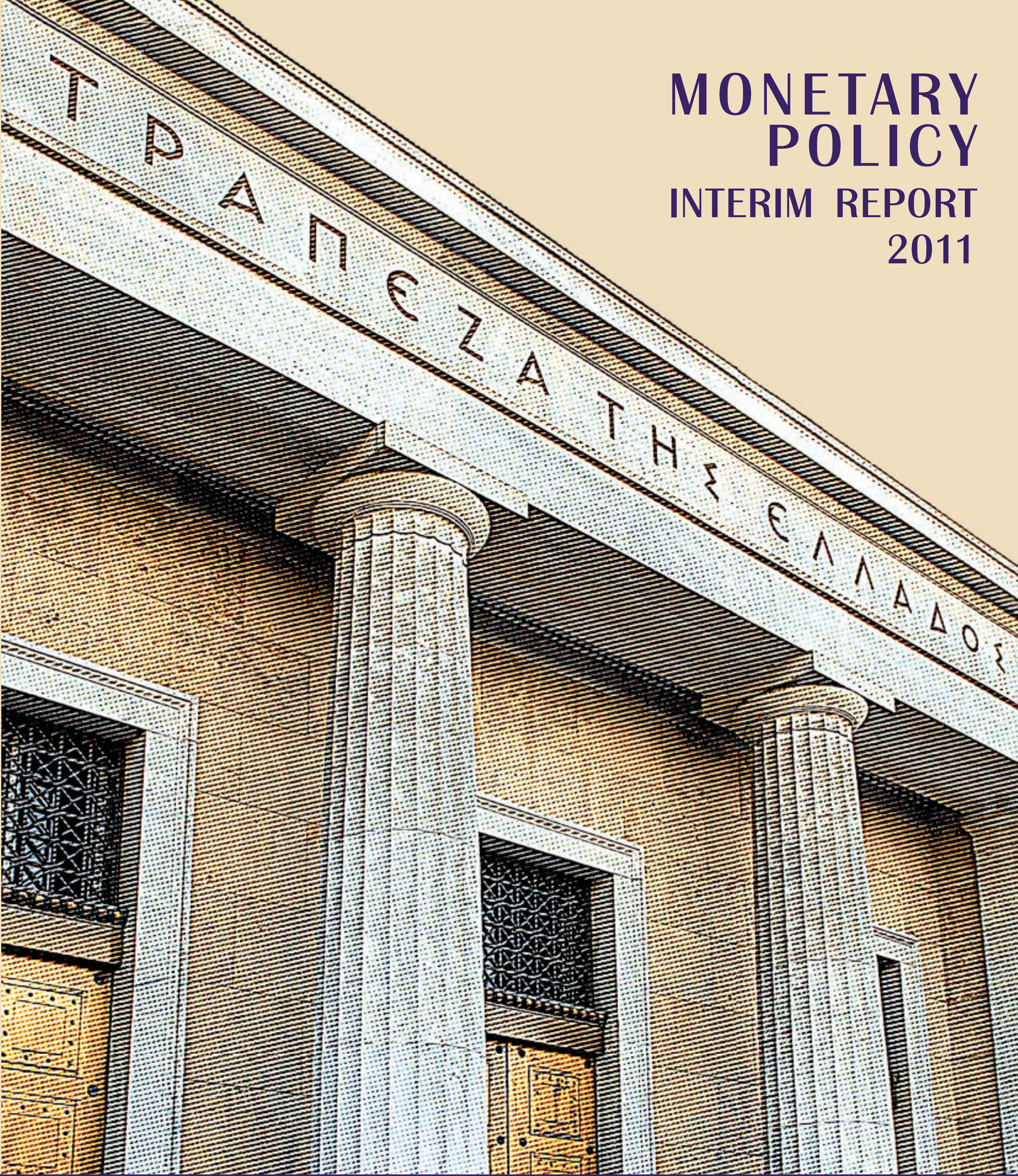
MONETARY POLICY

INTERIM REPORT 2011



NOVEMBER
2011

BANK OF GREECE
EUROSYSTEM

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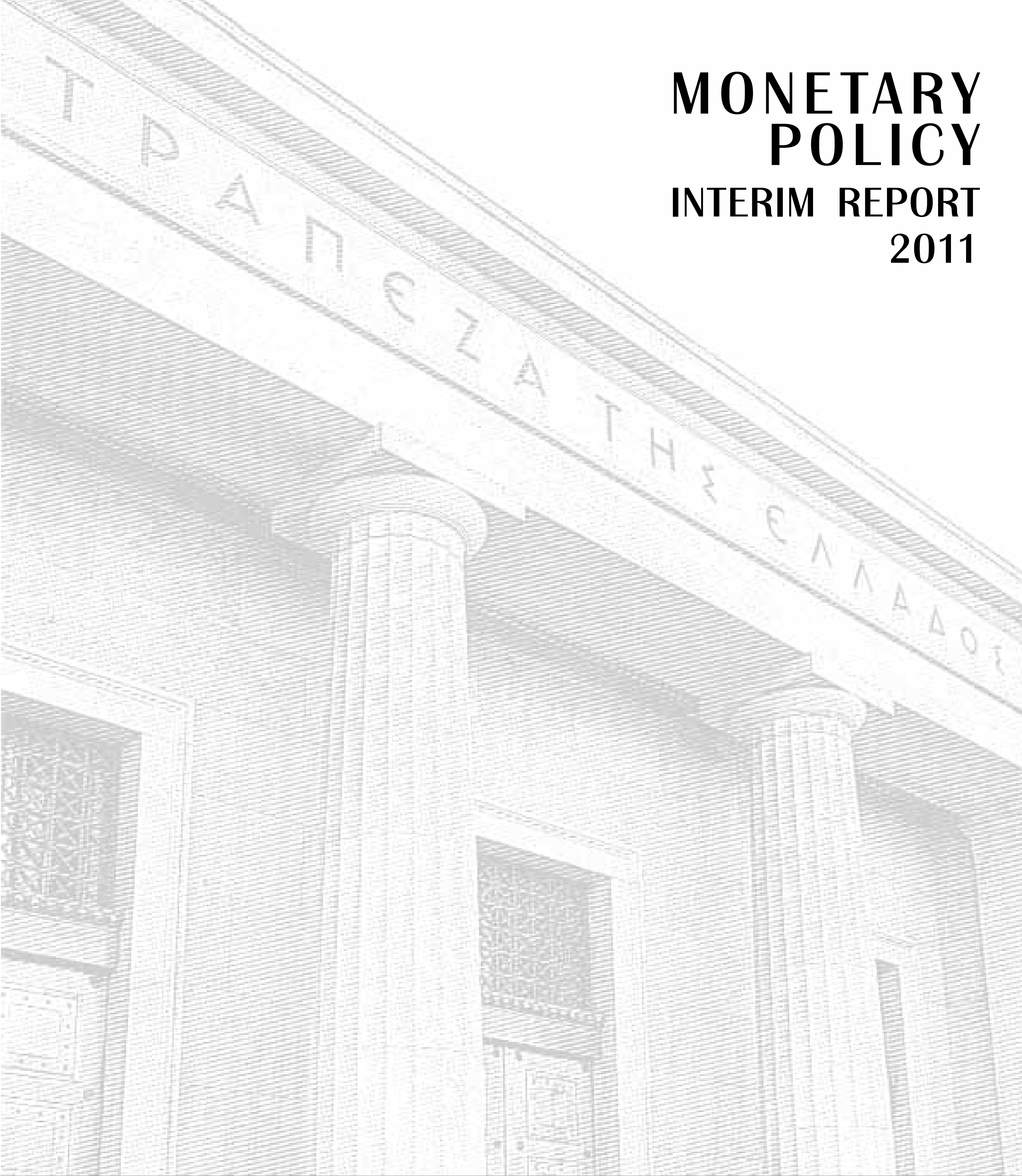

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EUROSYSTEM

To the Greek Parliament
and the Cabinet

In accordance with its Statute, the Bank of Greece submits its Interim Report on Monetary Policy 2011 to the Greek Parliament and the Cabinet.

The decision of the 26 October Euro Summit represents a milestone on the adjustment path of the Greek economy. The main aim of the agreement reached concerning Greece is to lighten the burden of government debt and its servicing costs, while the adoption of a new multiannual EU-IMF support programme for Greece is envisaged by the end of 2011.

About a year ago, the Bank of Greece considered that the debt could be sustainable. The Bank based its assessment on two assumptions: (a) full attainment of the fiscal targets that had been set —indeed, the Bank strongly encouraged the overachievement of those targets, wherever possible— and (b) a substantial improvement in competitiveness. In the event, however, the interrelated effects of a sharper-than-expected decline in crucial sectors of economic activity, an undershooting of the fiscal targets and delays in implementing structural reforms undercut earlier assessments about debt sustainability.

The new opportunity provided to Greece under the agreement of 26 October may well be the last. The country must avoid any further delay or deviation from targets at all costs. At the same time, all efforts need to focus on overshooting the targets. The present juncture is the most critical period in Greece's post-war history. *What is at stake is whether the country is to remain within the euro area in the future.* Effectively, Greece is faced with a choice between:

— an uncontrolled downward spiral that would wipe out the achievements that have been attained since the restoration of democracy in 1974, drive the country out of the euro area and set Greece's economy, standard of living, society and international standing back many decades;

or

— an all-out effort *within* the euro area, in close cooperation with our European partners and the international community, to mitigate shocks, shorten —to the extent possible— the difficult and long adjustment period, and lay solid foundations for the restructuring of the economy and reestablishment of sustainable growth.

Clearly, the latter entails costs. Incomes will decline and groups enjoying protection and privileges will become exposed to competition. However, the overall cost to society will be lower than otherwise in the medium term, and the long-run benefits will be higher than will be the case under the former option.

* * *

The new government is called upon to implement the agreement of 26 October consistently, promote the policy measures stemming from it, and lead the country to elections in due course. The recent political uncertainty created additional problems for the economy and the banking system. In order to safeguard financial stability, it will be necessary for the coalition government to exert strong and effective leadership, so that it can implement the policies required to ensure Greece's future within the euro area.

The first task of the new government is to restore confidence, which has been dealt a serious blow. However, in order to consolidate confidence in the prospects of the economy, the convergence of political forces reflected in the formation of the new government must become more substantive. Moreover, for the government to succeed, and the will of the citizens to be genuinely expressed in the upcoming elections, the true state of the economy and the international context must be described with utmost candour, possible solutions must be clearly analysed, and the costs and benefits of each option must be explained cogently.

* * *

The size of the fiscal adjustment achieved in 2010 was substantial. Despite delays, a number of noteworthy structural reforms were implemented, most importantly the reform of the social security system. However, the situation remains critical. Thus far, the pace and degree of policy implementation have failed to convince both the markets and the general public that Greece is on the road to achieving the goals set. This "credibility deficit" has its roots mainly in the fact that economic policy has often been conducted in a piecemeal manner, indecisively, with backtracking and delays, and following rather than leading developments. Thus, depending on the case:

• Measures that would move the economy in the desired direction lose impetus in their implementation, thus failing to deliver the expected results in full.

• The preparation and planning of measures do not adhere to the timetable laid down, thus making it necessary to search for last-minute "magic solutions".

• There is a resurgence of outdated attitudes and behaviour, which treat certain issues as non-negotiable if vested interests are threatened.

• "Horizontal", i.e. indiscriminate and across-the-board, approaches are used to curtail public spending, while the mechanisms that are inherently cost-generating remain untouched; this outcome prevails because public administration is unable to work out targeted solutions, which would be more effective and socially more equitable.

If we are to succeed where we have so far failed, it is necessary to eliminate this "confidence deficit" caused by, on the one hand, indecision and backtracking on economic policy and, on the other, social tensions fuelled by the illusion that a return to the policies of the past is possible.

Although it has often been argued that the deepening of the recession in 2011 and its projected continuation into 2012 are due to the impact on aggregate demand of the contractionary fiscal adjustment, international experience and numerous empirical studies have shown that a restrictive fiscal policy can have expansionary effects over the medium to long term, particularly in countries with very high levels of government debt. The negative macroeconomic impact of fiscal adjustment can be minimised and a country can return to growth faster if adjustment focuses on cutting primary expenditure —excluding investment spending— on a permanent basis and if the programme is implemented with determination, thus affecting positively households' and businesses' expectations.

Such conditions, however, are not satisfied, which explains why confidence has not recovered and the "credibility deficit" is growing. The fall in domestic demand and the economic contraction are disproportionately large in comparison to the magnitude of fiscal adjustment, precisely because the prevailing climate and expectations prevent economic recovery and the emergence of a "confidence effect".

In these circumstances, the recession is deepening:

— GDP should fall by about 5.5% or somewhat more in 2011. Recession is expected to continue into 2012, with GDP contracting by around 2.8%, while recovery is now expected in 2013, with GDP growth that year projected not to be higher than 1%. With exports of goods and services expected to rise this year and with imports having appreciably declined, the external sector should make a positive contribution to the change in GDP, though not yet sufficient to markedly mitigate the recession.

— The average decline in employment should be of the order of 5.5% this year, and the average unemployment rate is projected to come close to 17%; it may exceed 18% in 2012. These developments may have serious implications for social cohesion. They also imply a loss of human capital and the stock of skills and knowhow; coupled with a reduction in the stock of fixed capital as a result of the crisis, they make the pursuit of policies for recovery and growth even more imperative.

* * *

On the positive side, however, there are some encouraging signs, suggesting that in the midst of the crisis some underlying positive dynamics have been set in motion; provided they continue, these could lead to a significant restructuring of the economy over the medium term. These dynamics include the following:

— Reduced dependence of growth on domestic demand and a positive, albeit small (for the time being), contribution of the external sector.

— Partial recovery of the large losses in cost competitiveness recorded in 2001-2009. Three fifths of the large cumulative loss in competitiveness (as measured on the basis of relative unit labour costs) over the nine years from 2001 to 2009 are expected to be recovered, following the improvement (actual and expected) in 2010-2012. If this improvement in competitiveness is to prove sustainable, it will also have to be underpinned by productivity gains, stemming from structural reforms in product and labour markets.

— Changes in the structure of employment, with job creation shifting to the more productive businesses and branches of activity. Available data show that, while the number of employees in private sector enterprises with less than 20 employees decreased, the number of employees in those with over 50 employees rose. At the present time, these businesses effectively constitute the only option for jobseekers.

— Greater flexibility in the labour market, which can act as an antidote to unemployment. The tendency to adopt more flexible forms of employment, already apparent in the labour market, is also expected to become stronger, facilitated by the new provisions legislated in October, and will have positive effects on employment and productivity.

* * *

Developments in the international environment have contributed to the uncertainty in Greece. In the world economy, the major risks relate to uncertainty regarding the unfolding of the sovereign debt crisis in the euro area peripheral countries and the sustainability of the US government debt, as well as the difficulty of striking a balance between necessary fiscal adjustment and policies to stimulate economic activity, at a time that unemployment rates remain high in many advanced economies. The risks associated with the sovereign debt crisis pose a threat to financial stability, in Europe and beyond.

In early November, the European Commission published a marked downward revision of its macroeconomic projections for the euro area in 2012. At the policy level, efforts focus on developing a comprehensive framework of rules to deal with the impact of both the global financial crisis and the sovereign debt crisis, as well as to strengthen economic governance. The new framework will imply long-term commitments by all Member States, notably on fiscal discipline and the improvement in competitiveness – i.e. precisely the two major challenges that Greece has, in any case, to face.

The policy pursued by the ECB is contributing decisively to maintaining price stability and financial stability in the euro area, thereby helping to counter the effects of the crisis. This is achieved both through the interest rate policy and through open market operations injecting liquidity to credit institutions, as well as the Securities Markets Programme. These actions are essential for the provision of liquidity to credit institutions, operating inter alia in Greece, which have been shut out of the interbank market.

* * *

The challenges for the Greek banking system became more pressing in 2011. The deterioration in overall macroeconomic conditions and heightened uncertainty weighed heavily on deposits and the quality of banks' loan portfolios, leading to the continued inability of banks to draw funds from the interbank market. In addition, in the first half of the year, bank balance sheets were further burdened by the impact of the loss in the market value of Greek government bonds, while a further loss is expected to be recorded in banks' annual results.

Against this background, the stability of the banking system has come under strong pressure and banks need to urgently strengthen their capital base, restructure their balance sheets and redefine their business models. The creation of larger and stronger institutions is a necessary choice in the context of the ongoing restructuring of the banking system and will allow banks to successfully provide financial intermediation, thereby contributing to the reconstruction of the economy.

By the end of June 2011, capital adequacy ratios (CAR) had declined, mainly due to the impact of increased provisioning on regulatory capital, in view of the private sector involvement (PSI) associated with the initial agreement of 21 July. Moreover, given the continued deterioration in the economic environment and the effect of the write-downs on Greek government bonds following the recent decision of the Euro Summit, further substantial recapitalisation of the banking system is necessary. In addition, banks may be required to further raise capital once the diagnostic assessment of their loan portfolios, currently under way, is completed.

The diagnostic assessment of banks' loan portfolios being conducted will trace loan repayment dynamics, taking into account the great challenges posed by the recession. It will help banks to adjust their capital and provisions accordingly. Over the medium term, the results of the diagnostic assessment are expected to have a positive effect on the ability of Greek banks to access markets. Indeed, it may make it easier for them to return to the markets sooner.

A very positive development was the adoption of Law 4021/2011, introducing enhanced banking supervision and bank resolution measures. The law provides new options for managing and effectively addressing vulnerabilities in individual credit institutions. Most importantly, it provides options for preventing a disturbance in one bank from evolving into a systemic disturbance. The aim is to safeguard financial stability and ensure, to the extent possible, the uninterrupted flow of credit to the real economy through the banking system.

Today, banks remain shut out of the global markets and face the consequences of their shrinking deposit bases and the decline in value (or even ineligibility) of their collateral used to obtain refinancing from the Eurosystem. In the first half of 2011, the overall effect of these factors was a squeeze on bank liquidity. The maintenance of the Eurosystem's liquidity-providing measures, along with the liquidity-support measures taken at the domestic level, helped to mitigate these pressures, preventing a credit crunch. It is important to note that in the first half of 2011 the year-on-year rate of decline in private sector financing (-1.2%) was very small compared with the rate of contraction in nominal GDP (-6.2%).

Without these liquidity support measures, banks would have been forced to deleverage rapidly, thus substantially reducing credit to the economy, which would in turn have led to an even deeper recession.

Banks are expected to benefit in the immediate future from the implementation of the commitment of the Heads of State or Government of the euro area and the EU institutions to provide credit enhancement to be used by Greek banks in the Eurosystem's liquidity-providing operations during the Greek government bond exchange period.

Furthermore, apart from the Eurosystem's standard operations, since August the Bank of Greece has also provided exceptional funding to credit institutions to compensate for the withdrawal of deposits by the private and public sector and for the decline in the value of collateral eligible for monetary policy operations.

* * *

Following the decisions of 26 October, the new government must demonstrate that the country will fully honour its commitments, i.e. the programme of fiscal adjustment and structural reforms. However, in order to convince the markets and the general public, the country's strategy must be drawn up with a keen sense of responsibility and over a medium-term horizon. Restoring confidence in the prospects of the Greek economy is the only way to shorten the length of the recession, create the conditions for economic recovery and take advantage of the results of the decisions of 23 and 26 October.

There are two national objectives which we must now pursue at all costs:

First, to generate primary surpluses at higher rates than currently projected on the general government accounts.

Second, to speed up recovery and then achieve higher rates of growth in the years to come.

If we overshoot the fiscal adjustment targets, with an emphasis on expenditure reduction, and if, at the same time, recovery begins, thereby reversing the pessimistic projections for growth, it will be possible to reduce the debt-to-GDP ratio to levels below the present target of 120% and, in fact, to do so sooner than currently projected (i.e. earlier than 2020). If this happens, the climate could improve dramatically and a virtuous circle of growth would be set in motion.

We therefore need a strategy that fulfils certain conditions:

1. aims to change the conditions that generate problems. To this end, fiscal adjustment should go hand-in-hand with the rapid modernisation of the state and public administration;

2. steadfastly adheres to the targets set, continuously reaffirms them and stresses Greece's fundamental commitment to address the current crisis from within the euro area;

3. fully respects the timetables/schedules set;

4. overshoots, where possible, the initial targets;

5. secures the broadest possible social and political consensus;

6. produces, the earliest possible, tangible proof of the will to proceed rapidly with the implementation of this policy, e.g. by creating primary surpluses in the near future which rise over time, promoting major privatisations as soon as possible, attracting investors to ensure the better use of state assets (with the potential to create income and jobs), and closing down without delay those public sector entities which do not provide useful services;

7. mobilises resources available from the EU structural funds to re-launch major public investment projects; and

8. convinces investors that the economy will operate under a new framework which will ensure effective competition and the smooth functioning of markets, while favouring productivity.

In order to bolster the credibility of the fiscal adjustment programme, clear and positive messages must be provided that, this time, decisions will be implemented in full. This highlights the need for (a) specific programmes for each ministry and area of government action; (b) coordination of individual programmes by an effective central mechanism; (c) strong and steadfast political will, expressed through concrete actions in the various policy areas; (d) measures to increase the efficiency of public administration; and (e) close cooperation with the European Commission technical assistance task force.

* * *

Mitigating the recession and ensuring the fastest possible return of the economy to positive rates of growth call for a reversal of the economic climate and sharp progress with fiscal adjustment, which would provide a clear message that the economy is in a position to recover. At the same time, it is necessary to encourage private business activity, which has been strongly hit by the negative effects of reduced demand, lower competitiveness, weakening credit expansion and a heavier tax burden.

The Bank of Greece has argued that there is no room for further increasing the tax burden on businesses and households and that the policy for achieving the necessary increase in revenues should focus on capturing tax evasion. A further rise in the tax burden on those who already pay their taxes would not only exacerbate the recession, but would also prove counterproductive, i.e. it would reduce rather than increase revenue.

This factor must be a prime consideration in the formulation of the new legislative framework on taxation. That framework must avoid imposing new burdens, especially on those presumed to be honest taxpayers. It must also clearly describe the conditions – the first and foremost being progress with fiscal consolidation – under which the tax burden borne by honest taxpayers can be lightened.

A reversal of pessimistic expectations about the future of the economy, so as to stop the outflow of deposits, encourage households to consume and enterprises to invest, and foster exports, requires, among other things, the following:

- modernisation of the state and public administration;

- creation of conditions for the effective operation of competition in markets for goods and services;

- rapid progress towards rationalising the regulatory environment of product markets;

- bringing network services up to date, which is necessary for increasing productivity and attracting foreign investment; and

- promoting structural changes in the labour market in an orderly manner, on the basis of the new arrangements legislated in 2010-2011.

As the rate of credit expansion to the private sector remains negative and the decline in household income and business profits continues, economic recovery – and subsequently growth – can initially be financed through the following sources:

- the faster disbursement of funds under the National Strategic Reference Framework, in cooperation with the task force on technical assistance set up by the European Commission; and

- the implementation of the programme for privatisation and effective use of state property, which can become an important channel for attracting foreign capital and importing know-how and technology.

* * *

The long effort to adjust and reform the economy rests on two pillars – first, achieving fiscal consolidation and adjustment and, second, improving competitiveness and changing the production model.

Most analysts recognise that Greece has several potential competitive advantages that are important and relate to both its geographical position and, inter alia, its natural and human resources – such as renewable energy sources, specific minerals, climate, natural environment and ancient monuments, availability of highly-skilled workforce and an aptitude for entrepreneurship. However, at the current juncture, these advantages have been largely untapped.

This is mainly due to two factors:

- First, the "credibility deficit". As long as Greece is viewed as an example of fiscal derailment and its ability to make further substantial progress towards fiscal consolidation and economic recovery is under question, attracting foreign investment (and know-how) in order to utilise potential advantages will remain difficult or will only be possible on unfavourable financial terms. The same lack of incentives also relates to domestic investment initiatives – although there exist some important examples of Greek enterprises that, in extremely adverse conditions, have taken initiatives and scored successes in foreign markets.

- Second, delays and underachievement in promoting and implementing reforms that would facilitate the efficient functioning of product and labour markets, speed up recovery and restore conditions for a sustainable improvement in competitiveness and steady growth. In this case too, negative consequences are the same.

Underlying the above two factors is the "great patient", namely the operation of the state and public administration, which reflects and, at times, favours corporatist compromises and promotes corruption, the sweeping of problems "under the rug" *ad infinitum*, and the undermining of solutions proposed. The fact that the functioning of the state apparatus has not risen up to the challenge has had extremely large negative consequences.

For the adjustment programme to move forward, both of its pillars —fiscal consolidation and improvements in competitiveness— must be achieved at the same time, in order to deal with the vicious circle of depression-fiscal contraction-uncertainty, support economic recovery and consolidate growth prospects. This is the only way to demonstrate conclusively that *the country is creditworthy*. For this to occur, a detailed and binding Action Plan for Growth, as suggested by the Bank of Greece, is needed. If the policies are properly specified in the Action Plan (in order to ensure their effectiveness and internal coherence) together with social justice, then society's confidence can increase, and social and political dialogue —instead of turning out to be a "dialogue of the deaf" or a "war of all against all"— could become a meaningful and constructive dialogue focused on a socially equitable and, at the same time, more efficient allocation of the sacrifices that are urgently necessary to exit the crisis, also signalling the prospect of future benefits.

Such a road map could lead us, through an arduous but fruitful effort undertaken by all society, to the exit from today's severe crisis and *secure* the country's place within the euro area.

Athens, November 2011

George A. Provopoulos

Governor

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1 THE GREEK ECONOMY IS GOING THROUGH A NEW, EXCEPTIONALLY CRITICAL PHASE

The Agreement of 26 October

The decision of the 26 October Euro Summit represents a milestone on the adjustment path of the Greek economy that began in 2010. The main aim of the agreement concerning Greece was to lighten the burden of government debt and its servicing costs, so as to facilitate economic recovery and restructuring, and the transition to a new growth path that would ensure access to markets in the future. This decision envisages the adoption of a new multiannual EU-IMF support programme for Greece by the end of 2011, as well as enhanced programme monitoring and implementation mechanisms.

The new agreement revises the previous one of 21 July, mostly with regard to the voluntary participation of the private sector in the bond exchange, with a nominal discount of 50% on notional Greek debt held by private investors. The Member States of the euro area would contribute to the private sector involvement package the amount of 30 billion euro, while the official sector would provide additional financing of up to 100 billion euro until 2014. On the basis of the provisions in the agreement, the debt would fall to 120% of GDP by 2020.

Adverse domestic developments led to a revision of estimates on the dynamics of government debt and to the new agreement

About a year ago, the Bank of Greece considered that a debt restructuring/haircut was not necessary. The Bank based its assessment on (a) the full attainment of the fiscal targets that had been set —indeed, the Bank strongly encouraged the overachievement of those targets, wherever possible— and (b) a substantial improvement in competitiveness. Presently, however, the increased involvement of the private sector in the effort to reduce government debt, as envisaged in the decision of 26 October, is proven inevitable following the significant deterioration in crucial economic sectors:

• The fiscal targets set in the 2011 Budget are not expected to be met, while the draft 2012 Budget also anticipates deviations from the revised targets set in the Medium-Term Fiscal Strategy Framework.

• No progress has been made in implementing privatisations.

• Structural reforms in the government sector and with regard to the operation of markets have not progressed satisfactorily.

• There has been no tangible proof of a strong will to implement reforms, such as a faster progress in achieving primary fiscal surpluses and launching more radical structural reforms, which would strengthen the capacity of an economy to grow and thus reduce the "confidence deficit", improve expectations and, most of all, prevent the economy from falling into deep recession.

Deviations and delays overturned the assumptions underpinning the decision of the Summit of 21 July and, most of all, undercut earlier assessments on the dynamics and sustainability of the Greek debt, as the numerator in the debt/GDP ratio was growing faster, while the denominator declined further because of the recession, which was sharper and longer than expected.

Last opportunity to save the country and lay the foundations for sustainable growth

The arrangements of 26 October brought about a significant reduction in the debt and, under certain conditions, could put debt dynamics under control. This is a significant fact that can have a stabilising effect and improve expectations. It should be reminded, however, that also in the past (after the Memorandum was entered into, in May 2010) there has been a series of favourable arrangements for the debt, which did not produce the expected results, as the response from the Greek side has not been appropriate. Hesitation in undertaking the necessary actions did not allow to put the facilities provided by these favourable arrangements into good use, thus multiplying the economic and social cost of efforts made and drained confidence in the future of the economy.

The new opportunity provided to Greece under the agreement of 26 October may well be the last. The country must avoid all further delays or deviations from the targets agreed upon at all costs; every possible effort needs to focus on overshooting the targets. The present juncture is the most critical period in Greece's post-war history. **What is at stake is whether the country is to remain within the euro area in the future.** This is why it is no longer possible to ignore reality, which confronts us in the most urgent way with the following dilemma:

– an uncontrolled downward trajectory that would wipe out all that has been achieved since the restoration of democratic rule in 1974, drive the country out of the euro area and set Greece's economy, standard of living, society and international standing back many decades; or
– an all-out effort within the euro area, in close cooperation with our European partners and the international community, to mitigate shocks, shorten –to the extent possible– the difficult and long adjustment period and lay solid foundations for the restructuring of the economy and reestablishment of sustainable growth.

Clearly, the latter option entails costs. Incomes will decrease and certain groups that enjoyed protection and privileges will be exposed to competition. However, the overall cost to society will be lower than otherwise in the medium term, and the long-run benefits will be higher than would be the case under the former option, given that:

- The economy will be freed from dysfunctions and rigidities, while a more rational operation of the economy will create the conditions for sustainable growth;

- Greece will remain within the European Union and the euro area, participating in the processes forming their future course.

The implementation of the necessary policies requires a strong and effective government

The decision of the Euro Summit of 26 October clarifies the basic orientations and targets regarding the financing of the Greek economy in the next few years, thereby lifting a significant cause of uncertainty.

However, in order to establish a firmly positive environment, the decision on the broad orientations should be specified and effectively implemented in all its aspects. This entails long negotiations on individual crucial issues, such as the involvement of banks in the programme and the commitments to be undertaken in the context of the new loan agreement to be drafted by the end of the year.

The new government that took office on 11 November is called upon to implement the agreement of 26 October consistently, promote the policy measures stemming from it and, in due course, lead the country to elections. This is particularly important for the banking system as well, which showed resilience in the past two years to the uncertainty deriving from the debt crisis. The recent political uncertainty created additional problems for the economy and the banking system. In order to safeguard financial stability in this challenging environment, it will be necessary for the coalition government to exert strong and effective leadership, in order to implement the policies required to ensure Greece's future within the euro area.

The new government resulted from an agreement between three political parties in view of possible undesirable developments that seemed inevitable a few days earlier. Thus, the first task of the new government is to prevent such an eventuality and restore confidence, which has been dealt a serious blow. The fact that it is supported by a wide range of political forces is a *prima facie* positive development that can have a favourable effect on the confidence level in Greece and abroad.

However, in order to consolidate confidence in the prospects of the economy, the convergence of political forces reflected in the formation of the new government must become more substantive and last beyond the planned election. The upcoming period should be a time of reflection, realistic assessment of the potential of the economy and search for the optimal long-term choices. It would be useful if political debate was carried out in the terms of the future instead of the terms of the past, as this is what led us to the current distressing situation. There is one condition for the government to succeed and for the will of the citizens to be expressed authentically in the next election: the true state of the economy and the international context must be described with utmost candour, possible solutions must be clearly analysed, while the costs and benefits of each option must be explained cogently.

* * *

2 HAS THE MEMORANDUM FAILED OR HAS IT BEEN IMPLEMENTED FRAGMENTARILY?

The Memorandum of May 2010 and its ensuing updates aim at contributing to the objective of exiting the crisis with the lowest possible losses, by securing necessary financing. The obligation of Greece was and still is to restore fiscal balance in a relatively short time and to carry out radical reforms, which will facilitate a sustainable fiscal consolidation and help change the model of production through a competitive and outward-oriented economy.

Today, seventeen months later, the capacity of the economy to soon return to a virtuous circle has not been ensured given that:

- Recession has been sharper and longer than expected.

- Medium-term forecasts for growth have been revised downwards.

- The dynamics of government debt remain unfavourable, since the increase in receipts and the decrease in expenditure lag markedly behind the targets set.

- Social unrest heightens, which increases uncertainty.

As a consequence of the above, pessimistic expectations have been strengthened, which exacerbates recession and undermines the prospects of recovery.

The responsibility for implementing policies to promote the goals set by the Memorandum lies with the Greek government

All the above result from Greece's failure to implement, in a timely manner and to the required extent and depth, those policies that would effectively promote the targets set in the financial support agreement. The size of fiscal adjustment achieved in 2010 has been unprecedented in developed countries. Meanwhile, despite delays, a number of noteworthy structural reforms were implemented, the most important of which was the reform of the social security system. However, the situation remains critical.

The most serious problem is that, up to now, the implementation of economic policy has failed to convince the markets and the citizens that Greece is on the road to achieving the goals set. This "credibility deficit" has its roots mainly in the fact that economic policy has often been conducted in a piecemeal manner, indecisively, with backtracking and delays, and following rather than leading developments. Thus, depending on the case:

- Measures that would move the economy in the desired direction lose impetus in their implementation, thus failing to deliver the expected results in full.

- The preparation and planning of measures do not adhere to the timetable laid down, thus making it necessary to search for last-minute "magic solutions".

• There is a resurgence of outdated attitudes and behaviour, which treat certain issues as non-negotiable if vested interests are threatened.

• "Horizontal", i.e. indiscriminate and across-the-board, approaches are used to curtail public spending, while the mechanisms that are inherently cost-generating remain untouched; this outcome prevails because the public administration is unable to work out targeted solutions, which would be more effective and socially more equitable.

3 THE "CONFIDENCE DEFICIT" IS EXACERBATING RECESSION

If we are to succeed where we have so far failed, it is necessary to convince both markets and the citizens that we will exit the crisis, that the targets will be met. In other words, it is necessary to eliminate the "confidence deficit" caused by the weaknesses of economic policy and the social tensions fuelled by the illusion that a return to the policies of the past is possible.

It has often been argued that the deepening of the recession in 2011 and its projected continuation into 2012 are due to the impact of the contractionary fiscal adjustment on aggregate demand. Although this approach overlooks the fact that the economy had already entered recession in 2009 —that is during a period of fiscal relaxation— this is certainly a valid issue, at least in the short term. However, a restrictive fiscal policy is not by definition bound to have contractive effects. International experience and numerous empirical studies have shown that a restrictive fiscal policy can have expansionary effects over the medium to long term, particularly in countries with very high levels of government debt. In particular, the negative macroeconomic impact of fiscal adjustment can be minimised and Greece can return to growth faster if the programme implemented is considered by households and firms as a credible one, which would have a positive impact on expectations. For this to happen, adjustment should focus on cutting primary expenditure —excluding investment spending— on a permanent basis and the programme should be implemented with determination, so that its success can be considered certain.

Expectations play a crucial role

Such conditions, however, are not in place, which explains why confidence has not recovered and the "credibility deficit" is growing. The domestic economic climate is undergoing an almost continuous decline and the consumer confidence index reached a historic low in 2011. Negative expectations deter private investment and restrict current consumption by reducing the present value of the expected available income. Outside Greece, the "confidence deficit" has led to successive downgrades of Greece's credit rating, a sharp rise in interest rate margins on government bonds, while the economy's capacity to overcome the present crisis has been put into question repeatedly. On the basis of the above, it can be said that lower domestic demand and economic recession are *disproportionately* large in comparison with the magnitude of fiscal adjustment. This is so precisely because the economic climate has worsened and business and consumer expectations have declined to a very low level, thus contributing significantly to the high drop in domestic demand. The prevailing climate and expectations prevent economic recovery and the emergence of a "confidence effect" (see Box I.1 below). In these circumstances, recession is deepening.

4 MORE UNFAVOURABLE THAN EXPECTED ECONOMIC DEVELOPMENTS

Deeper recession in 2011 – Uncertain perspectives

After the publication of data on the second quarter of 2011, the initial forecast for a 3.8% decline in GDP included in the Updated Memorandum of July 2011 proved to be unrealistic. According to the latest estimates of the Ministry of Finance and the European Commission, GDP is expected to decline by about 5.5% in 2011, while a somewhat higher deceleration cannot be ruled out. The recession is expected to continue into 2012, with GDP contracting by around 2.8%, while recovery is now expected in 2013, with GDP growth projected to be not more than 1%. The worse-than-expected recession, negative forecasts for 2012 and a more remote prospect of recovery not only enhance uncertainty, but also negatively affect fiscal aggregates and debt dynamics.

The external sector is expected to make a positive contribution, though not sufficient to mitigate recession

On the domestic demand side, lower GDP is also associated with private and public consumption, which are estimated to decline in 2011 by around 6% and 8%, respectively, and with fixed capital formation, which is expected to decline by more than 15%. Exports of goods and services experienced a small decrease —on a national accounts basis— in the first half of the year (exports of goods increased), yet they are expected to increase over the year as a whole. Thus, as imports have declined appreciably at the same time, the external sector should make a positive contribution to the change in GDP, though not yet sufficient to markedly mitigate recession.

Rising unemployment

Economic recession entails great job losses (5.5% decrease in total employment on average this year). This, combined with the large number of the long-term unemployed, led to an increase in the number of the unemployed to an average of 802,000 in the first half of 2011. In fact, in August 2011 employment fell by 364,000 compared to August 2010 (-8.3%), while the number of the unemployed surged to 908,000 (18.4% of the workforce). According to Bank of Greece estimates, average unemployment in 2011 would reach 17%. Taking into account the latest GDP forecasts, unemployment would rise further to more than 18% in 2012.

The disuse or loss of productive potential is dangerous

The significant rise in unemployment and the loss of jobs could have serious implications for social cohesion, while they also imply a loss of human capital and the stock of skills and knowhow. These developments, coupled with a reduction in the stock of fixed capital as a result of the crisis, make the pursuit of policies for recovery and growth even more imperative.

5 RESTRUCTURING TRENDS ARE EMERGING

The aim of the efforts made since May 2010, in addition to fiscal adjustment, is to change the Greek model of production mainly by improving competitiveness and strengthening the outward-orientedness of the economy, so as to mitigate the high dependency on domestic demand. Signs of such change in the economic structure[1] have already emerged, but they are not yet strong enough. Indeed, in the midst of the crisis some underlying positive dynamics have been set in motion; provided they continue, these could lead to a significant restructuring of the economy over the medium term. For the time being, there is no strong evidence of such change to plausibly expect a permanent improvement soon. But these changes should be fostered and encouraged, as the success of the ongoing efforts will depend decisively on how fast they will be implemented.

In this regard, the following should be pointed out:

- The reduced dependence of growth on domestic demand and a positive, albeit small for the time being, contribution of the external sector, with increased exports and lower propensity to consume imported goods.

1 See also P. Mylonas and N. Magginas, "First signs of economic rebalancing, but high uncertainty and a tough fiscal program slow the adjustment process", National Bank of Greece, *Greece – Economic & Market Analysis*, October 2011.

• A partial recovery of the large losses in cost competitiveness recorded in the past decade.

• Changes in employment structure, with job creation shifting to the more productive businesses and branches of activity.

• Greater flexibility in the labour market, which can act as an antidote to unemployment (despite the fact that the already enacted institutional changes that could promote flexibility are not fully used yet).

The contribution of the external sector and the improvement of competitiveness

As already mentioned, the external sector made a positive contribution to GDP in the past two years, contrary to what happened in the prolonged earlier period, when GDP growth relied solely on domestic demand, i.e. mostly on consumption and —in certain periods— on investment. If the lower propensity to consume imported goods (because of the policies pursued up to now) becomes a more permanent feature of current consuming patterns of households and, at the same time, if exporting activity and substitution of imported goods are strengthened, a significant structural change will be promoted with regard to the sources of growth.

For this positive trend in the external sector to continue, the production of tradable goods and services should increase and competitiveness should improve significantly. In this regard, it is noted that unit labour costs in the whole economy dropped by 3.8% in 2010 and they are estimated to decrease by 2.1% in 2011 (in the euro area by -0.6-0.8% in 2010, while they are estimated to increase by 1.0-1.6% in 2011). This means that the real effective exchange rate (based on relative labour costs) vis-à-vis our partners in the euro area decreased by 3.0-3.2% in 2010 and is expected to decrease by 3.1-3.7% this year, while vis-à-vis Greece's 28 main trading partners it dropped by 7.0% in 2010 and is expected to drop by 3.5% this year. The lower real effective exchange rate entails an improvement in cost competitiveness by an equal amount. As a result, **the cumulative loss of cost competitiveness over 2001-2009, which reached 22.7% vis-à-vis Greece's trading partners in the euro area and 31.9% vis-à-vis its 28 main trading partners, has now narrowed markedly over the 2001-2011 period to 14.4-15.3% and 18.3%, respectively, i.e. by two fifths. However, the remaining loss to be recovered is still high and the effort should continue**.

In 2012, further progress is expected, as unit labour costs in the whole economy are expected to decline by 2.7% (or even more), while in the euro area they are expected to rise by 1.4%, which entails a further improvement in cost competitiveness by 4.1%. Thus, **over the twelve-year period from 2001 to 2012 the cumulative loss of cost competitiveness vis-à-vis Greece's partners in the euro area is expected to decline to 9.7-10.6% and vis-à-vis Greece's 28 main trading partners to 13.2%, i.e. by three fifths**.

It is noted, however, that the estimated and expected improvement in competitiveness based on the relative unit labour costs over the three-year period from 2010 to 2012 reflects the drop in average nominal earnings, while at the same time productivity fell slightly (in 2010) or remained unchanged (in 2011-2012). It is obvious that —after an initial "corrective" period— a sustainable improvement in competitiveness cannot rely on this mix of factors, as the negative impact of a continuous reduction of earnings on domestic demand would outweigh any positive impact on external demand. Therefore, **improving cost competitiveness should also rely on enhanced productivity, which can derive from structural reforms in the product and labour markets** and would enable higher potential growth and improved structural competitiveness.

With regard to **structural competitiveness**, which is measured by certain internationally comparable indicators, there are some signs of improvement in 2011. According to a recent report by the World Bank,[2] Greece has slightly

2 World Bank, *Doing Business 2012*, 20 October 2011.

improved its position in the global ranking on the Ease of Doing Business index. In particular, it ranked 100th among 183 countries, while last year it ranked 109th (or 101st, on the basis of a revised comparable ranking). It should be noted that in the two previous years its ranking deteriorated, after having improved in 2008.[3] According to the report, the better ranking this year reflects reforms in the areas of starting a business[4] and paying taxes.[5]

However, according to another recent report (by the World Economic Forum),[6] Greece's ranking on the basis of the Global Competitiveness Index (GCI) worsened: Greece ranked 90th among 142 countries, while last year it ranked 83rd among 139 countries.

It is a fact, however, that in 2010 and 2011 some progress was made towards a more efficient operation of the product and labour markets (see Chapter VI). As a result, Greece's relative position improved not only on the basis of the above World Bank indices, but also on the basis of several OECD indicators on market regulation.[7] The progress made is acknowledged in the recent OECD report on Greece (August 2011).[8]

Changes in employment

Economic recession resulted in great job losses primarily in construction, agriculture and manufacturing. In particular, the number of employees in the whole economy fell by 6.3% in the first half of 2011 compared with the respective period in 2010, while the number of employees in the private sector fell by 7.6%. It should be noted, however, that the magnitude of job losses varies between sectors and between enterprises. The greatest resilience to the crisis has been demonstrated by (a) sectors producing internationally tradable products and services, and (b) larger enterprises (employing more than 50 people).

Indeed, employment rose in the relatively large enterprises of the private sector. According to ELSTAT estimates, the number of employees in enterprises with more than 50 employees rose by 5.8%, while their number in enterprises with less than 20 employees (accounting for around 80% of total employment in the private sector) fell by 8.3%. Evidence from the past two years suggests that the structure of employment tends to change in favour of enterprises and sectors with high productivity. This is a promising development, as it reveals that a significant part of the private sector, presumably the most productive one, is still in a position to create jobs even amid a deep recession. At present, these businesses effectively constitute the only option for job seekers. The higher the number of such enterprises, the less the chances of job losses in the private sector. In macroeconomic terms, these changes in the structure of employment —if they are maintained— could improve overall productivity, costs and hence competitiveness.

Greater flexibility in the labour market as an antidote to unemployment

Another development in the labour market which is worth discussing is the emerging trend of private sector enterprises to increasingly opt for more flexible employment patterns, such as part-time work, job rotation and reduced working hours, as well as the conclusion of individual work contracts. Furthermore, some large and medium-sized enterprises have concluded special firm-level agreements, although the vast majority of enterprises do not seem eager to adopt this type of agreement yet, mostly due to the insufficient institutional framework. The tendency to adopt more flexible forms of employment, already apparent in the labour market, is expected to become stronger, facilitated by the new provisions of Article 37 of

3 World Bank, *Doing Business 2009*.
4 Launching one-stop-shop and the General Trade Register.
5 Reduced taxes on corporate profits.
6 World Economic Forum, *Global Competitiveness Report 2011-2012,* 7 September 2011.
7 On the basis of various indicators, Greece's position in 2011 is better than the average for OECD countries in 2008. A comparison with the average achieved by OECD countries in 2011 is not possible, as OECD has updated indicators only for Greece and not for the other countries.
8 OECD, *Economic Surveys: Greece 2011*, 2 August 2011, p. 108, 132, 136 and 144.

Law 4024/2011 that was enacted recently. If this is the case, the effects on employment and productivity will be positive.

6 UNCERTAINTY IN THE INTERNATIONAL ENVIRONMENT

Developments in the international environment, which seem very volatile, have contributed to ongoing uncertainty in Greece.

First of all, the recovery of the global economy in the first half of the year proved more fragile than anticipated and is expected to continue at a moderate pace in the second half. In the world economy, the major risks relate to uncertainty regarding the unfolding of the sovereign debt crisis in the euro area periphery, the sustainability of US public debt, as well as the difficulty of striking a balance between necessary fiscal adjustment and policies to stimulate economic activity, at a time when unemployment rates remain high in many advanced economies. The risks associated with the sovereign debt crisis also pose a threat to financial stability and are not confined to Europe, as increasingly high levels of debt, both public and private, can be seen in most advanced economies. As a result, the risk-free nature of government bonds has come into question.

More particularly in the euro area, the financial crisis revealed essential problems and non-sustainable trends in several countries. The European Union has focused on developing a comprehensive set of rules to deal with the consequences of the global financial crisis and the sovereign debt crisis, while strengthening economic governance in the EU and particularly in the euro area. In early November the European Union published a marked downward revision of its macroeconomic projections for 2012. The euro area GDP growth rate is now expected to decelerate to 0.5% in 2012, down from 1.5% this year, compared to last April's projection for 1.8% growth. A deceleration of this magnitude is not expected for other developed economies or for developing and emerging economies.

7 DECISIONS OF THE EURO SUMMITS OF JULY AND OCTOBER 2011 DIRECTLY RELEVANT TO GREECE

The deepening of the fiscal crisis in some euro area Member States in the second quarter of the year, combined with increased risk of a dissemination of the crisis, called for a coordinated intervention of the Heads of State or Government on 21 July 2011 in order to ensure financial stability. The agreement reached included measures to improve the sustainability of the Greek public debt and increase the efficiency and flexibility of the euro area stabilisation tools, namely the European Financial Stability Fund (EFSF) and the future European Stability Mechanism (ESM). At the same time, the determination of the euro area Heads of State or Government to reinforce convergence, competitiveness and economic governance was reaffirmed, as these elements are crucial to ensuring sustainable economic growth and job creation.

The agreement concerning Greece

The **21 July 2011** summit decided the adoption of a new programme for the provision of financial support to Greece jointly with the IMF and with the voluntary involvement of the private sector, in order to fully cover the financing gap until mid-2014. What is of great importance is that the programme provides for **lower interest rates** and **extended maturities for future** EFSF **loans** to Greece. At the same time, it was decided to **extend the maturities of loans under the existing financial support package**. The European leaders called for **a comprehensive strategy for growth and investment in Greece** and welcomed the Commission's decision to create a Task Force that would work with the Greek authorities to target the structural funds on more productive usages. Also the European Investment Bank (EIB) will be mobilised towards the goal of relaunching the Greek economy. Finally, the provision of technical assistance to help Greece implement its reforms was also decided.

On 26 October, the Heads of State or Government of the euro area (Euro Summit) agreed that further action was needed to restore confidence, as a follow-up to the important decisions taken on 21 July. This is why they agreed on a comprehensive set of additional measures, which partly amend the initial decisions of 21 July, mostly with regard to the level of official loans and the involvement of the private sector. In more detail:

- They reiterated their determination to continue providing support to all countries under programmes until they had regained market access, provided they fully implemented those programmes.

- They stated that they looked forward to the conclusion of a sustainable and credible new EU-IMF multiannual programme by the end of the year, which would include the following:

– The mechanisms for the monitoring of implementation of the Greek programme must be strengthened, as requested by the Greek government.

– The Private Sector Involvement (PSI) has a vital role in establishing the sustainability of the Greek debt. Greece, private investors and all parties concerned are invited to develop a voluntary bond exchange with a nominal discount of 50% on notional Greek debt held by private investors, so as to secure the decline of the Greek debt-to-GDP ratio with an objective of reaching 120% by 2020. According to the statement, "the Euro zone Member States would contribute to the PSI package up to 30 bn euro" while "the official sector stands ready to provide additional programme financing of up to 100 bn euro until 2014, including the required recapitalisation of Greek banks".

8 THE CONTRIBUTION OF THE ECB IS VERY IMPORTANT

The policy pursued by the ECB is contributing decisively to maintaining stability and countering the effects of the crisis. In particular:

In order to avoid broad-based inflationary pressures through second-round effects emerging from the persistent rise in commodity prices, which continued into the largest part of the first half of the year, the ECB Governing Council raised the Eurosystem key interest rates in April and in June 2011, by 25 basis points on each occasion. Over the following few months, it became progressively evident that the fiscal crisis and the deceleration of economic activity globally would contribute to a significant decline in the euro area GDP growth in the second half of 2011 and that forecasts on economic growth for 2012 would have to be revised downwards. Thus, in November 2011 the Eurosystem lowered its key interest rates by 25 basis points, so that they would reach a level compatible with the maintenance of price stability over the medium term.

During the current year, the ECB Governing Council extended, at least until mid-2012, the application of the fixed-rate tender procedure with full allotment to all open market operations regularly conducted by the Eurosystem.

In the second half of July and in August 2011 a sharp rise in yields and a reduction in the volume of transactions were observed in government bond markets in some euro area countries. The ECB Governing Council contributed to easing these tensions by reactivating in early August – after an interruption of more than four months – the Securities Markets Programme, as well as by conducting an open market operation, whereby the Eurosystem provided liquidity to the interbank market with a maturity of six months, for the first time after about nine months.

Furthermore, as European banks face difficulties in raising sufficient funds in US dollars due to the shock in the international financial markets, in mid-September the ECB Governing Council, in coordination with the Federal Reserve, the Bank of England, the Bank of Japan and the Swiss National Bank, decided to conduct by end-2011 three US dollar liquidity-providing operations with a maturity of three months as fixed rate tenders with full allotment.[9] In early October, the ECB Governing Council decided to conduct two more liquidity-providing open market operations with full allotment in 2011, with maturities of 12 months (for the first time since June 2009) and 13 months, respectively. Also, it was announced that in the period from November 2011 to October 2012 the Eurosystem would further boost the liquidity of the euro area banking system by purchasing covered bank bonds for a total amount of €40 billion.

Serious difficulties persist in the euro area money market concerning the redistribution of liquidity among banks as, inter alia, credit institutions operating in Greece, Ireland and Portugal are largely excluded from the interbank market. In order to raise liquidity, credit institutions that face difficulties in attracting deposits from the interbank market are forced to resort mostly to the Eurosystem's main and longer-term refinancing operations or to the marginal lending facility, as well as to extraordinary financing provided under the responsibility of national central banks.

9 THE BANKING SYSTEM MUST RISE TO THE CHALLENGES OF LIQUIDITY RISK AND THE NEED FOR RECAPITALISATION

As challenges became more pressing in 2011, the Greek banking system found itself at critical crossroads. The deterioration in overall macroeconomic conditions and heightened uncertainty weighed heavily on deposits and the quality of banks' loan portfolios, leading to a continued inability of banks to draw funds from the interbank market. In addition, in the first half of the year, bank balance sheets were further burdened by the impact of the loss in market value of Greek government bonds, while further losses are expected by the end of the year.

Against this background, the stability of the banking system has come under strong pressure, so that there is an urgent need for banks to strengthen their capital base, restructure their balance sheets and redefine their business models. The rapid and successful implementation of the above is necessary if banks are to play their traditional role of financial intermediation and contribute to economic recovery.

The decisions of the 26 October 2011 summit, in particular the elimination of uncertainty surrounding the bond portfolio and the planned recapitalisation, as well as the full transparency to be ensured by the diagnostic assessment of banks' loan portfolios, set the tone for the future.

In particular with regard to developments in the key aggregates of the Greek banking system in the first half of 2011 compared to the corresponding period in 2010, operating income rose by 9.1% at bank level and remained unchanged at banking group level, while operating costs fell by 6.7% and 5.2%, respectively. Net operating income increased significantly (40.2%) at bank level and more moderately (7.5%) at group level reaching €2 and €3 billion, respectively. International operations of Greek banking groups once again partly compensated for the negative financial results of domestic operations. However, the profit and loss account for the first half of the year, net of provisions, shows losses of €5.6 and €5.7 billion for banks and banking groups, respectively. This development is attributed to the following two factors. First, the provisions for impairment in the context of the private sector involvement (PSI) in the bond exchange, which amounted to some €5.4 and €5.8 billion for banks and banking groups, respectively. Second, the deterioration of the domestic macroeconomic environment and the financial situation of enterprises and households, which made it necessary to establish higher provisions to cover credit risk.

9 In addition to the operations with a weekly frequency and a maturity of seven days announced in May 2010, for which there was no demand from Eurosystem counterparties over much of 2010 and 2011.

Nevertheless, there has been a remarkable improvement in the efficiency ratio (operating income to operating costs) of about 10 percentage points at bank level and 3 percentage points at banking group level, mainly as a result of reduced operating costs. However, this positive development does not leave room for complacency. The continuing trend of declining income from main banking operations (due to the adverse macroeconomic environment) highlights the need for banks to achieve a further reduction of their operating costs by rationalising expenditure and disengaging from non-banking activities, while looking for partnerships that would contribute to a lasting improvement of their outlook and lead to more efficient banking intermediation in the new environment. The creation of larger and stronger entities is a necessary choice in the process of strengthening the banking system and it would allow banks to better address the challenges they face. Also, friendly business combinations and alliances with foreign strategic investors offer significant advantages, such as synergies and more effective size, capital robustness, international competitiveness and new prospects.

It is necessary to increase capital adequacy

By end-June 2011, the Capital Adequacy Ratio (CAR) and the Tier I capital were 12.0% and 10.9% for banks and 10.6% and 9.6%, respectively, for banking groups. This decline is mainly due to the impact on regulatory capital from increased provisioning, in view of the private sector involvement (PSI) associated with the initial agreement of 21 July.

Nonetheless, given the continued deterioration in the economic environment and the effect of the reduction in the value of Greek government bonds after the recent decision of the Euro Summit, further substantial recapitalisation of the banking system is necessary. As provided for in the latest update of the Memorandum, banks will have to maintain their Tier I capital above 10% as of 1 January 2012.

The significance of the diagnostic assessment of banks' loan portfolios

Banks may be required to raise capital once the diagnostic assessment of their loan portfolios is finalised. The diagnostic assessment is provided for in the updated Memorandum of July 2011, which stipulates that it should be assigned to a reputable international advisory firm to be selected by the Bank of Greece in consultation with the ECB/EC/IMF. The diagnostic assessment will trace loan-repayment dynamics, taking into account the great challenges posed by the recession. It will help banks to adjust their capital and provisions accordingly. It is to be noted that a similar diagnostic assessment was completed at end-March 2011 in Ireland and another one has been launched in Portugal.

It is estimated that over the medium term the results of the assessment will have a positive effect on the ability of Greek banks to access markets. Total transparency guaranteed by the diagnostic assessment and the fact that it will be carried out by an independent international firm will eliminate uncertainty. A clearer picture and the immediate coverage of any additional capital could only have a positive impact and it is quite possible that this will help banks return to the markets sooner.

The adoption of enhanced measures of banking supervision and bank resolution

Turning to legal measures, a very positive development was the adoption of the law introducing enhanced banking supervision and bank resolution measures (Law 4021/2011). The provisions of this law are of a preventive nature and form part of a wider European approach, which has been translated into similar legislative measures in other European countries.

The law provides the authorities with new options for managing and effectively addressing vulnerabilities in individual credit institutions. Most importantly, it provides options for preventing a disturbance in one bank from evolving into a systemic disturbance. The aim is to safeguard financial stability and ensure, to the extent possible, the uninterrupted flow of credit to the real economy through the banking system. For these reasons, on 9 October 2011 it was decided that the law would be implemented on Proton Bank, by establishing a New Proton Bank with the Hellenic Financial Stability Fund as its sole shareholder.[10] Its exposure was covered by the Hellenic Deposit and Investment Guarantee Fund (TEKE), i.e. by capital contributed by banks. Without weighing on the tax payer, this solution has secured all deposits, saved hundreds of jobs and its overall cost was lower than that of the alternative, which was the closure of Proton.

A credit crunch has been prevented, despite the squeeze on liquidity

Addressing the liquidity risk represents a major challenge, as today banks remain shut out of the global markets, face the consequences of their shrinking deposit bases, and their collateral, used to obtain refinancing from the Eurosystem, declines in value (or is even ineligible).

In the first half of 2011, under the effect of the above, the liquidity of banks fell by almost €40 billion, while at end-October 2011 the total drop since the beginning of the year amounted to some €80 billion, which caused a squeeze on bank liquidity. The maintenance of the Eurosystem liquidity-providing measures, along with liquidity-support measures at the domestic level[11] represented, in 2011 too, the only way to mitigate these pressures and helped prevent a credit crunch. It is important to note that in the first half of 2011 the year-on-year rate of decline in private sector financing (-1.2%) was very small compared with the rate of contraction in nominal GDP (-6.2%).

Without these liquidity support measures, banks would have been forced to deleverage rapidly, thus substantially reducing credit to the economy, which would in turn have led to an even deeper recession. Deleveraging would have a further negative effect on deposits, as decreased lending adversely affects deposits held by both firms and households, while the feedback loop between loans and deposits would make credit to the economy even more difficult, as bank liquidity would deteriorate. Moreover, in the absence of support measures, banks would be forced to not renew even profitable loans, which would have negative impact on their profitability and, therefore, capital adequacy.

The decisions of the euro area Heads of State or Government to provide credit support and the provision of exceptional funding by the Bank of Greece

A positive effect on bank liquidity is expected from the activation of the commitment by the Heads of State or Government of the euro area and the EU institutions to provide credit enhancement to underpin the quality of collateral so as to allow its continued use for access to Eurosystem liquidity operations by Greek banks during the voluntary bond exchange.

In the framework of the Eurosystem, the Bank of Greece also provides liquidity support to the banking system, when needed. Apart from the usual operations of the Eurosystem, the Bank of Greece has been providing exceptional funding since August in order to compensate for the withdrawal of deposits by the private and public sector and for the decline in the value of collateral eligible for monetary policy operations, given the inability of banks to draw funds from the market. This type of support is provided by Eurosystem national central banks to solvent credit institutions against collateral and upon approval by the ECB Governing Council.

10 The Hellenic Financial Stability Fund was established by virtue of Law 3864/2010 to safeguard financial stability in the Greek banking system by enhancing the capital adequacy of credit institutions.
11 The government guarantee scheme for the issuance of bank bonds was supported by €15 billion (in addition to the €15 billion provided for in Law 3723/2008) under Article 4 of Law 3845/2010, by an additional €25 billion under Article 7 of Law 3872/2010 and by €30 billion under Article 19 of Law 3965/2011.

10 DEVELOPMENTS AND PROSPECTS OF THE PRIVATE INSURANCE SECTOR

Private insurance companies also came under strong pressure, as the decline in economic activity negatively affected new premium income, on the one hand, and led to policy surrenders, on the other. In the first half of 2011, income from premia declined by 7.4% against the first half of 2010. At the same time, a downward movement was also observed in the value of investments by insurance companies, the bulk of which consists of government bonds, a development that put strain on the adequacy of regulatory capital.

The negative conjuncture that affected the sector also had a silver lining. Companies realised that it was necessary to create the conditions to effectively address the chronic structural weaknesses that had seriously put into question the credibility of private insurance in Greece. An important contribution to this development came from the Bank of Greece (which undertook the supervision of the market as of 1 December 2010) through a set of institutional measures.

The effort to form an insurance market consisting of much stronger entities, in terms of capital, will be long and arduous. Taking account of the difficulties, but also the challenges of our times, insurance companies should make the appropriate strategic choices that would lead to powerful entities, with sound organisation, able to cope not only with the consequences of the current adverse environment, but also with the additional capital requirements set by the new European supervisory framework (Solvency II).[12]

Processes to develop internal models for the calculation of the Solvency Capital Requirement for insurance companies are already monitored and, as regards insurance mediation, consultation procedures have been concluded on a set of rules that would help improve organisation and operation of insurance companies and eliminate unhealthy practices, which have burdened both consumers and insurance companies, and mostly the conscientious players in this sector.

11 AN EXIT POLICY FROM THE CRISIS

11.1 ADDRESSING THE CREDIBILITY CRISIS WITH CONCRETE ACTION IS A PRIORITY

Following the decisions of 26 October, the most urgent problem for the Greek economy is to demonstrate that the country will fully honour its commitments, i.e. the programme of fiscal adjustment and structural reforms. However, in order to convince the markets and the public in general, the country's strategy must be drawn up with a keen sense of responsibility and over a medium-term horizon. It should become clear that borrowing from the euro area countries and the IMF will be Greece's major source of funding for a considerable period of time; thus, the necessary measures should be taken in a timely manner, so as to avoid the payment of new loan instalments being linked with extraordinary measures. As long as our partners abroad and Greek citizens have serious doubts, the turmoil will continue and the vicious circle of recession, worsening expectations and fiscal contraction will carry on. In such a situation, the continuation of funding would be jeopardised and the risk of a collapse would be higher. Today, restoring confidence in the prospects of the Greek economy is the only way to shorten the length of the recession, create the conditions for economic recovery and take advantage of the results of the Euro Summit decisions of 23 and 26 October.

A policy to convince

There are two national objectives which we must now pursue at all costs:

First, to generate primary surpluses that will be higher than those projected on the general government accounts.

12 See Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance.

Second, to speed up recovery and then achieve higher rates of growth in the years to come.

If we overshoot the fiscal adjustment targets, with an emphasis on expenditure reduction, and if recovery begins, thereby reversing the pessimistic projections for growth, it will be possible to reduce the debt-to-GDP ratio to levels below the present target of 120% and, in fact, to do so sooner than currently projected (i.e. earlier than 2020). If this happens, the climate could improve drastically and a virtuous circle of growth would be set in motion.

We need a policy able to convince that it can bring these results. Such a policy should:

1 – be **intrinsically consistent** and aim to change the conditions that generate problems. A deficit reduction can be lasting when the underlying structural problems that cause and deepen deficits are adequately addressed. To this end, fiscal adjustment should go hand-in-hand with the rapid modernisation of the state and of public administration. Any improvement achieved in the deficit cannot be sustainable if not combined with major structural changes in the operation of the public sector;

2 – be applied **consistently over time**, i.e. to steadfastly adhere to the targets set, continuously reaffirm them and stress Greece's fundamental commitment to address the current crisis within the euro area;

3 – fully respect the **timetables** set;

4 – **overshoot**, where possible, the initial targets;

5 – ensure the broadest possible **social and political consensus**, so as to allow the continuation of the programme, which will necessarily have to run over the medium to long term in order to address the problems it is meant to, irrespective of changes in government;

6 – produce, the earliest possible, **tangible proof** of the will to implement the policy. Such proof includes, inter alia:

- creating primary surpluses in the near future which rise over time and can convince that debt dynamics are being reversed;

- promoting as soon as possible the major privatisations that have been announced;

- attracting investors to ensure effective use of state assets (with the potential to create income and jobs);

- closing down without delay those public sector entities that do not provide useful services.

7 – mobilise resources available from EU structural funds to re-launch major **public investment** projects that had been interrupted or suspended due to lack of funds or failure to efficiently and fully absorb the funds that are in principle available;

8 – convince investors that the economy will operate under a **new framework** which will ensure **effective competition and the smooth functioning of markets**, while **encouraging productivity improvements**. This can be done if the structural changes that ensure a new environment are implemented now.

11.2 FASTER FISCAL ADJUSTMENT WITH EMPHASIS ON THE EXPENDITURE SIDE

There was significant progress with fiscal adjustment in 2010, when the general government deficit declined by around 5 percentage points of GDP. The structural deficit, which takes into account the impact of the economic cycle, fell at an even faster rate.

However, following the very positive developments of 2010, in 2011 the adjustment lost its initial momentum – also as a result of the deeper recession. Already in May 2011, it was clear that the implementation of the Budget presented significant deviations from the targets. It was evident that the momentum of the previous year was fading and that after the across-the-board income cuts and tax increases, prevailing conditions called for a drastic reduction of the public sector and the immediate implementation of structural changes.

As the Bank of Greece had pointed out earlier, the following conditions should be met for this to happen: First, a fiscal policy should be drafted and strictly implemented – it should set clear objectives, specific measures of a permanent nature and a concrete timetable, with emphasis on cutting expenditure. Second, an extensive programme of privatisations and State property utilisation should be implemented at a fast pace.

The Medium-Term Fiscal Strategy Framework

The Medium-Term Fiscal Strategy Framework (MFSF) 2012-2015, as designed and adopted, attempts to give a realistic response to the above. It is a far-reaching programme with a clear timetable, well-defined objectives and specific measures. Under this Framework, as of 2012 the primary balance is expected to be positive, while in 2015 the general government deficit is expected to decline to 0.6% of GDP.

The privatisations

At the same time, the MFSF provides for an ambitious privatisation and State property utilisation programme with a clear timetable and quantitative targets, which is planned to yield €50 billion by end-2015.

Requirements for the success of fiscal adjustment

Lower primary expenditure

Drafting and adopting the MFSF, which was an obligation under Law 3871/2010 (that provides for drafting and updating on an annual basis medium-term fiscal programmes – actually, multiannual budgets), could have become a key contributor to restoring confidence, if it convinced that the fiscal targets would be achieved. If emphasis had shifted to reducing primary expenditure, such a result could have been feasible, as the reduction in expenditure would have been lasting. Nevertheless, in 2012-2015, the adjustment derives for the most part from the income side (about 53%). This entails higher uncertainty regarding the achievement of targets, as the deeper than expected recession in 2011 and the delay in the return to positive growth rates are expected to have a negative impact on income and, therefore, on the degree of achievement of the deficit and public debt targets. It should be noted that each 1% further decline in the economic activity, would automatically burden the general government deficit by about 0.5%.

The 2012 Budget and the decisions of October

In order to address the overruns of 2011, fiscal adjustment measures were decided upon during the summer. Although these measures fall within the scope of the MFSF, they were launched as early as 2011. Moreover, additional measures were announced in September and October and the draft Budget for 2012 was tabled in Parliament.[13] Based on the estimates of the Draft Budget for 2012, this set of decisions would drive the general government deficit in 2011 to €18,690 million, or 8.5%, and the primary deficit to 1.1% of GDP. First of all, these targets have been markedly revised with regard to both the initial forecasts and the more recent estimates included in the MFSF.

For 2012, it is estimated that the full implementation of the measures decided upon would lead to a general government deficit of €14.7 billion or 6.8% of GDP and to a primary **surplus** of 1.5% of GDP.

However, the new, revised targets (based on the Draft Budget) were impossible to achieve and new measures became necessary. These measures, which are mentioned in the Draft Budget, have been included in Law 4024 (which was passed by Parliament on 25 October). The law provided for the immediate implementation of new rates of pay in the public sector, cuts in higher pensions and a labour

13 The final Draft Budget for 2012 was expected to be tabled in Parliament after the present Report went to press.

reserve or pre-retirement scheme for about 30,000 civil servants. Other changes in the tax system have also been introduced, including a lower tax-free amount, repeal of tax exemptions, new income tax brackets and the introduction of an extraordinary real property levy that had been enacted before the submission of the Draft Budget to Parliament. The full implementation of these measures would improve the fiscal outlook for 2012, but would not be sufficient to reverse the deviation from the initial targets for 2011. Thus, fiscal policy should ensure that measures will be fully implemented and that the budgets for 2012-2015 will not deviate from their targets.

Finally, considering poor fiscal performance in 2011, delays in the implementation of structural changes, concessions in fully opening up closed professions and non-adherence to timetables, it is clear that in order to bolster the credibility of the fiscal adjustment programme, clear and positive messages must be provided that, this time, decisions will be implemented in full.

In this regard, the following are necessary:

1. Specific programmes for each ministry and area of public policy. Each programme should specify individual targets, set strict timetables, define implementation procedures, while it should also envisage measures of equivalent effect in case of deviation.

2. Coordination of all individual programmes by an effective central mechanism with a steering role, which would check results at short and regular intervals, solve any problems arising from the joint exercise of power and revise targets, if necessary.

3. Strong and steadfast political will, expressed through concrete action in various policy areas. General declarations are not sufficient. Adjustment must be promoted across the board at the same pace. Delays in any sector affect the entire effort and contribute to the persistence of the "credibility deficit".

4. Measures to increase the efficiency of public administration. The productivity bonus provided for in the new rates of pay should be linked to the achievement of the adjustment programme targets.

5. Close and constructive cooperation with the European Commission's Task Force on technical assistance.

11.3 STRUCTURAL REFORMS FOR RECOVERY AND GROWTH

Mitigating the recession and ensuring the fastest possible return of the economy to positive rates of growth call for a reversal of the economic climate and sharp progress with fiscal adjustment, which would provide a clear message that the economy is in a position to recover. At the same time, it is necessary to encourage private business activity, which has been strongly affected by the negative impact of reduced demand, lower competitiveness, weakening credit expansion and a heavier tax burden.

With regard to the latter, the Bank of Greece has argued that there is no room for further increasing the tax burden on businesses and households and that the policy for achieving the necessary increase in revenues should focus on combating tax evasion. A further rise in the tax burden of those who already pay their taxes would not only exacerbate recession, but would also prove counterproductive, i.e. it would reduce rather than increase revenue.

This factor must be a prime consideration in the formulation of the new legislative framework on taxation. That framework must avoid imposing new burdens, especially on those presumed to be honest taxpayers. It must also clearly describe the conditions – the first and foremost being the progress with fiscal consolidation – under which the tax burden borne by honest taxpayers, both individuals and businesses, can be lightened and undertake the commitment to do so as soon as these conditions are in place. Such a declaration of intentions would provide a clear message that in the foreseeable future tax rates will be reduced, which would strengthen the credibility of economic policy and improve expectations.

The starting point to reinforce recovery is by creating a climate helping to reverse pessimistic expectations about the future of the economy, so as to stop the outflow of deposits, encourage households to consume and enterprises to invest, and foster exports.

The **requirements** for a reversal of pessimistic expectations include, among other things, the following:

- modernising the State and the public administration, so as to better manage the crisis and consistently implement the law – particularly legislated reforms;

- creating the conditions for the effective operation of competition in markets for goods and services, e.g. in the cruising sector (by applying cabotage, as this is understood and applied in EU countries), and also in general, to ensure that reduced labour costs are reflected in prices;

- rapid progress towards rationalising the regulatory environment of product markets (including rules on pre-bankruptcy procedures, land use, etc.);

- bringing network services up to date, which is necessary to increase productivity and attract foreign investment;

- promoting structural reforms in the labour market in an orderly manner, on the basis of the new arrangements legislated in 2010-2011.

The **means** to ensure recovery include:

- taking advantage of the decisions on the faster disbursement of funds available under the National Strategic Reference Framework, in cooperation with the EU Task Force on technical assistance provided for in the decisions of 21 July (which has already assumed tasks). These funds can contribute to financing investment in infrastructure;

- implementing the privatisation and State property utilisation programme, which can become an important channel for attracting foreign capital and importing know-how and technology,

- implementing summer house development projects (which requires, inter alia, that appropriate land use plans have been developed).

As the rate of credit expansion to the private sector remains negative and the decline in household income and business profits continues, it is clear that economic recovery —and subsequently growth— and investment can initially be financed through the two sources mentioned above, namely maximising the use of funds under the National Strategic Reference Framework (NSRF) and attracting foreign investment capital. Action in both directions should be given top priority.

12 TAPPING INTO THE COUNTRY'S GROWTH POTENTIAL AND ACHIEVING SOCIAL CONSENSUS

It is well known that the effort to adjust and reform the economy rests on two pillars – first, achieving fiscal consolidation and adjustment and, second, improving competitiveness and changing the model of production, so as to increase outward-orientedness and open up positive prospects for growth in the context of a globalised economy and rising international competition.

Few are those who put into question the **productive potential** of the Greek economy. Most analysts recognise that Greece has several **potential competitive advantages** that are important and relate to both its geographical position and, inter alia, its natural and human resources – such as renewable forms of energy, specific minerals, climate, natural environment and ancient monuments, availability of highly-skilled workforce and an aptitude for entrepreneurship (which, curiously, flourishes when Greeks immigrate, but is suppressed or distorted within Greece).[14] However, these advantages are not being used.

This is mainly attributable to two factors:

- First, the **credibility deficit** that was mentioned earlier and is primarily related to the fiscal outlook and growth prospects. As long as Greece is viewed as an example of fiscal derailment and its ability to make further substantial progress towards fiscal consolidation (following the positive performance of 2010) and economic recovery (which, inter alia, will support public debt servicing in the future) is under question, attracting foreign investment (and know-how) in order to utilise potential advantages will remain difficult or will only be possible on unfavourable financial terms. The same lack of incentives also relates, mutatis mutandis, to domestic investment initiatives – though there exist important examples of Greek enterprises that, in extremely adverse conditions, have taken initiatives and scored successes in foreign markets.

- Second, **delays and underachievement in promoting and implementing reforms** that would facilitate the efficient functioning of product and labour markets, speed up recovery and restore conditions for a sustainable improvement in competitiveness and steady growth. In this case *too*, the negative consequences are the same.

Underlying the above two factors is **the "great patient", i.e. the operation of the State and public administration**, which reflects and, at times, favours corporatist compromises and promotes corruption, the sweeping of problems "under the rug" ad infinitum, and the undermining of proposed solutions. The fact that the functioning of the state apparatus has not risen up to the challenge has had extremely large negative consequences:

- It does not allow for a comprehensive and fast documentation, exploration and development of policies, which sometimes results in mistakes being made and corrected later, while —more often— in the absence of sufficient analysis and/or due to time constraints, "horizontal", i.e. indiscriminate and across-the-board, approaches are used, which are unavoidably (a) socially unfair, and (b) non-optimal in terms of effectiveness.[15]

- It hinders the effective implementation —and, hence, reduces the efficiency— of enacted policies; as a result, the adoption of additional measures that can yield quick results then becomes necessary, even when it is a known fact that such measures may have negative repercussions.[16]

- In turn, the above accentuate social reaction and undermine the prospect of social consensus.

For the adjustment programme to move forward, both of its pillars —fiscal consolidation and improvements in competitiveness— must be achieved at the same time, in order to deal with the vicious circle of depression-fiscal contraction-

14 See for example: (a) N. Karamousis and T. Anastasatos, "The Development of the Greek Economy: Sources, Prospects and the Role of Exports" (in Greek), Eurobank EFG, Economic Research and Forecasting Division, *Economy and Markets*, October 2011, (b) McKinsey, *Greece 10 years ahead*, study commissioned by the Hellenic Federation of Enterprises (SEV), September 2011, (c) P. Mylonas and N. Magginas, "First signs of economic rebalancing, but high uncertainty and a tough fiscal program slow the adjustment process", National Bank of Greece, *Greece – Economic & Market Analysis*, October 2011, (d) "AMBITIOUS GREECE: Fast-Forward to Economic Reconstruction" and "SUSTAINABLE GREECE: Long-Term Macroeconomic Stability With Sound Public Finances", *Economic Bulletin* by Alpha Bank, issue 116, October 2011, (e) "Special topic: Policies for Development", KEPE, *Greek Economic Outlook*, four-monthly publication, issue 16, October 2011, (f) Association of Greek Tourism Enterprises (SETE), "Proposal for a strategic development of Greek tourism 2011-2021: objectives and priorities" (in Greek), 10th Conference "Tourism and Development", November 2011, (g) Y. Stournaras (IOBE), "The measures that could rescue Greece" (in Greek), website of the Greek edition of the American magazine *Foreign Affairs*, (h) Boston Consulting Group, "Supporting Investment in the Greek Economy - A foreign investor perspective", study commissioned by the Ministry of Regional Development and Competitiveness, May 2011.

15 Quite indicative is the fact that, as a solution of last resort, the years of service were chosen to serve as the main criterion for the implementation of "the labour reserve" in the public sector. As has already been pointed out from various quarters, this entails the risk of the public administration losing a large number of experienced staff, while the fiscal benefit would be much lower than in the case of staff with shorter work experience.

16 This can be illustrated by the example of the increase in the VAT rate in restaurant services for revenue-enhancing reasons (even if applicable as of 1 September, so as to avoid consequences during the tourist season), although a standing objective of economic policy has been to boost tourism receipts also by prolonging the tourist season.

uncertainty, support economic recovery and consolidate growth prospects. This is the only way to demonstrate conclusively that Greece is creditworthy and not a "particular case" distinguished from all the other euro area countries (which are determined to "honour fully their own individual sovereign signature", as officially stated by the Heads of State or Government of the euro area on 21 July and 26 October).

For both pillars to be achieved at the same time and for progress to be made both in terms of fiscal consolidation and in terms of recovery, competitiveness and economic growth, general declarations and announcements are not sufficient. For this to occur, a detailed and binding Action Plan for Growth, as suggested by the Bank of Greece, is needed. This Plan would specify and effectively implement individual policies, and establish procedures that could lead to greater social and political consensus. If the various policies are properly specified, that is, their effectiveness and internal coherence are ensured, together with social justice, then society's confidence can increase, and social and political dialogue can have a favourable outcome. This means that instead of turning out to be a "dialogue of the deaf" or a "war of all against all", it could become a meaningful and constructive dialogue focused on a socially equitable and, at the same time, more efficient allocation of the sacrifices that are urgently necessary to exit the crisis, also signalling the prospect of future benefits.

A road map of this kind could lead us through an arduous, but fruitful, effort undertaken by all of Greek society, to the exit from today's severe crisis and secure the country's place within the euro area.

Box I.1

FISCAL CONSOLIDATION: AN INHIBITORY FACTOR FOR GROWTH?

The considerably larger than expected decline of economic activity in Greece in 2011 is partly due to the tight fiscal policy, but at the same time contributes to the deviation of public revenue and public expenditure from the targets set in the budget for 2011. Hence, it implies a higher debt-to-GDP ratio and necessitates a revision not of the stance, but of the structure of the fiscal policy pursued.

It is a fact that there is no room for easing up on fiscal consolidation efforts. Not only that, but current conditions make it imperative that efforts to achieve fiscal consolidation be intensified, same as the creation, the soonest possible, of sizeable primary surpluses for a number of years so that the debt-to-GDP ratio takes a downward path. There is no other solution. What is requested here, however, is to *reduce deficits and stabilise the debt ratio, minimising at the same time the adverse short-term*[1] *effects of tight fiscal policy on economic activity and (in the medium term) on growth.*

Fiscal adjustment may have a greater or a less negative short-term impact on economic activity and growth, depending on the various fiscal measures it contains and the structural reforms implemented along with purely fiscal measures. Namely, the relationship between fiscal expansion (or contraction) and economic activity does not constitute an increasing monotonic function, but is far more complicated. A characteristic example is the year 2009, when vast fiscal expansion in Greece not only did not boost economic activity, but even caused further recession (from -0.2% in 2008 to -3.2% in 2009) as well. Thus, a fiscal adjustment may be

1 The short- and medium-term effects of fiscal adjustment on growth are considered particularly positive, according to international literature.

less or more “growth-friendly”. Moreover, there are structural measures and reforms which, if materialised in parallel with fiscal measures, can strengthen the growth prospects of the economy.

The macroeconomic effects of fiscal adjustment have been systematically researched into, particularly in the last decade.[2] Research has shown that the nature of fiscal measures (the relative weight of the increase in revenue or the reduction in expenditure) considerably affects both the possibility of achieving sustainable fiscal adjustment and the macroeconomic effects of this adjustment. In more detail, a fiscal adjustment primarily based on primary expenditure cuts (excluding public investment) is far more likely to be sustainable and have only short-term negative macroeconomic implications, with the economy recovering in a short period (“expansionary fiscal adjustment”). By contrast, a fiscal adjustment largely based on tax increases and public investment cuts lasts for a very short time, is easily reversible and leads the economy to deeper and longer recession.[3]

In practice, a “growth-friendly” fiscal adjustment will contain measures that will contribute to a timely “compensation” for much of the reduction in total demand brought about by deficit reduction. If this “compensation” does not occur, then the economy will balance on lower levels of production, income and employment.

In this framework, “compensation” should stem mainly from two directions: increased exports and private investment. This is why efforts to reduce the fiscal deficit are typically accompanied by a large depreciation of the currency, particularly if there is a problem in the current accounts balance, so as to enhance competitiveness of the economy. Such depreciations took place in autumn 1985 in Greece (Stabilisation Programme 1986-1987), in the beginning of the 1990s in Sweden and Finland and in the beginning of the 2000s in Turkey. However, for the countries participating in the euro area, this is no longer an option. For this reason, the 2010 Memorandum included structural changes in the labour market (e.g. special firm-level collective agreements and flexible forms of employment), aiming to reduce the cost of Greek products and increase competitiveness. Nevertheless, special firm-level collective agreements have been relatively limited (by the end of October, only 12 such contracts had been signed) and private enterprises have explored other ways of containing labour costs (e.g. individual labour contracts). Thus, although exports have recorded a marked increase, they cannot, for the time being, compensate for the gap in demand. Besides, the drop in imports may not correspond to the size of the recession; as a result, the current account deficit, following its large reduction in 2009 (before the implementation of the measures), remains at high levels and is expected to stand to 9.8% of GDP in 2011.

Residential investment accounts for a large part (35% to 40% in certain years) of private investment in Greece. In autumn 2005, in view of the introduction of VAT in newly built real estate, the licenses of which would be issued after the 1st January 2006, there was a mas-

2 Alesina, A. and R. Perotti, “Fiscal Adjustments in OECD Countries: Composition and Macroeconomic Effects” *IMF Staff Papers*, Vol. 44 (June 1977), p. 205-248. See also Alesina, A. and S. Ardagna, “Large Changes in Fiscal Policy: Taxes versus Spending”, *Tax Policy and the Economy*, 2010, Vol. 24, ed. Jeffrey R. Brown (Cambridge, Massachusetts: NBER), as well as Ardagna, S., “Fiscal stabilizations: when do they work and why”, *European Economic Review*, vol. 48, 2004, p. 1047-1074.

3 Alesina, A. and R. Perotti, ibid, p. 211-212. There are, however, counterarguments. In a recent (2011) paper, it is argued that all literature of the 20-year period 1990-2010, which uses the cyclically-adjusted primary surplus (CAPB), introduces bias, leading to an overstatement of the expansionary results. See Guajando, J., D. Leigh and A. Pescatori, “Expansionary austerity: new international evidence”, *IMF Working Paper*, WP/11/58, July 2011.

sive issuance of building licenses. These residences were completed by the first half of 2008. The global financial crisis and the implementation of tighter criteria for bank credit limited considerably the interest of buyers, leading as a result to the creation of a large stock of new houses. Thus, building activity had been drastically reduced a while before the outbreak of the crisis in Greece, with negative repercussions on total investment. This development, coupled with the reduction of public investment that followed (by €1,800 million in 2010 and €950 million in 2011), affected business expectations adversely, particularly in the constructions sector, and made compensating for the demand gap with increased investment impossible. At this point the question arises why were more resources from NSRF 2007-2013 not absorbed, given that until 2010 less than 25% of the budgeted amount for Greece had been received. According to a recent OECD report,[4] the multiplier of public investment is very big and, as a consequence, its reduction had a major negative impact on economic activity.

The increase in investment and the compensation for domestic demand could be performed through foreign direct investment in Greece. This would have important advantages as it would simultaneously improve the current accounts deficit, particularly if a large part of production is exported. At the same time, the import of new technology and management methods enhances productivity, hence, the competitiveness of the economy. Unfortunately, in the last two decades Greece lags far behind in the attraction of foreign direct investment. But also, the existing foreign investment in Greece, measured as a percentage of GDP, is among the lowest in the world.[5]

The reasons are more or less known. The business climate in Greece is not considered "business-friendly". A "friendly" environment includes,[6] (i) a stable tax system, (ii) a clear and stable regulatory framework for firms, environmental protection and the labour market, (iii) the appropriate infrastructure, (iv) educated labour force, (v) strict observance of laws, (vi) low taxation, (vii) absence of obstacles for imports and exports, (viii) low administrative costs (red tape) and fast decisions (approval or rejection) on investment projects.

It is a known fact that very few of these conditions are met in Greece, e.g. (iv). Of the others, the tax system in particular is exceptionally complicated and has been changing constantly over the last 30 years. The ongoing fiscal adjustment was the cause of further successive changes in the tax system and the imposition of many extraordinary tax burdens on firms.

Modern economic theory admits that a country can avoid to a large extent the adverse impact of deficit reduction on economic activity and return to growth soon (e.g. in one year), if the fiscal adjustment programme is considered reliable and affects both consumer and business expectations positively. More specifically, fiscal adjustment based on a permanent reduction of primary expenditure may in the medium term lead (and, under extreme conditions, even in the short term) to an increase in economic activity and employment. In other words, tight fiscal policy may (in the medium term) have expansionary results. In order to achieve this positive result, three key requirements have to be met:

4 Op. cit., p. 39, Box 1.4. The multiplier of public investment is 0.8, of public consumption expenditure 0.5, of transfer payments 0.4, of direct taxes 0.2-0.4, and of indirect taxes 0.2.
5 OECD, ibid, p. 39 and Table 1.14.
6 See also Bank of Greece, Monetary Policy-Interim Report 2010, October 2010, p. 32-33.

a) the initial fiscal position must be particularly unfavourable (i.e. high deficit and debt);

b) fiscal adjustment must be based on a permanent, drastic reduction of primary expenditure (excluding public investment). According to Alesina and Perotti, the reduction of primary expenditure must exceed 70% of total investment;[7] and

c) the fiscal adjustment programme must be comprehensive and reliable, record in detail specific measures, the respective quantitative targets and the implementation schedule, and be driven by determination as far as its implementation is concerned.

The expansionary effect of fiscal adjustment (through the reduction of primary expenditure) stems from the *creation of favourable expectations* in the private sector for cuts in interest rates and taxes in the future. Favourable expectations for lower interest rates and taxes increase investment, as well as the present value of disposable income, leading to an increase in current consumption ("confidence effect"). As mentioned above, for the expansionary effect to arise, what is very important (apart from the initial fiscal conditions) is the *extent of the primary expenditure cut* and the *decisiveness* in general with which the programme is implemented and materialised, so that it inspires confidence and is successful.

In spite of the fact that in Greece fiscal conditions were particularly negative when the fiscal adjustment began, no "confidence effect" has been evident to date. The main reason for this is that probably fiscal adjustment was not based on the permanent and drastic reduction of primary expenditure. Specifically, according to the Memorandum of May 2010, from a total forecast deficit reduction of 11.1% of GDP by 2013, 4.0% would stem from an increase in taxes and 5.3% from a cut in primary expenditure,[8] of which 0.7% from a cut in public investment. The remaining 1.8% would come from "structural measures".

If, however, the measures of January, February and March 2010,[9] which preceded the Memorandum, are taken into account, same as the few measures of 2009 (which were purely tax measures), then the contribution of the decline in primary expenditure until the first half of 2011 was much smaller than 50% of the total fiscal adjustment effort. Moreover, in the Medium-Term Fiscal Strategy Framework (June 2011) the measures for the curtailment of expenditure represent about 50% of the total effort. Specifically, out of the total interven-

7 Op.cit., p. 222-223. Specifically, the article mentions that in 16 cases of successful fiscal adjustment, 73% of the adjustment stemmed from a reduction of primary expenditure (excluding investment). By contrast, in 46 cases of unsuccessful fiscal adjustment, expenditure cuts (excluding investment) contributed by about 44% to the adjustment. A more reliable fiscal adjustment programme is deemed to be one that includes specific targets and measures for the reduction of employment in the public sector, as markets consider it to illustrate the authorities' decisiveness.

8 IMF, *Greece: Request for Stand-By Arrangement*, 5 May 2010, p.11, Box 3.

9 The measures of January 2010 led to increased taxes on inheritances, donations and parental gifts and increased excise taxes on tobacco and spirits. On 9 February the excise tax on liquid fuels increased and the "freezing" of public sector wages was further specified (which, however, had already been included in the Stability and Growth Programme Update). On 3 March it was decided: (i) that an extraordinary levy on income will be imposed; (ii) that the VAT rates will increase (from 19% to 21%, from 9% to 10% and from 4% to 5%); (iii) that the excise tax on tobacco will increase anew; (iv) that a luxury tax will be imposed on certain goods; (v) that an excise tax on electricity will be imposed; (vi) that the maximum marginal rate on taxable personal income will increase to 45%; (vii) that the maximum marginal tax rate on real estate will increase to 2% etc. The measures of 3 March also included expenditure cuts, such as a 30% cut in Christmas and Easter bonuses and holiday allowance, a 12% reduction of benefits, the "freezing" of all pensions, a 7% wage reduction for employees of legal entities in private law owned by the State or subsidised by the budget and a cut in public investment by €500 million. Generally, the expenditure cuts included in the measures of March 2010 were no greater than 50% of the total performance of the measures. If the measures of January, February and March 2010, the Memorandum (5 May 2010) and the extraordinary tax on large profitable enterprises which was imposed in December 2009 are also taken into account, then the contribution from the reduced primary expenditure to total fiscal adjustment until spring 2011 was clearly smaller than 50%. This conclusion is further supported, if the measures adopted in 2009 are also taken into account. These measures, although of minor importance, were all tax measures: increased excise tax on tobacco and alcohol, extraordinary tax on incomes, increased excise tax on fuel, a levy on mobile telephony etc.

tions worth €28,351 million, €14,274 million (6.1% of GDP) regard expenditure, of which €950 million involve public investment cuts, while €14,077 million (6.0% of GDP) involve revenue.[10] All these have to be added to the two "amnesties" of pending tax cases (the second was announced immediately after the adoption of the MFSF 2012-2015), which are purely tax measures. Consequently, the contribution of expenditure cuts in total measures until autumn 2011 remains considerably below 50%. According to the OECD report on Greece, the first package of measures (2010) for the reduction of deficit was based by only 39.6% on expenditure reduction,[11] while the second package (2011) by 45.3%.[12]

The above show that the second requirement —which would allow the reduction of fiscal deficits to lead to an increase in economic activity and employment within a reasonable time horizon (e.g. 1 to 1.5 years)— is not met.

Beside the fact that a fiscal adjustment based on permanent and drastic cuts in primary expenditure favourably affects expectations for a future reduction of the tax burden, the drastic cut of primary expenditure offers other important advantages too, as has been repeatedly stressed by the Bank of Greece[13] and repeated briefly at this point:

(a) As Greek and international experience have taught, fiscal adjustment based on the reduction of primary expenditure is greater and sustainable.

(b) Within the European Union there is intense tax competition. For a country such as Greece, where competitiveness is low, the possibility of a further increase in the tax burden is inexistent. It goes without saying that every possible effort must be made in order to combat tax evasion and receive the taxes due, all the more so in order to restore justice among tax payers.

(c) As the Greek experience has shown, the level of tax revenue is far more affected by fluctuations in economic activity than expenditure. Consequently, in order to maintain a stable fiscal result (e.g. a balanced budget), tax rates and tax bases should change quite often, which is not functional in practice. By contrast, with the exception of interest payments, the change in other expenditure (primary expenditure) is easier under certain circumstances. Besides, the economic cycle essentially affects only expenditure for unemployment benefits and, in the case of Greece, expenditure for grants to social insurance funds, while economic fluctuations affect total tax revenue.

(d) *It has been proven that a stable tax environment minimises distortions and other negative effects on the economy in general and on economic development in particular.*[14]

(e) The reduction of primary expenditure implies the freeing up of resources and their shift from the non-tradable goods and services sector to the tradable goods and services sector, thus increasing the possibilities for a reduction in the current account deficit.

10 Law 3985/Government Gazette A 151/1-7-2011, Medium-Term Fiscal Strategy Framework 2012-2015, chapter B, MFSF 2012-2015 interventions, of the Government Gazette.
11 Op.cit., p.44, Table 1.3.
12 Op.cit., p.48, Table 1.4.
13 Bank of Greece, *Monetary Policy-Interim Report*, October 2010, p.143-144. See also V. Manesiotis, "Numerical fiscal rules in practice", Bank of Greece, *Economic Bulletin*, issue 35, June 2011, p.7-8.
14 Kopits, George, "Fiscal Rules: Useful Policy Framework or Unnecessary Ornament?", IMF, *Working Paper*, WP/01/45.

(f) Finally, for a country such as Greece, where the public sector is too large and ineffective, it is very important that its size is reduced, in order to reduce both the waste of money and its negative effects on private economic activity.

As early as in the 1990s, the Bank of Greece had begun to stress that fiscal adjustment must be based on the permanent reduction of primary expenditure. What is more, in recent years it suggested that 2/3rds of the fiscal adjustment[15] should stem from the reduction of primary expenditure and the remaining 1/3rd from taxation (including tax evasion). But the new package of measures recently announced by Portugal will also be based by 2/3rds on the reduction of expenditure and by 1/3rd on increased tax revenue[16] (the largest reduction of expenditure in the last 50 years).

In parallel with its containment, public spending should be restructured and re-oriented towards categories that are "growth-friendly", such as expenditure for the formation of human and fixed capital (public investment) and expenditure for research and development.

Furthermore, the third requirement does not seem to be met either. The authorities' decisiveness to implement measures timely and unwaveringly was not always visible. By contrast, there were often delays, retractions, postponements, weakening of measures and ambiguities. The adoption of measures which are afterwards not materialised or are postponed or weakened generates uncertainty and negative expectations. Of course, the situation has changed following the government announcements of 6 September 2011.

For all these reasons, *citizens were unable to hold high expectations*. Instead of a future reduction of the tax burden, tax payers know almost beyond doubt that by 2015 they will be paying high taxes and extraordinary levies. Furthermore, since they question whether the expenditure cuts will be fully materialised or not, as such measures are often postponed or weakened, they assume that new tax measures may be required.

Some economic analysts argue that the decline in domestic demand and the recession are disproportionately large relative to the size of fiscal adjustment. This is so because the economic climate and business and consumer confidence indicators have fallen to very low levels, contributing considerably to the large drop in domestic demand.[17] It is evident, therefore, that the expectations formed are not conducive to a swift recovery of the economy and the manifestation of a "confidence effect". This is why recession deepens. It may be advisable at this point to recall that the extensive fiscal adjustment of the period 1994-1999 was based, on the one hand, on an increase in taxes and a reduction in interest payments, but particularly favourable expectations were created as a result of the prospect of Greece's entry into the euro area. It is quite indicative that the real growth rate of total investment from 1.5% on average in the five-year period 1989-1993 accelerated to 6.1% in the period 1994-1999 and the growth rate of economic development of the economy from 1.2% on average

15 Bank of Greece, *Monetary Policy-Interim Report 2009*, Athens, October 2009, p. 34, and *Monetary Policy-Interim Report 2010*, Athens, October 2010, p. 21.
16 *Financial Times*, 1st September 2011.
17 Alpha Bank, *Weekly Economic Report*, 10 August 2011, p. 1 and 2. In a recent study (P. Konstantinou, Ath. Tagkalakis, "Boosting confidence: Is there a role for fiscal policy?", *Economic Modelling*, Volume 28, Issue 4, July 2011 (http://www.sciencedirect.com/science/article/pii/S026499931100037X) it is ascertained that the impact of direct taxation on consumer and business confidence is quite significant, a fact that can contribute to the interpretation of recent developments.

in the five-year period 1989-1993 accelerated to 2.8% in the period 1994-1999, in spite of the reduced general government deficit (by 10 percentage points of GDP).

Structural changes

As pointed out above, the reforms that usually accompany fiscal adjustment are extremely important, as they may contribute to minimising the negative macroeconomic effects of the fiscal adjustment and to the economy recovering fast.[18] Structural changes aim at correcting existing rigidities and distortions in the economy and facilitate the transfer and restructuring of production factors, enabling the economy to better adjust to extensive fiscal adjustment.

The Memorandum and the Medium-Term Programme have included very significant structural changes, the most important of which are the following: (i) labour market reforms, of which the most noteworthy is the adoption of special firm-level collective agreements, (ii) the opening up of the so-called "closed" professions, (iii) privatisations, (iv) the adoption of a "business-friendly" action plan for Greece, (v) mergers and/or the elimination of unnecessary public sector entities (in combination with "labour reserve"), (vi) faster court rulings on tax disputes etc. These are extremely important structural measures that can change the Greek society considerably.

Labour market reforms are many and of great importance, as they aim at more flexible labour relations, reducing the cost of production and enhancing the competitiveness of the Greek economy. They seek to facilitate the shift of production factors from sectors associated to domestic consumption towards those associated with investment and exports and to reorient production towards internationally tradable goods.

Equally important are privatisations, which are expected to play a decisive role in the reduction of the debt-to-GDP ratio and the import of funds and technology. A European Commission paper[19] posts a long list of advantages from privatisations, such as the early redemption of debt securities at higher market value (for each euro it is possible to redeem 1.6 euro), the slashing of grants and consequently annual deficits, the increase in the productivity of the company being privatised and hence the enhanced competitiveness of the economy, the attraction of foreign direct investment etc. Despite all this, the progress made to date is very limited.

Many of these reforms, which were launched from May 2010 onwards, were seen as fields of conflict. According to the recent OECD report on Greece, in spite of the progress recorded, there were delays, hesitation and retractions as far as the special firm-level collective agreements were concerned or the full opening of "closed" professions (e.g. in the case of pharmacies and in the practice of the profession of lawyer) or the privatisations programme and the effective use of the public sector real estate.[20]

To conclude, if structural changes had been expedited and the deficit reduction was larger, the recession of the Greek economy would have been considerably smaller.

18 European Commission, *The Economic Adjustment for Greece*, Fourth review-Spring 2011, Occasional paper 82, July 2011, p. 39-43.
19 Ibid, p. 33-34.
20 OECD, op.cit., p. 12, 14, 18 and 21.

II THE EXTERNAL ENVIRONMENT OF THE GREEK ECONOMY AND THE EUROSYSTEM'S SINGLE MONETARY POLICY AND INTERVENTIONS

1 INTERNATIONAL AND EURO AREA ECONOMIC DEVELOPMENTS AND PROSPECTS AND POLICY INTERVENTIONS

1.A DEVELOPMENTS AND PROSPECTS[1]

The slowdown of the world economy in 2011, particularly after the second quarter of the year, is attributed to a series of extraordinary events that led to a deteriorating international environment. These events had a bearing on the international economic climate that was already fragile as a result of long-standing structural problems and internal and external macroeconomic imbalances. Prominent among these extraordinary events were the new round of increases in world crude oil prices due to the uprising and turmoil in countries of Northern Africa and the Middle East, the serious anomalies in the world trade supply chain, as well as the recession in Japan owing to the natural disasters of March and the increased uncertainty from the intensifying sovereign crisis in the US and the euro area.

International organisations made downward revisions of their forecasts on GDP growth in 2011 and 2012, mainly in respect to the advanced economies, estimating that **world GDP** will grow by 4.0% in 2011 and 2012, compared with 5.1% in 2010. Emphasis was placed on the higher risk of a further deterioration, particularly for the euro area, according to the first signs provided by the leading economic indicators (PMI) in October. More recent European Commission forecasts estimate an even lower rate of increase of world GDP in 2011 and 2012 (3.7% and 3.5%, respectively). The slowdown will be more pronounced in the advanced economies (1.5% this year, compared with 2.8% in 2010), which were more harshly affected by a combination of factors and the decline in the growth rate of world trade, in an economic environment dominated by the sovereign crisis. The OECD estimates that in the seven largest advanced economies (excluding Japan) the rate of economic growth on an annual basis will not exceed 1% in the second half of 2011. The growth rate of economic activity in developing and emerging economies is also expected to decelerate in 2011, albeit remaining high (6.0%, from 7.3% in 2010), driven by the emerging economies of Asia, the real GDP of which is estimated to grow by 8.2% this year. Specifically, in 2011 the GDP growth rate is estimated to remain high in China (9.2%) and in India (7.5%), albeit lower than in 2010.

In **the US**, where expansionary fiscal policy options seem to be running out, due to an extremely high government deficit and a sharp increase in public debt (101% of GDP in 2011 from 95.2% in 2010), GDP growth —despite reduced unemployment and improved net exports— is expected to drop to 1.5% in 2011, from 3.0% in 2010, due to the larger than anticipated decline in public sector demand and in inventories. The monetary policy pursued and implemented, in combination with the economic slowdown, will lead to a small narrowing of the current account deficit to 3% of GDP in 2011. **Japan** was stricken by the strongest earthquake in its history and a tsunami in March 2011, which resulted in thousands of casualties and extensive destructions of its economic and energy infrastructures. The anticipated recession in 2011 (0.4% drop in GDP, compared with a 4.0% rise in 2010) stems mainly from the negative contribution of net exports and private consumption, which more than offset the positive contribution of the increased private and public investment for the restoration of these infrastructures.

In the **euro area**, GDP growth is not expected to change much in 2011: according to ECB staff, it will stand between 1.4% and 1.8% (compared with 1.8% in 2010), while the IMF forecasts a growth rate of 1.6%. The external balance will continue to have a favourable influence, while fixed capital formation (up by

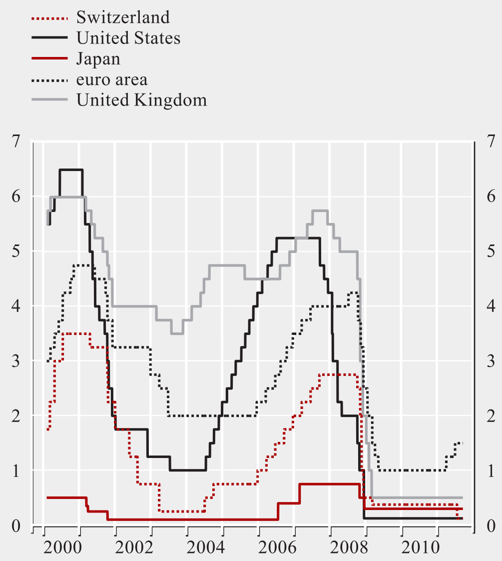
1 Based on macroeconomic developments until mid-November and taking into account the latest projections by the IMF (*World Economic Outlook*, September 2011) and the OECD (*Economic Outlook*, No. 89, June 2011 and *Interim Assessment*, 8 September 2011), ECB staff projections (8 September 2011) and European Commission forecasts (European Economic Forecast, 10 November 2011), as well as other available data.

2.6%, compared to a decrease of 0.8% in 2010) is expected to contribute considerably, for the first time since 2007. Private and public consumption should decelerate, remaining virtually stagnant in real terms. Despite the deteriorating international environment and the restrictive stance of fiscal policy, it is estimated that in four euro area economies activity is already faster and that Ireland and Spain will recover from recession. In 2011, Portugal is expected to go into recession; GDP in Cyprus will be virtually stagnant and Greece will record a large drop in GDP for third consecutive year. A key feature remains the sizeable difference in the performance of various economies (based on the rate of change of GDP). The unemployment rate is expected to remain high in the euro area (9.9%), although the situation in the labour market varies considerably across member countries, with unemployment rates ranging from 4.2% in Austria to 20.9% in Spain. Government deficit in the euro area as a whole is expected, according to the IMF, to narrow further in 2011, to 4.1% from 6.0% of GDP in 2010, as a result of fiscal consolidation efforts, under the pressure of the risk from the sovereign debt crisis in some euro area economies, while public debt should rise to 88.6% of GDP.[2] According to recent (November 2011) European Commission forecasts, GDP growth in the euro area is expected to stand at 1.5% in 2011 and to *decelerate considerably* to 0.5% in 2012, as the increased uncertainty will affect both consumption and investment adversely, and external demand will also decline.

Inflation picked up in 2011, in both advanced (2.6%, from 1.6% in 2010) and developing economies (7.5%, from 6.1% in 2010), mainly due to the large increase in world commodity prices, while some economies recorded a small pick-up in core inflation too. In the US and Japan, core inflation appears lower due to the negative effect exerted on prices and wages by the persistence, or even widening, of an already large output gap, while in the emerging economies inflationary pressures remain high. Inflationary pressures were stronger in early 2011, but are expected to subside towards the end of the year. Inflation in the euro area has been above 2% since December 2010 (2.2%) and, according to ECB staff estimates, will hover between 2.5% and 2.7% in 2011 (from 1.6% in 2010) and between 1.2% and 2.2% in 2012.

Chart II.1 Central bank policy rates (January 2000 - October 2011)

(percentages per annum, daily data)



Sources: Euro area: European Central Bank (ECB), interest rate on main refinancing operations; United States: 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.

The **volume of world trade** is forecast to increase in 2011 at a rate noticeably lower than in 2010 (7.5%, from 12.8% in 2010) – which was largely expected, as 2010 saw a strong recovery after the previous period's recession, while this year will also incorporate the adverse effects of the natural disasters that hit Japan in March on the supply chains of various industries worldwide (e.g. automobiles). **World crude oil prices** increased anew in the first four

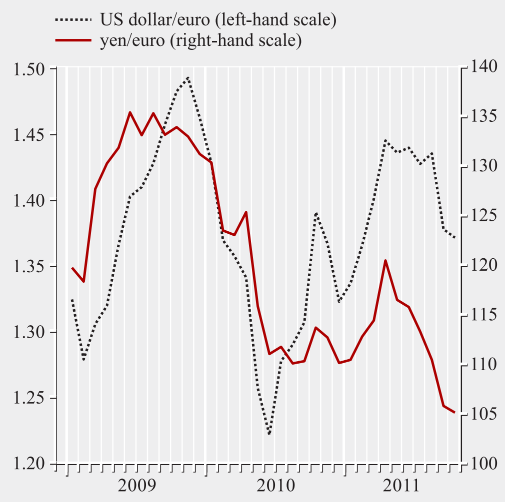
2 For a thorough exploration of the dynamics and the sustainability of sovereign debt in the euro area, see European Commission, Directorate-General for Economic and Financial Affairs, *Quarterly Report on the Euro Area*, vol. 10, no. 3, 12 October 2011, Chapter I ("Debt dynamics and sustainability in the euro area"), pp. 7-19.

months of 2011, rising above $100 per barrel for the first time since summer 2008 and reaching $126.6 per barrel on 2 May (UK Brent). This was a combined effect of strong international demand for oil by some countries, as well as of the serious anomalies in total supply and reserves due to the political instability and armed revolts in a number of Middle-Eastern and North-African countries. It is estimated that, on an annual basis, the average world price of three crude oil types will increase by 30.6% in 2011 (against 27.9% in 2010) to $103.2 per barrel (in euro terms the rise is estimated at 22.6% in 2011, from 34.3% in 2010). The **world non-oil commodity price index** is also forecast to rise considerably in 2011 (by 21.2% in dollar terms or 13.8% in euro terms).

Economic policy in the advanced economies is focused on taking measures to restore confidence in the sustainability of public finances, which suffered from the deepening debt crisis mainly in euro area countries, as well as on preserving in parallel the very favourable financial conditions for recovery. **Monetary policy** in the advanced economies remains accommodative in 2011 too (despite a small increase in policy rates in the euro area and the completion of the second round of quantitative easing in the US), taking into consideration the deteriorating international environment in the second and third quarters of 2011, in combination with the small decline of world oil prices since May. The US Federal Reserve Bank held its nearly zero policy rates unchanged, announcing in August that the circumstances call for keeping rates at extremely low levels at least until mid-2013 and launching in October 2011 a third round of quantitative easing. The Bank of Japan did not change its key rate (which stands at 0.30% since December 2008), but decided to expand its bonds purchase programme from 40 to 50 billion yen. In the euro area, several economies recorded accelerated economic growth in the first half of the year, allowing the ECB to increase its key rates twice in the course of 2011, on 13 April and 13 July (see Chart II.1). The economic slowdown in the euro area in the second half of the year and the estimate that inflationary pressures are weakening, as well as the new round of turmoil in euro area capital markets due to the additional

Chart II.2 Exchange rate of the euro against the US dollar and the Japanese yen (January 2009-October 2011)

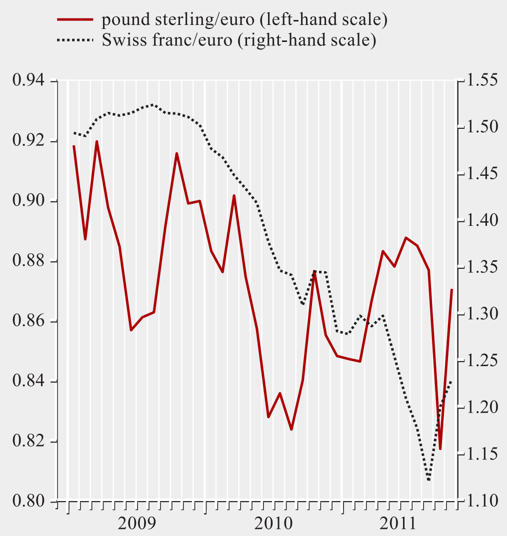
(monthly data)



Sources: ECB and Bank of Greece.

Chart II.3 Exchange rate of the euro against the pound sterling and the Swiss franc (January 2009 - October 2011)

(monthly data)



Sources: ECB and Bank of Greece.

Table II.1 Key macroeconomic aggregates of the world economy

	Number of states	Share in GDP[1] (%)	Output (annual percentage changes in real GDP)			Inflation[2] (annual percentage changes)			Fiscal balance (% of GDP)			Gross Government Debt (% of GDP)			Current account balance (% of GDP)		
			2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012	2010	2011	2012
World total	**184**	**100.0**	**5.0**	**3.7**	**3.5**	-	-	-	-	-	-				-	-	-
1. Advanced economies	*34*	*51.9*	*2.8*	*1.5*	*1.3*	*1.6*	*2.6*	*1.4*	*-7.5*	*-6.5*	*-5.2*	*104.4*	*109.5*	*112.9*	*-0.2*	*-0.3*	*0.1*
United States		19.9	3.0	1.6	1.5	1.6	3.2	1.9	-10.6	-10.0	-8.5	95.2	101.0	105.6	-3.3	-3.3	-3.1
Japan		5.9	4.0	-0.4	1.8	-0.7	-0.2	-0.1	-6.8	-7.2	-7.4	197.6	206.2	210.0	3.5	2.9	2.9
United Kingdom		2.9	1.8	0.7	0.6	3.3	4.3	2.9	-10.3	-9.4	-7.8	79.9	84.0	88.8	-2.5	-2.5	-0.9
Euro area	17	14.7	1.9	1.5	0.5	1.6	2.6	1.7	-6.2	-4.1	-3.4	85.6	88.0	90.4	-0.4	-0.6	-0.5
2. Emerging and developing economies	*150*	*48.1*	*7.3*	*6.0*	*5.9*	*6.1*	*7.5*	*5.9*	*-2.9*	*-1.9*	*-1.7*	*40.7*	*36.9*	*34.7*	*2.0*	*2.4*	*2.0*
China		13.7	10.3	9.2	8.6	3.3	5.5	3.3	-2.3	-1.6	-0.8	33.8	26.9	22.2	5.2	3.7	4.4
Russia		3.0	4	3.9	3.8	6.9	8.8	7.7	4.8	5.1	3.3	11.7	10	9.5	4.8	5.9	4

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

uncertainty caused by political instability in Greece after the Brussels Summit of 26-27 October, led to the ECB decision of 3 November to reduce its key rate by 25 basis points. **Fiscal policy** in the advanced economies is aimed, more firmly now, at further reducing the high deficits created over 2008-2009, so as to deal with the global crisis (see Table II.1). Particularly for euro area countries, 15 of which were subject to the "Excessive Deficit Procedure" in 2009-2010, the need to improve fiscal aggregates faster became more imperative in the course of 2011, under the pressure of uncertainty from the continuously rising government bond rates and relevant risk premia (CDS) in several euro area countries, including some of the larger ones. The IMF estimates that in the advanced economies as a whole, general government deficit will shrink further to 6.7% of GDP in 2011 (from 7.5% in 2010). In the US this deficit is forecast to remain rather high (10.0%), while in Japan it will widen a new on account of the unfavourable events. In the US, a decision was made in August for a frontloaded reduction of the deficit as of 2012, counterbalanced by an increase in the institutional ceiling on public debt. Gross public debt kept growing in 2011 in all major advanced economies, particularly the largest ones, therefore increasing risks and uncertainty in international markets.

The euro does not appear to be considerably affected by the deteriorating sovereign debt crisis within the euro area. Its nominal effective exchange rate, which in April 2011 was 4.5% stronger compared to December 2010, has only slightly declined since then, and in October was 2.9% higher than in December 2010. This seems to confirm the view that the sovereign debt crisis and its ensuing impact on financial stability have not translated into a euro stability problem.[3]

1.B SUMMITS FOR THE EURO – THE 21 JULY AND 26 OCTOBER AGREEMENTS

The deteriorating fiscal crisis in certain euro area countries in the second quarter of the year and the higher risk of contagion rendered necessary a coordinated intervention by euro area heads of state or government on 21 July 2011, in order to ensure the financial stability of the euro area as a whole and its Member States. The agreement reached included measures that sought to improve the sustainability of the Greek public debt, as well as to enhance the effectiveness and flexibility of the euro area stabilisation tools, namely the European Financial Stability Facility (EFSF) and the envisaged European Stability Mechanism (ESM). At the same time, the euro area heads of state or government reaffirmed their commitment to reinforce convergence, competitiveness and governance within the monetary union, as these elements are essential to sustainable economic growth and higher employment.

On 26 October 2011 euro area leaders amended certain important parameters of the 21 July agreement, while also making additional decisions aimed at restoring confidence, dealing with the current difficulties and further completing the economic and monetary union.

The agreement for Greece

As regards the part of the agreement relating to Greece in particular, following a request by the Greek government, it was decided on 21 July 2011 that a new programme for the country's financial support would be adopted, in common with the IMF and with the voluntary contribution of the private sector, to fully cover the financing gap until 2014. The EFSF was intended to be used as the financing vehicle. The total official financing, as was estimated by the 21 July agreement, amounted to €109 billion, including the funds deemed necessary for the credit enhancement of the new bonds that would ensue from the PSI (€35 billion), the possible recapitalisation of banks (€20 billion, through the Hellenic Financial Stability Fund) and the buyback of sovereign debt (€20 bil-

3 See J.-C. Trichet's interview to *Le Point*, 27 July 2011 (English translation available at the ECB website).

lion).[4] It is of particular importance that this new programme provides for lower interest rates, close to those of the Balance of Payments facility (currently around 3.5%), as well as lengthened maturities for the future EFSF loans to Greece (15-30 years instead of the previously applicable 7.5 years, with a 10-year period of grace), while it was also decided to extend the maturities of the loans under the existing financial support package.

At the same time, it was made clear that the expected private sector involvement (PSI) in the efforts for fiscal consolidation in Greece, via a programme of voluntary exchange or rollover of Greek government bonds, pertains exclusively to the case of Greece and is an exceptional and unique solution. According to the statement of euro area heads of state or government made on 21 July, the net contribution of the private sector to the reduction of public debt, i.e. the amount that would be derived after subtracting the cost of the new bonds' credit enhancement (amounting to €35 billion) for the Greek government, was estimated at €37 billion for the period 2011-2014. In addition, the programme for the debt buy back by the Greek government using funds borrowed from the EFSF (amounting to €20 billion) would contribute net €12.6 billion to the reduction of public debt. For the period 2011-2019, the total net contribution of the private sector involvement is estimated at €106 billion (according to European Commission calculations).

In their Summit of 26 October euro area leaders, taking into consideration the tensions in the market for Greek government bonds from July onwards, as well as the worsening macroeconomic conditions and some newer estimates regarding Greek public debt dynamics, agreed that further action is required to restore confidence, along with a comprehensive set of additional measures. They specifically decided to amend the terms of the programme for private sector involvement agreed on 21 July. The new programme will have to be agreed upon by end-2011 and the exchange of bonds must be carried out in early 2012. Although the programme's technical details have not been specified yet, the main points of the agreement, as stated in the official communiqué, are: (i) voluntary bond exchange with a nominal discount of 50% on notional Greek debt held by private investors; (ii) credit enhancement of the new bonds up to €30 billion from funds of euro area countries; and (iii) additional official financing of up to €100 billion, including the amount required for the recapitalisation of banks. The implementation of these decisions, in tandem with an ambitious programme of reforms, can decisively improve the sustainability and serviceability of Greece's public debt (with a view to reducing the debt to 120% of GDP in 2020), as well as its refinancing profile.

The 26 October agreement also mentions that Greece commits to pay to the EFSF all future cash flows from project "Helios" or other privatisation revenue in excess of those already included in the adjustment programme up to the amount of €15 billion, in order to further reduce its indebtedness.

Finally, in the specification of the technical details of the PSI programme, care will be taken so as the bonds, with which the existing government paper will be exchanged, have characteristics that render them eligible as collateral and allow their continued use for access to Eurosystem liquidity operations by Greek banks.

Comprehensive strategy for growth

Moreover, on 21 July European political leaders recognised the need to implement a comprehensive strategy for growth and investment in Greece. In this respect, they approved the creation by the European Commission of a special Task Force which will work with the

4 See European Commission, "Background document on the offer by the International Institute of Finance (IIF) and on Debt Buy Back (DBB)", published on the European Commission website (http://ec.europa.eu/economy_finance/articles/financial_operations/pdf/psi_en.pdf).

Greek authorities to target the structural funds towards more productive uses, while the European Investment Bank will also be mobilised in the direction of relaunching the Greek economy. Finally, they provided for exceptional technical assistance to help Greece implement the required reforms. The special Task Force created by the European Commission has already taken up work, specifying in cooperation with the competent Greek authorities the sectors requiring immediate support. The first report of the task force was expected by mid-November.

Mechanisms for the monitoring of implementation of the Greek programme

The 26 October agreement provides for the establishment of a monitoring capacity on the ground, with the participation of national experts and in cooperation with the Greek government and the Troika, for the duration of the new programme, to ensure the timely and full implementation of the reforms. This new role will be laid down in the Memorandum of Understanding.

Euro area stabilisation tools

As regards improving the effectiveness of the EFSF and of the future ESM so as to better deal with the potential risk of contagion, the 21 July agreement provides for increased flexibility of these tools linked to appropriate conditionality. In more detail, the EFSF and the ESM will be enabled to act on the basis of a precautionary programme, to finance recapitalisation of financial institutions through loans to governments (including in non-programme countries) and to intervene in the secondary markets on the basis of an ECB analysis and of a decision by mutual agreement of the Member States. The procedure for the ratification of the revised EFSF by the national parliaments was completed in mid-October.[5]

Under the 26 October agreement it was decided not to expand the guarantees backing the EFSF, but to leverage its existing resources along two basic options: first, by providing credit enhancement to new debt issued by Member States (thus reducing their funding cost), through the purchase of the risk insurance that will be offered to private investors as an option when buying bonds in the primary market; and second, by maximising the funding arrangements of the EFSF with a combination of resources from private and public financial institutions and investors, which can be arranged through Special Purpose Vehicles. The EFSF will have the flexibility to use these two options simultaneously, depending on the objective pursued and on market circumstances, thereby achieving a leverage effect that according to estimates could even reach up to 4 or 5, with an expected return of around €1 trillion. The final wording of the terms and conditions for the implementation of the relevant procedures is expected by the Eurogroup in November.

Banking system

On 26 October, the members of the European Council agreed on a comprehensive set of measures to strengthen confidence in the banking sector, which: (a) facilitates the banks' access to medium-to-long-term financing through a coordinated approach at EU level; and (b) increases the banks' capital ratio to 9% of the highest quality capital (Core Tier 1) by end-June 2012 (for Greece the target is set to 10%, as defined in the EU/IMF programme). For the capital increase, banks should first use private sources of capital, including through restructuring and conversion of debt to equity instruments. If necessary, national governments and the EFSF should provide support. National supervisory authorities must ensure that banks' plans to strengthen capital will not lead to excessive deleveraging, including maintaining the credit flow to the real economy.

5 According to the President of the European Parliament, H. Van Rompuy, a new momentum in the direction of implementing the 21 July agreement is provided by the German Federal Constitutional Court ruling of 7 September 2011, which confirms the validity of the support programmes for euro area countries in economic difficulties. This ruling is also expected to help strengthen stability in the euro area as a whole.

Fiscal consolidation, growth and economic governance

Stimulating economic growth and employment is a priority for European leaders with respect to all euro area countries, with emphasis on those countries under EU/IMF assistance. According to the 21 July decisions, all euro area countries are called upon to adhere strictly to the agreed fiscal targets, improve their competitiveness and address macroeconomic imbalances. At the same time, a temporary increase in co-funding rates from the Structural Funds is expected to contribute considerably to the growth-oriented efforts of the countries that are subject to consolidation programmes, while the lending rates and the loan maturities agreed for Greece will also be applied for Portugal and Ireland. On 4 October, the EU Council of Finance Ministers confirmed that it will ratify the European Commission's six legislative proposals for economic governance ("six-pack"),[6] which will enter into force in January 2012 and, according to the 26 October decisions, will be strictly implemented as part of the European Semester.[7]

The 26 October agreement further strengthens economic coordination and surveillance with the establishment of additional measures over and above the ones recently adopted for economic governance. It mentions, inter alia, the adoption of rules on balanced budget and the transposition of the Stability and Growth Pact rules into national legislation, as well as for drawing up budgets based on independent growth forecasts. In cases of deviations, it provides for closer monitoring and coordination during budget execution, while it also refers to a pragmatic coordination of tax policies, in anticipation of the European Commission proposals for a Common Consolidated Corporate Tax Base and for a Financial Transaction Tax.

Finally, it promotes at European level working methods for enhancing crisis management, ensuring better economic integration and strengthening governance in the euro area. On 21 July euro area leaders, among other things, recognised the need to reduce reliance on external credit ratings and called upon the European Commission to submit proposals on credit rating agencies. On 26 October, the President of the European Council, Mr. Van Rompuy, was mandated to identify, in cooperation with the President of the European Commission and the President of the Eurogroup, possible steps to strengthen the economic union, including exploring the possibility of limited Treaty changes. An interim report will be submitted in December 2011, while a report on the implementation of the agreed measures will have been completed by May 2012.

2 THE ECONOMIES OF SOUTH-EASTERN EUROPE[8]

The economies of South-East European countries seem to have reached a path of steady recovery, although the relatively high growth rates recorded in a number of them in the first quarter of 2011 show a clear deceleration trend in the course of the year. However, most countries are expected to achieve in 2011 an average annual GDP growth rate, which is higher than that of 2010. More specifically, GDP in Romania recorded a rise in the first quarter of 2011 for the first time since the onset of the crisis and is expected to remain at a positive rate of change in 2011 (1.7%, from -1.9% in 2010). By contrast, Croatia is the only country whose GDP recorded a negative rate of change in the first quarter, but is forecast to post a positive rate for the year as a whole (0.6%, from -1,2% in 2010). The growth rate in Bulgaria, although showing a deceleration trend in relation to its

6 These proposals were amended following consultation with the European Parliament, which then adopted them on 28 September 2011.

7 In addition, on 12 October 2011 the European Commission presented a "Roadmap" with specific proposals for —among other things— building robust economic governance and speeding up stability and growth-enhancing policies in Europe.

8 The South-East European economies that are discussed in this section include: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Montenegro, Former Yugoslav Republic of Macedonia (FYROM), Romania, Serbia and Turkey.

Table II.2 Key macroeconomic indicators of Southeastern European countries[1]

A. GDP and inflation
(annual percentage changes)

Country	GDP							Inflation						
	2007	2008	2009	2010 (estim.)	Q1 2011	Q2 2011	2011 (forecast)	2007	2008	2009	2010 (estim.)	Q1 2011	Q2 2011	2011 (forecast)
Albania	5.9	7.5	3.6	3.8	3.4	1.8	1.9	2.9	3.4	2.2	3.5	4.0	3.9	3.7
Bosnia-Herzegovina	6.2	5.7	-2.8	-3.0	-	-	2.1	1.5	7.4	-0.4	2.1	3.3	-	4.0
Bulgaria	6.4	6.2	-5.5	0.2	3.4	0.1	2.2	7.6	12.0	2.5	3.0	5.1	4.8	3.6
Croatia	5.1	2.2	-6.0	-1.2	-0.8	0.8	0.6	2.9	5.8	2.2	1.1	2.2	2.0	2.1
FYROM	6.1	5.0	-0.9	1.8	5.1	3.3	3.0	2.3	8.3	-0.8	1.6	4.1	4.7	3.8
Montenegro	10.7	6.9	-5.7	2.5	-	-	2.7	4.2	8.5	3.4	0.5	2.5	-	3.1
Romania	6.3	7.3	-6.6	-1.9	1.7	1.4	1.7	4.8	7.9	5.6	6.1	8.0	7.9	5.9
Serbia	5.4	3.8	-3.5	1.0	3.4	2.2	2.1	6.5	12.4	8.1	5.9	14.1	12.7	11.3
Turkey	4.7	0.7	-4.8	8.9	11.0	8.8	7.5	8.8	10.4	6.3	8.6	4.3	6.2	8.5

B. Current account balance and fiscal balance
(as percentage of GDP)

Country	Current account balance							Fiscal balance					
	2007	2008	2009	2010 (estim.)	Q1 2011	Q2 2011	2011 (forecast)	2007	2008	2009	2010 (estim.)	Q1 2011	2011 (forecast)
Albania	-10.4	-15.1	-13.5	-11.8	-11.8	-13.3	-10.9	-3.5	-5.9	-7.3	-4.2	-1.0	-3.7
Bosnia-Herzegovina	-10.7	-14.3	-6.2	-5.6	-7.1	-8.3	-6.2	1.2	-2.2	-4.5	-4.5	-	-3.5
Bulgaria	-30.2	-23.2	-9.0	-1.0	3.1	1.4	1.6	0.1	1.7	-4.3	-3.1	-1.0	-2.5
Croatia	-7.2	-9.1	-5.5	-1.4	-	-	-1.2	-2.5	-1.4	-4.1	-4.9	-	-5.5
FYROM	-7.0	-12.5	-6.4	-2.2	-4.4	-4.4	-5.5	0.6	-0.9	-2.7	-2.5	-0.8	-2.5
Montenegro	-39.5	-50.7	-30.1	-25.6	-	-	-21.5	6.6	0.5	-4.4	-4.9	-	-4.2
Romania	-13.4	-11.4	-4.2	-4.2	-0.7	-	-4.1	-2.5	-5.7	-9.0	-6.9	-0.9	-4.9
Serbia	-16.1	-21.6	-7.1	-7.2	-7.1	-6.8	-7.7	-1.9	-2.6	-4.5	-4.6	-0.8	-4.6
Turkey	-5.9	-5.7	-2.3	-6.6	-7.9	-9.7	-9.8	-1.0	-2.2	-6.7	-3.5	-	-2.4

Sources: WEO, *EU Candidate and Pre-Accession Countries Economic Quarterly*, European Commission (October 2011), EBRD (October 2011) and *Economic Forecast-Autumn 2011, European Economy 6* (provisional version).
1 Estimates for 2010 and forecasts for 2011 are expected to be revised.

performance in the first quarter, is expected to accelerate considerably (2.2%, from 0.2% in 2010). A quite strong acceleration of the growth rate is expected in Serbia (2.1%, from 1.0% in 2010), Bosnia and Herzegovina (2.1%, from -3.0% in 2010), FYROM (3.0%, from 1.8% in 2010) and Montenegro (2.7%, from 2.5% in 2010). On the other hand, Turkey and Albania, i.e. the two countries with the highest growth rates in 2010 (particularly the former), decelerated in 2011 (to 7.5%, from 8.9% in 2010 for Turkey, and 1.9% from 3.8% in 2010 for Albania) (See Table II.2.A).

The impeding slowdown of the initially strong recovery in most economies of the region is mainly due to external factors. More specifically, the projected decline of growth rates in some major economies in 2011 compared with 2010 (particularly the US, Japan and China) and the expected stagnation or small deceleration of the growth rate in the EU have an adverse influence on the growth prospects of the region's countries, considering also the strong effect of export developments on their growth performance.

It is worth noting that a major source of uncertainty in respect to growth prospects is the ongoing sovereign crisis in euro area countries. In particular, there are three main contagion channels for the region. The first one has already been mentioned and relates to real economy and decelerating growth mainly in the larger European countries. The second one is associated with the presence of large banking groups from euro area countries in the region and the possibility of shallower financial depth, which inter alia would further weaken the already low rate of credit expansion in most countries. Finally, the third channel refers to the role of financial markets and the likelihood of a stronger "risk aversion" on the part of investors. In more detail, although the fiscal situation of the countries in the region is generally better than that of euro area countries, a broad increase in risk aversion could create financing problems for countries with relatively high short-term debt – exactly as with the 2008 crisis.

Inflationary pressures, which increased anew to a considerable extent in the first months of 2011, are gradually easing in several countries. Compared to 2010 however, inflation in 2011 is expected to follow an upward path in Serbia, Bosnia and Herzegovina, FYROM and Croatia. In the remaining countries it is expected to stand close to its 2010 levels (see Table II.2.A).

Developments in the external sector are not uniform. In Bulgaria, and to a lesser extent in Albania, there is a clear trend of current account balance improvement, as the increase in exports exceeds the increase in imports. In most of the remaining countries, however, current account deficits are expected to deteriorate, mainly on account of worsened trade balances. The largest deterioration is expected in the case of Turkey, due to the considerable recovery of domestic demand and the high rate of growth (see Table II.2.B).

With respect to the fiscal situation, improvement is recorded in relation to 2010, as most countries move within their budget targets. Better economic conditions and the authorities' clear will to reduce government deficits have contributed to improved fiscal results (see Table II.2.B).

Monetary policy, despite the heightened inflationary pressures in the beginning of the year, is taking up an accommodative stance, seeking to rekindle and strengthen domestic demand. An exception is the unconventional monetary policy in Turkey, where monetary authorities maintain the key interest rate at low levels (5.75%), while increasing the credit institutions' cash reserve requirements at the same time. Their objective is on the one hand to ensure (through the key rate) continuation of the economy's unhindered financing by achieving financial stability, while seeking on the other hand (by maintaining cash reserve requirements at high levels) to improve the quality of funds, discouraging speculative attacks. However, the widening current account deficit undermines the sustainability of high growth rates and is reminiscent of the conditions that prevailed prior to the 2008 crisis.

Improved levels of economic activity in the countries of the region also reflect the situation prevailing in the financial sector. The positive rate of credit expansion, although slowing down after the first half of the year, stands at satisfactory levels in all these countries, a fact that increases the possibility of stronger economic growth.[9] Moreover, the formulation in several countries of a new funding model for

9 It should be noted that Turkey is an exception, given that the considerable economic growth it records is fully reflected in its credit expansion rate, which in the first half of 2011 accelerated by around 17%.

the financial sector, which will henceforth rely on internal sources of liquidity, has shielded the credit institutions' operation to a considerable extent. This reduced dependence has helped ensure conditions of robust growth, largely limiting the risk of interdependence, given the high share of foreign ownership. At the same time, the timely adoption of higher than anticipated capital requirements has helped to absorb the effects of the relatively high doubtful claims recorded, thus ensuring growth prospects.

Undoubtedly the countries of South-Eastern Europe have set on a path of steady recovery, the duration of which depends mainly on external factors and particularly on the evolution of the sovereign crisis in euro area countries. A timely and effective tackling of this crisis will greatly benefit the long-term growth prospects of these economies.

3 THE EUROSYSTEM'S SINGLE MONETARY POLICY AND INTERVENTIONS[10]

Already since early 2011, the ECB Governing Council had estimated that the rise in commodity prices, already underway in previous years as a result of higher economic activity and enhanced global liquidity, in addition to geopolitical tensions, had created inflationary risks. The Eurosystem, in order to avert inflationary pressures from spreading out through second-round effects[11] from the rise in commodity prices, increased its key interest rates[12] in April and July 2011, by 25 basis points each time (see Table II.3).

Despite increases in the key rates, the ECB Governing Council was estimating, up until September 2011, that the stance of the single monetary policy remained accommodative, i.e. continued to support economic activity and promote job creation in the euro area, among other things because short-term rates[13] were kept low. However, it noted (September 2011) that funding conditions in some financial markets have now become less favourable due to the resurgent fiscal crisis. In October 2011, the ECB Governing Council confirmed the estimate that short-term rates remained low, but funding conditions for enterprises and households were adversely affected by shocks in the financial markets. Thereafter, it became evident that, as economic activity weakened both in the euro area and worldwide, the inflationary pressures mentioned above that had manifested themselves earlier in the course of 2011, were about to ease. Based on this estimate of the ECB Governing Council, the Eurosystem proceeded to a reduction of the key rates by 25 basis points in November 2011, bringing them to levels consistent with the maintenance of price stability in the euro area over the medium term.

As regards the use of non-standard monetary policy measures, in the period from March to October 2011 the Eurosystem repeatedly[14] extended the conduct of open market operations with a maturity of one maintenance period,[15] as well as the use of fixed-rate tenders with full allotment (i.e. unlimited liquidity supply)[16] to all its regular open market operations conducted for the refinancing of credit institutions until mid-2012 (see Table II.4).

10 According to the introductory statements by the President of the ECB to the press conferences held after the first ECB Governing Council meeting of each month (whereat monetary policy is set) in the first eleven months of 2011, as well as ECB announcements and other ECB documents.
11 Second-round effects are recorded when consumer prices are pushed upwards either because profit margins have widened or wage increases were granted, in an effort to counterbalance the unfavourable impact of higher commodity prices on the purchasing power of enterprises and employees, respectively; see ECB, *Monthly Bulletin*, July 2004, pp. 28-30.
12 The key interest rates recorded in Table II.3 are set by the Eurosystem and aim to directly influence market rates and, ultimately in the longer run, inflation in the euro area.
13 Short-term interest rates are interest rates applicable on items (e.g. interbank loans, government and corporate bonds, bank deposits and loans to enterprises and households) that have a maturity (or residual maturity in the case of bonds) of up to one year.
14 In March, June, August and October 2011.
15 In 2011, maintenance periods ranged between 21 and 35 days (average duration: 30.3 days). A maintenance period is the predetermined time span over which compliance with reserve requirements is calculated according to the average daily balances. Average daily balances may not fall short of a given level (equal to the minimum reserve ratio 2% multiplied by the sum of a subset of the credit institution's liabilities (reserve base) at the end of the month before last). The daily balance of reserve requirements may vary from day to day.
16 Provided, of course, that credit institutions give to the Eurosystem adequate collateral for the funding they receive.

Table II.3 Changes in key ECB interest rates

(percentages per annum)

With effect from:[1]		Deposit facility	Main refinancing operations		Marginal lending facility
			Fixed rate tenders (fixed rate)	Variable rate tenders (minimum bid rate)	
2000	6 October	3.75	-	4.75	5.75
2001	11 May	3.50	-	4.50	5.50
	31 August	3.25	-	4.25	5.25
	18 September	2.75	-	3.75	4.75
	9 November	2.25	-	3.25	4.25
2002	6 December	1.75	-	2.75	3.75
2003	7 March	1.50	-	2.50	3.50
	6 June	1.00	-	2.00	3.00
2005	6 December	1.25	-	2.25	3.25
2006	8 March	1.50	-	2.50	3.50
	15 June	1.75	-	2.75	3.75
	9 August	2.00	-	3.00	4.00
	11 October	2.25	-	3.25	4.25
	13 December	2.50	-	3.50	4.50
2007	14 March	2.75	-	3.75	4.75
	13 June	3.00	-	4.00	5.00
2008	9 July	3.25	-	4.25	5.25
	8 October	2.75	-	-	4.75
	9 October	3.25	-	-	4.25
	15 October	3.25	3.75	-	4.25
	12 November	2.75	3.25	-	3.75
	10 December	2.00	2.50	-	3.00
2009	21 January	1.00	2.00	-	3.00
	11 March	0.50	1.50	-	2.50
	8 April	0.25	1.25	-	2.25
	13 May	0.25	1.00	-	1.75
2011	13 April	0.50	1.25	-	2.00
	13 July	0.75	1.50	-	2.25
	9 November	0.50	1.25	-	2.00

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

The second half of July and August 2011 saw sharp increases in yields and a shrinking of transaction volumes in the government bond markets of certain euro area countries. The Eurosystem, in order to help deal with these tensions in the financial markets, rigorously resumed after a four-month break its Securities Markets Programme, extended the use and conduct of the operations mentioned above, and supplied to the interbank market liquidity with a maturity of six months, which facilitates the banks' liquidity-management planning and supports the supply of credit to households and enterprises in the euro area.

Furthermore, given that on account of the shocks in international financial markets European banks face difficulties in raising adequate reserve assets in US dollars through the market as well, on 15 September the ECB Governing Council decided (in coordination with the Federal Reserve Bank, the Bank of England, the Bank of Japan and the Bank of Switzerland) to carry out by the end of 2011 three operations with a maturity of three months for the supply of US dollar liquidity, conducted as fixed-rate tenders with full allotment (in addition to the weekly operations with a maturity of seven days conducted since May 2010, for which however

Table II.4 Eurosystem's open market operations in 2011*

1. Main and longer-term refinancing operations:	
1.1 Main refinancing operations: provision of liquidity with a maturity of one week	**Frequency:** Once a week. **Procedure:** At least until 10 July 2012, fixed rate tender with full allotment.
1.2 Longer-term refinancing operations:	
1.2.1 Provision of liquidity with a maturity of one maintenance period	**Frequency:** Once at the beginning of each maintenance period. These operations will continue to be carried out at least until 10 July 2012. **Procedure:** Fixed-rate tender (at a rate equal to the MRO rate) with full allotment.
1.2.2 Provision of liquidity with a maturity of three months	**Frequency:** Once a month. **Procedure:** Tender with full allotment and an interest rate set ex post equal to the average value of the fixed rate in the MROs conducted over the life of the respective three-month operations.
1.2.3 Provision of liquidity with a maturity of six months	In order to address the tensions that resurfaced, in the second half of July initially, in some euro area financial markets, the Governing Council of the ECB decided (in early August) to conduct one operation with maturity of six months, settled on 11 August 2011. **Procedure:** Tender with full allotment and an interest rate set ex post equal to the average value of the fixed rate in the MROs conducted over the life of the respective six-month operation.
1.2.4 Provision of liquidity with a maturity of twelve/thirteen months	In the context of addressing the tensions mentioned above, the Governing Council of the ECB decided (in early October) to conduct one operation with maturity of 371 days (i.e. approximately twelve months), settled on 27 October 2011, and one operation with a maturity of 406 days (i.e. approximately thirteen months), settled on 22 December 2011. **Procedure:** Tender with full allotment and an interest rate set ex post equal to the average value of the fixed rate in the MROs conducted over the life of each of the respective longer-term refinancing operations.
2. Securities outright purchase operations:	
2.1 Securities Markets Programme	The Governing Council of the ECB decided in early May 2010 to conduct the programme. By end-March 2011 the Eurosystem had purchased securities worth €76.5 billion in total. These purchases were then discontinued and, due to repayments, the level dropped to €74 billion by early August 2011. Between August and October and in early November 2011, the Eurosystem resumed purchases of securities and on 11 November the value of the relevant securities portfolio amounted to €186.8 billion.
2.2 New covered bond purchase programme	As announced by the Governing Council of the ECB (in early October), the Programme will run from November 2011 to end-October 2012 and is expected to comprise purchases of bonds worth €40 billion.
3. Fine-tuning operations:	
3.1 Liquidity absorption on the last day of each maintenance period	**Procedure:** Collection of overnight deposits from credit institutions through variable-rate tenders with a maximum bid rate equal to the fixed rate on main refinancing operations.
3.2 Liquidity absorption on a weekly basis to sterilise the effect, on the overall liquidity of the banking system, of purchases made under the Securities Markets Programme	**Procedure:** Collection of weekly deposits from credit institutions through variable-rate tenders with a maximum bid rate equal to the fixed rate on main refinancing operations.
4. US dollar liquidity-providing operations:	
The Eurosystem enabled every week credit institutions to raise liquidity in US dollars with a maturity of 7 days against collateral eligible for the Eurosystem's credit operations in euro. Demand by credit institutions for raising funds through these operations was expressed only in the first two months of 2011 and in August-November. In mid-September 2011 it was announced that additional similar operations with a maturity of three months would be conducted on 13 October, 10 November and 8 December 2011. This was considered necessary since financial market shocks (after end-July) made it difficult for euro area credit institutions to raise US dollar liquidity from international markets. **Procedure:** Fixed rate tender with full allotment.	

* The table was compiled on the basis of data and information available in early November 2011. However, the announcements made by the Governing Council of the ECB by that date determine to a large extent the operations to be conducted at least until the end of 2011.

there had been no demand in the period from March to July 2011).

Moreover, in October 2011 the ECB Governing Council announced that two more open market operations with full allotment would be carried out. The first operation, with a maturity of approximately 12 months, was conducted in October 2011; the second will have a maturity of approximately 13 months and will be conducted in December 2011. It was also announced that in the period from November 2011 to October 2012 the Eurosystem would enhance even further the liquidity of the banking system by purchasing covered bank bonds[17] (from the primary or the secondary market) amounting to €40 billion in total.

The ECB Governing Council has repeatedly stressed that the total supply of liquidity and the procedures for its allotment will ensure that credit institutions in the euro area will face no liquidity constraints. But one should not overlook that non-standard measures (such as the unlimited supply of liquidity to credit institutions at a fixed rate) —adopted when tensions in the financial markets intensified considerably— are by nature temporary.

The ECB Governing Council recently reiterated that the single monetary policy must unwaveringly seek to achieve the Eurosystem's primary objective, i.e. maintaining price stability[18] in the euro area over the medium term. In order to set this policy, the ECB Governing Council combines the conclusions of the economic and monetary analyses it carries out.

In the context of economic analysis, it observed that euro area economic activity continued to recover in the period from January to November 2011. Of course, between the first and the second quarter of 2011 the quarterly rate of economic growth in the euro area slowed down. This is attributable, among other things, to the fact that in the first quarter this rate had been affected by an extraordinary, favourable factor,[19] the effect of which subsided in the second quarter. The slowdown of GDP growth is also attributable to a series of other factors, such as the impact of the natural disasters in Japan in March 2011, the fall in share prices and other consequences of the fiscal crisis, and finally, to the lagged effect of previous years' oil price increases on private consumption in the euro area.

GDP growth is expected to continue in the second half of 2011, at rates that will certainly be low,[20] mainly due to the effect of the ongoing tensions in many euro area government securities markets —which affect financing conditions for enterprises and households negatively— lower consumer and business confidence, and the decelerated GDP growth rate, combined with the downward revision of the economic outlook of the US. This forecast includes a high degree of uncertainty and one should not overlook the considerable risks that exist in relation to the growth prospects of economic activity in the euro area. The fiscal crisis and the ensuing financial turmoil are expected to affect economic activity adversely in 2012 as well. Therefore, one should anticipate a considerable downward revision of the respective projection for the euro area GDP

17 These are fixed-rate bonds with a medium- or long-term maturity, which are based on a set of loans (the "cover pool") granted by the issuing credit institution. The loans included in the cover pool are selected so as to be relatively secure, i.e. are either mortgage loans (with a relatively low loan-to-value ratio) or loans (including bond issues) to the public sector. Furthermore, as these loans remain in the balance sheet of the credit institution granting them, they do not weaken its incentives for selecting and monitoring the debtors, in contrast to what tends to be the case (in the absence of other collateral) with respect to other securities derived from bank loan securitisation (asset-backed securities). In fact, covered bonds provide double security (dual recourse) to the bondholders. These are creditors of the bank (in contrast to those holding other securities issued against bank loans, e.g. structured bonds). At the same time, in the case of covered bonds, bondholders have a preferential claim —i.e. by priority over all other creditors of the bank— on the loans that form the bonds' cover pool (see the published ECB report "Covered bonds in the EU financial system", December 2008). It should be recalled that the Eurosystem had successfully implemented a similar "covered bonds purchase programme" in the period from July 2009 to June 2010.

18 According to the definition that forms part of the Eurosystem's monetary policy strategy, price stability prevails when inflation rates are below, but close to, 2%.

19 Namely, the fact that in the first quarter of 2011 construction activity recovered from the levels of the last quarter of 2010, which were particularly low due to the adverse effect of weather conditions.

20 Indeed, the quarterly rate of GDP growth in the third quarter was 0.2% based on very recent flash estimates, published after the ECB Governing Council meeting of November 2011.

growth rate (which, in September 2011 the ECB staff estimated to stand between 0.4% and 2.2% on an annual basis).

The ECB Governing Council also observed, in the context of economic analysis, that inflation remained at high levels in the course of 2011, and indeed it picked up from 2.2% in December 2010 to 3% in September and October 2011, due to the increase in the prices of crude oil and other commodities, which continued to affect pricing in the early stages of the production process. It was repeatedly stressed during March-September 2011 that it was of primary importance to prevent second-round effects from the enterprises' pricing behaviour or employee wage demands, which would contribute to generalised increases in the prices of final products over the medium term. The ECB Governing Council currently estimates that inflation in the euro area will remain clearly above 2% in the next few months, while since September 2011 it has adopted the forecast that in the course of 2012 inflation will fall below 2%. This estimate relies on (i) expectations in the futures contract market regarding developments in commodity prices, and (ii) the fact —highlighted in November 2011— that the weakening of economic activity in the euro area, continuing since the second half of 2011 and expected to persist in 2012, will help contain the rise in the cost components (including wages) and the prices of final products.

Furthermore, the ECB Governing Council reiterates its strong commitment to help contain inflation expectations at levels consistent with an inflation rate below, but close to, 2% over the medium term,[21] a necessary condition for economic growth and employment in the euro area.

According to the latest ECB staff macroeconomic projections, published in September 2011, average annual inflation is estimated to stand between 2.5% and 2.7% in 2011, but to decline thereafter, and stand between 1.2% and 2.2% in 2012.

In the context of monetary analysis carried out by the ECB Governing Council in parallel with economic analysis, it has been observed that the underlying pace of monetary expansion,[22] which affects medium- and long-term inflationary pressures, remains at moderate levels. The actual rates of monetary[23] and credit[24] expansion also remain at relatively low levels, albeit this —as was noted by the ECB Governing Council in November 2011— does not entail that financial market tensions have affected bank credit supply adversely, at least not until the end of the third quarter of 2011. Of course, one cannot rule out the possibility of such an effect manifesting itself towards the end of the year or even later.

On the other hand, the ECB Governing Council has repeatedly noted over March-September 2011 that a large part of the liquidity accumulated before the financial crisis still remains in the euro area economy and this could facilitate generalised upward pressures on prices. However, a more recent estimate was that the increased money holding by economic agents in the euro area is probably due to a precautionary stance, given the increased uncertainty, and unrelated to the financing of spending.[25]

In October 2011 the ECB Governing Council underlined that the situation in the banking sector had to be very carefully addressed, given that the fiscal crisis creates various difficulties for banks – among other things, limited ability to raise liquid assets through the financial

21 Inflation expectations were successfully contained in the first ten months of 2011. See ECB, *Monthly Bulletin*, section 2.4 (which describes developments in bond markets), issues: February-November 2011.

22 The underlying pace of monetary expansion is calculated by the ECB using various alternative methods (see ECB, *Monthly Bulletin*, May 2008, Box 1, p. 15) and is not published. It is considered to be linked to developments in inflation more closely than the rate of increase in M3, taking into consideration the time lags.

23 M3 rate of change: September 2011: 3.1%, December 2010: 1.7%. It should be noted that in the last few months M3 growth may have been pushed upwards on account of tensions in the financial markets.

24 Rate of change in bank loans to the private sector including securitised loans (which do not appear in banks' balance sheets): September 2011: 2.7%, December 2010: 2.3%.

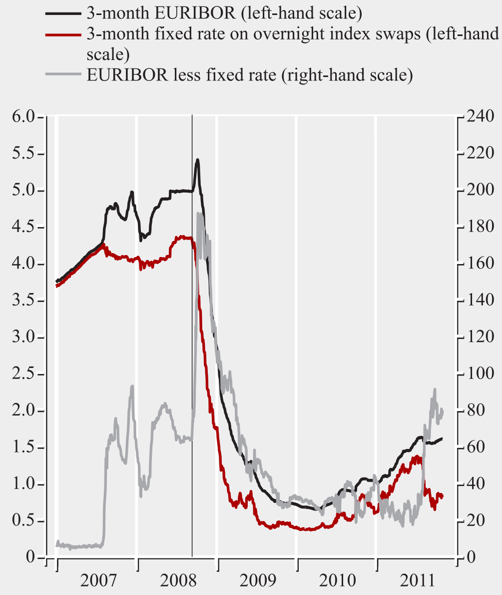
25 See the ECB President's speech before the European Parliament's Economic and Monetary Affairs Committee on 29 August 2011.

markets. As it had also done in the past, the ECB Governing Council called on euro area banks to shield their balance sheets by all means possible, to limit the allocation of profits to shareholders and withhold them to the extent possible, to refrain from paying exorbitant salaries to their executives and to tap on equity markets for strengthening their capital base. If need be, banks should take full advantage of the various support options made available by government authorities. Of course, government authorities on their part should put the respective support programmes in full effect. Moreover, the European Financial Stability Facility (EFSF) that lends the governments of member countries so that they can strengthen the credit institutions' capital base should also be put in effect and used in the future. Finally, in November 2011, the ECB Governing Council stressed that the extent of the adverse effects of the financial turmoil on economic activity depends on the robustness of the banks' balance sheets. As long as their balance sheets are robust, banks are in a position to supply the real economy of the euro area with adequate levels of credit. In this respect, the ECB Governing Council welcomes the decision reached in the Summit of 26 October 2011 to increase the credit institutions' Core Tier 1 ratio to 9% until the end of June 2012, as well as the care that will be taken in order to avoid an excessive deleveraging of credit institutions to this end.

From January to early November 2011, the three-month Euribor[26] increased (see Chart II.4). This rise in the three-month Euribor (and in the other interbank rates) in 2011 may initially be attributed to expectations of increases in Eurosystem key rates (which, as was mentioned above, largely materialised).[27] The rise of interbank rates in the first four months of 2011 is also accounted for by the fact that euro area credit institutions' total demand for liquidity from the Eurosystem was falling during this period,[28] a development that suggests the interbank market's improved operation and is associated with the decline in the outstanding amounts of the deposit facility, which was con-

Chart II.4 Interest rates and spreads in the euro area money market (January 2007-October 2011)

(percentages per annum and basis points; daily data)



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

stant in the first half of 2011, but was reversed thereafter. The first four months of 2011 saw some downward pressure on interbank loan rates due to lower counterparty risk premia[29] (see Chart II.4), as by then conditions in the interbank market improved.

However, in May and in the period from mid-June to end-September 2011 these premia increased and reached the highest levels recorded since the beginning of 2009, due to renewed concerns regarding the fiscal situation in a lot of member countries. This higher pre-

26 The three-month interest rate is representative of the euro area rates on interbank loans (with a maturity longer than overnight).
27 See BIS, *Quarterly Review*, June 2011, p. 7, Graph 5.
28 Liquidity demand followed a downward trend from February to April 2011 and an upward one in the period after.
29 Counterparty risk refers to the risk of the debtor in an interbank loan defaulting on its obligations. The risk inherent in interbank market investments is measurable by the spread between the Euribor rate and either the fixed rate on overnight index swaps (of a maturity corresponding to that of the interbank loan) or the rate on interbank loans against collateral of a corresponding maturity (EUREPO); see Bank of Greece, 2008 *Annual Report*, p. 49, footnote 6.

mium, combined with the effect of the expectations of further increases in ECB rates, explains the continued upward path of the three-month Euribor rate in the period from May to July 2011. In early August 2011 the rate decreased and remained practically stable until just before the end of September, despite the considerable rise in the premium, a development consistent with the sharp increase in credit institutions' demand for liquidity from the Eurosystem, as well as with money market expectations of a discontinuation of key rate[30] increases and an adoption of additional non-standard liquidity-enhancing measures. Finally, in October 2011 the three-month Euribor followed an upward path, while in early November it fell, due to the reduction of the key rates.

The volume of transactions in the market for interbank deposits with a maturity longer than overnight (collateralised or not) seems to have remained limited. Furthermore, throughout the period from January to early November 2011, there were still difficulties with the redistribution of liquid assets, particularly to credit institutions in Greece, Ireland and Portugal, which have been largely shut out of the interbank market.

These credit institutions were forced to resort mostly to the Eurosystem's main and longer-term refinancing operations or even to the standing marginal lending facility,[31] in order to raise the necessary funds. The ECB Governing Council has repeatedly stressed that banks with limited ability to raise funds through the interbank market should urgently improve their effectiveness and strengthen their capital base.[32]

30 See BIS, *Quarterly Review*, September 2011, p. 5, Graph 4.
31 Also reported (see IMF, "Lessons from the European Financial Stability Framework Exercise", 11 July 2011, pp. 57-58, e.g. for Ireland) were cases of individual credit institutions recoursing to the Emergency Liquidity Assistance, which is provided by the national central banks on their own responsibility. Activation of this mechanism, which has recently taken place in Greece as well, is not made in the context of the single monetary policy.
32 In order to facilitate the banks in raising medium-term loan funds through the market, the Summit of 26 October 2011 resolved, among other things, on giving the appropriate guarantees to the banks based on a coordinated approach at EU level.

III MACROECONOMIC DEVELOPMENTS IN GREECE AND PROSPECTS FOR 2011

1.1 ECONOMIC DEVELOPMENTS AND PROSPECTS

The recovery of the **economic climate** in early 2011 was short-lived (see Chart III.1B). After that, the economic sentiment indicator started to follow a declining path up until June, before partly rebounding in July and August, but deteriorated anew in the two months that followed. In October (before the decisions of the Summit of 26 October), it reached its lowest level since March 2009.

The **coincident indicator of economic activity**, compiled by the Bank of Greece (see Chart III.1), reflects the continuing deterioration of the macroeconomic environment.

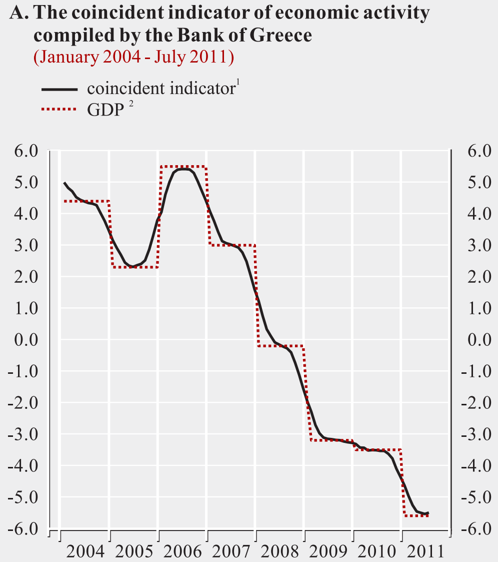
In greater detail, according to available three-month national accounts data,[1] the drop in GDP is gathering pace: its annual rate of change was -7.9% in the first half of 2011 (Q1: -8.3%, Q2: -7.4% – see Table III.1B) compared with -6.6% in the second half of 2010 and -0.2% in the first half of 2010.[2] For the year as a whole, based on the indications available up until mid-November, economic activity is estimated to decline by about 5.5%. In the nine-month period to September, the annual rate was -6.9%.

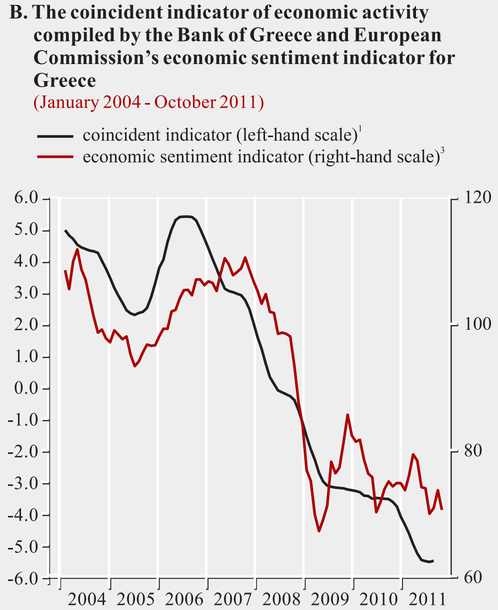
In the first half of 2011, as a result of the fiscal consolidation measures that are described in detail in Chapter IV, **public consumption** declined by 8.4% year-on-year (Q1: -6.9%, Q2: -9.7%).

The fall in GDP during the first half of 2011 was driven in particular by the 7.1% decline in private consumption (by 5.6 percentage points) and the 19.4% drop in investment (contribution: 3.3 percentage points). The decline in public consumption had a contribution of 1.5 percentage points. Recession deepened also on account of a more pronounced drop in investment between the first and the second half of 2011.

The **decline in private consumption** in the first half of the year is attributable to (i) the drop in households' disposable income, as a result of the wage cuts (see Section 3 of this chapter)

Chart III.1 Economic activity indicators





Sources: Bank of Greece (coincident indicator and 2011 GDP), ELSTAT (GDP for 2004-2010) and European Commission (economic sentiment indicator).
1 Annualised monthly percentage changes.
2 Annual rate.
3 Monthly data.

1 GDP rates are based on the estimates announced on 15 November 2011 and the rates of individual aggregates on the *quarterly* data that were available in October 2011, which are subject to revision.
2 ELSTAT data are not seasonally or workday adjusted.

Table III.1A Demand and gross domestic product 2005-2010

(2005 constant market prices)

	Value in million euro	Annual percentage change				
	2005	2006	2007	2008	2009	2010
1. Private consumption	134,725	4.3	3.7	4.0	-1.3	-3.6
2. Public consumption	34,937	2.3	7.6	-2.1	4.8	-7.2
3. Gross fixed capital investment	40,020	20.4	5.4	-6.7	-15.2	-15.0
3.1 Houses	18,120	31.4	-9.0	-28.2	-23.5	-18.0
3.2 Other construction	7,036	0.1	-8.7	39.6	13.3	-5.5
3.3 Equipment	13,043	15.6	37.0	1.3	-24.0	-20.0
3.4 Other	1,821	24.4	-10.2	-4.2	15.8	-7.1
4. Final domestic demand[1]	209,682	7.0	4.7	0.7	-3.1	-6.3
5. Inventories and statistical discrepancy (% of GDP)	1,302	0.5	1.6	1.2	-1.8	-1.3
6. Domestic demand	210,984	6.9	5.7	0.3	-5.6	-5.9
7. Exports of goods and services	44,807	3.1	6.9	3.0	-19.5	4.2
7.1 Exports of goods	20,490	5.1	4.1	-0.4	-15.7	5.4
7.2 Exports of services	24,317	1.4	9.5	5.9	-22.5	3.2
8. Imports of goods and services	62,741	8.2	14.6	3.3	-20.2	-7.2
8.1 Imports of goods	51.875	7.9	15.3	1.5	-21.0	-10.7
8.2 Imports of services	10,866	9.8	11.6	12.3	-16.5	7.0
GDP at market prices	193,050	5.5	3.0	-0.2	-3.2	-3.5
		Contribution to the change in gross domestic product (percentage points)				
1. Private consumption		2.99	2.58	2.78	-0.91	-2.68
2. Public consumption		0.41	1.34	-0.39	0.87	-1.39
3. Gross fixed capital investment		4.24	1.28	-1.62	-3.43	-2.98
3.1 Houses		2.95	-1.05	-2.91	-1.75	-1.06
3.2 Other construction		0.00	-0.30	1.21	0.57	-0.27
3.3 Equipment		1.05	2.74	0.12	-2.40	-1.56
3.4 Other		0.23	-0.11	-0.04	0.15	-0.08
4. Final domestic demand[1]		7.64	5.17	0.80	-3.47	-7.08
5. Inventories and statistical discrepancy		-0.13	1.16	-0.45	-2.90	0.57
6. Domestic demand		7.50	6.33	0.35	-6.37	-6.52
7. Exports of goods and services		0.72	1.57	0.71	-4.73	0.85
7.1 Exports of goods		0.54	0.43	-0.05	-1.67	0.50
7.2 Exports of services		0.18	1.14	0.75	-3.07	0.35
8. Imports of goods and services		2.68	4.88	1.23	-7.76	-2.30
8.1 Imports of goods		2.13	4.20	0.45	-6.57	-2.72
8.2 Imports of services		0.55	0.68	0.78	-1.18	0.43
9. Balance of goods and services (net exports)		-1.96	-3.31	-0.52	3.03	3.14
GDP at market prices		5.54	3.00	-0.16	-3.25	-3.52

Source: ELSTAT, National Accounts, revised data, base year=2005, 5-12 October 2011.
1 Excluding inventories and statistical discrepancy.

Table III.1B Demand and gross domestic product (Q1 2010-Q2 2011)

(2000 constant market prices)

	Annual percentage changes						
		2010				2011	
	2010	Q1	Q2	Q3	Q4	Q1	Q2
1. Private consumption	-4.6	0.8	-5.1	-5.8	-8.8	-7.9	-6.1
2. Public consumption	-8.3	-5.0	-6.1	-6.8	-13.4	-6.9	-9.7
3. Gross fixed capital investment	-16.5	-8.5	-15.2	-22.0	-19.4	-20.9	-17.9
3.1 Houses	-18.6	-18.1	-18.5	-19.5	-18.5	-20.1	-21.9
3.2 Other construction	-5.8	-1.2	-4.6	-7.0	-8.3	-16.0	-16.6
3.3 Equipment	-23.5	-7.1	-20.9	-32.7	-31.0	-25.9	-18.2
3.4 Other	21.9	7.8	13.9	47.4	21.6	9.5	-5.6
4. Final domestic demand[1]	**-7.3**	**-1.5**	**-6.9**	**-8.7**	**-11.8**	**-9.4**	**-8.5**
5. Inventories and statistical discrepancy (% of GDP)	0.0	0.8	-1.8	1.9	-0.8	1.4	-2.2
6. Domestic demand	**-5.9**	**0.4**	**-6.6**	**-6.6**	**-10.6**	**-8.9**	**-8.8**
7. Exports of goods and services	3.8	2.2	3.2	-0.9	12.8	-2.6	-1.4
7.1 Exports of goods	4.8	-1.4	-1.0	-0.8	23.0	5.5	2.2
7.2 Exports of services	3.2	5.8	6.3	-1.1	4.2	-10.3	-3.8
8. Imports of goods and services	-4.8	0.5	-8.4	-8.9	-3.2	-12.8	-7.6
8.1 Imports of goods	-8.4	-1.0	-12.4	-14.7	-7.0	-14.0	-7.1
8.2 Imports of services	11.1	10.8	7.8	14.5	11.2	-6.9	-9.2
GDP at market prices[2]	**-4.4**	**0.7**	**-4.0**	**-4.8**	**-8.8**	**-8.1**	**-7.3**
	Contribution to the change in gross domestic product (percentage points)						
1. Private consumption	-3.31	0.69	-3.83	-4.12	-5.99	-6.71	-4.51
2. Public consumption	-1.64	-0.90	-1.18	-1.23	-3.25	-1.16	-1.85
3. Gross fixed capital investment	-3.08	-1.66	-2.78	-3.96	-3.93	-3.68	-2.89
3.1 Houses	-0.85	-1.00	-0.83	-0.82	-0.75	-0.90	-0.84
3.2 Other construction	-0.23	-0.04	-0.18	-0.23	-0.47	-0.55	-0.65
3.3 Equipment	-2.18	-0.68	-1.88	-3.21	-2.94	-2.30	-1.35
3.4 Other	0.18	0.06	0.12	0.30	0.23	0.08	-0.06
4. Final domestic demand[1]	**-8.06**	**-1.83**	**-7.79**	**-9.30**	**-13.32**	**-11.16**	**-9.23**
5. Inventories and statistical discrepancy	1.66	2.29	0.59	2.25	1.52	0.46	-0.23
6. Domestic demand	**-6.39**	**0.46**	**-7.20**	**-7.04**	**-11.80**	**-10.70**	**-9.46**
7. Exports of goods and services	0.76	0.39	0.66	-0.20	2.18	-0.47	-0.30
7.1 Exports of goods	0.40	-0.13	-0.09	-0.06	1.89	0.50	0.21
7.2 Exports of services	0.36	0.52	0.72	-0.16	0.37	-0.96	-0.49
8. Imports of goods and services	-1.48	0.20	-2.63	-2.59	-0.91	-5.07	-2.25
8.1 Imports of goods	-2.10	-0.33	-3.09	-3.42	-1.56	-4.59	-1.61
8.2 Imports of services	0.67	0.67	0.49	0.87	0.66	-0.47	-0.65
9. Balance of goods and services	2.24	0.20	3.28	2.39	3.09	4.60	1.95
GDP at market prices	**-4.4**	**0.7**	**-4.0**	**-4.8**	**-8.8**	**-8.1**	**-7.3**

Source: ELSTAT, national accounts, 8 September 2011, non-seasonally adjusted data.
1 Excluding inventories and statistical discrepancy.
2 According to new ELSTAT estimates published on 15 November, annual GDP rates are revised as follows: 2010 Q1 = 0.4%, Q2 = -0.7%, Q3 = -4.6%, Q4 = -8.6%; 2011 Q1 = -8.3%, Q2 = -7.4%, Q3 = -5.2%.

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

(annual percentage changes[1])

	2009	2010	2011 (available period)
Volume of retail sales (excluding fuel and lubricants)	-9.3	-6.9	-9.1 (Jan.-Aug.)
Food-beverages-tobacco[1]	-6.1	-5.5	-6.5 (» »)
Clothing-footwear	1.4	-11.4	-16.8 (» »)
Furniture-electrical appliances-household equipment	-15.3	-12.7	-17.3 (» »)
Books-stationery-other	-24.0	-4.3	-4.3 (» »)
Revenue from VAT (at constant prices)	-10.2	0.1	-4.1 (Jan-Sept.)
Retail trade business expectations index	-21.4	-26.4	-0.9 (Jan.-Oct.)
New passenger car registrations	-17.4	-37.2	-34.4 (» »)
Tax revenue from mobile telephony[2]	13.2	37.1	-20.8 (Jan.-Aug.)
Outstanding balance of consumer credit[3]	2.0 (Dec)	-4.2 (Dec.)	-6.5 (Sept.)

Sources: ELSTAT (retail sales, cars), Ministry of Finance (VAT revenue, tax revenue from mobile telephony), IOBE (expectations), Bank of Greece (consumer credit).
1 Including big food stores and specialised food-beverages-tobacco stores.
2 Monthly service fee per connection until July 2009. A new tiered fee on mobile subscriptions and a fee on prepaid phone cards have been levied as of August 2009.
3 Including bank loans and securitised loans. The rates of change are adjusted for loan reclassifications, loan write-offs/write downs, foreign exchange valuation differences and a transfer of loans by one bank to a subsidiary domestic credit company in 2009.

and the significantly reduced number of employed persons (see Section 2 of this chapter); (ii) increased consumer credit constraints for households (see Table III.2 and Chapter V.3); and (iii) pervasive uncertainty. The **consumer confidence indicator** has been on a downward path since October 2009.

More specifically, according to national accounts data, **wages** in the first half of 2011 (at current prices) were cut by 9.4% on an annual basis (Q1: -8.9%, Q2: -9.7%), reflecting both a 3.1% cut in the compensation per employee (Q1: -3.8%, Q2: -2.3%) and a 6.5% decrease (on a national accounts basis) in the number of employees (Q1: -5.3%, Q2: -7.6%). In the first half of the year, the **gross operating surplus** of the economy fell by 2.5% (Q1: -3.7%, Q2: -1.4%).

Reduced private consumption in the first half of 2011 reflects the contraction of the **retail sales** volume, excluding fuel and lubricants, which entered into negative territory (-11.7%), and the reduced number of **new passenger car registrations** (-42.2% year-on-year, see Chart III.2B). According to data on outstanding **consumer loans**, the annual rate of **credit expansion** was negative throughout the first half of the year, deteriorating with every month.

Available data on private consumption after the first half and up until end-October remain negative (drop in the volume of retail sales by 0.5% in the two months July-August (-2.0% in July, +1.2% in August), drop in the number of new passenger car registrations by 4.0% in Q3, progressively steeper fall in consumer credit). The consumer confidence indicator, i.e. before the decisions taken in the Summit of 26 October 2011, recorded a historic trough in October 2011. However, since private consumption had already deteriorated significantly in the second half of 2010 (-7.3% year-on-year), it is expected that for **2011** as a whole, **private consumption will decline by about 6%**. For 2012 it is expected that consumption will continue to fall, albeit at a slower pace. However, the rationalisation of the economy, so that the share of consumption in GDP approaches euro area's, has not been achieved yet. According to revised annual national accounts data (October 2011), in 2010 the share of private consumption in GDP was 74.5% in Greece, compared with 57.5% in the euro area.

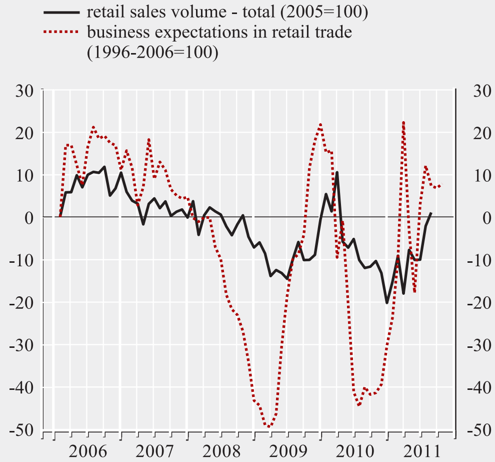
Fixed capital investment followed a downward path throughout 2010 (annual change -15.0% at constant prices, see Table III.1A) and in the first half of 2011 as well, at stronger rates (-19.4%), (Q1: -20.8%, Q2: -17.9%). This development reflects the continuing large decline in investment in **equipment (machinery and transport equipment)** and in **housing** investment. A further contraction of the Public Investment Programme (PIP), with disbursements dropping by 31.7% in the first half of 2011 year-on-year, also impacted adversely on **investment in other construction**. At the same time, the **volume of private construction activity** (based on building permits) recorded a sizeable annual decline of -44.6% in the first half of the year and **cement production** continued to drop (-35.8% in the same period). See also Table III.3.

According to available data for the third quarter of 2011, business sentiment in the construction sector[3] remained negative. The small improvement of the **confidence indicator in construction** in September —attributed to other-than-housing construction— was reversed in October. However, there were news on the positive side: the evaluation of investment plans submitted under the previous development law (L. 3299/2004) was completed, same as the approval of 140 such plans with a total budget of around €267 million; two important legislative initiatives were taken up, namely the new development law and the law on the fast-track construction of major projects;[4] finally, there has been effort for improved **absorption of the National Strategic Reference Framework – NSRF** (see Box VI.4 in Chapter VI).

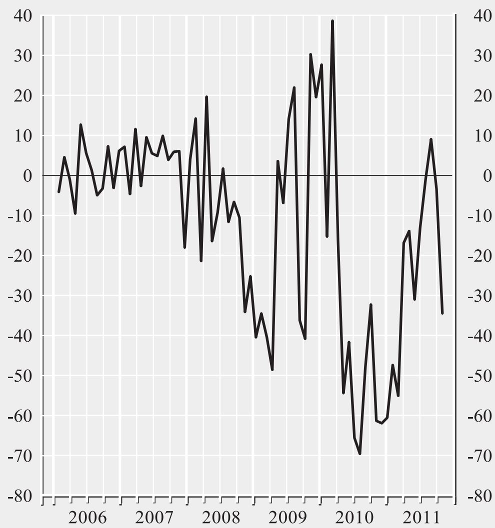
Given that demand for domestic final products and services, on the one hand, and business profitability, on the other, is not expected to improve much in the short term, investment demand will remain subdued and directly linked to the course of fiscal adjustment. For

Chart III.2 Consumer demand indicators

A. Sales volume and business expectations in retail trade[1]
(January 2006 - October 2011)



B. New passenger car registrations[1]
(January 2006 - October 2011)



Sources: ELSTAT (retail trade and cars) and IOBE (expectations). The index of business expectations is based on firms' estimates of sales and stocks as well as on their forecasts of business activity over the next quarter.
1 Percentage changes over same month of previous year.

3 For the third quarter, available data include: private construction activity based on building permits (July: -0.14%), cement production (July: -33.1%, August: -52.3%), PIP disbursements (Q3: -21.0%) and outstanding housing loans (July, August and September: -2.1%).

4 Which includes, among other things, the first three major investments in photovoltaic units as per an announcement by the Ministry for Development; countries such as Germany, the Netherlands and France have already shown great interest.

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

(annual percentage changes[1])

	2009	2010	2011 (available period)
Capital goods production	-22.5	-22.1	-5.8 (Jan.-Sept.)
Capacity utilisation rate in the capital goods industry	(73.4)	(66.1)	(63.2) (Jan.-Oct.)
Bank credit to domestic enterprises[2]	5.1 (Dec.)	1.1 (Dec.)	-0.9 (Sept.)
Disbursements under the Public Investment Programme	-2.8	-11.3	-31.8 (Jan.-Oct.)
Production index in construction (at constant prices)	-17.5	-31.6	-36.5 (Jan.-June)
Volume of new buildings and extensions on the basis of permits issued	-26.5	-23.7	-39.4 (Jan.-July)
Cement production	-21.4	-14.3	-35.1 (Jan.-Sept.)
Construction business expectations index	-31.4	-27.4	-30.8 (Jan.-Oct.)
Outstanding balance of total bank credit to housing[3]	3.7 (Dec.)	-0.3 (Dec.)	-2.1 (Sept.)

Sources: ELSTAT (capital goods production, volume of private construction activity, cement production, construction production), IOBE (capacity utilisation rate, business expectations index), Bank of Greece (loans to non-financial corporations, disbursements under the Public Investment Programme, housing loans).
1 Except for the capacity utilisation rate in the capital goods industry, which is measured in percentages.
2 Including 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 reclassifications, loan write-offs/write-downs, 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 credit company in 2009.
3 Including loans and securitised loans and taking into account loan reclassifications, loan write-offs/write-downs, foreign exchange valuation differences and a transfer of loans to a subsidiary domestic credit company in 2009.

2011 as a whole, it is estimated that investment will fall by more than 15%. For 2012 it is estimated that, if uncertainty is not removed, the fall will continue.

The drop in consumption and investment has led to a contraction in the **imports of goods and services** (on a national accounts basis), which in the first half of 2011 were by 10.5% lower than in the corresponding period of 2010 (2011 Q1: -12.9%, Q2: -7.6%). This drop was the result of a decline in the imports of goods by 11.1% and in the imports of services by 8.1%. **Exports of goods** (on a national accounts basis), after receiving an increase of 5.4% in 2010 (according to recently revised annual data), increased by a further 3.8% in the first half of 2011 (Q1: 5.5%, Q2: 2.2%). However, **exports of services** in the first half of 2011 decreased (-6.4%) year-on-year, on account of reduced transport receipts (see Section 4 of this chapter).

Exports of goods and services combined were thus reduced by 1.9%. Due to the limited decline in exports and the significant drop in imports, the **external sector** made a positive contribution to the change in GDP in the first half of the year.[5]

For ***2011 as a whole***, it is expected that exports of goods and services will increase by about 4%, on account of the very positive contribution of tourism in the second half of 2011. Imports of goods and services are estimated to decrease by about 7%, as the significant fall in imports in the second half of 2010 has led to the expectation that the particularly negative rate recorded in the first half of 2011 will be moderated in the second half.

DEVELOPMENTS IN SUPPLY

The reduction in investment in 2011, i.e. for fourth consecutive year, the decline in employment and the increased percentage of

5 The rates of decrease in imports were higher than those in exports. Notwithstanding that, the value of imported goods and services is by about 25% higher than the value of exported goods and services.

Table III.4 Indicators of industrial activity (2009-2011)

(annual percentage changes)

	2009	2010	2011 (available period)
1. Industrial production index (overall)	**-9.4**	**-5.9**	**-7.7 (9 months)**
Manufacturing	-11.2	-5.1	-8.1 (" ")
Mining-quarrying	-11.8	-6.5	-0.5 (" ")
Electricity	-4.2	-9.2	-9.4 (" ")
Main industrial groupings			
Energy	-2.9	-4.9	-9.1 (" ")
Indermediate goods	-18.4	-0.9	-8.3 (" ")
Capital goods	-22.5	-22.1	-5.8 (" ")
Consumer durables	-20.7	-13.4	-14.9 (" ")
Consumer non-durables	-4.1	-7.2	-4.9 (" ")
2. Industrial turnover index[1]	**-23.1**	**5.9**	**9.2 (8 months)**
Domestic market	-22.1	-0.8	0.1 (" ")
External market	-25.6	29.3	28.9 (" ")
3. Industrial new orders index[2]	**-27.7**	**3.7**	**4.2 (8 months)**
Domestic market	-23.0	-3.9	-13.6 (" ")
External market	-34.4	27.6	27.2 (" ")
4. Index of business expectations in industry	**-21.5**	**5.1**	**2.0 (10 months)**
5. Industrial capacity utilisation rate	**70.5**	**68.5**	**67.8 (10 months)**
6. Purchasing Managers' Index (PMI)[3]	**45.3**	**43.8**	**40.5 (Oct.)**

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

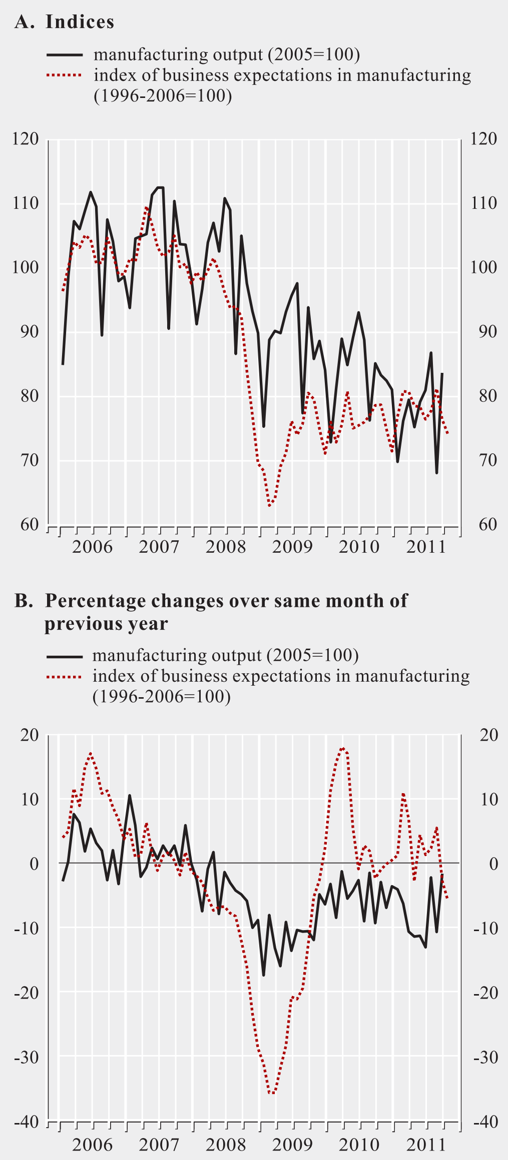
long-term unemployed have had a significant bearing on the annual **potential rate of economic growth**, which fell from 1.75% in 2005-2008 and entered into negative territory in 2011. Over the medium term, however, the potential rate of economic growth may pick up again, if a balance between aggregate demand and supply, which is seemingly on the way, is struck. This will push economic activity towards higher productivity sectors[6] and towards exports – increasing the exposure of Greek products to international competition (see also Box III.1 on the performance of exports and the penetration of imports).

As regards short-term developments, in the first half of 2011 **gross value added** fell by 7.6% (Q1: -8.1%, Q2: -7.1%). The decline in the sectors of construction, industry and "commerce, hotels and restaurants, transport and communications" was more marked. The latter sector, due to its significant share in total value added, had a much greater contribution than the other two.

In more detail, **gross value added in industry**, including energy, declined in the first half of 2011 by 9.0% on average (Q1: -6.3%, Q2: -11.7%), compared to a decline of 11.3% in the first half of 2010[7] (for 2010 as a whole it declined by just 5.0%, according to recently revised annual data). A similar drop was

6 Such as: Information and Communication (which includes *Computer programming, consulting and other activities, telecommunications*) and Financial and Insurance Activities (with value added per employee higher than the total economy's). Such sectors have increased – in 2010 relative to 2007 – their share (even if marginally, in the second case) in total value added.
7 Subject to revision.

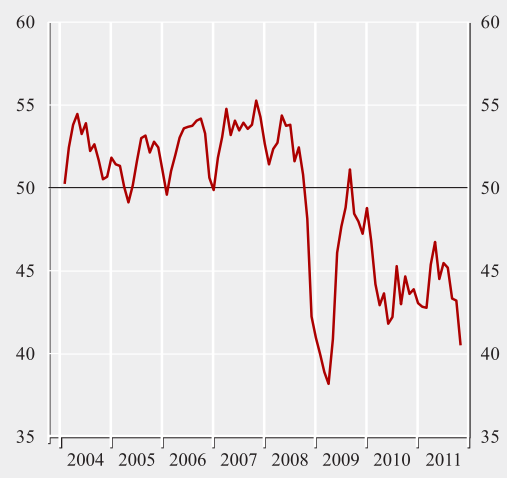
Chart III.3 Output and business expectations in manufacturing
(January 2006 - October 2011)



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

Chart III.4 Purchasing Managers' Index (PMI) for manufacturing
(January 2004 - October 2011)

(seasonally adjusted index; values over 50 indicate growth)



Sources: Markit Economics and Hellenic Purchasing Institute.

recorded in the industrial output index (total industry: -7.7%, manufacturing: -8.1%) in the first nine months of 2011.[8]

The drop in industrial output over January-September 2011 was broadly based across all categories of goods. The highest negative contribution, however, came from energy[9] and intermediate goods. The fall in the production of consumer durables was more pronounced compared to the year before (see Table III.4).

The **index of business expectations in industry** was, in the first half of 2011, higher on average (78.4 points) than one year before (75.7 points). In the third quarter, the difference relative to 2010 narrowed on account of the low levels recorded in September, whereas in Octo-

8 At branch level, the drop in manufacturing output during January-September 2011 was mainly the result of a continuing decline in the production of non-metallic minerals as well as of the steep fall in the production of oil and coal products, textiles, clothing-footwear and food-beverages (however, in September the production of food increased by 3.0%). Despite the recession in manufacturing, four branches –which in 2005 accounted for 13.5% of total manufacturing– namely basic metals, wood-cork, medicine and tobacco recorded an increase in their production during January-September 2011.

9 According to data by the Hellenic Transmission System Operator (DESMHE) that relate, however, only to the grid (i.e. excluding islands), the total demand for electricity was reduced by 0.9% in 2010. However, the demand for electricity by eligible customers connected to the high-voltage grid (metallurgies and large industrial enterprises) increased by 5.9% in 2010. As regards 2011, total demand for electricity during January-September 2011 fell by 2.1% (September 2011: +3.3%), which was attributable to the reduced (by 3.2%) demand by households and commercial and small industrial enterprises (September: +2.6%). By contrast, the demand from eligible customers connected to the high-voltage grid continued to increase in general (January-September 2011: +6.1%).

Table III.5 Activity indicators in the services sector (2009-2011)

(annual percentage changes)

	2009	2010	2011 (available period)
Services turnover indicators			
Motor trades	-15.7	-36.5	-36.2 (Jan.-June)
Wholesale trade	-8.9	-5.9	-12.1 (” ”)
Telecommunications	-8.9	-11.4	-12.3 (” ”)
Land transport	-31.5	-18.1	-8.2 (” ”)
Sea transport	-22.8	-8.5	-5.7 (” ”)
Air transport	-12.6	-3.3	16.9 (” ”)
Storage and transport supporting activities	-33.3	-10.9	-12.2 (” ”)
Travel agencies and related activities	-9.9	-24.5	-34.1 (” ”)
Tourism (hotels and restaurants)	-9.1	-8.2	-9.2 (” ”)
Legal, accounting and management consulting services	-12.4	-7.3	0.5 (” ”)
Architectural and engineering services	-18.6	-20.4	-15.1 (” ”)
Advertising and market research	-18.4	-23.8	-27.2 (” ”)
Passenger traffic			
Athens International Airport	-1.5	-5.0	-5.0 (Jan.-Sept.)
Aegean Airlines[1]	9.9	-5.1	1.1 (Jan.-June)
Piraeus port (OLP)	-3.8	-6.0	-1.9 (Jan.-July)
Business expectations index in the services sector	**-28.3**	**-9.3**	**-1.9 (Jan.-Oct)**

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

ber business expectations in industry deteriorated further (see Chart III.3). It is worth noting that firms' forecasts on the volume of their exports over the forthcoming 3-4 months have been positive since March 2010 (the differential between positive and negative forecasts during January-October 2011 is 13 points on average). Nonetheless, the **capacity utilisation rate** from the beginning of 2011 has been steadily declining and in October it stood at 66.0%, recording a historic low. The months of assured production in industry were 4.2 in October, i.e. below the average for 2006-2009.

The **Purchasing Managers' Index**, which in the first quarter of 2011 stood on average at the level recorded in 2010 (43.7 points), increased in the second quarter (to 45.6 points on average), before falling again in the third quarter (average: 43.9), constantly deteriorating thereafter and reaching in October its lowest level in the last 2.5 years (40.5) – see Table III.4 and Chart III.4. It is, however, important that as of May 2011 the sub-index of ***new export orders*** was constantly increasing up until August, moving above the threshold of 50 points, thereby suggesting increased orders (54.5 points in August, 51.5 points in July, 51.1 points in June and 50.1 in May), before falling considerably in September and October (to 47.8 and 47.7 points respectively).

Finally, **industrial turnover** and **industrial new orders** continued to increase in the first eight months of the year, a development attributed to the substantial expansion of both to the external market. Thus, during January-August 2011 the industrial turnover index rose by 9.2% (domestic market: 0.1%, external market: 28.9%) and the industrial new orders index by

4.2% (domestic market: -13.6%, external market: +27.2%) year-on-year.[10]

Gross value added in services continued to follow a downward path in the first half of 2011 (-7.5%), contributing 5.8 percentage points to the reduction of total gross value added (-7.6%). Trade, hotels-restaurants and transports-communications also recorded a significant fall (-11.8%). A large reduction in turnover was recorded across all branches of the sector (see Table III.5), with the exception of air transport because of increased international passenger traffic (by contrast, domestic passengers were significantly reduced) and the legal/accounting consultancy activities/services (a marginal increase of 0.5%).

The **index of business expectations in services** (excluding retail trade and banks), although still at historically low levels, recorded a mild increase both quarter-on-quarter and year-on-year, as a result of the relatively satisfactory levels of activity in tourism. However, this improvement was reversed in October. International arrivals at the 13 major airports of the country rose by 9.6% (according to data from the Association of Greek Tourism Enterprises) during January-October 2011. Arrivals and departures of foreign (cruise) passengers in the port of Piraeus in the same period also rose by 35.7%. Business estimates of current activity and demand in the services sector stand at low levels and forecasts on the future course of demand are pessimistic.

1.2 DEVELOPMENTS AND PROSPECTS IN THE REAL ESTATE MARKET

Following the contraction it experienced during the current crisis, the Greek real estate market remains subdued, without visible signs of recovery. This is related both to household expectations of a further decline in house prices and, more importantly, to the increased uncertainty of households regarding employment, their future incomes, as well as the overall economic outlook against the backdrop of Greece's fiscal and structural problems. The weak demand in the Greek real estate market is also associated with banks' more cautious and selective approach to mortgage applicants.[11] On the supply side, in the past three years the Greek real estate market has been marked by excess supply and a considerable stock of unsold properties. The decline in private construction activity and real estate investment during the current crisis has been almost commensurate to the fall in property sales, which can be seen as a reason why the excess stock of property accumulated by the end of 2008 has remained broadly unchanged.[12]

Despite excess supply and subdued demand in the real estate market over the past three years, house prices have displayed relative persistence. On the basis of data collected from credit institutions, apartment prices fell by 3.7% in 2009, 4.7% in 2010 and 4.6% in the first nine months of 2011 (-5.3%, -4.4% and -4.1% in the first, second and third quarter, respectively). This fall in prices since the start of the crisis has been stronger for "old" apartments (over 5 years old, -4.8%, -5.0% and -5.2% in 2009, 2010 and the first nine months of 2011, respectively) than for "new" apartments (up to 5 years old, -2.0%. -4.2% and -3.5% in 2009, 2010 and in the first nine months of 2011, respectively); this reflects the

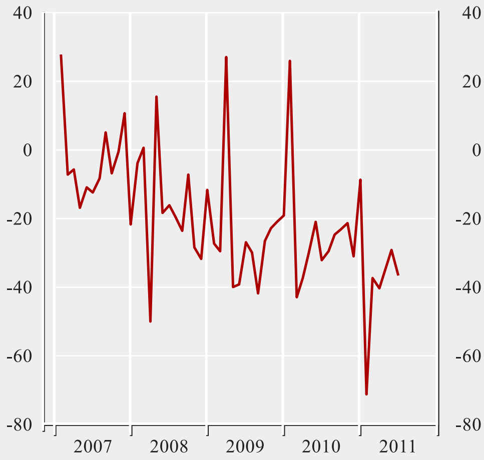
10 At manufacturing branch level, during the eight-month period January-August 2011, 15 out of 23 branches increased their turnover in the external market. The most important of these branches are: basic metals (+49.8%), oil and coal products (+41.3%), food (+7.5%), metallic products (+23.7%), chemicals (+9.6%), electrical equipment (+11.8%). As regards new orders from abroad, 8 out of the 12 manufacturing branches that are monitored recorded an increase, e.g. basic metals (+51.8%), metal products (+14.9%), chemicals (+9.3%), textiles (+4.1%), as well as smaller branches such as machinery and equipment (+37.9%).

11 Indeed, outstanding bank loans to households for house purchase fell at an annual rate of 0.3% in December 2010 and 2.1% in September 2011, but had increased at an annual rate of 3.7% in December 2009 and 11.2% in December 2008.

12 The decline in private construction activity has continued at a strong pace during the current crisis (-26.5% in 2009, -23.7% in 2010 and -39.4% in the first seven months of 2011 – see Chart III.5), while similar rates of decline have been recorded in residential investment (according to the recently revised annual data of ELSTAT, 2009: -23,5%, 2010: -18.0%, first half of 2011: -21,0%). Based on ELSTAT data collected from notaries nationwide, the number of notarial acts for real estate transactions fell from 158.0 thousand in 2008 to 136.0 thousand in 2009, while data from the Hellenic National Cadastre show that the number of properties sold fell by 14.0% in 2009, 13.0% in 2010 and 26.7% in the second quarter of 2011.

Chart III.5 Volume of new buildings and extensions on the basis of permits issued (January 2007-June 2011)

(percentage change over same month of previous year)



Source: ELSTAT.

relatively higher persistence of the prices of newly-built apartments, which are normally sold by developers.

In this context and despite the relative persistence of prices, the Greek residential market most likely does not seem to show signs of a major overvaluation, also given that the house price-to-rent ratio has been on a declining path over the past three years. However, downward pressures on prices are likely to continue in the next months, while a recovery in the real estate market seems to hinge on the improvement of business and household confidence, the supply of bank credit, as well as the prospects of a recovery in the Greek economy in general.

Turning to the commercial property market (offices, stores, industrial buildings, warehouses, etc.), its main features in the past few years have been subdued demand from businesses and a shift towards less costly premises, cautiousness in developing new investment projects, strong supply of mostly old properties, falling prices and tight credit conditions. There is also an increasing number of vacant retail stores and offices, a decline in rents and a renegotiation of lease contracts, mostly for secondary or regional properties.

2 LABOUR MARKET DEVELOPMENTS AND PROSPECTS

National accounts data show that in the first half of 2011 the decline in economic activity had a stronger impact on employment, which is explained by the long duration of the crisis in combination with increased uncertainty regarding the months to follow. Labour productivity (value added per employee) continued to decrease, albeit at a slower pace.

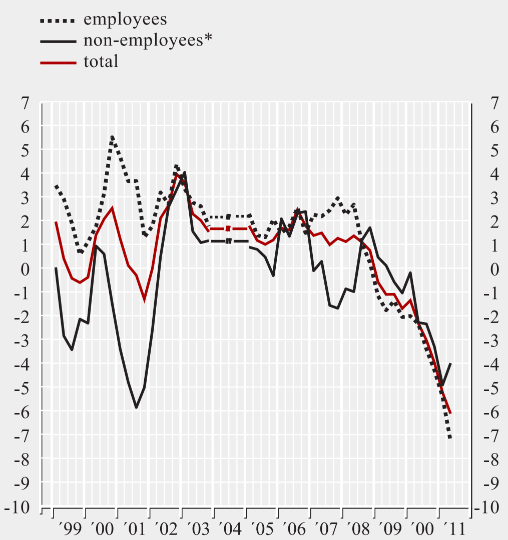
In more detail, according to the Labour Force Survey (LFS – see Chart III.6), in the first half of 2011 the average number of employed persons decreased by 251 thousand (5.7%) year-on-year (in the first half of 2010, the year-on-year decrease was 83 thousand persons or 1.8%). The number of employed persons declined at an increasing annual rate over the course of 2011 (first quarter: 5.2%, second quarter: 6.1%), continuing the trend already observed in early 2010. In addition, between the first and the second quarter of 2011, the number of employed persons fell (by 38.1 thousand) despite the fact that, due to the high seasonality of employment in Greece, the number of employed persons is (normally, but not this year) higher in the second quarter than in the first.[13] The decline in the number of employed persons continued at a faster pace in the months that followed (number of employed persons: 4,140 thousand in July and 4,035 thousand in August compared to 4,399 thousand in August 2010, annual rate of decline: 8.3% in August).

The decline in employment reflects both the difficulties that young people face in finding a job and the job losses in the sectors mostly affected by the crisis.

13 The number of employed persons in the accommodation and food service activities rose (by 31.5 thousand persons or 11.6%) between the first and the second quarter of 2011, but this did not suffice to compensate for the decreased employment in the other sectors.

Chart III.6 Employment (1999-2011)

(percentage changes over corresponding quarter of previous year)



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

Between the first half of 2010 and the first half of 2011, job losses concentrated in construction, manufacturing and agriculture.[14] Due to the characteristics of employment in construction and manufacturing —such as the high percentage of male and immigrant workers and the low average age of the persons employed in these sectors[15]— job losses in the period under review were proportionately higher for men, immigrants and young people aged 25-29.

In particular, in the first half of 2011 the rate of male employment declined to 54.7%, from 58.5% in the first half of 2010. In the same period, the number of employed persons between 25 and 29 years of age fell by 75 thousand or 14.5%. Finally, the number of employed immigrants (male and female) fell by 43.4 thousand persons (10.5%) between the first half of 2010 and the corresponding period in 2011 (employed persons of Greek citizenship declined by 207 thousand persons or 5.2%).

In the first half of the year, the number of employees fell by 6.3%, i.e. at a higher rate than in total economy (5.7%), since the number of "other employed persons", who represent around 36% of total employment (self-employed with or without personnel, assistants in family businesses), fell at a lower rate (4.5%). The decline in the number of employees was stronger in the private sector (7.6%) than in total economy. Among the "other employed persons", the self-employed without personnel showed the strongest resilience to the crisis, as their number in the first half of 2011 fell only by 2.4% year-on-year. By contrast, the number of the self-employed with personnel declined by 8.1% —however, the latter category numbers 330 thousand persons and represents only 1/5 of the self-employed.

The number of employees in the private sector declined more strongly in small and medium enterprises, while in enterprises with 50 or more employees employment is estimated to have increased. In particular, according to LFS data, the number of employees in enterprises with over 50 employees is estimated to have increased between the first half of 2010 and the first half of 2011 by 5.8%. By contrast, the number of employees in enterprises with less than 20 employees (who account for about 80% of employees in the private sector) fell by 8.3%.

The decrease in the number of employees in the private sector was accompanied by a decrease in the **average number of weekly working hours** by 0.6%. This development reflects, on the one hand, the decrease in standard working hours and, on the other, the increase

14 The decrease in employment in the primary sector represents a reversal of the trend recorded during 2009 and 2010 and has brought the number of employees in this sector back to 2008 levels.

15 On the basis of 2010 data, male employment in construction, manufacturing and agriculture accounts for 97%, 75% and 59.2% respectively – the corresponding percentage in total economy is 59.9%. The average age of the persons employed is 41.6 years. The average age of the persons employed in construction, manufacturing and agriculture is 39.8, 41.2 and 47.6 years respectively. The percentage of employed persons of foreign citizenship in construction, manufacturing and agriculture is 30.4%, 11.6% and 6.7%, against 9.4% in total economy.

in the number of employees who worked less than the standard hours. The number of persons who would like to work more hours has increased both in absolute terms and as a percentage of the employed persons.

In addition to the total number of employed persons, the number and the percentage of employed persons with a second job also decreased (first half of 2010: 140.2 thousand or 3.2%, first half of 2011: 105.2 thousand or 2.5%).

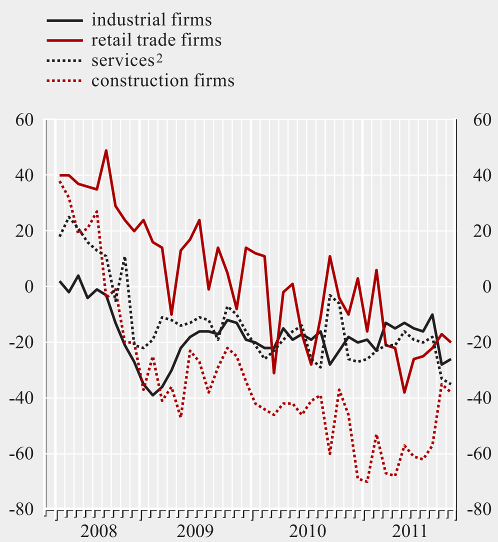
In October 2011, despite the significant decrease in employment that had already taken place, **firms' expectations** about the short-term prospects of employment, as reflected in IOBE business surveys (see Chart III.7), remained negative for all sectors.

Indicative of the uncertainty prevailing among enterprises is the increased share of employees on **fixed term contracts with a duration of less than a month** (first half of 2010: 6.0%, first half of 2011: 7.7%) in the total number of employees on fixed-term contracts. Many have entered into such contracts because they couldn't find a permanent job.

The decline in employment has led to a rise in the number of unemployed persons to 801.7 thousand (on average) in the first half of 2011. The **average unemployment rate** in the first half of the year was 16.1%, i.e. 4.3 percentage points higher than in the corresponding period of 2010. The unemployment rate increased at a slightly faster pace (by 0.4 percentage points) in the second quarter (4.5 percentage points) than in the first (4.2 percentage points) – which is an unusual development (see Chart III.8). In July, the unemployment rate rose further to 16.5% and in August it surged to 18.4% (a year-on-year increase of 6.2 percentage points). The male unemployment rate rose to 13.5% in the first half of 2011 (15.5% in August), up from 9.2% in the first half of 2010, and the female unemployment rate to 19.7% (22.3% in August), up from 15.4% in the first half of 2010. For young people aged 25-29 years the unemployment rate rose by 9 percentage points to stand at 27%, up from 18%. For young people aged 15-24 years – whose share in the labour force is small – the unemployment rate was 41.3% (43.5% in August), up from 31.1% in the first half of 2010.

Chart III.7 Business expectations[1] for employment (April 2008-October 2011)

(percentage balances)



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

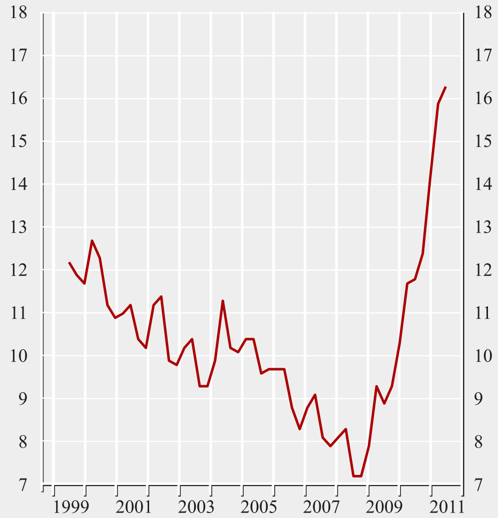
The year-on-year rise in the number of unemployed persons in the first half of 2011 (by 211 thousand persons) was lower than the fall in the number of employed persons (251 thousand). This gap, which occurred despite the larger number – compared to the first half of 2010 – of new entrants in the labour market, could be attributed to two factors:

- first, the significantly increased number of persons who have permanently exited the labour force[16] and

16 In the period from July 2010 to June 2011, the number of persons who exited the labour market due to retirement grew by 30% compared to the period from July 2009 to June 2010.

Chart III.8 Total unemployment rate (1999-2011)

(percentage of labour force)



Source: ELSTAT, Labour Force Surveys.

- second, the increased number of people who have lost their jobs, but are not looking for a new one, because they believe they will not find any.[17]

When taking into account the number of persons who are not looking for a job because they believe that they will not find one, those who are not looking for a job for other reasons and those who work part time because they cannot find a full-time job, the **rate of unemployment/underemployment** in the second quarter of 2011 stands at 21% (compared to an unemployment rate of 16.3%).[18]

As a result of the above, the rate of persons living in **workless households** has also increased significantly – from 9.8% in the first half of 2010 to 12.9% in the first half of 2011.

Finally, the increase in the share of **long-term unemployed**, i.e. those who remain without job for more than a year, in the total number of unemployed (first half of 2010: 46.2%, first half of 2011: 48.8%) is alarming because the probability of finding a job decreases as the duration of unemployment increases. Thus, unemployment becomes **structural** and there is the risk that high unemployment rates, job vacancies and high inflation rates emerge at the same time. According to OECD estimates,[19] the rate of structural unemployment in Greece has already risen by one percentage point between 2008 and 2010 (from 8.9% to 9.9%).

The responses of the labour market to the current crisis in other countries provide useful insight into those structural characteristics or parameters that can mitigate the impact of changes in economic activity on employment. Three characteristics or parametres in particular seem to have played a crucial role in mitigating this impact on the labour markets of countries like Austria and Germany: a sound fiscal situation, trust between labour unions and employer associations, and the existence of skilled labour.

3 INFLATION, LABOUR COSTS AND COMPETITIVENESS: DEVELOPMENTS AND PROSPECTS

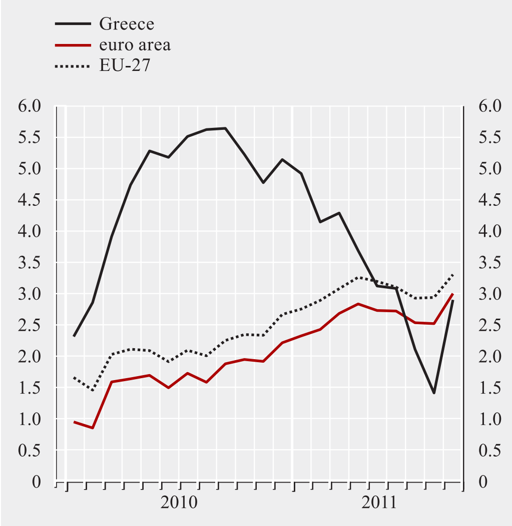
3.1 OVERVIEW OF DEVELOPMENTS AND PROSPECTS FOR 2011

In the first eight months of **2011**, inflation declined, as the impact of higher indirect taxes on the annual rate of increase in prices gradually faded out, while the decrease both in demand and in unit labour costs, mainly in the business sector, continued to have a strong disinflationary effect. Thus, the annual rate of increase of the Harmonised Index of Consumer Prices (HICP) declined significantly, from 4.9% in January 2011 to just 1.4% in August (see Chart III.9). Similarly, core inflation (which excludes energy and unprocessed food prices)

17 Among those who lost their jobs in the period from July 2010 to June 2011, 11.2 thousand persons were not looking for a job because they believed that they would not find one, while in the period from July 2009 to June 2010 the number of these persons was 6.5 thousand.
18 The differential between the two rates in the second quarter of 2011 has remained virtually unchanged since the second quarter of 2010 (11.8%, compared to 15.9%).
19 OECD (2011), *Economic Surveys: Greece*, p. 109.

Chart III.9 Harmonised index of consumer prices in Greece, the euro area and the European Union (January 2010 - September 2011)

(percentage changes over same month of previous year)



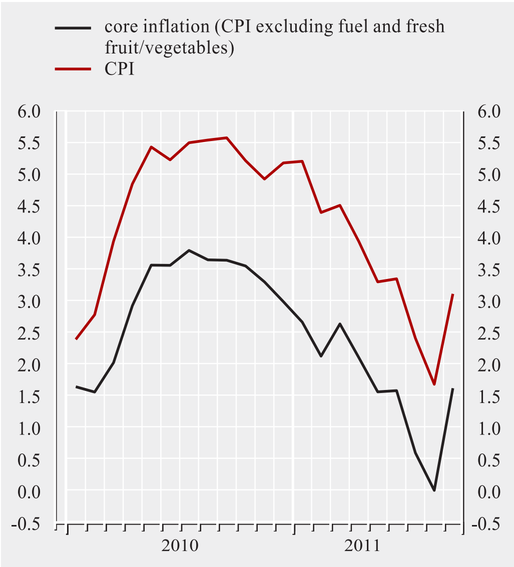
Sources: ELSTAT and Eurostat.

also declined sharply, from 2.8% in January 2011 to 0% in August (see Chart III.10). However, the impact of higher indirect taxes was exacerbated by the increased VAT on restaurant services (to 23% from 13%) as from September and the readjustment of excise taxes on heating oil in October. Thus, the annual inflation rate rose to 2.9% both in September and October, while core inflation also rose to 1.9% in September and to 1.6% in October. *For 2011 as a whole, according to the latest estimates*, the average annual HICP inflation rate is expected to decline considerably, to about 3.2%, from 4.7% in 2010, while average core inflation should decline to about 1.8%, down from 3.0% in 2010. In 2012, a further decline in the average HICP inflation is expected, to 1.7%, and in core inflation to 1.6%.

It should be reminded that average annual inflation in the euro area rose to 1.6% in 2010, while it is anticipated to stand at 2.5-2.7% in 2011 and to 1.2-2.2% in 2012, according to ECB staff (see Tables III.6 and III.7 and Chart III.11). *Therefore, the **inflation differential** between Greece and the euro area, following a temporary widening to 3.1 percentage points*

Chart III.10 Consumer Price Index and core inflation in Greece (January 2010 - September 2011)

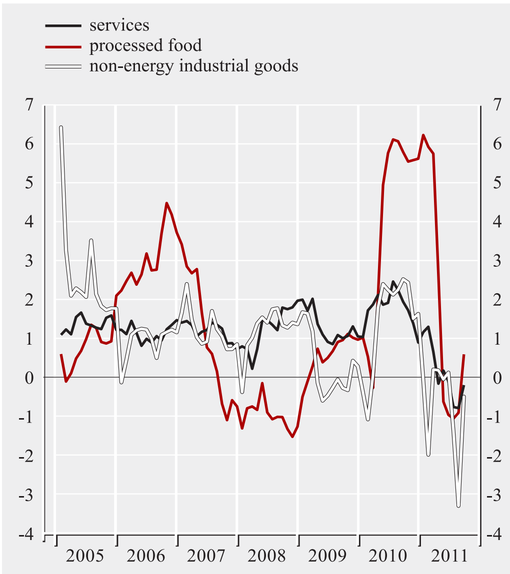
(percentage changes over same month of previous year)



Source: Calculations based on ELSTAT data.

Chart III.11 Annual inflation differentials between Greece and the euro area (2005 - 2011)

(selected indices; differentials in percentage points)



Source: Calculations based on Eurostat and ECB data.

Table III.6 Harmonised index of consumer prices: Greece and the EU (2009-2011)

(annual percentage changes)

Country	2009 (year average)	2010 (year average)	September 2010	September 2011
Austria	0.4	1.7	1.7	4.0
Belgium	0.0	2.3	2.9	3.4
Bulgaria	2.5	3.0	3.6	2.9
Cyprus	0.2	2.6	3.6	2.5
Czech Republic	0.6	1.2	1.8	2.1
Denmark	1.1	2.2	2.5	2.4
Estonia	0.2	2.7	3.8	5.4
Finland	1.6	1.7	1.4	3.5
France	0.1	1.7	1.8	2.4
Germany	0.2	1.2	1.3	2.9
Greece	**1.3**	**4.7**	**5.7**	**2.9**
Hungary	4.0	4.7	3.7	3.7
Ireland	-1.7	-1.6	-1.0	1.3
Italy	0.8	1.6	1.6	3.6
Latvia	3.3	-1.2	0.3	4.5
Lithuania	4.2	1.2	1.8	4.7
Luxembourg	0.0	2.8	2.6	3.8
Malta	1.8	2.0	2.4	2.7
Netherlands	1.0	0.9	1.4	3.0
Poland	4.0	2.7	2.5	3.5
Portugal	-0.9	1.4	2.0	3.5
Romania	5.6	6.1	7.7	3.5
Slovakia	0.9	0.7	1.1	4.4
Slovenia	0.9	2.1	2.1	2.3
Spain	-0.3	1.8	2.8	3.0
Sweden	1.9	1.9	1.5	1.5
United Kingdom	2.2	3.3	3.1	5.2
European Union - 27	1.0	2.1	2.3	3.3
Euro area	**0.3**	**1.6**	**1.9**	**3.0**

Source: Eurostat.

Table III.7 Contributions to the inflation differential between Greece and the euro area (2006-2011)

(percentage points)

	2006	2007	2008	2009	2010	2011 (Jan.-Sept.)
Differential of average annual rates of HICP change	**1.1**	**0.9**	**1.0**	**1.1**	**3.1**	**0.6**
Contributions:						
Core inflation	1.15	1.00	0.77	0.91	1.60	0.10
of which						
Services	0.43	0.50	0.56	0.64	0.71	0.05
Processed food	0.44	0.13	-0.14	0.14	0.52	0.25
Non-energy industrial goods	0.28	0.35	0.35	0.13	0.37	-0.20
Unprocessed food	-0.12	-0.06	0.03	0.39	-0.12	0.08
Energy	0.11	-0.03	0.24	-0.25	1.66	0.46

Source: Calculations based on Eurostat and ECB data.

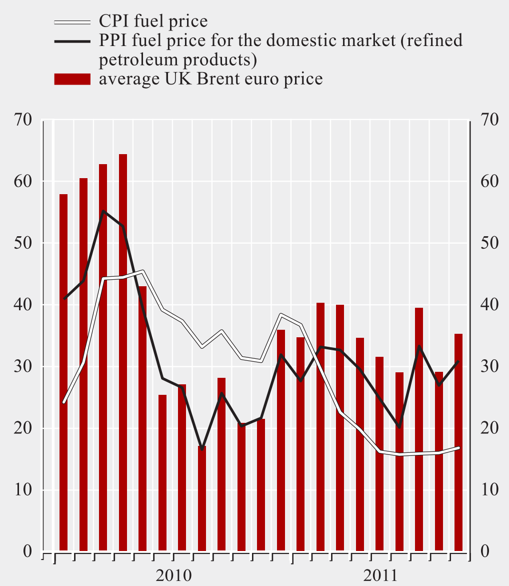
in 2010, is expected to fall to about 0.7 percentage points in 2011, i.e. below the 2001-2009 average, and to be fully eliminated in 2012.

3.2 MAIN DETERMINANTS OF INFLATION

The gradual weakening of the impact of higher indirect taxes was the main driver of the decline in inflation in the first eight months of 2011, despite the fact that —same as in 2010— the increase in indirect taxes was not fully passed on to consumer prices, as firms absorbed part of the increase by reducing their profit margins in an attempt to address subdued demand. Tax increases would have been passed on to consumers to a much lesser extent in the current context of falling demand, if competition in the domestic market had worked more effectively. According to available estimates, *if the impact of indirect taxes is not taken into account*, the annual rate of HICP inflation was just 0.2% in January 2011, 0% in February, 1.7% in March, 1.3% in April, May and June, 1.6% in July, 1.2% in August, 1.7% in September and 1.5% in October. Similarly, *without taking into account the impact of indirect tax changes*, core inflation moved into negative territory in January (-0.2%) and February (-0.8%), while standing at a mere 0.9% in March, 0.4% in April, 0.2% in May and June, 0.1% in July and then turning negative again in August (-0.2%), before rising to 0.8% in September and 0.5% in October. For 2011 as a whole, the average annual contribution of changes in indirect taxation is estimated to reach 1.88 percentage points (with a forecast inflation rate of 3.2%). Factoring in the contribution of *administered prices*, the total contribution would stand at 2.14 percentage points on average in 2011 (or 67% of inflation). In terms of core inflation, the average annual contribution of indirect tax increases is expected to reach 1.39 percentage points (average core inflation: 1.8%), while when taking into account the increases in *administered prices*, the total average annual contribution would reach 1.65 percentage points (or 93% of core inflation).

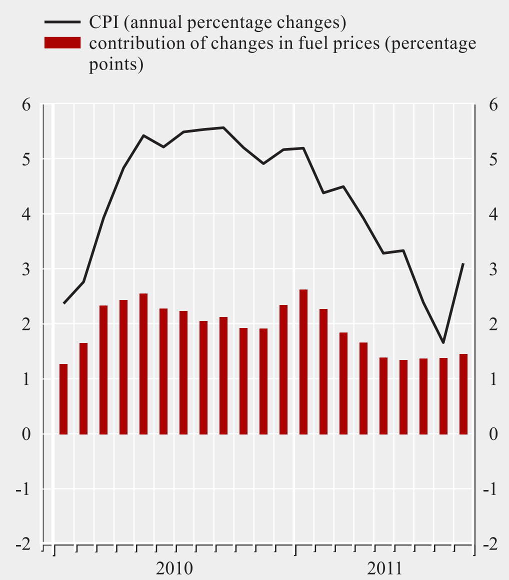
Chart III.12 Evolution of CPI/PPI fuel prices and of the euro price of Brent crude oil (January 2010 - September 2011)

(percentage changes over same month of previous year)



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

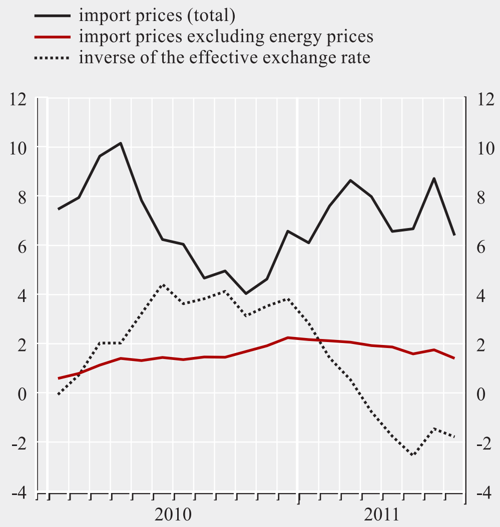
Chart III.13 Inflationary contribution of changes in fuel prices (January 2010 - September 2011)



Source: Calculations based on ELSTAT data.

Chart III.14 Import price index in industry and the inverse of the effective exchange rate of the euro, weighted on the basis of Greece's external trade (January 2010 - August 2011)

(percentage changes over same month of previous year)



Sources: ELSTAT and Bank of Greece.

The **increase in crude oil prices** in the global market, which averaged 36.1% annually in euro terms in 2010 (Brent oil – see Charts III.12 and III.13), has continued into 2011 pushing inflation upwards. According to the latest IMF forecasts, the price of oil in US dollars (annual average for three types of crude oil) should rise by 30.6% this year, compared with 27.9% in 2010,[20] while according to ECB staff macroeconomic projections (September 2011) the price of Brent oil would rise by 36.8% in US dollar terms and by 27.7% in euro terms.[21] Another factor with an inflationary effect this year is the continued recovery of non-energy import prices (see Chart III.14),[22] which reflects, inter alia, the increased prices of (non-energy) commodities in the global market.[23] The increase in these prices in euro terms is mitigated by the appreciation of the euro exchange rate (weighted on the basis of Greece's external trade) this year – it is estimated that the annual appreciation will average 0.5%-0.6%, compared with a 2.8% depreciation in 2010.

By contrast, **subdued demand** continued to exert a downward pressure on inflation, as mentioned above; this is reflected on the ongoing decline in profit margins, as implied by the available data on the results of 184 Athex-listed non-financial companies for the first half of 2011. In particular, gross profits fell by 11.5% year-on-year and net pre-tax profits fell even more (45.6%), while sales rose only by 4.6% in nominal terms, solely on account of the higher sales of the two refineries. Excluding the two refineries, the remaining 182 firms in the sample reported a drop of 7.6% in sales, 13.3% in gross profits and 89.9% in net profits (which were virtually eliminated), implying a narrowing of 1.2 percentage points in the gross profit margin and of 4.9 percentage points in the net profit margin.

The estimated further *fall* in **unit labour costs** in 2011, by 2.1% in total economy (following a fall of 3.8% in 2010) and by 3.6% in the business sector (2010: -2.7%), also had a disinflationary effect. At the total economy level, this development reflected a *decline* of 3.3% in nominal average gross earnings, following a fall of 4.8% in 2010 (see Table III.8). Compensation per employee[24] fell by 2.2%, while productivity (GDP per employee) is estimated to have remained virtually unchanged (-0.1%). It is worth noting that in the euro area unit labour costs for the total economy fell by 0.6-0.8% in 2010, but they are expected to rise in 2011 by about 1.0-1.6% (see Table III.9).[25]

The above estimates of unit labour costs take into account the following: (a) the provisions of Laws 3833/2010 and 3845/2010 on the freezing of minimum wages and the cuts in allowances to civil servants and employees of the broader public sector; (b) similar provisions of Law

20 See IMF, *World Economic Outlook*, September 2011.
21 See ECB, *Monthly Bulletin*, September 2011.
22 The prices of non-energy industrial goods imports increased at an annual rate of 1.4% in August 2011, i.e. same as in August 2010.
23 In US dollars, the IMF forecasts an increase of 21.2% this year, compared with 26.3% in 2010.
24 Including employer social security contributions and government expenditure on pensions.
25 Annual rate of increase: 0.2% in the first quarter and 1.3% in the second quarter of 2011.

Table III.8 Earnings and labour costs (2004-2011)

(annual percentage changes)

	2004	2005	2006	2007	2008	2009	2010	2011 (estim.)
Greece								
Average gross earnings (nominal):								
– total economy	7.2	4.4	5.7	5.2	6.2	4.6	-4.8	-3.3
– central government[1]	9.7	2.3	3.1	3.8	7.1	5.2	-8.5	-4.9
– public utilities	9.9	7.6	7.0	7.1	8.2	7.7	-5.5	-7.9
– banks	8.0	1.5[2]	10.8	8.9	0.0	3.7	-1.8	-4.1
– non-bank private sector	5.8	5.6	6.8	6.1	6.5	2.8	-2.9	-1.7
Minimum earnings	**4.8**	**4.9**	**6.2**	**5.4**	**6.2**	**5.7**	**1.7**	**0.9**
Average gross earnings (real)	**4.2**	**0.9**	**2.4**	**2.2**	**1.9**	**3.3**	**-9.1**	**-6.3**
Total compensation of employees	**8.9**	**5.8**	**7.8**	**8.2**	**8.5**	**3.2**	**-7.3**	**-5.1**
Compensation per employee	**7.6**	**3.9**	**5.9**	**5.6**	**6.8**	**4.9**	**-4.3**	**-2.2**
Unit labour costs:[3]								
– total economy	4.3	3.4	2.2	5.0	8.7	6.6	-3.8	-2.1
– business sector[4]	3.0	3.8	2.8	5.8	7.9	4.6	-2.7	-3.6

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

Table III.9 Average earnings and unit labour costs in total economy: Greece and the euro area (2001-2011)

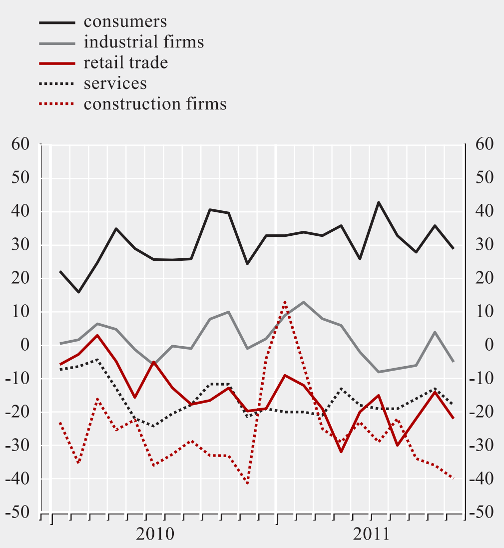
(annual percentage changes)

	Average earnings		Unit labour costs	
Year	Greece	Euro area	Greece	Euro area
2001	4.7	2.8	3.9	2.4
2002	6.6	2.7	5.5	2.5
2003	5.6	2.9	2.3	2.2
2004	7.2	2.6	4.3	1.0
2005	4.4	2.2	3.4	1.3
2006	5.7	2.5	2.2	1.1
2007	5.2	2.5	5.0	1.4
2008	6.2	3.3	8.7	3.7
2009	4.6	1.8	6.6	4.1
2010	-4.8	1.6	-3.8	-0.6 to -0.8
2011 (estimate)	-3.3	2.3	-2.1	1.0 to 1.6

Sources: For Greece: Bank of Greece estimates. For the euro area: European Commission, *Economic Forecasts*, Autumn 2011.

Chart III.15 Inflation expectations[1] of consumers and business firms (January 2010-October 2011)

(percentage balances)



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

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

3847/2010 on civil servants' pensions; (c) the three-year National Collective Labour Agreement signed on 15 July 2010 and Article 51 of Law 3871/2010;[26] (d) the provisions of Article 74 of Law 3863/2010;[27] (e) the provisions of Law 3899/2010;[28] (f) the more recent provisions on the wages of civil servants (Article 38, par. 1, 2 and 5 of Law 3986/2011[29] and Article 55, par. 23, of Law 4002/2011,[30] as well as (g) the latest provisions on the introduction of the new wage grid for the public sector, the labour reserve scheme, further cuts in the wages of civil servants and the encouragement of collective agreements at the firm level (Articles 4-37 of Law 4024/2011). As mentioned above, it has been estimated that these measures would lead to decreases of 3.3%, against 4.8% in 2010, in the average nominal gross wages in total economy, 4.9% in the average nominal gross wages of civil servants[31] (2010: -8.5%) and 2.7% in the average nominal gross wages of employees in the business sector (2010: -3,1%). The reduction of gross (pre-tax) wages in total economy in real terms was in the order of 6.3% in 2011, against 9.1% in 2010.

It should also be pointed out that the estimates regarding changes in the wages of *private sector non-bank employees* in 2011 take into account that, although average annual contractual earnings may have increased by 0.9% as a result of the provisions of the national collective labour agreement[32] and other sectoral collective agreements, *actual earnings have decreased.* In particular, according to rough estimates, 25% of employees in the *non-bank private sector* experienced wage cuts in the order of 10% (either through individual agreements and contracts or through collective agreements at the firm level),[33] while the newly introduced (as of 2010) option of hiring young people at sub-minimum wages and the reductions of overtime work are estimated to have contributed to a fall in labour costs per

26 The National General Collective Labour Agreement provided for zero increases in minimum wages during 2010 and for the next two years inflation-linked increases as follows: as of 1 July 2011 on the basis of average annual inflation in the euro area for 2010 (i.e. 1.6%) and as of 1 July 2012 on the basis of average annual inflation in the euro area for 2011 (last projected at 2.5-2.7%). As a result, the average annual rise in minimum wages stood at 1.7% in 2010 (solely due to the carryover effect from the 2009 increases), while the average annual rise will be 0.86% in 2011 and about 2.1-2.2%% in 2012. Moreover, Article 51 of Law 3871/2010 states that until the end of 2012 any wage increases following appeals to the Organisation for Mediation and Arbitration cannot deviate from the percentage increases laid down in the National General Collective Labour Agreement.

27 These provisions refer to cuts in severance pay, the hiring of young people at sub-minimum wages and lower premia for overtime work.

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

29 These refer to the reduction of overtime work, the establishment of a 2% solidarity contribution from the regular wages of civil servants and a 1% additional contribution from the persons insured with the Civil Servants' Welfare Fund, as well as the suspension of automatic salary increases based on seniority as of 1 July 2011 until the new unified public sector pay scale comes into effect.

30 This Law refers to 10%-50% cuts in certain allowances for various categories of civil servants (academics, research staff, etc.) applicable as of 1 July 2011.

31 As follows from ex post estimates of the public sector wage bill for 2011 included in the Draft Budget. According to these estimates, total expenditure on wages and pensions in the Ordinary Budget was reduced in 2011 by 4.7% only, as total personnel outlays fell by 7.9%, while expenditure on pensions increased by 3.9%, reflecting the higher number of pensioners, which outweighed the decrease in average pensions.

32 See footnote 26.

33 It is reminded that 10% of employees in this sector experienced similar cuts already in 2009, while 40-50% did so in 2010.

employee by about 0.5% – ultimately leading to a drop of 1.7% in average actual earnings (2010: -2,9%). In general, a key trend observed in the private sector in the course of 2011 is the shift towards more flexible patterns of employment (part-time work, short-time work and reduced working hours[34]), as well as the informal conclusion of individual contracts – i.e. choices that entail lower wages. At the same time, in order to reduce labour costs, enterprises have made use of collective contracts at the firm level (introduced by Law 3899 in December 2010), albeit to a limited extent only. By early October, 12 such contracts had been concluded, two of which concerned large enterprises and three medium ones. These contracts applied to 3,555 employees.

It should also be noted that five important collective agreements have been entered into in enterprises of the broader public sector (or enterprises in which the State has a stake): two in OSE and TRAINOSE (introduction of a new pay scale and reduced wages), one in OPAP (reduced wages and prolonged working hours), one in ELPE (wage freezing) and one in OTE (reduction of the average working time and wages by the end of 2014).

According to approximative estimates, unit labour costs should fall by 2.7% in total economy and by 2.5% in the business sector in *2012*.

3.3 DEVELOPMENTS IN COST AND PRICE COMPETITIVENESS

Developments in relative unit labour costs suggest that the recovery of losses in competitiveness that started in 2010 continued into 2011. According to Bank of Greece estimates, over 2001-2009, Greece's international competitiveness *vis-à-vis 28 trading partners* fell by a cumulative 18.7% on the basis of relative consumer prices and by 31.9%[35] on the basis of relative unit labour costs. In 2010, however, the CPI-based competitiveness indicator improved slightly by 0.3% (despite high inflation and exclusively due to the depreciation of the effective exchange rate of the euro), while the ULC-based indicator (taking into account developments in the effective exchange rate of the euro with regard to non-euro area trading partners) is estimated to have improved markedly, by 7.0%. It is estimated that the CPI-based competitiveness indicator will decline by 0.9% (by 3/5 due to the appreciation of the effective exchange rate of the euro) in 2011, while the ULC-based index will improve further, by 3.5%, despite the appreciation of the euro (see Table III.10). For developments regarding cost competitiveness vis-à-vis non-euro area countries, see also Section 5 in Chapter I.

4 EXTERNAL BALANCE: DEVELOPMENTS AND PROSPECTS

4.1 CURRENT ACCOUNT

4.1.1 REVIEW

Since 2009, the current account deficit has been falling steadily, both in absolute terms and as a percentage of GDP, almost exclusively on account of cyclical macroeconomic developments in Greece and its trading partners. More specifically, the deficit reached 14.9% of GDP in 2008, then dropped to 11.1% in 2009 and to 10.1% in 2010. A further drop is expected in 2011, to 9.8% of GDP, and prospects are that the drop will continue in the next two years.

The limited decline in the current account deficit in 2010 and 2011 reflects the fact that structural problems prevent the economy's low structural competitiveness from improving

34 According to data of the Hellenic Labour Inspectorate (SEPE), in the January-September 2011 period, 32.5% of the new work contracts (recrutitments) in the private sector involved part-time work and 8.6% short-time work, against 27.6% and 6.7%, respectively, in the January-September 2010 period, while the percentage of new full-time work contracts fell to 58.9%, from 65.7%. In addition, the number of existing full-time work contracts that were converted into part-time or short-time contracts (under an agreement between the employee and the employer or under a unilateral decision of the employer) reached 42,488, up from 15,577 in the corresponding nine-month period of 2010, i.e. they almost tripled (an increase of 173%).

35 Revised estimates taking into account new GDP data for 2005-2010.

Table III.10 Greece: revised 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
2001	1.7	1.1	0.3
2002	2.3	2.6	4.2
2003	5.0	5.4	3.9
2004	1.7	1.9	4.2
2005	-1.0	-0.1	0.4
2006	0.0	0.8	0.8
2007	1.3	1.6	4.1
2008	2.4	2.5	6.6
2009	1.2	1.6	3.8
2010	-2.8	-0.3	-7.0
2011*	0.6	1.0	-3.5
Cumulative percentage change between 2001 and 2011	12.9	19.4	18.3

Sources: Exchange rates: ECB, euro reference exchange rates. CPI: ECB, Harmonised Index of Consumer Prices where available. Unit labour costs in total economy: Bank of Greece estimates for Greece, ECB for the other countries.
* Provisional data and estimates.
1 Revised (on 1 January 2011) indices (compiled by the Bank of Greece) comprise Greece's 28 main trading partners. The weights used reflect the share of each partner country in Greece's manufacturing trade (SITC 5-8) during 1998-2000 for the 1993-2000 period and during 2004-2006 for the 2001-2011 period and take into account competition in third markets.

swiftly. If these problems are addressed, there can be a sustainable rise in the exports of goods, an improvement in the rate of substitution of domestic goods for imported ones (thereby limiting, inter alia, the high "import content" of certain output sectors), a reduction of the country's energy dependence and a mitigation —by providing better and broader tourist services— of the vulnerability of tourist receipts to cyclical income fluctuations in tourists' home countries (see also Box VI.3 in Chapter VI).

In January-August 2011 the current account deficit (see Table 6 of Statistical Annex) fell by 8.3% (January-September 2011: -8.6% based on data that could not be analysed in time for this report), as a result of the downturn in the domestic market, the economic recovery in foreign markets and the marked improvement in Greek products' cost competitiveness. These developments reduced the non-oil import bill substantially and led to a significant rise in the receipts from exports of goods and travel services. The rise in export activity is expected to continue, provided that it is coupled with increased output in the corresponding sectors, which is now the case for certain categories of raw materials only.

Despite frequent commotion and riots in the centre of Athens, which led to cancellations of tourist reservations from major foreign markets, tourist receipts increased considerably, mainly on account of a rise in tourist arrivals. By contrast, net transport receipts dropped as a result of lower international freight rates, despite the increase in world trade volume.

Finally, the income account deficit is expected to widen in 2011 due to the rise in net interest payments, while the current account surplus will remain broadly unchanged at its 2010 levels.

It is therefore expected that in 2011 the current account deficit will continue to fall. Nevertheless, a more drastic cut in this deficit would require structural measures aimed at bolstering structural competitiveness and attracting foreign direct investments: the Greek economy's performance in these sectors lags considerably and even shows signs of deterioration.[36]

4.1.2 TRADE BALANCE

The decline in the trade deficit by €1.1 billion in the January-August period reflects the €2.4 billion decrease in the trade deficit excluding oil and ships and the €0.1 billion fall in net payments for purchases of ships, which more than offset the rise in the net oil import bill by €1.4 billion. The import bill for all categories of products excluding oil and ships fell by 6.1% (January-September 2011: -4.6%), while the corresponding export receipts rose by 17.4% (January-September 2011: +18.8%), bringing the coverage rate of imports by export receipts to 50% (compared to 39% in the corresponding 2010 period). The drastic cut in the trade deficit is a result of the recession, as the decline in the import bill (imports are more than double the exports) is mainly attributed to lower consumer and investment spending, whereas the rise in exports is also associated with exporters' efforts to enter foreign markets in the face of slackening domestic demand.

According to ELSTAT data on trade, in January-August 2011 Greece's exports (excluding oil and ships) to EU markets rose by 11.3%, i.e. at a slightly slower rate than the total export bill (11.7%), and to third countries by 12.5%. Furthermore, according to the Bank of Greece's disaggregated data for the January-August period, the rise in exports involves all categories of goods. The category of metallurgical products, which registered a 58% rise in receipts, had the largest contribution in the total increase in non-oil export receipts, followed by chemicals (mostly plastics), machinery and agricultural produce (mainly food). Concurrently with the rise in exports, the industrial production index also recorded an increase in certain manufacturing sectors which are more export-oriented, such as basic metals and machinery. Despite the overall decline in imports, payments for the import of metallurgical products increased by 18.8%, probably reflecting the higher import bill for raw materials and intermediate goods, following the relevant price hikes. (For more details on the manufacturing sector's import penetration and export performance, see also Box III.1).

36 See, for example, the evolution of the country's ratings according to certain international indicators (World Economic Forum, *The Global Competitiveness Report 2011-2012*, IMD, *The World Competitiveness Yearbook 2011*, World Bank, *Doing Business 2011*.)

Box III.1

EXPORT PERFORMANCE AND IMPORT PENETRATION IN MANUFACTURING

Considerably lower imports, which reflect the slowdown of private consumption and investment, and higher exports of goods and services resulted in the positive contribution of the external sector to the change of GDP in 2010 and the first half of 2011.

These developments give rise to some questions:

(a) Is the rise in exports in 2010 and the first seven months of 2011 simply a reaction to the large and sharp drop in exports recorded in 2009 due to the decline in international trade?

(b) Has the breakdown of exports per type of product and destination changed? In other words, are exports directed to new markets?

Table A. Breakdown of Greek exports (excluding oil and ships)

a. By product category

	Export receipts in million euro							Percentage change				
	2008		2009		2010		2011	2009/2008		2010/2009		2011/2010
	first half	second half	first half	second half	first half	second half	first half	first half	second half	first half	second half	first half
Agricultural products	1,244 (19.1)	1,341 (18.0)	1,236 (22.1)	1,282 (21.8)	1,056 (19.8)	1,171 (19.5)	1,136 (18.4)	-0.6	-4.4	-14.6	-8.6	7.6
Chemicals. plastics	738 (11.9)	919 (12.9)	779 (13.9)	776 (14.9)	680 (15.9)	800 (16.9)	755 (17.9)	5.7	-15.6	-12.7	3.1	11.0
Metallurgy	1,161 (18.5)	1,421 (19.5)	890 (20.5)	770 (21.5)	845 (22.5)	1,046 (23.5)	1,320 (24.5)	-23.3	-45.8	-5.0	35.8	56.2
Mechanical equipment	560 (8.5)	622 (9.5)	402 (10.5)	464 (11.5)	394 (12.5)	456 (13.5)	447 (14.5)	-28.1	-25.3	-1.9	-1.8	13.4
Means of transport (excluding ships)	115 (1.4)	76 (2.4)	73 (3.4)	54 (4.4)	43 (5.4)	103 (6.4)	64 (7.4)	-36.6	-28.9	-40.8	90.3	47.9
Other manufacturing products	923 (13.4)	945 (14.4)	822 (15.4)	795 (16.4)	750 (17.4)	769 (18.4)	775 (19.4)	-10.9	-15.9	-8.7	-3.2	3.3
Unclassified products	1,788 (28.0)	2,126 (29.0)	1,395 (30.0)	1,744 (31.0)	1,553 (32.0)	1,666 (33.0)	1,689 (34.0)	-21.9	-18.0	11.3	-4.5	8.8
Total (excluding oil and ships)	6,527	7,449	5,598	5,886	5,322	6,011	6,186	-14.2	-21.0	-4.9	2.1	16.2

Source: Bank of Greece, balance of payments statistics.
The percentage share of each product category in total export receipts is given in parentheses.

Table A. Breakdown of Greek exports (excluding oil and ships) *(continued)*

b. By geographical destination

	Export receipts in million euro							Percentage change				
	2008		2009		2010		2011	2009/2008		2010/2009		2011/2010
	first half	second half	first half	second half	first half	second half	first half	first half	second half	first half	second half	first half
EU 25	4,541 (58.2)	4,180 (53.1)	3,659 (54.9)	3,617 (55.0)	3,859 (56.9)	4,123 (54.4)	4,322 (57.4)	-19.4	-13.5	5.5	14.0	12.0
Euro area	3,737 (47.9)	3,405 (43.2)	3,085 (46.3)	2,970 (45.2)	3,147 (46.4)	3,372 (44.5)	3,558 (47.3)	-17.5	-12.8	2.0	13.5	13.1
Southeastern Europe[1]	1,780 (22.8)	1,765 (22.4)	1,406 (21.1)	1,418 (21.6)	1,473 (21.7)	1,648 (21.7)	1,587 (21.1)	-21.0	-19.7	4.7	16.2	7.7
OECD[2]	477 (6.1)	670 (8.5)	604 (9.1)	491 (7.5)	447 (6.6)	546 (7.2)	498 (6.6)	26.7	-26.7	-25.9	11.1	11.3
United States	279 (3.6)	332 (4.2)	264 (4.0)	291 (4.4)	214 (3.2)	247 (3.3)	232 (3.1)	-5.4	-12.4	-18.9	-15.1	8.4
CIS	246 (3.2)	322 (4.1)	156 (2.3)	227 (3.4)	186 (2.7)	264 (3.5)	228 (3.0)	-36.6	-29.5	19.5	16.5	22.4
North Africa and Middle East[3]	412 (5.3)	502 (6.4)	478 (7.2)	477 (7.3)	473 (7.0)	584 (7.7)	516 (6.9)	16.1	-4.9	-1.2	22.4	9.2
China and Southeastern Asia[3]	120 (1.5)	130 (1.7)	121 (1.8)	130 (2.0)	166 (2.5)	212 (2.8)	170 (2.3)	1.5	-0.6	36.9	63.7	2.4
Other countries	225 (2.9)	307 (3.9)	238 (3.6)	216 (3.3)	178 (2.6)	202 (2.7)	209 (2.8)	6.1	-29.6	-25.4	-6.7	17.4
Total (excluding oil and ships)	7,799	7,878	6,662	6,577	6,781	7,580	7,529	-14.6	-16.5	1.8	15.3	11.0

Sources: Bank of Greece calculations based on Eurostat and ELSTAT trade statistics.
The percentage share of each product category in total export receipts is given in parentheses.
* Provisional data.
1. Albania, Bosnia-Herzegovina, Bulgaria, Croatia, FYROM, Montenegro, Romania, Serbia, Slovenia, Turkey.
2 OECD Member States not included in other categories.
3 Main trading partners in the region.

Table B. Gross output by sector

In million euro, 2005 prices

	2010 first half	2011 first half	2011/2010 first half
Food-beverages	3,297.4	3,140.5	-4.8%
Tobacco	162.7	179.0	10.0%
Textiles. clothing etc.	478.6	370.6	-22.6%
Wood and cork	114.8	115.4	0.5%
Paper-printing	511.5	447.5	-12.5%
Petroleum and carbon derivatives	4,135.9	3,337.9	-19.3%
Chemicals-pharmaceuticals-rubber	1,746.6	1,676.9	-4.0%
Non-metallic minerals	738.7	483.4	-34.6%
Metallurgy products	2,457.2	2,650.7	7.9%
Computers	661.0	575.4	-12.9%
Motor vehicles-equipment	173.7	133.8	-23.0%
Furniture and other activities	138.1	110.7	-19.8%
Repair and installation of machinery and equipment	100.1	90.8	-9.2%
Total manufacturing	**13,941.3**	**12,609.5**	**-9.6%**
Total manufacturing excluding oil	**9,805.3**	**9,271.6**	**-5.4%**

Source: Calculations based on ELSTAT data (Annual Industrial Survey, industrial production index, producer price index).

(c) To what extent has the decline in imports been accompanied by a substitution of until recently imported products by products domestically produced?

The rise in exports after June 2010 and in the first seven months of 2011 led total imports at current prices to resume the levels they had reached in the corresponding period of 2008. Although between the first half of 2010 and the first half of 2011 the imports of products from all manufacturing industries increased, the most important contribution was that of metallurgical products (see Table A). The rise in exports of metallurgical products contributed by 55% to the rise in total exports of products, excluding fuel and ships, and by 28% to the rise of total exports of goods. It is noted that the increase, by 56% in the first half of 2011, in the value of exports of metal products does not reflect only a rise in prices.

Fuel also made a significant contribution: about 40% of the total rise in goods exports between the first half of 2010 and the first half of 2011 was attributed to fuel. The value of fuel exports increased by 32%, while oil prices (in euro) recorded an almost equivalent increase over the same period. The geographic breakdown of the exports of products has remained unchanged (see Table A.b).

The rise in exports between the first half of 2010 and the first half of 2011 was accompanied by lower production in most industries (see Table B). Businesses tried to offset, through exports, the implications of reduced domestic demand. The export performance of manufacturing (except fuel), i.e. the share of production exported (see Table C) between the first half of 2010 and the first half of 2011 improved by 7.2 percentage points (from 30% to 37.2%). This constitutes the best performance since 2005. *Including fuel*, the export performance reached 41.5%, i.e. it rose by 9.6% percentage points against the first half of 2010. Never-

Table C. Export performance – Import penetration by sector[1]

a. Export performance

Sectors	2008 first half	2008 second half	2009 first half	2009 second half	2010 first half	2010 second half	2011 first half	Change in 2011/2010 first half (in percent-age points)
Food-beverages	15.3	18.8	19.0	18.2	16.2	17.6	19.2	3.1
Tobacco	103.7	63.9	62.1	60.0	65.7	54.2	61.2	-4.5
Textiles, clothing etc.	57.5	70.8	71.7	82.1	83.4	106.0	98.5	15.1
Wood and cork	9.2	10.2	12.7	10.2	4.1	7.9	6.7	2.6
Paper-printing	8.8	11.4	11.5	11.0	8.5	10.5	11.7	3.2
Petroleum and carbon derivatives	37.0	40.7	35.1	41.1	35.7	49.9	49.5	13.8
Chemicals-pharmaceuticals-rubber	39.1	51.2	42.1	43.9	36.9	48.6	42.9	6.0
Non-metallic minerals	9.8	10.2	11.6	11.3	10.6	12.3	8.4	-2.2
Metallurgy products	34.0	46.3	34.7	28.5	27.6	32.9	37.1	9.5
Computers	46.9	62.6	53.9	55.8	46.0	54.5	54.2	8.1
Motor vehicles-equipment	22.5	12.9	16.9	12.1	16.9	26.2	29.0	12.2
Furniture and other activities	49.6	36.9	29.1	33.2	35.9	37.0	46.3	10.5
Total manufacturing	**31.7**	**36.8**	**32.1**	**32.5**	**31.9**	**40.3**	**41.5**	**9.6**
Total manufacturing excluding oil	**29.6**	**35.3**	**31.2**	**29.6**	**30.0**	**35.3**	**37.2**	**7.2**

b. Import penetration

Sectors	2008 first half	2008 second half	2009 first half	2009 second half	2010 first half	2010 second half	2011 first half	Change in 2011/2010 first half (in percent-age points)
Food-beverages	37.3	39.3	36.1	35.9	33.8	33.6	34.0	0.18
Tobacco	106.8	72.7	64.4	62.7	67.7	60.0	57.5	-10.22
Textiles, clothing etc.	79.9	88.4	87.5	93.0	92.6	102.7	99.2	6.62
Wood and cork	63.7	66.8	63.1	61.2	50.1	47.6	36.8	-13.23
Paper-printing	51.1	51.7	48.0	41.4	41.8	41.1	37.5	-4.34
Petroleum and carbon derivatives	68.7	72.4	66.4	70.1	64.3	71.2	74.6	10.27
Chemicals-pharmaceuticals-rubber	72.2	78.9	71.6	74.6	69.2	74.9	73.1	3.93
Non-metallic minerals	19.3	20.2	20.3	17.9	16.3	17.3	20.8	4.54
Metallurgy products	51.4	57.9	44.7	40.6	39.3	38.8	42.5	3.19
Computers	88.6	92.4	90.9	90.5	86.4	87.4	86.9	0.41
Motor vehicles-equipment	88.5	87.5	83.0	85.0	89.9	83.4	85.5	-4.33
Furniture and other activities	84.3	81.3	80.0	80.1	80.8	80.1	81.9	1.03
Total manufacturing	**66.0**	**69.4**	**63.7**	**64.5**	**62.6**	**64.9**	**66.8**	**4.22**
Total manufacturing excluding oil	**64.9**	**68.2**	**62.7**	**62.5**	**61.7**	**61.5**	**61.8**	**0.10**

Sources: ELSTAT (industrial production index, Annual Industrial Survey) and Bank of Greece (import-export data).
1 *Import penetration* is the ratio of the value of imports to the apparent consumption (the sum of imports and non-exported domestic production) and *export performance* is the exported share of production.

theless, there are industries in which the volume of production rose between the first half of 2010 and the first half of 2011 (metal products, tobacco, timber and cork).

In spite of the notable drop in imports in all manufacturing industries, **import penetration in Greek manufacturing** – i.e. the ratio of the value of imports to apparent consumption (the sum of imports and the non-exportable domestic production) – continued to rise (see Table C), as apparent consumption decreased further. The rise in import penetration was small in total manufacturing; however, in certain industries (e.g. fuel) it was large. Thus, despite the sharp decrease in imports, it seems that the substitution of imports by domestically produced goods has not yet been materialised on a large scale.

4.1.3 SERVICES BALANCE

In January-August 2011, the surplus of the services balance increased by 5.7% or €534 million, mainly reflecting the strong rise in net receipts from travel and other services (by €604 and €540 million, respectively), while net transport receipts decreased by €609 million, given that the decline in gross receipts in this category was double that recorded for payments.

More specifically, gross travel receipts, i.e. spending by non-residents, registered a 10.0% rise (January-September 2011: +9.5%), while gross payments, i.e. travel spending abroad by residents, a 6.8% rise (January-September 2011: +5.0%); as a result, net travel receipts grew by 10.9% or €604 million year-on-year. The rise in gross travel receipts mainly reflects a 9.9% increase in tourist arrivals over the same period (January-September 2011:+10.4%),[37] which, in turn, is mainly accounted for by a recovery in world tourist traffic[38] and the fact that the turmoil in North African countries turned tourist flows towards other Mediterranean destinations, including Greece. As regards tourist receipts, the small positive effect that measures such as lower VAT rates on tourist accommodation services have on price competitiveness could be offset —after September 1st— by the higher VAT on restaurant services. The rise in travel payments (i.e. resident spending abroad) could mainly involve travels to neighbouring Balkan countries for the purchase of goods and services in view of lower prices, rather than leisure trips to other destinations, which are affected, according to estimations, by the decline in incomes.

In the same period, net transport receipts —chiefly for sea transports— declined by 12.3% (January-September 2011: -10.5%), mainly on account of a 25% drop in international freight rates[39] year-on-year. The transport capacity of the world fleet continued to increase at a faster pace than the world trade volume, resulting in lower freight rates. This trend is expected to continue for the remainder of 2011, on account of increased deliveries of new ships, on the one hand, and of smaller than expected growth in the world economy and the world trade volume in 2011, on the other.[40] However, the rise in the number of the world fleet's old ships that are being withdrawn or scrapped may partly halt the decline in freight rates.

Finally, net payments for "other" services declined considerably (by 50.8%).

4.1.4 INCOME ACCOUNT BALANCE

The income account deficit rose by 6.0% year-on-year, mainly due to higher (by 5.1%) net interest, dividend and profit payments.

37 Source: Bank of Greece's border survey.
38 UNWTO, *World Tourism Barometer Interim Update*, August 2011.
39 The Baltic Dry Index, which measures freight rates for dry (bulk) cargo ships, registered a 53.1% decline, whereas the Baltic Dirty Tanker Index recorded a smaller decline (16.7%) over the period under review.
40 See Chapter II.1a and OECD, "*What is the economic outlook for OECD countries? – An interim assessment*", 8 September 2011.

4.1.5 CURRENT TRANSFERS BALANCE

In January-August 2011, the current account balance showed a surplus of €883 million, similar to that of the corresponding 2010 period (€886 million). This development is accounted for by the fact that the rise in net general government transfer receipts (mainly from the EU) only marginally offset the increase in net transfer payments to the "other sectors" (mainly emigrants' remittances).[41] It should be pointed out that the bulk of the funds under EU current transfers for 2011 (direct aids and subsidies under the Common Agricultural Policy) has already been paid in the first two months of 2011.

4.2 CAPITAL TRANSFERS BALANCE

In the eight months between January and August 2011 the capital transfers surplus[42] increased to €1.1 billion, from €787 million in the same period of 2010.[43] Thus, the combined current and capital transfers balance stood at €2.0 billion, from €1.7 billion in the same period of 2010.

In the first half of 2011, the biannual target provided for in the Memorandum of Understanding in respect to the absorption of Community funds[44] was not achieved and the measures relating to the regulatory and organisational framework on the implementation of the NSRF were not materialised in full. However, by end September 2011, there was a total inflow of €1.3 billion and, as a result, the rate of absorption of structural funds, according to Bank of Greece provisional data, came close to 28% of Community funding[45] for the period 2007-2013, i.e. slightly lower than the corresponding EU-27 average. As underlined in the Fifth Review of the European Commission, this reflects the progress made in respect to the NSRF management and, therefore, the annual target for the absorption of Community funds remains feasible.[46] The increased absorption of available Community funds and, most importantly, the effective use thereof will be enhanced by recent decisions to raise the share of Community co-financing for NSRF projects and programmes with corresponding advance payments from Community funds, the enhanced role of the European Investment Bank (EIB) and the implementation of a comprehensive programme of technical assistance to Greece.[47]

The agreement with the European Commission on the revision of the NSRF, which places emphasis on entrepreneurship, exports, innovation and research and addresses unemployment, will facilitate maximum utilisation of the growth potential offered by Community funds.[48]

41 Current transfers from the EU mainly comprise direct aids and subsidies paid in the context of the Common Agricultural Policy (CAP), which are not distributed evenly throughout the year, as well as payments by the European Social Fund, whereas current transfers to the EU mainly comprise Greece's payments to the Community Budget.

42 Capital transfers from the EU mainly include receipts from the Structural Funds —apart from the European Social Fund— and the Cohesion Fund in the context of the CSF and the NSRF.

43 However, according to provisional data, in the eight months from January to August 2011 the capital transfers surplus rose to €1,224 million, from €873 million in the same period of 2010.

44 According to the Memorandum of Understanding (3 May 2010, Law 3845) and its updates of 6 August 2010, 22 November 2010, 11 February 2011 and 7 July 2011, the annual targets for the absorption of Community funds (on the basis of requests for payment) are: 2010: €2,750 million; 2011: €3,350 million; 2012: €3,730 million; and 2013: €3,890 million. These amounts do not include Agricultural Development. Amounts for 2007-2013 will be paid until 2015. Since 2011, the rule has been n+2 and not n+3, as was the case for 2007-2010, i.e. funds have to be absorbed within two years, once they are committed, in order to prevent the risk of losses. The annual amounts for the full absorption of Community funds by 2015 are determined in the Medium-term Fiscal Strategy Framework 2012-2015 (Law 3985/1 July 2011).

45 However, only specific programmes, such as "Competitiveness and Entrepreneurship", record high rates of absorption, unlike operational programmes relating to environment, sustainable growth, digital convergence, human resources development, education and lifelong learning. Regional programmes as a whole fall behind sectoral ones. See Ministry of Development, Competitiveness and Shipping – Integrated Information System, 30 September 2011.

46 See European Commission, *The Economic Adjustment Programme for Greece – Fifth review – Draft Oct. 2011*, p. 36 (unofficial draft). However, progress is made in respect to certain measures only (such as the submission of a specific time schedule for the preparation, selection and implementation of various projects), while other procedures have not been completed yet (e.g. legislative arrangements for the simplification of procedures relating to the environment, archaeological sites and expropriations). See pp. 78-79 of the review.

47 The European Commission has initially endorsed the increase in co-financing shares to 85%, retroactively since 1 July 2007, and has proposed a further increase to 95% —at maximum— as from 1 May 2010. This measure is also relevant to five more countries under fiscal consolidation or balance of payments programmes (Ireland, Portugal, Romania, Latvia and Hungary). See EU Council, 21 July 2011, Statement by Heads of State or government of the euro area and the EU institutions, Articles 4 and 12, statement by Mr. Barroso, 21 September 2011 (Speech/11/534) and European Commission, press release IP/11/942, Brussels, 1 August 2011.

48 Important in this respect will also be the implementation of the law on PPPs and of Law 3908/11 on investment, Community initiatives such as JEREMIE, JESSICA etc. (again with private sector involvement), the operation of ETEAN and the activation of the operational programme "National Contingency Reserve", which is co-financed by the European Social Fund.

It should be noted that, up until 2013, direct aids and subsidies in the context of CAP will remain largely unchanged, at about €2.5 billion annually. Therefore, total net EU transfers in 2011 (current and capital transfers less payments to the Community Budget) will stand at about €3.5 billion on a cash basis, against €2.6 billion in 2010.[49]

As regards prospects after 2013, total Community transfers to Greece (structural actions and transfers to the agricultural sector) will be reduced and given under completely different terms, according to European Commission's proposals for the Community Budget (CB) for 2014-2020[50] (see details in Box VI.4 of Chapter VI).

4.3 FINANCIAL ACCOUNT

In January-August 2011 the financial account showed a net inflow of €13.8 billion, compared with €15.7 billion in the corresponding period of 2010. In more detail, net inflows were recorded only under "other" investment (€26.5 billion), while net outflows were recorded both under direct investment (€1.4 billion) and portfolio investment (€11.3 billion).

The low level of foreign direct investment in Greece is a result of the Greek economy's structural problems and, in particular, product and labour market rigidities, weak infrastructures, as well as complex and time-consuming red tape procedures.[51] In the light of this, non-residents' direct investment in Greece registered a net outflow (disinvestment) of €218 million (compared to a net inflow of €237 million in the same period of 2010),[52] whereas there was a net outflow of €1.2 billion for residents' direct investment abroad,[53] against €506 million in 2010.

As regards portfolio investment, a net outflow of €11.3 billion was recorded in the same period (compared with a net outflow of €18.1 billion in the corresponding period of 2010), mainly on account of a €20.6 billion drop in non-residents' holdings of Greek government bonds and Treasury bills. This has been partly offset by a €10.0 billion decline mainly in resident credit institutions' and institutional investors' holdings of foreign bonds and Treasury bills.

Under "other" investment, a net inflow of €26.5 billion (compared to a net inflow of €34.0 billion in the corresponding period of 2010) is mainly attributable to net general government borrowing of €32.1 billion (gross borrowing under the support mechanism for the Greek economy came to €33.4 billion). This development was partly offset by a €1.9 billion rise in residents' deposit and repo holdings abroad and a €2.8 billion decline in non-residents' deposit and repo holdings in Greece (outflow).

Finally, at end-August 2011 Greece's reserve assets stood at €4.7 billion.

49 An inflow of €750 million is also expected in the course of 2011 because of the expiry of CSF III projects.

50 European Commission, "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions", "A Budget for Europe 2020", PART I, and "A Budget for Europe 2020" PART II: Policy fiches, COM (2011) 500 final, 29 June 2011, and European Commission, "Commission Staff Working Paper" SEC (2011) 868 final, 29 June 2011.

51 These problems have been repeatedly pointed out. See, for instance, (i) Bank of Greece, *Annual Report 2009*, (ii) IOBE, *Annual IOBE Report on Entrepreneurship in Greece*, 2010, (iii) Transparency International, *2010 Global Corruption Barometer*, (iv) World Bank, *Doing Business 2011*, and *Doing Business 2012*, (v) World Economic Forum, *Global Competitiveness Report 2011-2012*.

52 The most important transaction involves a €392 million inflow for the acquisition of a 10% stake in OTE (Hellenic Telecommunications Organisation) by Deutsche Telekom (Germany) and a €400 million inflow for the acquisition of Specifar Pharmaceuticals S.A. by Watson Pharmaceuticals Inc. (United States).

53 The most important transaction under this category involves an outflow of €491 million for a capital injection by EFG Eurobank Ergasias S.A. to its subsidiary "EFG Eurobank Ergasias SA Spolka Akcyjna Oddzial w Polsce" (Poland). There was also an outflow of €587 million for the acquisition by the National Bank of Greece of the remaining 50% (it already held 50%) of the closed-end fund CPT London (United Kingdom) held by Credit Suisse. It should be noted that there was no flow of money for this investment, as the positions between the two counterparties were netted out.

IV FISCAL DEVELOPMENTS AND PROSPECTS[1]

1 SUMMARY OF CURRENT DEVELOPMENTS AND THE OUTLOOK FOR 2011

The narrowing of the general government deficit by around 5 percentage points of GDP in 2010 was an important achievement – particularly during recession. As noted in the latest OECD report on Greece, the structural deficit (cyclically adjusted) fell by 7.25% of GDP in 2010, which has not been achieved by any other OECD country in the past three decades.[2]

However, the fiscal consolidation process has entered its most difficult phase, as the required fiscal interventions must involve structural measures and decisively deal with the weaknesses of Greece's public finances, i.e. tax evasion and squandering of public funds. Across-the-board cuts in wages, pensions and public investment, extraordinary levies and successive increases in tax rates will not necessarily have the desired results in the long run. First, lower disposable income exacerbates recession and adds to the uncertainty regarding developments in economic activity, employment and income in a period when (a) access to bank credit is anything but easy; and (b) bank deposits are used up in order to meet increased tax obligations. Second, these interventions undermine the sense of social justice, to the degree that the imperative need to take measures with quick results (partly due to the delays observed) does not allow for thorough processing, so as to ensure the fair allocation of the costs involved. Furthermore, the continuous adoption of practices such as the "settlement of pending tax cases" is a disincentive for tax compliance, while extraordinary taxes add new burden on taxpayers.

The execution of the 2011 Budget up until May shows significant deviations from the targets set. According to relevant data, the state budget deficit was €10,260 million, against a targeted €9,072 million and a deficit of €9,100 million in the corresponding period of 2010. Ordinary budget net revenue during the same period fell €2,163 million short of the target, while ordinary budget primary expenditure showed an overrun of €1,374 million. Indeed, had there been no delay in the execution of the Public Investment Budget (PIB) —which caused a decline of €1.5 billion in the Public Investment Programme against the previous year— the deviation from state budget targets would have been more pronounced. Over the same period, overdue debts reached almost €6.5 billion, €1.2 billion of which accumulated since the beginning of 2011.

Based on developments for this 5-month period, and in order to cover emerging deviations in 2011 and the estimated fiscal gap of around 3% of GDP, the government decided in June to take further fiscal measures. These measures are included in the Medium-Term Fiscal Strategy Framework (MTFS)[3] 2012-2015 and are being gradually implemented as of the second half of 2011.

These measures will cover the period 2011-2015 and are expected to yield €26,225 million, €12,784 of which from spending cuts and €13,442 from improved revenue.[4] Out of the total, measures of €5,931 million are expected to be implemented by end-2011; expenditure-reducing measures are projected to contribute €3,082 million and revenue-enhancing measures are estimated to yield €2,849 million.

As regards the current year, strict and timely implementation of the measures included in MTFS is crucial for the course of fiscal consolidation in these exceptionally demanding conditions. For this reason it was decided in September to speed up implementation. Given the deterioration of the financial condition as reflected in the 2012 Draft Budget presented on 3 October 2011, the government revised the target for the general government deficit for 2011 and 2012 (against the targets of the MTFS). In particular, the general government deficit is estimated to stand close to €18,690 million or 8.5% of GDP in 2011, against a targeted €16,361 million and €17,065 million in

1 Data on the basis of information available up to 17 November 2011.
2 OECD (2011), *Economic Surveys: Greece*.
3 Law 3985/1 July 2011, "Medium-Term Fiscal Strategy Framework 2012-2015".
4 Interventions under the MTFS have been revaluated in the 2012 Draft Budget on the basis of current financial developments and the schedule for the implementation of interventions.

the MTFS and the Economic Adjustment Programme (EAP), respectively. As for 2012, the general government deficit is estimated to stand at €14,658 million, or 6.8% of GDP, i.e. well above the levels projected in the MTFS (€12.9 billion), but in accordance with the initial target set in the EAP (€14.9 billion).

To ensure that revised targets for 2011 and 2012 are met, the Draft provides for additional measures to the amount of €2.1 billion (4/5 from revenue) and €5 billion (around 3/5 from revenue, of which €800 million through the increase in the EU contribution to investment programmes) respectively. Measures for 2011 include a new special levy on electricity-supplied buildings, unified wage grid for the public sector and reduced pensions, while for 2012 they also include the abolition of tax exemptions, deferred payment of the special benefit to judges, activation of the labour reserve scheme, increase in the EU contribution to co-financed projects and uniform excise duties on heating and diesel fuel.

The MTFS for 2011-2015 includes interventions aiming to deal with the long-term weaknesses of Greece's public finances. Among other things, they aim to (i) rationalise the compensation of employees, social and healthcare expenditure, (ii) reduce operating and defence expenditure, (iii) eliminate or merge public-sector entities, (iv) reorganise state-owned enterprises and organisations, (v) combat contribution evasion, (vi) broaden the tax base, and (vii) enhance tax compliance (which is expected to yield tangible results from 2013 on). However, as mentioned in previous Bank of Greece reports,[5] greater weight should have been attached to eliminating squandering and reducing public expenditure throughout 2011-2015; a reduced public sector would free up resources to be used more effectively by the private sector, thus enhancing economic growth (see also Chapter VI).

In order to enhance the credibility of the policy pursued and contribute to stabilising debt dynamics, the MTFS 2012-2015 provides for the implementation of an ambitious state asset privatisation and management scheme, based on a clear time schedule and specific quantitative targets, which is projected to yield €50 billion by end-2015. The effective implementation of the programme may contribute to a fast decline in the debt-to-GDP ratio.

The decisions of the euro summits of 21 July and 26 October 2011, discussed in Section 4 below, were particularly important for the stabilisation and the decrease —in the medium term— of the Greek sovereign debt.

In any event, Greece should abide by its obligations and commitments and implement in a timely and effective manner measures included in the MTFS (privatisations too). Maximum targeting and effectiveness of fiscal measures must be ensured in order to limit negative effects on economic growth. Such effects —if not, even partly, offset by other (mainly structural) measures— necessitate additional fiscal measures in order to achieve the initial targets to reduce fiscal deficits, and thus carry the risk of a vicious circle of negative prospects, recession and deficits.[6]

5 See Bank of Greece, Monetary Policy – Interim Report 2009, October 2009, p. 34; Bank of Greece, Monetary Policy 2009-2010, March 2010, p. 102; and Bank of Greece, Monetary Policy-Interim Report 2010, October 2010, p. 21.

6 According to the Budget for 2011 and the MTFS, measures to be taken until end-2011 should reach €19.4 billion (about 8% of GDP). Specifically, €14.3 billion on the basis of the 2011 Budget and €5.9 billion on the basis of the MTFS, and an additional €2.1 billion on account of the 2012 Draft Budget, while a loss in tax revenue is projected, stemming from a €1.7 billion reduction in the tax burden and a €1.2 billion decline in tax revenue, as the outcome of the measures taken was re-assessed (see MTFS). The above interventions aim to reduce the general government deficit by €5.6 billion (from €24.3 billion in 2010 to €18.7 billion in 2011, according to the 2011 Draft, while the target set in the EAP stands at €17.1 billion). *Therefore, the effectiveness of the measures (provided that the targets are achieved) is exceptionally low and is estimated at around 29%. That is, each additional euro coming from the measures (reduced expenditure or increased taxation) contributes only 0.29 euro to the reduction of the deficit.* The low effectiveness of measures is partly attributable to increased expenditure for interest payments and the impact of the recession on revenue and expenditure. According to a recent OECD report (see footnote 2 above), the measures taken in 2010 totalled €23.5 billion and the deficit was reduced from €36.3 billion in 2009 to €24.2 billion in 2010, i.e. by €12.1 billion. In other words, the effectiveness of interventions for the reduction of the deficit in 2010 was around 51.5%. *Thus, the fiscal adjustment measures became less effective, while also affecting the size of the GDP.* The OECD estimates the fiscal multiplier for 2011 at around 0.38, as included in the above report, and this means that interventions for 2011 (€19.4 billion) would narrow nominal GDP by 3.4 percentage points. According to OECD, the impact from the 2010 measures (€23.5 billion) reduced nominal GDP by 3.6% – under an estimated multiplier of 0.35.

2 FISCAL DEVELOPMENTS IN JANUARY-OCTOBER 2011 BASED ON FISCAL DATA

According to provisional data for the January-October 2011 period, the state budget deficit rose by 11.2%, to 9.2% of GDP or €20,104 million, against a deficit of 8.0% of GDP, or €18,081 million, in the corresponding period of 2010 (see Table IV.1). The widening of the state budget deficit against the corresponding period of 2010 is mostly attributable to lower revenue. It should be noted, however, that the target for the 10-month deficit was revised[7] to €20,362 million, which is in line with the new annual target for 2011 included in the Draft. In this context, the 10-month deficit seems to have improved by around €258 million against the revised target.

Net revenue under the ordinary budget in January-October 2011 fell short by €4,572 million (2.1% of GDP) against the initial estimates set in the 2011 Budget, and by €1,033 million against the revised target set in the Draft.[8] Moreover, revenue declined by 4.1% against the corresponding 10-month period of 2010 and compared with the revised annual target set in the Draft, which projected an *increase* of 0.8%. According to available detailed data for the January-September period, net revenue shows negative growth, which is attributable to: (a) decreased personal income tax collections due to lower income tax withheld, following the decline in average wages, pensions and employment; (b) decreased revenue from corporate income tax due to reduced profits in 2010; (c) reduced revenue from special consumption taxes (on fuel, alcoholic beverages and tobacco); (d) reduced VAT receipts[9] despite successive increases in VAT rates (VAT rates rose twice in 2010, and the low VAT rate was also raised as of 1.1.2011) and rising oil prices; (e) delays in collecting revenue from the settlement of tax arrears of 2010, income tax clearance, collection of the 2009 Single Tax on Real Estate (ETAK) for natural persons and the property tax for 2010 and 2011, owing to the ineffective tax collection mechanism; and (f) the strong (21.0%) increase in tax refunds, compared with a targeted annual decrease of 5.7%, due to higher tax refunds after the settlement of personal income taxes and clearing of older positions. In 10-month terms, this increase is 14.2%.

Ordinary budget primary expenditure (excluding grants to hospitals for the repayment of older debts, the procurement of military equipment, NATO expenditure and guarantees called in by organisations other than the general government) rose in January-October 2011 by 2.4%, or around €970 million, against a targeted annual increase of 0.3% set in the Draft. According to available information (9-month detailed data), this is attributable to higher expenditure for grants to the Manpower Employment Organisation (OAED), hospitals and social security funds (mainly TAP-OTE, OAEE and IKA).

Moreover, interest payments were significantly higher (19.5% or €2.5 billion) year-on-year, though remaining within the targeted annual increase of 23.3%.

During the period under review, a significant delay in the execution of the Public Investment Budget (PIB) was observed, as expenditure under the PIB was lower, by 37.4%, against 2010 and against a revised annual targeted decline of 10.6%. By contrast, PIB revenue was 38.1% (about €521 million) higher compared with January-October 2010. Thus, the PIB has made a significant contribution to containing the deficit in the period under review.

As regards the state budget for the entire year, measures announced on the basis of the MTFS, as well as the new measures included in the 2012 Draft Budget, are expected to have a positive effect on the general picture. Up to

7 The target is mentioned in the *Budget Execution Bulletin* of the Ministry of Finance.
8 The revision of monthly targets according to the Medium-Term Fiscal Strategy Framework has pushed back increased revenue resulting from the new measures towards the end of the year .
9 However, it should be noted that since July 2011, VAT payments can be made in (3 monthly) instalments, which has had a negative effect on the 9-month revenue.

Table IV.1 State budget balance

(million euro)

	January-October		Percentage change	Annual data						Percentage changes			
	2010	2011*	2011*/2010	2009	2010*	Budget 2011	MTFS 2011	Draft Budget Estimates 2011	Draft Budget Projections 2012	2010*/09	MTFS 2011/2010*	Draft Budget Estimates 2011/2010*	Draft Budget Estimates/Projections 2012/2011
I. Revenue	**42,280**	**41,118**	**-2.7**	**50,586**	**54,259**	**59,482**	**57,967**	**54,904**	**59,064**	**7.3**	**6.8**	**1.2**	**7.6**
1. Ordinary budget net revenue	40,913	39,230	-4.1	48,546	51,187	55,560	54,042	51,582	54,204	5.4	5.6	0.8	5.1
Revenue before tax refunds	*44,610*	*43,440*	*-2.6*	*53,443*	*56,156*	*59,320*	*57,802*	*56,242*	*57,944*	*5.1*	*2.9*	*0.2*	*3.0*
NATO revenue	*11*	*25*		*55*	*13*	*40*	*40*	*40*	*60*				
Tax refunds	*3,708*	*4,235*	*14.2*	*4,952*	*4,982*	*3,800*	*3,800*	*4,700*	*3,800*	*0.6*	*-23.7*	*-5.7*	*-19.1*
2. Public investment budget	1,367	1,888	38.1	2,040	3,072	3,922	3,925	3,322	4,860	50.6	27.8	8.1	46.3
– Own revenue				183	271	200	203	150	200	48.1	-25.1	-44.6	33.3
– Revenue from the EU				1,857	2,801	3,722	3,722	3,172	4,660	50.8	32.9	13.2	46.9
II. Expenditure	**60,361**	**61,222**	**1.4**	**83,729**	**74,879**	**79,288**	**77,775**	**77,463**	**76,624**	**-10.6**	**3.9**	**3.5**	**-1.1**
(State budget primary expenditure)	47,618	45,996	-18	71,404	61,656	63,368	61,773	61,163	58,724	-13.7	0.2	-0.8	-4.0
1. Ordinary budget	54,315	57,436	5.7	74,141	66,432	70,788	70,225	69,913	68,924	-10.4	5.7	5.2	-1.4
– Interest payments	12,743	15,226	19.5	12,325	13,223	15,920	16,002	16,300	17,900	7.3	21.0	23.3	9.8
– Ordinary budget primary expenditure	40,566	41,536	2.4	57,992	51,649	52,633	52,049	51,799	49,125	-10.9	0.8	0.3	-5.2
– Grants for the repayment of public hospitals' arrears	340	434	27.6	1,498	375	450	450	450	400				
– NATO expenditure	10	8	-20.0	51	23	40		40	60				
– Military equipment procurement programmes	550	200	-63.6	2,175	1,017	1,600	1,500	1,100	1,300	-53.2	47.5	8.2	18.2
– Forfeitures of guarantees of bodies outside the general government	106	32	-69.8	100	145	145	224	224	139				
2. Public investment budget	6,046	3,786	-37.4	9,588	8,447	8,500	7,550	7,550	7,700	-11.9	-10.6	-10.6	2.0
III. State budget balance	**-18,081**	**-20,104**	**11.2**	**-33,143**	**-20,620**	**-19,806**	**-19,808**	**-22,558**	**-17,560**	**-37.8**	**-3.9**	**9.4**	**-22.2**
% of GDP	-8.0	-9.2		-14.3	-9.1	-8.7	-8.8	-10.4	-8.2				
1. Ordinary budget	-13,402	-18,206		-25,595	-15,245		-16,183	-18,331	-14,720				
2. Public investment budget	-4,679	-1,898		-7,548	-5,375		-3,625	-4,228	-2,840				
IV. State budget primary surplus	**-5,338**	**-4,878**	**-8.6**	**-20,818**	**-7,397**		**-3,806**	**-6,258**	**340**	**-64.5**	**-48.5**	**-15.4**	**-105.4**
% of GDP	-2.3	-2.2		-9.0	-3.3		-1.7	-2.9	0.2				
V. General government deficit	**-**	**-**		**-15.8**	**-10.6**		**-7.3**	**-8.5**	**-6.8**				
% of GDP (on a national accounts basis)													
Amortisation payments	19,366			29,135	19,549		28,950	28,950		-32.9	48.1	48.1	

Source: Ministry of Finance.
* Provisional data.

the end of the year (November-December) interest payments amounting to about €1.1 billion shall be made. Therefore, in order to achieve the targeted state budget deficit of €22,558 million, the state budget primary deficit must be contained to around €1.4 billion in the last two months of the year.

The bills for the social solidarity contribution (one-off tax) for incomes over €12,000, as well as the €300 business tax imposed on the income of self-employed and traders, started being sent to tax payers in September; collection of amounts due is expected to be completed by the beginning of 2012. Additionally, collection of the new property tax (through electricity bills) is expected to be completed within the year or until February 2012 at the latest. 2011 revenue will be further supported by increased income tax, as the tax-free threshold was lowered (from €12,000 to €8,000 for people aged 30-65),[10] the collection of revenue from the settlement of tax arrears for 2010 and 2011, the clearance of personal income tax, the collection of the Single Tax on Real Estate (ETAK) for 2009 and VAT for 2010 and 2011,[11] the receipts from extraordinary taxation on high-capacity vehicles, pleasure boats and swimming pools, the higher car registration fees, the increased VAT on catering and non-alcoholic beverages (from 13% to 23%) and the increased special consumption tax on heating oil and natural gas. Furthermore, significant receipts from various non-tax revenue items are expected.[12]

Expenditure is projected to decline following the reduction of certain benefits to civil servants (under Law 4002/2011), the implementation of the unified wage grid as from 1 November 2011 (Law 4024/2011), as well as the reduction of higher pensions and the social solidarity contribution of employees and self-employed intended to support the unemployed. Therefore, the strict, immediate and effective implementation of the new measures (also those included in the MTFS) should contribute to achieving the revised targets outlined in the state budget, as long as the economic conditions do not deteriorate considerably more than projected in the Draft.

3 FISCAL DEVELOPMENTS IN JANUARY-OCTOBER 2011 BASED ON CASH DATA

According to available cash data for the January-October 2011 period, the state budget deficit —not including the OPEKEPE (Payment and Control Agency for Guidance and Guarantee Community Aid) account— decreased to €19,781 million, or 9.1% of GDP, against a deficit of €20,618 million (also 9.1% of GDP) in the respective period of 2010 and a deficit of 8.8% in the first nine months of 2011 (see Table IV.2. and Chart IV.1.). The lower cash deficit of the state budget against the corresponding figure for 2010 is attributable to a significant decline in the Public Investment Budget deficit. By contrast, the ordinary budget deficit rose in January-October 2011 compared with the respective 2010 period, which is due to both reduced revenue and higher expenditure under the ordinary budget.

In particular, ordinary budget cash revenue decreased by 1.2% in January-October 2011 year-on-year, despite the fact that it also includes VAT receipts (through the DIAS interbank system) for October this year to the amount of €1,079.97 million, whereas the corresponding receipts for the previous year where recorded in November. Expenditure rose by 6.3%, as primary expenditure increased by 2.5%. Ordinary budget expenditure does not include €4,011.5 million for the issuance of special bonds by the Greek gov-

10 Law 3986/2011 "Emergency Measures for the Implementation of the Medium-Term Fiscal Strategy Framework for the years 2012-2015". Law 4024/2011 "Retirement regulations, unified wage grid for the public sector, labour reserve scheme and other measures for the implementation of the Medium-Term Fiscal Strategy Framework 2012-2015" provides for a further reduction in the tax-free threshold to €5,000.

11 Efforts to collect the 2009 ETAK and the 2010 VAT until February 2012 are continuing, despite the obvious delays, in order to classify them in the national accounts for 2011, as is also the case for the social solidarity contribution and the extraordinary tax on real estate. By contrast, there is some uncertainty as to the collection of the 2011 ETAK by the end of the year.

12 Introductory Report on the 2011 Budget.

Table IV.2 State budget deficit on a cash basis[1,2] (central government net borrowing requirement)

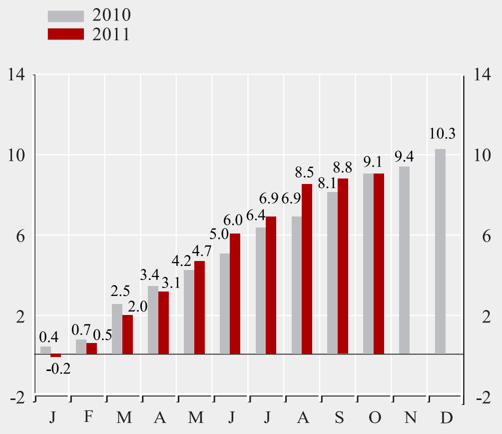
(million euro)

	Year		January - October		
	2009	2010	2009	2010	2011*
1. State budget	**32,622**	**23,396**	**27,119**	**20,618**	**19,781**
Percentage of GDP	14.1	10.3	11.7	9.1	9.1
– Ordinary budget[3]	25,318[4]	18,333[5]	20,558	16,016	17,582[6]
– Public investment budget	7,304	5,063	6,561	4,602	2,199

Source: Bank of Greece.
* Provisional data.
1 As shown by the respective accounts with the Bank of Greece and other credit institutions.
2 Not including movements in the account of the Payment and Control Agency for Guidance and Guarantee Community Aid (OPEKEPE).
3 Including movements in public debt management accounts.
4 Excluding expenditure of €3,769 million for the acquisition of preference shares of Greek banks pursuant to Law 3723/2008 on banks' capital support 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), but including proceeds of €673.6 million from the sale of Hellenic Telecommunications Organisation (OTE) shares, of €72.3 million from the privatisation of Olympic Airlines, as well as the payment of Greek government debt to the Agricultural Insurance Organisation (OGA) through the issuance of bonds of €531 million.
5 Including expenditure of: (i) €297.9 million (bond issue reopening) for the payment of government arrears to the Social Security Foundation (IKA); and (ii) €714.7 million (bond issuance) for the payment of government arrears to Hellenic Petroleum SA (ELPE), EGNATIA MOTORWAY SA and the Agricultural Bank of Greece (ATEbank), but excluding expenditure of: (i) €849.2 million (bond issue reopening) for the repayment of public hospitals' arrears pursuant to Article 27 of Law 3867/2010, which burdens the 2010 debt; and (ii) €424.3 million (bond issuance) for the settlement of financial obligations of the Hellenic Agricultural Insurance Organisation (ELGA), a replacement of previous loan under the same terms. Also excluding expenditure of €1,500 million for payment of capital of the Hellenic Financial Stability Fund.
6 Including revenue of €391.4 million from the sale of OTE shares, but excluding revenue of i) €675 million from ATEbank due to the acquisition of preference shares by the Greek State, and ii) €250 million from the Deposits and Loans Fund due to the reduction of its reserves. Excluding expenditure of i) €4,011.5 million in order for the Greek State to pay public hospitals' arrears (bond issue reopening), under Article 27 of Law 3867/2010, since these arrears were recorded in the years they were incurred but burden the debt of 2011, ii) €350 million in order for the Greek State to cover ELGA financial obligations (bond issuance), a replacement of a previous loan under the same terms, and iii) €140.2 million in order for the Greek State to pay debts to dismissed Olympic Airlines employees. Also excluding €1,227 million from the participation of the Greek State in capital increases, of which €1,144.5 million concerns the capital increase of ATEbank.

Chart IV.1 Net borrowing requirement of central government on a cash basis (January 2010 - October 2011)

(percentage of GDP)



Source: Bank of Greece.
Note: "Monthly" data refer to the cumulative sum for the period from the beginning of the year up to the reference month.
It is noted that the result of the Payment and Control Agency for Guidance and Guarantee Community Aid (OPEKEPE) is not included.

ernment to cover past liabilities of hospitals (see footnote 6 in Table IV.2); in ordinary budget balance also includes €391.4 million revenue from the privatisation of the Hellenic Telecommunications Organisation (OTE), though it leaves out transactions concerning the capital increase in the Agricultural Bank of Greece (ATE) and other entities of minor importance.

The public investment budget deficit decreased by 52.2% in the January-October period year-on-year, as the execution of the Public Investment Budget (PIB) is slower this year, while its revenue increased significantly against 2010.

4 MEDIUM-TERM PROSPECTS FOR DEFICIT AND DEBT

The Medium-Term Fiscal Strategy Framework is a fiscal strategy scheme with a specified time schedule, clear objectives and specific interventions, outlining the economic policy to be pursued until 2015, in order to achieve the fiscal adjustment objectives over the medium term. (It should be reminded that the preparation and annual updating of medium-term fiscal adjustment programmes — in other words multi-annual budgeting— is provided for by Law 3871/2010.) The adoption and application of the MTFS, involving comprehensive and effective implementation of the relevant provisions and policy measures, could also help accelerate fiscal consolidation and support economic activity.

According to the MTFS (as revised by the 2012 Draft Budget), the general government deficit is projected to stand at 8.5% of GDP (or €18,690) in 2011, against the initial target of €16,361 million in the MTFS and the targeted €17,065 million in the EAP, while at the end of the reference period (2015) the deficit is projected to stand at €1,525 million, or 0.6% of GDP. Moreover, according to the Draft, 2012 should witness a primary surplus of €3.2 billion, or 1.5% of GDP. In accordance with the MTFS, the primary surplus is expected to stand around at 8% of GDP in 2015, as long as the privatisation programme is fully implemented.

It should be noted that out of the total €8,041 million of the measures taken in order to achieve the targets for 2011 (as included in the MTFS and the Draft), about 56.6% (€4,549 million) involves revenue and only 43.4% (€3,492 million) involves expenditure. The Bank of Greece has repeatedly argued that cutting down government expenditure should contribute to fiscal adjustment by 2/3.[13]

This emphasis on increasing revenue is maintained throughout 2012-2015, as the largest part of the adjustment is planned to come from the revenue side (about 54.1%).[14] This implies higher uncertainty in meeting the ultimate objectives, as the deeper than expected recession in 2011 and the delays in returning to positive growth rates are expected to negatively affect revenue and, consequently, the targets for deficit and public debt. According to relevant estimates, each additional 1% drop in economic activity automatically adds around 0.5% to the general government deficit, thus calling for additional measures that would further weigh heavily on economic activity.[15]

Another source of concern is the projected revenue of €3 million between 2013 and 2015, estimated to come from enhanced tax compliance; this amount, however, is not fully secured. Further improvement —or, rather, overhauling— of the tax collection mechanism is absolutely necessary and urgent, in order to achieve these targets.

The MTFS includes a well-specified state asset privatisation and management programme, based on a concrete timetable, as well as quarterly aggregate revenue targets for 2011-2013. The implementation of this programme is estimated to drastically reduce public debt.[16]

The Euro Summit of 21 July 2011 took important decisions that could help accelerate and enhance Greece's efforts to address the debt crisis. The decisions should have a strong positive impact on refinancing, servicing costs and the sustainability of government debt. For the first time since the beginning of the crisis, the financial package to Greece provided, inter alia, for the voluntary participation of the private sector (Private Sector Involvement – PSI). This agreement offers a new funding scheme of €109 billion (until 2014), to be allocated as follows: (a) €34 billion for new loans to Greece; (b) €20 billion for the direct buyback of Greek bonds in the secondary market;

13 See footnote 5.
14 Taking into consideration revised estimates on the effectiveness of the measures provided for in the MTFS and the new measures included in the Draft (which are estimated at €5,010 million).
15 For more detailed information, see Girouard and André (2005), "Measuring cyclically-adjusted budget balances for OECD countries", OECD, Economics Department Working Paper No. 434.
16 The initial targets set in the Medium-Term Fiscal Strategy Framework projected revenue of €5 billion by end-2011, €15 billion by end-2012, €22 billion by end-2013, and €35 billion and €50 billion by end-2014 and end-2015, respectively. However, the target for revenue stemming from privatisation proceeds has been revised to €4 billion for 2011.

(c) €20 billion to support the Greek banking system (through the HFSF); and (d) €35 billion for the purchase of AAA bonds from the European Financial Stability Fund (EFSF), which would be held by the Greek government to encourage private sector involvement. The new scheme also provided for the extension of the average maturity of the new loan, from 7.5 to 15 and up to 30 years, with a 10-year grace period, as well as lower interest rates (about 3.5%).[17]

Private sector involvement provides for either voluntary bond exchanges for new bonds of the same nominal value and a 30-year maturity, or voluntary exchanges for bonds at 80% of their nominal value.[18] According to this arrangement, the private sector involvement is estimated to reach €54 billion for the 2011-2014 period and a total amount of €135 billion up to 2020.

However, the arrangement as a whole does not involve a direct reduction of gross debt, as both the amounts to support the Greek banking system (€20 billion, plus €10 billion from the previous agreement) and the amount for the purchase of bonds from the EFSF (€35 million) shall be recorded under public debt. This should offset the direct debt reduction by around €12.6 billion following the bond buyback in the secondary market and by around €13.5 billion following the exchange of (almost half the) bonds at 80% of their nominal value. The reduction mainly involved the "net present value", rather than the nominal value. However, the "net" debt would fall.

By contrast, lower cost of borrowing, significantly longer loan maturity, substantial period of grace and continued financing of the Greek state by the private sector would reduce amortisation payments and improve the cash liquidity of the public sector.

While the implementation of the above agreement had already started, recent data on the depth of the recession in Greece, as well as deviations from the targets set in the MTFS, caused a reshaping of the financial package to Greece. Thus, the decision of the 26 October 2011 Euro Summit, in the context of a general arrangement[19] to support the euro, involved a new financial package for Greece, which provided for the voluntary exchange of Greek bonds with a 50% discount on the nominal value. In essence, the voluntary involvement of the private sector will be much larger, compared with the initial agreement of 21 July. When the bond exchange is complete, Greece's gross debt will be reduced by €100 billion. The amount of the assistance rises from €109 to €130 billion by end-2014.

It should be noted that the favourable arrangements decided on 21 July concerning the terms of the loan from the euro area and the IMF (reduced interest rates and extension of loan maturity) are expected to remain effective after the decision of 26 October 2011.

Significant details of the new agreement have not been unveiled yet; however, if implemented, it should give a large boost to government liquidity, as interest expenditure will decline by 2 to 3 percentage points of GDP (between 2012 and 2020), and the same applies to amortisation payments.

17 The new average maturity and reduced interest rate shall also apply to the remaining amount (about €45 billion) of the €110 billion loan. The interest rate will be equal to the European support mechanism rate for EU countries facing balance of payment difficulties. When the agreement was concluded, this interest rate was around 3.5%.

18 According to the IIF, investors will be offered four new instruments: (1) a par bond exchange into a 30-year instrument, with an interest rate of 4.5% in constant terms; (2) a par bond offer involving rolling-over maturing Greek government bonds into 30-year instruments, with an interest rate of 4.5% in constant terms; (3) a discount bond exchange (80% of nominal value) into a 30-year instrument, with an interest rate of 6.42% in constant terms; (4) a discount bond exchange (80% of nominal value) into a 15-year instrument, with an interest rate of 5.9% in constant terms. For instruments 1, 2 and 3 the principal is fully collateralised by 30-year zero coupon AAA bonds by the EFSF. For instrument 4, the principal is partially collateralised by the EFSF. All offers cause a 21% loss in net present value terms. Moreover, based on IIF estimates, the agreement will extend the average maturity of the Greek public debt from 6 to 11 years.

19 The general arrangement provides for: a) enhancement of the EFSF resources (with available funds, including leveraged funds, of about €1 billion); b) European bank recapitalisation up to end-June 2012 (Core Tier 1 Capital at 9%); c) fiscal measures for troubled countries, such as Italy and Spain; and d) improvement of fiscal and financial governance in the euro area.

5 KEY FISCAL ADJUSTMENT MEASURES AND INSTITUTIONAL FISCAL REFORMS IN 2011 – AN OVERVIEW OF THE TARGETS SET IN THE MEDIUM-TERM FISCAL STRATEGY FRAMEWORK

The initial May 2010 EAP included significant interventions for 2011, as regards cutting expenditure by €1,500 million and increasing revenue by €4,050 million. These interventions were revised and complemented by new ones with the approval of the Budget for 2011.[20] Also, certain fiscal measures for 2010 also affected 2011 (carry-over effect). According to the 2011 Budget, these measures would yield €1,500 million on the revenue side and €1,150 million on the expenditure side.

In order to deal with the impact of the revised general government deficit for 2009 on the estimated 2010 deficit, the Budget for 2011 required additional measures, which involved cutting back expenditure (bringing in about €3,850 million) and increasing revenue (bringing in about €2,280 million). The measures mainly focused on non-central government public entities, i.e. state-owned enterprises (SOEs), hospitals and social security funds, but also aimed at combating tax evasion and improving the effectiveness of social expenditure.

As regards SOEs, the Budget for 2011 provided for higher revenue, lower operating costs and restructuring.[21] Healthcare expenditure would decline by improving the procurement system of hospitals and pension funds, lowering medicine prices and adopting electronic prescribing. Expenditure would also decrease after further cuts in fixed-term employment contracts and a moderation in defence expenditure. The measures to improve revenue focused on curbing fuel smuggling (input-output system), collecting overdue liabilities and tax fines, implementing the new framework for tax disputes and judicial appeal processes, increasing the tariff of judicial fees and settling tax disputes and pending social security cases.[22] Moreover, the 2011 Budget also provided for revenue from the renewal of operating licenses for telecommunication companies and the sale of bandwidth, as well as from the extension of the concession contract for Eleftherios Venizelos airport.

On the basis of the Budget for 2011, the above measures were expected to yield €14,330 million, exceeding the EAP targeted reduction (of €5 billion) of the general government deficit for 2011 (to €17,065 million, compared with the estimated, at the time, general government deficit of around €22 billion in 2010). The deviation stems from the need to provide for any automatic rise in expenditure due to higher debt servicing costs, the impact of the recession, as well as changes in the composition of demand (which could restrain tax revenue).

It has already been pointed out that, up to May 2011, there had been significant deviations in

20 In particular, freeing up resources (with the implementation of the Kallikratis Programme), containing intermediate consumption, saving resources through the operation of the Single Payment Authority, freezing pensions and reducing expenditure under the Public Investment Budget. On the revenue side, the interventions included: the implementation of green levies, an increase in real estate objective values, additional revenue from property taxes (following the settlement of building-code violations), broadening of the scope of services subject to VAT, an increase in the lower VAT rate to 13%, reduced VAT rates in certain categories (hotels, medicines), equalisation of the special consumption tax on heating oil and diesel, and heating oil subsidies. Moreover, measures included a special contribution for profitable businesses, as well as a reduced tax rate for businesses (to 20% from 24%). A positive effect is expected to stem from the taxation of imputed income, the taxation of remuneration in kind, as well as the accounting definition of income. The gambling market regulation (gambling rights and licenses) would also have a positive contribution to revenue.

21 It should be noted that interventions so far helped improve the financial situation in 17 SOEs which are part of the general government (Athens Metro Operating Company (AMEL), Attiko Metro, Hellenic Aerospace Industry (EAB), Thermal Buses Corporation (ETHEL), Greek Agricultural Insurance Organisation (ELGA), ERGOSE, National Radio and Television Organisation (ERT), Hellenic Defence Systems (EVO-PYRKAL), Trolley Buses Corporation (ILPAP), Athens-Piraeus Electric Railways (ISAP), Management Organisation Unit (MOD), Athens Urban Transport Organisation (OASA), Horse Racing Organisation of Greece (ODIE), Hellenic Railways Organisation (OSE)-National railway infrastructure management (EDISY), School Buildings Organisation (OSK), TrainOSE, TRAM). In the first five months of 2011, pre-subsidy losses declined by 44%, expenditure by 32% and the number of employees by 12.3% against the respective 2010 period. These savings led to a 29% decline in state subsidies.

22 Law 3943/2011 ("Combating tax evasion, staffing of the tax auditing department and other provisions under the Ministry of Finance") includes three priority actions: (1) curbing tax evasion by expediting tax dispute processes and tightening sanctions; (2) restructuring the control and collection mechanisms by reforming the audit system and improving evaluation of tax administration; and (3) improving the taxation framework and encouraging entrepreneurship by offering incentives.

the execution of the Budget for 2011.[23] In order to cover the deviations and the emerging fiscal gap, estimated at around 3% of GDP, the government decided to take further corrective measures as part of the Medium-term Fiscal Strategy Framework (MTFS) 2012-2015, to be implemented in the second half of 2011.[24]

According to the Draft, the new MTFS measures for 2011-2015 are expected to yield €26,225 million, i.e. €12,784 million from expenditure and €13,442 million from revenue.[25] In particular, 13 fields of priority have been identified: (1) rationalisation of the compensation of employees (€1,716 million); (2) reduction of operating costs (€1,119 million), (3) eliminating/merging entities and reducing state grants (€1,004 million); (4) restructuring of public enterprises and organisations (€1,314 million); (5) lower defence expenditure (by €1,200 million); (6) cost saving and improving results in healthcare (€979 million); (7) rationalisation of expenditure in medical care (€937 million); (8) lower expenditure in social security funds and rationalisation of social expenditure (€4,601 million); (9) improved revenue for social security funds and combating contribution evasion (€3,380 million); (10) enhancing tax compliance (€3,000 million);[26] (11) reduced tax exemptions and other tax revenue (€5,766 million); (12) improved results for local governments (€1,505 million); (13) lower expenditure under the Public Investment Budget (by €504 million).

To meet the targets set in the MTFS, implementation laws and regulations were passed in July and August 2011. Specifically, Law 3986/2011 ("Emergency measures for the implementation of the Medium-Term Fiscal Strategy Framework (MTFS) for 2012-2015") includes a series of provisions and regulations concerning state asset management (creation of the asset development fund – TAIPD, city planning provisions and state property investment identity and other regulations), tax and customs regulations,[27] fiscal regulations,[28] labour market and social security regulations and other provisions.[29] The TAIPD is already

23 Already in February 2011, in the context of the third review of the EAP, it had become obvious that additional corrective measures were necessary, amounting to at least 0.75% of GDP, in order to cover the projected fiscal gap and ensure the reduction of the general government deficit to €17,065 million.

24 According to the MTFS, deviations reflect: (1) the revision of the 2010 general government deficit by one percentage point of GDP (€2.5 billion) (the general government deficit stood at 10.5% in 2010, against an estimated 9.4% in the Introductory Report on the 2011 Budget); (2) the negative impact of the recession (€1 billion), since the recession proved stronger than what was initially projected by the EAP, resulting in shrinking tax revenue and social security contributions and rising social transfers; (3) revenue losses due to initiatives to reduce the tax burden (€1.7 billion), as additional interventions in this direction took place in 2011 concerning: (i) netting of debts (€1,000 million); (ii) VAT payment in instalments (€300 million); (iii) lower income tax due to the new tax scale for incomes below €40,000 (€400 million); (iv) a difference of €1.2 billion, following a reassessment of the measures. The yields of various measures provided for in the 2011 Budget were reassessed, estimating almost €2 billion lower revenue, whereas higher revenue, to the amount of €800 million from interventions with better-than-expected results were anticipated.

25 The MTFS provided for measures of €28.4 billion for 2011-2015, €6.7 billion of which concerned 2011 (€4 billion from lower expenditure and €2.7 billion from higher revenue), and €21.7 billion the period 2012-2015. For 2011-2015 as a whole, €14.3 billion should come from cutting down on expenditure and €14.1 billion from increased revenue. MTFS interventions have been reassessed in the Draft Budget for 2012 to match current financial developments and their implementation schedule; they amount to €26.2 billion (€12.8 billion from expenditure and €13.4 billion from revenue). For 2011, interventions are estimated to yield €5.9 billion – €3.1 billion from expenditure and €2.8 billion from revenue.

26 Measures to enhance tax compliance are expected to start producing results in 2013. However, already since May 2011 the government put into effect the "National operational programme to combat tax evasion 2011-2013", as provided for by Law 3943/2011 (Art. 1). Under the Law, this programme covers a three-year period. It includes: (a) an action plan against tax evasion; (b) recommendations on institutional changes; and (c) measures for the effective and coordinated operation of tax, judicial and prosecuting authorities.

27 The law includes regulations concerning income tax deductions, objective living expenses, social solidarity contribution for natural persons, extraordinary levies on objective expenditure (automobiles, pleasure boats, aircrafts, swimming pools, etc.) and a business tax on the self-employed. It also includes regulations on tax-exempt interest rates and real estate tax, increase in the VAT rate to 23% for catering, increases in car registration fees, equalisation of the special consumption tax on heating oil and diesel for businesses and an increase in the special consumption tax on heating oil for households.

28 It includes several fiscal measures (e.g. to combat unemployment, a special contribution to the Civil Servants Provident Fund, lower ceilings for financing local governments through Central Independent Resources), as well as provisions to restrict recruitment in the public sector.

29 Specifically, contributions imposed on main pensions (over €1,700) for the Intergenerational Solidarity Fund (AKAGE) are adjusted upwards, an additional contribution to pensions over €1,700 is imposed for pensioners below 60 years of age, while other contributions are introduced too: a special contribution for auxiliary pensions of over €300, an additional contribution for main and auxiliary pensions, welfare and sickness for the Unified Insurance Fund of the Independently Employed (ETAA), an extraordinary unemployment contribution for the self-employed insured under OAEE, ETAA and ETAP-MME and, with effect from 1 January 2013, a contribution to the Organisation of the Self-Employed (OAEE) per business sector, as a percentage of turnover. The one-off pension benefit to civil servants is reduced by 10% as of 1.1.2010 and for the personnel of the Public Power Corporation (DEH) by 15%. In addition, an annual levy (€200 per square meter) for smokers zones (half of the total floor area) for casinos and live music clubs with total floor area of over 300 square meters is imposed, while, from 1 July 2011 to 31 December 2011, auctions of first residence (for amounts due up to €200,000) are suspended.

operational and has taken up the tasks provided for by law, following the appointment of the Board of Directors.

Law 4002/2011 ("Amendments to the pension legislation of the public sector – Regulations for the development and fiscal restructuring – Issues within the competence of the Ministries of Finance, Culture and Tourism and Labour and Social Security") regulates the framework for tourist investment, with specific provisions on mixed-use resorts and the simplification of licensing procedures for tourist investment. In addition, this law attempts to rationalise pension expenditure and allows for assigning the auditing of taxpayers to private auditing companies, while it provides, among other things, for a new settlement of pending tax cases, the submission of overdue tax returns without penalty and an extended deadline for the settlement of tax lapses. Under the same law, issues concerning the administration of the Ministry of Finance are settled, attempts are made to rationalise the rents paid by the State for real estate property it uses, and provisions are included to regulate the gambling market. Lastly, the law provides for closing down or merging public sector entities.

Law 3996/2011 ("Reform of the Labour Inspectorate, social security regulations and other provisions") also includes provisions on combating social security contribution evasion. Moreover, Law 4014/2011 on environmental licensing regulates the issue of fines imposed on the settlement of building code violations.

Significant interventions are envisaged, or are under way, in healthcare. The National Organisation for the Provision of Healthcare Services (EOPYY), integrating the healthcare sectors of the Social Insurance Fund (IKA), the Self-Employed Workers' Insurance Organisation (OAEE), the Farmers' Insurance Fund (OGA) and the Civil Servants' Sickness Insurance Fund (OPAD), was established and launched in autumn 2011. The aim is to improve healthcare services and rationalise the benefits provided (healthcare expenditure) and the contributions of the insured. Moreover, there has been considerable progress regarding the central procurement system for healthcare goods and services,[30] the profit rates of pharmacies have been reduced,[31] IKA and National Healthcare System (ESY) hospitals have been integrated and the on-line collection of data on hospital expenditure has improved.

During the same period, a new plan for reorganising ESY services was presented, which includes mergers and other forms of integration of hospitals, clinics and laboratories, personnel and departments.[32] Moreover, substantial savings resulted from the expansion of the electronic "auction" system for the purchase of medicines in all hospital units. Moreover, a list of prescription drugs was compiled and a reference price system per therapeutic class was introduced, in order to collect the rebate from pharmaceutical companies.[33] Electronic prescribing is progressing despite some delay and is currently used in several health centres, OAEE and OPAD, while OGA and IKA only use the system with freelance doctors issuing prescriptions to their insured patients. Lastly, significant economic benefits have been recorded in hospitals after the implementation of the unified financial management system (double-entry system, computerisation and compilation of balance sheets).

30 The Healthcare Services Coordinating Council (SYSPY) finalised 16 new draft contracts with healthcare providers. The contracts will apply to all social security funds and cover medical, hospital and laboratory services. The contracts include consistent terms, in accordance with the applicable laws, concerning the operation of medical units, determination of healthcare costs, pricing of medical care, medicines, therapeutic applications and prosthetics (items and highest prices).

31 In addition, as pointed out in an announcement of the Ministry of Health, further reductions in the prices of medicines have been observed as of end-May 2011, resulting from the decline in wholesale profits from 7.8% to 5.4%.

32 Specifically, the number of ESY directors and deputy directors is reduced to 144 (from 175). Directors alone are reduced to 77 (from 131). The new ESY structure provides for 82 major and 50 associated hospitals, around 36,000 beds (from around 47,000), 1,700 clinics and 800 laboratories. Eight hospitals associated with the major hospitals will have a different purpose, while 6 hospitals shall be placed under a scientific cooperation status.

33 Any positive difference from the reference price is refunded by pharmaceutical companies to the social security organisations, as long as the companies have previously declared that they agree to be included in the prescription drugs list and the established compensation scheme.

There has been some improvement in the recording and disclosure of the general government overdue debt, although the accumulation of new overdue debt has reached alarming levels and could affect progress towards achieving the general government deficit targets on a national accounts basis. Therefore, it is necessary to improve and tighten the control of expenditure and commitments taken up by all entities classified in the general government.[34]

After completing reforms in major social security funds in July 2010, forthcoming interventions focus on auxiliary social security funds[35] and the reform of the heavy and hazardous professions list, in order to secure the long-term sustainability of social security funds. Public administration is set to undergo significant interventions, such as extended hours of work, reform of the remuneration system, establishment of electronic communication between the public and the private sector, creation of a Single Public Contracts Authority (Law 4013/2011), while progress has been made towards electronic recording and digitisation of legislation (a measure that will benefit mainly the private sector).

In order to further enhance fiscal efforts, deal with revenue deviations of 1% of GDP (as identified in the discussions with the European Commission/ECB/IMF in the context of the fifth review of the Economic Adjustment Programme) and to ensure meeting the deficit targets for 2011, the government decided on 11 September 2011 to impose a new special levy on real estate for 2011 and 2012, which will be collected through electricity bills (the relevant provision was included in Law 4021/2011).

6 THE DRAFT BUDGET FOR 2012

According to the Draft Budget for 2012, which was submitted to Parliament on 3.10.2011, the general government deficit (on the basis of ESA 95) is projected to stand at €18,690 million, or 8.5% of GDP in 2011, against the MTFS target of €16,361 million, or 7.3% of GDP, and an Economic Adjustment Programme target of €17,065 million. Respectively, the general government primary deficit should stand at higher-than-expected levels, i.e. €2,390 million, or 1.1% of GDP, against a targeted €358 million, or 0.2% of GDP, in the MTFS.[36]

As regards 2012, the general government deficit (on the basis of ESA 95) is estimated at €14,658 million, or 6.8% of GDP, in 2012, i.e. significantly higher than the MRFS projections (€12.9 billion), but quite similar to the initial EAP target (€14.9 billion). In 2012, the primary surplus is projected to stand at €3.2 billion, or 1.5% of GDP, against a targeted €4.0 billion, or 1.8% of GDP, in the MTFS.[37]

In order to reach the targets for 2011 and 2012, additional measures have to be taken, amounting to €2.1 billion (4/5 from revenue) and €5 billion (around 3/5 from revenue, out of which €800 million from the increased EU participation in investment projects), respectively.[38] The measures for 2011 include a new special levy on electricity-supplied buildings, a new wage grid and lower pensions, while the measures for 2012 also involve: the abolition of tax exemptions, deferred payment of the

34 As has been noted by OECD, and repeatedly pointed out by the Bank of Greece, it would be wise to further enhance the government's commitment regarding fiscal consolidation and stability through the adoption of numerical fiscal rules on public expenditure.
35 Actuarial reviews on auxiliary social security funds are expected to be completed by autumn 2011. According to the implementation law (3986/2011), the gradual withholding of 3%-10% of auxiliary pensions of over €300 will start at the beginning of autumn 2011.
36 See footnote 25.
37 The general government debt is estimated to reach €356,520 million at end-2011 (163.7% of GDP) and €371,920 million in 2012 (172.7% of GDP), i.e. it will be 9.0% of GDP higher than in 2011.
38 According to the Draft Budget, the MTFS target for general government debt (€16,359 million or 7.5% of GDP) in 2011 cannot be achieved. Deviations are estimated at around 2% (€4.3 billion) and are due to: (1) the execution of the budget by a total of €3.4 billion, due to shortfalls in revenue (€3.1 billion of ordinary revenue and €0.6 billion of PIB revenue, while expenditure is €0.3 billion lower); the shortfall in revenue is attributed to the recession and increased tax refunds, and (2) lower financial results of the social security funds by €0.7 billion, due to a decline in contributions. Moreover, according to the Draft, without any corrective measures, the deviation from the MTFS target for a general government deficit of €12,871 million in 2012 is estimated to reach €8.7 billion, or 4.1% of GDP. The deviation is attributable to: (1) the deterioration in the state budget deficit by €7.9 billion (€7 billion involve revenue, of which €6.4 billion ordinary budget revenue and €0.6 billion the PIB, while €0.9 billion involve expenditure, mainly interest payments), (2) the improvement in the national accounts adjustments by €2 billion (improved cash/accrued interest difference) and (3) the deterioration in the results of social security funds by €2.3 billion.

special benefit to judges, implementation of the labour reserve scheme, increase in the EU contribution to co-financed schemes and excise duties on heating and diesel fuel.[39]

The upward revision of the general government deficit for 2011 reflects the current adverse developments. However, there is a risk of lower-than-expected revenue from the new levy on real estate, due to administrative hurdles and, perhaps, the lack of liquidity on the part of taxpayers. In addition, if recession exceeds 5.5%, there will be further deviation, which could have a carryover effect.

The targets for 2012 are now more realistic in respect to the MTFS, reflecting the fact that the recession is expected to continue throughout 2012, which will result in lower-than-expected revenue. The adjustment for 2012 (as against 2011) relies on improving the results of both the state budget and non-central government entities (particularly SOEs).

The 2012 macroeconomic scenario may still prove to be ambitious, as it projects a significant deceleration of the downward path of investment and consumption, while it provides for a substantial increase in exports, despite estimates that world economic activity will slow down. If the decline in GDP in 2012 is stronger than projected in the Draft, the target for a 3.1% increase in ordinary budget revenue (pre-tax refund) against 2011 may not be achieved. It is also worth mentioning that, out of the additional measures of €5.0 billion provided for in the 2012 Draft, €4.2 billion stems from additional taxes, wage and pension cuts, and the implementation of the labour reserve scheme. The achievement of the goals also depends crucially on restoring the efficiency of the tax collection mechanism, as well as on the efforts to combat tax evasion.

39 Law 4024/2011 ("Retirement regulations, unified wage grid for the public sector, labour reserve scheme and other measures for the implementation of the Medium-Term Fiscal Strategy Framework 2012-2015") elaborates on the new measures provided for in the Draft Budget for 2012.

V MONEY, CREDIT AND CAPITAL MARKETS

1 MONETARY AGGREGATES

In January-September 2011, M3[1] (excluding currency in circulation) continued to follow the downward trend observed since early 2010. The annual rate of change in M3 was strongly negative, although on average it was slightly lower compared with the second half of 2010 (2011 Q3: -11.2%, 2010 Q4: -11.8%, see Table V.1). Unlike developments in Greece, the euro area M3 increased during this period, mainly because of the recovery in economic activity and the rise in short-term bank deposit rates. The differential between the two rates of change widened slightly, reflecting inter alia the different economic conditions between Greece and the other euro area countries.[2]

Monetary developments in Greece during the period under review are largely attributed to the deepening of recession, uncertainty among investors and the deleveraging of households. The increase in enterprises' and households' tax obligations also accounts for the decline in M3. More specifically, the adverse macroeconomic environment was the key determinant of monetary developments. In particular, due to the significant decrease in disposable income, households used their deposits[3] in order to cover consumer expenditure. Similarly, enterprises made use of their deposits in order to finance their operating costs or meet financial obligations, because of their limited possibilities of self-financing or raising funds from external sources. This behaviour of the private sector seems to interpret monetary developments to a greater extent than in the same period of the previous year.[4] Respectively, the drop in deposits can be attributed —to a greater extent than in 2010— to the observed decline in household indebtedness, as it is reflected in the negative flow of MFI financing to households.[5] The slowdown of M3 growth in Greece is also attributed to the heightened uncertainty amongst savers, which contributed to the substitution of assets within M3 with assets outside M3 (mainly large-value banknotes, deposits or financial investment abroad, or gold sovereign coins). By contrast, it appears that developments in the opportunity cost of holding money did not contribute to the decline in M3. On the supply side, increased holdings of banknotes by individuals, combined with increased holdings of liquid assets by credit institutions, are estimated to have exerted downward pressures on this monetary aggregate through the decrease in the money multiplier.[6] **At the same time, it seems that deposit creation through the banking system has been limited due to the deceleration of credit expansion.**[7]

Individual M3 components followed the same path, although at a different pace, affected also by changes in interest rates. In particular, as the overnight deposit rate registered a slight increase over the period under review and the interest rate on deposits with an agreed maturity of up to two years increased substantially, overnight deposits declined at an increasing rate (2011 Q3: -13.7%, 2010 Q4: -8.0%, see Table V.1),[8] while time deposits[9] decreased at a lower rate (2011 Q3: -9.0%, 2010 Q4: -13.8%, see Table V.1). Turning to other M3 components, holdings of repurchase agreements and

1 This aggregate, which constitutes the Greek contribution to the euro area M3, comprises overnight deposits, time deposits with an agreed maturity of up to 2 years and deposits reedemable at notice of up to 3 months, repurchase agreements, money market fund shares/units and debt securities issued by MFIs with a maturity of up to 2 years. It should be noted that, for the estimation of M3 in Greece, currency in circulation (M0) is not taken into account as, since January 2002, when euro banknotes were launched in replacement of national banknotes, currency in circulation can be estimated only for the euro area as a whole and not for each separate country.
2 This applies to both M3 and the more directly comparable M3 excluding currency in circulation.
3 Deposits included in M3 (excluding currency in circulation) account for almost the entire monetary aggregate in Greece (September 2011: 99.6%).
4 See Bank of Greece, *Annual Report 2010*, April 2011, section X.1.
5 During the 9-month period January-September 2011, the net flow of MFI credit to households stood at -€3,969 million, against -€882 million in the respective 2010 period. More information on bank credit to households can be found in section 3 below.
6 It is estimated that the money multiplier declined by almost 50% in the first half of this year compared with two years earlier. It should be noted that a lower money multiplier was also observed in the euro area during the financial crisis (see ECB, Working Paper No. 1290, "Non-standard monetary policy measures and monetary developments", p.11).
7 It is known that credit expansion, irrespective of its sources of financing, is in various ways linked with an increase in deposits.
8 In the January-September 2011 period, this category of deposits recorded a net outflow of €13.4 billion (January-September 2010: -€10.3 billion).
9 By €11.6 billion (January-September 2010: -€14.5 billion).

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

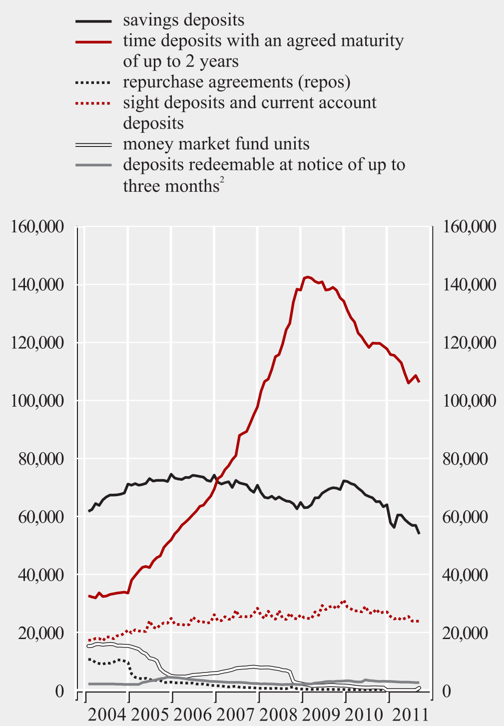
(non-seasonally adjusted data)

	Outstanding balances on 31.12.2010 (million euro)	Annual percentage changes[1]												
		2006	2007	2008	2009	2010					2011			
		Q4[2]	Q4[2]	Q4[2]	Q4[2]	Q1[2]	Q2[2]	Q3[2]	Q4[2]	Dec.[3]	Q1[2]	Q2[2]	Q3[2]	Sept.[3]
1. Overnight deposits	77,476	0.7	-0.9	-7.0	11.4	13.4	4.2	-4.1	-8.0	-11.9	-11.6	-12.6	-13.7	-16.4
1.1 Sight deposits and current account deposits	23,745	1.8	10.3	-3.6	15.7	14.4	3.7	-4.7	-7.6	-13.1	-8.4	-7.1	-9.1	-14.9
1.2 Savings deposits	53,731	0.2	-4.6	-7.9	9.5	12.8	4.5	-3.7	-8.1	-11.4	-13.1	-15.3	-16.0	-17.2
2. Time deposits with an agreed maturity of up to 2 years	106,050	37.5	42.2	39.1	2.7	-7.0	-13.5	-15.0	-13.8	-12.8	-11.2	-8.6	-9.0	-11.2
3. Deposits redeemable at notice of up to 3 months[4]	2,623	-24.4	-20.3	-24.2	64.2	56.9	14.9	5.3	-7.0	-9.6	-8.2	0.0	-15.0	-15.1
4. Total deposits (1+2+3)	**186,149**	**12.1**	**15.9**	**15.3**	**6.6**	**1.4**	**-6.2**	**-10.3**	**-11.3**	**-12.4**	**-11.3**	**-10.3**	**-11.1**	**-13.5**
5. Repurchase agreements	78	-35.7	-54.3	-11.4	-67.1	-39.6	-51.4	-50.1	-48.9	-54.3	-43.9	-27.5	-36.0	-29.0
6. Money market fund shares/units	752	-2.5	40.5	-58.8	-44.8	-27.7	-33.8	-46.3	-45.8	-39.2	-29.3	-7.0	-11.8	-19.6
7. Debt securities issued with a maturity of up to 2 years[5]	2	24.2	-	-	-	-	-	-	-	-	-	-	-	-
8. M3 excluding currency in circulation (4+5+6+7)	**186,981**	**10.6**	**14.7**	**14.4**	**4.8**	**0.3**	**-7.2**	**-11.1**	**-11.8**	**-12.5**	**-11.4**	**-10.2**	**-11.2**	**-13.6**

Sources: Bank of Greece and ECB.
1 Annual rates of change in the corresponding index, which is compiled on the basis of outstanding stocks for December 2001 and cumulative monthly flows, adjusted for exchange rate variations, reclassifications, etc.
2 The quarterly average is derived from monthly averages (which are calculated as arithmetic means of two successive end-of-month figures) and is not the three-month average of end-of-month annual growth rates (see the Technical notes in the "Euro area statistics" section of the ECB *Monthly Bulletin*).
3 Based on end-of-month levels.
4 Including savings deposits in currencies other than the euro.
5 This aggregate is calculated on a consolidated basis with the other euro area countries and thus does not include domestic MFIs' holdings of debt securities with a maturity of up to two years issued by euro area MFIs.

Chart V.1 Deposits, repurchase agreements and money market fund units in Greece[1] (January 2004 - September 2011)

(end-of-period balances; million euro)



Source: Bank of Greece.
1 These aggregates are included in M3 according to the ECB definition and therefore constitute the Greek contribution to the corresponding euro area aggregates.
2 Including savings deposits in currencies other than the euro.

money market fund shares/units decreased further over the reviewed period (see Table V.1 and Chart V.1).

The observed decrease in the main M3 components is consistent with developments in deposits by individual sector.[10] **Total deposits of the domestic private sector with domestic credit institutions declined considerably over the reviewed period and their annual rate of change stood at -11.6% in the third quarter (2010 Q4: -11.2%).**[11] **It is estimated that almost 1/5 of the total outflow was remitted to credit institutions abroad,**[12] **while a significant part is explained by the substitution of large-value banknotes for deposits.**[13] The fact that part of the decline in deposits with domestic MFIs is still attributed to their substitution with other assets due to increased uncertainty confirms the estimation that the rate of decline in M3 was higher than expected on the basis of the usual determinants of demand for money, i.e. income and the opportunity cost of holding money. Over the next months, the economic downturn is expected to keep on having a considerable negative effect on M3, also considering the time lag with which it is manifested.[14] By contrast, the uncertainty of depositors due to the sovereign debt crisis has direct effects on M3. So, particular importance is attached to the implementation of the decisions of the Euro Summit of 26 October, as it is expected to limit uncertainty and, consequently, contain the decline in M3. This positive development might not be fully reflected on the monetary aggregate before the adjustment of the banking system to increased capital adequacy requirements.

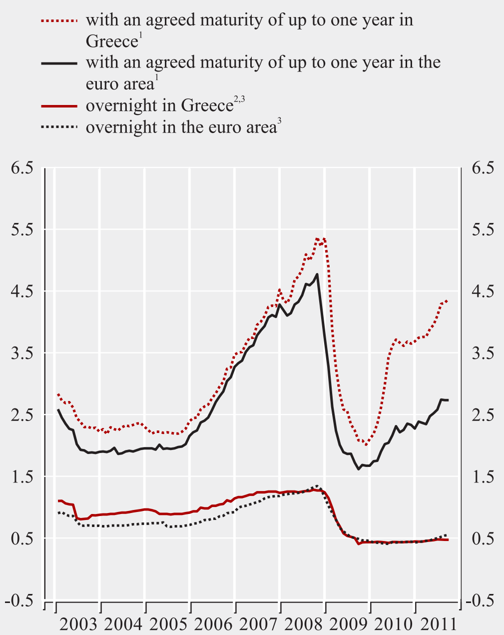
2 BANK DEPOSIT RATES

In January-September 2011, interest rates on new deposits with an agreed maturity recorded a marked increase, while interest rates on overnight deposits rose moderately (see Table V.2A and Chart V.2). As a result, the average deposit rate came to 2.55% in September 2011 against 2.15% in December 2010, i.e. it exceeded the average deposit rate in the euro area by 103 basis points. Moreover, in the major category, i.e. deposits by households with an agreed maturity of up to one year, the interest rate has been the highest in the euro

10 It should be noted that deposits by non-financial corporations had started their downward course since the beginning of 2009, almost one year earlier than deposits by households. This is consistent with the evolution of the business cycle and the fact that households' disposable income presents, as a rule, less fluctuations over the business cycle compared with firms' cash flows.
11 It should be noted that this figure includes all deposits by the private sector regardless of maturity and not deposits with an agreed maturity of up to two years, which are included in M3. In September 2011, private sector deposits included in M3 accounted for 98.2% of all private sector deposits.
12 The respective amount during the corresponding period of 2010 is estimated at over 30%.
13 It is estimated that the bulk was held for hoarding purposes, given the income elasticity of demand for currency and the negative rate of change in nominal GDP, together with the limited use of large-value banknotes for transaction purposes.
14 See Bank of Greece, *Annual Report 2010*, April 2011, Chapter X, footnote 10.

Chart V.2 Bank interest rates on new deposits by households in Greece and the euro area (January 2003 - September 2011)

(percentages per annum)



Sources: Bank of Greece and ECB.
1 Monthly average rate.
2 Interest rate on savings deposits (these deposits form the bulk of overnight deposits and their interest rate is almost identical to the overnight rate).
3 End-of-month rate.

area since June 2011 (see Table V.2B). The evolution of deposit rates in Greece is consistent with the rise in the key ECB monetary policy rate[15] and the deterioration of liquidity conditions of Greek banks.[16] The future course of interest rates is closely related to the evolution of Greek banks' liquidity, which is expected to improve with the implementation of the decisions taken on 26 October and the subsequent restoration of confidence in the banking system.

Real overnight deposit rates remained negative throughout the period under review (January-September 2011: -3.07%),[17] although on average they were lower compared with the

15 In January-September 2011, the interest rate on deposits with an agreed maturity of up to one year by households rose by 69 basis points, while the interest rate on ECB's main refinancing operations and the three-month Euribor rose by 50 and 52 basis points respectively. It should be reminded that the speed and the degree of the pass-through of changes in money market rates to bank deposit rates differ across deposit categories. According to a relevant ECB survey, the pass-through of changes in money market rates is stronger for time deposit rates and weaker for overnight deposit rates. See Box 1: "Results of the pass-through to euro area retail bank interest rates using an error correction modelling approach", ECB, *Monthly Bulletin*, August 2009.
16 For more details, see Section 7 below.
17 The figures refer to the average real interest rate of this period, which is calculated as the period's average nominal rate less the average inflation rate over the same period.

Table V.2A Bank interest rates on new deposits by households in the euro area and Greece

(percentages per annum)

	December 2010	September 2011	Change Dec. 2010/ Sept. 2011 (percentage points)
Overnight[1]			
Weighted average interest rate in the euro area	0.43	0.55	0.12
Maximum interest rate	1.10	1.11	0.01
Minimum interest rate	0.07	0.09	0.02
Interest rate in Greece	0.44	0.47	0.03
Interest rate differential between Greece and the euro area	0.01	-0.08	-0.09
With an agreed maturity of up to one year[2]			
Weighted average interest rate in the euro area	2.27	2.73	0.46
Maximum interest rate	3.98	4.37	0.39
Minimum interest rate	0.75	1.05	0.30
Interest rate in Greece	3.68	4.37	0.69
Interest rate differential between Greece and the euro area	1.41	1.64	0.23

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

Table VI.2B Bank interest rates on new deposits by households in euro area countries[1]

(percentages per annum)

	Overnight[2]		With an agreed maturity of up to 1 year[3]	
	December 2010	September 2011	December 2010	September 2011
Austria	0.57	0.80	1.22	1.80
Belgium	0.34	0.43	0.75	1.27
Cyprus	1.10	1.11	3.98	4.14
Estonia	0.12	0.12	1.19	1.44
Finland	0.43	0.47	1.68	2.14
France	0.08	0.09	1.87	2.21
Germany	0.71	0.91	1.06	1.53
Greece	**0.44**	**0.47**	**3.68**	**4.37**
Ireland	0.62	0.65	1.84[4]	2.32[4]
Italy	0.28	0.41	1.40	2.55
Luxembourg	0.71	0.94	0.80	1.05
Malta	0.28	0.30	1.96	1.87
Netherlands	0.43	0.54	2.49	2.82
Portugal	0.07	0.09	2.56	4.05
Slovakia	0.37	0.39	1.97	1.78
Slovenia	0.20	0.24	1.94	2.17
Spain	0.27	0.30	2.68	2.74

Sources: ECB and euro area NCBs.
1 Despite the efforts to harmonise statistical methodologies across the euro area, considerable heterogeneity remains in the classification of banking products, which is partly due to differences in national conventions and practices as well as in regulatory and fiscal arrangements.
2 End-of-month rate.
3 Monthly average rate.
4 The interest rate applies to all time deposits irrespective of maturity. The latest available data refer to August 2011.

same period of the previous year (January-September 2010: -4.14%).[18] Interest rates on all time deposit categories have been in positive territory since May 2011 (January-September 2011: 0.49%, January-September 2010: -1.45%). In fact, real interest rates on overnight deposits rose significantly over the year, due to the high nominal yields offered by credit institutions in this category of deposits and lower inflation, especially since June, thus coming at 1.31% in September (December 2010: -1.49%), i.e. much higher than their average (-0.13%) in the January 2003-August 2011 period.

In the euro area, deposit rates registered an increase across all categories, although it was slightly weaker compared with that of the corresponding rates in Greece. So, the average deposit rate differential between Greece and the euro area widened to 103 basis points in September 2011 (December 2010: 89 basis points). In the major category —deposits by households with an agreed maturity of up to one year— the differential rose further, reaching 164 basis points in September 2011 (December 2010: 141 basis points, December 2009: 43 basis points). This was the highest value in the past eight years.

3 CREDIT TO THE ECONOMY

The annual growth rate of the outstanding amount of total credit to the economy by

18 In September 2011, the real rate on overnight deposits was -2.58% (December 2010: -4.73%).

domestic MFIs[19] decelerated over the January-August 2011 period and turned negative in September 2011 (see Chart V.3 and Table V.3). This development came as a result, on the one hand, of the rate of credit expansion to general government that recorded a marked deceleration to 3.7% in September 2011 (December 2010: 28.3%)[20] and, on the other, of the annual rate of change in credit to the domestic private sector which was negative (-2.2%) in September 2011 (December 2010: 0.0%). The downward course of credit to the private sector (see Chart V.4) reflects the deceleration of the rate of change in credit to enterprises (which turned negative), as well as the increase in the negative rate of change in credit to individuals and private non-profit institutions, as well as to sole proprietors.[21] A deterioration was also seen in the net monthly flows of credit to the economy, the sum of which was negative (-€5.4 billion) in January-September 2011, owing to negative net flows of credit to general government (-€0.8 billion) and the private sector (-€4.6 billion).

The further worsening of **financing conditions of the domestic private sector is directly related to adverse developments in the key factors affecting loan supply and demand, which resulted from the great depth of the recession and the negative financial market sentiment**. The factors that strongly affected the supply side were: restrictions on banks' access to funding, heightened uncertainty surrounding economic prospects and the increase in non-performing loans. Pressures on banks' liquidity and their increased reliance on financing by the Eurosystem called for a reduction in the size of their balance sheets, partially by limiting new loans to the private sector. According to the Bank Lending Survey (April, July and October 2011) for the first three quarters of 2011, banks continued to apply stricter credit standards.[22] **However, it should be stressed that, despite pressures, the containment of the supply of credit by banks has moderated thanks to the ongoing implementation of non-standard measures by the ECB.** On the demand side, weakened economic activity adversely affected the financial position of households and enterprises, thus limiting their ability to undertake additional debt obligations. These constraints, together with the lower demand for loans from households and enterprises, have been recorded in the results of the Bank Lending Survey for the first three quarters of 2011.[23]

The ratio of the outstanding balance of credit to the non-financial private sector to GDP, according to financial accounts data, rose in March 2011, compared with December 2010, despite negative credit developments, due to the decrease in GDP (individuals and private non-profit institutions, sole proprietors: June 2011: 62.5%, December 2010: 60.7%, enterprises: June 2011: 66.3%, December 2010: 64.6%, see Chart V.5).

Financing to individuals and private non-profit institutions made the greatest contribution to

19 The outstanding balance of bank credit to general government and the domestic private sector is calculated as the sum of outstanding loans to general government and the domestic private sector, banks' holdings of Greek government debt securities and corporate bonds, plus the outstanding securitised loans and corporate bonds. The rate of change in credit is calculated on the basis of the difference between the outstanding amounts of bank credit on the two dates defining the reference period. Banks' write-offs/write-downs over the reference period are then added to this difference, which is adjusted for changes in the value of Greek government bonds (incorporated in the outstanding amount of credit to general government), as well as for foreign exchange valuation differences in respect of loans denominated in foreign currency, in order to obtain the net flow of total credit. In calculating credit expansion, net transfers of loans to affiliated banks or branches of credit institutions abroad are not taken into account. Although these transactions lead to changes in the outstanding amounts of credit, they are not taken into account in the net flow nor in the annual rate of change, as they do not actually affect the flow of credit to the domestic private sector.

20 The deceleration in the growth rate of credit to general government reflects the fact that the rate of change in the outstanding amounts of Greek government securities held by MFIs (other than the Bank of Greece) in their portfolios turned negative (-0.5%) in September 2011. The value of this portfolio was €44.9 billion in September 2011, thus showing an increase of just 39 million from January to September 2011.

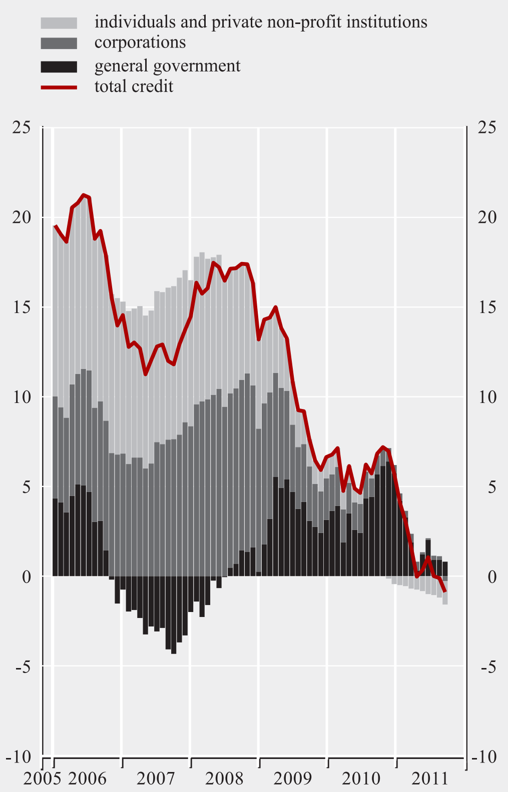
21 As of June 2010, loans to sole proprietors form a separate category and are not included in loans to enterprises.

22 The Bank Lending Survey is conducted by the Bank of Greece on a quarterly basis as part of a Eurosystem-wide survey. According to the latest Survey (October 2011), in the third quarter of 2011, banks introduced stricter credit standards for lending to enterprises, same as in previous quarters. Turning to households, banks applied stricter credit standards in the third quarter, especially for housing loans (they had already tightened their credit standards for consumer loans significantly in 2009-2010).

23 According to the October 2011 Survey, in the third quarter of 2011, demand for credit on the part of enterprises decreased, as in the previous quarter. As far as households are concerned, in this quarter the demand for loans – both consumer and housing – continued to decrease to a larger extent than in the previous ones.

Chart V.3 Total credit to the economy by domestic MFIs and its sectoral breakdown (December 2005 - September 2011)

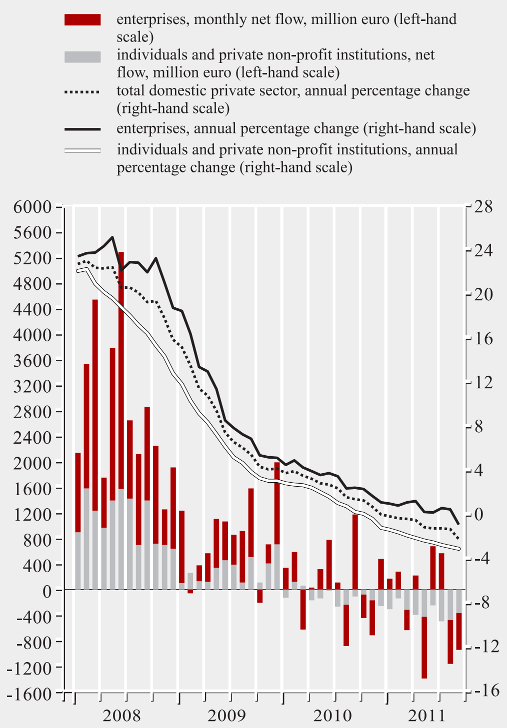
(annual percentage changes; shares in percentage points)



Source: Bank of Greece.
Note: Comprising outstanding MFI loans to the domestic private sector and general government, MFI holdings of government securities and corporate bonds and outstanding securitised loans and securitised corporate bonds. The rates of change are adjusted for exchange rate variations and write-offs carried out by banks during the reference period.

Chart V.4 Credit[1] to the domestic private sector by domestic MFIs (January 2008-September 2011)

(monthly flows[2]; annual percentage changes)



Source: Bank of Greece.
1 Comprising outstanding MFI loans, MFI holdings of corporate bonds and the outstanding amounts of securitised loans and securitised corporate bonds. The annual rates of change are adjusted for loan write-offs and valuation differences arising when loans denominated in foreign currency are valued in euro.
2 Net montlhy flows of credit are calculated as month-on-month changes in stocks of credit, adding loan write-offs and adjusting for exchange rate variations.

the reduction of credit to the private sector in January-September 2011.[24] In particular, the rate of **credit expansion to enterprises** decelerated and turned negative, standing at -0.9% (December 2010: 1.1%).[25] This deceleration, in addition to the abovementioned factors of supply and demand, is also attributable: (a) on the supply side, to the fact that banks incorporate in their credit standards an impairment of collateral risk, and (b) on the demand side, to the lack or postponement of investment plans.[26] Banks have cut down credit by reducing credit lines and new loans and further increased interest rates on both new and existing loans,[27] as well as the ratio of loan coverage with collateral. It should be reminded that a change in GDP has a lagged effect on the rate of change in credit to enterprises in Greece (as well as in the euro area as a whole). This empirical finding, combined with the

24 More specifically, financing of individuals and private non-profit institutions recorded a negative flow (-€3,202 million) in the 9-month period under review, which already exceeds (in absolute terms) the annual flow registered in 2010 (-€1,429 million). Financing of enterprises (see Table V.4 and Chart V.4) recorded a negative flow (-€663 million) during the same period.
25 A deterioration was also observed in the flows of credit to enterprises, as in the third quarter of 2011 a negative net flow of credit (-€711 million) was recorded, compared to a smaller negative flow in the second quarter of the year (-€80 million).
26 According to the Bank Lending Survey (October 2011), banks report that loan restructuring continues to exert an upward effect on demand.
27 This development refers to existing loans with a floating rate.

Table V.3 Total credit[1] to the economy by domestic MFIs

(annual percentage changes, non-seasonally adjusted data)

	2007	2008	2009	2010		2011					
	Q4[2]	Q4[2]	Q4[2]	Q4[2]	December[3]	Q1[2]	Q2[2]	Q3[2]	July[3]	August[3]	September[3]
1. Total credit by MFIs	13.3	16.3	6.5	6.8	5.7	3.6	0.5	0.0	0.0	-0.1	-0.9
2. Credit to general government	-14.6	7.3	17.2	32.7	28.3	17.9	5.2	4.9	4.0	4.0	3.7
3. Credit to the private sector	21.7	18.3	4.5	0.9	0.0	-0.2	-0.8	-1.4	-1.2	-1.3	-2.2
3.1 Enterprises[4]	20.3	21.8	5.5	2.0	1.1	1.0	0.7	0.3	0.6	0.5	-0.9
3.2 Sole proprietors[4]	-	-	-	1.4	0.3	0.1	-2.2	-4.1	-4.0	-4.0	-5.1
3.3 Individuals and private non-profit institutions	23.3	14.6	3.3	-0.3	-1.2	-1.5	-2.2	-2.8	-2.7	-2.9	-3.1
of which:											
3.3.1 Housing loans	22.9	13.1	3.9	0.5	-0.3	-0.8	-1.5	-2.0	-2.1	-2.1	-2.1
3.3.2 Consumer loans	22.6	18.4	2.4	-2.8	-4.2	-4.2	-5.0	-6.2	-5.9	-6.6	-6.5

Source: Bank of Greece.
1 Including MFI loans and holdings of corporate bonds and government securities, as well as securitised bank loans and corporate bonds. The rates of change are adjusted for loan write-offs/write-downs and foreign exchange valuation differences in respect of loans denominated in foreign currencies, as well as valuation changes in government securities. It should be noted that the rate of change in corporate credit is not adjusted for net transfers of loans and bonds by MFIs to subsidiaries or branches abroad. In February and March 2010, one bank repurchased part of these bonds (€686 million) and although this transaction led to an increase in the outstanding amount of credit, it was not included in the net flow of credit in February and is not reflected in its annual rate of change.
2 The quarterly average is derived from monthly averages (which are calculated as arithmetic means of two successive end-of-month figures) and is not the three-month average of end-of-month annual growth rates (see the Technical notes in the "Euro area statistics" section of the ECB Monthly Bulletin).
3 Based on end-of-month levels.
4 Since June 2010, loans to sole proprietors are presented separately and are no longer included in credit to enterprises.

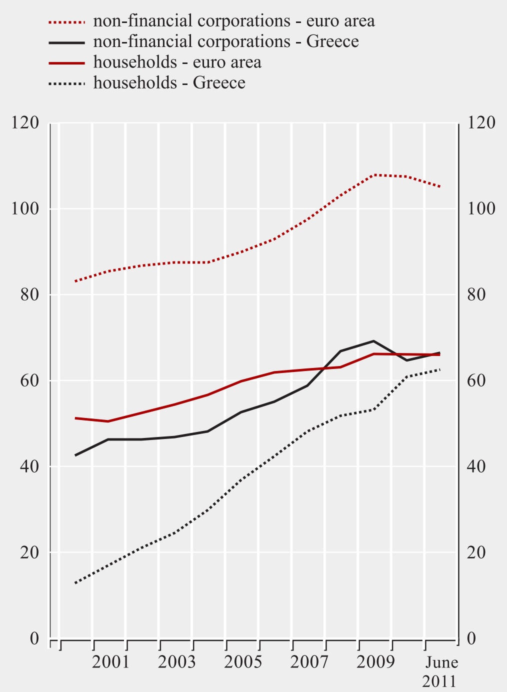
above factors and the now negative rate of change in credit, suggests that the negative rates of change in credit to enterprises will be maintained. Credit to the major sectors of economic activity, mainly industry and trade, has already registered negative rates of change and negative or very small positive flows in the period under review (see Table V.4).

The annual rate of change in **credit to individuals and private non-profit institutions** stood at -3.1% in September 2011 (December 2010: -1.2%). The negative rate of change rose considerably in the case of consumer loans and to a lesser extent in the case of housing loans. **Credit to sole proprietors** presented a negative annual rate of change in March 2011, which became stronger and reached -5.1% in September 2011 (December 2010: 0.3%). The Bank Lending Survey (October 2011) reveals that an additional important factor impeding the granting of housing and consumer loans, through the adoption of tighter credit terms and standards (such as increased interest rates), is the lower solvency of borrowing households. The already increased ratio of non-performing loans (to total loans) and extensive loan restructuring by banks, in order to facilitate households to meet their debt obligations, support banks' negative estimates. At the same time, demand for consumer and housing loans continues to drop, due to low consumer confidence, reduced expenditure for consumer durables and a wait-and-see stance on the part of households as regards a potential correction in real estate prices. Therefore the negative flow of housing and consumer loans worsened in recent months.

The evolution of MFI credit to the domestic private sector until the end of the year and in 2012 will largely depend —as well as other key economic aggregates— on the improvement of the macroeconomic environment through the successful implementation of the Medium-term Fiscal Strategy Framework 2012-2015 and of the decisions taken at the Summit of 26 October, so as to create more favourable prospects. The improvement of these factors is expected to ease exogenous pressures exerted on banks' liquidity levels; thus, it will be possible to revert the outflows of deposits caused by the uncertainty of households and enterprises, to limit the impairment of collateral offered by banks, so that they can continue to raise liquidity from the Eurosystem and, on the medium term, to recourse to borrowing from money and capital markets. Given these pressures, the prospect of a phasing-out of ECB's non-standard measures, banks' increased capital requirements (see also Section 7 below), and their participation in the Private Sector Involvement (PSI), national supervisory

Chart V.5 Debt of households[1] and non-financial corporations[2] in the euro area and Greece (2000-June 2011[3])

(percentages of GDP)



Sources: Bank of Greece and ECB (outstanding debt), Eurostat and ELSTAT (GDP). GDP figures for 2011, Bank of Greece forecast.
1 Household debt comprises the overall stock of household loans and securitised loans. Debt data are derived from the financial accounts of the household sector, which record the sector's total financial assets and liabilities.
2 The debt of non-financial corporations comprises loans, debt securities issued and pension fund reserves.
3 Since June 2010 financing to the self-employed has been included in households and not in non-financial enterprises. This change increases the outstanding debt of households and reduces the outstanding debt of non-financial corporations compared with December 2009.

Table V.4 Credit[1] to the domestic private sector by domestic MFIs

(annual percentage changes, non-seasonally adjusted data)

	Outstanding balances on 30.09.11 (million euro)	2007	2008	2009	2010		2011					
		Q4[2]	Q4[2]	Q4[2]	Q4[2]	December[3]	Q1[2]	Q2[2]	Q3[2]	July[3]	August[3]	September[3]
A. Enterprises [4,5]	**122,680**	**20.3**	**21.8**	**5.5**	**2.0**	**1.1**	**1.0**	**0.7**	**0.3**	**0.6**	**0.5**	**-0.9**
1. Trade	25,678	17.9	22.2	5.0	-2.1	-3.5	-3.4	-3.1	-5.0	-4.5	-5.9	-5.3
2. Industry[6]	23,907	11.0	17.4	-2.8	-1.3	-2.0	-1.2	-0.7	1.0	2.1	1.8	0.5
3. Shipping	18,306	25.7	24.6	3.9	6.9	4.2	6.5	4.6	0.3	-0.2	0.7	1.2
4. Contruction	11,131	28.6	37.4	2.2	2.3	1.9	0.2	-0.3	0.0	1.2	0.1	-2.1
5. Tourism	7,282	21.1	24.4	6.4	4.0	2.9	1.1	-0.2	0.1	0.8	-0.3	-0.8
6. Other financial institutions (non-MFI)	6,922	14.6	-2.4	7.4	4.2	8.2	4.0	-2.1	3.1	-2.6	8.4	-4.7
7. Electricity - gas - water supply	5,734	40.2	36.5	14.8	23.1	21.6	19.0	18.3	18.8	22.8	18.2	11.1
8. Agriculture	2,024	10.8	20.5	3.7	0.6	1.1	-0.7	-0.2	-2.9	-2.0	-3.4	-4.2
9. Transport - excluding shipping	1,966	39.6	35.7	19.5	-3.8	-9.2	-10.2	-10.8	-12.9	-17.3	-10.8	-11.9
10. Other sectors	19,730	27.4	23.8	12.3	5.0	4.1	4.5	5.0	2.8	3.5	2.8	1.4
B. Sole proprietors [5]	**15,713**	**-**	**-**	**-**	**1.4**	**0.3**	**0.1**	**-2.2**	**-4.1**	**-4.0**	**-4.0**	**-5.1**
C. Individuals and private non-profit institutions	**114,554**	**23.3**	**14.6**	**3.3**	**-0.3**	**-1.2**	**-1.5**	**-2.2**	**-2.8**	**-2.7**	**-2.9**	**-3.1**
1. Housing loans	79,170	22.9	13.1	3.9	0.5	-0.3	-0.8	-1.5	-2.0	-2.1	-2.1	-2.1
2. Consumer loans	33,680	22.6	18.4	2.4	-2.8	-4.2	-4.2	-5.0	-6.2	-5.9	-6.6	-6.5
- Credit cards	7,551	6.3	12.4	-0.4	-4.6	-5.4	-5.8	-7.0	-9.4	-9.1	-9.9	-9.4
- Other consumer loans[7]	26,129	30.9	20.9	3.5	-2.2	-3.7	-3.6	-4.4	-5.2	-4.9	-5.5	-5.6
3. Other loans	1,704	42.2	7.5	-2.3	9.6	10.7	12.1	14.7	23.7	25.9	26.7	15.0
TOTAL	**252,947**	**21.7**	**18.3**	**4.5**	**0.9**	**0.0**	**-0.2**	**-0.8**	**-1.4**	**-1.2**	**-1.3**	**-2.2**

Source: Bank of Greece.

1 Including MFI loans and holdings of corporate bonds, as well as the outstanding amounts of securitised loans and corporate bonds. The rates of change are adjusted for loan write-offs/write-downs and exchange valuation differences in respect of loans denominated in foreign currency. It should be noted that the rate of change in corporate credit is not adjusted for net transfers of loans and bonds by MFIs to subsidiaries or branches abroad. In February and March 2010, one bank repurchased part of these bonds (€686 million) and although this transaction led to an increase in the outstanding amount of credit, it was not included in the net flow of credit in February and is not reflected in its annual rate of change.

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

3 Based on end-of-month levels.

4 Sectors are listed in descending order of their share in total credit, with the exception of "other sectors". Growth rates are adjusted for loan write-offs/write-downs.

5 As of June 2010, loans to sole proprietors are presented separately and are no longer included in “credit to enterprises”.

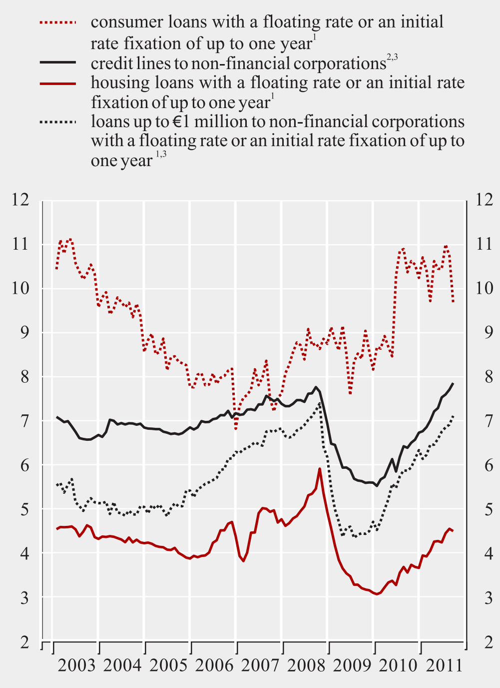
6 Comprising manufacturing and mining/quarrying.

7 Comprising personal loans and loans against supporting documents.

authorities are called upon (in line with the decisions of the Summit) to ensure that banks' efforts to increase their capital will not lead to extensive deleveraging, thus reducing the adverse impact on the flow of credit to real economy. Additionally, in the context of the measures aimed at restoring confidence in the EU banking sector, it has been agreed to provide more direct support to banks for their access to medium- and long-term funding through the provision of collateral.[28] In any case, it is estimated that negative flows and negative annual rates of change in credit will persist in 2012 as well. Based on estimates from the Bank Lending Survey, banks are expected to apply tighter credit standards over the following months, on account of their increased risk aversion. Also, credit to enterprises will depend on the increase in the flow of EU funds through programmes under the National Strategic Reference Framework (NSRF)[29] and the improvement of investment prospects. Finally, a positive contribution to the financing of SMEs will come from European Investment Bank loans granted on favourable terms through Greek banks and guaranteed by the Greek state.

Chart V.6 Bank interest rates on new loans in Greece (January 2003 - September 2011)

(percentages per annum)



Source: Bank of Greece.
1 Monthly average rate.
2 End-of-month rate.
3 See footnote 2 in Table V.5A.

4 BANK LENDING RATES, INTEREST RATE SPREAD AND SPREAD DIFFERENTIALS BETWEEN GREECE AND THE EURO AREA

Interest rates on new bank loans in Greece continued to rise during the first nine months of 2011 across all loan categories (see Table V.5A and Chart V.6), in line with the increase in key ECB rates and interbank rates. Among the major loan categories, the most significant increases were recorded in consumer loans with a maturity of one and up to five years.

The rise in short-term lending rates in Greece was generally greater than that of the ECB key policy rate and of interbank rates,[30] which implies, inter alia, a higher risk premium because of higher credit risk.[31] Over the period under review, the increase in medium- and long-term bank rates was considerably lower than the rise in government bond yields. This reveals that the financing from the Eurosystem weighed more on banks' pricing policy than developments in the bond market, which highlights the favourable effect of the non-standard monetary policy measures of the ECB on the borrowing cost of the private sector in Greece.

28 See also Section 7 below.
29 Among the decisions taken in the Euro Summit of 21 July, a strategy was formulated to boost and expedite the absorption of EU funds. More specifically, it was decided to lower the national share in co-financed programmes under the NSRF and to provide technical assistance through a task force that will be established by the European Commission.
30 The usual analytical approach of the ECB relates movements of short-term bank rates with the evolution of the 3-month Euribor and those of the medium- and long-term bank rates with the evolution of government bond yields. In the case of lending rates, floating rates or rates adjustable over a period of up to one year are considered to be short-term rates. By contrast, rates of over a year are deemed long-term rates.
31 The increased ratio of non-performing loans to the total loan portfolio of banks observed across loan categories in the first half of 2011 is indicative of the higher credit risk (see also Section 7 below).

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

(percentages per annum)

	December 2010	September 2011	Change Dec. 2010/ Sept. 2011 (percentage points)
A. Loans with a floating rate or an initial rate fixation of up to one year[1]			
A.1. Loans up to €1 million to non-financial corporations			
Weighted average interest rate in the euro area	3.50	4.18	0.68
Maximum interest rate	6.64	7.24	0.60
Minimum interest rate	2.55	2.73	0.18
Interest rate in Greece[2]	6.34	7.12	0.78
Interest rate differential between Greece and the euro area	2.84	2.94	0.10
A.2. Loans of more than €1 million to non-financial corporations			
Weighted average interest rate in the euro area	2.59	2.92	0.33
Maximum interest rate	6.18	6.07	-0.11
Minimum interest rate	1.95	2.31	0.36
Interest rate in Greece	4.98	6.04	1.06
Interest rate differential between Greece and the euro area	2.39	3.12	0.73
A.3. Housing loans			
Weighted average interest rate in the euro area	2.78	3.41	0.63
Maximum interest rate	5.16	5.61	0.45
Minimum interest rate	1.88	2.29	0.41
Interest rate in Greece	3.65	4.49	0.84
Interest rate differential between Greece and the euro area	0.87	1.08	0.21
A.4. Consumer loans			
Weighted average interest rate in the euro area	5.16	5.74	0.58
Maximum interest rate	18.99	17.66	-1.33
Minimum interest rate	3.16	3.60	0.44
Interest rate in Greece	10.27	9.70	-0.57
Interest rate differential between Greece and the euro area	5.11	3.96	-1.15
B. Loans with an initial rate fixation of over one and up to 5 years[1]			
B.1. Housing loans			
Weighted average interest rate in the euro area	3.52	3.86	0.34
Maximum interest rate	5.46	5.31	-0.15
Minimum interest rate	2.38	2.68	0.30
Interest rate in Greece	3.95	4.26	0.31
Interest rate differential between Greece and the euro area	0.43	0.40	-0.03
B.1. Consumer loans			
Weighted average interest rate in the euro area	5.95	6.57	0.62
Maximum interest rate	29.23	21.54	-7.69
Minimum interest rate	4.56	4.32	-0.24
Interest rate in Greece	8.21	10.54	2.33
Interest rate differential between Greece and the euro area	2.26	3.97	1.71

Sources: ECB and euro area national central banks.
1 Monthly average rates.
2 As of June 2010, loans to sole proprietors are presented separately and are no longer included in credit to enterprises.

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

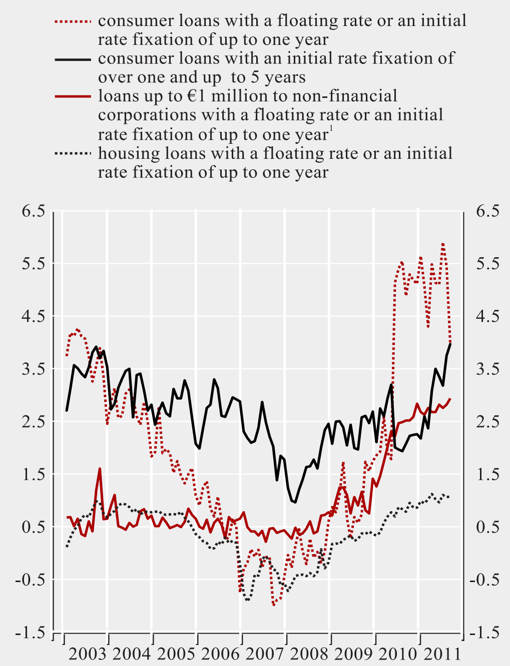
(percentages per annum)

	New loans with a floating rate or an initial rate fixation of up to one year[2]								New loans with an initial rate fixation of over one and up to five years[2]	
	To non-financial corporations									
	Loans up to €1 million		Loans over €1 million		Housing loans		Consumer loans		Consumer loans	
	Dec. 2010	Sept. 2011	Dec. 2010	Sept. 2011	Dec. 2010	Sept. 2011	Dec. 2010	Sept. 2011	Dec. 2010	Sept. 2011
Austria	2.55	3.01	2.20	2.61	2.75	2.98	4.95	5.10	4.88	4.32
Belgium	2.63	3.00	1.95	2.34	3.12	3.77	5.27	6.03	5.90	6.24
Cyprus	6.64	7.04	6.18	5.54	5.16	5.61	6.79	6.98	[3]	[3]
Estonia	5.01	3.75	4.12	4.48	3.23	3.28	18.99	17.66	29.23	21.54
Finland	2.96	3.33	2.48	2.31	2.08	2.52	3.39	3.79	4.67	6.35
France	2.65	3.18	2.19	2.83	3.06	3.63	6.40	5.89	5.68	6.12
Germany	3.77	3.99	2.78	2.96	3.38	3.77	3.16	3.60	5.27	5.69
Greece	**6.34**	**7.12**	**4.98**	**6.04**	**3.65**	**4.49**	**10.27**	**9.70**	**8.21**	**10.54**
Ireland	3.87	4.99	3.12	3.36	3.01	3.50	4.76	5.38	[3]	[3]
Italy	3.18	4.13	2.56	3.04	2.52	3.14	6.63	7.91	6.65	7.54
Luxembourg	2.69	2.73	2.52	2.59	1.88	2.29	[3]	[3]	4.56	4.69
Malta	4.81	4.08	4.32	2.99	3.42	3.35	[3]	[3]	[3]	[3]
Netherlands	3.47	3.70	2.29	2.59	3.58	4.07	[3]	[3]	[3]	[3]
Portugal	5.92	7.24	4.44	6.07	2.96	4.16	6.67	8.28	10.13	11.78
Slovakia	4.02	4.69	3.30	3.13	4.74	4.82	7.56	14.35	15.13	15.20
Slovenia	5.60	5.91	5.06	5.04	3.35	3.86	4.73	5.23	6.74	7.06
Spain	3.78	4.77	2.57	3.08	2.52	3.42	5.06	6.97	8.07	9.36

Sources: ECB and euro area national central banks.
1 Despite the efforts to harmonise statistical methodologies across the euro area, considerable heterogeneity remains in terms of instrument characteristics and relative weights; this partly reflects differences in national conventions and practices, as well as in regulatory and fiscal arrangements.
2 Monthly average rate.
3 These countries do not publish data on the respective interest rates.

Chart V.7 Bank interest rates on new loans: differentials between Greece and the euro area (January 2003 - September 2011)

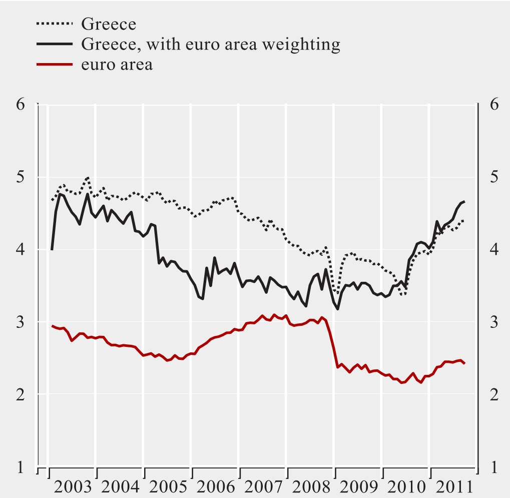
(percentage points)



Πηγές: Τράπεζα της Ελλάδος και ΕΚΤ.
1 Βλ. υποσημείωση 2 του Πίνακα V.5A.

Chart V.8 Average interest rate spread between new loans and new deposits in Greece and the euro area (January 2003 - September 2011)

(percentage points)



Sources: Bank of Greece and ECB.

As lending rates in Greece increased, in general, more than the corresponding rates in the euro area, their differential widened in most categories, as was also the case in the previous year (see Tables V.5A and V.5B and Chart V.7). The largest differential was observed in consumer loans without defined maturity, while the largest widening of the interest rate differential between Greece and the euro area was registered in consumer loans with an initial rate fixation of one and up to five years (see Chart V.7).

In more detail, the average interest rate on (housing and consumer) loans to individuals and private non-profit institutions in Greece stood at 6.81% in September 2011, i.e. higher by 77 basis points than at end-2010. This was the result of the broad-based interest rate increase in most housing and consumer loan categories (Table V.5A). As regards loans to non-financial corporations, a marked increase was registered in the interest rates of all loan categories, resulting in an average rate of 6.71% in September 2011, i.e. 96 basis points more than in December 2010. [32]

In January-September 2011, the interest rate spread in Greece maintained the upward trend it has been registering since mid-2010 and stood at 4.40% in September (December 2010: 3.93%, see Table V.6 and Chart V.8). As the interest rate spread in the euro area increased less over the same period, its difference from the highest Greek rate reached 198 basis points in September 2011, i.e. 31 basis points higher than the average rate in the January 2003-August 2011 period.

5 THE GOVERNMENT BOND MARKET

During the January-October 2011 period, lack of investment confidence remained the key

32 As noted above (footnote 21), since June 2010 loans to sole proprietors form a separate category and are no longer included in loans to enterprises. The average interest rate of this loan category rose by 87 basis points in the period under review, standing at 9.28% in September 2011.

Table V.6 Interest rate spread in Greece and the euro area

(percentage points)

	Average interest rate on new loans in Greece[1] (percentages per annum)	Average interest rate on new deposits in Greece[1] (percentages per annum)	Interest rate spread in Greece	Interest rate spread in Greece with euro area weighting	Interest rate spread in the euro area
Dec. 1998	16.21	8.12	8.09	...	...
Dec. 1999	14.02	6.98	7.04	...	...
Dec. 2000	9.68	4.00	5.68	...	...
Dec. 2001	7.26	1.96	5.30	...	...
Dec. 2002	6.29	1.67	4.62	...	...
Dec. 2003	5.92	1.20	4.72	4.45	2.77
Dec. 2004	5.94	1.22	4.72	4.18	2.54
Dec. 2005	5.79	1.27	4.52	3.59	2.56
Dec. 2006	6.38	1.87	4.51	3.63	2.88
Dec. 2007	6.67	2.53	4.14	3.48	3.09
Dec. 2008	6.72	3.27	3.45	3.27	2.63
Dec. 2009	5.09	1.32	3.77	3.40	2.29
Dec. 2010	6.08	2.15	3.93	4.02	2.25
Sept. 2011	6.95	2.55	4.40	4.67	2.42

Sources: Bank of Greece and ECB.
1 The average interest rate depends on the level of interest rates of individual categories of deposits/loans as well as on the weight of each type of deposit/loan in the corresponding total. Therefore, changes in the average interest rate reflect changes in the actual interest rates and/or changes in the weights of the instrument categories concerned. In order to smooth out the impact of abrupt changes in weights, the calculation of the average interest rate is based on the average of the weights over the past twelve months.

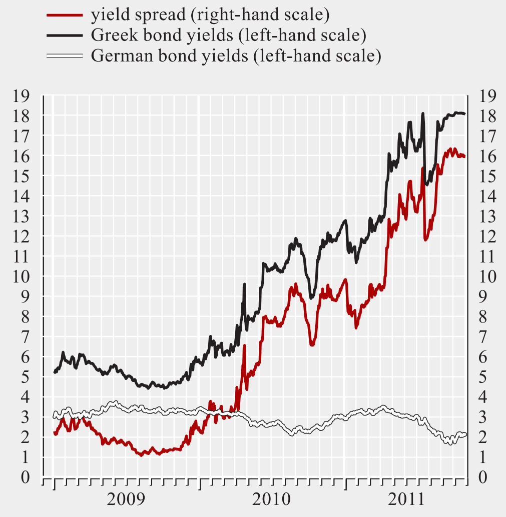
determinant of developments in the Greek government bond market. This was reflected in surging yields[33] and a particularly subdued transaction activity in the secondary market. Pressures on Greek bond prices were associated with heightened uncertainty surrounding Greece's fiscal and economic outlook.

In more detail, during the first half of 2011, Greek government bond yields picked up markedly (see Chart V.9), and their volatility was high, as credit rating agencies successively downgraded Greek sovereign debt.[34] A sizeable albeit temporary drop in Greek government bond yields was observed over the last ten days of July 2011, on the back of the decisions taken at the Euro Summit of 21 July, which were positively assessed by investors.[35] Nevertheless, further downgrades of Greek sovereign debt[36] put renewed upward pressure on Greek bond yields. Yields continued to rise until late October 2011 amid uncertainty concerning the implementation of the above-mentioned decisions. By way of illustration, the yield spread of the ten-year Greek bond vis-à-vis the German bond came to 15.90 percentage points at end-October 2011, i.e. up by 6.30 percentage points compared with end-December 2010. However, the 26 October Euro Summit reached important decisions concerning the nominal discount on notional Greek debt held by private investors. The implementation

33 Because of the extremely weak transaction activity in the Electronic Secondary Securities Market (HDAT), the valuation of Greek government securities was based on bid-offer prices of securities traded on the secondary market.
34 Moody's downgraded Greek sovereign debt from Ba1 to B1 on 7 March 2011. Standard and Poor's proceeded with credit rating downgrades from BB+ to BB- on 29 March 2011 and to CCC on 13 June 2011, while Fitch cut Greece's rating from BB+ to B+ on 20 May 2010 and to CCC on 13 July 2011.
35 For instance, the Institute of International Finance (IIF) urged its members to participate in the Private Sector Involvement (PSI) programme for Greece's financing. Furthermore, the ISDA (International Swaps and Derivatives Association) estimated that this programme would not constitute a credit event.
36 These downgrades were effectuated on 25 July 2011 by Moody's (from B1 to Caa1) and on 27 July 2011 by Standard and Poor's (from CCC to CC).

Chart V.9 Yields on the 10-year Greek and German government bonds (January - October 2011)

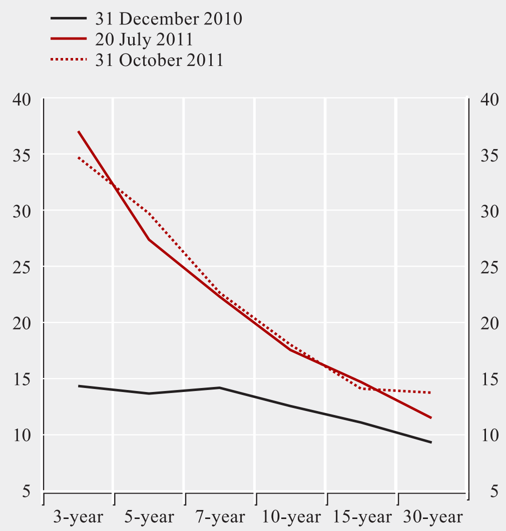
(daily data; yields in percentages per annum; yield spread in percentage points)



Source: Bank of Greece.

Chart V.10 Greek government paper yield curves

(yields in percentages per annum)



Source: Bank of Greece.

of the agreement is expected to contribute to limiting uncertainty and addressing the debt crisis.

The Greek government bond yield curve shifted considerably upwards at end-October 2011, compared with end-December 2010 (see Chart V.10). At the same time, its slope turned more negative, as the rise in yields was stronger at the shorter end of the maturity spectrum (3- and 5-year bonds). For instance, at end-October the negative yield spread between the ten-year and the three-year bond came to -16.70 percentage points (or -1,670 basis points), from -1.78 percentage points (or -178 basis points) at end-December 2010.

As mentioned above, high uncertainty among investors is reflected in plummeting transactions in the secondary Greek government bond market. Between January and October 2011 the average daily value of transactions in the Electronic Secondary Securities Market (HDAT) was €26 million, against €463 million and €1,230 million, respectively, in the corresponding periods of 2010 and 2009 (see Chart V.11).

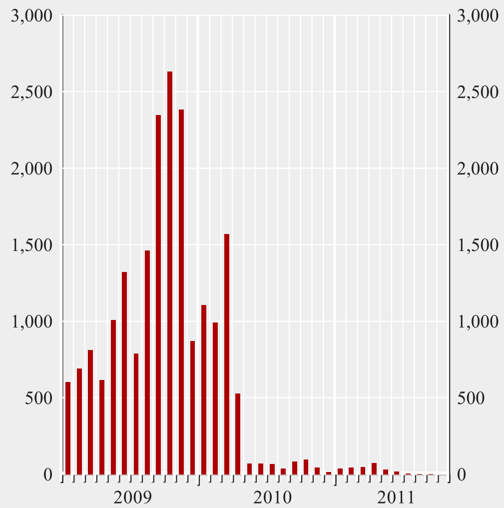
As a result of considerably adverse conditions prevailing in the secondary market, the Greek government proceeded exclusively to regular Treasury bill issues with a maturity of 13 and 26 weeks in the course of 2011. The average weighted cost of borrowing through these issues was high, similar to that observed during the intensification of the global financial turmoil in 2008, and came to 4.65%, 4.57% and 4.69% respectively in the three first quarters of 2011, and to 4.72% in October 2011 (see Chart V.12). However, a positive development lay in the fact that the average coverage ratio of these issues was high (3.1 times).

6 THE STOCK MARKET

The decline in share prices on the Athens Exchange (Athex), observed throughout 2010, persisted at an even stronger pace over January-October 2011 (see Chart V.13), compared with a much slighter decline in euro area share prices. Trading activity and raising of funds through the Athex were significantly reduced

Chart V.11 Average daily value of transactions in the Electronic Secondary Securities Market (HDAT) (January 2009 - October 2011)

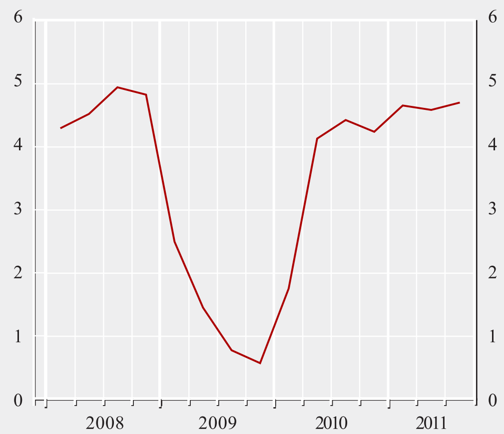
(million euro)



Source:Bank of Greece.

Chart V.12 Weighted average interest rate on Greek Treasury bills (Q1 2008-Q3 2011)

(percentages per annum)



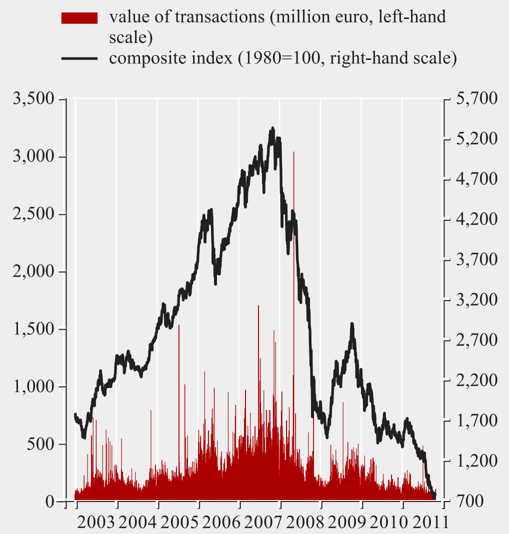
Sources: Public Debt Management Agency.

against the corresponding period of 2010 (see Chart V.13 and Table X.7).

In more detail, despite a short-lived rebound in the first two months of 2011, the Athex composite share price index dropped by 42.8% at

Chart V.13 Athens Exchange: composite share price index and value of transactions (January 2003 - October 2011)

(daily data)



Source: Athens Exchange.

end-October 2011, compared with end-December 2010, a development which is directly associated with investor uncertainty concerning the evolution of Greece's fiscal aggregates, as well as its unfavourable macroeconomic environment.[37, 38]

In the period under review the decline in the Athex composite index was more than double that of the Dow Jones Euro Stoxx (-16.1%) and the sharpest among the respective indices of euro area stock markets.

Turning to the remaining key aggregates, the average daily value of transactions in Athex decreased (reflecting lower share prices) by about 39% year-on-year, and came to some €92 million. The total amount of funds raised through the stock market dropped to €2.4 billion in the January-October 2011 period, com-

37 Non-residents' investment outflows in the stock market came to €201 million in January-October 2011.

38 These conditions are also reflected in the profitability of Athex-listed companies. Profits before interest, taxes, depreciation and amortisation declined by 16.5% in the first half of 2011, while losses of €4.4 billion were registered after tax and priority rights, mainly on account of the financial sector.

Table V.7 Funds raised through the Athens Exchange

(million euro)

Categories of firms and sectors	Number of firms January-October 2010	Number of firms January-October 2011*	Funds raised (million euro)[1] January-October 2010	Funds raised (million euro)[1] January-October 2011*
Listed firms	11	11	3,291.8	2,362.3
Newly listed firms	-	-	0.0	0.0
Total	**11**	**11**	**3,291.8**	**2,362.3**
Financial sector–Banks	4	3	3,197.5	2,156.4
Non-financial sector	7	8	94.3	205.9

Sources: Athens Exchange and Bank of Greece.
* Provisional data.
1 Capital increases through public offerings and private placements. Subscriptions to the capital increase are entered on the last day of the public offering period.

pared with €3.3 billion one year earlier (see Table V.7). Just as in 2010, almost the total of funds raised in 2011 related to financial corporations (3 banks).

As regards the banking sector, the rate of decline in the banking sub-index (-74.7%) was stronger than the decline in the Athex composite share price index and almost double the corresponding rate of the euro area banking sub-index (-36%). Surrounded by tensions, Greek banks saw their liquidity come under a lot of pressure and their profitability and loan portfolio quality deteriorate, amid adverse fiscal and economic conditions.

7 OVERVIEW OF RECENT DEVELOPMENTS IN THE BANKING SECTOR

Three main factors have influenced the evolution of banks' key aggregates and financial results in the first half of 2011: (i) an environment of shrinking liquidity, (ii) the voluntary participation of banks in the Greek government bond exchange programme, and (iii) the worsening quality of banks' loan portfolios against a background of macroeconomic recession. Increased provisioning for credit risk and for the impairment of Greek government bonds contributed to the losses posted by banks and banking groups. Banks' capital adequacy ratios declined slightly in the first half of 2011 and, given the continued deterioration of the macroeconomic environment, further recapitalisation of the banking sector is necessary. After June 2011, the most important developments related to intensifying pressures on liquidity, enhanced banking supervision and bank resolution measures, which were also implemented in the case of Proton Bank, and the diagnostic assessment of banks' loan portfolios.

Profitability – Efficiency

In the first half of 2011, the banking sector's operating income increased year-on-year by 9.1% at bank level, while it remained unchanged at banking group level (see Table V.8). Looking at individual income components, net interest income declined by 2.8% and 3.7% for banks and banking groups respectively, although the net interest rate margin remained virtually unchanged. Net fee income registered a sharper decrease (of 28.2% and 19.1% respectively). By contrast, other income improved, due to profits from the sale of operations, while losses from financial operations declined. Nevertheless, these developments mostly affected banking aggregates on a solo basis. Operating expenses fell by 6.7% and 5.2% for banks and banking groups respectively, in the first half of 2011 year-on-year.

Table V.8 Financial results of Greek commercial banks and banking groups (first half of 2010 – first half of 2011)

(million euro)

	Banks			Banking groups		
	First half of 2010	First half of 2011	Change (%)	First half of 2010	First half of 2011	Change (%)
Operating income	**4,176**	**4,555**	**9.1**	**6,773**	**6,776**	**0.0**
Net interest income	4,093	3,979	-2.8	5,891	5,675	-3.7
– Interest income	8,289	8,752	5.6	10,633	11,224	5.6
– Interest expenses	4,196	4,773	13.8	4,742	5,549	17.0
Net non-interest income	82	576	598.2	882	1,101	24.8
– Net fee income	591	425	-28.2	983	795	-19.1
– Income from financial operations	-612	-150	-	-302	-97	-
– Other income	104	301	190.9	201	403	100.3
Operating costs	**2,774**	**2,590**	**-6.7**	**3,988**	**3,783**	**-5.2**
Staff costs	1,653	1,540	-6.8	2,298	2,179	-5.2
Administrative costs	921	846	-8.2	1,333	1,251	-6.1
Depreciation	171	177	3.6	320	311	-2.5
Other costs	30	27	-9.4	38	41	8.2
Net income (operating income less costs)	**1,402**	**1,965**	**40.2**	**2,785**	**2,993**	**7.5**
Provisions for credit risk	2,536	3,073	21.2	3,104	3,636	17.1
Provisions for PSI losses		5,391	-		5,804	-
Profits/losses from participations			-	-4	-40	-
Pre-tax profits	**-1,134**	**-6,499**	**-**	**-323**	**-6,486**	**-**
Taxes	174	-844	-	371	-768	-
After tax profits	**-1,307**	**-5,655**	**-**	**-694**	**-5,719**	**-**

Source: Financial statements of Greek commercial banks and banking groups.

Against this background, total net income grew substantially at bank level (40.2%) and only slightly at banking group level (7.5%), on a year-on-year basis, standing at about €2 billion and €3 billion respectively. In the case of banks, the rise in total net income is actually due to a considerably sharper decline in expenses compared to income.

However, the financial results for the first half of the year, after provisioning, showed losses of €5.6 billion for banks and €5.7 billion for banking groups (see Table V.8). Underlying this development were mainly (i) impairment provisions, in view of the private sector involvement (PSI) in the Greek debt exchange programme, which amounted to about €5.4 billion and €5.8 billion for banks and banking groups respectively, and (ii) the unfavourable domestic macroeconomic environment and the ensuing deterioration in the financial condition of non-financial corporations and households, which made increased provisioning for credit risk imperative. These two factors had a negative impact on the evolution of ROA and ROE, which declined considerably year-on-year (see Table V.9). Nevertheless, the efficiency ratio (operating expenses/operating income) posted a remarkable improvement of approximately 10 and 3 percentage points on an individual and consolidated basis respectively, mainly on account of a substantial contraction in operating expenses. At first glance, this may appear positive, but the downward trend of income from core banking activities (because of adverse macroeconomic conditions) reveals the need for banks to further cut their operating costs by rationalising expenses, disengage from purely banking activities, and look for synergies.

The creation of larger and stronger institutions is a necessary choice in the context of the ongoing strengthening of the banking system. Besides, joining forces and forging alliances with foreign strategic investors will offer Greek banks considerable advantages, such as synergies and increased size, capital soundness, international competitiveness and prospects. These advantages will create the necessary conditions for Greek banks to more efficiently address the great challenges ahead.

Foreign business of Greek banking groups[39] continued to partly offset the negative effect of domestic business. The breakdown of foreign business shows that operating income decreased, on an annual basis, by 6.7% in the first half of 2011, while provisions for credit risk declined by 8.4%, reflecting an improvement of the macroeconomic environment in some of the countries they are active.

Credit risk

Turning to credit risk, the NPL ratio grew (June 2011: 12.8%, December 2010: 10.5% - see Table V.9) at an increasing rate compared with 2010, as the aforementioned significant deterioration in the financial condition of businesses and households had a further, albeit lagged, impact on their debt-servicing capacity.[40] An upward effect on the NPL ratio was also exerted by a decrease in the outstanding balance of loans (i.e. the denominator of the ratio). Another negative development was a slight decline in the coverage ratio (June 2011: 45.5%, December 2010: 46.2%), despite the significant increase in the stock of provisions in the first half of 2011. A higher increase (i.e. deterioration) was observed in the ratio of net NPLs (i.e. NPLs less accumulated provisions for credit risk) to total regulatory own funds (of about 14 percentage points).

Liquidity risk

Liquidity risk continued to represent the biggest challenge facing Greek banks, which, on the one hand, remained shut out of international money and capital markets and, on the other hand, faced the consequences of their shrinking deposit bases and the decline in value of collateral they use to obtain financing from the Eurosystem. In the first half of 2011, the overall effect of these factors was a squeeze on bank liquidity of about €40 billion. **The maintenance of the Eurosystem's liquidity-providing measures, along with liquidity-support measures taken at the domestic level,[41] helped to mitigate pressures on liquidity throughout 2011, preventing a credit crunch. Without these liquidity support measures, banks would have been forced to deleverage rapidly, thus substantially reducing credit to the economy, which would in turn have led to an even deeper recession. An eventual deleverage would further affect deposits, as the decrease in loans, due to the interaction between lending and deposits, has an adverse effect on deposits by businesses and households. As a result, the feedback loop between deposits and loans would further hinder the financing of the economy, as bank liquidity would also deteriorate.**

It is important to note that in the first half of 2011, despite these unprecedented pressures on bank liquidity, the year-on-year rate of decline in private sector financing was very small (-1.2%), compared with the rate of contraction in nominal GDP (-6.2%). Besides, the absence of any liquidity support measures would have led to non-renewal of even profitable loans, thus negatively affecting banks' profitability, as well as their capital adequacy.

39 National Bank of Greece, Eurobank EFG, Alpha Bank and Piraeus Bank.
40 It should be noted that Laws 3816/2010 and 3869/2010 provide for the rescheduling of loans for certain categories of over-indebted households and businesses, respectively.
41 The bank bond guarantee scheme was expanded by €15 billion under Article 4 of Law 3845/2010 (in addition to the €15 billion which were initially provided for by Law 3723/2008), by a further €25 billion under Article 7 of Law 3872/2010 and an additional €30 billion under Article 19 of Law 3965/18.5.2011.

Table V.9 Key vulnerability and shock-absorption capacity indicators of Greek commercial banks and banking groups

(percentages)

	Banks		Banking groups	
	December 2010	June 2011	December 2010	June 2011
Asset quality[1]				
Non-performing loans (NPLs) - total	10.5	12.8		
– Housing loans	10.3	11.9		
– Consumer loans	20.0	24.0		
– Business loans	8.8	11.2		
Accumulated provisions over NPLs	46.2	46.0		
Net-of-provisions NPLs to regulatory own funds	46.8	66.3		
Liquidity				
Loan-to-deposit ratio	116.8	128.0	120.9	130.8
Liquid asset ratio	25.5	25.5		
Asset/liability maturity mismatch ratio	-6.9	-6.9		
Capital adequacy				
Capital adequacy ratio	13.9	12.0	12.3	10.6
Tier 1 ratio	12.5	10.9	11.2	9.6
Core Tier 1 ratio	10.6	9.2	9.9	8.6
	first 6 months 2010	first 6 months 2011	first 6 months 2010	first 6 months 2011
Profitability				
Net interest margin	1.9	2.0	2.7	2.6
Cost-to-income ratio	66.4	56.9	58.9	55.8
Return on assets - ROA (after tax)	-0.6	-1.7	-0.3	-5.0
Return on equity - ROE (after tax)	-9.9	-27.1	-4.5	-22,4

Sources: Bank of Greece and financial statements of commercial banks and banking groups.
1 NPL data on international activities are not comparable and therefore the NPL ratio on a consolidated basis is not reported.

In the immediate future, the fulfillment, if deemed necessary, of the commitment by the Heads of State or Government of the euro area and EU institutions to provide credit enhancement is expected to have a positive effect on bank liquidity, as this will enable Greek banks to access the liquidity-providing operations conducted by the Eurosystem.

As part of the Eurosystem, the Bank of Greece provides, if needed, the necessary liquidity support to the banking system. Apart from the Eurosystem operations, since August 2011 the Bank of Greece has also provided exceptional funding to credit institutions to compensate for the withdrawal of deposits by the private and public sector and for the decline in the value of collateral eligible for monetary policy operations, as Greek banks were unable to tap to the markets for funding. Such support is also provided only to solvent credit institutions by the Eurosystem national central banks against sound collateral and subject to approval by the Governing Council of the ECB.

Capital adequacy

At end-June 2011, the capital adequacy of Greek banks and banking groups recorded a slight decline relative to 2010 (see Table V.9).

This is mainly due to the impact on regulatory capital from the envisaged private sector involvement (PSI) in the government bond exchange programme under the initial agreement of 21 July. At end-June 2011, the Capital Adequacy Ratio (CAR) and the Tier 1 capital ratio for banks stood at 12.0% and 10.9% respectively, and for banking groups at 10.6% and 9.6% respectively. A drop was also observed in the Core Tier 1 capital ratio, which came to 9.2% and 8.6% for banks and banking groups respectively.

Given the continued worsening of economic sentiment and the new —stricter— international regulatory framework, further recapitalisation of the Greek banking system is warranted. Besides, as provided for in the latest update of the Memorandum, banks must maintain a minimum Core Tier 1 capital ratio of 10% as from 1 January 2012. In addition, banks may be required to further raise capital once the diagnostic assessment of their loan portfolios, currently under way, is completed.

A diagnostic assessment of banks' loan portfolios is expressly provided for in the July 2011 update of the Memorandum, stating that a reputable and qualified international advisory firm should be commissioned by the Bank of Greece, in consultation with the EC/ECB/IMF, to perform such an assessment. Given the severe deterioration of overall economic conditions in Greece, a thorough analysis of the impact of the economic environment on banks' domestic loan portfolio was deemed necessary by the European Commission, the ECB and the IMF. The main objective of the diagnostic assessment is to trace the repayment dynamics of non-performing loans, which will help banks to adjust their provisions to the challenges posed by the recession. Actually, the EC/ECB/IMF had requested similar diagnostic assessments from all three countries participating in financial support programmes. Ireland was the first country to have already conducted such an assessment in end-March 2011, while the diagnostic assessment in Portugal started a few weeks ago.

It is estimated that over the medium term, the outcome of the diagnostic assessment will have a positive effect on international markets' perception of Greek banks. In fact, the results of the assessment will provide banks with a more accurate picture about their current level of capital and the capital injections that may be required. Furthermore, as the methodology of the diagnostic assessment is considerably different than those applied so far (e.g. stress testing, book entries, banks' internal credit risk assessment models), it will offer additional information that was not available until today. Absolute transparency, which is guaranteed by the involvement of an independent and internationally reputed firm, will eliminate market uncertainty. Such a clarified picture and the immediate coverage of any additional capital needs can only have a positive effect, making it easier for banks to return to the markets sooner.

It is preferable to achieve a strengthening of banks' capital adequacy with capital increases rather than with shrinking assets. This second option would have a negative impact on the economy, as well as on banks themselves. A capital increase, if needed, should rather come from the private sector (including all current shareholders). However, in any case, the HFSF is endowed with all necessary resources to fully support Greek banks, should the need arise.

Legislative issues

As regards legislative interventions in the financial sector, a very positive development was the adoption of Law 4021/2011 introducing enhanced banking supervision and bank resolution measures. The law gives new options for managing and effectively addressing vulnerabilities in individual credit institutions. The aim is to safeguard financial stability and ensure, to the extent possible, the uninterrupted flow of credit to the real economy through the banking system. It should be noted that this Law was adopted in the context of a broader European approach, which has recently materialised through similar legislative initiatives in other European countries, as systemic stability issues are highly prioritised. Law 4021 allows for an immediate, flexible and effective intervention in the event that a credit institution faces, or has been diagnosed with, a serious problem, given that the envisaged bank resolution measures can be enforced and implemented in a very short period of time.

On 9 October 2011, the provisions of Law 4021 were actually applied on Proton Bank through the establishment of the New Proton Bank, having the Financial Stability Fund as its sole shareholder and funded by the Hellenic Deposit and Investment Guarantee Fund (TEKE), i.e. with funds from banks' contributions. The solution chosen, without posing any burden on Greek taxpayers, secured the deposits of all customers, saved hundreds of jobs and contributed to the smooth continuation of business. But most importantly, it prevented a disturbance in one bank from evolving into a systemic disturbance, thus ensuring the confidence of the general public, and particularly of depositors, in the financial system. Besides, its cost was substantially lower than that of the alternative option, i.e. if Proton Bank seized to operate.

8 PRIVATE INSURANCE SECTOR: DEVELOPMENTS AND PROSPECTS

The economic downturn had a negative impact on the private insurance sector, leading to a drop in premium turnover and an increase in policy redemptions. At the same time, a decline was observed in the value of insurance companies' investment portfolios, the bulk of which relates to government bonds.

In Greece, 72 insurance firms are active, 55 of which are supervised by the Bank of Greece,[42] with total assets of about €15 billion. In terms of total premium turnover, Greek-based insurance firms account for 89.4%, branches of insurance firms based outside the EU and the EEA for 7.9%, branches of insurance firms based in the EU or the EEA for 2.4% and mutual insurance cooperatives for 0.3%.

The market is characterised by a high degree of concentration in the life insurance sector, which is not the case in the non-life sector. According to 2010 data, in the life insurance sector, the five and ten largest (on the basis of premium turnover) firms account for 71.0% and 91.7% of total premium turnover respectively. As regards the non-life sector, the five and ten largest insurance companies have a market share of 41.2% and 61.9% respectively.

In the first half of 2011, total premium turnover fell by 7.4%, against the corresponding period of 2010, with the life insurance sector declining by 11.3% and the non-life insurance sector by 4.5%.

Turning to capital adequacy, based on validated end-2010 data and taking into account the current legislative and regulatory frameworks, as well as capital increases of €102.5 million that took place in 2011, regulatory capital exceeds the minimum requirements by approximately €1 billion. It should however be noted that this amount also includes derogations provided for under the insurance law and the relevant regulatory decisions on solvency, though only part of the insurance market took advantage of these derogations. In particular, these derogations allow for:

(i) the recognition as liability of an amount of at least 70% of the pending claims reserve, regarding non-life business.

(ii) the valuation of Greek government bonds at their purchase price.

Under a more conservative approach that would not take into account the above-mentioned derogations, Greek insurance firms as a whole should have accumulated an additional €545 million by end-2010.

42 The branches of foreign firms are supervised by the competent authorities of their country of origin.

The present unfavourable economic juncture poses a major threat to the solvency of insurance firms, mainly because of the accelerating lapse and surrender rates of insurance policies, the declining rate of new insurance policies, the decreasing value of assets (e.g. Greek government bonds), the higher credit risk against premium debtors, etc.

Despite the negative conjuncture, developments in the insurance market, particularly in the first nine months of 2011, are quite positive, as insurance firms seem to have realized the urgency of effectively addressing a series of lasting structural rigidities, which had seriously challenged the reliability of private insurance as an institution in Greece. An important part in this development was also played by the Bank of Greece, which undertook the supervision of the insurance market (as from 1 December 2010). After more than 100 on-site inspections, the Bank of Greece proceeded, in constant consultation with all market players, to a number of structural interventions in the context of the three top priorities it had set upon assuming its supervisory functions. These priorities aim at:

- rationalising market operation,
- adopting supervisory procedures focused on effective risk management, and
- preparing insurance firms for a smooth transition to the complex and demanding environment that will be shaped by the supervisory framework "Solvency II".

With a view to safeguarding the soundness of the insurance market, the Bank of Greece, after having exhausted all alternative options in constant consultation with insurance firms, withdrew the authorisation of three companies that did not meet the minimum operating requirements. Overall, since 2008, 17 insurance firms have ceased to operate.

As regards the aforementioned positive developments, in the January-September 2010 period, insurance firms that are active in Greece showed considerable improvement in the fields of operational strategy, organisation and accounting transparency. The correct recognition of insurance liabilities, improved pricing policy, the decrease in commission fees, lower doubtful claims, as well as a break with the practice of magnifying turnover at all costs, contributed to an increase in profitability during the first half of 2011 and created the conditions for a substantial consolidation of the Greek insurance market.

These developments, albeit favourable, leave no room for complacency, and the effort to create an insurance market with a stronger capital base is expected to be long and strenuous – all the more so, considering that time is running out before the implementation of Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II).

Under the new framework, all insurance firms must make systematic efforts to meet any urgent capital needs, as well as to build adequate capital buffers against future adversities. The qualitative changes in the management and operation of insurance firms, which are being introduced by "Solvency II", are key to modernising and strengthening their secure functioning.

Fully aware of the difficulties and the challenges posed by the current juncture, insurance firms which are active in Greece should make the right strategic choices leading to the establishment of strongly capitalised and soundly organised business units. Towards this end, the Bank of Greece is actively working on the timely and effective transposition of the relevant Directive into the Greek institutional framework, as well as on the swift and extensive preparation of the market for the quantitative and qualitative requirements of "Solvency II", since it has observed that, despite the progress achieved so far, considerable weaknesses in understanding the new measurement method of capital requirements, as well as organisational deficiencies, still remain in several firms.

In order to ensure that Greek insurance firms adjust to the new framework and fully map possible weaknesses in know-how, staffing or infrastructure, the Bank of Greece is currently conducting an exercise, which, once finalised, will help insurance firms address in a timely manner any detected vulnerabilities. This exercise will give the private insurance industry the opportunity to familiarise itself, without delay and in practice —and in close cooperation with the regulatory authority— with the new operating conditions, as well as to reap the benefits of the expertise that the officers of the Bank of Greece acquire by participating in the international meetings of insurance supervisors. Furthermore, the systematic monitoring of the development of internal models that will calculate insurers' regulatory capital requirements is currently under way. The proper implementation of these models will enhance transparency and lower operating costs. In this respect, the cooperation between insurance firms, particularly between smaller ones, is encouraged, with a view to promoting cost-sharing in the development of such models.

As regards legislative adjustments to the new requirements, the Bank of Greece has completed the consultation on issues concerning the internal audit systems and the code of conduct of insurance intermediaries, while the comments on the consultation have been aggregated and classified and are at the final stage of the assessment. The main objective is to create a regulatory framework which contributes to upgrading the organisational structure and functioning of insurance intermediaries, with a view to eradicate ill practices that were working at the expense of consumers, insurers and, above all, professionals of the private insurance industry.

Lastly the Bank of Greece, in its effort to effectively protect consumers' interests, has successfully managed 350 complaints about insurance firms which are still active and, in fact, 19 firms have been summoned to hearing. Moreover, 80 inquiries on insurance intermediaries, posed by natural persons, legal entities and professional chambers, as well as 100 other inquiries and complaints (e.g. concerning insurers that are no longer active) have been examined.

VI MEANS AND CONDITIONS TO REVERSE THE ECONOMIC CLIMATE AND SUPPORT INVESTMENT AND EXPORTS

The deep recession of the Greek economy reflects the significant contraction of domestic demand (both consumption and investment). However, the current crisis is not cyclical in nature, but rather deeply structural, echoing the distorted allocation of resources in the economy.

Therefore, in order for the economy to recover, there is a pressing need for the following:

- First, to create a business environment that will help reverse pessimistic expectations for the future of the Greek economy and to encourage Greek and foreign businesses to invest.

- Second, to shift Greek businesses' focus abroad so as to make up for the decline in domestic demand and to finance capital goods imports.

- Third, to eliminate distortions that prevent the rational allocation of resources in the economy. (Inter alia, implementing reforms that can affect economic activity positively and directly, e.g. by eliminating legal restrictions on cruising services.)

- Fourth, to promote the privatisation and public property development programme, in order to create new investment opportunities.

- Fifth, to speed up absorption and make good use of the National Strategic Reference Framework (NSRF) funds.

1 A FAVOURABLE BUSINESS ENVIRONMENT IS ESSENTIAL FOR ENHANCING INVESTMENT

A favourable business environment requires, among other things, a stable, transparent and fair *institutional and regulatory environment*, the rules of which are *observed*, a citizen-friendly and effective public administration, as well as modern infrastructures.

The current institutional and regulatory environment, in which business activity must grow, is characterised by lack of stability and a labyrinthine complexity. As a result, institutional regulations are not fully implemented, causing lack of transparency and accountability, injustice and tolerance for infringements (tax evasion, corruption). Greece ranks low internationally in respect to the quality of its institutions and its ranking keeps deteriorating with time (see Table VI.1). Proof of the high correlation between quality of governance, labour productivity and effectiveness of public expenditure can be found in the relevant literature.[1]

Tax evasion[2] equals an unfair tax system and addressing it is essential, not only for reasons of social justice but also as a sine qua non for growth,[3] because: i) tax evasion may contribute to the survival of inefficient and unlawful firms at the expense of efficient and law-abiding ones and at the same time distort competition in the markets; and ii) losses in tax revenue inevitably lead either to higher future taxes that affect disposable income or to successive measures that change the tax system, creating a climate of uncertainty and instability. The OECD[4] suggested that Greek authorities should take measures to combat tax evasion, by e.g. publicising the names of tax evaders and putting a stop to such practices as "settlement of pending tax cases".[5]

1 See inter alia (i) St. Aubyn, M. (2008), "Modernising Public Administration and Economic Growth", *GPEARI Working Paper* WP-001; (ii) Olson, J.M., Sarna, N. and Swamy, A. (2000), "Governance and growth: A simple hypothesis explaining cross-country differences in productivity growth", *Public Choice*, 102, pp. 341-364; (iii) Kaufman, D., and A. Kraay (2002), "Growth without Governance", *Journal of LACEA Economia* 008687; (iv) Acemoglu, D., Robinson, J., and S. Johnson (2001), "The Colonial Origins of Comparative Developments: An Empirical Investigation", *American Economic Review*, 91, pp. 1369-1401; (v) Afonso, A., Schuknecht, L., and Tanzi, V. (2005), "Public sector efficiency: An international comparison", *Public Choice*, Springer, 123(3), pp. 321-347.

2 See e.g. Vasardani, . (2011), "Tax evasion in Greece: an overview", Bank of Greece, Economic Bulletin, 35, pp. 15-24.

3 See e.g. Matsaganis, M. and M. Flevotomou (2010), "Distributional implications of tax evasion in Greece", Hellenic Observatory papers on Greece and Southeast Europe, GreeSE Paper No. 31.

4 OECD (2011), *Economic Surveys: Greece*.

5 Law 4002/2011 also provides for a new round of "settlement of pending tax cases", the submission of overdue tax returns without penalty and the extension of the deadline concerning the deletion of prescribed tax cases.

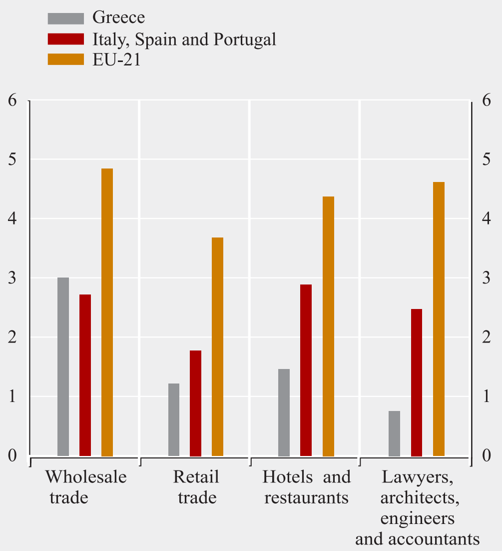
Table VI.1 World Economic Forum's composite competitiveness index

	2006	2007	2008	2009	2010	2011
Competitiveness index	**4.33 (47)**	**4.08 (65)**	**4.11 (67)**	**4.04 (71)**	**3.99 (83)**	**3.92 (90)**
Basic requirements	**4.96 (40)**	**4.70 (48)**	**4.66 (51)**	**4.49 (56)**	**4.49 (67)**	**4.36 (80)**
1. Institutions	4.36 (41)	4.31 (49)	4.10 (58)	3.83 (70)	3.67 (84)	3.52 (96)
2. Infrastructure	4.71 (29)	4.38 (35)	4.28 (45)	4.31 (47)	4.57 (42)	4.54 (45)
3. Macroeconomic environment	3.86 (102)	4.29 (106)	4.37 (106)	4.02 (103)	3.61 (123)	3.29 (140)
4. Health and primary education	6.92 (11)	5.83 (42)	5.89 (40)	5.81 (41)	6.13 (40)	6.09 (37)
Efficiency enhancers	**4.18 (47)**	**4.07 (57)**	**4.16 (57)**	**4.13 (57)**	**4.12 (59)**	**4.06 (65)**
5. Higher education and training	4.78 (34)	4.44 (39)	4.52 (38)	4.43 (43)	4.67 (42)	4.66 (46)
6. Goods market efficiency	4.17 (62)	4.24 (60)	4.22 (64)	4.09 (75)	3.91 (94)	3.88 (107)
7. Labour market efficiency	-	3.69 (120)	3.89 (116)	3.80 (116)	3.71 (125)	3.63 (126)
8. Financial market development	-	4.41 (60)	4.29 (67)	4.02 (83)	3.88 (93)	3.52 (110)
9. Technological readiness	3.58 (50)	3.29 (58)	3.50 (59)	3.86 (53)	4.06 (46)	4.21 (47)
10. Market size	-	4.33 (39)	4.52 (33)	4.59 (34)	4.52 (39)	4.42 (42)
Innovation and sophistication	**3.89 (45)**	**3.68 (59)**	**3.65 (68)**	**3.59 (66)**	**3.41 (73)**	**3.39 (81)**
11. Business sophistication	4.35 (46)	4.13 (62)	4.13 (66)	4.04 (66)	3.83 (74)	3.79 (77)
12. Innovation	3.43 (47)	3.23 (63)	3.18 (63)	3.14 (65)	3.00 (79)	2.98 (88)
Number of countries included in the report	125	131	134	133	139	142

Sources: World Economic Forum, *Global Competitiveness Report 2001-2010, Global Competitiveness Report 2011-2012* (8 September 2011).
Note: The table presents Greece's absolute scores in each category (scores are expressed on a 1-7 scale, with 7 being the most desirable outcome). The country's classification among the countries included in the report is given in parentheses.

Chart VI.1 Average business size in certain sectors

(employees per business; 2003-2007 average)



Source: OECD, Structural Business Statistics.
1 Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, UK.

Regulations governing the establishment or start of operation of firms and the administrative obligations of already active firms, although initially introduced with the aim to protect consumers, investors and the environment, now seem to rather serve a narrow, mere revenue-enhancing rationale. Moreover, already active firms often oppose to the removal of administrative obstacles, in order to avoid stronger competition. As the cost of establishment and start of operation of a firm increases, the number of new firms in any sector decreases. Thus, conditions of reduced competition are created. If the price elasticity of demand is low for active firms, prices are high and profit margins remain high too.[6]

The unstable institutional framework does not encourage long-term investments; as a result,

6 See Vettas, N. (2011), "Competition and regulation in product markets under crisis conditions in the Greek economy", in: G. Hardouvelis and C. Gortsos (eds.), *The international crisis, the Eurozone crisis and the Greek financial system*, pp. 347-58, Athens, Hellenic Bank Association (in Greek).

the country's productive capacity is fragmented in small firms (see Chart VI.1), which cannot benefit from economies of scale, have limited access to financing[7] and are mostly active in low- or middle-technology-intensive sectors (see Box VI. 1 in particular for the structure of the trade sector). This, combined with barriers to the entry of new firms or professionals in other sectors, leads to price increases and limited job creation and, therefore, to high unemployment rates.

7 See Maroulis, D., P. Mylonas, D. Nicolitsas and D. Politis (2001), "Bank interest rates in Greece and the eurozone", *Hellenic Bank Association Bulletin*, fourth quarter, pp. 19-26 (in Greek).

Box VI.1

STRUCTURAL FEATURES OF TRADE IN GREECE AND THE EURO AREA

Distributive trade, which mainly consists of retail and wholesale trade,[1] is an important sector of national economy and plays a crucial role in the transmission of monetary policy. Distributive trade industries —retail trade in particular— operate between producing enterprises and consumers and affect the formulation of final prices. It is therefore of particular interest to examine them in the light of monetary policy and it is very helpful to see how their key features affect the price level and dynamics.

The share of distributive trade in economic activity

Distributive trade in Greece accounts for almost 1/8 of gross value added (2010) and almost 1/5 of total employment (2010).[2,3] Even though wholesale trade is more important in value added terms (since it covers around 50% of distributive trade as a whole), retail trade accounts for most firms and employed persons.

A basic feature of distributive trade industries —especially retail— is their labour-intensive nature. Moreover, they generally present higher-than-average shares of self-employed, part-time workers (17.1% in retail trade in Greece), female employees (42.7%), young workers (21.5%), and low-skilled workers (47.8%).[4]

In Greece, distributive trade industries present certain particularities that differentiate them from the average of the corresponding industries in the euro area. For example, it is worth noting that 44.4% of the persons employed in those industries in 2010 were entrepreneurs and family members, a percentage which is almost double that in the euro area. In addition, each enterprise employs on average 3 employees, against 5 in the euro area, a fact that reflects the existence of a definitely greater number of small and very small enterprises in the Greek market.

Profit margins in both retail and wholesale trade are lower than the average of the economy, a feature attributed to the higher turnover rather than to the presence of competitive pressures. A similar conclusion is also drawn from a comparison with profit margins in the euro area[5] and EU countries that are members of the OECD, which are nevertheless lower than the Greek profit

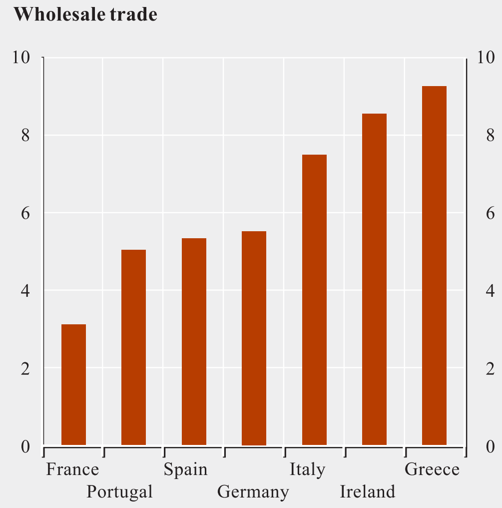
1 It also includes the branches of repair and maintenance of motor vehicles/motorcycles and household/other appliances.
2 Including self-employed and employees.
3 In the euro area, this branch corresponds to almost 1/3 of the non-financial sector in terms of turnover, number of companies and employed persons, or 1/5 in terms of value added and employment.
4 See ELSTAT, *Annual Structural Business Survey in Trade for the year 2007.*
5 See ECB (2011), "Structural features of distributive trades and their impact on prices in the euro area", September 2011, *Structural Issues Report.*

margins (see Chart A). Even though the Product Market Regulation indicator (PMR) was one of the highest in OECD countries in 2008, the structural changes implemented in the context of the harmonisation of the Greek legislative framework with the Community Directive on Services contributed to reducing regulatory constraints and, consequently, to improving this indicator.

Both in Greece and in the euro area, productivity[6] and the average labour cost in distributive trade industries registered an increase over the past decade, while remaining at lower levels than the average. In the euro area, the relatively low productivity in distributive trade industries is often pinpointed as a cause for Europe's competitiveness deficit against the US.

Gross operating profit margin (gross operating profit/turnover)

(percentages per annum; 2003-2007 average)



Source: OECD.

Recent developments in distributive trade

Distributive trade industries have recently experienced significant structural changes in Greece and the euro area, due to increasing concentration, internationalisation, and important changes in the form of retail stores.

The most radical technological innovation in this branch is undoubtedly the possibility to make purchases through the internet, which has already contributed to changing the form of several markets,[7] enhancing price transparency and comparability, competition, economies of scale and a wide array of choices available to the consumer. Although there are no official data on the share of internet purchases in Greece, they are estimated at around 2-3% with great potential for growth. The corresponding share in the euro area has risen over the past years and is now comparable to that of the US. However, it is worth noting that national and cross-border transactions in the euro area vary significantly, since the latter amount to just a small percentage (almost 2-4%) of the total.

Another important change to the form of retail sales is the expansion of discounters. Large international discount chains made a dynamic entry in the Greek market, recording significant growth. However, over the past three years – due to mergers and decisions of the parent companies to disengage from Greece – three chains have exited the market. At euro area level, the share of

6 Value added per employee.
7 E.g. of books, music, travel services, and technology products.

sales by discounters increased by 4 percentage points over the past decade, although the rate of growth varied across countries.

Another recent development is the expansion of modern superettes – convenience stores with extended working hours (including weekends). In Greece, as in the rest of the euro area, big retail store chains have made a dynamic entry in this segment of the market as well, aiming at a greater market share.

In Greece, where traditional forms of purchasing behaviour still prevail, the share of super and hyper markets amounts to just 40%, the share of discounters to around 7%, and that of other small retailers to 25%, considerably higher than the average of the euro area. Market distribution at European level is different, since the share of sales of supermarkets and hypermarkets seems now to have stabilised at around 60%, the share of discounters to 14%, while that of the small retailers to just 4%.

The larger market share of discount chain stores led to the emergence of private label products, which have been on a steady rise since 2001, though they have not taken the place of widely-recognised labels. In Greece, the share of private label products recorded a considerable increase in recent years and already represents more than 12% of total sales.[8] The Greek private label market offers a wide variety of products and its features are considered to be similar to those of western European markets.

Under the pressure of competition, together with the entry of multinationals in the Greek market, mergers and acquisitions accelerated and led to a higher concentration ratio[9] in this sector.[10] It is also interesting that the Greek retail trade market has a lower concentration ratio at national than at local level.[11]

The relationship between the structure of trade industries and price dynamics

With regard to the impact of the structure of trade industries on the price level and dynamics, three empirical findings[12] could be noted:

a) Price differentiation and the existence of cross-border differences regarding the price of substitutes are to a great extent attributable to structural features and the regulatory framework of distributive trade industries.

b) Strong competition is generally positively correlated with frequent price changes. Besides, large concentration in local markets seems to contribute to higher prices, particularly in food and beverages.

c) The pass-through of cost changes to producer prices is greater and faster than to consumer prices. Stronger competition contributes to a larger degree of pass-through of import prices to consumer prices. However, as regards food prices, differences in the type of store play a key role,

8 It should be noted that the four largest supermarket chains in the country account for 52% of the private label products market.
9 The concentration ratio can be interpreted as an ex ante indicator of the potential degree of competition. In other words, a market with a low concentration ratio (i.e. with many enterprises, each one having a small market share) is expected to be more competitive than a market with a high concentration ratio (i.e. fewer enterprises, each one having a larger market share).
10 It is indicative that the share of the largest retail trade company in Greece amounts to 18.1%.
11 See ECB (2011), ibid.
12 ECB (2011), ibid.

since the increased presence of discount supermarkets is associated with a higher degree of pass-through of price changes.

Policy proposals

On the basis of the aforementioned analysis, the following policy proposals can be formulated regarding both Greece and the euro area as a whole:

1. The implementation of targeted structural reforms, with first and foremost the abolition of existing regulatory barriers, could strengthen competition, reduce profit margins and thus, through a more effective distribution of financial resources, lead to higher production and real higher wages.

2. Achieving uniformity in the regulations[13] of the European product markets can maximise the benefits of cross-border transactions and purchases through the internet. The full and consistent implementation of the Services Directive[14] is an important step in this direction.

3. Lifting barriers in the labour market will allow meeting current employment needs in distributive trade and lead to the creation of new jobs, particularly for young people and individuals with low training skills.

13 For instance, the legal framework for consumer protection, purchases through the internet as well as issues related to VAT on cross-border transactions.
14 Directive 2006/123/EC of the European Parliament and the European Council, of 12 December 2006, on services in the internal market.

The weaknesses of the institutional environment are exacerbated by the inefficient operation of the **public administration**, which is called upon to safeguard it and implement the regulations. The relationship between citizens and state is often characterised by mutual mistrust. The roots for this should be sought, among other things, in the ineffective management of human resources in the public sector, the lack of meritocracy and the very limited use of new technologies. These weaknesses necessitate more than the adoption of numerical fiscal rules, such as the hiring-to-retirement ratio. These rules are reasonable, given the fiscal restraints on the country; they should be accompanied, however, by appropriate strategies, a pursuit of modernisation and ongoing personnel training.

The importance of **infrastructure** and generally **network industry services** for growth is high, as delays in efforts to modernise these sectors are transmitted to every other business sector supplied through networks. For instance, deficient port infrastructure causes significant losses in cruise receipts. Developments in the crucial energy sector, which provides "network services" to the entire economy, are discussed in Box VI. 2.

Box VI.2

INVESTMENT IN THE ENERGY SECTOR

The degree of potential investment in the energy sector depends on the deregulation of the electricity and natural gas markets, the enhancement of competition in the sector, sufficient financing and the promotion of structural reforms of a general nature (transparency, favourable legislation and removal of red tape).

In respect to electricity, the share of the Public Power Corporation (PPC), in the energy balance has been gradually decreasing after the implementation of Law 2773/1999 on the deregulation of the electricity market. Thus, the participation of PPC (in the grid, which is in practice open to competition) shrank to 76% in 2010, compared to 85% in 2009, mainly on account of the continuous penetration of new, independent energy producers over the last five years. In more detail, the market share of PPC in the generation of electricity using natural gas fell below 60% in 2010.[1] According to data of the Hellenic Association of Independent Power Producers on the construction of natural gas thermal plants, private investments of €1.5 billion have been realised until today. However, the realisation of investments in the energy sector has encountered several difficulties after the deregulation of the market, on account of the distortions and imbalances existing in its operation model, among other things.

With a view to opening the energy market further, the government has introduced key changes in respect to electricity and natural gas, through the adoption of Law 4001/2011 ("On the operation of electricity and natural gas energy markets, on hydrocarbon exploration, production and transmission networks and other provisions"), practically transposing the provisions of the Third Energy Package into Greek legislation (Directives 2009/72/EC and 2009/73/EC).[2]

According to the new Law, the companies involved in the management of electricity and natural gas networks are decoupled from those involved in their production and supply, to ensure non-discriminatory access of all participants to networks. More specifically, in reference to the electricity market, the law provides for the creation of three new companies.[3] In the natural gas market, the provisions mainly relate to the independence of the existing Transmission System Operator (DESFA – Hellenic Gas Transmission System Operator) from the Public Gas Corporation (DEPA). Moreover, the decision-making competences and independence of the Regulatory Authority for Energy (RAE) are substantially enhanced, in a way that the Authority will now be able to regulate, supervise and efficiently control the energy market, thus ensuring sound competition. Also, significant measures have been taken for the protection of consumers.

Seeking to create a more favourable environment for high-risk investments that will enhance research activity in the field of hydrocarbons in Greece, the new Law contains provisions for the restructuring and modernisation of the regulatory framework in this area. The establishment of a National Hydrocarbons Agency is therefore envisaged, managing the exclusive rights of the Greek state in regard to the exploration, research and exploitation of hydrocarbons. The agency will recommend transfer of these rights to interested oil companies "quid pro quo".[4] Moreover, issues involving the exploitation of the country's geothermal potential, the calls for tender for the establishment of new Gas Supply Companies (EPA), as well as the placement of major energy pipelines are settled, with the aim to speed up processes for the implementation of the relevant projects.[5]

1 Speech of the President and Chief Executive Officer of PPC on 19 May 2011.
2 The aim of the Third Energy Package is to set up the conditions that will facilitate completion of the energy market deregulation within the European Union so that a single energy market can be created by the end of 2014, also in accordance with the relevant decision taken by the European Council on 4 February 2011.
3 The following companies are thus created: (a) a wholly-owned subsidiary of PPC, "ADMIE SA" (Independent Power Transmission Operator), which will be responsible for the ownership, maintenance, management, exploitation and development of the Transmission System, (b) a second company, "LAGIE SA" (Hellenic Electricity Market Operator), responsible for the operation of the electricity market in the place of the existing Hellenic Transmission System Operator (DESMIE), and (c) a third company, "DEDDIE SA" (Hellenic Distribution System Operator), a wholly-owned subsidiary of PPC, responsible for the operation, maintenance and development of the Distribution Network.
4 In this context, by virtue of a Ministerial Decision (5 September 2011), the Ministry of Environment, Energy and Climate Change has already launched the first international call for expressions of interest to undertake seismic surveys in the broader Ionian Sea area and at the south of Crete, in order to explore the petroleum potential and to set off a round of concessions in these areas, within 2012.
5 The provisions concern the definition of the Burgas-Alexandroupolis oil pipeline route as well as the Interconnector Turkey-Greece-Italy (ITGI) and the Interconnector Greece-Bulgaria (IGB) natural gas pipelines route.

Furthermore, aiming at a complete reform of the energy market, the Ministry of Environment, Energy and Climate Change plans to proceed with the following as soon as possible: (a) changes in the management of hydroelectric power plants through the establishment of an independent authority for the management of water resources and hydroelectric power plants, (b) the opening up of lignite production to parties other than the PPC[6] and (c) the liberalisation of the energy market in the islands by adopting the relevant Code.

Meanwhile, one of the top priorities of the Ministry of Environment, Energy and Climate Change pursuant to Law 3851/2010 on addressing climate change is to facilitate the implementation of investments in projects involving Renewable Energy Sources. Particular emphasis in this area is given to expediting licensing procedures for land wind farms and photovoltaic systems (within a period of two years), as well as to activating procedures for the placement of marine wind parks (over the next ten years).[7,8]

It should be noted, however, that both the regulations introduced by the new Law on the implementation of the Third Energy Package and the priority goals of the Ministry of Environment, Energy and Climate Change are at the same time commitments under the updated Memorandum and have fixed deadlines.[9] Moreover, the Privatisations Programme of the Medium-term Fiscal Strategy Programme 2011-2015 (Law 3985/2011) provides for the sale of a large part of energy companies' shares to investors between 2011 and 2013 through the stock exchange or through direct negotiations.[10]

European, Asian and US businesses have lately taken keen interest in "greenfield investments" – specifically investments in Greece in the energy sector with particular emphasis on the expansion of alternative energy sources, mainly solar and wind energy.[11] The project "Helios" of the Ministry of Environment, Energy and Climate Change ambitions to attract investment of up to €20 billion for the production and export of 3,000 to 10,000 MW of solar power, on state-owned land of up to 50,000 acres. It is estimated that this project could result in the creation of 60,000 jobs.

6 Negotiations between the government and the European Commission for the opening up of the lignite market are under way (statements of the Minister of Environment, Energy and Climate Change on 8 September 2011).

7 According to the Annual Report of the RES Service for 2010 (in Greek), it is estimated that investments in RES projects in 2011 will reach €1.35 billion and the total amount for 2010-2020, €16.4 billion. Meanwhile, materialisation of these investments will require an additional investment of €4-5 billion in networks and interconnections; as a result, the average annual budget for investment in RES projects for the period 2010-2020 will amount to €2 billion. The Service for the Support of RES Investors of the Ministry of Environment, Energy and Climate Change (one-stop shop) was established by virtue of Law 3851/2010 and its principal mission is to provide information and to coordinate the processing of enquiries related to investment in RES-based energy generation.

8 In respect to photovoltaic systems, it should also be noted that, by virtue of the decision of the Inter-ministerial Committee for Strategic Investments taken on 12 September 2011, three investments totalling €1 billion were included in "fast-track" legislation so as to expedite the positive effect on growth.

9 The time schedule for the implementation of the structural reforms in the energy sector, as set in the Memorandum, is as follows:
a) *Deregulation of the energy market* (implementation of the Third Energy Package): Adoption of legislation for the decoupling of network activities from supply activities in the field of electricity and natural gas (July 2011). Actual finalisation of the decoupling of electricity and natural gas transmission systems from the electricity distribution system will take place in the first quarter of 2012.
b) *Lignite market*: Finalising the measures regarding the opening up of lignite-fired electricity generation to third parties (second quarter of 2011), commencing the implementation of measures (third quarter of 2011) and seeing it through to completion (second quarter of 2012).
c) *Opening up of the energy market in the islands*: Detailed plans to ensure maximum opening up of the market to the off-grid system (access of suppliers to off-grid systems, particularly in Rhodes and Crete). (third quarter of 2010).
d) *Water management*: Adopting legislation for assigning the management of water reserves to an independent agent (July 2011) and its establishment thereof (third quarter of 2011).
e) *Tariffs*: Elimination of tariffs for all end users, except for households and small businesses, as defined in the Second and Third Energy Package (fourth quarter of 2011). Adoption of further measures, by June 2013 at the latest, to ensure that energy tariffs reflect wholesale prices with the exception of vulnerable consumers.

10 In particular, the following are scheduled: (i) reduction of the participation of the State in the Public Gas Corporation (DEPA) and the Hellenic Gas Transmission System Operator (DESFA), by selling 55% and 31% of their shares, respectively, out of the 65% it currently holds (fourth quarter of 2011); (ii) selling 35% of government shares in the Hellenic Petroleum (ELPE) (it currently holds 35.5%) (first quarter of 2012); (iii) selling 17% of government shares in the PPC (current holding: 51%) (third quarter of 2012); and (iv) selling 100% of the off-shore natural gas storage area in Kavala (in 2013).

Such interest mainly stems from Greece's great potential for growth in this sector, the expertise of interested countries in RES production and their extensive energy transmission network, as well as from the fact that these countries seek alternative energy sources to the degree that they adopt policies of reducing the share of nuclear energy (i.e. Germany). Moreover, as the "Sahara Project" collapsed due to the political turmoil in Northern African countries,[12] Greece has emerged as an alternative.

Materialisation, however, of these private investments will be subject to financing from European banks and from the European Investment Bank. Alternatively, the creation of a Greek investment bank is examined, as it could constitute the main source of investment financing for the years to come. To this effect, officials from the German Investment Bank (KfW) will explore the possibility of giving their knowhow to the Greek government. In addition to providing technical assistance, cooperation between Greece and Germany includes the exploration of liquidity-enhancing possibilities through the cooperation with private banks for the provision of credit and the creation of special investment areas. It also includes a mapping of the country's investment opportunities and exploration of the possibility of exporting electricity to Germany.[13]

11 The Czech company CEZ, the biggest electricity producer in Central Europe, has expressed interest in acquisitions in the Greek market of electricity distribution and generation. Other major European companies such as the Italian Edison, GDF Suez and the German RWE and EON have expressed similar interest. Moreover, the Chinese Sinovel, the second largest wind turbine manufacturer in the world, has entered a strategic cooperation agreement with PPC for the development of wind parks and the construction of a wind turbine manufacturing plant in Greece. Finally, US companies have taken keen interest in Kozani, where the PPC is in the process of selecting a strategic investor for the construction of the largest photovoltaic park in the world, on an area of 5,200 sq.m. (the investment is estimated at around €600 million).

12 The energy project Desertec involved the exploitation of solar energy in the Sahara through the installation of RES generation plants in the desert. It would be able to supply energy to North-European countries, subject to the creation of the appropriate energy transmission network.

13 Press Releases of the: Min. of Economics, Min. of Regional Development, Competitiveness and Shipping, Min. of Environment, Energy and Climate Change, 25 August 2011.

In 2011 certain steps were taken towards simplifying administrative procedures for the establishment and operation of firms and towards modernising public administration. In more detail, the establishment of a firm can now take the form of a "one-stop procedure". The new procedure (which abolishes taxes, levies, the mandatory presence of a lawyer for smaller firms, etc.) minimises both the cost (by 54% for general partnerships and limited partnerships, 61% for an average limited liability partnership and around 50% for a société anonyme) and the time needed to establish a firm. From the beginning of April (4 April 2011) to the beginning of October (3 October 2011) 3,601 companies were established through this one-stop procedure.[8]

These changes helped improve Greece's relevant position in several OECD and World Bank entrepreneurship indicators (constraints for entrepreneurship, degree of regulatory simplification, administrative barriers and licensing constraints to retail trade, retail price control); in many such indicators, Greece's position in 2011 is better than the OECD countries' average in 2008.[9]

The unified pay scale in the public sector, together with an objective evaluation of the civil servants' efficiency, the introduction in June of regulations governing communication and transactions between the State and the citizens through new public sector technologies (Law 3979/2011), the improved allocation of strategic planning duties with the Kallikratis

8 See also the announcement of the Ministry of Development after the publication of the *Doing Business 2012* report of the World Bank (http://www.mindev.gov.gr/?p=5724).

9 As indicators were updated only for Greece and not for all OECD countries, a comparison with the OECD average is not possible for 2011. See also Chapter I.5.

Programme and the extension of civil servants' working time are only suggestive steps towards the modernisation of public administration.

2 STRENGTHENING THE EXPORT ORIENTATION

The direction of the necessary changes and the measures that have been taken will clearly improve the structural competitiveness of Greek products and, hence, export performance. Of particular importance for the improvement of exports is the removal of disincentives that reduce the size of business units and the enhancement of efforts to create business "clusters". International literature[10] underlines that higher education levels and the introduction of innovations have a beneficial effect on the quality of products, making them easier to export. However, a clear export strategy is necessary, which will support businesses in promoting their products abroad. To this end, it is significant to create national identity products (e.g. food products) and rationalise the customs clearing process (duration and cost of relevant procedures).[11] To deal with the liquidity issues of exporters, the Export Credit Insurance Organisation (ECIO), in cooperation with commercial banks, promotes a programme for enterprises ("Exostrefia") to facilitate lending to export-oriented companies.

In addition to the directions mentioned above, specific policy measures should be taken in shipping and tourism, two of the key sectors in external trade: Box VI.3 presents some suggestions.

10 Kierzenkowski, R. (2009), "The challenge of restoring French competitiveness", *OECD Economics Department Working Papers*, No. 720, OECD Publishing. http://dx.doi.org/10.1787/222054166088.
11 According to Doing Business indicators compiled by the World Bank, both the time needed to process exports (double the OECD countries' average) and the cost of this process is higher (by 6% in Greece compared with the average cost in OECD countries).

Box VI.3

POLICY MEASURES FOR SHIPPING AND TOURISM

A. SEA TRANSPORT

Shipping constitutes one of the most outward-looking sectors of the Greek economy, with little dependence on domestic economic conditions. The Greek-owned merchant fleet covers about 15% of the global needs for sea transport and specialises in the transport of dry bulk cargo and crude oil. Net receipts from the provision of shipping services cover more than 25% of the Greek trade deficit. Main determinants of inflows from shipping are the level of freight rates and the magnitude of the maritime cluster, which can be affected by the policy pursued.[1] To this effect, policy measures should aim at attracting ships to enter the national register, improving conditions for the establishment of shipping and ship management companies in Greece and attracting young people to seafaring.[2] The following suggestions —which have been stated in previous Bank of Greece reports and studies[3]— could help to this direction:

- Linking Greek institutes of higher and further education with shipping companies.

- Redefining services provided by Greek shipyards, in order to attract shipbuilding of specialised —high added value— vessels as well as ship repair works.

1 See Bragoudakis, Z. and St. Panagiotou (2010), "Determinants of the receipts from shipping services: the case of Greece", Bank of Greece, *Economic Bulletin*, No 34.
2 For instance, companies involved in the provision of technical (such as classification societies), insurance (such as P&I clubs), legal, financial, consultancy, training services, as well as in crew management.
3 See Panagiotou St. and Bragoudakis Z.(2010), "Sea transport and ocean-going shipping" in: G. Economou, I. Sampethai and G. Symigiannis (eds), *The Greek current account: causes for imbalances and policy suggestions*, Bank of Greece (in Greek).

• Improving the country's port facilities, concluding concession contracts with liner shipping companies and developing storage facilities, in order to enhance the country's role as a transit centre.[4]

B. TOURISM

The importance of tourism in the national economy and the balance of payments is evident from the fact that net travel receipts represent over half of the services surplus or 3.5% of GDP and around 30% of total receipts from the export of services. Moreover, tourism accounts for 17.9% of total employment and 15.3% of GDP (estimates of the Association of Greek Tourism Enterprises - SETE), which is quite impressive given the competitive environment (in 2011 our country ranked 29th out of 139 countries included in the Travel and Tourism Competitiveness Index of the World Economic Forum).[5]

Year 2011 has proven a very good one for Greek tourism, despite the unfavourable effect of social protests and strikes; the improvement is evidenced by a two-digit increase in arrivals. This result seems to reflect the impact of international political and economic developments, and not quite the effectiveness of specific policy measures.[6] Specifically, the good performance of the tourism industry in the current year is largely a result of the recovery in global tourist activity, which, according to the World Tourism Organisation, will be around 4.5% in 2011,[7] as well as of the recent turmoil in countries of North Africa, which shifted travellers to alternative tourist destinations, including Greece.

On the contrary, the policy measures taken (reduction of taxes at regional airports, reduction of VAT in tourist accommodation services, acceleration of visa issuing procedures from emerging —for Greek tourism— markets, liberalisation of cruises), although positive, are estimated to have played only a small part in enhancing incoming tourism.

Despite the efforts to increase revenue from non-EU cruise ships embarking at Greek ports, the liberalisation has not yielded the expected benefits. Cruise and tourism agents point out that, in order to attract cruise companies, it is necessary to reduce the requirements and bureaucratic procedures provided by the relevant legislation[8] and primarily to lift cabotage restrictions, according to which cruise companies are required to sign contracts with the Greek state.[9]

Improving the degree of openness of Greek tourism shall require[10] the adoption of a clear policy with no conflicting measures, the reduction of bureaucratic obstacles for new tourist investment (spatial planning, licensing, stable tax system), better infrastructure (airports, ports, rail-

4 The agreement for the concession of Pier II and III of the Piraeus Port Authority SA (PPA) container terminal to "Piraeus Container Terminal SA" (Sole Purpose Company – subsidiary of Cosco Pacific Limited) was ratified by virtue of Law 3755/2009. However, the transfer as well as the operation of port facilities by "Piraeus Container Terminal SA" was marked by reactions and red-tape difficulties (e.g. no refund of VAT to "Piraeus Container Terminal SA").

5 "The Travel and Tourism Competitiveness Report 2011" (World Economic Forum). The prominent performance of the tourism industry is stressed when compared with our country's performance based on the General Competitiveness Index, according to which Greece ranked 83rd out of 139 countries.

6 Specifically, the favourable effect of VAT reduction in accommodation services is partly offset by the increase of VAT in food services (as of 1 September). See Gazopoulou, A. (2011), "Assessing the Impact of Terrorism on Travel Activity in Greece", Bank of Greece Working Paper 127.

7 United Nations, "World Tourism Barometer", Interim Update, August 2011.

8 It is worth noting that the income generated from the cruise industry in Spain is multiple to that in Greece, despite the fact that the number of passengers is similar, precisely because the largest part of cruise income is generated from voyages embarking at ports of the same country. See European Cruise Council (2011), *The cruise industry: A leader in Europe's economic recovery*, 2011.

9 According to reports, the Minister of Development, Competitiveness and Shipping has committed to consider the proposal to lift cabotage restrictions.

10 OECD (2011), *Economic Surveys: Greece*, Paris.

way network) so as to attract higher-income tourists, as well as the promotion of alternative forms of tourism in order to reduce seasonality.

The recent Law 4002/2011 ("Amendments of pension legislation of the public sector – Regulations for development and fiscal restructuring - Issues within the competence of the Ministries of Finance, Culture and Tourism and Labour and Social Security") introduces the concept of **tourist estate** and rationalises, simplifies and accelerates the licensing process for **tourist investment**. These provisions are expected to extend the tourist season, lower dependence of tourist arrivals on the economic conjuncture, attract foreign direct investment and support local communities and the construction sector.

3 ELIMINATION OF DISTORTIONS THAT PREVENT THE RATIONAL ALLOCATION OF RESOURCES IN THE ECONOMY

One of the reasons behind the ineffective allocation of resources in the economy (hence the large number of very small businesses, little mobility between sectors, and the persistence of sectors that should have evolved into something new) can be found in the way that the labour market operates.

Among the features of the Greek labour market are a high employment rate in the primary sector, a significant percentage of self-employed, superabundance of persons practicing certain professions, concentration of employment in small production units, increased weekly hours worked and high rates of contribution evasion. The degree of contribution evasion is often used as an argument for the exceptional flexibility of the Greek labour market. This argument however ignores the fact that the size of shadow economy also reflects the limited flexibility of the official labour market. The labour market is characterised by dualism in at least two aspects: working conditions vary between the public and the private sector, as well as between formal (insured) and informal (uninsured) labour. High non-wage labour costs, high recruitment and layoff costs, eased conditions —until recently— for granting pensions, no match —in several cases— between wages and productivity growth, more favourable working conditions in the public sector, the disconnection of education from labour market needs, as well as obstacles and barriers to entry for specific professions, together with product market restraints, have contributed to the structural weaknesses of the labour market.

As from mid-2010, radical changes have been legislated in the labour market. Most of these changes, i.e. those announced up until April 2011, have already been presented in previous Bank of Greece reports. The recent measures incorporated in the "implementation law" (Law 3986/2011) of the MTFS framework and the Law "Retirement regulations, unified wage grid for the public sector, labour reserve scheme and other measures for the implementation of the Medium-Term Fiscal Strategy framework 2012-2015" (Law 4024/2011) include the reduction of the minimum remuneration for young persons aged up to 25 years, as well as the efforts to match firm-level developments with the wages that the firm agrees to pay to its personnel (through measures that facilitate the introduction of collective labour agreements at the firm level). It is estimated that both measures can, under certain conditions, help to boost competitiveness and employment, with positive effects both on consumption and on the revenue of social security funds from employer contributions.

Given that the economy is still in recession, there are no apparent positive results from these changes yet. However, it is possible that labour market developments (as reflected in the unemployment rate) would be even worse, had there been no measures taken. Moroever, some measures have not been fully implemented yet, either because they were accompanied by bureaucratic restrictions (e.g. in the case of collective labour agreements at firm level) or due to administrative barriers that remain (e.g. opening up closed professions).

In more detail, regarding firm-specific collective labour agreements, only few have been concluded (a total of 12 agreements covering 3,555 employees – see also Chapter III.3) for two reasons: First, small enterprises have no firm-level labour unions, thus agreements have to be concluded with the sectoral union, which enterprises may find difficult to achieve. Second, legal requirements for the implementation of the new type of agreement – a report submitted to the Social Inspection Council of the Labour Inspectorate (SKEEE), not to mention the time-consuming processes, including the ratification from the Court of First Instance of the conclusion of any association, have had a deterrent effect. On account of these difficulties *too*, many firms resort to individual employment agreements or informal agreements with employees. Such issues should be eliminated with the changes introduced by article 37 of Law 4024/2011.

Among the necessary labour market reforms that cannot be introduced yet, due to the fiscal situation, is the **tax wedge**, i.e. the difference between wage costs (including employer social security contributions) and the employee's net wage. A large "wedge" hinders recruitments. Recent estimates show that limiting the wedge by around 10 percentage points (from 40% to 30%) may lead to an increase in employment rates by 1.5-3.5 percentage points (i.e. the creation of 130-300 thousand jobs) within 5-10 years. It appears, however, that a decrease in the total (tax and other) wage burden is now under study for labour-intensive enterprises.

The **opening-up of closed professions** is one of the main objectives of the structural reforms programme, which also received wide social support. Barriers to entry into specific professions, territorial restrictions, the existence of minimum prices, guaranteed profit rates, limited opening hours and advertising bans are obstacles to labour supply in these professions.[12] The reforms lead, among other things, to higher remuneration, compared to what would be formulated under conditions of perfect competition and ineffective organisational structures. Laws 3918/2011 and 3919/2011 were stepping stones towards the liberalisation of professional activities (abolition of prefectural procedures to authorise the operation of pharmacies, increase in the number of notaries, licensing of self-employed legal practice without geographic restrictions, abolition of minimum remuneration, etc.). However, same as in the case of public-use trucks, the operational framework of which was legislated in the summer of 2010, liberalisation was not comprehensive. Thus, for instance, restraints on law firms were not abolished, despite the abolition of restraints on self-employed legal practice, the Presidential Decree on the increase in the number of notaries has not been issued yet, and the profit rates of pharmacies have not been significantly reduced, despite a recent decision of the Council of State that any restraint on professional activities is incompatible with the Greek Constitution.

Clearly, structural reforms in the labour market in the above directions should greatly improve the productivity and competitiveness of the Greek economy, especially if combined with a comprehensive growth strategy (growth plan, structural reforms in product markets, etc.).

4 PROMOTION OF THE PRIVATISATION AND PUBLIC PROPERTY DEVELOPMENT PROGRAMME

The privatisation and public property development programme could create an important

12 Kanellopoulos, K. (2011), "Market conditions and competition in the Greek economy: introduction, methodology and general conclusions" in: Kanellopoulos, K. (ed.), *Market conditions and competition in the Greek economy, Athens*, Centre of Planning and Economic Research – KEPE, (in Greek).

channel through which foreign direct investment will be attracted, thus facilitating the import of know-how and technology and encouraging the orientation of business activity towards the production of internationally tradable and competitive products.

5 SPEEDING UP ABSORPTION AND MAKING GOOD USE OF THE NATIONAL STRATEGIC REFERENCE FRAMEWORK (NSRF) FUNDS

The National Strategic Reference Framework (NSRF) is a key tool for financing economic activity, also contributing to address the balance of payments deficit.[13] However, absorption of funds from this source has not been satisfactory to date, both because of lack of funds for the required national participation and because of difficulties with the fund management mechanism.[14] In the course of the past two years, Greece has made efforts to secure the financing of its national participation (by a loan from the European Investment Bank – EIB) and to achieve faster absorption and maximum use of Community funds – by passing the new investment law (Law 3908/2011)[15] and establishing the National Fund for Entrepreneurship and Development (ETEAN).[16] The recent European Commission proposal to increase the share of Community co-financing and enhance the role of the European Investment Bank (EIB), along with the provision of technical assistance,[17] is expected to significantly promote the absorption and effective management of NSRF funds. Such decisions can free up national resources for other purposes and eliminate difficulties in the implementation of projects and programmes, thereby contributing to an overall strategy for economic growth and investment in Greece. The European Commission proposal and the new conditions regarding Community funds inflows are described in detail in Box IV.4.

13 For details on the contribution of the NSRF to the growth process, see Bank of Greece, *Annual Report 2010*, April 2011.

14 The biannual target for the absorption of Community funds was not attained in the first half of 2011. Despite the progress made in NSRF management, not all measures provided for in the Memorandum were implemented as far as the overall regulatory and organisational framework is concerned, e.g. certain legislative arrangements. However, the annual target remains feasible. See also Chapter III.4 and European Commission, *The Economic Adjustment Programme for Greece – Fifth review* – Draft Oct. 2011, p. 36 and pp.78-79 of the same report.

15 As regards the course of implementation of the Investment Law, the second phase was completed with the submission of 179 investment plans with a total budget of about €854 million, which are expected to create 1,590 jobs throughout Greece in manufacturing, tourism, the primary sector and services. Completion of the evaluation process is expected within the next four months. In the first phase (May 2011) 145 investment plans were submitted with a total budget of €725 million (Ministry of Development, Competitiveness and Shipping, press release of 14 November 2011).

16 As regards the operation of ETEAN, the programme for loans to enterprises is extended until end-2012 ("Guarantee for low-interest-rate loans for the purchase of raw materials, merchandise and services"), ensuring a certain degree of liquidity for enterprises. Since the commencement of the programme, loans of €102 million to more than 1,560 enterprises have been approved. Small and very small enterprises are selected for this programme and can receive bank loans which are by 80% guaranteed by ETEAN. These loans are granted at a maximum interest rate of 6% and a maximum amount of €300,000 per enterprise; the latter can use them to pay their suppliers (Ministry of Development, Competitiveness and Shipping, press release of 22 August 2011).

17 See EU Council, 21 July 2011, Statement by Heads of State or government of the euro area and EU institutions, Articles 4 and 12, and statement by Mr. Barroso, 21 September 2011 (Speech/11/534), 21 July 2011. These statements were made further to relevant decisions taken by the European Council on 23 June 2011 (European Council Conclusions, 23-24 June 2011, Brussels, 24 June 2011, article 18), the statement of Mr. Barroso on 23 June 2011 and the findings and proposals of the European Commission (*The Economic Adjustment Programme for Greece – Fourth review – Spring 2011*, Executive Summary, p. 3, and Quarterly Report on the Euro Area, Volume 10 No 2, 2011, p.5.

Πλαίσιο VI.4

INFLOW OF COMMUNITY FUNDS IN GREECE

The European Commission has proposed to **increase Community co-financing to 95%** (at the maximum) of the total cost of NSRF projects and programmes.[1] This proposal is expected to be approved by the Council and the European Parliament by the end of 2011. These measures concern Greece and five other EU Member States under fiscal consolidation or balance of payment

1 See European Commission, press release IP/11/942, Brussels, 1 August 2011.

support programmes and will be implemented retroactively from the date the country entered the programme (for the case of Greece, from 11 May 2010).[2] The measures **do not constitute new or additional funding**, but allow an earlier disbursement of funds already committed under the EU cohesion, rural development and fisheries policies. The Member States will have to request this higher Community contribution. The decline in national contribution to 5% is translated into about €4 billion, which enable the launch of programmes that had not been implemented due to limited national funding.[3] The top-up is an **exceptional temporary measure**, which ends as soon as the Member States stop receiving support under the financial assistance programmes. The European Commission has approved, at a first phase, Greece's request for increasing co-funding rates to 85%, on the basis of applicable regulations, retroactively from 1 January 2007.[4] Moreover, the European Council decided[5] on 23-24 June 2011 to implement a comprehensive **technical assistance programme** to support the structural reforms foreseen by the Memorandum and target them towards long-term growth. The technical assistance programme provides for the establishment of a task force based in Brussels and a smaller support task force in Athens, for the implementation of the plan already agreed with the EU and the IMF. The task force, which is already in Greece and is closely cooperating with Greek authorities and other Member States, will prepare quarterly reports to the EU and the Greek authorities. The first report was expected to be submitted by mid-November.

The role of the **EIB**, which grants loans to cover part of the national share in co-funded programmes, is enhanced. Financing of banks by the EIB in order to grant corporate loans will be facilitated by a new mechanism that will provide guarantees originating from structural funds.[6] The agreement reached with the EU for the revision and acceleration of NSRF (taking into account the actual circumstances in the country) is foreseen to be implemented in two stages. The first involves amendments to the financing schedules due to higher Community contribution rates.[7] National funds' savings may be directed to covering development costs that, according to the relevant EU regulations, are not eligible for Community financing. The second stage of revision, aspired at being approved in the course of 2012, relates to changes in the structure and content of Operational Programmes (OPs), with emphasis on boosting entrepreneurship, supporting exports, innovation and research and combating unemployment, as well as increasing the involvement of the private sector in the implementation of public works through public-private partnerships (PPPs)[8] and utilising Community Initiatives (JEREMIE,[9] JESSICA etc.), also with pri-

2 It concerns Member States that have received financial support in the context of the balance of payments mechanism for non-euro area countries (Romania, Latvia and Hungary) or from the European Financial Stabilisation Mechanism for euro area countries (Greece, Ireland and Portugal). A total of €2,884 million will be made available through the European Regional Development Fund, the Cohesion Fund, the European Social Fund, the European Fisheries Fund and the European Agricultural Fund for Rural Development. The amount corresponding to each country is: Greece €879 million, Ireland €98 million, Latvia €255 million, Hungary €308 million, Portugal €629 million and Romania €714 million.

3 See also statements by the Minister of Development, Competitiveness and Shipping (31 July 2011 and 1 August 2011).

4 For 2011, savings of Public Investment Programme funds amount to €1,275 billion. On the basis of payments already made, €875 million is expected to be returned to the national budget retroactively while, on the basis of payments to be effected by end-2011, another €400 million is anticipated (announcement by the Ministry of Development, Competitiveness and Shipping on 29 August 2011).

5 See Conclusions of the European Council 23-24 June 2011, Brussels, 24 June 2011 and *The Economic Adjustment Programme for Greece – Fourth Review – Spring 2011*, Executive Summary, p. 3.

6 See interview of Mr. P. Sakellaris, Vice-President of the EIB, 9 October 2011.

7 At this stage, no revision will be made to the priority axes of Regional Operational Programmes (ROPs) for the regions of Southern Aegean and Central Greece.

8 The PPP procedure has not progressed satisfactorily due to the overall liquidity problem in the economy (see Ministry of Development, Competitiveness and Shipping, 18 July 2011 and statement by the head of the task force, 16 September 2011).

9 As regards JEREMIE, the European Investment Fund (responsible for the implementation of this initiative), in collaboration with the Ministry of Development, Competitiveness and Shipping, announced the commencement of the procedure for the submission of proposals for the selection of intermediate specialised bodies to be involved in the implementation of venture capital investment in the field of Information and Communication Technologies. The products will be co-financed by the OP "Digital Convergence" and the ROPs "Macedonia-Thrace" and "Attica" for 2007-2013 (press release of the Ministry of Development, Competitiveness and Shipping, 18 May 2011).

vate sector involvement. The activation of the "National Contingency Reserve" operational programme, which is co-financed by the European Social Fund, will also contribute to the effective use of Community funds.[10]

As regards the contribution of Community funds to growth in the medium to long term, it should be noted that *in the post-2013 period* total Community transfers to Greece (structural measures and transfers to the agricultural sector) will be contained and provided under completely different terms, as reflected in the proposals of the European Commission for the Community Budget (CB) for 2014-2050.[11] According to these proposals, policy areas will be expanded and funding rules will be simplified, in order to enhance economic growth. More specifically, and unlike the current situation, investment may be co-financed not only by the EIB, but also through other funding resources and tools (risk capital, risk funds, local development funds etc).

The *Common Agricultural Policy* (CAP) is of particular interest for Greece. Its main directions concern: (i) the containment of direct aids and subsidies and the reallocation of funds both among Member States and at regional level, (ii) placing emphasis on the ecological character of CAP and (iii) enhancing measures that promote competitiveness and innovation.[12]

Finally, the cohesion policy[13] will focus on less developed areas and Member States of the EU. *Regions* with GDP per capita over 90% of the Community average will continue to receive support for a limited number of priority measures in the context of the "competitiveness" objective and funding will focus mainly on renewable energy, competitiveness, SMEs and innovation. *Countries* with GDP per capita over 90% of the Community average will continue to be eligible for Cohesion Fund financing.

In the context of the cohesion policy, Greece is expected to receive less funds, as the areas that will be financed under the "convergence" objective are expected to be reduced to three (from the current eight).[14] Overall, Greece's receipts will depend on the allocation of funds among the regions of 28 Member States (including Croatia as from 1 January 2014).

10 See details in Bank of Greece, *Annual Report 2010*, April 2010, Chapter V, footnote 10; announcement, circular and memo of the Ministry of Development, Competitiveness and Shipping, 31 July and 29 August 2011.
11 See European Commission, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – A Budget for the Europe 2020 – PART I, and A Budget for the Europe 2020 – PART II: Policy fiches*, COM (2011) 500 final, 29 June 2011 and European Commission, "Commission Staff Working Paper", SEC (2011) 868 final, 29 June 2011. The European Commission has already approved the overall legislative framework and the specific regulations for the Community funds with a view to adopting them by end-2012 (see European Commission, press release IP/11/1159, 6 October 2011).
12 The legal proposals of the European Commission for CAP were announced on 12 October 2011.
13 To ensure interlinking between sources of financing, the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund will be included in a common strategic framework.
14 The final negotiation and allocation of funds will have been completed before end-2012.

6 CONCLUSIONS

These five economic policy directions should be promoted together.

Since mid-2010, the government has proceeded with the adoption of legislative measures in these directions. In several cases, markets were skeptical with those initiatives or ignored them altogether, because, when put in practice, certain regulations were distorted so much that they did not any longer fulfill the purpose for which they were initially proposed or because they were tied down to bureaucratic requirements that could not be met.

Once the policy of structural reforms gains momentum and the situation of public finances is reversed, both foreign and domestic investors will have the opportunity to make good use of the growth potential of the country.[18] As it has been pointed out in the Annual Report of April 2011, key sources of growth in Greece could be large-scale investment in a different energy production and consumption pattern, the enhancement of tourism, a further development of merchant shipping, the expansion of export-oriented manufacturing branches (pharmaceutical products, certain metals and metallic minerals), the development of agricultural production with the processing of farming and livestock products, the establishment of Greece as a major hub for the transit of goods through the country's ports, as well as the provision of high-quality healthcare and educational services to "consumers" from the wider Balkan and Eastern Mediterranean region. Recent studies[19] have led to similar conclusions.

18 See also Chapter I.12.

19 See: (1) McKinsey, "Greece 10 years ahead", which was elaborated on account of SEV and was presented on 5 September 2011; (2) Boston Consulting Group, "Supporting investment in the Greek economy – A foreign investor perspective", elaborated for the Ministry of Regional Development and Competitiveness, May 2011. See also footnote 14 in Chapter I.

MONETARY POLICY MEASURES OF THE EUROSYSTEM

14 JANUARY 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

18 JANUARY 2010

The Governing Council of the ECB decided, in agreement with the Swiss National Bank, to stop conducting one-week Swiss franc liquidity-providing swap operations after 31 January 2010.

27 JANUARY 2010

The Governing Council of the ECB decided, in agreement with the Federal Reserve, the Bank of England, the Bank of Japan and the Swiss National Bank, to stop conducting US dollar liquidity-providing operations after 31 January 2010.

4 FEBRUARY 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

4 MARCH 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

The Governing Council decided to continue conducting its main refinancing operations (MROs), same as its special-term refinancing operations with a maturity of one maintenance period, as fixed rate tender procedures with full allotment for as long as necessary and at least until the end of this year's ninth maintenance period on 12 October 2010. Furthermore, the Governing Council also decided to fix the rate in the last 6-month LTRO, to be allotted on 31 March 2010, at the average minimum bid rate of the MROs over the life of this operation. The Governing Council also decided to return to variable rate tender procedures in the regular 3-month longer-term refinancing operations (LTROs), starting with the operation to be allotted on 28 April 2010. Allotment amounts in these operations will be set with the aim of ensuring smooth conditions in money markets.

Finally, in order to smooth out the liquidity effect of the 12-month LTRO conducted in 2009 and maturing on 1 July 2010, the Governing Council decided to carry out on that same date an additional six-day fine-tuning operation, as a fixed rate tender procedure with full allotment (the fixed rate being the same as the prevailing MRO rate).

8 APRIL 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

The Governing Council also decided to maintain beyond the end of 2010 the minimum credit rating threshold for marketable and non-marketable assets in the Eurosystem collateral framework at the level in force since October 2008, i.e. lowered from A- to BBB- on the basis of Fitch and Standard & Poor's rating scale, or to Baa3 on the basis of Moody's rating scale.

Furthermore, it was decided that the following instruments, fist included in the Eurosystem collateral framework in October 2008, will no longer be eligible as collateral after the end of 2010: (1) marketable debt instruments denominated in currencies other than the euro, i.e.

the US dollar, the pound sterling and the Japanese yen, and issued in the euro area; (2) debt instruments issued by credit institutions, which are traded on the accepted non-regulated markets; and (3) subordinated debt instruments when they are protected by an acceptable guarantee.

Finally, the Governing Council announced that in July 2010 a schedule of graduated valuation haircuts will be determined in relation to the assets rated in the BBB+ to BBB- range (or equivalent), excluding government debt instruments. The haircut for government debt instruments and possible debt instruments issued by central banks rated in the above range will be calculated as a 5% add-on over the haircut that would apply to similar assets with a higher credit quality (in the AAA to A- range).

3 MAY 2010

The Governing Council of the ECB decided to suspend the application of the minimum credit rating threshold (BBB-) in the collateral eligibility requirements for the purposes of the Eurosystem's credit operations in the case of marketable debt instruments issued or guaranteed by the Greek government. The Eurosystem will provide financing against these instruments regardless of their rating, given that the economic and financial adjustment programme for the Greek economy has been assessed by the Governing Council and found to be appropriate, and the Greek government has strongly committed to fully implement it.

6 MAY 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

10 MAY 2010

The Governing Council of the ECB decided to conduct interventions in the euro area public and private debt securities markets (Securities Markets Programme) to ensure depth and liquidity in those market segments which are dysfunctional on account of concerns on the fiscal condition of some euro area Member States. In order to sterilise the impact of the above interventions, specific operations will be conducted to re-absorb the liquidity injected through the Securities Markets Programme. This will ensure that the monetary policy stance will not be affected.

In order to address recent severe tensions in the financial markets, the Governing Council of the ECB also decided:

(i) To conduct a 6-month LTRO with full allotment on 12 May 2010, at a rate which will be fixed at the average minimum bid rate of the main refinancing operations (MROs) over the life of this operation.

(ii) To adopt a fixed-rate tender procedure with full allotment in the regular 3-month longer-term refinancing operations (LTROs) to be allotted at end-May and end-June 2010.

(iii) To reactivate, in coordination with other central banks, the temporary liquidity swap lines with the Federal Reserve, and resume US dollar liquidity-providing operations at terms of 7 and 84 days. These operations will take the form of repurchase operations against Eurosystem-eligible collateral and will be carried out as fixed rate tenders with full allotment.

10 JUNE 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

The Governing Council of the ECB also decided to adopt a fixed rate tender procedure with full allotment in the regular three-month LTROs to be allotted in July, August and September 2010.

8 JULY 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

28 JULY 2010

The Governing Council of the ECB reviewed the risk control measures in the framework for assets eligible for use as collateral in Eurosystem market operations rated in the BBB+ to BBB- range (or equivalent), excluding government debt instruments and determined a new haircut schedule, which will enter into force on 1 January 2011.

5 AUGUST 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

2 SEPTEMBER 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

Moreover, the Governing Council decided to conduct the 3-month LTROs to be settled at the end of October, November and December 2010 as fixed rate tender procedures with full allotment. The rates in these 3-month operations will be fixed at the average rate of the MROs over the life of the respective LTRO.

It also decided to continue to conduct its MROs as fixed rate tender procedures with full allotment for as long as necessary, and at least until 18 January 2011. The fixed rate tender procedure with full allotment will also remain in use for the special-term refinancing operations with a maturity of one maintenance period, which will continue to be conducted for as long as needed and at least until the end of 2010.

Finally, the Governing Council decided to carry out three fine-tuning operations when the remaining 6-month and 12-month refinancing operations mature: one six-day operation with announcement, allotment and settlement on 30 September 2010; one six-day operation with announcement, allotment and settlement on 11 November 2010; and one 13-day operation with announcement, allotment and settlement on 23 December 2010. The fixed rate tender procedure with full allotment will also be used in these three operations, the rate being the same as the MRO rate prevailing at that time.

7 OCTOBER 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively

4 NOVEMBER 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively

2 DECEMBER 2010

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

It also decided to continue conducting its main refinancing operations (MROs) as fixed rate tender procedures with full allotment for as long as necessary, and at least until 12 April 2011. This procedure will also remain in use for the Eurosystem's special-term refinancing operations with a maturity of one maintenance period, which will continue to be conducted for as long as needed, and at least until the end of the first quarter of 2011. The fixed rate in these special-term refinancing operations will be the same as the MRO rate prevailing at the time. Furthermore, the Governing Council has decided to conduct the three-month longer-term refinancing operations (LTROs) to be allotted at end-January, end-February and end-March 2011 as fixed rate tender procedures with full allotment. The rates in these three-month operations will be fixed at the average rate of the MROs over the life of the respective LTRO.

21 DECEMBER 2010

The Governing Council of the European Central Bank (ECB) has taken a decision, in coordination with other central banks, to extend the liquidity swap arrangements with the Federal Reserve up to 1 August 2011, and to continue to conduct US dollar liquidity-providing operations with a maturity of seven days. These Eurosystem operations will continue to take the form of repurchase operations against eligible collateral and will be carried out as fixed rate tenders with full allotment. The next US dollar liquidity-providing operation will be carried out on 22 December 2010, with settlement on 23 December; by way of exception, however, it will be conducted as a 14-day operation to cover the year-end.

13 JANUARY 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

3 FEBRUARY 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

3 MARCH 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively.

It also decided to continue conducting its main refinancing operations (MROs) as fixed rate tender procedures with full allotment for as long as necessary, and at least until 12 July 2011. This procedure will also remain in use for the Eurosystem's special-term refinancing operations with a maturity of one maintenance period, which will continue to be conducted for as long as needed, and at least until the end of the second quarter of 2011. The fixed rate in these special-term refinancing operations will be the same as the MRO rate prevailing at the time. Furthermore, the Governing Council decided to conduct the three-month longer-term refinancing operations (LTROs) to be allotted at end-April, end-May and end-June 2011 as fixed rate tender procedures with full allotment. The rates in these three-month operations will be fixed at the average rate of the MROs over the life of the respective LTRO.

31 MARCH 2011

The Governing Council of the ECB decided to suspend the application of the minimum credit rating threshold (BBB-) in the collateral eligibility requirements for the purposes of the Eurosystem's credit operations in the case of marketable debt instruments issued or guaranteed by the Irish government. The Irish government is implementing the economic and financial adjustment programme. The Governing Council has assessed the programme positively. The suspension is based on this positive assessment of the programme, the commitment of the Irish government to fully implement it and the Irish government's decisions to ensure a capital increase of €24 billion, for four Irish banks, and to deleverage and downsize the banking sector.

7 APRIL 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations of the Eurosystem will be increased by 25 basis points to 1.25%, and that the interest rates on the marginal lending facility and the deposit facility will be increased by 25 basis points to 2.00% and 0.50% respectively, with effect from 13 April 2011.

5 MAY 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.25%, 2.00% and 0.50% respectively.

9 JUNE 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.25%, 2.00% and 0.50% respectively.

It also decided to continue conducting its main refinancing operations (MROs) as fixed rate tender procedures with full allotment for as long as necessary and at least until 11 October 2011. This procedure will also remain in use for the Eurosystem's special-term refinancing operations with a maturity of one maintenance period, which will continue to be conducted for as long as needed, and at least until the end of the third quarter of 2011. The fixed rate in these special-term refinancing operations will be the same as the MRO rate prevailing at the time. Furthermore, the Governing Council has decided to conduct the three-month longer-term refinancing operations (LTROs) to be allotted at the end of July, August and September 2011 as fixed rate tender procedures with full allotment. The rates in these three-month operations will be fixed at the average rate of the MROs over the life of the respective LTRO.

29 JUNE 2011

The Governing Council decided to continue to conduct US dollar liquidity-providing operations with a maturity of seven days. These operations will continue to take the form of repurchase operations against eligible collateral and will be carried out as fixed rate tenders with full allotment. To this end, the Governing Council of the ECB has taken a decision, in coordination with other central banks, to extend the liquidity swap arrangements with the Federal Reserve up to 1 August 2012.

7 JULY 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations of the Eurosystem will be increased by 25 basis points to 1.50%, starting from the operation to be settled on 13 July 2011 and the interest rates on the marginal lending facility and the deposit facility will be increased by 25 basis points to 2.25% and 0.75% respectively, with effect from 13 July 2011.

The Governing Council of the ECB also decided to suspend the application of the minimum credit rating threshold (BBB-) in the collateral eligibility requirements for the purposes of the Eurosystem's credit operations in the case of marketable debt instruments issued or guaranteed by the Portuguese government. The Portuguese government has approved an economic and financial adjustment programme. The Governing Council has assessed the programme and considers it to be appropriate, while the Portuguese government is committed to fully implement it.

4 AUGUST 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.50%, 2.25% and 0.75% respectively.

Given the renewed tensions in some financial markets in the euro area, the Governing Council of the ECB also decided to conduct a supplementary liquidity-providing longer-term refinancing operation (LTRO) with a maturity of approximately six months on 11 August 2011. The operation will be conducted as a fixed-rate tender procedure with full allotment. The rate of the operation will be fixed at the average rate of the main refinancing operations (MROs) over the life of the supplementary LTRO.

The Governing Council also decided to continue conducting its MROs as fixed rate tender procedures with full allotment for as long as necessary and at least until 17 January 2012. This procedure will also remain in use for the Eurosystem's special-term refinancing operations with a maturity of one maintenance period, which will continue to be conducted for as long as needed, and at least until the end of the fourth quarter of 2011. The fixed rate in these special-term refinancing operations will be the same as the MRO rate prevailing at the time. Furthermore, the Governing Council decided to conduct the three-month LTROs to be allotted at the end of October, November and December 2011 as fixed rate tender procedures with full allotment. The rates in these three-month operations will be fixed at the average rate of the MROs over the life of the respective LTRO.

8 SEPTEMBER 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.50%, 2.25% and 0.75% respectively.

15 SEPTEMBER 2011

The Governing Council of the ECB decided, in coordination with the Federal Reserve, the Bank of England, the Bank of Japan and the Swiss National Bank, to conduct three US dollar liquidity-providing operations with a maturity of approximately three months covering the end of the year. These operations will be conducted in early October, November and December 2011. These will all take the form of repurchase operations against eligible collateral and will be carried out as fixed rate tender procedures with full allotment.

6 OCTOBER 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.50%, 2.25% and 0.75% respectively.

The Governing Council also decided to conduct two longer-term refinancing operations (LTROs), one with a maturity of approximately 12 months, on 27 October 2011, and the other with a maturity of approximately 13 months, on 22 December 2011. The operations will be conducted as fixed-rate tenders with full allotment. In both operations, the rate applied will be fixed at the average of the rates in the main refinancing operations (MROs) over the life of the relevant LTRO (371 days and 406 days, respectively), and interest will be paid at maturity.

The Governing Council also decided to continue conducting its MROs as fixed rate tender procedures with full allotment for as long as necessary and at least until 10 July 2012. This procedure will also remain in use for the Eurosystem's special-term refinancing operations with a maturity of one maintenance period, which will continue to be conducted for as long as necessary and at least until the above date. The fixed rate in each special-term refinancing operation will be the same as the MRO rate prevailing at that time. In addition, the Governing Council decided to conduct the three-month LTROs due to be allotted at the end of the months January-June 2012 as fixed-rate tender procedures with full allotment. In each of these three-month operations, the rate applied will be fixed at the average of the rates in the MROs over the life of the relevant LTRO.

Finally, the Governing Council also decided to launch a new covered bond purchase programme (CBPP2) involving purchases for an intended amount of €40 billion. Further details regarding the modalities of CBPP2 will be announced after the Governing Council's meeting on 3 November 2011.

3 NOVEMBER 2011

The Governing Council of the ECB decided that the interest rate on the main refinancing operations of the Eurosystem will be decreased by 25 basis points to 1.25%, starting from the operation to be settled on 9 November 2011, and the interest rates on the marginal lending facility and the deposit facility will be decreased by 25 basis points to 2.00% and 0.50% respectively, with effect from 9 November 2011.

The Governing Council also decided upon the technical modalities of the new covered bond purchase programme (CBPP2). It decided, inter alia, the following: the purchases of covered bonds will be distributed across the euro area. The counterparties qualified to participate in the CBPP2 are those eligible for the Eurosystem's monetary policy operations, together with any other counterparties that are used by the Eurosystem for the investment of its euro-denominated portfolios. In order to be qualified for purchase under the programme, covered bonds must: be eligible for use as collateral in Eurosystem credit operations; have a minimum rating of BBB- or equivalent from at least one of the major rating agencies; have a maximum residual maturity of 10.5 years; and have an issue volume of €300 million or more. Furthermore, the Governing Council decided to make its CBPP2 portfolio available for lending. Lending will be voluntary and conducted through security lending facilities offered by central securities depositories or via matched repo transactions with eligible counterparties.

STATISTICAL APPENDIX

TABLES

Table 1 Consumer price index: general index and basic sub-indices

Period		General index (2009=100)	General index: Percentage change over previous year	Goods (2009=100)	Goods: Percentage change over previous year	Services (2009=100)	Services: Percentage change over previous year	CPI excluding fresh fruit/vegetables and fuel (2009=100)	CPI excluding fresh fruit/vegetables and fuel: Percentage change over previous year	CPI excluding food and fuel (2009=100)	CPI excluding food and fuel: Percentage change over previous year
2007		94.9	2.9	96.4	2.5	92.9	3.5	94.5	2.9	94.6	3.0
2008		98.8	4.2	100.6	4.3	96.5	3.9	97.7	3.4	97.5	3.0
2009		100.0	1.2	100.0	-0.5	100.0	3.6	100.0	2.4	100.0	2.6
2010		104.7	4.7	105.6	5.6	103.6	3.6	103.0	3.0	103.4	3.4
2010	I	101.7	3.0	101.3	2.8	102.2	3.3	100.7	1.7	100.8	2.1
	II	105.3	5.2	106.9	6.2	103.3	3.8	103.4	3.3	104.0	3.8
	III	105.1	5.5	105.8	6.7	104.2	4.0	103.2	3.7	103.6	4.1
	IV	106.7	5.1	108.3	6.6	104.5	3.1	104.7	3.3	105.3	3.6
2011	I	106.5	4.7	107.3	5.9	105.5	3.2	103.2	2.5	103.3	2.5
	II	109.0	3.5	111.7	4.5	105.7	2.4	105.2	1.7	105.7	1.6
	III	107.6	2.4	108.9	2.9	106.0	1.8	104.0	0.7	104.0	0.3
2009	Jan.	98.7	1.8	98.4	-0.3	99.1	4.5	99.0	3.3	98.8	3.4
	Feb.	97.8	1.6	97.0	-0.4	98.8	4.3	97.9	3.2	97.4	3.3
	March	99.7	1.3	100.3	-0.8	98.9	4.2	100.0	3.1	99.9	3.2
	Apr.	100.0	1.0	100.5	-1.3	99.4	4.2	100.0	2.7	100.0	2.9
	May	100.3	0.5	100.8	-1.6	99.5	3.5	100.1	2.1	100.2	2.4
	June	100.2	0.5	100.7	-1.5	99.6	3.3	100.1	2.1	100.2	2.3
	July	99.5	0.6	99.2	-1.3	99.8	3.1	99.4	2.0	99.3	2.2
	Aug.	98.7	0.8	97.7	-1.1	100.1	3.3	98.7	2.1	98.4	2.3
	Sept.	100.6	0.7	100.6	-1.2	100.6	3.3	100.7	2.1	100.9	2.3
	Oct.	101.1	1.2	101.2	-0.4	101.0	3.4	101.0	2.0	101.2	2.3
	Nov.	101.6	2.0	101.9	1.1	101.2	3.2	101.4	2.0	101.6	2.4
	Dec.	101.8	2.6	101.6	2.3	102.0	3.1	101.8	2.0	102.1	2.4
2010	Jan.	101.0	2.4	100.3	2.0	102.0	2.9	100.6	1.6	100.7	1.9
	Feb.	100.5	2.8	99.3	2.4	102.0	3.3	99.4	1.5	99.2	1.9
	March	103.7	3.9	104.4	4.0	102.7	3.8	102.0	2.0	102.4	2.5
	Apr.	104.9	4.8	106.2	5.7	103.1	3.7	103.0	2.9	103.4	3.4
	May	105.7	5.4	107.5	6.6	103.3	3.8	103.7	3.6	104.2	4.1
	June	105.4	5.2	107.0	6.2	103.4	3.9	103.7	3.6	104.3	4.1
	July	104.9	5.5	105.6	6.4	104.1	4.3	103.2	3.8	103.6	4.3
	Aug.	104.2	5.5	104.2	6.7	104.2	4.0	102.2	3.6	102.4	4.1
	Sept.	106.2	5.6	107.6	7.0	104.3	3.6	104.3	3.6	104.9	4.0
	Oct.	106.4	5.2	107.8	6.6	104.4	3.4	104.6	3.5	105.2	4.0
	Nov.	106.6	4.9	108.2	6.1	104.5	3.3	104.7	3.3	105.4	3.7
	Dec.	107.0	5.2	108.9	7.1	104.6	2.6	104.8	3.0	105.4	3.3
2011	Jan.	106.3	5.2	107.1	6.8	105.3	3.2	103.3	2.7	103.4	2.7
	Feb.	104.9	4.4	104.4	5.1	105.5	3.5	101.5	2.1	101.3	2.1
	March	108.3	4.5	110.5	5.9	105.6	2.8	104.7	2.6	105.1	2.7
	Apr.	109.0	3.9	111.6	5.1	105.7	2.5	105.1	2.1	105.5	2.1
	May	109.2	3.3	111.9	4.1	105.7	2.3	105.3	1.5	105.7	1.4
	June	109.0	3.3	111.5	4.3	105.7	2.2	105.3	1.6	105.7	1.4
	July	107.4	2.4	108.8	3.0	105.8	1.7	103.8	0.6	103.7	0.2
	Aug.	105.9	1.7	106.1	1.7	105.8	1.6	102.2	0.0	101.9	-0.6
	Sept.	109.4	3.1	111.9	3.9	106.4	2.0	106.0	1.6	106.3	1.3
	Oct.	109.6	3.0	112.1	3.9	106.4	1.9	106.0	1.4	106.3	1.0

Source: Calculations based on ELSTAT data.

Table 2 Harmonised index of consumer prices: general index and basic sub-indices

Period		General index (2005=100)	General index: Percentage change over previous year	Unprocessed food (2005=100)	Unprocessed food: Percentage change over previous year	Processed food (2005=100)	Processed food: Percentage change over previous year	Non-energy industrial goods (2005=100)	Non-energy industrial goods: Percentage change over previous year
2007		106.4	3.0	104.2	2.2	109.1	3.7	103.8	2.2
2008		110.9	4.2	108.3	4.0	114.6	5.0	105.9	2.0
2009		112.4	1.3	112.5	3.9	116.5	1.6	106.7	0.8
2010		117.7	4.7	112.7	0.2	122.3	5.0	108.7	1.9
2010	I	114.3	3.0	112.7	-1.7	116.9	1.0	105.0	-0.3
	II	118.4	5.1	113.3	-1.8	122.9	5.0	110.4	2.4
	III	118.2	5.6	112.0	2.0	124.6	6.9	107.6	2.8
	IV	119.9	5.1	113.0	2.3	124.8	6.9	111.9	2.6
2011	I	119.4	4.5	115.7	2.7	126.3	8.1	104.9	-0.1
	II	122.3	3.3	118.8	4.9	127.0	3.3	111.6	1.1
	III	120.7	2.1	114.8	2.5	128.6	3.2	106.2	-1.3
2009	Jan.	111.0	2.0	114.6	5.4	115.2	2.2	105.5	2.1
	Feb.	109.8	1.8	114.1	5.5	115.7	1.8	101.9	2.3
	March	112.0	1.5	114.9	6.4	116.5	1.9	108.9	2.0
	Apr.	112.5	1.1	116.1	4.6	117.1	1.9	107.7	0.7
	May	112.8	0.7	116.7	6.4	117.2	1.4	107.8	0.2
	June	112.7	0.7	113.0	6.8	116.8	1.5	107.8	0.2
	July	111.8	0.7	110.9	6.9	116.7	1.5	104.9	0.2
	Aug.	110.9	1.0	108.3	3.9	116.5	1.5	101.3	0.5
	Sept.	113.0	0.7	110.2	3.9	116.4	1.4	107.9	0.2
	Oct.	113.6	1.2	110.4	0.5	116.6	1.4	108.4	0.0
	Nov.	114.3	2.1	111.3	-1.3	116.9	1.5	109.4	0.7
	Dec.	114.5	2.6	110.0	-1.5	116.8	1.6	109.4	0.7
2010	Jan.	113.6	2.3	110.9	-3.2	117.0	1.6	105.2	-0.3
	Feb.	112.9	2.9	113.1	-0.9	117.0	1.1	100.9	-1.0
	March	116.4	3.9	114.0	-0.8	116.7	0.2	109.0	0.2
	Apr.	117.8	4.7	115.1	-0.9	120.3	2.7	109.9	2.0
	May	118.7	5.3	113.9	-2.4	124.0	5.8	110.7	2.7
	June	118.5	5.2	110.8	-2.0	124.5	6.6	110.7	2.6
	July	118.0	5.5	110.0	-0.7	124.8	7.0	107.6	2.6
	Aug.	117.2	5.6	112.2	3.6	124.7	7.0	104.0	2.6
	Sept.	119.4	5.7	113.7	3.1	124.3	6.8	111.3	3.1
	Oct.	119.5	5.2	112.9	2.3	124.4	6.8	111.9	3.1
	Nov.	119.8	4.8	113.1	1.7	125.0	6.9	111.9	2.3
	Dec.	120.4	5.2	113.1	2.8	125.1	7.1	112.0	2.3
2011	Jan.	119.2	4.9	113.9	2.7	126.4	8.0	105.7	0.4
	Feb.	117.6	4.2	116.1	2.6	126.3	8.0	98.9	-1.9
	March	121.4	4.3	117.1	2.8	126.3	8.2	110.2	1.0
	Apr.	122.2	3.7	119.0	3.5	126.8	5.4	111.2	1.2
	May	122.4	3.1	119.7	5.1	127.1	2.5	111.7	1.0
	June	122.2	3.1	117.6	6.1	127.2	2.1	111.8	1.0
	July	120.5	2.1	115.5	5.0	127.7	2.4	106.1	-1.4
	Aug.	118.8	1.4	114.4	2.0	128.1	2.7	100.5	-3.3
	Sept.	122.8	2.9	114.4	0.6	130.0	4.6	112.0	0.7
	Oct.	123.0	2.9	115.5	2.3	130.1	4.6	111.9	0.0

Source: Calculations based on ELSTAT data.

Table 2 Harmonised index of consumer prices: general index and basic sub-indices *(continued)*

Period		Energy		Services		HICP excluding unprocessed food and energy	
		(2005=100)	Percentage change over previous year	(2005=100)	Percentage change over previous year	(2005=100)	Percentage change over previous year
2007		111.8	2.1	106.9	3.7	106.2	3.2
2008		127.2	13.8	111.0	3.8	109.8	3.4
2009		111.8	-12.1	114.6	3.2	112.2	2.2
2010		145.7	30.4	118.1	3.1	115.6	3.0
2010	I	130.9	27.0	116.8	3.0	112.8	1.5
	II	148.5	35.8	117.8	3.2	116.1	3.2
	III	150.2	30.2	118.8	3.6	115.9	3.9
	IV	153.1	28.4	119.1	2.6	117.5	3.3
2011	I	164.3	25.5	119.9	2.6	115.7	2.6
	II	171.3	15.3	120.0	1.9	118.3	1.9
	III	171.4	14.1	120.4	1.4	116.8	0.8
2009	Jan.	102.6	-16.7	113.9	4.4	111.2	3.3
	Feb.	103.5	-17.0	113.1	4.1	109.7	3.1
	March	103.2	-19.5	113.3	3.9	112.3	3.0
	Apr.	106.9	-17.8	114.1	3.8	112.4	2.5
	May	109.0	-18.8	114.2	3.2	112.5	1.9
	June	112.3	-18.0	114.2	2.8	112.5	1.8
	July	114.3	-17.2	114.4	2.7	111.5	1.7
	Aug.	116.8	-13.6	114.6	2.9	110.4	1.9
	Sept.	114.9	-14.4	115.1	2.7	112.9	1.7
	Oct.	118.5	-5.1	115.4	2.8	113.2	1.7
	Nov.	120.3	5.5	115.8	2.9	113.8	2.0
	Dec.	118.9	15.7	116.8	2.6	114.3	1.8
2010	Jan.	123.0	20.0	116.7	2.5	112.8	1.4
	Feb.	129.3	24.9	116.6	3.0	111.3	1.4
	March	140.3	36.0	117.2	3.5	114.3	1.8
	Apr.	145.7	36.3	117.8	3.3	115.5	2.7
	May	150.4	38.0	117.7	3.1	116.3	3.4
	June	149.5	33.1	117.9	3.2	116.5	3.6
	July	150.6	31.8	118.7	3.8	115.9	3.9
	Aug.	150.1	28.5	118.8	3.6	114.6	3.9
	Sept.	150.0	30.5	118.9	3.3	117.1	3.8
	Oct.	150.0	26.5	118.9	3.1	117.4	3.7
	Nov.	151.8	26.2	119.0	2.7	117.5	3.2
	Dec.	157.6	32.6	119.3	2.2	117.7	3.0
2011	Jan.	161.2	31.0	119.8	2.6	116.0	2.8
	Feb.	162.8	25.9	120.0	2.9	113.7	2.2
	March	168.9	20.4	119.9	2.3	117.6	2.8
	Apr.	171.8	17.9	120.0	1.9	118.1	2.2
	May	171.8	14.3	120.1	2.0	118.3	1.7
	June	170.3	13.9	120.1	1.9	118.4	1.6
	July	171.4	13.8	120.1	1.2	116.5	0.6
	Aug.	171.0	13.9	120.2	1.1	114.6	0.0
	Sept.	171.8	14.5	121.0	1.8	119.3	1.9
	Oct.	172.8	15.2	120.9	1.7	119.3	1.6

Source: Calculations based on ELSTAT data.

Table 3 Industrial producer price index (PPI) for the domestic market: general index and basic sub-indices

Period		PPI – domestic market (General index)		Energy (total)		Fuel		General index excl. energy	
		(2005=100)	Percentage change over previous year	(2005=100)	Percentage change over previous year	(2005=100)	Percentage change over previous year	(2005=100)	Percentage change over previous year
2007		111.7	4.1	115.4	6.3	117.0	2.7	109.4	2.7
2008		123.0	10.0	135.2	17.1	145.8	24.7	116.4	6.4
2009		115.8	-5.8	115.0	-15.0	104.2	-28.6	116.3	-0.1
2010		122.9	6.1	133.1	15.8	137.8	32.3	117.4	0.9
2010	I	120.7	6.4	127.5	16.9	128.0	46.6	117.0	1.1
	II	123.3	7.5	135.2	19.7	142.5	39.3	117.0	1.1
	III	122.6	4.9	132.5	12.9	136.2	22.7	117.4	0.6
	IV	125.0	5.6	137.3	13.8	144.6	24.6	118.4	1.0
2011	I	129.9	7.6	148.2	16.2	167.9	31.2	120.0	2.6
	II	132.1	7.1	153.7	13.7	177.8	24.7	120.5	3.0
	III	132.6	8.1	154.7	16.8	177.6	30.3	120.7	2.8
2009	Jan.	114.0	-3.4	110.1	-13.4	88.4	-35.0	116.1	2.6
	Feb.	113.3	-5.3	108.9	-15.4	87.1	-37.9	115.6	0.8
	March	112.9	-6.8	108.2	-17.8	86.5	-40.9	115.3	-0.1
	Apr.	113.2	-7.9	108.8	-19.9	93.3	-39.2	115.5	-0.3
	May	114.3	-9.4	111.9	-22.5	100.4	-41.4	115.7	-0.6
	June	116.7	-9.1	118.1	-20.6	113.3	-37.4	115.9	-1.2
	July	116.0	-11.1	115.6	-25.0	107.4	-41.0	116.2	-1.3
	Aug.	117.8	-8.1	120.2	-18.5	117.2	-29.7	116.6	-1.2
	Sept.	116.9	-7.9	116.2	-19.2	108.6	-31.4	117.3	-0.5
	Oct.	118.0	-3.8	119.6	-9.6	114.0	-12.2	117.1	-0.4
	Nov.	118.4	0.8	121.0	1.3	117.2	13.5	117.1	0.5
	Dec.	118.7	4.5	121.2	11.4	116.9	42.6	117.4	1.0
2010	Jan.	120.0	5.2	125.8	14.2	124.5	40.9	116.8	0.6
	Feb.	120.2	6.2	126.2	15.9	125.3	43.9	117.0	1.2
	March	121.8	7.9	130.6	20.7	134.2	55.2	117.1	1.5
	Apr.	123.5	9.1	135.1	24.1	142.6	52.7	117.2	1.5
	May	122.7	7.3	133.8	19.6	140.0	39.4	116.8	1.0
	June	123.8	6.1	136.7	15.7	145.1	28.0	116.8	0.8
	July	122.3	5.5	132.2	14.4	135.9	26.5	117.0	0.7
	Aug.	122.6	4.0	132.3	10.1	136.5	16.4	117.3	0.7
	Sept.	123.0	5.3	132.9	14.4	136.3	25.6	117.7	0.4
	Oct.	123.2	4.4	132.8	11.0	137.0	20.2	118.0	0.7
	Nov.	124.8	5.4	137.1	13.3	142.5	21.6	118.2	1.0
	Dec.	126.9	6.9	141.9	17.2	154.2	31.9	118.8	1.2
2011	Jan.	128.1	6.8	144.0	14.5	158.9	27.6	119.5	2.3
	Feb.	129.8	8.0	147.8	17.1	166.8	33.1	120.1	2.6
	March	131.7	8.2	152.8	17.0	178.0	32.6	120.4	2.9
	Apr.	133.3	7.9	156.9	16.2	184.6	29.5	120.5	2.8
	May	131.5	7.1	152.0	13.7	174.6	24.7	120.4	3.1
	June	131.6	6.3	152.1	11.3	174.1	20.0	120.5	3.1
	July	133.0	8.7	156.0	18.0	181.1	33.3	120.6	3.1
	Aug.	131.8	7.5	152.5	15.3	173.2	26.8	120.7	2.8
	Sept.	133.0	8.1	155.6	17.1	178.5	30.9	120.8	2.6

Source: Calculations based on ELSTAT data.

Table 4 Industrial producer price index (PPI) for the external market and import price index in industry

Period		PPI – external market				Import price index		Import price index excl. energy	
		General index		General index excl. energy					
		(2005=100)	Percentage change over previous year	(2005=100)	Percentage change over previous year	(2005=100)	Percentage change over previous year	(2005=100)	Percentage change over previous year
2007		108.0	3.0	105.6	2.5	106.9	2.6	105.8	3.0
2008		114.9	6.4	108.9	3.2	114.5	7.1	108.4	2.5
2009		108.0	-6.0	109.4	0.5	112.5	-1.8	108.9	0.5
2010		117.5	8.8	113.9	4.0	120.0	6.6	110.4	1.4
2010	I	114.2	9.4	112.3	3.6	117.8	8.3	109.6	0.8
	II	117.9	10.2	113.5	4.5	120.7	8.0	110.2	1.4
	III	117.7	7.5	114.2	3.9	120.1	5.2	110.5	1.4
	IV	120.2	8.3	115.5	4.3	121.2	5.1	111.2	1.9
2011	I	125.8	10.2	117.6	4.8	126.6	7.4	111.9	2.1
	II	127.8	8.4	118.1	4.0	129.2	7.1	112.1	1.8
	III	128.7	9.3	118.5	3.8	129.5	7.8	112.1	1.5
2009	Jan.	105.0	-6.3	108.6	1.2	108.8	-1.7	108.7	1.7
	Feb.	104.5	-7.7	108.6	0.4	108.8	-2.5	108.8	1.3
	March	103.8	-9.2	108.0	-0.5	108.7	-3.1	108.7	1.1
	Apr.	105.0	-9.0	108.1	-0.4	109.7	-3.7	108.5	0.7
	May	106.6	-10.0	108.7	0.0	111.6	-4.5	108.7	0.6
	June	109.4	-9.5	109.3	0.0	113.9	-4.8	108.9	0.3
	July	108.2	-10.7	109.2	-0.2	113.3	-6.4	108.9	0.1
	Aug.	110.7	-6.8	110.0	0.4	115.2	-2.9	109.0	-0.1
	Sept.	109.6	-7.0	110.5	0.4	114.0	-1.7	109.0	-0.5
	Oct.	110.6	-2.4	110.7	0.9	115.0	0.9	109.1	-0.3
	Nov.	111.1	2.0	110.5	1.2	115.7	4.0	109.1	0.2
	Dec.	111.3	6.6	111.0	2.4	115.5	6.3	109.1	0.5
2010	Jan.	113.1	7.8	111.8	2.9	116.9	7.4	109.3	0.6
	Feb.	113.6	8.7	112.1	3.2	117.4	7.9	109.6	0.8
	March	115.9	11.6	112.9	4.6	119.1	9.6	109.9	1.1
	Apr.	117.9	12.3	113.3	4.8	120.9	10.1	110.0	1.4
	May	117.5	10.2	113.5	4.5	120.3	7.8	110.1	1.3
	June	118.2	8.1	113.8	4.1	121.0	6.2	110.4	1.4
	July	117.2	8.4	113.6	4.0	120.1	6.0	110.3	1.3
	Aug.	117.8	6.4	114.2	3.9	120.6	4.6	110.5	1.4
	Sept.	118.1	7.8	114.6	3.8	119.7	4.9	110.5	1.4
	Oct.	118.4	7.0	114.7	3.6	119.6	4.0	110.9	1.7
	Nov.	119.8	7.8	115.5	4.5	121.0	4.6	111.1	1.9
	Dec.	122.4	10.0	116.3	4.7	123.0	6.6	111.5	2.2
2011	Jan.	123.7	9.4	116.9	4.6	124.0	6.1	111.7	2.1
	Feb.	125.6	10.5	117.7	4.9	126.3	7.6	111.9	2.1
	March	128.1	10.6	118.4	4.9	129.4	8.6	112.1	2.0
	Apr.	128.5	9.0	117.9	4.0	130.5	8.0	112.1	1.9
	May	127.1	8.2	118.1	4.0	128.1	6.5	112.2	1.8
	June	127.6	8.0	118.3	4.0	129.0	6.7	112.1	1.6
	July	129.3	10.3	118.9	4.6	130.6	8.7	112.2	1.7
	Aug.	127.9	8.6	118.5	3.7	128.3	6.4	112.0	1.4
	Sept.	128.7	9.0	118.1	3.0	129.6	8.3	112.0	1.4

Source: Calculations based on ELSTAT data.

Table 5 Employed persons of 15 years and over, by branch of economic activity

(thousands)

	Q2 2011	
	Total employed persons	Salaried employees
Total	**4,156.3**	**2,645.9**
Agriculture, forestry and fishing	509.8	50.9
Mining and quarrying	10.4	8.7
Manufacturing	417.0	306.4
Electricity, gas, steam and air conditioning supply	22.7	22.2
Water supply, sewerage, waste management and remediation activities	28.1	26.9
Construction	262.2	168.5
Wholesale and retail trade; repair of motor vehicles and motorcycles	772.9	431.0
Transportation and storage	205.5	139.1
Accommodation and food service activities	303.8	173.7
Information and communication	79.5	70.3
Financial and insurance activities	111.9	99.6
Real estate activities	4.5	0.6
Professional, scientific and technical activities	212.4	79.0
Administrative and support service activities	81.7	64.7
Public administration and defence; compulsory social security	365.9	365.9
Education	313.0	287.0
Human health and social work activities	238.7	196.6
Arts, entertainment and recreation	48.4	31.3
Other service activities	87.6	46.7
Activities of households as employers	78.6	74.8
Activities of extraterritorial organisations and bodies	2.0	2.0

Source: ELSTAT, Labour Force Survey.

Table 6 Balance of payments

(million euro)

		January-August			August		
		2009	2010	2011	2009	2010	2011
I	**CURRENT ACCOUNT BALANCE (I.A+I.B+I.C+I.D)**	**-16,149.5**	**-15,170.8**	**-13,918.8**	**-466.9**	**-198.6**	**-145.0**
I.A	***TRADE BALANCE (I.A.1–I.A.2)***	***-20,596.0***	***-19,990.2***	***-18,939.7***	***-2,277.8***	***-2,029.5***	***-2,169.7***
	Oil trade balance	-5,131.0	-6,191.3	-7,634.8	-820.0	-724.0	-959.6
	Non-oil trade balance	-15,464.9	-13,798.9	-11,304.9	-1,457.8	-1,305.6	-1,210.1
	Ship balance	-2,441.7	-2,503.7	-2,396.5	-199.9	-227.0	-321.1
	Trade balance excl. oil and ships	-13,023.2	-11,295.1	-8,908.4	-1,257.9	-1,078.6	-889.0
	I.A.1 Exports of goods	*10,013.8*	*10,694.1*	*13,180.2*	*1,236.3*	*1,358.1*	*1,834.8*
	Oil	1,978.4	2,994.1	4,126.4	304.2	410.0	621.0
	Ships (receipts)	556.8	491.4	588.2	32.3	45.2	37.5
	Other goods	7,478.6	7,208.6	8,465.5	899.8	902.9	1,176.3
	I.A.2 Imports of goods	*30,609.7*	*30,684.3*	*32,119.9*	*3,514.1*	*3,387.7*	*4,004.4*
	Oil	7,109.5	9,185.5	11,761.2	1,124.2	1,134.0	1,580.6
	Ships (payments)	2,998.5	2,995.1	2,984.8	232.2	272.2	358.6
	Other goods	20,501.8	18,503.7	17,373.9	2,157.7	1,981.5	2,065.2
I.B	***SERVICES BALANCE (I.B.1–I.B.2)***	***9,166.2***	***9,410.9***	***9,945.0***	***2,499.8***	***2,561.1***	***2,807.1***
	I.B.1 Receipts	*18,553.9*	*19,580.1*	*19,533.0*	*3,647.3*	*3,770.1*	*3,983.3*
	Travel	7,603.0	7,013.8	7,717.9	2,362.6	2,232.9	2,378.2
	Transport	9,065.3	10,441.6	9,306.7	1,079.3	1,278.6	1,223.5
	Other services	1,885.6	2,124.7	2,508.4	205.3	258.6	381.6
	I.B.2 Payments	*9,387.7*	*10,169.1*	*9,587.9*	*1,147.5*	*1,209.0*	*1,176.2*
	Travel	1,646.0	1,489.0	1,589.6	286.0	211.2	306.8
	Transport	4,594.7	5,492.0	4,966.4	534.9	665.4	585.5
	Other services	3,147.0	3,188.1	3,031.9	326.5	332.3	283.8
I.C	***INCOME BALANCE (I.C.1–I.C.2)***	***-6,225.0***	***-5,477.3***	***-5,806.9***	***-645.4***	***-571.8***	***-628.0***
	I.C.1 Receipts	*3,016.0*	*2,410.0*	*2,159.7*	*306.3*	*285.1*	*278.0*
	Wages, salaries	204.2	134.3	124.3	21.7	16.0	13.2
	Interest, dividends, profits	2,811.9	2,275.7	2,035.4	284.7	269.1	264.9
	I.C.2 Payments	*9,241.0*	*7,887.3*	*7,966.6*	*951.8*	*856.9*	*906.1*
	Wages, salaries	267.1	251.5	297.0	30.2	30.6	41.6
	Interest, dividends, profits	8,973.9	7,635.9	7,669.5	921.6	826.3	864.4
I.D	***CURRENT TRANSFERS BALANCE (I.D.1–I.D.2)***	***1,505.2***	***885.7***	***882.8***	***-43.5***	***-158.4***	***-154.5***
	I.D.1 Receipts	*4,272.5*	*3,855.5*	*3,568.8*	*310.4*	*228.3*	*142.2*
	General government (mainly transfers from the EU)	2,962.4	2,857.7	2,763.4	187.9	125.6	39.2
	Other sectors (emigrants' remittances etc.)	1,310.1	997.7	805.4	122.5	102.8	102.9
	I.D.2 Payments	*2,767.3*	*2,969.7*	*2,686.1*	*353.9*	*386.7*	*296.7*
	General government (mainly payments to the EU)	1,821.7	1,905.6	1,721.8	197.0	215.4	171.4
	Other sectors	945.6	1,064.1	964.3	157.0	171.4	125.3
II	**CAPITAL TRANSFERS BALANCE (II.1– II.2)**	**1,534.2**	**787.4**	**1,144.2**	**278.0**	**-13.2**	**579.9**
	II.1 Receipts	*1,739.5*	*970.4*	*1,304.2*	*303.2*	*11.7*	*604.8*
	General government (mainly transfers from the EU)	1,602.0	885.5	1,236.8	290.8	2.6	591.6
	Other sectors	137.5	84.8	67.4	12.5	9.2	13.2
	II.2 Payments	*205.4*	*183.0*	*160.0*	*25.2*	*24.9*	*24.9*
	General government (mainly payments to the EU)	8.9	12.8	8.9	1.0	0.7	0.9
	Other sectors	196.5	170.1	151.0	24.3	24.2	24.0
III	**CURRENT ACCOUNT AND CAPITAL TRANSFERS BALANCE (I+II)**	**-14,615.3**	**-14,383.4**	**-12,774.6**	**-189.0**	**-211.7**	**434.9**
IV	**FINANCIAL ACCOUNT BALANCE (IV.A+IV.B+IV.C+IV.D)**	**15,493.0**	**15,743.1**	**13,805.6**	**-70.1**	**778.7**	**26.5**
	IV.A DIRECT INVESTMENT [1]	***1,187.9***	***-269.4***	***-1,408.5***	***-5.7***	***-280.2***	***-119.6***
	By residents abroad	-651.7	-506.3	-1,190.3	-52.0	-124.0	-28.5
	By non-residents in Greece	1,839.7	236.8	-218.2	46.3	-156.2	-91.1
	IV.B PORTFOLIO INVESTMENT [1]	***21,085.0***	***-18,077.9***	***-11,266.8***	***-2,654.5***	***-11,880.2***	***-1,863.8***
	Assets	-8,708.9	9,637.3	9,490.6	-6,161.8	387.1	4,095.2
	Liabilities	29,794.0	-27,715.2	-20,757.4	3,507.3	-12,267.2	-5,959.0
	IV.C OTHER INVESTMENT [1]	***-6,758.0***	***33,989.4***	***26,475.9***	***2,598.0***	***12,935.1***	***1,981.8***
	Assets	-13,271.2	-4,342.1	-2,011.9	2,472.9	11,731.0	1,520.5
	Liabilities	6,513.2	38,331.5	28,487.8	125.2	1,204.1	461.4
	(General government loans)	*-1,859.5*	*18,521.3*	*32,069.0*	*-30.3*	*-329.6*	*-87.9*
	IV.D CHANGE IN RESERVE ASSETS [2]	***-22.0***	***101.0***	***5.0***	***-8.0***	***4.0***	***28.0***
V	**ERRORS AND OMISSIONS**	**-877.6**	**-1,359.7**	**-1,031.1**	**259.1**	**-567.0**	**-461.4**
	RESERVE ASSETS [3]				***3,348.0***	***4,624.0***	***4,723.0***

Source: Bank of Greece.
1 (+) net inflow, (-) net outflow.
2 (+) decrease, (-) increase.
3 Following Greece's entry into the euro area in January 2001, reserve assets, as defined by the European Central Bank, comprise monetary gold, the "reserve position" in the IMF, "Special Drawing Rights", and Bank of Greece's claims in foreign currency on non-euro area residents. Excluded are euro-denominated claims on non-euro area residents, claims (in foreign currency and in euro) on euro area residents, and the Bank of Greece share in the capital and reserves of the ECB.

Table 7 Monetary aggregates of the euro area[1,2]

(outstanding balances in billion euro, not seasonally adjusted)

End of period		Currency in circulation (1)	Overnight deposits (2)	M1 (3)=(1)+(2)	Deposits with agreed maturity up to two years (4)	Deposits redeemable at notice up to three months (5)	M2 (6)=(3)+(4)+(5)	Repurchase agreements (7)	Money market fund shares/units (8)	Debt securities up to two years (9)	M3[3] (10)=(6)+(7)+(8)+(9)
2006		578.4	3,107.1	3,685.5	1,404.9	1,554.1	6,644.5	267.4	636.2	196.0	7,744.1
2007		625.6	3,202.4	3,827.9	1,969.3	1,540.5	7,337.8	307.6	685.9	312.2	8,643.4
2008		711.8	3,279.1	3,990.9	2,477.8	1,568.1	8,036.8	346.5	749.2	266.1	9,398.4
2009		757.5	3,738.1	4,495.7	1,896.8	1,804.8	8,197.3	334.3	668.4	131.8	9,331.4
2010		793.6	3,901.2	4,694.8	1,785.1	1,914.9	8,394.8	433.8	570.4	121.2	9,520.0
2009	Jan.	716.7	3,370.8	4,087.5	2,392.7	1,596.9	8,077.0	335.3	766.2	216.2	9,394.5
	Feb.	721.7	3,407.6	4,129.3	2,355.0	1,621.4	8,105.7	335.9	778.6	214.3	9,434.2
	March	725.9	3,413.8	4,139.7	2,311.6	1,642.0	8,093.2	342.0	781.4	193.8	9,410.2
	Apr.	729.0	3,456.8	4,185.8	2,297.8	1,665.4	8,149.0	331.3	772.8	205.2	9,458.1
	May	729.7	3,474.9	4,204.6	2,254.4	1,684.2	8,143.1	326.1	757.7	197.7	9,424.3
	June	732.9	3,521.8	4,254.7	2,204.0	1,701.1	8,159.8	337.3	745.3	181.2	9,423.4
	July	734.6	3,588.5	4,323.1	2,143.4	1,724.6	8,191.1	328.7	752.5	170.4	9,442.4
	Aug.	740.9	3,619.7	4,360.5	2,087.4	1,742.9	8,190.8	315.2	746.8	155.8	9,408.3
	Sept.	745.8	3,657.1	4,403.0	2,026.3	1,760.2	8,189.5	326.5	746.1	147.8	9,409.6
	Oct.	747.9	3,713.7	4,461.6	1,963.6	1,780.6	8,205.7	301.0	741.8	138.4	9,386.6
	Nov.	753.4	3,715.2	4,468.7	1,916.8	1,790.1	8,175.6	312.2	721.8	133.5	9,342.8
	Dec.	757.5	3,738.1	4,495.7	1,896.8	1,804.8	8,197.3	334.3	668.4	131.8	9,331.4
2010	Jan.	761.1	3,771.1	4,532.2	1,854.5	1,816.8	8,203.5	320.5	657.5	131.4	9,312.8
	Feb.	765.4	3,792.1	4,557.5	1,838.2	1,827.1	8,222.8	331.6	642.3	124.9	9,321.6
	March	774.5	3,797.5	4,571.9	1,820.5	1,836.4	8,228.8	345.5	628.7	134.1	9,337.0
	Apr.	769.8	3,854.9	4,624.7	1,789.0	1,843.6	8,257.3	354.9	627.1	134.4	9,373.5
	May	778.9	3,872.7	4,651.6	1,794.3	1,849.1	8,295.0	358.9	618.7	129.1	9,401.5
	June	783.1	3,886.1	4,669.2	1,793.6	1,855.1	8,317.9	394.0	608.4	123.1	9,443.2
	July	782.8	3,907.6	4,690.4	1,785.3	1,867.0	8,342.7	390.2	592.2	126.9	9,451.7
	Aug.	790.0	3,917.8	4,707.8	1,794.2	1,883.5	8,385.5	391.2	597.1	126.5	9,500.0
	Sept.	790.6	3,890.1	4,680.7	1,795.1	1,897.5	8,373.3	400.1	593.5	128.4	9,495.3
	Oct.	791.8	3,892.9	4,684.6	1,804.3	1,908.6	8,397.6	377.3	579.4	122.6	9,476.9
	Nov.	795.9	3,889.5	4,685.4	1,795.7	1,917.7	8,398.9	431.4	585.3	119.6	9,535.2
	Dec.	793.6	3,901.2	4,694.8	1,785.1	1,914.9	8,394.8	433.8	570.4	121.2	9,520.0
2011	Jan.	802.6	3,881.2	4,683.8	1,807.9	1,916.3	8,408.0	408.4	575.2	127.4	9,518.8
	Feb.	804.8	3,886.6	4,691.4	1,820.3	1,918.2	8,430.0	441.3	573.9	125.6	9,570.7
	March	802.7	3,907.0	4,709.7	1,821.6	1,922.1	8,453.4	410.2	568.6	153.6	9,585.6
	Apr.	802.5	3,894.8	4,697.3	1,827.4	1,923.3	8,448.0	418.4	563.7	157.7	9,587.6
	May	812.5	3,889.4	4,702.0	1,852.4	1,933.9	8,488.4	457.3	556.3	158.1	9,659.9
	June	815.4	3,900.3	4,715.7	1,844.6	1,937.8	8,498.1	441.2	550.8	171.6	9,661.5
	July	816.3	3,913.8	4,730.1	1,849.6	1,944.1	8,523.7	455.7	535.3	174.2	9,688.7
	Aug.	825.4	3,954.1	4,779.5	1,849.9	1,953.4	8,582.8	499.8	546.4	172.2	9,801.1
	Sept.	832.3	3,948.3	4,780.6	1,865.2	1,959.2	8,605.1	508.7	552.7	182.7	9,849.1

Source: ECB.
* Provisional data.
1 Figures refer to the changing euro area composition.
2 Monetary aggregates comprise monetary liabilities of MFIs and central government (Post Office, Treasury) vis-à-vis non-MFI euro area residents excluding central government.
3 M3 and its components excluding non-residents' holdings of money market fund shares/units and debt securities of up to two years.

Table 8 The Greek contribution to the main monetary aggregates of the euro area

(outstanding amounts in million euro, not seasonally adjusted)

End of period		Overnight deposits			Deposits with an agreed maturity up to two years	Deposits redeemable at notice up to three months[1]	Repurchase agreements (repos)	Money market fund shares/units	Debt securities up to two years[2]	Total[3] (M3 excluding currency in circulation) (7)=(1)+(2)+ +(3)+(4)+ +(5)+(6)	Memo item: Currency in circulation[4]
		(1)	Sight deposits and current accounts (1.1)	Savings deposits (1.2)	(2)	(3)	(4)	(5)	(6)		
2006		100,108	26,030	74,078	69,301	2,965	1,568	5,808	490	180,240	13,377
2007		98,837	28,290	70,547	97,548	2,261	703	7,918	-1,587	205,680	14,247
2008		90,599	25,916	64,683	137,828	1,882	378	2,266	2,126	235,079	16,318
2009		103,165	31,057	72,109	134,003	3,141	189	1,539	-69	241,968	19,122
2010		90,831	26,977	63,854	117,623	3,015	87	935	6	212,497	20,383
2009	Jan.	87,801	24,904	62,897	141,972	2,085	268	2,052	1,796	235,974	17,735
	Feb.	87,691	24,776	62,916	142,315	2,119	277	1,852	1,635	235,889	17,848
	March	88,511	24,615	63,896	141,971	2,128	225	1,486	1,533	235,854	17,945
	Apr.	93,160	26,919	66,241	140,820	2,438	327	1,512	1,966	240,223	18,194
	May	92,007	25,748	66,259	140,258	2,543	265	1,530	1,887	238,490	18,322
	June	96,990	29,163	67,827	140,655	2,709	251	1,596	1,500	243,701	18,251
	July	96,415	27,771	68,644	137,865	2,889	265	1,682	1,263	240,379	18,557
	Aug.	97,942	28,580	69,362	138,050	2,967	236	1,706	1,239	242,140	18,385
	Sept.	98,853	29,093	69,760	138,804	2,930	232	1,724	1,013	243,556	18,498
	Oct.	97,506	27,964	69,542	137,766	3,080	226	1,656	891	241,125	18,595
	Nov.	98,626	29,498	69,128	135,157	3,087	184	1,599	325	238,978	18,706
	Dec.	103,165	31,057	72,109	134,003	3,141	189	1,539	-69	241,968	19,122
2010	Jan.	100,503	28,653	71,850	131,480	3,214	174	1,500	-75	236,796	18,859
	Feb.	99,125	27,983	71,142	128,957	3,138	149	1,306	-73	232,602	19,022
	March	98,051	27,253	70,798	127,505	2,918	169	1,167	-75	229,735	19,111
	Apr.	96,950	27,364	69,586	123,047	2,800	136	1,031	-48	223,916	19,254
	May	95,559	26,934	68,625	121,702	2,872	123	966	-17	221,205	19,376
	June	96,283	28,877	67,406	119,794	3,531	105	894	-7	220,600	19,640
	July	93,401	26,700	66,701	118,021	3,290	138	894	2	215,746	19,839
	Aug.	92,649	26,362	66,287	119,596	3,267	128	899	1	216,540	19,732
	Sept.	92,831	27,906	64,925	119,522	3,031	110	935	2	216,431	19,719
	Oct.	91,462	26,499	64,963	119,480	3,015	113	856	-2	214,924	19,768
	Nov.	89,981	26,837	63,144	118,568	3,104	106	853	1	212,613	19,927
	Dec.	90,831	26,977	63,854	117,623	3,015	87	935	6	212,497	20,383
2011	Jan.	89,282	26,331	62,951	115,593	2,959	84	952	5	208,875	19,930
	Feb.	87,613	25,770	61,843	115,362	2,887	102	995	5	206,964	19,952
	March	85,280	25,807	59,473	114,097	2,805	99	981	5	203,267	19,951
	Apr.	84,482	25,009	59,473	112,744	2,768	78	979	4	201,055	20,266
	May	83,469	25,510	57,959	109,074	2,780	118	922	4	196,367	20,211
	June	83,007	26,121	56,886	105,767	2,721	71	832	3	192,401	20,417
	July	80,568	24,515	56,053	107,060	2,654	73	788	2	191,145	20,359
	Aug.	80,551	24,526	56,025	108,410	2,617	88	806	2	192,474	20,463
	Sept.	77,476	23,745	53,731	106,050	2,623	78	752	2	186,981	20,702

Source: Bank of Greece.
1 Including savings deposits in currencies other than the euro.
2 This aggregate is calculated on a consolidated basis with the other euro area countries and thus does not include domestic MFIs' holdings of debt securities up to two years issued by euro area MFIs.
3 As in all other euro area countries, Greece's M3 can no longer be calculated accurately, since part of the quantity of euro banknotes and coins in circulation in each country is held by residents of other euro area countries (as well as non-euro area residents). Owing to these technical problems, the compilation of the Greek M0, M1, M2 and M3 was discontinued in January 2003.
4 Since January 2002, banknotes in circulation are calculated on the basis of Greece's key for subscription to the ECB's capital, excluding the percentage (8%) of issued banknotes assigned to the ECB.

Table 9 Greece: deposits of domestic firms and households with OMFIs,[1] by currency and type

(outstanding balances in million euro, not seasonally adjusted)

End of period		Total deposits	Breakdown by currency: In euro	Breakdown by currency: In other currencies	Breakdown by type: Sight deposits	Breakdown by type: Savings deposits	Breakdown by type: Time deposits
2006		173,374	151,324	22,050	23,528	77,858	71,988
2007		197,238	173,498	23,740	25,019	73,562	98,657
2008		227,253	200,638	26,615	21,827	67,328	138,098
2009		237,341	217,257	20,084	26,140	75,811	135,390
2010		209,521	191,988	17,533	22,865	66,706	119,951
2009	Jan.	228,583	200,338	28,245	20,685	65,526	142,372
	Feb.	229,143	201,132	28,011	20,836	65,570	142,737
	March	230,083	205,505	24,578	20,752	66,557	142,774
	Apr.	233,790	209,556	24,234	22,931	69,222	141,637
	May	232,038	208,326	23,712	21,710	69,329	140,999
	June	237,271	214,272	23,000	24,862	71,094	141,315
	July	234,286	211,619	22,667	23,697	72,080	138,509
	Aug.	236,163	212,690	23,473	24,548	72,881	138,734
	Sept.	237,594	214,978	22,616	24,684	73,232	139,678
	Oct.	235,272	213,535	21,737	24,099	73,104	138,069
	Nov.	234,261	213,057	21,204	25,349	72,720	136,192
	Dec.	237,341	217,257	20,084	26,140	75,811	135,390
2010	Jan.	232,889	212,593	20,296	24,210	75,628	133,051
	Feb.	229,685	210,105	19,580	23,797	74,853	131,035
	March	227,649	209,164	18,485	23,494	74,292	129,863
	Apr.	222,577	204,905	17,672	23,353	72,943	126,280
	May	220,106	201,634	18,472	23,058	72,069	124,979
	June	216,766	197,432	19,334	24,374	70,595	121,797
	July	212,253	194,139	18,114	22,525	69,797	119,932
	Aug.	213,003	194,153	18,850	22,217	69,371	121,415
	Sept.	212,903	195,238	17,665	23,619	67,785	121,499
	Oct.	211,515	194,029	17,486	22,398	67,813	121,303
	Nov.	209,128	190,743	18,385	22,524	66,082	120,522
	Dec.	209,521	191,988	17,533	22,865	66,706	119,951
2011	Jan.	205,438	188,543	16,895	22,063	65,552	117,823
	Feb.	202,815	186,494	16,321	21,057	64,428	117,330
	March	199,086	183,277	15,809	20,829	62,102	116,156
	Apr.	196,678	181,243	15,435	20,098	62,080	114,499
	May	191,815	176,699	15,116	20,333	60,569	110,914
	June	188,108	174,095	14,013	21,071	59,446	107,592
	July	187,143	173,435	13,708	19,941	58,552	108,649
	Aug.	188,574	174,786	13,788	20,211	58,493	109,870
	Sept.	183,128	169,563	13,565	19,615	56,210	107,304

Source: Bank of Greece.
1 Other Monetary Financial Institutions (OMFIs) comprise credit institutions (other than the Bank of Greece) and money market funds.

Table 10 Money market interest rates

(percentages per annum, period averages)

Period		Overnight deposits[1]	1-month deposits[2]	3-month deposits[2]	6-month deposits[2]	9-month deposits[2]	12-month deposits[2]
2007		3.87	4.08	4.28	4.35	4.41	4.45
2008		3.87	4.28	4.64	4.73	4.76	4.83
2009		0.71	0.89	1.22	1.43	1.54	1.61
2010		0.44	0.57	0.81	1.08	1.22	1.35
2009	Jan.	1.81	2.14	2.46	2.54	2.59	2.62
	Feb.	1.26	1.63	1.94	2.03	2.09	2.14
	March	1.06	1.27	1.64	1.77	1.84	1.91
	Apr.	0.84	1.01	1.42	1.61	1.69	1.77
	May	0.78	0.88	1.28	1.48	1.57	1.64
	June	0.70	0.91	1.23	1.44	1.54	1.61
	July	0.36	0.61	0.97	1.21	1.33	1.41
	Aug.	0.35	0.51	0.86	1.12	1.24	1.33
	Sept.	0.36	0.46	0.77	1.04	1.16	1.26
	Oct.	0.36	0.43	0.74	1.02	1.14	1.24
	Nov.	0.36	0.44	0.72	0.99	1.12	1.23
	Dec.	0.35	0.48	0.71	1.00	1.12	1.24
2010	Jan.	0.34	0.44	0.68	0.98	1.11	1.23
	Feb.	0.34	0.42	0.66	0.96	1.10	1.23
	March	0.35	0.41	0.64	0.95	1.09	1.22
	Apr.	0.35	0.40	0.64	0.96	1.10	1.23
	May	0.34	0.42	0.69	0.98	1.12	1.25
	June	0.35	0.45	0.73	1.01	1.15	1.28
	July	0.48	0.58	0.85	1.10	1.25	1.37
	Aug.	0.43	0.64	0.90	1.15	1.29	1.42
	Sept.	0.45	0.62	0.88	1.14	1.29	1.42
	Oct.	0.70	0.78	1.00	1.22	1.36	1.50
	Nov.	0.59	0.83	1.04	1.27	1.41	1.54
	Dec.	0.50	0.81	1.02	1.25	1.39	1.53
2011	Jan.	0.66	0.79	1.02	1.25	1.41	1.55
	Feb.	0.71	0.89	1.09	1.35	1.54	1.71
	March	0.66	0.90	1.18	1.48	1.72	1.92
	Apr.	0.97	1.13	1.32	1.62	1.86	2.09
	May	1.03	1.24	1.43	1.71	1.93	2.15
	June	1.12	1.28	1.49	1.75	1.95	2.14
	July	1.01	1.42	1.60	1.82	1.99	2.18
	Aug.	0.91	1.37	1.55	1.75	1.92	2.10
	Sept.	1.01	1.35	1.54	1.74	1.90	2.07
	Oct.	0.96	1.36	1.58	1.78	1.94	2.11

Source: Bloomberg.
1 Euro overnight index average (EONIA).
2 Euro interbank offered rates (EURIBOR).

Table 11 Greek government bond yields

(percentages per annum, period averages)

Period		3-year	5-year	7-year	10-year	15-year	20-year	30-year
2006		3.58	3.72	3.87	4.07	4.16	4.42	
2007		4.21	4.30	4.34	4.50	4.67	4.81	
2008		4.27	4.51	4.54	4.80	5.18	5.30	
2009		3.12	4.22	4.49	5.17	5.61	5.83	
2010		9.39	9.34	9.51	9.09	8.89	8.07	
2009	Jan.	3.93	5.22	5.26	5.59	6.21	6.46	
	Feb.	3.91	5.19	5.25	5.70	6.13	6.26	
	March	4.05	5.08	5.16	5.87	6.11	6.28	
	Apr.	3.63	4.72	4.71	5.50	5.78	5.86	
	May	3.10	4.14	4.53	5.22	5.54	5.71	
	June	3.05	4.20	4.55	5.33	5.73	5.93	
	July	2.57	3.62	3.99	4.89	5.40	5.70	
	Aug.	2.52	3.41	3.77	4.52	4.93	5.26	
	Sept.	2.26	3.36	3.77	4.56	4.91	5.31	
	Oct.	2.26	3.37	3.78	4.57	4.97	5.39	
	Nov.	2.45	3.63	4.06	4.84	5.51	5.65	
	Dec.	3.72	4.67	5.01	5.49	6.10	6.11	
2010	Jan.	4.72	5.40	5.61	6.02	6.50	6.36	
	Feb.	5.92	6.30	6.21	6.46	6.58	6.47	
	March	5.51	5.84	5.83	6.24	6.45	6.47	
	Apr.	7.91	7.87	7.87	7.83	7.46	7.08	
	May	8.28	8.59	8.39	7.97	8.28	7.69	
	June	9.41	9.50	9.57	9.10	9.68	9.11	
	July	11.17	10.85	10.94	10.34	10.34	9.08	
	Aug.	11.65	11.33	11.18	10.70	10.36	9.00	
	Sept.	11.63	11.65	11.76	11.34	10.49	8.89	
	Oct.	9.64	9.64	10.13	9.57	9.41	8.39	
	Nov.	13.08	12.27	12.91	11.52	10.35	9.13	
	Dec.	13.75	12.89	13.66	12.01	10.75	9.15	
2011	Jan.	13.78	12.94	13.32	11.73	10.58	8.89	
	Feb.	13.40	13.04	13.18	11.40	10.14	8.64	
	March	15.33	15.49	14.37	12.44	10.57	8.87	
	Apr.	19.11	18.04	16.30	13.86	11.27	9.40	
	May	24.28	20.87	17.86	15.94	13.19	10.52	
	June	26.48	22.83	19.04	16.69	13.97	11.54	
	July	28.96	24.37	19.66	16.15	13.73	10.98	
	Aug.	26.74	24.43	19.68	15.90	13.19	10.06	
	Sept.	31.51	28.88	22.27	17.78	13.97	10.08	
	Oct.	34.61	29.53	22.59	18.04	14.16	11.00	

Source: Bank of Greece.

Table 12 Domestic MFI loans to the domestic private sector by branch of economic activity[1,2]

(balances in million euro)

End of period		Grand total	Firms						Sole proprietors	Individuals and private non-profit institutions			
			Total	Agriculture	Industry[3]	Trade	Tourism	Other		Total	Housing	Consumer credit	Other
2006		179,452	93,576	3,185	19,515	23,712	4,800	42,364	-	85,877	57,145	26,597	2,135
2007		215,405	111,289	3,304	21,488	27,672	5,883	52,942	-	104,116	69,363	31,942	2,811
2008		249,661	132,458	3,856	24,873	32,985	7,032	63,713	-	117,203	77,700	36,435	3,068
2009		249,677	130,043	3,962	22,790	33,519	7,358	62,413	-	119,635	80,559	36,044	3,032
2010		257,846	123,244	2,060	24,269	25,355	7,355	64,205	16,483	118,119	80,507	35,081	2,532
2009	Jan.	250,266	132,994	3,879	24,944	33,245	7,081	63,846		117,272	77,813	36,449	3,010
	Feb.	250,438	132,951	3,933	25,001	33,454	7,148	63,415	-	117,487	78,003	36,513	2,971
	March	249,960	132,575	3,827	24,491	33,708	7,154	63,395	-	117,384	78,066	36,369	2,949
	Apr.	250,464	133,056	3,940	24,530	34,057	7,197	63,332	-	117,408	78,235	36,245	2,928
	May	250,865	133,182	3,974	24,640	34,176	7,312	63,080	-	117,683	78,396	36,318	2,970
	June	249,676	131,690	3,989	24,380	33,745	7,406	62,170	-	117,986	78,734	36,281	2,971
	July	250,473	132,140	4,011	24,363	33,773	7,380	62,612	-	118,334	79,042	36,384	2,908
	Aug.	250,707	132,234	3,913	24,232	33,322	7,196	63,572	-	118,472	79,145	36,445	2,883
	Sept.	251,820	132,924	3,970	24,042	33,775	7,192	63,944	-	118,896	79,560	36,392	2,944
	Oct.	251,528	132,583	3,987	23,886	33,454	7,172	64,084	-	118,945	79,670	36,329	2,946
	Nov.	251,848	132,746	4,028	23,892	33,207	7,249	64,370	-	119,103	79,958	36,166	2,978
	Dec.	249,677	130,043	3,962	22,790	33,519	7,358	62,413	-	119,635	80,559	36,044	3,032
2010	Jan.	250,167	130,611	4,076	22,964	33,408	7,428	62,736	-	119,556	80,704	35,875	2,977
	Feb.	251,173	131,521	4,063	23,031	33,183	7,512	63,732		119,652	80,878	35,791	2,984
	March	251,062	131,393	3,987	23,042	33,203	7,639	63,522	-	119,669	81,173	35,489	3,007
	Apr.	250,983	131,530	4,014	22,999	33,104	7,665	63,748	-	119,453	81,125	35,327	3,002
	May	252,072	132,718	4,012	23,060	33,088	7,640	64,919	-	119,353	81,110	35,193	3,050
	June	260,352	126,525	2,200	25,423	26,724	7,380	64,797	13,904	119,924	81,430	36,292	2,202
	July	258,943	125,529	2,189	24,991	26,718	7,345	64,286	13,929	119,485	81,334	35,960	2,192
	Aug.	258,776	125,452	2,191	24,662	26,633	7,349	64,617	13,812	119,512	81,450	35,898	2,163
	Sept.	258,476	123,543	2,155	24,471	25,873	7,274	63,771	15,618	119,316	81,201	35,834	2,281
	Oct.	257,256	122,772	2,051	24,687	25,663	7,244	63,127	16,429	118,055	80,033	35,621	2,401
	Nov.	258,023	123,361	2,052	24,540	25,607	7,295	63,866	16,444	118,217	80,302	35,443	2,472
	Dec.	257,846	123,244	2,060	24,269	25,355	7,355	64,205	16,483	118,119	80,507	35,081	2,532
2011	Jan.	256,852	122,894	2,064	24,658	25,125	7,301	63,747	16,465	117,493	80,128	34,884	2,480
	Feb.	256,737	122,999	2,057	24,698	25,134	7,283	63,828	16,450	117,288	80,028	34,702	2,558
	March	255,374	122,173	2,124	24,854	25,407	7,404	62,383	16,355	116,846	79,823	34,454	2,569
	Apr.	253,703	121,175	2,119	25,115	25,279	7,197	61,464	16,170	116,358	79,718	34,060	2,580
	May	253,193	120,934	2,077	24,918	25,266	7,182	61,492	16,032	116,227	79,794	33,811	2,622
	June	253,486	121,372	2,031	24,862	25,245	7,224	62,009	16,027	116,088	79,800	33,598	2,690
	July	254,242	122,287	2,032	25,526	25,149	7,224	62,357	16,004	115,951	79,936	33,241	2,773
	Aug.	252,484	121,352	2,002	25,096	24,661	7,133	62,461	15,846	115,286	79,575	33,885	1,826
	Sept.	252,947	122,680	2,024	23,907	25,678	7,282	63,789	15,713	114,554	79,170	33,680	1,704

Source: Bank of Greece.
1 Including loans, corporate bonds held by MFIs, securitised loans and securitised corporate bonds.
2 As of June 2010, loans to sole proprietors are presented separately and are no longer included in credit to enterprises.

Table 13 Greece: bank rates on new euro-denominated deposits of euro area residents

(percentages per annum, period averages unless otherwise noted)

Period		Deposits by households			Deposits by non-financial corporations		
		Overnight deposits[1,2]	Savings deposits[2]	Deposits with agreed maturity up to one year	Overnight deposits[2]	Deposits with agreed maturity up to one year	Repurchase agreements (repos)
2006		1.02	0.98	2.86	0.79	2.81	2.67
2007		1.22	1.14	3.95	1.03	3.94	3.70
2008		1.26	1.17	4.87	1.09	4.48	3.93
2009		0.63	0.56	2.74	0.50	1.65	0.68
2010		0.43	0.38	3.26	0.35	2.53	n.p.
2009	Jan.	1.15	1.05	4.89	0.92	3.53	1.65
	Feb.	0.98	0.88	3.87	0.73	2.36	1.33
	March	0.79	0.74	3.25	0.58	2.03	1.11
	Apr.	0.69	0.62	2.84	0.51	1.85	0.79
	May	0.58	0.50	2.58	0.48	1.67	0.71
	June	0.53	0.45	2.55	0.44	1.45	0.58
	July	0.52	0.46	2.34	0.46	1.25	0.43
	Aug.	0.50	0.45	2.24	0.40	1.12	0.34
	Sept.	0.48	0.43	2.08	0.38	1.14	0.30
	Oct.	0.43	0.37	2.08	0.37	1.16	0.27
	Nov.	0.43	0.37	2.01	0.41	1.08	0.32
	Dec.	0.43	0.37	2.10	0.35	1.18	0.34
2010	Jan.	0.43	0.37	2.18	0.37	1.21	0.30
	Feb.	0.44	0.38	2.35	0.36	1.29	0.37
	March	0.43	0.38	2.61	0.38	1.61	0.42
	Apr.	0.43	0.37	2.98	0.36	1.71	0.47
	May	0.42	0.37	3.42	0.38	2.06	0.56
	June	0.43	0.38	3.61	0.32	3.37	n.p.
	July	0.43	0.38	3.71	0.31	3.40	n.p.
	Aug.	0.43	0.38	3.66	0.32	3.14	n.p.
	Sept.	0.43	0.38	3.61	0.33	2.98	n.p.
	Oct.	0.44	0.38	3.68	0.34	2.98	n.p.
	Nov.	0.44	0.38	3.65	0.35	3.27	n.p.
	Dec.	0.44	0.38	3.68	0.36	3.29	1.92
2011	Jan.	0.44	0.38	3.74	0.34	3.40	n.p.
	Feb.	0.44	0.38	3.75	0.34	3.23	2.26
	March	0.45	0.39	3.76	0.41	3.39	2.45
	Apr.	0.46	0.39	3.88	0.38	3.56	2.94
	May	0.46	0.40	3.95	0.35	3.52	n.p.
	June	0.47	0.41	4.10	0.42	3.38	n.p.
	July	0.47	0.40	4.29	0.45	3.82	3.00
	Aug.	0.47	0.40	4.31	0.44	3.54	3.23
	Sept.	0.47	0.41	4.37	0.43	3.65	2.93

Source: Bank of Greece.
n.p.: Not published for reasons of confidentiality.
1 Weighted average of the current account rate and the savings deposit rate.
2 End-of-month interest rate.

Table 14 Greece: bank rates on new euro-denominated loans to euro area residents

(percentages per annum, period averages unless otherwise noted)

Period		Loans to individuals and private non-profit institutions[1]					Loans to sole proprietors[1]		Loans to non-financial corporations[1]		
			Consumer loans		Housing loans					With a floating rate or an initial rate fixation of up to one year	
		Loans without an agreed maturity[2,3]	With a floating rate or an initial rate fixation of up to one year	Average rate on total consumer loans	With a floating rate or an initial rate fixation of up to one year	Average rate on total housing loans	Loans without an agreed maturity[3,4]	With a floating rate or an initial rate fixation of up to one year	Loans without an agreed maturity[3,4]	Up to €1 million	Over €1 million
2006		13.45	7.89	8.57	4.24	4.30			7.18	5.76	4.37
2007		14.09	7.70	8.46	4.57	4.46			7.54	6.57	5.32
2008		14.80	8.65	8.96	5.10	4.81			7.61	6.82	5.71
2009		14.39	8.59	9.33	3.52	3.94			6.07	4.62	3.52
2010		14.18	9.79	9.53	3.42	3.67			6.25	5.53	4.27
2009	Jan.	14.81	9.15	9.82	4.55	4.97			6.66	5.45	4.24
	Feb.	14.72	8.84	9.81	4.16	4.65			6.63	4.99	4.12
	March	14.46	8.62	9.71	3.83	4.32			6.38	4.71	4.10
	Apr.	14.44	9.17	9.72	3.64	4.11			6.11	4.36	3.79
	May	14.31	8.54	9.14	3.52	3.97			6.10	4.56	3.59
	June	14.32	7.59	8.93	3.46	3.86			6.06	4.59	3.33
	July	14.44	8.36	9.09	3.27	3.68			5.87	4.33	3.44
	Aug.	14.33	8.54	8.99	3.27	3.72			5.83	4.41	3.22
	Sept.	14.31	8.43	9.25	3.19	3.57			5.82	4.44	3.23
	Oct.	14.20	9.06	9.46	3.15	3.56			5.79	4.43	2.96
	Nov.	14.22	8.59	9.13	3.14	3.49			5.80	4.49	2.99
	Dec.	14.08	8.18	8.94	3.08	3.41			5.81	4.70	3.24
2010	Jan.	14.05	8.69	8.96	3.05	3.44			5.72	4.52	3.23
	Feb.	14.14	8.65	9.36	3.08	3.42			5.87	4.72	3.37
	March	13.84	8.94	9.27	3.21	3.53			5.93	4.98	3.71
	Apr.	13.94	8.69	9.30	3.32	3.62			6.13	5.21	3.55
	May	13.92	8.48	9.30	3.36	3.63			6.29	5.56	3.77
	June	14.28	10.31	9.45	3.26	3.50	9.07	7.43	5.94	5.47	3.89
	July	14.29	10.88	9.79	3.54	3.78	9.19	6.84	6.25	5.74	4.73
	Aug.	14.31	10.92	9.86	3.67	3.89	9.23	7.87	6.48	5.87	4.51
	Sept.	14.33	10.40	9.75	3.54	3.74	9.21	7.63	6.45	5.86	5.28
	Oct.	14.29	10.65	9.87	3.72	3.92	9.43	8.07	6.56	5.94	5.32
	Nov.	14.41	10.57	9.82	3.67	3.83	9.47	7.99	6.62	6.14	4.94
	Dec.	14.40	10.27	9.68	3.65	3.79	9.57	7.83	6.79	6.34	4.98
2011	Jan.	14.59	10.73	9.84	3.93	4.05	9.58	8.27	6.81	6.14	4.89
	Feb.	14.64	10.44	9.88	3.91	4.04	9.72	8.40	6.90	6.23	5.37
	March	14.70	9.74	9.52	4.04	4.17	9.78	8.59	7.05	6.46	5.39
	Apr.	14.74	10.65	10.15	4.25	4.32	9.91	8.63	7.26	6.46	5.55
	May	14.89	10.48	10.22	4.26	4.33	9.98	8.86	7.34	6.59	5.48
	June	14.94	10.47	10.23	4.23	4.32	10.10	8.62	7.59	6.76	5.56
	July	15.06	11.03	10.45	4.44	4.52	10.19	8.74	7.65	6.85	5.76
	Aug.	15.24	10.77	10.55	4.54	4.57	10.35	9.14	7.76	6.92	5.88
	Sept.	15.26	9.70	9.95	4.49	4.51	10.44	8.93	7.91	7.12	6.04

Source: Bank of Greece.
1 Associated costs are not included. As of June 2010, loans to sole proprietors are presented separately and are no longer included in credit to enterprises.
2 Weighted average of the rates on loans to households through credit cards, on open account loans and on overdrafts from current accounts.
3 End-of-month interest rate.
4 Weighted average of the rates on corporate loans via credit lines and on overdrafts from sight deposit accounts.

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