the accumulation of non-performing loans gives rise to concern. This accumulation makes banks reluctant to extend new credit, as it signals a high level of credit risk. Moreover, the non-servicing of loans deprives banks of income that could otherwise be recycled into new loans. Accumulating non-performing loans force banks to tie up more capital for future loan-loss provisions.

The issue of problem loans to businesses and households must now be addressed in a systematic manner. Significant steps in this direction are already being taken by banks, as well as by the government.

The improvement in macroeconomic aggregates, if it continues, will bolster confidence in Greece and its banking system and will pave the way to a gradual normalisation of credit expansion in the medium term.

In the short term, however, the capacity for credit expansion will remain limited. This credit squeeze can be offset by companies turning to alternative sources of funds, such as internal capital generation, corporate bond markets, equity markets, private placements and other modern financing tools, as well as resources available from EU Structural Funds and the European Investment Bank.

8 POLICY TO SPEED UP RESTRUCTURING OF THE ECONOMY AND MOVE QUICKLY TO SUSTAINABLE GROWTH

The main objective of policy today is the strengthening of the productive capacity of the economy so that the emerging recovery can be the start of strong growth in the years ahead. The economy is in a process of transition from a growth model that has exhausted its limits to a new model, capable of ensuring robust, sustainable growth in the future. As the Bank of Greece has repeatedly stressed, this new growth model must be based on a shift:

- from production of non-tradables to production of tradables;

- from consumption to savings and investment.

Admittedly, while the old growth model was discredited suddenly and violently, the new model has yet to emerge clearly into sight. Transformation is, by its very nature, slow and painful, as it entails the elimination of obsolete activities, the emergence of new poles of attraction for capital, innovative investment, a reorientation of the banking system and cutting-edge entrepreneurship. As discussed in this year's Annual Report, the restructuring of the economy towards tradables production has already begun, but remains weak, against the backdrop of recession and heightened uncertainty. Restructuring can, however, be accelerated if economic policy assigns top priority to generating the necessary conditions conducive to growth.

Such a policy objective requires:

- Well-functioning markets for products, labour and capital. Until now, structural reforms in the product markets have lagged behind labour market reforms. Progress must therefore be stepped up in this particular area.

- A business environment in line with best international practices, with a low administrative burden for businesses and an efficient public sector. The institutional shortcomings in these areas and the benefits to be gained from the adoption of best practices have been pointed out in a number of reports from international organisations. It should, finally, be noted that the benefits from the smooth functioning of the products and services markets involve the reallocation of resources not only across, but also within sectors through mergers and acquisitions.

- A stable tax framework, with a steady commitment to reducing the tax burden on businesses and natural persons. Declining taxation would both increase the incentive to invest and make more funds available for investment. This presupposes a broadening of the tax base through an effective curbing of tax evasion.

- Accelerated implementation of the privatisation programme and strengthening of the legal framework for investor protection to attract foreign investment. A shift on the part of companies to market-based financing is crucial and urgently necessary, as the main challenge at present is how to maximise available financial resources to support the recovery.

- The productive use of programmes for the co-financing of loans and guarantees with resources from EU Structural Funds and the European Investment Bank (EIB).

- The active role of the banking system in the restructuring of other sectors of the economy, with specific actions to support truly viable businesses, whether new or old, and to encourage initiatives that promote a bold sectoral restructuring. By adopting such a stance, banks could effectively foster the transition to the new growth model that Greece so urgently needs.

9 THE CHALLENGES AND ROLE OF THE BANKING SECTOR TODAY

As the only sector to have been fully restructured and recapitalised, the banking system today is well-positioned to play an active role and spearhead the restructuring of the business sector. Of course, a transformation of such scope could not but have had its costs, especially for shareholders. Through this process, however, excess capacity has been largely eliminated, and the new banking system now stands on much more firmer ground, as demanded by the new growth model. It should be stressed that no other sector in Greece has undergone such or similar restructuring, although this was warranted by the unprecedented conditions generated by the economic crisis. What the banks have learned from experience can be equally valuable for businesses in other sectors and branches.

The banks are therefore called upon today to make an essential contribution to the transformation of production along the lines of the new sustainable growth model. Today, the limited liquidity available should be channelled into the real economy in a way that maximises its growth potential.

Bank strategy must be reoriented towards new patterns of lending and risk management. This would help avoid a recurrence of the trends of the previous decade, when credit was largely used for residential investment and consumption. This means that new credit must now go to dynamic outward-looking enterprises with favourable growth prospects. It goes without saying that in the context of such a reorientation from the banking system, it would be pointless, and even dangerous, to let weak, non-viable businesses and oversaturated sectors to continue operating as usual. Even if the scope for bank lending were theoretically large, providing liquidity to these enterprises would not help the economy grow healthily, nor would these enterprises survive in the long term.

In addition, the strengthening of businesses must be pursued through mergers and acquisitions, with support from the banks involved. At the same time, the businesses themselves must also take initiatives towards restructuring and reorganisation, and take advantage of synergies and networks that can help them cut costs and gain access to foreign markets.

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After five years of deep recession, the Greek economy is showing signs of recovery. We now face the challenge of turning the incipient signs of stabilisation into dynamic growth built on solid foundations. This, today, is the main item on the national agenda, the only way to ensure that the sacrifices of the past years will not have been in vain. The front-runners in this effort will be dynamic firms and sectors that shift their activities to new products and markets, generating a virtuous circle of growth. It is the duty of economic policy to facilitate this effort with all means available. The banking system can and must effectively support the restructuring of the economy towards a new growth model. The Bank of Greece, as the supervisor of the banking system, will strive to create the necessary conditions for this to happen.

III THE INTERNATIONAL AND THE EUROPEAN ECONOMIC ENVIRONMENT

1 DEVELOPMENTS AND PROSPECTS IN THE WORLD ECONOMY AND THE EURO AREA – POLICY RESPONSES

1.1 DEVELOPMENTS OVER THE PAST FOUR YEARS

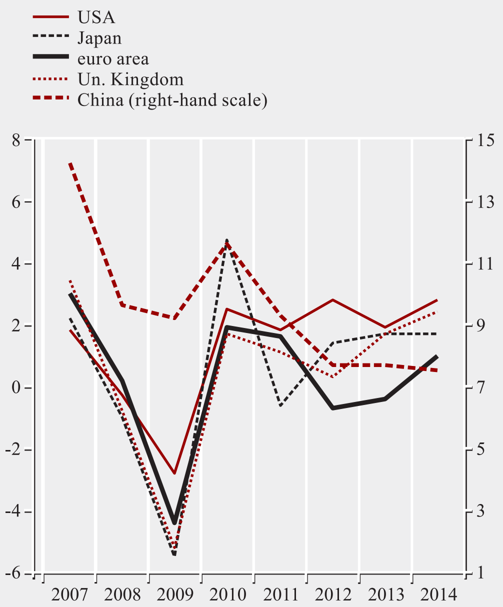
The global financial crisis that started in 2007-08 has brought to the fore the need to improve the regulatory framework and surveillance of the global financial system and has led to the provision of support to, and the restructuring of, the financial sector in many countries. At the EU level, important decisions were taken to enhance the institutional framework and financial sector supervision, so as to ensure financial stability in the euro area.

The financial and sovereign debt crises have been drivers of a major overhaul of economic governance in the EU, especially in the euro area, with the creation and activation of support mechanisms, the strengthening of economic and budgetary surveillance and policy coordination, and progress towards a "Genuine Economic Governance in the EMU", giving top priority to the creation of a banking union.

Improving economic governance is expected to enhance stability in the euro area, by enabling the early identification and correction of macroeconomic imbalances and the activation of effective crisis management mechanisms, where necessary. Noticeable progress has already been made in this direction, as fiscal and external deficits in the weaker Member States have been reined in considerably. However, it is too early to declare the crisis over; yet efforts to reinforce the EMU architecture and promote economic adjustment in individual countries are new being pursued on a more solid basis.

Chart III.1 World economy: real GDP

(annual percentage change)



Source: IMF, *World Economic Outlook Update*, January 2014.
Note: Estimates for 2013; forecasts for 2014.

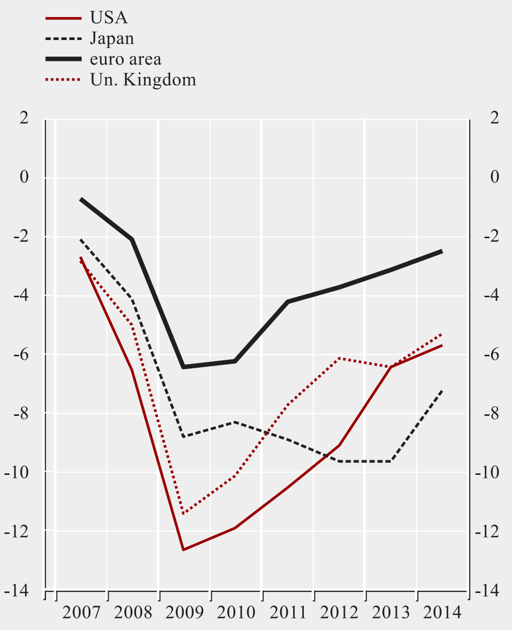
The sovereign debt crisis in the euro area and the creation and activation of support mechanisms

The financial crisis, which first broke out in the United States in 2007 and rapidly escalated in the autumn of 2008 after the collapse of Lehman Brothers, soon grew into a global economic crisis, causing the worst recession since the 1930s and considerable deterioration of public finances in most advanced economies (see Charts III.1 and III.2).

In 2010, the global financial crisis turned into a sovereign debt crisis in the euro area, threatening the stability of the economic and monetary union. Greece, the weakest economy in the euro area, with large deficits (fiscal and current account), high public debt and considerable structural problems, found itself in the eye of the storm. In view of the worsening crisis, the euro area Heads of State announced in March 2010 that they stood ready to provide financial support to Greece, if necessary.

In early May 2010, it was decided to support the Greek economy through bilateral loans provided by euro area Member States and the IMF, totalling €110 billion, following a request from the Greek government and the drafting of an economic adjustment programme.

Chart III.2 Advanced economies: fiscal balance as a percentage of GDP



Source: European Commission, *European Economic Forecasts*, November 2013.
Note: Estimates for 2013; forecasts for 2014.

At the same time, in May 2010, in order to safeguard stability in the euro area and address similar crises in the future, it was decided to establish a provisional backstop, the **European Financial Stability Facility** (EFSF), with a lending capacity of €440 billion (plus another €60 billion in funds guaranteed by the EU budget). A few months later, in October 2010, the European leaders decided to create a permanent crisis management mechanism, the **European Stability Mechanism** (ESM), which came into force in September 2012, thereby reaffirming their commitment to take all necessary measures to safeguard the stability of the financial sector and the euro area in general (see Box III.2).

Ireland (December 2010), **Portugal** (2011) and **Cyprus** (2013) applied for and received financial assistance from the European mechanisms and the IMF in the context of the implementation of economic programmes, while **Spain** received economic assistance only from the EU (in 2012) for the purpose of restructuring its banking system. As for **Greece**, the Euro Summit of 26 October 2011 approved a new financial support package of €109 billion, as well as a haircut of Greece's sovereign debt with the involvement of the private sector (PSI).

Enhanced economic and budgetary surveillance and policy coordination

The macroeconomic impact of the financial crisis highlighted the interconnectedness of the EU economies, especially the euro area countries, and the need for better coordination of economic and fiscal policies. Thus, for the first time, the issue of "European economic governance" was raised, with a view to formulating a common economic agenda and a robust framework for all Member States, especially as regards fiscal discipline and the focus of economic policy on improving competitiveness.

In May 2010, the European Commission recommended a strategy for enhancing economic governance, by introducing the **"European semester"**, which aims to synchronise fiscal and structural policies in the Member States and to ensure their compliance with the Stability and Growth Pact. The proposals in large part involved enhancing macroeconomic surveillance, through the establishment of procedures to identify and allow the timely correction of emerging macroeconomic imbalances. This strategy was reflected in September 2010 in a package of six legislative proposals, known as the **"six-pack"**. The new institutional framework incorporating these proposals was adopted by the Council and the European Parliament and came into force on 13 December 2011. According to the new framework:

1. Fiscal discipline and sanctions in the event of non-compliance take into consideration both the fiscal deficit and public debt.

2. Decision-making has been simplified with the introduction of reversed qualified majority voting (a recommendation by the European Commission is considered adopted

unless a qualified majority of Member States rejects it).

3. A scoreboard of indicators has been designed to facilitate the quantitative monitoring of macroeconomic imbalances and the launch of a new "Excessive Imbalance Procedure" where necessary.

2012 was a turning point for the EU and the euro area – the environment is gradually improving

2012 marked a turning point in the approach to the crisis, as institutional initiatives to improve economic governance intensified and uncertainty surrounding the outlook and future of the Economic and Monetary Union receded. The concerns about a possible breakup of the euro area, which had culminated in the first half of the year, gradually abated, as efforts towards a genuine integration of the EMU intensified.

In March 2012, the Heads of State or Government of all EU Member States (except for the Czech Republic and the United Kingdom) signed the **"Treaty on Stability, Coordination and Governance in the Economic and Monetary Union"**, also known as the Fiscal Compact from its fiscal provisions. This treaty, which came into force in January 2013, requires the contracting parties to introduce into their national legislation a fiscal rule guaranteeing that their budgetary position is balanced or in surplus, as well as a correction mechanism, to be triggered automatically in the event of significant observed deviations from the medium-term objective or the adjustment path towards it.

Market confidence in the euro area was further strengthened by a series of other events in the course of 2012, including the new Greek government's commitment to the implementation of the economic adjustment programme (June), Ireland's partial return to the global capital markets (July), and the new agreement of the Eurogroup on the sustainability of Greek debt (November).

A catalyst in restoring confidence and staving off the threat of a euro area breakup was to be the ECB announcement, on 6 September 2012, of a new programme of unlimited buying of distressed government bonds (**Outright Monetary Transactions**), subject to strict and effective conditionality attached to an appropriate economic programme.[1]

The crisis has shown that difficulties in one euro area Member State can have contagion effects on other countries. Therefore, enhanced economic and fiscal surveillance is warranted to contain problems before they become systemic. This was the purpose of the **"two-pack"**, which came into force on 30 May 2013 and introduced a new cycle of monitoring for the euro area, with Member States submitting draft budgetary plans for the forthcoming year.[2] The Commission then issues an opinion on these plans and may request a revised plan, in the event of a significant deviation from the obligations of a Member State. Member States experiencing financial difficulties or under an economic adjustment programme shall be put under "enhanced surveillance". Finally, Member States will undergo "post-programme surveillance" as long as 75% of any financial assistance drawn down remains outstanding.

Roadmap towards a genuine EMU – priority to completing the Banking Union

In December 2012, the European Council adopted the report "Towards a Genuine Economic and Monetary Union", launching a roadmap for its long-term strategic course. This report, together with the European Commission's "Blueprint for a Deep and Genuine Economic and Monetary Union", outlines the necessary steps to be taken towards establishing a strong and stable architecture in the financial, fiscal, economic and political

1 Ahead of this announcement, ECB President M. Draghi, speaking at a conference in London (July 2012), had stated that "the ECB is ready to do whatever it takes to preserve the euro". The news was favourably received by the international media and the markets.
2 An exception was made for Member States under economic adjustment programmes so as to avoid an overlap in reporting requirements.

domains, in order to secure the stability of the euro and the EU as a whole. The European Council is also promoting initiatives to strengthen the **social dimension of the EMU**. To this effect, the European Commission in October 2013 issued a proposal aimed at reinforcing surveillance of employment and social challenges and strengthening policy coordination.

In addition to the priority given to completing and implementing the framework for stronger economic governance, the European Council stressed that it was equally urgent to achieve progress towards a more integrated financial framework and break the vicious circle between banks and sovereigns. Direct recapitalisation of banks by the European Stability Mechanism, upon establishment and operation of the single supervisory mechanism (see below), will help in achieving these goals. In June 2013, the European Council stressed that the completion of the banking union was key to ensuring financial stability, reducing financial fragmentation and restoring normal lending to the economy.

Crucial steps in this direction were the approval of the **Single Supervisory Mechanism**, which will be fully operational in November 2014, as well as the general approach on which the EU Council recently agreed regarding the **Single Resolution Mechanism**. The two mechanisms will mark a major step towards the completion of banking union. According to the ECB,[3] "we should not create a Single Resolution Mechanism that is single in name only", but a mechanism where decision-making does not become overly complex and financing arrangements are adequate.

1.2 DEVELOPMENTS IN 2013 AND THE OUTLOOK FOR 2014[4]

Global economic growth is expected to accelerate in 2014 to 3.5% from 3.0% in 2013, together with a pick-up in world trade growth (at a rate which, we estimate, will be lower than the recent IMF projections, following the recent turmoil in the capital and foreign exchange markets of many emerging economies). The euro area is expected to make a positive contribution to the recovery of the world economy, with a growth rate close to 1% in 2014, against a negative rate of -0.4% in 2013. Underlying this positive development are the gradual restoration of confidence, progress in the area of institutional reforms and the improvement in economic indicators, such as the PMI in manufacturing across almost all euro area countries, including Greece.

World economic activity remained subdued and the growth rate of world GDP was almost unchanged in 2013 (at 3.0%, from 3.1% in 2012), although economic sentiment improved considerably in the last quarter of the year. These moderate growth rates are attributable to weak domestic demand in many economies, as a result of the unwinding of fiscal stimulus in advanced economies and restrictive monetary policy in emerging economies. The major economies had differing performance, with each facing a different mix of challenges (see Table III.1).

The rate of increase in the **volume of world trade** in goods and services, after remaining low and unchanged in 2012 and 2013 (up by 2.7%), mainly due to subdued global demand and difficulties in financing export companies in advanced economies, is expected to accelerate to 4.5% in 2014, although remaining below its long-term average (5.6% in 1980-2012).

GDP growth in the **advanced economies** edged down further (to 1.3%, from 1.4% in 2012), primarily as a result of lower public consumption and fixed capital formation. The more intensified, compared to previous years, implementation of fiscal adjustment programmes (in all advanced economies except Japan) and the required deleveraging

3 See M. Draghi, "Hearing at the Committee on Economic and Monetary Affairs of the European Parliament", 16.12.2013.
4 Main sources of data: International Monetary Fund, *World Economic Outlook*, October 2013 and *WEO Update*, 21 January 2014; European Commission, *European Economic Forecast: Autumn*, November 2013; OECD, *Economic Outlook*, November 2013.

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 percent-age changes)			Fiscal balance (% of GDP)			Gross public debt (% of GDP)			Current account balance (% of GDP)		
			2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
World total	**189**	**100.0**	**3.1**	**3.0**	**3.7**				**-4.3**	**-3.7**	**-3.0**	**80.8**	**79.7**	**79.6**			
1. Advanced economies	*35*	*50.4*	*1.4*	*1.3*	*2.2*	*2.0*	*1.4*	*1.7*	*-5.9*	*-4.5*	*-3.6*	*108.7*	*108.5*	*109.2*	*-0.1*	*0.1*	*0.2*
United States		19.5	2.8	1.9	2.8	2.1	1.2	1.6	-9.3	-6.5	-5.8	102.1	104.1	106.3	-2.7	-2.5	-2.9
Japan		5.5	1.4	1.7	1.7	0.0	0.2	2.3	-9.5	-10.0	-8.5	218.8	227.2	231.9	1.0	0.9	1.2
United Kingdom		2.8	0.3	1.7	2.4	2.8	2.6	2.3	-6.1	-6.4	-5.3	88.7	94.3	96.9	-3.6	-4.1	-4.2
Euro area	18	13.5	-0.7	-0.4	1.0	2.5	1.4	1.2	-3.7	-3.1	-2.5	92.6	95.5	95.9	1.9	2.9	3.0
2. Emerging and developing economies	*154*	*49.6*	*4.9*	*4.7*	*5.1*	*6.1*	*6.2*	*6.2*	*-2.1*	*-2.7*	*-2.5*	*36.5*	*35.3*	*34.1*	*1.4*	*0.8*	*0.8*
China		14.7	7.7	7.7	7.5	2.7	2.5	2.4	-2.2	-2.5	-2.1	26.1	22.9	20.9	2.3	2.5	2.7
Russia		3.0	3.4	1.5	2.0	5.1	6.7	5.7	0.4	-0.7	-0.3	12.5	14.1	14.6	3.7	2.9	2.3

Sources: IMF, *World Economic Outlook*, October 2013, *WEO Update*, January 2014, and *Fiscal Monitor*, October 2013. European Commission, *European Economic Forecast, Autumn 2013*, November 2013. OECD, *Economic Outlook*, No 94, November 2013.
Note: Estimates for 2013 and forecasts for 2014.
1 Percentage share in world GDP in 2012, 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.

of financial institutions and over-indebted private sector, despite undercutting recovery in 2013, helped to gradually restore confidence —severely hit in 2012, especially in the euro area— and ultimately helped improve the outlook for a more balanced and sustainable growth over the medium term.

The slowdown in advanced economies as a whole masks quite different developments across countries. In the **United States**, GDP growth slowed (to 1.9%, from 2.8% in 2012) under the weight of fiscal retrenchment, despite a continued strongly expansionary monetary policy and stock market ebullience. GDP growth in **Japan** accelerated (to 1.7%, from 1.4%), supported by the implementation of exceptionally expansionary fiscal and monetary policies and an improvement of the external balance. In the **United Kingdom**, GDP rebounded faster, by 1.7% in 2013, from 0.3% in 2012, while the rate of unemployment has already been trending downward since 2012.

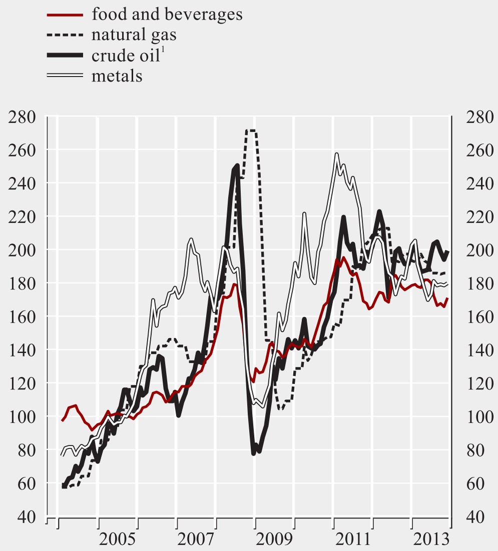
The **euro area** economy, after six consecutive quarters of declining real GDP, emerged from the recession in the second quarter of 2013 and kept growing in the second half of the year, while economic activity showed signs of stabilising in the economies facing the most difficulties. However, at average annual levels, the euro area once again registered a decline in GDP, albeit lower than in 2012 (-0.4%, against -0.7%).

The initiatives taken by the EU institutions to address the debt crisis and macroeconomic imbalances in the euro area, as well as the accommodative monetary policy pursued by the ECB, contributed to reducing high uncertainty and to averting tail risks, such as the risk of a euro area breakup, tangible in spring 2012.[5] However, tight credit and high unemployment in many Member States continued

5 See Editorial, European Commission, *European Economic Forecast: Autumn*, November 2013.

Chart III.3 Commodity price index (January 2004-December 2013)

(market prices;[1] monthly averages; 2005=100)



Source: IMF.
1 The latest observation refers to December 2013.
2 Average international price of UK Brent, WTI and Dubai.

to constrain the recovery of the European economy.

Developments differ considerably across the euro area economies, although the differences in terms of economic performance have narrowed. Eight euro area countries were in recession in 2013, down from ten the previous year. Certain euro area core countries, such as Germany, France and Austria, continued to post positive, yet very low, growth rates, while others, such as the Netherlands and Finland, remained in recession. Amongst the countries facing serious macroeconomic imbalances during the crisis, Greece, Portugal, Spain and Italy were still in recession (albeit of lesser intensity in 2013), while Ireland, which completed its adjustment programme in November, continues to post low, yet positive growth rates. Recession, tight credit and deleveraging of the private sector led to a further increase in the **rate of unemployment in the euro area**, with the jobless rate climbing to very high levels in those countries with the gravest internal and external imbalances.

Inflation in advanced economies dropped further in 2013 (to 1.4%, from 2.0% in 2012), as a result of the high and rising year-on-year production gap (3.2% of potential GDP in 2013, against 3.0% in 2012), the slower increase in unit labour costs and the small decline in international crude oil and other commodity prices (see Chart III.3). In 2014, inflation in advanced economies is expected to rise slightly to 1.7%, despite an anticipated small decline in international commodity prices (crude oil: by 0.3%, other commodities: by 6.1%), mainly due to the narrowing of the production gap and to the acceleration of unit labour costs in non-euro area advanced economies. Inflation in the euro area is expected to stand at 1.1% in 2014 (against 1.4% in 2013) according to Eurosystem staff projections. Low inflation will allow for the continuation of a **strongly expansionary monetary policy** in advanced economies, in order to facilitate economic recovery and improve the financial situation of the private and the public sector.

The **rate of unemployment** is estimated to have continued to drop in 2013 for the fourth consecutive year in the United States (to 7.5%) and for the third consecutive year in Japan (to 4.0%), mainly as a result of their respective strongly expansionary monetary and fiscal policies. In contrast, the rate of unemployment in the euro area rose further to 12.2%, i.e. 5.6 percentage points above the historic low of 2007 and 2008 (7.6%). For 2014, the rate of unemployment is expected to stabilise in the euro area at 12.1% and to start decreasing from 2015 onwards, while a further decrease is expected in the United States (to 6.9%) and Japan (to 3.9%).

In **emerging and developing economies**, GDP growth slowed further to 4.7% in 2013, from 4.9% in 2012, mainly on account of a stabilisation or decrease in international prices for commodities which they export, more restrictive monetary policy and a lower rate of credit expansion. The fact that GDP growth in certain emerging economies is expected to stabilise at rates lower than in the past,[6] together with the change in monetary policy and higher long-term interest rates in the United States, has, since mid-2013 and especially at the start of 2014, caused an outflow of funds, a decrease in exchange rates and an increase in key interest rates in many emerging economies.

In **2014**, world GDP growth is expected to accelerate to 3.5% (from 3.0% in 2013), i.e. less than in recent IMF projections, as external demand and world trade will be affected by the recent turmoil in foreign exchange rates in many emerging economies, and this impact may well prove to be more severe for all economic areas. The new risks to growth, both cyclical and structural, that have become apparent in emerging economies have already, since 2013, led to a small rebalancing of the composition of world GDP growth in favour of advanced economies. GDP growth in 2014 is expected to pick up to 2.0% in advanced economies and 4.9% in emerging and developing economies. The most significant **risks** to this outlook include a possible emergence of asset bubbles due to ultra-low key interest rates over a protracted period in advanced economies, or a possible "liquidity trap" in advanced economies. The consequences of the private and public sector debt overhang and, in the case of the euro area, the fragmentation of financial markets may continue to disrupt the monetary policy transmission mechanism. The IMF, in a recent update of its projections for the world economy, takes note of the risks posed by very low inflation in advanced economies, especially the euro area.

The anticipated recovery of the **euro area**, with GDP growth at 1.0%, will contribute significantly to a recovery of world trade. The announcement of the exit of **Spain** and **Ireland** from the adjustment programmes and the prospect of a primary surplus in **Greece** in 2013 and 2014, together with the continuous improvement in government bond yields in all three countries plus Portugal, have undoubtedly contributed to lowering uncertainty and to improving the economic sentiment and outlook in the euro area.

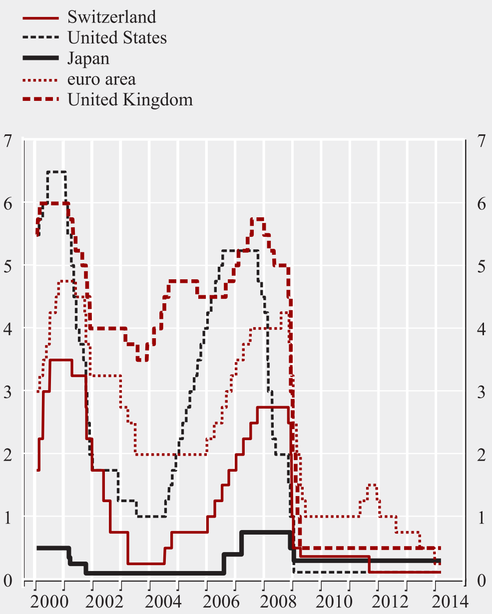
In the **United States**, despite the anticipated further fiscal adjustment and less expansionary monetary policy, GDP is expected to accelerate to 2.8% in 2014 and the rate of unemployment to decrease further, mainly due to a recovery of domestic demand in an environment of low inflation. In **Japan**, the rate of GDP growth is expected to remain stable, as the positive effect of the expansionary fiscal and monetary policy decided in December 2012 is likely to be offset by the effect of the planned increase in consumption tax from 5% to 8% in the second quarter of 2014. **China** is showing signs of a more structural deceleration of GDP growth, which is expected to slow to 7.5% in 2014, a development with far-reaching consequences for world trade, international commodity prices and Greek shipping.

Fiscal policy in advanced economies remained restrictive. With the exception of Japan, structural deficits were reduced for the third consecutive year in 2013 in an aim to eliminate the risks posed in many advanced economies by the exceptionally high and rising public debt (as a percentage of GDP). In almost all euro area economies, efforts to contain fiscal deficits continued unabated, in order to eliminate risks stemming from public finances and break the vicious circle between public finances, the real economy and the financial sector. The primary fiscal deficit in the euro area as a whole is estimated to have been nearly eliminated in 2013 (0.1% of GDP, down from 0.6% in 2012), and is expected to turn into a 0.5% surplus in 2014. Total general government deficit (including interest payments) is estimated to have fallen to 3.1% of GDP in 2013, from 3.7% in 2012, and is expected to decrease further to 2.5% in 2014. Gross public debt rose by almost 3 percentage points to 95.5% of GDP in 2013 and is expected to start decelerating from 2015 onwards.

6 See Box 1.2 "What Explains the Slowdown in the BRICS?", IMF, *World Economic Outlook*, October 2013.

Chart III.4 Central bank policy rates (January 2000 - 1 February 2014)

(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.

In the United States, although the fiscal cliff in early 2013 was finally avoided, the general government deficit was drastically cut, to 6.5% of GDP in 2013, from 9.5% in 2012, and fiscal adjustment is expected to continue at a milder pace in 2014 for the fifth consecutive year. In Japan, the decision to pursue an expansionary fiscal policy pushed up the already very high general government deficit, estimated at 10.0% of GDP in 2013 and 8.5% in 2014.

Monetary policy, with standard or non-standard measures, remains highly accommodative in advanced economies, geared towards decisively supporting recovery efforts from the great recession (see Chart III.4), but is becoming more restrictive in several emerging economies as a way to address overheating or capital outflows. In the euro area, where inflation is considerably lower than the medium-term target, the ECB continued its longer-term refinancing operations and further cut its key interest rate in two occasions, on 8 May and 13 November 2013, eventually bringing it to 0.25%. In the United States, the stronger than expected recovery and the ongoing downward trend in the rate of unemployment led the Federal Open Market Committee to announce that it would taper its monthly asset purchases in the context of QE3 by US$20 billion (by two consecutive decisions effective from January and February 2014) to US$65 billion. In Japan, the new target of the Bank of Japan to achieve an inflation rate of 2% by doubling its monetary basis is estimated to have contributed to an improvement in economic sentiment and trade balance by weakening the exchange rate of the yen from August 2012 onward.

Box III.1

THE EU'S MULTIANNUAL FINANCIAL FRAMEWORK FOR 2014-2020 AND FUNDING ALLOCATION TO GREECE

The 2014-2020 Multiannual Financial Framework (MFF)

On 2 December 2013, after two and a half years of intense negotiations, the EU's Multiannual Financial Framework (MFF) for 2014-2020 was finalised with its adoption by the Council. The MFF 2014-2020 sets the overall ceilings for commitment appropriations at €960 billion, i.e. 1.00% of the EU's gross national income (GNI), and for payment appropriations at €908.4 billion (0.95% of the EU's GNI).[1] The MFF also lays down the expenditure ceilings for the individual sub-headings of the European Structural and Investment

1 "Commitment appropriations" are legally binding promises to spend money which may be disbursed over several financial years. "Payment appropriations" are the actual amounts authorised for disbursement in a given year. All amounts are expressed in 2011 prices.

Funds,[2] internal affairs (border protection, immigration, consumer protection, etc.), the EU's external action and the administration of European institutions. The MFF is funded from the EU's own resources derived from customs duties on imports from outside the EU and from VAT, as well as from the Member States' contributions to the EU based on a standard percentage of each Member State's GNI.

The expenditure ceilings for the European Structural and Investment Funds reflect the priorities of the "Europe 2020" strategy for smart, sustainable and inclusive growth and support the strategy's eleven thematic objectives, as well as the European aim of achieving greater economic and social cohesion.[3]

Compared with the MFF for 2007-2013, total allocations in the new MFF have been reduced by €35 billion and now represent 1% of the EU GNI, down from 1.25% in the previous MFF.[4] More specifically, the total allocations for smart, sustainable and inclusive growth (MFF categories of expenditure 1 and 2, i.e. the categories associated with the European Structural and Investment Funds) have been reduced to €824 billion, from €867 billion in the MFF 2007-2013. The greater focus of the new MFF on "Europe 2020" strategy policies is evident from the increase in competitiveness and job creation expenditures from €91.5 billion (9% of overall expenditure ceilings) to €125.6 billion (13% of the overall ceilings).[5]

The European Structural and Investment Funds for 2014-2020

As regards the European Structural and Investment Funds in particular, the MFF 2014-2020 allocates: €288.8 billion in total to the European Regional Development Fund and the European Social Fund, €74.9 billion to the Cohesion Fund, €95.6 billion to the European Agricultural Fund for Rural Development (Pillar II of the Common Agricultural Policy – CAP), and €7.4 billion to the European Maritime and Fisheries Fund. €3 billion are allocated to the newly created Youth Employment Initiative (the total budget of which is €6 billion; the remaining €3 billion are to come from the European Social Fund), and €74.9 billion to agricultural subsidies under Pillar I of the CAP.[6]

In addition, the MFF 2014-2020 introduces innovative structural features aimed at maximising the performance of investments made through European funds. These include the elaboration, for the first time, of a common strategic framework governing all the European Structural and Investment Funds for the purpose of coordinating policies, maximising synergies and minimising overlaps. The new MFF also sets clearly measurable short- and long-term targets, and establishes a performance reserve amounting to 6% of the national allocation,

2 The European Structural and Investment Funds include: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).

3 The eleven thematic objectives of the "Europe 2020" strategy are: 1. Strengthening research, technological development and innovation, 2. Enhancing access to, and use and quality of, information and communication technologies, 3. Enhancing the competitiveness of small- and medium-sized enterprises, the agricultural sector (for the EAFRD) and the fisheries and the aquaculture sector (for the EMFF), 4. Supporting the shift towards a low-carbon economy in all sectors, 5. Promoting climate change adaptation, risk prevention and management, 6. Protecting the environment and promoting resource efficiency, 7. Promoting sustainable transport and removing bottlenecks in key network infrastructures, 8. Promoting employment and supporting labour mobility, 9. Promoting social inclusion and combatting poverty, 10. Investing in education, skills and lifelong learning, and 11. Enhancing institutional capacity and ensuring an efficient public administration.

4 In commitment appropriation terms and in 2011 prices.

5 European Commission Press Release on the EU's budget framework 2014-2020, 19.11.2013.

6 Expressed in current prices.

Allocation of European Structural and Investment Funds to Greece

(billion euro)

	NSRF 2007-2013	NSRF 2014-2020
European Regional Development Fund (ERDF)	12.2	8.3
European Social Fund (ESF)	4.3	3.8
Cohesion Fund	3.7	3.3
European Agricultural Fund for Rural Development (EAFRD)	3.7	4.2
European Maritime and Fisheries Fund (EMFF)	0.3	0.3
Infrastructure Fund		0.6
Territorial cooperation	0.2	0.2
Youth Employment Initiative		0.2
Total funds	**24.3**	**20.8**
Public Expenditure Estimate*		23.1

Source: Ministry of Development and Competitiveness.
* Including the national co-financing obligation.

to be released to the best performing programmes that have met pre-defined targets. Disbursement of funds will now be subject to "ex-ante conditionality", so as to ensure that the major thematic priorities are implemented in the most effective manner. Meanwhile, the allocation of structural and investment funds is more closely linked with good economic governance.[7] Specifically, the European Commission may request amendments to national operational programmes funded by the MFF in order to address macroeconomic imbalances or when a Member State is subject to an economic adjustment programme. The Commission may also propose the suspension of part or all of the commitments or payments when a Member State fails to take the necessary corrective action within the excessive deficit procedure or the macroeconomic imbalances procedure, or when it has insufficiently implemented the economic adjustment programme. Finally, the common set of rules applying to all European Structural Funds and increasing digitisation will simplify procedures and reduce the red tape on EU funding.

Resources allocated to Greece from the European Structural and Investment Funds

Under the MFF 2014-2020, Greece will be allocated up to €20.8 billion from the European Structural and Investment Funds, compared with €24.3 billion in the previous programming period 2007-2013 (see Table).[8] This amount is likely to be increased by some €2 billion in 2016 when allocations are revised on the basis of updated national GDP data.

7 Regulation (EU) No. 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No. 1083/2006.

8 This amount includes resources from the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the Connecting Europe Facility, the Territorial Cooperation Programmes, the Youth Employment Initiative, the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF). See the presentation entitled "The Partnership Agreement 2014-2020 – Priorities and Architecture", Ministry of Development and Competitiveness, 9.12.2013.

The resources allocated to Greece from the European Structural and Investment Funds will be utilised according to a Partnership Agreement submitted to the European Commission for approval (expected by late February 2014). The Greek Partnership Agreement for 2014-2020 incorporates the eleven thematic objectives linked to the "Europe 2020" strategy, as well as national priorities for economic growth and mitigating the effects of the crisis. It contains four national operational programmes: a) "Competitiveness and Entrepreneurship", with a budget of €3.8 billion (25% of the total structural and investment funds allocated to Greece). This programme focuses on sectors of the economy with comparative advantages and growth-boosting potential.[9] It also supports innovation with relevant expenditure increased to 8% of the total funds, from 4% in the previous period, and outward-oriented businesses, b) "Modernisation of the Public Sector", with a budget of €0.4 billion (3% of the total structural and investment funds allocated to Greece), aimed at streamlining public administration, c) "Environmental projects and transport", with a budget of €3.7 billion (roughly 24% of the total allocated to Greece) to cover new infrastructure projects as well as others still ongoing from the NSRF 2007-2013, such as the trans-European road and rail network, d) "Education, Training, Employment", with a budget of €2 billion (13% of the total allocated to Greece) aimed at enhancing social cohesion, employment and training, and ensuring the qualitative upgrading of the education system.

Apart from the four national operational programmes, 13 regional operational programmes are also envisaged, of a total budget of €5.4 billion (35% of the total structural and investment funds allocated to Greece).[10]

Moreover, the Partnership Agreement for 2014-2020 is expected to be executed through a more efficient fund management system thanks to a rationalisation of procedures.[11]

The resources to be made available from the European Structural and Investment Funds can make a significant contribution to economic recovery in Greece and help boost employment, especially at a time when new bank lending is sparse. The effective absorption of Community resources will help to address the social repercussions of the crisis, as well as to carry out the structural reforms outlined in the Memorandum.[12] Furthermore, the orientation of the funds in the new planning period towards outward-looking sectors with a comparative advantage will strengthen the shift of available resources towards branches that produce globally competitive products and services, thereby facilitating the transition to the much-needed new and sound model of sustainable growth. Together with the activation of private investment, the Structural Funds can yield considerable long-term benefits in regard to the economy's productivity and competitiveness.[13]

9 The priority sectors, selected on the basis of a study by McKinsey & Company ("Greece 10 years ahead"), include: tourism, agriculture and food processing, logistics, the environmental industry, the health sector, energy production and savings, information and communication technologies, and creative industries (e.g. Greek design).

10 The allocations from the European Structural and Investment Funds do not include the agricultural subsidies under CAP Pillar I, from which Greece is expected to receive around €2 billion per year starting from 2015, see Regulation (EU) No 1307/2013, 17.12.2013, of the European Parliament and the Council, Official Journal L 347/608, 20.12.2013. In 2014, the previous framework will continue to apply for direct payments, see Regulation (EC) No 73/2009 of the Council, 19.1.2009, Official Journal L 30/16, 31.1.2009.

11 Presentation of proposals for Greece's Partnership Agreement 2014-2020 by Development Minister, 9.12.2013.

12 See also Bank of Greece, *Annual Report 2012*, February 2013.

13 For the effects on the Greek economy of inflows from the EU, see the study commissioned by the Bank of Greece to the Hellenic Foundation for European and Foreign Policy (ELIAMEP), entitled "Assessment of the impact of policies funded by the EU budget on the course of the Greek economy" [in Greek], December 2013 (in press).

Box III.2

KEY DECISIONS AND MECHANISMS FOR ADDRESSING THE CRISIS AND PAVING THE WAY TO A GENUINE ECONOMIC AND MONETARY UNION

In response to the global economic crisis and the sovereign debt crisis, the EU institutions set up and activated support mechanisms for the euro area economies facing severe financing difficulties, and adopted a series of decisions to strengthen budgetary and economic surveillance and policy coordination in the EU, and the euro area in particular. More recently, priority has been given to the establishment of a Banking Union as a first crucial step towards a genuine EMU, in line with the European Council's decisions. The main reforms launched so far are the following:

1. SUPPORT MECHANISMS FOR EURO AREA MEMBER STATES[1]

European Financial Stability Facility (EFSF)

The EFSF was incorporated in Luxembourg as a public limited liability company (société anonyme) on 7 June 2010[2] with the euro area Member States as shareholders. Its loans are financed through the issuance of debt securities in financial markets, guaranteed by the euro area Member States, for the purpose of providing financial assistance to those Member States that are subject to an economic adjustment programme. The EFSF has an effective lending capacity of €440 billion. So far, a total €176.1 billion has been disbursed through the EFSF to Ireland, Portugal and Greece.[3] As of 1 July 2013, the EFSF may no longer engage in new financing programmes, but will remain active in financing the ongoing programmes.

European Stability Mechanism (ESM)

The ESM is a permanent intergovernmental organisation[4] established to safeguard financial stability in the euro area as a whole. As from October 2012, when it entered into force, the ESM became the main instrument for the provision of financial support to euro area countries. It is financed through the issuance of debt securities in financial markets and, unlike the EFSF, which relies on guarantees, has a total subscribed capital of €700 billion contributed by the euro area countries and a maximum lending capacity of €500 billion. The ESM grants loans to euro area countries experiencing financial constraints, intervenes in primary and secondary government bond markets, acts as a prevention mechanism and provides lending to national authorities for the purpose of the recapitalisation of financial institutions. So far the ESM has engaged in a financial assistance programme to Cyprus totalling €9 billion (of which €4.6 billion has been disbursed) and a programme totalling €41.3 billion for the funding of Spain's bank recapitalisation programme.[5]

1 Apart from the mechanisms created to address the crisis, the Treaty on European Union (Article 122(2)) already envisaged the possibility of granting EU financial assistance to a euro area Member State experiencing, or threatened with, exceptional occurrences beyond its control. This possibility became more practicable in 2010 with the establishment of the European Financial Stabilisation Mechanism (EFSM, Council Regulation (EU) No 407/2010 of 11 May 2010, Official Journal of the European Union, L 118, 12.5.2010). The EFSM, which has a much more limited lending capacity than the EFSF and the ESM, was first activated for the provision of financial support to Ireland and Portugal in the form of supplementary financing in the context of the economic adjustment programmes of the two countries.

2 See the EFSF Framework Agreement between the euro area Member States at http://www.efsf.europa.eu/attachments/20111019_efsf_framework_agreement_en.pdf. Articles of incorporation of the public limited liability company, Service Central de Législation Luxembourg C-No 1189, 8 June 2010.

3 According to the programmes already signed with the EFSM, €1.2 billion remain to be disbursed to Portugal, and €10.1 billion to Greece. Ireland officially exited its financial assistance programme on 8 December 2013.

4 The intergovernmental agreement on the establishment of the ESM and the Treaty on Stability, Coordination and Economic Governance in EMU were ratified by the Greek Parliament by Law 4063, Government Gazette A 71/30.3.2012.

5 The ESM financial assistance programme for Spain expired on 31 December 2013.

2. STRENGTHENING THE SURVEILLANCE AND COORDINATION OF BUDGETARY AND ECONOMIC POLICIES

European Semester

The European Semester is a yearly cycle of coordination for the assessment of budgetary and economic policies, with a view to ensuring consistency between the interconnected objectives of fiscal discipline and growth.

The six-pack – strengthening the Stability and Growth Pact

The "six-pack" (five Regulations and one Directive), adopted in 2011, reinforces the Stability and Growth Pact (SGP) and ensures stricter application of the fiscal rules (general government deficit below 3% of GDP and public debt below 60% of GDP). Furthermore, an Excessive Deficit Procedure may be launched on the basis of a high debt ratio that does not diminish at a satisfactory pace, while an Excessive Imbalance Procedure may be initiated in the event of excessive macroeconomic imbalances. The six-pack also introduces the imposition of financial sanctions in a gradual way, in the event of non-compliance with SGP rules.[6]

Euro Plus Pact

The Euro Plus Pact was signed in March 2011 by the euro area Member States and Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania.[7] The pact commits signatories to implement concrete reforms that build on the reforms agreed under the Europe 2020 strategy,[8] with an emphasis on the following sectors: competiveness, employment, sustainability of public finances and reinforced financial stability.

Treaty on Stability, Coordination and Governance in EMU ("Fiscal Compact")

The Treaty (TSCG) was signed on 2 March 2012 by all euro area countries and eight other EU Member-States[9] and entered into force on 1 January 2013.[10] The TSCG requires contracting parties to adopt fiscal rules which limit the annual structural deficit to 0.5% of GDP and to introduce national correction mechanisms to be triggered automatically in the event of significant deviations.

The two-pack

The "two-pack" consists of two Regulations[11] aimed at enhancing fiscal monitoring and surveillance applicable to all euro area Member States, by further strengthening the SGP after the reform introduced with the six-pack. The Regulations provide for a coordinated assessment of draft budgetary plans in the euro area within the context of the European Semester prior to their adoption by Member States. Member States experiencing or threatened with severe difficulties are subject to enhanced

6 The legislative acts that make up the six-pack are: (a) Council regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure; (b) Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances; (c) Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies; (d) Regulation (EU) No. 1174/2011 of the European Parliament and of the Council of 16 November 2011 on establishing enforcement measures to correct excessive macroeconomic imbalances in the euro area; (e) Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area; and (f) Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, OJ of the EU, L 306, 23.11.2011.

7 Conclusions of the Heads of State or Government of the euro area of 11 March 2011.

8 Europe 2020, the EU's strategy for smart, sustainable and inclusive growth, see http://ec.europa.eu/europe2020/index_en.htm.

9 Bulgaria, Denmark, Hungary, Latvia, Lithuania, Poland, Romania and Sweden.

10 See footnote 4.

11 Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, and Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, OJ L 140, 27.05.2013.

surveillance, which involves the early provision of requested data and quarterly reporting, as well as the application of appropriate measures to address such difficulties in a timely manner.

3. TOWARDS A "GENUINE ECONOMIC AND MONETARY UNION" – PRIORITY TO THE BANKING UNION

Further to the decisions of the European Council of December 2012 and the proposals put forward by the European Commission, the following legislative acts regarding the banking union were adopted or are currently under consultation with the competent EU institutions:

Single Supervisory Mechanism

With the adoption of two Regulations in October 2013,[12] a Single Supervisory Mechanism (SSM) for euro area banks was established, led by the European Central Bank in cooperation with national supervisory authorities. The SSM is a first important step towards an integrated Banking Union.

Single Resolution Mechanism

The Council of the EU agreed on a general approach to a Single Resolution Mechanism on 18 December 2013,[13] with the objective of reaching a final agreement with the European Parliament by May 2014.

In 2013 a final agreement was also reached on a new Deposit Guarantee Schemes Directive and a Bank Recovery and Resolution Directive.

12 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, and Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013, OJ L 287, 29.10.2013.

13 See Council of the European Union, Press Release 17602/13, 18.12.2013.

2 THE ECONOMIES OF SOUTH-EASTERN EUROPE

Economic developments in South-Eastern Europe after the 2008 crisis[7]

Prior to the 2008 crisis, the economies of South-Eastern Europe (SEE) had posted particularly high growth rates, which proved to be unsustainable. The large increase in credit expansion, especially after 2003, financed primarily by a surge in capital inflows, led to a large increase in domestic demand and to significant internal and external imbalances.

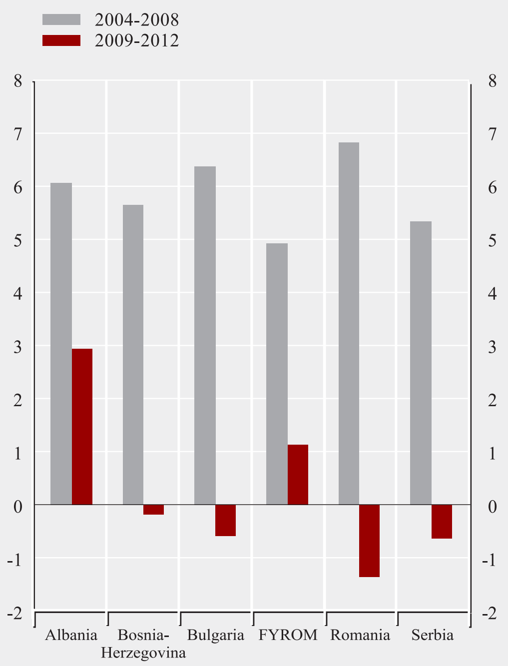
In greater detail, several countries experienced rising inflation and a sharp appreciation of the exchange rate, which resulted in competitiveness losses and the emergence of large external deficits. Expansionary fiscal policies led to sizeable structural deficits in the public sector. Deficit financing through capital inflows and the increasing share of foreign borrowing (mainly in euro) contributed to a higher external debt. Thus, the outbreak of the crisis found these countries with both significantly high external debt and external financing needs, making them particularly vulnerable. The subsequent large drop in capital inflows led to deep recession. The countries with the largest deficits were the ones most affected.

After the crisis of 2008 and the big recession of 2009, most of the SEE countries returned to positive, albeit rather low, growth (see Chart

7 The discussion covers Albania, Bosnia and Herzegovina, Bulgaria, the Former Yugoslav Republic of Macedonia (FYROM), Romania and Serbia.

Chart III.5 Real GDP in South-Eastern European countries

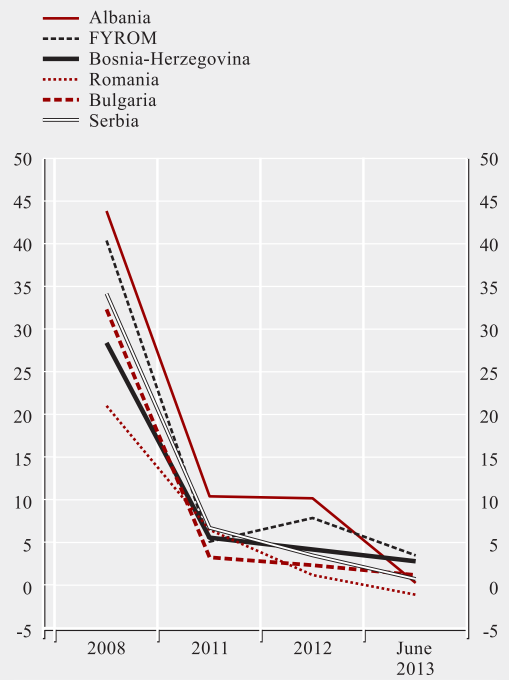
(average annual % change)



Source: European Commission.

Chart III.6 Bank credit to the private sector in South-Eastern European countries

(annual percentage change)



Source: National central banks.

III.5). One of the main reasons behind the slowdown in growth was the sovereign debt crisis in the euro area, which had second-round effects on the SEE countries mainly through two channels: The first was the decrease in exports, a large share of which used to be absorbed by European countries. The second channel was the capital account, with lower financing from European banking groups to their subsidiaries in the region after the crisis.

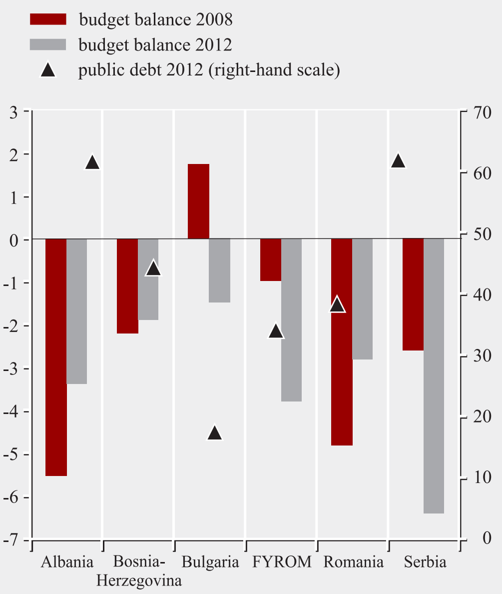
This lower financing to subsidiaries led to a deceleration of credit expansion. Indeed, in most SEE countries, credit expansion remains particularly low or even negative (see Chart III.6). In addition, low credit expansion is also related to a large increase in non-performing loans in nearly all countries in the region. High borrowing before the crisis, combined with low growth, has led to a sharp rise in the volume of non-performing loans (see Table III.2). This makes banks particularly reluctant to extend new loans, keeping credit expansion at low levels.

Fiscal adjustment has also contributed to low rates of growth. Fiscal deficits have decreased substantially since 2009, but in several countries remain relatively high. Furthermore, public debt in a number of countries exceeds 40% of GDP (see Chart III.7). The need to contain the upward course of public debt as a percentage of GDP is another reason why fiscal deficits must be curtailed.

Generally, for the SEE countries to achieve more balanced and sustainable growth, they will need to further curtail external and public deficits, accelerate structural reforms and restore the competitiveness of their economies. Although there is a clear trend towards reducing the imbalances of the pre-crisis era (especially as regards the external sector and inflation – see Table III.2), achieving sustainable growth hinges upon further, more effective efforts to attract foreign direct investment and allocate resources to the more productive sectors.

Chart III.7 Budget balance and public debt in South-Eastern European countries

(percentage of GDP)



Sources: European Commission and EBRD.

Developments in 2013 and prospects for 2014

In contrast with 2012, 2013 was a year of economic recovery[8] across the region (see Table III.2), although the drivers of growth were not the same everywhere. Growth in Serbia, Bulgaria and Romania was export-led, but driven by public spending in Albania and by private consumption in Turkey. The third quarter of 2013 saw the SEE countries continue to post positive growth rates, following the trend from the first half of the year, with the exception of Albania, where GDP shrank by 2% against the second quarter.

Inflation in most SEE countries continued to trend downward, mainly on account of subdued domestic demand and lower international prices for oil and raw materials.

8 One of the effects of higher output, although with a time lag in most cases, is the improvement or stabilisation of employment recorded in the SEE countries, with the possible exception of Serbia.

Table III.2 Key macroeconomic and banking indicators in South-Eastern European countries

	GDP (annual percentage changes)				Inflation (averages; annual percentage changes)				Current account balance (% of GDP)				CAR (%)		Loans/ deposits (%)		NPL ratio (%)	
Country	2012	Q3 2013	2013	2014	2012	Oct. 2013	2013	2014	2012	Q2 2013	2013	2014	2012	Sept. 2013	2012	Oct. 2013	2012	Sept. 2013
Albania[1]	1.6	-2.3	1.8	2.5	2.0	2.1	2.2	2.7	-10.8	-10.4	-9.4	-9.0	16.2	17.8	58.3	54.6	21.7	24.2
Bosnia-Herzegovina[1]	-0.9	-	0.5	2.0	2.1	0.7	1.8	1.8	-9.2	-7.5	-8.7	-7.9	14.1	14.6	119.6	115.5	12.7	14.9
Bulgaria	0.8	1.5	0.5	1.5	2.4	1.9	0.5	1.4	-1.3	0.6	0.3	0.0	16.6	16.9	97.7	89.1	16.6	17.2
FYROM	-0.4	4.1	2.1	2.5	3.3	3.4	3.0	2.7	-3.0	-3.4	-4.5	-5.3	17.1	17.3	89.4	89.0	10.1	11.5
Montenegro	-2.5	3.4[2]	1.9	2.3	4.1	3.5	2.0	2.1	-18.6	-16.1	-16.9	-16.3	14.7	13.4[3]	118.2	117.6	17.6	18.8[3]
Romania	0.7	4.1	2.2	2.1	3.4	4.5	3.3	2.5	-4.0	-	-1.2	-1.5	14.6	13.9	114.5	106.3	18.2	21.6
Serbia	-1.7	3.4	1.7	1.5	7.3	9.6	8.2	4.9	-10.2	-6.8	-4.9	-4.7	19.9	20.2	129.0	119.6	18.6	19.9
Turkey	2.2	4.4	3.5	3.0	9.0	7.3	7.7	7.2	-5.8	-6.6	-7.0	-6.6	17.9	15.7	103.0	110.1	3.2	2.7

Sources: European Commission, *European Economic Forecasts, Autumn 2013, EU Candidate & Pre-accession Countries Economic Quarterly, CCEQ*, 3/2013 and national central banks.
Note: Estimates for 2013; forecasts for 2014.
1 2013-2014 forecasts for Albania and Bosnia-Herzegovina are taken from the IMF, *World Economic Outlook*, April 2013.
2 Data refer to 2013 Q2.
3 Data refer to June 2013.

Current account deficits narrowed in the first half of 2013, as a result of subdued domestic consumption, which limited imports, and a relative recovery in external demand, which improved exports (see Table III.2). This trend continued into the third quarter of the year.[9] In contrast with the general regional trend, the current account deficit seems to be widening again in Turkey and is expected to reach 7.0% of GDP in 2013, against 5.8% in 2012.

Turning to public finances, significant deviations from the annual targets have in some cases called for a revision of annual budgets. In FYROM, a revision of the fiscal deficit (from 3.6% to 3.9% of GDP) became necessary after the annual target had been overshot, by more than 80%, already in August. In Albania, the initial target was exceeded by 11% in August, due to higher public expenditure and lower revenue (a typical election year). In Serbia and Montenegro, the public deficits were off course early in the year, requiring upward revisions. The picture was different in Turkey and especially in Bosnia-Herzegovina, where the budget registered a surplus equal to 0.4% of GDP in the first half of the year (against a targeted deficit of 2.0% of GDP for the year as a whole).

Except for Turkey, credit expansion in the region remains low due to the high percentage of non-performing loans and the partial withdrawal of funds by parent banking groups.[10]

According to all indications,[11] economic recovery in the region is set to continue in 2014 and, in most cases, to strengthen. Much will depend on the extent and pace of normalisation in external markets, especially in the euro area, which remains the main trading partner of the SEE countries. Low inflation and shrinking external deficits (except for Turkey) seem to make up the dominant scenario for 2014. The problem of weak credit expansion, combined with high NPL ratios, will (except in the case of Turkey) weigh on growth dynamics and broaden the scope for monetary easing. In fact, most of the countries in the region have already been pursuing quantitative easing policies since 2013 and cutting their key rates[12] in order to foster economic recovery.

9 It is noteworthy that, despite the downturn or recession affecting some of their major trade partners in the euro area, several SEE countries have managed to improve their export performance considerably by seeking alternative trade routes.
10 The withdrawal of funds appears to be continuing, albeit at considerably low rates and on a rather selective basis, as banking groups differentiate their strategy from one country to another. Recent studies confirm that the basic choice of banking groups is to remain active in the region, with the objective of strengthening their presence in certain countries (Monitoring Deleveraging and Credit in CESEE, Klingen C. (IMF) & Revoltela, D. (EIB), Vienna Initiative II Forum, October 2013).
11 According to forecasts by the European Commission and the International Monetary Fund (see Table III.2).
12 The monetary authorities of Serbia, Romania, Albania and FYROM have repeatedly opted to cut their interest rates.

Box III.3

CONCLUSIONS OF THE SYMPOSIUM ON "GROWTH CHALLENGES AND ECONOMIC INTEGRATION IN SOUTH-EASTERN EUROPE"[1]

The economies of South-Eastern Europe (SEE) were particularly affected by the 2008 global economic crisis. Suffering the consequences of a protracted recession, most SEE economies had still not recovered fully by the end of 2013. Reform momentum slowed down considerably, while investment, credit growth and both consumer and business confidence remain low. Real convergence of the SEE economies appears to have ground to a halt.

1 The Symposium was co-hosted by the Bank of Greece and the European Bank for Reconstruction and Development in Athens on 13 December 2013.

Policymakers agree that the period of strong credit growth fuelled by massive capital inflows is unlikely to be repeated, while the role of the EU as the main pillar of growth in the region has weakened, mainly on account of the crisis in the euro area. The SEE countries will therefore need to rely more on their own resources and speed up structural reforms if they want to create investment opportunities in production and export sectors capable of contributing to sustainable growth.

However, for this to happen, economic integration within the SEE region must be deepened in order to counter the adverse conditions in the global environment. The poor level of economic integration across the SEE is indeed a major impediment to growth. Intraregional trade, for instance, accounted for less than 10% of the region's GDP in 2012. Apart from the legacy of war and ethnic conflicts, serious administrative barriers and lacking infrastructure are also at play. The regulatory framework governing cross-border transactions is particularly constraining, while corruption is also part of the problem.

The aim of the Symposium was to identify potential new drivers of growth in the SEE countries. Emphasis was placed on three particular growth drivers with much to gain from intraregional integration: (a) the establishment of energy partnerships; (b) improving information and communications technology (ICT) and transportation infrastructure; and (c) fostering financial sector growth and strengthening the banking system.

As far as the energy market is concerned, enhancing intraregional integration and cooperation would enable a more effective use of existing infrastructure, thereby offsetting differences in energy reserves, while also boosting intraregional trade and opening up new energy markets (for renewable energy sources and natural gas). Ensuring low energy costs would in turn be crucial to enhancing competitiveness, especially in manufacturing.

Improving the quality of transportation hubs, coupled with the development of new trade destinations, is an important condition for strengthening growth. Despite the progress made, much remains to be done in terms of developing trans-European road networks and breaking the isolation of domestic markets. Harbour and airport modernisation would also help in this direction. Without doubt, the creation of synergies amongst the SEE countries would help to effectively tackle the problem.

The diffusion of knowledge creates value, improves productivity and boosts growth. However, in the ICT sector, the SEE countries continue to suffer the effects of the 2008 economic crisis and to face issues such as insufficient human resources, quality of infrastructure and investment. Intraregional integration would help to bolster the sector, by opening up possibilities for the expansion of networks and the creation of larger markets conducive to the provision of better-quality services.

An improved financial system capable of channelling adequate flows of credit into the economy is another key prerequisite to boosting growth. Further development of the domestic capital markets geared towards promoting saving and borrowing in domestic currency is a major priority in all the countries. In fact, the development of a regional capital market would be ideal.

Moreover, better financing conditions mean more efficient banks and sounder banking systems. A more concentrated banking sector and the ensuing higher profitability for banks would help in this direction by making financial stability less vulnerable to macroeconomic shocks and liquidity problems originating abroad. Reducing the number of banks by encouraging the smaller ones to seek synergies and take advantage of economies of scale, would lead to more effective intermediation, without necessarily dampening bank credit demand and supply. Restructuring of the banking systems would greatly benefit from cooperation with international financial institutions (such as the European Bank for Reconstruction and Development), which have the appropriate instruments for the smooth implementation of the procedure and for safeguarding financial stability.[2]

In closing, the SEE countries are at a critical crossroads, as they face considerable uncertainties. The conclusions of the Symposium underscored the need to strengthen intraregional integration and cooperation as a way to robust and sustainable growth. The region has definite potential in several sectors, but tapping this potential calls for concerted effort and strategy.

2 Besides, much experience can be drawn from the Vienna Initiative, which proved very successful in tackling problems common to the region's banking systems.

IV THE SINGLE MONETARY POLICY AND MEASURES TAKEN BY THE EUROSYSTEM

The turmoil in the global financial markets that started in 2007 prompted the Eurosystem to adopt non-standard monetary policy measures and, to the extent that the turmoil was associated with a decline in inflationary pressures (due to dampened economic activity), to lower its key interest rates. Financial markets in the euro area remain fragmented, while the Eurosystem expects to maintain its key interest rates at their present very low levels or to reduce them further, given the weak inflationary pressures.

Since the second half of 2007, the single monetary policy has been conducted amidst tensions in the financial markets. Insofar as the turbulence had an adverse effect on the availability and cost of financing for non-financial corporations and households, thereby contributing to an easing of inflationary pressures in the euro area, the response of the Eurosystem was to cut its key interest rates. Overall, between August 2007 (when the US sub-prime mortgage crisis began to spill over into the euro area money market) and the end of 2013, the main refinancing rate was lowered on twelve occasions, by a total of 3¾ percentage points. In 2014, the key interest rates have so far remained unchanged.

The financial turmoil also affected the monetary policy transmission mechanism and the ability of the Eurosystem to achieve its primary objective, i.e. to maintain price stability in the euro area over the medium term. In order to contain the impact of these developments, the Eurosystem introduced a number of non-standard monetary policy measures, designed for the most part to improve the availability and cost of liquidity for credit institutions. The non-standard measures included a wider range of open market operations, the move to a fixed rate tender procedure with full allotment for all operations, the provision of liquidity with full allotment, as well as the expansion of the list of assets accepted as collateral, a lowering of the reserve ratio, etc.

Tensions in the financial markets stemming from the sovereign debt crisis have now abated, but the financial markets remain fragmented along national lines. The slow pace of recovery, as well as weak monetary and credit growth, support expectations that the key interest rates will be maintained at present levels for an extended period of time or further reduced.

The global financial turmoil substantially changed the environment in which the single monetary policy is conducted, leading the Eurosystem to adopt innovative measures in an effort to counteract the adverse effects of the financial tensions.

After the first shocks in early 2007, the turmoil intensified from the summer of that year onwards, when credit rating agencies downgraded sub-prime mortgage-backed securities in the US, as a result of rising delinquency rates for US sub-prime mortgages.

The spillover to the single money market began to be felt in August 2007 in the form of liquidity constraints and upward pressures on interest rates. Credit institutions became increasingly reluctant to lend on the interbank market, fearing that potential counterparties held sizeable amounts of sub-prime residential mortgage-backed securities in their portfolios. The spreads between the Euribor rate and (a) the fixed rate on overnight index swaps[1] and (b) the Eurepo rate widened (see Chart IV.1).

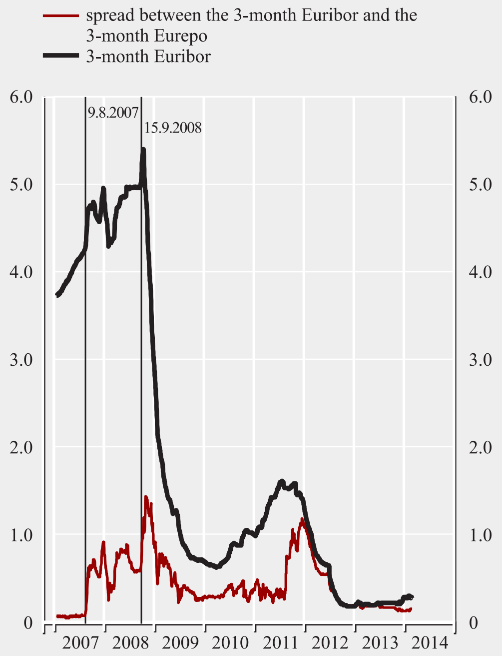
By conducting quick tender operations, the Eurosystem succeeded in stabilising the EONIA rate at around the levels of the main refinancing rate. In contrast, Euribor rates continued to trend upwards until late 2008. Clearly, the financial turmoil was impairing the monetary policy transmission mechanism.

More specifically, the monetary policy stance was determined by the main refinancing rate, which directly affected the EONIA rate. However, the evolution of short-term bank lending rates to non-financial corporations and households closely followed the course of the

1 With a maturity corresponding to that of the interbank loan.

Chart IV.1 Euro area: 3-month Euribor and spread between 3-month Euribor and 3-month Eurepo (January 2007-14 February 2014)

(percentages per annum; spread in percentage points; daily data)



Sources: ECB and European Banking Federation.
The vertical lines mark (i) the beginning of the impact on the interbank market of the U.S. subprime mortgage crisis; and (ii) the collapse of Lehman Brothers.

3-month Euribor. The widening spreads between the Euribor and EONIA rates indicated that monetary policy decisions were no longer having the desired effect on economic activity.

Although the Governing Council of the ECB assessed in the last months of 2007 that there were upside risks to price stability in the euro area, it chose not to raise key interest rates on account of heightened uncertainty about the economic outlook amidst the financial turmoil (see Chart IV.2). Inflationary pressures continued to mount in the first half of 2008, driven by rising global commodity prices, coupled with tight labour market conditions and high utilisation rates of industrial capacity in the euro area, which increased the risk of second-round effects on wages materialising, against a backdrop of vigorous monetary expansion. In response to these developments, the Eurosystem raised the key interest rates by 25 basis points in July 2008.

However, market tension intensified over the course of 2008 on account of a series of dramatic events in the US, starting with the near-collapse in mid-March of Bear Stearns and followed by the bailout of the two government-sponsored mortgage enterprises (Fannie Mae and Freddie Mac) by the Federal government. Turbulence peaked in the second half of September 2008 with the default of Lehman Brothers, triggering problems in the banking sector of many countries.

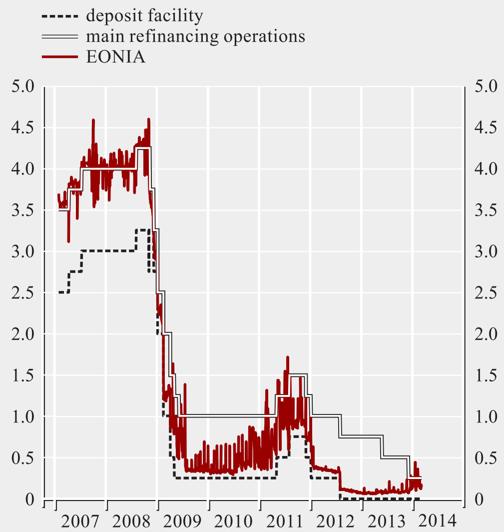
The limited availability and the higher cost of financing for non-financial corporations and households, which peaked with the failure of Lehman Brothers, and declining confidence soon took a toll on economic activity, which contracted sharply worldwide. The Governing Council of the ECB assessed that inflationary pressures in the euro area were easing and cut its main refinancing rate by a total of 175 basis points between October 2008 and the end of that year.

In response to the turmoil, in October 2008 the Eurosystem started to provide liquidity by conducting all open market operations as fixed rate tender procedures with full allotment against adequate collateral. It also increased the frequency of its longer-term refinancing operations (LTROs). Thus, over the next two years, during each maintenance period four LTROs were conducted: one for the length of the maintenance period, two with a three-month maturity and one with a six-month maturity. Furthermore, the Eurosystem expanded the list of eligible assets accepted as collateral in its liquidity-providing operations. By end-2010 several categories of previously ineligible debt instruments had been added to the list, while the minimum credit rating threshold in the collateral eligibility requirements was lowered.[2]

2 The minimum credit threshold for asset-backed securities (ABSs) remained unchanged at the time.

Chart IV.2 Changes in key Eurosystem rates and the EONIA rate (January 2007-14 February 2014)

(percentages per annum)



Sources: ECB and European Banking Federation.

The spread between the marginal lending facility rate and the deposit facility rate, i.e. the width of the corridor formed by the two standing facilities, was temporarily reduced by 100 basis points, in an aim to contain the volatility of very short-term money market rates.

Many banks established in the euro area conduct transactions in securities denominated in US dollars and/or are active in the US credit market. These assets are financed through US-dollar revolving short-term liquidity facilities so that banks are not exposed to currency risk. Prior to the crisis, euro area credit institutions raised US dollar liquidity from counterparties in the United States. However, both this type of funding and the international currency swap market were disrupted by the crisis, prompting the Eurosystem to adopt measures to increase the availability and reduce the cost of US dollar funding for European credit institutions.

Actually, since December 2007 the Eurosystem, in coordination with the Federal Reserve System, has been providing US dollar liquidity – from late 2008 through fixed rate tender procedures with full allotment (against collateral eligible for Eurosystem credit operations). After the collapse of Lehman Brothers, the volume of interbank transactions (not only between the euro area and other currency areas, but also within the euro area) contracted.[3] Credit institutions with excess reserves were reluctant to grant interbank loans, preferring instead to park their liquid assets in the Eurosystem's deposit facility. As a result, the outstanding amount of deposits with this standing facility has remained high since late 2008, although trending downwards since mid 2012.

Banks in need of additional funding had no other option[4] than to resort to the Eurosystem's open market operations. Thus, the Eurosystem assumed a financial intermediation role between banks with excess reserves and those in need of additional liquidity. This development is captured by the strong upward trend in the Eurosystem's total assets after the default of Lehman Brothers through mid-2012, which rose from about €1 trillion in mid-2008 to €2.6 trillion in June 2012. Thereafter, they decreased to roughly €1.9 trillion in late 2013.

Given that all bids submitted by Eurosystem counterparties were satisfied in the open market operations, the level of liquidity in the banking system was driven by the demand from counterparties and followed an upward path. Under these conditions of excess liquidity in the interbank market, the EONIA rate no longer closely followed the main refinancing rate, but moved closer to the deposit facility rate.[5]

The measures adopted by the Eurosystem (apart from the interest rate cuts), essentially

3 In the following years, the volume of transactions remained subdued, with a shift towards shorter-maturity operations against adequate collateral.
4 During a period in which attracting an adequate amount of deposits by households and non-financial corporations was not possible or because their business models implied high reliance on wholesale funding.
5 Except during certain periods in the following years, such as the second half of 2010 and the first half of 2011, when excess liquidity declined.

from the summer of 2007 onwards, were "non-standard", in the sense that they involved changes in monetary policy tools and procedures. Their purpose was to reverse the aforementioned deterioration in financing conditions more effectively than would have been possible solely via key interest rate cuts. Enhanced liquidity had to be provided to credit institutions, first, in order to safeguard the stability of the banking system and, second, to enable banks to continue supplying sufficient credit to the real economy in line with the Eurosystem's monetary policy stance. The key interest rates continued to be determined by the Governing Council of the ECB solely with a view to achieving its primary objective, i.e. maintaining price stability (and not to addressing strains in financial markets).

Thanks to the non-standard measures, interest rate cuts and financial sector support packages launched from October 2008 onwards by the EMU (and other) countries,[6] the Euribor rates had declined by the end of the first quarter of 2010. Bank lending rates to non-financial corporations and households also declined considerably.

However, in 2009 the economic downturn in the euro area deepened. Inflationary pressures eased, as also evidenced by the weaker pace of monetary expansion. Thus, the Eurosystem continued to lower its key interest rates, reducing the main refinancing rate by a total of 150 basis points and the width of the interest rate corridor by 50 basis points.

2009 also saw the Eurosystem introduce a longer-term refinancing operation (LTRO) with a maturity of one year and launch a covered bond purchase programme, aimed at easing funding conditions for banks through the issuance of such bonds.

Towards the end of the year, the Governing Council of the ECB announced that non-standard measures no longer required would gradually be phased out, as financial market conditions had shown signs of normalising over previous months. It should be noted, however, that at that stage market concerns about the sustainability of public finances in certain euro area countries, notably Greece, had only just started to emerge. Market pressure gradually built up, culminating in early May 2010, when the spreads for some euro area sovereign bonds (in addition to Greece's) surged and trading volumes shrank. This prompted the Governing Council of the ECB to reactivate certain non-standard measures[7] and launch the Securities Markets Programme (SMP).

Under the SMP, the Eurosystem intervened in the government debt securities markets in order to ensure depth in those market segments that were dysfunctional. This was deemed necessary as the monetary policy transmission mechanism had been impaired, hampering the achievement of the ECB's primary objective. Given that the pricing of many loans and private debt securities is directly affected by government bond yields, the surge in yields put upward pressure on the cost of financing in a number of euro area countries, even though the single monetary policy stance had remained unchanged. The purchase by the Eurosystem of government debt securities injected liquidity into the banking system, which was subsequently sterilised through weekly fine-tuning operations conducted to the present day.

The upward course of Euribor rates in 2010 and the first half of 2011 is attributed, among other factors, to higher counterparty risk premia, fuelled by mounting concerns about the exposure of banks, via their loan books and government securities holdings, to countries experiencing fiscal difficulties. Especially in countries for which the sustainability of public finances was in doubt, liquidity-constrained

6 The main purpose of these packages was to enhance banks' capital base and included purchases by the governments of EU Member States of newly issued preference shares, new issues of bank bonds guaranteed by the EU governments, and enhancement of deposit guarantee schemes.

7 For instance, the regular US dollar liquidity-providing operations, which had been discontinued in early 2010, were once more made available to credit institutions against adequate collateral.

credit institutions faced serious difficulties (when they had no collateral or only domestic government bonds to put forward) in attracting interbank deposits from credit institutions with liquidity surpluses in other Member States.

In 2011, inflationary pressures picked up, driven by rising global commodity prices. The implementation of non-standard measures over the past few years had led to a large build-up of liquidity in the euro area, which could have triggered second-round effects. Consequently, the Eurosystem raised its key interest rates in April and July by a total of 50 basis points. These increases soon had to be reversed. Indeed, during the summer of 2011 the government bond markets in certain euro area countries once again experienced tensions, while the functioning of the interbank market was also impaired. These developments had an adverse effect on financing conditions for the real economy, prompting the Governing Council of the ECB to cut interest rates in November and December, by a total of 50 basis points.

Towards the end of 2011, the ECB launched a new covered bond purchase programme. The cost of funding in US dollars for credit institutions was reduced. In addition, the list of eligible collateral to be used in Eurosystem open market operations was expanded, given the decline in the valuations of assets posted as collateral caused by financial market tensions.

More specifically, the minimum credit rating threshold for residential mortgage-backed securities or ABSs backed by loans to SMEs was reduced and the NCBs were allowed to accept on their responsibility additional performing credit claims (i.e. bank loans) as collateral.

Finally, an open market liquidity-providing operation with a maturity of three years was conducted for the first time, whereas, with a view to increasing interbank activity, the liquidity-absorbing fine-tuning operations on the last day of the maintenance period conducted as tender procedures discontinued.

In January 2012, the reserve ratio was halved to 1%. Many credit institutions resort to the Eurosystem for financing in order to meet their reserve requirements. In order to obtain the required amount of financing, they must post adequate collateral to the respective NCB. Thus, lowering the amount of minimum reserves freed up eligible collateral (which was in shortage) for other uses (e.g. on the interbank repo market). Lowering the reserve ratio also boosted money market activity, as some credit institutions were able to lend their liquidity to other banks, now that they no longer had to deposit it with the reserve account.

Despite the increases in energy prices over part of 2012 and indirect tax hikes throughout the year in many euro area countries owing to the need for fiscal consolidation, inflationary pressures remained moderate on account of weak economic activity, as also evidenced by the subdued pace of credit expansion. In fact, the Governing Council of the ECB decided to cut its key interest rates by 25 basis points in July in order to counteract the contractionary impact of sovereign debt crisis-induced tensions on economic activity.

This rate cut, like the earlier ones in the last two months of 2011, the substantial build-up of excess liquidity in the interbank market, as well as the gradual decrease of the counterparty risk premium after the conduct of the three-year LTROs, contributed to a sharp decline in the three-month Euribor (a benchmark for interbank market operations) from late 2011 to late 2012. Thereafter, this rate has remained broadly unchanged.[8]

In addition, the Governing Council of the ECB noted an improvement in the monetary policy transmission mechanism. These favourable

8 Movements in the three-month Euribor were observed in the course of 2013 and in early 2014, but their range did not exceed 12 basis points.

developments were driven by progress in containing fiscal imbalances and implementing structural reforms in several euro area countries, as well as by the establishment of an enhanced economic governance framework in the euro area.

The lowering of the deposit facility rate to zero in early July 2012 led to a decrease in recourse of credit institutions to the deposit facility. However, instead of using the available liquidity no longer deposited with the ECB to grant interbank loans or credit to the real economy, many credit institutions preferred to hoard it in the reserve accounts, thus creating excess reserves from the second half of 2012 onwards.

In the summer of 2012, the Governing Council of the ECB assessed that the increase in yields in certain euro area government bond markets (such as Italy and Spain) reflected a convertibility risk premium due to fears of the reversibility of the euro. The Governing Council considered this unacceptable and decided that exceptionally high risk premia in bond prices needed to be addressed in a fundamental manner, as the ensuing financial market fragmentation hindered the effective working of monetary policy. A sign of this fragmentation is the decrease in cross-border interbank transactions, which brought about considerable divergence in bank lending rates to non-financial corporations and households across the EMU countries.

In order to address the impairment of the transmission channel, the Eurosystem announced its readiness to undertake Outright Monetary Transactions (OMTs), i.e. outright purchases of short-term government bonds of a size adequate to ensure a normalisation of conditions in financial markets. The announcement of the OMTs (even if their actual activation has so far not been necessary) helped alleviate tensions in government bond markets, including regained access to the primary market for governments that had been temporarily cut off – this had also happened to certain banks –, the repatriation of funds to euro area periphery countries and a commensurate increase in outstanding deposits with the banking system of those countries. Nevertheless, the segmentation of financial markets along national borders has yet to be eliminated.

As regards collateral eligibility requirements, in mid-2012 the minimum credit rating threshold for several asset-backed securities (residential or commercial mortgage-backed securities, ABSs backed by loans to SMEs, consumer loans and financial leases) was again lowered.

Soon afterwards, the ECB announced the suspension of the application of the minimum credit rating threshold for marketable debt instruments issued or guaranteed by the central governments of countries that are eligible for OMTs or are under an EU-IMF programme and comply with the attached conditionality.

In 2013, the Eurosystem reduced the interest rate on the main refinancing operations by a total of 50 basis points, as negative GDP growth rates over several consecutive quarters and the persisting very low levels of monetary and credit expansion contributed to dampening inflationary pressures. Furthermore, the width of the interest rate corridor was reduced by 75 basis points, with the aim of limiting the volatility of the overnight rate. The Governing Council of the ECB announced that, given the macroeconomic conditions, it expected key interest rates to remain at their present very low levels for an extended period of time or to be reduced further.

With regard to the fragmentation of euro area financial markets, the Governing Council of the ECB noted that substantial progress has been made in banks' ability to raise funds in the retail and wholesale markets and stressed that steps to establish the Banking Union would contribute to reducing fragmentation. More recently, it underlined the specific role that the ongoing comprehensive assessment of systemic credit institutions in the euro area by the ECB would play in identifying where corrective action would be needed in the run-up to the activation of the Single Supervisory Mechanism.

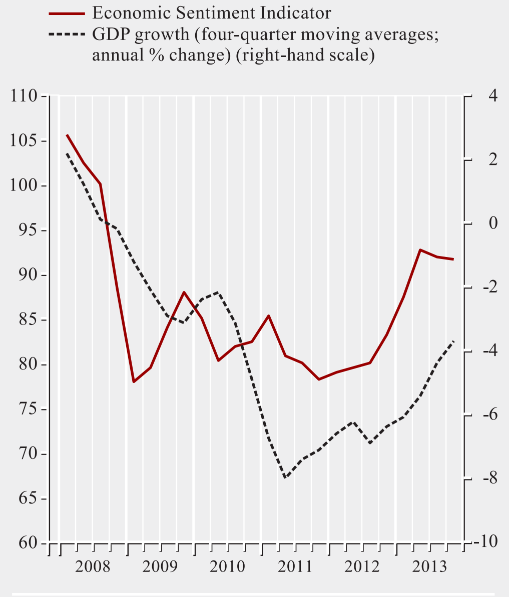
Lastly, in 2013 (as well as in the first months of 2014), excess liquidity in the interbank market declined owing to early repayment by several credit institutions of part or all of the amounts that they had borrowed in the three-year LTROs conducted in the previous years. This development points to easier funding conditions as a result of the aforementioned normalisation following the announcement of Outright Monetary Transactions (OMTs).

V MACROECONOMIC DEVELOPMENTS AND PROSPECTS IN GREECE

The four-year period 2010-2013 was characterised by cumulative declines (at constant prices) of 20.4% in GDP and of over 30% in households' disposable income. This contraction, unprecedented in scale among the OECD countries in the post-war era, occurred against a background of efforts to eliminate the extensive fiscal and external imbalances that had precipitated the crisis. These efforts were made in an environment of tight bank credit amid strong uncertainty, which exacerbated the resulting recession (see Chart V.1).

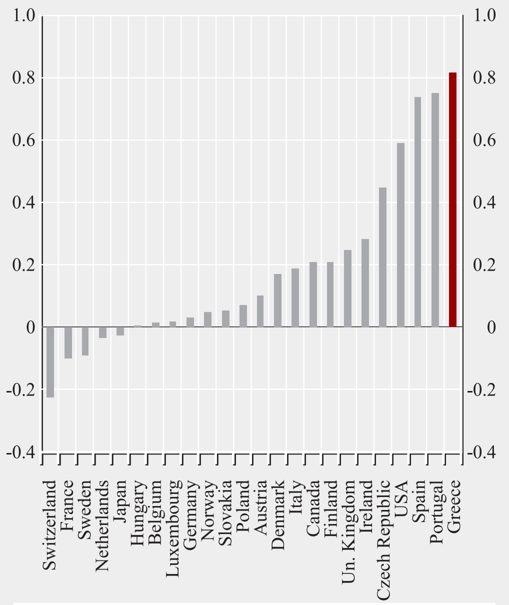
The economic policy for eliminating the imbalances relied on quick-yielding measures (e.g. wage and pension cuts, extraordinary taxes, etc.), as well as on measures aimed at restructuring the economy and, therefore, at paving the way to long-term sustainable growth. These quick-yielding measures led to the achievement of a general government primary surplus in 2013, a sizeable reduction in unit labour costs and a recouping of the losses in international cost competitiveness incurred over the period 2000-2009. In the labour market, significant structural reforms were made, primarily aimed at better aligning wage growth with firm performance, as well as at enhancing labour mobility across sectors. Progress with structural reforms in goods and services markets, by contrast, was markedly slower than in the labour market. Nevertheless, according to OECD estimates, Greece ranked first in responsiveness to structural reform recommendations made by the Organisation (see Chart V.2), by making it easier to start a business and by removing barriers to entrepreneurship (e.g. opening up closed professions, enhancing the protection of competition). However, continued efforts are still needed, first, to improve the efficiency of public administration rather than just cutting operating costs, and, second, to upgrade the institutional framework underpinning the economy.

Chart V.1 GDP growth and the Economic Sentiment Indicator (2008 Q1-2013 Q4)



Sources: ELSTAT, National Accounts, and IOBE/European Commission, Business and Consumer Surveys.

Chart V.2 Change in responsiveness to OECD[1] recommendations



Source: OECD (2013), *Economic Policy Reforms: Going for Growth*, OECD Publishing (Chart 1.2B).
1 The indicator represents the change between 2010 and 2012 of the responsiveness rate to OECD recommendations for reforms. It is based on a number of dummy variables recording action taken or not taken in certain policy areas. Each policy area is weighted according to the difficulty of undertaking the relevant reform.

I ECONOMIC ACTIVITY: DEVELOPMENTS AND PROSPECTS

During the period 2000-2010, the Greek economy was characterised by a growing general government deficit, a worsening external account deficit, an inflation rate above the euro area average and a high unemployment rate, while productivity per hour worked stood at only 56% of the euro area average.

These imbalances reflected, inter alia, the following:

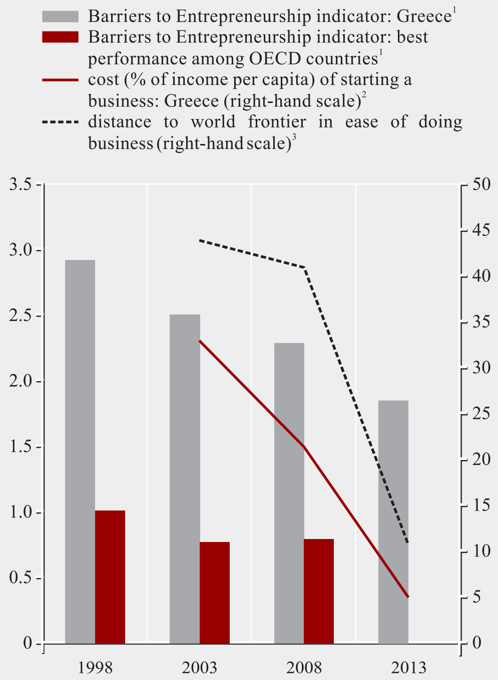
First, high private consumption, corresponding in 2000-2010 to 71.4% of GDP (or more than 90% of households' disposable income), compared with a euro area average of 57.0%.

Second, a high rate of residential investment (37.2% of total investment over the period 2000-2010).

Third, very low coverage of imports by exports. In the period 2000-2010, the export-to-import ratio was 65.2%.

Fourth, the Greek economy's poor scores for structural efficiency (as shown e.g. by the ease of doing business indicators, see Chart V.3).

Chart V.3 Business environment indicators



Sources: OECD (Product Market Regulation Database and *Economic Surveys: Greece*), and World Bank (*Doing Business*).
1 The Barriers to Entrepreneurship indicator, a component of the OECD Product Market Regulation (PMR) indicator, measures barriers to entrepreneurship in goods and services markets and ranges from 0 to 6, with 6 indicating the presence of barriers.
2 It refers to the costs of starting up a limited liability company.
3 According to the World Bank's Ease of Doing Business indicators (*Doing Business Report*).

Demand-side developments

Private consumption at constant prices in the first nine months of 2013, compared with the corresponding period of 2010, shrank by roughly 23% (see Tables V.1 and V.2). This decline is attributable to (a) fiscal consolidation (which entailed wage cuts in the public sector and tax hikes); (b) a decrease in the number of persons employed; (c) lower wages in the rest of the economy; and (d) declines in asset yields. During this period, the private consumption-to-GDP ratio fell, albeit not significantly, but still remains much higher than in the euro area (see Chart V.4).

Although changes in consumption patterns tend to be slow, some shifting in consumption has already been observed, with a larger share of total consumption expenditure being allocated to the satisfaction of basic needs (food, housing and utilities) and, conversely, a smaller share going towards non-basic needs (see Chart V.5).

The declines in consumption and investment resulted in a contraction of **imports of goods and services** (-29.3% on a national accounts basis between 2010 and 2013). **Exports of goods**, which account for half of total exports, rose by about 16% over this period, while **exports of services** fell by 4.4%. As a result, total exports at constant prices rose by 4.7% between 2010 and 2013. Thus, while receipts from exports of goods and services in 2009

Table V.1 Demand and GDP

(annual percentage changes and percentage point contributions to GDP, at constant market prices of 2005)

	2008	2009	2010	2011	2012	2013 Jan.-Sept.
Private consumption	4.3 (2.9)	-1.6 (-1.2)	-6.2 (-4.4)	-7.7 (-5.6)	-9.1 (-6.5)	-7.7 (-5.5)
Public consumption	-2.6 (-0.5)	4.9 (0.9)	-8.7 (-1.7)	-5.2 (-0.9)	-4.2 (-0.8)	-5.2 (-1.0)
Gross fixed capital formation	-14.3 (-3.9)	-13.7 (-3.2)	-15 (-3.0)	-19.6 (-3.6)	-19.2 (-3.0)	-11.6 (-1.6)
Residential investment	*-33.60* *(-4.2)*	*-20.70* *(-1.7)*	*-21.60* *(-1.5)*	*-18.00* *(-1.0)*	*-32.90* *(-1.6)*	*-36.80* *(-1.3)*
Domestic final demand[1]	-1.2 (-1.4)	-3.0 (-3.5)	-8.3 (-9.1)	-9.3 (-10.2)	-9.8 (-10.4)	-7.8 (-8.1)
Change in inventories and statistical discrepancy (% of GDP)	1.1	-1.8	-0.3	0.4	0.8	1.1
Domestic demand	-0.2 (-0.3)	-5.4 (-6.2)	-7.1 (-7.8)	-8.7 (-9.5)	-9.4 (-10.1)	5.9 (-6.1)
Exports of goods and services	1.7 (0.4)	-19.4 (-4.7)	5.2 (1.0)	0.3 (0.1)	-2.4 (-0.6)	2.0 (0.5)
Imports of goods and services	0.9 (-0.3)	-20.2 (7.7)	-6.2 (1.9)	-7.3 (2.3)	-13.8 (4.2)	-5.5 (1.6)
External demand	... (0.1)	... (3.1)	... (2.9)	... (2.4)	... (3.7)	... (2.1)
Gross domestic product at market prices[2]	-0.2	-3.1	-4.9	-7.1	-6.4	-4.0

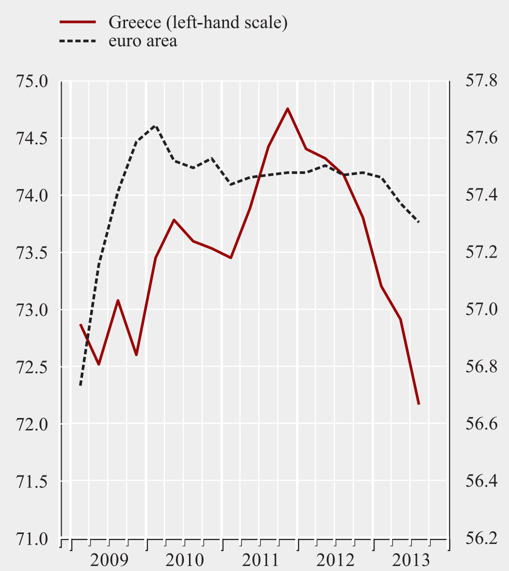
Source: ELSTAT, National Accounts, December 2013.
Note: Contributions to GDP (in percentage points) are given in parentheses.
1 Excluding inventories and statistical discrepancy.
2 According to ELSTAT flash estimates for Q4 (released on 14 February 2014), the contraction of GDP in 2013 as a whole was around 3.7%.

covered only 66% of the import bill, this share exceeded 90% in 2013, mostly on account of the significant decline in imports (see Chart V.6).

In 2014, consumption is expected to continue to drop, although at a much slower pace, as indicated by data for October-November 2013, with the retail trade volume projected to increase, albeit only marginally (+0.8%), compared with a decrease of 10.0% in the period January-September 2013. This estimate is also supported by car sales figures for January 2014, which show a year-on-year increase in sales for the fifth consecutive month, as well as by the intentions of consumers to purchase a car and carry out home improvements during 2014, as recorded in January 2014 in the IOBE-European Commission Consumer Survey, which paints a less negative picture than in previous quarters. Less pessimism is also reflected in the retail trade confidence indicator in January 2014 (see Table V.2).

Chart V.4 Private consumption as a percentage of GDP (2009 Q1- 2013 Q3)

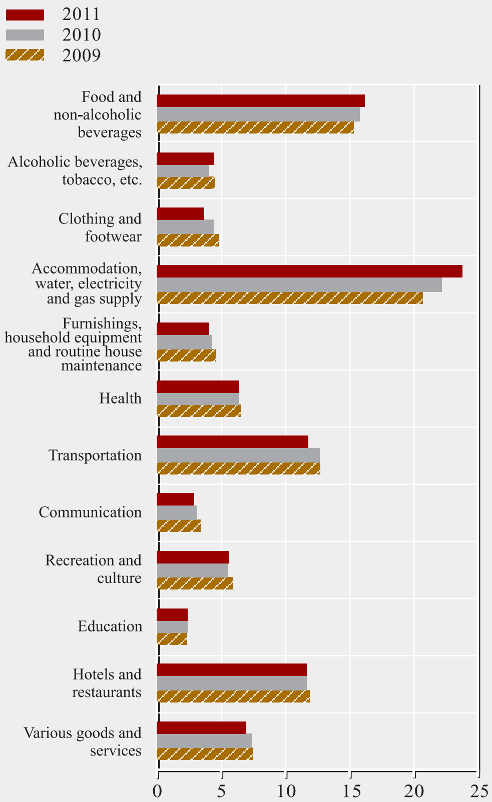
(percentages per annum; 4-month moving average)



Source: Eurostat.

Chart V.5 Evolution of consumption expenditure

(percentages in total)



Source: ELSTAT, breakdown of domestic final consumption expenditure by consumption purpose: including consumption expenditure of resident and non-resident households on the Greek territory, but excluding consumption expenditure of resident households abroad.

Over the period 2010-2013, **investment** expenditure, at constant prices, fell by about 51% (see Table V.1).[1] Some 47% of this decrease (24 percentage points) is attributed to a drop in residential investment, 17% (10 percentage points) to a decline in investment in other constructions – as a result of, inter alia, the cuts in the Public Investment Programme – and the rest to a contraction in business investment expenditure (machinery, transport equipment). Consequently, the composition of investment has changed: the share of residential investment has shrank, while, conversely, the share of business investment (investment in machinery and equipment) and investment in construction has increased (see Chart V.7). The drop in residential investment, analysed in Section 2 of this Chapter, inevitably affected demand, fixed investment and employment in a number of construction-related sectors (such as the cement and construction materials industries), but also freed up resources for investment in the production of tradable and exportable goods and services (see Box V.1). On the other hand, the increased share of business investment in total investment expenditure merely reflects more rapid disinvestment in the housing sector, despite the fact that investment in machinery and transport equipment has dropped significantly and at a higher rate than GDP (by about 42% at current and constant prices in the first nine months of 2013 over the corresponding period of 2009). According to the IOBE/European Commission's Business and Consumer Surveys, businesses attribute their lower business investment to widespread uncertainty, the liquidity squeeze and high taxes on profits.

Business investment is expected to recover in the course of 2014, as businesses seek to replace or expand their fixed assets – a step necessary for their survival. In fact, the second half of 2013 has already seen an increase, of 57.1%, in investment plans submitted for subsidisation under the development law. The positive outlook for 2014 is supported, first, by the introduction of a new framework for reviewing and approving subsidised investment (Law 4146/2013) and, second, by the availability of funding under both the National Strategic Reference Framework (2007-2013) and the Multiannual Financial Framework (2014-2020). Four major motorway construction projects (Olympia Odos, E65, Ionian Motorway, Aegean Motorway) are expected to resume in the first quarter of 2014. The business sector will benefit both directly and indirectly from these investments

1 The decline in investment has obviously been much greater since 2008, coming to a cumulative 65% approximately. During this period, 2/3 of the collapse in investment was related to residential construction (see Bank of Greece, *Monetary Policy – Interim Report*, December 2013, Special Feature III.1, pp. 57-64).

Table V.2 Indicators of consumer demand (2009-2013)

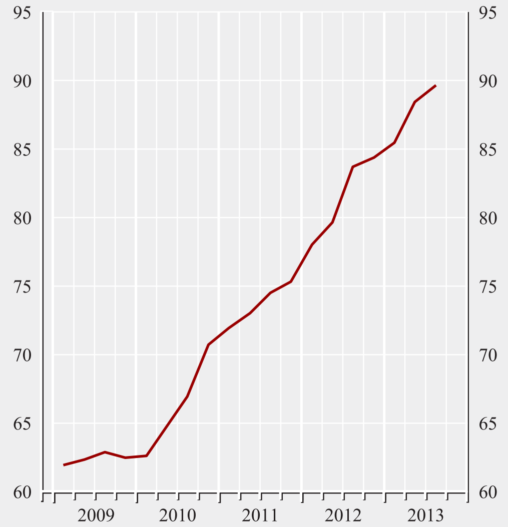
(annual percentage changes)

	2009	2010	2011	2012	2013 (available period)
Volume of retail trade (general indicator)	-11.4	-6.2	-10.2	-12.2	-8.3 (Jan.-Nov.)
Volume of retail trade (excluding fuel and lubricants)	-9.3	-6.9	-8.7	-11.8	-8.6 (Jan.-Nov.)
Food-beverages-tobacco[1]	-6.1	-5.5	-6.0	-8.9	-9.4 (Jan.-Nov.)
Clothing-footwear	1.4	-11.4	-18.8	-20.4	-2.0 (Jan.-Nov.)
Furniture-electrical appliances-household equipment	-15.3	-12.7	-15.7	-16.3	-6.1 (Jan.-Nov.)
Books-stationery-other	-24.0	-4.3	-5.2	-12.0	-0.8 (Jan.-Nov.)
Revenue from VAT (at constant prices)	-10.2	0.1	-5.9	-12.8	-6.6 (Jan.-Dec.)
Retail trade business expectations index	-21.4	-26.4	-0.5	-3.1	22.9 (Jan.-Dec.)[4]
New private passenger car registrations	-17.4	-37.2	-29.8	-41.7	3.1 (Jan.-Dec.)[5]
Tax revenue from mobile telephony[2]	13.2	37.1	-16.8	-7.9	-12.8 (Jan.-Dec.)
Outstanding balance of consumer credit[3]	1.8	-4.2	-6.4	-5.1	-3.9 (Jan.-Dec.)

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-beverage-tobacco stores.
2 Until July 2009: fixed monthly levy per subscription. Since August 2009: new scaled levy on mobile telephony subscriptions and a levy on pre-paid 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.
4 The figure for January 2014 was 27.6%.
5 The figure for January 2014 was 16.2%.

Chart V.6 Export-import ratio for goods and services (2009 Q1-2013 Q3)

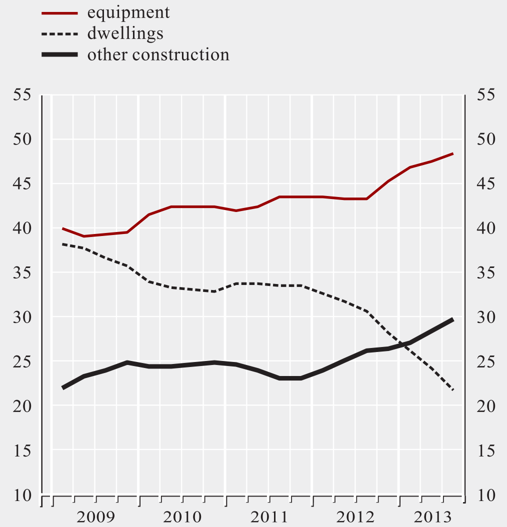
(percentages; 4-quarter moving average)



Source: ELSTAT, National Accounts.

Chart V.7 Investment by type of capital goods as a percentage of total investment (2009 Q1-2013 Q3)

(percentages; 4-month moving average)



Source: ELSTAT, National Accounts.

Table V.3 Indicators of investment demand (2009-2013)

(annual percentage changes[1])

	2009	2010	2011	2012	2013 (available period)	2014 (available period)
Capital goods output	-22.5	-22.1	-9.7	-16.4	-11.8 (Jan.-Nov.)	...
Capacity utilisation in the capital goods industry	73.4	66.1	62.7	58.2	61.4 (2013)	60.4 (Jan.)
Bank credit to domestic enterprises[2]	5.1	1.1	-2.0	-4.4	-4.9	...
Disbursements under the Public Investment Programme[3]	-2.8	-11.3	...	-10.5	14.5 (2013)	...
Production index in construction (at constant prices)	-17.5	-29.2	-28.1	-26.1	-6.9 (Jan.-Sept.)	...
Volume of private construction activity (on the basis of permits issued)	-26.5	-23.3	-37.7	-30.6	-29.4 (Jan.-Oct.)	...
Cement production	-21.4	-14.3	-37.8	-12.8	4.6 (Jan.-Nov.)	...
Business expectations index in construction	-31.4	-27.4	-27.8	26.1	50.6 (2013)	95.3 (Jan.)
Outstanding balance of total bank credit to housing[4]	3.7	-0.3	-2.9	-3.4	-3.3	...

Sources: ELSTAT (capital goods output, volume of private construction activity, cement production, production in construction), IOBE (capacity utilisation, business expectations), Bank of Greece (bank credit to domestic enterprises and housing, disbursements under the Public Investment Programme).
1 Except for capacity utilisation 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. 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 As of January 2012 actual cash payments and not appropriations under the public investment budget.
4 Comprising loans and securitised loans. The rates of change are adjusted for loan write-offs, foreign exchange valuation differences and the transfer of loans by one bank to a domestic subsidiary finance company in 2009.

and their positive impact on associated sectors (construction materials, means of transport, supporting services).

Other positive developments include the interest expressed by large foreign multinational corporations in moving part of their production facilities or distribution centres to Greece, as well as the continuation of the privatisation programme. A number of major tenders are currently in progress (for regional airports, a first group of four marinas, TRAINOSE-ROSCO), while preparations are under way for the launching of procedures, in the near future, of major privatisations, including the ones of the Piraeus Port Authority and the Thessaloniki Port Authority, Athens International Airport and the Ellinikon real estate. Based on the preparations carried out and the interest expressed by foreign investors, it is estimated that the privatisation programme could be accelerated in 2014, despite the fact that the completion of the relevant procedures is time-consuming and subject to external factors, such as compliance with EU legislation on competition and state subsidies. However, the course of investment demand should be seen as highly dependent on the outcome of the privatisation programme, in terms of its ability to both generate a positive investment climate and attract additional funds from investors (e.g. the maintenance investment of €239 million over the first three years of the concession period for regional airports, commitment for investment of €500 million over five years for the Piraeus Port Authority).

The course of the Public Investment Programme in 2013 was satisfactory. Payments under the Programme were 14.5% higher than in 2012 (see Table V.3). The target for 2014

Table V.4 Gross value added at basic prices and GDP at market prices (2008-2012 and Jan.-Sept. 2013)

(annual percentage changes and sectoral contributions to gross value added; at constant prices of 2005)

	Annual percentage changes					
	2008	2009	2010	2011	2012	2013 Jan.-Sept.
1. Agriculture, forestry and fishing	**2.0 (0.1)**	**5.2 (0.2)**	**5.5 (0.2)**	**-5.4 (-0.2)**	**-3.2 (-0.1)**	**-2.9 (-0.1)**
2. Secondary sector	**-10.2 (-2.1)**	**-8.5 (-1.5)**	**-9.9 (-1.7)**	**-12.6 (-2)**	**-4.5 (-0.7)**	**-3.9 (-0.6)**
2.1 Industry including energy	-9.7 (-1.2)	2.0 (0.2)	0.9 (0.1)	-7.4 (-0.9)	-1.7 (-0.2)	-1.7 (-0.2)
2.2 Construction	-11.0 (-0.9)	-24.6 (-1.8)	-32.3 (-1.8)	-28.4 (-1.1)	-15.6 (-0.5)	-13.8 (-0.4)
3. Tertiary sector	**2.8 (2.1)**	**-1.2 (-1)**	**-4.9 (-3.7)**	**-5.7 (-4.6)**	**-6.8 (-5.4)**	**-4.1 (-3.3)**
3.1 Trade, hotels and restaurants, transport and storage	-1.5 (-0.4)	-9.2 (-2.5)	-3.8 (-0.9)	-10.9 (-2.8)	-13.3 (-3.2)	-7.8 (-1.8)
3.2 Information and communication	17.2 (0.7)	7.6 (0.4)	-10.3 (-0.6)	-8.1 (-0.4)	-5.7 (-0.3)	-10.3 (-0.5)
3.3 Financial and insurance activities	11.6 (0.6)	-2.5 (-0.1)	-1.0 (-0.1)	-8.0 (-0.5)	-9.4 (-0.5)	-7.9 (-0.5)
3.4 Real estate activities	7.8 (0.9)	2.3 (0.3)	-8.1 (-1.1)	2.4 (0.3)	0.3 (0)	0.1 (0)
3.5 Professional, scientific and technical activities	-3.6 (-0.2)	7.4 (0.4)	-14.1 (-0.9)	-18.1 (-1)	-4.0 (-0.2)	-6.9 (-0.3)
3.6 Public administration and defence	3.8 (0.7)	1.1 (0.2)	-1.5 (-0.3)	-0.8 (-0.2)	-3.2 (-0.7)	-0.6 (-0.2)
3.7 Arts, entertainment and recreation	-4.1 (-0.2)	8.8 (0.3)	-0.7 (0)	-0.2 (0)	-11.4 (-0.5)	-0.9 (0)
4. Gross value added at basic prices	**0.0**	**-2.2**	**-5.2**	**-6.6**	**-6.2**	**-3.9**

Source: ELSTAT, quarterly national accounts, December 2013, non-seasonally adjusted data.
Note: Within parentheses, contributions to gross value added in percentage points.

has been set at €7 billion, slightly above the estimated outcome for 2013 (€6.65 billion). The ability to reach this target for 2014 will depend on the restrictions entailed by fiscal consolidation.

Between the first nine months of 2009 and the first nine months of 2013, the **gross value added of the economy** at constant prices declined by some 20% (see Table V.4). The decline in certain sectors (construction, trade) was much more pronounced (65% and 29%, respectively), leading to a marked decrease in their share in total economic activity. The construction sector, which accounted for 7.4% of the economy's total value added during the period 2000-2009, saw its share decrease to 3.1% during the period 2010-2013, while certain services subsectors, such as **trade, hotels and restaurants, and transport and storage**, saw their shares in total value added decline slightly from 25.5% to 24.0% (see Table V.5). The share of industry in total value added has remained stable (at close to 13%), despite the extensive changes that have taken place within the sector (see Tables V.6 and V.7), particularly in manufacturing. Traditional sectors (textiles, clothing, leather processing) have reduced their output by half or more. Other traditional, yet dynamic, sectors have reduced production by some 10% (food, tobacco) or have increased it marginally (metals: +6%). Finally, sectors with a strong export orientation (refineries, pharmaceutical firms) have increased their output at a double-digit rate.

Table V.5 Activity indicators in the services sector (2009-2013)

(annual percentage changes)

	2009	2010	2011	2012	2013 (available period)
A. Services turnover indicators					
1. Trade					
Wholesale trade	-8.9	-5.9	-13.5	-12.2	-11.6 (Jan.-Sept.)
Retail trade	-10.2	-1.1	-7.2	-11.0	-8.7 (Jan.-Nov.)
Motor trade	-15.7	-36.5	-26.5	-29.3	-6.2 (Jan.-Sept.)
2. Transport					
Land transport	-31.5	-18.1	-1.7	-3.3	-8.1 (Jan.-Sept.)
Sea transport	-22.8	-8.5	-2.7	-15.3	-7.6 (Jan.-Sept.)
Air transport	-11.7	-7.0	-0.9	-1.1	18.2 (Jan.-Sept.)
Storage and supporting transport activities	-32.2	-10.8	-7.9	-4.8	-6.7 (Jan.-Sept.)
3. Hotels and restaurants					
Accommodation and food service activities	-9.1	-8.2	-7.4	-17.2	-0.2 (Jan.-Sept.)
4. Information and communication					
Telecommunications	-8.9	-11.3	-8.9	-5.1	-13.2 (Jan.-Sept.)
Film, video, and TV programme production, recordings and music products	1.4	-6.6	-28.4	-4.9	-14.9 (Jan.-Sept.)
Programming and broadcasting activities	-6.7	-2.1	-27.1	-16.3	-13.8 (Jan.-Sept.)
5. Professional-scientific-technical activities					
Legal, accounting and management consulting services	-12.4	-7.3	-0.3	4.5	7.7 (Jan.-Sept.)
Architectural and engineering services	-18.6	-20.4	-19.6	-12.3	-11.4 (Jan.-Sept.)
Advertising and market research	-18.4	-23.8	-21.2	-16.7	-20.7 (Jan.-Sept.)
Travel agencies and related activities	-9.9	-24.5	-35.3	-26.9	6.9 (Jan.-Sept.)
B. Passenger traffic					
Athens International Airport	-1.5	-5.0	-6.3	-10.4	-3.2 (Jan.-Dec.)
Aegean Airlines[1]	9.9	-5.1	4.2	-5.8	9.0 (Jan.-Sept.)
Piraeus port (OLP)	-3.8	-6.0	-0.8	-17.5	1.0 (Jan.-Dec.)
C. Business expectations index in the services sector	**-28.3**	**-9.3**	**-2.9**	**-11.2**	**28.4 (Jan.-Dec.)**

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

Restructuring the economy by reallocating resources to more strongly export-oriented activities is of utmost importance. The extent to which this shift has actually taken place is still limited (see Table V.1). However, the structural reforms carried out in recent years and still ongoing in the labour and product markets will strengthen growth, as, inter alia, they facilitate the reallocation of funds from one sector to another. According to the OECD,[2] the benefits of the reforms already undertaken could be significant. Indicatively, based on OECD estimates, reforms that improve the product market regulation (PMR) indicator by about 0.8 percentage point

2 OECD (2013), *Economic Outlook*, Vol. 2013/2, OECD Publishing (http://dx.doi.org/10.1787/eco_outlook-v2013-2-en).

Table V.6 Indicators of industrial activity (2009-2013)

(annual percentage changes)[1]

	2009	2010	2011	2012	2013 (available period)	2014 (available period)
1. Industrial production index (general)	**-9.4**	**-5.9**	**-7.8**	**-3.4**	**-3.9 (Jan.-Nov.)**	...
Manufacturing	-11.2	-5.1	-8.5	-4.2	-1.9 (Jan.-Nov.)	...
Mining and quarrying	-11.8	-6.5	0.6	0.7	-10.5 (Jan.-Nov.)	...
Electricity	-4.2	-9.2	-8.8	-3.0	-8.2 (Jan.-Nov.)	...
Main industrial groupings						
Energy	-2.9	-4.9	-8.4	5.3	-4.3 (Jan.-Nov.)	...
Intermediate goods	-18.4	-0.9	-8.8	-10.6	-3.3 (Jan.-Nov.)	...
Capital goods	-22.5	-22.1	-9.7	-16.4	-11.8 (Jan.-Nov.)	...
Consumer durables	-20.7	-13.4	-15.6	-18.4	-15.1 (Jan.-Nov.)	...
Consumer non-durables	-4.1	-7.2	-4.8	-6.0	-2.0 (Jan.-Nov.)	...
2. Industrial turnover index[2]	**-23.2**	**6.0**	**7.1**	**3.0**	**-5.8 (Jan.-Nov.)**	...
Domestic market	-22.2	-0.7	-2.3	-6.4	-11.0 (Jan.-Nov.)	...
External market	-25.6	29.3	21.6	20.2	1.4 (Jan.-Nov.)	...
3. Industrial new orders index[3]	**-28.1**	**4.2**	**1.8**	**-8.1**	**-6.8 (Jan.-Nov.)**	...
Domestic market	-23.4	-3.4	-23.7	-11.9	-6.8 (Jan.-Nov.)	...
External market	-34.7	28.2	22.3	-4.6	-7.3 (Jan.-Nov.)	...
4. Index of business expectations in industry	**-21.5**	**5.1**	**1.4**	**0.4**	**13.7 (2013)**	**1.3 (Jan.)**
5. Industrial capacity utilisation rate	**70.5**	**68.5**	**67.6**	**64.4**	**65.9 (2013)**	**65.9 (Jan.)**
6. Purchasing Managers' Index (PMI)[4]	**45.3**	**43.8**	**43.6**	**41.2**	**49.6 (2013)**	**51.2 (Jan.)**

Sources: ELSTAT (industrial production index, industrial turnover and new orders), IOBE (expectations, industrial capacity utilisation rate), Markit Economics and Hellenic Purchasing Institute (PMI).
1 Excluding capacity utilisation in industry (%) and the PMI in manufacturing.
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.

translate into an increase in annual GDP growth of about 0.7 percentage point for over 10 years, through the improvement of total factor productivity. In Greece, the PMR indicator improved by about 0.4 percentage point between 2008 and 2013. The positive impact on GDP growth should be even larger, once labour market improvement is taken into account.

2014 is expected to be the first year of positive growth since the onset of the recession, driven by higher business investment and exports, which will more than offset the negative impact from the continued fall in consumption. Wage cuts are expected to be very limited, compared with those in the past two years, while employment in the private sector is expected to show signs of recovery and unemployment to start falling. Strengthening confidence in Greece's prospects, continuing structural reforms and ensuring adequate financing of the economy are the most pressing challenges in the year ahead.

2 DEVELOPMENTS AND PROSPECTS IN THE REAL ESTATE MARKET

Over the period 2010-2013, mounting pressures on market values, prices and rents of both residential and commercial properties

Table V.7 Industrial production

(2005=100)

	Weights 2005		Level 2009 (2005=100)	Average annual percentage changes				Level 2013 (2005=100)
				2010	2011	2012	2013	
Industry	**100.0**		**89.7**	**-5.9**	**-7.8**	**-3.4**	**-3.6**	**72.5**
1. Mining and quarrying	***6.1***	***100.0***	***81.5***	***-6.5***	***0.6***	***0.7***	***-9.8***	***69.6***
Mining of coal and lignite		56.6	92.9	-13.1	5.9	8.6	-14.7	79.1
Extraction of crude petroleum and natural gas		1.9	82.7	42.5	-24.3	-2.2	-7.9	80.3
Mining of metal ores		9.1	63.9	16.2	18.5	-13.9	-0.1	75.7
Other mining and quarrying		32.4	66.6	-0.1	-13.7	-13.6	2.0	50.6
2. Manufacturing	***69.8***	***100.0***	***88.2***	***-5.1***	***-8.5***	***-4.2***	***-2.0***	***71.9***
Food		18.2	100.8	-4.1	-0.9	-3.4	-5.0	87.9
Beverages		6.0	104.2	-7.6	-9.3	-8.3	-2.2	78.4
Tobacco		1.9	90.4	-17.5	10.5	-8.9	2.7	77.1
Textiles		3.1	52.8	-20.6	-22.0	-19.8	-14.8	22.3
Wearing apparel		3.4	62.9	-23.1	-25.2	-6.9	-4.1	32.2
Leather and footwear		0.6	79.2	-36.9	-15.6	-31.7	-1.2	28.5
Wood and cork		1.2	55.2	9.4	24.9	-29.5	-24.8	40.0
Paper and paper products		2.3	97.4	-3.4	-8.9	-10.8	2.5	78.3
Printing and reproduction of recorded media		1.9	88.1	-14.1	-24.5	-20.7	-9.9	40.8
Coke and refined petroleum products		11.3	104.8	5.7	-14.5	24.3	4.3	122.9
Chemicals and chemical products		5.3	83.4	1.5	-4.4	-12.2	2.1	72.6
Basic pharmaceuticals		2.5	149.9	2.4	-0.4	-5.2	13.4	164.4
Rubber and plastic products		4.2	91.8	-7.0	-7.7	-9.2	1.4	72.6
Non-metallic mineral products		10.3	69.3	-14.2	-35.7	-15.8	-1.7	31.6
Basic metals		8.0	82.7	12.0	6.4	-6.2	-5.6	87.2
Metal products		5.1	79.6	0.2	-4.4	-10.4	-13.1	59.3
Computers, electronics and optical products		1.2	41.7	-26.6	-23.6	-6.9	31.2	28.6
Electrical equipment		3.0	82.4	-4.1	-11.0	-6.1	-12.5	57.8
Machinery and equipment n.e.c.		2.1	82.1	-21.0	-8.0	-11.3	2.1	54.0
Motor vehicles, trailers and semi-trailers		0.8	72.8	-1.6	-30.5	-13.8	-2.4	41.9
Other transport equipment		1.6	84.4	-35.1	-32.4	-41.9	-10.2	19.3
Furniture		1.5	77.6	-19.0	-22.1	-29.9	-18.0	28.1
Other manufacturing activities		0.5	72.0	-10.5	-13.3	-12.7	-5.1	46.3
Repair and installation of machinery and equipment		4.1	75.2	-22.8	-1.4	-14.6	-14.8	41.6
3. Electricity	***20.8***	***100.0***	***94.7***	***-9.2***	***-8.8***	***-3.0***	***-6.9***	***70.8***
4. Water supply	***3.3***	***100.0***	***103.0***	***0.7***	***-1.6***	***1.0***	***-2.8***	***100.1***
Industry	**100.0**		**89.7**	**-5.9**	**-7.8**	**-3.4**	**-3.6**	**72.5**
Main industrial groupings								
Energy	36.8		97.5	-4.9	-8.4	5.3	-4.0	85.9
Intermediate goods	28.0		78.5	-0.9	-8.8	-10.6	-3.1	61.5
Capital goods	8.6		71.5	-22.1	-9.7	-16.4	-12.2	36.9
Consumer durables	2.3		77.6	-13.4	-15.6	-18.4	-14.6	39.5
Consumer non-durables	24.3		98.4	-7.2	-4.8	-6.0	-1.4	80.6

Source: ELSTAT.

were the main characteristic of the real estate market, as a considerable decline in demand resulted in excess supply. Reduced demand is attributable mainly to a surge in unemployment, a fall in households' disposable income, real estate tax hikes and an uncertain —at least until recently— tax regime, together with a liquidity squeeze against the backdrop of banks' tightened credit standards. Furthermore, expectations of further declines in house prices have had an adverse impact on the Greek real estate market.

In the **housing market**, the drop in prices has continued at a strong pace since 2011.[3] Data collected from credit institutions show a cumulative drop of 33.4% in apartment prices between 2008 (average level) and the last quarter of 2013. Data collected from real estate agencies suggest an even sharper decline. The falls in prices were stronger in the two major urban centres (Athens: -35.8% and Thessaloniki: -37.1%), compared with other cities (-30.9%) and other regions (-29.4%), as well as larger properties in relatively higher-value areas in Greece.

During the crisis, households' purchasing interests shifted towards smaller, older and more affordable properties in medium-value areas. Moreover, the percentage of cash transactions and the required down-payment for real estate purchases have increased. According to data from the quarterly survey of real estate agencies and property advisors conducted by the Bank of Greece, a mere 17% of transactions were financed by banks (compared with 82% in early 2009), while the average loan-to-value ratio came to roughly 35% (compared with 70% in early 2009). In addition, the average offer period more than doubled during the crisis (from about 5 months in early 2009 to almost a year in 2013), while the average difference between initially asked and final purchase prices rose significantly (from 12.6% to 20.7% respectively).[4]

The **commercial property market** has also seen a dramatic decline over the past few years, with significant pressures to renegotiate and reduce rents, especially for secondary retail properties, warehouses and non-prime office buildings. Both rental and market values dropped further in 2013, at an average annual rate of 16.3% and 16.9%, respectively (according to data from the survey of real estate agencies). The market for retail shops, subject to the strongest pressures since the onset of the current crisis, has shown weak signs of stabilisation. Positive expectations have been recorded in the sector of tourist properties and holiday residences, while there are certain indications of foreign investment inflows as a result of the participation of foreign funds in the share capital of Greek Real Estate Investment Companies (REICs).

Throughout the current crisis, the slump in business activity has been accompanied by reduced demand for commercial properties, with companies shifting towards cheaper premises. As a result, the market is characterised by excess supply, an increased number of vacant retail shops and offices, a dramatic fall in transactions, and a downward trend in prices. Moreover, as a result of financing constraints, coupled with an uncertain economic environment, investors remain rather reluctant. However, some agreements on the sale of high-end properties were concluded in the course of 2013, which are estimated to account for a €1 billion investment in the Greek commercial property market. REICs have also been active, as the new institutional framework on REICs (Law 4141/2013) introduced significant improvements and provided new incentives. These incentives should further bolster REICs as an

3 Until the end of 2011, the prices of apartments, most notably newly built ones, which are sold mainly by constructors, were relatively resilient; this is thought to be due to the high percentage of owner-occupancy, the large number of micro (family) businesses involved in residential construction which, before the current crisis, had earned substantial profits that enabled them to steer away from bank loans, the high cost of transactions (property transfer tax, notarial costs and lawyer fees, etc.), the increasing cost of construction that hampers the replacement of the existing stock of houses, the traditionally high confidence of Greek households in real estate, etc.

4 The results of the quarterly survey of real estate agencies and property advisors are available on the Bank of Greece's website: http://www.bankofgreece.gr/Pages/el/Statistics/realestate/publications.aspx.

institution and attract investor interest, and might also lead to the emergence of new venture schemes.

After delays of several years, notable efforts are now being made for the development of major **real estate properties (land and buildings) owned by the Greek state**, although the relevant public property development programme is still moving forward at a slow pace and has failed to generate significant revenues. The most important agreements concluded so far include the development of the International Broadcasting Centre (IBC) in the Municipality of Amaroussion and the land in Kassiopi (Corfu), as well as the sale of five properties situated abroad (London, Brussels, Tashkent, Belgrade and Nicosia), while an agreement on the development of a property in Paliouri (Halkidiki) has moved to the final phase. The most significant of all the state property development projects that are under way concerns the recent agreement on the exploitation and development of the Astir Vouliagmenis property, which is expected to generate high added value.

The swift completion of procedures for the development of public real estate assets already in progress (land in the former Ellinikon International airport, regional airports and harbours, etc.) is particularly important, as the relevant agreements are expected to attract further funds and mainly convey an appropriate positive message to international investors and markets.

A pick-up in demand and investment interest in the Greek real estate market, however, hinges on taking action to slash red tape and reduce the complexity of the existing institutional framework on urban planning. Red tape in the Greek real estate market, a multitude of legally prescribed procedures and charges (mandatory hiring of a lawyer, although this requirement was recently partly abolished, notarial costs, engineer certificate, energy certificate and, more recently, Unified Property Tax payment certificate, etc.), along with ambiguous urban planning regulations and multiple violations thereof, the lack of a stable and clear framework on regional planning and land use, as well as of a complete and accurate land register, are still some of the factors that discourage demand and often prevent the conclusion of investment agreements with prospective foreign investors. Many of these problems, together with the fact that the Greek state's property is not accurately recorded, hinder the development of public real estate assets.

The recovery prospects of the real estate market depend on, inter alia, further improving business and household expectations, easing bank financing conditions, reducing uncertainty and boosting the recovery prospects of the Greek economy. Tax hikes on real estate amidst the current crisis made the recession in the real estate market more pronounced and considerably discouraged demand. In fact, the distortion caused by the existence of real estate "objective" values, which in many cases (e.g. large properties in high-end areas, inner city Athens, etc.) significantly exceed market values, leads to **artificially excessive taxation of real estate** and a further contraction of values beyond what would be rational.

Recent legislation on real estate taxation reduced the uncertainty of the real estate tax regime, while the significantly lowered Property Transfers Tax (down to 3%) is expected to help boost the particularly low frequency of transactions in the Greek real estate market.[5]

5 The most significant changes in real property taxation enacted since early 2014 include: (a) the introduction of a Unified Property Tax (ENFIA – now imposed on all types of real estate, including land plots and agricultural properties) and an additional tax to be levied on owners of real estate valued at more than €300,000, in replacement of the special property tax paid through electricity bills (EETA, previously known as EETHDE) and the Real Property Tax (FAP); (b) the introduction of a Capital Gains Tax on property-selling owners (equal to 15% of the difference between the acquisition price and the selling price, progressively reduced depending on the holding period of the property); (c) special taxation on property income at a rate of 11% (with no tax-free amount) for revenues up to €12,000 and 33% for revenues over €12,000; and (d) a considerable cut in the Property Transfer Tax (to 3% from 8% for properties valued up to €20,000 and to 10% for higher-value properties). In addition, the requirement to disclose the origin of the funds used to buy or construct real estate property has been reintroduced. It should be noted that the implementation of the Capital Gains Tax came up against considerable difficulties, which have resulted in the freezing of a considerable number of transfers in the first two months of 2014.

Furthermore, it is expected that the extension of the suspension of part of primary residence auctions in 2014, coupled with the regained access of households with NPLs to the banking system and the new provisions allowing them to pay significantly lower and more affordable loan instalments, will help stabilise the market.

Downward trends in house prices should continue into the following quarters, albeit at a relatively more moderate pace, given that the high rates of decline recorded in 2012 and the first half of 2013 seemed to have eased in the third and fourth quarters of 2013.

3 EMPLOYMENT AND UNEMPLOYMENT: DEVELOPMENTS AND PROSPECTS

The recession has taken a heavy toll on employment: between the third quarter of 2009 and the third quarter of 2013, 904.2 thousand jobs were lost (-19.9%). As a result, the **employment rate** of the population aged 20-64 fell to 53.3% in the first nine months of 2013, from 64.4% in the corresponding period of 2010 and against Greece's target of 70% by 2020 (the target for the EU-28 as a whole has been set at 75%).

The decline in employment was not uniform over the entire period. Employment fell at an increasing rate from 2010 through the third quarter of 2012, but thereafter the decline in employment for both employees and the self-employed has slowed (see Chart V.8). As shown by data on private-sector dependent employment flows (Ergani Information System), the decelerating decline in employment appears to stem more from a rise in recruitments than from a decrease in employment contract terminations. Although figures for September 2013 onwards may have been partly affected by the imposition of stricter fines for undeclared labour (see Ergani press release, 6.1.2014), such a trend had already emerged earlier and may be attributable to the structural reforms in the labour market. The extent of the reforms is also reflected in the OECD Employment Protection Legislation (EPL) indicator, which measures the extent to which the labour market is constrained by regulations. Greece's score has improved and is converging towards the OECD average.

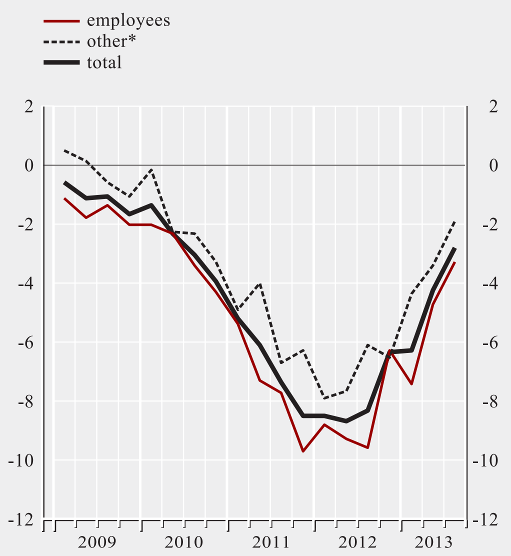
The decline in headcount employment stems from the closing of a large number of businesses (according to IKA data, about 75.6 thousand businesses —i.e. 30% of the total— have shut down) and from staff cutbacks by businesses that continue to operate. The **number of businesses** has decreased more in the sectors of trade, manufacturing, construction, hotels and restaurants, and education. In all sectors except manufacturing, the number of small businesses has decreased more than the number of large ones. Thus, the average number of persons employed by enterprise has risen.

The **occupational groups** most affected are unskilled workers, salespersons, machine operators and office clerks.

The use of **part-time employment** increased significantly, particularly in the private sector.

Chart V.8 Employment (2009 Q1-2013 Q3)

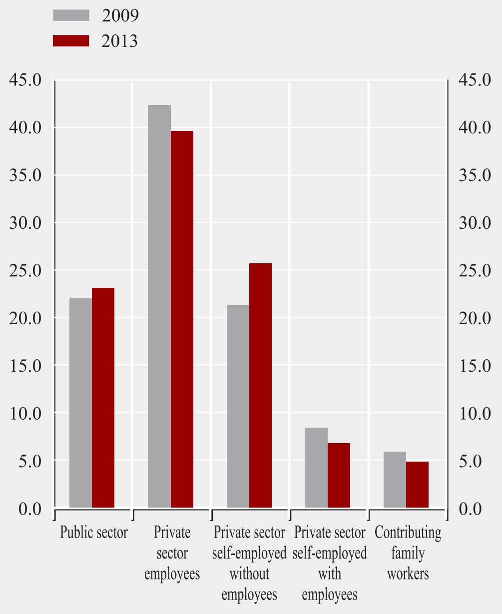
(year-on-year percentage change)



Source: ELSTAT, Labour Force Surveys.
* Other = self-employed with employees (employers) + self-employed without employees + contributing family workers.

Chart V.9 Employment by sector and professional status

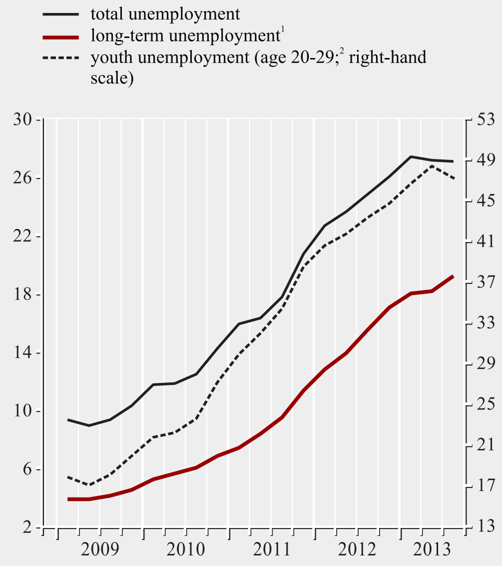
(percentage)



Source: ELSTAT, Labour Force Surveys.

Chart V.10 Unemployment rates (2009 Q1-2013 Q3)

(percentage of labour force)



Source: ELSTAT, Labour Force Surveys.
1 Defined as having been unemployed for over 12 months.
2 As a percentage of the labour force of the same age group.

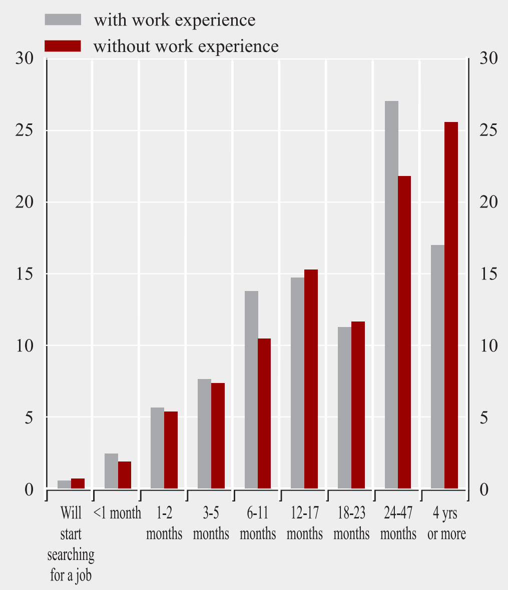
The share of part-time employees in the private sector rose by 5.2 percentage points to 12.9% in the first nine months of 2013, from 7.7% in the corresponding period of 2010, reflecting increased recourse in many sectors to part-time contracts, as well as the restructuring of employment in favour of sectors (e.g. retail trade) where part-time work is more widespread. The share of persons employed under a **fixed-term contract** has fallen, possibly on account of changes in severance pay entitlement conditions (severance pay is higher for a worker under a fixed-term contract who is dismissed before completing at least 12 months of consecutive employment than for a worker employed under an open-ended contract).

As a result of the above, certain **structural features** of the labour market have changed. The structure of employment has shifted towards higher skills, as well as towards the tertiary and primary sectors and away from the secondary sector – mainly due to the substantial decline of employment in construction, but also to lower employment in manufacturing. Although employment declined in both the public and the private sectors, the share of employment in the public sector was slightly higher in the first nine months of 2013 than in the corresponding period of 2009 (23.1% in 2013, up from 22.1%) (see Chart V.9). From 2010 to 2013, the share of employees in the private sector fell, while the share of self-employed without personnel (see Chart V.9) increased.

The **number of unemployed** increased by 880.3 thousand between the third quarter of 2009 and the corresponding period of 2013, and the unemployment rate rose from 9.3% and 12.4% in the third quarters of 2009 and 2010, respectively, to 27.0% in the corresponding period of 2013 (see Chart V.10). The **unemployment rate** in the third quarter of 2013 was the highest in the EU-28, followed by that of Spain, which was about one percentage point lower, according to the European Union Labour Force Survey (EU-LFS).

Chart V.11 Distribution of the unemployed (with or without work experience) by length of job search (2013 Q3)

(percentage)



Source: ELSTAT, Labour Force Surveys.

In terms of unemployment duration, about one fifth of the persons unemployed in 2013 had been unemployed since 2009. Unemployment of such duration is more frequent among the older aged group and persons with no previous work experience (see Chart V.11). Indicatively, of those who reported being unemployed for the past 4 years, roughly 30% had not worked before.

The large percentage of **long-term unemployed** (see Chart V.10) gives rise to concerns about a possible shortage of skills once growth resumes, which would put upward pressure on wages. However, such concerns are exaggerated, given the large supply of labour, as evidenced by both the large number of unemployed and of often skilled part-time workers who would have liked to work full-time.

In 2014, the unemployment rate is expected to decrease. Both the number of employees in the private sector and the number of self-employed are set to increase in the course of year. This trend stands to be reinforced by the employment and training programmes of the Manpower Employment Organisation (OAED). Such programmes —soon to be intensified, as recently announced— are much needed in the current context, in order to prevent the skills of the unemployed from becoming obsolete.

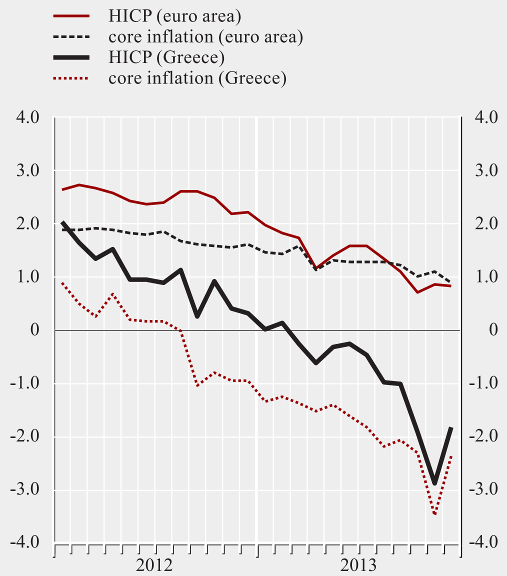
4 INFLATION, LABOUR COSTS AND PROFITS: DEVELOPMENTS AND PROSPECTS

4.1 INFLATION

Over the period 2010-2013, the average annual rate of HICP inflation was 2%. However, it varied considerably during this period (see Table V.8 and Chart V.12), rising to well above 2% in 2010 and 2011 (when it reached 4.7% and 3.1%, respectively), declining markedly to 1.0% in 2012 and sliding into negative territory in 2013 (-0.9%).

Chart V.12 Harmonised index of consumer prices (HICP) and core inflation in Greece and the euro area (January 2012-December 2013)

(year-on-year percentage changes; monthly data)



Sources: ELSTAT and Eurostat.

Table V.8 Price developments in Greece and the euro area

(annual percentage changes)

	2009	2010	2011	2012	2013
A. Euro area					
Harmonised Index of Consumer Prices (HICP) and its components					
Overall index	**0.3**	**1.6**	**2.7**	**2.5**	**1.4**
Goods	-0.9	1.8	3.3	3.0	1.3
Food	0.7	1.1	2.7	3.1	2.7
Processed food[1]	1.1	0.9	3.3	3.1	2.2
Unprocessed food	0.2	1.3	1.8	3.0	3.5
Industrial goods	-1.7	2.2	3.7	3.0	0.6
Non-energy industrial goods	0.6	0.5	0.8	1.2	0.6
Energy	-8.1	7.4	11.9	7.6	0.6
Services	2.0	1.4	1.8	1.8	1.4
Industrial producer prices	***-4.8***	***2.7***	***5.7***	***2.8***	***-0.2***
B. Greece					
Harmonised Index of Consumer Prices (HICP) and its components					
Overall index	**1.3**	**4.7**	**3.1**	**1.0**	**-0.9**
Goods	-0.1	5.9	4.0	1.9	0.7
Food	2.5	3.1	4.2	1.3	0.9
Processed food[1]	1.6	5.0	4.7	1.2	0.7
Unprocessed food	3.9	0.2	3.4	1.4	1.3
Industrial goods	-1.7	7.7	3.9	2.3	0.4
Non-energy industrial goods	0.8	1.9	-0.2	-0.6	-1.7
Energy	-12.1	30.4	16.7	12.6	6.3
Services	3.2	3.1	1.9	-0.2	-2.9
Industrial producer prices	***-5.8***	***6.1***	***7.4***	***4.9***	***-0.7***

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

Consumer price developments reflect changes in VAT rates (March and July 2010, January 2011), changes in excise duties (the latest of which was an increase in the excise duty on heating oil in October 2012), oil price variations, as well as sluggish demand. Indicative of the impact of indirect taxes on HICP inflation is the fact that average annual inflation excluding the impact of indirect taxes is estimated at 1.3% in the period 2010-2011 and at only 0.1% in 2012.

High inflation in 2010 and 2011 was largely driven by a continued double-digit increase in international oil prices (see Chart V.13), while 2011 also saw increases in unprocessed food prices. Thus, over the period 2010-2012, average annual core inflation —which excludes energy and unprocessed food prices— was on average 1.4 percentage points lower than the aggregate HICP index. Oil prices also pushed upwards the prices of industrial goods (see Table V.9). As a result, price increases were steeper for goods than for services.

In greater detail, with regard to the prices of fresh fruit and vegetables, a recent sector survey on the price levels of seven products conducted by the Hellenic Competition Commission (Dec.

Table V.9 Price indicators

(annual percentage changes)

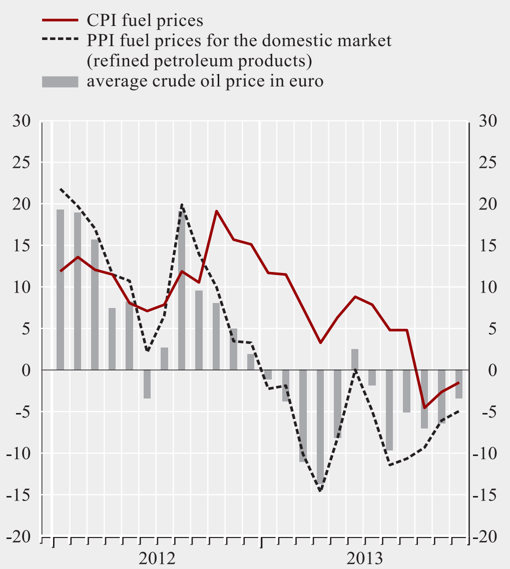
Year	Consumer Price Index: General index	Sub-indices: Goods	Services	CPI excluding fuel & fresh fruit and vegetables	CPI excluding food & fuel	Food and non-alcoholic beverages	Fresh fruit and vegetables	Fuel
2009	1.2	-0.5	3.6	2.4	2.6	1.9	5.3	-15.7
2010	4.7	5.6	3.6	3.0	3.4	0.1	-4.3	36.2
2011	3.3	4.2	2.3	1.5	1.3	3.1	5.1	18.8
2012	1.5	2.2	0.5	0.3	0.1	1.5	1.5	12.0
2013	-0.9	0.1	-2.2	-1.7	-1.9	0.0	3.0	4.6

Year	Industrial Producer Price Index – Domestic market: General index	Sub-indices: General index excl. energy	Intermediate goods	Consumer goods	External market: General index	Import price index in industry: General index	General index excl. energy
2009	-5.8	-0.1	-1.2	0.9	-6.0	-1.8	0.5
2010	6.1	0.9	2.3	-0.3	8.8	6.6	1.4
2011	7.4	2.7	4.8	1.1	8.8	7.6	1.5
2012	4.9	0.8	0.6	1.1	4.1	4.5	0.6
2013	-0.7	0.0	-1.1	1.1	-1.7	-2.7	-0.4

Source: ELSTAT and calculations based on ELSTAT data.

Chart V.13 Evolution of CPI/PPI fuel prices and of Brent crude oil prices (in euro) (January 2012 - December 2013)

(year-on-year percentage changes; monthly data)



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

2013)[6] concluded that, first, production costs for these products are higher in Greece than in other countries mostly due to the small size of agricultural producers, and, second, that wholesale undertakings, relatively small in size and disproportionately large in number, have a strong power of negotiation over farmers. It was generally found that price decreases are not passed on by wholesalers and retailers to the end-consumer as rapidly as price increases.

In 2013, the fact that previous indirect tax increases dropped out of calculations of annual inflation, combined with the decline in unit labour costs, which reached about 18% cumulatively over the period 2010-2013 (in the total economy), the sharp drop in disposable income and the ensuing severe contraction of demand, caused the rate of annual average headline inflation to turn negative as of March 2013 and the deflationary trend to intensify in

6 http://www.epant.gr/img/x2/news/news599_1_1386162734.pdf

the last quarter of the year. Other factors in this clearly negative rate of inflation towards the end of 2013 were the VAT rate cut on food services from 23% to 13%, the fact that the excise duty increases on heating oil in October 2012 dropped out of calculations of annual inflation, and the newly introduced mid-season sales in the first ten days of November. Thus, average inflation fell from 4.7% in 2010 to 3.1% in 2011, 1.0% in 2012 and -0.9% in 2013. Similarly, average core inflation (HICP inflation excluding energy and unprocessed food) also declined from 3.0% in 2010 to 1.7% in 2011, -0.1% in 2012 and -1.9% in 2013.

In 2014, the inflation rate is expected to remain broadly at the levels of 2013. However, core inflation is expected to decline at a much slower rate than in 2013.

4.2 LABOUR COSTS

The period 2010-2013 saw a large cumulative decline in average gross earnings in the total economy (-18.9%),[7] attributable to (a) fiscal consolidation (leading to public sector wage cuts); (b) regulatory reforms to enhance labour market flexibility; and (c) the economic recession that has increasingly weakened workers' bargaining power. Moreover, the nominal *minimum wage* declined cumulatively by 19.9%. The cumulative decline in average gross earnings was conducive to the following:

– first, in combination with a 1.3% increase in productivity (GDP per person employed), to a 18.2% decline in unit labour costs in the total economy, and to an even greater decline (of 23.9%) in the business sector (due to larger wage cuts and stronger productivity gains), which contributed to the recouping of the international cost competitiveness losses incurred in the previous nine years; and

– second, in combination with the 20.8% decline in the number of persons employed, to a 34.9% decrease in the total compensation of employees, including employers' social security contributions. This however had a severe impact on consumer demand, with the purchasing power of average gross earnings in the total economy contracting by 25.2%.

Amongst the institutional reforms adopted to enhance labour market flexibility, mention should be made of the enactment of Law 4024/2011, which allows groups of employees ("associations of persons", where there is no trade union) to sign firm-level collective agreements, while parties may also agree on wages lower than those provided for under the relevant industry-level collective agreement – but not below the minimum wage. Thus, in the span from end-October 2011 (when Law 4024 amending the relevant legal framework was passed) to early February 2014, some 1,445 firm-level collective agreements were signed (409 in 2013). As a general rule, these agreements freeze wages or adjust them downwards by 10%-40%. It is estimated that from end-2011 to end-2013 some 29% or more of employees in the business sector saw wage reductions as part of firm-level and individual employment agreements, 27.5% as part of industry- and occupation-level collective agreements, and an additional 8.4% as a result of the conversion of full-time contracts into part-time or short-time work contracts.

2013 saw the strongest rate of wage reductions in the past four years. The Bank of Greece estimates that average earnings in the total economy fell by 7.4%[8] (2012: -6.6%).

7 In addition, based on the Wage Index for the total economy compiled by ELSTAT (and assuming that year-on-year change in wages in the first nine months of 2013 is indicative of average annual change in wages for 2013 as a whole), the cumulative decline in gross earnings was 18.7% over the period 2010-2013 and 23.0% over the five-year period from the third quarter of 2009 to the third quarter of 2013.

8 According to ELSTAT, on a national accounts basis, compensation of employees declined at an annual rate of 12.1% and compensation per employee declined at an annual rate of 7.4% in the period January-September 2013, while on the basis of non-financial accounts by institutional sector, compensation of general government employees (including expenditure for civil servant pensions) declined at an annual rate of 7.7% over the same period and compensation of employees in the business sector declined by 14.8%. Also, the Wage Index in the total economy (excluding the primary sector and household activities – non-seasonally adjusted data) fell at an annual rate of 8.5% in the period January-September 2013. Finally, as shown by data from the Labour Ministry's Ergani Information System, the firm-level agreements in the business sector signed in the course of 2013 provide for wage reductions of 5.6%.

Table V.10 Earnings and labour costs (2007-2014)

(annual percentage changes)

	2007	2008	2009	2010	2011	2012	2013	Cumulative change 2010-2013	2014 (fore-cast)
Average gross earnings (nominal):									
– total economy	*5.2*	*6.2*	*4.6*	*-4.6*	*-1.7*	*-6.6*	*-7.4*	*-18.9*	*-1.5*
– central government[1]	3.8	7.1	5.2	-7.7	-0.5	-3.8	-4.8	-15.9	0.0
– public utilities	7.1	8.2	7.7	-5.5	-7.9	-9.5	-10.0	-29.1	0.0
– banks	8.9	0.0	3.7	-1.8	0.1	-7.5	-10.0	-18.2	-6.3
– non-bank private sector	6.1	6.5	2.8	-2.9	-1.7	-9.3	-8.0	-20.4	-1.4
Minimum earnings	**5.4**	**6.2**	**5.7**	**1.7**	**0.9**	**-19.6[3]**	**-2.9[3]**	**-19.9**	**0.0**
Average gross earnings (real)	**2.2**	**1.9**	**3.3**	**-8.9**	**-4.7**	**-7.6**	**-6.7**	**-25.2**	**...**
Total compensation of employees	**8.2**	**8.5**	**3.2**	**-6.9**	**-8.1**	**-14.0**	**-11.5**	**-34.9**	**-1.2**
Compensation per employee	**5.6**	**6.8**	**4.9**	**-4.0**	**-0.7**	**-6.0**	**-7.5**	**-17.1**	**-0.8**
Unit labour costs:									
– total economy	4.5	8.7	6.4	-2.1	-1.1	-8.1	-8.1	-18.2	-1.7
– business sector[2]	5.3	7.9	4.4	-1.1	-3.5	-12.3	-9.0	-23.9	-2.2

Sources: ELSTAT (GDP 2007-2012) and Bank of Greece estimates/forecasts (GDP for 2013-2014 and the other annual aggregates for 2007-2014).
1 Outlays for wages and salaries per employee.
2 The business sector comprises private and public enterprises and banks.
3 Average annual change in 2012 and carryover effect for 2013, based on the cut in minimum earnings by 22% (for persons aged 25+) and 32% (for persons under 25) as of 15 February 2012.

Table V.11 Average earnings and unit labour costs in total economy: Greece and the euro area (2001-2014)

(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	2.2	1.1
2007	5.2	2.5	4.5	1.4
2008	6.2	3.4	8.7	3.8
2009	4.6	1.8	6.4	4.3
2010	-4.6	2.0	-2.1	-0.6
2011	-1.7	2.2	-1.1	0.8
2012	-6.6	1.8	-8.1	1.9
2013 (estimate)	-7.4	1.8	-8.1	1.1
2014 (forecast)	-1.5	1.8	-1.7	0.7

Sources: For Greece: Bank of Greece estimates; for the euro area: European Commission, *Economic Forecast Autumn 2013.*

It is estimated that in 2013 unit labour costs fell by 8.1% in the total economy and by 9.0% in the business sector (see Tables V.10 and V.11).

For 2014, it is expected that the average decrease in earnings will be very limited compared with the last two years. In fact, for some categories of employees wage levels will remain stable, while average working hours in the private sector, on the decline since 2008, are likely to gradually start increasing. Thus, in 2014 unit labour costs are expected to decline by 1.7% in the total economy and by 2.0% in the business sector, also reflecting a slightly faster rise in productivity, as the economy starts to recover. All the above imply that the target set in the 2nd Economic Adjustment Programme (Feb. 2012), i.e. a reduction of 15% in unit labour costs over the period 2012-2014, will be overachieved by a wide margin, as the cumulative reduction over this period would reach 22.0%.

4.3 BUSINESS PROFITS

Based on financial statement data disclosed by ATHEX-listed non-financial corporations (apart from the two refineries), gross profits saw a continuous decline over the period 2010-2013. Net profits fell in 2010 and 2013, whereas net losses were recorded in 2011 and 2012. Overall, this period is characterised by lower profit margins, as well as by lower returns on equity and assets.

In the January-September 2013 period, both the net and gross profit margins[9] of ATHEX-listed non-financial corporations (i.e. their profits-to-turnover ratio) continued to narrow. According to the published financial statements of 164 ATHEX-listed non-financial corporations,[10] sales dropped by 7.5%, gross profits by 11.0% and net pre-tax profits by 52.2%. Thus, the gross profit margin shrank by 0.6 percentage point (to 14.1%, from 14.7% in January-September 2012) and the net profit margin by 1.8 percentage points (to 1.9%, from 3.7%). Moreover, both return on equity (ROE) and return on assets (ROA) declined (to 1.5%, from 3.2%, and to 0.7%, from 1.3%, respectively). The non-financial accounts of institutional sectors published by ELSTAT also point to a considerable decline in the profits of non-financial corporations, with the net operating surplus of non-financial corporations having decreased in January-September 2013 at an annual rate of 21.8%. Nevertheless, a comparison of the change in unit labour costs in the total economy (annual estimate: -8.1%) with the change in the GDP deflator (-2.6% in 2013, according to provisional ELSTAT estimates) offers a different picture of the course of profit margins in the economy. This comparison indicates that profit margins in the total economy have at first sight widened.[11] However, it takes into account only labour costs, leaving out other input costs (raw materials and intermediate goods, energy consumption), financial costs and the tax burden on businesses.

5 COMPETITIVENESS

The decline in labour costs has led to improved cost competitiveness. Available indicators compiled by the Bank of Greece and international organisations show that, after more than two decades of almost uninterrupted losses in international price and labour cost competitiveness, the Greek economy has from 2010 onwards recovered a significant part of its lost competitiveness.

According to the real effective exchange rate indices based on relative unit labour costs in the total economy, the Bank of Greece estimates that the improvement in 2013 (7.8%), cumulated with the improvement in the immediately preceding years, resulted in a full recovery of the competitiveness lost over 2001-2009 (see Table V.12). Indicators based on rel-

9 The gross profit margin is calculated as the ratio of gross pre-tax profits to sales, while the net profit margin is calculated as the ratio of net pre-tax profits to sales.
10 This figure does not include the two refineries.
11 The ratio of GDP deflator to unit labour costs is often used as an indicator of profit margins in the economy.

Table V.12 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	On the basis of relative unit labour costs in total economy
2000	-6.3	-6.9	-5.0
2001	1.7	1.1	0.7
2002	2.3	2.6	4.0
2003	5.0	5.5	4.0
2004	1.7	1.9	4.3
2005	-1.0	-0.1	0.5
2006	0.0	0.8	0.8
2007	1.3	1.6	3.6
2008	2.4	2.5	7.1
2009	1.2	1.6	3.3
2010	-2.8	-0.5	-5.1
2011	0.5	0.4	-2.3
2012	-2.0	-3.7	-12.2
2013*	2.0	-0.6	-7.8
Cumulative percentage change between 2001 and 2013	12.7	13.5	-1.0

Sources: Exchange rates: ECB, euro reference exchange rates. Consumer prices: CPI, HICP where available: ECB. Unit labour costs in total economy: Bank of Greece estimates for Greece, ECB for the other countries.
* Provisional data.
1 These indices are compiled by the Bank of Greece and include Greece's 28 main trading partners. Weights were 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 2001-2013. Weights take account of third-market effects.

ative consumer prices show a smaller improvement in competitiveness between 2010 and 2013, both on account of higher indirect taxes and energy costs, which weighed heavily on domestic prices, and on account of persisting distortions in domestic goods and services markets. Despite a significant nominal appreciation of the euro since late 2012, the Bank of Greece estimates that the real effective exchange rate in 2013 improved by 0.6%. This is attributed to negative inflation in Greece and to a substantial negative inflation differential between Greece and its trading partners. Thus, the cumulative loss of 18.7% during 2001-2009 fell to 13.5% in 2013. Price competitiveness is expected to improve further, given that the inflation differential between Greece and its main trading partners will remain significant in 2014.

In terms of structural competitiveness, progress is also being made, albeit at a slow pace and from a very low starting point. In more detail, according to the World Bank's Ease of Doing Business index (October 2013), Greece rose from 89th position to 72nd, out of 189 countries. Based on the World Economic Forum's Global Competitiveness Index (September 2013), Greece ranked 91st among 148 countries (compared with 96th in 2012). The IMD World Competitiveness Scoreboard (May 2013) places Greece 54th among 60 countries, i.e. four places higher than the previous year. Although Greece has the highest rate of responsiveness to OECD recommendations on structural reforms (see Chart V.2), it continues to rank last among the advanced economies on the basis of coincident indicators of overall competitiveness.

6 EXTERNAL BALANCE: DEVELOPMENTS AND PROSPECTS

Over the past five years, the Greek economy has made impressive headway in cutting its current account deficit by almost 16 percentage points in GDP terms and in generating a surplus in 2013 (see Table V.13). On account of the recession, the import bill for both consumer and investment goods has declined considerably. Exports of goods, including oil products, benefited from the recovery of the European economy until mid-2011, the expansion to markets outside the euro area, and improved cost competitiveness from 2010 onwards. In contrast, export receipts from services, mainly travel and transport, were negatively affected by peaks in uncertainty in Greece, as well as by weaker growth rates of international trade, which put downward pressure on freight rates (see Chart V.14). A significant contribution to restoring the current account balance to equilibrium, however, came from the lower net interest payments on central government debt following the PSI and the deferral of interest payments on loans under the Support Mechanism. As a result, interest payments for the year 2012 fell by €6.5 billion and, together with the €7.5 billion contraction in the trade deficit, accounted for roughly 90% of the narrowing of the current account deficit in 2012.

6.1 CURRENT ACCOUNT

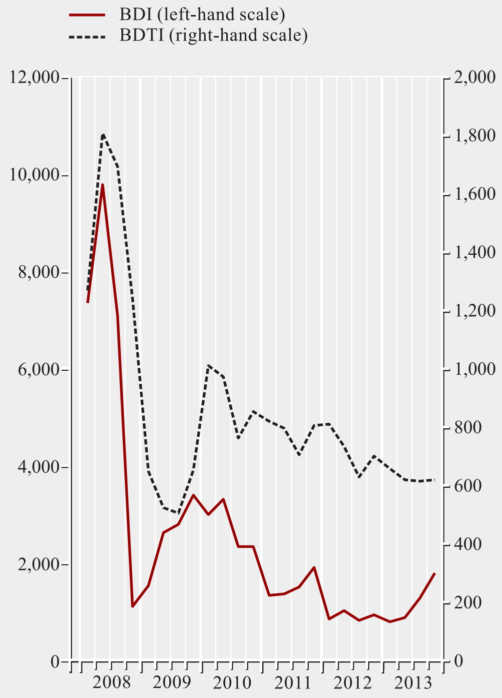
6.1.1 TRADE BALANCE

The sharp decline in the trade deficit accounts for about half of the overall improvement in the current account balance over 2010-2013. This reflects the narrowing of the non-oil deficit, whereas from 2012 onwards the continued improvement in the trade balance largely reflects a considerable reduction in the net oil import bill.

In 2013, export receipts at current prices rose above their level of 2008; this development was accompanied by an increase in the market share of Greek products in foreign markets – mainly outside the EU. This shift, which became more pronounced in 2012 and fostered a positive growth rate of total exports, did not continue into 2013, with Greek exports to the EU's traditional markets showing signs of recovery (see Chart V.15).

Chart V.14 Developments in sea freight indices

(quarterly data)



Source: Clarkson Research Services.

The increase in export receipts is attributable by about 50% to the oil sector, on account of both higher oil prices and export volumes, with sizeable contributions from food-beverages, metals and metal products, non-metallic minerals and plastics (Chart V.16). It should be pointed out that exports as a percentage of GDP and the foreign market shares for domestic products rose faster in Greece than in countries such as Portugal, Spain and Ireland (see Chart V.17). However, the Greek economy's export orientation, as measured by the exports-to-GDP ratio, remains much lower than that of the aforementioned countries, while a signifi-

Table V.13 Balance of payments

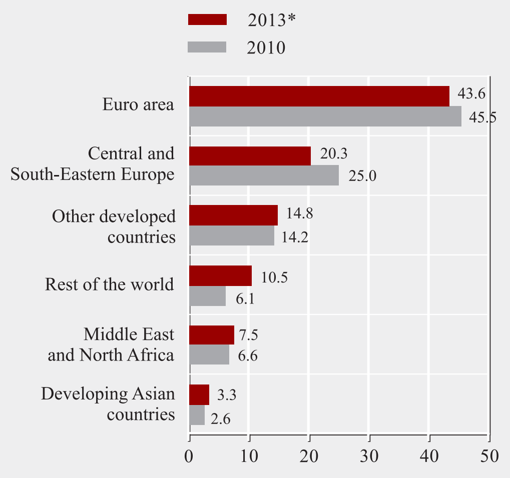
(million euro)

			January-December			
			2010	**2011**	**2012**	**2013**
I	**CURRENT ACCOUNT BALANCE (I.A+I.B+I.C+I.D)**		**-22,506.0**	**-20,633.5**	**-4,615.0**	**1,244.7**
	I.A	**Trade balance (I.A.1 – I.A.2)**	**-28,279.6**	**-27,229.1**	**-19,619.0**	**-17,229.4**
		Oil trade balance	-8,627.2	-11,126.9	-10,220.0	-7,697.5
		Non-oil trade balance	-19,652.4	-16,102.1	-9,399.1	-9,531.9
		Ships balance	-3,621.3	-3,261.2	-1,042.6	-1,483.3
		Trade balance excl. oil and ships	-16,031.1	-12,840.9	-8,356.4	-8,048.7
		I.A.1 Exports of goods	*17,081.5*	*20,230.6*	*22,020.6*	*22,534.8*
		Oil	4,950.0	6,187.7	7,426.4	7,941.2
		Ships (receipts)	798.6	754.7	737.8	443.0
		Other goods	11,332.9	13,288.2	13,856.5	14,150.7
		I.A.2 Imports of goods	*45,361.0*	*47,459.6*	*41,639.7*	*39,764.2*
		Oil	13,577.1	17,314.6	17,646.3	15,638.7
		Ships (payments)	4,419.9	4,015.9	1,780.4	1,926.2
		Other goods	27,364.0	26,129.2	22,213.0	22,199.3
	I.B	**Services balance (I.B.1 – I.B.2)**	**13,248.5**	**14,629.6**	**15,138.9**	**16,817.4**
		I.B.1 Receipts	*28,477.8*	*28,609.2*	*27,526.4*	*27,802.1*
		Travel	9,611.3	10,504.7	10,442.5	11,994.8
		Transport	15,418.4	14,096.6	13,287.4	12,089.9
		Other services	3,448.1	4,007.9	3,796.5	3,717.4
		I.B.2 Payments	*15,229.4*	*13,979.6*	*12,387.4*	*10,984.8*
		Travel	2,156.0	2,266.5	1,843.9	1,839.3
		Transport	8,155.4	7,234.4	6,328.0	5,553.0
		Other services	4,917.9	4,478.7	4,215.5	3,592.4
	I.C	**Income balance (I.C.1 – I.C.2)**	**-7,673.8**	**-8,594.8**	**-1,566.4**	**-2,819.0**
		I.C.1 Receipts	*4,009.3*	*3,322.1*	*3,832.2*	*3,542.4*
		Wages, salaries	199.7	188.0	200.8	209.3
		Interest, dividends, profits	3,809.6	3,134.1	3,631.4	3,333.1
		I.C.2 Payments	*11,683.1*	*11,916.9*	*5,398.6*	*6,361.4*
		Wages, salaries	377.6	470.0	468.0	453.0
		Interest, dividends, profits	11,305.5	11,447.0	4,930.7	5,908.4
	I.D	**Current transfers balance (I.D.1–I.D.2)**	**198.9**	**560.8**	**1,431.5**	**4,475.8**
		I.D.1 Receipts	*4,654.3*	*4,435.0*	*5,125.6*	*7,687.8*
		General government (mainly receipts from the EU)	3,188.5	3,254.9	4,060.2	6,410.6
		Other sectors (emigrants' remittances, etc.)	1,465.8	1,180.1	1,065.4	1,277.3
		I.D.2 Payments	*4,455.4*	*3,874.2*	*3,694.1*	*3,212.1*
		General government (mainly payments to the EU)	2,860.4	2,485.4	2,647.9	2,433.0
		Other sectors	1,595.0	1,388.8	1,046.2	779.0
II	**CAPITAL TRANSFERS BALANCE (II.1–II.2)**		**2,071.5**	**2,671.8**	**2,327.6**	**3,040.8**
	II.1	**Receipts**	**2,356.2**	**2,932.7**	**2,564.6**	**3,380.6**
		General government (mainly receipts from the EU)	2,239.3	2,798.5	2,486.0	3,298.9
		Other sectors	116.9	134.2	78.6	81.7
	II.2	**Payments**	**284.7**	**260.8**	**237.1**	**339.8**
		General government (mainly payments to the EU)	15.8	12.7	13.7	9.7
		Other sectors	268.9	248.1	223.3	330.1
III	**CURRENT ACCOUNT AND CAPITAL TRANSFERS BALANCE (I+II)**		**-20,434.5**	**-17,961.7**	**-2,287.5**	**4,285.5**
IV	**FINANCIAL ACCOUNT BALANCE (IV.A+IV.B+IV.C+IV.D)**		**20,853.9**	**17,838.1**	**2,658.2**	**-3,608.9**
	IV.A	**Direct investment[1]**	**-927.0**	**-452.6**	**827.1**	**2,405.5**
		By residents abroad	-1,176.2	-1,274.9	-527.3	469.0
		By non-residents in Greece	249.2	822.3	1,354.3	1,936.5
	IV.B	**Portfolio investment[1]**	**-20,855.0**	**-19,778.3**	**-99,903.9**	**-6,583.1**
		Assets	13,278.7	4,139.0	-58,086.1	1,023.6
		Liabilities	-34,133.6	-23,917.3	-41,817.8	-7,606.7
	IV.C	**Other investment[1]**	**42,538.8**	**38,050.0**	**101,744.1**	**675.8**
		Assets	7,658.7	7,638.7	13,863.4	17,491.9
		Liabilities	34,880.2	30,411.3	87,880.7	-16,816.1
		(General government borrowing)	29,978.2	39,873.9	109,093.9	30,061.21
	IV.D	**Change in reserve assets[2]**	**97.0**	**19.0**	**-9.0**	**-107.0**
V	**ERRORS AND OMISSIONS**		**-419.4**	**123.6**	**-370.8**	**-676.7**
RESERVE ASSETS			**4,777**	**5,332**	**5,500**	**4,172**

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

Chart V.15 Greek exports of goods, by destination

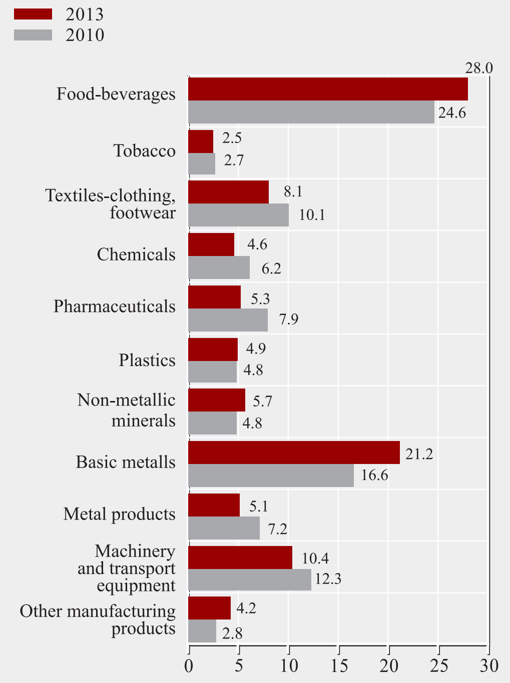
(percentage of total value of non-fuel and non-ship exports)



Source: Eurostat, COMEXT database.
* Data for January-September.

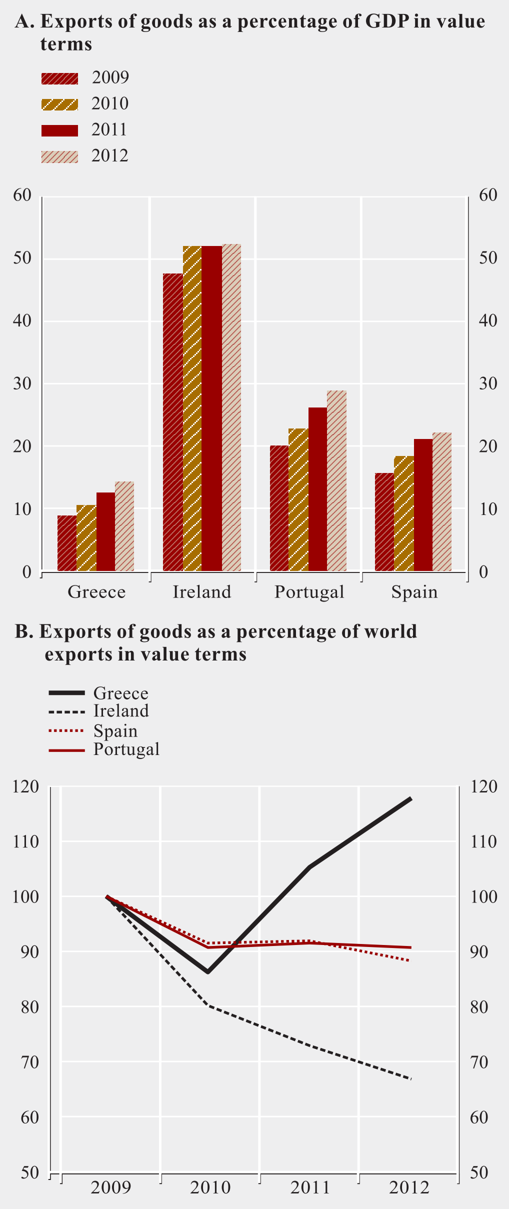
Chart V.16 Sectoral breakdown of Greek exports of goods

(percentage of total export receipts excluding fuel and ships*)



Source: Bank of Greece, Balance of payments statistics.
*Includes only those receipts that are classifiable, i.e. receipts above the threshold for reporting the product code.

Chart V.17 Exports of goods as a percentage of GDP and developments in world export market shares



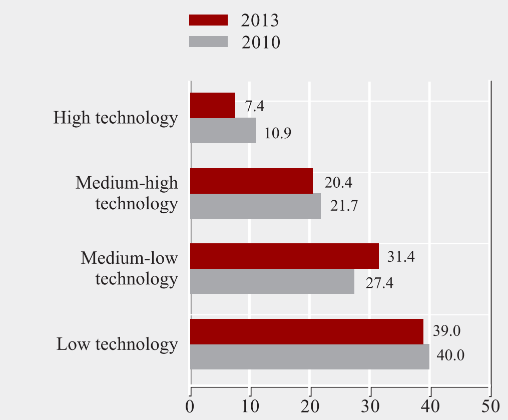
Source: Exports as a percentage of GDP: Eurostat-National Accounts; world export shares: IMF-Direction of Trade Statistics.

cant share of Greece's exports involves low-technology products (see Chart V.18).

The narrowing of the trade deficit is also, however, largely attributable to the lower import

Chart V.18 Exports of goods by technology content

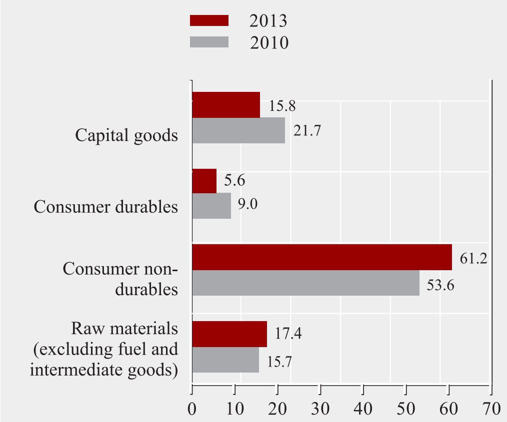
(percentage of total receipts excluding fuel*)



Source: Bank of Greece, Balance of payments statistics.
* Includes only those receipts that are classifiable, i.e. receipts above the threshold for reporting the product code.

Chart V.19 Imports of goods by use

(percentage of total payments excluding fuel and ships*)



Source: Bank of Greece, Balance of payments statistics.
* Includes only those payments that are classifiable, i.e. payments above the threshold for reporting the product code.

bill. The continued decline in household disposable income and worsening liquidity conditions for firms have contributed to an accelerated decline in the import bill in the past few years (see Chart V.19).

6.1.2 SERVICES BALANCE

During 2010-2013, the services balance showed a surplus of roughly €15 billion on average, recording an average annual rate of increase of over 7%. The services balance was thus key to reducing the trade deficit, accounting for about 70% of the reduction. In more detail, net travel receipts during the said period accounted, on average, for nearly 60% of total net receipts from services (4.3% of GDP) and financed more than 40% of the trade deficit. The bulk of travel receipts came from tourists from the EU-27, while the number of tourists from Russia has been rising in recent years. Over the same period, net transport receipts accounted for 3.4% of GDP and financed more than 30% of the trade deficit. However, they began to decrease from 2011 onwards, owing mainly to a significant decline in the Baltic Dry Index (BDI), as the increase in the global fleet transport capacity outpaced the growth of world trade volume.

In 2013, the services balance showed a surplus of €16.8 billion, up by 11.1% from 2012. This was mainly due to increased net travel receipts, which offset the decline in net transport receipts.

The outlook for the travel balance in 2014 is promising, with the Association of Greek Tourism Enterprises (SETE) anticipating tourist arrivals to exceed 18 million and receipts from tourism to overshoot €13 billion. The outlook for shipping in 2014 is also favourable, with projections for world trade volume trending upward,[12] and about half of the anticipated increase in freight rates[13] expected to pass through to higher shipping receipts.[14]

6.1.3 INCOME BALANCE

The burden on the income balance prior to the PSI, mainly from interest payments on Greek government bonds held by non-residents, accounted for more than 5% of GDP until 2012. This percentage, however, was

12 IMF, *World Economic Outlook*, October 2013.
13 Moody's Investors Service, *Global Credit Research*, 13.6.2013.
14 See Bragoudakis and Panagiotou (2010), "Determinants of the receipts from shipping services: the case of Greece", Bank of Greece, *Economic Bulletin*, 34, 41-52.

almost halved in 2012 following a significant reduction in net interest payments on this particular category of Greek government bonds as a result of the PSI, and also following the deferral of interest payments on loans under the Support Mechanism owing to interest rate changes. In 2013, the income deficit came to 1.5% of GDP, compared with 0.8% of GDP in 2012. This development reflects a rise in net interest, dividend and profit payments following a decline in net receipts from reinvested earnings, mainly on account of the sale of loss-making bank subsidiaries by non-residents.

6.1.4 CURRENT TRANSFERS BALANCE

In 2013, the current transfers balance recorded a surplus of €4.5 billion, some €3.0 billion more than in 2012, mainly owing to an increase in general government current transfer receipts (chiefly from the EU). Net transfer payments from the EU rose to €3.9 billion in 2013, from €1.4 billion in 2012 (see Table V.14). This development is mainly due to increased current transfer receipts as a result of ANFA returns of €2.4 billion, i.e. revenue passed on to Greece accruing to euro area NCBs from Greek government bonds held in their investment portfolio pursuant to the Eurogroup's decisions of 21 February and 27 November 2012. Meanwhile, in 2013 the rate of absorption of funds from the European Social Fund improved compared to previous years, while receipts under the Common Agricultural Policy remained unchanged at the average level of previous years. In the years ahead, net transfer payments from the EU are expected to remain high, mainly owing to ANFA returns.[15]

6.2 CAPITAL TRANSFERS BALANCE

In 2013, the capital transfers balance (mainly transfers from the EU) recorded a surplus of €3 billion, compared with €2.3 billion in 2012. Net capital transfers in 2013 came to €3.3 billion, owing to a significantly higher absorption rate of EU structural funds in the first half of the year (see Table V.14).

15 In 2014 and 2015, ANFA returns pursuant to the Eurogroup's decisions of 21.2.2012 and 27.11.2012 are expected to reach €2 and €1.6 billion, respectively.

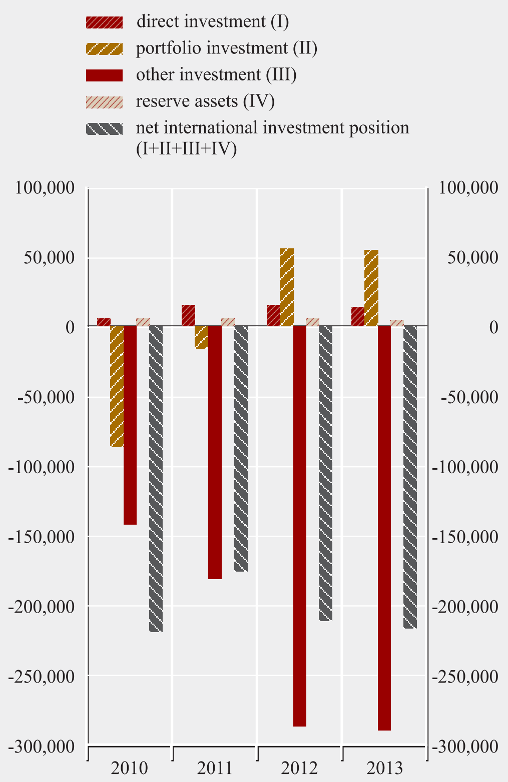
Table V.14 Transfers from the EU

		Million euro						% of GDP					
		2008	2009	2010	2011	2012	2013	2008	2009	2010	2011	2012	2013
A.1	Current receipts	4,679	3,528	3,189	3,255	4,060	6,411	2.0%	1.5%	1.4%	1.6%	2.1%	3.5%
A.2	Current payments	2,718	2,680	2,860	2,485	2,648	2,433	1.2%	1.2%	1.3%	1.2%	1.4%	1.3%
A	**Net current transfers**	**1,961**	**848**	**329**	**770**	**1,412**	**3,978**	**0.8%**	**0.4%**	**0.1%**	**0.4%**	**0.7%**	**2.2%**
B.1	Capital receipts	4,242	2,133	2,239	2,799	2,486	3,299	1.8%	0.9%	1.0%	1.3%	1.3%	1.8%
B.2	Capital payments	192	14	16	13	14	10	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%
B	**Net capital transfers**	**4,050**	**2,119**	**2,223**	**2,786**	**2,472**	**3,289**	**1.7%**	**0.9%**	**1.0%**	**1.3%**	**1.3%**	**1.8%**
C	**Total net transfers**	**6,011**	**2,967**	**2,552**	**3,556**	**3,884**	**7,267**	**2.6%**	**1.3%**	**1.1%**	**1.7%**	**2.0%**	**4.0%**
D	**Total net transfers excluding ANFA and SMP income**	**6,011**	**2,967**	**2,552**	**3,556**	**3,535**	**4,881**	**2.6%**	**1.3%**	**1.1%**	**1.7%**	**1.8%**	**2.7%**

Source: Calculations based on Bank of Greece, AMECO and ELSTAT data.

Chart V.20 International investment position and its components

(million euro)



Source: Bank of Greece.

With an absorption rate of 69% since 2007, Greece ranks 4th in the EU in terms of structural fund absorption.[16] In the upcoming period, the absorption rate will depend on the smooth transition to the next programming period 2014-2020, the implementation of operational programmes and the intensification of efforts for the absorption of funds from previous periods.[17]

6.3 FINANCIAL ACCOUNT BALANCE

The financial account balance in 2013 recorded a net outflow of €3.6 billion, against a net inflow of €2.6 billion n 2012. In more detail, a net outflow of €6.6 billion was recorded under portfolio investment, mainly on account of a decline in non-residents' holdings of Greek government bonds and Treasury bills, whereas net inflows (of €0.7 and €2.4 billion, respectively) were recorded under "other"[18] and direct investment.

Non-residents' direct investment in Greece recorded a net inflow of €1.9 billion (compared with a net inflow of €1.3 billion in 2012).[19] Residents' direct investment abroad showed an inflow (disinvestment) of €0.5 billion, against an outflow of €0.5 billion in 2012.[20]

At end-2013, Greece's reserve assets stood at €4.2 billion, compared with €5.5 billion at end-2012.

7 INTERNATIONAL INVESTMENT POSITION AND GROSS EXTERNAL DEBT

In 2013, Greece's net foreign liabilities increased by €6.0 billion, compared with 2012, and its International Investment Position (IIP)[21] had a negative balance of €216.8 billion at end-2013 (119.3% of GDP), compared with a negative balance of €210.8 billion in 2012 (see Table V.15 and Chart V.20). The

16 Press conference of the Greek Minister of Development and Competitiveness, 1.7.2013.
17 Based on provisional Bank of Greece estimates, net capital transfers from the EU will come to roughly €4 billion in 2014 and 2015.
18 "Other" investment recorded a net inflow of €676 million (compared with a net inflow of €101.7 billion in the same period of 2012), mainly owing to net general government borrowing of €30.1 billion, corresponding to gross public sector borrowing of €31.6 billion from the EFSF and the IMF.
19 The most important inflows under this category concerned: (a) an inflow of €622 million for the sale of a stake in the Hellenic Football Prognostics Organisation S.A. (OPAP) held by the Hellenic Republic Asset Development Fund (HRADF) to Emma Delta Ltd. (Cyprus); (b) an inflow of €585 million for the increase of the stake of Crédit Agricole S.A. in the share capital of Emporiki Bank (France); and (c) an inflow of €615 million for the participation of Invel Real Estate Partners (Netherlands) in the capital of National Bank of Greece's subsidiary NBG Pangaea Real Estate Investment Company.
20 The most significant transactions concerned: (a) an inflow of €208 million from the sale of Hellas SAT (Cyprus), a subsidiary of OTE (Hellenic Telecommunications Organisation S.A.), to Arab SAT (Saudi Arabia); (b) an inflow of €640 million from the sale of two Bulgarian subsidiaries of COSMOTE, Cosmo Bulgaria Mobile EAD (Globul) and Germanos Telecom Bulgaria S.A.; and (c) an inflow of €615 million from Invel Real Estate Partners (Netherlands) for the acquisition of a stake in National Bank of Greece's subsidiary NBG Pangaea Real Estate Investment Company.
21 The International Investment Position (IIP) reflects the country's net foreign liabilities, taking into account direct investment, portfolio investment, "other" investment and reserve assets. It should be noted that, in compliance with international reporting requirements, direct investment, bonds and equities are valued at market prices as at the last day of the reference period.

IIP was adversely affected by: first, a €29.6 billion increase in general government borrowing under the Support Mechanism; second, a €16.6 billion decline in resident credit

Table V.15 Greece's international investment position by type of investment and sector

(million euro)

	2010	2011	2012[1]	2013[2]
I. DIRECT INVESTMENT	**5,686**	**14,672**	**15,310**	**13,495**
1.1 Abroad by residents	31,899	37,131	34,080	33,610
1.2 In Greece by non-residents	26,213	22,459	18,770	20,115
II. PORTFOLIO INVESTMENT	**-86,767**	**-15,612**	**55,401**	**54,425**
1. General government	**-141,416**	**-73,152**	**-35,202**	**-30,791**
1.1 Assets	0	165	14,865	14,771
1.2 Liabilities	141,416	73,317	50,067	45,562
2. Bank of Greece	**16,122**	**14,475**	**15,749**	**16,727**
2.1 Assets	16,122	14,475	15,749	16,727
2.2 Liabilities	0	0	0	0
3. Other credit institutions	**33,105**	**31,162**	**63,568**	**61,521**
3.1 Assets	36,444	31,708	64,084	63,624
3.2 Liabilities	3,339	546	516	2,103
4. Other sectors	**5,422**	**11,903**	**11,286**	**6,968**
4.1 Assets	20,668	19,676	20,415	17,109
4.2 Liabilities	15,246	7,773	9,129	10,141
III. OTHER INVESTMENT	**-142,328**	**-180,504**	**-287,064**	**-288,927**
1. General government	**-40,486**	**-83,678**	**-191,656**	**-220,503**
1.1 Assets	0	0	946	1,757
1.2 Liabilities	40,486	83,678	192,602	222,260
2. Bank of Greece	**-85,922**	**-103,504**	**-97,080**	**-50,252**
2.1 Assets	1,166	1,246	1,275	1,354
2.2 Liabilities	87,088	104,750	98,355	51,606
3. Other credit institutions	**-30,088**	**-18,846**	**-23,719**	**-35,597**
3.1 Assets	86,334	72,345	51,783	35,150
3.2 Liabilities	116,422	91,191	75,502	70,747
4. Other sectors	**14,168**	**25,524**	**25,391**	**17,425**
4.1 Assets	25,076	32,684	37,143	34,330
4.2 Liabilities	10,908	7,160	11,752	16,905
IV. RESERVE ASSETS	**4,777**	**5,332**	**5,500**	**4,172**
NET INTERNATIONAL INVESTMENT POSITION (I+II+III+IV)	**-218,632**	**-176,112**	**-210,853**	**-216,835**
GDP[3]	**222,151**	**208,532**	**193,749**	**181,710**
% of GDP	**-98.4%**	**-84.5%**	**-108.8%**	**-119.3%**

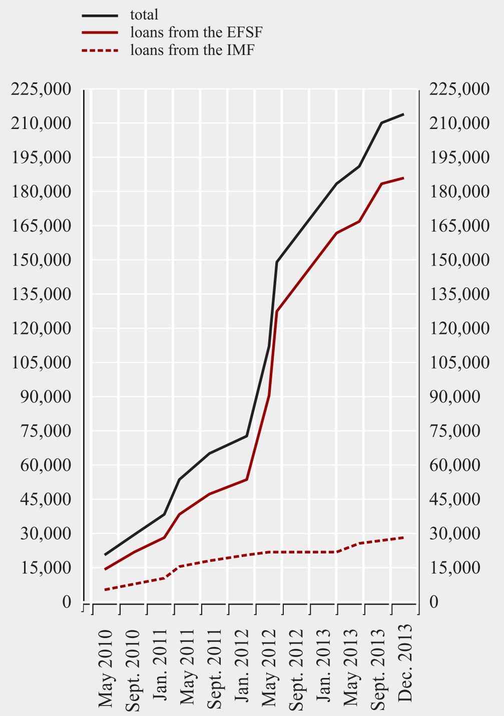
Source: Bank of Greece.
1 Revised data.
2 For 2013, Bank of Greece estimates based on provisional b.o.p. and i.i.p. data.
3 ELSTAT, provisional estimates, 14.2.2014.

institutions' deposit holdings abroad; and, third, a €2.8 billion decrease in the assets of "other sectors", mainly owing to a return of household and business deposits to the Greek banking system. The IIP was favourably affected by a €46.7 billion decrease in Greece's liabilities related to the operation of the TARGET system. This development reflects the shrinking of emergency liquidity assistance (ELA) from the Bank of Greece to Greek banks.

In 2013, Greece's gross external debt, which equals total IIP liabilities minus equity and financial derivatives, fell by €20.5 billion to €416.9 billion, compared with €437.4 billion at end-2012 (see Table V.16). This change reflects a decrease in Greece's liabilities related to TARGET accounts and a €25.1 billion increase in general government liabilities (in bonds and loans). It is worth pointing out that this increase, which also affects the IIP, is the result not only of net borrowing (under the Support Mechanism – see Chart V.21), but partly also of the higher valuation of tradable Greek government bonds still held by non-residents.

Chart V.21 General government debt under the support mechanism (balances)

(million euro)



Source: Bank of Greece.

Table V.16 Gross external debt position (at current prices)

(million euro)

	2010	2011	2012[1]	2013[2]
A. General government	**181,902**	**156,995**	**242,669**	**267,822**
B. Bank of Greece	**87,088**	**104,750**	**98,355**	**51,606**
C. Other credit insitutions	**116,422**	**91,191**	**75,502**	**70,747**
D. Other sectors	**16,691**	**9,698**	**13,521**	**19,505**
E. Direct investment	**5,072**	**7,548**	**7,411**	**7,315**
Debt liabilities to affiliated enterprises	1,635	1,847	2,097	2,064
Debt liabilities to direct investors	3,437	5,654	5,314	5,251
Gross external debt (A+B+C+D+E)	**407,175**	**370,182**	**437,458**	**416,995**
GDP[3]	**222,151**	**208,532**	**193,749**	**181,710**
Gross external debt as % of GDP[3]	**183.29%**	**177.52%**	**225.79%**	**229.48%**
Gross external debt of general government as % of GDP[3]	**81.88%**	**75.29%**	**125.25%**	**147.39%**

Source: Bank of Greece.
1 Revised data.
2 For 2013, Bank of Greece estimates based on provisional b.o.p. and i.i.p. data.
3 ELSTAT, provisional estimates, 14.2.2014.

Box V.1

THE CRISIS FAVOURS A SHIFT OF PRODUCTIVE ACTIVITIES TO TRADABLE GOODS AND SERVICES

The case for a more export-oriented economy

For a small open economy that is member of a single currency area, such as Greece, sustaining and increasing international competiveness is vital if it is to safeguard and improve its standard of living.

International competitiveness hinges upon the domestic allocation of resources between activities generating internationally tradable goods and services ("tradable sector") and activities generating non-tradable goods and services ("non-tradable sector"). Recent studies[1] acknowledge the fact that one of the main factors behind losses in international competitiveness in the European South was the overexpansion of the non-tradable sector (especially of the construction industry) up to 2008. Competitiveness losses occur when an oversized non-tradable sector deprives the tradable sector, which is characterised by relatively high productivity, of productive resources. The more serious the competition distortions in the non-tradable sector, the greater the losses in competitiveness. At the same time, the growth of the non-tradable sector increases demand for productive inputs, thereby leading to higher labour and capital costs in the total economy. Furthermore, it pushes up the prices of non-tradables that are also used in the production of tradables. As a result, the cost competitiveness of activities exposed to international competition worsens.

If tradables are defined as the products of the primary and secondary sectors, tourist services (food services, accommodation and transport), financial services, telecommunications and information services, and professional services, it is estimated that the value added of tradables in the Greek economy accounts for slightly over half of total value added (51.2% in 2009).[2]

Productivity in these sectors is significantly higher than in the sectors of non-tradable goods.[3] Therefore, a reallocation of resources in favour of the tradable sector of the Greek economy will bring considerable gains in productivity and, consequently, the standard of living. As a matter of fact, against a backdrop of deep recession and weakening domestic demand over the past four years, a shift to international markets would allow Greek firms to survive in the short run and expand their business in the future.

The resource reallocation mechanism

In an open market economy, productive resources (capital and labour) are normally allocated across productive activities according to their returns. As a result, a rise in the prices of tradables relative to the prices of non-tradables favours a restructuring of production in the Greek economy in favour of tradable goods and services.

1 See European Commission 2013a and 2013b, Malliaropulos and Anastasatos 2011 and 2013.

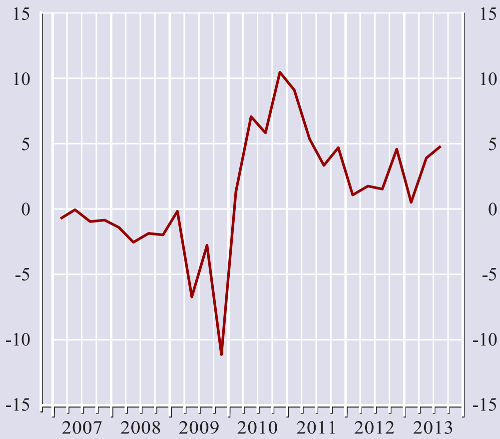
2 In the absence of a standardised definition, for the purposes of the present analysis the tradable sector comprises general (e.g. manufacturing) or potential (e.g. professional services) tradable activities. "Real estate management" is excluded from the calculation of total value added (see Gibson and Malley 2008). Alternative definitions of the tradable sector (e.g. excluding financial services, and communication and information services) do not affect the key qualitative conclusions of the present analysis.

3 Over the 2006-2011 period, gross value added per employee (constant prices 2005) in the tradable sector was, on average, up to 29% higher than in the non-tradable sector. See Chart III.6A, Bank of Greece, *Monetary Policy – Interim Report*, December 2013.

Chart A Prices of tradables and non-tradables

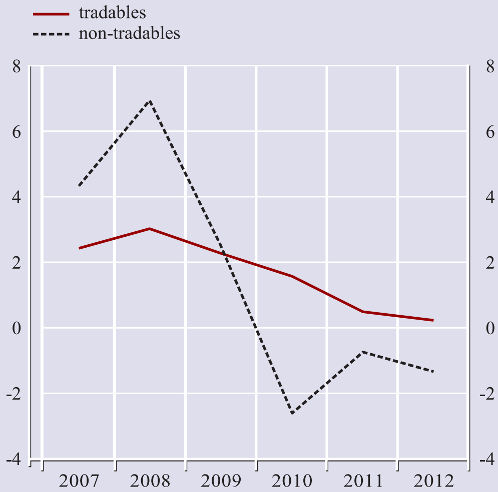
(year-on-year percentage change; quarterly data)

1. Relative prices of tradables



(annual percentage change)

2. Prices of tradables and non-tradables



Sources: Eurostat, Quarterly (panel 1) and Annual (panel 2) National Accounts and Bank of Greece calculations.

The prices of tradables in relative terms have increased since 2009. Chart A.1 shows the evolution of the relative prices of tradables, on an annual basis, for each quarter after 2007.[4]

While the average change was negative (-2.6%) until 2010, this pattern was reversed from the first quarter of 2010 onwards and has remained positive up to the third quarter of 2013 (average annual change of 4.3%). Chart A.2 shows that the positive rate of change in the relative prices of tradables is explained by the fact that the rate of change in the prices of non-tradables declined more steeply than that of tradable prices from 2008 onwards, and that the former was negative over the 2010-2012 period (-1.6%). The decline in non-tradable prices is mainly attributable to the reduction of staff costs in the public sector.

The evolution of prices varied across individual activities of the tradable and non-tradable sectors after 2010. The decline in prices since 2010 for the non-tradable sector as a whole is due to not only developments in public administration, but also a considerable drop in construction prices. The average annual change in prices was also negative across tradable activities, such as the primary sector and professional services. However, these activities have a small share in the total value added of tradables and, hence, a limited contribution to the rate of change in prices for the whole tradable sector.

Developments in production costs differed between tradables and non-tradables, as the tradable sector is more capital- and energy-intensive than the non-tradable sector.[5] Given the very small

4 Prices in the tradable and non-tradable sectors are calculated as the weighted average of price indicators by subsector, where the weighting is based on the share of each subsector in the output value of the whole sector (Source: Eurostat, National Accounts). As regards the quarterly data that are broken down according to NACE Rev. 2 one-digit numerical code (at a 10-industry level), trade is included in the tradable sector. With regard to the annual data, the rates of change in the prices of transport and trade are based on Bank of Greece calculations and estimates.

5 The shares of labour and energy in total production costs for the tradable sector are 17.4% and 5%, respectively, against 36.9% and 1.5%, respectively, for the non-tradable sector (calculations based on ELSTAT' s Input-Output Table for 2010).

Chart B Net profit margin in tradables and non-tradables*

(percentage points)

Sources: Eurostat, Annual National Accounts and Bank of Greece calculations.
* The net profit margin is defined as the ratio of net operating profit to gross output. A proxy of the remuneration of the self-employed has been deducted from the net operating profit.

share of energy costs in both sectors, cost developments after 2010 are marked by lower wage costs and have been favourable for both sectors.[6]

All in all, since 2009 the net profit margin of the non-tradable sector has declined sharply (see Chart B).[7] Over the same period, the net profit margin of the tradable sector remained broadly unchanged, thereby favouring a shift of productive resources towards the tradable sector.[8]

The extent of the rebalancing in favour of export-oriented activities during the crisis

Developments in construction compared with developments in industry are indicative of the ongoing restructuring of the Greek economy.

Although the slowdown in the construction industry had already started since the mid-2000s,[9] the recession intensified after 2010. Residential property prices plummeted over the 2010-2012 period (-21.9% on a cumulative basis),[10] while the construction cost of new residential buildings[11] decreased only marginally. As a result, the profit margin in construction declined sharply, thereby creating conditions that favour a shift of productive resources away from construction. In 2008, the construction industry had a share of 7.8% in total value added and a share of 7.9% in total employment, against 2.5% and 5%, respectively, in 2012.

Over the same period, the industrial sector has increased its share in total domestic output (17.2% of total value added in 2012, up from 14.3% in 2008). The strong improvement in the Industrial PPI (of 19.1% on a cumulative basis over the 2010-2012 period) and developments in firms' operating costs allowed for the widening of the net profit margin in industry.[12]

The evolution of the breakdown of the Greek economy into tradable and non-tradable sectors is presented in Chart C. The chart illustrates various indicators[13] of gross value added at current and

6 On a cumulative basis, by the end of 2013 wage costs have been reduced by 20% (Bank of Greece estimate for 2013). The cumulative increase in energy prices (based on the HICP excluding the impact of the excise duty and VAT) over the 2010-2012 period was more than double the decrease in wage costs (see Karabalis and Kondelis 2013). However, the share of energy costs in output is 3% for the Greek economy as a whole (calculations based on ELSTAT's Input-Output Table for 2010).
7 On a national accounts basis, the net profit margin is defined as the operating surplus (excluding depreciation) as a percentage of output value. The operating surplus applied here does not include the gross income of the self-employed. The income of the self-employed, calculated on the basis of the average compensation of employees, has been deducted from the operating surplus.
8 The resilience of the tradable sector's profit margin is also favoured by the limited pass-through of changes in wage costs to final prices, especially in the case of tradable goods and services (see European Commission 2013b).
9 The decline in construction activity after 2005 also reflects the completion of works associated with the Athens 2004 Olympic Games.
10 Bank of Greece data (see Table II.6, *Bulletin of Conjunctural Indicators*).
11 Producer Price Index in construction, ELSTAT.
12 From 7.9% in 2008 to 9.8% in 2011 (the last year for which there are available data). Calculations on a national accounts basis for the whole industrial sector (mining and quarrying, manufacturing and energy production). The analysis of industrial firms' financial statements indicates a drop in profitability indicators since 2009, albeit to a lesser extent on a cumulative basis relative to the construction industry (see e.g. Hellenic Federation of Enterprises, *Greek enterprises: Profit and loss account and employment analysis* [in Greek], various years).
13 They take the value of 1 in 2005, when a break occurred in the time series.

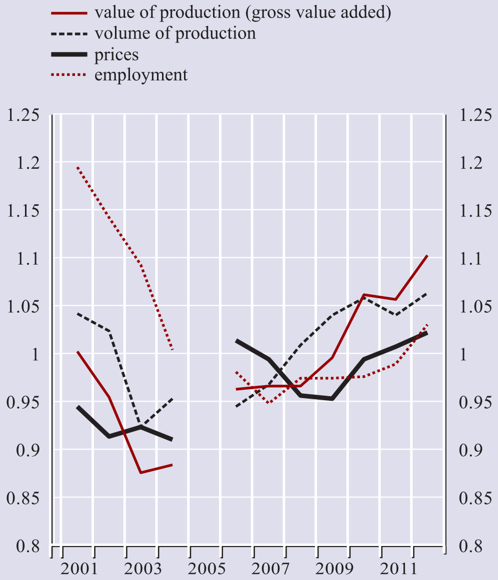
constant (2005) prices, employment and the level of prices for the tradable sector in relation to the non-tradable sector.

Relative tradable prices change in the same direction as the sector's output, albeit at a slower pace.[14] Between 2000 and 2004, the shift of production away from tradables is evident. Overall, during this period the tradable sector shrank by 8.6% in terms of output and by 16% in terms of employment.

This picture is reversed after 2007, as the output volume of tradables relative to non-tradables has increased. Over the 2008-2012 period, marked by recessionary conditions in all sectors of economic activity, a rise in the relative prices of tradables is observed, while, compared with non-tradables, the tradable sector grew by 5.4% in terms of output volume and by 5.7% in terms of employment. The relative share of investment in this sector has remained almost unchanged.

Chart C Evolution of the outwardness of the Greek economy

(indices; 2005=1)*



Sources: Eurostat, National Accounts and Bank of Greece calculations.
* Indicators refer to tradables expressed in terms of non-tradables.

In conclusion, given that the relative profit margin of tradable goods and services has improved, this sector's growth outlook is positive. The rebalancing of the economy in favour of tradable goods and services has already started, but remains particularly weak, against a backdrop of economic recession (see also the conclusions in European Commission 2013b and OECD 2013). The shift in production is expected to become more pronounced as the economy returns to growth and investment recovers.

Prospects and scope for policy initiatives

Recent indications about the outlook for employment and investment in the business sector suggest that the restructuring of the Greek economy in favour of the tradable sector is expected to gather pace in 2014. In the last quarter of 2013, the European Commission's economic sentiment indicators for the first quarter of 2014 imply that demand and employment prospects are rosier for the manufacturing sector[15] relative to (private) construction. Indeed, improved demand prospects are supported by the outlook for the evolution of demand in international markets. The more favourable prospects for export-oriented firms compared with domestic-oriented firms are also confirmed by the results of recent business surveys on small and medium-sized enterprises (SMEs) (National Bank of Greece, March and December 2013), as well as of a survey on the largest Greek enterprises (IOBE-NTUA 2013).[16]

Product, labour and capital market efficiency is crucial if resources are to be reallocated to the more productive export-oriented industries. In this regard, there is ample room for policy initiatives.

14 This implies low elasticity of substitution between tradables and non-tradables (see Corsetti, Dedola and Viani 2011).
15 See also the Markit PMI for the actual positive developments in manufacturing during the fourth quarter of 2013.
16 See http://www.sev.org.gr/Uploads/pdf/erevna_pa_17122013.pdf and http://www.liee-ntua.gr/wp-content/uploads/2013/12/Press_17_12_2013_tsak_final.pdf.

The European Commission (European Commission 2013b) notes the current inability of the Greek banking system to finance the tradable sector's operating costs and investment. Therefore, in addition to urgently tackling problems in the Greek banking system, it is also necessary to promptly take action to ensure export-oriented firms' access to liquidity (e.g. through increased financing from capital markets, better utilisation of EU funds).

Turning to the labour market, the recent reforms facilitate labour mobility within and across economic agents. However, additional policies are needed in order to improve the matching of workers' skills and firms' needs, such as education reform, promoting on-the-job training and implementing active employment policies.

Reallocation of resources is also encouraged by creating a best practice-compliant business environment, e.g. by cutting red tape costs for firms, enhancing public sector efficiency and introducing a stable tax regime. Institutional defects in these fields and the benefits from the adoption of best practices have been highlighted by international organisations in several studies (e.g. OECD 2013a, 2013b, and World Bank 2013).

Last, it should be noted that efficient goods and services markets would encourage a reallocation of resources among sectors, as well as a rebalancing in favour of the most productive businesses within sectors through mergers and acquisitions. However, a shift of domestic production towards more export-oriented activities and the most productive businesses is a necessary, but not sufficient condition for ensuring international competiveness. For this reason, it is important, among other things, to promote research and innovation as well as entrepreneurship.

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World Bank (2013), *Doing Business 2014.*

Box V.2

POVERTY, INEQUALITY AND SOCIAL COHESION: TRENDS AND CHALLENGES DURING THE CRISIS

The importance of examining the problems of inequality, poverty and social exclusion is self-evident, all the more so in the current circumstances of deep recession and unprecedented and protracted unemployment levels. The findings of relevant available studies may provide valuable insights into the public political and social debate concerning the economic and social policy measures necessary to ensure and enhance social cohesion. Moreover, as indicated in relevant studies, in periods of fiscal crisis and adjustment, targeted support to weaker population groups, first, contributes to maintaining social cohesion, which is vital for stability and growth and, second, is crucial for the success of the adjustment programme, i.e. the reduction of the fiscal deficit and public debt. What follows is a synopsis of the most important findings mainly regarding the magnitude of inequality and poverty in Greece and the changes in the relevant indicators during the recent period of financial and fiscal crisis. It also presents changes in households' consumption patterns during the same period.

- According to the latest EU Statistics on Income and Living Conditions of Households 2012 (EU-SILC)[1] released by ELSTAT, which take into consideration incomes in 2011, 23.1% of Greece's population, or 914,873 households and their members (totalling 2,535,700 persons), live below the relative poverty threshold (based on monetary incomes).[2] The **"relative at-risk-of-poverty" indicator** for Greece is now considerably higher than in all other EU countries (EU-28: 17.2% on average), as in the past two years Greece's ranking deteriorated against the six countries with a higher risk of poverty in the 2010 survey (Bulgaria, Spain, Croatia, Latvia, Lithuania and Romania). The average annual disposable income of total Greek households, i.e. the basis for calculating the monetary threshold of relative poverty, amounted to €17,977 in 2011, i.e. 16.7% and 25.8% lower than in 2010 and 2009, respectively.[3]

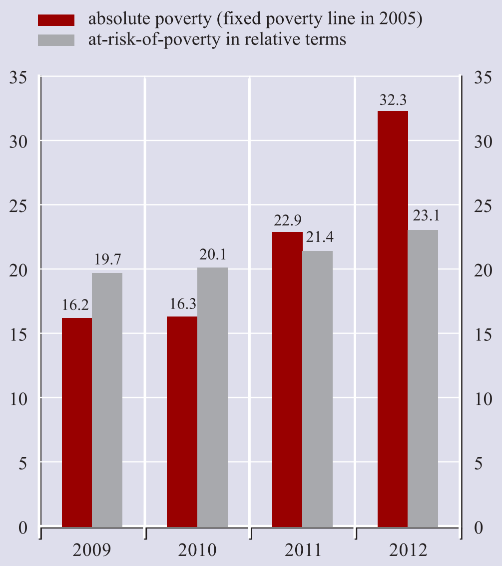
- Even higher against the EU-28 is the share of the Greek population living either at risk of poverty or in social exclusion, i.e. living in material deprivation or in households with very low work intensity. In the 2012 survey, this percentage stands at 34.6%, representing 3,795,100 persons, and is

1 EU-SILC is the main source of comparable statistics on income distribution, the risk of poverty and social exclusion in EU countries. It should be noted, however, that the surveyed population does not include groups which are poor by inference, including homeless or institutionalised persons, a large number of illegal economic immigrants, Roma, etc. See ELSTAT Press Release of 29.11.13, "Income and Living Conditions of Households 2012".

2 The *relative* poverty line follows the population's average living standards, whereas the *absolute* poverty line remains constant over time in terms of real purchasing power. The relative monetary poverty line (at-risk-of-poverty threshold) has been set at 60% of the median equivalised disposable income of all households (Eurostat definition). To calculate the equivalised household income, the first adult is given a weight of 1.0, the second and each subsequent person aged 14 and over are given a weight of 0.5, and each child under 14 is given a weight of 0.3. This method takes into account household economies of scale in consumption, household composition and the different needs of adults and children.

3 In the 2012 survey, the relative poverty threshold was €5,708 for a single-person household (against €6,591 and €7,178 in the 2011 and 2010 surveys, respectively) and €11,986 for a four-person household with two adults and two children under 14 (2011: €13,842, 2010: €15,073).

Chart A Absolute and relative at-risk-of-poverty rates during the crisis



Source: Eurostat.

higher than in any other EU country (EU-28: 25.1%), excluding Bulgaria (49.3%), Romania (41.7%) and Latvia (36.6%).[4]

• Other relative poverty indicators also point to similar conclusions as regards the magnitude of this problem in Greece and the relevant position of the country against the other EU countries. The **relative poverty gap (or intensity)**, which measures the distance of the poverty threshold (for total population) from the median equivalised disposable income of persons below the poverty threshold as a percentage of the poverty threshold, is calculated at around 29.9% in 2012 in Greece (EU-28: 24.1%). *This means that 50% of the poor have an income below 70.1% of the poverty line, i.e. below €4,000 per person on an annual basis.* Moreover, the population living in households where the working-age members have no job or work less than a total of 3 months in a year reached 1,010,900 persons, or 16.1%, of the population aged 18-59 years, from 837,300 and 544,800 persons in 2011 and 2010, respectively.

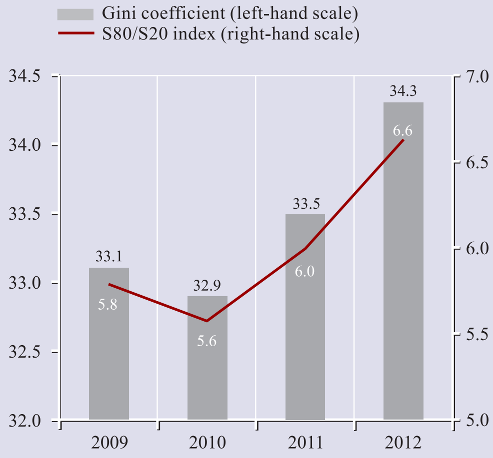
• According to available data, all relative at-risk-of-poverty rates rose in Greece in the first three years of the current crisis. Indeed, the relative poverty rate increased by 3.4 percentage points or 17.3% (incomes of 2008: 19.7%; 2011: 23.1%), the poverty gap rose by 5.8 percentage points or 24.1%, and the risk of poverty or social exclusion increased by 7.0 percentage points or 25.4%. Even more dramatic is the deterioration of poverty rates in the current crisis in absolute terms, i.e. when the poverty line remains stable over time in terms of real purchasing power. Indeed, the poverty rate for the year 2010, calculated on the basis of the poverty threshold for the year 2005 (60% of the median income for 2005 expressed in 2010 prices on the basis of the Harmonised Index of Consumer Prices), was 16.3%, while the same rate reached 22.9% in the next survey year (2011), and 32.3% in 2012. In other words, during the current crisis, and within just the past two years for which data are available, poverty levels almost doubled in absolute terms (increasing by 16 percentage points or 98.2%, see Chart A).[5]

4 The definition takes into account three indicators: (i) the percentage of persons at risk of poverty (see footnote 2); (ii) the percentage of persons in material deprivation, i.e. lack of at least four out of a list of nine material goods and services (telephone, colour television, washing machine, private passenger car, satisfactory heating, etc.); and (iii) the percentage of population living in households with low work intensity, i.e. the percentage of population aged 18-59 living in households where the working-age members worked less than 20% of their total work potential during the previous year.

5 Similar results were reached in recent studies by researchers of the Athens University of Economics and Business. See Athens University of Economics and Business, Policy Analysis Research Unit, Newsletter 5/2013, Manos Matsaganis and Chrysa Leventi, "Poverty in Greece: trends in 2013", and Newsletter 6/2013, Manos Matsaganis, "Poverty and social policy in (a) crisis: the case of Greece". These studies use alternative measures of relative and absolute poverty in 2012 and 2013. The aggregates used as indicators are the floating relative poverty line (equal to 60% of the median income), the fixed relative poverty line (equal to 60% of the median income in 2009, at constant prices) and the extreme poverty line (equal to the cost of a standard basket of consumer goods necessary to ensure a minimum living standard). The studies find that the percentage of the population with an income below the standard relative poverty threshold shows a slow and steady increase, from 19.4% in 2009 to 21.4% in 2012 and 22.3% in 2013. Alternatively, on the basis of a fixed threshold (the adjusted for inflation poverty threshold for 2009), a dramatic increase in poverty is recorded, from 19.4% in 2009 to 38.9% in 2012, and 44.3% in 2013. Moreover, it is estimated that one out of seven persons in 2013 live on an income which is below the extreme poverty threshold (one out of nine in 2012 and barely one out of 45 in 2009).

• **Developments in income inequality** during the current crisis are less unfavourable for Greece. However, the same data (EU-SILC 2012; incomes 2011) indicate that in terms of inequality Greece ranks high among EU countries (Gini coefficient: Greece: 34.3, EU-28: 30.4), excluding Spain (35.0), Latvia (35.9) and Portugal (34.5). Moreover, the wealthiest 20% of the country's population receives a 6.6 times higher income share than the poorest 20% (S80/S20 indicator), against 5.1 for the EU-28. Nevertheless, in the first three years of the current crisis, for which data are available, the above inequality indices (Gini coefficient and S80/S20) remained almost unchanged in the first year (2009 incomes), and increased moderately in the following year (2010, by 1.8% and 7.1%, respectively) and, more strongly, in the latest available year (2011, by 2.4% and 10.0%, respectively, see Chart B).

Chart B Income inequality indices during the crisis



Source: Eurostat.

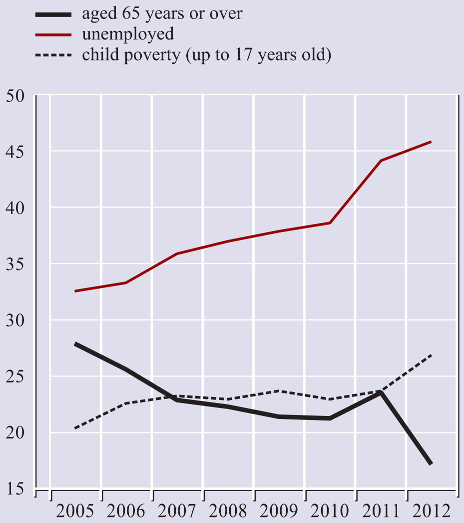
• In Greece, **groups at high risk of poverty** during the current crisis include principally the unemployed (who in the 2012 survey registered a relative poverty rate of 45.8%, against 38.5% in the 2010 survey), particularly unemployed men (52.1%, against 48.4%), single-parent households with at least one dependent child (66.0%, against 33.4%), households with two adults and three or more dependent children (36.8%, against 26.7%), economically inactive persons excluding pensioners (housewives, etc., 32.9%, against 27.6%), households living in rented accommodation (29.6%, against 27.2%), and children of 0-17 years of age (26.9%, against 23.0%), mainly the children of immigrants (44.4%, against 46.4%). *However, in recent years, poverty in Greece seems to rapidly shift away from the elderly towards younger couples with children, as well as young workers, mainly the unemployed* (see Chart C).[6] **The problem of protecting children and the unemployed from the worst impact of the economic crisis should now be addressed as one of the priorities for public policy in Greece.**[7]

• An examination of the indicators of **living conditions** in Greece shows a substantial deterioration during the current crisis (difficulties in meeting basic needs, poor housing conditions, housing costs, inability to repay loans or instalments for purchases, difficulty in paying bills and in meeting ordinary needs, low/declining quality of life) and an increase in material deprivation.[8] For instance, the percentage of the population facing financial difficulties which lead to deprivation

6 The substantial decline in the risk of poverty for persons aged 65 or over, from 23.6% in the 2011 survey to 17.2% in the 2012 survey, is attributable to a13.4% decline in the at-risk-of-poverty threshold (from €6,591 in 2011 to €5,708 in 2012), without a commensurate reduction in pensions of under €1,000 per month in 2011, the reference year for income; thus part of those elderly persons are now above the new at-risk-of-poverty threshold.
7 Similar recommendations are also made in the special chapter "A fair sharing of the costs and benefits of adjustment" in the recent OECD study, OECD *Economic Surveys: Greece 2013*, November 2013. Specifically, for a more effective social welfare system, among other things, the study recommends enhancing governance of social programmes by speeding up the consolidation of the management of social insurance funds; intensifying controls on recipients of welfare (especially disability) benefits; targeting benefits to protect the most vulnerable; introducing a properly targeted minimum income scheme, and a national programme of subsidised, means-tested school meals; increasing the duration of unemployment insurance benefits by one year; harmonising contribution rates to pension and sickness funds; expanding schemes to ensure access of vulnerable groups to healthcare; and taking further measures to protect public health. See also *Greece: Reforms of Social Welfare Programmes*, OECD, July 2013.
8 See also Municipality of Athens: "Results of the survey on poverty and social cohesion in Athens", press release 16.10.2013.

Chart C Changes in relative poverty in selected groups

(% of poverty)



Source: Eurostat.

of at least four out of nine material goods and services reached 19.5% in 2012, from 15.2% in 2011 and 11.6% in 2010.[9] Moreover, deprivation of basic foods and services does not affect only the poor, but also a large share of the non-poor population.

• The average monthly spending of households, according to the results of the Household Budget Survey conducted by the Hellenic Statistical Authority (ELSTAT) for 2012, reached €1,637, recording a nominal decline of 10.2% (or 11.6% in real terms) against 2011. The largest share of the average monthly spending of households goes to food (20.1%), followed by accommodation (13.9%) and transportation (12.8%), while education has a smaller share (3.5%). A comparison of the results of the 2012 Household Budget Survey with those of previous surveys shows a considerable decline in the average monthly spending of households, from €2,113 in 2010 (at 2012 constant prices) to €1,637 in 2012, which represents a decline of 22.5%. In 2010-2012, a continuous **change in household consumption patterns** is observed, with a shift of spending from hotels and restaurants, clothing-footwear, transportation, recreation, consumer durables and other goods and services towards spending on accommodation, food, alcoholic beverages and tobacco, communication and education (see Chart V.5 in the main text). Specifically, as a percentage of the family budget, spending on clothing and footwear fell from 7.2% in 2010 to 5.8% in 2012, consumer durables from 6.7% to 5.8%, hotels-restaurants from 10.7% to 9.8%, and transportation from 13.5% to 12.8%. By contrast, during the same period, a significant increase was recorded in the share of spending on accommodation, from 11.7% to 13.9%, as well as in the share of spending on food, from 18.0% to 20.1%.[10]

• To sum up, underlying the rise in poverty during the current crisis is the steep increase in the number of the unemployed (from 355 thousand in the third quarter of 2008 to 1,345 thousand in the third quarter of 2013) and the length of unemployment (the long-term unemployed rose from 185.4 thousand to 955.6 thousand, respectively), combined with serious defects in the public social safety net in Greece. The composition of the poor population and the consumption pattern of all households changed dramatically, while the sharp decline in household disposable income and the measures taken in the context of the fiscal adjustment effort have definitely led to a deterioration in the indicators of economic prosperity and social welfare, income inequality and, most importantly, absolute poverty (as calculated on the basis of a poverty line fixed to

9 Serious financial distress, resulting in deprivation of basic goods and services, includes difficulty to pay bills or buy food that comprises chicken or meat or fish or vegetables of equivalent nutritional value every second day; inability to afford a telephone, a colour television, a washing machine, a private passenger car; pay for a week of vacation; deal with extraordinary but necessary expenses; and, lastly, afford satisfactory heating.

10 In the period between 2011 and 2012, Household Budget Surveys recorded a substantial decline in the number of households that use central heating as their main source of heating (-22.6%), own or rent secondary or vacation houses (-2.8%), and own at least one private passenger car (-0.6%, while the number of cars fell by 3.1%). See ELSTAT, press release of 29.11.2013, "Household Budget Survey 2012".

pre-crisis levels). In this conjuncture, it is obvious that policy interventions should aim at improving the efficiency of reduced social expenditure, giving priority to eliminating extreme poverty in families with children, no employed members, no unemployment benefit or other income support and, quite often, no access to social security. Certain recent income support measures appear to be a step in the right direction. These include a single, means-tested, children support benefit, an unemployment benefit to the self-employed, a widening of the eligibility criteria for the long-term unemployment benefit (which, however, still reaches a small share of the long-term unemployed), as well as the pilot running of a minimum guaranteed income scheme, which is still under examination.

VI FISCAL DEVELOPMENTS AND PROSPECTS

Over the past four years, Greece has achieved a fiscal consolidation unprecedented by international standards, as a result of which a general government primary surplus is within reach in 2013. The general government primary balance, based on the Economic Adjustment Programme (EAP) methodology, is projected to turn into a surplus in excess of the 0.4% of GDP in 2013 forecasted in the 2014 Budget, improving by more than 11 percentage points of GDP from 2009. The structural primary balance of general government is expected to show a surplus of over 4.4% of potential GDP in 2013, improving by an estimated total of over 19.0 percentage points of potential GDP in 2010-2013. The successful implementation of the 2014 Budget should signal the achievement of sustainable fiscal consolidation, which, together with the return of the economy to growth, will mark the end of the crisis in Greece.

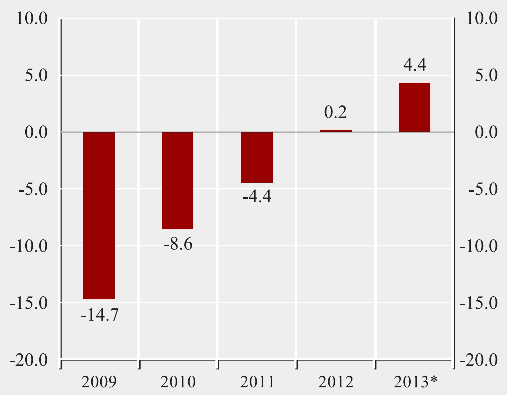
1 SUMMARY OF DEVELOPMENTS AND PROSPECTS[1]

The fiscal performance of 2013 marks the beginning of a new era for Greece's public finances. After four years of intense fiscal consolidation efforts, under adverse macroeconomic conditions, the achievement of a general government primary surplus, according to the Economic Adjustment Programme (EAP) methodology,[2] now seems to be within reach in 2013.

Available data for the period January-December 2013 on state budget implementation and the general government cash balance suggest that the primary surplus on a national accounts basis, using EAP methodology, will exceed the 0.4% of GDP projected in the 2014 Budget. The primary surplus is thus forecasted to improve by more than 1.9 percentage points of GDP from 2012 and by a total of over 11 percentage points of GDP from 2009 (see Table VI.1). The 2013 primary surplus, which remains to be confirmed by Eurostat in April 2014, constitutes, according to Eurogroup decisions of 26-27 November and 13 December 2012, a prerequisite for the euro area to undertake further initiatives in order to ensure that Greece can reach a debt-to-GDP ratio of 124% in 2020 and substantially lower than 110% in 2022.

Chart VI.1 Structural primary balance of general government

(percentage of potential GDP)



Source: Bank of Greece.
* Forecast.
Note: The structural primary balance of general government is calculated according to the Eurosystem methodology.

Excluding cyclical effects and the impact of temporary interventions on government revenue and expenditure, the structural[3] primary balance of general government improved by more than 19.0 percentage points of potential GDP in 2010-2013, as estimated using the Eurosystem methodology, with the structural primary balance in 2013 projected to show a surplus of over 4.4% of potential GDP (see Chart VI.1).

1 The cut-off date for data and information used in this chapter was 11 February 2014.
2 The EAP methodology differs from the ESA 95 methodology in that the general government balance for 2013 does not take into account: (a) the impact of support to financial institutions; (b) ANFA revenue, i.e. the transfer to the Greek State of profits on Greek government bonds (excluded from the PSI) held by the Eurosystem national central banks; (c) SMP revenue, i.e. the transfer of earnings on Greek government bonds by Eurosystem central banks; and (d) the retrospective interest rate cuts on loans under the first Greek Loan Facility. However, it includes the receipts from the property tax collected through electricity bills (EETHDE) in the second quarter of 2013 which, despite having been taken into account in the national accounts balance for 2012, are included in fiscal targets for 2013.
3 The structural balance is cyclically adjusted and net of temporary factors (such as one-off payments in support the country's banks). As a theoretical concept, its estimated size may vary considerably, depending on the quantification method used.

Table VI.1 General government and state budget balances

(percentages of GDP)

	2009	2010	2011	2012	2013
General government balance[1] *(national accounts data – convergence criterion)*	**-15.7**	**-10.7**	**-9.5**	**-9.0**	**-12.6***
– Central government	-15.4	-11.8	-9.0	-8.2	-
– Social security funds, local government, legal entities in public law	-0.3	1.1	-0.5	-0.8	-
General government deficit adjusted for net state support to financial institutions[1]	-15.8	-11.1	-9.8	-6.2	-2.2*
General government primary balance adjusted for net state support to financial institutions[1]	-10.6	-5.3	-2.7	-1.2	2.1*
General government primary balance (Hellenic Economic Policy Programme)[2]				-1.5	0.4*
State budget deficit					
Administrative data[2]	**-14.6**	**-10.0**	**-10.9**	**-8.1**	**-3.0**
Cash data[3]	**-14.1**	**-10.5**	**-11.1**	**-5.5[4]**	**-7.0[5]**

Sources: Bank of Greece, Ministry of Finance and ELSTAT.
* Provisional data (State General Accounting Office, Introductory Report on the 2014 Budget).
1 ELSTAT data, as notified to the European Commission (Excessive Deficit Procedure). Figures may not add up due to rounding.
2 State General Accounting Office data (State Budget Execution Bulletins and Introductory Report on the 2014 Budget).
3 Bank of Greece data for the state budget deficit (on a cash basis) excluding movements in the OPEKEPE account.
4 Excluding accrued interest of €4,751 million, paid in the form of EFSF notes, on PSI bonds, as well as interest payments of €519 million due to the debt buyback through EFSF notes.
5 Excluding revenue of €2.0 billion due to transfers of earnings on Greek government bond holdings of Eurosystem central banks (Securities Markets Programme - SMP). Including expenditure of around €6,155 million for the payment of arrears.

Unlike 2010-2012, when fiscal consolidation was mainly driven by revenue increases, adjustment in 2013 primarily relied on measures designed to rationalise and cut back on public social spending, staff costs and government consumption expenditure, as provided for in the Medium-Term Fiscal Strategy (MTFS) Framework 2013-2016 (see Box VI.1). A positive contribution to increased revenue in 2013, in cyclically adjusted terms, came from reforms in social security contributions and indirect taxes under the MTFS frameworks 2012-2015 and 2013-2016. Overall, the measures taken in 2010-2013 are estimated to have delivered an initial €73.4 billion, or 36.2% of GDP, equally divided between revenue increases and expenditure cuts.

Yet, the favourable results leave no room for complacency. Fiscal consolidation must continue in the years ahead, in order to bring the public debt-to-GDP ratio on a firm downward path and to allow Greece to gradually return to the international capital markets.

The target set in the 2014 Budget for the achievement of a general government primary surplus of 1.6% of GDP, based on EAP methodology, is slightly higher than the respective target set in the second EAP (1.5% of GDP). Successful implementation of the 2014 Budget would signal the attainment of sustainable fiscal consolidation, which, together with the return of the economy to growth, would help restore Greece's credibility, bolster confidence and mark the end of the crisis in Greece (see Box VI.2). However, repeated delays in fulfilling commitments under the EAP, as well as mounting political acrimony in the run-up to the forthcoming elections are factors of uncertainty.

Furthermore, for the fiscal achievements to be sustainable over the medium to the long term, the macroeconomic environment should improve and Greece should return to growth in 2014. Economic recovery would allow for a faster decrease in the public debt-to-GDP ratio, as it would reverse the particularly negative impact of the "snowball effect" (i.e. the increase in the debt-to-GDP ratio linked to the spread between the nominal interest rate and the nominal rate of GDP growth), which in 2010-2013 contributed no less than 59.7 percentage points of GDP to the increase in public debt as a percentage of GDP.

In addition, an improved macroeconomic environment and reduced uncertainty would help attract foreign investment and accelerate the privatisation programme, thus serving to further reduce the public debt and to improve the medium- to long- term prospects for the Greek economy.

Top priority in attaining the fiscal targets in the years ahead must be given to upgrading the tax administration and the tax collection mechanism, as well as to reducing the backlog of tax cases pending before the courts, as ways to address tax and contribution evasion. Progress in these areas would help expand the tax base, thereby leading to higher revenue, but also foster a climate of social equity, with everyone contributing to the fiscal consolidation effort according to their tax-paying capacity. This would enhance tax compliance, thereby facilitating the continuation of the fiscal effort as well as fiscal target achievement in the years ahead.

Despite the progress made in key areas (intensification of tax audits, especially for tax payers with a high risk of tax evasion; increased autonomy of tax authorities; better target-setting in terms of anticipated public revenue, etc.), the fight against tax and contribution evasion has not yet produced the intended results. Hence, the recourse to new tax hikes and new tax measures, which put a disproportionate burden on compliant tax payers. Indicatively, while the first EAP in May 2010 had projected revenue gains from combatting tax evasion as early as 2013, this target was later pushed back to 2014-2016, with improved tax administration projected to yield revenue gains of 0.4% of GDP in 2014 and, cumulatively, of 1.5% of GDP by 2016.

Progress in this area is a prerequisite for the sustainability of fiscal consolidation. According to a recent OECD report (2013),[4] if tax collection efficiency in Greece had been similar to the OECD average in 2011 (at existing VAT and social security contribution rates), the level of Greek government revenues could have been 6 percentage points of GDP higher. This would have more than covered any fiscal gap of 2014-2016. However, as stated in the abovementioned OECD report and pointed out by the Bank of Greece in its *Monetary Policy Report* (May 2013),[5] tax efficiency declines in periods of recession. In the case of VAT, this decline in efficiency may reflect an increase in tax evasion and a shift in consumer spending towards essential goods with a lower VAT rate. Therefore, the anticipated upturn of economic activity and strengthening of tax mechanisms can be expected to improve tax performance and bolster public revenue in the years ahead.

Despite tangible progress in downsizing the public sector through the application of a 1:5 attrition rule (allowing only one in every five employees exiting the public sector to be replaced by a new hire), efforts to address public overspending through a restructuring and rationalisation of State operations must continue in order to achieve fiscal savings targets, reduce red tape and the administrative burden on the public sector, and improve the quality of public services.

Furthermore, as recommended in the OECD report (2013), significant efficiency gains could also be achieved through further development of e-government to boost public sector productivity and facilitate private citizen interaction with government departments and agencies. Such improvement hinges upon the acceleration of administrative reform (still pending) and the performance evaluation of public services and civil servants on the basis of transparent and objective criteria. Tighter monitoring

4 OECD (2013), *Economic Surveys: Greece*, November.
5 Bank of Greece (2013), *Monetary Policy 2012-2013*, May, Box IV.2, pp. 69-70.

and control of expenditures is also needed to stop the accumulation of government arrears, especially in social security funds and the National Organisation for the Provision of Health Services (EOPYY). The accumulation of government arrears, as well as shortfalls in privatisation proceeds pose risks to liquidity in the economy, growth, and the coverage of the State's future financing requirements.

A further strengthening of the institutional framework governing budget preparation, implementation and monitoring through the establishment of an independent fiscal council should further ensure fiscal sustainability in the post-Memorandum era (see Box VI.3).

Overall, a more efficient public administration is needed to carry out required structural reforms, such as the introduction in the legislation of the OECD Principles of Better Regulation with a view to reducing by 25% the administrative costs entailed by existing regulations in 13 important sectors of the economy (including energy, public procurement, company law, VAT and the environment). However, the attainment of concrete reform outcomes hinges upon proper monitoring of implementation. To this end, improved co-operation between competent authorities is necessary, while, as recommended by the OECD, this task could be entrusted to an independent agency.

2 CURRENT FISCAL DEVELOPMENTS (JANUARY-DECEMBER 2013)

General government (State General Accounting Office data)

According to general government data compiled by the State General Accounting Office, the general government deficit stood at 3.9% of GDP in 2013, down from 7.0% of GDP in 2012. The general government primary deficit was 0.2% of GDP in 2013, against 0.4% of GDP in 2012. The improvement from 2012 is primarily attributable to lower interest payments, cuts to wage and pension spending, and SMP revenue, while the payment of government arrears negatively affected the general government balance, through not on a national accounts basis, as these arrears concern previous years.

The State Budget (administrative data)

The period January-December 2013 saw an overachievement of the revised targets for the state budget. The state budget deficit thus came to 3.0% of GDP, down from 8.1% of GDP in the corresponding period of 2012 (see Table VI.2). The primary balance of the state budget recorded a surplus of 0.3% of GDP, against a deficit of 1.8% of GDP in the corresponding period of 2012, with an overachievement against the revised targets set by the Ministry of Finance of about €600 million.

It should be noted that the improved results stemmed entirely from the ordinary budget, the deficit of which turned out €1.1 billion lower than the revised targets. What is more, this outcome was achieved through measures on both the revenue and expenditure sides.

Ordinary Budget Revenue

In 2013, ordinary budget revenue (before tax refunds)[6] recorded a slightly positive growth rate (0.1%) for the first time since 2010 (see Table VI.3), as the revised target (for a reduction of 1%) set in the Introductory Report to the 2014 Budget was overachieved by €521 million. This better revenue performance is primarily attributable to receipts from the property tax collected through electricity bills (EETHDE), the collection of the real property tax (FAP) due from 2011, 2012 and 2013, as well as to ANFA and SMP revenue.

Revenue from direct taxation declined by 4.9% compared with 2012, but was €181 million higher than expected, owing to better targeting by the State General Accounting Office. Receipts in this category were bolstered con-

6 Including special revenue from licensing and concession fees.

Table VI.2 State budget balance

(million euro)

	Annual data					Percentage changes			
	2011	2012	2013		2014	2012/2011	2013/2012		2014/2013
			Estimates	Execution	Budget		Estimates	Execution*	Budget/ Execution*
	(1)	(2)	(3)	(4)	(5)	(6=2:1)	(7=3:2)	(8=4:2)	(9=5:4)
I. Revenue	**53,932**	**51,925**	**53,242**	**53,018**	**54,695**	**-3.7**	**2.5**	**2.1**	**3.2**
1. Ordinary budget (net)	50,159	48,325	48,106	48,423	49,693	-3.7	-0.5	0.2	2.6
Revenue before tax refunds	*54,285*	*51,482*	*50,921*	*51,442*	*52,252*	-5.2	*-1.1*	*-0.1*	*1.6*
Special revenue from licensing and consession fees	*1,157*	*15*	*86*	*86*	*230*				
Tax refunds	*5,283*	*3,172*	*2,901*	*3,105*	*2,789*	*-40.0*	*-8.5*	*-2.1*	*-10.2*
2. Public investment budget	3,773	3,601	5,136	4,595	5,002	-4.6	42.6	27.6	8.9
– Own revenue	147	166	200	76	200	12.9	20.5	-54.2	163.2
– Receipts from the EU	3,626	3,434	4,936	4,520	4,802	-5.3	43.7	31.6	6.2
II. Expenditure	**76,705**	**67,614**	**59,327**	**58,459**	**56,248**	**-11.9**	**-12.3**	**-13.5**	**-3.8**
(State budget primary expenditure)	60,357	55,391	53,227	52,415	50,098	-8.2	-3.9	-5.4	-4.4
1. Ordinary budget	70,146	61,499	52,677	51,809	49,448	-12.3	-14.3	-15.8	-4.6
– Interest payments	16,348	12,223	6,100	6,044	6,150	-25.2	-50.1	-50.6	1.8
– Ordinary budget primary expenditure	51,996	47,529	44,831	44,230	41,946	-8.6	-5.7	-6.9	-5.2
– Procurement of military equipment	360	410	650	529	583				
– Call-in of guarantees from entities	1,442	796	956	879	699				
within the general government	1,249	679	522	514	466				
outside the general government	193	117	434	365	233				
– Fee for disbursement of EFSF loans	0	541	140	127	70				
2. Public investment budget	6,559	6,114	6,650	6,650	6,800	-6.8	8.8	8.8	2.3
III. State budget balance	**-22,773**	**-15,688**	**-6,085**	**-5,441**	**-1,553**	**-31.1**	**-61.2**	**-65.3**	**-71.5**
% of GDP	**-10.9**	**-8.1**	**-3.3**	**-3.0**	**-0.8**				
1. Ordinary budget	-19,987	-13,174	-4,571	-3,386	245				
2. Public investment budget	-2,786	-2,513	-1,514	-2,055	-1,798				
IV. State budget primary balance	**-6,425**	**-3,465**	**15**	**603**	**4,597**	**-46.1**	**-100.4**	**-117.4**	**662.4**
% of GDP	**-3.1**	**-1.8**	**0.0**	**0.3**	**2.5**				
Amortisation payments	28,843	23,905	12,755	12,755	24,930	-17.1	-46.6	-46.6	95.5
GDP (at current prices)	208,532	193,749	182,911	182,911	183,089	-7.1	-5.6	-5.6	0.1

Source: Ministry of Finance.
* Provisional data.

Table VI.3 Ordinary budget revenue

(million euro)

	2010	2011	2012	2013*	Percentage changes 2011/2010	2012/2011	2013*/2012
I. Direct taxes	**20,224**	**20,318**	**21,096**	**20,065**	**0.5**	**3.8**	**-4.9**
1. Income tax	14,287	12,933	13,311	11,496	-9.5	2.9	-13.6
– Personal	9,398	8,285	9,968	7,979	-11.8	20.3	-20.0
– Corporate	3,149	2,760	1,715	1,681	-12.4	-37.9	-2.0
– Special categories of income tax	1,670	1,888	1,628	1,837	13.1	-13.8	12.8
2. Property taxes	487	1,172	2,857	2,991	140.7	143.8	4.7
3. Tax arrears	2,874	1,911	1,812	2,826	-33.5	-5.2	56.0
4. Extraordinary and other direct taxes	2,576	4,302	3,116	2,752	67.0	-27.6	-11.7
II. Indirect taxes	**31,042**	**28,632**	**26,082**	**24,548**	**-7.8**	**-8.9**	**-5.9**
1, Customs duties and special contributions on imports-exports	217	198	154	146	-8.8	-22.2	-5.2
2. Consumption taxes on imports	2,046	1,910	1,433	1,378	-6.6	-25.0	-3.8
– VAT	1,796	1,810	1,380	1,322	0.8	-23.8	-4.2
– Cars	226	89	44	45	-60.6	-50.6	2.3
3. Consumption taxes on domestic products	27,150	25,106	23,147	21,462	-7.5	-7.8	-7.3
– VAT	15,578	15,077	13,575	12,526	-3.2	-10.0	-7.7
– Fuel	5,698	4,653	4,464	4,228	-18.3	-4.1	-5.3
– Tobacco	2,913	3,045	2,707	2,503	4.5	-11.1	-7.5
– Road duties	1,591	1,117	1,305	1,183	-29.8	16.8	-9.3
– Special levies and contributions on cars	52	42	36	35	-19.2	-14.3	-2.8
– Other	1,317	1,172	1,059	987	-11.0	-9.6	-6.8
4. Transaction taxes	1,120	905	733	819	-19.2	-19.0	11.7
– Capital transfers	702	509	387	503	-27.5	-24.0	30.0
– Stamp duties	414	393	342	313	-5.1	-13.0	-8.5
5. Other indirect taxes	509	513	614	743	0.8	19.7	21.0
III. Total tax revenue	**51,266**	**48,951**	**47,178**	**44,614**	**-4.5**	**-3.6**	**-5.4**
IV. Non-tax revenue[1]	**4,912**	**6,490**	**4,318**	**6,915**	**32.1**	**-33.5**	**60.1**
– Transfers of earnings on Greek government bond holdings by the Eurosystem central banks (ANFA and SMP)			303	2,715	-	-	-
V. Total revenue before tax refunds[1]	**56,179**	**55,442**	**51,497**	**51,528**	**-1.3**	**-7.1**	**0.1**

Source: State General Accounting Office.
* Provisional data.
1 Including revenue from licensing and concession fees.

siderably by the property tax collected through electricity bills (EETHDE) for 2012 and 2013 and property taxes. Specifically:

- Invidual income tax receipts dropped by a sizeable 20.0% relative to 2012, mainly reflecting a decrease in tax withholding as a result of the decline in employment and wages. Furthermore, this category of revenue had been bolstered in 2012 by the social solidarity levy on individual income earned in 2012.[7] It should

7 A double social solidarity levy was imposed in 2012 on income earned in 2011 and 2012. The levy on 2011 income was included in other direct taxes. The levy on 2012 income was withheld on a monthly basis and spread out across the entire year, similarly to monthly income tax withholding.

be noted that this revenue category was also boosted in 2013 by additional tax measures taken early in the year.[8]

• Receipts from corporate income tax fell compared with 2012 (-2.0%). This was due to the fact that most businesses, including banks, recorded significant losses in 2012. In addition, owing to the deadline extension for filing 2013 tax returns, one of the tax instalment deadlines was in January 2014.

• The special income tax categories recorded an increase of 12.8% relative to 2012. This was due in part to increased receipts from taxation on deposits, as a result of the tax rate increase from 10% to 15% as of 1 January 2013.

• Receipts from taxes on inheritance, gifts, parental donations and real estate increased by 4.7% compared with 2012, due to the collection of the last instalments of the property tax paid through electricity bills (EETHDE) for 2012 and of three instalments for 2013. The 2013 EETHDE will be paid in five bi-monthly instalments, the last of which falling due in the first months of 2014. It should be noted that the 2013 EETHDE has been reduced by 15% compared with 2012.

• Revenue from tax arrears grew considerably (56%) compared with 2012. This category was bolstered by receipts from the real property tax (FAP) for 2010[9] and from the payment of FAP instalments for 2011, 2012 and 2013. Collection is expected to be completed by February 2014. Lastly, this category was bolstered by the final two instalments of the 2012 income tax.

• Other direct taxes fell (-11.7%) from one year earlier, mainly due to lower receipts from the social solidarity levy compared with 2012.[10]

Receipts from indirect taxation fell for the third consecutive year, by 5.9%, declining across most indirect tax categories. However, as a result of better targeting by the State General Accounting Office, receipts were marginally higher than expected (€29 million). In more detail:

• VAT receipts, although lower (-7.4%) than in 2012 due to the continuing economic downturn,[11] were considerably higher than expected (overshooting the target by €204 million). It should be noted that as of 1 August 2013,[12] VAT on restaurant services was lowered from 23% to 13%.

• Receipts from taxation on liquid fuel declined (-5.3%) relative to 2012, falling short of the 2013 target, despite the substantial increase in the excise tax on heating oil.[13] This decline stems from a drop in liquid fuel consumption,[14] as a result of higher heating oil prices and the protracted recession.

• The above tax receipt shortfalls were covered by higher receipts (30%) from taxes on capital transfers, owing to the share capital increases launched by banks.

Non-tax revenue increased noticeably (by 60.1%), mainly on account of ANFA and SMP revenue (€682 million and €2,033 million, respectively).

Finally, tax refunds in 2013 came to €3,105 million (roughly the same level as in 2012), overshooting the revised annual target by €204 million.

Ordinary Budget Expenditure

In 2013, ordinary budget expenditure declined further (-15.8%) from 2012 and was reined in more than estimated in the Introductory Report to the 2014 Budget. This was mainly the result of a major effort to contain ordinary

8 For fiscal year 2013, new tax law 4110/2013, amongst other provisions, abolishes the tax-free threshold of €5,000 as well as most tax exemptions, and introduces a new tax scale for wage earners and pensioners.
9 FAP notices for 2010 were mailed to taxpayers between October and end-2012. All installments were due in the first quarter of 2013.
10 The 2012 levy also included an emergency social solidarity levy for 2011, see footnote 7.
11 According to ELSTAT, the turnover index in January-October 2014 declined by 9.5%.
12 Law 4172/2013.
13 Law 4092/2012 aligned the excise tax on heating oil with that on diesel oil.
14 According to ten-month consumption data, total liquid fuels dropped by 13.4%.

Table VI.4 Outlays under the ordinary budget and the public investment budget

(million euro)

	Annual data					Percentage changes			
	2011	2012	2013*		2014	2012/11	2013*/12		2014/13
			Estimates	Execution	Budget				
	(1)	(2)	(3)	(4)	(5)	(6=2:1)	(7=3:2)	(8=4:2)	(9=5:4)
I. Outlays under the ordinary budget	**70,146**	**61,499**	**52,677**	**51,809**	**49,448**	**-12.3**	**-14.3**	**-15.8**	**-4.6**
1. Personnel outlays	21,818	20,511	18,543	18,422	18,412	-6.0	-9.6	-10.2	-0.1
of which: wages	15,246	13,947	12,745	12,572	12,372	-8.5	-8.6	-9.9	-1.6
pensions	6,572	6,564	5,798	5,850	6,040	-0.1	-11.7	-10.9	3.2
2. Social security and healthcare	18,150	17,134	15,935	15,922	13,271	-5.6	-7.0	-7.1	-16.6
of which: grants to social security funds	15,153	14,466	12,650	12,740	10,622	-4.5	-12.6	-11.9	-16.6
grants to hospitals for payment of arrears	435	400	400	400	400	-8.0	0.0	0.0	0.0
3. Operating and other expenditure	7,027	6,408	6,624	6,337	5,369	-8.8	3.4	-1.1	-15.3
of which: consumer expenditure and off-budget items	2,153	2,064	2,175	1,732	1,754	-4.1	5.4	-16.1	1.3
4. Earmarked spending	5,001	3,474	3,526	3,549	3,774	-30.5	1.5	2.2	6.3
5. Reserve			203	0	1,120				
6. Interest payments	16,348	12,224	6,100	6,044	6,150	-25.2	-50.1	-50.6	1.8
7. Ministry of National Defence programmes for procurement of military equipment	360	410	650	529	583	13.9	58.5	29.0	10.2
8. Guarantees called to bodies classified inside general government	1,249	679	522	514	466	-45.6	-23.1	-24.3	-9.3
9. Guarantees called to bodies classified outside general government	193	117	434	365	233				
10. Loan disbursement fee to the European Financial Stability Facility (EFSF)	0	541	140	127	70	-	-74.1	-76.5	-44.9
II. Outlays under the public investment budget	**6,559**	**6,114**	**6,650**	**6,650**	**6,800**	**-6.8**	**8.8**	**8.8**	**2.3**
1. Project execution	1,500	1,500	...	...	...				
2. Grants	5,016	4,570	...	...	...				
3. Administrative costs	43	44	...	...	...				
III. Outlays under the state budget (I+II)	**76,705**	**67,614**	**59,327**	**58,459**	**56,248**	**-11.9**	**-12.3**	**-13.5**	**-3.8**
Primary expenditure under the state budget (III-I6)	60,357	55,390	53,227	52,415	50,098	-8.2	-3.9	-5.4	-4.4
Primary expenditure under the ordinary budget (I1+I2+I3+I4+I5)	51,996	47,529	44,831	44,230	41,946	-8.6	-5.7	-6.9	-5.2
Amortisation payments	28,843	23,905	12,755	12,755	24,930	-17.1	-46.6	-46.6	95.5

Source: State General Accounting Office.
* Provisional data.

budget primary expenditure and, on the other hand, of a significant decline in interest payments relative to 2012 (see Table VI.4).

Based on available disaggregated data, developments in the main categories of ordinary budget expenditure are as follows:

- Wage and pension spending declined further (-10.2%) in 2013. In fact, the budgeted target was overshot as a result of the measures implemented to contain this expenditure category. This better-than-expected development is attributable to a better performance in trimming wage costs, given that the pension expenditure declined, but fell short of the target, due to the larger number of retirements. Specifically, the major wage- and pension-related measures implemented in 2013 involved the rationalisation of special wage regimes, the extension of the unified wage grid to other civil servant categories, the elimination of holiday and summer bonuses for civil servants and pensioners, staff cuts in universities and technological institutes, the increase of the statutory retirement age by two years, further adjustment of main and supplementary pensions, and scrutiny and cross-checking of personal data to verify entitlement to retirement benefits and allowances.

- Social security and healthcare spending also decreased (-7.1%) in 2013, in line with the revised annual target, following the implementation of rationalisation measures. However, outlays for grants to social security funds, despite falling (-11.9%), recorded a small deviation from the target (an overrun of €90 million), mainly due to higher funding of the wage earners' fund (Social Insurance Institute – IKA) and the Public Power Corporation (DEH).

- Operating and other expenditure also fell (-1.1%) in 2013, against a revised targeted increase from 2012, owing to a considerably larger containment of consumption expenditure.

- Earmarked spending increased (+2.2%) in 2013 against 2012, and slightly overran the revised target (by €23 million).

- Finally, interest payments declined substantially (-50.6%) in 2013, having declined already in 2012. The lower interest payments from 2012 onwards are attributable to the decrease in the level of public debt following the PSI in March 2012 and the bond buyback in December 2012, the lower interest rate spread on loans under the Support Mechanism, and the deferral of interest payments on European Financial Stability Facility (EFSF) loans (Eurogroup decisions of 27 November 2012).

Public Investment Budget

The public investment budget deficit of 2013 fell short of the revised target in the Introductory Report to the 2014 Budget by €541 million, due to delays in payments from the EU Funds. However, public investment expenditure met the revised target, increasing by 8.8% from 2012. This was the first increase in public expenditure since 2009, a most welcome development.

State Budget developments on a cash basis

In 2013, the cash deficit (borrowing requirements) of the state budget[15] increased by 1.5% of GDP from 2012 (see Table VI.5 and Chart VI.2). This development stems mainly from the fact that primary expenditure has been affected by the payment of arrears, ANFA revenue and privatisation proceeds. Thus, making the necessary adjustments, the cash balance for 2013 improved by 0.8% of GDP compared with 2012.

State budget borrowing requirements and amortisation payments were financed exclusively through borrowing from the Support Mechanism, almost half of which was used to repay government debt (Treasury bills, foreign borrowing, etc., see Table VI.6), as well as government arrears.

15 Excluding movements in the OPEKEPE (Payment and Control Agency for Guidance and Guarantee Community Aid) account.

Table VI.5 State budget deficit on a cash basis[1,2]

(million euro)

	Annual data				
	2009	2010	2011	2012	2013*
State budget	**32,622**	**23,396**	**23,144**	**10,697**	**12,794**
% of GDP	14.1	10.5	11.1	5.5	7.0
– Ordinary budget[3]	25,318[4]	18,333[5]	20,462[6]	8,503[7]	10,785[8]
– Public investment budget	7,304	5,063	2,682	2,194	2,009

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 Aid) account.
3 Including movements in public debt management accounts.
4 Not taking into account expenditure of €3,769 million for the acquisition of preference shares of Greek banks pursuant to Law 3723/2008 and of €1,500 million for the issuance of bonds to cover the capital increase of the Guarantee Fund for Small and Very Small Enterprises (TEMPME SA), but including revenue of €673.6 million from the sale of OTE shares, of €72.3 million from the privatisation of Olympic Airlines, as well as the issuance of a bond amounting to €531 million, the proceeds of which were given as a grant to OGA to cover obligations of the Greek government.
5 Including expenditure of: a) €297.9 million (bond issue reopening) for the payment of past government debt to the Social Insurance Institute (IKA); and b) €714.7 million (bond issuance) for the payment of Greek government debt to the Hellenic Petroleum SA (ELPE), EGNATIA MOTORWAY SA, and the Agricultural Bank of Greece, but excluding expenditure of: a) €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 b) €424.3 million (bond issuance) for the settlement of financial obligations to 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.
6 Not including revenue of: a) €675 million from the sale of preference shares of the Agricultural Bank of Greece by the Greek State; and b) €250 million from the Deposits & Loans Fund due to the reduction of its reserves. By contrast, including privatisation proceeds of €1,536 million, but excluding expenditure of: a) €4,011 million (bond issue reopening) for the repayment of public hospitals' arrears pursuant to Article 27 of Law 3867/2010, which burdens the 2011 debt; b) €350 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; and c) €140.2 million (bond issuance) for covering the State's debt to the former employees of Olympic Airlines that were laid off. Also, not including expenditure of €1,551.8 million for the participation of the Greek State in capital increases, of which €1,434.5 million relate to the capital increase of the Agricultural Bank of Greece as well as to the proceeds from a bond issue reopening (€1,380 million) paid for the purchase by the Greek State of preference shares of the National Bank of Greece and Piraeus Bank.
7 Including revenue of: i) €303 million relating to ANFA returns; and ii) €10.6 million from privatisation proceeds, but excluding expenditure of: i) €4,751 million for interest paid on PSI bonds, as well as interest payments of €519 million due to debt buyback in the form of EFSF short-term securities; ii) €9.9 million (bond issuance) for covering the State's debt to the Jewish Community of Thessaloniki; and iii) €73 million for the participation of the Greek State to capital increases (Horse Racing Organisation of Greece (ODIE), Hellenic Vehicle Industry (ELVO), Hellenic Defence Systems SA, etc.). Including expenditure of €901.3 million relating to Greece's participation in the European Stability Mechanism (ESM).
8 Including revenue of: a) €682 million relating to ANFA returns; and b) €998 million from privatisation proceeds (sale of IBC premises, etc.), but excluding revenue of €2.0 billion from transfers of earnings on Greek government bond holdings by the Eurosystem central banks (Securities Markets Programme - SMP). Not including €37.6 million for the participation of the Greek State in capital increases (Hellenic Defence Systems SA, etc.). Including expenditure of about €6,155 million for the payment of arrears, and €901.3 million relating to Greece's participation in the European Stability Mechanism (ESM).

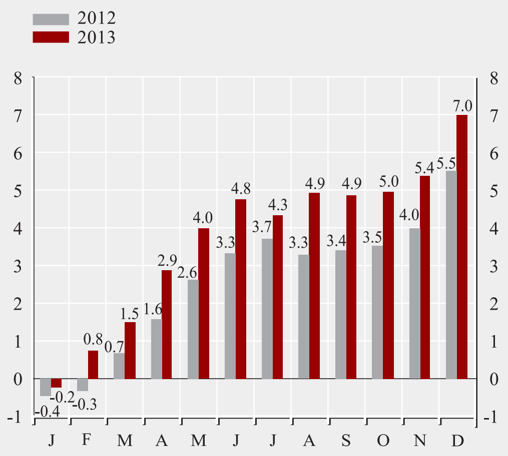
Government arrears

In order to achieve the target of the Economic Adjustment Programme (EAP) on the reduction of the total level of government arrears (government expenditure arrears and pending tax refunds), partners agreed to finance arrear settlement with an aim to avoid creating new ones. In this context, in December 2013 a programme for the repayment of government arrears amounting to €8 billion was implemented. Within 2013, a total of €6 billion of arrears were paid, as delays in the implementation of the programme slowed down the pace of repayment. These payments represented cash expenditure of the state budget, but do not affect the national accounts balance of the general government for 2013, as they burdened the balance of the year in which the corresponding arrears were generated.

The payment of arrears has a positive effect on liquidity in the economy, on condition that no new ones are created. In 2013, however, new arrears were generated amounting to €1.4 billion, mainly by the Civil Servants' Welfare Fund and the National Organisation for the Provision of Health Services (EOPYY). It is important to continue efforts for a more effective control and containment of spending, as

Chart VI.2 Net borrowing requirement of central government on a cash basis (January 2012-December 2013)

(percentages of GDP)



Source: Bank of Greece.
Notes: "Monthly" figures refer to cumulative percentages from the start of the year. Excluding the balance in the OPEKEPE (Payment and Control Agency for Guidance and Guarantee Community Aid) account.

well as the completion of the arrear settlement programme, which was extended in 2014 with an annual target of €1.5 billion. It should be noted that government arrears at end-2013 totalled €4.7 billion, of which €519 million were pending tax refunds.

General Government Debt

According to the Introductory Report to the 2014 Budget, public debt is estimated to have reached €321 billion or 175.5% of GDP in 2013, from €303.9 billion or 159.6% of GDP in 2012 (see Table VI.7). The increase observed in the level of public debt in 2013 is mainly attributable to the financing of the planned recapitalisation of banks through the Hellenic Financial Stability Fund (€7.2 billion) and additional borrowing for the payment of government arrears of €6.5 billion. Despite extremely low interest rates, the spread between interest rates and the growth rate still

Table VI.6 Financing of the state budget cash deficit

(million euro)

	2010		2011		2012		2013*	
	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
Greek government bonds and Treasury bills[1]	1,155[4]	4.9	-19,763[5]	-85.4	-8,365[6]	-78.2	-11,799	-92.2
Change in the balances of central government accounts with the credit system[2]	-8,148	-34.8	3,086	13.3	-2,895	-27.1	3,415	26.7
External borrowing[3]	-1,314	-5.6	-1,650	-7.1	-1,071	-10.0	-3,600	-28.1
Borrowing from the IMF/EU	31,703	135.5	41,471	179.2	23,028	215.3	24,778	193.7
– from the EU	*21,000*		*31,900*		*21,397*		*18,100*	
– from the IMF	*10,703*		*9,571*		*1,631*		*6,678*	
Total	**23,396**	**100.0**	**23,144**	**100.0**	**10,697**	**100.0**	**12,794**	**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 the payment of arrears of public hospitals and of the Hellenic Agricultural Insurance Organisation (ELGA). See also footnote 5 in Table VI.5.
5 Excluding bonds issued by the Greek government for the payment of arrears of public hospitals, ELGA and Olympic Airlines. See also footnote 6 in Table VI.5.
6 Excluding expenditure of €9.9 million (bond issuance) for covering the State's debt to the Jewish Community of Thessaloniki.

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

(million euro)

	2006	2007	2008	2009	2010	2011	2012
Short-term	2.478	2.180	5.791	12.335	11.886	14.464	18.723
– securities	943	1.625	5.496	10.820	9.121	11.844	16.516
– loans	1.536	555	295	1.515	2.765	2.620	2.207
Medium- and long-term	221.409	236.617	256.768	285.878	316.623	339.857	284.431
– securities	178,600	192,712	211,515	242,802	244,312	240,154	77,098
– loans	42,809	43,905	45,253	43,076	72,311	99,703	207,333
Coin and deposits	988	693	728	1,477	1005	820	774
Total	**224,876**	**239,490**	**263,287**	**299,690**	**329,514**	**355,141**	**303,928**
% of GDP	*107.8*	*107.3*	*112.9*	*129.7*	*148.3*	*170.3*	*156.9*
– euro-denominated debt	222,820	237,574	261,655	298,430	329,514	355,141	303,928
of which:							
to the Bank of Greece	*(7,991)*	*(7,521)*	*(7,051)*	*(6,581)*	*(6,111)*	*(5,684)*	*(5,212)*
to the IMF/EU					*(27,121)*	*(65,379)*	*(174,558)*
– non-euro denominated debt	2,056	1,916	1,632	1,260	6,013	9,185	9,987[2]
of which: to the IMF/EU					*(4,704)*	*(7,831)*	*(8,541)*

Source: State General Accounting Office.
1 According to the definition in the Maastricht Treaty.
2 Valuation using exchange rates as at 31 December of each year.

Table VI.8 Decomposition of changes in the general government debt-to-GDP ratio[1]

(percentages of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013*
General government debt-to-GDP ratio	97.4	98.9	110.0	107.8	107.3	112.9	129.7	148.3	170.3	156.9	175.5
Changes in the general government debt-to-GDP ratio	-4.2	1.4	11.2	-2.2	-0.5	5.6	16.8	18.6	22.0	-13.4	18.6
– Primary balance	0.7	2.6	1.0	1.3	2.0	4.8	10.5	4.9	2.4	4.0	8.3
– Change in GDP and change in interest rates	-4.3	-1.9	0.7	-3.5	-2.2	0.5	6.2	11.2	16.9	18.0	13.6
– Deficit-debt adjustment[2]	-0.6	0.8	9.5	-0.1	-0.2	0.3	0.1	2.6	2.7	-35.5	-3.3

Sources: Ministry of Finance, General Directorate of Economic Policy, "Hellas: Macroeconomic Aggregates".
* Provisional data.
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 rate on government debt
SF_t = deficit-debt adjustment

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

weighs heavily on government debt. Furthermore, it is expected that the primary surplus (according to ESA 95, see footnote 2 for deficit terminology) will contribute to an increase in public debt, while the stock-flow adjustment is projected to reduce it (see Table VI.8).

In 2014, the projected achievement of a primary surplus should have a downward effect on public debt; however, the snowball effect is expected to continue, although to a smaller degree. As a result, public debt in 2014 is expected to stabilise at 2013 levels and stand at €320 billion, or 174.8% of GDP. This is an important development, which, together with the continued attainment of primary surpluses and the return of the economy to growth, should drive down the debt-to-GDP ratio.

3 THE 2014 BUDGET

According to the Introductory Report to the 2014 Budget, the general government deficit (based on ESA 95, excluding the impact of the bank support programme) should stand at €4,266 million, or 2.3% of GDP, in 2014 and the general government primary surplus (based on ESA 95) is projected to be €5,399 million (or 2.9% of GDP). Excluding ANFA and SMP revenue, the primary balance (according to the EAP definition) is forecast to show a surplus of €2,956 million or 1.6% of GDP, i.e. marginally higher than the EAP target of €2,751 million or 1.5% of GDP. Compared with 2013, the primary balance is projected to improve by around 1.2% of GDP in 2014.

Most of this adjustment is expected to come from the State Budget, the cash primary balance of which is projected to be a surplus of 2.5% of GDP, up from a surplus of 0.3% of GDP in 2013 (and a deficit of 1.8% of GDP in 2012) (see Table VI.2). This improvement is expected to stem both from higher state budget net revenue, as a result of an expected better performance of direct tax revenue, and from the containment of ordinary budget primary expenditure.

Achieving the targets for 2014 relies on: measures with an expected yield of around €3.4 billion, already adopted and included in the Medium-Term Fiscal Strategy (MTFS) Framework 2013-2016; a new structural action programme aimed at increasing revenue from social security contributions and combatting contribution evasion; a better macroeconomic outlook for 2014; improved tax compliance and tackling tax evasion.

4 MAIN FISCAL POLICY MEASURES AND INSTITUTIONAL FISCAL REFORMS

Fiscal policy measures

Fiscal efforts should continue in the next years, in order to attain the EAP targets for a general government primary surplus of 1.5% of GDP in 2014, 3.0% of GDP in 2015 and 4.5% of GDP in 2016. The 2014 Budget includes measures already passed by Parliament and included in the MTFS 2013-2016, with an estimated yield of €3.4 billion. These measures include, most importantly, changes in taxation, such as the new individual income tax scale for all taxpayers; increase in taxation for sole proprietors and self-employed; and abolition of most tax exemptions, whereas existing imputed income criteria are maintained. Furthermore, 2014 revenue is expected to be boosted by an increase in the taxation of general and limited partnerships' profits, a hike to 26% (from 20%) in the tax rate on retained profits of sociétés anonymes and limited liability companies[16] and the imposition of a 15% capital gains tax on equities, shares of partnerships, government and corporate bonds, and financial derivatives (Law 4172/2013). However, the imposition of the capital gains tax, compounded by the 0.2% financial transactions tax already in place, may have an adverse impact on transactions. The imposition of a "stay and sail" tax on leisure boats visiting Greece, the taxation of formerly tax-exempt reserves, as well as the introduction

16 A 10% additional tax, against the previously applicable 25%, will be imposed on distributed profits.

of pre-completed tax returns for pensioners should further support revenue. Moreover, the implementation of a structural action programme aiming to increase revenue from social security contributions and combat contribution evasion is estimated to contribute at least €600 million annually.[17]

Law 4223/2013[18] introduced a unified property tax (ENFIA) on real estate, while reducing the real estate transfer tax to 3%, from about 10%. The provisions of the aforementioned law are fiscally neutral and are expected to rationalise property taxes, in line with the practices of other OECD countries (see footnote 4). Among other things, the shipping community will be required to pay an extra amount of tax on an annual basis over the next three years (2014-2016) to help Greece overcome the economic crisis.[19] Furthermore, the said law provides for the taxation, at a 26% rate, of the business profits of non-profit legal entities (irrespective of the category of accounting books they keep). A provision of the omnibus law on the suspension of auctions extends the application of a reduced VAT rate of 13% on restaurant services (which has been in place since 1 August 2013) until 31 December 2014, as the government judged that this reduction had a positive effect on private activity and did not lead to a substantial drop in VAT revenue.[20]

Savings will come from the operating and the defence expenditure side, while the limitation of the means-tested Social Solidarity Pension Supplement (EKAS) entitlement to persons over 65 years of age and the curtailment of one-off and supplementary pensions pursuant to earlier legislation will contribute positively. A Ministry of Health amendment to a law adopted on 28 November 2013[21] contributes to further lowering the prices of pharmaceuticals by redefining the prices of originators and generics, as well as rebates. These provisions achieve additional annual savings of €480 million from the budgets of social security funds, the National Organisation for the Provision of Health Services (EOPYY) and hospitals.

However, as mentioned also in the Medium-Term Fiscal Strategy Framework (MTFS), additional measures amounting to €1,877 million in 2015 and €2,765 million in 2016 are required to ensure the achievement of the 2015 and 2016 targets. These measures are expected to be included in the revised MTFS 2014-2017, which has been delayed due to protracted negotiations with the troika.

Institutional fiscal reforms

In 2013, efforts to reform tax administration and modernise tax procedures were continued. Specifically, new legislation was passed in an aim to reorganise the audit mechanism, accelerate the collection of tax arrears and tackle tax evasion. Emphasis has been placed on audits of high-wealth taxpayers, debts are classified as collectable and uncollectable, fines are reduced to 1/5 in case of voluntary compliance, e-garnishment (automated seizure of debtors' bank accounts) is introduced, and fast-track auctions of debtors' assets may be conducted in settlement of debts to the State.

In the context of efforts to combat tax evasion, it was decided to enhance independence of tax administration.[22] To achieve this, the responsibilities of the General Secretariat of Public Revenue in tax and customs issues were increased, while care was taken to enhance the efficiency of tax audit mechanisms and tax collection procedures. Furthermore, through pro-

17 Law 4225/2014 "Upgrading and improving social security funds' contribution collection mechanisms, fines for uninsured and undeclared work, and other provisions within the scope of the Ministry of Labour, Social Security and Welfare".

18 "Unified Property Tax and other provisions".

19 This extra tax will be equal to double the amount of tax certified per ship in the previous year.

20 According to the State General Accounting Office explanatory report, revenue losses in 2014 from keeping the VAT rate at 13% (instead of bringing it back to 23%) should reach €107 million, depending on private consumption developments. See draft law "Government Council for Private Debt Management, Institution for Growth in Greece, provisions on the Hellenic Republic Asset Development Fund, and other emergency provisions", tabled to Parliament on 19 December 2013.

21 "Adaptation of national legislation to the provisions of Guideline 2011/24/EU of the European Parliament and the Council of 9 March 2011 on the application of patients' rights in cross-border healthcare (OJ L 88/45/4 April 2011)".

22 Law 4152/2013 "Emergency measures to implement Laws 4046/2012, 4093/2012 and 4127/2013".

visions included in the law on the new Unified Property Tax (ENFIA) and Law 4224/2013, the auditing capacity of the tax mechanism was strengthened (e.g. by authorising auditors to conduct audits round-the-clock), and the fines and penalties to be imposed in cases of tax evasion, lack of tax certificate and delayed payment of certified taxes were increased. Also, by an amendment to Law 4172/2013 it was clarified that individual income (whether or not from business activity) can be determined on the basis of any available data or through indirect audit techniques, as is currently the case with the self-employed and enterprises. This applies where declared income is incompatible with personal living expenses or where the increase in the taxpayer's property is not justified by declared income. At the same time, further steps are taken to simplify the rules of tax recording of transactions,[23] while a provision in the omnibus law on the suspension of auctions simplifies the arrears certification and collection system.[24]

Law 4225/2014 of the Ministry of Labour, Social Security and Welfare, adopted by Parliament on 11 December 2013, includes similar measures to strengthen audit and cross-checking mechanisms, and imposes heavier fines in an effort to combat social security contribution evasion. The new legislative framework is expected to contribute to reducing social security funds' deficits through the collection of arrears.

Nevertheless, tax audit results to date are not particularly encouraging as, although audits of the self-employed and high-wealth taxpayers have been intensified, the number of audits falls short of the revised targets, while the rate of collection of tax arrears misses the annual target.

On the positive side, a permanent and an extraordinary tax and contribution arrears collection scheme was adopted (which facilitates debtors facing financial difficulties due to the economic recession), to replace the repeated tax amnesties which, as pointed out by OECD (2013), discourage tax compliance and lead to the accumulation of arrears.

Although major actions have been taken to cut public expenditure, there are still delays in the implementation of changes. Moreover, the non-implementation of the unified wage grid in certain public sector services and agencies raises questions of fair and equitable treatment, and deprives the adjustment programme of budgeted resources.

Nevertheless, the effective application of the 1:5 attrition rule and the reduction of staff on fixed-term contracts helped reduce the total regular and other staff of the public sector (excluding public enterprises and organisations – DEKOs) by 19,670 persons in the period January-November 2013, bringing the civil service headcount to 681,388 in November 2013, from 701,058 in December 2012 and 868,457 in December 2009. In the context of public sector downsizing and in an effort to improve the quality of public services, actions were taken in 2013 to reorganise public organisations and enterprises, such as the Hellenic Broadcasting Corporation (ERT), Hellenic Defence Systems (EAS), the Hellenic Vehicle Industry (ELVO), the General Mining and Metallurgical Company (LARCO). Equally positive are the actions planned in February 2014 to simplify administrative procedures by removing administrative burdens, rationalising structures through the abolition of public entities, and better utilising human resources through a new, transitional method of evaluation of civil servants' performance.[25] The activation of the National Public Electronic Procurement System is expected to lead to considerable cost savings, cut red tape and improve public sector efficiency.

23 The mandatory use of a consignment note is abolished and is replaced by the application of appropriate safeguards for monitoring the inventories received and not yet invoiced by the suppliers, as well as the inventories already shipped and not invoiced yet.

24 In case of voluntary compliance, debtors are offered a choice of which debt to repay first, a decision so far made by the tax authority.

25 The draft law "Administrative simplifications – Abolition and Merger of Legal Persons and Services in the Public Sector – Amendment to provisions of Presidential Decree 318/1992 (A 161), and other provisions" was tabled to Parliament on 11 February 2014.

Furthermore, in order to tackle the operational problems of the National Organisation for the Provision of Health Services (EOPYY), a law was passed in February 2014[26] according to which EOPYY will henceforth be solely a purchaser (not provider) of health services. Acting solely as health services purchaser, EOPYY will be able to conclude more cost-effective contracts with health services providers and thus achieve a rational use of available resources. The same law also provides for the development of a National Primary Health Care Network (PEDY), a unified system of Primary Health Care (PFY) in Greece, through the unification of the PFY structures of EOPYY and the National Health System (ESY). To this end, the total of tenured employees and staff employed on open-ended private-law contracts of the Health Units of EOPYY is automatically transferred to the mobility scheme for one month (and remunerated at 75% of their salaries) and subsequently reallocated/transferred to ad hoc organic posts in the Administrations of the local Health Districts. This is expected to reduce the fragmentation of the health system and strengthen both PFY units and specialised services.

Another positive development was the revision of the fiscal framework under Law 4111/2013, which provides for stricter supervision of, and imposition of sanctions on, all General Government entities in an aim to reduce deviations from the targets, as well as to oblige these entities to take corrective action.

In 2013, efforts were made to galvanise the programme for the utilisation of public property. In this context, the Hellenic Football Prognostics Organisation (OPAP), the State Lottery and Hellenic Gas Transmission System Operator SA (DESFA) were privatised, and the Hellenic Republic Asset Development Fund (HRADF) announced the highest bidder for Astir Palace Vouliagmeni SA. However, the unsuccessful outcome of the privatisation process of Public Gas Corporation SA (DEPA) led to a new downward revision of the revenue target for 2013 (to €1,230 billion, against an initially planned €2.6 billion).

According to the 2014 Budget, the annual target for revenue from privatisations in 2014 has been set at €3,560 million. To this end, the government approved the restructuring and privatisation of Hellenic Defence Systems (EAS), the Hellenic Aerospace Industry (EAB) and the General Mining and Metallurgical Company (LARCO) in 2014, and the Public Power Corporation (DEH) (in three stages) by 2016. While the Hellenic Republic Asset Development Fund (HRADF) continues to prepare the privatisation of certain assets (e.g. small ports and marinas, the Piraeus Port Authority (OLP), the Thessaloniki Port Authority (OLTH), regional airports, TRAINOSE SA, the Hellenic Company for Rolling Stock Maintenance SA (ROSCO), the Hellinikon real estate, Public Gas Corporation SA (DEPA), as well as real estate abroad), a securitisation of future revenue from the utilisation of public real property is also planned. Moreover, the payment of government arrears to the Athens Water Supply and Sewerage Company (EYDAP) and the Thessaloniki Water Supply and Sewerage Company (EYATH) will improve the financial position of these companies and facilitate their privatisation. In order to achieve the targets of the privatisation programme, the Hellenic Republic Asset Development Fund (HRADF) and all the bodies involved need to accelerate procedures and intensify efforts.

26 Law 4238/2014 "National Primary Health Care Network (PEDY), change in the objective of EOPYY, and other provisions".

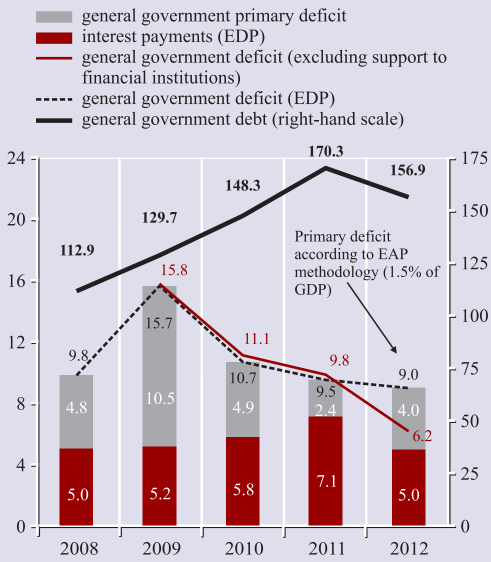
Box VI.1

FISCAL DEVELOPMENTS DURING THE PERIOD 2010-2012

Despite delays in meeting the requirements under the Economic Adjustment Programme (EAP), political turmoil and an adverse climate worldwide, the fiscal consolidation effort in 2010-2012 played a key role in reducing budgetary imbalances. The general government deficit in 2012 stood at 9.0% of GDP, down from 15.7% of GDP in 2009. Excluding the net impact of state support to financial institutions, the deficit reduction is significantly larger, with the general government deficit in 2012 coming to 6.2% of GDP (see Chart A).

Chart A General government deficit, primary deficit and debt

(as a percentage of GDP)



Source: ELSTAT.

The general government primary deficit, in accordance with EAP methodology, came to 1.5% of GDP in 2012, narrowing by about 9.0 percentage points of GDP over the period 2010-2012. Excluding cyclical effects and the impact of temporary interventions on government revenue and expenditure, the improvement in the general government structural primary balance between 2010 and 2012 is much larger, estimated at 14.9 percentage points of potential GDP. The structural primary balance turned into a small surplus of 0.2% of potential GDP in 2012 (see Chart VI.1 in the main text).

Of the narrowing of the general government primary deficit as a percentage of GDP (based on EAP methodology) during the 2010-2012 period around 38% is attributable to a reduction in the primary expenditure-to-GDP ratio and about 62% to an increase in the revenue-to-GDP ratio. Primary expenditure declined by 3.4 percentage points of GDP, coming to 45.4% of GDP in 2012. Accordingly, revenue increased by 5.5 percentage points of GDP over the 2010-2012 period, coming to 43.9% of GDP in 2012.

The decrease in primary spending as a percentage of GDP is due to reduced staff costs, lower intermediate consumption expenditure of the public sector and a drastic cut in the public investment programme.[1] Conversely, social spending, despite declining in nominal terms by 9.5% (or €4.7 billion), trended upwards as a percentage of GDP, reaching 22.9% of GDP in 2012 (up from 21.2% of GDP in 2009), partly as a result of rising unemployment and increased retirements.

The key interventions on the expenditure side, particularly in 2010, were aimed at delivering a prompt fiscal outcome and, therefore, relied mainly on cuts in wages, pensions, benefits and bonuses. With a view to cutting down on wage costs in the public sector, a unified wage grid and

1 Staff costs were reduced to 12.4% of GDP in 2012, from 13.4% of GDP in 2009. Over the same period, the intermediate consumption expenditure of the public sector decreased by 2.4% of GDP, while public investment dropped by 1.3% of GDP, thus coming to 5.0% and 1.8% of GDP, respectively, in 2012.

a Single Payment Authority for civil servants were introduced (under Law 3845/2010). As a result of a tight recruitment policy in line with the 1:5 attrition rule and a commensurate decline in fixed-term contracts, the general government headcount has decreased by 194,093 persons since 2009 and stood at 713,258 persons at end-2012.[2]

As part of an overall effort to downsize of the public sector and to overhaul local government, curb squander in the public sector and achieve economies of scale, a law on the New Architecture of Local Government and Decentralised Administration was passed ("Kallikratis Programme", Law 3852/2010). Besides, 2010 saw the launch of an effort to abolish and merge public entities and bodies, which, however, has not delivered any tangible results so far. Special emphasis was placed on the restructuring of state-owned enterprises, especially the OSE-TRAINOSE and the Athens Urban Transport Organisation (OASA) groups of companies.[3]

Several measures were also aimed at reining in government spending on health and reorganising public hospitals (under Laws 3840, 3868/2010); as a result, public health expenditure dropped from 7.4% of GDP in 2009 to 5.8% of GDP in 2012.[4] A National Organisation for the Provision Health Services (EOPYY) was created, with a view to rationalising health services and contributions, but in spite of serious efforts to repay past arrears, the ongoing accumulation of new arrears by EOPYY suggests that spending is still not under control.

The social security reform of July 2010 (Laws 3863, 3865/2010) introduced changes in the calculation of pensions and a gradual increase in the retirement age from 2015 onwards. Social security reform is considered successful, as it has led to a drastic reduction in future pension expenditure as a percentage of GDP.[5] Over the 2011-2012 period, important new legislation was passed, including the merger of the major supplementary pension funds of wage earners into a single supplementary pension fund (ETEA), as well as the establishment of a notional defined contribution system for those insured after 1.1.2011. A rise in the statutory retirement age was also introduced, from 65 to 67, effective from 1.1.2013,[6] while at the same time a number of key measures contributed to the restructuring and better targeting of social expenditure.

At the same time, crucial institutional reforms were implemented (under Laws 3871/2010 and 4111/2013), which laid the foundations for an improved budgeting and monitoring system at general government level, a tighter control over public spending, the possibility of adjusting expenditure ceilings according to the performance of revenue, the adoption of corrective measures and the drafting of medium-term fiscal policy plans.

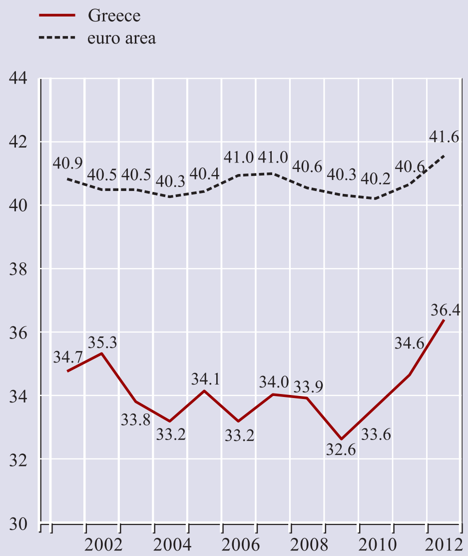
Direct and indirect taxation, as well as revenue from social security contributions were the main pillars of fiscal consolidation on the revenue side. In more detail, direct taxes increased from 8.3% of GDP in 2009 to 10.1% of GDP in 2012, while indirect taxes increased from 11.3% of GDP in 2009 to 12.5% of GDP in 2012. Furthermore, social security contributions grew from 12.7% of GDP in 2009 to 13.7% of GDP in 2012. Because of the tax measures adopted between 2010 and

2 In 2011, reduction in hirings was achieved by implementing the 1:5 attrition rule.
3 Laws 3833, 3845, 3871, 3891, 3895, 3899/2010; Laws 3899, 3920, 3986, 4002/2011; and Laws 4038, 4051/2012.
4 The estimate for 2012 is made in a recent IMF report. See IMF (2013), "Greece: Fourth review under the Extended Arrangement under the Extended Fund Facility, and request for waivers of applicability and modification of performance criterion", *IMF Country report No. 13/241*, July (Box 2, p. 30).
5 More specifically, while prior to the reform it was estimated that public pension spending in 2060 would account for 24.1% of GDP, after the reform this figure has been cut to 14.6% of GDP (European Commission (2012), *The 2012 Ageing Report*, p. 154, Table 2.27).
6 Under Laws 4024/2011, 4093/2012 and 4052/2011.

2012, the tax burden (i.e. total direct and indirect taxes, social security contributions and taxation on capital) rose by about 4% of GDP, from 32.6% in 2009 to 36.4% in 2012 (see Chart B). However, it still falls short of the corresponding euro area averages (although this differential is narrowing), probably as a result of the tax authorities' failure to tackle tax and contribution evasion.

Chart B Tax burden

(as % of GDP)



Sources: ELSTAT and Eurostat.

In order to immediately boost revenue, especially in 2010, successive hikes in indirect taxes were introduced, such as increases in VAT rates and in the excise taxes on tobacco, alcohol and fuel.[7] In addition to raising indirect taxes, the main objective of most tax measures was to bolster revenue. Emphasis was put on broadening the tax base by placing an additional burden on compliant taxpayers rather than by curbing tax evasion. More specifically, it was decided to impose extraordinary levies on individuals and corporations and to introduce a property tax collected through electricity bills. Moreover, there were successive changes in individual and corporate income taxation as well as in real estate taxation, e.g. by lowering the tax-free threshold and limiting tax reliefs and by adjusting tax rates, with a view to further increasing public revenue.[8] However, the frequent changes in the basic income tax scale and the repeated adoption of new tax measures, which usually affect those who already pay their taxes regularly, did not help create a stable institutional and taxation framework.

Meanwhile, a number of efforts were made to enhance the tax collection mechanism. Already since 2010 an effort has been launched to restructure tax services with a view to intensifying audits of population groups with a high risk of tax evasion. In May 2011, a number of measures were adopted (under Law 3943/2011) speeding up the tax dispute resolution procedures, imposing stricter penalties, introducing a Public Prosecutor for Financial Crime, restructuring the tax audit and collection mechanism and establishing an Internal Affairs Service. In 2012, it was decided to strengthen the operation, independence and accountability of the tax authorities by appointing a General Secretary of Public Revenue (under Laws 4046, 4093/2012). Lastly, the use of indirect audit techniques (presumptive determination of taxable income on the basis of various data) for all taxpayer categories was introduced (under Laws 4038, 4079/2012).

Nevertheless, the fight against tax evasion has not delivered encouraging results; thus, the target for revenue from measures against tax evasion (of 1.5% of GDP on a cumulative basis) has been deferred to the 2014-2016 period.

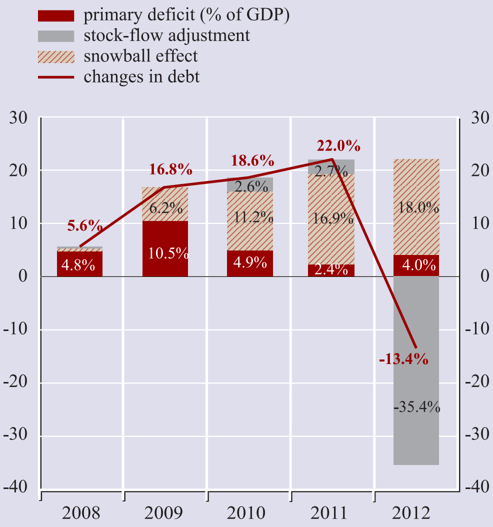
7 The most important tax measures during the 2010-2012 period are included in Laws 3815, 3828, 3833, 3842, 3843, 3845, 3888, 3988/2010; 3986, 4002, 4021, 4024/2011; and 4038, 4046, 4051, 4072, 4092, 4093, 4110/2012.
8 The substitution of the Code of Books and Records with the Code of Tax Recording of Transactions contributed to simplifying the tax system.

Public debt

Public debt rose from 129.7% of GDP in 2009 to 170.3% in 2011, to stand at 156.9% of GDP in 2012. Public debt-to-GDP dynamics were affected by primary deficits. However, excluding state support to financial institutions, the contribution of primary deficits to the upward path of debt declines as the country's fiscal position improves. Developments in the relationship between interest rates and growth (snowball effect) have had a particularly adverse impact, as despite the low rates on government borrowing under the support mechanism, the public debt-to-GDP ratio increased by 46.0% of GDP on a cumulative basis over the 2010-2012 period (see Chart C).

Chart C Decomposition of changes in the general government debt-to-GDP ratio

(as a percentage of GDP)



Source: Ministry of Finance.

The decline in public debt as a percentage of GDP for 2012 is a result of both the PSI in March 2012 and the debt buyback agreement (in December 2012). The effect of the above-mentioned developments is reflected in the stock-flow adjustment, which is estimated at 35.4% of GDP for 2012.

In detail, the decrease by €51.2 billion in the stock of debt during 2012 is due to the PSI (-€106 billion), as well as to the debt buyback agreement (-€31.9 billion). At the same time, this decrease was largely offset by (a) the recapitalisation of Greek banks through new debt issues (amounting to €41 billion); (b) loans totalling €11.3 billion to finance the debt buyback operation; (c) a €16.2 billion write-down on government bonds held by Greek social security funds, which however has not led to a reduction of debt as it refers to intra-government debt; and (d) the new borrowing requirements of the Greek government (amounting to €17.4 billion) to finance the 2012 deficit (including the payment of accrued interest in February 2012).

On the positive side, a Hellenic Republic Asset Development Fund was established, which has contributed to better planning and coordinating the privatisation and public real estate utilisation programme. However, the implementation of this programme has been marked by serious delays and frequent revisions of the highly ambitious targets set under the Medium-Term Fiscal Strategy 2012-2015 (projected revenue of up to €50 billion by the end of 2015). Overall, revenue from privatisations over the 2012-2012 period amounted to about €1.7 billion, having so far had a negligible effect on public debt dynamics.

Box VI.2

THE ROLE OF CAPITAL MARKET EXPECTATIONS IN THE FISCAL CONSOLIDATION EFFORT

A key assumption of the Economic Adjustment Programme (EAP) is that fiscal consolidation will lead to an improvement in expectations about the medium- to long-term prospects of the Greek economy. That is, that international markets will welcome the fiscal consolidation efforts, and domestic consumers and investors (despite the direct negative effect of fiscal tightening) will also form positive expectations of an exit from the recession and a victory over the debt crisis. Over the medium term, these positive expectations should help to limit the negative impact of fiscal consolidation and contribute to faster recovery.

Using the SVAR model of Blanchard and Perotti (2002) and on the basis of findings by Ardagna (2009), Laubach (2009), Favero and Giavazzi (2007, 2012) and Tagkalakis (2013), the impact of a decrease in government spending and an increase in public revenue on real GDP is examined over the period from the first quarter of 2000 to the first quarter of 2013.[1] Following Ardagna (2009), the path of the Athens Exchange (Athex) share price index and the spread between 10-year Greek and German government bonds are used as proxies for capital market expectations.

To assess the role of expectations, the following two cases are examined: (a) In the first case, it is assumed that the variables that reflect market expectations do not respond to a cut in government expenditure or an increase in taxes (restricted SVAR). In this case, only the direct effects of fiscal measures on output are examined, i.e. no account is taken of any indirect effects through financial variables. (b) In the second case, none of the above restrictions are applied and financial variables respond directly to any changes in the fiscal stance (unrestricted SVAR).

The key results are summarised as follows:

- Under the unrestricted SVAR approach, government spending cuts and tax hikes as part of the fiscal adjustment effort improve the medium- to long-term expectations of capital markets about the prospects of the Greek economy, as reflected in a rise in the share price index and a narrowing of the spread.

- These positive effects on the share price index help mitigate, in terms of both size and duration, the negative impact of fiscal adjustment on real GDP, as opposed to the second case, in which the expectations channel is not included (restricted SVAR). More specifically, all negative effects on GDP fade away 4-5 years after the initial government spending cut, whereas the negative impact from the initial tax increase persists, but merely accounts for less than 1/3 of the impact estimated under the restricted SVAR approach (in which the expectations channel is not included).

- Where fiscal consolidation leads to a narrowing of spreads, real GDP shows signs of recovery 3-3.5 years after the initial fiscal measures – in comparison with the restricted SVAR model, where the expectations channel is not included –, i.e. the direct adverse impact from fiscal adjustment on GDP starts to reverse.

- Where the expectations channel is not included (e.g. for exogenous reasons, such as delayed implementation of the adjustment programme or slow decision-making at EU level), a fiscal adjustment that places greater emphasis on tax increases is estimated to have a considerably stronger and more protracted negative impact on GDP.

1 Blanchard, O. and R. Perotti (2002), "An empirical characterization of the dynamic effects of changes in government spending and taxes on output", *Quarterly Journal of Economics*, 117, 1329-68. Ardagna, S. (2009), "Financial markets' behavior around episodes of large changes in the fiscal stance", *European Economic Review*, 53(1): 37-55. Favero, C. and F. Giavazzi (2007), "Debt and the effects of fiscal policy", NBER, Working Paper No 12822. Favero, C. and F. Giavazzi (2007), "Measuring tax multipliers: The narrative method in fiscal VARs", *American Economic Journal: Economic Policy*, 4, 69-94. Laubach, T. (2009), "New evidence on the interest rate effects of budget deficits and debt", *Journal of the European Economic Association*, MIT Press, vol. 7(4), 858-885, 06. Tagkalakis, A. (2013), "The unemployment effects of fiscal policy: recent evidence from Greece", *IZA Journal of European Labor Studies*, 2.1 (2013): 11.

Conclusions

• The discussion confirms that fiscal adjustment favourably affects capital market expectations, which in turn mitigate the negative impact of fiscal adjustment. In the case of Greece, this should contribute to the exit of the Greek economy from the crisis.

• The creation of such positive expectations advocates a frontloaded fiscal effort. However, it also highlights the fact that any delays in the implementation of the adjustment programme and/or institutional weaknesses that hamper swift decision-making at EU level (e.g. during the management of the debt crisis) are likely to disrupt the expectations channel and, by implication, prevent the mitigation of the direct negative effects of fiscal adjustment.

Box VI.3

INDEPENDENT FISCAL INSTITUTIONS AND FISCAL PERFORMANCE

The role played by independent Fiscal Institutions (FIs) —Fiscal Councils (FCs) and all other non-partisan fiscal agencies— in ensuring sound fiscal management has grown in importance, as the intense political cycle leaves ample room for fiscal derailment. With a view to improving the monitoring of fiscal developments, the mandate of FIs is to help reduce deviations from fiscal targets, which could put the future path of an economy at risk. Their role consists in providing independent assessments of a country's economic outlook, fiscal deficit and public debt, and evaluating compliance with budgetary rules.

The literature on FIs focuses on the advisability of introducing them (Debrun[1] et al. 2007, 2012), the scope of their functions (Kopits[2] 2011 and Calmfors[3] et al. 2010a), as well as the weight and influence of FIs in public debate and fiscal policy-making (Curristine[4] et al. 2013). Meanwhile, according to Schaechter et al. (2012),[5] the introduction of fiscal rules has increased significantly around the world over the past decade (from merely 7 in 1985 to a total of 167 by 2011), thereby further broadening the scope for FI intervention.

Turning to EMU, since the Fiscal Compact entered into effect on 1 January 2014, all Member States are required to set up independent FIs, entrusted with the task of monitoring the observance of commitments undertaken by EMU Member States under the new Stability and Growth Pact (SGP).

Empirical evidence

Empirical studies (although limited in number) point to a positive contribution of independent FIs to improved fiscal performance. For instance, Lebrun (2006),[6] Coene (2010)[7] and Hagemann

1 Debrun, X. And M.S. Kumar (2007), "The discipline-enhancing role of fiscal institutions: Theory and empirical evidence", International Monetary Fund, Fiscal Affairs Department. Debrun, X., M. Gérard, J. Harris (2012), "Fiscal policies in crisis mode: Has the time for fiscal councils come at last?", International Monetary Fund, Fiscal Affairs Department.
2 Kopits, G. (2011), "Independent fiscal institutions: Developing good practices", *OECD Journal on Budgeting*, Volume 2011 no. 3.
3 Calmfors, L., G. Kopits and C. Teulings (2010), "A new breed of fiscal watchdogs", EURO Intelligence 2010.
4 Curristine, T., J. Harris and J. Seiwald (2013), *Case studies of fiscal councils, functions and impact*, International Monetary Fund.
5 Schaechter, A., T. Kinda, N. Budina and A. Weber (2012), "Fiscal rules in response to the crisis – Toward the 'next generation' rules. A new dataset", IMF Working Paper WP/12/187, International Monetary Fund.
6 Lebrun, I. (2006), "Fiscal councils, independent forecasts and the budgetary process: Lessons from the Belgian case", in Ayuso-i-Casals et al. (2006), *Policy instruments for sound fiscal policy*, Palgrave MacMillan.
7 Coene, C. (2010), "Lessons from Belgium", paper presented at the Conference on Independent Fiscal Institutions, Budapest, 18-19 March.

(2011),[8] by comparing fiscal performance indicators from before and after the operation of FIs, found that the latter play a role in improved fiscal performance. Furthermore, Debrun and Kumar (2008),[9] in their examination of a sample of 15 EU Member States, claim that there is a complementarity between fiscal rules and fiscal councils, as fiscal rules are positively correlated to fiscal performance, while FIs also contribute to the better implementation of such rules.

A. The Fiscal Compact

The Fiscal Compact is part of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG),[10] which establishes a strict framework of rules to ensure the attainment of objectives and avert any fiscal deviations and imbalances in the future. Member States are required to create an automatic mechanism for the correction of any deviations from such objectives.

Under the Fiscal Compact, Member States are required to have in place strict numerical fiscal rules with clearly defined targets and mechanisms for effective and timely monitoring. These rules must be based on reliable and independent analysis, and unbiased and realistic macroeconomic forecasts carried out by independent bodies or bodies endowed with functional autonomy vis-à-vis the fiscal authorities of the Member States.[11]

Under Article 4(5) of Directive 2011/85/EU, Member States shall specify which institution is responsible for producing macroeconomic and budgetary forecasts and must make public the official macroeconomic and budgetary forecasts prepared for fiscal planning, including the methodologies, assumptions and relevant parameters underpinning those forecasts.

B. The usefulness of Financial Institutions

Under the Fiscal Compact, national FIs are responsible for the surveillance of budgetary positions and the monitoring of Member States' compliance with the balanced budget rule during the economic cycle and the activation of a correction mechanism in the event of significant observed deviation. Therefore, FIs must be independent and autonomous in order to be able to:

- Produce impartial assessments of the observance of country-specific fiscal rules and obligations.

- Provide constant information to the public about fiscal developments.

- Issue recommendations addressed to governments regarding fiscal and macroeconomic developments in connection with the objectives that must be met,[12] thus increasing electoral accountability, since governments will have to either justify any disagreement with FIs' recommendations or adopt them (act or explain).

8 Hagemann, R. (2011), "How can fiscal councils strengthen fiscal performance?", *OECD Journal: Economic Studies*, Vol. 2011/1.
9 Debrun, X. and M.S. Kumar (2008), "Fiscal rules, fiscal councils and all that: Commitment devices, signaling tools or smokescreens?", Proceedings of the Banca d'Italia Public Finance Workshop, Banca d'Italia, Rome.
10 Ratified by Law 4063/2012.
11 As provided for in Article 6(1) (b) of Directive 2011/85/EU.
12 More specifically, under Regulation (EU) No 472/2013 implementing TSGC, those bodies shall provide public assessments relating to: (a) the occurrence of circumstances leading to the activation of the correction mechanism for cases of significant observed deviation from the medium-term objective or the adjustment path towards it in accordance with Article 6(2) of Regulation (EC) No 1466/97; (b) whether the budgetary correction is proceeding in accordance with national rules and plans; and (c) any occurrence or cessation of circumstances referred to in the tenth subparagraph of Article 5(1) of Regulation (EC) No 1466/97 which may allow a temporary deviation from the medium-term budgetary objective or the adjustment path towards it, provided that such a deviation does not endanger fiscal sustainability in the medium term.

Nevertheless, this presupposes that, in addition to the aforementioned independence and autonomy, national FIs will also have the necessary resources and access to the information they need to fulfil their mandate, as well as duly qualified and skilled personnel.

Optimising the effectiveness of National Fiscal Councils, as the Bank of Greece has repeatedly stressed,[13] is part of a broader framework and complements the establishment of both fiscal rules and quantitative budgetary objectives, as all of these elements together make up a comprehensive fiscal strategy.

In conclusion, a strict framework of national budgetary rules, coupled with the European rules and institutions currently in force, if properly complemented with an independent national fiscal body entrusted with the observance of country-specific fiscal obligations, will contribute to a sound management of public finances and will help avert the risk of a future fiscal derailment. In line with the TSGC requirements and Greece's international commitments, this calls for the creation of a new independent authority which will assume the role of a FI.

13 Bank of Greece, *Annual Report* (various years: 1999, 2001, 2003, 2004, 2008).

ANNEX TO CHAPTER VI
TAX POLICY MEASURES

During 2013, efforts to consolidate fiscal adjustment and discipline continued through actions aimed at boosting tax revenue and overhauling the tax system. The main arrangements were included in seven laws: two tax laws passed in January[1] and July 2013, the April and May omnibus laws, the Tax Procedures Code passed in July, the law on the new unified property tax and the December omnibus law. These laws completed the first phase of the tax reform through the adoption of a new, simplified income tax code. Moreover, they set out the new penalties for tax violations and contribute to combatting tax evasion, with a view to revamping tax administration and modernising tax procedures. Finally, a unified property tax is introduced, to replace the property tax collected through electricity bills (EETA) and the real property tax (FAP).

Omnibus Law **4141/2013** (April 2013)[2] includes, inter alia, a number of provisions on the organisation of the audit mechanism, the speedier collection of tax arrears and the combatting of tax evasion, with a view to boosting tax revenue. In this context, emphasis is placed on audits of high-wealth taxpayers, debts are classified as collectable and uncollectable, fines are reduced to 1/5 in case of voluntary compliance, e-garnishment (automated seizure of debtors' bank accounts) is introduced, and fast-track auctions of debtors' assets may be conducted in settlement of debts to the State.

Explanatory circular **DES/A1077357/EX 10.5.2013** implements the provision of Law 4079/2012 on indirect methods of presumptive determination of the taxable income of all taxpayers (individuals, self-employed, corporations). Every taxpayer's real taxable income will be determined on the basis of the total of his revenue and expenses, assets (movable and immovable) and deposits.

In the context of the anti-corruption campaign, a "Strategic plan to combat corruption in tax and customs administration" was launched in May. It includes improving the legal and institutional framework on transparency, tightening internal and external (tax and customs) audits, enhancing (internal and external) cooperation and exchange of information, strengthening prevention, and raising awareness and promoting public integrity.

Decision **POL.1101/13.5.2013 of the General Secretary of Public Revenue** lays down the criteria of eligibility for exemption from the property tax collected through electricity bills, as well as for payment of this tax in a larger number of instalments in 2013.

Omnibus Law **4152/2013 (May 2013)**[3] includes important provisions on real estate taxation. It also includes provisions aimed at collecting tax arrears, promoting voluntary tax compliance and enhancing the powers of the General Secretariat of Public Revenue. Specifically:

– The property tax collected through electricity bills (EETHDE) is renamed Special Emergency Property Tax (EETA), still collected through electricity bills. The law introduces an across-the-board cut of 15% in the tax, payable in five bi-monthly instalments. The real property tax (FAP) for 2011 and 2012 will be paid in up to seven monthly instalments, and for 2013 in four monthly instalments. The minimum instalment amount is €50.

– Dependents of over 18 years that have no income are exempt from presumptive taxation on the basis of living expenses and from the obligation to file a tax return.

– The law introduces a new legal framework for instalment schemes for debt related to tax and for social security contributions. Debts will be payable in 48 instalments; for individuals with debts of up to €5,000, the number of instalments will be unlimited, and the minimum instalment amount will be €10. The same

1 Law 4110/2013. Measures passed up to February 2013 are described in the *Annual Report 2012*, pp. 150-156.
2 "Development investment tools, extension of credit, and other provisions".
3 "Emergency measures implementing Laws 4046/2012, 4093/2012 and 4127/2013".

exception applies to those with debts of over €5,000, provided they can prove that their capacity to pay is seriously impaired by the crisis. An annual interest rate of 8.75% will apply to restructured debts.

– The law lays down terms and conditions for the write-off of debts to the State. Specifically, it introduces criteria for classifying debt as uncollectable and write-off conditions. For debts of up to €1.5 million, the decision to classify a debt as collectable or uncollectable is made by the General Secretary of Public Revenue with the consent of the Collection Policy Directorate or the Customs Procedures Directorate, as appropriate; for debts of over €1.5 million, the consent of the competent section of the Hellenic Court of Audit will be required.

– Changes in the VAT payment system are introduced: Upon filing a periodic VAT return, obligors will pay a minimum amount of €10. The remaining amount will be payable in two monthly instalments, provided that the return has been filed on time.

– Administrative resolution of tax disputes is upgraded: Before appealing to the administrative courts against a decision of a tax authority, the taxpayer has to pay 50% of the disputed amount.

Law **4170/2013**[4] includes provisions on administrative and organisational matters of the Ministry of Finance. Particular emphasis is placed on the implementation of e-garnishment. It transposes into Greek law Council Directive 2011/16/EU of 15 February 2011, which introduces automatic exchange of information among the EU Member States to combat tax fraud. It also expedites the procedure for opening bank accounts of persons suspected of tax evasion upon the request of tax auditors. Another provision allows the authorities to garnish deposits held with credit institutions, using modern technologies and ensuring the safe traffic of the relevant data. The law also requires all bank account owners to disclose their tax registration numbers. Finally, when family benefit claimants are means-tested, all their incomes are included in the means-test, including separately taxable income.

Omnibus Law **4172/2013**,[5] passed in July, includes the new Income Tax Code and introduces a new individual and corporate income tax framework, applicable to incomes earned as from 2014. At the heart of the consolidated legislation lies tax Law 4110/2013,[6] passed in January, which increased the tax burden and introduced separate taxation of incomes according to their source. Specifically, the omnibus law introduces provisions on individual and corporate income taxation, tax withholding, tax evasion and tax avoidance. In more detail, the new Income Tax Code:

– Consolidates several legal provisions, mainly of tax Law 4110/2013,[7] concerning individual and corporate income taxation, and tax withholding.

– Describes in detail the business expenses eligible for deduction from gross income.

– Provides that the net business losses of a fiscal year are carried forward to be set off against business profits over the next five fiscal years.

– For the umpteenth time, a capital gains tax is introduced on all financial instruments, at 15% (on listed and non-listed shares, derivatives, Greek government and corporate bonds, as well as Treasury bills acquired as from 1 January 2014). Any capital losses of a given year are carried forward to the next years without time limitation.

4 "Transposition of Directive 2011/16/EU, provisions on the Hellenic Accounting and Auditing Standards Oversight Board (ELTE), amendments to the statute of the Legal State Council, and other provisions".
5 "Income taxation, emergency measures implementing Laws 4046/2012 and 4127/2013, and other provisions".
6 Tax Law 4110/2013 was presented in *Annual Report 2012*, pp. 153-155.
7 Its main provisions were described in *Annual Report 2012*, pp. 153-155.

– The capital gains tax levied on property-selling owners is reduced to 15%.[8] The time of purchase of the real estate is no longer a criterion; as a result, the capital gains tax is levied on real estate resold after 1 January 2014, no matter when acquired. Capital gains are equal to the difference between the acquisition price and the selling price, adjusted for inflation.

– A taxpayer's expenses for purchase or construction of real estate, acquisition of equities, mutual fund shares/units and bonds, as well as any funds used for the establishment of companies or participation in capital increases will be included in the presumptive determination of taxable income; in order to avoid paying additional taxes, the taxpayer must prove the origin of these funds.

– A luxury goods tax is levied on cars, swimming pools and aircraft retrospectively as from 2013, instead of 2014 as initially envisaged under Law 4111/2013. For fiscal year 2013, the tax will be paid in a lump sum. A discount of 1.5% is granted in the case of timely submission of the income tax return and timely payment of the total luxury goods tax due. As it is impossible to certify this tax together with the income tax in the current fiscal year, it may be separately certified exceptionally for fiscal year 2013.

– From 1 August 2013 to 31 December 2013, the VAT rate for restaurants and catering was reduced from 23% to 13%; under Law 4224/2013 (see below), this cut was extended until 31 December 2014.

Law 4174/2013[9] includes the Tax Procedures Code and consolidates several legal provisions on tax procedures, relationships between the taxpayer and the tax administration, the tax collection procedure, and adopts anti-tax evasion measures recommended by the European Commission.

Specifically, among other things, the law specifies the tax collection procedure; allows citizens to benefit from tax amnesties on conditions, introducing measures to safeguard the state's interests in the collection of taxes, e.g. by empowering the authorities to seize movables and immovables without a court order; and provides that interest and fines are payable in case of tax violations and late tax payments or filings. Finally, it provides for reductions in fines in order to facilitate their collection.

Under a Legislative Act published in Government Gazette **A176/9.8.2013**,[10] the authorities may seize assets of businesses that are implicated in tax evasion and have a substantial amount of assessed debts also in night time, in weekends, on holidays and in August.

Under **Law 4203/2013**,[11] passed in November, the prescription period for serving audit orders and any decisions imposing taxes, duties, fines and levies, normally ending on 31 December 2013, was extended by two more years. This provision applies to all tax matters (income, VAT, capital, real estate, etc.).

Law 4223/2013,[12] passed in December, completed the first phase of tax reform by levying a unified property tax (ENFIA) on all real estate, replacing the property tax collected through electricity bills and the real property tax. It also supplements, clarifies and amends the Income Tax Code[13] and the Tax Procedures Code.[14] In more detail:

– As from 1 January 2014, a unified property tax (ENFIA) is levied on all real estate (buildings, urban and non-urban land) on the basis of size, location and other features. ENFIA is equal to the sum of a main tax on each real estate and a supplementary tax on the total value of real estate interests of the (individual

8 Law 4110/2013 had levied a capital gains tax on transfers of real estate at 20% as from 1 January 2013, but this provision was not implemented.
9 "Tax procedures and other provisions".
10 "Emergency provisions implementing the Public Revenue Collection Code".
11 "Regulation of issues concerning renewable energy sources, and other provisions".
12 "Unified property tax, and other provisions".
13 Law 4172/2013, see above.
14 Law 4174/2013, see above.

or corporate) taxpayer. Specifically, for dwellings, the main tax is between €2 and €13 per square metre; for urban land, between €0.003 and €9 per square metre; and for non-urban land, €0.001 per square metre. The tax is levied on all real estate, with the exception of properties owned by the State, the Hellenic Republic Asset Development Fund (HRADF) and Public Properties Company SA; other public entities, non-profit institutions, etc. are all subject to the tax for all properties other than owner-used. A 50% discount or full exemption is granted to vulnerable social groups, while legal entities may benefit from deferment so that they can choose to pay ENFIA at a more opportune time. The tax is payable in a lump sum or in equal monthly instalments of no less than €10 each, until the last working day of December of the year concerned. There will also be a supplementary tax payable by owners of real estate valued at over €300 thousand, at rates between 0.1% for real estate with a total value exceeding the €300 thousand tax-free amount and 1% for real estate with a total value exceeding €1 million. Under the same law, the real estate transfer tax is reduced from 10% to 3% as from 1 January 2014.

– For the years 2013-2016, the shipping community will be subject to an extraordinary tax to help the government tackle the economic crisis, equal to two times the final tax certified per ship in the previous year.

– The time limit for replacement of old-technology cars with new cars of up to 2,000cm^3 engine capacity is extended until 31 December 2014, the tax incentives remaining unchanged (exemption from, or reduction in, registration fees).

– A number of provisions of the same law supplement and finalise the July Income Tax Code (Law 4172/2013): The €9,250 cap on expenses eligible to be deducted from the gross income of the self-employed is abolished. A number of special tax incentives are introduced, e.g. R&D expenses –with a 30% increment– are eligible for deduction from gross business income. The taxable income of the first bracket of the tax scale is increased by 50% for taxpayers domiciled on islands with less than 3,100 inhabitants; likewise, the tax rates on legal entities' profits from business activities on such islands are cut by 40%.

– Non-profit legal entities' business profits are taxed at 26%, regardless of the type of accounting books they keep.

– There are also changes in the receipts collection system: As from 2014, wage earners and pensioners are required to collect receipts for goods and services equal to 10% of their income.[15] The eligible expenses and the categories of wage earners and pensioners exempt from the 10% requirement will be specified by decision of the Minister of Finance.

– Income tax on deferred wage and pension payments will be withheld at 20%. As from 2015, individuals will be filing their tax returns until 30 April every year, and tax will be paid within five months from filing.

– The law amends the provisions on the eligibility of interest expenses for deduction from business income: The percentage of eligible net interest expenses is increased on a permanent basis (from 25% to 30%); especially for the next three years, it is raised further (to 40-60% of EBITDA). Likewise, the amount of net interest expenses eligible as fully deductible business expenses is raised to €5 million for a transitional two-year period, and €3 million on a permanent basis. Finally, any interest expense not deducted is carried forward to the next years without time limitation.

– Those who carry out transactions in listed shares, sovereign or corporate bonds, units in partnerships and financial derivatives are exempt from the requirement to keep

15 Against 25% of their income under the current system (Law 4110/2013).

accounting books. This corrects the distortion caused by the Income Tax Code (Law 4172/2013), which provided that whoever carries out three trades on an exchange within a period of six months is considered a professional and is subject to 26% or 33% tax, being also obliged to keep an income-expenses book. With respect to bonds issued by non-listed firms, any investor that carries out three trades within a period of six months is considered a professional and is obliged to keep an income-expenses book. Explanatory circular **POL.1004/2.1.2014**[16] determines the way of valuation of securities acquired in the past.

– The Tax Procedures Code, passed in July, (Law 4174/2013) is amended to include all taxes and fines envisaged in the legislation in force. Moreover, a number of transitional provisions are introduced to clarify the transition to the new regime. Specifically, the scope of the Tax Procedures Code is expanded to include, in addition to income tax and VAT, a number of other taxes, duties, levies and pecuniary penalties.

– Failure to pay tax of at least €10,000 per year (for individuals or those required to keep single-entry books) or at least €60,000 per year (for those required to keep double-entry books) constitutes tax evasion. Moreover, under the Tax Procedures Code, if the tax administration verifies tax evasion, it may take pre-emptive measures or measures safeguarding public interest, e.g. freezing 50% of the offender's deposits in all kinds of accounts and contents of safe deposit boxes. Finally, sociétés anonymes, limited liability companies and branches of foreign firms are required to obtain a tax compliance certificate for another two years, on threat of a fine of €5 thousand to €40 thousand.

– The deferment of the levy of a 20% tax on TV advertisements is extended by one more year (the levy will take effect as from 1 January 2015, instead of 1 January 2014).[17]

Law **4224/2013**,[18] passed in December, amends the provisions of the Tax Procedures Code[19] that concern fines imposed for tax arrears: The assessment and collection procedure is simplified and the debtors are allowed, for the first time, to choose which among their debts to pay – a decision so far made by the tax authority. There are also changes in the calculation of interest and other administrative sanctions in case of late payment, as well as in the conditions and circumstances of exemption from interest.

Finally, under Law **4235/2014**,[20] the flat tax on tobacco is raised from €80 to €82.5 per tax unit (1,000 cigarettes).

16 "Determination of the acquisition price, under Article 42(4) of Law 4172/2013, in transfers by individuals of securities acquired before 29 September 1999".
17 This tax had originally been introduced by Law 3835/2010. This is the fourth deferment of its implementation.
18 "Government Council for Private Debt Management, Institution for Growth in Greece, provisions on the Hellenic Republic Asset Development Fund, and other emergency provisions".
19 Law 4174/2013.
20 "Administrative measures, procedures and sanctions in the implementation of the EU and domestic legislation in the areas of foods, fodder and animal health and protection, and other provisions within the scope of the Ministry of Rural Development and Foods".

VII MONEY, CREDIT AND CAPITAL MARKETS

Since late 2009, the sovereign debt crisis in Greece has weighed heavily on monetary and credit developments, capital markets and the banking system. Deposits and bank lending recorded a sharp fall, bank interest rates increased significantly, government bond yields rose steeply and equity prices plummeted. Banks were shut out of international money and bond markets and recorded losses —partly due to the restructuring of sovereign debt— and had to tie up capital in loan-loss provisions, given the significant increase in troubled assets.

The Bank of Greece and the government relieved pressures on bank liquidity and in 2012 began to replenish the capital base of core banks with funds lent to Greece under the second loan agreement. In mid-2012, strong deposit outflows came to a halt, bank rates and government bond yields started to decline, equity prices to recover, the decrease in bank financing to the real economy began to slow down and bank liquidity started to recover. Specifically, in 2013 the recapitalisation of banks was completed, the restructuring and consolidation of the banking sector progressed further and outflows of deposits were only limited. The reduction of loans to the private sector was contained and commercial banks' reliance on central bank funding was reduced as credit institutions regained access to the cross-border interbank market, while bank interest rates and long-term yields followed a steady downward path.

So long as uncertainty is not reignited, developments will continue to be favourable as the economy starts to recover, and may even gather pace and traction. The restoration of bank liquidity and internal capital generation, along with falling funding costs for the financing of the real economy will, in turn, contribute to supporting the growth of economic activity.

The banking sector in Greece did not contribute to the sovereign debt crisis that broke out in late 2009; on the contrary, it was severely affected by it. However, it has overcome adversity without disruption of financial stability, was restructured with the support of the Bank of Greece and the government, and has contributed to tackling the crisis by preventing a sharp credit squeeze.

Uncertainty caused by the crisis triggered large outflows of deposits from the Greek banking system. Household deposits abroad grew significantly, as did the estimated volume of domestic currency in circulation.

Outflows of deposits and loss of access to international money and bond markets put a strain on credit institutions' liquidity, while the restructuring of sovereign debt and the deterioration in the quality of their loan portfolios caused by the recession led to erosion of the banking system's capital base.

Banks responded to the shrinking of their deposit base by raising interest rates on time deposits; large outflows, however, only ceased when confidence in the economic outlook of Greece started to be entrenched. Thus, interest rates on time deposits, after following an upward course from the onset of the financial crisis to June 2012, have been declining ever since.

So long as confidence prevails and the country's economic performance improves, there will be no outflows; on the contrary, the stock of domestic deposits will begin to rise as deposit demand increases in line with the recovery of economic activity.

In recent years, the annual rates of change in total bank lending to non-financial corporations and households declined and turned negative. Both credit supply and demand have fallen. The Eurosystem and the Bank of Greece supported the liquidity of credit institutions. In addition, funds borrowed from Greece's European partners and the IMF under the second loan agreement were injected to Greek core banks through the Hellenic Financial Stability Fund (HFSF) in order to replenish their capital base. The banking system's recapitalisation was carried out on the basis of a calculation of credit institutions' capital needs by the Bank of Greece. Enhancing banks' liquidity and capital base has contributed to containing the decline in credit expansion, which was thus proportionally smaller than the decline in deposits and nominal GDP. Among all types of credits, consumer credit recorded the steepest fall.

In addition to the above, other important policy measures taken already since end-2008 included the provision of capital support to Greek banks through the acquisition of preference shares by the Greek government and the issuance of government-guaranteed bank bonds, amidst mounting concerns in the international financial markets after the collapse of Lehman Brothers; the supply of sufficient volume of banknotes to the public from late 2009 onwards, in order to meet swelling demand; and the adoption, in 2011, of a legislative framework on the resolution of troubled banks.

In the first years of the crisis, bank lending rates edged up mainly as a result of the rise in deposit rates, increased credit risk and the need to contain credit supply not only by tightening non-interest rate credit standards, but also through the pricing mechanism. During 2011, the nominal interest rate started to decline, at different times for each type of loan. Underlying this development, still in progress, were several factors, such as the declines in Euribor rates and in the cost of banks' funding by the Bank of Greece (from 2012 onwards).

As long as the uncertainty caused by the crisis does not return, the deposit rate will decrease, thus creating the conditions for a further decline in bank lending rates, provided that competition in the banking sector is safeguarded. In an environment of economic recovery (i) confidence in banks will be strengthened, which will in turn help broaden their access to the international wholesale deposit market, while plans to raise funds from the bond market are already under way; (ii) hoarded banknotes will be increasingly re-deposited in bank accounts; (iii) demand for domestic retail deposits will rise; and (iv) banks' capital adequacy will improve through reinvested profits and a more effective management of troubled assets. All this will help create the necessary conditions for an increase in the supply of bank loans over the medium term, pushing lending rates downwards. Lowered credit risk will also help in this direction.

The path of the crisis is often described in terms of the changes in the yield spread between Greek and German long-term government bonds. Indeed, the yield spread, on the rise since the end of 2009, peaked on the eve of the restructuring of sovereign debt in early 2012. In mid-2012, the yield spread narrowed significantly following the formation of the coalition government, which ensured the implementation of economic policy in line with Greece's obligations under the second loan agreement, which would allow Greece to remain in the euro area. In the same vein, changes in equity prices initially reflected the uncertainty and recession caused by the crisis. Since mid-2012, however, they have reflected the favourable effect of the progress made in correcting macroeconomic imbalances, introducing structural reforms and —notably— restructuring the banking system.

Acquisitions and resolution measures, coupled with the recapitalisation of Greek banks, have led to an increase in the market share of the four core banks, from about 65% of total bank assets in 2009 to over 90% in 2013. This development contributes to eliminating excess capacity, thus paving the way for taking advantage of synergies and economies of scale, and creates much stronger banks. However, in such circumstances of increased concentration, it is necessary to safeguard competition.

Non-recurring events (such as the recognition of negative goodwill in the context of the aforementioned restructuring of the banking system) have led to credit institutions making profits in 2013. In 2010-2012, however, banks recorded losses due to increased provisioning for credit risk and the restructuring of sovereign debt. Profits also suffered due to the rise in deposit rates and recourse to ELA funding by the Bank of Greece, while interest income declined due to the reduction in performing loans.

In conclusion, the appropriate business model for Greek banks in the new banking landscape should ensure internal capital generation, firstly by rationalising operating costs. Credit institutions should provide a full range of properly priced banking services and should seek —in addition to managing troubled assets more effectively— to shed non-core banking business and redesign their foreign business.

1 BANK DEPOSITS

A feature of the crisis was the large and recurring monthly outflows of deposits of non-financial corporations and households (see Table VII.1). Outflows typically coincided with peaks in uncertainty, while inflows were recorded whenever confidence strengthened. These outflows partly reflected a decline in demand for deposits, coupled with the downward trend in nominal incomes and of the volume of transactions in the real estate market and the domestic financial market.

Out of the 33 months from the onset of the financial crisis (late October 2009) to June 2012, 27 were marked by outflows of deposits. Cumulatively, total net outflows of deposits[1] amounted to €111 billion (39% of the initial balance of deposits as at September 2009). Net outflows of deposits of non-financial corporations came to €20 billion (52% of the initial balance) and household deposit outflows amounted to €69 billion (36%). As regards non-financial corporations and households in particular, net outflows of time deposits reached €53 billion or 39%, while net outflows of overnight deposits came to €35 billion or 36%.

The fact that the largest share of deposit outflows is accounted for by non-financial corporations suggests that the latter can manage their liquidity more effectively than households, avoiding keeping large outstanding balances in their deposit accounts for long periods of time. A relevant phenomenon discussed in Box VII.1 is the lower use —in comparison with the pre-crisis period— of trade credits among non-financial corporations and their substitution with direct settlement of transactions, mainly in cash.

The proportionally lower outflows of overnight deposits are linked to their use as a payment instrument. Therefore, even amidst a crisis, their substitutability is relatively low.[2] By contrast, time deposits are mainly held for investment purposes. Under conditions of heightened uncertainty, banknotes or bank deposits or other investment abroad were perceived by the public to be more attractive, thus offsetting disadvantages such as the risk of theft or destruction of banknotes, the comparatively limited liquidity of assets held abroad for a resident in Greece, etc. Finally, the fact that time deposits have decreased proportionally more is consistent with the finding of many traditional studies on money demand that the income elasticity of broad money is higher than that of narrow money.

By the second quarter of 2012, bank deposits held abroad by Greek non-financial corporations (excluding MFIs) and households had increased by €24 billion, namely 160% compared to the third quarter of 2009. Holdings of equities and bonds issued abroad recorded a proportionally smaller increase. If the repatriation of funds observed in the July 2012-December 2013 period (of about €5.7 billion) continues, it is possible that funds of about €20

1 Including deposits with banks in Greece (other than the Bank of Greece) by general government, non-financial corporations, insurance firms, other financial institutions, households and non-residents.
2 Certain relatively large-value payments cannot be made in cash for reasons of security and compliance with the legislation in force. A good example is the payment of wages by companies, which are credited to employees' bank accounts.

Table VII.1 Deposits in Greece (excluding the central government and non-residents)[1]

(annual percentage changes;[2] year averages)

	2009	2010	2011	2012	2013
1. Overnight deposits	3.3	1.4	-13.8	-19.9	-1.4
1.1 Sight deposits and current account deposits	6.9	1.4	-9.4	-17.3	11.1
1.2 Savings deposits	2.0	1.4	-15.9	-20.8	-7.3
2. Time deposits with an agreed maturity of up to 2 years	16.8	-12.3	-10.8	-13.5	6.8
3. Deposits redeemable at notice of up to 3 months[3]	23.8	17.6	-9.5	-14.9	-8.5
4. All the above (1+2+3)	10.5	-6.6	-12.1	-16.2	3.2

Source: Bank of Greece.
1 Including deposits by residents of other euro area countries.
2 Annual rates of change in the respective index adjusted for exchange rate variations, reclassifications, etc.
3 Including savings deposits in currencies other than the euro.

billion may gradually return over the medium term, which will be useful for financing the domestic economy.

It is also estimated that the stock of banknotes in circulation[3] in the second half of 2012 was more than double compared with 2009, despite the fact that economic activity decreased significantly (while deposit rates had increased). The difficulties that the Bank of Greece had to overcome in order to satisfy without delay the upsurges of demand for cash without imposing caps, in an effort to avoid creating additional concerns to the public at times of heightened uncertainty, should not be underestimated.

Banks sought to stem deposit outflows by raising the interest rate on time deposits, while the rate on overnight deposits hardly changed (see Section VII.2). This policy contributed to only a marginal increase in the share of time deposits in total deposits of non-financial corporations and households, from 58% in 2009 to 60% in the second half of 2012, whereas in 2013 this share decreased, as did the interest rate on time deposits.

However, deposit outflows were reversed only after mid-2012, when confidence in the country's economic outlook strengthened. As a result, the second half of 2012 saw almost exclusively net inflows. Of the deposits that returned in the second half of 2012, 96% were time deposits and 4% overnight deposits, despite the fact that the interest rate on time deposits was on a downward course. This is indicative of the sensitivity of non-financial corporations' and households' time deposits to the changes in uncertainty.

Outflows of deposits were again recorded in 2013, but they were much lower on average (€600 million on a monthly basis) than during the period from the outbreak of the crisis to mid-2012 (€4 billion). This comparison confirms that outflows in 2013 were not caused by surges in uncertainty – except for the large outflow in April, which was a result of the insecurity caused by the crisis in Cyprus and the haircut of deposits held with Cypriot banks – but were due to the downward trend in nominal GDP. However, the outstanding amounts of both total deposits and deposits of non-financial corporations and households remained on average higher in 2013 than in 2012.

Developments in non-residents' deposits also affected the overall liquidity of the banking system. Between September 2009 and December 2013, non-residents' deposits decreased by 69% – those of non-financial corporations by

3 In fact, total banknotes put into circulation by the Bank of Greece. As a result of the Monetary Union, i.e. the virtually free flow of banknotes and coins between euro area countries, banknotes and coins put into circulation by the Bank of Greece do not necessarily equal the currency in circulation on Greek territory.

42% and those of households by 31%. This development is probably not associated directly with the economic downturn in Greece, but may reflect the fact that domestic banks were less attractive to non-residents than banks abroad (or branches of Greek banks abroad).

2 BANK INTEREST RATES AND THE COST OF CREDIT INSTITUTIONS' REFINANCING BY THE BANK OF GREECE

As mentioned above, banks faced sizeable deposit outflows in late 2009. Their access to international money markets had already been constrained during the previous two years due to the financial turmoil. In late 2009, however, access was almost completely lost, a development precipitated by downgrades of the country's and banks' credit ratings.

In order to mitigate the impact on their liquidity, banks gradually increased interest rates on time deposits (December 2009-June 2012). They also raised interest rates on overnight deposits (May 2010-December 2012),[4] albeit only marginally, given that the substitutability of these deposits is smaller.

Between November 2009 (when it reached a trough) and June 2012 (when it peaked), the interest rate on time deposits of households (non-financial corporations) rose by 3 (3.4) percentage points.

When outflows were halted after mid-2012, the interest rate on time deposits of households started to decline. Between June 2012 (peak) and December 2013, it decreased by about 2 percentage points. The interest rate on time deposits of non-financial corporations had started to decline in April 2012. Between June 2012 and December 2013, it dropped by about 1½ percentage points.

Lending rates started to rise in late 2009 and their upward course continued until 2011. Between trough (October 2009) and peak (December 2011), the weighted average interest rate on credit to non-financial corporations rose by about 2¾ percentage points. The interest rate on loans of over €1 million, mostly to large non-financial corporations, increased more (by 3¾ percentage points) than the interest rate on smaller loans, which are usually extended to small and medium-sized enterprises (2¾ percentage points), obviously in an effort by banks to diversify their loan portfolios and limit the average amount per loan. Finally, between the lowest (December 2009) and the highest level recorded during the crisis (August 2011), the weighted average interest rate on housing loans (consumer loans) increased by about 1¼ (1½) percentage points.

The upward course of lending rates (between end-2009 and 2011) was consistent with:

1. the rise in the average deposit rate, as it affects the cost of banks' funding for new lending;

2. the rise in Euribor rates (by one percentage point for the three-month interest rate between March 2010 and July 2011), since these are used as reference rates for many loan agreements – especially housing and consumer loans;

3. the rise in ECB rates (April and July 2011), which increased the cost of credit institutions' refinancing by the Bank of Greece. Refinancing cost increased further due to credit institutions' recourse to emergency liquidity assistance (ELA, essentially from August 2011 onwards) at an interest rate that was higher than that of the Eurosystem's open market operations and marginal lending facility (to which credit institutions have access through their accounts with the Bank of Greece).

Due to deposit outflows and the loss of access to the interbank market, the reliance of credit institutions on monetary policy operations and

4 Overnight deposits comprise savings and sight deposits and current accounts.

ELA grew. In 2009, the outstanding amount of deposits (excluding interbank deposits) with the banking system was over 6 times higher than the outstanding amount of Eurosystem financing. In the first half of 2012, outstanding central bank funding had reached 4/5 of outstanding deposits. In 2013, however, outstanding central bank funding fell to about 1/3 of deposits.

Banks' refinancing became more difficult (late 2009 – early 2012) due to the decline in the prices of Greek sovereign bonds (the major form of collateral available to domestic banks), coupled with the rise in valuation haircuts applied by the Eurosystem as the country's credit rating suffered repeated downgrades. Moreover, due to these downgrades, bank covered bonds and ABSs were no longer accepted as eligible collateral in monetary policy operations (in 2011-2012). The amounts of liquidity that could be raised from the Eurosystem using credit institutions' securities portfolios as collateral decreased continuously. In order to mitigate this adverse development, the government increased the total amount of guarantees it provided on bonds issues by credit institutions to make them eligible as collateral (in 2010-2011) and lent government securities to credit institutions for the same purpose.

During 2011, the course of nominal lending rates was reversed and turned downwards. Between December 2011 and December 2013, the interest rate on business credit declined by about 1¾ percentage points. The interest rate on housing (consumer) loans followed a downward course after August 2011 and declined until November 2013 by about 1¾ (3¼) percentage points.

The continuing decline in nominal rates is consistent with:

1. the drop in Euribor rates after July 2011 (by December 2013 the three-month interest rate had declined by about 1¼ percentage points);

2. the aforementioned decline in deposit rates;

3. the significant decrease in the cost of refinancing by the Bank of Greece since the end of 2012. This decline reflects the cuts in Eurosystem interest rates and followed the readmission of the securities issued or guaranteed by the Greek government as eligible collateral in the Eurosystem monetary policy operations in late December 2012. Credit institutions consequently substituted the recourse to ELA with participation in Eurosystem operations. Before that, the share of ELA in total financing by the Bank of Greece had increased from 14% in August 2011 to 55% in June and 95% in November 2012[5] (2013: 20%).

However, it should be noted that, according to a simple estimate,[6] lending rates in real terms have trended upwards since 2010. This is probably due to the fact that the simple calculation overestimates the real interest rate, because it underestimates the inflation expected over the medium term, since the latter is approximated by actual inflation, which is temporarily negative due to the long recession.

3 CREDIT AGGREGATES

Annual growth rates of bank financing to both non-financial corporations and households (see Chart VII.1) had begun to decline before 2009. Since late 2007 banks tightened their credit standards, thus limiting credit supply, mainly because they encountered difficulties in raising liquidity from the financial markets due to the international turmoil.

In the following years, demand declined for all types of bank credit, as economic activity shrank, prices and rents in the housing market fell, interest rates rose and uncertainty heightened.

5 The restructuring of Greece's sovereign debt, the recapitalisation and resolution of the banking system, as well as the debt buyback operation contributed to reducing banks' recourse to ELA, as credit institutions acquired EFSF notes, which are eligible collateral with low valuation haircuts in ordinary monetary policy operations as well as in cross-border interbank transactions.
6 The real interest rate in a given month is that month's nominal rate minus the year-on-year rate of inflation in the same month.

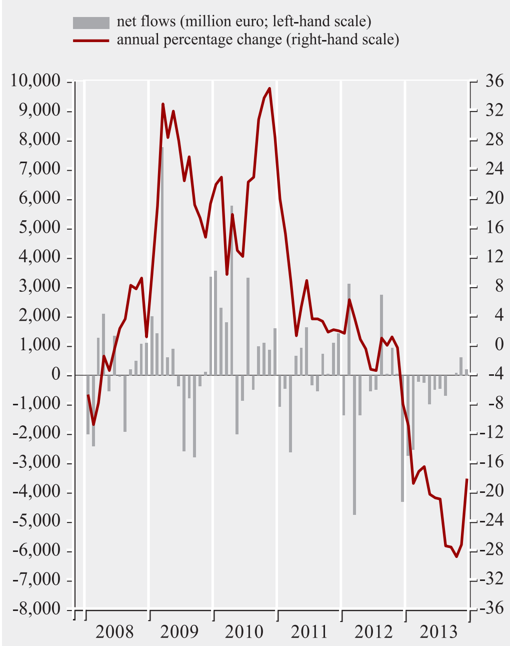
Chart VII.1 Credit[1] to non-financial corporations and households by MFIs in Greece (January 2008-December 2013)

(annual percentage change)

Source: Bank of Greece.
1 Domestic MFI credit to non-financial corporations and households includes the outstanding amounts of loans and, in the case of enterprises, corporate bonds held by MFIs (essentially credit institutions and the Bank of Greece), as well as the outstanding amounts of loans and, in the case of enterprises, securitised corporate bonds. The annual rates of change are adjusted for loan write-offs, reclassifications and transfers of loans, and foreign exchange valuation differences on loans denominated in foreign currency.

Chart VII.2 Credit[1] to general government by domestic MFIs (January 2008-December 2013)

(monthly net flows; annual percentage changes)



Source: Bank of Greece.
1 Credit to general government by domestic MFIs comprises the outstanding amounts of bank loans to this sector, as well as MFI holdings of government bonds. The rates of change and net flows are adjusted for loan write-offs and reclassifications, as well as valuation differences in the government bond portfolio due to price and exchange rate variations (thus largely eliminating the effects of the restructuring of Greek sovereign debt in early 2012).

Moreover, from late 2009 to early 2013, banks continued to tighten their credit standards as they faced difficulties also in attracting retail deposits. In addition, the capital base available to support the lending activity of the banking system was shrinking (see Section VII.6).

In 2012 and 2013, the recapitalisation and restructuring of the banking system restored banks' capital adequacy, while their access to funding for new lending improved (see Section VII.1 and VII.2). However, the effect of troubled assets and of the obligation of commercial banks (under the Memorandum) to limit their reliance on central bank funding are still important constraints on credit expansion. Several initiatives at EU level and the action taken by the Hellenic Fund for Entrepreneurship and Development (ETEAN) have contributed to strengthening bank loans supply.

Moreover, the deceleration of the economic downturn contributes to containing the decrease in credit demand. Meanwhile, the improvement in the economic outlook will encourage banks to supply credit over the medium term, as this outlook points to reduced credit risk in the future.

The moderation in the decline of credit demand and supply (as evidenced by the Bank Lending Survey) explains the fact that the rate of decrease in bank credit, primarily to households and secondarily to non-financial corporations, has declined from the end of 2012 onwards.

With respect to bank credit to households, it is worth noting that between 2009 and 2013 the share of consumer loans shrank (from 32% to 29%), while the corresponding share of housing loans increased.[7] This reflects the fact that consumer credit is more short-term: as these loans were not renewed in the context of widespread deleveraging, their outstanding amount declined quickly, whereas outstanding housing loans have longer time to maturity. Moreover, arrears are relatively more frequent in consumer loans (see Section VII.6),[8] and as a result banks avoid extending new loans of this type.

As regards non-financial corporations, in the 2009-2013 period the only sectors that have increased their borrowing from the banking system were tourism, shipping, and the electricity, gas and water supply industries. Two outward-looking sectors (tourism, shipping) benefited in comparison with other, less outward-looking sectors. This indicates that the allocation of loans by banks was in principle consistent with the needs of the restructuring of the economy. However, under the circumstances, the amount of credit supplied by banks is not sufficient to build the new productive model of the Greek economy. As regards the share of individual sectors of economic activity in overall credit expansion to non-financial corporations, trade recorded the sharpest decline (of 4 percentage points, from 26% to 22%).

In the 2009-2011 period, for which a full detailed sectoral analysis is available, value added declined in all sectors except shipping and electricity, etc. The ratio of outstanding bank loans to value added increased in all sectors.[9] This was so because, with the help of the policy instruments discussed in Section VII.6, bank financing either increased or declined less than value added. For the sectors of shipping and electricity etc., where value added increased, bank financing increased even faster.[10] Although the supply of bank credit is necessary to support economic activity, continued lending to businesses that are not viable over the long term should be avoided.

Finally, the share of general government in the total financing of the economy by banks was reduced (2009: 19%, 2013: 13%). The supply of credit to the government sector by domestic banks (see Chart VII.2) was largely replaced by financial support from the EU Member States and the IMF.

7 This development is not due to any differences in the frequency of loan write-offs/write-downs between the two types of loans.
8 This of course means that repayments are rarer, therefore —excluding write-offs/ write-downs— the total outstanding amount of loans in this category decreases slower than if all consumer loans performed properly.
9 Outstanding amount adjusted for reclassifications and write-offs/write-downs. But for this adjustment, the ratio of financing to value added would decrease in agriculture, forestry, fishery, trade and other activities (real estate management, education, health and other services).
10 The available data show a continued rise in the ratio of bank loans to value added in the construction industry throughout 2012 and in the twelve-month period between 2012 Q4 and 2013 Q3. By contrast, in the agricultural sector this ratio was lower between 2012 Q4 and 2013 Q3 (given the adjustment mentioned in footnote 9).

Box VII.1

CHEQUES AS AN INSTRUMENT OF TRADE CREDIT IN RECENT YEARS

Cheques (as opposed to banker's drafts, which are deemed equivalent to cash) serve, among other things, as instruments of trade credit: post-dating generates a delay between the date of the transaction (when the cheque is typically written) and the date on which the bank account of the issuer (payer) is debited. This delay increases the importance of the payer's creditworthiness, as the payee has to assess whether the payer will have sufficient funds in his bank account to honour the cheque when due. Furthermore, cheques can be used as collateral to obtain bank credit.

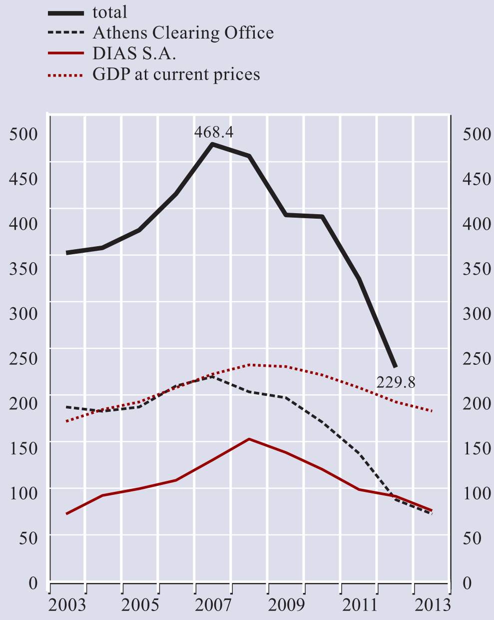
Data from DIAS S.A., which refer only to electronically processed cheques, allow a breakdown into banker's drafts and cheques. In 2013, *private* cheques had a share of 85% in the total number of cheques in the DIAS system (down from 90% in 2008), while in value terms their share was 67% (down from 72% in 2008).

The Survey on the Access to Finance of SMEs (SAFE), conducted by the European Commission and the ECB, investigates, among other things, the availability of trade credit.[1] Greek firms' responses to this survey point to continuous declines in the availability of trade credit from the second half of 2010 to mid-2012 and a gradual reversal thereafter – broadly consistent with the change in the number of cheques in DIAS. For many firms, the shrinking use of cheques implied a further shrinking in the availability of credit in addition to that of bank credit.

The chart shows the evolution, in value terms, of cheques (including banker's drafts) in Greece, based on data from: (i) the Athens Clearing Office, (ii) the DIAS electronic system, and (iii) credit institutions, respectively.[2]

Value of cheques (including banker's drafts) and nominal GDP

(billion euro)



Sources: Bank of Greece, Athens Clearing Office, DIAS Interbanking Systems S.A., ECB and ELSTAT.
Note: The total value of cheques in 2013 is not yet available.

The total value of cheques over the 2003-2008 period, which was a multiple of the outstanding amount of bank credit to the private sector and substantially higher than nominal GDP,[3] under the plausible assumption that the bulk of cheques were post-dated, is indicative of the important role of this type of trade credit as a source of external financing for businesses.

The decline observed in the number and value of cheques since 2008, both of which almost halved[4] by end-2012 relative to 2007, reflects the recession of the Greek economy and the concomitant contraction in business transactions, including those in the real estate market.[5] It also reflects an increase in credit risk, leading to a preference for payments in cash and to a tightening of banks' standards regarding the granting of cheque books, as well as a long-term international shift away from the use of cheques in transactions given the high management costs involved.[6]

1 It should be noted that the concept of trade credit under this survey also includes trade credit instruments other than cheques.
2 It should be pointed out that the cheques which are recorded by the Athens Clearing Office and DIAS S.A. refer to transactions between two accounts held with different banks, while the third series (total) also includes the transactions between two accounts held with the same bank.
3 A comparable value of cheques as a percentage of GDP is recorded for Portugal.
4 Outpacing the decline in GDP and in short-term bank credit.
5 For the 2008-2012 period, the change in the number of bank cheques is correlated to the change in the number of transactions in the real estate market.
6 ECB (2010), *The Payment System: payments, securities and derivatives, and the role of the Eurosystem.* As a paper-based instrument, cheques are costly to process and settle, compared with other payment instruments such as e-payments and credit transfers. As a result, banks are seeking ways of reducing costs through the dematerialisation of the clearing and settlement process.

Increased credit risk is mirrored in available data on bounced cheques:[7] although bounced cheques have been on a downward path since 2010, their share in total cheques rose considerably over the 2009-2012 period relative to the previous six years. Businesses' recourse to the use of cash during the crisis served the dual purpose of avoiding bounced cheques, the frequency of which had increased, as well as of mobilising hoarded banknotes which businesses anyway held in response to the overall uncertainty generated by the crisis. Indeed, a strong negative correlation can be observed between the stock of banknotes in Greece and the number of cheques in circulation.

The fact that the value of cheques (as recorded in DIAS) as a percentage of nominal GDP declined during the crisis confirms that the lower value of cheques does not merely reflect a contraction in transactions, but also an increasing substitution of cash for cheques in the settlement of business-to-business transactions. Furthermore, the fact that the ratio of the value of personal cheques (as recorded in DIAS) to sight deposits by non-financial corporations and households declined during the crisis suggests that the decrease in the value of cheques was not only due to a drop in the outstanding balance of bank deposits on which cheques may be drawn. It appears that, despite the declining use of cheques, economic agents continued to hold sight deposits for their other features, notably the possibility of overdraft facilities or credit transfers.

Economic recovery, improving confidence and the resulting decline in credit risk are expected to have a favourable effect on the future path of trade credit. As far as cheques are concerned, however, this path will crucially depend on the long-term trend towards substitution away from this instrument.

7 Tiresias S.A.

4 THE BOND MARKET

In 2008, especially after the collapse of Lehman Brothers, and in the beginning of 2009, due to the financial turmoil, conditions in the Greek sovereign bond market started to deteriorate, as investors made a drastic upward reassessment of risks internationally. The yields of Greek sovereign bonds started to rise in the last quarter of 2009 (see Chart VII.3), in line with repeated downgrades of the country's credit rating. As a result of these developments the government was eventually shut out of international capital markets in the second quarter of 2010.

The rise in yields was driven by concerns about the sustainability of Greek sovereign debt, the fiscal and other macroeconomic imbalances of the Greek economy and the question whether EU support would be sufficient. Despite the financial support to Greece as from May 2010 and the implementation of the Securities Markets Programme by the ECB (see Chapter IV), uncertainty about the economic outlook mounted during 2011, as reflected in the repeated downgrades of the country's credit rating during that period. As a result, there was a continuous rise in bond yields.

The bond swap operation took place in March (and, secondarily, in April) 2012 in the context of the PSI. This restructuring of public debt led to a significant improvement in the country's fiscal position and yields on the new bonds stood at significantly lower levels. However, they soon came under pressure, mainly because uncertainty about the outcome of the sovereign debt crisis and the country's prospects in the EU peaked during the election period.

After mid-June 2012, following the formation of the coalition government, investors' confidence began to improve gradually, as economic policy was aligned to the country's obligations under the loan agreements, which led to an almost continuous decline in yields. In 2013, the downward trend in yields was driven by both the progress in fiscal consolidation and the improvement in several macroeconomic aggregates and the prospects of the Greek economy, as reflected in the upgrades of the country's credit rating by two major international agencies. The gradual improvement in the climate is evidenced by the fact that yields were increasingly affected by international developments rather than by country-specific factors.

More specifically, at end-2013 Greek sovereign bond yields fell to 8.5%[11] (14.2.2014: 7.6%), against 11.5% at end-2012 – this decline was significantly sharper than the decrease in the bond yields of other countries with high public debt, such as Portugal and Italy. The yield spread between Greek and German 10-year sovereign bonds narrowed to 655 basis points at end-2013 (coming close to its June 2010 levels), against 1,017 basis points at end-2012 (average for the 2001-2007 period: 25 basis points, 14.2.2014: 591 basis points).

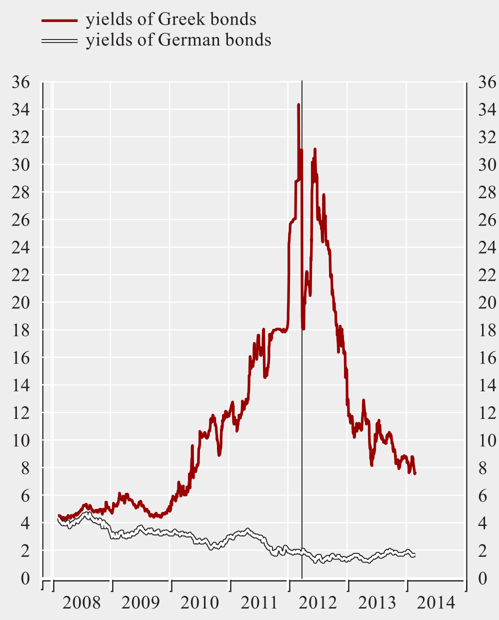
The yield curve for Greek bonds, which had been negative since April 2010, became positive again in 2013, for maturities between 10 and 15 years.

The period since 2009 has been marked by a considerable reduction in the marketability of Greek bonds. The average daily trading volume in the Dematerialised Securities System – SAT (Electronic Secondary Securities Market – HDAT) declined during that period and in 2013 stood at €218 million (€6 million), against €10 billion (€1.3 billion) in 2009.

Since April 2010, the government has been issuing only Treasury bills (exclusively with a maturity of 13 and 26 weeks since 2011). In 2013 the amount raised through Treasury bills was €39.4 billion, down by about 10% compared with 2012, while the weighted average interest rate, which had started to decline in 2012, stood at 4.1% in 2013 (in the first two months of 2014: 3.9%).

Chart VII.3 10-year Greek and German government bond yields[1] (January 2008-14 February 2014)

(daily data; in percentage points)



Source: Bank of Greece.

1 As Greek government bonds are traded on several regulated markets (e.g. HDAT, BrokerTec, MTS, ICAP etc.), as well as on electronic OTC trading platforms (e.g. Reuters, Bloomberg), divergences in prices (and corresponding yields) are occasionally observed across data providers. These divergences became more evident in Q4 2011 due to considerably lower transactions in Greek bonds; therafter they narrowed, but have not been eliminated. The vertical line represents the date on which new Greek government bonds were admitted to trading (12 March 2012), following the completion of the exchange of the Greek government bonds under the PSI.

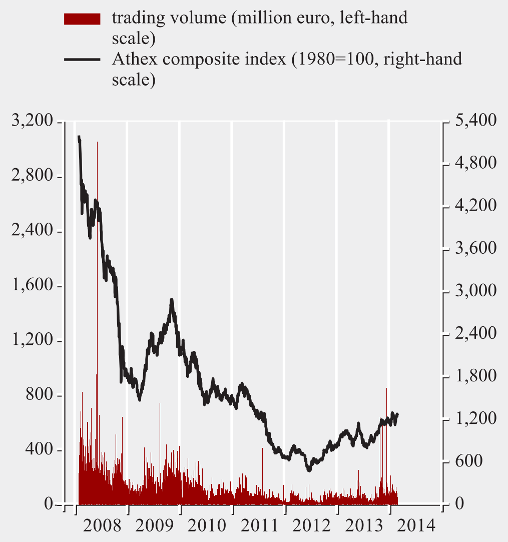
5 THE STOCK MARKET

As a result of the negative investment climate prevailing since late 2009 due to the crisis, coupled with the effect of the recession on the financial aggregates of listed companies, share prices on the Athens Exchange declined sharply (14.10.2009 – 5.6.2012: -84%, see Chart VII.4). Share prices in the Greek stock market were decoupled from those in other developed

11 Based on Reuters data.

Chart VII.4 Athens Exchange: composite share price index and trading volume (January 2008 -14 February 2014)

(daily data)



Source: Athens Exchange.

markets. Share prices fluctuated below their downward trend in synch with the surges in uncertainty that were leading to increases in the yield spread between Greek and German government bonds.

After mid-2012, stock prices followed an upward course (6.6.2012 – 31.12.2013: +144%) on the back of improved confidence and macroeconomic conditions, but also as a result of structural reforms, and in particular the successful recapitalisation of Greek banks partly with private funds. Another indication of the improving climate in the stock market is the recoupling of developments on the Athens Exchange with those in international stock markets.

In more detail, in 2013 the Athex composite index rose by 28% (1.1.2014 – 14.2.2014: 10%), outperforming the euro area Dow Jones EURO STOXX index. The downgrade of the Greek stock exchange by MSCI to emerging market status led to a significant inflow of funds from foreign investors, who are particularly attracted to these markets.

After a large decline (-75%) in 2009-2012, the average daily trading volume on the Athens Exchange increased in 2013 and stood at €87 million (1.1.2014 – 14.2.2014: €100 million). This came as a result of the aforementioned net inflow of non-residents' funds, which came to €2.3 billion in 2013, against a cumulative outflow of €1.4 billion over the previous three years. Between 2009 and 2013, it was mainly Greek banks that raised capital on the Athens Exchange. Capital raising by non-financial corporations declined considerably during the said period and was particularly subdued in 2012 and 2013 (2008: €472 million, 2012 and 2013 (combined): a total of €226 million).

From late 2009 to June 2012, bank share prices dropped by 96% (14.10.2009 – 5.6.2012), as a result of the impact of the crisis on Greek banks (see Section VII.6). Then, until early April 2013, bank share prices declined further due to the prevailing uncertainty about the ability of the private sector to adequately cover the capital needs in the context of the recapitalisation process so as to retain control of core banks. Since then, until the end of 2013, bank share prices rose by 75% (1.1.2014 – 14.2.2014: 9%) as uncertainty dissipated, banks' financial results improved and positive expectations emerged due to the successful restructuring of the banking system.

6 DEVELOPMENTS IN THE BANKING SECTOR

In Greece, in contrast with other countries, the banking sector not only did not cause the crisis, but also faced unprecedented challenges that were successfully tackled through coordinated action by the Bank of Greece and the government. The first shocks were felt upon the onset of the international financial crisis in 2008 and then pressures mounted due to the domestic fiscal crisis. The fact that, despite pressures, the stability of the banking system was safeguarded is an achievement, as is the fact that during the necessary radical restructuring of the banking system not a single depositor suffered a loss on their savings. The next crucial step for the Greek banking system is already being implemented on the basis of a long-term sustainable business model, which will contribute to recasting and supporting a new growth model for the Greek economy over the medium term.

In the first years of the crisis, banks did not take bold action and merger initiatives were aborted. After the erosion of banks' capital base due to the PSI, the need to restructure and strengthen the sector became imperative. This was achieved through a combination of mergers, resolution measures and recapitalisation.[12] At the same time, foreign banks reduced their presence in Greece due to, on the one hand, the problems facing parent companies as a result of the international crisis, and, on the other hand, the reorientation of their strategies.[13] The market share of other Greek banks also contracted.[14] The structure of the Greek banking sector is now totally different from that at the beginning of the crisis. Excess capacity has been eliminated, fewer but stronger banks are in operation, and the first benefits from the exploitation of synergies are already visible.

According to end-September 2013 data, the assets of the four core banks accounted for 91.6% of the total assets of the banking system, up from 63.4% in 2009. If the branches of foreign banks are taken into account, the number of credit institutions has fallen to 43, down from 66 at end-December 2008.

The Bank of Greece, in its capacity as supervisory authority, has repeatedly asserted that the size of the Greek economy and the present economic conjuncture call for fewer banks that are more resilient to economic shocks. Certainly, safeguarding the interests of financial services users requires, in addition to financial stability, also protecting effective competition in the banking system.

The liquidity, profitability and capital base of the Greek banking system as a whole came under strong pressure as a result of the combined effect of:

− its being shut out of international markets;

− continuous deposit outflows;

− the restructuring of public debt;

− the impact of the recession on the size and quality of loan portfolios.

With regard to liquidity, a clear change is evident in the structure of bank liabilities (see Chart VII.5), as the shares of deposits, bank bonds and interbank funding appear reduced, particularly in the period 2008-2011. However, there has been an improvement since June 2012 with the gradual return of deposits to the banking system and the regained access, still limited, to the international interbank repo market.

Deposit outflows resulted in a worsening of the loan-to-deposit ratio, despite reduced new lending. With the gradual return of deposits, this ratio fell to a satisfactory level compared with the corresponding euro area average (see Chart VII.6).

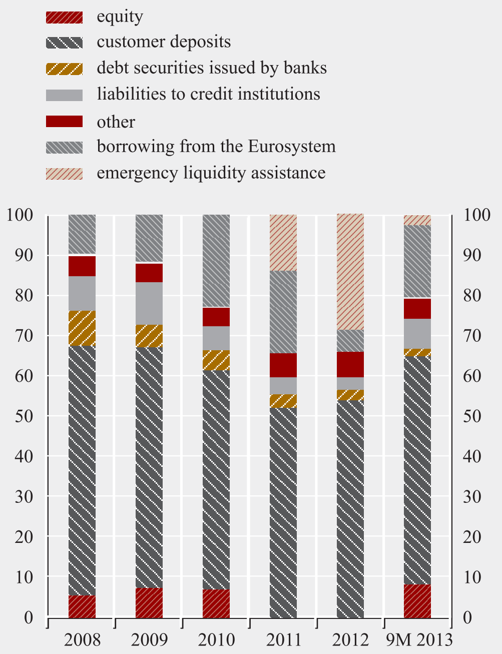
Bank aggregates were critically affected by the impairment of banks' capital base due to the restructuring of public debt in March 2012, as a result of which Greek banks suffered losses of €37.7 billion. These losses were the most important factor in the calculation of banks' capital needs in the context of the recapitalisation exercise carried out by the Bank of Greece in 2012.

The recession and the increased tax burden led to a worsening of the financial situation of

12 Piraeus Bank acquired the healthy part of ATEbank, Geniki Bank, the domestic operations of Cypriot banks (Hellenic Bank, Bank of Cyprus and Cyprus Popular Bank) and Millennium Bank (Greece). National Bank of Greece acquired the healthy part of First Business Bank and Probank, as well as the total deposits of the Cooperative Banks of Achaia, Lamia and Lesvos-Lemnos. Eurobank acquired New Proton Bank and New TT Hellenic Postbank. Finally, Alpha Bank acquired Emporiki Bank and the total deposits of the Cooperative Banks of Western Macedonia, Dodecanese and Evia.
13 The parent companies fully covered the capital needs of their subsidiaries and branches in Greece before these were sold.
14 "Other Greek banks" include small commercial banks, cooperative banks and the Consignment Deposits and Loans Fund.

Chart VII.5 Percentage structure of liabilities of Greek banking groups[1]

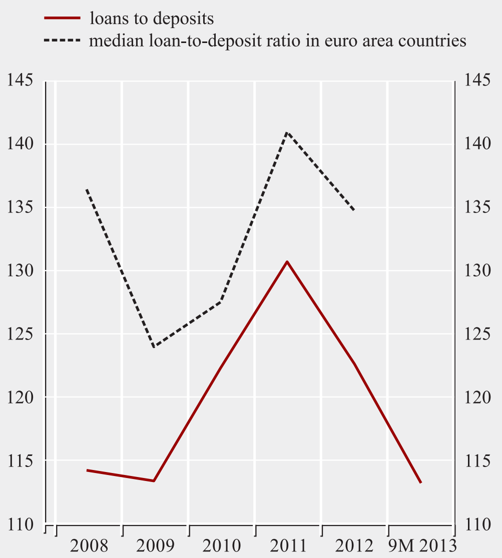
(percentages)



Source: Bank of Greece.
1 The share of equity in total liabilities is rounded to 0% for 2011 and -1% for 2012.

Chart VII.6 Loan-to-deposit ratio of Greek commercial banks and euro area banks

(on a consolidated basis; %)



Sources: ECB and Bank of Greece.

households and non-financial corporations. Thus, credit risk increased, while the ratio of non-performing loans to total loans (NPL ratio) increased by a factor of six within five years (September 2013: 31.2%, December 2008: 5.1%) (see Chart VII.7). The NPL growth rate had been moderate up to 2010, but rose significantly in 2011 and 2012, as a result of the deepening recession and the general uncertainty that seemed to have affected transacting behaviour. In the January-September 2013 period it showed signs of stabilisation. As in previous years, at end-September 2013, the highest NPL ratio was recorded in consumer loans[15] (45.8%), given that these loans are typically not backed by collateral (see Chart VII.7). Housing loans had a lower NPL ratio (September 2013: 25.8%), while the respective ratio for corporate loans stood at 31.2%.

In order to facilitate borrowers and stem the accumulation of NPLs, banks applied loan forbearance measures, at first hesitantly and then more actively. At the same time, banks sought to enhance collateral on loans already granted (so as to mitigate losses in case of default) and tightened their credit standards.

The crisis also affected those factors that determine the resilience of the banking sector, i.e. bank profitability, provisioning policy and capital adequacy. In the three-year period that followed 2009, a year of poor profitability, banks had to establish increased provisions for credit risk, and, especially in 2011, were affected by the public debt restructuring. As a result, they suffered significant (after-tax) losses.

The period 2009-2012 saw a drop in net interest income, which has been the most important source of income for banks over time. Interest income fell, on the one hand, due to increased NPLs (on which interest owed is not collected) and, on the other hand, as a result of a drop in the outstanding balance of loans (given the reduction in new lending). At the same time,

15 Including credit cards and current account overdrafts.

interest payments were occasionally increased also as a result of recourse to the emergency liquidity assistance (ELA) from the Bank of Greece.[16] Lower activity in the banking sector also affected net commission income, the second largest source of income for banks. Moreover, the economic recession also led to a drop in "other income", i.e. dividend income from subsidiaries, income from insurance operations, etc. A downturn was also recorded in banks' income from their international activities in South-Eastern Europe, with the exception of Turkey, where banking operations remained highly profitable. The above negative effects were offset, although to a small degree only, by cuts in operating costs, mainly staff costs. In the coming years, the management of operating costs is expected to improve further through synergies.

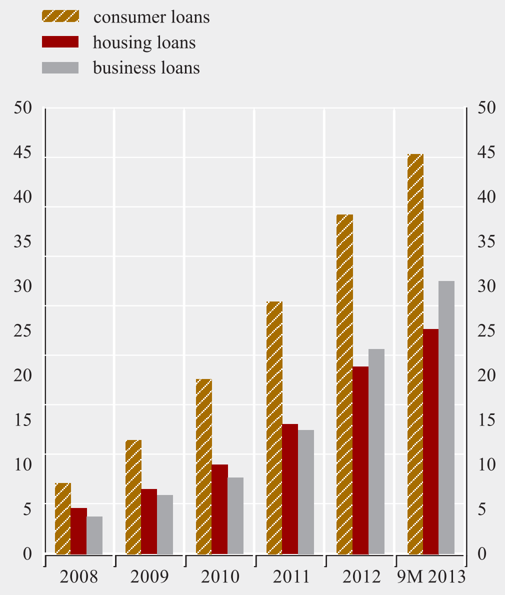
In addition, banks' results (see Chart VII.8) were affected by their worsening loan portfolios, which made it necessary to establish increased provisions for credit risk.[17] On the other hand, this policy helped to maintain a relatively satisfactory, and close to the euro area median, coverage of NPLs by accumulated provisions (coverage ratio).

Signs of recovery in all categories of income can be seen in the 2013 results reported so far, although after-tax profits stem mostly from one-off events. Also, efforts to curb operating costs were continued.

Although Greek banks entered the crisis with satisfactory capital adequacy ratios, the heavy losses they suffered from 2010 onwards and especially the impact of the PSI resulted in most banks being faced with a capital shortage at end-2011 (see Chart VII.9). Following the bridge recapitalisation of core banks in 2012 and the completion of the recapitalisation process by mid-2013, the capital adequacy ratios of Greek banks have been restored. The Hellenic Financial Stability Fund (HFSF) is now the largest shareholder in each of Greece's four core banks, and has a buffer of over €8 billion that could be used

Chart VII.7 Developments in NPL ratios per loan category

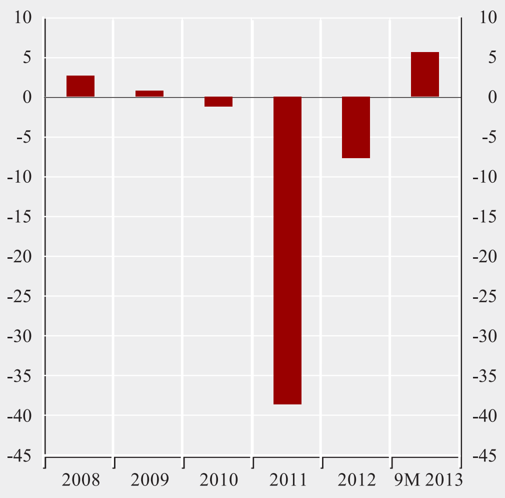
(percentages)



Source: Bank of Greece.

Chart VII.8 After-tax profits of Greek banking groups

(billion euro)

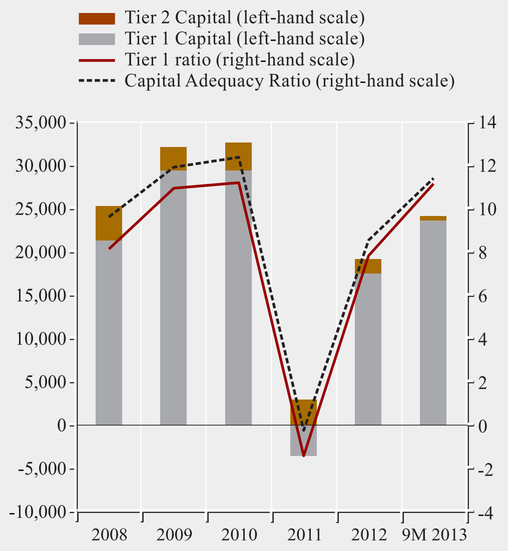


Source: Bank of Greece.

16 ELA is remunerated at higher interest rates than liquidity raised through Eurosystem operations.
17 Between end-2008 and end-September 2013, banks' accumulated provisions for credit risk more than tripled.

Chart VII.9 Composition of regulatory capital and developments in capital adequacy of Greek commercial banks

(left-hand scale: million euro; right-hand scale: percentages)



Source: Bank of Greece.

should a bank need further capital support in the light of the results of the stress tests underway. Another positive development has been the improvement in the quality of capital, which now includes almost exclusively Tier 1 capital, while in 2008 Tier 2 capital accounted for one fifth of total capital (see Chart VII.9).[18]

Under these adverse circumstances, the Bank of Greece and the government took a number of decisive actions aimed at safeguarding financial stability and protecting depositors. The most important of these actions involved:

– uninterrupted satisfaction of banks' short-term liquidity needs and the public's demand for cash;

– securing adequate public funds for the recapitalisation and restructuring of the Greek banking sector;

– resolution of weak banks,[19] under an enhanced legal framework; and

– a demand on all Greek banks to increase their capital to an adequate level on the basis of conservative estimates.

The establishment of an appropriate institutional framework for the resolution of credit institutions by Law 4021/2011[20] allowed a smooth restructuring of the banking sector. By the end of 2013, six commercial banks and six cooperative banks had been resolved, either through the transfer of their healthy part to another bank or through the establishment of an interim credit institution.[21]

Seeking to improve transparency and confidence in the banking sector and in compliance with its obligations under the Memorandum, in July 2013 the Bank of Greece engaged BlackRock Solutions, for the second time, to conduct a diagnostic assessment of Greek banks' loan portfolios. The results of the assessment, together with the restructuring plans already submitted by the banks, will be taken into account during the ongoing stress test exercise.

The major challenges facing the Greek banking sector on the Greek economy's path to recovery are:

– diversifying banks' funding sources;

– managing troubled assets (i.e. NPLs and forborne loans);

– recasting banks' business model in line with the emerging new economic conditions;

18 As a result of offers to buy back hybrid instruments and subordinated debt instruments issued by Greek banks, recapitalisation costs were partly shared by the holders of these instruments.
19 According to the proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms, the term "resolution" refers to the restructuring of an institution in order to ensure the continuity of its critical functions, preserve financial stability and restore the viability of all or part of that institution.
20 Amending and refining Law 3601/2007.
21 In July 2012, the HFSF sold the two interim credit institutions that had been established (New Proton Bank and New TT Hellenic Postbank) to Eurobank.

– ensuring that the banking industry contributes to the overall effort to overhaul the real economy.

In 2013, as already mentioned, Greek banks regained access to interbank funding. Also, foreign funds and institutional investors participated in the capital increases of Greek banks and then in sales of their shares.[22] However, the key remaining challenge for banks is to issue (unsecured) bank bonds in international markets, when conditions allow. Subsequently, the possibility of issuing ABSs could also be considered. Diversifying funding sources will reduce Greek banks' reliance on the Eurosystem and allow them to grant more new loans over the medium term.

It is necessary to ensure effective management of troubled assets. The accumulation of NPLs discourages the extension of new credit, inter alia, by depriving banks from funds that could be channelled into new loans. It also makes provisioning necessary and increases banks' capital needs, thus further reducing banks' risk appetite and, therefore, their ability to grant loans. Improving the quality of loan portfolios through effective management, coupled with improved economic conditions, would strengthen depositors' and markets' confidence, on the one hand, and lead to lower interest margins, on the other hand.

The above can only be achieved by developing a business model that will be sustainable over the long term. Planning in the banking sector should focus on the following: (a) rationalising operating costs and, more generally, higher internal capital generation via operating profits; (b) shedding non-core business; (c) redesigning foreign business; (d) actively managing troubled assets; (e) providing the full range of banking services and implementing sound pricing policies.

The Bank of Greece will continue to act with a view to preserving the stability of the banking sector, protecting deposits and ensuring well-capitalised, viable credit institutions.

7 THE PRIVATE INSURANCE MARKET

Overview of developments in the private insurance market after the Bank of Greece took over its supervision

In 2013, three years were completed since the Bank of Greece took over the supervision of the private insurance market. The accumulated problems of this sector, compounded by the impact of the fiscal crisis, inevitably led to the withdrawal of authorisation of five insurance companies, while two more companies closed down on their own initiative, after transferring their portfolios to another firm. The institutional measures and audits undertaken by the Bank of Greece focused on consolidating the private insurance market to the benefit of consumers and ensuring the timely preparation of the market for the new institutional framework (Solvency II). The in-depth and intensive inspections that were carried out put pressure on companies to continuously improve their processes and also to carry out capital increases totalling about €2 billion.

A steady course towards rationalising and streamlining structures is crucial if the insurance market is to develop effectively, despite the adverse economic conjuncture. In this regard, through its continuous inspections the Bank of Greece aims at improving the internal organisation of insurance companies, as well as at ensuring the transparency of transactions and the protection of the market and, by implication, of the financial sector in general from any unfair and detrimental practices, to the benefit of the Greek society and economy.

The private insurance market in 2013

At end-September 2013, the Greek insurance market comprised 72 insurance undertakings under the right of establishment, with total

22 Characteristically, the stake of Millennium BCP in Piraeus Bank was acquired mostly by foreign investors for an amount of €400 million. A positive development in 2013 was the exercise of a part of the Alpha Bank warrants, as a result of which shares with a value of €96 million were purchased.

assets of €14.9 billion. In terms of gross written premiums, the market shares of Greek insurance sociétés anonymes, subsidiaries of EU groups and branches of insurance undertakings either from third countries or from other EU Member States were 50.9%, 42.8% and 6.3%, respectively. As regards market concentration in terms of gross written premiums, the five and ten largest undertakings hold 71.8% and 89.8% of the life insurance market and 37.5% and 63.2% of the non-life insurance market, respectively.

In the January-September 2013 period, the main features of the insurance market were a decline in gross written premiums for the second consecutive year and continued capital increases which amounted to €200 million in the reviewed period. With regard to other aggregates, income from all types of premiums fell by 9.75% year-on-year to €3 billion, of which 40.3% came from life insurance and 59.7% from non-life insurance. In particular, income from life insurance fell by 13.7% and from non-life insurance by 6.9%. The total Technical Reserves of insurance undertakings supervised by the Bank of Greece declined further to €11.7 billion (2012: €12.0 billion). This is due to developments in the life insurance market and, more specifically, to policy redemptions and the decline in new business.

During the same period, the Bank of Greece continued its policy of intensified on-site inspections of insurance undertakings, carrying out over 100 on-site inspections and imposing appropriate sanctions in cases of non-compliance with the regulatory framework. Also, regular meetings were held with the management and executives of insurance undertakings, where issues of administrative organisation and compliance were raised, with an emphasis on preparations to ensure that market practices and the internal organisation are brought into line with the requirements of Solvency II.

In the context of these preparations, in 2013 the Bank of Greece continued to participate in the design and implementation of European exercises concerning the quantitative impact of Solvency II. In particular, the Bank of Greece, in cooperation with the European Insurance and Occupational Pensions Authority (EIOPA), participated in the long-term guarantee assessment, a European impact assessment of Long-Term Guarantee (LTG) products.

Moreover, the eight Working Groups established in 2012 on the initiative of the Bank of Greece continued to work on improving the quality of appropriate statistical data of undertakings, as well as on designing appropriate actuarial models for the assessment of particular insurance risks. The Bank of Greece, in cooperation with insurance undertakings, designed and developed software for the compilation of statistics and the support of these models. The relevant reports were also finalised.

In addition to the Solvency II interim measures, the Bank of Greece expanded its regulatory scope to insurance intermediation by adopting Executive Committee Acts 30 and 31/30.9.2013 (Government Gazette B 2556). Under Act 30/2013 "*Regulation of issues related to the administrative and accounting organisation of insurance undertakings, particularly with regard to business policy, acquisition of new business and the relevant networks, as well as the monitoring of premium writing, collection of premia and payment of commission fees, and relevant ethics rules*", insurance undertakings are required, inter alia, to adopt and implement a commercial policy, a sales regulation and a premium writing and collection management policy, the minimum standards of which are laid down in the said Act. The Act also describes the fundamental principles governing the transactions between insurance undertakings and insurance intermediaries and lays down specific requirements related to record-keeping and regulatory filings. Act 31/2013 "*Code of Conduct of (Re)insurance Intermediaries*" describes the information and professional behaviour standards that intermediaries have to comply with in promoting insurance products vis-à-vis both customers and other intermediaries or insurance undertakings. The Act includes an indicative typology of unfair or misleading practices and provides for the imposition of administrative penalties on insurance intermediaries using such practices. This Act also repealed Presidential Decree 298/86 (Government Gazette A 133) "*Rights and obligations of insurance agents and insurance producers and Code of Conduct for these professions*", according to which insurance agents could withhold the premiums collected from customers for two months. With regard to the time of premium payment, Article 33(2) of Legislative Decree 400/1970 is now applicable. These Acts entered into force on 1 January 2014.

In addition to amending the regulatory framework on insurance intermediation, the Bank of Greece also completed a first round of visits to large (re)insurance intermediation undertakings. These meetings provided the opportunity for a constructive exchange of views helping the insurance intermediation sector to prepare for assuming an enhanced role under Solvency II.

Finally, in the context of stress-testing credit institutions, the Bank of Greece assessed the capital needs of those insurance undertakings that are bank subsidiaries.

VIII ENVIRONMENT, ENERGY AND CLIMATE CHANGE

2013 saw the further substantiation of scientific findings on climate change and the additional documentation of policy proposals for urgent action. Although international cooperation on reducing emissions did not make significant headway, there are indications that 2015 could be a year of positive developments, when a new universal agreement is due for approval. The European Union is currently examining new policy objectives for climate and energy, adopting a more ambitious stance in certain areas and a more moderate one in others as a result of the toll that relatively high energy costs have had on the European economy's competitiveness. Greece continues to be within the Kyoto targets and now also ranks better on the basis of a new indicator of competitiveness adjusted to environmental sustainability than it used to based on a non-adjusted index. However, a recent study underlined the need to address the side-effects that certain changes to the Emissions Trading System are likely to have on the competitiveness of Greek industries, prompting the government to submit a relevant proposal to the European Commission in January 2014. The main body of legislative and administrative measures over the past twelve months concerned the restructuring and privatisation of the Public Power Corporation, renewable energy sources and the issue of "energy poverty" in conjunction with the smog problem. Finally, the most important energy-related investments involved SOCAR's acquisition of a majority of the share capital of the Hellenic Gas Transmission System Operator (DESFA) and the selection of the Trans Adriatic Pipeline (TAP) for the transportation of natural gas from Azerbaijan to Europe, via Greece. Also worth noting is a recent agreement giving British Petroleum exclusive rights to the oil output of the Prinos field over the next six years.

1 CLIMATE CHANGE RESEARCH AND PUBLIC POLICY: INTERNATIONAL DEVELOPMENTS

1.1 SCIENTIFIC FINDINGS AND REPORTS OVER THE PAST TWELVE MONTHS

The most significant scientific report on climate change in the past few months was the Fifth Assessment Report (AR5) of Working Group I of the UN Intergovernmental Panel on Climate Change (IPCC), published in September 2013.[1] With contributions from 259 authors from 39 countries, the report concludes that human impact is the main cause of the increase in temperature since the mid-20th century, underlining that this increase is undeniable, as shown by the unprecedented changes recorded in the climate system and by increasing evidence. As Sir Nicholas Stern noted after the release of the IPCC Assessment Report, "governments and businesses should be left in no doubt about the dangers of delaying further cuts in greenhouse gas emissions".[2]

A few months earlier, a report by the International Energy Agency[3] had come to the following very interesting conclusions:

– CO_2 emissions reached a record high in 2012.

– The two largest emitters (the United States and China) have both taken encouraging steps towards "decarbonisation". In 2012 gas emissions in the United States fell to levels of the mid-1990s, while China's emissions grew by one of the smallest amounts in a decade.

– Nevertheless, trends in CO_2 emissions suggest that the long-term average increase in temperature could reach as much as 5.3ºC.

These findings are echoed in a UN Environment Programme report,[4] which concludes that, if necessary action is not taken by 2020 to reduce greenhouse gas emissions and contain the average temperature increase to 2ºC, more difficult and costlier means will be needed

1 IPCC, 2013: Summary for Policymakers. In: *Climate Change 2013: The Physical Science Basis. Contribution of Working Group I to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change* [Stocker, T.F., D. Qin, G.-K. Plattner, M. Tignor, S.K. Allen, J. Boschung, A. Nauels, Y. Xia, V. Bex and P.M. Midgley (eds.)]. Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA.
2 Nicholas Stern, "World leaders must act faster on climate change", *Financial Times*, 30 September 2013.
3 IEA, *Redrawing the Energy-Climate Map*, 10 June 2013.
4 UN Environment Programme, *Emissions Gap Report*, 5 November 2013.

thereafter. Meanwhile, in 2013 and early 2014 scientists continued to investigate the correlation between climate change and extreme weather events, which are occurring with increasing frequency.[5] The fact that man-made climate change is responsible for the increasingly frequent extreme weather events is also corroborated by the scientific reports of the European Academies' Science Advisory Council (EASAC)[6] and the IPCC[7].

1.2 INTERNATIONAL POLICY DECISIONS AND CONSIDERATIONS

The 19th United Nations Conference on Climate Change

The 19th yearly session of the UN Conference on Climate Change, also known as the COP19, held in Warsaw on 11-22 November 2013,[8] was supposed to lay the groundwork for the signing of new binding global climate agreement in Paris in 2015 (committed to containing the global temperature increase to 2ºC by 2100). However, the Warsaw climate change talks came to a close without setting a timetable for the submission of legally binding emission targets, with the rapidly developing economies (that also have huge greenhouse gas emission footprints) arguing that they are still developing and, therefore, should be exempted from the measures applying to developed countries, and the developed nations, on their side, rejecting the demand for compensation from the small island states for damage due to sea level rise. To make matters worse, representatives of hundreds of environmental NGOs, who had come to the conference as observers, stormed out of the talks to protest the hosting, just a few kilometres away, of the International Coal Summit.

In the end, the following was achieved:

– first, the participating countries decided to initiate or intensify domestic preparation for their intended national contributions towards the international agreement sought to be concluded in 2015 and to come into force in 2020;

– second, the conference also decided to establish an international mechanism to provide most vulnerable populations with better protection against loss and damage caused by extreme weather events and slow-onset events such as rising sea levels;

– third, developing countries should be helped to reduce greenhouse gas emissions from deforestation and the degradation of forests (the United States, Norway and the UK pledged to finance the Collaborative initiative on Reducing Emissions from Deforestation and forest Degradation in developing countries, also known as the REDD+ initiative, with US$280 million); and

– fourth, developed countries (including Austria, Belgium, Finland, France, Germany, Norway, Sweden and Switzerland) have paid or pledged over US$100 million in contributions to the Adaptation Fund, while 48 of the poorest countries of the world finalised a compre-

5 See for instance Peterson, T.C., M.P. Hoerling, P.A. Stott and S. Herring, (eds), "Explaining Extreme Events of 2012 from a Climate Perspective", *Bulletin of the American Meteorological Society*, 2013, vol. 94(9), 1-74, as well as "Assessing the Role of Global Warming in Extreme Weather of 2012" and "Research Cites Role of Warming in Extremes", *New York Times*, 5-6 September 2013. See also a report released by Australia's Climate Council in mid-January 2014 ("Australian heatwave shows man-made climate change, scientists say", *Financial Times*, 16 January 2014), and a summary of the findings of the Rutherford Appleton Laboratory on solar activity ("Is our sun falling silent?", BBC News, 18 January 2014, and "Is the planet headed towards overheating or a mini ice age?;" [in Greek], *Imerisia*, 25 January 2014.

6 See (1) "Extreme Weather Events in Europe: preparing for climate change adaptation", Norwegian Meteorological Institute in collaboration with the EASAC, 2013, sponsored by the Norwegian Academy of Science and Letters, contributors: Øystein Hov, Ulrich Cubasch, Erich Fischer, Peter Höppe, Trond Iversen, Nils Gunnar Kvamstø, Zbigniew W. Kundzewicz, Daniela Rezacova, David Rios, Filipe Duarte Santos, Bruno Schädler, Ottó Veisz, Christos Zerefos, Rasmus Benestad, John Murlis, M. Donat, Gregor C. Leckebusch, Uwe Ulbrich and (2) "Trends in extreme weather events in Europe: implications for national and European Union adaptation strategies", EASAC *Policy Report 22*, 2013, by Øystein Hov, Ulrich Cubasch, Erich Fischer, Peter Höppe, Trond Iversen, Nils Gunnar Kvamstø, Zbigniew W. Kundzewicz, Daniela Rezacova, David Rios, Filipe Duarte Santos, Bruno Schädler, Ottó Veisz, Christos Zerefos, Rasmus Benestad, Mike Norton, John Murlis.

7 *IPCC Special Report on Managing the Risks of Extreme Events and Disasters to Advance Climate Change Adaptation* (SREX), ed. Field, C.B., V. Barros, T.F. Stocker, D. Qin, D.J. Dokken, K.L. Ebi, M.D. Mastrandrea, K.J. Mach, G.-K. Plattner, S.K. Allen, M. Tignor, and P.M. Midgley, Cambridge University Press, 2012.

8 UNFCCC, "UN Climate Change Conference in Warsaw keeps governments on a track towards 2015 climate agreement", Press release, 23 November 2013. The conference was attended by the 195 countries that have signed the United Nations Framework Convention on Climate Change, followed by the Kyoto Protocol of 1997, ratified by 192 countries to date.

hensive set of plans to deal with the impacts of climate change.

On 14 January 2014 Christiana Figueres, executive secretary of the UN Framework Convention on Climate Change, estimated that a draft agreement (for approval in 2015) would be ready for discussion by the end of the year and would comprise a goal of zero net greenhouse gas emissions by the second half of the century.[9]

It is also quite telling that, at the time of the conference, UN Secretary General Ban Ki-moon stated: "I have been urging the leaders of the world that they should raise the level of their ambitions and they should prioritise their already limited resources on climate change", adding that "They should have a broader vision rather than looking at short-term domestic considerations".[10]

Similar views were expressed by leading scientists and commentators on the occasion of the UN Conference. Jeffrey Sachs (Special Advisor to the UN Secretary General and Director of the UN Sustainable Development Solutions Network) marked out four key pillars: more electricity from low-carbon technologies rather than coal; replacing fossil fuels with electricity as the fuel source for sectors such as cars and household heating; greater energy efficiency in industry and the home; and the end of deforestation.[11] The well-known columnist Martin Wolf drew attention to the latest findings of economist William Nordhaus,[12] namely that the cost of containing the increase in global temperature to 2ºC would be 1.5% of global output, provided the right action were taken, but far costlier if countries responsible for half the emissions did not participate.[13] Moreover, the World Economic Forum (WEF), on the occasion of the release of its annual report *Global Risks 2014* (16 January 2014) summarising the survey responses of leaders and decision-makers from the global economy, underscored that one of the four key threats that could impact global stability in the next five to ten years is "*slow progress on global challenges, where persisting deadlock in global governance institutions leads to failure to adequately address environmental and developmental challenges that are truly global in nature*". The respondents surveyed for the report ranked extreme weather events and climate change amongst the five most likely risks, and climate change the second most potentially impactful risk.[14]

*

The OECD also released two important reports in October and November 2013,[15] underlining that "credible and consistent carbon pricing must be the cornerstone of government actions to tackle climate change"and that "carbon taxes and emissions trading systems are the most cost-effective means of reducing CO_2 emissions".

It should also be mentioned that the EU policy was initially summarised in the European Commission's Communication entitled "An EU Strategy on adaptation to climate change",[16] adopted by the ECOFIN Council on 21 June 2013. On 18 December 2013, the Permanent Representatives Committee, composed of the ambassadors of the 28 EU member states, approved a compromise agreed with the European Parliament on a draft regulation (submitted by the European Commission on 7 November 2012) on reducing the use and the emissions of fluorinated greenhouse gases (F-gases), i.e. hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF_6). This regulation (which now only

9 "Compelling case for global deal on climate, says UN", *Financial Times*, 14 January 2014.
10 "UN presses rich nations to act on climate funds", *Financial Times*, 22 November 2013.
11 Jeffrey Sachs, "We risk more Haiyans if we ignore climate change", *Financial Times*, 16 November 2013.
12 William Nordhaus, *The Climate Casino*, Yale University Press, 2013.
13 M. Wolf, "Green growth is a worthwhile goal", *Financial Times*, 26 November 2013.
14 World Economic Forum, "Worsening Wealth Gap Seen as Biggest Risk Facing the World in 2014", news release of 16 January 2014 concerning the report *Global Risks 2014*.
15 OECD, 1) *Climate and carbon: Aligning prices and policies*, Environment Policy Paper No.1, October 2013, 2) *Effective carbon prices*, 4 November 2013.
16 16 April 2013, COM(2013) 216 final.

needs to be formally adopted) aims to phase down the total amount of hydrofluorocarbons that can be sold by as much as 80% and to reduce fluorinated greenhouse gas emissions by two thirds by 2030.[17] Previously, the United States and China had signed a similar agreement to phase down the consumption and production of hydrofluorocarbons in June, while the G20 leaders made a relevant commitment in September.[18]

On 22 January 2014 the European Commission communicated its proposals on a policy framework for climate and energy in the period from 2020 to 2030. The proposed new framework sets targets for 2030 which —after approval or amendment by the European Council on 20-21 March 2014— will replace the targets set for 2020 by the European Council in March 2007 (also called the "20-20-20" targets as they included a 20% reduction in EU greenhouse gas emissions by 2020 compared with 1990 levels, a 20% increase in the share of EU energy consumption produced from renewable resources and a 20% improvement in energy efficiency —translating into energy savings— by 2020 compared with the 2007 estimates for 2020). Before the proposals were submitted, the ministers of France, Germany, UK and Italy had addressed a letter to the European Commission (7 January) proposing that a more ambitious binding target be set – *for a 40% reduction in emissions by 2030 from 1990 levels*.[19] A heated debate has been going on since then on questions such as: (i) whether binding goals should be set for the use of renewable energy sources, (ii) which combination of means and targets would be best, in order to *both* reduce emissions *and* avoid hurting the competitiveness of certain economic sectors[20] (see also Section 2.2 below). In the end, the Commission's proposals, considered insufficient by leading environmental organisations,[21] provide for the following:[22]

1st A binding target of reducing greenhouse gas emissions by 40% below the 1990 level by 2030 (binding at the Member State level and, thus, requiring national measures). Emissions by sectors not subject to the emissions trading system will need to be reduced by 30% below 2005 levels. The Commission called upon the Council and the European Parliament to agree that the EU will commit to reducing emissions by 40% at the upcoming negotiations for the new universal climate agreement, to be concluded in Paris at the end of 2015.

2nd A binding target *at the EU level (but not at the Member State level*) of increasing the share of renewable energy sources to at least 27% of the EU's total energy consumption by 2030. The purpose of setting this target at the EU level, without requiring translation into national targets, is to drive continued investment in renewable energy, while also leaving the Member States greater flexibility in transforming their energy systems.

17 See "Climate action: Commission proposes significant reduction in emissions of climate-warming fluorinated gases", press release of 7 November 2012, and "Memo – European Commissioner Connie Hedegaard welcomes major step forward to reduce some of the most dangerous greenhouse gases", press release of 18 December 2013.

18 Hydrofluorocarbons (HFCs) were widely used as a substitute for chlorofluorocarbons (CFCs), after the production and use of the latter was phased down under the Montreal Protocol because of their depleting effect on the ozone layer. While HFCs are not ozone-depleting, their emissions, if left unabated, can be expected to contribute increasingly to the greenhouse effect, as their potential impact on the temperature rise is *up to 23,000 times stronger* than that of carbon dioxide. See European Commission, "The warming effect of F-gases on the atmosphere is up to 23,000 times stronger than carbon dioxide", press release of 18 December 2013 and "Curbing a Potent Greenhouse Gas", *New York Times* editorial, 7 January 2014.

19 Regarding the energy policy problems inside the EU and the different national stances, see also "Europäische Energiewenden", *Frankfurter Allgemeine Zeitung*, 29 October 2013.

20 See also N. Butler, "Energy Policy – Europe takes power", *Financial Times*, 5-6 January 2014 and "EU considers scrapping 2030 binding renewables targets", *Financial Times*, 14 January 2014; "Sluggish Economy Prompts Europe to Reconsider Its Intentions on Climate Change", *New York Times*, 17 January 2014; "Rewrite energy policy and re-industrialise Europe", article by Lakshmi Mittal, chairman and CEO of ArcelorMittal, *Financial Times*, 20-21 January 2014; statements by German Minister of Economic Affairs and Energy, Sigmar Gabriel, "German Energy Official Sounds a Warning", *New York Times*, 21 January 2014; and "Germany cautions on impact of renewables", *Financial Times*, 21-22 January 2014; "High energy prices hold Europe back", *Financial Times* editorial, 21-22 January 2014.

21 See "European Commission's proposals on the new climate and energy package 2030 a step backwards for Europe", WWF press release, 22 January 2014, http://www.wwf.gr/news/913-2030 [in Greek]; "New EU climate targets 'weaken renewable energy goals'" and "EU sets out new climate change goals", *Financial Times*, 22-23 January 2014; and "Europe, Facing Economic Pain, May Ease Climate Rules", *New York Times*, 23 January 2014.

22 See "2030 climate and energy goals for a competitive, secure and low-carbon EU economy", European Commission press release, 22 January 2014.

3rd Improved energy efficiency will continue to play an essential role in the transition to a competitive and sustainable energy system, but its role within the time horizon of 2030 "will be analysed in greater detail in a review of the Energy Efficiency Directive to be concluded later in 2014".

The Commission's communication is accompanied by a report on energy prices and costs, which amongst other findings states that: (a) energy prices have increased in almost all Member States since 2008, mainly due to taxes and levies, but also due to higher network costs; (b) a look at energy prices in countries that are EU trading partners, especially gas prices in the United States,[23] shows that increasing energy prices could undermine Europe's competitiveness, especially in energy-consuming industries; (c) energy price increases can be partially offset by the economic yields of efficient energy and climate policies, competitive energy markets and measures to improve energy efficiency, such as the use of more energy efficient products. The report adds that "*European industry's energy efficiency efforts may need to go even further, bearing in mind physical limits, as competitors do the same and the European industry invests abroad to be closer to expanding markets*". Meanwhile, the European Commission adopted a Recommendation aiming to ensure that proper environmental and climate safeguards are in place for "fracking" – the high-volume hydraulic fracturing technique used notably in shale gas operations. It is worth noting that, according to Fatih Birol, chief economist at the International Energy Agency, high energy costs in Europe are not due to EU policies for addressing climate change or renewable energy subsidies, but rather to the high cost of imported energy.[24] Moreover, a Climate Strategies report, based on the findings of leading European research institutions, came to the conclusion that the cost of energy exerts little effect on the competitiveness of the European economy and that Europe must remain in the lead of global efforts for decarbonisation.[25]

Against this background of issues, it is interesting that Chancellor Merkel, in a state of the nation address of her coalition government, confirmed an ambitious plan to increase the use of renewable sources of energy, in order to meet 80% of Germany's energy needs by 2050, compared with the current 25%.[26]

In the United States as well, new impetus to policy on climate change was provided when regulations issued by the federal Environmental Protection Agency (that do not require approval by Congress) essentially put a stop to the construction of new coal-fired power plants and may also force existing ones to cease operating. Moreover, as reported in the press,[27] the US Secretary of State is seeking close cooperation with China on a new global agreement in 2015, in which the United States and other countries would commit to historic reductions in greenhouse gas emissions. In 2013, China had been in the spotlight on account of the acute smog problem in its cities caused by high levels of greenhouse gas emissions and the extensive use of coal for power generation.[28] President Obama, in his State of the Union address on 28 January 2014, stressed that the safe extraction of natural gas had brought the US closer to energy independence, opening the way for an expansion of solar energy use.[29]

23 The decrease in energy costs in the United States reflects, amongst other factors, increasing use of shale gas, which however seems to have led to increased carbon exports and thereby to an "outsourcing" of greenhouse gas emissions to other regions of the planet. On this issue and the prospects of Europe proceeding to an economically profitable extraction and use of shale gas, see (a) Daniel Yergin, "The Global Impact of US Shale", Project Syndicate, 8 January 2014, (b) Florence Gény, *Can Unconventional Gas be a Game Changer in European Gas Markets?*, Oxford Institute for Energy Studies, December 2010, and (c) G. Paleologou, "Europe's energy treasure is dividing", *Kathimerini*, 9 February 2014 [in Greek].

24 "Energy price gap with the US to hurt Europe for 'at least 20 years'", *Financial Times*, 30 January 2014.

25 See Climate Strategies, *Staying with the Leaders: Europe's Path to a Successful Low-Carbon Economy*, 6 February 2014, and "Claims of high EU energy prices 'overblown'", *Financial Times*, 7 February 2014.

26 "Chancellor Merkel delivers State of the Nation", *Deutsche Welle*, 29 January 2014.

27 "Kerry Quietly Makes Priority of Climate Pact", *New York Times*, 2 January 2014.

28 See Thomas Friedman, "Too Big to Breathe?", *New York Times*, 5 November 2013; "China's Dirty Air" (editorial), *New York Times*, 7 November 2013; "A year in a word: Airpocalypse – China is getting airy ambitions", *Financial Times*, 31 December 2013.

29 President Barack Obama, "State of the Union Address", 28 January 2014.

Table VIII.1 Greenhouse gas emissions[1] and the Kyoto Protocol targets

	2011 data							Provisional estimates 2012	
	1990	Kyoto Protocol (base year)[2]	2011	Change 2011 over 2010	Change 2011 over 1990	Change 2011 over base year	Kyoto targets 2008-2012	Change 2012 over 2011	Change 2012 over 1990
Country	(in million tonnes of CO_2 equivalents)			(percentage changes)				(percentage changes)	
Austria	78.2	79.0	82.8	-2.6	6.0	4.8	-13.0	-3.0	2.8
Belgium	143.1	145.7	120.2	-8.8	-16.0	-17.5	-7.5	-2.3	-18.0
Denmark	68.7	69.3	56.2	-8.1	-18.1	-18.9	-21.0	-7.0	-23.9
Finland	70.4	71.0	67.0	-10.1	-4.9	-5.6	0.0	-7.6	-12.1
France	556.4	563.9	485.5	-5.6	-12.7	-13.9	0.0	0.7	-12.1
Germany	1,250.3	1,232.4	916.5	-2.9	-26.7	-25.6	-21.0	1.4	-25.7
Greece	*104.6*	*107.0*	*115.0*	*-1.9*	*10.0*	*7.5*	*25.0*	*1.2*	*11.3*
Ireland	55.2	55.6	57.5	-6.5	4.1	3.4	13.0	0.4	4.5
Italy	519.0	516.9	488.8	-2.3	-5.8	-5.4	-6.5	-5.0	-10.5
Luxembourg	12.9	13.2	12.1	-1.3	-6.2	-8.1	-28.0	-3.1	-9.1
Netherlands	211.8	213.0	194.4	-7.1	-8.2	-8.8	-6.0	0.4	-7.9
Portugal	61.0	60.1	70.0	-2.0	14.8	16.4	27.0	-0.2	14.5
Spain	282.8	289.8	350.5	0.5	23.9	21.0	15.0	0.9	22.8
Sweden	72.8	72.2	61.4	-6.2	-15.5	-14.8	4.0	3.9	-18.8
United Kingdom	767.3	776.3	552.6	-7.0	-28.0	-28.8	-12.5	3.1	-25.7
EU-15	**4,254.5**	**4,265.5**	**3,630.7**	**-4.2**	**-14.7**	**-14.9**	**-8.0**	**-0.3**	**-14.9**
EU-27[3]	**5,574.4**	**...**	**4,550.2**	**-3.3**	**-18.4**	**...**	**...**	**-0.9**	**-19.1**

Source: For 2011: European Environment Agency Technical Report no. 8/2013, *Annual European Union greenhouse gas inventory 1990-2011 and inventory report 2013*, 29.5.2013. For 2012: European Environment Agency Technical Report no. 14/2013, *Approximated EU GHG inventory: Early Estimates for 2012*, 30.9.2013.
1 Total emissions excluding land use, land-use change and forestry, as well as emissions from international aviation and shipping.
2 For CO_2, CH_4 and N_2O, all Member States chose 1990 as their base year. For HFC, PFC and SF_6, 12 Member States chose 1995 as their base year, while Austria, France and Italy chose 1990. For Cyprus, Malta and the EU-27, there are no Kyoto Protocol targets or base year data.
3 Provisional estimates for 2012 refer to the EU-28, in view of Croatia's entry into the EU as its 28th member, as from 1.7.2013.

Finally, in Greece, WWF-Greece released an extensive report in September 2013,[30] with a sustainability roadmap for the Greek economy.

2 RECENT DATA ON GREENHOUSE GAS EMISSIONS IN THE EU AND GREECE (2011-2012) AND CHANGES TO THE EMISSIONS TRADING SYSTEM

2.1 LATEST AVAILABLE DATA ON EMISSIONS

In 2011, total greenhouse gas emissions in the EU-27 (excluding land use, land-use change and forestry, as well as emissions from international aviation and shipping) came to 4,550 million tonnes of CO_2-equivalent, 18% less than in 1990. Greenhouse gas emissions in the EU-15 came to 3,631 million tonnes (15% less than in 1990), accounting for 80% of total EU-27 emissions (compared with 76% in 1990). Amongst the older Member States, Germany and the UK were the largest emitters of greenhouse gases in the EU in 2011 (32% of total EU-27 emissions and 40% of EU-15 emissions), followed by France and Italy (13% each). The Member States with the smallest shares were Luxembourg (0.3%), Denmark, Ireland, Sweden and Finland (1% each), with similar shares in total EU-15 emissions (see Table VIII.1).

30 WWF Greece, *A living economy for Greece*.

Table VIII.2 Greenhouse gas emissions by source: EU-27, EU-15 and Greece

(in million tonnes of CO_2 equivalents)

	1990	1995	2000	2005	2006	2007	2008	2009	2010	2011
EU-27										
Energy	4,297	4,029	3,981	4,084	4,080	4,015	3,936	3,659	3,763	3,614
Industrial processes	458	437	390	403	400	412	388	323	335	332
Solvents	17	14	13	12	12	12	11	10	10	10
Agriculture	600	517	505	478	474	475	474	463	460	461
Waste	204	198	177	152	150	146	142	139	137	133
*Total**	*5,574*	*5,195*	*5,066*	*5,129*	*5,117*	*5,059*	*4,952*	*4,593*	*4,705*	*4,550*
EU-15										
Energy	3,282	3,206	3,259	3,348	3,329	3,265	3,200	2,972	3,048	2,898
Industrial processes	353	350	310	311	303	308	292	254	261	253
Solvents	13	12	11	10	10	9	9	8	8	8
Agriculture	434	412	413	385	380	380	379	370	369	370
Waste	172	166	144	119	116	113	109	106	104	102
*Total**	*4,255*	*4,146*	*4,138*	*4,173*	*4,138*	*4,075*	*3,989*	*3,710*	*3,790*	*3,631*
Greece										
Energy	77	81	96	106	105	107	104	100	92	92
Industrial processes	10	12	14	14	12	12	12	10	10	9
Solvents	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	9	10	9	9	9	9
Waste	6	6	6	5	5	5	5	5	5	5
*Total**	*105*	*109*	*126*	*135*	*131*	*134*	*130*	*124*	*117*	*115*

Sources: European Environment Agency, *Annual European Community greenhouse gas inventory 1990-2011 and inventory report 2013*, 29 May 2013; 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 1990-2011*, April 2013.
* Excluding land use, land-use change and forestry, as well as international aviation and shipping.

However, it is worth noting that countries which, owing to their size, account for high shares of total greenhouse gas emissions in fact *rank better in terms of emissions per capita or emissions per unit of GDP.*[31] This most likely reflects better performances as a result of the energy efficiency of power and other industrial plants, energy-saving by households and businesses, energy market deregulation, etc.

Breaking down the emissions of the six main greenhouse gases in the EU-27 in 2011, carbon dioxide (CO_2) accounts for the largest share (82%), followed by methane (CH_4) and nitrous oxide (N_2O) with 9% and 7%, respectively. As regards the trends of these emissions, CO_2 emissions in 2011 came to 3,743 million tonnes (down 15% from 1990), while CH_4 and N_2O came to 389 and 335 tonnes of CO_2-equivalent, 35% and 36%, respectively, less than in 1990. As for the source of the gas emissions (see Table VIII.2), energy-related activities are the major source of greenhouse gases, with 79% in 2011 in the EU-27 (3,614 million tonnes of CO_2-equivalent). Agriculture is the second most important source with a share of 10% (461 million tonnes of CO_2-equivalent), fol-

31 For instance, Luxembourg and Finland account for a small share of emissions (just 0.3% and 2% of total EU-15 emissions), but rank amongst the countries with the highest emissions per capita (23 and 13 tonnes of CO_2-equivalent, respectively) and per unit of GDP (0.45 and 0.40 kg of CO_2-equivalent, respectively). Conversely, Germany and the UK, as mentioned previously, with the largest shares of total emissions, produce 11 and 9 tonnes of CO_2-equivalent per capita and 0.37 and 0.30 kg of CO_2-equivalent per unit of GDP.

lowed by industrial processes and waste, with shares of 7% and 3% (332 and 133 million tonnes of CO_2-equivalent, respectively).

As regards the trends of greenhouse gas emissions vis-à-vis the Kyoto Protocol targets, it is worth noting that most of the EU-15 Member States are on track to meet their national commitments (see Table VIII.1). Amongst the older Member States, eight (including Greece) have already overachieved their Kyoto Protocol targets, while the remaining seven still have some way to go. **The target set for Greece under the Kyoto Protocol was for the increase in greenhouse gas emissions over the period 2008-2012, relative to the base year, to be contained at 25%. Greece's greenhouse gas emissions in 2011 were just 7.5% above 1990 levels (therefore, well on track, a development attributable to some extent to the economic downturn) and in 2012 increased by 1.2%, based on provisional estimates (once again, remaining on track).**

2.2 CHANGES TO THE EMISSIONS TRADING SYSTEM AND THEIR POSSIBLE ECONOMIC IMPACT ON GREEK INDUSTRY

According to EU legislation, the third phase of the Emissions Trading System (ETS), running from 2013 to 2020, provides for a significant increase in the share of allowances to be auctioned. *Auctioning, not free allocation, is now the default method for allocating allowances*, while for those allowances still given away for free, harmonised allocation rules shall apply.

As pointed out in a recent study by Greece's Foundation for Economic and Industrial Research (IOBE),[32] *as from 1 January 2013 the electricity generation companies in most EU Member States are required to purchase all of their CO_2 emission rights. This expenditure constitutes an additional cost that pushes up electricity prices. Depending on the structure of the market, this expenditure may be passed through, in full or in part, to the prices charged by energy suppliers, thereby burdening final electricity consumers (indirect emission costs). The practice followed by the Public Power Corporation, Greece's virtually exclusive power supplier, is to pass the cost of purchased emission rights through to the prices charged to its customers.*

This hurts the competitiveness of firms for which electricity is a significant production cost component, as well as of those competing with third-country firms not burdened with indirect emissions costs. The affected firms are thus exposed to the risk of "carbon leakage", meaning that they may be unable to recover from the deterioration in competitiveness and forced either to cease business or to relocate to countries unburdened with carbon emission restrictions.

According to the IOBE study, the economic impact of higher indirect emission costs on the sectors of Greek industry exposed to the risk of carbon leakage is significant. The manufacturing sectors defined as exposed to the risk of carbon leakage[33] account for 5.9% of value added and 4.1% of employment in domestic manufacturing, while also contributing substantially to the trade balance, since their exports in 2012 came close to €1.5 billion (5.4% of total Greek exports and 14.3% of industrial exports, excluding petroleum products).

In order to estimate the economic impact, the study used three scenarios with different prices for carbon emission rights (€5, €15 and €15/tCO_2). In the scenario with the price of €5/tCO_2 (closest to the one in effect today), the total loss of value added to the economy due to indirect emission costs was estimated at €95 million, while in employment terms the losses came to 1,921 jobs. The higher the price of carbon emission rights, the more the losses increased, reaching as much as €474 million and 9,600 jobs (in the scenario using a carbon emis-

32 IOBE, *Economic impact of the pass-through to electricity prices of the cost of purchasing CO_2 emission rights on the sectors most exposed to the risk of "carbon leakage"*, 23 October 2013. This matter was discussed at a conference on "Competitiveness and Climate Change Policies", organised by the Business Council for Sustainable Development of the Hellenic Federation of Enterprises (SEV-BCSD) on 6 February 2014.

33 These sectors are part of the broader sectors of textiles, paper, chemicals and basic metals, with a 15% share in value added and a 13% share in overall employment in manufacturing.

sion price of €25/tCO_2). These estimates do not explicitly take into account the likelihood of bankruptcy due to higher energy costs. Yet, the risk of bankruptcy is very substantial after a protracted period of recession. Moreover, the study found that, taking into account the multiplier effects stemming from the interconnection between the directly affected sectors and the rest of the economy (indirect impact), together with the impact on demand due to incomes from direct and indirect activity (induced impact), *the total impact on the economy was estimated at over €3.4 billion in terms of value added and at 70,000 jobs in terms of employment.*

This negative impact could largely be avoided with a mechanism that compensates for the indirect emission costs (provided for in Directive 2009/29/EC), while the cost of such a mechanism could be largely offset by tapping foregone tax revenue or in other ways. Similar compensatory mechanisms are already in place in some European countries (e.g. Germany, the UK and Norway). IOBE pointed out in October 2013 that Greece has not yet drafted such a plan. However, on 24 January 2014 it was announced that the Ministry of Environment, Energy and Climate Change, assuming initiatives in the context of European energy and climate policy development, had issued recommendations for **special care to be given to countries facing prolonged economic recession, as well as countries whose geographical position makes them vulnerable to competition** from countries that have not joined the CO_2 emissions trading scheme, "with simultaneous respect, on the part of these countries, to all commitments against climate change and the greenhouse effect". According to a study submitted by the Ministry of Environment, Energy and Climate Change to the European Commission, based on the current prices of emission rights on energy exchanges, the impact of direct and indirect emission costs on the Greek economy for the period 2013-2020 would, as estimated, amount to €380 million (about 0.2% of GDP) and 5,500 jobs lost annually. The study estimates that "*the recent decision of the European Parliament to backload, i.e. postpone, the auction of some 900 million emission allowances in order to drive up their prices would cost Greece as much as €2.2 billion (1.1% of GDP) and 32,700 jobs (...). If, in addition, certain sectors should be excluded from the "carbon leakage" list, the additional cost to Greece would amount to €90-550 million and another 1,200-7,600 jobs.*"[34]

3 RECENT GREEK LEGISLATION AND OTHER MEASURES ON THE ENVIRONMENT, ENERGY AND CLIMATE CHANGE – ENVIRONMENTALLY SUSTAINABLE COMPETITIVENESS

3.1 MAIN LEGISLATIVE AND ADMINISTRATIVE MEASURES

– On 24 July 2013, the restructuring and privatisation plan for the Public Power Corporation (PPC) was adopted by the government (Ministerial Act 15)[35], which provided for the ownership unbundling of the Independent Power Transmission Operator (IPTO) from the PPC by the end of the second quarter of 2014, for the creation of a new vertically integrated, viable and competitive power company (to receive about 30% of the production capacity of PPC) and for the privatisation of PPC. As regards IPTO, the initial plan was amended by draft law "Regulation of matters related to IPTO SA", submitted to Parliament and passed on **6 February 2014**. New Law 4237/2014 states that the ownership unbundling will be carried out by the PPC through (a) the sale and transfer to a private investor still to be selected of 66% of the shares issued by IPTO SA by virtue of a Share Sale and Purchase Agreement to be concluded by the end of the second quarter of 2014 and (b) the acquisition by the Greek State of 34% of the company's shares (statutory minority). As regards the PPC, the law stipulates that the deadline for the completion of the restructuring and privatisation procedures cannot extend beyond the first quarter of 2016.

34 Ministry of Environment, Energy and Climate Change, press release, 24 January 2014 [in Greek].
35 Government Gazette, issue A, 168/24 July 2013.

– On 14 October 2013 the government announced a broadening of eligibility criteria so that more households would be entitled to the heating oil subsidy.

– On 24 October 2013, Law 4203/2013 "Regulation of Renewable Energy Matters and other provisions"[36] was passed by Parliament. This law, inter alia, (a) lays down specific criteria for licence extension for the installation of RES projects, (b) clarifies matters relating to the licencing of major hydroelectric projects and the possibility of installing such projects in forest areas, (c) provides for the conditional change in RES project site, (d) clarifies matters relating to the payment to household consumers of amounts corresponding to the 1% contribution of the pre-VAT sale prices of RES-generated electricity, (e) limits the annual price adjustment of RES-generated electricity, except for photovoltaics, to 25% of the previous year's CPI, and (f) defines criteria for the setting of electricity prices for new photovoltaic projects. Moreover, this is the first time that "interruption contracts" have been provided for and made available by IPTO to high voltage industrial users (e.g. steel, cement and glass plants), in accordance with which energy-consuming industries, in exchange for a discount in electricity rates, agree to limit or even interrupt their consumption, thereby enabling a stabilisation of the power system through a reduction of the power loads, whenever the sufficiency and safety of the power system is at stake. As in other European countries, the financial cost of this arrangement will be borne not by consumers, but by all power generators through a "transitional supply security fee". This law, for the first time, also provides for the installation of photovoltaic stations and small wind generators (up to a total capacity of 50 KW), as well as for a special programme for the rational development of small wind generators.

– On 23 December 2013, in an effort to address the pressing smog problem (suspended particulate matter in the atmosphere), two Ministerial Decisions were issued (one amending the application of "Social Household Rates" for electricity and another one on the eligibility criteria for a special "Solidarity Services Rate"). A Joint Ministerial Decision was also issued regarding "short-term action plans to address atmospheric pollution due to suspended particulate matter". A second Joint Ministerial Decision was issued on 3 January 2014 on the "special subsidy to household electricity consumers as a means to address atmospheric pollution caused by suspended particulate matter".

– On 2 January 2014 the Regulatory Authority for Energy (RAE) announced its decision regarding an increase, as from 1 March 2014, of the special fee for reducing emissions of atmospheric pollutants, if by that date the arrangements for the definitive settlement of the deficit of the Special Account for RES and High Efficiency Cogeneration (of the Greek Electricity Market Operator LAGIE SA) have been enacted and regulated or have not yielded sufficient results.

– On 24 January 2014 the Ministry of Environment, Energy and Climate Change announced that it had submitted a study to the European Commission recommending that special care be taken to ensure that vulnerable countries and sectors can meet the increase in energy costs from the changes in the emissions trading system.

– On 6 February 2014, Law 4237/2014 on IPTO was passed by Parliament (the draft law had been submitted on 20 December 2013).

3.2 THE TAXATION OF HEATING OIL, THE SMOG PROBLEM AND THE ENERGY EFFICIENCY OF BUILDINGS

Last year's *Annual Report*[37], in its reference to the equalisation of the special levy on heating and motor fuels and to the granting of heating subsidies,[38] had mentioned the factors and con-

36 Law 4203/2013 "Arrangement of matters relating to Renewable Energy Sources and other provisions", Government Gazette, issue A, 235/1 November 2013.
37 *Annual Report 2012*, February 2013, pp. 185-186.
38 Article 5 of Law 4092/2012, October 2012.

straints at the heart of this complex matter, as consideration must be given simultaneously to:

– public revenue, under conditions of fiscal adjustment but also of a need to combat fuel adulteration;

– "energy poverty";[39]

– the protection of public health, at immediate and long-term risk from the concentration (above tolerable levels) of suspended particulate matter in the atmosphere (as a result of wood-burning);[40]

– the need to reduce greenhouse gas emissions (by cutting back on the use of oil and firewood, but also of lignite in power generation).

As mentioned previously, the government has already taken useful measures, both to increase the number of heating oil subsidy recipients and to discourage recourse to wood-burning by making electricity not only more affordable for poor households, but also preferable for many more households (not just poor ones) during smog peaks. However, the matter still needs to be reviewed comprehensively and in depth along two axes: changing the energy model as regards the heating of houses and other buildings (in favour of using environment-friendly energy sources) and intensifying efforts to improve the "energy efficiency" of buildings (e.g. by upgrading heat insulation, options encouraged by projects such as "Saving at home").[41] According to a report of the Ministry of Environment, Energy and Climate Change on the first three years of energy inspections of buildings (9 January 2011-9 January 2014),[42] two thirds of the 509,000 energy efficiency certificates issued over this period concerned buildings (mostly apartments) to be rented out. It is worth noting that: (a) both the number and the percentage of certificates issued after a first energy inspection doubled in 2013 relative to 2012 (14.7% of the total, from 7.5%) in order to meet the requirements for participation in the project "Saving at home" and (b) inspection data "*point to the huge potential for energy-saving from the country's building stock*" (as established by the Ministry of Environment, Energy and Climate Change).[43]

3.3 NEW INDICATOR OF ENVIRONMENTALLY SUSTAINABLE COMPETITIVENESS

For the first time, in its latest competitiveness report (*Global Competitiveness Report 2013-2014*, 6 September 2013), the World Economic Forum incorporated a competitiveness indicator adjusted to environmental sustainability, which takes into account "the set of institutions, policies and factors that make a nation remain productive over the longer term while ensuring social and environmental sustainability". It is worth noting that Greece ranked 56th amongst 126 countries on the basis of this adjusted index, while ranking 91st amongst 148 countries on the basis of the Global (non-adjusted) Competitiveness Index.

4 ENERGY SECTOR INVESTMENT

Two were the major developments in the field of energy investment in 2013:

– On 28 June 2013 Azerbaijan chose the Trans Adriatic Pipeline (TAP) for the transportation of natural gas from the Caspian Sea to Europe.

39 See a survey by the Built Environment Physics Laboratory of the University of Athens, summarised in a press article in *To Vima*, 24 November 2013, and http://env.mg.uoa.gr.

40 See Prof. D. Kremastinos, "How dangerous smog from burning firewood really is", *Ta Nea*, 9 January 2014 [in Greek]. Also "Smog from burning wood has turned us into Beijing", *Ta Nea*, 10 January 2014 [in Greek], citing comments from Mr. Gerasopoulos, Research Director at the Institute for Environmental Research and Sustainable Development of the National Observatory of Athens, on an ongoing study for measuring suspended particulate matter in the Athens area, as well as from Prof. K. Katsouyianni at the Medical School of the University of Athens and Prof. P. Behrakis at the Harvard School of Public Health.

41 See also Law 4122/2013, in transposition of Directive 2010/31/EU of the European Parliament and of the Council.

42 Ministry of Environment, Energy and Climate Change press release, 16 January 2014 [in Greek].

43 For the revised terms of the programme that apply to households with an annual family income of €80,000 or less, see http://www.ypeka.gr/Default.aspx? tabid=526&language=el-GR [in Greek]. Low-income households are entitled to a subsidy for 70% of the expenditure and to an interest-free loan for the remaining 30%, while higher-income households are entitled to a subsidy for 15% of the expenditure and to an interest-free loan for the remaining 85%.

The TAP will cross Northern Greece, Albania and the Adriatic Sea, ending in Italy. Greece is expected to reap significant benefits from this decision, in terms of both foreign direct investment and job creation.

– On 21 December 2013, the Hellenic Republic Asset Development Fund (HRADF) and HELLENIC PETROLEUM SA signed an agreement to sell 66% of the shares of the Hellenic Gas Transmission System Operator (DESFA) SA to the State Oil Company of the Azerbaijan Republic (SOCAR). At the same time, a Shareholder Agreement was signed between the Greek State, HRADF and SOCAR on the management of DESFA after the shares are transferred to SOCAR.

The privatisation of the Public Gas Corporation of Greece (DEPA) remains on the agenda of HRADF for 2014.

Meanwhile, as part of the programme for the development of RES, the Ministry of Environment, Energy and Climate Change continued to approve the environmental conditions for the construction and operation of large wind farms. In December 2013 and January 2014 alone, such approvals were issued for 23 wind parks on islands not connected to the national power grid and on the mainland, with a total capacity of 888 MW. As estimated by the Ministry of Environment, Energy and Climate Change, the real economy stands to gain some €1.1 billion from their construction.

Also worth mentioning is the agreement signed on 13 January 2014, by which British Petroleum (BP) acquires the exclusive rights to the output of the Prinos oil field over the next six years.

5 THE WORK OF THE CLIMATE CHANGE IMPACTS STUDY COMMITTEE (CCISC) IN 2013

5.1 PHASE 2 OF THE IMPACTS STUDY

The Climate Change Impacts Study Committee (CCISC) of the Bank of Greece continues its research activities, given that research –on which knowledge and forecasting can later be based– can prove essential in addressing factors that either presently affect or are expected to affect the natural environment in the future.

As shown by studies by the scientific community in Greece and worldwide (see Section 1.1 of this chapter), adaptation to climate change has become crucial to preserving the planet's resources and to ensuring human survival, both now and in the future. This is why the CCISC, after conducting a first study to estimate the environmental, economic and social impacts of climate change in Greece, has currently moved on to Phase 2 of the study which consists in formulating a *national strategy for adaptation to climate change* (NSACC), to be based on in-depth sectoral studies. The study on tourism is nearly complete, while a second sectoral study, focusing on the health impacts of climate change, is currently being planned and mapped out.

5.2 GREEK TOURISM AND CLIMATE CHANGE: ADAPTATION POLICIES AND A NEW GROWTH STRATEGY

Sea level rise, increasing temperature levels and other related phenomena, such as changes in humidity and wind conditions, as well as the possible further loss of water resources, are some of the impacts that climate change is expected to have on tourism, the tourism product and tourism climate indices. In the context of its sectoral study of tourism, the CCISC, together with representatives from tourism business associations and experts in the field, organised a conference on "Greek tourism and climate change: adaptation policies and a new growth strategy", held on 9 July 2013. In attendance were well-renowned scientists, the heads of tourism bodies and organisations, the Secretary General of the Ministry of Tourism and the Secretary General for the Aegean and Island Policy. The actions proposed for the adaptation of tourism to climate change would contribute in a first stage to the recovery of the Greek economy and at a later stage to its sustainable growth, with a substantial positive impact on GDP and employment.

As regards entrepreneurship in the tourism sector, it was underlined that investment initiatives must have a long-term horizon and a global approach. The proposals stressed the need for:

– a development and expansion of the tourism product to include all regions of Greece, as well as all seasons;

– investment initiatives that respect Greece's cultural and environmental heritage; and

– a reduction of the environmental footprint of existing infrastructures.

Highlighting the distinct but complementary roles of the State and private businesses, the proposals regarding the role of the State stressed the need for:

– a channelling of available resources, however limited at present, towards improving infrastructure, so as to contribute to an upgrading of tourism and environmental services;

– an improvement in the sector's business environment;

– coordination of central and local authorities, together with a reinforcement of decentralisation; and

– support of tourism/environmental education at the university level.

Other proposals worthy of note touched upon the need for:

– the co-financing of infrastructure works through public and private sector partnerships;

– the collective participation of businesses in the financing of activities serving to prolong the tourism season;

– a review of the special land use plan for tourism;

– the implementation of an environmental standard system;

– an upgrading in services provided by marinas; and

– the design of new tourism products, with an emphasis on small units and traditional accommodation.

Relevant information has been posted on the website of the Bank of Greece, while the results and recommendations of the conference and the CCISC study will be published in a special volume.

ANNEX

ANNUAL ACCOUNTS FOR THE YEAR 2013

AND AUDITOR'S REPORT

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BALANCE SHEET AS AT 31 DECEMBER 2013
EIGHTY–SIXTH YEAR

(in euro)

ASSETS	31.12.2013	31.12.2012
1. Gold and gold receivables	**4,145,310,521**	**5,984,958,512**
2. Claims on non-euro area residents denominated in foreign currency	**1,059,044,295**	**992,872,970**
2.1 Receivables from the International Monetary Fund (IMF)	889,700,605	925,936,960
2.2 Balances with banks and security investments, external loans and other external assets	169,343,690	66,936,010
3. Claims on euro area residents denominated in foreign currency	**323,744,770**	**343,692,770**
3.1 General government	269,674,472	286,157,016
3.2 Other claims	54,070,298	57,535,754
4. Claims on non-euro area residents denominated in euro	**23,869**	**23,873**
4.1 Balances with banks, security investments and loans	23,869	23,873
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	**63,225,800,000**	**19,346,500,000**
5.1 Main refinancing operations	61,780,800,000	17,401,500,000
5.2 Longer-term refinancing operations	1,385,000,000	1,945,000,000
5.3 Fine-tuning reverse operations	0	0
5.4 Structural reverse operations	0	0
5.5 Marginal lending facility	60,000,000	0
5.6 Credits related to margin calls	0	0
6. Other claims on euro area credit institutions denominated in euro	**9,790,608,293**	**101,850,944,365**
7. Securities of euro area residents denominated in euro	**21,119,431,709**	**20,782,519,037**
7.1 Securities held for monetary policy purposes	6,070,173,067	6,964,976,237
7.2 Other securities of euro area residents denominated in euro	15,049,258,642	13,817,542,800
8. General government long-term debt denominated in euro	**5,657,654,356**	**6,170,409,022**
9. Intra-Eurosystem claims	**1,742,834,574**	**1,813,849,138**
9.1 Participating interest in the ECB	531,289,922	533,636,713
9.2 Claims equivalent to the transfer of foreign reserves to the ECB	1,129,060,170	1,131,910,591
9.3 Net claims related to the allocation of euro banknotes within the Eurosystem	0	0
9.4 Net claims arising from balances of TARGET2 accounts	0	0
9.5 Other claims within the Eurosystem (net)	82,484,482	148,301,834
10. Items in course of settlement	**1,592,003**	**2,341,587**
11. Other assets	**2,428,819,510**	**2,464,824,430**
11.1 Coins	66,350,306	69,373,412
11.2 Tangible and intangible fixed assets	815,306,920	824,757,986
11.3 Other financial assets	29,261,974	29,122,874
11.4 Off-balance-sheet instruments revaluation differences	241,762	137,272
11.5 Accruals and prepaid expenses	647,824,052	684,101,549
11.6 Sundry	869,834,496	857,331,337
TOTAL ASSETS	**109,494,863,900**	**159,752,935,704**

OFF-BALANCE-SHEET ITEMS	31.12.2013	31.12.2012
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	20,844,649,345	19,791,242,415
2. Greek government securities and other debt securities relating to the management and custody of assets of public entities, social security funds and private agents and EFSF securities owned by the Hellenic Financial Stability Fund	16,546,729,134	15,702,881,516
3. Assets eligible as collateral for Eurosystem monetary policy operations and intraday credit	84,630,052,242	25,568,946,751
4. Assets accepted by the Bank of Greece as eligible collateral for emergency liquidity assistance to credit institutions	58,286,098,571	191,524,930,187
5. Other off-balance-sheet items	26,495,148,210	22,694,818,331
TOTAL OFF-BALANCE-SHEET ITEMS	**206,802,677,502**	**275,282,819,200**

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 members of the European System of Central Banks (ESCB).

(in euro)

LIABILITIES	31.12.2013	31.12.2012
1. Banknotes in circulation	**24,640,887,450**	**23,576,814,320**
2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	**1,958,581,341**	**2,168,651,315**
2.1 Current accounts (covering the minimum reserve system)	748,581,341	1,369,351,315
2.2 Deposit facility	1,150,000,000	410,000,0000
2.3 Fixed-term deposits	0	0
2.4 Fine-tuning reverse operations	0	0
2.5 Deposits related to margin calls	60,000,000	389,300,000
3. Other liabilities to euro area credit institutions denominated in euro	**0**	**0**
4. Liabilities to other euro area residents denominated in euro	**7,985,961,670**	**7,188,910,666**
4.1 General government	6,943,160,210	5,721,347,961
4.2 Other liabilities	1,042,801,460	1,467,562,705
5. Liabilities to non-euro area residents denominated in euro	**990,392,122**	**1,008,139,644**
6. Liabilities to euro area residents denominated in foreign currency	**76,581,690**	**32,019,524**
7. Liabilities to non-euro area residents denominated in foreign currency	**2,128**	**2,224**
7.1 Deposits and other liabilities	2,128	2,224
7.2 Liabilities arising from the credit facility under ERM II	0	0
8. Counterpart of special drawing rights allocated by the IMF	**874,914,774**	**911,998,065**
9. Intra-Eurosystem liabilities	**61,955,261,464**	**112,814,781,585**
9.1 Liabilities related to promissory notes backing the issuance of ECB debt certificates	0	0
9.2 Net liabilities related to the allocation of euro banknotes within the Eurosystem	10,839,345,715	14,459,590,040
9.3 Net liabilities arising from balances of TARGET2 accounts	51,115,915,749	98,355,191,545
9.4 Other liabilities within the Eurosystem (net)	0	0
10. Items in course of settlement	**1,799,852**	**3,232,633**
11. Other liabilities	**1,167,521,706**	**769,535,751**
11.1 Off-balance-sheet instruments revaluation differences	1,310	96,926
11.2 Accruals and income collected in advance	32,433,809	116,573,701
11.3 Sundry	1,135,086,587	652,865,124
12. Provisions	**6,651,794,477**	**6,213,496,005**
13. Revaluation accounts	**2,375,664,547**	**4,249,859,880**
14. Capital and reserves	**815,500,679**	**815,494,092**
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	84,500,000
14.4 Special reserve from the revaluation of land and buildings	507,247,856	507,247,856
14.5 Other special reserves	1,266,099	1,259,512
TOTAL LIABILITIES	**109,494,863,900**	**159,752,935,704**

2 The Bank of Greece's Eurosystem key as at 31 December 2013 was 2.80097%.

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.

4 Account balances related to monetary policy operations are disclosed under distinct items.

5 Gold has been valued at the price provided by the ECB as at 31 December 2013: €871.220 per fine oz, compared with €1,261.179 as at 31 December 2012.

6 Claims/liabilities denominated in foreign currency have been converted to euro using the euro foreign exchange reference rates of the ECB as at 31 December 2013.

7 Marketable securities (other than held-to-maturity) are valued at the mid-market prices of 31 December 2013. Marketable securities classified as held-to-maturity and non-marketable securities are valued at amortised cost subject to impairment. In financial year 2013 no impairment losses were incurred.

8 "Other off-balance-sheet items" include the promissory note of €26 billion (SDR 23.3 billion) issued by the Greek government for the total amount of the loan received from the IMF until 31 December 2013.

9 Certain items of the balance sheet and the profit and loss account for the year 2012 have been reclassified to ensure comparability with the respective items of the year 2013.

PROFIT AND LOSS ACCOUNT FOR THE YEAR 2013

(in euro)

	2013	2012
1. Net interest income	**1,386,780,492**	**2,673,764,628**
1.1 Interest income	1,864,134,636	3,827,258,869
1.2 Interest expense	-477,354,144	-1,153,494,241
2. Net result of financial operations, write-downs and risk provisions	**26,806,573**	**66,279,995**
2.1 Realised gains arising from financial operations	26,806,573	66,279,995
2.2 Write-downs on financial assets and positions	-10,077,881	-73,849
2.3 Transfer from provisions for foreign exchange rate, interest rate, credit and gold price risks	10,077,881	73,849
3. Net income from fees and commissions	**70,215,064**	**71,834,689**
3.1 Fees and commissions income	72,870,971	75,723,080
3.2 Fees and commissions expense	-2,655,907	-3,888,391
4. Income from equity shares and participating interests	**54,181,615**	**20,133,200**
5. Net result of pooling of monetary income	**52,200,784**	**148,822,314**
6. Other income	**10,137,298**	**14,600,772**
Total net income	**1,600,321,826**	**2,995,435,598**
7. Staff costs	**-146,748,221**	**-157,870,006**
8. Pension benefit expenses	**-98,370,014**	**-112,234,922**
9. Other administrative expenses	**-37,019,678**	**-40,072,577**
10. Depreciation of tangible and intangible fixed assets	**-13,981,296**	**-13,583,648**
11. Consultancy fees for the auditing of the Banking System	**-4,260,362**	**-10,291,676**
12. Provisions	**-468,793,052**	**-2,342,733,566**
Total expenses	**-769,172,623**	**-2,676,786,395**
PROFIT FOR THE YEAR	**831,149,203**	**318,649,203**

DISTRIBUTION OF PROFIT

(Article 71 of the Statute)

(in euro)

	2013	2012
Dividend to be distributed: €0.49728 per share for 19,864,886 shares (compared to €0.5376 per share in 2012)*	9,878,410	10,679,362
Tax on dividends (tax rate 26%, Article 9, paragraph 30, Law 4110/2013)	3,470,793	2,669,841
To the Government	817,800,000	305,300,000
	831,149,203	**318,649,203**

* *The gross dividend for financial year 2013 amounts to €0.6720 per share. Dividend to be distributed (€0.49728 per share) is subject to withholding tax at a rate of 10% in accordance with Law 4110/2013, Article 6 paragraph 2.*

Athens, 20 January 2014

THE GOVERNOR

GEORGE A. PROVOPOULOS

THE DIRECTOR OF THE ACCOUNTING DEPARTMENT

MARIA MAVRIDOU

To the Shareholders of BANK OF GREECE S.A.
(Translated from the original in Greek)

Report on the Financial Statements

We have audited the accompanying financial statements of the BANK OF GREECE A.E. (the "Bank") which comprise the balance sheet as of 31 December 2013 and the statement of income, the appropriation account 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 the accounting standards prescribed by Greek Law, where the Guideline of the ECB does not provide specific direction, as well as, for such internal control as management determines is 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 on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank of Greece as at 31 December 2013 and of its financial performance for the year then ended in accordance with the accounting principles prescribed by the ECB as adopted by the Bank in Article 54A of its Statute and the accounting standards prescribed by Greek Law, where the Guideline of the ECB does not provide specific direction.

Report on Other Legal and Regulatory Requirements

We verified that the contents of the Report of the Governor relating to the statement of income for 2013 are consistent and corresponds with the accompanying financial statements within the scope set by Articles 37 and 43A of C.L. 2190/1920.

Athens, 20 January 2014

KPMG Certified Auditors A.E.
SOEL Reg. No 114

Marios T. Kyriacou Certified Auditor Accountant SOEL Reg. No 11121	Nikolaos Vouniseas Certified Auditor Accountant SOEL Reg. No 18701

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 to the European System of Central Banks, as set out by the European Central Bank (ECB) in its Guideline ECB/2010/20 of 11 November 2010, as amended by Guidelines ECB/2011/27 of 21 December 2011 and ECB/2012/29 of 10 December 2012.

These rules and practices are based on internationally accepted accounting standards and 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 Codified 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. 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 are approved, if such events affect the condition of assets or liabilities at 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 the 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 the trade date.

– On settlement/value date, the off-balance-sheet booking entries are reversed, and the transactions are booked on balance sheet accounts.

– Applying 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.

– Accrued interest, premiums and discounts related to financial instruments denominated in foreign currency are calculated and recorded daily, and the foreign currency position is also affected daily.

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 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 at 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 securities, other than those classified as held-to-maturity, are valued at the mid-market prices prevailing on the balance sheet date, on a security-by-security basis, using the ISIN code as the security identifier; for the year ending on 31 December 2013, mid-market prices of 31 December 2013 were used.

• Marketable securities classified as held-to-maturity and non-marketable securities are valued at amortised cost subject to impairment.

• Securities classified as held-to-maturity for monetary policy purposes are valued at amortised cost and are subject to impairment tests, which are harmonised across the Eurosystem.

Income recognition

• Realised gains and losses arising from the sale of foreign currency, gold and securities are taken to the Profit and Loss Account. Such realised gains and losses are calculated by reference to the average cost of the respective asset on the date 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 on any one security or currency or on gold holdings are not netted against unrealised gains on other securities or currencies or gold. The average cost of a financial asset giving rise to an unrealised loss at year-end is adjusted to the year-end exchange rate or market price.

• Premiums or discounts arising on purchased securities are calculated and presented as part of interest income and are amortised over the remaining life of the securities.

• Impairment losses are taken to the Profit and Loss Account and are not reversed in subsequent years unless the impairment decreases and the decrease can be related to an observable event that occurred after the impairment was first recorded.

Off-balance-sheet instruments

Foreign exchange forward transactions, forward legs of foreign exchange swaps and other currency transactions involving an exchange of one currency for another at a future date are included in the net foreign currency positions for the purpose of calculating average purchase costs and foreign exchange gains and losses.

Banknotes in circulation

The ECB and the 17 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 key.[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 according to their Eurosystem key. The share of banknotes in circulation that has been allocated to the Bank of Greece is disclosed under 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".[3] These interest-bearing claims or liabilities are disclosed under the sub-item "Net claims/liabilities related to the allocation of euro banknotes within the Eurosystem".

For the year of the euro cash changeover and the following five years, intra-Eurosystem balances arising from the allocation of euro banknotes are adjusted in order to avoid significant changes in the monetary income of NCBs relative to previous years.

The amounts of these adjustments were calculated by taking into account the differences between the average value of banknotes in circulation of each NCB during the reference period (referring to the 24-month period beginning 30 months before the adoption of the single currency by the relevant Member State) and the average value of banknotes that would have been allocated to it during the same period according to the ECB 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. This year, adjustments arise from the entry of the NCBs of Cyprus and Malta (1 January 2008), Slovakia (1 January 2009) and Estonia (1 January 2011).

1 Decision of the ECB of 13 December 2010 on the issue of euro banknotes (recast) (ECB/2010/29), OJ L 35, 9.2.2011, p. 26, as amended.
2 "Banknote allocation key" means the percentages that result from taking into account the ECB's share (8%) in the total euro banknote issue and applying the subscribed capital key to the NCBs' share in that total.
3 Decision of the ECB 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 L 35, 9.2.2011, p. 17, as amended.

Interest income and interest expenses on these claims/liabilities are cleared through the accounts of the ECB and are disclosed in the Profit and Loss Account of each NCB of the Eurosystem under "Net interest income".

ECB profit distribution

The Governing Council of the ECB has decided that the income from its share (8%) of the total euro banknote issue and the net income from securities purchased under the Securities Markets Programme (SMP) is due in full to the NCBs in the financial year it accrues. The ECB will distribute this income to the NCBs in January of the following year in the form of an interim profit distribution.[4] This income will be distributed in full to the NCBs, unless the ECB's net profit for the year is lower than the income from such sources, and subject to any decisions by the Governing Council to make transfers to the ECB's provision for foreign exchange rate, interest rate, credit and gold price risks. The Governing Council may also decide to charge the costs incurred by the ECB in connection with the issue and handling of euro banknotes against income earned on euro banknotes in circulation.

The amounts distributed to NCBs are disclosed in the Profit and Loss Account under "income from equity shares and participating interests".

Post-balance-sheet events

Assets and liabilities are, in principle, adjusted for events that occurred between the annual balance sheet date and the date on which the balance sheet was approved by the General Meeting of Shareholders, if such events materially affect the condition of assets and liabilities at the balance sheet date, and, if necessary, provisions are formed out of the results of the financial year.

Post-balance-sheet events that do not affect the condition of assets and liabilities on the balance sheet date are only disclosed in the notes.

Intra-ESCB balances/intra-Eurosystem balances

Intra-ESCB balances result from cross-border payments between EU central banks (for the most part initiated by private entities). 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 and then assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis the ECB only. TARGET2-related intra-Eurosystem balances of the Bank of Greece vis-à-vis the ECB denominated in euro are presented on the balance sheet as a single net asset or liability position and disclosed under "Net claims/liabilities arising from balances of TARGET2 accounts".

Intra-ESCB balances of non-euro area NCBs that result from payments not effected through the TARGET2 system are disclosed either as "Claims on non-euro area residents denominated in euro" or as "Liabilities to non-euro area residents denominated in euro".

4 Decision of the ECB 25 November 2010 on the interim distribution of the income on euro banknotes in circulation and arising from securities purchased under the Securities Markets Programme (recast) (ECB/2010/24), OJ L 6, 11.1.2011, p. 35, as amended.
5 TARGET2: Trans-European Automated Real-time Gross settlement Express Transfer system.

Various other intra-Eurosystem euro-denominated balances (such as the interim distribution of ECB profits and the redistribution of monetary income) are recorded on the balance sheet of the Bank of Greece as a single net asset or liability position under "Other claims within the Eurosystem (net)"or "Other liabilities within the Eurosystem (net)".

Intra-Eurosystem claims arising from the participation of the Bank of Greece in the capital, reserves and provisions of the ECB are disclosed under "Participating interest in the ECB".

Intra-Eurosystem balances arising from the allocation of euro banknotes in circulation among NCBs are included as a single net asset or liability position under "Net claims related to the allocation of euro banknotes within the Eurosystem" or "Net liabilities related to the allocation of euro banknotes within the Eurosystem".

Intra-Eurosystem balances arising from the transfer of foreign reserve assets to the ECB by the NCBs joining the Eurosystem are denominated in euro and reported under "Claims equivalent to the transfer of foreign reserves to the ECB".

NOTES ON THE BALANCE SHEET

ASSETS

1. Gold and gold receivables

Gold and gold receivables	31.12.2013	31.12.2012	Change
Volume in fine troy ounces (thousands)	4,758.0	4,746.0	12.0
Volume in tonnes	148.0	147.6	0.4
Value (€ million)	4,145.3	5,985.0	-1,839.7

The amounts reported above comprise the Bank's gold holdings (3,606 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 non-international standard gold and gold coins (166 thousand ounces). A large part of gold holdings is kept with banks abroad.

Gold and gold receivables increased slightly (by 12 thousand ounces) against the previous financial year, reflecting higher holdings of gold sovereigns (up by 9 thousand ounces) and non-international standard gold and gold coins (up by 3 thousand ounces), while the €1,839.7 million decrease in their euro-denominated value is attributable to the significant decline in the price of gold in 2013.

The valuation result of gold (value as at 31 December 2013, compared with the average acquisition cost) came to €2,359.4 million and is disclosed under liability item 13 "Revaluation accounts". This amount constitutes unrealised profit and serves as a buffer against any losses from gold price movements.

Gold has been valued at its euro price per fine troy ounce as at year-end. This price is in line with the ECB reference exchange rates and derived from the USD price of gold quoted on the London market at year-end and the euro/USD exchange rate on the same date. On 31 December 2013, the price of gold was €871.220 per fine ounce, compared with €1,261.179 on 31 December 2012.

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 foreign 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.

Receivables from the IMF *(in millions)*	31.12.2013 *SDR*	*Euro*	31.12.2012 *SDR*	*Euro*	Change *SDR*	*Euro*
SDR holdings	554.7	620.3	553.5	645.2	1.2	-24.9
SDR component of Greece's quota in the IMF	240.9	269.4	240.8	280.7	0.1	-11.3
Total	**795.6**	**889.7**	**794.3**	**925.9**	**1.3**	**-36.2**

- **SDR holdings**

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.

The SDR holdings are used for the payment of commissions, interest, various expenses and other liabilities arising from IMF loan payments to Greece under the IMF/EU support mechanism for Greece. 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.

- **Greece's SDR quota in the IMF**

The Bank of Greece has lent the Greek State in order to fulfil its quota in the IMF and manages the relevant claims. The euro component of Greece's quota in the IMF (€961.9 million) is reported under liability item 5 "Liabilities to non-euro area residents denominated in euro". Greece's total quota came to 1,101.8 million SDR on 31 December 2013.

The decline in the euro equivalent of these claims was due to end-of-year adjustments because of the appreciation of the euro vis-à-vis the SDR. Valuation was based on the SDR/euro exchange rate as at 31 December 2013, as quoted in the Bulletin of the ECB euro foreign exchange reference rates, i.e. 1 SDR = €1.1183, compared with €1.1657 as at 31 December 2012.

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, balances on correspondent accounts abroad, Treasury bills and foreign banknotes held in the Bank's vaults.

Categories of claims	31.12.2013	31.12.2012 *(in € millions)*	Change
Time deposits with banks abroad	114.4	23.2	91.2
Current account balances with correspondents abroad	18.3	8.6	9.7

Marketable securities (bonds, Treasury bills)	16.5	11.6	4.9
Cash holdings of foreign currency	20.1	23.5	-3.4
Total	**169.3**	**66.9**	**102.4**

The largest part of these assets as at 31 December 2013 was denominated in US dollars.

3. Claims on euro area residents denominated in foreign currency

This item includes claims on general government that stem from long-term loans and time deposits with correspondent banks abroad.

3.1 General government

These claims include:

– loans in SDRs granted by the Bank of Greece to the Greek State to finance the SDR component of its quota in the IMF;

– loans in USD and a gold-linked loan to the Greek State to finance its participation in international organisations.

These claims amounted to €269.7 million on 31 December 2013, against €286.2 million on 31 December 2012. The decrease is mainly due to end-of-year adjustments because of fluctuations in exchange rates and the price of gold in 2013 (the euro appreciated vis-à-vis the SDR and the US dollar and the price of gold decreased).

3.2 Other claims

The balance as at 31 December 2013 includes foreign currency-denominated time deposits with euro area correspondents, which came to €54.1 million on 31 December 2013, compared with €57.5 million on 31 December 2012.

4. Claims on non-euro area residents denominated in euro

4.1 Balances with banks, security investments and loans

This item comprises interest-bearing current account balances with banks abroad (outstanding balance as at 31 December 2013: €24 thousand).

5. Lending to euro area credit institutions related to monetary policy operations denominated in euro

This item consists of outstanding balances of loans granted by the Bank of Greece to domestic credit institutions, in the context of the single monetary policy in the euro area countries.

Categories of operations	31.12.2013 (in € millions)	31.12.2012	Change
Main refinancing operations (MROs)	61,780.8	17,401.5	44,379.3

Longer-term refinancing operations (LTROs)	1,385.0	1,945.0	-560.0
Marginal lending facility	60.0	0	60.0
Total	**63,225.8**	**19,346.5**	**43,879.3**

Liquidity is provided to counterparties via refinancing operations (main and longer-term) and under the marginal lending facility against adequate collateral in the form of marketable and non-marketable assets that meet the Eurosystem's collateral eligibility criteria.

It should be noted that, under Article 32.4 of the Statute of the ESCB and of the ECB, the income and losses that arise from Eurosystem monetary policy operations are allocated to the NCBs according to their respective Eurosystem keys.

Losses can only materialise if both the counterparty fails and the proceeds from the realisation of the collateral provided by the counterparty are not sufficient. When specific assets are not eligible as Eurosystem collateral but are accepted as eligible collateral by an NCB, the risk is borne by the NCB accepting the collateral concerned and is not shared among the Eurosystem.

In particular, the following must also be noted:

5.1 Main refinancing operations
The main refinancing operations are executed through reverse liquidity-providing transactions with a maturity of one week, usually through regular weekly tenders. These operations play a key role in achieving the objectives of the monetary policy pursued. Since October 2008, these operations have been conducted as fixed rate tenders with full allotment.

5.2 Longer-term refinancing operations
These operations aim to provide counterparties with additional longer-term refinancing. They are executed as reverse transactions with a maturity of one reserve maintenance period (up to 35 days), but also with maturities of 3, 6, 12 and 36 months. Since October 2008, they have been conducted as fixed rate tenders with full allotment. The outstanding amount of these operations as at 31 December 2013 mainly resulted from operations with a maturity of 36 months.

5.5 Marginal lending facility
Through these operations, NCBs provide overnight liquidity to the counterparties at a pre-specified interest rate against eligible collateral.

6. Other claims on euro area credit institutions denominated in euro

In addition to current account balances with correspondent banks abroad, this item includes, as from 18 April 2012, ELA (Emergency Liquidity Assistance) operations, following an agreement between the ECB and the Eurosystem NCBs that conduct ELA operations, in the context of the harmonisation of their financial statements at Eurosystem level.

These operations provide emergency liquidity to solvent domestic credit institutions facing temporary liquidity problems. They are not part of the single monetary policy of the Eurosystem, but are conducted by NCBs on the basis of the applicable institutional framework of the Eurosystem with the approval of the European Central Bank.

Liquidity provided through these operations amounted to €9.8 billion on 31 December 2013, compared with €101.8 billion on 31 December 2012, having declined significantly by €92 billion. This decrease came as a result of both the normalisation of financial conditions and credit institutions' renewed access to Eurosystem credit operations and to international money market funding.

For ELA operations providing Emergency Liquidity Assistance (ELA) to credit institutions facing temporary liquidity problems the Bank of Greece receives adequate collateral. Also, the Greek State provides a direct guarantee to the Bank.

The Bank of Greece assumes the costs and risks arising from ELA operations.

7. Securities of euro area residents denominated in euro

7.1 Securities held for monetary policy purposes

Categories of securities	31.12.2013	31.12.2012	Change
	(in € millions)		
Covered Bond Purchase Programme – CBPP1	1,193.3	1,346.9	-153.6
Securities Markets Programme – SMP	4,876.9	5,618.1	-741.2
Total	**6,070.2**	**6,965.0**	**-894.8**

– Securities purchased under the Covered Bond Purchase Programme – CBPP1[6]

These are euro-denominated covered bonds, issued by euro area banks and firms, with maturities of up to 12 years, which have been purchased by the Bank of Greece.

This programme expired on 30 June 2010. The Eurosystem holdings of covered bonds as at 31 December 2013 amounted to €41.6 billion.

On 3 November 2011 the ECB decided to launch a second Covered Bond Purchase Programme (CBPP2),[7] in which the Bank of Greece did not take part.

– Securities purchased under the Securities Markets Programme (SMP)[8]

The Eurosystem's Securities Markets Programme (SMP) came into effect in May 2010. Under this programme, the ECB and the NCBs were able to purchase euro area public and private securities to address malfunctions in certain sectors of the euro area securities market and restore the smooth operation of the monetary policy transmission mechanism in euro area countries. In September 2012, the ECB Governing Council decided to discontinue this programme.

Under this programme the Eurosystem NCBs and the ECB purchased bonds worth €178.8 billion by 31 December 2013. The purchases involved euro area government bonds.

6 Decision of the ECB of 2 July 2009 on the implementation of the covered bond purchase programme (ECB/2009/16), OJ L 175, 4 July 2009, p. 18.
7 Decision of the ECB of 3 November 2011 on the implementation of the second covered bond purchase programme (ECB/2011/17), EE L 297, 16 November 2011, p. 70.
8 Decision of the ECB of 14 May 2010 establishing a Securities Markets Programme (ECB/2010/5), OJ L 124, 20 May 2010, p. 8.

According to Article 32.4 of the Statute of the ECB, any losses arising from holdings in the context of the SMP programme, if realised, will be allocated in full to the NCBs of the Eurosystem, according to their Eurosystem key.

The Governing Council of the ECB assesses, on a regular basis, the financial risks associated with securities purchased under the Securities Markets Programme (SMP) and the two covered bond purchase programmes (CBPP1 and CBPP2).

Securities purchased under the SMP and the CBPP1 are held to maturity and valued at amortised cost subject to impairment.

During the test carried out at end-2013 at Eurosystem level, the Governing Council of the ECB identified one impairment indicator relating to holdings of Irish government bonds. This occurred in February 2013 as a result of the restructuring of Ireland's public debt through the exchange of promissory notes with long-term government bonds. The ECB Governing Council considered that the occurrence of this impairment indicator did not warrant an impairment of the SMP portfolio since, on the basis of information available as at 31 December 2013, there was no evidence of changes in the estimated future cash flows. No impairment losses were therefore recorded at end-2013 on the Bank of Greece's holdings of Irish or other securities under the SMP.

7.2 Other securities of euro area residents denominated in euro

This item includes euro-denominated bonds and Treasury bills issued by euro area governments, including the Greek State. These portfolios are part of the Bank's own fund investment.

Categories of securities	**31.12.2013**	**31.12.2012**	**Change**
	(in € millions)		
A′ Marketable securities issued by euro area governments (other than those classified as held-to-maturity)			
Euro area securities, other than Greek government securities			
Bonds	1,256.1	640.9	615.2
Treasury bills	3,312.8	3,746.9	-434.1
Greek government securities			
Treasury bills	585.9	0	585.9
Total A′	**5,154.8**	**4,387.8**	**767.0**
B′ Marketable securities classified as held-to-maturity			
Greek government bonds	3,553.1	3,807.1	-254.0
Bonds issued by other euro area governments	6,341.4	5,622.6	718.8
Total B′	**9,894.5**	**9,429.7**	**464.8**
Grand total	**15,049.3**	**13,817.5**	**1,231.8**

As shown in the table, the major part of the Bank's investment portfolios consists of securities held to maturity (Total B).

These are valued at amortised cost and are subject to impairment. The impairment test carried out at end-2013 showed no evidence of impairment.

The remaining securities (Total A) were valued at the mid-market prices prevailing on 31 December 2013. Gains were taken to revaluation accounts, and losses (€6.3 million) 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 granted by the Bank of Greece to the Greek State. Specifically, it consists of:

– interest-bearing loans granted to the Greek State until 31 December 1993;

– interest-bearing loans granted 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 granted by the Bank to the Greek State for the purpose of financing the euro component of Greece's quota in the IMF. The part of this quota which is deposited by the IMF with the Bank is disclosed under liability item 5 "Liabilities to non-euro area residents denominated in euro".

Outstanding balance as at 31.12.2013	€5,657.7 million
Outstanding balance as at 31.12.2012	€6,170.4 million
Decrease	€512.7 million

The decrease stems from the gradual repayment of interest-bearing loans.

9. Intra-Eurosystem claims

9.1 Participating interest in the ECB

The table below shows the items related to the Bank's participation in the ECB's capital, reserves and provisions.

As at 31.12.2013	***(%)***	***(in € millions)***	
ECB's subscribed capital (applying to all 28 EU Member States)		**10,825.0**	
Bank of Greece's key for subscription to the ECB's capital (capital key)	1.9483		
ECB capital paid up by the 17 Eurosystem NCBs		**7,529.7**	
Eurosystem key	2.80097		
Bank of Greece's share in the capital of the ECB			210.9

Bank of Greece's contribution to the ECB's reserves and provisions	320.4
Total participating interest in the ECB as at 31.12.2013	**531.3**

Pursuant to Article 28 of the Statute of the European System of Central Banks (ESCB) and of the ECB, the national central banks of the ESCB are the sole subscribers to and holders of the capital of the ECB.

Subscription to the ECB 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).

The participation of the Bank of Greece in the ECB's capital is €210.9 million and has been paid up in full. It corresponds to 2.80097% (Eurosystem key) of the ECB capital paid up by the 17 NCBs of the Eurosystem, which, following the adjustments made in 2013, stands at €7,529.7 million.

The remaining amount (€320.4 million) relates to the Bank's contribution to the ECB's reserves and equivalent provisions.

Pursuant to Article 29.3 of the Statute of the ESCB, the weightings of the NCBs' keys for subscription to the ECB's capital are adjusted every five years after the establishment of the ESCB (latest adjustment: 2009). Also, according to Article 49.3 of the ESCB Statute, the subscribed capital of the ECB is automatically increased whenever a new Member State accedes to the EU and its respective NCB joins the ESCB. The increase is determined by multiplying the prevailing amount of the subscribed capital by the ratio, within the expanded capital key, between the weighting of the entering NCB and the weighting of those NCBs that are already members of the ESCB.

On 1 July 2013, when Croatia joined the European Union as a new Member State, the ECB's subscribed capital increased from €10,760.7 million to €10,825.0 million. The Bank of Greece's key for subscription to that capital came to 1.9483% from 1.9649%, thereby reducing the Bank's share in the ECB's capital, reserves and provisions from €211.4 million to €210.9 million and from €322.2 million to €320.4 million, respectively.

It should be noted that, as from 1 January 2014, due to the five-yearly adjustment of the weightings of NCBs' key for capital subscription and the entry of Latvia into the Eurosystem, the Bank of Greece's key for subscription to the capital of the ECB came to 2.0332% and its Eurosystem key came to 2.90547%.

9.2 Claims equivalent to the transfer of foreign reserves to the ECB

As at 31.12.2013	***(%)***	***(in € millions)***
Total foreign reserves transferred to the ECB by the 17 NCBs of the Eurosystem		40,309.6
Eurosystem key of the Bank of Greece	2.80097	

Claims equivalent to the transfer of foreign reserves to the ECB as at 31.12.2013	1,129.1

These claims stem from the transfer of foreign reserve assets to the ECB, in accordance with the provisions of the Treaty establishing the European Community (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 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]

The adjustments to the keys for subscription to the capital of the ECB on 1 July 2013 led to the adjustment of the Bank of Greece's claim from the transfer of foreign reserve assets to the ECB. Because of the decrease in its capital key, the Bank of Greece's claim declined by €2.8 million (from €1,131.9 million to €1,129.1 million).

9.3 Net claims related to the allocation of euro banknotes within the Eurosystem

On 31 December 2013, the net balance of the allocation of euro banknotes in circulation within the Eurosystem represented a liability of the Bank of Greece and is therefore disclosed under liability item 9.2 "Net liabilities related to the allocation of euro banknotes within the Eurosystem".

9.4 Net claims arising from balances of TARGET2 accounts

On 31 December 2013, the net balance related to the ESCB balance (TARGET2) was negative for the Bank of Greece and therefore disclosed under liability item 9.3 "Net liabilities arising from balances of TARGET2 accounts".

9.5 Other claims within the Eurosystem (net)

Other claims within the Eurosystem (€82.5 million) stemmed from the following:

– From the Bank of Greece's net result from the allocation of the Eurosystem's monetary income for 2013[10] (€43.8). The monetary income pooled by the Bank of Greece was lower than its share according to its Eurosystem key, namely:

Monetary income pooled by the Bank of Greece	€424.0 million
Monetary income allocated to the Bank according to its Eurosystem key ...	€467.8 million
Positive net result	€43.8 million

– From €356 thousand received by the Bank due to adjustments made to the reallocation of monetary income for the previous years.

9 Guideline of the ECB of 3 November 1998 as amended by the Guideline of 16 November 2000 on the composition, valuation and modalities for the initial transfer of foreign-reserve assets, and the denomination and remuneration of equivalent claims (ECB/2000/15), OJ L 336, 30.12.2000, p. 114.

10 The amount of monetary income to be allocated to the Bank of Greece has been calculated on the basis of the latest available provisional ECB data as at the date of preparation of this balance sheet and its approval by the General Council of the Bank.

– From €38.4 million received by the Bank from the ECB interim profit distribution for 2013.

10. Items in course of settlement

The outstanding balance of €1.6 million concerning items in course of settlement on 31 December 2013 relates to unsettled cheques in circulation and interim account balances under settlement.

11. Other assets

11.1 Coins

This item represents the value of coins issued by the 17 euro area countries and held by the Bank of Greece.

Value of coins as at 31.12.2013	€66.4 million
Value of coins as at 31.12.2012	€69.4 million
Decrease	€3.0 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, and are valued at acquisition cost adjusted for depreciation and impairment.

The value of fixed assets as at 31 December 2013, less accumulated depreciation, is reported.

Depreciation is calculated on a straight-line basis over the expected useful life of the asset.

Net book value of fixed assets

Asset category:	31.12.2013	31.12.2012	Change	Depreciation rate (%)
		(in € millions)		
Land	542.3	542.3	0	0
Buildings and fixtures	231.7	235.2	-3.5	2.5
Buildings under construction and advance payments of asset acquisitions	16.0	17.4	-1.4	0
Other equipment	23.8	29.2	-5.4	8-24
Capitalised expenses (software costs, etc.)	1.5	0.7	0.8	20-24
Total	**815.3**	**824.8**	**-9.5**	

11.3 Other financial assets

This item includes the Bank's participating interests in DIAS Interbanking Systems SA, the Hellenic Deposit and Investment Guarantee Fund (HDIGF), the Hellenic Exchanges Holding SA, Clearing, Settlement and Registry SWIFT, as well as the Bank for International Settlements (BIS) denominated in SDRs.

These assets are valued at acquisition cost, and their value was €29.3 million as at 31 December 2013.

11.4 Off-balance-sheet instruments revaluation differences

Outstanding balance as at 31.12.2013	€242 thousand

This item represents the result of the year-end revaluation of outstanding balances in foreign currencies recorded in off-balance-sheet (memorandum) accounts.

It comprises unrealised gains amounting to €242 thousand, stemming from the valuation of Greek State securities (warrants), and recorded in revaluation accounts. They are disclosed in off-balance-sheet accounts at par value.

11.5 Accruals and prepaid expenses

This item includes purchased accrued interest on securities and also interest and other income accrued but not collected until 31 December 2013. The latter are to be collected in the next financial year and relate mainly to interest income on loans granted by the Bank in the context of the single monetary policy of the Eurosystem, 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.

Outstanding balance as at 31.12.2013	€647.8 million
Outstanding balance as at 31.12.2012	€675.8 million
Decrease	€36.3 million

11.6 Sundry

This item consists of inventories of the Printing Works Department (IETA), balances on the Bank's suspense debit accounts, the outstanding balances of loans to the Bank's staff, as well as the assets from the former main and supplementary pension funds of its staff.

Outstanding balance as at 31.12.2013	€869.8 million
Outstanding balance as at 31.12.2012	€857.3 million
Increase	€12.5 million

LIABILITIES

1. Banknotes in circulation

Outstanding balance as at 31.12.2013	€24,640.9 million
Outstanding balance as at 31.12.2012	€23,576.8 million
Increase	€1,064.1 million

This item consists of the Bank's share of the total euro banknotes in circulation at Eurosystem level, calculated on the basis of its banknote allocation key (2.5770%). The change resulted from the rise in total euro banknotes in circulation, both inside and outside the euro area, to €956.2 billion as at 31 December 2013, compared with €912.6 billion as at 31 December 2012 (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 €23.1 billion in 2013, from €22.8 billion in 2012.

	31.12.2013	31.12.2012	Change
	(in € millions)		
Value of euro banknotes put into circulation by the Bank of Greece	35,480.2	38,036.4	-2,556.2
Less:			
Liability resulting from the ECB's share in the total euro banknotes in circulation (8% of the total value of euro banknotes in circulation multiplied by the Eurosystem key) [11]	-2,142.6	-2,050.2	-92.4
Less:			
Liability resulting from the allocation within the Eurosystem of euro banknotes in circulation[11]	-8,696.7	-12,409.4	3,712.7
Value of euro banknotes put into circulation by the Bank of Greece according to the banknote allocation key	**24,640.9**	**23,576.8**	**1,064.1**

As shown in the table, the value of euro banknotes put into circulation by the Bank of Greece decreased by €2,556.2 million due to the continuing trend of return of banknotes withdrawn from the banking system mainly in 2011 and the first half of 2012.

2. Liabilities to euro area credit institutions related to monetary policy operations denominated in euro

2.1 Current accounts (covering the minimum reserve system)

These accounts include reserves held by domestic credit institutions in current accounts with the Bank of Greece serving to fulfil reserve requirements and also used for settlement purposes. Cur-

11 Disclosed under liability item 9.2 "Net liabilities related to the allocation of euro banknotes within the Eurosystem".

rent account holdings of credit institutions with the Bank of Greece are remunerated on a daily basis at the applicable main refinancing operation (MRO) rate of the Eurosystem.

Outstanding balance as at 31.12.2013	€784.6 million
Outstanding balance as at 31.12.2012	€1,369.4 million
Decrease	€620.8 million

The average balance of these accounts in 2013 was €1.9 billion, compared with €1.8 billion in 2012.

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 particular, it consists of overnight deposits placed by credit institutions with the Bank of Greece at a pre-specified interest rate.

Outstanding balance as at 31.12.2013	€1,150.0 million
Outstanding balance as at 31.12.2012	€410.0 million
Increase	€740.0 million

2.5 Deposits related to margin calls

This item refers to deposits made by counterparties in those instances when the market value of the assets pledged as collateral in Eurosystem credit operations falls short of an established trigger point (asset item 5).

Outstanding balance as at 31.12.2013	€60.0 million
Outstanding balance as at 31.12.2012	€389.3 million
Decrease	€329.3 million

4. Liabilities to other euro area residents denominated in euro

4.1 General government

This item comprises deposits of the Greek State (central government), public entities and the Deposits and Loans Fund.

Outstanding balance as at 31.12.2013	€6,943.2 million
Outstanding balance as at 31.12.2012	€5,721.3 million
Increase	€1,221.9 million

The average balance of these deposits increased in the course of 2013 to €6.2 billion, from €4.4 billion in 2012.

4.2 Other liabilities

Outstanding balance as at 31.12.2013	€1,042.8 million
Outstanding balance as at 31.12.2012	€1,467.6 million
Decrease	€424.8 million

This item records the balances of deposits held by various entities.

These liabilities include a €488.8 million deposit by the Hellenic Financial Stability Fund (HFSF), funds from the European Investment Fund and the European Investment Bank totalling €455 million, outstanding balances of mainly interest-free deposit accounts of various entities and the total outstanding balances of the clearing accounts of the Athens Exchange.

The HFSF deposit consists in funds from the EU/IMF Support Mechanism for Greece and is remunerated at the EONIA rate minus 10 basis points or the deposit facility rate, whichever is the higher. It is noted that, throughout 2013, the interest rate on this deposit was close to zero.

The European Investment Fund and the European Investment Bank deposits are interest-bearing (average annual rate: 0.34%) and are intended to provide support to Greece in the fields of agricultural economy and enterprises.

5. Liabilities to non-euro area residents denominated in euro

Outstanding balance as at 31.12.2013	€990.4 million
Outstanding balance as at 31.12.2012	€1,008.1 million
Decrease	€17.7 million

This item includes deposits by various entities.

The bulk of these liabilities (€961.9 million) consists of a deposit account in euro the IMF holds with the Bank and corresponds to the euro component of Greece's quota in the Fund. Through this account, the Bank effects financial transactions with third countries, according to IMF instructions.

The decrease reflects adjustments for exchange rate variations due to the appreciation of the euro against the SDR in 2013.

6. Liabilities to euro area residents denominated in foreign currency

These liabilities mainly stem from interest-bearing deposits of public entities denominated in foreign currency.

Outstanding balance as at 31.12.2013	€76.6 million
Outstanding balance as at 31.12.2012	€32.0 million
Increase	€44.6 million

7. Liabilities to non-euro area residents denominated in foreign currency

7.1 Deposits and other liabilities

This item contains €2,000 of interest- and non-interest- bearing deposits of various entities.

8. Counterpart of special drawing rights allocated by the IMF

This item consists of a liability to the IMF stemming from the cumulative allocation of special drawing rights (SDR 782.3 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 678.8 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 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 31.12.2013	€874.9 million
Outstanding balance as at 31.12.2012	€912.0 million
Decrease	€37.1 million

The decrease reflects adjustments for exchange rate variations due to the appreciation of the euro against the SDR in 2013.

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 31.12.2013	€10,839.3 million
Outstanding balance as at 31.12.2012	€14,459.6 million
Decrease	€3,620.3 million

The balance as at 31.12.2013 is made up of the following:

– €2,142.6 million; this refers 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 according to its Eurosystem capital key. This amount was €92.4 million higher on 31 December 2013 than on 31 December 2012 (€2,050.2 million), due to the general increase in euro banknotes in circulation at Eurosystem level.

– €8,696.7 million stemming from the reduction of 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 share according to the banknote allocation key. In 2013, this amount decreased by €3,712.7 million due to the decline in the value of euro banknotes the Bank actually put into circulation that year (see table on p. A26).

9.3 Net liabilities arising from balances of TARGET2 accounts

These are net liabilities to the ESCB stemming from the Bank's cross-border transactions with other national central banks of the Eurosystem, the ECB and non-Eurosystem EU central banks that participate in the TARGET2 system (Trans-European Automated Real-time Gross settlement Express Transfer system).

This balance is remunerated on a daily basis at the applicable Eurosystem MRO rate.

TARGET2 account, year-end balances (in € millions)						
31.12.2007	**31.12.2008**	**31.12.2009**	**31.12.2010**	**31.12.2011**	**31.12.2012**	**31.12.2013**
10,796.6	35,348.3	49,036.1	87,088.1	104,750.0	98,355.2	51,115.9

TARGET2 account, average annual balances (in € millions)						
2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
9,298	14,650	37,647	77,022	93,090	105,084	63,893

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 2010-2012, there was a significant gradual increase in the balance of this account, due to the weak financial conditions that prevailed and their impact on cross-border payments. However, in 2013 due to the improved economic climate, the balance of this account declined significantly by €47,239.9 million, returning to February 2010 levels, and is continuing to trend downwards.

9.4 Other liabilities within the Eurosystem (net)

On 31 December 2013, the net balance of other transactions of the Bank of Greece with the Eurosystem represented a claim of the Bank of Greece and is therefore disclosed under asset item 9.5 "Other claims within the Eurosystem (net)".

10. Items in course of settlement

This item mainly consists of the float of cheques and payment orders whose settlement is pending, totalling €1.8 million.

11. Other liabilities

11.1 Off-balance-sheet instruments revaluation differences

Balance as at 31.12.2013	€1,310

This item represents the result of the year-end revaluation of outstanding balances in foreign currencies recorded in off-balance-sheet (memorandum) accounts.

These differences, totalling €1,310, stem from the valuation of forward transactions and are disclosed in the revaluation accounts (liability item 13).

11.2 Accruals and income collected in advance

This item represents interest expenses accrued but not paid until 31 December 2013 and other expenses. Such expenses will 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 31.12.2013	€32.4 million
Balance as at 31.12.2012	€116.6 million
Decrease	€84.2 million

11.3 Sundry

Sundry liabilities	31.12.2013	31.12.2012	Change
	(in € millions)		
Dividends to be distributed	9.9	10.7	-0.8
Tax on dividends	3.5	2.7	0.8
Profit to be transferred to the Greek State	817.8	305.3	512.5
Liability to the Greek State (SDR component of Greece's quota in the IMF)	269.4	280.7	-11.3
Other liabilities	34.5	53.5	-19.0
Total	**1,135.1**	**652.9**	**482.2**

This item comprises the distributable profit for the year, tax on dividends, profit to be transferred to the Greek State, the Bank's liability towards the Greek State regarding the SDR component of Greece's quota in the IMF (the corresponding claim of the Bank on the IMF is recorded under asset item 2.1 "Receivables from the IMF"), other taxes to be paid, the balances of credit suspense accounts and other accounts on behalf of third parties (suppliers, etc.), as well as other liabilities.

12. Provisions

Category of provision	31.12.2013	31.12.2012	Change
	(in € millions)		
a. Special provisions against operational risk, unexpected losses and doubtful claims	126.0	139,5	-13.5
b. Provision for pension benefits	2,099.8	2,095.5	4.3
c. Provision against financial risks (including risks associated with the Bank's investment activities and risks arising from Eurosystem monetary policy operations)	3,231.0	3,208.1	22.9
d. Provision against general risks under Article 71 of the Statute	1,195.0	770,4	424.6
Total	**6,651.8**	**6,213.5**	**438.3**

Total provisions amounted to €6,651.8 million.

The practice of establishing adequate provisions and reserves is followed in the context of the principle of prudence followed by the ECB and the Eurostystem NCBs. It aims to strengthen the Bank's financial position, so that it can best fulfil its mandate and live up to the risks it assumes.

The Bank reviews these provisions annually and adjusts them according to a risk assessment. Several factors are taken into account in this risk assessment, including but not limited to:

– the amount of risky assets;
– risk exposure;
– financial risk assessments and valuations;
– money market developments and general economic conditions in the euro area and Greece;
– current reserves and provisions;
– the outstanding balances of revaluation accounts.

In greater detail:

a. Special provisions against operational risk, extraordinary losses and doubtful claims

These are special provisions directly associated with the Bank's operation that cover inter alia:

– administrative deficits;
– employee compensation paid upon retirement;
– doubtful claims.

These provisions are established on the basis of actual needs and obligations and their level is determined following an estimation of the amounts likely to be required for covering risks and possible losses and any unrecoverable part of doubtful claims.

b. Provision for pension benefits

Pursuant to Article 64 of Law 3863/2010, the Bank has undertaken and provides social insurance for its staff in the main and supplementary pension plans.

This provision has been established to cover this obligation and to meet the staff's social insurance needs in general. The amount of the provision has been calculated almost entirely on the basis of actuarial studies.

c. Provision against financial risks (including risks from the Bank's investment activities and risks arising from Eurosystem monetary policy operations)

In keeping with its standard practice, which is in line with that of the ECB and of the other central banks of the euro area, and taking into account both the results of the relevant risk assessments by the ECB and by its own Risk Management Unit and the results of the impairment tests on its held-to-maturity portfolios of debt securities (SMP and CBPP1, own funds), the Bank increased marginally this provision in 2013.

Specifically, this provision is intended to cover:

- Credit risks arising from the provision of liquidity to the credit system and from securities purchased under the Securities Market Programme (SMP) and the Covered Bond Purchase Programme (CBPP1);

- Credit and market risks (interest rate risk, exchange rate risk) associated with securities and foreign exchange portfolios managed by the Bank.

As regards the special provision against counterparty risks arising from Eurosystem monetary policy operations, which was first established in financial year 2008, following a decision by the

Governing Council of the ECB and in accordance with Article 32.4 of the ESCB/ECB Statute, the remaining amount of €8.1 million was fully released.

The Bank's initial share in that provision (totalling €5,736 million at Eurosystem level) was €149.5 million.

In financial years 2009, 2010, 2011, 2012 and 2013, after the gradual utilisation of collateral accepted in Eurosystem monetary policy operations and the reduction of the relevant risk, the entire amount held in the initial provision (€5,736 million) was gradually released. The respective amounts released for the Bank were €45 million in 2009, €47 million in 2010, €32.8 million in 2011, €16.6 in 2012 and €8.1 million in 2013. They were transferred to income from unused provisions and are reported under Profit and Loss Account item 5 "Net result of pooling of monetary income".

It should be noted that income arising from Eurosystem monetary policy operations is allocated to all NCBs (including the Bank of Greece). In turn, each NCB makes a contribution to risk provisions according to its Eurosystem key.

The current institutional framework governing the provision of sufficient eligible assets by credit institutions as collateral for Eurosystem liquidity and the control of risks is adequate.

However, the increased activity of the Eurosystem in money markets, mainly over the 2009-2013 period, with a view to safeguarding financial stability, while also generating satisfactory income, resulted in higher risk exposure.

Against this background and in order to protect against all possible risks, provisions are established as required by the prudence principle.

The extent to which these provisions will be used will depend on future money market developments.

d. Provision against general risks under Article 71 of the Statute
This provision is intended to cover potential general risks and obligations of the Bank of Greece arising from the performance of its functions as the country's central bank and under international agreements, as stated in Article 71 of its Statute.

13. Revaluation accounts

In accordance with the accounting rules and principles set out by the European Central Bank for the ESCB NCBs, and specifically 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 (serving 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-2013 resulted in unrealised gains of €2,375.7 million (largely stemming from gold), which were transferred to the corresponding revaluation accounts (see breakdown in the table below).

Unrealised valuation gains	31.12.2013	31.12.2012	Change
	(in € millions)		
– on securities	16.3	30.3	-14.0
– on gold	2,359.4	4,219.6	-1,860.2
Total	**2,375.7**	**4,249.9**	**-1,874.2**

Unrealised losses of €10.1 million arising at the year-end from the revaluation of foreign currency positions and securities were taken to the Profit and Loss Account and were covered by the provision established for this purpose.

14. Capital and reserves

The Bank's capital and reserves amount to €815.5 million.

The Bank's capital and its ordinary reserve stand at €111.2 million each.

In more detail, capital and reserves are:

14.1 Capital

The Bank's capital, after having been increased by 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 October 1996 and Cabinet Acts 8/4 February 2000, 32/23 May 2002, 17/4 July 2005 and 8/10 June 2008, now stands at €111,243,362 and is divided into 19,864,886 shares of a par value of €5.60 each.

14.2 Ordinary reserve

The ordinary reserve amounts to €111,243,362, after reaching the level of the Bank's capital.

14.3 Extraordinary reserve

The extraordinary reserve amounts to €84.5 million, unchanged from the previous year.

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 of the Bank 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.

The outstanding amount as at 31 December 2013 was €507.2 million.

14.5 Other special reserves

These amount to €1.3 million and represent the value of artworks and fixed assets (mostly buildings) transferred gratis to the Bank.

OFF-BALANCE-SHEET (MEMORANDUM) ITEMS

	31.12.2013	31.12.2012	Change
	(in € millions)		
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	20,844.6	19,791.3	1,053.3
2. Greek government securities and other debt securities relating to the management and custody of assets of public entities, social security funds and private agents and EFSF securities owned by the Hellenic Financial Stability Fund	16,546.7	15,702.9	843.8
3. Assets eligible as collateral for Eurosystem monetary policy operations and intraday credit	84,630.1	25,568.9	59,061,2
4. Assets accepted by the Bank of Greece as eligible collateral for emergency liquidity assistance to credit institutions	58,286.1	191,524.9	-133,238.8
5. Other off-balance-sheet items*	26,495.2	22,694.8	3,800.4
Total	**206,802.7**	**275,282.8**	**-68,480.1**

* "Other off-balance-sheet items" include:
– a non-interest bearing, non-negotiable promissory note of €26 billion (SDR 23.3 billion) issued by the Greek government for the total amount of the loan received from the IMF until 31 December 2013 in the context of the EU/IMF support package for Greece. The Greek government is solely responsible for repaying this loan. The note is kept at the Bank of Greece, which acts as fiscal agent for the Hellenic Republic vis-à-vis the IMF;
– forward and spot 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.

GENERAL NOTES ON THE PROFIT AND LOSS ACCOUNT FOR 2013

The Bank's profit in 2013 amounted to €831.1 million, up from €318.6 million in 2012.

ANALYSIS OF THE PROFIT AND LOSS ACCOUNT FOR 2013

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 €1,600.3 million, compared with €2,995.4 million in 2012, down by 46.6%.

Specifically:

- ***Net income from interest, financial operations and the reallocation of the Eurosystem's monetary income*** came to €1,465.8 million, against €2,888.9 million in the previous financial year (-49.3%).

- ***Net income from fees and commissions*** fell by 2.2% to €70.2 million, from €71.8 million in 2012.

- ***Income from equity shares and participating interests*** rose by €34.1 million to €54.2 million, from €20.1 million in 2012.

- ***Finally, other income*** came to €10.1 million, from €14.6 million in the previous financial year, down by 30.8%.

EXPENSES

Total expenses fell by €1,907.6 million to €769.2 million in 2013, from €2,676.8 million in 2012, largely reflecting lower provisioning costs, while general operating expenses excluding provisions declined as well.

Specifically:

- ***The Bank's general operating expenses excluding provisions*** (staff costs, pensions, depreciation and other expenses) dropped by €33.7 million (-10.1%) to €300.4 million, from €334.1 million in 2012, despite being significantly burdened by extraordinary expenditure of €4.3 million required for the auditing of the banking system.

- ***Provisions*** declined considerably to €468.8 million in 2013, compared with 2012 (see notes on liability item 12).

NOTES ON NET OPERATING INCOME ACCOUNTS

The Bank's net income in 2013 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 €1,600.3 million, compared with €2,995.4 million in 2012, down by 46.6%.

Net income (as compared with that of the previous financial year) can be broken down as follows:

1. Net interest income

Net interest income (interest income less interest expense) decreased by 48.1% to €1,386.8 million, from €2,673.8 million in the previous financial year.

Interest can be broken down as follows:

1.1 Interest income

Interest income decreased by €1,963.1 million to stand at €1,864.1 million, compared with €3,827.2 million in 2012, mainly due to the decline in emergency liquidity assistance (ELA) to credit institutions.

Interest income	2013	2012	Change
	(in € millions)		
a. Interest on lending to credit institutions related to monetary policy operations	364.3	418.2	-53.9
b. Interest on securities held for monetary policy purposes	365.6	408.2	-42.6
c. Interest on special funding to credit institutions against collateral and guarantee by the Greek government	484.9	2,272.1	-1,787.2
d. Interest on investment portfolios (excluding Greek government debt securities)	272.8	289.0	-16.2
e. Interest on the investment portfolio of Greek government debt securities	305.5	320.5	-15.0
f. Remuneration of long-term euro-denominated claims arising from the transfer of foreign reserve assets to the ECB	5.4	8.6	-3.2
g. Interest on long-term claims on the Greek State	62.2	105.4	-43.2
h. Interest on the IMF reserve tranche position and SDR holdings	0.7	0.9	-0.2
i. Interest on loans to the personnel of the Bank of Greece	2.6	4.1	-1.5
j. Other interest income	0.1	0.2	-0.1
Total	**1,864.1**	**3,827.2**	**-1,963.1**

In particular:

a) Interest on lending to credit institutions related to monetary policy operations

This refers to the Bank's funding of domestic credit institutions through the liquidity-providing open market operations conducted by the Eurosystem in the context of the euro area single monetary policy and under the marginal lending facility.

In 2013, this income fell to €364.3 million, from €418.2 million in 2012, mainly due to the drop in the main refinancing operation (MRO) rate from 0.88% in 2012 to 0.55% on average in 2013.

Interest by type of operation is as follows:

Interest on lending to credit institutions	**2013**	**2012**	**Change**
	(in € millions)		
– main refinancing operations (MROs)	352.1	224.6	127.5
– longer-term refinancing operations (LTROs)	8.9	184.6	-175.7
– marginal lending facility	3.3	9.0	-5.7
Total	**364.3**	**418.2**	**-53.9**

b) Interest on securities held for monetary policy purposes

This amounted to €365.6 million in 2013 (2012: €408.2 million) and refers to interest from securities purchased by the Bank under the Eurosystem's first covered bond purchase programme (CBPP1) and the 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 proper functioning of the monetary policy transmission mechanism. The value of the Bank's holdings of CBPP1 and SMP securities as at 31 December 2013 was €6.1 billion, against €7.0 billion as at 31 December 2012, valued at amortised cost.

c) *Interest on special funding to credit institutions against collateral and guarantee by the Greek government*

This amounted to €484.9 million, against €2,272.1 million in 2012, and represents interest on emergency liquidity made available to credit institutions mainly through emergency liquidity assistance (ELA) operations (see notes on p. A18 "Other claims on euro area credit institutions denominated in euro").

d) Interest on investment portfolios (excluding Greek government debt securities)

This largely consists of interest on euro-denominated debt securities issued by euro area governments.

Interest by type of asset	2013	2012	Change
	(in € millions)		
– on debt securities	272.7	288.9	-16.2
– on time deposits and current accounts	0.1	0.1	0
Total	**272.8**	**289.0**	**-16.2**

The €16.2 million decrease stemmed mainly from the lower yields on foreign debt securities.

e) Interest on the investment portfolio of Greek government debt securities

Interest on the Bank's portfolio of Greek government securities decreased by €15.0 million relative to the previous financial year (2013: €305.5 million, 2012: €320.5 million), mainly due to a decline in the average yield of this portfolio.

f) 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 on 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 prevailing marginal MRO rate. The relevant interest amount fell by €3.2 million to €5.4 million in 2013 (2011: €8.6 million), mainly on account of the decrease in the MRO rate (the average level of this rate was 0.55% in 2013, compared to 0.88% in 2012).

g) Interest on long-term claims on the Greek State

This represents interest on loans granted by the Bank of Greece to the Greek State up to 31 December 1993.

This interest income totalled €62.2 million in 2013, down by €43.2 million compared with 2012 (€105.4 million), due to a decrease in the 12-month euro LIBOR and LIBID rates applicable to the loans granted to the Greek State and resulting from the conversion of the debit balances of the account "Foreign exchange valuation differences under Law 1083/80", and the gradual repayment of all loans.

h) Interest on the IMF reserve tranche position and SDR holdings

In 2013, this item stood at a lower level than in 2012 (2013: €0.7 million, 2012: €0.9 million). It mainly comprises interest on Greece's SDR 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 decrease is largely attributable to a fall in the SDR interest rate. A corresponding decrease was recorded in interest expense on the Bank's SDR liabilities to the IMF.

i) Interest on loans to the personnel of the Bank of Greece

Interest on (housing or personal) loans granted by the Bank of Greece to its staff amounted to €2.6 million (2012: €4.1 million).

ι) Other interest income

This item stood at €153 thousand, compared with €215 thousand in 2012.

1.2 Interest expense

Interest expense decreased by 58.6% to €477.4 million in 2013, from €1,153.5 million in 2012.

Interest expense	2013 (in € millions)	2012	Change
a. Interest on intra-ESCB balances (TARGET2)	378.1	937.8	-559.7
b. Interest on net liabilities related to the allocation of euro banknotes within the Eurosystem	69.9	162.4	-92.5
c. Interest on banks' current accounts in the context of monetary policy operations (including minimum reserves)	9.8	19.6	-9.8
d. Interest on deposits of the Greek State	17.2	28.2	-11.0
e. Interest on euro- and foreign currency-denominated deposits of various entities	1.7	2.6	-0.9
f. Interest on SDR allocations of the IMF	0.7	1.0	-0.3
g. Interest on deposits of the Hellenic Financial Stability Fund	0	1.9	-1.9
Total	**477.4**	**1,153.5**	**-676.1**

Specifically:

a) Interest on intra-ESCB balances (TARGET2)

Interest expense on the TARGET2 account (in € millions)						
2007	2008	2009	2010	2011	2012	2013
369.7	545.2	477.1	779.8	1,186.8	937.8	378.1

The above interest expense is calculated on the basis of the daily net balance of the TARGET2 account dedicated to euro-denominated transactions with the ECB and the other ESCB NCBs.

The decrease in 2013 is due to a decline in the daily average balance of the TARGET2 account (2013: €63.9 billion; 2012: €105.1 billion) and to a decline in the key ECB interest rate on TARGET2 balances from an average of 0.88% in 2012 to 0.55% in 2013.

b) Interest on net liabilities related to the allocation of euro banknotes within the Eurosystem

This item came to €69.9 million in 2013 from €162.4 million in 2012, owing to the fact that the value of euro banknotes actually put into circulation by the Bank in 2013 was higher than the value of euro banknotes that would have been allocated to it according to its banknote allocation key. Interest calculated on the basis of the key ECB interest rate and amounting to €69.9 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) corresponds to its share according to the 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);

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 involves interest paid on banks' minimum reserves since interest paid on the deposit facility and on deposits related to margin calls came to zero.

This item decreased significantly, by €9.8 million, from €19.6 million in 2012 to €9.8 million in 2013, due to the substantial decline in the key ECB interest rate (from an annual average of 0.88% in 2012 to 0.55% in 2013), the prevailing zero interest rate on the ECB's deposit facility throughout 2013, and the drop in 2013 of the average amount of bank deposits to €2.2 billion, from €3.7 billion in 2012 (mainly due to a decline in deposits related to margin calls).

d) Interest on deposits of the Greek State

Interest on deposits fell to €17.2 million, from €28.2 million in 2012, due to a reduction of the interest rate.

The average daily interest rate of the Greek State cash management account came to 0.51% in 2012, compared with 0.81% in 2012.

e) Interest on euro- and foreign currency-denominated deposits of various entities

This item decreased to €1.7 million, from €2.6 million in 2012, due to a decline in the deposits of the European Investment Fund and the European Investment Bank and the reduction of the average interest rate from 0.50% in 2012 to 0.34% in 2013.

f) Interest on SDR allocations of the IMF

Interest on the Bank's liabilities from the allocation of IMF special drawing rights (SDRs) decreased by €0.3 million, from €1 million in 2012 to €0.7 million in 2013, due to a drop in the SDR interest rate.

g) Interest on deposits of the Hellenic Financial Stability Fund

This interest expense fell to zero from €1.9 million in 2012, due to the zero interest rate prevailing on average in 2013, down from 0.18% in 2012.

2. Net result of financial operations, write-downs and risk provisions

The net result of financial operations in 2013 decreased by €39.5 million to €26.8 million, from €66.3 million in 2012.

A breakdown is provided below.

2.1 Net realised gains arising from financial operations	**2013** *(in € millions)*	**2012**	**Change**
– foreign exchange operations	6.4	3.3	3.1
– transactions in securities	13.9	47.9	-34.0
– foreign exchange valuation differences due to changes in the €/SDR parity	1.1	0.5	0.6
– purchases and sales of gold coins	5.4	14.6	-9.2
Total	**26.8**	**66.3**	**- 39.5**
2.2 Write-downs on financial assets and positions (unrealised losses)			
– from the revaluation of securities and foreign currency positions	-10.1	-0.1	- 10.0
Total	**-10.1**	**- 0.1**	**-10.0**
2.3 Transfer from the provision for foreign exchange rate, interest rate, credit and gold price risks	**10,1**	**0.1**	**10.0**
Grand total	**26.8**	**66.3**	**-39.5**

As shown in the table, the €39.5 million reduction of the net result from financial transactions was due to the drop in gains from securities transactions.

Moreover, the results for 2013 include unrealised losses of €10.1 million (2012: €74 thousand) from the year-end revaluation of securities and foreign currency positions (item 2.2). These losses were covered in full by the provision established for this purpose.

3. Net income from fees and commissions

Net income from fees and commissions fell by 2.2% to €70.2 million in 2013, from €71.8 million in 2012.

A breakdown is provided below.

Net income from fees and commissions	2013	2012 *(in € millions)*	Change
3.1 Fees and commissions income			
– from the management of Greek government securities	9.9	11.6	-1.7
– from payments and receipts on behalf of the Greek State	36.9	35.3	1.6
– from management of the "Common Capital of Legal Entities in Public Law and Social Security Funds according to Law 2469/97"	16.8	17.2	-0.4
– from private insurance supervision	4.3	4.9	-0.6
– other	5.0	6.7	-1.7
Total	**72.9**	**75.7**	**-2.8**
3.2 Fees and commissions expense	**-2.7**	**-3.9**	**1.2**
Total net income from fees and commissions	**70.2**	**71.8**	**-1.6**

4. Income from equity shares and participating interests

Income from equity shares and participating interests rose to €54.2 million in 2013, from €20.1 million in 2012.

Income from equity shares and participating interests	2013	2012 *(in € millions)*	Change
• income from the ECB			
– from the ECB's interim profit distribution	38.4	16.1	22.3
– from the distribution of the ECB's net profit	11.9	0	11.9
• other income from equity shares and participating interests	3.9	4.0	-0.1
Total	**54.2**	**20.1**	**34.1**

• Income from the ECB

In 2013, the Bank received from the ECB an amount of €38.4 million corresponding to its allocated share in the ECB's interim profit distribution. The Bank's share in the remaining distributable ECB income earned in 2012 (€11.9 million) benefited financial year 2013.

• Other income from equity shares and participating interests

This income, amounting to €3.9 million, largely consists of deferred payments of dividends for financial year 2012 in respect of the Bank's participating interests in the Bank for International Settlements (BIS), DIAS Interbanking Systems SA and the Hellenic Exchanges Holding S.A.

5. Net result of pooling of monetary income

	2013	2012	Change
	(in € millions)		
Net monetary income pooled by the Bank of Greece	424.0	527.5	-103.5
Monetary income allocated to the Bank according to its capital key	467.8	657.3	-189.5
– Monetary income reallocation for the year[12]	43.8	129.8	-86.0
– Corrections to monetary income reallocation of previous years	0.3	2.4	-2.1
– Transfer to income from the provision against counterparty risks arising from Eurosystem monetary policy operations	8.1	16.6	-8.5
Total	**52.2**	**148.8**	**-96.6**

As shown in the table, the net result from the pooling and reallocation of Eurosystem monetary income was €52.2 million in 2013, compared with €148.8 million in 2012.

Specifically:

Net result of pooling and reallocation of Eurosystem monetary income
Monetary income is the income pooled by 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;
– euro-denominated liabilities to euro area credit institutions related to monetary policy operations;
– net intra-Eurosystem liabilities arising from balances of TARGET2 accounts;
– net intra-Eurosystem liabilities related to the allocation of euro banknotes within the Eurosystem.

Any interest paid by an NCB on liabilities within the liability base is to be deducted from the monetary income to be pooled by that NCB.

The assets that are held against the liability base ("earmarkable assets") are the following:

– lending to euro area credit institutions related to monetary policy operations denominated in euro;

12 The amount of monetary income to be allocated to the Bank of Greece has been calculated on the basis of the latest available provisional ECB data as at the date of preparation of this balance sheet and its approval by the General Council of the Bank.

– securities held for monetary policy purposes. These include covered bonds issued by euro area credit institutions and securities under the Securities Markets Programme (SMP). Covered bond yields are calculated daily on the basis of the latest available marginal rate for the Eurosystem's main refinancing operations, while for SMP securities actual yields are calculated.
– intra-Eurosystem claims equivalent to the transfer of foreign reserves to the ECB;
– net intra-Eurosystem claims arising from balances of TARGET2 accounts;
– net claims related to the allocation of euro banknotes within the Eurosystem;
– a limited amount of gold holdings according to each NCB's paid-up share in the capital of the ECB. Gold is considered 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 according to their paid-up shares in the capital of the ECB. Pooling and reallocating monetary income brings about net reallocation effects, owing to different yields earned by NCBs from earmarked assets and different debit interest paid on the liability base. Moreover, the level of the liability base and the level of the NCBs' earmarked assets usually differ from their corresponding levels on the basis of their Eurosystem key.

The positive result (€43.8 million) recorded in 2013 was due to the fact that the monetary income actually pooled by the Bank in 2013 (€424 million) was lower than the €467.8 million calculated according to the Bank's capital key in the share capital of the ECB (see footnote 12). It also reflected income of €0.3 million arising from corrections to monetary income reallocation for previous years (see note on liability item 9.5).

This method of allocation of the Eurosystem's monetary income was established by decision 2010/23 of the Governing Council of the ECB.

Transfer to income from the provision against counterparty risks arising from Eurosystem monetary policy operations

The Bank's income in 2013 includes a transfer of a further €8.1 million (in addition to the €45 million transferred in 2009, the €47 million transferred in 2010, the €32.8 million transferred in 2011 and the €16.6 million transferred in 2012) from the €149.5 million provision against counterparty risks arising from monetary policy operations.

This provision was initially established in 2008, following a decision by the Governing Council of the ECB on 18 December 2008, in response to the prevailing exceptionally adverse conditions in the money market, which also affected the liquidity-providing monetary policy operations.

In this context, the Governing Council of the ECB decided, in line with the principle of prudence, to establish a total provision of €5.7 billion as a buffer against counterparty risks arising from the monetary policy operations.

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 participating countries according to their subscribed shares in the capital of the ECB.

Under the above-mentioned decision of the Governing Council of the ECB, the total amount of the provision (€5.7 million) is adjusted after the reassessment of the outcome of sale or maturity of securities and the annual revaluation of collateral received from defaulted counterparties.

The favourable outcome of the revaluation of collateral and the remaining unsecured risk exposure in 2009, 2010, 2011, 2012 and 2013 has gradually led to the final elimination of the relevant risk and therefore the release of the total Eurosystem provision in 2013 and the transfer to income of a total amount of €5.7 billion from the unused provisions of Eurosystem NCBs for 2009, 2010, 2011, 2012 and 2013.

6. Other income

Other income decreased by €4.5 million to €10.1 million, compared with €14.6 million in 2012.

Other income includes revenue of €8.9 million from the activities of the Bank's Printing Works Department (IETA), derived from the production of items on behalf of the Greek State (coins, lottery tickets, passports, forms), as well as other revenue, amounting to €1.2 million, from accreditation fees, tax discounts, etc.

OPERATING COSTS, DEPRECIATION AND PROVISIONS

	2013	2012	Change
	(in € millions)		
• STAFF COSTS	146.7	157.9	-11.2
• PENSION BENEFIT EXPENSES	98.4	112.2	-13.8
• OTHER ADMINISTRATIVE EXPENSES	37.0	40.1	-3.1
• DEPRECIATION OF TANGIBLE AND INTANGIBLE FIXED ASSETS	14.0	13.6	0.4
TOTAL EXPENSES EXCLUDING CONSULTANCY FEES FOR THE AUDITING OF THE BANKING SYSTEM AND PROVISIONS	296.1	323.8	-27.7
• CONSULTANCY FEES FOR THE AUDITING OF THE BANKING SYSTEM	4.3	10.3	-6.0
TOTAL EXPENSES EXCLUDING PROVISIONS	300.4	334.1	-33.7
• PROVISIONS	468.8	2,342.7	-1,873.9
TOTAL EXPENSES	769.2	2,676.8	-1,907.6

NOTES ON THE EXPENDITURE ACCOUNTS

Total expenses in 2013 fell by €1,907.6 million to €769.2 million, from €2,676.8 million in 2012, on account of lower provisioning and reduced operating costs.

In particular:

- **Operating costs excluding provisions (staff costs, pensions, depreciation and other costs)** dropped by €33.7 million (or -10.1%) to €300.4 million, from €334.1 million in 2012, despite being burdened by extraordinary expenses of €4.3 million for the auditing of the banking system.

In greater detail:

— ***Staff costs*** fell by €11.2 million (or -7.1%) to €146.7 million, from €157.9 million in 2012.

— ***Pension benefit expenses*** fell by €13.8 million to €98.4 million, from €112.2 million in 2012, due to pension-cutting laws.

— ***Other administrative expenses*** decreased by €3.1 million (or -7.7%) to €37.0 million, from €40.1 million in 2012. These include the expenditure of the Printing Works Department (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 cost of premises, the procurement of computer hardware and other equipment, insurance premiums, overhead costs, etc.

— ***Depreciation of assets*** increased by €0.4 million (or 2.9%) to €14.0 million, from €13.6 million in 2012.

— ***Extraordinary consultancy fees for the auditing of the banking system*** in 2013 came to €4.3 million.

- **Provisions in 2013** came to €468.8 million, in order to cover operating risks and other obligations of the Bank (see notes on liability item 12 "Provisions").

DISTRIBUTION OF PROFIT

(Article 71 of the Statute)

Bank of Greece's profit amounted to €831.1 million in 2013, compared with €318.6 million in 2012.

The General Council proposes to the General Meeting of Shareholders that the profit be distributed as follows:

	2013	2012
	(in euro)	
Dividend to be distributed: €0.49728 per share on 19,864,886 shares (compared with €0.5376 per share in 2012)	9,878,410	10,679,362
Tax on dividends (tax rate: 26%; Article 9 para. 30 of Law 4110/2013)	3,470,793	2,669,841
To the government	817,800,000	305,300,000
	831,149,203	**318,649,203**

The gross dividend for financial year 2013 amounts to €0.6720 per share. Dividend to be distributed (€0.49728 per share) is subject to withholding tax at a rate of 10% in accordance with Law 4110/2013, Article 6 paragraph 2.

Athens, 20 January 2014

For the General Council
THE CHAIRMAN

GEORGE A. PROVOPOULOS
GOVERNOR OF THE BANK OF GREECE

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