MONETARY POLICY
INTERIM REPORT 2014

DECEMBER
2014

BANK OF GREECE
EUROSYSTEM

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Printed in Athens, Greece
at the Bank of Greece Printing Works

ISSN 1108 - 2690

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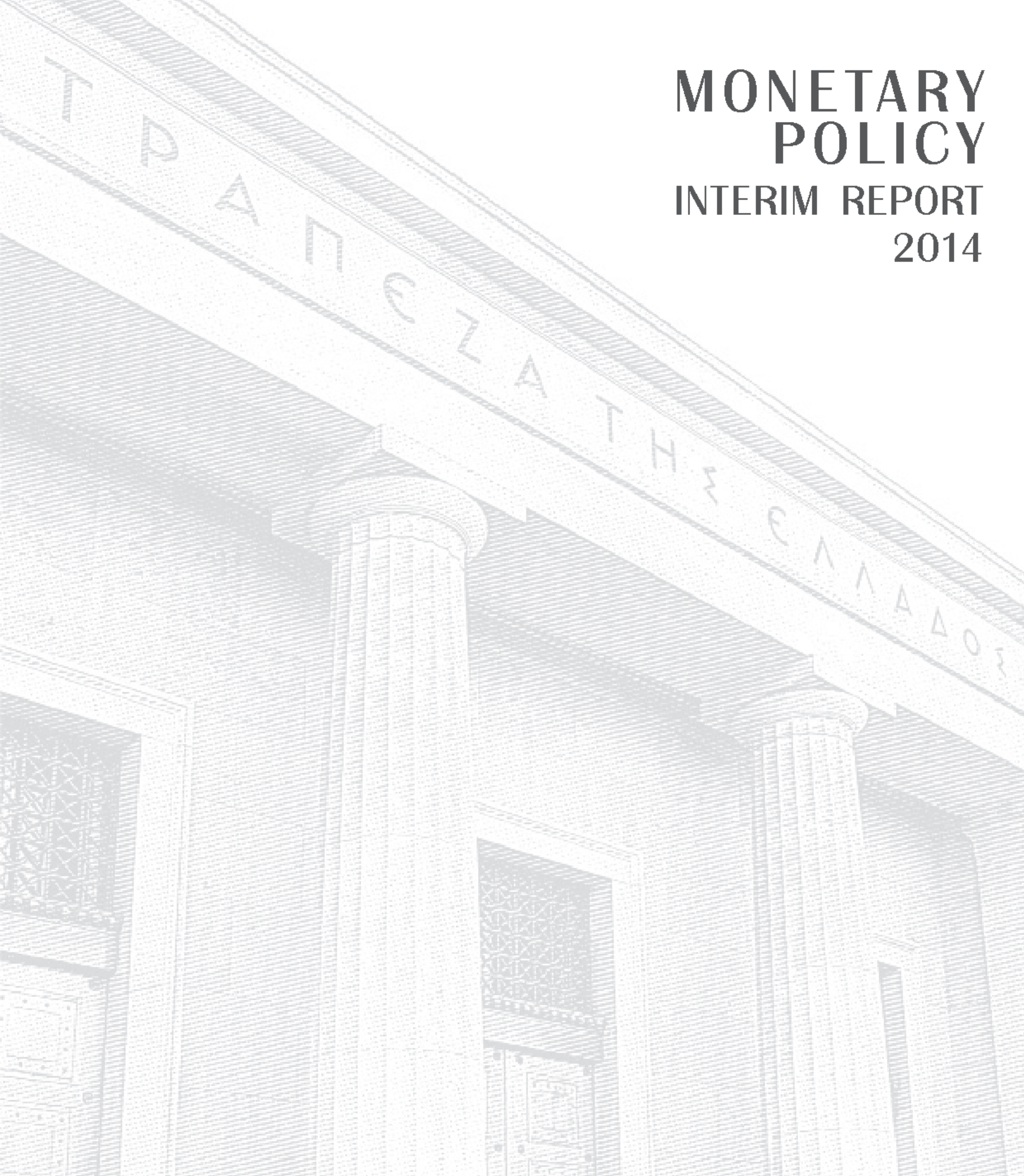

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To the Greek Parliament
and the Cabinet

In its previous Report on Monetary Policy in June 2014, the Bank of Greece, based on information available at the time, had assessed that the Greek economy was stabilising, making the return to positive growth very likely.

This assessment has subsequently been confirmed, with GDP posting positive year-on-year growth rates in the second and third quarters of 2014, after six years of steep decline. GDP grew by 0.6% in the first nine months of 2014 relative to the same period of 2013, driven by buoyant exports and the recovery of private consumption and investment in transport and machinery equipment.

More specifically, in the period January-September 2014:

- Exports of goods and services increased by 8.4% year-on-year, with tourism services and shipping displaying strong performance.
- Private consumption rose by 1.5% year-on-year.
- Investment in transport and machinery equipment rose by 8.4%, after five consecutive years of contraction.

Other positive developments worthy of note are an increase of 1.5% in dependent employment and a decrease of 1.6% in the number of unemployed in the first half of 2014, relative to one year earlier. However, the unemployment rate remains particularly high, despite having decreased.

Unit labour costs in total economy continued to fall in 2014, bringing the cumulative improvement in cost competitiveness since 2010 to 20%. Structural competitiveness is also showing signs of picking up, as suggested by indicators compiled by the World Bank and other international organisations.

Based on the data currently available, GDP growth is projected to reach 0.7% in 2014 and to strengthen to 2.5% or slightly more in 2015, if the recent decline in oil prices in the international market is taken into account. In addition, the current account is expected to continue to improve, posting a surplus of approximately 1.5% of GDP in 2014.

Additionally, it is estimated that the fiscal target of the general government according to the Economic Adjustment Programme is also likely to be overachieved for the third year in a row, indicating that the improvement in fiscal aggregates is sustainable.

* * * *

Global economic growth is expected to remain modest in 2014, before picking up slightly in 2015. This forecast is subject to considerable downside risks and uncertainty. Despite the gradual improvement in financial conditions since the beginning of this year, rising geopolitical risks to global growth (from Ukraine-Russia and the Middle East) have dampened foreign demand and the rebound of world trade. Turning to the euro area, declining inflation, an anaemic economic recovery, progressively lower inflation expectations throughout 2014, as well as subdued monetary and credit expansion led the Governing Council of the ECB to adopt additional non-standard monetary policy measures. These measures are designed to avert the risk of too prolonged a period of decline in the general price level, as this would set in motion a vicious circle of recession and deflation.

The Governing Council of the ECB is unanimous in its commitment to intensify the use of non-standard monetary policy measures or introduce additional unconventional instruments within its mandate, with a view to averting the risk that inflation in the euro area remains too low for too long.

* * * *

As detailed in the present Report, the prospects for the year ahead are positive. More specifically, 2015 should see investment demand gain strength and export activity increase further, thereby allowing the growth path of the economy to take firmer hold.

The favourable outlook for investment in 2015 is supported by a number of factors including: (a) Greece's absorption of resources from the National Strategic Reference Framework (NSRF) and funding from the European Investment Bank (EIB); (b) satisfactory progress of infrastructure projects; and (c) the speeding-up of the privatisation programme.

The anticipated restoration of more normal financing conditions, given the opportunity for Greek banks to obtain liquidity from the Eurosystem at low cost which would allow them to finance export firms with a comparative advantage, is expected to complement the significant gains in the Greek economy's competitiveness over the past five years, giving exports of goods and services an additional boost.

Encouraging signs of a pick-up in private consumption in 2015 include the rise in employment, the improvement in consumer and retail confidence indicators, the deceleration in the rate of decline in consumer credit, as well as a projected stabilisation of earnings (net earnings will increase slightly).

This positive outlook is nonetheless subject to downside risks, domestic as well as global, and uncertainties, that could weigh on business sentiment in the months ahead and delay or even halt the recovery. This is why the focus of economic policy must be to maintain and strengthen current momentum towards a definitive exit from the crisis. Emphasis has to be placed on the following priorities:

(a) Speeding up structural reforms in the goods and services markets in order to enhance competition and innovation, increase price flexibility and improve competitiveness. These actions will render Greece more attractive to foreign direct investment and help to accelerate privatisations and foster job creation in competitive and viable businesses.

(b) Streamlining public administration with a focus on speeding up the administrative reform, ensuring the proper functioning of justice, slashing red tape, reducing the administrative burden on citizens and businesses, and eradicating corruption.

(c) Strengthening active labour market policies with particular emphasis on education and training, as a way to improve the job-finding chances of people on the sidelines of the labour market, such as the long-term unemployed and young people, who have borne the burden of unemployment.

(d) Pursuing fiscal consolidation in the years ahead. The primary focus should be to **curb tax evasion** by strengthening tax administration, with a view to broadening the tax base and fostering the sense of social justice. Direct or indirect tax exemptions, other than those granted on grounds related to social solidarity and/or economic growth considerations, need to be re-examined. Care should be taken to ensure the **viability of social security funds** by again reviewing the regime of various exemptions from the general provisions. All of the above actions would make it possible to **gradually lower personal and corporate tax rates**, in order to foster economic activity in a fiscally neutral manner.

* * * *

The recovery of economic activity is gradually being reflected in the aggregates of Greek commercial banks. Operating profits are improving slowly but steadily, and capital adequacy is now satisfactory, following successful capital increases and the implementation of restructuring plans by the four systemic banks. This was also confirmed by the results of the Comprehensive Assessment, including the EU-wide stress test exercise, conducted by the ECB in cooperation with the European Banking Authority (EBA), made public on 26 October 2014.

However, despite the increase in the banks' deposit base, the strong capitalisation and the regained access to the interbank market and the global capital markets, the banking system still faces important challenges. First and foremost is the constraint on banks' lending capacity arising from the large stock of non-performing loans on their balance sheets. This, combined with the weak demand for bank loans, has resulted in continued negative credit expansion to the real economy, impeding the revitalisation of economic activity.

Consequently, **the effective management of non-performing loans (NPLs) is an immediate priority**. Greek banks must now adopt an active management of distressed loans, in a manner that not only eases the burden on cooperating borrowers facing temporary difficulties in servicing their debt, but also enables banks in the long run to unlock funds tied up in troubled loans that are unlikely to be repaid.

Based on the above, it is estimated that banks could substantially reduce the troubled assets on their balance sheets by choosing to actively manage their non-performing loans through recourse to: (a) the supervisory framework for the management of loans in arrears and non-performing loans provided for in Bank of Greece Executive Committee Act 42/30.5.2014, and (b) from 1.1.2015 the workout options described in the Code of Conduct provided for in Law 4224/2013. Meanwhile, the recently enacted legislation on the settlement of non-performing business loans can be expected to motivate debtors and banks to seek viable solutions to the problem. In any event, the workout solutions available to banks for the management of non-performing loans must be selected in a manner that does not give rise to moral hazard.

The **Greek banking system** has emerged stronger from the stress tests and the comprehensive balance sheet assessment recently completed by the ECB. Against this background, the banking system should draw on its own recent experience with restructuring and **take on an active role in the sectoral restructuring of the economy, by channelling credit to truly viable businesses**. Funds should not be tied up in businesses with no prospect of survival, at the expense of healthy businesses, with a potential to generate economic growth and job creation. The banking sector must be assisted in this effort through improvements in the legal framework that would lift restrictions on, for instance, (pre-) bankruptcy procedures, out-of-court settlements or, as already mentioned, a speeding up of the judicial procedure.

* * * *

After six years of recession and five years of fiscal adjustment, the economy has stabilised and is showing signs of improvement. If this momentum is maintained, the economy is likely to return to a steady growth path in the next few years. For this forecast to be realised, however, the restructuring of the economy and the reforms (some of which have already been mentioned) must be pursued with determination in order to address all the challenges, risks and uncertainties for Greece's prospects once the ongoing financial support programme from the EU is over. Such an outcome is possible only in an environment of consensus and cooperation among the political bodies that will ensure continuity.

As indicated during the recent turmoil in capital markets which led to a spike in 10-year Greek government bond yields to above 9%, Greece still needs the support of a reliable precautionary credit programme from its European partners until it can sustainably cover its borrowing needs on international markets. In this context, of utmost importance is our relationship of mutual trust and cooperation with our partners. This relationship will be strengthened further if Greece is granted further debt relief in line with the Eurogroup commitment of 27 November 2012.

The immediate elimination of uncertainty on the domestic front and the commitment to advancing reforms are prerequisites for strengthening both economic growth and employment and for the country's definitive exit from the crisis.

Athens, December 2014
Yannis Stournaras
Governor

MONETARY POLICY COUNCIL OF THE BANK OF GREECE

CHAIRMAN

Yannis Stournaras

MEMBERS

Ioannis Papadakis

Ioannis Mourmouras

Ilias Plaskovitis

Charalampos Stamatopoulos

George Tavlas

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1 THE FORECAST OF A RECOVERY OF THE ECONOMY IN 2014 HAS BEEN CONFIRMED

After six consecutive years of steep decline, GDP posted positive year-on-year growth rates of 0.4% and 1.6%, respectively, in the second and third quarters of 2014 based on seasonally adjusted data, after contracting by 0.3% in the first quarter. As a result, GDP grew by 0.6% on average in the first nine months of 2014 relative to the same period of 2013, driven by buoyant exports and the recovery of private consumption and investment in transport and machinery equipment. More specifically:

- Despite a slowdown in world trade growth, Greek exports of goods and services increased by 8.4% year-on-year in the period January-September 2014, reflecting an improvement in the Greek economy's competitiveness. Tourism services and shipping displayed strong performances.

- Private consumption rose by 1.5% year-on-year in the nine months through September 2014 and is expected to increase for the year as a whole, as suggested by improving leading indicators, such as consumer and retail confidence indicators and new passenger car registrations. Investment in transport and mechanical equipment recovered by 8.4% in the first nine months of the year, after five consecutive years of contraction.

- Other positive developments worthy of note are an increase of 1.5% in dependent employment and a decrease of 1.6% in the number of unemployed in the first half of 2014, relative to one year earlier. According to the information system "ERGANI" on dependent employment flows in the private sector, net hiring was positive over the period January-October 2014 (120,000 people). However, the unemployment rate remains particularly high (26.6% in the second quarter), despite having decreased.

- Unit labour costs in total economy continued to fall in 2014, bringing the cumulative improvement in cost competitiveness since 2010 to 20%. Structural competitiveness is also showing signs of picking up. According to the World Economic Forum's global competitiveness index, Greece moved up the ranking to 81st place, from 91st in 2012, while according to the World Bank's ranking on the "ease of doing business", Greece advanced to 61st place, from 65th.

- Based on the data currently available, GDP growth is projected to reach 0.7% in 2014 and to strengthen to 2.5% or slightly more in 2015, if the recent decline in oil prices in the international market is taken into account. In addition, the current account is expected to continue to improve, posting a surplus of around 1.5% of GDP in 2014.

- Finally, it is estimated that the fiscal target of the general government according to the Economic Adjustment Programme is also likely to be overachieved for the third year in a row, indicating that the improvement in fiscal aggregates is sustainable.

2 THE GLOBAL ECONOMY IS EXPECTED TO IMPROVE MODESTLY AMIDST HEIGHTENED RISKS

Global economic growth is expected to remain modest in 2014, before picking up slightly in 2015. According to the latest ECB staff macroeconomic projections, the euro area is expected, for the first time in two years, to return to positive, albeit moderate, growth (0.8% in 2014), with projections revised substantially downward from early this year. The current projections suggest a marginal pick-up in economic activity (1.0%) in 2015, driven by stronger private consumption as household real incomes benefit from low inflation and improved employment figures.

Euro area inflation is expected to remain low. According to the ECB staff projections, annual HICP inflation in the euro area is expected to be 0.5% in 2014, 0.7% in 2015 and 1.3% in

2016. Inflation rates have long remained low, reflecting developments in energy and food commodity prices and the appreciation, until recently, of the euro. The slow pace of economic recovery in the euro area and the continued contraction of credit to the private sector also contribute to persistently low inflation.

These projections are subject to considerable downside risks and uncertainties. Despite the gradual improvement in financial conditions since the beginning of the year, rising geopolitical risks (from Ukraine-Russia and the Middle East) have dampened foreign demand and the rebound of world trade. It should also be pointed out that global debt accumulation, as well as the risks associated with a possible deterioration in economic developments, both continue to increase. More generally, there is a risk in the medium term that the advanced economies may return to stagnation or sluggish growth.

Against this background of heightened uncertainty for the global and the European economy, the IMF, the OECD and other international organisations, as well as the European Commission, underline the need to boost private and public investment, especially in the euro area where investment dropped sharply during the crisis.

3 DYNAMIC ACTION BY THE ECB TO AVERT THE RISK OF DEFLATION AND RECESSION IN THE EURO AREA

Declining inflation, an anaemic economic recovery, progressively lower inflation expectations throughout 2014, as well as subdued monetary and credit expansion in the euro area led the Governing Council of the ECB to adopt additional measures, in order to prevent deflationary conditions from taking hold in the euro area.

If price declines are allowed to persist too long in the euro area, they can become entrenched in inflation expectations, thereby leading to higher real interest rates and to a postponement of consumption and investment expenditure. Such a development would put further downward pressure on prices, setting into motion a vicious circle of recession and deflation. One aspect of this vicious circle is that deflation makes it difficult to reduce public and private sector debt. Furthermore, too long a period of low inflation in the euro area would further hamper recovery in the periphery economies, requiring them to make a greater effort to improve competitiveness vis-à-vis their euro area partners.

In pursuing its price stability mandate, the Governing Council of the ECB lowered the interest rate on main refinancing operations (MROs) in June and September 2014 by a total 20 basis points (to 0.05%, i.e. to the effective lower bound) and, for the first time, took the rate on the deposit facility into negative territory (-0.20%). In the context of its forward guidance about the future stance of the single monetary policy and in order to prevent deflationary expectations from taking hold, the Governing Council of the ECB announced that, given the outlook for inflation, it would keep the key interest rates at low levels for a prolonged period of time and adopted a series of new non-standard monetary policy measures.

In greater detail, a series of eight targeted longer-term refinancing operations (TLTROs) was introduced in September, enabling credit institutions to borrow from the Eurosystem at a very low fixed rate, provided that they fulfil certain conditions relating to the net growth of their lending to the real economy. Such credit will normally be repayable in September 2018. However, those banks whose net lending to the non-financial private sector (excluding loans to households for house purchase) in the period to 30 April 2016 is below the benchmark set by the Eurosystem will be required to repay the funds sooner.

More specifically, banks that, at least until recently, had been deleveraging must be able to increase their net lending activity during the two years from May 2014 to June 2016, relative to the start of 2014. Greek banks already took part in the first TLTRO conducted in September, raising €5.2 billion, and can be expected to take part in the following TLTROs, thereby securing liquidity, ideally until September 2018, so long as demand for loans in the Greek economy increases sufficiently as GDP recovers.

Meanwhile, in the last quarter of 2014 the Eurosystem started to conduct purchase programmes for asset-backed securities (ABSs) and covered bonds. Special provisions have been made regarding the collateral eligibility of securities issued by banks of Member States that do not meet the minimum credit quality threshold applicable to the rest of the euro area, in the case of Member States that are under an economic adjustment programme or have access to an enhanced conditions credit line (ECCL).

The TLTROs and the ABS and covered bond purchase programmes will help to ensure that the monetary policy stance remains very accommodative, increasing the total assets of the Eurosystem and the interbank liquidity surplus, thereby causing interbank rates to decline. This, in turn, can be expected to feed directly through to lower lending rates for euro area non-financial corporations and households. A revival of the ABS and covered bond markets can also be expected, giving banks additional incentive to offer more favourable terms than in the past on new loans eligible for securitisation. Furthermore, the outright purchases of securities by the Eurosystem will trigger a process of portfolio reallocation, whereby investors will seek to replace securities purchased by the Eurosystem with alternative investments in debt securities, thereby leading to a generalised decline in yields and a commensurate decrease in financing costs for a wide range of issuers.

The Governing Council of the ECB is unanimous in its commitment to intensify the use of non-standard monetary policy measures or introduce additional unconventional instruments within its mandate, with a view to averting the risk that inflation in the euro area remains too low for too long.

4 INTERNATIONAL MARKET SENTIMENT REMAINS FRAGILE, HAMPERING GREECE'S EFFORT FOR A SMOOTH RETURN TO CAPITAL MARKETS

In the first half of 2014, Greek government bond yields and the cost of borrowing for Greek businesses on international capital markets followed an almost uninterrupted downward trend, as confidence in the prospects of the economy picked up and the markets were anticipating a gradual exit from the crisis. The favourable developments in bond yields created suitable conditions for Greece's successful return to the markets, for Greek banks to access funding and for businesses to tap international corporate bond markets. At the end of September, however, investor sentiment began to deteriorate, reflecting, at first, a slowdown in economic activity in the euro area and, subsequently, investor uncertainty about the progress of structural reforms and fiscal consolidation in Greece, as well as the possibility of Greece's early exit from the financial support programme.

Against this background, the yield on the 10-year Greek government bond spiked in mid-October to over 9%, a level not seen for nearly a year. Thereafter it de-escalated somewhat, falling to 7.5% by early December. The turmoil in the markets also took its toll on Greek businesses, faced with far higher rates than their counterparts elsewhere in Europe.

5 THE GREEK BANKING SYSTEM IS SUFFICIENTLY CAPITALISED, BUT STILL FACES THE CHALLENGE OF MANAGING NON-PERFORMING LOANS

The stabilisation and incipient recovery of economic activity are gradually feeding into the aggregates of Greek commercial banks. Operating profits are improving slowly but steadily, and capital adequacy is now satisfactory, following successful capital increases and the implementation of restructuring plans by the four systemic banks. This was also confirmed by the results of the Comprehensive Assessment, including the EU-wide stress test exercise, conducted by the ECB in cooperation with the European Banking Authority (EBA), made public on 26 October 2014. Under the dynamic balance sheet assumption, three of the four Greek banks that took part in the Comprehensive Assessment were found to have no capital shortfall, while the fourth has practically no shortfall.

However, despite the increase in the banks' deposit base, the strong capitalisation and the regained access to the interbank market and the global capital markets, the banking system still faces important challenges. First and foremost is the constraint on banks' lending capacity arising from the large stock of non-performing loans on their balance sheets. This, combined with the weak demand for bank loans, has resulted in continued negative credit expansion to the real economy, impeding the revitalisation of economic activity.

The ratio of NPLs to total loans continued to rise in the first half of 2014, albeit at a decelerating rate: over one third of outstanding loans are non-performing. Business loan arrears (on loans of €1 million or more) are concentrated in a fairly small number of industries and a small number of borrowers (see Special feature VI.2). Furthermore, the industries with the highest NPL ratios are also the ones with the largest increases in NPLs, including industries with the highest borrowing activity in the past. A large share of NPLs is owed to multiple creditors, while a significant share of NPLs are at least three years overdue.

6 THE ROLE OF THE BANK OF GREECE IN THE NEW SUPERVISORY FRAMEWORK

As of 4 November 2014, the Single Supervisory Mechanism (SSM) assumed responsibility for the direct supervision of euro area banks. The new mechanism comprises the ECB and the national competent authorities of the participating countries. Within this setup, the Bank of Greece will continue to play an important role, monitoring the implementation in Greece of the supervisory standards specified by the SSM, while also actively participating, together with coordinators at the ECB, in the joint supervisory teams that evaluate the condition of Greek banks.

The main aims of the supervision are to ensure the soundness and efficiency of the credit system and, more generally, of the financial sector of the economy. In this context, the Bank of Greece has, amongst other things, a macro-prudential mandate, aimed to enhance the resilience of the credit system and reduce the accumulation of systemic risk. In particular, the Bank of Greece identifies, monitors and evaluates such risk and takes the measures provided for by law.

7 POSITIVE PROSPECTS FOR 2015

After the turnaround of the economy in 2014, the prospects for the year ahead are positive. More specifically, 2015 should see investment demand gain strength and export activity increase further, thereby allowing the growth path of the economy to take firmer hold.

The favourable outlook for investment in 2015 is supported by a number of factors including: (a) Greece's absorption of resources from the National Strategic Reference Framework (NSRF) and funding from the European Investment Bank (EIB); (b) further progress in major infrastructure projects —especially Greece's four main highways— and the potential of public-private partnerships, which apart from an immediate growth impact on construction investment, are expected to leverage investment capacity in the building materials industry and supporting services. Positive externalities are also expected from the speeding-up of the privatisation programme.

The anticipated restoration of more normal financing conditions given the opportunity for Greek banks to obtain liquidity from the Eurosystem at low cost, which would allow them to finance export firms with a comparative advantage is expected to complement the significant gains in the Greek economy's competitiveness over the past five years, giving exports of goods and services an additional boost. The relative weakening of foreign demand from the euro area is expected to be offset by stronger demand from other markets, also supported by the depreciation of the euro.

Encouraging signs of a pick-up in private consumption in 2015 include the rise in employment, the improvement in consumer and retail confidence indicators, the deceleration in the rate of decline in consumer credit, as well as a projected stabilisation of earnings (net earnings will increase slightly). Deflation, which exerts a positive impact on household real disposable income, will continue but will gradually weaken by end-2015.

8 HEIGHTENED RISKS AND UNCERTAINTIES

This positive outlook is nonetheless subject to downside risks, domestic as well as global, and uncertainties, that could weigh on the business climate in the months ahead and delay or even halt the recovery.

Domestic uncertainties hamper not only progress with the economic adjustment programme but also the implementation of an effective growth strategy once the financial support programme is over. Eliminating this uncertainty would facilitate the implementation of necessary reform policies as well as a definitive exit from the crisis.

Global risk factors refer to a slowdown in the global economy and in the euro area in particular, and to geopolitical developments in the Middle East and Ukraine, which accentuate global market uncertainty and increase the risk of correction, prompting flights to safety. Coupled with domestic uncertainties, such developments could intensify market concerns about the course of the Greek economy, as had occurred before in October 2014, and overshadow the noteworthy progress achieved on the fiscal and macroeconomic fronts.

9 IN ORDER TO AVERT RISKS, THE REFORM EFFORT MUST BE SUSTAINED AND GEARED TOWARDS A RECOVERY OF THE ECONOMY AND A DEFINITIVE EXIT FROM THE CRISIS

In order to address the above-mentioned challenges, mitigate the risks and uncertainties about the course of the Greek economy and bolster recovery, it is necessary to ensure that economic policy remains focused on the following priorities:

(a) Speeding up structural reforms in the goods and services markets in order to enhance competition and innovation, increase price flexibility and improve competitiveness. These actions need to be geared towards enhancing competition in the sectors of energy and road and sea transport; lifting the barriers to entry and the restrictive regulations in retail trade and professional services; and simplifying licensing procedures for investment projects. These actions will render Greece more attractive to foreign direct investment and help to accelerate privatisations and foster job creation in competitive and viable businesses.

(b) Streamlining public administration with a focus on speeding up the administrative reforms, ensuring the proper functioning of justice, slashing red tape, reducing the administrative burden on citizens and businesses, and eradicating corruption and its root causes (e.g. legislative complexity or the discretionary power of public servants in their dealings with citizens which leaves room for under-the-table transactions).

(c) Strengthening active labour market policies with particular emphasis on education and training, as a way to improve the job-finding chances of people on the sidelines of the labour market, such as the long-term unemployed and young people, who have borne the brunt of unemployment. It is therefore necessary to address the hysteresis phenomena that can considerably slow down the de-escalation of unemployment and lead, in the end, to human capital depreciation, with negative repercussions on the long-term potential growth rate of the economy. However, attention must also be equally placed on the monitoring and results-based assessment of these active policies, as well as on fighting undeclared and uninsured work.

(d) Pursuing fiscal consolidation in the years ahead. The primary focus should be to **curb tax evasion**, with a view to broadening the tax base and fostering the sense of social justice. Efforts must centre on strengthening tax administration, intensifying tax audits through cross-checking, applying modern, risk-based audit methods and activating a nationwide asset registry. Direct or indirect tax exemptions, other than those granted on grounds related to social solidarity and/or economic growth considerations, need to be re-examined. Care should be taken to **ensure the viability of social security funds** by again reviewing the regime of various exemptions from the general provisions. Meanwhile, the better targeting of public expenditure (with an emphasis on **public investment**) and a continued effort to improve the efficiency of public services could also help save public resources. All of the above actions would make it possible to **gradually lower personal and corporate tax rates**, in order to foster economic activity in a fiscally neutral manner. The further strengthening of the domestic budgetary framework with the establishment of an Independent Fiscal Council will enhance fiscal supervision and contribute to the sustainability of public finances.

(e) The effective management of non-performing loans (NPLs) is an immediate priority. Greek banks must now adopt an active management of distressed loans, in a manner that not only eases the burden on cooperating borrowers facing temporary difficulties in servicing their debt, but also enables banks in the long run to unlock funds tied up in troubled loans that are unlikely to be repaid. Based on the above, it is estimated that banks could substantially reduce the troubled assets on their balance sheets by choosing to actively manage their non-performing loans through recourse to: (a) the supervisory framework for the management of loans in arrears and non-performing loans provided for in Bank of Greece Executive Committee Act 42/30.5.2014, and (b) from 1.1.2015 the workout options described in the Code of Conduct provided for in Law 4224/2013. Meanwhile, the recently enacted legislation on the settlement of non-performing business loans can be expected to motivate debtors and banks to seek viable solutions to the problem. In any event, the workout solutions available to banks for the management of non-performing loans must be selected in a manner that does not give rise to moral hazard. The risk of distorted incentives would become visible if across-the-board measures were to be proposed, instead of an approach that takes into account the actual income and wealth of individual borrowers. Positive outcomes are also expected from the collaboration between banks with borrowers in common, as well as from targeted actions in industries exhibiting a high concentration of troubled loans amongst few debtors and a high risk of financial difficulties spilling over to sound businesses.

The **Greek banking system** has emerged stronger from the stress tests and the comprehensive balance sheet assessment recently completed by the ECB. Against this background, the banking system should draw on its own recent experience with restructuring and **take on an active role in the sectoral restructuring of the economy, by channelling credit to truly viable businesses**. Funds should not be tied up in businesses with no prospect of survival, at the expense of healthy businesses with a potential to generate economic growth and job creation. The banking sector must be assisted in this effort through improvements in the legal framework that would lift restrictions on, for instance, (pre-) bankruptcy procedures, out-of-court settlements or, as already mentioned, a speeding up of the judicial procedure.

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After six years of recession and five years of fiscal adjustment, the economy has stabilised and is showing signs of improvement. If this momentum is maintained, the economy is likely to return to a steady growth path in the next few years. For this forecast to be realised, however, the restructuring of the economy and the reforms (some of which have already been mentioned) must be pursued with determination in order to address all the challenges, risks and uncertainties for Greece's prospects once the ongoing financial support programme from the EU is over. Such an outcome is possible only in an environment of consensus and cooperation among the political bodies that will ensure continuity. Greece still needs the support of a reliable precautionary credit programme from its European partners until it can sustainably cover its borrowing needs on international markets. In this context, of utmost importance is our relationship of mutual trust and cooperation with our partners. This relationship will be strengthened further if Greece is granted further debt relief in line with the Eurogroup commitment of 27 November 2012.

Eliminating uncertainty on the domestic front and committing to the advancement of reforms are prerequisites for strengthening both economic growth and employment and for the country's definitive exit from the crisis.

II THE EXTERNAL ENVIRONMENT OF THE GREEK ECONOMY

It is estimated that the growth rate of the **world economy** *will remain relatively low (3.3%) in 2014 for the third consecutive year, and will be uneven among the larger economies, while it is expected to increase to 3.8% in 2015, according to IMF forecasts. The United States and the United Kingdom among advanced economies, and China and India among emerging ones are expected to be the best performers for 2014 and also have the best outlook for 2015. After two years of recession, the* **euro area** *is estimated to resume positive, albeit low, growth (0.8%) in 2014, which is projected to increase to 1.3% in 2015,*[1] *with domestic demand being the main driver of recovery.*

However, these forecasts are subject to significant **risks and uncertainties***. Despite a further gradual improvement in financial conditions, geopolitical risks (from Ukraine-Russia and the Middle East) to global growth have risen in the course of the year, adversely affecting external demand and the recovery of world trade. Since September, financial market volatility has increased, while there was also a reversal of the downward trend in government bond yields, which was however temporary. Continued debt accumulation should also be stressed, as it increases risks in the event of an unfavourable change in economic parameters. Over the medium term, there still exist risks of a return to conditions of stagnation and low growth rates in advanced economies.*

In this environment of heightened uncertainty about the world and the European economy, international organisations point out **the need to strengthen investment***, especially in the euro area where it has considerably decreased during the crisis; European institutions have taken initiatives (see Special feature II.1) with a view to accelerating growth rates in the euro area.*

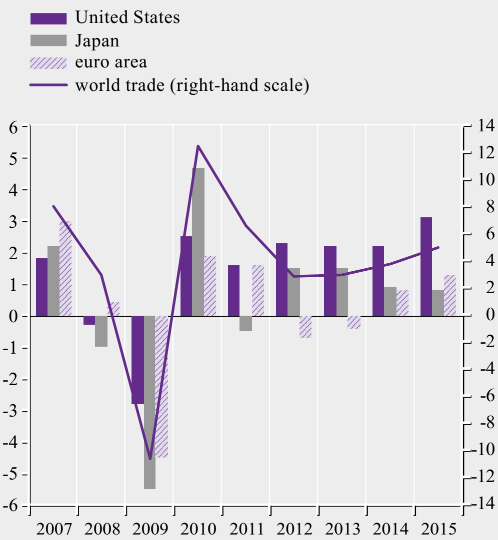
1 GLOBAL AND EURO AREA ECONOMIC DEVELOPMENTS AND PROSPECTS AND POLICY RESPONSES

World economy

According to IMF forecasts, the growth rate of the **world economy** *is estimated to stand at 3.3% in 2014, unchanged against 2013, and increase to 3.8% in 2015. This year,* GDP growth accelerated in advanced economies and decelerated in developing ones, while in 2015 GDP growth is projected to accelerate in both economic areas, i.e. to 2.3% in advanced economies and to 5.0% in emerging and developing economies.

Chart II.1 World trade and GDP in the United States, Japan and the euro area

(percentage changes in volumes)



Source: International Monetary Fund, October 2014.
Note: 2014: estimates, 2015: forecasts.

In **advanced economies**, the most favourable outlook for 2015 is that of the United States, with GDP growth projected to rise to 3.1% from 2.2% in 2014, and the United Kingdom, despite a small decline in the growth rate. The growth rate of the Japanese economy will remain low (0.8% from 0.9% in 2014) under the pressure of higher indirect taxation and subdued external demand, in spite of the large depreciation of the Japanese yen in 2013-2014. In **emerging economies**, the best performing countries are China, with just a slight decline in its growth rate to 7.1% from 7.4% in 2014, and India, with GDP growth accelerating to 6.4% from 5.6%.

1 According to more recent European Commission and OECD forecasts, the euro area growth rate will be 1.1% in 2015.

Table II.1 Key macroeconomic aggregates of the world economy

	Number of countries	Share in GDP[1] (%)	Output (annual percentage changes in real GDP)			Inflation[2] (annual percentage changes)			Fiscal balance (% of GDP)[3]			Gross government debt (% of GDP)			Current account balance (% of GDP)		
			2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
World total	**189**	**100.0**	**3.3**	**3.3**	**3.8**												
1. Advanced economies	*36*	*43.6*	*1.4*	*1.8*	*2.3*	*1.4*	*1.6*	*1.8*	*-4.3*	*-3.9*	*-3.1*	*105.5*	*105.7*	*105.3*	*0.4*	*0.3*	*0.2*
United States		16.4	2.2	2.2	3.1	1.5	2.0	2.1	-5.8	-5.5	-4.3	104.2	105.6	105.1	-2.4	-2.5	-2.6
Japan		4.6	1.5	0.9	0.8	0.4	2.7	2.0	-8.2	-7.1	-5.8	243.2	245.1	245.5	0.7	1.0	1.1
United Kingdom		2.3	1.7	3.2	2.7	2.6	1.6	1.8	-5.8	-5.3	-4.1	90.6	92.0	93.1	-4.5	-4.2	-3.8
Euro area	18	12.3	-0.5	0.8	1.1	1.4	0.5	0.8	-2.9	-2.6	-2.4	93.1	94.5	94.8	2.4	2.5	2.6
2. Emerging and developing economies	*153*	*56.4*	*4.7*	*4.4*	*5.0*	*5.9*	*5.5*	*5.6*	*-1.7*	*-2.1*	*-2.0*	*39.3*	*40.1*	*40.7*	*0.8*	*0.8*	*0.5*
China		15.8	7.7	7.4	7.1	2.6	2.3	2.5	-0.9	-1.0	-0.8	39.4	40.7	41.8	1.9	1.8	2.0
Russia		3.4	1.3	0.2	0.5	6.8	7.4	7.3	-1.3	-0.9	-1.1	13.9	15.7	16.5	1.6	2.7	3.1

Sources: IMF, *World Economic Outlook*, October 2014 and *World Economic Outlook Database*, October 2014, European Commission, *European Economic Forecast, Autumn 2014*, November 2014.
Notes: For 2014 and 2015, forecasts.
1 Percentage share in world GDP in 2012, based on purchasing power parities.
2 HICP for the euro area and the United Kingdom, CPI for the other countries. Year averages.
3 Of general government.

Among non-EU geographical areas **that constitute important destinations for Greek exports**, the emerging and developing economies of Europe and the countries of the Middle East and North Africa are expected to record relatively satisfactory GDP growth rates in 2015 —taking into account increased geopolitical risks and uncertainties— i.e. 2.9% and 3.9% respectively. In Russia, GDP growth is forecast to stand at 0.5% in 2015 (despite higher risks of weaker growth), from 0.2% in 2014, as a consequence of the crisis in Ukraine and sanctions against Russia.

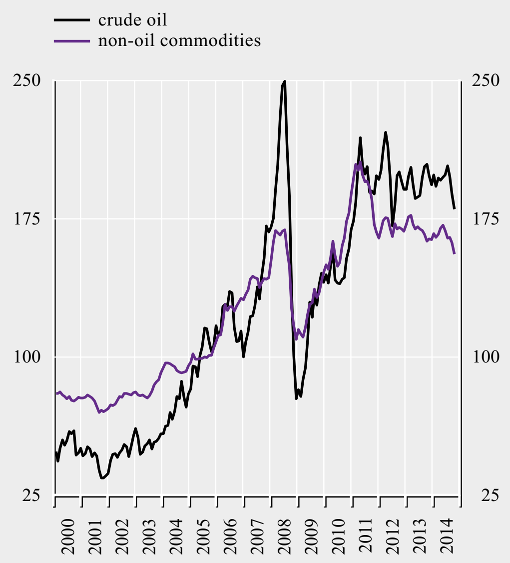
Despite a further gradual improvement in financial conditions, **geopolitical risks** (from the Middle East and Ukraine-Russia) to global growth have risen in the course of the year, adversely affecting external demand and the recovery of world trade. Since September, financial market volatility has increased, while there was also a reversal of the downward trend in risky bond yields —which was, however, temporary in most cases— and a shift of investors to safe havens. The IMF points out that private and public sector deficits are contracting, but are not being reversed, leading to further debt accumulation and, subsequently, higher risks.

The **volume of world trade** in goods and services increased in 2014 by 3.8%, against 3.0% in 2013, although the rate was slower than initially projected. It is expected that the growth rate will pick up further to 5% in 2015, but remain below its long-term average. Despite the severe geopolitical tensions in the Middle East and the Ukraine, international crude oil prices are estimated to decline to average 2014 levels, because of an excessive total crude oil supply due to increasing extraction of shale gas and oil in the United States, and the country's decreasing dependence on foreign energy.

Monetary policy in the advanced economies continued to be highly accommodative and

Chart II.2 World prices of primary commodities (January 2000-October 2014)

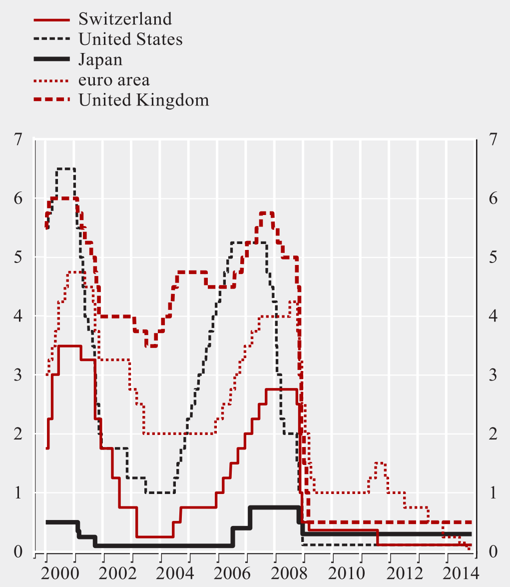
(2005=100, monthly data)



Source: IMF Primary Commodity Prices, November 2014.

Chart II.3 Key central bank rates (January 2000-30 November 2014)

(percentages per annum; daily data)



Sources: Euro area: European Central Bank, interest rate on main refinancing operations; United States: Federal Reserve Bank, federal funds target rate; Japan: Bank of Japan, official discount rate; UK: Bank of England, repo rate; Switzerland: Swiss national bank, average target range for three-month Libor.

supportive of growth, while room for manoeuvre seemed limited at least in the United States and the United Kingdom. It should be noted that the Bank of Japan recently announced new, non-standard monetary policy measures. **Fiscal policy** stance was restrictive in the United States and Japan, aiming at further reducing risks to sovereign debt, which however went on increasing in both countries, as well as in the euro area.

Global **external imbalances** are significantly reduced, in terms of flows, since the large current account deficits in the United States and the corresponding surpluses in China and Japan have declined. Nevertheless, since these have not been reversed, imbalances in the net international investment position continue to rise.

The euro area

After two years of negative growth rates, the euro area **is expected to resume positive, albeit low, growth rates,** i.e. 0.8% in 2014, which is projected to accelerate to 1.3% in 2015 (1.1%, European Commission and OECD – see footnote 1). Domestic, mainly, and external demand are expected to contribute to growth, but the increase in fixed capital formation will remain subdued (0.6% in 2014 and 1.7% in 2015). Industrial production, even though it increased in September (at an annual rate of 0.6%), still remains at 2010 levels. The rise in households' real income, owing to the very low inflation and the improvement in employment, is estimated to contribute to the expected rise in private consumption. Exports are estimated to recover in the second half of 2014 and during 2015, as the impact of the recent depreciation of the euro will be turning increasingly visible and external demand will be gradually gaining momentum.

Inflation is expected to reach 0.5% in 2014, well below the ECB target, and 0.8% in 2015, as the output gap remains high, while international crude oil prices, non-oil commodity prices and industrial output prices are expected to decline in euro terms in 2014 and 2015.

The **rate of unemployment** in the euro area remained high, i.e. 11.6% in 2014, slightly lower than in 2013, and is expected to decline further to 11.3% in 2015. Unemployment rate differentials across member countries are expected to remain large. In Greece and in Spain, the rates of unemployment are projected to decrease to 25.0% and 23.5%, respectively, in 2015 (from 26.8% and 24.8% this year), while next year it is expected that the lowest rates will be recorded in Germany (5.1%) and Austria (5.4%).

The performance of individual economies remained uneven in 2014, reflecting (i) fragmentation of financial markets within the euro area, (ii) the weakness of banking institutions to expand credit, (iii) the impaired —due to the crisis— financial condition of both the private and the public sector and (iv) the ongoing fiscal adjustment, especially in countries that were most hardly hit by the debt crisis. The pace of economic recovery weakened in the course of 2014, and in the second quarter GDP growth declined to 0.1%, from 0.3% in the first quarter, as the economies of France, Germany and Italy contracted. In addition, conjunctural surveys point to a worsening of the economic environment. In the third quarter, however, three out of the four major economies of the euro area (all except Italy) returned to positive rates of change in GDP.

A rebalancing of growth rates is forecast for 2015, as the economies of Spain, Ireland, Portugal and Greece gradually recover and are expected to record GDP growth rates higher than the average euro area rate. No member country is expected to be in recession in 2015, against three in 2014 (Italy, Cyprus and Finland).

In almost all euro area economies, **policies continued to be focused on reducing fiscal deficits**, aiming at eliminating the risk of a debt crisis, reducing government bond yields and returning to international capital markets for those economies that were cut off in 2010-2011. The general government primary balance is estimated to have turned slightly positive in 2014, after consistently recording deficits for six years, while it is projected to show a surplus of 0.3% of GDP in 2015. The aggregate general government deficit is estimated to have declined to 2.6% of GDP in 2014 and is projected to drop slightly further in 2015. Gross public debt increased slightly to 94.5% of GDP in 2014 from 93.1% in 2013, and it is expected to start declining as a percentage of GDP from 2016.

The **uneven adjustment of external**, mostly, and fiscal **imbalances** observed across euro area economies (economies recording significant deficits shifted into surpluses from 2013, while economies recording significant surpluses did not change), the reluctance of some countries to undertake structural reforms, and the very high unemployment rates in certain cases, constitute the **major challenges**, both economic and political, that the governments of Member States must face in a more effective way. **Geopolitical risks**, mostly the effects of the crisis in Ukraine-Russia, are the most important sources of uncertainty about the economic prospects of the euro area and the European economy in general. The IMF points out that probability is now higher for the euro area to experience recession again for the third time after the 2008 crisis.

Monetary policy remained accommodative, as the ECB lowered its key policy rate twice, in June and in September, while adopting a combination of non-standard measures. In June, it introduced a series of targeted longer-term refinancing operations (TLTROs). In September 2014, the ECB introduced the asset-backed securities (ABS) purchase programme with underlying assets consisting of claims and a covered bonds purchase programme (CBPP3) both in the secondary and in the primary securities markets. At the same time, expectations and economic prospects of the euro area will be positively influenced by the remarkable progress made towards reinforcing economic governance and creating a banking union, after the completion of the assessment and, finally, the assumption by the ECB of the supervision of euro area credit institutions as from November 2014.

2 THE ECONOMIES OF SOUTH-EASTERN EUROPE[2]

In the first half of 2014, the economies of most South-Eastern European countries recorded positive growth rates. However, on the basis of data releases for the second quarter of 2014 and of international organisations' estimates,[3] **a slight slowdown in economic activity** is expected for the remainder of this year and for 2015. Indeed, in some cases (Albania, Serbia), growth rates in the second quarter of 2014 were negative, while Romania saw a significant decline in its growth rate. By contrast, growth in FYROM and, to a lesser extent, in Bulgaria appears to be quite strong. Overall, the average growth rate in this region (excluding Turkey) is expected to fluctuate around 2.1%-2.2% in 2014, from roughly 2.3% in 2013, and pick up slightly in 2015.

Turkey saw a significant slowdown in its growth rate in the second quarter of the year compared with the first quarter (from 4.7% to 2.1%), mainly on account of subdued domestic demand. For 2014 as a whole, GDP growth is forecast to decelerate significantly to 2.6%, while in 2015 it is expected to accelerate to 3.3% as a result of the lagged effect of the expansionary monetary policy.

The declining growth rates in most countries of the region reflect the effect of different factors in each country. Specifically, the reduction in industrial production, the fall in investment, as well as the negative consequences of the floods in May, dampened growth in several countries, mostly in the western Balkans. Growth rate moderation in Turkey and Romania is, to a large extent, driven by lower private investment. By contrast, the improved performance of FYROM and Bulgaria is primarily associated with a rebound in private consumption. Finally, the **heightened geopolitical risks** (the crisis in Ukraine) have not yet considerably affected the countries of this region, but Turkey is put under more strain, due events in neighbouring countries (Syria and Iraq).[4]

Based on data for the January-August 2014 period, **inflation** in most countries remains on the downward course it has embarked since last year. This is primarily due to the slow contraction of the negative output gap, the receding international energy and food prices, as well as the low imported inflation from the euro area resulting from the pegging of several national currencies to the euro. In fact, in countries such as Bosnia and Herzegovina, Bulgaria, Montenegro and FYROM strong deflationary trends are recorded. Nevertheless, it should be noted that the downward trend in inflation could be reversed in the remainder of the year and in 2015, as a result of a further pick-up in domestic demand. In Turkey, inflation in August (9.5%) was well above the annual target of 5%, reflecting a significant rise in domestic food prices, the relaxed monetary policy and the effect from the depreciation of the Turkish lira.

According to forecasts by international organisations, in several countries the reduction of deficits in the **current account balance** seems to be coming to a halt in 2014. This is mainly driven by a gradual recovery in domestic demand, as well as by a decline in external demand, mainly from euro area countries. The relative recovery in domestic demand is the main reason for the marginal deterioration in the external balance of Bulgaria and Romania and, to a larger extent, FYROM. The remain-

2 Albania, Bosnia and Herzegovina, Bulgaria, Montenegro, Former Yugoslav Republic of Macedonia (FYROM), Romania, Serbia and Turkey.

3 European Commission (EC), International Monetary Fund (IMF) and European Bank for Reconstruction and Development (EBRD).

4 The region's energy dependence from Russia is limited. Bulgaria and Turkey are the two countries with the highest energy dependence, which still is less than 30% of their total energy requirements. As regards commercial relations, Bulgaria and Serbia are the only countries whose imports from Russia amount to about 5% of their total imports. No country of the region exports to Russia more than 2% of total exports.

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

Country	GDP (annual percentage changes) 2012	2013	Q1 2014	Q2 2014	2014	2015	Inflation (averages, annual percentage changes) 2013	Aug. 2014	2014	2015
Albania[1]	1.6	1.4	1.7	-0.6	2.1	3.3	1.9	2.0	2.7	2.8
Bosnia-Herzegovina[1]	-1.2	2.1	2.7	-	2.0	3.2	-0.1	-0.6	1.1	1.5
Bulgaria	0.5	1.1	1.1	2.1	1.7	2.0	0.9	-0.6	-0.8	1.2
FYROM	-0.4	2.2	3.5	4.3	3.0	3.2	2.8	-0.5	2.5	2.3
Montenegro	-2.5	3.3	1.5	0.3	2.9	3.6	2.2	-1.1	1.8	2.7
Romania	0.6	3.5	3.9	1.2	2.5	2.6	4.0	0.8	2.5	3.3
Serbia	-1.0	2.6	0.1	-1.1	1.1	1.9	2.2	1.5	3.8	4.5
Turkey	2.1	4.1	4.7	2.1	2.6	3.3	7.5	9.5	8.6	7.4

Country	Current account balance (% of GDP) 2013	Q1 2014	Q2 2014	2014	2015	Capital adequacy ratio (%) 2013	Q2 2014	Loans/ deposits (%) 2013	Aug. 2014	NPL ratio (%) 2012	2013	Q2 2014
Albania[1]	-10.7	-11.1	-11.6	-10.3	-12.4	18.0	17.5	55.3	54.8	22.5	23.5	24.1
Bosnia-Herzegovina[1]	-5.5	-5.8	-	-7.5	-7.0	15.2	-	115.2	116.1*	13.5	15.1	15.5
Bulgaria	2.1	-0.8	-0.2	1.0	0.2	16.9	21.2	87.7	85.5	16.6	17.2	17.2
FYROM	-1.9	-1.8	-1.5	-3.7	-3.8	16.8	16.9	89.7	89.7	10.3	11.3	11.6
Montenegro	-14.6	-14.3	-15.2	-14.4	-14.5	14.4	-	115.1	108.8	17.6	18.4	17.5
Romania	-1.1	-	-	-1.2	-1.6	15.0	17.0	101.3	99.2	18.2	21.9	19.2
Serbia	-6.1	-5.9	-	-4.6	-4.3	20.2	19.9	119.0	114.4	18.6	19.9	21.1
Turkey	-7.9	-7.5	-6.5	-6.0	-3.9	15.3	14.1	110.8	115.6	2.9	2.7	2.8

Sources: European Commission, *European Economic Forecast, Spring 2014*, *EU Candidate & Pre-accession Countries Economic Quarterly* – CCEQ, 3/2014 and national central banks.
* June 2014 data.
1 2014-2015 forecasts for Albania and Bosnia-Herzegovina are derived from the IMF, *World Economic Outlook* (WEO), October 2014.

ing countries in the western Balkans, Albania, Montenegro and Bosnia-Herzegovina, continue to record exceptionally high deficits. In Serbia, low domestic demand contributed to a marginal reduction in the external deficit, despite falling export performance. In Turkey, the external deficit's upward trend over the past few years seems to reverse, as it started a downward course in the first half of 2014. This development is due to the declining growth of domestic demand, as well as to a relatively small decrease in exports.

The evolution of **public finances** is quite heterogeneous across countries in this region. In Serbia and Bosnia-Herzegovina, two countries hit by the floods in May, public revenue did not go as planned in the January-August period and resulted in a widening of the deficit. FYROM finds itself in a similar situation, with its fiscal deficit standing at 3.2% of GDP already in the first eight months of the year, against an annual target of 3.9%. Fiscal developments in Albania and Montenegro took the opposite direction. A considerable deviation from the initial deficit target is observed in Bulgaria, resulting in its revision from 1.8% to 4% of GDP. By contrast, Romania witnesses a remarkable improvement in its fiscal deficit, which was 0.25% of GDP in the first eight months of 2014, against 1.3% in the same period of 2013. In Turkey, the execution of the budget seems to be evolving smoothly, as until the end of

August the deficit had approached last year's level, i.e. 1.2%-1.3% of GDP, well below the annual target (1.9% of GDP).

In most countries, with the exception of Turkey, FYROM and Bosnia and Herzegovina, the **credit expansion** continued its downward trend also in the first half of 2014. In fact, in Serbia and in Albania, negative rates were recorded.[5] This problem is associated, on the one hand, with weak domestic demand dynamics and, on the other hand, with the rising volume of non-performing loans. It should be noted that in both countries with negative rates of credit expansion, the NPL ratio has risen to particularly high levels, i.e. 21.1% in Serbia and 24.1% in Albania. A clearly different picture emerges for Turkey, where credit expansion continued to increase also in the first half of 2014 at an average annual rate above 25%, while the NPL ratio stands below 3%. The collapse of one of the major domestic banks in Bulgaria is still a pending issue and, as a result, the country's financial stability is, to a certain extent, put to the test. In general, however, the economies in the region have stable banking systems that maintain relatively high capital adequacy ratios (above 15%).

5 In Albania, from July onwards, there are signs that this negative course may be coming to a halt, also because of further monetary policy easing, with the intervention rate reaching the historically low 3%.

Special feature II.1

FIXED INVESTMENT IN THE EURO AREA: REASONS FOR ITS SIGNIFICANT SHORTFALL AND INITIATIVES TO SUPPORT IT

Fixed investment in the euro area as a whole declined sharply as a percentage of GDP during the global economic crisis and the sovereign debt crisis, a development that reflects mainly the strong fall in investment in countries that were severely hit by the sovereign debt crisis, such as Greece, Ireland, Spain and Portugal (see table).

Fixed capital formation

(% of GDP)

	2007	2008	2009	2010	2011	2012	2013
Euro area	21.9	21.5	19.4	19.0	19.0	18.4	17.7
Greece	26.6	22.6	19.9	17.6	15.1	13.2	12.1
Ireland	25.6	22.0	16.1	12.2	10.6	10.7	11.2
Spain	30.7	28.7	23.6	22.2	20.7	19.2	17.7
Portugal	22.2	22.5	20.5	19.6	18.0	16.0	14.8

Source: European Commission, *European Economic Forecast, Spring 2014*, Statistical Annex.

As shown in the table, fixed investment in the euro area declined as a percentage of GDP by around 4 percentage points between 2007 and 2013. In Greece, Ireland, Spain and Portugal the decrease in investment was much larger, reaching about 14 percentage points in Greece and Ireland.

An analysis of the determinants of this sharp contraction in investment reveals that its major causes were weak economic activity and an estimated lower potential output compared with the pre-crisis period, but also the need to restructure the economies and reduce excess capacity in certain sectors, such as construction, as well as the need for households' and enterprises' balance sheet repair. Additional factors that are related to the sovereign debt crisis and continue to weigh on investment expenditure, albeit to a less extent than two years ago, are the decline in public investment, the fragmentation of financial markets and high levels of economic uncertainty:

- The decline in **public investment** resulted largely from the sovereign debt crisis which signalled a need for significant fiscal consolidation in the euro area. It also reflected a continuation of the trend, which had started to emerge before the crisis, towards shifting parts of public sector investment to the private sector, in areas such as education and transport.[1]

- The weak rebound in investment is also attributable **to the fragmentation of financial markets** in several euro area member countries, which limits credit supply and hinders the improvement of financial conditions and the smooth financing of real economy.

- Finally, investment activity was adversely affected by **increased uncertainty** as regards the economic outlook, the resolution of the sovereign debt crisis and the capacity of the banking system to finance investment projects. According to a survey, the fear that banks' balance sheet condition might lead to a credit crunch is one of the main reasons why corporations have sought to hoard liquid assets rather than invest.[2]

A breakdown of investment by sector of economic activity shows that, overall, the fall in the services and construction sectors has been very strong compared with previous business cycles, while the decline in the industrial sector has been similar to that observed in earlier downturns.[3]

It is estimated that investment will gradually recover, as the factors that contributed to its shortfall will be losing momentum. Uncertainty surrounding the stability and viability of the euro area has already receded considerably and the economy's financing conditions are gradually improving, in spite of significant risks for a weaker recovery (see recent IMF forecasts). In addition, significant progress towards fiscal consolidation leaves room, where relevant, for increased spending on targeted public investment in infrastructure and other growth-enhancing investment expenditure (e.g. in research & development and innovation).

Despite the positive impact of the above factors, additional actions are deemed necessary to give a substantial boost to investment, notably public investment in infrastructure.[4] The European institutions have taken certain important decisions to boost investment, such as:

- The capital of the European Investment Bank (EIB) was raised by €10 billion in 2013, thus increasing the financing of investment programmes that year by 37%.

- The EU multiannual financial framework 2014-2020 is more strongly oriented towards investment and the support of research and innovation.

1 See M. Buti and Ph. Mohl, "Lacklustre investment in the eurozone: is there a puzzle?", www.voxeu.org, June 2014.
2 See "Investment and investment finance in Europe", European Investment Bank, 2013, http://www.eib.org/attachments/efs/investment_and_investment_finance_in_europe_en.pdf.
3 See ECB, "Factors behind the fall and recovery in business investment", *Monthly Bulletin*, April 2014.
4 In its *World Economic Outlook* (October 2014), the IMF pointed out that in countries with infrastructure needs, the time is right for an infrastructure investment push, since the borrowing costs are low in relation to the expected return on investment. An increase in infrastructure investment is expected to raise output both in the short and in the long term by boosting total demand and by increasing total supply respectively. In a sample of advanced economies, a one percentage point of GDP increase in public infrastructure investment leads to a GDP increase by about 0.4% in the course of one year and by 1.5% in four years.

- The agenda of J.C. Juncker, new President of the European Commission, for investment totalling €300 billion over the next three years with the concerted action of different European organisations and mechanisms has already been announced and is to be presented in more detail within a period of three months after the new Commission assumes its tasks.[5]

Finally, on 14 October 2014, the EU's Economic and Financial Affairs Council, in its conclusions on *"measures to support investment in Europe"*, called on the European Commission and the European Investment Bank, in the context of the Task Force they established for supporting investment, to identify potentially viable investment programmes and to lay the foundation for a pipeline of projects aimed to boost EU competitiveness and growth in the medium to long-term. A first report on the progress made on these strands of work will be submitted to the Council in December 2014.

5 J.C. Juncker, "A new start for Europe: My agenda for jobs, growth, fairness and democratic change", July 2014. http://ec.europa.eu/about/juncker-commission/docs/pg_en.pdf. In addition, the IMF suggests more flexibility in labour markets, higher productivity in over-indebted economies, and private investment boosting in surplus countries.

III THE SINGLE MONETARY POLICY IN THE EURO AREA

The very low inflation rates prevailing in the euro area for a prolonged period of time, the declining medium- to longer-term inflation expectations, which have also reached low levels, the recent weakening of economic recovery and subdued monetary and credit growth led the Governing Council of the ECB to reduce its key interest rates to the effective lower bound and introduce the targeted longer-term refinancing operations (TLTROs), as well as outright asset purchase programmes. These measures should contribute to a general decline in financing costs in the euro area and support bank lending, especially to small and medium-sized enterprises. By bolstering economic activity in the euro area and supporting a depreciation of the exchange rate of the euro, the new measures adopted by the Eurosystem should create the conditions for inflation rates to return towards 2% in the medium term.

The primary objective of the single monetary policy conducted by the Eurosystem is to maintain price stability in the euro area over the medium term, that is to achieve an average inflation rate in the euro area countries of below, but close to, 2%.

However, inflation in the euro area has remained at extremely low levels for several months, while medium- to longer-term inflation expectations have followed a downward trend for a prolonged period and some relevant indicators have already fallen below 2%.

The persistence of very low inflation for too long can lead to deflation, i.e. a continuous decline in the general level of prices, which would be detrimental to the euro area economy. In order to help inflation rates return to levels closer to 2% —by contributing to a strengthening in economic activity, a depreciation of the exchange rate of the euro and stronger credit expansion to the real economy of the euro area— the Eurosystem cut its key interest rates in June and September 2014 down to historic lows or the effective lower bound. The Governing Council of the ECB indicated that, given the weak inflation outlook, key interest rates would not be increased for an extended period of time and adopted a new package of non-standard monetary policy measures.

In particular, last September a series of eight targeted longer-term refinancing operations (TLTROs) was launched, through which credit institutions will be able to obtain financing from the Eurosystem at a very low fixed interest rate, normally repayable in September 2018. However, banks that fail to meet the benchmark set by the Eurosystem regarding lending to the euro area non-financial corporations and households (excluding loans for house purchase) over the two-year period ending in April 2016 will be required to pay back the funds borrowed at an earlier date. This provides a strong incentive for banks to increase their lending activity relative to the recent past. This will mostly benefit the euro area small and medium-sized enterprises.

Moreover, in the last quarter of 2014 the Eurosystem started to conduct asset purchase programmes, involving asset-backed securities (ABS) and covered bonds. The programmes will last for at least two years. It should be noted that the minimum credit quality threshold (a rating of BBB- or equivalent) required by the Eurosystem for the eligibility of debt instruments under these programmes will not be applied in the case of marketable debt instruments issued by Greek or Cypriot banks. These Eurosystem interventions should contribute to an increase in those types of loans that serve as underlying assets for ABS or covered bank bonds, as well as to an across-the-board decline in the cost of market-based debt financing in the euro area.

The Governing Council of the ECB is committed to making wider use of non-standard monetary policy instruments within its mandate, if needed. Moreover, it tasked ECB staff and the relevant Eurosystem committees with ensuring the timely preparation of additional measures to be implemented, should it become necessary to further address risks of too prolonged a period of low inflation. It was also pointed out that the TLTROs combined with the asset purchase programmes will yield results over the medium term and that they will have a sizeable impact on the Eurosystem balance sheet, which is expected to increase to its early-2012 levels. In early 2015, the Governing Council will assess (a) the degree of monetary accommodation, (b) the expansion of the Eurosystem's assets, and (c) the medium-term impact on inflation from the recent decline in crude oil prices.

1.1 ECONOMIC ANALYSIS, MONETARY ANALYSIS AND MONETARY POLICY MEASURES BY THE GOVERNING COUNCIL OF THE ECB

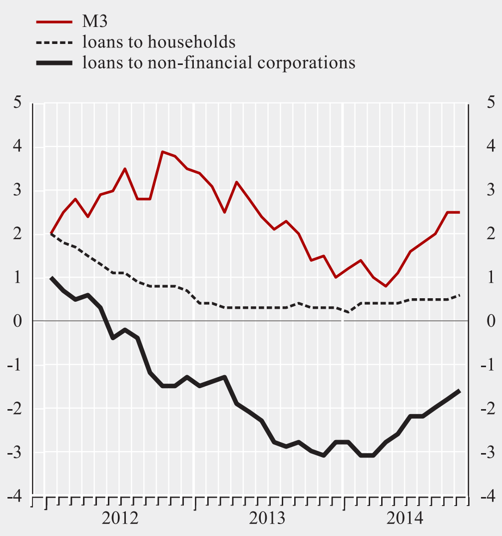
The growth of economic activity, albeit weak and uneven across euro area members, now appears to have lost momentum, as quarterly GDP growth rates in the second and the third quarter of 2014 were subdued. Various survey-based indicators and data available until November 2014 point to a weakening of economic growth, while GDP projections by several organisations, including the Eurosystem, are being revised downward, though still remaining in positive territory.

Throughout 2014 monetary analysis was also confirming that inflationary pressures in the euro area would remain weak over the medium term. The Governing Council of the ECB noted the low growth rate of the monetary aggregate M3 (December 2013: 1.0%, October 2014: 2.5% – see Chart III.1). With regard to the determinants of broad money supply, monetary growth was driven by cross-border capital inflows from countries outside EMU, reflecting rising confidence of international investors in euro area assets.

On the other hand, the growth rate of bank credit to non-financial corporations remained negative (December 2013: -2.9%, October 2014: -1.6%). This development can be explained, first, by the fact that demand for loans by the business sector normally follows

Chart III.1 Loans to the private sector[1] and M3 in the euro area (January 2012-October 2014)

(annual percentage changes)



Source: ECB.
1 Including securitised loans or loans otherwise transferred by credit institutions.

the increase in economic growth with a time lag, as businesses finance their activities (production/investment) initially from undistributed profits and other external non-bank financing sources (such as corporate bond markets) and only have recourse to banks at a later phase of the economic recovery. Second, at present many enterprises avoid to contract new loans, given that they are already highly indebted. Besides, banks also remain cautious towards new lending, given higher credit risk perceptions and a widespread and ongoing process of portfolio restructuring, deleveraging and balance sheet repair in the business sector.

So far in 2014, the annual growth rate of bank lending to households has remained broadly unchanged at around 0.5%. Banks' credit standards remain tight compared with their average levels in previous years. However, according to the results of the latest euro area bank lending survey, credit standards for loans to enterprises and households alike continued to ease between the second and the third quarter of 2014. In addition, banks report a continued rise in demand for loans by non-financial corporations and households.

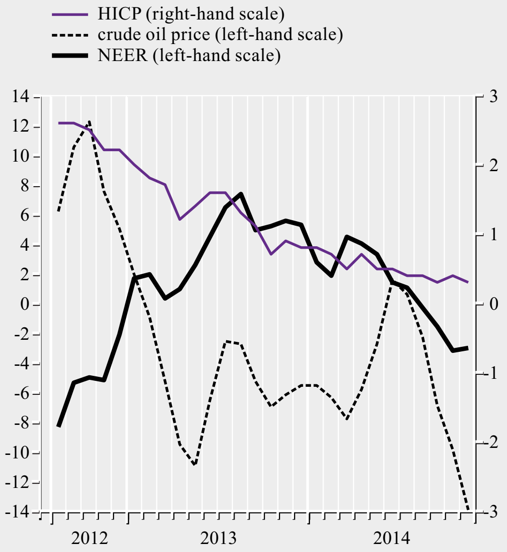
The comprehensive assessment of the balance sheets of significant euro area banks, which was recently concluded by the ECB, identified necessary adjustments which, once implemented, will ultimately improve not only banks' soundness, but among other things also their lending capacity.

HICP inflation in the euro area continued to decline in the course of 2014 and stood at 0.3% in November 2014, down from 0.8% at end-2013. Throughout 2014, the Governing Council of the ECB pointed out that the inflation rate had been low for a protracted period and was expected to remain so also in the near term, before picking up gradually in the course of 2015 and 2016 to levels closer to 2%. According to the latest Eurosystem staff macroeconomic projections (December 2014), average annual HICP inflation in the euro area is expected to stand at 0.5% in 2014, 0.7% in 2015 and 1.3% in 2016. Given the timeline of the projections, the decrease in crude oil prices after mid-November could not have been taken into account. Therefore, projections may have overestimated inflation rates in the near term. More generally, in relation to the recent fall in crude oil prices, the Governing Council of the ECB stressed the importance of avoiding spillovers from these developments to inflation expectations and wage formation.

The decline in inflation (see Chart III.2) is due to developments in energy and food commodity prices over the past years, the depreciation of the euro against other major currencies, as well as to a chronic shortfall of euro area aggregate demand. Against the background of these inflation developments, the weakened economic recovery, the resulting downward revision of inflation projections and the gradual decline in inflation expectations throughout 2014 led the Governing Council of the ECB to the conclusion that additional measures were necessary in order to prevent deflationary forces in the euro area from setting in.

Chart III.2 Harmonised index of consumer prices in the euro area, crude oil price[1] and nominal effective exchange rate of the euro[2] (August 2012-November 2014)

(annual percentage change)



Sources: ECB and Bloomberg.
1 Three-month moving average, Brent oil price, €/barrel.
2 As measured vis-à-vis the currencies of the 20 major euro area trading partners.

A falling general level of prices entails serious risks to the economy. It can trigger a downward deflationary spiral. Prolonged declines in prices can be entrenched in expectations, leading to a rise in real interest rates and a postponement of consumer and investment spending, which can feed back into further downward pressure on prices, thereby setting a vicious circle in motion. An aspect of this vicious circle is the fact that the falling level of prices makes it more difficult to reduce the stock of debt and alleviate the debt burden of both the public and the private sector.

Certainly, a deceleration or fall of prices in the euro area periphery is to some extent necessary to improve competitiveness and support a shift of resources towards the production of export products that can drive growth in these countries. However, this price adjustment will not

Table III.1 Changes in key ECB interest rates

(percentages per annum)

Date of interest rate change:[1]		Deposit facility	Main refinancing operations (fixed rate tenders)	Marginal lending facility
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
	14 December	0.25	1.00	1.75
2012	11 July	0.00	0.75	1.50
2013	8 May	0.00	0.50	1.00
	13 November	0.00	0.25	0.75
2014	11 June	-0.10	0.15	0.40
	10 September	-0.20	0.05	0.30

Source: ECB.
1 Changes in the deposit facility and the marginal lending facility rates are effective from the first main refinancing operation following the Governing Council decision (when the fixed rate on the main financing operations changes), not the date of the Governing Council meeting on which this decision is made.

continue in the long term; it will come to an end once domestic macroeconomic imbalances in the periphery are corrected, when there will no longer be a risk of very low or negative inflation rates to be maintained – especially at euro area level.

Against this background, in June 2014 the ECB cut its key interest rates (see Table III.1) thereby setting, for the first time, a negative interest rate on the deposit facility. In September, the key interest rates were further reduced to the effective lower bound. These cuts will contribute to a decline in the general level of interest rates in the euro area.

In order to guide the expectations of market participants and, more generally, economic agents as to the future path of short-term interest rates, the Governing Council of the ECB reaffirmed (similarly to its previous announcements in the period from mid-2013 onwards) that the very accommodative stance of the single monetary policy would be continued and that the key interest rates would remain at the present lower-bound levels for many months ahead, given the inflation outlook for the euro area.

In line with this affirmation, it was announced that the main refinancing operations (i.e. operations for the provision of liquidity to Eurosystem counterparties, mostly banks, with a maturity of one week), as well as longer-term refinancing operations (i.e. with a maturity of three months) would continue to be conducted as fixed rate tender procedures with full allotment, subject to the provision of adequate collateral by counterparties, at least until the end of 2016.

The Governing Council of the ECB repeatedly stressed its absolute determination to ensure that medium- to longer-term inflation expectations would not deviate from the levels considered consistent with the Eurosystem's primary objective of maintaining price stability (an inflation rate of slightly below 2%) in the euro area in the medium term.

In order to prevent the current very low rates of inflation in the euro area from becoming entrenched in inflation expectations, the Governing Council of the ECB confirmed that it stands ready to implement all non-standard monetary policy measures within its mandate, swiftly and to the full extent necessary. In this respect, ECB staff and relevant Eurosystem committees were tasked with ensuring the timely preparation of further non-standard measures, which could be implemented if needed.

With a view to immediately enhancing liquidity in the banking system, the weekly fine-tuning operations sterilising the liquidity injected under the Securities Markets Programme (SMP) were suspended as from June 2014.

Given that the generally slow pace of economic recovery in the euro area is associated with credit constraints, in June 2014 the Eurosystem introduced the Targeted Longer-Term Refinancing Operations (TLTROs) (see Box III.1). Finally, in September 2014 the Eurosystem announced two new asset purchase programmes, namely the asset-backed securities purchase programme (ABSPP) and the third covered bond purchase programme (CBPP3).

The Governing Council of the ECB intends to expand the Eurosystem balance sheet back to its 2012 size by this package of measures, which is designed to provide further monetary accommodation in the absence of any scope to further reduce key interest rates which have reached the effective lower bound.

The ECB has repeatedly stressed that if the Eurosystem monetary policy is to effectively support economic activity, which would help the euro area inflation rate to reach levels considered consistent with price stability, Member States should implement further structural reforms. If entrepreneurship is not effectively promoted and obstacles to the establishment of new or the expansion of existing companies are maintained (e.g. red tape) or if taxation is heavy, the measures adopted by the Eurosystem to encourage bank lending particularly to small and medium-sized enterprises will have a limited impact, as demand for bank credit by the business sector could be insufficient.

Regarding fiscal policies, the Governing Council of the ECB has repeatedly noted the progress made by Member States towards fiscal consolidation. This progress was achieved through the implementation of the Stability and Growth Pact (SGP), which had a crucial contribution to the preservation of confidence in the euro area. It should also be stressed that the SGP provides a high degree of flexibility, enabling to address the budgetary costs of structural reforms and to provide the necessary support to aggregate demand in the euro area. The SGP enables the pursuit of fiscal policies geared towards supporting economic growth by minimising the inevitable tax distortions, improving public services and implementing public investment. It goes without saying of course that, apart from supporting economic activity, fiscal policies should also ensure public debt sustainability.

Box III.1

TARGETED LONGER-TERM REFINANCING OPERATIONS (TLTROs), ASSET-BACKED SECURITIES PURCHASE PROGRAMME (ABSPP) AND COVERED BOND PURCHASE PROGRAMME (CBPP3)

Through the **Targeted Longer-Term Refinancing Operations** (TLTROs) the Eurosystem provides financing to banks at a fixed interest rate. The interest rate is equal to the rate on the Eurosystem's weekly main refinancing operations (MROs) prevailing at the time of take-up (currently 0.5%), plus a fixed spread of 10 basis points (i.e. a total borrowing cost for banks of 15 basis points).

The maximum duration of TLTROs is four years – all targeted operations will mature (and the funds provided through them will be repaid) in September 2018. However, Eurosystem counterparties are given the possibility of early repayment. In addition, in case a bank that has raised funds from the Eurosystem is unable to channel them into lending of a sufficient level to non-financial corporations or even to households (excluding loans for house purchase) ("lending to the real economy" for the purposes of the TLTROs), it will be required to pay back borrowings in September 2016, either in whole or in part depending on the amount of lending it has granted to the real economy. Lending for house purchase is not encouraged by TLTROs in order to prevent an excessive rise in prices in those euro area real estate markets that are prone to overheating and speculative behaviour.

Through the first two TLTROs (conducted in September and December 2014), banks are entitled to raise funds from the Eurosystem up to a total amount equal to 7% of their loans to non-financial corporations and households (excluding loans for house purchase) outstanding at end-April 2014, namely about €400 billion for the euro area as a whole – already €82.6 billion has been raised through the first TLTRO.

Six further TLTROs will follow between March 2015 and June 2016; they will be conducted on a quarterly basis. In the framework of these operations, banks will be able to raise additional funds from the Eurosystem depending on their lending activity in the period between May 2014 and shortly before the relevant allotment (precisely, two months before the TLTRO date).

Banks that provided *on average* a positive monthly net flow of lending to the real economy (i.e. new loans and other lending facilities minus capital payments for existing loans or other forms of credit) in the twelve-month period from May 2013 to April 2014 ("reference period") will be entitled to a borrowing allowance from the Eurosystem equal to three times the *cumulative* net flow of lending they will grant from May 2014 up to two months before the conduct of the targeted operation.

Furthermore, banks that exhibited in the past negative average *monthly* lending to the real economy will also be able to raise funds from the Eurosystem. These banks can acquire this entitlement on condition that their *cumulative* net lending from May 2014 up to two months before the TLTRO date shows that their lending activity has been enhanced compared with the May 2013-April 2014 period. The Table on the following page shows the borrowing allowance for these banks.

Banks that will raise funds through TLTROs will be required to repay in whole or in part their borrowings in September 2016, should their lending activity between May 2014 and April 2016 proves to be inadequate. This means that these banks will benefit from cheap funding from the Eurosystem for two years less than banks with adequate lending activity, which will repay borrowings in September 2018.

In particular, in the case of banks that reduced their loan portfolio in the reference period (May 2013-April 2014):

(a) If the *cumulative* net bank lending to the real economy in the period from May 2014 to April 2016 ("CUMLENDING") is more negative than twelve times the *average* net *monthly* bank lending to the real economy in the reference period ("NMLENDING"), that is if 0 > 12 x NMLENDING > CUMLENDING, then banks will be required to repay the full amount of their borrowings in all TLTROs, namely their borrowings since September 2014.

Cumulative potential amount of financing to be raised from the Eurosystem in the context of all targeted operations (TLTROs) from March 2015 onwards[1]

After the TLTRO of March 2015:	3 x {cumulative net lending to the real economy[2] during the period May 2014-January 2015 *minus* 9 x average monthly net flow of bank credit to the real economy recorded during the period May 2013-April 2014}[3]
After the TLTRO of June 2015:	3 x {cumulative net lending to the real economy during the period May 2014-April 2015 *minus* 12 x average monthly net flow of bank credit to the real economy recorded during the period May 2013-April 2014}
After the TLTRO of September 2015:	3 x {cumulative net lending to the real economy during the May 2014-July 2015 *minus* 12 x average monthly net flow of bank credit to the real economy recorded during the period May 2013-April 2014}
After the TLTRO of December 2015:	3 x {cumulative net lending to the real economy during the May 2014-October 2015 *minus* 12 x average monthly net flow of bank credit to the real economy recorded during the period May 2013-April 2014}
After the TLTRO of March 2016:	3 x {cumulative net lending to the real economy during the May 2014-January 2016 *minus* 12 x average monthly net flow of bank credit to the real economy recorded during the period May 2013-April 2014}
After the TLTRO of June 2016:	3 x {cumulative net lending to the real economy during the May 2014-April 2016 *minus* 12 x average monthly net flow of bank credit to the real economy recorded during the period May 2013-April 2014}

Source: ECB.
1 The available financing through the TLTROs to be conducted during the period March 2015-June 2016 will be additional to the funds raised by credit institutions in the context of the first two targeted operations in September and December 2014.
2 Bank lending to the real economy comprises bank credit to non-financial corporations and households, excluding housing loans.
3 The formula applies only if the expression in brackets is positive. Given that the average monthly net lending recorded in the May 2013-April 2014 period is assumed to be negative, the expression is positive if: a) cumulative net bank lending to the real economy in the post-April 2014 period is positive, or b) cumulative net bank lending to the real economy in the post-April 2014 is negative but lower in absolute terms than 12 times the average monthly net lending in the May 2013-April 2014 period. It is noted that, in the TLTRO of March 2015, credit institutions may borrow only if their cumulative net lending to the real economy in the May 2014-January 2015 period is less strongly negative than nine times the average monthly net lending in the May 2013-April 2014 period.

(b) If the *cumulative* net bank lending to the real economy in the period from May 2014 to April 2016 is less negative than twelve times the *average* net *monthly* bank lending to the real economy in the period from May 2013 to April 2014, that is if 0 > CUMLENDING > 12 x NMLENDING, but from March 2015 up to the final TLTRO of June 2016 the bank borrowed an amount greater than its allowance as per the above table —possibly because its lending in the last quarters had been negative contrary to its expectations— then the bank will have to repay the amount by which it has exceeded its allowance.

TLTROs strongly motivate banks to grant new loans. Unlike older longer-term refinancing operations, they have a longer duration (that can reach four years compared with three years for the longer-term refinancing operations conducted in the past) and a fixed interest rate which is not subject to uncertainty. By contrast, the interest rate on the long-term refinancing operations conducted in the recent past could be calculated with precision only ex post, i.e. upon maturity of an operation. This is also the case for the three-month longer-term refinancing operations that are also being conducted presently.

Furthermore, longer-term refinancing operations provided (and still provide) liquidity *unconditionally*, without offering incentives for channelling liquidity into the private non-financial sector, as opposed to, for example, the public sector. It should be noted that eligible collateral for

TLTROs is not different in principle from that used in the other Eurosystem liquidity providing operations.

As already observed at least temporarily, regarding the first TLTRO that has been conducted, TLTROs will contribute to an increase in excess liquidity in the money market, which should trigger a decline in interbank interest rates. As a direct consequence, bank financing conditions for non-financial corporations and households will improve, as the interest rate on many bank loans is associated with an interbank rate used as a reference rate.

Bank funding through TLTROs is expected to substitute the issuance of bank bonds to some extent, as it entails much lower borrowing cost. The ensuing lower supply of bank bonds will generate an increase in their prices and an equivalent decline in their yields, which would also benefit banks that do not participate in open market operations, but continue to raise funds by issuing bonds. In the framework of the first TLTRO, a relatively stronger participation was observed among banks with substantial liabilities from issued bonds maturing before the second TLTRO date (December 2014). It is estimated that these banks would incur relatively higher borrowing costs (compared with other credit institutions) if they attempted to raise funds from the open market for a four-year period.

Furthermore, investors that usually place large amounts in bank bonds are likely to shift alternatively to corporate bonds, when a relative shortage of new bank bonds appears. This means that financing conditions for (large) non-financial corporations that raise funds directly from the open market will also improve.

The **Asset-Backed Securities Purchase Programme** (ABSPP) was initiated in November 2014 and is planned to last for at least two years. It concerns asset-backed securities[1] i.e. securitised bank claims against the euro area private sector, including loans for house purchase. Securities deriving from the securitisation of claims (ABS – asset-backed securities) must be characterised by simplicity, which means that only bank loans should be used as underlying assets, as opposed to derivatives or securitised products, while ABS issuers have to provide detailed information on the quality of the securitised loans. These products must be issued in a member country of the Monetary Union and they must be denominated in euro (and not in foreign currencies). The Eurosystem will make purchases in the secondary or even the primary market, mostly through four asset managers.

Given that the downgrades of many ABS (mostly subprime mortgages in the US) by rating agencies triggered the financial turmoil in 2007, concerns have been expressed regarding the impact of such securities on the quality of the Eurosystem's assets, as well as regarding the room for losses for the Eurosystem. However, the default rate for ABS issued in Europe is much lower than that for ABS in the US. Furthermore, the Eurosystem has a long experience in assessing the quality of ABS, as they have been used for many years as eligible collateral in main refinancing operations.

The ABSs to be purchased by the Eurosystem in the framework of the programme must essentially fulfil the same conditions as when used as eligible collateral, taking into account the dif-

1 A group of loans are combined into a pool, usually by the credit institution that has granted them. This pool is transferred to a specially created investment vehicle and forms part of its assets. Securitised products, i.e. assets made available to investors, usually appear in the liabilities of the entity in question. The income accruing to investors from their holdings in ABS derives from the smooth servicing (by the ultimate borrowers) of the group of loans in the assets of the specially created investment vehicle. Sometimes, the vehicle enhances this income using other sources or partly covers it with guarantees, a method known as credit enhancement.

ference between outright purchase of securities and eligibility of securities as collateral (the latter entails, *inter alia*, an only temporary acquisition of the securities by the Eurosystem and, therefore, a temporary risk exposure). Among the other conditions set under the programme, ABSs must have a credit rating equal to or higher than the minimum rating applicable in the Eurosystem, i.e. currently BBB- (or equivalent to Baa3 or equivalent to BBBl). A limit has also been set regarding the issue share the Eurosystem is allowed to acquire. Furthermore, the Eurosystem may only purchase senior tranches of ABSs, i.e. ABS classes ranking higher in the order of priority. ABS classes that lack the above features and are in a medium order of priority (mezzanine tranches), thus presenting a higher risk, can be acquired by the Eurosystem as long as they are covered by guarantees offered by entities with high credit standing (such as Member States, development banks, etc.).

As from October 2014 and for a period of at least two years, the Eurosystem will be implementing the **Covered Bond Purchase Programme** (CBPP3)[2] for euro-denominated bonds issued by euro area credit institutions. The Eurosystem will purchase bank bonds from credit institutions included in its eligible counterparties either for the purposes of conducting monetary policy operations or for the purposes of managing euro-denominated portfolios.

The programme in question, which is the third outright covered bond purchase programme, will also be the most ambitious one. It is estimated that the covered bank bond purchase programme, together with the asset-backed securities programme, can contribute to the generation of additional liquidity up to €1 trillion. The existing eligible covered bonds total €600 billion up to now, while eligible asset-backed securities €400 billion. Indeed, it has been pointed out that these programmes have a stronger liquidity-enhancing capacity than targeted operations. This is due to the fact that the extent of participation of banks in targeted operations can vary, as it depends on the conditions of demand for bank credit by the real economy. On the other hand, the extent to which the Eurosystem will be able to increase its securities portfolio will be determined by the relative attractiveness of the terms the Eurosystem will choose to offer.

Given that the volume of transactions in the ABS markets is presently very low, as the global financial crisis pre-eminently affected these markets, the acquisition of such securities by the Eurosystem will lead to a significant decrease in their yields. As a result, interest rates on new securitised loans will fall.

Furthermore, the liquidity to be generated by the two securities purchase programmes will exert downward pressure on interbank interest rates. Ultimately, in the context of portfolio restructuring, investors will channel the additional liquidity towards other financial assets, which will exert downward pressure on the yields of a wide range of securities, as well as on the exchange rate of the euro. This would bring about a general improvement in financing conditions, which would contribute to a wider transmission of the Eurosystem's accommodative monetary policy stance beyond the borrowers whose loans have been securitised.

In addition, the transfer of asset-backed securities to the Eurosystem by banks contributes to an enhancement of that part of their capital base which is available to support the extension of new credit. However, the capital base of banks (and, therefore, their lending capacity) will also ben-

2 Covered bonds rely on a pool of loans (the cover pool) granted by the issuing credit institution and remaining in its balance sheet. They provide a high degree of security to bondholders, as the latter are deemed to hold a privileged claim —i.e. a claim having priority over the claims of all other bank creditors— on the underlying loans in the event of bank failure.

efit from the reduction of troubled assets that will be achieved thanks to the lower financing costs in the economy combined with the resulting boost of economic activity. In general, if the programme contributes to a reversal of the structural trend of decline followed by the ABS market after 2007 (irrespective of the quality of the underlying assets), the liquidity of banks' loan portfolios will be significantly enhanced. This will have an expansionary effect on the supply of bank credit, which will be maintained after the conclusion of the programme.

The acquisition of covered bank bonds on a significant scale by the Eurosystem will put upward pressure on the prices of these securities, which will make them more attractive. If banks are to issue a larger volume of covered bonds, they must also increase the volume of their loans in the categories used in the cover pool. Therefore, the programme will contribute also to boosting credit expansion by banks.

Greek banks have already participated in the first targeted longer-term refinancing operation and raised funds exceeding €5 billion (that is, about 60% of their total allowance through the two first targeted operations in the course of 2014), compared with a total financing from the central bank averaging €54 billion in the first nine months of 2014. Although the net flow of credit from the Greek banking system to the real economy is likely to remain negative for quite some time —it averaged about €-0.5 billion in the reference period— Greek banks will be able to benefit from the cheap financing provided via the targeted operations throughout the four-year period up to 2018, if there is sufficient demand for bank credit from non-financial corporations and consumers. In addition to demand for bank loans, the availability of eligible collateral in the portfolios of Greek banks will put a significant restriction on the ability of Greek banks to participate in targeted operations, given that bank bonds covered by State guarantees will no longer be eligible for Eurosystem operations as of March 2015.

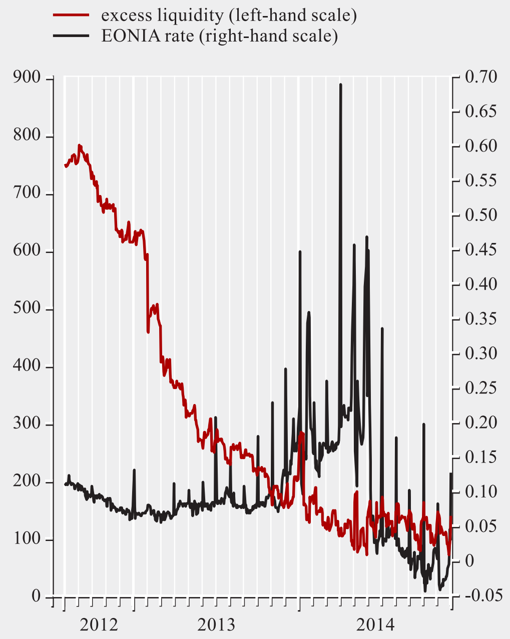
Finally, it should be noted that, by way of derogation from arrangements applicable to the remaining euro area countries, purchase programmes will also include securities issued by euro area credit institutions from member countries with rating below BBB- (Greece, Cyprus). Under normal circumstances, asset-backed securities and covered bonds issued by credit institutions from these countries are given ratings below BBB-. Therefore, in the absence of a derogation, the securities from Greek and Cypriot banks would not meet the minimum credit rating accepted by the Eurosystem and would not be eligible for purchase by the Eurosystem in the framework of the programmes. At the same time, however, various conditions have been set, ensuring that the risk to the Eurosystem associated with the securities of Greek and Cypriot banks is equivalent to the risk from ABSs and covered bonds issued in other member countries. For example, an issue share limit of 30% has been set with regard to the securities of Greek banks the Eurosystem is allowed to acquire, compared with 70% for the remaining countries (except Cyprus). Moreover, the Eurosystem can purchase such financial instruments issued in Greece or Cyprus on condition that Greece and Cyprus implement some kind of "adjustment programme" under the aegis of the European Union.

1.2 DEVELOPMENTS IN THE SINGLE MONEY MARKET

During the first four months of 2014, developments in the euro area money market were dominated by a gradual decline in excess liquidity. This was largely due to the early repayment of a significant part of the financing that banks had obtained from the Eurosystem through the three-year longer-term refinancing operations conducted in late 2011 and early 2012.

Chart III.3 Excess liquidity[1] in the euro area banking system and the EONIA rate (August 2012-November 2014)

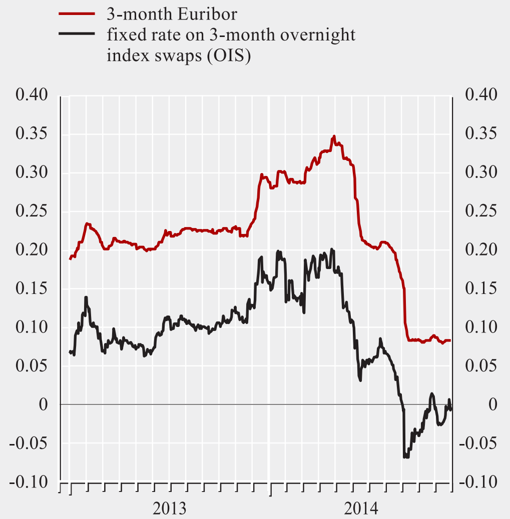
(daily data, billion euro and percentages per annum)



Sources: ECB and Bank of Greece calculations.
1 Credit institutions' (or other Eurosystem counterparties') holdings at the deposit facility plus current account holdings in excess of the minimum reserve requirements.

Chart III.4 Euro area money market rates (January 2013-November 2014)

(percentages per annum; daily data)



Sources: ECB and European Banking Federation.

As a result, the EONIA rate (the average interest rate in the overnight interbank market) followed an upward course (see Chart III.3), while its volatility also rose significantly – given the fluctuations of excess liquidity around its overall downward trend. The EONIA rate tended to spike towards the end of each month, when banks wish to show liquid assets in their balance sheets, which refer to the last day of each month.

Interbank Euribor rates also increased in the first four months of the year (see Chart III.4). Thus, in the period through April 2014 the Governing Council of the ECB repeatedly indicated that it was closely monitoring money market conditions and their potential impact on the monetary policy stance. Upward pressures on money market interest rates made it at times difficult for the Eurosystem to collect deposits through the weekly fine-tuning operations sterilising the liquidity injected under the Securities Markets Programme.

As the communications of the Governing Council of the ECB in May 2014 generated expectations for a further easing of the single monetary policy, money market rates started to decline, including the EONIA swap rate, which incorporates expectations for the future path of the EONIA rate. In the wake of the June and the September decisions, the downward course of interest rates became more solid —both the EONIA and the EONIA swap rate were at times negative— with the euro weakening concomitantly.

It should be pointed out that the downward pressure on money market rates was consistent with the halt in the gradual decline in excess liquidity (which had been going on since early 2012). This halt was achieved —despite the fact that the early repayment of past three-year longer term refinancing operations continued also after March 2014— with the suspension of the Eurosystem weekly liquidity-absorbing fine-tuning operations. The conduct of the first TLTRO in September also contributed to a temporary increase in excess liquidity.

IV MACROECONOMIC DEVELOPMENTS AND PROSPECTS IN GREECE

In 2014 economic activity was characterised by a gradual consolidation of positive growth rates, coupled by a stabilising trend in employment for the first time after the onset of the crisis. This was driven by higher exports and a recovery in private consumption. However, total investment has not recovered yet, despite the fact that business confidence rose for the best part of the year.

Stronger investment demand and a further increase in exports are expected in 2015, which should give growth dynamics a more permanent character. Inflation is expected to remain negative also in 2015, affected by reduced international oil prices.

It should however be noted that significant risks associated with political, geopolitical and international uncertainties may delay growth and burden the business environment in 2015.

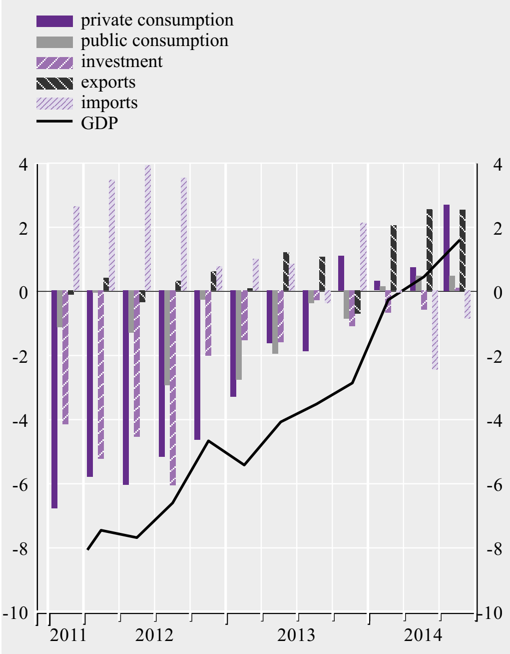
Quarterly GDP releases show that **the economy returns to positive rates of growth, after six consecutive years of recession**. According to seasonally adjusted data, GDP at constant 2010 prices rose by 0.4% in the second and 1.6% in the third quarter of 2014, while in January-September 2014 the increase was 0.6%.

The recovery in private consumption counterbalanced the shortfall in investment, while the increase in exports made a positive contribution towards positive growth rates, as evidenced by the quarterly analysis of demand components (see Chart IV.1). The evolution of disposable income and improved economic environment (see Chart IV.2) had a positive effect on consumer behaviour, despite the fact that fiscal restraints continue to burden household spending. On the other hand, investment remains weak because of, among other things, reduced bank financing and high borrowing costs.

Exports rose in January-September 2014, **also because of improved competitiveness of Greek exports of goods and services**, despite the fact that external demand (mostly from EU markets, which represent Greece's main trading partners) did not increase as expected. Export dynamics were more pronounced in shipping and tourism, the latter also supported by the country's improved image abroad and instability in the Eastern Mediterranean. Turning to exported goods, oil products, food and chemicals/plastics continue to post positive rates of growth (see Chart IV.16).

Chart IV.1 Contributions to annual changes in GDP

(quarterly data, seasonally adjusted; contributions in percentage points)

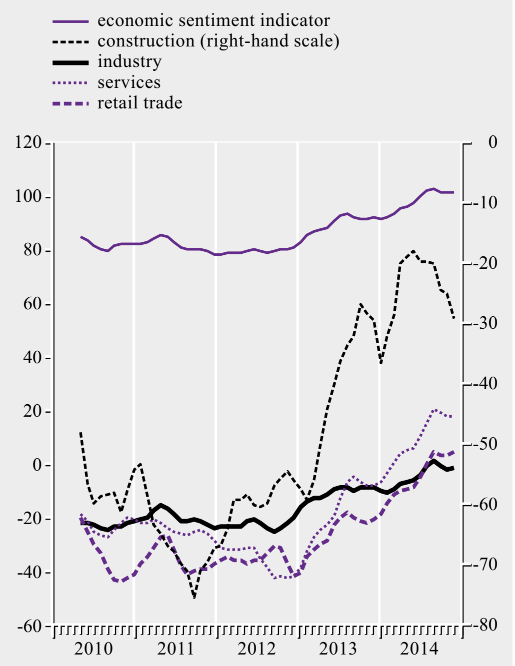


Source: ELSTAT, National Accounts, November 2014.

The shortfall in investment during January-September 2014 **is mainly associated with the large decline in residential investment**, while investment in transport equipment and machinery recovered against 2013.

Among the positive developments were the stabilisation of employment and **the decline in the number of the unemployed**. The gradual stabilisation of employment is considered to be associated with substantially lower labour costs (because of a series of measures including a reduction in minimum wages, decentralised

Chart IV.2 Economic sentiment indicator[1] and sectoral confidence indicators[1]



Source: IOBE/European Commission, business and consumer survey results.
1 Three-month moving average.

collective bargaining and a limitation of the extended effect of collective agreements after termination), enhanced flexibility (part-time employment, job rotation), and an improved economic environment. Nevertheless, the rate of unemployment remains high (26.6% in the second quarter of 2014).

It is estimated that **inflation will remain in negative territory** also in 2015, as a result of the negative effect of indirect taxes on prices, the drop in energy (oil) prices and the decline in unit labour costs. This anti-inflationary direction will also be supported by structural reforms in product and labour markets. It is expected that deflation will abate gradually in 2015.

Given the situation so far, **it is estimated that GDP will grow by 0.7% in 2014 and accelerate to 2.5% or more in 2015** if the recent decline in oil prices is taken into account. Faster growth in 2015 is expected to be driven by a further increase in exports and stronger investment demand.

The main risks to the economic outlook over the medium term include uncertainty within the country, insufficient improvement of financing conditions and reform fatigue. Lower than expected growth in the euro area and geopolitical risks constitute additional threats.

1.1 ECONOMIC ACTIVITY: DEVELOPMENTS AND PROSPECTS

Developments on the demand side

In January-September 2014 GDP rose by 0.6% (at constant 2010 prices and on the basis of seasonally adjusted data), against -4.0% in 2013 as a whole (see Table IV.1). Specifically, the annual rate of change in GDP turned from negative (-2.9% in the fourth quarter of 2013 and -0.3% in the first quarter of 2014) to positive (0.4% and 1.6% in the second and third quarters of 2014, respectively – see Chart IV.1). It should be noted that the annual rate of change in GDP in the second and the third quarter of 2014 became positive for the first time since the first quarter of 2010, while on a quarterly basis the rate of change in GDP has been positive since the first quarter of 2014.

This reflected a recovery in private consumption (1.5% in January-September 2014, against -2.1% in 2013) and a faster growth of exports (+8.4%, against +1.5% in 2013), particularly in services (see Table IV.1). By contrast, total investment continued to decline (-3.3%, against -9.4% in 2013), albeit at a significantly lower rate, mainly due to an increase in demand for transport equipment (+24.4%, against +16.1% in 2013).

The rise in private consumption is largely **attributable to the slower decline in disposable income** of households and non-profit institutions serving households (NPISHs)[1] (see Chart IV.3), as

1 According to quarterly non-financial accounts of institutional sectors published by ELSTAT, this income fell by 5.7% in January-June 2014 year-on-year, against a decline of 8.2% in the first half of 2013.

Table IV.1 Demand and GDP

(seasonally adjusted data; annual percentage changes and percentage point contributions, at 2010 prices)

	2010	2011	2012	2013	2014 Jan.-Sept.
Private consumption	-6.9 (-4.9)	-10.7 (-7.5)	-7.9 (-5.4)	-2.1 (-1.5)	1.5 (1.0)
Public consumption	-4.4 (-0.9)	-6.4 (-1.4)	-5.1 (-1.1)	-6.7 (-1.5)	0.1 (0.0)
Gross fixed capital formation	-20.8 (-4.3)	-17.0 (-2.9)	-28.5 (-4.5)	-9.4 (-1.1)	-3.3 (-0.4)
Residential investment	-26.5 (-1.7)	-14.7 (-0.7)	-33.3 (-1.6)	-27.7 (-0.9)	-51.0 (-1.3)
Final domestic demand[1]	-9.0 (-10.2)	-10.9 (-11.8)	-10.3 (-11.0)	-4.0 (-4.1)	0.7 (0.7)
Change in inventories and statistical discrepancy (% of GDP)	-0.4	0.0	1.3	0.2	-0.1
Domestic demand	-7.1 (-7.9)	-10.6 (-11.5)	-9.2 (-9.8)	-5.1 (-5.2)	-0.6 (-0.6)
Exports of goods and services	4.3 (0.8)	1.0 (0.2)	1.0 (0.2)	1.5 (0.4)	8.4 (2.3)
Imports of goods and services	-5.5 (1.7)	-7.8 (2.4)	-9.4 (2.9)	-2.9 (0.9)	3.8 (-1.1)
External demand	... (2.5)	... (2.6)	... (3.1)	... (1.3)	... (1.2)
Gross domestic product at market prices	-5.3	-8.9	-6.6	-4.0	0.6

Source: ELSTAT, National accounts, November 2014.
Note: Within parentheses, contributions to GDP in percentage points.
1 Excluding inventories and statistical discrepancy.

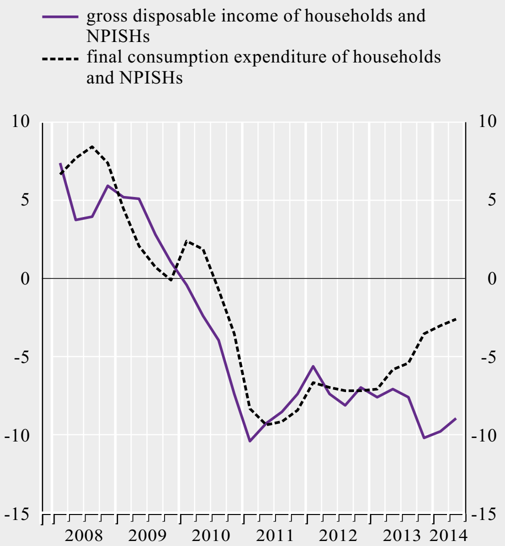
well as to the positive annual rate of change recorded in the compensation of dependent labour in the third quarter, but also to **the decline in uncertainty about future household incomes and the country's economic outlook** in general, as illustrated by economic sentiment indicators (see Chart IV.2).

The recovery in private consumption was reflected in retail sales, which grew by 2.2% in January-September 2014, and the substantial increase in the number of new private passenger car registrations in the first ten months of 2014 (see Table IV.2 and Chart IV.4). Other encouraging signs for a further increase in private consumption in 2015 include a gradually improving consumer confidence, better business expectations in retail trade and slower decline in consumer credit.

The **slower decline in gross fixed capital formation** in 2014 **has not yet led to a recovery in total investment demand**, despite the considerable

Chart IV.3 Private consumption and households' disposable income[1] (2008 Q1-2014 Q2)

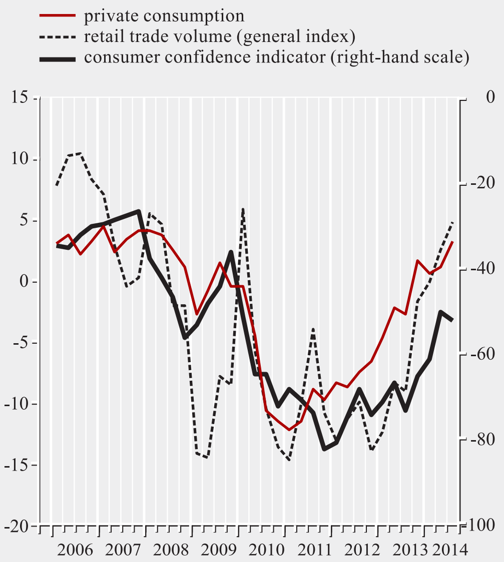
(annual percentage changes)



Source: ELSTAT, National Accounts.
1 Four-quarter moving average.

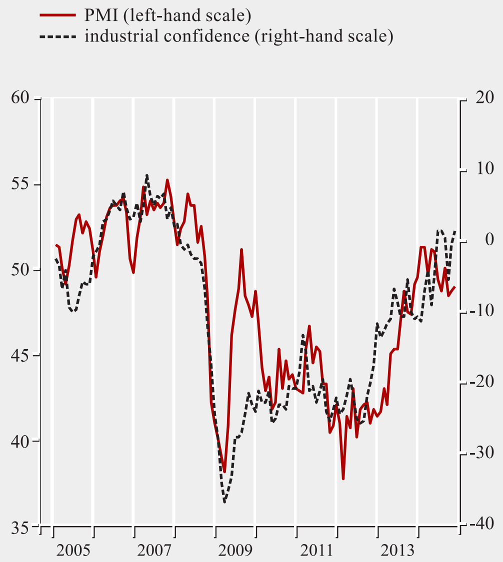
Chart IV.4 Private consumption and consumer demand indicators (2006 Q1-2014 Q3)

(annual percentage changes[1])



Sources: ELSTAT (private consumption, retail trade), IOBE and European Commission (consumer confidence indicator).
1 Consumer confidence indicator: weighted percentage balances.

Chart IV.5 Purchasing Managers' Index[1] (PMI) and industrial confidence indicator (January 2005-November 2014)[2]



Sources: PMI: Markit Economics and Hellenic Purchasing Institute. Industrial confidence: IOBE and European Commission.
1 Seasonally adjusted; values over 50 indicate expansion.
2 Seasonally adjusted; percentage balances.

improvement in domestic business environment, as reflected in relevant indicators[2] (see Table IV.3). Nevertheless, the stronger demand for transport equipment and machinery observed in January-September 2014 is expected to be maintained, as businesses gradually restore their financials and are motivated to replace and expand their productive capital —which was also affected by technological depreciation during the crisis— in order to maintain their market share.

The positive outlook for investment in 2015 is also based on the following:

1. Utilisation of resources available from the National Strategic Reference Framework (NSRF) and the European Investment Bank (EIB), which are expected to reach €5.2 billion by end-2015, including the required bank financing (without taking into account funds from the recently established Hellenic Investment Fund and the New Economy Development Fund).

2. Satisfactory progress in infrastructure —mostly through the reactivation of four large motorway construction projects— **as well as the dynamics of Public-Private Partnerships (PPPs)**[3] which, apart from their direct effect on construction investment, are also estimated to encourage investment in other sectors (e.g. building materials industry, auxiliary services). Developments in the Public Investment Programme during 2014 demonstrate a smooth project funding, as related payments in January-October 2014 were 23.9% higher than a year before. Lastly, it is estimated that the target of utilising €6.4 billion from the Public Investment Programme will be attained.

The evolution of business investment initiatives will depend on the developments in the

2 The economic sentiment indicator for Greece, compiled by the European Commission, recorded a significant increase and came to a level substantially higher than its average for 2013 (99.5 in January-November 2014 against 90.8 in 2013).
3 It should be noted that 23 projects totalling €2.8 billion are under way and 9 new contracts of €650 million are to be signed in the first half of 2015.

Table IV.2 Indicators of consumer demand (2009-2014)

(annual percentage changes)[1]

	2009	2010	2011	2012	2013	2014 (available period)
Volume of retail trade (overall index)	-11.4	-6.2	-10.2	-12.2	-8.1	2.2 (Jan.-Sept.)
Volume of retail trade (excluding fuel and lubricants)	-9.3	-6.9	-8.7	-11.8	-8.4	0.0 (Jan.-Sept.)
Food-beverages-tobacco[2]	-6.1	-5.5	-6.0	-9.0	-9.1	1.5 (Jan.-Sept.)
Clothing-footwear	1.4	-11.4	-18.8	-20.6	-2.2	6.9 (Jan.-Sept.)
Furniture-electrical appliances-household equipment	-15.3	-12.7	-15.7	-16.3	-6.2	-7.0 (Jan.-Sept.)
Books-stationery-other	-24.0	-4.3	-5.2	-12.1	-0.1	10.4 (Jan.-Sept.)
Revenue from VAT (at constant prices)	-10.2	0.1	-5.9	-12.8	-6.6	-1.4 (Jan.-Oct.)
Retail trade confidence indicator	-21.4	-26.4	-0.5	-3.1	22.9	27.6 (Jan.-Nov.)
Consumer confidence indicator	-46	-63	-74	-75	-69	-50 (November)
New private passenger car registrations	-17.4	-37.2	-29.8	-41.7	3.1	30.2 (Jan.-Oct.)
Tax revenue from mobile telephony[3]	13.2	37.1	-16.8	-7.9	-12.8	-11.3 (Jan.-Sept.)
Outstanding balance of consumer credit[4]	1.8 (Dec.)	-4.2 (Dec.)	-6.4 (Dec.)	-5.1 (Dec.)	-3.9 (Dec.)	-2,6 (October)

Sources: ELSTAT (retail trade, cars), Ministry of Finance (VAT revenue, tax revenue from mobile telephony), IOBE (retail confidence), IOBE and European Commission (consumer confidence), Bank of Greece (consumer credit).
1 Excluding the consumer confidence indicator (weighted percentage balances of positive and negative answers).
2 Comprising big food stores and specialised food-beverages-tobacco stores.
3 Until July 2009: fixed monthly levy per subscription. Since August 2009: new scaled levy on mobile telephony subscriptions and a levy on pre-paid mobile telephony.
4 Comprising bank loans and securitised loans. The rates of change are adjusted for loan reclassifications, loan write-offs/write-downs, foreign exchange valuation differences and the transfer of loans by credit institutions to their non-resident subsidiaries and, in 2009, to a domestic subsidiary credit company.

Table IV.3 Indicators of investment demand (2009-2014)

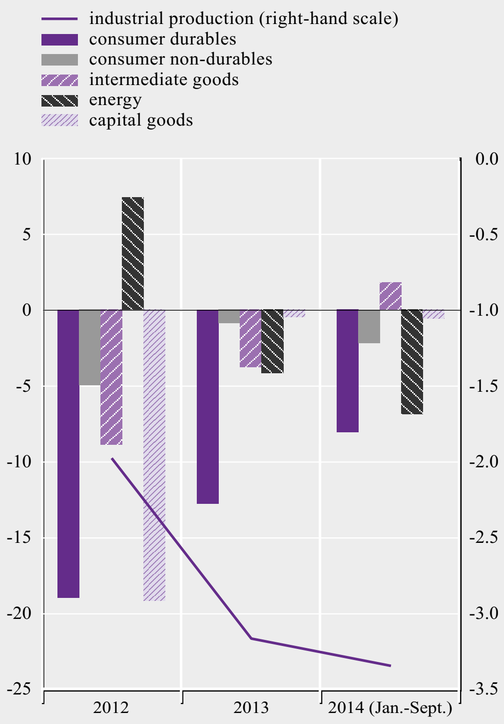
(annual percentage changes)[1]

	2009	2010	2011	2012	2013	2014 (available period)
Capital goods output	-22.5	-22.1	-13.5	-19.2	-0.5	-0.6 (Jan.-Sept.)
Capacity utilisation rate in the capital goods industry	73.4	66.1	62.7	58.2	61.4	64.6 (Jan.-Nov.)
Bank credit to domestic enterprises[2]	5.1 (Dec.)	1.1 (Dec.)	-2.0 (Dec.)	-4.4 (Dec.)	-4.9 (Dec.)	-3.8 (Oct.)
Disbursements under the Public Investment Programme[3]	-2.8	-11.3	...	-10.5	14.5	23.9 (Jan.-Oct.)
Production index in construction (at constant prices)	-17.5	-29.2	-41.3	-33.4	-8.2	9.7 (Jan.-Sept.)
Volume of private construction activity (on the basis of permits issued)	-26.5	-23.3	-37.7	-30.6	-25.6	-4.4 (Jan.-Aug.)
Cement production	-21.4	-14.3	-37.8	-12.8	3.4	-3.2 (Jan.-Sept.)
Construction confidence indicator	-31.4	-27.4	-27.8	26.1	50.6	22.3 (Jan.-Nov.)
Outstanding balance of total bank credit to housing[4]	3.7 (Dec.)	-0.3 (Dec.)	-2.9 (Dec.)	-3.4 (Dec.)	-3.3 (Dec.)	-3.2 (Oct.)

Sources: ELSTAT (capital goods output, volume of private construction activity, cement production, production in construction), IOBE (capacity utilisation, construction confidence), Bank of Greece (bank credit to domestic enterprises and housing, disbursements under the Public Investment Programme).
1 Except for capacity utilisation in the capital goods industry, which is measured in percentages.
2 Comprising loans and corporate bonds, securitised loans and securitised corporate bonds but excluding (as of June 2010) loans to sole proprietors. The rates of change are adjusted for loan reclassifications, loan write-offs/write-downs, foreign exchange valuation differences and the transfer of loans by credit institutions to their non-resident subsidiaries and, in 2009, to a domestic subsidiary credit company.
3 As of January 2012 actual cash payments and not appropriations under the Public Investment Budget.
4 Comprising loans and securitised loans. The rates of change are adjusted for loan reclassifications, loan write-offs/write-downs, foreign exchange valuation differences and the transfer of loans by credit institutions to their non-resident subsidiaries and, in 2009, to a domestic subsidiary credit company.

Chart IV.6 Industrial production

(annual percentage changes of index)



Source: ELSTAT.

domestic business environment, the fluctuations of international and, mainly, European demand and the course of the privatisation programme. It is estimated that the considerably successful outcome of the privatisation of regional airports —at a price much higher than the consultant's appraisal and with a commitment for total investment of €1.4 billion— will contribute to an acceleration of investment in 2015. High-profile privatisation projects are at an advanced stage, including the Piraeus and the Thessaloniki Port Authorities, regional airports and TRAINOSE-ROSCO; their finalisation, apart from an improvement in the business environment, will require further funds for maintenance and support of relevant infrastructure in the years to come.

By contrast, **residential investment keeps on falling** (-51% in January-September 2014), although relevant indices[4] reveal a gradual deceleration of negative pressures in the housing market. In any case, the sharp drop in construction investment since 2008 has rendered the share of construction investment in total investment more rational (from 40.6% in 2007 to 22.1% in 2013) and has freed up resources for more productive and extrovert sectors – though it hit all economic activity branches that are associated with construction. The negative trend in housing investment is estimated to continue in 2015.

Developments on the supply side

In January-September 2014, gross added value in total economy rose by 0.7% at constant prices against the respective period of 2013. The evolution of supply components largely reflects changes in demand. Services related to consumption and tourism made a positive contribution, while construction made a negative contribution (see Table IV.3).

Industrial output was negative in January-September 2014 (-3.4%) against the respective 2013 period. It should however be noted that this is mainly due to the plummeting of electricity production (-13.4%) because of lower household demand, while manufacturing output dropped marginally (-0.4%). As evidenced by the business expectations index (IOBE), the PMI, and the 2 percentage point increase in capacity utilisation, manufacturing improved slightly in January-September 2014. During the same period, a considerable number of manufacturing branches started registering higher production, while intermediate goods posted a positive rate of change (1.8%, see Chart IV.6).

The clear improvement in the construction output index in the first half of 2014 shows that, despite the large decrease in the sector's added value since 2008, construction firms have enough room to remain active in the

4 The decrease in the volume of building permits decelerated from -25.6% in 2013 to -4.4% in January-August 2014; the building works index compiled by ELSTAT also shows a de-escalation of negative pressures (-3.5% in the first half of the year, against -17.3% in 2013).

Table IV.4 Gross value added at basic prices

(seasonally adjusted data; annual percentage changes and sectoral contributions to gross value added; at prices of 2010)

	2009	2010	2011	2012	2013	2014 (Jan.-Sept.)
Agriculture, forestry and fishing	8.4 (0.2)	5.3 (0.2)	-5.8 (-0.2)	-2.2 (-0.1)	-7.2 (-0.3)	-1.4 (0.0)
Secondary sector	-4.8 (-0.8)	-15.5 (-2.6)	-13.1 (-2.0)	-13.4 (-1.9)	-9.4 (-1.3)	-4.1 (-0.5)
Industry including energy	1.5 (0.2)	-20.1 (-2.6)	-10.5 (-1.1)	-8.3 (-0.9)	-6.7 (-0.7)	-1.8 (-0.2)
Construction	-20.0 (-1.0)	-1.3 (-0.1)	-19.5 (-0.9)	-27.7 (-1.0)	-19.1 (-0.6)	-13.5 (-0.3)
Tertiary sector	-3.5 (-2.8)	-3.8 (-3.1)	-8.3 (-6.7)	-4.9 (-4.0)	-2.7 (-2.2)	1.3 (1.1)
Trade. hotels and restaurants. transport and storage	-8.9 (-2.3)	-6.5 (-1.6)	-13.7 (-3.3)	-5.5 (-1.3)	-2.5 (-0.6)	5.9 (1.4)
Information and communication	-1.4 (-0.1)	-14.0 (-0.6)	-9.6 (-0.4)	-7.3 (-0.3)	3.2 (0.1)	-2.2 (-0.1)
Financial and insurance activities	2.5 (0.1)	-11.5 (-0.6)	-12.9 (-0.6)	-7.1 (-0.3)	-6.2 (-0.3)	-5.9 (-0.3)
Real estate activities	0.2 (0.0)	16.4 (2.4)	-3.5 (-0.7)	-2.3 (-0.4)	0.8 (0.2)	0.3 (0.1)
Professional. scientific and technical activities	-4.0 (-0.3)	-21.1 (-1.4)	-11.2 (-0.6)	-9.1 (-0.5)	-8.9 (-0.5)	-8.0 (-0.4)
Public administration and defence	-3.2 (-0.6)	-1.4 (-0.3)	-2.9 (-0.6)	-6.4 (-1.4)	-5.3 (-1.2)	2.0 (0.4)
Arts. entertainment and recreation	8.5 (0.4)	-22.5 (-1.1)	-14.2 (-0.6)	5.2 (0.2)	0.2 (0)	-2.0 (-0.1)
Gross value added at basic prices	-3.5	-5.6	-8.9	-5.8	-3.7	0.7

Source: ELSTAT, Quarterly National Accounts, November 2014, non-seasonally adjusted data.
Note: Within parentheses, contributions to GDP in percentage points.

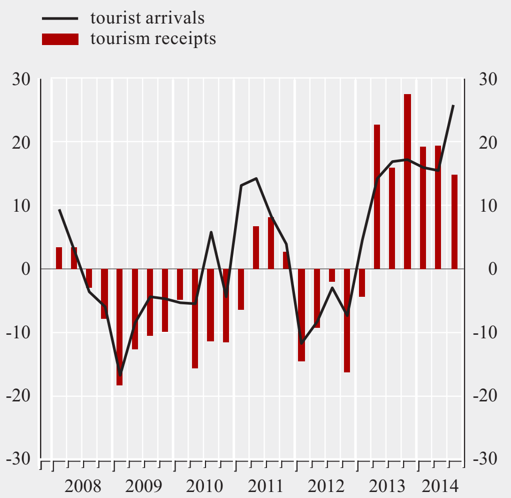
domestic market, especially in large infrastructure projects. Business expectations, although improved in relation to 2013, are still negative, mainly because of the sharp drop in construction activity.

The increase in added value in services at an annual 1.3% in January-September 2014 came mainly from trade, hotels-restaurants and transport-communication. By contrast, a decrease was registered in the sectors of business, scientific and technical activities, information and communication, financial and insurance activities[5] as well as in art and entertainement (see Table IV.4). Business expectations in services (excluding retail trade and banks) maintained their upward trend in the

5 According to the Hellenic Association of Insurance Companies, the production of insurance contracts in the first nine months of 2014 declined by 1.0% against the corresponding period of 2013; this is attributable to a 11.8% increase in life insurance and a 10.0% decrease in insurance against loss.

Chart IV.7 Tourist arrivals and tourism receipts (2008 Q1-2014 Q3)

(rates of change)



Sources: Bank of Greece and ELSTAT.
Note: Tourism receipts at constant prices of base year 2010; seasonally adjusted data.

Table IV.5 Activity indicators in the services sector (2009-2014)

(annual percentage changes)

	2009	2010	2011	2012	2013	2014 (available period)
A. Services turnover indicators						
1. Trade						
Wholesale trade	-8.9	-5.9	-13.5	-12.1	-12.1	0.1 (Jan.-June)
Retail trade	-10.2	-1.2	-7.2	-11.0	-8.6	-0.8 (Jan.-Aug.)
Motor trade	-15.7	-36.5	-26.5	-29.3	-3.1	21.7 (Jan.-June)
2. Transport						
Land transport	-31.5	-18.1	-1.7	-3.2	-4.1	-1.8 (Jan.-June)
Sea transport	-22.8	-8.5	-2.7	-15.3	-7.4	-18.6 (Jan.-June)
Air transport	-11.7	-7.0	-0.9	-1.1	14.3	14.7 (Jan.-June)
Storage and supporting transport activities	-32.2	-10.8	-7.9	-4.8	-7.0	3.8 (Jan.-June)
3. Hotels and restaurants						
Accommodation and food service activities	-9.1	-8.2	-7.4	-17.2	4.8	17.2 (Jan.-June)
4. Information and communication						
Telecommunications	-8.9	-11.3	-8.9	-5.1	-11.6	-5.8 (Jan.-June)
Film. video and TV programme production, recordings and music products	1.4	-6.6	-28.4	-4.9	-5.0	5.0 (Jan.-June)
Programming and broadcasting activities	-6.7	-2.1	-27.1	-16.3	-7.9	22.0 (Jan.-June)
5. Professional-scientific-technical activities						
Legal, accounting and management consulting services	-12.4	-7.3	-0.3	4.5	0.9	-0.6 (Jan.-June)
Architectural and engineering services	-18.6	-20.4	-19.6	-12.3	-14.0	-32.5 (Jan.-June)
Advertising and market research	-18.4	-23.8	-21.2	-16.7	-20.9	-10.2 (Jan.-June)
Travel agencies and related activities	-9.9	-24.5	-35.2	-26.9	11.3	2.3 (Jan.-June)
B. Passenger traffic						
Athens International Airport	-1.5	-5.0	-6.3	-10.4	-3.2	20.3 (Jan.-Oct.)
Aegean Airlines[1]	9.9	-5.1	4.2	-5.8	44.6	14.1 (Jan.-Sept.)
Piraeus Port (OLP)	-3.8	-6.0	-0.8	-17.5	1.0	15.5 (Jan.-Sept.)
C. Services confidence indicator	-28.3	-9.3	-2.9	-11.2	28.4	24.7 (Jan.-Oct.)

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

third quarter of 2014 and rose by 23.8% in relation to the third quarter of 2013.

Turnover at current prices data (see Table IV.5) show an **upward movement in sectors related to tourism**, e.g. accommodation and catering (17.2%) and air transport (14.7%).

The increase in sectors related to tourism is also evidenced by the clear improvement, in the third quarter of 2014, of expectations (by 12.8%) of tourism businesses, according to IOBE's Business and Consumer Surveys.[6] Revenue from tourism services in January-September 2014 rose by 16.2% at constant prices, in line with the increase in tourist arrivals (see Chart IV.7). Tourism receipts (at constant prices, excluding cruises) rose by 12.1%.

At the same time, negative pressures on retail businesses abated and the rate of decrease in

6 The rate of change came to +22.2% in November (IOBE, Business and Consumer Survey, November 2014).

the turnover of the retail trade (including fuel) decelerated considerably, from -10.3% in January-September 2013 to -0.8% in the corresponding 2014 period. Lower prices in many categories of goods and discounts offered by firms contributed to a further increase in household consumption and have led to a gradual improvement of business expectations in retail trade since the second half of 2013. Recent structural reforms in the sector also contributed to this development.[7]

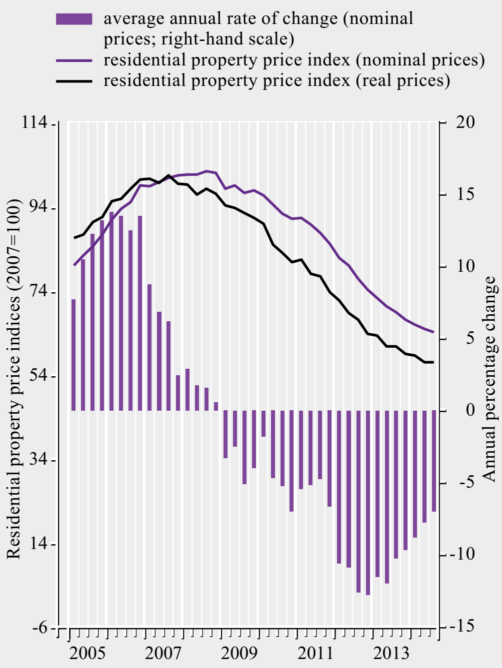
1.2 DEVELOPMENTS AND PROSPECTS IN THE REAL ESTATE MARKET

2014 witnessed persisting pressures on commercial values, prices and rents of both residential and commercial properties, albeit at a slightly lower rate (see Chart IV.8). The main characteristics of the Greek real estate market in 2014 were anemic demand and excess supply, which can be attributed to a contraction in households' disposable income and high unemployment, as well as liquidity shortage against the backdrop of banks' tight credit standards.

Data collected from credit institutions show an average annual rate of decline of 7.8% in **apartment prices** over the first nine months of 2014, against -10.9% in 2013. On a cumulative basis apartment prices dropped by 37.1% between 2008 (average level) and the third quarter of 2014, while the decline was stronger in the two major urban centres, as well as for larger properties in relatively higher-value areas of the country.[8] The downward path of residential property prices is likely to persist in the following quarters, but at a relatively weaker pace. The housing market is expected to recover with a relative time lag, largely depending on an increase in households' disposable income, a rise in employment, and an improvement in bank financing conditions.

In the **commercial real estate market**, both investment climate and expectations are improving since the beginning of this year, with investor interest mainly focusing on income

Chart IV.8 Residential property price index



Source: Bank of Greece.

property. In terms of investment interest, the most dynamic sectors appear to be that of tourism properties-hotel units as well as that of prime office buildings and retail properties, while an increasing shift of the overall interest towards prime large warehouses is also apparent. Nevertheless, pressures to renegotiate and reduce rents, especially for secondary retail properties, warehouses and non-prime office buildings, persisted. In 2014, prime commercial property prices showed signs of stabilisation, which are expected to strengthen from 2015 onwards, while the prices of non-prime retail property are projected to drop further in the coming quarters.

7 Notable examples include Law 4254/2014 "Measures to support the Greek economy in the context of implementation of Law 4046/2012 and other provisions", Government Gazette A 85/7.4.2014 (subparagraphs F.1-F.5) and Law 4177/2013 "Regulations for the market of products and the supply of services and other provisions", Government Gazette A 173/8.8.2013 (pp. 2693-2711).

8 The results of the quarterly survey of real estate agencies and property advisors, which is conducted by the Bank of Greece, point to an even sharper decline in residential property prices during the current crisis.

Excess taxation of real estate property over the past few years, which was deemed necessary for a more equitable distribution of the brunt of fiscal adjustment, exacerbated the recesion in the real estate market and considerably discouraged demand. Furthermore, the implementation of a capital gains tax on real estate transfers (under Law 4172/2013) in early 2014 led to stagnancy in the Greek real estate market, due to considerable uncertainty regarding the modalities of the capital gains tax on real estate. This, however, was gradually addressed with the latest amending provisions (Law 4254/2014). Recent legislation on real estate taxation, with the signifcantly lowered Property Transfer Tax to 3%, has shifted the tax burden from property transfer towards ownership.

2 EMPLOYMENT AND UNEMPLOYMENT: DEVELOPMENTS AND PROSPECTS

After a dramatic decline in the previous years and especially in 2011-2013, **employment has entered a phase of stabilisation**. At the same time, **the number of the unemployed** declined by 1.6% in the first half of 2014 against the respective 2013 period.

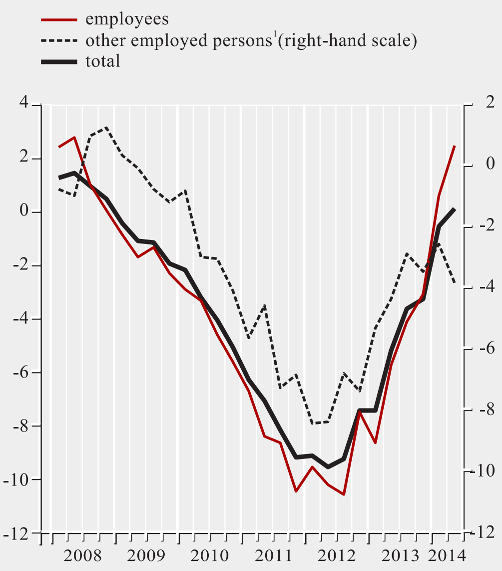
The gradual stabilisation of employment is also attributable to substantially lower labour costs (on the back of measures such as the reduction in minimum wages, decentralised collective bargaining and a limitation of the extended effect of collective agreements after termination), enhanced flexibility in employment (part-time employment, job rotation), as well as improved economic environment. Nevertheless, the rate of unemployment remains high (26.6% in the second quarter of 2014).

According to the Labour Force Survey conducted by ELSTAT and the ERGANI information system of the Ministry of Labour, **salaried employment registered a positive rate of change for the first time after 2008**. In particular, in the first half of 2014, the number of employees in the private sector rose by 1.5% against the first half of 2013, when the respective change was -7.2%. Contrary to the increase in the number of salaried employees, a decrease was registered in other categories, because of the termination of operation of small enterprises (the decrease was more pronounced for the self-employed with personnel, see Chart IV.9).[9]

ERGANI data on salaried employment flows in the private sector point to a possible increase in employment. After a continuous negative balance between hirings and separations in 2007-2012, hirings of salaried employees overshot exits by 133,000 people in 2013. In January-October 2014, the balance between hirings and separations was again positive, though somehow reduced compared to a year

Chart IV.9 Employment (2008-2014 Q2)

(year-on-year percentage changes)

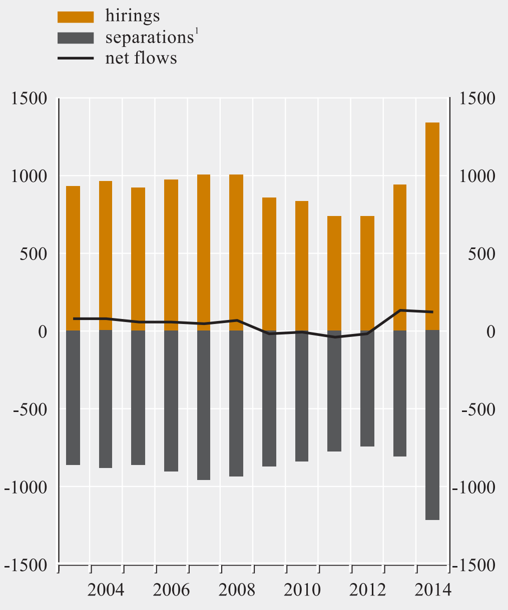


Source: ELSTAT, Labour Force Surveys.
1 Other employed persons = self-employed with employees (employers) + self-employed without employees + contributing family workers.

9 According to the report and the policy document "Development for Small-Medium Enterprises in Greece", which was drafted with the cooperation of social partners representing small-medium enterprises, the Union of Hellenic Chambers and the European Commission Task Force for Greece, 214,618 small-medium enterprises terminated their operation and 723,598 jobs were lost in 2010-2013 (see Chapter 2 of the above report).

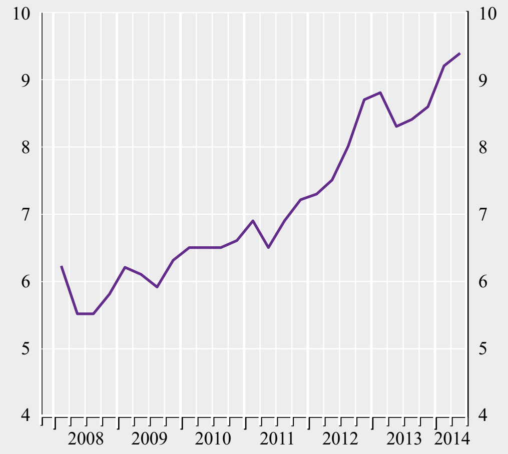
Chart IV.10 Dependent employment flows in the private sector

(thousand persons, first ten months of each year)



Sources: Manpower Employment Organisation (OAED) and ERGANI System.
1 Including voluntary quits, as well as employment contract terminations and expirations.

Chart IV.11 Part-time employment rate (2008-2014 Q2)



Source: ELSTAT, Labour Force Survey.

before (January-October 2014: 120,000, January-October 2013: 131,000 people, see Chart IV.10).[10] It is worth noting that the upgrade of ERGANI, as decided by the Employment Council, will help enhancing employment, as it will offer new information on sectoral and occupational needs of businesses and will facilitate more effective interventions in the labour market, also contributing to the fight against undeclared and uninsured labour.[11]

Turning to individual sectors, **tourism services** (hotels, restaurants etc.) registered **positive growth for the first time** in the first half of 2014 (10.2% against -7.7% and -6.2% in the respective periods of 2012 and 2013), because of the particularly favourable tourist season. By contrast, manufacturing, construction and wholesale-retail trade maintained their negative signs, though the rate of decrease in employment decelerated.

As regards employment status, **the decrease in full-time employment continued in 2014**, with a parallel increase in the **share of part-time employment** (9.3% of the total of employed persons in 2014, against 6.2% in 2009), against the background of the lifting of institutional constraints in the labour market, which facilitated the use of more flexible forms of employment (see Chart IV.11).[12] In the second quarter of 2014, the highest rates of part-time employment were registered in agriculture, wholesale-retail trade and tourism (with 17.2%, 15.9% and 12.8% of the total of part-time employment respectively). The turn of businesses towards more flexible forms of employment is corroborated by ERGANI data, which breaks down new hirings by employment status.[13]

10 As regards group dismissals, the High Employment Council of the Ministry of Labour approved (on 11 June 2014) the dismissal of 45 (out of 75) people working in Hellenic Halyvourgia. This was the first decision of the Council under its new operating rules. This development is very important, as the institutional framework on group dismissals is under review.

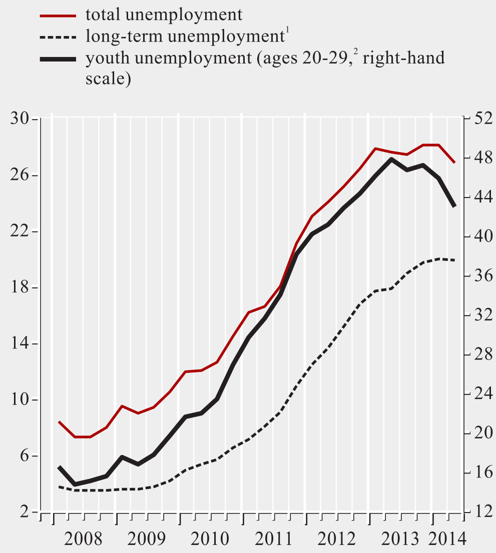
11 According to the new framework: (i) a census of private sector employment is conducted on an annual basis, (ii) new information on the needs of firms in personnel per sector and occupation is included and (iii) the implementation of programmes of active employment policies is systematically monitored (Ministry of Labour, 1.9.2014).

12 In the second quarter of 2014, 65.7% of part time employees had opted for the specific employment status because they could not find full-time employment, up from 60.1% in 2012.

13 59.4% of new hirings concerns part-time or job-rotation employment (see monthly press releases issued by the Ministry of Labour and ERGANI data, October 2014).

Chart IV.12 Unemployment rates (2008 - Q2 2014)

(percentage of labour force)



Source: ELSTAT, Labour Force Surveys.
1 With a duration of twelve months or more.
2 As a percentage of the labour force of the same age group.

Together with the stabilization of employment, Labour Force Survey and OAED data point to a decrease in the number of the unemployed, along with a marginal deceleration of the rate of unemployment in the first half of the year (see Chart IV.12). However, the rate of unemployment still stands at exceptionally high levels (26.1% in July and 25.9% in August, on the basis of seasonally adjusted data), while the **share of long-term unemployment** (i.e. for more than 12 months) has risen considerably to **19.8% of the labour force**.

Furthermore, **youth unemployment** remains high (people aged 20-29), but decelerated for the first time in the first half of 2014 (to 44.8%, from 47.4% a year before). However, the rate of youth unemployment and also the share of *young people who are not in education or employment* remain significantly high in relation to the period before the crisis and in comparison to corresponding figures in other EU countries. On the other hand it should be noted that many people of this age group remain active, as their participation in the labour force was 68.3% in the second quarter of 2014 (slightly down from 70.1% in the second quarter of 2012).

Turning to the evolution of unemployment by gender, male unemployment rose more than female unemployment over the past six years. Therefore, the participation of men in unemployment rose (50% in 2014, from 42% in 2009), with a parallel decrease in the respective share of women.

The integration of the unemployed into the labour market is expected to be slow, given the current rate of underemployment. The deceleration of unemployment – especially for the young – will be assisted by active employment policies, as programmes and actions financed from NSRF resources for 2014-2020 are gradually being implemented. According to the initial planning by the Ministry of Labour, over €1 billion will be channeled to employment in 2014-2016, to the benefit of 397,400 unemployed people. To this direction, employment and training programmes offered by OAED, as well as improvements in the content and the structure of ERGANI, for more effective intervention in the labour market, will also help in addressing the structural component of unemployment.

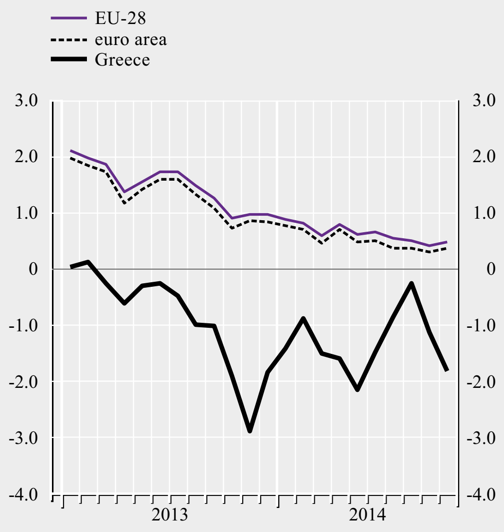
3 DEVELOPMENTS AND OUTLOOK OF INFLATION, LABOUR COSTS AND COMPETITIVENESS

3.1 INFLATION

Annual inflation has been hovering in negative territory since March 2013. The average annual rate of change in the Harmonised Index of Consumer Prices (HICP) became negative for the first time in 2013, reaching -0.9% (see Chart IV.13). Core inflation (HICP excluding energy and unprocessed food prices) moved to a similar direction and came to -1.9% (see Chart IV.14). The negative rates of change in these two aggregates are attributable to the cumulative decrease in domestic demand and labour costs over the past three years.

Chart IV.13 Harmonised index of consumer prices

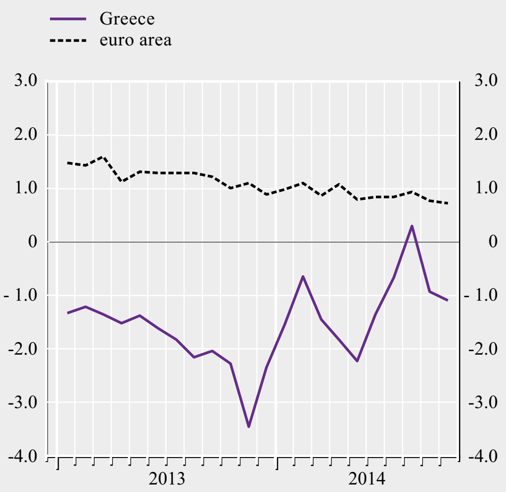
(year-on-year percentage changes)



Sources: Eurostat and ELSTAT.

Chart IV.14 Core HICP inflation (HICP excluding energy and unprocessed food)

(year-on-year percentage changes)



Sources: Eurostat and calculations based on ELSTAT data.

These factors, combined with a further decline in world oil prices in euro, the negative effect of indirect inflation and reforms in product markets, will contribute to a further decrease in inflation in 2014. The harmonised index is expected to be around -1.3% and core inflation -1.0% in 2014. The clear deceleration of the negative rate of change in prices included in 2014 core inflation compared to 2013 is an indication of a deceleration of overall inflation and its stabilisation around 0.0% in the last quarter of 2015.

The level of general prices has been negative for a period of about two years (and lower in relation to the euro area – see Table IV.6). Despite the risks entailed if this persists for long, it has already contributed to an **increase in real income** of consumers and **competitiveness** in significant economic sectors, e.g.

Table IV.6 Contributions to the inflation differential between Greece and the euro area (2009-2014)

(percentage points)

	2009	2010	2011	2012	2013	2014 (Jan.-Oct.)
Average annual HICP inflation differential	**1.1**	**3.1**	**0.4**	**-1.5**	**-2.2**	**-1.8**
Contributions:						
Core inflation	0.91	1.60	-0.04	-1.64	-2.58	-1.68
of which						
Services	0.64	0.71	0.01	-0.86	-1.81	-1.36
Processed food	0.14	0.52	0.21	-0.29	-0.21	-0.11
Non-energy industrial goods	0.13	0.37	-0.26	-0.49	-0.56	-0.21
Unprocessed food	0.39	-0.12	0.08	-0.16	-0.18	-0.26
Energy	-0.25	1.66	0.40	0.35	0.55	0.10

Source: Calculations based on Eurostat and ELSTAT data.

tourism which, also because of the geopolitical developments in the Eastern Mediterranean, has surged for the second consecutive year.

3.2 LABOUR COSTS

In 2014 the average decline in earnings was much smaller than in the past two years (see Tables IV.7 and IV.8). Earnings maintained their downward course in some private firms, but remained stable or rose a little in others.[14] In greater detail, it is estimated that average gross earnings decreased by 1.5% in total economy and 2.0% in the business sector.[15] However, the average labour cost per employee in the business sector decreased by 3.0% (i.e. more than gross earnings), due to the 2.9 percentage points decline in employers' social security contributions in the business sector as from 1.7.2014 (Law 4254/2014). At the same time, average net earnings (before taxes) of employees in the business sector dropped by only 1.4% in 2014, i.e. less than gross earnings, because of the one percentage point decline in employees' social security contribution as from the same date (also by virtue of law 4254/2014).

It is estimated that **unit labour costs decreased** by 2.6% in total economy and 3.0% in the business sector in 2014, **reflecting higher productivity and lower employers' social security contributions**. These estimates translate into a cumulative decrease in unit labour costs in the business sector by 21.6% in 2012-2014, against

14 According to information from 255 firm-level collective agreements posted on the Ministry of Labour website, covering the January-mid-November 2014 period.

15 According to ELSTAT (quarterly national accounts), wages decreased at an annual 1.1% in January-September 2014, as their rate of change turned from negative (-2.7%) in the first quarter into positive (+2.1%) in the third quarter of the year. Also, according to financial accounts of institutional sectors published by ELSTAT, in the first quarter of 2014 wages decreased at an annual 0.7% in the business sector and 5.8% in general government – these rates also include the decrease in employment. However, the Wage Index in total economy (excluding the primary sector and household activities – not seasonally adjusted data, hourly earnings) dropped at an average annual rate of 1.4% in the first half of 2014.

Table IV.7 Earnings and labour costs (2009-2015)

(annual percentage changes. unless otherwise indicated)

	2009	2010	2011	2012	2013	2014 (estimate)	2015 (forecast)
Greece							
Average gross earnings (nominal):							
– total economy	*4.6*	*-4.6*	*-1.7*	*-6.6*	*-6.5*	*-1.5*	*0.1*
– central government[1]	5.2	-7.7	-0.5	-3.8	-1.2	0.0	0.4
– public utilities	7.7	-5.5	-7.9	-9.5	-10.0	0.0	0.0
– banks	3.7	-1.8	0.1	-7.5	-10.0	-6.3	0.0
– non-bank private sector	2.8	-2.9	-1.7	-9.3	-8.0	-1.4	1.0
Minimum earnings	**5.7**	**1.7**	**0.9**	**-19.6**[3]	**-2.9**[3]	**0.0**	**0.0**
Average gross earnings (real)	**3.3**	**-8.9**	**-4.7**	**-7.6**	**-5.7**	**-0.2**	**0.6**
Total compensation of employees	**3.2**	**-6.9**	**-8.1**	**-14.0**	**-10.9**	**-1.9**	**0.2**
Compensation per employee	**4.9**	**-4.0**	**-0.7**	**-6.0**	**-6.7**	**-1.6**	**-0.1**
Unit labour costs:							
– total economy	7.8	-1.6	0.8	-7.9	-7.3	-2.6	-2.5
– business sector[2]	5.8	-0.6	-1.6	-12.1	-8.1	-3.0	-2.4

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

Table IV.8 Average earnings and unit labour costs in total economy: Greece and the euro area (2001-2014)

(annual percentage changes)

	Average earnings		Unit labour costs	
Year	Greece	Euro area	Greece	Euro area
2001	4.7	2.7	4.4	1.9
2002	6.6	2.7	5.7	2.6
2003	5.6	2.7	1.6	2.4
2004	7.2	2.3	3.7	0.9
2005	4.4	2.3	4.8	1.6
2006	5.7	2.5	1.9	1.0
2007	5.2	2.7	4.5	1.5
2008	6.2	3.5	8.9	3.8
2009	4.6	1.9	7.8	4.5
2010	-4.6	2.2	-1.6	-0.6
2011	-1.7	2.2	0.8	0.5
2012	-6.6	1.9	-7.9	1.8
2013	-6.5	1.8	-7.3	1.4
2014 (estimate)	-1.5	1.5	-2.6	1.1
2015 (forecast)	0.1	1.6	-2.5	0.9

Sources: For Greece: Bank of Greece estimates, based on revised GDP figures (October 2014); for the euro area: European Commission, *Economic Forecast, Autumn 2014*, and *Statistical Annex of European Economy, Autumn 2014*.

a targeted 15% set in the Second Economic Adjustment Programme in February 2012.

Average gross earnings are expected to stabilise (+0.1%) in total economy and the business sector, average labour costs per employee are expected to decline by 0.8% and average net earnings in the business sector are expected to rise slightly (+0.6%, due to the carry-over effect from the decrease in employers' and employees' social security contributions in mid-2014). Unit labour costs are expected to keep decreasing in 2015, by 2.5% in total economy and 2.4% in the business sector, reflecting an acceleration of the rate of increase in productivity and the abovementioned carry-over effect.

3.3 BUSINESS PROFITS

In the first half of 2014 non-financial corporations **listed on the Athens Exchange posted an increase in their gross and net profit margins** (i.e. profits-to-turnover ratio). On the basis of economic statements published by 162 non-financial corporations listed on the Athens Exchange,[16] sales rose modestly (by 2.8%) and gross profits by 8.3%, while corporations posted net pre-tax profits, though they were 19.5% lower than in the first half of 2013 (€309.9 million against €384.9 million). Thus, the gross profit margin rose by 0.7 of a percentage point (to 13.6%, from 12.9% in the first half of 2013) and the net profit margin remained positive, but dropped to 2.8%, from 3.6% a year earlier. ROE and ROA remained positive, but decreased slightly in comparison to the first half of 2013 (to 1.5% and 0.6%, from 1.9% and 0.8% respectively).

The non-financial accounts of institutional sectors published by ELSTAT give a somehow different picture: in the first half of 2014, the gross operating surplus of non-financial cor-

16 Not including the two refineries.

porations decreased by an annual 5.7% and net operating surplus by 5.1% while —as mentioned above— wages decreased by an annual 2.7% in total economy and 0.7% in the business sector over the same period. This is consistent with the picture derived from a comparison of the change in unit labour costs in total economy (annual estimate: -2.6%) with the change in the GDP deflator (-3.0% in January-September 2014, according to ELSTAT), which suggests a decrease in the profit margin in total economy.[17]

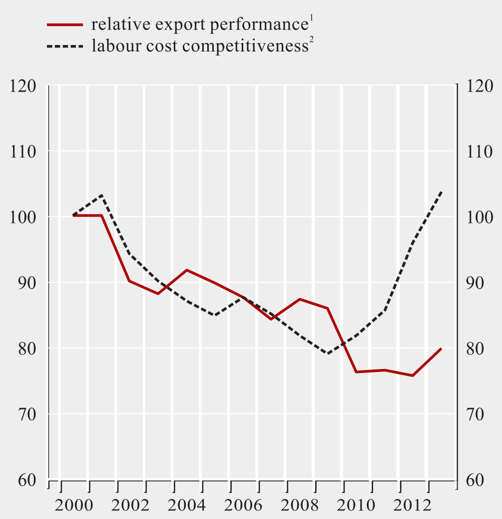
3.4 INTERNATIONAL COMPETITIVENESS

The loss in labour cost competitiveness suffered by the Greek economy in 2000-2009 **was regained in 2010-2013**, mainly because of labour market reforms and the deep and protracted recession that led to a large decline in demand for labour. According to the revised real effective exchange rate index based on unit labour costs compiled by the Bank of Greece, the cumulative loss in competitiveness against Greece's major trading partners (it had reached 18.7% in 2000-2009 and was later limited and eliminated in 2013), improved by 7.1 percentage points; this means that competitiveness has improved by 5.1% compared to 2000. For 2014, despite an anticipated small appreciation of the euro in relation to 2013 (at an annual average of 0.7%), labour cost competitiveness is expected to remain unchanged against the 28 major trading partners and improve by 1.0% against the euro area (see Table IV.9).

An even more significant improvement is that of the harmonised competitiveness indicator compiled by the ECB, which in the second quarter of 2014 was 7.3 percentage points lower than in 2000. **Greece is now the second best performer (after Germany) in terms of the evolution of labour cost competitiveness** since 2000. By contrast, the cumulative loss of competitiveness on the basis of consumer prices, which had reached 18.5% in 2000-2009, decreased – though at a relatively slower pace due to the delayed deceleration of domestic inflation to levels lower than in the major trading partners, a fact attributable to increases in indirect taxes, energy prices and financing costs. Gains in consumer price competitiveness actually started in 2011, when inflation differentials between Greece and its major trading partners became negative for the first time since 2000; it was 0.1 percentage point in 2011, 1.7 percentage points in 2012 and 2.7 percentage points in 2013. For 2014, despite an anticipated small further appreciation of the euro vis-à-vis 2013 levels, consumer price competitiveness is expected to improve further, by 1.7%, both against Greece's 28 major trading partners and against the euro area. A considerable improvement is also demonstrated by the respective ECB harmonised competitiveness indicator, which was decelerating by an annual 1.7% in the third quarter of 2014 and was 11.7% higher than in 2000.

Chart IV.15 Greece's labour cost competitiveness and export performance compared with the euro area

(indices 2000=100)



Sources: Bank of Greece and Eurostat: relative export performance; ECB: competitiveness.
1 Ratio of Greece's exports of (non-shipping) goods and services to EU-17 exports of goods and services at 2010 constant prices.
2 The inverse of the ULCT-deflated real effective exchange rate index vis-à-vis 37 trading partners.

17 This comparison does not take into consideration the cost of other inflows (raw material and intermediate products, energy consumption), financial costs and tax.

Table IV.9 Nominal and real effective exchange rate (EER) indices[1] (2000=100)

	Nominal EER	Real EER*			
		Broad EER-28		EER-euro area	
		CPI-deflated	ULCT-deflated[2]	CPI-deflated	ULCT-deflated
2000	100.0	100.0	100.0	100.0	100.0
2009	115.5	118.5	118.7	109.2	109.3
2010	112.2	118.0	115.5	112.6	110.3
2011	112.7	118.5	112.2	113.0	107.4
2012	110.5	114.2	102.1	111.3	100.1
2013	112.7	113.4	94.9	108.7	91.9
2014**	113.4	111.4	94.9	106.9	91.0

Source: ECB: exchange rates, CPI, unit labour costs in the total economy for Greece and competitor countries.
* The index is subject to regular revisions.
**Estimates.
1 Nominal and real EER indices are computed against: a) the broad group of Greece's 28 main trading partners (broad EER-28); and b) the euro area (EER-euro area). Weights are calculated on the basis of imports and exports of manufacturing goods (SITC 5-8).
2 The ULCT-deflated REER series were revised in November 2014. Unit labour costs in total economy for Greece are calculated by the ECB and not by the Bank of Greece.

Labour cost competitiveness seems to have affected export performance since 2009 (see Chart IV.15). As analysed in the previous Bank of Greece Monetary Policy Report, competitiveness gains have not yet been fully translated into an increase in exports. The close relationship between competitiveness and exports has been broken since 2009, due to a lack in investment and financing (see *Monetary Policy*, June 2014, Special feature III.3).

Structural competitiveness, on the basis of major composite indices of international competitiveness, after deteriorating for a number of years, has been exhibiting **signs of improvement** since 2013. According to the World Economic Forum competitiveness index, Greece climbed to the 81st position (91st last year); according to the "ease of doing business" index of the World Bank, Greece rose to the 61st position (65th and 89th in the previous years). Despite the fact that Greece is the country that has responded in the best possible manner to OECD recommendations for the adoption of structural reforms, it still ranks last among EU-28 and all advanced economies on the basis of most composite international competitiveness indices. According to these indices, the **main obstacles** of Greek enterprises are **access to financing, red tape and an ever-changing tax framework**.

4 DEVELOPMENTS AND PROSPECTS IN THE BALANCE OF PAYMENTS

In January-September 2014, the current account registered a larger surplus than in 2013, which reached €3.8 billion (see Table IV.10 and Table 2 in the Statistical Appendix). This improvement is largely attibutable to a higher surplus in the services balance.

It should be noted that the **combined balance of goods and services saw a surplus** of €3.2 billion in the first nine months of the year (against €1.4 billion in 2013), despite the increase in the trade deficit. **Total exports of goods and services rose** by 8.5% (against 2.8% in the respective period a year before).

The improvement in the current account balance is expected to continue and the surplus is expected to be close to 1.5% of GDP in 2014. This will most probably come from a higher surplus in the services balance, as receipts from

Table IV.10 Key components of the balance of payments

(million euro)

	January-December			January-September		
	2011	2012	2013	2012	2013	2014
I CURRENT ACCOUNT	-20,633.5	-4,615.0	1,088.5	-2,806.2	2,401.7	3,753.3
Balance of goods and services	-12,599.5	-4,480.1	-250.5	-2,731.2	1,422.2	3,198.9
Goods	*-27,229.1*	*-19,619.0*	*-17,229.4*	*-15,651.8*	*-12,893.0*	-13,591.4
Oil	-11,126.9	-10,220.0	-7,697.5	-8,165.1	-6,017.3	-5,883.6
Ships	-3,261.2	-1,042.6	-1,483.3	-829.4	-932.6	-1,827.2
Balance of goods excluding oil and ships	-12,840.9	-8,356.4	-8,048.7	-6,657.3	-5,943.0	-5,880.6
Services	*14,629.6*	*15,138.9*	*16,978.9*	*12,920.6*	*14,315.2*	16,790.3
Travel	8,238.2	8,598.6	10,317.0	7,909.6	9,407.0	10,473.0
Transport	6,862.2	6,959.3	6,536.9	5,435.8	4,864.4	5,926.4
Other services	-470.8	-419.0	125.0	-424.6	43.9	390.9
Income balance	-8,594.8	-1,566.4	-3,127.2	-1,637.8	-2,665.5	-2,235.9
Current transfers balance	560.8	1,431.5	4,466.2	1,562.9	3,644.9	2,790.4
II CAPITAL ACCOUNT	**2,671.8**	**2,327.6**	**3,040.8**	**1,582.6**	**2,782.2**	**1,789.2**
III CURRENT AND CAPITAL ACCOUNT (I+II)	**-17,961.7**	**-2,287.5**	**4,129.3**	**-1,223.2**	**5,184.0**	**5,542.6**
IV FINANCIAL ACCOUNT	**17,838.1**	**2,658.2**	**-3,299.5**	**2,561.2**	**-4,023.1**	**-3,952.0**
Direct investment[1]	-452.6	827.1	2,713.6	897.7	1,174.2	743.0
Portfolio investment[1]	-19,778.3	-99,903.9	-6,583.1	-75,584.1	-7,497.7	-793.3
Other investment[1]	38,050.0	101,744.1	677.0	77,262.8	2,358.2	-3,438.7
RESERVE ASSETS	5,332.0	5,500.0	4,172.0	5,941.0	4,559.0	5,015.0

Source: Bank of Greece.
1 (+) net inflow, (-) net outflow.

tourism and shipping are projected to be positive. Turning to the trade balance, goods will make a smaller contribution, despite the positive effect from improved competitiveness, as external demand recovers at a rate slower than expectations. The positive contribution of the transfers balance is expected to continue, but it will most probably be lower in 2014.

The trade deficit declined considerably, in line with the increase in net payments for the purchase of ships. Receipts from the export of goods accelerated, though at a slower pace than in 2013 (4.2% in January-September 2014, against 4.7% in the same period of 2013[18]), mainly because of the deceleration of the rate of increase in receipts from the export of fuel. Excluding fuel, the larger contirubtion to the increase in export receipts came from chemicals and plastics, machinery and electrical equipment, textiles, food and beverages, while no significant changes were observed in the composition of exports by product (see Chart IV.16).

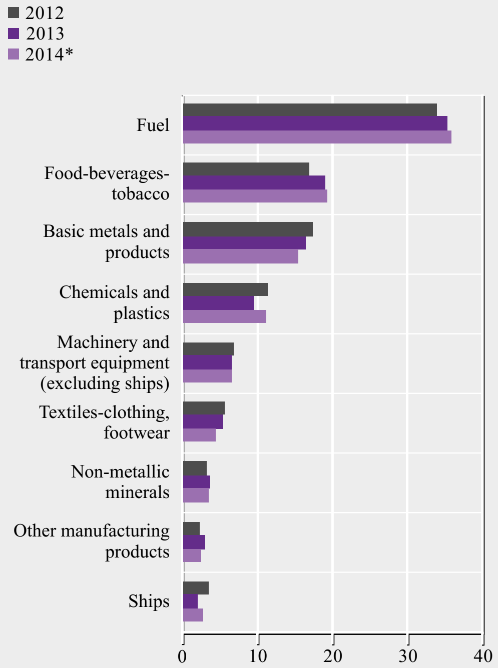
Turning to the geographical breakdown of Greek exports, after the significant shift towards non-euro area markets, which contributed to the recovery of Greek exports in 2012, no major changes have been observed over the past two years.

The import bill rose, largely because of **payments for the purchase of ships**, which increased by 80% in relation to the corre-

18 At real terms, the rate of increase in exports in 2014 is estimated higher (6.2%), because of lower export prices.

Chart IV.16 Sectoral breakdown of exports of goods

(% of total export receipts)



Source: Bank of Greece, Balance of payments statistics.
* January-September 2014 data.

sponding 2013 period. Payments for the import of fuel remain unchanged, while those for other goods demonstrated a small increase (because of higher payments for the import of consumer goods).

The services surplus improved substantially in relation to the same period of 2013, which is attributable to the impressive increase in tourism and the notable performance of sea transport receipts.

Tourism expenditure by non-residents rose by 11.1%, reflecting a 22.2% increase in tourist arrivals, but lower average expenditure per trip.[19] The improved picture of the country abroad and protracted instability in the Eastern Mediterranean made a positive contribution. The largest share of arrivals was from EU countries, arrivals from the USA and China rose, while those from Russia decreased only a little compared to last year, despite the crisis in the Ukraine. Forecasts are positive for both tourist traffic and tourism receipts, as long as there are no negative effects from the geopolitical environment or domestic political developments.

Receipts from transport services, mainly sea transport, rose by 8.3%, owing to better freights and a deceleration in the rate of increase in the world fleet.

Over the same period, the "other services" balance improved considerably and turned into a surplus, largely because of receipts from construction services and secondarily from information technology services.

In January-September 2014, both the current account and capital transfers balances were in surplus, though at levels lower than in 2013. In particular, total net transfers from the EU (current and capital transfers minus payments to the Community Budget) came to €4.5 billion, from €6.2 billion in the corresponding 2013 period.

On the basis of September 2014 data, cumulative inflows into the National Strategic Reference Framework (NSRF) reached €17 billion (including advances); as a result, the absorption rate reached almost 83% of Community funding. This brings Greece to one of the first positions in terms of absorption compared to other EU-28 Member States.

In 2014-2020, Community transfers to Greece will reach €20.8 billion (an amount that could increase by another €2 billion, after the review of national allocations in 2016).

In January-September 2014, the financial account balance showed a net outflow of €4.0

19 Also, passenger traffic in the Athens International Airport rose by 20.3% year-on-year in January-October 2014. Over the same period, tourist arrivals at the 17 major airports of the country rose by 15%, according to the Association of Greek Tourism Enterprises (SETE). These data are confirmed by SETE estimates, according to which international arrivals at all entry points will reach 20.5 million (plus another 2.5 million cruise visitors) and tourism receipts will exceed €13.5 billion (SETE, press release 10.11.2014).

billion. The net outflow in portfolio investment came mainly from an increase in residents' investment in bonds and Treasury bills abroad, which was partly counterbalanced by higher investment by non-residents in Greek shares. A net outflow of €3.4 billion was registered under "other investment", mainly attributable to the decrease in non-residents' holdings in deposits and repos in Greece, which was largely counterbalanced by the increase in loan obligations of the public and the private sector to non-residents and the decrease in residents' holdings in deposits and repos abroad.

Direct investment by non-residents reached about €1.2 billion in January-September, which was about three times that of the corresponding 2013 period.[20] As Greece has made considerable progress in terms of fiscal adjustment and competitiveness, and since economic indices allow optimism for a stabilisation of economic activity, FDI is expected to increase, mainly in services, e.g. in the financial sector, shipbuilding, energy and tourism.

20 The most important transaction concerns an inflow of €595 million for the participation of Capital Group Companies Inc. (USA) to the capital increase of Eurobank in May 2014.

V FISCAL DEVELOPMENTS AND PROSPECTS

It is estimated that the fiscal target of the economic adjustment programme at general government level will be achieved for the third consecutive year, providing strong evidence that the progress made these past few years is sustainable. After outperforming the primary balance target set in the adjustment programme by 1.2% of GDP in 2013, further improvement is expected in 2014 regarding both the primary and the structural primary balance of the general government. These achievements, particularly against an adverse global economic and geopolitical background, constitute clear and measurable evidence of the Greek economy's positive outlook. The country's successful return to international markets after four years of exclusion signals the recognition of the Greek efforts and paves the way for further financing of the country's borrowing requirements by funds raised through the international markets. Fiscal efforts must continue over the upcoming years, effectively supported by the completion of the structural reforms. Alongside an already observable recovery of economic activity, ensuring a steadily improving fiscal balance will contribute decisively in lowering the debt-to-GDP ratio and help the country get back on track towards sustainable growth.

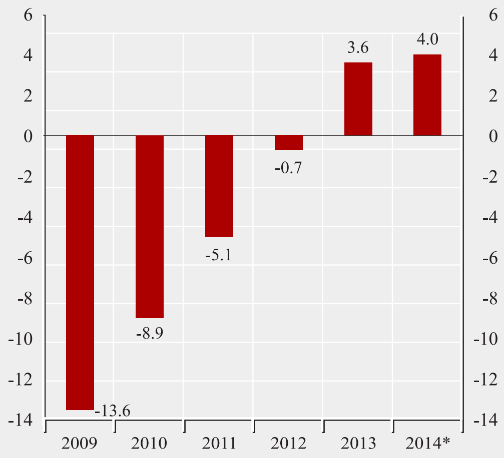
1 OVERVIEW OF DEVELOPMENTS AND PROSPECTS[1]

The evolution of fiscal aggregates over the past five years clearly demonstrates that public finances are on a track of consolidation and redress of the fiscal imbalances that were identified over the same period.

The fiscal indicators show improvement over time, despite the undeniable adverse impact of the sizeable drop of GDP during the crisis. The fiscal effort has produced clear and measurable results, since the general government primary balance, as defined in the economic adjustment programme, registers a surplus of about 1.2% of GDP in 2013 – improved compared with both the adjustment programme target for a balanced primary budget and with the Medium-Term Fiscal Strategy Framework (MTFS) 2015-2018 estimates of a primary surplus equal to 0.8% of GDP (see Table V.1). Its upward revision compared with the MTFS is attributable as much to the transition to the national accounts standard ESA 2010 as to other data revisions. The structural[2] primary balance of the general government shows remarkable improvement since 2009 (about 17 percentage points in the 2010-2013 period) and records a surplus of 3.6% of potential GDP in 2013 (see Chart V.1); for 2014 it is estimated to improve further by around half a percentage point (structural primary surplus: 4.0% of potential GDP). This considerable progress in fiscal adjustment is also noted by the IMF,[3] according to which the country's cyclically adjusted primary surplus as a percentage of potential GDP registered a cumulative

Chart V.1 Structural primary balance of general government

(as a percentage of potential GDP)



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

1 This chapter takes into account data and information published by 4 December 2014.
2 The structural balance isolates the permanent component of the cyclically adjusted balance by removing the effect of temporary factors (e.g. one-off expenditure to strengthen the banking sector). It is a theoretical notion and its estimates may vary greatly depending on the calculation method used.
3 IMF (2014), *Fiscal Monitor*, October (Statistical Table 4).

Table V.1 General government and state budget balances

(as a percentage of GDP)

	2010	2011	2012	2013*
General government balance[1] *(national accounts data - convergence criterion)*	**-11.1**	**-10.1**	**-8.6**	**-12.2**
– Central government	-10.6	-9.2	-8.1	-14.5
– Social security funds, local government, legal entities in public law	-0.5	-0.9	-0.5	2.3
General government deficit adjusted for net state support to financial institutions[1]	-11.5	-10.4	-5.9	-1.8
General government primary balance, adjusted for net state support to financial institutions[1]	-5.6	-3.2	-0.9	2.2
General government primary balance (Economic Adjustment Programme)[2]			-1.3	1.2
State budget deficit				
Administrative data[2]	**-10.0**	**-10.9**	**-8.1**	**-3.0**
Cash data[3]	**-10.5**	**-11.1**	**-5.5[4]**	**-7.0[5]**

Sources: Bank of Greece, Ministry of Finance and ELSTAT.
* Provisional data.
1 ELSTAT data as notified to the European Commission (Excessive Deficit Procedure). Figures may not add up due to rounding.
2 State General Accounting Office data (Medium-Term Fiscal Strategy Framework 2015-2018. Introductory Report on the 2015 Budget).
3 Bank of Greece data for the state budget deficit (on a cash basis) excluding movements in the OPEKEPE account.
4 Excluding accrued interest of €4,751 million, paid in the form of EFSF notes, on PSI bonds, as well as interest payments of €519 million due to the debt buyback through EFSF notes.
5 Excluding revenue of €2.0 billion due to transfers of profits on Greek government bond holdings of Eurosystem NCBs (Securities Markets Programme – SMP). Including expenditure of around €6,155 million for the payment of arrears.

improvement of 18.7 percentage points in the 2010-2013 period – a fact that makes Greece's fiscal consolidation the largest ever achieved by a developed country. It is worth mentioning that in the same period the respective improvements in the cyclically adjusted primary surpluses of Ireland, Portugal and Spain are estimated at 7.8, 8.2 and 7.2 percentage points of potential GDP, respectively.

Based on the national accounts data announced by the Hellenic Statistical Authority (ELSTAT) and Eurostat in October 2014 on the basis of ESA 2010,[4] the general government deficit in 2013 stood at 12.2% of GDP, against a deficit of 8.6% of GDP in 2012. This widening of the deficit is entirely attributable to banking sector support costs. Adjusted for net government support to financial institutions over these two years, the deficit appears considerably improved, having narrowed from 5.9% in 2012 to 1.8% in 2013.

The above thus far positive developments in public finances, which have already been recognised by the country's EU partners,[5] create a favourable setting for the country's financing through the international markets and open up the path for implementation of the commitments of EU partners as regards taking measures for ensuring the sustainability of Greek public debt. Quite indicative is the narrowing of the yield spread between Greek and German government bonds, as well as the recent return of Greece to international markets through two bond issues. In more detail, on 10 April 2014 the Greek government issued a 5-year bond (€3 billion) with a 4.95% yield and an annual coupon of 4.75%, which was followed by a 3-year bond (€1.5 billion) issued on 10 July 2014 with a 3.5% yield and a coupon of 3.375%. In both cases demand exceeded sup-

4 On 13 October 2014, the Hellenic Statistical Authority (ELSTAT) announced the updating of fiscal data for the EDP period 2010-2013. This update included data revisions resulting from the application of ESA 2010 for the first time. More specifically, the 2013 fiscal deficit was revised to 12.2% of GDP, from 12.7% in April 2014. Correspondingly, the primary deficit narrowed by €901 million, i.e. stands at 8.2% of GDP, down from 8.7% in April 2014. The improvement of the deficit is attributable by 0.2% of GDP to the change of the national accounts standard, and by 0.3% to other revisions.
5 See Eurogroup statement, May 2014.

ply, with the respective funds offered for the 5- and the 3-year bonds amounting to €20 billion and €3 billion. Nevertheless, the upward trend observed in government bond yield differentials since October 2014 highlights the importance of creating and maintaining an environment of confidence, associated mainly with expectations regarding a smooth completion of the programme and the sustainability of fiscal achievements.

It is however worth mentioning that Greece's efforts to capitalise on the progress of its public finances by successfully returning to the international markets is anything but facilitated, as it takes place in an adverse global environment, in both geopolitical and economic terms (since euro area growth, albeit positive, is expected to be lower than anticipated at the beginning of the year).

Still, it is estimated that the 2014 Budget will move within the range set in the adjustment programme. According to the Introductory Report on the 2015 Budget, the general government primary surplus based on the adjustment programme for 2014 is expected to reach 1.8% of GDP (around €3.3 billion). This estimate is above the target (1.5% of GDP), and incorporates both the expenditure for a partial restoration of the salaries of the judiciary and the military and law enforcement personnel (0.1% of GDP), plus back payments thereof (0.3% of GDP), and the 30% reduction of the excise duty on heating oil.

Decisive are the steps taken to address the structural problems of fiscal management and fiscal planning. Law 4270/2014 "Principles of financial management and supervision (transposition of Directive 2011/85/EU) – public accounting and other provisions" moves in the direction of the new Fiscal Compact and strengthens the fiscal government framework through a set of rules that cover the path of structural deficits, the level of public debt and the rate at which this should be reduced when it exceeds 60% of GDP. More specifically, given that the fiscal deficit should not be over 3% of GDP, the structural deficits should not exceed 0.5% of GDP, while when public debt lies above the reference value (60% of GDP), the excess amount should be reduced by 1/20 on average every year over a three-year period.

The better than targeted improvement of fiscal aggregates seems to allow room for addressing the two-way interaction between fiscal policy interventions and the GDP components. The Introductory Report on the 2015 Budget seems to move along these lines; according to it, the target set in the adjustment programme for general government primary surplus of 3.0% of GDP in 2015 is achieved even after incorporating not only the negative carry-over effect of 2014 measures (partially restored earnings of the judiciary and of the military and law enforcement personnel; reduced excise duty on heating oil), but also the higher number of instalments for paying overdue debts to the government and the maintained lower VAT rate on restaurants and cafés, while public investment remains unchanged in nominal values vis-à-vis the MTFS 2015-2018. On the other hand, the special solidarity contribution is expected to be maintained in 2015, reduced by 30%.

A recent IMF report[6] demonstrates the importance of infrastructure projects and productive public investment in strengthening economic activity and lowering the debt-to-GDP ratio. According to this report, it is estimated that an increase of public investment by 1% of GDP leads to an increase of GDP by 0.4% the same year, and 1.5% in the next four years, while the positive effect on GDP is even stronger in periods of recession. Moreover, it is estimated that productive public investment can lead to a lowering of the debt-to-GDP ratio, even when fully financed through government borrowing, provided that interest rates are low enough in real terms.

Maintaining a successful fiscal consolidation path paves the way for lowering the public debt

6 *World Economic Outlook*, Chapter 3, October 2014.

as a percentage of GDP, which is estimated to set on a downward course from 2015 onwards. According to the Introductory Report on the Budget, public debt is projected to reach 177.7% of GDP in 2014 (from 174.9% in 2013), and then drop to 171.4% of GDP in 2015. The observed higher debt-to-GDP ratio in 2014 compared with 2013 is exclusively attributable to the drop in nominal GDP, while in nominal terms debt is estimated to be about €1.3 billion lower in 2014 against 2013 (standing at €318 billion).

Given the undeniable progress made so far, particular attention should be paid to the other factors that determine public debt developments over time, with an emphasis on economic growth. Progress in structural reforms is deemed crucial for enhancing investment and strengthening the GDP, and should thus be continued, as it is expected that it will offer considerable benefits to economic growth in the long run. According to a European Commission report,[7] Greece ranks 36th among 189 countries (having climbed 110 positions) in terms of reforms related to the ease of doing business. The introduction of the General Electronic Commercial Registry (GEMI) and the institution of the Private Company (PC) help simplify business start-up procedures while lowering administrative costs.

The continued rise in unemployment from 2009 up to the first quarter of 2014 does not facilitate an improvement of the Greek economy's growth and demonstrates the need for interventions to reverse its negative impact. In the context of fiscal policy-making, it is possible to opt for measures that incentivise employment growth and minimise distortions. Such measures can be associated with a targeted reduction of the tax burden, in the form of either lower tax rates or reduced social security contributions, as is already the case with the reduction of social security contributions by a total of 3.9 percentage points since 1 July 2014. The IMF report[8] argues that there is a negative correlation between the employment income tax wedge[9] and employment. A reduction of employers' contributions is estimated to effectively contribute in lowering youth unemployment, especially in a labour market characterised by a number of rigidities.

2 CURRENT FISCAL DEVELOPMENTS (JANUARY-OCTOBER 2014)

General government (General Accounting Office data)

According to cash data on general government collected by the General Accounting Office, in January-October 2014 the general government cash balance recorded a deficit of 0.9% of GDP, against a deficit of 2.3% of GDP in the corresponding period of 2013. The general government primary balance in the same period improved by 1.1% of GDP and recorded a surplus of 1.9% of GDP, compared to a surplus of 0.8% of GDP in the corresponding period of 2013. The improved balance compared with 2013 is mainly attributable to the large cut of expenditure for the payment of overdue debts in 2014 compared with 2013.

State Budget (fiscal data)

In the period from January to October 2014 the state budget recorded a deficit of 1.3% of GDP, compared with a deficit of 1.6% of GDP in the corresponding period of 2013 (see Table V.2). The state budget primary balance was in surplus (1.5% of GDP), compared with a primary surplus of 1.4% of GDP in 2013 (revised annual target for a primary surplus of 2.8% of GDP). This result is deemed to be even better when taking into account that (a) the 2013 balance includes revenue from the Securities Markets Programme (SMP), i.e. returns on Greek government bonds transferred over by Eurosystem central banks

7 "Market Reforms at Work in Italy, Spain, Portugal and Greece", *European Economy* 5/2014.
8 *Fiscal Monitor*, October 2014.
9 The tax wedge is calculated as the difference between the employer's wage labour cost and the employee's net earnings.

Table V.2 State budget balance

(million euro)

	January-October			Percentage changes		Annual data					Percentage changes			
	2012	2013	2014*	2013/12	2014*/13	2012	2013	2014		2015	2013/12	2014/13		2015/14
								MTFS forecasts 2015-2018	2015 Budget estimates	2015 Budget forecasts				
	(1)	(2)	(3)	(4=2:1)	(5=3:2)	(6)	(7)	(8)	(9)	(10)	(11=7:6)	(12=8:7)	(13=9:7)	(14=10:9)
I. Revenue	**36,701**	**42,950**	**41,319**	**17.0**	**-3.8**	**51,926**	**53,018**	**55,935**	**55,280**	**55,603**	**2.1**	**5.5**	**4.3**	**0.6**
1. Ordinary budget (net)	34,143	38,936	37,807	14.0	-2.9	48,325	48,423	50,783	50,149	50,871	0.2	4.9	3.6	1.4
Revenue before tax refunds	*36,678*	*40,882*	*40,382*	*11.5*	*-1.2*	*51,482*	*51,442*	*53,689*	*52,811*	*53,171*	*-0.1*	*4.4*	*2.7*	*0.7*
Special revenue from licensing and concession fees	*0*	*102*	*269*			*15*	*86*	*230*	*474*	*577*				
Tax refunds	*2,535*	*2,048*	*2,844*	*-19.2*	*38.9*	*3,172*	*3,105*	*3,136*	*3,136*	*2,877*	*-2.1*	*1.0*	*1.0*	*-8.3*
2. Public Investment Budget	2,558	4,013	3,513	56.9	-12.5	3,601	4,595	5,152	5,131	4,732	27.6	12.1	11.7	-7.8
– Own revenue	145	61	56	-57.9	-8.2	166	76	200	200	750	-54.2	163.2	163.2	275.0
– Receipts from the EU	2,413	3,951	3,457	63.7	-12.5	3,434	4,520	4,952	4,931	3,982	31.6	9.6	9.1	-19.2
II. Expenditure	**49,420**	**45,908**	**43,768**	**-7.1**	**-4.7**	**67,614**	**58,459**	**56,542**	**56,041**	**55,705**	**-13.5**	**-3.3**	**-4.1**	**-0.6**
(State budget primary expenditure)	38,770	40,360	38,666	4.1	-4.2	55,391	52,415	50,642	50,341	49,805	-5.4	-3.4	-4.0	-1.1
1. Ordinary budget[1]	46,637	42,583	39,650	-8.7	-6.9	61,499	51,809	49,742	49,241	49,305	-15.8	-4.0	-5.0	0.1
– Interest payments	10,650	5,548	5,102	-47.9	-8.0	12,223	6,044	5,900	5,700	5,900	-50.6	-2.4	-5.7	3.5
– Ordinary budget primary expenditure	34,835	35,835	33,825	2.9	-5.6	47,529	44,230	42,612	42,416	41,887	-6.9	-3.7	-4.1	-1.2
– Procurement of defence equipment	209	237	137	13.4	-42.2	410	529	533	450	700	29.0	0.8	-14.9	55.6
– Call-in of guarantees from entities *of which*	573	839	545	46.4	-35.0	796	879	642	624	818	10.4	-27.0	-29.0	31.1
within general government	514	497	411			679	514	439	451	667				
outside general government	59	342	134			117	365	203	173	151				
– Fee for disbursement of EFSF loans	370	124	42			541	127	55	51	0				
2. Public Investment Budget	2,783	3,324	4,118	19.4	23.9	6,114	6,650	6,800	6,800	6,400	8.8	2.3	2.3	-5.9
III. State budget balance	**-12,720**	**-2,958**	**-2,448**			**-15,688**	**-5,441**	**-607**	**-761**	**-102**				
% of GDP	**-6.5**	**-1.6**	**-1.3**			**-8.1**	**-3.0**	**-0.3**	**-0.4**	**-0.1**				
1. Ordinary budget	-12,494	-3,647	-1,843			-13,174	-3,386	1,041	908	1,566				
2. Public investment budget	-225	689	-605			-2,513	-2,055	-1,648	-1,669	-1,668				
IV. State budget primary balance	**-2,070**	**2,590**	**2,654**			**-3,465**	**603**	**5,293**	**4,939**	**5,798**				
% of GDP	**-1.1**	**1.4**	**1.5**			**-1.8**	**0.3**	**2.9**	**2.8**	**3.1**				
Amortisation payments	12,532	11,667	22,922	-6.9	96.5	23,905	12,755	24,930	24,930	16,130	-46.6	95.5	95.5	-35.3

Source: Ministry of Finance.
* Provisional data.
1 Excluding expenditure for payment of arrears.

Table V.3 State budget deficit on a cash basis[1,2]

(million euro)

	Annual data		January-October	
	2012	2013	2013	2014*
State budget	**-10,697**	**-12,794**	**-9,074**	**-2,250**
% of GDP	-5.5	-7.0	-5.0	-1.2
– Ordinary budget[3]	-8,503[4]	-10,785[5]	-9,797[6]	-1,656[7]
– Public Investment Budget	-2,194	-2,009	723	-594

Source: Bank of Greece.
* Provisional data.
1 As shown by the respective accounts with the Bank of Greece and other credit institutions.
2 Excluding the OPEKEPE (Payment and Control Agency for Guidance and Guarantee Community Aid) account.
3 Including movements in public debt management accounts.
4 Including revenue of: a) €303 million relating to ANFA returns; and b) €10.6 million from privatisation proceeds, but excluding expenditure of: a) €4,751 million for accrued interest on PSI bonds paid in the form of EFSF notes, as well as interest payments of €519 million due to the debt buyback through EFSF notes; b) €9.9 million (bond issuance) for covering the State's debt to the Jewish Community of Thessaloniki; and c) €73 million for the participation of the Greek State in capital increases (Horse Racing Organisation of Greece (ODIE), Hellenic Vehicle Industry (ELVO), Hellenic Defence Systems SA, etc.). Including expenditure of €901.3 million relating to Greece's participation in the European Stability Mechanism (ESM).
5 Including revenue of: a) €682 relating to ANFA returns and b) €998 million from privatisation proceeds (sale of IBC premises etc.). Excluding revenue of €2.0 billion from the transfer of Greek bond yields from the Eurosystem central banks (Securities Markets Programme - SMP). Excluding the participation of the Greek State (€37.6 million) in capital increases of Hellenic Defence Systems SA etc. Including expenditure of: a) roughly €6,155 million for the payment of arrears and b) €901.3 million relating to Greece's participation in the European Stability Mechanism (ESM).
6 Including revenue of: a) €682 million relating to ANFA returns; and b) €911 million from privatisation proceeds, but excluding revenue of €1.5 billion regarding Securities Markets Programme (SMP) income transfers from Eurosystem central banks. Also excluding expenditure of: €32 million for the participation of the Greek State in capital increases (Hellenic Defence Systems SA, etc.), but including expenditure of a) about €5,287 million for the payment of arrears and b) €901 million relating to Greece's participation in the European Stability Mechanism (ESM).
7 Including revenue of: a) €518 million relating to ANFA returns; b) €480 million from Bank of Greece's profits; c) €1,310 million from the repayment of preferential shares; and d) €328 million from privatisation proceeds. Excluding revenue of €62 million for transfers corresponding to profits on Greek bonds held by the Eurosystem central banks (Securities Markets Programme – SMP). Also excluding expenditure of: €51 million for the participation of the Greek State in capital increases (DEPOS SA and EAB SA), but including expenditure of a) about €336 million for the payment of arrears and b) €451 million relating to Greece's participation in the European Stability Mechanism (ESM).

amounting to €1,500 million, against only €62 million in 2014; (b) tax refunds in 2014 are roughly €800 million higher than in 2013; (c) collection of the uniform tax on real estate (ENFIA) started with a delay; and (d) investment expenditure in 2014 is considerably higher than in 2013.

The improvement is attributable to the cutback in ordinary budget expenditure by 6.9%, compared with an annual target of -5.0%, despite the higher spending for social protection (about €500 million). In contrast, ordinary budget revenue before tax refunds records a decrease of 1.2% compared with the corresponding period of last year, attributable mainly to the shortfall observed in indirect taxes and particularly VAT, as well as to deferred ENFIA collections due to the two-month extension of the deadline for the payment of the first instalment, and the anticipated new favourable arrangement for overdue debts. This arrangement is expected to halt the upward trend of overdue corporate and household debts to the government, which by September 2014 had risen to around €70 billion.

State Budget (cash data)

The state budget cash balance improved by 3.8% of GDP in the first ten months of 2014 compared with 2013, and stood at a deficit of 1.2% of GDP against a deficit of 5.0% of GDP in the corresponding period 2013 (see Table V.3). The state budget primary cash balance recorded a similar improvement (3.5% of GDP) and stood at a surplus of 1.6% of GDP against a deficit of 1.9% in the corresponding period of 2013. This improvement is also attributable to extraordinary factors, associated with revenue from the repurchase of preference shares by financial institutions, the payment of higher profits by the Bank of Greece to the government, the collection of increased

ANFA revenue transfers, as well as lower expenditure for overdue debt repayments. Excluding these factors, the state budget primary cash balance improved marginally (by 0.1% of GDP) against the corresponding period of last year. However, a considerable improvement of 0.9% of GDP was recorded in the ordinary budget primary balance, attributable to contained primary expenditure, which was largely offset by a worsened public investment budget balance due to increased investment expenditure in 2014, which exceeded the target for the period by €69 million.

3 PUBLIC DEBT

According to fiscal data announced by ELSTAT in the context of the Excessive Deficit Procedure (EDP) in October 2014, nominal debt rose by €430 million in 2013, of which €284 million is attributable to the inclusion of certain entities in general government as a result of the application of the national accounts standard ESA 2010.

For 2014, the Introductory Report on the State Budget projects that the general government debt will rise to 177.7% of GDP (or €318 billion), from 174.9% of GDP (or €319.1 billion) in 2013.[10] This rise is exclusively attributable to the drop of nominal GDP in 2014 compared with 2013, as the debt in nominal terms is projected to fall by €1.3 billion. It is estimated that continuing improvement of the primary balance, implementation of the privatisation programme, and economic recovery will contribute positively in lowering the general government debt-to-GDP ratio from 2015 onwards. Thus, in 2015 public debt is projected to stand at 171.4% of GDP (€316 billion).

10 For 2013, the recent revision according to the ESA 2010 has been taken into account.

VI MONEY, CREDIT, BANKING, CAPITAL MARKETS AND THE PRIVATE INSURANCE MARKET

As confidence in the country's economic outlook was maintained in 2014, there was no systematic net outflow of deposits, while declining bond yields enabled credit institutions and the Greek government to tap the open capital market through successful new bond issuance. Although the recapitalisation of the banking system was concluded (the ECB's Comprehensive Assessment did not find any significant capital shortfalls for Greek systemic banks) following its radical restructuring, credit growth to the real economy has remained negative, thus dampening the incipient recovery of economic activity. The main cause is the high and rising stock of troubled loans in banks' balance sheets, which calls for coordinated action by all stakeholders – and the Bank of Greece has already provided guidelines in this respect. Moreover, the government's recent legislative initiative to address corporate loans that are in arrears or non-performing is expected to provide the appropriate incentives and encourage borrowers and banks to work together towards viable solutions to the problem.

With the climate of confidence undisturbed, hoarding of banknotes and flight of deposits did not occur again in 2014. On the contrary, despite the downward trend of deposit rates, there was a net inflow of deposits into the domestic banking system.

However, despite the increase in the banks' deposit base, the strong capitalisation and the regained access to the interbank market and the global capital markets, the banking system still faces important challenges. First and foremost is the constraint on banks' lending capacity, arising from the large stock of non-performing loans on their balance sheets. This combined with the weak demand for loans, has resulted in continued negative credit expansion to the real economy, impeding the revitalisation of economic activity.

The NPL ratio continued to rise in the first quarter of 2014, with more than one third of outstanding bank loans presenting servicing problems. Corporate NPLs (over €1 million) are concentrated in a small number of sectors of economic activity and a relatively small number of borrowers. A large percentage of NPLs are owed to multiple creditors. Moreover, a large part of loans classified as non-performing are more than three years in arrears.

Addressing the NPL problem calls for efforts from all sides, otherwise troubled loans are not likely to be resolved, given the growth rates projected for the Greek economy in coming years, and will continue to act as a constraint on banks. The Bank of Greece has provided guidelines for addressing the issue in the context of its supervisory framework and has also contributed to the development of a relevant Code of Conduct, which, among other things, envisages a number of options for the treatment of NPLs. Moreover, the government's recent legislative initiative to tackle corporate loans in arrears provides the appropriate incentives to encourage borrowers and banks to work towards viable solutions to the problem.

A more effective management of troubled assets would help to revive credit growth. Moreover, economic recovery will set in motion a virtuous circle, whereby credit growth would benefit from the positive effect that GDP growth will exert on credit demand, demand for deposits, confidence in the Greek economy, hence the access of credit institutions to funding from global financial markets, and, finally, to a certain extent on borrowers' repayment capacity. Credit growth will continue to be supported by the co-financing and guarantee instruments available from the ETEAN, the EIB and the newly established Hellenic Investment Fund, particularly those targeting small and medium-sized enterprises. The challenge now is to further increase the absorption of these funds.

In the first half of 2014, the operating profitability of Greek banks improved, reflecting reduced interest expenses as a result of lower deposit rates and a virtual elimination of credit institutions' recourse to emergency funding from the Bank of Greece, and cuts in operating costs through voluntary early retirement schemes and network downsizing. However, after provisions for credit risk, Greek banks have reported losses both on a solo and on a consolidated basis.

Indeed, banks are forced to continue to make very high provisions – they have in fact succeeded in increasing their NPL coverage ratio by over 50% during the first half of 2014 (from total provisions made in recent years), while the capital adequacy ratio of Greek banking groups now exceeds 16%.

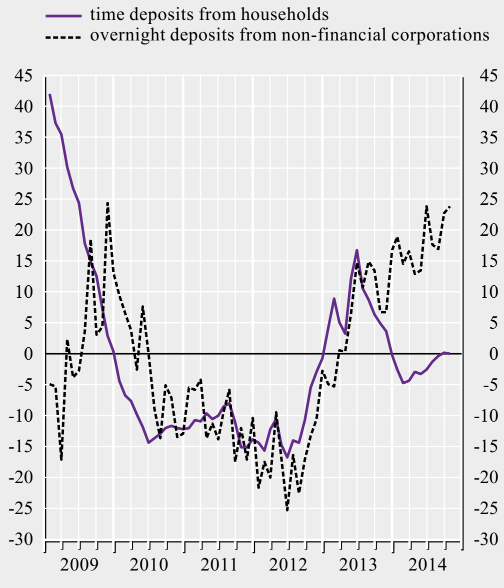
In the context of the establishment of the Single Supervisory Mechanism (SSM), the ECB has assumed responsibility for the supervision of "significant" banking groups in the euro area, including the four core banks in Greece. By ensuring more effective supervision and more consistency across Member States, this major institutional reform will safeguard financial stability in the euro area. This will ultimately help create the necessary conditions for banks' lending policy to provide enhanced support to economic growth within the Monetary Union.

The Comprehensive Assessment was part of the preparatory work for the establishment of the SSM and involved an asset quality review and a stress test. As far as the Greek banking system is concerned, the results of the Comprehensive Assessment suggested that three of the four core banks had no capital shortfall under the dynamic balance sheet approach and the fourth had no material shortfall, while it was confirmed that the capital raising and restructuring plans implemented by the four Greek banks under review had significantly strengthened their capital positions.

Turning to developments in the securities market, Greek government bond yields broadly followed a downward trend, as fiscal consolidation and structural reforms progressed in Greece, bolstering investor confidence. Declining yields created favourable conditions for the successful issuance of new medium- and long-term bonds by the Hellenic Republic. Yields, however, showed some erratic movements, particularly towards the end of the period under review, reflecting market nervousness triggered by uncertainty about the prospects of domestic economic policy and by adverse economic developments at the euro area level. Although the prices of bonds issued by large and export-oriented Greek businesses followed an almost uninterrupted upward course until shortly before the end of the reviewed period, the composite share price index of the Athens Exchange declined overall between end 2013 and November 2014, and this decline was broadly based across the banking and other sectoral sub-indices.

Chart VI.1 Overnight deposits from non-financial corporations[1] and time deposits from households[1] (January 2009-October 2014)

(annual percentage changes)



Source: Bank of Greece.

1 BANK DEPOSITS

Net inflows of private sector deposits to the Greek banking system were observed almost throughout the first ten months of 2014, although deposit rates dropped. This development must therefore reflect an underlying increase of transactions in the Greek economy as well as the fact that —as opposed to the period until mid-2012— confidence was maintained. In a climate of confidence, phenomena of banknote hoarding or deposit withdrawals did not reoccur (on the contrary, the period between January and September 2014 saw a net return of banknotes to the banking system of €5 billion and a return of deposits of about €1 billion).

As a result of the net inflow of deposits, the annual growth rate of time deposits by non-financial corporations stood at positive and gradually increasing levels and the annual rate of decline in household time deposits was contained (see Chart VI.1). The annual growth rate of overnight deposits by non-financial corporations remained very strong (ten-month average: 18%), which is consistent with an increased volume of transactions. By contrast, the rate of change of household overnight deposits turned negative. The outstanding amounts of general government deposits as well as of non-residents' deposits with Greek credit institutions increased between December and October 2014.

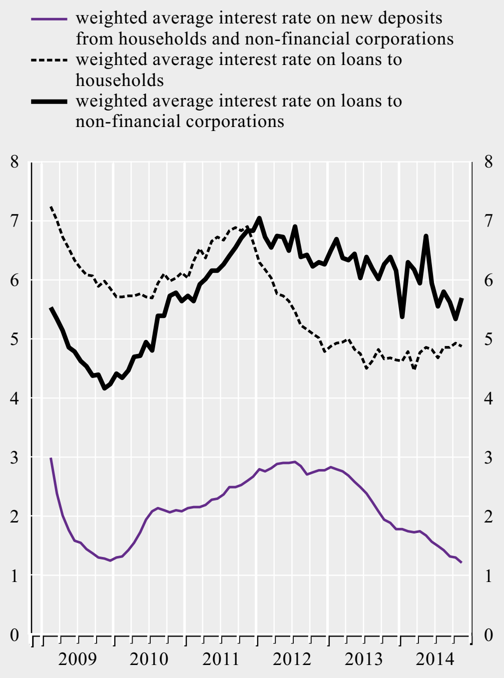
Provided that confidence is maintained, the expected economic recovery should boost deposits. Moreover, on the money supply side, the increase in banks' lending activity, which can be achieved to the extent that the conditions discussed below are fulfilled, will entail the opening of new accounts, to be credited the amount of the loan.

2 BANK DEPOSIT RATES

As mentioned above, bank deposit rates continued their downward trend during the first ten months of 2014, returning to levels last seen before the outbreak of the crisis in October 2009 (see Chart VI.2). In the absence of systematic net deposit withdrawals, banks did not have to offer high interest rates to attract deposits in order to fund their lending, which, anyway remains subdued. Moreover, banks'

**Chart VI.2 Interest rates on new bank deposits and loans
(January 2009-October 2014)**

(percentages per annum)



Source: Bank of Greece.

costs of funding from alternative sources, namely the money and bond markets, have declined worldwide, exerting downward pressure on retail interest rates.

This trend in global financial markets will be strengthened, among other things, by the set of monetary policy measures recently launched by the Eurosystem.[1] This implies that, even when loan demand in Greece picks up, given that the concurrent economic growth will boost demand for deposits, it is likely that banks will not have to increase their retail interest rates.

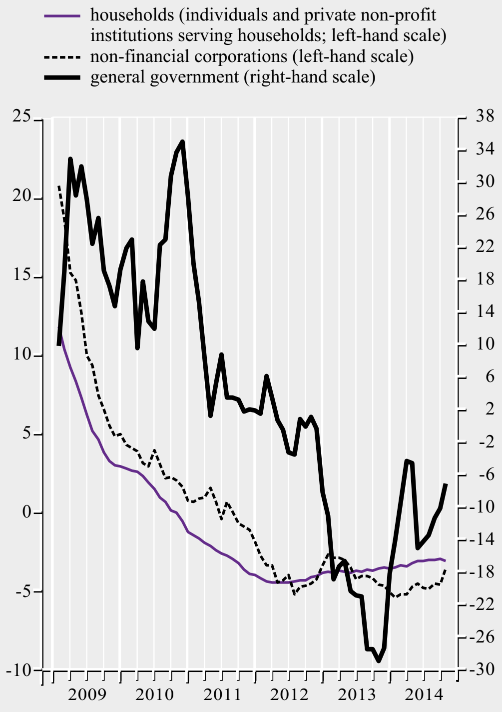
3 BANK CREDIT

The restructuring, consolidation and recapitalisation of Greek banks and their restored

1 As discussed in Chapter III, there are a number of technical parameters that prevent Greek banks from reaping the full benefits of these policy measures.

Chart VI.3 Bank credit to non-financial corporations, households and general government
(January 2009-October 2014)

(annual percentage change)



Source: Bank of Greece.

access to international money markets have increased the banking system's ability to supply credit to the real economy. The broad stabilisation of retail deposits have contributed in this direction. Also, the slower decline in economic activity and the recovery that followed must have contributed in a strengthening of demand for bank loans. However, some large and export-oriented Greek non-financial corporations have raised significant amounts of funds from the international capital market, taking advantage of the prevailing favourable conditions for bond issuance. This development has had a dampening effect on demand for bank credit.

Still, the results of the bank lending survey for Greece point to increases in credit demand over recent quarters (after a long period of decline), both from non-financial corporations and from households. Moreover, banks' credit standards appear to have remained unchanged in 2014, after several years of net tightening.

Nevertheless, the contraction of banks' loan portfolios continued, as monthly disbursements of new loans were still below monthly principal and interest payments from existing loans. On the other hand, the rate of decline in bank credit to both non-financial corporations[2] and households was contained (see Chart VI.3).

A number of factors continue to act as constraints on both demand and supply of credit. Uncertainties regarding the economic prospects of the country, which have not yet dissipated, continue to squeeze demand and supply of loans. Credit risk, albeit de-escalating, remains elevated (as evidenced by difficulties in servicing many existing loans), making banks more reluctant to grant new loans at relatively low interest rates.

There is no doubt that the stock of banks' troubled assets is very high, weighing heavily on their lending capacity. Insofar as problem loans are not serviced smoothly, they put bank liquidity, hence their lending capacity, under strain. Moreover, the high level of non-performing loans means that banks need to put considerable part of their own funds aside to form adequate provisions for credit risk so that they can cover impairment losses in the future. However, the level of the required provisions depends on how the servicing of problem loans and the quality banks' loan portfolio in general will play out, both of which are inevitably subject to uncertainty. This uncertainty in turn generates nervousness among investors and makes banks' funding from the capital market more difficult, by increasing the funding costs (compared with what would have been the case in the absence of uncertainty). An increase in funding costs, coupled with the need to cover current and future impairment losses, makes it harder for banks to lower their lending rates.

2 However, the slowdown in credit expansion to non-financial corporations exhibited a volatile monthly pattern.

Once economic activity picks up, the remaining uncertainties dissipate and an exit from the crisis is more clearly in sight, then demand for bank loans can be expected to recover. Credit risk will decline and the private sector's ability to service its existing loans will improve – albeit to a limited extent as discussed below. Furthermore, the expected shift of banks towards an active management of non-performing loans should strengthen bank liquidity, minimise the need for provisioning or write-offs and reduce financial market uncertainty. All these factors will create favourable conditions for stronger credit expansion to the real economy.

Moreover, banks have now repaid a considerable part of the financing they had obtained from the Eurosystem at the peak of the crisis (including the emergency liquidity provided by the Bank of Greece). This means that the necessary further reduction in domestic credit institutions' dependence on central bank financing will result in unlocking more bank reserves to be channeled into the real economy.

Finally, the growth of bank credit to non-financial corporations and households in coming years will be supported by both the recent measures of the Eurosystem (see Chapter III) and the financing instruments available from ETEAN, the EIB and the recently established Institution for Growth (see Special feature VI.1). These co-financing schemes will enable credit institutions to extend new loans at comparatively lower interest rates or less strict collateral requirements, especially where credit institutions are protected by guarantees from these entities. While further initiatives in this field would be most welcome, what is urgently needed now is to increase the absorption of these funds by cutting red tape within and across the entities involved, by a more active engagement of banks and by raising awareness among small and medium-sized firms about the financing programmes available to them. However, no financing programme of this type can make up for the lack of viable business projects, which is a function of the macroeconomic climate and the degree of flexibility of the microeconomic business environment.

Credit expansion to general government continued to decline. Given that the borrowing requirements of this sector are now mainly financed by the country's international creditors, new bank lending to general government has virtually come to a halt, although repayments of existing loans continue, while banks' holdings of Greek government bonds portfolio have also declined as a result of redemptions in the ten months between January and October 2014.

4 BANK LENDING RATES

Regarding the cost of bank financing to non-financial corporations, both the overdraft rate and the rate on medium- to long-term loans of less than €1 million followed a downward trend in 2014. This development reflected a possible decline in credit risk in the Greek economy on the back of improved economic conditions, the favourable effect of the aforementioned programmes supporting bank lending to small and medium-sized enterprises, as well as banks' lower funding costs. The interest rate on new medium- to long-term loans of over €1 million is typically more volatile (since it refers to a smaller number of loans compared with the case of smaller loans) and was higher on average in the January-October 2014 period than in the second half of 2013.

Interest rates on bank loans to households followed an upward trend (see Chart VI.2), driven by mortgage rates. Interest rates on consumer credit showed divergent developments across individual types. The increase in interest rates on housing loans is consistent with revived demand for housing loans as recorded by the bank lending survey.

As the economy recovers, credit risk should decline, banks' funding costs should remain low —as discussed above— while the cuts in banks' operating expenses following the restructuring of the banking system will be gradually implemented, all contributing to lower lending rates. On the other hand, a pickup in credit demand and banks' need to offset impairment losses by positive net income from performing loans are likely to act in the opposite direction. The impact on the pricing policies of core banks from the increase in concentration in recent years —which was necessary for shielding the stability of the banking system— must be closely monitored.

5 DEVELOPMENTS IN THE BANKING SECTOR

The stabilisation and incipient recovery of economic activity in Greece is gradually being reflected in the aggregates of Greek commercial banks. Operating profits are improving, mainly as a result of higher net interest income and cuts in operating costs. Following successful capital increases by the four core banks, capital adequacy is now satisfactory. In fact, the Comprehensive Assessment conducted by the ECB[3] showed that the capital increases and restructuring plans implemented by the four core banks had significantly strengthened their capital positions. Three of the four Greek credit institutions that took part in the Comprehensive Assessment had no capital shortfall under the dynamic balance sheet approach,[4] and the fourth[5] had practically no shortfall. However, significant challenges remain, the most important being the effective management of non-performing loans (see Special feature VI.2).

The ECB conducted the Comprehensive Assessment exercise in preparation for assuming its banking supervision responsibilities under the SSM for the credit institutions of the euro area. The scope of the project was threefold. Specifically it had to i) achieve transparency through the enhancement of the quality and quantity of the information related to the real condition of credit institutions, ii) identify all the measures necessary to remedy for cases of financial and economic weaknesses, and iii) enhance the confidence of all stakeholders, depositors, markets and investors towards the solvency of banking institutions of the euro area. The main objective of the Comprehensive Assessment is to safeguard financial stability and enhance the growth prospects of the euro area economy.

The Comprehensive Assessment encompassed 130 credit institutions[6] with total assets of €22.1 trillion. The exercise took one full year to be completed, covered the examination of every portfolio of every participating bank, and involved the ECB, all the relevant national competent authorities, the EBA, as well as third party experts.

The comprehensive assessment consisted of two components:

(i) A thorough and detailed asset quality review (AQR), which was a bottom-up approach for examining banks' assets.[7]

The review was a point-in-time assessment of the accuracy of the carrying value of banks' assets as of 31 December 2013, based on conservative valuation and provided a starting point for the stress test. The AQR was undertaken by the ECB and the national competent authorities and was based on the CRR/CRD IV definition of the regulatory capital as of 1 January 2014.[8]

(ii) A top-down forward-looking stress test which examined the resilience of banks' solvency under two hypothetical scenarios, base-

3 See Press Release, *Results of the Comprehensive Assessment exercise*, 26.10.2014, Bank of Greece.
4 Under the "dynamic balance sheet" approach, the Comprehensive Assessment exercise took into account the changes in the size and composition of banks' balance sheets as envisaged in their submitted restructuring plans. By contrast, the static balance sheet approach assumed unchanged size and composition of banks' balance sheets.
5 Namely Eurobank Ergasias.
6 In addition to significant banks, the Comprehensive Assessment exercise also included a number of smaller banks in smaller euro area countries.
7 Under the bottom-up approach, the analysis was based on data at the level of individual loans/borrowers (typically based on sampling). Under the top-down approach, the analysis used data aggregated at the level of loan type.
8 The CRR/CRD IV prescribes more strictly the assets qualifying as regulatory own funds. It also establishes uniform EU-wide definitions.

line (hurdle rate of 8.0% of CET1) and adverse (hurdle rate of 5.5% of CET1). The scenarios cover the period of 2014-2016 and have been developed jointly with the European Commission, the ESRB and the ECB. The exercise was carried out on the basis of consolidated year-end 2013 figures and also incorporated the new information arising from the AQR.

Because the restructuring plans of the Greek banks had not been officially approved and published before 31 December 2013, Greek banks implemented the "static balance sheet" assumption, in line with the EBA methodology. Given that the static balance sheet projections were not fully representative of these banks' future capital positions, since they had been already implementing restructuring plans in the course of 2014, they also performed the exercise under the "dynamic balance sheet" approach. The latter approach incorporated the restructuring plans that had been assessed and approved by the EU DG Competition, while following the EBA methodology to ensure a level-playing field. A number of banks' commitments were embedded in the restructuring plans, including disposal of assets and subsidiaries, reduction of operating expenses and reduction in the cost of deposits. Additionally, capital raising measures to date were incorporated into the projections. The results of the exercise did not include the positive impact from the recent legislation that allowed Greek banks to convert part of their deferred tax assets[9] into deferred tax credits.

Banks' operating results in the first half of 2014 improved further compared with 2013 (see Table V.1). Operating income was positively affected by lower interest payments as a result of a considerable decline in interest rates on time deposits and no recourse to the Emergency Liquidity Assistance. Operating expenses dropped, reflecting cost-saving gains from voluntary retirement schemes implemented in the course of 2013 and from continued rationalisation of bank branch networks. Net income, however was not sufficient to cover provisioning for credit risk. The positive impact of the recognition of deferred tax has helped banks and their groups to post after tax profits.

The quality of Greek banks' portfolios deteriorated further although the growth rate of new non-performing loans fell slightly during the year. The ratio of non-performing loans to total loans (NPL ratio) rose to 34.1% at end-June 2014 from 31.9% at end-December 2013. The deterioration was comparatively smaller in housing loans (June 2014: 27.4%, December 2013: 26.1%) and more pronounced in business loans (June 2014: 34.6%, December 2013: 31.8%) and in consumer credit (June 2014: 50.2%, December 2013: 47.3%). However, the coverage ratio (ratio of accumulated provisions for credit risk to non-performing loans) increased (June 2014: 50.5%, December 2013: 49.3%), as banks rightly followed conservative credit risk provisioning policies.

A further decline in interest expenses is rather unlikely; also, the anticipated rise in interest income is small, at least in the short term, given the ongoing deleveraging of bank assets and the projected path of loan supply and demand in the near future. Against this background, the effective management of NPLs, also preventing the creation of new ones, acquires crucial importance for banks' return to profitability and ability to channel resources into the real economy. This view is supported by the fact that the projected growth rates for the years ahead are expected to have a relatively small dampening effect on the NPL ratio.

More specifically, econometric estimates of the Bank of Greece, based on the GDP and employment projections in the medium-term fiscal strategy programme and three alternative scenarios regarding the evolution of the inter-

9 Deferred tax assets (DTA) are amounts of income tax that are refundable in future periods and arise from: (i) deductible temporary differences; (ii) unused tax losses carried forward; and (iii) unused tax credits carried forward. Deferred tax credits (DTCs) on the other hand are receivable claims on the State, the recognition of which does not rely on the future profitability of the credit institution. For this reason, DTCs fully qualify as regulatory own funds.

Table VI.1 Financial results of Greek commercial banks and banking groups with shares listed on the Athens Exchange (first half of 2013 - first half of 2014)

(million euro)

	Banks			Banking groups		
	H1 2013	H1 2014	Change (%)	H1 2013	H1 2014	Change %
Operating income	**2,680**	**3,592**	**34.0**	**5,006**	**5,414**	**8.1**
Net interest income	2,132	2,939	37.9	3,761	4,247	12.9
– Interest income	5,852	5,543	-5.3	8,189	7,692	-6.1
– Interest expenses	3,721	2,604	-30.0	4,427	3,445	-22.2
Net non-interest income	549	653	-	1,245	1,167	-6.3
– Net fee income	295	329	11.4	719	735	2.3
– Income from financial operations	270	92	-	435	120	-
– Other income	-17	232	-	91	312	242.7
Operating costs	**-2,100**	**-2,015**	**-4.1**	**-3,236**	**-2,999**	**-7.3**
Staff costs	-1,206	-1,085	-10.0	-1,793	-1,577	-12.0
Administrative costs	-745	-757	1.6	-1,166	-1,132	-2.9
Depreciation	-149	-173	15.6	-278	-290	4.5
Net income (operating income less costs)	**580**	**1,577**	**172.0**	**1,770**	**2,415**	**36.4**
Provisions for credit risk	-3,038	-2,924	-3.8	-3,665	-3,490	-4.8
Other impairment losses[1]	-476	-107	-77.4	-263	1	-100.4
Non-recurring profits/losses[2]	6,787	-7	-	7,062	-11	-
Pre-tax profits	**3,852**	**-1,460**	**-**	**4,903**	**-1,085**	**-**
Taxes	2,221	2,255	-	2,100	2,166	-
Profits/losses from discontinued operations	1	-52	-	-25	-228	819.7
After tax profits	**6,075**	**743**	**-**	**6,978**	**853**	**-**

Source: Financial statements of Greek commercial banks.
1 Impairment losses on securities as well as on tangible and intangible assets.
2 In the first quarter of 2013 non-recurring profits were mainly due to the positive effect from the acquisition of banks by core banks (negative goodwill).

est rate margin (measured as the difference between the average lending and deposit rates), suggest that the NPL ratio will stop rising in the course of 2015. Under the more optimistic scenario, the NPL ratio is projected to decline by a cumulative four percentage points by end-2016 relative to mid-2014, to stand close to 30%. This points to the need to address the problem of NPLs, through concrete policy measures that should be tailored to the Greek reality and not entail additional capital needs for banks.

Based on the above, it is estimated that banks could substantially reduce the troubled assets on their balance sheets by choosing to actively manage their non-performing loans through recourse to (i) the supervisory framework for the management of loans in arrears and non-performing loans provided for in Bank of Greece Executive Committee Act No 42/30.5.2014,[10] and (ii) from 1.1.2015 the work-out options described in the Code of Conduct provided for in Law 4224/2013.

10 The main provisions of this Act require each credit institution to: (a) establish an independent arrears and NPLs management (ANPLM) function; (b) develop a separate, documented ANPLM strategy, the implementation of which will be supported by appropriate Management Information Systems (MIS) and procedures; and (c) establish regular reporting to the management of the credit institution and the Bank of Greece.

In any event, the workout solutions available to banks for the management of non-performing loans must be selected in a manner that does not give rise to moral hazard, i.e. not encourage loan delinquency among borrowers who are objectively capable of repaying their debts. This risk is visible in the case of across-the-board measures that are not based on an effective assessment of borrowers' actual income and assets. With particular regard to corporate loans, business viability is an additional, crucial factor to be considered. Funds should not be tied up in businesses with no prospect of survival, at the expense of healthy businesses, with a potential to generate economic growth and job creation.

In terms of capital adequacy, the Common Equity Tier 1 on a consolidated basis rose to 15.9% in June 2014 (from 12% in December 2013) and Capital Adequacy Ratio to 16.2% in June 2014 (from 13.4% in December 2013), mainly as a result of capital increases by the four core banks as well as of higher deferred tax assets.

Despite the positive results of the Comprehensive Assessment, the Bank of Greece considers that banks need to maintain capital adequacy ratios well above the regulatory minimums, for reasons of prudence, especially considering that the NPL ratio remains very high.

Finally, on 4 November 2014, the ECB assumed its tasks related to the supervision of banks in the euro area. The Single Supervisory Mechanism (SSM) comprises the ECB and the national competent authorities of the participating countries. Its main aims are to ensure consistent supervision and contribute to the safety and soundness of credit institutions and the stability of the European financial system. The ECB will directly supervise 120 significant banking groups, which represent 82% of banking assets in the euro area, including the four Greek core banks. The supervision of significant banking groups is carried out by the Joint Supervisory Teams, consisting of staff of the ECB and the national competent authorities. For all other 3,500 banks the ECB will set and monitor the supervisory standards and work closely with the national competent authorities in the supervision of these banks.

6 FINANCIAL MARKETS

6.1 DEVELOPMENTS IN INTERNATIONAL CAPITAL MARKETS

The Eurosystem decisions of June and September 2014 helped to sustain the downward trend in euro area sovereign bond yield spreads. Non-financial corporate bond yields also continued to decline, while euro area stock prices increased. On the other hand, the growth of financing to non-financial corporations from the peripheral euro area bond markets decelerated compared with 2013.

The declining trend in yields halted temporarily in September due to uncertainty about the commitment of euro area economies to fiscal discipline, as well as the projected economic slowdown in Monetary Union. High volatility and concerns about the outlook of the euro area banking sector as a whole were initially triggered by adverse news about a large Portuguese banking group. Later on, changing market expectations about the then forthcoming results of the ECB's Comprehensive Assessment also fuelled financial market volatility. In November, signs that the Eurosystem would expand its monetary policy toolbox bolstered investor confidence in bond markets.

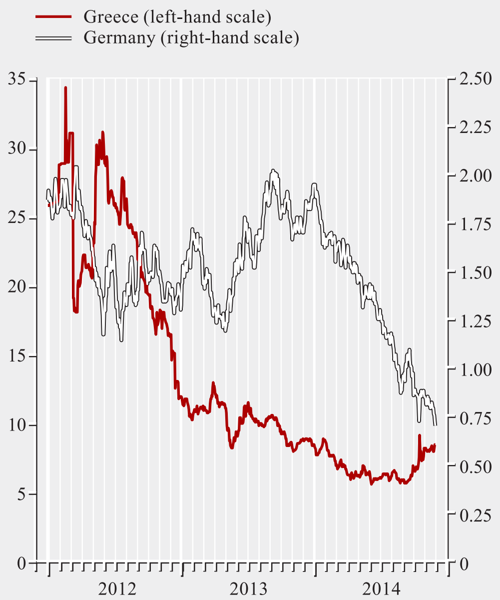
Overall, however, the yields of sovereign bonds that are perceived as safe havens stood at historically low levels, even turning negative at times (at shorter maturities), indicating investors' willingness to pay for safety. Risk minimisation remains the key concern in asset allocation decisions, and the weak economic outlook growth is expected to continue to dampen investor sentiment in the euro area. Against this backdrop, developments in issuance and prices of Greek securities will largely be shaped by this risk-averse market environment.

6.2 GREEK GOVERNMENT BONDS

In the first half of 2014, on the back of improvements in overall financial market conditions in the euro area and strengthened investor confidence and sentiment towards the Greek economy in particular, Greek government bond yields continued their downward trend. In May-August 2014, for the first time since the emergence of Greece's debt problems in early 2010, yields fell to below 6%. During that period, the yield spread between the Greek ten-year benchmark bond and the corresponding German bond stood below 500 basis points, i.e. comparable with the levels prevailing before the downgrade of Greek sovereign debt to below investment grade in April 2010 (see Chart VI.4).

Chart VI.4 Yields on ten-year Greek and German government bonds (January 2012-November 2014)

(daily data, percentages per annum)



Source: Bank of Greece.

From end-September 2014 onwards, investor sentiment deteriorated, initially owing to economic developments in the euro area, leading to increased volatility and a slight rise in the bond yields of vulnerable euro area member countries. Subsequently, as domestic political uncertainty fuelled investors' concerns about the completion of structural reforms and fiscal consolidation in Greece, Greek government bond yields followed an upward course. This trend intensified during October 2014, bringing the ten-year Greek government bond yield to above 9% in mid-October, close to the levels prevailing in the fourth quarter of 2013. This development was not reversed, not even after positive news came in, regarding in particular the smooth execution of the 2014 Budget and the overachievement of fiscal targets in the year to October, or after the prospects of an improvement in domestic economic activity were confirmed.

Following (i) the ECB's decision to reduce the haircuts applicable to bonds issued (or guaranteed) by the Hellenic Republic and used as collateral in Eurosystem refinancing operations; and (ii) the discussions with Greece's creditors on the extension of a credit line aimed to help the country return to market financing, investor uncertainty eased, and the upward trend in yields came to a halt. Still, Greek sovereign bond yields remained elevated throughout November (ten-year bond yield on 28.11.2014: 8.4%).

The conditions prevailing in early 2014 enabled the Greek government to issue medium- to longer-term securities, with maturities of five years (10 April 2014, issue amount €3 billion, coupon rate: 4.75%) and three years (10 July 2014, issue amount €1.5 billion, coupon rate: 3.375%). Moreover, liquidity conditions in the secondary market improved, and the average daily value of transactions in the Electronic Secondary Market for Government Securities (HDAT) increased substantially (€44 million) in January-November 2014, compared with the corresponding period of 2013 (€6 million). Over the same period of 2014, the average daily value of transactions in the Dematerialised Securities System (DSS) stood at €300 million, compared with €218 million in 2013.

The issuance of medium- to longer-term bonds, along with regular issues of Treasury bills (January-November 2014: €34 billion, January-November 2013: €37 billion), help to cover part of the borrowing requirements of the Greek government, while at the same time alleviating investor uncertainty regarding the valuation of Greek sovereign bonds by addressing the problem of missing segments of the yield curve. This supported a decline in Treasury bill interest rates (weighted average rate in January-November 2014: 2.6%, January-November 2013: 4.1%) and a normalisation of the yield curve (see Special feature VI.4).

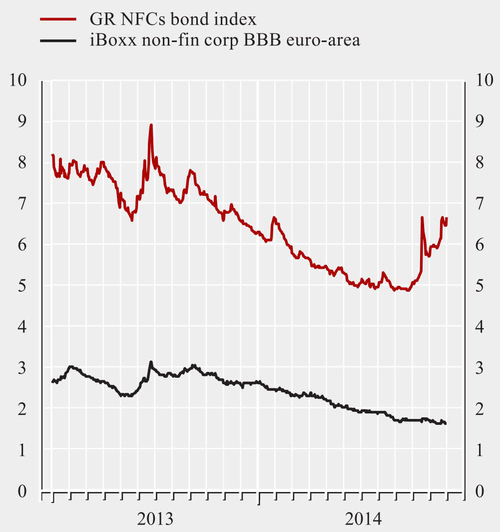
6.3 CORPORATE BONDS

The stabilisation of the domestic economic environment and the resulting improvement in confidence in the Greek economy enabled large Greek non-financial firms to issue corporate bonds. In the course of the first half of 2014, Greek companies with strong export activity and sound balance sheets raised €2.5 billion from international bond markets, mainly with the aim to repay bank loans. The weighted average interest rate on these issues was 4.7%, considerably lower than in previous issues by the same companies (2013: 8.3%).

The remarkable improvement in the secondary market valuations of outstanding issues, which was observed throughout 2013 and in January-September 2014, was reversed as from mid-October 2014. Specifically, according to the composite index compiled by the Bank of Greece, the weighted average yield on Greek corporate bonds dropped to 5% at end-September 2014, from 6.2% in December 2013 (see Chart VI.5), while its spread vis-à-vis euro area corporate bonds (as measured by the iBoxx NFC EA BBB index) fell to 315 basis points, from 365 basis points at the end of 2013, despite the improved valuations of corporate bonds in the rest of the euro area.

Chart VI.5 Greek and euro area corporate bond yields (January 2013-November 2014)

(daily data; yields in percentage points)



Sources: Bank of Greece (GR NFCs bond index) and Thomson Datastream (iBoxx non-fin corp BBB euro-area).
Note: The Greek index shows the weighted average yield on bonds issued by Greek non-financial corporations on international bond markets since December 2012. Weights are calculated daily on the basis of the market value of underlying securities.

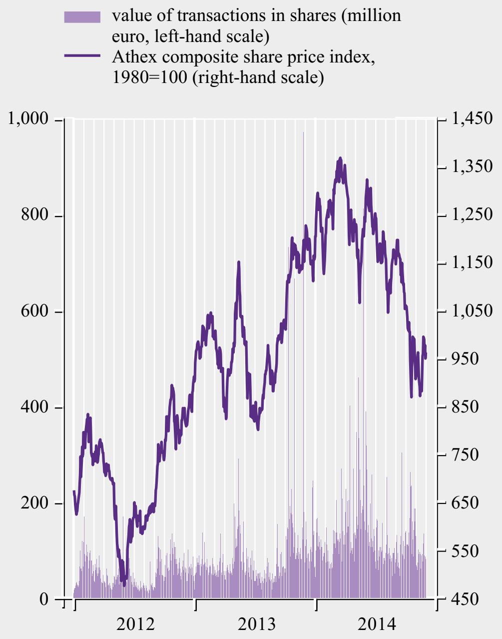
However, October 2014 saw a sharp increase in the cost of market-based debt financing of domestic firms, for the reasons mentioned above and despite their robust fundamentals, as well as a temporary decoupling of Greek corporate yields from their euro area counterparts. By late November, the weighted average yield on Greek non-financial corporate bonds had increased to 5.4% and its spread over the corresponding yield of euro area corporate bonds had widened to 480 basis points. If this trend is not reversed, further fund raising by Greek firms are likely to encounter difficulties in further tapping international capital markets, due to both higher costs and reduced demand for Greek assets.

6.4 THE STOCK MARKET

The positive performance of share prices on the Athens Exchange (Athex) during the first half of 2014 was gradually reversed, with the composite Athex index recording losses of 17%

Chart VI.6 Athens Exchange composite share price index and value of transactions (January 2012-November 2014)

(daily data)



Source: Athens Exchange.

between the beginning of the year and end-November (see Chart VI.6), driven by falls in the stock prices of banks and the other large capitalisation companies. This decline was partially offset by gains in the small and medium capitalisation segments for most of the period between January and November, which probably reflected optimistic expectations.

Banking shares were initially affected by the capital increases made by banks during the first half of 2014. Thereafter, in particular from late September, the shares of Greek banks as well as of other euro area countries were affected by uncertainty about any capital shortfalls that might arise following the completion of ECB's Comprehensive Assessment (1 October-24 October: Euro Stoxx Bank Index: -4%, Athex banking sub-index: -4%). The decline in the prices of Greek bank shares continued into November, due to domestic uncertainty (27 October-28 November: -10%), despite the positive results of the Comprehensive Assessment announced on 26 October and the improved market conditions for the shares of European banks.

Total market capitalisation of companies listed on the Athens Exchange stood at €60 billion on 28 November 2014, against €67 billion on 31 December 2013. Between January and October 2014 the funds raised through the Athens Exchange came to €8.7 billion, mainly reflecting the capital increases of Greek banks, while the same period also saw the first new listing since 2009. Finally, between January and November 2014 the average daily value of transactions increased by 50% compared with one year earlier, to €130 million.

7 PRIVATE INSURANCE MARKET

At end-September 2014, the insurance market in Greece comprised sixty-eight (68) insurance undertakings operating under the right of establishment,[11] with total assets of €15.7 billion. In terms of gross written premiums, the aggregate market share of Greek insurance undertakings was 94.2%, of which 45.03% was accounted for by subsidiaries of EU-based groups, while 5.8% was held by branches of insurance undertakings from EU Member States or third countries. As regards market concentration in terms of gross written premiums, the five and ten largest life insurers held 78.5% and 92.2% of the life insurance market and the five and ten largest non-life insurers held 38.8% and 58.8%, respectively, of the relevant market.

In the January-June 2014 period, the insurance market experienced a drop in gross written premiums for the fourth consecutive year. However, this masked divergent developments across life and non-life segments, with the former starting to recover and showing positive growth and the latter declining.

11 Establishment refers to the head office as well as any agency or branch of an undertaking, as specified in Article 2a of Legislative Decree 400/1970.

Income from all types of premiums fell by 3.4% year-on-year in the first half of 2014, driven by a drop of 10.53% in non-life insurance premiums, which was partly offset by an increase of 7.71% in life insurance premiums. Total premium income stood at €2.05 billion (Jan.-June 2013: €2.12 billion), of which 39.1% came from life insurance and 60.9% from non-life insurance.

Total technical reserves of insurance undertakings supervised by the Bank of Greece increased to €11.9 billion (Jan.-June 2013: €11.7 billion).

Throughout the January-September 2014 period, the Bank of Greece focused on monitoring compliance with Executive Committee Acts No. 30 and No. 31/30.9.2013 that came into force on 1 January 2014. To this end, it intensified its on-site inspections in respect of insurance undertakings and independent insurance intermediaries and, where cases of non-compliance were detected, recommended corrective action.

In the context of preparations for the full implementation of Solvency II[12] as from 1 January 2016,[13] the European Insurance and Occupational Pensions Authority (EIOPA) issued its Interim Guidelines, effective from 1 January 2014. These guidelines address the quantitative (Pillar I) and qualitative requirements (Pillar II) of the new regulatory framework, as well as requirements for supervisory reporting (including EU-wide reporting formats) and disclosure of information (Pillar III).

In preparation for the quantitative requirements under Pillar I, the Bank of Greece, in collaboration with EIOPA, conducted a stress test that encompassed the entire insurance market. The exercise had two elements: a core stress module and a low yield module. Its purpose was to assess the impact on the financial condition and capitalisation of insurance undertakings. According to the criteria set by EIOPA, insurance undertakings were divided into two subsets. The first comprised twelve insurance undertakings whose results were forwarded to EIOPA, and the second group comprised all other undertakings. The results of the EU-wide stress test will be announced by EIOPA by the end of this year. In preparation for the qualitative requirements under Pillar II, Bank of Greece experts held meetings with the managements and relevant staff of almost all insurance undertakings, with the aim to provide information about the Interim Guidelines on System of Governance, which describe the organisational and operational structure of an insurance undertaking, identifying four key functions (actuarial, internal audit, risk management and compliance). Also, the need was pointed out for insurance undertakings to step up their preparations for bringing their practices, methods and systems effectively into line with the new rules. In this context, the Bank of Greece asked insurance undertakings to prepare a gap analysis against the requirements of the forthcoming Solvency II environment. This analysis provides the basis for identifying needs and actions required for the convergence and harmonisation of insurance firms with the new European regulatory framework. Moreover, the Bank of Greece has requested regular progress reports on Pillar II governance issues, as well as Pillar III pilot reports.

The eight working groups set up in 2012 on the initiative of the Bank of Greece with the mandate to enhance the quality of firms' statistics and develop appropriate actuarial models for assessing specific insurance risks continued their work. The project, which is implemented in collaboration with insurance undertakings, is currently in its final phase and progressing ahead of schedule. Its completion, with the finalisation of the relevant reports, is expected before the end of this year.

The regulatory interventions of the Bank of Greece have expanded to the sector of insurance intermediation, with the adoption of Executive Committee Act 38/1.4.2014 (Gov-

12 Directive 2009/138/EC.
13 Directive 2013/58/EC.

ernment Gazette B 1340/27 May 2014) *"Adjustment of the compulsory minimum amounts of insurance cover against civil liability of insurance intermediaries"*, as these amounts were specified in Article 4 (1A) point (6) of Presidential Decree 190/2006.

Special feature VI.1

INITIATIVES TO SUPPORT ACCESS TO FINANCE OF SMEs: DEVELOPMENTS AND PROSPECTS

Small and medium-sized enterprises (SMEs)[1] dominate the Greek corporate sector, accounting for over two thirds of total value added and over four fifths of total employment in that sector. The crisis has taken a heavy toll on the financial condition of Greek SMEs. Between 2008 and 2013, SME employment fell by 27%, while one in four SMEs closed down.[2] In order to tackle these problems, in particular to alleviate the financing constraints of SMEs, a number of initiatives have been taken at the national and European level.

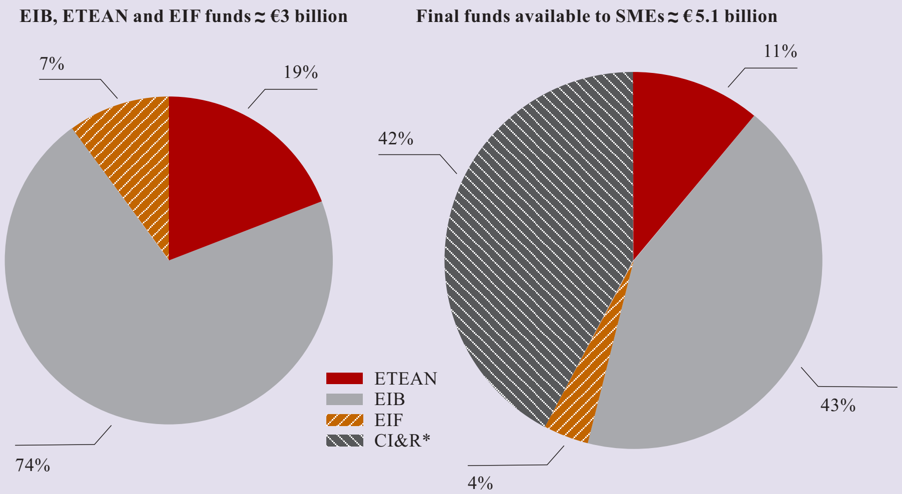
In the past few years, the Hellenic Fund for Entrepreneurship and Development (ETEAN), the European Investment Bank (EIB) and the European Investment Fund (EIF) have been working closely with domestic credit institutions to support lending to Greek SMEs. Through various financing programmes —some launched in 2011 and others added later— these institutions have made roughly €3 billion available for financing to Greek SMEs via the domestic banking system. Given that most programmes require co-financing from credit institutions[3] and under some programmes the funds can be recycled,[4] the total stock of final funds potentially available to SMEs (by end-2015) is, thus far, estimated to exceed €5 billion (see Chart A), corresponding to about 10% of the current outstanding amount of bank loans to SMEs.

Support to SMEs can be grouped into two categories: (a) lending instruments, whereby the aforementioned entities finance or co-finance together with domestic credit institutions bank loans to SMEs carrying attractive interest rates; and (b) guarantee instruments, whereby the funds are used to provide guarantees covering part of the credit risk undertaken in SME loans credit and other financing instruments (e.g. letters of credit). SMEs benefit from lower nominal interest rates and lower collateral (including cash collateral) required by banks for extending loans or other credit instruments.

At first, the absorption of funds available under the various instruments was poor mainly because of subdued demand. In the course of 2014 however, the absorption rate[5] picked up significantly across most instruments (see Chart B).[6] By August 2014, over €1 billion, i.e. approximately 30%

1 According to the Annex to Commission Recommendation 2003/361/EC (Title 1, Article 2), SMEs are defined as enterprises, irrespective of their legal form, which employ fewer than 250 persons and have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million.
2 See European Commission, "2014 SBA FactSheet Greece", p.1.
3 Depending on the co-financing arrangement, credit institutions are required to top up the funds provided for SME loans by the aforementioned entities with a varying amount of own resources. Indicatively, under the EIB's two most significant facilities Global Loans State Guarantee and Global Loans Guarantee Fund, credit institutions are required to top up the total budget by contributing an amount of funds equal to 33% of the amount provided by the EIB, while under EIF's facilities, as well in the even more important (in terms of the amount of funds offered) ETEAN "Business restart" programme, a *pari passu* co-financing arrangement with credit institutions is applied.
4 For instance, under EIB's Trade Finance facility, the funds are used for four-month loan guarantees and so they can be recycled up to three times a year, supporting a transaction volume worth many times their own.
5 The absorption rate is defined as the total amount corresponding to loan signatures by domestic credit institutions and SMEs as a ratio of the total stock of funds committed to this facility, where the latter is the sum of the initial funds contributed by all financing parties (including local banks) excluding any reallocations of resources among different financing instruments and also excluding all de-commitments due to poor absorption.
6 This does not apply to ETEAN's Thematic Tourism, Water Desalination, Waste Management, Green Infrastructures and Applications programme, as undrawn funds have been cancelled.

Chart A Structure of funds



*CI=credit institutions; R=revolving funds.

Sources: Hellenic Fund for Entrepreneurship and Development (ETEAN), European Investment Bank (EIB), European Investment Fund (EIF) and Bank of Greece calculations.

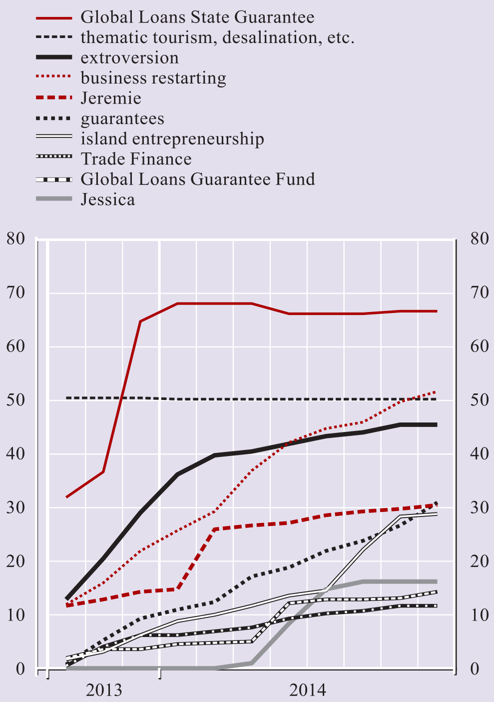
of combined commitments had been disbursed, while signatures had exceeded available commitments by a third. On average, guarantee instruments had a lower absorption than lending instruments. The recovery in demand for business loans is likely to have played a key part in the growing recourse to the lending instruments. Additionally, a number of refinements in the design of the instruments helped in this direction; they include (a) lifting (in 2012) of the prohibition for the financing of working capital; (b) introduction of higher credit limits per project; and (c) conditional lifting of the restriction on financing businesses operating for less than three years. Lastly, the absorption of undrawn funds was accelerated by the reallocation of resources from financing facilities with surplus funds to those in need of funds.

Absorption rates vary across various instruments (see Chart C),[7] reflecting their specific features (nominal interest rate, fees, guarantee requirements by banks, private co-financing requirements and eligibility of beneficiaries and expenditure), as well as the different launch dates.[8]

Co-financing arrangements have succeeded in reducing credit contraction (see Chart D). However, Greek SMEs are still facing financing constraints, which points to the importance of fully reaping the potential benefits of the financing programmes. Full absorption of available commitments could potentially lead to an increase of up to 4% in the stock of existing SME bank lending by the end of 2015. The lifting of restrictions on the geographical allocation of resources, i.e. the possibility of reallocating resources among regions, would be another important step in this direction.

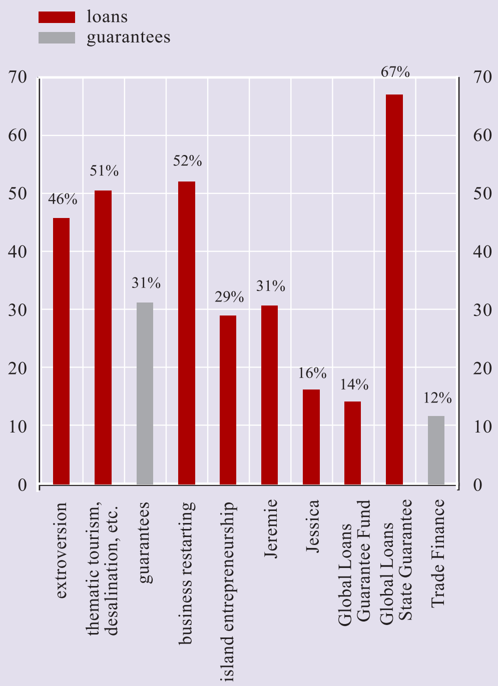
7 For the EIB's Global Loans Guarantee Fund facility, not all the amounts committed for Greek credit institutions had been disbursed by August 2014, leading to an underestimation of the absorption rate reported here.
8 The Global Loans Guarantee Fund and Trade Finance facilities are among the latest to have been launched. The Trade Finance facility was designed to enhance the creditworthiness of Greek banks, although this need had gradually declined by the time the facility became operational.

Chart B Rate of absorption of available funds (October 2013-August 2014)



Sources: Hellenic Fund for Entrepreneurship and Development, European Investment Bank, European Investment Fund, Ministry of Development and Competitiveness, General Secretariat for Public Investment-NSRF, Hellenic Bank Association. Bank of Greece calculations. The rate of absorption is defined as the ratio of signatures for loans to SMEs benefiting from the finance programmes to the total stock of funds available under the programmes. For the Trade Finance programme, the percentage is calculated over the initial funds of EIB, excluding any revolving funds.

Chart C Rate of absorption of funds per finance programme (August 2014)



Sources: Hellenic Fund for Entrepreneurship and Development, European Investment Bank, European Investment Fund, Ministry of Development and Competitiveness, General Secretariat for Public Investment-NSRF, Hellenic Bank Association. Bank of Greece calculations. The rate of absorption is defined as the ratio of signatures for loans to SMEs benefiting from the finance programmes to the total stock of funds available under the programmes. For the Trade Finance programme, the percentage is calculated over the initial funds of EIB, excluding any revolving funds.

SMEs' access to finance could also be bolstered by measures designed to meet the need for greater diversification of funding sources, a concern shared by many developed economies. Traditional funding options (bank loans, guarantee schemes, etc.) could be supplemented by increased use of alternative financial engineering products, such as:

a) Equity funding. Examples of equity funding instruments include inter alia venture capital, equity crowdfunding, specialised platforms for public listing of SMEs.[9]

9 Equity funding is basically an investment practice in which an investor provides financing to a company in return for participation in the company's capital. In so doing the investor acquires an interest in the company's profits, but also the obligation to share its risks. Examples of equity funding instruments include: a) Venture capital. A form of financing of (investment in) the establishment, development and acquisition of a business – typically one that cannot be financed from traditional sources because of the substantial risk it involves, in which the funder (investor) – typically a venture capital – usually participates in the company's capital increase, or receives in return preferred stocks or convertible bond loans; b) Equity crowdfunding. A practice which consists in raising many small amounts of money from a large number of people, typically via an Internet platform. Investors usually receive in return a participation in the company's capital and profits (equity-based crowdfunding/crowdinvesting). Other common types of equity crowdfunding are donation-based crowdfunding (money given as a donation), reward-based crowdfunding (money given in return for non-monetary rewards) and lending-based crowdfunding/crowdlending (lenders receive fixed periodic income until full repayment of their original funding); c) Platforms for public listing of SMEs via which SMEs can raise money through capital increases and public offerings of new shares; and d) Derivatives, such as stock futures, options and warrants.

b) Hybrids,[10] e.g. convertible bonds and mezzanine finance. These are typically loans that, under certain conditions, are convertible to equity participations.

c) Non-bank financing, e.g. corporate bonds, securitised debt and covered bonds.

In Greece, entities involved in non-traditional SME financing include:

1. The New Economy Development Fund SA TANEO, which is financing SMEs in the form of equity financing by acquiring a minority participation in venture capital funds investing solely in innovative Greek SMEs.

2. The EIF, which, through its local fund managers, provides financing to Greek firms in the form of equity financing using resources from the Jeremie ICT-VC programmes (information and communication technologies and venture capital).

Chart D Rate of change in outstanding loans to SMEs*
(March-August 2014)

Source: Bank of Greece.
*Annualised four-month moving average.

3. The Institution for Growth in Greece (IfG), an umbrella fund with an initial capital of €200 million (€100 million from the Greek government and €100 million from the German state investment bank KfW) which, aside from financing SMEs in the form of loans and guarantees through its first sub-fund "IfG – Greek SME Finance S.A.", will also finance SMEs in the form of equity financing and other finance instruments.

4. The Athens Exchange, which, through its multilateral trading facility Alternative Market (EN.A) and its two distinct components (EN.A Plus and EN.A STEP), is supporting SME funding by offering SMEs the opportunity to raise capital from the broader investor community through the issuing of shares and bonds.

Apart from the already available non-traditional funding options, it is important that other options, already used abroad, be considered as well. They could include (a) the market of securitised business loans (relevant measures have already been included in the new European initiatives for SMEs); (b) crowdfunding and peer-to-peer lending, either of which allows legal entities to raise finance from the general public mainly via an Internet platform; and (c) private placement and mini-bond markets. Further action should also be taken to modernise the existing institutional framework in such a way as to provide incentives and protection for investors, as well as increase their access to financial information, which would in turn allow them to make risk-informed decisions.

10 Hybrids are a form of funding that combines lending-based and (occasionally) equity funding features, which is considered of higher risk than traditional funding, but still lower than equity funding. Examples of equity funding are: (a) subordinated debt (a form of loan- or bond-based financing which is repayable only after other debts have been repaid); (b) equity-related debt (a form of debt convertible into shares in the funded company, such as convertible bonds or bonds with warrants); and (c) profit participation mechanisms (an entitlement to future profits of the company.

Special feature VI.2

CHARACTERISTICS OF LARGE NON-PERFORMING CORPORATE LOANS

The present provides a brief overview of the main characteristics of corporate loans of over €1 million, based on end-2013 data. For our analysis, we have used a sample of about 16,000 borrowers, with a total exposure of €98.5 billion (corresponding to 54% of Greece's 2013 GDP at current prices). About 6,000 of these borrowers were found to be behind on their loan payments, with the amounts overdue totalling nearly €28.5 billion (15.6% of Greece's GDP for 2013).

Based on the main descriptive statistics of the non-performing loans (NPLs) in the sample, roughly three quarters of the borrowers had a total exposure of up to €5 million, while exposure levels were found to be negatively correlated with the NPL ratio. In other words, large-exposure borrowers tended, on average, to have a lower NPL ratio than their counterparts with an exposure of €1 to €5 million. In quantitative terms, however, the bulk of NPLs is concentrated in a relatively small number of borrowers, who in turn are concentrated in relatively few industries. Indicatively, about half of the NPLs are concentrated in a few hundred borrowers, half of whom were from just six industries (out of a total of 88 industries included in the two-digit statistical classification NACE Rev. 2).

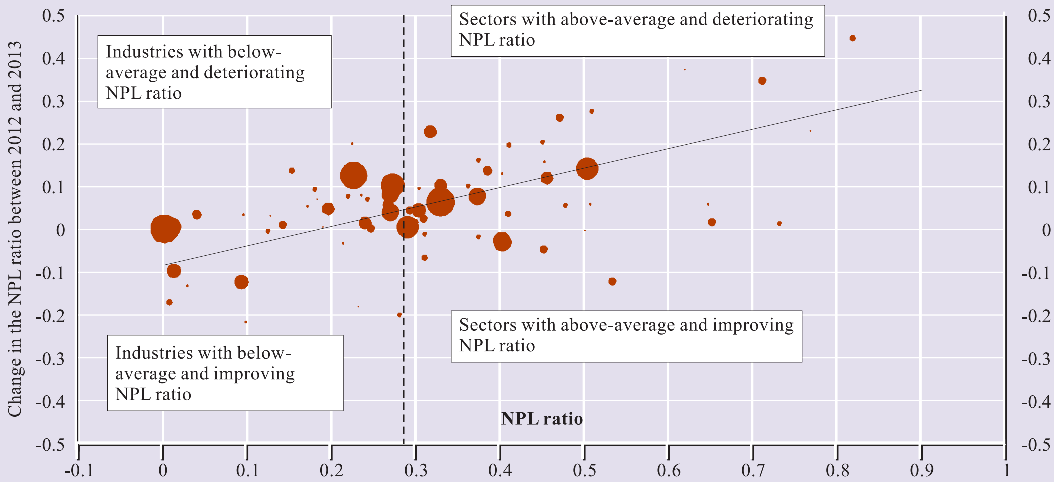
Another key feature of the loans in the sample was that nearly half of the NPLs have been outstanding for at least three years. *In this category too*, the NPLs were concentrated in a relatively small number of borrowers, from a small number of industries, mainly construction, wholesale and retail trade, accommodation, real estate activities, civil engineering, food industry, human health activities and the textiles industry. In fact, based on an analysis of financial statements (wherever relevant data were available), the financial statement dynamics showed that for most borrowers in this category the chances of them servicing their loans were slim.

As regards common borrowers with loans from more than one core banks, one-third of the NPLs in the sample involved about 800 common borrowers with NPLs amounting to roughly €11 billion. In fact, some of these borrowers even had NPLs with all four of Greece's core banks, worth roughly €3 billion. Moreover, borrowers with exposures to multiple banks were found to have a lower NPL ratio than borrowers who owed to just one bank.

In terms of industry distribution, 30 industries, with an absorption of 23% of total bank credit in the sample, had an NPL ratio of 38% to 91%, while another 28 industries, with an absorption of 58% of the total credit, had an NPL ratio of 21% to 37%. At the other end of the spectrum were 30 industries with an absorption of the remaining 19% of extended bank credit and an NPL ratio of 0% to 20%.

Two additional key characteristics were observed at industry level. First, the NPL ratio was found to be positively correlated to its annual rate of change (see Chart A). In other words, the industries with the highest NPL ratios were also the ones with the sharpest NPL ratio deterioration from 2012 to 2013, including a number of Greece's once larger borrower industries, as shown by the size of dots in Chart A. Second, in the industries with higher NPL ratios, troubled loans were concentrated in a relatively small number of borrowers (see Chart B), whereas in the industries with lower NPL ratios, troubled loans were found to be dispersed across a relatively large number of borrowers.

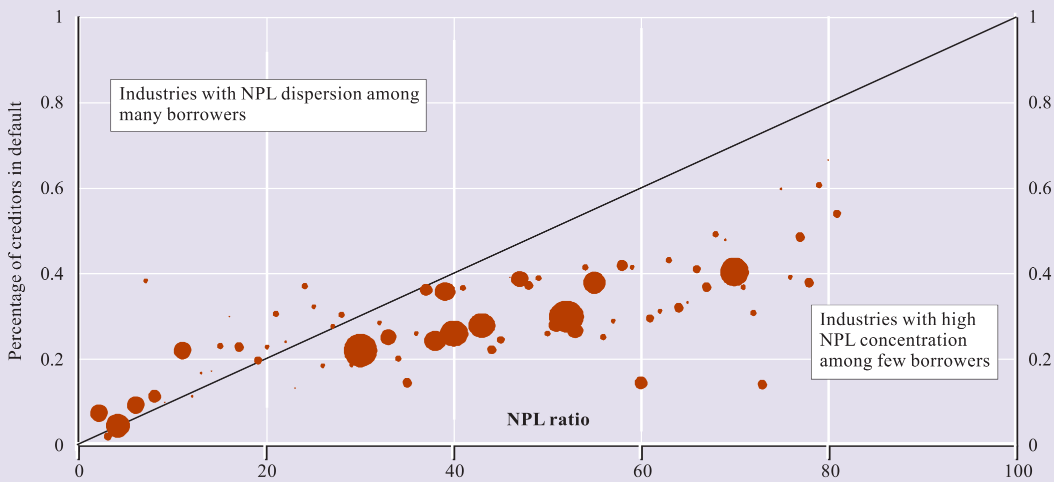
Chart A Non-performing loans (NPL) ratio and its changes



Source: Bank of Greece calculations.

More analytical data on NPLs are given at industry level in the table for 19 industries accounting for a total of 80% of NPLs in the sample. Most of the industries concerned have absorbed more than 1% of aggregate credit extended to all industries (column 8). Indications of the size of the problem in each industry are given by the NPL ratio (column 2) and by the percentage of borrowers with NPLs within each industry as at end-2013 (column 5). The problem is aggravated in nearly all industries from end-2012 to end-2013 with very few exceptions, as shown by the change in the NPL ratio (column 3). The year-on-year change in the percentage of borrowers with NPLs

Chart B Ratio of non-performing loans (NPLs) to total loans and percentage of creditors in default per sector



Source: Bank of Greece calculations.

Sectoral NPL profiles

Sector (1)	Ratio of NPLs to total loans (2013) (2)	Change in the NPL ratio between 2012 and 2013 (3)	Percentage of NPLs throughout the 2011-2013 period (4)	Percentage of creditors with NPLs per sector in 2013 (5)	Change in the percentage of creditors with NPLs per sector between 2012 and 2013 (6)	Degree of borrower concentra-tion (7)=(2)-(5)	Share of loans to sector's enterprises to the total of loans to all sectors of the sample (8)	Outstand-ing balance of NPLs at end-2013 (in million euro) (9)
Construction of buildings	50.86%	14.23%	66.27%	42.47%	7.63%	8.39%	6.64%	3,317,034
Wholesale trade, except of motor vehicles and motorcycles	33.48%	6.49%	54.55%	31.15%	4.94%	2.33%	9.92%	3,261,797
Water transport	23.24%	12.62%	0.00%	23.99%	11.44%	-0.75%	8.89%	2,029,834
Real estate activities	27.78%	10.37%	16.40%	28.52%	9.60%	-0.74%	7.18%	1,959,073
Accommodation	29.58%	0.62%	30.58%	31.24%	2.78%	-1.66%	6.43%	1,867,416
Civil engineering	37.83%	7.69%	56.98%	40.44%	3.13%	-2.61%	3.95%	1,467,855
Food service activities	27.46%	4.01%	58.25%	26.41%	1.66%	1.05%	4.26%	1,148,586
Retail trade, except of motor vehicles and motorcycles	27.57%	8.20%	53.51%	38.29%	6.02%	-10.71%	3.84%	1,039,371
Wholesale and retail trade and repair of motor vehicles and motorcycles	30.93%	4.46%	52.56%	40.75%	5.84%	-9.81%	2.52%	764,338
Undifferentiated goods- and services-producing activities of private households for own use	33.51%	10.34%	0.00%	29.51%	7.55%	4.00%	2.14%	705,153
Financial and insurance activities	32.31%	22.77%	7.23%	29.38%	14.65%	2.94%	2.20%	699,170
Fishing and aquaculture	82.19%	44.71%	13.30%	55.21%	21.06%	26.98%	0.71%	575,322
Human health activities	24.50%	1.47%	53.62%	27.35%	4.34%	-2.84%	2.30%	553,726
Manufacture of textiles	65.62%	1.70%	73.89%	48.74%	3.37%	16.88%	0.85%	548,388
Manufacture of chemicals and chemical products	40.85%	-2.82%	78.96%	15.31%	0.45%	25.54%	1.29%	518,584
Manufacture of basic pharma-ceutical products and pharma-ceutical preparations	53.86%	-12.06%	94.74%	14.16%	-3.13%	39.71%	0.89%	472,281
Other professional, scientific and technical activities	47.64%	26.07%	25.33%	39.88%	10.73%	7.75%	0.96%	447,642
Manufacture of other non-metallic mineral products	39.07%	13.75%	66.23%	42.82%	5.90%	-3.75%	1.09%	417,043
Manufacture of fabricated metal products, except machinery and equipment	27.20%	5.83%	60.78%	38.05%	2.92%	-10.85%	1.54%	411,227

at end-2013 (column 6) implies that the problem is, in many cases, rapidly spreading to other companies within the same industry. In 12 of the 19 industries, more than half of all NPLs had been overdue for at least three years (see column 4). Lastly, column 7 shows the concentration of borrowers with NPLs by industry. Positive values indicate a high concentration of NPLs in a small number of borrowers, while negative values indicate a high dispersion of NPLs across a large number of borrowers. Based on the percentages given in the table, six industries have a high concentration of NPLs in a relatively small number of borrowers.

In conclusion, the NPLs of large debtors are concentrated in a relatively small number of industries, while several industries have a high concentration of NPLs in a relatively small number of borrowers. Technically speaking, strong concentration can make NPL management easier, provided that credit institutions have an appropriate institutional and bankruptcy framework to draw on that facilitates, simplifies and speeds up pre-court or in-court settlement. Given that delays tend to be worse in industries with an already high share of NPLs, priority should be given to addressing the problem in these industries so as to reduce the risk of contagion to healthy companies.

Special feature VI.3

THE MACRO-PRUDENTIAL MANDATE OF THE BANK OF GREECE

Under Article 55A of its Statute (10th Edition, 2013), the Bank of Greece *"shall exercise, inter alia, its macro-prudential tasks with a view to strengthening the resilience of the financial system and decreasing the build-up of systemic risks. In particular, the Bank shall identify, monitor and assess such risks and adopt the measures provided for by law"*. The Bank of Greece assumed this responsibility in accordance with Recommendation of the European Systemic Risk Board of 22 December 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3). The macro-prudential mandate consists in the conduct of macro-prudential policy with the ultimate objective of contributing to the safeguard of the stability of the financial system as a whole, by strengthening its resilience and decreasing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.

In fulfilling its macro-prudential mandate, the Bank of Greece follows the Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1). These intermediate objectives include:

a. appropriately regulating credit growth and leverage, including mitigating and preventing any excessive credit growth and leverage;
b. preventing and mitigating excessive maturity mismatch and market illiquidity;
c. limiting direct and indirect exposure concentrations;
d. limiting the systemic impact of misaligned incentives with a view to reducing moral hazard;
e. strengthening the resilience of financial infrastructures.

By Law 4261/2014,[1] transposing Directive 2013/36/EU[2] into national legislation, the Bank of Greece was specified as the "designated authority"[3] responsible for a set of macro-prudential instruments, which may be used to achieve the ultimate and intermediate macro-prudential policy objectives. Such instruments are the setting of the countercyclical buffer rate, the requirement to maintain a systemic risk buffer and the measures provided for by Article 458 of Regulation (EU) No. 575/2013.[4]

1 Law 4261/2014 re: "Access to the activity of credit institutions and prudential supervision of credit institutions and investment firms (transposition of Directive 2013/36/EU), repeal of Law 3601/2007, and other provisions".
2 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.
3 According to Directive 2013/36/EU, each Member State shall designate a public authority or body ("designated authority") that is responsible for setting the countercyclical buffer rate for that Member State. The designated authority may also be entrusted by the Member State with the application of other macroprudential instruments among those envisaged by Directive 2013/36/EU and Regulation (EU) No. 575/2013.
4 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

Special feature VI.4

THE YIELD CURVE OF GREEK GOVERNMENT BONDS

The continuous improvement in the valuation of outstanding Greek government bonds from the second half of 2012 until the last quarter of 2014 enabled the issuance of new 3- and 5-year bonds on 10 April and 10 July 2014, respectively. These issues were tangible proof of growing confidence among international and domestic investors towards the prospects of the Greek economy, as well as the continuation of fiscal adjustment and structural reform policies in Greece. Thus, the successful bond issues contributed to a further improvement in the valuation of Greek government bonds as a whole.

Expectations about Greek government bond yields are a key factor behind a decision on future bond issuance. Expectations can be modelled using econometric tools in line with international literature, which enable a dynamic determination of the yield curve, capturing the factors that underlie the valuation of bonds all along the term structure. This Special feature presents a third-degree polynomial model, estimated recursively on the basis of non-parametric models of the yield curve.[1] Introducing time-variation, allows the dynamic estimation of the parameters of the Greek government bond yield curve. The bond yields estimated at weekly frequency for each maturity are shown in Chart A.

The estimation of the Greek government bond yield curve for a continuous set of maturities suggests that the 5-year bond issue was a successful one, not only because it was the first medium-term funding since 2010, but also because it led to the normalisation of the Greek government bond yield curve. Moreover, the subsequent downward shift of the curve, i.e. the decline in yields across the full spectrum of maturities, is associated with improved investor confidence in the Greek economy. In this respect, it is worth noting that yields continued to decline through September, despite the heightened volatility in the bonds of vulnerable euro area countries, mainly reflecting concerns about the growth prospects of the euro area, while a surge in yields was observed in October, when uncertainty in the Greek bond market increased sharply.

Consequently, there is evidence of strong confidence effects on Greek government bond yields across the term structure. Thus, by estimating the parameters of the yield curve, i.e. its slope and level, as a function of factors relating to domestic and European developments, it is possible to determine the factors that affect the movements of the curve. It should be pointed out that the level of the curve (first-degree parameter) refers to the level of interest rates, while the slope of the curve (second-degree parameter) refers to the relationship between yields for different maturities. Furthermore, an additional (third-degree) parameter is used for estimating the yield curve, i.e. curvature, which refers to the relationship between different maturity segments of the curve.

The slope and level parameters were used to estimate the effect of different explanatory variables that are related to the prevailing conditions of confidence in the Greek and the European economies, the yields on euro area low-rated corporate bonds and the level of systemic risk in euro area stock exchanges. Chart B illustrates the causality between confidence[2] in the Greek economy and the yield curve parameters. The results of the econometric estimation using a VAR model

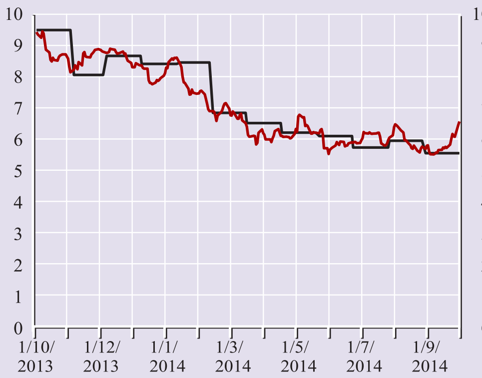
1 Based on the model of Diebold and Li (2006), "Forecasting the term structure of government bond yields", *Journal of Econometrics*, 130, 337-364.
2 As captured by the industrial confidence indicator, which is a component of the economic sentiment indicator.

Chart A Estimated yield curve of Greek government bonds (1 October 2013-1 October 2014)

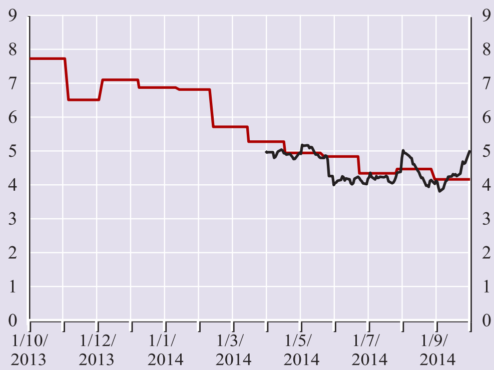
(daily data, percentage points)

estimated yields
actual yields

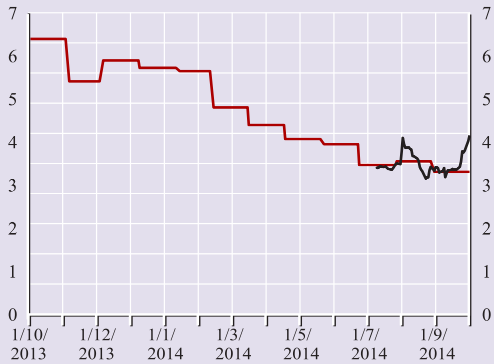
10-year bonds



5-year bonds



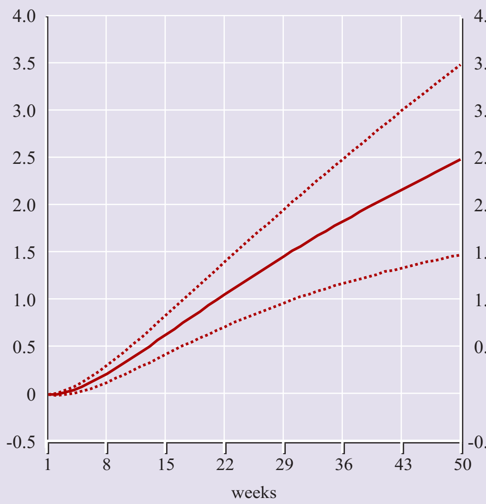
3-year bonds



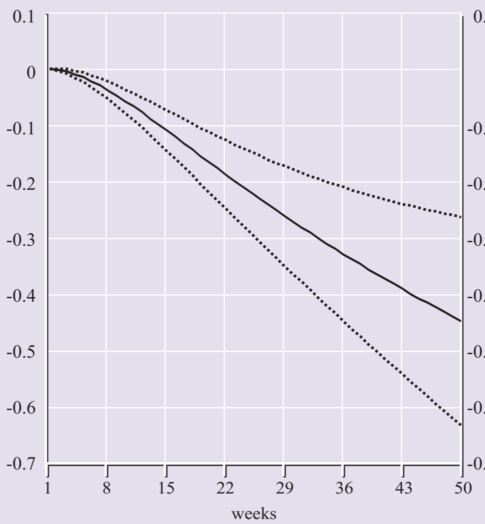
Source: Econometric estimates, Bank of Greece.
Note: The charts show the segments of the yield curve estimated with a weekly rolling window using a third-degree polynomial model (see Diebold and Li, 2006).

Chart B Impulse response functions, accumulated

Slope parameter



Level parameter



Source: Econometric estimates, Bank of Greece.

suggest a significant causal relationship between confidence in the Greek economy and the evolution of yields on the entire Greek bond curve.

Indicatively, a permanent increase (decrease) of 5 points in the business confidence indicator for Greece (September 2014 value: 95.3) is expected to reduce (elevate) the level of the yield curve by 50 basis points and steepen its slope, thereby leading to a widening of the yield differential between 10-year and 3-year bonds to 375 b.p. after one year (from 255 b.p. on 1.10.2014). It should be noted that the steeper slope of the yield curve signals an improvement in expectations for a strengthening of economic activity. Moreover, a permanent improvement of 5 basis points in the business confidence indicator would bring about a permanent decline in the 10-year bond yield to levels below 6%. Conversely, with a permanent decline of 5 points in the business confidence indicator (to the levels prevailing in the first quarter of 2014), the 10-year Greek government bond yield would come close to 11% and the slope of the curve would flatten by about 100 basis points. Therefore, the factors that shape the conditions of confidence in the Greek economy strongly affect market-based financing conditions, as captured by yields across the entire maturity spectrum of the Greek government bond yield curve.

MONETARY POLICY MEASURES OF THE EUROSYSTEM

17 JUNE 2014

The Governing Council of the ECB, in cooperation with the Bank of England, the Bank of Japan and the Swiss National Bank, decided to extend the conduct of one-week liquidity provision operations in US dollars beyond 31 July 2014, which was the deadline according to an earlier announcement (24 January 2014). The operations take the form of repurchase transactions against eligible collateral and are carried out as fixed-rate tenders with full allotment.

3 JULY 2014

The ECB announced that, as from January 2015, Governing Council meetings dedicated to monetary policy will be held with a new frequency of six weeks. Non-monetary policy meetings will continue to be held at least once a month. It was also decided that reserve maintenance periods will be extended to six weeks (instead of four) in order to match the new frequency of conduct of monetary policy meetings.

As from January 2015, the ECB will publish regular accounts of the Governing Council's monetary policy meetings.

The Governing Council of the ECB decided on technical details regarding targeted longer-term refinancing operations, announced on 5 June 2014. These operations are designed to enhance the functioning of the monetary policy transmission mechanism by supporting bank lending to the real economy. Banks will be able to borrow up to 7% of a specific part of their loans in two operations in September and December 2014. After this, banks will be able to raise additional funds up three times the difference between the net lending (i.e. lending to real economy since April 2014) and the benchmark at the time it is claimed. The benchmark is set at zero for the banks that will have exhibited positive eligible net lending in the twelve-month period up to 30 April 2014. For the remaining banks the benchmark is connected to the average monthly net lending in the twelve month period up to 30 April 2014. The banks that borrow in the targeted longer-term refinancing operations but fail to achieve their benchmarks as at 30 April 2016 will be required to pay back their borrowings in full in September 2016. At the same time, the banks participating in longer-term refinancing operations are subject to the obligation to report additional information to the Eurosystem with regard to their loan portfolios. The initial targeted longer-term refinancing operations will be conducted on 18 September and on 11 December 2014 and the other operations in March, June, September and December 2015 and in March and June 2016.

4 SEPTEMBER 2014

The Governing Council of the ECB decided to reduce the interest rate on the main refinancing operations by 10 points to 0.05%, starting from the operation to be settled on 10 September 2014. Also, the interest rate on the marginal lending facility and the interest rate on the deposit facility will be decreased by 10 basis points to 0.30% and -0.20% respectively. At the same time, the Governing Council of the ECB decided, starting with the fourth quarter of 2014, the purchase of (i) asset backed securities and (ii) covered bonds issued by euro area credit institutions.

The Governing Council of the ECB decided to modify the loan-level reporting requirements for asset-backed securities backed by consumer loans, leasing and credit cards, which are used as collateral in Eurosystem monetary policy operations. As of October 2014, such securities for which the mandatory level of compliance with reporting requirements has not been attained and for which the data provider has not given an explanation for that non-compliance nor has he provided an action plan for achieving compliance, will become ineligible for use as Eurosystem collateral. The Governing Council of the ECB may temporarily accept as collateral securities that do not fulfill the reporting requirements, on a case-by-case basis and subject to the provision of explanations for the failure to achieve the mandatory score required.

2 OCTOBER 2014

The Governing Council of the ECB decided on the operation details of the asset-backed securities and the covered bonds purchase programmes. The Eurosystem collateral framework will be the guiding principle for the eligibility of assets to be purchased. ABSs and covered bonds from Greece and Cyprus that are currently not eligible as collateral for monetary policy operations will be subject to specific rules. The two programmes will last for at least two years, starting in the fourth quarter of 2014.

7 NOVEMBER 2014

The Governing Council of the ECB decided to suspend repayments of the three-year longer-term refinancing operations during the year-end period. The last repayment of 2014 will be settled on 23 December. Repayments will resume on 14 January.

19 NOVEMBER 2014

The Governing Council of the ECB after taking into account: a) that the minimum credit rating is not applied on marketable debt instruments issued or fully guaranteed by the central government of a euro area member country which is subject to a programme of the European Union and the International Monetary Fund and b) the fact that market conditions for the Greek tradable assets have improved, decided to reduce valuation haircuts applicable to marketable debt instruments issued or fully guaranteed by the Hellenic Republic.

STATISTICAL APPENDIX

TABLES

Table 1 Consumer price index: general index and basic sub-indices

Period		General index		Goods		Services		CPI excluding fresh fruit/vegetables and fuel		CPI excluding food and fuel	
		(2009=100)	Percentage change over previous year	(2009=100)	Percentage change over previous year	(2009=100)	Percentage change over previous year	(2009=100)	Percentage change over previous year	(2009=100)	Percentage change over previous year
2010		104.7	4.7	105.6	5.6	103.6	3.6	103.0	3.0	103.4	3.4
2011		108.2	3.3	110.0	4.2	105.9	2.3	104.6	1.5	104.8	1.3
2012		109.8	1.5	112.5	2.2	106.5	0.5	105.0	0.3	104.9	0.1
2013		108.8	-0.9	112.6	0.1	104.1	-2.2	103.2	-1.7	102.9	-1.9
2013	I	108.7	0.0	111.5	1.3	105.2	-1.6	102.7	-1.3	102.3	-1.5
	II	110.2	-0.5	114.7	0.7	104.5	-2.1	104.5	-1.5	104.4	-1.7
	III	107.9	-1.0	111.2	0.2	103.8	-2.6	102.2	-2.0	101.7	-2.3
	IV	108.5	-2.2	112.8	-1.9	103.1	-2.5	103.2	-2.1	103.0	-2.4
2014	I	107.2	-1.3	110.9	-0.5	102.7	-2.4	101.7	-1.0	101.1	-1.2
	II	108.6	-1.5	113.0	-1.5	103.0	-1.5	103.2	-1.2	103.0	-1.4
	III	107.3	-0.6	110.7	-0.4	102.9	-0.9	102.1	0.0	101.6	-0.1
2012	Jan.	108.7	2.3	110.0	2.7	107.2	1.8	104.6	1.3	104.4	1.0
	Feb.	107.1	2.1	107.3	2.8	106.8	1.2	102.4	0.9	101.9	0.6
	March	110.1	1.7	112.8	2.1	106.8	1.1	105.2	0.5	105.3	0.2
	Apr.	111.1	1.9	114.5	2.6	106.7	1.0	106.1	0.9	106.3	0.7
	May	110.7	1.4	113.9	1.8	106.7	0.9	106.0	0.7	106.2	0.4
	June	110.4	1.3	113.3	1.6	106.7	0.9	106.0	0.6	106.2	0.4
	July	108.9	1.3	110.7	1.7	106.7	0.8	104.4	0.6	104.3	0.5
	Aug.	107.8	1.7	108.6	2.4	106.8	0.9	102.7	0.5	102.2	0.4
	Sept.	110.4	0.9	113.7	1.7	106.3	-0.1	105.7	-0.3	105.8	-0.5
	Oct.	111.3	1.6	115.6	3.1	106.0	-0.4	105.7	-0.3	105.7	-0.5
	Nov.	110.8	1.0	114.7	2.1	105.9	-0.5	105.5	-0.5	105.5	-0.7
	Dec.	110.5	0.8	114.6	2.3	105.4	-1.2	105.3	-0.6	105.3	-0.8
2013	Jan.	109.0	0.2	111.8	1.6	105.5	-1.6	103.3	-1.2	103.0	-1.4
	Feb.	107.2	0.1	108.8	1.4	105.1	-1.6	101.0	-1.4	100.2	-1.6
	March	109.9	-0.2	113.9	1.0	104.9	-1.7	103.9	-1.2	103.8	-1.4
	Apr.	110.4	-0.6	115.0	0.4	104.7	-1.9	104.7	-1.2	104.7	-1.4
	May	110.2	-0.4	114.7	0.7	104.6	-1.9	104.5	-1.4	104.4	-1.6
	June	109.9	-0.4	114.6	1.1	104.1	-2.4	104.1	-1.7	104.1	-1.9
	July	108.1	-0.7	111.4	0.7	104.0	-2.5	102.3	-2.0	101.9	-2.3
	Aug.	106.4	-1.3	108.4	-0.2	103.9	-2.7	100.5	-2.1	99.7	-2.5
	Sept.	109.2	-1.1	113.8	0.1	103.4	-2.8	103.7	-1.9	103.6	-2.1
	Oct.	109.1	-2.0	113.9	-1.5	103.2	-2.6	103.8	-1.8	103.7	-1.9
	Nov.	107.6	-2.9	111.3	-3.0	103.1	-2.7	102.5	-2.9	102.1	-3.3
	Dec.	108.6	-1.7	113.2	-1.2	102.9	-2.3	103.4	-1.8	103.2	-1.9
2014	Jan.	107.4	-1.5	111.1	-0.5	102.6	-2.7	101.9	-1.4	101.3	-1.6
	Feb.	105.9	-1.1	108.6	-0.2	102.6	-2.4	100.4	-0.6	99.5	-0.8
	March	108.4	-1.3	113.0	-0.8	102.7	-2.2	102.9	-1.0	102.7	-1.1
	Apr.	108.9	-1.3	113.8	-1.0	102.8	-1.8	103.4	-1.3	103.3	-1.4
	May	108.1	-2.0	112.1	-2.2	103.0	-1.6	102.7	-1.7	102.4	-2.0
	June	108.7	-1.1	113.3	-1.2	103.1	-1.0	103.4	-0.7	103.3	-0.7
	July	107.4	-0.7	110.8	-0.5	103.1	-0.9	102.1	-0.2	101.7	-0.2
	Aug.	106.1	-0.3	108.6	0.2	102.9	-1.0	101.0	0.4	100.1	0.4
	Sept.	108.3	-0.8	112.8	-0.9	102.7	-0.7	103.3	-0.4	103.1	-0.5
	Oct.	107.3	-1.7	111.1	-2.4	102.5	-0.7	103.0	-0.8	102.8	-0.9

Source: Calculations based on ELSTAT data.

Table 2 Balance of payments

(million euro)

	January-December			January-September		
	2011	2012	2013	2012	2013	2014
I CURRENT ACCOUNT (I.A+I.B+I.C+I.D)	**-20,633.5**	**-4,615.0**	**1,088.5**	**-2,806.2**	**2,401.7**	**3,753.3**
I.A TRADE BALANCE (I.A.1–I.A.2)	***-27,229.1***	***-19,619.0***	***-17,229.4***	***-15,651.8***	***-12,893.0***	***-13,591.4***
Oil trade balance	-11,126.9	-10,220.0	-7,697.5	-8,165.1	-6,017.3	-5,883.6
Non-oil trade balance	-16,102.1	-9,399.1	-9,531.9	-7,486.7	-6,875.6	-7,707.8
Ship balance	-3,261.2	-1,042.6	-1,483.3	-829.4	-932.6	-1,827.2
Trade balance excl. oil and ships	-12,840.9	-8,356.4	-8,048.7	-6,657.3	-5,943.0	-5,880.6
I.A.1 Exports of goods	*20,230.6*	*22,020.6*	*22,534.8*	*16,090.9*	*16,842.0*	*17,554.5*
Oil	6,187.7	7,426.4	7,941.2	5,471.7	6,110.4	6,247.2
Ships (receipts)	754.7	737.8	443.0	603.3	350.4	465.5
Other goods	13,288.2	13,856.5	14,150.7	10,015.9	10,381.6	10,841.7
I.A.2 Imports of goods	*47,459.6*	*41,639.7*	*39,764.2*	*31,742.7*	*29,735.1*	*31,145.9*
Oil	17,314.6	17,646.3	15,638.7	13,636.6	12,127.6	12,130.9
Ships (payments)	4,015.9	1,780.4	1,926.2	1,432.7	1,283.1	2,292.7
Other goods	26,129.1	22,213.0	22,199.3	16,673.3	16,324.6	16,722.3
I.B SERVICES BALANCE (I.B.1–I.B.2)	***14,629.6***	***15,138.9***	***16,978.9***	***12,920.6***	***14,315.2***	***16,790.3***
I.B.1 Receipts	*28,609.2*	*27,526.4*	*27,959.5*	*22,282.0*	*22,593.2*	*25,217.1*
Travel	10,504.7	10,442.5	12,152.2	9,359.7	10,819.2	12,020.1
Transport	14,096.6	13,287.4	12,089.9	10,185.5	9,050.3	9,805.1
Other services	4,007.9	3,796.5	3,717.4	2,736.8	2,723.7	3,391.8
I.B.2 Payments	*13,979.6*	*12,387.4*	*10,980.6*	*9,361.4*	*8,277.9*	*8,426.7*
Travel	2,266.5	1,843.9	1,835.2	1,450.1	1,412.2	1,547.2
Transport	7,234.4	6,328.0	5,553.0	4,749.7	4,185.9	3,878.7
Other services	4,478.7	4,215.5	3,592.4	3,161.4	2,679.8	3,000.9
I.C INCOME BALANCE (I.C.1–I.C.2)	***-8,594.8***	***-1,566.4***	***-3,127.2***	***-1,637.8***	***-2,665.5***	***-2,235.9***
I.C.1 Receipts	*3,322.1*	*3,832.2*	*3,423.0*	*2,861.2*	*2,581.8*	*2,625.8*
Compensation of employees	188.0	200.8	209.3	145.8	155.4	156.7
Investment income	3,134.1	3,631.4	3,213.7	2,715.3	2,426.5	2,469.1
I.C.2 Payments	*11,916.9*	*5,398.6*	*6,550.2*	*4,499.1*	*5,247.3*	*4,861.8*
Compensation of employees	470.0	468.0	453.0	350.4	344.8	341.9
Investment income	11,447.0	4,930.7	6,097.1	4,148.6	4,902.3	4,519.9
I.D CURRENT ACCOUNT (I.D.1–I.D.2)	***560.8***	***1,431.5***	***4,466.2***	***1,562.9***	***3,644.9***	***2,790.4***
I.D.1 Receipts	*4,435.0*	*5,125.6*	*7,687.8*	*4,503.0*	*6,323.9*	*5,067.8*
General government (mainly transfers from the EU)	3,254.9	4,060.2	6,410.6	3,688.4	5,319.0	4,215.5
Other sectors	1,180.1	1,065.4	1,277.3	814.6	1,005.1	852.3
I.D.2 Payments	*3,874.2*	*3,694.1*	*3,221.6*	*2,940.0*	*2,679.1*	*2,277.4*
General government (mainly payments to the EU)	2,485.4	2,647.9	2,433.0	2,096.7	2,079.1	1,692.1
Other sectors	1,388.8	1,046.2	788.6	843.5	600.1	585.3
II CAPITAL ACCOUNT (II.1– II.2)	**2,671.8**	**2,327.6**	**3,040.8**	**1,582.6**	**2,782.2**	**1,789.2**
II.1 Receipts	*2,932.7*	*2,564.6*	*3,380.6*	*1,757.2*	*3,039.4*	*2,042.8*
General government (mainly transfers from the EU)	2,798.5	2,486.0	3,298.9	1,698.9	2,977.8	1,988.2
Other sectors	134.2	78.6	81.7	58.5	61.7	54.6
II.2 Payments	*260.8*	*237.1*	*339.8*	*174.5*	*257.2*	*253.5*
General government (mainly payments to the EU)	12.7	13.7	9.7	12.0	3.8	7.7
Other sectors	248.1	223.3	330.1	162.3	253.5	245.9
III CURRENT ACCOUNT AND CAPITAL ACCOUNT (I+II)	**-17,961.7**	**-2,287.5**	**4,129.3**	**-1,223.2**	**5,184.0**	**5,542.6**
IV FINANCIAL ACCOUNT (IV.A+IV.B+IV.C+IV.D)	**17,838.1**	**2,658.2**	**-3,299.5**	**2,561.2**	**-4,023.1**	**-3,952.0**
IV.A DIRECT INVESTMENT [1]	***-452.6***	***827.1***	***2,713.6***	***897.7***	***1,174.2***	***743.0***
Abroad	-1,274.9	-527.3	591.5	-233.0	798.8	-421.8
Home	822.3	1,354.3	2,122.2	1,130.5	375.4	1,164.8
IV.B PORTFOLIO INVESTMENT [1]	***-19,778.3***	***-99,903.9***	***-6,583.1***	***-75,584.1***	***-7,497.7***	***-793.3***
Assets	4,139.0	-58,086.1	1,023.6	-39,225.9	1,155.9	-5,762.5
Liabilities	-23,917.3	-41,817.8	-7,606.7	-36,358.3	-8,653.8	4,969.2
IV.C OTHER INVESTMENT [1]	***38,050.0***	***101,744.1***	***677.0***	***77,262.8***	***2,358.2***	***-3,438.7***
Assets	7,638.7	13,863.4	17,491.9	13,191.0	15,699.4	1,968.9
Liabilities	30,411.3	87,880.7	-16,814.9	64,071.9	-13,341.1	-5,407.6
(General government loans)	*39,873.9*	*109,093.9*	*30,061.2*	*75,124.8*	*30,624.2*	*5,997.9*
IV.D CHANGE IN RESERVE ASSETS [2]	***19.0***	***-9.0***	***-107.0***	***-15.0***	***-58.0***	***-463.0***
V ERRORS AND OMISSIONS	**123.6**	**-370.8**	**-829.8**	**-1,337.8**	**-1,160.6**	**-1,590.5**
RESERVE ASSETS [3]	***5,332.0***	***5,500.0***	***4,172.0***	***5,941.0***	***4,559.0***	***5,015.0***

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 3 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[2]	Breakdown by currency: In other currencies	Breakdown by type: Sight deposits[2]	Breakdown by type: Savings deposits	Breakdown by type: Time deposits
2009		237,342	217,258	20,084	26,140	75,811	135,391
2010		209,522	191,989	17,533	22,865	66,706	119,951
2011		174,137	160,789	13,348	19,601	53,439	101,097
2012		161,373	149,975	11,398	18,173	44,844	98,357
2013		163,052	153,682	9,369	20,500	44,566	97,986
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	174,787	13,788	20,211	58,493	109,871
	Sept.	183,128	169,563	13,565	19,615	56,210	107,304
	Oct.	176,323	163,782	12,541	19,202	54,699	102,422
	Nov.	172,759	160,232	12,527	18,695	53,236	100,828
	Dec.	174,137	160,789	13,348	19,601	53,439	101,097
2012	Jan.	168,873	156,194	12,679	17,468	52,178	99,227
	Feb.	164,308	152,078	12,229	17,014	50,621	96,673
	March	165,283	152,988	12,295	16,593	49,077	99,613
	Apr.	165,877	153,387	12,490	17,230	49,317	99,330
	May	157,367	145,599	11,768	16,679	48,459	92,229
	June	150,513	139,435	11,078	15,982	46,543	87,988
	July	153,825	142,488	11,336	16,174	46,129	91,522
	Aug.	153,328	142,185	11,143	15,490	45,545	92,292
	Sept.	154,246	143,326	10,920	15,949	45,154	93,143
	Oct.	155,190	144,231	10,959	15,830	44,533	94,827
	Nov.	155,816	144,912	10,904	15,997	43,718	96,100
	Dec.	161,373	149,975	11,398	18,173	44,844	98,357
2013	Jan.	160,897	150,354	10,543	16,014	43,590	101,293
	Feb.	163,948	153,044	10,904	15,813	43,509	104,625
	March	163,954	153,252	10,703	16,155	43,417	104,382
	Apr.	162,177	152,438	9,739	16,789	43,492	101,896
	May	163,300	153,477	9,822	16,979	43,298	103,023
	June	162,563	152,854	9,709	17,455	43,533	101,575
	July	162,275	152,725	9,550	17,467	44,028	100,780
	Aug.	162,050	152,444	9,606	17,523	44,428	100,099
	Sept.	161,201	151,934	9,267	18,007	44,131	99,063
	Oct.	160,230	151,127	9,103	17,531	43,833	98,866
	Nov.	160,870	151,817	9,053	18,072	43,797	99,001
	Dec.	163,052	153,682	9,369	20,500	44,566	97,986
2014	Jan.	160,822	151,487	9,335	17,962	43,637	99,223
	Feb.	160,378	151,311	9,068	17,672	43,282	99,424
	March	160,830	151,723	9,107	18,407	42,991	99,432
	Apr.	161,141	152,155	8,986	19,041	42,940	99,160
	May	161,911	152,436	9,475	18,983	42,914	100,014
	June	162,834	153,195	9,638	20,512	43,137	99,185
	July	162,980	153,384	9,596	19,732	42,971	100,277
	Aug.	164,001	154,538	9,464	19,882	43,411	100,708
	Sept.	164,510	154,433	10,077	20,581	43,106	100,823
	Oct.	164,251	154,141	10,110	20,258	43,192	100,802

Source: Bank of Greece.
1 Other Monetary Financial Institutions (OMFIs) comprise credit institutions (other than the Bank of Greece) and money market funds.
2 Including electronic money.

Table 4 Greek government bond yields

(percentages per annum; period averages)

Period		3-year	5-year	7-year	10-year	15-year	20-year	30-year
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
2011		26.18	22.88	18.97	15.75	12.97		10.72
2012					22.50	20.23	19.04	17.84
2013					10.05	10.24	9.86	9.10
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
	Nov.	34.08	29.31	22.50	17.92	14.20		13.76
	Dec.	45.88	34.85	26.90	21.14	16.71		14.85
2012	Jan.	68.08	47.04	41.84	25.91	20.10		16.91
	Feb.	77.65	50.35	44.05	29.24	21.51		17.28
	March[1]				19.06	17.91	16.90	15.59
	Apr.				21.48	20.18	18.63	17.11
	May				26.90	24.50	22.59	21.37
	June				27.82	25.36	24.32	23.09
	July				25.82	24.58	23.39	22.26
	Aug.				24.34	22.73	21.10	20.33
	Sept.				20.91	20.30	18.96	18.54
	Oct.				17.96	17.34	16.79	15.98
	Nov.				17.20	15.85	15.62	14.50
	Dec.				13.33	12.37	12.13	11.18
2013	Jan.				11.10	10.66	10.28	9.51
	Feb.				10.95	10.63	10.39	9.42
	March				11.38	11.35	10.89	9.88
	Apr.				11.58	11.60	10.85	9.87
	May				9.07	9.48	9.03	8.42
	June				10.07	10.19	9.59	9.06
	July				10.53	11.06	10.37	9.44
	Aug.				10.01	10.47	10.13	9.25
	Sept.				10.15	10.53	10.11	9.21
	Oct.				8.74	9.16	9.03	8.43
	Nov.				8.41	8.90	8.89	8.38
	Dec.				8.66	8.87	8.76	8.32
2014	Jan.				8.18	8.44	8.35	7.98
	Feb.				7.70	7.88	7.77	7.41
	March				6.90	7.08	7.06	6.78
	Apr.		4.92		6.20	6.43	6.49	6.30
	May		4.95		6.38	6.64	6.82	6.71
	June		4.25		5.93	6.50	6.59	6.32
	July	3.42	4.17		6.10	6.78	6.77	6.50
	Aug.	3.63	4.45		6.09	6.90	6.95	6.66
	Sept.	3.48	4.26		5.89	6.54	6.62	6.59
	Oct.	5.33	5.88		7.26	8.13	8.03	7.57

Source: Bank of Greece.
1 On 12 March 2012, after the completion of the exchange of the Greek government bonds under the PSI, the new bonds were admitted to trading.

Table 5 Domestic MFI loans to the domestic private sector by branch of economic activity[1,2]

(balances in million euro; not seasonally adjusted)

End of period		Grand total	Firms							Individuals and private non-profit insitutions			
				Non-financial corporations				Other financial institu-tions and insurance compa-nies	Sole pro-prietors and unincor-porated partner-ships				
					of which								
			Total	Total	Industry	Trade	Shipping			Total	Housing	Con-sumer credit	Other
2009		249,677	130,043	123,821	22,790	33,519	10,031	6,222		119,635	80,559	36,044	3,032
2010		257,846	123,244	116,514	24,269	25,355	17,498	6,730	16,483	118,119	80,507	35,081	2,532
2011		248,535	120,126	113,045	23,405	24,687	18,008	7,081	15,359	113,050	78,393	32,985	1,672
2012		227,655	107,335	100,758	22,162	22,168	12,442	6,577	13,790	106,530	74,634	30,236	1,660
2013		217,920	103,204	96,610	21,481	20,038	11,838	6,593	13,888	100,827	71,055	28,382	1,390
2011	Jan.	256,852	122,894	116,347	24,658	25,125	17,485	6,548	16,465	117,493	80,128	34,884	2,480
	Feb.	256,737	122,999	116,484	24,698	25,134	17,356	6,516	16,450	117,288	80,028	34,702	2,558
	March	255,374	122,173	115,794	24,854	25,407	16,983	6,379	16,355	116,846	79,823	34,454	2,569
	Apr.	253,703	121,175	114,880	25,115	25,279	16,273	6,295	16,170	116,358	79,718	34,060	2,580
	May	253,193	120,934	114,935	24,918	25,266	16,944	6,000	16,032	116,227	79,794	33,811	2,622
	June	253,486	121,372	115,041	24,862	25,245	16,927	6,331	16,027	116,088	79,800	33,598	2,690
	July	254,242	122,287	116,026	25,526	25,149	17,254	6,262	16,004	115,951	79,936	33,241	2,773
	Aug.	252,484	121,352	114,641	25,096	24,661	17,140	6,711	15,846	115,286	79,575	33,885	1,826
	Sept.	252,947	122,680	115,758	23,907	25,678	18,306	6,922	15,713	114,554	79,170	33,680	1,704
	Oct.	251,106	121,670	113,926	23,884	25,153	17,600	7,744	15,529	113,907	78,869	33,385	1,654
	Nov.	249,996	121,244	113,564	23,764	24,954	17,710	7,680	15,363	113,389	78,506	33,194	1,689
	Dec.	248,535	120,126	113,045	23,405	24,687	18,008	7,081	15,359	113,050	78,393	32,985	1,672
2012	Jan.	249,087	121,138	111,836	23,325	24,342	17,238	9,302	15,259	112,690	78,104	32,778	1,808
	Feb.	246,841	119,455	110,418	23,138	24,146	16,182	9,037	15,149	112,237	77,857	32,568	1,811
	March	245,113	118,316	110,126	23,054	24,053	16,231	8,190	15,067	111,729	77,601	32,300	1,828
	Apr.	242,708	116,365	108,730	23,021	23,643	16,300	7,636	15,002	111,341	77,381	32,141	1,818
	May	242,040	116,193	108,594	22,802	23,495	16,837	7,599	14,975	110,872	77,124	31,911	1,837
	June	240,141	114,529	107,224	22,879	23,590	14,803	7,305	15,011	110,601	77,002	31,745	1,854
	July	234,334	112,050	104,863	22,036	22,810	14,994	7,186	13,879	108,406	75,747	30,858	1,801
	Aug.	233,035	111,011	104,016	21,976	22,674	14,530	6,995	13,954	108,070	75,482	30,776	1,811
	Sept.	231,818	110,320	103,419	22,011	22,641	14,190	6,902	13,957	107,541	75,098	30,634	1,809
	Oct.	230,674	109,599	102,850	22,142	22,351	14,097	6,749	13,854	107,221	74,897	30,509	1,815
	Nov.	229,787	109,241	102,599	22,046	22,243	14,081	6,642	13,843	106,702	74,683	30,381	1,637
	Dec.	227,655	107,335	100,758	22,162	22,168	12,442	6,577	13,790	106,530	74,634	30,236	1,660
2013	Jan.	225,506	106,485	100,010	22,445	21,785	12,124	6,475	13,650	105,371	73,864	29,898	1,609
	Feb.	224,990	106,393	99,736	22,088	21,653	12,373	6,658	13,619	104,977	73,662	29,684	1,630
	March	228,361	109,975	103,248	22,367	22,212	13,586	6,728	13,698	104,688	73,524	29,511	1,653
	Apr.	226,310	108,457	101,811	22,196	22,053	13,225	6,647	13,630	104,222	73,273	29,323	1,626
	May	224,164	107,019	100,539	21,734	21,714	13,072	6,481	13,650	103,494	72,721	29,145	1,629
	June	223,817	106,798	100,340	21,728	21,751	12,901	6,459	13,365	103,654	72,613	29,399	1,643
	July	222,457	105,899	99,495	21,630	21,482	12,691	6,405	13,440	103,117	72,252	29,233	1,632
	Aug.	221,790	105,519	99,195	21,409	21,307	12,746	6,324	13,392	102,879	72,042	29,192	1,645
	Sept.	220,993	105,033	98,742	21,303	21,239	12,481	6,291	13,391	102,570	71,899	29,042	1,628
	Oct.	219,649	104,364	98,063	21,325	21,065	12,486	6,301	13,510	101,775	71,701	28,606	1,468
	Nov.	218,950	103,718	97,102	21,446	20,572	12,050	6,616	13,883	101,349	71,493	28,441	1,415
	Dec.	217,920	103,204	96,610	21,481	20,038	11,838	6,593	13,888	100,827	71,055	28,382	1,390
2014	Jan.	217,612	102,923	96,147	21,648	20,017	11,940	6,777	14,229	100,460	70,803	28,267	1,390
	Feb.	216,638	102,251	95,731	21,545	19,985	11,876	6,520	13,693	100,695	71,121	28,155	1,418
	March	215,867	101,827	95,397	21,552	20,114	11,854	6,430	13,681	100,359	70,968	27,974	1,417
	Apr.	215,139	101,291	94,867	21,260	20,024	11,846	6,425	13,676	100,172	70,819	27,936	1,416
	May	214,352	101,125	94,620	21,046	19,953	11,997	6,505	13,232	99,996	70,718	27,797	1,481
	June	214,810	101,665	95,108	20,875	19,944	12,820	6,557	13,304	99,842	70,613	27,744	1,485
	July	213,856	101,200	94,881	20,752	19,769	12,967	6,319	13,172	99,484	70,363	27,639	1,482
	Aug.	213,531	101,184	94,975	20,810	19,779	13,054	6,209	13,164	99,183	70,104	27,602	1,477
	Sept.	212,777	101,117	94,916	20,854	19,501	13,424	6,201	13,484	98,176	69,890	26,812	1,474
	Oct.	212,527	101,582	95,406	20,959	19,447	13,541	6,176	13,248	97,697	69,674	26,594	1,429

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 and unincorporated partnerships are recorded separately and are no longer included in credit to enterprises.

Table 6 Greece: bank rates on new euro-denominated deposits by euro area residents

(percentages per annum; period averages unless otherwise indicated)

Period		Deposits by households			Deposits by non-financial corporations		
		Overnight deposits[1,2]					
		Total	of which Savings deposits[2]	Deposits with an agreed maturity up to one year	Overnight deposits[1,2]	Deposits with an agreed maturity up to one year	Average rate on total deposits
2009		0.63	0.56	2.74	0.50	1.65	1.71
2010		0.43	0.38	3.26	0.35	2.53	1.91
2011		0.47	0.40	4.18	0.41	3.55	2.44
2012		0.47	0.42	4.78	0.44	4.19	2.84
2013		0.44	0.38	3.68	0.45	3.34	2.30
2011	Jan.	0.44	0.38	3.74	0.34	3.40	2.18
	Feb.	0.44	0.38	3.75	0.34	3.23	2.18
	March	0.45	0.39	3.76	0.41	3.39	2.21
	Apr.	0.46	0.39	3.88	0.38	3.56	2.29
	May	0.46	0.40	3.95	0.35	3.52	2.32
	June	0.47	0.41	4.10	0.42	3.38	2.39
	July	0.47	0.40	4.29	0.45	3.82	2.51
	Aug.	0.47	0.40	4.31	0.44	3.54	2.51
	Sept.	0.47	0.41	4.37	0.43	3.65	2.55
	Oct.	0.48	0.41	4.50	0.44	3.75	2.62
	Nov.	0.48	0.41	4.62	0.43	3.64	2.68
	Dec.	0.48	0.41	4.88	0.48	3.76	2.81
2012	Jan.	0.47	0.41	4.79	0.41	4.03	2.78
	Feb.	0.47	0.41	4.86	0.46	4.08	2.83
	March	0.47	0.41	4.94	0.53	4.43	2.89
	Apr.	0.47	0.41	4.96	0.47	4.37	2.92
	May	0.48	0.42	4.90	0.46	4.26	2.91
	June	0.48	0.42	5.01	0.46	4.17	2.94
	July	0.47	0.42	4.82	0.40	4.29	2.86
	Aug.	0.47	0.42	4.56	0.40	4.04	2.72
	Sept.	0.46	0.41	4.60	0.45	4.19	2.75
	Oct.	0.47	0.42	4.64	0.41	4.12	2.79
	Nov.	0.47	0.42	4.60	0.41	4.20	2.79
	Dec.	0.49	0.43	4.70	0.46	4.15	2.85
2013	Jan.	0.48	0.42	4.59	0.47	4.23	2.81
	Feb.	0.48	0.42	4.49	0.49	4.22	2.78
	March	0.49	0.42	4.36	0.44	3.95	2.71
	Apr.	0.49	0.42	4.22	0.44	3.72	2.60
	May	0.49	0.42	4.06	0.44	3.70	2.51
	June	0.41	0.33	3.89	0.49	3.24	2.40
	July	0.47	0.39	3.48	0.46	3.28	2.26
	Aug.	0.47	0.39	3.29	0.47	2.91	2.10
	Sept.	0.39	0.33	3.10	0.40	2.82	1.96
	Oct.	0.39	0.33	2.97	0.41	2.83	1.90
	Nov.	0.39	0.33	2.83	0.41	2.59	1.81
	Dec.	0.37	0.31	2.82	0.45	2.65	1.81
2014	Jan.	0.33	0.28	2.80	0.37	2.74	1.77
	Feb.	0.33	0.28	2.80	0.35	2.74	1.74
	March	0.33	0.28	2.81	0.38	2.85	1.76
	Apr.	0.34	0.27	2.71	0.34	2.55	1.69
	May	0.33	0.26	2.53	0.36	2.48	1.59
	June	0.33	0.26	2.39	0.30	2.40	1.51
	July	0.29	0.22	2.28	0.30	2.30	1.45
	Aug.	0.28	0.21	2.13	0.28	2.14	1.34
	Sept.	0.26	0.20	2.08	0.26	2.10	1.32
	Oct.	0.26	0.20	1.94	0.25	1.95	1.23

Source: Bank of Greece.
1 Weighted average of the interest rates on current account deposits and savings deposits.
2 End-of-month interest rate.

Table 7 Greece: bank rates on new euro-denominated loans to euro area residents

(percentages per annum, period averages unless otherwise indicated)

Period		Loans to individuals and private non-profit institutions[1]					Loans to sole proprietors and unincorporated partnerships		Loans to non-financial corporations[1]			Average rate on total loans
		Consumer loans without an agreed maturity[2,3]	Consumer loans with an agreed maturity: With a floating rate or an initial rate fixation of up to one year	Consumer loans with an agreed maturity: Average rate on total consumer loans with an agreed maturity	Housing loans: With a floating rate or an initial rate fixation of up to one year	Housing loans: Average rate on total housing loans	Loans without an agreed maturity[3,4]	Loans with an agreed maturity and a floating rate or an initial rate fixation of up to one year	Loans without an agreed maturity[3,4]	Loans with an agreed maturity and a floating rate or an initial rate fixation of up to one year: Up to €1 million	Loans with an agreed maturity and a floating rate or an initial rate fixation of up to one year: Over €1 million	
2009		14.39	8.59	9.33	3.52	3.94			6.07	4.62	3.52	6.02
2010		14.01	9.79	9.53	3.42	3.67			6.25	5.53	4.27	5.64
2011		14.67	10.16	9.96	4.28	4.33	10.06	8.76	7.50	6.77	5.74	6.68
2012		14.64	8.19	8.40	3.32	3.26	10.20	7.68	7.66	6.87	5.92	6.09
2013		14.43	7.62	7.53	2.92	2.82	9.61	7.36	7.39	6.51	5.77	5.60
2011	Jan.	14.28	10.73	9.84	3.93	4.05	9.46	8.27	6.81	6.14	4.89	6.17
	Feb.	14.33	10.44	9.88	3.91	4.04	9.63	8.40	6.90	6.23	5.37	6.41
	March	14.39	9.74	9.52	4.04	4.17	9.70	8.59	7.05	6.46	5.39	6.38
	Apr.	14.44	10.65	10.15	4.25	4.32	9.85	8.63	7.26	6.46	5.55	6.57
	May	14.58	10.48	10.22	4.26	4.33	9.91	8.86	7.34	6.59	5.48	6.62
	June	14.64	10.47	10.23	4.23	4.32	10.03	8.62	7.59	6.76	5.56	6.64
	July	14.76	11.03	10.45	4.44	4.52	10.13	8.74	7.65	6.85	5.76	6.79
	Aug.	14.94	10.77	10.55	4.54	4.57	10.29	9.14	7.76	6.92	5.88	6.89
	Sept.	14.96	9.70	9.95	4.49	4.51	10.40	8.93	7.91	7.12	6.04	6.94
	Oct.	14.93	10.07	10.22	4.65	4.56	10.38	8.97	7.92	7.27	6.20	7.02
	Nov.	14.93	9.30	9.57	4.48	4.40	10.46	8.97	7.93	7.18	6.13	6.90
	Dec.	14.90	8.49	8.92	4.18	4.14	10.47	8.94	7.90	7.26	6.64	6.82
2012	Jan.	14.86	8.76	9.17	3.98	3.97	10.36	9.19	7.90	7.20	6.10	6.63
	Feb.	14.83	8.80	9.09	3.77	3.75	10.33	8.58	7.86	7.02	5.81	6.46
	March	14.79	8.19	8.66	3.62	3.53	10.30	8.22	7.80	7.02	6.16	6.38
	Apr.	14.77	8.34	8.79	3.55	3.44	10.35	7.91	7.78	6.89	6.23	6.34
	May	14.70	8.27	8.69	3.54	3.40	10.30	7.89	7.69	7.05	5.84	6.21
	June	14.66	8.16	8.54	3.42	3.33	10.25	7.79	7.69	6.92	6.55	6.29
	July	14.60	7.88	8.10	3.13	3.07	10.19	7.33	7.61	6.87	5.71	5.92
	Aug.	14.52	8.32	8.40	2.99	2.94	10.14	6.82	7.57	6.71	5.82	5.88
	Sept.	14.49	7.75	7.89	3.01	2.95	10.06	7.31	7.54	6.79	5.46	5.77
	Oct.	14.51	8.04	8.01	2.88	2.84	10.05	7.17	7.49	6.75	5.70	5.76
	Nov.	14.50	8.11	7.93	2.94	2.88	10.02	7.03	7.49	6.75	5.62	5.63
	Dec.	14.49	7.60	7.47	3.04	2.98	10.00	6.96	7.52	6.46	6.07	5.76
2013	Jan.	14.48	7.91	7.64	2.99	2.91	10.00	7.03	7.46	6.67	6.40	5.88
	Feb.	14.48	8.10	7.69	3.04	2.96	9.99	7.82	7.52	6.66	5.84	5.79
	March	14.50	7.96	7.57	3.18	3.08	9.98	7.45	7.56	6.62	5.80	5.78
	Apr.	14.48	7.86	7.40	3.08	2.92	9.96	7.61	7.49	6.78	5.96	5.75
	May	14.45	7.70	7.60	2.84	2.76	9.91	7.61	7.45	6.52	5.37	5.53
	June	14.35	6.63	6.84	2.80	2.74	9.55	7.40	7.43	6.62	6.01	5.54
	July	14.36	7.50	7.28	2.85	2.72	9.46	8.05	7.42	6.47	5.72	5.55
	Aug.	14.40	8.41	8.33	2.89	2.74	9.48	7.34	7.36	6.49	5.49	5.54
	Sept.	14.38	7.40	7.47	2.93	2.76	9.29	7.14	7.20	6.63	5.93	5.56
	Oct.	14.58	7.51	7.62	2.85	2.77	9.28	6.95	7.19	6.40	6.14	5.61
	Nov.	14.39	7.32	7.60	2.75	2.68	9.13	7.15	7.29	6.20	5.80	5.50
	Dec.	14.35	7.16	7.35	2.81	2.78	9.25	6.79	7.29	6.06	4.73	5.12
2014	Jan.	14.44	7.98	8.17	2.70	2.70	9.10	7.76	7.24	6.32	6.00	5.66
	Feb.	14.43	7.80	7.94	2.73	2.73	9.07	6.66	7.23	6.17	5.88	5.40
	March	14.38	7.81	7.89	2.95	2.86	9.05	6.99	7.23	6.04	5.57	5.46
	Apr.	14.57	7.69	7.83	3.03	2.97	9.01	6.55	7.22	6.19	6.64	5.82
	May	14.52	7.80	8.06	2.94	2.91	8.94	6.59	7.22	6.09	5.57	5.45
	June	14.52	6.73	7.22	2.80	2.95	8.40	6.08	7.00	5.46	5.20	5.18
	July	14.43	7.13	7.59	3.00	3.08	8.37	6.07	6.90	5.78	5.54	5.37
	Aug.	14.46	6.75	7.53	2.98	3.10	8.26	6.54	6.79	5.57	5.56	5.31
	Sept.	14.46	7.05	7.63	3.11	3.20	8.25	6.09	6.66	5.54	5.12	5.21
	Oct.	14.48	7.22	7.87	2.98	3.03	8.25	6.59	6.58	5.53	5.63	5.36

Source: Bank of Greece.
1 Associated costs are not included.
2 Weighted average of the rates on loans to households through credit cards, on open account loans and on overdrafts from current accounts.
3 End-of-month interest rate.
4 Weighted average of the rates on corporate loans via credit lines and on overdrafts from sight deposit accounts.

ISSN: 1108 - 2690